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March 11, 2004

(170)

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
Docket No. R-1181

Communications Division
Office of the Comptroller of the Currency
Docket No. 04-06

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation

Chief Counsel's Office
Office of Thrift Supervision
No. 2004-04

Re: CRA Interagency Proposal

Dear Sir/Madam:

The California Bankers Association (CBA), a trade association established in 1891, representing banks and savings institutions in California (hereafter, simply "banks"), appreciates this opportunity to comment on the interagency proposal to amend the regulations promulgated under the Community Reinvestment Act. CBA's members comprise of almost 90 percent of the banks and savings and loan associations in California (hereafter, "banks"), ranging in size from several million dollars in assets to hundreds of billions.

We commend the agencies' ongoing efforts to update and improve the regulations issued under the CRA. As discussed more fully below, CBA strongly supports increasing the asset size limit below which banks are eligible for less complex CRA examinations. We understand that, at this time, the agencies are submitting three specific proposals for comment: adjusting the definition of "small institution;" considering violations of other laws when assigning a CRA rating; and modifying the contents of public evaluation files. We also provide additional comments on other, non-specific, changes that the agencies suggest they may make in the form of interpretations, guidelines, and examiner training. We provide comments on the following issues: balancing quantitative and qualitative factors; investment test; service test; and the treatment of purchases and originations of home mortgages.

"Small institution." It remains a viable presumption today that a small bank meets the credit needs of its community if it makes a certain amount of loans relative to deposits taken. A small 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. We agree with the agencies' observations that raising the threshold is justified given substantial asset growth and consolidation in the industry. This reasoning is doubly appropriate in a more populous state such as California, where a single branch can exceed the current $250 million threshold. It is also appropriate to disregard the existence of bank holding companies when setting the limit, as this factor has little or no bearing on whether or how a bank meets the credit needs of its community.

Under the existing rules, a bank with more than $250 million in assets faces a panoply of additional requirements that substantially increase regulatory burdens without necessarily producing additional benefits as contemplated by the Community Reinvestment Act. CBA continues to believe that some of these requirements, such as the investment and service tests, and the recordkeeping and reporting requirements are not specifically authorized by the statute. At any rate, under the current rules, banks as small as $251 million in assets are, in concept, subject to the same requirements as banks a thousand times larger.

Regardless of where the limit is set, we recognize it is unavoidable currently that banks above and below the limit are treated radically differently. This cliff effect is moderated to a degree by applying the concept of performance context but, at present, it is inescapable that the amount of time that a "large" institution close to the limit spends to comply with the regulation is disproportionate to the beneficial activities actually taken within the communities served. We believe a more rational, long term solution is to phase in specific regulatory requirements more gradually based on different asset-size ranges.

Until such time, CBA strongly supports adjusting the threshold, but $500 million is too modest a mark. In California even a $500 million bank often has only a handful of branches. Raising the limit to $1 billion rather than $500 million is appropriate in two important aspects. First, keeping a focus on lending would be entirely consistent with the purpose of the Community Reinvestment Act, which is to ensure that banks meet the credit needs of the communities they serve.

Second, raising the limit to $1 billion will have only a small effect on the amount of total industry assets covered under the more comprehensive large bank test. According to the agencies' own findings, raising the limit from $250 to $500 million would reduce total industry assets covered by the large bank test by less than one percent (from slightly more than 90% of total industry assets to a little less than 90%). The change will, however, have the salutary effect of reducing the number of banks subject to the large bank test by one half.

According to FDIC data available as of December 31, 2003, raising the limit to $1 billion will reduce the amount of assets subject to the more onerous test by only 4% (to about 85%). Yet, the additional relief provided would, again, be substantial, removing more than 500

additional banks (compared to a $500 million limit) from the large bank category. Accordingly, we strongly encourage the agencies to raise the limit to at least $1 billion.

