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Bank Partnerships With Community Development Financial Institutions and Benefits of CDFI Certification

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This *Community Developments Fact Sheet* explains how national banks and federal savings associations (collectively, banks) can partner with community development financial institutions (CDFI) to promote economic revitalization and community development. This fact sheet also explains how those partnerships are considered under the Community Reinvestment Act (CRA) and describes how banks can become certified as CDFIs.

What Are Community Development Financial Institutions?

CDFIs are mission-driven financial institutions that create economic opportunity for individuals and small businesses, quality affordable housing, and essential community services throughout the United States. Four types of institutions are included in the definition of a CDFI: community development banks, community development credit unions, community development loan funds (most of which are nonprofit), and community development venture capital funds. Some, but not all, CDFIs are certified by the CDFI Fund.[1]

Certified CDFIs are specialized financial institutions with a primary mission of promoting community development.[2] CDFI Certification is an official designation of the CDFI Fund. CDFI Certification is the U.S. Department of the Treasury's recognition for specialized financial institutions serving low-income communities. Regulated institutions, such as banks and credit unions, and nonregulated institutions, such as nonprofit or for-profit loan funds and

[1] The CDFI Fund, part of the U.S. Department of the Treasury, in part provides financial and technical assistance to community-based financial institutions that provide affordable credit, capital, and financial services to underserved people and communities. Refer to 12 USC 4703.

[2] Refer to the Riegle Community Development and Regulatory Improvement Act (12 USC 4701 et seq., implemented by 12 CFR 1805). Refer to 12 USC 4702(5)(A) for the definition of a "CDFI."

venture capital funds, may be certified as CDFIs.[3]

Why Partner With a CDFI?

CDFIs can help banks reach and serve the needs of underserved populations and communities because they have access to and expertise in serving these populations and geographies, or because they offer customized products that meet unique needs. Banks may partner with CDFIs to deliver lending products that are outside of the banks' risk profile or business model. These may include loans to start-up businesses or community facilities or for uses such as acquisition or predevelopment. CDFIs may be able to offer greater flexibility in loan terms, including high loan-to-value ratios, deferred principal repayments, subordination, and unsecured loans. A CDFI may finance all (through a referral) or a portion (through a loan participation) of a customer's loan request.

Banks may partner with CDFIs to provide educational services, such as business planning, credit counseling, and home-buying classes, to help borrowers use credit effectively.

Banks often partner with CDFIs to implement community revitalization strategies. Many public agencies and philanthropic institutions provide subsidies to CDFIs, which can be an efficient and effective way of addressing community issues. CDFIs blend subsidies with specialized expertise and traditional debt, expanding the scale and impact of those subsidies. Banks are a significant source of lending capital to CDFIs through grants, loans, or equity-equivalent investments, or through participation lending with CDFIs.

CDFIs and CRA Consideration

> The information in this section is consistent with the CRA regulations and "Interagency Questions and Answers Regarding Community Reinvestment."[4]

Certain bank loans, services, and investments in CDFIs may be eligible for CRA consideration if the CDFI's activities promote community development and meet the CRA's geographic requirements. Specifically, banks may receive CRA consideration for qualifying activities located in the bank's assessment area(s) or loans located in a broader statewide or regional area that includes the bank's assessment area(s) that have a purpose, mandate, or function to serve the bank's assessment area. Qualifying activities in a broader statewide or regional area that do not serve the bank's assessment area may also be considered, as long as the bank has been responsive to community development needs and opportunities in its assessment area(s).

The Office of the Comptroller of the Currency (OCC) will consider any information provided by a bank that reasonably demonstrates that the purpose, mandate, or function of the activity meets the CRA definition of community development, and the activity meets the CRA's geographic requirements. Such information could include, for example, a prospectus, loan proposal, community action plan, or other relevant information provided to the bank by the CDFI.

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[3] Refer to 12 CFR 1805.201.

[4] 12 CFR 25 (national banks), 12 CFR 195 (federal savings associations), and 81 Fed. Reg. 48505, "Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment; Guidance."

