CDBA Community Development Bankers Association
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May 14, 2021

Via Electronic Submission

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave., NW
Washington, DC 20551

RE: Issues Specific to Subchapter S and Mutual CDFI Banks, per Amendment to the Capital Rule to Facilitate the Emergency Capital Investment Program (ECIP); Docket No. R-1741 and RIN No. 7100-AG11

Dear Ms. Misback:

The members of the Community Development Bankers Association (CDBA) respectfully submit the enclosed comments regarding Subchapter S (Sub S) and Mutual CDFI bank-specific issues in response to the interim final rule (IFR) request for comments related to the Board of Governors of the Federal Reserve System (the Board's) implementation of the Emergency Capital Investment Program (ECIP).

CDBA is the national trade association for banks and thrifts that are US Treasury-designated Community Development Financial Institutions (CDFIs). Our members have a primary mission of promoting community development and target at least 60% of their total lending and activities to Low- and Moderate-Income (LMI) communities and customers that are underserved by traditional financial service providers. Sub S and Mutual structures are common throughout the CDFI bank and MDI industries – some industry estimates place between 30% and 40% of these eligible banks in one of these categories. However, these banks are heavily disfavored (versus C Corps) under the current proposed terms of the ECIP program and existing Board regulatory requirements, especially due to their limitation to receiving Sub Debt only, rather than preferred equity.

ECIP has an enormous potential to improve the economic lives of millions of people in the nation's most distressed communities. ECIP also has the potential to catalyze the next phase of growth and development for CDFI Banks and MDIs. Yet, distressed communities served by Sub S and Mutual CDFI banks will see only a fraction of the benefit relative to those served by C Corps without material changes to the Subordinated Debt term sheet and regulatory treatment of ECIP capital. Without the adjustments outlined below, tremendous opportunity will be lost and ECIP will fall short of meeting its Congressionally mandated purpose.

AMEND THE DEBT TO EQUITY / LEVERAGE RATIO AND DOUBLE LEVERAGE RATIO FOR SUB S AND MUTUAL BANKS

CDBA strongly recommends that the Board modify the Small Bank Holding Company Policy Statement (the Policy Statement) in connection with the IFR and create an exception under Section 2.C (Dividend restrictions). This exception should allow S Corp and Mutual bank holding companies to exceed a 1.0:1

debt-to equity ratio and still issue dividends. Because S Corp and Mutual CDFI banks and MDIs are small organizations, it will be impossible for them to keep their debt-to-equity ratios at 1.0:1 while applying for the amounts Congress authorized. As an example, some CDFI banks estimate that the current regulations would variously limit S Corp and Mutual banks' ECIP capital to only 2% or 5% of assets, a fraction of the potential (up to 15% for banks with assets greater than $2 billion, 25% for those $500 million to $2 billion, and 30% for those under $500 million) allowed under ECIP rules.

Providing such an exception to exclude 100% of ECIP Sub Debt from the Board's Debt to Equity and Double Leverage Ratios would be consistent with the position the Board took with respect to the Temporary Asset Relief Program (TARP), established by the Emergency Economic Stabilization Act of 2008. At the time TARP was established, the Board amended Section 2.A of the Policy Statement to add language clarifying that:

> *"Notwithstanding any other provision of this policy statement and for the purposes of compliance with paragraphs 2.C [Dividend Restrictions]… a bank holding company that has made a valid election to be taxed under Subchapter S…may exclude from debt subordinated debentures issued to the United States Department of the Treasury under [TARP]".*

Further, we urge the Board to modify the bank holding company double-leverage ratio as part of its overall safety and soundness supervisory review of the organization. The double-leverage ratio is generally computed by dividing the bank holding company's investment in the banking subsidiary by its total equity capital. A double-leverage ratio will be considered by the Board to be high once it exceeds 120%. At this point, the bank holding company may become subject to additional regulatory scrutiny by the Board's supervision and regulation team. CDBA recommends that the Board modify the definition of the double-leverage ratio to exclude from the ratio some portion, or all, of an ECIP-related BHC investment into a banking subsidiary.

If the Board does not make these amendments, this time to acknowledge ECIP and exclude ECIP Sub Debt from the overall debt calculation for the purposes of calculating these ratios, S Corp and Mutual CDFI banks and MDIs will be forced to limit their capital application. The organizations closest to the underserved communities will be materially curtailed in their ability to participate in ECIP, expand services in needy communities, and reach deep to address systemic economic challenges.

ELIMINATE UNEQUAL TERM SHEET OFFERINGS FOR SUB S AND MUTUAL BANKS

CDBA strongly urges the Board and regulatory Agencies to revisit the term sheet for subordinate debt offered to Sub S and Mutual Banks. We believe several provisions are in direct conflict with the ECIP authorizing statute:

- ECIP's authorizing statute says that the maximum rate for both forms of capital is 2%.[1] The Sub S and Mutual term sheet, however, states that banks receiving Subordinate Debt are subject to a maximum rate of 2.5%. The rate on both investments should adhere to the statutory maximum of 2%, without exception.
- The statute states that sub debt should receive treatment consistent with the Tier 1 treatment for preferred stock.[2] Yet, the Sub S and Mutual term sheet say it will be treated as Tier 2. The

[1] "No dividends, interest or other similar payments shall have a rate exceeding 2 percent per annum for the first 10 years."
[2] "Consistent with requirements . . . applicable to the terms of preferred stock issued by institutions participating in the program."

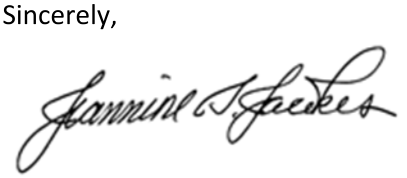
capital treatment should be consistent with the statute. Thus, the capital treatment for all ECIP investments should adhere to the Tier 1 statutory requirement for “consistency” as required by the statute.

- The C Corp term sheet offers stock with perpetual maturity, while the Sub S and Mutual term sheet offers a 15 year term. This discrepancy is inconsistent with the ECIP statute and amounts to preferential treatment for C Corps. The Board must ensure the capital offered to Sub S and Mutual banks is “consistent with requirements …applicable to the terms of preferred stock issued by institutions participating in the program.” CDBA recommends that a term of not less than 30 years – but preferably 40 years – would make the subordinated debt instrument comparable in practical terms for the perpetual term of the C Corp offering. For example, Trust Preferred Securities, when they were used, had a term of up to 30 years. A term of 15 years for ECIP capital is entirely inadequate.

In conclusion, the membership of CDBA appreciates the thoughtful consideration of the Board and its staff as ECIP is implemented. This is a wonderful opportunity to expand the positive influence of a long-standing market-based solution within COVID-impacted communities, and we sincerely 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.

Sincerely,



Jeannine Jacokes
Chief Executive Officer