FEDERAL RESERVE BANK
OF NEW YORK

[Circular No. **10753**
December 29, 1994]

PUBLIC WELFARE INVESTMENTS BY STATE MEMBER BANKS AND BANK HOLDING COMPANIES

Amendments to Regulations H and Y

Effective January 9, 1995

To All State Member Banks and Bank Holding Companies in the Second Federal Reserve District, and Others Concerned:

Following is the text of a statement issued by the Board of Governors of the Federal Reserve System:

> The Federal Reserve Board has issued final amendments to Regulation H (Membership of State Banking Institutions in the Federal Reserve System) regarding public welfare investments by state member banks, and a corresponding Regulation Y (Bank Holding Companies and Change in Bank Control) interpretation for bank holding companies.
>
> The amendments are effective January 9, 1995.
>
> The final amendments permit state member banks to make certain public welfare investments without specific Board approval and other public welfare investments with specific approval. The amendments also address the procedural aspects of these investments.

Enclosed — for state member banks, bank holding companies, and others who maintain sets of the Board's regulations — is the text of the amendments, effective January 9, 1995, as published in the *Federal Register.* Additional copies are available at this Bank (33 Liberty Street) from the Issues Division on the first floor, or by calling our Circulars Division (Tel. No. 212-720-5215 or 5216). The notices and requests for approval described in the amendments, and any questions on this matter, may be directed to our Banking Applications Department (Tel. No. 212-720-5861).

WILLIAM J. MCDONOUGH,
President.

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PUBLIC WELFARE INVESTMENTS

Amendments to Regulation H
Docket No. R-0838

Amendments to Regulation Y
Docket No. R-0860

[Enc. Cir. No. 10753]

12 CFR Part 208

[Regulation H; Docket No. R–0838]

Membership of State Banking Institutions in the Federal Reserve System

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule.

SUMMARY: The Board is amending its Regulation H to implement a provision of the Depository Institutions Disaster Relief Act of 1992 that authorizes state member banks to make investments designed primarily to promote the public welfare to the extent permissible under state law and subject to regulation

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by the Board. The amendment would permit state member banks to make certain public welfare investments without prior approval and other public welfare investments with specific Board approval. The amendment also addresses the procedural aspects of these investments.

EFFECTIVE DATE: January 9, 1995.

FOR FURTHER INFORMATION CONTACT: Stephanie Martin, Senior Attorney (202–452–3198), Legal Division; Sandra Braunstein, Manager for Community Affairs, (202–452–3378), Division of Consumer and Community Affairs; Larry Cunningham, Supervisory Financial Analyst, Division of Banking Supervision and Regulation (202–452–2701); for users of the Telecommunications Device for the Deaf (TDD) only, Dorothea Thompson (202–452–3544); Board of Governors of the Federal Reserve System, Washington, DC 20551.

SUPPLEMENTARY INFORMATION: The Depository Institutions Disaster Relief Act of 1992 [1] amended the Federal Reserve Act [2] to loosen the restriction on the ability of state member banks to purchase, sell, underwrite, and hold investment securities. The amendment allows state member banks to make investments that are designed primarily to promote the public welfare. The investment must not violate state law or expose the bank to unlimited liability. The aggregate of the bank's public welfare investments must not exceed the sum of five percent of the bank's capital stock actually paid in and unimpaired and five percent of its unimpaired surplus fund. The Board may waive this limit by order, on a case-by-case basis, and permit a bank to make investments in an amount not exceeding the sum of ten percent of the capital stock actually paid in and unimpaired and ten percent of the unimpaired surplus fund of the bank. Finally, the Board must limit a bank's investments in any one project.

In the past, the Board has dealt with requests by state member banks to make public welfare investments on a case-by-case basis. To reflect the recent Federal Reserve Act amendment and to facilitate public welfare investments by state member banks, the Board is amending Regulation H (12 CFR Part 208) by adding a new section entitled Community Development and Public Welfare Investments. This amendment will permit state member banks to make certain public welfare investments without prior approval.

[1] Pub. L. 102–485, 106 Stat. 2771, 2774, section 6(b).

[2] Section 9, paragraph 23 (12 U.S.C. 338a).

Summary of Final Rule

The final rule identifies classes of public welfare investments that do not require prior approval, leaving less common investments and investments of more than five percent of a bank's capital stock and surplus subject to case-by-case review. Under the final rule, a state member bank may make an investment, without prior approval, if the investment previously has been determined to be a public welfare investment by the Board or the Comptroller of the Currency or is an investment in a community development financial institution as defined in the Community Development Banking and Financial Institutions Act of 1994.[3] In addition, the rule allows state member banks to invest without prior approval in an entity established solely to engage in one or more of the following activities: low- and moderate-income housing; nonresidential real-estate development in a low- or moderate-income area that is targeted towards low- and moderate-income persons; small business development in a low- or moderate-income area; job training or placement for low- and moderate-income persons; job creation in a low- or moderate-income area for low- and moderate-income persons; and technical assistance and credit counseling to benefit community development.

The final rule uses the Department of Housing and Urban Development's (HUD's) Chapter 69 Community Development definition of low- and moderate-income persons and the Small Business Administration's definition of small business. Low- or moderate-income area is defined as an area in which the median family income is less than eighty percent of the median family income of the Metropolitan Statistical Area, or, for non-metropolitan areas, the state.

