Progreso Financiero
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August 15, 2011

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

RE: Federal Register, Volume 76, Number 127 – *Community Development Financial Institutions Bond Guarantee Program*

Dear Ms. Harris,

Progreso Financiero ("Progreso") is pleased to respond to your request for public comment on the Community Development Financial Institution Bond Guarantee Program created by the Small Business Jobs Act of 2010. Progreso believes this program will be an important catalyst for CDFI participants in the pursuit of our collective mission to increase access to capital to lower-income and underserved communities by providing a low-cost, stable funding source tailored to the needs of CDFI's and enabling CDFI's to access the public capital markets for the first time.

The need our lower-income communities have for empowering sources of capital, specifically minority communities, is immediate and real. A July 2011 Pew Research Center report found that the recent recession took a far greater toll on black and Latino households, with median wealth falling by 53% and 66% respectively between 2005 and 2009. CDFIs, which by statue and mission are singularly focused on providing access to capital for these underserved communities, have the opportunity to address this problem, but they themselves also need access to stable and reliable sources of capital to re-lend and scale. The CDFI Bond Guarantee Program would be transformational in helping CDFIs do just that: (1) the amount of capital - $5 billion – that could be unlocked to CDFIs, and in turn, to lower-income communities, is significant and exponentially more than has been provisioned in the past, and (2) the program allows CDFIs to tap, for the first time, the public capital markets for loan capital, dramatically changing the landscape of funding opportunities for their loan portfolios and allowing them a chance to scale their operations in a cost-effective way.

As the Department of Treasury begins to formulate regulations for this program, we would like to share our comments and responses to the questions set forth in the Federal Register, Volume 75, Number 127, published on July 1, 2011. We have included these comments in Exhibit A attached hereto.

With six years of experience providing responsible, credit-building loans to lower-income and underserved Latinos, Progreso would also like to share its perspective, based on its own experiences, on the challenges CDFIs face in accessing affordable capital in the pursuit of their important missions.

Progreso Financiero and our Mission

Founded in 2005 by a Latino MBA student from Stanford, James Gutierrez, Progreso is dedicated to the economic advancement of the Latino community and aims to be the financial partner for life to over 20 million lower-income and underserved Latinos. Progreso believes that the key to asset building is building a basic credit score. Since only 3% of its applicants have sufficient credit history and a high score, Progreso's first solution was to design a responsible, transparent and credit building small loan product that helps lower-income Latinos secure funds needed for common emergencies while also building a positive record in the major credit bureaus.

After six years of constant improvements to its core small, unsecured loan offering (average loan of $1,000), Progreso is moving towards its longer term vision of being a full service financial services partner to its clients, which provides products that serve an empowerment and security mission such as life insurance, investment accounts and student loans. In late 2010, Progreso, through a banking partner, introduced an FDIC-insured bank account to accompany its small loan offering and now counts over 70,000 active account holders and $1.5 million of monthly deposits. Progreso's goal is to help Latino families achieve their lifelong aspirations and build economic wealth.

Through multiple sales points located inside supermarkets and at standalone locations within predominantly Latino communities and by hiring sales people from the community, Progreso is able to provide a culturally relevant experience and build long term relationships based on trust with its clients. The company currently serves its clients in 67 locations including 53 locations throughout California, and 14 in Texas, and has grown to over 500 employees (mostly hired from low income communities themselves)

Progreso believes in the moral collateral of its clients and has invested millions of dollars in building an alternative credit scoring system that uses over 1400 attributes, mostly obtained from its application and non-credit bureau sources, to assess creditworthiness in clients who have thin/no credit files or poor credit scores. Progreso believes that as a for-profit company, it will be able to achieve sustainability and therefore have the greatest and most sustainable social impact on a very large underserved population in the U.S. (20 to 25 million persons).

The need for Progreso and other CDFIs has always been great but has only been magnified by the financial crisis and the subsequent regulatory backlash that has had a chilling effect on the availability of financial services to lower-income and under-banked communities across America. Progreso has received strong recognition from regulators and legislators for providing a fair and affordable alternative to sub-prime and payday loans, and it has been certified as a CDFI by the U.S. Treasury. In 2010, in partnership with California Senate Majority Leader Dean Florez, Progreso led a successful effort that was unanimously approved in both Houses, to amend California's 100-year old consumer finance lending law and enable more innovation and competition in providing responsible, credit building small dollar loans to lower-income communities.

Progreso provides small, unsecured loans and FDIC-insured accounts linked to a Visa debit card to help its clients establish and build credit at affordable terms, as well as move them from the cash economy into mainstream banking. Its core loan product has the following characteristics:

- Fully-amortizing installment loan ranging from $250 - $2,500 (~$1,000 on average)
- 6 to 18 months (11 month average) term

- Fixed-rate with an average interest rate of 26% (average APR of 36% including origination fees)
- Fixed bi-weekly/semi-monthly payments with no prepayment penalty
- All payments reported to credit bureaus and credit education is provided to borrowers
- Underwriting policies that validate income and do not put a borrower beyond their means
- Credit education at the point of disbursement and transparent pricing/documentation

Progreso's products provide a responsible, low-cost alternative to sub-prime credit cards and payday loans. These other options are characterized by very high APRs (ranging from 85% - 450%+), and do not offer customers credit education nor, in the case of pay-day loans, the opportunity to establish or repair credit, which enables long-term asset building and the opportunity to graduate to lower-cost financing options. In contrast, Progreso's loans are in-line with the guidelines established by the FDIC in its small dollar program pilot in 2008 and 2009.

Since its founding in 2005, Progreso has originated over 170,000 loans (~12,500 loans last month and over $150 million in new loans estimated for this year alone) comprising nearly 50 fully-seasoned historical monthly origination vintages while sustaining an overall static pool, cumulative loss rate of under 8% during the economic downturn in 2009-2010. Progreso's outstanding loan portfolio is over $75 million and, with the help of the CDFI bond guarantee program, Progreso plans to grow the portfolio to over $400 million by December 2013. Below is a chart showing Progreso's historical monthly loan origination volume.

2009	2010	2011 (YTD)
16,584	68,593	77,953

As described more fully below, Progreso has made significant investments in proprietary loan processing, servicing technology and risk management systems. Progreso has recruited a deep bench of industry veterans, institutional investors, U.S. Hispanic community leaders, Silicon Valley entrepreneurs, and business leaders to help it scale and produce high social and economic impact. Members of Progreso's management team have previous experience at well-respected organizations and companies such as Accion Texas, HSBC, Providian/Washington Mutual, PayPal, Capital One, Fair Isaac, Experian, Visa, Morgan Stanley, Goldman Sachs, First Marblehead, and Bain and Company.

Progreso's Underwriting and Servicing Capabilities

Progreso has developed a unique, proprietary credit-scoring engine and technology platform that allows Progreso to predict risk among applicants having little to no credit history ("thin-file" or "no-file"), and in turn, lend at fair rates and achieve low losses.

Progreso's portfolio has been stress tested by the recent economic downturn in which Progreso's primary market of California was disproportionately impacted. During 2008 and 2009, Progreso's loan loss rates increased by only 30% whereas many banks and credit card companies experienced a 200-

300% increase as compared to historical loss rates. Since 2009, Progreso has been able to reduce loss rates by approximately 30% from pre-downturn levels, resulting in better performance than 2006-2007.

Progreso's strong performance is due to its diligent underwriting and collection practices as well as its robust proprietary IT and operating systems which allow it to effectively and cost-efficiently track, process and manage its portfolio throughout the life of each individual loan. Progreso's collection processes and IT and operating systems were developed by Progreso's risk management team which has over 65 years of experience managing in excess of $25 billion of near- and sub-prime credit card assets.

