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Report to Congressional Committees

May 2015

COMMUNITY DEVELOPMENT CAPITAL INITIATIVE

Status of Program Investments and Participants

GAO-15-542

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GAO Highlights

Highlights of GAO-15-542, a report to congressional committees

Why GAO Did This Study

Treasury established CDCI under the Troubled Assets Relief Program (TARP) in February 2010 to help banks and credit unions certified as Community Development Financial Institutions maintain their services to underserved communities in the aftermath of the 2007-2009 financial crisis. The program's initial dividend or interest rate of 2 percent on investments increases to 9 percent after 8 years in 2018. TARP's authorizing legislation mandates that GAO report every 60 days on TARP activities, including CDCI. This report examines (1) the status of the CDCI program and Treasury's plan for winding down the program, (2) the financial condition of remaining program participants, and (3) how the future dividend and interest rate increase could affect the remaining participants. GAO last reported on this CDCI program in June 2014.

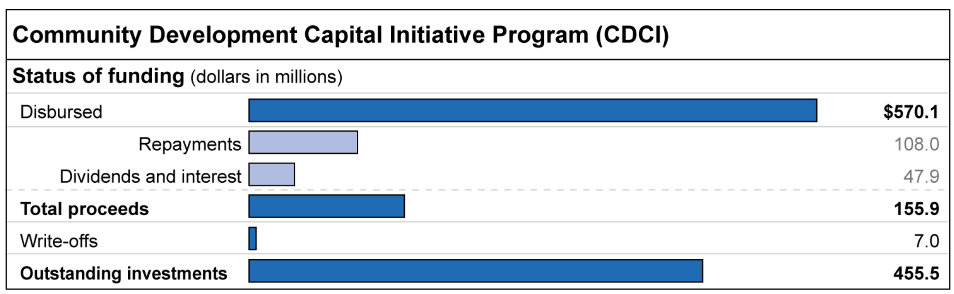
GAO reviewed Treasury reports on CDCI and used regulatory financial data to compare the financial condition of remaining CDCI participants with other nonparticipating community development institutions. GAO also interviewed staff from Treasury, the regulators of banks and credit unions, and representatives of a selected sample of CDCI participants. These participants were selected because measures of their financial conditions fell below the median for all participants. Treasury, FDIC, and the Federal Reserve provided technical comments on a draft of this report that were incorporated, as appropriate, and in written comments, NCUA noted the report accurately described CDCI participant conditions.

View GAO-15-542. For more information, contact A. Nicole Clowers at (202) 512-8678 or clowersa@gao.gov.

What GAO Found

As of March 31, 2015, 64 of the 84 participating banks and credit unions remained in the Community Development Capital Initiative (CDCI), and 80 percent of the Department of the Treasury's (Treasury) $570 million total investment remained outstanding. Treasury's most recent estimated lifetime cost of the program—the present value of all program outflows and inflows—was $100 million, an amount that is $20 million higher than the February 2014 estimate. According to Treasury, the increase in the program's estimated cost reflects the loss of future higher dividend and interest income as participants make repayments earlier than expected and their financial conditions change. Treasury continues to consider approaches to winding down the CDCI program and has discussed options with industry associations.

Status of the Community Development Capital Initiative, as of March 31, 2015



Source: GAO analysis of Treasury data. | GAO-15-542

Note: Treasury invested in 84 institutions by purchasing preferred equity or subordinated debt.

The financial condition of CDCI participants as of December 2014 had generally improved since year-end 2013. The median indicators of financial condition that GAO examined for the banks remaining in CDCI had all improved, including those indicating higher profitability and stronger capital positions. However, although CDCI credit union participants had a higher year-end 2014 median return on assets and median net worth, they also had slightly worse median measures of loan delinquency.

Regulators said that many CDCI participating banks would likely be able to repay their CDCI investments before the scheduled dividend or interest rate increase. But they noted that participants with relatively weaker financial conditions could have difficulty paying higher dividends and interest payments and redeeming their CDCI investments. For example, one regulator noted that CDCI institutions could have more difficulty raising additional capital from other investors because these investors would have to be willing to accept the lower returns and longer investment horizons that can result from the institutions' community development mission. Treasury staff said they would consider restructuring participating institutions' investments on a case-by-case basis to help such institutions better afford the CDCI capital and attract private capital.

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Abbreviations

CDCI	Community Development Capital Initiative
CDFI	Community Development Financial Institutions
CPP	Capital Purchase Program
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
EESA	Emergency Economic Stabilization Act of 2008
FDIC	Federal Deposit Insurance Corporation
NCUA	National Credit Union Administration
OCC	Office of the Comptroller of the Currency
TARP	Troubled Asset Relief Program
Treasury	Department of the Treasury

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May 5, 2015

Congressional Committees

The Community Development Capital Initiative (CDCI) was created in February 2010 to assist eligible, certified Community Development Financial Institutions (CDFI) and their communities cope with the effects of the 2007-2009 financial crisis.[1] Through this program, the Department of the Treasury (Treasury) provided capital to CDFI banks and credit unions by purchasing preferred equity and subordinated debt from them.[2] Treasury's purchase authority ended in September 2010, after making a total of approximately $570 million in investments in 84 institutions. CDCI was one of the programs implemented under the Troubled Asset Relief Program (TARP), which gave Treasury the authority to buy or guarantee up to $700 billion of the "troubled assets" that were believed to be at the heart of the financial crisis, including mortgages, mortgage-backed securities, and any other financial instruments deemed necessary, such

[1]CDFIs are financial institutions that provide financing and related services to communities and populations that lack access to credit, capital, and financial services. Treasury's CDFI Fund provides the designation, which allows CDFIs to apply for the CDFI Fund's financial assistance. Although CDFIs include banks, thrifts, credit unions, loan funds, and venture capital funds, only institutions that have a federal depository institution supervisor (i.e., banks, thrifts, and credit unions) could apply for CDCI assistance. The federal depository institution supervisors for this program include the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the National Credit Union Administration (NCUA). During the application period, the Office of Thrift Supervision was also a federal supervisor, but it was abolished by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Pub. L. No. 111-203, § 313, 124 Stat. 1376, 1523 (2010) (codified at 12 U.S.C. § 5413).