Under the final rule, the investment must not violate state law or expose the bank to unlimited liability. The rule limits aggregate public welfare investments without prior approval to up to five percent of the capital stock and surplus of the state member bank and limits any single investment without prior approval to not more than two percent of a bank's capital stock and surplus. In addition, to make public welfare investments without prior approval, a state member bank must be at least adequately capitalized and rated a composite CAMEL "1" or "2" and at least "satisfactory" in its last consumer compliance examination. In addition, the bank must not be subject to any written agreement, cease and desist order, capital directive, or prompt corrective action directive issued by the Board or a Federal Reserve Bank acting under delegated authority. A state member bank must receive Board approval before making an investment that falls outside of the rule's parameters. In no event may aggregate public welfare investments exceed ten percent of the bank's capital stock and surplus.

Within 30 days after making a public welfare investment without prior approval, a state member bank must advise its Reserve Bank of the amount of the investment and the identity of the entity in which the investment is made. If a bank has a preexisting public welfare investment on the rule's effective date that would not require prior approval under the rule, the bank must notify its Reserve Bank of the investment within sixty days after the effective date of the rule. For other preexisting public welfare investments, the bank must apply to the Board for approval of the investment within one year after the rule's effective date.

If a public welfare investment ceases to meet the statutory requirements or any requirements established by the Board in granting approval, the bank must divest itself of the investment to the extent that the investment ceases to meet those requirements. This divestiture is governed by the same requirements as divestitures of interests acquired by a lending subsidiary of a bank holding company or a bank holding company itself in satisfaction of a debt previously contracted. (See 12 CFR § 225.140.) Divestiture is not required if the investment ceases to meet the non-statutory requirements concerning capital, examination ratings, and enforcement actions.

Summary of Comments and Section-by-Section Analysis

The Board proposed amendments to Regulation H regarding public welfare investments by state member banks in May 1994 (59 FR 27247, May 26, 1994). The Board received nine public comments on the proposed rule: four from trade associations, three from community development organizations, and two from bank holding companies. The public comments and the Board's responses to the comments are discussed in the section-by-section analysis below.

Section 208.21(a)(1)

Definition of low- and moderate-income area. The Board proposed to define "low- and moderate-income

[3] Title I of Pub. L. 103–325, 108 Stat. 2160, section 103(5).

area" as an area in which the median family income is less than eighty percent of the median family income of the Metropolitan Statistical Area, or, for non-metropolitan areas, the state. One commenter stated that "low- and moderate-income area" should include disadvantaged areas designated by statute as requiring special government assistance that might not qualify under the proposed definition.

The Board has addressed the concern that the proposed rule's coverage was too narrow by amending § 208.21(b)(1) to broaden the universe of investments that are permissible without prior approval. (This amendment is discussed below.) The Board has adopted the definition as proposed.

Section 208.21(a)(2)

Definition of low- and moderate-income person. The proposed rule's definition of "low- and moderate-income person" incorporated the definition in Chapter 69 of the HUD statute on community development. One commenter supported use of the HUD standard of 80% of median income in defining the upper limit for qualifying investments. The Board has adopted the proposed definition, with a minor citation correction.

Section 208.21(a)(3)

Definition of small business. The Board proposed to incorporate the definition of "small business" as it applies to entities eligible for financial or other assistance under the Small Business Administration's Small Business Investment Company and Development Company programs. The Board received no public comments on this definition and has adopted it as proposed.

Section 208.21(b)(1)(i)–(iii)

Investments not requiring prior approval. The proposed rule provided that state member banks could make an investment without prior approval if the Board has determined the investment is a public welfare investment or if the entity in which the bank invests engages solely in one or more specified community development activities.

One commenter stated that the proposed standards were narrower than the Federal Reserve Act's requirements and could exclude public-purpose projects and mixed use projects where low- and moderate-income residents are only some of the project's beneficiaries, particularly in rural areas where low- and moderate-income families are not concentrated.

In the final rule, the Board has broadened the scope of investments that are permissible without prior approval. Specifically, a state member bank may invest in an entity if the Comptroller of the Currency (OCC) has determined, by order or regulation, that investment in that entity by a national bank is a public welfare investment under section 5136 of the Revised Statutes (12 U.S.C. 24). This provision will provide greater consistency in investments that are permissible for state member banks and national banks and will eliminate the need in many cases for determinations by two regulatory agencies. In addition, under the final rule a state member bank may, without prior approval, invest in a community development financial institution as defined in section 103(5) of the Community Development Banking and Financial Institutions Act of 1994. Congress has found that community development financial institutions play an important role in promoting economic revitalization and development in troubled communities and has established a special fund to invest in and assist these institutions. Therefore, the Board believes that investment in community development financial institutions by state member banks should be considered public welfare investments.

Additionally, under § 208.21(d), the Board could make a general determination for investments in entities engaged in a particular activity. For example, if the Board determined that an investment in an entity engaged in development activities in a federally-specified enterprise zone was a permissible public welfare investment, it might also determine that an investment in any similar entity engaged in similar activities would not require prior approval.

Two commenters argued that the proposed restrictions were too broad. These commenters stated that the prior approval exemption should be provided only for those investments that address the needs of low- and moderate-income persons and communities in ways not readily available through the private market. These commenters suggested that the Board add criteria similar to those in the OCC's rules on public welfare investments. These commenters also suggested that a qualifying public welfare investment should be required to include nonbank community involvement to ensure that low- and moderate-income community residents will benefit from the investment.

