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236

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Ms. Jennifer Johnson
Secretary, Board of Governors
of the Federal Reserve System
20th Street and Constitution Ave., N.W.
Washington, D.C. 20551

Attn: Docket No. R-1112

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

Attn. Docket No. 2001-XX

Ladies and Gentlemen:

Capital One, F.S.B. and Capital One Bank (together, "Capital One") are pleased to submit comments regarding the _Joint Advance Notice of Proposed Rulemaking: Community Reinvestment Act Regulations_ issued on July 19, 2001.

Capital One Financial Corporation, Falls Church, Virginia (together, with all of its subsidiaries and affiliates, "Capital One") is a holding company whose principal subsidiaries, Capital One Bank, Glen Allen, Virginia and Capital One, F.S.B., Falls Church, Virginia, offer consumer lending and deposit products, including credit cards, installment loans, and automobile financing.

Capital One had 38.1 million customers and $35.3 billion in managed loans outstanding as of June 30, 2001. A Fortune 500 company, Capital One is one of the largest providers of MasterCard and Visa credit cards in the world.

Capital One firmly believes in the goals of the Community Reinvestment Act (together with its implementing regulations, the "CRA") – financial institutions have an obligation to help meet the credit needs of their entire communities, including low and moderate income areas and individuals. However, Capital One also believes the regulations that implement the CRA should be revised to accommodate and address advances in technology, modernization within the financial industry, and the creation of new business models and strategies that have occurred over the past several years. Clearly, the 1977 law and the revisions to the CRA regulation that were issued on May 4, 1995, did not adequately anticipate or address the issues shaping the financial industry today and the forces creating the financial industry of tomorrow. In that regard, the formation of national direct lenders, the passage of interstate banking laws, the creation of "virtual" financial institutions, and the proliferation of financial services delivered through telephone and electronic media were non-existent in 1977.

In some ways, Capital One is similar to traditional retail, "brick and mortar" financial institutions. Like these banks, we provide loans, take deposits, and offer other financial services. More broadly, however, Capital One is not at all a traditional bank.

- Capital One's banks are both national and global (not local) in opportunity and scale.
- We deliver financial services and products via mail, telephone and the internet.
- As a "branchless" banking institution, we do not maintain physical locations to deliver services.
- Our products and services are available and accessible to customers twenty-four hours a day, 365 days a year.
- We apply new technology and innovative business strategies to common industry products to create innovative financial solutions uniquely personalized for each customer.

Capital One was created and shaped by the needs and demands of the customers and the communities we serve. Compliance with the CRA as it stands today, however, is particularly difficult because our business model is not that of the more traditional "large retail bank". If we are required to meet the same requirements as banks that have branches and clearly defined service areas, we will have to alter our successful business model. This, in turn, could lead to a reduction in product and service offerings, and eventually result in limited consumer choice and limited access to financial services.

There are several areas where we believe the CRA creates an unequal burden on institutions like Capital One. These issues, as well as suggestions for revision of the CRA, are identified below.

Areas of Unequal Burden and Suggested Revisions in the CRA Regulation

1. Bank Designation

Area of Concern

Although the CRA accommodates wholesale and limited purpose institutions, recognizing that these businesses differ from traditional depository institutions, the CRA does not make adequate provision for financial institutions that exclusively employ alternative, non-branch delivery systems as their primary distribution channel. In recent years, several "non-traditional" financial institutions have been launched which rely exclusively upon telephony, Internet, or direct mail to serve and correspond with their respective customers. Non-traditional institutions such as Capital One, which do not employ retail branch networks, operate at a severe disadvantage in respect of compliance with the CRA. In effect, non-traditional institutions are being required to emulate the products, services, operations, and business models of "brick and mortar" institutions solely in order to meet the requirements of the CRA (like local service requirements), while maintaining and supporting their existing business strategy. We do not believe that this result is consistent with the original spirit or intent of the CRA.

Suggested Revision

We propose that non-branch, national lenders be treated in a manner similar to wholesale and limited purpose banks. These institutions would be subject to a modified community development test, which in turn would examine an institution's community development lending, investments, and services in their entirety, *including activities outside of the assessment area*, provided that the bank is also helping to meet the credit needs of its local assessment area. Under this scenario, Capital One could look to expand its CRA lending and investment activity to communities throughout the country where we have non-bank operations or where our associates reside.

