ISSUE BRIEF
Credit Union community development financial institutions (CDFIs)
EXECUTIVE SUMMARY

Credit union community development financial institutions (CDFIs) are crucial to the communities they serve. This is especially true as banks have been closing at a rapid rate, especially in rural and underserved areas. The National Association of Federally-Insured Credit Unions (NAFCU) is committed to ensuring that CDFIs are able to successfully operate in the underbanked communities that are typically low-income and minority populations.

NAFCU has been tirelessly advocating for credit union CDFIs so they are not left out of the conversations happening on Capitol Hill. This CDFI Issue Brief is intended to shed light on the great work that CDFIs do while also informing you of the advocacy efforts underway to ensure their work can continue. The goal is to help readers better understand what a CDFI is and what NAFCU is doing to guide legislation and regulations favorable to CDFIs. NAFCU will continue to update this Issue Brief to provide readers insight into CDFI developments most meaningful to credit unions.

Here is a brief summary of NAFCU’s legislative and regulatory priorities on CDFI issues:

**Legislative Asks**

1. Appropriate more funds to CDFIs.
2. Streamline the CDFI certification application process.
3. Update the statute governing CDFIs and the CDFI Fund.

**Regulatory Asks**

1. Address the CDFI certification application backlog.
2. Allow the National Credit Union Administration’s (NCUA) streamlined CDFI certification application process to exist for Minority Depository Institutions (MDIs).
3. Implement a mandatory cure period before decertification.
4. Allow credit unions to become certified and maintain their certification through the other targeted populations (OTP) standard.
5. Adopt the current standards used for grant reports (TLRs) for the Annual Certification and Data Collection Report (ACR).
6. Develop pilot programs within the Federal Housing Financing Agency (FHFA) that will allow the
7. Increase the Department of Housing and Urban Development’s engagement (HUD) with CDFI and MDI credit unions to provide access to affordable mortgage credit for low- and moderate-income and first-time homebuyers.
BACKGROUND

CDFIs are mission-focused financial institutions that provide services to underserved communities while also helping to grow local economies by providing affordable housing and supporting small, minority-owned businesses. The main goal of a CDFI is to offer services and products at low or no cost to its target community. During challenging times, including the COVID-19 pandemic, CDFI credit unions have worked to help their members access stimulus payments, combat financial insecurity, and obtain emergency loans.

A community needs basic financial services, affordable credit, and investment capital to thrive economically. In low-income or underserved communities, access to financial services is often limited. Due to the mission and requirements of certification for CDFIs, these organizations play a key role in expanding financial inclusion to markets that are in need, especially during times of crisis. There are nearly 500 CDFI credit unions today, an increase of more than 50 percent over the last two years. Currently, credit unions make up one-third of all CDFIs; they collectively serve nearly 17 million predominantly low-income consumers and communities of color and have combined assets of over $230 billion.¹

Credit unions and more specifically, CDFI credit unions have great experience helping their members during trying times. Congress has also recognized this and in response to the pandemic, Treasury awarded $1.25 billion in relief funds to 863 CDFIs through the CDFI Rapid Response Program.² Additionally, the CDFI Equitable Recovery Program was established to award grants to CDFIs to respond to the economic impacts of the pandemic by expanding lending, grant making, and investment activity in low- or moderate-income communities and by serving borrowers that have significant unmet capital or financial services needs and were disproportionately impacted by the pandemic.³

To become certified as a CDFI under current CDFI Fund standards, an entity must have a primary mission of promoting community development (primary mission test); be a financial institution; provide development services in conjunction with financing

activities; direct at least 60 percent of its financial product activities to one or more approved Target Markets; and maintain accountability to its target markets.  

Because of their mission, CDFIs have access to funding that other financial institutions do not. CDFIs also have close relationships to the communities they serve and want to utilize their knowledge of specific local needs to improve disaster response and further encourage economic growth. This access to funding and their close relationships with their communities helps CDFIs get funds to the people who need it most. CDFIs play an important role in supporting community revitalization efforts by delivering the loans and investments necessary to help individuals and small businesses thrive.

