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October 20, 2004

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

Re: Community Reinvestment, RIN number 3064-AC50
Proposed Increase to Eligibility for the Streamlined Small-Bank CRA Exam

Dear Mr. Feldman:

The Independent Community Bankers of America (ICBA)¹ appreciates this opportunity to comment on the FDIC's Community Reinvestment Act (CRA) proposal. The proposal would increase the asset size limit for eligibility for the streamlined "small-bank" Community Reinvestment Act (CRA) examination to \$1 billion (and eliminate the separate qualification based on holding company affiliation); add a new community development criterion to the streamlined exam for banks between \$250 million and \$1 billion; and expand the definition of community development to include activities that benefit rural residents.

Summary of ICBA Comments

ICBA strongly supports the proposal and commends the FDIC for taking this important step to help alleviate the crushing regulatory burden facing community banks while not weakening CRA. Since the inception of the streamlined CRA exam, ICBA has strongly supported it and advocated expanding eligibility to more community banks in order to reduce unnecessary regulatory burden. The proposal will result in more cost effective and efficient CRA examination and compliance for community banks, while enhancing community banks' ability to devote their community development resources to activities that are needed most in their local communities.

¹The 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 promoting 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.

Expanding eligibility for the streamlined exam will not change the way community banks do business or lessen their resolve to reinvest in their communities. In fact, by alleviating unnecessary paperwork and examination burden, it will allow community banks to reallocate and redirect both human and financial resources to their communities and customers.

The ICBA and community bankers strongly disagree with opponents of the proposal who claim that communities, particularly rural communities, will lose community development investments as a result of the proposed changes. In fact, the greater flexibility of the proposed new community development criterion, as compared to the current, restrictive investment test, will allow community banks to focus efforts locally, based on market needs and opportunities and the bank's strategic strengths—instead of being forced to make “qualified investments” that may have little direct impact in their own communities.

Likewise, the expanded definition of community development to include activities that benefit rural residents recognizes the unique needs of rural areas where, because of population patterns, it is often difficult to isolate activities that are focused solely on low- and moderate-income individuals or geographies. Activities that revitalize or stabilize rural areas should not be excluded from CRA credit just because higher income residents will also benefit from the economic development.

The FDIC's proposal recognizes that it is counterproductive to impose unnecessary regulatory burden on community banks by examining banks with less than \$1 billion in assets for CRA compliance using the same procedures and methods as for a \$100 billion or \$500 billion bank. A \$1 billion limit for the streamlined CRA exam also recognizes the dramatic demographic shifts that have taken place in the banking industry in the last 10 years. If adopted, approximately the same vast percentage of banking industry assets—85 percent—would be covered by the large bank exam as when the streamlined exam size limit was first set at \$250 million in 1995.

ICBA favors the four banking agencies working diligently to develop a uniform approach to CRA, but it must be the right approach—one that reduces unnecessary regulatory burden while encouraging community development and reinvestment. We believe the FDIC's approach achieves that balance. We do not believe that interagency differences should delay implementation of the FDIC's proposal.

Specific Comments

The Streamlined Exam Is Not an Exemption from CRA

Contrary to gross mischaracterizations by opponents of the proposal, the streamlined exam is *not* an exemption from CRA requirements. Community banks examined under the CRA streamlined review are and would continue to be examined to ensure they lend to all segments of their communities, including low- and moderate income individuals and neighborhoods.

Examiners would continue to conduct a thorough CRA review to assess the bank's loan-to-deposit ratio; the percentage of loans made in the community; the distribution of loans to borrowers of different income levels and businesses and farms of different sizes; the geographic distribution of loans across neighborhoods of different income levels; and the bank's responses to written complaints about its CRA performance. In addition, banks between \$250 million and \$1 billion would be assessed on their community development activities including lending, investments and services.

The streamlined exam is in full accord with the stated purpose of the Community Reinvestment Act. Under the statute, bank regulators are to assess each institution's record of helping to meet the *credit* needs of the local communities in which the institution is chartered, including low- and moderate-income neighborhoods, consistent with safe and sound operations.² The statute and purpose of CRA do not look to investments, grants and services to the community—but to the lending needs of the community.³

The major difference from the large bank exam is that the streamlined exam is focused, like the CRA statute itself, on *lending*. In addition, banks under \$1 billion in assets would be freed from burdensome data collection and reporting on small business, small farm and community development lending required under the large bank exam (requirements not clearly authorized by Congress). The burden for assessing compliance would shift to examiners, and examiners would assess the bank's lending record using existing bank files.⁴

The proposed change recognizes the regulatory burdens imposed by CRA and adjusts the burdens—but does not cut back on the requirements of the CRA itself. Ultimately, by freeing community banks from unnecessary burdens and costs, the proposal would allow more community banks to engage in the types of local activities that the CRA is designed to promote.

