ICBA
INDEPENDENT COMMUNITY BANKERS of AMERICA

January 24, 2005

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: No. 2004-53

Re: Community Reinvestment Act – Community Development, Assigned Ratings, No. 2004-53

Dear Sir or Madam:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to comment on the Office of Thrift Supervision's (OTS) proposed revisions to the Community Reinvestment Act (CRA). The ICBA applauds the OTS for taking steps that will help alleviate the regulatory burden driving many community banks out of their communities by causing them to either sell or merge with larger institutions with greater resources to manage the crushing burden of regulatory compliance demands.

Overview of ICBA Comments

The ICBA believes that the proposals will inject much-needed flexibility into the CRA process that will allow thrifts to better serve their communities. Ironically, one of the main arguments against the proposal focuses on the added flexibility that would be granted for rural communities. Rural areas are rarely as neatly segregated into low- and moderate-income census tracts as urban areas, yet it is primarily urban residents claiming the OTS proposal would undermine the CRA. Many studies, including several recently conducted by the FDIC, have shown that many rural communities across America are

[1]The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to protecting the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace. For more information, visit ICBA's website at www.icba.org.

struggling or withering.[2] The ICBA believes that the OTS proposal will help alleviate this situation and bring needed community and economic development by allowing rural banks to invest in their own communities under the CRA. The OTS proposal will help rural communities stay vibrant by keeping funds local.

For larger institutions, those with over $1 billion in assets, the proposal will add flexibility to the CRA assessment process. In many ways, the OTS proposal to revise the matrix builds upon the strategic plan that was part of the 1995 revisions to the CRA that never attained the success that community groups and regulators hoped it would.

Background

In February 2004, recognizing the need to begin reducing the ever-accumulating burden on the banking industry, especially community banks, the federal banking agencies proposed increasing the asset-size limit for eligibility for the small bank streamlined CRA exam from $250 million in assets to $500 million while simultaneously eliminating the separate holding company size qualification. Unfortunately, the agencies were unable to reach consensus. However, last July the OTS independently increased the threshold to $1 billion in assets; the OCC and the Federal Reserve withdrew their proposals. Subsequently, the FDIC issued a new proposal to set the limit at $1 billion. The FDIC also proposed adding a new community development assessment factor for banks between $250 million and $1 billion in assets that would consider a combination of community development activities. At the same time, the FDIC proposed expanding the definition of "community development" activities to include activities that benefit rural residents or areas without requiring the activities to be directed solely at low- or moderate-income individuals. The FDIC proposal is still pending.

OTS Proposal

The OTS is now proposing two additional changes to CRA to further alleviate burden. First, for all banks, the definition of community development would be expanded to include activities that benefit rural residents or areas. Second, and perhaps more significant, the OTS is proposing to give thrifts subject to the large-bank CRA exam (those with over $1 billion in assets) additional flexibility. Under the current large bank CRA exam, thrifts are rated for their lending, investments and services according to a matrix, with a 50% weight for lending and 25% each for investments and services. Under the OTS proposal, at least 50% of the assessment would still be based on lending, but the remaining 50% could be allocated in any way the institution deems appropriate.

Definition of Community Development

Under the proposal, the definition of "community development" would be expanded to include investments that benefit rural residents or areas (similar to the pending FDIC proposal). In addition, the OTS might also include areas affected by natural or other disasters or other major community disruptions.

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[2] See, e.g., *Rural Depopulation: What Does It Mean for the Future Economic Health of Rural Areas and the Community Banks that Support Them?* by Jeffrey Walser and John Anderlik, part of the FDIC's Future of Banking Study, published in April 2004.

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Expanding the Definition of Community Development Will Aid Rural Areas. The ICBA also strongly supports the OTS proposal to expand the definition of activities that qualify as community development for CRA purposes. While the current definition limits community development activities to those that benefit low- and moderate-income individuals or areas, the proposal would expand the definition to include activities that benefit rural residents or areas. The revised definition would specifically include affordable housing (including multifamily rental housing) for low- or moderate-income individuals *or individuals in rural areas*, community services targeted to low- or moderate-income individuals *or individuals in rural areas* and activities that revitalize or stabilize low- and moderate-income geographies *or rural areas*.

Rural communities across the United States are struggling with unique community and economic development needs and challenges. In fact, the plight of our nation's rural communities was one rationale advanced by the Federal Reserve for retreating from the February 2004 proposed CRA regulatory relief. The OTS' proposed expanded definition of "community development" addresses this problem by including activities that benefit rural residents as well as those that benefit low- and moderate-income individuals.

The National Association of Development Organizations Research Foundation recently reported that inadequate public infrastructure is viewed as the most significant roadblock to economic development in small town and rural America.[3] The remote nature of rural regions and weak local educational systems rounded out the top three greatest hurdles to job creation and growth in smaller communities. Limited access to venture capital and business development financing also ranked as significant problems.

