



INTERMEDIATE SMALL BANK

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

PUBLIC DISCLOSURE

October 24, 2011

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

Herald National Bank
Charter Number: 24857

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New York, NY 10022

Office of the Comptroller of the Currency

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NOTE: This document is an evaluation of this 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. This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

INSTITUTION'S CRA RATING: This institution is rated Satisfactory.

The Lending Test is rated: Satisfactory.

The Community Development Test is rated: Satisfactory.

Factors supporting the institution's rating include:

- Herald National Bank's (Herald) average net loan-to-deposit ratio over the past eleven quarters is reasonable at 68 percent, meeting the standards for satisfactory performance.
- A majority of bank loans were originated within the bank's assessment area (AA).
- The bank's record of lending to businesses of different sizes is reasonable.
- The geographic distribution of lending to businesses by census tract income level is also reasonable when compared to AA demographics and is very good when compared to the performance of other regional banks in its AA.
- The bank demonstrated an adequate responsiveness to community development (CD) needs and opportunities in its AA through qualified CD activities.

Scope of Examination

This Performance Evaluation assesses the bank's performance in meeting the credit needs of the communities in which it serves. We evaluated Herald National Bank under the Intermediate Small Bank (ISB) performance criteria, which included a Lending Test and a Community Development (CD) Test.

The evaluation period for the lending test covers the bank's performance from November 24, 2008 through October 21, 2011. Under the lending test, we focused our review on the bank's small business lending activities as this is the bank's primary lending product by volume and dollar amount originated and purchased during the evaluation period. Residential mortgage loans subject to filing under the Home Mortgage Disclosure Act are not significant lending activities of the bank and, as such, were not included in our evaluation.

The CD test, which includes CD loans, CD investments and CD services, was also evaluated over the period of November 24, 2008 through October 21, 2011. This test assesses the bank's responsiveness to identified community development needs and takes into consideration the volume, mix and qualitative aspects of the activities. All CD activities were reviewed to ensure they met the regulatory definition for community development.

In assessing the bank's CRA performance, consideration is given to the bank's financial capacity, its size, local economic and demographic factors, market competition and any

legal impediments. The entire population of business loans was evaluated in light of these performance context factors.

As part of this CRA evaluation, the bank's publicly filed information on HMDA loans was tested for accuracy. Information pertaining to small business lending was also tested, although the bank was not legally required to capture or report such information due to its asset size. This test included an evaluation of the bank's processes to ensure that the data collected was reliable. We found no significant errors in the loan data and utilized recorded information in our analyses.

Description of Institution

Herald commenced business on November 24, 2008. The bank received its charter to operate three full-service branch locations in New York. The branches are located in New York County (main office in mid-town Manhattan), Kings County (Brooklyn) and Suffolk County (Melville, Long Island). All three branches are atypically situated in that the branches are not level branches but are instead uniquely situated in a commercial building or an office park. Due to the setup of the branches, developing walk-in customer relationships is rare. Rather, deposit and lending relationships are usually established through Board and management's direct marketing efforts to and interactions with identified businesses in their communities. Alternatively, relationships may also be established through existing customer referrals.

The bank offers an array of products and services designed to meet the needs of small and mid-sized businesses, professionals and high net worth individuals in its defined market area. Products and services include private banking, personal and commercial lending, wealth and cash management and international trade finance. The branches are open weekdays from 8:30AM to 4:00PM.

Since its inception, Herald has experienced rapid and significant growth. The Board signed a Formal Agreement with the OCC in April 2010, which required improvements in risk management practices and prudent underwriting standards. As of September 30, 2011, the bank reported total assets of \$486.7 million, down from year-end 2010 of \$505 million. The bank's asset structure is currently supported by \$319 million in gross loans and \$135 million in investment grade securities. The loan portfolio is concentrated in real estate lending (61 percent) and commercial lending (36 percent). Of the \$194 million in real estate loans, 90 percent of the loans are commercial real estate. See Table 1 for distribution of the bank's loan portfolio by loan type.

