December 22, 2017

The Honorable Janet L. Yellen
Chair
Board of Governors of the Federal Reserve System
Eccles Board Building
20th and C Street, N.W.
Washington, D.C. 20219

The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Mr. Joseph Otting
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, D.C. 20219

Submitted electronically.

Re: Docket ID OCC–2017–0018, Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996

Dear Chair Yellen, Chairman Gruenberg, and Comptroller Otting:

MidFirst Bank[1] (MidFirst or the Bank) generally supports the direction the proposed rule takes to simplify the capital rules, particularly the increases to the caps for mortgage servicing assets (MSAs) and investments in capital of unconsolidated financial institutions, as well as the elimination of the aggregate 15% cap for non-advanced approaches. We agree that each asset class should be treated individually. However, we recommend further refinements in the rule regarding the treatment of both asset classes.

Summary of Recommendations:

As a mid-sized bank, MidFirst has long believed that the capital treatment of MSAs and investments in capital of unconsolidated financial institutions deserved modification. With

[1]MidFirst is a federally chartered savings association with $14 billion in assets and ranks as one of the nation's premier privately held banks. Headquartered in Oklahoma City, MidFirst Bank has more than 50 banking centers in Oklahoma, 22 banking centers in Arizona, three (3) banking centers in Denver, and one banking center (1st Century Bank, a division of MidFirst) in Los Angeles. In addition, MidFirst services home mortgage loans nationwide and is the 13th largest servicer of Federal Housing Administration loans in the country.

changes in the residential mortgage market, including the advent of the Ability-to-Repay rules, the CFPB Mortgage Servicing Rules, and corresponding underwriting and servicing operational changes, MSAs represent a significantly different asset from when the Basel III capital rules were first proposed and later finalized. MSAs also differ inherently from a true intangible asset in that they have defined cash flows. As such, we agree that MSAs should be treated independent of intangible assets and the established caps should reflect their uniqueness. However, we disagree that a 250% risk-weighting should be applied to MSAs in excess of the 25% of the common tier 1 equity capital threshold. Rather, the risk-weighting should be reduced to 100% to reflect the highly regulated regime in which they exist, and the prevalence of credit-enhancement on the underlying residential loans.

With respect to investments in capital of unconsolidated financial institutions, or more specifically, Trust Preferred Securities (TruPS) it is important to recognize that: (a) no new TruPS have been, or can be, issued; (b) all TruPS that are currently outstanding were issued by financial institutions that successfully weathered the 2008 economic downturn and now operate in a more closely-regulated environment; and (c) TruPS held as assets are already subject to stringent accounting rules that include write-downs for projected future risk. For these reasons, we urge the regulators to remove the capital deduction for TruPS required by Basel III and permit banks to retain the diversified assets that remain.

Each of these dynamics suggests that it is now appropriate to revisit the original assumptions that gave rise to the Basel III capital regulations, and in combination they make a clear case for change in capital treatment.

Analysis of the Relief Proposed:

In this comment letter, MidFirst Bank focuses on the relief proposed as it impacts (1) MSAs and (2) TruPS because of their meaningful holdings in both asset classes.

- **Elimination of the aggregate 15% deduction threshold.**

The aggregate deduction provisions contained in the Basel III capital are properly eliminated. MidFirst believes that each of these assets should be considered on its own and that, if applied properly by financial institutions, and subject to regulatory oversight, the need for an aggregate cap is obviated. MSAs, deferred tax assets (DTAs), and TruPS present such varied and uncorrelated risks that their grouping has always seemed incongruous. As a result, MidFirst supports the elimination of the 15% aggregate deduction threshold.

- **MSAs.**

As a federally chartered savings association, MidFirst Bank's core business is to serve the residential mortgage market. For MidFirst Bank, this takes the shape of servicing government-insured residential mortgage loans. For the reasons outlined below, MidFirst Bank asserts that the 250% risk weighting assigned to MSAs above the 25% threshold is excessive and would cause significant hardship to mid-sized institutions that are committed to the asset class. Instead, the regulatory agencies to which this letter is addressed (the Agencies) should reduce the risk weighting to reflect the current realities of the market. Moreover, the Agencies should seek ways to recognize the value of government guaranteed credit enhancements on the underlying collateral.

