August 5, 2022

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

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

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

Subject: Community Reinvestment Act

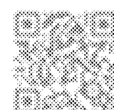
Comptroller Hsu, Chairman Gruenberg, and Chairman Powell,

We write on behalf of the community advisory board and board of directors of The Change Company, LLC (collectively "The Change Company"), a national community development financial institution (CDFI) certified by the United States Department of the Treasury's CDFI Fund to service low-income communities, low-income borrowers, African American borrowers, and Hispanic/Latino borrowers across America. We are the largest non-bank CDFI originator of residential loans in America. In 2021, we originated over $7.5 billion in loans, and approximately 70% of our lending is to underserved and underbanked borrowers. Our community advisors are comprised of national non-profit, faith-based, and community organizations that advocate on behalf of minority and low-income communities.

The Change Company was founded in partnership with The National Diversity Coalition, The National Asian American Coalition, and numerous other community, faith-based, civic, and banking industry leaders.[1]

The Change Company believes that the interagency proposal to modernize the Community Reinvestment Act (the "Proposal") is critical to improving the efficacy and impact of the

[1] See e.g., https://www.businesswire.com/news/home/20171020005725/en/National-Diversity-Coalition-Announces-Launch-Lending-Platform; and, https://www.businesswire.com/news/home/20171103005518/en/California-Leaders-Launch-Capital-Corps-LLC.



CRA. Key improvements to existing CRA regulations that are already included in the Proposal (which The Change Company strongly supports) include increased transparency, measurement, and accountability.

Currently, the CRA is the only bank statutory requirement under which regulators do not require banks to report activity quarterly and systematically. Consequently, regulators do not include CRA data in timely, systematic, public reports on the safety and soundness of banking institutions, the impact of depository institutions' CRA activities on markets and regions, or general lending across America. As a result, the American public is unable to differentiate banks with socially responsible CRA programs on a timely basis when making banking decisions and/or engaging in advocacy.

The Change Company strongly supports the regulatory agencies' desire to adopt new CRA regulations, especially on behalf of the unbanked and underbanked, as well as LMI communities across America. On that basis, there are certain necessary and important modifications to the Proposal that we submit for your consideration in the final rule (the "Rule"). We believe these recommendations (the "Recommendations" or a "Recommendation") are consistent with the publicly stated goals of the FRB, OCC, and FDIC. We also believe they will make the Rule less susceptible to gamesmanship in providing CRA credit for activities that have no or negligible beneficial impact on community development and LMI communities. We believe this will make the CRA more impactful over the long term.

Additionally, we believe that the current Proposal introduces substantial (and unnecessary) uncertainty into the relationship between banks and CDFIs as it relates to CRA-qualifying activities and credit. In fact, there is a lack of clarity in the Proposal that undermines decades of consistent guidance that the FRB, FDIC, and OCC have provided to banks and CDFIs since at least 1996.

As recently as 2019, the OCC updated its guidance to banks and the public through the issuance of a fact sheet clarifying the nuances of CRA credit for bank-CDFI partnerships and investments. (See https://www.occ.gov/publications-and-resources/publications/community-affairs/community-developments-fact-sheets/pub-fact-sheet-bank-partnerships-with-cdfis.pdf).

It is critical that the Proposal be amended to clarify banks' ability to receive CRA credit for their investments in CDFIs. At a minimum, the final Rule must clarify that existing regulatory guidance is not overridden by the new Rule and that banks can continue to rely on existing regulatory guidance for CRA credit. This includes confirming that the new Rule continues the pass-through lending test credit Banks may receive by investing in equity and equity-equivalent securities of CDFIs.

Additionally, the new Rule should (i) specifically incorporate existing regulatory guidance and precedent relating to CDFI equity and equity-equivalent investments, and (ii) directly correct additional issues that have repeatedly impeded bank-CDFI partnerships in the past and which should be resolved in this rulemaking, and (iii) make the credit based on investment in CDFIs, purchases of CDFI loans, and loans made to CDFIs all count under the CRA's community development test (since in each case the bank is partnering with CDFIs for the purpose of community development).

By addressing these issues, the thousand-plus CDFIs across America will be able to form more meaningful partnerships with banks, to assist the unbanked and underbanked with

more scale and impact, and to enhance the effectiveness of the CRA for the next generation.

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This letter also seeks to urge that the final Rule eliminate three activities from CRA eligibility that do not currently impact community development and the issues of the underbanked:

1. Eliminate CRA credit for the acquisition and holding of securities guaranteed by the federal government. When securities are guaranteed by the U.S. government, that in itself creates a large, liquid market for these securities, and as a result, purchasing such securities does not help the underbanked.
2. Eliminate CRA credit for the financing and re-financing of multi-family housing for wealthy investors when such financing does not result in any material community development. Banks that lend money to wealthy real estate investors should not receive CRA credit; this is particularly true when the investor has an investment-grade credit rating.
3. Eliminate CRA credit for the extra costs of paying brokers to originate CRA investments and loans instead of originating loans directly to a bank's community. Banks should receive the highest-quality CRA credit when they partner directly with CFDIs and other CDEs rather than Wall Street bankers.

Additionally, the Proposal must provide greater clarity and guidance relating to investments in, loans to, and partnerships with CDFIs. As proposed, the new Rule would risk wreaking havoc with existing and potential bank-CDFI partnerships and could introduce unintended uncertainty and negative consequences for CDFIs and their borrowers across the country.

Therefore, we request that the FRB, OCC, and FDIC ensure that the final Rule includes the following enhancements and clarifications that are not currently in the Proposal:

A. Confirm that banks will be eligible to receive pass-through lending credit for equity investments in CDFIs.[2]

B. Clarify that banks will receive CRA credit for all investments in or loans to CDFIs certified by the United States Department of the Treasury's CDFI Fund.

C. Clearly state that banks will receive either (i) 2x CRA credit or (ii) CRA credit in the innovative category for their equity investments in CDFIs, including if the CRA credit is calculated using the pass-through lending test credit. It would be unfortunate if the new Rule was less attractive for banks that pursue CDFI partnerships than the Rule previously adopted by the OCC.

D. Clarify that banks will receive community development CRA credit under the pass-through lending test for all loans made to underserved borrowers made by a CDFI pursuant to a CDFIs certification by the United States Department of the Treasury's CDFI Fund.

