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April 6, 2004

Communications Division
Public Information Room
Mailstop 1-5
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219
Docket No. 04-06

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 200551
Re: Docket No. R-1181

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: No. 2004-04

Re: Community Reinvestment Act Regulations

Dear Sir or Madam:

The Independent Community Bankers of America (ICBA)[1] strongly supports the proposed increase in the asset size limit for banks eligible for the small bank streamlined Community Reinvestment Act (CRA) examination process. We applaud the proposal to increase the limit to $500 million in assets and eliminate the separate holding company qualification, although we believe that a preferable threshold would be $2 billion in assets. While community banks will still be subject to CRA, the proposal will free many community banks from the more onerous compliance burdens associated with the large bank CRA examination and free them to concentrate efforts and resources on serving their communities. The bulk of CRA examination resources should be focused on truly large banks whose hundreds or thousands of local branches never see a CRA examiner, not on community banks that cannot thrive unless they serve their communities.

[1] ICBA represents the largest constituency of community banks in the nation and is dedicated exclusively to protecting the interests of the community banking industry. We aggregate the power of our members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.

Overview. At a time when banking monoliths stretch from coast-to-coast, evaluating the CRA performance of large complex banking organizations and small locally owned and operated community banks on the same examination standards simply does not make sense. Increasing the small bank size limit will not undermine the purposes of CRA. Instead it will free larger community banks from unnecessary costs, improving their productivity and enhancing their ability to meet the credit needs of their communities. If the agencies' proposal is adopted, the regulatory paperwork and examination burden will be eased for 1,350 community banks between $250 million and $500 million of assets. These banks will no longer be subject to the investment and service tests, nor to CRA loan data collection and reporting requirements. Even so, the percentage of industry assets examined under the large bank tests will decrease only slightly from a little more than 90% to a little less than 90%.

The small bank examination process, the most successful innovation of the 1995 CRA revisions, has worked well. The ICBA applauds the agencies for recognizing that it is time to expand this critical burden reduction benefit to larger community banks. This will allow more community banks to focus on what they do best—fueling America's local economies. Adjusting the asset size limit also more accurately reflects significant changes and consolidation within the banking industry in recent years. To be equitable, banks should be evaluated against their peers, not in the same context as banks hundreds of times their size that stretch from coast to coast. Extending the streamlined exam to more community banks would do more than any other change to foster the goals of the 1995 CRA reform—to insure the regulations emphasize performance over process and eliminate unnecessary regulatory burden.

The Threshold Should be Higher Than $500 Million. While the proposed increase is a good first step, the size of banks eligible for the small-bank streamlined CRA examination should be increased to $2 billion, or at a minimum, $1 billion. As FDIC Vice Chairman John Reich commented when the FDIC Board discussed the proposal, "many in the industry will say it doesn't go far enough, and I'm inclined to agree with them." He expressed concerns that the regulatory burden is drowning small community-based banks, and that the agencies are regulating community banks out of existence. This is a point that cannot be underscored strongly enough, as has been stressed at EGRPRA[2] outreach meetings held by the agencies.

In today's market, $500 million in assets is not representative of a large bank. When the small bank streamlined examination was first considered, 17 percent of the banking industry's total assets were subject to the small bank exam using a $250 million asset limit. Due to changes in industry demographics since the small bank streamlined examination was adopted in 1995, if the asset limit were increased to $1 billion today, only slightly more than 15 percent of industry assets would be subject to the small bank exam—still less than the percentage of assets covered when the streamlined examination was first adopted nearly ten years ago.

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[2] The Economic Growth and Regulatory Paperwork Reduction Act of 1996. The statute requires the federal banking agencies to review their regulations and identify provisions that are outdated, unnecessary, or unduly burdensome. That review is currently underway.

Community Banks are Integral Parts of their Communities With or Without CRA. Community activists seem oblivious to the costs and burdens imposed by CRA examinations and the effect these costs have on the local bank. Yet, community activists object to bank mergers that remove the local bank from the community. To keep the local banks in the community where customers have better access to decision-makers, community activists must recognize the regulatory burdens that are strangling smaller institutions and forcing them to consider selling to larger institutions that can better manage these burdens.

It cannot be stressed strongly enough that increasing the size of banks eligible for the small-bank streamlined CRA examination does not relieve banks of CRA responsibilities. Since the success and survival of many community banks is closely intertwined with the success and viability of their communities, the proposal will merely eliminate some of the most burdensome exam requirements, such as the data-collection requirements, imposed on larger banks and thrifts.

In a survey of ICBA leadership bankers, virtually all reported offering special deposit services for low- and moderate-income residents of their communities because it is good business. These are services they report they would offer regardless of CRA requirements. Additionally, these bankers almost all reported that they provide community services that do not currently receive CRA credit, such as monetary contributions to civic organizations, service on local community committees, special loans to non-profit organizations and churches and support for local charities. As one banker commented, "success depends on not only opening a branch but involvement in the community." Community banks truly prosper or decline with the economies of their communities.