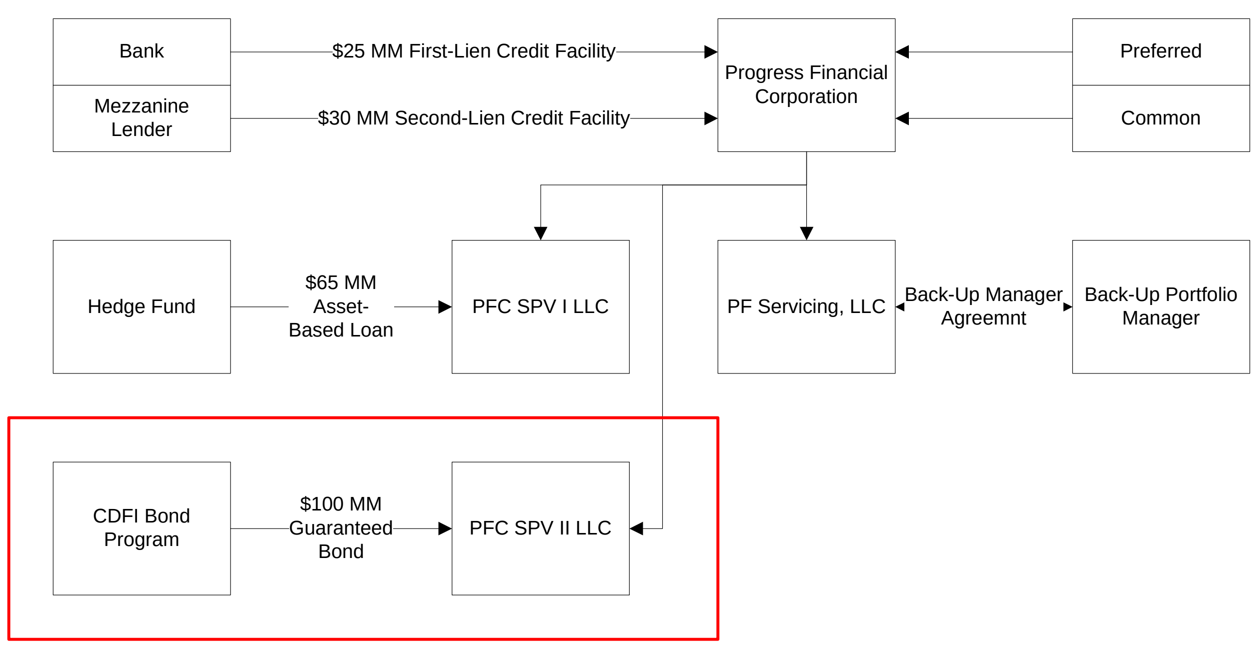
Progreso's Challenges Raising Debt Capital to Fund its Loans

To build its funding capacity for loan origination growth and prepare for capital markets access, Progreso has built a financing team with deep experience (35+ years) in the securitization market for consumer assets (credit cards, mortgages, autos, student loans, etc.), including both issuer and banking (ex-Goldman, Credit Suisse, Wachovia, and Bank of America) experience.

Progreso has three credit facilities totaling $120 million to fund loan growth, including

- a $25 million revolving bank line with Silicon Valley Bank and Bank of America (CDFI lending group),
- a $30 million corporate second-lien loan with a mezzanine debt fund, and
- a $65 million securitized loan to a special purpose vehicle (SPV) with a New York based hedge fund.

The following is a diagram of Progreso's corporate structure including its credit facilities:



For the first four and half years of its development, Progreso had to use equity to fund its operations **and** 100% of its loans. In the beginning, prospective lenders told the company that it had to build up enough history and data in its loan making to attract debt capital. Therefore, Progreso had to convince venture capital investors to use equity capital to grow the operation and its loan making with 0% leverage through 2010. Fortunately, Progreso has been well-capitalized and closed its fourth institutional equity round in January 2011 for $20 million ($74 million in aggregate equity capital raised to date) from major venture capital firms. Progreso is one of the few examples of traditional, private venture capital funding an initiative to reinvigorate low-income Latino families and communities.

Despite strong equity-backing and superior asset performance, Progreso has faced steep challenges in obtaining the debt capital needed to sustain its growth. Funding costs have been high (including mid-teens interest rates on hedge fund debt) primarily because the company is not yet self-sustaining and cash flow positive. High funding costs, in turn, constrain sustainability making it more difficult to produce the margins needed to access bulk warehouse funding opportunities.

Progreso expects to eventually leverage its extensive credit history and data to raise such bulk financing in the form of securitized warehouse loans to an SPV and subsequently access sustainable, lower cost funding in the form of asset-backed bonds issued in the term securitization market. However, with its profitability constrained by high funding costs, Progreso faces challenges in accessing this capital. Additionally, unlike depository institutions who can rely on using deposits to fund their loan making, Progreso always faces the challenge of securing reliable and predictable sources of low-cost loan funding. This was very apparent for all non-depository lenders during and since the financial crisis. Many did not survive and some, like Progreso, barely made it through.

Consequently, the company faces a real challenge in meeting the growing need for economic empowerment and responsible, credit building loans in the Latino community.. Without lower cost and sustainable funding, the company will face difficult decisions in how to sustain its business and meet the expanding needs of its clients.

The CDFI bond guarantee program is timely in that it directly addresses the funding cost and funding availability problem for Progreso and many other CDFIs. The program could provide Progreso with an earlier timeline to accessing public markets where it will have an opportunity to showcase its low losses and the creditworthiness of under-served Latinos in the public domain, and strengthen the credibility of community development finance to institutional investors. With access to public markets, Progreso will be able to achieve its mission and sustainability, fund its rapid growth, and make a larger positive impact on the Latino community.

Conclusion

Progreso appreciates the opportunity to comment on issues regarding the CDFI bond guarantee program. We believe the Program will leverage the ability of a wide range of CDFI's to carry out their social missions with significantly greater scale and efficiency and help expand future access by CDFI participants to mainstream financial markets. We are excited about the opportunities afforded by the program and look forward to working with you on the development of the program.

Thank you for your kind attention.

Sincerely,

James G. Gutierrez
Chief Executive Officer
Progreso Financiero

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High Level Comments

- **Eligibility**: All CDFIs (as per the CDFI certification process) are providing loans that serve low-income and underserved communities. Therefore, all CDFIs should be eligible, regardless of the types of loans they make (e.g., mortgage, real estate/project finance, small business, small dollar credit building, etc.) and the structure, terms and rates of their loans. Our communities already suffer from a severe lack of capital access. Putting additional limitations on those institutions that already provide responsible access would set our lower-income communities even farther back.

- **Structure**: Any entity or subsidiary of a CDFI should be eligible to be an issuer. The preferred structured should be a special purpose subsidiary to which the loans originated by a CDFI are transferred and that issues the debt via the Bonding Program (similar to typical asset backed securitization structures). This structure is important because underwriting by bond investors should be based on the historical performance of the loans made by the CDFIwhich provide the cash flow to repay the bonds (see note on "Underwriting Criteria"). The Bonding Program should allow other structures, but encourage all applicants to evolve to this special purpose/asset backed structure and document in their application what investment they intend to make in their loan performance reporting capacity in order to eventually be able to issue via this preferred structure (see note below regarding "Bridge to Mainstream Financial Market Access").

- **Ensuring the Program's Launch and Full Deployment**: The Program should require a two-step application process and should be on a first serve, first come basis. In order to ensure the public-private appeal of this Program and to contribute to reducing government's spend, the application process should require issuers to seek a third party (i.e., a rating agency or private insurer) evaluation to determine the appropriate risk reserve required above the 3% mandated in the statue. This evaluation should be based on the type (mortgage, small business, unsecured small loans, etc.) and historical loss performance of the underlying assets. Additionally, all applicants should undergo a "means assessment" to determine the appropriate size of the proposed bond issuance. The assessment should be based on historical loan origination volume and the capital plan of each applicant so that the $1B guarantee is allocated appropriately across CDFIs. As low income communities suffer from a continued lack of access to capital, the application process will ensure that $900 million per year or 100% of new lending capacity enabled by this Program is actually deployed in our hardest hit communities.

- **Loan Proceeds Can Be Used to Refinance Existing Debt**: Provided that existing debt being refinanced was used to finance loans that are consistent with the mission and purpose of CDFIs, proceeds from a bond issuance under the Program should be allowed to repay and refinance existing debt. Furthermore, the proceeds used to refinance existing should count towards the requirement that 90% of all bond proceeds be used for making loans that are consistent with the purpose of CDFIs.

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- **Re-Investment of Bond Proceeds**: Because CDFIs may make multiple loans to the same customer over the life of their relationship and because many loan terms are shorter term in nature, proceeds from the repayment of the underlying loans being financed by the bond issuance should be allowed to be reinvested for the term of the bond in new underlying loans (rather than being required to repay the bond). This type of re-investment is typical in the structure finance market and is commonly referred to as a "revolving" structure.

- **Underwriting Criteria**: CDFIs have special experience in underwriting borrowers unique to their markets (e.g., lower-income communities, underserved, etc.). Therefore, there should be no arbitrary underwriting requirements, such as minimum FICO scores of a borrower. Underwriting of a bond issuance should only be based on the historical credit performance of a CDFIs loans. This, however, only works if a CDFI is able to provide and report (with high data integrity) loan level performance of its assets. The application process should request that CDFIs indicate their capabilities or what steps they are taking to improve their capabilities in these areas (see note on "Bridge to Mainstream Financial Market Access" below).

- **90% Use of Proceeds Requirement Should not include Risk Reserve:** Issuers, as defined in the statute, must use 90% of bond proceeds to make loans or refinance existing debt, backed by previously made loans. The calculation of this 90% should be based upon the proceeds net of the risk reserve requirement and not the gross proceeds of the bond issuance.

- **CDFIs Should be Able to Serve as their Own Servicer:** In many cases, CDFIs collect payments directly from their borrowers. They also have other collection practices that are unique to their markets. For these reasons, the Program must allow a CDFI or any of its subsidiaries to act as the primary servicer of its own loans.

