Decision of the
Supervision Appeals Review Committee

Case No. 2010-07

I. Summary of Findings.

After consideration of the timely filed written submissions of the parties, the record of this case, and following the February 10, 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") (formerly the Division of Supervision and Consumer Protection) appropriately evaluated the Bank's CRA performance under the Small Bank Performance Standards ("Performance Standards," or, the "Standards"). The Committee finds that the Bank's CRA performance is less than satisfactory because the Bank's lending ratios in low- and moderate-income census tracts were disproportional to the ratio of these tracts in the Bank's Assessment Area. Further, the Bank has failed to demonstrate that its performance under other criteria of the Performance Standards is sufficiently robust to compensate for its weak performance in Geographic Penetration.

II. Background.

A. Introduction.

***, ***, *** (the "Bank") is a state-chartered, non-member commercial bank with total assets of $136 million. It is a wholly owned subsidiary of ***, a one-bank holding company, and has been in operation since 2005. The Bank has one office location in an upper-income census tract[1] in ***, has no branch offices, and markets itself as for professionals and caters to high net-worth customers. The Bank's major product line is commercial lending, which, as of September 30, 2010, comprised about 64% of its loan portfolio. Where the Bank's expertise or resources are limited, it has aligned itself with several network partners to facilitate the origination of various other popular financial services.

The Community Reinvestment Act, enacted as Title VII of the Housing and Community Development Act of 1977,[2] is intended to encourage depository institutions to help meet the credit needs of the communities in which they operate, specifically

[1] A census tract (also called a geography) is a geographic region defined by the U.S. Census Bureau for the purpose of taking the decennial census. A census tract or 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.
[2] Pub. L. No. 95-128, 91 Stat. 1147, 12 U.S.C. §§ 2901 *et seq.* (1977).

including low- and moderate-income neighborhoods, consistent with safe and sound banking operations. Congress mandated that 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"). The Federal financial supervisory agencies take the record of an institution into consideration when approving applications for new branches or for mergers or acquisitions.

The Bank was first evaluated under the Small Bank Performance Standards in December 2006 as part of the Bank's first full-scope Exam (Compliance and CRA). The Bank received a Compliance rating of "3" and an overall CRA rating of "Satisfactory" under the small bank lending test, a streamlined assessment method for small institutions that contains 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 ("LTD");
2. The percentage of loans and other lending-related activities in the bank's Assessment Area ("Lending Inside the Assessment Area");
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 Penetration," or "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.

In this first CRA Evaluation, the Bank's performance under each of the five Performance Standards was considered reasonable. The Evaluation, however, took specific note that the Bank had originated only a limited number of small-business loans within the low- and moderate-income areas. Nevertheless, the Examiner found that the Bank's performance was augmented by a relatively high volume of community development loans. Although at that time, the Bank had been open for fewer than two years, it had, during the Evaluation period, originated seven community development loans, totaling $3.9 million and representing 13% of the Bank's total loans. The Examiner, on the Comments and Conclusions page of the Compliance Report of Examination, included instructions to the Bank to monitor its lending efforts with regard to low- and moderate-income areas:

> The bank's current performance and targeted customer base warrants the need for management to monitor the bank's lending efforts, particularly borrower distribution and geographical penetration. The Board and senior management is also requested

> to seek out community development loans to augment any weak performance identified under the small bank lending test.[3]

DCP conducted concurrent compliance and CRA examinations of the Bank, as of May 3, 2010. The DCP exam team assigned the Bank a Consumer Compliance Rating of "2," finding that management had maintained effective compliance despite the occurrence of disclosure violations, but, under the Small Bank Performance Standards, rated the Bank's CRA performance NTI for the Evaluation period January 1, 2007, through December 31, 2009. According to the May 3, 2010 CRA Evaluation, the NTI rating was "based primarily on the poor distribution of small business loans in low- and moderate-income geographies" despite the FDIC's past recommendations for the need to increase lending initiatives to these census tracts.

The Bank timely filed a Request for Review of a Material Supervisory Determination (the "Request") with the Division Director on October 5, 2010, arguing that its CRA rating of NTI should properly have been "Satisfactory," and that the rating was inconsistent with both the CRA rating system and the ratings of its similarly situated competitors. In a November 3, 2010 letter to the Bank's Board, the Director denied the Bank's Request for Review, finding that the Bank's lending among geographies of different income levels was not satisfactory and that its performance under the remaining criteria of the Standards was reasonable, though insufficiently robust to augment the weak performance under the Geographic Penetration criteria or affect the overall rating. The Bank timely appealed the Director's decision on December 1, 2010.