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[2] See, e.g., https://www.occ.gov/publications-and-resources/publications/community-affairs/community-developments-fact-sheets/pub-fact-sheet-bank-partnerships-with-cdfis.pdf, "CRA consideration based on pro rata share of a CDFI's loans and qualified investments," page 4; and, https://www.fdic.gov/consumers/community/cdfi/cdfis_sectionv.pdf, "CRA Consideration of CDFI Investments and Lending Activities", page 33.

E. Provide full CRA credit for loans originated to unbanked and underbanked borrowers[3] that are originated by non-bank CDFIs (even if they are immediately sold to third-party investors).

F. Provide banks credit for all loan purchases from CDFIs that result in providing CDFIs with liquidity to make additional loans. Given that CDFIs are required to make over 60% of their loans to underbanked borrowers, banks should receive credit independent of the nature of the loans purchased or the use of the specific proceeds by the CDFI.

We discuss each of these Recommendations in turn.

First, general recommendations relating to the CRA Proposal:

1. Eliminate CRA Credit for the Acquisition and Holding of Securities Guaranteed by the Federal Government.

The OCC has publicly estimated that over $50 billion in CRA credit is awarded annually for MBS, SBA, and other securities that are originated by a third-party lender, securitized into a Wall Street security guaranteed by the federal government or a government sponsored-entity ("Guaranteed Securities"), and then acquired by a bank and placed on a bank's balance sheet for CRA credit.[4]

The acquisition and trading of these Guaranteed Securities on the secondary market after the origination of the loan does not increase community development or CRA impact. In addition, the provision of CRA credit to banks that purchase these Guaranteed Securities for their investment portfolios does not materially increase the liquidity of Guaranteed Securities, which are already backed (i.e., subsidized) by the creditworthiness of the United States government.

In other words, incentivizing secondary market purchases through the provision of CRA credit for these securities does not result in an increase in loan originations in the communities that the CRA seeks to support. In fact, it may depress the total origination of Guaranteed Securities eligible for CRA credit because banks do not have to engage in the resource-intensive task of loan originations to achieve CRA compliance. Instead, they can simply purchase a security on the secondary market.[5] Adopting our Recommendation will reverse this inappropriate incentive and result in increased bank originations in LMI communities – especially among large banks.

In fact, Wall Street has created unique "CRA-eligible" securities ("CRA Securities") that trade with lower liquidity than their sister securities that are not CRA-eligible. For instance, Guaranteed Securities that are "CRA-Eligible" (such as Fannie Mae MBS) regularly have less than 10% of the trading liquidity generally associated with standard Fannie Mae MBS that are not CRA-eligible ("Standard Securities"). This holds true for Fannie Mae, Freddie Mac, and Ginnie Mae securities. Removing CRA loans from the population of loans in Standard Securities harms the overall government and agency mortgage securitization market by increasing the percentage of high-balance loans in Standard Securities.

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[3] Including any loan to a target market certified by the United States Treasury's CDFI fund for the originating CDFI.

[4] Speech by Comptroller Joseph Otting to the National Diversity Coalition, February 27, 2020.

[5] Today, we estimate well over $10 of CRA credits is awarded annually to banks that purchase and hold Guaranteed Securities issued by Fannie Mae, Freddie Mac, and Ginnie Mae securities for each for every $1 of CRA credit awarded to banks originating the loans that are placed into the Guaranteed Securities.

Unfortunately, by allowing Wall Street investors to implicitly create securities that red-line (or exclude) certain communities and populations from Standard Securities by segregating loans to LMI and minority populations into CRA Securities, Wall Street bankers and investors are permitted a back-door method of creating securities whose underlying loans exhibit credit characteristics consistent with the worst practices of redlining (e.g., no loans in LMI census tracts and an underrepresentation of loans to minority borrowers).

Additionally, banks are not currently required to justify their investments in CRA Securities that are also Guaranteed Securities by demonstrating that the investment has a primary purpose of community development in order for the bank to receive CRA credit. In fact, banks generally would not be able to provide such a justification if required. Instead, current regulations treat the purchase of these CRA securities as CRA activities "per se". The primary purpose of acquiring a Guaranteed Security is typically to obtain an investment that is federally guaranteed and is credited with certain regulatory liquidity characteristics in a bank's ALCO modeling. It is not to pursue community development.[6]

By removing the banking industry's ability to obtain over 10% of annual CRA credits (over $50 billion of the approximately $481 billion in total CRA lending and investments) by acquiring Guaranteed Securities, banks will necessarily have to replace these CRA credits with alternative CRA-qualifying activities that would result in community development and community impact and/or loan originations to LMI borrowers (thereby expanding access to capital) instead of simply purchasing loans originated by others.[7]

There are numerous examples of securities that have been phased out of government programs without distorting the market, causing liquidity runs, or sacrificing the value of existing securities. We believe the same well-tread path should be followed with respect to the removal of CRA credit for Guaranteed Securities.

The plan would likely include the following aspects: (i) existing CRA-eligible securities as of the year-end following the one-year anniversary after the adoption of the Proposal as a Rule would be grandfathered and retain CRA eligibility, including on transfers, purchases, and sales until their final maturity; (ii) newly issued securities after the grandfather date would no longer receive CRA eligibility, and therefore the capital markets would no longer create such specialized securities. Loans currently diverted into specialized CRA securities would instead be treated as similar loans and placed into Standard Securities, thereby creating a larger, more liquid marketplace of more homogenous Guaranteed Securities for all investors to price and trade in an orderly fashion.

We believe that the elimination of the CRA credit currently awarded for the purchase of Guaranteed Securities would increase the value of CRA credits earned for loan originations. The resources that banks are willing to invest in the origination of new CRA-eligible loans are directly related to the regulatory incentives in place to cause a bank to originate loans in an LMI community (instead of simply buying a security). Limiting CRA credits to those activities that actually contribute to community development places a greater premium on the value of CRA-eligible activities. This means that banks will seek to originate more CRA-eligible loans by making greater pricing concessions to LMI borrowers in order to originate CRA-eligible loans. Additionally, it means that banks will invest more in building a business development network in LMI communities to originate CRA-eligible loans that they

[6] Which would require the acceptance by the bank of some risk to achieving a return exceeding the relevant risk-free rate.
[7] We continue to support full credit for the origination of the loans themselves.

otherwise would not need to attract if they were able to obtain the same credit by simply acquiring Guaranteed Securities which do not result in community development benefits.

