EQUALIZE CAPITAL

James P. Sheesley
Assistant Executive Secretary
Attention: Comments RIN 3064AF81
Federal Deposit Insurance Corporation
550 17th Street, NW, Washington, DC 20429

Re: RIN 3064-AF81

Mr. Sheesley,

I would like to address the Joint Notice of Proposed Rulemaking on the Community Reinvestment Act. Before getting in to detailed responses to individual changes in the proposal, I would like to explain who we are, our part in the Community Reinvestment Act, and some additional changes not put forth in the proposal that would help further the goals of the Community Reinvestment Act.

Equalize Capital LLC (Equalize) is an SEC-registered investment adviser. Equalize currently manages a public mutual fund and a private fund. Both of these funds are designed to help banks meet their CRA requirements while providing financing to underserved communities throughout the United States. One of the funds invests in small business loans, focusing on loans originated under the SBA's 504 loan program, USDA Rural Development loan programs, and Bureau of Indian Affairs loan programs. The other fund focuses on residential mortgage loans to borrower using an ITIN number for tax paying purposes, rather than a Social Security Number. This results in a population of underserved and underbanked borrowers, a large percentage of whom are minority and low-income individuals.

The loans we target in both funds do not have robust secondary markets, making these loans less attractive for potential originators and purchasers. We believe our funds provide an alternative that helps expand the secondary markets for these loans, making them more attractive for originators and helping to expand access to credit to some underserved markets.

We believe the fund structure offers many advantages that make it attractive from a CRA perspective. Many banks, particularly small and intermediate-size banks, may not have the in-house expertise to originate SBA 504 loans or ITIN mortgage loans, and may lack the scale to devote resources to these types of loans that occur infrequently in many communities. The fund structure also allows small and intermediate-size banks to participate in projects benefitting their communities that might be inaccessible to them directly due to legal lending limit restrictions. These banks can get access to the loans produced by other originators (both bank and non-bank) that they might otherwise be unable to originate themselves.

From the originator perspective, our funds offer an outlet for banks that may not wish to hold onto these loans due to a number of reasons, such as CRE concentration concerns. Non-bank lenders gain the ability to fund loan originations they otherwise could not commit to making. In fact, many of the originators we purchase loans from frequently ask us about our interest in purchasing a loan before they go through the process of originating the loan. If we are not interested, they frequently do not originate the loan.

In addition to the fact that our funds are providing credit to projects that could otherwise not obtain financing, the funds provide another feature that should be welcome by community groups and regulators. There has been much discussion in recent years about CRA-qualified products that are bought and sold frequently, in an attempt to provide CRA credits to multiple banks without really doing anything to expand access to credit.

Our funds are structured so that this is not an issue. Both funds provide limited liquidity to investors. The funds are designed as buy-and-hold investors in loans. As a result, the funds limit the amount that investors can redeem at any one time. In both funds, redemptions are limited to one redemption window per quarter. One of the funds limits the quarterly redemption to 5% of fund assets while the other allows up to 15% of fund assets. Consequently, fund investors know that they must hold their investments for at least two quarters. In addition, they are not guaranteed the ability to completely liquidate their investment in any quarter, as other banks might also request a redemption, limiting the amount that any one bank can redeem. In this way, bank investors are aware that investments in these funds are not short-term investments.

Despite the alignment of the investments made by our funds and the goals of the Community Reinvestment Act and the advantages provided by the fund structure, our funds and others like them sit in a gray area in the regulations. In some cases, it is uncertain how an examiner will treat an investment in either of our funds. For small banks, the issue is particularly unclear.

We understand the desire of the regulators to minimize the CRA data collection burdens on small banks by relying on data that is already collected for other purposes. However, the reliance on using data collected for the small businesses on the Call Report or on data collected for HMDA also sharply limits the ability of small banks to utilize any creative ways to meet their CRA obligations. Investing in a small business loan or a residential mortgage loan through a fund investment will not show up in the Call Report or in HMDA data, even when the fund investment achieves the same CRA goals as a direct investment.