B. Summary of the Parties' Contentions.

The Bank asserts that its NTI rating is inconsistent both with the CRA rating system as set forth in the *FDIC Compliance Manual*, and with the ratings given its similarly situated competitors. The Bank argues that its lending in low- and moderate-income areas is not dissimilar to other banks that have received "Satisfactory" evaluations. Alleging that its Performance Context was not given appropriate consideration, the Bank contends that its demographic profile was largely ignored by the Examiner, and, further, that DCP failed to consider or even address the current economic conditions that have restricted small business lending nationwide and, in particular, in its Assessment Area. Finally, DCP essentially overstated the significance of the Bank's Geographic Penetration profile, to the exclusion of the other four Performance Standards. Properly considered, asserts the Bank, its performance in the other four areas easily should have augmented its performance under the Geographic Standard.

DCP, in response, points out that the Bank's demographic profile is not the issue but the fact that the Bank's primary focus is on upper-income borrowers to the exclusion

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[3] The Bank's 2006 Report of Examination (Compliance); Excerpt: Examiner's Comments and Conclusions, at 4.

of low- and moderate-income potential customers. Further, the Division contends that it is not the Bank's struggles for profitability that have hindered its lending in low- and moderate-income areas, but rather, that the Bank has taken no affirmative steps to improve its geographic performance by reaching out in any meaningful way to a wide swath of potential customers. Similarly, the Bank's argument that its performance under the other four Performance Standards is exemplary and should augment its Geographic Penetration rating is not borne out by the record of the case. Finally, DCP disputes that the other institutions to which the Bank compares itself are either similarly situated or comparable in performance.

In accordance with the *Guidelines for Appeals of Material Supervisory Determinations* ("*Guidelines*"),[4] 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 February 10, 2011 Committee 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. Performance Context.

Under the CRA, an institution's performance is judged in the context ("Performance Context") of information about the institution and its Assessment Area. 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. In contending that its Performance Context was not accurately considered, the Bank argues that the Examiner failed to give appropriate weight to the demographic data that make up the Bank's Performance Context:

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[4] The *Guidelines* are set out at 75 Fed. Reg. 20,358 (April 19, 2010).

- Operation as a new, small bank with more limited resources than its competitors and with smaller advertising and marketing budgets than those banks against which it is judged;
- Struggle for profitability in a highly competitive environment as a de novo bank lacking name recognition;
- Hindrance by a downtown *** locale, distant from low- and moderate-income areas, which are more conveniently proximate to the Bank's competitors than to the Bank; and
- Location in a crowded and bustling district with no parking and poor customer accessibility.

Moreover, the Examiner failed to consider the fact that the Evaluation period included the nation's worst recession since the 1930s, and that, just as small business lending contracted on a national level, the Bank's small business lending in low- and moderate-income areas diminished significantly. This trend was exacerbated, reasons the Bank, by the Bank's size, location, lack of history and reputation, and by the very strong competition of the other institutions in the Bank's Assessment Area.

The Bank complains in its Request and before the Committee that the Examiner ignored the Bank's Performance Context and focused instead on the Bank's business plan – specifically, the Bank's decreased number of loans in low- and moderate-income areas is, to the Examiner "simply a reflection of [his] unfounded assumptions about the Bank's business strategy." Finally, the Bank specifically disputes the accuracy of information contained in the Evaluation to the effect that there are 30 low-income census tracts within a three-mile radius of the Bank with 2,127 small businesses in those tracts. The Bank contends that there are only 14 low-income census tracts within a three-mile radius of the Bank.

DCP's Position. DCP argues that the Bank's diminished level of lending in low- and moderate-income areas was not the result of the Bank's history nor its size, location, or position in the market. The CRA Report acknowledges that the economic downturn led to the softening in the commercial and real estate markets, and that "property values have shown significant declines that inhibit an institution's ability to originate real estate loans." Additionally, the Report concedes that the Bank operates "in a highly competitive environment." However, under the Bank's business strategy of focusing primarily on upper-income borrowers and their credit needs, the Bank operates with limited community visibility: the Bank has no ATM, no night drop or drive-up facilities, no formal advertising program, and no outreach programs geared to the low- and moderate-income borrower or potential customer. Moreover, the upper-income focus has resulted in disproportionate lending in the upper-income geographies. Although 24% of the census tracts in the Bank's Assessment Area are upper-income, 75% of the Bank's small business loans were made in those upper-income tracts.

