

REGULATION BB
COMMUNITY REINVESTMENT ACT
PERFORMANCE EVALUATION

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GENERAL INFORMATION

The Community Reinvestment Act ("CRA") requires each federal financial supervisory agency to use its authority when examining financial institutions subject to its supervision, to assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the institution. Upon conclusion of such examination, the agency must prepare a written evaluation of the institution's record of meeting the credit needs of its community.

This document is an evaluation of the CRA performance of The Merchants Bank of New York prepared by the Federal Reserve Bank of New York on behalf of the Board of Governors of the Federal Reserve System, the institution's supervisory agency, as of September 14, 1998. The agency evaluates performance in assessment area(s), as they are delineated by the institution, rather than individual branches. This assessment area evaluation may include visits to some, but not necessarily all of the institution's branches. The agency rates the CRA performance of an institution consistent with the provisions set forth in Appendix A to 12 CFR Part 228.

INSTITUTION

INSTITUTION'S CRA RATING: SATISFACTORY.

The level of compliance of The Merchants Bank of New York with the CRA is based on an evaluation of the performance criteria for large retail institutions specified under the CRA with respect to the lending, investment and service tests.

Performance under the lending test is rated "high satisfactory" based on the following findings:

- Merchants' community development lending is outstanding, totaling \$13.7 million. Ninety-five percent of this amount is represented by a revolving line of credit to a non-bank Small Business Administration ("SBA") lender that originated loans to various types of businesses in New York County.
- Business lending activity reflects an adequate responsiveness to the credit needs of the assessment area based on the bank's business strategy of serving customers with annual sales of \$1 million to \$200 million, its resources and asset size. A substantial amount of lending activity is to the jewelry, apparel and fur industries.
- The overall distribution of small business loans is adequate. While the geographic penetration in low- and moderate-income ("LMI") areas is low overall, factors involving the bank's business strategy and location of businesses served by that strategy heavily influenced the assessment of the bank's performance.
- Distribution of small business loans to businesses of different sizes is poor.

Performance under the investment test is rated "needs to improve" based on the following finding:

- The bank's level of qualified investments is poor totaling \$595 thousand.

Performance under the service test is rated "low satisfactory" based on the following findings:

- The bank's delivery systems are adequately accessible to geographies and individuals of different income levels in bank's assessment area.
- There were no changes in branch locations and business hours, and services do not vary in a way that inconvenience portions of the assessment area.
- The bank provides an adequate level of community development services through technical assistance and services.

The following table summarizes the performance level of The Merchants Bank of New York with respect to the lending, investment, and service tests.

PERFORMANCE LEVELS	THE MERCHANTS BANK OF NEW YORK		
	PERFORMANCE TESTS		
	Lending Test*	Investment Test	Service Test
Outstanding			
High Satisfactory	X		
Low Satisfactory			X
Needs to Improve		X	
Substantial Noncompliance			

* Note: The lending test is weighted more heavily than the investment and service tests in determination of the overall rating.

DESCRIPTION OF INSTITUTION

The Merchants Bank of New York ("Merchants"), a wholly owned subsidiary of Merchants New York Bancorp Inc., is headquartered in New York County, the borough of Manhattan in New York City. Established in the early 1900s, Merchants operates seven branches located in the midtown and downtown areas of Manhattan. These branches are relatively distant from most of the LMI census tracts in the assessment area.

Under the bank's business strategy, Merchants provides lending and deposit services to small and medium-sized businesses. The bank's typical business customers have annual sales of \$1 million to \$200 million. Merchants has developed a niche in lending to the jewelry, apparel and fur industries in Manhattan. Of the bank's total commercial loan portfolio as of December 31, 1997, 22 percent and 12 percent were loans to the wholesale jewelry and jewelry manufacturing industries, respectively. Lending to the apparel and fur industry also represented 12 percent of Merchants' commercial loan portfolio. The remaining 54% were loans which were distributed among a variety of business sectors, none of which exceeded 12% in lending activity. Retail lending has not historically been part of Merchants' business strategy as the bank offers only personal and new automobile loan products. Home mortgage loans are available only as an accommodation to business customers. Retail deposit products are offered in the form of savings and money market accounts, certificates of deposit, and checking accounts.

