Carolina Small Business DEVELOPMENT FUND

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street, SSW, Suite 3E-218
Washington DC 20219

Anne E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington DC 20551

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

August 5, 2022

RE: Comments on Community Reinvestment Act Joint Notice of Proposed Rulemaking to the Office of the Comptroller of the Currency (Docket ID OCC-2022-002), the Board of Governors of Federal Reserve System (Docket No. R-1769 and RIN 7100-AG29), and the Federal Deposit Insurance Corporation (RIN #3064-AF81)

In response to the above request for comments, Carolina Small Business Development Fund (CSBDF) respectfully submits the comments below for your consideration. CSBDF is an unregulated revolving loan fund operating as a 501(c)(3) nonprofit Community Development Financial Institution (CDFI). We foster economic development in underserved communities by providing affordable capital, business services, and policy research to support small businesses. For more than 30 years, we have remained committed to our vision of creating economic opportunity for all by working to spotlight the importance of entrepreneurship as the engine of regional economic growth. Thanks in part to our broad coalition of partners, we have been able to provide 1,116 small business loans and 1,495 grants which created or saved 6,526 full-time jobs. Our commitment to evidence-based change includes a robust research program, and our work on CDFI evaluation and alternative impact metrics has been published by leading scholarly outlets.[1]

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OUR LENDING ECONOMIC IMPACT[2]

+9.3 Indirect Jobs PER SMALL BUSINESS LOAN	**$621,314 Earnings** SUPPORTED PER LOAN	**1.01 Earnings Multiplier** ECONOMIC ROI FOR LOANS

ROLE OF CDFIS IN MEETING CRA GOALS

Equitable access to financial services, especially in communities that have a high proportion of lower income and/or minority residents, is an enduring federal policy challenge.[3] For many decades, lack of access to banking services and credit has resulted in widespread disinvestment across historically marginalized neighborhoods, a trend accelerated by historic redlining behavior across the nation's banking sector.[4] Several landmark legislative packages have been passed in order to redress these issues, and among the most important is the Community Reinvestment Act (CRA).[15] Though the CDFI designation was subsequently by the Riegle Act,[2] the CDFI community is critical to the CRA's community development policy goals.[6]

SUPPORTED CHANGES TO PROPOSED RULE

UNIFIED REGULATORY FRAMEWORK. Like most CDFIs loan funds, a substantial portion of CSBDF's lending capital and operating support is provided by CRA-regulated institutions. These entities are vital partners for us, and the debt and grant funding they provide are essential to our operations. For that reason, we commend the rule's structure as a joint proposal which creates a unified regulatory framework. This prevents institutions from changing their regulatory charters with the intention of being subject to the set of CRA regulations which are most advantageous to them. The balkanized nature of previous proposed changes made this outcome very likely, and a jointly proposed rule helps solve the issue.

IMPACT REVIEW FACTORS FRAMEWORK. A holistic assessment of community development impacts is necessary to realize the CRA's policy goals. We thus strongly support a qualitative evaluation of community development activities in addition the to proposed quantitative measures under the Community Development Financing and Community Development Services tests. We also strongly commend the activities outline under item (7) of the impact factors framework, which recognizes the value of grant contributions. CDFI loan funds like ours provide significant grant funding in addition to

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[1] Community Reinvestment Act, 42 U.S.C. 69 § 5301 (1977).

[2] Riegle Community Development and Regulatory Improvement Act, 12 U.S.C. 47 § 4701 (1994).

small business loans. Our activities around cash aid to small businesses reflects a growing body of literature which shows how these interventions can be especially effective during a time of crisis.[7] During economic shocks like COVID-19, the grant support of CSBDF and other CDFIs with similar commitments to the communities they serve can make the difference between small businesses failing or surviving.

