Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429Re: RIN 3064–AC50; FDIC Proposed Revision of the CRA Regulations; 12 CFR Part 345; 69 Federal Register 51611; August 20, 2004

May 8, 2005

Dear Sir:

The FDIC proposes to add a new community development criterion, hereafter CD, to the small bank examination standard for banks between $250 million and $1 billion. These new CD guidelines would require evaluation of the bank's community development activities, i.e., lending, services and/or investments, the mix to be determined by the opportunities present in the community and the bank's own strategic strengths.

We recommend that:

- The FDIC create a new CRA examination, 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. In other words, treat all banks under $1 billion in assets the same as a streamlined small bank examination group.
- The FDIC **not** adopt a community development test separate from the CRA streamlined evaluation.
- The FDIC give guidance on how CD loans, investments and services will be compared under the CD guidelines, and that the bank's capital cost of the activity should be the basis of any comparison.
- The FDIC expand the definition of "community development" to include specifically rural residents, regardless of the median income of the census tract. The FDIC should also clearly define "rural" for the purposes of the "community development" guideline.

Why Revise the CRA Process?

It is our feeling that community banks need relief from the large bank examination, therefore all banks with assets under $1 billion should be treated as the small bank streamlined examination group.

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. This forced 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 "investment test" has proven to be a huge regulatory challenge for community banks. We believe this has resulted in many

having to send money out of their communities to comply with this large bank test. The FDIC's proposal to increase the threshold for the small bank should include a provision that all banks under $1 billion in assets are to be treated under the streamlined approach. The streamlined exam has proven to be a tremendous improvement.

Regulatory Burden

The infamous Paperwork Reduction Act is in contradiction to what is really happening. 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.

On May 12 of 2004 FDIC Vice Chairman Reich, before the Subcommittee on Financial Institutions and Consumer Credit of the House Financial Services Committee, noted the magnitude of the problem for community banks. In the hearing "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**. Further, he stated "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." As it relates to the CRA revision, 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. Banks under $1 billion in assets simply do not have the financial resources to handle the paperwork challenge, after all, the community bank is already serving their communities. Also, the credit unions are serving their communities with the very same product mix and they do not have to comply with the CRA regulations, this is very absurd and it runs contrary to the idea of a free and competitive business environment free of government burdens.

The Investment Test Challenge

For small banks, the investment test is often an incredible regulatory challenge for small, rural banks.

- First, the definition of qualified investments is too narrow. 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." This narrow definition results in

many valuable 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 best example of this effect is 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. Investments, including grants and charitable contributions, by banks are funneled by the regulatory requirements into very specific types of activities and recipients. 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.

- Secondly, the CRA regulations define "qualified investments" as those having a primary purpose of community development. Again, by the narrow definition of what qualifies, the regulations have decreased the pool of "qualified investments" available to banks and savings associations. Smaller banks subject to the large bank investment test that they are unable to compete with multi-billion dollar banks and installment loan corporations 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.

  Our bank has limited resources available through security brokers to meet the demands of the qualified investment requirements. We try to find opportunities through other sources like forming community bank groups to share investment opportunities, however, there is a limited supply line of those qualified investments. We rely heavily on mortgage back securities in LMI census tracts to supplement our investment test requirements, many times we have to buy mortgage backed securities where the LMI loans are located outside our assessment area. Again, our money is being diverted outside our assessment area to meet the qualified investment requirements.

Specific Comments on the FDIC's Proposal

The FDIC now proposes to raise the small bank threshold to $1 billion but includes an added community development requirement, similar to the large bank examination's review of community development lending, services and investment for large banks. In this proposal, community development would be considered in a single test for small banks.

The FDIC's current proposal increases the regulatory relief for banks from $500 million to $1 billion.

We believe that the FDIC's original proposal should be adopted. The FDIC should also adopt the streamlined small bank requirements for those banks under $1 billion in assets.

Under the current proposal, the underlined intention of the proposal clearly grants CRA credit to a bank or savings association for investing or lending outside of the institution's assessment area. This is in direct contradiction of the purpose of the statute. The fact that the Agencies could adopt implementing regulations and guidance that achieve the exact opposite of the purpose of the statute suggests that somehow the Agencies have gone seriously astray.

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. By not focusing on the type of activity, e.g., 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. Althoughthe FDIC's proposal has another important benefit: creating a mid-tier CRA bank exam, **the regulatory requirements are still too burdensome for banks between $500 million and $1 Billion in asstes.**

We urge the FDIC to implement the same streamlined procedures used for small banks under $1 billion in assets.

The FDIC specifically requests comments on whether the new CD guidelines should be made a separate test in addition to the small bank standard. **We oppose 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, this would create the wrong 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.

- Secondly, we believe that a separate CD test would create a new CD obligation, not contained in the 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 will change the intent of the CRA act.

- Thirdly, 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, how much weight should be placed on just one category of community lending. CD loans are 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. Inevitably, the regulators will try to decided the amount of weight they want to apply to CD loans.

Additional Issues Raised by the Addition of a CD Procedure

We are 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, we 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. We suggest 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.

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, we suggest 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.

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

Expanding 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. We support this position. The FDIC should be 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. We believe that the expansion of the definition of "community development" should include rural residents, even if the census tract 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 away from its community. The FDIC's proposal would, we earnestly hope, put a stop to such results.

We strongly support expanding 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. We know 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, regardless 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 do support expanding the definition of community development to include those rural residents who are not owners of farms. It appears to us 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, we urge the FDIC to explore the possibility of better defining the term "rural" in order to provide clear guidance to bankers and examiners.

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. 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.

We recommend that the FDIC clearly define "rural" for the purposes of the "community development" criterion.

Conclusion

1. The FDIC should treat all banks under $1 billion in assets the same without regard to the size of the bank's holding company. The streamlined CRA examination procedures should be applied to them, regardless of asset sized under $1 billion, but with the mandatory consideration of their community development lending, services and/or investments.

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

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

4. The FDIC should expand 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.

We urge your careful consideration in light of the financial impact on banks with assets under $1 billion. Community banks have been and will continue to service all segments of their community, we need regulatory relief.

Finally, credit unions need to be included in the CRA regulatory compliance environment. They act like a bank and operate like a bank, they want to compete with the banks, yet they don't want to play under the same rules.

Sincerely,

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