[2]In this report, "bank" refers to banks, thrifts, and bank or savings and loan holding companies. In addition, some banking institutions are formed as S corporations, a designation that affected the form of Treasury's investment. An S corporation elects to be taxed under subchapter S of chapter 1 of the Internal Revenue Code and thus does not pay income taxes. Instead, the corporation's income or losses are divided among and passed through to its shareholders. For purposes of this report, the term bank includes S corporations.

as equity investments.[3] CDCI offered favorable capital terms, including a relatively low dividend or interest rate, an important benefit for CDFIs that often did not have the same access to capital markets as larger banks. For example, approved CDFIs issued preferred equity or subordinated debt securities to Treasury with initial dividend or interest rates of 2 percent that would increase to 9 percent after 8 years (2018).[4] Treasury has continued to oversee its CDCI investments and collect dividend and interest payments. Some participants have redeemed their securities and exited the program with the approval of their primary federal regulators.

This report is based on our continuing analysis and monitoring of Treasury's activities in implementing the Emergency Economic Stabilization Act of 2008 (EESA), which provided us with broad oversight authorities for actions taken under TARP and required that we report at least every 60 days on TARP activities and performance.[5] To fulfill our statutorily mandated responsibilities, we have been monitoring and

[3]TARP was authorized by the Emergency Economic Stabilization Act of 2008 (EESA). Pub. L. No. 110-343, 122 Stat. 3765 (2008) (codified at 12 U.S.C. §§ 5201 et seq.). EESA, which was signed into law on October 3, 2008, established the Office of Financial Stability within Treasury and provided it with broad, flexible authorities to buy or guarantee troubled mortgage-related assets or any other financial instruments necessary to stabilize the financial markets. EESA originally authorized Treasury to purchase or guarantee up to $700 billion in troubled assets. The July 2010 Dodd-Frank Act reduced Treasury's authority to purchase or insure troubled assets to a maximum of $475 billion. Section 1302(1)(A) of the Dodd-Frank Act, 124 Stat. at 2133 (codified at 12 U.S.C. § 5225(a)(3)).

[4]The securities that Treasury purchased from S corporations have a 3.1 percent interest rate until 2018, when the rate will increase to 13.8 percent. However, given the tax treatment of S corporations, these rates equate to after-tax effective rates of 2 percent and 9 percent, respectively (assuming a 35 percent tax rate)—the same rates applied to securities issued by other classes of institutions participating in CDCI.

[5]Section 116 of EESA, 122 Stat. at 3783 (codified at 12 U.S.C. § 5226).

providing updates on TARP programs, including CDCI.[6] This report discusses (1) the status of the CDCI program and Treasury's plans for winding down the program, (2) the financial condition of remaining participants, and (3) how the pending dividend or interest rate increase could affect remaining participants.

To describe the financial status of CDCI and Treasury's plan for ending the program, we analyzed Treasury reports on the number of institutions that made full repayments, the amounts of dividends and interest paid to Treasury, CDCI investments outstanding, and the estimated lifetime cost of the program. We also interviewed Treasury staff who oversee the CDCI program about their plans for winding it down. To assess the financial condition of the remaining CDCI institutions, we used regulatory financial data from SNL Financial to compare various indicators of financial health—such as ratios of delinquent loans to total assets, capital to total assets, or net worth to total assets—for remaining CDCI participants with the same indicators for banks and credit unions that were not participating.[7] We conducted separate analyses for banks and credit unions because the two types of institutions file different regulatory reports and have different financial indicators. We have assessed the reliability of Treasury data and the SNL Financial data as part of previous studies. We determined that their compilation had not changed and we

[6]See, for example, GAO, *Troubled Asset Relief Program: Treasury Continues to Wind down Most Programs, but Housing Programs Remain Active*, GAO-15-197 (Washington, D.C.: Jan. 6, 2015); *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Years 2014 and 2013 Financial Statements*, GAO-15-132R (Washington, D.C.: Nov. 7, 2014); *Troubled Asset Relief Program: Treasury Could Better Analyze Data to Improve Oversight of Servicers' Practices,* GAO-15-5 (Washington, D.C.: Oct. 6, 2014); *Troubled Asset Relief Program: Government's Exposure to Ally Financial Lessens as Treasury's Ownership Share Declines*, GAO-14-698 (Washington, D.C.: Aug. 5, 2014); *Community Development Capital Initiative: Status of the Program and Financial Health of Remaining Participants*, GAO-14-579 (Washington, D.C.: June 6, 2014); *Troubled Asset Relief Program: Status of the Wind Down of the Capital Purchase Program,* GAO-14-388 (Washington, D.C.: Apr. 7, 2014); *Troubled Asset Relief Program: Treasury Sees Some Returns as It Exits Programs and Continues to Fund Mortgage Programs*, GAO-13-192 (Washington, D.C.: Jan. 7, 2013); *Troubled Asset Relief Program: As Treasury Continues to Exit Programs, Opportunities to Enhance Communication on Costs Exist,* GAO-12-229 (Washington, D.C.: Jan. 9, 2012); and *Troubled Asset Relief Program: Status of Programs and Implementation of GAO Recommendations,* GAO-11-74 (Washington, D.C.: Jan. 12, 2011).

