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Re: **FDIC** - 12 CFR Part 345; **FRB** - Docket No. R-1181; **OCC** - Docket No. 04-06; **OTS** - No. 2004-04; Proposed Revisions to the Community Reinvestment Act Regulations; 69 Federal Register 5729; February 6, 2004

Dear Sir or Madam:

The Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve Board, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision (the Agencies) have proposed to make amendments to the Community Reinvestment Act (CRA) regulations. The Agencies propose (1) to amend the definition of "small institution" to mean an institution with total assets of less than \$500 million, without regard to any holding company assets, and (2) to provide specifically that evidence that an institution, or any of an institution's affiliates the loans of which have been considered pursuant to §__.22(c), has engaged in specified discriminatory, illegal, or abusive credit practices in connection with certain loans will adversely affect the evaluation of the institution's CRA performance. The Agencies also propose to change how the data disclosed in CRA disclosure statements is presented, in order to make it more useful to the public. The proposed revisions will affect all FDIC-insured financial institutions.

The American Bankers Association (ABA) brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership - which includes community, regional and money center banks and

holding companies, as well as savings associations, trust companies and savings banks - makes ABA the largest banking trade association in the country.

The ABA strongly supports increasing the asset threshold for a small bank under CRA and the elimination of the holding company test for a small bank. At the same time we urge the Agencies to increase the asset threshold to an even higher level. Additionally, the ABA has several concerns about the Agencies' enforcement of consumer protection laws via the CRA rating and about the proposed treatment of affiliates, and requests additional clarifications or modifications to the proposal. Further, our small banks are concerned that the release of business lending data in the new format will compromise the privacy of some of their borrowers. Finally, we suggest some additional minor changes to recommend to the regulations: one dealing with the treatment of bank subsidiaries of banks and one dealing with the authority of the Agencies to grant CRA credit for investment in minority institutions.

The Agencies Urgently Need to Raise the Threshold for a Small Bank Under CRA

The most significant improvement in the 1995 revised CRA regulations was the addition of the small institution CRA examination, which actually did what the Act required: required examiners, during their examination of the bank, to look at the bank's loans and assess whether the bank was helping to meet the credit needs of the bank's entire community. It imposed no investment requirement on small banks, since the Act is about credit not investment.¹ It added no data reporting requirements on small banks, fulfilling the promise of the Act's sponsor, Senator Proxmire, that there would be no additional paperwork or recordkeeping burden imposed on banks if the Act passed. And it created a simple, understandable assessment test of the bank's record of providing credit in its community: the test considers the institution's loan-to-deposit ratio; the percentage of loans in its assessment areas; its record of lending to borrowers of different income levels and businesses and farms of different sizes; the geographic distribution of its loans; and its record of taking action, if warranted, in response to written complaints about its performance in helping to meet credit needs in its assessment areas.

Now the Agencies propose to raise the asset threshold for a small institution from \$250 million to \$500. The Agencies state that several factors make such an increase appropriate:

- First, with the increase in consolidation at the large end of the asset size spectrum, the gap in assets between the smallest and largest institutions has grown substantially since the line was drawn at \$250 million in 1995. The growing asset gap between the smallest above-the-threshold institutions and the largest institutions has meant that the disproportion in compliance burden has grown on average.

¹ ABA believes it important to note that the streamlined small institution evaluation comes closest to what the Congress intended when adopting the Community Reinvestment Act. The Act itself provides that:
 "SEC. 804. (a) IN GENERAL.--In connection with its examination of a financial institution, the appropriate Federal financial supervisory agency shall-

(1) assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution;"

Since in 1977 there was only one examination of a financial institution, the safety and soundness examination, it is clear from the statute that the Agencies were to make a general assessment of the institution during that safety and soundness exam. No additional data collection, no additional paperwork and no service and investment tests were contemplated by Congress when it enacted the Community Reinvestment Act.