Currently, Capital One associates spend over 50,000 hours annually volunteering in their respective communities. Capital One could build upon this activism by significantly increasing community development loans and investments to low-to-moderate communities outside of our current assessment area. If all non-branch national lenders were allowed to pursue this strategy, billions in additional capital would potentially be accessible to low-to-moderate communities across the country – which is the ultimate goal of CRA -- rather than being trapped in one local assessment area.

In addition, consideration should be given to allowing such institutions to take CRA credit for mortgages and small business loans (assuming these types of loans are regularly offered by the bank) that the bank makes outside its assessment area. Under this option, these banks would continue to provide the credit to low- to moderate-income communities and borrowers that they have done in the past plus they would expand their community development lending, investments and services to many states and communities beyond their immediate assessment area.

2. Assessment Area

Area of Concern

For many of the same reasons, Capital One is also concerned about assessment area designations. CRA assessment areas are linked to the deposit-taking branch systems and ATMs employed by the majority of retail banks and thrifts. Because institutions like Capital One do not employ retail branches for the delivery of their products and generally acquire deposits nationally, identifying an appropriate assessment area can be quite difficult and confusing for both the institution and its regulators. In addition, the lack of physical presence makes outreach efforts and identification of appropriate loans and investment opportunities within a local assessment area more difficult.

Suggested Revision
One of the principal obstacles for a non-branch national lender is the increasingly obsolete construct of the local assessment area. For example, consider the assessment area for Capital One, F.S.B.:

- Contains Fairfax County, City of Fairfax, City of Falls Church, and City of Alexandria.
- Has only one low-income census tract out of 249. Only 19 moderate-income tracts.
- Has only 700 low-income households out of 357,735 total (0.20%). Only 35,677 households were identified as moderate-income (less than 10.00%).
- There are 39 competing financial institutions within the Assessment Area.
- Less than 0.64% of Capital One's loan and small business customers reside within the assessment area.
- A miniscule percentage of its deposits come from the assessment area.

Given the limited number of low- to moderate-income households and census tracts, coupled with the high number of competing banks with a retail branch presence, it has been very difficult for Capital One to identify profitable, sound lending and investment opportunities within its narrowly defined assessment area. Unprofitable investments, whether or not they qualify for CRA, are not in the best interest of our associates, the company, our community, and our stakeholders. As a consequence, and because our experience to date has been that investments we make for CRA purposes have considerably lower returns than other investments, we have had to limit the level of such investments. If we had more flexibility with regard to our definition of assessment area and our ability to provide loans, investments or services on more equal footing, however, we believe we would be able to make more capital available for community and economic development.

As we have no local branch lending operations, inherent limitations in our business model, with respect to skills, business strategy, and resources, also hinder our ability to serve our assessment area. The systems and operations within our business organization were created expressly to market our products and services over a broad geographic area. To tailor our products to meet the needs of a specific, narrowly defined geography such as our existing assessment area is costly and drains resources away from our primary business strategy. Similarly, to declare and serve a nationwide assessment area would be practically impossible, requiring the devotion of enormous resources, both financial and staff related and would be contrary to the original intent of the CRA.

We propose that the CRA be revised to allow for examiner flexibility in the application of the "inside/outside" test on core products. This test can encourage unsafe and unsound lending by non-branch, national lenders within their CRA assessment area, and reduce CRA lending in the surrounding areas. In addition, greater flexibility regarding assessment areas would allow institutions that experience difficulty in identifying CRA qualifying investments within narrowly defined assessment areas or areas which have very small low- to moderate-income populations to expand their reach in order to achieve CRA goals. These changes allow both traditional and non-traditional national lenders to "cast a wider net" in identifying quality community reinvestment opportunities without sacrificing local market knowledge and straining internal systems. It also provides an incentive for both traditional and non-traditional national lenders to participate in rural community investment initiatives where they do not have a physical retail presence, thus increasing access to capital overall.

