Small Institutions

Examination Procedures and Sample Format for Public Disclosure of Examination Results

The Examination Procedures for Small Institutions (which include the CRA Ratings Matrix for Small Institutions) and the Sample Format for Public Disclosure of Examination Results follow. Both documents are also available on the web site of the Federal Financial Institutions Examination Council.

Examination Procedures: www.ffiec.gov/cra/pdf/cra_exsmall.pdf

Sample Format for Public Disclosure of Examination Results: www.ffiec.gov/cra/pdf/ex_instruct_s.pdf

Small-Institution Performance Evaluations

Interagency Guidance on Using the Streamlined Assessment Method

This guidance, issued on November 26, 1996, was adopted by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

This interagency guidance supplements the CRA examination procedures for small institutions. The guidance is designed to facilitate the proper use of the examination procedures and to promote consistency among the agencies in presenting examination findings.

Public evaluations should include efficient, substantive, and complete discussions of facts, data, and analysis that lead to conclusions about performance. The determination of the ''reasonableness'' of the loan-to-deposit ratio, the proportion of lending within an institution's assessment area, or the geographic and borrower distribution of lending is clearly not a simple task. It is precisely this difficulty that places an increased importance upon the written explanation of the examiner's analysis and conclusions, and prompts the issuance of this guidance.

Description of the Assessment Area

Demographic Information

The interagency public evaluation format requires that the discussion of an institution's assessment area include descriptive information regarding population, median income, employment, community credit needs, and business opportunities. Any information that was considered by the examiner in forming overall conclusions regarding the institution's performance should be included in this description.

Information regarding the racial or ethnic composition of an assessment area should be included in the public evaluation only where a finding of racial discrimination impacted the institution's performance. The CRA regulation focuses primarily on lending to borrowers and geographies of different income levels. An institution's fair lending record affects its CRA record in cases where substantive violations of the fair lending laws are found. The inclusion of race and national origin data in each public evaluation, whether or not fair lending issues are present, may contribute to public confusion regarding the purpose of the Community Reinvestment Act as compared to the fair lending laws.

Assessment-area descriptions should include, however, information regarding the number and percentage of low-, moderate-, middle-, and upper-income geographies and families within the assessment area since this information is always relevant to conclusions regarding an institution's CRA performance. It may be useful to use tables indicating the percentage of geographies and families in each income category to convey this information clearly.

Assessment-Area Delineation

Regulation BB makes it clear that an institution's ability to properly draw an assessment area is not a consideration in evaluating its performance. As a result, the public evaluation should not refer to the assessment area's compliance with regulatory requirements. If the examiner finds that the assessment area does not comply with regulatory requirements, that fact should be noted in the report of examination. The public evaluation should be based on the appropriate (redrawn) assessment area.

Community Contacts

The description of the assessment area should also include information obtained from community contacts that the examiner used in forming conclusions about the institution's performance. Community contacts provide insight that can help update, and lend perspective to, data gathered from other sources. These contacts are a very important part of the CRA examination. The public evaluation should note information from recent relevant contacts that were made in connection with the CRA examination being conducted, as well as in connection with other examinations, including those conducted by staff from other agencies.

Examiners should include as much information as possible about community contacts to give the reader of the public evaluation an understanding of the contact's background and knowledge of the area. General statements that ''several contacts'' were made and the information was used in evaluating the institution's performance are not adequately descriptive.

It is usually sufficient to identify the types of contacts made without indicating the name of the contact or the organization represented. A discussion of community contacts in the public evaluation might state, for example, ''Two contacts were made during the examination. One contact was a representative from an organization that provides affordable housing to low-income residents in the county.

The other contact focused on small business development. Information from a community contact made by [another agency] with a governmental housing authority was also used in analyzing the institution's lending record.''

Information regarding comments made by community contacts should be included in the public evaluation, absent a request to the contrary by the person contacted. Those comments should be specific enough that the reader can understand how conclusions were reached later in the public evaluation, but not so specific as to identify the contact.

Conclusions with Respect to Performance Criteria

Facts, Data, and Analysis

As noted in the format for small-institution public evaluations, overall conclusions must address key aspects of an institution's CRA performance based upon an analysis of facts and data derived from the examination process. The public evaluation should be written in a way that allows the reader to understand how the examiner arrived at conclusions for each of the performance criteria. Comments in this section should explicitly relate facts and data regarding the institution's performance to the examiner's findings.

