

April 8, 2013

Ms. Lisa Jones
Manager, CDFI Bond Guarantee Program
Community Development Financial Institutions Fund
U.S. Department of Treasury
1500 Pennsylvania Avenue, NW
Washington DC 20220

Subject: Proposed Interim Final Rule implementing the Community Development Financial Institutions (CDFI) Bond Guarantee Program as established in section 1134 of the Small Business Jobs Act of 2010; Billing Code; 4810-70-P -- RIN 1559-AA01

Dear Ms. Jones:

The following comments are being submitted by the Community Development Bankers Association (CDBA) in response to the Community Development Financial Institution Fund's (CDFI Fund) request for public comment on the Interim Final Rule implementing the CDFI Bond Guarantee Program (CBGP). The Interim Final Rule was published in the Federal Register on February 5, 2013. We thank you for the opportunity to comment and look forward to working with you to make the program a success. As outlined in our July 19, 2012 comment letter, we urge the U.S. Department of Treasury to implement the program in a manner that enables the entire, diverse CDFI sector to use the program for the benefit of distressed communities across the country.

Within the enclosed letter, we will focus first on explaining how the CBGP presents an opportunity to enable CDFI banks to significantly expand provision of credit in Low-and Moderate-Income (LMI) communities given the program's design and a rapidly changing and restrictive bank regulatory environment. Among the recommendations, our highest priority is ensuring that the Use of Bond Proceeds and Secondary Loan Requirements are consistent with allowing CDFI banks to use proceeds as Tier 1 capital if approved by the Federal banking regulatory agencies. As such, we ask for the US Treasury's and CDFI Fund's support as we seek an exception to the Basel III rule for the CBGP. A second tier set of recommendations is focused on ensuring the CDFI Bond Program proactively mitigates potential conflicts with other regulatory rules that might otherwise prevent CDFI bank participation. A third tier set of recommendations focuses on issues of general concern regarding the program's structure and requirements. Like our colleagues in other sectors of the CDFI industry, overall program fees and other costs are the greatest concern. The subsequent recommendations are listed in descending priority order.

Changing Operating Environment for CDFI Banks

On June 7, 2012, the Federal banking agencies released three far-reaching proposed rulemakings that significantly alter the capital and lending landscape for all banks. Two of the three proposed regulations (Basel III and Standardized Approach to credit risk weighting) will affect small banks and are very likely to have a disproportionately negative impact on CDFI banks by limiting the way they can tailor loan products for their customers and by increasing the amount of capital they will need to maintain. If adopted as proposed, these rules will have dire

consequences for credit availability in low income communities. A final rule is expected to be issued later in 2013. We recognize that the CDFI Fund and US Treasury have no direct role in the development of these proposed rules. However, both have a unique opportunity with the CBGP to mitigate the impact of these proposals and increase credit flowing to LMI communities served by CDFI banks.

As you know, CDFI Banks have limited access to capital markets because of their small size and modest returns; much of the private capital that might be available is not compatible with CDFI banks' mission of serving LMI communities. CDFI banks do, however, have the ability to raise capital through self-generated returns and a growing -- but still modest -- pool of socially motivated investors. But generating capital from these sources requires time—more time even than other small commercial banks, which do not have a double-bottom line focus.

Opportunities to Support the Work of CDFI Banks

1. Supporting CDFI Bank Capitalization Strategies

Use of Bond Proceeds: As articulated in our August 12, 2011 and July 19, 2012 letters, CDBA urged the Treasury Department to allow CBGP bond proceeds to be used as a tool to strengthen the regulatory capital of CDFI banks. As noted, raising capital that meets the regulatory definition of Tier 1 capital is of paramount importance to CDFI banks and CDFI Bank Holding Companies (BHC). CDBA is seeking an exception under the Basel III rule from the Federal banking regulatory agencies under which capital raised through the CBGP would be given Tier 1 consideration. A list of special exceptions to the Basel III rule is expected to be published as part of a final rule later in 2013.

