

MEMORANDUM

TO: File No. S7-09-13

FROM: Giles T. Cohen
Office of Commissioner Luis A. Aguilar

DATE: April 9, 2014

SUBJECT: Meeting with Representatives of City First Enterprises

On April 9, 2014, Commissioner Aguilar, Marc A. Leaf, Counsel to the Commissioner, and Giles T. Cohen, Counsel to the Commissioner, met with the following individuals:

- John Hamilton, President, City First Enterprises
- Lisa Gans, EVP, City First Enterprises
- Suzanne Adatto, AVP, City First Enterprises

The discussion included, among other things, the Commission's proposed rules for Crowdfunding.



CITYFIRST
ENTERPRISES

CROWDFUNDING & COMMUNITY DEVELOPMENT FINANCE



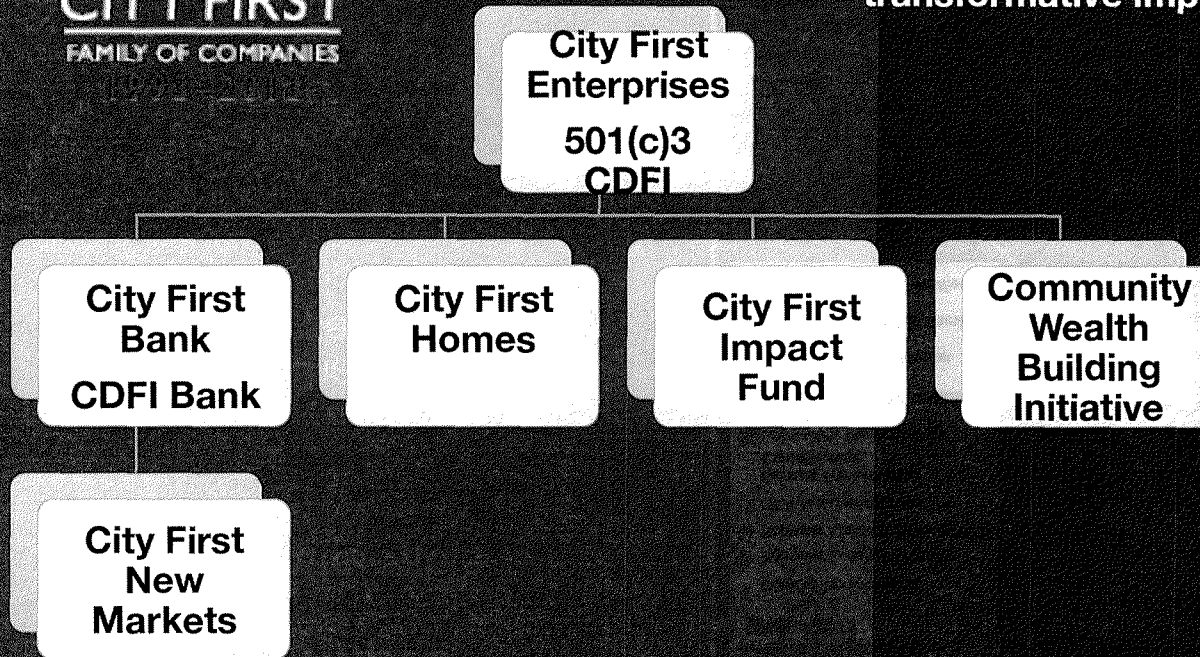
Agenda

1. City First Enterprises
