167

NEW JERSEY LEAGUE
COMMUNITY & SAVINGS BANKERS
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October 16, 2001

Office of Thrift Supervision
Regulation Comments
Chief Counsel's Office
1700 G Street, N.W.
Washington, DC 20552

Re: Docket No. 2001-49 - *Community Reinvestment Act Regulations*

Dear Sir or Madam:

The Compliance and Community Reinvestment Act Committee of New Jersey League – Community & Savings Bankers* ("the League") appreciates this opportunity to comment on the banking regulatory agencies advance notice of proposed rulemaking on the Community Reinvestment Act (CRA) regulations.

Large Retail Institutions

Do the regulations strike the appropriate balance between quantitative and qualitative measures, and among lending, investments, and services? If so, why? If not, how should the regulations be revised?

No. The regulations do a poor job in evaluating the qualitative measure of CRA activities, particularly in the lending test. For example, a loan made to create affordable housing units receives credit for just one single loan. That single loan, however, may have provided affordable housing opportunities for many low- or moderate- income individuals. There is no mechanism within the reporting system to provide a quantitative measure (number of units provided) of the effects of this loan. Therefore, it is up to individual examiners to consider the qualitative measure (the impact) of this loan in a local community. Under the lending test, where institutions are being evaluated against aggregate lenders, this qualitative piece needs to be included. Two loans originated in a low- or moderate-income area that resulted in the building of 50 affordable housing units will probably have a greater impact on a community than two single-family loan originations.

* The New Jersey League – Community & Savings Bankers is a trade association representing 71 of New Jersey's savings banks and savings & loan associations with total assets of over $50 billion and 5 commercial banks. The League's wholly-owned subsidiary, the Thrift Institutions Community Investment Corporation ("T.I.C.I.C.") assists League members in forming consortia to make loans on low-to-moderate income housing projects. T.I.C.I.C. has facilitated loans on over 3,100 affordable housing units throughout New Jersey and has loans in process on over 1,100 more housing units.

In keeping with the spirit of CRA, to assess an institution's record of helping to meet the credit needs of local communities, greater value should be placed on the efforts made by financial institutions to prepare people before they take on additional debt. There are too many "CRA Loan programs" available that give additional credit to individuals who will not be able to repay the debt. Financial institutions should never place people in a position of accumulating too much debt, even in the name of CRA. When a financial institution is compared to all aggregate lenders, these special loan programs offered by some lenders are included in the equation. Therefore, this quantitative measure of CRA performance, in terms of number of loans, does not always provide an accurate assessment of how financial institutions are helping local communities in their quest to receive credit.

Financial institutions should not be judged on geography-based standards. They can provide more innovative and effective loan programs and community programs if freed from this artificial restriction.

Does the lending test effectively assess an institution's record of helping to meet the credit needs of its entire community? If so, why? If not, how should the regulations be revised?

No. The CRA encourages financial institutions to provide loans to all areas of its community, including low- and moderate-income areas. Some financial institutions originate a large number of loans in a given year because they conduct business in several counties. These high-volume institutions are penalized when percentages of low- and moderate-income area loans are calculated. For example, if a financial institution originates 300 loans in a year, with 10 being in low- or moderate-income areas, the percentage of loans in low- or moderate-income areas is 3.3%. However, if another financial institution originates 1000 loans in a year, with 20 being in low- or moderate-income areas, the percentage of loans in low- or moderate-income areas is 2%. During the exam process, the difference in percentages is sometimes viewed as a large discrepancy. The extent to which an examiner takes this difference into consideration appears to be a very subjective area. While the exam procedures address this disparity to a certain extent, it does not always receive a great deal of consideration.

Additionally, many small institutions are major contributors to the well-being and economic viability of local communities and groups that support those communities. Focusing strictly on loans ignores these many other ways in which an institution can benefit its communities.

Does the service test effectively assess an institution's record of helping to meet the credit needs of its entire community? If so, why? If not, how should the regulations be revised?

No. Some of the activities included in the service test are not given adequate consideration, yet they are very labor intensive and directly impact lending activity in the local community. Specifically, participation in the Federal Home Loan Bank's Affordable Housing Program and First Home Club come to mind as activities that (wrongly) receive minimal credit in the service test. The former requires submitting very complex applications for grant funds for affordable housing projects, and, if the applications are successful, spending a great deal of time on paperwork to draw down the funds, then monitoring the project's compliance for ten years. The latter involves counseling low-to-moderate income households on budgeting, setting up savings programs, monitoring the monthly and processing additional paperwork to draw down the grant funds in conjunction with the home purchase and mortgage. When credit is granted for educational types of services, it does not appear to be given a great deal of weight.

Other activities such as "build days" for local chapters of Habitat for Humanity also are not "qualified CRA services." Yet, financial institutions still choose to participate because the collaborative efforts of these types of activities has a great impact on the ability of Habitat to produce affordable housing units. These activities, and others like them, deserve a much greater level of credit, perhaps tied in with the lending test where the credit received is more significant.

Are the definitions of "community development" and related terms appropriate? If so, why? If not, how should the regulations be changed? Are the provisions relating to community development activities by institutions that are subject to the lending, investment, and service tests effective in assessing those institutions' performance in helping to meet the credit needs of their entire communities? If so, why? If not, how should the regulations be revised?

