

**Decision of the  
Supervision Appeals Review Committee**

**Case No. 2011-01**

***I. Summary of Findings.***

After consideration of the timely filed written submissions of the parties, the record of this case, and following the June 28, 2011 deliberative meeting of this Committee, we have denied the Bank's appeal. For the reasons set forth in this decision, the Committee upholds as fully supported, the Bank's Community Reinvestment Act ("CRA") rating of Needs to Improve ("NTI"). In accordance with Part 345 (Community Reinvestment) of the FDIC Rules and Regulations, the FDIC's Division of Depositor and Consumer Protection ("DCP," the "Division") appropriately evaluated the Bank's CRA performance under the Small Bank Performance Standards. The Committee affirms the conclusions of the Director and finds that the Bank's less-than-satisfactory CRA performance is manifested in its low level of loans and the poor geographic distribution of the loans that were originated or purchased.

***II. Background.***

***A. Introduction.***

The Community Reinvestment Act (the "CRA"), enacted as Title VII of the Housing and Community Development Act of 1977,<sup>1</sup> is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, specifically including low- and moderate-income neighborhoods, consistent with safe and sound banking operations. Congress mandated that the financial supervisory agencies, including the FDIC, enforce the Act by examining and assessing an institution's record in helping meet the credit needs of the local communities in which the institution is chartered (the "CRA Evaluation," "Performance Evaluation," or "PE"). The CRA also requires that the FDIC take the CRA record of an institution into consideration when approving applications for new branches or for mergers or acquisitions. *See* 12 U.S.C. § 2903(a)(2).

\*\*\* Bank, \*\*\*, \*\*\* (the "Bank") is a state-chartered, non-member independent bank with total assets of nearly \$234 million . Headquartered in \*\*\*, \*\*\*, the Bank is controlled by its principal shareholder and family trusts. The Bank operates two full-service offices – a main office in \*\*\* and a branch in \*\*\*, \*\*\*. The Bank has also located a loan production office ("LPO") in \*\*\*, \*\*\*, which operates a deposit-taking ATM. Finally, the Bank operates two ATMs in outstate locations for an affiliate in \*\*\*, \*\*\*, and \*\*\*, \*\*\*.

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<sup>1</sup> Pub. L. No. 95-128, 91 Stat. 1147, 12 U.S.C. §§ 2901 *et seq.* (1977).

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The Bank received an NTI and a Satisfactory in its two ratings periods before the period at issue in this proceeding. In October of 2006, the Bank filed a new Business Plan with the FDIC as part of a strategy to transform its business model from a monoline credit card lending institution to a more traditional retail bank. The Business Plan contemplated opening new branches, the purchase of assets from the FDIC, and entering into FDIC-assisted transactions. The FDIC approved the Business Plan in January 2007.

The Bank was evaluated under the small bank exam procedures in an August 2010 full-scope Exam (Compliance and CRA). Violations of section 5 of the Federal Trade Commission Act (“FTC Act”), initially identified in a 2009 Visitation, were cited during the Examination and were the result of the CMS weaknesses. Additionally, the Bank continued to receive a substantial number of written consumer complaints on its credit card operations. Also identified at the Compliance Examination were repeat violations of Part 339 of the FDIC’s regulations on flood insurance.

Under the Small Bank Performance Standards, which focus primarily on assessment area lending criteria, the Bank received, in its August 2010 PE, a CRA rating of “NTI.” The small bank lending test is a streamlined assessment method for small institutions that is based on five Performance Standards:

1. The institution’s loan-to-deposit ratio, adjusted for seasonal variation and, as appropriate, other lending-related activities such as community development loans or “qualified investments”<sup>2</sup> (“LTD ratio”);
2. The percentage of loans and other lending-related activities in the Bank’s assessment area (“In-Assessment Area Performance”);
3. The distribution of lending among borrowers of different income levels and businesses of different sizes (“Borrower Distribution”);
4. Lending distribution among different income-level geographies (“Geographic Distribution”); and
5. The Bank’s record of taking action, if warranted, on written complaints about its CRA performance (“Complaint Review”).

