Federation

Credit Unions United to Serve the Underserved

By e-mail: cdfihelp@cdfi.treas.gov

August 12, 2011

Jodie Harris
Policy Specialist
CDFI Fund
U.S. Department of the Treasury
601 13th Street, NW., Suite 200 South
Washington, DC 20005

Re: Comment on CDFI Bond Guarantee Program authorized by the Small Business Jobs Act of 2010 (PL111-240)

Dear Ms. Harris:

The National Federation of Community Development Credit Unions ("Federation") represents more than 230 credit unions that serve predominantly low-income communities throughout the United States. Our member community development credit unions (CDCUs) serve 1.6 million members and in aggregate hold more than $11 billion in community-controlled assets.

Approximately 200 credit unions are currently certified by the CDFI Fund, with dozens more awaiting certification or planning to apply, a number that is certain to increase when the parameters of the CDFI Bond program are fully elaborated.

The CDFI Bond program presents an important opportunity to CDFI credit unions at a time of acute, continuing economic distress with little prospect of early improvement. The program as outlined in the legislation offers the prospect of access to long-term capital at advantageous rates. If it is properly structured and implemented, it has the potential to stabilize and support the growth of a financial sector that specializes in serving low- and moderate-income households that have suffered disproportionately from the recession.

The Federation has been an active participant in the CDFI Bond Policy Group (BPG), which has developed general principles to guide the program, as well as detailed recommendations. Above all, we have argued for flexibility in program design, enabling maximum diversity in financial structures, providers, and uses of the CDFI Bond proceeds by the CDFI field. We support the recommendations of the BPG with the elaborations and clarifications that we have outlined below.

Certain general program parameters are essential if the CDFI Bond Program is CDFI credit unions are to be able to participate fully.

1. Secondary capital must be an eligible use of bond proceeds.

Secondary Capital is long-term, equity-like debt available only to credit unions designated low-income by the National Credit Union Administration (NCUA), the federal regulator for credit unions. It is counted as net worth, subject to terms and conditions defined by NCUA. Credit unions must by regulation have ratios of net worth to total assets of seven-percent (7%) or higher in order to be classified as "well capitalized." Unless they are well capitalized, they are constrained from adding deposits (and therefore, loans), and frequently, from expanding their membership in low- and moderate-income communities.

The Federation has surveyed our membership and held discussions with a task force of interested CDCUs. Our investigations have made it clear that **secondary capital is the most compelling and fruitful use for CDFI Bond proceeds.** Investments of secondary capital enable credit unions not merely to fund loans, but to *leverage* their net worth -- to expand their deposit base and generate loans for the full range of credit needs in underserved communities, including but not limited to housing, microenterprise, working capital for small businesses, education, and other essential needs of their members. We do anticipate that some credit unions would use bond proceeds to match-fund long-term mortgage loans; however, our investigations indicate that the demand for these funds would be narrower than for secondary capital.

There is extensive precedent for secondary-capital investment in CDFI credit unions by the Treasury Department. The CDFI Fund has long made secondary capital loans to CDCUs directly. In 2010, the Treasury Department's Community Development Capital Initiative (CDCI) made $69.9 million in low-cost, long-term secondary capital investments in 48 CDCUs.

In addition, over the last 15 years, the CDFI Fund has made multiple awards to the National Federation of CDCUs as a certified CDFI intermediary in order for the Federation to provide secondary capital to credit unions. This mechanism has enabled the Fund to reach a broader and more diverse group of credit unions, including small ones, than would otherwise have been possible.

We recommend that the CDFI Fund consult as appropriate with NCUA to ensure that secondary capital investments under the CDFI Bond program conform, or can be conformed, to NCUA regulations. NCUA demonstrated great responsiveness in 2010 in working with Treasury to ensure that the CDCI program would allow effective credit union participation.

Finally, we note that our recommendation to explicitly recognize secondary capital as an acceptable use of bond proceeds parallels that of the Community Development Bankers Association. CDBA has called for structuring investments so that they count as Tier 1 capital for community development banks. Secondary capital for credit unions has somewhat different characteristics, but the need and rationale for this use of funds is comparable.

2. The CDFI Bond Program Should Align with Existing CDFI Fund Programs

The CDFI Fund has a 15-year history of funding a variety of CDFIs, delivery channels, and financial products. We recommend that the CDFI Bond program be structured so as to utilize and incorporate all the innovations and flexibility that the Fund has developed over the years. Along with the Community Development Bankers Association, we recommend that the CDFI Bond Program "be consistent in the use of definitions, reporting requirements, and other program implementation features with the CDFI Fund's existing programs."