**LEGISLATIVE OUTLOOK**

Lawmakers continue to direct more attention to CDFI appropriations than to reforms to the CDFI Fund and program. President Biden, in his fiscal year 2023 budget, proposed increasing CDFI funding by 23 percent from fiscal year 2022 and cited the funding as supporting opportunities for minority-owned businesses, affordable housing development, and community revitalization projects. NAFCU has continuously advocated for more funding to CDFIs and supports proposals to increase funding. Although the allocation of funds is important, the CDFI Fund is also in need of improvements to ensure that all who qualify have access to the allocated funds. NAFCU’s advocacy to lawmakers and federal agencies can help shift the legislative focus.

In order to improve the CDFI Fund and its certification process, Congress should begin with updating 12 U.S.C. § 4701, the statute that governs the CDFI Fund and its program, to require Treasury and the CDFI Fund to develop and implement a simpler, more modern approach. NAFCU has been working with members of Congress to advocate for certain changes to the CDFI rules and requirements. NAFCU is requesting changes such as:

› Streamlining the CDFI certification application process;
› Requiring a mandatory cure period before the CDFI Fund issues a decertification to a financial institution;

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7 12 C.F.R 1805. Community Development Financial Institutions Program.
› Consider the primary mission test satisfied if an entity:

- primary mission is to serve low-income designated census tracts or residents of areas that are natural disaster zones
- received a designation as a financial institution that serves low-income consumers by the institution’s federal or state regulator (e.g. low-income designated credit union by the NCUA);

› Allowing a targeted population to include a Natural Disaster Zone defined as an area that has been affected by a catastrophic event;
› Establishing that in the case of a national emergency declaration by the President, the eligibility requirements for a CDFI are deemed satisfied if the financing entity continues to provide products or services in the ongoing support and development of their community; and
› Requiring the CDFI Fund to provide technical assistance for improving or enhancing technological capabilities to deploy new programs, products, and services.

In February 2022, a NAFCU member testified at a Senate Banking subcommittee hearing to share credit unions’ recommendations regarding CDFIs and MDIs. This testimony highlighted the credit union difference and reiterated NAFCU’s call for Congress to increase funding for the CDFI program as well as recommended that the certification and recertification processes be streamlined and the FHFA and HUD establish specialized mortgage loan programs for CDFIs and MDIs.

Although Congress has yet to adopt the recommendations outlined above, recent programs and proposals focused on CDFIs and MDIs have been positive for the industry. But again, NAFCU would like to stress that additional funding alone cannot and will not solve the structural issues with the certification and recertification process. These changes, in addition to the other recommendations above, are necessary to truly help CDFIs support their communities.

The Consolidated Appropriations Act, 2021 established the Emergency Capital Investment Program (ECIP) to encourage low- and moderate-income community financial institutions to augment their efforts to support small businesses and consumers in their communities. Through ECIP Treasury will provide $9 billion in capital directly to CDFIs or MDIs. Of that $9 billion, $2 billion was set aside for CDFIs and MDIs with less than $500 million in assets and an additional $2 billion for CDFIs

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and MDIs with less than $2 billion in assets. NAFCU supports the ECIP program and encouraged CDFI credit unions to apply for funding through it.

The Fiscal Year 2022 omnibus appropriations package, which was enacted in March 2022, included $1.75 billion for the CDFI Fund under the Minority Lending Program, but only MDIs that are certified as CDFIs on the date that the funding round opens will have access to those funds. It is imperative for all CDFIs to have access to appropriated funds, as evidenced by the CDFI Fund’s May 2022 announcement that at the close of the fiscal year 2022 application round for the CDFI Program and the Native American CDFI Assistance Program, 719 organizations requested a combined $577.9 million in awards, which is nearly three times the amount of available funding. This underscores the need for additional funding to be appropriated to CDFIs so they can help underserved areas.

The CDFI Crisis Fund Act would create a new $2 billion emergency fund for CDFIs. The fund is authorized to make grants to CDFIs providing financial assistance to small businesses and low-income communities in certain circumstances. The fund is triggered by certain emergency declarations, including the COVID-19 emergency period; certain disaster declarations; a specified increase in a statewide unemployment rate; or a specified increase in the national unemployment rate. NAFCU supports this bill as it would allow CDFIs to provide extra support to their communities in the wake of natural disasters and economic disruptions when the need for assistance is most acute.

