STATE OF MINNESOTA
DEPARTMENT OF COMMERCE

In the Matter of the Proposed Rules Relating to the Rating of Interstate Banks

Statement of Need and Reasonableness

I. INTRODUCTION

The proposed rules outline a process to financial institutions in the state of Minnesota which are owned by an interstate bank holding company to rate their lending performance as it relates to meeting the needs of their service areas and in reaching goals for community reinvestment and developmental loans.

II STATEMENT OF STATUTORY AUTHORITY

1) The Minnesota Department of Commerce proposes to adopt as permanent rules Minn. Rules Parts 2655.0700 to 2655.1300. Under the terms and conditions of the Reciprocal Interstate Banking Act (Laws 1986, Chapter 339, Section 49.9)

II. STATEMENT OF NEED

2)Minn. Stat. ch 14 (1986) requires the Commissioner to make an affirmative presentation of facts establishing the need for and reasonableness of the rules being proposed. In general terms, this means that the Commissioner must set fourth the reasons for the Departments proposal, and the reasons must not be arbitrary or capricious. However, to the extent that need and reasonableness are separate, need has come to mean that a problem exists which requires administrative attention, and reasonableness means that the solution proposed by the commissioner is appropriate.

3) The Commissioner of Commerce is required to (among other duties) "rate each financial institution owned by an interstate bank holding company on its lending performance." (48.98 Subd.3).

4) Further this performance shall be evaluated on the basis of a five point scale. The law specifically states that: "The commissioner shall adopt by rule a five point rating scale based on the institution's financial performance in meeting the credit needs of the community and its performance in reaching its targeted level of developmental loans."

5) The premise and rationale for this rating system is established and outlined in the law which requires that "an interstate bank holding company shall provide a level of developmental loans as defined by the commissioner by rule" (48.991).

6) This developmental loan requirement level has been established to assure that the legislative intent that interstate banks participate actively in the stabilization and growth of the state economy, is fulfilled.

III. STATEMENT OF REASONABLENESS

7) The Commissioner is required by Minn. Stat. ch. 14 to make an affirmative presentation of facts establishing the reasonableness of the proposed rules. Reasonableness is the opposite of arbitrariness or capriciousness. It means that there is a rational basis for the Departments proposed action. It is reasonable to assume that in order for the Commissioner to rate the performance of an Interstate Bank, measurable criteria must be set fourth.

8) In addition, economic distress results from a failure of leadership and it is both reasonable and realistic to conclude that ~~Bankers~~ financial institutions who are major leaders in economic matters at all levels have an obligation and duty to provide positive leadership.

IV. FILING REQUIREMENTS

9) Prior to receiving ~~a license~~ approval to ~~bank~~ operate in Minnesota ~~an interstate bank~~ under the Regional Interstate Banking Act ~~much submit~~ must be submitted an application and supporting information which justifies ~~its~~ the fiduciary and ethical suitability to conduct business in the state of Minnesota.(48.99). In order for the commissioner to measure a financial institutions performance over a given period of time, a portion of this material shall include an analysis of the distress and loan entitlement needs of the community, areas and persons the financial institution plans to serve and further a proposal and set of objectives with regard to service to loan entitled persons and distressed areas.

10) This analysis should yield a targeted level of developmental loans specific for the financial institution making the application and this targeted level then becomes the basis for the commissioner's annual review of the ~~banks~~ institution's performance.

V. DEVELOPMENTAL LOANS

11) Developmental loans may be broadly defined as loans to individuals, families, proprietorships, partnerships, corporations, eleemosynary and quasi-public and public bodies which can be regarded as particularly beneficial to the stabilization or growth of a local economy, especially a distressed economic area; and loans to individuals or families, whether in distressed areas or not who may be disadvantaged or in need of special consideration, herein referred to as loan entitled persons or families. The developmental loan, while it is an economic instrument, is also a social instrument which, when wisely administered provides guidance, counsel, and care. Thus, the developmental loan becomes a tool for wise economic leadership, a charactreristic that is encouraged by the Regional Interstate Banking Act.

12) The law specifically states that: "A 'developmental loan' includes, but is not limited to, (1) loans for low and moderate income housing, loans for community development corporations, loans to women and minority owned businesses, student education loans, and (2) loans within distressed areas and on any Indian reservation for any commercial non-real estate purpose, home loans, home improvement loans, and operating loans to family farmers" (48.991).

13) A distressed area may be defined as an area of economic decline or stagnation which can be identified by high levels of unemployment, difficult economic conditions, and special credit needs. In fact, the law requires that the commissioner define distressded areas in terms of the related "area's unemployment rate, economic conditions, and credit needs",on an annual basis.