*FDIC Compliance Manual, Section XI Small Banks.*

The Bank’s Performance Evaluation focused on the lending products that form the Bank’s primary business lines and the majority of the lending activity within the designated assessment areas – its commercial, construction, and multi-family residential lending. Covering the period of 2008, 2009, and the first six months of 2010, the PE analyzed all originated loans in these lending categories (as opposed to a sampling of loans). Although the Bank originates secured credit cards, the substantial volume of its

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<sup>2</sup> Under the CRA regulation, a qualified investment means a lawful investment, deposit, membership share, or grant that has as its primary purpose community development. 12 C.F.R. § 345.12(t).

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credit card lending is outside the designated assessment areas; accordingly, that lending category was not reviewed as a part of the PE. The Bank also operated \*\*\* Mortgage (“XYZ”), a wholly owned subsidiary that originated residential mortgage loans between August and December of 2009. As requested by the Bank, DCP reviewed and analyzed XYZ’s Home Mortgage Disclosure Act (“HMDA”) loans.

As noted, the DCP exam team rated the Bank’s CRA performance “Needs to Improve” for the Exam period. According to the August 2, 2010 PE, the “NTI” rating was based on the Bank’s low level of lending and poor distribution of loans originated within low- and moderate-income geographies. According to the CRA Evaluation, the Bank’s size and financial condition, as well as the lending opportunities and needs in its assessment areas, should properly have supported a more robust average net LTD ratio. Additionally, the analysis of the Bank’s Geographic Distribution figures was significantly below demographics in aggregate data used for CRA comparisons.

The Bank was advised of the proposed downgrade at the exit meeting for the Performance Evaluation on October 28, 2010 and, on November 23, 2010, submitted a letter to the Regional Office (“RO” or the “Region”), addressing the downgrade. The Region responded by letter on December 14, 2010, and on January 11, 2011, finalized the CRA Evaluation.

On February 8, 2011, the Bank timely filed a Request for Review (the “Request”) of its “NTI” CRA rating, arguing that the rating should rather have been a “Satisfactory” and that DCP’s assignment of “Needs to Improve” ignored the performance context in which the Bank operated; failed to define the Bank’s deposit base accurately, thus skewing the Bank’s LTD ratio; rejected the Bank’s assessment area delineation, thus understating its In-Assessment Area Performance; and undercounted the effect of its growth in lending during the Evaluation Period.

In response, on March 21, 2011, the Director affirmed the Division’s earlier findings, determining that the Bank’s Geographic Distribution was poor in view of its failure to originate *any* loans in low- and moderate-income census tracts<sup>3</sup> within the Bank’s assessment areas. Although the Director sustained the Bank’s “NTI” rating, he issued a revised PE in response to several matters identified during the Request for Review process. Slight addition errors were corrected in two tables. Additionally, the Fair Lending or Other Illegal Credit Practices Review (“Illegal Practices Review”) comment of the CRA Evaluation was expanded. The Bank timely appealed the Director’s decision on April 20, 2011.

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<sup>3</sup> A census tract is a geographic region defined by the U.S. Census Bureau for the purpose of taking the decennial census. A census tract (also called a geography) usually coincides with the limits of a city, town, or other administrative area. Such tracts are small, relatively permanent statistical subdivisions; they are delineated by local committees of census data users and are designed to be relatively homogeneous units with respect to population characteristics, economic status, and living conditions.

***B. Summary of the Parties' Contentions.***

The Bank argues that its "NTI" rating is erroneous and fails to reflect accurately its performance in meeting the credit needs of its entire assessment area. Chartered originally as a limited-purpose bank, the Bank grew substantially with total assets of over 1 billion by December of 2003. That growth coincided with a "change in the FDIC's supervisory approach toward banks" according to the Bank, subjecting the Bank to "heightened scrutiny" by its primary regulator. The Bank tells of devoting significant efforts and resources to address the FDIC's concerns – efforts including substantial capital infusions from the Bank's owner and the active oversight of operations by senior Bank management and the board of directors. By September of 2006, the Bank had improved, a success story the Bank asserts was never appropriately recognized by the FDIC, representing a comeback from a Consent Order entered into by the Bank before the period at issue. The Bank, with the knowledge and encouragement of the FDIC, formed a new Business Plan.

In furtherance of its new, FDIC-approved Business Plan, the Bank filed an application to open a branch in \*\*\*, \*\*\*. The Bank had been advised by the FDIC that its application would be handled under expedited processing procedures. However, in September, the FDIC notified the Bank that its branch application could not be considered on an accelerated basis because of the section 5 violations identified at the 2009 Visitation. The Bank argues that it is now faced with a "classic Catch-22" predicated on what it views as flawed and untested section 5 findings. Those untested findings prohibit the branching and retail expansion, which are, according to the Bank, the foundation of its current Business Plan, which is the platform that would allow it to meet its CRA obligations.

