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Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 1-5
Washington, DC 20219
Docket ID OCC-2007-0012

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th and Constitution Ave., NW
Washington, DC 20551
Docket No. OP-1290

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
RIN Number 3064-AC97

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: ID OTS-2007-0030

Dear sir or madam:

The Consumer Bankers Association ("CBA") appreciates the opportunity to comment on the interagency proposal to revise the CRA Q&A (the "Proposal"), as issued by the federal bank and thrift regulatory agencies (the "Agencies").

CBA is the recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in consumer, auto, home equity and education finance,

electronic retail delivery systems, privacy, fair lending, bank sales of investment products, small business services and community development. The CBA was founded in 1919 to provide a progressive voice in the retail banking industry. The CBA represents over 750 federally insured financial institutions that collectively hold more than 70% of all consumer credit held by federally-insured depository institutions in the United States.

Our comments are divided into two sections: First, a comment regarding the treatment of investments in multi-investor, multi-project funds, an issue of particular concern to CBA members; and second, a number of other important comments we wish to make in response to the Proposal.

Investment Test—Scope of Test: National and Regional Funds

Proposed § __.23(a)-2

This proposed Q&A addresses investments in multi-investor, multi-project funds that operate across multiple geographies. We support the Agencies' efforts to offer uniform guidelines for the treatment of investments in such funds under CRA. Examiners have not been consistent in their treatment of this issue, either between Agencies or within Agencies, and a uniform approach is needed. In this comment, we offer several alternative approaches that we believe would enhance the long term viability of CRA and the future of community development.

Funds that are composed of multiple investors and that invest in projects in multiple states constitute a significant part of many institutions' community development investments and have grown into a critical part of the government's efforts to provide affordable housing to low- and moderate-income communities. For example, of the \$75 billion invested in Low-Income Housing Tax Credits ("LIHTC") since the inception of the program in 1986, these funds are responsible for 70%-80%. It is vital that we continue to support and encourage these funds.

From a community development, financial institution, and fund perspective, there is benefit to geographical diversity:

- It permits the fund to mitigate financial risk by:
 - having a diverse geographic portfolio of properties/projects nationwide, thereby reducing risk if one geographic area experiences a downturn;
 - allowing for diversity in types of projects;
- It helps the fund achieve economies of scale;
- It allows the fund to be responsive and flexible in terms of allocating the proceeds from investors to geographies and properties/projects where they are most needed, including smaller and/or rural markets, including markets where no local bank has the expertise to do the complex transaction; and
- It increases the likelihood that the fund will be able to find viable investments and/or loans within its mission.
- It helps smaller localities and underserved areas attract investment dollars.

Since most of the investors in these funds are banks seeking CRA consideration, a uniform, rational CRA treatment is important to their continued viability. While banks have the alternative of putting more of their money in proprietary funds and direct investments, the benefits of the multi-investor, multi-geography funds will be lost. Some critical markets will struggle to attract capital, such as those geographies with limited presence of CRA-motivated banks and certain important property types, such as those that provide special needs housing. They either will not be able to attract the capital needed to build affordable housing or will have to pay higher than others to attract the capital, making affordability less achievable. The investments will be less efficient as we lose the benefit of economies of scale found in the large multi-state, multi-investor funds.

Proprietary funds and direct investments, as compared with multi-investor, multi-project funds, have an increased safety and soundness risk due to the lack of geographic diversity and the loss of the shared risk. They are also less efficient, since they lack the economy of scale. Direct investments have an added negative, as the bank now has the added responsibility of monitoring LIHTC compliance, which would otherwise be handled by the fund manager. Because this is highly inefficient without a large number of direct investments in the bank's portfolio, the level of compliance oversight may be weak, further increasing the safety and soundness risk.

