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Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552
Attention: No. 2004-53
By Fax: 202-906-6518
By e-mail: regs.comments@ots.treas.gov

Re: No. 2004-53--Proposed Changes to Community Reinvestment Act Regulation of the Office of Thrift Supervision

Dear Sir or Madam:

JPMorgan Chase Bank, N.A. and its bank affiliates (collectively, "JPMorgan Chase") appreciate the opportunity to comment upon the Notice of Proposed Rulemaking (the "Proposal") regarding proposed changes to the Community Reinvestment Act ("CRA") regulation (the "Regulation") of the Office of Thrift Supervision ("OTS").

As is more thoroughly described below, JPMorgan Chase believes that providing banks with greater flexibility in determining their CRA performance has merit, but the Proposal eliminates many crucial CRA elements that are responsive to community credit and banking needs. These elements include a bank's record of opening and closing branches and providing products and services designed to meet the needs of local communities, including low- and moderate-income ("LMI") communities. While many of the Proposal's provisions are similar to suggestions that JPMorgan Chase made in its October 2001 comment letter responding to the

Advance Notice of Proposed Rulemaking of the four bank regulatory agencies (the "Agencies"), 66 Fed. Reg. 37602 (July 2001), they allow banks to omit "participation, including investments in community development projects and programs," which was an original CRA assessment factor and the most responsive reinvestment element of the CRA today. Indeed, it is the community development partnerships between banks and community organizations that have had the most visible and meaningful impact on LMI communities in recent years.

JPMorgan Chase also has grave concerns because only the OTS is proposing modifications and, if adopted, the proposed changes will only apply to OTS-chartered banks and savings associations. JPMorgan Chase believes that the banking industry needs regulations that implement banking laws that are uniform and consistent across all banking charters. The apparent rift among the Agencies damages the rule-making process and it is unclear whether this rift is an aberration or the harbinger of the disintegration of interagency rule-making. JPMorgan Chase strongly urges the Agencies to return to the rule-making table and provide the industry with the uniformity and consistency in banking regulations that the industry has come to expect and which makes the industry stronger.

If the Agencies do not re-convene and propose a uniform rule, JPMorgan Chase prefers the current rule to a new rule that only applies to a segment of the industry. JPMorgan Chase is taking this opportunity to respond to the specific questions in the Proposal in the event that either the OTS or the Agencies, collectively, decide to move forward with any changes to the CRA regulation.

A. *Solicitation of comments on the Definition of "Community Development"*

1. **Should the definition of "community development" be expanded? If so, how?**
   a. **Does the proposed change to the community development definition encompass the full range of community development activity that benefits rural areas?**
   b. **Should the definition include a savings association's demonstrated participation in other types of community activities?**
   c. **Should the regulation provide for the Director of OTS to determine that additional activities that benefit the public welfare constitute "community development?"**

JPMorgan Chase does not believe that the definition of community development needs to be expanded to include non-LMI rural communities as the Proposal suggests. The Proposal is flawed in proposing that all community development services in rural communities and all efforts to revitalize and stabilize rural communities are CRA eligible. JPMorgan Chase believes that the OTS should continue to use the current rule's performance context and other regulatory guidance when determining whether or not activities in rural communities, that are not specifically LMI communities, should receive consideration in the CRA examination. The current rule's performance context as well as interagency guidance and the FFIEC Interagency Questions and Answers regarding Community Reinvestment provide examiners with a considerable amount of latitude to give CRA credit for community development activities. For example, this latitude allows for CRA credit (i) for projects in the broader geographical area outside of the bank's immediate CRA assessment area; (ii) for projects that are outside an LMI community but that have an impact on nearby LMI geographies; and (iii) for projects where the local municipality has an established redevelopment plan regardless of whether the market is LMI.

Counting all rural activities as eligible for CRA eligibility is too expansive and could result in counting the development of affluent golf and skiing communities as CRA-eligible. This was clearly not the intent of Congress when it passed the CRA. At the same time, it is reasonable that the OTS and other agencies pay more attention to and evaluate the performance of banks in their rural markets as well as in their large urban markets. Urban markets receive far greater reinvestment scrutiny due to the concentration of bank deposits in large cities and the large, dense population of LMI households.