Specifically, the Bank contends that DCP (1) failed to give sufficient consideration to the performance context in which the Bank operates – including the challenges presented by the Bank's attempt to enter the highly competitive \*\*\* market in a time of economic downturn; (2) accorded insufficient weight to the Bank's substantial expansion in lending during the relevant period; (3) failed to acknowledge the special nature of the Bank's deposit base in calculating its LTD ratio and evaluating the adequacy of the ratio; and (4) improperly considered issues relating to the Bank's earlier practices regarding monthly maintenance fees (the section 5 violations).

DCP, in response, asserts that (1) the examiners, in accordance with well-defined procedures, fully considered the Bank's performance context in assigning the CRA rating, including such indices as relevant demographic data, the Bank's capacity to lend, its size and financial condition, and the performance of other institutions in the same area; (2) the Bank's increase in lending did not result in furthering the prime intent of the CRA – better serving the credit needs of the assessment area, especially when considering the assessment area's low- and moderate-income geographies; (3) the Bank's LTD ratio was appropriately evaluated in accordance with regulatory authority and guidance; and (4) the CRA requires that an institution's compliance with laws and

regulations barring discrimination on a prohibited basis and other illegal credit practices be considered in evaluating a bank's CRA performance.

In accordance with the *Guidelines for Appeals of Material Supervisory Determinations* ("*Guidelines*"),<sup>4</sup> the Committee reviews for consistency with the policies, practices, and mission of the FDIC, and the reasonableness of, and support for, the positions of the parties. The Committee granted the Bank's request to appear at the Committee's June 28, 2011 deliberative meeting. Under the *Guidelines*, the burden of proof on all matters at issue rests with the institution. The scope of the Committee's review is limited to the facts and circumstances existing at the time of the CRA Evaluation. No consideration has been given to facts or circumstances that developed after that period.

### ***III. Analysis.***

#### ***A. The Bank's Performance Context.***

Under the CRA, an institution's performance is judged in the context of information about the institution and its assessment area ("Performance Context"). This Performance Context includes:

- Demographic data on median income levels, distribution of household income, nature of housing stock, housing costs, and other relevant data;
- Lending and lending-related opportunities;
- Product offerings and business strategy, capacity and constraints, past performance, and the performance of similarly situated lenders;
- Public file and any written comments about the bank's CRA performance; and
- Any other relevant information.

***The Bank's Position.*** The Bank contends that there is no evidence that the examiners, in evaluating the Bank's success in meeting the credit needs of the communities it serves, adequately considered the Performance Context in which it operates. Thus, despite the requirements of the CRA statute and regulation to take such factors into account in evaluating the Bank's performance, the examiners essentially glossed over the demographic data and the broad range of economic, institution- and community-specific information in which it operated. The Bank's Performance Context included unique circumstances that distinguished it from the other banks in the \*\*\* market – circumstances that put it at a disadvantage in comparison to institutions that were not so hindered. The Bank argues that its success depended upon realizing the

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<sup>4</sup> The *Guidelines* are set out at 75 Fed. Reg. 20,358 (April 19, 2010).

assumptions set forth in the Bank's Business Plan, which included branching authority, access to FDIC-assisted transactions, and the ability to purchase FDIC assets.

And yet, according to the Bank, its efforts to implement its Business Plan were thwarted, not just by the economic crisis or by the Bank's difficulty in penetrating the \*\*\* banking market (although these were significant contributing factors), but specifically by the refusal of the FDIC to authorize branching and access to FDIC-assisted transactions. The challenges of the economic climate in \*\*\* – job losses, the collapse of the housing market, plummeting business revenues, were aggravated, the Bank argues, by the area's fiercely competitive banking market. The Bank cites the domination of that market by such large mortgage companies and financial institutions as \*\*\*, \*\*\*, \*\*\*, \*\*\*, \*\*\*, \*\*\*, and \*\*\*, noting that in recent CRA evaluations of these peers, the FDIC explicitly acknowledged "intense home mortgage competition" in the vicinity. Because of the economic and competitive climate, it was absolutely essential that the Bank gain a "meaningful retail presence" in the \*\*\* market by implementing its Business Plan, and, according to the Bank, the FDIC was "expressly aware" that (1) the success of the Business Plan was dependent upon the Bank's ability to gain that presence and (2) the Bank couldn't gain that retail presence without the FDIC's grant of branching authority and the Bank's access to FDIC-assisted transactions. The FDIC, however, "at the eleventh hour," in September 2009, pulled its support of the Bank's branching plans, with devastating implications for the success of the Business Plan.