As we have said, the majority of investors in these national and regional funds are banks, which have CRA responsibility and which are hoping to obtain CRA consideration under the Investment Test. But ironically, the geographic diversity and range that make these funds so valuable also create a CRA problem for those institutions, since there is a mismatch between the way in which the Investment Test is usually measured and the reality of community development investments in these funds. Banks are given CRA consideration for investments in their assessment area, or a broader statewide or regional area, but the projects in which the fund invests are not all located in those confines. This raises a fundamental question for the banks and the examiners: How much of the bank's investment should get CRA consideration? At present, there appears to be no clear answer, and the Agencies (and examiners) have had to respond on a case-by-case basis.

Recommendation

Because of the unique and critical role these funds play in community development and in furtherance of government programs, the CRA regulation should do everything possible to encourage them. Unfortunately, it is evident that usual ways of assessing CRA consideration work at cross purposes with these funds. Therefore, we wish to propose several alternatives that we believe will most cleanly cut the Gordian knot.

We believe the paramount goal of any approach to this issue should be to ensure that institutions receive *maximum credit for their investments*, and that the CRA consideration

should be *fairly distributed*. The most practical way to do this is to eliminate the artificial distinction that is driven by the assessment area. Therefore, we recommend that an institution receive full CRA credit for the entire amount of its investment in a multi-project, multi-geography fund regardless of the location of the fund's projects, *provided* that at least one of the fund's projects is located in the bank's assessment area(s) or the broader statewide or regional area that includes the bank's assessment area(s). This is a unique approach, but we believe it is warranted by the unique problems encountered by the mismatch between CRA and bank investments in multi-investor, multi-project funds.

However, if the Agencies do not choose to adopt this approach, we would recommend the following alternative: If an institution has adequately addressed the needs of the assessment area to which it would like to allocate a part or whole of that investment credit, then the institution should receive full CRA credit and full weight for the fund's investments in all projects, regardless of their location.

This alternative approach is modeled on Q&A §__.25(e)-1, addressing how examiners evaluate a wholesale or limited purpose institution's qualified investments in a fund that invests in projects nationwide. As in that answer, the examiner in this case would consider a broader statewide or regional area that includes the institution's assessment area(s) when determining whether the institution has adequately met the needs of the assessment area(s). This is in keeping with the existing guidance addressing the regulation's requirement that qualified investments and community development loans or services must benefit an institution's assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s).¹

Precedent also exists for using this approach as a means of encouraging investment by large retail banks. This is similar to an approach the Agencies recently adopted to address the unique situation created by Hurricanes Katrina and Rita in the Gulf Coast. In that case, in order to encourage investment, banks located outside the designated disaster areas were informed that they can receive positive CRA consideration for activities that revitalize or stabilize the designated disaster areas, provided that the banks have otherwise adequately met the CRA-related needs of their local communities.²

We believe this solution is perfectly in keeping with the goals of CRA and the Agencies' regulations: To encourage depository institutions to help meet the credit needs of the

¹ When referring to CDOs and programs that often operate on a statewide or even multistate basis in Q&A §__.12(h)-6, the Q&A says: "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)." That is also true of a national or regional fund that is making an investment in the bank's assessment area; therefore, the same principal should apply, and the geographic area for which the financial institution can get CRA consideration should be the broader statewide or regional area that includes the assessment area. This is implicit in the phrasing of the question posed in §__.23(a)-2 ("...[S]hould an institution be able to demonstrate that an investment...meets the geographic requirements of the CRA regulation by benefiting one or more of the institution's assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s)?").

² See e.g. OCC Bulletin 2006-6.

communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound banking operations. No institution would be able to get CRA consideration for investments outside of its geography until the needs of its local market have been met. It is also important to stress that—with either alternative we are recommending—there would be no double-counting of investments. Every institution would only get CRA consideration for its own investments. More importantly, CRA would not become an artificial obstacle to the development of beneficial regional funds by pulling consideration from institutions on terms that are nothing more than a regulatory construct.

Additional Comments

1. Primary Purpose in Mixed-Income Projects

§ __.12 Definitions

§ ____ .12(h) Community Development Loan

The Proposal makes some small alterations in the Q&A (formerly § __.12(i)) dealing with the definition of “primary purpose” for community development. The Proposal, with the only substantive change underlined, reads as follows:

§ __.12 (h) – 8: What is meant by the term “primary purpose” as that term is used to define what constitutes a community development loan, a qualified investment or a community development service?

