Community Development Bankers Association
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September 10, 2020

Ms. Jodie Harris
Director
Community Development Financial Institutions Fund
U.S. Department of Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Ms. Mia Sowell
Acting Program Manager
Small Dollar Loan Program
Community Development Financial Institutions Fund
US Department of Treasury
1500 Pennsylvania Avenue, NW
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RE: Response to Notice and Request for Information, Small Dollar Loan Program

Dear Director Harris and Ms. Sowell:

The members of the Community Development Bankers Association (CDBA) respectfully submit the enclosed comments on the Notice and Request for Information published by the Community Development Financial Institutions Fund (CDFI Fund) in the Federal Register on July 27, 2020. As stated, the CDFI Fund is seeking comment on its planned Small Dollar Loan Program (SDLP), a new program, authorized by the Dodd-Frank Wall Street Reform and Consumer Protection Act, to be administered by the CDFI Fund.

CDBA is the national trade association of banks and thrifts that have a primary mission of promoting community development. As of August 14, there are 145 banks and 102 bank holding companies with the Treasury's Community Development Financial Institutions (CDFIs) designation. CDBA membership comprises a majority of all CDFI banks and 57% of the total assets of the CDFI bank sector.

CDFI banks strongly support the efforts of the CDFI Fund to promote investments in low income and underserved communities by providing grants for Loan Loss Reserves (LLR) and Technical Assistance (TA) to enable Certified CDFIs to establish and maintain SDLPs. We appreciate the opportunity to provide feedback to maximize the effectiveness of this program for the benefit of the most underserved communities in the nation.

CDBA members and other CDFI depositories are primed to be the leaders in this initiative due to the wide range of their operating environments, histories and market demographics, as well as the built-in consumer protections and the complementary deposit products that come with their charters. With this background in mind, CDBA members wish to stress that the SDLP should strive to promote positive outcomes for consumers while minimizing harm.

To ensure the program promotes positive outcomes, CDBA urges the CDFI Fund to seize this opportunity to help CDFI banks adopt technology that will support CDFI-based SDLPs' competitiveness and sustainability well into the future. Examples of uses of technology include automating the marketing, underwriting, funding, servicing, and portfolio management of these loans. Further, where possible, the CDFI Fund should encourage institutions to achieve scale through technology-sharing partnerships between similarly structured lenders with complementary skills and target markets. Especially important, such technology can help ensure stakeholders (internal and external) are comfortable with the risk management associated with consumer financial products, for example, through better data organization and record management.

In addition, to protect consumers and the integrity of the CDFI industry, CDBA notes that practices that cause consumer harm (e.g. exacerbating the debt cycle through high costs and frequent renewals, and harassment or intimidation during collection) are well documented and should be prohibited. Applicants with a history of these practices should be carefully scrutinized, and their participation should be strongly discouraged. CDBA urges the CDFI Fund to be proactive and encouraging applicants to incorporate alternatives to debt collection, such as work outs, into their programs. In addition, selling delinquent or non-performing program loans to third parties should be prohibited.

While many applicants to the program are likely to be new to SDLPs, many CDFI banks have extensive experience offering small dollar loans in a variety of forms that range from convenience products to intentionally designed products focused on specific consumer outcomes. These banks' markets range from sparsely populated, rural communities to dense, urban areas. Some of our members report making loans as small as $500, and others have made "small dollar" loans up to $3,500. Some loans are priced as low as 5%, (simple interest), and others carry an APY of 16% or higher. Some members are accustomed to offering the loans as an accommodation, simply with the expectation that the community benefit is a worthy investment, while others focus on establishing the product's sustainability through an acceptable profit margin. Origination fees range widely, with some members waiving fees on the smallest loans. Importantly, CDBA banks do not universally report to the credit bureaus on these products, but some of those that do balance the reporting by requiring the completion of financial literacy curricula prior to applying, or by offering customers financial counselling over the term of the loan.

Our comments are organized below to respond to questions raised in the Notice and Request for Information.

I. SDLP Application

**A. Consumer Need**

*Question 1.*
"What market characteristics of lenders and lending products should the CDFI Fund prioritize in order to maximize the impact of its SDLP awards, including both need and environment?"

CDBA believes the SDLP should prioritize markets characterized by thin financial resources and high exposure to predation.