Finally, the Bank points to its (earlier) March 20, 2008 letter in which it had informed the FDIC that, owing to the then-current economic conditions, it was reconsidering proceeding with the Business Plan, implementation of which included steps to grow and diversify the Bank. The Bank advised the FDIC that it would curtail loan growth until the market and regulatory conditions warranted a change in strategy. The CRA Evaluation failed to recognize or endorse this effort in any way.

***DCP's Position.*** DCP disputes the Bank's assertion that there is no evidence that the examiners adequately considered the Bank's Performance Context, noting that that allegation is directly contradicted by the August 2010 Evaluation. In fact, DCP asserts, in accordance with FDIC procedures, the examiners reviewed detailed materials to establish the Bank's Performance Context. The Examiner-in-Charge ("EIC") spent some six weeks reviewing bank products, loan files, board meeting minutes, committee minutes, call report data, business plans, and loan policies. The examination process also involves extended conversations with both management and staff on bank operations and strategy.

The examiners also reviewed demographic reports available through CRA Wiz, an automated tool used by the regulators to map a Bank's lending patterns. The CRA Wiz reports specifically included an Assessment Area-In-Depth report and Assessment Area Overview report that contained detailed census data on population, housing statistics, employment, affordability ratios, and income. Examiners also used CRA Wiz

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to compile detailed reports (updated annually by Dun and Bradstreet) on the business demographics of the Bank's assessment areas.

DCP explains that, as essentially a de novo institution, the Bank was compared to other, similarly situated banks ("SSBs"), including \*\*\*, \*\*\*, \*\*\*, and \*\*\*. Examiners for the Bank reviewed Call Reports and CRA PEs, focusing on LTD ratios and Borrower and Geographic Distribution figures to determine if there were lending opportunities in the assessment area during the Bank's Evaluation period. This review demonstrated, not only that lending volume among the SSBs was substantially stronger than the Bank's, but that, as assessment-area businesses continued to have credit needs, there were lending opportunities for the Bank in its assessment area.

Community groups, interviewed by examiners, specifically identified small business lending as a significant credit need within the Bank's assessment area. Moreover, one representative for a not-for-profit community development financial institution revealed that small business loans are a major credit need in \*\*\*. A representative for a small business development center ("SBDC") stated that: (1) \*\*\* had experienced a population increase of 20 percent between 2000 and 2008, primarily related to the drawing of a large number of retirees to \*\*\*; (2) the overall decline in housing prices in \*\*\* has been less severe in \*\*\* where retirees support demand for housing; and (3) area banks have opportunities to participate with this SBDC in providing credit to small businesses in \*\*\*.

Further, DCP notes, the numbers reveal that the Bank had the capacity to lend. This capacity is reflected in the Bank's June 30, 2010 Tier One Capital ratio (higher than 98 percent of the banks in its peer group, as defined by the Uniform Bank Performance Report ("UBPR") for that date). The Bank's size and financial condition did not limit its ability to lend and meet assessment area credit needs during the relevant period. The December 31 UBPR reflects that the Bank's Return on Assets was higher than 99 percent of its peer group. There were no constraints specific to the Bank during the Evaluation Period. Moreover, other than the economy, which affected all banking institutions in the area, Bank management failed to identify any factors that negatively affected the Bank's ability to provide lending in its assessment area.

In response to the Bank's contentions that the FDIC's refusal to grant the Bank branching authority was instrumental in thwarting the Bank's Business Plan, DCP responds that the Bank did not file a branch application with the FDIC until 2009. At that time the Bank qualified for expedited processing under the FDIC's rules.<sup>5</sup> However, when the examiners preliminarily noted section 5 violations were identified in the 2009 Visitation, the FDIC appropriately removed the branch application from expedited processing and the Bank was notified by letter September 18, 2009. Furthermore, the majority of the Evaluation Period, from the 2005 CRA Evaluation forward, had passed

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<sup>5</sup> 12 C.F.R. § 303.40

without any significant lending. DCP argues that the Bank has failed to show how the addition of a branch would have enhanced the Bank's level of lending in less than one year to the 2010 CRA Evaluation, especially in view of the low level of lending originated by the Bank in \*\*\*, where two branch offices are located. Finally, the Bank opened an LPO and a deposit-taking remote service facility ("RSF") at the proposed branch location in \*\*\*. Because of the RSF, this area was considered an assessment area. Few loans were originated within this area during the entire Evaluation period.