We believe this Recommendation will have additional CRA benefits within banking and for non-bank CDFIs. Unfortunately, an increasing number of OCC and FDIC banks have completely exited their consumer and mortgage lending businesses over the last decade. Instead of originating loans to serve their markets, including the needs of minority and low-income populations, banks have sought to eliminate the compliance risks associated with consumer lending, and instead acquire Guaranteed Securities to achieve CRA compliance.

Similarly, when approached for material partnerships by local CDFIs, banks are telling CDFIs that they are eschewing CDFI partnerships in favor of acquiring Guaranteed Securities that qualify for CRA credit. Therefore, the current policy of allowing banks to obtain over $50 billion of CRA credit by buying Guaranteed Securities (such as MBS) is accelerating banks' departure from consumer and mortgage lending. It is also hampering banks' willingness to form partnerships with CDFIs that would benefit underserved communities.

We believe that in addition to correcting the questionable statute that allows for CRA credit for Guaranteed Securities, this Recommendation will meaningfully increase the CRA's positive impact on underbanked LMI communities. It will also cause banks to engage in CRA lending directly, increase partnerships with CDFIs and other partners that lend directly to the underbanked in a bank's market service area, and promote other benefits consistent with the CRA as highlighted above.

2. **Eliminate CRA Credit for Financing and Re-Financing Multi-Family Housing for Wealthy Investors When such Financing Does Not Result in Material Community Development.**

Wealthy borrowers are neither underserved nor underbanked, and incentivizing bank lending to wealthy borrowers is not within the mandate of the CRA. In fact, many believe that loans facilitating gentrification and the displacement of LMI populations are antithetical to the goals of the CRA.

However, the Proposal currently continues to allow banks to receive CRA credit for loans made to wealthy investors (including large institutions and funds) to finance multi-family properties, even when the loan has no discernable relationship to any community development activity. For instance, a multi-family loan to a wealthy institutional investor (e.g., a billion-dollar fund) that re-finances multi-family properties in an LMI census tract should not receive CRA credit unless the use of funds includes one or more community development benefits, such as:

- Proceeds of the loan are used for the construction, rehabilitation, improvement, or other community benefit relating to the property.
- Proceeds are invested into another property in an LMI community that benefits from construction, rehabilitation, improvement, or other community benefit.
- Proceeds are invested into a business or civic activity that results in jobs, economic benefit, or other CRA-eligible activity in a LMI community.

The Rule should not allow CRA credit when the funds lent to a wealthy multi-family investor are not used for a discernable community development activity, such as a rate and term

refinancing, a cash-out refinancing where the cash-out is used solely to provide a cash distribution to the property owners (wealthy "accredited" investors), or a cash-out refinancing where the cash-out is used as a down payment for the acquisition of new property outside of LMI census tracts with no connection to job creation in an adjacent LMI community.

This Recommendation is consistent with legislation adopting Opportunities Zones, which acknowledges that capital used to acquire properties in an Opportunity Zone does not, by itself, create community development, economic, or employment impact on the LMI community. Instead, to qualify for Opportunity Zone incentives, the statute requires that the capital is used to invest in the Opportunity Zone by making material improvements to real estate or bringing a business or jobs into the community. Similarly, the statutory intent of the CRA is not simply to have banks and wealthy investors buy properties in LMI areas; rather, it is for investments to facilitate improvements in those areas in terms of community development, jobs, and other improvements.

By eliminating banks' ability to receive credit automatically for making loans to wealthy borrowers who are investing in multi-family properties when the proceeds of the loan are not used for community development activities, the CRA will become more effective and impactful and hew more closely to its statutory requirements. This will ensure that CRA credit goes to community development activities and to loans that actually have a community development purpose. It will also exclude activities that are deemed per se CRA-eligible (even though there is no community benefit) while the sole benefit goes to wealthy investors who live outside LMI communities.

Our Recommendation will require that bank loans that receive CRA credit are made to LMI borrowers or that the proceeds actually have a community benefit. The justification implicit in providing CRA credit to loans in an LMI community (even with community impact and even to a wealthy investor) is that it is necessary to incentivize banks to lend in LMI areas within their market service areas. However, this suggests that CRA credit is being used to reward banks for not engaging in illegal red-lining or violations of fair lending laws. We believe that the current laws related to red-lining and fair lending are insufficient to prevent banks from making loans to wealthy investors who seek to finance properties in LMI areas in a bank's market service area that do not have a material indication of community development.

3. Eliminate CRA Credit for the Extra Costs of Paying Brokers to Originate CRA Investments and Loans Instead of Originating Loans Directly to a Bank's Community.

Existing regulations acknowledge the numerous benefits of direct relationships built through retail banking businesses compared to brokered and wholesale businesses. With respect to bank deposits, both the OCC and the FDIC have acknowledged that although the costs for wholesale and brokered deposits may be lower than the costs associated with retail deposits at times, brokered and wholesale deposits are more volatile, less reliable, and less strategic to a bank's core business. Similarly, for a bank's loan portfolio, studies have found that brokered and wholesale loans (including SNICs) can generally experience more volatility in credit performance, experience adverse selection in terms of duration risk, payoff risk and credit risk, and generate less non-interest income than retail-originated loans.

CRA loans and investments sourced directly by a bank in the communities it serves also have numerous benefits over those sourced through brokers and wholesale channels. Banks that understand the needs of their markets are better able to address those needs, and banks with direct community relationships are better able to design innovative solutions to the most pressing issues facing the LMI communities they serve.

Loans and investments that are sourced through Wall Street and other brokers should not be incentivized over retail-originated loans and investments sourced directly between a bank's employees and community organizations or individuals in a bank's service area. Unfortunately, the Proposal will inadvertently have this effect and should be modified to remedy this situation.

For instance, compare Bank A and Bank B. Bank A hires an internal team of community bankers and allocates its budget to build relationships with CDFIs in its market areas to make direct investments, provide bespoke services, and lend money to CDFIs and other community organizations. Bank B outsources its CRA to a Wall Street investment bank that forms a private equity fund with a 2% management fee and 20% incentive fee to source CRA deals. Bank B hires no internal community bankers to build community relationships.