ECONOMIC DEVELOPMENT & CDFI CRA CREDIT. We strongly support the proposed language stating activities in support of certified CDFIs are eligible for CRA credit.[8]This update is in line with the broader definitional updates on how regulators interpret the definition of economic development for purposes of CRA compliance. These changes are important because they formalize the importance of CDFIs in sustainable development and highlight the industry's role in providing affordable capital.[3] They further substantiate the value CDFIs have as economic development organizations which enhance community vitality, support local employment, and create entrepreneurial ecosystems that contribute to the tax base. Research has long shown that CDFIs are effective development entities in part because their mission-driven nature allows them to fulfill a locale's unmet economic needs in ways that are not otherwise possible.[9]

UPDATED ASSESSMENT AREAS. The proposed framework allows regulated institutions to receive credit for community development activities outside of their facility-based assessment area. This is a much-needed change which reflects the interconnected nature of the country's economy. In recent years, there has been a precipitous rise in income inequality, and much of that increase has been concentrated in extraordinary wealth disparities across a small number of communities.[10] By providing credit for activities outside of the assessment area, the framework is especially helpful for the growing number of regulated institutions that are primarily or entirely without retail bank branches. These changes are particularly helpful for smaller state and regional development organizations, whose grassroots operations are a key component of the CRA's policy goals.

The agencies have requested specific feedback about whether banks should delineate the specific geographies outside their assessment area where they anticipate conducting community development financing activities. We believe this would be counterintuitive to the intent of the proposed change. If regulated banks are only allowed to receive credit for these activities outside of their assessment areas by previously identifying target geographies, it could disincentivize seeking new investment opportunities. The agencies have also asked whether all banks should have the ability to count community development activities outside of their assessment areas, and not just large banks. We believe allowing smaller institutions to receive credit outside of their facility-based areas is equally critical for the aforementioned reasons.

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[3] A key reason why CDFIs and similar entities can act as effective coordinators is their level of responsiveness to community. See William Simon, *The Community Economic Development Movement: Law, Business, and the New Social Policy* (Durham, NC: Duke University Press, 2001).

CONCERNS AND RECOMMENDED IMPROVEMENTS

RACE AS AN EXPLICIT EXAMINATION FACTOR. The largest oversight in the proposed framework is that it does not explicitly list race as an examination factor. While we certainly acknowledge and support that the intent of the CRA is to uplift low- and moderate-income communities, racial minorities are subject to enduring capital access constraints that are often unrelated to their income.[11] Focusing on income will not close racial wealth gaps, simply because by aggregate numbers, there are more low- and moderate-income whites than nonwhites. The extant literature has thoroughly documented the large array of barriers to small business success for firms owned by racial and ethnic minorities.[12] Relevant issues include limited access to capital, poor or non-existent entrepreneurial network support, and a dearth of comprehensive technical assistance options.

The COVID-19 pandemic has in many ways exacerbated these issues because its adverse effects have been most acutely felt in majority-minority communities. For example, during the initial stages of the pandemic the proportion of firm closures for white-owned firms (17%) was substantially lower than those owned by Asian (25%), Hispanic (32%), and Black (41%) entrepreneurs. [13] CSBDF has a great deal of experience with this, as our services are open to small business owners and entrepreneurs from all backgrounds, but our programmatic activity has an intentional focus on certain constituencies — including individuals of color.

Previous iterations of proposed CRA regulatory changes were clear about these issues and were intentional about the inclusion of race in reform efforts. While the agencies do note the importance of minimizing racial discrimination in the preamble to the proposed changes, the substantive updates are otherwise silent about this important issue. The one exception is large banks would now be required to disclose the racial and ethnic distribution of mortgage applications and originations. This is useful data, although it does not look like the data disclosure will be utilized in the CRA evaluation process. We strongly urge regulators to reconsider their position on this issue and make substantive updates to reflect these concerns. The agencies should consider improvements like providing CRA credit for CDFI investments affirmatively targeting historically marginalized racial and ethnic groups. This might include, for example, single family mortgage and small business loans to BIPOC individuals or similar special purpose credit programs.

REVENUE-BASED DEFINITION OF SMALL BUSINESS. The agencies propose the use of the Consumer Financial Protection Bureau's (CFPB) definition of small business as meaning firms with $5M or less in annual revenues. The stated reason for this change is the complexity of the current definitional framework, which has a two-pronged size and purpose test that can be difficult to demonstrate for compliance purposes. While we concur that the existing definition is unnecessarily complex, switching to the CFPB's definitional standard will likely redirect capital towards larger firms. While annual revenues are not the sole component of the current definitional framework, the current maximum of $1M is notably lower than the proposed $5M change. Over time the threshold for what it means to be a "small business" continues to increase, which has the practical effect of disincentivizing loans to very small firms.

