From: Hubert Van Tol <hvantol@centurytel.net> on 04/12/2004 12:30:05 PM
Subject: Regulation BB - Community Reinvestment Act

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LOGO

April 6, 2004

Docket No. R-1181
Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington DC 20551

Dear Ms. Johnson:

As the executive director of Fairness In Rural Lending, a policy organization that focuses on the community reinvestment needs of the rural upper Midwest, I would encourage you to pay more attention to how the Community Reinvestment Act can be used to support needed community development in smaller and rural communities. As a member of the National Community Reinvestment Coalition, Fairness in Rural Lending urges you to either substantially modify the proposed changes to the Community Reinvestment Act (CRA) regulations or else withdraw the regulation. As a member of the Federal Reserve's Consumer Advisory Council I urge the banking agencies to more thoroughly study the effects of these proposed changes to the CRA regulation.

Fairness In Rural Lending believes that the regulations should be modified in two basic ways:

1. The large bank threshold should be left as it is until evidence is provided that the cost of the regulatory burden outweighs the benefits to small communities and rural areas of keeping banks in the $250 -$500 million asset range under the large bank test.

2. The predatory lending standard, while a positive concept, must be redefined in a way that doesn't result in "asset-based lending" becoming the de facto definition of predatory lending.

In these times of budget cutbacks it is essential that community development lending, and investment and services aimed at moderate income communities be encouraged to its fullest extent. As government spending on community development recedes, we need all responsible businesses, but especially banks, to step up to the plate to help improve the communities that they are part of. While the overall national statistics may suggest that banks with asset sizes between $250 and $500 million are a small part of the overall banking picture in the United States, they in fact are often a major factor in the lending and investment activities in rural Midwestern counties.

Small Banks are Prospering

In proposing an increase in the large bank asset size, I fear the regulators may have fallen prey to the old small town/rural trick of poor mouthing one's circumstances when in the presence of big city relatives. In spite of the "heavy regulatory burden" that they would like you to believe they are under, the small community banks, at least those in the upper Midwest, are doing very well.

Within an hour's drive of the offices of Fairness In Rural Lending there are 26 banks, with assets of $250 million or less, located in towns with fewer than 5,000 people. All of these institutions were profitable in 2003. In fact their income-to-asset ratios, on average, compare quite favorably with their large bank relatives. Seven of these banks are in towns of less than a thousand people; towns in which most of the other basic businesses like grocery stores, pharmacies, and hardware stores are either long gone or on their last legs. Yet the small banks, in spite of their "heavy regulatory burden" remain quite profitable.

It is time for the regulators to stop listening to the sob stories of the community bankers and instead begin asking them to provide some creative community development lending, investment and services in exchange for the significant government subsidies that they receive. They should be held

responsible for playing a significant role in maintaining and rebuilding their communities.

Smaller Banks Are Capable of Community Development Activities

The banks that I mentioned above are all smaller than $250 million, but the regulators are proposing that even slightly larger banks should be exempted from taking the large bank exam. That effort must be halted. Banks larger than $250 million are perfectly capable of providing community development investment and services at a rudimentary level. While they shouldn't be expected to do the same things that a multi-billion dollar bank is; their size and the level of investment opportunities can be accounted for in the CRA examination's performance context.

In a recent speech to the payday lenders' trade association, Consumer Financial Services Association of America, one of the FDIC's associate directors, Steven Fritts, reportedly stated that the banks currently involved in payday lending have average assets of $300 million. It is truly remarkable that the FDIC seems to simultaneously be making the case that banks in the $250 million to $500 million range are sophisticated and well-staffed enough to be involved in the risky, complex business of payday lending, an activity that drains wealth from low and moderate income communities; while at the same time saying that they are too small to be expected to do a reasonable job of community development lending and investment that will build these communities and provide the banks with stronger long-term customers. There is something very wrong with that picture.

