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September 20, 2004

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

Re: **RIN 3064–AC50**; FDIC Proposed Revision of the CRA Regulations; 12 CFR Part 345; 69 Federal Register 51611; August 20, 2004

Dear Sir:

The Federal Deposit Insurance Corporation (FDIC) currently has a proposal out for comment that increases the small bank threshold for CRA streamlined examination for small banks from $250 million to $500 million, without regard for the size of the bank holding company, if any. Now the FDIC proposes increasing the "small institution" test for banks under the Community Reinvestment Act from the current $250 million to $1 billion, without regard to holding company affiliation, but the FDIC also proposes to add a new community development criterion (CD criterion) to the small bank examination standard for banks between $250 million and $1 billion. This new CD criterion would require evaluation of the bank's community development activities – lending, services and/or investments – the mix to be determined by the opportunities present in the community and the bank's own strategic strengths. The FDIC's proposal would affect about 875 state nonmember banks. The American Bankers Association (ABA) brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership - which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks - makes ABA the largest banking trade association in the country.

ABA wholeheartedly commends the FDIC for its unflinching analysis of the current CRA regulations and its recognition that the regulations, revised in 1995, are not working as intended with respect to community banks and must be revised.[1] ABA strongly supports the adoption by the FDIC of the revisions proposed on August 20, together with the already proposed increase in the small bank threshold in the FDIC's initial proposal. As discussed in more detail below, ABA recommends that:

1. The FDIC raise the threshold for a small bank CRA exam to $500 million without regard to the size of the bank's holding company.

[1] Examples from bankers or from CRA Public Evaluations of how the investment test results in **disinvestment** from the bank's community are given in sidebars to the text of this comment.

2. The FDIC create a new CRA examination for larger community banks (those from $500 million to $1 billion), without regard to the size of their holding company, that would apply the streamlined CRA examination to them but with the mandatory consideration of their community development lending, services and/or investments.

3. The FDIC not adopt a community development test <u>separate</u> from the CRA streamlined evaluation.

4. The FDIC give guidance on how CD loans, investments and services will be compared under the CD criterion, and ABA suggests that the bank's capital cost of the activity should be the basis of any comparison.

5. The FDIC enlarge the definition of "community development" to include specifically rural residents, irrespective of the median income of their census tract. FDIC should also clearly define "rural" for the purposes of the "community development" criterion.

The Need for Revision of the CRA Regulation

<u>Community banks need relief from the large bank examination</u>

The 1995 revision of the CRA regulation's two most significant changes were (1) the creation of a streamlined CRA examination for banks less than $250 million in assets that were not owned by a holding company with more than $1 billion in assets and (2) the addition of the "investment test" for larger banks that for the first time <u>forced</u> banks to give money to CRA-qualified NGOs (nongovernmental organizations) or else make equity investments in a very small class of "CRA-qualified" projects or entities. The streamlined exam has proven to be a tremendous improvement. The "investment test" has proven to be a daunting regulatory challenge for community banks, resulting in many having to send money OUT OF THEIR COMMUNITIES to comply with this large bank test. [Examples of such disinvestment are given in the sidebars, such as the one to the right of this page.] The FDIC's proposal to increase the threshold for the small bank examination and make significant and positive changes in the investment test for smaller banks directly addresses this regulatory failure of the "investment test."

The small bank streamlined CRA examination was a major improvement over the original CRA regulations because it did for the first time what the Act actually required - and no more: required examiners, during their examination of the bank, to

> The May 2002 CRA PERFORMANCE EVALUATION of a $500 million bank, by the FDIC states that:
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> "The bank purchased the tax credit investment fund during the prior CRA performance evaluation period, but maintains a book balance of $321,000 as of the date of this evaluation. This fund covers the Midwest and, **although none of the actual properties in the fund are located in the bank's assessment area**, includes a greater area that encompasses the bank's assessment areas. Some of the properties in the fund are located in close proximity to the bank's assessment area. Since the investment covers the entire assessment area, each of the bank's assessment areas is allowed to receive credit for it as a qualifying investment in that specific area. **Given the limited opportunities for the bank to purchase qualifying community development debt or equity investments in its assessment area, the level is considered acceptable.** [Emphasis added.]

look at the bank's loans and assess whether the bank was helping to meet the credit needs of the bank's entire community.[2] In particular, it imposed no investment requirement on small banks, which is appropriate since the Act is about credit, not investments. And it created a simple, understandable but real assessment of the bank's record of providing credit in its community: the assessment considers the institution's loan-to-deposit ratio; the percentage of loans in its assessment areas; its record of lending to borrowers of different income levels and businesses and farms of different sizes; the geographic distribution of its loans; and its record of taking action, if warranted, in response to written complaints about its performance in helping to meet credit needs in its assessment areas. This simplified assessment was created by the Agencies because it accurately measured a small bank's record of helping to meet the credit needs of its entire community while significantly reducing regulatory burden.

