

www.bankcherokee.com

April 5, 2004

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Docket No. R-1181
Proposed Revisions to the Community Reinvestment Act

Dear Ms. Johnson,

Cherokee State Bank ("Bank"), a \$243 million bank with five branches located in St. Paul, Minnesota, welcomes this opportunity to provide comments on the proposal to amend regulations implementing the Community Reinvestment Act ("CRA"). Four of our branches are located in urban settings. Our flagship office and one branch are located in moderate-income census tracts. Another branch opened in 1994 in a Hispanic market, is located in a low-income census tract.

We are proud of our ninety-six year tradition of helping all the communities we serve to grow and prosper. We have always seen our success tied to the success of the communities we serve.

We strongly support the proposal to increase the asset size from \$250 million to \$500 million for banks to be eligible for the small bank streamlined CRA examination. In fact, we would like to see the agencies consider the threshold be increased to 1 billion. Our comments will focus on the costs of the regulatory burden, the ability to compete and examination resource allocation. First we would like to include a few remarks taken directly from a speech delivered by FDIC Chairman Donald E. Powell to the National Association for Business Economics on March 26, 2004. He speaks to the trends of community bank consolidation and defines community banks as those that "typically have less than one billion dollars in assets". His remarks follow:

"The story of banking in the U.S. is fast becoming a tale of two industries. At one end are the dozen or so large complex banking organizations whose size is measured in the hundreds of billions. Some have assets in the range of one trillion dollars in assets. At the other end are thousands of community banks, which typically have less than one billion dollars in assets.

*Two data points help convey the scale of this transformation. Since 1985 the number of **community** banks declined by half, from over 14,000 to just over 7,000 today. In 1985, the top ten banking organizations held 16% of industry deposits. Today their share is 40%.*

*This consolidation trend suggests the largest institutions may grow even larger and community banks will continue to decline in number. We could well see a banking industry with a few institutions having assets in the trillions of dollars, and perhaps only half as many **community** banks as we have today."*

Costs of regulatory burden

Under the current rules, Cherokee State **Bank** will begin data collecting on January 1, 2006. The **Bank** is already **planning** a nine month lead time beginning in **April**, 2005 to create the systems, procedures, controls, and the needed training to be in place before the deadline. All of this **will take** resources. The collection and reporting are **complex** requirements with many subtle nuances. The end product, just **as** with **HMDA** data and reporting, **must be** accurate. It **will take** **quality** processes and procedures and then scrubbing and re-scrubbing of the data to ensure data quality. The data quality is Critical because at *exam* time **community** banks are held to the same standard as the large multi-billion dollar regional banks with which they compete. Large **bank CRA** data collection and reporting comes at a significant cost; surely those dollars could be better spent adding new loans, products and services to the local communities **we serve**.

Ability to compete

We find it ironic that community **groups** seem oblivious to the costs associated with items like the large bank CRA data collection and reporting requirements, yet **these** groups decry the **bank** mergers that eliminate local banks from the community. They **want** the local decision makers **with** a vested interest in the success of the community, not someone making decisions five states **away**. Community groups cannot have it both ways. They are missing the direct connection between the **ability** of the community banks to comply with the ever-growing regulatory burden **and at the same time** compete **against** the large **institutions**. The large institutions can more effectively **manage** the regulatory burden by developing processes and procedures and then spreading the development costs across many banks. Standard forms, centralized processing and strong internal controls that not **only** create additional efficiencies, but result in a uniform, **high** standard **end** product. **community banks**, while being held by examiners to the same high standards for the end product, do not share the luxury of spreading the costs and creating those same large bank efficiencies. For us, the implementing and ongoing costs for the regulatory burden come from just one source, our bottom **line**. **One of the reasons** that the bank consolidation trend that Mr. Powell's refers to will continue **is the** inability of community banks to absorb the costs associated with the ever-growing and complex regulatory burden. The *large* bank CRA data collection and reporting requirements are **examples** of the ever **growing**, complex and costly regulatory burden for "small" community banks.

The **Large Bank CRA Investment Test** is mother area where **most community banks** cannot compete **and** is clearly skewed **towards truly large institutions**. Three multi-state/multi billion dollar banks- Wells **Fargo**, **US Bank** and **TCF** dominate the Minneapolis/St. Paul MSA. The **challenges** of competing with **them** for qualified investments in **this market are** daunting at best. **Although the** Investment Test performance criteria **guidance** contained with the regulation encourage investments that are "responsive" and "innovative", as we move towards large bank **CRA** in 2006 we are bracing for an investment arena that **will be** "unavailable" **and** "in Fargo".

Examination resource allocation

We believe the regulatory **agencies will** have a strong interest in seeing **an** increase for **what** asset size constitutes a large bank, **It is a continual** challenge to not only develop a staff **with** CRA expertise, but also meet **the maximum** time deadlines between **CRA** exams. The small bank **streamlined** examination process is much simpler for **examiners**, yet it accomplishes **the** goals of **the** CRA. **By not increasing** the threshold to \$500 million more **banks will be** subject to the more complex large bank exam. From a **risk** standpoint, one has **to** question if spending numerous hours analyzing complex loan **and community** data and **then** writing a carefully worded report for a **community bank** is the best use of agency resources. **It would be interesting to know** if the **agencies have analyzed** the cost **savings** to the examination **process** if the **large** bank threshold is increased from \$250 to \$500 million (affecting approximately 1100 **banks**). The savings has to **be** significant.

The proposal to increase the large bank threshold to at least \$500 million **is** an example of legislators, **regulators**, other **financial institutions** and community groups working to **forge** a more effective, yet **fair**, approach to **the** goals of **the** CRA. For legislators, the proposal ensures that the **spirit** and intent of **the** CRA remain intact. For regulators, the proposal allows **them** to reallocate examination assets to **better** match **risk**, schedules and examiner expertise. **And** finally, for both banks **and** consumer **groups**, the reduced **costs** of regulatory burden **will** assist **with** the continued viability of **community banks** and **also** add resources back to the community in the **form** of **new** loans, products **and** services.

Thank you for the opportunity to share our views on this important proposal.

Sincerely,



Heidi R. Gesell
President and CEO

William J. Patient
CRA and Compliance Officer