Renewable Energy Tax Advisors LLC
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October 3, 2023

VIA ELECTRONIC MAIL

Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

James P. Sheesley, Assistant Executive Secretary
Attention: Comments/Legal OES (RIN 3064–AF29)
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E–218
Washington, DC 20219

RE: Comments on Notice of Proposed Rulemaking
Regulatory Capital Rule: Amendments Applicable to Large Banking Organizations and Banking Organizations with Significant Trading Activity
(Docket ID OCC–2023–0008; Docket No. R–1813, RIN 7100–AG64; RIN 3064–AF29)

Ladies and Gentlemen,

In connection with your Notice of Proposed Rulemaking ("**NOPR**") on regulatory capital, we are pleased to submit comments concerning the proper risk weighting of U.S. tax equity investments in renewable energy projects. As explained herein, we urge you to retain the 100% risk weighting for qualifying renewable energy U.S. tax credit financings, consistent with the NOPR's proposed treatment for U.S. Low Income Housing Tax Credit ("**LIHTC**") investments.

Renewable Energy Tax Advisors LLC ("**RETA**") is a boutique tax consulting firm serving the U.S. clean energy industry. RETA's clients include U.S. tax equity investors, project developers and sponsors, manufacturers of renewable energy equipment, and contractors who engineer and construct the projects.

BACKGROUND:

U.S. Banks provide over 80%-90% of the tax equity financing for U.S. tax credit investments in renewable energy projects. Most returns on these tax equity financings are in the form of U.S. income tax credits and other U.S. tax benefits. Financing these U.S. tax credits is critical in promoting important public welfare goals of combating climate change, creating domestic jobs, and expanding domestic investment, as reflected in the provisions of the Inflation Reduction Act of 2022, in which the U.S. Government broadly expanded and increased renewable energy U.S. tax incentives.

Under the current bank regulatory capital framework, these low-risk U.S. tax equity investment financings carry a 100% risk weighting, provided a bank's total equity investments are less than 10% of its capital. The current regulatory framework applies a 100% risk weighting to both LIHTC and renewable energy tax credit transactions.

Renewable energy U.S. tax equity financings are materially different from speculative private equity investments and, as discussed later, are similar in nature to other U.S. tax credit financings such as LIHTC transactions. From an underwriting standpoint, these transactions are intentionally structured to be very low risk and the yields are similar to debt, reflecting the low risk profile of the underlying investments. These U.S. tax credit financings are attractive to banks as they carry little, if any, entrepreneurial risks, and most of the returns are based on U.S. government tax incentives. Project cash flows are typically highly contracted / bond-like with investment grade counterparties. Additionally, the U.S. tax equity investor typically has structural protections against project underperformance and legal mechanisms to protect against issues such as tax credit recapture risk. Finally, the investor's returns in these U.S. tax equity financings are never dependent on appreciation in the value of the underlying project company. The typical tax equity transaction structures are well known and have been successfully utilized to finance hundreds of projects over the past 15 years.

For these and other reasons, both the U.S. Financial Accounting Standards Board ("**FASB**") as well as the Office of the Comptroller of the Currency ("**OCC**") have concluded that many of these U.S. tax equity financings are very different from other private equity investments. Based on these conclusions, both the FASB and OCC provide for special treatment of most U.S. tax equity financings.

FASB Guidance. The FASB recently expanded its special non-equity/non-cash method accounting treatment to renewable energy U.S. tax credit equity financings, acknowledging the unique characteristics of these transactions (the "**FASB Guidance**")[1]. Back in 2014 the FASB first added a special U.S. GAAP accounting rule regarding LIHTC projects. Under this special rule, qualified U.S. tax equity investments in LIHTC projects made primarily for the purpose of receiving U.S. income tax credits needn't be accounted for under the normal equity method or cost method of accounting. Instead, they could be accounted for under a proportionate amortization method ("**PAM**") of accounting. In allowing the PAM method, the FASB explained these types of U.S. tax equity financing investments receive substantially all their return through the receipt of U.S. tax credits and other tax benefits, and thus have substantially "different risks and rewards than do traditional equity investments."

While the 2014 rule focused on LIHTC investments, the FASB recommended considering expanding the PAM to other U.S. tax credit financings, including those in renewable energy projects. Accordingly, the FASB then launched a study to formally consider expanding the PAM to other U.S. tax credit financings including renewable energy U.S. tax credit investments.

[1] FASB Accounting Standards Update No. 2023-02, March 2023. Entitled "*Investments – Equity Method and Joint Ventures*" addressing the "*Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method*".

In March of this year, the FASB formally expanded the ability to use the PAM to renewable energy U.S. tax equity investments, provided the profile of the investment satisfies certain requirements.

Among the requirements to qualify for PAM accounting under the FASB Guidance, a tax equity investment financing (i) must expect that "substantially all the projected benefits are from income tax credits and other tax benefits" (ii) must have a projected yield that is positive based solely on income tax credits and other tax benefits, and (ii) be a limited liability investment.

OCC Guidance. In recognition of these and other reasons, OCC issued guidance in 2021 confirming banks' ability to participate in U.S. tax equity financings under its general lending authority (the "**OCC Guidance**")[2]. Specifically, a national bank may invest in a "tax equity financing" provided that such transaction is the "functional equivalent of a loan". Such a determination is based on a strict seven-part test and the satisfaction of five additional requirements. It's worth noting that the 2021 OCC guidance was issued in appreciation of, years after the release of, the Basel III accord.

