California Bankers Association
Established 1891

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October 17, 2001

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System

Communications Division
Office of the Comptroller of the Currency

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation

Chief Counsel's Office
Office of Thrift Supervision

Re: CRA Advance Notice of Proposed Rulemaking

Dear Sirs/Madams:

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 advance notice of proposed rulemaking ("ANPR") regarding the Community Reinvestment Act.

We commend the agencies for its efforts to improve the regulations issued under the CRA. CBA wholeheartedly agrees with the fundamental goals of issuing the ANPR, which are to consider any changes to ensure that the regulations properly focus on banks' actual performance in meeting the credit needs of their communities, to promote consistency in examinations, and to eliminate unnecessary burdens. Our comments will attempt to address some but not all of the questions raised by the ANPR. Because this is not a proposal of specific changes, we will provide general, high level comments without necessarily offering specific rule changes. We will provide more specific comments when specific changes are proposed.

Big Picture. As a threshold matter, we emphasize that should any changes be introduced, the agencies must ensure that the benefits of the change outweigh any new burdens. Most of our members not in the small bank CRA category are concerned that complying with CRA has become unnecessarily burdensome.

Several years ago, the CRA regulations were rewritten for the ostensible purpose of simplifying CRA by moving away from process (12 performance factors) and emphasizing actions--making loans, making investments, and providing services in the community. Banks are

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to be evaluated based on their particular circumstances (performance context) that allow for flexibility on how these goals are met.

In the few years since the revisions, banks in the small bank category have reaped the greatest benefit. Because banks with less than $250 million in assets operate within smaller, defined communities, the fact that they make a certain amount of loans relative to their deposits within their assessment areas sufficiently demonstrates that they are meeting the credit needs of their communities. CBA believes this presumption remains viable.

As to institutions with more than $250 million in assets, the work necessary to prepare for examinations evokes the old, process-driven CRA. While some of the burdens of the former CRA regulation were eliminated, the updated CRA added new requirements, such as the investment and service tests, and new recordkeeping and reporting requirements, none of which is specifically authorized by the statute. A mark of a successful CRA regulation is how much time a CRA officer spends taking actions beneficial to the bank's local community compared with work required solely to prepare for examinations. Some of our members feel that the need for documentation in support of CRA activities has steadily increased.

With respect to smaller institutions that fall above the $250 million cutoff, the data collection requirements are particularly burdensome. As noted to CBA by a member bank that recently passed the cutoff mark, its recordkeeping, reporting, and examination preparation requirements represented an additional cost of over $50,000 unrelated to the investment of new dollars or services into its community. CBA asks that the agencies reassess the data collection and reporting requirements to ensure that the burdens created by these requirements justify what benefits they may bring.

Lending, Investment and Service Test/Balance. A bank's record of meeting the credit needs of its community should properly remain the central focus of CRA. The statute itself addresses the credit needs of a community, and does not refer to investments and services. Banks have differing views about the proper balance among the three test. Some view the three tests as different opportunities to meet CRA requirements, and others find it a burden to find suitable investments and services.

The existing, three-test approach would be improved if banks were given more discretion to satisfy CRA through the three tests in a manner appropriate to their particular situations. Thus, under the large bank examination procedures, a bank, at is option, should be able to satisfy its CRA obligations by relying primarily on making qualifying loans. Those that wish to continue to rely on investments and services may elect to do so. This approach would allow for maximum flexibility for each bank to be responsive to the specific needs of its community. We discuss other specific concerns about the investment test in another section.

Qualitative/Quantitative Standards. Banks and examiners rely on a bank's performance context to assess CRA performance, so standards must have both quantitative and qualitative elements. As already discussed, we recommend that the data collection requirements of CRA, including documentation associated with the investment and service tests, should be reevaluated and streamlined where appropriate. For example, there might be streamlined data collection requirements for banks that do not make more than a specified number of reportable loans.

Many of the concerns of our members center on the inconsistency and uncertainty of CRA examinations. The agencies should explore means of reducing sources of uncertainty arising from factors unrelated to the intended flexible approach of the revised CRA. These factors may include issues such as examiner training, consistency of focus by examiners from year to year, and more communications between examiners prior to the examination. Uncertainties in the existing regulations and guidelines include what constitutes a community development loan, how loans are treated where only a portion of the proceeds is intended to benefit LMI individuals, what activities are "innovative," and many aspect of the investment test.

Some examiners apparently believe that a bank cannot achieve an outstanding CRA rating unless its activities are innovative and complex. This is the wrong approach. If conventional lending, investment and service opportunities are available and a bank actively seeks them out, then the fact that those opportunities lack aspects of creativity should not hurt a bank's rating. Nor should it prevent a bank from achieving an outstanding 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. Innovation and complexity cannot be ends in themselves.

