COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS FUND

Bank Enterprise Award Program

2003 - 2004 Application Supplemental Guidance for Applicants

Applicants should use this guidance in conjunction with the BEA Program Regulations, FY2003- FY 2004 NOFA, Glossary of Terms, and Application (all available on the BEA page of the Fund's website: www.cdfifund.gov).

Supplemental Guidance for Applicants

The following supplemental guidance for Applicants is intended to provide additional information on specific types of Qualified Activities as well as the CDFI Fund's policies and treatment of certain issues. Any information provided should be considered in conjunction with the BEA Program regulations, FY 2003-2004 NOFA, and the Application. The guidance is organized alphabetically by subject.

Commercial Real Estate Loans and Related Project Investments: Generally limited to transactions with a total principal value of less than or equal to $1 million that are used to finance "community assets" such as the purchase, construction, or renovation of real estate where over 50 percent of the leasable (or occupable) square footage is for the provision of one or more of the following: health care, charter schools, job training, day care, elder care centers, homeless services, or retail. Notwithstanding the foregoing, the Fund may, in its discretion, consider transactions with a principal value of over $1 million subject to review and approval of a "community benefit statement." The Applicant must provide a narrative demonstrating that the proposed project offers, or significantly enhances the quality of, a facility or service not currently provided to the Distressed Community.

Community Services: Community Services Activities must:

A. Promote community development through:
   - ✓ Provision of technical assistance and consulting services to residents in managing their personal finances through consumer education programs;
   - ✓ Provision of technical assistance and consulting services to newly formed businesses located in the Distressed Community;
   - ✓ Provision of technical assistance or servicing the loans of Low- and Moderate-Income homeowners or homeowners located in the Distressed Community; or
   - ✓ Other similar services provided Low- and Moderate-Income individuals in a Distressed Community or enterprises integrally involved in a Distressed Community deemed appropriate by the Fund.

B. Enhance: (1) access to capital in the form of lending or investment; (2) access to financial services; or (3) organizational capacity or expertise of entities integrally involved in a Distressed Community (e.g., small business counseling).

C. Create a direct benefit to Residents of Distressed Communities or entities integrally involved in a Distressed Community (e.g., business or non-profit organizations located in or serving a Distressed Community); and

D. Be provided directly by a bank employee acting as a representative of the bank (i.e., the activity must be undertaken as a bank employee) and the service provided must utilize the financial, banking, or business expertise of the employee.

Applicants should report Community Services based on the administrative costs of providing such services. For staff time, use the number of hours contributed times the hourly salary of the staff member. For other administrative costs (such as printing costs for informational materials), Applicants should report the actual cost. In reporting the cost of Community Service activities, the Applicant should certify that the reported items are an accurate reflection of the actual costs incurred in delivering the service.

Double Funding: The Community Development Banking and Financial Institutions Act of 1994 prohibits an insured depository institution that is a certified CDFI from receiving a BEA Program Award if it has: (i) an application pending under the CDFI Program; (ii) directly received assistance under the CDFI Program within the preceding 12-months; or (iii) ever directly received assistance under the CDFI Program for the same activity for which it seeks a BEA Program Award. (See 12 U.S.C. § 1834a(g) and 12 C.F.R. §§ 1805.102(a) and 1806.102(a))

The Fund will not issue a BEA Program Award to a BEA applicant, if such applicant has an application pending under the CDFI Program at the time the Fund issues its BEA Program Awards. To illustrate this policy, we offer the following example:

> **Example 1:** On November 20, 1999, the Fund receives a BEA application from ABC Bank, an insured depository institution that also is a certified CDFI. On January 20, 2000, the Fund receives an application from ABC Bank for a CDFI Program Award. On September 25, 2000, the Fund selects and notifies awardees of their BEA Program Awards. ABC Bank's CDFI Program application is still pending. As a result, ABC Bank is ineligible to receive a BEA Program Award because it has an application pending under the CDFI Program.

