

NEW YORK CLEARING HOUSE

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December 3, 2001

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20219
Attention: Jennifer J. Johnson, Secretary
Docket No. R-1112

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

Office of the Comptroller of the Currency
250 E Street, NW
Washington, DC 20219
Attention: Communications Division, Public Information Room, Mailstop 1-5
Docket No. 01-16

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

Re: Advance Notice of Proposed Rulemaking --
Community Reinvestment Act Regulations

Ladies and Gentlemen:

The New York Clearing House Association L.L.C. (the "Clearing House")*
appreciates the opportunity to comment on the advance notice of proposed rulemaking (the

* The member banks of the Clearing House are: Bank of America, National Association, The Bank of New York, Bank One, National Association, Bankers Trust Company, Citibank, N.A., First Union National Bank, Fleet

“ANPR”) regarding the current regulations (the “Current Regulations”) promulgated under the Community Reinvestment Act (the “CRA”). 66 Fed. Reg. 37602 (July 19, 2001).

A. INTRODUCTION

As an initial matter, the Clearing House would like to apologize for the delay in submitting this comment letter. The Clearing House is located in lower Manhattan and many of its members are located in New York; all of its members were deeply affected by the tragic events of September 11. Since that time, considerable effort has been devoted to emergency initiatives related to the attacks and their aftermath.

The Clearing House member banks are deeply committed to the principles of the CRA. They believe that strong and vibrant communities will help provide a strong and vibrant banking system and a sound, balanced economy. In addition, they believe that these principles can be implemented consistently with a safe and sound banking system.

The Clearing House believes that the Current Regulations have generally been effective in advancing the goals of the CRA. Accordingly, a wholesale revision of the Current Regulations would be unwarranted and counterproductive.

We respectfully suggest, however, that there is some room for improvement in the Current Regulations, and that several significant changes are needed to sustain the effectiveness of the CRA in the future. In addition, certain helpful changes can be made in the examination process and in examiner training without a need to amend the Current Regulations. We believe that the recommendations discussed below will enhance the contribution of depository institutions to their local communities by providing greater flexibility, stronger incentives, more clearly defined obligations and, of most importance, a closer alignment of programs that are beneficial to local communities with recognized CRA credit. These recommendations are also

designed to reduce regulatory burden and minimize conflict between CRA programs and sound banking practices.

B. RECOMMENDATIONS

1. The performance tests should be more flexible.

We recognize that there are certain advantages for both depository institutions and examiners in developing standard, formulaic performance tests. Such tests are relatively easy to apply, and banks can have a greater element of certainty as to their performance ratings.

There are, however, disadvantages for depository institutions and communities if examination adherence to formula-based tests becomes too rigid and one-dimensional. Such an approach restricts the ability of depository institutions to address adequately the different needs of different communities and fails to recognize that depository institutions have varying strengths and capabilities. Moreover, it has been our member banks' experience that the advantages of formula-based performance tests have been limited because different formulae are used by different banking agencies and different examiners even within the same banking agency.

The Current Regulations do recognize a "performance context", but our banks have found that this concept is often unevenly applied in the actual evaluation process. We recognize that the Current Regulations also attempt to deal with this issue by permitting a depository institution to adopt a strategic plan. Very few institutions have done so, however, and with good reason. The process is very long and cumbersome. Proprietary information about not only CRA programs but also major lines of business must be disclosed.

Accordingly, we recommend that the performance tests be evaluated with more flexibility to ensure not merely a fair evaluation for depository institutions, but to encourage a more targeted approach to meeting communities' actual needs and matching those needs with a depository institution's own business strategy and compatibilities. This could be done without significant regulatory change if depository institutions are clearly providing the lead role in developing their respective performance contexts. The examiners would, of course, have the

opportunity to evaluate both actual performance against context and the appropriateness of the context, but there would be an implicit presumption that depository institutions best understand their own business strategies, products, capabilities and communities.

The Clearing House believes that the advantages of increasing the flexibility of the performance tests through greater reliance on depository institution-developed performance context are numerous. Most importantly, depository institutions will be able to establish for themselves which elements of their CRA programs should be emphasized to provide the greatest benefit to their communities. No two depository institutions are alike in their products, business strategies and capabilities, and no two communities are alike in their needs and available resources. When depository institutions can make the most effective use of their own resources, the communities are the direct beneficiaries. In addition, if depository institutions are permitted to adopt more customized CRA programs in their areas of expertise, they will be more likely to be innovative and devote more resources.

