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DBA

Delaware Bankers Association

THE DELAWARE BANKERS ASSOCIATION

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October 31, 2001

Communications Division
Mailstop 1–5
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219
Re: Docket No. 01-16

Robert E. Feldman, Executive Secretary
Attention: Comments/OES
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Re: 12 CFR Part 345; RIN 3064–AC50

Ms. Jennifer J. Johnson, Secretary,
Board of Governors of the
Federal Reserve System
20th Street & Constitution Avenue, NW
Washington, DC 20551
Re: Docket No. R–1112

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Re: Docket No. 2001–49

Re: Advance Notice of Proposed Rulemaking on the Community Reinvestment Act Regulations; 66 Federal Register 37602; July 19, 2001

Dear Madams and Sirs:

On July 19, 2001, the Federal Deposit Insurance Corporation ("FDIC"), the Federal Reserve Board ("Fed"), the Office of the Comptroller of the Currency ("OCC"), and the Office of Thrift Supervision ("OTS"), in aggregate (the "Agencies" or "regulators") published a Joint Agency Advance Notice of Proposed Rulemaking ("ANPR") as part of their review of the Community Reinvestment Act ("CRA") regulations. As the Agencies expressed it, the ANPR begins "our assessment of the effectiveness of the regulations in achieving their original goals of (1) emphasizing in examinations an institution's actual performance in, rather than its process for, addressing CRA responsibilities; (2) promoting consistency in evaluations; and (3) eliminating unnecessary burden."

The Delaware Bankers Association (DBA) appreciates the opportunity to submit comments in response to your joint ANPR on the Community Reinvestment Act Regulations in Volume 66, Federal Register, page 37602, dated July 19, 2001. In Delaware, the Community Reinvestment Act applies to all FDIC-insured depository financial institutions that are members of the Delaware Bankers Association ("DBA").

The Delaware Bankers Association is a not-for-profit, private trade Association that represents forty (40) dues and tax paying financial institutions ("FIs") chartered to do banking business in the State of Delaware and all of whom are members of your respective Agencies. Our membership comprises virtually every type of FI from small community FIs to limited purpose and wholesale FIs. They range in size from approximately $35 million to over $40 billion in assets. Collectively, they maintain assets of over $140 billion in the State. Accordingly, we are filing this formal response on their behalf and we appreciate the opportunity to comment on this important matter.

OVERVIEW

In the ANPR, the Agencies raise a threshold question: ***whether any change to the regulations would be beneficial or warranted***. DBA believes that all changes to the CRA regulations need to be considered not only for the increased benefits it would bring to our respective communities (which is the ultimate goal of CRA), but also for the costs imposed to make the change, i.e., whether an adequate evaluation of any change will include the direct and indirect costs necessary to implement and maintain the change, for both the FIs and the Agencies. In an era of ever increasing budgetary restraints, DBA is reluctant to request major changes except where necessary. *Accordingly, changes should increase the flexibility of FIs to comply with the* requirements of the Act without significantly increasing regulatory burden. Likewise, it appears prudent that the Agencies should also consider the impact such changes will have on their overall budgets and operations including, but not limited to, examiner training and the efficiency and effectiveness of FI CRA compliance reviews. Nonetheless, DBA submits its recommendations, which are set out below following the order of issues listed by the Agencies in the ANPR.

DBA RECOMMENDATIONS:

1. Large FI exam: Investment, lending and service tests

The Agencies ask if the regulations strike the appropriate balance between quantitative and qualitative measures, and among lending, investments, and services. The primary focus of the CRA is the requirement that the Agencies evaluate insured depository FIs for how well the FIs are helping to meet the credit needs of the entire community.

In light of this requirement, some of our member FIs are concerned about the on-going debate involving subprime lending and the goal of meeting the credit needs of the entire community. Specifically, on January 31, 2001, the FFIEC agencies issued the expanded *Guidance for Subprime Lending*. This Guidance contains an expansive definition of subprime loans and, among other things, levies additional capital requirements and burdens on FIs that specialize in that market. However, while we recognize that there is a legitimate tension between necessary regulatory mandates to encourage safety and soundness and the industry's need to provide credit to a broad band of consumers and small businesses, especially to those that have historically been ignored by the traditional lending market place, we pose this question to the Agencies: If the credit needs of these consumers and small businesses with impaired credit histories cannot be met through legitimate subprime lending where loan pricing is based on risk, how, other than through CRA loans, will they obtain credit? Since it is not the intent of CRA to have FIs making loans for the sole purpose of satisfying the lending component of the CRA examination, how then will subprime customers be served?