- **MSAs are subject to accounting treatments, deposit insurance rules, and hedging strategies that are not considered in the proposed rule.**

The rigorous controls that exist on an institution's treatment of MSAs are sufficient to grant a 100% risk-weighting for non-deducted MSAs. Each of the controls seeks to prevent an artificial inflation of the value of the asset. First, the periodic (no less than annually) valuation analyses that are required under current accounting rules have the practical impact of ensuring that MSAs are carried at or below their market value. Second, institutions know how to successfully hedge the interest rate risk associated with MSAs, which is a common and widespread practice. Third, to further manage risks associated with these assets, regulators already require banks to meet certain minimum risk-based capital ratios.

A persistent theme in the rationale for punitive treatment of MSAs is the "high level of uncertainty regarding the ability of banking organizations to realize value from these assets, especially under adverse conditions."[2]. This theme was previously discussed in the June 2016 Report to the Congress on the Effect of Capital Rules on Mortgage Servicing Assets, which was drawing its conclusions from a flawed analysis of failed institutions during the crisis and the resulting ability of the FDIC to sell the residual MSAs of the failed institution in liquidation. The FDIC's experience in liquidating MSAs of failed institutions on an "as-is, where-is" basis should not be a justification to punish ongoing concerns in a well-capitalized institution.

MidFirst Bank requests that the Agencies retain the 100% risk weighting for non-deducted MSAs.

- **Basel III has shifted the business of mortgage servicing from well-regulated insured depository institutions to lightly regulated non-banks, to the detriment of consumers and contrary to the goal of Basel III of increasing the stability of the system.**

MSAs have been a significant component of MidFirst's business plan for decades. A key part of the Bank's strategy is its specialization in servicing government-insured loans (FHA, VA, and USDA), which allows it to establish long-term customer relationships and provide excellent service to these customers in a responsible and publicly accountable way. MidFirst's servicing business is subject to no fewer than three federal regulators, all of which have consistently assigned high ratings to the Bank's operations, thus establishing MidFirst as a top-tier servicer. The transparency required under such rigorous regulatory oversight creates a culture of accountability that ultimately results in real benefits to the Bank's servicing customers. MidFirst sees value in that kind of enhanced regulatory oversight, but in the post-Basel III era, the punitive capital treatment levied by Basel III has caused MSAs to continue to shift to non-bank

[2] *Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996*. 84 FR 49992 (October 27, 2017).

servicers that are not supervised by prudential regulators charged with ensuring both regulatory compliance and institutional safety and soundness, and are arguably less publicly accountable for errors and non-compliance.

This shift in the asset from highly regulated entities to less regulated entities was likely an unintended consequence of the Basel III rules. One of the primary purposes behind implementation of Basel III was to increase the safety and soundness of the financial system by limiting concentrations in certain asset classes for the predominant institutions of the day, which were banks. However, the impact of the imposed limitations on MSRs has had the opposite effect. By driving the asset from the diverse holdings of banks and into non-bank mortgage companies, MSAs are now predominantly held by non-bank financial institutions that are subject to less prudential regulation and less aggressively enforced capital requirements. Consumers will also bear the brunt of such a move, as they will be unable to rely upon regulators to hold institutions responsible for inadequate operational procedures that result in poor treatment of customers.

MidFirst believes that if the proposed rule's retention of the 250% risk-weighting for non-deducted assets were implemented, further flight of the asset to unregulated entities is guaranteed, which could threaten the stability of the financial system and lead to poor outcomes for consumers.

