



RECOMMENDATIONS ON THE COMMUNITY REINVESTMENT ACT TO EXPAND REACH AND IMPACT

October 12, 2017

The National Federation of Community Development Credit Unions (the “Federation”) appreciates the opportunity to share our thoughts on the Treasury Department’s review of the Community Reinvestment Act (CRA).

The Federation promotes the financial independence of working families and communities, expanding access to safe and responsible financial products and services through credit unions. More than 300 credit unions are certified as Community Development Financial Institutions (CDFIs), continuously reinvesting more than \$90 billion in economically vulnerable communities around the country. CDFI credit unions – also known as CDCUs – serve more than 8.5 million members in low-income rural and urban communities across 46 states. As the national trade association and CDFI intermediary committed to building the capacity and expanding the reach of these mission-driven credit unions, we advocate for policies that strengthen the *institutions*, their *members* and the *communities* they serve.

In July of this year, Treasury’s report on the regulatory environment for banks and credit unions included the following Core Principles:

- Empower Americans to make independent financial decisions and informed choices in the marketplace, save for retirement, and build individual wealth;
- Prevent taxpayer-funded bailouts;
- Foster economic growth and vibrant financial markets through more rigorous regulatory impact analysis that addresses systemic risk and market failures, such as moral hazard and information asymmetry;
- Enable American companies to be competitive with foreign firms in domestic and foreign markets;
- Advance American interests in international financial regulatory negotiations and meetings;
- Make regulation efficient, effective, and appropriately tailored; and
- Restore public accountability within Federal financial regulatory agencies and rationalize the Federal financial regulatory framework

In its recommendations on CRA, the report notes “Treasury believes that it is important that banks’ CRA investments better align with the needs of the communities that they serve, are made in a manner that is consistent with a firm’s safety and soundness, and that such investments be subject to efficient and effective supervision.”

The Federation wholeheartedly supports this goal. CDFI credit unions are member-owned not-for-profit financial cooperatives, accountable to the members of the low-income communities they serve. They are regulated and insured depository institutions subject to



supervision and examination by the National Credit Union Administration (NCUA) and state regulatory authorities.¹ As such loans, investments and service activity with CDFI credit unions fulfill Treasury's recommended criteria. The Federation is pleased to share our observations and recommendations to increase the efficiency and expand the impact of CRA for those individuals and communities who need it most.

1. CRA has significant, positive impacts and should be expanded.

Since 1996, CRA-covered banks and thrifts made more than 551,000 community development loans worth \$796 billion. The annual dollar amount of community development loans more than quadrupled between 1996 and 2014, from \$17.7 billion to \$74.6 billion, respectively. These capital investments can have outsized impacts in specific regions; a study by NCRC found that every two years banks issued \$5.8 billion in community development loans and investments in Appalachia alone. This infusion of capital supports affordable housing and economic development projects that benefit low- and moderate-income communities.

A robust CRA does more than just increase the amount of capital that flows into low-income, minority and distressed communities; it also improves the quality of that capital. Specifically, studies have shown that increased CRA assessment area lending by banks (reported under CRA exams) correlates with *decreased* subprime lending in those communities.

In our own work with CDFI credit unions, bank CRA investments in the form of *non-member deposits* and *secondary capital* have leveraged billions of dollars of lending in low-income communities. CDFIs are one of the most effective mechanisms to channel capital into under-resourced communities, and CDFI *credit unions*, structured as financial cooperatives, can ensure that deposits are invested locally and earnings are returned in the form of interest on deposits, better rates on lending and more services offered.

Near-equity secondary capital loans leverage even greater community development impact. As of June 2017, CDFI credit unions had more than \$160 million in secondary capital. While these funds come from many sources, there have been an increasing number of banks making secondary capital loans as part of their CRA lending test. A longitudinal study the Federation conducted on secondary capital investments from the US Treasury during the period 2010-2015 showed that these equity-like loans leveraged **60 times** the amount in new loans made in low-income and distressed communities. CDFI credit unions use secondary capital loans to leverage deposits for community development up to ten times and make that capital available in loans that provide affordable access to credit to consumers, boost entrepreneurship, expand businesses and facilitate homeownership.

