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EXPLORING HOW COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS SUPPORT UNDERSERVED COMMUNITIES

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING, TRANSPORTATION, AND COMMUNITY DEVELOPMENT

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED SEVENTEENTH CONGRESS

SECOND SESSION

ON

EXAMINING THE CHALLENGES FACED BY UNDERSERVED COMMUNITIES WHEN IT COMES TO ACCESSING CAPITAL AND THE FINANCIAL SYSTEM

JANUARY 5, 2022

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C O N T E N T S

WEDNESDAY, JANUARY 5, 2022

WITNESSES

Additional Material Supplied for the Record

EXPLORING HOW COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS SUPPORT UNDERSERVED COMMUNITIES

WEDNESDAY, JANUARY 5, 2022

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
SUBCOMMITTEE ON HOUSING, TRANSPORTATION, AND
COMMUNITY DEVELOPMENT,
Washington, DC.

The Subcommittee met at 10 a.m., via Webex, Hon. Tina Smith, Chair of the Subcommittee, presiding.

OPENING STATEMENT OF CHAIR TINA SMITH

Chair SMITH. Good morning. I call the Subcommittee on Housing, Transportation, and Community Development to order.

Today, we are going to take a look at Community Development Financial Institutions or CDFIs. Our hearing will explore how the Federal Government can help support their innovative work and how we can work together to address some of the challenges faced by underserved communities when it comes to accessing capital and the financial system.

The COVID–19 pandemic has not been the great equalizer. It has laid bare the disparities in our society that existed before the pandemic, and too often it is Black and Brown and indigenous families who have faced the most significant burdens.

But the economic disparities did not start, as I said, during the pandemic. According to the Federal Reserve, as of 2019, a typical Black family's net worth was just 15 percent of a typical White family's worth; a typical Hispanic family's net worth was about 19 percent of a White family's; and, the typical net worth for Native American families is also just a fraction of the typical White family's. While there are many causes for this great inequity, one factor is a lack of access to capital and to financial services for people of color, indigenous communities, and in small towns and rural places.

When the CDFI Fund, the Federal agency that oversees CDFI programs, when it was established in 1994, there were about 80 CDFIs. Today, there are more than a thousand, many with innovative models that were not even imagined when the CDFI Fund was first established, and they have played a critical role in bringing capital and financial services to a wide variety of underserved communities, from urban areas to small towns and rural places to tribal lands. For instance in Minnesota, the African Development Center helped fund two malls that have more than 450 African small businesses and over 500 jobs.

The Indian Land Company, the ILCC, Indian Land Capital Company, forgive me, made a loan of nearly $1 million to the Lower Sioux to allow them to expand their land by about 10 percent. I appreciated the opportunity to visit with them last summer and learn about this project.

And in 2018 I visited University Enterprise Labs, which was funded in part by Sunrise Banks, which is a certified CDFI, with support from the New Markets Tax Credit Program. Those funds have helped expand the cutting-edge life sciences incubator in an area that is currently shared by industrial uses and students on the border of St. Paul and Minneapolis.

With their successful track record of reaching underserved communities, Congress has looked to CDFIs as effective community development organizations to implement programs. So here is just a few examples:

In 2000, Congress enacted the New Markets Tax Credit, which provides tax incentives to allow CDFIs to work on economic development projects in economically distressed areas. That program has proven successful, and I am glad to be a supporter of bipartisan legislation from Senator Cardin and Senator Blunt to update and expand that tax credit.

During the Great Recession, Senator Menendez offered legislation to establish the CDFI Bond Guarantee Program. The bond guarantee program provides stable, long-term sources of capital for CDFIs without any subsidy from taxpayers. Earlier this week, Senator Rounds and I introduced legislation to make that program permanent and to adjust some of its loan requirements to make it more accessible to smaller CDFIs who might want to participate. I am looking forward to hearing from our witnesses today about how our legislation could make a difference for community development.

In 2020, Congress set aside $25 billion of PPP lending for CDFIs to distribute because CDFIs have relationships with many communities that banks and credit unions just were not able to reach. CDFIs made more than 100,000 PPP loans in the first months of that program, and that effort was critical to helping thousands of small businesses stay afloat.

In addition, in the bipartisan, year-end funding package that we enacted at the end of 2020, Congress made an historic investment in CDFIs and Minority Depository Institutions, providing rapid relief grants. As a result of that program, 27 Minnesota CDFIs received grants totaling $38 million, funds that will be invested in our State to support new lending and services. Senator Warner played an important role in getting this investment enacted, and I know that many of us supported the work that he has done. I look forward to hearing from our witnesses today about how that funding is making a difference in their communities.

So before I turn to Senator Rounds, I would like to thank Mike for being such a good partner in planning and organizing this hearing. As you were saying at the beginning, this is a hearing where we tend to focus on what we can find agreement on, on where we can find common ground, and approach this from a perspective of solutions, and that is very important. I know that we have a shared interest in building strong communities in our States and around the country and especially in supporting economic development and access to capital in the indigenous communities that both of our States share.

As I mentioned before, yesterday we joined together to introduce together legislation to update the CDFI Bond Guarantee Program to make it more available for smaller CDFIs. And we have also done legislation together to support access to mortgages for Native Americans in a partnership between CDFIs and the U.S. Department of Agriculture. So I am hopeful that today's hearing will help us identify additional areas where we can work together and pave a path to advancing these important pieces of legislation and others that we will hear about today.

So, Senator Rounds, thank you so much for your partnership, and you are now recognized.

OPENING STATEMENT OF SENATOR MIKE ROUNDS

Senator ROUNDS. Thank you, Madam Chair, and let me reciprocate as well. I most certainly have appreciated the opportunity to work directly with you and your team. I think this is the way the legislative process should work, and I have appreciated your openness to having these discussions. And I look forward to additional legislation being an item that can be moved forward from this Subcommittee and perhaps actually making some very positive changes throughout the Midwest and hopefully across the rest of the country. So I thank you for your leadership, and I thank you for your interest in cooperating and in working together.

I also want to thank our witnesses for taking the time to virtually attend today's hearing. I would especially like to thank Ms. Lakota Vogel, from my home State of South Dakota, for her willingness to testify. I look forward to hearing from all of you.

Community Development Financial Institutions, or CDFIs, are critical in rural South Dakota as they provide services to the underserved communities that often fall through the cracks of our traditional financial systems. It is because of these institutions that many can buy their first home or launch a business that will bring much-needed jobs to a rural community.

Today, however, I mainly want to focus my remarks on the impact Native CDFIs have on Native populations as well as the challenges which they still face. Native CDFIs are unique because they are anchored in local culture and are passionate about creating opportunities for long-term growth. As members of the community themselves, staff members know how to bridge the gap between cash economies and traditional financial products. They also play an important role in laying the groundwork for new investment in Native communities by providing access to capital financial assistance and literacy. This results in new Native-led businesses, opportunities for entrepreneurship, and additional jobs.

Oftentimes, Native CDFIs are the first encounter Native families and individuals have with financial institutions. Because Native CDFIs serve a large unbanked population, they will often refer individuals to a local bank to open an account, many of whom are the first in their generation to do so and begin a journey toward financial stability.

A recent study by the Minneapolis Fed found that trust between a borrower and a lender is critical for a successful loan. And since Native CDFIs design their services to include a cultural element, they can better build that trust. By providing financial workshops, training, and counseling that integrates cultural values in community-specific situations, Native CDFIs lead to more robust credit building.

The Minneapolis Fed researchers also found that establishing Native CDFIs on or near reservations can improve individuals' credit outcomes. What is best for the 5,000-person town of Eagle Butte, South Dakota, is different from what is best for Native populations in the Black Hills of South Dakota. And since they are able to tailor their programs to their specific community, they find more success.

The Minneapolis Fed reported that adding just one Native CDFI staff member per 1,000 residents leads, on average, to a 45-point increase in the Equifax risk score of individuals who have low creditworthiness.

Even though our Native CDFIs are able to be effective, they still face challenges. Adequate capital access continues to be a problem as demand in Native areas is outpacing supply. The Chair and I have worked on several pieces of legislation to try to increase access to this much-needed capital. Last year, we introduced the Native American Rural Homeownership Improvement Act, which would expand the USDA 502 lending pilot program, where USDA partnered with Native CDFIs to employ loans to eligible Native borrowers. Senator Smith and I also introduced legislation today that would lower the minimum bond offered by the CDFI Bond Guarantee Program from $100 million to $25 million in order to increase access to smaller CDFIs, like Native CDFIs. These are just a few of the ways we have tried to address this problem, and I look forward to exploring this issue and others during this hearing.

Again, we welcome all of you here today to our first Subcommittee hearing of 2022, and I look forward to hearing from our witnesses on Native CDFIs and traditional CDFIs.

Thank you, and thank you, Madam Chair.

Chair SMITH. Thank you so much, Senator Rounds.

I am now going to introduce our witnesses. I am so grateful to all of you for joining us today. I will introduce all three of you at once and then turn to each of you to make your opening statements.

First, I would like to welcome John Holdsclaw, IV, as President of the CDFI Coalition and Executive Vice President of Strategic Initiatives at the National Cooperative Bank in Washington, DC, Welcome, Mr. Holdsclaw.

I am delighted to welcome Frank Altman, who is the founder and CEO of Community Reinvestment Fund, USA, based in my hometown of Minneapolis, Minnesota. Welcome, Frank.

And also, it is wonderful to have join us today Lakota Vogel, who is Executive Director of the Four Bands Community Fund in Eagle Butte, South Dakota. Welcome, Lakota, Ms. Vogel.

Welcome to all of you for your willingness to speak with us today.

And before you begin your opening statements, I have a few reminders. Once you start speaking, there will be a slight delay before you are displayed on the screen. And to minimize any background noise, please click the mute button until it is your turn to speak or to ask questions.

You should all have one box on your screens labeled "clock" that will show how much time you have remaining. For witnesses, you will have 5 minutes for your opening statements, and your full written statements will be made part of the record. For all Senators, the 5-minute clock applies for your questions. When you have about 30 seconds remaining for your statements or questions, you will hear a little bing, a little bell ring to remind you that your time is almost expired. It will ring again when your time has expired.

And if there is any technology issue, we will move to the next witness or Senator until we get it resolved.

To simplify the speaking order process for Senators, Senator Rounds and I have agreed to go by seniority for this hearing as we are fully virtual, and we will proceed first through Subcommittee Members by seniority and then turn to any non-Subcommittee Members in order of seniority who wish to ask questions.

I will now turn to Mr. Holdsclaw for 5 minutes for your opening statement.

STATEMENT OF JOHN HOLDSCLAW, IV, PRESIDENT, CDFI COALITION, WASHINGTON, D.C.

Mr. HOLDSCLAW. Thank you, Chairwoman Smith, Senator Rounds, and Members of the Subcommittee. My name is John Holdsclaw, IV. I am the President of the CDFI Coalition and EVP of Strategic Initiatives at the National Cooperative Bank. Thank you for this opportunity today to testify on the CDFI Fund and the success of CDFIs in delivering financial services to underserved, low-income, urban, rural, and Native communities.

The CDFI Coalition is a national membership organization made up of more than 150 organizations, including loan funds, community development banks, community development corporations, venture funds, microlenders, Native American organizations, and credit unions.

The Fund was established in 1994 as a key policy apparatus for revitalizing disadvantaged communities, especially those hit very hard during the COVID pandemic. However, before the pandemic, low-income communities, rural, tribal, and communities of color faced significant obstacles in accessing financial services. Today, the Fund has more than 1,300 certified CDFIs across the country, providing community development and lending services in all sizes and types of communities. These CDFIs leverage $12 in private capital for every dollar in Federal support.

In fiscal year '22, the CDFI Fund financial assistance awards unleashed $39 billion loans and investments to 125,000 businesses and millions of individuals. They financed 50,000 units of affordable housing and thousands of nonprofits and facilities. Native CDFIs have made $1.6 billion in loans and investments.

In regards to PPP, or the Paycheck Protection Plan, Congress established a set-aside. And according to SBA, through May of 2020, CDFIs, or community financial institutions including CDFIs, made 1.3 million PPP loans totaling $30 billion or 21 percent of all the loans. The average loan size was $21,000 compared to $41,000 across all other lending classes. For example, 78 percent of all community financial institution PPP loans went to businesses requesting less than $250,000. Moreover, 15.7 percent of all of those community financial institutions-made loans were made to businesses in rural communities, closely keeping with the 16.6 percent of all the loans that went to rural businesses.

So with the recent growth in the industry, it presents both opportunities and challenges. The Federal Government—and thank you—has made an unprecedented investment into CDFIs over the past several years with the hope of scaling the industry and expanding its impact. However, Congress and the CDFI Fund can do more to scale the CDFI movement while ensuring that certified CDFIs maintain their role as trusted, mission-driven lenders in underserved communities.

The CDFI Coalition urges Congress to provide $1 billion in annual appropriations for CDFI assistance programs through the CDFI Fund. The CDFI Coalition urges Congress to invest more in CDFIs by increasing the annual authorization level to $1 billion for the CDFI Fund. We believe that this will result in the financing of an additional 100,000 affordable housing units, thousands of loans and investments in childcare centers, health centers and community facilities, nearly 2 million consumer and home ownership loans, and hundreds of thousands of loans in investments in businesses in targeted areas.

The CDFI Fund also strongly encourages Congress to build the administrative capacity of the Fund. To sustain the recent momentum and growth in the industry, Congress should provide additional resources to the agency to administer a growing portfolio of financial assistance awards, bonds, and tax credits.

We also support the Bond Guarantee Improvement Act—thank you, Senator Smith, and thank you, and Senator Rounds—that was introduced yesterday. The permanent extension and other improvements contained in that legislation have the potential to further prompt revitalization in distressed and rural communities.

All said, thank you again for the opportunity to be here today to talk about the impact of community financial institutions, Community Development Financial Institutions or CDFIs, and I welcome the opportunity to answer any questions that you may have. Thank you.

Chair SMITH. Thank you so much. Now we turn to Mr. Altman.

STATEMENT OF FRANK ALTMAN, FOUNDER AND CEO, COMMUNITY REINVESTMENT FUND, USA, MINNEAPOLIS, MINNESOTA

Mr. ALTMAN. Thank you, Chair Smith, Ranking Member Rounds, and distinguished Members of the Subcommittee. I am pleased to participate in this important hearing to discuss the role of CDFIs in supporting underserved communities.

I am Frank Altman, CEO and cofounder of Community Reinvestment Fund. We are a national CDFI based in Minneapolis whose mission is to help improve lives and strengthen communities through innovative financial solutions. We were certified as a CDFI in 2009. However, we have been active as an organization since 1988. So we have been around for more than 30 years working in these markets.

CRF has been the beneficiary of six financial assistance awards and the rapid response grant. We have received $919.5 million in New Markets Tax Credit allocations across—since the beginning of the NMTC program, and we have also issued $940 million in bonds on behalf of 8 CDFIs as a qualified issuer for the CDFI Bond Guarantee Program. Since our founding, we have deployed more than $3.5 billion in financing in serving more than 2.3 million people, and we have made loans to small businesses in more than 1,000 mostly low-income communities in all 50 States and the District of Columbia, creating or preserving more than 156,000 jobs.

Early on, in response to the need for liquidity for revolving loan funds and organizations that were lending in these communities, we created the first secondary market for community development loans and issued the first asset-backed securities collateralized by these assets. Our vision was to connect community-based lenders to private investors in the public capital markets, and we continue to work toward that effort.

Over the years, we have funded more than 9,000 small business loans, two-thirds of which went to businesses owned by women or people of color. And our deep expertise in small business lending led us to obtain an SBA nonbank national 7(a) license, one of now three nonbank CDFIs offering this product nationally.

Today, I want to focus my remarks particularly on the work that we have done both nationally and in Minnesota to reflect on what we have learned. CRF has a long history of partnering with other CDFIs. We have worked with more than 250 CDFIs and development finance agencies over the years, both nationally and in the Twin Cities.

And in Minneapolis, more than a decade ago, we made more than 100 subordinate loans to support small businesses along Lake Street, Franklin Avenue, and primarily in the Phillips and Powderhorn Park neighborhoods. We did this in partnership with local banks and other CDFIs, and our joint efforts revitalized these neighborhoods, resulting in a 62 percent decline in crime from 1988 to 2009 and rising property values. This lending laid the foundation for a major redevelopment project, the Midtown Exchange, a former Sears distribution center, long vacant more than 10 years, with 2 million square feet, a very daunting project to redo. But working with the city and the strategy the city had for this development, CRF and two other CDFIs were able to provide tax credits from the New Markets Tax Credit Program to redevelop this building into a mixed use building, including the headquarters for Allina Health, the Allina Commons portion of this project, bringing the headquarters of a major nonprofit financial health care system into this very low-income neighborhood.

And nearby, in the same neighborhood, we used New Markets Tax Credits to finance the Banyan Community, a few blocks from the Midtown Exchange. Banyan supports more than 150 children with early childhood education and childcare and after school programs in a very low-income community.

Sadly, the murder of George Floyd erased much of the progress we made in the Powderhorn Park neighborhood, but we stand ready to be a supporter in rebuilding this area along Lake Street and others with funds that we are receiving and have received from the CDFI Fund and others.

The pandemic has caused—oh, I am going to run way out of time. Sorry about this. I will get back to this in the question area, but thank you very much.

Chair SMITH. Thank you, Mr. Altman. We will have a chance to hear the rest of your comments, I am sure.

Next, we will hear from Ms. Vogel.

STATEMENT OF LAKOTA VOGEL, EXECUTIVE DIRECTOR, FOUR BANDS COMMUNITY FUND, EAGLE BUTTE, SOUTH DAKOTA

Ms. VOGEL. Thank you, Chairwoman Smith, Ranking Member Rounds, and distinguished Members of the Subcommittee. I am honored to have been included as a voice in this important hearing, to share the successes and challenges of CDFIs serving underestimated communities across the Nation.

My name is Lakota Vogel. I am an enrolled member of the Cheyenne River Sioux Tribe, born and raised on a ranch in South Dakota. I am the Executive Director of Four Bands Community Fund. It is a 22-year-old rural, Native CDFI that started by serving all residents of the Cheyenne River Sioux Reservation in north-central South Dakota and expanded in 2013 to serve Native entrepreneurs across the entire State. I am on the executive committee of the South Dakota Native Homeownership Coalition and a member of the Mountain Plains Regional Native CDFI Coalition.

I am here today to share the perspective of on-the-ground leaders within the Native CDFI movement, which spans about 69 separate organizations operating across 27 States. The core of our mission and purpose of our programming is aimed at leveling inequities stemming from an historic lack of investment and access to capital as well as noninclusive policies in the communities we serve.

With over two decades of experience, Four Bands Community Fund has continuously improved our products and services to successfully deploy over $25 million across the State. We utilize an integrated approach in lending, which Ranking Member Rounds mentioned. It fuses relationship building and learning with loan products. Our suite of programs are designed to revive traditional culture and support self-sufficiency by focusing on two core areas: entrepreneurship, and consumer lending and home ownership.

So within the entrepreneurship space, Four Bands offers a comprehensive business training program alongside of customized business coaching. We also have several products to help entrepreneurs access capital, up to $250,000, and they can use that capital for inventory, leasehold improvements, really any commercial purpose. We also operate a business incubator that provides physical space in addition to our entrepreneur programming for at least six businesses in the community of Eagle Butte, South Dakota.

Our average business loan client is a female head of household who dreams of starting a business in the service industry that does not require a lot of startup capital. It could be like a restaurant, a daycare, a hair salon. In turn, these industries have a thin profit margin and have more difficulty accessing capital from financial institutions because of their small-dollar nature and small balance sheet.

Four Bands has deployed over $200 million to the small business sector—I wish 200 million. Twenty million dollars to the small business sector, resulting in the creation and expansion of over 300 Native-owned businesses across the State. And we can proudly say, due to lots of innovation and partners like CRF and Frank Altman and resource stacking, we did not lose one small business during the pandemic across the State that was within our portfolio.

The other core area we focus on is consumer and home ownership. So a unique challenge within our communities is invisible credit histories. We are fortunate to have four financial institutions serving the Cheyenne River Sioux Reservation, but only one of them, the credit union, reports to the credit bureaus. So we have generations of borrowers utilizing debt tools for decades at the local financial institutions, and they remain invisible. And it is not due to any individual borrower choices or behavior, but it is due to institutional decisions.

Four Bands began reporting to the credit bureaus in 2010. Our foresight and community-mindedness has primed our market for home ownership. So as our balance sheet grew, we were finally able to offer mortgage products to our community in 2019 in partnership with USDA as one of the pilot sites for the 502 direct lending program. We were able to close 8 mortgages and spur the demand to close a total of 42 mortgages on Cheyenne River within 1.5 years.

My recommendations today are simple. Advance the Native American Rural Homeownership Improvement Act. Thank you to Chairwoman Smith and Ranking Member Rounds for cosponsoring this legislation. Access to these funds should include all Native CDFIs across the Nation.

The second recommendation I have is just increase the Native American CDFI Assistance appropriations to $50 million to meet the needs. Our program needs are increasing across the Nation, and the annual appropriations for NACA have remained stagnant since 2014.

All this to say the tool, the Native CDFI tool, works; it is just chronically undercapitalized. We are part of the communities we serve. We run into our clients at the grocery store. We sit on the daycare board of directors, desperately trying to keep these vital programs running. And as Native CDFI staff and community members, we are woven into the fabric of the community in almost every aspect of our clients' financial lives. There is no comparison to sitting across from our clients at tax time, assessing their earnings for the year and planning for the future. We are the gentle nudge to savings accumulation and a sounding board for many of the financial decisions our families make.

We believe how you perceive is how you proceed. We perceive opportunity because our success as Nation builders is intricately woven into the success of our neighbor.

Thank you for this opportunity to testify.

Chair SMITH. Thank you so much, Ms. Vogel.

I appreciate all of your testimony really so much.

We are now going to turn to our first round of questions, and I will begin. So let me—I would like to first drill down a little bit onto the CDFI Bond Guarantee Program. We noted Senator Menendez, who is joining us today, worked on this back at the beginning, started this back at the beginning of the—during the Great Recession. And yesterday, Senator Rounds and I introduced a bill that would reauthorize and update the Bond Guarantee Program. And as was mentioned in your testimony, our bill would reduce the program's loan size requirements so they could be more accessible to smaller CDFIs and for smaller community development projects.

Mr. Altman, let me turn to you first. Could you share some examples with us of how the changes that Senator Rounds and I are proposing might help get more capital into the hands of smaller CDFIs and ultimately into the communities that they serve?

Mr. ALTMAN. Sure. Thank you, Chair Smith. The Bond Guarantee Program is a vital program in the CDFI toolbox. Yet, it has only been used by about 26 CDFIs, and the biggest barrier to utilization has been the need to either come together as a group to obtain a $100 million bond or to be a large organization that a balance sheet can support $100 million in debt. And so that has limited the CDFI bond guarantee to really the largest CDFIs in the country. And in a few cases there have been groups of CDFIs that have come together, but it is very difficult because if one CDFI in a group decides it has to wait that can just make the program inaccessible for all the other CDFIs that are coming together. So by lowering the bond size to $25 million, we believe that many more CDFIs will be able to access this vital program.

And why is it so vital? It provides very low-cost, long term debt to the balance sheets of CDFIs. So it is being used to match-fund long-term assets, particularly in affordable housing, daycare, and other facilities that need long-term financing. So it is a very, very powerful program if we can put it together in a slightly different way.

Chair SMITH. Thank you very much.

Ms. Vogel, would you like to comment on this as well and how you can see this being advantageous to Native CDFIs?

Ms. VOGEL. You know, honestly, we support all of—the CDFI industry is great in that we all support one another, and I trust Frank and John and the work that they do with the advocacy. You know, as a person on the ground doing the work, it is nice to have the big brothers out there watching out for these things, and so we have been getting updates from them on passing this. So we definitely support the legislation that has been, you know, advanced by you and Ranking Member Rounds.

So we are looking forward to learning more from CRF and the CDFI Coalition about how we can better utilize the program, but longer-term debt to match what is needed within our community, you know, sounds like a win to me.

Chair SMITH. Thank you so much. Let me ask you, stay with you, Ms. Vogel. Senator Rounds mentioned this, as did I, that he and I have introduced legislation to make permanent a program to expand access to mortgages in tribal communities. Our bill is based on a pilot that USDA has been conducting in South Dakota, in which they partner with Native CDFIs to make loans under the USDA's Section 502 mortgage lending program. And I know that you have been involved in this pilot program. Could you just talk a little bit with us about how the pilot program helped to serve the Cheyenne River Sioux and what you see as the community benefit of this strategy?

Ms. VOGEL. Yeah, as I mentioned before, there have not been any private mortgages on Cheyenne River Sioux Reservation for a very long time. If there are mortgages, it is wrapped into a small business loan or an ag loan or a personal loan, and so the USDA capital allowed us to develop a mortgage product for the market. And I hate to even say the word "mortgage" within my market because it spurred such a demand there where we have had a pipeline of over, you know, $18 million of demand for mortgage products.

So the 502 product allowed us the longer term debt capital to begin serving the market and priming for home ownership. Without that, we would not have been able to deploy the 42 mortgages that we have closed in the year and half that we have been operating the product.

Chair SMITH. Thank you so much.

I really appreciate the partnership with Senator Rounds on this, and I think I will turn the questioning now to Senator Rounds.

Senator ROUNDS. Thank you, Madam Chair.

Ms. Vogel, I am going to continue with you for just a minute, and that is, as Senator Smith has indicated and has talked a little bit about, I really think it is important to talk about the USDA 502 pilot program and the reason why it was successful there at—you know, within north-central South Dakota.

You are talking about a rural area, and you are talking about an area which is on the reservation, which means that a lot of the land is in tribal trust. And since it is in tribal trust, is that one of the reasons why we are really looking for a local understanding of what it means to be able to get a mortgage and how you actually get title to the land and so forth? Can you talk about that a little bit in terms of how critical this particular 502 lending program might impact other tribal trust land areas as well?

Ms. VOGEL. Yeah. I think it goes back to relationship lending and all CDFIs are based off of relationship lending. So while tribal trust has its complexities, it is really about the CDFIs walking alongside with their customers down to the BIA realty office to begin processing the paperwork. Instead of me remaining in my desk and sending my client, you know, down the path of where they should go next, we actually walk with them through that process. And so the relationships that we hold on the ground, taking donuts to the realty officer so they speed up the TSR certification process, it is all a little trick of the trade and the importance of us being here and understanding what it means to develop homes within our communities.

So, yes, on-the-ground is important. Understanding how home ownership affects community development and ultimately economic development is important to that. Tribal trust is complex, but anybody can do it if you are willing to invest in your community.

Senator ROUNDS. The Four Bands Community Fund, which is the name of your organization, tell me because I think there is a lot of folks out there that maybe do not understand how small we really are. How many folks actually work—how many lenders do you have? How many staff members do you have there?

Ms. VOGEL. I have eight staff members, nine including myself, but really just three that are working on the lending side. Because we offer the technical assistance and the program development, we have, you know, more team focusing on the education components within the community.

Senator ROUNDS. We talked about first-generation individuals that are actually getting involved in financial institutions and lending. Can you share a little bit about the challenges of moving from a cash economy to one in which you have a relationship with a lender and the expertise and the walking through the steps of what you do for an individual member or family when they come in?

Just an average family in terms of somebody on the res there, they are in the ag community or whatever, and they come in, and they are looking for a way to try to get into a home or to start a business. What do you find in terms of the challenges they face?

Ms. VOGEL. I mean, the first thing is just a lack of infrastructure. So you know, you have a daycare or a Head Start teacher, a cook, you know, a grandma that is caring for three children. She walks into the building and says, I want to buy a home for my—my goal is to retire and take care of my three grandchildren. And the first thing she does is find land to put the house on, and the hard part is getting electric, water, sewer, and things like that.

So what we are asking individuals in rural economies to do is to develop piecemeal the infrastructure needed to grow the economies, and it is difficult for them because that is an outside cost of the loan-to-value. Generally the infrastructure improvements are not included in loan-to-value in traditional financial institutions. So CDFIs can adjust and view those as part of the loan-to-value.

You know, it really is just that small town relationship building, but our average AGI is $27,000, which is, you know, half of what the State of South Dakota is earning. So a lot of our families are looking to be brought into the mainstream financial institutions, and that takes money and time. And that is what John Holdsclaw was advocating for, funding the CDFI Fund at the level that is needed so then the money can trickle out to us and support our administrative costs to provide the services that are needed within our communities. You know, it is all a part of the system.

Senator ROUNDS. I am going to—no, that is OK. And I know I am going to run out of time, but I want to get to one more question for sure. Private companies, including larger banks, are partnering with CDFIs across the country to make a social impact on distressed communities or communities that have got, you know, first-generation borrowers. Ms. Vogel, could you discuss how larger, private financial institutions, like Wells Fargo in South Dakota, are partnering with Native CDFIs, like yours, to increase access to capital?

Ms. VOGEL. Yes. That was also mentioned in John's testimony of saying we leverage. Every dollar of Federal investment is leveraged, you know, at least 12 times with different investments. So we are going after different pots of funding through corporate investments like Wells Fargo to build back, you know, the business economies and community economies that we are operating within.

Senator ROUNDS. Great. So you have a partner there, and this is an opportunity to perhaps get more of the private lenders actively involved where they literally do not find a path forward right now.

Ms. VOGEL. Right. And foundations. We have an historic lack of investment in philanthropy in the rural Native regions, and so we need philanthropy and corporations to step up.

Senator ROUNDS. Thank you.

Thank you, Madam Chair. And once again, thanks for putting together this particular Committee hearing today. I think this is really important and this is one area where we absolutely can make a difference. And this is bipartisan in nature, and I think, Chairwoman Smith, I really do appreciate your leadership on this and your interest in finding a path forward that really would make a difference in a lot of our rural areas.

Chair SMITH. Thank you so much, Senator Rounds. That is great. Our next—I will now turn to Senator Reed.

Senator REED. Well, thank you very much, Madam Chair and Senator Rounds also, to your leadership on this issue. It is vitally important and something that touches everywhere.

Ms. Vogel, there are so many people that are unbanked or underbanked, and they are at the mercy many times of payday lenders. Can you share your experience with providing sustainable and affordable small-dollar loans to members of your community?

Ms. VOGEL. Yes, I can. Thank you, Senator. You know, Four Bands has been providing a credit builder loan at 11 percent interest for some time now, and we chose to have a lower interest rate to keep it affordable to the family. But we were involved in a State initiative to cap the interest rate in the State of South Dakota at 36 percent, which was successfully passed. And since then we have not seen payday lenders show up within the credit histories of our clients that come through, and they have successfully been able to access other products to meet that short-term cash need within the household. And it has helped us to have that capped interest rate and to not hurt the families.

Senator REED. Well, and it also indicates that you seem to be able to function and survive and prosper as well as commercial banks in the State with the 36 percent interest cap. Is that accurate?

Ms. VOGEL. Yes, it is, and it is a business decision. It is just like any other business decision. If you have a loss leader, which the credit builder product does not necessarily bring us the best income, but you have other products that can offset the cost for that administrative expense to offer the important product to the community.

Senator REED. As you know, under the Military Lending Act, which I was actively involved with, we established 36 percent interest on loans to servicemembers, and we have legislation now which would extend that to everyone. What impact would that have nationwide? I presume from your experience in South Dakota—it is very progressive, South Dakota—that it would not have an adverse impact.

Ms. VOGEL. I do not think it would have an adverse impact. I believe in American innovation, and I think that if you cap the interest rate it would keep products safe and affordable for the families that are the most vulnerable and there would be innovative products that would be released onto the market that could fit the need and, you know, fill the gap that was left, a void there.

Senator REED. Thank you very much, and thank you for your work, indeed, all of you for your great work.

Mr. Holdsclaw, one of the impressions I had about the first round of PPP is that the big banks got there first, grabbed the money for their big clients, and small business men and women, particularly minority communities, found nothing. They were—in fact, I got calls, as I am sure my colleagues did, from many small businesses, restaurants, et cetera, who had had relationships with these banks for years, could not get anything out of them. And that is why, I think one of the reasons, the second time around we made sure CDFIs had a role in distributing the money. Can you talk about that?

I think again you made a decisive impact on getting money to the rural areas where it is needed, to small business people. And leaving it to the big folks, we have not seen that. Can you comment, please?

Mr. HOLDSCLAW. I sure can, Senator. Thank you for the question. True, there was a lot of disparity as related to the larger banks in the first tranche, and the Coalition took the position, as well as other trade associations across the industry, to give a pot of money for CDFIs.

And I think what you saw was, as I mentioned in my testimony, those loan sizes went down way below the average. But also, too, you saw more Black and Brown borrowers. I know, for example, Self-Help Credit Union based in North Carolina, 63 percent of all of their PPP loans went to businesses of color, owned by people of color.

And so again, I think it was effective to give as an alternative to those larger banks. Not knocking banks. I do work for a bank. But that said, to give them that alternative to be able to access the PPP program, especially in those communities that were hardest hit, that were Black and Brown. So I am happy that we were able to advocate on that behalf, and I am happy that CDFIs were able to step up during that crucial time to support those businesses that necessarily did not get that in the first tranche.

Senator REED. Well, I think the lesson is that if we are doing support or assistance to small business that CDFI has to be a big part of it, that just turning the keys over to large institutions will not get the money to where it should be.

Mr. HOLDSCLAW. I concur, Senator.

Senator REED. Again, thank you, Madam Chairwoman, and thank you, Ranking Member.

Mr. HOLDSCLAW. Thank you.

Chair SMITH. Thank you, Senator Reed.

We will now turn to Senator Daines.

Senator DAINES. Chairwoman Smith, thank you. I am excited for this Subcommittee hearing actually because the CDFIs have played a very big role in my home State of Montana. They continue to play a really vital role in supporting a lot of our underserved communities across our State. In fact, if you look at the numbers in Montana, CDFIs have invested more than $218 million. If we look, that spans over about 4,000 loans. And CDFIs in my home State, like MoFi, which operate primarily in Montana, in Idaho, in Wyoming, they have got a really strong track record of boosting economic growth and, importantly, creating great jobs.

I am particularly passionate about the New Markets Tax Credit, which provides tax credits for community development entities to make investments in our lower-income communities. In fact, we can point to a new YWCA in Missoula, which I happened to tour back in August of 2020. We have a new wellness center in the Fort Peck Indian Reservation.

So consequently, I have really seen firsthand that the New Markets Tax Credit, it works. And I strongly support making it permanent and would reach out to my colleagues on both sides to suggest we work together to find permanence.

Certainly one of the frustrating parts of Washington, DC, is the temporary nature of policies that are good policies. Let us make this one permanent, work together to that outcome.

We recently, in Congress, extended the NMTC through 2025, which will provide much-needed certainty for all stakeholders who utilize and rely on this incentive. Congress has extended it so many times. At this point, I think we should agree, when it gets extended so many times, let us just make the temporary nature go away entirely and make it permanent.

And so I have a question for the whole panel. The question is this: In your mind, what would be some of the benefits of making the credit permanent, and do you think that would make the credit even more effective? And, Mr. Holdsclaw, why don't you start off with your response to that?

Mr. HOLDSCLAW. Thank you, Senator. You know, like you stated, in the State of Montana and across the country, the New Markets Tax Credit Program has proven to be vitally successful, and I think—and I could not concur with you more in regards to making it permanent because you see every year when people or CDFIs apply, or CDEs apply, for the program that it is already overprescribed. So the need is there, but again, I think it is a perfect example of a private public partnership to where those outside dollars can be combined with the expertise of the Community Development Entity to impact communities.

And so, definitely strongly agree in making it permanent and increasing the allocation authority of the New Markets Tax Credit Program. The New Markets Tax Credit Coalition is doing some amazing work advocating on that behalf and one that I definitely appreciate your support.

I want to defer to some of the other panelists if they have any response.

Senator DAINES. Mr. Holdsclaw, thank you.

Mr. Altman or Ms. Vogel? Why don't I start with Ms. Vogel? Do you have a thought on that?

Ms. VOGEL. I will give my time to Mr. Altman. He has got the experience with New Markets Tax Credits.

Senator DAINES. Great. Mr. Altman.

Mr. ALTMAN. Thank you. Yes, I actually served as the first President of the New Markets Coalition back in the beginning of the program in 2000, and so we have been very, very involved over a long period of time to really make this program successful. It has never been plagued with scandal. It has been incredibly effective, and it should be made permanent. So I appreciate your statements there, Senator.

Senator DAINES. Mr. Altman, thank you.

Mr. ALTMAN. A couple of other points I would make——

Senator DAINES. Please.

Mr. ALTMAN. ——is that it should be indexed for inflation as part of its permanency. It should be made permanent now, when the opportunity is here. I know there has been some discussion about waiting until 2025, when this extension rolls up, but the need is now. It should be made permanent, and it should be widely available to CDEs.

Senator DAINES. Well, thank you.

Ms. Vogel, I know you have spent a lot of time working in Indian Country. Anything, any thoughts you might want to share on what has worked and what has not worked to increase CDFI investment in Indian Country?

Ms. VOGEL. Well, just quickly on the New Markets Tax Credits, we do not have many investments into Indian Country with New Markets Tax Credits. A lot of us have tried to innovate and create different models to address that and access the New Markets Tax Credits, to get an allocation, and it has not worked successfully.

So I would really encourage us all to take a deep look at what are the systemic issues going on with the program that are inhibiting investment into Indian Country, and that could take a team at the CDFI Fund. So I think there is just some eyes that need to be put on it and, you know, the way that we perceive things and taking a look at things. So we need to be involved in that as an advisory panel and taking a look at things.

Senator DAINES. Ms. Vogel, thank you. It is a very helpful comment. Appreciate the observation.

Chairwoman Smith, thank you. I am out of time.

Chair SMITH. Thank you so much, Senator Daines.

Now we will turn to Senator Menendez.

Senator MENENDEZ. Thank you, Madam Chair, to you and the Ranking Member for holding this hearing. Throughout the pandemic, we saw that minority and women-owned small businesses were hit particularly hard. At the same time, we saw the vast majority of funding under the Paycheck Protection Program go not to these businesses that were most affected but to predominantly White-owned businesses with preexisting relationships with banks. So I would like to ask Mr. Altman and Ms. Vogel, how did you

CDFIs work to prioritize lending to the hardest hit small businesses, particularly minority and women-owned businesses?

Mr. ALTMAN. I will start. This program really brought out the best in CDFIs. We were able to network with a number of CDFIs that did not have either business lending capacity or were not yet eligible in the first round. CRF, because we had a 7(a) license, we were able to mount the PPP program from day one, and we linked together with organizations around the country that referred their borrowers to us so that we could make those loans. And we worked together. They would do a lot of the prep work with the borrowers, and then we did the final lending.

And that led to $700 million in PPP loans originated by CRF through a network of 47 organizations, including Four Bands, and the median loan size of those business loans was $21,000. So we really were getting to the mom-and-pop companies, the very small businesses. And two-thirds of the loans that we made, where we had information on ethnic or racial characteristics, were made to businesses owned by people of color and/or women. So that is exactly, I think, the way that the CDFI industry was able to partner with others.

And I should say that on the banking side, because the PPP program was so important, we were able to raise hundreds of millions of dollars in credit facilities from large banks to fund that PPP activity that we did in concert with many other organizations.

Senator MENENDEZ. Ms. Vogel.

Ms. VOGEL. Do you mind if I——

Senator MENENDEZ. No. Go right ahead.

Ms. VOGEL. OK. Thank you for that question. And I think that, you know, our experience was at first a lot of panic when we found out about the PPP program and the inability for us to access a lot of the funds for our borrowers. We had borrowers bringing all of the Federal programs—the EIDL, PPP—to us and saying, how do I get access to this? Our first instinct was to refer to financial institutions, and many of them were not serving borrowers that were outside of their portfolios at the beginning in these small banks.

And so we had to, you know, scramble and find a partner. And thank goodness CRF had created this tool. And so we looked for partners alongside that were also giving us a little bit of a kickback because we spent a lot of time, administrative time, packaging the loans, working with the borrowers, getting their, you know, balance sheets straight to send off to the next level, and CRF was generous enough to offer something. Many of the other financial institutions just wanted us to send them borrowers without any sort of support back to the CDFI, which was very frustrating. So we are thankful for CRF and what they were able to do, and there were a few others out there that did the same.

We were on the ground. We were trying to get the resources into the hands of the community members that needed it the most and successfully did it through partnerships like CRF.

Senator MENENDEZ. Great. Well, to support the important work CDFIs do in New Jersey and, for that fact, around the country, I led the effort to establish the CDFI Bond Guarantee Program over 10 years ago. That program allows CDFIs to access long-term, low-cost capital to jumpstart economic growth and community development, all at no cost to the taxpayers.

Mr. Holdsclaw, you noted in your testimony that the program has supported $1.3 billion in affordable financing for community facilities, nonprofits, commercial real estate, other community development projects. Could you explain to the Committee in more detail how the program helps these projects actually come to life?

Mr. HOLDSCLAW. Thank you, Senator, and thank you for your support of that 10 years ago. I think that, you know, the Bond Guarantee Program has provided again an opportunity for the folks who have received it always in the desire and access to garner more capital. So I think that it became a game changer from that standpoint of while we do want to encourage folks, or encourage the limits to come down to be able to expand it to more individuals, I just think that the way the program is structured just allowed more CDFIs, or the ones who have been able to access the program, just another avenue or another vehicle on top of the FA&TA programs that were already out there and already existed. So again, making that limit go down a little lower, to $25 million as opposed to $100 million, will only expand the net even more for other folks to be able to access that program.

Senator MENENDEZ. Madam Chair, I am out of time. Just one last question, would it be fair to say that if the CDFI bond program had not existed that some of these projects would not have taken off from the ground?

Mr. HOLDSCLAW. Very fair to say. Very fair.

Senator MENENDEZ. All right. Thank you, Madam Chair. I have other questions. I will submit them for the record.

Chair SMITH. Thank you so much, Senator Menendez.

Next up for questioning, unless Senator Tester is with us, which I think he is not, we will go to Senator Cortez Masto from Nevada.

Senator CORTEZ MASTO. Thank you. Thank you, Madam Chair. Thank you to both you and the Ranking Member for having this hearing. It is so important. I really appreciate the comments from the panel members today and all the good work that you are doing.

But let me start with Mr. Holdsclaw and Mr. Altman. Let me talk a little bit about the Housing and Economic Recovery Act of 2008 and get your thoughts here. So we all know Congress allowed nondepository Community Development Financial Institutions to become members of the Federal Home Loan Banks. Mr. Holdsclaw, what has been the impact of providing a secondary market for CDFI loans through the Federal Home Loan Banks?

Mr. HOLDSCLAW. Thank you, Senator. A great question. I think it is obvious to see that the number of CDFIs who have joined the Federal Home Loan Banks system has increased. When you look in 2011, you had 8. You look at 2021, you now have 67.

So as we all know, that system exists to support housing opportunities and community development, much like CDFIs do as well. And so through this membership, as we talked about throughout this testimony, CDFIs are always on the lookout for affordable sources of capital, and I think that the Federal Home Loan Banks system has given our members or our industry the low cost, flexible, on-demand capital that they need through these advances. And I think that CDFIs are able to take this capital and use it as a funding source for mortgage products, for very low and low to moderate-income communities. And so I think that as the banks offer the letters of credit to CDFIs to help secure these additional obligations I think you are just going to see the numbers rise as the need or fight for capital is going to become more apparent as we move on.

So with the CDFIs becoming the shareholders of the bank, they can also earn high yielding investments and can participate in all the various programs that the Federal Home Loan Banks system provides, like for example, the Federal Home Loan—the Federal Bank of New York has grant programs that support lending for disaster relief, affordable housing, and homebuyers. So I think, Senator, as time goes on, you are only going to see those numbers increase from 67 on up.

Senator CORTEZ MASTO. Yeah, no. I think that is great and that is a positive, and I think it is wonderful to hear the benefits from the change in the law. But I also know that, unfortunately, the law did not permit Community Development Financial Institutions to join as community financial institutions, and that has also had an impact.

And so, Mr. Altman, I appreciate the Community Reinvestment Fund's support of a bill that I have introduced to allow CDFIs to pledge small business, small agriculture, and community development loans to receive advances from the Federal Home Loan Banks. So, Mr. Altman, how would the opportunity to pledge nonhousing loans to the Federal Home Loan Banks affect your and other Community Development Financial Institutions?

Mr. ALTMAN. It would be very, very helpful. We have looked over time since this opportunity to become a member of the Federal Home Loan Banks, and we have decided that we could not because of the collateral requirements, just not having the right collateral to meet the standards of the bank or having the right kind of collateral to get a significant advance. So we have gone elsewhere for liquidity.

Now that said, we have been supported outside of membership by investments made by the Federal Home Loan Bank of Chicago, and I know other Federal Home Loan Banks have looked at other ways to support CDFIs. But CDFI membership, I think, would be greatly enhanced by the bill that you have introduced.

Senator CORTEZ MASTO. Yeah, no. I appreciate that because I think my understanding is just in 2008 was a drafting error more than any opposition to allowing this to occur, and so I would encourage my colleagues to support my proposal to permit nondepository CDFIs to pledge the same collateral as other community financial institutions.

And then to the Chairwoman, I would request permission to place into the record the 2015 GAO report, Federal Home Loan Banks: Collateral Requirements Discourage Some Community Development Financial Institutions from Seeking Membership.

Chair SMITH. Without objection, so ordered.

Senator CORTEZ MASTO. Thank you. And I know I only have so much time left, but here is the other thing that I am going to ask the panel members to help with. I think we all do—and this is a great opportunity here to see bipartisan work happening. We all support greater investments in Community Development Financial Institutions.

Unfortunately, I am aware that these entities exist unevenly across the Nation. There is only one Treasury certified CDFI in Nevada. In the past 30 years, we have had only 8 awards to a Nevada-based CDFI. So my question, Mr. Holdsclaw, is: How can the CDFI Coalition assist the development of CDFIs in underserved States like Nevada, and what should we be considering? How do we bring more of those resources into a community that is underserved?

Mr. HOLDSCLAW. Senator, I would say in the time I have left, obviously, advocate for more technical assistance dollars for emerging CDFIs in Nevada. Also, work to increase the small and emerging CDFI program or SECA. Then last, but not least, you know, there are webinars; there are other things that emerging CDFIs can do. And I know we as a coalition have a lot of western-based, rural CDFI members, and I am more than happy to talk to your staff, to bring folks together, and put you all in touch with them.

Senator CORTEZ MASTO. Thank you. And I am looking forward to that because I know about the technical assistance funds. They are just not reaching Nevada. So if there is a way that we can get your support and innovation ideas about how we do this and grow this in Nevada, I would be open to that.

Thank you, everyone.

Chair SMITH. Thank you very much.

Senator Van Hollen.

Senator VAN HOLLEN. Thank you, Madam Chair, and I want to thank you and Senator Rounds for bringing us together on this important hearing today. And to all the panelists, thank you for your input.

Also, good to see my friend and colleague, Senator Warner, and it was good to work with him and others in providing that big bump-up to CDFIs as part of the bill we passed last December, and I do have a couple questions regarding the status of the rollout there.

But first, I also serve on the appropriations committee, and I chair the subcommittee that oversees the appropriations through the Department of Treasury to CDFIs. And we have been working on a bipartisan basis to try to increase funding for CDFIs given the critical role they play in economic development at the community level. And, we have unveiled a proposed budget for this fiscal year that we are now in, for fiscal year 2022, that would increase the CDFI allocation by $90 million, take it to $360 million from the current amount of $270 million.

So my first question to Mr. Holdsclaw is: Do you agree that CDFIs have the capacity to absorb this additional funding, and what would be consequences if we are not able to provide the additional funding, if we simply straight-line CDFI funding at current levels?

Mr. HOLDSCLAW. Thank you, Senator. I do think—I think if COVID has proven nothing else in what CDFIs were able to do, that CDFIs can be the first line of financial defense for underserved communities across the country. So I do feel like—and thank you for your support of the appropriations levels—that

CDFIs would be able to absorb that increased amount. I think that the performance during COVID has shown that.

In regards to the second part of your question, obviously, all CDFIs worry and are concerned about access to capital and loan production and whatnot. I just feel like the need is so great that I would have a hard time finding what would be necessarily detrimental to those types of funds.

Also, too, Senator, I do not know if you were here during my testimony, but I also talked about not only that money going to the CDFIs but also the Fund being able to have enough administrative support internally to deal with the demand of surge of applications for certified CDFIs going right now as well as the awarding of grants and allocation authority from last year. They are very short-staffed. But I think there is also a play there as well. CDFIs can get a lot of that money from an FA&TA standpoint. I think there is also, too, a desire from the Coalition's standpoint for us to support the CDFI Fund from an administrative standpoint.

Senator VAN HOLLEN. No, I appreciate that, and I think that is one of the things we would like to do and work with you and your members to make sure that we do that. We want to—obviously, we have got to support the folks at Treasury who are administering the program and the folks in the field.

So I referred to the December bill, the two big programs that are still in the process of implementation. There is the Emergency Capital Investment Program and the Emergency Support and Minority Lending Program. Based on the feedback you are hearing, are there any concerns with the rollout that we should be aware of at this particular point, or do things seem to be going smoothly, putting aside the issue with the fact that non depository institutions cannot participate? And I agree with my colleagues who would like to remedy that situation.

Mr. HOLDSCLAW. Right. Well, from our membership, Senator, we are not hearing anything negative in regards to the rapid response.

And then obviously, a couple weeks ago, the ECIP program, you know, when I would check in with some of the folks who were able to garner some of that money, I would hear things like, you know, transformational game changer again because—especially from a lot of the minority deposit institutions that I reached out to. I had a conversation with the second oldest CEO of the second oldest Black bank in the country in Durham, North Carolina, and he just said, you know, it is unbelievable what that is going to allow him to be able to do.

Senator VAN HOLLEN. Great. No, I think this is something that, you know, we are all proud of the funds that were made available and look forward to working with you.

My final question, Mr. Altman, relates to providing opportunity for more CDFIs to participate as lenders under the SBA programs. This was an issue that, you know, really came to a head I think during this pandemic in the PPP programs. We saw that CDFIs could be very important conduits for those funds, but we do not have enough CDFIs who are certified with SBA programs. What do you think we can and should be doing in that regard?

Mr. ALTMAN. Well, two things. I think more CDFIs ought to have access to the license that we have. There are only 14 of these national nonbank SBA 7(a) licenses, and only 3 CDFIs hold those at this point. It does allow us to be a national lender, which is important.

Then the SBA also has been operating a pilot program called Community Advantage that allows CDFIs to make SBA-guaranteed loans up to $250,000. That program should be made permanent, and I believe there has been legislation introduced to make it permanent because it is a vital tool and many of the CDFIs who were part of that pilot program were able to access the PPP program very effectively.

And I think there is another aspect to all this, and that is the role of technology in supporting the lending that CDFIs do. In the SBA world, SBA loan origination is a complicated process. And CRF has developed a platform called SPARK that CDFIs are now using to originate their SBA loans, but it is a very, very useful and forward-looking platform that—I think it is important for the CDFI world to be able to access technology platforms as banking is doing right now, and so that should be part of the SBA discussion as well.

Senator VAN HOLLEN. Thank you, and thank you, Madam Chair.

Chair SMITH. Thank you so much, Senator Van Hollen. I certainly so much appreciate your leadership on the appropriations subcommittee.

And, Senator Warner, welcome to the Subcommittee. It is great to have you given your deep interest and commitment to supporting CDFIs. So thank you for being with us.

Senator WARNER. Well, thank you, Chair Smith, and I really appreciate the fact that you and Senator Rounds are holding this hearing and thank the panel. I think CDFIs—I think we have all—at least I, speaking personally, have come to much more fully understand the incredibly valuable role they play in our financial system and, frankly, the opportunity to expand that role.

And I want to thank Senator Van Hollen for his work as an appropriator to make sure that we take this moment and continue to expand it. I am very proud of the fact that so many of us on this Committee, in a bipartisan way, work so hard to get that $12 billion, you know, that came out of the Jobs and Neighborhood Investment Act into the last COVID package.

And I think, as Senator Van Hollen pointed out in his line of questioning, the rollout has been pretty darn good. You know, the grants went out the first round. The second round will come out later.

The fact that we had close to—what was it? Almost $13 billion of requests on the ECIP program—and so we were way over subscribed on that item—shows, I think, the capacity of this group of institutions obviously serving underserved communities.

You know, I think we need to mark as well what Senator Cortez Masto talked about, how we expand this, the network of CDFIs in a much, much greater way.

So I want to hit two or three points pretty quickly. First, I am going to start with Mr. Altman. I am really interested in this whole idea of can we take CDFI portfolios and securitize them. I think that is the next big step we need to move to. I have had conversations with the Fed.

I know, Mr. Altman, that CRF, your entity, has done some securitizations in the past. I think, you know, what else should we able to do? What tools—do you need additional tools from Congress? Do we need to continue to nudge the Fed? How can we make, either on an individual basis or on an ability to aggregate, pools of loans from a variety of CDFIs into an easier securitization process?

Mr. ALTMAN. Thank you for that question. We actually did pioneer the use of securitization as a tool early on, and we have securitized through 21 different issues, securitized mostly small business and nonprofit loans but also close to $100 million in multifamily affordable housing loans. And those securities, at least the latter ones that we did, were large enough to be rated by Standard & Poor's, something that people said will never happen. And this was all done without any particular government support other than maintaining compliance with tax laws and so forth.

After the crash, the market for securities just collapsed, and we had to move in a different direction. And then the accounting rules changed and required—even though securitizations are bankruptcy-remote, usually done through special purpose vehicles, it required the special purpose vehicles to come back onto the balance sheets of the issuer. So that made it virtually impossible for an organization like CRF to continue to securitize without having a much larger balance sheet. And so we moved to other tools because the balance sheet just was not there to support it from an accounting perspective, and I think that is one of the issues that needs to be examined.

The second issue is securitization works the best when the assets that are being securitized are standardized. And CDFIs, in general—and we certainly came to the market recognizing this. CDFIs, in general, do their own thing, and the ability to create standardized products that can be fed into a security is still a challenge. But once we have standardized products—and I will use the PPP product as a prime example. That was a standardized product across the entire industry, and it became very liquid. And so CDFIs need to have the ability, if they want to securitize, to create products that are the same across different CDFIs, not that all their products are the same, but that the ones that they want to securitize can be put into facilities that are of like benefit.

So those would be my basic comments.

Senator WARNER. We would like to keep working with you on this because we have had conversations with both the Fed on potentially creating SPVs and with private capital. And that is where I want to move my last question to, which is: How do we better leverage private capital?

And I would like to hear from Mr. Holdsclaw as well on this, and the balance of the panel, because you know, private—there is a lot of talk from private capital about wanting to get in. You know, I know some large entities, like Google, have been pretty creative in using their balance sheet. But I think that can help us on securitization. And I also want to make sure that—some of the CDFIs and MDIs, in particular, that are most in need could not meet all the requirements even to get the ECIP program. So is there also a way where some of this private capital that might be more at risk can help smaller and other entities?

So I know my time is up, Madam Chair, but if I could have the panel answer on how we can better leverage private capital, I would love to hear from everybody, starting with Mr. Holdsclaw.

Mr. HOLDSCLAW. Thank you, Senator, and thank you for your past support for CDFIs. I think that, you know, in the wake of the racial and social reckoning that we had last year coming from George Floyd, I think you saw this influx of private corporations coming together and making deposits into MDIs and others. I think that—as well as foundations.

I think that I would say one way to increase it is to look at the smaller and emerging CDFIs again, to try to get some of those, like you said, those MDIs who are unable to do ECIP, to be able to get and foster those relationships between them as well because, again, we have this gap where some folks were unable to capitalize off of it and some were not—some were, and some were not.

And so I think that just the continuing education and bringing folks together outside of some type of racial and social reckoning, to show that CDFIs are here. They are—you know, they are first responders from a financial standpoint. And educating other folks about the smaller and emerging ones, I think, will level the playing field from a private investment standpoint.

Senator WARNER. Others? I know my time is up, but I do not want to—I am not a Subcommittee Member. I do not want to overdo.

I will go back to the Chair, but Madam Chair, I just—one of the things I hope the Subcommittee would look at as well—you know, we know that Lael Brainard in her previous role was leading the efforts on CRA reform. I would love to get maybe for the record from the panel how we can use CRA reform to also help with CDFIs. And thank you and Senator Rounds so much for holding this hearing.

Chair SMITH. Thank you so much, Senator Warner, and I think those are all great, great issues to follow up on and look forward to continuing to work with you on this.

Senator WARNER. Thank you.

Chair SMITH. So I believe—unless I am mistaken and not seeing anybody, I believe that everybody who is interested has gone through their first round of questions. So let me turn to Senator Rounds.

Senator Rounds, would you like to ask a second round of questions?

Senator ROUNDS. At this time, I think I have had my questions answered, and it has actually been a very good Subcommittee hearing. I think we have had some very good participation by Members, not just of the Subcommittee, but other Members of the Banking Committee as well. I think this has been a good, informational meeting, and I think with regard to some new ideas and so forth it has been a very beneficial meeting. And I thank you, Madam Chair, and I would defer at this time.

Chair SMITH. Well, thank you. Thank you very much.

I actually do have just a couple of follow-ups that I would like to ask the panel before we close, and so let me just get to those quickly. The first is this: You know, when the pandemic struck in 2020, a lot of State legislatures, including my State legislature, developed some economic relief packages for small businesses, and they turned to CDFIs. CDFIs stepped up to help in distributing these funds so that they got to traditionally underserved communities. And now I have heard that some of these CDFIs in Minnesota are facing challenges maintaining or getting certification because those emergency loans were outside of the narrow definition of their target market.

And let me just ask—so let me just finish by saying the CDFI Fund at the Department of Treasury, which sets these rules, has provided some target market exemptions for PPP loans but has not done the same for these State-funded pandemic loans. Mr. Altman, I just want to turn to you about this. I am wondering if you have heard about this and if you have any recommendations or thoughts that we can take back to Treasury.

Mr. ALTMAN. Yes. Yes, it is a challenge. We are a national organization. There are several different ways the CDFI Fund permits target markets. Low-income targeted populations is one where you literally have to show that low income people directly were benefiting or by using proxies like being a resident of affordable multifamily housing and others.

There is another one called Investment Areas, and that is a geography that has been established by the CDFI Fund based on certain characteristics of census tracts. Investment Areas tend to be limited and are held accountable by advisory committees. So for an organization that is national, like CRF is and several other CDFIs, it is impossible to have 50 advisory committees to be able to operate Investment Areas nationally. So we really advocate for a reform there to enable national Investment Areas under that target market test.

And then there is other targeted markets which tend to be specific ethnic or racial groups that are target markets for CDFIs, and oftentimes the accountability mechanism there is also limiting. So accountability is very important. Oftentimes CDFIs use their boards as an accountability mechanism. That needs to be streamlined, I think.

And then finally, this issue that you are raising, Senator, of CDFIs being asked to take up the sort of frontline effort, with them being restricted in where or to whom they can lend, is an issue. And I think during this period of recovery, after the pandemic, the CDFI Fund needs to provide some relief to CDFIs who might be lending for issue-related purposes but not necessarily inside of their target markets.

Chair SMITH. Mr. Holdsclaw, would you like to add to that? I am sure—I wonder if you have heard about this as well.