JPMorgan Chase believes that the rule should be transparent to all lenders and to the public and that the Director of OTS should not determine which additional activities, if any, that benefit the public welfare constitute "community development" except through written interagency guidance. If there are additional community development activities that would benefit the public welfare, then all banks, regardless of their charters, should have an opportunity to participate in the activities and to receive CRA recognition for their efforts.

2. **Would it be appropriate for the definition of "community development" to expressly provide that community development also includes, in any area (rural or not, low- or moderate-income or not):**
    a. **Community services targeted to individuals in areas affected by natural or other disasters or other major community disruptions: and**

b. **Activities that revitalize or stabilize areas affected by natural or other disasters or other major community disruptions?**
c. **What other types of major community disruptions should be covered (*e.g.*, civil unrest, arson)?**

Although the definition of community development works very well in most circumstances, it does not specifically include activities that aid areas devastated by a natural disaster or acts of terrorism or war. The tragic events in New York and Washington have underscored the fact that in a disaster, whether it is a hurricane, earthquake, flood, terrorist attack or act of war, people and communities are lost or severely damaged. Beyond the horrendous loss of life and its enduring pain, communities may include not only large corporations, but also the "mom and pop" small business service providers, as well as street vendors, restaurants, hotels and other businesses that provide jobs to people of all income levels, including LMI individuals.

Banks have traditionally recognized the need to assist those in need for the short term as well as to provide support to the community in its efforts to rebuild. Short term initiatives may include, for example, waiving credit card, mortgage and home equity late fees, offering a three-month mortgage payment moratorium for retail customers who are having difficulties related to the disaster and creating special programs for businesses which require additional funds because of the disaster. Investments may include disaster relief funds to be distributed to both victims and to survivors who have suffered economic hardships. Efforts for the long term may include advisory services to local and state agencies and real estate development loans to rebuild storefronts and help create jobs for low wage earners.

The Regulation does not specifically recognize efforts by financial institutions to assist their communities in time of need. Examiners will give credit only to those efforts that primarily target LMI individuals or census tracts with the burden of proof put upon the institution. Because the types of relief banks provide help anyone, regardless of income or LMI location, banks may not receive CRA credit for these initiatives that truly help their communities to rebuild. The CRA states that banks have "a continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered." JPMorgan Chase suggests that the definition of community development be expanded to add new language that includes activities that provide disaster relief to geographies, businesses and individuals that have been victims of a natural disaster, an act of terrorism or war.

3. **As proposed, OTS would not expand the first paragraph of the definition of community development to include affordable housing (including multifamily rental housing) for individuals in rural areas who are not low- or moderate-income.**
    a. **Would it be appropriate to cover such activities?**
    b. **Do such activities contribute to community development? If so, how?**
    c. **Are there difficulties with housing affordability and availability in rural areas (*e.g.*, marketability on the secondary mortgage market) that could appropriately be addressed by revising the definition of "community development?"**

JPMorgan Chase believes that it would be inappropriate to expand the definition of community development to include affordable housing (including multifamily rental housing) for individuals in rural areas who are not LMI. In the performance context, examiners should take into consideration the correlation between local income and the availability of affordable home-ownership and affordable rental housing at all income levels.

A far more important omission in the definition of community development is its failure to take into consideration the lack of affordable housing availability in high cost markets where households even at 100% of the median income may not be able to afford to purchase a modest home. JPMorgan Chase believes that, if anything, the definition should be expanded to include the lack of affordable housing in high cost areas.

4. **As proposed, OTS would not expand the third paragraph of the definition of "community development" to include activities that promote economic development by financing business or farms in rural areas without regard to their size or gross annual revenues.**
    a. **Would it be appropriate to cover such activities?**
    b. **Do such activities contribute to community development? If so, how?**
    c. **Are there difficulties with financing business or farms of various sizes or gross annual revenues in rural areas that could appropriately be addressed by revising the definition of "community development?"**

JPMorgan Chase believes that it would be inappropriate to expand the third paragraph of the definition of "community development" to include activities that promote economic development by financing business or farms in rural areas without regard to their size or gross annual revenues. If the CRA were expanded to include all customers in rural communities, including all corporate farming conglomerates, it would greatly weaken the CRA by distracting its focus from those households and communities that have been traditionally neglected and who have greatly benefited from the CRA.