The Bank's contention that its struggles for profitability and attempts to control marketing and advertising expenses are justifying factors in the Bank's level of lending in low- and moderate-income areas is undercut by the facts. During the three-year Evaluation period, the Bank increased assets by 227% and its loans by 400%. Additionally, the Bank's assertion that its competitors are more conveniently located to low- and moderate-income areas, vastly limiting the Bank's opportunities to lend to these areas, is not supported by the facts. The CRA Report relied on data[5] showing that the nearest low-income tract is less than 1 mile from the Bank, and the nearest concentration of low-income tracts is only 1½ miles away. Within a 3-mile radius from the Bank, there are 2,127 small businesses located in 30 low-income tracts. The nearest moderate-income tract is less than 1 mile from the Bank, and the nearest concentration of moderate-income tracts is 1½ miles distant. Within a 3-mile radius of the Bank, there are 4,696 small businesses located within 29 moderate-income census tracts.

B. Geographic Penetration.

An analysis of Geographic Penetration centers on the distribution of loans within the low- and moderate-income geographies of an institution's Assessment Area in comparison to demographic percentages from the decennial census and to aggregate lending data.

The Bank's Position. The Bank asserts that its performance in lending to geographies of different income levels is similar to that of other banks within its Assessment Area, citing the records of five institutions.

The Bank argues that the difference in these performances from that of the Bank is statistically insignificant. Each of the institutions cited by the Bank has achieved "Satisfactory" CRA ratings with lending designations of "Adequate" or "Reasonable." The Bank, on the other hand, received a Geographic Penetration of "Poor" and a CRA rating of "NTI."

DCP's Position. DCP responds that Examiners fully considered competition in the area, as well as the performance of other, similarly situated institutions supervised in the Bank's Assessment Area. In most cases, performance of the Bank's comparables was materially stronger than the Bank's, and assigned ratings were consistent with CRA rating system guidelines.

DCP notes that the Region has had numerous discussions with the Bank, coupled with four formal recommendations to the Bank's Board and senior management

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[5] The Bank's small business loan originations and home mortgage loan originations in 2007, 2008, and 2009 were evaluated to assess the Bank's lending performance. D&B Business Demographic data for 2007, 2008, and 2009 were used as a comparison tool when evaluating the Bank's small business lending activity. 2000 U.S. Census data, as well as 2007 and 2008 aggregate home mortgage lending data, were used as a comparison tool when evaluating the Bank's home mortgage lending performance. The aggregate lending data reflect home mortgage loans made within the Assessment Area by lenders subject to the data reporting requirements of the Home Mortgage Disclosure Act.

concerning the Bank's marginal CRA performance, particularly with respect to Borrower Distribution and Geographic Penetration. In addition to the Comments in the Bank's first CRA Evaluation (12/11/06), cited earlier, those discussions include:

1. ***Excerpt from page 1 of 4/27/09 Compliance Examination.*** *Meeting with Management:* "… Since inception, the bank has been subject to only one CRA evaluation. Although examiners did not evaluate the bank's CRA performance, Examiner *** encouraged management to continue to monitor its performance prior to the next regulatory evaluation. President *** discussed the bank's current efforts to monitor its performance and committed to continued monitoring going forward."
2. ***Excerpt from the Bank's internally prepared CRA Annual Performance Report (same comment in both the 2008 and 2009 Bank-prepared reports).*** "… As the numbers reflect, the predominant number and amount of loans are originated within the Bank's AA. The nature of the Bank's clientele, more affluent, and the lack of a formal advertising program, new clients generally are referrals, which makes the origination of low- and moderate-income loans a challenge for the Bank."
3. ***Excerpts from 12/11/06 CRA Evaluation.*** *Borrower Profiles:* "… [T]he distribution of lending to small business owners reflects an excellent penetration, in contrast to a poor penetration for home equity lines of credit….the Bank's distribution of home equity loans reflects a poor penetration among individuals of different income levels…. [T]he Bank did not originate any home equity lines of credit to low- and moderate-income borrowers…. The Bank did not originate any small business loans in low- and moderate-income areas."
4. ***Excerpt from page 1 of the 1/20/06 Compliance Visitation.*** *Community Reinvestment:* "… Based upon loan originations reviewed for compliance, 100% of all loans reviewed were in the identified assessment area. Loans originated by the Bank, however, all tend to be to wealthy individuals living in upper income areas. As the Bank intends to market itself as a private bank, it will need to identify lending opportunities in its assessment area that serve low- and moderate-income individuals, small businesses, and low- and moderate-income areas."
5. ***Excerpt from 3/23/06 written response by the Bank to above comment, signed by Bank's Compliance Officer:*** "Subsequent to the visitation, census tracts designations have been verified for each loan in the bank's loan portfolio to assist in identifying loans in low- and moderate-income areas…. Management is sensitive to the need to identify lending opportunities in its assessment area

> that serve low- and moderate-income individuals and will monitor the bank's performance."

