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FUND

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*October 27, 2004*

VIA E-MAIL

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

**SUBJECT: PROPOSED REVISIONS TO THE CRA REGULATION – RIN NUMBER 3064-AC50**

Dear Mr. Feldman,

On behalf of Community Reinvestment Fund, Inc. ("CRF"), I appreciate this opportunity to comment on the Federal Deposit Insurance Corporation's ("FDIC") proposed revisions to the Community Reinvestment Act ("CRA") regulations, as published in the *Federal Register* on August 20, 20004.

**BACKGROUND**

Community Reinvestment Fund is a national nonprofit financial services organization headquartered in Minneapolis, MN. We provide new loan capital for community-based development lenders by operating a secondary market for their loans. CRF purchases performing economic development and affordable housing loans from private nonprofits, governmental and quasi-public agencies. We pool these loan obligations and transform them into securities through the process of securitization. These securities are then sold to banks, insurance companies, pension funds and other qualified institutional investors. As of June 30th, CRF had purchased approximately $352 million in loans from 109 lending organizations in 24 states and the District of Columbia. In turn, we have provided nearly $326 million to those selling organizations for reinvestment in their communities.

Recently, CRF completed the sale of its *first rated debt offering*, with the highest class of certificates in this offering receiving an AAA rating from Standard & Poor's. These certificates are backed by a pool of loans totaling $84.7 million and which consist of 45 multifamily, low-income housing tax credit properties in California, Florida, Wisconsin and Washington state.

CRF has also been instrumental in developing the New Markets Tax Credit ("NMTC") program administered by the Treasury Department's Community Development Financial Institutions Fund ("CDFI" Fund) and the Internal Revenue Service. We received $162.5 million in NMTCs in March of 2003 – the largest allocation awarded to a national organization in the first round of funding. We were subsequently awarded an additional $150 million of tax credits in the second round of funding announced in May of this year. We believe this new federal program will bring much needed capital to low-income communities.

**CRF'S POSITION ON CRA**

CRF has always been a strong proponent of the Community Reinvestment Act. We believe that this law has been extremely effective in encouraging banks and development lenders to build partnerships to finance revitalization activities in distressed communities across the country. In addition, we strongly supported the major amendments to the CRA regulations that were adopted in 1995 by all four Federal banking agencies. These amendments emphasized a depository institution's "performance" over "process" and in our view, they strengthened both the structure and implementation of the CRA regulations.

**COMMENTS ON THE FDIC'S PROPOSED REVISIONS TO THE CRA REGULATION**

I would like to offer specific comments on each of the FDIC's three proposed revisions to the CRA regulations including: (a) changing the definition of a "small bank"; (b) adding a community development criterion to the streamlined CRA evaluation for small banks; and (c) expanding the definition of "community development" to encompass a broader range of activities in rural areas.

**SMALL BANK DEFINITION**

CRF has serious reservations about the FDIC's proposal to redefine a "small bank" as an institution with $1 billion or less. We are concerned that raising the asset size threshold from $250 million to $1 billion for a "small bank" and ignoring affiliations with large holding companies (defined as having total assets of $1 billion or more) will result in a dramatic decrease in CRA investing activity in low- and moderate-income communities across the country. In our view, the decrease in investment activity will be particularly acute in rural areas and in states where there are fewer financial institutions. We agree, as noted by the federal bank regulatory agencies, that there have been tremendous changes in the financial services industry since the CRA regulations were amended in 1995. With the repeal of both the Glass-Steagall [1] and the McFadden Acts[2], there has been substantial consolidation among depository institutions - primarily through mergers and acquisitions. However, we disagree that because of this industry consolidation, it is appropriate to quadruple the

[1] The Glass Steagall Act prohibited common ownership of commercial and investment banking organizations.

[2] The McFadden Act prohibited interstate banking.

asset size or threshold for a "small bank".[3] According to the FDIC's logic, defining a "small bank" as having $1 billion or less in total assets is simply in keeping with changes taking place in the banking industry and will not have *a material effect* on the volume of industry assets evaluated under the more detailed three part CRA test.

