

understanding the context in which the institution's performance should be evaluated: (1) The economic and demographic characteristics of the assessment area(s); (2) lending, investment, and service opportunities in the assessment area(s); (3) the institution's product offerings and business strategy; (4) the institution's capacity and constraints; (5) the prior performance of the institution and, in appropriate circumstances, the performance of similarly situated institutions; and (6) other relevant information. The final rule clarifies that a proposed strategic plan will also be evaluated in the same context. However, all of the factors described in the performance context would not necessarily apply to each strategic plan. In this regard, the performance of similarly situated lenders would not generally be appropriate for evaluating future goals under a strategic plan.

Under the 1994 proposal, the assessment context would have included examiner-developed information on the credit needs of an institution's service area. Many commenters interpreted the proposal to mean that the agencies would prepare a detailed needs assessment for each institution's service area(s). Several bank and thrift commenters criticized such a role for the agencies, reasoning that institutions know their communities far better than a regulatory agency, and that agency-prepared assessments would lead to credit allocation. Some community organization commenters, while more supportive of the concept of agency prepared needs assessments, were concerned that the proposal might imply that institutions did not need to make an effort to know their communities' credit needs, but could instead look to the agencies for that determination.

The agencies did not intend to suggest that an agency-developed needs assessment would prescribe the credit needs an institution must address. Instead, the examiner-developed information on credit needs was intended to help inform the examiner's judgment about the institution's record of performance. Institutions are in the better position to know their communities, and it is neither appropriate nor feasible for the agencies to prepare a detailed assessment of the credit needs of an institution's community. Thus, under the final rule the agencies will analyze the information an institution maintains on the credit needs of its community along with relevant information available from other sources. At the same time, the

final rule does not establish a requirement that each institution prepare a "needs assessment" to be evaluated by the examiner as urged in some comments provided by financial institutions and community organizations.

Under the final rule, the agencies will neither prepare a formal assessment of community credit needs nor evaluate an institution on its efforts to ascertain community credit needs. Instead, the agencies will request any information that the institution has developed on lending, investment, and service opportunities in its assessment area(s). The agencies will not expect more information than what the institution normally would develop to prepare a business plan or to identify potential markets and customers, including low- and moderate-income persons and geographies in its assessment area(s). This information from the institution will be considered along with information from community, government, civic and other sources to enable the examiner to gain a working knowledge of the institution's community. In response to comments, the final rule also clarifies that information about lending, investment, and service opportunities in an institution's assessment area will, where appropriate, be obtained from tribal governments, as well as from other sources.

Statutory limits on investment authority. Several thrift commenters had concerns about the application of the investment test to thrift institutions because of their limited investment authority. Rather than providing a blanket exemption from the investment test, the final rule modifies the "capacity and constraints" section of the performance context to clarify that examiners should consider an institution's investment authority in evaluating performance under the investment test. A thrift that has few or no qualified investments may still be considered to be performing adequately under the investment test if, for example, the institution is particularly effective in responding to the community's credit needs through community development lending activities.

Safety and soundness. The CRA requires the agencies to assess an institution's record of helping to meet the credit needs of its entire community, consistent with the safe and sound operation of the institution. A number of industry commenters were concerned that the 1994 proposal would not have stressed the importance of the safety and soundness of an institution's

operation to the same extent as the CRA statute or the current regulations. These commenters responded primarily to the omission of a statement in the 1993 proposal that the CRA does not require any institution to make loans or investments that are expected to result in losses or are otherwise inconsistent with safe and sound operations. The agencies did not intend by this omission to encourage unprofitable or otherwise unsafe and unsound practices. The agencies firmly believe that institutions can and should expect lending and investments encouraged by the CRA to be profitable. The final rule explicitly reflects this belief and addresses the importance of safety and soundness considerations in several sections and in the ratings appendix. The agencies assess an institution's record of helping to meet community credit needs with careful attention to the constraints imposed by safety and soundness. As in other areas of bank and thrift operations, unsafe and unsound practices are viewed unfavorably. The ratings appendix specifically states: "The bank's overall performance, however, must be consistent with safe and sound banking practices. * * *"

Flexible underwriting approaches. The final rule states that the agencies permit and encourage an institution's use of flexible underwriting approaches to facilitate lending to low- and moderate-income individuals and areas, but only if consistent with safe and sound operations. This is consistent with, and clarifies, language in the 1994 proposal. Some commenters urged that the rule expressly identify particular types of areas or borrowers covered by this provision. Mentioning particular types of borrowers or areas in the regulatory text is unnecessary and inconsistent with the principle of evaluating each institution and its community based on their characteristics, capacity, and needs. However, certain borrowers or areas, such as Native Americans residing in Indian country, may face difficulties obtaining credit that could warrant special consideration. The efforts of lenders that utilize innovative or flexible methods, in a safe and sound manner, to address these or other unusual underwriting issues are recognized under the lending test.

The Lending Test

The lending test in the final rule is substantially similar to the 1994 proposal. However, there are some significant changes in response to the comments.

Consideration of originations and purchases. The 1994 proposal would