The Wall Street fund (aware of Bank A's reputation for a strong CRA program) then replicates Bank A's portfolio dollar-for-dollar by investing in participations in each of the investments and loans that Bank A sources directly. Bank B becomes an investor in the Wall Street private equity fund claiming CRA credit for each of the fund's loans and investments but develops no relationships with any community group and provides no services. Bank B should NOT receive more CRA credit for investing in the identical basket of investments and loans through the Wall Street fund as Bank A does directly.

Under the current Proposal, we believe that Bank B would receive greater CRA credit because Bank B would receive credit for the entire amount invested in the Fund, including the cost of the loans acquired by the fund, plus the costs paid by Bank B to the Wall Street fund managers and investment bankers who sponsor and manage the fund. Simply put, Bank B would receive CRA credit for its costs of outsourcing its CRA program to Wall Street since those costs would be part of the fund Bank B invested in. In our view, this is an ineffective policy that is unfair to Bank A. In addition, such policies consistently result in less capital being directed to LMI communities, despite the fact that one of the CRA's primary objectives is to facilitate community development in these areas.

Our Recommendation is that the Proposal be modified to reduce the amount of CRA credit awarded to brokered loans and investments. We propose a 10-20% reduction in a Bank's CRA credit to deduct from the CRA credit the total costs (or "Loan") of a traditional managed fund structure that includes a 2/20 fee structure. We believe a 10% discount is appropriate for a fund with no incentive fee (only management and other fees), and a 20% discount is appropriate for a fund that has both a management fee and an incentive fee.

This is appropriate given that the average life of these funds is 5-12 years. Our Recommendation provides a level playing field for banks that pursue a retail, relationship-based CRA model, and will not disadvantage them competitively compared to banks that seek a brokered or wholesale approach to the CRA. Encouraging (or at least not disadvantaging) banks to develop real community relationships and create bespoke and innovative solutions to community needs has been at the heart of the CRA for over four decades. As such, we believe it would behoove the OCC and the FDIC to ensure that the

Rule retains the proper incentive structure so that banks are not unintentionally encouraged to sever community relationships in favor of Wall Street-brokered CRA programs as they would be under the Proposal.

Second, CDFI-Specific Recommendations Relating to the CRA Proposal:

In 1996, the banking regulatory agencies recognized EQ2s as investments eligible for CRA consideration.[8] This guidance provided a safe-harbor for investments in CDFIs that exhibit the following six characteristics **(Six Safe-Harbor EQ2 Characteristics)** as meeting the minimum standards to qualify for Equity Equivalent treatment under CRA regulations:[9]

i. The EQ2 is carried as an investment on the investor's balance sheet in accordance with GAAP.

ii. The EQ2 is a general obligation of the CDFI that is not secured by any of the CDFI's assets.

iii. The EQ2 is fully subordinated to the right of repayment of all of the CDFI's other creditors.

iv. The EQ2 does not give the investor the right to accelerate payment unless the CDFI ceases normal operations (e.g., goes into bankruptcy or changes its line of business).

v. The EQ2 carries an interest rate that is not tied to any income received by the CDFI.

vi. The EQ2 has a rolling term and therefore an indeterminate maturity.

This initial recognition was based on an EQ2 that met what the investor represented were conditions which included the six characteristics listed above. The regulatory agencies, however, did not define minimum standards for EQ2s; rather, the agencies based their response on the investor's representations. The six standards, then, were not considered a requirement, but served as the equivalent of a safe harbor.

In 1997, the regulatory agencies offered additional guidance, saying that EQ2s, "...would not have to conform precisely to the model addressed in the June 27, 1996, letter," provided that the instruments have attributes that are characteristic of traditional equity investments.[10] The OCC first recognized an EQ2 in January 1997.

It is our understanding that this Guidance remains effective and operable. Also, it is our understanding that investments that qualify for Equity Equivalent classification under the guidance are eligible to be treated as Equity Investments for all purposes relating to the CRA, including eligibility for pass-through lending test credit (PT Lending Credit).

Additionally, it is our understanding that the analysis above for Equity Equivalent treatment of an investment in a CDFI relates to any investment in a CDFI irrespective of: the corporate form of the CDFI (e.g., S-Corporation, C-Corp, LLC); the tax status of the CDFI (e.g., 501(c)(3), mutual, for-profit); the status of the CDFI as a depository institution (e.g., Depository, Non-Depository); the structure of the legal documents between the Bank and the CDFI (e.g., subordinated debt, preferred equity, membership interests in an LLC,

[8] Federal Financial Institutions Examination Council (FFIEC), Interagency CRA Interpretive Letter. May 30, 1997.
[9] Beth Lipson, "Equity Equivalent Investments," Community Investments, Federal Reserve Bank of San Francisco (March 2002).
[10] FFIEC, Interagency CRA Interpretive Letter (May 30, 1997).

convertible debt, convertible preferred) so long as the investment is carried on the bank's balance sheet as an investment under GAAP; or the classification of the capital by the CDFI under GAAP rules as debt, equity, or otherwise, so long as it is carried on the bank's balance sheet as an investment under GAAP.[11]

In sum, it is our understanding that the following statements are consistent with current regulatory guidance:

- A Bank's CDFI investment that reflects the **Six Safe-Harbor EQ2 Characteristics**, or otherwise has characteristics of traditional equity investments, qualifies as an Equity Equivalent investment and the bank may properly classify it as an Equity Investment for CRA purposes.
- A Bank's ability to qualify its CDFI investment as an Equity Investment is not impacted by the CDFI's tax status, its corporate form, or the financial attractiveness[12] of the investment itself.

Community banks can make equity and equity-equivalent loans (EQ2) and investments in CDFIs. EQ2s are long-term, fully subordinated debt instruments that function like equity in key respects. These loans have rolling terms, with intermediate maturities, as long as CDFIs carry out their community development purposes. EQ2 capital makes it easier for CDFIs to offer more responsive financing products with longer loan terms.[13]

In 2014, the FDIC provided a clear overview of a bank's ability to qualify an investment for lending performance test treatment, including the methodology for calculating the amount of lending credit attributable to the bank's investment.

Moreover, when investments support a CDFI intermediary and that intermediary in turn makes loans to small businesses or LMI individuals or in LMI areas, the institution may choose to have its investment considered in three ways:

1. The total amount of the bank's community development investment in the CDFI may be considered under the investment or community development test as a community development investment.
2. A pro rata share (based on the bank's share of CDFI equity) of loans made by the CDFI to the ultimate small business or LMI borrowers or areas can be considered under the bank's lending performance test.
3. An institution may choose to allocate a share of its investment amount for consideration under the investment or community development test and allocate the remainder for consideration under the lending test.

