Far from cheering CRA reform, CDFIs are worried

By Brendan Pedersen
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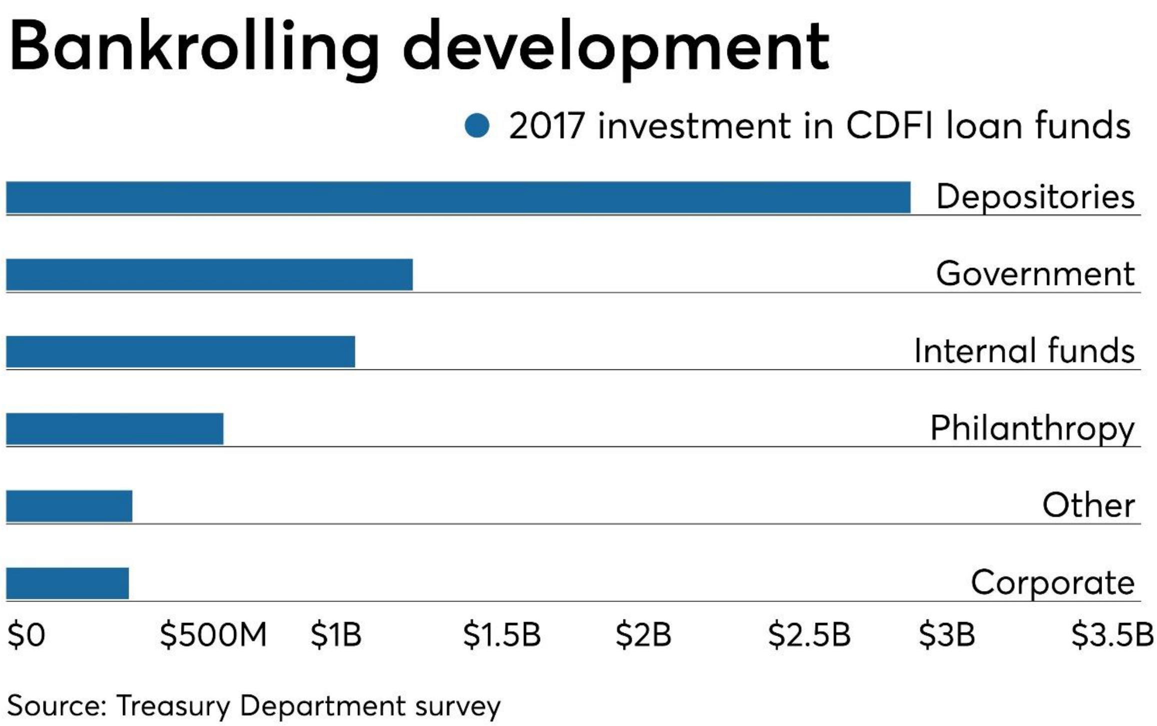
WASHINGTON — A plan to modernize the Community Reinvestment Act should theoretically be welcomed by community development financial institutions, but many such organizations are raising alarm about a key component of the proposal written by two federal regulators.

The framework drafted by the Office of the Comptroller of the Currency and Federal Deposit Insurance Corp. would place a new emphasis on the dollar amount of CRA projects for banks to be in compliance. This worries CDFI loan funds, which specialize in making relatively small credits and worry the new plan will lead to less capital from bank partners.

“Ultimately, our average loan size is $23,000. These are small dollar amounts that without incentive could be lost,” said Sara Razavi, CEO of Working Solutions, a CDFI in San Francisco**.** “We’re happy to see CDFIs listed as strong partners in the rule, but there's a concern that there are a whole lot of CDFIs and micro lenders that are going to be in trouble.



CDFIs are a diverse crowd; over 40% of them are depository institutions or depository holding companies. But over 50% are nonbank loan funds that often act as local intermediaries between mainstream banks and their communities, particularly in remote or rural regions of the country.

A huge chunk of the funding for CDFI loan funds comes from banks, which can earn CRA credit for that financial backing. CDFI funds participating in a recent Treasury Department survey said over 41% of their capital came from depository institutions in 2017, which was significantly more than other sources of funding.