Banks Subject to the Streamlined Exam Would Not Shirk Reinvestment Obligations

Opponents suggest that without the investment test of the large bank exam, communities will lose investments that serve low- and moderate-income residents and economic development efforts in communities served by community banks would be undermined. They also suggest that the proposal will eliminate regulatory incentive for

² Community Reinvestment Act, 12 U.S.C. Sections 802 (b) and 804(a)(1).

³ 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.

⁴ It is also important to recognize that a collateral benefit to reduced regulatory burden is that much of the costs for compliance are passed along to bank customers, so that the costs of complying with these many demands increases the costs of consumer credit.

community banks to provide affordable or basic banking services that serve an important first step to bringing the unbanked into the mainstream of financial services.

This sky-is-falling rhetoric is unfounded and fails to recognize the reality of community banking. Ignoring the needs of the community is not a viable business model for a community bank. The success and survival of community banks, particularly those in small towns and rural areas, depends on the success and vitality of their communities. That means community banks must be responsive to community needs. Economic and community development is the lifeblood for community banks and rural communities. Reinvesting in the community is not only the law – it is good business for community banks.

Banks with less than \$250 million in assets and not affiliated with a holding company over \$1 billion in assets have been examined for nearly 10 years using the streamlined CRA exam. These banks have been successful and committed contributors to their communities, especially in rural areas, even though they have not be required to undergo the large bank CRA exam.

Likewise, banks between \$250 million and \$1 billion would continue to reinvest in their communities and engage in community development activities if examined as proposed by the FDIC.

The vast majority of community banks reach out into their communities, make low- and moderate-income loans, offer special deposit services for low and moderate-income residents, and otherwise spend time and financial resources to promote economic development and meet the credit needs of their communities. They do this because it is good business and it helps ensure a vital community.

Banks currently eligible for the streamlined review report undertaking many and varied affordable housing and community development activities without being subjected to a separate investment or community development test. For example, these banks provide loans that provide essential living services and homes for the handicapped, housing grants for first-time homebuyers through a Federal Home Loan Bank program, loans to support local job creation for low- and moderate-income individuals, joint projects with vocational development programs, lease and other financing for local schools, bond financing for state and local public works projects, and office space and staff support for Habitat for Humanity, to name a few.

We are unaware of complaints that banks under \$250 million in assets do not successfully serve the credit and community development needs of their communities. They are not exempt from CRA requirements. Community banks between \$250 million and \$1 billion in assets are engaged in many similar activities – and will continue to do so regardless of whether they are assessed under a streamlined CRA exam. However, freeing these banks from the regulatory and bureaucratic demands of the large-bank CRA review will free capital and human resources that can be directed towards serving their communities.

New Community Development Criterion Will Promote Service to Communities Better Than the Investment Test

The FDIC proposes to add a new community development criterion to the streamlined exam for banks between \$250 million and \$1 billion in assets. The new criterion would assess banks on their overall community development activities, and would consider a combination of community development lending, investments and/or services. Each bank would have flexibility to balance the different activities based on community needs, market opportunities and the bank's strategic strengths.

ICBA supports the proposal and believes it will improve the CRA regulation by promoting service and reinvestment in communities better than the existing investment test. At the same time, we note that the FDIC still has outstanding the February 2004 interagency proposal to increase the asset size limit for the streamlined exam up to \$500 million—without the additional community development criteria. ICBA would also support a combination of the two proposals, that is, the existing streamlined exam for banks up to \$500 million in assets, and the streamlined exam including the new community development criterion for banks with \$500 million to \$1 billion in assets.

The investment test of the current large bank CRA exam is flawed for community banks. The definition of “qualified investments” is too restrictive and qualified investments that target only the requisite low- and moderate-income residents and areas are often not available in many community banks' assessment areas. The perverse result is that community banks report they are forced to *divert* resources away from their communities in order to meet the investment test.

In an ICBA/Grant Thornton study of the costs of CRA compliance for community banks, nearly 70 percent of “large” community banks reported that the opportunities for qualified investments are highly competitive and not readily available.⁵ Community banks must compete with multi-billion dollar banks for the limited supply of qualifying investments. Even banks over \$750 million in assets find it difficult to locate qualified investment opportunities, in part because they may be located in areas where low- and moderate-income tracts are not as neatly segregated as they are in large urban metropolitan areas.

These restrictions on community development activities severely hamper “large” community banks' ability to meet local demands. For example, excluded are investments in local municipalities, municipal economic development corporations, and other loans and investments that provide needed financing to provide infrastructure and jobs but which do not satisfy existing restrictions.