While large and intermediate banks often have the scale and resources necessary to originate SBA 504 loans, and USDA RD loans, and the multilingual personnel needed to target immigrant and minority mortgage borrowers, such is rarely the case for small banks. Consequently, small banks often have the greatest need for flexible, innovative ways to meet their CRA requirements. Under current guidelines, it is unclear how a small bank could benefit from a creative solution such as our funds.

Before moving on to comments regarding specific changes that are in the proposed rulemaking, I would like to address a change that is <u>not</u> in the proposed rulemaking. We believe that all banks, but small banks in particular should be afforded the ability to utilize creative solutions to their CRA needs in the form of fund investments designed for CRA compliance. We believe that this can be accomplished without adding any significant data collection burden on the banks.

Fund structures are allowable investments for banks. They are categorized as equity investments on a bank's balance sheet. For purposes of CRA consideration, large banks and intermediate-small banks can submit these investments for consideration as community development investments or, in some cases, community development loans. However, small banks are not evaluated under the community development guidelines unless they specifically ask their examiner to consider their community development activities. It is unclear if a residential mortgage loan held in a fund would even be considered a Community Development activity under the definition proposed, and thus whether it would qualify even when a small bank requests that its community development activities be evaluated. Even if a small bank requests community development activities be evaluated, it seems that these banks can get no benefits from residential mortgage loans or small business loans held in a fund structure for their basic facility-based lending requirements, even when a loan held in the fund is nearly identical to a loan held directly on the bank's balance sheet.

We would suggest a change that would greatly improve the flexibility that banks have for taking advantage of investments in a fund structure. For purposes of risk weighting, the treatment of equity exposures are outlined in §.51 through §.53 of the regulatory capital rules. Banks are required to use the full look-through, simple modified look-through, or alternative modified look-through approaches for equity exposures to mutual funds and other investment funds to determine risk weighted assets for their equity exposures. We would propose that the same approach be applied when evaluating a bank's fund investments for CRA purposes. This would not require any new data collection efforts by a bank investing in a fund, as the fund advisor typically provides all of the necessary information to the bank, including loan data such as income level, and census tract data at the individual loan level. In addition, it furthers the goals of the CRA by allowing a bank to capture activity that currently is not captured in small bank regulatory exams and count small business loans and residential mortgage loans held in a fund structure in the same way these types of loans are captured elsewhere on the balance sheet for CRA purposes. It lets loans with similar characteristics be classified with similar loans. This will allow small banks the flexibility to utilize innovative and creative means of furthering CRA goals and meeting their requirements.

## III. Community Development Definitions

Under the proposed CRA rule, a bank may, depending on its size, be evaluated for its community development lending, investments, and/or services under various tests. These activities must have community development as their primary purpose. Community development activities currently fall into four broad categories. The agencies propose to revise the community development definitions in order to clarify eligibility criteria for different community development activities by including eleven categories that establish specific eligibility standards for a broad range of community development activities.

Under current CRA rules, there is a hole in the regulations concerning fund investments. If a bank invests in a fund that holds residential mortgages or small business loans, the investment may not qualify for CRA consideration, even if the same loan would qualify were it held directly on the bank's balance sheet. For instance, a residential mortgage loan to a low-income borrower does not seem to qualify under any of the criteria for consideration as having a primary purpose of "Community Development", nor would it seem to qualify as supporting affordable housing. Though the fund investment might indeed provide funding for low income mortgages that might not otherwise be available, it seems that a bank investing in such a fund would not get any CRA credit for the investment. For small banks, this is especially problematic, as the bank can only get credit for a fund investment by requesting that its exam include its Community Development activities, but the definition of Community Development activities seems to exclude more basic loan types that would be captured in a CRA exam if it is held directly on a bank's balance sheet.

> *"While single-family mortgages qualify under the lending test,*[65] *activities that support the construction of affordable housing or other activities to promote affordable homeownership for low-or moderate-income individuals are considered as affordable housing under the community development definition."*

*Question 10.* What changes, if any, should the agencies consider to ensure that the proposed affordable housing definition is clearly and appropriately inclusive of activities that support affordable housing for low- or moderate-income individuals, including activities that involve complex or novel solutions such as community land trusts, shared equity models, and manufactured housing?