Mr. HOLDSCLAW. I have heard about it, Senator, and again, probably if it is not corrected you are going to start to see more and more of this because you are having more States now that are developing programs that are CDFI-specific.

I mean, one of the things that we have thought about at the Coalition is to try to get everybody on the same page, is to have a stakeholder meeting to renew the discussion on the proposed rule and also note that there are some, again, as Frank stated, some complications as it relates to the targeted market certification. And so we would like to be able to sit down in this stakeholder meeting and hash some of these things out and help the Fund as they start to deal with more and more of these issues.

Chair SMITH. Well, thank you. I look forward to working with you and everyone on that. I think this is a—this is something that we should be able to find a solution to.

Last question I just want to highlight before I close is several of you in your testimony mentioned the role that CDFIs can help in expanding childcare businesses. This is such an important issue at a moment where we are seeing workforce shortages and we are seeing deep challenges in the childcare sector caused by the pandemic, really challenges that existed way before the pandemic. This seems to me to be a really important opportunity.

So, Mr. Holdsclaw, let me just stay with you. Is there anything more that you would like to say just to highlight the important role that CDFIs can play in addressing this challenge of childcare shortages and childcare deserts?

Mr. HOLDSCLAW. I would, Chairwoman, and you got me in my sweet spot as a proud Head Start child and having the opportunity to have visited parents in Community Action Head Start in Minnesota. I think that in my mind the childcare piece of what a lot of CDFIs do across the country is probably one of the most—least known about.

You have got organizations like CEI in Maine that have a 40-year track record of working with childcare facilities from a finance standpoint. But there is also a development services point here as well because CDFIs also have a mission in providing those development services, which is more or less them helping build the capacity for a childcare center that is trying to open early care and education.

So I think that they play a great role, but it is one that we probably need to do a better job of highlighting. I would be happy to send over to the office any information that we have in regards to some of the programs that our members have from a childcare center standpoint, finance facility.

Chair SMITH. Thank you so much.

And then, Ms. Vogel, I will close with you because I know that this is an issue that you are deeply committed and passionate about. Congratulations, by the way, on being a finalist for the Build Back Better Regional Challenge in this area. So would you like to say anything more about this?

Ms. VOGEL. Yeah. I think daycares are, you know, such an important and vital part of any economy, including the rural economies, and they are a hard business model to fund in the traditional way. And so CDFIs can step up in a role and create unique financial products to match the daycare model, you know, because it is a hybrid of almost a social program. And it is underfunded federally, so it definitely needs more Federal support for daycare centers across the Nation.

But as far as what CDFIs can do, we can—if we can get access to more flexible capital to offer more patient capital, you know, lower interest rates, for these types of models, it will really help. And then as developers within our community, Four Banks is looking at, you know, building the buildings and then helping with the operations costs to offset the cost to the actual family member to make it more affordable to our community through the Build Back Better Regional Competition, hopefully. So thank you for this opportunity.

Chair SMITH. Thank you so much. Well, you are exactly right. It is a question of facilities and upgrading and improving facilities that we need to support more, as well as making the business model for childcare actually function for parents and for providers, where we have situations where, you know, providers are making, you know, not even enough to support their families at the same time that parents are priced out of childcare because it is so expensive. So there is many opportunities here.

I want to just thank all of our panelists for a terrific discussion today about the opportunities that we have to support Community Development Financial Institutions.

Senator Rounds, thank you so much again for the opportunity to work together. I think that we have heard a lot today about areas of bipartisan opportunity to come together, including the two bills that you and I are leading on, the Bond Guarantee Program and also the Section 502 Mortgage Lending Program, but other areas where we can find bipartisan agreement, including New Markets Tax Credits, and I hope also providing increased funding for CDFIs. So I look forward to continuing our work together on this.

I want to thank everybody. Thanks to our witnesses for being here today and providing your testimony.

And for Senators who wish to submit questions for the record, those questions are due 1 week from today, which will be Wednesday, January 12th.

For our witnesses, you will have 45 days to respond to any questions for the record. Thank you again.

And with that, our hearing is adjourned.

[Whereupon, at 11:29 a.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF JOHN HOLDSCLAW, IV

PRESIDENT, CDFI COALITION, WASHINGTON, D.C.

JANUARY 5, 2022

My name is John Holdsclaw, IV, President of the CDFI Coalition, and I am the Executive Vice President of Strategic Initiatives at the National Cooperative Bank, a leading financial institution dedicated to providing banking solutions to cooperatives, their members, and socially responsible organizations nationwide. Thank you for this opportunity to testify on the Community Development Financial Institutions Fund (CDFI) Fund and the success of CDFIs in delivering financial services to underserved low-income urban, rural, and tribal communities.

About the CDFI Coalition The CDFI Coalition was formed in 1992 by a variety of nonprofit organizations and activists concerned about the persistent and pervasive lack of financing capital available in distressed urban neighborhoods and poor rural communities. Our Coalition is made up of more than 150 organizations—including loan funds, community development banks, community development corporations, venture funds, microlenders, Native American organizations, and credit unions—that are working to finance affordable housing, small businesses, and community facilities at the ground level.

About the CDFI Fund

The Community Development Financial Institutions (CDFI) Fund was established within the Department of Treasury in the Riegle Community Development and Regulatory Improvement Act (P.L. 103-325) of 1994. The purpose of the agency is to "promote economic revitalization and community development through investment in and assistance to community development financial institutions, including enhancing the liquidity of community development financial institutions."

The CDFI Fund administers the following core programs, and each program awards funds annually through an independent and competitive application process, including the Financial Assistance (FA), Technical Assistance (TA) Awards, The Native American CDFI Assistance (NACA) Program, The Bank Enterprise Award (BEA) Program, New Markets Tax Credit (NMTC) Program, Capital Magnet Fund, the CDFI Bond Guarantee Program, Economic Mobility Corps, and Small Dollar Loan Program.

The Challenges Facing Low-Income Communities and Populations

Even before the pandemic, low-income communities and communities of color faced significant obstacles in accessing financial services, including mortgage, consumer, and business loans, financing for community facilities and affordable housing, and the patient, flexible capital needed to sustain a healthy economy. These are the communities CDFIs serve.

One of the biggest challenges facing underserved communities and populations is the lack of existing assets. Indigenous people and people of color, in particular, have fewer assets to use to secure loans. For example, the median net worth of White families is nearly nine times greater than Black families, according to the Federal Reserve's 2019 Survey of Consumer Finances. Entrepreneurs of color are therefore less likely to self-finance a business or borrow funds from friends and family.

With fewer resources to tap into, businesses in low-income communities tend to be smaller than businesses in more prosperous communities. The average business in a low-income community has 20 percent fewer employees than businesses in other areas, according to a 2017 report by the Small Business Administration.

According to a working paper published in 2018 by the Richmond Federal Reserve, Black and Latino business owners are significantly more likely to be discouraged borrowers. [1] Minority borrowers face more scrutiny and receive less assistance when applying for bank loans than their White urban counterparts.

Small towns and farming communities also continue to be underserved by conventional lenders. The number of community banks in the United States has declined by an average of 300 per year over the past 30 years, according to data from the Federal Deposit Insurance Corporation. During the Great Recession, when lending plummeted nationwide, in Appalachia, lending "decreased to a greater extent, standing at 18 percent below national levels at the end of the recession . . . in the Region's economically distressed counties, lending was 56 percent below national levels. Further, growing disparities were found in lending to businesses with reve-

[1] Financing Patterns and Credit Market Experiences: A Comparison by Race and Ethnicity for U.S. Employer Firms. Report by Alice Robb, Ph.D., for the Office of Advocacy, U.S. Small Business Administration, February, 2018.

nues of less than $1 million and in counties with limited access to non- credit card bank lending."[2]

Residents of Indian Country also face significant challenges in securing commercial credit, including significantly longer distances from brick-and-mortar financial institutions and poor and limited internet for mobile or online banking. This is compounded by a lack of equity resources, collateral, and credit history; experiences and perceptions among Native entrepreneurs that commercial bank financing is difficult to secure; and a lack of diversity in funding sources.[3] According to an analysis of 2018 Census and Bureau of Labor data by the National Community Reinvestment Coalition, Native Communities experience the highest rates of unemployment (6.6 percent) and poverty (25.4 percent) among minority groups.[4] Native CDFIs are often the only resources for financial products and services in tribal communities.

A 2019 report by the Federal Reserve found that since the end of the last (great) recession, "low-income neighborhoods have experienced larger declines in the number of banks and larger increases in the number of alternative financial services companies compared to higher-income areas."

The COVID–19 crisis has exacerbated the already difficult situation. According to an April 2020 report by the Department of Health and Human Services,[5] residents of low-income communities are more likely to work in professions at high risk of COVID infection: as "essential workers" in public-facing retail or service sector jobs, as nurses, and as first responders. Excess deaths during the pandemic surged in low-income communities during the recent pandemic, and in particular, rural counties and tribal lands. For example, in Navajo County, AZ, more than 15 people out of 1,000 died in 2020, up more than 40 percent from the annual average of 11 people per 1,000.[6]

After early pandemic relief funds were gobbled up by large companies in higher-income areas, Congress made an effort to ensure pandemic relief resources reached difficult to serve communities, and CDFIs were part of those successes, as I will discuss in a moment. With the Omicron outbreak underway, we must again think critically about how we can equitably direct resources to ensure recovery resources reach the areas of greatest need. CDFIs can once again play a part.

About CDFIs and Their Mission CDFIs emerged to help address the challenges facing low-income communities and disadvantaged populations discussed earlier. They provide financial services in urban neighborhoods and rural areas underserved by traditional financial institutions, particularly those communities with high rates of poverty and unemployment. Certified CDFIs must target at least 60 percent of their financial products and services to low-income communities and populations.

The CDFI industry has grown significantly since the advent of the CDFI Fund in 1994. Today, the CDFI Fund has certified 1,298 CDFIs across the country, providing vital community development lending services in all sizes and types of communities. Certified CDFIs include 565 loan funds, 416 credit unions, 134 depository institution holding companies, 167 banks or thrifts, and 16 venture capital funds, located in rural and urban areas in all 50 States, the District of Columbia, Puerto Rico, and Guam.

By leveraging over $12 in private capital to every $1 in Federal support, CDFIs are filling the critical missing lending gap encountered in many communities, creating jobs, improving housing and community facilities, building wealth, and creating economic opportunity.

Recent Impact

The CDFI Fund administers a growing portfolio of programs designed to create jobs, build affordable housing, construct and support essential community facilities, provide financial counseling, and invest in neighborhood revitalization initiatives—all in distressed and underserved communities lacking access to traditional lending or banking institutions.

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[2] "Access to Capital and Credit in Appalachia and the Impact of the Financial Crisis and Recession on Commercial Lending and Finance in the Region". July 2013, Josh Silver and Archana Pradhan, National Community Reinvestment Coalition; and Spencer M. Cowan, Woodstock Institute.

[3] Miriam Jorgensen and Randall K.Q. Akee. 2017. "Access to Capital and Credit in Native Communities: A Data Review", digital version. Tucson, AZ: Native Nations Institute.

[4] Dedrick Asante Muhammad, Rogelio Tec, and Kathy Ramirez, November 18, 2019. "Racial Wealth Snapshot: American Indians/Native Americans".

[5] "The Impact of the First Year of the COVID–19 Pandemic and Recession on Families With Low Incomes". Amanda Benton, Erica Meade, and Alec Vandenberg for the Department of Health and Human Services. Sep 20, 2021.

[6] Amanda Montanez; Source: "County-Level Estimates of Excess Mortality Associated With COVID–19 in the United States", by Calvin A. Ackley, et al. Preprint posted May 5, 2021.

The latest impact data from an independent audit by the Department of Treasury highlighted the impact of CDFI Fund programs in 2020.

- CDFI Fund Financial Assistance Award recipients unleashed $39 billion in loans and investments to 125,000 businesses and millions of individuals. They financed 50,000 affordable housing units and thousands of nonprofits and community facilities.
- Healthy Foods Financing award recipients financed 409 grocery stores, markets, and fresh food projects totaling over 4 million square feet.
- Native Assistance Program recipients helped Native CDFIs originate $1.6 billion in loans and investments to nearly 2,500 businesses and tens of thousands of individuals.
- New Markets Tax Credit allocatees made $3.3 billion in loans and investments to hundreds of projects in low-income communities, creating nearly 13,000 permanent full-time jobs and 23,000 construction jobs.
- Over the past 5 years, through 2020, Capital Magnet Fund award recipients helped secure financing commitments for tens of thousands of affordable housing units. Since 2013, the CDFI Bond Program has supported $1.3 billion in affordable financing for community facilities, nonprofits, commercial real estate, and other community development projects.
- CDFI Fund financial assistance helped boost the capacity of hundreds of CDFIs in 2020. The Small-Dollar Loan Program enabled 52 CDFIs to increase their capacity to provide fair and affordable loans in their communities and to help unbanked and underbanked borrowers build their credit. The Economic Mobility Corps, Bank Enterprise Awards, and CDFI Technical Assistance programs all helped boost CDFI capacity to serve low-income communities.

Fiscal Year (FY) 2021 was the busiest year in the history of the CDFI Fund. Altogether, the CDFI Fund provided nearly $1.5 billion in monetary awards and loans, including $1.25 billion through the CDFI Rapid Response Program and over $180 million in technical and financial assistance awards. The Fund also committed to guaranteeing $100 million in bonds and allocated $5 billion in New Markets Tax Credits.

CDFIs and Pandemic Relief

CDFIs played an essential role in helping stabilize and support vulnerable communities during the pandemic. America's low-income rural and urban communities have borne not just the health consequences but also the economic consequences of the pandemic. High unemployment rates and small business failure were primarily concentrated in the underserved communities where CDFIs work.

During this unprecedented time in history, CDFIs answered the call of marginalized communities and small businesses through participation in the Paycheck Protection Program (PPP) and delivering innovative financial products and programs to provide loans and investments; capacity building; training and technical assistance services; and promoting development services efforts that bring credit and capital to individuals and communities.

After the first round of PPP loans went overwhelmingly to sophisticated borrowers and well-connected businesses, Congress established a set-aside for future rounds for Community Financial Institutions (CFIs), which included CDFIs and other mission-based lenders. The effort succeeded. Community lenders reached underserved businesses with a much greater proportion of their PPP loans than conventional banks. According to the SBA, through May of 2021, CDFIs made 1.3 million PPP loans totaling over $30 billion or 21 percent of total loans. Their average loan size was $21,653 compared to $41,560 across all lender classes, and nearly 40 percent of their loans reached business in low- and moderate-income communities, compared to 28 percent across all lending sources.

Additionally, CFI loans reached more small businesses. For example, 78 percent of their PPP loans went to businesses requesting less than $250,000. Moreover, 15.7 percent of CFI-made loans were made to businesses in rural communities, closely keeping with the 16.6 percent of all loans (some $45.5 billion) that went to rural businesses.

The 116th Congress made a substantial investment in CDFIs. Recognizing the critical role played by CDFIs in rural and urban communities across the country, The Consolidated Appropriations Act, 2021 (P.L. 116-260) provided:

- $1.25 billion for CDFIs to provide technical and financial services to communities and businesses hard hit by the Coronavirus pandemic. In February, the

CDFI Fund released the application for the so-called Rapid Response Program (RR), and in June 2021, it awarded grants to 850 certified CDFIs;

- $1.75 billion for CDFIs and Minority Depository Institutions (MDIs) increase lending and investing activity targeted to low-income and minority communities and populations. We hope to see more information from the CDFI Fund on this initiative soon; and
- $9 billion for the Emergency Capital Investment Program (ECIP). ECIP was designed to provide capital to depository institutions that are certified CDFI or MDIs. The Department of the Treasury opened the application process for CDFI's and MDIs in March 2021 and received over 200 applications totaling more than $12 billion in requests. On December 14, Secretary Yellen and Vice President Harris announced the deployment of $8.7 billion of direct investments in banks, credit unions, and holding companies that are certified CDFIs or MDIs.

As the economy slowly improves, the small businesses that survive will have a pressing need for the patient capital, particularly working capital, to get their businesses back on their feet. CDFIs could have done more if they had the capital and if more CDFIs had been approved as PPP lenders during the early days of the program and can do more going forward.

Looking to the Future

The recent growth of the CDFI industry presents both opportunities and challenges. The Federal Government made an unprecedented investment into CDFIs over the past few years with the hope of further scaling the industry and expanding its impact. CDFIs' performance during the pandemic showed they have the capacity to deliver a high volume of financial products and services to communities and people outside the economic mainstream. However, Congress—and the CDFI Fund—can do more to scale the CDFI movement while ensuring that certified CDFIs maintain their role as trusted, mission-driven lenders in underserved communities.

Proposals

$1 billion in annual appropriations for CDFI assistance programs through the CDFI Fund: The CDFI Coalition urges Congress to invest more in CDFIs by increasing the annual authorization to $1 billion for the CDFI Fund. The CDFI Coalition projects the following outcomes from $1 billion in annual appropriations for the CDFI Fund:

- $12 billion in total investment in low-income communities, over 100,000 affordable housing units created or preserved, thousands of loans and investments in childcare centers, health clinics, and community facilities, nearly two million consumer and home ownership loans, and hundreds of thousands of loans and investments in businesses in target markets.

Strengthen the Bond Guarantee Program (BGP): Despite the unique benefits of the BGP, the program has not realized its full potential. Only 26 CDFIs have participated in the bond program and as Qualified Issuers, and many CDFIs, particularly smaller organizations, are not able to access this valuable source of long-term, fixed-rate financing. The CDFI Coalition agrees with CRF, USA's recommendations on strengthening the program by (1) reducing the minimum bond issuance from $100 million to $25 million and (2) increasing program efficiency and consistency by granting the BGP permanent authority.

Build the administrative capacity of the CDFI Fund: To sustain the recent momentum and growth in the CDFI industry, Congress should support efforts to build the administrative capacity of the CDFI Fund. The previous Administration proposed four consecutive budgets aimed at dismantling the Fund. The agency needs more resources to administer a growing portfolio of financial assistance awards, bonds, and tax credit. The CDFI Fund needs more people and an investment in systems to administer its programs and authorities, to say nothing of compliance monitoring and providing technical assistance.

Seek additional CDFI feedback on the certification process: With the additional administrative resources, the CDFI Fund can refocus on overhauling the certification process. The Fund released its draft certification rule for public comment in 2019 but delayed implementation of the rule due to the pandemic. The pandemic has drastically altered the situation in CDFIs' target markets.

Since 2019, the CDFI industry has grown significantly in size and scope. Before proceeding with the certification rule crafted in 2019, the Coalition urges the CDFI Fund to convene stakeholder meetings with the CDFI industry. Many CDFIs—including CDFI loan funds—have used additional resources to expand their service areas. The certification rule proposed in 2019 may make it difficult for many established CDFIs to scale and serve more markets. This is particularly the case for CDFIs with a multistate footprint.

The certification rule must also ensure CDFIs maintain their high standards for thoughtful lending and investment in their target markets. With more resources, the CDFI Fund can continue to monitor the performance of the expanding CDFI investment footprint and ensure that new entrants to the industry are providing affordable financial products and services in underserved communities.

Update the Community Reinvestment Act: The Community Reinvestment Act has been a powerful tool in delivering financial services to historically disadvantaged populations. CDFIs rely on CRA to secure capital from private financial institutions, a key source of capital. Without CRA, today's CDFI industry would be a fraction of its current size and the scale of its lending and impact correspondingly reduced. Communities count on CDFIs, and CDFIs depend on CRA to secure capital. The Coalition was pleased that the Office of the Comptroller of the Currency withdrew the final rule for its misguided 2020 CRA overhaul earlier this year. We are encouraged by the willingness of the three regulatory agencies to work together on a CRA unified framework. While CRA has been generally successful, it is in need of an update and a tune-up. To meet CRA's requirements, banks invest in affordable housing, small businesses, and other community development activities that bring historically disadvantaged populations into the economic mainstream. However, as the recent pandemic and the protests of the summer of 2020 made clear, the legacy of discriminatory red-lining lives on in many communities of color where poverty and unemployment still outpace the national average and community infrastructure is inadequate. With the right data-driven reforms, CRA can be much more effective in delivering on its original promise for these communities.

At a baseline, CRA modernization should result in a net increase in both the quantity and quality of financial products and services available in LMI areas. The burden is on Federal regulators to show—with data and evidence—that their reform proposals can meet those baseline goals for reform. The Coalition believes a modernized CRA framework should meet the following five tests. Reforms should: (1) boost the voices and input of community groups in conducting CRA exams and developing CRA ratings; (2) generate additional investment in traditional community development activities in CRA deserts; (3) encourage thoughtful, high-impact investments significant benefits to low- to moderate-income (LMI) communities; (4) strengthen accountability for financial institutions; and (5) most importantly, ensure financial institutions are serving people of color and traditionally disadvantaged groups.

Conclusion

The last Congress made a substantial bet on CDFIs as a conduit for delivering relief and revitalization to our hardest-hit communities and populations. Thus far, the bet has paid off. The CDFI industry is growing, serving more businesses and families, and delivering financial services to areas of persistent poverty and unemployment. Providing more resources through the CDFI Fund will ensure the continued growth of mission-driven financial services.

Thank you for this opportunity to testify. I would be happy to respond to any questions.

PREPARED STATEMENT OF FRANK ALTMAN

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JANUARY 5, 2022

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Capital for Communities – Opportunities for People®

Written Testimony of Frank Altman
Founder and Chief Executive Officer
Community Reinvestment Fund, USA

Before the
Housing, Transportation, and Community Development Subcommittee
Committee on Banking, Housing, and Urban Affairs
United States Senate
January 5, 2022

Thank you Chair Smith, Ranking Member Rounds, and distinguished members of the Subcommittee, I am pleased to participate in this important hearing to discuss the role of Community Development Financial Institutions (CDFIs) in supporting underserved communities.

My name is Frank Altman. I am CEO of Community Reinvestment Fund, USA (CRF), a national CDFI based in Minneapolis, Minnesota that I founded in 1988. I serve on the Board of Directors of the New Markets Tax Credit (NMTC) Coalition of which I was a founding member and first President. I also serve on the San Francisco Federal Reserve Bank's Advisory Board of the Center for Community Development Investments and am an advisor to the Social Innovation Initiative at Brown University in Providence, RI. I am an active member of The Financial Innovations Roundtable and the US SIF: Forum for Sustainable and Responsible Investment.

I thank the members of this Subcommittee for their long-standing support of Community Development Financial Institutions (CDFI) Fund programs that organizations like CRF use to bring needed critical credit and resources to revitalize underserved, low-income and communities of color as well as rural areas.

I appreciate the opportunity to be with you today to reflect on the role CDFIs have played and continue to play working with and in underserved communities promoting economic revitalization and community development. This topic is both timely and importatnt considering the vital role CDFIs performed as 'first responders" supporting and sustaining underbanked and unbanked communities and small business owners during the COVID-19 pandemic.

The CDFI industry has developed and matured significantly since the CDFI Program was authorized 28 years ago - and in my testimony today I will focus on two very specific issues that Congress could address as part of a CDFI Fund modernization effort – **the process for certifying CDFIs and the CDFI Bond Guarantee Program.** Before turing to these two issues, let me provide some background on my organization.

Community Reinvestment Fund, USA

CRF was launched in 1988, six years before the bill creating the CDFI Fund was signed into law. Through my work at the Minnesota Department of Energy and Economic Development, I saw the need to innovate new ways to bring capital to what were then called revolving loan funds, the forerunners of today's CDFIs, that were fundamental to the premise on which CRF was founded. Initially, purchasing community development assets from local nonprofits and development lenders, CRF has become a national organization with over $160 million in assets and a staff of 76 people. Our mission is *to improve lives and strengthen communities through innovative financial solutions*.

In 2009, CRF was certified as a Community Development Financial Institution (CDFI), and in this capacity we actively work to channel resources from the capital markets to support community economic development efforts and help mission-driven organizations improve efficiency and build capacity. For the past 33 years we have worked with community partners, investors, foundations, and financial institutions to deliver more than $3.5 billion in loans, investments, and bonds, resulting in the creation or preservation of 156,300 jobs, the financing of nearly 19,600 affordable housing units and funding for a wide range of community facilities. Since its inception, CRF has funded more than 9,300 small business loans, two-thirds of which were made to businesses owned by women or people of color. CRF has deployed resources in more than 1,000 mostly low-income communities in all 50 states and the District of Columbia serving more than 2.3 million people.

Widely known as a financial innovator with expertise in adapting financing tools to connect underserved communities to new sources of capital, CRF pioneered the creation of the first secondary market for small business and affordable housing loans. We were the first to tap the capital markets issuing asset-backed securities collateralized by community development loans. Our securities have been purchased by mainstream institutional investors (banks, pension funds, and insurance companies) to support projects and businesses serving low-income people and distressed communities.[1]

CRF actively participates in three CDFI Fund programs: the Financial Assistance Program, including the Rapid Response Program, the New Markets Tax Credit Program and the CDFI Bond Guarantee Program. We have received six Financial Assistance Awards and a Rapid Response grant which we are using to support our small business lending activities. Together with its wholly-owned affiliate, National New Markets Tax Credit Fund, Inc., (NNMTCF), CRF has received $919.5 million in tax credits all of which have been deployed as flexible loans for both non-profit and for-profit operating businesses located in low-income communities across the country. In 2013, CRF was named the first Qualified Issuer (QI) for the CDFI Bond Guarantee Program. Since 2014, we have issued $940 million in bonds on behalf of eight CDFIs in seven funding rounds.

CRF is also a seasoned Small Business Administration (SBA) 7(a) lender through its subsidiary, CRF Small Business Loan Company. Since 2012, CRF is one of three CDFIs to become a national non-depository 7(a) lender, of which there are only 14 in the country. We use this guaranteed loan product to fund BIPOC and other underserved entrepreneurs, including women, veterans and small businesses located in low- and moderate-income (LMI) areas. To date, we have financed more than ***$1 billion in SBA 7(a) and PPP loans combined.*** As a Preferred Lender in

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[1] Since 1989, CRF has issued 19 series of Notes totaling $284.7 million backed by community development loans. Three of our debt offerings totaling $176 million have been rated and all of which included a senior tranche rated "AAA" by Standard & Poor's. We have also issued three series of Notes backed by multifamily affordable housing loans, including one Standard & Poor's rated issue totaling $84.9 million, backed by 45 multifamily affordable housing loans.

the 7(a) program, CRF has been ranked among the top lenders nationally and has originated in excess of 580 7(a) loans for more than $312.8 million creating or retaining nearly 13,200 jobs.

Our Work in the Twin Cities and in the Pandemic

Historically, CRF has used its financing expertise and resources to partner with Twin Cities-based organizations building trust and bringing the voice of the community into our work. For example, we collaborated with local banks to make more than 100 subordinate loans to support businesses along Franklin Avenue and Lake Street in the Phillips and Powderhorn Park neighborhoods. This lending sparked the revitalization of these neighborhoods resulting in a 62% decline in crime rates from 1998 – 2009 and an increase in property values that exceeded the City average.

Our lending activities in these neighborhoods laid the groundwork for a major redevelopment project known as the Midtown Exchange. Using New Markets Tax Credits, CRF partnered with two other tax credit recipients to finance the Allina Commons which included the historic Sears building, with more than 2 million square feet that sat vacant in downtown Minneapolis for more than ten years. This building became the centerpiece of the City's strategy for reviving one of its most economically distressed areas. The renovated and expanded building houses the headquarters for Allina Health, a not-for-profit health care system based in Minneapolis.

Tragically, George Floyd was murdered in the Powderhorn Park neighborhood and much of the progress made here has been erased. In response, we supported a Corridor Rebuild and Reimagine effort in partnership with the Lake Street Council in 2020 to disburse grant funds to help Lake Street Corridor businesses recover from damages incurred from civil unrest. We are also a member of the Catalyst Coalition, an on-going collaboration among six mission-driven organizations led by people of color working to develop a supportive business ecosystem for underserved entrepreneurs in the Twin Cities.

When COVID-19 hit, CRF, along with other CDFIs, became a "first responder" utilizing three unique capabilities that allowed us to assist thousands of small businesses in the wake of this disaster. Working with 47 community partners from across the country, **including Four Bands Community Loan Fund**, we utilized our deep SBA lending expertise, and two innovative technology platforms we developed. The first platform, called **Connect2Capital** (C2C), seamlessly matches small businesses with responsible loan products offered by a network of more than 80 CDFIs. To date more than $200 million has been funded through this platform. The second platform, known as **SPARK,** offers transformative loan origination software which enabled its customers to originate $8.9 billion in Paycheck Protection Program (PPP) loans during multiple funding rounds. CDFIs were among the lenders using **SPARK** and were able to originate 14,562 PPP loans worth more than $1 billion. CRF alone made $700 million in PPP loans *with a median loan size of $21,000* preserving 70,248 jobs. More than two hundred of our PPP loans went to small businesses and nonprofits in the Twin Cities, 69% are either led or owned by BIPOC (Black, Indigenous and People of Color) individuals or located in low- or moderate-income census tracts.

CRF has also engaged in local relief lending programs. In 2020, we also originated 1,700 loans totaling over $43.8 million through an innovative Chicago recovery loan fund which retained 6,475 and created 3,144 jobs respectively.

We are now participating in COVID recovery loan funds in 19 states and the District of Columbia, including the recently launched Minnesota Inclusive Growth Fund, an initiative of the Catalyst Coalition.

CDFI Fund and its Programs

The CDFI Fund was established more than 25 years ago with a mission **to expand economic opportunity for underserved people and communities by supporting the growth and capacity of a national network of community development lenders, investors, and financial service providers**. The vision of the CDFI Fund is to economically empower America's underserved and distressed communities by providing programs and resources to support this national network of CDFIs and their stakeholders. CDFIs share a common vision of expanding economic opportunity for those people and places left behind by mainstream financial institutions and to demonstrate that they can determine their own future and achieve prosperity.

During the past two and half decades, the CDFI industry has grown significantly from less than 200 organizations in 1996 to more than 1,000 certified CDFIs with support from the Fund's programs and resources. CDFIs play an important role in ensuring the long-term, sustained economic recovery of low-income and BIPOC communities. Using a relatively small amount of federal funds, CDFIs attract private capital and generate outsized impact in disinvested communities. However, as the economy confronts new challenges, the CDFI industry is at an inflection point. We are being asked to step up and scale our activities while reaching deeper to serve historically overlooked areas and underserved populations. This hearing affords an opportunity to look for ways to improve how the CDFI Fund and its programs can assist CDFIs in meeting current challenges and those that lie ahead.

I have focused my comments and policy recommendations today to two issues of particular importance to CRF and many other CDFIs. Both issues – once resolved – will significantly enhance CRF's ability, as well as that of other CDFIs, to reach additional underserved communities through collaboration with our peers, especially small and emerging CDFIs across the country. I also limited my recommendations to the existing suite of programs and initiatives administered by the CDFI Fund – including the CDFI certification process, the Bond Guarantee Program, and the New Markets Tax Credit. I hope the subcommittee will consider convening a hearing in the near future to discuss opportunities for the CDFI industry to access public capital markets (discussed below) and leverage the capacity of CDFIs as community-based agents of change.

Modernize CDFI Certification

I would like to call your attention to a pressing need at the CDFI Fund – undertaking revisions to its certification policies and procedures. This is an issue of particular importance to a national CDFI, like CRF for several reasons. As a nationwide organization employing a diverse set of lending and investment products and programs, we strongly support the Fund's stated goal of fostering "…a diversity of CDFI types, activities, and geographies, and to enable market-driven solutions to emerge in a constantly changing economic environment." The world in to which CDFIs were born in 1994 has changed in almost every conceivable way. Not only has the number of CDFIs grown significantly but the types of financing products and services offered have expanded dramatically. Competition from other financial service providers has increased exponentially while the technology used to deliver products and services has undergone a transformation comparable to that which occurred during the Industrial Revolution. Today many borrowers seek credit online rather than through conventional channels. To serve their customers, CDFIs must adopt new business models, new technology tools, while developing new partnerships and new ways of achieving their missions.

CDFI certification regulations and guidance are fundamental to the CDFI Fund's role of creating a national network of community development lenders. Under the current framework, an organization must meet a series of tests or requirements to be granted certification, including (but not limited to) having a primary mission of community development, being predominantly engaged in financing, and providing technical assistance to clients, serving one or more Target Markets[2] approved by the Fund and demonstrating accountability to their Target Markets through representation on governing and/or advisory boards. CDFIs are required to direct *at least 60 percent*[3] of their lending or investing activities to their approved Target Market(s).

Certification has become a powerful capital raising instrument for CDFIs, allowing an organization to apply for grants from CDFI Fund programs as wells as from a broad range of public and private funders. However, these regulations have largely remained unchanged since the Fund was established. Updating the Fund's certification framework is critical if CDFIs are to be financially sustainable and create meaningful impact in underserved communities, especially those that may be more difficult to reach, such as Native and rural areas. Modernizing certification policies and procedures will enable the CDFI industry to realize a path to scale. Without such a path it will be difficult – perhaps impossible - to make a meaningful difference in the lives of low-income people and places. We believe these policies and procedures can be reformed to provide CDFIs with more flexibility to support their clients, particularly small businesses, rather than preventing them from assisting worthy customers. Furthermore, these changes are essential to ensuring an equitable recovery from the pandemic.

The CDFI Fund's response to the coronavirus crisis provides a valuable precedent for the kind of flexibility many CDFIs, especially small business lenders, are seeking. In the early days of the pandemic CDFIs responded to desperate calls from BIPOC, rural and very small business owners unable to access the initial round of PPP loans because they lacked a banking relationship or needed help with the documentation requirements. The CDFI Fund provided administrative flexibility ensuring that these community-based "first responders" were not penalized for lending outside of their approved Target Market(s). This relief from certification guidance saved tens of thousands of small businesses, if not more. Without a waiver from the Fund,[4] CDFIs could have violated certification requirements

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[2] See CFR 12 §1805.104(ll) Definition of a Target Market and CRF 12 §1805.201(b)(3) Certification as a Community Development Financial Institution. Target Markets consist of areas meeting specific distress criteria and/or Targeted Populations defined as individuals or an identifiable group of individuals, including an Indian Tribe, who are low-income persons or otherwise lack access to loans or equity investments. See Public Law 103-325, Riegle Community Development and Regulatory Improvement Act of 1994, September 23,1994, Title I, Subtitle A, §103 Definitions (20).

[3] CDFI Fund Expands Target Market Eligibility for Payroll Protection Program Lending; Message from the Director via email – December 9, 2020.

[4] CDFI Fund Expands Target Market Eligibility for Payroll Protection Program Lending; Message from the Director via email – December 9, 2020; Target Market Waiver Extended for Lending under Round Three of Paycheck Protection Program; Program Update via email – January 27, 2021.

running the risk of non-compliance or potentially de-certification at the moment their loans were needed most. The certification framework should promote the work of CDFIs not preclude them from carrying out their mission and commitment to serve customers who are experiencing enormous financial hardship.

To its credit, the CDFI Fund has recognized the need to reform the certification rules having issued a Request for Comment[5] and proposed new certification documents[6] which lay the groundwork for an updated framework. Unfortunately, Fund staff had to suspend these efforts to implement critical pandemic relief programs. Nevertheless, the existing certification rules are constraining organizations, like CRF, from meeting the pressing need for credit among small businesses and nonprofit customers across the country. Without the necessary changes, the current framework will continue to limit the ability of CDFIs to fully address the credit and capital needs of the most vulnerable populations and communities. When certification becomes an obstacle to economic opportunity for the people and places CDFIs serve then it is no longer fulfilling its intended purpose and must be revised.

We also wish to note that other federal programs, such as the Treasury Department's State Small Business Credit Initiative (SSBCI) envisions a role for CDFIs in deploying $10 billion appropriated by the American Rescue Plan Act of 2021. States are allocated a portion of these funds to be used for loans and investments in small businesses. Given the enormous funding provided for this program and statutory mandates to reach socially and economically disadvantaged (SEDI) businesses as well as very small businesses, CDFIs will be essential to ensuring these resources reach historically marginalized firms. Yet, many states do not have CDFIs that can lend statewide, due to lack of capacity, Target Markets that do not align with state programs, or other factors. Several states are facing this situation and have invited CRF to originate loans under their SSBCI programs to augment local CDFI capacity. This program exemplifies CDFIs' need for increased flexibility to lend beyond their approved Target Markets if they are to participate effectively. The Fund should consider aligning its certification requirements with other federal programs.

Recommendations

Three critical changes to the certification framework would provide CDFIs with the flexibility to meet the needs of underserved communities more effectively. We have written extensively on all three changes outlined below in comment letters[7] appended to this testimony.

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[5] Community Development Financial Institutions Fund Notice and Request for Comment on policies and procedures to certify an organization as a Community Development Financial Institution, Federal Register, Vol. 82 No. 5, January 9, 2017.
[6] Request for Public Comment on CDFI Certification Application and Reporting Tools, May 6, 2020.
[7] See CRF's Comment Letter on the CDFI Fund's Annual Certification and Data Collection Report Form, September 8, 2014; CRF's Comment Letter on the interim rule implementing the Community Development Financial Institutions Program (CDFI Program), October 26, 2015; CRF's Comment Letter on the Notice and Request for Information regarding the current policies and procedures to certify an organization as a Community Development Financial Institution (CDFI), March 10, 2017 and CRF's Comment Letter on Comments on Notice and Request for Public Comment on proposed CDFI Certification Requirements and Documents, November 4, 2020.

1) **Establish and approve a National Investment Area (IA)[8] Target Market that includes eligible census tracts anywhere in country**.

   In its proposed certification documents,[9] the Fund recommended removing geographic boundaries on most types of Target Markets, including those comprised of Investment Areas and some Targeted Populations. This change acknowledges how technology has enabled CDFIs to deliver financial products across larger geographic areas including low- and moderate-income communities. Allowing CDFIs to make loans in eligible areas outside of their approved Target Markets, would stimulate the flow of credit to small businesses and other borrowers in underserved communities, such as Native and rural areas. This change also reflects the nature of small business lending where demand may vary depending on local lending conditions and the needs of individual firms. CDFIs *must* have the ability to respond to credit demand from clients located in underserved areas as it arises *not* solely based on geographic restrictions determined by past lending activities.

2) **Create clear guidance qualifying loans to Low-Income Targeted Population (LITP) Target Market.**[10]

   Many CDFIs are certified to serve Low-Income Targeted Populations (LITP). Typically, CDFIs qualify loans serving this type of Target Market by "looking through" the project to the "end beneficiaries" of their financing activities. For example, a loan to develop a multifamily affordable housing project using a government program, like the Low-Income Housing Tax Credit (LIHTC), qualifies as serving a LITP based on program requirements mandating that a certain percentage of the housing units be rented to low-income families. Similarly, a CDFI making a loan to a charter school, or a community health center may use proxies, such as the number of students receiving free or reduced lunches or the number of Medicaid eligible patients, to verify the financing is serving low-income people.

   Small business lenders have a particular challenge because there is no commonly used proxy for loans serving low-income persons. In the absence of clear guidance, each CDFI has established its own approach and metrics for qualifying their small business loans based on information demonstrating (1) the business owner is a low-income person; (2) the business is hiring low-income people; (3) the business provides jobs accessible to people with limited skills or education; or (4) the employees are residents of low-income communities. The lack of CDFI Fund guidance means that no industry standard exists. Without the certainty that these methods would be acceptable under the current certification framework, CDFIs run the risk that the Fund could disallow these qualification methods. If this were to happen many CDFI small business lenders could fall out of compliance with the current rules or be required to use a different method, known as Census Block geocoding, described in the Fund's certification Transaction Level Report.[11]

[8] Definition of an Investment Areas can be found at 12 CFR §1805.201 (b)(3)(ii) Certification as a Community Development Financial Institution.
[9] Request for Public Comment on CDFI Certification Application and Reporting Tools, May 6, 2020.
[10] Definition of a Low-Income Targeted Population Target Market can be found in the CDFI Certification Application Supplemental Guidance and Tips, updated February 12, 2019, pg. 32.
[11] https://www.cdfifund.gov/sites/cdfi/files/documents/ctlr-final-may-2020.pdf

CDFIs serving LITP Target Markets must have a process for preserving the option to develop and use their own methods for qualifying loans directed to this type of Target Market. They should be permitted to submit to the Fund for approval well-established qualification methods that have allowed them to successfully serve low-income people without excessive reporting burdens. Furthermore, the practice of relying on long standing proxies must be maintained as an acceptable means of demonstrating loans are serving a LITP Target Market.

3) Develop Accountability Methods to enable (1) & (2).

The CDFI industry needs straightforward, practical ways of demonstrating accountability to their Target Markets. For CDFIs that means having reasonable representation on their governing and/or advisory boards that keep them informed about the credit needs of the businesses, nonprofits, individuals, and families in their approved Target Markets.

The CDFI Fund's revised CDFI Certification Application[12] does not require a geographic connection to satisfy board member accountability requirements which conforms with elimination of geographic boundaries for most Target Markets. Moreover, simplified accountability representation requirements for CDFI governing and advisory boards as well as allowing a board member to represent more than one Target Market will make it much easier for CDFIs to meet this certification test with a reasonable number of boards that are manageable in size. We eagerly await a proposed rule that clearly defines how a CDFI can be approved for and demonstrate accountability to a National Investment Area Target Market.

CDFIs need certification rules that foster and promote their mission-driven financing and technical assistance activities while providing certainty that they remain in good standing with the Fund. I *strongly urge* the members of this Subcommittee to encourage the CDFI Fund to work collaboratively with the CDFI industry to implement these revisions to ensure CDFIs can bring the promise of economic opportunity and realize a vision of a just economy for all.

CDFI Bond Guarantee Program

Enacted in 2010 as part of the Small Business Jobs Act (P.L. 111-240), the CDFI Bond Guarantee Program (BGP) was designed to address a pressing need for long-term, fixed-rate capital that CDFIs could use to finance essential larger scale projects in under-resourced urban, rural, and Native communities – including long-term care or health care facilities, childcare centers, charter schools, commercial space for expanding local businesses and nonprofit organizations as well as stabilization of at-risk owner-occupied housing. The BGP was specifically intended to address this gap, and is one of the few sources of long-term, fixed rate capital available to CDFIs. When lenders can match long-term assets and long-term liabilities, they significantly reduce interest rate risk.

[12] https://www.cdfifund.gov/sites/cdfi/files/documents/cdfi-certification-application-for-comment-may-2020.pdf

Unlike other CDFI Fund programs, the BGP is not a grant program, but is instead a federal credit program that functions at no cost to taxpayers. The bonds are debt instruments that must be repaid. Under the BGP, an organization applies to Treasury to be certified as a Qualified Issuer (QI) of CDFI bonds and once approved, a QI has the authority to issue 30-year bonds that are fully guaranteed by the Treasury Department. A QI uses the proceeds from the bond to make Bond Loans to one or more eligible CDFIs to finance or refinance a qualified community development activity.

The Treasury Department has approved five organizations as Qualified Issuers, including CRF, Opportunity Finance Network (OFN), Bank of America (BofA), Wisconsin Housing and Economic Development Authority (WHEDA) and Stonehenge Community Development, LLC (Stonehenge). Three QIs (CRF, OFN and BofA) have issued all the CDFI Bonds to date. Between 2013 and 2020, a total of 14 CDFI Bonds were issued which resulted in $1.7 billion in financing available to 26 eligible CDFIs. (See Appendix for Chart on CDFI Bond Guarantee Issuance from 2013 – 2020) This $1.7 billion in BGP financed loans has leveraged more than $16 billion in additional investment to support community development projects and businesses in low-income communities.

One novel example of how the BGP has supported critical financing gaps in low-income and communities of color is the SUN (Stabilizing Urban Neighborhoods) Fund – an innovative foreclosure relief initiative launched in late 2009 by Aura Mortgage Advisors - a CDFI and an affiliate of Blue Hub Capital, a CDFI headquartered in Boston. SUN was designed to address the eviction crisis during the Great Recession. A licensed residential mortgage lender, Aura is using 100% of the Bond Loan Fund Proceeds to provide residential owner-occupied home mortgages to residents of low-income areas in states around the country as well as to expand its existing lending in low-income areas in Massachusetts.

Strengthening the Bond Guarantee Program

Despite the unique benefits of the BGP, the program has not realized its full potential. Only 26 CDFIs have participated in the bond program and as a QI, CRF works with many CDFIs, particularly smaller organizations, that are not able to access this valuable source of long-term, fixed-rate financing. This raises the question of why and what might be done to increase utilization of this program?

Based on our experience as a Qualified Issuer, we recommend the following changes to the BGP:

1) Reduce the minimum bond issuance from $100 million to $25 million

2) Increase program efficiency and consistency by granting the BGP permanent authority

3) Provide a small credit subsidy to ease collateral and credit requirements of this program

4) Consider making the bonds issued under the BGP a public capital markets product.

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Minimum Threshold for CDFI Bond Issues

Under current law (12 USC 4713 a(e)) a CDFI Bond Issue must have a minimum aggregate principal of $100 million before Treasury can guarantee a CDFI bond to a Qualified Issuer. A Bond Issue can include multiple CDFI Bonds (a series) as long as the aggregate demand supports a $100 million bond. If a QI is working to issue a CDFI Bond for several CDFIs and one of them decides not to proceed before closing, leaving the QI short of the required $100 million threshold, then all the CDFIs involved are at risk of losing access to Bond financing. Unless the QI can secure another qualified CDFI to join the series and bring the aggregate bond issue back to $100 million or the QI can find another QI willing to include additional CDFIs in their Issue, the remaining CDFIs will have to regroup and try again in a future round. This scenario has played out on multiple occasions since the program was launched and several CDFIs have been unable to pursue CDFI Bond Loans because the $100 million threshold could not be met.

The $100 million minimum makes it difficult for small and medium sized CDFIs to participate in the BGP as they are generally seeking smaller bond loans, in the $10 million to $25 million range. Based on data from the CDFI Fund on 35 CDFI Bond Loans, there appears to be a demand for loans under $50 million. **Sixty-five percent of the loans are for $50 million or less, 44% of the loans are $25 million or less, and 24% of the loans to date are for $15 million or less.**[13]

Prohibiting the issuing of a CDFI Bond unless there is at least $100 million in demand has created a bottleneck and limited the flow of BGP financing to CDFIs in need of long-term, fixed-rate capital at a time when this source of financing could help pandemic impacted communities to recover and rebuild.

<u>**Recommendations**</u>

1) Reduce the minimum Bond Issue from $100 to $25 million.

This simple statutory change will immediately increase the efficiency of the BGP by allowing CRF and other QIs to issue 'right sized' Bond Loans to a broader segment of the CDFI industry. This change will make BGP financing more accessible to smaller CDFIs, rural CDFIs, Native CDFIs and other CDFIs seeking long-term, fixed rate financing for underserved areas across the country.

2) Permanent Authorization of the Bond Guarantee Program

The BGP was originally authorized in the Small Business Jobs Act of 2010 (P.L. 111–240) with an authorization sunset on September 30, 2014. Since then, authority for the BGP has been extended annually via the Financial Services and General Government (FSGG) Appropriations bill providing program authority for another year and granting Treasury the authority to guarantee additional CDFI Bonds.

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[13] Analysis by CRF using Bond Guarantee Data from the CDFI Fund.

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A permanent authorization of the BGP would provide stability and predictability to the BGP while vastly improving the efficiency for QIs, CDFIs, as well as the CDFI Fund staff administering this program. The BGP is a sound, well managed program and to date there have been no delinquencies or defaults on any payment under this program.

3) Provide Credit Subsidy to Ease Collateral & Credit Requirements

Sound collateral and credit requirements are essential to the BGP as this program is guaranteed by the U.S. government. We recognize the enormous task of structuring a program that balances the benefits of a federal guarantee with the appropriate credit and underwriting standards. Based on our experience of issuing $940 million in bonds on behalf of eight CDFIs in seven funding rounds since 2014, CRF has seen firsthand the challenges some CDFIs (particularly smaller organizations) face when trying to meet the collateral and credit standards of this program. Therefore, I urge the members of this Subcommittee to explore the option of providing a small credit subsidy for the BGP to enable the Fund staff to underwrite guarantee applications based on the underlying financial strength of individual CDFIs using commercially reasonable standards that are deemed safe and sound. The purpose of the BGP is to provide guarantees on bonds where proceeds are used for eligible community or economic development purposes while at the same time, not incurring any losses. These objectives mandate stringent underwriting criteria and significant collateral requirements that smaller CDFIs are unable to meet. A small credit subsidy could allow for more flexible standards that enable CDFIs with smaller balance sheets to access the long-term, fixed rate financing offered by this program.

Recommendation

The Subcommittee and the CDFI Fund should explore the possibility of providing a small credit subsidy to create additional flexibility in the collateral, credit, and underwriting requirements of the BGP. This could be accomplished through a combination of statutory and regulatory changes as well as administrative guidance included the Notice of Guarantee Authority (NOGA) issued for each round of the program.

4) Make BGP a Public Capital Markets Product

On a separate but related note, I encourage the Subcommittee to explore how the BGP could evolve to become an investment product available to investors in the public capital markets. This program was initially envisioned for private sector investors that would allow CDFIs to access capital at scale. The legislation included a prohibition on bonds issued under this program from being considered for Community Reinvestment Act (CRA) credit.[14] This prohibition clearly signals Congress' intent to allow the bonds issued under the BGP to be sold to private investors. However, it was subsequently determined that the Federal Financing Bank was required to be the sole investor in

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[14] INVESTMENT IN GUARANTEED BONDS INELIGIBLE FOR COMMUNITY REINVESTMENT ACT PURPOSES.—Notwithstanding any other provision of law, any investment by a financial institution in bonds or notes guaranteed under the Program shall not be taken into account in assessing the record of such institution for purposes of the Community Reinvestment Act of 1977 (12 U.S.C. 2901). Small Business Jobs Act of 2010 – Public Law 111-240, Sept. 27, 2010; Part III – Other Matters § 1134. Guarantees for bonds and notes issued for community or economic development purposes.

these bonds. CDFIs have gained visibility and need to expand their sources of long-term capital. Additional hearings on this topic would be a welcome opportunity to explore a path to scale the capacity and financing activities of CDFIs.

Other CDFI Fund Programs

CRF participates in a number of CDFI Fund programs, and therefore I would like to add the following additional recommendations for Subcommittee members to consider:

1) **Provide $1 billion in annual appropriations for CDFI Fund programs and administrative costs.** If there is anything the coronavirus crisis has demonstrated, it is that CDFIs are essential organizations in underserved communities. This agency and its programs must have the resources commensurate with the responsibilities and the tasks with which they have been charged. I join my fellow witnesses in calling for a top line appropriation of $1 billion for the CDFI Fund for FY 2022.

2) **Make the New Markets Tax Credit (NMTC) Program permanent.** While this Subcommittee does not have jurisdiction over the NMTC, the CDFI Fund plays an important administrative role in this unique tax credit program that attracts private sector investment to underserved communities. Since the inception of the NMTC Program in 2000, the CDFI Fund has completed 17 allocation rounds and has made 1,354 awards totaling $66 billion in tax allocation authority. According to the New Markets Tax Credit Coalition, these allocations "… have delivered nearly $110 billion total project financing to over 7,000 projects" through 2020.[15]

Conclusion

I appreciate having the opportunity to reflect on the transformative and collaborative work that the CDFI Fund has supported and the impactful work that CRF and our CDFI colleagues have been able to do over the last 30 years.

I would like to remind the members of the Subcommittee that CDFIs, like the tiny private boats that rescued stranded British soldiers from the beaches at Dunkirk in 1940, demonstrated their ability to deliver PPP loans to people and places our most sophisticated financial institutions were unable to reach during one of the worst economic crises our country has ever faced.

As our nation contends with the twin challenges of the pandemic and unprecedented racial and economic inequities, modernizing the CDFI certification rules and the Bond Guarantee Program will advance the work of CDFIs and allow them to bring new resources to support underserved communities and their residents. The pandemic response has created new excitement about the potential of the CDFI industry and placed new demands on the CDFI Fund and its programs to utilize its market-based strategies to address chronic economic challenges in disadvantaged areas of the country by leveraging private investment. CRF will continue to advocate for the resources necessary to support this critical Agency, its programs, and its staff.

[15] https://nmtccoalition.org/fact-sheet/

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I urge the members of this subcommittee to consider our recommendations to modernize the CDFI certification rules to ensure this framework continues to advance the goals and mission of the Fund. I also *strongly encourage* members to support Chair Smith and Ranking Member Rounds' proposed BGP legislation introduced today that would reduce the minimum bond issuance from $100 to $25 million and grant permanent authority to this program. This legislation addresses significant barriers for smaller CDFIs to access this program and bring long-term resources to underserved communities. I remain hopeful that bonds issued under this program can evolve into a public capital markets product.

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APPENDIX

I. Bond Guarantee Information

CDFI Bond Guarantee Issuance – 2013 – 2021

Fiscal Year	Qualified Issuer	CDFI Bond Issue ($ in millions)	Eligible CDFI and Bond Loan Amount ($ in millions)
2013	CRF	$125	Community Development Trust - $125
2013	BoA	$100	LISC - $50 Enterprise - $50
2013	OFN	$100	Clearinghouse CDFI - $100
2014	CRF	$200	Capital Impact Partners - $55 IFF - $25 Low Income Investment Fund - $65 The Reinvestment Fund RF - $55
2015	CRF	$100	Raza - $100
2015	OFN	$100	Clearinghouse - $100
2015	OFN	$127	Bridgeway Capital - $15 Chicago Community Loan Fund - $28 Citizens Potawatomi Community Dev. Corp. - $16 Community Loan Fund of NJ - $28 Community Ventures Corp - $15 Federation of Appalachian Housing Enterprises $15 Kentucky Highlands Development Corp -$10
2016	CRF	$165	Capital Impact Partners - $40 Low Income Investment Fund - $50 The Reinvestment Fund - $75
2016	BoA	$100	Self Help - $100
2017	CRF	$100	Aura Mortgage Advisors - $100

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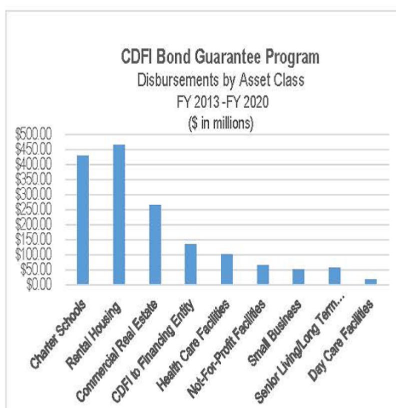
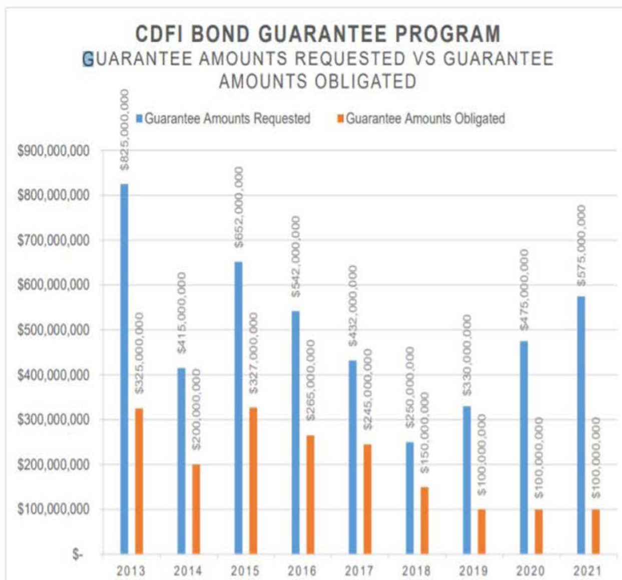
Fiscal Year	Qualified Issuer	CDFI Bond Issue ($ in millions)	Eligible CDFI and Bond Loan Amount ($ in millions)
2017	OFN	$145	Impact Seven - $10 Building Hope - $25 Coastal Enterprises Inc - $20 Community First Fund - $10 Florida Community Loan Fund - $30 Greater MN Housing Fund - $10 Homewise Inc - $15 Housing Trust Fund Silicon Valley - $25
2018	CRF	$150	Clearinghouse CDFI - $150
2019	OFN	$100	Community Loan Fund of NJ - $25 Federation of Appalachian Housing Enterprises - $20 Greater MN Housing Fund - $55
2020	CRF	$100	Clearinghouse -$100
2021	BofA	$100	Self Help

Source: CRF BGP Background and Impact Overview – June 2021 prepared by The Feighan Team



Source: CRF BGP Background and Impact Overview – June 2021 prepared by The Feighan Team



Source: Office of the Inspector General, Department of the Treasury, Audit of the Community Development Financial Institutions Fund's Financial Statements for Fiscal Years 2021 and 2020, December 15, 2021.

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CDFI Bond Guarantee Program

Disbursements by Asset Class as of September 30, 2021

Asset Class	**Since Inception Disbursements *($millions)***	**Proposed Disbursements *($millions)***	**Geography *(Based on YTD Disbursements)***
Charter Schools	$364.9	$438.4	AZ, CA, CO, CT, DC, FL, GA, HI, IL, MD, MI, MN, NJ,NM, NY, OH, PA
Rental Housing	$369.3	$473.9	AL, AZ, CA, DC, FL, GA, IL, KY, LA, MA, MD, MO, MN, NC, NJ, NM, NV, NY, OH, OR, PA, TN, TX, WI, WV,UT
Commercial Real Estate	$263.7	$285.7	AZ, CA, IL, LA, MA, MI, NJ,NC, NV, NY, OK, OR, PA
CDFI to Financing Entity	$115.2	$136.7	KY, MA, NJ, NM
Health Care Facilities	$74.2	$111.3	CA, DC, IL, KY, NC, NY, WI
Not-for-ProfitOrganizations	$65.2	$86.6	AZ, CA, FL, MA, MI, NM,NJ, NV, NY, PA, TN
Senior Living and Long-Term Care	$20.3	$68.0	CA
Small Business	$51.2	$61.2	AZ, CA, KY, NJ, FL, PA, CO,MA, NV
Day Care Centers	$13.0	$30.0	KY, NM, NY
Totals	**$1,337.0**	**$1,692.0**	

Source: Office of the Inspector General, Department of the Treasury, Audit of the Community Development Financial Institutions Fund's Financial Statements for Fiscal Years 2021 and 2020, December 15, 2021.

II. CRF Certification Comment Letters

a. CRF's Comment Letter on the CDFI Fund's Annual Certification and Data Collection Report Form, September 8, 2014

b. CRF's Comment Letter on the interim rule implementing the Community Development Financial Institutions Program (CDFI Program), October 26, 2015

c. CRF's Comment Letter on the Notice and Request for Information regarding the current policies and procedures to certify an organization as a Community Development Financial Institution (CDFI), March 10, 2017

d. CRF's Comment Letter on Comments on Notice and Request for Public Comment on proposed CDFI Certification Requirements and Documents, November 4, 2020

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September 8, 2014

Brette Fishman
Management Analyst
Community Development Financial Institutions Fund
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20020

Dear Ms. Fishman:

On behalf of Community Reinvestment Fund, USA, (CRF), we appreciate this opportunity to provide comments and share our views on the Community Development Financial Institutions Fund's (CDFI Fund) proposed Annual Certification and Data Collection Report Form. Our comments are in response to the CDFI Fund's request for public comment on the proposed form published in the Federal Register on July 9, 2014.