Generally, the ability to obtain funds in the private market is a matter of price rather than access. The rate at which funding in the private market would be prohibitive would vary with each project and would be difficult to specify in a rule of general application. In addition, the Board believes that the community development projects described by the rule will usually have some form of community support. The Board believes that any benefit in requiring a showing of non-bank community involvement in a project would be outweighed by the additional regulatory burden involved.

One commenter requested that the Board clarify that investments may be made in either non-profit or for-profit community development projects without prior approval. The final rule does not distinguish between non-profit and for-profit investments. Either type of investment is permissible as long as it meets the rule's requirements.

Section 208.21(b)(1)(iv)

The proposed rule provided that a state member bank could invest without prior approval in an entity that engages solely in one or more specified community development activities.

Engaged solely. Two commenters stated that requiring an entity to engage *solely* in one of the specified activities is too restrictive. The commenters noted that many companies invest in community development but are diverse and multi-functional. One commenter suggested that the Board substitute "primarily" for "solely." The Board believes that the term "primarily," which could be interpreted to mean 51 percent or even lower, is not narrow enough for purposes of investments without prior approval. If a state member bank wishes to invest in an entity that does not engage solely in the listed activities, it may ask for a Board determination that the investment is a public welfare investment. The Board has retained the "solely" language in the final rule.

Where the Board used the term "primarily" in the proposed rule, it intended to cover those projects targeted towards low- and moderate-income persons. The Board has substituted the phrase "targeted towards" for "primarily" in the final rule (§ 208.21(b)(1)(iv) (B) and (D)).

Indirectly engaged. One commenter asked that the Board clarify whether the rule covers investment in a firm that engages in enumerated activities through a wholly-owned subsidiary. The Board believes that investment in an entity that engaged solely in the listed activities through one or more subsidiaries would be permissible. The Board has revised the final rule (§ 208.21(b)(1)(iv)) to clarify this point.

Lending activity. The Board has revised the rule to allow investments without prior approval in entities

engaged solely in public welfare lending activities.

Section 208.21(b)(1)(iv)(A)

Investments in low- and moderate-income housing. The Board proposed to allow investment without prior approval in entities that are engaged in certain activities related to low- and moderate-income housing. The Board specifically requested comment on whether low- and moderate-income housing should be defined as housing where a majority of the units are occupied by low- and moderate-income persons (as proposed) or whether the definition should be based on other federal programs, such as the low-income housing credit in section 42 of the Internal Revenue Code. The Board received six public comments on this issue.

Three commenters supported the test proposed by the Board. One of these commenters stated that section 42 of the Internal Revenue Code should apply only if a corporation makes an investment in a housing project specifically to benefit from a low-income housing tax credit. Another of these commenters suggested that the rule's definition of low- and moderate-income housing reflect the current HUD definition, which stratifies the definition further to include very low income designations.

One commenter stated that requiring a majority of residential units to be occupied by low- and moderate-income persons would tend to segregate the poor from people who could help them prosper. This commenter suggested that the test should be satisfied by any housing "occupied by low- to moderate-income persons," or if necessary, including a low occupation threshold amount such as 15 percent.

Two commenters suggested that a qualifying investment should meet the "majority of units" requirement as well as a requirement that either (1) at least 20 percent of the units be occupied by individuals whose incomes do not exceed 50 percent of area median income, or (2) at least 40 percent of the units be occupied by individuals whose incomes do not exceed 60 percent of the area median income, adjusted for family size. The commenters believed that the additional restriction (which is based on the definition of "low-income housing project" in the Internal Revenue Code) would insure that qualifying investments would provide a minimum level of benefit to low-income persons.

The Board believes that the additional restrictions on the test for low- or moderate-income housing would not provide sufficient flexibility in the final rule. However, the Board believes that tax credits could provide a powerful incentive for banks to invest in low-income housing. Therefore, the Board has adopted a revised version of the low- and moderate-income housing provision that would allow investment in residential property in which a majority of the units are occupied by low- or moderate-income persons *or* that meets the definition of a qualified low-income building under section 42 of the Internal Revenue Code.

Section 208.21(b)(1)(iv)(B)

Investments in nonresidential real property. The Board proposed to allow investment without prior approval in entities that are engaged in certain activities related to nonresidential real property or other assets located in a low- or moderate-income area and to be used primarily by low- and moderate-income persons. Two commenters strongly supported the inclusion of this category. Other than the revision to the term "primarily," the Board has adopted this provision as proposed.

Section 208.21(b)(1)(iv)(C)

Small businesses in low- or moderate-income area. The Board proposed to allow investment without prior approval in entities that invest in small businesses located in a low- or moderate-income area to stimulate economic development. Two commenters suggested that the Board add emphasis on minority small businesses, which are an especially underserved segment of the small business community. The Board believes it would be difficult to determine what criteria to use to identify disadvantaged small businesses and has not adopted this suggestion.

One commenter stated that the Board should permit investments in all small businesses, as such investments would stimulate economic development regardless of whether the businesses are located in low- or moderate-income areas. The expansion of the types of investment permissible without prior approval (§ 208.21(b)(1) (ii) and (iii)) should help address the concerns raised by this commenter. The Board has adopted the provision as proposed.