***B. The Bank's Increased Level of Lending in its Assessment Area.***

A bank's CRA performance is evaluated on the distribution of its lending within its assessment area, across borrowers and neighborhoods of different income levels. For residential mortgage lending products, CRA evaluations consider the distribution of loans across low-, moderate-, middle-, and upper-income borrowers and areas, with a special focus on lending to low- and moderate-income borrowers and areas.

***The Bank's Position.*** The Bank argues that it has increased its In-Assessment Area Performance substantially, from \$3.2 million as of December 31, 2007 (the beginning of the relevant period) to \$44.7 million by the end of the period, June 30, 2010. Although loans originated by XYZ, the Bank's wholly owned subsidiary, are properly considered in the PE, the Bank argues that the FDIC has failed to accord those loans appropriate weight, dismissing them as "minimal." Four of the seven XYZ loans in \*\*\* (which has no low- and moderate-income geographies), aggregating \$761,350, were to low- and moderate-income borrowers.

The Bank also cites two business loans made in its assessment area, aggregating \$625,000, one of which was in a low- and moderate-income census tract and \$3.2 million in seven loans in or to low- and moderate-income census tracts or borrowers.

The Bank is critical of the DCP Assistant Regional Director's (the "ARD") 2010 response to the Bank's 2010 letter following up on the Evaluation exit meeting. The ARD relied heavily on SSBs in the Bank's assessment area, including \*\*\* and \*\*\* in evaluating the Bank's CRA performance, institutions that the Bank finds distinguishable. Both banks had dramatically higher lending levels at the beginning of the period, because they "were not artificially restrained in their retail platform" as the Bank was by the FDIC's refusal to allow branching. Before either institution commenced operations, both would have had all required policies and procedures approved by the FDIC, and they both would have had all personnel in place and infrastructure related to retail lending supported and operational. But development and approval of policies and procedures, staff hiring, and other preparatory efforts could not begin, the Bank asserts, before the Business Plan was approved and operational, as "doing so before would have been premature." Accordingly, both banks enjoyed considerable advantages in originating retail credits over the Bank.



The Bank disputes the relevance of the ARD's argument that the Bank failed to address how the raw increase in its loan portfolio helped meet assessment area credit needs, arguing "[That] is not the test. Presumably, lending in the assessment area helps meet assessment area credit needs." Finally, with regard to serving the credit needs of the assessment area, the Bank notes, "Identifying a need . . . is not the same as identifying credit-worthy borrowers."

***DCP's Position.*** DCP argues that the increase in the Bank's lending during the Evaluation Period did not result in serving community credit needs, including the needs of low- and moderate-income census tracts within the bank's assessment areas because the increase did not include loans in low- and moderate-income geographies. The loans made did increase by a healthy amount, but nearly 60 percent of the final amount (some \$44 million) was made up of three large-dollar loans originated between November 2009 and May 2010. The increase in lending did not result in a single commercial, construction, or multi-family loan in a low- and moderate-income census tract within the Bank's assessment area during the period from January 2008 to June 30, 2010. The lending increase, thus, had no effect on the 33 low- and moderate-income geographies that are within the Bank's assessment area. Furthermore, none of the XYZ low- and moderate-income residential mortgage loans within the Bank's assessment areas during 2009 were located in low- and moderate-income census tracts.

Finally, the business loans and the seven loans to low- and moderate-income tracts or borrowers that the Bank cites, DCP points out, were all originated after the August 2, 2010 evaluation date and, therefore, cannot be considered until the Bank's next CRA Evaluation.

***C. The Bank's LTD Ratio and the Appropriate Calculation of the Deposit Base.***

The LTD ratio represents a measurement to evaluate whether a bank is reinvesting its deposits in the community from which those deposits come.