BACKGROUND

CRF is a national, non-profit CDFI, and the nation's leader in channeling resources from the capital markets to support community development financing activities. Our mission is to improve the lives of disadvantaged people and strengthen distressed communities through innovative finance. Since 1988, CRF and its affiliates have been engaged in promoting long-term sustainable economic growth in low-income communities and on behalf of low-income people. We have delivered more than $1.5 billion in capital to small businesses, community facilities and affordable housing projects located in more than 800 communities across the country. In partnership with 200 local lending partners, we have funded 2,438 loans in 46 states and the District of Columbia. Working collaboratively with these local lending partners, CRF has directly assisted more than 612,000 people, including financing 19,000 housing units, 3,700 childcare slots, 9,850 slots at educational facilities, financing over 1,491 small businesses, creating or retaining 71,000 jobs and funding community facilities that serve over 502,000 people.

CRF was founded on a vision of improving the lives of people living and working in economically distressed communities by providing access, in partnership with local community development organizations, to public and private sector resources throughout the country. The hallmark of CRF is our ability to adapt financing tools to connect underserved communities to new sources of capital. We were the first nonprofit financial intermediary to issue securities collateralized by community economic development assets. Since 1989, CRF has issued 19 series of Notes totaling $284.7 million backed by community development loans. Three of our debt offerings totaling $176 million have been rated and all of which included a senior tranche rated "AAA" by Standard & Poor's. Similarly, we have issued three multifamily affordable housing securities, including one Standard & Poor's rated issue totaling $84.9 million, backed by 45 multifamily affordable housing loans.

As a major participant in the New Market Tax Credit (NMTC) Program, we created a tax credit product to support operating businesses with long-term, flexible financing at below-market interest rates. Since 2000, CRF and its affiliate, National New Markets Tax Credit Fund, Inc., (NNMTCF) have become one of the largest NMTC Allocatees in the country, receiving tax credit allocations in 7 of the 10 funding rounds totaling $749.5 million and investing $52.5 million on behalf of other Allocatees, providing 387 NMTC loans to date.

With the contraction in bank lending to small businesses resulting from the Great Recession, CRF sought to address the tremendous need among underserved borrowers and firms located in distressed communities to access appropriate credit products. We obtained one of 14 national non-depository SBA 7(a) licenses to offer this government guaranteed loan

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product to borrowers unable to access conventional credit, typically small businesses located in low-income areas as well as those owned by women, minorities and/or veterans.

Most recently, in 2013 CRF was selected as one of the first Qualified Issuers (QI) in the inaugural round of the CDFI Bond Guarantee Program. We closed our first Bond Issue in early August of this year. Our long and successful track record of developing and implementing credit programs to finance small businesses, affordable housing, community facilities and other community development projects in economically challenged areas makes us uniquely suited to this transformative new program offering long-term, fixed rate funding for Community Development Financial Institutions (CDFIs).

CDFI CERTIFICATION

The issue of CDFI Certification is critically important to the well-being and success of the CDFI industry. CRF has a strong interest in how the Fund's proposed Annual Certification and Data Collection Report Form will affect individual organizations as well as the industry overall. Perhaps the CDFI industry's greatest strength is its flexibility to deliver credit and capital to a wide range of borrowers across a variety of different geographies while fulfilling the Fund's mission as embodied in its Certification requirements. With increased recognition and value placed on the CDFI 'brand", it is even more important to ensure CDFI Certification is based on a sound and effective set of criteria that allows the industry to remain competitive and vibrant.

GENERAL CERTIFICATION COMMENTS

Before offering specific comments on the proposed Annual Certification and Data Collection Report Form (Form), we would like to address the broader issue of CDFI Certification. Although we appreciate the need to establish an efficient mechanism for recertifying existing CDFIs, there are broader questions related to the current certification criteria (both regulatory and agency guidance) as well as the process for certifying applicant organizations. The Fund solicited comments on the authorizing statute (The Riegle Community Development and Regulatory Improvement Act of 1994) in 2010, however, to our knowledge, there has not been a thorough review and assessment of the both the process and the criteria used to certify CDFIs. Moreover, there has only been one systematic recertification effort conducted by the Fund in 2013. Given the dramatic changes in the financial markets and technological developments over the past decade, a rigorous review of the Fund's certification policies and procedures would seem to be in order. Instituting a new recertification process is the *best* time to re-examine certification regulations and Agency guidance to make sure the current framework is both *relevant and meaningful* to the environment in which CDFIs operate. With this in mind, we wish to discuss key challenges presented by the current certification framework and how such challenges could be addressed before turning to specific comments on the proposed Annual Certification Report Form.

I. Certify CDFIs to serve a National Target Market of Investment Areas

As a national, non-profit financial institution and certified CDFI, we have a unique perspective on this issue. In 2012, when we began offering our national SBA 7(a) loan product (one of two CDFIs approved to offer this product nationally) we became acutely aware of the investment in staff, training and technology needed to offer this product successfully in a highly competitive market. To cover costs and make this product financially sustainable, CDFIs must be able to scale their lending activities to support a 7(a) platform. In addition, the very nature of small business lending makes it a more episodic form of financing. Generally speaking, small business borrowers request a single loan of a relatively small amount with limited likelihood of repeat lending opportunities. With the onset of the Great Recession and the dramatic contraction of bank lending to small business, CDFIs stepped up to fill this credit gap. As a CDFI with a national profile, we regularly receive loan requests from all over the county. It is difficult to turn these worthy borrowers in CDFI eligible census tracts away when we know our loan could create economic opportunity in low-income communities.

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Under the current certification framework, the Fund has not certified *any* CDFI for a national Target Market composed of eligible Investment Areas because there is no established mechanism for a CDFI to demonstrate accountability to such a Target Market. The inability to define an acceptable accountability mechanism for a national Target Market composed of all CDFI Investment Areas prevents the Fund from approving such a Target Market. This raises two serious questions. First, "How can the Fund ask CDFIs offering national loan products, such as the SBA 7(a), to limit their ability to deliver such products in what is clearly a national marketplace driven by dramatic changes in information technology?" Second, "Doesn't the lack of policy guidance tie the hands of successful CDFIs seeking to scale their lending operations to meet credit demand from low-income areas?" If so, the inability to certify CDFIs for a national market perpetuates the very situation – lack of access to appropriate credit sources – the Fund was established to address. This situation is especially challenging given there are many CDFIs the Fund has certified to serve national Target Markets composed of Low-income Targeted Populations (LITP) and which maintain accountability to such Target Markets through Governing and/or Advisory Boards.

We respectfully urge the Fund to develop regulations and/or guidance to allow CDFIs to be certified for a *National* Investment Area Target Market by establishing a meaningful way for applicants to demonstrate accountability to such Markets through new or existing mechanisms. Specifically, we ask the Fund to consider the following approaches:

- *Accept the SBA 7(a) "credit elsewhere" test as evidence of accountability for the purposes of serving a National IA Target Market*. The federal SBA 7(a) program was established to serve borrowers that Congress determined lack access to affordable credit and capital on reasonable terms, and, in particular minorities, women and veterans. It is a nationwide program. By its very existence, the SBA 7(a) program is a *federal policy conclusion* that small businesses meeting its eligibility requirements seeking loans of $5 million or less lack access to credit and capital nationwide. In fact, the 7(a) loan application requires SBA lenders to document the borrower's inability to obtain credit elsewhere. This application requirement ensures that lenders remain accountable to the borrowers they serve by providing credit to small businesses unable to access loans from conventional financial institutions. An Urban Institute report published in 2008 has confirmed that this provision is adhered to by lenders.[1]

- *Develop new accountability mechanisms using innovations in data and data gathering techniques.* Dynamic changes in technology have rendered many of the current accountability mechanisms less effective when compared to information about local credit conditions provided by new data sets available through online platforms. For example, using new data tools, such as google maps, it is possible to find an address, view a photo of a building thousands of miles away from a personal computer. Much more granular data is also available with the advent of big data. Policy Map recently began including a state level data set called *Longitudinal Employer Household Data* that allows users to profile small businesses by geography, by the percentage of low-income workers they employ, and by whether or not have they have received small business loans. This data tool could help a CDFI determine if small firms located in eligible census tracts and employing low-income workers are having difficulty accessing credit. Armed with this knowledge, CDFIs could work directly with small businesses across the country to address their credit needs with appropriate loan products.

CDFIs are experts at accessing government programs to serve distressed markets and borrowers unable to tap traditional sources of credit. With the onset of the financial crisis, CDFIs watched small business credit dry up in their

[1] http://www.urban.org/UploadedPDF/411602_executive_summary.pdf

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communities and across the country. They responded, at the urging of the CDFI Fund[2], by joining the ranks of SBA Community Advantage Lenders as well as offering their own small business credit products. CRF sought and obtained a national license to provide the full SBA 7(a) product. As noted above, to use these new product capabilities in a financially sustainable fashion, CDFIs need to expand their Target Markets to meet demand from credit-starved small businesses. This demand ebbs and flows over time and across broad geographic areas. Changes in the marketplace offer new ways for CDFIs to establish and maintain accountability to larger Investment Areas that may ultimately prove even more informative than current accountability mechanisms. But the inability to develop and test new accountability mechanisms threatens to harm the very industry the Fund was created to support. Without a *National Target Market designation comprising eligible Investment Areas*, CDFIs will be constrained to geographic areas that make it uneconomic to offer certain products, thus limiting their capacity to offer the resources small businesses in underserved areas so desperately need. Without safe credit options, small businesses may fall prey to an even greater threat to their wellbeing - the growing numbers of online companies offering loans on terms many consider to be predatory. While not all of these online providers offer dangerous products to underserved small businesses, it is vitally important to preserve the ability of CDFIs to offer appropriate credit products to businesses in low-income communities. ***We strongly urge the Fund to work with the industry to develop new accountability mechanisms to enable CDFIs to remain competitive and capable of serving the markets to which they are committed.***

II. Issue guidance on small business loans serving Low-income Targeted Population Target Markets

CDFI small business lenders are also challenged by the lack of clear guidance about how to qualify loans serving a LITP Target Market at the local, regional or national level. Generally speaking, these CDFIs qualify loans serving this Target Market by “looking through” the project to the “end beneficiaries” of their financing activities. For example, a loan to develop a multifamily affordable housing project using a government program, like the Low-Income Housing Tax Credit (LIHTC), qualifies as serving a Low-income Targeted Population based on program requirements mandating that a certain percentage of the housing units be rented to low-income families. Similarly, a CDFI making a loan to a charter school or a community health center “looks through” the project to the “end beneficiaries” using proxies, such as the number of students receiving free or reduced lunches or the number of Medicaid patients, to verify the financing is serving low-income people.

Just as CDFIs can rely on the federal LIHTC as a methodology for determining low-income people are the “end beneficiaries” of loans to tax credit projects, so too, should they be able to rely on other federally-accepted methodologies for determining low-income people are the “end beneficiaries” of certain small business loans. Often the small business financing provided by CDFIs create and retain jobs for low-income people regardless of where the borrower is located. The CDFI Fund’s authorizing legislation clearly supports this approach to qualifying small business loans as it explicitly states *CDFI Fund Financial Assistance may be used to serve Targeted Populations by making loans to businesses that provide jobs for low-income people.*[3]

Unfortunately, no similar methodology exists under current guidance for qualifying CDFI small business loans as serving LITP Target Markets. We understand the Fund is open to examining and potentially adopting approaches used by other federal programs, like HUD’s Community Development Block Grant (CDBG) Program, for verifying jobs

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[2] Letter from Donna J. Gambrell, Director of the CDFI Fund, to CDFI Partners regarding participation in the SBA Community Advantage Program, March 25, 2011.

[3] Public Law 103-325, Riegle Community Development and Regulatory Improvement Act of 1994, Section 108(b)(1)(B).

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created or retained through these loans are benefitting low-income people. Guidance on this issue would give CDFIs flexibility to assist small businesses that are *not* be located in an eligible census tract (IA) but which are creating and retaining employment opportunities for low-income people. The Fund's authorizing legislation was drafted with the intent to empower CDFIs to use Financial Assistance Awards to address the credit and capital needs of underserved places and *populations* through small business lending. The statute is very clear on this point and the absence of regulatory or agency guidance should be addressed so as to align the law and respective regulations. ***We strongly recommend the Fund develop and implement a protocol for CDFIs to qualify their small business loans as serving LITP Target Markets*** to recognize the benefits provided to low-income people through these loans. We stand ready to assist you in this effort.

III. Expand the definition of Other Targeted Populations for CDFIs using SBA programs

The last issue we wish to highlight is the changing demographics of small business owners in this country, especially in low-income communities and among underserved borrowers. We urge the CDFI Fund to expand its definition of Other Targeted Populations to include a broader range of borrowers using the SBA 7(a) and related programs. The 7(a) loan program is, by definition, a federal policy conclusion that small businesses meeting its eligibility requirements seeking loans of $5 million or less lack access to credit and capital nationwide. As noted above, the 7(a) application requires SBA lenders to document the borrower's inability to obtain "credit elsewhere". Minority-, women- and veteran-owned firms face additional obstacles to obtaining credit and therefore SBA places a priority on serving these borrowers with the 7(a) product. Research, such as a 2008 Urban Institute analysis[4], has demonstrated that these particularly underserved borrowers are more likely to obtain a loan through the 7(a) program than in the conventional market. Moreover, a 2013 Congressional Research Service analysis concludes that the program meets its goals.[5]

The SBA has defined a "minority-owned" or "socially disadvantaged" firm more broadly than the CDFI Fund. Under the Minority Small Business and Capital Ownership Development program - also known as the 8(a) Business Development (BD) program, individuals who are members of the following groups are deemed to be "socially disadvantaged" based on the fact they have been subject to "racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities": Black Americans; Hispanic Americans; Native Americans (American Indians, Eskimos, Aleuts, or Native Hawaiians); Asian Pacific Americans (persons with origins from Burma, Thailand, Malaysia, Indonesia, Singapore, Brunei, Japan, China (including Hong Kong), Taiwan, Laos, Cambodia (Kampuchea), Vietnam, Korea, The Philippines, U.S. Trust Territory of the Pacific Islands (Republic of Palau), Republic of the Marshall Islands, Federated States of Micronesia, the Commonwealth of the Northern Mariana Islands, Guam, Samoa, Macao, Fiji, Tonga, Kiribati, Tuvalu, or Nauru); Subcontinent Asian Americans (persons with origins from India, Pakistan, Bangladesh, Sri Lanka, Bhutan, the Maldives Islands or Nepal) (13CFR 124 §124.103).

Given the SBA has determined individuals in these racial, cultural, and ethnic groups face discrimination affecting their ability to access credit, we request that CDFIs using the SBA 7(a) program be permitted to use the SBA definition of

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[4] http://www.urban.org/UploadedPDF/411596_504_gap_analysis.pdf

[5] http://fas.org/sgp/crs/misc/R41146.pdf

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"socially disadvantaged" borrowers to qualify a small business loan as serving an OTP Target Market without undertaking additional research or producing further studies documenting the fact that these individuals lack access to affordable credit. In other words, expand the CDFI Fund's definition of Other Targeted Populations to include those borrowers the SBA has deemed to be "socially disadvantaged" for the purposes of SBA 7(a) small business loans. Not only is this approach in keeping with the regulations of the 7(a) program under which CDFIs are operating, but it best reflects the types of small business borrowers who are starting and operating small businesses in this country. A 2010 study by the SBA revealed, "Immigrants are found to have higher business ownership and formation rates than non-immigrants. Roughly one out of ten immigrant workers owns a business and 620 of 100,000 immigrants (0.62 percent) start a business each month."[6] Adopting this expanded definition of Other Targeted Populations would better align CDFI and SBA program objectives while remaining true to the Fund's mission of fostering economic opportunity and promoting community development investments that benefit underserved populations and distressed communities across the country. These borrowers have proved beyond the shadow of a doubt they are unable to access conventional credit and they have signed a federal application attesting to this fact. What additional proof do we need to determine that these are the *very* borrowers the Fund was established to support?

COMMENTS ON ANNUAL CERTIFICATION AND DATA COLLECTION REPORT FORM

We wish to offer the following comments on specific Certification Data requested in the CDFI Fund's proposed Form and as defined in the accompanying Glossary.

I. **Part I. Certification Data**

   a. **Target Market Test -** #19. The Respondent attests that the Target Market(s) for which it is approved to serve have not changed since their CDFI Certification was last affirmed by the CDFI Fund. (Yes/No)

   b. **Target Market Test -** #20. If the Respondent indicates that the Target Market(s) has changed, please describe changes.

   In our view, these questions raise a host of important but unaddressed issues for CDFIs. For example, "What constitutes a change to a CDFI's Target Market?" Or "How can CDFIs modify their Target Market(s) in a timely fashion in response to changes in their marketplace?" Given that this Form will be filed annually by CDFIs, how quickly will the Fund staff respond to CDFI requests to amend their Target Market(s)? If a CDFI has a modification request pending at the CDFI Fund, how should the organization respond to either or both of these questions? What are the implications of responding in the affirmative to Question # 19 for the certification status of the organization as well as for other awards, allocations and/or certifications (as a CDE) it may have received from the Fund? We would strongly urge the Fund to provide detailed guidance on the questions we have raised to ensure proper and effective procedures are in place to enable CDFIs to modify their Target Market(s) in light of the increasingly competitive environment in which they operate.

   c. **Target Market Test -** #21. List the Target Market(s) that are the basis for current certification.

   This request would seem to be duplicative assuming the Fund already has this information in its

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[6] *Immigrant Entrepreneurs and Small Business Owners and their Access to Financial Capital* by Robert W. Fairlie, Ph.D. Economic Consulting, Santa Cruz, CA, under contract no. SBAHQ-10-R-0009, May 2012.

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Certification Database.

II. **Part II. Financial and Operational Data**

a. **Loans/Investments Originated -** #21. Purpose

The financial products listed in this section of the Form are all assumed to be *originated* by a CDFI. Often, CDFI purchase loans that have been originated by another organization seeking to generate balance sheet liquidity. The Fund should consider amending the title of this section to ***Loans/Investments Originated or Purchased*** to fully capture the financing activities of CDFIs.

In addition, we suggest the Fund include another category of Real Estate Loans entitled **"Real Estate – Acquisition and/or Permanent Financing"** to reflect how multifamily affordable housing projects are financed by CDFI. This option captures the common practice whereby one CDFI provides early stage financing for an affordable housing project, including site acquisition, pre-development, construction and/or bridge financing while longer term or permanent take-out financing may come from another source, such as another CDFI. This approach reflects the fact that many CDFI rely on short term funding sources and are not able to offer longer term (25+ year) financing that matches the term of the asset. As a CDFI with extensive capital markets experience, CRF is able to offer long term permanent financing to both new and existing multifamily affordable housing projects. We believe this capability is important to our CDFI partners and request that the Fund add this loan category to its proposed list.

b. **Staff and Consultants** - #28 Total number of Full Time Equivalents (FTEs) – Staff Only

i. FTEs devoted to Development Services

It would be helpful to have guidance to assist CDFIs in estimating information such as the number of FTEs devoted to Development Services. Many CDFIs do not have staff *exclusively* dedicated to providing Development Services but rather some portion of their staff's time is spent providing these services. A methodology to help CDFIs calculate this data point would ensure greater consistency in reporting this information across the industry.

III. **Part III. Target Market Data**

a. **Loan and Investment Information** - #s 1 & 2 **and Loan Information -** #s 7 & 8

These two data sets appear to be asking for the same information, e.g. the total number of loans and investments in the Target Market(s) versus the total number of loans and investments originated in Target Market(s). Are #s 1 & 2 looking for all loans and investments in the Target Market(s) while #s 7 & 8 are asking about loans and investments originated in Target Market(s) during a the reporting period (or the most recent fiscal year)? If so, this should be clarified by adding "*during the most recent Fiscal Year"* to #s 7 & 8.

b. **Development Services**

i. **Total # of Development Services provided in the Target Market(s)** - # 11

ii. **Total $ of Development Services provided in the Target Market(s)** - # 12

iii. **Total # of Development Service clients in the Target Market(s)** - # 13
iv. **Total # of clients in the Target Market(s)** - # 14

As noted above in Part II. Financial and Operational Data, under Staff and Consultants, many CDFIs deliver their Development Services in the context of the financial product or services they are providing. In reviewing the data requested on Development Services in #s 11 – 14, it might be useful to explore alternative ways for CDFIs that do not offer Development Services as a separate activity to report on these Services rather than using estimates of the number of clients served to calculate the # and $ amount of Services provided. We question the usefulness and the accuracy of such data and therefore the value of requesting it from CDFIs whose model does not include a differentiated set of Development Services. Perhaps it would be more informative to ask those CDFIs that roll their Development Services into their Financial Products or Services to estimate what percentage of their financing clients receive Development Services. This information could be compared to the total number of loans, investments, or financial services delivered in a given period and the total dollar amount of those Financial Products or Services to arrive at a sense of the magnitude of Development Services being provided by a CDFI. We welcome a dialogue with our industry colleagues about more meaningful ways CDFIs without a distinct set of Development Service offerings might report on how they deliver this assistance to their clients.

IV. Part IV. Impact Data

There are a number of data items listed in this section of the Form that are not currently collected by CDFIs due to lack of an industry-accepted set of impact data points. It would be advisable to provide a transition period during the first reporting cycle to allow CDFIs to align their data collection activities with the new set of data points included in this Form.

a. **Housing** - #3 Number of Affordable Housing Units Created or Rehabilitated

We assume this data point is defined by the Term *Number of Housing Units Created or Rehabilitated"* included in the Glossary accompanying the proposed Form. If this assumption is correct, we would suggest modifying the name of this data point as well as the definition in the Glossary to read as follows: *Number of Affordable Housing Units Created, Rehabilitated,* ***Financed or Acquired.*** (Please note the definition in the Glossary neglected to include the word "***Affordable***" and which should be added as well.) Adding the phrase ***"Financed, or Acquired"*** recognizes two types of CFDI financing activities otherwise reflected in the proposed Form: (1) the provision of long-term permanent financing for multifamily affordable housing projects, generally funded in the stages, as described above in Part II. Financial and Operational Data (Loans/Investments Originated - # 21 Purpose); and (2) the purchase or acquisition of these loans from organizations seeking balance sheet liquidity.

b. **Business Technical Assistance** - # 28 $ Dedicated to Business Technical Assistance

As discussed in Part IV Development Services, many CDFIs do not break out the Development Services or the Business Technical Assistance they provide to their clients. Requesting a dollar value for this Business Technical Assistance may produce information of limited value for those organizations that integrate their assistance into their lending or investing process. Again, we urge

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the Fund to engage the industry in a dialogue about the kind of information related to Development Services and specifically, Business Technical Assistance that would be more informative and helpful to the Fund.

c. **Geographic Areas Served** (Drop Down)

If a CDFI collects data where its lending or investing activities are located but does not focus on specific geographic areas, how should it respond to this section of the Form? Is this an optional section to allow a CDFI to reflect particular geographic markets or areas it serves or is it intended to capture the types of geographic markets where its lending or investing occurred during the most recent fiscal year? Additional clarification as to how a CDFI should respond to this section would be helpful.

d. **Population Served**

We observed the absence of a separate category for "Hispanic/Latino" clients. This is especially puzzling because the Fund's Certification materials (Application and Guidance) specifically mention Hispanics with regard to Other Targeted Populations. Not including a separate category for "Hispanics/Latino" populations would seem to be inconsistent from a programmatic perspective. Could the Fund clarify whether this omission was an oversight, or if not, explain why this population was not included? We favor adding a box for "Hispanics/Latinos".

V. **Glossary**

a. **Business (Loans)**

The definition of Business Loans is far too narrow and does not accurately reflect the types of loans CDFIs are making. We are particularly concerned that the list of Business Loan examples only includes "microcredit, working capital, and lines of credit" but fails to mention two of the *most essential types of small business loans* - those used to acquire, expand or rehabilitate owner-occupied real estate and to purchase equipment. With a significant number of CDFIs engaged in small business lending (witness the growth of the Goldman Sachs 10,000 Small Businesses Initiative), we strongly encourage the Fund to expand the list of examples of small business loans to include "***term loans for acquiring or rehabilitating owner-occupied real estate or purchasing equipment.***" It is important to note, loans used to acquire or rehabilitate owner-occupied real estate are separate and distinct from real estate loans made to construct, expand or modify facilities to be leased by unaffiliated third-party businesses. In the latter case, the business developing the property will *not* occupy 51% or more of the space and is deemed to be engaged in real estate development. This type of loan would fall into the category of a **Real Estate – Rehabilitation – Commercial Loan,** another separately defined term included in the Glossary.

b. **Real Estate – Rehabilitation – Housing Development – Multi Family**

The definition provide for this type of loan refers a Financial Note used to rehabilitate or acquire multifamily housing. Again, we are concerned this definition is far too narrow and should be expanded

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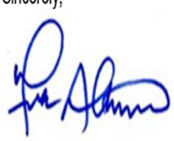
to include the broad category of financing activities associated with affordable multifamily housing loans. To better reflect the breadth of activities included in this type of real estate lending, we recommend modifying the definition to read as follows: "**Financial Note is to rehabilitate, acquire or *finance* multifamily housing.**" To ensure consistency across the program, the same change should be included in the definition of **Real Estate – Rehabilitation – Housing Development – Single Family.** In a similar fashion, the definition of **Number of Housing Units Created or Rehabilitated** should revised to read as follows: **"The Number of Housing Units constructed, rehabilitated, acquired, or *financed* through the housing development loans/investments originated *or purchased* during the reporting period."** Note, we added the phrase "***or purchased***" as an acquisition generally takes place through a loan purchase.

Conclusion

We appreciate this opportunity to share our views and recommendations on the proposed Annual Certification and Data Collection Report Form as well as the broader issue of CDFI Certification. As the CDFI industry has gained increasing visibility and recognition, it is paramount that the certification framework remain both relevant and flexible. Certification is the "gateway" not only to the Fund and its resources, but to a broad community of stakeholders, investors, and supporters who share the CDFI industry's mission and passion. We must preserve the imprimatur of this unique and successful model but not at the cost of rendering it uncompetitive or financially unviable. Certification must not be a static state but rather a dynamic tool and process that adapts as CDFIs respond to changes in their markets. We commend the CDFI Fund Staff for their efforts and stand ready to work with them to ensure certification is both effective and meaningful in the context of the environment in which CDFIs operate. Please do not hesitate to contact me with any questions regarding comments included in this letter.

Sincerely,



Frank Altman

President and CEO

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October 26, 2015

Amber Kuchar
CDFI Program Manager
Community Development Financial Institutions Fund
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20020

Dear Ms. Kuchar:

On behalf of Community Reinvestment Fund, USA, (CRF), we appreciate this opportunity to comment on the interim rule implementing the Community Development Financial Institutions Program (CDFI Program) as requested by the Community Development Financial Institutions Fund (CDFI Fund) in the Federal Register on August 31, 2015.

BACKGROUND

CRF is a national, non-profit CDFI, and the nation's leader in channeling resources from the capital markets to support community development financing activities. Our mission is to improve the lives of disadvantaged people and strengthen distressed communities through innovative finance. Since 1988, CRF and its affiliates have been engaged in promoting long-term sustainable economic growth in low-income communities and on behalf of low-income people. We have delivered more than $1.9 billion in capital, including through the issuance of CDFI guaranteed bonds, to small businesses, community facilities and affordable housing projects located in more than 800 communities across the country. In partnership with 200 local community partners, we have funded 2,438 loans in 48 states and the District of Columbia. Working collaboratively with these local lending partners, CRF has directly assisted more than 612,000 people, including financing 19,000 housing units, 3,700 childcare slots, 9,850 slots at educational facilities, financing over 1,491 small businesses, creating or retaining 71,000 jobs and funding community facilities that serve over 502,000 people.

The hallmark of CRF is our ability to adapt financing tools to connect underserved communities to new sources of capital. Whether it was pioneering the establishment of a secondary market for community development loans, issuing the first S&P-rated securities backed by these assets, becoming one of the largest NMTC Allocatees in the country, or being approved as the first Qualified Issuer under the CDFI Bond Guarantee program, we search for ways to scale new and existing credit programs or products to meet the credit needs of communities and borrowers left out of the economic mainstream. In 2011, prompted by the Great Recession and the significant contraction in bank lending to small businesses, CRF obtained one of 14 national non-depository SBA 7(a) Small Business Lending Company licenses. Our vision was to offer this government guaranteed loan product to borrowers unable to access conventional credit, typically small businesses located in low-income areas as well as those owned by women, minorities and/or veterans. Over the past three years, CRF not only launched its SBA 7(a) lending product, but now ranks among the 100 most active 7(a) lenders in the country. Our very success with this product is what prompts our comments below on the CDFI Fund's revised interim rule.

COMMENTS ON THE INTERIM RULE

The Fund is requesting comments on a number of changes to the CDFI Program interim rule. We have focused our comments on how CDFIs demonstrate accountability to their Target Market(s) and, in particular, how the Fund's change to Section 1805.201(b) (5) of the regulations significantly limits the types of permissible accountability methods that will be available to CDFIs. Under the current rule, CDFIs are allowed to use a variety of mechanisms to meet this certification requirement including: representation on a governing or advisory board; convening community meetings; conducting focus

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groups; and/or administering customer surveys. This approach has allowed CDFIs to select the most appropriate method for their Target Market(s) and to make use of more than one method if they have multiple Target Markets.
Based on the Fund's revision to the interim rule, a CDFI will now be required to demonstrate accountability to residents of its Target Market in one of two ways - through representation on *either* its governing board or an advisory board. CDFIs will no longer be able to use surveys, focus groups or community meetings, as they have in the past. The Fund has not offered any explanation for this change, and the interim rule is silent on a number important questions. For example, will CDFIs currently using these alternative mechanisms be "grandfathered" for their existing Target Market(s) or will they be required to replace these mechanisms with appropriate governing or advisory board representation? If CDFIs using surveys, focus groups, or community meetings are required to move to one of the two permissible accountability mechanisms, will there be a transition period and process for CDFIs to implement these changes? The absence of any guidance as to how this change to the accountability criteria would be implemented raises concerns about the need for such a change as well as the possible implications for CDFIs.

CRF believes this change in accountability mechanisms is ill advised for several reasons.

I. Reduces the flexibility of CDFIs to utilize a variety of accountability options for different Target Markets

This revision to the accountability mechanisms is particularly problematic for small business lenders, like CRF, who, in the aftermath of the Great Recession, have tried to expand their Investment Area (IA) Target Market(s) in response to the unmet credit needs of small businesses in low income communities. As banks curtailed or reduced their small business lending activities, CDFIs stepped in to fill the gap, often providing credit that was not otherwise available. For some CDFIs, the ability to expand their Target Markets directly depends on the use of alternative accountability mechanisms. Restricting these accountability options would therefore compound the challenges CDFIs face when attempting to expand their geographic reach in the context of existing accountability requirements.

As a CDFI small business lender with a national SBA 7(a) license, CRF would like to become certified to serve a national Target Market comprised of all Investment Areas (eligible census tracts). We noted in a prior comment letter[1] that, under the current certification framework, the Fund has not certified *any* CDFI for a national Target Market that includes all eligible Investment Areas simply because there is no approved mechanism for a CDFI to demonstrate accountability to such a Target Market. Without a national Investment Area (IA) Target Market option, CRF has taken an incremental approach to expanding its original 6 state IA Target Market through the use of alternative accountability mechanisms. Had these alternative mechanisms not been available, we might not have been able to add 9 more states to our original IA Target Market, as we already had established advisory boards for each of the existing 6 statewide Investment Areas. It would have been nearly impossible to manage 15 advisory boards that meet with any regularity. Thus we opted to use a survey mechanism to demonstrate accountability to the credit needs of small businesses in these additional Investment Areas. If the interim rule is adopted as is, how will CDFIs seeking to expand their Target Markets meet the accountability requirements for certification without alternative mechanisms?

II. Fails to address challenges for CDFIs seeking national Target Market(s) that reflect their business model

Eliminating alternative accountability mechanisms fails to address a key shortcomings with the existing certification criteria. The lack of an approved accountability mechanism for a national Investment Area Target Market has come at a high price for CRF and the CDFI industry as a whole. As we described in our earlier

[1] See CRF's Comment Letter on the CDFI Fund's Annual Certification and Data Collection Report Form, September 9, 2014

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comment letter,[2] when CRF secured a national SBA 7(a) license, we made a significant investment in staff, training and technology to support our new SBA lending product. Without the ability to lend into a national Target Market, we are unable to truly scale our operations and realize the economic benefits of these investments. Our current IA Target Market constrains our ability to compete with the growing array of online lenders who are not subject to any geographic limitations but whose products may not always be the best choice for small business borrowers. Small business lending by its nature is episodic and requires a lender to respond to loan requests across town and across the country. With a national profile, CRF frequently receives loan requests from areas outside of its IA Target Market. It is difficult to turn worthy borrowers away when we know our loan could create economic opportunity so desperately needed in low income communities.

In the absence of a national IA Target Market designation, CRF has been able to qualify some of its small business loans as serving another Target Market for which it is certified. Like a number of CDFIs, we initially applied for and were granted a national Low Income Targeted Population (LITP) Target Market for our multi-family affordable housing financing products. Generally speaking, CDFIs serving a national LITP Target Market are able to qualify their loans by looking through to the "end beneficiary" of the financing being provided. For example, a loan to finance a multifamily affordable housing project using a government program, like the Low-Income Housing Tax Credit (LIHTC), qualifies as serving a Low-income Targeted Population based on program requirements mandating that a certain percentage of the housing units be rented to low-income families. Similarly, a CDFI making a loan to a charter school or a community health center "looks through" the project to the "end beneficiaries" using proxies, such as the number of students receiving free or reduced lunches or the number of Medicaid patients, to verify the financing is serving low-income people.

Unfortunately, it is not as clear cut nor has the CDFI Fund provided any guidance or protocols for qualifying small business loans as serving LITP Target Markets. CDFIs with a LITP Target Market have developed their own methodologies for qualifying small business loans as serving low income populations based on information demonstrating (1) the business owner is a low income person (especially true for microenterprise businesses); (2) the business is hiring low income people; or (3) the employees are residents of low income communities. The absence of CDFI Fund guidance on how to qualify these loans for a LITP Target Market means that no standard or uniform industry methodology exists. Each CDFI has established its own approach and metrics for qualifying their small business loans which has led to debate within the industry as to whether certain metrics for qualifying loans actually promote policies that run counter to the goals of CDFIs. For instance, some question whether qualifying loans to small businesses that create or retain jobs for low income people indirectly promotes lending to firms offering lower wage employment opportunities rather than higher paying positions that can help individuals or families build assets and raise their standard of living and quality of life. CRF has grappled with this issue as we aspire to fund businesses that create living wage jobs. However, we see the benefits of supporting firms offering jobs accessible to low income people. To address this issue, we undertake a detailed analysis of the businesses we finance by the industry code and job classification to determine if these firms offer workers an "opportunity ladder" to advance professionally and build assets.

Finally, although not certified to serve an Other Targeted Population (OTP), we are not aware of any CDFIs that have received a national OTP Target Market certification. Again, it appears the absence of an approved accountability mechanism is a key stumbling block to granting a CDFI a national OTP Target Market. In addition,

[2] Ibid.

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the CDFI Fund's Certification Application and the Supplemental Guidance and Tips[3] refer to an OTP Target Market for a "specified geographic unit" implying a national Target Market is not an option.

III. Out of step with increasing use of data in credit markets and by the CDFI Fund

Phasing out the use of customer surveys, focus groups, and even community meetings runs counter to developments we are witnessing in the credit markets and even at the CDFI Fund. Significant advancements in the internet and the use of technology have fueled the exponential growth of on-line marketplace lending. Central to the success of these lenders is the increasing use of "big" and more granular data to identify new customers, evaluate and approve their loan requests. Using data-driven platforms, many of these lenders can fund loans in a matter of hours through the use of new scoring models or algorithms relying on vast amounts of information that can be quickly analyzed by sophisticated software programs. The ability to collect and process large quantities of data using technology brings new efficiencies to the lending process as well as much deeper and more detailed information about the credit needs of borrowers. The Treasury Department expressed interest in the role these online marketplace lenders play in the small business credit market and recently issued a Request for Information[4] on, among other things, whether these lenders have the potential to "expand access to credit for historically underserved market segments?" Similarly, small businesses are turning to online lenders to meet their credit needs. According to a survey conducted by Federal Reserve Banks of New York, Atlanta, Cleveland, and Philadelphia between September 9th and November 7th, 2014, 18% of small businesses located in 10 states applied to online lenders for credit.[5]

At the very time credit markets are harnessing data-driven platforms to better understand capital needs of small businesses, the Fund appears to be heading in the opposite direction by excluding the use of surveys, focus groups and community meetings as accountability mechanisms. Many, if not all, of these alternative mechanisms can be adapted for an online environment making it easier to gather information from participants anywhere in the country in real time and at their convenience without leaving their homes or businesses. For example, the Federal Reserve Bank of Cleveland recently published a study of how small business owners view online alternative lenders and their credit products using online focus groups. These focus groups took the form of online discussions that allowed a geographically diverse group of small business owners to share their perceptions of online lenders and to evaluate mock loan products by visiting lenders' websites.[6] Contrary to the approach adopted in the interim rule, online tools or versions of alternative accountability mechanisms are extremely well suited to capturing information that could help CDFIs demonstrate even *greater* accountability and responsiveness to small business owners in their Target Markets than they could achieve through their governing and/or advisory boards because these mechanisms of the direct connection to borrowers and the highly granular nature of the data being provided/collected.

[3] Community Development Financial Institutions Fund, Certification Application, Supplemental Guidance and Tips (Updated through February 2014), page 20.

[4] https://www.federalregister.gov/articles/2015/07/20/2015-17644/public-input-on-expanding-access-to-credit-through-online-marketplace-lending

[5] http://www.newyorkfed.org/smallbusiness/SBCS-2014-Report.pdf , page 13.

[6] Alternative Lending through the Eyes of "Mom and Pop" Small Business Owners: Findings from Online Focus Groups, A Special Report of the Federal Reserve Bank of Cleveland by Barbara J. Lipman, Federal Reserve Board of Governors and Ann Marie Wiersch, Federal Reserve Bank of Cleveland, August 25, 2015, page 2.

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At the same time, the CDFI Fund is moving towards much greater use of data and online tools to measure and evaluate the impact of CDFIs individually as an industry. In her speech at the 2015 CDFI Coalition Institute in Washington, DC, CDFI Fund Director Annie Donovan stressed the importance of data and how the Fund intends to use data to strengthen the industry. She underlined a lack of data on CDFI impact as a major drawback the industry must address as it inhibits our ability to tell a compelling story about the contribution CDFIs are making in their communities. Improving the quality of data collected as well as greater use of technology to gather this information are important priorities for the Director and will be a focus for the Fund under her leadership. Given the Fund's new emphasis on data and technological modernization of its infrastructure, we are puzzled by the exclusion of accountability mechanisms with the potential to provide rich data on the credit needs of CDFI borrowers in a highly efficient and timely fashion.

IV. Works against the CDFI Fund's mission and other initiatives

By reducing the options accountability options available to CDFIs, the CDFI Fund appears to at odds with its own mission "…to increase economic opportunity and promote community development investments for underserved populations and in distressed communities in the United States."[7] Fewer accountability mechanisms constrain CDFIs from meeting credit needs of underserved small businesses by limiting the growth of their Target Markets even in the face of clear demand from firms located in eligible census tracts and/or serving low income people outside their designated Target Markets. This is particularly true for CDFIs engaged in small business lending. The Fund actively encouraged CDFIs to participate in the SBA's Community Advantage Program through which they can offer the 7(a) guaranteed loans product.[8] Opening up the 7(a) program to CDFIs sparked the growth of the CDFI small business lending sector by providing these lenders with a valuable new tool with which to support their borrowers. This new capability was introduced in response to the financial crisis as conventional lenders significantly reduced their small business lending. To meet the demand for credit, many CDFIs have grown their business lending activities by amending and/or adding *all* types of Target Markets and using a variety of accountability mechanisms to do so. Excluding these mechanisms appears counterproductive to the Fund's efforts to encourage CDFI participation in the Community Advantage program so as to make SBA 7(a) loans more accessible to small businesses in low income areas or underserved borrowers.

RECOMMENDATIONS ON THE INTERIM RULE & CDFI ACCOUNTABILTY CRITERIA
CRF would like to offer several recommendations related to the interim rule and the CDFI certification accountability criteria more broadly.

I. Maintain Existing Accountability Mechanisms in the Near Term

The CDFI Fund should preserve the accountability mechanisms currently available to CDFIs. Limiting these options would only further constrain CDFIs seeking to expand or amend their existing Target Markets, especially organizations engaged in small business lending. We know of no good reason to eliminate these alternative mechanisms nor has the Fund explained the reasoning behind this change. If the interim rule is adopted as

[7] https://www.cdfifund.gov/about/Pages/default.aspx

[8] Letter to CDFI partners from Donna J. Gambrell, Director of the Community Development Financial Institutions Fund, US Department of Treasury, March 25, 2011.

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proposed, at the very least, the Fund should "grandfather" or preserve the rights of CDFIs currently using these alternative mechanisms.

II. Develop National Accountability Mechanisms for CDFI Small Business Lenders Serving IA Target Markets

CDFIs must be able to create impact in the "age of the internet." For CDFIs with the ability and the tools to deliver credit to a market that is national in scope, there should be an approved and effective accountability mechanism that enables them to do so without having to create 50 advisory boards each with 4 or 5 members. It is simply not possible to manage such a large number of advisory boards with up to 250 members in total. One approach we strongly urge the Fund to consider is to rely on a CDFI's SBA 7(a) lending designation as a means of assuring accountability to small business borrowers in eligible census tracts. The federal SBA 7(a) program was established to serve borrowers that Congress determined lack access to affordable credit and capital on reasonable terms, and, in particular minorities, women and veterans. It is a nationwide program. By its very existence, the SBA 7(a) program is a federal policy conclusion that small businesses meeting its eligibility requirements and seeking loans of $5 million or less lack access to credit and capital nationwide. In fact, the 7(a) loan application requires SBA lenders to document the borrower's inability to obtain credit elsewhere. This application requirement ensures that lenders remain accountable to the borrowers they serve by providing credit to small businesses that are unable to access capital from conventional financial institutions. An Urban Institute report commissioned in 2008 has confirmed that this provision is adhered to by lenders. [See - http://www.urban.org/UploadedPDF/411602_executive_summary.pdf]

III. Develop National Accountability Mechanisms for CDFIs Small Business Lenders Serving OTP Target Markets

We also believe the Fund should create national accountability mechanisms for CDFI small business lenders that seek to lend to Other Targeted Populations nationally. Adding an unspecified number of OTP representatives to an existing governing board can be difficult if the organization's by-laws include size limitations or other accountability obligations such as for tax-exempt status. We believe there may be more direct and effective ways to demonstrate accountability that could be applied to a national OTP Target Market. Specifically, we would encourage the CDFI Fund to again use the SBA 7(a) program as an accountability mechanism. The SBA has demonstrated that minorities, women and veterans are more likely to obtain a loan through its 7(a) program than in the conventional market. A second 2008 Urban Institute analysis of the 7(a) program[9] supports the fact that 7(a) is reaching these underserved borrowers. In addition, a 2013 Congressional Research Service analysis concludes that the program meets its goals.[10] Moreover, in December 2010, the SBA launched the Community Advantage Program, a pilot initiative aimed at increasing the number of 7(a) lenders reaching underserved communities by enlisting community-based, mission focused financial institutions such as CDFIs. The CDFI Fund actively encouraged CDFIs to participate in this program as outlined in a letter from Director Gambrell.[11]

[9] http://www.urban.org/UploadedPDF/411596_504_gap_analysis.pdf

[10] See http://www.fas.org/sgp/crs/misc/R41146.pdf

[11] Letter to CDFI partners from Donna J. Gambrell, Director of the Community Development Financial Institutions Fund, US Department of Treasury, March 25, 2011.

Like the Fund, the SBA requires Community Advantage (CA) Lenders to ensure that at least 60% of their CA loans are made in the CA underserved markets. The same approach could also be applied to CDFIs with a national SBA 7(a) license.

IV. Provide Guidance for Qualifying Small Business Loans Serving LITP Target Markets

Both the CDFI Fund's authorizing statute[12] and the regulations[13] clearly state that financial assistance provided by the Fund may be used by CDFIs "…to serve investment areas or targeted populations by developing or supporting businesses ***that provide jobs for low-income people or are owned by low-income people"*** (emphasis added). However, the regulations and the CDFI Fund's supplemental guidance are silent as to how a CDFI can qualify their loans as serving this Target Market. Unlike small business loans serving Investment Areas which can be geocoded using the Fund's mapping system, there is no approved methodology for CDFIs to verify their loans are benefitting a low income population. If CDFIs are certified to serve a LITP Target Market and are explicitly permitted to use Fund resources to make small business loans that support low income people, it would seem appropriate for the Fund to provide guidance on qualifying loans as serving this Target Market. Such guidance would better align certification Target Markets with eligible uses of Financial Assistance. It would also create consistency across the industry and remove uncertainty for CDFIs by establishing an approved set of protocols for ensuring their loans are serving their designated Target Market.

V. Explicitly permit the use of Multi-State or Regional Advisory Boards

When CDFIs expand their Investment Area Target Markets, they should not be required to create separate Advisory Boards for each new geographic unit or area. Adding multiple Advisory Boards becomes difficult to manage and can distract a CDFI from its lending activities and related services. **We would encourage the CDFI Fund to adopt the same approach applied to CDE applicants.**[14] CDEs may demonstrate their accountability to a multi-state or nationwide service area by appointing *"to its board a staff person or a board member from a "nationwide community development organization primarily serving Low Income Communities."* With the growth of the CDFI industry, more organizations are serving larger geographic areas and must have reasonable ways of creating advisory boards that reflect these broader service areas.

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[12] Public Law 103-325, Riegle Community Development and Regulatory Improvement Act of 1994, Section 108(b)(1)(B)

[13] 12 USC §4707(b)(1)(B)

[14] Question #26 of the CDFI Fund's CDE Certification Question and Answer guidance specifically addresses how a CDE can demonstrate accountability to Low Income Communities in its service area if it is serving a large geographic area (e.g., a state, a multi-state region or the entire nation)?
The Fund advises entities that serve a large geographic area should appoint at least one person that is accountable to LICs throughout the service area to its board or advisory board. For example, an organization serving the entire nation should appoint to its board a staff person or a board member from a nationwide community development organization primarily serving LICs.
An organization without at least one person on its governing board or advisory board(s) that can reasonably be deemed to be representative of LICs throughout the organization's service area may still be certified as a CDE, provided that the Fund determines that at least 20% of its governing board or advisory board(s) is representative of a cross-section (e.g., urban and rural) of LICs in its service area. Determinations regarding what constitutes a cross-section of a particular service area will be made on a case-by-case basis by the Fund. Organizations, particularly those serving multi-state geographies, may wish to establish multiple advisory boards in order to meet this requirement.

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CONCLUSION
We appreciate this opportunity to share our views and recommendations on the Interim Rule as well as the broader issue of accountability requirements for CDFI Certification. The CDFI brand is gaining greater recognition. It is critical that the certification framework should empower CDFIs to achieve their full potential to positively impact the people and places they serve and not hamstring CDFIs by restricting which low income communities and low income persons can benefit from their services. We urge the Fund to consider using the Interim Rule as an opportunity to address issues that continue to constrain CDFIs from successfully and sustainably competing in the Target Markets they serve. We believe this will enable them to fulfill their mission and that of the CDFI Fund.

We commend the CDFI Fund Staff for their efforts and would be please to answer any questions regarding comments included in this letter.

Sincerely,

Frank Altman
President and CEO

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March 10, 2017

Mr. David Meyer
Certification, Compliance Monitoring and Evaluation Manager
Community Development Financial Institutions Fund
1801 L Street, NW 6th floor
Washington, DC 20036

Submitted via email to cdfihelp@cdfi.treas.gov

RE: CDFI Fund Certification Policies and Procedures

Dear Mr. Meyer:

Community Reinvestment Fund, USA, appreciates the opportunity to provide our views on the CDFI Fund's current policies and procedures used to certify an organization as a Community Development Financial Institution (CDFI) as requested in the *Federal Register* on January 9, 2017. These policies and procedures are important to achieving the mission of the CDFI Fund as certification is the first step to accessing CDFI Fund programs and capacity building resources. However, during the past 23 years, the significance of certification has grown beyond mere eligibility for financial and technical assistance from the Fund. CDFI certification carries the imprimatur of strong community development mission enabling these organizations to not only participate, in other federal programs, but also to access private funding. Most notably, loans and investments in CDFIs are deemed eligible for consideration under the Community Reinvestment Act. Philanthropic institutions and increasingly private "impact" investors have come to rely on this designation as a sign that an organization has a true mission of and commitment to community development.

Overview

CRF is a national, market-driven nonprofit Community Development Financial Institution headquartered in Minneapolis, MN. We tap the capital markets to stimulate growth and job creation in economically challenged rural and urban areas across the country. We use the tools of Wall Street to accomplish our mission of empowering people to improve their lives and strengthen their communities through innovative financial solutions. Since 1988, CRF and its affiliates have delivered more than $2.2 billion in loans, investments and bonds located in more than 900 communities across the country. In partnership with over 200 local lending partners, we have funded more than 2,600 loans in 48 states and the District of Columbia. Working collaboratively with local lending partners, CRF has helped to improve the lives of more than 1.7 million people annually by financing small businesses, charter schools, health clinics, and community facilities; including more than 19,000 affordable housing units, and creating or retaining 79,000 living wage jobs.

CRF has been an innovator and a participant in a wide range of federal programs. CRF and its affiliate, National New Markets Tax Credit Fund, Inc. (NNMTCF) have become one of the largest New Markets Tax Credit (NMTC) Allocatees in the country, receiving tax credit allocations in seven of the ten funding rounds totaling more than $830 million and investing

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$52.5 million on behalf of other Allocatees, providing 393 NMTC loans to date. In 2013 CRF was selected as the first Qualified Issuer (QI) in the inaugural round of the CDFI Bond Guarantee Program. Since that time, CRF has issued four bond transactions on behalf of six CDFIs totaling $590 million.

With the contraction in bank lending to small businesses during the Great Recession, CRF sought to address the tremendous needs of underserved borrowers and firms located in distressed communities to access appropriate credit products. We obtained one of 14 national non-depository SBA 7(a) licenses to offer this government guaranteed loan product to borrowers unable to obtain conventional credit, typically small businesses located in low-income areas or those owned by women, people of color and/or veterans. Since launching our SBA 7(a) lending product, CRF has made more than 300 7(a) loans totaling $168 million helping to create or retain more than 5,900 jobs. CRF currently ranks among the top 100 SBA 7(a) lenders in the country.

Comments

CRF would like to thank the CDFI Fund staff for undertaking this review of its certification policies and procedures. This is an issue of particular importance to national CDFIs like CRF for several reasons. As a national organization employing a diverse set of lending and investment products and programs, we strongly support the Fund's stated goal of fostering "...a diversity of CDFI types, activities, and geographies, and to enable market-driven solutions to emerge in a constantly changing economic environment." The world into which CDFIs were born in 1994 has changed in almost every conceivable way. Not only has the number of CDFIs grown from nearly 200 to more than a thousand, but the types of financing products and services offered have expanded to virtually every corner of the financial services field. More importantly, the environment in which CDFIs operate has changed dramatically. Competition from other financial service providers has increased exponentially while the technology used to deliver products and services has undergone a transformation comparable to that which occurred during the Industrial Revolution. Today many potential borrowers seek funding online rather than through conventional institutions. To serve their customers, CDFIs must adopt new operating and business models, new technology tools, develop new partnerships and new ways of thinking about how to achieve their missions.

CDFI certification regulations and guidance – the very passport that allows these organizations to tap vital sources of public and private funding - has largely remained unchanged since the Fund was established. This review of the Fund's certification framework is critical if CDFIs are to be financially sustainable and create meaningful impact for the communities and populations they are committed to serving. Modernizing certification policies and procedures will enable the CDFI industry to define a path to scale. Without such a path it will be difficult – perhaps impossible - to make a difference in the lives of low-income people and places. We believe these policies and procedures can be reformed by creating opportunities for new organizations to become CDFIs ***without*** sacrificing primary mission.
We are pleased to share our comments and recommendations below on the questions included in the CDFI Fund's Request for information.

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Certification Criteria

Legal Entity
To satisfy the legal entity test, the CDFI Fund requires evidence of an Applicant's incorporation/organization/establishment, such as IRS documentation, establishing documents filed with appropriate authorities, or charter numbers for Insured Depository Institutions and Credit Unions at the time of certification application.

1. *The statute does not indicate how long an organization must be in existence to be considered a "person (other than an individual)." Should there be a minimum period of time an organization should be in existence before applying for CDFI certification? If so, how long? If not, why not?*

   In general, an Applicant should be in existence for at least one year before applying for CDFI certification. However, an exception should be made if an existing CDFI sets up a special purpose entity (SPE) and wishes to have this entity certified as a CDFI in order to participate in a federal program. For example, some CDFIs have expressed a need to establish an Affiliate that must also be certified as a CDFI in order for them to participate in the Bond Guarantee Program. The Fund has amended the certification regulation with respect to the financing entity test so as to allow the Affiliate CDFI to rely on the Controlling CDFI's track record in order to meet this test. We believe the requirement that an organization be in existence for one year should be waived for Applicants sponsored by a CDFI for purposes of participating in the BGP. There should be no waiting period for these Applicants as they are created for operational purposes to allow the sponsoring CDFI to access the BGP and therefore should be considered to have been in existence for the same amount of time as their sponsoring CDFI.

2. *Is there additional documentation beyond an organization's establishing documents filed with State jurisdictions that should be accepted to demonstrate that an organization is a legal entity?*

   Documents such as articles of incorporation filed with State jurisdictions seem to be the most reliable form of information to demonstrate that an organization is a legal entity. There may be other such documents, that we are not aware of, that would also be acceptable. Other commenters may provide alternative documentation that could be acceptable to the Fund.

Primary Mission
The statute states that a CDFI must have "a primary mission of promoting community development," but specifies few criteria for meeting that test. The CDFI Fund currently allows Applicants for certification to meet this test by providing board-approved organizational documents that demonstrate that the Applicant has a primary mission of promoting community development along with a narrative statement describing how the Applicant's mission is consistent with the CDFI Fund's and a brief description of Financial Products offered. Insured Credit Unions that have received a Low-income Designation from the National Credit Union Administration are deemed to have met this criterion by virtue of their designation.

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1. *Should the currently required board-approved documentation and narrative statement be sufficient to demonstrate an Applicant's primary mission, or should the CDFI Fund apply a more prescriptive primary mission test? For example, should the CDFI Fund provide a more explicit, possibly quantitative, definition of what it means to "promote community development" that Applicants would be required to meet? If so, what should be the definition and what test should be applied? Are there criteria that the CDFI Fund should not consider and why?*

   As noted in the RFI, the authorizing statute states that a CDFI must have a "primary mission of promoting community development" but offers no specific criteria as to what constitutes such a mission. We recognize this leaves open the opportunity for Applicants to document a mission of community development that may not be reflected in *all* the activities of the organization. Nevertheless, CRF sees potential danger should the CDFI Fund adopt a more explicit or quantitative definition of what it means to "promote community development."

   A foundational principle of the Fund was to encourage a wide range of organizations using a variety of strategies to promote community development in distressed communities and on behalf of historically underserved populations. Allowing Applicants to provide board-approved documentation and a narrative statement to demonstrate a primary mission of community development permits organizations the ability to choose how they wish to meet this requirement. This flexibility fosters innovation in business models, organizational structures and approaches to promoting community development. Imposing a more explicit or quantitative definition would have to take into account the needs of such diverse communities and populations, as well as the capacity of organizations serving these borrowers, making it virtually impossible to set a standard that could be applied to all Applicants.

   When determining whether an Applicant meets the primary mission test, the Fund assesses the authenticity of the organization's commitment to its mission rather than the quantity of its lending or investing activities. An Applicant's operating history may be useful in demonstrating its commitment to mission. However, this should not disqualify or be required for new entities so as to allow CDFIs to be established in communities or among populations where no such institution may exist. Applicants should be free to submit information, including the nature and volume of their lending and/or investment activities, but the Fund should not require Applicants to submit such information for purposes of meeting the primary mission test.

   Finally, given the power and the tremendous growth in the use of social media and the internet, it might be useful for the CDFI Fund staff to review an Applicant's online presence to ensure consistency between the organization's brand, its messaging and its stated mission of community development. Although, subjective in nature, a review of the Applicant's website, any social media campaigns, as well as how they present their brand online, could provide additional insights as to whether an Applicant has a primary mission of community development.

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2. *Should there be different standards for meeting the primary mission test for nonprofit versus for-profit organizations, particularly for for-profits that are not Insured Depository Institutions? If so, what different standards should be applied?*

   No, the same standards for the primary mission test should be applied to both nonprofit and for-profit organizations, regardless of whether the for-profit organization is an Insured Depository Institution. While there are far fewer non-depository for-profit certified CDFIs, we firmly believe that for-profit institutions can maintain a commitment to mission as well as their mandate to earn a profit. The emerging new forms of corporate governance, including B Corps, Low Profit Limited Liability Companies (L3Cs) demonstrates that mission and margin can successfully coexist. We are encouraged by the potential of these new innovative corporate structures to create better social and environmental outcomes for the people and places CDFIs serve.

3. *What evidence can the CDFI Fund use to confirm an Applicant's adherence to a stated community development mission? For example, how can the CDFI Fund distinguish between an organization that is fully committed to a community development mission and one that targets the same communities or populations as a CDFI and claims a community development mission, but whose practices do not demonstrate intent to create community development and/or are predatory in nature?*

   CRF wishes to thank the CDFI Fund for raising this very difficult but critical question. For the past 20 plus years, there has been relatively little concern about verifying or confirming an Applicant's stated community development mission. This situation changed with the dramatic growth of predatory home mortgage products that led to the bursting of the so-called "bubble" in the residential mortgage market. The financial crisis and the Great Recession that followed were devastating for low-income communities and their residents. Vast sums of wealth were stripped from families living in these communities who were largely people of color. This experience was a wake-up call for CDFIs on several fronts. They realized their customers had been targeted by large, well-resourced mortgage brokers and lenders with whom they simply could not compete. Not only were CDFIs powerless to prevent what was happening, but many of the borrowers victimized later arrived on our doorsteps looking for a way out of their predatory mortgage products. Many of these competitors were beyond the reach of regulators and free to offer products that were clearly unsafe for consumers. Subsequently, the Consumer Financial Protection Bureau was established and has taken steps to avoid such a crisis in the future.

   A parallel scenario is now playing out in the consumer and small business lending arena. The dramatic growth in online marketplace lending is filling the void left by traditional banking sector, which scaled back its small business lending in response to increased regulatory oversight and perceived concerns about risk. Financial technology ("fin tech)" firms have flooded the market fueled by an enormous influx of private equity/venture capital and the promise of double-digit returns[1]. Often these fintech firms are offering predatory loan products online to both small businesses and consumers while operating outside of any regulatory oversight. More and more borrowers, attracted by the speed and ease of accessing a small business or consumer loan from an online lender, are finding themselves saddled with multiple loans from these lenders that they are unable to repay. These customers are increasingly seeking help from CDFIs but in many cases it is too late to save the business.