Our recommendation of increased flexibility is not simply an issue of greater emphasis on qualitative as opposed to quantitative factors. It is also a question of flexibility in applying quantitative tests. As the ANPR notes, “not all activities of the same numerical magnitude have equal impact or entail the same relative importance. . . .” 66 Fed. Reg. at 37604. At the same time, we believe that further “temper[ing]” of quantitative factors by “evaluat[ion] of qualitative factors” is desirable. See id.

2. There should be a “community development” test for large retail institutions.

The Clearing House respectfully submits that the Current Regulations should be supplemented with an optional community development test for retail institutions. This test could totally replace the current three-part test, replace only the investment test or be one part of a two-part test consisting of retail banking and community development. Because this test would have components of lending, service and investment, it should be weighted at 30% if it replaces the investment test and at 40% to 50% if there is a two-part test. Depository institutions could be given the option of remaining with the now-familiar three part test.

We believe that the community development test has worked well for wholesale and limited purpose banks for two reasons -- both of which are at least indirectly applicable to retail banks. First, the flexibility in this test recognizes that wholesale and limited purpose banks emphasize different and often specialized products and services. Although retail institutions provide a broader range of products and services, a variation of the same basic principle also applies to retail banks. Retail institutions may, in general terms, have similar suites of products and services, but not all retail banks have the same emphases or the same capabilities in providing those products and services. This is often not a question of lack of ability, but of special emphasis and special ability. Some institutions will focus on mortgage lending, others on small business lending and still others on non-mortgage retail lending as part of their overall strategic business plan. Both depository institutions and their communities will benefit if depository institutions can concentrate their community efforts on their respective fields of expertise.

The second reason is that the needs of communities differ widely. Although loans to purchase or refurbish homes and to small businesses may be fundamental to most communities, there may be other needs of equal or greater magnitude in particular communities. Moreover, in some communities there are more than adequate resources for mortgage and small business lending, and those communities would be best served if some of the depository institutions devoted their CRA programs to different types of lending or different community development programs.

Our member banks believe that community development should be viewed comprehensively and holistically, as opposed to the "silo" approach to community development inherent in the Current Regulations. As will be discussed in the following section of this letter, there are numerous products, services and programs that are required by communities. A specific community development test would promote the most effective community solutions.

3. The definition of "community development" should be expanded.

The Clearing House believes that the definition of "community development" in the Current Regulations should be expanded. The current definition is unduly restrictive and

fails to recognize a number of important community development programs that banks could provide.

There are, for example, several types of loans that do not qualify as community development loans notwithstanding their important role in community development. These include loans to hospitals in LMI communities, loans to not-for-profit organizations that serve LMI communities, student loans to members of LMI families and loans to businesses or projects supported by local governments for the express purpose of community development, but which do not satisfy examiner criteria.

In addition, the need for a broader community development standard is all too unfortunately illustrated by the September 11 tragedies. The current definition does not recognize loans or investments that are made for the purpose of rebuilding areas destroyed by acts of terrorism. This means that loans (other than small business loans), by banks to spur the recovery of areas of lower Manhattan destroyed by the World Trade Center attacks will not qualify as community development activities under the CRA. Clearly, however, these activities are and will be designed to foster community development.

Therefore, the Clearing House respectfully submits that the definition of "community development" should be revised to recognize a greater array of activities that have community development as their purpose. The definition also should be revised to include specifically activities that further the recovery of areas destroyed by acts of terrorism or natural disaster.

4. The investment test should be modified (or eliminated).

Although CRA-qualifying investments can undoubtedly benefit a community, the demands of examiners and the needs of the market have created a situation whereby banks are effectively being required to make investments that are inconsistent with sound banking practices. Our member banks find that examiners often require an ever-increasing volume of new investments to qualify for an outstanding investment rating, and even for a satisfactory rating. In major metropolitan areas, however, there are often only a limited number of opportunities for CRA-qualifying investments and a large number of institutions competing for

them. The consequence is to require depository institutions to make investments that do not produce an appropriate return.

This problem will be substantially eliminated if our proposal for a community development test is adopted, under which investments become only one part of that test. If depository institutions are provided with flexible means to meet their CRA requirements, the pressure on investment pricing will be reduced and depository institutions will be able to channel their CRA activities into programs that the communities need as opposed to programs that the CRA regulations mandate.

Whether the investment test is retained or is folded into a new community development test, the focus should be changed from new investments made within a particular year to the absolute level of investments. Our recommended approach would encourage longer-term investments, which are of particular importance to developing communities and represent an institution's long-term commitment to these communities.