A8. A loan, investment or service has as its primary purpose community development when it is designed for the express purpose of revitalizing or stabilizing low- or moderate-income areas, designated disaster areas, or underserved or distressed nonmetropolitan middle-income areas, providing affordable housing for, or community services targeted to, low- or moderate-income persons, or promoting economic development by financing small businesses and farms that meet the requirements set forth in 12 CFR __.12(g). To determine whether an activity is designed for an express community development purpose, the Agencies apply one of two approaches. First, if a majority of the dollars or beneficiaries of the activity are identifiable to one or more of the enumerated community development purposes, then the activity will be considered to possess the requisite primary purpose. Alternatively, where the measurable portion of any benefit bestowed or dollars applied to the community development purpose is less than a majority of the entire activity’s benefits or dollar value, then the activity may still be considered to possess the requisite primary purpose if (1) the express, bona fide intent of the activity, as stated, for example, in a prospectus, loan proposal, or community action plan, is primarily one or more of the enumerated community development purposes; (2) the activity is specifically structured (given any relevant market or legal constraints or performance context factors) to achieve the expressed community

development purpose; and (3) the activity accomplishes, or is reasonably certain to accomplish, the community development purpose involved. The fact that an activity provides indirect or short-term benefits to low- or moderate-income persons does not make the activity community development, nor does the mere presence of such indirect or short-term benefits constitute a primary purpose of community development. Financial institutions that want examiners to consider certain activities under either approach should be prepared to demonstrate the activities' qualifications.

CBA Comment:

The focus of our comment is the impact on mixed-income affordable housing projects. These have become a significant part of community development efforts in recent years; yet CRA has become a stumbling block rather than a supporter of these projects.

At the very heart of the Community Reinvestment Act is the charge for financial institutions to provide products and services to low- and moderate-income families and individuals and to provide lending and other assistance in distressed low and moderate-income geographies. The industry's significant response to this challenge has been to provide both financing and equity products that support affordable housing opportunities in all income segments of communities.

The ability to respond, and obtain corresponding examination credit, to protect or create affordable housing in middle- and upper-income neighborhoods is actively discouraged by the current examination rules, which require the "primary purpose" of a project to be community development. Because this has been interpreted to mean the *majority* of the units must be reserved for low- and moderate-income individuals, it is virtually impossible for an institution to receive favorable consideration for mixed-income housing (for example, where a project has 80% of the units at market rate and 20% of the units reserved for low- and moderate-income individuals) in middle- and upper-income census tracts. This practice is at odds with current development practices of many local and state governments.

Many of the financing agencies, such as Municipal Housing Departments and State Housing Finance Authorities, now favor mixed-income developments. It is not merely that municipal rules sometimes require the inclusion of a percentage of affordable units, but that these localities and financing agencies may prefer development where a minority of the project's units is designated for low- and moderate-income households. The government favors mixed-income projects and may also favor developments in middle- and upper-income geographies because it perceives that these types of projects in a variety of census tracts will build more sustainable communities than if they were all relegated to low- and moderate-income geographies. Many experts in community development also agree that mixed-income projects in a variety of census tracts are a key ingredient of community development.

When municipalities require developments to provide for a minimum number of affordable units, in some instances, these units may only represent 10 to 20 per cent of the total so that the public subsidy is reduced. The required number of affordable units may reflect a government decision based the number of affordable units that the overall project could reasonably support with available public dollars. The number of affordable units in these situations would never be a majority nor reasonably be considered the primary purpose of the development.

As an effective means for sustaining levels of affordable housing within these markets, most financial institutions provide loans, equity and, perhaps even grants, to support these projects simply because they directly benefit low- and moderate-income individuals and families. Exam credit is not given for these projects because the majority of the units are not reserved for low- and moderate-income individuals. Therefore, to align the CRA regulation with current government policies and practices regarding affordable housing, "primary purpose" should also include lending and investment activities conducted pursuant to a local, state, federal or tribal government development policy, plan or program.