[7]SNL Financial is a private service that disseminates data from quarterly regulatory reports, among other information.

are using them in the same manner, and therefore found the data to be reliable for the purposes of our review.

To examine challenges associated with the pending dividend and interest rate increase, we used a selected sample of CDCI program participants that had been interviewed for our June 2014 report and had financial health indicators below the median of all participants on at least two of the seven indicators that we analyzed.[8] We interviewed two banks and four credit unions from this sample.[9] We also interviewed staff from Treasury responsible for overseeing the CDCI program, and staff from the regulators that oversee CDCI-participating institutions, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board of Governors (Federal Reserve), the Office of the Comptroller of the Currency (OCC), and the National Credit Union Administration (NCUA). Appendix I has more information on our scope and methodology.

We conducted this performance audit from January 2015 to May 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Created in 2010, CDCI was one of the later TARP programs and was intended to help mitigate the adverse impact that the financial crisis was having on communities underserved by traditional banks. CDCI is structured much like the TARP Capital Purchase Program (CPP), in that both provide capital to financial institutions by purchasing preferred equity and subordinated debt from them. However, CDCI differs from CPP in several important ways. First, whereas CPP provided assistance to a range of banks, CDCI financial assistance was provided to CDFI institutions, which provide financial services to low and moderate income,

[8]GAO, *Community Development Capital Initiative: Status of the Program and Financial Health of Remaining Participants*, GAO-14-579 (Washington, D.C.: June. 6, 2014).

[9]We attempted to contact the institutions with the most financial health measures below the median for their institution type and were successful in interviewing staff from two banks and four credit unions.

minority, and other underserved communities. Second, CDCI provided more favorable capital terms than CPP had offered to its participating institutions. Specifically, CDCI investments had an initial dividend or interest rate of 2 percent, compared with 5 percent under CPP. The dividend or interest rate increases to 9 percent after 8 years under CDCI, but increased after 5 years under CPP. Finally CDCI also provided assistance to credit unions, which were institutions that had not been eligible for CPP.

Treasury finalized the last of its $570 million in CDCI investments in September 2010, just before its TARP purchasing authority expired. The 84 original participating institutions included 36 banks and 48 credit unions. Twenty-eight of the 36 banks were former CPP participants that were in good standing in that program and thus were allowed to refinance their CPP shares for a lower rate in CDCI. Of these 28 banks, 10 received additional disbursements under CDCI.

As shown in table 1, CDCI terms varied depending on the type of institution receiving the capital. In general, banks received capital by issuing to Treasury preferred stock representing not more than 5 percent of their risk-weighted assets. The capital they received in return was generally treated as Tier 1 capital for regulatory purposes, with a perpetual term. Federal banking regulators classify capital as either Tier 1—currently the highest-quality form of capital—or Tier 2, which is weaker in absorbing losses.[10] Credit unions issued unsecured subordinated debentures totaling not more than 3.5 percent of their total assets. In exchange, Treasury provided participating credit unions with secondary capital that boosted their net worth until 5 years before the maturity date,

[10]Tier 1 capital consists primarily of common equity. Tier 2 is supplementary capital and includes limited amounts of subordinated debt, limited amounts of loan loss reserves, and certain other instruments. New capital regulations issued by the banking regulators in 2013 revise the bank regulatory capital structure. The rules implement higher minimum risk-based capital ratios and a new common equity tier-1 capital requirement, among other things. The new minimum risk-based capital ratios began to apply for certain smaller banking organizations subject to the rules in January 2015.

at which point the debt would begin amortizing at 20 percent per year.[11] All institutions participating in CDCI are required to make quarterly dividend or interest payments to Treasury. All institutions received funding in 2010 and will face a dividend or interest rate increase during 2018.

Table 1: Community Development Capital Initiative (CDCI) Program Terms by Institution Type

Type of institution	Number of institutions	Type of security	Size of offering	Regulatory capital status	Term or maturity (length from date of investment)	Dividend or interest rate
Bank or thrift	27	Preferred stock	Not more than 5 percent of risk-weighted assets	Tier 1 capital	Perpetual	2 percent for the first 8 years (until 2018); 9 percent thereafter
S-corporation	9	Unsecured subordinated debentures[a]	Not more than 5 percent of risk-weighted assets	Tier 2 capital for a bank or savings association; Tier 1 capital for a bank holding company	13 years for a bank or savings association; 30 years for a bank holding company or savings and loan holding company	3.1 percent for the first 8 years (until 2018); 13.8 percent thereafter
Credit union	48	Unsecured subordinated debentures	Not more than 3.5 percent of total assets and not more than 50 percent of capital and surplus	Secondary capital[b]	8 or 13 years	2 percent for the first 8 years (until 2018); 9 percent thereafter

Source: GAO analysis of Treasury summary terms for CDCI. │ GAO-15-542

[a]In the event of liquidation of a company, unsecured subordinated debentures are generally paid after other bonds and debt obligations.

