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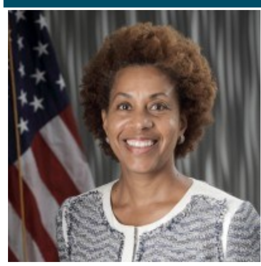
Section 1071 Final Rule Will Be Issued Before March 31, 2023



Patrice Ficklin, Fair Lending Director at the Consumer Finance Protection Bureau (pictured, left), spoke at the Colloquium and confirmed that the final rule on Section 1071 will be issued shortly.

Representatives from the Consumer Finance Protection Bureau (CFPB or the Bureau) confirmed at the Colloquium that the issuance of a final rule on small business data requirements for Section 1071 of the Dodd-Frank Act is forthcoming and will be issued before March 31, 2023.

Section 1071 amended the Equal Credit Opportunity Act (ECOA), subject to the rules adopted by the CFPB, to require financial institutions to collect and report certain data in connection with credit applications made by small businesses, including women– and minority-owned small businesses. Referring to the NPR, the Bureau is proposing to apply Section 1071 to "covered financial institutions," defined as financial institutions that satisfy a loan origination threshold of at least 25 credit transactions to small businesses in each of the two preceding calendar years. Under this definition, the *(continued on page 3)*

CRA Modernization Update: Regulator Silence on Timeline of Final Rule Issuance

At the 26th CRA & Fair Lending Colloquium hosted by Wolters Kluwer at Caesar's Palace, Las Vegas, Nov 13-17, representatives from the Federal Reserve Board (FED), Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC), collectively the Agencies, were careful to stress that they are currently engaged in an active rulemaking process and could not comment on any particulars of the interagency Notice of Proposed Rulemaking (NPR) to modernize the Community Reinvestment Act (CRA) released on May 5. These same representatives said they were actively reviewing the over 1,000 unique comments that were received following the 90-day comment period which ended on August 5. No information was provided regarding *(continued on page 2)*

SBA 7(a) Loan Profile: BMK Ventures, Virginia Beach, Virginia

As of September 30, 2022, the SBA Loan Fund had total assets of roughly $841 million, consisting of over 1,300 SBA 7(a) loans, over 70 per cent of which are located in low– or moderate (LMI) income or otherwise economically distressed communities. When portfolio managers at the SBA Loan Fund screen loans in the secondary market, they look for loans that not only meet the technical requirements for community development but also those loans that meet the spirit under which the CRA was created. The SBA 7(a) loan to BMK Ventures is an example of such a loan. Left, first responders.

The SBA 7(a) loan to BMK Ventures is an example of the type of loan that portfolio managers at the Solomon Hess SBA Loan Fund (SBA Loan Fund) look to acquire and allocate to bank investors for CRA credit under Community Development.

BMK is a Certified Service-Disabled Veteran-Owned Small Business that provides medical supplies and kits that support the operational safety and survivability of military, law enforcement, and first responder personnel in the field *(continued on page 3)*

Inside

CRA Modernization *(from page 1)*

next steps or the timing for the issuance of the Final Rule.

Grovetta Gardineer, Senior Deputy Comptroller for Bank Supervision Policy at the OCC, said that her agency is "working closely with interagency partners who share a common goal of strengthening and modernizing the CRA." Eric Belksy, Director of the Division of Consumer and Community Affairs at the FED, said that the Agencies received "incredibly rich and detailed feedback in the comment letters" and that the "strength of the rulemaking process is in the comment review period."

Many bank CRA practitioners, industry experts and community advocates sat on panels at the Colloquium and expressed grave concern for the interagency proposed rules, citing the increased complexities around the proposed Retail Lending Tests, lack of incentives to undertake community development activities, and the burdens of a short transition period despite proposed phasing of implementation dates. Some panelists welcomed the concept of including a second NPR and subsequent comment period in this rulemaking process to modernize the CRA as the general sentiment was that there are too many issues in the current proposed rules that need amending. While it is unclear whether the Agencies will consider another round of proposed rules and comments, it is clear that they do remain committed to an interagency Final Rule that will strengthen and modernize the CRA. "It is important to get it right," Belksy said. "CRA is complex."