The CDFI Bond Guarantee Program Improvement Act reduces the CDFI Bond Guarantee Program minimum issuance amount from $100 million to $25 million and reduces the amount allowed to be held in a CDFI’s relending account. The House version of this bill has been advanced by the House Financial Services Committee and now moves to the full House for consideration. NAFCU has expressed support for this valuable line of long-term capital to CDFIs through the Federal Financing Bank. This legislation will have an immediate and positive impact on CDFIs and the communities they serve.

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REGULATION

The regulatory landscape for CDFIs has not changed much throughout the years. In 2020, the CDFI Fund solicited public comment on proposed changes to the certification application. The comment period closed on November 5, 2020. The proposal includes changes to the following certification application sections:

› Primary Mission Test
› Target Market Test
› Board Accountability

Further summary and analysis of this proposal can be found in the CDFI Fund section below. A brief background and explanation of other regulatory developments are also discussed below.

Department of the Treasury & the CDFI Fund

The CDFI Fund is an office of the U.S. Department of the Treasury responsible for overseeing CDFI certification and funds. NAFCU has advocated for several changes to improve the process of obtaining and maintaining CDFI certification.

Application Backlog

NAFCU has requested that Treasury allocate more resources to address the application backlog for CDFI certification and streamline the CDFI application process as soon as possible. As the number of credit unions applying to become CDFI designated institutions continues to grow, many applicants have seen the application process drag on as they await approval. Specifically, some applicants have had their applications on hold for over a year with no communication from the CDFI Fund. NAFCU is aware of over 10 members that waited more than 6 months to receive a decision on their certification application. Towards the end of 2021 the average amount of applications approved per month decreased significantly to less than 5 applications a month. Without a CDFI certification credit unions do not have access to funds available to CDFIs only. For many credit unions, a decision on their CDFI certification application is standing between them providing a number of needed services to their members. In a letter to Treasury, NAFCU also requested that the CDFI Fund openly communicate with applicants regarding delays and approval times. Through a blog post in December 2021, the CDFI Fund announced that it can no longer provide a definitive timeline, which was previously 90 days, for when a certification
determination will be rendered. The CDFI Fund also announced that it is in the process of adding staff and will automatically reject applications that are incomplete or inaccurate rather than reaching out to the applicant to resolve any issues.

In advance of a hearing in February on the ways federal support for MDIs and CDFIs have launched a new era for disadvantaged communities, NAFCU wrote to Chairwoman Maxine Waters and Ranking Member McHenry to, among other things, improve the CDFI certification process. NAFCU also wrote to the Senate Banking Committee requesting that they ensure that Treasury has the necessary resources to clear the application backlog and return to a swift review and approval process. Credit unions should not be left wondering how long it may take to approve their application as this uncertainty and delay will likely have a chilling effect on applications, which will, in turn, negatively impact communities that need support and assistance from CDFIs.

**Certification and Data Collection Changes**

The CDFI Fund is also working on a new certification application that it has admitted will require CDFIs to report even more data to the CDFI Fund and will likely require many CDFIs to adjust how they do business.\(^{12}\) The proposed changes will require the CDFI Fund to:

- examine the alignment between an organization’s mission, its strategy, and its products for the primary mission test;
- eliminate the geographic restrictions on most Target Markets;
- allow entities that are spun off from other entities that have an eligible financial product to become certified CDFIs in less than 12 months;
- allow assets related to loans purchased from entities that are not CDFIs but were directed to an applicant’s Target Market count as assets and staff time devoted to financing; and
- set clear board member percentage standards by removing the geographic connection from board member accountability.

Additionally, the CDFI Fund has proposed changes to the Annual Certification and Data Collection Report (ACR) and certified organizations that do not receive financial assistance will be required to submit a Certification Transaction Level Report (CTLR).\(^ {13}\) The proposed revisions to the ACR will automate some of the existing reporting and


include the collection of additional data to align with the proposed revisions to the certification application, mentioned above.

