

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

MEMORANDUM

To: Members, Subcommittee on Economic Growth, Tax, and Capital Access
From: Sharice Davids, Chairwoman
Date: May 18, 2021
Re: Subcommittee on Economic Growth, Tax, and Capital Access Hearing:
“Examining the Role of Community Development Financial Institutions and
Minority Depository Institutions in Small Business Lending”

The Committee on Small Business will meet for a hybrid hearing titled “Examining the Role of Community Development Financial Institutions and Minority Depository Institutions in Small Business Lending.” The hearing is scheduled to begin at **10:00 A.M. on Tuesday, May 18, 2021, in person in 2360 Rayburn House Office Building, and virtually via the Zoom platform.** The hearing will introduce Members to Community Development Financial Institutions (CDFIs) and Minority Depository Institutions (MDIs), and will discuss the impact these institutions make in their communities, especially with respect to supporting local entrepreneurs. Members will also learn about the SBA and non-SBA programs intended to support CDFIs and MDIs.

Panel

- Ms. Aissatou Barry-Fall, President/CEO, Lower East Side People’s Federal Credit Union, New York, NY
- Mr. Everett Sands, Founder/CEO, Lendistry, Brea, CA
- Mr. Robert James II, President, Carver Development CDE and Chairman, National Bankers Association, Savannah, GA
- Mr. Walter L Davis, Founder, Peachtree Providence Partners Holding Company, Charlotte, NC

Background

Community Development Financial Institutions

Community development financial institutions (CDFIs) are specialized financial institutions that work in markets underserved by traditional financial institutions. CDFIs provide a range of financial products and services on a fair and transparent basis in economically distressed markets, such as mortgage financing for low-income and first-time homebuyers and nonprofit developers, flexible underwriting and risk capital for needed community facilities, technical assistance, and loans and investments to small businesses in low-income areas. CDFIs operate in both rural and urban communities. CDFIs include regulated institutions, such as community development banks

and credit unions, and nonregulated institutions, such as loan and venture capital funds. Today, there are CDFIs in all 50 states, the District of Columbia, Puerto Rico, and Guam. As of April 14, 2021, there are 1,264 CDFIs certified by the Department of the Treasury (Treasury).¹

Minority Depository Institutions

Minority Depository Institutions (MDIs) are depository institutions (including credit unions) where 51 percent or more of the stock is owned by minority individuals, including Black Americans, Asian Americans, Hispanic Americans, and Native Americans.² In addition to institutions that meet this ownership test, the Federal Deposit Insurance Corporation (FDIC), which maintains a list and tracks the insured MDIs it supervises, as well as those supervised by the Office of the Comptroller of the Currency (OCC) and the Federal Reserve will consider an institution for MDI designation if a majority of its Board of Directors is minority and the community the institution serves is predominantly minority. Many MDIs are also CDFIs.

As of December 31, 2020, there are 142 MDIs insured by the FDIC.³ Historical data published by FDIC shows MDIs have steadily consolidated since the Great Recession. They have declined in number from a peak of 215 in 2008 to 142 in 2020, but in that time span, increased in average asset size. This trend of diminishing access points to MDIs is worrisome because MDIs better serve borrowers who live in low- and moderate-income (LMI) census tracts.⁴ A study published by the FDIC in 2019 found that compared with non-MDIs, MDIs originate a greater share of SBA 7(a) loans to borrowers in LMI census tracts and to borrowers in census tracts with higher shares of minorities.⁵ While MDIs tend to outperform non-MDI community banks in revenue generation, MDIs, particularly small MDIs, have much higher expenses. As a result, MDIs have long underperformed other community and noncommunity banks when measured by their efficiency ratio (the cost to generate a dollar of revenue).

Federal Programs for CDFIs and MDIs - Small Business Administration

Paycheck Protection Program

The Paycheck Protection Program (PPP) was established in the CARES Act.⁶ Banks and other private lenders make fully guaranteed SBA loans to small businesses negatively impacted by the COVID-19 pandemic. In total, over \$800 billion has been appropriated for PPP. The PPP and Health Care Enhancement Act⁷ (Enhancement Act) included set-asides of newly-appropriated PPP funds so that community lending institutions, including CDFIs, Certified Development Companies

¹ CDFI Fund, *List of Certified CDFIs*, <https://www.cdfifund.gov/sites/cdfi/files/2021-04/CDFI%20Cert%20List%202004-14-2021%20Final.xlsx>.