CDBA recommends that the CDFI Fund prioritize the following market characteristics in order to maximize impacts:

- CDFI Fund investment areas and eligible target populations;
- Federal Financial Institutions Examination Council (FFIEC) distressed and underserved census tracts, nonmetropolitan middle-income geographies, and persistent poverty counties;
- CRA deserts when identified and published by the Office of the Comptroller of the Currency (OCC), per updates to 12 CFR Parts 25 and 195, May 20, 2020[1];
- Areas with high concentrations of payday lenders, check cashers, and pawn shops;
- And areas that do not otherwise qualify above, but where demographic and economic trends are increasingly negative, such as those with dwindling populations and increasing rates of poverty and unemployment.

*Question 2.*
"How should such characteristics be measured?

CDBA recommends that these characteristics be measured based on areas of highest need. These can be ranked by existing high levels of distress/poverty, trends of increasing distress/poverty, and proportions of historically disadvantaged and underserved populations. These criteria will help ensure loans are deployed in areas of high need as there is a high correlation between these communities and concentrations of predatory financial services.[2]

[1] Per the OCC: "The final rule defines CRA desert as an area that has been confirmed by the agency to be a CRA desert because it has significant unmet CD or retail lending needs and where: (1) few banks have branches or non-branch deposit-taking facilities; (2) there is less retail or CD lending than would be expected based on demographic or other factors; or (3) the area lacks community development organizations or infrastructure. The final rule also provides that the agency will maintain an illustrative list of CRA deserts and includes a process for banks to obtain confirmation that an area meets the definition of a CRA desert."

[2] Pew Charitable Trust, "Payday Lending in America: Who Borrows, Where They Borrow, and Why"; July 19, 2012; www.pewtrusts.org/en/research-and-analysis/reports/2012/07/19/who-borrows-where-they-borrow-and-why

**B. Track Record**

*Question 1.*

"What characteristics should determine whether an Applicant has a limited track record with small dollar loans?"

CDBA notes that while it helps to make the distinction between experienced and inexperienced lenders, it is not clear that either group should be granted a blanket priority for participation in the SDLP. For example, many lenders with no or limited experience in small dollar loans may have been unable to enter the market due to high barriers to entry, but will be able to serve precisely the communities that need it most through participation in the SDLP.

With that in mind, CDBA suggests that lenders with less than one year of active small dollar lending experience should be considered to have a "limited track record." CDBA urges the CDFI Fund to limit the measurement of experience to time duration, and not to measure experience based on a lender's total small dollar loan output or on the percentage of small dollar loans with their portfolio. Both the dollar-value and the numbers of loans are potentially relatively small, so that these percentages would be inadequate for the purpose, even for smaller CDFIs.

*Question 2.*

"What questions should the CDFI Fund ask Applicants with no track record or limited track record with small dollar loans?"

CDBA suggests that, in the absence of a strong track record of small dollar lending, the CDFI Fund should prioritize consumer health. This can be achieved by ensuring that even applicants that are new to the product have the governance, technology, and regulatory compliance safeguards in place to avoid causing harm. For those that do not have strong controls in place, the CDFI Fund should establish a baseline for safe and sound operation of the program, while accepting that new steps will need to be taken. The ideal applicant will recognize what steps are still required to stand up the program, and articulate them in the application, even if they are not in place.

These questions should be direct, and illustrative but not numerous or require exhaustive analysis or discourse. Below are examples of some questions CDBA recommends for consideration:

- Please state your organization's goal in applying to the program.
    - How will your participation benefit your target market and the local economy?
- What are the market characteristics of your target population?
- How will your participation in this program benefit your target borrowing population?

- Describe which of the following your organization has in place, and their role in ensuring your success as a small dollar lender within safe and sound lending practices:
  - Management and board committees and composition (e.g., executive, governance, credit, compliance, technology and information security, operations, marketing, etc.);
  - Experience and responsibilities of staff and management responsible for the program, including any roles on committees identified above;
  - And policies and procedures already in place, or identified as needed, that will help ensure the program's success

*<u>Question 3.</u>*
"What questions should the CDFI Fund ask Applicants with a demonstrated track record with small dollar loans?"

CDBA suggests that, while an applicant may have an established track record of small dollar lending, the underlying principle of the CDFI Fund should remain to prioritize consumer health. As with less experienced applicants, this can be achieved by ensuring that more experienced applicants have the governance, technology, and regulatory compliance safeguards in place to avoid causing harm.

As before, these questions should be direct, and illustrative but not numerous or require exhaustive analysis or discourse. Below are examples of some questions CDBA recommends for consideration:

- What in your experience as a small dollar lender encourages your organization to continue offering the product? Please speak to this specifically in the context of applying for this grant.
- Please describe the small dollar lending program your organization has in place including its length of operation, product design, and historic and current loan volume including trends and performance.
- What are the market characteristics of your target population?
- How will your participation in this program benefit your target borrowing population?
- Describe which of the following your organization has in place, and their role in ensuring your success as a small dollar lender within safe and sound lending practices:
  - Management and board committees and composition (e.g., executive, governance, credit, compliance, technology and information security, operations, marketing, etc.);
  - Experience and responsibilities of staff and management responsible for the program, including any roles on committees identified above;
  - And policies and procedures already in place, or identified as needed, that will help ensure the program's success.