Community banks in rural areas are often called upon to provide funding for crucial local projects, such as municipal infrastructure or community improvements, or to help create jobs by attracting businesses to their communities and providing small business credit. Because of population patterns, rural areas are often not neatly segregated into low-, moderate- and high-income areas. It is frequently difficult to isolate needed community development activities in rural areas so that they are focused solely on low- and moderate-income individuals or geographies. Community development activities in rural areas should not be ineligible for CRA credit, as they are now, because they do not benefit *only* low- and moderate-income individuals.

The proposal will appropriately allow banks in rural areas to receive CRA credit for supporting needed economic or infrastructure development such as job creation to employ rural individuals or provide better paying jobs in rural areas where average incomes are lower than in metropolitan areas. Even more important, the proposal will encourage the development of infrastructure that is often challenging in rural areas because of lower tax bases and lower property values. Activities as diverse as funding a local water project or school construction, rehabilitating a Main Street retail district, or

[3] *"EForum Results: The Pulse of Small Town and Rural America,"* NADO Research Foundation, August 2004, page 6.

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offering a special program to bring the unbanked into the financial mainstream, would qualify.

The ICBA strongly disagrees with those who predict the OTS proposal will be the collapse of the rural economy. In fact, the proposal will benefit local rural communities by letting community banks devote capital to the local economy and residents—and not to regulatory compliance or making far-flung investments that have no impact on their communities.

Definition of "Rural." The OTS asks whether the term "rural" should be defined in the regulation, and if so, how it should be defined. The ICBA believes that it would be helpful to bankers and examiners for the FDIC to provide guidance on what is "rural," either through a Q&A, examination procedures which have been developed after public input, or a Financial Institution Letter. However, because demographics are constantly changing, providing the guidance outside a regulatory definition would provide greater flexibility and facilitate the agency's ability to update the parameters for rural community development as needed.

The ICBA suggests that a definition be drafted and published for public comment to ensure appropriate feedback. Factors that should be taken into account include population size and density and whether all or most of the area is outside a Metropolitan Statistical Area (MSA).

Activities that Help Finance Businesses or Farms in Rural Areas. The ICBA also believes that the definition of "community development" should include activities that help finance businesses or farms in rural areas without regard to their size or gross annual revenues. Capital is leaving rural areas. In some rural communities, only farms or small businesses provide the engine for economic development. These businesses provide economic stimulus to the rural community that benefits low- and moderate-income residents by providing jobs, providing demand for other products and services in the local community, and creating support for the local infrastructure, including housing, health needs and education.

Additional Community Development Factors. The OTS proposal would also consider adding community development efforts that benefit areas affected by natural disasters. The ICBA supports this step. When an area is hit by a natural disaster, as the world has so recently been reminded in the countries around the Indian Ocean, the need for economic support to redevelop damaged infrastructure is critical. There is no clearer example of community reinvestment than steps that help an area recover from the devastation imposed by a natural disaster. The ICBA believes that the OTS proposal is both logical and well within the parameters of the CRA. It is essential that local communities affected by natural disasters be rebuilt to ensure that the economy in those areas continues to be strong. Activities that benefit individuals and businesses affected by natural disasters provide vital assistance for that recovery.

The ICBA also believes that another factor might be considered. Many local communities, especially those in rural areas, are often deeply affected when the mainstay

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of the local economy, such as a major manufacturing plant, is closed. For example, many local communities in Maine, North Carolina, Illinois and other communities across the country have been devastated when the local plant closed. The ICBA recommends that the proposed definition of "community development activity" be expanded to include response to *any* event that has a major impact on the local economy. To state it conversely, any activity that results in building a strong, healthy community should be granted credit under the CRA, regardless of the event that cause the disruption, be it natural disaster, plant closing, civil unrest, or other cause. The critical element is that credit be given for steps that help the local economy recover.

Changes to the Assessment Matrix for Large Thrifts

The second element in the OTS proposal would grant added flexibility for how larger thrifts (those with over $1 billion in assets) are assessed on lending, investments and services. Again, the OTS objective is reducing burden while encouraging large retail savings associations to focus their community reinvestment efforts on the types of activities needed by the communities they serve, consistent with safe and sound operations.

Currently, the assessment matrix used by examiners to evaluate larger thrifts is structured with a 50% weighting for lending and 25% each for investments and services. Under the changes being considered by the OTS, lending would still receive at least 50% of the weight, but each large savings association could allocate the remaining 50% of the assessment among lending, investments and services in whatever way it deemed appropriate. In theory, a savings association could be judged entirely on lending activities (a point that has raised objections among community activists). To a certain extent, examiners assess large institutions using a performance context that considers this factor, but the OTS approach would give each large savings association greater flexibility in determining how an examiner would assess its CRA performance.

In part, the OTS is considering this step to address problems encountered by larger institutions in finding appropriate investments within their assessment areas. One of the problems with the large bank CRA three-part assessment is the ability of banks and thrifts to find investments that both satisfy the CRA criteria and truly benefit the local community. Banks often report making investments that only have a minimal or negligible benefit for the local community but, because they may benefit a larger statewide or regional area, qualify for CRA purposes. As a result, to satisfy CRA, banks report making investments that are actually pulling capital away from the local community. The OTS proposal would allow individual institutions to tailor their CRA activity to ensure that more funds are devoted to the local economy.

