DEPARTMENT OF THE TREASURY

WASHINGTON, D.C.

# The Treasury Department's Approach to Community Finance Policy

The Treasury Department's approach to community finance policy flows from Treasury's mission to create economic and job opportunities and reflects the view that opening responsible access to capital in financially underserved communities will increase competitiveness and support economic growth. Treasury's approach has been informed by considerable public input, including extensive outreach and engagement with community finance practitioners and investors, solicitations of public comments on proposed policies and information-collection forms, and formal requests for information.

Community finance is a subset of financial services focused on (1) opening access to responsible capital, credit, and financial services to low-income or financially underserved households, small businesses, or non-profit organizations; and (2) financing place-based community and economic development activity in economically distressed geographies.[1] Community finance is often undertaken by community development financial institutions (CDFIs) certified by Treasury's CDFI Fund, minority depository institutions (MDIs) designated by financial regulators, or similar community-oriented lenders and investors.

Below is a description of the principles Treasury applies in its community finance efforts, with specific examples of relevant Treasury policymaking.

- ***Establish responsible financing standards for community finance***. While community finance is broadly understood to have a public purpose – namely, creating access to capital for financially underserved people and in economically distressed geographies – a lack of clarity about what products, services or business models qualify under the definition of community finance can be problematic. Without clear definitions and guardrails, there is a risk that resources intended for the benefit of the public could be misused or used less impactfully than intended. With too many restrictions, however, there is a risk of limiting innovation and potential for scale. Some investors have stated that a lack of clarity about what is defined as socially impactful is also a barrier to investments in the field.

  Examples of this principle in action. In the updated CDFI certification application that Treasury published in December 2023, and in the State Small Business Credit Initiative (SSBCI) policy guidelines, Treasury has substantially clarified what financing activities, services, and business models are consistent with its community finance programs. While the CDFI Fund's previous certification application reflected the basic statutory requirements for certification, it did not adequately differentiate how a mission-oriented CDFI operates from the activities of other lenders. For the first time, the revised certification application identifies responsible financing standards, including a specific list of products and services that are inconsistent with CDFI certification. The application also provides greater clarity about how an organization will be determined to be accountable to its target market, where it is required to focus at least 60 percent of its lending in order to be certified. Similarly, the SSBCI program guidelines provide clarity by requiring certain disclosures to small business borrowers and placing limits on certain fees. Also, while purchasing

[1] Place-based community and economic development includes the development or preservation of community assets and community-serving infrastructure that reinforces economic opportunity (such as affordable housing or facilities for the delivery of quality childcare, healthcare or education) or economic development efforts that create jobs or facilitate business growth (such as small businesses incubators or commercial development in locations that are accessible to low-income workers and consumers).

ownership interests is generally not an eligible use of SSBCI funding, an exception was carved out to support transitions to employee ownership.

These federal funds result in significant leveraging of private capital and may serve as a model for private investment strategies. Further, CDFI certification is used by other government programs and private-sector investors as a criterion for distributing resources and by regulators to provide flexibility, eligibility, exemptions, or waivers.[2] In addition, given the potential private-sector interest in socially motivated investment,[3] the updated standards associated with CDFI certification could meaningfully influence a significant amount of social finance activity in the years ahead.[4]

- ***Differentiate "deep impact" lending***. Making loans to financially underserved borrowers or in an economically distressed community – referred to as "deep impact" loans – can cost a lender more to originate and may produce less revenue than other types of loans. Community lenders often need to spend more time and resources to prepare a borrower that is financially underserved or located in an economically distressed community, or to more fully understand the risk associated with the loan. Such loans are also often made in smaller amounts or with concessionary terms, which result in less revenue to the lender. In some cases, though not all, such loans may also entail greater credit risk. For these reasons, there is often a financial disincentive to make deep-impact loans. Policies that incentivize such loans help to counterbalance the financial disincentives and increase lending to borrowers and geographies that experience the greatest challenges in accessing capital.

