



Community Reinvestment Fund, USA
801 Nicollet Mall, Suite 1700 West
Minneapolis, Minnesota 55402
800 475.3050/612 338.3050 tel
612 338.3236 fax www.crfusa.com

Capital for Communities—
Opportunities for People™

August 31, 2010

John E. Bowman
Acting Director
Office of Thrift Supervision
1700 G Street, NW.,
Washington, DC 20552

ATTN: OTS – 2010 – 0019

Dear Mr. Bowman:

On behalf of Community Reinvestment Fund, USA, I am pleased to respond to the federal bank supervisory agencies request for public comments on the Community Reinvestment Act regulations published in the *Federal Register* on June 23, 2010. CRF has been a strong proponent of the Community Reinvestment Act for more than 20 years and has submitted numerous comment letters on a wide range of issues related to the CRA. We believe the CRA is critical to ensuring that low wealth communities and their residents have access to financial resources especially in these difficult economic times. We appreciate the opportunity to share our views and recommendations for revising and strengthening the CRA regulations.

BACKGROUND

Community Reinvestment Fund, USA ("CRF") is the nation's leader in accessing the capital markets to support community development financing activities. Over the past 22 years, we have delivered more than \$1.2 billion in capital to low- and moderate-income communities through our New Markets Tax Credit ("NMTC") facilities and our securitization activities. These resources have leveraged an additional \$1.1 billion in total project costs.

As a national nonprofit financial intermediary and certified Community Development Financial Institution ("CDFI"), we provide new loan capital for local community development lenders – private nonprofits (such as CDFIs) and governmental agencies – in two ways; by operating a secondary market for their loans and by funding their NMTC-eligible transactions. Through our secondary market, CRF purchases performing small business, economic development, affordable housing and community facility loans from our lending partners that we then pool and transform into securities through the process of securitization. These securities are sold to banks, thrifts, insurance companies, pension funds and other institutional investors. Since inception, CRF has funded a total of 2,296 loans in 46 states and the District of Columbia. Working collaboratively with 154 lending partners, CRF's financing activities have directly assisted more than 368,000 families, financed 16,317 affordable homes, supported small businesses creating or retaining more than 43,200 jobs in over 750 communities and funded community facilities serving almost 280,000 people.



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CRF pioneered the development of asset-backed community development securities to help community development lenders tap capital markets resources. Since 1989, we have issued 19 series of Economic Development Revenue Notes totaling \$267 million and 3 Affordable Housing Securities totaling \$178 million. In 2004, CRF issued our first rated debt offerings – one secured by affordable housing loans and a second collateralized by small business loans. Both transactions included senior tranches rated “AAA” by Standard & Poor’s. CRF has subsequently issued additional rated debt offerings that have brought more than \$100 million in capital, primarily to low-income communities.

CRF played an instrumental role in creating and shaping the New Market Tax Credit (“NMTC”) program. These efforts led us to develop our own highly successful and unique tax credit financing product that delivers critical loan capital to small business and nonprofit borrowers in low-income communities. CRF’s affiliate, National New Markets Tax Credit Fund, Inc. (“NNMTCF”), is one of the country’s largest allocatees, receiving NMTC award allocations totaling \$597.5 million as well as investing \$52.5 million in allocations on behalf of other allocatees. To date, we have funded 365 NMTC loans totaling \$603.5 million in 187 cities in 34 states.

COMMENTS ON CRA REGULATIONS

CRF is a strong supporter of CRA and has actively participated in all manner of related policy debates throughout our 20 plus year history. Drafting numerous comment letters, speaking out in conferences and other public venues, we believe this statute and its regulatory framework are essential to ensuring capital and credit flow to *all* communities in this country, particularly low- and moderate-income neighborhoods. Without question, CRA has been the catalyst for economic and community development in so many of America’s distressed, underserved and disaster-stricken communities. In the wake of the financial crisis and the current recession, effective, energetic CRA regulations are vital to assuring those living in low- and moderate-income communities have access to resources to rebuild and revitalize their communities.

We commend the federal banking agencies for conducting these hearings and wish to offer the following comments and recommendations as to how the CRA regulations could be enhanced.

A. GEOGRAPHIC COVERAGE

What are the best approaches to evaluating the geographic scope of depository institution lending, investment and/or deposit-taking activities under CRA? Should geographic scope differ for institutions that are traditional branch-based retail institutions compared to institutions with limited or no physical deposit-taking facilities? Should it differ for small local institutions compared to institutions with a nationwide customer base? If so, how? As the financial services industry continues to evolve and uses new technologies to serve customers, how should the agencies adapt their CRA evaluations of urban and rural communities?



