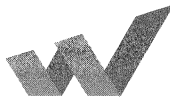
LINCOLN
Highway 2 & Old Cheney Road
1204 West O
27th & Old Cheney Road
17th & South
84th & Holdrege
27th & Cornhusker Highway
50th & O

OMAHA
180th & Pacific
97th & Q
10th & Cornhusker Road



WEST GATE BANK®

Our interest is ***you***

Carl J. Sjulin
President

Via Electronic Submission

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: RIN 3064-AE91 (FDIC)
R-1638 (Federal Reserve)
OCC-2018-0040 (OCC)
Proposed 25% MSA Cap in CBLR

Dear FDIC, Federal Reserve and OCC:

Thank you for the opportunity to tell the story of small community banks like West Gate Bank that service their customers' mortgages. This comment letter focuses solely on the proposed 25% cap on MSA inclusion in capital for purposes of the CBLR. The 25% cap is a holdover from Basel III that has nothing to do with small community banks in the United States. As a matter of national sovereignty, it is time for regulators to rectify the mistake when Basel III was applied to all banks regardless of size, risk model or capital levels. The CBLR is a perfect opportunity for regulators to cut the cord on Basel III concepts (such as low MSA caps) that are inapplicable to community banks.

Here is a snapshot of West Gate Bank and our mortgage servicing metrics:

- $616 mil assets
- 10 branches in Lincoln and Omaha, Nebraska
- Traditional community bank/family owned for 51 years/active mortgage division
- $63 mil in capital (12% CET1)
- $13 mil MSA using conservative LOCOM methodology (.68% of $1.9 bil UPB)
- $4 *mil Basel III deduction from capital due to 10% cap on MSAs*
- Service 13,000 mortgage loans ($146,000 ave. reflecting Nebraska rural market)
- Retaining servicing is important to our customers and key to our mortgage model
- All organic growth through mortgages originated by West Gate Bank (no PMSRs)
- Only 20 mortgage loans 90 days past due/high grade portfolio
- Outstanding ratings from prudential regulators and Fannie for mortgage servicing

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Member FDIC

Large mortgage servicing companies do not want to service $146,000 mortgages in non-metro areas. Without a local servicer like West Gate Bank, the cost of mortgage credit to consumers will increase. Consumers would also lose the personal customer service that is best provided by the originating bank—including handling escrows for flood, tornado and other local issues.

THE 25% CAP PREVENTS THE SCALE REQUIRED FOR MORTGAGE SERVICING

- Mortgage servicing is a scale business that requires a critical mass to perform properly
- Servicing requires significant up-front investments in specialized software, compliance, IT and training to satisfy the multitude of compliance, regulatory and investor requirements
- The CBLR 25% cap is **unreasonably low and discriminates** against small community banks given their limited capital base
- No small community bank can service mortgages to the scale required to do the job correctly with the 25% cap in CBLR. West Gate Bank can only service 16,000 mortgage loans before reaching the 25% cap—and we have been in the servicing business only 8 years and use a conservative LOCOM valuation
- Community banks that service **larger** mortgages or use **fair value** for MSAs will reach the 25% cap even faster further limiting the number of mortgages they can service

THE 25% CAP SHOULD BE INCREASED TO AT LEAST 50%

- In light of their relatively small capital base, community banks need the ability to include MSAs up to **at least 50% of capital**. This is still a substantial reduction from the 100% cap in Basel II which caused no material losses for the FDIC insurance fund based on the 2016 Joint Regulatory Report to Congress on MSAs (*see* page 13 citing only one bank failure since 2007 due to mortgage servicing and only 3 failures where MSAs were a "factor")
- Based on the CBLR requirements of 9% capital and traditional bank model (both of which reduce risk), any losses to the fund from MSAs at community banks would be *infinitesimal*
- Large publicly traded **Basel III banks** are likely to get an increase in the 10% cap to 25% when the final rule comes out later this year, so it only makes sense to increase the MSA cap in CBLR to at least 50%

THE MSA "CLIFF" SHOULD BE CHANGED TO AN EXCLUSION

- The MSA cap should be changed from a "cliff" that disqualifies banks to an "exclusion" methodology that mirrors Basel III
- ***Let community banks stay in CBLR by excluding MSA in excess of the cap***
- **Dollar for dollar capital** is a stiff penalty that insulates the FDIC from loss and will allow a bank time to adjust. The 6 month transition in CBLR is too short for banks to effectively sell MSAs and prepare for the huge difference in the Basel III capital regime
- It only makes sense to use the same methodology for both capital regimes; no reason for CBLR to use the "death penalty"

THE 25% CAP IS BAD PUBLIC POLICY

- Isolating mortgage servicing with punitive capital rules is bad public policy that **disconnects customers from their local community bank**
- The cap is inconsistent with our **CRA mandate**

- Forcing the sale/transfer of servicing **raises costs to consumers and reduces choice**
- Does it make sense for regulators to run small community banks out of servicing? As stated by **FDIC Chairman McWilliams** in her March 14, 2019 speech in Washington: "*The role of government in our society is to promote, not inhibit, growth and opportunity.*"
- MSA values can be effectively **regulated through the exam process**. There are metrics to evaluate the quality and value of MSRs just like a loan. The MSA value can be charged down like any other bank asset
- **Servicing is not a risky business activity**. Processing payments is the easiest and safest thing we do, and we have a natural hedge against prepayments through repeat business from the same customers
- No need for arbitrary up-front limitations that attempt to manage an entire banking activity via autopilot. This leads to unfair and discriminatory results that are contrary to the purpose and spirit of the enabling legislation S. 2155
- Mortgage servicing provides an **excellent ALM hedge** against rising interest rates. The 25% cap prevents WGB from fully utilizing the best natural hedge tool available
- Servicing also is an excellence source of **escrow deposits** that are best processed and reinvested by community banks back into their local economies
- Small community banks need to retain mortgage servicing to **compete effectively** against large national non-banks. Offering local servicing is a differentiator for community banks that is valued by our customers
- By Congressional mandate, CBLR is supposed to be a **simplification** rule for **small community** banks, yet it incorporates a foreign Basel III concept intended for the systemically important mega banks that caused the mortgage crisis

An MSA cap of less than 50% poses a significant impediment for community banks to competitively finance the purchase of their customers' home—the most important financial transaction most customers ever undertake. Home ownership is the American Dream that local community banks are a perfect partner. As stated by Chairman McWilliams in the same speech: ***"[The FDIC] is committed to insuring that our regulatory framework does not stand in the way of the American Dream, but that it makes it possible.***"

Thank you for considering the importance of fostering the local servicing of mortgages by community banks.

Sincerely,

Carl J. Sjulin
Chairman, President and CEO

CBLR comment letter 2019/cjs/H