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Recent CRA Regulatory Changes and the CRA Qualified Investment Fund

September 2016

This report focuses on regulatory guidance that indirectly affects the CRA Qualified Investment Fund. This report does not purport to be a comprehensive analysis of the changes or clarifications made to existing Community Reinvestment Act (CRA) regulation. Changes made to community development lending or services or technical corrections may not be addressed by this report. For additional guidance please see https://www.ffiec.gov/cra/qnadoc.htm.

The Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (FRB), and the Federal Deposit Insurance Corporation (FDIC), collectively "the Agencies," implement the CRA through regulations that are interpreted primarily through the "Interagency Questions and Answers Regarding Community Reinvestment". These provide guidance for use by agency personnel, financial institutions, and the public. The Questions and Answers (Q&As) were first published by the Federal Financial Institutions Examination Council (FFIEC) in 1992 and were last published in full by the Agencies on March 11, 2010.

On July 15, 2016, the Agencies adopted final revisions to the "Interagency Questions and Answers Regarding Community Reinvestment." The Agencies adopted nine of the 10 proposed Q&As, revised four additional existing Q&As, adopted two new Q&As based on questions and suggestions provided by commenters and made technical corrections to 25 Q&As.

The goal of this paper is to provide Community Capital Management's (CCM) assessment of the revisions and new Q&As primarily in regards to the CRA Qualified Investment Fund (CRA Fund). CCM is the registered investment adviser to the CRA Fund (ticker symbol: CRAIX). The CRA Fund was created in 1999 to help banks garner positive consideration on the investment test portion of their CRA exams. It is a market-rate bond fund that invests in high credit quality fixed income securities whose proceeds are designed to positively impact communities throughout the United States as designated by its shareholders.

Revisions of Existing Q&As

Community Development is considered in the CRA evaluations of all types and sizes of financial institutions. The Agencies believe that community development generally improves the circumstances for low- and moderate-income persons and stabilizes and revitalizes the communities in which low- and moderate- income persons work and live. The Agencies provided additional clarification of several Q&As that addressed community development related topics.

Economic Development

Community development is defined in the CRA regulations to include "activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company (SBDC) or Small Business Investment Company (SBIC) programs or have gross annual revenues of $1 million or less."

Activities also promote economic development by financing small businesses or farms if they meet both the size and purpose test. The size test indicates that the beneficiaries of an activity must meet the size eligibility standards of the SBDC or SBIC programs or have gross annual revenues of $1 million or less. The purpose test indicates that a financial institution's activities must promote economic development consistent with the CRA regulations. The existing Q&A further states that activities promote economic development if they "support permanent job creation, retention, and/or improvement for persons who are currently low- or moderate-income, or support permanent job creation, retention, and/or improvement either in low or moderate-income geographies or in areas targeted for redevelopment by Federal, state, local, or tribal governments." The guidance also noted that "the Agencies will presume that any loan to or investment in a SBDC, SBIC, Rural Business Investment Company, New Markets Venture Capital Company, or New Markets Tax Credit-eligible Community Development Entity promotes economic development."

The revised regulatory guidance clarifies the meaning of the phrase "promote economic development" by including the following interpretations:

(1) Any loans to or investments in Community Development Financial Institutions (CDFIs) that finances small businesses or small farms, promotes economic development.
(2) Reference to persons who are "currently" low- or moderate-income was removed to clarify that community development activities may extend beyond the support for low-wage jobs.
(3) Examiners will now employ appropriate flexibility in reviewing any information provided by a financial institution that reasonably demonstrates that the purpose, mandate, or function of the activity meets the "purpose test".
(4) Examiners will also now consider the qualitative aspects of performance. For example, activities will be considered more responsive to community needs if a majority of jobs created, retained, and/or benefited low- or moderate-income individuals.

The Agencies added examples of activities that would meet the purpose test of promoting economic development. The Agencies are adopting this final Q&A with reference to activities that are considered to promote economic development if they support permanent job creation, retention, and/or improvement:

- for low- or moderate-income persons;
- in low- or moderate-income geographies;
- in areas targeted for redevelopment by Federal, state, local or tribal governments;
- by financing intermediaries that lend to, invest in, or provide technical assistance to start-ups or recently formed small businesses or small farms; or
- through technical assistance or supportive services for small businesses or farms, such as shared space, technology, or administrative assistance.

The final Q&A also recognizes Federal, State, local, or tribal economic development initiatives that include provisions for creating or improving access by low- or moderate-income persons to jobs or to job training or workforce development programs.

CCM, on behalf of the CRA Fund, assesses the size and purpose test when evaluating investments that promote community development. CCM's investment strategy includes a use of proceeds analysis on each security prior to purchase to confirm its primary purpose is community development and is a CRA-qualified investment.

Revitalize or Stabilize Underserved Nonmetropolitan Middle-Income Geographies

Community development includes activities that revitalize or stabilize underserved nonmetropolitan middle-income geographies. The CRA regulation provides that activities revitalize or stabilize an underserved nonmetropolitan middle-income geography if they help to meet essential community needs, including the needs of low- or moderate-income individuals.

The Agencies also adopted a new Q&A (Q&A § ___.12(g) – 4), which explains that the various examples included throughout the Questions and Answers are not exhaustive. Financial institutions are encouraged to submit information about activities they believe meet the definition of community development loan, qualified investment, or community development service to examiners for consideration.

