

August 22, 2023

Dr. Lael Brainard  
Director  
National Economic Council  
1650 17th St NW  
Washington, DC 20006

**RE: The Impact of Proposed Bank Regulatory Capital Requirements on Tax Equity Investment in Clean Energy**

Dear Director Brainard,

On behalf of the undersigned organizations, we are writing to express our profound concerns about proposed bank regulatory capital requirements that threaten to derail the clean energy transition.

The Inflation Reduction Act (IRA) has key goals which will benefit Americans: substantially lower the nation's carbon emissions, catalyze investments in energy production and manufacturing, create good jobs, and lower energy costs. Providing efficient, low-cost capital is a key ingredient to accomplishing these goals.

Tax equity, largely provided by domestic banks, has been a critical financing source for clean energy projects. The IRA extended and expanded the use of federal tax incentives to various renewable and carbon emission reduction technologies as well as the domestic manufacturing of advanced energy equipment. To meet the goals of the IRA, many forecasters estimate that tax equity will need to increase from a \$20 billion annual market to \$50 billion. Banks are poised to increase their tax equity investments to meet this demand. However, impending changes in bank regulatory capital requirements by banking regulators would quadruple the capital requirement on tax equity investment, which is not reflective of its risk profile and could severely reduce banks' capacity in providing tax equity.

Substantially higher capital costs for banks could significantly increase the costs of clean energy projects and result in far fewer projects being built. Furthermore, carbon reduction goals may not be met, jobs could be lost, manufacturing could be stunted, and equitable access to clean, low-cost energy could be reduced – all of which are inconsistent with the administration's climate initiatives and the IRA.

**Tax equity is not traditional private equity investment, but a unique form of equity with loan-like characteristics**

The U.S. government has incentivized the energy transition through the tax code. Renewable energy projects typically have a high level of contracted revenue, limited variable operating costs and relatively predictable cash flows. Projects are often held in a limited liability corporation (LLC) and taxed as partnerships. In most cases, the project sponsors do not have sufficient tax liabilities to efficiently use the tax benefits that may be available for these projects. Thus, the Sponsor sells non-controlling passive interests in the LLC to tax equity investors in a structured tax equity transaction. This structure is designed to allow tax equity investors to fund a large portion of the capital cost of the project and to receive a pre-negotiated rate of return which consists primarily of the value of available tax credits and other tax benefits. The tax equity investor has limited downside exposure as the tax equity investment will receive most of its return from more predictable tax credits and other tax benefits, and it has other

protective features such as no senior debt in the project, and its priority over a sponsor's return. In many ways tax equity has more loan-like characteristics versus true equity investments.

Domestic banks have been major providers of tax equity, representing over 80-90% of the roughly \$20 billion annual market. In fact, in a recognition of the importance of tax equity financing and its loan equivalent nature, in 2021, the Office of the Comptroller of the Currency (OCC) codified and streamlined the process for the banks to participate in tax equity financing under the general lending authority.<sup>1</sup> Many banks have increased their tax equity financing since the OCC rulemaking.

While the IRA provides new tax credit monetization options through transferable tax credits and direct pay, tax equity is expected to remain the most common and preferred option for project developers given its ability to monetize both tax credits and other tax benefits such as tax depreciation. Tax equity also provides additional value to developers in the form of long-term commitments to fund projects, which the developers can use to raise construction finance, and can help facilitate the entrance of large buyers into the still developing tax credit transfer market by providing underwriting and project diligence expertise.

### **The treatment of tax equity in the proposed capital requirements is both unwarranted and particularly detrimental to IRA-incentivized projects**

Under existing regulatory capital rules, tax equity receives a 100% risk weight so long as a bank's total equity investments are below 10% of its capital. The excess equity investments exceeding 10% of a bank's capital would be assessed at 400% risk weight, i.e., quadrupling the capital requirement.

The Federal Reserve, OCC, and Federal Deposit Insurance Corporation (FDIC) issued a Notice of Proposed Rule (NPR) on the finalization of Basel III rules on July 27, 2023. As part of the proposal's bank regulatory capital rules, there is no longer a 10% threshold test. Instead, the proposed rules provide a 100% risk weight for public welfare investments such as the low-income housing tax credit investments. All other non-publicly traded equity investments (which renewable energy tax equity investments would be grouped into) attract a 400% risk weight.

Applying the same risk weighting for tax equity as private equity is unwarranted and ignores the fact that tax equity investments have a very different risk profile as discussed above. A 400% risk weight would make it prohibitively expensive for the banks to extend tax equity financing. Leading tax equity providers

---

<sup>1</sup> Section 12 CFR § 7.1025 allows National Banks to engage in tax equity finance transactions and defines the criteria that make these investments the "functional equivalent of a loan". (1) The structure of the transaction is necessary for making the tax credits or other tax benefits available to the national bank or Federal savings association; (2) The transaction is of limited tenure and is not indefinite, including retaining a limited investment interest that is required by law to obtain continuing tax benefits or needed to obtain the expected rate of return; (3) The tax benefits and other payments received by the national bank or Federal savings association from the transaction repay the investment and provide the expected rate of return at the time of underwriting; (4) Consistent with paragraph (c)(3) of this section, the national bank or Federal savings association does not rely on appreciation of value in the project or property rights underlying the project for repayment; (5) The national bank or Federal savings association uses underwriting and credit approval criteria and standards that are substantially equivalent to the underwriting and credit approval criteria and standards used for a traditional commercial loan; (6) The national bank or Federal savings association is a passive investor in the transaction and is unable to direct the affairs of the project company; and (7) The national bank or Federal savings association appropriately accounts for the transaction initially and on an ongoing basis and has documented contemporaneously its accounting assessment and conclusion.