- **Bridge to Mainstream Financial Market Access:** While this Program will be transformational, it only lasts for five years. If this Pilot Program is not renewed by Congress, it would be most unfortunate if the participating CDFIs would then suffer from a lack of capital after 5 years of tremendous access. Therefore, this Program must also prepare participating CDFIs to be ready to meet the requirements of mainstream financial market access. For this reason, we strongly recommend that the CDFI Fund, as part of its application, require participants who are not yet ready for mainstream financial market access (without a government guarantee) to take the necessary steps over the Pilot Program's tenure to develop those capabilities, such as loan systems of record that can report loan level asset performance detail with high integrity and provide electronic files of loan payment and credit performance and loan document quality assurance and retention processes that meet the collateral requirements of private sector capital markets.

1. Definitions

(a) Section 114A(a) of the Act provides certain definitions applicable to the CDFI Bond Guarantee Program. In particular, Section 114A(a)(2) of the Act defines eligible community or economic development purpose as any purpose described in section 108(b) [12 U.S.C. 4707(b)] and includes the provision of community or economic development in low-income or underserved rural areas. The CDFI Fund is interested in comments regarding all definitions found in the Act as they relate to the program, including the following:

(i) How should the term ''low income'' be defined as such term is used in Section 114A(a)(2)?

The term "low-income" should be defined as any household whose income is 150% or less of the IRS guidelines for qualification for the Earned Income Tax Credit (EITC) or which reside in a Low-to-Moderate Income (LMI) census tract as designated by the US Census Bureau. A CDFI should be considered to engage in eligible community or economic development if at least 70% of its customers meet this definition.

While the official federal poverty guidelines are used by many federal agencies, not all agencies rely on them. Among these that have developed their own guidelines is the IRS in their requirements for the EITC (Oregon Center for Public Policy, "How We Measure Poverty: A History and Brief Overview", *http://www.ocpp.org/poverty/how.htm*). The EITC has been one of the most effective government programs at reducing poverty -having "lifted an estimated 6.6 million people out of poverty, including 3.3 million children" according to the IRS (*http://www.eitc.irs.gov/central/abouteitc/*). Part of the effectiveness of the EITC is based in definition of "low-income" households whose higher limit recognizes the additional burdens that are placed on working families that have two or more dependent children. (Research Department, Minnesota House of Representatives, "The Federal Earned Income Tax Credit and The Minnesota Working Family Credit", p. 19; www.house.leg.state.mn.us/hrd/pubs/feicwfc.pdf*).*

EITC is, therefore, a more reliable measure of "low-income" for agencies focused on lifting people out of poverty.

(ii) How should the term ''rural areas'' be defined as such term is used in Section 114A(a)(2)? For example, is a rural community any census tract that is not located in a metropolitan statistical area (MSA)? Respondents should discuss how a particular definition would enable the program to target businesses and residents in rural areas, and discuss whether there are particular measures that should not be used because they may inadvertently disadvantage certain populations (i.e., provide examples of particular households or communities that would not qualify under specific definitions).

Rural areas should be defined as all areas categorized as Large Rural, Small Rural, or Isolated areas of the Rural-Urban Commuting Areas (RUCA) codes system, which was developed by the Health Resources and Service Administration's (HRSA's) Office of Rural Health Policy (ORHP), the Department of Agriculture's Economic Research Service (ERS), and the WWAMI Rural Health Research Center (RHRC).

Rural-Urban Commuting Areas (RUCAs) offer a much more exact and refined classification of rural areas than MSAs. MSAs are defined at the county level or higher, whereas RUCAs are defined at the zip code level and "[utilize] the standard Bureau of Census Urbanized Area and Urban Cluster definitions in combination with work commuting information to characterize all of the nation's Census tracts regarding their rural and urban status and relationships." (WWAMI Rural Health Research Center, http://depts.washington.edu/uwruca/).

Especially in western states where counties may be larger than entire states in the eastern U.S., this difference can have a profound impact. For example, California's San Bernadino-Riverside-Ontario MSA (www.calmis.ca.gov/file/maps/msa2003.pdf) has an area of 27,313 square miles – roughly equal in size to the combined areas of New Jersey, New Hampshire, Connecticut, Delaware, and Rhode Island (27,649 square miles combined). Looking at it from the MSA perspective, the entire area is considered non-rural, despite the fact that it is over 90% desert and the eastern-most reaches are more than 100 miles from any population centers. On the other hand, RUCA codes give us a much better picture of the true nature of this area, showing the majority classified as Rural Large, Rural Small, or Isolated Area (http://depts.washington.edu/uwruca/ruca-maps.php).

(iii) How should the term ''underserved'' be defined and/or measured?

We recommend that the CDFI Fund look to the Fund's authorizing statute (Sec. 103) and related regulations regarding "investment areas" and "targeted populations" in defining "underserved." In addition to rural communities, there are many ethnic communities within urban areas and MSAs that have been neglected by mainstream lenders and should be included in the definition of eligible community or economic development purposes.

(iv) Should ''eligible community or economic development purpose'' be defined to allow a CDFI or its designated Qualified Issuer to only invest inside the CDFI Fund Target Market that it was certified to serve?

We recommend that ''eligible community or economic development purpose'' be defined to allow a CDFI or its designated Qualified Issuer to invest inside any Target Market that has been recognized by the CDFI Fund of the U.S. Department of the Treasury, and should not be restricted to the Target Market that a CDFI was certified to serve.

Allowing CDFIs to invest in additional Target Markets that meet the 'low-income' and 'underserved rural' requirements of the CDFI program empowers these institutions to be flexible to market opportunities and to improve the financial opportunities and well-being of more people. Many low-income neighborhoods contain multiple Target Markets made up of distinct races and ethnicities. As CDFIs learn to bring economic opportunity to one Target Market, they become experts at tactics that are applicable to serving other Target Markets. Because of the geographic overlap of Target Markets, it is often possible for CDFIs to use existing infrastructure to serve additional Target Markets. By allowing CDFIs to invest in the additional Target Markets where they have expertise and reach, they can be more effective in responding to new opportunities and the changing demographics and positively impact the lives of the people with whom they come into contact.

2. Use of Funds

(a) The Act defines a loan as any credit instrument that is extended under the CDFI Bond Guarantee Program for any eligible community or economic development purpose. Section 114A(b)of the Act states that the Secretary of the Treasury (the Secretary) shall guarantee payments on bonds or notes issued by a qualified issuer if the proceeds of the bonds or notes are used in accordance with this section to make loans to eligible community development financial institutions (CDFIs)

(1) For eligible community or economic development purposes; or

(2) To refinance loans or notes issued for such purposes.

The CDFI Fund invites and encourages comments and suggestions germane to the criteria and use of funds. The CDFI Fund is particularly interested in comments including the following:

(i) Should there be any limitations on the types of loans that can be financed or refinanced with the bond proceeds? Are there any uses of bond or note proceeds that should be excluded or deemed ineligible regardless of the fact that the use was in a low income or underserved rural area?

The CDFI certification process already includes a robust process for evaluating organizations against the eligibility criteria, specifically having a mission to extend access to capital and economic development among low-income and underserved communities. CDFIs address the problem of economic disenfranchisement using different approaches, products and organizational structures. It follows that limiting the type of loans that can be financed or refinanced with bond proceeds would negatively impact the scale and scope of the work of the CDFI community, which is already challenged to meet the need of millions, much less thousands. As long as the use of funds meet the required definitions of low income, underserved geographic areas, or underserved ethnic communities the loans should be allowed.

When looking at the use patterns of loans, it's relevant to note that people of low income have a multitude of financial needs, many of which cannot be anticipated. Among our borrowers, we've found that many use their consumer loans to fund small side businesses, which grow into full-time small businesses with the help of consecutive loans. We also see plenty of cases where customers with small businesses end up using their loans to address personal needs, such as health issues or car repairs. Ultimately, our goal as a CDFI is to provide our borrowers with responsibly-constructed, fairly priced, credit building loans that can be paid back in a timely fashion, not to micromanage the use of the loan proceeds. Borrowers are best positioned to judge how their loan funds should be used. To do otherwise would threaten to sink them further into poverty.