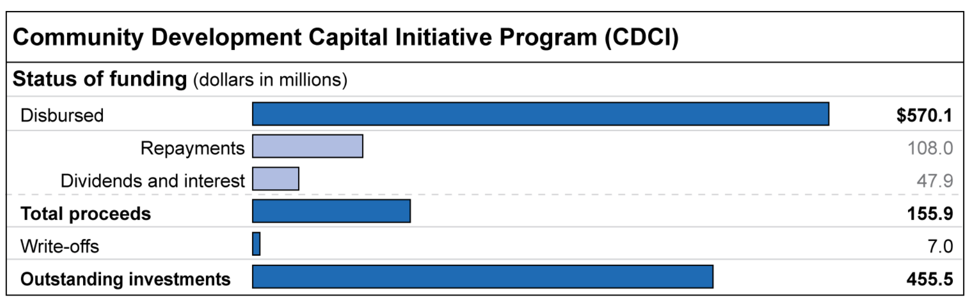
[11]Secondary capital (also called supplemental, alternative, or contributed capital) is capital beyond that built through retained earnings. According to NCUA, its purpose is to provide a further means—beyond setting aside a portion of earnings—for low-income designated credit unions to build capital to support greater lending and financial services in their communities and to absorb losses. As a result, the institutions may be less likely to fail. Secondary capital accounts must have a minimum maturity of 5 years, but subject to written approval of NCUA, low-income designated credit unions may request an early redemption exception for all or part of secondary capital accepted from the federal government or any of its subdivisions at any time after it has been on deposit for 2 years. The accounts must be established as uninsured, non-share instruments. The uninsured secondary capital funds on deposit (including interest paid into the account) must be available to cover operating losses in excess of the low-income designated credit union's net available reserves and undivided earnings. Additionally, funds used to cover such losses may not be replenished or restored to the uninsured secondary capital accounts.

[b]Secondary or supplemental capital is capital beyond that built through retained earnings which provides funding to support lending and other financial services and to absorb losses.

Most Participants Remain in CDCI Program

In its March 2015 report to Congress, Treasury reported that 64 of the original 84 CDCI participants remained in the program as of March 31, 2015, including 28 banks and 36 credit unions. Of the original participants, 18 institutions had exited through full repayments, 1 institution exited after a failure, and 1 institution merged with another CDCI bank, according to Treasury.[12] As of the end of March 2015, Treasury also reported that the outstanding investment balance for CDCI was over $455 million, representing approximately 80 percent of the original investment, with repayments totaling about $108 million since the program's origination. Treasury has written off $7 million, which came mostly from an investment in one institution whose assets were liquidated when its banking subsidiary entered receivership. Treasury has also collected almost $48 million in dividends and interest.[13]

Figure 1: Status of Community Development Capital Initiative (CDCI), as of March 31, 2015



Source: GAO analysis of Treasury data. | GAO-15-542

Note: Amounts may not total due to rounding.

At the beginning of the program in 2010, Treasury estimated the CDCI program's lifetime cost would be $290 million, an amount that represents

[12]U.S. Department of the Treasury, Troubled Asset Relief Program, *Monthly Report to Congress: March 2015*, April 10, 2015.

[13]U.S. Department of the Treasury, Office of Financial Stability, *Dividends and Interest Report*, April 10, 2015.

the expected value of all program outflows (investments) and inflows (repayments and dividends and interest received).[14] As participants made repayments and other conditions improved, this estimated cost fell to $80 million as of February 28, 2014.[15] However, Treasury's latest available estimate indicated that, as of February 28, 2015, the CDCI program's lifetime cost would be about $100 million. Treasury staff told us that the recent increase in the lifetime cost reflected changes in the various factors used in the cost estimation model, including interest rates and participants' financial conditions. In addition, they explained that as additional repayments from participating institutions are received or expected, the current cost increases because the program will not receive the previously-projected higher income from the 9 percent dividends and interest after 2018 on the earlier than expected repaid investments .

Treasury continues to consider various approaches to winding down the CDCI program. In 2014, Treasury staff told us that they had yet to finalize an exit strategy for CDCI, but were studying various alternatives and would need to consider the interests of participating institutions and taxpayers. When we spoke with Treasury staff in March 2015, they indicated that they continued to consider options and had discussed options for winding down CDCI with trade associations representing community development and minority depository institutions, which generally must have ownership of at least 51 percent of the institution by one or more socially and economically disadvantage individuals, whose members have received CDCI capital.[16] As part of its exit strategy for CPP, which also provided funding to banks, Treasury has conducted auctions to sell its shares of participating institutions to other investors. Although acknowledging auctions are an option for CDCI, Treasury staff indicated that they would hold auctions only if doing so would not affect

[14]Treasury staff told us that the $290 million included some projected investments that subsequently were not made so that the initial lifetime cost for the investments that actually were made originally was about $274 million.

[15]GAO-14-579.

[16]Under Section 308 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Congress established goals for regulators, including preserving the number of minority depository institutions, preserving their minority character in cases of merger or acquisition, promoting and encouraging creation of new minority depository institutions, and providing for training, educational programs, and technical assistance to prevent insolvency. Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, § 308, 103 Stat. 183, 353 (codified at 12 U.S.C. § 1463 note).

the status of any CDCI participants that were currently designated as minority owned depository institutions.