From CRF's perspective, focusing exclusively on industry assets captured under the "large bank" CRA examination misses a critical element in the "community development equation"– that the *total number of institutions* subject to the three-part test will decline significantly (by as much as 1300 depositories according to some community-based organizations). This decline in institutions deemed to be "large banks" or conversely, the increase in the number of banks considered to be "small banks" (e.g. evaluated under the "streamlined" CRA examination test) could significantly reduce the number and volume of bank investments in critical community development funding vehicles, such as the Low Income Housing Tax Credit ("LIHTC") which provides vital resources for the development of affordable housing, as well as Equity Equivalents ("EQ2s") - a newer form of equity-like capital being raised by many nonprofit development lending organizations. Under this proposal a substantial number of banks would no longer be required to meet all three components of the "large bank" CRA test – the lending, investment and services tests. The CRA performance of these institutions would be evaluated under the "small bank" test – which concentrates primarily on the lending activities of the depository institution. Our concern is that without the mandate to meet the requirements of the investment and services test, many of these smaller institutions would cease to build partnerships with community development organizations and engage in essential investment activities. Unlike their larger counterparts, smaller banks make their credit decisions at the local level and in many rural areas – these banks are the only depository institutions in their communities. If they are not encouraged (through regulation) to participate in these vital community development investment activities an important financing resource may simply disappear in some communities.

CRF has a particular interest in the investment test because several products that we offer to depository institution investors would be directly affected if fewer banks were subject to the three-part CRA test. For example, CRF has raised permanent capital (nonprofit equity) in the form of Equity Equivalents ("EQ2s") from a number of small banks over the past several years. In addition, when we securitize the loans we purchase, CRF issues Revenue Notes – securities that are considered to be *"qualified investments"* for the purposes of the investment test under the existing CRA regulations. Finally, this proposed change could adversely impact investments in Community Development Entities ("CDE's"), like CRF's National New Markets Tax Credit Fund. These entities are the vehicles through which funding from New Markets Tax Credits is made available to

[3] According to the August 20th Notice of Proposed Rulemaking, roughly the same percentage of industry assets (85.1% in 1995 versus 86.2% in 2004) will still be held by "large banks" that are subject to the three part CRA examination (which includes the lending, investment and services tests).

low-income community businesses. Reducing in the number of institutions required to make community development investments could dramatically diminish the attractiveness of EQ2s, Revenue Notes and CDEs and thus discourage future investments in our products and/or our organization.

In our view, industry assets are *not* a good benchmark for assessing the effectiveness of the CRA regulations because this metric ignores the importance of small banks in financing community development investments in their communities. We believe that the number of industry participants – though they may be small in terms of asset size – is a better measure of the effectiveness of these regulations. Radically increasing the asset size of a "small bank" would actually exacerbate the negative effects of banking consolidation – such as the decline in number of community banks and moving credit decisions away from the local level - and ultimately weaken – not strengthen the effectiveness of these regulations. We would urge the FDIC *not* to raise the asset threshold for a "small bank" above the existing $250,000 level.

Finally, we oppose the FDIC's proposal to treat small banks affiliated with a holding company having assets of $1 billion or more – as a "small bank" for CRA purposes. Under the current regulations, if a depository institution is affiliated with a holding company of this size, then the institution is evaluated under the "large bank" CRA test. We strongly agree with other commenters who suggested that "by reducing the holding company threshold from the definition of a "small bank," the regulators will not only reduce the number of institutions subject to the large bank test, but also create a potential loophole for large holding companies to exploit when trying to evade CRA compliance." Further, we believe that holding companies with over $1 billion in assets have ample resources to establish and implement the infrastructure necessary to engage in and report on community reinvestment activities under the "large bank" test.

**RECOMMENDATION ON SMALL BANK DEFINITION**

We would recommend leaving the current definition of "small bank" as it is, in other words, *not raising the asset threshold to $1 billion* and *not eliminating affiliations with a holding company (having assets of $1 billion or more) from consideration.* If the agency were compelled to modify the definition of "small bank," we would strongly urge the FDIC to increase the asset size to $500 million rather than $1 billion and to maintain the holding company affiliation as a consideration. If the agency does raise the asset size of a "small bank," we believe it would be essential to establish a meaningful community development criterion or test with significant incentives to ensure that banks continue to make investments that are vital to their communities. (See next section for additional discussion)

As a final point, we would also strongly urge the FDIC to work in concert with other Federal banking and thrift regulators as we have grave concerns that the lack of regulatory consistency could undermine the integrity of the supervisory system by inadvertently encouraging banks or thrifts to switch their charters in order to circumvent CRA requirements. Such a development could be harmful to the safety and soundness of the banking system.