² FDIC, *FDIC Definition of Minority Depository Institution*, <https://www.fdic.gov/regulations/resources/minority/mdi-definition.html>; see also NCUA, *Fact Sheet: Minority Depository Institutions*, <https://www.ncua.gov/files/publications/resources-expansion/mdi-fact-sheet.pdf>.

³ FDIC, *MDI List – Fourth Quarter 2020*, <https://www.fdic.gov/regulations/resources/minority/mdi.html>.

⁴ FDIC, *2019 MDIs: Structure, Performance, and Social Impact*, <https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf>.

⁵ FDIC, *2019 MDIs: Structure, Performance, and Social Impact*, <https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf>.

⁶ P.L. 116-136.

⁷ P.L. 116-139.

(CDCs) and SBA Microloan Intermediaries could participate in the program on equal footing with large banks. These set-asides were intended to maximize PPP lending in traditionally underserved business communities.

As of May 10, 2021, SBA is only accepting PPP applications originated by participating community financial institutions, including CDFIs, CDCs, SBA Microlenders, and MDIs until May 31, 2021.⁸ According to SBA's public data, as of May 9, 2021, the current round of PPP has approved over 5.7 million loans for a total of \$260 billion, with an average loan size of approximately \$45,487.⁹ On May 3, 2021, SBA communicated to congressional staff approximately \$9 billion remained in the community financial institution (CFI) set-aside.¹⁰

Community Advantage 7(a) Loan Program

In 2011, SBA established the Community Advantage 7(a) Loan Program (CA) as a three-year pilot program designed to meet the credit, management, and technical assistance needs of small businesses in underserved markets.¹¹ CA has been extended numerous times, most recently through September 30, 2022.¹² CA provides mission-oriented lenders, primarily nonprofit financial intermediaries focused on economic development, access to 7(a) loan guaranties for loans of \$250,000 or less. In the Congressional Budget Justification for FY2019, SBA noted the CA program “reached significantly more women and minorities than the traditional 7(a) loan program.” Eligible lending partners include SBA-authorized CDCs, SBA-authorized Microlenders, SBA-authorized Intermediary Lending Pilot Program intermediaries, and Non-federally regulated CDFIs. Furthermore, CA lenders are required to make at least 60 percent of their CA loans in underserved markets, including LMI communities, new businesses, veteran-owned businesses, and those located in rural areas. In 2020, the House of Representatives passed by a voice vote H.R. 7903,¹³ a bill introduced by Rep. Judy Chu that would have authorized the CA program through FY2025.

504/CDC Loan Guaranty Program

Authorized by the Small Business Investment Act of 1958, the SBA 504/CDC Loan Guaranty program (the “504 program”) backs long-term fixed-rate loans up to \$5.5 million to support investment in major fixed assets, such as land, buildings, heavy equipment, and machinery. The program is delivered by local CDCs, which are private, nonprofit corporations established to

⁸ U.S. Small Bus. Admin., *Paycheck Protection Program*, <https://www.sba.gov/funding-programs/loans/covid-19-relief-options/paycheck-protection-program>.

⁹ U.S. Small Bus. Admin., *Paycheck Protection Program: Data as of 05/09/21*, (May 9, 2021), <https://www.sba.gov/sites/default/files/2021-05/2021.05.10%20-%20SBA%20COVID%20Relief%20Program%20Report.pdf>.

¹⁰ Briefing by U.S. Small Bus. Admin. Office of Cong. and Legislative Affairs, Washington, DC (May 3, 2021).

¹¹ U.S. Small Bus. Admin., *Community Advantage Participant Guide*, Version 6.0 (2020), <https://www.sba.gov/sites/default/files/2020-06/CA%20Guide%20Version%206%20FINAL%20508%2006-01-20.pdf>.

¹² U.S. Small Bus. Admin., *SBA Information Notice No. 5000-180014*, (Sep. 26, 2018), <https://www.sba.gov/sites/default/files/2018-09/Notice%205000-180014%20Community%20Advantage%20Extension%20to%202022.pdf>.