As it stands, strict adherence to the current definition of assessment areas produce the ironic result of discouraging or limiting an institution's ability or willingness to serve LMI consumers. This phenomenon could not have been the original intention of the CRA.

3. Performance Evaluation

Area of Concern
Several areas within the performance evaluation create a severe disadvantage for non-branch institutions.

Lending Test - The lending test today represents the principal criterion comprising a bank's CRA rating. It is impossible to achieve a "Satisfactory" overall rating unless an institution receives at least a "Low-Satisfactory" rating on the lending test. This requirement, however, is not applied to the investment or services test. Thus, for institutions without retail branch networks, the lending test can create a substantial burden, particularly given the application of the "inside-outside" test and, as described below, the greater weight given under the CRA to home mortgage lending. Resources must be devoted to creating and marketing products that do not fit the business strategy of the bank, instead of a more appropriate focus on community development programs or community development investments.

In addition, the CRA emphasizes mortgage lending (indeed it is hard to achieve an "Outstanding" rating without an active program) which effectively discriminates against the lending products (e.g. credit cards, installment loans and auto loans) that may very well benefit low- to moderate-income communities in a more significant way. The bias in favor of mortgage lending fails to recognize that many low- to moderate-income borrowers can only buy homes after building a credit history, which now usually begins with a credit card product. An auto (and hence an auto loan) is often an essential requirement for having a job and thus income to pay a mortgage. These credit products are key entry vehicles to the financial system and building blocks towards owning a home. They are also critical to the stability of families and communities. Finally, compelling non-mortgage lenders to deviate from their core business in order to address such a "deficiency" is both illogical and unsound. Continuing this emphasis on mortgage loans impairs the ability of institutions that do not have mortgage operations to achieve high ratings under the current test, and discriminates between business models in a manner not intended by Congress.

Investment Test – As stated above, the overall CRA rating of a bank is heavily weighted towards an institution's performance under the lending test. Financial institutions that lack retail delivery systems or traditional lending operations must rely upon qualified investments, grants, and services to meet their CRA performance requirements. By its nature, equity capital presents greater risk than debt capital. Thus, the incentives to provide equity capital for CRA purposes are greatly diminished. Yet, the current regulation appears to assume that there are considerable CRA investment opportunities that would meet the test of safety and soundness. Based upon our experience and significant efforts, we have not found this to be the case.

Service Test – Capital One believes that the service test should be updated to recognize changes in the financial industry, particularly delivery methods and modern business strategy. The current regulation emphasizes the presence of traditional "brick & mortar" delivery outlets in low- to moderate-income areas to quantify performance under this test (including the availability of tellers walk-in facilities, etc.). In effect, the more service outlets that are accessible to low- to moderate-income populations, the better an institution's service test performance rating. Currently, financial institutions that operate without traditional branch networks are not contemplated within the regulation. This omission penalizes non-branch financial institutions and fails to recognize on-going technology developments and improvements in the delivery of products and services. We believe that delivering services over the internet is just as, if not more, "customer-friendly" – allowing a consumer to remain in the comfort of their own home. This inherent restriction also, in turn, negatively influences these institutions' overall CRA performance evaluation rating.

Suggested Revision

The dominance of the lending test, and its impact on the overall CRA performance evaluation, is an issue that affects all financial institutions. We believe that combining the lending and investment tests would give banks more flexibility to carry out their CRA mission in a manner that best fits their business strategy. Financial institutions could meet their CRA obligations by a combination of the two activities, participating in either lending or investments according to their organizational strengths and capacities. In addition, specific emphasis on mortgage lending should be re-evaluated and strong consideration given to according other lending products equal consideration. In short, remove the biases and encourage examiner flexibility.

This proposal would reduce or eliminate the burden of creating niche CRA lending and investing operations, which drain resources away from primary business activities and are often not profitable. This change would also clearly communicate the equal importance of both loans - *all types of loans* - and equity investments in meeting the credit needs of low- to-moderate communities, as well as creating a greater incentive to make more of these products available.