B. Solicitation of Comments on Alternative Weights Election

1. Are there ways OTS could make the process even more flexible than outlined in this proposal? (2)

JPMorgan Chase believes that a two-part test as described below will give banks the flexibility they need to manage their CRA responsibilities while at the same time more efficiently serve community needs without diminishing the CRA impact on their communities.

<u>Reorganize CRA Structure from Three Tests to Two Tests</u>

JPMorgan Chase recommends that the current Regulation be reorganized to provide more flexibility to banks to design CRA programs that align their business strategies, interests and strengths with community needs. We recommend that the Regulation for large banks be divided into two tests: Retail Banking and Community Development. A reorganized Regulation would allow for a more holistic approach to the distinct retail banking and community development needs of local communities.

<u>How the Retail Lending Test Could be Structured</u>

In a two-part CRA test, the Retail Banking Test would combine mortgage, small business and optional consumer lending with retail banking products and services. Retail banking services are basically distribution networks, such as branches and ATMs. Combining retail lending with retail banking distribution systems would provide a better alignment between the Regulation and the core businesses of savings associations.

The benefit of combining retail lending with retail distribution is that the CRA evaluation could better balance the quantitative and qualitative measures within one test rather than across multiple tests. For example, a bank may be only average in mortgage lending because of the very competitive market in which it operates. It may, however, offer some very innovative, niche LMI mortgage products through an alternative banking delivery system. In the current evaluation process, the innovative mortgage products are assessed as part of the Lending Test and the alternative delivery systems are assessed as part of the Services Test. By separately assessing and rating retail lending and retail distribution, the evaluation process does not align with the way banks manage their businesses. As a result, the innovative mortgage initiative may not gain sufficient recognition as a result of being split between the Lending and Service Tests. The combination of the two under one test, the Retail Banking Test, achieves a more holistic result.

Another institution may not have enough LMI branches relative to its local competition but offer highly flexible LMI mortgage products while providing mortgage counseling in near-by LMI communities to reach these households. By combining retail lending and retail banking services in the same test, examiners will be better able to assess how well the institution is meeting local credit needs.

As part of JPMorgan Chase's proposed two-part test, community development lending would move into the new Community Development Test.

<u>How the Community Development Test Could be Structured</u>

JPMorgan Chase recommends that community development lending be moved into the new Community Development Test that would be exactly the same as the current Community Development Test for wholesale and limited purpose banks. A separate Community Development Test would evaluate community development lending, community development investments and community development services. These three elements would be examined in concert and allow for a bank to balance its response to local community needs based on its capacity and expertise for meeting those needs. A restructured rule that has a Community Development Test would ensure more flexibility to balance qualitative and quantitative measures and will make CRA more sustainable for the benefit of both banks and LMI communities.

2. **Would it be appropriate to provide the savings association flexibility in the way that CRA ratings are assigned by offering a choice of weights for the lending, service, and investment test within the large retail institution test? If so, why not?**

<u>Provide for Flexible Weighting of Each Test</u>

With respect to the appropriate weight each test should have, some banks believe that Congress intended them to meet their CRA responsibilities solely through retail banking operations and that community development activities were not intended to be a requirement of the Regulation. Other banks believe that community development activities are so important to the health and prospects of local LMI communities that these activities alone could, at a bank's option, fulfill the bank's CRA responsibility. In recognition of the fact that every bank has a unique business strategy, assessment area, set of resources and corporate culture, JPMorgan Chase recommends that large banks be allowed to determine the amount of weight for each of the two tests, within certain parameters. The minimum amount of weight for the Retail Banking test would be 50% and the minimum amount of weight for the Community Development Test would be 25% and the final 25% would be at the discretion of the bank as to how much more would be allotted to the retail banking test and to the community development test.

JPMorgan Chase firmly opposes the Proposal's suggestion to allow lending to comprise up to 100% of the total CRA evaluation. This extreme revision to the current and all prior CRA rules would deplete private sector resources that are so critical to the development of lower-income communities. For example, such a rule would no longer review branch distribution, including a bank's record of opening and closing branches, that has been a major focus of CRA since the first rule was implemented. Basic banking products and services would no longer be considered. Even community development services, such as board memberships and mortgage counseling, would no longer be considered as important to the development of LMI communities. And again, the Proposal has eliminated large parts of the new CRA rule as well as most of the original, substantive assessment factors. In effect, the Proposal has reinterpreted the CRA itself.

