

August 12 , 2004

MEMORANDUM TO: The Board of Directors

FROM: Michael J. Zamorski
Director
Division of Supervision and Consumer Protection

William F. Kroener, III
General Counsel

SUBJECT: Notice of Proposed Rulemaking on CRA¹

I. Recommendation

On February 6, 2004, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and the Board of Governors of the Federal Reserve System (FRB) (collectively, the agencies) published a notice of proposed rulemaking (NPR) seeking comments on two fundamental and other limited changes in the regulations implementing the Community Reinvestment Act (CRA), 12 U.S.C. 2901 et seq., 69 Fed. Reg. 5729 (Feb. 6, 2004). One of those changes was to amend the definition of “small bank” from a bank with total assets of less than \$250 million that was not owned by a holding company that had total assets of more than \$1 billion to a bank with total assets of less than \$500 million, with no consideration of holding company ownership.

Upon review and consideration of the comments received in response to the February 2004 NPR, and consideration of a range of other alternatives involving the small bank asset threshold and the evaluation of community development activities, the attached NPR makes a new proposal to:

- a. change the definition of “small bank” to raise the asset size threshold to \$1 billion with no consideration of holding company ownership;
- b. add a community development activity criterion to the streamlined evaluation method for small banks with assets greater than \$250 million up to \$1 billion; and.
- c. expand the definition of “community development” to encompass a broader range of activities in rural areas.

The attached NPR seeks comment on these and any other options for improving the effectiveness of the CRA rules and reducing regulatory burden. The NPR would not address any other aspects of the February 2004 NPR. Instead, the NPR would note that we anticipate that those other aspects of the February 2004 NPR will not be acted upon until a final decision is made regarding the small bank definition and other matters raised in this proposal.

We recommend that the Board approve the attached NPR, authorize its publication in the Federal Register for a 30-day comment period, and accept related comments following such publication. Finally, we recommend that the Board authorize the Executive Secretary and the General Counsel (or their designees) to make changes to the text of the Federal Register document that are technical or otherwise non-substantive.

II. Background

In 1995, following a number of public hearings and publication of two proposed rules (see 58 Fed. Reg. 67466 (Dec. 21, 1993) and 59 Fed. Reg. 51232 (Oct. 7, 1994), respectively), the agencies jointly amended their CRA regulations to establish a performance-based system to assess institutions' performance in helping to meet their communities' credit needs. At that time, the agencies agreed that "[a]ny regulatory changes that are determined to be necessary to improve the rule's effectiveness will be made at that time." 60 Fed. Reg. 22156, 22177 (May 4, 1995).

On July 19, 2001, the agencies published an advance notice of proposed rulemaking (ANPR) seeking comments on a number of issues dealing with the regulations implementing the CRA. 66 Fed. Reg. 37602 (July 19, 2001). The ANPR mentioned a number of issues regarding the existing CRA regulations.

In the February 6, 2004, NPR the agencies stated the belief that the CRA regulations are essentially sound, but were in need of some updating to keep pace with changes in the financial services industry. Therefore, the agencies proposed amending their respective regulations. First, the agencies proposed to amend the definition of "small bank" to mean an institution with total assets of less than \$500 million, without regard to any holding company affiliation. Second, to better address abusive and predatory lending practices in CRA evaluations, the agencies proposed amending their regulations to more completely describe circumstances in which an institution, (or any of an institution's affiliates, the loans of which have been considered for CRA purposes), that has engaged in discriminatory, illegal, or abusive credit practices in connection with certain loans, would have such practices adversely affect the evaluation of the institution's CRA performance. In addition, the agencies proposed several enhancements to the data disclosed in CRA public evaluations and CRA disclosure statements. Finally, the agencies stated that they would address other issues raised in connection with the ANPR through additional interpretations, guidance, and examiner training. The FDIC received over 930 comments on the February 6, 2004 NPR.

III. The Proposed Rule

A. Small Bank Definition

The current definition of small bank states:

Small bank means a bank that, as of December 31 of either of the prior two calendar years, had total assets of less than \$250 million and was independent or an affiliate of a

holding company that, as of December 31 of either of the prior two calendar years, had total banking and thrift assets of less than \$1 billion.