According to the "Interagency Questions and Answers Regarding Community Reinvestment," there is a presumption that any loan or service to or investment in a CDFI that finances small businesses or small farms promotes economic development, and thereby meets the definition of community development.

Loans to CDFIs

A bank may receive CRA consideration for a loan to a CDFI in different ways, depending on the size of the bank and the loan amount and structure. For CRA purposes, banks are effectively classified into categories, which have somewhat different evaluation standards: large banks, small banks, intermediate small banks, and wholesale and limited purpose banks.

For banks evaluated as large banks, and for small banks other than those that are intermediate small banks, examiners will consider loans to CDFIs that meet the definition of a small business loan under the lending test as a small business loan, even if the loan also has a primary purpose of community development. Loans to CDFIs in amounts greater than $1 million, however, will not meet the small business loan definition and, therefore, may be considered as community development loans if the loans meet the geographic requirements and have a primary purpose of community development.

Under the community development test for wholesale and limited purpose banks, examiners will consider loans that have a primary purpose of community development regardless of the loan amount. Intermediate small banks can elect to have examiners consider any loans with a primary purpose of community development as community development loans, so long as the loans are not otherwise considered as a home mortgage, consumer, small business, or small farm loan.

As discussed previously, banks may receive consideration for community development loans generated by the CDFI if the loans meet the CRA geographic requirements. Specifically, a bank may receive consideration for community development loans, qualified investments, and community development services that benefit the geographies or individuals in the banks' assessment area(s) or, in certain circumstances, the broader statewide or regional area(s) that includes the bank's assessment area(s), as explained previously.

Bank Purchase of CDFI Loans

A bank may receive CRA consideration for purchases of small business, small farm, or home mortgage loans originated by a CDFI to low- or moderate-income borrowers in the bank's assessment area(s). These loans are considered under the retail portion of the lending test for large banks and the lending test for small banks and intermediate small banks.

Qualified Investments in CDFIs

A bank can invest in a certified CDFI through the OCC's public welfare investment authority for national banks and through the general lending and investment authorities and community development-related investment authorities for federal savings associations. Those investments may also be eligible for CRA consideration.

Under the CRA, qualified investments in CDFIs can take a variety of forms, depending on whether the CDFI is a nonprofit or for-profit entity. Qualified investments in nonprofit CDFIs might include deposits,[5] membership shares, equity equivalent investments, and grants. Qualified investments in for-profit CDFIs may include limited partnership interests and stock.

A bank may receive CRA consideration based on either (1) the full amount of its equity or equity-like investment in the CDFI (investment amount approach), or (2) a share of the CDFI's loans and, if applicable, the CDFI's qualified investments (pro rata share approach). The bank's share of the CDFI's loans is based on its equity or equity-like interest in the CDFI. Its share of qualified investments is based on the ratio of the CDFI's qualifying investments to the CDFI's total assets. The following examples illustrate these approaches.

CRA consideration based on investment in the CDFI: Under the investment amount approach, a bank making a $1 million equity or equity-like investment in a CDFI may receive consideration for the $1 million investment under the bank's investment test (large banks) or community development test (intermediate small banks, wholesale banks, and limited purpose banks). Small banks that meet the lending test standards for satisfactory performance may request consideration of qualified investments to achieve an outstanding performance rating.

CRA consideration based on pro rata share of a CDFI's loans and qualified investments: Under the pro rata share approach, a bank may claim consideration for a pro rata share of the CDFI's loans as community development loans under the applicable lending test. The bank's pro rata share is based on its percentage of equity or equity-like interest in the CDFI. For example, if a bank made a $1 million investment in the CDFI that has a total capitalization of $10 million, the bank's percentage of equity or equity-like interest is 10 percent. If the CDFI originated $18 million in loans during the examination period under review, the bank could receive consideration for $1.8 million in community development loans ($18 million x 10 percent = $1.8 million). To receive consideration, the loans generated by the CDFI and claimed by the bank would need to benefit the bank's assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s).