- Second, the number of institutions defined as small has declined by over 2,000 since the threshold was set in 1995, and their percentage of industry assets has declined substantially.
- Third, some asset growth since 1995 has been due to inflation, not real growth.
- Fourth, the Agencies are committed to reducing burden where feasible and appropriate.

The Disproportionate Regulatory Burden on Small Institutions

The ABA strongly agrees with the Agencies that the threshold for eligibility for the small bank examination should be raised. Moreover, we believe that the Agencies' own analysis of the need for this change in fact argues for an even higher threshold for a small bank. When the CRA regulations were rewritten in 1995, the banking industry recommended that community banks of at least \$500 million be eligible for a less burdensome small institution examination. Our reasons at that time closely parallel the reasons given by the Agencies now for an increase: the regulatory burden on small institutions is enormous and disproportionate to their assets, and growing more so annually, it was wrong to subject a \$251 million bank to the same examination as a \$100 billion bank, and continuing inflation would soon make even more small banks subject to the large bank examination. All of our reasons are even more valid today, as we consider that there are soon to be two trillion dollar banks.

The Agencies indicate that their regulatory burden analysis led them to conclude that the appropriate division between a small and large bank was \$250 million. However, we note that for large bank safety and soundness examinations, the Office of the Comptroller of the Currency uses \$1 billion for the division between small and large banks. For application of independent auditing requirements, the Agencies chose, in 1994, \$500 million for the line between small and large banks. And just recently, the Federal Deposit Insurance Corporation's Chairman Powell made a major policy speech urging that very large banks be treated completely differently from smaller banks for deposit insurance purposes. We believe all of this suggests that the initial decision to divide small and large banks at \$250 million for CRA was an error on the low side. And the passage of almost a decade since that decision has only made the \$250 million threshold more incorrect.

Since 1995, the regulatory burden on small banks has grown significantly larger, including just in the last few years massive new reporting requirements under HMDA, the USA Patriot Act and the privacy provisions of the Gramm-Leach-Bliley Act. But the nature of community banks has not changed. When a community bank must comply with the requirements of the large institution CRA examination, the costs to and burdens on that community bank increase dramatically. This imposes a dramatically higher regulatory burden that drains both money and personnel away from actually helping to meet the credit needs of the institution's community. Currently, a bank with more than \$250 million in assets faces significantly more requirements that substantially increase regulatory burdens without consistently producing additional benefits as contemplated by the Community Reinvestment Act.

ABA believes that it is as true today as it was in 1995, and in 1977 when Congress enacted CRA - - that a community bank meets the credit needs of its community if it makes a certain amount of loans relative to deposits taken. A community bank is typically non-complex; it takes deposits and makes loans. Its business activities are usually focused on small, defined geographic areas where the bank is known in the community. In today's banking market, even a \$500 million bank often has only a handful of branches in one or two local communities. We believe that the Agencies are correct that the small institution examination does accurately capture the information necessary for

examiners to assess whether that community bank is helping to meet the credit needs of its community, and nothing more is required to satisfy the Act. And we believe that raising the small bank threshold does greatly reduce the regulatory burden on the bank, which is the central goal of the Agencies' current regulatory burden reduction review under Section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996.

The Percentage of Total Industry Assets Analysis

The Agencies further note that raising the asset threshold to \$500 million and eliminating the holding company limitation would change the percentage of industry assets subject to the large retail institution test only slightly, from a little more than 90% to a little less than 90%. The Agencies argue that that decline, though slight, would more closely align the current distribution of assets between small and large banks with the distribution that was anticipated when the agencies adopted the definition of "small institution."