3. What would be the impact on lending, investments and services of offering alternative weights?

The purpose of realigning the three current tests and allowing more flexibility in how each test is weighted is to make the CRA more sustainable over time by achieving a win-win between a bank's need to be profitable and to manage risk and a community's need for capital and banking services. Currently the Lending Test is weighted 50%, the Investment Test is weighted 25% and the Retail Banking/Community Development Services Test is weighted 25%. In the current Lending Test, the entire weight is on mortgage, small business and optional consumer lending. Banks that provide community development loans can improve their CRA rating, but a failure to provide any community development loans will not have a negative impact on their CRA rating. In fact, banks all over the country could stop doing any community development lending immediately and few, if any, of them would lose their "satisfactory" CRA ratings.

Advocates are concerned that the current Investment Test will be eliminated, but they seem not to recognize the lack of weight given to community development lending compared to community development investments in an evaluation of a bank's CRA performance. <u>While community development lending has no weight, community development investments comprise 25% of the CRA rating</u>! The irony is that bankers, who know how to assess and manage lending risk, understand community development lending, while community development investing, akin to venture capital investing, is foreign to what most banks and savings associations do in the normal course of their business. Here, we are not talking about community development grants, but rather investments in equity funds and qualified tax credit ventures. The vast majority of banks do not have the resident expertise to evaluate such investment opportunities because it is not in their charters to engage in this business except to meet their CRA obligations. Fortunately for cautious banks, they may meet the Investment Test challenge by buying mortgage-backed securities and making qualified community development grants.

JPMorgan Chase does not propose to eliminate the Investment Test, but rather to reorganize the current rule to combine all of the community development activities to allow banks to design and manage more rationale and meaningful community development programs.

4. **Should OTS place limits on the savings association's ability to opt for particular weights? How could OTS help ensure that a savings association would select weights that focus on the types of activities the communities it serves need? How could OTS take a savings association's selection of a weight alternative into consideration as part of the performance context? Is there an appropriate role for public participation beyond existing opportunities for provision of information regarding the performance context and submission of comments about the savings association's CRA performance? *See* 12 CFR 563e.21(b)(2), 563e.21(b)(6), 563e.29(c) and 563.e43 (a)(1) and Q&A 21(b)(2)-2, 66 FR at 36631.**

JPMorgan Chase has recommended that at least 50% of the weight should be on retail bank lending (mortgage, small business and optional consumer) and retail banking services (branches, products and alternative delivery systems) and that at least 25% of the weight should be on community development activities (lending, investing and services) with a final 25% of the weight distributed between the two tests at the bank's discretion.

5. **What logistical and practical issues would have to be addressed in providing a choice of weights and how should these issues is addressed (*e.g.*, timing and method of alternative selected)?**

Such issues can be worked out during the course of the CRA examination.

6. **Would it be useful for OTS to publish examples of weight alternatives in the preamble to the final rule or elsewhere?**

Yes, it would be useful for OTS to publish examples of weight alternatives in the preamble to the final rule. Banks appreciate agency guidance.

7. **For ease of administration implementation, would it be appropriate for OTS to limit the choice of weights to a list containing several options? Is so, what options should be offered? Which options would a savings association be likely to choose?**

See JPMorgan Chase's comments on reorganizing the current rule into a two-part test and assigning minimum weights by test.

8. **Would it cause confusion for savings associations, community organizations, or the public to allow customized weight combinations that might be selected by only one or a few institutions (e.g., lending 57%, service 28%, and investment 15%)?**

JPMorgan Chase recommends that weights be allocated in five percentage point integers. For example, under the JPMorgan Chase proposal, a bank could allocate 25 percentage points in five percentage point integers to either the Retail Banking or the Community Development Tests.

9. **Would it be appropriate for the alternative weights to require at least 50 percent weight to lending, as proposed? Why or Why not? If a rating matrix that gives less than 50 percent to lending were to be offered, would that be consistent with the purposes of CRA?**

See JPMorgan Chase's comments on reorganizing the current rule to a two-part test and assigning minimum weights by test.