Consideration of credit terms and practices. CBA and its members strictly support maintaining the highest standards when providing credit to customers, and ensuring compliance with all lending laws. Nevertheless, we are wary of the regulatory creep that is evident in the proposal to overlay compliance with other banking laws onto the CRA regulatory framework. The overriding purpose of the Community Reinvestment Act is to ensure that banks meet the credit needs of the communities they serve. The regulations promulgated under the Community Reinvestment Act should be strictly and narrowly crafted to advance the purposes of this underlying law and this law only. As already noted, we believe the regulations already overstep their legal tether by imposing onerous recordkeeping and reporting requirements, and by mandating investment and service activities that are, at best, only marginally related to the provision of credit.

Neither CBA nor its members doubt the importance of complying with the Equal Credit Opportunity Act, Fair Housing Act, Federal Trade Commission Act, HOEPA, RESPA, and TILA. But each of these laws was passed by Congress at different times to achieve different and distinct purposes. Each includes its own compliance mechanisms and specifies the consequences of violations. Compliance with each of those laws is already strictly monitored by the agencies and others, in accordance with the intent of Congress when passed.

We are not aware of any authority in the Community Reinvestment Act or in these other statutes (and the agencies have not proffered any available authority) that permits the agencies by regulation to consider compliance with separately-passed acts when assessing a bank's compliance with the Community Reinvestment Act. To do so is to arrogate to administrative agencies the power to enhance (i.e., alter) the enforcement scheme of underlying laws, an activity that is clearly legislative in nature and outside of the legal purview of administrative agencies.

We are particularly troubled by any attempt to tie CRA assessments with the still-amorphous concept of predatory lending. The agencies note in the proposal that they will "consider all credible evidence of discriminatory, other illegal, or abusive credit practices that comes to their attention." We hope that the agencies would not look to compliance with local predatory lending laws that have proliferated in recent years, including in this state, which are so poorly and broadly drafted that, in several cases (including Oakland, California), ratings organizations refuse to rate <u>any</u> loans originated in jurisdictions in which they are passed.

One such ordinance proposed (but not yet passed) in another major California city defines a home loan as a covered predatory loan, *regardless* of fees or rates, if the creditor had violated *any* provision of TILA or RESPA. It is difficult enough that banks have to navigate their way through nonsensical and misdirected predatory lending laws and ordinances. To cross-enforce such laws with CRA assessments only compounds the unfairness.

More specifically, the agencies propose to develop specific rules addressing "equity stripping," one of the "central characteristics" of predatory lending. This is the practice of making home-secured loans without regard to borrowers' ability to repay. Of course, CBA member banks condemn these unscrupulous practices perpetrated largely by loosely-regulated non-depository creditors in the marketplace. But the agencies' new emphasis suggests the need also to establish a bright line between a loan that is considered predatory and one that is innovative, particularly when, in the course of meeting its CRA obligations, a bank makes loans on terms that normally would not be acceptable under conventional underwriting standards.

Lastly, while the agencies suggest that the proposed change will not entail specific evaluations of individual complaints or loans, banks can hardly take comfort in the direction in which this proposal leads. The proposal is fraught with the promise of further reporting and other complexities. The proposal to consider the activities of banks' affiliates would add yet another layer of complexity and another basis for extra paperwork. We fear that these proposals are exercises in administrative experimentation that serve only to bring about the continued transformation of the CRA regulations and, in view of the clear statutory purpose of the Community Reinvestment Act, to make them unrecognizable. For the foregoing reasons, CBA opposes the proposed enhancements to section __.28(c) of the regulations.

Public file (originations v. purchases). The agencies propose to distinguish between mortgage purchases and originations in banks' public evaluations. While this change would not result in additional burdens on banks, CBA nevertheless does not support the change. Underlying this proposal is the implication that purchases are not as desirable as originations under CRA. Not only is there no statutory basis for making this distinction, but we maintain that the public benefits of purchasing loans may be under-appreciated. There is little doubt that the availability of capital for secondary market purchases of mortgages has vastly enhanced their availability and affordability. Also, treating originations and purchases differently under the lending test establishes another degree of complexity for which little benefit is achieved.

Other comments. These are comments to future guidance not specifically proposed at this time.

