

900 Nineteenth St. NW, Ste. 400
Washington, DC 20006
TEL: (202) 857-3100
FAX: (202) 296-8716
E-MAIL: info@acbankers.org
<http://www.AmericasCommunityBankers.com>



October 19, 2001

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
Attention: Comments/OES
550 17th Street, N.W.
Washington, D.C. 20429

Communications Division
Public Information Room
Mailstop 1-5
Office of the Comptroller of the Currency
Attention: Docket No. 01-16
250 E Street, S.W.
Washington, D.C. 20219

Ms. Jennifer J. Johnson
Secretary
Board of Governors of
the Federal Reserve System
20th Street & Constitution Avenue, N.W.
Attention: Docket No. R-1112
Washington, D.C. 20551

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
Attention: Docket No. 2001-49
1700 G Street, N.W.
Washington, D.C. 20552

Re: Community Reinvestment Act Regulations
66 FR 37602 (July 19, 2001)

Dear Sir or Madam:

America's Community Bankers¹ ("ACB") welcomes the opportunity to comment on the joint advance notice of proposed rulemaking ("ANPR") issued by the federal banking agencies as part of the review leading to a possible revision of the regulation implementing the Community Reinvestment Act ("CRA"). The ANPR was issued as part of comprehensive review of the current regulations and asks whether the current regulation should be changed and if so how. The federal banking agencies made a commitment to this review when the current version of the regulation was adopted after an extensive review process.

General

The industry has evolved dramatically in the years since the adoption of the current regulation in the mid1990's. Sweeping financial services reform was enacted by

¹ACB represents the nation's community banks of all charter types and sizes. ACB members, whose aggregate assets exceed \$1 trillion, pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities.

242

Congress, the industry continued to consolidate, technology changed the way that insured institutions and their unregulated competitors are able to deliver products and services. The products and services themselves have changed. More and more insured institutions find that the means to survival is in finding a niche and serving it. Given these changes, now would seem to be an ideal time to review and revise the regulation that implements CRA.

Not only have there been enormous changes to the industry since 1994, but the financial services world is very different from the world that existed in 1977, when CRA was originally enacted. The statute does not contemplate an environment in which lending and deposit taking frequently is done electronically and community is a much broader term than the immediate surrounding geographic area. The types of services that insured institutions are permitted to offer have expanded and include a wide array of products that serve all financial needs of the customer and provide more than savings and mortgage finance opportunities. In 1977, insured banks and savings institutions provided financing for the majority of home purchases. In 2001, the percentage is greatly reduced and uninsured and unregulated competitors have homogenized the mortgage markets to the extent that community banks are not able to compete effectively.

All of these changes suggest that the agencies, insured institutions and community groups must think much more flexibly and creatively about what it means to serve the credit needs of the community. CRA can no longer be about housing only. Providing affordable housing finance is an important policy goal, but CRA must be much broader. Lenders that have no CRA obligations are the primary source of mortgage credit and insured institutions are left to try to compete with lenders offering lower rates. They can afford to do that because their infrastructure is much less expensive and they can develop loan products using economies of scale. A regulation and examination process that requires rigid adherence to a set of benchmarks established even six years ago will not work in today's environment. Therefore, ACB agrees that a review of the regulation, guidance, and examiner procedures is useful and necessary.

However, we strongly urge the agencies not to make changes to the regulation without considering the compliance burden of regulatory change and whether the change will achieve meaningful benefits. Any changes to the regulation must also take into account the changes in the industry, and must recognize that it is no longer possible to develop a regulation with which every institution in every community can easily comply. Community reinvestment is local and in many cases very specific. Any CRA regulation must be flexible enough to accommodate all situations.

We also believe that the industry will continue to evolve at a rapid rate and that rather than amending the regulation to keep pace, the agencies should retain as flexible a regulation as possible. They should make changes to the interpretive guidance and examination procedures and provide examiner training that will help examiners understand the innovative and complex transitions that frequently are involved in community lending. A more open, consultative examination process would be welcome. Examiners must be able to look at the institution and what it does in the context of the

whole community and what it needs, not just at the opportunities for community banks to finance housing. ACB cannot emphasize enough the importance of examiner training and guidance.

Suggested Changes

There are some changes to the current regulation that ACB would support. Raising the threshold over which an institution is considered to be a large institution is an example of such a change. We strongly urge the agencies to raise that threshold to \$1 billion in assets. So much has changed since 1977 that it is hard to suggest a factor that is the most important. This is clearly one of the most significant changes. Industry consolidation, interstate branching, and the ability to offer additional products have enabled the majority of insured institutions to grow exponentially.