This has also been observed in low-income populations outside the US. Jonathan Murdoch writes in his article "Banking Low-Income Populations: Perspectives from South Africa" that was included in Michael Barr and Rebecca Blank's book, "Insufficient Funds: Savings, Assets, Credit and Banking Among Low-Income Households", published in 2009, that

> *"Even for those households with ongoing businesses, when we asked how they would use a capital loan, most said that they would use additional funds for their personal needs, rather than to expand their business… However, when looking into the lives of Financial Diaries households, we found that this distinction was often difficult to make. Installment credit was often used to buy school uniforms, which are necessary for children to attend school. Similarly, a savings club loan may be taken to pay for a funeral. Or credit at the local store may be taken to buy food. This reality does not mesh easily with the distinction between productive and consumption debt. If the lack of a school uniform would have prevented school attendance then it is difficult not to see this debt as productive—though it would not generate a short-term cash flow to service the loan. The key issue for success in repaying loans is having a sufficiently steady cash flow to service debt, whatever its purpose."*

Finally, Michael Barr himself testified in front of the House Financial Services Committee in March 2010 on "Community Development Financial Institutions (CDFIs): Their Unique Role and Challenges Serving Lower-Income, Underserved and Minority Communities". In that testimony he stressed the good work that CDFIs are doing in their communities in their varying ways:

> *"CDFIs are able to reach low-income populations that have often traditionally lacked access to mainstream lenders. CDFIs also help bring mainstream financial institutions to these markets, for example through participating in loans with, or co-investing with, mainstream lenders. In this way, CDFIs serve as a bridge to the financial mainstream for their borrowers. CDFIs have helped finance small businesses, build charter schools, create homeownership opportunities, and support community health and child care centers. In short, CDFIs help finance our communities and revitalize our neighborhoods."*

Limiting the types of loan products that can be financed or refinanced with the bond could unintentionally constrain this progress and innovation.

(ii) Should the capitalization of: (1) Revolving loan funds; (2) credit enhancement of investments made by CDFIs and/or others; or (3) loan loss reserves, debt service reserves, and/or sinking funds in support of a Federally guaranteed bond, be included as eligible purposes?

Yes, so long as the use of such proceeds is to provide for community or economic development in low-income areas, underserved rural areas, or underserved ethnic communities.

(iii) Should there be any limits on the percentage of loans or notes refinanced with the bond proceeds? If so, what should they be?

Many CDFI's, such as Progreso, have been forced to use more expensive sources of funds to finance loans that would qualify for the CDFI bond Guarantee Program. Allowing for the refinancing of such higher cost financings of qualifying loans through the bond program will enable CDFIs to lower their cost of funds and free up much needed capital, allowing CDFI's to serve the needs of more of the underserved. So long as the original purpose of the loans or notes refinanced with bond proceeds was to provide for community or economic development in low-income areas, underserved rural areas, or underserved ethnic communities, there should not be any limits on the percentage of loans or notes refinanced with bond proceeds.

(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?

Yes. So long as the purpose of the loans purchased from other CDFI's was to provide for community or economic development in low-income areas, underserved rural areas, or underserved ethnic communities, CDFI's should be allowed to use bond proceeds to purchase such loans from other CDFI's. This will make it easier for smaller CDFI's who might not ordinarily be able to participate in the bond program to gain access to these funds. This is similar to the arrangement that Citibank has with Accion Texas, whereby the bank purchases loans made by Accion. By allowing loans purchased from other CDFI's to be eligible collateral, larger CDFI's could become liquidity providers for smaller CDFI's, as Citibank is for Accion.

The CDFI selling the loans should be required to invest 90% of the proceeds from the sale to support additional community development activities, consistent with the percentage of bond proceeds that the CDFI Bond Guarantee Program requires CDFIs issuing guaranteed bonds to use to support such activities.

(v) Should the CDFI Fund place additional restrictions on the awardees' loan products, such as a cap on the interest rate, fees and/or late payment penalties or on the marketing and disclosure standards for the products? If so, what are the appropriate restrictions?

The CDFI certification process already includes a robust process for evaluating organizations against the eligibility criteria, specifically having a mission to extend access to capital and economic development among low-income and underserved communities. CDFIs are also a diverse set and range in size and approach when addressing the unique needs of their target markets. Placing additional restrictions on loan products, such as caps on interest rate, fees, and late penalties, risks applying a one-size-fits-all approach that could limit the program's reach and success. Consider, for instance, the difference between providing a $250,000 mortgage and a small loan of $500. Both products help low-income borrowers meet a need and the process, infrastructure and operations required to fulfill the need are similar. Yet, the costs are not proportional to the size of the loan and therefore result in large differences in interest rates needed to cover the costs. Since a one-size-fits-all approach does not work for all loan types, one would have to evaluate interest, fees and late fees based on what is most commonly available in lower-income communities. In the area of small dollar loans, for example, this would mean comparing to payday loans.

While restrictions should not be placed, loans made by CDFIs should follow responsible lending guidelines, namely:

1. Part of the underwriting should include an affordability test.
2. All costs of the loan should be clearly communicated in easy-to-understand language.
3. Loan documents and disclosures should be provided in the language of the borrower.
4. Payments should be predictable for easy budgeting.
5. Credit education should be provided as part of the loan experience.

(b) Section 114A(c)(1) states that a capital distribution plan meets the requirements of the subsection if not less than 90 percent of the principal amount of guaranteed bonds or notes (other than the cost of issuance fee) are used to make loans for any eligible community or economic development purpose, measured annually, beginning at the end of the one-year period beginning on the issuance date of such guaranteed bonds or notes. The CDFI Fund welcomes comments regarding this provision, specifically regarding what penalties the CDFI Fund should impose if an issuer is out of compliance.

For the purposes of calculating what percentage of proceeds have been used to make loans for an eligible community or economic development purpose, the sum of (a) the proceeds used to make such loans and (b) the proceeds used to fund the required risk reserve should be divided by the gross proceeds of the bond issuance net of the cost of issuance.

In the event, upon the one-year anniversary of a bond issuance, less than 90% of the bond proceeds have been used to make loans or fund the required risk reserve, the amount of such shortfall should be required to be returned to bondholders as a payment of principal. It will be important that CDFI's applying to issue bonds under the program, accurately estimate that amount of loans they will be able to disburse (see 2(d)(i)b), so that bondholders do not receive large prepayments from the release of unused funds. If investors do not have confidence that the proceeds from their bonds will be put to work to make loans, they will require higher interest rates from CDFI's to compensate for the perceived prepayment risk. For this reason, we would also propose that any CDFI that prepays more than 5% of the bond proceeds raised due to the inability to lend such funds should be prohibited from participating in further bond offerings for one-year. It's important that the funds made available under the program reach the underserved, and to that end CDFI's need to only ask for funds that they have confidence they can put to work making loans.

It will also be important for the integrity of the bond program, that the CDFI Fund, as the guarantor, is able to enforce compliance of the use of proceeds. In the event that a CDFI does not apply such unused funds to prepay the bonds, the CDFI Fund, as the guarantor of the bonds and per the terms of the guarantee, should have the right to recoup such shortfall amount from the CDFI that issued the bonds. The CDFI Fund could then take legal action to enforce such contractual claim. In this situation, the principal amount of the bonds has not been reduced but the bonds remain 100% guaranteed, so the bondholder should be indifferent and confidence in the bond program will be maintained. To the extent that the CDFI pays the shortfall amount to the bondholders after one year, then its obligation shall be satisfied per the guarantee contract and the CDFI Fund, as guarantor, shall have no further claim on the CDFI. However, as a penalty for noncompliance, the CDFI should be precluded from further participation in such CDFI Bond Guarantee Program for 3 years. In the event that the CDFI Fund recovers amounts through the legal enforcement of its claim upon the CDFI, the CDFI Fund shall apply such proceeds to pay principal on the bonds. While no one likes to contemplate the necessity of such provisions, in order for the program to have integrity in the eyes of the investor community, such enforcement provisions will need to exist in order to ensure the program operates as planned.

(c) Section 114A(c)(2) states that not more than 10 percent of the principal amount of guaranteed bonds or notes –, multiplied by an amount equal to the outstanding principal balance of issued notes or bonds, minus the risk-share pool amount—may be held in a relending account and may be available for new eligible community or economic development purposes.

(i) How should the CDFI Fund define ''relending'' account as stated in Section 114A(c)(2)? How should it differ from the loans made under Section 114(c)(1)?

The "relending" account does not need to be a segregated bank account but can be a subaccount of the CDFI's existing bank account, so long as the CDFI accurately tracks the amount of such collections on the underlying loans that have been collected to be relent and the amount of such relending.

There should not be any difference in the requirements for loans made from "relending" account proceeds versus the loans funded directly out of bond proceeds.

We believe that the "relending" account should be able to be recycled, such that loan cash flows not required to pay the servicing fee to the servicer and debt service to bondholders can be deposited in the relending account to make new loans rather than applied to pay principal on the bonds. We interpret the 10% limitation to mean that in the event that the amount on deposit in the relending account on a scheduled bond payment date exceeds 10% of the bond proceeds, then those excess funds need to be applied to pay principal on the bonds. The ability to relend and revolve the relending account is important because many CDFI's are relationship lenders, not merely executing a single transaction with their customers but rather making a series of loans to or refinancing loans for the same customers over a period of time. The ability for the relending account to be recycled will allow CDFIs to continue to serve their customers' needs. The only restrictions on such a recycling should be as committed to by the CDFI per the terms of the bond and that in no event will the reinvestment of collections in new underlying loans cause the maturity of the bonds to exceed 30 years.