In 1995, it was plain to all parties that the regulatory burden of CRA needed to be reduced, which was why it was one of the primary reasons given by regulators, bankers, and even community groups for urging revision of the CRA regulations. Since 1995, the need for regulatory burden relief has only grown. Congress has added massive new reporting and compliance burdens, including the USA Patriot Act, the privacy provisions of the Gramm-Leach-Bliley Act, and the new FACT Act. And the Agencies have added their own new burdens, including enormously burdensome, new Home Mortgage Disclosure Act reporting. But the nature of community banks has not changed. The regulatory burden on small institutions is enormous and disproportionate to their assets, and growing more so annually. The significance of this problem was highlighted in testimony on May 12 of this year by FDIC Vice Chairman Reich, before the Subcommittee on Financial Institutions and Consumer Credit of the House Financial Services Committee. In the hearing entitled "Cutting Through the Red Tape: Regulatory Relief for America's Community-Based Banks," Vice Chairman Reich noted that there had been 801 new final regulations adopted since 1989. He then testified, "I believe that in looking to the future, regulatory burden will play an increasingly significant role in shaping the industry and the number and viability of community banks. While many new banks have been created in the past two decades, I fear that, left unchecked, regulatory burden may eventually pose a barrier to the creation of new banks." He concluded his testimony by saying, "I believe that if we do not do something to stem the tide of ever increasing regulation, America's community banks will disappear from many of the communities that need them most."

A February 2003 CRA Public Evaluation of a $500+ million bank has this statement from the FDIC examiners:

"**Through community contacts and other research it was determined that there are very few community development investment opportunities and vehicles.** Further, many of the community development entities contacted are not indigenous to the assessment area and cover the entire MSA or a significant portion of the MSA. Their primary focus has been in other areas of the MSA which retain greater need. Therefore the lack of investment instruments by the Bank is not a concern. Within the evaluation period, [the bank] has donated 276 grants totaling $261,203. Although this is noteworthy and reflects the commitment of the Bank to serve the communities within the assessment area, of these, [only] 16 of the grants totaling $42,897 meet the definition of qualified investments for CRA. …. **Given the limited opportunities locally, the Bank could expand its search for qualified investments on a broader basis, such as region-wide or statewide, that would include the assessment area of the bank.** [Emphasis added.]

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[2] The mandate of the Community Reinvestment Act is in Subsection 804(a), which was part of Title VIII of the Housing and Community Development Act of 1977—codified at 12 U.S.C. 2903.

"**SEC. 804.** (a) IN GENERAL.--In connection with its examination of a financial institution, the appropriate Federal financial supervisory agency shall--

(1) assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution; and

(2) take such record into account in its evaluation of an application for a deposit facility by such institution."

When a community bank must comply with the requirements of the large institution CRA examination, the costs to and burdens on that community bank increase dramatically. This imposes a dramatically higher regulatory burden that drains both money and personnel away from helping to meet the credit needs of the institution's community. How does the large bank examination pose a regulatory burden on banks greater than $250 million? When a $251 million bank becomes subject to the same large bank examination as a $1 trillion bank, it must suddenly follow a whole new approach to the CRA exam, an abrupt transition that some bankers have likened to falling off a cliff.[3] In qualitative terms, first, the bank must begin the data collection required for small business and small farm loans, including the laborious geocoding of the loan location to the census tract. If the bank is not a Home Mortgage Disclosure Act reporter, because it is not in an MSA, then this means that is must acquire census tract information for loan location coding for the first time and train an employee in geocoding. Second, it must prepare extensive material for the examiners, as the burden of the exam now falls much more on the large bank than the small bank. It must separately document its services and its investments, including often extensive information to demonstrate that the service or loan qualifies for CRA credit. And then the bank must begin the often fruitless search for qualifying investments in its assessment area.