Among the low-risk and debt-like indicators needed to qualify under the OOC Guidance, the tax equity investment must (i) be structured so the tax benefits and other payments fully repay the investment and provide the expected rate of return, (ii) be of limited tenure tied to the tax credit timeframe and expected rate of return period, (ii) not rely on any appreciation in the overall project, (iii) follow a structure necessary for monetizing the tax benefits, and (iv) follow underwriting and credit approval criteria similar to commercial loans.

NOPR TREATMENT OF TAX EQUITY INVESTMENT FINANCINGS

On July 28, 2023, the OCC, the FDIC, and the Federal Reserve issued the NOPR regarding regulatory capital.

The NOPR would retain the 100% risk weight for a narrow set of equity investments in certain public welfare investments such as the LIHTC investments, where substantially all the investment returns are in the form of U.S. income tax credits and other tax benefits. The NOPR explained the rationale for retaining the 100% risk weight on these LIHTC equity exposures, by stating they "generally receive favorable tax treatment and/or investment subsidies that make their risk and return characteristics different than equity investments in general. Recognizing this more favorable risk-return structure and the importance of these investments to promoting important public welfare goals, the proposal would effectively retain the treatment of equity exposures that qualify as community development investments and equity exposures to small business investment companies under the current capital rule and assign such exposures a 100 percent risk weight."

However, the NOPR would increase the capital risk weight for all other non-public investments to 400%, a four-fold increase. While this 400% risk weight would apply to speculative private equity investments, it would also apply to low-risk renewable energy U.S. tax credit equity financings, even though LIHTC tax equity investments and renewable energy tax equity investments share the same relevant characteristics.

COMMENTS AND RECOMMENDATIONS

[2] Section 12 CFR §7.1025, effective April 1, 2021

It is surprising the NOPR allows for a 100% risk weighting for LIHTC tax credit financings but requires a 400% risk weighting for renewable energy tax credit financings. If anything, renewable energy U.S. income tax credits arguably have a lower risk profile than LIHTC's, since the LIHTC recapture period can be as long as 15 years while clean energy tax credit recapture periods, if any, are generally only 5 years. Additionally, requiring a 400% capital risk weight for low-risk U.S. tax credit financings is inconsistent with the actual risk profile of these arrangements, particularly for those investments that qualify under the OCC's 2021 guidance or the FABS's 2023 guidance.

It seems that the decision to apply a 100% risk weighting to LIHTC U.S. tax equity financings but a 400% risk weighting to similar renewable energy U.S. tax equity financings was unintended and was an inadvertent oversight.

Further, lumping these low-risk U.S. government tax credit financings in with speculative private equity investments would be misguided. Such a "one size fits all" risk weighting requirement would devastate the U.S. Tax Equity financing markets. Quite simply, regarding U.S. tax equity financing investments in renewable energy projects, requiring a 400% risk weight is a solution in search of a problem.

Accordingly, we recommend the risk weight for "qualifying" U.S. income tax credit financing investments in renewable energy projects be consistent with the risk weight afforded LIHTC investments. Both should be subject to a 100% risk weighting. For these purposes we recommend a "qualifying" U.S. income tax credit financing be any U.S. tax equity investment that qualifies for special treatment under either the above-noted OCC Guidance or FASB Guidance.

Based on this approach, we recommend the 100% risk weighting categories in the NOPR's table for "Risk Weights Applicable to Equity Exposures under the Expanded Simple Risk-Weight Approach (ESRWA)" be expanded to as follows:

RISK WEIGHTING	EQUITY EXPOSURE
100%	An equity exposure that qualifies as a community development investment under section 24 (Eleventh) of the National Bank Act
	An equity exposure to an unconsolidated small business investment company or held through a consolidated small business investment company, as described in section 302 of the Small Business Investment Act.
	An equity exposure to a U.S. tax credit investment eligible for the proportional amortization method pursuant to the FASB's Accounting Standards Update 2023-02.
	An equity exposure that qualifies as a tax equity finance investment under 12 CFR 7.1024.
400%	An equity exposure that is not publicly traded.

Lastly, we also recommend you consider applying these two additional 100% risk weighting classifications on a "to the extent" basis. For example, assume a bank invests $80X into a renewable energy U.S. tax equity financing but, based on the project's U.S. tax benefits, only a $75X investment would have qualified for the 100% risk weighting. Under a "to the extent" rule, the risk weighting for the first $75X of investment would be 100%, while only the excess $5X investment would be subject to the 400% risk weighting.

SUMMARY

One of the stated goals of the NOPR is to update capital requirements to "better reflect the risks of these banking organizations' exposures." In the case of most U.S. income tax equity investment financings, a four-fold increase in the required capital requirement does not "better reflect the risks" of such low-risk investments. Both the FASB and the OCC have identified the unique low-risk characteristics of most U.S. tax equity financings and have accordingly afforded special treatment to these financings. Indeed, the NOPR acknowledges the uniqueness of these types of financings in allowing a 100% risk weight for similarly structured LIHTC investments. Lastly, the NOPR's proposed 4-fold increase in risk weight would have the unintended consequence of wreaking havoc on the stable and efficient U.S. tax equity marketplace. Instead, we encourage you to allow equity exposures in "qualified" U.S. tax credit investments in renewable energy projects to maintain their current 100% risk weighting.

Thank you for your consideration of these comments and recommendations. Should you have any questions or require any additional information please do not hesitate to contact us.

Sincerely,

/s/ Daniel Nelson

Daniel Nelson
Partner
Renewable Energy Tax Advisors LLC