BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

DIVISION OF CONSUMER AND
COMMUNITY AFFAIRS

CA 19-1

February 25, 2019

TO THE OFFICERS AND MANAGERS IN CHARGE OF CONSUMER AFFAIRS SECTIONS AND FINANCIAL INSTITUTIONS SUPERVISED BY THE FEDERAL RESERVE:

Applicability to Community Banking Organizations: This guidance applies to all institutions supervised by the Federal Reserve, including those with total consolidated assets of $10 billion or less.

SUBJECT: New Markets Tax Credits and Public Welfare Investments

The Federal Reserve is issuing this letter to inform financial institutions of a recent determination made under the Public Welfare Investment ("PWI") provision of the Federal Reserve Act ("FRA").

The Board recently considered the requirements of the Department of Treasury's New Markets Tax Credit ("NMTC") program and determined that a NMTC-eligible investment, directly or indirectly, in an entity that is a "qualified community development entity" as defined in section 45D(c)(l) of the Internal Revenue Code is "designed primarily to promote the public welfare" within the meaning of section 9(23) of the Federal Reserve Act ("FRA").[1] Accordingly, state member banks ("SMBs") are authorized to make investments qualifying for the NMTC Program under section 9(23) of the FRA (12 USC 338a), as long as those investments comply with all other applicable statutory and regulatory criteria.[2]

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[1] Letter dated July 2, 2018, from Ann E. Misback, Secretary of the Board, to Wendy Goldberg, Esq., Sullivan and Cromwell, LLP.

[2] Prior to this determination, NMTC proposals by SMBs had been approved under delegated authority because they otherwise satisfied the public welfare investment criteria of section 22(b)(1) of Regulation H, 12 CFR 208.22(b)(1).

Section 9 (23) of the FRA authorizes SMB to make investments "directly or indirectly, each of which is designed primarily to promote the public welfare, including the welfare of low- and moderate-income communities or families, to the extent permissible under state law."

The Board's Regulation H (12 CFR 208.22) establishes procedures for public welfare investments by SMBs. Under Regulation H, investments meeting certain criteria, including investments that the Board has determined are designed to primarily promote the public welfare, may be eligible for post notice procedures.[3] Investment proposals that do not fall within the scope of investments listed in Regulation H or that raise significant legal, policy, or supervisory issues must receive the Board's specific consent.

Established in 2000, the NMTC Program[4] authorizes institutions or individuals to receive federal income tax credits for making equity investments in specialized financial institutions known as Community Development Entities[5] ("CDEs"). The Treasury Department's Community Development Financial Institutions Fund[6] ("CDFI Fund") certifies and awards NMTC allocations[7] to qualified CDEs, the primary mission of which must be to serve or provide investment capital for Low Income Communities[8] ("LICs"). Generally, entities that make an equity investment in a qualified CDE are eligible to receive NMTCs if the qualified CDE uses

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[3] An SMB that qualifies for the post notice procedures is required to submit to the Reserve Bank a notice of the investment not more than 30 calendar days after making the investment.

[4] The NMTC Program was established as part of the Community Renewal Tax Relief Act of 2000. The goal of the program is to spur revitalization efforts of low-income and impoverished communities across the United States and Territories. See https://www.cdfifund.gov/programs-training/Programs/new-markets-tax-credit/Pages/default.aspx.

[5] A CDE is a domestic corporation or partnership that is an intermediary vehicle for the provision of loans, investments, or financial counseling in low-income communities. NMTC Program applicants must be certified CDEs by the CDFI Fund to receive an NMTC allocation. To become certified as a CDE, an organization must submit a CDE Certification Application to the CDFI Fund for review. The application must demonstrate that the applicant meets each of the following requirements to become certified: be a legal entity at the time of application; have a primary mission of serving LICs; and maintain accountability to the residents of is targeted LICs. See https://www.cdfifund.gov/programs-training/certification/cde/Pages/default.aspx

[6] The CDFI Fund was established through the Riegle Community Development and Regulatory Improvement Act of 1994. The goal of the Fund is to promote economic revitalization in distressed communities throughout the United States by providing financial assistance and information to community development financial institutions ("CDFIs"). CDFIs are financial institutions that provide credit and financial services to underserved markets and populations.

[7] The CDFI Fund has been authorized to administer the NMTC program. CDEs apply to the CDFI Fund each year not for tax credits directly, but for an award of allocation authority to raise a certain amount of capital, or Qualified Equity Investments from investors.

[8] LICs are defined as any population census tract if (A) the poverty rate for such tract is at least 20 percent, or (B) (i) in the case of a tract not located within a metropolitan area, the median family income for such tract does not exceed 80 percent of statewide median family income, or (ii) in the case of a tract located within a metropolitan area, the median family income for such tract does not exceed 80 percent of the greater of statewide median family income or the metropolitan area median family income. 26 USC § 45D(e)(1)

substantially all of the cash it receives to invest in businesses located in or serving LICs[9].

Reserve Banks are asked to distribute this letter to supervised institutions in their districts, appropriate supervisory staff, staff engaged in community affairs and outreach, and community development stakeholders in their districts. If you have any questions, please contact Alison Thro, Assistant General Counsel, at (202) 452-3236, David Alexander, Counsel, at (202) 452–2877, or Marysol McGee, Senior Community Development Analyst, at (202) 452-3131. In addition, questions regarding this letter may be sent via the Board's public website.[10]

Sincerely,

Suzanne Killian
Senior Associate Director

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[9] Treasury Regulation § 1.45D-1(c)(5)(i) defines substantially all to mean at least 85 percent and provides two alternative methods for meeting the substantially-all requirement. The substantially all requirement must be satisfied for each annual period in the 7-year credit period. For the first annual period, the requirement is considered met if the calculation is performed on a single testing date and the result is at least 85%. For all subsequent annual periods, the substantially-all requirement is considered met if the calculation is performed every six months and the average of the two computations for the annual period is at least 85%. In the seventh year of the 7-year credit period, 85% is reduced to 75%.

[10] See http://www.federalreserve.gov/apps/contactus/feedback.aspx.