By nature, a bank with less than $1 billion in assets will concentrate its lending within the local community and will more likely reach into the community because bank management is involved in community development activities. The loan data collection and reporting as well as the investment test are more suited to larger financial institutions. The cost of compliance in both these areas can be a hardship on smaller community banks, since many compliance costs are fixed and weigh disproportionately on smaller banks. As a result, any benefit to the consumer is far outweighed by the financial impact on the bank, which uses up resources that could be better allocated to serving the community.

ICBA/Grant Thornton CRA Cost Study. ICBA has long urged federal regulators to increase the CRA small bank size limit, preferably to $2 billion in assets. CRA compliance examination costs place an unfair burden on "large" community banks. A 2002 ICBA/Grant Thornton study entitled *The High Cost of Community Bank CRA Compliance: Comparison of 'Large' and 'Small' Community Banks* reveals that CRA compliance costs can more than double when community banks exceed $250 million in assets and are no longer subject to streamlined examinations. A survey of community banks showed the mean employee cost attributable to CRA is 36.5 percent higher at large community banks than at small community banks. In each of two case studies—one contrasting costs for a bank that grew from "small" to "large" bank status, and one

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contrasting costs for a “small” and “large” bank owned by the same holding company—CRA compliance costs were four or more times greater for large community banks than for small ones.

The study showed that the investment test of the large bank exam is also a cost burden for large community banks. Ninety-two percent find the market for CRA investment opportunities “competitive” or “highly competitive” and 69 percent say such investments are “not readily available.” Half report giving yield concessions to make CRA-qualified investments.

In supporting the current regulatory proposal, the agencies referred to cost studies that quantify the increased CRA exam burden for larger community banks. The agencies also cited changing industry demographics as the gap between “mega-banks” and those under $1 billion grows. Because of industry consolidation and bank asset growth, the number of banks defined as “small” has declined by 2000 since the $250 million small bank threshold was originally established in 1995.

Investment Test. Opponents of the proposal contend that community investments will disappear if smaller institutions are no longer subject to the investment test of the large bank CRA examination. As noted above, community bankers report that they would be involved in the local community and make investments in community development because their success and survival depends on the success and the survival of the community and because they are integral parts of those communities. Nonetheless, to address this concern the agencies should consider giving all banks, even those not subject to the three-part large bank CRA exam, credit for community development activities, such as such as hospital funding, school funding or road funding and other activities that generally benefit the community. While many of these projects would continue without CRA credit, the incentive would acknowledge banks’ contributions to the community.

The agencies have declared their intention to provide additional guidance, through revised examination procedures, on community development investments and the application of the performance context. The ICBA considers this an area of sufficient importance that any revisions should be issued for public comment to give interested parties an opportunity to participate in the discussion. If certain investments are to be evaluated for their benefit to the community under examination procedures, then the public should have the opportunity to comment on how those evaluations will be made. This is especially important since much of the criticism of the current evaluation, e.g., about whether investments are innovative or creative, is the result of misapplication of the existing standards by examiners.

Other Changes

Abusive Lending. In addition to the proposal to increase the size of banks eligible for the small bank streamlined CRA exam, the agencies propose to clarify that predatory or abusive loan practices can affect a bank’s CRA rating. The proposal would

explicitly provide that a pattern or practice of loans based primarily on collateral or foreclosure value instead of the borrower's ability to repay would be indicative of predatory lending.

The ICBA does not view consideration of abusive lending practices in a CRA evaluation as a substantial change from existing examination procedures. Since the regulators stress that assessment of predatory practices will not be incorporated as a new element in CRA exam procedures, the ICBA does not object to this change, although it is more appropriate to use compliance examinations and fair lending reviews, which are better designed for this purpose, to identify and stop abusive lending practices.

While the ICBA does not view the proposal as a major departure from existing procedure, we urge the agencies to offer better guidance than merely listing certain regulations and suggesting that a violation of one of these regulations could lead to a downgrade in the bank's CRA rating. A bank could inadvertently have a technical violation of one of these regulations without engaging in any abusive or deceptive practice. More specifics about the kind of violations that could affect the rating should be provided, such as through an interagency Q&A. Insufficient guidance leaves too much room for uneven interpretation and enforcement by examiners.

While it might be appropriate for the CRA examination team to consider violations brought to their attention by another examiner within the same agency, referrals from other outside sources should be treated differently to ensure reliability. Moreover, any referrals that might be used to downgrade a bank's CRA rating should only be considered if the issue is final and not subject to pending discussions or investigation, and the bank should have had an opportunity to defend its actions. Whenever a CRA examiner considers these issues, the matter should be fully discussed with bank management at the start of the CRA review to put the bank on notice and allow it to ameliorate problems or raise any related points that should be considered.

Loans Made Primarily on Collateral Value. The regulators have identified equity stripping as the predatory practice that is most easily addressed by regulation. Accordingly, the proposal would provide that loans made primarily on the basis of the value of collateral would be considered predatory. The ICBA believes that further guidance is needed and that the final rule should be more specific in excluding certain loan programs, such as reverse mortgages, to ensure there is no room for misinterpretation or confusion.