Proposed Changes Have an Uneven Effect

Before proposing a change of this magnitude the banking regulators would do well to actually study and measure the effects that reducing this much community development investment and service will mean for the more rural parts of the United States. If the upper Midwest is at all typical, we're sure that you will find that the effects will vary widely, even between neighboring states.

In Iowa for instance the proposed regulation will eliminate the large bank test for 20 of the current 40 institutions, with branches in the state, that have assets greater than $250 million. In Wisconsin the proposed change removes 36 out of 64 banks from large bank test coverage. However at the local level the difference in effect in these two neighboring states is quite remarkable.

In Iowa, 20 out of 99 counties do not currently have a branch office of a bank with assets greater than $250 million. If the threshold is lifted to $500 million, 29 out of 99 Iowa counties will not have the office of a "large bank." In Wisconsin, on the other hand, only 2 out of 72 counties are currently without a "large bank," and the change in regulation would not alter this number.

In Wisconsin there are nine large banks that each have more than 50 branch offices, resulting in a large branch structure that blankets the state. Iowa on the other hand has only 3 large banks with more than 50 branches located in the state. As a result states like Iowa, and especially the most rural parts of Iowa, will lose dramatically if this proposal is enacted, as non-profit community developers find it harder to identify banking partners that will engage in community development investment in their communities.

There appears to be no regulatory rationale for raising the "large bank" threshold other than to adjust for inflation. Moreover, there appears to have been no substantial reason for initially setting the threshold at $250 million, except that it was a nice round number. Fairness in Rural Lending proposes that before instituting a change of this magnitude, the regulators actually undertake an objective study that measures the real costs of the additional regulation versus the benefits that having the investment and service tests extended to additional communities.

Rural CRA Data Will Become Even Less Useful

Anyone who attempts to understand trends in rural mortgage lending is hampered greatly by HMDA collection rules that exempt a majority of the loans in many rural counties from being reported. Similarly, this raising of the large bank threshold will undercut the usefulness of the small farm and small business data in rural communities. An even broader segment of the market will be excused from providing this information and the data will be of limited use for rural communities. The CRA law does not exempt rural communities from its purview; yet time and time again the regulators, under the guise of easing the regulatory burden, have reduced the value of the law for rural communities. It is time for this devaluing of rural America to stop.

Predatory Lending Standard.

The proposed CRA changes contain an anti-predatory screen that will do little to slow predatory lending and more than likely will actually perpetuate abusive lending. The proposed standard states that loans based on the foreclosure value of the collateral, instead of the ability of the borrower to repay, can result in downgrades in CRA ratings. The asset-based standard falls short because it will cover only a minor proportion of what most community groups consider to be predatory lending.

When community groups today talk about predatory lending, asset-based lending is only one part of their concern, and very little asset-based lending is done by the institutions that the banking regulators perform CRA exams on. When Fairness In Rural Lending speaks of predatory lending we are speaking of:

1. Loans in which the borrower pays a higher interest rate and higher fees than their credit rating should dictate,

2. High cost loans in which equity is stripped because large fees are rolled into the principal of the loan and financed, thus hiding the true cost of the transaction from the customer,

3. High cost loans in which single premium credit insurance and similar junk products are financed,

4. High cost loans in which prepayment penalties penalize a borrower who improves their credit record by making it impossible or very costly for them to refinance into a better loan,

5 High cost loans in which an early balloon payment virtually traps the borrower into refinancing with the same lender,

6. High cost loans that replace other high cost loans (flipping) with little discernible benefit to the borrower.

Some of the institutions that the regulatory agencies examine for CRA do this kind of lending through the non-bank affiliates of their holding companies, some of them do not have effective screens to prevent the purchase of these kinds of loans from other institutions, some of them agree to service these kind of loans without screening the loans for these practices, some of them provide lines of credit to other institutions that do this kind of lending, some of them securitize these kinds of loans without having an effective screen to prevent their inclusion in a mortgage-backed security.