We recommend amending Answer A8, and adding additional Q&As, as follows (new language underlined):

A8. A loan, investment or service has as its primary purpose community development when it is designed for the express purpose of revitalizing or stabilizing low- or moderate-income areas, designated disaster areas, or underserved or distressed nonmetropolitan middle-income areas, providing affordable housing for, or community services targeted to, low- or moderate-income persons, or promoting economic development by financing small businesses and farms that meet the requirements set forth in 12 CFR __.12 (g). To determine whether an activity is designed for an express community development purpose, the agencies apply one of two approaches. First, if a majority of the dollars or beneficiaries of the activity are identifiable to one or more of the enumerated community development purposes, then the activity will be considered to possess the requisite primary purpose. Alternatively, where the measurable portion of any benefit bestowed or dollars applied to the community development purpose is less than a majority of the entire activity's benefits or dollar value, then the activity may still be considered to possess the requisite primary purpose if (1) the activity is conducted pursuant to a local, state, federal or tribal government development policy, plan or program; (2) the express, bona fide intent of the activity, as stated, for example, in a prospectus, loan proposal, or community action plan, is primarily one or more of the enumerated community development purposes; [(2)] (3) the activity is specifically structured (given any relevant market or legal constraints or performance context factors) to achieve the expressed community development purpose; and [(3)] (4) the activity accomplishes, or is reasonably certain to accomplish, the community development purpose involved. The fact that an activity provides indirect or short-term benefits to low- or moderate-income persons does not make the activity community development, nor does the mere presence of such indirect or short-term benefits constitute a primary purpose of community development. Financial institutions that want examiners to

consider certain activities under either approach should be prepared to demonstrate the activities' qualifications.

Recommended New Questions and Answers:

§ __.12(h)-9: How will a financial institution receive favorable consideration for lending and investment dollars in mixed-income projects which create or preserve affordable housing units in low-, moderate-, middle- and upper-income geographies where less than the majority of the units are reserved for low- and moderate-income individuals?

A9. Loans and investments in a mixed income project in a low- and moderate-income geography where less than the majority of the units are reserved for low- and moderate-income individuals will receive CRA consideration for the entire dollar amount lent to or invested in the project if the project meets the purpose test in Question 8 above; such loans and investments in middle and upper-income neighborhoods will receive CRA consideration for the entire dollar amount lent to or invested in the project if the project is part of a local, state, federal or tribal government development policy, plan or program, or, if the project is not part of a local, state, federal or tribal government development policy, plan or program, then such loans and investments will receive pro-rata credit for the percentage of dollars lent to or invested in the project that is affordable to low- and moderate-income individuals.

Recommended New Question:

§ __.12(h) – 10: What is a local, state, federal or tribal government development policy, plan or program?

A10. A local, state, federal or tribal development policy, plan or program is a government-sanctioned policy, plan or program that supports economic revitalization, economic development, or small business creation, or provides an incentive to develop housing, at least 10 percent of which is affordable to low- and moderate-income individuals. Such a government-sanctioned policy, plan or program may be evidenced by either the use of public funds, such as subsidies, tax credits or tax abatements, or by the provision of benefits, such as a higher floor-to-area ratio than would otherwise be permitted.

2. Community Development Services

The Board has proposed modifying the answer to § __.12(i) regarding the definition of community development services as follows:

§ __.12 (i)-3: What are examples of community development services?

A3. Examples of community development services include, but are not limited to, the following:

...

- Establishing school savings programs [and developing]
- Developing or teaching financial [education] literacy curricula for low- or moderate-income individuals.

- Providing other financial services with the primary purpose of community development, such as...free government or payroll check cashing that increases access to financial services for low-or moderate income individuals.

