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MEMO

From: Kenneth H. Thomas, Ph.D.

To: www.Regulations.gov, Docket ID: OCC-2018-008 Doc. #2019-27940

Date: April 8, 2020

Re: Fourth Comment on OCC/FDIC CRA NPR:
"Misleading Messages on MBS and Multipliers"

The purpose of this comment is to attempt to correct the record on misleading messages, mainly being disseminated by misinformed community groups, regarding Mortgage Backed Securities (MBS) that unfortunately resulted in unnecessary and counterproductive MBS Multipliers in the joint Notice of Proposed Rulemaking (NPR) by the OCC and FDIC.

This document will conclude the following about targeted CRA MBS:

1. Affordable Housing is the single most important credit need in virtually every community in America.
2. The current Affordable Housing Crisis has disproportionately impacted Low- and-Moderate Income (LMI) households and communities, and this situation has worsened with the additional economic and other problems caused by the COVID-19 Pandemic.
3. There are numerous Affordable Housing "Hot Spots" such as Miami, New York, and San Francisco; the COVID-19 Pandemic has made a bad situation in New York even worse.
4. CRA targeted MBS are the single most important financial instrument that allows the continued production of needed single-family and multifamily Affordable Housing.
5. Various misinformed community groups have disseminated misleading messages about the frequent trading and other gaming of MBS for CRA exams without any documentation.
6. These misleading messages have found their way to sympathetic regulators who unfortunately have proposed an unprecedented 50% "haircut" or discount on the CRA value of MBS in the NPR.
7. This haircut is especially surprising since fewer than 1% of all ANPR comments even mentioned MBS problems, yet the NPR authors responded to them rather than the 99% of ANPR commenters who were silent on this (non)issue.
8. The proposed 50% haircut will not only adversely impact the very large MBS market but also the availability of Affordable Housing and ultimately LMI borrowers and renters.
9. Even if there was an MBS problem, the NPR's proposed averaging of balances for CRA credit would eliminate it. Yet, even with the fix, the NPR still imposed the 50% haircut?
10. The NPR reflects regulatory favoritism by providing full CRA credit for one CRA investment, LIHTCs, that has a documented history of fraud, abuse, and other problems, but haircuts CRA MBS by 50% for undocumented claims of frequent trading and gaming.
11. The proposed 50% haircut on MBS bonds should be immediately withdrawn.

This document will conclude the following about the proposed Multipliers in the NPR:

1. Multipliers can either be qualitative or quantitative.
2. The current CRA regulations use *qualitative* multipliers that are subjectively applied by examiners in terms of whether or not they give CRA "extra credit" to lending and community development activities based on their innovativeness, creativity, responsiveness, etc.
3. The NPR proposes various *quantitative* Multipliers, most notably a 50% haircut on MBS.
4. There is absolutely no basis in fact or otherwise for the proposed 50% haircut for MBS.
5. The proposed 50% haircut on MBS will have a significant adverse impact on the production of Affordable Housing and ultimately LMI individuals and communities, not to mention the banks themselves; this is truly a Lose, Lose, Lose proposal.
6. The entire concept of quantitative Multipliers proposed in the NPR should be eliminated, as they have been not properly researched in terms of their size or ultimate impact.
7. If, however, the Multiplier concept is retained, it should be changed as follows to maintain the continued production of Affordable Housing:

    a. *No* multiplier for MBS secured by loans in LMI geographies (i.e., 50% haircut)
    b. *Double* multiplier for MBS secured by loans to LMI borrowers AND also for investments in exclusively community development vehicles like national CRA mutual funds with all of their investments being MBS secured by loans to LMI borrowers.
    c. *Triple* multiplier for MBS secured by loans to LMI borrowers in Affordable Housing Hot Spots AND also for investments in exclusively community development vehicles like national CRA mutual funds with all of their investments being MBS secured by loans to LMI borrowers in Affordable Housing Hot Spots.