12 C.F.R. §345.12(t).

The proposed definition as stated in the February 2004 NPR was:

Small bank means a bank that, as of December 31 of either of the prior two calendar years, had total assets of less than \$500 million.

The public comments received on the NPR came from industry entities, community organizations, and individuals. In addition, the FDIC received comments from Federal legislators and one state regulator. The comment letters were split between banks favoring the proposal and community organizations opposing it. Of those comment letters, FDIC received 534 letters clearly in favor of increasing the size limit in the definition of small banks, and 334 letters against the proposal. Of the letters in favor of the proposal, 475 of the commenters favored a higher small bank asset threshold than the \$500 million amount proposed in the NPR. The most common amount mentioned in those letters was a threshold of \$1 billion, although some commenters suggested raising the threshold to \$2 billion.

The new proposed definition states:

Small bank means a bank that, as of December 31 of either of the prior two calendar years, had total assets of less than \$1 billion.

We recommend that the Board publish for comment a specific proposal to increase the small bank definition to \$1 billion, rather than take final action on the existing NPR without providing this additional opportunity for comment.

The proposal seeks comment on whether placing community banks with assets between \$250 million and \$1 billion under the small bank performance standards could benefit local communities because those banks would be able to focus more of their resources—both time and financial—on community-based lending activities rather than, for example, data collection and reporting technical requirements.

B. Community Development Criterion

The consideration of community development activity has been part of the CRA evaluation process since its inception for all sizes of institutions. However, some large banks have indicated that they often have difficulty competing with multi-billion dollar banks for qualified investments required under the large bank tests. To address this concern, the NPR proposes, along with raising the small bank definitional threshold to \$1 billion, to amend the small bank performance standards to incorporate a community development criterion for banks with assets between \$250 million and \$1 billion.

The proposed criterion would assess a bank's record of helping to meet the credit needs of its assessment area(s) through a combination of its community development lending, qualified investments, or community development services. The criterion would be mandatory, and would be evaluated along with the current streamlined criteria applicable to small banks. Notably, it would permit banks to better and more

meaningfully balance their community development activities based on the opportunities in the market and their own strategic strengths. For example, a covered bank may perform well under this community development criterion by engaging in any type of community development activity – be it community development lending, community development investments, or community development services, as opposed to all three.

Community development activities for banks with assets greater than \$250 million and up to \$1 billion will be considered by the FDIC when assigning a CRA rating. The regulation will continue to reflect that for a small bank to receive an “Outstanding” CRA rating, the FDIC will consider the extent to which that bank exceeds a satisfactory level of performance under each of the performance standards, now including an explicit community development criterion applicable to banks with assets greater than \$250 million and up to \$1 billion.

Banks with assets under \$250 million can continue to attain an “Outstanding” rating in two ways, consistent with the present rules. First, an “Outstanding” rating can be assigned when the bank’s performance materially exceeds satisfactory standards for each of the five existing streamlined lending criteria. Second, an “Outstanding” rating can be assigned when a bank meets the satisfactory standards for each of the five existing streamlined lending criteria, and in addition, requests consideration of community development activities and those activities are found to warrant an “Outstanding” rating.

In addition to the comments on the proposed community development criterion for banks with assets greater than \$250 million and up to \$1 billion, the FDIC is requesting specific comment on whether we should apply a separate community development test, in addition to the existing streamlined performance criteria that would be applicable to these banks, and on how performance would be weighted and evaluated in determining an overall CRA rating.

C. Community Development Definition and Rural Areas

Rural communities also raise noteworthy issues in the community development context. As explained in the NPR, many community organization commenters expressed concern about investments in, and services to rural communities. To address these concerns, the NPR proposes to amend the definition of “community development”, which now focuses on activities that benefit low- and moderate-income individuals. As proposed, “community development” activity could benefit either low and moderate income individuals or individuals in rural areas, or serve to revitalize or stabilize low- or moderate- income geographies or rural areas. The NPR seeks comment on whether there is a more applicable, readily understandable way to define community development to ensure that it encompasses activity that benefits rural areas.

IV. Comment Period

Comments are to be received within 30 days of publication of the NPR in the Federal Register.

A draft of the proposed Federal Register notice is attached.

Attachment

Concur:

John M. Brennan
Deputy to the Chairman

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