The danger to CDFI customers is abundantly clear but these predatory lenders also pose a threat to the CDFI industry. Should an organization claiming to have a primary mission of community development be certified without actually adhering to such a mission, the value, the integrity and the very foundation of the CDFI industry could be put at risk. To avoid such a dangerous outcome, there are a number of steps the Fund might take to ensure that only Applicants with a true mission of community development receive the CDFI designation including, but not limited to:

- As discussed in #1 above, a review of marketing materials including, but not limited to, websites, social media campaigns, printed advertisements, or other collateral information available in the public domain could be conducted to affirm the Applicant's adherence to its stated mission. Such a review could be conducted at the discretion of staff or where concerns may exist.
- Where appropriate, requesting information on past operating history and practices from Applicants that have been in existence and can supply such information, showing the types of loans they offer, profiles of typical customers, and terms of their products. This may not be warranted in all circumstances as will be discussed in greater detail in #4 below and could be handled on a case by case basis.
- Thorough consideration of how the Applicant demonstrates and maintains accountability (discussed below) to its designated Target Markets can also shed light on whether an Applicant is truly committed to a mission of community development both rhetoric and its practices. An Applicant demonstrating effective mechanisms for accountability provides additional insurance that the Fund is certifying CDFIs with a proper mission of community development.

4. *To what extent should the CDFI Fund evaluate the Financial Products and/or Financial Services offered by an Applicant to determine its ability to meet the primary mission test? What test would the CDFI Fund apply in any such evaluation of Financial Products and/or Financial Services?*

Under most circumstances, the role of the CDFI Fund is not to evaluate the Financial Products and/or Financial Services offered by an Applicant for purposes of meeting the primary mission test. However, the explosion of new

[1]According to a 2015 survey conducted by Accenture, investments in "FinTech" (Financial Technology – the industry typically associated with marketplace lending) tripled from 2013 to 2014 moving from $4B to more than$12B respectively. Investors are citing the opportunity to earn double-digit returns in marketplace lending while often referencing the current lack of small business regulation as primary reason for investing.

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financial products and services, particularly in the residential mortgage, small business, and consumer credit markets has raised concerns about the ability of borrowers to make informed financial choices. While CDFIs pride themselves on providing access to responsible, transparent credit products coupled with development services that help borrowers to be successful, other credit providers, particularly online and marketplace lenders, offer products and services customers simply do not understand and often cannot afford. As noted above, if an organization engaged in predatory lending were to become a certified CDFI, this could profoundly harm the value and the integrity of the CDFI brand.

The CDFI Fund should have the ability to review or evaluate the financial products and/or services being offered by an Applicant to ensure such products and services are not predatory in nature, the terms of the products and /or services are fully and clearly disclosed, and the Applicant does not employ misleading or inappropriate marketing techniques. We understand the challenge lies in trying to establish a standard or test to apply when evaluating financial products and/or services. Clearly, this will require further research and discussion with industry participants but one model the Fund may wish to consider is the Small Business Borrowers Bill of Rights[2]. This bill, fashioned by a multifaceted coalition of organizations, including several CDFIs, defines responsible small business lending based on six fundamental financing principles that all small businesses deserve, and articulates lender and broker practices that uphold these principles. In more highly regulated areas, such as mortgage lending and consumer finance, the Fund could look to existing federal or state laws and regulations to serve as a guide for what is acceptable when evaluating similar products and /or services offered by an Applicant who falls outside the current regulatory framework.

5. *Currently, by statute, Depository Institution Holding Companies wishing to be certified as CDFIs must provide documentation that their parent, Subsidiaries, and Affiliate organizations collectively meet the primary mission test. Should the CDFI Fund also make this a requirement for Non-Regulated CDFIs, for example, a Non-Regulated for-profit financial institution? Why or why not?*

We don't see a need to require Non-Regulated CDFIs to document that their parent, Subsidiaries, and Affiliate organizations collectively meet the primary mission test. In fact, such a requirement might limit the ability of CDFIs to exploring new approaches to increasing the sustainability of their organizations. As it becomes more challenging to raise resources from foundations and government agencies, CDFIs need to adopt innovative financing strategies to support their operations and programmatic activities. Having several entities under the umbrella of a mission-driven CDFI parent could strengthen its financial well-being. Given the changing landscape for funding CDFIs (e.g. potential for significant reduction in federal resources for community development) and

[2] http://www.responsiblebusinesslending.org

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the growing emphasis on achieving self-sufficiency, the Fund should encourage CDFIs to develop creative funding structures and diversity their sources of financial support to scale their mission-driven activities. Furthermore requiring CDFIs to document that their parent, Subsidiaries, and Affiliate organizations collectively meet the primary mission test ignores a glaring oversight in the current certification regulations with regard to off balance sheet entities and activities. Under current regulations, CDFIs engaged in New Markets Tax Credit (NMTC) financing do ***not*** receive any consideration for these activities in terms of the Target Market test (addressed below), though they bring vital gap financing and significant community impact. Similarly, CDFIs may facilitate the flow of capital and credit to projects or programs without having their own capital at risk. For example, if an individual CDFI lacks the scale of capital to address a financing need but engages other financial institutions, like banks, to provide credit, the CDFI is strengthening the financial fabric of a community by helping borrowers to access conventional loans. CRF's initiative known as Detroit Home Mortgage (DHM) (http://www.detroithomemortgage.org) is just such an example. DHM is designed to address the appraisal gap in Detroit by working with five commercial banks to restart the conforming mortgage market in struggling neighborhoods throughout the city. Under this program, homeowners receive two loans – a conforming first mortgage and a second mortgage – to fund rehabilitation of a home. CRF conceived and launched this initiative. We manage the fund holding the second mortgages. Although we raised grant dollars for DHM, the scale of this operation far exceeds our balance sheet. Unlocking conventional bank financing was the key to success, yet our efforts and the sweat equity we invested are not counted towards our overall CDFI Target Market activities.

When the CDFI Fund was established, it was designed to support the model of a community-based organization serving a local market. As the industry has matured, CDFIs realize that to truly "move the needle" in terms of community impact, they must be able to reach into the capital markets, leverage the balance sheets of larger institutions and utilize technology to facilitate the flow of resources to low-income communities. The role of capital facilitator will become increasingly important if we are to bring about meaningful improvement for the people and places we serve. The Fund should find ways to encourage and recognize this new role for CDFIs, not constrain innovative financing strategies that emerge as CDFIs grapple with a declining pool of public funding sources.

Financing Entity
Insured Depository Institutions and Credit Unions are deemed to automatically meet this criterion. Non-Regulated CDFIs must demonstrate that they engage in direct financial activity (e.g., the provision of Financial Products, Financial Services, and Development Services) as reflected on financial statements and executed notes, and must dedicate a predominance of their assets to Financial Products, Development Services, and/or similar financing.

1. *The CDFI Fund does not currently define the term "predominance," but in practice accepts a plurality of assets as meeting this criterion. Should the term "predominance" be defined more specifically, and if so, how?*

While the CDFI Fund's practice of defining the term "predominance" as a plurality of assets may be less precise than some might like, this definition has afforded CDFIs needed flexibility for the purposes of meeting the

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Financing Entity test. The CDFI Fund uses the Asset Allocation Table contained in Attachment A – the data portion of the CDFI Certification Application to verify that an Applicant is dedicating a "predominance" of their assets to Financial Products, Development Services, and/or similar financing. Our understanding has been that the Fund wants to see that 51% or more of an Applicant's total assets are dedicated to financing products and related activities (including Development Services). This may be informal guidance but it led us to believe that Applicants/CDFIs were expected to dedicate the majority of their financial and technical assistance resources to financing and similarly related activities. The danger in defining the term "predominance" more precisely is that it could limit the Fund's discretion when certifying new or existing CDFIs. The strength of the certification process was that it allowed for a dialogue between the Applicant and the staff to discuss the unique structure and operational aspects of individual CDFIs.

The bigger concern we have is that the volume of CDFIs' off balance sheet activities has been increasing in recent years as these organizations utilize a variety of complex financing products and programs. For example, at the time the Fund was established the only major tax credit program available for community development was the Low-income Housing Tax Credit (LIHTC). Since that time, the New Market Tax Credit program has become a successful tool used by CDFIs to finance high impact projects in communities across the country. CDFIs marshal public and private resources in a variety of ways. Often their financing activities are conducted off balance sheet for tax, legal, or liquidity reasons. Yet these activities are clearly related business lines of the CDFI. Excluding off balance sheet activities does not present a full picture of the Applicant or CDFI as a financing entity. They should be allowed to count these assets for the purposes of this test, not penalized because of balance sheet constraints. We strongly urge the CDFI Fund to permit the inclusion of off balance sheet financing activities (including, but not limited to, New Markets Tax Credit, Low-income Housing Tax Credits, other tax credit transactions as warranted) conducted through Special Purpose Entities (SPEs) and other off balance sheet vehicles so these important financing activities are taken into account.

2. *Should entities that provide less than a plurality of financing activity ever be considered Financing Entities? If so, under what circumstances and is there a minimum level of activity that should be required?*

   Under limited circumstances, entities with less than a plurality of their assets dedicated to financing activity may be considered Financing Activities. One such scenario might involve newly launched or start-up organizations seeking certification with the understanding that the Applicant would achieve a plurality of financing activity within specified time period. A limited degree of latitude should be provided to the CDFI Fund as there may be unanticipated situations where it would be appropriate to waive this requirement for some period of time.

3. *Currently, the amount of assets and staff time dedicated to financing activities are used to measure the level of a CDFI's financing activity. How else could a CDFI's level of financing activity be measured?*

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CRF believes there are alternative ways to measure the level of a CDFI's financing activity beyond the amount of its assets and staff time dedicated to such activities. For example, the CDFI Fund could take a "portfolio" approach to evaluating a CDFI's level of financing activity. This approach would take into consideration all of a CDFI's financing activities both on-balance sheet and off-balance sheet. As noted above in Q #1 and in Q #5 in the Primary Mission section, there should be a way for CDFIs to report on financing activities they *facilitated* – meaning without their involvement financing would not have been provided – but where they did not invest their own capital in the transaction. Thus a CDFI would be measured based on their "portfolio" of financing activities some of which involve direct investment of their own capital and, in other instances, where they invested their efforts in *securing* capital but the resources did not come from their balance sheet.

4. *For Non-Regulated CDFIs, is the current "predominance of assets" test appropriate, or should alternatives or additional considerations be permitted?*

   In general, the same standard of "predominance of assets" should be applied to both Regulated and Non-Regulated CDFIs. All types of CDFIs should be subject to the same standards.

5. *Should Non-Regulated CDFIs be permitted to include the financing or Financial Services activity of a mission-driven Subsidiary as part of the assessment of the parent CDFI's financing activities?*

   Yes, we support the comments of the CDFI Coalition on this question.

6. *Should Non-Regulated CDFIs be permitted to rely upon the financing or Financial Services activity of a parent CDFI as part of the assessment of the Subsidiary's or Affiliate's financing activities?*

   Yes, in certain circumstances Non-regulated CDFIs should be permitted to rely upon the financing activities or Financial Services activity of a parent CDFI as part of the assessment of the Subsidiary's or Affiliate's financing activities. For example, we support the CDFI Fund modification to the certification criteria in April 2015 through an interim rule that permitted an Affiliate of an Eligible CDFI to rely on the Controlling or parent CDFI's track record to meet the Financing Entity test for the purposes of participating in the CDFI Bond Guarantee Program. In this case, an Affiliate of an Eligible CDFI engaged in the CDFI Bond Guarantee program may utilize the activities of its parent CDFI to comply with the Financing Entity requirement for certification. We assume this modification under the Interim Rule remains in place and does not require further action.

7. *Should an organization applying for CDFI certification be required to transact a minimum number or dollar amount of loan or equity investments to be considered a financing entity? Should the Applicant be required to have at least one or more years of loan or equity investment origination? If so, what should those rules be?*

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An organization applying for CDFI certification should be required to transact a minimum number but not dollar amount of loan or equity investments to be considered a Financing Entity. The expectation has been that an organization seeking to become a CDFI should demonstrate its ability to make loans or investments. While there has been no formal minimum number of transactions, it was generally understood that an Applicant should have completed about six loans or investments as evidence of its capacity to extend credit or capital. The CDFI Fund's *Supplemental Guidance and Tips to the CDFI Fund Certification Application* (Updated through February 2014) states on page 17, "An organization that is not a regulated entity must demonstrate that it has begun to use its own capital to provide Financial Products to non-affiliated entities. In general, to be deemed to have begun the use of 'its own capital,' the organization must have closed an appropriate number of transactions within the specified time period to demonstrate that it is in regular operation. In determining the appropriate number of transactions, the CDFI Fund, in its sole discretion, may consider a variety of factors."

We support preserving the CDFI Fund's discretion to determine the appropriate number of transactions an Applicant must complete to show it is in regular operation. CDFIs engage in different types of lending and investing activities and close vastly different numbers of transactions based on the nature of those activities. A CDFI micro-lender typically makes more loans in a given year than a CDFI making venture capital investments. In addition, launching a new CDFI requires a ramp up period when only a few loans or investments may be made. However existing organizations seeking certification may have a much larger number of loans or investments to demonstrate their operational capabilities. There may be instances when it would be beneficial for the CDFI Fund to certify organizations that have not been originating loans or investments for at least a year, such as in the case of communities affected by a natural disaster. Therefore, the Fund should have the ability to exercise discretion when certifying early stage organizations.

On a related note, the Fund should clearly define what is meant by a CDFI's "own capital". All CDFIs receive loans from banks or other funders which they use to make loans to borrowers in their Target Market(s). Often times, banks seeking to meet their Community Reinvestment Act (CRA) requirements provide resources to CDFIs because they have expertise in lending to low-income communities and people. If the capital CDFIs are utilizing comes from financial institutions, foundations, or government sources, can they claim they are truly using their "own capital"? This raises the question of whose capital are CDFIs really using and how long must resources reside on a CDFI's balance sheet in order to be deemed its "own capital"?

Many companies outsource major parts of their business to other firms that have a specific expertise creating networks to more efficiently produce goods and services. Similarly, many in the CDFI industry have begun to embrace the concept of financial networks to increase the scale, productivity and impact of our lending activities. Just as in the case of off balance sheet financing activities discussed above, if CDFIs were to implement lending or financial networks to more effectively deploy capital, where one CDFI might originate a loan using the capital of another organization (which may or may not be a CDFI), would such an approach run afoul of the requirement to deploy one's "own capital"? Would using a networked approach jeopardize a CDFI's certification status or

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prevent an Applicant from being certified as a CDFI, even though breaking up aspects of the lending function might produce a more sustainable CDFI industry and ultimately better outcomes for borrowers and communities? We believe these questions warrant further consideration by the CDFI Fund and discussion with industry participants.

8. *Should an organization that only services loans or Equity Investments or has very few transactions be considered a financing entity?*

In our view, an organization that only services loans or Equity Investments should not be considered a Financing Entity nor should one that has only made a very small number of transactions. While we are not comfortable prescribing a specific volume of lending or investing activity as requirement or threshold for certification, there are some fundamental characteristics of a CDFI. The organization should be engaged in lending and investing on an ongoing basis and while the number of transactions may vary over time and under different economic conditions, there should be a reasonable prospect that the entity will be actively extending its own credit or capital. Simply servicing the loans of another lending organization should not qualify an Application to become a CDFI.

9. *Should certified CDFIs be required to offer loans or Equity Investments each year, in order to maintain certification status?*

Except dire circumstances, such as the financial crisis and the Great Recession, it is reasonable to expect that CDFIs will be offering loans and Equity Investments each year. Like any other lender, CDFIs may decide to expand or contract their suite of credit products in response to market demand or need. Introducing a new financial product or service or discontinuing an offering will reduce origination volume in a given year. There may be periods during which a CDFI suspends its lending or investing activities due to risk or other market factors. The CDFI Fund should exercise its judgment rather than imposing an annual origination requirement for certified CDFIs. Moreover, we urge the Fund to provide a reasonable grace or cure period before revoking a CDFI's certification. A CDFI in this situation should be permitted to engage in a dialogue with CDFI Fund staff to explain the reasons why it has suspended its lending or investing activities.

10. *Currently, non-arms-length transactions do not contribute to meeting the financing entity criteria. For example, transactions made with Subsidiaries and/or Affiliates are not considered to be arms-length transactions. Should some transactions with Affiliates be permissible as evidence of an organization being a financing entity? If so, which ones? How should an "arms-length transaction" be defined?*

No comment.

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11. *Should Applicants be required to disclose the expected amount and types of lending that may be made to Affiliates and Insiders in their certification applications? Should such transactions be limited as a condition of certification? Why or why not?*

    No comment.

12. *Current CDFI Program regulations use the term "similar financing activities" in its definition of the term "Financial Products." How should the CDFI Fund determine what is included in "similar financing activities?"*

    This phrase was most likely intended to provide the Fund with the option capture financing activities that it had not considered when the certification framework was first established. As the community development field has evolved and become more sophisticated, CDFIs adapted conventional financing products to suit their customers' needs or created new ones altogether. One set of financing activities we believe should be included in "similar financing activities" are those attributed to CDFI Intermediaries. Specifically, placing deposits in certified CDFI credit unions or banks, making loans or providing guarantees to other certified CDFIs, or other means of extending credit or supplying liquidity to certified CDFIs should be included in this category.

    It is also important to preserve the Fund's ability to expand the definition of "similar financing activities" so that CDFIs are encouraged to innovate and deploy new products. Community development borrowers deserve access to as wide an array of responsible products and services as possible. The certification criteria should reflect the dynamic nature of financing activities and ensure that CDFIs are not restricted to antiquated tools due to an outmoded framework.

Target Market

Threshold Target Market Test: Although no threshold level of service is indicated in the statute or regulation, current CDFI Fund policy requires that an organization must serve at least one eligible Target Market and must direct at least 60 percent of all of its Financial Product activities to one or more eligible Target Market to qualify for certification. In general, both the number and dollar amount of the organization's Financial Product activities should be at least 60 percent of all of its Financial Product activities in the most recent fiscal year. If an organization does not meet the 60 percent threshold in terms of either number or dollar amount of transactions (but not both), the organization can provide an argument as to why the figure is less than 60 percent and the CDFI Fund reserves the right to accept or reject the explanation.

1. *Is the current standard that 60 percent of a CDFI's Financial Product activities must be in qualified Target Markets the right standard? If not, what percentage of transactions should be in and/or to a qualified Target Market to demonstrate that an organization serves that Target Market and why?*

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The current 60 percent standard for the volume of a CDFI's Financial Product activities deployed in qualified Target Markets is appropriate and should be maintained. However, the standard has worked well because of the latitude afforded the Fund when applying this standard to individual CDFIs. As noted in the preamble to this section, while CDFIs are generally required to extend 60 percent of both the number and dollar amount of their lending and/or investing activities in eligible Target Markets, if a CDFI does not meet the threshold in either the number or dollar amount (but not both), the Fund may accept an explanation as to why this situation has occurred and thus deem the CDFI to be in compliance with its certification requirements. This flexibility is crucial for CDFIs that make a large number of small loans (such as small business loans) as well as a small number of large loans (like multi-family affordable housing loans). A CDFI with this type of product mix may be able to meet the 60 percent test based on the dollar volume of its lending activities but not on the basis of the number of its loans.

We wish to reiterate the recommendation proposed in Q #1 of the Financing Entity section that CDFIs be permitted to count their off balance sheet financing activities, and specifically their NMTC transactions, towards the 60 percent threshold. CDFIs use these financing programs to complement their other lending/investing activities. They are clearly mission-aligned lines of business. Excluding off balance sheet activities does not present a full picture of how the Applicant or CDFI is serving its Target Market(s). They should be allowed to include these assets for the purposes of the 60 percent test, rather than being penalized for choosing to use tax credits or other off balance sheet strategies to meet their borrowers' financing needs. We strongly recommend that the CDFI Fund allow CDFIs to include NMTC and other similar off balance sheet financing activities conducted through Special Purpose Entities (SPEs) and similar vehicles so these important financing activities are taken into account under the Target Market test.

2. *Should there be different thresholds for different institution types (i.e., Insured Depository Institutions and Credit Unions, nonprofit loan funds, and venture capital funds)?*

   No, a uniform threshold should be provided across all types of CDFIs regardless of the type of institution. This standard has worked well in the past and should remain in place.

3. *The CDFI Fund currently relies on self-reported summary data submitted by Applicants to demonstrate that they meet the Target Market threshold test. Should statistical sampling of transactions be required to establish a current baseline of activity and document the Target Markets that they are serving?*

   It is not clear why the CDFI Fund is raising the question of whether to make statistical sampling of transactions required and therefore, we have no comment.

4. *The August 31, 2015 Interim CDFI Program Regulations added the provision of Financial Services as a means of demonstrating that an applicant serves a Target Market. However, the CDFI Fund does not currently have a*

method of recognizing or applying the provision of Financial Services toward the current 60 percent threshold test for certification. In addition to the level of Financial Products provided by an Applicant, how should an Applicant receive credit for the provision of Financial Services toward meeting any threshold test? How should this be measured? If an Applicant requests credit for providing Financial Services, should there be a separate minimum level of Financial Products that must be provided by the Applicant?

CRF does not offer Financial Services as defined by the CDFI Fund and has no comment on this question.

5. *The CDFI Fund currently first considers an Applicant's financial activity during its most recent fiscal year in determining whether it meets the threshold test. Is this the appropriate time period to consider, or should a longer period of time be considered? If so, should the Applicant be required to meet the threshold in each year of the test, for a time period, or should an average be considered? Should the CDFI Fund consider an Applicant's portfolio of loans outstanding?*

   The CDFI Fund should consider a 3 year rolling average of a CDFI's financial activity to determine whether it meets the threshold test. Normal variations in lending activity occur and major disruptions such as the Great Recession make it difficult to apply this test to a single year of financing activity.

   We also recommend that the CDFI Fund reinstate its policy of recertifying CDFIs every three years as annual certification presents a significant burden for many, especially smaller, CDFIs. At the very least, the Fund should consider recertifying CDFIs every two years so as to reduce this challenging reporting requirement.

Investment Areas: The statute requires that an Investment Area must meet at least one of the economic distress criteria (poverty rate greater than 20 percent; Median Family Income (MFI) at 80 percent or below specific MFI benchmarks; unemployment rate 1.5 times the national average) and has significant unmet needs for Financial Products and Services, or is wholly located within an Empowerment Zone or Enterprise Community.

1. *The CDFI Fund's current practice is to define Investment Areas that are composed of one or more units of geography that meet certain distress criteria. Units include but are not limited to counties, census tracts, and Indian Reservations. Should the CDFI Fund change this practice? If so, how?*

   In our view, the CDFI Fund's definition of Investment Areas is outmoded and potentially harmful to its mission in light of the profound changes taking place in certain markets. The small business lending arena is a prime example of why the Investment Area definition is too narrow. This market has undergone a major shift in new technology and delivery systems that are revolutionizing how small businesses obtain loans. Speed and ease of access are propelling the growth of national online and market-place lenders. Although the lion's share of small business credit is still provided by depository institutions, a new generation of customers raised on video games and comfortable operating on their smart phones could ultimately make conventional lenders obsolete.

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CRF has always had a business model of delivering small business and other financing products to borrowers in low-income communities across the country. We firmly believe the future of small business lending in all communities and among all types of borrowers, including those unable to access traditional forms of credit, lies in meeting small business owners where they are while providing responsible loan products through a process that is seamless, simple, and fast. In the wake of the financial crisis, we became one of three CDFIs with a national SBA 7(a) license. We quickly discovered the enormous pent up demand for small business loans as banks retreated from this market, especially for loans below $1 million. As a CDFI, our mission is to empower borrowers through innovative financing solutions. Just like the internet, our borrowers know no geographic boundaries. Even with an expanded set of states comprising our Investment Area Target Markets, we clearly see a compelling need for a National Investment Area (IA) Target Market designation. We address this need and how the CDFI Fund can properly implement such a Target Market in the National Target Markets question below as well as in the Accountability section of this comment letter.

2. *Currently the CDFI Fund allows Investment Areas to be composed of a set of contiguous geographic units that may include a small portion of units that individually do not qualify as Investment Areas. Should the CDFI Fund continue this practice, or should all units within the Investment Area meet the Investment Area qualifications?*

   The CDFI Fund should continue the practice of allowing a set of contiguous geographic units to qualify as Investment Areas even if they include a small portion of units that individually do not qualify. Contiguous geographic units often share a lack of private capital investment even though a business on one side of a street is in an eligible census tract while another on the other side of the street is not.

<u>Targeted Populations</u>: Targeted Populations include Low-Income Targeted Populations (LITP) and Other Targeted Populations (OTP) for a specific geographic unit. LITP, for a specified geographic unit, by statute includes individuals whose family income (adjusted for family size) is 80 percent of the area MFI (for metropolitan areas). LITP in non-Metropolitan Areas is the greater of 80 percent of the area MFI; or 80 percent of the statewide non-Metropolitan Area MFI. The CDFI Fund currently includes, for a specific geographic unit(s), African-Americans, Hispanics, Native Americans, Native Alaskans, Native Hawaiians, and Other Pacific Islanders among the groups automatically considered eligible for an OTP Target Market. Applicants are permitted to seek OTP recognition for other populations by demonstrating that the group lacks access to capital.

1. *Should the Targeted Populations be expanded to automatically accept more specifically defined Other Targeted Populations that are eligible for other Federal programs that support economic development in Low-Income communities? If so, which ones and why?*

   The CDFI should automatically expand the definition of OTP to match those that are eligible for other Federal programs that support economic development in Low-Income communities. As we have suggested in an earlier

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comment letter[3] the demographics of small business owners in this country are changing, especially in low-income communities and for underserved borrowers. As more and more CDFIs offer SBA products, accepting a broader definition of OTP will facilitate greater use of mutually reinforcing programs.

We urge the CDFI Fund to align its definition of OTP with what the SBA deems to be a "minority-owned" or "socially disadvantaged" firm. Under the Minority Small Business and Capital Ownership Development program, also known as the 8(a) Business Development (BD) program, individuals who are members of the following groups are deemed to be "socially disadvantaged" based on the fact they have been subject to "racial or ethnic prejudice or cultural bias within American society because of their identities as members of groups and without regard to their individual qualities": Black Americans; Hispanic Americans; Native Americans (American Indians, Eskimos, Aleuts, or Native Hawaiians); Asian Pacific Americans (persons with origins from Burma, Thailand, Malaysia, Indonesia, Singapore, Brunei, Japan, China (including Hong Kong), Taiwan, Laos, Cambodia (Kampuchea), Vietnam, Korea, The Philippines, U.S. Trust Territory of the Pacific Islands (Republic of Palau), Republic of the Marshall Islands, Federated States of Micronesia, the Commonwealth of the Northern Mariana Islands, Guam, Samoa, Macao, Fiji, Tonga, Kiribati, Tuvalu, or Nauru); Subcontinent Asian Americans (persons with origins from India, Pakistan, Bangladesh, Sri Lanka, Bhutan, the Maldives Islands or Nepal) (13CFR 124 §124.103).

As the SBA has determined individuals in these racial, cultural, and ethnic groups face discrimination affecting their ability to access credit, we also request that CDFIs be certified to serve Target Markets using this expanded definition of OTP without having to undertake additional research or producing further studies documenting that these individuals lack access to affordable credit.

2. *CDFIs currently are approved to serve Targeted Populations within a defined geographic unit at below and up to a national level. Should all Applicants proposing to serve Targeted Populations be approved to serve such Target Markets nationally?*

CDFIs approved to serve Targeted Populations should not be automatically approved to serve such Target Markets nationally. As a national CDFI, we believe an organization should make an intentional decision to serve a national Target Market(s). Therefore, a CDFI's business model, operational strategies and capabilities should reflect a national focus. These organizations should specifically request national certification and demonstrate their ability to serve such a market to the Fund. Similarly, CDFIs wishing to serve one or more states should be allowed to do so assuming they can demonstrate their capability to serve a statewide or multi-state market.

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[3] See CRF's Comment Letter on the CDFI Fund's Annual Certification and Data Collection Report Form, September 8, 2014.

National Target Markets: Currently, in order to be certified with a Target Market national in geographic scope, CDFIs need to show that they have conducted their financing activities broadly across the variously defined regions of the country, (e.g. Northeast, West, Midwest, South, Southeast, etc.).

1. *Given that it is unlikely that most CDFIs that work broadly across the nation will complete transactions in every State every year, how can organizations demonstrate that they serve a national Target Market, whether for an Investment Area or for a Targeted Population? Should there be a certain minimum geographic dispersion of actual investments?*

   During the course of our 28 year history, CRF has extended credit in 48 states and the District of Columbia. We agree, it is highly unlikely that a CDFI will complete transactions in every state each year. The volume of CDFI lending activities is not large enough to achieve this level of geographic dispersion in such a short time. However, as an active small business lender, we strongly believe CDFIs, like any other lender or investor, need to be able to respond to demand in their Target Market(s).

   If an Applicant or existing CDFI requests National Target Market certification, and can demonstrate both the intent and capacity to serve such a Market either by virtue of its historical track record of making geographically dispersed loans or investments, or through some other means acceptable to the Fund, then such an Applicant/ CDFI should be granted national certification. Depending on how long the Applicant/CDFI has been in operation, a minimum geographic dispersion of actual loans or investments might consist of transactions in more than a specified number of states. Traditionally, when considering an application for national certification, the CDFI Fund has looked for loans/investments in groups of states including: the northeast, southeast, south central states, north central states, northwest, and the south west. We strongly encourage the Fund to consider an Applicant's or CDFI's entire portfolio of loans over time as evidence of its ability and willingness to make loans/investments on a national basis. An Applicant or CDFI should not be penalized for lack of loans or investments in a given state or states in a particular year, as this may reflect lack of demand for credit during a certain period of time.

2. *Some CDFIs serve multiple markets that are part of a multi-State region or are comprised of geographically unconnected markets. When should the CDFI Fund recognize these practices as constituting a national Target Market?*

   As noted in our comments above (Targeted Populations Q #2), CDFIs seeking national Target Market certification should make an intentional decision to serve such a market and this decision should be clearly reflected in their business model, the operational structure and the organizational goals. We do not believe the CDFI Fund should make a determination about whether a CDFI serving multiple markets should be deemed to be serving a national Target Market.

Additional Recommendations on Target Markets:
The Fund should be permitted to certify Applicants and / or CDFIs Investment Areas and Targeted Populations before they have made a loan or investment in the requested Target Market. This requirement prevents new Applicants and existing CDFIs from entering new Target Markets and limits their ability to bring valuable products and services to underserved areas and individuals. It is an artificial cap on CDFI growth and impact. Instead Applicants and / or CDFIs should be asked to demonstrate through plans (e.g. business, marketing, or strategic plans), partnerships, research, or outreach activities they have conducted, as well as past expansion efforts, their intent and capacity to deliver financing products and / or services in a new Target Market(s).

Development Services
A CDFI directly, through an Affiliate, or through a contract with another provider, must have a track record of providing Development Services in conjunction with its Financial Products and/or Financial Services. Development Services means activities undertaken by a CDFI, its Affiliate or contractor that promote community development and shall prepare or assist current or potential borrowers or investees to use the CDFI's Financial Products or Financial Services. For example, such activities include, but are not limited to, financial or credit counseling; homeownership counseling; and business planning and management assistance.

1. *Should the CDFI Fund more explicitly define Development Services? If so, how should it be defined?*

   The CDFI Fund should create a new category of Development Services comprised of services to other CDFIs. This new category would include loan servicing, contract underwriting, technology and other services that build or enhance the capacity of mission-aligned lenders including, but not limited to, CDFIs, public and/or private nonprofit organizations lending or investing in low-income communities or to low-income or disadvantaged populations. This new category draws on the approach described above (Financing Entity Q # 7) as to how financial networks or in this case, value exchange networks, might increase the scale, financial sustainability and community development impact of the CDFI industry. In a value exchange network, one CDFI provides services to another CDFI (or mission-aligned organization) enabling the recipient organization to be more effective in their community development lending or investing activities. Examples of CDFIs offering such services include: Pacific Community Ventures' national online business advisory services platform (https://businessadvising.org/) and its impact evaluation service (*Insight*); Reinvestment Fund's data service (Policy Map); or CRF's high touch contract loan servicing function that currently services 6700 loans totaling $1.2 billion on behalf of 52 organizations. We provide this service so that smaller CDFIs and nonprofits unable to make the necessary financial investments in infrastructure, technology and staffing have access to a high quality loan servicing platform. This service allows mission-driven lenders to focus on what they do best, making loans to low-income borrowers and projects and improves outcomes for their borrowers by providing loan servicing that is sensitive to their needs.
   Development Services have evolved since the CDFI Fund was established. The Fund should expand the definition of Development Services by creating a new category to encompass high value services that improves the productivity and multiplies the impact of CDFIs and other nonprofit, mission-aligned lenders. We welcome a

dialogue with CDFI Fund staff, as well as industry participants, to capture and more clearly define these services and how they might be accounted for as a new category of Development Services.

2. *Should the CDFI Fund require CDFIs to provide a corresponding Development Service for each Financial Product and Financial Service?*

   CDFIs should *not* be required to provide corresponding Development Services for each Financial Product or Service offered. CDFIs should be accorded the flexibility to provide Development Services based on their business model, their evaluation of the market need as well as that of individual borrowers. Some borrowers may require such services and some may not. Moreover, under existing certification regulations, Development Services *do not* have to be offered by the CDFI itself, but may be provided by a third party contractor. How and what types of Development Services are made available to customers in conjunction with a CDFI's Financial Products or Services should remain at the discretion of the CDFI with the expertise to evaluate whether a borrower needs services and which ones will best meet their needs.

3. *Should a certified CDFI be required to offer each Development Service each year to maintain certification status?*

   Requiring a CDFI to offer Development Services each year to maintain certification status seems highly prescriptive and contrary to the definition of a CDFI. Instead, the Fund should look to the intent and capacity of a CDFI to offer Development Services. Through the recertification process, the Fund has the ability to monitor the Development Services offerings of a CDFI. Should the Fund have concerns that a CDFI is failing to comply with this test, it has the option of entering into a dialogue with the CDFI and/or to take specific steps to remedy the situation. Ultimately, the Fund has the ability to decertify or not renew the certification of any CDFI it believes no longer meets the requirements set out in the regulations and accompanying guidance.

Accountability
The CDFI Fund currently requires that a CDFI maintain accountability to its Target Market through representation on its governing board and/or advisory boards. Prior to recent changes in the regulation, a CDFI could demonstrate accountability through other mechanisms such as focus groups, community meeting, and/or customer surveys.

1. *What percentage of a CDFI's board members should satisfy accountability rules? Should different percentages apply to different types of boards, i.e. governing vs. advisory boards?*

   CRF believes a CDFI should maintain accountability to its Target Market(s) through its governing board. Governing boards have responsibility for overseeing the operations of a CDFI and therefore have the ability to hold the organization accountable to its Target Market(s). We fully support the use of other accountability mechanisms (as discussed below) to complement or supplement the role of the governing board in ensuring a CDFI is responsive to the needs of borrowers in its Target Market(s). CDFIs should be allowed to establish

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advisory boards if they wish to gain additional understanding and insights as to the credit and capital needs in its Target Market(s) but their ability to ensure an organization is complying with the accountability test is far more limited than that of a governing board.

As to what percentage of a CDFI's board members are needed to satisfy accountability rules, we agree with the comments of the CDFI Coalition's Memorandum to Director Donovan[4], which urge the CDFI Fund to adopt the approach applied to the certification of CDE applicants for both advisory and governing boards. To be a certified CDE 20 percent of the governing or advisory board members must be accountable and can be accountable to larger geographic areas.[5] For CDE certification, a governing or advisory board member can be "an employee or board member of a non-affiliated community-based or charitable organization that provides more than 50 percent of its activities or services to Low-Income Persons and/or LICs [Low-income Communities][6].

2. *Is representation on an advisory board sufficient to demonstrate accountability?*

   As we noted in Q #1 directly above, we do not view advisory boards as sufficient to demonstrate accountability. They may be used to augment the accountability provided by a CDFI's governing board but should not be relied on in and of themselves to ensure accountability.

3. *Should CDFIs be able to demonstrate accountability through means other than board membership? If so, how?*

   Again as noted above, we believe governing boards should be the primary mechanism through which CDFIs demonstrate accountability to their Target Markets. That said, CDFIs should be accorded flexibility if they chose to augment or supplement this primary mechanism with other methods of maintaining accountability, especially if they have multiple Target Markets. As we explained in our comment letter on the CDFI Fund's Interim Rule[7], we

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[4] CDFI Coalition, pg. 9.

[5] In the Fund's CDE Certification Question and Answer guidance, the Fund directly addresses having board members accountable to large regions or nationwide: "**26) How do I demonstrate accountability to LICs in my service area if I am serving a large geographic area (e.g., a state, a multi-state region or the entire nation)?** The Fund advises entities that serve a large geographic area should appoint at least one person that is accountable to LICs throughout the service area to its board or advisory board. For example, an organization serving the entire nation should appoint to its board a staff person or a board member from a nationwide community development organization primarily serving LICs. An organization without at least one person on its governing board or advisory board(s) that can reasonably be deemed to be representative of LICs throughout the organization's service area may still be certified as a CDE, provided that the Fund determines that at least 20% of its governing board or advisory board(s) is representative of a cross-section (e.g., urban and rural) of LICs in its service area. Determinations regarding what constitutes a cross-section of a particular service area will be made on a case-by-case basis by the Fund. Organizations, particularly those serving multi-state geographies, may wish to establish multiple advisory boards in order to meet this requirement."

[6] CDE Certification Board Table pdf, available on the CDFI Fund's websites at https://www.cdfifund.gov/programs-training/certification/cde/Pages/default.aspx .

[7] CRF, October 26, 2015.

were disappointed by the Fund's decision to eliminate the use of several accountability mechanisms including community meetings, focus groups, and customer surveys. This change significantly reduced the options available to CDFIs to strengthen their accountability resources.

We respectfully recommend that the Fund:

a) Reinstate the use of community meetings, focus groups, and customer surveys and work with the CDFI industry to address past shortcomings associated with these accountability mechanisms. We see great potential for all three of these methods given the rise of virtual communities and new channels for communication. These alternative mechanisms can be adapted for an online environment making it easier to gather information from participants anywhere in the country in real time. For example, the Federal Reserve Bank of Cleveland published a study of how small business owners view online alternative lenders and their credit products using online focus groups. These focus groups took the form of online discussions that allowed a geographically diverse group of small business owners to share their perceptions of online lenders and to evaluate mock loan products by visiting lenders' websites.[8] This study demonstrates how alternative accountability mechanisms adapted for an online environment are extremely well suited to capturing information that could help CDFIs demonstrate even *greater* accountability and responsiveness to small business owners in their Target Markets, particularly if those Target Markets encompass large geographic areas. In addition, online focus groups, community meetings, and/or surveys provide a direct connection to borrowers in their Target Markets.

b) Permit the use of alternative mechanisms. Specifically, we strongly urge the Fund to consider relying on a CDFI's SBA 7(a) lending designation as a means of assuring accountability to small business borrowers in eligible Investment Area census tracts. The federal SBA 7(a) program was established to serve borrowers that Congress determined lack access to affordable credit and capital on reasonable terms, and, in particular minorities, women and veterans. It is a nationwide program. By its very existence, the SBA 7(a) program is a federal policy conclusion that small businesses meeting its eligibility requirements and seeking loans of $5 million or less lack access to credit and capital nationwide. In fact, the 7(a) loan application requires SBA lenders to document the borrower's inability to obtain credit elsewhere. This SBA application requirement ensures that lenders remain accountable to the borrowers they serve by providing credit to small businesses that are unable to access capital from conventional financial institutions. An Urban Institute report commissioned in 2008 confirmed that lenders adhere to this provision.[9] While the SBA does not require 7(a)

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[8] Alternative Lending through the Eyes of "Mom and Pop" Small Business Owners: Findings from Online Focus Groups, A Special Report of the Federal Reserve Bank of Cleveland by Barbara J. Lipman, Federal Reserve Board of Governors and Ann Marie Wiersch, Federal Reserve Bank of Cleveland, August 25, 2015, page 2.

[9] http://www.urban.org/research/publication/key-findings-evaluation-small-business-administrations-loan-and-investment-programs

loans be made in CDFI-eligible Investment Areas, CDFIs with a national SBA 7(a) license seeking to use this accountability method could be required to direct their lending activities to qualified Investment Areas. A similar approach could also be applied to CDFIs with a national 7(a) license that would like to use this product to serve a national OTP Target Market. The SBA has also demonstrated that people of color, women and veterans are more likely to obtain a loan through its 7(a) program than in the conventional market. A second 2008 Urban Institute analysis of the 7(a) program[10] supports the fact that 7(a) is reaching these particularly underserved borrowers. In addition, a 2013 Congressional Research Service analysis concludes that the program meets its goals.[11]

c) _Develop new accountability mechanisms harnessing innovations in data and data gathering techniques_. Dynamic changes in technology offer the opportunity to gather and analyze information about local credit conditions using new data sets available through online platforms. For example, using new data tools, such as google earth and google maps, it is possible to find an address, view a photo of a building thousands of miles away from a personal computer. Much more granular data is also available with the advent of big data. Policy Map includes a state level data set called *Longitudinal Employer Household Data* that allows users to profile small businesses by geography, by the percentage of low-income workers they employ, and whether or not have they have received small business loans. This data tool could help a CDFI determine if small firms located in eligible census tracts and employing low-income workers are having difficulty accessing credit. Armed with this knowledge, CDFIs could work directly with small businesses across the country to fulfill their credit needs with appropriate loan products.

Another example of how data is being used to address community development challenges is the Motor City Mapping project, a comprehensive analysis of all 380,217 parcels of land in the City of Detroit. This effort brought experts from Data Driven Detroit, a data intermediary that partners with socially-minded groups seeking data to drive decision-making, and Loveland Technologies, a private data mapping firm, together to create this survey of blighted buildings in Detroit to help city officials decide what to do about them. This information also informs CDFIs working in the city as they develop residential lending rehabilitation financing programs to repopulate and revitalize distressed neighborhoods.

The ability to collect and process large quantities of data using technology brings new efficiencies to the lending process as well as much deeper and more detailed understanding about the credit needs of borrowers. The Fund should encourage and collaborate with CDFIs in developing these new tools.

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[10] http://www.urban.org/research/publication/competitive-and-special-competitive-opportunity-gap-analysis-7a-and-504-programs

[11] http://www.fas.org/sgp/crs/misc/R41146.pdf

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4. *Is a business plan and a stratified, statistically significant random sample of lending by asset class and location sufficient to document accountability? Under what circumstances?*

   We have no comment on this question.

5. *Should accountability requirements differ based on a CDFI's type of Target Market, and if so, how?*

   No, accountability requirements should not vary based on CDFI type or Target Market. However, CDFIs should have a variety of tools available to meet this requirement and they should choose the tools best suited to their business model, the Target Market(s) they serve, and the Financial Products and/or Services they offer. Different communities and populations have different credit and capital needs. Accountability is essentially "market research" or determining what credit gaps exist in the market and how can a CDFI help borrowers overcome those gaps. There are many ways to assess the need or conduct market research, including soliciting public input through hearings and comment periods, but we believe data provides valuable insights in helping CDFIs determine and address community credit needs. The accountability requirements should encourage greater use of data by CDFIs in designing their financing activities and support services to ensure they are responsive to the credit needs of borrowers in their Target Markets.

6. *How should the CDFI Fund assess accountability if a CDFI's Target Market includes borrowers or investees who are not members of a Targeted Population themselves (e.g., small businesses, micro businesses, and affordable housing developers, charter schools), but whose "end-beneficiaries" are?*

   As a CDFI with a national LITP Target Market, we face this question with regard to both our multifamily affordable housing and small business lending activities. In practice, many CDFIs serving a national LITP Target Market qualify or verify the accountability of their loans by looking through to the "end beneficiary" of the financing being provided. For example, a loan to finance a multifamily affordable housing project using a government program, like the Low-Income Housing Tax Credit (LIHTC), qualifies as serving a Low-income Targeted Population based on program requirements mandating that a certain percentage of the housing units be rented to low-income families. Similarly, a CDFI making a loan to a charter school or a community health center may "look through" the project to the "end beneficiaries" using proxies, such as the number of students receiving free or reduced lunches or the number of Medicaid patients, to verify the financing is serving low-income people. However none of these practices have been approved or blessed by the Fund in regulation or guidance.

   The situation becomes more complicated when applied to small business lending activities as "end beneficiaries" are not as easily identified or defined. CDFIs with a LITP Target Market certification have developed their own methodologies for qualifying small business loans as serving low-income populations based on information demonstrating (1) the business owner is a low-income person (such as for microenterprise businesses); (2) the

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business is hiring low-income people; (3) the business provides jobs accessible to low-income people; or (4) the employees are residents of low-income communities. The absence of CDFI Fund guidance on how to verify that these loans are serving LITP "end beneficiaries" means each CDFI has developed its own approach and metrics for qualifying their small business loans. This situation has led to debate within the industry as to whether certain metrics for qualifying loans promote policies that are contrary to the goals of CDFIs. For instance, some question whether qualifying loans to small businesses creating or retaining jobs for low-income people indirectly promotes lending to firms offering lower wage employment opportunities rather than higher paying positions that help individuals or families build assets, raise their standard of living and quality of life. CRF has grappled with this issue as we aspire to fund businesses that create living wage jobs. However, we see the benefits of supporting firms offering what we refer to as "job ladders" or positions that are accessible to low-income people and allow employees to advance to higher paying, more responsible positons within the business. Our approach has been to undertake a detailed analysis of the businesses we finance by the industry code and job classification to determine if these firms offer workers an "opportunity ladder" to advance professionally and build wealth.

We have asked the CDFI Fund to provide guidance on this issue in two previous comment letters.[12] The absence of uniform industry standards for CDFIs means these organizations run the risk of unintentional non-compliance. We recommend that the Fund develop specific protocols for verifying different types of loans or investments based on the nature of the borrower/project and the "end beneficiaries". CDFIs should be permitted to use various proxies to automatically qualify their loans to easily demonstrate accountability to their Targeted Population (TP) Target Markets. For example, financing an affordable housing project developed with the LIHTC, a charter school serving children eligible for free or reduced lunches, or a community health center whose patients receive Medicaid, should qualify as loans or investments to eligible TP Target Markets. The Fund should seek comment from the CDFI industry and interested stakeholders on the specific proxies to be used when qualifying financing activities that support "end beneficiaries". The list of proxies should be regularly updated as CDFIs are continually finding new ways to serve "end beneficiaries

Given the complexities associated with vetting the accountability of small business loans, the Fund staff should solicit additional comments from CDFIs engaged in this type of financing to develop a specific set of protocols for this asset class. It may be difficult to qualify all small business loans using a single methodology or measure, we recommend that CDFIs be allowed to demonstrate accountability to small business "end beneficiaries" based on one of the four approaches described above: lending to low-income business owners, businesses that hire low-income people; businesses that provide jobs accessible to low-income people; or whose employees live in low-income areas. There may be other ways to qualify small business loans serving "end beneficiaries" as well. We welcome the opportunity to work with Fund staff as they develop this important guidance.

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[12] See CRF's Comment Letters on the CDFI Fund's Interim Rule implementing the CDFI Fund Program, October 26, 2015 and its Annual Certification and Data Collection Report Form, September 8, 2014.

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7. *How should a CDFI demonstrate accountability to a national Target Market, in particular an Investment Area national in scope? Should there be a requirement to have local accountability to supplement a national governing or advisory board? In this context, how should the term "local" be defined?*

CRF *firmly believes* a national Investment Area Target Market is essential to the future of the CDFI industry. As a national, non-profit financial institution and certified CDFI, with a national SBA 7(a) license, we have a unique perspective on this question. During the past six years, we have found ourselves faced with the challenge of turning away worthy borrowers simply because they fall outside of our existing set of Target Markets. This also places financial constraints on our overall capacity to carry out our mission. We applaud the Fund raising this crucial question and we urge staff to work with industry participants, like CRF, to craft a national accountability mechanism that allows CDFIs to help the millions of small business borrowers whose *only* other credit source may be an online or marketplace lender offering predatory or inappropriate loan products that will ultimately harm their business.

As we described in question #3, there are a number of other ways a CDFI could demonstrate accountability to a national Target Market composed of Investment Areas. The Fund could utilize a designation from an established and proven federal program, such as the SBS 7(a), to serve as a proxy or means of verifying that a CDFI is accountable to the credit needs of borrowers in a national IA Target Market. It should be noted that with the exponential growth of marketplace and online lenders the small business credit market in this country has become, for all intents and purposes, a national market. Using the SBA 7(a) designation as an accountability mechanism would simply level the playing field for CDFIs rather than continuing to put them at a competitive disadvantage vis a vis these platform lenders.

The CDFI Fund could also reinstate accountability methods, like focus groups, including online groups, community meetings, and customer surveys, with guidance as to how they could be utilized at a national level to demonstrate a CDFI is satisfying the accountability test. As noted above, these methods could be adapted for an online environment and implemented or delivered to a virtual community that is national in scope.

As noted above, there is a tremendous opportunity to harness innovations in data and data gathering techniques. New technology tools exist, never envisioned when the Fund was first established, that make it possible to collect and analyze vast quantities of highly granular data in real time. Online and marketplace lenders are using this data to reach borrowers CDFIs will never be able to reach if we rely on existing channels and methods.
As to the question of having local accountability to supplement a national governing or advisory board, in our view this should not be a requirement but rather should be up to the CDFI how they choose to serve and remain accountable to their Target Market(s). If a CDFI wishes to supplement its knowledge of its Target Market(s) with other forms of accountability such an advisory board, focus groups, or customer surveys, they should be able to do so and to determine how they wish to define the term "local" for the purpose of this additional form of accountability.

8. *How should an Applicant that utilizes a web-based lending platform, especially one that serves a national Target Market, demonstrate accountability?*

   Applicants using a web-based lending platform should be afforded the same mechanisms for demonstrating accountability as other Applicants. They should be able to utilize governing and/or advisory boards, as well as the other accountability tools we proposed the Fund should adopt in Q #3 above. In addition, web-based Applicants may create new approaches to demonstrating Target Market accountability and the Fund should remain open to reviewing and updating CDFI certification criteria to incorporate new mechanisms. For example, CRF designed and implemented a survey in collaboration with a group of nonprofit community lenders and business advisory service providers to better understand the needs of small businesses in Baltimore. We launched the survey and collected responses through an online tool we developed known as Connect2Capital. The responses were used to inform the development of new financing products and support services for entrepreneurs and small businesses in Baltimore City, a community struggling with high poverty and social unrest. Web-based platforms can gather or analyze the credit needs of low-income communities and underserved borrowers in a far more efficient and objective fashion by tapping a host of new data sources available through online resources such as Policy Map, the Motor City Mapping project, as well as municipal websites, like the City of Chicago's Data Portal, that offer information on a wide variety of economic and community development activities at the local level. The growth of civic data resources such as the Civic Data Design Lab at MIT also offers a wealth of information and potential for collaboration with new partners CDFIs never dreamed of when the Fund was first created. Our expectation is that web-based platforms will have the expertise, talent and technology to pioneer new ways of demonstrating accountability by developing and delivering credit products well suited to the needs of borrowers, especially those serving a national Target Market.

<u>Non-Governmental Entity</u>

By statute, a CDFI Shall not be an agency or instrumentality of the United States, or any State or political subdivision thereof. An entity that is created by, or that receives substantial assistance from, one or more government entities may be a CDFI provided it is not controlled by such entities and maintains independent decision-making power over its activities. In the CDFI Certification application, the Applicant must respond to a series of questions designed to surface/discover issues or circumstances that may prevent an Applicant from meeting this criteria.

1. *Are the current standards for establishing that an Applicant is not owned or controlled by a governmental entity sufficient?*

   The current standards for establishing that an Applicant is not owned or controlled by a governmental entity appear to be sufficient for the purposes of the Non-Governmental Entity test.

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2. *Are there additional or alternative questions and/or documentation the CDFI Fund should require to determine if an Applicant is an agency or instrumentality of a Federal, State or local government?*

Not at this time.

Certification Policy and Procedures

A. *Should the CDFI Fund request information on the reason for applying for certification and intended use (e.g., funding requirement, marketing)?*

It is not clear to us why the CDFI Fund would seek this information and whether an Applicant would be able or willing to provide a response to this question. What might be more useful would be for the Fund to conduct a survey of CDFIs as to what they find beneficial about CDFI certification. If anonymity was preserved, respondents might be willing to respond candidly. This information might also inform the Fund's planning and resource allocation decisions.

B. *Are there additional sources of data collected by other federal agencies that can be used to meet any of the seven certification tests? If so, please describe.*

As CDFI have become active participants in the SBA's 7(a) (both Community Advantage and to a lesser degree the full 7(a) program) data on the location, race, gender, ethnicity and former/current military status of borrowers using this program could be extremely helpful in better understanding the credit needs of these historically underserved small business owners. The comprehensive nature of the 7(a) loan application coupled with a large number of borrowers makes this a rich data source for analyzing the "non-bankable" small business credit market at a national level.

Additional CDFI Policy and Procedures Recommendations:
The CDFI Fund should create and implement a timely review process whereby the Fund responds to requests from CDFIs to modify or expand its Target Markets. The inability to respond to such requests puts CDFIs at risk of non-compliance with certification requirements and often limits their ability to compete and serve its customers. In some cases, a CDFI's inability to respond to market demand may drive borrowers to choose inappropriate or predatory loan products thus putting them in danger. Such an outcome is clearly not a desirable outcome for the CDFI Fund given its stated mission.

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General Certification Questions for Public Comment

A. *"Community-based" is a term often used to describe CDFIs. How should "community-based" be defined and what does it mean for CDFIs to be "community- based"?*

No comment.

B. *Although not defined in statute, the CDFI Fund allows Applicants that serve Native communities to self-designate themselves as Native CDFIs and apply for Financial Assistance and Technical Assistance through the Native CDFI Program. Applicants that self-designate as a Native CDFI must attest to providing 50 percent or more of their products and services to Native lands or Native populations. Should the CDFI Fund continue to allow Applicants to self-designate as Native CDFIs or should there be more defined standards that the CDFI Fund should verify? If so, what should they be?*

No comment.

C. *Should CDFIs be allowed to be composed of multiple legal entities (Subsidiaries and/or Affiliates)? And if so, must a CDFI include all of its Subsidiaries and/or Affiliates for consideration?*

Yes, as the CDFI industry has matured and become more sophisticated, CDFIs' corporate structures have become more complex. For example, the April 10, 2015 Interim Rule amended the CDFI Fund certification regulations to permit a CDFI's Affiliate to rely on the Controlling CDFI's activity or track record in order to meet the financing entity requirement, solely for the purpose of the Affiliate participating as an Eligible CDFI under the CDFI Bond Guarantee Program. This is just one instance where having multiple legal entities including Affiliates or Subsidiaries helps a CDFI to access funding sources or meet other legal requirements.

D. *Should CDFI certification standards have more "bright-line" tests, i.e. specific thresholds and benchmarks that are, where possible, quantitative in nature, or should the CDFI Fund maintain flexibility to evaluate Applicants on a case by case basis, even at the expense of certainty for applicants?*

The CDFI Fund should maintain flexibility to evaluate Applicants using qualitative measures rather than relying on 'bright-line" tests such as thresholds and benchmarks that are more quantitative in nature.

E. *In addition to earlier questions regarding potentially different Primary Mission or Target Market standards based on institution type, are there other CDFI certification criteria standards that should vary based on institution type or the type of CDFI?*

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None that come to mind.

F. *Should "start-up" entities be able to be certified? How should the term "start-up" be defined?*

No comment.

G. *Are there additional areas of CDFI certification policy or the CDFI certification application review process that could use improvement? If so, how?*

No comment.

Conclusion

CRF recognizes this request for information represents an enormous undertaking on the part of the CDFI Fund staff. We are grateful for this effort and appreciate the opportunity to share our views and recommendations on CDFI Certification policies and procedures. The CDFI brand continues to gain greater recognition in the market. It is critical that the certification framework remain fresh and relevant so CDFIs are able to achieve their full potential to bring economic growth and opportunity to the people and places they serve. The world into which CDFIs were born more than 20 years ago has changed immeasurably and the rules that inform CDFIs must not restrict their ability to lift up those outside the economic mainstream. We believe this review of CDFI certification will only serve to help both CDFIs and the CDFI Fund fulfill their respective missions. We stand ready to assist the Fund staff in whatever way we can!

Sincerely,

Frank Altman
President and CEO

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November 4, 2020

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RE: Comments on Notice and Request for Public Comment on proposed CDFI Certification Requirements and Documents

Dear Director Harris, Ms. McInnes and Mr. Bischak:

Thank you for this opportunity to comment on the Notice of Information Collection and Request for Public Comment published by the Community Development Financial Institutions (CDFI) Fund in the Federal Register on May 7, 2020. The CDFI Fund is seeking comments on its proposed and/or continuing information collection activities certifying CDFIs and assessing their on-going compliance with such requirements. Over the past several years, there has been an effort underway to update the CDFI Certification Application and associated reporting requirements. This effort culminated with the request for public comments on three key Certification documents which reflect the Fund's proposed changes to the Certification criteria: the revised CDFI Certification Application, the revised Annual Certification and Data Collection Report (ACR) and the new Certification Transaction Level Report (CTLR).

The changes being proposed by the CDFI Fund are critical to maintaining the strength and integrity of the CDFI "brand" which has become a passport for certified CDFIs to access other federal programs and to receive significant funding from both private and public philanthropic organizations. The revised Certification rule, as reflected in these three documents, will determine the standards entities will have to meet to become or maintain their status as a Certified CDFI going forward. It is critical that the industry participate and inform these standards and that they reflect the diversity of the CDFI industry. Community Reinvestment Fund, USA (CRF) has been actively engaged in the review effort and has provided detailed comments on many aspects of the criteria at each stage of the process. We appreciate the transparency and openness the Fund staff have shown as they reviewed the Certification framework in great detail. We have chosen to compile our comments on all three documents into a single letter for simplicity purposes and we urge the Fund to carefully consider our recommendations as well as those of our industry partners.

BACKGROUND

Community Reinvestment Fund, USA, a national Community Development Financial Institution (CDFI), is a leader in channeling resources from the capital markets to support community economic development and helping mission-driven organizations improve efficiency and build capacity. Our mission is *to empower people to improve their lives and strengthen their communities through innovative financial solutions*. For the past 32 years we have worked with community partners, investors, foundations, and financial institutions to deliver over $3 billion in loans, investments, and bonds, resulting in the creation or preservation of 140,000 jobs, the financing of nearly 19,600 affordable housing units and funding for a wide range of community facilities. Since its inception, CRF has funded more than 4,400 small business loans, over 2,400 of which were made to businesses owned by women or people of color. CRF has deployed resources in more than 1,000 communities in 49 states and the District of Columbia and served more than 1.9 million people.

CRF was founded on a vision of improving the lives of people living and working in economically challenged communities by providing access, in partnership with local community development organizations, to public and private sector resources throughout the country. We are best known as a financial innovator with expertise in adapting financing tools that connect underserved communities to new sources of capital including establishing the first secondary market for small business and affordable housing loans to supply liquidity to development finance agencies, CDFIs and other mission-driven lenders. We pioneered the creation of securities collateralized by community development assets to offer mainstream institutional investors (banks, pension funds, and insurance companies) with a way to invest capital at scale in projects and businesses serving low-income people and revitalizing distressed communities. Since 1989, CRF has issued 19 series of Notes totaling $284.7 million backed by community development loans. Three of our debt offerings totaling $176 million have been rated and all of which included a senior tranche rated "AAA" by Standard & Poor's. We have also issued three multifamily affordable housing securities, including one Standard & Poor's rated issue totaling $84.9 million, backed by 45 multifamily affordable housing loans.