(ii) If the capitalization of revolving loan funds is deemed an allowable use of funds under Section 114A(a)(4), what activities would be eligible under the relending account?

The relending account should be used to make additional loans either to existing or new CDFI customers, so long as such loans provide for community or economic development in low-income areas, underserved rural areas, or underserved ethnic communities.

(iii) If additional reserves are held, should they be permitted to be funded from the relending account?

Any additional reserves required should be set aside from the proceeds of the bonds at the time of issuance. The remaining proceeds should be able to be deposited into a relending account to be lent and relent per the terms of the bond issuance and consistent with the Program.

(iv) Should a sinking fund, or any other reserve to allow for the payment of debt service, be permitted to be funded from the relending account?

Yes. Deposits to sinking funds and debt service payments should be allowed to be funded from the relending account. Depending upon the cash flow characteristics of the underlying loans (e.g., delayed payments of interest or principal such as is common for construction loans or education loans), allowing the use of relending account funds to cover debt service will expand the variety of underlying loans that can made through the bond program.

(d) Section 114A(d) states that each qualified issuer shall, during the term of a guarantee provided under the CDFI Bond Guarantee Program, establish a risk-share pool, capitalized by contributions from eligible community development financial institution participants, of an amount equal to three percent of the guaranteed amount outstanding on the subject notes and bonds.

(i) 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?

a. Should the interest rate on the bonds be increased?

Rather than increase the interest rate on the bonds, it would be more beneficial for the CDFI Fund to require excess cash flows remaining on the underlying loans after the payment of the servicing fee to the servicer and interest due to the bond holders to be deposited into the risk reserve account, until such time as the amount on deposit in the risk reserve account is sufficient to cover the expected losses as determined at such time.

See (b) below for a discussion of how the risk reserve should be sized.

b. Should a larger risk-share pool be required?

We recommend a two part application process. The first part should involve a "means assessment" focused on (a) accurately estimating the dollar amount of loans a CDFI will be able to disburse in the following year from the date of the bond issuance and (b) assessing the underlying qualifications and capabilities of the CDFI applicant in meeting such estimate (and bond request). Once the appropriate capital amount is determined and approved, a CDFI would be approved for part two of the application, which would focus on "risk assessment" where the appropriate of risk sharing reserve would be determined.

Part two of the application would require applicants to seek a third party (e.g., a rating agency or insurance company), as approved by the government, to determine the appropriate risk sharing reserve (as a percentage of the bond issuance), given the historical performance of the applicant's loan assets, beyond the 3% mandated by law, in order to mitigate any additional risk incurred by the US government which would act as a guarantor of the issuance. Any additional risk sharing beyond the 3% in the statute, as determined by the third party, would be funded via proceeds from the bond issuance, and be required as part of the issuance to receive the government's guarantee.

Issuing CDFIs should have to post a minimum risk sharing reserve of 3% per the statute or such greater amount as an independent assessment of the risk of loss indicates (part two of the application process). This amount must be funded at the time of bond issuance and should be allowed to be funded out of bond proceeds.

As discussed above in (a), excess cash flows remaining on the underlying loans after the payment of the servicing fee to the servicer and interest due to the bond holders should be deposited into the risk reserve account, until such time as the amount on deposit in the risk reserve account is sufficient to cover the expected losses as determined at such time. At its option, CDFI may provide a third-party assessment of the remaining expected losses on an annual basis and adjust the risk reserve as described above.

c. Should the CDFI Fund require restrictions, covenants and conditions (e.g., net asset ratio requirement, first loss requirements, first lien position; over-collateralization, replacement of troubled loans)?

In general, covenants and restrictions should be limited to only those most essential to ensuring repayment of the bonds, so as not to allow undue complexity to limit participation by CDFIs and make the bond structures too complex for investors. The main focus should be on adequacy of collateral and cash flow to meet debt service requirements, security in the assets financed, and adherence to program guidelines. We would recommend the following basic covenants requirements:

- The CDFI should grant the bondholders a first-lien on the underlying loans being financed and should covenant to take all necessary actions to maintain such lien. Through the guarantee agreement, the guarantor should have a second-lien on the underlying loans to allow them to recoup guarantee payments in the event that the guarantee was drawn upon to cover debt service.
- If the risk reserve is sized to cover the expected losses of the loans, it will not be necessary to have an additional net asset ratio requirement. The only requirement should be to maintain a sufficient risk reserve as described above.
- So long as the risk reserve is adequately funded, it should not be required that CDFIs replace troubled loans. The reserve was created to cover losses on such troubled loans in the first place. CDFIs should have the option of replacing troubled loans, however, allowing them to take action to strengthen their bond issuance if necessary.
- Excess spread (measured as the yield on the underlying loans less the cost of servicing, cost of funds, and net losses) should be required to be greater than zero. If the excess spread becomes less than zero, then the cash flows of the underlying assets are no longer sufficient to support the bond offering. Upon such a trigger event, all cash flows collected on the underlying loans remaining after payment of servicing and interest should be directed to repay bond principal to reduce the risk that the guarantee is drawn upon. If

the bond has reinvestment features, reinvestment should be halted upon such a trigger event occurring, so that cash collections can be directed to repay the bonds rather than be reinvested in new loans.

(ii) How should the CDFI Fund assess and compensate for different levels of risk among diverse proposals without unduly restricting the flexible use of funds for a range of community development purposes? For example:

a. Should the CDFI Fund take into account the participation of a risk sharing partner? What should be the parameters of any such risk-sharing?

The CDFI Fund should take into account the participation of a risk sharing partner. However, since giving credit to the risk sharing partner exchanges the credit risk of the underlying loans for the counterparty risk of the risk sharing partner, the amount of credit given should depend upon the rating of the risk sharing partner. We would recommend that the amount of such risk sharing partners loss coverage be multiplied by 0%, 50%, 70%, 85% and 100% for counterparties rated less than BBB, BBB, A, AA, and AAA, respectively based upon the highest rating they have from at least one nationally recognized statistical rating agency. This adjusted risk sharing coverage amount should be factored in sizing the risk sharing reserve amount. In the event that the risk sharing partner's rating changes, that should be considered in the annual recalculation of the required risk sharing reserve amount.

b. Should the Fund take into account an independent, third-party credit rating from a major rating agency?

As described above, we recommend allowing the rating agencies or insurance companies to be considered as third-party experts for the purposes of certifying the expected loss on the underlying assets in order to calculate the required risk reserve. Rating agency ratings should also be taken into account in calculating the amount of credit to give to risk sharing from a risk sharing partner. Because of the government guarantee, we do not think it will be necessary for the rating agencies to provide ratings on the bonds.

(iii) Are there restrictions, covenants, conditions or other measures the CDFI Fund should not impose? Please provide specific examples, if possible.

In order to ensure that the bond program is available to the broadest number of eligible participants and can be used by them to serve the greatest number of people, subject to the eligibility requirements, there should not be any arbitrary restrictions, covenants or conditions. So long as the use of proceeds is consistent with providing for community or economic development in low-income areas, underserved rural areas, or underserved ethnic communities, and there are basic covenants and conditions to ensure that in the expected case the bonds should be able to be repaid, additional restrictions should not be necessary.

(iv) Should the qualified issuer be allowed to set aside the three percent from the bond proceeds or should these funds be separate from the proceeds?

The required amount of risk sharing reserve should be allowed to be funded from the bond proceeds.

<u>3. Guarantee Provisions</u>

(a) Section 114A(a)(3) defines a guarantee as a written agreement between the Secretary and a qualified issuer (or trustee) pursuant to which the Secretary ensures repayment of the verifiable losses of principal, interest, and call premium, if any, on notes or bonds issued by a qualified issuer to finance or refinance loans to eligible CDFI. The CDFI Fund invites and encourages comments and suggestions relating to the guarantee provisions, especially:

(i) How should the CDFI Fund define and determine ''verifiable losses of principal, interest, and call premium''?

It will be important for developing investor confidence in the program, that guarantee payments be made timely such that in the event of a guarantee payment investors receive their cash flows (i.e., interest and principal) at the same time as they would if no guarantee payment were to be due. If guarantee payments are made only on a delayed basis, then investors will charge a premium for such risk, increasing the cost of funds to the CDFI issuers of the bonds.

The guarantee should insure the payment of interest, principal and call premium when due per the terms of the bonds. The CDFI issuing the bond should be required to complete a bond payment report 10 business days prior to the date of any required payment of interest, principal or call premium on the bonds and submit such report to the guarantor. The report should specify the sources and uses of cash flow and indicate the need for any guarantee payments. The cash flows on the asset should be certified by the servicer per their reports, which should be included as support for the bond payment report. Per the terms of the guarantee agreement between the CDFI and the guarantor, the guarantor should have the right to perform diligence on any CDFI for which a guarantee payment has been made, at the CDFI's expense, to verify the proper application of funds.

