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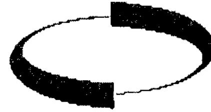

NATIONAL
COMMUNITY CAPITAL
ASSOCIATION

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
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October 30, 2003

Mr. John D. Hawke, Jr.
Office of the Comptroller of the Currency
250 E Street, SW, Washington, DC 20219
Fax: (202) 874-4448 regs.comments@occ.treas.gov.
Attention: Docket No. 03-14

Ms. Jennifer J. Johnson, Secretary,
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW, Washington, DC 20551
Fax: (202) 452-3819 regs.comments@federalreserve.gov
Attention: Docket No. R-1154

Mr. Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW, Washington, DC 20429
Fax: (202) 898-3838 comments@FDIC.gov.
Attention: Comments, FDIC

Regulation Comments, Chief Counsel's Office,
Office of Thrift Supervision
1700 G Street, NW, Washington, DC 20552
Fax: (202) 906-6518 regs.comments@ots.treas.gov
Attention: No. 2003-27

To Whom It May Concern:

On behalf of the National Community Capital Association (NCCA), a network of more than 150 member community development financial institutions (CDFIs), I am pleased to provide comments in response to the Advanced Notice of Proposed Rulemaking on the proposed Risk-Based Capital Rules, published on August 4, 2003.

Founded in 1985, NCCA is the leading network of community development financial institutions (CDFIs), which invest in small businesses, quality affordable housing, and vital community services in underserved markets. Nationwide, CDFIs manage more than $8 billion that they lend and invest to create opportunities for economically disadvantaged people and communities. CDFIs have helped move economically underserved people and markets into the mainstream financial system, provided an alternative to predatory lenders, opened new markets to banks, and successfully redefined the perception of risk in low-income communities.

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NCCA applauds U.S. bank regulators and others who recognized the vital role of Community Reinvestment Act (CRA) investments in the U.S., and negotiated for a special rule for "Legislated Program Equity Exposures." This section wisely preserves the current capital charge on most equity programs made under legislated programs that involve government oversight. CRA-related investments are generally held harmless under the proposed rule. Insured depository institutions investing in such programs therefore would set aside, by and large, the same amount of capital for CRA investments under the new rules as they do now—about $8.00 for every $100 of capital invested.

Given that CRA investments in affordable housing, and community and economic development, have a different risk/return profile than other equity investments, that treatment is appropriate. Based on considerable experience in the U.S. to date, CRA equity investments may sometimes provide lower yields than other investments but they also have lower default rates and volatility of returns than other equity investments. *For example, CDFIs in the network I represent have cumulative default rates of less than 2.3%, which is comparable to major banks.*

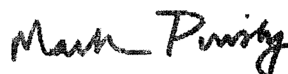
NCCA and its members, however, are extremely concerned about the potential consequence of the proposed rules that could affect adversely the amount of equity capital flowing into investments under the CRA. Specifically, the "materiality" test of the proposed rules requires institutions that have, on average, more than 10 percent of their capital in ALL 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 excluded from the new capital charges.

Having to include CRA investments, with their very different risk/reward profile, in the "materiality" bucket of more liquid, higher-yielding, more volatile equity exposures could have an unintended chilling effect on the flow of equity capital to communities in need. CDFIs and their bank partners have invested substantially in affordable housing and economic development (for example, through Low Income Housing Tax Credits (LIHTC) or New Markets Tax Credits (NMTC)) that currently approach, or even exceed, the 10 percent threshold just from CRA-qualified investments alone. If the materiality test is adopted as proposed, it could discourage banks from making CRA investments to avoid triggering the higher capital charges on non-CRA investments. We understand that these higher capital charges could be twice as much on publicly-traded equities, and three times as much on non-publicly traded ones.

Financial institutions' support for affordable housing and community revitalization is well-established public policy in the United States. Bank regulators and the Congress have encouraged and incentivized investment in poor communities through such public policy initiatives as the 1992 Public Welfare Investments (Part 24), the 1995 CRA revisions that specifically encouraged equity investments, and both the LIHTC and NMTC program incentives. Furthermore, in 2000, the Federal Reserve Board released a study confirming that CRA-related investing is by-and-large profitable and, more importantly, it pleases the double-bottom line—social impact and financial reward, with little or no risk to investors. These facts, combined with a remarkable performance record of CRA-related investments and more than a $1 trillion invested to date, provide a strong rationale to exclude CRA investments from the materiality test calculation.

On behalf of the community development finance industry, we respectfully submit these comments and are happy to provide any assistance that may be useful in your deliberations on these proposed rules. Thank you for your consideration.

Sincerely,



Mark Pinsky
President and CEO