In particular, we recommend that the program **explicitly recognize the role of CDFI-certified intermediaries**. The $100-million minimum bond size virtually ensures the need for aggregators. Even our largest CDFI credit unions have indicated that they would be highly unlikely to issue their own $100 million bond, so it is critical that an intermediary be able to aggregate on behalf of multiple CDFIs. The Federation, like some of our colleague organizations, is a certified CDFI intermediary with a 30-year history of channeling investments into scores of CDCUs. We believe this experience will be valuable in implementing the CDFI Bond program. The Fund should explicitly recognized that funds invested in CDFIs by an aggregator or intermediary be considered deployed.

3. Maximum Flexibility for Risk-Share Pools is Essential.

The CDFI Bond Program should allow for a variety of structures for the risk-share pool. We expect that various mechanisms will be offered by direct issuers and by intermediaries or aggregators.

- Funding the risk-share pool out of bond proceeds is one model that should be permitted.
- Under another model, participants would pledge collateral in the form of liens on a basket of loans held in their portfolio. The approach suggested by one CDFI credit union is as follows:

> Treasury is encouraged to implement a reserve structure which is similar to the collateralization requirements practiced by the Federal

> Home Loan Bank system. For instance, along with the issuance of secondary capital from a bond fund, a companion instrument could be issued, establishing Treasury's right to receive reserve payments from a credit union. The instrument could collateralize Treasury's interest with a senior, superior lien on specific assets, yet would not require the transfer of cash or assets to Treasury until a certain loss was identified. This alternative would provide Treasury risk mitigation and reduce potential cash flow and yield impediments for a credit union that had received funds from a bond fund.

Where an aggregator issues a bond on behalf of a variety of CDFIs, we recommend that the risk-share pool not require for any case, joint and several liability: that is, if one participant in the aggregated pool does not perform, there should be no recourse other than to that institution's collateral or *pro rata* share of the pool.

The Fund has asked (question 2), "In the event that the CDFI Fund determines that there is a risk of loss to the government for which Congress has not provided an appropriation, what steps should the CDFI Fund take to compensate for this risk?" The Federation supports the position of the Bond Policy Group that a variety of measures should be acceptable, such as "over-collateralization, affirmative covenants, third party guarantees and/or bond insurance" and others. Regarding interest rate increases, we recommend that these *not be applied to the bond issuer*, but rather that the issuer, which may be an aggregator, be permitted to raise interest rates on the end borrower and use the proceeds to fund increased reserves.

Specific Program Design Questions

In general, the Federation supports the recommendations of the CDFI Bond Policy Group. In response to several specific questions posed by the CDFI Fund, by way of elaboration and clarification we offer the following responses.

2 (iv) Should CDFIs be allowed to use bond proceeds to purchase loans from other CDFIs? If so, should the CDFI that sells the loans be required to invest a certain portion of the proceeds from the sale to support additional community development activities?

CDFIs should be allowed to use the proceeds to purchase loans from other CDFIs. This is a particularly important function for CDFI intermediaries, such as the Federation. With the support of the CDFI Fund, we have established a secondary market to purchase affordable mortgages issued by low-income credit unions, thus enabling them to replenish their capital. The CDFI Fund would enable us to greatly expand the scope of this activity. Credit unions generally face regulatory constraints on their ability to originate and hold mortgages in portfolio; with rates currently reaching historic lows, some credit unions would be unable to issue additional loans unless they are able to sell a portion of their current portfolio.

4 (v) Should the CDFI Fund require the issuer to have a minimum net capital (real equity capital) and require a set amount of net capital be held for the term of the bond? If so, what is a reasonable level to require?

The Fund should not require a specific level of minimum net capital. It is essential that the Fund's standards for underwriting issuers be industry-specific and/or institution specific. For example, while non-depository CDFI loan funds may routinely have net-worth (net-asset) ratios of twenty percent, it would be entirely inappropriate to underwrite credit unions to the same standard. Rather, the prevailing statutory and regulatory standards for "adequately" or "well-capitalized" credit unions should be applied. These net-worth standards are 6% and 7% respectively.

6 (e) What specific industry standards for impact measures (businesses financed, units of affordable housing developed, etc.) should the CDFI Fund adopt for evaluating and monitoring loans financed or refinanced with proceeds of the guaranteed notes or bonds?

While financing of businesses and affordable housing are undoubtedly important measures, it is vital that the Fund recognize the critical role that CDFI credit unions play in providing loans to low- and moderate-income households for essential needs, including but not limited to education, work-related expenses, microenterprise, medical emergencies, and access to rental housing, The lack of credit for these basic needs has limited economic recovery. Accordingly, impact measures should include data from CDFI credit unions such as the volume and number of loans made.

We thank you for the opportunity to comment on this important program. Please feel free to contact me by phone (212-809-1481) or e-mail (crosenthal@cdcu.coop).

Sincerely yours,

Clifford Rosenthal

Clifford N. Rosenthal
President and CEO