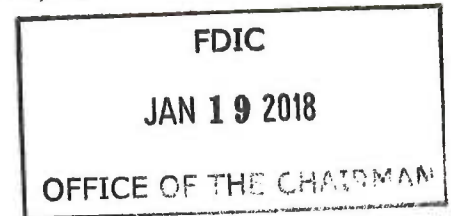




Success through Partnership

December 20, 2017

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



The Honorable Jerome Powell  
Chair  
Board of Governors of the Federal Reserve System  
Eccles Board Building  
20<sup>th</sup> and C Street, N.W.  
Washington, D.C. 20219

The Honorable Joseph Otting  
Comptroller of the Currency  
Office of the Comptroller of the Currency  
400 7<sup>th</sup> Street, N.W.  
Washington, D.C. 20219

Re: Proposed Rule for the Simplification of Capital Rules – 82 Federal Register 49984 (October 27, 2017)

Dear Chairman Gruenberg, Chairman Powell, and Comptroller Otting:

Fremont Bank, a \$3.8 billion California state chartered commercial bank in the San Francisco Bay Area (and its holding company, Fremont Bancorporation) in general supports the Agencies' proposal to simplify the risk-based capital standards to address certain problems, most notably the provisions affecting Mortgage Servicing Assets (MSAs). It also wishes to comment on certain aspects of the proposal dealing with MSA's.

The Basel III capital rule which was finalized in 2013 included a multi-year transition period that phases in certain aspects of the rule. In general, during the transition period banks must phase in the capital deduction requirement for the amount of MSAs that exceed 10% of common equity. These deductions are currently taken at 80% of the full amount and are scheduled to be fully phased in by 2018. The Proposed Rule would increase the MSA deduction threshold from 10% to 25% of Common Equity Tier 1 Capital and would fully implement Basel III by having deductions taken at the 100% level. Fremont Bank supports the proposal to increase the deduction threshold to 25%. The Proposed Rule would also increase the capital risk weighting for MSAs from 100% to 250%. For the reasons stated below, Fremont Bank believes this increase is unwarranted and arbitrary.

With regard to the capital treatment of MSAs, Fremont Bank supports the conclusions highlighted in the Agencies' joint report to Congress as required by the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). In that report the Agencies stated:

“[T]he regulatory capital rules are too complex given community banks' size, risk profile, condition, and complexity. The agencies therefore are developing a proposal to simplify the regulatory capital rules in a manner that maintains safety and soundness and the quality and quantity of regulatory capital in the banking system.

The EGRPRA report further states that “amendments would likely include... simplifying the current regulatory capital treatment for MSAs...”

Fremont Bank fully supports both of these intentions expressed in the EGRPRA report and in the Proposed Rule. We share the view that regulatory capital standards are more complex than necessary to achieve their prudential and supervisory purpose and we are pleased that the Agencies are considering simplification efforts.

### **Capital Treatment of MSAs – A Look at Fremont Bank's Experience**

Fremont Bank supports raising the MSA deduction threshold from 10% to 25% of Common Equity Tier 1 Capital, having deductions taken at the 100% level

Servicing mortgage loans is a specialty of Fremont Bank as a natural adjunct to its mortgage lending origination function. Over time, the Bank's servicing portfolio has grown to \$11 billion and it has provided a strong source of stabilizing fee income. While the Bank has been very conservative in valuing this intangible asset, it has now reached the 10% of capital threshold for its MSAs, making the Bank extremely interested in and supportive of the current Proposal to increase the threshold to 25%.

The Bank has found that mortgage servicing is an important way to maintain valuable long-term customer relationships in what might otherwise be a transaction only interaction with borrowers. The Bank's MSAs and its loan servicing portfolio are useful tools in allowing the bank to sell long term mortgage loan assets to manage its interest rate and concentration risks, for example, while retaining the customer relationship and fee income. Fremont Bank has a very strong interest, therefore in maintaining its status as a strong mortgage servicer. Again, to be clear, Fremont Bank supports the provisions of the Proposed Rule which would increase the MSA deduction threshold from 10% to 25% of Common Equity Tier 1 Capital, which deductions would be taken at the 100% level.

Fremont Bank opposes the proposed increase in the risk weighting of MSAs beyond the current level of 100%

The risk weight for MSAs are scheduled to rise to rise from 100% to 250%. MSAs should not carry a capital risk weighting 5 times higher than the underlying residential loan that they

emanate from. This is an arbitrary and punitive capital treatment of MSAs and has negative unintended impacts on community banks and their customers.

As a result of the punitive and arbitrary capital treatment under Basel III, Fremont Bank notes that mortgage servicing assets have migrated to non-bank mortgage servicers at an accelerated rate. While we do not believe the shift was intended by the Agencies it is nonetheless occurring. Because these transfers are driven by Basel III-related issues and not the core competencies of the parties involved, banks like Fremont Bank that are strong servicers and want to remain in the business may be forced to shed the asset for reasons having nothing to do with sound banking practices and prudential balance sheet management. And as a Subchapter S institution, Fremont Bank and its holding company face limitations in the form of shareholder limits in trying to raise new equity capital.

With the transfer of servicing out of the institution, Fremont Bank would be losing one of its two primary relationships with retail customers (deposit and mortgage loan relationships). The Bank would also be losing a safe and sound earning asset and its natural hedge to the loan production side of the business. The punitive capital treatment imposed by a risk weighting of 250%, on balance, will reduce the aggregate demand for MSAs, creating a less liquid market that could result in lower prices more mortgages sold in the secondary market and higher rates for mortgage borrowers. None of this is advantageous. Customers and the banks that serve them well should not be penalized by the punitive and arbitrary treatment of MSAs as a 250% risk weighted asset under the Proposed Rule, which is clearly more severe than the current 100% risk weighting.

The accounting rules require banks to put MSAs onto their balance sheets and then the regulatory capital rules penalize banks for this required practice. As a result, Fremont Bank supports the proposal to increase the MSA deduction threshold to 25% of Common Equity Tier 1 Capital. A 25% deduction, although still a significant restriction compared to previous capital treatment, would lessen the disruption to customers and the relationships they have chosen to build with their bank. Moreover, for the portion of MSAs that are not deducted, Fremont Bank believes the risk weight should be set no higher than 100%.

Fremont Bank is sensitive to the fact that institutions might try to manipulate MSA's to generate the appearance of higher capital levels, but its own treatment of MSAs is highly conservative. Said another way, Fremont bank recognizes that MSAs are an intangible asset, which can be difficult to value and which could be manipulated to create higher (but illusory) capital levels. Capital abuses, however, should be addressed directly at the level of MSA valuation and not through an arbitrary process of applying a 250% risk weighting. Fremont Bank also notes that MSAs are an integral aspect of residential home loans, which themselves carry a risk weighting of only 50%. It would be more consistent and more appropriate to assign the same risk weighting to MSAs.

Fremont Bank thanks you for considering these issues. If the Agencies would like additional information regarding these comments, please contact the undersigned, Chris Chenoweth, at 510-795-5753 ([chris.chenoweth@fremontbank.com](mailto:chris.chenoweth@fremontbank.com)).

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Sincerely,  


Fremont Bank  
By Chris Chenoweth,  
SVP, CAO, and Chief Legal Officer