

July 7, 2020

Ms. Jodie Harris  
Director  
Community Development Financial Institutions Fund  
U.S. Department of Treasury  
1500 Pennsylvania Avenue NW  
Washington, DC 20220

Ms. Tanya McInnis  
Program Manager, Certification, Compliance Monitoring & Evaluation  
Community Development Financial Institutions Fund  
U.S. Department of Treasury  
1500 Pennsylvania Avenue NW  
Washington, DC 20220

RE: Comments on CDFI Program Equity Investment Policy

Dear Director Harris and Ms. McInnis:

On behalf of the members of the Community Development Bankers Association (CDBA), we respectfully submit the enclosed comments in response to the Request for Information (RFI) related to Equity Investment Policy under the CDFI Fund Financial Assistance (FA) Program published in the Federal Register on June 8, 2020. We appreciate the opportunity to provide feedback in order to maximize the effectiveness of all programs for the benefit of the most underserved communities in the nation.

CDBA is the national trade association of banks and thrifts with a primary mission of promoting community development. There are 148 banks and 104 bank holding companies (BHCs) with the Treasury's Community Development Financial Institutions (CDFIs) designation.

CDFI banks strongly support the efforts of the Community Development Financial Institutions Fund (CDFI Fund) to build the capacity of CDFIs as mandated by Congress through the provision of financial assistance. Many CDFI banks and holding companies have received financial assistance in the form of equity investments since the CDFI Fund made its first awards in 1996.

Equity investments are the most powerful form of capital that a CDFI bank or BHC can receive. CDFI banks and BHCs use equity investments as capital. Capital is leveraged to grow deposits and assets, which take the form of loans to customers. Generally, each single dollar of equity capital in a CDFI bank can be leveraged to make \$12.00 in loans.

Long-term, patient equity capital from partners like the CDFI Fund, which are interested in mission and impact (rather than financial return), empowers many CDFI banks' to focus on serving the underserved instead of maximizing shareholder profit. The equity capital provided by the CDFI Fund has a direct and catalytic effect on CDFI bank ability to focus on long-term stakeholders and community verses shareholder gain.

Requiring a CDFI bank or BHC to repurchase or redeem an equity investment would have a highly negative impact on both the institution and its community. The purpose of the CDFI Fund is to build the capacity of CDFIs and empower them to increase provision of products and services. In order to provide patient capital to borrowers, CDFIs need patient investors. CDBA strongly believes requiring repurchase or redemption of equity investments is in direct conflict with the CDFI Fund's authorizing statute. Such a policy would not build CDFI banks – it would destabilize and potentially destroy them. **Such an act would be comparable to asking a nonprofit CDFI to surrender and repay grants received in past years.** Likewise, such an action would destabilize the communities the CDFI Fund is supposed to be helping. We strongly urge you to abandon this potentially destructive idea.

CDBA has serious concerns about the implications of the questions posed in the RFI. Even the suggestion of requiring CDFI Banks to buy back equity invested by the CDFI Fund creates uncertainty. It has the potential to threaten the financial stability and mission-driven growth prospects of several longstanding, deep-mission CDFI banks in our membership. The RFI has created great concern, which is exacerbated by the economic and social uncertainty facing our country. CDFIs have been our financial first responders and committed equity capital continues to be instrumental to advancing the mission and purpose of CDFIs, especially to our member banks where equity investments are the most critical and hardest to obtain capital injections.

#### PURPOSE OF THE CDFI FUND

In creating the CDFI Fund, Congress explicitly recognized the effectiveness of CDFIs in meeting the credit and financial service needs of these underserved communities.

In 12 USC 4701(b), Congress states that the purpose of the CDFI Fund was *“to promote economic revitalization and community development through investment in and assistance to community development financial institutions.”* With the Conference Report and related Committee Reports, Congress expressly recognized the diversity of CDFI types and the difference in forms of capital needed by each business model. As such, the authorizing statute gave the CDFI Fund great flexibility to provide *“financial assistance through equity investments, deposits, credit union shares, loans, and grants.”* Congress provided strong direction that the CDFI Fund's role was to build the capacity of the industry and empower CDFIs to serve and improve the well-being of their communities.