This is the fourth comment I have submitted on this NPR on CRA Reform. Before providing more details and documentation on this comment, I will first summarize my relevant background on CRA reform.

My Relevant Background on CRA Reform

My current and past expertise in CRA in general and its reform in particular are relevant to this comment. In short, I have spent the majority of my professional life since 1977 focused on the CRA. I was greatly honored to have known and spent time with former Senator William Proxmire, the "Father of CRA."

I am proud of the fact that my first book on CRA, <u>Community Reinvestment Performance</u> (Probus Publishing, Chicago, 1993), received the only endorsement he ever gave to any CRA publication:

> *Dr. Thomas' book, <u>Community Reinvestment Performance</u>, is far and away the best analysis of government regulation that I have seen in any field. He spotlights the regulatory problems that continue in CRA and points out precisely how they are being overcome. CRA will benefit enormously from this superlative examination and report.*

I have worked closely with numerous banks, community groups, and regulators on CRA since 1977, including training federal bank CRA examiners. Besides acting as a CRA consultant and being on the boards of various financial institutions, I have launched two different CRA mutual funds devoted primarily to affordable housing.

I had the privilege of testifying before Congress and federal bank regulators several times on CRA and related bank regulatory and public policy issues. Many of the recommendations in my books, including various CRA exam procedures and tests, were directly implemented into current bank regulations, and more details in this regard are found at www.CRAHandbook.com in The CRA Handbook (McGraw Hill, New York, 1998).

I was honored to receive the first "Award of Excellence" for that book from the National Community Reinvestment Coalition (NCRC), along with Representative Joseph P. Kennedy and Comptroller Ludwig.

In summary, I have a vested interest in getting CRA reform "right," which I define as being what Senator Proxmire intended. We got it right in 1995 when I worked with Comptroller Ludwig and his OCC staff on the last major reform of CRA, and that is my goal during the present effort.

Misleading Statements in the NPR About MBS Frequent Trading and "Gaming"

The NPR states on page 33 that there is:

> *"…concern that the current framework gives too much CRA credit to certain activities, such as credit for the full value of frequently traded MBS, regardless of how long they remain on a bank's balance sheet and even when they do not result in new qualifying activities."*

The NPR also repeats this undocumented claim about "concerns related to frequent trading of MBS with the hypothetical mention of a bank that "purchased a qualifying MBS on January 1, 2019 and sold the MBS on February 1, 2019."

What bank does this or has ever done that, considering the transaction costs and other factors in this market? There is no evidence in the NPR whatsoever to justify whether frequent MBS trading, flipping or other "gaming" of the CRA system exists other than in the mind of the author of this section of the NPR and in the minds of misinformed community group representatives as reflected in their comments in the ANPR and NPR.

The NPR goes on to propose that CRA credit will be given for the "average month-end outstanding amount on a bank's balance sheet of any qualifying "loan or investment." So, now the NPR has broadened its undocumented accusation against just MBS investments to also loans, again with no supporting evidence. Is this alleged gaming problem with CRA investments or loans or both? In any case, the NPR ends up with a proposed averaging solution to a nonexistent problem.

The NPR concludes by claiming that its proposed averaging solution will solve this (nonexistent) problem which results in "apparent" inflation by gaming the system:

> *"This approach would help to eliminate the apparent inflation of the level of a bank's CRA activity that results from banks purchasing loans or investments just prior to a CRA evaluation and then selling those loans and investments when the evaluation is complete."*

The NPR thus moves from a "concern" about "frequently traded MBS" to a claim about "apparent inflation" from flipping "loans or investments" before and after a CRA exam. In addition to a complete lack of evidence for any such gaming, the NPR's going back and forth between loans and investments is confusing.

Such gaming may exist with CRA loans, but based on my decades of experience in working with banks and mutual funds on CRA investments, this is certainly not the case with MBS. Even assuming such MBS gaming existed, the proposed "fix" in the NPR would remedy it.