According to the Agencies, raising the threshold and eliminating the holding company limitation really barely changes the percentage of industry assets subject to the large retail institution test, due to changes in the industry since the regulation was first adopted. Thus, the Agencies consider raising the threshold as a minimal change. In fact, the Agencies state that that the change results in a small decline, but the decline, though slight, would more closely align the current distribution of assets between small and large banks with the distribution that was anticipated when the Agencies adopted the definition of "small institution." The Agencies calculate that, after adoption of the proposal, the amount of small bank assets would be just over 10% of total industry assets. However, our calculations show that on January 1, 1996, when the small bank examination went into effect, banks and savings associations under \$250 million held just under 14% of the total assets of the banking industry. Thus, the Agencies' proposed increase in the threshold does not even restore the asset balance between large and small banks under CRA as it existed on January 1, 1996. The Agencies, in their proposal, are really just preserving the current *status quo* under the regulation, which has been altered from its original alignment by a drastic decline in the number of banks, inflation and an enormous increase in the size of large banks. We believe that this is inadequate and does not even approach the balance that the Agencies say that they intended to achieve.

Related to this analysis of the distribution of assets in small banks, the Agencies, when explaining why they will not propose any changes to the investment test, write that "we propose to address concerns about the burdens of the investment test by means other than replacing or restructuring it. As explained later in this notice, we are proposing to raise the asset-size threshold at which an institution becomes subject to the large retail institution test and, therefore, the investment test. This would respond to comments that smaller institutions at times have had difficulty competing for investments. As noted earlier, the change would not materially reduce the portion of the nation's bank and thrift assets covered by the large retail institution test, including the investment test."² However, as shown above, raising the threshold to \$500 hardly moves the percentage of assets subject to the investment test, and so will provide little or no relief from the problems posed to small banks by the investment test. Banks between \$250 million and \$1 billion have had problems complying with the investment test since its inception, as the Agencies' assessment of the performance context of those institutions in their CRA Public Evaluations clearly show. If the Agencies really intend to address the investment test by reducing regulatory demand for too few qualified investments, then the Agencies' own analysis actually demonstrates that the Agencies need to raise the threshold above \$500 million rather than just preserve the current *status quo* of this regulation.

² 69 Federal Register 5734.

ABA believes that if the Agencies raise the threshold to \$1 billion, this would more closely align the proposal with what the Agencies originally did in 1996. As of January 1, 2004, banks and savings associations with assets of \$1 billion or less hold just over 15% of the total assets of the banking industry, but as the Agencies have noted, that percentage of assets will continue to decline as the industry consolidates. While a \$1 billion threshold would only raise the percentage of assets under the small bank exam slightly over the 1996 percentage of 14%, it would have a significant impact on the regulatory burden on small banks, reducing the compliance burden on more than 500 additional banks and savings associations (compared to a \$500 million limit). Accordingly, ABA urges the Agencies to raise the threshold to at least \$1 billion, providing significant regulatory relief while, to quote the Agencies in the proposal, not diminishing “in any way the obligation of all insured depository institutions subject to CRA to help meet the credit needs of their communities. Instead, the changes are meant only to address the regulatory burden associated with evaluating institutions under CRA.”

The Impact of Certain Credit Terms and Practices

The Specification of Credit Terms and Practices That Might Downgrade a CRA Rating

The CRA regulations provide that evidence of discriminatory or other illegal credit practices adversely affect an evaluation of an institution’s CRA performance and may affect the rating, depending upon consideration of factors specified in the regulations. Interagency guidance states that this provision applies when there is evidence of certain violations of law, including certain violations of the Equal Credit Opportunity Act, Fair Housing Act, Home Ownership and Equity Protection Act, Real Estate Settlement Procedures Act, Truth in Lending Act, and Federal Trade Commission Act. The Agencies propose to include specific examples of violations of these laws in the CRA regulation and propose to provide that evidence of violations of these laws and other applicable consumer protection laws affecting credit practices, including State laws if applicable, may also adversely affect the institution’s CRA evaluation. ABA is concerned about the breadth of this language, which appears to make a substantive change in the current regulation and guidance, and requests some clarifications, if not modifications.