As of June 30, 1998, Merchants had \$1.2 billion in total assets, of which \$336 million (28 percent) represented net loans and leases. Of the total number of net loans and leases, 94 percent were commercial and industrial loans. With deposits totaling \$871 million, Merchants' loan-to-deposit ratio is 38.6 percent. Most of Merchants' assets are concentrated in investments, primarily U.S. Treasury, agency and municipal securities. As of June 30, 1998, investments totaled \$832 million or 67.2 percent of total assets.

Merchants' previous CRA examination was conducted as of June 4, 1996, at which time the bank received an overall rating of "satisfactory." There are no financial or legal factors that would impede Merchants from fulfilling its responsibilities under the CRA.

DESCRIPTION OF ASSESSMENT AREA

Merchants has one assessment area, and it includes all of New York County, located in PMSA 5600 (New York, NY). At the prior CRA examination, Merchants' assessment/ delineated areas were limited to designated areas surrounding its seven branches.

A map of Merchants' assessment area follows:

The bank's assessment area meets the requirements of 12 CFR 228.41 of Regulation BB and does not arbitrarily exclude any LMI geographies. The demographic and statistical information used to describe Merchants' assessment area, and to evaluate the performance context within which the bank operates, was obtained from sources that include the United States Department of Commerce's Bureau of the Census, U.S. Department of Housing and Urban Development, U.S. Department of Labor, and discussions with bankers and community groups. The 1990 U.S. Census was the source of housing, income and population data.

New York County, which is part of PMSA 5600, has a population of 1.5 million, representing approximately 17 percent of the PMSA population and 8 percent of the New York State population. A significant amount of the assessment area's population and geographies are LMI. Major concentrations of LMI population and geographies are located in northern Manhattan.

Of the 305 thousand families in the assessment area, 28.8 percent are low-income, 13.8 percent moderate-income, 14.4 percent middle-income, and 43 percent are upper-income. Of the 298 census tracts in the assessment area, 74 or 24.8 percent are low-income, 65 or 21.8 percent are moderate-income, 33 or 11.1 percent are middle-income, and 126 or 42.3 percent are upper-income. Families living below the poverty level represent 17.4 percent of the families in the assessment area.

Affordable housing is a significant need in the assessment area. The 1990 median family income for the assessment area is \$36,831, which is slightly below the state's median family income of \$39,741 and the PMSA's median family income of \$37,515. The assessment area's median housing value, however, is \$471,074, which is significantly higher than the state housing value of \$130,351 and the PMSA's value of \$207,142. Owner-occupied housing represents only 16.3 percent of the housing stock compared with rental housing, which represents 74.9 percent of the housing stock. Accordingly, affordable rental housing is an even greater need for LMI individuals in the assessment area.

Small businesses are an important part of New York City's economy. Of the 151,101 business establishments in New York County, 120,600 or 80 percent are small businesses with \$1 million or less in gross annual revenues ("GAR"). This statistic reveals that most of the businesses in New York County are not within the bank's business strategy but such businesses comprise the majority of businesses within most census tracts. Based on the large number of small businesses in New York County and information obtained through community contacts, small business financing is an important credit need in the bank's assessment area.

There are 2,648 business establishments in the wholesale jewelry and jewelry manufacturing industries, of which 2,369 or 90 percent have annual sales of \$1 million or less. There are 8,987 business establishments in the apparel and fur industries (manufacturing, wholesale and retail), of which 5,008 or 56 percent have annual sales of \$1 million or less.

Industry statistics for the wholesale jewelry, jewelry manufacturing, apparel and fur industries indicate that most of these businesses are located in Manhattan's midtown area. These establishments are located near the Merchants branches at 62 West 47th Street, 1040 Avenue of the Americas, and 295 Fifth Avenue. For the West 47th Street branch, approximately 1,794 or 68

percent of all wholesale jewelry and jewelry manufacturing establishments are located within the 47th Street area. Of this total, approximately 1,645 establishments or 92 percent are businesses with annual sales of \$1 million or less. For the Avenue of the Americas and Fifth Avenue branches, 5,078 or 57 percent of all apparel and fur establishments are located within areas adjacent to and surrounding these branches. Of this total, approximately 2,416 or 48 percent are establishments with annual sales of \$1 million or less.

