

## **MEMORANDUM**

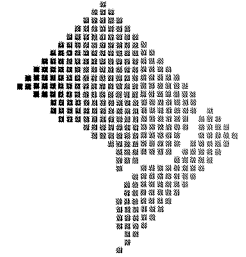
**To:** File

**From:** Ty Gellasch, Counsel to Commissioner Kara Stein  
U.S. Securities and Exchange Commission

**Date:** March 26, 2014

**Re:** Meeting with City first Enterprises

On March 25, 2014, Commissioner Stein, Allison Lee, and Ty Gellasch met with John Hamilton, Suzanne Adatto, and Lisa Gans from City First Enterprises. The parties discussed crowdfunding proposals. Attached is a handout provided by City First.



**CITYFIRST**  
ENTERPRISES

# **CROWDFUNDING & COMMUNITY DEVELOPMENT FINANCE**

---



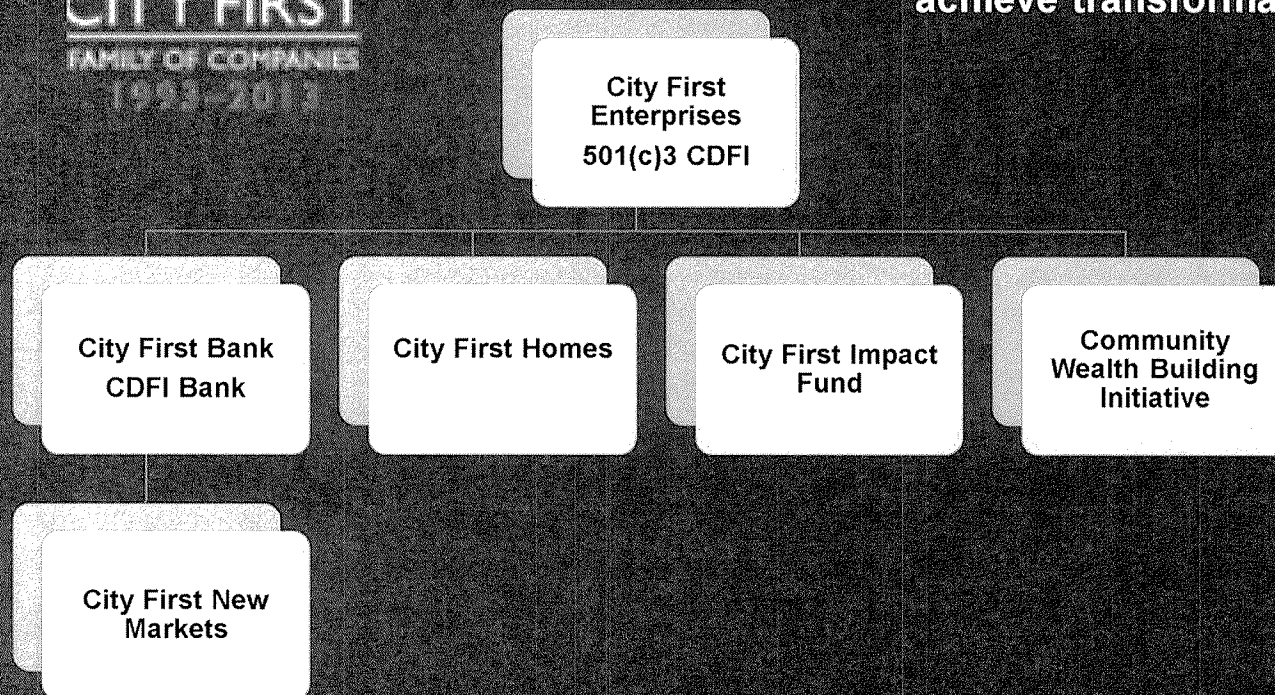
## Agenda

1. City First Enterprises
2. CDFIs and Crowdfunding
  1. Recommendations for Regulation Crowdfunding with CDFIs

# City First Family 1993-2014



**CFE Mission:**  
Develop and launch innovative community development solutions that expand opportunity for low-income families and strengthen underserved communities. Creatively deploy mission finance in ways that achieve transformative impact.