For example, the statement that ''an institution makes virtually all of its loans in its assessment area'' is not sufficient. If applicable, a better presentation of this conclusion would be ''Examiners reviewed and verified the institution's internal analysis of credit extensions made during the examination period. A substantial majority of the institution's lending was conducted within its assessment area. The review included the institution's two major product lines, commercial and one- to four-family mortgage loans. The examination found that 94 percent of the commercial loans and 96 percent of the mortgage loans made by the institution were within its assessment area. By volume, 84 percent of commercial loans and 88 percent of mortgage loans made by the institution were inside its assessment area.''

Likewise, statements asserting that lending to low- and moderate-income individuals reflects the population within the assessment area without further explanation are not sufficiently informative. This type of a statement implies that the credit needs in this assessment area were proportional to the various income levels represented in the overall population. This is not, however, always true, necessary, or relevant. Perhaps, there were limited lending opportunities in one or more income categories. For instance, a mortgage lender may be unable to tap the very low-income geographies because of a high number of rental properties. Alternatively, a consumer lender may be equally unable to make consumer credit available to high-income residents who prefer to take on second mortgages. To avoid this problem, public evaluations should include an analysis of performance that includes information from the materials used to develop the examiner's understanding of the performance context about loan demand in the various areas with income levels, as appropriate.

Loan-to-Deposit Ratio

Discussions of the loan-to-deposit ratio in the public evaluations should reference the information that is used to support the conclusion that the ratio is or is not reasonable. This may, for instance, require a discussion of other similarly situated lenders in the assessment area under review or other support, as appropriate. If, for instance, an institution has a lower average loan-to-deposit ratio than other similarly situated lenders in its assessment area and the examiner finds this delineation ''reasonable,'' the discussion should distinguish the institution under review from the similarly situated lenders in the assessment area. Consulting recent examinations performed in the assessment areas may assist in this analysis.

It is important to remember that the loan-to-deposit ratio is a quick reference for determining whether an institution is lending. As such, it is not usually of central importance in the streamlined examination. Furthermore, by calling for an analysis of the adequacy of the loan-to-deposit ratio, the agencies do not intend to foster lending levels that might be considered unsafe or unsound. There is no fixed ratio that can be considered reasonable. Rather, loan-to-deposit ratios will vary depending on an institution's charter, its business strategy, the demographics of its assessment area, and other factors that make up the context in which the institution performs. There are occasions, however, where a loan-to-deposit ratio is so low that it becomes a central issue in the examination. For instance, where an institution makes very few loans during an examination cycle, the distribution of those loans is clearly not as relevant to the institution's performance rating as the fact that the institution may not be lending very much in any case.

Origination

When analyzing an institution's lending performance, Regulation BB directs examiners to focus on loans originated since the last examination. To this end, the public evaluation should indicate the number and types of loans that were reviewed to conduct the analysis. Applications and denials are generally not relevant to the analysis and, therefore, are not discussed in the examination procedures. A discussion of applications and denials may be appropriate, however, in a larger discussion of an institution's performance context. For instance, a discussion of applications and denials may be useful in explaining poor performance due to a lack of credit demand.

Activities that are in the planning stages that have not resulted in loan originations should not be considered in evaluating the institution's performance. This would include situations where an institution participates in a consortium developed to revitalize a downtown area but, at the time of the examination, has made no loans and the size of the loan pool has not yet been determined. In this example, there is no performance to evaluate during the examination period even though the activity would likely receive positive consideration once loans are made.

Loans to Small Businesses and Small Farms

Where loans to small businesses and small farms are a major product line for the institution, it is important to analyze the distribution of lending to businesses or farms of different sizes. It is often difficult to determine the number of small businesses and farms using the statistical data gathered prior to the examination. Reliable data on the number of small businesses or farms in any given area is often scarce. Possible sources of information include local farm bureaus, extension agencies, and chambers of commerce. Supporting conclusions regarding the geographic or borrower distribution of small business and farm loans requires an analysis of the institution's small business and farm loans to businesses and farms of different sizes. This analysis is particularly important where the examination concludes that the institution exceeds the standards for Satisfactory performance.