And these loans reach people that other financial institutions are simply unable to help. For example, a typical CDCU systematically reaches deep into their market place originating anywhere between 50%-65% of their consumer loans to borrowers with B, C, D and E credit. Our analysis shows that despite these low credit scores at origination these borrowers not only succeed with their credit union loans but migrate up the credit path to higher credit scores and access to larger, longer-term and productive credit such as automobile, home mortgage and small business loans. In other words, CDFI credit unions provide low-income

¹ In recent years NCUA has increased its focus on CDFI credit unions, establishing an MOU with Treasury and the CDFI Fund to promote CDFI certifications and issuing specific Supervisory Letters regarding the examination of CDFI credit unions



consumers with a path to the financial mainstream, where they can qualify for competitive financing from a broader range of institutions – including CRA banks themselves.

2. Regulators can remove uncertainty and increase efficiency by pre-qualifying CRA loans and investments in certified CDFIs

The efficient flow of CRA capital into our nation’s most distressed communities is hampered by delays resulting from examination periods and the ability for banks to determine whether innovative approaches and strategies will qualify for their CRA exams. While guidance has improved over the years, the presumption of eligibility is restricted to a subset of CDFI activities, which burdens banks and regulators alike with the additional steps needed to track, verify, examine and determine eligibility of each of their activities. CDFIs are certified – and annually re-certified – based on seven requirements that include (i) a primary mission of community development; and (ii) delivery of financial products and services to specifically defined CDFI Target Markets. Bank loans and investments in CDFIs for the purpose of further capital deployment in CDFI Target Markets could be pre-approved to be eligible as CRA activities.

While a bank’s direct provision of capital and services can only be fully accounted and tracked after the fact, the Federation recommends that loans and investments in certified CDFIs be presumed eligible for CRA consideration and receive a pre-qualification that such activity will be counted toward a bank’s overall CRA activity. As it currently stands, banks are never certain that activities that diverge from existing practice will be approved as eligible until after the fact. Despite the written intention of CRA that banks be innovative in their approach to serving their assessment areas, the current examination structure offers disincentives to innovation.

3. Assessment Areas should be redefined to qualify all community development activity to certified CDFIs and to Persistent Poverty Counties as eligible under lending, investment and service tests.

CRA Assessment Areas continue to be defined by the location of deposits, even as wholesale banks manage trillions of dollars in assets and business on a national scale yet have a small CRA assessment area. Rural and other non-metropolitan communities have not fared well in the changing US economy. Although rural America accounts for less than 20 percent of the country’s overall population, 85 percent of persistent-poverty counties are outside of metro areas. These distressed rural areas suffer from little to no outside investment.

With more than 200 member institutions in 46 states, the Federation frequently finds those institutions serving some of the most disinvested and hardest to serve communities are doubly challenged by the difficulty in attracting capital from outside their regions to redeploy in their local economies. Because these areas fall outside of most CRA assessment areas, those banks that would most want to provide loans or investments cannot receive CRA credit for their activities and therefore direct capital back to the regions that are more populated with financial institutions and available capital.

New challenges and economic needs present opportunities to evaluate how public policy helps to channel capital. The Federation recommends amending CRA regulations for wholesale financial institutions and those banks whose market are in a significant number of US states



(>30%) be assessed on their community reinvestment activities beyond their immediate footprint. Specifically, we recommend that activity from these financial institutions into persistent poverty counties and through CDFIs serving demonstrated target markets be considered eligible under lending, investment and service tests.

4. The Lending Test should be enhanced to consider all community development loans to CDFIs eligible throughout the life of the loan.

When banks make loans through CDFIs, those loans revolve many times over in their communities. As noted above, secondary capital loans to CDFI credit unions have been shown to leverage 60 times their value in loans. Currently the CRA lending test is only calculated at loan origination. Because the typical CRA examination period is 2.5 years, banks are incentivized to lend at short-terms. Shorter-term capital is less effective and generates less impact on communities. Loans made to CDFIs become even less effective as the CDFI must then deploy the capital and recover the principal in an even shorter period of time.

The Federation recommends that the CRA lending test take into account the greater value and potential impact of longer-term capital in distressed communities. This enhancement will improve efficiency and effectiveness by providing incentives for banks to deploy CRA capital in institutions that will recycle capital and multiply benefits in a series of community development loans.