***The Bank's Position.*** The Bank contends that its LTD ratio fully supports a "Satisfactory" rating when the FDIC's own procedures are properly applied. Under the CRA regulation, the ratio is to be considered in the context of factors indicating the nature of the ratio or its reasonableness in light of the facts and circumstances of the bank. The Bank cites FDIC guidance for examiners in evaluating the LTD ratio in examination procedures for small banks:

Evaluate whether institution's average loan-to-deposit ratio is reasonable in light of information from the performance context, including, as applicable, the institution's capacity to lend, the capacity of other similarly situated institutions to lend in the assessment area(s), demographic and economic factors present in

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the assessment area(s), and lending opportunities available in the institution's assessment area(s).

FDIC Compliance Manual, Community Reinvestment Act – Small Bank, XI-1.3 (June 2006).

Unlike most community banks, which draw the bulk of their deposits from the communities they serve, the Bank explains that in its case the overwhelming majority of its deposits come from its owners and related individuals. These “owner-affiliated” deposits, which accounted for approximately 93 percent of the Bank's total deposits as of June 30, 2010, the Bank argues, in no way represent true deposit gathering by the Bank in its community.

The Bank asserts that the unique nature of these types of affiliated deposits have been recognized in CRA evaluations, citing examples of two banks regulated by the Office of the Comptroller (“OCC”). In an earlier opinion, the OCC conducted a CRA Exam of an institution under the small bank standard. In making its finding on the institution's LTD ratio, the OCC considered the bank's deposit ratios and noted that although the average ratio for the Evaluation Period was 38 percent, when the head office and affiliate deposits were excluded, the LTD ratio increased to 54 percent, and when only the domestic deposits were considered, the ratio was 78 percent.

Similarly, in another opinion, the Ombudsman overturned an “NTI” rating by examiners based on findings that the bank's lending performance was in need of improvement and its LTD ratio was less than reasonable. The Ombudsman raised the rating to “Satisfactory,” noting that the bank's deposit base included a high level of deposit accounts from public funds, insider relationships, and other large depositors. The large depositors contributed to the bank's relatively low LTD ratio.

The Bank concludes that applying the mandated performance context analysis and excluding the owner-affiliated deposits from the LTD ratio calculation results in a dramatically different and “far more favorable result than that obtained by the FDIC.” According to the Bank, based on total outstanding loans of \$60.7 million as of June 30, 2010, the total LTD ratio, properly calculated by using only community-derived deposits, was 449.6 percent; limited to loans within the assessment area, the ratio was 325.2 percent. These ratios meet and exceed levels needed to support a “Satisfactory” rating.

***DCP's Position.*** DCP distinguishes the two OCC examples. In the first case, the CRA Performance Evaluation specifically points out the volatile nature of the deposits:

These deposits are for funding dollar-denominated transactions, and balances are typically volatile as a result of daily transaction activity. Consequently, the branch would be unable to use a significant portion of these deposits for lending purposes.

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The Bank's owner-affiliated deposits are, on the contrary, significantly less volatile in nature as the Bank exercises greater control over withdrawals. The Bank does not state otherwise. The Bank could (and presumably did) rely on owner-affiliated deposits for lending during the Evaluation Period.

In the second case, DCP points out that the Ombudsman considered the following Performance Context factors, all of which are factually distinct from the Bank's circumstances:

- The institution maintained a significant number of deposit accounts from public funds, insider relationships, and other large depositors with a low-level of loan demand;
- The community was heavily banked (one financial institution for every 800 residents);
- The assessment area was composed largely of upper-income individuals;
- The area was declining in population; and
- There were no low- and moderate-income census tracts in the assessment area.

Also of note, argues DCP, is the fact that the Ombudsman opinion specifically acknowledges that there were large depositors at the bank and a low loan demand within the assessment area. Significantly, the Ombudsman made no adjustment in the calculation of the bank's LTD ratio.

In contrast, according to interviews with representatives from the community in the Bank's assessment area, views bolstered by the performance of SSBs, there *were* opportunities to lend in the assessment area. DCP argues that an analysis of \*\*\* demographics conducted by the FDIC shows that there is one financial institution headquartered in \*\*\* for every 26,000 residents in the state. There is one branch banking office (including those of large national and regional banks) for every x,xxx \*\*\* residents. The Bank's assessment area constitutes a competitive banking market but it bears no comparison to the Ombudsman case ratio of one financial institution for every 800 residents.

\*\*\* has a growing population trend, and the upper-income residents of the assessment area do not represent a majority. In contrast to the institution in the Ombudsman Opinion, which had no low- and moderate-income census tracts, the Bank's assessment area has 33 low- and moderate-income census tracts.

