206

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October 17, 2001

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street NW
Washington, DC 20552
Attention: **Docket No. 2001-49**

Dear NAME:

I am writing in response to the Joint Advance Notice of Proposed Rulemaking (ANPR) [Docket No. 2001-49] concerning Community Reinvestment Act Regulations.

The Community Development Venture Capital Alliance (CDVCA) is a membership association representing more than 100 organizations involved in the provision of equity capital for businesses in low-income areas. CDVCA promotes the use of the tools of venture capital to create jobs, entrepreneurial capacity and wealth to advance the livelihoods of low-income people and the economies of distressed communities. Community development venture capital funds are community development financial institutions, investments in which generally qualify under the Community Reinvestment Act.

There are several questions from the ANPR that we believe our significant for our constituency. In particular, we are concerned that: (1) the investment test must remain a separate component of the CRA Performance Evaluation, (2) both qualitative and quantitative measures must be used and should emphasize community development impact, and (3) the definition of assessment area needs to be updated.

Before addressing these issues, it may be helpful to describe in broad terms what community development venture capital (CDVC) funds do and CDVCA's thoughts on how to consider any changes to the current regulations.

Community development venture capital funds are specialized financial institutions with expertise in making equity and equity-like investments in businesses located in distressed areas, and in businesses that directly benefit low-income persons through job creation. About 50

domestic CDVC funds are currently making investments, and another 10 are in the process of raising capital. Together they manage well over $300 million in capital.

CDVC funds invest in a range of businesses from apparel manufacturing facilities in Arkansas, to organic recycling plants in Maine, to minority-owned breweries in California. Like traditional venture capital funds, CDVC funds bring capital and business management expertise to the funds in which they invest. In addition, CDVC funds also bring a strong social mission to create jobs for low-income people and to promote economic development in distressed regions. Thus, CDVC funds pursue a "double-bottom line," seeking both financial and social returns.

The goal of the CRA is to promote community development. Community development, as defined in the regulations, means: (1) Affordable housing; (2) Community services targeted to low- or moderate-income individuals; (3) Activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs (13 CFR 121.301) or have gross annual revenues of $1 million or less; or (4) Activities that revitalize or stabilize low- or moderate-income geographies. CDVCA supports these definitions. They are specific yet flexible, and give examiners clear guidance on how to measure community development. We urge the regulators to consider any proposed modifications to CRA in light of these definitions. If a proposed change does not ensure that community development will be furthered, it should be considered antithetical to the goals of CRA and not proposed as a change to the current regulations.

The Investment Question

The single most significant issue for CDVCA and its members is the on-going need to include the Investment Test as a separate component of the CRA Performance Evaluation for large banks. We strongly recommend a more quantitative approach, and greater consideration of the community development impact of qualified investments.

First, there is an ongoing need for equity capital. As you are no doubt aware, Federal Reserve Chairman Greenspan has emphasized the fundamental role that equity capital plays in small and large business development. In his speech at the Federal Reserve's *Conference on Business Access to Capital and Credit* held in Arlington, Virginia in 1999, Mr. Greenspan noted that the need for private equity investments is "especially true in lower-income communities, where the weight of expansive debt obligations on small firms can severely impede growth prospects, or more readily lead to business failures." Our experience, and the experiences of the nearly 50 funds that currently make equity investments in distressed communities throughout the country, fully supports the Chairman's position. The dramatic need for patient capital, and its power to make effective the underlying demand for credit, necessitates that the investment test be included as a basic component of the CRA Performance Evaluation, and not as something extra that a depository institution can choose to pursue or not.

Second, we recommend that the ratio of community development investments to the bank's assets be used as a benchmark for assessing the quantity of a bank's qualified investments—if not this exact formula, then some other equally simple rule. A quantitative approach would help to strengthen the Investment Test and make it more transparent to all parties involved. Qualified investments could then be weighted according to their community development impact. For example, qualified investments that are more risky and offer greater social returns could be allocated greater CRA credit than other qualified investments, which offer less risk and fewer social returns. We believe that the language in the current regulations supports this view. By adopting a quantitative approach and focusing on the community development impact of the bank's investments, examiners will help to push banks to make more effective investments, and the community development impact will determine the structure of the investment, rather than the other way around.

As for the concern expressed by some lenders that there are insufficient investment opportunities in their assessment areas, we would contend that this is rarely the case, and that exceptions should not be used to make the rules. Included is a map showing the states where CDVC funds currently invest. As you can see, most states have at least one CDVC fund that invests in it, and many states have more than one. Even states where there are no CDVC funds offer a great opportunity for banks. For example, the Oklahoma MetaFund Community Development Corporation, a multi-bank CDC and a member of CDVCA, opened in January 2000 with more than $10 million in capital from twenty Oklahoma banks. Oklahoma MetaFund is a tremendous local achievement, and an excellent example of the possibilities encouraged by the Investment Test. CDVCA is also working to promote the growth of more funds in states with few equity options available to small businesses, states like Louisiana, South Carolina, and North Dakota.

Finally, banks and financial institutions play a critical role in capitalizing CDVC funds, thanks in large part to the investment test. Of the CDVC funds that formed in 1998 and 1999, 58 percent of the capital they raised came from banks, up from an already substantial 34 percent of total capital managed, which banks provided to the funds started before 1997. The dramatic increase in funding from banks coincides with the introduction of the Investment Test as part of the three-part examination process that became effective for large banks in 1995.