5. The Investment Test should be strengthened by focusing the presumption of eligibility on certified CDFIs and Minority and Women-Owned Depositories (MWDIs)

The sweeping 1995 revision of CRA regulations established provided the first recognition of CDFIs as eligible for qualified investments and community development loans, on par with minority- and women-owned depositories and low-income credit unions.² The 1995 Final Rule also stipulated that loans, investments and services “must have community development as their primary purpose” in order to be considered eligible. The Federation notes that in 1995 only 2.6% of all credit unions were designated as Limited Income Credit Unions (LICUs) by NCUA, yet by June 2017 fully 44% of all credit unions are LICU designated.³ By contrast, in 1995 the CDFI Fund was just beginning the certification process and no credit unions had yet been certified, yet today, 6% of all credit unions are CDFI certified.⁴ The Federation further notes that while CDFI certification requires a primary purpose of community development, LICU designation does not.

The Federation therefore recommends that the regulations reserve the presumption of eligibility for Minority- and Women-Owned Depositories and certified CDFIs (which includes CDFI credit unions) and remove the preference for low-income credit unions

² Federal Register 22156 (May 4, 1995) Rules and Regulations, 12 CFR, Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Office of Thrift Supervision, Treasury (OTS). Joint final rule.

³ NCUA 5300 Call Report data as of 12/31/1995 and 6/30/2017. 1995 data showed 311 LICUs out of 11,886 active credit unions, while June 2017 data shows 2,535 LICUs out of a total of 5,815 active credit unions.

⁴ The CDFI Fund shows 326 CDFI certified credit unions as of August 31, 2017, a number just slightly larger than the 1995 number of LICUs. <https://www.cdfifund.gov/programs-training/certification/cdfi/Pages/default.aspx>



6. Strengthen the Service Test to increase effective impact in CRA Assessment Areas.

The Federation recommends that CRA service test be more explicit to challenge banks to engage in activities that can demonstrably show increased access to responsible financial services in CRA assessment areas. As it is currently interpreted by CRA examiners, it seems banks are strongly encouraged toward volunteerism as the primary mechanism for meeting this test. While having skilled volunteers is important for all community based organizations that is respectfully a very limited interpretation of the intent of a service test. Banks have access to greater infrastructure than CDFIs or other institutions seeking to reach and serve well low-income consumers and communities.

The ability of banks to get substantial credit for tapping this infrastructure and opening up their platforms, delivery systems and technology to a broader customer base served by CDCUs is a perfect example of innovative approaches to extending service where it is needed.

The Federation recently formed a partnership with Citi who recognized that an important way that they could help expand service to low-income consumers would be to open up their ATM networks surcharge-free to CDCU members and users. The bank decided to move forward with this concept despite not knowing for certain whether examiners would value this contribution. This represents an incredibly efficient and effective form of meeting a CRA service test, and an innovative approach to making the service test meaningful. In another example, Citi and other financial institutions have sought to demonstrate their commitment to the service test through participations in Bank On campaigns offering secure, low-fee (without overdraft) accounts to consumers. This represents another innovative approach to the service test that should be rewarded and encouraged. It is time to make the service test as meaningful and impactful as the other two CRA tests. In order to do so, banks will need more immediate feedback from the regulators that their proposed activities in fact meet the service test.

7. CRA should track both the quality and the quantity of lending and activity under the three tests.

Recent history has demonstrated that not all capital is created equal in terms of its impact on intended communities. During the subprime mortgage crisis, an influx of capital at high cost and in an irresponsible manner was shown to be destructive. Thus, as banks present their CRA plans, examiners should be reviewing not only the amount of lending and other CRA activity in targeted assessment but the quality of the loans, investments and financial services. Data collection efforts under CRA should be concrete and specific not only track the numbers and volume of loans and services to underserved consumers, homeowners and business but also the rates and terms of that activity.

Summary

The Community Reinvestment Act has provided a vehicle for channeling of investment into underserved capital areas for more than 40 years. Like all legislation, there are opportunities to update, refine and adapt to the changing environment. We appreciate the opportunity to share our thoughts on how the role of CDFI credit unions can help to ensure the targeting of CRA activity to maximum impact on the consumers and communities that need it most.