5. Banks should have greater incentive to achieve an "outstanding" rating.

The Current Regulations do not establish an adequate incentive for banks to achieve an "outstanding" rating. Although there is a substantial difference in the level of commitment necessary for a bank to earn an "outstanding" rating versus a "satisfactory" rating, the result of receiving one rating as opposed to the other is merely nominal.

The Clearing House believes that the Current Regulations should be revised to provide specific incentives for banks to achieve an "outstanding" rating. For example, an ideal incentive would be the creation of a CRA-comment "safe harbor". Under such a safe harbor for banks with an "outstanding" examination rating, public comments on CRA performance would only be accepted as relevant if the commenter were able to demonstrate a serious CRA-related deficiency that occurred since the examination. This would save the banks valuable time and resources in the application process.

The result of the Clearing House's proposed revision would be beneficial both to depository institutions and the communities. The incentive created by the revision would

encourage depository institutions to increase their commitments to their CRA programs to the levels necessary for a bank to earn an "outstanding" rating versus a "satisfactory" rating. If nothing more is done to delineate between these two ratings, however, banks will have little reason to commit these extra resources.

6. Miscellaneous.

a. Letters of Credit. We believe that letters of credit should be treated as loans for purposes of the lending test. Although the Current Regulations provide for consideration of letters of credit, it has been some of our member banks' experience that they are rarely given any weight. Yet, as is the case with letters of credit in general, letters of credit to support LMI communities can provide a highly efficient way to encourage commerce and investment, and they are used when they represent the best product for a customer's needs. A letter of credit does not, of course, involve an immediate disbursement of cash, but the bank is obligated to fund its letter of credit whenever the predicate conditions are satisfied.

b. Originations and Purchases. We believe that the Current Regulations are correct in not distinguishing between loan originations and loan purchases. Both the originator and the holder provide a useful service to the community. The current approach creates efficiency by enabling depository institutions to focus on their special capabilities and promotes greater liquidity in the lending market.

c. Abusive Lending Practice. We do not believe that the Current Regulations should be revised to deal with the issue of abusive lending practices. These are serious issues, but they should continue to be dealt with in the examination process.

d. Branch-Centric Service Test. It has been our member banks' experience that examiners' evaluations of service performance rely heavily, and in some cases almost exclusively, on a comparison of a depository institution's percentage of branches in LMI areas with the percentage of the population in LMI areas. Although we recognize that "bricks and mortar" installations may be particularly important in LMI communities, at least some meaningful weight should be given to the alternative delivery channels for banking services.

These channels, which have an increasingly significant impact in all communities, include telephone banking, ATMs and computer banking.

In addition, the service test should incorporate financial education and advice, as well as delivery. The best delivery systems will not be used unless the members of the community know how to use them. We believe that an element of the service test should be a bank's programs to increase financial literacy and provide credit counseling and other financial advice to both individuals and community development organizations.

e. 80/20 Housing Projects. Our member banks have been informed that so-called 80/20 housing project loans cannot be included as community development loans. This view reflects an overly mechanistic application of the general standard that more than 50% of a program (i.e., the "primary" purpose) must benefit LMI individuals or communities.

Our member banks believe that this approach fails to recognize the theory of 80/20 projects, as well as the value of these projects to LMI individuals and communities. Builders of apartment complexes can qualify for tax-exempt financing for if at least 20% of the units have reduced rental rates for LMI tenants. In order to make the project financially viable, it is often necessary that the remaining 80% of the units be leased at market rates. Thus, the 80/20 projects not only make additional housing units available to LMI individuals, but help to break down racial barriers in housing. Because the entire loan to an 80/20 project supports LMI individuals, there is a strong case for the entire loan to qualify as a community development loan. At the very least, the portion of the loan directly related to LMI individuals should receive CRA credit.

f. Qualifying Community Development Services. We believe that more flexibility should be provided in determining what qualifies as a community development service. One example is a Habitat for Humanity project to construct homes for LMI families. A number of financial institutions provide infrastructure for such programs, and others provide financial support by helping to purchase supplies and equipment, arranging for transportation and permitting employees to participate with pay. These institutions, however, do not receive CRA credit for providing a community development service.

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The Clearing House appreciates your consideration of its views. Should you have any questions, please do not hesitate to call Norman Nelson at (212) 612-9205.

Very truly yours,

A handwritten signature in black ink, appearing to read "Norman Nelson", written over a horizontal line.