*Question 4.*
"What questions should the CDFI Fund ask Applicants with a demonstrated track record with loans that have similar characteristics to small dollar loans as defined by the SDLP, but may not meet the definition of small dollar loans for the SDLP?

CDBA urges the CDFI Fund to adopt a substantially similar approach to these applicants as to those described above.

*Question 5.*
"The CDFI Fund would like to gain a better understanding of diversity of experience with small dollar loan products. If you are a trade organization, what percentage of your membership currently offers a small dollar loan product? On average, how many years have your members offered this product?"

CDBA members have a diversity of experience. Some have offered products for many years, but – as the markets for CDBA banks range widely in geography and demographics, and the business model for CDFIs vary just as widely based on variables such as asset size, state of operation, and length of operation – percentages and averages cannot speak to the experience of members. Furthermore, many CDFI banks may not offer such a product in the form of a "program" or specially designated product code, but do make loans that would be recognized as "small dollar" as the need of customers arises.

**C. Technical Assistance Strategy**

*Question 1.*
"What types of TA services do organizations need when developing a small dollar loan program?"

CDBA urges the CDFI Fund to provide TA funding for the range of competencies required to stand up and manage a consumer finance product. However, the most pressing need is for technology to ensure products are scalable to compete in the increasingly digital market. While each of the basic requirements of operating a lending program have associated overhead costs, there are additional costs associated with standing up new products. Some tasks that may benefit from funding for technical assistance include modifying or drafting policies and procedures, training branch and lending staff, designing reports for management oversight and governance and compliance, modifying product fields in core systems, developing applications (in-branch or digital/online), developing and conducting outreach/marketing, or adopting technology that allows for partial or full automation of the application through servicing process.

*Question 2.*

"What questions should the CDFI Fund ask Applicants to assess their TA strategy for implementing an SDLP award?"

CDBA strongly urges the CDFI Fund to keep this section simple. A short open ended question should meet the need, such as:

- Identify the steps and which costs related to Technical Assistance your implementation of a small dollar loan product will require.

**D. Other Application information**

<u>*Question 1.*</u>
"What data fields, questions, or tables should be included in the Application to ensure collection of relevant information that supports the Applicant's track record, business strategy, or TA strategy?"

CDBA urges the CDFI Fund to consider the amount of time required in applying, and suggests that the following fields are relevant and should be included. (The list is not intended to be comprehensive):

- Organization type (e.g. loan fund, bank, or credit union);
- Length of operation;
- Primary funding sources;
- Board composition and organization chart with CVs of key officers charged with implementing the program;
- If a bank, most recent CRA rating;
- If a loan fund, most recent Aeris rating;
- Asset size;
- Portfolio composition by product;
- Identify existing technologies and resources related to delivery of the small dollar loan;
- And identify technology and resources needed, but not yet in place, related to the delivery of the small dollar loan.

II. <u>Minimum and Maximum Award Sizes</u>

<u>*Question 1.*</u>
"If your organization already offers small dollar loans (or other products with similar risk), what percentage and dollar amount of the portfolio is reserved for LLRs for small dollar loans?"

CDBA suggests that, as it relates specifically to a LLR award, a maximum amount should be awarded based on the total amount the applicant plans to originate, e.g. a maximum award of 25% of the total projected originations.

*Question 2.*
"What other information or data should the CDFI Fund take into consideration when determining the minimum and maximum award amount for grants for LLRs and/or TA?"

CDBA urges the CDFI Fund to consider the applicant's ability to leverage funds into loans. For example, a CDFI bank may be able to leverage capital between 10x and 12x into loans.

For LLRs, the CDFI Fund should also consider the term and the consequent time period between the origination of a small dollar loan and the date it may actually charge off. Each program will be different, but some programs may allow for modifications and/or amendments to the loan. These types of allowances may significantly delay the charge off. Therefore loans that are originated in the 2nd year of the program may not charge off until the 3rd year. Depending on the term of the loan, this may adversely affect the lenders ability to utilize the LLR for an actual loss as it could be outside of the reporting period.

*Question 3.*
"What should the CDFI Fund take into consideration when determining the minimum and maximum award amount for a Recipient with:

a. A demonstrated track record, if the reporting period is two years?"