Geographic and Borrower Distribution

Examiners should refrain from including broad statements regarding the dispersion of loans throughout an assessment area without further discussing the adequacy of an institution's geographic distribution of lending at the income level. Dispersion is only one element of an analysis of geographic distribution. Specifically, a dispersion analysis is done to determine whether any significant gaps or lapses in lending are present in the institution's assessment area. The main focus of this analysis is the institution's geographic distribution of loans among low-, moderate-, middle-, and upper-income geographies. The regulation and examination procedures specifically direct that the analysis be conducted with respect to each of the four income categories separately. Examiners may use an institution's internal analysis of geographic distribution after verifying its accuracy. If such an analysis is not available, a sample of loan files must be used to conduct a geographic distribution analysis.

Similarly, examiners may use an institution's internal analysis of its lending by borrower income, if available, after verifying its accuracy. If the institution has not prepared a reliable analysis, loan files should be sampled to analyze lending distribution by borrower income. If the information necessary to do a distribution analysis by borrower income is not available in loan files, the examiner may use other available information as a proxy for such information. Of course, any information used to reach conclusions regarding lending distribution by borrower income or geography must be discussed in the public evaluation.

Finally, there may be situations where an analysis of lending distribution by geography and borrower income appears to exceed standards for a Satisfactory rating but, upon closer analysis, the institution's overall lending activity is very low. For instance, if an institution has only made a dozen loans since its last examination, it would be very difficult to justify a conclusion that the distribution of its loans met the standards for a Satisfactory rating, even if each loan was in a low- or moderate-income area or to a low- or moderate-income individual.

Where there is insufficient information available to perform a meaningful geographic- or borrower-distribution analysis, examiners should type ''analysis was not meaningful'' across the appropriate rows of the performance evaluation grid. The discussion of the analysis should explain why the analysis could not be performed. For example, where an assessment area consists entirely of middle-income census tracts and the examiner has concluded that proxies that would enable a meaningful geographic analysis are not available, the public evaluation should state that fact.

Elements Supporting an Outstanding Rating

A rating of Outstanding will normally be accompanied by an explanation that expressly considers not only a small institution's lending but also its performance in qualified investments and delivery of retail services. Although a small institution can receive an Outstanding rating based on the strength of its lending performance, the appendix to the CRA regulation makes it clear that in assessing whether an institution's performance is

Outstanding, the [agency] considers the extent to which the institution exceeds each of the performance standards for a Satisfactory rating and its performance in making qualified investments and its performance in providing branches and other services and delivery systems that enhance credit availability in its assessment area. Consequently, the examination procedures provide that a small institution can receive an Outstanding rating without a review of investments and services only when its lending performance is so exceptional that the examiner determines that a review of investments and services would not further improve the institution's performance level. In other words, the review of investments and services would be superfluous in the presence of what is already considered to be an Outstanding level of performance based on lending alone.

Note that an Outstanding institution is characterized not only by a high loan-to-deposit ratio and a high percentage of loans in its assessment area but also by an ''excellent'' penetration of borrowers at all income levels and an ''excellent'' dispersion of loans throughout geographies of different incomes in its assessment area.

The examination procedures recognize that institutions can exceed the standards for Satisfactory performance in varying degrees. In CRA (as in other rating systems), the Satisfactory category embraces a rather broad range of different performance levels. Some institutions that have strong lending records will end up with the same rating as other institutions that are marginally Satisfactory. Nevertheless, there is a difference between institutions rated Outstanding and those rated at the high end of the Satisfactory range.

An institution may exceed standards for Satisfactory performance in three ratable categories and still not merit an Outstanding. To receive an Outstanding on the strength of its lending performance, the institution must materially exceed the standards for Satisfactory in some or all of the criteria. The judgment that an institution materially exceeds Satisfactory standards and warrants an Outstanding rating should be based on largely indisputable evidence that an entire community is being served, including an excellent penetration of low and moderate borrowers and geographies within its assessment area(s). Remember that the Community Reinvestment Act specifically requires the agencies ''to assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods.'' Application of the streamlined examination does not alter the policy focus of the overall evaluation. Serving the credit needs of low- and moderate-income borrowers and neighborhoods should not get lost in the process of calculating loan-to-deposit ratios and ''in-out'' percentages.

While small institutions do not go through the same rigors as the large-institution examinations, small institutions are not intended to be unduly favored when it comes to assigning ratings for their performance. In addition to determining whether an institution has exceeded some or all of the standards for a Satisfactory rating, the agencies will consider a small institution's investment and service performance based on a broad range of investment and service activities. For example, the examination procedures permit an Outstanding rating if the institution's performance with respect to the five core criteria generally exceeds Satisfactory and its performance in making qualified investments and providing branches and other services and delivery systems in the assessment area(s) supplements its performance under the five core criteria sufficiently to warrant an overall rating of Outstanding.