¹³ H.R. 7903, 116th Cong. (2020).

promote economic development within their communities, many of which are CDFIs. 504 loans generally have a three-party structure: 1) a third-party lender (typically a bank or credit union) providing 50 percent or more of the financing; 2) a CDC providing up to 40 percent via a 504/CDC debenture; and 3) a small business borrower contributing at least 10 percent. In 2021, the House passed two bipartisan bills to modernize the 504 program.¹⁴

Microloan Program

Congress created the Microloan Program in the Small Business Act (section 7(m)) in 1991, which makes funds available to nonprofit, community-based lenders (many of whom are CDFIs) who in turn make very small loans to eligible borrowers—mainly higher-risk, underserved entrepreneurs, whose businesses generally serve their local communities. Though the maximum loan amount is \$50,000, the average Microloan in FY2020 was about \$14,000. These borrowers may be unable to get a traditional loan due to poor credit, no credit history, or a lack of business experience. Microloans reach demographic groups that would otherwise not be served by the private sector or even the SBA’s 7(a) program. For example, Microloans have been a capital source for women (who in FY2020 received about 47 percent of Microloans issued) and minority borrowers (who in FY2020 received over 51 percent of Microloans issued).¹⁵ In 2021, the House passed two bipartisan bills that seek to update the program rules and terms and make it more affordable for intermediaries and borrowers. It also improves program data collection and reporting.¹⁶

Other Federal Programs for CDFIs and MDIs

Department of the Treasury CDFI Fund

The CDFI Fund (Fund), an agency within Treasury, administers several programs that encourage the role of CDFIs and similar organizations in community development.¹⁷ Established by Congress under the Riegle Community Development and Regulatory Improvement Act of 1994, the Fund’s core CDFI program provides two types of monetary awards, financial assistance (FA) and technical assistance (TA). These awards are given to CDFIs to build their capacity to serve low-income people and communities that lack access to affordable financial products and services.

Department of the Treasury Emergency Capital Investment Program

Congress established the Emergency Capital Investment Program (ECIP) under the Consolidated Appropriations Act, 2021, to improve the ability of CDFIs or MDIs, especially those located in LMI communities, to respond to the COVID-19 pandemic. Under ECIP, Treasury will provide up to \$9 billion in capital directly to CDFIs or MDIs to provide loans, grants, and forbearance for small firms, minority-owned firms, and consumers disproportionately impacted by the economic effects of COVID-19.¹⁸ The funding will provide long-term, low-cost equity and subordinated debt for participating institutions. Treasury will set aside \$2 billion for CDFIs and MDIs with less than

¹⁴ H.R. 1490, 117th Cong. (2021); H.R. 1482, 117th Cong. (2021).

¹⁵ See, CRS Report R41057, <https://www.crs.gov/reports/pdf/R41057>.

¹⁶ H.R. 1502, 117th Cong. (2021); H.R. 1487, 117th Cong. (2021).

¹⁷ See, CDFI Fund, <https://www.cdfifund.gov/>.

¹⁸ See, U.S. Dept. of Treasury, *Emergency Capital Investment Program: Supporting the Efforts of Low- and Moderate-Income Community Financial Institutions*, <https://home.treasury.gov/policy-issues/coronavirus/assistance-for-small-businesses/emergency-capital-investment-program>.

\$500 million in assets and an additional \$2 billion for CDFIs and MDIs with less than \$2 billion in assets. Treasury extended the ECIP application deadline to July 6, 2021.

Federal Reserve Board

To boost PPP effectiveness, the Federal Reserve Board established the Paycheck Protection Program Liquidity Facility (PPPLF), under which the Federal Reserve supplies liquidity to participating financial institutions (many of which are CDFIs) through term financing backed by the institution's PPP loans.¹⁹ CDFIs testifying before Congress praised the PPPLF as a lifeline enabling CDFIs and other small lenders to deliver more PPP loans, but noted that only CDFIs with correspondent relationships with depository institutions with master accounts with the Federal Reserve were able to participate.²⁰ The process of developing those relationships was time-consuming and complex, limiting access to liquidity at a time when CDFIs needed it most. On March 8, 2021, the Board announced it will extend the PPPLF to June 30, providing continued support for the flow of credit to small businesses through PPP.

Office of the Comptroller of the Currency

In July 2020, the OCC launched Project REACH (Roundtable for Economic Access and Change) to promote financial inclusion through greater access to credit and capital.²¹ Project REACH brings together leaders from the banking industry, national civil rights organizations, business, and technology to identify and reduce barriers that prevent full, equal, and fair participation in the nation's economy. The Project includes a Pledge to strengthen MDIs through which participating banks sponsor one or more MDIs to provide a stable source of capital and investment and provide training, exchange programs, and mentorship to MDI executives and board members.

Federal Deposit Insurance Corporation

In November 2020, FDIC began developing a new "Mission-Driven Bank Fund" to provide a vehicle for private sector and philanthropic investment in FDIC-insured MDIs and CDFIs.²² Fund investments in eligible MDIs and CDFIs may include direct equity, structured transactions, funding commitments, and loss-share arrangements. The Fund will target a minimal rate of return to investors, who may also choose to reinvest any returns in the Fund or in aligned non-profit enterprises that support mission-driven banks.