We ask for the US Treasury's and CDFI Fund's support as we seek an exception to the Basel III rule for the CBGP. Without a Basel III exception, the requirements of the Federal Credit Reform Act (FCRA) would make Bond Loans issued under CBGP ineligible for consideration as Tier 1 capital because they are (1) amortizing instruments and (2) senior to other creditors. However, there is regulatory precedent for Tier 1 treatment of long-term debt instruments. CBGP debt has a maturity of up to 30 years and is more patient, less volatile, and less expensive than other debt-based capital vehicles regulators have limited, such as Trust Preferred Securities. We are hopeful that, with your support, the regulators will agree to provide Tier 1 treatment for CBGP debt issued by the very limited universe of CDFI banks and CDFI BHCs that receive CDFI certification and retain it through the term of the loan. This would allow CDFIs that have limited access to capital markets with the ability to build equity over time and enable them to meet and continue to meet the proposed new Basel III capital standards. Further, used as capital, the impact of the CDFI bond proceeds would be maximized because the CDFI bank could further leverage the capital and significantly increase total lending.

Secondary Loan Requirements: **As the CDFI Fund prepares to issue its guidance on Secondary Loan Requirements, we strongly urge you to ensure those requirements allow a Secondary Loan to include a transaction between a CDFI BHC and its CDFI bank or nonbank affiliate(s).** Under this proposed scenario, a CDFI BHC would be the Eligible CDFI that is the recipient of a Bond Loan. That Eligible CDFI would, in turn, make a Secondary Loan to its affiliated CDFI bank or nonbank affiliates (who would be considered the "Secondary Borrower"). Such Secondary Loans should include new transactions and refinancing of other instruments (e.g. Trust Preferred Securities). The Federal Reserve's regulations outlines the requirements and restrictions of such BHC relationships and, of course, any transactions would need to be in compliance with these rules and any other rules deemed applicable by the Federal banking regulatory agencies. If we are collectively successful in convincing the banking

regulatory agencies to include CBGP capital as an exception to the Basel III rule, this structure will be the most effective method for getting Tier 1 capital to the CDFI banks. If we are not successful in getting such an exception, this structure will still allow capital to be counted as Tier 2 capital. While Tier 2 capital is far less desirable, it may still be of some usefulness to a small handful of well capitalized banks as the economy gradually improves and excess banking industry liquidity subsides.

2. Need to Mitigate Potential Conflicts with Federal Bank Regulatory Agency Requirements

Counterparty Risk: We strongly urge the US Treasury and CDFI Fund to provide greater clarification and explicitly limit the potential counterparty risk associated with Eligible CDFIs participating in a single bond issue. Per the Interim Final Rule, we understand that within a single Bond Issue, the Risk Share Pool will be cross-collateralized by all participating Eligible CDFIs. We also understand that the contribution of each CDFI to the pool will be available to pay a default on any Bond Loan which is part of the Bond Issue. We urge Treasury and the CDFI Fund to issue more explicit statements within a final rule and any legal documents associated with the Bond Issue and individual Bond Loans, making clear that each Eligible CDFI incurs no liability for the losses beyond their portion of the Risk Share Pool and, further, that no additional assessments to recapitalize a depleted Risk Share Pool can be mandated on Eligible CDFIs that are not the source of losses. Without more explicit language limiting counterparty risk, CDBA is concerned that the potential contingent liability will strongly dissuade program participation. We are also concerned that without such an explicit limitation, the Federal regulatory agencies will prohibit CDFI banks and their holding companies from participation in the program.

