Mortgage Bankers Association
National Association of Realtors®
National Association of Home Builders
Community Home Lenders of America
United States Mortgage Insurers
Manufactured Housing Institute

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RE: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity

Docket ID OCC–2023–0008; RIN 3064–AF29; R–1813, RIN 7100–AG64

Dear Sir/Madam;

The undersigned organizations appreciate the opportunity to comment on the notice of proposed rulemaking (NPR) issued by the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC) and the Board of the Governors of the Federal Reserve System (the Board) (jointly, "the Agencies") to implement the final components of the Basel III standards to which the U.S. banking system has been gradually transitioning over many years. Each of our organizations will be submitting more detailed comments on this far-reaching proposal, but we want to highlight critical concerns and provide collective recommendations to fix key aspects of the NPR that needlessly threaten to restrict the availability and raise the cost of credit for residential mortgages.

The so-called Basel "end game" proposal will impact more than three dozen large US banks, including more than two dozen regional banks that support the mortgage market and are not currently subject to the heightened capital standards on U.S. GSIBs (Globally Systemically Important Banks). These large banks play a critical role in the mortgage market as lenders, mortgage holders, servicers, aggregators and providers of warehouse and MSR financing to independent mortgage bankers (IMBs) – functions that could be impaired if this rule is not changed. The rule will have far-reaching implications not just for housing but for the broader economy and was issued with virtually no economic impact analysis and few justifications for the mortgage-related changes.

We are particularly opposed to the following provisions of the NPR that would directly impact the mortgage and housing markets:

1. **Proposed revision to risk weights assigned to mortgages held on a bank's balance sheet**.

The NPR revises the current risk weights assigned to residential mortgages held on a large bank's balance sheet based on loan-to-value (LTV) ratio. Without supporting impact analysis, the Banking Agencies chose to "gold plate" the Basel framework risk weights for home mortgages by adding twenty percentage points across the board and removing any capital relief for the risk-mitigating effect of private mortgage insurance. As a result, large banks will face higher capital requirements than those imposed under the current applicable rules for loans with LTVs greater than 80%.

Although bank origination of residential mortgages has been declining in recent years -- due in significant part to current capital rules that make mortgages less attractive to hold -- bank portfolio lending continues to fill a market gap for mortgages to LMI borrowers that otherwise would not qualify for the government-backed loan programs that traditionally serve that market. Despite significant interest in the banking community to bridge access and affordability gaps in home ownership, the NPR will only make these goals more difficult to achieve. Moreover, the additional capital required for holding high-LTV loans directly contradicts the Agencies' policy objectives embodied in the recent major revision to the Community Reinvestment Act rules.

Recommendations:

Rather than pursue unnecessary gold-plating, we recommend that the Agencies:

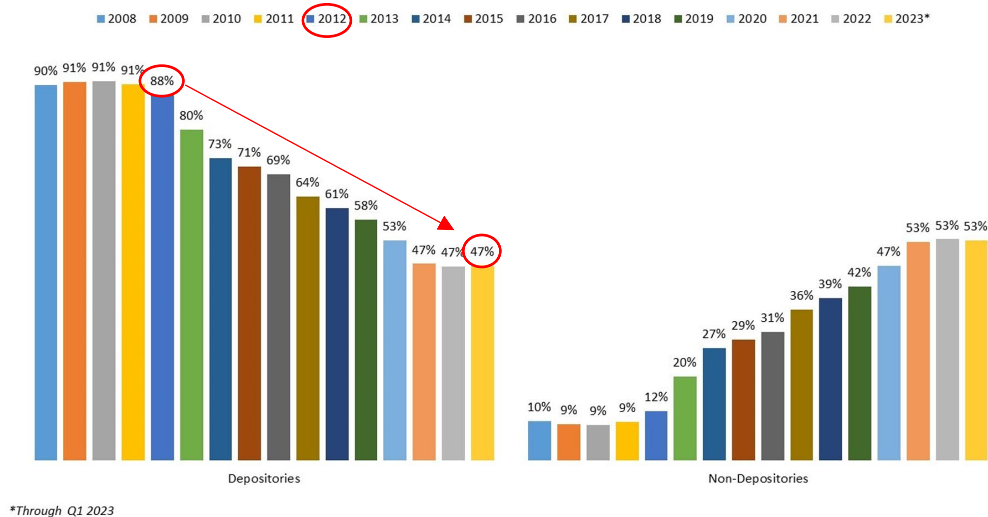
- adopt the Basel III recommended risk weights by LTV;
- provide appropriate credit for private mortgage insurance that reflects the coverage level on the loan; and
- in order to address the level playing field concerns cited in the NPR, provide smaller institutions the option to adopt the LTV-based risk weights and MI recognition.