## APPLICATION OMISSION

In recent years, CDBA has been troubled that the CDFI Fund no longer gives for-profit CDFIs the option to receive equity investments under the FA Program. Specifically, in the FA application and in AMIS, the CDFI Fund has removed the option to select equity investments. Furthermore, it has substantially removed all references to this option in guidance materials. We believe this omission is in direct conflict with the CDFI Fund's authorizing statute, which specifically states that equity investment is an eligible form of assistance.

## WHY EQUITY KEEPS MORE MONEY IN COMMUNITIES

Each dollar of capital in a CDFI bank can leverage 12-times that amount in deposits to support lending in the community. The non-taxable status of equity investments make it an effective tool for maximizing resources dedicated toward mission. Prior to the Tax Cuts and Jobs Act of 2017, the corporate tax rate was a whopping 38.9%. Thus, if the CDFI Fund (the CDFI Fund) provided \$1 million in financial assistance as a grant, the CDFI bank only realized \$610,000 after taxes. That new capital would have leveraged just \$7.32 million to support lending. However, if that same \$1 million is provided as an equity investment, the CDFI bank will pay no taxes and the equity will be leveraged to support \$12 million in loans. Therefore, the difference in leveraged lending between a \$1 million grant and a \$1 million equity investment would have been \$4.68 million, making the preference of equity over grants exceptionally clear.

Today, providing FA as a non-taxable equity investment still injects more money into the CDFI and the community. Since the 2017 tax act, corporate tax rates are approximately 21%, thus reducing the taxes a CDFI bank pays on a grant, but still unnecessarily siphoning off valuable resources that are best spent in low-income communities.

## MATCHING FUNDS

We are frustrated by the CDFI Fund's practice of limiting awards to grants if an awardee pledges retained earnings as a match. In the early years of the CDFI Fund, it demonstrated flexibility and allowed CDFI banks and BHCs to use retained earnings to match either a grant or equity investment. The statute requires FA be provided in a form that is "comparable in form and value" to the matching funds. No reasonable policy explanation has been provided to justify why a grant would be considered more comparable in form and value to retained earnings than an equity investment. No opportunity for public comment on this matter has ever been provided. We urge you to return to the CDFI Fund's original practice. We believe the CDFI Fund's current practice undermines Congressional intent, while inequitably limiting the benefits of CDFI certification to an entire (dedicated and effective) sector of the CDFI industry.

## GENERAL QUESTIONS ON CDFI BANK AND BANK HOLDING COMPANY EQUITY

The capitalization strategies of CDFI banks focus on raising capital – not decreasing capital. CDFI banks have an average size of \$441 million in total assets, and are generally privately held (versus publicly traded). With a few notable exceptions, CDFI banks' capital is illiquid, meaning banks do not generate sufficient returns to buy out investors' equity holdings and there are not buyers readily available for existing equity investment shares.

Most CDFI banks do not have strategies for redeeming and repurchasing equity from shareholders. While investors in small banks often get a return “*on* their investment, (dividends)” rarely do they get a return “*of* their investment (principal).” This is a structural challenge common to small banks (CDFIs and non-CDFIs alike), as small banks are generally not large or profitable enough to access public markets and thus do not have a regular mechanism for valuation. (While a very small number of larger CDFI banks have reached a level of scale that they can regularly pay dividends, and an even smaller subset have achieved a modest capacity to provide liquidity to a limited number of investors, the vast majority have not.) Among privately held institutions, the value of the shares are only determined irregularly by an independent third party (e.g. auditor), and are most commonly valued at book value.

The impact of requiring a CDFI bank or BHC to repurchase or redeem an equity investment would be potentially devastating -- to both the institution and its community. Such an action could threaten its financial viability. At a minimum, it will require a CDFI bank to reduce its balance sheet and lending to match its reduced capital. In the end, the real risk is to the community, small businesses and customers that depend on the CDFI banks to support them.