In simpler quantitative terms, the FDIC's estimate of the CRA paperwork burden, if this latest proposal were to be adopted, is 194,000 hours. The FDIC's current estimate (as required by the Paperwork Reduction Act) of the CRA paperwork burden is roughly 623,000 hours. The total decrease is therefore estimated to be about 429,000 hours on about 875 banks that would be newly-classified as small banks. This works out to be about 490 hours per bank and about 68% total burden reduction from the large bank examination. However, our experience with Paperwork Reduction Act estimates leads us to believe that 1 hour of reportable burden had about 2-3 hours of additional unreported burden associated with it. Thus the paperwork burden reduction alone is extensive, and this reduction is particularly important since it is a reduction of the burden on smaller banks that are most significantly overburdened.

A December 2002 CRA Public Evaluation of a $750+ million bank has this statement from the FDIC examiners:

"The majority of the bank's qualified investments are in targeted mortgage backed securities collateralized by residential mortgages to low- and moderate-income borrowers in [state]. **A broader statewide area was selected by management given the limited qualified investments strictly within the bank's assessment area.** [The bonds of the city were not investment grade during the period of the exam, so the bank could not buy them.] **As such, the bank was previously not able to safely invest in these bonds, but rather focused on obtaining qualified investments in the broader statewide area** [name of the state] **that assisted low- and moderate income borrowers.**" [Emphasis added.]

The Regulatory Challenge of the Investment Test for Small Banks

The investment test for small banks is often an incredibly daunting regulatory challenge for small, rural banks. First, the definition of qualified investments is too narrow, as it is clearly designed for the larger urban environment. A qualified investment is defined in the FDIC's CRA regulation at 12 CFR 345.12(s) as a "lawful investment, deposit, membership share, or grant that has as its primary purpose community development."[4] This narrowness of the definition results in many valuable

[3] In this instance, the CRA regulation's "cliff effect" is triggered by a very small increase in assets resulting in an enormous increase in burden.

[4] FDIC's CRA regulation provides at 12 CFR 345.12(h):

community activities and investments that benefit the entire community but not the specific low- and moderate-income (LMI) residents and areas targeted by the regulations being excluded from consideration under CRA. Thus, community banks often have to miss real opportunities to support their communities in favor of investments acceptable to the regulators. The most prominent example of this effect is seen in the treatment of the investment by smaller banks in general municipal obligations of their communities. Under current CRA interpretations, these municipal bonds must be targeted to low- or middle-income residents or narrow community development programs or else banks cannot receive credit for their investments. Thus investments, including grants and charitable contributions, by banks are funneled by the regulatory requirements into very specific types of activities and recipients. Again, while these goals may be socially desirable, the authority for the regulators to establish these goals and also to exclude other community investments from CRA consideration is not provided in the Community Reinvestment Act.

It is instructive to list some of the things that the Agencies will not count for CRA. For example, grants to United Way appear not to qualify for CRA investment credit, because many United Way organizations do not target just low- and moderate-income people. Only if the bank specifies that its contribution is targeted to a particular recipient, like a homeless shelter, will examiners give CRA credit for the contribution. Contributions to the American Lung Association, the American Diabetes Association and other organizations devoted primarily to health research for the entire community, or even their community-based local chapters, do not appear to qualify for CRA credit. Other organizations, such as Youth Clubs that benefit a broad cross-section of the community but do not clearly target low- and moderate-income persons or neighborhoods or revitalize or stabilize LMI geographies, most museums, most orchestras and performing arts organizations, and many other civic or community-based organizations do not qualify. Yet most people would consider support of such organizations as "community reinvestment." Investments and loans that help bring a major new employer to a community, if the company exceeds the small business revenue limits, may not be "community development" unless the bank can convince examiners that the company's presence will "revitalize or stabilize low- or moderate-income geographies."

A 2001 FDIC CRA Performance Evaluation of a $400 million bank states:

"The bank's qualified investments consist **solely of charitable contributions**. In addition to contributions made to organizations inside the assessment area, **positive consideration was given to donations made to certain entities just outside the assessment area due to the limited investment opportunities inside the assessment area**. [Emphasis added.]