**\$250 Million in Assets**



**Home to over 50 Employees**



**Winner of White House Social Innovation Fund award (CFE)**



**CFBank consistently ranked top 5 by NCIF for mission impact**



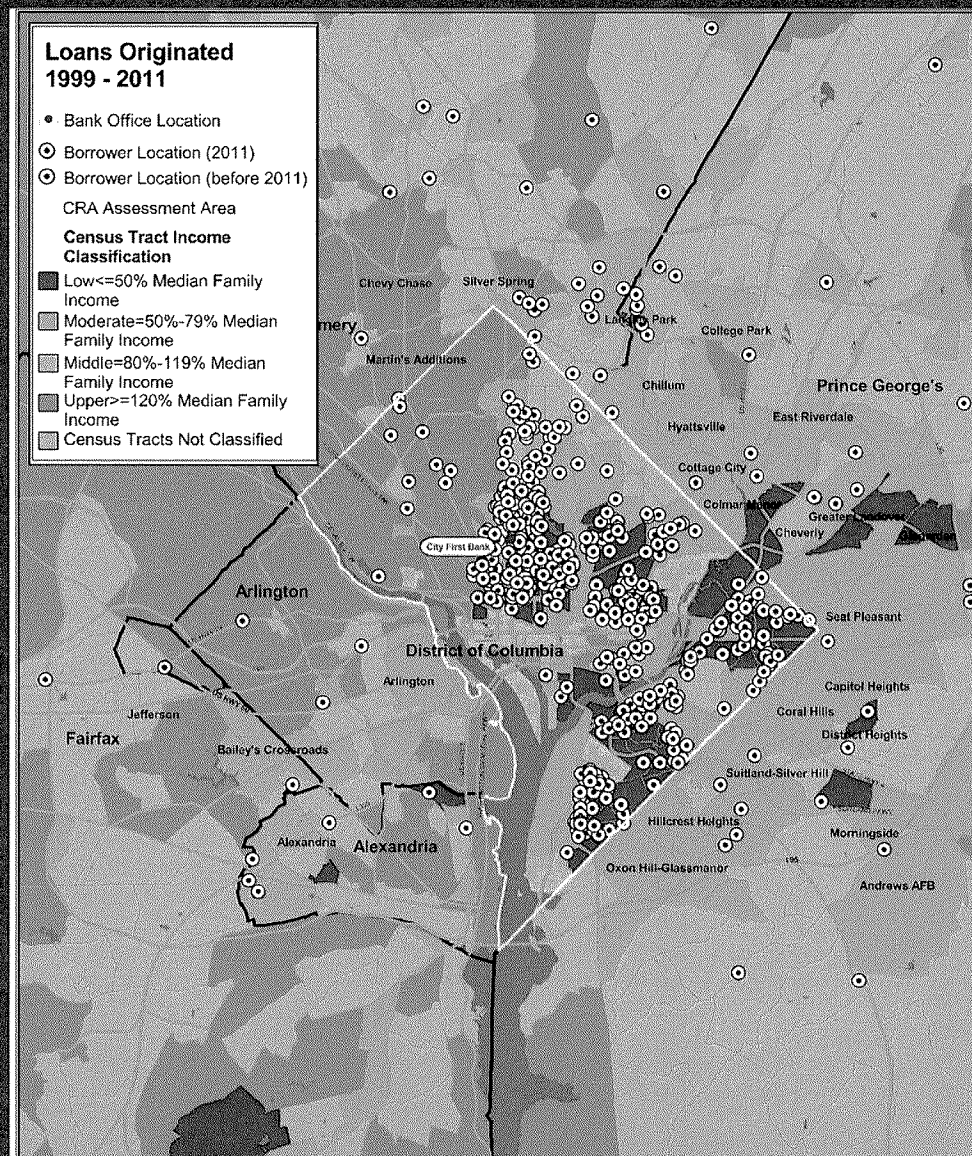
# City First Impact

5,000 affordable homes

7,000 charter school seats

3,400 jobs created or retained

80% of City First Bank loans are in low-to-moderate income communities



## CDFIs: Community Financing at Scale

Community Development Financial Institutions (CDFIs) are dedicated to delivering responsible, affordable lending and investment to help low-wealth individuals and communities join the economic mainstream.