## CDFI FUND CONTROL RESTRICTION

The Riegle Act requires that the CDFI Fund may not own more than fifty percent (50%) equity in a CDFI. Thus, the CDFI Fund should develop internal policies to ensure that it does not provide equity investments in excess of such amount at the time of making an award. Most CDFI banks and BHCs keep track of the percent of equity controlled by individual shareholders on an ongoing basis. Thus, they can provide accurate information on the share of stock the CDFI Fund will own at the time of application and before disbursement. If the CDFI Fund inadvertently exceeds its statutory limit, it should consider the options outlined below. The CDFI Fund should not penalize a CDFI if the CDFI Fund's actions resulted in holding more than a 50% interest in the CDFI.

The RFI asks whether the CDFI Fund should require redemption or repurchase of shares. As discussed above, such an action could have dire consequences for CDFI banks and the communities they serve. Alternatively, the RFI suggests requiring a CDFI bank or bank holding company to dilute its shares to decrease the percentage held by the CDFI Fund. We note that such a solution is only feasible if there are other investors willing to buy the newly issued stock at the time of dilution. In the absence of that market, a CDFI bank that is required to dilute its

shares risks damaging its credibility with existing and potential private investors. We think this strategy is both harmful and impractical.

#### CDFI FUND INVESTMENT EXIT STRATEGY

As noted above, requiring a CDFI bank or BHC to repurchase or redeem an equity investment would have a highly negative impact on both the institution and its community. This concept runs counter to the purpose of the CDFI Fund to build the capacity of CDFIs. It also threatens to erase much of the progress toward building the CDFI bank sector that the CDFI Fund has accomplished since its enactment. Furthermore, we strongly believe requiring repurchase or redemption of equity investments is in direct conflict with the CDFI Fund's authorizing statute. Such a policy will both destabilize and potentially destroy CDFI banks and the communities they serve.

In developing an equity strategy and exit strategy, the primary consideration of the CDFI Fund should be remembering its Congressionally mandated purpose. As noted above, Congress stated that the purpose of the CDFI Fund was *"to promote economic revitalization and community development through investment in and assistance to community development financial institutions."* Congress directed the CDFI Fund to build the capacity of the industry so that CDFIs can address the needs in their communities. Congress intended to build institutions and communities – not destabilize them.

As noted, CDFI banks and BHCs have capital liquidity options ranging from "zero" to "extremely limited." Thus, there is no way to characterize a "typical exit" as exits are far from typical. Generally, CDFI banks and BHCs have very few sources for new capital.

We believe the CDFI Fund should maintain its commitment to the work of CDFI banks by continuing to be a patient investor, as envisioned by Congress at the creation of the CDFI Fund. Given the CDFI Fund's lack of desire to continue as a patient investor, we urge that you adopt a "no harm" policy whereby you allow the stock or holdings to be transferred for zero, or a de minimus, consideration to one (or more) of the parties outlined below at the choosing of the CDFI bank or BHC:

- (1) A mission-aligned nonprofit affiliate of the bank or BHC;
- (2) A mission-aligned nonprofit that is not affiliated but is selected by the bank or BHC; or
- (3) The CDFI bank or BHC itself

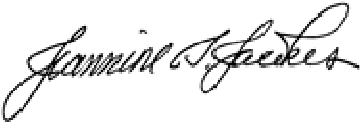
Maintaining the mission focus on CDFI banks is critically important to ensuring the institution can maintain a focus on low-income communities. Thus, we believe these are the only reasonable exit strategies given the CDFI Fund's congressionally mandated purpose. Such transfers could occur at the end of the three-year Assistance Agreement compliance period. To be noted, each of these options will need to be more fully developed. For example, ensuring the amount of the holdings will not trigger the new owner to become a bank holding company.

We are pleased to work with the CDFI Fund to develop strategies to operationalize these options.

The membership of CDBA appreciates the opportunity to provide feedback in order to maximize the effectiveness of all programs for the benefit of the most underserved communities in the nation. We look forward to future discussion on these important issues.

If you have any questions, please contact Jeannine Jacokes, CDBA Chief Executive Officer, at 202-689-8935 ext. 222 or [jacokesj@pcgloanfund.org](mailto:jacokesj@pcgloanfund.org).

Thank you for considering our recommendations.

A handwritten signature in black ink, appearing to read "Jeannine Jacokes". The signature is written in a cursive, flowing style.

Jeannine Jacokes  
Chief Executive Officer