Instead of stopping with this proposed solution to a nonexistent problem, the NPR takes a punitive twist to haircut the value of all MBS by 50%, without any distinction between those secured by loans to LMI borrowers vs. those secured by loans in LMI geographies. This unnecessary and unwarranted haircut to the most important financial instrument supporting Affordable Housing is totally counter to good CRA public policy and rulemaking and a serious blemish on the NPR.

Example of MBS Misleading Messages by Community Groups in ANPR and NPR

"Community Group A" made the following MBS misstatements in an ANPR comment:

- *"CRA guidance should discourage the use of brokered "Wall Street"-type securities to meet CRA requirements"*

- *"As the [Community Group A] has previously discussed with various federal regulatory agencies, the purchase of Fannie Mae and other GSE mortgage backed securities ("MBS") does not help anyone except Wall Street brokers, and provides limited benefits for local communities."*

- *"We recommend that MBS…should receive discounted CRA credit of approximately one-half or less of the credit that would be received by a bank that originates a loan."*

Reality Check for Community Group A:

- "Wall Street brokers" handle CRA securities such as LIHTCs as well as non-CRA securities such as Treasury bills, notes and bonds.

- This community group obviously has the ear of "various federal regulatory agencies" since it "previously discussed" this topic with them.

- If MBS only help Wall Street brokers, do banks, insurance companies, mutual funds and many other financial institutions buy them simply to generate fees for those brokers?

- Anyone or any group that thinks that MBS "provides limited benefits for local communities" has no clue what MBS are or how they are used as the main source of funds for Affordable Housing.

- This group's recommendation that MBS receive "discounted CRA credit of approximately one-half or less" was unfortunately blindly accepted by the NPR authors.

"Community Group B" made the following MBS misstatements in an NPR comment:

- *"We are against the use of MBS in general."*

- *"The old system did incent financial institutions to buy MBS and keep them only until their CRA exam."*

- *"Nonetheless, we worry that the new method still has loopholes that invite exploitation."*

- *"If an examiner counts MBS as a qualifying activity, it could allow for double-counting: once when the originator makes the loan, and then secondly, when it is sold."*

Reality Check for Community Group B:

- Anyone or any group "against the use of MBS in general" is also against Affordable Housing, so why would a community group be opposed to Affordable Housing?

- Other than these blanket generalizations, there is absolutely no proof or documentation put forward that any financial institution gamed a CRA exam by buying and selling before and after the exam.

- Even the NPR's proposed averaging of MBS balances (the "new method") causes this community group to "worry" that there are still "loopholes that invite exploitation."

- What "loopholes" and what possible "exploitation" is envisioned, especially by a misinformed community group that is "against the use of MBS in general?"

- There is no "double-counting" when a loan is made and then when it is sold, since these are two separate financial transactions and two separate instruments, first a loan and then an investment, that enable a bank to make more loans for Affordable Housing. This comment again shows an unfortunate lack of knowledge of MBS.

Why Did the NPR Ignore the Relevant MBS Input of 99% of the ANPR Commenters?

If frequent trading of CRA MBS was a real problem, then it would have been raised as a serious issue in the ANPR and NPR comments. Since the NPR comments are still being tallied, we can only review the published ANPR comments.

The fact is that very few of the roughly 1,500 comments on the OCC's Advance Notice of Proposed Rulemaking (ANPR) even mentioned MBS. Specifically, only 115 commenters (106 excluding duplicates), fewer than 10% of the total, even referenced MBS in response to question #18 about possibly limiting or excluding the CD treatment of certain activities, citing investments in MBS as an example.

Of the 106 comments mentioning MBS, 89 or 84% were *supportive* of them for CRA credit and only 17 or 16% were not. Of those 17 negative MBS comments, only eight even mentioned the concept of multiple MBS trading. Those latter eight comments represent about one-half of 1% of all ANPR comments. In other words, much CRA reform ado about nothing.

