MORTGAGE BANKERS ASSOCIATION

October 14, 2013

Honorable Ben S. Bernanke
Chairman
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
(Docket No. R-1460)

Honorable Thomas J. Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219
(Docket ID OCC-2013-0008)

Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th St, NW
Washington, DC 20429
(RIN No. 3064-AE01)

Re: Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions

Dear Sirs:

The Mortgage Bankers Association[1] (MBA) appreciates the opportunity to comment on the proposal *Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions* (Proposed Rule). The following contains background information and MBA's general comments and observations. Appendix A contains our response to specific questions contained in the Proposed Rule.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

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MBA's main recommendation in this letter is for U.S. bank regulators to recalibrate the proposed increase in the leverage ratio so that it does not become the primary tool for banks to allocate scarce capital. Risk-based capital is a much more precise measure and should be the primary regulatory capital driver.

Background

In 2010, the Basel Committee for Banking Supervision (BCBS), an international committee of bank regulators, issued the Basel III regulatory capital framework for implementation by the respective member countries. In addition to an update of the risk-based capital (RBC) framework, Basel III included a supplemental leverage ratio in which the denominator is measured using average on-balance sheet assets plus certain off-balance sheet exposures. The numerator is Tier 1 capital. In the leverage ratio, the assets in the denominator are not risk-weighted. The proposed minimum leverage ratio was set at 3 percent.

The risk-weighting of assets makes the RBC ratio a more precise measure of balance sheet safety and soundness. The leverage ratio, which is a blunt regulatory instrument, ignores the riskiness of the respective assets and focuses on overall leverage. It is meant to be a backstop to the RBC ratio to prevent a bank from loading up on low risk assets, like U.S. Treasury securities and Ginnie Mae MBS, which have a 0% risk weight but still carry some interest rate risk.

The Proposed Rule is applicable to the top eight banks in the United States and would raise the leverage ratio minimum to 5 percent for bank holding companies and to 6 percent for insured depositories owned by those bank holding companies. The eight banks are far from compliant with the Proposed Rule. Bank regulators acknowledge that using data from the third quarter of 2012, the eight bank holding companies would have to raise $63 billion in total Tier 1 capital to meet the proposed ratio[2]. Further, a prudent bank will want to maintain a safety margin in its regulatory capital ratios to prevent falling out of the "well-capitalized" category, so the capital deficit is really much higher than the $63 billion suggested.

General Comments

Will Change Management's Focus to ROA

Companies attempt to maximize profit and return for shareholders within economic and regulatory constraints. Today's RBC regime defines the scarce resource as capital, and capital is allocated to various loans and investments based upon RBC and return on that RBC. By raising the leverage ratio to the point where capital becomes scarcer from a leverage ratio standpoint than from a RBC standpoint, in order to maximize profits, banks will turn to return on assets (ROA) as the primary tool to allocate scarce capital. This could result in irrational decision-making from a safety and soundness standpoint and increase instead of decrease the systemic risk posed by large banks. For example, unsecured commercial loans or credit card loans, which have a higher ROA than repos collateralized

[2] *Federal Register*, Volume 78, No. 161, Tuesday August 20, 2013, page 51107.

by U.S. Treasury bills or Agency mortgage-backed securities, may be the incremental asset of choice. Single A rated securities may become more attractive than AAA securities under the proposed leverage ratio limits. See Appendix B for an example of how the leverage ratio can become the binding constraint for a bank, resulting in focus on ROA.

MBA recommends that the U.S bank regulators should, at a minimum, recalibrate the proposal so that leverage ratio truly becomes a back-up to the more precise RBC ratio and not the driving ratio for these large banks.

Will Put U.S. Banks at a Competitive Disadvantage

Since the BCBS proposal is for a 3 percent minimum leverage ratio, and the proposed U.S. standards would be significantly higher, MBA notes that this could disadvantage the largest U.S. banks as they attempt to compete on a global basis. In the absence of a BCBS change to match the Proposed Rule, U.S. bank regulators should recalibrate the required ratio downward so that the impact on competition is minimal.

Other Potentially Significant Unintended Consequences

The creation of a non-risk based capital limit that is close to being more restrictive than risk-based measures may have the following general consequences:

- Introduce banking industry capacity constraints at a time when the U.S. is still trying to recover from the recent recession.
- Increase the costs of lending on lower ROA products like mortgages, resulting in fewer consumers being able to afford mortgages. (See Appendix C for example of potential pricing impact.)
- Cause banks to select unsecured, riskier loan products over secured, less risky products solely on the basis of ROA.