First, each of these laws already contains specific penalties and corrective provisions to protect consumers. While some violations do affect the provision of credit, some violations seem more technical or even unrelated to any CRA concern. For example, errors in providing rescission notices do occur, but rarely, if ever, are they part of a pattern or practice of abuse. Rather they are inadvertent or result from systems failures. Nonetheless, the strict provisions of the Truth in Lending Act will result in extension of the rescission period or even penalties against the bank. Additional punishment of the bank by downgrading the bank’s CRA rating not only appears to be a double punishment but also appears to be irrelevant to whether the bank is helping to meet the credit needs of the community. This is particularly true because any violations found by examiners or the bank that might downgrade the CRA rating will be corrected under the provisions of the Truth in Lending Act. Additionally, the proposed regulatory language appears to allow even more unrelated violations of credit laws to affect a CRA rating. Compliance officers have asked already whether a violation of Section 23A on transactions with affiliates involving mortgage lending might not trigger a downgrade in a CRA rating. Could errors in reading flood maps for requiring flood insurance result in a CRA downgrade?

We are especially concerned about language in the preamble indicating that “evidence of violations of other applicable consumer protection laws affecting credit practices, including State laws if

applicable, may also adversely affect the institution's CRA evaluation." Such an interpretation of the existing provision would be a great expansion of the Agencies' guidance, which provides that violations of other provisions of consumer protection laws generally will not adversely affect an institution's CRA rating. In addition, state laws that are not applicable to institutions because of being preempted by federal law should not be made part of the credit and terms part of the regulation. While it appears that the Agencies will not consider evidence of violations of state laws, if they are inapplicable to an institution, we ask that this be made explicitly clear in any final regulation. However, in that case, ABA notes that such consideration of state laws preempted by federal law for federally chartered institutions creates different tests under CRA, depending on whether an institution is a state or federal charter. We do not think that a good approach to CRA.

We conclude that the Agencies are proposing language that is much too broad, and which is not necessary. As the Agencies note, they do not intend to make a substantive change in the current regulation and guidance. However, we believe that they are doing so, and they should not. As proposed, the new regulatory language is just too broad and not uniformly applicable. If the Agencies intend to proceed with this rewriting of the regulation, then the list of violations that will have this result should be limited and must be comprehensive rather than just illustrative.

Prohibiting Equity Stripping

The Agencies further propose to explicitly address the abusive practice of equity stripping by revising the regulations to provide that evidence of a pattern or practice of extending home mortgage or consumer loans based predominantly on the foreclosure or liquidation value of the collateral by the institution, where the borrower cannot be expected to be able to make the payments required under the terms of the loan, adversely affects an institution's overall rating. ABA believes that it is legally incorrect to introduce substantive law on abusive lending into the CRA regulations. The Community Reinvestment Act is not a substantive consumer protection law but rather is a Congressional mandate to the Agencies requiring them to assess a bank's record of meeting the credit aspects of its convenience and needs requirements. As a result, and as the Agencies are aware, violations of the Community Reinvestment Act may not be enforced by the Agencies with any of their normal enforcement powers, such as cease and desist orders, civil money penalties, or other enforcement mechanisms. The Agencies are limited under the strict wording of the Act to issuing CRA ratings and taking those ratings into account in applications for deposit-taking facilities. It is not clear from the Agencies' discussion of equity stripping as to whether equity stripping is a violation of any of the laws just specified as adversely affecting a CRA rating. If it is, then evidence of equity stripping already will be used by the Agencies to downgrade a CRA rating. If it is not, then the CRA regulations are not the place to prohibit equity stripping, as they will gain no enforcement power to punish it, to order restitution or to otherwise prevent it. Rather, the Agencies should address it in rulemaking as part of their enforcement of Section 5 of the Federal Trade Commission Act, and then use the provisions of the existing CRA regulation and the Interagency Guidance to adversely impact the institution's CRA rating. ABA urges the Agencies to withdraw this part of the proposal. If the Agencies believe that equity stripping should be addressed by them, it should be done as part of one of the consumer protection regulations.