It is indeed troubling that the NPR would propose a drastic solution such as haircutting MBS by 50% to a nonexistent problem where fewer than 1% of all ANPR comments even mentioned multiple MBS trading.

What is the purpose of even having an ANPR, if the NPR ignores its results and puts forward a questionable proposal that addresses an issue that was not important to 99% of ANPR commenters?

If the NPR ignores the ANPR results in this way, does this mean that the final rule will similarly ignore these and other NPR comments? If the final rules on CRA have already been decided, why even have an ANPR or NPR and take the time to comment on them?

How MBS Are Critical to Affordable Housing

Affordable housing is the single most important community development need in the U.S. today. The COVID-19 Pandemic is making the Affordable Housing Crisis even worse because of the reduced or lost incomes of the unprecedented number of unemployed workers and shuttered businesses. New York City, which has always been one of the epicenters of the Affordable Housing Crisis, is unfortunately also the epicenter of the current Pandemic.

There is no question that targeted MBS focusing on single- and multifamily Affordable Housing is the most important financial instrument to provide capital and liquidity for this purpose. Community groups and others who do not understand such MBS or their value to our society need to be educated about this critical financial instrument.

Purchased MBS allows originators to make more commercial and residential mortgage loans, since the proceeds from the sale of the securities are used to provide additional mortgages in local communities. This increases the overall supply of Affordable Housing. Any private or worse yet public effort to limit MBS, as is the case with the NPR's proposed 50% haircut, can kill the MBS goose that lays the golden Affordable Housing egg.

The fact is that MBS provide the critical market liquidity to encourage continued lending to support LMI borrowers and communities. Therefore, MBS play the most crucial role in the provision of Affordable Housing. Any effort to reduce CRA credit for MBS as proposed in the NPR will adversely impact affordable housing, which is totally contrary to CRA and sound public policy.

Finally, if enacted as written, the NPR would result in a shrinkage of credit to LMI borrowers, an effect diametrically opposite to the spirit and letter of CRA. Besides inadvertently diverting credit from needy LMI borrowers, the NPR proposal would risk increasing the cost and financing of Affordable Housing.

This is not the time and certainly New York City and other major cities being devastated by the COVID-19 Pandemic are not the places to cut back on critically needed Affordable Housing, which would be the likely result of the proposed NPR 50% haircut.

Given the constraints on the balance sheets of most lenders and the relative costs of capital, maintaining and expanding their lending to LMI residents and communities requires a robust and reliable secondary market for securities backed by CRA loans.

Expansion of the secondary markets for these securities in turn expands the amount of lending directed to LMI borrowers and communities by providing needed liquidity to the banks so they can continue providing credit.

CRA Qualified MBS agency investments—typically being agency bonds with higher quality ratings-dovetail well with a bank's capital maintenance objectives as well as with a bank's safety and soundness objectives.

The NPR proposal for a 50% haircut on MBS would not only reduce the amount of Affordable Housing to LMI borrowers and communities but also increase the cost of such housing. If banks are no longer allowed 100% CRA credit for such investing, they may look to alternative investments that may be riskier and likely not as beneficial to local community development.

Thousands of banks and other financial institutions have invested in agency-targeted MBS, and they play a critical role in the investment portfolio of those banks. The NPR's 50% hair cutting of the CRA value of MBS could potentially reduce the attractiveness of this critical element of these investment portfolios by at least one-half, and this could have adverse safety and soundness ramifications.

Banks, for example, may increase their credit risk as they reallocate their investment portfolio to account for the reduction of MBS caused by the NPR rule. Besides increasing credit risk, bank investment income may suffer and this could ultimately impact the profitability and even capital levels of these banks.

CRA is supposed to be safety and soundness neutral, but this is not the case with this ill-conceived NPR proposal.