Any amount considered under the lending test would equal the bank's pro rata share, based on its equity investment of community development loans made by the CDFI during the period under review, provided that these loans benefit the bank's assessment area or a broader statewide or regional area that includes the assessment area. (See the Interagency

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[11] See e.g., Federal Register / Vol. 81, No. 142 / Monday, July 25, 2016 / Rules and Regulations, §__.12t(4), §__.12h(1-8), §__.22d(1); pages 48532-48540; CRA INVESTMENT HANDBOOK, Federal Reserve Bank of San Francisco, March 2010, pg. 30.

[12] The March 28, 1997, CRA Interpretive Letter specifically notes that the interest rate of the EQ2 does not have to be below market and that the tenor of the investment does not have to be 10 years.

[13] See supra, page 41.

Q&A at Section 12_.23(b) for the complete agency interpretation of dividing the funding consideration between tests).[14]

Further, the 2016 Interagency Q&A (referenced in the FDIC's March 2014 publication, which was later updated to include the reference) Section 12_.13(b) states,

> § .23(b) – 1: Even though the regulations state that an activity that is considered under the lending or service tests cannot also be considered under the investment test, may parts of an activity be considered under one test and other parts be considered under another test?
>
> A1. Yes, in some instances the nature of an activity may make it eligible for consideration under more than one of the performance tests. For example, certain investments and related support provided by a large retail institution to a CDC may be evaluated under the lending, investment, and service tests. Under the service test, the institution may receive consideration for any community development services that it provides to the CDC, such as service by an executive of the institution on the CDC's board of directors. If the institution makes an investment in the CDC that the CDC uses to make community development loans, the institution may receive consideration under the lending test for its pro rata share of community development loans made by the CDC. Alternatively, the institution's investment may be considered under the investment test, assuming it is a qualified investment. In addition, an institution may elect to have a part of its investment considered under the lending test and the remaining part considered under the investment test. If the investing institution opts to have a portion of its investment evaluated under the lending test by claiming its pro rata share of the CDC's community development loans, the amount of investment considered under the investment test will be offset by that portion. Thus, the institution would receive consideration under the investment test for only the amount of its investment multiplied by the percentage of the CDC's assets that meet the definition of a qualified investment.[15] [XI.12.22]

In fact, the FDIC and fellow bank regulators have provided clear, consistent guidance with respect to EQ2 investments for more than 20 years. In 1996, the banking regulatory agencies recognized EQ2s as investments eligible for CRA consideration.[16] This recognition was based on an EQ2 that met what an investor represented were conditions which included six specific characteristics. Interagency guidance has resulted in a safe-harbor for investments in CDFIs that exhibit these six characteristics[17] as meeting the minimum standards to qualify for Equity Equivalent treatment under CRA regulations.[18]

The regulatory agencies did not define minimum standards for EQ2s; rather, the agencies based their response on the investor's representations. The six standards were not considered a requirement, but served as the equivalent of a safe harbor.

In 1996, bank regulators also outlined the options for banks to receive CRA credit for their investments in CDFIs – guidance which has largely remained intact for nearly 25 years. According to the CRA Investment Handbook, Federal Reserve Bank of San Francisco,

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[14] Supra page 33.
[15] Interagency FAQ, page XI.12.22.
[16] Federal Financial Institutions Examination Council (FFIEC), Interagency CRA Interpretive Letter. May 30, 1997.
[17] It is these same six characteristics that NAAC incorporated into its investment with Partner Bank.
[18] Beth Lipson, "Equity Equivalent Investments," Community Investments, Federal Reserve Bank of San Francisco (March 2002).

March 2010, page 31, "On June 27, 1996, the OCC issued an opinion jointly with the Federal Deposit Insurance Corporation, Office of Thrift Supervision, and the Federal Reserve Board that Citibank would receive favorable consideration under CRA regulations for its equity equivalent investment in National Community Capital. The OCC further stated that the equity equivalents would be a qualified investment that bank examiners would consider under the investment test, or alternatively, under the lending test. In some circumstances Citibank could receive consideration for part of the investment under the lending test and part under the investment test. This ruling has significant implications for banks interested in collaborating with nonprofit CDFIs because it entitles them to receive leveraged credit under the more important CRA lending test. The investing bank is entitled to claim a pro rata share of the incremental community development loans made by the CDFI in which the bank has invested, provided these loans benefit the bank's assessment area(s) or a broader statewide or regional area that includes the assessment area(s). The bank's pro rata share of loans originated is equal to the percentage of 'equity' capital (the sum of permanent capital and equity equivalent investments) provided by the bank."

In 1997, the regulatory agencies offered additional guidance, saying that EQ2s would not have to conform precisely to the model addressed in the June 27, 1996 letter, "...provided that the instruments have attributes that are characteristic of traditional equity investments".[19]

In fact, for more than two decades, the FDIC's public guidance relating to EQ2 treatment for lending test credit for bank investments in CDFIs under the CRA has remained consistent, including on several occasions since 2010:

- In 2010, Bank Regulators highlighted the fact that pass-through lending test credit aligned CRA credit with the actual impact a bank's capital had on increased CRA-eligible lending activities. See e.g., CRA Investment Handbook, Federal Reserve Bank of San Francisco, March 2010, page 31, "For example, assuming a nonprofit CDFI has "equity" of $2 million—$1 million in the form of permanent capital and $1 million in equity equivalents provided by a commercial bank—the bank's portion of the CDFI's "equity" is 50 percent. Now assume that the CDFI uses this $2 million to borrow $8 million in senior debt. With its $10 million in capital under management, the CDFI makes $7 million in community development loans over a two-year period. In this example, the bank is entitled to claim its pro rata share of loans originated—50 percent or $3.5 million. Its $1 million investment results in $3.5 million in lending credit over two years. This favorable CRA treatment provides another form of "return on investment" for a bank in addition to the financial return. The favorable CRA treatment is a motivating factor for many banks to make an EQ2 investment."
- In 2016, Bank regulators highlighted that investments in CDFIs are often more responsive to community needs than direct lending conducted by the bank. See, e.g., Federal Register / Vol. 81, No. 142 / Monday, July 25, 2016 / Rules and Regulations, page 48534. § .21(a)—3: "'Responsiveness' to credit and community development needs is either a criterion or otherwise a consideration in all of the performance tests. How do examiners evaluate whether a financial institution has been 'responsive' to credit and community development needs? A3. Activities are more responsive if they are successful in meeting identified credit and community development needs. For example, investing in a community development organization that specializes in originating home mortgage loans to low- or

[19] FFIEC, Interagency CRA Interpretive Letter (May 30, 1997).

moderate-income individuals would be considered more responsive than an investment of the same amount in a single-family mortgage-backed security in which the majority of the loans are to low- or moderate-income borrowers. Although both of these activities may receive consideration as a qualified investment, the former example would be considered to be more responsive than the latter."