The CDFI certification application process is cumbersome as it currently stands, and a lot of credit unions must outsource the process to ensure that it is done correctly because they lack the resources and expertise to complete the application. These proposed changes may make the process even more complicated and burdensome as the majority of low-income credit unions lack the resources to comply with the new requirements of the application, ACR, and in the future CTLR. The NCUA’s streamlined application process (explained in the NCUA section below) analyzed a credit union’s lending activities, among other indicators, and, if they qualified, provided the credit union with the necessary information to complete and submit the streamlined certification application to the CDFI Fund. This process was a great help to those credit unions that qualified to use it. The newly proposed requirements have led the NCUA to phase out its streamlined application process. NAFCU will continue to advocate for a streamlined application process, especially for low-income credit unions and MDIs.

**Cure Period**

In 2016, the CDFI Fund launched a mandatory Annual Certification and Data Collection Report (ACR) for all certified CDFIs,¹⁴ which allows the CDFI Fund to annually assess CDFIs’ compliance with certification guidelines and to collect data that provides insights into the CDFI industry. This annual recertification process has caused numerous problems for credit unions.

Implementing a cure period that allows CDFIs reasonable time to address specific issues without fear of sudden loss of certification and recapture of funds will allow more CDFIs to maintain their certification and continue to access the resources necessary to serve their communities.

Currently, the CDFI Fund is not required to provide a cure period, or the cure period offered is too short to allow CDFIs to adequately address changes in their market, especially in communities severely affected by the pandemic. During a meeting with the CDFI Fund, NAFCU expressed concerns about the decertification of CDFI credit unions and the need for a longer cure period.

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The cure period should meet three specific criteria:

1. **Strict Confidentiality**: as with CAMELS ratings for credit unions, the imposition of a cure for any reason should be kept between the CDFI Fund and the financial institution.

2. **Sufficient Duration**: CDFIs that have seen their CDFI financing activities disrupted by pandemic shutdowns, remote work, Paycheck Protection Program loans, and massive mortgage refinancing can hardly fix their target market percentages within a six-month cure period. NAFCU generally supports a longer cure period to prevent the abrupt decertification of CDFI credit unions.

3. **Limited Privileges**: CDFIs placed in a confidential cure should not be permitted to apply to any CDFI programs until the cure has been resolved. This will prevent CDFIs from extending cure periods with new Agreements and maintain the focus where it belongs--on regaining full CDFI eligibility by serving targeted communities and populations.

The risks associated with decertification are harmful because any adverse action by the CDFI Fund may be misperceived by the public as a negative rating from a federal agency regarding institutional safety and soundness. Additionally, decertification prevents a credit union from accessing critical grants and other funding sources to help its members and communities. NAFCU has met with the CDFI Fund to discuss the possibility of a longer cure period. NAFCU will continue to advocate for cure periods to prevent sudden decertification without a fair opportunity to resolve issues.

**Other Targeted Populations**

To become certified as a CDFI under current CDFI Fund standards, an entity must, among other qualifications, direct at least 60 percent of its financial product activities to one or more approved Target Markets. There are three types of Target Markets: Investment Areas (IA), Low-Income Targeted Populations (LITP), and Other Targeted Populations (OTP). The LITP is defined as a low-income population for a specified geographic unit containing individuals whose family income (adjusted for family size) is up to 80 percent of the area median family income for metropolitan areas, or up to 80 percent of the greater of the area median family income or the statewide non-metropolitan area median family income for non-metropolitan areas. OTP-qualifying populations are identified as African-American; Hispanic American; Native American; Native Alaskan, residing in Alaska; Native Hawaiian, residing in Hawaii; and Other Pacific Islander, residing in other Pacific Islands; along with ADA-qualifying Americans.
A growing number of credit unions have requested certification based on minority target populations as borrowers. Credit unions are not specifically targeting minority populations for the purpose of CDFI certification, but they are using algorithmic tools to find borrowers in need and better serve their market. The CDFI Fund is currently penalizing credit unions that submit OTP data by placing their certification applications on hold and discouraging applicants from relying on OTP at all. Furthermore, credit unions are being decertified, in part, because of their reliance on OTP data for their ACR. NAFCU spoke with the CDFI Fund as well as NCUA’s Chairman Todd Harper, about the OTP standard and explained the negative impact it is having on our members. NAFCU followed up the meeting with a letter to Chairman Harper describing this OTP standard issue and the need for resolution from the CDFI Fund.