Collateral Requirements: We strongly urge you to consult with the Federal banking regulatory agencies to ensure that any collateral requirements imposed under the CBGP do not conflict with restrictions or requirements imposed by the agencies on banks and BHCs. In the post-Dodd-Frank regulatory environment, regulators have been increasingly more conservative in allowing banks to pledge assets as collateral. Secondly, to the extent feasible, CDBA urges the CDFI Fund to be flexible with regard to the required collateral that must be pledged to secure a Bond Loan and/or Secondary Loan, recognizing the wide range assets and activities that CDFIs engage in. Collateral could include assets currently owned by the institution or could take the form of external credit enhancements (e.g. third party letters of credit, guarantees). With regard to the requirements for pledging loans receivable as collateral, CDBA urges the CDFI Fund to follow precedents established by other Federal agencies in securing advances, such as the Federal Home Loan Banks, that many of the CDFI banks already use. Unless prohibited by regulators, some CDFI banks and their holding companies may have the ability to pledge portions of their securities or other investment portfolios, bank owned real estate (e.g. real estate for bank or branch operations), and other assets.

Priority Over Other Creditors: The FCRA requires that a Federal guaranteed instrument must have priority over other creditors (or by extension other equity holders). In the case of CDFI holding companies, some have Trust Preferred Securities that could be repaid using CBGP proceeds. Other institutions (to a limited extent) may have private debt that would need to be subordinated or repaid with CBGP proceeds. Some CDFI banks and holding companies may have borrowings from other Federal sources (e.g. Federal Home Loan Banks, Federal Reserve). For example, investments received through the Treasury Department's Community Development Capital Initiative (CDCI) are an instrument that mandates priority status. This

circumstance will require further discussion with the Office of Financial Stability to determine whether they would be willing to subordinate, share risk or allow their investments to be repaid using CBGP proceeds. **We urge the agency to review each Federal source on a case-by-case basis to determine whether other issuing Federal agencies have the authority to subordinate or to share risk on a pari passu basis with the CDFI Bond Guarantee Program. In some circumstances, it may be necessary for CDFI Fund to be flexible in how it implements the requirement for priority in the case of other Federal creditors.**

Customer Profiles: Section 1808.619 states that the “Bond Documents and Bond Loan documents shall specify such monitoring and financial reporting requirements as deemed appropriate by the CDFI Fund.” Among the reporting items listed are “Customer Profiles.” The interim rules state that a “Qualified Issuer shall require each Eligible CDFI to compile such data on the gender, race, ethnicity, national origin, or other information on individuals and entities that utilize its products and services as the CDFI Fund shall prescribe and as is permissible under applicable law. In general, such data will be used to determine whether residents of Investment Area(s) or members of Targeted Population(s) are adequately served and to evaluate the impact of the CDFI Bond Guarantee Program.” As the US Treasury and CDFI Fund are aware, the Federal banking regulations prohibit banks from collecting of certain types of demographic data. **As you work to promulgate the model Bond Documents and Bond Loan Documents, we ask that the documents specifically acknowledge these restrictions and that the application review process not disadvantage and compliance process “hold harmless” CDFI banks because they cannot collect this data.**

3. General Recommendations & Concerns

Program Costs: The primary goal of the CBGP is to get credit into communities to create jobs, strengthen businesses, revitalize neighborhoods, build affordable housing, and facilitate provision of community services. We recognize the CDFI Fund has the very difficult task of making the program flexible enough to work for a wide range of CDFIs engaged in different lines of business; thus, some of the complexity of the structure grows out of the desire to accommodate diverse needs. CDBA is concerned, however, that the complexity of the program will result in additional costs that threaten program feasibility for many CDFIs. Alternatively, it could result in the creation of end loan products with pricing that is inaccessible to Secondary Borrowers. The Interim Final regulations anticipate up-front costs that are associated with issuance of the bond, as well as other on-going costs throughout the bond term. Upfront costs include:

- Bond Issuance Fees paid by each Eligible CDFI to its Qualified Issuer for expenses, administrative costs, and fees for services incurred in connection with the issuance of the Bond and Bond Loan. These fees are intended to cover costs associated with general program management and underwriting organizations for the purpose of determining “credit worthiness” and whether they can be designated as Eligible CDFIs. In addition, each Eligible CDFI is likely to have significant legal, accounting, and other fees that will need to be paid to third party vendors associated with bond issuance. Unfortunately, only 1% of the bond issuance costs is permitted to be financed into the Bond; upfront costs will likely require significant upfront cash outlays above the 1%. **We urge the CDFI Fund to raise this cap.**
- Risk Share Pool Fees paid by each Eligible CDFI to the Qualified Issuer (and held by the Master Servicer) to mitigate the risk of loss for assets financed by the Eligible CDFIs. While this fee is only paid based on draw downs, since all of the proceeds must be closed (or at least committed) within two years (and disbursed with 5 years), it will require significant

upfront cash outlays to participate in the program. Unless some or all of these proceeds can be financed over the life of the Bond, the costs will significantly reduce the number of CDFIs that can meaningfully participate in the program. **We urge the CDFI Fund to allow all or some portion of this fee to be financed into the bond and paid over time.**

On-going costs include:

- **Bond/Bond Loan Rate:** We understand that the Federal Finance Bank (FFB) is required to issue Bonds at current Treasury rates of comparable maturity. In addition, it is anticipated that the FFB will be required to add a modest spread to cover its expenses.
- **Agency Administration Fees** paid to the CDFI Fund in amounts equal to 10 basis points of the amount of the unpaid principal balance of the Bond. **We urge that the CDFI Fund cap fees at not greater than 10 basis points; and if actual administrative costs are less, the cost savings should be passed on to the program participants.**
- **Intermediary Fees:** CDBA appreciates the CDFI Fund preventing Intermediary parties from adding a spread on bond pricing. However, we are concerned with the extent to which fees or other surcharges will be added at the levels of: (1) the Bond Issuer to the Eligible CDFI(s); (2) Eligible CDFI to Secondary Loan borrowers; and (3) the Master Servicer to either Qualified Issuer or Eligible CDFIs. The structure outlined in the Interim Final rule specifies multiple independent parties that are part of each bond structure. CDBA is concerned that so many parties will significantly increase costs and result in duplication of functions. **We urge the CDFI Fund to:**
 - **Clarify the roles of the Qualified Issuer, Master Servicer, Eligible CDFI, and Secondary Borrower to ensure there is not duplication of functions (e.g. servicing, compliance) that could lead to unnecessary costs.**
 - **Give priority to applications that demonstrate cost effectiveness, including applications whereby Eligible CDFIs and Secondary Borrowers may be related entities (e.g. Affiliated CDFI holding companies and CDFI banks).** Affiliated entities are more likely to provide the needed functions in the most efficient and cost effective manner versus third party intermediaries.

Risk Mitigation: CDBA fully understands that the CBGP is subject to FCRA and must result in a zero subsidy cost to the Federal government. We, however, believe that the Interim Final Rule focuses too much attention on Treasury risk mitigation at the expense of the program impacts intended by Congress. The “belt and suspenders” risk mitigation requirements (e.g. full recourse to the Eligible CDFIs, the 3% risk share pool, pledging of hard collateral, and the possible need for additional credit enhancement) are excessive in the face of the actual performance of CDFIs and their loan portfolios. **We believe that a zero subsidy cost can be achieved with less layering of risk mitigation tools. We urge the Treasury Department to relax such requirements lest it undermine the ability of CDFIs to participate in the program in a meaningful way or create the community-level benefits Congress intended.**

Program Structure Alternatives: **As a new program, we recommend that the CDFI Fund allow for maximum flexibility for participants to design program structures that make sense for different types of CDFIs and use of bond proceeds.** Of great interest is the ability to create structures that enable CDFIs to manage risk and cost (e.g. utilizing affiliated entities within the Eligible CDFI and Secondary Borrower roles). As noted above, we urge greater flexibility with respect to risk management tools. Specifically, we urge the CDFI Fund to allow participants to create limited recourse structures that help CDFIs manage risk, including permitting existing Affiliates or newly formed Affiliates of Eligible CDFIs (created for CBGP) to be Eligible CDFIs for the purposes of program implementation.