San Francisco Fed Publication Encourages MBS to Promote Affordable Housing

The "CRA Investment Handbook" of the Federal Reserve Bank of San Francisco at https://www.frbsf.org/community-development/files/CRAHandbook.pdf makes the following statements about the value of CRA-qualified MBS:

> *"Mortgage-backed securities (MBSs) are a popular vehicle among financial institutions looking to invest in their own communities."*
>
> *"Community Reinvestment Act (CRA) officers and other bank investment officers appreciate the return and safety that MBSs provide relative to other securities."*
>
> *"They also appreciate that they are widely available compared with other qualified investments."*
>
> *"Moreover, bankers today find that CRA qualified MBSs can typically provide a respite from concerns over the disruptions facing the mortgage markets and the questions surrounding the various mortgage products and underwriting standards."*
>
> *"For decades, mortgage-backed securities have played a crucial role in housing finance in the United States, making financing available to home buyers at lower costs and facilitating the availability of funds throughout the country."*

"Investors include corporations, banks and thrifts, insurance companies, and pension funds."

"MBSs are popular because they provide a number of benefits to investors, including liquidity, yield, and capital management flexibility."

"Reasons to consider MBSs as part of a CRA strategy include:

- *Payment of principal and interest is guaranteed*
- *Market rate return*
- *No management fees*
- *Favorable capital treatment*
- *Liquid investment: can be sold or borrowed against*
- *Flexible: can be tailored to a bank's assessment area and sold in varying amounts*
- *Low transaction costs*
- *Available everywhere, even in rural areas."*

Investors increase the supply of financing for affordable housing through this product by leveraging investment in affordable housing from nondepositories and by creating incentives for loan originators"

Documented Reasons Why Banks Do NOT Frequently Trade or "Game" CRA MBS

Based on decades of working with and in both banks and mutual funds involved in CRA MBS transactions, I do not believe CRA MBS are frequently traded or gamed for CRA exams. In fact, I have never witnessed a bank actively buying and selling MBS in an attempt to game a CRA rating, and there are many reasons for this:

1. CRA investments like MBS receive continuing CRA consideration over every Review Period that the investment remains in a bank's portfolio. That is, CRA exams give credit for current as well as prior period investments. Thus, there is no incentive to sell MBS and game the system to purchase new MBS, since a bank will get full credit for its existing MBS (and avoid the time, trouble and transaction costs of selling and buying again).

2. If a bank sells its MBS after an exam, it will then be required to buy more MBS for the next exam. Why would any bank go through this trouble and take on additional interest rate and other risks, when the easiest course of action is to hold on to the securities since they will be granted CRA credit at the next exam. The fact is that newer and especially just issued CRA-qualified MBS trade at a significant premium to other seasoned CRA MBS that have circulated widely in the market. Therefore, any bank investment desk trying to game the system would typically be forced to buy a more expensive bond and then sell it later at a lower price and book a loss. Such a trading loss is an expensive way to comply with CRA.

3. IF a bank was gaming the CRA exam, then the examiners would certainly find out about it during their evaluation of CRA investments and not only criticize the bank but perhaps not provide requested CRA credits. No bank would risk such a problem with their bank examiners, since they visit the bank every few years for CRA exams as well as safety and soundness exams where they also review investment portfolios.

4. IF a bank was using a CRA gaming strategy, bank management or internal or external auditors of the investment portfolio would likely expose this frequent trading and gaming and eliminate it. Why would a CRA, compliance, or investment officer take such a risk, when there is no significant upside for them or their bank? Also, frequent CRA MBS trading and gaming are likely in violation of most bank investment policies.

5. Any selling of MBS carries interest rate, credit, prepayment, pay-down and other risks, not to mention the increased time and transaction costs, so banks prefer a buy and hold strategy rather than any trading of their MBS. As a general rule, bank management is significantly more focused on the bank's safety and soundness than compliance or CRA, and this overriding concern would obviate taking short-term interest rate and other risks on a long-term bond in order to game its CRA goals. It is cheaper and less risky just to comply with the standard practice of buying and holding CRA MBS.