Similarly, CRF played an instrumental role in shaping and launching key federal community development programs, including the New Markets Tax Credit (NMTC) and the CDFI Bond Guarantee Program (BGP). Together with its affiliate, National New Markets Tax Credit Fund, Inc., (NNMTCF), we have received $919.5 million in tax credits of which $869.5 million have been deployed in the form of flexible loans for both non-profit and for profit operating businesses located in low-income communities throughout the country. Since 2003, we have made 335 Qualified Low Income Community Investments (QLICIs) with $869.5 million of deployed Qualified Equity Investments (QEIs).

In 2013, CRF was named the first Qualified Issuer (QI) for the CDFI Bond Guarantee Program. We are the only QI to issue bonds in six of the seven funding rounds conducted to date, and our total issuance since 2014 stands at $940 million on behalf of eight CDFIs.

When faced with the dramatic contraction in bank lending during the Great Recession, CRF found a way to bring responsible credit to marginalized small businesses unable to secure conventional bank loans. We acquired one of 14 national non-depository SBA 7(a) licenses to offer this Government guaranteed loan product to support our mission of lending to small businesses located in LMI areas or owned by people of color, women and/or veterans. Since launching our SBA 7(a) lending product in 2012, CRF has made more than 511 7(a) loans totaling nearly $276 million helping to create or retain more than 12,373 jobs. With the onset of the COVID-19 pandemic, CRF used its SBA expertise and its proprietary loan origination software to originate Paycheck Protection Program Loans for a total of $519 million in closed loans and $527 million in disbursed loans which preserved 51,045 jobs. We also participated in an early and novel recovery loan fund in Chicago where we originated 862 loans for nearly $22 million which retained 2,022 jobs and created 813 jobs. CRF is a Preferred Lender under the SBA 7(a) program and has been ranked among the top SBA 7(a) lenders nationally.

General Comments: Overview of Proposed new Certification Application and Accompanying Documents

The CDFI Fund staff is to be commended for undertaking the complex task of modernizing the CDFI Certification criteria. The current framework has been in place since the Riegle Community Development and Regulatory Improvement Act of 1994 was passed and the Fund was created. It is a testament to the framers of the Riegle Act that the industry has grown from 196 certified CDFIs in 1997 to nearly 1,100 such organizations today. However, the technological changes and the evolution of the CDFI industry have made it necessary to revisit and revise key Certification requirements.

We appreciate the effort to update the Certification criteria and the current proposal has several positive aspects which we strongly endorse. In particular, the recognition and implementation of a National Target Market comprised of Investment Areas is a welcome and long overdue policy change. National CDFIs, like CRF, will now be able to make loans to worthy small business borrowers regardless of where they are located and receive credit towards the 69% threshold under the Target Market test. Policy changes to the Accountability requirements are also quite favorable by introducing more flexible and manageable ways an entity can demonstrate it is accountable to its designated Target Market(s).

The revised Certification documents do, however, raise a number of concerns and questions which should be addressed before finalizing the new criteria. First, the CDFI Fund's approach to strengthening the Primary Mission test by asking overly detailed questions about an Applicant's Financial Products and/or Services will not achieve its objective of screening out organizations that should *not* be certified. The details of the CDFI's Financial Products and/or Services should be determined by the Applicant's management and overseen by its governing board, not the CDFI Fund. The proposed approach is not a foolproof means for confirming an Applicant has a Primary Mission of community developing and it makes the Application process significantly more burdensome without assurances it will improve data quality and collection methods. It also places the CDFI Fund in a role of evaluating the products and/or services of Applicants which may be better left to other agencies such as the Consumer Financial Protection Bureau.

A second key concern is the CDFI Fund's decision to revoke its right to exercise discretion when an Applicant is unable to meet the 60% threshold required for the Target Market test. This is a serious and dangerous policy change that could have unintended consequences as described in greater detail in our discussion of the Sixty Percent Threshold Requirement (Target Market section). The Fund should reconsider implementing this change.

Finally, we are concerned about all the policy changes related to Low Income Targeted Population Target Markets referenced in the revised Certification documents that are still under development. Specifically, under the new criteria the CDFI Fund will require Applicants and CDFIs to use only "approved" Target Market Verification Processes to confirm that at least 60% of their financing activities are being directed to their designated Target Market(s). However the Fund has yet to publish a list of "approved" processes, nor has it established a process for Applicants to seek approval for Target Market Verification Processes that they have developed themselves. For instance, many CDFIs serving a Low Income Targeted Population look to the "end beneficiaries" to qualify the loans they are making to their Target Market(s). This long standing approach needs to be included in the Fund's list of "approved" Target Market Verification Processes so that CDFIs can continue to finance vital housing, community facilities and small business borrowers across the country. Lastly, while the Fund has introduced an alternative method for qualifying loans to a LITP Target Market known as the Census Block Group geocoder, this new CDFI Information Mapping System tool has not been created and therefore cannot be tested. It is impossible for CDFIs and industry stakeholders to fully understand and comment on the revised Certification documents until *all* the outstanding components of the new criteria have been completed and reviewed.

We respectfully recommend that the CDFI Fund review all comments carefully and engage in a collaborative dialogue with the industry and all interested stakeholders to address all the unfinished aspects of the proposed Certification criteria. We strongly advise against publishing a final rule on this important policy at this time.

REVISED CDFI CERTIFICATION APPLICATION

Section by Section Review and Detailed Comments:

Applicant Basic Information

Overview

Under the current CDFI Certification Application, the Basic Information (BI) section collects general information about the Applicant (and for a regulated financial institution, its Affiliates[1]) that must be provided for the CDFI Fund to evaluate

[1] Affiliate: a company or entity that Controls, is Controlled by, or operates under common Control with another company. https://www.cdfifund.gov/Documents/CDFI%20Certification%20Application%20for%20Comment%20May%202020.pdf, CDFI Certification Application for public comment, pg. 3, accessed 10/07/20.

whether an Applicant meets the requirements for CDFI Certification. The CDFI Fund is proposing to require that non-regulated entities (e.g. nonprofit loan funds) be subject to the same requirement and include Affiliate information in the BI section. (See discussion below.)

Questions Related to Basic Information

Question #6. What is a reasonable grace period for currently certified CDFIs to come into compliance with the new certification criteria?

The CDFI Fund should allow existing CDFIs up to three (3) years to comply with the new certification requirements. This process could require some CDFIs to change their business models, their governing and/or advisory board structures, methods of verifying loans directed to approved Target Markets, as well as potentially selling or allowing loans or lines of business to be sold, run off, or otherwise discontinued in order to meet the new certification criteria.

Question #7. Currently applicants are allowed to submit CDFI Certification Applications at any time throughout the year. The CDFI Fund is considering transitioning to a quarterly submission schedule, which would allow applicants to submit CDFI Certification Applications only within a specific time period every three months. Should the CDFI Fund transition to a quarterly CDFI Certification Application cycle?

The CDFI Fund should maintain a rolling Certification Application process as a quarterly Application cycle could lead to long delays and significant backlogs of pending applications. This could make it difficult for entities to become certified in a timely fashion and provide Financial Products and Financial Services to borrowers in their approved Target Markets. The current COVID-19 crisis is an example of how an Applicant seeking to become a CDFI might be forced to wait three months to file their application and receive a designation which, in turn, could directly enhance the organization's ability to raise and deploy funds in its defined Target Markets as rapidly as possible.

Specific Application Questions/Topics

Affiliates

As noted above, the key change to the Basic Information section[2] is to place Depository Institution Holding Companies (DHICs) and (Nonprofit) Loan Funds on equal footing with regard to the treatment of Affiliates. Thus, if the CDFI Certification Applicant is **not** a DIHC, an Affiliate of a DIHC, or a Subsidiary of an Insured Depository Institution (IDI), in addition to presenting Affiliates relevant to any special CDFI Certification provision or exception, it must identify any Affiliate in its family of entities that meets any of the following criteria for consideration in connection with the Primary Mission requirements:

[2] https://www.cdfifund.gov/Documents/CDFI%20Certification%20Application%20for%20Comment%20May%202020.pdf, CDFI Certification Application for public comment, page 18, accessed 10/07/20.

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1. The Affiliate Controls[3] the Applicant, except if the Controlling entity is a Tribal Government;
2. The Affiliate directly engages in Financial Product and/or Financial Services activity and the Applicant and the Affiliate are under the mutual Control of another entity; or
3. The Affiliate directly engages in Financial Product and/or Financial Services activity and the Applicant Controls the Affiliate.

Comment

We wish to offer some general comments on Affiliates pertaining to the Basic Information section of the revised Certification Application. Generally speaking, many CDFIs use off-balance sheet special purpose entities (SPEs) or vehicles which do not have any employees and whose role is primarily to hold assets. These SPEs are sometimes referred to as "brain dead" in that they exist for legal reasons but are not fully functional affiliates. We assume the CDFI Fund is not expecting Applicants to include each of these vehicles in the Application as they are simply financing structures without day-to-day operations. CDFIs may appoint the board of such entities, however investors tend to retain control and therefore these entities should not be captured in the BI section. CRF has a number of these off-balance sheet entities associated with its New Markets Tax Credit (NMTC) Program. Since the activities of these NMTC entities have never been included the 60% threshold required under the Target Market test, we assume they would not be listed as Affiliates for the purposes of CDFI Certification.

There are also instances where a CDFI or Applicant may have an entity which it controls but which was established in order to allow the organization to access a license to participate in another federal program. In this case, the affiliate or subsidiary is wholly owned by the CDFI with whom it contracts to provide staff, as well as other resources to carry out its activities. We believe these types of entities should not be reflected in the BI section as well since they were created to meet programmatic requirements but, for all intents and purposes, are one in the same with the parent CDFI or Applicant.

Primary Mission

Overview

In the past, it has been difficult to articulate and apply the Primary Mission test through a specific set of standards or criteria. The Fund proposes requiring CDFI Certification Applicants to attest to and provide additional information to determine their dedication to a series of community development principles including:

- Documenting a community development mission for a 12 month period prior to applying for certification;

[3] Ibid, pg. 3. "Control, Controlled or Controlling: (1) Ownership, control, or power to vote 25% or more of the outstanding shares of any class of voting securities of any company, directly or indirectly or acting through one or more other persons; (2) Control in any manner over the election of a majority of the directors, trustees, general partners or individuals exercising similar functions of any company; or (3) Power to exercise, directly or indirectly, a controlling influence over the management, credit, or investment decisions or policies of any company."

- Alignment between its community development strategy and its Financial Products and/or Financial Services provided to distressed communities and/or underserved populations;
- Demonstrating responsible financing practices that do not harm consumers as evidenced by affordable and transparent products or services, fair collections practices and compliance with federal, state and local laws and regulations;
- Affiliates that offer Financial Products and Financial Services must provide evidence of a primary mission of community development (except if the parent or Affiliate is a tribal government) as has been required of DIHCs, affiliates of DIHCs and Subsidiaries of IDIs.

While this approach provides a more robust set of criteria for verifying an Applicant meets this test, there are potential drawbacks of relying so heavily on its Financial Products and/or Financial Services to confirm a Primary Mission of community development. Placing an affirmative obligation on the Applicant to show its products and/or services do not harm consumers could unintentionally limit the flexibility for entities to offer Financial Products or Services that strike the appropriate balance between the needs of their borrowers and their own financial viability based on the credit risks they assume. We recognize this is delicate balance but several of the questions, especially Q. PM12 & Q. PM13, suggest the CDFI Fund is applying a "litmus test based on a laundry list" of terms and conditions to assess whether an entity has Primary Mission of community development based on its products and services. If the objective is to screen out organizations that offer predatory credit products, we are not convinced this approach will keep these organizations from being certified. Applicants do have the opportunity to explain why their Financial Products may exceed certain restrictions (such as interest rate ceilings) but it is unclear what criteria the CDFI Fund will apply to include or exclude such products.

It is also unclear whether the Fund can use its discretion to consider qualitative factors beyond the terms of an Applicant's Financial Products or Financial Services. The Fund should have the ability to look beyond the Application to review an Applicant's website, its messaging and any social media campaigns to see how the entity's online presence aligns with its stated mission of promoting community development. We also see benefit in continuing to request that Applicants provide a narrative describing their history and how they carry out their mission through their financing activities.

The changes proposed to the Primary Mission test warrant further investigation by the CDFI Fund by soliciting additional, in-depth industry input, holding stakeholder interviews and conducting surveys to ensure the revised Application only confers certification on entities that embody and preserve the CDFI "brand".

Questions Related to Primary Mission

Question #8. Are the questions in the revised application appropriate to determine an entity's community development intent?

In an effort to protect and preserve the integrity of the CDFI Certification "brand," the Fund has taken an approach to assessing or evaluating an entity's community development intent that we believe is flawed. The objective, which we wholeheartedly support, is to ensure that "bad actors" such as predatory lenders offering abusive loan products are not certified as CDFIs. However, while the Fund's intent is commendable, the approach of examining every aspect of an

Applicant's Financial Products or Services through a detailed list of drop down boxes will not achieve the stated goal. In our view, the Fund is asking for too much detail about an Applicant's products and services in this section and appears to be "micromanaging" CDFI financing activities. This approach could have the unintended effect of driving CDFIs to offer "plain vanilla" products and services to avoid burdensome scrutiny while stifling innovation.

Recommendation: The nature and terms of an Applicant's/CDFI's Financial Products and Financial Services should be determined by the organization's leadership and governing board. It should not be the purview of the CDFI Fund to set the terms of such products and services.

Question #12. Are there any other practices related to the responsible provision of Financial Products, especially those related to mortgage or other real estate lending, and to equity investments, for which either the presence or absence of which should be considered for purposes of CDFI Certification?

CRF conceived of and helped to launch an innovative single family mortgage product and supporting rehabilitation fund in the City of Detroit in which banks received regulatory approval to offer home mortgages with higher than normal loan-to-value (LTV) ratios in order to restart conventional mortgage lending in this market. We offer this initiative an example of a responsible lending product with nontraditional terms designed to meet a specific need in the mortgage market at a particular time. Mission-driven lenders often innovate and create products to address a need in the local market. The terms of such products should be carefully considered and should not preclude an entity from being certified simply because the terms are outside the norm.

We have serious concerns about the CDFI Fund's approach to evaluating Applicants' Primary Mission. The Fund should not attempt to regulate CDFIs' products as there are other agencies, such as the Consumer Financial Protections Bureau charged with this responsibility. However, should the Fund decide to collect information about CDFIs' financial products, we would encourage you to inquire about abusive practices related to small business loan products – especially given the exponential growth of online lending platforms many of which offer predatory products. This question should include suspicious or deceptive practices related to small business loans not just those pertaining to consumer products and equity investing. Loans carrying excessive interest rates with hidden fees, a speedy application process requiring no credit check, often encouraging repeated refinancing and rollovers, and where the cost of loan is not clearly stated, or where products may be disguised as savings or credit repair loans are examples of the types of products that raise serious concerns. Merchant cash advances (which are technically not loans) and loans targeted to borrowers with low or no-credit scores or history should also be captured in this question.

Question #13. For purposes of CDFI Certification, should an entity be required to indicate that it offers or engages in at least one or more of the types of Financial Services and practices identified in the questions on "Responsible Financing Practices – Financial Services"?

This question is confusing as it is not clear *how* such a requirement would apply to non-depository Applicants that do not offer and do not have the capacity to offer Financial Services[4] to meet CDFI Certification requirements? Would an applicant financing multifamily housing be required to offer checking or savings accounts? Moreover, unregulated Applicants (those that are not banks, bank holding companies, or credit unions) are not permitted to offer Financial Services which only compounds the confusion surrounding this question. The CDFI Fund should provide additional clarification regarding this question.

Question #15. Are there circumstances that the CDFI Fund should consider as an exception to the rule related to the treatment of Affiliates under the Primary Mission requirement?

Under the current framework, Subsidiaries of Insured Depository Institutions (IDIs), Depository Institution Holding Companies (DIHCs), and Affiliates or Subsidiaries of DIHCs are required by statute to meet the certification test collectively. To avoid disparate treatment among financial services providers, the CDFI Fund is proposing to apply the primary mission test, regardless of entity type, to all parent entities and to any Subsidiary or Affiliate *that engages in financing activities (emphasis added).*

The Fund is proposing to require that an Applicant and any relevant Affiliate must be able to demonstrate an acceptable Primary Mission of community development in place for at least the full 12 months completed just prior to the submission of the application.[5] This new policy may inadvertently pose a problem for established CDFIs in the following scenario. If a CDFI were seeking to recertify while at the same time considering an investment in a newly established affiliate, the start-entity would be deemed an Affiliate under the proposed certification guidelines. Often a start-up affiliate raises capital before making loans or investments and thus, such an entity would not meet the proposed Primary Mission test even though the existing CDFI would have had a Primary Mission in place for the 12 months prior to submitting its recertification application. We don't believe the CDFI Fund intends to preclude these types of investments by Applicants or CDFIs seeking to become certified or recertified and should clarify its position.

Recommendation: The CDFI Fund should clarify that Applicants or CDFIs seeking to be certified may make investments into newly established Affiliates that have a Primary Mission of community development but which, as start-ups, have not had this mission in place for at least 12 months prior to the submission of their application.

[4] See the definition of Financial Services and how such Services are considered by the CDFI Fund for Certification purposes at https://www.cdfifund.gov/Documents/CDFI%20Certification%20Application%20for%20Comment%20May%202020.pdf, CDFI Certification Application for public comment, pg. 3, accessed 10/07/20.

[5] Ibid, pg. 30.

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Specific Topics / Application Questions

Responsible Financing Practices – Military Annual Percentage Rate (MAPR)

CRF strongly supports policies that encourage responsible financing practices, however, the mandated use of the Military Annual Percentage Rate (MAPR)[6] method to calculate the Annual Percentage Rate for Certification purposes, regardless of the type of borrower or credit product, raises several questions and recommendations the Fund should consider and address. In particular:

1. Were other methodologies to calculate the Annual Percentage Rate considered and if so, which ones and why were they not selected?
2. As noted in the Updated Frequently Asked Questions, the MAPR is required by statute for certain types of consumer credit extended to active duty service members and their family members.[7] It appears this methodology was designed for consumer loan products. Nevertheless, the revised CDFI Certification Application states that the MAPR is being implemented "***regardless of borrower status***"(emphasis added).[8]

Does the Fund intend to apply this methodology to small business loans, commercial real estate loans, consumer loans (such as mortgages and auto loans), etc.? If so, we strongly suggest that the CDFI industry be provided more time to assess this methodology and test it to make sure it works for all types of loans. For instance, as a national SBA 7(a) lender, CRF would like to know what the implications would be of using the MAPR for this government guaranteed loan product? This policy change may also require adjusting various technology and reporting software tools used to originate, monitor and service 7(a) as well as other types of loans CDFIs offer. Did the CDFI Fund consult with the SBA to understand how the MAPR could be applied to the Agency's loan products used by CDFIs?

We are also concerned that using the MAPR to calculate the APR might actually increase confusion among small business borrowers, especially those working with both banks and CDFIs on a loan request. If CDFIs are required to use the MAPR calculation method but a bank is not, then the borrower would be comparing two rates that are calculated differently. Borrowers unfamiliar with the MAPR would need information as to how the APR is calculated under this method. Imposing

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[6] See 32 CFR § 232.4 of the Military Lending Act. Additional information may be found at the Consumer Financial Protection Bureau's Military Lending Act (MLA), Interagency Examination Procedures – 2015 Amendments, Terms of Consumer Credit Extended to Covered Borrowers (Calculation of MAPR), pg. 6-9.

[7] https://www.cdfifund.gov/Documents/CDFI%20Certification%20Public%20Comment%20FAQ%2009242020.pdf Proposed CDFI Certification Application, ACR & CTLR – Request for Public Comment, Frequently Asked Questions Updated October 2020, Q. 7, pg.6, accessed 10/08/20.

[8] https://www.cdfifund.gov/Documents/CDFI%20Certification%20Application%20for%20Comment%20May%202020.pdf, CDFI Certification Application for public comment, pg. 30, accessed 10/07/20.

universal adoption of the MAPR method creates additional complexity and burden for both CDFIs and their small business customers without providing offsetting benefits.

Recommendation: The CDFI Fund should seek further comment on the MAPR, giving CDFIs an opportunity to familiarize themselves and test this methodology on their loan products to determine if requiring this standard across the board would improve transparency and comparability without adding significant compliance burden. The Fund should also consider how this policy will affect CDFIs' lending activities when they are part of a larger transaction with other types of lenders, such as banks and credit unions, who are not required to use this APR calculation method.

Question PM09 What are the Applicant's community development objective(s)?

In reviewing the drop down options available, another option specifically designed for CDFIs engaged in small businesses (not micro) lending should be included to capture the outputs or objectives of this activity which include, but are not limited to, creating jobs for local residents, building wealth, delivering essential goods and services, and strengthening the social fabric of the community. Options such as *promoting financial access*, *economic development*, or *community revitalization* don't fully reflect the benefits of a robust, vibrant small business ecosystem in economically distressed communities.

Recommendation: We recommend adding the following drop-down option to the current list in the proposed Certification Application - "***Promote access to capital and credit for underserved small businesses***". We believe this option would apply to a substantial segment of the CDFI industry focused on small business (but not microenterprise) lending.

Question PM11 For each community development objective selected in question PM10, identify the type of output or outcome supported by the Financial Product(s) in which the Applicant engages.

Question #1 in the Notice of Information Collection and Request for Public Comment asks commenters, "Is the information that will be collected by the revised application necessary and appropriate for the CDFI Fund to consider for the purposes of CDFI Certification?" Question PM11 is seeking to collect information on outputs and outcomes. In our opinion, such information is better suited to impact data collection efforts or activities rather than the CDFI Certification process. If the entity seeking to be certified is a relatively new organization it may be difficult to predict or identify what outcomes (even in the short or medium term) will be supported by the Financial Products the Applicant intends to offer even if it can identify likely outputs. Moreover, what if the Applicant's outputs and/or outcomes change over time? Is there a plan to update and collect these data points on an on-going basis? If so, please describe this plan.

Recommendation: If the CDFI Fund intends to collect impact data, such as outputs and outcomes, they should do so through the Transaction Level Report (TLR), the proposed Certification Transaction Level Report (CTLR), or an impact reporting document rather than through the Certification Application as impact is not one of the criteria for becoming a certified CDFI. The Certification Application should not serve as a "backdoor" for the Fund to gather impact information.

Question PM12 For each output selected in question PM11, what Financial Product terms, conditions, or practices does the Applicant employ to promote positive community development results for underserved population(s) and/or residents of economically distressed communities?

Question PM12 seems to draw a one-to-one correlation between the terms of Financial Products and positive community development impact. The multiple choice nature of this question oversimplifies how CDFIs use a customized set of products, services, expertise, partnerships, etc., to improve opportunities for underserved populations and/or economically distressed communities. CDFIs conduct their financing activities in a nuanced way rather than using a "cookie-cutter" approach as suggested by the structure of this question. They are intentional and creative in addressing the credit and capital needs of their borrowers taking both quantitative and qualitative factors into consideration. Often, CDFIs improvise and adapt their products to fit the needs of a particular customer or set of circumstances. Thus it may be difficult to match the options in the drop list to specific positive community development results. We also observed that the list of drop down options included in this question bear a strong resemblance to the list used in Question #14 in the Business Strategy Section of the New Markets Tax Credit Allocation Application.

We are also concerned that the Fund appears to associate CDFI Financial Products with characteristics such as below-market pricing, reduced fees and/or more flexible loan terms. There are many CDFI products which offer borrowers *access to capital or credit* without any subsidy. These borrowers may be unable to secure a loan or investment from a mainstream financial institution and simply having access to credit is what defines or differentiates a CDFI's Financial Product(s). CDFI lenders, like CRF, offering government guaranteed credit products, must adhere to the terms dictated by the loan program and therefore have limited leeway to modify such terms. Products, like the SBA 7(a), are designed for small businesses unable to obtain conventional credit and borrowers must demonstrate they are unable to obtain credit elsewhere as part of the loan application process.

If CDFIs offer concessionary terms on their loan products they may not be properly pricing the risks they are assuming, which could compromise their financial sustainability. Over the years, the CDFI Fund has set expectations and industry benchmarks for financial ratios (e.g. Net Assets ratio) and would appear to be working at cross purposes if it were to require below-market rate pricing or concessionary terms on CDFI loan products. Subsidy is only one tool in the CDFI toolbox to make their Financial Products accessible and appropriate for underserved borrowers and those located in low- and moderate-income communities. Drawing a one-to-one correspondence between each output a CDFI selects and the terms of one or more of its Financial Products without the context of a particular transaction does not tell the full story of how CDFIs take a flexible approach to adjusting terms of their capital and credit products to fit the needs of a borrower.

Finally, it is not clear how the Fund will keep up with new innovations in product terms that CDFIs may offer either prior to or after being certified. Will the current list of drop down options be regularly reviewed and updated?

Recommendation: We ask the CDFI Fund to re-examine its approach to this question and determine if requesting a narrative in place of the current list of drop down options would be a better approach. The Fund should also consider the questions we raised above and, **at the very least, we recommend that an option such as "*Unable to access credit elsewhere*" be added to the list of drop down options in Question PM09.**

Question PM13 For each Financial Product term, condition, or practice selected in question PM12, explain how positive community development results for underserved population(s) and/or residents of economically distressed communities are supported?

As discussed in question PM12, there is not a one-to-one correlation between the terms, conditions, or practices reflected in a CDFI's Financial Product(s) and its community development results. Like the previous question, this question fails to account for qualitative factors and assumes a causal relationship between the terms, conditions, or practices of a CDFI's Financial Product(s) and the community development outcomes it achieves. The Fund's approach to both PM12 and PM13 appears to be flawed as it rests on the assumption that primary mission can be accurately assessed through a granular examination of the characteristics of an Applicant's Financial Products and that these Products generally offer some form of subsidy rather than providing access to credit that the borrower would not otherwise be able to secure.

Recommendation: The Fund needs to re-examine its approach to assessing an Applicant's Primary Mission through a detailed review of its Financial Products. We suggest considering alternative methods for evaluating Primary Mission which would include an analysis of an Applicant's Financial Product(s) as well as a careful review of its web presence, marketing materials, social media campaigns and any other pertinent information. We also see value in combining these two questions into a single narrative describing an entity's mission, its theory of change, and how its products and financing activities, advance positive community development in the markets or populations it serves. This would present a more complete picture than simply selecting a predetermined series of drop down options. It should be noted. the process outlined in question PM13 must be repeated for each Financial Product output selected. Some Applicants may find this process so laborious they simply choose fewer outputs to shorten the process and reduce the amount of information they must provide. The Fund should explore ways to obtain the information needed without placing undue burden on Applicants.

Question PM19 As of at least 12 months completed just prior to submission of the CDFI Certification Application, for each of the Applicant's loan products, does the Applicant disclose the periodic payment due, the total amount to be repaid over the life of the loan, the total finance charges over the life of the loan, the annual percentage rate (APR) – or for open-ended loans, the effective APR – of the loan?

We are confused as whether this question applies to small business loans or is intended to encourage transparency and disclosure for consumer loan products? Disclosing the Annual Percentage Rate (APR) and the total amount to be repaid by the borrower over the life of the loan may not be meaningful or tell the whole story if applied to some types of small business loans like the 7(a) product which carries a variable rate prescribed by the SBA as a spread above the Prime Rate. As the Prime Rate fluctuates it can be difficult to calculate the APR and to provide the borrower with a total amount to be repaid over the life of the loan. In addition, the APR includes not only the interest rate a borrower will pay but also the

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fees and other transactions costs associated with a loan. The 7(a) loan product has a few such fees (e.g. a guarantee fee, packaging fee, etc.) and they are disclosed separately and not built into the APR.

Recommendation: CRF appreciates the CDFI Fund's objective of requiring lenders to fully disclosure the terms of their loans to borrowers so they can make informed decisions about taking on credit obligations. However, we encourage the Fund to review whether this question should apply to all small business loans products, such as the SBA 7(a) and other government-related small business loan products. Applying the same disclosure requirements to small business and consumer loans without careful consideration of whether such an approach is meaningful for business loans, may result in inappropriate requirements for certain types of loans that provide little or no benefit for the customer.

Question PM20 Has the Applicant had programs for each of its loan products (including credit cards) to waive fees or interest, reduce interest rates, forgive principal or otherwise modify loans to assist struggling borrowers for at least the 12 full months completed just prior to the submission of the CDFI Application?

Question PM20 assumes CDFIs have the ability to waive fees or reduce interest payments, forgive or otherwise modify loans to assist struggling borrowers. As a full SBA 7(a) lender, CRF is prohibited by the program from offering fee, interest waivers, or forgiveness on 7(a) loans (excluding Paycheck Protection Program Loans). This question does not account for program requirements over which Applicants have no control and must abide by if they wish to offer these government (guaranteed) loan products. We are also confused by the reference to loan forgiveness in this question as the Fund clearly defines Financial Products as *excluding* "forgivable loans unless they have been pre-approved".[9]

Recommendation: We request that the CDFI Fund clarify how this question would apply to CDFIs or Applicants using government loan programs, such as the SBA 7(a), that may preclude them from offering the concessionary terms described in PM20. Furthermore, it would be helpful for the Fund to reconcile its definition of a Financial Product (which excludes forgivable loans) with its references to forgiveness as a possible form of loan modification.

Financing Entity

Overview

The revised Certification Application reminds us that a Certified CDFI must be an entity whose predominant activity is the provision, in arms-length transactions, of Financial Products and/or Financial Services, and that it has been engaged in such activity for at least 12 months. Unless otherwise indicated, the provision of Financial Products must be arm's-length and on balance sheet.

When determining the "**Assets Dedicated to the Direct Provision of Financial Products and /or Financial Services**" the revised Certification Application notes that **"*unless otherwise directed, the asset information provided in the***

[9] Ibid, pg. 2.

Financing Entity section of the application should be based on the Applicant's information only. Do not use a consolidated statement."[10] (emphasis added)

Specific Topics / Application Questions

Question FE-AO7 Instructs the Applicant to attach its non-consolidated, current fiscal year-to-date financial statements.

Under Generally Accepted Accounting Principles (GAAP) accounting rules, many CDFIs are required to prepare consolidated financial statements. The CDFI Fund should align its Certification requirements for the Financing Entity test with GAAP rather than mandating that Applicants prepare non-consolidated fiscal year-to-date financial statements which would only impose additional reporting burdens on entities.

Target Market

Overview

To be a Certified CDFI, an entity must demonstrate that it serves at least one eligible Target Market (either an Investment Area or Targeted Population). In addition, it must direct at least 60% of both the number and dollar volume of arm's-length, on-balance sheet Financial Products to one or more eligible Target Markets. Under current guidance, if an Applicant fails to meet the 60% threshold, an exception may be provided based on a justification that is satisfactory to the CDFI Fund.

Under the proposed certification framework, all new CDFI Applicants must meet the applicable Target Market percentage benchmarks over the 12 full months completed just prior to submission of the application. To maintain the certification status, Certified CDFIs are required to demonstrate compliance with the Target Market percentage benchmarks based on a three-year average through the last day of their most recently completed fiscal year.[11] To confirm activity to the Target Market(s), transaction level data will be submitted annually through the CTLR for those CDFIs that do not submit a TLR.

Finally, new CDFI Certification Applicants must meet the relevant Financial Product activity percentage threshold, without exception, in both the number and dollar amount of such activity—the CDFI Fund will discontinue its current practice of providing exceptions to the Target Market threshold requirement.[12] An entity may continue to serve a combination of eligible Target Market types, for the purposes of calculating the overall Target Market percentage of an entity's activity,

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[10]Ibid, pg. 45.

[11] Certified CDFIs with less than three years of CDFI Certification will be measured based upon the full history of their financing activity, up to three full fiscal years but not earlier than through the 12 months prior to the submission of their application. CDFI Certification Application for public comment, pg. 53, https://www.cdfifund.gov/Documents/CDFI%20Certification%20Application%20for%20Comment%20May%202020.pdf accessed on 10/12/20.

[12]https://www.cdfifund.gov/Documents/FY%2020%20CDFI%20Certification%20Quick%20Facts%2005052020%20508%20compliant%20FINAL.pdf, Proposed CDFI Certification Application, Request for Public Comment, Revision Quick Reference, Community Development Financial Institutions Fund , U.S. Department of Treasury, May 2020, pg. 8, accessed 10/13/20.

each Financial Product transaction or Financial Service item may be counted towards only one Target Market type (even if the transaction or account qualifies as having been directed to more than one Target Market). If an Applicant falls below the required level for any of the applicable Target Market percentage benchmarks, ***it will not be eligible for CDFI Certification***. (emphasis added)[13]

Investment Areas

Under the new certification policy, entities serving an Investment Area consisting solely of individual qualified census tracts as their Target Market will be able to count *all* activity in qualified census tracts toward their Target Market requirements. Similarly, entities that serve certain Targeted Populations will be able to count all qualifying activity toward their Target Market requirements, regardless of location. This is a departure from current policy which requires entities to identify the specific geographic area(s) within which they propose to serve an Investment Area(s) and/or Targeted Population(s) as their Target Market. Only transactions within the identified geographic area(s) are eligible to count toward the 60% level of financing activity that must be directed to their approved Target Market(s).[14] By removing the geographic boundaries on most Target Market designations and measuring all of an entity's eligible activity to its designated Target Market type(s) (i.e., Investment Areas and/or Targeted Populations) toward the 60% threshold, a CDFI will be able to serve its designated Target Market type(s) at whatever level it is capable, including nationally and or through the use of financial technology, without having to seek additional approval.[15]

Targeted Population

A Targeted Population is defined as individuals, or an identifiable group of individuals who are low-income or lack adequate access to Financial Products or Financial Services. The Targeted Population is specific to the individual borrowers whose socio-economic characteristics are used to determine inclusion in the Target Market.[16] Targeted Populations that are not already approved by the CDFI Fund, in the future these Target Markets must be submitted for

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[13] https://www.cdfifund.gov/Documents/CDFI%20Certification%20Application%20for%20Comment%20May%202020.pdf, CDFI Certification Application for public comment, pg. 53, accessed 10/13/20.

[14] https://www.cdfifund.gov/Documents/2020-09747-Certification%20Application.pdf, Federal Register / Vol. 85, No. 89 / Thursday, May 7, 2020, pgs. 27277 – 27278, accessed 10/13/20.

[15] https://www.cdfifund.gov/Documents/2020-09747-Certification%20Application.pdf, Federal Register, May 7, 2020, Vol. 85, No. 89, pg. 27278, accessed on 10/07/20.

[16] https://www.cdfifund.gov/Documents/CDFI%20Certification%20Application%20for%20Comment%20May%202020.pdf, CDFI Certification Application for public comment, pg. 55, accessed 10/13/20.

approval prior to being proposed in a CDFI Certification Application.[17] The Applicant must use the CDFI Fund's approved verification processes to demonstrate that it is serving the Targeted Population.[18]

Target Market Verification Processes

A Target Market verification process or combination of such processes will be used to verify whether the appropriate percentage of an Applicant's Financial Products and/or Financial Services are being deployed to their designated Target Market(s). Only those Target Market verification processes approved by the CDFI Fund may be used when compiling Target Market data.[19]

Applicants may request approval of a Target Market verification process(es) not already accepted by the CDFI Fund to compile Target Market data for the CDFI Certification Application, however, the new process(es) must be approved by the CDFI Fund prior to submission of the application. Approved CDFI Fund Target Market Verification Processes must be used exactly as approved unless and until modification of the process is authorized by the CDFI Fund.[20]

Specific Topics / Application Questions

Sixty Percent Threshold Requirement

The revised CDFI Certification Application – Revision Quick Reference document states that Applicants seeking to become CDFIs will be required to direct the prescribed percentage of their lending and/or investing activity to the Target Market Types for which they are certified both in terms of the number and dollar amount of such activity. This requirement will be applied without exception meaning the CDFI Fund will no longer provide exceptions on a discretionary basis to the Target Market threshold requirement."[21] It is important to emphasize that neither the statute nor the regulations states what

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[17] https://www.cdfifund.gov/Documents/FY%2020%20CDFI%20Certification%20Quick%20Facts%2005052020%20508%20compliant%20FINAL.pdf, Proposed CDFI Certification Application, Request for Public Comment, Revision Quick Reference, Community Development Financial Institutions Fund , U.S. Department of Treasury, May 2020, pg. 8, accessed 10/13/20.

[18] https://www.cdfifund.gov/Documents/CDFI%20Certification%20Application%20for%20Comment%20May%202020.pdf, CDFI Certification Application for public comment, pg. 55, accessed 10/13/20.

[19] https://www.cdfifund.gov/Documents/CDFI%20Certification%20Application%20for%20Comment%20May%202020.pdf, CDFI Certification Application for public comment, pg. 57, accessed 10/13/20.

[20] Ibid.

[21] https://www.cdfifund.gov/Documents/FY%2020%20CDFI%20Certification%20Quick%20Facts%2005052020%20508%20compliant%20FINAL.pdf, Proposed CDFI Certification Application, Request for Public Comment, Revision Quick Reference, Community Development Financial Institutions Fund, U.S. Department of Treasury, May 2020, pg. 8, accessed 10/13/20.

percentage of a CDFI's activities must be devoted to its Target Market(s).[22] However, the Fund's guidance for completing a certification application requires that at least 60% of a CDFI's "Financial Product" activities must be in qualified Target Markets (Investment Areas, Low Income Targeted Populations or Other Targeted Populations).[23]

This proposed change poses risks for both the CDFI Fund as well as Applicants and existing CDFIs. It is not clear why the Fund decided to rescind its ability to provide exceptions to the Target Market threshold requirement. Such discretion is crucial to maintaining flexibility to consider the specific circumstances of a particular Applicant's lending and/or investing activities. Implementing an inflexible rule could result in an Applicant being denied certification (or an existing CDFI being decertified even using a three-year average) often because of mathematical anomalies rather than a failure by the entity to direct its financing activities to its approved Target Markets. For example, when an entity makes loans of very different sizes and in differing quantities, it may fail to meet the 60% threshold for ***either the number of units or the dollar amount.*** For example, let's assume an entity originates five loans in a given year. Three of the five loans (60% of the units) are made to its approved Target Markets however, two of the loans are for $500,000 each and one loan is for $1 million. In this case, the dollar value of the eligible loans is only $2 million or 40% of the total value of the loans originated. A similar situation could arise if an entity makes a small number of large facilities or affordable housing loans while also originating a larger volume of small business loans. For instance, if a CDFI originates 100 loans in a year of which five loans of $2 million each and 55 loans of $1,000 each are made in its approved Target Markets. The remaining 45 loans for $35,000 each are *not* in its eligible Target Markets. In this scenario, only 55% of the units are directed to approved Target Markets but 86% of the dollar value of the loans originated are serving its approved Target Markets. Situations like these occur frequently and therefore it is critical that the CDFI Fund preserve its discretion with regard to the 60% threshold for the Target Market test. In addition, national emergencies, such as the current COVID-19 pandemic and economic crises, like the Great Recession, offer compelling examples of circumstances where the CDFI Fund may wish to retain discretion as it relates to the 60% test.

Recommendation: The CDFI Fund *should* maintain its discretion related to the 60% threshold for the Target Market test.

National Investment Area / Targeted Population Target Markets

The single most important and positive change to the CDFI Certification policies is the removal of geographic boundaries on most types of Target Markets, including those comprised of Investment Areas and some Targeted Populations. This change is particularly noteworthy for two reasons: (1) it recognizes the changing nature of delivering Financial Products and/or Financial Services in all communities across the country, including low- and moderate-income areas; and (2) it no longer discourages CDFIs from providing loans in eligible census tracts or to eligible populations outside of the geographic areas specified for their approved Target Market(s). Under current policy, transactions outside of a CDFI's approved

[22] Memorandum to Annie Donovan, Director of the CDFI Fund from the CDFI Coalition re: Modernizing the CDFI Certification Process, May 6, 2016.

[23] CDFI Fund Supplemental Guidance and Tips (February 2014) p. 20.

Target Market(s) *cannot* be counted towards the 60% threshold of their financing they are required to direct to their approved Target Market(s), even if the loan is made in a qualified census tract or to a qualified member of a Targeted Population. These qualified loans actually counted *against* a CDFI seeking to meet the Target Market test reducing the amount of credit available to eligible borrowers. As the geographical and technological reach of CDFIs has expanded, this policy has become a barrier to advancing the CDFI Fund's goals and its mission. CRF has long argued for a National Investment Area Target Market and applauds this decision by the Fund to allow CDFIs to address the credit needs of small businesses anywhere in the country with safe, appropriate credit products. This policy change comes at a critical time for our economy and for small businesses struggling to recover from the coronavirus pandemic. It will also encourage CDFIs to embrace and adopt new financial technology which is critical to the success of the industry reaching and effectively supporting small business owners, nonprofits and other community-based organizations in the recovery phase of this public health crisis. We commend the Fund staff for taking this important step in modernizing the CDFI Certification criteria.

With the advent of a National Investment Area Target Market, we request the CDFI Fund implement the following policy changes:

1. Automatically grant CDFIs a blanket National Investment Area (IA) Target Market (assuming they can meet the Accountability requirements) so that they can address the critical need for credit in the COVID-19 crisis
2. Consider adopting the Accountability model applied to the certification of Community Development Entities (CDEs) in the New Markets Tax Credit Program for CDFIs that wish to have a National IA Target Market. To be a certified CDE, 20 percent of the governing or advisory board members must be accountable and can be accountable to larger geographic areas.[24] For CDE certification, a governing or advisory board member can be "an employee or board member of a non-affiliated community-based or charitable organization that provides more than 50 percent of its activities or services to Low-Income Persons and/or LICs [Low-income Communities].[25] Utilizing the CDE Accountability requirements for CDFIs with a National IA Target Market will

[24] In the Fund's CDE Certification Question and Answer guidance, the Fund directly addresses having board members accountable to large regions or nationwide: "**26) How do I demonstrate accountability to LICs in my service area if I am serving a large geographic area (e.g., a state, a multi-state region or the entire nation)?** The Fund advises entities that serve a large geographic area should appoint at least one person that is accountable to LICs throughout the service area to its board or advisory board. For example, an organization serving the entire nation should appoint to its board a staff person or a board member from a nationwide community development organization primarily serving LICs. An organization without at least one person on its governing board or advisory board(s) that can reasonably be deemed to be representative of LICs throughout the organization's service area may still be certified as a CDE, provided that the Fund determines that at least 20% of its governing board or advisory board(s) is representative of a cross-section (e.g., urban and rural) of LICs in its service area. Determinations regarding what constitutes a cross-section of a particular service area will be made on a case-by-case basis by the Fund. Organizations, particularly those serving multi-state geographies, may wish to establish multiple advisory boards in order to meet this requirement."

[25] CDE Certification Board Table pdf, available on the CDFI Fund's websites at https://www.cdfifund.gov/programs-training/certification/cde/Pages/default.aspx, accessed 10/31/20.

better align the CDFI and CDE Certification rules, simplifying reporting and regulatory requirements for Applicants participating in both programs.

Target Market Verification Processes

The revised Certification Application states that Applicants ***must*** use an approved Target Market verification process or a combination of approved processes to verify or qualify that their Financial Products or Financial Services meet the Target Market criteria.[26] Moreover, "only those Target Market verification process(es) approved by the CDFI Fund may be used when compiling Target Market data. Applicants may request approval of a Target Market verification process(es) not already accepted by the CDFI Fund however, to use a new Target Market verification process(es) when compiling Target Market data for the CDFI Certification Application, the new process(es) must be approved by the CDFI Fund prior to submission of the application. Approved CDFI Fund Target Market Verification Processes must be used exactly as approved unless and until modification of the process is authorized by the CDFI Fund."[27]

The proposed Target Market Verification Process policy raises a number of questions that have not been addressed in the revised Certification Application or elsewhere in the supporting documents. In particular:

1. Is there a list of "approved verification processes" and, if so, where can it be found?

   Question #11 of the Updated FAQs for the Proposed CDFI Certification Application, ACR & CTLR states that the CDFI Fund is "developing a comprehensive list of approved [Target Market verification] processes an entity may use without seeking prior approval and this list will be made available prior to the finalization of the revised application… Entities still will be able to request approval of a Target Market verification process(es) not already accepted by the CDFI Fund."[28]

   With all due respect, we find it *unacceptable* that the list of approved Target Market verification processes is still being developed and therefore, we are unable to comment or provide input on this crucial aspect of the Certification criteria.

   Recommendation: We *strongly* urge the Fund **not** to finalize the revised application until industry practitioners have had an opportunity to review and respond to this list of approved processes.

[26] https://www.cdfifund.gov/Documents/CDFI%20Certification%20Application%20for%20Comment%20May%202020.pdf, CDFI Certification Application for public comment, pg. 57, accessed 10/14/20.

[27] Ibid.

[28] https://www.cdfifund.gov/Documents/CDFI%20Certification%20Public%20Comment%20FAQ%2009242020.pdf Proposed CDFI Certification Application, ACR & CTLR – Request for Public Comment, Frequently Asked Questions Updated October 2020, Q.11, pg.8, accessed 10/16/20.

2. What is the process for requesting approval from the CDFI Fund of a new Target Market verification process?

   Question #12 of the Updated FAQs for the Proposed CDFI Certification Application, ACR & CTLR states that "Applicants or CDFIs requesting approval for a currently unapproved Target Market verification methodology will need to submit the request in writing for review. The details and timeframe for submission are under development."[29]

   Again, we are troubled that the process and the timeline for submitting unapproved Target Market verification methodologies to the CDFI Fund for approval have yet to be determined. It would appear the Fund has not anticipated or fully developed all aspects of the revised Certification Application and the supporting rules and/or guidance. The lack of detail and clarity makes it very challenging for CDFIs to operate, much less innovate new products and services, if they lack the certainty of how such offerings could affect their Certification Application and/or current Certification status.

   Recommendation: We *strongly* urge the CDFI Fund to develop and publish the details of this approval process prior to finalizing and implementing the revised Certification Application as well as the Annual Certification and Data Collection Report (ACR) and the Certification Transaction Level Report (CTLR), all of which will be directly affected by this process.

3. A large influx of requests to approve individual verification processes could overwhelm the CDFI Fund staff. How would such a situation be handled? What is the timeframe for review and approval of such a process?

4. Is there an opportunity to discuss or amend a proposed verification process should the Fund decline to accept a new verification process(es)?

5. What happens if you answer "No" to Question TM07? Would this prevent the Applicant from being certified without approval of its Target Market verification process? If so, this should be clearly stated in the Application along with guidance as to what Applicants in this situation should do.

As noted in our past comment letters,[30] many CDFIs serving an LITP Target Market qualify or verify that their loans serve their approved Target Market(s) by looking through the borrower to the "end user or beneficiary" of the financing being provided. For example, a loan to finance a multifamily affordable housing project using a government program, like the Low-Income Housing Tax Credit (LIHTC), qualifies as serving a Low-income Targeted Population based on program requirements mandating that a certain percentage of the housing units be rented to low-income families. Similarly, a CDFI making a loan to a charter school or a community health center may "look through" the project to the "end beneficiaries"

[29] Ibid, Q. 12, pgs.8-9, accessed10/16/20.

[30] See CRF's Comment Letters on the CDFI Fund's Certification Policies and Procedures, March 10, 2017, its Interim Rule implementing the CDFI Fund Program, October 26, 2015 and its Annual Certification and Data Collection Report Form, September 8, 2014.

using proxies, such as the number of students receiving free or reduced lunches or the number of Medicaid eligible patients, to verify the financing is serving low-income people. However, to the best of our knowledge, none of these practices have been approved by the Fund in regulation or guidance.

The situation becomes more nuanced when applied to small business lending activities since "end users or beneficiaries" are not as easily identified or measured. CDFIs with a LITP Target Market certification have developed their own methodologies for qualifying small business loans as serving low-income populations based on information demonstrating (1) the business owner is a low-income person (such as for microenterprise businesses); (2) the business is hiring low-income people; (3) the business provides jobs accessible to low-income people; or (4) the employees are residents of low-income communities. However, each of these methods may require the collection of sensitive or personal data and may be burdensome for small businesses with limited capacity. The absence of CDFI Fund guidance on how to verify that these loans are serving LITP "end users/beneficiaries" means each CDFI has developed its own approach and metrics for qualifying their small business loans balancing the need for information and the limited bandwidth of small firms.

The absence of uniform industry standards for CDFIs means these organizations run the risk of unintentional non-compliance. We have requested the Fund develop specific protocols for verifying different types of loans or investments with input from industry practitioners based on the nature of the borrower or project and the "end users/beneficiaries". CDFIs should be permitted to use various proxies (as described above) to easily qualify their loans and demonstrate they are directing their lending to their approved Targeted Population (TP) Target Market(s). The Fund should not implement a policy on Target Market verification processes without first seeking comments and detailed input from the CDFI industry and interested stakeholders on specific proxies and/or methodologies to be used to qualify financing activities that support "end users/beneficiaries". The list of proxies should be regularly updated as CDFIs are continually finding new ways to serve "end users/beneficiaries.

In the case of small business lenders serving a LITP Target Market, the Fund staff should solicit additional comments from CDFIs engaged in this type of financing to develop a specific set of protocols for this asset class. Due to the difficulties of qualifying all small business loans using a single methodology or measure, we recommend that CDFIs be allowed to demonstrate they are serving small business "end users/beneficiaries" based on one of the four approaches described above: lending to low-income business owners, businesses that hire low-income people; businesses that provide jobs accessible to low-income people; or whose employees live in low-income areas. There may be other ways to qualify small business loans serving "end users/beneficiaries" as well. We have provided additional comments in Certification Transaction Level Report (CTLR) section below where we also address questions related to LITP Target Market verification processes.

Recommendation: We ask the CDFI Fund to respond to all the questions noted above, and *strongly encourage* the staff to seek input and feedback from the CDFI industry on this critical aspect of the certification criteria. Not doing so, runs the risk of upending existing Target Market verification processes and practices that CDFIs have used for decades and could place their certification status in jeopardy. The approved Target Market verification processes must be clearly stated and must entail reasonable data collection requirements that do not impose an undue burden on CDFIs or their customers. Finally,

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there must be a well-articulated path for Applicants to anticipate and address Fund staff concerns about the verification processes they propose to use. Without such assurances, new and existing CDFIs will be left in limbo, unable to deliver vital capital and credit to the communities and people that depend on them.

<u>Question TM03.1</u> What type(s) of Financial Product(s) and/or Financial Service(s) is needed within the Investment Area but is not currently available at a level sufficient to meet the need?

Noticeably absent from the drop down list of options for this question is a "Small Business Loan" option. We distinguish a Small Business Loan from a Small Dollar Loan and/or a Microenterprise Loan on the basis of size. As a national SBA 7(a) lender, CRF generally originates loans above $150,000 and offers loans of up to $5 million under the program guidelines.

<u>Recommendation</u>: The CDFI Fund should add "Small Business Loan" to the drop down list included in Question TM03.1.

<u>Question TM03.2 & TM03.3</u> Indicate the basis for the Applicant's determination that the Financial Products and/or Financial Services identified as being needed within the Investment Area are actually needed within the area.

Indicate the basis for the Applicant's determination that the Financial Products and/or Financial Services identified as being needed within the Investment Area are not currently available at levels sufficient to meet the existing need.

What information is the Fund looking for in these questions? Banks or other types of lenders may be present in a given area but may not making loans to borrowers typically served by CDFIs. Is the Fund asking if other lenders are offering loans with similar or equivalent terms and conditions? If so, this should be clearly stated. It should be noted that fintech lenders are active everywhere because they are online which makes these questions even more confusing.

Additionally, we are concerned that Question TM03.3 may unintentionally imply that there is a certain level at which Financial Product(s) and/or Financial Service(s) are deemed "*sufficiently available*". If such a level has been reached, would the Fund assume that additional Financial Products or Services are not necessary since the need has been met with an adequate supply? The dangerous assumption underlying this question is that the Fund is suggesting customers or organizations in Investment Area(s) should not have an abundance of credit options/services available to them, as is the case for customers in affluent areas. Instead customers in low-income areas are *only* require a *sufficient supply* of such Products and/or Services. We don't believe this is the Fund's intention and it should clarify this point in Question TM03.3.

Finally, these two questions are closely related and provide a clear example of where the revised Certification Application could be streamlined for efficiency purposes. Since both questions require the Applicant to provide a narrative, it would seem beneficial to combine the two into a single question and ask respondents to address both the *need* and the *current availability* of particular Financial Product(s) and/or Financial Service(s) within the Investment Area.

<u>Recommendation</u>: The CDFI Fund should clarify what information it is seeking in Questions TM03.2 and TM03.3 and that it does not intend to certify Applicants *only* when there is an *insufficient supply or level* of Financial Product(s) or Financial Service(s) to avoid the appearance of credit allocation or to suggest that customers operating in Investment Area(s) should not have choices when seeking such Products or Services. These questions should be combined into a single narrative.

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Question TM07 Is the Applicant using a Target Market verification process that is not identified on the full list of approved CDFI verification processes to determine whether or not Financial Product transactions have been directed to an allowed Target Market?

This question allows the Applicant to respond either in the affirmative or the negative. However, Questions TM07.1 and TM07.2 are predicated on a "Yes" response and assume that the CDFI has obtained separate approval for such a verification process. It offers no path or guidance for entities that answer "Yes" to this question but *have not* secured separate approval of their Target Market Verification process.

Recommendation: This oversight should be addressed so Applicants know how to proceed if they are using a Target Market verification process that is not identified on the full list of approved Target Market verification processes and have not received approval from the CDFI Fund to use their process.

Development Services

Overview

Applicants seeking to be Certified as a CDFI must demonstrate a track record of providing (directly or through an Affiliate or a contract with another provider) Development Services in conjunction with its Financial Products or Financial Services. Development Services are activities that promote community development and prepare or assist current or potential borrowers to access a CDFI's Financial Products or Financial Services. These activities may include financial or credit counseling, homeownership counseling, and business planning.[31]

According to the Revision Quick Reference to the Proposed CDFI Certification Application "no substantive policy changes are being implemented in the Development Services section of the CDFI Certification Application."[32] However, the revised Certification Application characterizes a Development Service as "…a formal *stand-alone* (emphasis added) training, counseling, or technical assistance service that promotes access to and/or success with an entity's Financial Products and/or Financial Services, and that the entity offers separately and distinctly from its other products/services."[33]

Moreover, the revised Certification Application details a specific list of Development Service requirements including:[34]

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[31] https://www.cdfifund.gov/Documents/FY%2020%20CDFI%20Certification%20Quick%20Facts%2005052020%20508%20compliant%20FINAL.pdf, Proposed CDFI Certification Application, Request for Public Comment, Revision Quick Reference, Community Development Financial Institutions Fund , U.S. Department of Treasury, May 2020, pg. 10, accessed 10/16/20.

[32] Ibid.

[33] https://www.cdfifund.gov/Documents/CDFI%20Certification%20Application%20for%20Comment%20May%202020.pdf, CDFI Certification Application for public comment, pg. 62, accessed 10/16/20.

[34] Ibid.

- Offering at least one Development Service;
- Demonstrating control over the content and delivery parameters of their Development Service(s);
- Clearly linking the Development Service(s) provided by the Applicant or a relevant Affiliate, to at least one of the Applicant's Financial Products or Financial Services;
- Making at least one Development Service available on an ongoing basis at least four times per year;
- Tracking delivery of and participation in the Development Service(s); and
- Tracking staff time spent on the administration and delivery of the Development Service, if the Applicant is the provider.

Publicly-available online training can be considered a Development Service only if the Applicant can demonstrate that it has a relationship with the developer of the training, either because the Applicant is the developer, an Affiliate is the developer, or the Applicant has a service agreement in place with the developer.[35]

The proposed Certification Application also describes those activities that CDFI Fund does not consider to be Development Services:[36]

- Training, counseling, or technical assistance not clearly intended to prepare consumers to access and/or be successful with a Financial Product and/or Financial Service offered by the Applicant.
- Making referrals, to training, counseling, or technical assistance services provided by other entities.
- Information presented in newsletters, flyers, or online.
- Workshops for children or conferences/workshops for broad audiences.
- Presentations made at one-off events or at regular events held by other entities.
- Marketing events/activities.
- Services provided at the will and discretion of other entities (e.g., publicly available online training).
- Non-structured conversations with consumers on Development Services subject matter.

Specific Topics / Application Questions

Changes to Development Services

Although the CDFI Fund asserts that it is not making any "substantive policy changes" to the Development Services section of the revised Certification Application, we are concerned by the subtle shift in the Fund's approach to this criteria. In particular, we were surprised by the addition of language characterizing Development Services as "a formal *stand-alone*"(emphasis added) training, counseling, or technical assistance service. This language was not contained in existing Certification guidance documents including, but not limited to, CDFI Fund Glossaries, the AMIS - Submission Guidance for CDFI Certification Application Updated – November 01, 2018, or the CDFI Certification Application Supplemental

[35] Ibid.

[36] Ibid.

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Guidance and Tips Updated – November 01, 2018. The addition of this language raises the question as to whether the Fund has changed its view on what kind of technical assistance activities meet the definition of Development Services?

CRF has long provided Development Services in the form of highly customized, one one-on-one technical assistance (TA) to our small business customers seeking to access our loan products – especially our SBA 7(a) loan. This technical assistance, while focused on helping customers secure a small business loan, can be wide ranging, including but not limited to, developing financial statements and/or projections, preparing market analyses, restructuring existing debt to improve cash flow, building a borrower's credit profile, and explaining specific requirements of a loan product, like the SBA 7(a). To best support and strengthen the small business owner, these business advisory services are embedded in credit discussions with the prospective customer rather than being offered as a formal standardized offering. This form of TA has been at the foundation of CRF's lending process and is essential to how we offer our loan products. It is integral to the ability of our customers to be successful in using our Financial Products.

In addition to providing technical assistance directly to our customers, CRF frequently refers small business borrowers to local Small Business Development Centers (SBDCs) and business advisory organizations, like SCORE, that can provide specialized SBA expertise and knowledge that complements and augments the capacity of our staff. These referral recommendations are made to trusted partners to ensure that customers get the best possible advice and guidance when seeking a loan.

The nature, format, frequency, and amount of TA services provided to its customers should be left to the discretion of the individual CDFI. Every customer is different, and CDFIs have developed the necessary expertise to recognize and respond appropriately to each customer's needs. Some may require support from a CDFI while others may not. It is vital that the Fund maintain a flexible definition of Development Services so as to allow CDFIs to deliver the type and form of assistance that fits the needs of the customer rather than dictating a one-size-fits all approach to this important aspect of CDFI Certification. Inflexible parameters will limit CDFIs but even more importantly, they will rob customers, especially those that are underserved or operating in low- and moderate-income communities, of this critical element that can help them achieve their dreams through economic opportunity.