In addition to claiming the pro rata share of the CDFI's loans as community development loans, a bank may also claim a pro rata share of any qualified investments made by the CDFI. If the investing bank opts to have a portion of its equity or equity-like investment evaluated under the lending test by claiming its pro rata share of the CDFI's community development loans, the bank would receive consideration under the investment test for only the amount of its investment multiplied by the percentage of the CDFI's assets that meet the definition of a qualified investment. As in the previous example, if a bank makes a $1 million investment, and qualified investments compose 6 percent of a CDFI's assets, the bank could receive consideration for a qualified investment of $60,000 ($1 million x 6 percent = $60,000) and its share of community development loans ($1.8 million).

Services to CDFIs

Financial services provided to CDFIs, such as technical assistance, are eligible for CRA consideration. Examples of technical assistance to CDFIs include

[5] Community development loan funds do not take deposits, unlike CDFI banks and credit unions.

- developing loan application and underwriting standards.
- serving on the board of directors or on loan review committees.
- developing secondary market vehicles or programs.
- assisting in financial product marketing.
- furnishing financial services training for staff.
- contributing accounting or bookkeeping services.
- assisting in fundraising.

Loan referrals may receive CRA consideration if the bank refers borrowers to a CDFI after the bank reviews the borrowers' eligibility for bank financing and determines that they do not qualify for a loan from the bank.

How Does CDFI Certification Benefit Banks?

Many banks have obtained CDFI certification to access financial and technical assistance from the CDFI Fund through the following programs:

- CDFI Program and Native American CDFI Assistance Program
- Special purpose programs, including the Community Development Capital Initiative and the CDFI Bond Guarantee Program

CDFI certification is also required to access certain benefits under the Bank Enterprise Award Program to support an organization's established community development financing programs.[6]

Additionally, a bank with CDFI certification can register with the CDFI Fund and be automatically designated as a community development entity (CDE). The CDE designation is necessary to access the New Markets Tax Credit Program.[7]

CDFIs are exempt from the Consumer Financial Protection Bureau's ability-to-repay requirements for dwelling-secured transactions if they meet certain other applicable requirements.[8]

Some CDFIs have found that CDFI certification increases their ability to raise capital from other sources, such as banks, foundations, and government agencies at all levels.

Generally, under the regulatory capital rules, investments in entities designated as CDFIs may be exempt from certain deductions and receive more preferential risk-weighting than investments in entities that are not CDFIs.[9]

How Does a Bank Become Certified?

Banks can apply for CDFI certification by submitting a certification application at any time to the CDFI Fund. The application and additional materials can be downloaded from the CDFI Fund website. Generally, an applicant will receive a determination of CDFI certification status within 90 days from the date the application is received.[10]

[6] Refer to 12 CFR 1806.200 and Program Overview.

[7] Refer to 26 USC 45D.

[8] The ability-to-repay requirement is under the Truth in Lending Act (Regulation Z) at 12 CFR 1026.43 (a)(3)(v)(A).

[9] Refer to 12 CFR 3.2.

[10] Refer to Application Guidance.

A certified CDFI must meet the following criteria:[11]

- Be a legal entity.
- Have a primary mission of promoting community development.
- Be a financing entity.
- Provide development services, such as training and technical assistance, that prepare borrowers to access the bank's financial products.
- Principally serve one or more target markets, as defined by the CDFI Fund.
- Be accountable to the target markets served, either through a governing board or advisory board with board members that are representative of the target market, or through other methods, approved by the CDFI Fund, that are incorporated into the applicant's decision-making process.
- Be a nongovernmental entity and not be controlled by a government entity (excluding tribal governments).

Resources

- CDFI Fund
- OCC, *Community Developments Insights*, "Community Development Loan Funds: Partnership Opportunities for Banks"
- OCC's CDFI and Community Development Bank Resource Directory
- OCC's District Community Affairs Officers
- OCC's Public Welfare Investments Resource Directory

[11] Refer to CDFI Certification.