Table 1 – Loan Distribution as of September 30, 2011		
Loan Type	Dollar Amount (000s)	Percent of Total Loans (%)
1-4 Family Residential Properties Closed-end First Lien	\$18,833	6
1-4 Family Residential Properties Closed-end Junior Lien	0	0
1-4 Family Residential Properties Open-end	0	0
Commercial Construction and Land Development	2,766	1
Multifamily Residential	70,399	22
Owner Occupied Non-Farm Non-Residential Properties	56,732	18
Other Non-Farm Non-Residential Properties	44,849	14
Total Real Estate Loans	193,579	61
Commercial and Industrial	116,046	36
Consumer Open-end	7,904	3
All Other	1,101	0
Total Loans	\$318,630	100%

Source: September 30, 2011 Consolidated Report of Income and Condition.

There are no financial or legal factors impeding the bank's ability to help meet the credit needs of the communities it serves. This is the bank's first CRA performance evaluation.

Description of Assessment Area(s)

Herald's branches are located in New York, Kings and Suffolk counties within the State of New York. The bank delineated its outermost market boundaries from the southern natural border of Central Park extending down through lower Manhattan, the boroughs of Brooklyn and Queens and out through the western most section of Suffolk County, Long Island. New York, Kings and Queens counties are part of the New York-White Plains-Wayne, NY-NJ Metropolitan Division (MD), and Nassau and Suffolk counties are part of the Nassau-Suffolk, NY MD. Although all five counties are contiguous in nature, we requested that management adjust its AA to include one additional census tract in Suffolk County to eliminate the appearance of a potential lending gap. Herald's market area complies with the regulatory AA delineation requirements of 12 CFR §25.41. We aggregated the counties into one AA in assessing the bank's lending performance.

The bank's AA consists of 1,975 census tracts (CTs). Of this total number, 147 CTs are low-income, 491 CTs are moderate-income, 804 CTs are middle-income, 481 CTs are upper-income and 52 CTs are not categorized. Based on 2000 US Census information, there are more than 2.7 million housing units in the bank's market area and of this, 42 percent are owner-occupied units, 56 percent are rental units and five percent are vacant units. 95 percent of all housing units are occupied.

As of 2011, the number of persons living in the AA is 7.1 million and, of this figure, 54 percent are minority in origin. The population constitutes 2.6 million households in the area. The majority of the households, 76 percent, are living on salaried incomes, while twenty four percent are on social security, 14 percent on retirement income and five

percent on public assistance. There are 393,000 (or 15 percent) households living below the poverty level. By income level of census tracts, nearly 42 percent of the households are living in middle-income tracts, 25 percent each in the moderate- and upper-income tracts and 7 percent in the low-income tracts. The weighted average HUD updated MSA median family income for 2011 is \$73,142.

Based on 2011 Business Demographic Data, there are a total of 804,207 established businesses and farms in the bank's AA. The number of reported businesses operating in the area has increased by 49 percent from the prior year of 539,981 operating businesses in the AA. Approximately 66 percent of the 804,207 businesses fall under the \$1 million revenue category. This revenue category, when further segregated into less than \$500,000 and \$500,001 to \$1 million, reflects that a significant portion of the revenues (62 percent) were earned by businesses in the less than \$500,000 category. Businesses exceeding \$1 million in revenues accounted for four percent of the businesses. Nearly 30 percent of the businesses did not report any revenues in 2011 which typically reflects new start-up businesses in the AA during the year.

Businesses in the AA tend to be micro-small businesses in nature. Nearly 61 percent of the businesses have an employee base of 1-4 persons. Local businesses are primarily service-oriented in their mission and are single location entities.

Herald operates in a market area that is highly competitive. The bank's AA is home to some of the largest money center financial institutions in the global market. There are numerous community banks, thrift institutions, branches of super-regional giants and multi-national financial institutions as well as local mortgage bankers and brokers, all competing for the same local customer base and potential funding opportunities. Within the bank's defined market area, there are 128 established institutions. Based on FDIC's Deposit Market Share Report as of June 30, 2011, the top ten regional giants account for over 85 percent of the market share with well over 1,500 branch offices. Herald, in comparison, holds a fractional percentage (0.05) of the market share, ranks 63rd in terms of deposit size and operates three branches in the AA.