DCP emphasizes that the senior management team at the Bank is experienced and has established contacts and relationships to facilitate lending. The Bank's Chairman was previously Chief Executive Officer of the *** and was also involved with several other community organizations that seek to help small businesses and low- and moderate-income borrowers in such areas. Community contacts have indicated a need for Bank participation in local business associations in low- and moderate-income areas to help small businesses increase their financial knowledge and facilitate small business lending. Another community contact cited a need for portfolio lenders to offer products for first-time homebuyers, with larger down payment requirements for applicants with insufficient credit history or trade-lines required for an acceptable credit score. Based on the results of the current CRA Evaluation, the Division argues that the Bank has neither been actively involved with any of these organizations, nor is it evident that any outreach efforts have been initiated. The Bank's sponsored events during the past year are limited to philanthropic events that did not highlight the Bank's lending programs. In its appeal, the Bank has not even suggested that it is planning such initiatives or that it has ever attempted outreach to its community.

During the three-year review period, the Bank originated a total of 84 small business loans totaling $26.1 million in the Assessment Area, of which only one loan (1% by number volume and less than 1% by dollar volume) was originated in low-income tracts. Those figures are evidence of a poor level of lending when compared to the demographic factor of 5% (the percentage of businesses in low-income tracts within the Assessment Area). The Bank's level of lending in moderate-income tracts remained poor throughout the review period – only seven loans (8% by number volume and less than 1% by dollar volume) were originated in this tract. The Bank's performance is more consistent with the limited opportunities to lend in low-income tracts; performance in the moderate-income tracts, however, continued to significantly trail the demographic average of 16% of businesses in moderate-income tracts within the Assessment Area.

DCP indicates that, to compound the problem, the Bank's level of lending in moderate-income tracts significantly decreased from five loans in 2007 to one loan each in 2008 and 2009 at the same time that the level of lending in middle- and upper-income tracts increased. The Bank originated 76 of its small business loans (90% by number volume and 95% by dollar volume) in middle- and upper-income census tracts. Small business performance is deemed poor and in need of improvement.

C. Performance under the Other Criteria. The CRA rating system, as set out in the *FDIC Compliance Manual*, provides that a bank's performance need not fit each aspect of a particular rating profile to receive that rating – exceptionally strong performance in other areas may compensate for weak performance in others.

The Bank's Position. The Bank argues that even if its performance under the Geographic Penetration Standard is weak, its performance under the other Standards is sufficient to outweigh any perceived flaw in its Geographic Distribution. The Bank argues that the Examiner relied too heavily on the Geographic Penetration Standard, to the exclusion of the other four criteria. The Bank points out that its ***LTD Ratio*** is strong, that, as of the Evaluation date, the ratio was 100%, a metric that has been steadily increasing since the Bank was chartered and during a period when other de novo institutions were decreasing their lending activities.

The Bank also relies on its strong performance in ***Lending Inside the Assessment Area***. That figure, the Bank points out, has ranged from 72% to 100% during the Evaluation period. Moreover, the Bank made over 50% of its business loans to small businesses and extended two community development loans totaling $1.1 million and 1.1% of its total loans. The Bank additionally points out that it has received no complaints on its CRA performance from the public.

Finally, the Bank proffers "XYZ" Bank of *** as an example of an institution rated "Poor" on Geographic Distribution yet earning an overall "Satisfactory" CRA rating. XYZ has an Assessment Area with 14.6% low-income and 27.4% moderate-income census tracts, and in 2005, extended 14.3% of its loans to low- and moderate-income borrowers. Like XYZ, the Bank argues, the Bank's strong performance in other areas should compensate for a weak performance in its distribution of loans in low- and moderate-income areas.