CCM, on behalf of the CRA Fund, provides shareholders supporting documentation on the use of bond proceeds for community development purposes on each earmarked investment. The examples provided in the revised regulatory guidance are representative of the types of projects that the CRA Fund has helped finance on behalf of its shareholders since its inception in 1999. CCM continues to invest in bonds financing projects that the Agencies view as essential to community development.

The non-exhaustive list of projects that the Agencies now list as meeting essential community needs as part of Q&As § __.12(g)(4)(ii) – 4 includes the following:

- a new or expanded hospital that serves the entire county, including low- and moderate-income residents;
- an industrial park for businesses whose employees include low- or moderate-income individuals;
- a new or rehabilitated sewer line that serves community residents, including low- or moderate-income residents;
- a mixed-income housing development that includes affordable housing for low- and moderate-income families;
- a renovated elementary school that serves children from the community, including children from low- and moderate-income families;
- a new or rehabilitated communications infrastructure, such as broadband internet service, that serves the community, including low- and moderate-income residents; or
- a new or rehabilitated flood control measure, such as a levee or storm drain, that serves the community, including low- and moderate-income residents.

Other activities in the area, such as financing a project to build a sewer line spur that connects services to a middle- or upper-income housing development while bypassing a low- or moderate-income development that also needs the sewer services, generally would not qualify for revitalization or stabilization consideration in geographies designated as underserved. If an underserved geography is also designated as a distressed or a disaster area, additional activities may be considered to revitalize or stabilize the geography, as explained in Q&As § __.12(g)(4)(ii) – 2 and § __.12(g)(4)(iii) – 3.

The Adoption of New Q&As

The Agencies generally promote an institution's responsiveness to credit and community development needs by providing that the greater an institution's responsiveness to credit and community development needs in its assessment area(s), the higher the CRA rating. More and more, financial institutions are looking to be innovative in ways that are responsive to local community development needs.

Because of the use of these concepts in the CRA regulations and Q&As, the agencies proposed two new Q&As to set forth general guidance on how examiners evaluate whether a financial institution has been responsive to credit and community development needs and the standard for how innovativeness is found throughout the regulations.

Responsiveness

The new Q&A, § __.21(a) – 3, was intended by the Agencies to encourage institutions to think strategically about how to best meet the needs of their communities on their performance context. This includes three factors that examiners consider when evaluating responsiveness: quantity, quality, and performance context. Thus, examiners will look at the effectiveness of activities with emphasis on evaluating responsiveness in light of the performance context.

The final Q&A also includes how examiners will determine whether an institution has been responsive to the credit and community development needs of its assessment area(s). The Q&A states that, "Examiners will also consider as responsive to assessment area needs community development activities that support an organization or activity that covers an area that is larger than, but includes, the institution's assessment area(s). This is true if the purpose, mandate, or function of the organization or activity includes serving geographies or individuals located within the institution's assessment area(s), even though the institution's assessment area(s) did not receive an immediate or direct benefit from the institution's participation in the organization or activity."

The CRA Fund is responsive to the assessment areas of its shareholders. Financial institutions invest in a national community development mutual fund organized in 1999 with the purpose of providing community development investments specifically in the institution's assessment areas.

The CRA Fund also holds investments benefiting an entire state in which the institution is located. Per the regulatory guidance, examiners would consider these investments when evaluating the institution's responsiveness to community development needs and opportunities in its assessment area(s) even if the fund had not provided an investment within the institution's assessment area(s).

Innovativeness

There is a standard of innovativeness that is found throughout the Q&As. The Agencies adopted the new Q&A § __.21(a) – 4 to clarify the types of activities considered innovative.

Per the new Q&A, "all innovative practices or activities will be considered when an institution implements meaningful improvements to products, services, or delivery systems that respond more effectively to customer and community needs, particularly those segments enumerated in the definition of community development."

CRA-qualified investments in the CRA Fund are purchased and earmarked dollar for dollar to each institution's assessment area(s). This process occurs per CRA exam cycle financing new and meaningful community development projects and initiatives. This method has been in place since the CRA Fund's inception in 1999 and we believe it to be the only national CRA-qualified investment fund of its kind to have this type of innovative earmarking.

ABOUT COMMUNITY CAPITAL MANAGEMENT & THE CRA QUALIFIED INVESTMENT FUND

There is no guarantee the Agencies will provide favorable view of the CRA Qualified Investment Fund. For additional information on this piece or general questions on the Community Capital Management and the CRA Qualified Investment Fund, please contact 877-272-1977 or visit www.ccminvests.com or www.crafund.com.

Community Capital Management, Inc. is the registered investment advisor to the CRA Qualified Investment Fund CRA Shares (CRAIX). The CRA Shares are designed specifically for banks looking to receive positive consideration on the investment test portion of their CRA Exam. The CRA Qualified Investment Fund was launched in August of 1999 and seeks to provide current income consistent with the preservation of capital through investments in high credit quality fixed income securities that support community development activities.

The CRA Qualified Investment Fund is distributed by SEI Investments Distribution Co. (SIDCO) which is not affiliated with Community Capital Management, Inc.

Investing involves risk including loss of principal. Bonds and bond funds will decrease in value as interest rates rise. The Fund is not diversified. Carefully consider the fund's investment objectives, risks, charges, and expenses. This and other information can be found in the fund's prospectus, which can be obtained by calling 866-202-3573. Please read carefully before investing.