We propose measuring an institution's performance under the service test not by the number of distribution outlets within a low- to moderate-income community, but by the level of product innovation, new product testing, and delivery channel development. Under this scenario, all financial institutions would be measured by their ability to reach low- to moderate-income customers through means that are the most appropriate to their business strategy - whether the institution leverages local non-profit relationships, opens new branches, uses direct marketing, or modifies existing products to attract low-to-moderate customers. The result would be increased access and service to low- to moderate-income communities. As long as regulators continue to emphasize the opening of new branches as the sole means to serve low- to moderate-income populations, however, there will continue to be a disincentive for national lenders without branch networks to invest in new delivery channels to disenfranchised communities. Put simply, retail branches are costly to implement and operate, and are a cost prohibitive option for most non-traditional financial institutions. Finally, as discussed next, we would also like to see more tangible cognizance taken of an organization's volunteer activities and in-kind services under this test. We have found that we are able to make a measurable impact in our communities that helps to stabilize and improve them, but do not receive credit for Community Development Service.

4. Definition of Community Development Service

Area of Concern

There are a number of services/initiatives that have a long-term, permanent economic benefit to the local or regional community, which may not qualify as community development services under CRA. Examples of these types of initiatives include:

- *Youth Programs* - A study released by Vanderbilt University researcher Mark Cohen quantifies the potential benefits in saving a high-risk youth by estimating three lifetime social costs. Costs associated with the typical career criminal are pegged at $1 million to $1.3 million; a heavy drug user at $330,000 to $809,000; and a high school dropout at $291,000 to $466,000. Allowing for duplication of crimes committed by heavy drug users who are also career criminals, the formula arrives at an "overall estimate of the monetary value of saving a high-risk youth of $1.5 million to $2 million."

- *Literacy Programs* - Business spends $25 billion a year teaching workers reading and other basic skills. Added to that amount is the cost of accidents caused by poor reading and the lost purchasing power of semi-literate marginal workers. Among adults with low literacy skills, 43 percent live in poverty and 17 percent receive food stamps. In contrast, among adults with strong literacy skills, fewer than five percent live in poverty and less than one percent receive food stamps.

- *Workforce Development Programs* – Programs which prepare individuals to seek full-time employment or teach new job skills which enable workers to obtain higher wage earning jobs have a long term beneficial effect upon local economies and community stability.

The current regulation is very limiting in that it only provides credit under CRA if the community development service is related to the provision of financial services. Yet the definition of community development for purposes of evaluating loans and investments is much broader and includes "Community services targeted to low- or moderate-income individuals."

Suggested Revision

At a minimum, Capital One believes the definition of community development services needs to be expanded to include all activities which may have a beneficial effect on sustaining and stabilizing low- and moderate-income communities, similar to the definition of community development applied to loans and investments. Financial institutions, like other corporations, can and do serve their communities in a myriad of ways. Creating disincentives to broadening good corporate citizenship by effectively favoring some programs over others does little to advance the true goals of the CRA.

Capital One understands and supports the aims and goals of CRA and its focus on low- to moderate-income communities. With the changing demographics of America's inner cities - increasing in diversity of income, age, and ethnicity - the needs of our communities will become more diverse as well. As the needs of communities expand, it may be time to reexamine the definitions of community development activities. Perhaps, the measure of a community development activity should not be simply the degree to which it affects the low- to moderate-income population. Instead, possibly, the measure of a community development activity could be the degree to which that activity benefits a community as a whole, including but not limited to low- to moderate-income populations. This important distinction could enable financial institutions to support initiatives vital to building sustainable communities such as work force development, public health and education. Redefining community development activities is an issue worthy of further discussion and evaluation.

CONCLUSION

Capital One believes that the issues discussed above and the suggested revisions to the CRA will reduce artificial barriers and create incentives to deliver capital and other benefits to the communities we serve. While many of the banks in the country may be comfortable with the CRA as it currently stands, we believe that some improvements are overdue. Non-branch, and particularly national lenders were not well-contemplated by, and are not well-served by, the current regulations. In doing so, the industry and its regulators can together realize the goals for which the CRA was intended.

We thank you for this opportunity to comment on this important regulation and would welcome the opportunity to discuss these issues with you. Should you have any questions, please do not hesitate to contact me at (703) 875-1470.

Sincerely,

FR Borchert, III

Frank R. Borchert, III
Vice President, Deputy General Counsel
and Assistant Secretary