CDBA members suggest that $250,000 would be an adequate maximum for a large, experienced lender applying for LLR, if defaults are in the 5% to 10 % range. For TA, a range of 20% to 25% of projected costs is appropriate. Related, CDBA urges the CDFI Fund to consider that the reporting period should be responsive and reflect the maturity date of the last loan originated during the award period, rather be an arbitrary period such as two years.

b. "A limited track record (or plans to enter the small dollar loan line of business shortly after receiving an award) if the reporting period is three years?"

CDBA notes that three years is a long reporting period for loans that would conceivably be termed at one year on the long end and often even shorter. The reporting period should reflect the maturity date of the last loan originated during the award period. The maximum loan amount should not necessarily be different for a lender with a limited track record; please see comment above.

## III. Small Dollar Loan Characteristics, Policies, and Practices

*Question 1.*
"What characteristics of a Recipient's small dollar loan program could help achieve this objective (of giving "consumers access to mainstream financial institutions"?)

CDBA strongly supports this objective. One suggestion that will inevitably be made is to consider a borrower's "ability to repay." However, CDBA notes that requiring a determination of the ability to repay could be detrimental to the goals of the program. CDBA urges the CDFI Fund to consider alternatives. First, often a small dollar loan is an alternative to a payday loan, check casher, or pawn shop charging much higher rates/fees; the attraction of these predatory products incudes ease of access. If the CDFI Fund requires a CDFI bank to establish and document an "ability to repay" (beyond underwriting within the bounds of the banks obligation to operate in a "safe and sound" manner) on each small dollar loan, it will be time consuming and therefore discouraging to consumers. Experienced CDBA members also note that payment options such as automated clearing house (ACH) or payroll deductions contribute to a positive borrower experience and encourage access to mainstream financial services.

Lenders can also help customers by offering an option for borrowers to complete a financial literacy course at no-cost before applying. (Lenders should be encouraged to carefully consider how this is implemented, as <u>requiring</u> such courses may pose an unnecessary hurdle to entry for some borrowers.)  A financial literacy course, and the product design itself, may also entail the opening of a low or no minimum checking or savings accounts with a requirement to hold a portion of the loan proceeds at the bank as a form of collateral (e.g. on a borrow-and-save model).

One especially effective element is to introduce a longer term on the loan than is typical for non-CDFI SDLPs. CDBA members that are experienced with small dollar loan products recommend up to a one-year term. These members note that one year appears to be both effective in reducing the burden of each months payment, while being short enough not to discourage borrowers who find they are "only" halfway to full repayment after 12 months. Terms longer than one year are less effective, and potentially burdensome for the borrower.

CDBA members have also shared that one other potential suggestion, the adoption of "alternative credit scores," is a potential red herring – they have not in our members' experiences enhanced their ability to gauge credit risk among underbanked populations, and may contribute only in the sense that they drive up program costs.

## IV. <u>Regulatory Requirements and Restrictions</u>

*<u>Question 1.</u>*
"Is there an expectation the regulatory costs associated with implementing a small dollar loan product will vary widely depending upon the type of CDFI, asset size, anticipated product volume, loan terms, and intended customers? If so, how should this be addressed in the SDLP NOFA and Application?"

CDBA believes the regulatory costs may vary somewhat for CDFI banks as three national regulators (OCC, FDIC, and the Federal Reserve), the CFPB, and all state regulators have a role in bank oversight. However, the compliance costs of offering small dollar loans, while not negligible, may be overstated for CDFI banks, as CDFI banks have discretion to design products within the bounds of safe and sound banking practices and state usury laws, and are already accustomed to complying with banking regulations such as the Equal Credit Opportunity Act and the Truth in Lending Act. The compliance variation will likely be found in unregulated CDFIs, which will likely find a greater challenge in starting a program.

The CDFI Fund's SDLP should consider that larger lenders, measured by asset size (e.g. CDFI banks as a whole, compared to other CDFIs), are more likely to be prepared to scale a successful program over a larger geographic area. Within this group, the CDFI Fund should give priority for TA awards to those CDFI banks which are relatively small, as these lenders will require the most assistance with the operating costs of the program.

*Question 2.*

"Will the cost burden for those CDFIs with a previous track record of implementing a similar loan product vary considerably when compared to CDFIs developing a new small dollar loan product without prior experience? If so, how?"

Yes, it will vary. The cost of standing up a new product can take considerable employee resources, and even for institutions with a previous track record, participating in this program may include revising existing policies, reviewing governance and oversight, adding a new product to the core system, establishing new vendor relationships (credit reporting and loan servicing software), and the costs of collecting on delinquent loans.