On whether CRA has become a numbers game, many bankers are expressing concern that the levels of lending now expected of them would have been simply unsustainable, even if the economy had continued to grow at its 1990s pace. Certainly these levels of lending are not sustainable now, and bankers are concerned that examiners do not understand the performance context of these FIs or these types of lending. DBA urges the Agencies to seriously review this "sustainability" issue in examiner guidance.

Investment Test – DBA recommends that consideration be given to the possible elimination of the Investment Test so long as investments are substitutable for loans. Under this recommendation, there would be no separate level of investments required of FIs, but certain investments would be countable towards the Lending Test. While this appears to be a major change, it solves many of the specific problems that are mentioned as issues in the ANPR and greatly increases FIs' flexibility in complying with CRA. Large FIs committed to major community development lending programs in urban metropolitan statistical areas ("MSAs") will continue to receive CRA credit for their important activities while smaller FIs will not be forced to search for investment opportunities that do not exist for them in their markets.

Under this approach, DBA recommends that investments be adjusted for the cost of the capital to support the investment, when substituting investments for loans. For example, a grant that qualifies as a "CRA qualified investment" would be roughly equivalent to a loan ten times the amount of the grant, since the capital required of a well-capitalized FI is 10% of the loan, but a grant consists of 100% capital, which will not be recovered.

However, should the Investments Test remain, DBA believes that the definition of qualified investments is far too narrow, artificially limiting the availability of qualified investments. DBA believes that these definitions should be liberalized. For example, investments in municipalities' general obligation bonds no longer qualify for CRA credit, as they are not targeted sufficiently to meet the regulatory requirements. This is should be changed so that communities can truly benefit. Therefore, if the Investment Test is to be retained, then DBA strongly recommends considerable liberalization of the definitions, or else there will continue to be a scarcity of qualified investments.

As another type of example, currently programs to support job training creation and education may not qualify. Such programs are designed to provide effective assistance to help meet the financial needs of the community and, therefore, should qualify under the Investments Test. Financial literacy is a good example. Programs to teach basic financial skills are not provided in many schools, most often due to lack of funds. If a FI is willing to provide or fund that education, it is addressing local school systems' financial needs as well as the needs of the students. The mere fact that some of the students do not qualify as low or moderate income should not disqualify that type of program.

Precedent for this type of approach has already been established by the Agencies. Specifically, FIs can receive CRA credit for investment in a SBIC regardless of whether it directly benefits low to moderate–income individuals. Thus, it would make sense to permit other similar investments. Accordingly, DBA urges the Agencies, should it decide to retain the Investments Test, that the test be expanded to include investments and service projects designed to benefit the community as a whole so long as they include low to moderate-income individuals.

Lending Test – On whether originations should count more than purchases of loans, both originations and purchases increase the flow of credit. DBA sees little value in discouraging loan purchases. DBA recommends that no change be made. Attempts to value originations and purchased loans differently will introduce an unnecessary level of complexity for little benefit.

On whether CRA ratings should include a negative impact of predatory lending, DBA recommends that predatory lending continue to be part of the fair lending examination, not the CRA examination. There is simply no agreement on how to define predatory lending at this time, and to try to incorporate predatory lending into CRA would create more problems than it might solve.

Service Test - DBA believes that the service test depends too heavily on branches and recommends developing a broader definition of service. DBA strongly opposes a standard of considering "not only the delivery method and type of service but also the effectiveness of the delivery method," partly because that would require more data collection and reporting in order to meet whatever the Agencies defined as the measure of effectiveness.

DBA further believes that the scope of qualifying services is too limited and should be expanded. Currently, programs that support job training, job creation and education may not qualify if they are not given for the sole purpose of and to the limited areas containing low and moderate income people. One such example is financial and business training and/or mentoring in the public schools. Such programs should qualify since they are designed to provide effective assistance to help meet the financial needs of the community. With our Statewide integrated school systems, low and moderate-income school children attend schools in all census tracts and other children should not be denied this training because of where they live. This type of training is imperative to the future success of children and aimed at avoiding future financial pitfalls that may occur in adulthood without such instruction, thereby taking a proactive, as opposed to the current reactive, stance on financial literacy and, prospectively, reducing the number of low and moderate income citizens.

A remedy to this exclusionary aspect would be to expand the rules to include service activities designed to benefit the community as a whole if they include low- to moderate-income individuals. In addition to geographies, the qualified service definition should be expanded to include services performed that supplement staffing needs of non-profit organizations that benefit low and moderate-income individuals or geographies. For example, office work or other duties performed at non-profit organizations that save the designated organizations costs should also qualify.