### Mission Oriented

Certified by Dept. of Treasury for primary mission of promoting community development in low- and moderate-income populations and census tracts

### Strong Foundation

Collectively manage \$64.1 billion in assets

### Track Record of Results

Cumulatively, CDFIs have financed:

- \$30B to more than 83,000 businesses
- 9,000 community projects
- 1M housing units, created or maintained
- 500,000 jobs in many of the most vulnerable communities around the country

### National Reach

800 CDFIs provide financing in all 50 states and D.C., originate \$6B a year in mission finance

### Responsible Lenders

Loan-loss rates lower than commercial banks



Copyright (C) 1990-2007 (2004) Inc.



## **CDFI Capital Demand is Growing**

**“More than one quarter (27%) of CDFIs reported that they are capital constrained, nearly double the 14% reported in the second quarter of 2012. Not only is this a dramatic jump, it is the first time the rate has exceeded 20% since the second quarter of 2011.”**

**“CDFIs could have made nearly \$200M in additional loans in the second quarter of 2013 if financing capital were available.”**

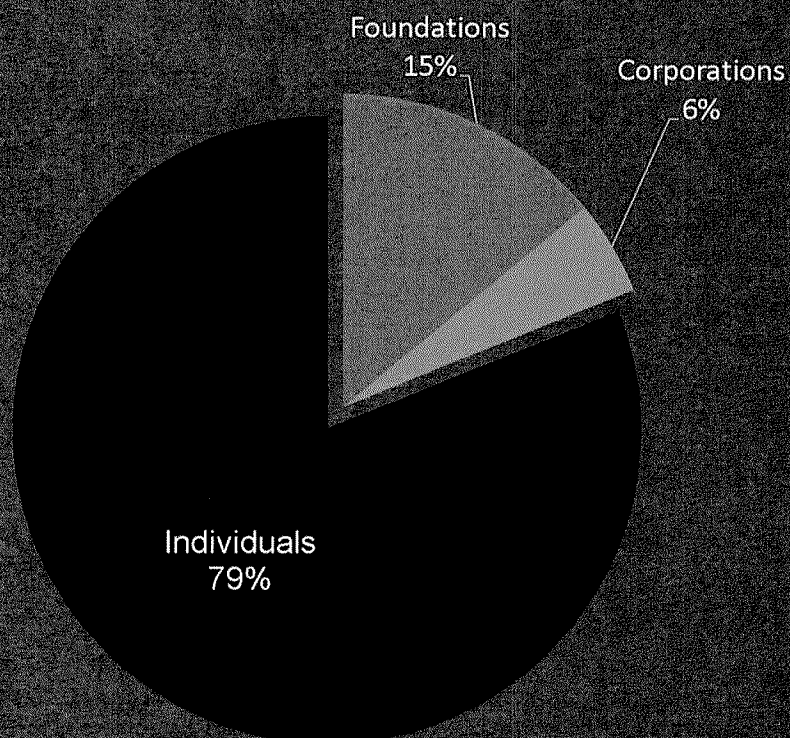
**“The majority of CDFIs expect demand for their financing in the next quarter to increase.”**

