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HOUSING VERMONT

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30 October 2003

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Attention: Docket No. R-1154

Dear Ms. Johnson:

Housing Vermont appreciates the opportunity to comment on the proposed Risk-Based Capital Rules, commonly known as the Basel Proposals.

By way of introduction, Housing Vermont is a state wide non-profit development company that works to develop safe, decent, and affordable housing in partnership with local non-profit housing groups and municipalities. We have developed over 3,000 units across Vermont and most of those units have been developed with the equity raised from local Vermont banks through the syndication of Low Income Housing Tax Credits (LIHTC).

We are concerned about a potential unintended consequence of the proposed rules that could affect adversely the amount of equity capital Vermont banks invest in affordable housing. The proposal appears to be in conflict with 12 CFR part 24, the regulation governing investments that are designed primarily to promote the public welfare.

The Good News

The vital role of such LIHTC investments in the U.S. is clearly recognized in part of the proposals. It is apparent that U.S. bank regulators, working with those of other nations, negotiated a special rule for "Legislated Program Equity Exposures." This section wisely preserves the current capital charge on most equity investments made under legislated programs, "recognizing this more favorable risk/return structure and the importance of these investments to promoting public welfare goals." Insured depository institutions investing as a result of such programs therefore would set aside, by and large, the same amount of capital for CRA equity investments under the new rules as they do now – about $8.00 for every $100 of capital invested.

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Given that CRA investments in affordable housing and community and economic development all have a different risk/return profile than other equity investments, that treatment is very appropriate. Based on experience to date – and in the U.S. there is considerable experience – CRA equity investments may well provide lower yields than other equity investments. They also have much lower default rates and volatility of returns than other equity investments. For example, Ernst and Young reported in 2002 that the loss experienced from housing tax credit properties was only .14% over the period 1987-2000, and .01% on an annualized basis. <u>It is important that the final regulations make clear that all equity investments eligible for CRA credit under Part 24 are "Legislated Program Equity Investments" that are held harmless from higher capital charges</u>.

<u>THE PROBLEM</u>

The "materiality" test of the proposed rules is of great concern (cf page 45927 of the proposed rules). The materiality test requires institutions that have, on average, more than 10 percent of their capital in <u>ALL</u> equity investments, to set aside much higher amounts of capital on their non-CRA investments, such as venture funds, equities and some convertible debt instruments. As drafted, this calculation includes even CRA investments that are specifically held harmless from the new capital charges.

At the end of the day, it sets up unfair competition between CRA equity investments and all other equity investments for space in the "materiality bucket". It also sets up an unfair competition between CRA investments that are equity investments, and those that are not (like mortgage backed securities and loan pools).

Having to include CRA equity investments, with their very different risk/reward profile, in the proposed "materiality" bucket of more liquid, higher-yielding, more volatile equity exposures will have an unintended chilling effect on the flow of equity capital to those in need. Some insured depository institutions that meet the credit needs of their communities with substantial investments in affordable housing tax credits and/or Community Development Financial Institutions, currently approach, or even exceed, the 10 percent threshold just from CRA-qualified investments alone. While the proposed rule would grandfather these institutions' current levels of investment for 10 years, it also raises a red flag discouraging comparable levels of equity investment in low-and moderate income communities going forward. If the test is adopted as proposed, it will put pressure on depository institutions to minimize investments in low yielding, less liquid CRA equity investments, to avoid triggering the much higher capital charges on, and thus reducing the profitability of, non-CRA equity investments. These higher capital charges will double on publicly-traded equities, and triple or quadruple on non-publicly traded ones.

We understand that the rules will initially apply only to the biggest banks. Yet we believe it is fair to say that regulators expect that most other insured depository institutions will comply, sooner or later, and some banks will voluntarily comply immediately, as a matter of best practices. It makes no sense to set up a conflict between the profitability of non-CRA equity investments, and the level of CRA-qualified equity investments.

Depository institutions' support for affordable housing and community revitalization is well-established public policy in the United States. Numerous, recent studies, including those conducted by both the U.S. Treasury Department and the Federal Reserve Board, document that programs supporting these goals have had considerable positive impact on the nation's low- and moderate-income communities, with little or no risk to investors.

THE SOLUTION

Housing Vermont respectfully submits that the proposed rules should exclude all CRA-related investments that qualify under the Part 24 regulations from the materiality test calculation. Doing so would avoid disrupting an important marketplace serving accepted U.S. public policy goals. It will also preserve depository institutions' flexibility to respond to the credit needs of its community without regard to the form of that response

Thank you for your consideration. Please let me know if you require additional information and any form of assistance that will be useful in deliberations on these rule proposals.

Sincerely yours,

R. Andrew Broderick
President
Housing Vermont