- In 2019, the OCC updated its guidance relating to Bank investments in and partnerships with CDFIs by publishing a new Fact Sheet titled, "Bank Partnerships With Community Development Financial Institutions and Benefits of CDFI Certification" (https://www.occ.gov/publications-and-resources/publications/community-affairs/community-developments-fact-sheets/pub-fact-sheet-bank-partnerships-with-cdfis.pdf). This continued the long tradition of providing banks with CRA credit for equity and EQ2 investments in CDFIs, including an option to elect pass-through lending credit.

A. Confirm that banks will be eligible to receive pass-through lending credit for equity investments in CDFIs.

The OCC, FDIC, and FRB each have a long, appropriate history of providing banks with the option of electing to receive pass-through lending credit for their equity investments in CDFIs. The Rule should confirm that bank regulatory guidance relating to CRA pass-through lending test credit for investments in CDFIs remains intact and is incorporated (either specifically or by reference) into the final Rule. We recommend that the final Rule simply reiterate the guidance provided in the 2019 OCC Fact Sheet relating to the options pursuant to which banks can calculate their CRA credit for CDFI investments. This would provide certainty relating to the methodology available to banks prior to their receipt of two (2) times credit as provided under the Proposal – which we support and believe is critically important.

Additionally, the final Rule should clarify that banks should report pass-through lending test credit as if the loans made by the CDFI for which the bank receives credit were made by the bank directly. In that case, the loan would count for the bank's lending tests by market service area and by loan size, as if each loan were made by the bank itself.

B. Clarify that banks will receive CRA credit for all investments in or loans to CDFIs certified by the United States Department of the Treasury's CDFI Fund.

Banks should receive CRA credit for all investments in and loans to CDFIs certified by the United States Department of the Treasury's CDFI Fund. This will streamline Bank-CDFI reporting and remove unnecessary bureaucracy and unintended consequences. This will also allow banks to set up innovative and specialized lending programs to address community needs with large CDFI community partners and to receive CRA credit based on the use of the bank's funds. It will not prevent a bank from being able to partner with a CDFI that has the capabilities and relationships needed to enhance the bank's CRA activities due to unrelated programs conducted by the CDFI outside the bank's market service area.

The FDIC-OCC Rule should clarify that no "majority requirement" should be appropriately applied on a community partner's overall activities so long as a bank's capital is primarily used for community development purposes. CDFI certification requires that a majority of the CDFI's financing activities be used to expand access to capital for underserved borrowers and communities. Additionally, federal CDFIs must have a primary purpose of community development. Applying additional, overlapping "tests" and requirements is more

burdensome than helpful, and interferes with the CRA's impact more than it furthers the statute's effectiveness.

See e.g., Federal Register / Vol. 81, No. 142 / Monday, July 25, 2016 / Rules and Regulations, page 48532. § II.12(t)—4. "A4. Examples of qualified investments include, but are not limited to, investments, grants, deposits, or shares in or to: Financial intermediaries (including CDFIs, New Markets Tax Credit- eligible Community Development Entities, CDCs, minority- and women-owned financial institutions, community loan funds, and low-income or community development credit unions) that primarily lend or facilitate lending in low- and moderate-income areas or to low- and moderate-income individuals in order to promote community development, such as a CDFI that promotes economic development on an Indian reservation."

Given that the "majority requirement" is not relevant to many of the types of entities listed as examples of qualified investments (such as CDCs, CDEs, and others that "facilitate" lending), we understand that investments in CDFIs where the investment capital is primarily used for lending that promotes community development would be considered a qualified investment (notwithstanding what other unrelated activities a large CDFI might conduct in other geographies or with other banks).

For instance, national CDFI's with a large minority lending program outside Bank A's MSA (e.g., addressing African American homeownership in South Los Angeles) should not be precluded from accepting a qualified investment from a bank in Texas even though a majority of its overall loans may not be CRA-qualified loans for the Texas Bank since that bank does not have branches or operations in Los Angeles. Instead, the CDFI should be allowed to set up a special program for the Texas Bank that directs all of the Bank's Equity Investment into CRA-eligible loans in its Texas MSA. That investment by the Texas Bank into the Texas-specific program would be a qualified investment in a CDFI with a primary purpose of community and economic development in LMI communities in the Texas Bank's MSA. Additionally, subject to the limitation that the Texas Bank is not allocated more than its pro rata share of the CDFI's overall lending activity, the Bank should be permitted to receive pass-through lending credit that prioritizes the loans made by the CDFI's Texas lending financed by the Texas Bank since that was how the Bank's capital was actually used.

In this example, the Texas Bank would receive no CRA credit for any non-CRA Loan. In addition, the CDFI and Bank would have effectively increased lending that promotes economic development in the Bank's MSA, and the partnership between the Bank and the CDFI would have enabled a positive outcome that is more closely tied to community needs than if the Bank did not partner with the CDFI (a stated goal of CRA policy).

In fact, applying a Majority Requirement to the CDFIs overall operations would interfere with community development, be counterproductive to the CRA's goals, and increase regulatory burdens. It would also reduce community banks' ability to partner with national CDFIs with footprints much larger than those of local and regional banks, thereby increasing credit, vendor, and counterparty risks for the bank. This would reduce our nation's ability to address the problems of America's unbanked and underbanked through CDFI partnerships in any scalable way by requiring CDFIs remain small, local, sub-scale lenders.