anticipate that annual tax equity investments in the clean energy sector could shrink by 80-90%, and many banks could exit the renewable tax equity market entirely, if the 400% risk weight is applicable. The increase in pricing that would be needed to accommodate the 400% risk weight would be astronomical, and the project investment would no longer be viable for the developer if that cost is passed along to them. In fact, despite the effective date of the proposed rules being 2025, this uncertainty has already caused many bank investors to take a pause on issuing new investment commitments, which will cause a disruption to the project developments and put many thousands of manufacturing and construction jobs at risk.

## Recommendations

It is critical and advisable for the Federal Reserve, OCC and FDIC to expand the 100% risk weight category to include tax equity for renewable energy. Investments in government-mandated clean energy tax credits should not be subject to Basel III’s punitive requirements for equity exposures for reasons similar to those applicable to equity investments in low-income housing credit (LIHTC) investments. Although the risk profile of renewable energy investments is substantially similar to LIHTC investments, and the level of government support is comparable, renewable energy investments do not qualify as community development investments. Updates are necessary to afford them the same treatment.

We recommend that the 100% risk weight category in “Table 2: Risk Weights Applicable to Equity Exposures under the Expanded Simple Risk-Weight Approach (ESRWA)” on page 162 of the NPR to include two additional categories: (1) investments that meet the stringent criteria set by the OCC to qualify as loan equivalent,<sup>2</sup> and (2) the investments that qualify for the proportional amortization method (PAM) of equity accounting under Financial Accounting Standards Board (FASB) rules<sup>3</sup> as they, by definition, would derive most of their returns from federal tax incentives, similar to LIHTC investments. The table below shows the exposure types we recommend adding to the 100% risk weight category.

Risk Weight	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 that qualifies as a tax equity finance investment under 12 CFR 7.1025 <b>and</b> earns any of the following clean energy tax credits under sections 45, 45Y, 45Q, 45V, 45X, 45Z, 48, 48D, or 48E of the Internal Revenue Code, or future tax credits.
	An equity exposure to a tax credit structure that meets the criteria to be accounted for under the proportional amortization method as described in ASC 323 of the FASB’s Accounting Standards Codification.

<sup>2</sup> <https://www.occ.gov/news-issuances/bulletins/2021/bulletin-2021-15.html>

<sup>3</sup> <https://www.fasb.org/Page/ShowPdf?path=ASU+2023-02%E2%80%94Investments%E2%80%94Equity+Method+and+Joint+Ventures+%28Topic+323%29%E2%80%94Accounting+for+Investments+in+Tax+Credit+Structures+Using+the+Proportional+Amortization+Method.pdf>

Please do not hesitate to contact ACORE's Vice President of Government Affairs, Allison Nyholm at [nyholm@acore.org](mailto:nyholm@acore.org) or Senior Vice President of Programs and Sustainable Finance, Lesley Hunter, at [hunter@acore.org](mailto:hunter@acore.org) with any additional questions you may have.

Sincerely,

American Council on Renewable Energy  
American Clean Power Association  
Clean Energy Buyers Association  
Solar Energy Industries Association  
Arevon  
Avangrid  
BlueWave  
Clearway Energy  
Copenhagen Infrastructure Partners  
Cordelio Power  
Cypress Creek Renewables  
DNV Energy USA Inc.  
Ecoplexus Inc.  
EDF Renewables  
EDP Renewables  
EIP Storage, LLC  
Enel North America  
ENGIE North America  
Eolian, L.P.  
Form Energy  
HASI  
Hy Stor Energy  
Intersect Power  
Invenergy  
kWh Analytics  
Leeward Renewable Energy, LLC  
Longroad Energy  
MasTec, Inc.  
Mississippi Clean Hydrogen Hub  
Monarch Private Capital, LLC  
NextEra Energy  
Nordex USA  
Onward Energy  
Ørsted  
Pattern Energy  
Pine Gate Renewables, LLC  
Primergy Solar, LLC  
RWE  
SB Energy  
Siemens Energy, Inc.  
SOLV Energy  
Terra-Gen, LLC  
TPI Composites, Inc.  
Vesper Energy Development, LLC  
Vestas – American Wind Technology, Inc.

cc:

John Podesta, Senior Advisor to the President for Clean Energy Innovation and Implementation, White House Office of the Chief of Staff

Ali Zaidi, Assistant to the President & National Climate Advisor, Office of Domestic Climate Policy

Wally Adeyemo, Deputy Secretary of the Treasury, U.S. Department of the Treasury

Dorothy Lutz, Climate Policy Fellow, White House Office of Domestic Climate Policy

Brandon DeBot, Special Assistant to the President for Tax Policy