In the absence of information from the Agencies regarding timing or next steps, CRA bank practitioners encouraged each other to be familiar with the proposed rule and run self-assessments on their banks and systems, scope out the additional work streams that would be required to implement the rule as proposed and identify the needs that need to be addressed in order to be ready once the Final Rule is released. Most banks, however, admitted to not having the resources or capacity to take any action until the Final Rule is released, with the expectation that this date is not imminent. ■

CRA Practitioners Express Grave Concerns Regarding Complexities in Interagency NPR

The CRA & Fair Lending Colloquium (Colloquium) hosted by Wolters Kluwer is an annual event in November that brings together banking regulators, practitioners, industry experts and community advocates to discuss key banking issues related to the CRA and Fair Lending laws and regulations. After a two year hiatus when the Colloquium was held virtually, the Colloquium returned to live programming this year Nov 13-16 at Caesar's Palace in Las Vegas, NV. In 2023, the Colloquium will be in Austin, TX from Nov 12-15. Left, a panel.

At the recent Colloquium, representatives from the Agencies said that they are currently reviewing the over 1,000 unique comment letters received to the interagency NPR to modernize the CRA released on May 5 with the 90-day comment period ending on August 5. While Agency representatives were careful not to comment on particulars of the proposal citing their status of active rulemaking, industry participants were not bound by any limitations and were not shy about voicing their personal thoughts on the proposed rule. Most felt that the NPR went too far in terms of amending the current framework for evaluating CRA activities and implementation of the proposed rule as final could lead to a "race to the bottom" in terms of CRA.

Key concerns raised include the following:

1. **Few banks will be able to receive an Outstanding rating which could lead to banks not striving to be the best.** Analysis of the proposed thresholds needed to achieve an Outstanding rating reveal that only a scant number of banks will be able to attain this lofty rating under the proposed rules. This is compared against the roughly 15-17% of banks that receive Outstanding ratings currently. "If there is a certainty that an Outstanding rating is not achievable, then the focus could shift to just checking the boxes to ensure that the bank is complying with the baseline requirements to achieve a Satisfactory rating, and a low satisfactory rating, at that, " said Jim Matthews, SVP CRA Compliance Officer at Capital One.

2. **Incentives will lead to a reduction in Community Development work.** Under the proposed regulations, Retail Lending tests would have a combined weighting of 60% vs. the 40% combined weighting of the Community Development tests. "If activities in Community Development will not affect the overall rating, there will be very little incentives for banks to act in this important area," said Buzz Roberts, President and CEO for the National Association of Affordable Housing Lenders. Marty Spencer, CRA Officer of Independent Bank agreed. "If so much focus is on new Retail Lending tests, that takes resources away from everything else."

3. **Focus on quantitative metrics takes shift away from qualitative judgements**. Bankers and industry experts agree that qualitative data should be more important to explain all the new data and quantitative metrics that the new framework requires. Horatio Mendez, President and CEO to the Woodstock Institute, said, "Qualitative information will be even more important, especially to explain the huge amount of data presented, and especially the data outliers." Panelists agreed that some level of qualitative judgement needs to be included in CRA evaluations. *(continued on page 3)*

Practitioners Concerned *(from page 2)*

4. **Short transition period will require focus on compliance activities and take resources away from innovative or community engagement activities.** Panelists agreed that banks will be so focused on checking the boxes to ensure that the complex data requirements are correct that there will be little time and resources devoted to the activities most beneficial to the communities. Resources are limited and the transition period as proposed is short and the proposed rules are very complex. "Compliance activities, sadly, will have the full attention of senior management for the time being and innovative and community engagement activities will take a backseat," said Reza Aghamirazadeh, Head of Community Development at Citizens Bank.

Individuals on the Colloquium panels did acknowledge that there are some positive aspects of the proposed rules on CRA modernization. However, most felt that the regulators were too heavy handed in the depth of changes proposed. Panelists suggested that a another round of NPR and associated comments is warranted based on the severity and amount of issues raised.

It is unclear, however, as to whether the Agencies will consider this option in the rulemaking progress. While the regulators did stress that they are working together and considering all the comments received, no information was shared on next steps or any kind of timeline. ■

SBA 7(a) Loan Profile *(from page 1)* The company also distributes products that support tactical medicine, fire and rescue, and training simulations.