  Examples of this principle in action. In the Emergency Capital Investment Program (ECIP) Rate Reduction Guidelines and the CDFI Equitable Recovery Program (CDFI ERP) Notice of Funding Availability (NOFA), Treasury has prioritized types of loans made to financially underserved borrowers that may be more difficult or costly for the lender to deliver, but that produce economic opportunity in the most financially underserved communities and that Treasury has identified as more impactful in achieving the statutory purposes of these programs. In ECIP, the dividend or interest rate that participating institutions pay Treasury will be reduced if they achieve specified benchmarks for increasing their qualified lending to targeted populations. When ECIP participants engage in deep-impact lending, Treasury provides additional credit toward this rate reduction. Deep-impact lending includes loans to low-income borrowers and underserved small businesses, for deeply affordable housing, and in persistent-poverty communities, Native communities, and U.S. territories. Treasury published examples of ECIP applicants that have demonstrated strong track records in deep-impact lending. The first round of ECIP reporting shows that, over approximately six months in 2022, about one third of total originations by ECIP participants were deep-impact loans.

  The CDFI Fund has also taken action to incentivize deep-impact lending. The CDFI ERP prioritizes awards to institutions that have a strong track record of deep-impact lending. In the application for the CDFI Fund's New Markets Tax Credits (NMTC) competition, the CDFI Fund revised the definition of areas of economic distress to include Native areas and U.S. territories. The CDFI Fund

[2] For example, the October 2023 rulemaking amending the regulations implementing the Community Reinvestment Act included incentives for covered institutions to invest in and through CDFIs; the Consumer Financial Protection Bureau provides an exemption from its Ability to Repay/Qualified Mortgage Rule for certified CDFIs; and in 2022, the Small Business Administration made certain changes to the Community Advantage Pilot Program to make it more accessible to mission-based lenders, including CDFIs.

[3] The Global Impact Investing Alliance (GIIN) 2022: Sizing the Impact Investing Market report estimates the size of the worldwide impact investing, or socially motivated investment, market to be $1.2 trillion.

[4] The CDFI Fund's FY 22 Annual Financial Report indicates that CDFIs made over $90 billion in loans or investments since the start of the pandemic. The CDFI Fund estimates that CDFIs leverage funding they receive from the CDFI Fund by a multiple of eight to one.

also sought public comment on whether ECIP's deep-impact lending definition should be incorporated into the CDFI Fund's flagship Financial Assistance Program.

- ***Collect disaggregated demographic data***. Extensive research demonstrates that the experience and outcomes for consumers in the U.S. financial services and real estate markets are shaped fundamentally by race, gender, and other demographic categories. Understanding the demographics of borrowers is essential for understanding which segments of a financially underserved market a community lender is serving. In the case of ECIP and CDFI ERP, Congress required Treasury to study and report on program impacts disaggregated by ethnic group, to the extent possible.

  Examples of this principle in action. In the applications and reporting requirements for SSBCI, ECIP, and CDFI ERP, as well as in the new CDFI certification application, Treasury requires applicants or program participants to report to Treasury disaggregated data on the beneficiaries of their community finance activities or their organizational leadership. Jurisdictions participating in SSBCI will report demographic information collected from small businesses that receive capital through the SSBCI program, including data on race, ethnicity, sexual orientation, and gender identity. Applicants for ECIP and CDFI ERP were required to provide information on their track record of lending, and projected lending, to minority communities. Participants in both programs are required to report annually their lending to minority borrowers, disaggregated by race and ethnicity. The revised CDFI certification application requires applicants to report on the race, ethnicity, and gender of the applicant's board of directors and executive staff and on the race and ethnicity of borrowers. Certified CDFIs also submit information annually on the race and ethnicity of their borrowers. These data will provide greater transparency into the ultimate beneficiaries of community finance programs.

- ***Encourage equitable community engagement***. Community engagement is essential for ensuring that government policies and programs are aligned with the needs of the targeted beneficiaries. Community engagement can help identify challenges early in the program design or implementation process, supporting timely and cost-effective solutions. When deploying emergency resources, there is typically far less time for planning, and community engagement can help federal, state, and local agencies quickly assess community needs and market conditions.