6. CRA-qualified MBS are more expensive than other MBS, partly because their underlying CRA-qualifying mortgages are customized for a buying bank's Assessment Areas. A bank would take a risk by selling a qualified MBS, because it may not be able to find a suitable buyer with a similar Assessment Area and then later find a replacement MBS customized for that same Assessment Area for the next exam.

7. Some markets like Salt Lake City, Miami, Wilmington, etc. have such a great demand for CRA MBS, that banks buy anything they can find and keep them in their portfolio to avoid the risk of not being able to find them at a later date, regardless of their price. Thus, if anything, banks are more likely to buy and hold CRA MBS and even portfolio additional ones beyond their immediate needs, since they ultimately will need more of them on each exam as they grow or do M&A deals.

8. Different banks have different Assessment Areas, and an MBS tailored for one bank will not provide CRA credit for another. Thus, it may be difficult to find a buyer with the same Assessment Area, so a bank will just hold on to its MBS rather than trying to find a buyer. The "frequent trading" argument would be appropriate for a totally homogenous financial instrument like a U.S. Treasury Bill, but not a heterogeneous instrument like targeted MBS that are customized for each bank's Assessment Area(s).

9. Even assuming two banks with identical Assessment Areas, the potential MBS purchaser would need access to detailed borrower income, loan pay-down, and other data to provide CRA credit documentation to examiners. These types of transactions are detailed and take time and often require signing NDAs to even look at a possible MBS purchase. This is another reason why banks buy and hold their CRA MBS to avoid the time and cost involved in such transactions.

10. CRA mutual funds that deal exclusively in CRA investments like targeted MBS that support Affordable Housing on behalf of investing banks likewise have a buy and hold strategy, since there is no need to engage in trading the portfolio, which would increase transaction costs and reduce fund performance.

Regulatory Favoritism: CRA Examiners Have Long Been Biased Against Targeted CRA MBS

Having spoken to and met with dozens of CRA examiners and regulators for decades, I have concluded that many of them have a strong bias against banks using targeted MBS to meet their CRA investment needs simply because they are "too easy." When asked about their bias, the general response is that "Bankers simply write a check and make their CRA investment problem disappear!"

This attitude and practice is wrong. A CRA investment should be mainly evaluated on the basis of its responsiveness to community credit needs, and the #1 need in almost every community in America is for Affordable Housing. And, the #1 way to meet that need is through CRA MBS. Period.

The effort a banker puts in on deciding and buying the most appropriate CRA investment to meet Assessment Area credit needs should be irrelevant to an examiner. That would be like an examiner giving CD service credit to one banker helping Habitat for Humanity build a house on a Saturday afternoon but then refusing CD investment credit to another banker who "simply" wrote a big check to that same organization for building supplies and stayed home that day to watch college football.

Examiners are telling many bankers they are "not happy" with their CRA MBS investments and want other ones that require greater "effort" like LIHTCs or special equity or investment deals. This type of regulatory favoritism by examiners is totally inappropriate and improper, and they should give CRA credit where it is due, especially when it involves CRA MBS supporting critically needed Affordable Housing.

When a regulator haircuts the value of an important Affordable Housing investment like CRA MBS, it sends the wrong message to other banks and the market as a whole that these vital investments are not as attractive or desirable as other CRA investment options, and this could be disruptive to the market for these instruments.

Rather than being dictated by rogue examiners, CRA investment decisions should be made by a bank's investment committee and approved by its board, after it has ascertained credit needs within its Assessment Area(s).

It is reasonable for an examiner to give more credit to a CRA MBS that is secured by a loan that benefits an LMI borrower or renter compared to a CRA MBS secured by a loan to a middle- or upper-income person in an LMI census tract. In fact, many examiners will give NO credit for the latter investment and require targeted MBS benefit LMI borrowers rather than LMI geographies.

I would respectfully suggest that this anti-CRA MBS bias by the regulators may have had something to do with the NPR's proposed 50% haircutting of this important investment, despite the fact that 99% of ANPR commenters did not even mention multiple trading of MBS.