The CRA regulations define "qualified investments" as those having a primary purpose of community development. By narrowly defining what qualifies, the regulations have decreased the pool of "qualified investments" available to banks and savings associations. Repeatedly, ABA has been told by smaller banks subject to the large bank investment test that they are unable to compete with multi-billion dollar banks for a share of the limited pool of qualifying investments. This is particularly true because many large banks are competing heavily for the limited pool of qualified investments as insurance that they will pass the investment test. Even small banks that are examined under the small bank examination have experienced this drought in opportunities to make

"(h) Community development means:
(1) Affordable housing (including multifamily rental housing) for low- or moderate-income individuals;
(2) Community services targeted to low- or moderate-income individuals;
(3) Activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs (13 CFR 121.301) or have gross annual revenues of $1 million or less; or
(4) Activities that revitalize or stabilize low- or moderate-income geographies.

qualified investments. Small banks need such investments in order to boost their CRA ratings from Satisfactory to Outstanding, a goal of many small banks that are proud of the roles they play in their communities. The final result is often that the bank will make investments or contributions in or to "CRA-qualified" projects and organizations OUTSIDE of its assessment area in order to meet the investment test requirements, as evidenced by the excerpt from a CRA exam in the sidebar to this paragraph. The result turns CRA's basic purpose on its head and reeks of credit allocation.

Specific Comments on the FDIC's Proposal

The February 6, 2004, Interagency proposal to revise the CRA regulation proposed simply to raise the small bank threshold from $250 million to $500 million. ABA strongly supported that proposal, but urged the banking agencies to raise the threshold for the small bank streamlined examination to $1 billion. The FDIC now proposes to raise the small bank threshold to $1 billion but includes an added community development criterion, similar to the large bank examination's review of community development lending, services and investment for large banks. Thus, while community development for large banks is considered under three separate tests, community development would be considered in a single test for small banks. At the same time, the FDIC specifically requests comment on whether there is another appropriate threshold to use when defining small banks that would <u>not</u> be subject to the CD criterion.

The FDIC's current proposal unnecessarily diminishes the relief already proposed by the FDIC for banks from $250 million to $500 million, but it importantly increases the regulatory relief for banks from $500 million to $1 billion. **We believe that the FDIC's original proposal should be adopted and that the FDIC should also adopt this new proposal for a small bank streamlined examination with a CD criterion applicable to banks over the $500 million threshold. ABA believes that this would be a significant improvement in the current CRA regulations and would create a much improved "investment test" component that might be a model for reform of the investment test component of the large bank examination.**

<u>Raising the Threshold for the Streamlined Exam without a Community Development Criterion</u>

First, as ABA stated in its comment letter on the Interagency proposal, the agencies recognize that there a number of reasons for the CRA streamlined examination threshold to be raised from the $250 million adopted in 1995.

- First, with the increase in consolidation at the large end of the asset size spectrum, the gap in assets between the smallest and largest institutions has grown substantially since the line was drawn at $250 million in 1995. The growing asset gap between the smallest above-the-threshold institutions and the largest institutions has meant that the disproportion in compliance burden has grown on average.

- Second, the number of institutions defined as small has declined by over 2,000 since the threshold was set in 1995, and their percentage of industry assets has declined substantially.

> A $400 million bank president wrote to the ABA:
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> "We asked [the FDIC examiners] how we could comply [with the investment test] in a farm community of 3,500 population, that doesn't issue bonds and doesn't have a lo-mod census tract? They didn't have any answers because they didn't have any experience covering two states. She finally said to purchase bonds for lo-mod housing from downtown Chicago, 5 hrs. away."

- Third, some asset growth since 1995 has been due to inflation, not real growth.

- Fourth, the smaller the bank and the smaller the community, the greater the difficulty the bank will have in complying with the investment test.

The result of all of these factors, according to our calculations, show that on January 1, 1996, when the small bank examination went into effect, banks and savings associations under $250 million held just under 14% of the total assets of the banking industry. If the FDIC and the other agencies were to adopt a $500 million threshold today, then approximately 15% of total industry assets would be subject to the small bank streamlined examination without a CD criterion. In other words, adopting a $500 threshold just restores the *status quo* of the regulation when it was first adopted in 1995.[5]

ABA urges the FDIC to raise the threshold for a small bank CRA exam to $500 million.