Activities of Affiliates that are not Subsidiaries of the Bank

The Agencies asked in their Advance Notice of Proposed Rulemaking whether the provisions that permit consideration of an institution's affiliates' activities at the option of the institution are effective in evaluating the performance of the institution in helping to meet the credit needs of its entire community and consistent with the CRA statute. ABA wrote that it believed that the *status quo* should be retained, allowing depository institutions at their option to request consideration of affiliate activities. ABA continues to believe that this provides the greatest flexibility for institutions

and is more consistent with the Act than either mandatory inclusion of affiliate lending or total exclusion of affiliate lending. Mandatory inclusion of affiliates not subsidiaries of the financial institution is simply not authorized under the statute, which directs the Agencies to evaluate financial institutions, not holding companies or affiliates of the financial institution. However, allowing financial institutions to include affiliate activities at the option of the institution gives financial institutions greater flexibility under the regulations.

The Agencies now propose to clarify that an institution's CRA evaluation also can be adversely affected by evidence of discriminatory, other illegal, and abusive credit practices by any affiliate, if any loans of that affiliate have been considered in the CRA evaluation pursuant to __.22(c)(1) and (2). Loans by an affiliate currently are permitted to be included in an institution's evaluation of one of its assessment areas only, and the proposal would be similarly limited to affiliate lending practices within any assessment area. Since the Agencies do not have to permit institutions to claim affiliate lending for CRA credit, requiring institutions to be evaluated on all of the lending of the affiliate in the institution's assessment area does not seem to be excessive. However, the Agencies ask further if they should provide that evidence of discriminatory, other illegal, or abusive credit practices by an affiliate whose loans have been considered in an institution's evaluation will adversely affect the institution's rating whether or not the activities were inside any of the institution's assessment areas. ABA believes that this would pose very difficult due diligence problems for banking institutions. Affiliates that are subsidiaries of the bank are already considered to be part of the bank and are subject to the Agencies' examination and supervision. However, many bank affiliates are controlled by a parent holding company and are not controlled by the affiliated bank. These affiliates may lend over much larger geographic areas than the affiliated bank. Holding a bank responsible for a complete due diligence on loans of an affiliate (that the bank does not control) in areas in which the bank had no branch and no employees (and therefore not an assessment area of the bank) would impose significant new burden. This is even more burdensome than if the bank were actually buying the loans of the affiliate. Further, it would violate principles of corporate governance and be inconsistent with the current system of regulatory and supervisory oversight. We believe that the practical considerations of such a decision by the Agencies would simply mean that the bank would not claim the affiliate loans for CRA purposes in any circumstances, which would make the option of claiming an affiliate's loans no longer a viable option. We do not believe that is what the Agencies intend, or they would just prohibit claiming an affiliate's loans for CRA purposes in the first place. Therefore, we urge the Agencies to not consider affiliate lending outside of assessment areas of the affiliated bank.

New CRA Data Release Format

The regulations do not now provide for disclosure of business and farm loans by geography (census tract) in the CRA Disclosure Statement the Agencies prepare for every institution's public file. Rather, the regulations provide for aggregation of that data across tracts within tract-income categories. The Agencies intend to revise the regulations so that the Disclosure Statement would contain the number and amount of the institution's small business and small farm loans by census tract. Dozens of small, mostly rural, institutions have told us that there are too many instances in which they will have only one or two business borrowers in a census tract, and the disclosure of this information will, in a small community, simply mean that the loan information on those customers will be publicly available. As a result of this ill-considered change in policy, the privacy of the financial information of those borrowers will be breached. ABA believes that the Agencies are proposing to violate financial privacy of some borrowers, and we oppose it.

Additional Matters

The Appropriate Treatment of Bank Subsidiaries of Banks

In a few instances, a bank or savings association owns another bank or savings association and they operate in the same assessment area(s). For example, a retail financial institution might own a small, limited purpose institution (a credit card bank) or a much larger multi-state bank might own a small bank in one of the multi-state bank's assessment areas. For virtually all regulatory and supervisory issues, these institutions would be treated on a consolidated basis, whether for capital or compliance or safety and soundness reviews, except for CRA. As a result, the limited purpose subsidiary bank must meet the community development test for limited purpose institutions, even though it is essentially just a department of the main (and larger bank) being operated as a wholly-owned subsidiary. In the other instance, the two banks find that they compete for CRA loans with each other, and then the larger bank sells some of its loans to the small bank in order to bolster that bank's lending. Both of these situations, and there may be other such examples, appear to create unnecessary burden and could be simplified. In the first instance, we suggest that if the Agency receives a request from the institutions for consolidated treatment, then the Agencies examine the two institutions together and do a consolidated analysis, giving each institution the same grade.