While thousands of community banks continue to be smaller than the \$250 million threshold, there are many that are between \$250 million and \$1 billion in assets. It is incomprehensible that those institutions have to be judged on the same basis as the multibillion dollar banks. This arbitrary threshold makes no sense. The resources available to these institutions are vastly different, the philosophy of the institution and management, the operating strategy, and business plan are all different. Additionally, smaller "large" institutions are not able to engage in certain activities or offer products on the same terms and conditions as the large institutions without risking criticism from safety and soundness examiners. The stage must be set for a realistic standard that will promote and encourage community lending.

We also suggest that the agencies look at the investment test and decide whether to eliminate it or revise it so that it can provide a meaningful measure. The investment test does not take the ongoing nature of the types of investments into account. Under the current circumstances, an institution that wishes to make an investment is likely to get more credit for purchasing investment securities than it is for working in a partnership with a community group to build a community center or store. It appears that the investment test is based on a quantitative analysis rather than a qualitative analysis of what an institution can do to really help the credit needs of the community.

Competition has changed the nature of the way that community banks serve their communities. Small community banks with scarce resources are not able to develop loan programs that take advantage of economies of scale in the same way that large institutions can. ACB believes that an important element in the development of the performance context is a realistic perspective of the nature of the competition in the community. In an effort to develop an objective standard for examining CRA, the focus of what really is needed to meet the needs of communities has been minimized.

Community banks have had a CRA obligation since 1977. Many of these institutions participate in the lives of their communities and invest in all types of projects. Many of these projects are not the kind for which examiners routinely give credit. As an incentive for institutions to continue these activities, they should be given some kind of extra credit

or should have the ability to get an outstanding depending on the activity. In short, examiners must understand that banks are not only community lenders, they are also, of necessity, community leaders.

The following areas of emphasis are those that have been highlighted for several years by the ACB's policy making groups. Change in most of these areas can be accomplished though the use of questions and answers, other interpretative guidance, and examiner training.

- Incentives for both large and small institutions to achieve higher ratings;
- Reduction of burdensome recordkeeping requirements for all sizes of institutions;
- Acknowledgment of the use of alternative delivery systems by all institutions and a further acknowledgement of the role of technology in the fulfillment of CRA;
- An expansion of the degree of favorable consideration received by institutions for out-of-assessment-area provision of lending and other financial services;
- Provision should be made for banks facing difficulty obtaining necessary CRA credit as a result of abnormal competition for CRA credits in their assessment areas; and
- An expansion of the institutions eligible to use the small institution examination procedures to those institutions of a billion dollars in assets or less.

As mentioned above, the change that ACB believes is one of the most important to minimize burden is to increase the size of an institution that is considered to be a small institution from \$250 million in assets to an institution with \$1 billion in assets. Competition in the financial services area is intense and in many communities small to medium sized community banks are disadvantaged vis a vis the large banks that are doing business in the same community. Application of the regulation results in banks of very different sizes with vastly different resources being examined using the same criteria. In the few short years since the adoption of the current CRA rule, the industry has changed dramatically as consolidation has continued apace. Today there are banks with assets over \$400 billion. To consider a \$250 million bank a large bank as though they were the same as a \$400 billion bank is inherently unfair.

To the extent that the threshold amount for small banks that are not affiliated with a holding company is raised from \$250 million in assets, we also suggest that the threshold for holding companies be raised to \$5 billion in assets. In 1994, when these asset sizes were established, the levels were arbitrary then and they are more so now.

ACB members are committed to making credit available to the communities in which they operate. Community banks serve the financial services needs of their communities and their customers. These financial needs involve all aspects of family life. It is no longer possible to limit service to these customers to providing home mortgage and consumer credit and basic deposit products. Communities themselves are each different and what is successful in meeting the needs in one geography is not successful in another. If regulations cannot be community-specific, then examiners must be that much more flexible.

While we support the intent of the CRA, we are on record with the federal banking agencies about concerns we have in connection with its regulatory implementation, the examination procedures, the resulting and extensive regulatory interpretation of what is a very simple statute, and the inherent regulatory burden it continues to impose. The use of quantitative benchmarks is useful in some situations. However, a regulation that looks only at the quantitative results misses the point of the beneficial reasons to have CRA at all.

ACB believes it is appropriate to have a legal framework to guide financial institutions in community investment activities. ACB will continue to work with the Congress and the agencies to ensure that the intent of the CRA is not lost in its implementation. In addition to a review of the current regulation, we strongly urge that the examination procedures and the examiner training materials be reviewed carefully. Examiner consistency or inconsistency is a concern we hear about often from our members. In addition, statements and policies do not always find their way into the field. Finally, we encourage the continued use of the question and answer format as a method of responding to interpretive issues. We encourage the agencies to review the actual experience of institutions under the most recent revisions to the regulation that implements CRA.

The following comments respond to the specific questions posed by the agencies. Each of the questions represents a broad set of issues many of which are interrelated.