Time Period for Obligation for Bond Loan Proceeds: To manage risk and potential losses to the US

Treasury and Eligible CDFIs, it is critically important that Eligible CDFIs engage in prudent screening and underwriting of Secondary Loans. The requirement that 50% of Bond Loan proceeds must be closed within 1 year of issuance and that 100% of Bond Loan proceeds be closed within 2 years creates an incentive for Eligible CDFIs to expose themselves and the US Treasury to losses. Too much compliance pressure to work quickly to close a large volume of loans using capital that may have many restrictions could result in CDFIs approving poorer quality credits than they might otherwise do. Furthermore, the requirement to close loans financed with Bond Loan proceeds within a short time frame within markets still recovering from a recession could mean that weaker credits have a higher probability of being approved. **In the interests of protecting the US Treasury, Eligible CDFIs, and the reputation of the entire CDFI industry, we strongly urge you to lengthen the time frame for closing of Secondary Loans funded with bond proceeds to five years to match the time frame for disbursement of Secondary Loan proceeds.**

Secondary Loan Pricing: The Interim Final Rule released on February 5 suggests that, among other features, the CDFI Fund will seek to set minimum and maximum limits on pricing for Secondary Loans. We urge the CDFI Fund to exercise caution in setting inflexible and arbitrary limits on pricing without the benefit of seeing the types of products, risk profile of transactions, and program structures that CDFIs may develop for the CBGP. **We advise the CDFI Fund to hold off on setting limits until it has the opportunity to understand better how the program works.**

Investment Areas: A technical clarification is sought regarding the CDFI Fund's intent about which types of Target Markets are intended to benefit from CBGP. In the Executive Summary (under Background), the interim rule states "[t]he Bonds will support CDFI lending in Investment Areas by providing a source of low-cost, long-term capital to Eligible CDFIs." This statement is repeated intermittently in other parts of the rule. Further, in the Part V "Rulemaking Analysis" section, the rule contains a confusing definition of Targeted Population that appears to merge the definitions of "Targeted Population" and "Investment Area" as they appear 12 CFR 1804. It is not clear whether the CDFI Fund intended to only allow Targeted Populations that are located within Investment Areas to benefit from the CBGP or whether the limitation is a technical drafting error. Elsewhere throughout the interim rule it appears that the CDFI Fund intended to include all types of Target Markets (e.g. Investment Area, Low Income Targeted Population, and Other Targeted Population, regardless of whether they are located within a qualified Investment Area). **We urge the CDFI Fund to address internal inconsistencies, and recommend that the interim rule be inclusive of all Target Market types as defined in 12 CFR 1804.**

Urging Expedited Issuance of Guidance & Documents

As the CDFI industry works to quickly develop plans to help the CDFI Fund meet its September 30, 2013 deadline to issue the first \$500 million in bonds, **we strongly urge you to issue guidance and legal documentation covering critical details of the program:**

- Guidance on the requirements an organization must meet to be deemed an Eligible CDFI is critical for knowing which entities are potentially eligible to participate in the program.
- Potential participants need guidance on the requirements and content of the Capital Distribution Plan. Given the minimum \$100 million bond issue requirement, most organizations will need to organize with other CDFIs to participate in a single bond issue

and will need to begin preparing materials for a Capital Distribution Plan. Without further guidance from the CDFI Fund, progress by organizations seeking to use the CBGP is stalled.

- Without access to the Legal Documents associated with the program it will be impossible for potential participants to fully understand their responsibilities and obligations.
- Secondary Loan transaction guidance is needed. Without greater clarity on the types and features of eligible transactions, it will be impossible for CDFIs to plan and prepare Capital Distribution Plans in sufficient time.

We thank you for consideration of these recommendations and look forward to working with you to preserve credit availability in distressed communities. If you have questions or comments, please contact Jeannine Jacokes, Chief Policy Advisor, at (202) 689-8935 ext. 22 or jacokesj@pcgloanfund.org.

Sincerely,

The Membership of the Community Development Bankers Association

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