2. CDFIs and Crowdfunding
3. 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



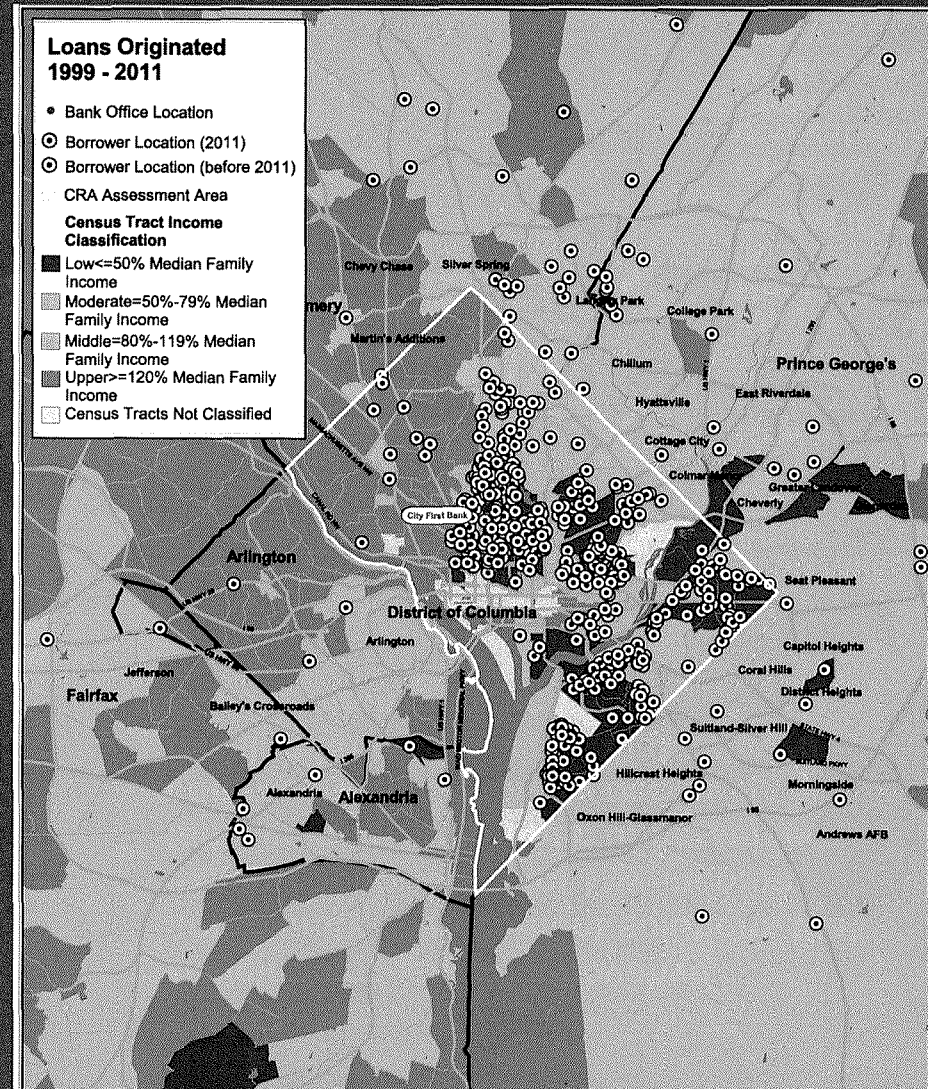
7,000 charter school seats



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 development in low-wealth populations and census tracts

Strong Foundation

National Reach

Responsible Lenders

800 CDFIs provide financing originate \$6B a year in mission

Track Record of Results

\$64.1 billion in assets

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



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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.”

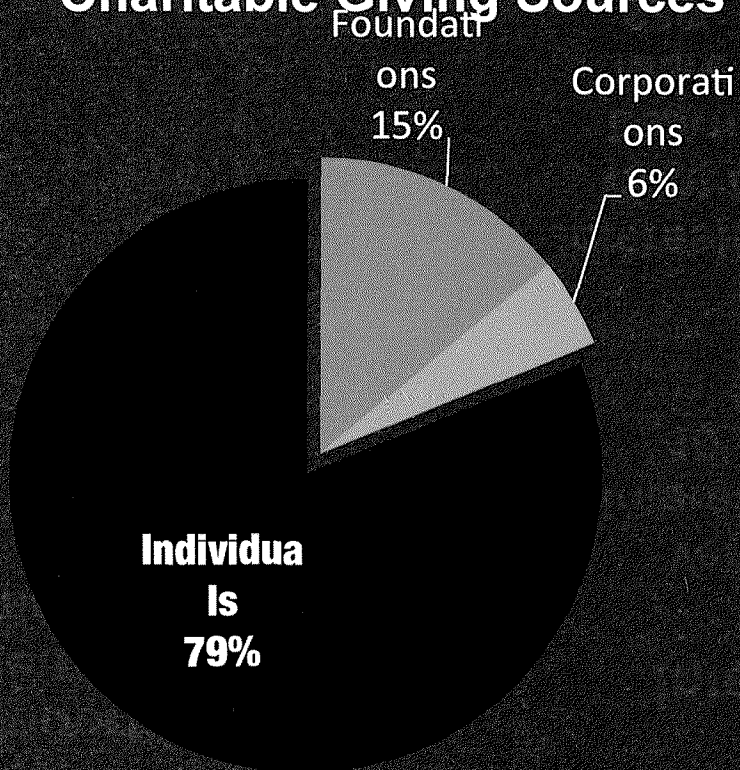
“The majority of CDFIs expect demand for their financing in the next quarter to increase.”