The Fund will no select an organization to receive a BEA Program Award if the Fund has directly disbursed assistance under the CDFI Program to such BEA applicant within 12 months prior to the date the Fund selects organizations to receive BEA Program Awards. To illustrate this policy, we offer the following examples:

> **Example 2:** ICU Bancorp, a depository institution holding company and a certified CDFI, applied for a CDFI Program award in January 1999. In September 1999, the Fund decided to award ICU Bancorp a CDFI Program award in the form of an equity investment. On November 20, 1999, the Fund receives a BEA application from ABC Bank. ABC Bank is a wholly owned subsidiary of ICU Bancorp and a certified CDFI. On March 10, 2000, the Fund enters into an Assistance Agreement with ICU Bancorp and shortly thereafter disburses the equity investment to ICU Bancorp. ICU Bancorp uses the Fund's equity investment to purchase stock in ABC Bank. ABC Bank is eligible to receive a BEA Program Award because the Fund disbursed the equity investment to ICU Bancorp -- not ABC Bank.

> **Example 3:** On January 20, 1999, the Fund receives a CDFI Program application from XYZ Bank. XYZ Bank is an insured depository institution and a certified CDFI. On September 25, 1999, the Fund decided to award XYZ Bank a CDFI Program Award. On November 22, 1999, the Fund received a BEA application from XYZ Bank. On March 25, 2000, the Fund disburses the CDFI Program award to XYZ Bank. On September 25, 2000, the Fund selects and notifies applicants of their BEA Program Awards. XYZ Bank is ineligible to receive a BEA Program Award because the Fund disbursed the CDFI Program Award to XYZ Bank within 12 months prior to the date the Fund selects organizations to receive BEA Program Awards.

The Fund will not issue a BEA Program Award to a BEA applicant, if such applicant has ever directly received assistance under the CDFI Program for the same activities for which it seeks a BEA Program Award. To illustrate this policy, we offer the following examples:

> **Example 4:** JKL Bank is an insured depository institution and a certified CDFI. It received a CDFI Program Award from the Fund in September 1998. In March 1999, the Fund and JKL Bank entered into an Assistance Agreement under the CDFI Program. Shortly thereafter, the Fund disbursed the CDFI Program Award to JKL Bank. The CDFI Program Assistance Agreement covers the period from January 1, 1999 through December 31, 2003. The five-year Comprehensive Business Plan submitted by JKL Bank as part of its CDFI Program application indicates that JKL Bank will expand its lending and service activities within its Investment Area. JKL Bank would like to submit an application under the BEA Program to increase its Development and Service Activities within an eligible Distressed Community. JKL

Bank's Investment Area encompasses the Distressed Community. JKL Bank is ineligible to receive a BEA Program Award for such activities, because they are the same activities for which JKL Bank received a CDFI Program Award.

Example 5: On September 30, 1996, PDQ Bank, an insured depository institution and a certified CDFI, received a CDFI Program Award from the Fund. In August 1997, the Fund and PDQ Bank entered into an Assistance Agreement under the CDFI Program. Shortly thereafter, the Fund disbursed the CDFI Program Award to PDQ Bank. The CDFI Program Assistance Agreement covers the period from January 1, 1997 through December 31, 2001. The five-year Comprehensive Business Plan submitted by PDQ Bank as part of its CDFI Program application indicates that PDQ Bank will expand its lending and service activities within its Investment Area. PDQ Bank would like to submit an application under the BEA Program to increase its CDFI Equity Investment activities. The Comprehensive Business Plan submitted to the Fund in 1996 did not discuss the applicant engaging in CDFI Equity Investment activities because this is a new product line for PDQ Bank. PDQ Bank is eligible to receive a BEA Program Award for such activities because they are different than the activities for which PDQ Bank received a CDFI Program award

Equity-Like Loans: For purposes of this NOFA, Equity-Like Loans must meet the following characteristics:

1. At the end of the initial term, the loan must have a definite rolling maturity date that is automatically extended on an annual basis if the borrower continues to be financially sound and carrying out a community development mission;
2. Periodic payments of interest and/or principal may only be made out of the CDFI borrower's available cash flow after satisfying all other obligations;
3. Failure to pay principal or interest (except at maturity) will not automatically result in a default under the loan agreement; and
4. The loan must be subordinated to all other debt except for other Equity-Like Loans.