Through 1997, New York City continued to experience economic growth driven primarily by the financial services industry. Personal income rose 8.7 percent in 1997. The city's unemployment rate remains high compared with national figures but is experiencing a downward trend. The seasonally adjusted unemployment rate for New York City in September 1998 was 7.8 percent, down from 9.2 percent in September 1997. In comparison, the seasonally adjusted unemployment rate for the U.S. in September 1998 was 4.6 percent, down from 4.9 percent in September 1997. For details, see Exhibit on page BB14.

SCOPE OF EXAMINATION

This evaluation of Merchants' CRA performance covered the period between June 5, 1996, and September 14, 1998. The examination included the bank's small business loan originations and community development loans reported under the CRA. The analysis of small business loans included originations between April 1, 1996, and June 30, 1998. The analysis of community development loans included originations between June 5, 1996, and September 14, 1998. The bank originated a very small volume of home mortgage loans during the examination period. This activity was not included in the scope of the examination because these loans were made either to accommodate a business loan customer or to secure funds a customer needed for business purposes. Bank investments, deposits, grants and services qualifying as community development were also included in the evaluation. In addition, the bank's system and record of delivering its products and services throughout its assessment area were evaluated on the basis of information supplied by the bank and community contacts.

For evaluation of the geographic distribution of loans, geographies were classified on the basis of the Census Bureau's 1990 Census income data. For both geographic distribution and borrower characteristics, given the bank's focus on middle market lending in particular industries, small business lending was evaluated in the context of 1997 data collected by the American Business Institute. This information provided details on the location and revenue size of businesses in New York County as well as specific industry information on the diamond manufacturing, wholesale diamond, apparel and fur industries.

CONCLUSIONS WITH RESPECT TO PERFORMANCE TESTS

LENDING TEST

Merchants' performance under the lending test is rated high satisfactory.

Lending Activity

Merchants' lending activity reflects an adequate response to the business credit needs in the bank's assessment area. In light of Merchants' business strategy, resources, asset size and the nature of its customers' credit needs, the bank's volume of lending during the examination period was acceptable. A high percentage of the bank's lending activity was within its assessment area.

For the examination period, the bank reported 12,395 small business transactions totaling \$1.5 billion. This high volume represents lending to several hundred borrowers who require multiple advances, under approved guidance lines of credit, for very small amounts throughout a given year. As of September 1998, the bank had 649 guidance lines of credit to borrowers. Of this total, 37 guidance lines of credit were to borrowers with GAR of \$1 million or less.

Of the total volume reported, 8,987 or 73 percent of the number of reported transactions and \$1.2 billion or 76 percent of the dollar volume of reported transactions were made in the bank's assessment area.

A substantial share of the bank's lending is attributable to its large concentration of asset-based lending to the wholesale jewelry and jewelry manufacturing industries. Asset-based lending is an important form of financing for both industries. The use of two-party negotiable notes as payment between parties is a common business practice in the wholesale jewelry and jewelry manufacturing industries. This form of payment generates a large volume of notes for small amounts ranging from \$1,000 to \$30,000. An important credit need for these industries is the ability to borrow against such notes for working capital purposes. Merchants is one of a few banks involved in this form of financing.

While several larger banks provide financing to the jewelry industries, a community contact, who is a representative of an industry trade group, said Merchants is a leader in serving these industries. The bank's focus on providing credit facilities for under \$1 million and its extensive knowledge of these industries' business practices were key factors, according to a community contact, in Merchants' success in serving the credit needs of the wholesale jewelry and jewelry manufacturing industries.