14) A distressed area outside of the Twin City area would normally be designated as an entire county, however in the case of the Twin City Metropolitan area, the commissioner may designate an area smaller than a county as distressed. The Twin City Metropolitan area counties are Anoka, Carver, Dakota, Hennepin, Ramsey, Scott and Washington.

VI. RATING CRITERIA AND PROCEDURE

15) The targeted level of developmental loans and a financial institution's rating under Part 2655.1300 shall be based on the situation of its community and the financial institution's performance based on the twelve basic criteria listed in paragraph 20. The situtation of the community shall be determined from the following characteristics:

A) The economic condition of the community or communities which the financial institution intends to serve. This shall be measured by criteria that include unemployment rates, industrial growth, commercial growth, single and multi-family housing starts, government and institutional growth, and agricultural growth.

B) The social composition of the community as measured by the incidence of entitled individuals. This shall be measured by the actual incidence of unemployment, the incidence of persons of color, the incidence of women eighteen to sixty years of age.

C) The actual fiscal capacity of the financial institution to provide loans and credit. This shall be determined by a composite factor which shall include loan exposure, capital adequacy, asset quality, earnings, and liquidity.

D) The actual local demand for credit and loans without economic leadership intervention; and, as a corrollary measure the proportion of loans and credits made in the local community(ies) as compared with loans and credits made out of the communities. This shall be measured by a composite factor made up of the proportion of loans made in the service area of the financial institutionin the State of Minnesota and outside the state of Minnesota, the quality of these loans as indicated by the level of nonperforming loans and the economic value of these loans, that is the estimated economic growth impact of these loans on the State of Minnesota and the community(ies) served by the financial institution.

16) Each of the four situtational variables must be made objective or explicit in advance as part of the interstate banking plan and application.

In other words, the financial institution, in cooperation with the Commissioner, must prepare a report which shows what the actual need for developmental loans is in the area the financial institution expects to serve, and show how its plan undertakes to meet this need in its own service area or in other areas of the state.

17) While a whole series of situtations and combinations of situtations will appear from these norms two polar types can be identified at this time:

A) A financial institution could be located in an area in which there is no need for developmental loans.

B) A financial institution could be located in an area in which the levels of economic distress are so high that almost all individuals and institutions could benefit from developmental assistance.

18) These types of financial institutions provide the basis for establishing developmental loan obligations, and in particular, provide the basis for a sliding scale measure to assess the financial institution's responsibility to provide developmental loans.

19) This analysis will yield a classification of financial institution's in terms of community type, and by extension, the obligation of the bank to make developmental loans.

20) The Commissioner shall make the annual rating based on the financial institution's performance performance on the following 12 basic criteria;

A) Activities conducted by the financial institutionto ascertain credit needs of its community, including the extent of the financial institution's efforts to communicate with members of its community regarding the credit services being provided by the financial institution.

B) the extent of the financial institution's marketing and special credit related programs to make members of the community aware of the credit services being provided by the financial institution.

C) The extent of participation by the financial institution board of directors or board of trustees in formulating the financial institutionpolicies and reviewing its performance with respect to the purposes of th e Community Reinvestment Act of 1977.

D) The geographic distribution of the financial institutioncredit extensions, credit applications and credit denials;

E) Any practices intended to discourage application for types of credit set fourth in the financial institution's annual community reinvestment plan or application;

F) Evidence of prohibited discriminatory or other illegal credit practices:

G) the financial institution's participation, including investments, in local community development and redevelopment projects or programs;

H) the financial institution's origination of residential mortgage loans, housing rehabilitation loans, home improvement loans and small business or small farm loans within its community or the purchase of such loans originated in its community;

I) the financial institution's participation in governmentally insured, guaranteed or subsidized loan programs for housing, small business or small farms;

J) The financial institution's plan and demonstrated experience in assisting in (1) the development of ecomomically disadvantaged and underserved neighborhoods, (2) meeting the credit and deposit service needs of low-income, moderate-income and minority residents, and (3) helping small, minority, and women owned businesses.

K) The financial institution's ability to meet various community credit needs based on its financial condition, size, legal impediments, local economic conditions and other factors. and

L) Other factors that in the judgment of the commissioner, reasonably bear upon the extent to which a financial institution is helping to meet the credit needs of its entire community, including, without limitation, the financial institution's participation in credit counseling services.

(21) The Commissioner shall make the annual rating based on a five-point scale using data provided by the financial institution. Scoring will be occur based on empirical data provided by the financial institution and few subjective judgments will be required. Financial institutions will be ranked in one of the following catagories;

A. Excellent performance

B. Good performance

C. Satisfactory performance

D. Less than satisfactory performance

E. Unsatisfactory performance