  Examples of this principle in action. Treasury has strongly encouraged community engagement in its numerous community finance programs. In ECIP, Treasury required applicants to provide a plan describing how the applicant will engage in community outreach and communication with borrowers and other community members. These plans could include community benefits agreements and were required to include quantitative details about the applicant's planned community outreach and communication approach.

  The CDFI ERP NOFA required an applicant to submit a business plan that "demonstrates that the Applicant has engaged with and obtained input on its business strategy from geographies and populations that it proposes to serve with a CDFI ERP Award and that the Applicant proposes culturally and linguistically relevant marketing and/or outreach efforts that will support the deployment of CDFI ERP Award consistent with its business strategy."

  The CDFI Fund also published new FAQs for the NMTC Program with additional guidance on how applicants should discuss the benefits to low-income persons and residents of low-income communities in their applications. The FAQs also state that applicants should discuss their track record of project-specific community engagement, including the specific methods used and how the input received shaped those investment decisions.

- ***Support capacity building***. Opening access to capital for the most financially underserved borrowers often requires significant investments in building the capacity of those borrowers. CDFIs are statutorily required to provide development services for their borrowers and potential borrowers. Further, many institutions that focus on lending to the most financially underserved may themselves benefit from capacity building funding, training, and other resources.

  Examples of this principle in action. The SSBCI Technical Assistance Grant Program has made available funding to support legal, accounting, and financial advisory services to very small and underserved businesses applying for SSBCI or other small business programs. Treasury also provided resources to the Minority Business Development Agency (MBDA) to support the Capital Readiness Program (CRP), which targets incubators and accelerators that provide services to underserved businesses. Most recently, Treasury announced the new competitive SSBCI Investing in America Small Business Opportunity Program, under which Treasury will award grants to support programs that propose innovative and high-impact models for delivering technical assistance.

  The CDFI Technical Assistance Program makes available funding to CDFIs explicitly to build their own capacity. Both of the CDFI Fund's COVID emergency funding programs (the Rapid Response Program and CDFI ERP) provided applicants the option to seek a minimum award size, which did not include lending performance requirements, so that they could function as technical assistance awards for institutions that were not prepared to take on higher compliance requirements associated with larger awards. The CDFI Fund is also implementing a Native NMTC Technical Assistance Initiative aimed at increasing the number of Native Community Development Entities that are well positioned to compete for an NMTC allocation.

- ***Coordinate with interagency partners and the private sector***. The resources that flow from Treasury's community finance programs do not operate in a vacuum. These programs complement resources from other agencies and private investors. Coordination across federal programs with aligned purposes can promote the effectiveness of targeted activities. In addition, alignment of federal data-collection requirements can reduce reporting burdens and improve the government's ability to measure and evaluate aggregate impacts across multiple programs. Federal community finance resources can facilitate private investment to financially underserved borrowers and in economically distressed places by helping to mitigate risk.

  Examples of this principle in action. In July 2022, Treasury and five other federal agencies established the Interagency Community Investment Committee (ICIC) to foster collaboration and alignment in the implementation of programs that benefit underserved communities. Treasury led the release of a request for information to solicit public input on how the ICIC can promote economic conditions and systems that reduce racial disparities and produce stronger economic outcomes for all communities. The ICIC has now expanded to seven agencies, and in June 2023 the ICIC published the results of the request for information and an action plan, which Treasury is now working to implement.

  Also in July 2022, a coalition of private-sector companies and foundations working to make investments in underserved communities in alignment with federal community finance investments formed the Economic Opportunity Coalition (EOC). At Treasury's 2023 Freedman's Bank Forum, the EOC announced a $3 billion deposits commitment by its members to make deposits in CDFIs and MDIs, after having achieved the $1 billion commitment that they announced at the 2022 Freedman's Bank Forum.