(ii) Should the CDFI Fund permit a call upon the guarantee at any point prior to the issuer liquidating the available assets? If so, under what condition should a call on the guarantee be permitted?

In order to ensure the broadest possible acceptance of the guarantee and the lowest possible cost of funds for the CDFI's, the guarantee should be able to be drawn upon for timely payment of interest and principal when due. To instead restrict guarantee payments to only be able to be made until after the underlying assets have been sold, will make the bonds less attractive since they will not ensure timely payment of interest at all times, and thus investors would require additional yield to compensate for this risk. While interest must always be paid timely, the timing of the payment of principal can be delayed until funds are available (such as after the sale of the underlying collateral), and the CDFI Fund should require principal to be payable only to the extent of funds available. The only exception to this is that the guarantee should be able to be drawn upon at the final maturity of the bonds. In the event that the guarantee is drawn upon before the assets are sold, the guarantee agreement should specify that the proceeds of such asset sale be directed to the guarantor (as second lienholder in the assets) to refund guarantee payments made.

(b) Section 114A(e)(1) indicates that the Treasury guarantee shall be for the full amount of a bond or note, including the amount of principal, interest, and call premiums not to exceed 30 years. The Treasury may not guarantee any amount less than $100 million per issuance.

(i) Should the CDFI Fund set specific guidelines or prohibitions for the structure of the bond (e.g., callable, convertible, zero-coupon)?

So long as the cash flows of the underlying loans being funded can support the repayment terms of the bonds, undue restrictions should not be applied.

- The bonds should be allowed to be callable by the issuer, but only to the extent that the issuer has the proceeds available for repayment; meeting a call maturity should not be an obligation of a guarantor. It's important to note that investors will charge more interest for the risk of the bonds being callable, so while callable structures should be allowed, CDFI's issuing callable bonds should consider the costs carefully.
- Zero-coupon structures should be allowed as they can help better match asset cash flows to liability cash flows for certain types of loans, such as construction and student loans, that have delayed payment or interest accrual features.
- With respect to "convertible" structures, it is not clear to us into what security a CDFI would want to convert a bond. For this reason, we recommend that convertible structures not be allowed.

(ii) Should bonds that are used to fund certain asset classes be required to have specific terms or conditions? Should riskier asset classes or borrowers require additional enhancements?

Because of the diversity and uniqueness of CDFI lending programs, there should not be specific terms or conditions specified by asset class. Rather the only requirements should be that the projected expected case cash flows on the assets be sufficient to repay the bonds per their terms; the CDFI should have to provide such a projection as part of the application process. With respect to the comparative riskiness of various asset classes, our proposal that the risk reserve be sized specifically for each transaction addresses the potential variability in the risk of loss. The sizing of the risk reserve will take into consideration the historical performance of the CDFI's loans and will also consider the performance of comparable asset classes.

(c) Section 114A(e)(2) states limitations on the guarantees.

(1) The Secretary shall issue not more than 10 guarantees in any calendar year under the program.

(2) The Secretary may not guarantee any amount under the program equal to less than $100 million but the total of all such guarantees in any fiscal year may not exceed $1 billion.

(i) Can qualified issuers apply for multiple issuances? Should there be a limit per qualified issuer? If so, what should that limit be?

Yes, provided that applicants complete the two-part application process each time. As described in Section 2(d)(i)b, we recommend that the CDFI Fund develop a two-step application process. In the first step, CDFI's submit an application that details the proposed financing and use of funds ("means assessment"). Based upon the requested amounts and the ability of the CDFI's to substantiate in the application their ability to put the funds to work to make loans, the CDFI Fund will then allocate available proceeds to applicants. As the second phase of the application process, CDFI's with allocated bonding capacity would complete a "risk assessment" process.

<u>**4. Eligible Entities**</u>

(a) Section 114A(a)(1) defines an eligible entity as a CDFI (as described in section 1805.201 of title 12, Code of Federal Regulations, or any successor thereto) certified by the Secretary that has applied to a qualified issuer for, or that has been granted by a qualified issuer, a loan under the program. The CDFI Fund welcomes comments on issues relating to eligible entities, particularly with respect to the following questions:

(i) Should the CDFI Fund require one qualified issuer (or appointed trustee) for all bonds and notes issued under the program?

The Fund should not require one qualified issuer (or appointed trustee) for all bonds and notes issued under the program because doing so would prevent multiple CDFIs (or their designates) from becoming direct issuers.

To be clear, CDFIs or any of their wholly owned subsidiaries ("designates") should be eligible to be an issuer under the Program.

(ii) Should the CDFI Fund permit an entity not yet certified as a CDFI to apply for CDFI certification simultaneous with submission of a capital distribution plan?

No. The demand by existing CDFIs for flexible, low cost financing is vast. Therefore, only existing CDFIs (and their SPE-designates) should be eligible to apply for participation in the CBGP. Application for CDFI certification should be a separate process. Once certified, a CDFI should be able to apply to the CBGP to be evaluated for eligibility for the guarantee.

(iii) Should the CDFI Fund allow all existing CDFIs to apply, or should there be minimum eligibility criteria?

The CDFI Fund should allow all existing CDFIs (or their designates) to apply solely on the basis of being CDFI certified in good standing, without additional minimum eligibility criteria. Applicants should then be evaluated for participation in the CBGP subject to the requirements described in comment 3(c)(i) above.

A multi-faceted problem deserves a multi-faceted solution. The goal extending access to capital and economic development to low-income, rural underserved, and underserved ethnic communities cannot be reached by any single method or agent, but rather requires a large assortment of agencies employing their varied expertise to target the many sources and faces of poverty and economic disenfranchisement. All existing CDFIs have already been certified to this goal and have demonstrated an ability to improve the economic possibilities of low-income, underserved rural, and underserved ethnic populations. Limiting the type of CDFIs that can access these funds will constrain our ability as a country to address this problem, and will limit the number of hard-working people who gain access to the capital and economic opportunities that they desire and deserve.

(iv) The Act states that a qualified issuer should have ''appropriate expertise, capacity, and experience, or otherwise be qualified to make loans for eligible community or economic development purposes.'' How should the CDFI Fund determine that a qualified issuer meets these requirements?

Qualified bond issuers should demonstrate a significant and sustained track record of investing in and supporting economic development in low-income, rural underserved and underserved ethnic communities. At a minimum, a qualified issuer should be a certified CDFI (or its designate) in good standing and can be for-profit or non-profit. It should also meet the eligibility requirements described in comment 3(c)(i) above.

With respect to asset-backed bond structures, CBGP eligibility requirements should apply to the CDFIs that are originating (and likely servicing) the loans that are transferred to the designated SPE. CDFIs originating loans that are part of this structure should demonstrate the organizational capacity to execute an asset-backed bond, e.g. the ability to originate loans in the time period proposed, to underwrite loans with proven credit performance, and to have the appropriate systems in place to service their loans after origination. In addition, the issuer/aggregator CDFI (or its designate) must show that they are experienced (or can partner with experienced entities) in asset-based financings and in managing portfolios successfully.

(v) What penalties should be imposed in the event that a CDFI participating in the program ceases to be a certified CDFI? What remedies and cure periods should the CDFI Fund allow in the event of a lapse in CDFI certification?

CDFIs that lose their certification while participating in an asset-backed bond issue should lose their eligibility for participation in the CBGP if not re-certified within 12 months. Pooled asset-backed bond structures should allow for the replacement of CDFIs that lose their eligibility for the CBGP.

(b) Section 114A(a)(5) defines a master servicer as an entity approved by the Secretary in accordance with subparagraph (B) to oversee the activities of servicers, as provided in subsection (f)(4).

(i) Should the CDFI Fund require one servicer for all bonds and notes issued under the program?

No, the CDFI Fund should not require only one servicer, but rather allow individual CDFIs to service their own loans.

(ii) Should the CDFI Fund require the master servicer and servicers to have a track record of providing similar services? How should the CDFI Fund evaluate the capabilities of prospective servicers and master servicers?

Yes, servicers should be able to show a successful track record of managing a portfolio of loan assets with respect to the duties in 114.A(f)(3). Master servicers should be required only for bond issuances with multiple servicers and should have a successful track record with respect to the definitions and duties in 114(a)(5) and 114(f)(4).

(iii) Should the CDFI Fund pre-qualify servicers and make those groups known to CDFIs wishing to submit a capital distribution plan for consideration?

CDFIs that originate loans financed with guaranteed bond proceeds are best positioned to service their own loans. Therefore, it is not necessary to prequalify servicers. However, the CDFI Fund should pre-qualify master servicers for bond issuances with multiple servicers and make them known to CDFIs prior to submission of an application.