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The geographic scope of a depository institution's lending, investing and deposit-taking activities has become an ever more complex and challenging aspect of the Community Reinvestment Act. Changes in technology and how banks operate have dramatically altered the way credit is delivered and, in some cases, made an institution's assessment area increasingly irrelevant. We are concerned that by continuing to limit CRA responsibilities to a geographic area, the regulations may become an obstacle to achieving the underlying goal of this law - ensuring all communities and individuals, including low- and moderate-income communities and their residents, have adequate access to credit.

CRA activities should be evaluated in the context of a bank's business model. An internet-based bank with no physical deposit-taking facilities should *not* be evaluated in the same way as a traditional branch-based retail banking organization. Nor should small local community banks be evaluated in the same fashion as large wholesale institutions with no branch network. The geographic premise of CRA has become obsolete for many deposit-taking institutions that operate with a national footprint. Access to capital is no longer a matter just of geography but rather of the nature of the delivery mechanism and the expertise of banking organizations of different sizes and activities. We must modernize CRA in the following two ways to reflect the changing realities of the marketplace if we are to ensure that capital flows to low-wealth communities:

(i) Grant CRA Credit for all CDFI-related loans, investments and activities

To ensure credit reaches *all* communities, particularly low- and moderate-income areas, we urge the agencies to provide CRA credit for loans to or investments in Community Development Financial Institutions ("CDFIs") regardless of whether the CDFI is located or active in a bank's assessment area. Under the current regulations, banks may receive CRA credit for "capital investments, loan participations, and other ventures undertaken by an institution in cooperation with minority- or women-owned financial institutions and low-income credit unions ("MWLIs") as long as these activities help to meet the credit needs of local communities in which MWLIs are located or chartered."¹ Banks may receive favorable CRA consideration even if the MWLIs are not located in or such activities do not benefit an institution's assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s).² CDFIs have community development as their primary mission and are expert at delivering credit and capital to low-wealth communities. These organizations should be accorded the same treatment as MWLIs. Placing CDFIs on par with MWLIs would allow banks to make loans or investments in communities where they may not have a physical presence but where their resources would significantly contribute to the credit needs and economic well-being of its residents. In addition, it would offer lending and investment opportunities for depository institutions that do not serve a traditional geographic assessment area(s), such as large national wholesale or internet-based banks.

¹ Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment; Notice, Federal Register, Vol. 75, No. 47, March 11, 2010, page 11645, §____.12(g) – 4.

² Ibid.



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(ii) Provide CRA credit for any investments in nationwide funds

Second, provide CRA credit for any investments made in *nationwide funds*. The current Interagency CRA Questions & Answers include a question clarifying the CRA treatment of investments in a *nationwide fund* with a primary purpose of community development under the Investment Test. For years, CRF has advocated that there needs to be greater recognition of the benefits pooled investment vehicles bring in delivering capital to distressed and underserved communities.

As an issuer of asset-backed community development securities that clearly constitute such a *nationwide fund* for CRA purposes, we are very pleased to see an Interagency question added that addresses the role and treatment of such funds under the regulations. While this question recognizes *nationwide funds* as "...important sources of investments for low- and moderate-income and underserved communities throughout the country and can be an efficient vehicle for institutions making qualified investments that help meet community development needs,"³ it does not go far enough. Additional flexibility is needed to make sure that bank investors in these funds are able to receive *full* CRA credit for their investments. This is particularly important for low- and moderate-income communities that typically do not have access to innovative vehicles for delivering capital and credit. Pooled investment vehicles are a useful way to expand access to credit for LMI communities and all disincentives associated with these vehicles must be removed. We respectfully urge that banks be granted full CRA credit for any investments in *nationwide funds* which serve a national market. Providing this additional flexibility will expand the opportunities for banks to invest in vehicles that reduce risk through diversification while efficiently allocating resources to communities in need of credit. Similar treatment should also be provided under the Community Development Test for wholesale or limited purpose institutions making a "*qualified investment in a fund that invests in projects nationwide and which has a primary purpose of community development.*"⁴

We also encourage regulators to simplify the documentation requirements for *nationwide funds*. Currently, fund managers are usually asked to document that specific projects or investments are earmarked for a given bank investor in order for that institution to receive CRA credit. This requirement avoids the potential for double counting a project or investment by more than one bank but it creates a significant reporting and documentation burden for fund managers. Based on our own experience as an issuer of asset-backed community development securities, we recommend permitting a bank investor to claim a pro-rata share of the overall fund for CRA purposes. Existing documentation requirements reduce the efficiency benefits of using pooled vehicles and limit the capital that could flow to communities particularly from national institutions that do not have a traditional geographic footprint.

³ Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment; Notice, Federal Register, Vol. 75, No. 47, March 11, 2010, page 11659, §____.23(a) – 2.

⁴ Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment; Notice, Federal Register, Vol. 75, No. 47, March 11, 2010, page 11661, §____.25(e) – 1.



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B. SMALL BUSINESS AND CONSUMER LENDING EVALUATIONS AND DATA

Should the agencies revise the evaluation of and/or data requirements for small business and small farm lending activities or for consumer lending activities, including activities or products designed to meet the needs of low- and moderate-income consumers? If so, what changes are needed?

(j) Raise the visibility of Small Business Activities

Lending and investing in small businesses has become a key focal point of efforts aimed at stimulating economic growth across the country. Operating a secondary market for small business loans gives CRF a unique perspective on the challenges these firms face in accessing affordable credit today. We believe the Interagency Questions and Answers ("Q's & A's") are a key resource for banks seeking to determine whether a loan or investment will receive CRA credit. Illustrating CRA-eligible small business activities that are eligible for CRA credit is a powerful tool for encouraging banks to engage in these activities. In our view, increasing the number and variety of CRA-eligible small business examples in this reference document could raise both the visibility and the volume of these lending and investment activities. Given the significant role small businesses play in creating and retaining jobs, we urge the agencies to include additional examples of CRA-eligible small business loans, investments and services the Q's and A's to help banks better understand how they can meet their community reinvestment responsibilities through support for small businesses.

C. COMMUNITY DEVELOPMENT

What are the opportunities to better encourage community development loans, investments and services to support projects that have a significant impact on a neighborhood? Should the agencies consider revisions to the Community Development Test or to the definition of community development? How could the rules most effectively balance support for community development organizations of different sizes, varying geographic scope, and in diverse rural and urban communities? How might they balance incentives for meeting local needs as well as the needs of very distressed areas or those with emergency conditions?

We see a number of opportunities to modify the Community Development Test as well as the definition of "Community Development" to encourage increased community development loans, investments and services to support projects that have a significant impact on a neighborhood or community. We recommend the agencies consider the following three regulatory changes, one of which has been discussed above.

(j) Provide regulatory incentives for investments that capitalize CDFIs

One of the best ways to enhance CRA-eligible community development loans and investments is to create incentives that reward banks providing grants, equity or Equity Equivalent Investments ("EQ2s")⁵ to CDFIs. Grant dollars are

⁵ Equity Equivalent Investments are defined as unsecured debt that has some of the same advantages as equity because it is subordinate to all other debt and carries a rolling term, the investor has limited right to accelerate payment, and interest is not tied to income. CDFI Program Glossary FY 2005.



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extremely helpful but often hard to raise - especially in challenging economic conditions. Equity Equivalent Investments are particularly important because they serve as "equity" for nonprofit CDFIs enabling these lenders to attract and leverage significant private sector capital that can be reinvested in underserved and low-wealth communities. These organizations are among the most effective intermediaries for delivering credit in low- and moderate-income communities and often, CDFI participation in a transaction determines the success of a project or loan. However, without strong equity bases, CDFIs cannot expand their lending and investment activities. The CRA regulations should reward banks that help to build the capital base of these organizations and regulators should consider providing extra credit or greater weight in the CRA examination process for grants, equity or Equity Equivalent Investments in CDFIs.

We should note that under current regulations, banks making community development grants *do* receive CRA credit under the Investment Test, however the weight given is often insignificant because the dollar amount of grants pales in comparison to the dollar volume of investments. In addition, grants are more costly in that they provide no return and earn less CRA credit than investments that can "continue to qualify under the Investment Test in subsequent exams as long as they remain in the bank's portfolio."⁶

(ii) Eliminate all geographic criteria under the Community Development Test

We urge the agencies to provide CRA credit to wholesale or limited purpose banks for community development loans, investments and services regardless of whether the activity takes place in the institution's assessment area(s) or a broader statewide or regional area that includes its assessment area(s). The Community Development Test should be modernized to reflect how technology and innovation have weakened the link between deposit-taking activities and lending to specific geographic areas. Assessment areas for wholesale, limited purpose and now internet-based banks are not meaningful due to technological developments and changes in how banks provide credit to our economy. These institutions source their deposits and other short-term funds across the country or through the capital markets. Similarly, they lend nationally and therefore do not serve a particular geography. Under current regulations, these banks are required to reinvest in the communities where they are located which tends to concentrate their CRA lending and investments in a few locales while other communities may not be adequately served.