The Financial Health of Remaining CDCI Institutions Has Improved, but Is Mixed Compared with Other CDFI Institutions

Our analysis showed that the financial conditions of the banks and credit unions participating in CDCI had generally improved since 2013. In our June 2014 report on CDCI, we found that the number of CDCI institutions that missed quarterly dividend or interest payments had generally been low, with nine institutions (seven banks and two credit unions) of the program's original 84 participants having missed at least one quarterly payment.[17] According to Treasury's latest report to Congress, two banks had unpaid noncumulative dividends outstanding as of March 31, 2015. Institutions can elect whether to pay dividends and interest and may not pay for a variety of reasons, including decisions that they or their federal and state regulators make to conserve cash and maintain (or increase) capital levels. However, investors may view a company's ability to make these payments as an indicator of its financial strength and may see failure to pay full dividends or interest as a sign of financial weakness.

[17] GAO-14-579.

CDCI Banks Saw Improvements in Financial Measures in 2014

The financial conditions for banks participating in the CDCI program appear to have improved since the end of 2013. The median of all seven indicators of financial condition that we analyzed for banks participating in CDCI at year-end 2014 had improved.[18] As shown in table 2, at the end of 2014 the CDCI participating banks had higher median returns on assets and better capital positions than at year-end 2013. In addition, the median of the bank participants' indicators of loan performance had all improved since year-end 2013.

[18]The seven measures are: (1) The Texas Ratio, which helps determine the likelihood of a bank's failure by comparing its troubled loans to its capital and is calculated by dividing a bank's nonperforming assets plus loans 90 or more days past due by its tangible equity and reserves. Larger Texas ratios are considered a sign of poor financial health. (2) The return on average assets measure, which shows how profitable a bank is relative to its total assets and how efficient management is at using its assets to generate earnings. It is calculated by dividing a bank's net income by the average of its assets over a specific time period, such as a quarter or year. Banks that have greater returns on average assets are considered financially healthier. (3) Noncurrent loan percentage, which is the sum of loans and leases 90 days or more past due and in nonaccrual status. Greater noncurrent loan percentages indicate lower bank health. (4) Net charge-offs to average loans ratio, which is the total dollar amount of loans and leases charged off (removed from balance sheet because of uncollectibility), less amounts recovered on loans and leases previously charged off divided by the average dollar value of loans outstanding for the period. Greater net charge-off to average loans ratios indicate lower bank health. (5) The Tier 1 risk-based capital ratio, which measures Tier 1 capital (equity capital, retained earnings, and disclosed reserves) as a share of risk-weighted assets. Banks that have a larger Tier 1 risk-based capital ratio are considered healthier. (6) Common equity Tier 1 ratio, which is a bank's equity capital excluding any preferred shares, retained earnings, and disclosed reserves as a share of risk-weighted assets. Banks with larger common equity Tier 1 ratios are considered healthier. (7) Reserves to nonperforming loans, which are the funds a bank holds to cover loan losses divided by loans that are 90 days or more past due. Banks with larger reserves to nonperforming loans are considered financially healthier.

Table 2: Median Financial Information for Remaining Community Development Capital Initiative (CDCI) Banks, as of December 31, 2013, and December 31, 2014

	Banks participating in CDCI in 2013	Banks participating in CDCI in 2014
Number of institutions	28	28
Total assets (dollars in thousands)	$401,997	$425,029
Texas Ratio[a]	29.62%	23.09%
Return on average assets	0.75	0.86
Noncurrent loan percentage	2.11	1.59
Net charge-offs to average loans ratio	0.40	0.22
Tier 1 risk-based capital ratio[b]	15.70	16.15
Common equity Tier 1 ratio	14.10	15.43
Reserves to nonperforming loans	62.19	66.79

Source: GAO analysis of SNL Financial data. | GAO-15-542

[a]The Texas Ratio is defined as nonperforming assets plus loans 90 or more days past due divided by tangible equity and reserves. Institutions with lower Texas Ratios are financially healthier than those higher ratios.

[b]The Tier 1 risk-based capital ratio measures Tier 1 capital as a share of risk-weighted assets.

In our June 2014 report, we found that the banks participating in CDCI were generally in better financial condition than other CDFI banks that did not participate in the CDCI program.[19] However, a comparison of the median financial condition indicators as of year-end 2014 for CDCI banks and the same indicators for all other CDFI banks presented a somewhat more mixed picture. The median for the CDCI participants was slightly better than for the nonparticipant banks for some measures, but for others they were slightly worse, as shown in table 3. For example, the median CDCI bank return of average assets was higher and their median noncurrent loans percentage was lower than the median for the other CDFI banks. In contrast, the CDCI banks' median Texas Ratio and their net charge-offs to average loans ratios were worse than the other CDFI banks.

[19]GAO-14-579.

Table 3: Median Financial Information on Remaining Community Development Capital Initiative (CDCI) Banks and Non-CDCI Banks, as of December 31, 2014

	Remaining CDCI banks	Non-CDCI (all other CDFI banks)[a]
Number of institutions	28	77
Total assets (dollars in thousands)	$425,029	$146,797
Texas Ratio[b]	23.09%	17.68%
Return on average assets	0.86	0.60
Noncurrent loan percentage	1.59	1.76
Net charge-offs to average loans ratio	0.22	0.20
Tier 1 risk-based capital ratio[c]	16.15	16.25
Common equity Tier 1 ratio	15.43	16.25
Reserves to nonperforming loans	66.79	74.35

Source: GAO analysis of SNL Financial data. | GAO-15-542

Note: The figures in the table represent median values for all institutions in the particular population.

[a]The non-CDCI group consisted of 77 banks that were certified as Community Development Financial Institutions (CDFI) as of December 2014 by Treasury's CDFI Fund but were not participating in CDCI.