I would also note that the discounting of one CRA investment (like MBS) relative to alternative CRA investments (like LIHTCs) suggests regulatory favoritism, which is totally inappropriate (see following section).

Assuming the CRA MBS frequent trading or gaming was a real problem, the NPR's proposed fix of only giving credit for the *average balance* of an investment over time rather than at a point in time (i.e., during the exam) adequately addresses that "problem." Yet, even with this fix, why would the NPR still penalize CRA MBS with the 50% haircut?

Why Didn't the NPR Haircut LIHTC CRA Investments With a Documented History of Problems?

The NPR discounted the value of CRA MBS by 50% based on undocumented concerns of frequent trading and gaming levied by misinformed community groups. Yet, the NPR did not impose any such restrictions on LIHTCs, another major category of CRA investments, which have a well-documented history of problems including fraud and abuse. The November 13, 2017 report by the Cato Institute titled "Low-Income Housing Tax Credit: Costly, Complex, and Corruption-Prone" makes the following points:

> *Major banks are the largest investors in LIHTC projects. That is partly because the projects help them fulfill requirements of the Community Reinvestment Act (CRA). In one recent year, 85 percent of total LIHTC equity investment was by banks, with the five largest U.S. banks accounting for half of the total. The CRA is a major driver of LIHTC investment.*
>
> *So does the LIHTC mainly benefit investors and businesses or low-income tenants? In a report on the LIHTC, the Congressional Budget Office (CBO) said, "the tax credit may allow investors to capture much of the benefits for themselves rather than their tenants." Similarly, economists Edward Glaeser and Joseph Gyourko have argued that the "LIHTC is not very effective along any important dimension—other than to benefit developers and their investors."*
>
> *Some statistical studies support that view. A study by Gregory Burge found that "the LIHTC program may significantly benefit project developers and owners, with approximately one-third of the programs' cost going to low-income households in the form of rent savings." Thus, "the LIHTC program is an inefficient mechanism for generating benefits to low-income households." Economist Ed Olsen notes that LIHTC projects often receive other government aid, and so tenants may only capture about 24 percent of overall project subsidies.*
>
> *The LIHTC is a ripe target for fraud and abuse, which is perpetrated by tenants, developers, and government officials. Tenants abuse the program by occupying housing units to which they are not eligible, often by claiming a false income level on disclosure forms. Developers abuse the program by inflating their reported construction costs to receive excess tax credits.*
>
> *Los Angeles was hit by a major LIHTC scandal last year. Describing the federal indictment, the Los Angeles Times said, "Advanced Development and Investment Inc. [ADI] engaged in a conspiracy to fraudulently obtain more than $50 million in loan proceeds for affordable housing projects … others submitted fraudulent invoices that 'significantly overstated' the true costs of framing, plumbing, drywall and other construction work at affordable-housing projects built with taxpayer support."*
>
> *Lack of oversight has also made the LIHTC program susceptible to abuse. The NPR investigation found that "little public accounting of the costs exists, even among government officials and regulators charged with monitoring the program." The IRS hands out the LIHTC benefits, but its oversight "has been minimal," said the GAO in 2015. The IRS has audited just 13 percent of the state housing agencies that hand out the tax credits.*

As stated above, “LIHTC is a ripe target for fraud and abuse.” LIHTCs have been the subject of many more reports and articles claiming widespread fraud and abuse throughout the county, but the NPR is silent regarding any possible haircut for this obviously regulatory favored instrument.

CRA MBS, which have a much larger and more direct impact on providing Affordable Housing, are unfortunately out of favor with regulators, and this is evident in the NPR, which provides 100% CRA credit for LIHTCs but an unwarranted 50% haircut for targeted MBS.

The NPR’s regulatory favoritism of LIHTCs over CRA MBS is troubling for many reasons:

1. LIHTCs have a long documented history of fraud and abuse (see above), but this is not the case with CRA MBS, the subject of undocumented claims of frequent trading and gaming.