“As we’ve grown, the cheapest source of capital has been from our bank partners,” Razavi said. “As an industry, that’s surprising, but we’re primarily funded in lending capital by banks and their CRA presence.”

That could change with the proposal spearheaded by the OCC, CDFI leaders warn.

They say several changes in the reform plan are aimed at giving them a boost, such as a provision to double CRA credit for banks that lend eligible dollars to CDFIs, and the opportunity for banks to receive CRA credit for lending to CDFIs outside their assessment areas. Loans to CDFIs are also listed on the regulators’ illustrative list of CRA qualifying activities.

"Some of the changes being suggested around assessment areas seem promising for CRA deserts," said Jennifer Vasiloff, the chief external affairs officer of the Opportunity Finance Network, a national association of CDFIs. "There are a lot of common-sense changes that we’re glad to see."

But Vasiloff and others say the regulators' support for adding a dollar-amount component for calculating a bank's CRA obligations could represent a more direct threat to development-focused organizations that specialize in small loans.

“These are pretty fundamental changes that we’re talking about,” she said. “We’re concerned about the more global changes to the law that don’t have a ‘CDFI’ label attached to them but will have an even greater impact on us.”

The current CRA framework grades banks largely through separate tests, including a community development test. But the proposal emphasizes a new single ratio of total CRA activity to deposits, and the dollar value of CRA-related loans and other projects gets computed into the score.

“Even if you count CDFI lending twice or have access to new geographic areas, it’s the volume of the small-dollar lending that can’t keep up,” said Vasiloff. “It’s just not going to add to the CRA score’s numerator in a meaningful way.”

The average size of a microfinance loan serviced by a CDFI loan fund was $6,041 in 2018, according to data from the Opportunity Finance Network. The average consumer loan was even smaller, at $2,583. For the entire CDFI industry, the average microfinance loan was $15,263, and the average consumer loan was $4,189.

On the whole, CDFIs represent a fraction of the finance industry: While there are more than 1,000 CDFIs certified by the U.S. Treasury, they only held about $108 billion in combined assets as of 2016. And most CDFIs are tiny by bank standards: The vast majority of CDFIs have fewer than $100 million of assets, while fewer than two dozen CDFIs have more than $1 billion of assets, according to Treasury data from 2016.

But advocates say their small size is what makes many CDFIs valuable to a wide swath of communities across the country. And while many CDFIs currently see the CRA as instrumental in their receiving support from banks, they fear the impact of banks having other, more lucrative avenues to comply with the law.

“CDFIs are able to be much more customized in their approach to lending, spend more time with the borrower, and provide technical assistance or counseling that mainstream banks aren’t as well set up to do,” Vasiloff said. “We can provide guidance and service that borrowers benefit from and improve the ability to pay the loan.”

Critics of the OCC and FDIC's proposal, including Federal Reserve Gov. Lael Brainard, have said that a single score with strong emphasis on the dollar value of CRA investment could undercut the incentive for banks to back small loans in low-to-moderate-income communities. Community groups have long said that that kind of investment is critical to boosting localities with disparate needs.

“If I’m a banker that’s just trying to meet their CRA obligation as easily as possible, and a few large activities will get to that number with less work than several small ones, I don’t need to spend time trying to understand what’s happening in a particular community,” said Eric Weaver, founder and senior adviser of the Opportunity Fund, a large nonprofit microfinance organization with an affiliated CDFI based in San Jose, Calif. “There can be smaller activities that are a lot more meaningful, but in this proposal, it won’t get the same kind of credit.”

Weaver added that the proposal could lead to a bigger divide between larger CDFIs capable of handling pricier investments and other institutions.

“You need to worry about creating a second-tier financial system,” Weaver said. “Larger CDFIs can handle big investments, so that kind of shift is going to be beneficial for an organization like mine. But this is going to be to the detriment of small CDFIs.”

The OCC was not able to comment for this story by press time.