

Supervisory Letter

NCUA | Office of Examination & Insurance
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SL No. 16-01
September 19, 2016

TO: All NCUA Staff

SUBJECT: CDFI-Certified Credit Union Supervision

This supervisory letter provides information about the supervision of credit unions that are recognized as community development financial institutions, or CDFIs, and establishes a consistent framework for the exam and supervision process.

The guidance in this document applies to all CDFI-certified credit unions. If you have any questions on the following material, please direct them to your immediate supervisor or regional management.

I. Background

The [Community Development Financial Institutions Fund](#) (CDFI Fund), managed by the U.S. Department of the Treasury, helps generate economic growth and opportunity in some of our nation's most distressed communities. It accomplishes this by offering tailored resources and programs that invest federal dollars and private sector capital in financial institutions that support economically disadvantaged communities. The financial and technical assistance granted by the CDFI Fund allows credit unions to enhance or expand products and services to better serve memberships of modest means.

NCUA [signed a partnership agreement with the CDFI Fund](#) on January 21, 2016 with the aim of streamlining the application process by which a credit union can become certified as a CDFI. As of August 2016 there are 295 CDFI-certified credit unions. NCUA Chairman Rick Metsger has established a goal of adding more than 200 CDFI-certified credit unions in 2016. To support this goal, field staff should encourage eligible credit unions to apply for CDFI certification and be familiar with the unique characteristics of CDFIs.

Supervisory letters are official agency examination policy. These letters communicate guidance to NCUA field staff on regulations and exam procedures. Each supervisory letter focuses on a specific topic, providing background information and outlining any related regulatory and statutory requirements. Supervisory letters may also require field staff to perform certain procedures during an examination; in these cases, the letter will provide instructions to help field staff implement the procedures. Supervisory letters are intended to provide a framework for more consistent application of staff judgment with respect to conclusions about a credit union's financial and operational condition, and related CAMEL and risk ratings. These letters also provide a consistent approach for evaluating the adequacy of a credit union's relevant risk-management processes. Supervisory criteria detailed in a supervisory letter are not strict requirements, unless noted as required by law or regulation. The supervisory criteria contained in these letters are used by field staff to evaluate a credit union's condition based on the preponderance of relevant factors. Generally, supervisory letters are shared with the public as an attachment to a Letter to Credit Unions.

Characteristics of a CDFI Credit Union

NCUA recognizes and accepts there are some risks inherent in the business model of a community development financial institution. A CDFI-certified credit union, much like a low income designated credit union, may have a very different risk profile than other credit unions. A CDFI-certified credit union often needs to assume different risks in the types of member service programs they employ to achieve their community development mission. NCUA's focus is not on avoiding these risks, but rather on ensuring CDFI-certified credit unions adequately manage the risks.

Common characteristics of CDFIs include:

- Higher operating expenses
- Reliance on fee income
- Low dollar transactions
- Frequent transactions
- Higher delinquency
- Use of less traditional funding sources to support various products and services¹

II. Exam and Supervision Procedures

CDFI-certified credit unions may rely on less traditional funding sources to provide financial services to their membership. This includes financial and technical assistance granted by the CDFI Fund to allow credit unions to enhance or expand products and services to better serve their community.

Reliance on less traditional funding sources can present the risk that increased expenditure on new member service infrastructure, special lending programs, and other activities can be unsustainable for a credit union if the funding provider decreases or discontinues funding in the future. NCUA will accept the risk to a credit union that funding may be reduced or discontinued if a credit union has developed and faithfully administered a reasonable business plan involving CDFI funding.² When these conditions are met, examiners and examination reports will support CDFI-related activities.

In assessing a CDFI-certified credit union's condition, field staff should focus on evaluating:

- If the business plan is reasonable, and whether any new or modified programs associated with reliance on any non-traditional funding are properly managed.

¹ Such sources may include nonmember deposits, secondary capital, technical assistance grants and loans from NCUA's [Community Development Revolving Loan Fund](#), and CDFI financial and technical assistance grants.

² The business plan must be appropriate for the size and complexity of the credit union.

- Whether the credit union is faithfully following its business plan.
 - Whether the credit union is using any non-traditional funding in accordance with the terms of the funding.
 - The extent to which the credit union is properly accounting for the non-traditional funding.
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III. Grant Accounting

[NCUA Accounting Bulletin No.07-2](#) revised the agency's [Accounting Manual for Federal Credit Unions](#) to address basic accounting for grants received by small credit unions, but did not cover specific CDFI grant accounting issues.