2. LIHTCs primarily benefit developers and their investors rather than low-income residents who benefit from CRA MBS (see above).

3. LIHTC abuse and fraud are costly to the U.S. government and taxpayers, but this is not the case for CRA MBS.

4. CRA MBS represent a much larger and more important source of funds for Affordable Housing than LIHTCs.

5. The largest banks aggressively buy up LIHTCs for CRA credit, leaving community banks relatively few opportunities to compete for them; CRA MBS, however, are available to all sized community banks virtually everywhere and usually represent the largest portion of their CRA investment portfolio.

The Misuse and Misapplication of Multipliers in the NPR

Multipliers can either be qualitative or quantitative. The current CRA regulations use *qualitative* multipliers that are subjectively applied by examiners in terms of whether or not they give “extra CRA credit” to lending and community development activity based on their innovativeness, creativity, responsiveness, etc.

These qualitative guidelines, which are left to the discretion of examiners, are different from the more explicit quantitative “multipliers” proposed in the NPR. The problem with multipliers is that they do not adjust for relevant Performance Context factors.

For example, a fixed rule of applying a multiplier of two for investing in a CDFI minority bank Certificates of Deposit as compared to no multiplier for CRA MBS secured by loans to LMI borrowers represents a 50% haircut for the latter investment.

This multiplier procedure, however, may be flawed if the bank being evaluated is in a market where Affordable Housing is the most critical credit need. In that case, MBS secured by loans to LMI borrowers are the primary vehicle for providing Affordable Housing, whereas the funds provided to a minority bank may or may not be used for that purpose.

An experienced on-site CRA examiner, familiar with the market and the banks, would recognize this difference and the critical importance of MBS secured by loans to LMI borrowers as being most responsive to community credit needs.

However, a bank receiving effectively half credit for such MBS secured by loans to LMI borrowers through the formulaic multiplier approach in the NPR may reallocate resources to other less impactful investments in its Assessment Area or not do them at all.

It is therefore recommended that the entire concept of quantitative Multipliers proposed in the NPR be *eliminated,* since they have been not properly researched in terms of their size or ultimate impact. Consider, for example, the following unanswered questions:

1. Why does the NPR favor LIHTCs, with a history of fraud, abuse and other problems, but disfavors CRA MBS with no such comparable history?

2. Why does the NPR discount CRA MBS by 50%, as recommended by one community group in the ANPR (see above) vs. a lower number like 10%?

3. Why does the NPR also discount CRA-qualified municipal bonds by 50%?

4. Why does the NPR specifically mention CDFIs for favored multiplier treatment but does not mention other CRA investments like national CRA mutual funds that exclusively support Affordable Housing via CRA MBS secured by loans to LMI borrowers?

5. Why does the NPR not distinguish between CRA MBS secured by loans to LMI borrowers vs. CRA MBS secured by loans in LMI geographies?

6. Why does the NPR fail to provide extra credit for CRA investments benefiting LMI borrowers in Affordable Housing Hot Spots like Miami, New York, and San Francisco?

7. Why does the NPR penalize CRA MBS with a 50% haircut for a perceived problem of frequent trading and gaming when the same NPR "fixed" that problem by providing CRA credit based on average balances over time rather than at a point in time?

In conclusion, IF the NPR Multiplier concept is retained, it should be changed as follows to maintain the continued production of Affordable Housing and avoid regulatory favoritism:

1. *No* multiplier for MBS secured by loans in LMI geographies (i.e., 50% haircut)

2. *Double* multiplier for MBS secured by loans to LMI borrowers AND also for investments in exclusively community development vehicles like national CRA mutual funds with all of their investments being MBS secured by loans to LMI borrowers.

3. *Triple* multiplier for MBS secured by loans to LMI borrowers in Affordable Housing Hot Spots AND also for investments in exclusively community development vehicles like national CRA mutual funds with all of their investments being MBS secured by loans to LMI borrowers in Affordable Housing Hot Spots.