Section 208.21(b)(1)(iv) (D) and (E)

Job training and employment opportunities. The Board proposed to allow investment without prior approval in an entity that (i) invests in, develops, or otherwise assists job training or placement facilities or programs that will be used primarily by low- and moderate-income persons or (ii) invests in an entity located in a low- or moderate-income area if that entity creates long-term employment opportunities, a majority of which will be held by low- and moderate-income persons. The Board received no public comments on these provisions. Other than the revision to the term "primarily," the Board has adopted these provisions as proposed.

Section 208.21(b)(1)(iv)(F)

Investments in credit counseling. The Board proposed to allow investment without prior approval in entities that provide technical assistance, credit counseling, research, and program development to low- and moderate-income persons, small businesses, or nonprofit corporations to help achieve community development. Two commenters strongly supported the inclusion of this category. The Board has adopted this provision as proposed.

Section 208.21(b)(2)

Permitted by state law. The Board proposed to allow investments without prior approval only if the investment is permitted by state law. The Board received no public comments on this provision and has adopted it as proposed.

Section 208.21(b)(3)

Limited liability. The Board proposed to allow investments without prior approval only if the investment will not expose the bank to liability beyond the amount of the investment. The Board received no public comments on this provision and has adopted it as proposed. This provision would preclude a state member bank from acting as a general partner. A general partner is normally liable for all of the debts of the partnership, which could be greater than the partner's investment.

Section 208.21(b) (4) and (5)

Percentage of capital limitation. The Board proposed to allow investments without prior approval only if the investment does not exceed the sum of two percent of the bank's capital stock and surplus and if the aggregate all such investments of the bank does not exceed the sum of five percent of its capital stock and surplus. The Board received no comments on this provision and has adopted it as proposed.

Definition of capital. The Board proposed to define capital stock and surplus as it is defined in a Board interpretation on state member bank undivided profits (12 CFR § 250.162). One commenter suggested that the Board define capital and surplus as total Tier 1 and Tier 2 capital, plus that balance of a bank's allowance for loans

and lease losses not included in Tier 1 and Tier 2 capital. The commenter stated that this information can be easily gleaned from call report, would ease compliance, and would be consistent with the OCC's proposed definition of capital and surplus for purposes of lending limits. The Board believes that the capital definition suggested by the commenter is broader than anticipated by the "capital and surplus" language of the statute. For many years, rules establishing limitations on the activities of state member banks in terms of a bank's capital structure have used a well-established definition of capital stock and surplus that includes undivided profits plus allowance for loan and lease losses. As these items are readily ascertained from the Schedule RC Balance Sheet report (total equity capital (line 28); allowance for loan and lease losses (line 4b), the Board has adopted the definition of capital and surplus as proposed.

Section 208.21(b) (6)–(8)

Requirements regarding bank condition. The Board proposed to allow investments without prior approval only if the bank is well capitalized or adequately capitalized, received a composite CAMEL rating of "1" or "2" as of its most recent examination, and is not subject to any written agreement, cease and desist order, capital directive, or prompt corrective action directive issued by the Board or a Federal Reserve Bank.

One commenter stated that CAMEL 3-rated institutions do not pose the same risks to safety and soundness as 4- and 5-rated institutions. The commenter suggested that an improving 3-rated institution with adequate capital should be able to request a waiver from the Board to forego the application process for future public welfare projects (consistent with the OCC's public welfare investment rule). The Board believes, however, that it would need to review a 3-rated bank's status upon each public welfare investment request to determine whether the bank was improving and that a blanket application waiver for improving 3-rated banks would not be appropriate.

The Board has made two revisions to the proposed provision. First, the Board has expanded this provision to preclude investment without prior approval by banks operating under a memorandum of understanding. Second, the final rule will require a bank to have overall ratings of at least "satisfactory" from its most recent consumer compliance examination in order to make a public welfare investment without prior approval.

Section 208.21(c)

Notice to Reserve Bank. The Board proposed to require a bank that made an investment without prior approval to notify its Federal Reserve Bank within 30 days of making the investment. The proposed notice would include the amount of the investment and the identity of the entity in which the investment is made. The Board received no public comments on this provision and has adopted it as proposed.

Section 208.21(d)

The Board proposed that a state member bank would be able to make public welfare investments other than those specified in the regulation with prior Board approval.

Scope of public welfare investments. One commenter suggested that the Board provide further guidance as to the boundaries of public welfare investments that are not directly related to low- and moderate-income communities or families. The Board's expansion of investments permissible without prior approval should address this commenter's concerns.

Application procedures. Three commenters suggested that the rule should address application procedures and time limits for public welfare investments. The Board has added provisions to § 208.21(d) to describe the minimum information that a public welfare investment request should contain in order to enable the Board to determine whether the investment would meet the Federal Reserve Act's requirements. The final rule also provides that the Board will normally act on requests within 60 days, unless the Board notifies the bank that a longer period is necessary. Accordingly, a bank should request Board approval of a public welfare investment at least 60 days prior to the day the bank wishes to make the investment.

Section 208.21(e)

Divestiture. The Board proposed that a bank must divest itself of an investment made in accordance with the regulation to the extent that the investment exceeds the scope of, or ceases to meet, the requirements of the regulation. The Board proposed that the divestiture be made in the manner specified in Regulation Y for interests acquired by a lending subsidiary of a bank holding company or the bank holding company itself in satisfaction of a debt previously contracted. The Board received no public comments on this provision and has adopted it as proposed.