(iv) Should a CDFI issuer be allowed to serve as its own servicer?

CDFI issuers should be allowed to serve as their own servicers. Most CDFIs have unique asset or borrower characteristics requiring customized approaches to optimizing loan collections. For example, Progreso's loan customers make a large percentage of their payments in person and in cash. Self-servicing of assets also will allow CDFI issuers to maintain long term relationships with their customers. Reporting for the CBGP should be consistent with the reporting required under the issuer's existing financing programs as long as it meets customary standards for the applicable assets. Reporting requirements are discussed further in comment 9(i) below. If a master servicer is required (in the event of bond issuances with multiple servicers), each servicer should be required to provide reports and data directly to the master servicer.

(v) Should the master servicer be eligible to serve as a program administrator or servicer for a qualified issuer? If so, how should potential conflicts of interest be managed?

There are certain responsibilities assigned to the program administrator (e.g., compliance monitoring) which could be delegated to a third party, including potentially the master servicer. There are certain other responsibilities of the servicers that could be performed by the master servicer. The CDFI Fund should maintain the right to replace the entity to which these responsibilities have been delegated or re-assign such responsibilities in order to manage potential conflicts of interest.

(c) Section 114(a)(8) defines qualified issuers as a CDFI (or any entity designated to issue notes or bonds on behalf of such CDFI) that meets certain qualifications: (1) Have appropriate expertise, (2) have an acceptable capital distribution plan, and (3) be able to certify that the bond proceeds will be used for community development.

(i) How should a CDFI demonstrate its expertise?

As noted above, the application should require a two-step process (see 2(d)(i)b). Step one should include a "means assessment", where CDFIs would need to describe their loan making expertise (e.g., originations, underwriting, servicing, etc.) in detail, including a description of their internal capabilities (e.g., technology, systems, etc.) and senior officers/management teams. CDFIs would also need to demonstrate the last 3 years of quarterly loan origination (dollar and unit) volume and resulting, quarterly static pool loan loss statistics. This information would be relevant in helping the Program Administrator evaluating the appropriate level of guarantee and capital need per bond/applicant.

Separately, step one should also require CDFIs to demonstrate the minimum criteria suggested below in 4(c)(iv) and 4(c)(v).

(ii) Are there any institutions that should be prohibited from serving as qualified issuers?

All CDFIs that meet the requirements in comment 4(a)(iv) should be eligible to serve as qualified issuers.

As stated above in our comments on section 4(a)(iii), the problem of economic disenfranchisement requires a multi-faceted solution executed by the complete spectrum of CDFIs. As all existing CDFIs have demonstrated and been certified in their mission to provide economic access, they should qualify as part of that solution and no additional restrictions should be imposed. Particularly in the current economic environment which has caused tightened lending practices by mainstream lenders, the CDFI Fund can best serve as a catalyst for economic growth by allowing the full spectrum of CDFIs to serve as qualified issuers.

(iii) Should the CDFI Fund establish minimum criteria for serving as a qualified issuer?

See 4(a)(iv) above.

(iv) Should the CDFI Fund set a minimum asset size for CDFI participation as a qualified issuer?

Asset size requirements for qualified issuers should be dictated by market forces but in no event should be less than $100,000 in loans originated in the last 12 months prior to application.

(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?

Minimum net capital for issuers should be $1 million to ensure that issuers are economically sustainable.

(vi) Should qualified issuers be required to obtain an independent, third-party credit rating from a major rating agency?

Qualified issuers should not be required to obtain a credit rating from a major third-party rating agency. Rather, the CDFI Fund should designate third-party experts in credit risk analysis to perform an independent assessment of the expected losses on the issuer's assets. In addition to providing an independent informed view, these experts can assist CDFIs in gathering and analyzing their historical data to allow for proper analysis.

5. Capital Distribution Plan

(a) Section 114A(a)(8)(B)(ii)(II) states that a qualified issuer shall provide to the Secretary: (aa) an acceptable statement of the proposed sources and uses of the funds and (bb) a capital distribution plan that meets the requirements of subsection (c)(1). The CDFI Fund seeks comments relating to the capital distribution plan requirement, specifically:

(i) What elements should be required in an acceptable statement of proposed sources and uses of the funds? How should the CDFI Fund measure acceptability?

The statement should include a detailed breakdown of the uses of funds including the 90% or greater portion of proceeds used to make loans for eligible community or economic development purposes. The 90% deployment test should include as qualified investments the (i) direct origination by CDFIs of qualified loans, (ii) repayment of debt used by CDFIs to fund qualified loans, and (iii) purchase of qualified loans from other CDFIs, and it should count also the amount of reserves funded by the bond proceeds.

There should also be a detailed breakdown of uses of the remaining portion of bond proceeds.

(ii) What elements should be required in a capital distribution plan? Are there examples of such plans, Federal or otherwise, upon which the CDFI Fund should model the CDFI Bond Guarantee Program's capital distribution plan requirements and application materials?

In addition to providing a detailed sources and uses statement, applicants should provide (i) a business plan describing their loan origination, risk management, information systems and servicing capabilities, and (ii) a financial plan including projections of the underlying assets to be originated and serviced by the applicant and financed by the guaranteed bond, as well as the related cash flows that will be used to repay the bond.

(iii) Should the CDFI Fund require specific intended uses of all the bond proceeds in the capital distribution plan or should the qualified issuers just be required to demonstrate an intended pipeline of underlying assets?

Applicants should be required to specify the intended uses of all the bond proceeds as well as provide a projection of the intended pipeline of underlying assets and cash flows that illustrate the ability of the applicant to use the proceeds in a quantity and manner that meets the deployment test and also service the assets and guaranteed bond.

(iv) Should the CDFI Fund set minimum underwriting criteria for borrowers? Should applicants be required to demonstrate satisfaction of those criteria in the capital distribution plan?

No, the CDFI Fund should not set minimum underwriting criteria for end-borrowers. Each applicant's loan underwriting practices should be market-driven and follow industry best practices for credit risk management. Because CDFI's develop unique approaches to serve their target markets, in many cases in order to provide the services that other financial institutions cannot, a one-size-fits-all underwriting box will unnecessarily exclude many lenders with a successful historical track record of serving their target markets. Furthermore, for competitive purposes, applicants should not be required to share proprietary details with respect to their own loan underwriting methodologies.

6. Accountability of Qualified Issuers

(a) The CDFI Fund welcomes comments on how to monitor the use of proceeds and financial performance of qualified issuers, particularly with respect to the following questions:

(a) What tests should the CDFI Fund use to evaluate if 90 percent of bond proceeds have been invested in qualified loans?

All risk share, credit and liquidity reserves, and costs of issuance should count as deployed assets for the purposes of the 90% deployment test. For the purposes of this test, "investments in qualified loans" should be interpreted to mean investments that meet CDFI threshold standards for eligible community or economic development and include (i) direct originations by CDFIs of qualified loans, (ii) repayment of debt used by CDFIs to fund qualified loans, and (iii) purchase of qualified loans from other CDFIs.

(b) Should reports be required from the qualified issuer more frequently than on an annual basis?

To provide flexibility in meeting borrower needs, the 90% deployment test should be applied once per year.

(c) What types of tests should the CDFI Fund use to evaluate satisfaction of the low-income or rural requirement set forth in Section 114A(a)(2)?

The CDFI Fund should require qualified issuers to provide in the annual report the percentage of borrowers who qualify for the low-income or rural requirement. The CDFI Fund may request, with advance notice, a qualified issuer to provide detail of their borrowers' zip code, loan amount, and income.

(d) What support, if any, would applicants and awardees like to receive from the CDFI Fund after having issued a bond?

To promote learning, the CDFI Fund should make available to awardees and applicants summary information (consistent with the type of information that the master servicer will report periodically to the bondholder) for each of the bonds issued under the CBGP. The CDFI Fund should also share transaction terms and pricing for the guaranteed bonds.

(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?

CDFIs cover a broad range of financial products and target markets, so coming up with detailed industry standards for impact measures that would fit for all cases is not likely nor advised. A very basic requirement for each program participant would be to report on the number of borrowers impacted and the total dollars lent. Additionally, it would be useful for each qualified issuer to decide its own impact measures and report these on an annual basis.

(f) Should achievement of some standards or outcome measures be mandatory?

We believe that the achievement of the aforementioned impact measures should not be mandatory. Qualified issuers should have already demonstrated upon acceptance into the program their commitment to the community and the high quality of the products and services provided.

(g) Are the approval criteria for qualified issuers as listed in Section 114A(a)(8)(B) adequate? If not, what else should be included?

