COLONIAL
Banking | Home Loans | Insurance

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Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th Street SW
Suite 3E-218, Mail Stop 9W-11
Washington, DC 20219

Submitted electronically via: www.regulations.gov; Docket ID OCC-2017-0018

RE: Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996 ("EGRPRA")

Dear Sir or Madam:

The adoption by the federal banking agencies of the "Transitions NPR"[1], which stayed the phase-in of capital rules implemented under Dodd-Frank and Basel III (hereinafter referred to as "DFA-Basel III") in 2013, was very much appreciated. Thank you for this opportunity to provide additional commentary to achieve significant regulatory capital simplification for smaller financial institutions beyond this initial stop-gap measure via the proposed "Simplifications NPR"[2].

Colonial Savings, F.A., is a federal savings association with $1.1 billion in total assets, $208.4 million in mortgage servicing assets (MSAs), and $247.4 million in equity[3] as of September 30, 2017. Computed without regard to the DFA-Basel III regulatory adjustments that limit MSAs, the tier one capital leverage ratio is 22.4% as of the most recent quarter end. Under the Transitions NPR, the MSA limitation results in a deduction of $146.9 million from capital and reduces the leverage capital ratio to 10.3%.

This limitation of MSAs is of particular concern. Please consider my comments below, which I believe are necessary to achieve simplification and retain an appropriate regulatory capital treatment to maintain the safety and soundness of the banking system.

Question 9: *What impact would the agencies' proposed changes to the treatment of MSAs, temporary difference DTAs, and investments in the capital of unconsolidated financial institutions for non-advanced approaches banking organizations have on (i) risks to the safety and soundness of the banking system and (ii) regulatory burden on non-advanced approaches banking organizations? If possible, please provide relevant data to support comments.*

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[1] 82 FR 55309 (November 21, 2017). Regulatory Capital Rules: Retention of Certain Existing Transition Provisions for Banking Organizations That Are Not Subject to the Advanced Approaches Capital Rules.
[2] 82 FR 49984 (October 27, 2017).
[3] CET1 elements of common stock (plus related surplus) and retained earnings; Schedule RC-R, Part 1, Lines 1. and 2.

In short, I believe the proposal has not removed the DFA-Basel III limitations enough for smaller to mid-sized institutions (up to $50 billion in assets) to continue serving this important segment of the economy – housing – in a safe and sound manner. Exhaustive research across multiple reports failed to identify a conclusive basis or explanation of a 25% limitation. This percentage is approximately equal to the currently frozen level of the phased-in percentage, which disallows 72%[4] compared to a 75% disallowance under this proposed Simplifications NPR.

In the federal banking agencies' Report to the Congress on the Effect of Capital Rules on Mortgage Servicing Assets[5] ("MSA Effect Report"), it is enumerated that a number of failed depository institutions reported significant reductions in the values of their MSAs leading up to their failures. Additionally, the report concludes that smaller banks (less than $10 billion in assets) only increased their MSA holdings (as a percentage of CET1) because of the withdrawal of the aggregators from the market[6] - a forced business strategy on the part of smaller banks.

Therefore, by logical extension, the Simplifications NPR has proposed a 25% limit on the amount of MSAs in regulatory capital as being necessary to continue to protect banking organizations from sudden fluctuations in value.

However, it was noted the analysis of the effect of MSAs ***excluded*** savings associations from the failed bank data[7] and from the discussion of the role of mortgage servicing[8]. Because the analysis so glaringly neglected this subset of financial institutions, I believe a different conclusion regarding the effects of MSAs may have been reached had the data analyses included well-capitalized savings institutions.

As discussed in more depth below, for well-capitalized institutions that make mortgage servicing their primary business model, removing the 25% limitation would achieve a simpler capital framework. Retaining the increased risk weight of MSAs from 100% to 250% would effectively limit the concentration risk and contribute to the safety and soundness of these institutions.

Question 11: *What, if any, operational challenges does the proposed treatment of MSAs, temporary difference DTAs, and investments in the capital of unconsolidated financial institutions pose? What, if any, modifications should the agencies consider to address such challenges?*

The proposed threshold is unduly restrictive to an institution with a charter that is designed to promote and foster home ownership through mortgage lending. Retention of servicing rights is desired as a means to retain the customer relationship and promote stability across a variety of financial planning needs for our current customer base.

With the lower amount of MSAs includable in capital under the proposal and a higher risk weight assigned to that portion, "fewer banks may want to retain these servicing

[4] Individual threshold of 10% with 90% disallowed times 80% phase-in freeze (90% x 0.80 = 72% disallowed).
[5] Report to the Congress on the Effect of Capital Rules on Mortgage Servicing Assets, June 2016, https://www.federalreserve.gov/publications/other-reports/files/effect-capital-rules-mortgage-servicing-assets-201606.pdf.
[6] Ibid., 31.
[7] Ibid., 13.
[8] Ibid., 19.

rights and instead may seek to sell them to nonbank financial institutions that are not subject to [these rules]."[9]

As discussed below in response to questions 14 and 15, for institutions with higher leverage capital removing the capital threshold limitations and reducing the risk-based capital weights to five (the four originally implemented in 1992 plus the 250% risk-weight for MSAs) would be an appropriate step toward simplifying the capital framework.

