



November 5, 2010

Financial Stability Oversight Council  
c/o United States Department of the Treasury  
Office of Domestic Finance  
1500 Pennsylvania Avenue, N.W.  
Washington, D.C. 20220

Re: FSOC-2010-0002

Public Input for the Study Regarding the Implementation of the Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds

Dear Ladies and Gentlemen:

The membership of the NMTC Working Group includes over thirty participants in the New Markets Tax Credit ("NMTC") industry, including allocattees, investors, lenders, and professionals who work together to resolve technical NMTC Program issues. We respectfully submit our comments in response to the Financial Stability Oversight Council's ("FSOC") request for public input for the Study Regarding the Implementation of the Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds (the "Study"). In the Dodd-Frank Wall Street Reform and Consumer Protection Act enacted on July 21, 2010 (the "Act"), Section 619 prohibits banking entities from engaging in proprietary trading and from maintaining certain relationships with hedge funds and private equity funds (the "Volcker Rule"). As described in more detail below, we recommend that the Study specifically permit banking entities to continue making NMTC investments and not be limited by the Volcker Rule. We believe that such an exemption would be consistent with Congress' intent and plan for the purpose of the NMTC Program. We have organized our comments below in order of the questions included in the notice and request for information.

#### Questions 3 and 4

While the Act prohibits certain activities by banking entities, Section 619(d)(1) allows several permissible activities as an exception. Specifically, investments that promote the public welfare are identified as a permitted activity (**emphasis added**):

Investments in one or more small business investment companies, as defined in section 102 of the Small Business Investment Act of 1958 (15 U.S.C. 662), **investments designed primarily to promote the public welfare**, of the type permitted under paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), or investments that are qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure, as such terms are defined in section 47 of the Internal Revenue Code of 1986 or a similar State historic tax credit program.

Paragraph 11 of Section 5136 of the Revised Statutes further states (**emphasis added**):

To make investments designed primarily to promote the public welfare, **including the welfare of low- and moderate-income communities or families (such as by providing housing, services, or jobs)**. A national banking association may make such investments directly or by purchasing interests in an entity primarily engaged in making such investments.

The NMTC community, as well as other similar tax credit communities, including the low-income housing tax credit and the renewable energy tax credit, applaud the inclusion of such language since we believe it recognizes and is consistent with Congress' legislative intent in enacting tax credits that provide incentives for banking entities to make investments in underserved economic areas (Section 45D), affordable rental housing (Section 42), and renewable energy resources (Sections 45 and 48), all of which promote the public welfare.

We request that the FSOC issue specific guidance that these tax credit programs, as well as state and local programs that were created for a similar purpose as these federal tax credit programs, qualify as permissible activities by a banking entity as they meet the requirements of promoting public welfare in Section 619(d)(1)(E) and paragraph 11 of Section 5136 of the Revised Statutes. We believe this would be consistent with the treatment that the historic rehabilitation tax credit has already received by being specifically identified in Section 619(d)(1)(E) of the Act. We believe such guidance in any final rule should be similar to the Joint Committee on Taxation's footnote 344<sup>1</sup> in its report on the Health Care and Education Affordability Reconciliation Act of 2010 which stated the following regarding the codification of the economic substance doctrine and its application to different tax credit programs (**emphasis added**):

**If the realization of the tax benefits of a transaction is consistent with the Congressional purpose or plan that the tax benefits were designed by Congress to effectuate, it is not intended that such tax benefits be disallowed.** See, e.g., Treas. Reg. sec. 1.269-2, stating that characteristic of circumstances in which an amount otherwise constituting a deduction, credit, or other allowance is not available are those in which the effect of the deduction, credit, or other allowance would be to distort the liability of the particular taxpayer when the essential nature of the transaction or situation is examined in the light of the basic purpose or plan which the deduction, credit, or other allowance was designed by the Congress to effectuate. Thus, for example, it is not intended that a tax credit (e.g., section 42 (low-income housing credit), section 45 (production tax credit), section 45D (new markets tax credit), section 47 (rehabilitation credit), section 48 (energy credit), etc.) be disallowed in a transaction pursuant to which, in form and substance, a taxpayer makes the type of investment or undertakes the type of activity that the credit was intended to encourage.