Geographic Distribution of Lending

Overall, Merchants has an adequate geographic distribution of its small business transactions within its assessment area. Of the 8,987 transactions in the bank's assessment area, 1,105 or 12 percent were in LMI geographies. While geographic penetration in LMI areas is low overall, several performance context factors were considered in assessing the geographic distribution of the bank's loans. These factors included the bank's focus on lending to businesses with annual sales of \$1 million to \$200 million and to particular industries. The location of these businesses was a key performance context factor that revealed limited lending opportunities within LMI geographies. Other key factors included the relative distance of the bank's branches from most of the assessment area's LMI geographies and the importance of a branch presence in establishing and maintaining small business lending relationships.

The geographic distribution of the bank's small business transactions reveals that most of the bank's lending occurred within the geographic areas of concentration for the previously mentioned industries and for businesses with GAR of more than \$1 million. As previously stated, several Merchants branches are adjacent to these industry concentrations. For Merchants' 47th Street branch, 4,223 or 47 percent of its small business transactions in the assessment area were located within the 47th Street area. For the 1040 Avenue of the Americas and 295 Fifth Avenue branches, 2,067 or 23 percent of the bank's small business transactions in the assessment area occurred in areas adjacent to these branches.

Gaps in lending were noted in several LMI geographies adjacent to the branch offices located at 434 Broadway and 93 Canal Street in downtown Manhattan. A review of the opportunities for lending in these areas reveals that a substantial share of the business establishments are those with annual sales of \$1 million or less that are not within the bank's strategy. Industry data indicates only a small number of wholesale diamond businesses are located in this area and that the garment and textile industries are located in midtown Manhattan.

Borrower Characteristics

Merchants has a poor distribution of lending to businesses of different sizes. As previously noted, 80 percent of all businesses in the bank's assessment area have revenues of \$1 million or less, indicating a critical credit need the bank does not address as a result of its business strategy. While the average size of the bank's small business loan transactions was \$130 thousand, only 629 or 7 percent of the 8,987 small business loan transactions were to businesses with GAR of \$1 million or less.

Few if any direct loans were made to most of the wholesale jewelry and jewelry manufacturing businesses, with annual sales of \$1 million or less, which represent the majority of such businesses in the jewelry industries.

The aforementioned industry information, however, provides another aspect of the bank's performance. Given the presence of these industries in the West 47th Street area, the high concentration of business lending by the bank in this area, and the small dollar amounts of many of the notes discounted by the bank, it can be reasonably concluded that a large portion of the notes discounted by the bank are issued by small businesses within the 47th Street area. The typical small dollar amount of these notes would support the conclusion that the note makers are businesses with annual sales of \$1 million or less. Furthermore, Merchants management has stated that it believes many of the makers of notes it discounts are businesses with annual sales of \$1 million or less.

While Merchants' strategy does not include direct loans to most of the wholesale jewelry and jewelry manufacturing businesses in the 47th Street area, the bank provides liquidity to these industries, which include small businesses where the normal course of business is to pay its suppliers with short-term notes for small dollar amounts.

Community Development Lending

Merchants' community development lending performance is outstanding. During the examination period, community development loan commitments totaled \$13.7 million, of which \$8.1 million or 60 percent represented new commitments originated since the prior examination (June 4, 1996). Total commitments at this examination represent a 118 percent increase since the prior examination when community development loan commitments totaled \$6.3 million. All commitments represent indirect lending initiatives for small businesses. This concentration reflects the bank's overall strength and its focus on business lending.

Of the bank's total community development loan commitments, \$13 million or 95 percent represents a revolving line of credit to a non-bank SBA lender. During the examination period, Merchants funded \$12.2 million in SBA loans originated by this non-bank lender to various businesses in New York County. These businesses included several restaurants, a supermarket, a software company, a highway construction firm, several hair stylists, a laundromat, and several wholesalers. Many of these loans were for inventory purchases and working capital.

Using business types as a proxy for the type of employees a business would utilize, it is reasonable to conclude that Merchants has funded SBA loans which have at least supported the retention of jobs for LMI individuals. It should be noted that 12 percent of the total dollar amount of SBA loans funded is to two businesses located in LMI census tracts north of 96th Street in New York County.