Opportunity Finance Network Survey – January 2014

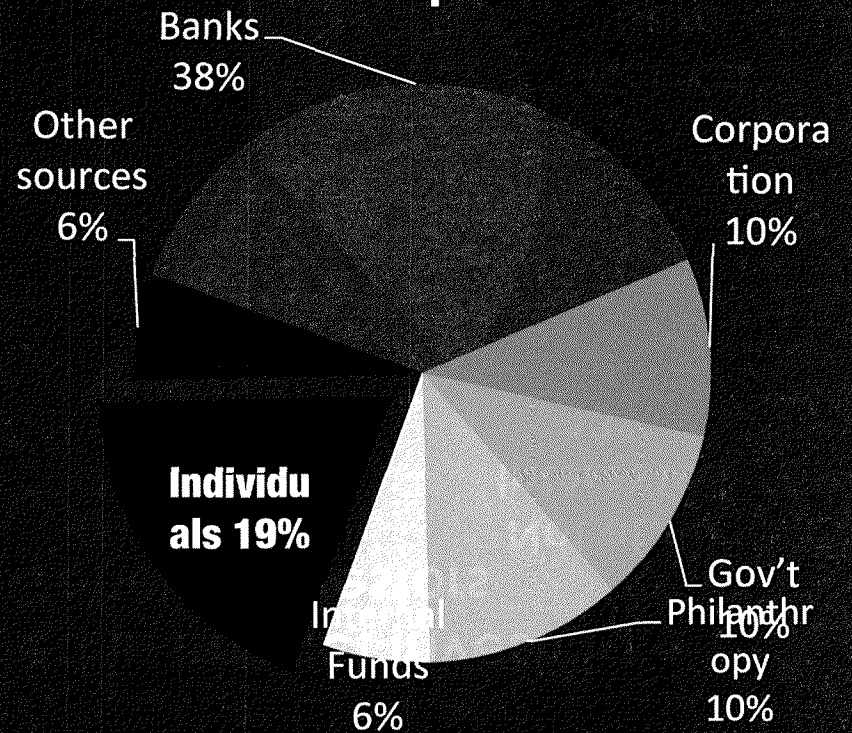
Source: Opportunity Finance Network – CDFI Market Conditions – Second Quarter 2013 – Report I – Results and Analysis Published January 2014

Opportunity: Demand for Mission Funding

Charitable Giving Sources



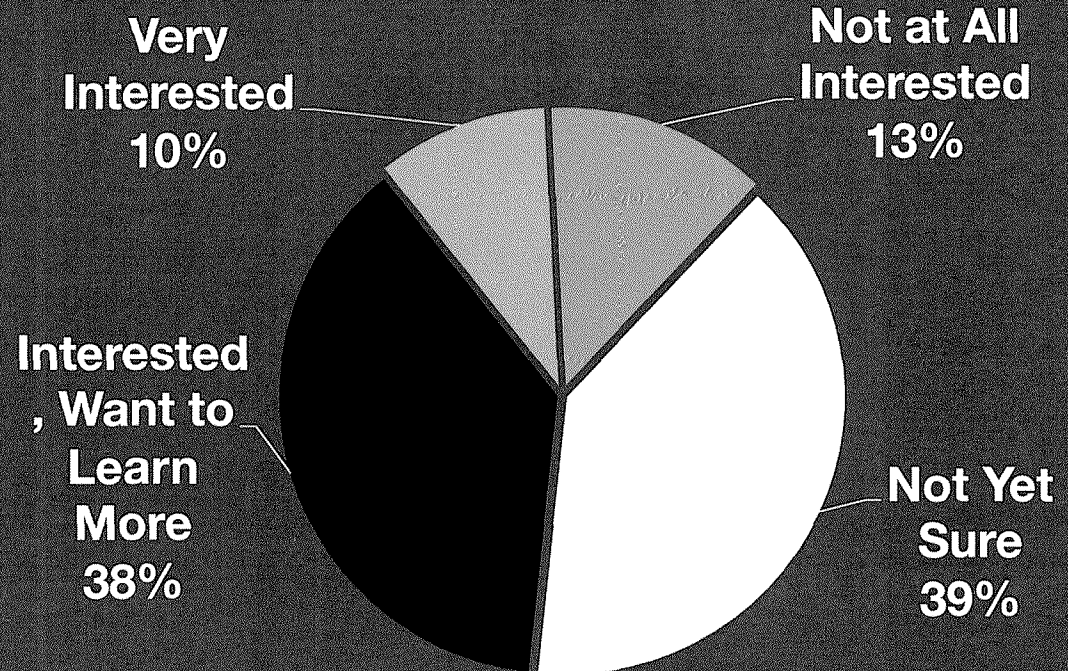
CDFI Capital Sources



Source: First Enterprise 2013 Survey of CDFI Capital Sources and CDFI Investment Opportunities. Second chart: Data based on the data provided in the survey.

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 Institutions*, May 2010.