Specific products key to real estate finance likely to be impacted by the Proposed Rule:

- Repos and other financing for businesses that presently receive low risk-weights and high return on equity (ROE) under RBC rules would be unattractive under the Proposed Rule because of low ROA. Thus, repos backed by Ginnie Mae, Fannie Mae or Freddie Mac MBS would be less attractive under the leverage ratio constraint.
- Unsecured commercial loans would be more attractive than secured lines of credit because they have a stronger ROA. In the mortgage banking industry, this could constrain warehouse lines of credit needed to finance the production of new mortgages and MBS. Such lines of credit are collateralized by highly-liquid mortgages in the process of delivery into the secondary market

The Proposed Rule could have a pro-cyclical impact:

- With ROA being the primary driver, as banks enter a downturn, they will look to shrink balance sheets where ROA is low and it is easiest to shrink balance sheet

footings. Thus, repo financing and warehouse lines of credit, essential for new mortgage production, will shrink because of lower ROA coupled with relatively fast turnover. This will magnify any housing recession impacts. This occurred during the last cycle when banks quickly exited or curtailed warehouse lending, making warehouse line availability one of the constraints that fed the housing recession.
- Loans to high quality investment grade counterparties will also be less attractive from an ROA standpoint and likely easier to wind down than loans to lower grade counterparties. This could put more risk in banks' portfolios, exacerbating a credit cycle. It could also make winding down a troubled bank ultimately more expensive to the FDIC.

The Proposed Rule would be counter to the regulatory initiative to increase liquidity.
- The Basel III framework adopted in the United States includes new minimum liquidity ratios.
- Liquid assets are generally assets with low risk-weighting under risk-based capital rules and low ROA.
- Liquid assets are relatively easy to wind down. Thus, with ROA and the leverage ratio as primary drivers, banks could be incented to wind down liquidity at the time that it is needed most.

The Proposed Rule could adversely impact liquidity and pricing throughout the banking system.
- Fed funds and due from bank accounts are assets with low risk-weighting and low ROA.
- In a crisis, banks could quickly reduce leverage by reducing Fed Funds and due from bank balances.
- This could adversely impact short-term money markets and have adverse downstream impacts on regional and community banks.

Attached please find in Appendix A MBA's responses to specific questions posed in the Proposed Rule.

MBA appreciates the opportunity to comment on the Proposed Rule. Any questions on MBA's response should be addressed to Jim Gross at 202-557-2860 or jgross@MBA.org.

Sincerely,

David H. Stevens
President and Chief Executive Officer

Appendix A

Responses to Specific Questions

Question 1: How would proposed strengthening of the supplementary leverage ratio for covered BHCs and their subsidiary IDIs contribute to financial stability and thus economic growth?

MBA's Response: See general comments above titled, *Will Change Management's Focus to ROA* and *Other Potentially Significant Unintended Consequences.* MBA believes the Proposed Rule will result in banks focusing more on ROA and less on return on risk-weighted capital resulting in potential irrational behavior and a reduction in financial stability. Further, the Proposed Rule could result in a reduction in lending with a negative impact on economic growth. MBA believes the Basel III framework has been positive for financial stability, and we question whether this effort to further limit leverage is necessary given the steps already taken.

Question 2: Would the proposed strengthening of the leverage ratio mitigate public-policy concerns about the regulatory treatment of banking organizations that may pose risks to the broader economy?

MBA's Response: No. The strengthening of the leverage ratio may increase public-policy concerns. See general comments above titled, *Will Change Management's Focus to ROA* and *Other Potentially Significant Unintended Consequences.*

Dodd-Frank included several efforts designed to reduce the systemic risk of the largest financial institutions. These moves were good public policy. No institution should be too big to fail. Increased capital requirements as part of the Basel III process were the right response. However, there are costs to the economy and the financial system to driving capital requirements higher than justified by the circumstances or imposing a "one size fits all" approach to assets of widely divergent credit risk and liquidity.

Question 3: The agencies solicit commenters' views on what economic data suggest about leverage ratios and risk-based capital ratios as predictors of bank distress and thus tools to prevent the failure of large systemically important banking organizations.

MBA's Response: We believe the data consistently shows that both asset quality and capitalization are essential factors to predicting distress, and thereby preventing failure, of banks and other financial organizations. Risk-based capital is an inherently superior methodology because it incorporates both factors. It is also more "fault tolerant" in that mis-estimating the appropriate risk weight for one asset class should have less impact on the predictive quality of the model. On the other hand, the simple leverage ratio model systematically mis-estimates the appropriate risk weight of virtually all asset classes by essentially imposing a 100% risk weight on every asset. The appropriate response to concerns over whether the risk weights assigned to particular asset classes

are properly calibrated is not to abandon the exercise altogether. Rather it is to infuse the process of estimating risk weight parameters with more empiricism and analytical rigor, just as it would be with any other important econometric model.