2. *Small FIs: The Streamlined Small FI Evaluation*

DBA is opposed to classifying small FIs held by a $1 billion or more FI holding company ("BHC") from being treated as a small FI. DBA believes that this provision encourages loss of independence in community FIs and is antithetical to the statute's purpose. DBA recommends removing this BHC limitation on the definition of "small FI."

More importantly, DBA advocates an increase in the size of "small FIs." The small FI test clearly confirms or disproves whether a community FI is lending in its community, which is really all that the Act demands that the Agencies evaluate. The DBA notes that since the adoption of the regulation in 1995, the largest FIs have increased their share of total financial assets held by the banking industry, and the range in asset size from a $250 million FI to the largest FI has increased dramatically. It seems incomprehensible that the regulators would class a $250 million FI with a $250 billion FI, but this regulation does. DBA supports raising the asset size for a small FI to $1 billion, but is concerned that such a change not be done as an offset for imposing additional burden on larger FIs.

3. Limited Purpose and Wholesale FIs: The Community Development Test

As originally adopted, a "*limited purpose*" FI was not defined except in the most general terms. This was the case until 1998 when the FFIEC issued a series of questions and answers to provide guidance to covered FIs and their examiners. That document defined a "*limited purpose*" FI as one that only offered consumer credit cards or auto loans. This definition, unsupported by the underlying regulations, dramatically limited the scope of the category. These products are cited in the regulation, but only as examples, not requirements.

This affected many FIs that previously qualified as "*limited purpose*". Those that offered any product other than auto loans or consumer credit cards were suddenly put into a category designed for a traditional community or regional FI and subjected to standards with which they could not comply under their original business plans. Even FIs that offered only one product to a limited group of customers could no longer qualify as limited purpose if that product was not on the list.

The effect of the change in designation is significant. Under the standard assessment test, the lending component carries twice as much weight as the investment and service components. In order to receive a satisfactory rating, the limited purpose FI must get a minimum low satisfactory on the lending component. If a FI's product line is limited, it is more challenging to satisfy this component. FIs are then faced with the decision of making an investment or restructuring the investment as a loan, incurring substantial legal fees in doing so. When the end result is the same, it seems contradictory to modify the structure of a commitment and incur additional expenses solely to satisfy a part of the test that is now given greater weight because of the change in designation.

Applying modified standards to the traditional categories of FIs temporarily alleviated this problem. But the result is awkward and illogical. For example, a FI that only issues business cards to the customers of specific companies cannot be logically classified as a full service commercial FI serving all the residents of a specific geographical area. A better long-term solution is needed.

The Agencies evaluate the FI's performance based on factors that make up the performance context. Two factors are the FI's product offerings and business strategy and the FI's capacity and constraints. Even if a FI is considered in its performance context, the designation given by regulators puts a FI with a specialized or limited product line at a disadvantage.

Based on the above examples, DBA strongly urges the agencies to eliminate specific products currently listed from the definition of "*limited purpose*", thereby opening the designation to a broader range of FIs. This would also better reflect the increasingly diverse group of financial service providers in the post-Gramm-Leach-Bliley Act ("GLBA") world. Accordingly, DBA recommends that the Agencies draft a new definition to more clearly accommodate limited purpose banks as defined by the Gramm-Leach-Bliley Act [see Gramm-Leach-Bliley act at Title I, Section 107 ("*limited purpose bank relief*"), Pub. L. 106-102, November 12, 1999, 113 Stat. 1338] (known more pejoratively as "*non traditional banks*") as industrial banks, credit card banks, and other non-traditional banks that do not provide a full range of products and services to residents of a specific geographical area.

DBA further recommends that any FI that only offers a single product to a limited group of customers should qualify as limited purpose regardless of product type. FIs should be classified in the category that best describes their specific set of products and services. That would allow a FI that offers customized products, even a fairly large number of them, to be classified as "*limited purpose*" if it is not trying to be a primary provider of financial services to all the people in a particular community.

Furthermore, DBA supports liberalization of the community development test, in line with the need for liberalization of qualified investments that compose the Investment Test, to grant CRA credit for a wider range of investments and services to better meet the needs of the community. DBA also supports expansion of the availability to use the community development test for more FIs, as suggested by the Agencies.

4. Strategic Plan

The Agencies appear to be concerned that the strategic plan has not been used very much, and thus ask if it is a truly effective alternative method of evaluation. DBA recommends retaining the strategic plan option; however, DBA would like to comment on the complexity of the strategic planning process and, in particular, the lack of uniformity among the Agencies. It appears that because of its complexities, only a handful of FIs have opted for the strategic plan alternative. In our state, we have an example of a state-chartered industrial loan company operating under a strategic plan while its limited purpose ("nonbank bank") national bank operates under the conventional large bank test. Given the growing diversity of FIs as a result of GLBA, it becomes ever more important for the Agencies to consider viable, easy to execute and administer approaches to the current strategic plan.