Finally, DCP asserts that there is no regulatory authority for excluding owner-affiliated deposits from the calculation of the LTD ratio. Though there are several Interagency CRA Q&As dealing with the LTD ratio, none suggest such a recalculation. The Q&A most relevant, suggests to the contrary:

§ 11.26(b)(1) 3: *If an institution makes a large number of loans off-shore, will examiners segregate the domestic loan-to-deposit ratio from the foreign loan-to-deposit ratio?*

A3. No. Examiners will look at the institution's net loan-to-deposit ratio for the whole institution, without any adjustments.

**D. DCP's Consideration of the Section 5 Violations.**

Under CRA regulations,<sup>6</sup> the evaluation of a bank's CRA performance takes into account evidence that a bank engaged in illegal lending discrimination or other illegal credit practices that are inconsistent with helping to meet community credit needs.

***The Bank's Position.*** The Bank complains that the section 5 violations identified during the 2009 Visitation are improperly before the Committee to support DCP's "NTI" rating and that they have thwarted the Bank's branching strategy. The Bank argues that because it does not concede the validity of the UDAP allegations, because they represent untested allegations, and because, even if true, they were not considered in determining the rating, they have no relevance to this proceeding except to the extent that the dispute has been used by DCP to thwart the Bank's branching strategy.

The Bank argues that when it sought to have the UDAP allegations contained in the original Illegal Practices Review section of the PE expunged, DCP instead took the opportunity to completely rewrite the section to support the "NTI" rating where the allegations had expressly *not* supported the rating initially:

*Original: Fair Lending or Other Illegal Credit Practices Review section.*

Substantive violations of section 5 of the Federal Trade Commission Act were identified during the concurrent compliance examination of the bank. Although substantive, these violations involved a consumer loan product that was not considered in the current CRA evaluation. As such, a lowering of the bank's overall CRA rating from Needs to Improve to Substantial Noncompliance was not deemed warranted.

*Revised: Fair Lending or Other Illegal Credit Practices Review section.*

Substantive violations of section 5 of the Federal Trade Commission Act were identified during a concurrent FDIC examination that evaluated the bank's compliance with various consumer protection regulations. The section 5 violations were noted in connection with a consumer loan product offered by the bank on a national basis during the evaluation period. Although [the Bank] did have a number of policies and

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<sup>6</sup> 12 C.F.R. §§ 345.28-29.

procedures in place that were designed to ensure compliance with consumer protection regulations, the scope and depth of these policies and procedures were not sufficient to prevent the noted section 5 violations. While the practices that caused the section 5 violations were discontinued by [the Bank] during the evaluation period, the substantive nature of the violations further supports the assigned “Needs to Improve” CRA rating.

***DCP’s Position.*** The Community Reinvestment Act and its implementing regulation require that an institution’s compliance with laws and regulations barring discrimination on a prohibited basis and other illegal credit practices be considered when evaluating CRA performance and assigning a CRA rating. Specifically, “[t]he FDIC’s evaluation of a bank’s CRA performance is adversely affected by evidence of discriminatory or other illegal credit practices in any geography by the bank . . . [.]” 12 C.F.R. § 345.28(c). Section 5 violations are explicitly covered. 12 C.F.R. § 345.28(c)(iii).

If evidence of discriminatory or other illegal credit practices in any geography by the bank is found, the FDIC is to consider:

- a) The nature, extent, and strength of the evidence of the practices;
- b) The policies and procedures that the bank has in place to prevent the practices;
- c) Any corrective action the bank has taken, or has committed to take, including voluntary corrective action resulting from self-assessment; and
- d) Any other relevant information.

DCP disputes the Bank’s contention that the PE made clear that the allegations, even if true, were not considered in determining the CRA rating. Although the consumer loans on which the violations were based were not themselves considered as part of the CRA Evaluation, evidence of illegal credit practices was found. DCP considered the nature, extent, and strength of that evidence, the policies the Bank had in place to prevent the practices, and any corrective measures taken. DCP factored that information into its CRA rating and deemed that it further supported the “NTI” rating but did not justify a lower rating. In both the original and the revised wording of the Illegal Practices Review section of the PE, the evidence of the violations supports the “NTI” rating. DCP was required by the CRA to consider the evidence and take it into consideration in rating the Bank under the CRA.