How examiners treat a bank's performance context is another key to achieving a degree of certainty. A bank's CRA activities are judged against its own strategic focus, the activities of other comparable banks, and the needs and opportunities in its community. If the performance context is prepared by the bank, it should be entitled to deference. If elements of an examiner's performance context for the bank is relied upon, then the examiners should be required as early in the process as possible to obtain the bank's concurrence.

CBA is also concerned that examinations are far from uniform across agencies. For example, one agency should not evaluate the level of a bank's investments in relation to its Tier 1 capital while another agency as a percentage of total investments. Uniformity among agencies is an important issue because, in one fashion or another, banks are judged against each other both by examiners and the public. The agencies should place a high emphasis on ensuring not only

that the CRA regulations are standard, but that CRA training and examinations are uniform across agencies.

Investment Test. Because there is no statutory basis for the lending test, this test should not be a mandatory element of the CRA examination. Smaller institutions find it increasingly difficult to compete with larger ones for the best investment opportunities. They can compete neither on the amount of resources to invest or the amount of risk to assume, and are left to spend a great deal of time finding scarce investment opportunities. This challenge is exacerbated by examiners' narrow reading of what constitutes community development under the investment test.

Examiners give credit to those investments that benefit low-to-moderate income (LMI) areas or fulfill a community development purpose. But few investments or grants neatly meet these criteria. Most organizations engage in activities or a mix of activities that may or may not clearly benefit targeted LMI areas or individuals. Even when a CRA officer finds an organization that is appropriate, she must still conduct time-consuming documentation to substantiate that funds are directed to acceptable activities. Some investments may be passed over altogether even if they would benefit an LMI area because substantiating the flow of funds is deemed to be too difficult. In the end, the CRA officer faces the task of convincing a skeptical examiner and would likely obtain only partial credit for her efforts. In addition to our prior suggestion to liberalize reliance on the investment test, CBA also recommends expanding the scope of qualifying investments and clarifying the regulations and guidelines accordingly.

Numbers Game. Some CBA members indeed believe that examiner expectations of the adequate level of CRA activities are ever increasing. This is caused, in part, by the fact that banks are given little guidance on how many loans or investments are "sufficient" to achieve a satisfactory or outstanding rating. Because examiners have exposure to other banks through exams, the activities of the highest performer, one way or another, becomes the benchmark for everyone else. Thus, the bar is constantly raised. The agencies should seek ways to address this expectation creep.

Originations vs. Purchases. Since there is no statutory basis for making a distinction between originations and purchases for CRA purposes, CBA would not support this change. Both originations and purchases result in loans being made. Also, treating originations and purchases differently under the lending test establishes another degree of complexity for which little benefit is achieved.

However, we would not oppose additional credit being given to a bank, under the service test for example, to the extent that it provides other value along with originations, such as operation of a branch in a LMI area and providing credit counseling. But we emphasize that recognizing these additional services should not also require that the purchase of loans receive discounted credit compared to originations.

Predatory Lending. The serious issue of predatory lending is being addressed in legislatures at all levels throughout the country. We find, in general, that these efforts are not satisfactory, partly because of the difficulty of defining predatory lending. HUD and the Treasury have determined that there may be elements of age and race discrimination associated with predatory lending. Thus, screening for predatory lending is and should remain an appropriate subject of inquiry under the fair lending examination.

Large Bank Test Threshold. Banks with assets of greater than $250 million are assessed under the full large bank test. While we understand that a cutoff at any level is somewhat arbitrary, in California, a $300 million bank has much more in common with a $100 million bank than with a $5 billion bank. CBA recommends that the cutoff for large bank examinations is raised substantially to at least $1 billion. Alternatively, a mid-level category should be created for banks between $250 million and, say, $1 billion in assets, who would be subject to something less than the full blown large bank examination procedures.

Assessment Area. In general, we find that examiners are not questioning banks' designation of assessment areas. It is important that examiners remain deferential to a bank's performance context particularly when it has recently opened an office in a new area. Some CBA members have expressed concerns that examiners on occasion fail to make this distinction and look to market statistics of banks that are more established in the area.

CBA appreciates the opportunity to provide this comment letter. We reiterate that we support any efforts to reduce unnecessary burdens associated with CRA compliance, to return the focus on performance, and to foster more consistency in examinations. Please do not hesitate to call the undersigned if you have any questions.

Sincerely,

Leland Chan
General Counsel

for Mary Lou Bonkofsky
Member, CBA Regulatory Compliance Committee