*Question 3.*

"Is there an anticipation that the cost burden for implementing a new small dollar loan program will vary significantly between CDFIs of varying size and complexity? How should this be addressed in the SDLP NOFA and Application?"

Please see CDBA's answers to questions 1 and 2 in this section. The cost of standing up a new product will take considerable employee resources, including drafting new policies and establishing governance and oversight. CDFIs of varying sizes can be correspondingly various in their preparation requirements, particularly with regard to technology. This could be addressed by making the Technical Assistance grant size responsive to an institution's size and level of experience.

Costs could be also mitigated while ensuring positive impact by permitting industry groups to partner and submit as a class for their members to offer a common product and take advantage of scale opportunities through technology-based shared services. (See VI.1 below.)

*Question 4.*

"For those CDFIs that decide to implement a homogenous small dollar loan product (e.g., standard rate, term, amount, etc.), is there an expectation this approach will result in lower regulatory and/or financial costs? If so, how? How should this be addressed in the SDLP NOFA and Application?"

CDBA urges the CDFI Fund to establish a program that provides maximum flexibility to reflect and meet the needs of the wide range of communities and CDFI lenders, which naturally represent a variety of cost models, market needs, and regulatory requirements. To the extent that there are costs to individual institutions to standing up a program, these could conceivably be mitigated through a "homogenous" product option, or an option for industry groups to partner on applications which incorporate shared services technology to achieve scale. However, the introduction of a "homogenous" product should not obligate CDFIs to adopt it, nor should the CDFI Fund discourage CDFIs from pursuing innovation through highly individualized "heterogeneous" products.

V. Financial Institution Type

*Question 1.*
"Are there specific topics that are unique to various organization types that the CDFI Fund should consider when drafting the application questions? (Yes/No)."

Yes

*Question 2.*
"If yes, please describe the topics that are unique to the following organization types, based on the information that could be provided in the Applicant's track record, business plan, projected outcomes, and management capacity.

a. Certified CDFI banks/thrifts?"

CDBA notes that banks and thrifts (along with credit unions) bring a strong advantage in the ability to tie small dollar loans to savings products – a valuable potential component of a SDLP. One effective example of this is the borrow-and-save model, where part of the loan starts a savings account at the depository lender. Once a borrower fully repays the loan, the savings and the interest earned belong to the borrower.

Additionally, as regulated entities, banks and thrifts have several layers of controls built in to help ensure that small dollar loan products are offered in a safe and sound manner that complies with existing regulations.

e. "Certified CDFI bank/thrift partnership with a non-CDFI Federally Insured Depository Institution."

CDBA does not see a situation where a CDFI bank would benefit from partnering with a non-CDFI depository on this program. Further, CDBA urges the CDFI Fund to severely limit CDFI partnerships of any type with non-CDFI depositories. Both banks and credit unions are at least as capable, and vastly more experienced, in meeting the needs of low- and moderate-income (LMI) consumers for affordable financial products and services. To the extent that a non-depository CDFI would like to partner with a depository on the program, the depository should be a CDFI, or a consortium of depository CDFIs.

CDBA urges the CDFI Fund to guard against potential “rent a bank” arrangements in its program design to the extent allowable under the law. CDBA is particularly concerned that the OCC’s “true lender” proposal[3] of July 20, 2020 introduces risk in the form of partnerships that would match **non-depository for-profit CDFIs** with **non-CDFI depositories.** The risk arises as the proposed rule “specif(ies) that a bank makes a loan and is the “true lender” if, as of the date of origination, it is (1) named as the lender in the loan agreement or (2) funds the loan.” In these circumstances, a non-depository, for-profit CDFI could ignore state interest rate limits as long as an OCC regulated non-CDFI bank “funded the loan.” This opens the door to potentially detrimental “rent a bank” schemes whereby the non-depository for-profit CDFI would claim to act as an “agent” for a national bank, while originating the loan at an interest rate that falls outside of the mission of the CDFI Fund and the goals of this program.

## VI. Community Partnerships

*Question 1.*
“Please describe or provide examples of partnerships that may wish to apply for an SDLP award.”

CDBA believes the most successful partnerships will leverage technology to bring institutions with complementary skills together. One suggestion for a successful partnership is when a non-profit, non-lender refers clients receiving financial counseling to a CDFI bank. The arrangement ensures that borrowers are prepared and knowledgeable about financial products, reducing risk in the product and relieving the lender of some marketing uncertainty. Lenders may also arrange with these non-profits to provide counselling services to borrowers engaged through other channels. Services could be offered at no cost to the borrower over the course of the loan. Both options can be mutually beneficial.