Section 208.21(f)

Preexisting investments. Under the Board proposal, if a state member bank has an ongoing public welfare investment that would not require prior approval under the regulation and was made prior to the rule's effective date, the bank must notify its Federal Reserve Bank of the investment within 60 days after the effective date. For other ongoing investments made prior to the rule's effective date, the bank must request Board approval within one year of the effective date. The Board received no public comments on these provisions and has adopted them as proposed.

Other Comments

Community Reinvestment Act

Three commenters requested that the Board address the relationship between the proposed rule and banks' obligations under the Community Reinvestment Act (CRA). One commenter was concerned that the new investment levels would be interpreted as mandatory for state member banks by some community groups and requested that the Board clarify the role such investments should play in bank's overall CRA program. Another commenter believed that public welfare investments should be considered in assessment of a bank's CRA compliance in order to encourage bank participation in lending consortia outside the bank's delineated service area. A third commenter stated that the types of investments envisioned in this rule should not supplant the bank's responsibilities under the CRA.

The Board has determined not to refer to the CRA in this regulation. The requirements of the CRA will continue to apply to state member banks. Public welfare investments that are authorized under this regulation may or may not qualify for CRA "credit," depending on the nature of the investment and the requirements of the CRA.

Regulation Y

Two commenters urged the Board to adopt a corresponding interpretation to Regulation Y (12 CFR Part 225) so that the treatment of bank holding companies and state member banks will be consistent. The Board has adopted an interpretation to Regulation Y, published elsewhere in today's **Federal Register**.

Capital Treatment

One commenter requested that the Board address the capital effects of this proposal. The Board believes that public welfare investments should not receive special accounting, capital, or examination treatment.

Regulatory Flexibility Act Certification

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 605(b)), the Board certifies that the amendments to Regulation H will not have a significant economic impact on a substantial number of small entities, and that any impact on those entities should be positive. The amendments will reduce the regulatory burden for many state member banks by permitting them to make certain investments that had previously required Board approval, and will have no effect in other cases.

Paperwork Reduction Act

In accordance with section 3507 of the Paperwork Reduction Act of 1980 (44 U.S.C. 3507), the information collection has been reviewed by the Board under the authority delegated to the Board by the Office of Management and Budget (5 CFR Part 1320, Appendix A) after consideration of the comments received during the public comment period.

The collections of information in this regulation are in 12 CFR 208.21. This information is required to allow oversight of state member banks while permitting them to make certain public welfare investments. This information will be used to track public welfare investments and approve or deny certain new investments.

The estimated annual burden per respondent varies from 2 to 10 hours, depending on individual circumstances, with an estimated average of 2.3 hours. There will be an estimated thirty-five respondents filing investment notifications, averaging 2 hours, an estimated fifteen respondents filing applications, averaging 2.5 hours, and an estimated two respondents filing divestiture notifications, averaging 5 hours.

List of Subjects in 12 CFR Part 208

Accounting, Agriculture, Banks, Banking, Confidential business information, Crime, Currency, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Securities.

For the reasons set forth in the preamble, the Board is amending 12 CFR Part 208 as set forth below:

PART 208—MEMBERSHIP OF STATE BANKING INSTITUTIONS IN THE FEDERAL RESERVE SYSTEM (REGULATION H)

1. The authority citation for Part 208 continues to read as follows:

Authority: 12 U.S.C. 36, 248(a), 248(c), 321–338a, 371d, 461, 481–486, 601, 611, 1814, 1823(j), 1828(o), 1831o, 1831p–1, 3105, 3310, 3331–3351, and 3906–3909; 15 U.S.C. 78b, 78l(b), 78l(g), 78l(i), 78o–4(c)(5), 78q, 78q–1, and 78w; 31 U.S.C. 5318.

2. A new § 208.21 is added to Subpart A to read as follows:

§ 208.21 Community development and public welfare investments.

(a) *Definitions*—(1) *Low- or moderate-income area* means:

(i) One or more census tracts in a Metropolitan Statistical Area where the median family income adjusted for family size in each census tract is less than eighty percent of the median family income adjusted for family size of the Metropolitan Statistical Area; or

(ii) If not in a Metropolitan Statistical Area, one or more census tracts or block-numbered areas where the median family income adjusted for family size in each census tract or block-numbered area is less than eighty percent of the median family income adjusted for family size of the State.

(2) *Low- and moderate-income persons* has the same meaning as low- and moderate-income persons as defined in 42 U.S.C. 5302(a)(20)(A).

(3) *Small business* means a business that meets the size eligibility standards of 13 CFR 121.802(a)(2).

(b) *Investments that do not require prior Board approval.* Notwithstanding the provisions of section 5136 of the Revised Statutes (12 U.S.C. 24 (Seventh)) made applicable to State member banks by paragraph 20 of section 9 of the Federal Reserve Act (12 U.S.C. 335), a State member bank may make an investment, without prior Board approval, if the following conditions are met:

(1) The investment is in a corporation, limited partnership, or other entity:

(i) Where the Board has determined that an investment in that entity or class of entities is a public welfare investment under paragraph 23 of section 9 of the Federal Reserve Act (12 U.S.C. 338a), or a community development investment under Regulation Y (12 CFR 225.25(b)(6));

(ii) Where the Comptroller of the Currency has determined, by order or regulation, that an investment in that entity by a national bank is a public welfare investment under section 5136 of the Revised Statutes (12 U.S.C. 24 (Eleventh));

(iii) Where that entity is a community development financial institution as defined in section 103(5) of the Community Development Banking and Financial Institutions Act of 1994 (12 U.S.C. 4702(5)); or

