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U.S. House of Representatives
Committee on Financial Services
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October 24, 2003

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Washington, DC 20552

The Honorable Donald E. Powell
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Dear Sirs:

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 reduce needed equity capital for affordable housing and community 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. On 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

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characteristics markedly different than 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 10 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 conflict 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,

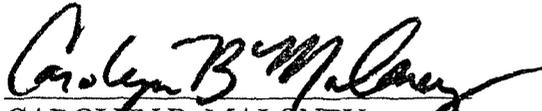

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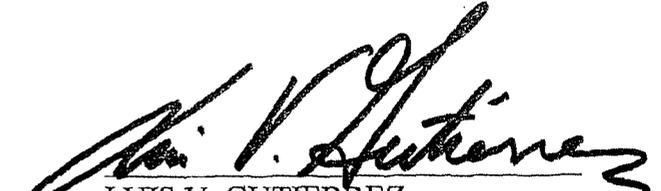
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