Herald started its operations at a time when the economy and financial markets were facing a sharp downturn. Current economic conditions remain challenging and recovery has been slow to-date. Job growth and employment opportunities have fluctuated in response to uncertainty surrounding the fiscal and regulatory policies and economic recovery. The unemployment rate, averaging at 8 percent for the nine-month period in 2011, is below the 8.5 percent recorded average for 2010 and 8.4 percent for 2009; however, it is still significantly higher than the 5.6 percent average in 2008. Personal bankruptcies are also on the rise and are expected to top out in 2012 before reversing trend. Businesses are weakened from the lack of demand or spending from households. Newer businesses entering the market in the last couple of years are particularly hard hit as they struggle to achieve profitability. Newer businesses are also finding it difficult to obtain credit in the absence of a demonstrated performance trend. As a result, many businesses, faced with uncertainties about their future, have opted to curtail additional debt exposures and growth plans.

Credit needs in the AA were determined through discussions with management, review

of current housing and demographic information and an interview with a local community group. Identified needs for the local communities are affordable financial products and services for low-income households and small business lending.

Conclusions with Respect to Performance Tests

LENDING TEST

Herald's performance under the Lending Test is considered "Satisfactory". The bank's loan-to-deposit ratio is reasonable and a majority of its lending activities were originated inside the AA. While the bank had exercised poor penetration of loans to business of different sizes, it is considered reasonable when evaluated using loan size as a proxy for small business lending performance. The geographic distribution of businesses loans reflects reasonable dispersion among geographies and exceptional dispersion when compared to peer. There were no CRA-related complaints filed during the evaluation period.

Loan-to-Deposit Ratio

Herald's quarterly average loan-to-deposit (LTD) ratio is reasonable given the bank's size, financial condition and credit needs of the AA. The average LTD ratio was calculated using quarterly information derived from the bank's Report of Condition from November 2008 through June 30, 2011. The calculated ratio, based on quarterly averages over the last eleven quarters, was 68 percent. Quarterly LTD ratios for the bank ranged from a low of 37 percent at March 31, 2009 to a high of 92 percent at September 30, 2010. Thereafter, quarterly ratios fluctuated between 70 to 75 percent of total deposits. Competition for loans and deposits has impacted the LTD ratio. Although lagging slightly behind peer performance, Herald has demonstrated the ability and willingness to lend in its AA. The bank's LTD ratio indicates an adequate responsiveness to community credit needs and meets the standards for satisfactory performance.

Lending in Assessment Area

A majority of the bank's loans were made inside its AA and reflects an adequate responsiveness to identified credit needs. Table 2 illustrates the bank's lending activities by volume and dollar amount of loans. Based on our analysis, 53 percent of the loans by number and 51 percent by dollar amount were made within the AA.

Table 2 – Lending in AA										
Loan Type	Number of Loans					Dollars of Loans (000)				
	Inside		Outside		Total	Inside		Outside		Total
	#	%	#	%		\$	%	\$	%	
Residential	7	54	6	46	13	10,965	44	13,887	35	24,852
Commercial	130	53	116	47	246	46,635	53	40,567	47	87,205
Total	137	53	122	47	259	57,603	51	54,454	49	112,057

Lending to Businesses of Different Sizes

The distribution of lending among borrowers reflects poor penetration of loans to small businesses. There are a total of 804,207 established businesses and farms in the bank's AA. Of this figure, 99 percent (or 799,065) are categorized as non-farm businesses. As reflected in Table 3, 66 percent of the total number of businesses reported annual revenues of less than \$1 million. The table also shows that the bank's penetration of loans to small business is poor by both volume and dollar amount.

Table 3 - Borrower Distribution of Loans to Businesses in AA				
Business Revenues (or Sales)	≤\$1,000,000	>\$1,000,000	Unavailable/ Unknown	Total
% of AA Businesses	66	4	30	100
% of Bank Loans in AA by #	22	78	0	100
% of Bank Loans in AA by \$	23	77	0	100

Source: 2011 Business Geo-demographic Data and bank data.

Table 3A below provides a breakdown of small business lending using loan size as a proxy for revenues. This table is used when a significant number of businesses in the demographic area did not report any revenues. Using loan size as a proxy presents a clearer picture of Herald's lending activities. The table shows that nearly half of the loans originated (48 percent) over the evaluation period were for amounts of \$250,000 or less. Given the bank's performance by loan size, lending to small businesses is considered reasonable in light of the bank's de novo status, tightened credit market conditions and the level of competition from well-established financial institutions.