Accounting for CDFI grant revenue can differ based on the type of grant award and its characteristics. Examiners will review CDFI grant agreements to determine whether a grant includes restrictions and/or conditions. CDFI Financial Assistance (FA) grants normally include conditions, while CDFI Technical Assistance (TA) grants are typically restricted to a specific purpose and may include conditions.

Credit unions often receive disbursement of both TA and FA grants in a single payment after a grant agreement has been executed and the grant period has commenced. The timing of typical CDFI grant accounting entries depends on:

- 1) When a credit union has an executed grant agreement,
- 2) When a credit union receives grant disbursement(s), and
- 3) When a credit union earns the grant revenue.

Unless a credit union receives grant disbursements and earns grant revenue simultaneously, the time lag between these two events will dilute (lower) the credit union's net worth ratio and possibly trigger additional actions necessary to meet regulatory net worth requirements.

It is important that credit unions recognize grant revenue as soon as appropriate to avoid any negative implications from these timing differences. Examiners will consider these timing issues when evaluating the capital adequacy of the credit union.

Attachment 1, *Accounting for Community Development Financial Institution (CDFI) Grants*, provides illustrative accounting entries for recording CDFI grants in accordance with generally accepted accounting principles (GAAP). When a credit union recognizes grant income (regardless of any conditions or restrictions), it is reported as other non-operating income on NCUA Call Reports.

IV. Additional Guidance Relevant to CDFI Credit Unions

This document builds on previously issued NCUA guidance, including:

- NCUA Supervisory Letter 10-CU-01, [*Supervising Low Income Credit Unions and Community Development Credit Unions*](#)
- NCUA Supervisory Letter 09-03, [*Reviewing Adequacy of Earnings*](#)
- [*NCUA Accounting Bulletin 07-2*](#)

Field staff may also find the following resources helpful:

- CDFI content on NCUA's [*Small Credit Union Learning Center*](#)
- [*CDFI Fund website*](#)

If you have any questions on the information provided in this letter, please direct them to your immediate supervisor or regional management.

Sincerely,

/s/

Larry Fazio
Director
Office of Examination & Insurance

Attachment I

Accounting for Community Development Financial Institution (CDFI) Grants

Example 1: Financial Assistance Grants

Illustrative Entries – CDFI Financial Assistance Grant \$1,500,000. The grant agreement restricts \$1,000,000 to a revolving loan fund for residential real estate loans and \$500,000 as a loan loss reserve. Grant conditions require one-to-one matching funds.

The below illustrative entries show how to account for three typical CDFI grant accounting events. These entries can occur on the same day or years apart.

1. When the credit union possesses a fully executed CDFI grant agreement awarding funds:

Debit	CDFI Grant Revenue Receivable	\$1,500,000	
	Credit	Unearned CDFI Grant Revenue	\$1,500,000

2. When the credit union receives disbursement of all the initial grant funds (assumes one payment for the entire grant):

Debit	Cash	\$1,500,000	
	Credit	CDFI Grant Revenue Receivable	\$1,500,000

3. When the credit union earns (recognizes) the grant revenue by meeting the grant's performance obligations (grant conditions have been satisfied):

Debit	Unearned CDFI Grant Revenue	\$1,500,000	
	Credit	CDFI Grant Revenue	\$1,500,000

Example 2: Technical Assistance Grants

Illustrative Entries – CDFI Technical Assistance Grant \$100,000. The grant agreement restricts the use of the funds to acquire technology in the form of \$40,000 for a telephone system and \$60,000 for a data processing system.

1. When the credit union possesses a fully executed CDFI grant agreement awarding funds:

Debit	CDFI Grant Revenue Receivable	\$100,000	
	Credit	Unearned CDFI Grant Revenue	\$100,000

2. When the credit union receives disbursement of all the initial grant funds (assumes one payment for the entire grant):

Debit	Restricted Cash	\$100,000	
	Credit	CDFI Grant Revenue Receivable	\$100,000

3. Upon expending all or portions of the Technical Assistance funds in accordance with the grant restrictions:

Debit	Telephone System	\$40,000	
	Credit	Restricted Cash	\$40,000

Debit	DP System	\$60,000	
	Credit	Restricted Cash	\$60,000

4. Assumes \$40,000 telephone system and \$60,000 DP system acquisition occurs on the same day:

Debit	Unearned CDFI Grant Revenue	\$100,000	
	Credit	CDFI Grant Revenue	\$100,000