Notwithstanding the foregoing, the Fund reserves the right to determine, on a case-by-case basis, if an instrument evidences an Equity-Like Loan.

Applicants should submit to the Fund all documents evidencing loans that they wish to be considered as Equity-Like Loans not later than 45 days prior to the end of the applicable Assessment Period. The purpose for this request is to enhance the Fund's ability to provide feedback to applicants as to whether a transaction meets the Equity-Like Loan requirements prior to the end of the applicable Assessment Period. The Fund will not redraft instruments or provide language for applicants. However, the Fund may comment as to the consistency of a proposed instrument with the above-stated policy requirements. Such information will allow applicants, if they so choose, to modify the instruments to conform to the program requirements prior to the end of the Assessment Period. This process is intended to prevent circumstances in which an applicant executes loan documents without review by the Fund only to learn after the close of the Assessment Period that the transaction is ineligible for a Bank Enterprise Award. The Fund cannot guarantee timely feedback to applicants that submit the aforementioned documentation less than 45 days prior to the end of the applicable Assessment Period.

First Accounts: For purposes of the BEA Program, a First Account is low-cost bank account provided to an "unbanked" individual (i.e., someone who currently does not have a banking relationship with a mainstream financial institution). To receive consideration as a First Account activity under the BEA Program, an account must:

- Be an individually owned account at a Federally-insured depository institution;

- Permit a minimum of four cash withdrawals and four balance inquiries per month, which are included in the monthly fee, through any combination of ATM transactions and/or over-the-counter transactions;
- Allow access to the depository institution's on-line point-of-sale network (if it has one);
- Require no minimum balance except as required by Federal or state law;
- Provide a monthly statement; and
- Provide the same consumer protections available to the institution's other account holders.

Optional Considerations in Developing a First Account Product: All First Accounts must offer the required features listed above in order to be considered a Qualified Activity under the BEA Program. In designing a First Account product, BEA Program applicants may also wish to consider how offering additional features could reduce costs, increase utility to consumers, and increase demand for these low-cost account products. Applicants may wish to consider the following features in designing First Accounts:

- <u>Low Monthly Fee</u>: Keeping the monthly servicing fee charged to account holders as low as feasible will make a First Account more appealing to unbanked consumers. For a typical unbanked Federal benefit recipient, monthly fees were an important factor in the overall decision to enroll in an ETA-like product. Lowering the monthly fee from $4 to $3 on an account like the ETA was predicted to increase overall participation by 33%.

- <u>All-Online Design and Flexible Account Opening Standards</u>: Creating an "all-online" First Account that permits no check-writing and reduces or eliminates off-line debits can reduce the risk of overdraft for account holders and institutions, thereby reducing costs to both parties. Studies indicate that at least half of currently unbanked families had a bank account at some time in the past.[1] Some of these now-unbanked families may have exited the financial services mainstream due to experiences with bounced checks or other off-line debits that led to overdrafts and high associated fees. BEA Program applicants may wish to consider how design of a First Account product could minimize the possibility of overdrafts. To the extent that First Accounts incorporate an all-online design, BEA Program applicants may also wish to consider making these accounts available to all consumers, including those who may have had overdraft problems in the past.

- <u>Direct Deposit</u>: Working with businesses located in Distressed Communities to use an institution's Direct Deposit payroll service may increase account ownership because such employers can encourage their low-wage employees to enroll in First Accounts. At the same time, Direct Deposit can save employers money over issuing paper checks to employees. Similarly, costs to a financial institution for processing a Direct Deposit are significantly lower than for handling a paper check deposit.[2]

- <u>Payment of Interest on Balances</u>: Offering the payment of interest on First Accounts balances may increase the appeal of these accounts to unbanked families. Financial institutions may, at their option, pay interest on ETA balances. Research commissioned by

---

[1] A 1997 study by John Caskey at Swarthmore College found that 71% of heads of household without deposit accounts had held a checking or savings account in the past. (See Caskey, John. 1997. *Lower Income Americans, Higher Cost Financial Services*. Filene Research Institute & Center for Credit Union Research, University of Wisconsin-Madison.) The Federal Reserve's analysis of the 1998 Survey of Consumer Finances indicated that 48% of families without a checking account had owned such an account in the past (See Kennickell, Arthur B., Martha Starr-McCluer and Brian J. Surrette. 2000. "Recent Changes in Family Finances: Results from the 1998 Survey of Consumer Finances." *Federal Reserve Bulletin* (January): 1-29).