Qualitative/quantitative standards. The agencies may seek to clarify through interagency guidance how qualitative considerations should be applied when assessing a bank's lending, investments, and services. We recognize the difficulty of crafting clear regulations and applying them in a manner that achieves the potentially conflicting goals of flexibility and consistency. This issue is particular pertinent to the investment test. The agencies have received comments from banks about the challenge of finding suitable investment opportunities, where competition for the best opportunities can be fierce. Over the years, CBA has expressed concerns that the investment test places too much weight on quantitative factors.

At the same time, CBA members continue to voice frustrations over differential treatment by examiners from one year to the next, by examiners of different banks supervised by the same agency, and by examiners among different agencies. Moreover, the two qualitative factors specifically addressed in the regulations—innovation and complexity—in some ways have

become enshrined as ends in themselves, such that their absence can be the basis for preclusion from a higher rating. A bank should properly receive recognition for finding innovative ways to engage in CRA activities where conventional opportunities are lacking or where a transaction could not be made through conventional means. But if a bank can best respond to the needs of its community by providing conventional forms of loans, investments, and services, then the absence of innovation is irrelevant.

The tension between being consistent and flexible can be ameliorated through examiner training within each agency and better coordination among different agencies. Some uncertainty can also be eliminated if a bank's CRA performance is judged against its own strategic focus. If the performance context is prepared by the bank, then it should be entitled to deference. Any examiner-generated performance context information that will be used should be communicated to the bank as early as possible prior to an examination.

Investment test. The agencies may develop additional interagency guidance on the investment test. CBA emphasizes again that, because there is no statutory basis for the investment test, this test should not be a mandatory element of the CRA examination. Nevertheless, as its elimination appears unlikely, in the alternative, we generally support the agencies' proposed clarifications.

We support any guidance to clarify that the investment test is not to be a source of pressure on banks to make imprudent equity investments. This clarification contemplates the possibility that, in some areas, suitable investment opportunities are lacking, or that opportunities can be found only with an unreasonable amount of time and effort. Therefore, any guidelines should acknowledge this possibility, and further clarify that banks confronted with such limitations would not be penalized. For the same reason, we also support guidance on counting community development activities outside of assessment areas, as long as any effort taken to search beyond a bank's assessment areas is at the bank's option. Any blanket requirement to look for opportunities beyond a bank's assessment areas would only ensure increasing finding and due diligence costs.

As noted above, we agree that the presence of "innovation" and "complexity" is applicable only in recognition of a bank's efforts to engage in CRA activities where a transaction could not be made through conventional means. We also agree that guidance would be useful regarding the treatment of prior investments and commitments for future investments. Appropriate weight should be given to investments already on the books. We believe that the duration of an investment depends on factors that should be unrelated to a bank's CRA examination cycle, and that banks should not be expected to churn investments to satisfy CRA requirements.

Finally, as to demonstrating the "primary purpose" of an investment of serving low- and moderate-income people, our members have suggested that establishing proof is often painstaking, and good investments are passed over even though the benefits to communities at large, or to particular segments of a community, are evident, albeit difficult to substantiate. Few organizations engage in activities and serve segments of the community in ways that are entirely

consistent with, and recognized by, the CRA regulations. Also, it is not always feasible, with respect to a broader investment vehicle, for a bank to direct funds only to narrow, acceptable activities within the investment. Therefore, CBA welcomes any guidelines to relieve the pressure on banks to track investments in order to document the provision of services to targeted individuals and communities.

Service test. The agencies did not indicate an intent to issue further guidance on the provision of banking services for low- and moderate-income persons, but we must respond to a comment made by "many" community organizations in this regard. We hope that the agencies will give no credence whatsoever to the suggestion that banks should report data on the distribution of deposits by income. It would be difficult to imagine a more efficient means of overwhelming banks with paperwork while simultaneously conducting a wholesale invasion of privacy on the populous, all for purported benefits that are, at best, dubious.

CBA appreciates the opportunity to provide this comment letter. We reiterate that we support any efforts to reduce unnecessary burdens associated with CRA compliance. Raising the "large institution" limit is a significant step forward in this regard. Please do not hesitate to call the undersigned if you have any questions.

Sincerely,

Leland Chan
General Counsel