As a result, community banks (particularly those in non-urban areas) report making investments to satisfy CRA criteria, such as statewide housing bonds or mortgage-backed securities that have little direct benefit in their own communities.

⁵ “*The High Cost of Community Bank CRA Compliance: Comparison of ‘Large’ and ‘Small’ Community Banks*,” prepared by Grant Thornton on behalf of the Independent Community Bankers of America, August 2002.

These investments may benefit a statewide or regional area, but they ultimately take resources away from the local community, diverting local funds instead of reinvesting them.⁶ While this interpretation of the existing CRA regulation was intended to facilitate community investment activities, it has had the opposite impact. Local communities would be better off if community banks were permitted to truly reinvest those dollars locally in the form of loans, investments and/or services to support their own local economies and residents, as contemplated by the new community development criterion.

The proposed community development requirement for banks between \$250 million and \$1 billion is appropriately more flexible than the large bank investment test since it considers not only investments but also community development lending and services. The combined assessment provides a greater degree of flexibility that should allow community banks to establish more effective community development programs that are more beneficial to the local community because each community bank can tailor its community development activities both to what is needed in the community and to the bank's strategic strengths. Expanding the criterion will go a long way to rectifying the flaws in the existing application of the investment test. It will return the focus to *community development*, instead of arbitrarily requiring a particular type of activity, i.e., investment.

Some community bankers are apprehensive about the new approach, since history suggests that a different approach can easily lead to more—not less—regulatory burden. These bankers are concerned about how this new criterion will be implemented, measured, and applied. For example, if examiners continue to mandate investments in markets that include but do not directly benefit the local community, the new criterion has the potential to continue to disadvantage the bank's own community. Therefore, ICBA strongly encourages the FDIC to work with industry representatives and other interested stakeholders as it develops a final rule and examination guidance to apply the new community development criterion.

The FDIC asks whether the new community development criterion should be a separately scored test for banks between \$250 million and \$1 billion. ICBA opposes a separate community development test, as such a two part lending and community development test system will not yield the same burden-reducing benefits as the streamlined exam with the additional community development criterion. A community bank's record of meeting the credit needs of its community should be judged on the totality of its activities. Adding a separate community development test would present the danger of again distorting a bank's activities to meet arbitrary tests as has been the case with the investment test. A separate test also brings with it the challenges of assigning weights to the various tests in order to determine a composite CRA rating—again an arbitrary process.

⁶ Community bankers also report that at the same time competition for these investments has increased in recent years, the yields on those that are available have decreased. These factors combine to produce a negative impact on the bank's capital.

Expanding the Definition of Community Development Will Aid Rural Areas.

The ICBA also strongly supports the FDIC 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 FDIC's proposed new 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.⁷ 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

⁷ "EForum Results: The Pulse of Small Town and Rural America," NADO Research Foundation, August 2004, page 6.

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

The ICBA strongly disagrees with those who predict the FDIC 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 FDIC 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).

The FDIC Proposal Will Restore Equity in the Face of Changing Industry Demographics

Industry demographics have changed dramatically since 1995, and it is time that regulatory requirements catch up with the demographic changes. While it is true that more than 800 community banks would benefit from the FDIC’s proposal, the absolute number of banks affected does not tell the full story. Even if the threshold for the streamlined exam were increased to \$1 billion, 85% of industry assets would still be subject to and examined under the large bank CRA examination process. That percentage figure is actually somewhat less than the 17% of industry assets covered by the streamlined exam when it was originally adopted in 1995.

Since 1995, the industry has seen dramatic concentration and the creation of several mega-banks with assets in the hundreds of *billions*. The asset gap and other differences between the largest institutions and community banks are growing. Moreover, a more telling statistic is that since 1995 the number of small institutions has declined by 2,000. The FDIC proposal will result in more cost effective and efficient CRA examination and compliance for community banks and will help restore the balance in CRA regulation between the streamlined and large bank exams that existed in 1995.

The Proposal Will Provide Needed Regulatory Burden Relief

One of the most significant issues facing community banks is the crushing regulatory burden. Regulatory burden consumes a significant and growing proportion of

community banks' financial and human resources and has a negative impact on their ability to compete effectively in the marketplace. While CRA is but one aspect of regulatory burden that affects community banks, community banks incur a disproportionately high and unnecessary regulatory cost when subjected to the large bank CRA exam. Resources consumed by regulatory burden would be better devoted to service to customers and communities.

