April 6, 2004

Docket No. R-1181
Jennifer J. Johnson
Secretary of the Board
Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington, DC 20551

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

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

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

RE: Proposed Changes to the Community Reinvestment Act

Dear Ladies and Gentlemen:

The Conference of State Bank Supervisors (CSBS)[1] is pleased to have the opportunity to comment on the interagency Notice of Proposed Rulemaking (Proposal) to amend the regulations that implement the Community Reinvestment Act. The Proposal makes several significant changes that CSBS would like to address.

Amending the Definition of "Small Institution"

The Proposal suggests increasing the threshold definition of a small institution from $250 million to $500 million regardless of the institution's holding company status. It should be noted that by increasing the asset threshold for the definition of a small institution, the Proposal does not eliminate the obligations under the CRA regulations for any of the institutions under $500 million. Rather, if this change goes into effect, institutions with less than $500 million in assets would no longer have to comply with a series of requirements that large banks are subject to, such as data reporting and the investment test. This proposed change, therefore, expands the number of institutions that are eligible for evaluation under the streamlined small institution test.

[1] CSBS is the national organization of state officials responsible for chartering, regulating and supervising the nation's 6,500 state chartered commercial and savings banks and over 400 state-licensed branches and agencies of foreign banks.

CSBS understands that most community banks, by necessity, are required to be an active participant in and fully serve their community to remain profitable. Additionally, we have heard from small banks as to the increased difficulty and cost of meeting the requirements of the large bank CRA tests. We also recognize, however, that this change may have strong implications for rural and inner city areas. Taking these separate views into account, CSBS would like to work with the Federal regulatory agencies to more fully analyze the communities that could be most affected by this change and weigh these costs against our strong support for regulatory burden relief.

Proposed Definition for Predatory Lending

To better address abusive lending practices in CRA, the Proposal would amend the regulation to specifically provide that Federal agencies will take into account evidence that an institution, or any affiliate included in the institution's performance evaluation, has engaged in illegal practices, including unfair and deceptive practices. Specifically, the Proposal would make it clear that the Federal agencies will consider a pattern or practice of secured lending based predominantly on the liquidation or foreclosure value of the collateral in cases where the borrower cannot be expected to be able to make the payments required under the terms of the loan. Evidence of such abusive practices would adversely affect the institution's CRA performance evaluation.

CSBS feels strongly that the asset-based definition of abusive lending in this Proposal is not sufficient. The CRA regulations should note that there are numerous other factors that should be considered when determining whether the institution has participated in a *pattern or practice* of abusive lending and CRA regulations should make that very clear. CSBS does not support this narrow definition and discourages the Federal banking agencies from adopting this language as the de facto universal standard in connection with predatory lending activity. State governments have been on the forefront of defining and addressing predatory lending activity. CSBS would be happy to provide additional information on other types of abusive practices that have been identified by the state banking departments.

The Federal agencies note that other aspects of predatory lending, such as "loan flipping," the refinancing of special subsidized mortgage loans, and "fee packing" could also demonstrate evidence of unfair and deceptive practices that violate section 5 of the FTC Act. In this matter, the Proposal seems ambiguous and could be enforced on an uneven basis across the various Federal banking regulatory agencies. Instead of a general statement about having the authority to enforce section 5 of the FTC Act, the regulation should expressly state the lending activities (if noted as a *pattern or practice*) that will adversely affect an institution's performance evaluation. CSBS also encourages the Federal banking agencies to clarify that they **may** also consider the following predatory activity based on examiners' evaluations: equity stripping, loan flipping, large pre-payment penalties, negative amortization provisions, an extraordinary yield spread between a consumer's APR and the Treasury yield when total points and fees exceed a certain percentage of the total loan amount, as well as any other appropriate examples. CSBS also encourages the agencies to

consider requiring institutions to demonstrate a net tangible benefit for the consumer in obtaining the loan that would be apparent during the examination.

Furthermore as noted previously in this letter, 12 states have specifically provided a much more explicit definition of predatory lending. Violations of these state laws should be noted in and adversely affect an institution's performance evaluation.

Affiliate Lending

The Proposal notes that financial institutions can still elect to include affiliates on CRA examinations at their option. In this regard, CSBS would like to highlight a recent study by the Joint Center for Housing Studies of Harvard University[2], which chronicles the changing mortgage lending landscape. According to the study, "25 years ago banks and thrifts originated the vast majority of home purchase loans… Today, less than 30 percent of home purchase loans are subject to intensive review under CRA. In some metropolitan areas this share is below 10 percent." Much of this erosion of home purchase originations within the purview of CRA is attributed to a substantial portion of home purchase lending activity being conducted by mortgage brokers, finance companies, and affiliates/operating subsidiaries of depository banking institutions.[3] The past decade has witnessed a dramatic restructuring of the mortgage industry, including the explosion of mortgage banking operations taking place outside the actual depository institution. "Banking operations operating outside of their CRA assessment areas have expanded rapidly and today constitute the fastest growing segment of the residential mortgage market. As a result, between 1993 and 2000 the number of home purchase loans made by CRA-regulated institutions in their assessment areas as a share of all home purchase loans fell from 36.1 percent to 29.5 percent."[4] The Harvard study also found that some institutions would make good, prime loans within their assessment areas, while focusing on subprime lending activity outside the depository institution's assessment area.