The approval criteria for qualified issuers listed in Section 114A(a)(8)(B) are that the qualified issuer should:

1. Have appropriate expertise, capacity, and experience, or otherwise be qualified to make loans for eligible community or economic development ; and
2. Provide an acceptable statement of the proposed sources and uses of the funds; and,
3. Provide a capital distribution plan that meets the requirements of subsection (c)(1): not less than 90 percent of the principal amount of guaranteed bonds or notes (other than costs of issuance fees) are used to make loans for any eligible community or economic development purpose; and
4. Certify that the bonds or notes to be guaranteed are to be used for eligible community or economic development purposes.

The approval criteria listed in Section 114A(a)(8)(B) are sufficient. An “acceptable statement of the proposed sources and uses of the funds” should be one that demonstrates that 90 percent of the principal amount of the guaranteed bonds or notes will be used for eligible communities or economic development.

In addition, all applicants should be required to complete the process outlined in 2(d)(i)b to apply for the Program.

7. Prohibited Uses

(a) Section 114A(b)(5) provides certain prohibitions on use of funds including, ''political activities, lobbying, outreach, counseling services, or travel expenses.'' The CDFI Fund encourages comments and suggestions germane to prohibited uses established in the Act, specifically as to whether there are other prohibited uses that the CDFI Fund should include.

The CDFI Fund should include no additional prohibited uses of funds. In order for CDFIs to effectively serve their Target market(s), they must be empowered to use the funds for as many purposes as allowable. Additional restrictions and requirements would place an unnecessary burden on CDFIs and hamper their ability to respond to market conditions. CDFIs are held accountable to the CDFI Fund and their defined target markets for their focus on effectively helping individuals in those markets – this accountability provides the strongest and most effective check on how CDFIs use their funds; additional restrictions would be ineffective in advancing the mission of promoting community development.

8. Servicing of Transactions

(a) Section 114A(f) states that, in general, to maximize efficiencies and minimize cost and interest rates, loans made under this section may be serviced by qualified program administrators, bond servicers, and a master servicer. This section further outlines the duties of the program administrator, servicers, and the master servicer. Comments regarding the servicing of transactions are welcome, specifically:

(i) The Act lists certain duties of a program administrator. Should there be other requirements?

The duties of a program administrator listed in 114A(f)(2) are sufficient, but as described in comment (ii) below, they may include elements that are best delegated to other transaction parties.

(ii) The duties of a program administrator suggest that the CDFI Fund will serve as the program administrator for all issuances. Should the CDFI Fund require that each qualified issuer have a designated program administrator as suggested in section 114A(a)(7)?

Some of the duties listed in the Act relating to program administrator are appropriate for the CDFI Fund to perform in their entirety (including approving and qualifying eligible community development financial institution applications for participation in the CBGP), while others are not. For example, bond packaging is better left to the issuer or its designate and compliance monitoring with regard to issuer and portfolio performance is better performed by the issuer (or its designate) and/or servicer. Each Bond Guarantee applicant should propose the responsibilities of each party to the transaction based on the specifics of the proposed structure and use of proceeds. That way, the CDFI Fund can act as program administrator for a particular guaranteed bond, but delegate certain responsibilities to other parties.

(iii) If so, should the servicer be eligible to serve as a program administrator for a qualified issuer?

While it is useful to have a separate program administrator for each guaranteed bond, as discussed in comment 8(ii) above, certain duties with respect to bond packaging and compliance monitoring may be delegated to the issuer or servicer.

(iv) Who should be responsible for resolving troubled loans?

The servicer(s) should be responsible for collecting on all loans in the pool backing the guaranteed bond, which may include following established and customary practices of retaining third parties to assist with certain collection activities in the normal course of business.

(v) On what basis should servicers be compensated?

The compensation should be determined on an application by application basis and should be based on either (a) a percentage of the dollar amount of loans in the pool that is backing the guaranteed bond or (b) a fixed dollar amount per loan per month. Compensation levels should be market based, customary for the CDFIs business and assets, and consistent with the prior compensation experience of the servicer.

(vi) Are there any duties not listed that should be included in sections 114A(f)(2) through 114A(f)(4)? Are there any prohibitions or limitations that should be applied?

The duties as listed in sections 114A(f)(2) and 114A(f)(4) are sufficient. For the program administrator, we discussed in comment 8(ii) above the potential need to delegate certain duties to the issuer or the servicer. Likewise, for the master servicer, certain listed duties including (i) monitoring of collection comments and foreclosure actions and (ii) loan administration and servicing, may best be delegated in whole or part to the servicer.

9. General Compliance

The CDFI Fund welcomes comments on general compliance issues related to monitoring the guarantee portfolio, particularly with respect to the following questions:

(i) What types of compliance measures should be required by the CDFI Fund? Should the CDFI Fund mandate specific reports to be collected and reviewed by the servicer and ultimately the master servicer? If so, please provide examples.

The servicer should be required to complete a periodic bond payment report 10 business days prior to the date of any required payment of interest, principal or call premium on the bonds and submit such report to the guarantor. The report should specify the sources and uses of cash flow and indicate the need for any reserve or guarantee payments. Included in each report should be a detailed accounting of loan balance and payment activity, as well as a summary of loan aging, defaults, and recoveries. The asset cash flows should be certified by the servicer per their reports, which should be included as support for the bond payment report. Per the terms of the guarantee agreement between the CDFI and the guarantor, the guarantor should have the right to perform diligence on any CDFI for which a guarantee payment has been made, at the CDFI's expense, to verify the proper application of funds. All CDFIs participating in a bond issue should also be required to submit financial reports annually to the CDFI Fund at the end of the CDFI's fiscal year. If a master servicer is required (in the case of bond issuances with multiple servicers), each servicer should be required to provide servicing reports directly to the master servicer.

(ii) The Act states that ''repayment shall be made on that portion of bonds or notes necessary to bring the bonds or notes that remain outstanding after such repayment into compliance with the 90 percent requirement of paragraph (1).'' How should the CDFI Fund enforce this requirement?

In the event upon the submission of annual compliance reporting and subject to applicable cure periods, less than 90% of the bond proceeds have been used to make eligible investments in qualified loans, the amount of such shortfall should be required to be returned to bondholders as a payment of principal. In the event that a CDFI does not apply such unused funds to prepay the bonds, the CDFI Fund, as the guarantor of the bonds and per the terms of the guarantee, should have the right to recoup such shortfall amount from the CDFI that issued the bonds. The CDFI Fund could then take legal action to enforce such contractual claim. In this situation, the principal amount of the bonds has not been reduced but the bonds remain 100% guaranteed, so the bondholder should be indifferent and confidence in the bond program will be maintained. To the extent that the CDFI pays the shortfall amount to the bondholders after one year, then its obligation shall be satisfied per the guarantee contract and the CDFI Fund, as guarantor, shall have no further claim on the CDFI. However, in the event that the CDFI Fund recovers amounts through the legal enforcement of its claim upon the CDFI, the CDFI Fund shall apply such proceeds to pay principal on the bonds.

(iii) What penalties should the CDFI Fund impose if a qualified issuer is deemed noncompliant?

Non-compliant CDFIs should be precluded from further participation in the Program.

(iv) The Act provides that the qualified issuer pay a fee of 10 basis points annually. What penalties should be imposed for failure to comply?

Nonpayment of the 10bps administration fee should be a default under the bond, allowing the bondholder to seek legal enforcement remedies for payment. The probability of this occurring would be very low, however, since administration fee payments should occur before any payments of interest and principal on the bond.

10. General Comments

The CDFI Fund is also interested in receiving any general comments and suggestions regarding the structure of the CDFI Bond Guarantee Program that are not addressed above.

We believe the CBGP will leverage the ability of a wide range of CDFIs to carry out their social missions with significantly greater scale and efficiency. The long term success and viability of the CBGP depends on proof of concept including risk mitigation, asset performance, bond compliance, and development of investor confidence, all of which will enable access to the broader capital markets. Participants will need to develop and demonstrate core competencies in loan origination, risk management, asset servicing, and debt servicing. Critical elements include providing timely and accurate documentation and data reporting down to the individual loan level. Because many CDFIs will need to bundle their loans to achieve the $100 million minimum issuance, partnerships with other CDFIs who can lend additional capabilities in risk underwriting, technology, analytics and reporting should be encouraged to maximize participation and the industry's standing.

Bridge to Mainstream Financial Market Access: While this Program will be transformational, it only lasts for five years. If this Pilot Program is not renewed by Congress, it would be most unfortunate if the participating CDFIs would then suffer from a lack of capital after 5 years of tremendous access. Therefore, this Program must also prepare participating CDFIs to be ready to meet the requirements of mainstream financial market access. For this reason, we strongly recommend that the CDFI Fund, as part of its application, require participants who are not yet ready for mainstream financial market access (without a government guarantee) to take the necessary steps over the Pilot Program's tenure to develop those capabilities, such as loan systems of record that can report loan level asset performance detail with high integrity and provide electronic files of loan payment and credit performance and loan document quality assurance and retention processes that meet the collateral requirements of private sector capital markets.