[b]The Texas Ratio is defined as nonperforming assets plus loans 90 or more days past due divided by tangible equity and reserves.

[c]The Tier 1 risk-based capital ratio measures Tier 1 capital as a share of risk-weighted assets.

CDCI Credit Unions Saw Improvements in Some Financial Measures in 2014

The financial condition for the credit unions participating in CDCI had improved since 2013, as measured by five financial indicators we examined (see tab. 4).[20] For example, at the end of 2014 the CDCI credit unions' median return on assets and net worth were higher than at year-

[20]The five measures are: (1) The return on average assets measure, which shows how profitable a company is relative to its total assets and how efficient management is at using its assets to generate earnings. It is calculated by dividing a credit union's net income by the average of its assets over a specific time period, such as a quarter or year. Credit unions with greater returns on average assets are considered financially healthier. (2) The delinquent loans ratio is the sum of loans 60 days or more past due divided by total loans. A higher ratio indicates lower institution health. (3) Net charge-offs to average loans ratio, which is the total dollar amount of loans charged off (removed from the balance sheet because of uncollectibility), less amounts recovered on loans previously charged off divided by the average dollar value of loans outstanding for the period. Greater net charge-offs to average loans rations indicates lower institution health. (4) The net worth ratio is the total of a credit union's regular reserves, any secondary capital, its undivided earnings, and its net income or loss divided by its total assets. A higher net worth ratio indicates a healthier credit union. (5) The delinquent loans to net worth ratio is a credit union's total value of its delinquent loans to net worth, with lower ratios indicating a healthier credit union.

end 2013. However, the participating credit unions had slightly worse median measures for some of the loan delinquency ratios.

Table 4: Median Financial Information on Community Development Capital Initiative (CDCI) Credit Unions, as of December 31, 2013, and December 31, 2014

	Credit unions participating in CDCI in 2013	Credit unions participating in CDCI in 2014
Number of institutions	36	36
Total assets (dollars in thousands)	$19,217	$18,811
Return on average assets (percent)	0.27%	0.44%
Delinquent loans ratio	1.82	1.88
Net charge-offs to average loans ratio	0.54	0.52
Net worth ratio	7.34	7.40
Delinquent loans to net worth ratio	9.56	10.19

Source: GAO analysis of SNL Financial data. | GAO-15-542

Note: The figures in the table represent median values for all institutions in the particular population.

Further, our analysis for this report showed that, in general, the credit unions still participating in CDCI continued to be in worse financial condition than other CDFI credit unions (see table 5). This is consistent with our observations from our June 2014 report in which we found that the credit unions participating in CDCI were generally in worse financial condition than CDFI credit unions that did not participate in CDCI.[21]

[21] GAO-14-579.

Table 5: Median Financial Information on Remaining Community Development Capital Initiative (CDCI) Credit Unions and Non-CDCI Credit Unions, as of December 31, 2014

	Remaining CDCI credit unions	Non-CDCI (all other CDFI credit unions)[a]
Number of institutions	36	201
Total assets (dollars in thousands)	$18,811	$55,406
Return on average assets (percent)	0.44%	0.56%
Delinquent loans ratio	1.88	1.08
Net charge-offs to average loans ratio	0.52	0.59
Net worth ratio	7.40	10.33
Delinquent loans to net worth ratio	10.19	6.34

Source: GAO analysis of SNL Financial data. | GAO-15-542

Note: The figures in the table represent median values for all institutions in the particular population.

[a]The non-CDCI group consisted of 201 credit unions that were certified as Community Development Financial Institutions (CDFI) as of December 2014 by Treasury's CDFI Fund but were not participating in CDCI.

Financial Regulators Are Monitoring the Financial Health of CDCI Participants

Treasury and federal banking regulators told us that they are routinely monitoring indicators of the financial health of CDCI participants. Treasury staff said that they monitor the entire CDCI portfolio on an ongoing basis, including reviewing participants' financial statements and various metrics. They also receive reports on dividend and interest payments and have had discussions with some institutions and with representatives of trade associations whose members are participating in the program. Treasury staff noted that the financial health of CDCI participants is influenced by the same factors affecting the financial health of the banking sector as a whole, including the country's economic growth, unemployment rates, and changes in interest rates.

Banking and credit union regulators told us that they primarily monitored the health of participating CDCI institutions through routine supervision activities. For example, FDIC officials told us that the community development missions of CDFI institutions, including those in CDCI, means that the institutions often have higher costs and are less profitable than other lenders. However, they indicated that their supervision of CDCI banks was not materially different from their supervision of other banks, and included regular examinations that used the same rating system of management and financial strength that is used for all institutions.[22] Staff from the Federal Reserve, OCC, and NCUA also told us they supervised CDCI participants in the same way they oversaw their other regulated institutions. NCUA staff noted that some of the credit unions participating in CDCI were designated as “low-income credit unions”—that is, more than 50 percent of their members had incomes of 80 percent or less of the median income for their area.[23] These institutions are eligible for additional technical assistance and face fewer restrictions on obtaining capital and accepting deposits from nonmembers.

Financially Weaker CDCI Participants Likely to Face Challenges with Upcoming Dividend or Interest Rate Change

Although some CDCI participants may be able to exit the CDCI program without difficulty, others may experience more challenges. Banking regulator staff told us that the financial condition of many of the CDCI bank participants was healthy enough to allow the institutions to repay their CDCI investments by the time that the dividend and interest rate increase. They noted that these institutions would likely continue to hold their CDCI investments until closer to the date of the increase because the 2 percent rate they were currently paying was lower than the cost of capital from other sources.