**Opportunity Finance Network Survey – January 2014**

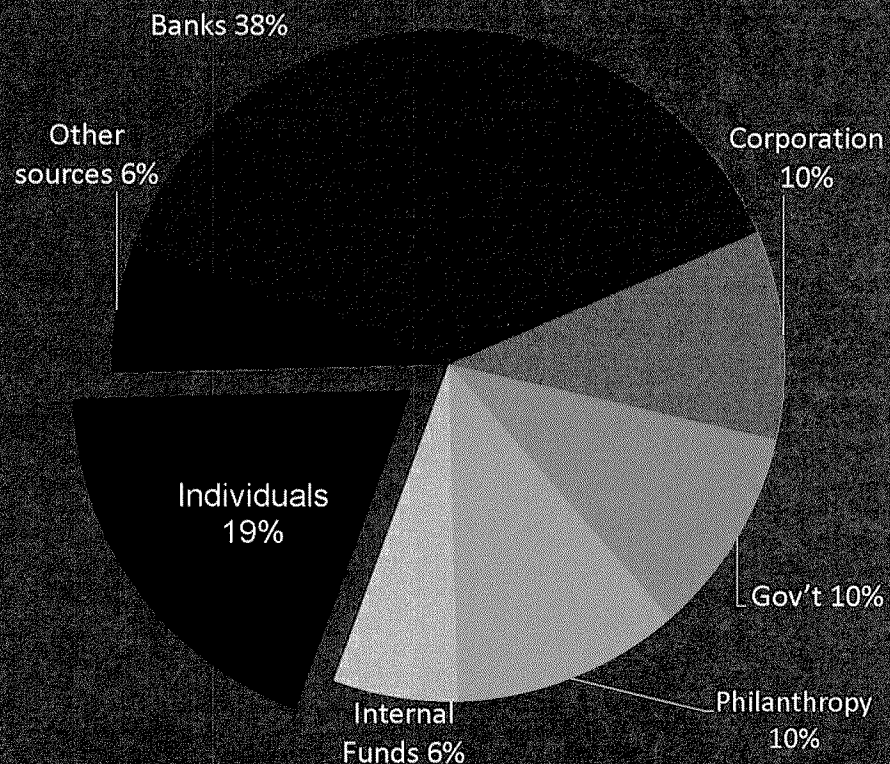
Source: Opportunity Finance Network – CDFI Market Conditions – Second Quarter 2013 – Report I – Results and Analysis Published January 2014