Question 4: Would the proposal create any risk-reducing incentives and around what specific activities? Would the proposal create incentives for subject banking organizations to take additional risk and if so, would this effect be expected to limit the safety and soundness benefits of the proposal?

MBA's Response: A leverage ratio rule would in general limit banks from holding on their balance sheet U.S. Treasury, Ginnie Mae MBS, and agency MBS or providing repo financing of these products to others. Although these securities carry little if any credit risk, they can pose interest rate risk. Repo financing of these products generally has even less interest rate risk because of the excess collateral requirements of the repo. However, an improperly calibrated leverage ratio that becomes the leading constraint for a bank can lead to a focus on ROA and not return on risk-weighted capital. See general comments above titled, *Will Change Management's Focus to ROA* and *Other Potentially Significant Unintended Consequences.*

The proposal would create incentives for banks to shed low return/low risk business lines, and move into high return/high risk business lines. Many of the low return/low risk business lines are effectively customer service businesses that meet short-term cash flow needs of households and businesses.

Question 5: What are commenters' views on the proposed calibration of the leverage standards? Is the proposed 6 percent well-capitalized standard for subsidiary IDIs and the proposed 5 percent minimum supplementary leverage ratio plus leverage buffer for covered BHCs appropriate or should these requirements be higher or lower? In particular with regard to covered BHCs, what are the advantages and disadvantages of establishing the minimum supplementary leverage ratio plus leverage buffer at 5 percent for all covered BHC's versus establishing the amount between 4 and 5.5 percent according to each covered BHC's risk-based reflect the minimum supplementary leverage ratio of 3 percent plus between 1 and 2.5 percent depending upon each covered BHC's risk-based capital surcharge)? With respect to the subsidiary IDIs of covered BHCs, the agencies seek commenters' views on what, if any, specific challenges these institutions would face in meeting the proposed well-capitalized threshold of 6 percent beginning on January 1, 2018.

MBA's Response: MBA believes that the Proposed Rule calibrates a leverage ratio threshold that is too high and would focus banks' attention inordinately on ROA instead of return on risk-weighted assets. Likewise, to keep U.S. banks competitive in the global markets, leverage ratio thresholds should be set at no higher than those set for other Basel nations. See general comments above titled *Will Change Management's Focus to ROA* and *Will Put U.S. Banks at a Competitive Disadvantage.*

Question 6: The agencies solicit commenters' views on whether a strengthened leverage ratio requirement would enhance the competitive position of U.S. banking organizations relative to foreign banking organizations by enhancing the relative safety of the U.S. banking system. Alternatively, could the proposed strengthened leverage ratio requirement place U.S. banking organizations at a competitive disadvantage relative to foreign banking organizations and if so, in what areas?

MBA's Response: MBA believes that the proposed rule will make the U.S. banking organizations potentially less safe because it will inordinately focus them on ROA instead of return on risk-weighted assets.

At the core of the Basel process is an attempt to harmonize capital standards globally and calibrate capital requirements to asset risk. This Proposed Rule runs directly counter to that goal, as it would place higher capital standards on large US banks and make them less competitive in the global markets. See general comments above titled *Will Change Management's Focus to ROA* and *Will Put U.S. Banks at a Competitive Disadvantage.*

Question 7: How would this proposal affect counterparty incentives and behavior?

MBA's Response: U.S. banks may be seen as having increased their risk if they are close to breaching the leverage limit and thus focusing on ROA not return on risk-weighted capital. See general comment above titled *Will Change Management's Focus to ROA.*

Question 8: The agencies seek commenters' views on the macroeconomic implications of the proposal, particularly the potential effects the proposal could have on the allocation of credit and the volume of lending. For example, could a strengthened leverage ratio requirement as proposed cause a shift in favor of lending to individuals and businesses as opposed to markets- based activity by banking organizations? If covered BHCs were better capitalized as a group, to what extent would this improve their ability to serve as a source of credit to the economy during periods of economic stress? Conversely, to what extent would the proposal create incentives for banking organizations to shrink or otherwise modify their activities?

MBA's Response: See general comment above titled *Will Put U.S. Banks at a Competitive Disadvantage.* The proposal could result in a shift of assets across the banking system. The transition would be uncertain, and could result in an increase in both market volatility and a reduction in the access to credit for certain key sectors of the financial markets.

Question 9: What are the incremental costs to banking organizations of the proposed rule compared to the costs of currently anticipated and planned capitalization initiatives?