In terms of determining what receives CRA credit, we think the definition of small business requires more nuance than a simple $5M size threshold might allow. There is a direct correlation between firm ownership characteristics and firm revenues size. Certain categories of very small enterprises are predominately owned by historically disenfranchised constituencies — including the lower-income entrepreneurs that the CRA is designed to assist.[14] To some extent this issue can be minimized by leveraging CDFIs and other community lending entities to provide credit to very small firms. However, the goal of the CDFI model is that small businesses "graduate" to receiving credit from traditional financial institutions. If CRA-regulated institutions and financial intermediaries can receive credit for loans to "small" businesses with up to $5M in revenues, they may be less likely to engage in the time-consuming underwriting process required for much smaller firms. We would encourage the agencies to consider how a $5M revenues definition could unintentionally suppress lending for smaller firms.

IMPACT REVIEW FACTORS FOR CDFIS (QUESTION 35). The CDFI industry writ large has encouraged the agencies to broadly include all types of support for CDFIs as an impact review factor.[15] We argue that the agencies should consider assigning a higher weight to grant support for relatively less well-resourced Community Development Financial Institution loan funds. While we value and appreciate the contributions of large CDFI entities, the CRA both the current and proposed guidelines allow larger CDFI loan funds to disproportionately benefit from the provision of equity and debt compared to smaller entities. For example, some institutions can easily get CRA credit by providing debt to extremely large certified CDFIs. While all CDFI loan funds need capital to lend out to their borrowers, it costs less for a financial institution to lend money to a large CDFI. That relative cost should be appropriately evaluated by regulators.

Regulated institutions should receive more CRA credit for investing in smaller CDFI loan funds than larger ones. Consider that in 2019, the nation's 490 CDFI nonprofit loan fund had just $31.4M average assets.[16] But just two CDFIs, Local Initiatives Support Corporation (LISC) and Enterprise Community Partners, Inc. held 16.9% (2.4B) of all non-profit loan fund assets.[17] Excluding these two entities, the average assets of CDFI loan funds drops from $31.4M to $29.2M. Community development is a holistic process, and meaningful change requires that regulated institutions be incentivized to provide both direct and indirect support to a range of organizations through several different mechanisms.

The agencies have a duty to help ensure a large variety of community entities have a chance to receive financial support.[4] To be sure, despite being chronically under-resourced, smaller CDFIs have shown to be highly effective through their strategic use of social capital and similar strategies to maintain organizational growth and continuity.[18] But without changes, the CDFI industry will continue to suffer from bifurcation of resources in ways that ultimately harm historically marginalized communities. Providing support to small- and medium-sized CDFIs, especially via operating grants, should receive higher weight in CRA compliance audits.[19] The rule makes some progress in this area by recognizing the value of additional indirect support via impact factor 8 (activities that reflect bank leadership through multi-faceted or instrumental support). We hope that in practice this support is delivered to smaller and lower capacity CDCs and CDFIs through needed mechanisms like IT infrastructure upgrades and compliance reporting assistance.

There are a few additional ways that we believe the agencies could structure impact factors in ways that empower CDFIs to help marginalized communities. First, consider specifically emphasizing financing which empowers CDFIs to provide longer-term loan options to their borrowers. Maturity mismatches continue to be a challenge in offering affordable credit terms to structurally disadvantaged borrowers, and the CRA can help address this ongoing challenge. Second, we believe regulated financial institutions should receive more CRA credit for capital provided to CDFIs at or below the federal funds rate. One of the biggest barriers to CDFI loan funds meeting credit needs in the communities they serve is the cost of capital. The rate at which many CDFIs borrow from banks is high relative to the risk of their portfolios. By providing higher weight for rates at or below the federal funds rate, CRAs can provide loan at more affordable terms to those they serve.

Thank you for the opportunity to comment on the proposed changes to the Community Reinvestment Act. Please let us know if we can do anything to be of assistance as your agencies consider any final changes.

Sincerely,

[redacted]

Kevin S. Dick, CEcD
President and CEO
Carolina Small Business Development Fund

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[4] We do acknowledge that non-financial support of CDFIs and similar entities can be valuable. For example, institutions that provide access to senior staff to help build CDFI capacity in technology are positively shaping community development outcomes. But we strongly encourage the agencies to weigh the value of volunteering hours and similar activities relative to the level of direct financial support a regulated institution provides to community development entities.

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