¹⁹ Federal Reserve Board, *Policy Tools: Paycheck Protection Program Liquidity Facility (PPPLF)*, <https://www.federalreserve.gov/monetarypolicy/ppplf.htm>; see also Federal Reserve Discount Window/Payment System Risk, *FAQs: New Paycheck Protection Program Liquidity Facility*, <https://www.frbdiscountwindow.org/pages/general-information/faq#list-item-1%20A0>.

²⁰ *The Next Steps for the Paycheck Protection Program: Hearing Before the H. Comm. on Small Business*, 117th Cong. (2021) (statement of Hilda Kennedy, Founder/President, AmPac Business Capital); *The Paycheck Protection Program: Performance, Impact, and Next Steps: Hearing Before the S. Comm. on Small Business and Entrepreneurship*, 117th Cong. (2021) (statement of Lisa Mensah, President and CEO, Opportunity Finance Network).

²¹ OCC, *OCC Announces Project REACH to Promote Greater Access to Capital and Credit for Underserved Populations*, News Release 2020-89, (Jul. 10, 2020), <https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-89.html>.

²² FDIC, *Press Release: FDIC Seeks Financial Advisor to Establish New "Mission-Driven Bank Fund" to Support FDIC-Insured Minority Banks and Community Development Financial Institutions*, (Nov. 18, 2020), <https://www.fdic.gov/news/press-releases/2020/pr20125.html>.

National Credit Union Association

The National Credit Union Administration (NCUA) is the independent federal agency that regulates, charters, and supervises federal credit unions. NCUA also provides deposit insurance for the country's credit union members. NCUA's Office of Credit Union Resources and Expansion offers various forms of support for MDI credit unions through its MDI Preservation Program, which includes technical assistance; training; chartering assistance; and, if the credit union also has a low-income designation, access to grants, loans, and the agency's MDI mentoring program.²³

Benefits of Community Financial Institutions in Serving Small Businesses

During the COVID-19 pandemic, small businesses reported greatest levels of satisfaction with CDFIs and small banks (inclusive of MDIs). The 2021 Federal Reserve Small Business Credit Survey on Employer Firms showed 70 percent and 61 percent of respondents reported being satisfied about the support they received during the pandemic from CDFIs and small banks, respectively.²⁴ At the same time, only 13 percent and 20 percent of firms owned by Blacks and Latinos respectively reported receiving the full amount of financing sought, showing these two specific communities remained underserved during the pandemic. To combat this historic funding gap, Congress enacted set-asides within PPP funding specifically for CFIs (which include CDFIs and MDIs). SBA's data shows CFIs were best able to reach underserved small businesses, as CFIs were the only type of PPP lender that performed above program average in all three of the following categories: 1) percent of loans less than \$150,000; 2) percent of loans in LMI areas; and 3) percent of loans in rural areas.²⁵ This shows CDFIs and MDIs are best positioned and able to deliver affordable financial services to low-income communities who will need it to recover from the COVID-19 pandemic. If the federal government intends to promote economic development for communities of color, MDIs and CDFIs portend to play a key role.

Conclusion

CDFIs and MDIs play a critical role in extending access to affordable capital to small businesses, especially those in underserved markets. To that end, Congress amended the PPP on multiple occasions to help the program better reach entrepreneurs left behind by larger institutions. As the economy continues to slowly recover from the COVID-19 pandemic, the federal government must remain intentional in its engagement with CDFIs and MDIs, and consider all programmatic changes intended to improve the ability of these mission lenders to reach their target markets. To that end, the Committee remains committed to working with SBA to help its capital access programs serve the underbanked and monitoring the engagement of the federal banking regulators with CDFIs and MDIs as it relates to small business lending.

²³ NCUA, *Minority Depository Institution Preservation*, <https://www.ncua.gov/support-services/credit-union-resources-expansion/resources/minority-depository-institution-preservation>.

²⁴ Federal Reserve Bank, *2021 Small Business Credit Survey: Report on Employer Firms*, <https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2021/2021-sbcs-employer-firms-report>.

²⁵ U.S. Small Bus. Admin., *Paycheck Protection Program: Data as of 05/09/21*, (May 9, 2021), <https://www.sba.gov/sites/default/files/2021-05/2021.05.10%20-%20SBA%20COVID%20Relief%20Program%20Report.pdf>.