

EXECUTIVE SUMMARY

The Federal Deposit Insurance Corporation (FDIC) is an independent agency created by Congress to maintain stability and public confidence in the nation's financial system by: insuring deposits, examining and supervising financial institutions for safety and soundness and consumer protection, and managing receiverships. In support of that mission, the FDIC conducts an array of outreach activities to help banks enhance Community Reinvestment Act (CRA) performance and promote community development activities. The purpose of this guide is to provide information that will help community banks identify and evaluate opportunities to partner with community development financial institutions (CDFIs).

CDFI Types and Community Focus

CDFIs are specialized financial institutions that provide financial products and services to populations and businesses located in underserved markets. These institutions have community development missions and a reputation for lending responsibly in low-income communities. CDFIs include banks and bank holding companies, as well as credit unions, loan funds, and venture capital funds.

CDFIs fill a niche in the nation's financial services system by specializing in providing credit to borrowers and communities that may be difficult for traditional banks to serve. Many borrowers may be creditworthy but often lack credit history, or have a poor past experience with alternative or predatory credit providers or a minimal amount of personal savings. To accommodate this market, CDFIs offer products with more flexible underwriting standards, combine a range of below-market financing with their own resources, and provide technical assistance with their lending activities to help ensure that borrowers use credit and capital effectively.

Regulatory Context: Community Reinvestment Act, Public Welfare, and Safe and Sound Banking Practices

In some instances, the most effective and efficient way for a traditional financial institution to meet the market needs of low-income borrowers in their assessment areas may be through investments in, loans to, or other collaboration with a CDFI. In addition to helping traditional banks reach underserved, low-income communities in their assessment areas, loans to and investments in qualifying CDFIs may be useful in helping banks meet their CRA obligations.¹ Under the CRA, community development activities can be delivered directly through, or in cooperation with, a CDFI partner that serves an area which includes the bank's assessment area. Banks evaluated under the large, intermediate-small, or small bank examination standards may receive consideration for activities in collaboration with CDFIs.

To be eligible for CRA consideration, community development investments must be qualified investments. A qualified investment is a lawful investment, deposit, membership share, or grant with a primary purpose of community development. The U.S. Department of the Treasury certifies CDFIs under its CDFI Certification Program. CDFI certification is formal acknowledgement from the CDFI Fund that a financial institution has a primary mission of promoting community development. Because CDFIs certified by the CDFI Fund are required

1. Office of the Comptroller of the Currency, Treasury; Federal Reserve System; Federal Deposit Insurance Corporation; and Office of Thrift Supervision. "Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment," 75 Federal Register 11648, 11652. (March 11, 2010). Available at: <http://www.ffiec.gov/cralpdf/2010-4903.pdf>.

primarily to serve a community development purpose, the Interagency Questions and Answers Regarding Community Reinvestment (Q&As, the guidance on CRA issued by federal regulators) explicitly recognize loans to and investments in CDFIs as examples of community development loans and qualified investments.²

Banks making investments to CDFIs should be aware of the laws, regulations and guidance applicable to public welfare investments: for national banks, 12 USC §24(Eleventh) and 12 CFR 24; for state member banks, 12 USC § 338a and 12 CFR 208; for state nonmember banks, 12 USC 1831a and 12 CFR Part 362. All state banks are also subject to Section 24 of the Federal Deposit Insurance Act.³ Section 24 of the Federal Deposit Insurance Act generally permits state banks to make the same types of investments or engage in the same types of activities as national banks. State banks, if permitted by state law, may invest in public welfare investments that are permissible for national banks under 12 CFR 24. CDFIs with active certifications from the CDFI Fund are considered to be public welfare investments according to 12 CFR 24.⁴ Other CDFIs may also meet these requirements for public welfare investments. However, state nonmember banks investing in non-certified CDFIs should consult with the FDIC regional or area office that oversees the bank's headquarters to make sure they are within the scope of permissible investments.⁵

As with any investment, banks are expected to carefully evaluate CDFI financing opportunities.

This guide is organized in the following sections:

Section I, Introduction, describes the purpose of the guide and provides a historical overview of the CDFI industry.

Section II, CDFI Organizational Structures, examines key characteristics, including legal structure, regulatory oversight, and lending and investment opportunities, associated with CDFI banks and bank holding companies, credit unions, loan funds, and venture capital funds. Each CDFI type has a different legal structure and different investment opportunities.

Section III, Financing Approaches, describes the types of investments that can support CDFIs.

Section IV, Evaluation of Bank/CDFI Partnership Opportunities, discusses the steps that might be considered in assessing a bank/CDFI partnership. Any investment in or loan to a CDFI should be predicated on appropriate due diligence and in accordance with prudent banking principles.