Investor Protection Concerns

Securities experts & investor protection advocates urge

*"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 26th 2012 event. Posted August 2nd, 2012

CDFI Jobs Portal

An alternative investor protection model for mission investors:

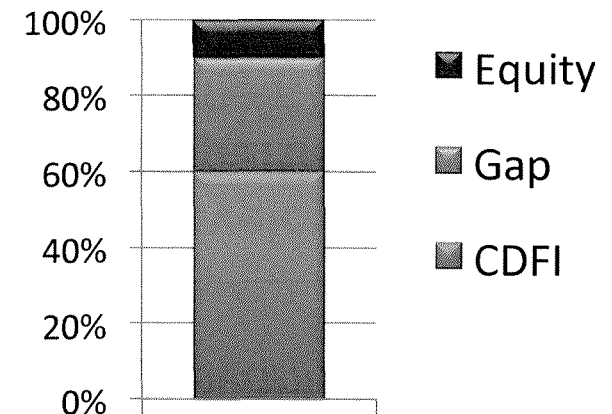
- Operated by 501(c)3, federally regulated, CDFI entity
- Requires “skin in the game” from:

- 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’

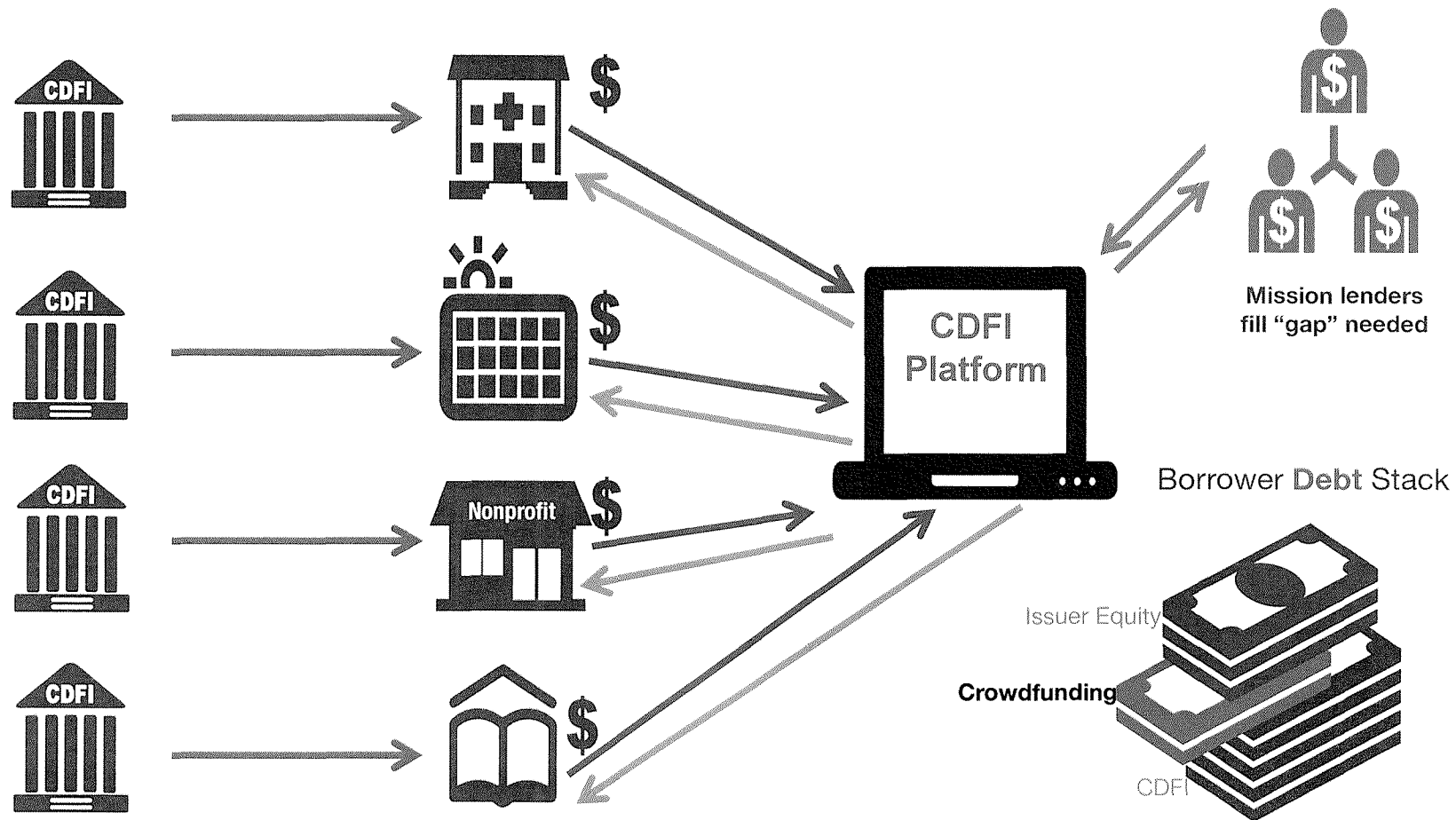
Example Financing Structure



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