Some have argued that the OTS approach would deplete the investments and services that larger institutions make. However, according to the stated purposed of the Community Reinvestment Act, "Congress required each appropriate federal financial supervisory agency to assess an institution's record of helping to meet the *credit* needs of the local communities in which the institution is chartered, consistent with safe and sound operations (*emphasis added*)."[4] The statute and the regulatory purpose of CRA do not

[4] Section 11(b) of the banking agencies' Community Reinvestment Act regulations.

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look to investments, grants and services to the community – but to the lending needs of the community.[5] The OTS proposal would still assess banks over $1 billion in assets on meeting the community's credit needs, and is therefore fully consistent with the statutory purpose.[6] Just as now, larger thrifts would have an examination that is focused, like the CRA statute itself, on ***lending***. The proposed change recognizes the regulatory burdens imposed by CRA and adjusts the burdens – but does not cut back on the fundamental lending requirements of the CRA statute.

For example, one larger institution has stressed that its strength actually lies in the services the bank provides. Allowing banks to address CRA with a greater flexibility in a way that is consistent with their market strategy would allow banks to leverage their resources more effectively. The OTS approach would allow the institution to determine the most effective way to reinvest in its local community. However, what is critically important is that the types of products, services and investments that qualify for the CRA is expanded to take steps that allow each bank to truly serve its local community.

The ICBA does not believe that it is necessary for the OTS to institute restrictions on the weightings in the matrix that individual thrifts might elect. The ICBA does encourage the OTS, though, to incorporate examples of the different types of weighting alternatives as guidance. And, as noted above, since the fundamental basis for the CRA is lending – and ensuring that *credit* is provided locally, the ICBA concurs that at least 50% of the matrix should be based on lending analysis. The ICBA also agrees that, given that CRA is fundamentally a lending analysis, that a thrift should receive at least a "low satisfactory" on its lending assessment to receive an overall "satisfactory" CRA rating.

Some critics have suggested that the OTS' approach would allow a thrift to adopt a matrix that is solely based on lending. Theoretically, this is true. However, when the CRA revisions were undertaken in the early 1990s, one the of the underpinnings of the three-part investment test was that larger institutions felt that investments and services that they provided were not given sufficient credit under CRA analysis. The ICBA believes it extremely unlikely that any large institution would elect an assessment matrix that did not include some component of services and investments. For example, as noted above, one larger financial institution finds that their strength lies in services.

Regulator Disparity

The ICBA recognizes that if the OTS adopts this proposal, the federal banking regulatory agencies will have different approaches to CRA evaluations. While there are

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[5] The investment and service tests were adopted in 1995 to provide a means for larger banks to have many of their community development activities recognized along with their lending activities. However, in the intervening years, the application of these criteria have become costly and burdensome and have begun to actually disadvantage local communities. Even community groups have raised concerns about these tests, as often discussed at meetings of the Federal Reserve's Consumer Advisory Council.

[6] It is also important to recognize that a collateral benefit to reduced regulatory burden is that, because much of these compliance costs are passed along to bank customers, reducing burden and thereby reducing costs can reduce the cost of consumer credit.

advantages to uniform approaches to regulatory requirements, different institutions – national banks, state banks, and thrifts – are each under supervisory systems that differ in many ways. For example, the dual banking system, with both state and federal charters, has often been cited as one of the reasons for the dynamic financial system we have in the United States today. A difference between regulators in this area may be another instance that produces successful and innovative solutions to community reinvestment issues.

However, that being said, the ICBA encourages the federal banking agencies to work together to resolve their differences to develop a standard approach to CRA examinations. First, having a uniform definition will help ensure consistency and reduce the chance for confusion, especially for companies that have different charters under the same holding company umbrella. Second, a uniform approach to CRA exams will help ensure as level a playing field as possible between competing institutions. Third, having a uniform approach will allow the agencies to work together to develop consistent and equal exam treatment. However, any coordinated interagency approach must clearly recognize and minimize regulatory burden as well as incorporate provisions that recognize the great diversity of communities, both urban and rural.

Conclusion

The ICBA supports the OTS proposal as a means to begin to turn the tide of ever increasing regulatory demands. Expanding the definition of community development to include activities that generally benefit rural areas recognizes the realities of rural demographics and that CRA is not solely a regulation that should be designed to solve the problem of the inner city. The ICBA believes that this definition could be expanded to include activities that help recovery from natural disasters and other problems that beset local communities, thereby taking steps that support the very nature of the CRA. And, allowing larger institutions the flexibility to establish their own assessment matrix for CRA acknowledges the institution's understanding of its local market and individual business plan while still ensuring CRA requirements are met.

Should you have any questions or need additional information, please contact the undersigned by telephone at 202-315-2409 or by e-mail at robert.rowe@icba.org.

Thank you for the opportunity to comment.

Sincerely,

Robert G. Rowe

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