From: "JOHN PRITSCHER" <jpritscher@cicchicago.com> on 11/03/2003 04:01:44 PM
Subject: Basel Accord II

November 3, 2003

TO:
Office of the Comptroller of the Currency Att: Docket No. 03-14.
Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System

Robert E. Feldman, Executive Secretary, Federal Deposit Insurance Corporation
Regulations Comments, Chief Counsel's Office, Office of Thrift Supervision

Community Investment Corporation (CIC) appreciates the opportunity to comment on the proposed Risk-Based Capital Rules, commonly known as the Basel Proposals.

CIC is a large loan pool created by Chicago's banking community to make sure that multifamily rehabilitation loans are readily accessible in the 6-county Chicago metro area. Fifty banks share in every CIC loan, pooling risk, but our losses over the last 19 years are actually lower than their conventional loans not perceived as being in risky areas. Last year CIC did 131 loans for the rehab of 2300 apartment units in low-rent areas, almost always below 50% of Area Median Income; only one involved sale of tax credits.

Since CIC is a loan pool, selling mortgage-backed notes to our investors on a quarterly basis, the unintended consequences of the Basel Proposals would not directly hit us. Nonetheless, they would have serious negative consequences on the lower-income areas where our loans are concentrated.

Since the language in the letter from Congressmen Frank, Kanjorski, Emanuel, Gutierrez et al. clearly makes the points that we wish to support, we will quote from their letter:

It is our understanding that proposed regulations implementing the New Basel Capital Accord seek to include public welfare investments made by banks in compliance with the Community Reinvestment Act (CRA) in a broader risk test for determining capital charges for higher-risk, non-CRA investments. We are concerned that this may create a strong disincentive for banks to make future CRA investments and greatly revitalization.

The notice of proposed rulemaking published jointly by the financial regulatory agencies on August 4, 2003, appears inconsistent in applying the Basel II risk-based capital requirements to CRA equity investments. One
the one hand, the proposed rule leaves unchanged the low capital requirements on most equity investments made under CRA and other government supervised programs. The rule specifically recognizes that CRA-related investments, including investments in affordable housing and community development corporations (CDCs), benefit from favorable tax treatment and investment subsidies that make their "risk and return characteristics markedly different that equity investments in general." This approach accurately reflects, in our view, the experience of CRA investments to date as having much lower default rates and volatility of return than private equity investments.

The rule takes a contradictory approach, however, in proposing to include CRA investments in a new "materiality" test designed to assess risk exposure for banks' higher risk equity holdings. Under this test, when the bank's total equity holdings, including CRA investments, exceed 10 percent of Tier 1 plus Tier 2 capital, the bank must set aside substantially higher amounts of capital for non-CRA investments. Given the fact that many large banks and thrifts have sizeable investments in housing tax credits or CDCs that may already approach 1-percent of total capital, the new materiality standard will discourage future CRA investment to avoid triggering higher capital charges on the banks' other equity holdings.

It strikes us as inappropriate to use a bank's holdings of longer-term,low-risk CRA investments as a significant factor for determining the amount of risk capital the bank must maintain for more liquid, higher yielding and more volatile equity holdings. If the proposed materiality test is adopted, it will clearly discourage the largest banks that must comply with the new standard from making substantial new CRA investments. Since many other large banks and thrift institutions also are expected to comply voluntarily with the new standards, the result could be a substantial reduction in new CRA investment and a potential loss of billions of dollars in future equity investment in housing and community projects.

We do not believe the financial regulatory agencies intended to discourage future investment in public welfare investments nor create unnecessary conflicts between the Basel II capital standards and the goals of the Community Reinvestment Act. While we understand the materiality test is intended to implement specific procedural requirements in the Part III of the Basel II accord, we read the requirements as providing sufficient regulatory flexibility to permit more effective procedures for measuring credit exposure without discouraging CRA investment. We urge that appropriate changes be made to the proposed rule to remove CRA-related investments from the materiality test for determining capital requirements for other bank equity holdings.

Sincerely,

JOHN PRITSCHER
President

cc: Judy Kennedy, National Association of Affordable Housing Lenders