Carolina Small Business DEVELOPMENT FUND

The Honorable Joseph Otting
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th St SW #3E-218
Washington, DC 20219

November 17, 2018

Re: Comment on Docket ID #OCC-2018-008 - Reforming Community Reinvestment Act Regulatory Framework

Dear Mr. Otting,

In response to the above advanced notice for proposed rulemaking, Carolina Small Business Development Fund (CSBDF) respectfully submits the below comments for your agency's consideration. CSBDF is a 501(c)3 nonprofit community development finance institution (CDFI). Our organization is dedicated to promoting economic development by reducing barriers to entrepreneurship across North Carolina and adjacent regions. We help small and medium sized businesses start strong and sustain their growth through affordable financing and free technical assistance. In addition, we have multiple programs designed to target communities with high concentrations of under-served firms. We strive to increase the efficacy and effectiveness of our operations through collaborative programming, accessible policy research, and joint initiatives with other mission-focused organizations in both the public and private sector.

CSBDF has engaged in small business lending since 2010. Across North Carolina and surrounding states, we've issued 687 loans totaling over $56M in deployed capital. Recipients of CSBDF financing have reported creating or saving 2,400 jobs. Our programs are intentional about ensuring affordable financing is available to both startups and seasoned firms in distressed communities across the region. About 35% of our borrowers are rural businesses, 37% are women-owned, 57% are minority-owned, 18% are veteran-owned, and 33% are owned by low income individuals. Our organization's work in lending is supplemented by free one-on-one counseling which has served 1,344 entrepreneurs. We're also proud to offer numerous free workshops, group trainings, and networking events which have been attended by over 8,000 people.

We support in broad terms the agency's goal to ensure the Community Reinvestment Act (CRA) remains an effective mechanism for local economic development. Concurrently, we strongly believe that any CRA changes must be reflective of the law's original intention - targeted and sustainable growth in underserved communities. The CRA's regulatory incentives for financial institutions have been successful in fostering a robust network of 1,100+ CDFIs across the United States. And as you know, many CDFIs serve a critical economic development role by providing secondary lending options for underserved business owners.

But while the CRA has made much progress towards improving community economic development for underserved communities, there is still much more work to do. In the context of the proposed reforms, we believe there is a need to promote better transparency and accountability. By providing better guidance to CRA-regulated institutions about what types of actions receive compliance credit, banks will be more likely to engage in a larger variety of community development activities. Under the current regulatory framework, activities that qualify for CRA credit can sometimes be ambiguous or unclear. To that end, we recommend the following changes that the ANPRM discusses or asks for public comment on:

Adjust Definitions for Small Business and Small Business Loans

The CRA's current definition of community development includes financing activity to all small firms that meet the Small Business Administration's (SBA) industry-dependent size standards.[1] If the industry does not meet the SBA definition, the CRA considers small business lending to be inclusive of all loans to firms with $1M or less in gross annual revenues. We believe these definitions may be too expansive and may conflict with the CRA's purpose to promote investment in underserved communities. In many industries, providing loans to firms with less $1M in revenue would support businesses with large numbers of employees. While we believe this type of lending is important for economic development, companies at that size are obviously not small businesses. Lending activity to these larger firms is likely to already be profitable for banks, so there is little need to promote it through CRA regulation mechanisms.

Admittedly, defining what constitutes a small business is challenging because small firms encompass so many different types of ownership structures and industries. For that reason, we believe the agency should *not* consider definitions that rely *primarily* on annual revenues or employment size alone. Instead, we recommend a concise two-pronged approach that uses annual revenues as a starting point but also requires lending activities be targeted in areas that reflect the regulatory intention of the CRA:

I. Generally, small business lending can include financing of firms with less than $1M in annual revenues.

II. But to qualify as small business lending for purposes of the CRA, loans must be targeted to firms owned by underserved borrowers or firms which operate primarily in underserved, rural, and/or low-income communities.

By drawing on a two-pronged approach, the agency will ensure that the definition of what constitutes a "small business" is inclusive enough to promote community development. At the same time, this will enable the agency to also ensure lending is targeted to high need areas that would otherwise see little investment.

[1] The agency's industry-specific size standards for contracting in 13 CFR § 121.201 includes firms with up to $550M in revenues and 1,500 employees as "small."

Minimize Ratio-Based Performance Measurement for CRA Compliance Testing

The proposed rules suggest the agency wishes to move towards a more quantitative evaluation framework. In particular, the rules recommend an asset-based ratio test to measure CRA compliance. However, activities which should broadly qualify as promoting community development will not be easily quantifiable through such tests. The needs of communities served by the CRA are diverse and multi-faceted. Although we appreciate the need to move towards evaluation frameworks that are more quantitative, we strongly recommend against the use of "one size fits all" tests to measure CRA compliance.