The ICBA believes the FDIC's proposal correctly recognizes that CRA compliance burdens place an unfair burden on "large" community banks. A 2002 ICBA/Grant Thornton study entitled *The High Cost of Community Bank CRA Compliance: Comparison of 'Large' and 'Small' Community Banks* showed that CRA compliance costs can more than double when community banks exceed \$250 million in assets and are no longer eligible for streamlined examinations. A survey conducted as part of the study showed that the mean employee cost attributable to CRA examination is 36.5 percent higher at large community banks than at small community banks. Further, in each of two specific cases analyzed in the study—one contrasting costs for a "small" and "large" bank owned by the same holding company, and one contrasting costs for a bank that grew from "small" to "large" bank status—CRA examination and paperwork costs were four times and ten times greater, respectively, for large community banks than for small ones. This is the only study of its kind contrasting costs of the small and large bank CRA exam for community banks that ICBA is aware of. It demonstrates the tremendous impact of regulatory burden associated with the large bank CRA exam for community banks.

The FDIC's proposal must be viewed in light of the overall regulatory burden that disproportionately impacts community banks and threatens their continued viability. Regulation burden is one of the top three or four concerns of community bankers today. The burden has been increased dramatically in recent years as Congress and the regulators constantly impose new reporting and compliance requirements such as the privacy title of the Gramm-Leach-Bliley Act; anti-money laundering/anti-terrorist financing provisions of the USA-PATRIOT Act; accounting, auditing and corporate governance reforms of the Sarbanes-Oxley Act; consumer disclosures and other obligations under the FACT Act; and expanded data collection and reporting under the Home Mortgage Disclosure Act.

As pointed out so eloquently by FDIC Vice Chairman John Reich, the number of community banks is dwindling, in part due to the level of regulatory burden.⁸ Reich stressed the importance of regulatory burden reduction to community banks and the communities they serve in Congressional testimony: "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....if we do not do something to stem the tide of ever increasing regulation, America's community banks will disappear from

⁸ Statement of John M. Reich, Vice Chairman, Federal Deposit Insurance Corporation on Consideration of Regulatory Reform Proposals before the Committee on Banking, Housing and Urban Affairs, United States Senate, June 22, 2004

many of the communities that need them most.” Two Federal Reserve economists have reached a similar conclusion.⁹

The proposed changes to the CRA rules will do much to alleviate this burden and free many community banks from the analysis, data collection and other paperwork needed to demonstrate compliance with the large bank CRA tests. In fact, one of the advantages to the FDIC’s proposed three-tier system, with banks under \$250 million subject to the current streamlined exam, banks between \$250 million and \$1 billion subject to the streamlined exam with an added community development criterion, and banks over \$1 billion subject to the existing large-bank exam is that it provides an added transition phase between the streamlined exam and the large bank process. The ICBA believes this is preferable to the current regulation, and will further help alleviate the existing regulatory burden when a bank transitions from the streamlined CRA exam to the large-bank process.

Without the changes to CRA and other rules, the likelihood steadily increases that smaller institutions will merge with larger banks to address the increasing costs of regulatory compliance. When the Federal Reserve withdrew its February 2004 proposal to set the streamlined exam asset limit at \$500 million, it said it was concerned that rural communities would suffer from diminished community development investments. In our view, the FDIC proposal will do more to help rural communities and equally important, by reducing regulatory burden it will help make it easier for community banks to stay independent and focus on their local communities. As any resident of a rural community can tell you, the loss of the local bank through merger with a larger out-of-area bank is a major blow to the local community.

Conclusion

Expanding eligibility for the streamlined exam will not change the way community banks do business, but it will free resources for them to better serve communities. Regulatory burden reduces the level of community development capital and drives the consolidation of the community banking industry, taking community banks out of local communities.

Not only do regulatory costs consume valuable human and financial resources that could be better devoted to local communities, but if the regulatory burden load is not lightened, community banks will cease to fulfill their important role in supporting communities and providing a viable competitive alternative to conglomerate financial services providers, who have little commitment to thousands of small towns and cities served by community banks.

The FDIC’s proposal would increase the ability of community banks to serve their communities by relieving them of the more onerous regulatory burden associated with the large bank exam. The proposal would not exempt any banks from CRA obligations, but recognizing the disproportionate impact that regulatory burden has on small banks, the

⁹ “*Small Banks Far From Thriving*,” *American Banker*, August 20, 2004, p. 10

proposal would allow more banks to be reviewed under streamlined procedures and help alleviate that burden.

The streamlined exam was the most successful innovation of the 1995 CRA revisions. It achieved the goals of the revisions by emphasizing performance over paperwork, while maintaining an effective review of a bank's CRA record. Now is the time to extend the burden-reducing benefits of the streamlined exam to more community banks.

If you have any questions or need additional information, please contact the undersigned or Robert Rowe, ICBA regulatory counsel, by telephone at 202-659-8111 or by e-mail at karen.thomas@icba.org or robert.rowe@icba.org.

Thank you for the opportunity to comment.

Sincerely,



Karen M. Thomas
Executive Vice President
Director, Regulatory Relations Group