Creating a Middle-Tier Streamlined CRA Examination with a Community Development Criterion for Small Banks Greater Than $500 Million But Less Than $1 Billion

The remainder of the FDIC's proposal involves whether the FDIC should create a new CRA examination for larger community banks (those from $500 million to $1 billion) that would apply the streamlined CRA examination to them but with the mandatory consideration of their community development lending, services and/or investments. **ABA urges the FDIC to do so.**

All of the agencies are aware that the investment test has always been problematic for small banks, particularly rural small banks. In fact, it was the number of CRA Public Evaluations of these banks highlighting the scarcity of qualified CRA investments that led the Agencies to propose to "clarify" the regulation in one of the official CRA Questions and Answers in 1999.[6] At that time, ABA wrote that it had "deep reservations about this proposed Q&A. The underlined portion of the proposed answer clearly grants CRA credit to a bank or savings association for investing or lending outside of the institution's assessment area (community). This is, of course, exactly the opposite of the purpose of the statute. The fact that the Agencies could adopt implementing regulations and

[5] Please see the ABA comment letter of April 6, 2004, already on file with the FDIC, for our full arguments.

[6] **Proposal No. 1: Sec. _. 12(i) and Sec. 563e.12(h)**
Proposed Q5: Must there be some immediate or direct benefit to the institution's assessment area(s) to satisfy the regulations' requirement that qualified investments and community development loans or services benefit an institution's assessment area(s) or a broader statewide or regional area that includes the assessment area(s)?
Proposed A5: No. The regulations, for example, recognize that community development organizations and programs are frequently efficient and effective ways for institutions to promote community development. These organizations and programs often operate on a local, statewide, or even multi-state basis. <u>Therefore, an institution's activity is considered a community development loan or service or a qualified investment if it supports an organization or activity that covers an area that is larger than, but is located in, the broader statewide or regional area that includes the institution's assessment area(s).</u> <u>The institution's assessment area need not receive an immediate or direct benefit from the institution's specific participation in the broader organization or activity, provided the purpose, mandate, or function of the organization or activity includes serving geographies or individuals located within the statewide or regional area that includes the institution's assessment area.</u> Furthermore, the regulations permit a wholesale or limited purpose institution to consider community development loans, community development services, and qualified investments wherever they are located, as long as the institution has otherwise adequately addressed the credit needs within its assessment area(s). [Emphasis added.]

guidance that achieve the exact opposite of the purpose of the statute suggests that somehow the Agencies have gone seriously astray."[7]

The FDIC's current proposal to reform the investment test into a community development test that looks at the bank's community development lending, services and investments as a whole appears to be a major step toward improving the CRA regulation.[8] By not focusing on the type of activity (loan, service or investment) but instead focusing on whether the combination results in community development, the FDIC aids bankers in flexibly meeting their entire community's credit needs. The FDIC's proposal also appears to go a long way to ending CRA's requirement that banks send money out of their communities in order to find enough CRA-qualified investments. We believe that the FDIC's proposal also has another important benefit: by creating a mid-tier CRA bank exam, the FDIC creates a transition examination toward the large bank examination, greatly reducing the "cliff effect" in the current regulation.

ABA urges the FDIC to create a new CRA examination for larger community banks (those from $500 million to $1 billion) that would apply the streamlined CRA examination to them but with the mandatory consideration of their community development lending, services and/or investments.

The FDIC specifically requests comments on whether the new CD criterion should be made a separate test in addition to the small bank standard. ABA opposes the creation of a separate test, for several reasons. First, such a separation creates the impression that CD lending is totally different from the provision of credit to the entire community, which is the statutory standard of review under the Community Reinvestment Act. ABA believes that would create an incorrect impression. The Community Reinvestment Act is not about a particular form or recipient of lending. It is clearly about providing credit to the entire community. That is why the current small bank test is so valid: it looks primarily at the bank's lending in its community – as required by the law. The test considers the institution's loan-to-deposit ratio; the percentage of loans in its assessment areas; its record of lending to borrowers of different income levels and businesses and farms of different sizes; the geographic distribution of its loans; and its record of taking action, if warranted, in response to written complaints about its performance in helping to meet credit needs in its assessment areas.