Additional Observations

Information Regarding Process-Oriented Activities

Process-oriented activities, such as the internal monitoring of the geographic distribution of loans, needs ascertainment, marketing, and efforts to achieve CRA objectives, rarely substantiate strong performance or explain poor performance. These activities may, on occasion, be discussed to explain elements of the performance context that affect the institution.

Consideration of Prior Ratings

The performance-context procedures require examiners to consider the prior performance rating, among other factors, when evaluating the institution. The prior rating is of interest to the public and should be considered in assessing current performance.

Fair Lending

The fair lending portion of the compliance examination is the appropriate medium for analyzing an institution's performance with respect to making credit decisions in compliance with the Equal Credit Opportunity Act and the Fair Housing Act. Findings of discrimination on a prohibited basis, however, should be discussed in the CRA and examination report in accordance with the guidance provided in the sample Public Evaluation.

Instructions for Sampling at Small Institutions

These instructions were distributed as attachment B to CA 02-3 (January 24, 2002).

Examiners are required to estimate three proportions in connection with examinations of small institutions: the proportion of loans inside and outside of an assessment area; the proportion of loans in low-, moderate-, middle-, and upper-income geographies in an assessment area; and the proportion of loans to low-, moderate-, middle-, and upper-income borrowers within an assessment area. Examiners are to interpret the estimated proportions based on the performance context and other information obtained during the examination.

Under the revised regulation, small banks are not required to collect data for CRA examination purposes. However, some small institutions may choose to provide data regarding their loans, including the census-tract locations and borrower incomes, similar to those being required for large institutions. Some institutions may even provide a summary of their distribution of loans. In this case, as long as the examiner is able to verify the bank's information using the guidance provided with respect to sampling with data accuracy in CA 01-8, the examiner will not need to perform sampling to evaluate the bank's CRA performance but may use the data supplied by the bank.

Step 1

Examiners should select samples for one or more major product lines, taking into account factors such as the institution's business strategy and its areas of expertise. As an initial matter, it will be acceptable to select for review for these purposes among the same categories of loans that are to be used when reviewing large banks, i.e. mortgages, small business and farm loans, and consumer loans.[1]

Step 2

The total number of loans, both originated and purchased by the institution, for a major product category will be defined as the ''universe'' of loans. In order to determine the number of loans for the sample (known as the sample size), examiners should know the number of loans in the universe, even if this requires them to count the number of loans manually.

This universe can include

- The total number of loans since the last examination, or
- The total number of loans in the previous year, or
- The total number of loans in the previous six months.

The universe of loans should cover at least the activity in the six months prior to the examination. It should cover at least the prior year if the number of loans made in the last six months is less than 50. If the universe of loans for the previous year for any particular product category is less than 50, then all loans made or purchased since the last examination for that product should be included in the universe. Moreover, when selecting the universe, examiners should ensure that loans included in the universe are representative of the bank's loan activity during the entire examination period.

Step 3

The examiner should determine the number of loans to be sampled. Use the sampling software to determine the appropriate number of loans to be selected for each product category being examined. The software computes the sample size based on the universe of loans for each product and the desired confidence and precision levels.

Initially, examiners should select samples based on a 90 percent confidence interval, with a plus or minus 5 percent level of precision. This means that there is a 90 percent chance that the results from the sample will be within 5 percent of the true proportion, for whichever criteria are being evaluated. This confidence interval was chosen because it should ensure an acceptable reliability of results. However, examination reports for small banks should be monitored closely during the first year of experience with this new sampling approach so that a review of the results of implementing this policy can be done when there has been adequate field experience. For loan products or institutions that require further investigation or are undergoing greater scrutiny for any reason, a 95 percent confidence level with plus or minus 5 percent precision should be used. A more stringent statistical framework using a higher confidence level is necessary because in these cases examiners will need results with a higher degree of reliability.

How to Select a Random Sample

Once the number of loans to be sampled is known,

1. According to Regulation BB, the major consumer product categories are defined as home equity, motor vehicle, other secured, other unsecured, and credit card.

the examiners should select these loans from a list of loans unique to that product, if one is available from the bank. If no unique list or other sorting system is available for use, the examiner must restrict the random sampling procedures below to each product category that can be segregated.