While banks should make loans based primarily on credit history and the borrower's ability to repay, barring banks from making loans on the basis of collateral value will greatly restrict credit availability. At times, individuals who have experienced credit problems need collateral equity to help reestablish creditworthiness. Banks should be able to lend based on the collateral to allow them to take into account the loan applicant's ability to generate income in the future. Other loans based on collateral value that should not be considered equity stripping include reverse mortgage programs

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or loans to self-employed individuals. The text of the final rule should make clear that any restrictions on collateral-based lending does not restrict legitimate practices, such as reverse mortgages, loans to self-employed borrowers or other loan applicants where reliance on the collateral may be appropriate for safe and sound lending but is neither abusive nor predatory.

Unfair and Deceptive Acts or Practices. The proposal would also rely on the Federal Trade Commission Act's definition of unfair and deceptive practices to determine whether certain loans might be considered predatory. Generally, the ICBA does not object to this approach, although more guidance may be needed in the future to ensure that bankers and examiners understand what facets of loan products might run afoul of this standard. If abusive lending practices could detract from the bank's CRA rating, it is important there be a clear understanding between examiners and financial institutions as to what is considered "abusive." This guidance can be provided in the form of best practices, Q&As or examination procedures that are established after an opportunity for public review and comment.

Other Issues. Under the proposal, examiners would consider discriminatory or illegal practices in the bank's CRA evaluation no matter where they occur, even if outside the bank's assessment area. The ICBA does not object to this element of the proposal, since the assessment area should not define proper lending practices. Second, if a bank elects to have a specific loan portfolio of an affiliate included in its CRA evaluation, the proposal would clarify that the examiner may consider the entire lending record of the affiliate in that particular portfolio. The ICBA also agrees with this clarification. However, the regulators should also consider that to the extent evaluations depart from the original purpose and goal of the CRA statute, i.e., ensuring that a bank meets the credit needs of the community where the bank takes deposits,[3] the less likely evaluations will meet the primary goal of the statute.

Public File. A final proposed change would provide that CRA disclosures prepared by the agencies for "large banks" will include a breakdown of the number and amount of small business and small farm loans by census tract. This data is now disclosed only in the aggregate across tracts within income categories.

Generally, census tracts are large enough to ensure that the privacy of individual borrowers is properly protected. However, for smaller census tracts, especially those in rural areas, it is critical that the agencies establish procedures to consolidate the data to ensure the privacy of individual borrowers is properly protected. In isolated census tracts with limited loan activity, disclosing the information where the borrower can easily be identified undermines and destroys confidentiality. Congress and federal banking regulators require banks to protect the security and confidentiality of customer information. Therefore, if the agencies propose to release information as proposed,

[3] Section 802(b) of the Community Reinvestment Act states: "It is the purpose of this title to require each appropriate Federal financial supervisory agency to use its authority when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions." 12 USC 2901; Title VII of Pub. L. 95-128, 91 Stat. 1147 (October 12, 1977).

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they should take the proper steps to offer the same level of security for the customers of the banks they supervise. Absent such assurances, or if data cannot be sufficiently aggregated to protect the identity of individual borrowers, the disclosures should not be made.

The agencies also propose to distinguish between purchased loans and originated loans in the data released by the agencies for a bank's public file. Although the agencies will not distinguish purchased loans from originated loans for CRA evaluation purposes, the ICBA is concerned that the proposed change is the first step toward making such a distinction. While some argue that purchased loans do not merit the same level of credit under CRA as originated loans, purchased loans should be given equal importance since they help support bank lending activities.

While the agencies stress that these changes to the data released for the bank's public file will not require banks to make any revisions to their current reporting and will only change how the agencies disclose the data, the ICBA questions how long this will hold true. Inevitably, changes to the way data is disclosed eventually results in reformatted reporting systems by banks to facilitate the processing of the data by the agencies.

Conclusion. The ICBA welcomes the proposal. Increasing the asset-size of banks eligible for the small bank streamlined CRA examination process is an important step to reducing regulatory burden. We also support eliminating the separate holding company qualification for the streamlined examination, since it places small community banks that are part of a larger holding company at a disadvantage to their peers. While community banks will still be subject to and comply with the general requirements of CRA, this change will eliminate some of the most problematic and burdensome elements of the current CRA regulation from community banks that are drowning in regulatory red-tape. In an age of trillion dollar banks, examining a $500 million bank using the 'large bank' CRA exam procedures is completely unwarranted. The ICBA urges the agencies to consider going further to increase the asset size limit for the streamlined examination to $2 billion or, at least, $1 billion in assets to better reflect the current demographics of the banking industry.

Thank you for the opportunity to comment. If you have any questions or need any additional information, please contact ICBA regulatory counsel Robert Rowe, or the undersigned, at 202-659-8111 or by e-mail at robert.rowe@icba.org or karen.thomas@icba.org.

Sincerely,

Karen M. Thomas
Executive Vice President
Director, Regulatory Relations Group