If the regulators are serious about putting a dent in predatory lending they will find a way to lower an institution's CRA rating if any of its affiliates engage in these practices, or participate at any point along the financial services chain. Drying up sources of capital and places for the rogue brokers to pass off bad loans is a crucial element in any attempt to solve the predatory lending problem. We hope the regulators will rise to the task.

Lending Outside of Assessment Area Should be Considered

Fairness In Rural Lending urges that consideration of the negative effects of an affiliate's lending not be limited to the institution's assessment area. To limit a review of predatory lending practices to the assessment area will especially damage the ability of rural communities to combat this kind of lending.

For example Citigroup, with its CitiFinancial affiliate and HSBC with its Household and Beneficial affiliates both do a large amount of high cost lending in Wisconsin, but have no CRA obligation to provide us with beneficial prime-priced products or to make investments to support the work of non profit organizations providing low cost housing, or supporting small business development in low and moderate income communities. Their size, dominance in the market, and marketing capacity threatens to overwhelm some of the positive prime rate lending done by our local lenders because they primarily offer products that hook low and moderate income customers on an expensive debt treadmill that is hard to get off.

An anti-predatory standard must apply to all loans made by the bank and all of its affiliates, not just real-estate secured loans issued by the bank in its "assessment area" as proposed by the agencies. CitiFinancial's mode of operation in rural areas is to blanket the community with offers for a $5,000 personal loan at 19% interest rates and then once they have engaged a customer, attempt to roll that loan over into an existing mortgage loan. Most of the customers who take the bait for the $5,000 loan are able to resist the attempt to turn it into a loan secured by their home; but that doesn't mean that the $5,000 personal loans shouldn't be scrutinized for their effects on low and moderate income communities.

Enhanced Data Disclosure is Positive but Limited

The federal agencies propose that they will publicly report the specific census tract location of small businesses receiving loans in addition to the current items in the CRA small business data for each depository institution. This will improve the ability of the general public to determine if banks are serving traditionally neglected neighborhoods with small business loans. Also the regulators propose separately reporting purchases from loan originations on CRA exams and separately reporting high cost lending (per the new HMDA data requirement starting with the 2004 data).

While we welcome the enhanced data disclosure, the positive aspects of the proposed data enhancements do not begin to make up for the significant

harm caused by the small bank and predatory lending standard proposals. Furthermore, the federal agencies have given no indication that they intend to use the data enhancements in order to make CRA exams more rigorous. The agencies must not merely report the new data on CRA exams, but must use the new data to provide less weight on CRA exams to high cost loans than prime loans and assign less weight for purchases than loan originations. We also reiterate that raising the small bank definition will remove over 1,000 banks from the CRA small farm and small businessreporting requirement.

The Failure of This Proposal to Truly Update the CRA

The worst part of this proposal is the failure of the regulatory agencies to seriously update the regulation. The federal banking agencies did not update the rules regarding assessment areas in this proposal, and thus missed a vital opportunity to continue to expand CRA's effectiveness. Increasingly large financial institutions are doing business far from their deposit-taking branches and home offices.

Thus in a state with a large number of rural communities like Wisconsin we find some of the largest financial institutions in the country becoming an increasing part of our overall financial services market, by pushing high cost loans through affiliates, but having no CRA obligations to provide services and investments to communities that are by and large the kind of low and moderate income communities that CRA was designed to benefit. In addition banks can still elect to include affiliates on CRA exams at their option. They can thus manipulate their CRA exams by excluding affiliates not serving low- and moderate-income borrowers and excluding affiliates engaged in predatory lending. The game playing with affiliates will end only if the federal agencies require that all affiliates be included on exams.

We urge the regulators to go back to the drawing board to come up with a proposal that truly meets the needs of communities by updating CRA to meet current market realities. As currently written we believe that this proposal does more harm than good.

Thank you for your attention to this critical matter.

Sincerely,

Hubert Van Tol
Executive Director

Cc:
  National Community Reinvestment Coalition