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Board of Governors of the Federal Reserve System
Via e-mail:

RE: Docket No. R-1386
Community Reinvestment Act Regulation Hearings

The Independent Bankers Association of Texas is a trade association representing over 500 independent, community banks domiciled in Texas. As "community banks," its members are truly committed to serving their local communities well. However, more and more, such banks have come to find that Community Reinvestment Act relates more to paper work than to meaningful community results.

Background. CRA was enacted in 1977, with some modifications. At that time, Texas was still a unit-banking state with branches absolutely prohibited by the Texas Constitution. Commercial banks were largely involved in making business loans while savings and loan associations made residential mortgage loans, and credit unions provided consumer credit to their members (with restrictive field of membership requirements). Since then, the "shadow banking" industry has significantly dominated residential mortgage lending, and credit unions are significant competitors to banks (although they are still not subject to CRA). Although the banking industry has changed significantly, the CRA has been static in its core requirements to a large extent. (The updated FAQs are, however, an excellent example of a positive response to changes in banking and are to be commended.)

Geographic coverage. A core concept for CRA is that banks should make loans where they take deposits. However, in Texas, a handful of giant interstate banks dominate the urban centers and control approximately 70% of total state deposits. When these institutions came to Texas, many of them first eliminated small, rural branches. Yet, their assessment areas are so broad as to be meaningless as compared to the stringent requirements placed on their smaller brethren.

Almost all banks, including even the smaller rural banks, have online banking services. Customers can do business by phone. Institutions like USAA even take consumer deposits by image conveyed by smart phones. Remote deposit capture means that many customers can transmit check deposits digitally. Expanded use of ACH also changes the significance of a branching network.

With all of the changes in delivery of banking services, the entire concept of assessment area appears to us to be outmoded. Yet, our members must expend significant resources in software and other resources to manage their census tract analyses and compliance monitoring. The compliance cost reduces the capital that our members have available to leverage in making loans.

Affiliate activities. One of the questions is whether affiliates should be considered along with the bank. Candidly, we believe that the Dodd-Frank Act and its changes to federal preemption will result in affiliate structures collapsing. However, it is premature to anticipate this result, we think.

Small business and consumer lending. This topic asks about data requirements for small business and small farm lending activities, including activities or products designed to meet low to moderate income (LMI) consumers. It is important to note that USDA-Farm Credit Banks and production credit associations compete with banks for rural loans. These include traditional farm production loans but also now include rural and small town business loans and even residential mortgages in rural areas. This competition affects the ability of community banks to make loans to agribusiness, farmers, and rural communities generally. We recommend against even more data collection on small farm and small business lending. The additional record keeping adds to the cost of providing this lending service. Also, it will be hard to gather all of the monitoring info (race, age, etc.) and then explain to the customer that the information is not being used in making the credit decision!

Ratings and incentives. Currently, the examination process segments the ratings into "outstanding, high satisfactory, satisfactory, low satisfactory, needs to improve, and unsatisfactory." Right now, however, only "satisfactory" is used on the official rating. We do not recommend expanding the public categories, however, as we do not believe that consumers will readily perceive the distinctions among these.

The disincentives for a less than satisfactory rating are huge and include inability to branch, inability to merge or acquire failed banks, inability to obtain long term FHLB advances, inability of financial holding companies to engage in new activities, disqualification for state public fund deposits (in Texas) and for some local public fund deposits (varies by locality) and reputation cost. We believe that these costs are severe and should not be expanded.

Effect of evidence of discriminatory or other illegal credit practices on CRA Performance Evaluations. We believe that it is a very bad idea to expand the types of practices that could affect CRA performance evaluations. This is based on the experience of a number of our members with regard currently to fair lending examinations. We would submit that it is unfair and abusive for a CRA rating to be dropped below satisfactory for an isolated incident. And yet, that appears to be happening. Also, the concept of "pattern or practice" is pretty loose. An FDIC attorney has said that as few as two loans that appear to have "disparate impact" can create a "pattern or practice" even in banks with more than $1 Billion in assets.

Expanding this rigid analysis to other laws and regulations is troubling. Ultimately, it could actually have the opposite effect of its intention by chilling lending activities.

Standards. There are other areas of concern in CRA with regard to applicable standards. For example, banks are expected to meet "benchmarks" that are based on "peer" performance. The examiners know what these are, but they are not always readily apparent to bankers until the exam. Further, the determination of what is truly a "peer" bank needs further consideration. Size is relevant, of course, but state location, market type (urban vs. suburban vs. rural) and business strategy (retail focus vs. commercial) all affect a particular bank's activities.

Conflicting "messages." Over and over, the CRA requirements appear to run counter to certain safety and soundness expectations. For example, there is Interagency Guidance on Subprime Lending that absolutely discourages lending to borrowers with credit scores below 660. Various bulletins on subprime lending appear to confuse lending to borrowers with subprime characteristics with predatory lending. The entire state of Texas has an average credit score of 550. The border areas have a lower average credit score, we believe. But if the bank were to reduce its lending based on poor credit scores, it would be in trouble for not meeting the credit needs of its LMI customers. If loans to customers with poor credit scores do NOT have higher interest rates, then safety and soundness examiners may conclude that the loans are not being appropriately priced for risk.

Banks must be profitable and should have reasonable net interest margins. Retained earnings are a significant factor in capital. Again, pressure to offer special products/loans for the LMI sector can conflict with other important regulatory objectives.

Qualifying activities. The CRA regulation and FAQs should encourage creativity and allow banks to be innovative and flexible in designing new products and services that can reach out to ALL sectors of the community. The revised FAQs recognize this but should be further expanded.

Other. The increased record keeping requirements (more data fields) and the continuing restrictions on products is resulting…and will continue to result on an accelerating basis…in the erosion of available products and services. Between fair lending examinations and unpredictable UDAP assertions, banks are being herded into cookie-cutter products. This means less choice for customers—who apparently can't be trusted to select products from their trusted bankers. The mind-boggling increase in regulatory requirements is making compliance cost one of the biggest factors for community banks. Ultimately there will be fewer institutions, meaning less choice in the marketplace.

Bottom line: CRA as currently in the law and regulations is out of touch with the financial services industries and with the desires and needs of <u>real</u> customers. Congress should either apply these onerous requirements to ALL competitors or scrap it. We understand that the regulators cannot change the law. However, we believe that the disconnect between current financial services in the real world and the CRA world of 1977 is severe and leads to arbitrary results in examinations. Neither bankers nor customers are well served by the current regime.

Sincerely,

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