Another example would be allowing industry groups to partner and submit as a class for their members to take advantage of scale opportunities through technology-based shared services. For example, a cohort of CDFI banks might partner to work with a white label financial technology (FinTech) loan origination platform to drive online customer

[3] Docket ID OCC-2020-0026, https://occ.gov/news-issuances/news-releases/2020/nr-occ-2020-97.html

acquisition and initial underwriting, while allowing individual banks to fund and service loans in their respective service areas. This form of partnership might also be used to establish a common program to manage defaults, assist with efforts to work out loans (or collect if desired), and even balance lender portfolios at a manageable charge-off level across partners.

*Question 2.*
"What are the benefits to end users if the Recipient of the SDLP award is a partnership?"

CDBA notes that all partnerships introduce a certain amount of risk, as they are inherently more complicated. However, a strong partnership should deliver economies of scale, reduced shared costs, and expand consumer benefits via complimentary lender skill sets. The risk would be that the partnership might end up being more trouble to establish and maintain than expected, or that it may fail to work entirely, exposing the CDFI Fund and the partners to reputation and even legal risk. Ideally, a partnership for this program's purposes would be based on a pre-existing relationship centered on a related product delivery model.

*Question 3.*
"What additional or specific criteria should the CDFI Fund use to evaluate Applicants that apply as a partnership?"

CDBA strongly urges the CDFI Fund to limit the participation of depository institutions to certified CDFIs. Non-lender non-profits should have a sufficiently public profile to be evaluated for their record of consumer complaints (by, e.g., either the Better Business Bureau or a suitable government authority), their financial health through publicly available tax filings, the strength and experience of their leadership, and a demonstrated track record providing the service they will contribute to proposed partnership. CDFIs should be evaluated on the criteria required for participation, as well as for their preparedness to operate within a partnership. Both parties should have designated and experienced staff to oversee the partnership, and these staff should be clearly accountable to senior management. A comprehensive draft memorandum of understanding would, ideally, be prepared prior to the application being submitted.

*Question 4.*
"Which responsibilities should be conducted solely by the CDFI entity and not the partner organization during the Period of Performance of the SDLP award?"

CDBA urges the CDFI Fund, at the minimum, to ensure that CDFIs are responsible for establishing underwriting standards and for funding and servicing the loan.

*Question 5.*
"How can the CDFI Fund determine if a non-CDFI partner has 'a primary mission to serve targeted Investment Areas?'"

CDBA strongly believes that the CDFI Fund should place trust in CDFIs to determine the best partner for them serve their targeted Investment Areas.

In the case of partnerships with non-CDFI depositories, CDBA urges that the participation of depositories be limited to CDFI depositories, but in the event it appears beneficial on a case-by case basis to include non-CDFI depositories, the CDFI Fund should consider a bank's track record of serving its CRA assessment area as expressed in its CRA rating, as a proxy for primary mission. Unfortunately, there is not a corresponding standard for credit unions, and, for many credit unions, the field of membership criteria has been stretched beyond recognition.

## VII. Evaluation Criteria for Measuring Success

*Question 1.*
"Please describe some of the outcomes associated with offering a small dollar loan product. (An outcome measures the successes and achievements associated with the product.)"

CDBA recommends the CDFI Fund consider the following outcomes to measure the success and achievement associated with the product:

- Are customers satisfied?
- Did customers transition to lower-cost financial products?
- Did customers establish savings/build assets?
- Do initial results suggest the product is sufficiently profitable to continue financially?
- Were partners satisfied?
- What was the effect on consumer credit scores?
- Did customers demonstrate "stickiness" to the CDFI, by, e.g., using additional products?
- Did the applicant establish its commitment to responsibly reinvest in the community?

In addition, although the CDFI Fund should track repayment rates, CDBA cautions that managing SDLPs can be challenging in the early stages. CDBA emphasizes that there should be no requirement or threshold related to repayment rates.

*Question 2.*
"Please describe some of the outputs a financial institution and/or its stakeholders experience as a result of offering a small dollar loan product. (An output identifies the end result that occurred after the small dollar loan product was offered.)"

CDBA recommends the CDFI Fund consider the following outputs that should result from participating in the SDLP:

- Increase in loan volume,
- Loan repayment rate,
- Rate of customer retention (relationships built),
- And change in deposit account balance.

*Question 3.*

"Many financial institutions have not previously offered a small dollar loan product, or have a limited track record of doing so. Please describe some of the barriers to entry financial institutions may experience related to small dollar loan products."