Recommendation: We urge the CDFI Fund to confirm its commitment to allow CDFIs to offer flexible, tailored, Development Services that reflect the needs of CDFI customers and the challenges they may be facing (e.g. the COVID-19 pandemic). Regardless of whether these services are delivered in person, through technology, as part of the lending process, and/or at a frequency that is best suited to the individual customer, it should be clear that such activities meet the criteria for CDFI Certification. Dictating the types of Development Services a CDFI provides to its customers will undermine the trust these organizations have built and the success they have achieved in helping to improve the economic health and well-being of low- and moderate-income communities and their residents.

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Accountability

Overview[37]

Under the existing rules, a Certified CDFI must maintain accountability to its Target Market—the residents of an Investment Area(s) or members of a Targeted Population(s)—through representation on its governing board or advisory board. Currently, governing and advisory board members must represent both the Target Market(s) and the related geography(ies).

The revised CDFI Certification Application does not require there to be a geographic connection in order to satisfy board member accountability requirements. This is to conform with elimination of the requirement to identify geographic boundaries for most Target Markets.

An Applicant or CDFI must maintain accountability to residents of its Investment Area or Targeted Population, through representation on its governing board and/or advisory board(s). The CDFI Fund requires that a board consist of no less than three (3) members. In determining whether an Applicant maintains accountability to its proposed Target Market(s), the governing board structure must be assembled in the following manner: (1) at least one governing board member is accountable to each proposed Target Market; *and* (2) at least 33% of the governing board is accountable to the overall proposed Target Market(s).

Specific Topics / Application Questions

Accountability to National Investment Area Target Market

As noted in the Target Market section, CRF is extremely pleased to see the implementation of a National Target Market comprised of Investment Areas (IA) or eligible census tracts anywhere in the United States. This pre-qualified National IA Target Market is welcome news for CDFIs engaged in small business lending with a national service area and recognizes there is an *urgent* need for CDFIs to be able to respond to credit requests from potential customers in pre-qualified or eligible census tracts regardless of where they are located. We commend the Fund staff for taking this important step to enable CDFIs to serve the critical credit needs of their customers throughout the country.

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[37] This section draws from two sources:
https://www.cdfifund.gov/Documents/FY%2020%20CDFI%20Certification%20Quick%20Facts%2005052020%20508%20compliant%20FINAL.pdf, Proposed CDFI Certification Application, Request for Public Comment, Revision Quick Reference, Community Development Financial Institutions Fund, U.S. Department of Treasury, May 2020, pg. 9, accessed 10/16/20 and
https://www.cdfifund.gov/Documents/CDFI%20Certification%20Application%20for%20Comment%20May%202020.pdf, CDFI Certification Application for public comment, pg. 68, accessed 10/16/20.

The Fund has also greatly simplified the Accountability requirements associated with CDFI governing boards as well as advisory boards. The new rules provide clear guidance to CDFIs as how many board members must be accountable to each proposed Target Market as well as the total percentage of board members that must be accountable to the overall proposed Target Market(s). This guidance will enable CDFIs as to create a board structure that meets the Accountability criteria – a welcome change.

Nonetheless, we believe additional clarification should be provided to CDFIs seeking to serve a National IA Target Market. The Fund should confirm that a CDFI with a National IA Target Market can meet its accountability requirements by including *at least* one member of a national organization on its governing board (assuming this accountability method is being used) who is an "*individual who works for (as an employee or board member) an organization that primarily provides services to residents of the Investment Area.*"[38] (emphasis added) Of course the CDFI's governing board must meet *all* the requirements of the new rules outlined above. It might be helpful to provide an example of how a CDFI could meet this new accountability requirement for the purposes of CDFI Certification. Note, as we recommended in the National Investment Area / Targeted Population Target Markets section above, the Fund should consider aligning the Accountability criteria for National IA Target Markets with the guidance provided to Community Development Entities (CDEs) in the New Markets Tax Credit (NMTC) program by the Fund in its CDE Certification Question and Answer document.[39]

Related to the changes in Accountability criteria, we also assume if an Applicant or CDFI is approved to serve a National IA Target Market and demonstrates Accountability to this Target Market through its governing board, they would not be required to maintain previously established Advisory Board(s) that served as accountability mechanisms for one or more approved statewide or regional IA Target Markets. If an Applicant or CDFI can meet the Accountability requirements through its governing board under the new Certification criteria then these Advisory boards would be redundant though an entity might choose to keep and utilize them for other purposes (market research, partnership opportunities, etc.).

Recommendation: We encourage the CDFI Fund to issue additional clarifying guidance on two aspects of the Accountability requirements associated with the new National IA Target Market. First, we suggest the Fund provide specific guidance on the types of representatives of national organizations that could demonstrate accountability to this Target Market for CDFI Certification. Second, if a CDFI is able to satisfy the new Accountability criteria through its governing board, then such an entity would not be required to retain existing Advisory Boards previously established to comply with Accountability requirements for formerly designated statewide or regional IA Target Markets that are no longer applicable.

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[38] https://www.cdfifund.gov/Documents/FY%2020%20CDFI%20Certification%20Quick%20Facts%2005052020%20508%20compliant%20FINAL.pdf, Proposed CDFI Certification Application, Request for Public Comment, Revision Quick Reference, Community Development Financial Institutions Fund, U.S. Department of Treasury, May 2020, pg. 9, accessed 10/19/20

[39] "The Fund advises entities that serve a large geographic area to appoint at least one person that is accountable to LICs throughout the service area to its board or advisory board. For example, an organization serving the entire nation should appoint to its board a staff person or a board member from a nationwide community development organization primarily serving LICs." New Market Tax Credit CDE Certification Question & Answer, Community Development Financial Institutions Fund, July 2005, pgs. 9 – 10.

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Question #16 of the Updated FAQs for the Proposed Certification Application, ACR & CTLR

We are pleased to see Question 16 in the Updated FAQs clarifies that a board member of a CDFI *may* meet the Accountability test for more than one Target Market. Allowing board members to represent more than one Target Market will make it much easier for Applicants and CDFIs to have manageably sized governing boards while serving a diverse set of Target Markets. We applaud this change as it will enable us to expand our Target Markets to include Targeted Populations we are already serving but for which we could not be certified as the Accountability requirements would have made our governing board unusually large and potentially unwieldy.

Question #17 of the Updated FAQs for the Proposed CDFI Certification Application, ACR & CTLR

Do employees of a certified CDFI that serves a Targeted Population meet the accountability test to serve on the board of another entity serving that Targeted Population?

The CDFI Fund should further clarify of this question. It states that "An employee of a certified CDFI may meet the accountability test on the basis of her or his employment for a certified CDFI *only* (emphasis added) when serving as a board member for a CDFI with a Target Market of OTP-CDFI. An employee of a CDFI may still serve on the board of other CDFIs that do not have a Target Market of OTP-CDFI but must meet the accountability test based on other accountability criteria. For example, a Hispanic employee of a certified CDFI may meet the accountability test if serving on the board of another CDFI with a Target Market of OTP-Hispanic on the basis of being a member of the Other Targeted Population. However, a white employee of a certified CDFI would not meet the accountability test if serving on the board of another CDFI with a Target Market of OTP-Hispanic, even if the CDFI by which the board member is employed also has a Target Market of OTP-Hispanic. Either employee would meet the accountability test if serving on the board of another CDFI with a Target Market of OTP-CDFI."[40]

We assume this question is ***only*** applies to the Accountability requirements for the governing boards of CDFIs serving OTP Target Markets and ***does not*** apply to such requirements for governing boards of CDFIs serving LITP Target Markets. We find it hard to believe that the CDFI Fund would not allow an employee or a board member of a CDFI (with an LITP Target Market) to provide accountability as a representative of an organization that serves low-income people or communities on the governing board of another CDFI. Otherwise, it would appear that CDFI employees / board members could *only* serve on the board of a CDFI that is serving other CDFIs (i.e. CDFI Intermediaries) or if the employee demonstrates accountability through another characteristic (such as race or ethnicity). This rule makes no sense for CDFIs with an LITP Target Market. In fact, it is common practice for leaders of CDFIs to sit on each other's governing boards to meet the accountability requirements for CDFI Certification as well as to provide their expertise and partnership opportunities. For

[40] https://www.cdfifund.gov/Documents/CDFI%20Certification%20Public%20Comment%20FAQ%2009242020.pdf Proposed CDFI Certification Application, ACR & CTLR – Request for Public Comment, Frequently Asked Questions Updated October 2020, Q.17, pg.11, accessed 10/19/20.

these reasons, we believe the guidance provided in Question 17 was intended to focus *exclusively* on the accountability criteria for OTP Target Markets which mandates that board representatives be members of the OTP in order for them to be deemed accountable to the Targeted Population.

Recommendation: The CDFI Fund should clarify that Question 17 of the Updated FAQs applies *only* to the Accountability requirements for OTP Target Markets and not for LITP Target Markets. We do not believe the Fund intends to restrict the ability of CDFI employees and/or board members serving an LITP Target Market(s) to provide accountability to such populations when serving on the governing boards of other CDFIs with a similar Target Market(s).

CERTIFICATION TRANSACTION LEVEL REPORT (CTLR)

Overview

The Certification Transaction Level Report (CTLR) is a new reporting document intended to support both the revised Certification Application and the Annual Certification and Data Collection Report (ACR). Applicants seeking CDFI Certification and certified CDFIs that are not current Financial Assistance recipients and therefore do not submit an annual Transaction Level Report (TLR) to the CDFI Fund will be required to file this new report.

Questions Related to the CTLR

Will the methods for qualifying loans outlined in the CTLR be applied in the TLR which CDFIs that have received a Financial Assistance (FA) award are required to file? Specifically, will CDFIs filing the TLR be required to use the same methods for qualifying LITP loans as detailed in the proposed CTLR? If so, when will this new methodology be incorporated into the TLR and when will CDFI award recipients be required to comply?

Specific Topics/Questions

LITP End Users and Implications for Small Business Lending

The issue of which Target Market verification processes CDFIs use is extensively discussed in above (see Target Market Verification section). These processes are particularly challenging for CDFIs with LITP Target Market(s) engaged in small business lending. We will briefly recap several concerns discussed above related to LITP End Users.

The CTLR explicitly states that entities may code loans as serving an LITP Target Market however, such coding should be based on the collection of income data per the CDFI Fund's Regulations and the CDFI Fund's approved LITP income verification processes. For cases where the CDFI Fund has approved an entity's method to determine LITP End Users that method can be used to designate transactions as long as there is supporting documentation.[41] Similarly, the revised Certification Application states that "only those Target Market verification processes approved by the CDFI Fund may be used when compiling Target Market data" and refers CDFIs to "the full list of approved CDFI Fund verification

[41] https://www.cdfifund.gov/Documents/CTLR%20FINAL%20MAY%202020.pdf, Certification Transaction Level Report, pg. 4.

processes."[42] Unfortunately, as is explained in Questions 11 and 12 of the Updated FAQs for the proposed Certification Application, ACR and CTLR, the CDFI Fund is still "developing a comprehensive list of all approved processes an entity may use" as well as a "process for obtaining approval for a verification methodology that is not yet approved."[43]

Recommendation: The CDFI Fund should ***refrain*** from finalizing new CDFI Certification documents and criteria until practitioners and industry participants have a reasonable opportunity to offer comments and input on potential LITP Target Market verification processes and protocols. Without standard processes or guidance from the CDFI Fund and due to the significant challenges of collecting household (family) income from small business employees, many CDFIs developed their own verification methodologies by using proxies to confirm that their loans are being directed to low-income end users. This approach was modeled after similar practices used by CDFIs lending to affordable housing projects, charter schools, community health centers and other community organizations, where they routinely utilized low-income proxies (e.g. the Low Income Housing Tax Credit, students receiving free and reduced lunches, Medicaid eligible patients, etc.) to demonstrate that the end users or ultimate beneficiaries of their financing activities are low-income people. Small business lending CDFIs have relied on their own verification methodologies for many years, perhaps decades. To potentially upend them without a reasonable comment period and the opportunity to gain uniform Fund approval for a broader list of verification processes could have negative repercussions for the CDFI industry as well as the small businesses that depend on them.

CIMS Census Block Group Geocoding

To address the difficulties of collecting income data from small business employees, the CDFI Fund introduced its own proxy or alternative method for qualifying small business loans as serving LITP Target Markets. This approved alternative proxy method is known as Census Block Group Geocoding and would be available to CDFIs through the CDFI Information Mapping System (CIMS). According to the CTLR, "This proxy LITP method provides a standardized approach for determining LITP status that overcomes a data limitation that many CDFIs confront when attempting to implement the statutory guidance for collecting household income adjusted for family size. With the exception of mortgage loans, CDFIs and other lenders underwriting consumer and business loans typically do not collect information on family or household income adjusted for family size, which means they cannot readily confirm whether the loan meets the statutory requirements for a Low-Income Targeted Population. The LITP Census Block method provides an approved alternative approach for coding transactions that constitutes a safe harbor."[44]

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[42] https://www.cdfifund.gov/Documents/CDFI%20Certification%20Application%20for%20Comment%20May%202020.pdf, CDFI Certification Application for public comment, pg. 57, accessed 10/14/20.

[43] https://www.cdfifund.gov/Documents/CDFI%20Certification%20Public%20Comment%20FAQ%2009242020.pdf Proposed CDFI Certification Application, ACR & CTLR – Request for Public Comment, Frequently Asked Questions Updated October 2020, Qs.11 & 12, pg.8, accessed 10/20/20.

[44] https://www.cdfifund.gov/Documents/CTLR%20FINAL%20MAY%202020.pdf, Certification Transaction Level Report, pg. 4.

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Question 13 of the Updated FAQs explains how the Census Block Group geocoder actually works. This LITP methodology uses a combination of a borrower's location and the income distribution of a Census Block Group. It generates a 12-digit code for a loan based on its geocoded location in a Census Block Group. Unlike the geocoding of Investment Areas (which are based on census tracts), the proposed LITP methodology would be based on an underlying Census Block Group's percentile distribution (i.e. the block group's rank compared to other block groups) of household income that is less than or equal to 80% of Area Median Income. This approach would enable CDFIs to code transactions as low-income based on a borrower's location in a qualified LITP census block group that is outside of a qualified Investment Area census tract.[45]

Our concerns about the Census Block Group Geocoder are three-fold. First, CDFIs are not familiar with and therefore do not understand the Census Block Group Geocoding method at this time. They need an opportunity to familiarize themselves with this proposed approach. Second, this new geocoding capability has not yet been built in CIMs as the Fund makes quite clear in Question 20 of the Updated FAQs.[46] Third, without the ability to test this LITP methodology, CDFIs engaged in small business lending have no way of knowing whether this alternative verification process will allow them to qualify their loans. Since most CDFIs have had their lending criteria and processes in place for many years, it is *essential* that they be able to determine if the loans they are making or have made would be deemed to be serving their LITP Target Market(s). If, for some reason, this alternative methodology is not a good fit for some CDFIs, the Fund should provide an expedited process to review Target Market verification processes developed by individual CDFIs to assure a smooth and uninterrupted transition to the new Certification rules.

Recommendation: The CDFI Fund should provide educational webinars on the Census Block Group Geocoder to help CDFIs understand this alternative LITP verification methodology. They should also make this new tool ***available as soon as possible*** in CIMS so CDFIs, especially small business lenders, can test this alternative approach. Along with this new geocoding tool, the Fund needs to provide a detailed process and timeframe for reviewing and approving LITP methodologies developed by individual CDFIs in the event that this tool is not a suitable option for some entities. Finally, the Fund ***should not*** implement a final set of revised and/or new Certification documents and criteria until CDFI practitioners and industry participants have had an opportunity to provide comments and feedback on both the Census Block Group Geocoder as well as the Fund's process for vetting other LITP Target Market verification processes.

ANNUAL CERTIFICATION AND DATA COLLECTION REPORT FORM (ACR)

Overview

Question Related to the ACR

[45] https://www.cdfifund.gov/Documents/CDFI%20Certification%20Public%20Comment%20FAQ%2009242020.pdf, Proposed CDFI Certification Application, ACR & CTLR – Request for Public Comment, Frequently Asked Questions Updated October 2020, Q.13, pg.9, accessed 10/20/20.

[46] Ibid, Q. 20, pg.12.

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Section 1. Primary Mission / Community Development Strategy of the ACR states, "*Currently certified CDFIs that received their certifications prior to the implementation of the revised application* ***will be required to submit a revised Certification Application separately*** *and will not be required to respond to this question in the ACR until such time.*"[47] (emphasis added) This statement makes it clear that currently certified CDFIs *will* be required to be recertified by submitting a revised Certification Application. This requirement is not stated in the revised Certification Application itself and should be clearly reflected in that document.

Recommendation: The CDFI Fund should clearly indicate that *all* currently certified CDFIs will be required to prepare and submit a revised CDFI Certification Application to demonstrate adherence to and compliance with the new Certification criteria once it has been implemented. The Fund should also provide a timeframe within which certified CDFIs will be expected to submit this Application and the process that will be used to ensure timely review and recertification of these organizations.

CONCLUSION

We appreciate the significant efforts of the CDFI Fund staff to strengthen the CDFI Certification criteria. This has been a long and challenging process due to the diverse CDFI landscape and the critical nature of preserving the CDFI "brand". Changes in product offerings and technology as well as dramatic shifts in the economic environment have added complexity to this effort.

In light of these factors, we respectfully request that the Fund look carefully at all the comments submitted by industry stakeholders before finalizing its certification policy. There are several aspects of the certification criteria that merit further industry input and where tools and processes necessary to implement this new rule have yet to be developed. The Fund should provide an opportunity for additional comments and input where appropriate to ensure the new policy is thoroughly considered and achieves the objectives the CDFI Fund has articulated.

Thank you again for your on-going efforts to support and grow the CDFI industry. We stand ready to assist you in efforts to strengthen CDFI Certification criteria. Please do not hesitate to contact me if you have any questions about the comments contained in this letter.

Sincerely,

Frank Altman
CEO

[47] https://www.cdfifund.gov/Documents/Annual%20Certification%20Report%202020%20Final.pdf, Annual Certification and Data Collection Report for public comment, August 12, 2019, pg. 3, accessed 10/21/20.

PREPARED STATEMENT OF LAKOTA VOGEL

EXECUTIVE DIRECTOR, FOUR BANDS COMMUNITY FUND, EAGLE BUTTE, SOUTH DAKOTA

JANUARY 5, 2022

Thank you Chairwoman Smith, Ranking Member Rounds, and distinguished Members of the Subcommittee I am honored to have been included as a voice in this important hearing to share the successes and challenges of CDFIs serving underestimated communities across the Nation.

My name is Lakota Vogel. I am an enrolled member of the Cheyenne River Sioux Tribe, born and raised on a ranch in South Dakota. I am the Executive Director of Four Bands Community Fund, a 22 year old rural, Native CDFI that started by serving all residents of the Cheyenne River Sioux Reservation in north central South Dakota and expanded in 2013 to serve native entrepreneurs across the entire State. I am on the executive committee of the South Dakota Native Homeownership Coalition and a member of the Mountain Plains Regional Native CDFI Coalition.

I am here today to share the perspective of on the ground leaders within the Native CDFI movement, which spans 69 separate organizations operating across 27 States. The core of our mission and purpose of our programming is aimed at leveling inequities stemming from a historic lack of investment and access to capital, as well as noninclusive policies, in the communities we serve.

With two decades of experience, Four Bands has continuously improved our products and services to successfully deploy over $25 million across the State. We utilize an integrated approach in lending which fuses relationship building and learning with loan products. Our suite of programs are designed to revive traditional culture that supports self-sufficiency by focusing on two core areas:

- *Entrepreneurship*—Four Bands offers a comprehensive business training program, customized business coaching, and several lending products to help entrepreneurs at various stages of development start or expand a business. Our business loans provide up to $250,000 in capital that can be used for equipment and inventory purchases, working capital, acquisition of land or buildings, construction of buildings, and/or leasehold improvements for a commercial space. We also operate a business incubator that provides physical space, in addition to our entrepreneur programming, to six businesses. Our average business loan client is a female head of household who dreams of starting a business in the service industry that doesn't require a lot of start up capital, such as a restaurant, day care or a hair salon. In turn, these industries have a thin profit margin and have more difficulty accessing capital from financial institutions because of their small dollar nature and small balance sheet. Four Bands has deployed over $20 million to the small business sector resulting in the creation/expansion of over 300 native owned small businesses and we can proudly say, due to lots of innovation, with partners like CRF, and resource stacking, we did not lose one small business to the pandemic across the State.
- *Consumer and Home Ownership*—A unique challenge within our communities is invisible credit histories. We are fortunate to have 4 financial institutions serving Cheyenne River, but only 1 of them, the Credit Union reports to the Credit Bureaus. So we have generations of borrowers, utilizing debt tools for decades at the local institutions who remain invisible not due to the individual borrowers behaviors but due to institutional decisions. Four Bands began reporting to the credit bureaus in 2010. Our foresight and community mindedness, has primed our market for home ownership.

As our balance sheet grew, we were finally able to offer mortgage products to our community in 2019 in partnership with USDA as 1 of the 2 pilot sites for the 502 Direct Lending program. While we were able to close 8 mortgages with initial pilot, we spurred the demand and have since closed a total 42 mortgages on Cheyenne River within 1-and-a-half years.

My recommendations today are simple:

1. Advance the Native American Rural Homeownership Improvement Act. Thank you to Chairwoman Smith and Ranking Member Rounds for cosponsoring this legislation. The pilot was an enormous success and we've now built up a demand of over $7 million that cannot be met within our community. Access to these funds should include all Native CDFIs across the Nation.
2. Increase the Native American CDFI Assistance (NACA) appropriations to $50M to meet the needs. Overall Government spending has increased by 30 percent, and the CDFI Fund appropriations have increased by 13.7 percent,

but the annual appropriations for NACA have remained stagnant since 2014 and demand for service is increasing.

All of this to say, the tool, the Native CDFI tool works, it's just chronically undercapitalized. We are part of the communities we serve. We run into our clients in the grocery store. We sit on the Daycare Board of Directors desperately trying to keep these vital programs running. As Native CDFI staff and community members, we are woven into the fabric of the community and almost every aspect of our clients financial lives. There's no comparison to sitting across from our clients at tax time, assessing their earnings for the year and planning for the future. We are the gentle nudge to savings accumulation and the sounding board for many of the financial decisions our families make. We believe "how you perceive is how you proceed." We perceive opportunity because our success as Nation builders is intricately woven into the success of our neighbor.

Thank you for this opportunity to testify.

RESPONSES TO WRITTEN QUESTIONS OF CHAIR SMITH FROM JOHN HOLDSCLAW, IV

Q.1. What steps, if any, should be taken to improve the diversity of leaders in the CDFI sector?

A.1. Community development initiatives succeed when organizations are representative the communities they serve. Congress should continue to support programs and initiatives that bolster the capacity of emerging CDFIs, many of which are led by people of color. Since FY 2004, the CDFI Fund has included a Small and Emerging CDFI (SECA) category as part of the FA award. The SECA category provides smaller levels of financial assistance to CDFIs with fewer assets or those in operation for fewer than three years. CDFIs use SECA awards for financing capital, loan loss reserves, capital reserves, financial services, or development services. In appropriations statutes, Congress typically waives the requirement for SECA award recipients to provide a "match."

A 2014 study by the Carsey Institute found that SECA grants have been successful in building the organizational capacity of new and emerging CDFI loan funds. "Assets and loans grow, earned income grows, as does personnel expense. The CDFI [Fund] investment strengthens these organizations and causes growth." [1]

In FY 2021, the CDFI Fund made 68 SECA grants for a total of $19.9 million. Bolstering and creating permanent funding streams through programs like SECA for small and emerging CDFIs is one strategy to improve the diversity of leaders within the CDFI sector.

Q.2. What do you believe to be the biggest challenge to CDFI certification for prospective CDFIs?

A.2. Right now, the biggest challenge is that the CDFI Fund needs more staff and resources.

As I testified, the economic consequences of the COVID–19 pandemic on low-income communities and populations have been severe, and CDFIs have stepped up to provide financial products and services in economically distressed communities through the Paycheck Protection Program (PPP) and other programs. In the Consolidated Appropriations Act of 2020, Congress made a historic investment in CDFIs. The combination of continuing need to revitalize distressed communities, as well as the opportunity afforded by the greater appropriations, has increased the interest in the CDFI program and, consequently, in CDFI certification. There has been a great increase in the number of certified CDFIs. In 2017 there were some 700 certified CDFIs, and in 2021, there are now more than 1,300.

Appropriations to support the work of the Fund have not kept pace. In 2017, the CDFI Fund had 77 full-time employees (FTEs). The number actually fell to 70 in 2020. The budget request proposes to fund 89 positions in 2022.

The CDFI Fund needs more staffing and improved technology to handle the growth in certified CDFIs over the last 5 years, in addition to the increased demand that has been developed by new organizations seeking to become certified CDFIs. The Fund needs to in-

[1] "CDFIs Stepping Into the Breach: An Impact Evaluation", 2014, Carsey Institute for Public Policy University of New Hampshire.

vest in an expanded and robust technical assistance program to assist existing certified CDFIs in implementing programs and to assist new organizations seeking certification on the details of certification policy and procedures.

Q.3. How has the CDFI Fund's guidance and technical assistance (e.g., webinars, meetings, user guides, etc.) been helpful to you? How do you believe the CDFI Fund can improve outreach and guidance?

A.3. The CDFI Fund can improve its technical assistance by providing on the ground technical assistance aimed at both existing organizations as well as those considering CDFI certification. Such an effort conducted by CDFI Fund employees, qualified technical assistance organizations or both should be aimed at program implementation and compliance issues for existing CDFIs and training and technical assistance on certification and related topics for those organizations considering seeking certification.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MENENDEZ FROM JOHN HOLDSCLAW, IV

Q.1. The Build Back Better Act currently being debated by Congress contains many crucial investments in community development. For instance, the House-passed version of the bill provides \$2.2 billion dollars to eligible institutions, including CDFIs, to assist first-time, first-generation homebuyers. It also contains \$3 billion dollars for these institutions for community facilities and other housing and civic infrastructure.

Could you describe what kind of impact these programs could have in the communities your institution serves?

A.1. In addition to the \$5.2 billion you mentioned, provisions within the House-passed Build Back Better (BBB) legislation included a substantial investment in Federal housing and community development programs totaling \$17.5 billion, including \$925 million at the CDFI Fund to establish the Housing Investment Fund, a new program authorization designed along the lines of the Capital Magnet Fund. Other programs that received substantial investments within the legislation include housing vouchers, public housing, HOME, CDBG, and new initiatives for community revitalization.

CDFIs have a strong track record of financing community facilities and affordable housing. In 2020, according to data from the 2020 Annual Certification report, CDFIs provided nearly \$6 billion in capital to health care facilities, schools, nonprofits, daycare centers, and other community facilities. They also provided \$38 billion in financing for mortgages and home improvement loans.

CDFI Program award recipients—who represent a mere fraction of all CDFI activity, financed nearly 50,000 units of affordable housing.

CDFIs leverage \$12 for every dollar in Federal assistance. The CDFI Coalition recently projected the impacts for \$1 billion in annual appropriations for the CDFI Fund (our FY 2022 and FY 2023 request):

- \$12 billion in total investment in low-income communities, over 100,000 affordable housing units created or preserved, thousands of loans and investments in childcare centers, health clinics, and community facilities, nearly two million consumer and home ownership loans, and hundreds of thousands of loans and investments in businesses in target markets.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARNOCK FROM JOHN HOLDSCLAW, IV

Q.1. What do you think we can do to make the process to becoming a CDFI more efficient for institutions that are qualified and want to become certified to be able to do so?

A.1. As indicated in my responses to Senator Tina Smith's questions, the CDFI Fund needs additional staff and resources to improve the efficiency of the CDFI Certification Process. On January 31, CDFI Fund Director Jodi Harris released a message outlining the agency's priorities and ongoing initiatives. Included within her message was an acknowledgment that while there had been a working agency policy for CDFI applications to be processed within 90 days of receipt, the CDFI Fund is now unable to keep to that timeline. Reports from applicants indicate that current wait times for certification now hovers between 6–10 months.

There are four primary elements needed to help create a more efficient certification process. Certainly, increasing department staffing to adequately handle the volume and complexity of certification applications is in order. Additionally, direct case management and business hour access to a staff-answered helpline would offer a capacity for prompt responses and immediate assistance to certification applicants that is currently missing. Working in tandem with that approach, increasing investment in application Technical Assistance resources and detailed application guidance would facilitate greater application efficiency. Ultimately, the resources provided should work to ensure that the current application backlog decreases, the timeline for certification by agency staff gets back to within a 90-day processing window, and the CDFI Fund continues to maintain its high standards for CDFI certification.

Q.2. Would you please describe your experience working with the Paycheck Protection Program? How did your members leverage their experience as a CDFI to get the relief out to communities you serve?

A.2. When PPP was first enacted, all businesses and financial institutions were not treated equally. Large banks and businesses with established finance infrastructure were best equipped to leverage Federal pandemic resources. The communities, financial institutions, and businesses most at risk of collapse were the last in line for access to these resources.

According to the SBA's COVID Relief Paycheck Protection Program Report (data as of 05/24/2021), Community Financial Institutions.[2] approved 1,389,287 loans for more than $30.08 billion of PPP funds. The average loan size was $21,653, and 77.9 percent of

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[2] Community Financial Institutions (CFIs) include four types of mission lenders—Minority Depository Institutions (MDIs), Small Business Administration (SBA) microlenders and Certified Development Corporations.

these loans went to firms requesting less than $150,000 in PPP loans. 39.7 percent of funds went to businesses located within low- and moderate-income communities.

During the disbursement of PPP loans, our members saw a record jump in public requests for information about how to access CDFIs within local communities. What the experience from PPP shows is that with additional resources, CDFIs have the capacity to provide a much greater level of financial products and services to low-income communities and populations.

Q.3. Have your members been able to utilize the CDFI Rapid Response Program, and has the program been effective?

A.3. The money from the Rapid Response Program (RRP) was awarded in June 2021. Subsequently, our members are just starting to see the results in their communities. The program was established to provide the necessary capital for CDFIs to respond to economic challenges created by the COVID–19 pandemic, particularly in underserved communities, and those challenges remain to this day.

Overall, 863 CDFIs were awarded $1.25 billion in RRP funds for distribution. The legislation directed at least $25 million to be awarded to benefit Native Communities. When the awards were released, the award recipients included 58 organizations that committed to direct their awards to investments in Native American, Native Alaskan, and Native Hawaiian communities; they received a total of $54.6 million in awards. In addition, 28 organizations that primarily serve Puerto Rico received $47.3 million in awards, and 90 minority depository institutions received a total of $133.9 million in awards.

In terms of meeting the needs of small towns and rural America, 277 CDFIs serving small urban areas received $414 million in awards, and 245 CDFIs serving rural users received $353 million in RRP awards.

Given the high demand and general scramble to access initial pandemic-relief funds, such as Paycheck Protection Program loans, the ability to separately access additional pandemic-relief RRP funds has been beneficial for our member CDFIS. Given the effects of the Delta and Omicron variant waves in prolonging business recovery efforts from COVID–19, the availability of the RRP funds is extremely helpful for vulnerable businesses still attempting to manage the economic fallouts from the pandemic.

Q.4. The Build Back Better Act as passed by the House includes a new Community Restoration and Revitalization Fund (CRRF) program at the Department of Housing and Urban Development. I strongly support the CRRF proposal to advance place-based policies that could be scaled significantly such as those led by Purpose Built Communities, a national nonprofit founded in Atlanta, Georgia, after the successful revitalization of the East Lake neighborhood. Would you please speak to the potential impact of a program such as the CRRF to support community led development projects? Would you elaborate on the importance of including local community stakeholder in these development projects, and why strategies should be place-based?

A.4. Last fall, the CDFI Coalition joined with a coalition of Main Street advocates, parks and public space organizations, affordable housing developers and stakeholders, and other mission-based entities to support the creation of the Community Restoration and Revitalization Fund (CRRF) at HUD. Congressional support for investments in "community-led redevelopment projects in distressed communities" as part of the Build Back Better Framework reflects a critically important recognition that neighborhoods need a holistic ecosystem of resources to thrive.

As community partners who have worked with urban, suburban, and rural communities for decades, we are aligned behind a common belief that robust civic infrastructure is essential to creating neighborhoods where people want to live, work, and play, as civic infrastructure are the places that boost our economy, increase our economic and environmental resiliency, support our health and well-being, and strengthen our democracy.

The specific projects may vary between neighborhoods, but across the country, we see immense value in the community assets that serve as the connective tissue between people and places, particularly when they are located near housing that is affordable to households across the income scale.

However, we have also worked for decades with communities that have received neither adequate nor equitable investment in this critical infrastructure. In these neighborhoods, segregation and concentrated poverty continue to entrench cycles of disadvantage that are proven to disproportionately impact Black, Latino, and other communities of color.

Q.5. Would you speak to strategies to target Federal investments to catalyze and accelerate holistic community revitalization, beyond just putting roofs over folks head? How can we leverage Federal dollars to ensure access to quality education, safe and affordable housing, as well as access to health care?

A.5. There are a variety of very effective Federal programs that provide discrete funding for specific activities. Community development tax credits support the construction of affordable housing, bond programs support new school construction, and grant programs support new and improved federally qualified health centers, to name a few examples. All of these initiatives can (and do) benefit from the participation of CDFIs.

As flexible, mission-driven, community-based financial institutions, CDFIs are attuned and responsive to a broad range of community needs. They have a track record of mobilizing $12 in capital for every dollar of Federal support and putting those resources to work in support of affordable housing, small business loans, and the improvement of social services. To ensure community development programs meet the needs of distressed and underserved communities, we urge Congress to consider set-asides for CDFIs when crafting new initiatives. The CFI (and CDFI) set-asides in PPP helped deliver more support to the hardest-hit communities. Recent legislation in the House to expand access to childcare and early childhood education would set aside as much as 15 percent for CDFIs to serve as intermediaries and technical assistance providers, and several States have set aside funding through the CARES Act and ARPA for CDFIs for this purpose.[3]

RESPONSES TO WRITTEN QUESTIONS OF CHAIR SMITH FROM FRANK ALTMAN

Q.1. Please describe the role of a qualified issuer in the CDFI Bond Guarantee program. How does a qualified issuer interact with other CDFIs? What role do they play in facilitating financing?

A.1. The Qualified Issuer (QI) has a multifaceted role in the CDFI Bond Guarantee program (BGP). In the initial stage when a CDFI(s) is looking for resources, the QI serves as the ambassador for the BGP, explaining and educating prospective participants about the program, the nature of the capital available, eligibility, as well as how and when the funds must be deployed.

If the CDFI is deemed to be a "good fit" for the program, the QI transitions to serving as a "mission-driven advisor providing technical compliance and structuring services." In this stage, the QI assists certified CDFIs in their effort to access the BGP which provides fixed-rate, 30 year fully amortizing debt provided by the Federal Financing Bank—the sole investor in bonds issued through this program. As a "mission-driven" advisor providing technical compliance and structuring services, the QI assesses the creditworthiness of the eligible CDFI to confirm its ability and willingness to repay the bond obligation. As part of this process, the QI will evaluate the lending, disbursing, servicing, and monitoring capabilities of the CDFI. The QI will then prepare and submit a guarantee application to the CDFI Fund on behalf of the eligible CDFI. It will also prepare and submit a term sheet. During this period, the QI facilitates an ongoing review, presentation, and negotiation of terms with the bondholder (Federal Financing Bank) and the Guarantor (Treasury Department as represented by the CDFI Fund program staff). Assuming the guarantee application is approved, the QI is listed as the lender of record and issues the bond. Throughout this process, the QI is providing technical assistance to the eligible CDFI(s) on how to best leverage the bond funds to support its lending activities most effectively. This involves actively engaging with and listening to the eligible CDFI(s) to design and develop financial structures that meet the credit needs of the borrowing CDFI(s).

Once the bond has been issued, the QI takes on the role of "program administrator" managing, monitoring, and guiding the CDFI(s) as they utilize the Bond Loan funds. Servicing oversight is a key function performed by the QI staff facilitating draw-downs on Bond Loan funds for the participating CDFI(s). They also offer technical assistance with respect to pricing strategy and optional redemption of Bond Loan funds. As program administrator, the QI provides oversight and guidance to the CDFI participant(s) assisting with compliance, reporting, receiving, and reviewing each Secondary Loan Certification. The QI is responsible for enforcing the

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[3] "Capitalizing on the Capabilities of Child Care Resource and Referral Agencies and Community Development Financial Institutions To Stabilize and Increase the Supply of High-Quality Child Care". *https://info.childcareaware.org/hubfs/2021-CCRR%20and%20CDFI%20Intermediaries%20PaperFINAL-1.pdf*

terms and requirements of the Bond Trust Indenture and Bond Loan Agreement as well as the Agreement to Guarantee. Collateral and credit enhancements are reviewed by the QI staff on an ongoing basis. Agency administrative fees are paid by the QI pursuant to a predefined payment plan. The QI also submits all required reports and additional documentation as requested by the CDFI Fund in a commercially reasonable fashion.

In summary, the QI is responsible for sourcing, structuring, evaluating, and closing of Bond Loans with eligible CDFIs. Through the sales process, the QI assesses the capacity of the eligible CDFI(s) to lend and key capabilities required to meet the standards and expectations associated with a Federal credit program. Each QI maintains a robust front-end process to source, review, approve, and negotiate terms for a wide variety of CDFIs seeking to access the Bond program. The QI also provides ongoing support on technical matters such as strategies for accessing the debt, structuring, and utilizing program funds, and troubleshooting issues that arise over the term of the bond. Thus the QI's role is to build the capacity of eligible CDFIs to use the Bond Loan funds most effectively to support their financing activities in underserved communities.

Q.2. Please describe how the Bond Guarantee program has been used for childcare facilities.

A.2. The Bond Guarantee program has been used to support childcare facilities. According to the Office of the Inspector General, Department of the Treasury, Audit of the Community Development Financial Institutions Fund's Financial Statements for Fiscal Years 2021 and 2020, December 15, 2021, $13 million has been disbursed since inception of the Bond Guarantee program for childcare facilities with another $30 million in proposed disbursements. One organization on whose behalf CRF has issued guaranteed bonds is the Low Income Investment Fund (LIIF), a preeminent CDFI. LIIF provided the following examples of how they have used bond guarantee resources to finance childcare facilities.

The Low Income Investment Fund (LIIF), a national nonprofit CDFI loan fund and a leading CDFI in the early care and education finance space, has used BGP for three childcare facilities since 2016. Each of these projects reflects a unique and flexible use of the program, including helping childcare providers purchase the facility they previously rented and helping a developer finance a mixed-use development in which a childcare provider was a tenant.

- Mission Child Care Consortium, Inc. (San Francisco, CA). Mission Child Care Consortium, Inc. (MCCCI) has provided subsidized childcare in San Francisco for over 35 years. In 2017, LIIF provided a $3.5 million loan to purchase the building that MCCCI had been leasing since 1985. The purchase price (and appraisal) was $5.6 million, and the remaining balance was covered by a combination of grants and cash equity. This allowed MCCCI to replace their $312,000 annual lease with a $267,000 annual mortgage payment, alleviating some financial pressure on the organization. MCCCI intended to raise funds over the 10-year term of the loan to make periodic unscheduled principal reductions to the outstanding balance to be refinanced at maturity. They have now reduced the principal balance to $2.4 million.

- St. Nicks Alliance/Small Steps Daycare (East Williamsburg, Brooklyn, NY). LIIF provided $13.5 million in total financing to help preserve a community facility in East Williamsburg, Brooklyn that had been a staple of the community for over 40 years, providing both childcare and a senior center to low-income residents. In 2013, a new owner purchased the property with the intent of evicting the center operator and redeveloping the site as luxury condominiums, even going as far as serving the center staff with a 30-day eviction notice on Christmas Eve. After a lengthy legal and PR battle, armed with support from the community and local elected officials, SNA succeeded in securing an agreement to purchase the property directly from the owner. LIIF provided a $7.47 million acquisition loan to SNA Ainslie LLC, an affiliate of St. Nick's Alliance (SNA), to help bridge grant funding that local elected officials had designated for the project. LIIF then provided $4 million in permanent financing for the project in the form of a 25-year loan through BGP. LIIF was able to make this BGP loan because it is a program of a strong multiservice nonprofit with the balance sheet to support the long-term debt service obligations even though the childcare center may encounter volatility in its operating revenues over the years.
- Cooper Gardens-Tender Tots Child Care (Bronx, NY). LIIF provided $9 million loan to L&M Development Partners, Inc., to finance the multitenant commercial component of a mixed use affordable housing property in which one of the tenants was a childcare center. The commercial component of the project was too large to be included within the housing financing, so BGP was a good option that helped the developer secure the construction financing. The developer had the strength and wherewithal to carry the project to completion, which took several years. LIIF's BGP loan provided long-term predictability to the developer at a competitive rate, which will help keep rents to the commercial tenants—including the childcare center—for many years.

In addition to using BGP for childcare facilities, LIIF completed a $10 million New Markets Tax Credit (NMTC) structure in partnership with the City of San Francisco's Office of Early Care and Education to enable financing for multiple childcare centers. Mission Neighborhood Center (MNC) leased a commercial space in a new construction building (which included three commercial spaces and 157 units of affordable housing) and needed financing to build out the 8,150 square foot space. The combination of grant funding and $2.44 million in NMTC subsidy brought the interest rate down to 1.28 percent with annual debt service of $30,000. Although not applicable to this project, a potential use of BGP for other childcare facilities financed using NMTC would be converting the NMTC financing to permanent financing through BGP, thereby allowing the provider to access long-term, low-cost, fixed-rate financing at the end of the 7-year NMTC period.

Q.3. What effects would the CDFI Bond Guarantee Program Improvement Act have on the program and on CDFIs' ability to raise capital? How would it impact childcare facilities?

A.3. CRF believes the CDFI Fund Bond Guarantee Program Improvement Act would expand the ability of CDFIs to raise capital and to provide additional support for childcare facilities. LIIF, a CDFI on whose behalf CRF has issued Bond funds provided the response below.

The CDFI Bond Guarantee Program Improvement Act would have a positive impact on the program and would increase CDFIs' ability to direct BGP resources to childcare facilities. First, permanently authorizing BGP will provide much-needed certainty and clarity about the program's ongoing ability to serve as a reliable resource to CDFIs and our borrowers. Certainty and reliability are critical ingredients to successful financing across all asset classes, including childcare, and can motivate further innovation. Second, reducing the minimum loan size to $25 million will also help increase smaller CDFIs' access to the program, many of whom likely have existing relationships with local childcare providers who could benefit from BGP financing.

While the CDFI Bond Guarantee Program Improvement Act would have a positive impact on CDFIs working to finance childcare facilities, the most urgent and critically needed form of assistance for childcare facilities is additional grant capital. The childcare business model itself is economically tenuous. Even with childcare costs already out of reach for most households, staffing demands, nontraditional hours, and other unique expenses required to care for young children means that it costs more to operate a childcare program than most tuition payments can cover. The childcare sector overall has been historically underfunded, so what little operating subsidies that are available to childcare providers often help them simply break even.

There is also no dedicated source of Federal funding to acquire, construct and renovate childcare facilities, meaning that providers must be incredibly innovative in finding flexible sources of affordable capital to meet their facility's needs. Most childcare providers are unable to access traditional financing sources to cover costly acquisition, renovation, or construction costs associated with improving their facility or opening and expanding into a new space. Many CDFIs, including LIIF, have been working for decades to cobble together various resources from State and local governments, philanthropy, and private sources to help providers meet their facility needs. Given the challenging economics in the industry, the vast majority of providers are unable to accommodate or sustain debt financing, and instead rely on grant capital and other forms of forgivable loans.

The National Children's Facilities Network (NCFN), which LIIF cochairs, is a Network of more than 60 CDFIs, financial and technical assistance intermediaries, and other childcare stakeholders focused on elevating the importance of high-quality childcare facilities and strong business models. NCFN strongly supports Federal funding to establish a dedicated source of capital to acquire, construct and renovate childcare facilities, with a set-aside of resources for CDFIs and other intermediaries to offer critical technical assistance and capacity building support. This model has been proposed in Assistant Speaker Katherine Clark's Child Care is Infrastructure Act (H.R. 1911), as well as included in an early version of the House Ways and Means Committee's Build Back Better Act.

Q.4. Why do you believe that secondary markets are needed for CDFI small business lending?

A.4. When I cofounded Community Reinvestment Fund, USA (CRF) in 1988, there were scores of community-based revolving loan funds (RLFs) in cities, neighborhoods and small towns throughout Minnesota that were lending money for business and economic development from a variety of funds. All of these RLFs relied on repayments from borrowers to recapitalize their funds for future lending. The slow rate at which these RLFs received cash repayments often caused them to run out of cash sufficient to make more loans. Very few of these RLFs were capable of raising cash by borrowing, so they were unable to respond to local needs in a reliable and consistent manner. CRF was created to provide liquidity to RLFs (precursors to CDFIs) and public economic development agencies by allowing them to sell their loans and use the cash to make new loans. This secondary market greatly increased the velocity of dollars in the RLFs and reduced their need to seek government or philanthropic grants. CRF served as an aggregator of loans from local RLFs and ultimately transformed the loan pool into investable securities through the process of asset securitization.

Secondary markets would be extremely helpful for CDFI small business lenders because they will provide liquidity through the purchase of loan assets, thereby alleviating the lending constraints imposed by the size of their balance sheets. An active secondary market will enable CDFIs to significantly expand their lending volumes without overleveraging their balance sheets. And it will provide safe, responsible lending products for small businesses. Having a secondary market would therefore allow CDFIs to free up space on their balance sheet when they reach a point where they need to raise additional equity to maintain a prudent leverage ratio (equity as a percent of assets).

Two critical infrastructure components are needed to do this at scale: First, CDFIs need access to a large-scale and liquid secondary market where they can sell their loans on an ongoing basis. The secondary market for the guaranteed portion of SBA 7(a) loans offers a good example of an effective secondary market for small business loans. Second, secondary market intermediaries need access to warehouse facilities to enable them to aggregate loans for securitization. The larger the pool of aggregated loans, the lower the risk to investors through asset diversification. Larger pools are also more cost efficient and ultimately deliver better pricing to CDFIs.

Periods of financial stress, such as the Great Recession and the COVID–19 pandemic, demonstrated the critical role CDFIs played providing a lifeline to struggling small and BIPOC-owned businesses that did not have an existing relationship with a commercial bank by offering Paycheck Protection Program (PPP) and other types of relief loans. They soon exhausted their existing lending capital and would not have been able to make more PPP loans without the Federal Reserve System's Paycheck Protection Program Liquidity Facility (PPPLF) which extended credit to eligible financial institutions (including CDFIs) taking the loans as collateral at face value. While the PPPLF was a secured financing vehicle rather than an asset-purchase vehicle, it showed that the Federal Reserve could play a direct role in supporting CDFI liquidity needs to continue lending during the crisis.

The lessons of the PPPLF provide policymakers with a road map of how to help CDFIs increase their impact and reach underserved BIPOC, rural and Tribal communities. Specifically, policies that foster the development of secondary markets for small business loans, as well as other types of CDFI loans, are an essential component of a well-functioning financial system that incorporates liquidity mechanisms to support the smooth flow of credit to customers by providing an outlet for these assets. Furthermore, funding facilities offering a ready source of cash, like a discount window for CDFIs, would ensure these institutions have the financial resources to expand their lending to meet the credit needs of their clients. Both the ability to sell assets through secondary markets and accessing cash through funding facilities are vital if CDFIs are to reach scale and deliver meaningful impact. CRF is encouraged by the Senate Banking Subcommittee's interest in exploring how to promote the development of secondary markets for CDFI loans and welcomes the opportunity to offer additional input on potential legislative proposals.

Q.5. Please describe the current state of the secondary market for, and securitization of, CDFI loans.

A.5. At present, there is no formal or established secondary market for and/or securitization of CDFI loans. The Riegle Community Development and Regulatory Improvement Act of 1994 (P.L. 103-325; Sept. 23, 1994), which authorized the CDFI Fund and its programs, envisioned a role for secondary markets to provide liquidity for CDFI lenders and their loans. Section 113 (12 U.S.C. 4712) authorizes the CDFI Fund to "provide assistance for the purpose of providing capital to organizations to purchase loans or otherwise enhance the liquidity of community development financial institutions" if such organizations meet specific requirements. However, Congress never appropriated funding for Section 113 (12 U.S.C. 4712) and therefore, it has never been implemented. This section needs to be modernized or updated to provide a platform for piloting the CDFI Fund's role in stimulating secondary markets for CDFI loans.

Prior to the Great Recession, CRF's business model was to operate a secondary market for community development loans. We aggregated these loans on our balance sheet using a warehouse line of credit provided by a bank. Once we had purchased a predetermined volume of loans, we issued asset-backed securities collateralized by these community development loans. However, due to changes in the market, we have not engaged in this activity since that time. As noted above, there is a well-developed secondary market for government guaranteed SBA 7(a) loans that is available to CDFIs on a limited basis. As one of three CDFIs operating a Small Business Lending Company, CRF offers the regular SBA 7(a) loan product and frequently sells the guaranteed portion of these loans into the secondary market. More than 100 CDFIs are approved to participate in the SBA's Community Advantage (CA) Pilot Program which offers a scaled-down version of the 7(a) product capped at $250,000 and with more flexible pricing. Some, but not all, CA lenders are approved to sell the guaranteed portion of their loans into the secondary market. While the CA loan product is a useful tool, it is a pilot program that has not been made permanent at this time.

While CDFI loans are not currently widely securitized, [1] there are one-off securitizations of these assets, such as the recent $297 million offering by The Change Company, which was collateralized by residential loans originated by this CDFI. In the absence of a formal secondary market for CDFI loans, assets most likely to be securitized are those that exhibit a high degree of standardization, a common set of underwriting criteria and a well-established track record of being securitized, such as residential mortgages. Small business loans, on the other hand, do not typically share a common set of underwriting criteria, especially those originated by CDFIs, making them more difficult to securitize.

In response to the pandemic, CRF in collaboration with other CDFIs developed and administered a series of Recovery Funds using limited liability companies (LLCs) and off-balance sheet structures such as Special Purpose Vehicles (SPVs) to purchase loans from CDFIs that make small-balance business emergency loans. Over the last 24 months, these Recovery Funds have deployed $250 million and have purchased over 5,000 loans from CDFIs with an average loan size between $40,000 to $70,000. Providing these smaller loans is a specialty for many CDFIs who reach smaller businesses owned by socially and economically disadvantaged persons or businesses located in low-to-moderate income communities.

CRF and its partners established Recovery Funds in New York, Chicago, Washington, and California with a first-loss loss reserve of State and/or local funds. CRF helped establish a similar regional Recovery Fund covering 13 southeastern States with a privately funded loan loss reserve. We recently launched a similar fund in Minnesota which has credit enhancement from private funders. The off-balance sheet pooled loan structures serve the same purpose as a secondary market for CDFI lenders. CDFIs originating loans can sell up to 95 percent of qualifying small-balance loans to the pooled vehicle thereby obtaining funds to continue making more loans.

These pooled vehicles are the first step toward securitization and are critical because they free up space on CDFIs' balance sheets, thereby allowing the CDFIs to engage in additional lending. They

[1] Wikipedia defines Securitization as the financial practice of pooling various types of contractual debt such as residential mortgages, commercial mortgages, auto loans or credit card debt obligations (or other nondebt assets which generate receivables) and selling their related cash flows to third party investors as securities, which may be described as bonds, pass-through securities, or collateralized debt obligations (CDOs). Investors are repaid from the principal and interest cash flows collected from the underlying debt and redistributed through the capital structure of the new financing. Securities backed by mortgage receivables are called mortgage-backed securities (MBS), while those backed by other types of receivables are asset-backed securities (ABS).

have also been instrumental in introducing CDFIs to the practice of originating a standard loan product that can be purchased by the SPV and which provides improved liquidity. The next step is to take the pooled loan fund and use its assets to issue securities backed by the business loan cash flows and sell them to investors. Our research suggests that between $200–$250 million is the volume of loans needed to make a securitized transaction economically feasible so we have demonstrated that these pooled loan structures can reach the required scale.

Q.6. What reforms do you believe should be made to the market for CDFI loans, what impacts would they have, and what role should Congress play in reforms?

A.6. Through CRF's role in several Recovery Funds, including the Chicago Resiliency Fund, the California Rebuilding Fund, the New York Forward Fund, Southern Opportunity and Resilience Fund (SOAR), the Washington Flex Fund and the Minnesota Inclusive Growth Fund, that utilize an SPV structure, we have found that several aspects of this structure have laid the groundwork for providing a source of liquidity for CDFIs and paving the way to securitize small business loans. For example, the following criteria have made these Recovery Funds successful: (1) a standardized loan product with common eligibility criteria and terms; (2) a reasonable risk retention requirement mandating CDFI retain a portion of the loans they sell to the SPV; (3) the ability of the CDFIs to service or sub-service the loans they sell (i.e., retain servicing rights); (4) a common technology platform that matches small business borrowers with CDFIs offering appropriate loan or credit products; (5) a fund structure that brings private sector capital from impact lenders to support the purchase/acquisition of CDFI loans (or portions thereof); (6) access to coordinated, well-resourced business advisory services; (7) and a robust marketing strategy.

SPV structures, like the Recovery Funds, using Federal resources (such as those authorized in Section 113 of the Riegle Community Development and Regulatory Improvement Act of 1994) in a subordinate position to private capital (at the bottom of the capital stack), enables a scalable approach to aggregating and securitizing small business loans. However, we recommend a number of changes or modifications to Section 113 [12 U.S.C. 4712] including (but not limited to): (1) include language to explicitly allow capital assistance to be used to raise resources to purchase loans from CDFIs; (2) reduce or eliminate the match requirement given magnitude of capital assistance awards; (3) eliminate the limitation on other assistance a capital assistance awardee may receive from the CDFI Fund; (4) reiterate that a capital assistance awardee need not be a CDFI; (5) increase the amount of capital assistance to at least $20 million per awardee; (6) provide exemptions from relevant Federal securities registration requirements (e.g., Securities Act, Investment Company Act, and Investment Advisor Acts), the taxable mortgage pool rule when securitizing CDFI mortgages, as well as risk retention rules when securitizing loans originated by CDFIs (or provide alternative way to meet the risk retention requirement). Minimum requirements for organizations seeking capital assistance as well as selection criteria should also be reviewed and modified as needed for this unique role and scale of activity. Finally, there are accounting and tax rule changes regarding consolidation and tax exemption that present challenges to the securitization of CDFI loans that would need to be addressed but may be beyond the scope of Congress and a legislative solution.

In addition, modifications to the Treasury Department's guidance for the SSBCI program in which CDFIs will play an important role could stimulate the development of secondary markets and securitization structures for CDFI loans. The SSBCI program offers a unique opportunity to utilize pooled loan structures to provide liquidity for CDFIs. Under Treasury policy guidance, an entity such as a CDFI must bear 20 percent or more of the risk of loss in any loan transaction and may not pool the risk of loss with other loans. The SSBCI rules require the losses on each loan backed by SSBCI funds to be reconciled and administered individually. (U.S. Department of the Treasury State Small Business Credit Initiative Frequently Asked Questions, p.3) A lender can economically administer the calculation of loan losses transaction-by-transaction when the lender is making relatively few loans of a significant size. However, this requirement is costly for a loan portfolio consisting of many small-balance loans which is precisely the case for CRF's Recovery Funds. Treasury's rule raises the administrative cost of operating a pooled loan fund, which is the key to the success of these Recovery Funds. Furthermore, Treasury's SSBCI requirements prevent CDFIs from using SSBCI dollars as first-loss capital at the bottom of the capital stack unless these funds are pari passu or matched on a one-to-one basis with private sector capital. As noted above, the SPV model can also advance the securitization of CDFI small business loans by aggregating loans until a reasonable volume has been acquired and they can be packaged into asset-backed securities. Modifications to Treasury's guidance could significantly improve the SPV model for both CDFIs originating and selling loans into this aggregation structure and for the eventual securitization of these assets. We hope such changes will be implemented.

In terms of impacts, creating an ongoing source of liquidity through an SPV structure or something akin to the Paycheck Protection Program Liquidity Facility (PPPLF) at the Federal Reserve would allow CDFIs to significantly increase their lending activities by allowing them to pledge their loans and receive cash to continue to lend. However, CDFIs remain constrained by their balance sheets as they must raise additional equity to meet funders' requirements and protect against risk of loss associated with the loans on their balance sheets. Secondary markets using securitization of these loans provide CDFIs with a solution to both their balance sheet constraints and their need for liquidity without having to raise additional equity in a short time period.

This would allow for more capital and credit to flow to small businesses especially, BIPOC-owned small businesses as well as those in low-income communities, rural areas, and Indian Country. Securitization of these loans would be the final step in reaching the capital markets where institutional and impact investors could invest in securities backed by these loans.

Congress has a significant role to play in advancing policies that facilitate the development of secondary markets for CDFI small business and other loans, by providing resources to support research and innovation, removing legislative obstacles to aggregating and securitizing these assets, and convening experts to further this effort. Congress should also consider support for resources that build the capacity of CDFIs including, but not limited to, funding for the evaluation and adoption of technology that increases organizational efficiency and customer experience, and development of common platforms and tools that are accessible to all CDFIs. Finally, data collection and reporting remain a key challenge for CDFIs and impedes the ability to securitize CDFI loans. More and better data on CDFI loans would help rating agencies and investors better evaluate the true risk associated with these loans.

Q.7. What are the technology needs of CDFIs, and should Congress consider supporting technology investments?

A.7. CDFIs have significant technology needs to bring efficiency and scale to their operations. For example, CDFI small business lenders are looking for technology to assist them with customer acquisition, loan origination, loan servicing and portfolio monitoring, among other needs. CDFIs need assistance in evaluating, adopting, and on-boarding new technology systems. As an industry, CDFIs could reduce the costs of technology systems by agreeing to standardize their products and processes through a coordinated approach. CDFIs also need resources to invest more in software development and staff with the requisite technology skills. Could Federal funds be used to support a centralized technology/innovation hub that attracts the talent to build tools that all CDFIs can access? Relying on individual CDFIs to do this on their own impedes the industry's ability to scale and creates redundancy for small organizations that have limited R&D budgets.

Congress should provide funding for CDFIs to adopt and/or upgrade their technology systems. It is incredibly hard for CDFIs to raise grant funds for infrastructure investments, yet funders are willing to provide more capital for loans. If CDFIs could implement efficient technology systems, they would be able to lend capital to their customers and communities more effectively and compete with online or fintech lenders who may offer predatory or abusive loan products.

CRF has developed two technology solutions or platforms to ensure that small businesses are able to access safe, appropriate credit products and that CDFIs have the tools they need to serve their small business customers. Our Connect2Capital platform (C2C) is a marketplace where small business owners can be matched with credit products offered by CDFIs and similar responsible, mission-driven lenders that meet their needs. As of January 2022, $250 million in loans funded by CRF's partners has been facilitated by C2C, 74 percent of C2C loans have gone to businesses owned by Black Indigenous and other People of Color, women, members of the LGBTQ+ community, and/or Veterans. We also developed a software solution, known as SPARK, which provides a streamlined, seamless process to originate small business loans. Not only does SPARK allow lenders to quickly originate SBA and other business loans, but it also offers a user-friendly customer experience meeting businesses where they are. Increasingly, entrepreneurs are seeking loans online, and CDFIs must be able to offer them a competitive product and process that they can access over the internet or through a mobile device.