(iv) Where that entity, directly or indirectly, engages solely in or makes loans solely for the purposes of one or more of the following community development activities:

(A) Investing in, developing, rehabilitating, managing, selling, or renting residential property if a majority of the units will be occupied by low- and moderate-income persons or if the property is a "qualified low-income building" as defined in section 42(c)(2) of the Internal Revenue Code (26 U.S.C. 42(c)(2));

(B) Investing in, developing, rehabilitating, managing, selling, or renting nonresidential real property or other assets located in a low- or moderate-income area and targeted towards low- and moderate-income persons;

(C) Investing in one or more small businesses located in a low- or moderate-income area to stimulate economic development;

(D) Investing in, developing, or otherwise assisting job training or placement facilities or programs that will be targeted towards low- and moderate-income persons;

(E) Investing in an entity located in a low- or moderate-income area if that entity creates long-term employment opportunities, a majority of which (based on full time equivalent positions) will be held by low- and moderate-income persons; and

(F) Providing technical assistance, credit counseling, research, and program development assistance to low- and moderate-income persons, small businesses, or nonprofit corporations to help achieve community development;

(2) The investment is permitted by State law;

(3) The investment will not expose the State member bank to liability beyond the amount of the investment;

(4) The investment does not exceed the sum of two percent of the State member bank's capital stock and surplus as defined under 12 CFR 250.162;

(5) The aggregate of all such investments of the State member bank does not exceed the sum of five percent of its capital stock and surplus as defined under 12 CFR 250.162;

(6) The State member bank is well capitalized or adequately capitalized under §§ 208.33(b) (1) and (2);

(7) The State member bank received a composite CAMEL rating of "1" or "2" under the Uniform Financial Institutions Rating System as of its most recent examination and an overall rating of at least "satisfactory" as of its most recent consumer compliance examination; and

(8) The State member bank is not subject to any written agreement, cease and desist order, capital directive,

prompt corrective action directive, or memorandum of understanding issued by the Board or a Federal Reserve Bank.

(c) *Notice.* Not more than 30 days after making an investment under paragraph (b) of this section, the State member bank shall advise its Federal Reserve Bank of the investment, including the amount of the investment and the identity of the entity in which the investment is made.

(d) *Investments requiring Board approval.* (1) With prior Board approval, a State member bank may make public welfare investments under paragraph 23 of section 9 of the Federal Reserve Act (12 U.S.C. 338a), other than those specified in paragraph (b) of this section.

(2) Requests for approval under this paragraph should include, at a minimum, the amount of the proposed investment, a description of the entity in which the investment is to be made, an explanation of why the investment is a public welfare investment under paragraph 23 of section 9 of the Federal Reserve Act (12 U.S.C. 338a), a description of the State member bank's potential liability under the proposed investment, the amount of the State member bank's aggregate outstanding public welfare investments under paragraph 23 of section 9 of the Federal Reserve Act, and the amount of the State member bank's capital stock and surplus as defined in 12 CFR 250.162.

(3) The Board will act on a request under this paragraph within 60 calendar days after receipt of a request that meets the requirements of paragraph (d)(2) of this section, unless the Board notifies the requesting State member bank that a longer time period will be required.

(e) *Divestiture of investments.* A State member bank shall divest itself of an investment made under paragraph (b), (d) or (f) of this section to the extent that the investment exceeds the scope of, or ceases to meet, the requirements of paragraphs (b)(1) through (b)(5), or paragraph (d) of this section. The divestiture shall be made in the manner specified in 12 CFR 225.140, Regulation Y, for interests acquired by a lending subsidiary of a bank holding company or the bank holding company itself in satisfaction of a debt previously contracted.

(f) *Preexisting investments.* (1) For ongoing investments made prior to January 9, 1995 that are covered by paragraph (b) of this section, a State member bank shall notify its Federal Reserve Bank of the investment not more than sixty days after January 9, 1995.

(2) For other ongoing investments made prior to January 9, 1995, a State member bank shall request Board approval not more than one year after January 9, 1995.

By order of the Board of Governors of the Federal Reserve System, December 2, 1994.

William W. Wiles,

Secretary of the Board.

[FR Doc. 94–30160 Filed 12–8–94; 8:45 am]

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12 CFR Part 225

[Regulation Y; Docket R–0860]

Bank Holding Companies and Changes in Bank Control

AGENCY: Board of Governors of the Federal Reserve System.

ACTION: Final rule; interpretation.

SUMMARY: The Board has revised its interpretation regarding the scope of community development activities permissible for bank holding companies to incorporate several decisions by the Board and to reflect statutory changes that have broadened the authority of national and state member banks to make certain community welfare investments.

EFFECTIVE DATE: January 9, 1995.

FOR FURTHER INFORMATION CONTACT: Scott G. Alvarez, Associate General Counsel (202/452–3583), or Deborah M. Awai, Senior Attorney (202/452–3594), Legal Division; or Don E. Kline, Associate Director (202/452–3421), or Larry R. Cunningham, Supervisory Financial Analyst (202/452–2701), Division of Banking Supervision and Regulation of the Board of Governors of the Federal Reserve System. For the hearing impaired *only*, Telecommunications Device for the Deaf (TDD), Dorothea Thompson (202/452–3544).