No. The definition of "community development" is too narrow to truly assess a financial institution's record of meeting the credit needs of its local communities. The regulation specifically states that community development loans, investments and services must relate to low- or moderate-income areas, low- or moderate-income individuals, or small business financing. There are times, however, when a middle- or upper-income community may need some type of revitalization. While it is important to assist our low- and moderate-income areas, it is also important to maintain other communities in our assessment area. For example, many of our local communities wish to undertake "downtown improvement" projects in an effort to keep business owners in business. Financial institutions often choose to participate in special loan programs to assist these businesses. Unfortunately, many of these local communities are in middle-income or upper-income areas. Therefore, no "community development" credit is received even though these programs play an important role in maintaining these communities. The Community Reinvestment Act provides that regulators are to ". . . assess the institutions record of meeting the credit needs of its <u>entire community</u>, including low-and moderate-income neighborhoods. . ." (*emphasis added*). Additionally, as mentioned earlier, community development loans are reported as single loans. There is no mechanism in the reporting process to measure the number of affordable housing units created from one community development loan.

<u>Small Institutions</u>

Do the provisions relating to asset size and holding company affiliation provide a reasonable and sufficient standard for defining "small institutions" that are eligible for the streamlined small institution evaluation test? If so, why? If not, how should the regulations be revised?

The streamlined small institution approach should be applicable for institutions with assets of at least $500 million. Smaller institutions face particular hurdles in cultivating CRA-eligible loans. These institutions have relatively small staffs along with limited marketing and advertising budgets. Many are forced to buy eligible loans at a premium from larger and more sophisticated lenders, who are often times their competitors, in order to meet CRA obligations.

<u>Strategic Plan</u>

Does the strategic plan option provide an effective alternative method of evaluation for financial institutions? If so, why? If not, how should the regulations be revised?

Not in the present CRA scheme. If it were effective, the strategic plan option would be readily and often used today. Institutions should be given greater flexibility to devise and execute a self-created CRA plan in a more broad-based CRA scheme.

Performance Context

Are the provisions on performance context effective in appropriately shaping the quantitative and qualitative evaluation of an institution's record of helping to meet the credit needs of its entire community? If so, why? If not, how should the regulations be revised?

In the difficult and changing area of housing and lending, specific and quantifiable measures can often be misleading or of little help. Should an institution that has the ability and the market to generate low- and moderate-income loans be allowed to pass for doing the mere minimum, while a hard-working institution in an area that offers few lending opportunities be criticized for not making the minimums?

The performance context should also go beyond the demographics of a particular assessment area. For example, for recent exam periods, the disastrous effects of Hurricane Floyd in New Jersey prompted financial institutions to create special loan programs to help people rebuild. The effects from Hurricane Floyd were not necessarily experienced in low- or moderate-income areas. Nevertheless, rebuilding efforts were vital to sustain some of our middle- and upper-income areas. It is not clear that a great deal of CRA credit will be received for these activities. Again, the CRA requires assessment of how well an institution meets the credit needs of its entire community, not just the portion classified as low- to moderate-income.

Assessment Areas

Do the provisions on assessment areas, which are tied to geographies surrounding physical deposit-gathering facilities, provide a reasonable and sufficient standard for designating the communities within which the institution's activities will be evaluated during an examination? If so, why? If not, how should the regulations be revised?

The concept of "assessment area" is outmoded and should be eliminated as it often hinders CRA activities. It should be replaced along with the "small bank"/"large bank" tests currently used. Consideration should be given to replacing the current scheme with two or more "tests" that do not rely on size. Each bank would be required to choose the test most appropriate to its operations.

One test could replicate the current "assessment area" test. An institution that operates as a community bank in defined neighborhoods, served by distinct branch sites, may choose to be judged on its efforts in those areas. A second test could look at the overall efforts of an institution to enhance affordable housing efforts without restrictions of an assessment area. The institutions could choose projects, programs or geographic areas to enhance affordable housing without the restriction of meeting specific percentage tests in defined areas. This type of test might encourage strong support for innovative loan programs and housing projects that would otherwise have difficulty finding funding. A third test could separately target for low- and moderate-income borrowers, so that a single institution could concentrate its efforts on those census tracts within its branch network, but also receive credit for loans to low- and moderate-income borrowers outside of those areas. A fourth test could be the current "strategic plan" option, an open-ended option, but better defined to draw more interest. Now that CRA examinations will fall, for the most part, in four-year intervals, this plan could become more popular. Interim review initiated by the institution (not full examinations) could give an institution the ability to change approaches during the period between examinations to encourage greater use of this option.

Affiliate Activities

Are the data collection and reporting and public file requirements effective and efficient approaches for assessing an institution's CRA performance while minimizing burden? If so, why? If not, how should the regulations be revised?

Financial institutions that originate loans through the Small Business Administration often find themselves struggling with their inability to include them as Community Development Loans. The regulations mandate that we report these loans as small business loans. Financial institutions should be able to "double-count" some of these loans as community development loans. Often, SBA loans are originated to start-up businesses that would normally not be able to obtain financing through traditional commercial lending guidelines. It is up to the financial institution to maintain information on these types of loans for examiner consideration.

Additionally, there are many discrepancies that exist in terms of how HMDA loans are reported. Because HMDA data is a primary tool used in evaluating a financial institution against other lenders, there needs to be greater consistency in terms of what loans need to be reported.

Should the examination guidelines be revised or is there a need to add more or different examiner training?

There needs to be some additional consistency in the examination process. Although the CRA regulations are now more focused than they were previously, there is still a great deal of subjectivity in the process. While this subjectivity cannot be completely eliminated, it would be helpful if all examiners followed similar procedures. For example, some examiners appear to place a great deal of emphasis on aggregate lenders, while others may place more emphasis on regulated lenders only. The degree of emphasis may result in very different lending test results. It is difficult to compete with lenders who are not operating within the same safety and soundness constraints that we face. If all aggregate lenders are going to be used, then there should be some consideration given to the performance context within which they operate, and appropriate adjustments should be made.

If you have any questions, please contact Jim Meredith at (908) 272-8500, extension 614.

Sincerely,

Samuel J. Damiano
President

SJD/jmm