MBA's Response: The incremental costs to banking organizations of the Proposed Rule could be significant since infrastructure will need to be put in place for off-balance sheet positions that must be included in the denominator of the leverage ratio and the calculation of the off-balance sheet portion of derivative contracts that must be included in the denominator of the leverage ratio.

Question 10: The agencies are interested in comment on the appropriate measure of capital that should be used as the numerator of the supplementary leverage ratio. Among the many measures of capital used by banks, regulators and the market, the agencies considered the following measures: (1) Common equity tier 1 capital, (2) tier 1 capital, (3) total capital, and (4) tangible equity (as these terms are defined in the agencies' capital regulations as of the date of the issuance of this proposed rule, including the 2013 revised capital approaches). What are the advantages and disadvantages of each of these as well as alternative measures?

MBA's Response: MBA believes that Tier 1 capital plus the allowance for losses should be used in the numerator since credit losses on loans and securities[3] are available to absorb credit losses before capital is impacted.

Question 11: What, if any, alternatives to the definition of total leverage exposure should be considered and why?

MBA's Response: MBA believes that the leverage ratio should be calibrated such that (1) it provides a similar result to the leverage rule applicable to other Basel nations and (2) will not make it the "limiting factor" when compared with RBC limits for most banks. The fact that the eight banks are presently short by $63 billion indicates that the leverage ratio hurdles are set too high under the Proposed Rule.

Question 12: In light of the proposed enhanced leverage requirement and ongoing standardized risk-based capital floors, should the agencies consider, in some future regulatory action, simplifying or eliminating portions of the advanced approaches rule if they are unnecessary or duplicative? Are there opportunities to simplify the standardized risk-based capital framework that would be consistent with safety and soundness or other policy objectives?

MBA's Response: There is an inherent conflict between the goal of simplifying capital regulation to avoid operational complexity and the goal of matching capital to risk. The final Basel III risk-based standard, particularly with respect to mortgages, balances these goals well. However, increasing reliance on the leverage ratio goes too far towards simplicity and neglects the potential impact of not matching capital to risk.

Question 13: The proposed scope of application is U.S. top-tier BHCs with more than $700 billion in total assets or more than $10 trillion in assets under custody and their

[3] Proposed rules by FASB and IASB would require allowance for losses to be recorded for debt securities as well as for loans.

subsidiary IDIs. Should the proposed requirements also be applied to other advanced approaches banking organizations? Why or why not? Should all IDI subsidiaries of a covered BHC be subject to the proposed well-capitalized standard, and if not, why? Please provide specific factors and the associated rationale the agencies should consider in establishing any exemption from the proposed well-capitalized standard.

MBA's Response: MBA believes that the Proposed Rule is ill-designed and itself may pose systemic risk. See general comment above titled *Other Potentially Significant Unintended Consequences.* Making the rule applicable to more banks would exacerbate the problem.

Appendix B

Example of How Leverage Becomes Binding Capital Constraint

Bank ABC

Balance Sheet as of 9/30/XX

	(000,000's)	Risk Weight	Risk Weighted
Assets:			
Cash	$ 15,000	0%	$ -
U.S. Treasury and GNMA	200,000	0%	-
U.S. Agency Securities	100,000	20%	20,000
Residential mortgages	200,000	50%	100,000
Credit card receivables	50,000	100%	50,000
Commercial loans	100,000	100%	100,000
Other assets	10,000	100%	10,000
Total assets:	$ 675,000		$ 280,000
Liabilities and Capital:			
Deposits	$ 630,000		
Other Liabilities	5,000		
Total liabilities	635,000		
Capital:	40,000		
Total Liabilities and Capital:	$ 675,000		

NUMERATOR	$ 40,000	
DENOMINATOR	$ 280,000	
Risk-based capital ratio	14.29%	Well-capitalized

Leverage Ratio	5.93%	Inadequate capital

This is a case where the limiting factor is now the leverage ratio, and this bank may start managing based on ROA not return on risk-weighted capital.

Appendix C

Customer Pricing Impact Example

	Today's Leverage Rule		Proposed Leverage Rule	
If:				
Repo facility	$	100.00	$	100.00
Minimum leverage ratio		3%		6%
Targeted return on capital:				
After tax		12%		12%
Pre-tax (Assume 35% tax rate)		18.5%		18.5%
Bank cost of funds		-0.150%		-0.150%
Then:				
Required capital	$	3.00	$	6.00
Targeted net yield	$	0.554	$	1.108
Cost of funds	$	(0.150)	$	(0.150)
Targeted gross yield in dollars	$	0.704	$	1.258
Targeted gross yield as % of principal		0.70%		1.26%
Change in required repo yield		**0.55%**		
Percentage increase in pricing to repo customer		**78.69%**		