**COMMUNITY DEVELOPMENT CRITERION**

The FDIC is also proposing to add a *mandatory* community development performance criterion to the "streamlined" CRA test for banks with assets between $250 million and $1 billion. This community development criterion would be evaluated along with the current criterion applicable to all small banks which focuses primarily on lending activities and includes five components.[4] For banks subject to this community development criterion, the FDIC would assess a bank's record of helping to meet the needs of its assessment area(s) through a combination of its community development lending, investing or service activities. In other words, a bank could choose to engage in one or more community development activities based on opportunities in the market and the bank's strategy for serving its market. Under the FDIC's proposal, a bank with assets greater than $250 million but no more than $1 billion would *only* receive an "Outstanding" CRA rating if the institution exceeds the "Satisfactory" performance standards for each of the six criterion, including the new explicit community development standard.

**RECOMMENDATION ON COMMUNITY DEVELOPMENT CRITERION**

CRF supports the notion of creating a *mandatory* community development criterion as part of the definition of "small bank." However, we would prefer to see a *separate mandatory community development test* that is specifically dedicated to assessing the performance of an institution's community reinvestment activities. We believe a separate test would carry more weight and serve to underscore the importance of these activities rather than simply including community development activities as an additional component of the "small bank" evaluation standards.

We would recommend that the existing five lending components of the "streamlined test" should be assigned a combined weighting of 75% and that the new community development test should carry a weight of 25%. As is currently the case, a depository institution should be required to exceed the "Satisfactory" performance standards for each of the five lending criterion, *as well as for the new community development test,* in order to receive an "Outstanding" CRA rating under the revised regulations.

[4] The five components under the existing CRA regulations are as follows: the depository'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 the credit needs in its assessment areas.

Finally, we urge the agency to consider providing "extra credit" (perhaps twice as much) to banks that engage in investment activities under the separate community development test. This would provide an incentive for depositories to continue to make qualified investments in LIHTCs, EQ2s, or directly into CDEs, all of which are vital to communities, especially in rural areas.

**COMMUNITY DEVELOPMENT DEFINITION AND RURAL AREAS**

The third change proposed by the FDIC to the CRA regulations would expand the definition of "community development" to encompass a broader range of activities in rural areas. Many bankers have voiced concerns about the difficulties they face when trying to conduct CRA activities in rural areas. While CRF appreciates the unique challenges of lending and investing in rural communities, ***we oppose this proposed change*** because we have serious reservations about the specific language put forth by the FDIC. Under the agency's proposal, the definition of "community development" would be amended to include affordable housing and community services provided to low- or moderate-income individuals *"or individuals in rural areas"(emphasis indicates new language to be added).* This new language could make it considerably easier for depository institutions to meet their CRA requirements because *any loan* made to an individual in a rural area would treated as a CRA loan, regardless of the borrower's income. Banks would be free to ignore the credit needs of low- and moderate-income borrowers since they could meet their CRA requirements by making loans to wealthier borrowers, as long as they were located in rural areas. Because CRF's mission is to support community and economic development lending organizations, the ultimate beneficiaries of our activities have always been low- and moderate-income individuals and the communities in which they live. Tacitly encouraging discriminatory lending practices, such as these, directly contradicts our mission as well as the intent and the spirit of the Community Reinvestment Act.

**CONCLUSION**

In closing, we would like to commend the agency for seeking new approaches to balancing the credit needs of local communities with the regulatory burden imposed by the CRA regulations. We appreciate the opportunity to share our views on the agency's new proposal. However, we wish to reiterate our serious concerns that this proposal, as outlined, *will not* strengthen the effectiveness of the CRA regulations and the role depositories play in helping to meet the credit needs of their communities. We would therefore urge the FDIC to carefully weigh the ramifications of the proposed revisions before making such changes. Should you or your staff have any questions regarding the information presented in this letter, please do not hesitate to contact me directly.

Sincerely,

Frank Altman
President