2. **Proposed reduction in the cap on MSR holdings**

The NPR would revise the current framework for category 3 and 4 banks that caps MSRs as a percentage of common equity tier 1 (CET1) capital at 25%. Just 5 years ago, the Agencies raised the cap for all non-advanced approach banks from 10% to 25% to encourage banks to stay in the servicing business. With little explanation or analysis, the NPR proposes to reduce the cap back down to 10% for Category 3 and 4 banks.

The current risk weights for MSRs, put in place in 2013, are already excessive -- MSRs have an extremely high 250% risk weight, and MSRs above the CET1 cap are deducted from capital. The punitive treatment of MSRs has been cited by many analysts – including the Financial Stability Oversight Council – as a primary contributor to banks' exodus from the mortgage servicing market.[1] In 2012, the year before the current rules were put in place, banks held 88% of all servicing assets; today they hold only 47%.

Who Are the Mortgage Servicers?



By extending the punitive treatment of MSRs to even more banks, as proposed, banks are likely to resume their exit from the servicing market with significantly harmful downstream impacts on the mortgage market and consumers.

Reduced demand for MSRs will erode liquidity and impair MSR values not just for banks but for all market participants. Because the process of mortgage banking produces an MSR asset with every loan that is manufactured and sold, the NPR will impact IMBs, community banks, credit unions, and – most importantly – their borrowers. The value of the MSR asset is embedded as an interest rate "strip" – a portion of a borrower's note rate. When servicing assets are attractive and in high demand, the price of the mortgage is bid up, and the servicing strip and note rate to the borrower is reduced.

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[1] FSOC_20230421_Minutes.pdf (treasury.gov); page 7.

The proposed rule does the opposite – by making the capital treatment for servicing assets even more unattractive, banks will further reduce their appetite for mortgage servicing, MSR values will decline, and borrowers' financing costs will be higher as a result.

Recommendations:

Given the lack of supporting analysis and the significant market-wide impact of the proposed changes to MSR capital requirements, we recommend that the Agencies:

- retain the current 25% cap on MSRs as percentage of CET1; and
- reverse the recent bank exodus from mortgage servicing by lowering the current punitive 250% risk weight assigned to MSRs for all banks.

3. Proposed increase in the capital requirements on warehouse lines of credit

Banks serve the real estate finance market through direct lending to borrowers and also — just as critically — by providing revolving funding to IMBs to facilitate origination activity through warehouse lines of credit. Today, the warehouse lending channel supports more than half of all single-family mortgage origination – a share of the market that has grown substantially over the past decade.

The NPR proposes doubling the applicable "credit conversion factor" (CCF) for the unused portion of commercial lines of credit – including mortgage warehouse funding facilities -- from 20% to 40%. Because mortgage markets can experience significant demand volatility, IMBs secure funding facilities from multiple warehouse lenders and pre-position extra draw capacity to support potential spikes in application volume. Similarly, banks offer lines of credit to finance MSRs and mortgage servicing advances – a critical need to support servicing loss mitigation activities.

The proposed doubling of the CCF could make this additional liquidity – which served the market well during the recent pandemic refinance boom and forbearance wave – prohibitively expensive for banks to offer and their IMB customers to maintain. As a result, the NPR's treatment would make the U.S. housing finance market less resilient and less liquid.

Recommendations:

To ensure stable liquidity for the mortgage market, we recommend that the Agencies:

- preserve the current 20% credit conversion factor on any unused portion of a warehouse line; and

- reduce the current 100% risk weighting on warehouse lines to instead align with the risk weight of the underlying financial collateral.[2]

Conclusion

The undersigned organizations believe the NPR will diminish access to mortgage credit and further reduce the affordability of housing for first-time homebuyers and underserved communities – outcomes that are fundamentally at odds with key policy objectives of the current Administration. Our recommendations provide fixes to the proposed capital rule and address long-standing problems with the current rules that will strengthen the stability of our housing finance system by incenting large banks to increase their direct and indirect role in residential finance.

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[2] This recognizes the unique nature of warehouse lending, where the bank is actually in possession of the financial collateral securing the line.