The balance of the bank's community development commitments – approximately \$700 thousand – is to small business loan funds, three of which originate loans to small businesses in New York City and two of which provide loans to small businesses throughout New York State.

Innovative and Flexible Lending Practices

The bank made little use of innovative and/or flexible lending practices. Since Merchants began offering SBA loans in September 1996, the bank has originated 12 SBA loans.

INVESTMENT TEST

Merchants' needs to improve rating on the investment test is based on its poor level of qualified investments, which exhibited poor responsiveness to credit and community development needs. The bank's qualified investments are neither complex nor innovative.

Dollar Amount of Qualified Investments

The bank has a poor level of qualified investments, particularly those that are not routinely provided by private investors. Qualified investments total \$595 thousand. Of the total qualified investments, \$500 thousand or 84 percent supported local economic development in the form of deposits in credit unions serving LMI areas and a community development bank. The remaining 16 percent or \$95 thousand of qualified investments represented grants to various community service and economic development organizations. At the prior examination, the bank had total deposits and grants to eligible community development financial institutions and organizations totaling \$182 thousand.

Innovative and Complex Qualified Investments

None of these investments are considered innovative or complex.

Responsiveness to Credit and Community Development Needs

Although \$445 thousand of the total qualified investments are new since the prior examination, the overall low level of qualified investments demonstrates a poor responsiveness to credit and community development needs.

SERVICE TEST

Merchants' rating on the service test is low satisfactory, based on the bank's record of providing an adequate level of banking services in its assessment area.

Accessibility of Delivery Systems

Merchants' delivery systems are adequately accessible to geographies and individuals of different income levels in the bank's assessment area. The main system for delivering banking services is through the branch network. As of September 30, 1998, Merchants operated seven full-service branches located in downtown and midtown Manhattan.

There are no branches north of 47th Street where most LMI census tracts and LMI individuals are located. None of the seven branches are located in a low-income census tract, and one is located in a moderate-income census tract in the Chinatown area of Manhattan. Three of the six branches outside LMI census tracts are located in census tracts adjacent to LMI census tracts.

The availability of alternative delivery systems is limited. Merchants has no automated teller machines ("ATMs"), but it offers ATM cards to its customers for use at ATMs associated with the NYCE and Cirrus networks. Customers can make deposits to their accounts by mail.

Changes in Branch Locations

Merchants' branch closing policy is adequate and conforms to the *Joint Interagency Policy Statement Regarding Branch Closings*. No branches have been opened or closed since the prior examination; thus, the accessibility of its delivery systems, particularly in LMI census tracts or to LMI individuals, was not affected.

Reasonableness of Business Hours and Services in Meeting Assessment Area Credit Needs

Services do not vary in a way that inconveniences portions of its assessment area, particularly LMI geographies and LMI individuals. All branches are open weekdays between 9 a.m. and 3 p.m., and none have extended hours. The same banking services are provided at each branch.

The following products and services are available at all branches: business and personal checking accounts; business and personal savings and money market accounts; business loans and letters of credit; and personal installment loans and new automobile loans.

Community Development Services

Merchants provides an adequate level of community development services. Two bank officers are members of loan committees for two economic development corporations. One officer is also on the Board of Directors of an economic development corporation. Employees have participated in fund-raising for two community development service organizations. One officer teaches a finance course to young business entrepreneurs.

COMPLIANCE WITH FAIR LENDING LAWS

No credit practices were identified that violated the substantive provisions of the antidiscrimination laws and regulations, including the Equal Credit Opportunity Act (Regulation B), the Fair Housing Act, the Home Mortgage Disclosure Act (Regulation C), and all relevant agency regulations pertaining to nondiscriminatory treatment of credit applicants.