CBA Comments:

a) Throughout the Proposal, the term “financial education” is being replaced with the term “financial literacy.” We are not sure why, but we believe it is actually a change for the worse and runs counter to trends in usage. Financial education is a clearer phrase and is more precise. Financial literacy is a metaphor. We have also heard it suggested that the latter term is pejorative; and we do not see any reason to offend unnecessarily.

b) The reference to “free” check cashing needs to be changed to “affordable” or perhaps “low-cost.” If the service is effectively increasing access to financial services for low- and moderate-income individuals, whether or not it is free should be immaterial. The expectation that the check cashing service must be free improperly suggests a view of CRA as a form of charity, rather than a sustainable part of the business of banking.

c) The Supplementary Information accompanying the Proposal states on 37972, “The agencies also propose to revise the example of community development services describing various types of consumer counseling services to highlight credit counseling that can assist borrowers in avoiding foreclosure on their homes.” It is not clear what this is referring to, since the section on foreclosure avoidance has no proposed changes.

d) We are concerned about the practicality of proving that financial education seminars benefit LMI individuals when they are not held in conjunction with a not-for-profit partner. We are therefore recommending the inclusion of a Q&A in §.__.24 to address this issue (**see below**).

3. Grants to Arts and Culture Organizations

§ __.12(s) Qualified investment

§ __.12(t) – 4: *What are examples of qualified investments?*

The Board has proposed the following answer, in relevant part, which is changed only as noted by the underlined portion:

A4. Examples of qualified investments include, but are not limited to, investments, grants, deposits or shares in or to:

- Facilities that promote community development by providing community services for low- and moderate-income individuals, such as youth programs, homeless centers, soup kitchens, health care facilities, battered women’s centers, and alcohol and drug recovery centers;

CBA Comment:

We recommend the inclusion of grants to arts and culture organizations as examples of community services that are qualified investments.

Arts and culture organizations are critical to the development and strength of communities. These organizations nurture and facilitate community development through education and programming. Arts and culture organizations inspire children and youth to serve as agents of change while simultaneously cultivating their leadership skills and fostering a commitment to community service. Moreover, these organizations serve as an essential educational resource to the local communities. Through their involvement with these organizations, children can learn basic literacy skills, as well as enhance their critical and analytical abilities. Many of these organizations are located in underserved communities, or at least are focused on serving the individuals in these areas. Furthermore, arts and culture organizations serve to revitalize and stabilize the communities where they are located. Given these attributes and benefits of many arts and culture organizations, grants to these organizations should be considered CRA qualified investments.

Recommended revisions to Answer to § __.12(t) – 4 (*new language underlined*):

A4. Examples of qualified investments include, but are not limited to, investments, grants, deposits or shares in or to:

- Facilities that promote community development by providing community services for low- and moderate-income individuals, such as youth programs, homeless centers, soup kitchens, health care facilities, battered women’s centers, arts and culture organizations, and alcohol and drug recovery centers;

4. Letters of Credit

§____.22—Lending Test

§____.22 (a) (2)-1: *How are lending commitments (such as letters of credit) evaluated under the regulation?*

CBA Comment:

As proposed (and substantially unchanged), the Agencies will consider lending commitments (such as letters of credit) only at the option of the institution. Commitments must be “legally binding” between an institution and a borrower in order to be considered. They will be used by examiners only to “enhance their understanding of an institution’s performance.”

Currently, letters of credit are not included in the lending tables at the end of performance evaluations but are mentioned only in the text of the lending performance discussion, thus receiving lesser ‘weight’ than a loan. Additionally, the dollar value of letters of credit is not included in the comparison to Tier 1 Capital that is referenced in the community development lending summary discussion. In practice, this results in a significant undervaluation of letters of credit as a community development vehicle and does not do justice to the importance of the bank’s commitment.

Letters of credit are legally binding guarantees by the institution of a debt or other legal obligation of the account party. As such, the credit risk is identical to a conventional loan. When the proceeds of a bond issue enhanced by the institution’s letter of credit are used for the construction of real estate improvements, standard construction loan procedures govern the disbursement of the bond funds. The bond trustee may only disburse bond proceeds upon written authorization from the letter of credit provider. As with a loan, such authorization is normally preceded by satisfaction of construction loan draw procedures and documentation. In the event of a default and subsequent drawing on the letter of credit, the institution assumes ownership of the mortgage-secured bonds in order to preserve and protect its collateral position.