*Answer 10.* In addition to including mortgage-backed securities that finance affordable housing for community development consideration, the agencies should also include mutual funds and other similar fund structures that invest in low- and moderate-income housing for community development consideration.

III. Community Development Definitions

C. Economic Development

4. Support for Financing Intermediaries

We support the proposal to recognize and include activities with financial intermediaries under the definition of Economic Development for evaluation under the Retail lending Test. However, we believe that mutual funds and other similar structures should be included among the financial intermediaries included. We also believe that the ability to "look through" the fund structure to the underlying assets held by a fund - much like the way funds are treated for risk weighting purposes is done – should be permitted. Since banks evaluated under the small bank category may not be evaluated under the retail lending test, this method should specifically be allowed for small banks, permitting them to include relevant assets under the facility-based lending test. Fund structures can be an efficient way of providing much needed capital to small businesses and can provide banks with an efficient and innovative means of supporting small businesses and creating jobs in their community.

*Question 64. Should retail loan purchases be treated as equivalent to loan originations? If so, should consideration be limited to certain purchases – such as from a CDFI or directly from the originator? What, if any, other restrictions should be placed on the consideration of purchased loans?*

We share the concern about loan purchases that do not provide liquidity to the originator and purchases that may reflect churning. However, we believe the regulations should recognize the benefits of pooled structures, such as close-end mutual funds, where the ability of investors to churn assets is severely limited. We believe that such pooled structures can provide significant liquidity to loan originators and thus expand the market, while providing investing banks an efficient method of reaching market niches they might not otherwise have the resources to pursue. Such investments can provide long term capital to underserved markets without encouraging churning.

*Question 142. Should additional consideration be provided to small banks that conduct activities that would be considered under the Retail Services and Products Test, Community Development Financing Test, or Community Development Services Test when determining the bank's overall institution rating?*

The focus on data already collected by banks for Loans to Small Businesses (for the Call Report) or residential loan data collected as part of HMDA serves the goal of reducing data collection costs for small banks. However, it also limits the flexibility of small banks to use a non-traditional approach to providing capital to small businesses and homebuyers. As we have noted previously, allowing banks to "look through" the form of an investment in a mutual fund or other pooled loan structure to the underlying assets in the fund would allow small banks a much greater degree of flexibility without a noticeable increase in data collection requirements. In fact, such data collection requirements would fall on the management of the fund or other pooled investment product. Small banks that invest in a fund that purchases residential mortgages or small business loans could then add their proportional share of the fund's loans, or loans specifically assigned to the bank, to their numbers for small business loans or residential mortgage loans to LMI individuals or census tracts.

**§ __.13 Community development definitions**

*(4) Purchases of mortgage-backed securities that contain a majority of either loans financing housing for low-or moderate-income individuals or loans financing housing that otherwise qualifies as affordable housing under paragraph (b) of this section.*

We believe this definition should also include mutual funds and other pooled investment vehicles that purchase mortgages for low- or moderate-income individuals and that such funds would qualify for credit according to the proportion of mortgages within the fund that are for LMI individuals.

**IV. Qualifying Activities Confirmation and Illustrative List of Activities**

*Although some stakeholders wanted the confirmation process to be open to all stakeholders, including community groups, as is the case for the process implemented by the OCC, the agencies believe that the proposal to limit the requestors to banks evaluated under CRA would accomplish the desired goal of increased certainty of eligibility.*

As a non-bank provider of products designed to help banks meet their CRA obligations, we contest the assertion that only banks should be included in the confirmation process. Banks are not the only source of innovation when it comes to CRA solutions. As is the case with many other non-bank product and service providers, we spend considerable amounts of time and money designing, creating and marketing new CRA products. The inability to determine whether such products will actually qualify for CRA consideration is a significant deterrent to the creation of new, less common, more complex, or innovative products for banks. If we can’t be part of the process up front, many innovative new products may never get past the idea stage and will never be submitted by a  bank as part of the confirmation process. This will stifle innovation.

Sincerely,

Joe Gladue
President & CFO
Equalize Capital LLC

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