Section V, Regulatory Context and Bank/CDFI Partnerships, explains possible ways that CDFIs may be a useful tool or means to help banks meet the CRA lending, investment, and service test criteria. It also provides information on the requirements for "qualified investments" under CRA, particularly guidance on public welfare investments.

2 Office of the Comptroller of the Currency, Treasury; Federal Reserve System; Federal Deposit Insurance Corporation; and Office of Thrift Supervision. "Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment," 75 Federal Register 11648, 11652. (March 11, 2010).

3 The definition of a state bank as used in this document can be found in Section 3 of the FDI Act.

4 12 C.F.R. Part 24. Community Development Corporations, Community Development Projects, and Other Public Welfare Investments. Office of the Comptroller of the Currency. 61 Federal Register 49660, (September 23, 1996). Available at <http://www.occ.gov/news-issuances/federal-register/12cfr24.pdf>

5 Section 24 of the Federal Deposit Act, 12 USC 1831a. FDIC Law, Regulations, Related Acts. 1000-Federal Deposit Insurance Act. (July 31, 1997). Available at <http://fdic.gov/regulations/lawsrules/1000-2600.html>.

Section VI, Case Examples of Partnership Options, highlights bank/CDFI partnerships gathered from a review of recent CRA evaluations. The case examples illustrate some of the most common types of partnership arrangements, but they do not cover the full range of bank/CDFI partnerships. The particular form a bank/CDFI partnership takes depends on a bank's business strategy, market needs, capacity of the CDFI partner, and partnership goals. In addition, depending on its business strategy and market needs, a bank can elect to engage in a range of relationships with multiple CDFIs or have several types of relationships with one CDFI.

Bank/CDFI partnership options described in this section include:

Providing equity capital using traditional equity instruments. Banks can make various types of investments to build the equity capital of CDFIs. Depending on the CDFI type, the qualified investments can take many forms, including stock purchases, grants, and ownership interests in CDFI venture capital funds.

Providing equity equivalent investments, or EQ2s, to enhance the CDFI's lending flexibility. Banks can make EQ2s in nonprofit CDFIs as permitted by law and regulation and in accordance with safety and soundness standards. EQ2s are long-term, fully subordinated debt instruments with features, such as rolling terms, that allow them to function in a manner similar to equity. EQ2 capital makes it easier for CDFIs to offer more responsive financing products with longer loan terms.

Providing funds for lending using traditional debt instruments. Community banks can extend loans through various debt instruments to CDFIs for relending to low-income borrowers. Interest rates and length of investment terms can vary. Investors who choose a lower rate of return and longer investment terms help CDFIs provide less costly and more responsive financing to low-income borrowers. By providing a lower cost of funds to the CDFI, these investments may enable CDFIs to offer lower loan rates or to pay for services such as technical assistance to help borrowers use their financing effectively.

Providing deposits. Banks can make deposits in CDFI depositories to provide funds for lending to low-income borrowers. Deposits in FDIC-insured CDFI banks are insured by the FDIC up to the maximum allowed by law. The National Credit Union Administration (NCUA) provides similar coverage for deposits in NCUA-insured CDFI credit unions.

Providing capital for loans or investments using New Markets Tax Credits. Community banks can make qualified equity investments in Community Development Entities (CDEs), which are intermediary groups certified by the CDFI Fund to participate in the New Markets Tax Credit Program. In return for the equity investment, the CDE provides the investor bank with federal tax credits. The CDE uses the qualified equity investments made by the investors to make qualified low-income community investments.

Providing technical assistance. Community banks can provide technical assistance to CDFIs, such as the volunteer service of a bank officer as a CDFI board director or member of an advisory board or credit review committee. Technical assistance can also include product development, strategic and financial planning, and professional development of CDFI staff.

Collaborating with banks to invest in loan pools and consortiums. Two or more financial institutions can participate in a loan to a CDFI for a larger amount than either bank may have been willing or able to make independently. The funds can be organized as a lending consortium in which the participating banks pool their funds as investments in a consortium.

Collaborating with CDFIs in loan participations. Community banks and CDFI partners can collaborate on loans, which are serviced by either the traditional bank or CDFI, to a specific borrower. Loan participations can help traditional banks diversify their lending portfolios and reduce credit risks.

Providing loan servicing. Community banks can service the loans of CDFIs that have limited capacity to process and service loans. Alternately, CDFI depositories and loan funds can service the community development loans of traditional banks, thereby helping lower operating costs for banks and providing additional resources for CDFIs.

Providing bank services. Community banks can provide a variety of banking services, such as deposit accounts, to CDFIs.

This guide does not substitute for the legal, tax, and accounting advice that banks may need when evaluating investment options. All FDIC-supervised institutions should be aware of and follow fair lending, fair housing, and other applicable lending and civil rights laws and regulations, and nothing in this guide is intended or should be interpreted to suggest otherwise.

The programs referenced in the guide are current as of the date of the publication and may change.