Instead, the OCC and FDIC should ensure the final Rule eliminates the Majority Requirement for CDFIs and instead only ensure that a bank's investments have a primary

purpose of community development and/or that the funds be used primarily to finance qualifying activities. The OCC and FDIC should encourage banks to partner with large, well-funded, institutional quality CDFIs that operate on a national scale, including serving underserved borrowers such as the persistently underbanked and unbanked, even when such services may not qualify for CRA credit. The OCC and FDIC should also award a bank CRA credit so long as the bank's funds are directed towards qualifying lending programs and services within the bank's footprint.

The Rule must not require a CDFI to stop making non-CRA-qualifying minority lending in order to attract Bank capital. Applying the Majority Requirement to a CDFI mortgage lender will reduce minority lending focused on addressing the urgent issues impacting African Americans and Native Americans. Ultimately, the final rule should not require CDFIs to forfeit their CDFI certifications and solely act as a CDC in order for a bank to receive credit for entering into the same partnership due to the fact that the Majority Requirement is not applied to CDCs. We do not believe the final Rule should be interpreted in a way that would disfavor CDFIs or lending to minority markets outside a Bank's market.

Therefore, it is important for the OCC and FDIC to clarify that the Majority Requirement is solely related to qualification for the Investment Test so that examination staff understand that misapplication of the Majority Requirement by applying it to pass-through Lending Credit (and in situations like the above) is inconsistent with OCC-FDIC policy and can result in unintended negative consequences.

Very simply, the Rule should adopt a bright line that bank investments and loans to CDFIs qualify for CRA credit.

C. Ensure that banks will receive 2x CRA credit (or innovation treatment for CRA credit based on CDFI partnerships) for their equity investments in CDFIs, including if the CRA credit is calculated using the pass-through lending test credit.

The final Rule should ensure that the 2x credit be applied not just to the amount of capital invested in a CDFI, but to the amount of CRA credit to which a bank is entitled under the pass-through lending test. Therefore, the bank should calculate its CRA credit consistent with current guidance under the pass-through lending test. Then each loan and investment for which the bank is awarded credit should be award double credit. Each loan should be reported as if the loan were made directly by the bank itself and then reported twice to reflect the double credit. Therefore, a small balance loan should receive double credit, not based solely on the dollar amount of the loan, but also on the percentage of small balance loans made by the bank overall and by MSA.

The Rule should ensure that pursuant to the pass-through lending test, a bank can receive lending credit in excess of the amount of its investment in a CDFI if the CDFI (through the use of leverage or otherwise) makes more than $1 of loans each year for each $1 of equity on its balance sheet. Further, this credit will be doubled, with no maximum, based on the double (2x) credit for CDFI equity investments.[20]

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[20] This is consistent with regulatory guidance and incentives which have been in place for at least a decade. See e.g., CRA Investment Handbook, Federal Reserve Bank of San Francisco, March 2010, page 31. "For example, assuming a nonprofit CDFI has "equity" of $2 million—$1 million in the form of permanent capital and $1 million in equity equivalents provided by a commercial bank—the bank's portion of the CDFI's "equity" is 50 percent. Now assume that the CDFI uses this $2 million to borrow $8 million in senior debt. With its $10 million in capital under management, the CDFI makes $7 million in community development loans over a two-year period. In this example,

D. Clarify that banks will receive community development CRA credit under the pass-through lending test for all loans made to underserved borrowers made by a CDFI pursuant to a CDFIs certification by the United States Department of the Treasury's CDFI Fund.

The Rule should clarify that all CDFI-originated loans made to the CDFI's target markets certified by the United States Department of Treasury's CDFI Fund should qualify as CRA-eligible loans pursuant to the pass-through lending test when funded by capital from a bank. CRA regulations have historically provided credit to banks that provide financing to underserved communities which have been designated by a government organization for economic development. For instance, emergency and disaster recovery areas can receive special CRA qualification. Similarly, municipally designated economic development zones can receive unique eligibility for CRA qualification. Congress and the President implemented the CDFI Fund to attempt to expand access to capital to underserved populations who have been systematically left behind by depository institutions.

The FDIC has determined that more than 30 million households and 25% of the American population that are either underbanked or unbanked. This structural flaw in America's economy results in generational poverty in certain low-income communities and communities of color – as well as the existence of perpetual banking deserts. CDFIs are certified by the United States Department of the Treasury to serve specific underserved populations that have been approved by statute as target markets or that qualify based on independent academic research that confirms the existence of a systemic lack of access to capital. Once a CDFI is certified to serve a target market underserved by depository institutions, CDFI loans to these target markets should qualify for CRA community development credit (and not retail test credit, under the pass-through lending test) when financed with bank capital. This should occur even if the loan is a SFR mortgage since CRA credit is received through the bank's partnership with a CDFI.

It is appropriate for banks to leverage the expertise of the United States Department of the Treasury and the U.S. Congress and work with CDFIs to expand access to capital to the underserved communities and borrowers in their assessment areas as certified by the CDFI Fund. The Rule should specifically state that loans made by CDFIs (that are financed with bank capital) to the borrowers in the CDFI's certified target markets are eligible to receive CRA credit under the pass-through lending test.

In addition, loans purchased from CDFIs should receive credit for providing CDFIs liquidity to make new loans. This should occur irrespective of the nature of the loan purchased, as the benefit is to the CDFI, and the CDFI will reinvest that liquidity in new loans that are at least 60% directed toward LMI communities or underbanked Americans. It is unduly burdensome, costly, and counterproductive for the Rule to require CDFIs to keep two sets of books when they partner with banks – one to determine whether a loan qualifies under the CDFIs statutory requirements to serve underserved borrowers, and another to determine whether a loan also qualifies under a bank's regulatory requirements independent from the CDFI's certification by the U.S. Treasury.

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the bank is entitled to claim its pro rata share of loans originated—50 percent or $3.5 million. Its $1 million investment results in $3.5 million in lending credit over two years. This favorable CRA treatment provides another form of "return on investment" for a bank in addition to the financial return. The favorable CRA treatment is a motivating factor for many banks to make an EQ2 investment." [emphasis added].

E. Provide full CRA credit for loans originated to unbanked and underbanked borrowers that are originated by non-bank CDFIs (even if immediately sold to third party investors).

The Proposal includes a provision that CRA-qualifying loans originated for sale may only receive 25% credit if the loan is sold shortly after its origination. This severely discounts the difficulty, expense, and expertise it takes for CDFIs to reach unbanked and underbanked borrowers who are creditworthy. By definition, underbanked and unbanked borrowers are consumers who are being left behind by the 5,000-plus banks in the country and the providers of mainstream credit products. These Americans, when creditworthy borrowers, should be the central benefactors of the CRA.