- **With the advent of the "Ability to Repay Rules" and other important legislative and regulatory developments relating to the residential mortgage market, Basel III's punitive risk-weighting standards are no longer necessary.**

From a safety and soundness perspective and a regulatory burden perspective, the punitive risk weight assigned to MSAs should be reconsidered. There have been significant changes in the legal landscape governing mortgages since the Basel Committee recommendations regarding MSAs. When proposed by the Basel Committee in 2012, the treatment of MSAs was viewed in light of the economic crisis that was (in part) set off by abuses in the U.S. mortgage lending market. MSAs were viewed as particularly risky in 2012 as a result of poor mortgage performance during the crisis (2008-2012) when subprime and Alt-A mortgage defaults spiked total mortgage default rates to historical highs. However, the mortgage crisis was linked to origination practices and home prices — not MSRs. Banks know how to hedge and manage MSAs, as evidenced by the fact that there were no confirmed bank failures resulting solely, or even primarily, from MSA holdings. In addition, since 2012 a host of mortgage market reforms have been enacted to enhance stability in the mortgage market including, but not limited to the Ability-to-Repay rules and Truth in Lending Act changes. When viewed in combination, the underwriting improvements driven by statutory changes in the mortgage market have had the net result in further stabilizing the value and performance of MSAs.

In sum, the legislative and regulatory developments that have restored prudence to the residential mortgage market have addressed concerns that make the punitive risk-weighting seem particularly excessive. This heavy-handedness and redundancy with respect to MSAs risk weighting does not meet a rational cost-benefit analysis. MidFirst suggests that the Agencies remove the punitive restrictions placed on MSAs by changing the risk-weighting back to 100%.

- **The Agencies should consider the value of mortgage insurance in the risk-weighting of MSRs and how the credit enhancement offsets any capital deduction requirements.**

As stated previously, a majority of the loans that MidFirst services are government-insured through the FHA, VA, and USDA programs. These loans are backed by the full faith and credit of the United States and pose little to no credit risk to bondholders or lenders who own the loans. The Agencies have recognized the strength of this guarantee and assigned loans insured by FHA a 20% risk-weighting for banks that put these loans (or securities collateralized by these loans) on their balance sheets. It stands to reason that the servicer of that same loan should not be subjected to more onerous treatment by the Agencies.

The main risk to servicers of a government insured loan is a liquidity event set off by a rash of unexpected delinquencies, or major operational defects on the part of the servicer that would trigger significant offsets to the amount claimed under government guarantees. As such, we think that the Agencies should consider offering a capital relief option for well-performing servicers (as measured by the government insurance programs) from the 250% risk-weighting. This "earned" relief would be subject to frequent review and only available to those institutions that affirmatively seek, and qualify for, the relief.

- **TruPS.**

Similar to MSAs, TruPS exist in a new legal and accounting environment that obviates the need for the continued punitive treatment of the asset class under the Basel III rules. Since the final Basel III rules were promulgated, TruPS have been significantly written down under current accounting rules to reflect all realized and projected future defaults. The TruPS that remain constitute diversified, long-term investments with adjustable interest rates, but only if they can be retained. Given that there have been no new issuances since 2007, the TruPS market is stable and winding down. Continued adverse treatment is not necessary and is disproportionally harming smaller community banks.

Approximately 25 community banks were very severely affected by the adoption of the Basel III risk-weighting for TruPS. The net impact on the capital base of U.S. institutions is estimated to be approximately $150 million across these 25 community banks, thus disproportionally impacting the lending capacity of these smaller institutions. According to industry studies, elimination of the deduction would create additional lending capacity in excess of $1.5 billion.

MidFirst suggests that the Agencies remove the any capital deduction for TruPS required by Basel III.

Reponses to Selected Questions Posed:

9. What impact would the agencies proposed treatment 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, provide relevant data to support comments.

(i) *The Risks to the safety and soundness of the banking system of a 250% risk-weighting for non-deducted MSAs*:

MidFirst's servicing business is subject to no fewer than three federal regulators, all of which have consistently assigned high ratings to the Bank's operations, thus establishing MidFirst as a top-tier servicer. The transparency required under such rigorous regulatory oversight creates a culture of accountability that ultimately results in real benefits to the Bank's servicing customers. MidFirst sees value in that kind of enhanced regulatory oversight, but in the post-Basel III era, the punitive capital treatment levied by Basel III has caused MSAs to continue to shift to non-bank servicers that are not supervised by prudential regulators charged with ensuring both regulatory compliance and institutional safety and soundness, and are arguably less publicly accountable for non-compliance.