However, some CDCI participants, particularly those whose financial conditions are relatively weak, anticipated having difficulty paying the increased dividend and interest rate and redeeming their CDCI investments. As noted earlier, in 2018 the quarterly dividend and interest rate for banks and credit unions participating in CDCI will rise from 2 percent to 9 percent. In addition, although most of the banks issued preferred stock to Treasury when they received their CDCI investments, the credit unions received subordinated debentures, and these debentures are due to be redeemed when they mature for some credit

[22]These ratings known as CAMELS include assessments of an institution’s capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk.

[23]Low-income members are those members whose family income is 80 percent or less than the median family income for the metropolitan area where they live or national metropolitan area, whichever is greater, or those members who earn 80 percent or less than the total median earnings for individuals for the metropolitan area where they live or national metropolitan area, whichever is greater. For members living outside a metropolitan area, NCUA is to use the statewide or national, nonmetropolitan area median family income instead.

unions in 2018 and for others in 2023.[24] Because they are less profitable, CDCI institutions may not be able to retain enough funds from their earnings to replace their CDCI capital.

We contacted six institutions—including two banks and four credit unions—with relatively weak financial positions that we had interviewed last year to determine how their conditions had changed and what their plans were for exiting the program. Staff from two of the banks we spoke with told us that their financial conditions had been improving over time, but they added that redeeming their CDCI investments before the scheduled rate change would be challenging. Furthermore, they told us that meeting the higher capital standards that were currently being implemented in the United States would make repaying their CDCI investments more difficult.[25]

If the remaining participants are able to repay their CDCI investment they may need to replace this capital with capital from other external sources. For example, several remaining participants we spoke with were unsure whether they would be able to grow their retained earnings enough to not have to seek additional external capital. While these institutions attempt to grow their retained earnings, the institutions told us their ability to make additional loans in their communities would be reduced. Other options the remaining participants we spoke with cited in terms of managing the upcoming dividend or interest rate change included looking for opportunities to merge with another institution or seeking to renegotiate the terms of their CDCI investments.

Staff from Treasury and the four financial regulators all noted that they were aware that some CDCI participants were likely to face these challenges. Staff from OCC noted that obtaining additional capital from

[24]Subordinated debentures are a type of unsecured bond whose holders will not receive repayment during the liquidation of the issuer until all other bonds and debts are repaid.

[25]The standards being implemented by U.S. banking regulators are based on Basel III reform measures, which were developed by the Basel Committee on Banking Supervision to strengthen the regulation, supervision, and risk management of the banking sector. The measures include both liquidity and capital reforms. The Basel Committee on Banking Supervision, on which the United States serves as a participating member, developed international regulatory capital standards through a number of capital accords and related publications, which have collectively been in effect since 1988. Basel III does not apply to credit unions. The National Credit Union Administration is in the process of revising its capital standards.

other investors for these institutions could also be challenging because an investor in a typical community bank wants to be assured of timely repayment with a set time horizon. In contrast, they said that CDFI institutions must generally find investors willing to accept lower returns or longer investment horizons because of the institutions' community development missions. Staff from FDIC and OCC told us that redeeming CDCI investments represented a material change to the financial condition of these institutions. Because most of the CDCI investments were made to these institutions' holding companies, the Federal Reserve must approve such material changes, although the other regulators that oversee the holding companies' depository institution subsidiaries told us they are also consulted about these changes when they occur.[26] Staff from some of the regulators also told us that if institutions do not have sufficient income to make the higher 9 percent dividend and interest payments or redeem their shares, they could direct the institutions to develop plans to obtain additional capital. To assist credit unions, NCUA officials told us that they were exploring ways to expand access to secondary capital, which they said could help the CDCI credit unions replace the capital from that program.

Treasury staff also noted they face some limitations in their ability to assist institutions that experience difficulties repaying their CDCI investments. Treasury staff have had some discussions with staff from trade associations representing community development and minority banks about CDCI wind-down options. However, they also told us that they face legal limitations in their ability to alter the terms and conditions of the CDCI program, such as by lowering the increase in the dividend and interest rate scheduled to take effect in 2018. They explained that such alterations could be considered a new issuance of securities, which would not be allowed since the authorized period of time for making investments has closed. Although they saw limited ability to make changes on a program-wide basis, they said they had more flexibility to consider restructurings of an individual institution's investments on a case-by-case basis to help such institutions better afford the CDCI capital and attract private capital.

[26] If the institution did not have a holding company and the depository institution received the investment, then the redemption of the capital would have to be approved by its primary federal regulator.

Agency Comments

We provided a draft of this report to Treasury, FDIC, the Federal Reserve, NCUA, and OCC for their review and comment. NCUA provided written comments that we have reprinted in Appendix II. In its written comments, NCUA noted that our report clearly describes the financial condition of remaining credit union participants and the possible challenges of those that remain in the program beyond 2018. Treasury, FDIC and the Federal Reserve provided technical comments that were incorporated, as appropriate. OCC did not provide any comments.

We are sending copies of this report to the Special Inspector General for TARP, interested congressional committees and members, Treasury, FDIC, and NCUA. The report also is available at no charge on the GAO website at http://www.gao.gov.

If you or your staff members have any questions about this report, please contact A. Nicole Clowers at (202) 512-8678 or clowersa@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix III.