To select files, the examiner should calculate the interval to use for sampling by dividing the number of loans in the universe by the number of loans in the sample and rounding up to the nearest whole number. For example, if there are 150 loans in the universe and 86 in the sample, the calculation is 150/86=1.74, which, when rounded, is 2. The examiner should start by choosing either the first or second loan and then proceed through the list of 150 loans and select every other file. After the first pass through the list, the examiner would have selected 75 of the 86 needed for the sample. To select the 11 additional files, the examiner should follow the same process with the remaining files on the list. Dividing 75 (the remaining files not already selected for the sample) by 11 yields 6.82, which rounds up to 7. This time the examiner would start by selecting any of the first 7 loans on the list and then select every seventh file thereafter. This will add 10 to the sample. Having done this, 85 files will have been selected for the sample and 65 files not selected. Selecting 1 more file, at random, from the 65 not already selected, will complete the sample.

Calculating Proportion Estimates and Resulting Reliability

The next step is to calculate the proportion estimates as itemized in the examination procedures. Once the loan data are entered, the software program will generate the following reports for examiner use:

Comparisons of Credit Extended Inside and Outside of the Assessment Area[2]

- The percentage of the number of loans (by product type) inside and outside the assessment area
- The percentage of the dollar amount of loans (by product type) inside and outside the assessment area

The results from the sample will be accompanied by a precision range (or confidence interval), plus or minus, around the estimate. For example, sampling for the percentage of loans (within a product type) outside of the assessment area may result in a proportion estimate of 32.5 percent with a plus or minus 5 percent precision interval at the 90 percent confidence level. This means that there is a 90 percent probability that the percentage of the institution's loans of this type outside the assessment area is between 27.5 percent to 37.5 percent. The resulting precision interval is influenced by a range of factors, including the confidence level, and the incidence of missing data. In general, the narrower the range around the resulting estimate, the more accuracy that has been achieved from the sampling procedures.

Distribution of Credit within the Assessment Area(s)[3]

In accordance with the examination procedures, examiners should tabulate the following proportions based on *only those loan records from the sample that are within the assessment area* for each product category:

- The number and percentage of loan originations (by product type, if applicable) in low-, moderate-, middle-, and upper-income geographies
- The dollar amount and percentage of loan originations (by product type, if applicable) in low-, moderate-, middle-, and upper-income geographies
- The number and percentage of loan originations (by product type, if applicable) to low-, moderate-, middle-, and upper-income borrowers
- The dollar amount and percentage of loan originations (by product type, if applicable) in low-, moderate-, middle-, and upper-income borrowers
- The number and percentage of loan originations to small businesses/farms of different sizes (by revenue)
- The dollar amount and percentage of loan originations to small businesses/farms of different sizes (by revenue)

Examiners are to follow the guidelines in the examination procedures to interpret the results from the sampling and, ultimately, to assign a rating to the institution's lending performance. Note that the precision ranges for the distribution estimates may be broader than those for the ''In/Out'' analysis. This may be the case because the original sample size will have been reduced by those loans located *outside* the assessment area. Though it would be possible to augment the sample with additional loan records, this is not required in most cases because the time and expense involved do not seem justified by the greater precision of the results obtained. However, if the precision interval in such circumstances is more than 15 percent, the examiner should select, and enter, additional files

2. Sampling software will compute the proportion estimates for the examiner if they are available. Examiners will evaluate the results following the criteria outlined in the examination procedures.

3. Again, the sampling software will compute these results for examiners once the necessary data have been entered.

from within the assessment area in order to reduce the precision interval below 15 percent.

Examiners should take particular care in their interpretations of proportion estimates to low- or moderate-income geographies that are in the single digits. Even a high degree of precision in the sampling will not allow examiners to make fine distinctions when dealing with small proportion estimates. For example, if the total number of loan originations in a product line was 500 since the last examination and the sample results show a 2 percent penetration to low- and moderate-income areas, then the resulting precision interval could be between .8 percent and 4.6 percent, using a 90 percent confidence level. Such a result does not allow the examiner to distinguish a .8 percent from a 4.0 percent penetration.

Examiners should also understand that the analytical reports do not identify specific tracts, or geographic ‘‘gaps,’’ in a bank’s lending. Therefore, while the software can be used to determine the distribution of loans made to different income geographies, examiners cannot rely on it to identify significant gaps in a bank’s lending.