This shift in the asset from highly regulated entities to less regulated entities was likely an unintended consequence of the Basel III rules. One of the primary purposes behind implementation of Basel III was to increase the safety and soundness of the financial system by limiting concentrations in certain asset classes for the predominant institutions of the day, which were banks. However, the impact of the imposed limitations on MSRs has had the opposite effect. By driving the asset from the diverse holdings of banks and into non-bank mortgage companies, MSAs are now predominantly held by non-bank financial institutions that are subject to less prudential regulation and less aggressively enforced capital requirements. Consumers will also bear the brunt of such a move, as they will be unable to rely upon regulators to hold institutions responsible for inadequate operational procedures that result in poor treatment of customers.

MidFirst believes that if the proposed rule's retention of the 250% risk-weighting for non-deducted assets were implemented, further flight of the asset to unregulated entities is guaranteed, which could threaten the stability of the financial system and lead to poor outcomes for consumers.

(ii) *The regulatory burden on mid-sized savings and loan holding companies of a 250% risk-weighting for non-deducted MSAs*:

- MSAs are subject to accounting treatment, deposit insurance rules, and hedging strategies such that additional punitive capital treatment unnecessarily increases the expense of the asset without a commensurate enhancement to safety and soundness.

When viewed on balance, the rigorous controls that exist on an institution's treatment of MSAs are sufficient to grant a 100% risk-weighting for non-deducted MSA's. Each of the controls listed above seeks to prevent an artificial inflation of value of the asset. First, the periodic (no less than annually) valuation analyses which are required under current accounting rules have the practical impact of ensuring that MSAs are carried at or below their market value. Second, institutions know how to successfully hedge the interest rate risk associated with MSAs, which is a common and widespread practice. Third, to further manage risks associated with these assets, regulators already require banks to meet certain minimum risk-based capital ratios.

A persistent theme in the rationale for punitive treatment of MSAs is the "high level of uncertainty regarding the ability of banking organizations to realize value from these assets, especially under adverse conditions." This theme was previously discussed in the June 2016 Report to the Congress on the Effect of Capital Rules on Mortgage Servicing Assets, which was drawing its conclusions from a flawed analysis of failed institutions during the financial crisis and the resulting ability of the FDIC to sell the residual MSAs of the failed institution in liquidation. The FDIC's experience in liquidating MSAs of failed institutions on an "as-is, where-is" basis should not be a justification to punish ongoing concerns in a well-capitalized institution.

MidFirst Bank requests that the Agencies retain the 100% risk weighting for non-deducted MSAs.

- With the advent of the "Ability to Repay Rules" and other important legislative and regulatory developments relating to the residential mortgage market, the Basel III's punitive risk-weighting standards for MSAs do not meet a rational cost-benefit analysis.

From a safety and soundness perspective and a regulatory burden perspective, the punitive risk weight assigned to MSAs should be reconsidered. There have been significant changes in the legal landscape governing mortgages since the Basel Committee recommendations regarding MSAs. When proposed by the Basel Committee in 2012, the treatment of MSAs was viewed in light of the economic crisis that was (in part) set off by abuses in the U.S. mortgage lending market. MSAs were viewed as particularly risky in 2012 as a result of poor mortgage performance during the crisis (2008-2012) when subprime and Alt-A mortgage defaults spiked total mortgage default rates to historical highs. However, the mortgage crisis was linked to origination practices and home prices – not MSRs. Banks know how to hedge and manage MSAs, as evidenced by the fact that there were no confirmed bank failures resulting solely, or even primarily, from MSA holdings. In addition, since 2012 a host of mortgage market reforms have been enacted to enhance stability in the mortgage market including, but not limited to, the Ability-to-Repay rules and Truth in Lending Act changes. When viewed in combination, the underwriting improvements driven by statutory changes in the mortgage market have had the net result in further stabilizing the value and performance of MSAs.