CDBA recommends the CDFI Fund consider the following barriers to entry:

- Regulatory uncertainty: While small dollar loan products fall squarely within the "wheel house" of depository CDFIs, some smaller banks or credit unions might not have the institutional knowledge to appreciate the extent to which the banking regulators have encouraged and provided guidance for those offering these products. The CDFI Fund can help ensure broad and representative participation by enlisting the federal regulators to help provide outreach and assurance among CDFI depositories.

- Profitability uncertainty: While all CDFIs endeavor to operate at a level of financial sustainability, depository CDFIs have exceptional obligations in the form of shareholders and safety and soundness obligations which might discourage them from participating in an otherwise untested program. The CDFI Fund should provide assurance to the lenders that the program has sufficient flexibility to allow lenders to design and price products at a level that the lender determines will meet the expectations of both its shareholders and stakeholders.

- Reputational uncertainty/risk of criticism: While CDFIs generally enjoy a strong reputation where they are known, the CDFI brand itself may be insufficient to guard against criticism from understandably skeptical community advocates or even government officials who are accustomed to small dollar loans being the province of predatory lenders. The CDFI Fund should conduct active outreach to prepare stakeholders for the launch of the product and engage community in the program's success. This outreach should be conducted both directly by the Fund, and through materials and tool kits for trade groups and the CDFIs themselves.

## VIII. Performance Goals, Compliance, and Reporting

### A. Period of Performance

*Question 1.*

"Should a SDLP Recipient with a limited track record (e.g., those with less than two years of experience) be required to report on its use of the SDLP award for more than two years?"

CDBA suggests that an accurate figure can be best achieved by requiring a SDLP Recipient as described above to report through the maturity date of the last loan originated during the award period. Reporting should be limited to annual reports.

*Question 2.*
"Are there additional factors the CDFI Fund should consider in determining the Period of Performance?"

CDBA members report that product term is an important additional factor to consider. While small dollar loan products are commonly thought of as short-term loans, CDBA members report that extending the term on small dollar loan products, in some cases out to a year (but not necessarily longer), improves the affordability and therefore the repayment rate of these loans, contributing positively to community impact. In a situation where the period of performance goes through the maturity date of the last loan originated, this would be one year after the origination of the last loan originated.

**B. Performance Goals**

*Question 1.*
"What is the minimum dollar volume of small dollar loans that an award recipient should be expected to make based on its award amount (for example, $10 of loan volume for every $1 of award)? Should this ratio vary based on the amount of award used for LLR vs. TA, and if so, why and how?"

CDBA members note that the loss risk on small dollar loan products is probably the biggest obstacle initially for lenders. For discussion purposes, the CDFI Fund might consider that, if an expectation is that 25% of loans will end up as a charge off, the Fund might expect a ratio of $4 loan in volume for every $1 of award. This would eliminate the charge-off risk and potentially encourage CDFI's to enter the market.

CDBA members also note that, if the award is used to effectively to "buy down" the interest rate via LLR awards, there might be a corresponding increase in applications. However the extent to which potential borrowers are rate sensitive has not been established, and a minimum remains difficult to establish on this point.

*Question 2.*
"Are there other performance goal(s) the CDFI Fund should consider for SDLP Recipients who commit to using their awards for

a. Loan Loss Reserves?"

CDBA urges the CDFI Fund to identify a base threshold for leveraging impact for LLR awards (e.g. 5x). This will influence the credit enhancement level, total dollars deployable, underwriting risk levels, and ultimately pricing of the product that award recipients will consider in the context of their own business models.

"b. Technical Assistance?"

CDBA suggests that Technical Assistance award recipients should demonstrate that awards contribute to the efficient marketing, underwriting, funding, servicing, and portfolio management of a small dollar loan program. The correct measure for this activity is against the award recipient's own stated goals.

*Question 3.*
"What units of measurements should be used in establishing performance goals for Recipients? For example, cumulative dollar amount of small dollar loans closed over the Period of Performance, growth in average size of small dollar loan portfolio outstanding over the Period of Performance, etc."

CDBA notes that the units or measurement for performance goals will naturally depend on the goals of each program, and will therefore vary. Some programs may have more innovative ideas/approaches that warrant different performance goal requirements. Generally, the cumulative dollar/number of small dollar loans originated would be an appropriate baseline measurement.

*Question 4*
"Should there be any differences in the reporting goals for award Recipients with limited track records versus established track records? If yes, please describe."

Yes. CDBA urges the CDFI Fund to recognize that recipients with limited or no track record should not be expected to grow the portfolio at the same rate as an experienced lender. Lenders should be permitted to set goals that are appropriate not just to their experience level but also to their market need and institutional capacity and comfort level.