C. *Solicitation of Comment on Eliminating the Investment Test*

1. Would a preferable alternative be to eliminate the investment test? If so, why? If not, why not?

As noted above, JPMorgan Chase does not recommend that the Investment Test be eliminated but rather combined into a new community development test. Currently, the Investment Test does not assess how well an institution is meeting the credit needs of the entire community. It assesses how much the institution has invested, whether the investments are CRA-eligible, whether any investments are innovative or complex and how the portfolio compares quantitatively, but not qualitatively, with the investment portfolios of peer institutions. The performance evaluation does not consider whether making investments is aligned with the bank's business strategy or whether the investments even yield a return, because the Regulation requires large retail banks to make CRA-eligible investments regardless of these considerations. This is different from the way in which investments are assessed at wholesale and limited purpose banks. These banks can choose among community development lending, community development investing and community development services to meet their CRA responsibilities and the needs of local communities. Wholesale and limited purpose banks can better align their CRA initiatives with their business strategies and examiners can easily balance the qualitative and quantitative measures. All large banks should have the same opportunity to manage their community development responsibilities.

While there is no published formula for the amount of CRA eligible investments that a bank should have on its books, there is regulatory expectation that a CRA portfolio will increase over time. The current stand-alone Investment Test for large retail banks is of concern because there are not enough eligible investment funds or other investment vehicles to grow a large, profitable, responsive and diverse CRA portfolio that has a meaningful impact on local community development needs. There may be enough investment opportunities, however, to grow a very large, modestly profitable portfolio of CRA eligible investments that has little community development value in terms of responsiveness to community development needs. In a numbers game, the latter is the portfolio of choice.

Many CRA-eligible funds that have the most impact have relatively low returns. Low-income housing tax credits that are so important to low-income housing development have experienced dramatic drops in their yields in recent years. By combining community development lending, investments and services, institutions would have the flexibility to build more sustainable community development programs. They will be able to invest for the right reasons and at the right time and not simply to satisfy the Regulation and its current focus on the quantitative measures.

2. What would be the impact on investments of eliminating the investment test?

JPMorgan Chase does not recommend that the Investment Test be eliminated but rather combined into a new community development test that includes community development lending and community development services because CRA-eligible investments, including grants, are critical to LMI communities and they should be encouraged but not mandated.

3. If the investment test were eliminated as a mandatory separate component of the large retail institution test, should investment still be considered?

a. At a savings association's option or to raise a rating?

All banks and savings associations should have an affirmative obligation to provide a combination of community development loans, investments and/or services. Community development activities should not be optional. Currently, community development lending has no weight other than to raise a rating and community development services comprise only a fraction of the weight under the Services Test. Too much effort is currently expended relative to the recognition received in performance examinations. Community development activities are important to local communities and they should be recognized, evaluated and integrated into the ratings' schematic. They should not be an after-thought.

b. Within one of the other test (e.g., under the lending test treated similarly to community development loans)?

Community development investments should be considered within the context of a new Community Development Test that is modeled on the current test for limited purpose and wholesale banks.

c. In some other fashion (e.g., treating investments interchangeably with community development services and loans under a new community development test)?

As is more fully described above, JPMorgan Chase proposes a two-part test:

- Retail Banking Test (mortgage, small business and optional consumer lending and retail banking services) with a minimum weight of 50%; and
- Community Development Test (any combination of community development loans, investments and services) with a minimum weight of 25%.

4. If the investment test were eliminated as a mandatory separate component of the large retail institution test, what weight should be given to the remaining components of the test (e.g., lending 75% and service 25%, weight lending and service 50% each)?

With respect to the appropriate weight each test should have, some banks believe that Congress intended them to meet their CRA responsibilities solely through retail banking operations and that community development activities were not intended to be a requirement of the Regulation. Other banks believe that community development activities are so important to the health and prospects of local LMI communities that these activities alone could, at a bank's option, fulfill the bank's CRA responsibility. In recognition of the fact that each bank has a unique business strategy, assessment area, set of resources and corporate culture, JPMorgan Chase recommends that a new Retail Banking Test count for at least 50% of a bank's CRA rating, a new Community Development Test count for at least 25% of the bank's CRA rating and large retail banks be allowed to determine 25% of the weight for each of the two tests.

JPMorgan Chase respectfully thanks the OTS for this opportunity to comment on its proposed revisions to the regulation that implements the Community Reinvestment Act.

Sincerely yours,

cc:

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