In the second case, if requested by the institutions, rather than forcing a reshuffling of loans by sale to the subsidiary, we suggest that the lending performance of the main bank and its subsidiary be tested on a consolidated basis for CRA. Therefore, we request that the Agencies amend either the Questions and Answers or the CRA Regulation, whichever is appropriate, to allow these banking institutions to have their lending activity be considered on a consolidated basis for CRA. Such amendment to the regulations or Q&A might provide:

Lending Test for a Parent Bank and a Subsidiary Bank in the Same Assessment Area(s)

At the request of both a parent financial institution and its wholly-owned subsidiary financial institution, the Agency may perform the lending test on a consolidated basis in any common assessment area subject to the following constraints:

- (1) The parent and its subsidiary may not claim any loan origination or loan purchase more than once; and
- (2) No other affiliate of the parent and its subsidiary may claim a loan origination or loan purchase claimed by the parent/subsidiary.
- (3) Each of the financial institutions will receive the same lending performance ratings as the other.

The Agencies' Failure To Give CRA Credit For Investment in Minority Institutions

Since 1999, ABA and the National Bankers Association have been requesting that the Agencies implement the special grant of authority to recognize investments in minority institutions. The Community Reinvestment Act directs each Agency to assess each institution's record in helping to meet the credit needs of its entire community (12 USC 804(a)). In Section 804(b), the Community Reinvestment Act specifically authorizes each Agency to "consider as a factor capital investment, loan participation, and other ventures undertaken by the [majority-owned] institution in cooperation with minority- and women-owned financial institutions and low-income credit unions provided that these activities help meet the credit needs of local communities in which such institutions and credit unions are chartered." The Agencies have never adopted any regulations granting CRA credit for such investments, participations and other ventures, though we have been told that Agencies have

occasionally given CRA credit on an ad hoc basis to individual institutions. ABA believes that the Agencies have done a disservice to minority- and women-owned institutions and low-income credit unions by failing to implement this authority. ABA again requests that the Agencies issue regulations implementing this unused authority.

ABA notes that this provision of the statute has only one geographical restriction: that the “activity” help meet the credit needs of the minority- or women-owned institution's community. The statute makes no reference to the community of the majority-owned institution, so that such investing institutions could be given CRA credit for these specific investments, even though they might be outside of the institution’s assessment area. The instances in which the Agencies have given CRA credit for investments in minority- and women-owned institutions have apparently never been in institutions outside of the investing institution's assessment area (community). ABA recommends that the Agencies provide that such investments, participations and other ventures result in CRA credit to the majority-owned institution without regard to the location of the minority- or women-owned institution or low-income credit union, as permitted by the statute. Further, ABA recommends that grants for professional development and training of personnel of a minority- or women-owned institution or low-income credit union should count as either capital investment in the institution or as a credit-related service.

Conclusion

Most importantly, ABA strongly supports increasing the asset-size of banks eligible for the small bank streamlined CRA examination process. This is an essential step in revising and improving the CRA regulations and in reducing regulatory burden. Moreover, we believe that the Agencies’ own analysis makes the case for, and ABA recommends, raising the threshold to \$1 billion. ABA also strongly supports eliminating the separate holding company qualification for the small institution examination, since it places small community banks that are part of a larger holding company at a disadvantage to their peers and has no legal basis in the Act. While community banks, of course, still will be examined under CRA for their record of helping to meet the credit needs of their communities, 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.

Sincerely,



Paul A. Smith
Senior Counsel