

September 15, 2004

Robert E. Feldman  
Executive Secretary  
Attn: Comments/Legal ESS  
Federal Deposit Insurance Corporation  
550 17<sup>th</sup> St., N.W.  
Washington D.C., 20429  
Re: RIN number 3064-AC50

Dear Mr. Feldman:

I am writing from the Woodstock Institute to comment on the Federal Deposit Insurance Corporation's (FDIC) proposed changes to their regulation of the Community Reinvestment Act. Woodstock Institute is a Chicago-based research and policy organization that for over 30 years has worked extensively on community reinvestment policy. The FDIC's proposal would, for banks it regulates, change the definition of institutions considered "small" for CRA purposes from any institution with less than \$250 million in assets and not part of a holding company with over \$1 billion in assets to include all institutions with less than \$1 billion in assets regardless of holding company size. Additionally, the FDIC proposal would add a community development criterion for institutions between \$250 million and \$1 billion in assets and amend the definition of "community development" to include a rural development component.

We are deeply concerned about the FDIC's proposal for a number of reasons. **First**, the proposal would shift a significant number of financial institutions currently considered "large" for CRA purposes to "small" status. "Small" banks are subject to streamlined CRA exams that do not consider an institution's level of community development lending, investments, grants, and services to low- and moderate-income communities. Additionally, "small" institutions are not required to report small business lending data. There is a significant concern that small cities and rural areas predominantly served by these mid-sized institutions will be particularly hard hit by this change. **Second**, the community development criterion proposed by the FDIC for institutions between \$250 million and \$1 billion that would allow these banks to choose one activity from community development lending, investments, or services to be considered toward their final CRA rating, is vaguely defined and its weight on CRA exams is unclear. **Finally**, changing the definition of "community development" to include any type of rural

development, regardless of its impact on low- and moderate-income (LMI) households or communities would allow banks to get CRA credit for investing in projects that have little or no benefit for LMI markets.

### **Change in Asset Threshold for “Small” Banks**

Increasing the asset level for banks considered “small” for CRA purposes would have a strong negative effect on community development efforts nationwide. Under the streamlined small bank CRA exam, these midsized institutions would have little incentive to provide critical community development lending, investments, or services to LMI communities and would have little accountability for their small business lending in these communities.

In order to understand the potential impacts of the FDIC’s proposal on community development activities, we analyzed data for institutions active in 2003<sup>1</sup> in the state of Illinois. Our analysis for Illinois indicates that by changing the FDIC small bank definition:

- The number of “large” FDIC regulated institutions active in the state would decline by 86 percent and the number of “small” institutions would exceed 97 percent;
- These “small” institutions would control nearly 75 percent of FDIC regulated assets state-wide;
- The number of banking offices in urban,<sup>2</sup> LMI census tracts operated by “large” FDIC regulated institutions would decline by 63 percent to the point where over 77 percent will be operated by “small” banks;
- In 2003, these banking offices controlled nearly \$3.4 billion in LMI deposits, or over 10 percent of all LMI deposits state-wide. Adding OTS LMI deposits that will also be shifting, 13 percent of all Illinois LMI deposits would be changing under new OTS regulations to small institution status (see Table 1);
- In rural areas, “large” FDIC regulated banking offices would decline by over 91 percent until over 98 percent were operated by “small” institutions;
- In 2003, these offices controlled 8 percent of rural deposits state-wide. When combined with rural deposits held by OTS-regulated thrifts, over 11 percent of all rural deposits would shift to small institution status (see Table 1);
- An analysis of the most recent CRA exams<sup>3</sup> of effected FDIC institutions shows that \$635 million in community development lending and \$114 million in community development investments statewide that are threatened by this proposal. These banks also provided significant community development services to LMI communities;
- In 2002, FDIC banks that would shift to small status originated nearly 11,000 small business loans in Illinois for close to \$1.5 billion.<sup>4</sup>

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<sup>1</sup> Based on analysis of FDIC 2003 Summary of Deposits data

<sup>2</sup> For this analysis, an urban area was considered any county within a metropolitan statistical area (MSA). Rural areas were any county not in an MSA.

<sup>3</sup> The most recent CRA exams of effected institutions were released between 2000 to 2004. Community development lending and investment activity would be for preceding years. For a number of effected institutions, their most recent CRA exam was conducted using small bank standards and had no information on community development lending and investments.