The Quantitative vs. Qualitative Question

There is clear need for both quantitative and qualitative measures of CRA performance. Quantitative measures are critical ingredients in the CRA Performance Evaluation and help to standardize the examination process. At the same time, not all of CRA activities are the same simply because their dollar amounts may be equal. For all three tests—lending, investment, and service—it is necessary and appropriate to weigh the community development impact of the activities.

We strongly recommend that both quantitative and qualitative measures be clarified. On the quantitative side, appropriate use of benchmarks that relate an institution's activities to its asset size or recent earnings, and to peer institutions, would be an improvement in the use of quantitative measures in the CRA Performance Evaluation. Appropriate implementation of such benchmarks will help banks and communities know what is expected and possible. They also aid examiners in their work by setting out the scope of work and the specific measures to use in their evaluations of lender performance.

The tendency of benchmarks, however, is to become standards that are hastily applied. This should be avoided. We recommend a continued emphasis on the qualitative criteria contained in the regulations to offset this tendency. For example, the Investment Test for large banks requires that an institution's evaluation be based on the following performance criteria: (1) The dollar amount of qualified investments; (2) The innovativeness or complexity of the qualified investments; (3) The responsiveness of qualified investments to credit and community development needs; and (4) The degree to which the qualified investments are not routinely provided by private investors. We believe that a careful application of these standards to each qualified investment would greatly enhance the accuracy and validity of the Investment Test. At the same time, these criteria need to be interpreted in light of the overarching goal of CRA, which is community development impact. Innovation and complexity should be encouraged, but not for their own sake. If certain investments are innovative and help to overcome a particular barrier, these innovations should be rewarded with *additional* CRA credit. But if the modifications are meant merely to appear innovative in order to garner CRA consideration, no additional credit should be given—indeed examiners should discourage this kind of activity. And in no case should an institution be penalized for providing a "plain vanilla" investment, when a "plain vanilla" investment is what works best. For example, several years ago the "equity equivalent" was both innovative and complex. Today with more and more lenders using equity equivalents they are perhaps less innovative, but no less effective in helping to meet the credit and community development needs provided by the CDFIs who receive them.

Along these lines, we are concerned that a strict adherence to innovation and complexity, without reference to community development impact, might be missing the mark. Many banks directly help capitalize CDVC funds through low-interest loans, equity equivalents, and as limited partners. The *banks'* investments may appear ordinary, however, the investing activities of CDVC *funds* are not. CDVC funds make highly specialized, innovative, and oftentimes complex investments in their portfolio companies. To the extent that these equity investments by CDVC funds create jobs, build wealth in the community, *and* leverage debt, we believe that qualified investments by banks that promote equity should be given additional weight in the Investment Test.

The Assessment Area Question

A third important issue for CDVCA and its members is the question of CRA Assessment Areas. With dramatic changes to the financial services industries, thanks to the Financial Modernization Act of 1999, it is clearly time to reconsider CRA's reliance on an outdated notion of locally funded deposits. In general, we support an expanded definition of the assessment area, one that recognizes a lender's actual lending activity, and not simply the areas around its branch and ATM network, which can be highly localized. We recommend that a lender's assessment area be defined as: (1) the metropolitan statistical areas (MSAs) and counties in which it has branches and ATMs, **plus** (2) any MSA or non-metropolitan county where it originates more than a significant portion of its own lending activity (for example, 0.5 percent), **and** (3) any MSA or non-metropolitan county where its lending activity accounts for a significant portion of the loans made in those areas (again, 0.5 percent). Some banks may complain that these modifications will increase their assessment areas; but it will do so only to the extent that banks take advantage of the dramatic increase in geographic expansion made possible by Gramm-Leach-Bliley.

Without these modifications, we are concerned that lenders will cherry-pick easy lending opportunities and ignore other loans and qualified investments in areas outside their "designated" assessment area. We believe this is likely despite the findings of a recent Federal Reserve study, which showed that the banks most involved in CRA lending activity are no less profitable than those that do little lending in low-and-moderate income areas; indeed, they may be more profitable. An assessment area that is defined by the activities of the bank is consistent with the original legislation, which simply requires lenders help to meet the credit needs of all areas in which they do business, consistent with safe and sound business practices.

Finally, we recommend that the current scope of the Investment Test, which evaluates a bank's qualified investments based on its assessment area "or a broader statewide or regional area that includes the bank's assessment area(s)," be maintained.

In sum, we believe that the changes made to the CRA regulations in 1995 dramatically improved its effectiveness. The change in emphasis from process to performance and the use of a three-part examination with separate lending, service, and investment tests, were vast improvements over the earlier regulations. To change this emphasis or to alter these basic components would be a step backward. In order to move forward, CDVCA and its members support increased use of quantifiable measures, weighted according to their community development impact.

Thank you very much for the opportunity to comment on the ANPR.

Sincerely,

Kerwin Tesdell

President
CDVCA

CDVC Funds in the US as of September 2001

CDVC Funds (Fall 2001)
● In formatin
● Investing
States Receiving CDVC Investments
No CDVC funds investing
CDVC funds investing

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