#### Question 5(i)

In addition to specifically identifying investments in NMTCs as a permissible activity, we further recommend that banking entities that make investments in NMTCs should not be deemed to be involved in a transaction in which there is a material conflict of interest with the banking entities' clients, customers or counterparties as limited in Section 619(d)(2)(A)(i). The size of the investments and loans by banking entities in the NMTC industry, when compared to the overall bank assets or activities, is very small and generally not material to the bank entities. Furthermore, in order to maintain the integrity of the tax credit program and ensure that investors are making the types of investments that Congress intended,

---

<sup>1</sup> Joint Committee on Taxation Technical Explanation of the Revenue Provisions of the "Reconciliation Act of 2010," as Amended, in Combination with the "Patient Protection and Affordable Care Act", JCX-18-10, March 21, 2010, page 152.

participants are strictly monitored for compliance with the NMTC program's rules and regulations by the Community Development Financial Institutions Fund ("CDFI Fund") and the Internal Revenue Service (the "IRS"). Since the investments are in total small and not material to the banking entities and since there is a large amount of oversight by the CDFI Fund and the IRS, we believe that these transactions should be specifically identified as not being material.

#### Question 5(ii) and 5(iii)

In addition, to the investments in NMTC transactions not being material as discussed above, we believe that the investments would not result in material exposure, directly or indirectly, to high-risk assets or high-risk trading strategies or pose a threat to the safety and soundness of a banking entity. Based upon informal conversations with members of the NMTC industry and public statements made by members of the IRS, we are unaware of any events that have triggered recapture of any investor's NMTCs. We believe this a tremendous testament to the investment soundness that participants in the program have relied upon. We also believe that if a particular investment was deemed to have been made in an asset with a perceived higher risk because of its location within a low-income community, that the NMTC sufficiently mitigates the investor's risk through achievement of a reasonable return on its investment while Congress also achieves its intent of promoting public welfare through such investments. As such, we believe investments in NMTCs would not result directly or indirectly in any exposure to high risk assets or high risk trading activities or pose a threat to the safety and soundness of a banking entity and request that NMTC transactions be specifically identified as permissible activities.

#### Conclusion

If a banking entity were to be deemed to have a material conflict of interest or material exposure from investments in high risk assets or the investments pose a threat to the safety and soundness of a banking entity because of its investment in a NMTC transaction or its syndication of NMTC investments, the Volcker Rule would eliminate nearly all current NMTC syndicators or investors. Such a reduction in the number of syndicators or investors would dramatically reduce pricing for NMTCs, reducing the amount of subsidy to low income community development and potentially eliminate any ability of the NMTC program to achieve its objective of incentivizing investment in low income communities. Uncertainties about the permissibility of these types of transactions will create potential impediments to the growth and efficiency of the industry and the amount of investments in low income communities. For the same reasons described above in our comments on Questions 3 and 4, we do not believe the intent of the Volcker Rule was to limit banking entities to participate in tax credit transactions that, in form and substance, meet the intent for which they were created by Congress. Thus, we request further guidance exempting NMTC transactions, as banking entities will have serious concerns regarding future NMTC industry involvement if clear guidance is not received quickly.

The concern for participants in the NMTC program is that the definitions for items like "material conflict of interest" or "high risk assets" will be too broadly defined. This outcome could have unintended consequences on certain industries that were not meant to be affected by this rule. We believe that guidance on this issue will alleviate industry concerns and allow the NMTC program to better serve its intended purpose of bringing capital to a need that has historically had inadequate access to capital. We are excited about the positive impact that the NMTC Program is having on the nation's low-income communities and low-income persons and the potential for future success. However, we feel that the program can only become even more efficient and deliver more assistance to the end users if this guidance is provided. Thank you in advance for your time and careful consideration of this issue.

Please do not hesitate to contact us if you have any questions regarding our comments or if we can be of further assistance.

Yours very truly,  
Novogradac & Company LLP

by   
Michael J. Novogradac

Novogradac & Company LLP

by   
Brad Elphick