Jointly responding to Questions 14 and 15:

Question 14: *While the proposed rule addresses comments received during the EGRPRA review regarding the complexity of the risk based capital standards, the agencies seek comment on additional alternatives to simplify and streamline the regulatory capital rules. The agencies recognize the difficulties in achieving simplification of the risk based capital standards, particularly the burden related to their calculation and reporting, and the potential disparate impact to smaller and medium sized banks relative to their GSIB counterparts. Therefore, the agencies seek comment on whether they should consider a fundamental change to the manner in which banking organizations calculate and comply with minimum capital standards such as through the use of a simple U.S. GAAP based equity to assets ratio (leverage ratio) for non-GSIB banks. If so, what would be the appropriate definition and level for the ratio? Also, what relief should be realized upon implementation of this capital standard relative to changes in the call report and other reporting standards?*

Question 15: *The agencies also seek comment on whether they should consider more comprehensive simplifications to the capital rule for small and medium-sized banking organizations by, for example, further simplifying risk-weighted assets and the definition of capital, or reducing the number of regulatory capital ratios, consistent with legal requirements. What specific simplifications should the agencies consider and why?*

Worthy of reconsideration to achieve a simpler capital framework is the following excerpt from the April 9, 2013, appeal made by Senators Bob Corker, David Vitten, Susan Collins, Sherrod Brown, and Elizabeth Warren while addressing the Federal Reserve Bank Board of Governors, Thomas J. Curry, OCC Comptroller, and Chairman Gruenberg, FDIC[10] (underline added for emphasis):

> *"There is widespread, bipartisan agreement that excessive leverage played a major role in the 2008 financial crisis and ensuing need for taxpayer bailouts.* ***<u>Constraining leverage through the use of a simple and effective leverage ratio</u>*** *would go a long way toward correcting deficiencies in the capital regulation of large, complex financial institutions that proved to be seriously over leveraged prior to the crisis.*
>
> *In addition, we believe that we* ***<u>should not move forward with an overly complicated capital regime for smaller institutions</u>****. As you know, community banks, for example, have a very different business models than globally active financial institutions, and while there may be merit in improving the capital framework applicable to them, this should be a secondary priority to constraining leverage at the largest firms. The new Basel III capital standards were designed for large, internationally active banks, as was appropriate. We urge you to complete work on capital standards for the largest banks before turning to the smaller institutions. Then,* ***<u>devise a simpler framework that, unlike the current proposals, will be within read and capabilities of community institutions.</u>****"*

[9] GAO-17-93; Report to the Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate – Mortgage-Related Assets, Capital Requirements Vary Depending on Type of Asset (December 2016); page 20.
[10] www.regulations.gov; Docket ID OCC-2012-0008-1746 (April 9, 2013). Comment letter submitted in response to <u>Regulatory Capital Rules (Part I): Regulatory Capital, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions</u>.

As well, in November of 2011, Federal Reserve Board Governor Daniel K. Tarullo stated in The Evolution of Capital Regulation[11],"It is instructive that during the height of the crisis, counterparties and other market actors looked almost exclusively to the amount of tangible common equity held by financial institutions in evaluating the creditworthiness and overall stability of those institutions. They essentially ignored the Tier 1 and total risk-based capital ratios in regulatory requirements."

These preceding excerpts underscore the limitations inherent in risk-based capital requirements and how users of capital ratios always fall back to the leverage capital ratio to determine strength. Risk weights may indicate areas of credit-risk in the balance sheet, but do not address liquidity or interest-rate risk, which can cause banks and nonbank mortgage servicers to fail.

For small to mid-sized institutions (up to $50 billion in assets) not subject to the market-risk rules, consider the following modifications:

1) For institutions that maintain a common equity tier 1 leverage ratio of Nine Percent (9%)[12] or higher, no threshold limitation for MSAs, deferred tax assets, and investments in the capital of unconsolidated financial institutions (Basel III Regulatory Adjustments).
2) Reduce the number of risk-weight categories to five: 0%, 20%, 50%, 100%, 250%, with MSAs retaining a 250% risk-weight.

CONCLUSION

Maintaining a higher common equity leverage ratio is a better overall indicator of capital strength and lower default risk. Additionally, the higher capital levels that allow growth in MSAs reward institutions that want to pursue the mortgage service business in order to lower servicing costs through economies of scale. This drives down costs to consumers, retains mortgage servicing among regulated agencies, and fuels a very important sector of our economy – housing. The higher core capital level ensures these institutions are not a safety and soundness concern.

Thank you for this opportunity to comment.

Sincerely,

Ron Hopkins, CPA
Regulatory Reporting

[11] https://www.federalreserve.gov/newsevents/speech/files/tarullo20111109a.pdf
[12] Reviewed UBPR (9/30/17), All Banks in Nation Peer Group Average Distribution (by Percentile Rank) Report; Selected ratio between the Tier One Leverage Capital Ratios for 10th percentile ranking at 8.60% and 9.14% for 20th percentile ranking; level of capital would include a super majority of all banks in nation.