When the CDFI Fund was established, the framers did not envision the technology needs of CDFIs in the future. We strongly believe Congress should support funding for technology.

Furthermore, CDFIs (like CRF) that provide technology resources, such as C2C and SPARK, should be permitted to count these platforms as Development Services, a requirement for CDFI certification and which the Fund defines as " . . . activities that promote community development and are integral to the Applicant's provision of Financial Products and Financial Services. Such services shall prepare or assist current or potential borrowers or investees to utilize the Financial Products or Financial Services of the Applicant." (CDFI Fund, Department of the Treasury, Revised Interim Rule, *Federal Register*, December 13, 2005, link) Including technology resources and platforms as Development Services would allow the Congress to fund these activities and enhance the ability of CDFIs to meet their primary mission of community development and significantly scale of their impact. CDFIs should be encouraged to innovate and build the robust ecosystem in which they conduct their lending activities. Technology tools exemplify the kind of innovation Congress should be fostering.

Q.8. What steps, if any, should be taken to improve the diversity of leaders in the CDFI sector?

A.8. CDFI leaders must reflect the communities and people they serve. Therefore, intentional efforts must be made to recruit BIPOC leaders as well as BIPOC staff at all levels of CDFI organizations. There is a transition taking place among leaders who created CDFIs 25 years ago and this provides a valuable opportunity to bring more diverse leadership to our industry.

At CRF, we have taken specific steps to diversify our senior leadership and our staff with the opportunity for succession. Our board is majority minority, and this model of diversification will be replicated across all levels of the organization. We believe this approach will help bring more diverse leaders to the top of the organization. With a substantial number of CDFI loan fund founders moving on, we expect to see more BIPOC leaders at the helm of these organizations and sitting on their boards. The recent $9 billion under the Emergency Capital Investment Program (ECIP) will strengthen the balance sheets of CDFI depository institutions and further enhance diverse leadership and lending in sector.

Q.9. What do you believe to be the biggest challenge to CDFI certification for prospective CDFIs?

A.9. As detailed in our written testimony, there are several challenges to CDFI certification for both prospective and existing CDFIs.

A. Navigating and understanding the certification process, requirements, technical language, and technology systems can be daunting especially for a small or new organization whose staff lacks prior knowledge of the CDFI regulatory framework and how it evolved. This challenge is exacerbated by two related factors—limited CDFI Fund staff resources due to underfunding and the long delays in processing and approving certification applications. The CDFI Fund recently issued two communications detailing their staff and workload challenges as well as the steps they are taking to address these problems; (See *https://www.cdfifund.gov/node/1012651* and *https://www.cdfifund.gov/impact/435*). While some of these steps are encouraging, such as restructuring the Office of Certification, Compliance Monitoring and Evaluation into two departments, the statement in the January 31, 2022, communication that "The CDFI Fund will automatically reject any incomplete or inaccurate application" raises concerns. The pandemic has imposed enormous burdens on the Fund staff, however without the definition of what constitutes an incomplete or inaccurate application, it is possible that applicants unfamiliar with the certification regulations and guidance and without the ability to hire a consultant may inadvertently submit an application with errors that is automatically rejected. Applicants are limited to making email "service requests" to the Fund's help desk and/or attending monthly Certification Conference calls. These options may work well for simple, straightforward questions however, they do not lend themselves to complicated or nuanced issues that applicants may encounter. Resources should be provided to the Fund to offer a robust call center or help desk with staff who have deep knowledge about the details and intricacies of CDFI certification.

B. Target Market designation and expansion present significant challenges for existing CDFIs, especially as the world has changed dramatically since the Fund was established in 1994. As described in our written testimony for the January 5th hearing, the advent of technology in delivering credit to small business owners has altered the financial services landscape forever. If CDFIs are to compete and offer safe credit products to entrepreneurs, they must be able to meet their customers where they are in terms of geography and ease of user experience. CDFIs need to be able offer their loan products across larger geographic areas, including on a nationwide scale, and they need to deliver their products through technology channels that provide quick response times and a streamlined underwriting and approval process. The experience of making Paycheck Protection Program (PPP) loans provided a clear illustration of the kind of lending CDFIs will be called upon to do in the future. The CDFI Fund needs to provide a process by which existing CDFIs can expand or modify their approved Target Markets without having to re-apply for certification. This is burdensome for both the CDFI and the Fund staff. In addition, CDFIs that have the capacity to serve Investment Areas (IA) across the country should be granted a National IA Target Market to which they are accountable through a governing or advisory board.

C. CDFIs are seeking guidance and leadership from the CDFI Fund in the area of Target Market verification. As stipulated in guidance, CDFIs must direct 60 percent of their lending (by volume and dollar amount) to their approved Target Markets. To confirm that they are meeting this requirement, CDFIs use the Fund's mapping service to determine if a loan is located in an IA which the CDFI has been approved to serve. However, for CDFIs with Low Income Targeted Population (LITP) Target Markets, it is unclear what types of verification methods they can use to qualify or demonstrate that their loans are serving this type of Target Market. In the absence of clear guidance, CDFIs have relied on proxies (such as the Low-Income Housing Tax Credit, eligibility for Medicaid, and free and reduced lunches), to verify that loans are serving low-income people as well as developing their own verification methods, particularly for loans to small businesses where the owner is not a low-income individual, but the business is providing employment to low-income people. In a Notice and Request for Public Comment published in the *Federal Register* on May 7, 2020, the CDFI Fund proposed a default proxy method using a Census Block Group geocoder (which has not yet been made available) to determine if loans may be designated as LITP. Without the ability to test this new geocoder, CDFIs are very concerned that requiring them to use this method could invalidate past loans or restrict their ability to serve small businesses or consumers who otherwise would qualify under their current verification methods. We have called upon the Fund to establish a process by which CDFIs can present their existing verification methods for approval by the Fund to ensure they can continue to serve low-income customers who may fall outside this new geocoding system, especially those in rural or sparsely populated areas.

D. Lastly, as CDFIs are becoming larger and more sophisticated, they are establishing holding company structures with affiliates and subsidiaries. Having to certify each and every affiliate or subsidiary separately is both time consuming and labor intensive. A more holistic approach to certifying affiliates and subsidiaries would streamline the process for applicants as well as for Fund staff. One issue that should be addressed as part of certifying affiliates and subsidiaries is the requirement that they must already have made or be making loans in a requested Target Market. This requirement makes it difficult for a new entity to be certified in a timely fashion. This "catch 22" makes it harder for the affiliate to begin lending or investing activities and therefore certification must be anticipated well in advance (perhaps a year or more). Creating a prospective rather than a retrospective approach to certifying affiliates and subsidiaries of existing CDFIs that need to launch their lending or investing activities quickly would be enormously beneficial. The certification requirements for Bond Guarantee Program participants offer an example of how this could be done. In the BGP, the CDFI Fund permits a CDFI's Affiliate to rely on the Controlling CDFI's activity or track record to meet the financing entity requirement for participation as an Eligible CDFI under the CDFI Bond Guarantee Program. This approach could serve as a model for more broadly certifying affiliates and subsidiaries of existing CDFIs.

Q.10. How has the CDFI Fund's guidance and technical assistance (e.g., webinars, meetings, user guides, etc.) been helpful to you? How do you believe the CDFI Fund can improve outreach and guidance?

A.10. Yes, these convenings and materials have been helpful but are not sufficient. More technical assistance is needed. Often a new organization seeking to become certified or an existing CDFI with a question or a concern needs to have a conversation with Fund staff about a technical or nuanced issue. We understand the CDFI Fund staff have been stretched thin while designing, managing, and deploying an enormous amount of funding over the past 2 years. Nonetheless, we are concerned that if there are no options for directly engaging with Fund staff other than through a service request (email communication) then many CDFIs will not be able to access the information, oral guidance, and advice they need to participate in CDFI Fund programs. This would be a step backward as the hallmark of the CDFI industry has been the ability to interact, support, and learn from the staff at the Fund and thus advance its mission.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MENENDEZ FROM FRANK ALTMAN

Q.1. The Build Back Better Act currently being debated by Congress contains many crucial investments in community development. For instance, the House-passed version of the bill provides $2.2 billion dollars to eligible institutions, including CDFIs, to assist first-time, first generation homebuyers. It also contains $3 billion dollars for these institutions for community facilities and other housing and civic infrastructure.

Could you describe what kind of impact these programs could have in the communities your institution serves?

A.1. As a Qualified Issuer (QI) in the CDFI Bond Guarantee Program (BGP), we would welcome these resources for the communities we serve directly and through the BGP and New Markets Tax Credit (NMTC) programs. The NMTC program is routinely oversubscribed due to the highly competitive nature of the program. When we receive allocations, there are so many worthy projects, and we are only able to fund a small fraction of the potential pipeline. Similarly, the CDFIs on whose behalf we issue bonds under the BGP—are on the front lines providing resources to underserved communities and have limited sources of long-term, patient funding. They must make difficult decisions between which projects to fund and which ones they are not able to support. More resources such as the $2.2 billion in the House passed version of the Build Back Better bill would allow CDFIs to have multiple sources of funding to address the financing needs in urban, rural, and Native communities ravage by the pandemic and looking to build their community and civic infrastructure.

One example of a program that assisted first-time, first-generation homebuyers and would have benefited from capital like that which would be available under the Build Back Better Act (BBA) is the Detroit Home Mortgage Program (DHM). This program, which CRF helped to launched in 2016, was a collaborative effort between local banks, foundations, CDFIs, the City of Detroit, and community organizations to address financial gaps in appraisals so that borrowers could afford to buy, renovate, and live in a home in the City of Detroit. DHM was designed as a temporary market intervention to increase the number of mortgages throughout the city by laying the groundwork for real, negotiated appraisals in real estate transactions. DHM served as a catalyst by allowing buyers and sellers to negotiate low appraisals to determine the true value of the home. As a result, neighborhoods throughout the City of Detroit saw increases in the availability of mortgages.

If risk capital, such as what would be provided through the BBA, had been available in 2016, DHM could have launched much faster and on a larger scale. As of October 2021, the program closed 244 mortgages and spurred at least another 144 in other lending from our originating partners. Detroit has seen mortgage market growth every year since the inception of DHM. Mortgage lending in the city is almost back to prefinancial crash levels with realtors reporting a total of 2,180 mortgages which is very close to being a healthy market again. The last time there were more than 2,000 mortgages in Detroit was 2007. With borrowers choosing where to live, DHM reached more than half of all the neighborhoods in Detroit, providing a catalyzing effect for increased lending throughout the city. DHM's impact has also been sustained during the COVID–19 pandemic, which is very important to know that there will be a lasting effect on the city. There have been no defaults for any of the mortgages that are in the DHM fund. While DHM had its intended impact, there are many postindustrial cities that could benefit from a similar program if capital was available to support this type of intervention allowing many more families to become homeowners and revitalizing cities like Detroit.

The $3 billion dollars available to institutions, like CDFIs, for community facilities and other housing and civic infrastructure would complement and augment existing financing tools and programs, such as the NMTC and the Bond Guarantee programs. The latter, as we noted in our written testimony, has been challenging for smaller and medium-sized CDFIs to access due to the $100 million minimum bond threshold requirement. This funding from BBA would help CDFIs reach smaller projects that often are not cost effective. Having access to resources like this could be catalytic attracting private sector financing and stimulating neighborhood revitalization through the development and rehabilitation of community facilities as well as other critical infrastructure projects.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARNOCK FROM FRANK ALTMAN

Q.1. Would you please describe your experience working with the Paycheck Protection Program? How did your members leverage their experience as a CDFI to get the relief out to communities you serve?

A.1. CRF was proud to support small businesses during the pandemic by delivering Paycheck Protection Program (PPP) loans to underserved borrowers across the country. We leveraged two proprietary technology platforms: (1) Connect2Capital (C2C) which matches small business borrowers with an appropriate loan product (in this case, the PPP loan) and SPARK, a software solution that allows lenders to originate loans (including a customized process for PPP loans) based on the characteristics of the credit product. CRF worked closely with more than 47 CDFI and community-based partners nationwide to ensure that their small business customers and nonprofit organizations, particularly small and economically disadvantaged, businesses and those that are BIPOC-owned, were able to obtain a PPP loan. Many of these borrowers were very small and were not being served by banks. Through CRF's national network of community-based partners, our technology platforms, and our dedicated staff, we were able to make nearly 4,500 loans and for a total of $700 million with a median loan size of just $21,000. Most importantly, these loans helped to save more than 68,000 jobs.

Q.2. What do you believe is driving the gap of CDFI investments between urban and rural communities? What are the long-term benefits of making sure rural counties are receiving their fair share of CDFI investments?

A.2. It is unclear what is driving the gap of CDFI investments between urban and rural communities, but we need to ensure all communities receive a fair share of resources. CDFIs are not present in all communities. In addition, it may be more costly to serve rural communities as it is critical to build trusted relationships with local partners (such as a development finance agency) or be present in the community. Rural ecosystems are different from those in urban communities. Nonetheless rural areas can be better served as evidenced by the New Markets Tax Credit program where 20 percent of the investments must be made in rural communities. In some cases, NMTC investments in rural communities have exceeded this level.

Early in our history, CRF undertook a rural initiative across 14 States to provide access to capital to businesses and nonprofits thousands of local communities. It was a significant effort, and an essential aspect was having a strong partner, in this case the foundation of U.S. West, then a major telecommunications firm serving this region. More private–public partnerships could increase CDFI investments in rural counties.

In terms of CRF's current lending activities, we serve rural areas through several channels. With our small business products (including both SBA 7(a) and non-SBA loans), 18 percent of our total dollar volume and 16 percent of the total number of loans have been made to businesses in rural areas since 2012. Using New Markets Tax Credits, 36 percent of the dollar amount and 29 percent of the number of financings have been directed to rural businesses. We also originated $700 million in Paycheck Protection Program (PPP) loans of which 10 percent of the dollar amount and 17 percent of the total number of loans went to organizations in rural areas.

To specifically address the gap in CDFI investments in rural areas, CRF recently launched a joint venture with Conduit Capital, a leading impact investment firm to create RuralWorks, a Rural Business Investment Company (RBIC, license pending), with the mission to increase economic mobility, generate community wealth, and build a more equitable and resilient rural economy. RuralWorks provides integrated capital to growth-oriented businesses operating in rural communities. By creatively engaging a range of local and national resources and partners, RuralWorks creates value and outcomes rooted in local people, places, and businesses.

Q.3. Minority-owned CDFI Fund awardees are experiencing asset growth at a slower pace than their peers, with little to no progress on closing the asset gap. What do you believe is driving this gap and how are communities that your organization serves hurt by its persistence?

A.3. Lack of access to equity capital is one factor that may be driving the gap in asset growth minority-owned CDFI Fund awardees are experiencing when compared to awardees that are not minority owned. To address this gap, Congress provided $9 billion through The Emergency Capital Investment Program (ECIP) as part of the Consolidated Appropriations Act of 2021. This program targeted funding to CDFIs and Minority Depository Institutions (MDIs) by providing loans, grants, and forbearance for small businesses, minority-owned businesses, and consumers, especially in low-income and underserved communities, that may be disproportionately impacted by the economic effects of the COVID–19 pandemic. Treasury set aside $2 billion for CDFIs and MDIs with less than $500 million in assets and an additional $2 billion for CDFIs and MDIs with less than $2 billion in assets.

Q.4. Would you speak to strategies to target Federal investments to catalyze and accelerate holistic community revitalization, beyond just putting roofs over folks' head? How can we leverage Federal dollars to ensure access to quality education, safe and affordable housing, as well as access to health care?

A.4. This is an important topic and in our view, this is exactly what the Build Back Better legislation was intended to do—stimulate holistic revitalization across all the key elements that make up the social determinants of health by providing funding for affordable housing, early childhood education, more affordable post-secondary education (in an earlier version of the bill), addressing the dangers of climate change, reducing the high cost of prescription drugs and hearing aids, as well as other resources that will improve the quality of life for residents of distressed areas. The bipartisan Infrastructure Bill that Congress passed will improve the built environment by repairing our aging roads and bridges as well as bringing broadband and internet access to communities across the country that lack connectivity. These two key legislative initiatives (understanding that the future of the Build Back Better bill is uncertain) are the blueprint for an effective strategy for targeting Federal investments that could successfully catalyze and accelerate holistic and mutually reinforcing community revitalization particularly in underserved and communities of color.

RESPONSES TO WRITTEN QUESTIONS OF CHAIR SMITH FROM LAKOTA VOGEL

Q.1. What steps, if any, should be taken to improve the diversity of leaders in the CDFI sector?

A.1. Response not received in time for publication.

Q.2. What do you believe to be the biggest challenge to CDFI certification for prospective CDFIs?

A.2. Response not received in time for publication.

Q.3. How has the CDFI Fund's guidance and technical assistance (e.g., webinars, meetings, user guides, etc.) been helpful to you? How do you believe the CDFI Fund can improve outreach and guidance?

A.3. Response not received in time for publication.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MENENDEZ FROM LAKOTA VOGEL

Q.1. The Build Back Better Act currently being debated by Congress contains many crucial investments in community development. For instance, the House-passed version of the bill provides $2.2 billion dollars to eligible institutions, including CDFIs, to assist first-time, first-generation homebuyers. It also contains $3 billion dollars for these institutions for community facilities and other housing and civic infrastructure.

Could you describe what kind of impact these programs could have in the communities your institution serves?

A.1. Response not received in time for publication.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARNOCK FROM LAKOTA VOGEL

Q.1. Your organization is unique in both geography and the population being served. What challenges do you face on a day-to-day serving your community, and where are you finding success?

A.1. Response not received in time for publication.

Q.2. What types of challenges has your organization experiences accessing CDFI Fund awards or other assistance from the CDFI Fund? What further resources from the Fund do you think would enable you to better serve your community?

A.2. Response not received in time for publication.

Q.3. Would you speak to strategies to target Federal investments to catalyze and accelerate holistic community revitalization, beyond just putting roofs over folks head? How can we leverage Federal dollars to ensure access to quality education, safe and affordable housing, as well as access to health care?

A.3. Response not received in time for publication.

United States Government Accountability Office

Report to Congressional Requesters

April 2015

FEDERAL HOME LOAN BANKS

Collateral Requirements Discourage Some Community Development Financial Institutions from Seeking Membership

GAO-15-352

GAO Highlights

Highlights of GAO-15-352, a report to congressional requesters

April 2015

FEDERAL HOME LOAN BANKS

Collateral Requirements Discourage Some Community Development Financial Institutions from Seeking Membership

Why GAO Did This Study

The Housing and Economic Recovery Act of 2008 (HERA) made nondepository CDFIs eligible for membership in the FHLBank System. The System includes 12 regional FHLBanks that make loans, known as advances, to their members at favorable rates. GAO was asked to review the FHLBanks' implementation of HERA provisions relating to nondepository CDFIs. Among other things, this report discusses (1) challenges posed by membership and collateral requirements for nondepository CDFIs, and (2) FHFA and FHLBank efforts to facilitate broader nondepository CDFI participation in the System.

GAO analyzed data on membership rates as of December 2014 and advances obtained as of September 2014; reviewed requirements for gaining membership and obtaining advances; and interviewed FHLBank and FHFA officials and a sample of nondepository CDFIs based on selected criteria, including geography and asset size. Specifically, GAO interviewed 10 nondepository CDFIs that were members (one from each FHLBank district with a nondepository CDFI member when GAO began work) and 12 that were not members (one from each of the 12 districts).

GAO makes no recommendations in this report. GAO provided a draft of this report to FHFA and the 12 FHLBanks for comment. FHFA and four FHLBanks provided technical comments that were incorporated into the report as appropriate.

View GAO-15-352. For more information, contact Daniel Garcia-Diaz at (202) 512-8678 or GarciaDiazD@gao.gov.

What GAO Found

Collateral requirements rather than membership requirements discouraged some nondepository community development financial institutions (CDFI)—loan or venture capital funds—from seeking membership in the Federal Home Loan Bank (FHLBank) System. CDFIs are financial institutions that provide credit and financial services to underserved communities. Less than 6 percent of nondepository CDFIs (30 of 522) were members of the System as of December 2014 (see figure). Requirements for membership (such as stock purchase amounts) can vary where regulation gives FHLBanks discretion, but nondepository CDFIs GAO interviewed generally stated these requirements did not present a challenge. In addition, most FHLBanks imposed collateral requirements on nondepository CDFIs—such as haircuts (discounts on the value of collateral)—comparable with those for depository members categorized as higher risk. (This was sometimes also the case for other nondepository members such as insurance companies.) FHLBank officials stated nondepository CDFIs have different risks compared with depository members (for example, nondepository CDFIs are not supervised by a prudential federal or state regulator as are other FHLBank members). To address these risks, they imposed more restrictive requirements. Some of the nondepository CDFIs GAO interviewed cited limited availability of eligible collateral and steep haircuts as challenges for obtaining advances and therefore a disincentive to seeking membership. Less than half of the nondepository CDFIs that were members as of September 2014 had borrowed from the FHLBanks; the cumulative advances from October 2010 to September 2014 totaled about $307 million (less than 1 percent of the total advances outstanding as of December 2014). Two FHLBanks made the majority of the advances.

Rates of Nondepository CDFI Membership by FHLBank District, as of December 2014

	Cumulative number of non-depository CDFI members 2010	2011	2012	2013	2014	Total CDFIs in district	Membership rate
Atlanta	1	1	1	1	2	73	2.74%
Boston	0	0	0	1	4	48	8.33
Chicago	0	1	1	1	1	24	4.17
Cincinnati	1	3	4	4	4	30	13.33
Dallas	0	0	2	3	4	45	8.89
Des Moines	0	1	1	1	1	48	2.08
Indianapolis	0	0	0	1	2	13	15.38
New York	0	0	1	2	2	63	3.17
Pittsburgh	0	0	0	0	1	32	3.13
San Francisco	0	2	3	4	5	68	7.35
Seattle	0	0	0	0	2	53	3.77
Topeka	0	0	0	0	2	25	8.00
Total	**2**	**8**	**13**	**18**	**30**	30 + 492 nonmembers = **522**	**5.75%**

Members / Nonmembers   CDFI = community development financial institution

Source: GAO analysis of FHFA membership database and CDFI Fund data. | GAO-15-352

The Federal Housing Finance Agency (FHFA), which oversees the System, and FHLBanks have facilitated efforts to broaden nondepository CDFI participation in the System by educating about and promoting membership to nondepository CDFIs. For example, FHFA officials told us that they encouraged the FHLBanks to hold a conference to discuss nondepository CDFI membership. Officials from 10 FHLBanks also stated that they had solicited applications from CDFIs. In late 2014, several FHLBanks amended stock purchase and collateral requirements to better accommodate nondepository CDFI membership and access to advances.

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Figures

Abbreviations

CARS	CDFI Assessment and Ratings System
CDFI	community development financial institution
CDFI Fund	Community Development Financial Institutions Fund
FDIC	Federal Deposit Insurance Corporation
FHFA	Federal Housing Finance Agency
FHLBank	Federal Home Loan Bank
FHLBank System	Federal Home Loan Bank System
GAAP	generally accepted accounting principles
HERA	Housing and Economic Recovery Act of 2008
NCUA	National Credit Union Administration
OFN	Opportunity Finance Network
Treasury	Department of the Treasury

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April 23, 2015

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
House of Representatives

The Honorable Carolyn Maloney
Ranking Member
Subcommittee on Capital Markets and
Government-Sponsored Enterprises
Committee on Financial Services
House of Representatives

The Honorable Keith Ellison
House of Representatives

The Federal Home Loan Bank System (FHLBank System), which is a government-sponsored enterprise created to support mortgage lending and related community development, includes 12 regional Federal Home Loan Banks (FHLBank) with over 7,300 financial institutions that are active members. The primary mission of the FHLBank System is to serve as a reliable source of liquidity for its members. To carry out its mission, the FHLBank System issues debt in capital markets, generally at relatively favorable rates due to its status as a government-sponsored enterprise, and each FHLBank makes loans known as advances to its member financial institutions. As of December 31, 2014, the FHLBanks had about $566 billion in total outstanding advances. FHLBank members must pledge collateral to secure these advances.

FHLBank members include banks, thrifts, credit unions, and insurance companies—as well as community development financial institutions (CDFI) certified by the Community Development Financial Institutions Fund (CDFI Fund) within the Department of the Treasury (Treasury).[1] CDFIs can be federally insured depository institutions such as community development banks and certain credit unions or nondepository institutions

[1] The CDFI Fund was established by the Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. No. 103-325, § 104, 108 Stat. 2160, 2166 (1994).

such as community development loan funds or venture capital funds. Depository CDFIs have been eligible to apply for FHLBank membership since 1989 and nondepository CDFIs since 2010, when the Federal Housing Finance Agency (FHFA) implemented provisions of the Housing and Economic Recovery Act of 2008 (HERA) that authorized such membership.[2] FHFA is the supervisor and regulator of the FHLBank System and aims to promote the safe and sound operation of FHLBanks and the achievement of their mission.

You asked us to examine the FHLBanks' implementation of HERA provisions relating to nondepository CDFIs. This report discusses (1) how nondepository CDFIs differ from other members of the FHLBank System, in particular depository members; (2) the membership and collateral requirements for nondepository CDFIs and challenges posed by these requirements; and (3) FHFA oversight of FHLBanks in relation to nondepository CDFIs and efforts by FHFA and FHLBanks to increase participation of nondepository CDFIs in the FHLBank System.

To describe differences between nondepository CDFIs and other members of the FHLBank System, we reviewed relevant sections of HERA, FHFA's final rule on nondepository CDFI membership, and other relevant information from the FHLBanks and CDFI industry. We analyzed data on members' asset size from FHFA's membership database as of December 31, 2014. To address membership and collateral requirements, we reviewed relevant legislation and regulations, and documentation (such as membership applications and FHLBank guidance on assessing nondepository CDFIs for membership) to determine membership requirements and identify any differences among FHLBank policies.[3] We analyzed data on the number of nondepository CDFIs that were members in calendar years 2010 through 2014 from FHFA's membership database as of December 31, 2014. We calculated the

[2]See Pub. L. No. 110-289, § 1206, 122 Stat. 2654, 2787 (2008) (codified at 12 U.S.C. § 1424(a)); 12 C.F.R. Parts 1263, 1290. In addition to community development loan funds and venture capital funds, HERA made state-chartered credit unions without federal insurance eligible for FHLBank membership. They must meet stricter financial standards than federally insured depository institutions. See 12 CFR § 1263.11(b)(3)(iii).

[3]Nondepository CDFIs are subject to specific financial condition requirements. We requested and received financial data from the CDFI Fund but determined that the dataset did not contain relevant data needed to determine how many nondepository CDFIs could meet these financial condition requirements.

membership rate (the percentage of nondepository CDFIs in each district that were members) by using data from FHFA's membership database and Treasury's CDFI Fund. In addition, we reviewed relevant documentation such as FHLBank collateral guidelines and product and credit policies to determine the FHLBanks' requirements for obtaining advances. While we were able to review each FHLBank's collateral policies and procedures, the confidentiality of such proprietary information limited what we could publicly disclose in our report.[4] We also obtained data from each FHLBank on the amount of advances nondepository CDFI members obtained from October 2010 through September 2014 (the most recent data available at the time of our request). We reviewed documentation on and interviewed knowledgeable officials about the data we used and determined they were sufficiently reliable for assessing members' asset size (data from FHFA's membership database), the membership rates for nondepository CDFIs (data from FHFA's membership database and the CDFI Fund), and the amount of advances each nondepository CDFI member obtained (data from individual FHLBanks).

We interviewed officials from the 12 FHLBanks, 3 trade groups, 10 nondepository CDFIs that were members of the FHLBanks, and 12 nondepository CDFIs that were not members to help understand the level of demand for FHLBank membership and obtain views on any challenges associated with obtaining membership and advances. We selected the two purposive, nonrandom samples of nondepository CDFIs (10 members and 12 nonmembers) using data from FHFA's membership database. We sought variation in factors such as geographic location and asset size. The results of our interviews with the 22 nondepository CDFIs cannot be generalized to all nondepository CDFIs.

To evaluate FHFA's oversight, we reviewed relevant laws, legislative history, and regulations in relation to authority to expand membership to nondepository CDFIs and FHFA's oversight authority. We also reviewed FHFA's examination policies for membership and collateral requirements to obtain advances. To determine what, if any, findings concerned membership and advance practices, we analyzed each FHLBank's

[4]Specifically, because the collateral haircut (discount) policies of the FHLBanks generally are considered proprietary information, we were unable to attribute specific policies to individual FHLBanks. Where appropriate, we used randomly assigned numbers when discussing FHLBank collateral policies to prevent disclosure of FHLBank identities.

examination results for fiscal years 2010 through 2013 (the most recent available at the time of our request). We interviewed FHFA and the 12 FHLBanks to further understand examination policies and practices for membership and advances and discuss any efforts to facilitate broader nondepository CDFI participation in the FHLBank System. See appendix I for a more detailed description of our methodology.

We conducted this performance audit from May 2014 to April 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

The CDFI Fund provides certification to CDFIs that meet the six statutory and regulatory criteria of the Fund.[5] CDFI Fund certification is conferred on CDFIs that have the primary mission of providing capital and development services to economically distressed communities generally underserved by conventional financial institutions. CDFIs provide products and services (such as mortgage financing for low-income and first-time homebuyers and financing for not-for-profit affordable housing developers) that otherwise may not be accessible in these communities. CDFIs can be for-profit or nonprofit institutions and can be funded by private and public sources. Depository CDFIs such as community development banks and credit unions obtain capital from customers and nonmember depositors. Depository and nondepository CDFIs may obtain funding from conventional financial institutions, such as banks, in the form of loans. In addition, both types of CDFIs may receive funding from corporations, individuals, religious institutions, and private foundations. Finally, CDFIs may apply for federal grants and participate in federal loan programs. For example, Treasury's CDFI Fund makes grants, equity investments, loans, and deposits to help CDFIs serve low-income people

[5]The CDFI Fund confers certification to a legal entity that meets six statutory and regulatory criteria: the CDFI must have a primary mission of promoting community development; serve principally an investment area or targeted population; be an insured depository institution, or make loans or development investments as its predominant business activity; provide development services (such as technical assistance or counseling) in conjunction with its financing activity; maintain accountability to its target market; and be a nongovernmental entity.

and communities.[6] Other federal funding sources include loan programs administered by the Department of Agriculture and the Small Business Administration. As of December 31, 2014, there were a total of 933 certified CDFIs (411 depository and 522 nondepository).

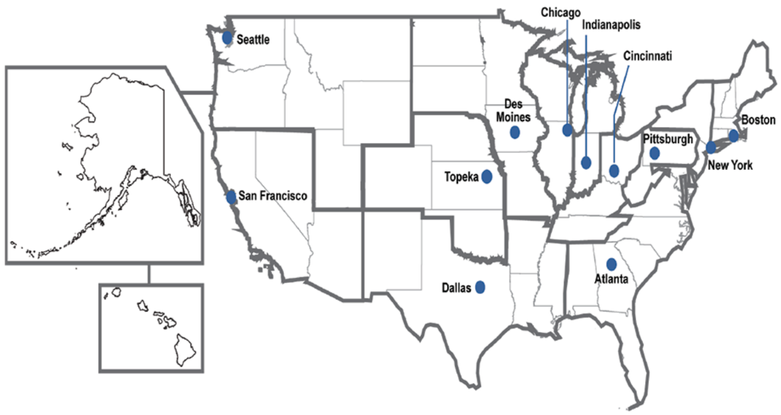
The 12 FHLBanks are regionally based cooperative institutions owned by member financial institutions (see fig. 1).[7] To become a member of its regional FHLBank, a financial institution (such as a nondepository CDFI) must meet certain eligibility requirements and purchase capital stock; thereafter, it must maintain an investment in the capital stock of the FHLBank sufficient to satisfy the minimum investment required for that institution in accordance with the FHLBank's capital plan.[8]

[6]The CDFI Fund administers a number of programs that make awards to CDFIs annually through competitive application processes. Its programs include those that provide financial assistance awards, technical assistance grants, bond guarantees, and tax credit allocation authority.

[7]On February 27, 2015, the FHLBank of Des Moines and the FHLBank of Seattle announced that the members of both FHLBanks had ratified an agreement approved by their boards of directors in September 2014 to merge. The FHLBanks anticipate that the merger will be effective by the middle of 2015.

[8]12 C.F.R. § 931.3(d).

Figure 1: The 12 Federal Home Loan Banks and Districts



Source: Federal Home Loan Banks (data); MapInfo (map). | GAO-15-352

The FHLBanks extend advances almost exclusively to their members, which in turn can use the advances to fund lending such as mortgages.[9] Advances are the largest category of assets of the FHLBanks on a combined basis, representing about 62 percent of all assets as of September 30, 2014. Other benefits of FHLBank membership for financial institutions include earning dividends on their capital investments and access to various products and services, such as letters of credit and payment services. The FHLBanks also offer affordable housing and community and economic development lending through the Affordable Housing Program and the Community Investment Program. Under these programs, the FHLBanks provide grants and advances to their members, and the members use these funds to benefit certain households or

[9]Although they are not FHLBank members, the FHLBanks also make advances to eligible housing associates (primarily state housing finance agencies). The eligibility requirements and application process for organizations seeking to be certified by FHLBanks as housing associates are set forth in 12 CFR Part 1264. Housing associates represented approximately 0.06 percent of the par value of advances outstanding as of December 31, 2014.

communities.[10] Some of the FHLBanks have their own programs designed to support community development. For instance, FHLBank-Chicago developed its Community First Fund in 2013 as a $50 million revolving loan fund that supports member and nonmember community development institutions, including CDFIs.

The FHLBanks protect against credit risk on advances by requiring borrowers to pledge collateral. As established by statute and FHFA regulations, the FHLBanks must develop and implement collateral standards and other policies to mitigate the risk of default on outstanding advances. Collateral arrangements vary with borrower credit quality, borrowing capacity, and collateral availability, as well as the FHLBank's overall credit exposure to the borrower. Each FHLBank establishes borrowing capacity by determining the amount it will lend against each collateral type. An FHLBank can require additional or substitute collateral during the life of an advance to protect its security interest. For example, additional collateral is required when a member does not have sufficient collateral pledged to support outstanding credit exposure. Substitution generally occurs if the borrower's previously pledged collateral becomes ineligible. An FHLBank also may establish separate or additional collateral requirements for different member types (such as insurance companies) perceived to have different types of risks than federally insured depository institutions.

Based on the borrower's financial condition, the collateral pledge method generally falls into one of three categories: blanket lien, listing, and delivery.

- Blanket lien is the least restrictive collateral status and generally is assigned to lower-risk institutions. A blanket-lien agreement secures

[10]Each FHLBank must contribute annually to its Affordable Housing Program the greater of (1) 10 percent of the FHLBank's net earnings for the previous year or (2) the FHLBank's pro rata share of an aggregate of $100 million to be contributed in total by the FHLBanks. 12 U.S.C. §1430(j)(5)(C); 12 C.F.R. §1291.2(a). Recipients are to use Affordable Housing Program funds to benefit very-low income and low- or moderate-income households. Very low-income households are defined as households with incomes of 80 percent or less of area median income. Very low-income households are defined as households with incomes of 50 percent or less of area median income. 12 C.F.R. § 1291.3. Under the Community Investment Program, housing advances must benefit households at or below 115 percent of area median income, while economic development advances must benefit either low- or moderate-income households or economic development projects located in low- or moderate-income neighborhoods. 12 U.S.C. § 1430(i)(2).

the right of the FHLBank to specified member assets, which may be all of the member's assets in the event the member fails or defaults on outstanding advances, usually on a first lien status. Generally, the FHLBank has priority over all other creditors, including the Federal Deposit Insurance Corporation (FDIC).[11] Most FHLBanks rely on a blanket lien agreement to secure advances without taking possession of the collateral, and the borrower may retain possession of documentation on eligible collateral pledged to the FHLBank.

- Under listing status, the borrower may retain possession of documentation on specific collateral pledged, but must provide a list of loans pledged with detailed loan information.

- Under delivery status, the borrower delivers pledged collateral to the FHLBank or a third-party custodian approved by the FHLBank.[12] This typically puts the security interest of the FHLBank in the most senior position over other creditors.

FHLBanks also seek to manage risk and mitigate potential losses by applying varying haircuts, or discounts, to collateral pledged to secure advances. For example, an FHLBank member might seek to pledge a portfolio of single-family residential mortgage loans with a value of $100 million to secure an advance from its district FHLBank.[13] If the FHLBank applied a haircut of 25 percent to such collateral, the member generally would be able to secure advances of up to $75 million, subject to other

[11]In a typical bank or thrift failure, FDIC, acting as receiver, is responsible for all advances and other credit obligations of the failed institution. Generally, FDIC will facilitate a purchase and assumption transaction with another financial institution, which then will become responsible for the FHLBank advances. If another financial institution were not found to assume the failed institution's obligations, FDIC would be responsible for the payment of the FHLBank advances by selling the failed institution's assets, including collateral that had been pledged to secure the advances, to mitigate losses to the Deposit Insurance Fund. However, such a sale could not occur until FDIC had fully satisfied or repaid the outstanding credit obligations of the failed institution. An acquiring bank also may purchase and assume the assets and liabilities of the failed member, including collateral that had been pledged to secure advances.

[12]The method of delivery depends on the type of collateral being pledged. Tangible collateral, such as certified securities or mortgage promissory notes, is delivered by physically transferring these documents to the FHLBank or its custodian. Intangible collateral, such as securities that exist only in electronic form, is delivered by crediting them to the account of the FHLBank or its custodian.

[13]Single-family mortgage loans are loans for 1–4 unit properties.

risk-management policies of the FHLBank.[14] The FHLBanks may apply haircuts based on factors such as risks associated with the member's creditworthiness, the type of collateral being pledged, and illiquidity of the collateral.

Nondepository CDFIs Differ from Other FHLBank Members in Several Ways

The differences among nondepository CDFIs and other FHLBank members range from the degree to which they focus on community development to differences in size and supervision. Two member types—nondepository and depository CDFIs—share a primary community development focus. As noted previously, both types of CDFIs must have a primary mission of promoting community development to be certified by the CDFI Fund. CDFIs serve as intermediary financial institutions that promote economic growth and stability in low- and moderate-income communities. Frequently, CDFIs serve communities that are underserved by conventional financial institutions and may offer products and services that generally are not available from conventional financial institutions. Such products and services include mortgage financing for low-income and first-time homebuyers; homeowner or homebuyer counseling; financing for not-for-profit affordable housing developers; flexible underwriting and risk capital for needed community facilities; financial literacy training; technical assistance; and commercial loans and investments to assist start-up businesses in low-income areas. Although other FHLBank members may provide similar services to similar populations, community development may not be their primary mission.

Nondepository CDFIs are smaller in asset size than most depository institution and insurance company FHLBank members. As of December 31, 2014, active members of the FHLBank System had approximately $20 trillion in assets. As shown in table 1, as of the same date, median assets for nondepository CDFI members (approximately $43 million) were lower than median assets for both depository members (approximately $207 million) and insurance company members (approximately $975 million). The largest nondepository CDFI had about $708 million in assets, while the largest insurance company member had assets of about $393 billion and the largest depository member had assets of about $2 trillion. In addition, the 30 nondepository CDFI members altogether

[14] For example, FHLBanks may set limits on the total amount of outstanding advances to an individual member. These limits are independent of the level of eligible collateral that a member must pledge to secure its advances.

accounted for about .01 percent of the total assets of all active FHLBank members, whereas depository and insurance company members held about 77 percent and about 23 percent of FHLBanks assets, respectively.

Table 1: Distribution of Total Assets for FHLBank Members by Type, as of December 31, 2014 (Dollars in Millions)

	Number of active members	Minimum assets	25th percentile	Median	75th percentile	Maximum assets
Nondepository community development financial institutions[a]	30	$0.90	$20.65	$42.57	$83.20	$707.86
Depository institutions[b]	7,025	3.15	102.71	207.28	477.27	2,008,808.00
Insurance companies[c]	302	0.70	217.29	974.58	5,590.22	392,833.72

Source: GAO analysis of FHFA data. | GAO-15-352

[a]Assets for one nondepository CDFI are as of December 31, 2013, assets for another nondepository CDFI are as of March 31, 2014, and assets for a third nondepository CDFI are as of June 30, 2014. Assets for all other nondepository CDFIs are as of December 31, 2014.

[b]Depository institution members include commercial banks, credit unions, depository CDFIs, savings associations, and savings banks. Assets for one credit union and one commercial bank were not available. Assets for all other depository institutions are as of December 31, 2014.

[c]Assets for two insurance companies were not available. Assets for all other insurance companies are as of December 31, 2014.

In addition, nondepository CDFIs are not supervised by a prudential federal or state regulator unlike other FHLBank members. Depository FHLBank members are regulated and supervised by federal and state agencies that have responsibility for helping ensure the safety and soundness of the financial institutions they oversee, promoting stability in the financial markets, and enforcing compliance with applicable consumer protection laws.[15] To achieve these goals, regulators establish capital requirements for banks and conduct on-site examinations and off-site monitoring that assesses their financial condition, including assessing their compliance with applicable laws, regulations, and agency guidance. The insured depository institutions also must submit to their regulators quarterly financial information commonly known as Call Reports that

[15]See 12 U.S.C. § 1831o. The Board of Governors of the Federal Reserve System oversees state-chartered banks and trust companies that belong to the Federal Reserve System; FDIC regulates state-chartered banks that do not belong to the Federal Reserve System as well as federally insured state savings banks and thrifts; the National Credit Union Administration (NCUA) supervises federally chartered or insured credit unions; and the Office of the Comptroller of the Currency supervises national banks and federal savings associations. The Bureau of Consumer Financial Protection supervises the consumer businesses of banks with over $10 billion in assets.

follow generally accepted accounting principles (GAAP).[16] Insurance companies are regulated primarily by state insurance commissioners and are subject to examination.[17] While the CDFI Fund's review standards are not equivalent to the examination standards applicable to regulated depository institutions, the Fund requires a nondepository CDFI to submit its most recent year-to-date financial statements prepared in conformity with GAAP for certification and funding eligibility. The CDFI Fund also requires nonprofit and for-profit nondepository CDFIs receiving awards to annually submit financial statements—including information on financial position, operations, activities, and cash flows—that have been audited by an independent certified public accountant. However, only a subset of CDFIs receives CDFI Fund awards and is subject to such reporting.

In addition to financial statements of individual nondepository CDFIs, other sources can provide information on the financial performance of nondepository CDFIs overall or individually. For example, the CDFI Fund reports on its analysis of financial data from nondepository CDFIs. The CDFI Snapshot Analysis for fiscal year 2012 (the most recent available at the time of our review) notes that community development loan funds, one type of nondepository CDFI, had rates of loan loss (loans that may prove uncollectible) of 1 percent, which compared favorably with depository CDFIs and mainstream financial institutions.[18] A national network of CDFIs reported that its members' annual net charge-off rate (debts an entity is unlikely to collect) was the same as for all FDIC-

[16]A Federal Financial Institutions Examination Council Call Report (officially known as the Consolidated Report of Condition and Income) must be filed by all FDIC-insured depository institutions on a quarterly basis. Insured credit unions must file quarterly Call Reports with NCUA. An NCUA Call Report may reflect regulatory accounting principles other than GAAP if the credit union has total assets of less than $10 million (except that a federally insured state-chartered credit union may be required by its state credit union supervisor to follow GAAP regardless of asset size).

[17]State insurance regulators typically conduct on-site financial solvency examinations every 3 to 5 years. Insurance companies file annual National Association of Insurance Commissioners statements with their state regulators.

[18]Of the 296 community development loan funds in the sample of 350 CDFIs, 253 provided loan loss rates. See Department of the Treasury, CDFI Fund, Office of Financial Strategies and Research, *CDFI Snapshot Analysis: Fiscal Year 2012* (Washington, D.C.: April 2014). The CDFI Fund notes that data were self-reported by community development loan funds and published data were based on validation reporting rules and cleansing protocols.

insured institutions in fiscal year 2012.[19] It also noted that its members had provided more than $33 billion in cumulative financing for community development activities from their inception through the end of fiscal year 2012. This financing, the network reported, helped to create or maintain nearly 600,000 jobs, support the development or rehabilitation of more than 960,000 housing units, and start or expand nearly 94,000 businesses and microenterprises. And, for a fee, a community development loan fund can be assessed by an independent third party, and receive a financial strength and performance rating. [20]The third party rates a CDFI using a methodology similar to that used by banking regulators.

In the case of financial failure, nondepository CDFIs and depository members also undergo different processes for liquidating assets to repay the FHLBanks for any advances. Depository members, including depository CDFIs, are insured by FDIC or NCUA, which means that FDIC or NCUA would serve as the receiver in the event of failure.[21] In a typical bank or thrift failure, FDIC, acting as receiver, is responsible for outstanding advances of the failed institution. FDIC will facilitate a purchase and assumption transaction with another financial institution or sell the failed institution's assets, including collateral that had been pledged to secure the advances, to mitigate losses to FDIC's Deposit

[19]See Opportunity Finance Network (OFN), *Opportunity Finance Institutions Side by Side, Fiscal Year 2012 OFN Member Data Analysis/Fifteenth Edition* (Philadelphia, Pa.). The primary source of data for this publication was OFN's Fiscal Year 2012 Annual Member Survey. The survey was sent to all CDFIs that were network members as of August 31, 2013; 200 members completed the survey. OFN supplemented survey data with publicly available data for one CDFI, and new member application data for 8 CDFIs that became members after the survey was conducted. The publication presents data points for as many as 209 CDFIs.

[20]The CDFI Assessment and Ratings System (known as CARS®) is a proprietary tool owned by Aeris, an information service for community investors. As of March 2015, Aeris had rated more than 100 CDFIs. The tool assesses a nondepository CDFI's condition in five areas: capital, asset quality, management, earnings, and liquidity. Each component is rated on a scale of 1 to 5, with 1 being the best. The component ratings are then used to develop a composite rating of 1 to 5. This rating methodology is based on the CAMELS analysis used by regulators to rate banks.

[21]FHLBanks generally have priority over all other creditors, including FDIC, to obtain the collateral necessary to protect against losses on their outstanding advances. The procedures for liquidating an insurance company vary from state to state.

Insurance Fund.[22] Because nondepository CDFIs are not federally or state insured, according to FHFA, the FHLBanks likely would go through the federal bankruptcy process to settle claims should a nondepository CDFI with FHLBank advances fail.

Collateral Requirements Pose Greatest Challenge for Nondepository CDFIs

Collateral requirements (which must be met to obtain advances) rather than the membership requirements themselves can discourage nondepository CDFIs from seeking FHLBank membership. Because regulations allow the FHLBanks to set their own thresholds for meeting some membership requirements, the requirements varied. The rates of nondepository CDFI membership also varied by FHLBank and were low. The FHLBanks generally impose collateral requirements on nondepository CDFIs that are comparable to those imposed on depository members categorized as higher risk and in some cases, comparable to those imposed on insurance companies. Officials from the nondepository CDFIs we interviewed generally cited steep haircuts (discounts) and the availability of eligible collateral as the primary challenges to obtaining advances; in addition, some viewed the requirements as a disincentive to seeking membership (because advances are a primary benefit of membership).

Although FHLBanks Had Varying Thresholds for Some Membership Requirements, Most Nondepository CDFIs We Interviewed Were Able to Meet the Requirements

Certain Membership Requirements Varied

While nondepository CDFIs must meet seven standards for FHLBank membership, the thresholds the FHLBanks set for meeting certain of the requirements varied. The Federal Home Loan Bank Act and FHFA's regulations establish the membership requirements for nondepository CDFIs. Nondepository CDFIs must

[22] FDIC could not sell the assets the failed institution had pledged to the FHLBank until FDIC had fully satisfied or repaid the failed institution's outstanding credit obligations to the FHLBank.

- be duly organized under tribal law, or the laws of any state or the United States.
- be certified by the CDFI Fund.
- make long-term home mortgage loans, which are defined by statute to include loans secured by first liens on residential real property. Under FHFA regulations, institutions satisfy this requirement if they originate or purchase long-term first mortgage loans on single-family or multifamily residential property, or certain farm or business property that also includes a residence, or purchase mortgage pass-through securities representing an undivided ownership in such loans. By regulation, FHFA has defined "long-term" loans to include those with an original term to maturity of 5 years or more.
- be in a financial condition that would allow advances to be safely made to it. FHFA developed four financial condition standards for the FHLBanks to use in their assessments—a net asset ratio of at least 20 percent; positive average net income over the preceding 3 years; a ratio of loan loss reserves to loans and leases 90 days or more delinquent of at least 30 percent; and an operating liquidity ratio of at least 1.0 for the 4 most recent quarters, and for 1 or both of the 2 preceding years.[23] If the nondepository CDFI met the standards, it would be presumed to be financially sound, and satisfy the requirement. If the CDFI did not meet one or more standards, the CDFI may offer a rebuttal and the FHLBank would perform a separate analysis to determine if the CDFI was financially sound.
- have management whose character is consistent with sound and economical home financing. Under FHFA's regulations, an applicant meets this requirement if it certifies to the FHLBank that neither the CDFI nor its senior officials have been the subject of any criminal, civil, or administrative proceedings reflecting upon creditworthiness, business judgment, or moral turpitude in the past 3 years and that

[23]Net asset ratio is calculated as the residual value of assets over liabilities. Net income, also called earnings, is calculated as gross revenues less total expenses. Loan loss reserves are the amount reserved for loans expected to be uncollectible. Liquidity is calculated with the numerator of the ratio being unrestricted cash and cash equivalents and the denominator of the ratio being the average quarterly operating expense for the 4 most recent quarters. Net asset ratio, net income, and loan loss reserves are calculated based on information derived from the applicant's most recent financial statement.

there are no known potential criminal, civil, or administrative monetary liabilities, lawsuits, or unsatisfied judgments arising within the past 3 years that are significant to the applicant's operations.

- have a home financing policy that is consistent with sound and economical home financing. Under FHFA regulations, applicants meet this requirement if they provide a written justification, acceptable to the FHLBank, explaining how and why their home financing policy is consistent with the FHLBank System's housing finance mission.
- have mortgage-related assets that reflect a commitment to housing finance. They are not required to meet the statutory requirement that applies to certain insured depository institutions to hold at least 10 percent of their assets in residential mortgage loans to be eligible for FHLBank membership.

In addition, the FHLBanks also must require all new members to purchase capital stock.

The FHLBanks have discretion in developing rules to assess compliance with some of the listed requirements. For example, the FHLBanks can set thresholds (such as dollar amounts or percentages) to satisfy requirements for which FHFA has not set thresholds—such as the requirement for making long-term home mortgage loans and the requirement to hold mortgage-related assets.[24] Each FHLBank also can develop its own requirement for membership stock purchases, subject to FHFA approval. We reviewed the three requirements for which the FHLBanks have discretion in making rules and found that the requirements varied across the FHLBanks.

Making long-term mortgages. Eight of the 12 FHLBanks we reviewed had not developed a threshold for nondepository CDFIs to satisfy the long-term mortgage requirement, while four had specified a dollar amount or percentage of assets in long-term mortgage loans. FHFA expects that

[24]In September 2014, FHFA issued a proposed rule that would change the FHLBank membership requirements. For example, the proposed rule would establish a new quantitative test requiring all members, including nondepository CDFIs, to hold 1 percent of their assets in home mortgage loans on an ongoing basis. Because this new ongoing quantitative asset requirement would subsume the existing regulatory membership eligibility requirement that CDFIs and other nondepositories hold an unspecified amount of undefined "mortgage-related assets" at the time of application for membership, the rule would also delete the latter requirement. See 79 Fed. Reg. 54847 (Sept. 12, 2014).

in assessing the applicant, the FHLBanks will assess the extent to which nondepository CDFIs have a commitment to housing finance requirements in light of their unique mission and community development orientation. The four FHLBanks that had quantitative minimums had minimum requirements that ranged from $1,000 to $1 million in dollar amounts, and from 1 percent to 2 percent of total assets. One FHLBank's stated policy included an exemption from its particular minimum requirement for nondepository CDFIs that plan to incorporate long-term mortgage loans into future business strategies. Another FHLBank that had a dollar minimum recently gave a nondepository CDFI an exemption from the minimum requirement based on the assessment that the CDFI had significant commitment to housing in accordance with regulatory and membership requirements. For the remaining eight FHLBanks that did not set a minimum requirement, nondepository CDFIs can satisfy the long-term mortgage requirement by documenting that they have originated or purchased more than one such loan or qualifying mortgage investment.

Mortgage-related assets. Four of the 12 FHLBanks we reviewed did not have minimum requirements for the mortgage-related asset requirement, 5 had quantitative and qualitative measures (such as an assessment of the CDFI's housing-related activities and mission), and 3 had only quantitative measures.[25] The highest minimum quantitative requirement for mortgage-related assets as a percentage of total assets was 10 percent. The three FHLBanks with only quantitative requirements had the lowest requirements, with one FHLBank requiring two mortgage-related assets, another requiring $1,000 in mortgage-related assets, and another requiring the lower of 1 percent of total assets or $10 million in mortgage-related assets.

Stock purchases. The amount of stock that members must purchase varied according to each FHLBank's funding strategy (see table 2). FHLBank members must hold a certain amount of membership capital stock as a continuing condition of membership. Each FHLBank determines as a part of its capital plan the amounts that all members must purchase in membership capital stock and sets its requirement based on the FHLBank's business model. Five of the 12 FHLBanks we reviewed calculated the membership stock purchase as a percentage of

[25]Five FHLBanks have policies that allow them discretion to consider other variables if a nondepository CDFI does not meet the quantitative requirement.

the member's total assets. The other 7 FHLBanks calculated the purchase as a percentage of a specific asset category, such as mortgage-related assets or certain assets eligible to be pledged as collateral.

Table 2: Requirements for Purchases of Membership Stock by FHLBank, as of November 2014

FHLBank	Stock purchase percentage	Assets to which the stock purchase percentage is applied[a]	Minimum investment	Maximum investment
Atlanta	0.09%	Total	No minimum[b]	$15 million
Boston	0.35	Subset	$10,000	25 million
Chicago	1.00	Subset	10,000	Lesser of 9.9% of FHLBank's total outstanding capital stock or $250 million
Cincinnati	0.03 to 0.15	Total	1,000	25 million
Dallas	0.04	Total	1,000	7 million
Des Moines	0.12	Total	10,000	10 million
Indianapolis	1.00	Subset	1,000	35 million
New York	0.15	Subset	1,000	No maximum
Pittsburgh	0.10	Subset	10,000	45 million
San Francisco	1.00	Subset	100	25 million
Seattle	0.50	Subset	500	15 million
Topeka	0.10	Total	1,000	500,000

Source: GAO analysis of FHLBank information. | GAO-15-352

[a]Subset is used when the FHLBank calculates the membership stock purchase percentage using more narrowly defined assets, such as mortgage-related assets, rather than total assets.

[b]Stock transactions for FHLBank-Atlanta occur in $100 increments.

The FHLBanks also require members to purchase activity-based stock. That is, members must acquire a specific amount of stock based on the product—such as advances or letters of credit—the FHLBank provided to that member. The purchases are specified as a percentage of the dollar amount of each transaction the member conducted with the FHLBank. For example, among the 12 FHLBanks, the purchase requirements on advances ranged from 2 percent to 5 percent. For instance, if a member had a $2 million advance transaction with the FHLBank, it would have to purchase from $40,000 to $100,000 in capital stock.

Most CDFIs Were Able to Meet Membership Requirements

While FHLBank and CDFI industry officials we interviewed cited several membership requirements that could pose a challenge for nondepository CDFI applicants (including financial condition, long-term home mortgage loan, mortgage-related assets, and stock purchase requirements), most of the nondepository CDFIs we interviewed were able to meet these requirements or stated that they would be able to meet the requirements.

Financial condition requirements. Officials we interviewed from 9 of the 12 nonmember nondepository CDFIs stated that they would be able to meet the financial condition standards, while 2 stated that they would potentially face challenges with the financial condition standards.[26] In addition to interviewing officials from nondepository CDFIs that were nonmembers, we reviewed the applications of the 27 nondepository CDFIs that were members as of September 2014. Seven of the 27 nondepository CDFIs did not meet at least one of the financial condition standards at the time of their application, but made successful rebuttals and became members.[27]

Making long-term mortgages. Of the 12 nonmember nondepository CDFIs we interviewed, officials from 1 cited the "makes long-term home mortgage loans" requirement as a challenge for membership. In addition, officials from 1 of the 10 member nondepository CDFI we interviewed cited this as a challenge, but noted that they received an exemption from the minimum quantitative requirement imposed by the FHLBank. The officials from the remaining 11 nonmember and 9 member CDFIs did not identify this requirement as a challenge. Officials from two FHLBanks stated that CDFIs in general may face challenges meeting this requirement, as some nondepository CDFIs may not make or hold long-term home mortgage loans if they are not involved in mortgage lending.

Mortgage-related assets. Although the mortgage-related asset requirement varies among the FHLBanks, none of the officials from the 12 nonmember nondepository CDFIs we interviewed stated that they would face challenges meeting this requirement.

[26]Officials at one CDFI stated that they were not sufficiently familiar with the membership requirements to know if the CDFI could meet the requirements.

[27]Four of the seven CDFIs did not meet the net asset ratio standard, three of the seven CDFIs did not meet the loan loss reserves standard, two of the seven CDFIs did not meet the positive net income standard, and two of the seven CDFIs did not meet the liquidity ratio standard. Four of the seven CDFIs failed two financial condition standards, with a total of 11 standards failed among seven CDFIs.

Stock-purchase requirements. Officials from 1 of the 12 nonmember CDFIs we interviewed stated that the amount of membership stock they would be required to purchase was cost prohibitive, while officials from the 10 member CDFIs we interviewed stated that the amount required was not a challenge to membership. Nondepository member CDFIs we interviewed were able to purchase the required amount of membership stock. Officials from one nonmember nondepository CDFI in the FHLBank-Chicago district said that the CDFI was approved for membership, but did not become a member because the stock purchase requirement was too high. FHLBank-Pittsburgh recently amended its capital plan by lowering the membership and activity-based stock purchase calculations, citing benefits to CDFIs. In addition, FHLBank-Chicago recently reduced its minimum membership stock purchase requirement to make it less costly for nondepository CDFIs and others to join. (We discuss these and other changes later in this report.)

Rates of Nondepository CDFI Membership Were Low

The rates of nondepository CDFI membership generally were low, ranging from 2.08 percent to 15.38 percent of nondepository CDFIs in each FHLBank district (see fig. 2). As of December 31, 2014, 30 of the 522 nondepository CDFIs were FHLBank members, and 6 of the 12 FHLBanks had membership rates of less than 5 percent for the nondepository CDFIs in their districts. The number of nondepository CDFI members has increased every year since the first joined in 2010. Forty percent (12 of 30) of the current nondepository CDFI members joined the FHLBank System in 2014. As of the end of 2014, all 12 FHLBanks had at least one nondepository CDFI member; 2 approved their first nondepository CDFI member in 2013 and another 3 did so in 2014.