Proceeds of the 7(a) loan were used to finance equipment purchased for business operations. BMK Ventures is located in a middle income census tract that is a Community Development Financial Institutions (CDFI) Fund Qualified Investment census tract. The CDFI Fund has identified specific geographic units that meet its criteria of economic distress and that should qualify as community development investments. The CDFI Fund designated this area as targeted for investment based on its poverty rate. The borrower self-reported to the SBA that this loan supported the creation and/or retention of 27 jobs. This is a Veteran-owned small business. ■

Section 1071 Final Rule *(from page 1)* requirements would apply to a variety of entities that engage in small business lending, including banks, savings associations, credit unions, online lenders, platform lenders, CDFIs, lenders involved in equipment and vehicle financing, commercial finance companies, governmental lending entities and nonprofit lenders. The Bureau is also proposing to permit creditors that are not covered financial institutions to voluntarily collect and report data under Section 1071 in certain circumstances.

In the NPR, the CFPB proposes the definition of small businesses to be small businesses with $5 million or less of gross annual revenues (GAR) in its preceding fiscal year.

The Bureau is seeking approval from the Small Business Administration (SBA) for this alternate small business size standard pursuant to the Small Business Act.

The NPR also proposes an 18-month transition period after the Final Rule is published in the *Federal Register*.

Industry practitioners are concerned about having to implement two major regulatory changes in 2023 citing limited resources. The regulators acknowledge how this could be a heavy burden on banks and efforts were made to integrate elements of Section 1071 with whatever final rule on CRA modernization that the Agencies will issue. The Bureau issued the NPR on Section 1071 in August 2021 with a comment period that ended on January 6, 2022. ■

SBA Loan Fund Impact Metrics

as of Sept 30, 2022

20,006 jobs

1,092 loans

304 loans

243 loans

33 loans

120 loans

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SOLOMON HESS CAPITAL MANAGEMENT
431 Park Ave, Suite 401
Falls Church, VA 22046
WWW.SOLOMONHESS.COM

SBA Loan Fund Impact: Supporting Community Development

Since inception in 2004, the Solomon Hess SBA Loan Fund has invested over $2.8 billion in small business loans. These loans, made to over 4,900 small businesses located in 47 states, have helped to create and/or retain over 71,000 jobs. Over 70% of the loans in which we have invested are located in low and moderate income or otherwise economically distressed census tracts. The majority of these loans are made to under-served small businesses that do not have access to conventional commercial debt.

Managing Good Capital Well

Solomon Hess Capital Management ("Solomon Hess") is an alternative asset manager specializing in fixed income. Our mission is to provide investors with community and economic development-focused investment funds that generate both competitive risk-adjusted returns and positive quantifiable community impact. Founded in 2004 and located in Falls Church, Virginia, Solomon Hess has over $840 million of assets under management. Solomon Hess is Fund Manager to the SBA Loan Fund and investors include banking institutions of all sizes that are seeking Community Development Investment or Lending test credit within the Community Reinvestment Act (CRA) rules via exposure to SBA 7 (a) loans and related assets. Other investment opportunities with Solomon Hess include investing in our Absolute Return strategy. We offer our strategies as funds or separate accounts.

Michelle Go Lai

SVP, Investor Services & Marketing

431 Park Avenue, Suite 401, Falls Church, VA 22046

T. 703.466.0483 F. 703.356.8383

mgolai@solomonhess.com www.SolomonHess.com

The Solomon Hess SBA Loan Fund LLC attempts to provide its investors with CRA credit related to their participation in the Fund. Investment decisions are not always exclusively based on the economic characteristics or investment merit of a specific asset. Certain CRA eligible securities sought by the Fund in specific geographies may not provide as great an economic benefit to the Fund as the same securities located in non-CRA geographies. The Fund may engage in transactions at times for reasons related to CRA considerations that may not be desirable from an investment standpoint. If one or multiple federal banking regulators, such as the OCC, FDIC or the Federal Reserve Board, were to deem an investment in the Fund as not qualifying for CRA credit, the impact to Fund investors could be material.