## Opportunity: Demand for Mission Funding

Charitable Giving Sources



CDFI Capital Sources

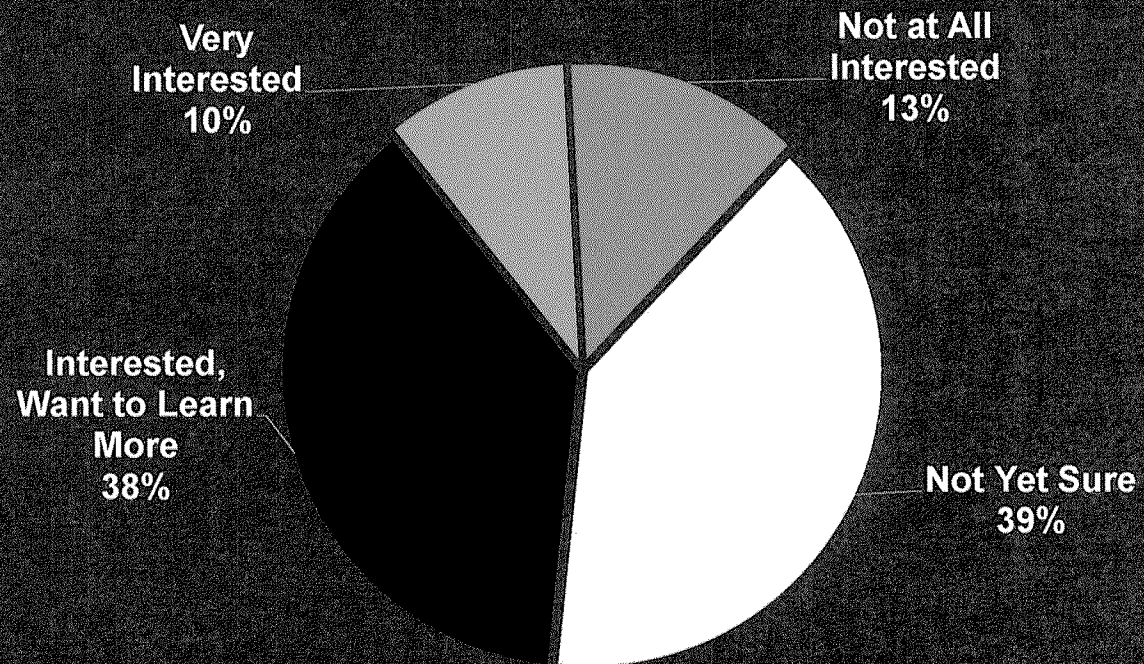


Source: FirstChart, 2013 Spring USA Giving USA 2013 Report Highlights. Accessed June 13, 2014. Coverage of program 2013-2014.  
Secondary: Extrapolation based on The Financial Crisis and CDFIs: A Spot Look at 2007-2009 CDFI Data, CDFI Fund.



## Opportunity: Demand for Impact Investing

### Interested in Impact Investing – General Investors



\*For U.S. population with over \$80K HH income

Source: Hope Consulting, Money for Good: The US Market for Impact Investment and Charitable Gifts from Individual Donors and Foundations, May 2010

## Investor Protection Concerns

**Securities experts & investor protection advocates urge strong investor protection:**

***"A great deal is at stake with the crowdfunding rules, particularly the potential expansion of fraud in this area with accompanying harm to small investors. We urge the Commission to adopt strong investor-protective rules for crowdfunding offerings. To fall short of this standard creates the risks that crowdfunding will become a notorious debacle and that many small investors will be harmed."***

Secretary of Commonwealth of Massachusetts William F. Galvin

***"The proposals could not only generate front-page scandals, but reduce the very thing they are being promoted to increase: job growth."***

Professor John Coates of Harvard Law School

***"Nothing in the bill requires or even incentivizes issuers to use any capital that may be raised to expand their businesses or create jobs in the U.S."***

Commissioner Luis A. Aguilar of the Securities and Exchange Commission

## Senate Co-Author on CDFIs & Crowdfunding

**“Suggestions include ensuring crowdfunding can fill the financing gap for projects supported by federally-regulated, 501(c)3 CDFIs, a clarification to ensure that CDFIs and issuers can make sure investors understand the mission and charitable aspects of investments, and fast treatment from the SEC and FINRA related to registration and membership.”**

-Statement for the Record of Senator Jeff Merkley Regarding Crowdfunding in Title III of H.R. 3606 July 26, 2012



# Milken Institute Crowdfunding Roundtable

*Summarizing topline consensus JOBS Act Crowdfunding event:*

**“Coupling securities crowdfunding with...community development financial institution financing could benefit all involved parties. This partnership would allow crowdfunded businesses to benefit from the expertise of sophisticated investors.”**



**MILKEN INSTITUTE**  
CHANGING THE WORLD IN INNOVATIVE WAYS

“Crowdfunding: Promoting the Promise and Minimizing the Peril”,  
summarizing July 26<sup>th</sup> 2012 event. Posted August 2nd, 2012

# CDFI Jobs Portal

## An alternative investor protection model for mission investors:

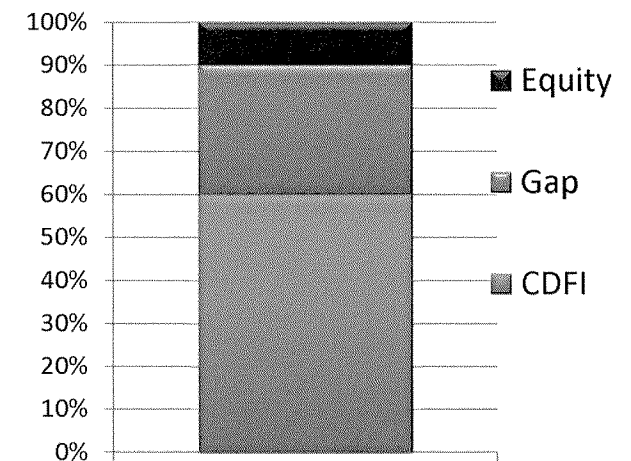
- Operated by 501(c)3, federally regulated, CDFI entity
- Requires “skin in the game” from:

- issuer and
- a **sophisticated, mission-driven CDFI co-lender**

- Limits rates of return
- Participating CDFIs required to meet certain objective criteria

- Typically structured as **low-yield, debt** ‘gap financing’

Example Financing Structure

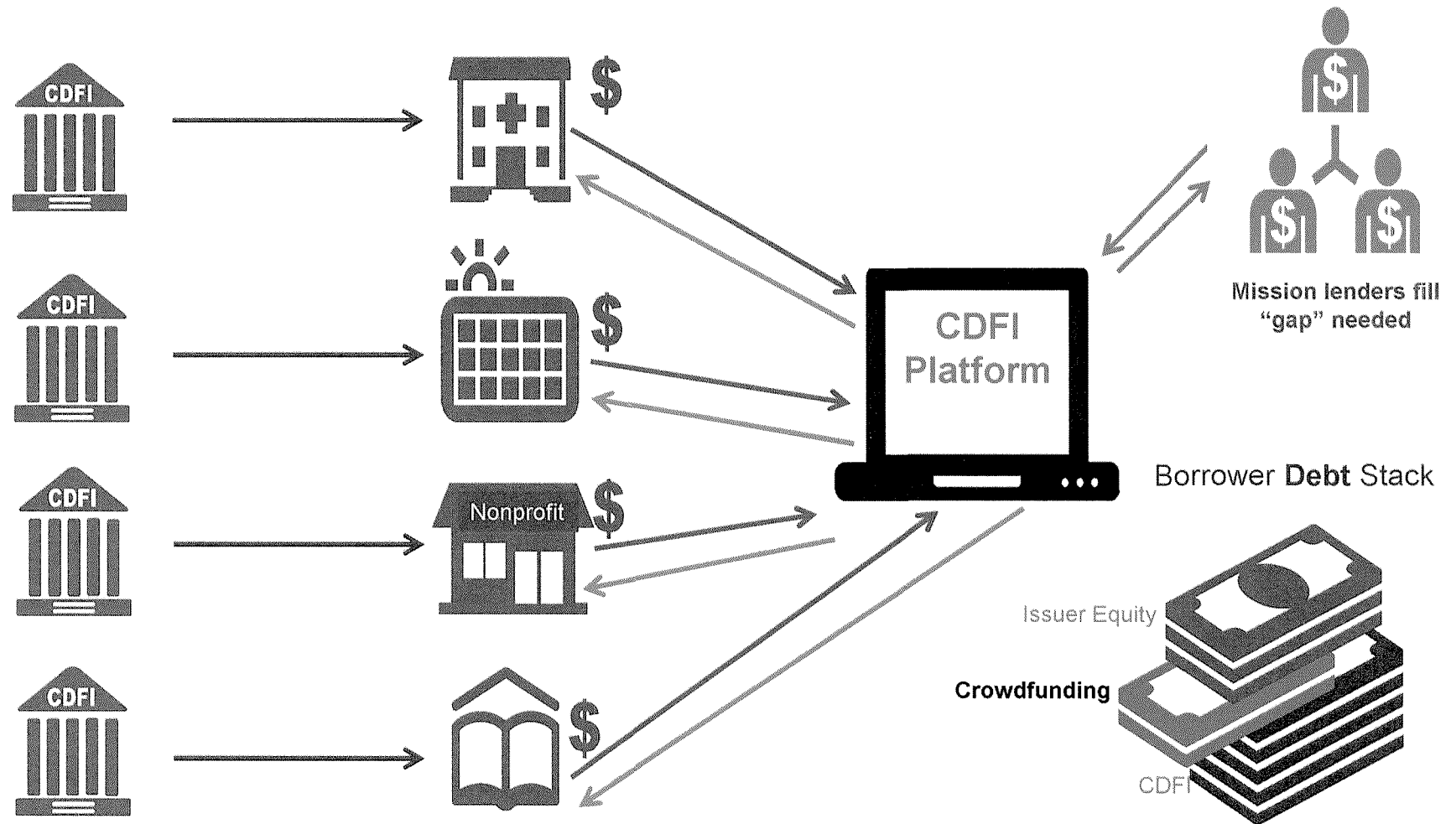


## Investor Protections: Jobs Portal & Standard Portal

Investor Protections	Jobs Portal	Standard Portal
Restricted to low rate of return (to discourage “get rich quick” investor incentives)	Yes	No
CDFI co-lender “skin in the game”	Yes	No
Strict standards & ongoing quality control of CDFI co-lender	Yes	No
Subject to Gramm-Leach-Bliley privacy rules ensuring investor privacy protection	Yes	No
Proven financial strength overseen by Federal regulators	Yes	No



## How It Works



# Challenges for CDFI Participation

**Anticipated rules may prevent CDFIs & mission investors from meaningfully participating in crowdfunding for community impact.**

**Challenges include:**

- **Portal liability**
- **Costs for issuers**
- **Concerns for CDFI co-lender**
- **Communicating mission impact**



## Concern 1: Portal Liability

### Barrier in Proposed Rules:

- Current standard for misstatements and omissions will add to costs for Funding Portals and therefore issuers
- High due diligence standard will require looking behind every statement

### Proposed Solution:

- Solution 1: Reconsider designation of Funding Portal as issuer
- Solution 2: Develop a safe harbor for Funding Portals exhibiting supplementary set of investor protectors e.g. CDFI co-lender through CDFI Jobs Portal
- Solution 3: Clarify standard of care that an intermediary must satisfy to meet its due diligence obligations





## Concern 2: High Costs for Issuance

### Barrier in Proposed Rules:

- Cost of an issuance significantly increases cost of capital

### Proposed Solution:

- Solution 1: Reduce burden for yearly financial updates after issuance
- Solution 2: Provide technical assistance for issuers



## Concern 3: CDFI Co-Lender

### Barrier in Proposed Rules:

- CDFI co-lender should not incur liability
