Community Reinvestment Act

The Investment Test: What Banks Need to Know

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Banks have operated under the Community Reinvestment Act (CRA) for 31 years. The CRA requires banks to help meet the needs of low- and moderate-income (LMI) persons and distressed geographies through lending, investment, and service. Over this period, banks have responded in many creative and impactful ways to the needs of their communities, particularly in investments. Examinations have also changed as examiners have recognized new methods and presented them as examples for other banks to follow. The result has been an increase in the complexity of CRA investments and, in turn, expectations under the Investment Test. This article focuses on that Test, and how banks can succeed in meeting it.

THE CONTEXT FOR PERFORMANCE AND EVALUATION

Banks, businesses, public and private organizations and institutions, and the people who run their CRA compliance programs help form and sustain communities. These communities exist within a local economy. All of these organizations, their communities, and the local economy establish the context in which examiners evaluate a bank's CRA investment performance and determine its rating.

Examiners use *their* understanding of this performance context to identify and estimate the range and depth of needs the bank should be serving, and they evaluate each bank's effort and effectiveness in making relevant investments. Leading banks are able to use their own knowledge of the performance context to position themselves and obtain the rating they seek.

Within this context, these banks select from a myriad of often complex lending and investment tools to make appropriate investments. Examples include Mortgage Backed Securities, New Market Tax Credits, tax credits, bonds, equity in projects and more. Even grants, historically a mainstay of CRA Investment Test Compliance, have become more complex tool.

INVESTMENT TEST RATINGS

As the chart below shows, the Investment Test accounts for approximately 25% of a bank's total CRA score. Regulators use the Investment Test to evaluate whether each bank:

- Is putting money into the community to help LMI individuals and geographies and whether the dollar amount of the total investment is appropriate, given the bank's growth since the last regulatory exam.
- Has helped to meet the needs of its assessment area through its use of investments.

- Had an opportunity to make an investment in an area and whether the bank led the effort to build meaningful investment programs.
- Provided investments that responded to the needs of LMI individuals in a way that is innovative or flexible.

Component Testing Rating Chart FDIC Examination Manual – September 2015

COMPONENT TEST RATING	POINTS FOR LENDING	POINTS FOR INVESTMENT	POINTS FOR SERVICE
Outstanding	12 Points	6 Points	6 Points
High Satisfactory	9 Points	4 Points	4 Points
Low Satisfactory	6 Points	3 Points	3 Points
Needs to Improve	3 Points	1 Points	1 Points
Substantial Noncompliance	0 Points	0 Points	0 Points

ACHIEVEMENT THROUGH CRA INVESTMENT

Every leading bank has set a goal for its rating under the investment test, but many struggle to achieve that goal. To help immediately in this effort, we provide a list of trends bank executives must know about CRA Investment Test performance and the steps they should be taking ahead of their next CRA examination. This list is the result of our study of hundreds of Performance Evaluations:

- ✓ CRA investments often involve blended financing through tax credit tools. The bank receives a tax credit, a government-backed, taxpayer incentive, in exchange for equity. This equity provides the LMI organization a way to pursue a public purpose without going to the costly for-profit market. Regulators give a rating of complex and innovative, if more than one tool is blended into a project.
- ✓ Investments in brick and mortar projects are highly valued by regulators. These projects are located in Opportunity Zones, Hub-zones, Food Desert Zones, Tax Increment Financing Target Zones, EPA Designated Lead Paint and/or Superfund Zones and New Market Tax Credit Zones.
- ✓ Foundations and philanthropists are collaborating with banks and participating in projects to help revitalize neighborhoods through large impactful investments. This foundation/bank collaboration is increasing at an accelerating rate.
- ✓ Banks are teaming up with Community Development Financial Institutions (CDFI) and foundations to build neighborhood revitalization projects. Banks fund CDFI Loan pools with contracts that involve low down-payment, low interest rate and no collateral loans to add to

affordable housing and small business growth. Bankers value these investments because the dollars invested in CDFIs can be earmarked for each assessment area and can be taken as investment or lending CRA credit depending on the gap the bank faces when it is examined.

- ✓ Bank investment in Small Business is a priority, especially in rural areas. Small business assistance ranges from grants providing technical assistance to a bank provided business incubator. Several CDFIs specialize in managing small business loan pools and banks are a major equity equivalent provider. Banks also invest in Small Business Investment Corporations, a deposit, stock or Membership Share in a Corporation. These SBICs help banks invest in small businesses, without taking direct risks in business startups that are too small to get venture capital.
- ✓ More banks are using CRA bonds designed to help finance infrastructure, economic development projects and LMI schools, located in distressed geographies.
- ✓ Regulators give credit to banks that identify a credit need and build an investment opportunity within their assessment area. If a bank executive helped lead the revitalization effort of a space that has become outdated such as an old sprawling shopping mall, then the bank's investment has a good chance of being designated innovative, responsive and complex.
- ✓ CRA credit is available for investments that lead to banking of the unbanked and stimulating the expansion of economic diversity into mainstream banking.
- ✓ Grants for programs that train LMI people how to use bank services are valued. Grants directed toward helping LMI people access their Earned Income Tax Credits are receive extra weight. Grants that help LMI individuals learn to use financial education programs on-line to achieve self-sufficiency are prized.
- ✓ Regulators are looking for bank-led community partnerships that involve the bank's investment of dollars and expertise. These investments are considered responsive to local needs because a bank executive is involved.
- ✓ The quantity and quality of investments must be equivalent to that offered by other banks with a similar market share in the assessment area to earn a Satisfactory Rating. The regulators are expecting an increase in the bank's investments over each regulatory cycle that is equivalent to the bank's rate of growth in that market.

These items are strong inferences of regulators' interest that banks have a continuous process for developing responsive investment strategies. Responsiveness requires volume, but it also involves multi-layered, customized, local solutions.

Banks should use this checklist as a tool for evaluating their likely score on the Investment Test. For some, their newly discovered status will demand deeper analysis or additional advice. When that happens, additional resources are available but getting an early start is a critical success factor.

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