Large Retail Institutions: Lending, Investment and Service Tests

Large institutions under the current regulation are examined using the lending, investment and service tests. The investment test is misunderstood by institutions and others. It either must be revised, eliminated or its relative importance reduced. A suggestion that is frequently made is that investments that are not directly related to housing should be given credit. Families, after all, have many credit needs. Another suggestion is that the investment test could be an optional component. For example, if an institution has a particularly good investment record, it will get some form of extra credit. Further, to the extent that the investment test is retained, the weighting in the overall exam should be proportional to the portfolio mix of the institution.

The lending test disadvantages smaller "large" institutions. Our members are forced to compete with truly large banks that "buy up" all of the qualifying loans in certain census tracts. These loans are routinely made on loan terms that if made by community banks would be immediately criticized as unsafe and unsound. While raising the threshold over which an institution is deemed to be a large institution will help, this problem will not be solved by raising the threshold alone.

The nature of competition in many geographic areas precludes smaller institutions from competing head to head with large institutions that can offer loans at lower rates. Consideration should be given to looking at the markets, the competition, and making a determination that out of assessment area lending or non housing related community

development lending should be counted under the lending test. As part of establishing the performance context, consideration should be given to whether the housing needs of the community are being met by large out of market competitors and therefore community focused institutions should be granted credit for alternative lending activities. Although the lending test is not supposed to be numbers test, we have heard that it is and we believe that the efforts to create an objective standard for lending has resulted in the denial of credit for certain loans. This is an example of where more intensive examiner training can be very helpful in looking at the community as distinct from other communities.

Further, the lending test focuses exclusively on housing related credits. In reality, there are other loans that community banks make to improve a community that make it more livable and create an opportunity for more housing to be made available. For example, one of our members worked diligently to finance a new grocery store in an area in which there were no stores within a 10-mile radius. However, the current lending test does not take into account the impact of this credit and its size and minimizes the contribution to the reinvestment of the community. It is not just one loan—it may, in fact, be the loan that will allow housing to be developed in this area—this is true community reinvestment and should be recognized as such by the regulation. Regulators and examiners alike must recognize that community banks are the engines of the local economy and that serving a community takes many forms.

We suggest that examiner training and guidance be given so that examiners can look for these types of development loans. Frequently these loans are much more time consuming and resource intensive to make. They require flexibility and innovation that is overlooked by examiners who do not understand how the transactions work. In addition, these loans and, to a certain extent, investments will only be made by institutions that have a commitment to the community. These institutions understand that without the infrastructure, community centers, stores and other non-housing loans, the credit needs of the community are not being met.

One of the questions frequently debated is whether loans originated by the institution should be given the weight as loans purchased by the institution as part of the three-prong test. ACB believes that purchased loans should be granted the same weight. Loan purchases have the same effect on communities of loans originated. The loan is made, the money is reinvested, and the community is served.

Small Institutions: The Streamlined Small Institution Evaluation

As part of the last revision of the CRA regulation, the inclusion of the small institution streamline examination procedures was a welcome change to the regulation. Its development was a reflection that small institutions should be able to be examined for CRA quickly and easily by looking at a few important factors. It represents a reduction in the paperwork that a small institution must retain thus eliminating regulatory burden. However in an effort to provide a simple test, differences in communities and institutions

have been minimized. Small institutions deserve to have their activities recognized even if they do not fit into the strict guidelines of the small institution examination procedures.

The small institution streamlined examination is very focused on lending by the institution. We suggest that even as part of a streamlined examination there has to be a mechanism for taking investments, community development activities and services into account without requiring the small institution to elect to be examined under the large institution examination procedures.

Anecdotally, we have heard that small institutions cannot get an outstanding rating. This is inherently unfair. ACB suggests that a small institution should be able to get credit for activities that it undertakes if they serve the needs of the community but are outside the scope of the small institution examination. For example, if an institution works with the community to arrange financing for the development of infrastructure or other community services that will promote stability and economic growth, it should get credit. Perhaps such an activity would enable the institution to get an outstanding rating.

Strategic Plan

CRA was enacted to encourage insured institutions to serve all segments of their communities by lending in the communities from which they received deposits. The advent of Internet banking and the ability of institutions to do both deposit and lending activities in numerous communities using a variety of delivery channels raises the question of how lending and other activities in communities should be measured. The current regulation that implements CRA requires insured institutions to establish assessment areas that are the basis for the examination and rating process. One of the options available to institutions under the current regulation is the ability to develop a strategic plan. Such an option provides that the institution be able to draft a plan with the input of community organizations and others. The appropriate regulatory agency would review and approve the plan and for the duration of the effectiveness of the plan, if the institution met the goals established, it would receive a satisfactory rating. The strategic plan option was developed as a reflection of the number of institutions that had begun to do business in novel and innovative ways. The standard examination process and measures of performance are not appropriate for the business of many institutions today.