A. Nicole Clowers
Director
Financial Markets and Community Investment

List of Committees

The Honorable Thad Cochran
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The Honorable Barbara Mikulski
Vice Chairwoman
Committee on Appropriations
United States Senate

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Appendix I: Objectives, Scope, and Methodology

This report discusses (1) the status of the Community Development Capital Initiative (CDCI) program and Treasury's plans for exiting, (2) the financial condition of institutions remaining in the program, and (3) how the pending dividend or interest rate increase could affect remaining participants.

To describe the financial status of CDCI, we analyzed data from Treasury. In particular, we used Treasury's Monthly Report to Congress issued in April 2015 and Treasury's March 31, 2015, Dividends and Interest Report to determine the dollar amounts of principal, dividends, and interest; outstanding investments; the number of remaining and former participants; and the estimated lifetime cost of the program. We also interviewed staff from Treasury responsible for overseeing the CDCI program about their monitoring efforts and their plans for exiting the program.

To assess the financial condition of program participants, we used SNL Financial (a private service that disseminates data from quarterly regulatory reports, among other information) to obtain regulatory financial data on the 64 remaining CDCI banks and credit unions and on a comparison group of CDFI institutions that did not participate in CDCI. To identify the comparison groups, we used the Treasury CDFI Fund's list of certified CDFIs as of January 31, 2015. This list included 168 banks, thrifts, and depository institution holding companies, as well as 243 credit unions.[1] We chose to limit our comparison groups to certified CDFIs rather than the universe of banks and credit unions because they shared a community development mission and generally have smaller asset balances. We excluded CDCI institutions affiliated with other CDCI instructions, such as subsidiaries of CDFI holding companies. SNL Financial had data on 105 of the 168 CDFI banks, thrifts, and depository institution holding companies ("banks") and 237 of the 243 CDFI credit unions. We divided the bank and credit union lists into two groups each: (1) those remaining in CDCI, and (2) those that had never participated in CDCI. We defined remaining CDCI institutions as those with their full or partial investments outstanding to Treasury; this group included the 28 banks and 36 credit unions. The final comparison groups included 77 non-CDCI banks and 201 non-CDCI credit unions. We conducted

[1] The list of certified CDFIs also included loan funds and venture capital funds. However, we did not include these unregulated entities in our comparison groups because they were not eligible for CDCI.

separate analyses for banks and credit unions because the two types of institutions file different regulatory reports and have different financial indicators. For our bank analysis, we used financial measures that were similar to those we had identified in our previous reporting on banks participating in Treasury's Capital Purchase Program. These measures help demonstrate an institution's financial health as it relates to a number of categories, including profitability, asset quality, capital adequacy, and loss coverage. For our credit union analysis, we obtained information from the National Credit Union Administration on the measures it typically uses to assess credit unions' financial health. We selected at least one measure in each of the four categories (profitability, asset quality, capital adequacy, and loss coverage) we used for the bank analysis. We chose to present median values.

To understand how the pending dividend or interest rate increase could affect remaining participants, we interviewed staff from the four regulators that oversee CDCI bank and credit union participants—the Federal Deposit Insurance Corporation, the Federal Reserve Board of Governors, the Office of the Comptroller of the Currency, and the National Credit Union Administration. From the 17 banks and credit unions we contacted in 2014, we identified a purposive sample of those institutions whose financial indicators ranked below the median on at least two of the financial health indicators that we analyzed.[2] We attempted to contact the institutions with the most financial health indicators below the median for their institution type and were successful in interviewing staff from two banks and four credit unions. The results of our interviews cannot be generalized to all remaining CDCI banks and credit unions.

We determined that the financial information used in this report, including the CDCI program data from Treasury and the financial data on banks and credit unions from SNL Financial, was sufficiently reliable to assess the status and condition of CDCI and institutions that participated in the program. For the data from Treasury, we tested Treasury's internal controls over financial reporting as they related to our annual audit of the Office of Financial Stability financial statements for the Troubled Asset Relief Program and found the information to be sufficiently reliable based on the results of our audits of fiscal years 2010 through 2014 financial statements. We assessed the reliability of the SNL Financial data by

[2] GAO-14-579.

performing manual testing of required data elements and reviewing existing information about the data and the system that produced them. In addition, we have assessed the reliability of SNL Financial data as part of previous studies and found the data to be reliable for the purposes of our review. We verified that no changes had been made that would affect the data's reliability.

We conducted this performance audit from February 2015 to May 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Comments from the National Credit Union Administration

National Credit Union Administration

April 27, 2015

A. Nicole Clowers
Director, Financial Markets and Community Investment
U.S. Government Accountability Office
441 G Street, NW
Washington, D.C. 20548

Dear Ms. Clowers:

We reviewed the U.S. Government Accountability Office's report entitled *Community Development Capital Initiative: Status of Program Investments and Participants (GAO-15-542).*

The report clearly describes the financial condition of the remaining credit union participants of the Community Development Capital Initiative and the possible challenges of those that remain in the program beyond 2018.

Thank you for the opportunity to comment.

Sincerely,

Mark Treichel

Mark Treichel
Executive Director

cc: James Hagen, Inspector General - NCUA

1775 Duke Street - Alexandria, VA 22314-3428 - 703-518-6300

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

A. Nicole Clowers (202) 512-8678 clowersa@gao.gov

Staff Acknowledgments

In addition to the contact named above, Cody Goebel, Assistant Director; Emily Chalmers; Patrick Dynes; Risto Laboski; Marc Molino; and Patricia Moye made contributions to this report.

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