(iii) Put CDFIs on equal footing with MWLs by amending the definition of Community Development

Finally, as discussed above, we believe CDFIs should be accorded the same treatment as MWLs under the definition of Community Development. This change would allow banks to receive CRA credit regardless of where a CDFI is located if they invest, engage in loan participations or partake in other cooperative ventures with such an institution. Amending the definition of community development to include CDFIs would remove all assessment area(s) constraints and permit depository institutions to use other criteria when choosing to make CRA-eligible loans,

⁶ Mark Willis, "It's the Rating Stupid: A Banker's Perspective on the CRA," Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act, A Joint Publication of the Federal Reserve Banks of Boston and San Francisco, February 2009, page 65.



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investments or provide services. With more than 870 CDFIs across the country, modifying this definition would encourage more high impact community development loans, investments and services while effectively balancing support for community development organizations of different sizes, varying geographic scope, and in diverse rural and urban communities.

D. RATINGS AND INCENTIVES

Is there an opportunity to improve the rules governing CRA ratings to differentiate strong, mediocre, and inadequate CRA performance more consistently and effectively? Are there more effective measures to assess the qualitative elements of an institution's performance? Are there regulatory incentives that could be considered to encourage and recognize those institutions with superior CRA performance?

Ratings and incentives play a critical role in how banks choose to meet their CRA obligations. We support the concept of giving organizations with a superior CRA performance some special or enhanced designation. As part of this effort, we assume the agencies would seek to be consistent in how they define "superior CRA performance" and that this definition would be consistent with specific activities promoted in the regulations. For instance, if the regulations encourage partnering with or providing grants to or equity investments in CDFIs – then these priorities should also be reflected in any ratings or incentive systems for superior CRA performance. We offer two specific recommendations related to ratings and incentives.

(i) Redefine "innovative and complex" loans and investments in the context of current credit conditions

First, we urge the agencies to reexamine the concept of "innovative and complex" lending practices and qualified investments for CRA purposes, taking into account existing credit conditions. Over the years, banks' investments in CRF's community development securities have been considered to be "innovative and complex" qualified investments by CRA examiners. The financial crisis and ensuing recession have dramatically lowered the risk tolerance of depository institutions and reduced their willingness to lend and invest, especially in LMI communities. Many of the sophisticated financial instruments and vehicles that were employed a few years ago are no longer available.

As small businesses struggle to access a line of credit or a term loan, the concept of "innovative or complex" lending and investment needs to be recalibrated in light of current economic conditions. For example, just a few years ago, that same CRA examiner might have viewed a bank making SBA guaranteed loans in LMI communities to be routine rather than "innovative or complex". However, the significant tightening of credit standards since 2008 has made it increasingly difficult for small firms to access affordable credit. SBA guaranteed 7(a) or 504 loans to businesses in distressed or underserved communities *should be* deemed "innovative and complex" by virtue of the fact banks have been slow to open up the small business credit market and extend these types of loans.

(ii) Create incentives for banks to make longer term loans

Second, we would encourage the agencies to create incentives for banks to make longer term loans and investments.



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Under the current regulations, banks are rewarded for making short-term loans or investments that match the CRA examination cycle. These loans or investments mature and the bank often extends a new loan or investment in order to receive CRA credit in the next examination period. This "teaching to the test" may result in a mismatch between the type of loan capital or investments CDFIs and other community-based financial institutions need and what the banks are willing to provide. Banks should receive CRA credit for however long the loan or investment remains outstanding. If depository institutions were granted on-going CRA credit for an existing loan in their portfolio over more than one CRA examination period, these institutions might offer loan or investment terms that would have greater impact or be more responsive to the needs of CDFIs and the borrowers they serve in low- and moderate-income communities. Alternatively, the regulations could provide credit (or some portion thereof) at the back end of longer term loans or investments.

CONCLUSION

In closing, we wish to reiterate our strong support for the Community Reinvestment Act and commend the staff of the Federal Banking Agencies for undertaking such a thorough and comprehensive review of these regulations. Over the past 30 years, CRA has played a major role in stimulating lending and investing in underserved, distressed and disaster-stricken communities. These communities have suffered disproportionately in the wake of this devastating recession. If the CRA is to remain an effective tool for assuring that our most vulnerable communities have access to capital and credit, its regulations must reflect innovations in technology and industry practices. The best way to assure that these regulations do not become outdated and ineffective is through periodic review and reexamination exercises, including public hearings and comment periods, that offer all stakeholders a chance to share their views and concerns with the supervisory agencies. We applaud the agencies for conducting these hearings and encourage them to engage in similar outreach efforts on a regular basis in the future. Again, we appreciate this opportunity to share our views on the CRA regulations and welcome questions regarding the comments and recommendations presented in this letter.

Sincerely,

A handwritten signature in blue ink that reads "Warren McLean".

Warren McLean

Vice President of Development