We believe that the process for the strategic plan option should be made less onerous. It can be particularly useful for a FI that does not readily fit into one of the other categories. Nevertheless, the flexibility a strategic plan is important because of the proliferation of financial services and providers over the past several years. No one can anticipate what new kinds of institutions will emerge in the future or what type of CRA programs that might be devised in the future. Therefore, encouraging strategic plans for those FIs that do not readily fit another category may result in more novel and effective programs, especially if the scope of community development investments and service is changed and/or expanded. However, to require a strategic plan would be problematic for many FIs unless the process becomes more flexible and less cumbersome.

5. Performance Context

DBA recommends that FIs be provided more information by the Agencies on how the performance context is formulated by the examiners. It is recommended that consideration be given to a mandatory consultation with the depository FI by examiners before formulation of the performance context so that there is a clearer understanding of the examiners' analysis and formulation of the performance context. Furthermore, peer comparisons should be between more comparable FIs. Currently, it appears that comparisons made by examiners to "peer" FIs in the assessment area are not, in fact, made to valid peer FIs resulting in inappropriate examination results. This issue may be significantly resolved if the definition of Small Institution be increased from $250 million in assets to FIs up to $1 billion in assets as noted above in *Section 2*.

6. Assessment Areas

DBA does not recommend eliminating the geographic\branch basis of the Community Reinvestment Act in delineating the assessment area. DBA suggests that to the extent out-of-market lending is supported by out-of-market deposits, then that lending should be ignored for CRA purposes. DBA acknowledges that FIs that want such treatment will need to be able to document at least the amount of out-of-market deposits, but that appears preferable to being downgraded under the Lending Test.

Although the current standards for assessment areas work well, the DBA suggests minor modifications. Under the current standards, a FI's primary assessment area is its local community. That is where a FI -- and its employees--can make the biggest difference. When it has done all it feasibly can in that area, investments and activities in other areas can be taken into account. Therefore, we do believe that some modest changes should be considered regarding CRA activities in other areas. Currently, the second stage assessment area is the region where the FI is based. That works well in most instances, but it excludes other areas where the FI or an affiliate may have a special ability to conduct effective CRA programs. For example, some FIs may have affiliates or parent companies located in other parts of the nation that are involved in programs to help meet needs in those areas. Accordingly, those programs should also qualify for second stage credit.

7. Activities of Affiliates that are not Subsidiaries of the FI

DBA believes that the status quo should be retained, allowing depository FIs to request consideration of affiliate activities at their option. DBA believes that this provides the greatest flexibility for FIs and is more consistent with the Act than either mandatory inclusion of affiliate lending or total exclusion of affiliate lending.

8. *Data Collection and Maintenance of Public Files*

DBA recommends ending the current data collection requirements since it does not appear permissible under the Act. As an alternative, DBA recommends that FIs making less than 250 reportable loans be exempt from the data collection. More importantly, DBA strongly opposes adding any more data collection as such additional collection and reporting would be burdensome, impermissible under the statute, of little analytical value and would further reduce the efficiency and effectiveness of the examination.

9. *Other matters*

DBA recommends that the Agencies conduct an annual comparative review of CRA ratings by each Agency to determine if any Agency's ratings distribution varies significantly from the other Agencies. In a small state with a full complement of FIs regulated by all of the Agencies (frequently by the same Agencies, but from different regions/districts), rating discrepancies become magnified and subject to active discussion since all FIs are familiar with each other's CRA activities. Accordingly, such variances should be cause for further review as to the reasons for the variations, especially differences in examination procedures and training. DBA also recommends that the Agencies conduct surveys of FIs recently examined for CRA performance to elicit any problems in the examination, focusing on examiner knowledge, apparent inconsistencies or significant differences of opinion about how the examination was conducted, and the degree of concurrence between FIs and examiners on the results.

CONCLUSION

The DBA appreciates the opportunity to provide comments to the Agencies on the ANPR regarding possible revision of the Community Reinvestment Act. DBA recommendations are meant to make the regulations more closely follow the statute than they currently do and to give all FIs more flexibility in demonstrating that they are helping to meet the credit needs of the entire communities in which they are chartered.

Thank you for your review and consideration of our position on this important issue. As always, we would be pleased to provide any additional information. You may contact me at 302-678-8600.

Very truly yours,

David G. Bakerian

David G. Bakerian
Executive Vice President