Moreover, the institution’s assumption of the bondholder’s risk of loss produces a net positive impact on the cost of funds for project development, even after factoring in letter

of credit fees paid to the institution. The interest rate discount available via issuance of tax-exempt bonds is a cost efficient means to finance the creation and sustainability of affordable housing. Bonds that are enhanced with a letter of credit issued by a rated institution bear an interest rate reflective of the credit of the institution rather than the real estate.

In addition to the interest rate advantage, the use of tax-exempt bonds enables utilization of the “as of right” 4% Low Income Housing Tax Credit. Equity generated from the sale of tax credits does not require a cash return from the real estate. The combination of low interest rates and return-free equity produces the economic feasibility of affordable rents, even in an environment of escalating housing costs. Letters of credit are a critical component of this financing structure.

Thus, letters of credit should be given full consideration with respect to the evaluation of community development lending under the CRA lending test. This alternative financing option should be given equal consideration to other types of community development loans and included in the performance evaluation lending tables. These types of transactions truly embody an institution’s use of its full resources to address the needs of its local communities.

Recommended New Answer to § ____.22 (a) (2)-I:

A1. Letters of credit can be a critical component in the production of affordable housing. For example, through their issuance, lower cost tax-exempt bond financing is facilitated and eligibility for 4% Low Income Housing Tax Credits is triggered. During the term of the letter of credit, risk of loss is transferred from the bondholders to the institution. The bond rating will reflect the credit rating of the issuer of the letter of credit, thereby lowering the borrowing cost to the project. Should a default occur in the underlying debt structure, the letter of credit would be drawn and the institution would assume the position of mortgage secured bondholder. Credit risk to the institution is not materially different when compared to a conventional mortgage loan, yet letters of credit can provide efficiencies in the production of affordable housing. Therefore, letters of credit will be considered and given the same weight as loans, with regard to an institution’s performance in community development lending, provided that a clear community development benefit is shown. Examples include, but are not limited to:

- Letters of credit that enhance tax-exempt bonds issued for the construction of affordable housing;
- Letters of credit in favor of municipalities to guarantee payment & completion of project site work, utility connections, and other project-related requirements; or
- Letters of credit used to purchase forward fixed interest rate locks for permanent financing on affordable housing projects.

5. Financial Education Programs

§ __.24 Service Test

CBA Comment:

In the definitions, new __.12(i) provides that developing or teaching financial education curricula for low- or moderate-income individuals is an example of a community development service. We wish to raise a practical problem that stems from this treatment, and suggest a solution.

For the most part, it is infeasible and problematic to require income information from participants in financial education seminars that are not held in conjunction with a not-for-profit partner with community development as its mission. This is particularly true with seminars held at bank branches and at workplace sites. For an institution bringing to bear its full resources to address the needs of or local communities, this presents a particularly vexing conundrum.

Alternative methodologies can be used to show the benefit to an LMI community. For example, for a financial education seminar held at a large retail store, information can be obtained from an outside, governmental source, like the Department of Labor, that indicates the average hourly wage for workers in this particular industry. That hourly wage can be translated into an annual income that can then be compared to the HUD updated area median family income. As another example, the location of the branch in an LMI community in which financial education seminars are conducted can be used to establish an LMI constituency.

Recommended New Question and Answer:

§ __.24 (e)-2: How can an institution alternatively prove that financial education seminars benefit an LMI constituency?

A2. The agencies will presume that any financial education seminars provided in conjunction with organizations with a community development mission serve an LMI population. With respect to financial education seminars conducted not in conjunction with organizations with a community development mission, alternate methodologies may be used to establish the benefit to an LMI population. The methodologies may include, but are not limited to, the following:

- The annualized average hourly wage for workers in a particular industry for financial seminars conducted at a workplace within that industry,
- Financial education seminars conducted in conjunction with a program of a community organization with a community development purpose, and

- Financial education seminars conducted in an LMI community.

* * *

Thank you once again for the opportunity to present our comments. If you have any questions, feel free to contact me.

Sincerely,

/s/

Steven I. Zeisel
Senior Counsel
szeisel@cbanet.org