The strategic plan option is a very positive development for institutions that do business in nontraditional ways. However the practical ability of institutions to use the current strategic plan option has been diminished by the difficulty in getting these plans adopted. A suggestion for change is that the actual regulation be largely unchanged, but that the guidance to the regional offices of the contents and process of developing and approving a strategic plan be substantially revised.

The strategic plan option should be promoted more at the regional or local level, but that support for using this option should be stronger from Washington. Rather than changing the regulation, it is important to have a flexible alternative. The operating procedures developed for evaluation of strategic plans should be reassessed and amended to be more

accessible. An example of this is that the agencies should have a time limit by which they are required to approve or disapprove a plan that has been submitted, similar to the time limits on other applications filed at the agency.

Traditional institutions that begin to do some business using the Internet generally should be treated the same as institutions that have Internet only operations. Each should be able to develop a plan that meets its business and strategic goals. The value of enabling each type of institution to have individualized plans is that flexibility and creativity will be promoted. Each institution can be more or less innovative in the way it meets the needs of the communities served. An institution that does only some business over the Internet can have a more traditional assessment area and plan to comply with the law.

Performance Context

The current regulations provide that an institution's performance is evaluated in the context of information about the institution, its community, its competitors, and its peers. Such an evaluation makes sense to the extent that it recognizes that communities and institutions are different. The difficulty is balancing the quantitative and the qualitative measures. Providing specific quantifiable goals can make it easier for the examiner to determine whether the institution has met its requirements, but it takes away the incentive to undertake innovative and complex projects. Another frequent concern is that peer information is hard to obtain because many community banks do not know have true peers in the communities they serve.

While ACB believes that the use of peer comparisons is a useful tool, there is a concern that it is hard to establish who are the peers. Examples of the information that is relevant in determining peers are geography, asset size, market segments served, demographic characteristics, deposit base, type of lending performed, and operational strategies and products offered.

Examiner training and education can help to resolve some of these concerns. At a minimum, examiners should work with institutions to let them know what factors were used in developing the performance context. A more consultative process should be undertaken so that all important community factors can be taken into account. Examinations must be realistic and relevant to the institution and to the community it serves.

Assessment Areas

Because the statute is geography-based, the determination of an institution's assessment area is another obvious place for close review. Changes in the technology of delivery channels and the replacement of physical branches with electronic delivery of products and services have created challenges in this area. On how to resolve this issue there is not overwhelming agreement among ACB members. The differing views are based on the business strategies employed by each institution. As a reflection that many of the community banks offering on line services also retain a strong branch network, retaining

the existing assessment area designation for the vast majority of institutions would be welcome. However, it is suggested that for those institutions that have Internet only operations, a separate assessment area designation be developed.

ACB is already on record as supporting the granting of credit for some out-of-assessment area activities. This is particularly important for institutions that are in very competitive markets. The best use of their CRA dollars can be in loans and investments outside the assessment area of the institution. Credit for these activities should be limited to those situations where it has been determined that the needs of the institution's assessment area have been met. Regulators must accept the reality of Internet banking at institutions of all sizes.

Activities of Affiliates

Under the lending, investment and services tests, an institution can elect to have the activities of its affiliates considered as part of its own record of performance. ACB recommends that the agencies not change this option. We believe that if a community bank has an affiliate that is engaged in community work, they should have the opportunity to have that affiliate's work counted for CRA purposes. However, depending on the products offered by the affiliate, we do not believe that all activities of affiliates should be considered. This would result in skewed results.

Data Collection and Maintenance of Public Files

ACB believes that data should be collected only if it can be shown that such data are useful and that benefit of the information derived can be demonstrated. The collection of the data and the maintenance of the files are a burden and the agencies must be able to show that the information is useful. We have never been convinced that the data collected is useful.

Conclusion

While we welcome this review of the regulation, we urge the agencies not to make changes for the sake of change, but to build on what is already working in the current regulation implementing CRA. ACB supports a more flexible and broader perspective of CRA. We believe that institutions that serve their communities should get credit for what they do. Examiners should be able to understand complex transactions and give the appropriate credit. The small institution exam guidelines should be available to institutions with \$1 billion in assets and institutions should have incentives to participate in their communities, not just invest in securities.

ACB stands ready to provide input and assistance in this effort. We would like to be able to continue to communicate our views on this very important subject during your review

process. If you have any questions regarding this letter or the attachments, please contact the undersigned at (202) 857-3121 or cbahin@acbankers.org.

Sincerely,

Charlotte M. Bahin

Charlotte M. Bahin
Director of Regulatory Affairs
Senior Regulatory Counsel