Figure 2: Rates of Nondepository CDFI Membership by FHLBank District, as of December 31, 2014

	Cumulative number of non-depository CDFI members						
	2010	2011	2012	2013	2014	Total CDFIs in district	Membership rate
Atlanta	1	1	1	1	2	73	2.74%
Boston	0	0	0	1	4	48	8.33
Chicago	0	1	1	1	1	24	4.17
Cincinnati	1	3	4	4	4	30	13.33
Dallas	0	0	2	3	4	45	8.89
Des Moines	0	1	1	1	1	48	2.08
Indianapolis	0	0	0	1	2	13	15.38
New York	0	0	1	2	2	63	3.17
Pittsburgh	0	0	0	0	1	32	3.13
San Francisco	0	2	3	4	5	68	7.35
Seattle	0	0	0	0	2	53	3.77
Topeka	0	0	0	0	2	25	8.00
Total	**2**	**8**	**13**	**18**	**30**	30 (members) + 492 (nonmembers) = **522**	**5.75%**

Members
Nonmembers

CDFI = community development financial institution

Source: GAO analysis of FHFA membership database and CDFI Fund data. | GAO-15-352

Note: The number of nondepository CDFI members each year is a cumulative number and represents nondepository CDFIs that had been approved for membership and purchased stock by December 31, 2014. The membership rate is calculated by dividing the number of nondepository CDFI members by the total number of nondepository CDFIs in the FHLBank district.

According to FHFA officials, some nondepository CDFIs may not be good candidates for FHLBank membership. They noted that the majority of nondepository CDFIs make nonhousing loans such as microloans, small business loans, and commercial loans. In addition, FHFA officials stated that many of the nondepository CDFIs engaged in housing-related activities have low asset volumes.

Nondepository CDFIs Are Subject to Comparatively More Stringent Collateral Requirements, Which Can Be a Disincentive for Obtaining Membership

Due to the differences between nondepository CDFIs and other FHLBank members discussed earlier, representatives from the FHLBanks stated that nondepository CDFIs have certain risks that depository members do not have. The risks cited included the lack of supervision by a regulator and uncertainty related to the liquidation process in the event of insolvency. As noted previously, the FHLBanks are required by statute and FHFA regulations to develop and implement collateral standards and other policies to mitigate the risk of default on outstanding advances. To address risks associated with nondepository CDFIs, the FHLBanks can place limits on eligible collateral and generally impose collateral requirements on nondepository CDFIs seeking advances that are comparable to those imposed on depository members categorized as higher risk and, in some cases, insurance companies. Some of the CDFIs and FHLBanks we interviewed cited these collateral requirements as a disincentive for nondepository CDFI membership.

Eligible Collateral for Nondepository CDFIs Varied among FHLBanks

Although they are allowed by regulation to accept certain types of collateral from all of their members, some FHLBanks have chosen to limit the types of eligible collateral that nondepository CDFIs can pledge. (This is also sometimes the case for other nondepository members such as insurance companies.)

- FHLBanks can accept FHLBank deposits as collateral.
- The securities collateral FHLBanks can accept includes U.S. Treasury and agency securities, U.S. agency mortgage-backed securities, and privately issued mortgage-backed securities (including residential and commercial).[28]
- The types of mortgage collateral that FHLBanks can accept include single-family and multifamily mortgage loans; mortgage or other loans issued, insured, or guaranteed by the U.S. government or its agencies; commercial real estate loans; and home equity loans or lines of credit.[29]

Nondepository CDFIs are eligible to pledge FHLBank deposits, securities, and mortgage loans as collateral for advances at all 12 FHLBanks. During

[28] 12 CFR § 1266.7. Eligible types of securities collateral for pledge to FHLBanks consist of (1) privately issued mortgage-backed securities; (2) agency securities that are issued, insured, or guaranteed by the U.S. government, or any agency thereof, including mortgage-backed securities issued or guaranteed by Freddie Mac, Fannie Mae, Ginnie Mae, or any other agency of the U.S. government; and (3) securities backed by, or representing an equity interest in, mortgages or other loans insured or guaranteed by the United States or any U.S. agency.

[29] 12 CFR § 1266.7. Eligible types of loan collateral for pledge to the FHLBanks consist of (1) mortgage loans that are fully disbursed, whole first mortgage loans on improved residential real property not more than 90 days delinquent; (2) mortgages or other loans that are insured or guaranteed by the United States or any U.S. agency, regardless of delinquency status; and (3) other real estate-related collateral provided that it has a readily ascertainable value, can be reliably discounted to account for liquidation and other risks, can be liquidated in due course, and the FHLBank can perfect a security interest in such collateral. Other real estate-related collateral includes but is not limited to second mortgage loans, including home equity loans; commercial real estate loans; and mortgage loan participations.

the course of our work, three FHLBanks—Atlanta, New York, and Pittsburgh—changed their policies to allow mortgage loans as eligible collateral from nondepository CDFIs. Pittsburgh changed its policies in August 2014, New York in September 2014, and Atlanta in December 2014. All the other FHLBanks have had policies that allowed mortgage loans as eligible collateral from nondepository CDFIs since nondepository CDFIs became eligible for membership in 2010. Officials from FHLBanks in Atlanta, New York, and Pittsburgh stated that due to the different risks posed by nondepository CDFIs, they initially took conservative stances on accepting loan collateral. The risks they cited included the lack of a clear resolution mechanism in the case of bankruptcy and the FHLBank not being able to obtain blanket liens on pledged collateral.

Within the general collateral categories (such as securities and mortgage loans), each FHLBank can impose specific collateral eligibility requirements, such as the quality of the collateral. For example, for nondepository CDFIs, one FHLBank disallows nonagency mortgage-backed securities, another FHLBank disallows commercial real estate collateral, and five FHLBanks disallow home equity lines of credit or home equity loans. At two FHLBanks, nondepository CDFIs can pledge mortgage loan collateral only if the CDFIs have certain credit ratings.

Collateral Requirements for Nondepository CDFIs Are Comparable to Those for Higher-Risk Institutions

The collateral requirements—specifically, the pledge method and haircuts—applicable to nondepository CDFIs seeking advances are comparable to those generally imposed on depository members categorized as higher risk and, in some cases, to those imposed on insurance companies. Based on our review of each FHLBank's policies, all FHLBanks evaluate the creditworthiness and financial condition of their members, including nondepository CDFIs. Factors included in many of the evaluations are capital adequacy, asset quality, management quality, earnings, and liquidity. Additionally, the FHLBanks (with the exception of Topeka) assign credit ratings to their depository members that indicate the creditworthiness and financial condition of these members.[30] Of the 11 FHLBanks that assign credit ratings to depository members, 9 also assign credit ratings to nondepository CDFIs, with 2 (Atlanta and San Francisco) using a separate rating system specific to nondepository CDFIs. The remaining FHLBanks (New York and Indianapolis) do not

[30]FHLBank-Topeka does not assign specific credit ratings to members, but evaluates financial performance based on a set of criteria and assigns a pass or fail rating.

assign credit ratings to nondepository CDFIs. While the metrics and methodology used to evaluate members differ, policies across FHLBanks generally reflect differential treatment between depository institutions and nondepository CDFIs (and other nondepository institutions such as insurance companies). For example, all FHLBanks require nondepository members to deliver collateral but generally only depository members with low credit ratings are required to list or deliver collateral.

The FHLBanks differed in the extent to which they varied haircuts (discounts) for nondepository CDFIs and depository institutions.[31] For securities collateral, eight FHLBanks imposed the same haircut on nondepository CDFIs as on depository members for all eligible types of securities collateral. In contrast, four imposed higher haircut ranges on nondepository CDFIs. For loan collateral,

- six FHLBanks generally applied the same haircuts to nondepository CDFIs and depository institutions. One applied a higher-range haircut for single-family mortgages to nondepository CDFIs than to depository institutions;
- five FHLBanks applied higher haircut ranges to nondepository CDFIs than to depository institutions; and
- another FHLBank applied the lower end of the haircut range to nondepository CDFIs.

FHLBanks generally varied the haircut based on the types and quality of collateral, credit score or financial condition of the member, and pledge method (for loans).[32] In general, haircuts were higher for collateral with lower ratings or of lower quality. See tables 3 and 4 for the specific haircuts each FHLBank imposed on nondepository CDFIs and depository institutions for securities and loan collateral.[33] In all cases, each FHLBank may change these requirements at its discretion. See appendix II for

[31]In some cases, the FHLBanks treat all nondepository institutions the same; therefore, the haircuts applied to insurance companies are the same as those of nondepository CDFIs.

[32]All FHLBanks require securities to be delivered to the FHLBank or third-party custodian; the variation in pledge method is only applicable for loan collateral.

[33]The haircut for cash and FHLBank deposits is 0 percent across all FHLBanks

more information on each FHLBank's credit rating system and collateral requirements for advances, and how they may differ for nondepository CDFIs and depository institutions.

Table 3: Percentage Haircut (Discount) for Selected Securities Collateral for Depository Institutions and Nondepository CDFIs by FHLBank, as of December 2014

FHLBank	Securities collateral types					
	U.S. Treasury and agency securities[a]		Nonagency MBS		Nonagency, commercial MBS	
	DIs	CDFIs	DIs	CDFIs	DIs	CDFIs
1	3-14%[b]	8-19%[b]	21-28%[b]	26-33%[b]	21-33%[b]	26-38%[b]
2[c]	1-12[b]	1-12[b]	10-19[b]	10-19[b]	7-21[b]	7-21[b]
3[c]	3-16[b,d]	3-16[b,d]	10-47[b,d]	10-47[b,d]	13-56[b,d]	13-56[b,d]
4[e,c]	3-7[b]	3-7[b]	50	[f]	15-50[b]	15-50[b]
5	3	8-11[b]	10-28[d]	30	10-28[d]	30
6	3-5[b]	3-5[b]	15-30[b]	15-30[b]	15-30[b]	15-30[b]
7	2-5[b]	2-5[b]	2[g]	2[g]	2[g]	2[g]
8	5-6[b]	5-6[b]	10-12[b]	10-12[b]	12-18[b]	12-18[b]
9	1-15[b]	2-21[b,d]	13-34[b,d]	39-57[b,d]	14-41[b,d]	44-67[b,d]
10[c]	2-4[b,d]	2-12[b,d]	10	10-30[b,d]	5-10[b]	5-30[b,d]
11	1-7[b]	1-7[b]	20-45[b]	20-45[b]	20-25[b]	20-25[b]
12[c]	5-11[b]	5-11[b]	9-45[b]	9-45[b]	13-47[b]	13-47[b]

Source: GAO analysis of FHLBank information. | GAO-15-352

MBS = mortgage-backed securities; DI = depository institution; CDFI = nondepository community development financial institution

Note: The haircuts for different FHLBanks are not comparable. The FHLBanks provided discrete haircut values depending on factors such as type and quality of collateral and credit ratings; these haircut values are grouped into a range. The quality of collateral accepted may differ across FHLBanks. For example, one FHLBank accepts commercial mortgage-backed securities that are rated AA and higher, while another accepts commercial mortgage-backed securities that are only rated AAA. We did not include all securities collateral types accepted by the FHLBanks because they were only mentioned in some FHLBanks' documents. For example, we excluded second mortgage-backed securities; student-loan asset-backed securities; and municipal, state, or local government securities. The information above is not inclusive of all information that the FHLBanks may take into consideration in determining a haircut. For example, based on a field review of the pledged collateral, the FHLBank may impose additional haircuts. Thus, the haircuts presented in this table are minimum haircuts.

[a]We excluded certain securities from our analysis because they were only mentioned in some FHLBanks' documents.

[b]The specific type of collateral, collateral rating or collateral quality, or the maturity of collateral determines where the haircut falls within the range. Generally, a higher haircut is given to collateral with a longer maturity or lower quality.

[c]For FHLBanks 2, 3, 4, 10, and 12, the haircuts for insurance companies are the same as those of nondepository CDFIs. For FHLBanks 2, 3, 4, and 12, these haircuts are also the same as depository institutions.

[d]The credit score or financial condition of the member determines where the haircut falls within the range.

[e]For nondepository CDFIs that execute an agreement to establish a specific lien on assets pledged to Bank 4, discounts applied to securities collateral are increased by 20 percent. For example, a discount of 10 percent increases to 12 percent.

[f]Collateral is ineligible.

[g]For Bank 7, the haircut for nonagency MBS and commercial MBS starts at the haircut indicated in the table and will vary. However, the FHLBank document does not specify how much the variation could be.

Table 4: Percentage Haircut (Discount) for Selected Loan Collateral for Depository Institutions and Nondepository CDFIs by FHLBank, as of December 2014

FHLBank	Mortgage loan collateral types									
	Single-family residential mortgages		Multifamily residential mortgages		Commercial real estate		Home equity loans/lines of credit		Government guaranteed loans	
	DIs	CDFIs	DIs	CDFIs	DIs	CDFIs	DIs	CDFIs	DIs	CDFIs
1[a,b]	10%	15%[c]	20%	25%[c]	25%	30%[c]	15%	[d]	—[e]	—[e]
2[b]	23-34[f]	23-34[c,f]	35	35[c]	38	38[c]	38	[d]	7-13[f]	7-13[c,f]
3[b]	20-45[f]	20-45[c,f]	28-43[f]	28-43[c,f]	33-45[f]	[d]	14-48[f]	[d]	9-13[f]	9-13[c,f]
4[b]	20-40[f,g]	25-40[c,f]	27[h]	27[c]	35[h]	35[c]	50[h]	50[c]	10-25[f,g]	10-25[c,f]
5[i]	6-36[f,g,j]	14-25[c,f]	21-35[j]	27[c]	21-36[j]	27[c]	5-40[f,g,j]	[d]	—[e]	—[e]
6[k]	20-25[g]	50[c]	30-35[g]	50[c]	30-35[g]	50[c]	40-45[g]	50[c]	20-35[f,g]	50[c]
7[b]	10-25[g]	10-25[c,j]	25	25[c]	30	30[c]	55	[d]	N/A[l]	N/A[l]
8	22-46[f]	22-46[c,f]	30-62[f]	30-62[c,f]	27-62[f]	27-62[c,f]	25-44[f]	25-44[c,f]	11-15[f]	11-15[c,f]
9	6-33[f,g,j]	33[c,j]	13-47[f,g,j]	39-43[c,j]	9-39[f,g,j]	33-36[c,j]	13-43[f,g,j]	N/A[l]	N/A[l]	N/A[l]
10[b]	5-35[f,g,j]	5-35[c,f,j]	22-45[f,g,j]	22-45[c,f,j]	30-50[f,g,j]	30-50[c,f,j]	20-70[f,g,j]	20-70[c,f,j]	15	15[c]
11	8-31[g,j]	23[c]	10-31[g,j]	21[c]	12-35[g,j]	24[c]	18-44[g,j]	36[c]	—[e]	—[e]
12[b]	20-31[g]	20[c]	36-43[g]	36[c]	43-50[g]	43[c]	33-60[g]	33[c]	—[e]	—[e]

Source: GAO analysis of FHLBank information. | GAO-15-352

DI = depository institution; CDFI = nondepository community development financial institution; N/A = not applicable

Note: The haircuts for different FHLBanks are not comparable. The FHLBanks provided discrete haircut values depending on factors such as type and quality of collateral and credit ratings; these haircut values are grouped into a range. The quality of collateral accepted may differ across FHLBanks. For example, one FHLBank specifies that it accepts conventional single-family residential mortgage loans, while another provides a range for traditional, subprime, and nontraditional mortgage loans. We did not include all loan collateral types accepted by the FHLBanks because they were only mentioned in some FHLBanks' documents. We excluded agricultural real estate loans, land loans, construction loans, and student loans. The information above is not inclusive of all information that the FHLBanks may take into consideration in determining a haircut. For example, based on a field review of the pledged collateral, the FHLBank may impose additional haircuts. Thus, the haircuts presented in this table are minimum haircuts. Four FHLBanks also vary the basis (e.g., market value, unpaid principal balance) for determining loan collateral values in relation to the pledge method.

[a]Nondepository CDFIs cannot pledge second-lien loans to Bank 1 while depository institutions can. The haircut in this table includes only the first-lien loans for comparability between depository institutions and nondepository CDFIs. Additionally, the FHLBank established a separate and higher

haircut for members that have not undergone an on-site review. We did not include those haircut requirements.

[b]For FHLBanks 1, 2, 3, 4, 7, 10, and 12, the haircuts for insurance companies are generally the same as those of nondepository CDFIs. For FHLBanks 2, 3, 7, and 10, these haircuts are also the same as depository institutions.

[c]The required pledge method is generally delivery.

[d]The collateral is ineligible.

[e]We could not determine this information from the documentation provided by the FHLBanks.

[f]The type, rating, or quality of collateral determines where the haircut falls within the range. Generally, a higher haircut is given to collateral with a lower quality.

[g]The pledge method affects where the haircut falls within the range. In some cases, the haircut applicable to collateral pledged using listing status may be lower than that of blanket lien status. Delivery may be required based on the financial strength of the member.

[h]The required pledge method is listed reporting.

[i]Bank 5 assigns multifamily residential mortgage and commercial real estate loans one of three levels (levels 1-3) based on reporting requirements from the least level of detail to most level of detail. Additionally, commercial real estate collateral could be standard or special purpose. Nondepository CDFIs are only allowed to pledge standard, level 3 loans. For comparability between nondepository CDFIs and depository institutions, haircuts assigned to level 1 and 2 and special-purpose collateral are excluded in the table. In addition, Bank 5 does not accept loan collateral from nondepository CDFIs with the highest credit risk according to its internal rating system.

[j]The member's credit score or financial condition determines where the haircut falls within the range.

[k]Nondepository CDFIs only may borrow from Bank 6 if they have passable credit ratings according to the FHLBank's internal rating system, unless otherwise approved.

[l]Bank 7 explained that it does not apply different haircuts to government-guaranteed loans; Bank 9 indicated that it did not develop a haircut for nondepository CDFIs for home equity loans/lines of credit and that it does not distinguish between guaranteed and unguaranteed loans.

Few FHLBanks Had Specific Advance Terms and Conditions for Nondepository CDFIs

Four FHLBanks—Des Moines, New York, Pittsburgh, and San Francisco—had conditions on advance terms and borrowing limits specific to nondepository CDFIs. In general, advance terms and conditions varied widely. For example, FHLBanks offered advances with terms to maturity ranging from overnight to 30 years. FHLBanks may establish an overall credit limit for their borrowers. For example, the overall credit limit for FHLBank-Chicago was 35 percent of a member's total assets. However, the amount a borrower can obtain is also partly dependent upon the amount and value of qualifying collateral available to secure the advance. FHLBanks may impose additional restrictions depending on the financial condition of the borrower, such as restrictions on the type of product, term of advance, and amount of credit available. Examples of specific conditions imposed on nondepository CDFIs by the four FHLBanks include the following:

- FHLBank-Des Moines imposed a maximum amount of borrowing capacity and term available based on member credit ratings. Nondepository CDFIs were subject to a lower borrowing capacity than depository institutions with the same ratings.

- FHLBank-New York limited the maximum advance term to 5 years for nondepository CDFIs.
- FHLBank-Pittsburgh limited the maximum advance term to 2 years for nondepository CDFIs.
- FHLBank-San Francisco had a term limit of 7 years for its nondepository CDFIs.

For more information on each FHLBank's advance terms and borrowing limits for nondepository CDFIs and depository institutions, see appendix III.

Lack of Eligible Collateral Viewed as Primary Challenge to Obtaining Advances and Steep Haircuts Viewed as Disincentives

Officials from most of the nondepository CDFIs we interviewed cited access to low interest-rate advances from the FHLBanks as the primary benefit of membership, and some FHLBanks and nondepository CDFIs officials cited collateral requirements as challenges or disincentives to obtaining advances. Officials from three FHLBanks stated that the lack of eligible collateral was a disincentive for nondepository CDFIs seeking membership.

- Officials from 21 (10 members and 11 nonmembers) of the 22 nondepository CDFIs we interviewed cited access to low interest-rate advances from the FHLBanks as the primary benefit of membership.
- Officials from 5 of the 12 nonmember nondepository CDFIs interviewed said that they would not be interested in membership if they could not obtain advances.
- Officials from 10 FHLBanks and 12 (6 members and 6 nonmembers) nondepository CDFIs stated that lack of eligible collateral was a challenge to obtaining advances for nondepository CDFIs. The reasons the officials provided for lack of collateral eligibility included
  - not possessing mortgage-related collateral,
  - not having unencumbered assets (those free and clear of liens or claims by other creditors), and
  - not having quality collateral that met FHLBank standards.
- For example, officials from FHLBank-Chicago stated that most nondepository CDFIs possessed assets, such as small business loans, that did not qualify based on statute and regulation as eligible

collateral.[34] Officials from four FHLBanks and seven nondepository CDFIs (three members and four nonmembers) stated that the requirement to pledge unencumbered assets was a challenge for nondepository CDFIs. Collateral encumbrance may occur when a CDFI is also a loan consortium that makes loans to borrowers on behalf of its members.[35] Quality of collateral also affected collateral eligibility. For instance, officials from FHLBank-Cincinnati provided an example of a nondepository CDFI member whose collateral consisted exclusively of subprime mortgage loans. Due to the FHLBank's constraints on exposure to subprime residential mortgage loan collateral (no more than 60 percent of borrowing capacity could stem from these loan types), the FHLBank was not able to accept the loans as collateral.

- Steep haircuts were cited as a disincentive to applying for advances. Officials from 6 (2 members and 4 nonmembers) of the 22 nondepository CDFIs we interviewed cited high haircuts as a disincentive for obtaining advances. For example, officials from a nondepository CDFI member said that their haircuts were very steep and that they likely will not obtain advances again unless the FHLBank eased the requirements. Officials from a nonmember nondepository CDFI in another district stated that the haircut was too restrictive.

Officials from all the member nondepository CDFIs we interviewed said that FHLBank membership had not affected their business activities or that they had not considered changing their business activities to better meet the collateral requirements. However, officials from three of the

[34]The Federal Home Loan Bank Act permits community financial institutions to pledge alternative collateral such as small business, small farm, and small agribusiness loans, and securities representing a whole interest in these secured loans. Community financial institutions are defined as any FHLBank member with deposits insured by FDIC and average total assets below a specified cap. For more information, see GAO, *FHFA Oversight of FHLBank Alternative Collateral*, GAO-10-792 (Washington, D.C.: July 20, 2010). The Small Business and Community Investments Expansion Act of 2015 (H.R. 1355) was introduced in 2015 to allow CDFIs to pledge the types of collateral community financial institutions are eligible to pledge.

[35]A loan consortium is formed by the joining of two or more financial institutions to invest in a pool of funds and make loans to a borrower using participation loans or lines of credit. Investors in a loan consortium share the costs and risks of lending. Each investor allows a prorated draw based on its respective commitment amount and shares any losses proportionally.

nonmember nondepository CDFIs we interviewed said that they have been taking actions to obtain assets that could be used as eligible collateral. One of these nonmember nondepository CDFIs was buying mortgage-backed securities to better meet collateral requirements. Additionally, officials from five FHLBanks said that their nondepository CDFI members had changed the structure of certain loans or repositioned their assets to create eligible collateral for advances.

Less Than Half of Nondepository CDFI Members Have Borrowed from FHLBanks

From October 2010 to September 2014, less than half of the nondepository CDFI members obtained advances from the FHLBanks. Six FHLBanks provided 115 advances totaling about $306.7 million to 12 nondepository CDFIs during this period (see fig. 3). However, two FHLBanks provided 57 advances to four nondepository CDFIs that accounted for almost 98 percent of the total advance amount. Of the 115 advances, approximately 36.5 percent had terms of less than 1 year (including advances with overnight terms), 15.7 percent had terms of more than 1 year to less than 5 years, 44.3 percent had terms of 5 years or longer, and 3.5 percent had open terms.[36]

[36]Long-term advances only may be made to (1) provide funds to any member for residential housing finance; and (2) provide funds to any community financial institution for small business, small farms, small agribusiness, and community development activities. 12 U.S.C §1430(a)(2). Long-term is defined by FHFA to mean a term to maturity of 5 years or greater. 12 CFR § 1266.1. The advances with open terms originated from FHLBank-San Francisco. With an open term, the advance does not have a stated maturity date. Rather, the advance reprices each day, and interest payments are due at the end of each month. Members have the opportunity each day to pay down their open advances without a prepayment fee.

Figure 3: Total Advances Made to Nondepository CDFIs by FHLBank District, from October 2010 through September 2014

	Number of advances	Amount of advances (dollars in millions)	Number of nondepository CDFI members that obtained advances
Atlanta	10	$183.0	1 of 2
Boston	1	0.2	1 of 3
Chicago	2	3.0	1 of 1
Cincinnati	9	2.1	3 of 4
Dallas	46	2.4	3 of 4
Des Moines	0	0	0 of 1
Indianapolis	0	0	0 of 2
New York	0	0	0 of 2
Pittsburgh	0	0	0 of 0
San Francisco	47	116.0	3 of 5
Seattle	0	0	0 of 2
Topeka	0	0	0 of 1
Total	**115**	**$306.7**	12 of 27[a]

Terms of advance
- Overnight
- <1 year, excluding overnight
- ≥1 year - <5 years
- ≥5 years
- Open[b]

CDFI = community development financial institution

Source: GAO analysis of FHFA membership database and FHLBank information. | GAO-15-352

[a]At the time of our analysis (September 2014), 27 nondepository CDFIs were members of the FHLBank System. Another 3 nondepository CDFIs joined the FHLBank System in November and December 2014, for a total of 30.

[b]The advances with open terms originated from FHLBank-San Francisco. With an open term, the advance does not have a stated maturity date. Rather, the advance reprices each day, and interest payments are due at the end of each month. Members have the opportunity each day to pay down their open advances without a prepayment fee.

FHFA and FHLBanks Have Made Efforts to Facilitate Broader Participation of Nondepository CDFIs in the FHLBank System

FHFA and FHLBanks have made efforts to broaden the participation of nondepository CDFIs in the FHLBank System. According to FHFA officials, FHFA's final rule implementing the HERA provisions that allow nondepository CDFI membership in the FHLBank System allows for certain flexibilities in meeting membership requirements. FHFA oversight of FHLBanks did not focus on FHLBanks' membership approval process or advance and collateral practices as it relates to nondepository CDFIs and did not identify any safety and soundness concerns or action plans. FHFA and the FHLBanks have undertaken several efforts to help promote membership of nondepository CDFIs in the FHLBank System.

FHFA Final Rule on Membership for Nondepository CDFIs Includes Flexibilities

As noted previously, FHFA's final rule to implement HERA provisions on nondepository CDFI membership in the FHLBank System allows for certain flexibilities in meeting membership requirements. In 2009, FHFA drafted a proposed rule that sought to amend the membership regulations and issued it for public comment. The substantive issues raised in the comments on membership focused on the criteria that FHFA proposed for FHLBanks to use in evaluating the financial condition of nondepository CDFIs applying for membership. According to FHFA officials, the CDFI community also was concerned about nondepository CDFIs not meeting basic membership requirements, such as making long-term mortgage loans and carrying mortgage-related assets.

FHFA reviewed the comments and issued a final rule in January 2010. If an applicant cannot meet the presumptive financial conditions, the final FHFA regulations allow nondepository CDFIs to submit additional information demonstrating that the applicant is in sufficiently sound condition to obtain membership and advances. The final rule also did not extend the requirement to demonstrate that 10 percent of their total assets are in residential mortgage loans to nondepository CDFI applicants.

Examinations of FHLBanks Found No Safety and Soundness Concerns with Advance Practices

FHFA oversight of FHLBanks as it relates to nondepository CDFIs did not focus on membership processes due to the low risk posed, and its oversight of collateral practices did not identify areas of concern. FHFA conducts annual examinations of the FHLBanks that cover these topics, among others. According to FHFA officials, FHFA examines FHLBanks' membership approval processes to ensure that they comply with FHFA's eligibility requirements and implement a risk-management process that is intended to mitigate the FHLBanks' exposure to significant risks, especially legal, credit, and operational risk.

FHFA reviewed aspects of each FHLBank's membership process periodically in 2010 through 2013.[37] However, according to FHFA, it did not focus on processes specific to nondepository CDFIs because nondepository CDFIs pose low safety and soundness and credit risks, in aggregate, to FHLBanks due to their low rates of membership and

[37]An FHFA official stated that FHFA did not conduct a specific membership examination for one FHLBank during 2010 through 2013 but reviewed aspects of membership as part of a different examination module.

advances. According to FHFA officials, FHFA currently reviews each nondepository CDFI's application for membership and has not objected to any nondepository CDFI application submitted by the FHLBanks. It primarily reviews applications to gather information about the FHLBanks' membership approval process.

In annual examinations of each FHLBank in 2010 through 2013, FHFA reviewed the FHLBanks' collateral and advance practices for nondepository CDFIs and did not find any safety and soundness issues. FHFA's advances and collateral examination manual calls for it to evaluate the FHLBanks' procedures for analyzing and monitoring members, including nondepository CDFIs, and their outstanding advances. The manual also advises that special attention be given to FHLBanks' collateral practices for CDFIs because nondepository CDFIs have no dedicated regulator. Furthermore, FHFA advises that FHLBanks' credit risk-management procedures be tailored to address risks unique to each member type. For example, FHLBanks should consider that nondepository CDFIs likely are covered by federal bankruptcy statutes and not by the same receivership laws as insured depository institutions.

Efforts to Facilitate Nondepository CDFI Participation in the FHLBank System Include Education and Outreach

FHFA and the FHLBanks have undertaken several efforts to help educate nondepository CDFIs about and promote membership in the FHLBank System. According to FHFA officials, FHFA conducted a training session and webinar on the membership rule in February 2009, followed up on questions from CDFIs about the regulations, and tracked the progress of nondepository CDFIs in gaining membership. Officials from FHFA have made themselves available for questions about and problem solving in relation to the rules. According to FHFA and FHLBank officials as well as nondepository CDFIs we interviewed, FHFA has been encouraging FHLBanks to discuss ways in which they could increase nondepository CDFI membership and access to advances in a safe and sound manner. For example, at a speech to the FHLBank boards and executive management in early 2014, FHFA encouraged all the FHLBanks to meet collectively to discuss collateral practices that might facilitate advance activity with nondepository CDFIs, and emphasized the importance of the FHLBanks' understanding of CDFI business models and funding needs. According to FHFA officials, as a result of that speech, the FHLBanks held a conference in August 2014 with the nondepository CDFI community to discuss facilitating membership and better understand the business of nondepository CDFIs. As a follow-up to the conference, FHLBank credit officers held nondepository CDFI credit review training in October 2014. Furthermore, the FHFA Director also met with nondepository CDFI officials and trade groups in July 2014.

In addition, all FHLBanks performed their own outreach to the nondepository CDFI community. For example, all the FHLBanks met with FHFA and nondepository CDFI members and nonmembers at the August 2014 conference to better understand nondepository CDFIs. Ten of the FHLBanks we interviewed have initiated discussions with and solicited membership applications from nondepository CDFIs since the conference. Some FHLBanks made changes in response to feedback from nondepository CDFI members. As noted previously, three of the FHLBanks that had restrictive collateral eligibility requirements amended these requirements to make obtaining advances easier for nondepository CDFIs. Two FHLBanks also made changes to their capital stock purchase requirements to allow a nondepository CDFI to be able to meet the stock purchase amount. According to the FHLBank officials, FHFA has been supportive of the changes they made to better accommodate nondepository CDFI membership and access to advances. FHFA officials told us that they have continued to encourage the FHLBanks to facilitate broader nondepository CDFI membership and access to advances.

Agency and Third Party Comments and Our Evaluation

We provided a draft of this report to FHFA and the 12 FHLBanks for their review and comment.[38] FHFA and four FHLBanks (Chicago, Cincinnati, Indianapolis, and Topeka) provided technical comments, which we incorporated as appropriate. The other eight FHLBanks did not provide any comments.

In its comments, FHLBank-Chicago also stated that our report unfairly compares nondepository CDFIs with depository institutions and that a better comparison would be regulated institutions versus nonregulated or less regulated institutions (because claims would be handled similarly for regulated institutions). Specifically, FHLBank-Chicago noted that an FHLBank likely would go through the federal bankruptcy process to settle claims if a nondepository CDFI with FHLBank credit outstanding failed, whereas a federal or state regulator would facilitate the process to settle claims if a regulated institution such as a bank, credit union, or insurance company with FHLBank credit outstanding failed. However, the purposes of our report explicitly include discussing how nondepository CDFIs differ from other members of the FHLBank System (in particular, depository members) and the membership and collateral requirements for these CDFIs. We understand that risks vary by type of institution and noted

[38] We sent the report to the Council of Federal Home Loan Banks, which then passed it to the 12 FHLBanks.

several differences—including in supervision and the liquidation of assets—between nondepository CDFIs and other types of FHLBank members in our report. Comparing the collateral requirements for nondepository CDFIs with those for depository institutions enabled us to determine how the FHLBanks address the different risks posed by nondepository CDFIs. Moreover, in terms of resolution treatments, there is no uniform approach to settling claims even within the category of "regulated institutions." For instance, FHFA stated in one of its advisory bulletins that "FHLBanks face risks lending to insurance companies that differ in certain respects with lending to federally-insured depository institutions" and noted that "laws dealing with a failed insured depository institution are well known and uniform across the country, whereas, the laws dealing with the failure of an insurance company are less well known to the FHLBanks and, though similar, may vary somewhat from state to state."[39] Therefore, we maintain that our comparisons were fair and made no change to the report in response to this comment.

In another comment, FHLBank-Chicago stated that the report implies that by loosening collateral requirements (some of which are dictated by law or regulation), more nondepository CDFIs would be eligible or willing to become FHLBank members. It noted that this was not necessarily the case, as a majority of nondepository CDFIs would not qualify for membership because of their lines of business (small business lending, microlending, and commercial lending) and because they have encumbered assets. We believe that these points are already adequately addressed in our report. Specifically, in the report we note that the types of eligible collateral are dictated by regulation. In addition, we state in the report that FHFA officials told us that some nondepository CDFIs may not be good candidates for FHLBank membership because the majority of nondepository CDFIs make nonhousing loans such as microloans, small business loans, and commercial loans. Furthermore, we note that several FHLBanks and nondepository CDFIs we interviewed told us that the requirement to pledge unencumbered assets was a challenge for nondepository CDFIs. We undertook these interviews to help understand the level of demand for FHLBank membership and obtain views on any challenges associated with obtaining membership and advances. Therefore, we made no change to the report in response to this comment.

[39]FHFA, *Collateralization of Advances and Other Credit Products to Insurance Company Members*, Advisory Bulletin 2013-09 (Washington, D.C.: Dec. 23, 2013).

In its comments, FHLBank-Indianapolis stated that the report could do a better job of making it clear that (1) FHLBanks accept assets as collateral and develop haircut methodologies to comply with regulations and an expectation of no losses in the event of default and (2) pledging illiquid assets can increase the haircut. In response, we added language in the body of the report that reiterated language in our background section stating that FHLBanks are required by statute and FHFA regulations to develop and implement collateral standards and other policies to mitigate the risk of default on outstanding advances. We also added language to the report noting that the illiquidity of assets can affect haircuts.

As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the appropriate congressional committees and members, the Director of FHFA, the Council of the FHLBanks, and the 12 FHLBanks. This report will also be available at no charge on our website at http://www.gao.gov.

Should you or your staff have questions concerning this report, please contact me at (202) 512-8678 or garciadiazd@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix IV.

Daniel Garcia-Diaz
Director, Financial Markets and
Community Investment

Appendix I: Objective, Scope, and Methodology

The objectives of this report were to discuss (1) how nondepository community development financial institutions (CDFI) differ from other members of the Federal Home Loan Bank (FHLBank) System, in particular depository members; (2) the membership and collateral requirements for nondepository CDFIs and challenges posed by these requirements; and (3) Federal Housing Finance Agency (FHFA) oversight of FHLBanks in relation to nondepository CDFIs and efforts by FHFA and FHLBanks to increase participation of nondepository CDFIs in the FHLBank System.

To describe differences between nondepository CDFIs and other members of the FHLBank System, we reviewed relevant sections of the Housing and Economic Recovery Act of 2008 (HERA) and FHFA's final rule on nondepository CDFI membership in the FHLBank System. In addition, we reviewed other relevant information from the FHLBanks and CDFI industry, such as reports by the Department of the Treasury's Community Development Financial Institutions Fund (CDFI Fund) and the Opportunity Finance Network. We determined that these studies were methodologically sound and reliable for our purposes. To compare the asset sizes of different types of FHLBank members (nondepository CDFIs, depository institutions, and insurance companies), we analyzed available data on their assets from FHFA's membership database as of December 31, 2014. For these institution types, we calculated the distribution of their assets (minimum assets, 25th percentile, median assets, 75th percentile, and maximum assets). To assess the reliability of these data, we reviewed information about the system, interviewed knowledgeable officials, and analyzed the data for logical consistency and completeness. We found that these data were sufficiently reliable for the purpose of comparing the asset sizes of different types of FHLBank members.

To address membership and collateral requirements, we reviewed relevant legislation and regulations, such as the Federal Home Loan Bank Act and FHFA's final rule on nondepository CDFI membership. We also reviewed documentation—such as nondepository CDFI membership applications and available FHLBank guidance on assessing nondepository CDFIs for membership—from each of the FHLBanks to determine membership requirements and identify any differences among

FHLBank policies.[1] Specifically, one GAO analyst reviewed each FHLBank's requirements for membership and identified differences. For example, in the three areas where FHLBanks had discretion, the analyst determined whether FHLBanks had set a minimum quantitative or qualitative threshold that an applicant needed to meet. A second analyst then verified the accuracy of this information. Nondepository CDFIs are subject to specific financial condition requirements. We requested and received financial data from the CDFI Fund but determined that the dataset did not contain relevant data needed to determine how many nondepository CDFIs could meet these financial condition requirements.

To determine the number of nondepository CDFIs that were members from calendar years 2010 through 2014, we analyzed data from FHFA's membership database as of December 31, 2014. To calculate the membership rate (the percentage of nondepository CDFIs in each district that were members), we used (1) data from FHFA's membership database on the number of members as of December 31, 2014, and (2) data from the CDFI Fund on the total number of nondepository CDFIs as of December 31, 2014. We assessed the reliability of data from both systems by reviewing any relevant documentation, interviewing knowledgeable officials, and analyzing the data for logical consistency and completeness. We determined that the data were sufficiently reliable for the purposes of assessing rates of membership for nondepository CDFIs.

To determine each FHLBank's requirements for obtaining advances and any differences among the FHLBanks, we reviewed relevant documentation such as each FHLBank's collateral guidelines and product and credit policies. Using these documents, we identified the haircut (discount) for eligible collateral types for depository and nondepository institutions and other collateral requirements, such as the term of advances and collateral pledging methods. Our review of FHLBank documents showed that FHLBanks do not describe their collateral requirements uniformly. Although we took several steps that enabled us to present comparable categories of collateral across the FHLBanks, our analysis did not account for differences in the eligibility criteria for collateral that may be accepted, such as quality of collateral. As a result,

[1]We reviewed all the nondepository CDFI membership applications that had been approved as of September 2014 (the most recent available at the time of our request).

the haircuts for different FHLBanks are not comparable. First, we excluded from our analysis the following types of collateral because they were only mentioned in some FHLBanks' documents: U.S. Treasury separate trading of registered interest and principal securities, agency structured bonds, agency collateralized mortgage obligation accrual bonds, second mortgage-backed securities, student loan asset-backed securities, agricultural real estate loans, land loans, construction loans, student loans, mutual funds, and municipal or state and local securities. Second, because some FHLBanks identified specific haircuts for securities, such as those originating from the Federal Deposit Insurance Corporation, while other FHLBanks listed haircuts for a general category of agency securities, we grouped all the agency securities and provided the range of haircuts. We included in the agency securities category any securities issued or guaranteed by the U.S. government, including those originating from the Federal Deposit Insurance Corporation, National Credit Union Administration, Fannie Mae, Freddie Mac, Ginnie Mae, the Federal Home Loan Banks, and the Small Business Administration. Third, because some FHLBanks identified specific haircuts for specific government-guaranteed loan collateral while others did not, we grouped all government-guaranteed loan collateral together, including loans originating from the Farm Service Agency, Department of Agriculture, Small Business Administration, Federal Housing Administration, and Department of Veterans Affairs. Fourth, because haircuts can vary based on the quality of the collateral pledged, we provided the range of haircuts for each type of collateral accepted by each FHLBank.[2] While we were able to review each FHLBank's collateral policies and procedures, the confidentiality of such information limited what we could publicly disclose in our report. Specifically, because the collateral haircut policies of the FHLBanks generally are considered proprietary information, we were unable to attribute specific policies to individual FHLBanks. Where appropriate, we used randomly assigned numbers when discussing FHLBank collateral policies to prevent disclosure of FHLBank identities.

Additionally, we obtained data from each FHLBank on the amount of advances secured by each nondepository CDFI member from October 2010 to September 2014 (the most recent data available at the time of our request). We assessed the reliability of these data by obtaining

[2]For example, one FHLBank specified that it accepts conventional single-family residential mortgage loans while another FHLBank accepts first lien, traditional, subprime, and nontraditional mortgage loans.

information from the six FHLBanks that provided advances to nondepository CDFIs on the system they used to store the data and the procedures in place for recording and ensuring the accuracy of the data. We also reviewed the data for logical consistency and completeness. We determined that the data were sufficiently reliable for reporting the amount of advances obtained by nondepository CDFs. We also interviewed officials from the 12 FHLBanks, 3 trade groups, 10 nondepository CDFIs that were members of the FHLBanks, and 12 nondepository CDFIs that were not members to understand the level of demand for FHLBank membership and obtain views on any challenges associated with membership processes and obtaining advances.[3]

To develop the purposive, nonrandom sample of 10 nondepository FHLBank member CDFIs to interview, we selected a nondepository CDFI from each of the 10 FHLBanks that had a nondepository CDFI member as of March 31, 2014 (the most recent data available when we began our work and selected members to interview). In addition to geographic diversity, we sought variation in asset size, financial institution type, and FHLBank advance status. We also selected a purposive, nonrandom sample of 12 nondepository CDFIs that were not members of the FHLBank System, one from each of the 12 FHLBank districts. We selected these 12 from a sample of nondepository CDFIs that were identified during our meetings with member CDFIs and CDFI trade groups as being interested in FHLBank membership. In addition to geographic diversity, we sought variation in asset size when selecting nonmembers to interview. We interviewed officials from all 22 nondepository CDFIs by telephone, focusing on the background of the CDFI and its experience with and opinions of the FHLBank membership and advance processes. The views expressed by the nondepository CDFIs in our sample cannot be generalized to the entire population of nondepository CDFIs.

To evaluate FHFA's oversight, we reviewed relevant laws, legislative history, and regulations (including its final rule on nondepository CDFI membership) to identify FHLBanks' authority to expand membership to nondepository CDFIs and FHFA's oversight authority. We also reviewed FHFA examination policies related to membership and collateral requirement to obtain advances. To determine if membership and

[3]The three trade groups we interviewed—the Opportunity Finance Network, National Association of Affordable Housing Lenders, and Housing Partnership Network—are knowledgeable about nondepository CDFIs.

advance practices were reviewed and there were any findings, we analyzed each FHLBank's examination results for fiscal years 2010 through 2013 (the most recent examinations available at the time of our request).[4] We interviewed FHFA and the 12 FHLBanks to further understand examination policies and practices for membership and advances and discuss any FHFA efforts to facilitate broader nondepository CDFI participation in the FHLBank System.

We conducted this performance audit from May 2014 to April 2015, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[4]An FHFA official stated that FHFA did not conduct a membership examination for one FHLBank during 2010 through 2013 but reviewed aspects of membership as part of a different examination module.

Appendix II: Federal Home Loan Bank Collateral Requirements for Nondepository Community Development Financial Institutions and Depository Institutions

The collateral requirements—specifically the pledge method for loan collateral and haircuts (discounts)—assessed on advances to nondepository community development financial institutions (CDFI) vary from those imposed on depository members.[1] For example, all Federal Home Loan Banks (FHLBanks) require nondepository CDFIs to deliver collateral (a requirement that also would be applied to higher-risk depository institutions), and in some cases, nondepository CDFIs receive higher haircuts than depository institutions.[2] For each FHLBank, we compare the pledge method and haircuts applied to depository institutions and nondepository CDFIs below (see table 5).

Table 5: Requirements for Pledge Method and Haircut (Discount) by FHLBank, as of December 2014

FHLBank	Requirements for pledge method and haircut
Atlanta	FHLBank-Atlanta assigns depository members a credit risk rating of 1-10 (lowest to highest risk). It has a separate risk rating system (101-104, lowest to highest risk) for nondepository community development financial institutions (CDFI) that is based on meeting the four financial conditions for membership. A 10 rating for 2 consecutive quarters requires the depository member to deliver collateral. In comparison, all nondepository CDFIs must deliver collateral. Only nondepository CDFIs with the rating of 101 and 102 are eligible to pledge loan collateral. For securities collateral, nondepository CDFIs receive a haircut that is higher than depository members with all credit ratings. For loan collateral, depository members with a credit score of 10 receive a higher haircut than nondepository CDFIs. In comparison to depository members with a credit score of 1-9 that deliver collateral, nondepository CDFIs receive an additional 6 percentage points in haircut.[a]
Boston	FHLBank-Boston places depository and nondepository CDFIs members into three categories: (1) those with a generally satisfactory financial condition; (2) those that show weakening financial trends; and (3) those with financial weaknesses that present the FHLBank with an elevated level of concern. Collateral requirements for members in the respective categories primarily vary in the degree of documentation the member must provide to the FHLBank for pledged loan collateral. Category 1 members generally may report by blanket pledge status for single-family residential mortgage loans but must list all other loans. Members in categories 2 and 3 must list all loans. In addition, members in category 3 must deliver to the FHLBank (or an approved third-party) all loan documentation required by the FHLBank. Nondepository CDFIs fall under category 3. FHLBank-Boston generally applies the same haircut to all members for eligible collateral. (The haircut for single-family residential mortgage loans starts at a higher percentage for categories 2 and 3 members than for category 1 members.)

[1]All FHLBanks require securities to be delivered to the FHLBank or third-party custodian; the variation in pledge method is only applicable for loan collateral.

[2]FHLBanks that allow insurance companies (another type of nondepository institution) to pledge mortgage loan collateral also require them to deliver those collateral. Some FHLBanks impose the same haircuts for nondepository CDFIs and insurance companies.

FHLBank	Requirements for pledge method and haircut
Chicago	FHLBank-Chicago ranks its members, including nondepository CDFIs, on a 7-point scale (1, 2, 3, 4, 4-, 5, and 5-) that ranges from strong capacity to meet financial commitment (1) to material default risk present (5-). For depository members, the FHLBank may (1) increase the haircut and require listed reporting for those with a rating of 4- and (2) require delivery for those with a rating of 5 and 5-. For securities collateral, FHLBank-Chicago applies a higher haircut range for nondepository members than depository members. For loan collateral, the FHLBank generally requires nondepository members to deliver collateral and applies the same haircut range as it does for depository members.
Cincinnati	FHLBank-Cincinnati ranks its members, including nondepository CDFIs, on a scale of 1-7 (lowest to highest risk). The FHLBank assigns nondepository CDFIs a rating of 5, with higher risk ratings assigned based on judgments about the institution's financial condition. The FHLBank assigns the pledge status based on its perception of credit risk posed by the institution; all nondepository CDFIs must deliver collateral. For all members, FHLBank-Cincinnati varies its haircut range by the credit score. Due to the credit rating, the FHLBank haircut range is comparatively higher for nondepository CDFIs.
Dallas	FHLBank-Dallas ranks its members, including nondepository CDFIs, on a scale of A-E* (lowest to highest risk). Depository members assigned ratings of D, E, or E* are placed into delivery pledge status. Nondepository CDFIs are assigned a credit rating of D if they meet all requirements for membership; those that do not meet the presumptive criteria for membership are assigned a rating of E or E* with different levels of mitigating factors.[b] FHLBank-Dallas establishes haircuts based on the pledge method, and thus nondepository CDFIs receive the haircut applicable to those required to deliver collateral. The haircuts for depository members and nondepository CDFIs on eligible collateral are comparable.
Des Moines	FHLBank-Des Moines ranks its members, including nondepository CDFIs, on a scale of A-F (A-strong, B-good, C-acceptable, D-weak, E-troubled, EFN or EFV-insolvency vulnerable, and F-likely insolvency; officials stated that institutions with EFN or EFV and F ratings are considered stressed). Depository members assigned ratings of E must list collateral and those considered stressed must deliver collateral. In contrast, all nondepository members must deliver collateral. There is no difference between the haircut applied to depository institutions and nondepository members. For both, haircut ranges for securities collateral depends on if the institution is considered stressed and the haircut ranges for eligible mortgage loan collateral depends on the extent to which the loan portfolios meet FHLBank's underwriting requirements for those collateral.
Indianapolis	FHLBank-Indianapolis scores its depository members on a scale of 0-100 (lowest to highest level of financial stress). It does not assign ratings to nondepository CDFIs, but the FHLBank stated that it would complete a financial review of each CDFI prior to making an advance. The FHLBank allows financially sound depository members to pledge under blanket status; in comparison, nondepository members must pledge under delivery status. FHLBank-Indianapolis varies its collateral ranges by the pledge method. For securities collateral, FHLBank-Indianapolis applies the same haircut range to nondepository CDFIs and depository members. For loan collateral, nondepository CDFIs receive the haircuts applicable to members that deliver collateral, which are at the lower end of the haircut range.
New York	FHLBank-New York scores its depository members on a scale of 1-9 (lowest to highest). It does not assign ratings to nondepository CDFIs, but does assess the financial conditions of the members. The FHLBank may increase the haircut or require delivery of collateral for depository institutions that are considered not well capitalized or with a credit rating of 6 or higher but require the delivery of collateral for all nondepository CDFIs. It categorically applies an additional 5 percent haircut on eligible collateral from nondepository CDFIs (compared with depository institutions).
Pittsburgh	FHLBank-Pittsburgh scores its members, including nondepository CDFIs, on a scale of 1-10 (lowest to highest risk). For depository members, the FHLBank may require delivery of collateral if a member has a rating of 8 or higher or impose an additional 15 percent haircut on pledged loan collateral and an additional 5 percent haircut on securities collateral for a member with a credit rating of 10. In comparison, nondepository CDFIs must be ranked 1-6 to pledge loan collateral, and all are required to deliver collateral. For securities collateral, the FHLBank applies the same haircut to depository institutions and nondepository CDFIs. For all eligible loan collateral, the FHLBank applies a higher haircut to nondepository CDFIs. The FHLBank stated that it may adjust this rate higher or lower based upon individual analysis of the loan collateral and the potential to price loans through a third party if it is able to receive accurate and detailed loan listing information.

FHLBank	Requirements for pledge method and haircut
San Francisco	FHLBank-San Francisco assigns credit ratings of 1-10 (lowest to highest risk) to depository institutions. For depository institutions, the FHLBank varies the pledge method required and the haircut assessed based on credit rating. FHLBank-San Francisco has a separate risk rating system for nondepository CDFIs (low, moderate, and high risk), but for the purpose of the haircut, nondepository CDFIs are grouped with depository institutions that receive a credit rating of 8-10. Nondepository CDFIs therefore receive higher haircuts on loan collateral than depository institutions with credit ratings from 1-7. Additionally, all nondepository CDFIs are required to deliver collateral while delivery of collateral is required for depository members with credit rating of 8-10.
Seattle	FHLBank-Seattle assigns one of the following ratings to its members, including nondepository CDFIs, based on financial condition: acceptable, watch, serious, and critical. The FHLBank evaluates each member on a case-by-case basis and establishes collateral requirements based on the evaluation. All nondepository CDFIs are required to deliver collateral, while depository members rated as critical are required to deliver collateral. The FHLBank applies the same haircut ranges for depository institutions and nondepository CDFIs.
Topeka	FHLBank-Topeka does not assign specific credit ratings to members, but operates on a pass or fail financial performance evaluation based on a set of criteria for most types of members. If a member fails to meet those criteria, the FHLBank will conduct further financial analysis, called financial narratives, to determine if further credit action should be applied. Those actions related to advance haircut and pledge requirements may include but are not limited to applying a higher haircut and requiring the delivery of original collateral documents to the FHLBank. However, the FHLBank requires a financial narrative for nondepository CDFIs every quarter; the FHLBank also requires the delivery of collateral for all nondepository CDFIs. The FHLBank applies the same haircut ranges for depository institutions and nondepository CDFIs for eligible collateral.

Source: GAO analysis of FHLBank information. | GAO-15-352

[a]For FHLBank-Atlanta, the haircut for single-family residential mortgages varies based on the pledge method, credit rating, and collateral type. The haircut received by nondepository CDFIs for this type of collateral is 6 percentage points higher when compared to depository members with a rating of 1-9 that are required to deliver the collateral. When the haircut for nondepository CDFIs is compared to the haircut for depository members with ratings of 1-9 that list the collateral, the difference is greater. When compared to depository members with ratings of 10 that are required to either deliver or list the collateral, the haircut for nondepository CDFIs is lower. For commercial real estate and multifamily mortgage loans, nondepository CDFIs receive an additional 6 percentage points in haircut in comparison to depository members with credit scores of 1-9, but a lower haircut in comparison to depository members with a credit score of 10.

[b]As discussed previously, if a nondepository CDFI does not meet one or more of the four financial condition standards for FHLBank membership, the CDFI may offer a rebuttal, and the FHLBank would perform a separate analysis to determine if the nondepository CDFI was financially sound.

Appendix III: Federal Home Loan Bank Advance Terms and Borrowing Limits for Nondepository Community Development Financial Institutions and Depository Institutions

Most Federal Home Loan Banks (FHLBanks) do not have advance terms and borrowing limits specific to nondepository community development financial institutions (CDFI). However, four FHLBanks (Des Moines, New York, Pittsburgh, and San Francisco) do have specific advance terms and borrowing limits. We summarize the advance terms and borrowing limits for each FHLBank below (see table 6).

Table 6: Advance Terms and Borrowing Limits by FHLBank

FHLBank	Advance terms and borrowing limits
Atlanta	FHLBank-Atlanta does not have advance terms or borrowing limits specific to nondepository community development financial institutions (CDFI). The credit limit for all members is up to 30 percent of a member's assets unless otherwise approved.
Boston	FHLBank-Boston does not have advance terms or borrowing limits specific to nondepository CDFIs. However, representatives from the FHLBank stated that the FHLBank may determine the term on a case-by-case basis. The credit limit for all members is 50 percent of the member's total assets unless otherwise approved.
Chicago	FHLBank-Chicago does not have advance terms or borrowing limits specific to nondepository CDFIs. The credit limit for all members is 35 percent of the member's total assets unless otherwise approved. Additionally, the outstanding advance generally may not exceed 20 times the amount of the member's holdings of the FHLBank's capital stock.
Cincinnati	FHLBank-Cincinnati does not have advance terms or borrowing limits specific to nondepository CDFIs. The credit limit for all members is 50 percent of the member's total assets unless otherwise approved.
Dallas	FHLBank-Dallas does not have advance terms or borrowing limits specific to nondepository CDFIs. The credit limit for all members is 50 percent of the member's total assets unless otherwise approved. FHLB-Dallas restricts advances for members with the lowest credit rating to 30 days.
Des Moines	FHLBank-Des Moines imposes the advance term and maximum amount of borrowing capacity available based on member credit ratings A-F (A-strong, B-good, C-acceptable, D-weak, E-troubled, ETN or EFV-insolvency vulnerable, and F-likely insolvency; institutions with the ETN or EFV and F categories are considered stressed). For depository members, borrowing capacity is 35 percent of total assets for those with ratings of A-C, 25 percent for D ratings, 20 percent for E ratings, and 10 percent or less for stressed members. The FHLBank does not impose term limits for depository members with credit ratings of A-D but imposes a 5-year advance term limit on depository members with ratings of E, and 1 year or less for stressed members. For nondepository members, borrowing capacity is 30 percent of total assets for those with ratings of A-C, 20 percent for D ratings, 10 percent for E ratings, and 5 percent or less for stressed members. Additionally, the advance term limit for nondepository members with credit ratings of A-D is 20 years, 5 years for those with credit ratings of E, and 1 year or less for stressed members.
Indianapolis	FHLBank-Indianapolis does not have advance terms or borrowing limits specific to nondepository CDFIs. The credit limit for depository members is 50 percent of the member's adjusted assets (defined as total assets less borrowing from all sources) unless otherwise approved. The credit limit for nondepository CDFIs is evaluated on a case-by-case basis dependent upon the institution's financial condition and eligible collateral. Representatives from the FHLBank-Indianapolis stated that although the FHLBank does not have a policy on limiting the type or term of an advance, it might do so based on the quality of the collateral pledged and a review of the nondepository CDFI's financial condition.

FHLBank	Advance terms and borrowing limits
New York	FHLBank-New York imposes a credit limit of 30 percent to 50 percent of the borrower's total assets for all members unless otherwise approved. The FHLBank limits the maximum advance term to 5 years for nondepository CDFIs and restricts nondepository CDFIs from borrowing advances with embedded options.[a] In comparison, FHLBank-New York may limit the product type, term of the advance, or both for depository institutions based on the nature of the FHLBank's concerns about the member's financial condition, which may be triggered by the capital ratio and credit rating.
Pittsburgh	FHLBank-Pittsburgh imposes a credit limit of 50 percent of a member's total eligible loan assets for depository and nondepository CDFI members. For depository members, FHLBank-Pittsburgh uses its internal credit rating to determine the actual lending amount and advance term (1-10; lowest to highest risk). For depository institutions, those with ratings of 1-7 receive an unlimited term; a rating of 8 limits the term to 1 year or less; and a rating of 9-10 limits the term to 90 days. FHLB-Pittsburgh limits the maximum advance term to 2 years for nondepository CDFIs unless otherwise approved.
San Francisco	FHLB-San Francisco establishes financial availability for each member based on thorough underwriting of the applicant's creditworthiness. (Financial availability determines the maximum amount and maximum term for bank credit without additional review and approval by the FHLBank.) The maximum financial availability recommended for a nondepository CDFI member is no more than 150 percent of the member's net asset value; financial availability for amounts in excess of 100 percent of the member's net asset value will be limited to a maximum term of 2 years. FHLBank-San Francisco has a term limit of 7 years for its nondepository CDFI members.
Seattle	FHLB-Seattle does not have advance terms or borrowing limits specific to nondepository CDFIs. Rather, the FHLBank determines the advance term and credit limits for all members on a case-by-case basis. At the time of membership, the FHLBank completes a credit review to establish a credit line and collateral arrangement. Borrowing capacity is limited to the lesser of (1) the approved credit line (dollar amount or percentage of assets), (2) calculated borrowing capacity based on the amount of eligible collateral pledged, or (3) the maximum amount allowed based on the customer's stock investment in the FHLBank.
Topeka	FHLBank-Topeka does not have advance terms or borrowing limits specific to nondepository CDFIs unless the financial condition warrants such a limit. The credit limit for all members is 40 percent of the borrower's total assets, although exceptions may be granted up to 55 percent with approval from the FHLBank's president. The FHLBank operates on a pass or fail financial performance evaluation based on a set of criteria. The FHLBank will conduct further financial analysis to determine if further credit action should be applied if a member fails to meet those criteria. Those actions related to advance terms and borrowing limits may include but are not limited to the following: (a) restricting the terms of advances, (b) restricting the types of advances, and (c) restricting the aggregate amount of credit.

Source: GAO analysis of FHLBank information. | GAO-15-352

[a]An embedded option is a characteristic of an investment that gives the issuer or holder the right to alter the level and timing of the cash flows of the investment. 12 C.F.R. § 703.2.

Appendix IV: GAO Contact and Staff Acknowledgments

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