- Clarification over 'objective criteria' for filter

### Proposed Solution:

- Clarify that CDFI co-lending does not constitute investment advice
- Clarify what constitutes objective criteria
  - Clarify that using CDFIs or subset of CDFIs as co-lenders is not subjective criteria



## Concern 4: Marketing of Mission Elements

### Barrier in Proposed Rules:

- Restrictions on marketing/communication to the terms of the offering will impede community enterprises ability to attract capital because their investors will respond to mission impact information, rather than traditional returns

### Proposed Solution:

- Permit communication/promotion around non-financial term, mission-related scope and impact





## The CDFI Leverage

*CDFIs, as credentialed community lenders with track record and expertise, can act as a responsible bridge between mission investors and neighborhood needs.*

### Crowdfunding with CDFIs will:

- **Facilitate market for financially secure mission investment for crowdfunding investors**
- **Offer a supplementary set of investor protections**
- **Support capital formation for community development**

## Requested SEC action to make Crowdfunding more viable for Community Development impact

### Funding Portal Liability

- Solution 1: Reconsider designation of Funding Portal as issuer
- Solution 2: Develop a safe harbor for Funding Portals exhibiting supplementary set of investor protectors e.g. CDFI co-lender through CDFI Jobs Portal
- Solution 3: Clarify standard of care that an intermediary must satisfy to meet its due diligence obligations

### Costs on Issuers

- Solution 1: Reduce burden for yearly financial updates after issuance
- Solution 2: Provide technical assistance for issuers

### CDFI Co-Lender

- Clarify that CDFI co-lending does not constitute investment advice
- Clarify what constitutes objective criteria
  - Clarify that using CDFIs or subset of CDFIs as co-lenders is not subjective criteria

### Communications and Marketing

- Permit communication/promotion around non-financial term, mission-related scope and impact