[2] In the context of EFT '99, Treasury found that the cost of processing a Direct Deposit for a Federal payment is $0.01, versus $0.42 for processing and mailing a paper check.

Treasury showed that the payment of a passbook rate of interest on an electronic account like the ETA significantly increased the number of unbanked Federal benefit recipients that signed-up for such an account. Other Treasury research estimates that the higher balances would, for the most part, offset the cost of paying interest on ETA balances that account holders would be expected to maintain.[3]

- Bill Payment: Including a limited number of money orders (issued either electronically or through a teller) in the monthly service charge may increase the utility and appeal of First Accounts to unbanked consumers. An all-online First Account design would likely preclude check-writing capabilities; however, account holders would probably still seek a convenient, low-cost method to make long-distance payments. Studies indicate that unbanked families frequently use money orders to pay bills.[4] These money orders could be bundled with stamped envelopes (which many check cashing outlets sell with money orders) to further facilitate customer payments. BEA Program applicants may also wish to consider deploying technologies in Distressed Communities that would allow First Accounts holders to pay their bills online (e.g., ATM or internet bill payment).

IDAs: For both the Baseline Period and the Assessment Period, an Applicant may derive the total percentage of Low- and Moderate-Income individuals who are IDA account holders by: (1) providing a certification that such customers are Low- and Moderate-Income individuals and providing a brief analytical narrative with information describing how the Applicant determined that such customers were Low- and Moderate-Income individuals; (2) using the Fund's methodology described above; or (3) the Fund will presume that IDAs established for Project Participants by financial institutions, as published in Program Announcement OCS-2000-04 ("IDA Program Announcement") in the Federal Register (64 FR 69824) in Part II (G)(3) of the IDA Program Announcement, benefit Low- and Moderate Income individuals based on the requirements of the IDA Program.

In-kind contributions: In-kind contributions to CDFIs (such as donation of equipment or office space) are not a Qualified Activity and should not be reported.

Materially Below Market Rates for CDFI Deposits: Insured Certificates of Deposit placed by an Applicant in a CDFI that is bank, thrift, or credit union must earn a rate of interest that is determined by the Fund to be Materially Below Market. A Materially Below Market interest rate is an annual rate that does not exceed 80% of the rate on a U.S. Treasury bill of comparable maturity as of the date the deposit is placed. For a three-year deposit, use the three-year rate posted for U.S. Government Securities, Treasury Constant Maturity on the Federal Reserve website at www.federalreserve.gov/releases/H15/update on the day the Certificate of Deposit is placed. The rate on the website is updated daily at approximately 4:00 p.m. ET. If, at the time the Certificate of Deposit is placed, the posted three-year rate is from the previous day, Applicants should use the posted rate. Applicants must print the rate from the website for the date a Certificate of Deposit is placed. This sheet should be submitted with the application as documentation.

Participation Loans: A participation loan is a loan that is made jointly by two or more lenders to a borrower. Some participation loans involve a promissory note that references all of the

[3] *ETA Initiative: Optional Account Features*, Dove Associates, June 1998. Dove estimated that paying a passbook rate of interest (2%) on ETA balances would add only $0.06 per month to costs.
[4] Caskey found that 69% of surveyed households without deposit accounts had purchased more than 10 money orders in the previous year, and that 39 percent had purchased more than 30 (Caskey 1997).

lenders to the transaction with each independently disbursing loan proceeds to the borrower. However, the most common form of participation loan involves one of the lenders serving as a "lead lender" or "agent" for the group. In this case, the borrower signs the note to the order of the lead lender, solely. The lead lender then disburses all loan proceeds and the borrower makes payments of principal and/or interest solely to the lead lender. The other "participating lenders" usually sign a "participation agreement" that outlines their agreement to fund a portion of the loan issued by the lead lender, their respective rights to loan proceeds, and the obligations of all parties to the transaction. The lead lender and all of the participating lenders generally sign this agreement. It is important to note that the disbursement of funds to the lead lender or agent to fund loans to third parties by one or more participating lenders to the lead lender or agent does not constitute an eligible Qualified Activity.