In sum, the legislative and regulatory developments that have restored prudence to the residential mortgage market have addressed concerns that make the punitive risk-weighting seem particularly excessive. This heavy-handedness and redundancy with respect to MSA risk weighting does not meet a rational cost-benefit analysis. MidFirst suggests that the Agencies remove the punitive restrictions placed on MSAs by changing the risk-weighting back to 100%.

10. **What are the benefits and drawbacks of (i) proposed elimination of the 250% risk weight for significant investments in the capital of unconsolidated financial institutions in the form of common stock and (ii) the proposed risk-weighting methodology for investments in the capital of unconsolidated financial institutions when such investments are in the form of equity exposures?**

With respect to investments in capital of unconsolidated financial institutions, or more specifically, Trust Preferred Securities (TruPS) it is important to recognize that: (a) no new TruPS have been, or can be, issued; (b) all TruPS that are currently outstanding were issued by financial institutions that successfully weathered the 2008 economic downturn and now operate in a more closely-regulated environment; and (c) TruPS held as assets are already subject to stringent accounting rules that include write-downs for projected future risk.

TruPS exist in a new legal and accounting environment that obviates the need for the continued punitive treatment of the asset class under the Basel III rules. Since the final Basel III rules were promulgated, TruPS have been significantly written down under current accounting rules to reflect all realized and projected future defaults. The TruPS that remain constitute diversified, long-term investments with adjustable interest rates, but only if they can be retained. Given that there have been no new issuances since 2007, the TruPS market is stable and winding down. Continued adverse treatment is not necessary and is disproportionally harming smaller community banks.

Approximately 25 community banks were very severely affected by the adoption of the Basel III risk-weighting for TruPS. The net impact on the capital base of U.S. institutions is estimated to be approximately $150 million across these 25 community banks, thus disproportionally impacting the lending capacity of these smaller institutions. According to industry studies, elimination of the deduction would create additional lending capacity in excess of $1.5 billion.

For these reasons, we urge the regulators to remove the capital deduction for TruPS required by Basel III and permit banks to retain the diversified TruPS assets that remain.

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

(i) *Operational Challenges posed by the 250% risk-weighting of non-deducted MSAs:*
The 250% risk-weighting limits MidFirst Bank's ability to grow its successful servicing business. MidFirst is regularly recognized by Ginnie Mae as a top-tier servicer, and both the market and consumers value MidFirst's ability to manage this asset. If the 250% risk-weighting were to take effect, MidFirst would need to seriously examine its ability to serve the market beyond the existing portfolio.

As a result, MidFirst Bank suggests that the Agencies remove the punitive restrictions placed on MSAs by changing the risk-weighting back to 100%.

(ii) *Modifications to the 250% risk-weighting of non-deducted MSAs:*
The Agencies should study how to include the value of mortgage insurance in the risk-weighting of MSRs and how that credit enhancement can offset capital deduction requirements.

A majority of the loans that MidFirst services are government-insured through the FHA, VA, and USDA programs. These loans are backed by the full faith and credit of the United States and pose little to no credit risk to bondholders or lenders who own the loans. The Agencies have recognized the strength of this guarantee and assigned loans insured by FHA a 20% risk-weighting for banks that put these loans (or securities collateralized by these loans) on their balance sheets. It stands to reason that the servicer of that same loan should not be subjected to more onerous treatment by the Agencies.

The main risk to servicers of a government-insured loan is a liquidity event set off by a rash of unexpected delinquencies, or major operational defects on the part of the servicer that would trigger significant offsets to the amount claimed under government guarantees. As such, we think that the Agencies should consider offering a capital relief option for well-performing servicers (as measured by the government insurance programs) from the 250% risk-weighting. This "earned" relief would be subject to frequent review and only available to those institutions that affirmatively seek, and qualify for, the relief.

Conclusion:

Thank you very much for considering these issues regarding the proposed. If the Agencies would like additional information or context regarding these comments, please contact me.

Sincerely,

[redacted]

M. Randolph Sparks
General Counsel
MidFirst Bank