Evaluation metrics that use relative asset sizes may disincentivize financial institutions from providing funding to smaller CDFI programs. In our experience, smaller but highly targeted investments can have disproportionate impacts in underserved communities. For example, some of our most high impact programs – like those targeting veteran or Latino entrepreneurs - began with small investments. Research shows CDFIs are only beginning to reach underserved subpopulations (for example, minority or disabled veterans). Without regulatory incentive to fund these smaller programs, financial institutions are likely to prefer larger investments that are easy to implement.

Increase Weighting of Community Development Activities in CRA Assessment Process

We recommended that the CRA rating process continue to place an emphasis on community development activities. Currently such activities account for 25% of the CRA's investment test weight, and we recommend increasing that to a minimum of 40%. For financial institutions that have limited to no involvement in development work via home mortgages and small business lending, the weight should be higher. Ultimately, the CRA is one of the only regulatory incentives financial institutions have to make investments in underserved regions. Retaining and increasing the weight of community development activities provides an avenue to ensure regulated institutions will continue to fund these important activities.

Broaden Non-Metropolitan Rural Assessment Areas to the State Level

As a statewide development organization, we know there is a strong need to promote investment in rural areas. Concurrently, steps must be taken to ensure regulated institutions continue to have incentives for investments in population dense communities. While the nature of assessment areas does tend to drive capital to urban centers, such areas have a strong and enduring need for community development assistance. The aggregation of non-metropolitan areas within each state into a single assessment area is one way to accomplish both of these goals.

Retain Metropolitan Assessment Areas but Provide Additional Credit for Selected Activities

Additionally, the use of traditional assessment areas can pose a myriad variety of challenges to banking institutions. In the era of internet banking, using traditional branch or ATM footprints to determine a metropolitan assessment areas are often viewed as suboptimal. However, the use of these assessment areas serves a purpose in promoting targeted investments within high need communities. Although consideration of other types of bank operation footprints (like back offices) may seem like an appropriate way to define assessment areas, such operations are unlikely to be located in the types of communities where the CRA seeks to promote development. For these reasons, we recommend that only truly branchless or online only banks should have their activities evaluated solely on a national basis. For financial institutions with some sort of branch presence, we believe community development beyond their assessment area should be credited, but only if there is sufficient evidence that the primary assessment area has been satisfactorily served. CRA activities that are national in scope, or otherwise extend beyond a bank's primary assessment area, could be further incentivized by adding extra weight to investments in underserved or distressed populations.

Treat CDFIs like Minority-Owned, Women-Owned, and Low-Income Institutions

CRA assessments currently give credit to banks that invest in minority-owned, women-owned, and low-income depository institutions/credit unions. Regulated institutions receive CRA credit for investments in these institutions even when the activity falls outside of the bank's assessment area. Given that CDFIs all share a mission to operate in underserved communities, we recommend investments in CDFIs be given the same type of treatment. The requirements to obtain CDFI certification from the Department of Treasury are substantial. To receive and retain the CDFI designation, the organization must have a primary mission of engaging in activities that target low income individuals and other populations that lack access to capital. CDFIs in effect are targeting the same underserved populations as minority-owned, women-owned, and low-income depository institutions and credit unions. This kind of update simply modernizes the CRA, because the regulations were obviously written before the CDFI designation existed.

Incentivize Banks to Make Long-Term Loans to CDFIs

Presently CRA regulations do not give credit for CDFI loans past the initial disbursement year. CRA credit only counts for the year in which the loan occurred. We recommend treating lending activity the same as other types of investments. CRA credit should be awarded both on the initial disbursement and in subsequent years. This policy change will ensure regulated institutions have an incentive to make long-term loans, which are needed to meet the needs of low income and underserved populations.

Improve Transparency by Requiring Regulated Institutions to Report on CDFI Activities

Unlike many federal and state regulations on community and economic development, the CRA has made good first steps in providing public compliance data for regulated institutions. But the structure and reporting format of current CRA data makes it difficult to use both for the general public and research practitioners. In particular, banks are not currently required to report on CDFI-specific investments. We believe there is great value in such data, as it is one of the only ways to systematically track how banks target support for populations that lack capital access. To support such efforts, we recommend that regulated institutions be required to collect data on (1) the number of CDFIs they lend or make investments into and (2) the amount of those loans and other investments. These additional reporting requirements strike a balance between the need for better transparency while also minimizing additional regulatory burden on financial institutions.

Thank you for the opportunity to comment on the proposed changes to the Community Reinvestment Act. Please let me know if I can do anything to be of assistance as the agency considers these changes.

Sincerely,

Lenwood V. Long
President and CEO
Carolina Small Business Development Fund