SUPPLEMENTARY INFORMATION: The Board has previously determined that the making of equity and debt investments in corporations or projects is designed "primarily to promote community welfare" as an activity that "is closely related to banking" under section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)) (BHC Act). 12 CFR 225.25(b)(6). The Board has also previously adopted an interpretation that provides guidance regarding the types of investments that are considered to be permissible for bank holding companies under this authority.

Section 6(b) of the Depository Institutions Disaster Relief Act of 1992 (12 U.S.C. 338a), enacted on October 23, 1992, amended section 9 of the Federal Reserve Act to permit state member banks to invest in the stock of community development corporations that are designed primarily to promote the public welfare of low- and moderate-income communities and persons in the areas of housing, services and employment. On November 30, 1994, the Board adopted a final rule amending Regulation H, 12 CFR 208, that permits state member banks to make certain investments without specific Board approval.

The Board believes that these revisions are consistent with the Board's interpretation of, and decisions regarding, the scope of community welfare activities permissible for bank holding companies. Accordingly, the Board has revised its interpretation of Regulation Y, 12 CFR 225.127, to reflect that bank holding companies that have received approval under section 4(c)(8) of the BHC Act and § 225.25(b)(6) of the Board's Regulation Y to engage in activities that promote community welfare may make similar investments permissible for state member banks. These community development corporation and project investments by bank holding companies would primarily benefit low- and moderate-income persons or small businesses, and address demonstrated community needs by providing housing, services, and jobs to low- and moderate-income communities. In particular, the revised interpretation provides that a bank holding company may, directly or through a subsidiary:

- Invest in and provide financing to a corporation or project or class of corporations or projects that the Board previously has determined is a public welfare project pursuant to paragraph 23 of section 9 of the Federal Reserve Act (12 U.S.C. 338a);
- Invest in and provide financing to a corporation or project that the Office of the Comptroller of the Currency previously has determined, by order or regulation, is a public welfare investment pursuant to section 5136 of the Revised Statutes (12 U.S.C. 24 (Eleventh));
- Invest in and provide financing to a community development financial institution pursuant to section 103(5) of the Community Development Banking and Financial Institutions Act of 1994 (12 U.S.C. 4702(5));
- Invest in, provide financing to, develop, rehabilitate, manage, sell, and rent residential property if a majority of the units will be occupied by low- and moderate-income persons, or if the property is a "qualified low-income building" as defined in section 42(c)(2) of the Internal Revenue Code (26 U.S.C. 42(c)(2));
- Invest in, provide financing to, develop, rehabilitate, manage, sell, and rent nonresidential real property or other assets located in a low- or moderate-income area and to be used primarily for low- and moderate-income persons;
- Invest in and provide financing to one or more small businesses located in a low- or

moderate-income area to stimulate economic development;

- Invest in, provide financing to, develop, and otherwise assist job training and placement facilities or programs designed primarily for low- and moderate-income persons;
- Invest in and provide financing to an entity located in a low- or moderate-income area if that entity creates long-term employment opportunities, a majority of which (based on full time equivalent positions) will be held by low- and moderate-income persons; and
- Provide technical assistance, credit counseling, research, and program development assistance to low- and moderate-income persons, small businesses, or nonprofit corporations to help achieve community development.

Community development corporation and project investment proposals by a bank holding company that comply with these requirements and do not exceed five percent of the total consolidated capital stock and surplus of the bank holding company when aggregated with similar types of investments made by depository institutions controlled by the bank holding company, may be made without additional Board or Reserve Bank approval. For purposes of this interpretation, the term total consolidated capital stock and surplus of the bank holding company means total equity capital and the allowance for loan and lease losses. For bank holding companies that file the FR Y–9C (Consolidated Financial Statements for Bank Holding Companies), these items are readily ascertained from Schedule HC—Consolidated Balance Sheet (total equity capital (line 27h) and allowance for loan and lease losses (line 4b)). For bank holding companies filing the FR Y–SP (Parent Company Only Financial Statements for Small Bank Holding Companies), an approximation of these items is ascertained from the Balance Sheet (total equity capital (line 16e) and allowance for loan and lease losses (line 3b)) and from the Report of Condition for Insured Banks (Schedule RC—Balance Sheet (line 4b)).

The revised interpretation does not define the full scope of community welfare projects that may be permissible for bank holding companies, and is intended only to provide guidance regarding the types of projects that, in the Board's experience, have been proposed by bank holding companies. Accordingly, a bank holding company that proposes to invest in a community development corporation or project that is not discussed in the interpretation may, nonetheless, seek Board approval to invest in or conduct such project pursuant to § 225.25(b)(6) of the Board's Regulation Y. Such a proposal must include a detailed description and an explanation of how the project would serve the community welfare.

Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 605(b)), the Board does not believe that these changes will have a significant adverse economic impact on a substantial number of small entities. The revised interpretation will reduce regulatory burdens imposed by the Board's procedures on small bank holding companies, and have no particular adverse effect on other entities.

Paperwork Reduction Act Analysis

In accordance with section 3507 of the Paperwork Reduction Act (44 U.S.C. 3507), the revised interpretation has been reviewed by the Board under the authority delegated to the Board by the Office of Management and Budget. The Board believes there is no impact on the paperwork burden for bank holding companies.

List of Subjects in 12 CFR Part 225

Administrative practice and procedure, Banks, banking, Federal Reserve System, Holding companies, Reporting and recordkeeping requirements, Securities.