EXHIBIT

Summary of Census Tract Demographics New York County					
	Census Tracts by Income Level				
	Low	Moderate	Middle	Upper	Total
Census Tracts Used for Analysis	74	65	33	126	298
% of Tracts Used for Analysis	24.8%	21.8%	11.1%	42.3%	100%
Total Population	307,879	358,652	125,262	695,743	1,487,536
% of Total Population	20.7%	24.1%	8.4%	46.8%	100%
Number of Families	87,957	42,199	43,842	131,370	305,368
% of Families	28.8%	13.8%	14.4%	43%	100%
Owner-occupied Housing Units	2,606	9,823	9,094	106,450	127,973
% of Owner-occupied Housing Units	2%	7.7%	7.1%	83.2%	100%
Renter-occupied Housing Units	101,280	133,368	55,719	298,082	588,449
% of Renter-occupied Housing Units	17.2%	22.7%	9.5%	50.7%	100%
Total Business Establishments	16,500	22,683	12,614	99,304	151,101
% of Business Establishments	10.9%	15%	8.3%	65.7%	100%

CRA APPENDIX A

SCOPE OF EXAMINATION			
TIME PERIOD REVIEWED		6/5/96 TO 9/14/98	
FINANCIAL INSTITUTION			
Merchants Bank of New York			PRODUCTS REVIEWED Small Business Loans Community Development Loans Qualified Investments
AFFILIATE(S)			
N/A		AFFILIATE RELATIONSHIP	PRODUCTS REVIEWED
LIST OF ASSESSMENT AREAS AND TYPE OF EXAMINATION			
ASSESSMENT AREA	TYPE OF EXAMINATION	BRANCHES VISITED	OTHER INFORMATION
New York County	On - site	N/A	

CRA APPENDIX B

GLOSSARY

AREA MEDIAN INCOME: (1) The median family income for the MSA, if a person or geography (block numbering area or census tract) is located in an MSA; or (2), if a person or geography (census tract or block numbering area) is located outside an MSA, the statewide non-metropolitan median family income.

ASSET-BASED LENDING: Financing that advances credit secured by a firm's balance sheet assets, such as inventory, receivables, or collateral other than real estate.

ATM: Automated teller machine.

BNA: Block numbering area.

COMMUNITY DEVELOPMENT: (1) Affordable housing including multifamily rental housing for low- or moderate-income individuals; (2) community services targeted to low- or moderate-income individuals; (3) activities that promote economic development by financing businesses or farms that meet the size eligibility standards of 13 CFR 121.802 (a)(2) or have gross annual revenues of \$1 million or less; or (4) activities that revitalize or stabilize low- or moderate-income geographies.

CRA: Community Reinvestment Act.

GEOGRAPHY: A census tract or a block numbering area delineated by the United States Bureau of the Census in the most recent decennial census (1990).

LMI: Low- and moderate-income, as in LMI census tracts.

LOW-INCOME: An individual income that is less than 50 percent of the area median income (i.e., of the median family income for the MSA, if the individual is located in an MSA, or, if the individual is located outside an MSA, of the statewide non-metropolitan median family income), or a BNA or census tract median family income that is less than 50 percent of the area median income. Accordingly, a low-income census tract is one in which the median family income is less than 50 percent of the area median income.

MIDDLE-INCOME: An individual income that is at least 80 percent and less than 120 percent of the area median income, or a BNA or census tract median family income that is at least 80 percent and less than 120 percent of the area median income.

MODERATE-INCOME: An individual income that is at least 50 percent and less than 80 percent of the area median income, or a BNA or census tract median family income that is at least 50 percent and less than 80 percent of the area median income.

PMSA: A primary metropolitan statistical area as defined by the director of the Office of Management and Budget.

QUALIFIED INVESTMENT: A lawful investment, deposit, membership share, or grant that has as its primary purpose community development.

SBA: Small Business Administration.

SMALL BUSINESS LOANS: Such loans are defined in Regulation BB, Section 228.12 (u) with reference to the definition of such loans in the instructions for preparation of the Consolidated Report of Condition and Income. These instructions define small business loans as loans with original amounts of \$1 million or less that have been reported in Schedule RC-C, Part 1, (1.e)(4) of the report.

UPPER-INCOME: An individual income that is 120 percent or more of the median family income in an MSA or a census tract in which the median family income is 120 percent or more of the median family income in an MSA.