By tapping into national and international capital markets and utilizing computer technology, larger banking organizations and their mortgage company affiliates have come to dominate the mortgage market. "By 2000, 25 lending organizations accounted for 52 percent of all home purchase loans that year."[5] With several mega-bank merger applications currently being reviewed and others expected to be announced, the trend toward consolidation of the nation's largest mortgage lending organizations is expected to continue.

Much of depository institutions' subprime lending is now being conducted through non-depository operating subsidiaries of these financial institutions and outside the reach of CRA. Furthermore, many of these operating subsidiaries, especially those owned by the largest

[2] May 2002, "The 25th Anniversary of the Community Reinvestment Act: Access to Capital in an Evolving Financial Services System," Prepared for the Ford Foundation by the Joint Center for Housing Studies, Harvard University, Cambridge, Massachusetts. The study can be located at http://www.jchs.harvard.edu/research/crareport.html.
[3] Ibid., page 4.
[4] Ibid., page 6.
[5] Ibid., Section 10, Conclusion.

banking institutions, are doing much of their subprime lending outside their deposit-taking assessment areas.

Although banking affiliates are addressed in the CRA regulations, there does not appear to be any reference to operating subsidiaries that are under the control of depository institutions. Neither interagency guidance to examiners nor the CRA Questions & Answers address how CRA examinations should scrutinize operating subsidiaries. The only guidance in regard to operating subsidiaries and CRA that CSBS could locate was from the OCC. OCC Bulletin 97-26 states, "In conducting the lending test, examiners consider affiliate loans – including loans made by operating subsidiaries – only if requested by the bank." In a letter to John Taylor, President and CEO of the National Community Reinvestment Coalition, dated October 20, 1997, the OCC states, "The CRA regulations do not require a bank to use its subsidiaries (or affiliates) to increase the lending and investments that are considered in the bank's CRA evaluation. Consideration of an affiliate's loans or qualified investments is distinct from the performance context… and is only done at the option of the bank." (emphasis in original letter)

The OCC's guidance, however, seems in direct contradiction to its recent assertion that national bank operating subsidiaries are considered a "department" of the bank. Furthermore, the OCC has stated that courts have consistently treated operating subsidiaries and their parent bank as equivalents, unless Federal law requires otherwise, in considering whether a particular activity is permissible. Although CSBS strongly disagrees with the OCC's preemption rule released the beginning of January 2004, those regulations include amendments to part 7 of the OCC regulations[6] codifying the OCC's belief that the bank and its operating subsidiaries are inexplicably linked so far as its regulations are applied. It would follow, then, that based on the OCC's recent interpretations, the agency would agree that operating subsidiary finance and lending activity, at the very least, should be considered during a CRA performance evaluation.

If CRA is to continue benefiting lower income people and communities, it must be modified to reflect industry changes and emerging financial services needs. Accordingly, CSBS urges the Federal regulatory agencies to expand not only the definition of depository institution to include operating subsidiaries directly under the institution's control, but also capture finance and lending activity outside the banking organization's assessment area. This would, therefore, extend the reach of CRA to all activities of the depository institution as well as of those entities under the control of the depository institution. As indicated previously in our comments, CSBS is very willing to work with the agencies, the industry, and consumer groups in evaluating the impact of this recommendation in the interest of balancing consumer protection goals against imposing additional regulatory burden.

[6] In the preamble to the rule, the OCC references operating subsidiaries as Federally-licensed entities that are subject to the same terms and conditions as apply to the parent bank. Thus, by virtue of preexisting OCC regulations, the changes to part 7, including the new anti-predatory lending standard applicable to lending activities, apply to both national banks and their operating subsidiaries. CSBS maintains that these operating subsidiaries are state-created and state–licensed corporations. Two court cases are currently outstanding on this issue. For more information on each of the arguments, refer to *Wachovia v. Burke* in Connecticut or *Wachovia v. Watters* in Michigan.

Additional Disclosure in CRA Public Evaluations

The Proposal would also modify the institution's public CRA evaluation. A public performance evaluation is a written description of an institution's record of helping to meet community credit needs, and includes a rating of that record. An evaluation is prepared at the conclusion of every CRA examination and made available to the public. The agencies intend to make publicly available HMDA and CRA data to disclose the following information in CRA performance evaluations by assessment area:

- The number, type and amount of purchased loans;
- The number, type and amount of HOEPA loans and loans for which rate spread information is reported under HMDA (data that will be available in mid-2005);
- The number, type and amount of loans that were originated or purchased by an affiliate and included in the institution's evaluation, and the identity of such affiliates.

CSBS supports providing additional data in CRA public evaluations. Additional data disclosure should provide more transparency and assist the public in determining if an institution is fulfilling its requirements under the CRA rules, without imposing additional burden onto an already highly regulated banking industry.

Conclusion

CSBS believes that cooperative efforts between state and Federal authorities to ensure that financial institutions fully understand compliance requirements, especially in regard to low-income people and communities, will have a greater impact than individual efforts at either the state or Federal level. We would welcome opportunities to work with the Federal regulatory agencies to develop joint initiatives and guidance in this area. Thank you for your consideration and we invite you to call on us if we can provide additional information on any of the state initiatives noted in our letter.

Best Personal Regards,

Neil Milner
President and CEO