Table 3A - Borrower Distribution of Loans to Businesses by Loan Size in AA				
Loan Size (000's)	Number of Loans	Percent of Number	Dollar Volume of Loans	Percent of Dollar Volume
\$0 - \$100,000	39	30	2,524,000	5
\$100,001 - \$250,000	24	18	4,597,000	10
\$250,001 - \$1,000,000	67	52	39,517,000	85
Total	130	100	46,638,000	100

Source: Loan population

Geographic Distribution of Loans

Herald's geographic distribution of loans reflects reasonable dispersion of lending throughout the AA and meets the standards for satisfactory performance.

The bank's AA, which consists of Kings, Queens, Nassau and portions of New York and Suffolk Counties, has a total of 1,975 census tracts. Of these, seven percent (147) are designated low-income tracts, 25 percent (491) moderate-income tracts, 41 percent (804) middle-income tracts and 24 percent (481) upper-income tracts. The income level of the remaining three percent (52) of tracts is unknown.

Table 4 provides a percentage breakdown of non-farm businesses in each income tract and the percentage of bank loans made in each income tract. Over the evaluation period, Herald made five loans to businesses located in a low-income tract and 24 loans to businesses in moderate-income tracts. The percentages of lending activities in both the low- and moderate-income (LMI) census tracts have satisfactorily met the percentage of businesses located in these geographies.

Table 4 - Geographic Distribution of Loans to Businesses in AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Loan Type	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans	% of AA Businesses	% of Number of Loans
Commercial	4	4	18	18	37	25	40	52

Source: 2011 Business Geo-demographic Data and loan data.

Table 4A provides compares Herald's geographic lending performance to other institutions lending within the AA. As illustrated in the table, Herald's small business lending activities outperformed those of its peer in the LMI census tracts as a percentage of total loans made in the AA.

Table 4A - Herald vs Peer Distribution of Small Business Loans in AA								
Census Tract Income Level	Low		Moderate		Middle		Upper	
Total Loans	Loan Count	% of Total Loans	Loan Count	% of Total Loans	Loan Count	% of Total Loans	Loan Count	% of Total Loans
Herald (28)	1	4	10	36	11	39	6	21
Peer (145,680)	4,985	3	21,574	15	50,709	35	66,813	46

Source: 2010 Peer Small Business Data

Responses to Complaints

A review of OCC's Customer Assistant Group's complaint records, as well as the bank's Public CRA File, revealed no CRA-related complaints filed since the bank opened in November 2008. Therefore, analysis of this criterion was not applicable.

COMMUNITY DEVELOPMENT TEST

Under the CD Test, Herald was assessed for its responsiveness to community development needs and opportunities in its AA. These needs and opportunities include affordable housing for LMI individuals; community services targeted to LMI individuals; activities that promote economic development or activities that revitalize or stabilize a local economy. Benefits received by the individuals or geographies must be in the bank's AA.

Number and Amount of Community Development Loans

Over the evaluation period, Herald originated one loan that qualified as a CD loan. The qualified loan was made to a borrower that owns and manages a multi-family residential building. More than half of the 16 units are designated as Section 8 units, in which the landlord receives authorized assistance on behalf of low-income households who might not otherwise be able to afford such units. Total amount of the qualifying CD loan is \$700,000. Positive consideration was given for this CD activity.

Number and Amount of Qualified Investments

Herald also made a total of four investments that met the definition of CD investments. The largest investment made was in the amount of \$2 million to a CRA qualified investment fund that provides financing for affordable housing to low-income families to a broader statewide area that included the bank's AA. The remaining three qualified donations were made to a rescue mission, a local food bank and a non-profit organization, all of which were in the bank's AA, each in the amount of \$2,500. The bank also received positive consideration for the number of investment and donation activities, totaling \$2,007,500, made over the evaluation period.

Extent to Which the Bank Provides Community Development Services

A member of the bank provided financial services to a rescue mission organization in applying for a grant with the New York Federal Home Loan Bank. The \$2 million grant is to be used to provide additional beds in lower Manhattan to help house the homeless in the area. Herald received positive consideration for this service.

Responsiveness to Community Development Needs

Overall, based on the bank's financial capacity and available resources, the bank's community development performance is satisfactory and demonstrates an adequate responsiveness to CD needs in its AA.

Fair Lending or Other Illegal Credit Practices Review

We found no evidence of discriminatory or other illegal credit practices inconsistent with helping to meet community credit needs.