Inclusion of an evaluation of an additional category of CD lending (and services to aid lending and investments as a substitute for lending) fits well within the concept of serving the whole community. But we believe that a separate CD test would create a new CD obligation, not contained in the

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[7] The agencies did not adopt this formulation of the proposal, but reworded and finally adopted it in the 2001 CRA Q&A. The final wording still grants CRA credit for investments outside of a bank's assessment area that will have no direct impact or benefit on the bank's assessment area. "The institution's assessment area(s) need not receive an immediate or direct benefit from the institution's specific participation in the broader organization or activity, provided that the purpose, mandate, or function of the organization or activity includes serving geographies or individuals located within the institution's assessment area(s)." See 66 Federal Register at 36626-27, July 7, 2001.

[8] As best as we can determine, the actual genesis of a community development test rather than an investment test originated with very large urban banks that proposed this in comments to the 2001 ANPR, because they believed that the major urban community development projects they were sponsoring required a flexible mix of investments, loans and services from the bank, and the large bank exam's investment test did not accommodate such projects easily. The large banks told ABA that community development is a complex and difficult endeavor that is made more difficult and inefficient by these artificial divisions between community development lending, investments and services.

statute, that would take on a life and emphasis of its own that would be separate from, and in addition to, lending to the entire community. This would inevitably lead to another distortion of the Community Reinvestment Act. Also, a separate test would likely become a focal point for continuous criticism by CRA activists, since that is where their grants and donations will be counted. Finally, as noted by the FDIC in the proposal, it would also raise the difficult question of how much weight in the examination should be placed on just one category of community lending. That is, are CD loans worth twice as much as loans to businesses in the community? Or are they worth less than such loans? These are not questions that should be asked by regulators.

ABA opposes the creation of a community development test separate from the CRA streamlined evaluation.

Additional Issues Raised by the Addition of a CD Criterion

ABA is concerned that the creation of a CD test raises additional issues that need to be considered. The new CD criterion will put CD loans, CD investments, and CD services into the same category for evaluation with the bank allowed to vary the mixture of loans, services and investments as required by the bank's own character and by the nature of the bank's community. This valuable flexibility, however, raises questions of how to compare differing mixtures of loans, services and investments. If investments are to be compared with loans, bankers need to know whether they are "dollar for dollar" equivalent or should some other formula be used in converting investments or services into the equivalent of a loan. ABA suggests that CRA credit for investments needs to be adjusted for the cost of the capital to support the investments, when comparing investments to loans. The same would be true for services compared to loans, where the cost of the services would need to be evaluated in its cost to capital, and thus its indirect impact on credit availability.

For example, a grant that qualifies as a "CRA-qualified investment" would be roughly equivalent to a loan ten times the amount of the grant, since the capital required of a well-capitalized bank is 10% of the loan. Thus a loan of $100,000 is the credit equivalent of a grant of $10,000, since the grant money consists of 100% capital that will not be recovered and will no longer support that amount of lending into the community. This proposed capital cost valuation for true investments as well as for grants should be incorporated into the CRA regulations' overall definition of "qualified investment."

Further issues in finding an equivalency between CD investments, services and loans arise from consideration of the duration of the loan versus the duration of the service or investment. The duration of a grant to a community group is generally annual, but in a credit equivalent sense, it's duration is infinite, since the capital is now gone from the bank, so no additional loans can be made on the missing capital. Since most community development loans are treated more as business rather than consumer loans, a typical duration of five to ten years might be appropriate. In that case, grants might then be converted into their credit equivalent values and then "booked" for CRA purposes for ten years. However, ABA just suggests these guidelines as an approach to what will be the difficult problem of arriving at a method of comparing CD loans, services and investments for the purposes of the CD criterion.

ABA urges the FDIC to give guidance on how CD loans, investments and services will be compared under the CD criterion, and suggests that the capital cost of the activity should be the basis of any comparison.

Enlarging the Definition of “Community Development” to Include Rural Residents
The FDIC also proposes to change the definition of “community development” from only focusing on low- and moderate-income area residents to including rural residents. The FDIC said that this proposed change was intended to allow a broader range of activities by banks in rural areas to receive CRA credit. **The ABA strongly supports the FDIC’s proposal.**

ABA and FDIC are both aware that the CRA definition of “community development” has a strongly urban focus. As a result, there are often very few opportunities for rural community banks to provide qualified CRA loans, investments or services. In reviewing the CRA Performance Evaluations of rural community banks, one so often finds examination findings very similar to “[g]iven the limited opportunities for the bank to purchase qualifying community development debt or equity investments in its assessment area, the level is considered acceptable” that one suspects this is now a standard paragraph for examiners. ABA believes that the enlargement of the definition of “community development” to include rural residents, even if the census tract (which may contain tens or even hundreds of square miles in largely rural areas) is not an LMI census tract, would go a long way toward eliminating the current distortions in the regulations. These distortions can and do result in a small rural bank being told to invest in housing bonds in Chicago 250 miles away from its community. The FDIC’s proposal would, we earnestly hope, put a stop to such results.