#### ***IV. The Committee’s Findings.***

The fact that stands out for this Committee is that during the entire Evaluation period, from January 2008 to June 30, 2010, the Bank did not originate a single commercial, construction, or multi-family loan in a low- and moderate-income census tract within the Bank’s assessment area. This omission stands in spite of the fact that 21

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percent of the businesses and 23 percent of the multifamily housing units in the Bank's assessment area were located in low- and moderate-income geographies. Nowhere does the Bank even allege that it has met the credit needs of its assessment area, including low- and moderate-income neighborhoods. In fact, we find particularly revealing the Bank's response to the ARD's argument that the Bank had failed to address how the raw increase in its loan portfolio helped meet assessment area credit needs: "That is not the test. Presumably, lending in the assessment area helps meet assessment area credit needs."

Actually, lending in the assessment area is only part of the test – the foundational principle of the CRA involves meeting the credit needs of the communities in which a bank operates, *specifically including low- and moderate-income neighborhoods*. The Bank has failed to demonstrate its grasp of this concept. In discussing credit needs, the Bank asserts that "Identifying a need is not the same as identifying credit-worthy borrowers." However, the record of this case reveals no steps that the Bank took to identify assessment area credit needs, creditworthy borrowers, or to document that there were applicants that were not creditworthy. The Bank's admissions at the Committee's June 28 deliberative meeting buttressed this record finding, making clear that the Bank had failed even to take the necessary steps to establish a platform for CRA lending. At the time of the meeting, the Bank acknowledged that it had yet to find and employ a lending officer for CRA loans.

We reject the Bank's notion that the examiners ignored the Bank's Performance Context, essentially glossing over demographic data. The record is replete with evidence of the broad range of data on which DCP relied in the CRA Performance Evaluation – demographic reports, census data, housing statistics, and community-specific information gleaned from extensive interviewing of community groups.

That un rebutted data and interview evidence identified that (1) small business lending was a significant credit need within the Bank's assessment area; (2) a population increase of 20 percent between 2000 and 2008 within the assessment area, primarily consisting of retirees, offered abundant ground for lending opportunities; and (3) the decline in housing prices was less severe in \*\*\* where retirees were interested in building vacation homes. Additionally, Call Reports and CRA Performance Evaluations for SSBs (also un rebutted) demonstrate that lending volume among SSBs was substantially stronger than the Bank's lending. Clearly, there were lending opportunities in the assessment area

The Committee also finds persuasive DCP's citation of the Bank's Tier One Capital figures (higher than 98 percent of the banks in its peer group), confirming the Bank's capacity to lend. Additionally, the December 31, 2009 UBPR reveals that the Bank's return on assets was higher than 99 percent of its peer group, further confirming the Bank's ability to lend.

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The Committee also determines that DCP's decision to remove the Bank's branch application from expedited processing was not part of an FDIC plan to thwart the Bank's Business Plan; rather, it was justified and appropriate when examiners noted section 5 violations identified in the 2009 Visitation. The fact that the CRA Evaluation revealed a low level of lending originated in \*\*\*, where two branch offices were located reveals that branching was not the answer that the Bank apparently believed it was. The Bank's opening of an LPO and deposit-taking RSF at the proposed branch location was similarly unsuccessful, further evidence that branching and the implementation of the Business Plan would not improve the Bank's operations and clearly had no relevance to its meeting the credit needs of the communities it served, specifically including low- and moderate-income neighborhoods.

The Committee finds that the Bank's LTD ratio is appropriately calculated, according to both regulatory authority and guidance. We further find the cited OCC examples distinguishable on their facts.

Finally, the Committee finds that the section 5 violations are properly before this Committee, but only to the extent that DCP has, in arriving at the Bank's "NTI rating, considered: (1) evidence of such violations; (2) the policies and procedures the Bank has in place to prevent the practices; (3) any corrective action the Bank has taken; and (4) any other relevant information. Whether or not the violations are adjudicated by another tribunal, and whether or not that tribunal finds liability, DCP was required by the CRA to consider the evidence and take it into consideration in the Bank's CRA rating.

***V. Conclusion.***

For the foregoing reasons, the Bank's appeal is denied as set forth in this opinion. This decision is considered a final supervisory decision by the FDIC.

By direction of the Supervision Appeals Review Committee of the FDIC, date August 12, 2011.

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Valerie J. Best  
Assistant Executive Secretary