Innovative partnerships between banks and CDFIs that can increase originations to underbanked and unbanked consumers should not be discounted by the new Rule. While bank loan originations are, by definition, to borrowers who are not unbanked or underbanked, CDFIs primarily lend to the underbanked and unbanked. It may make sense to provide only 25% credit to a bank that originates a loan to a borrower who is "banked" and already has access to the banking system and mainstream credit. The initial origination is not the critical value added. Therefore, we do not argue with the Proposal's implicit judgement that the length of time for which a bank holds the loan on its balance sheet is the best measure of the CRA value to be awarded for the loan.

However, in the case of CDFI lending, the critical value is the origination of a CRA-qualifying loan to an underserved, underbanked (or unbanked) borrower who would otherwise be left out of the banking system. Without the CDFI's relationship and connectivity with the borrower (which traditional banks have been unable to develop), the loan would not otherwise be made, and another generation could pass with a community of minority and/or low-income borrowers passed over by depository institutions.

In this case, it would be inappropriate to base CRA credit on the amount of time for which the loan sits on a CDFIs balance sheet, as the true value added is based on the CDFIs unique ability to originate the loan itself. Instead, the Proposal should be revised to provide banks 100% credit for loans made through CDFIs even if those loans are sold immediately after their origination.

Based on the pass-through lending test, banks should be rewarded with full credit for developing innovative partnerships with CDFIs to increase access to capital to creditworthy borrowers to whom banks are unable to lend directly. This is particularly the case with respect to residential lending given the CFPB's adoption of regulation which prevents banks from utilizing underwriting techniques that CDFIs have proven to be necessary for serving certain underserved, creditworthy populations safely and prudently. For instance, the CFPB has provided certain exemptions to Regulation Z's Appendix Q and Ability-to-Repay Rules for CDFI's with appropriate governance controls. As such, the Rule must recognize the critical role CDFI partnerships play in consumer lending to underserved populations and ensure that new CRA regulations do not impair bank-CDFI partnerships unintentionally.

F. Provide banks credit for all loan purchases from CDFIs that result in providing CDFIs with liquidity to make additional loans.

Given that CDFIs are required to make over 60% of their loans to underbanked borrowers, banks should receive credit independent of the nature of the loans purchased or the use of the specific proceeds by the CDFI. This is the case for two primary reasons:

1. **Primary purpose of community development**: Banks currently receive community development loan consideration and/or CRA lending test consideration if a bank makes a loan directly to a CDFI (or alongside a CDFI through loan participation) on a specific project. Banks can also receive CRA retail lending test consideration for loans purchased from a CDFI. In both cases, this eligibility is due the fact that CDFIs have a *primary purpose of community development*. In other words, the eligibility is based on the understanding that CDFIs are designed to fulfill financing voids in LMI communities, and that when CDFIs are able to do so, this in turn creates mutually beneficial partnerships as banks are typically unable to effectively penetrate areas best suited for CDFIs.

   At the same time, CDFIs often engage in "market rate/general market" financing activities as a means to subsidize their lower-return lending/investments within LMI communities. This is due to the fact that without "market rate" activity, it is nearly impossible for CDFIs to remain financially solvent. As a result, providing community development and broad CRA consideration to all loans/investments purchased from CDFIs would increase bank participation in CDFI loan purchases. **This would in turn allow CDFIs to recapture and recirculate capital into underserved and underbanked communities and households**. This would also allow banks to purchase higher-credit-quality loans originated by CDFIs, thereby offsetting some of the risks typically associated with LMI financing. Overall, this provision would increase the safety and soundness of CDFI loan purchases.

2. **Scarcity of liquidity restricts CDFI's impact:** Currently, most CDFIs face extremely limited options for liquidity as they are unable to meaningfully participate in the secondary market with banks seeking to purchase CDFI loans. As such, most CDFIs must hold their assets until maturity or full repayment. This results in inconsistent financing within LMI communities as CDFIs routinely halt or suspend loan originations until they obtain additional capital. However, CDFIs with access to secondary market participants are able to recapture their initial capital and redeploy it to other borrowers. **If banks had the ability to receive CRA consideration for any CDFI loan, this would exponentially increase access to capital in underserved markets.**

Conclusion

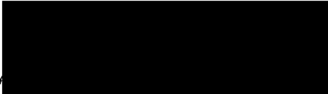
We appreciate your consideration of these Recommendations to refine the Proposal prior to enacting the Rule. We believe it is critical to tailor the Rule to prevent activities that have *de minimus*, negligible, or no community benefit from receiving CRA credit. Since the inception of the CRA, banks have earned CRA credit for an increasing number of CRA activities and, once an activity has become eligible, it has been nearly impossible for the activity to be removed from eligibility.

During this period, America has seen the advent of the internet, the emergence of online trading markets in securities, the proliferation of variable-rate mortgages, the rise of personal computing, and dozens of other innovations that have changed how banking services impact LMI communities. Over the same period of time, however, America has seen almost no progress in reducing the number of unbanked and underbanked. In addition, as a percentage of their respective populations, most communities of color now have less homeownership than ever before.

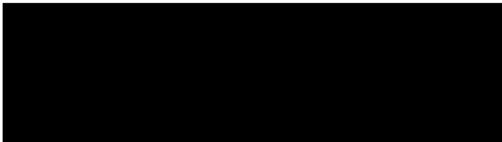
Today, more than 32 million households are underbanked, while America continues to suffer from banking deserts, an inability to provide mainstream credit products to communities of color and LMI populations, and a crisis in affordable housing. It is critical that CRA modernization evaluate not only what should count, but what should not count toward achieving CRA credit.

In our view, only investments and loans made with a primary purpose of community development or that have a discernable positive impact on economic development in an LMI community or for an LMI borrower should be rewarded with CRA credit. By removing large categories of loans (such as those outlined in the Recommendations above) from CRA eligibility, the Rule would provide a more accurate assessment of true CRA activity and ensure that it results in a positive impact in LMI communities. We believe these Recommendations would help to reduce the number of unbanked and underbanked across America and at long last begin to enable the CRA to fulfill its great promise.

Sincerely,



Antonio Villaraigosa
Chairman, Board of Directors



Everett Bell
Chairman, Community Advisory Board

Steven Sugarman
Founder