<sup>4</sup> Not all FDIC banks effected by the proposal reported small business data in 2002.

**Table 1.** Illinois LMI and rural deposits held by FDIC- and OTS-regulated institutions that would shift from large to small status, 2003

	<u>LMI Deposits</u>		<u>Rural Deposits</u>	
	Shifting from Large to Small (\$\$\$ thousands)	Share of All LMI Deposits	Shifting from Large to Small (\$\$\$ thousands)	Share of All Rural Deposits
FDIC	\$3,381,822	10.4%	\$2,415,243	7.8%
OTS	\$815,729	2.5%	\$1,063,482	3.4%
Combined	\$4,197,551	12.9%	\$3,478,725	11.2%

As the above analysis shows, FDIC banks with between \$250 million and \$1 billion in assets have a strong presence in Illinois LMI and rural communities. These institutions have contributed significant levels of community development lending, investments, and services and have originated a considerable number of small business loans. The FDIC’s proposal to shift these banks to “small” status would threaten these activities and deliver a devastating blow to community development efforts statewide.

**Community Development Criterion and Rural Development Component**

The proposed addition of a community development criterion for FDIC-regulated banks with between \$250 million and \$1 billion needs to be significantly refined before it can be considered an adequate proposal. Most importantly, the weight of the community development criterion relative to other exam criteria must be determined. If this criterion is given equal weight to lending considerations, it may be a more viable alternative than if it is given only cursory consideration. Additionally, small business lending data must continue to be reported for institutions between \$250 million and \$1 billion in assets. These institutions are significant small business lenders, and the loss of this data would be a critical blow to analysis of community reinvestment activity. Please note this comment on the community development criterion in no way lessens our opposition to the proposed change to the definition of small bank.

The inclusion of a rural community development component to the mid-sized bank exam is troubling. The FDIC proposal states that rural community development activity, regardless of its impact on LMI households, can be applied to the community development test. Although we believe targeting community development in rural communities is important, we feel this activity should still be targeted to benefit LMI households or communities. Otherwise, financial institutions could be given CRA credit for activities such as strip mall, housing development, or even golf course financing that have limited or no impact on LMI households or communities.

The FDIC justifies its proposal by reference to the banking community’s complaints about the difficulty mid-sized institutions have complying with the investment test. We think these complaints unjustified particularly given the growth of intermediary institutions that amass investments from such banks nationwide and invest them on the banks’ behalf. But the FDIC justification is troubling for another reason. The other non-lending component of the large bank exam is the service test. There is increasing

understanding nationally of the necessity for access to basic bank retail services for lower-income families to build assets. Yet the FDIC proposal on expanding the definition of small banks is completely silent on both the justifications for and the consequences of withdrawing the application of the service test to banks between \$250 million and \$1 billion in assets. It is as if the FDIC turned a blind eye to a critical part of its CRA implementation responsibilities. The appropriate implementation of the service test is critical to bringing lower-income people into the financial mainstream. The Agency also ignored the consequences of withdrawing the mandate on these banks to publicly report small business lending data. Smaller institutions in many markets have a much larger share of small business lending than their size would predict. The loss of public data on that activity will seriously reduce the pressure on those institutions to maintain their current level of small business lending activity to the detriment of the critical small business community in lower-income neighborhoods.

We do not believe that the regulatory burden for mid-sized financial institutions is sufficient to justify the potential loss of essential development resources for LMI and rural communities nationwide. Our analysis of Illinois indicates that the FDIC's proposed changes would shift significant banking resources in LMI and rural communities to "small" banks. Once these institutions are subject to streamlined CRA exams, they will no longer be examined and given credit for activities such as their investments in affordable housing developments, developing innovative financial services products that reach the unbanked, or expanding their branch networks into underserved communities. Without this incentive, it is less likely that banks will participate in such activities in LMI communities. Additionally, these banks, which are significant small business lenders, will no longer publicly report essential small business lending data which would be a critical blow to monitoring community reinvestment performance. The proposed community development criterion is vague and may not adequately emphasize appropriate levels of community development activity, and the rural development component offers no benefit to LMI communities or households.

We thank you for your consideration of our comments and urge the FDIC to withdraw the proposed changes to its CRA regulation.

Sincerely,

Geoff Smith  
Project Director