**Target Market Standards**

There is a continuous conflict between the standards used by the CDFI Fund for grant reports (TLRs) and those used for the ACR. While TLRs use “Eligible Market(s) and/or the Recipient’s approved Target Market,” ACRs are restricted to “approved” Target Markets only.

The conflict between standards causes CDFIs and the CDFI Fund to be burdened with duplicative work. If the two compliance reports were in alignment the CDFI Fund would save thousands of hours of staff time. Allowing CDFIs to use the same data for both TLR grant reports and ACRs would significantly decrease the burden on CDFIs and increase efficiency.

**National Credit Union Administration**

In 2016, the NCUA and CDFI Fund joined efforts and developed a streamlined application process that would allow low-income designated credit unions to complete an online participation form with the NCUA. The NCUA’s Office of Credit Union Resources and Expansion would review the credit union’s products, services, and other indicators to determine whether it qualified for the streamlined certification application. Qualified applicants would then receive the necessary information from the NCUA to complete and submit the streamlined certification application to the CDFI Fund, which makes the final certification decisions.

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In February 2022, the NCUA announced that the streamlined application process was being phased out and applications are being consolidated under one process. NAFCU immediately objected to the phase-out of this streamlined application, which has helped many low-income designated credit unions and MDIs become CDFIs. NAFCU was informed that this phase-out is due to the increased data reporting requirements that the CDFI Fund is expected to implement soon (summarized above in Certification and Data Collection Changes). However, at this time, it is unclear exactly when the streamlined application will be phased out.

NAFCU has met with both the CDFI Fund and the NCUA to stress the importance of this streamlined application process. When speaking with Chairman Harper, NAFCU requested that the streamlined application be retained in a limited capacity for MDIs only. Some credit unions do not have the resources to complete the application for CDFI certification on their own or hire an outside company to do it for them. This process has been helpful for those small credit unions that serve low-income communities and need access to the benefits of CDFI certification the most. NAFCU is disappointed to see this process eliminated and is working with the NCUA to find a way to preserve the streamlined application.

**Federal Housing Finance Agency and Department of Housing and Urban Development**

NAFCU wrote to the FHFA suggesting that it launch pilot programs and consider additional programs targeted toward buying mortgages from CDFIs, as this will help underserved borrowers and first-time homebuyers achieve homeownership while allowing credit unions to better support their communities. Most of the mortgages originated by CDFIs are considered non-conforming (as they do not meet the government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac's, loan-to-value, debt-to-income, or FICO score standards, as well as other requirements) and the GSEs are unable to purchase these loans. As a follow-up to the letter, NAFCU met with FHFA Director Sandra Thompson and her team to discuss the idea of GSEs purchasing non-conforming loans from CDFI credit unions. In response, Freddie Mac has committed to conducting outreach to CDFIs to understand their unique challenges and needs and improve CDFIs and MDIs' access to capital, in its Equitable Housing Finance Plan. NAFCU will continue to advocate for CDFI credit unions to be able to sell more of their mortgages to the GSEs and will keep you updated on the progress.

NAFCU met with HUD to encourage collaborative work with CDFI and MDI credit unions to provide access to affordable mortgage credit for low- and moderate-income and first-time homebuyers. NAFCU also reiterated our asks described in a letter sent
in response to HUD’s draft 2022-2026 strategic plan. Specifically, NAFCU recommended that HUD conduct a study to determine the level of participation of CDFIs in FHA loan insurance programs and offer targeted training and resources to grow the number of CDFIs that are FHA-approved lenders. Additionally, HUD should streamline the approval process for FHA lenders to further grow the number of CDFIs that are FHA-approved lenders. NAFCU will continue to work with HUD and Ginnie Mae to ensure that CDFI credit unions can sell their mortgages to the secondary market.

RESOURCES

For more information on becoming a certified CDFI and to stay updated on the legislative and regulatory issues of CDFIs, please visit the links below:

› Begin here to become a certified CDFI.
› The NCUA also provides background and guidance to becoming a CDFI.
› NAFCU has a CDFI Refresher on its Compliance Blog.