A participation loan is treated as any other loan under the BEA Program. As such, it may qualify as either a CDFI Support Activity or a Distressed Community Financing Activity. In order for a participation loan to be considered a CDFI Support Activity, the borrower must be a CDFI and the monies drawn must be used to support the CDFI's activities. If the CDFI Partner is participating in, or otherwise facilitating, the loan transaction -- but is not the actual borrower -- the transaction will not be considered a CDFI Support Activity. In order for a participation loan to be considered a Distressed Community Financing Activity, the borrower or activity financed must be located within or integrally involved in a designated Distressed Community.

As with other loans, in order for a participation loan to be a Qualified Activity under the BEA Program, the loan must be closed and an initial disbursement made during the applicable Assessment Period. Thus, all parties to the transaction must sign and execute the loan documents within the Assessment Period specified in the applicable Notice of Funds Availability. If the transaction involves a participation agreement between two or more lenders, such agreement may be signed prior to or during the Assessment Period provided that the note or loan agreement is signed within the Assessment Period. A BEA Program applicant will not receive a BEA Program award for a participation loan unless it is specifically named as a lender or party to the original transaction in either the note or the participation agreement. Accordingly, a BEA Program applicant will not receive credit for purchasing a participation in a loan after the loan's origination if the applicant was not part of the original participation agreement.

In some cases, participation agreements between lenders may be in effect for multiple years, involve multiple loan agreements or notes, or involve multiyear disbursements on a single loan. While a participation agreement among lenders may be executed prior to an applicable Assessment Period, a BEA Program applicant shall receive an award only for a loan funding a particular Qualified Activity that is closed during the Assessment Period. Thus, a transaction involving a disbursement on a loan closed prior to the beginning of or after the end of the applicable Assessment Period is ineligible for a BEA Program award.

In some cases, a group of lenders may choose to renew or extend a participation loan the term of which is expected to expire during an applicable Assessment Period. As is the case with all renewed loans under the BEA Program, in the case of a loan that matures, is fully paid and is then renewed during the Assessment Period, the applicant will be ineligible to receive the full value of its share of the principal amount of the renewed participation loan. However, in the case of a participation loan that is not set to expire during the Assessment Period but is refinanced, the BEA Program applicant will be eligible to receive only the value of its share of any increase in the principal amount of the refinanced loan.

Renewals: Loans and Deposits that are renewed during the Baseline Period or the Assessment Period are not eligible as a Qualified Activity.

Refinancings: Refinancing of loans (including fixed rate and adjustable rate mortgages) may be valued only at the amount of increase to the principal amount of the loan (i.e., the new credit available). For example, if an Applicant originally financed a loan for $100,000 and the borrower subsequently wanted to refinance the loan and increase the amount borrowed to $125,000, the Applicant can only claim an increase in the principal amount ($25,000) for the purpose of receiving an award.

Technical Assistance: Technical assistance provided by an Applicant to a CDFI must be reported based on the administrative cost of providing the services. For staff time, report the number of hours contributed times the hourly salary of the staff member. For other administrative costs (such as printing costs for informational materials), report the actual cost. An Applicant should submit an itemized list of costs that it is seeking to be considered as a Qualified Activity. In reporting the cost of technical assistance activities, the Applicant should certify that the reported items are an accurate reflection of the actual costs incurred in delivering the service.

Technical Assistance or IDA Match Contributions: An Applicant shall report any financial literacy training or other types of technical assistance provided to ETA or IDA holders under the Community Services category. An Applicant should also report funds provided to match IDAs, either directly or through a non-profit entity, under Community Services.

Technical Assistance to First Account holders: Applicants seeking a BEA Program award for providing financial literacy classes or one-on-one technical assistance to First Accounts holders must submit documentation of the costs of providing such services and report such activities as Community Service Activities.