**C. Reporting Requirements for Recipients**

*Question 1.*
"Should SDLP recipients structure their loan systems to track usage of the SDLP at a loan level? Would this be a burden, and if so, in what way?"

CDBA notes that tracking data is critical to understanding the changes in the risk portfolio. However, restructuring a loan system to accomplish this may be unavoidable for many lenders if personal loans are not already offered, and even establishing a new product in any core system will require some work. Some smaller lenders may find that it is easier to track loan usage outside of their loan system due to the challenges in deriving customized reports from databases. The CDFI Fund should set the smallest acceptable minimum requirement for tracking data, and permit lenders to track usage in the manner best adapted to their size, cost structure, and other resources. However, in order to encourage higher levels of sophistication, the Fund should encourage technology sharing partnerships between similarly structured lenders with complementary skill sets and target markets.

*Question 2*
"In addition to annual reporting, should the CDFI Fund require supplemental (e.g. quarterly, semiannually, etc.) reporting for limited experience award Recipients?"

CDBA strongly urges the CDFI Fund not to require supplemental reporting as described above. The first likely effect will be to discourage participation, followed by frustration and noncompliance among those that do participate. The key challenge for many lenders will be to make changes in reporting systems or adopt new technology to capture required fields so that the desired level of reporting is possible.

IX. General

*Question 1.*
"Are there any clarifications the CDFI Fund should consider providing to the Proposed Definitions of Key Terms?"

CDBA members with experience making small dollar loans report that, at least occasionally, an individual may apply for a personal small dollar loan with the intention of using it for a commercial purpose, such as buying supplies for a home-based enterprise. While CDBA recommends permitting program CDFIs to build flexibility into the program, we primarily urge the CDFI Fund to clarify the permissibility one way or the other.

CDBA further notes that some innovative lenders may seek to deliver small dollar loans through card-based delivery systems. Lenders may also find a market for products which entail a revolving component, versus a term loan structure. CDBA strongly urges the CDFI fund to permit participating CDFIs flexibility in their choice of delivery system, and to clarify what delivery systems will be permitted. CDBA further urges the CDFI Fund to permit flexibility in the structure of loans. It is therefore essential for lenders to know whether the product will be limited to a term product, or whether there may be flexibility to structure the product as a line (with multiple draws permitted, and payments made only on the amount outstanding) or a revolver.

CDBA also asks the CDFI Fund to clarify whether there is an intended range of approved use of funds in the program (or prohibited uses), or whether lenders may themselves determine any restrictions based on their market, regulatory environment, and business model.

*Question 2.*
"Please describe potential unintended impacts (positive or negative) of SDLP awards on overall credit availability within underserved communities."

CDBA is concerned that consumers with existing poor credit, or little or no experience with personal loans, are at risk of exacerbating poor credit or even initiating a detrimental history that is difficult to resolve. This risk may be minimized to some extent but cannot be entirely ruled out. The CDFI Fund should enlist experienced lenders and community partners to assist program participants by circulating "best practices" (such as financial counselling, offering longer terms, and providing savings components) that can be built into product offerings to minimize potential harm.

*Question 3.*
"Is there any other information the CDFI Fund should consider in establishing this program?"

CDBA members emphasize the importance of sharing lessons learned through the program, and suggest the CDFI Fund develop a system for facilitating this sharing, such as a message board, to approach sharing in as close to "real time" as possible. A system like this will help identify opportunities and mitigate risks, such as fraud, early on, and promote a general feeling of cooperation and industry collegiality.

The most central lessons "already" learned and shared are (1) the importance of building a financial literacy and counseling component into the program and (2) offering a savings component to the extent possible, both to mitigate lender risk and provide borrowers with a joint feeling of success in paying off debt while concurrently building assets. These contribute as "buffers" to ensure that the program goal of minimizing harm to borrowers extends to borrowers with no or already poor credit.

In conclusion, the membership of CDBA fully appreciates the thoughtful consideration of the CDFI Fund and its staff in continuously seeking to improve the effectiveness of the CDFI industry in contributing to positive outcomes in LMI communities. We sincerely we appreciate the opportunity to comment and offer feedback. We look forward to future discussion on these important issues.

If you have any questions, please contact Jeannine Jacokes, CDBA Chief Executive Officer, at 202-689-8935 ext. 222 or *jacokesj@pcgloanfund.org*, or Brian Blake, Public Policy Director at 646-283-7929 or *blakeb@pcgloanfund.org*.

Thank you for considering our recommendations.

The Membership of the Community Development Bankers Association

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