DCP's Position. The Bank's 2006 CRA Report also found that the Bank had failed to make any loans in low-income census tracts and only two loans in moderate-income geographies. Nevertheless, the Bank received a "Satisfactory" rating because its low lending in low- and moderate-income areas was mitigated by the seven community development loans totaling $3.9 million that the Bank originated in these census tracts. In contrast, the Bank's small-business lending in moderate-income areas represented a declining trend of 11% in 2007, 7% in 2008, and 4% in 2009. The number of community development loans also declined – to one loan in 2008 and 2009. The Bank's argument that its high LTD ratio and high percentage of Loans Inside the Assessment Area should mitigate the decreasing lending in low- and moderate-income areas misses the mark. Neither of these factors affected penetration to low- and moderate-income areas.

The Bank's reliance on the 2005 CRA Evaluation of XYZ located in *** is also misplaced. The two banks are not at all similar except that XYZ was also assigned a "Poor" performance rating for Geographic Penetration. XYZ, however, received a "Satisfactory" rating on its Evaluation in view of its Performance Context issues: (1) the faltering economy; (2) unemployment; (3) high business and housing costs; (4) a lack of single companies or dominant industries in the counties that make up XYZ's Assessment Area; and (5) the after-effects of other area-specific matters negatively influencing the economy.. A recommendation was also included in XYZ's Compliance Report noting that improvement under the Geographic Penetration criteria was necessary. XYZ is no longer active, as it was merged with a *** bank the next year.

IV. The Committee's Findings.

Even before the beginning of the 2007 to 2009 Evaluation period, the Bank was on notice to monitor its lending efforts with respect to the low- and moderate-income areas. The Bank's Compliance Officer specifically acknowledged that need in writing on March 23, 2006. There is a long progression of similar warnings running throughout the Evaluation period.

The record in this case is clear and unrebutted. The Bank has focused primarily on upper income borrowers and on their credit needs to the exclusion of the credit needs of the low- and moderate-income census tracts. One (of many) metric stands out: although 24% of the census tracts in the Bank's Assessment Area are upper income, 75% of the Bank's small business loans were made in those tracts. The Bank's objection that its struggles for profitability and its attempts to control marketing and expenses justify its low level of lending to the low- and moderate-income tracts is contradicted by its asset growth (227%) and the growth of its loan portfolio (400%). The Bank is well situated to serve low- and moderate-income customers at a level that reaches the modest demographic for the area.

This Committee rejects the Bank's reliance on five other banks it asserts are comparable with regard to their lending levels. The use of raw numbers without comparison, support, or even argument does not assist the Bank's case. It appears to the Committee that the ratings of the other banks were both appropriate and consistent with the CRA rating system. The distinctions noted by a review of the documents are unchallenged by any submission from the Bank.

It also appears by a review of the record that the Bank has repeatedly and consistently been cautioned about its marginal CRA performance. We also note the written response of the Bank's Compliance Officer to one formal recommendation, acknowledging, specifically, the need for outreach to the low- and moderate-income borrowers.

Of particular interest to this Committee is the remarkable experience and established contacts of the Bank's senior management team, to facilitate the very sort of lending the CRA was enacted to foster. Community contacts confirmed the need for outreach to low- and moderate-income are. And yet in this appeal, the Bank has not suggested a single initiative or program that would answer any such need. Indeed, at the February 10 deliberative meeting of the Committee with the parties, each Committee member sought, without success, to hear from the Bank specific examples of the Bank's outreach to the low- and moderate-income community.

Congress mandated that this agency implement the Community Reinvestment Act by examining and assessing an institution's record in helping meet the credit needs of their local communities, specifically including low- and moderate-income neighborhoods. The numbers are clear on this record. The Bank originated 84 small business loans totaling $26.1 million in their Assessment Area, of which 1 loan (1%) was originated in a low-income tract, compared with a demographic of 5% (the percentage of businesses in low-income tracts in the Assessment Area). The Bank's performance in moderate-income areas was similarly poor. Lending in these tracts was limited to seven loans (8% by number volume and less than 1% by dollar volume). These numbers trail the demographic of 16%. Yet this was the same period in which the Bank's lending in the middle- and upper-income tracts increased. The Bank's numbers cannot be said to meet the credit needs of the Bank's local community.

Finally, under the CRA rating system, as set out in the *FDIC Compliance Manual*, a bank's performance need not fit each aspect of a particular rating profile to receive that rating **– *exceptionally strong*** performance in other areas may compensate for weak performance in others. The Committee finds that the Bank has been unable to demonstrate exceptionally strong performance under any of the other criteria to augment its performance under the Geographic Penetration Standard.

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 March 31, 2011.

Valerie J. Best
Assistant Executive Secretary