For the reasons set forth in the preamble, the Board amends 12 CFR Part 225 as set forth below:

PART 225—BANK HOLDING COMPANIES AND CHANGE IN BANK CONTROL (REGULATION Y)

1. The authority citation for Part 225 continues to read as follows:

Authority: 12 U.S.C. 1817(j)(13), 1818, 1831i, 1813p-1, 1843(c)(8), 1844(b), 1972(1), 3106, 3108, 3310, 3331–3351, 3907, and 3909.

2. Section 225.127 is amended as follows:

a. In the first sentence of paragraph (a), the reference "§ 225.4(b)" is revised to read "§ 225.23";

b. In the fifth sentence of paragraph (a), the word "permissable" is revised to read "permissible";

c. In the last sentence of paragraph (d), the reference to "§ 225.4(b)(1)" is revised to read "§ 225.23";

d. In paragraphs (a), (b), (c), and (d), all references "§ 225.4(a)(7)" are revised to read "§ 225.25(b)(6)"; and

(e) New paragraphs (f), (g), and (h) are added.

The additions read as follows:

§ 225.127 Investment in corporations or projects designed primarily to promote community welfare.

* * * * *

(f) Section 6 of the Depository Institutions Disaster Relief Act of 1992 permits state member banks (12 U.S.C. 338a) and national banks (12 U.S.C. 24 (Eleventh)) to invest in the stock of community development corporations that are designed primarily to promote the public welfare of low- and moderate-income communities and persons in the areas of housing, services and employment. The Board and the Office of the Comptroller of the Currency have adopted rules that permit state member banks and national banks to make certain investments without prior approval. The Board believes that these rules are consistent with the Board's interpretation of, and decisions regarding, the scope of community welfare activities permissible for bank holding companies. Accordingly, approval received by a bank holding company to conduct activities designed to promote the community welfare under section 4(c)(8) of the Bank Holding Company Act (12 U.S.C. 1843(c)(8)) and § 225.25(b)(6) of the Board's Regulation Y (12 CFR 225.25(b)(6)) includes approval to engage, either directly or through a subsidiary, in the following activities, up to five percent of the bank holding company's total consolidated capital stock and surplus, without additional Board or Reserve Bank approval:

(1) Invest in and provide financing to a corporation or project or class of corporations or projects that the Board previously has determined is a public welfare project pursuant to paragraph 23 of section 9 of the Federal Reserve Act (12 U.S.C. 338a);

(2) Invest in and provide financing to a corporation or project that the Office of the Comptroller of the Currency previously has determined, by order or regulation, is a public welfare investment pursuant to section 5136 of the Revised Statutes (12 U.S.C. 24 (Eleventh));

(3) Invest in and provide financing to a community development financial institution pursuant to section 103(5) of the Community Development Banking and Financial Institutions Act of 1994 (12 U.S.C. 4702(5));

(4) Invest in, provide financing to, develop, rehabilitate, manage, sell, and rent residential property if a majority of the units will be occupied by low- and moderate-income persons or if the property is a "qualified low-income building" as defined in section 42(c)(2) of the Internal Revenue Code (26 U.S.C. 42(c)(2));

(5) Invest in, provide financing to, develop, rehabilitate, manage, sell, and rent nonresidential real property or other assets located in a low- or moderate-income area provided the property is used primarily for low- and moderate-income persons;

(6) Invest in and provide financing to one or more small businesses located in a low- or moderate-income area to stimulate economic development;

(7) Invest in, provide financing to, develop, and otherwise assist job training or placement facilities or programs designed primarily for low- and moderate-income persons;

(8) Invest in and provide financing to an entity located in a low- or moderate-income area if that entity creates long-term employment opportunities, a majority of which (based on full time equivalent positions) will be held by low- and moderate-income persons; and

(9) Provide technical assistance, credit counseling, research, and program development assistance to low- and moderate-income persons, small businesses, or nonprofit corporations to help achieve community development.

(g) For purposes of paragraph (f) of this section, low- and moderate-income persons or areas means individuals and communities whose incomes do not exceed 80 percent of the median income of the area involved, as determined by the U.S. Department of Housing and Urban Development. Small businesses are businesses that are smaller than the maximum size eligibility standards established by the Small Business Administration (SBA) for the Small Business Investment Company and Development Company Programs or the SBA section 7A loan program; and specifically include those businesses that are majority-owned by members of minority groups or by women.

(h) For purposes of paragraph (f) of this section, five percent of the total consolidated capital stock and surplus of a bank holding company includes its total investment in projects described in paragraph (f) of this section, when aggregated with similar types of investments made by depository institutions controlled by the bank holding company. The term total consolidated capital stock and surplus of the bank holding company means total equity capital and the allowance for loan and lease losses. For bank holding companies that file the FR Y–9C (Consolidated Financial Statements for Bank Holding Companies), these items are readily ascertained from Schedule HC—Consolidated Balance Sheet (total equity capital (line 27h) and allowance for loan and lease losses (line 4b)). For bank holding companies filing the FR Y–SP (Parent Company Only Financial Statements for Small Bank Holding Companies), an approximation of these items is ascertained from the Balance Sheet (total equity capital (line 16e)) and allowance for loan and lease losses (line 3b)) and from the Report of Condition for Insured Banks (Schedule RC—Balance Sheet (line 4b)).

By order of the Board of Governors of the Federal Reserve System, December 2, 1994.

William W. Wiles,

Secretary of the Board.

[FR Doc. 94–30159 Filed 12–8–94; 8:45 am]

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