ABA strongly supports enlarging the definition of “community development” to include specifically rural residents, irrespective of the median income of their census tract.

The FDIC further asks if “rural” needs to be defined, and if so, how that term should be defined. ABA notes that some CRA activists have already suggested that the FDIC’s proposal would allow CRA credit for loans to upper-income, part-time hobby farmers or to “farming” communities in affluent suburbs. First, we note that the present definition of “community development” already includes loans to small farms, if they meet the size eligibility standards of the Small Business Administration, irrespective of the owners, so that changing the definition will not affect the validity of those loans. However, there are more than farmers who are rural residents needing credit, and we, as noted above, do support enlarging the definition of community development to include those rural residents who are not owners of farms. In that case, it appears to ABA that a clear definition of “rural” would assist both bankers and examiners in determining whether a loan qualifies for consideration as a “community development” loan. Therefore, ABA urges the FDIC to explore the possibility of better defining the term “rural” in order to provide clear guidance to bankers and examiners.

ABA has looked at several possible definitions of “rural,” and we tentatively favor use of “metro” and “non-metro counties,” as designated by the Office of Management and the Budget. In 2003, OMB defined metro areas as (1) central counties with one or more urbanized areas, and (2) outlying counties that are economically tied to the core counties as measured by work commuting. Outlying counties are included if 25 percent of workers living in the county commute to the central counties, or if 25 percent of the employment in the county consists of workers coming out from the central counties—the so-called “reverse” commuting pattern. Non-metro counties are outside the boundaries of metro areas and are further subdivided into two types: micropolitan areas centered on urban clusters of 10,000 or more persons and all remaining “noncore” counties. The advantage to this definition is that it generally reflects the political subdivisions of the state and are readily understandable.

However, the disadvantage of the use of metro/non-metro is that it appears to us to allow suburban sprawl around urban centers to overwhelm rural populations, leaving the rural residents without the opportunity to benefit from the proposed change in the definition of community development. ABA has already heard from three agricultural banks that are now Home Mortgage Disclosure Act reporters because their rural counties are on the edge of major urban sprawl and were reclassified as part of an MSA, even though the banks are on the other side of the county. Thus it appears that the metro/non-metro approach does not cover all rural residents and that there will need to be an alternate test for rural that will not exclude those rural residents whose counties are on the edges of major metropolitan centers. ABA regulatory and agricultural lending staff members are available to discuss possible alternatives with the FDIC staff.

ABA recommends that the FDIC clearly define "rural" for the purposes of the "community development" criterion.

Conclusion

ABA commends the FDIC for proposing these important improvements in the Community Reinvestment Act regulation. ABA believes that the FDIC's proposal directly addresses the two most significant problems in that regulation: the imposition of a large and unnecessary regulatory burden on small banks and the imposition of an investment test that is largely unworkable with respect to small banks. ABA recommends that the FDIC adopt its two pending CRA proposals, resolving their differences as follows:

1. The FDIC should raise the threshold for a small bank CRA exam to $500 million without regard to the size of the bank's holding company.

2. The FDIC should create a new CRA examination for larger community banks (those from $500 million to $1 billion), with regard to the size of the bank's holding company, that would apply the streamlined CRA examination to them but with the mandatory consideration of their community development lending, services and/or investments.

3. The FDIC should not adopt a community development test separate from the CRA streamlined evaluation.

4. The FDIC should give guidance on how CD loans, investments and services will be compared under the community development criterion, and ABA suggests that the bank's capital cost of the activity should be the basis of any comparison.

5. The FDIC should enlarge the definition of "community development" as it has proposed to do, in order to include specifically rural residents, irrespective of the median income of their census

tract. FDIC should also clearly define “rural” for the purposes of the “community development” criterion.

If you have any questions about this comment, please call the undersigned.

Sincerely,

Paul Alan Smith

Paul Smith
Senior Counsel