January 16, 2024

The Honorable Jerome Powell
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

The Honorable Michael Hsu
Comptroller
Office of the Comptroller of the Currency
400 7th Street, SW, Suite 3E–218
Washington, DC 20219

The Honorable Martin Gruenberg
Chair
Federal Deposit Insurance Corporation
550 17th Street,
NW Washington, DC 20429

Re: Regulatory capital rule: Amendments applicable to large banking organizations and to banking organizations with significant trading activity

Dear Chair Powell, Comptroller Hsu, and Chair Gruenberg:

On behalf of the Center for Responsible Lending,[1] thank you for the opportunity to comment on the notice of proposed rulemaking (Proposed Rule) by the Board of Governors of the Federal Reserve System (Federal Reserve Board), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) (collectively, the Agencies) regarding the large bank regulatory capital rule. While we commend the Agencies for seeking input on this important topic, we have significant concerns with the existing proposal's potentially chilling impact on portfolio mortgage lending by larger banking participants.

Introduction

As written, the proposed rule would significantly increase the capital required for larger banking organizations that hold mortgages in portfolio. Currently, the risk weight on owner-occupied residential mortgages is a uniform 50%. The agencies' proposal, however, would retain or decrease the risk weight for mortgages with an LTV ratio equal to or below 80%, while

[1] The Center for Responsible Lending is a non-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices, including student loan debt incurred as a result of fraudulent representations by higher learning institutions. CRL's views on student lending are informed by its affiliation with Self-Help, one of the nation's largest nonprofit community development financial institutions. Self-Help has provided $6 billion in financing to 70,000 homebuyers, small businesses and nonprofits and serves more than 80,000 mostly low-income families through 30 retail credit union branches in North Carolina, California, and Chicago.

increasing the risk weight to 60% for mortgages with an LTV ratio of 80-90% and to 70% for mortgages with an LTV ratio of 90-100%. For the reasons discussed below, we believe that result would unnecessarily restrain responsible access to mortgage credit for several consumers without producing any meaningful reduction in market risk.

Discussion of CRL's Concerns with the Proposal

In the discussion of the proposed risk weights for residential mortgages, the Agencies state that they "are supportive of home ownership and do not intend the proposal to diminish home affordability or homeownership opportunities, including for low-and-moderate-income (LMI) home buyers or other historically underserved markets." The agencies thus solicited comments on how the proposal would impact such opportunities. The unfortunate but, in our view, inescapable answer is that the proposal would have precisely the adverse effect that the Agencies seek to avoid.

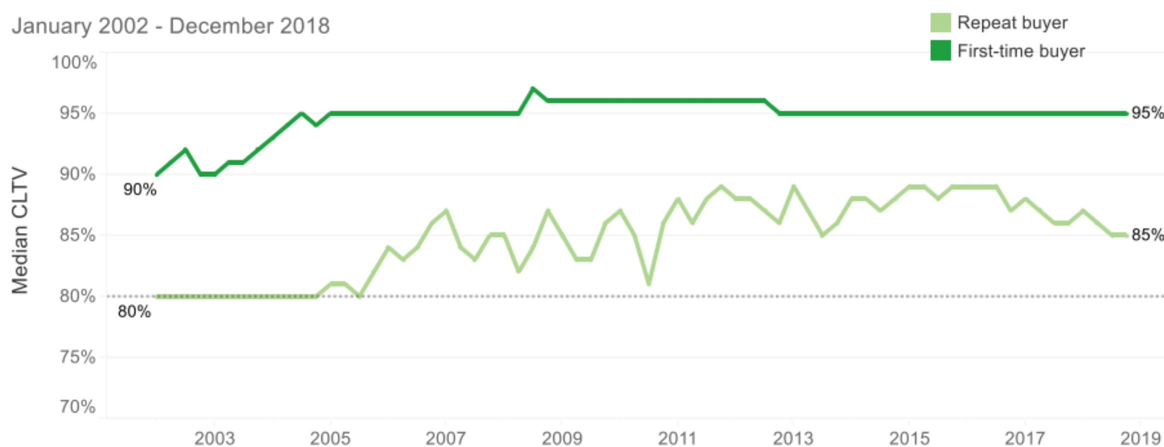
(1) There will likely be a significant need for higher LTV Loans among first-time homebuyers for the foreseeable future.

In its current form, the proposed rule would have two predictable consequences: first, it would make the banks covered by the rule less willing to make higher LTV residential mortgage loans unless the loans can be sold or securitized; and second, for those higher LTV loans that banks make and hold in portfolio, it will increase the price of the loans as the banks will require higher returns in order to achieve their return-on-equity (ROE) objective given the higher capital they will be required to hold. Those consequences would, in turn, negatively affect homeownership opportunities, especially for LMI individuals and people of color.

The reason that homebuyers take out higher LTV mortgages—which carry higher monthly payments because of the requirement for mortgage insurance as well as because of risk-based pricing by lenders—is simply that such borrowers do not have sufficient liquid assets to make a larger down payment. That is truer of those seeking to become homeowners than for repeat buyers (who can draw upon equity build in their price home to make a down payment on a new home) or for refinancers (for whom LTV is calculated based on appreciation in their equity since their original purchase as well as the amortization of their loan since origination).

Thus, the proposal's negative impact will fall primarily on first-time homebuyers who are disproportionately low and moderate income and people of color. For example, according to the most recent Survey of Consumer Finances, the homeownership rate ranges from 90% for those in top income decile to 42% for those in the bottom income quintile. Similarly, the homeownership rate ranges from 73% for White families to 46% for Black families meaning that the percentage of Black would-be-homebuyers is double the percent for Whites.
But it is not just the fact that the pool of first-time homebuyers is disproportionately comprised of lower income households and households of color that makes the Agencies' proposal so problematic. Even more troubling, within that pool the adverse impact will inevitably vary by income which means, given the large gap in the income of White households and households of color, the impact will vary by race and national origin. Simply stated, individuals with less

income—who are disproportionately people of color—are less likely to have accumulated large savings to use for a down payment because their income is consumed by day to day expenses and thus they are more dependent on higher LTV loans than more affluent individuals. And, first-generation, first-time homebuyers—who are even more disproportionately people of color--are especially unlikely to be able to make large down payments since their parents' ability to generate wealth, and thus to assist with a down payment, is limited by their lack of access to homeownership.[2] Thus, the groups most likely to be adversely impacted by the proposal are precisely the groups about whom the Agencies expressed concerns in the proposal.
The available data bears this out. The figure below shows the median CLTV of first-time and repeat homebuyers and confirms the disparity in CLTVs for the two groups:[3]



National Mortgage Database

Although we have not located any published reports disaggregating these data by race, national origin or income, the table below does show disaggregated data for conventional, conforming home purchase and refinance mortgages originated in 2018 and 2019:[4]

	Home Purchase		Refinance	
	2018	2019	2018	2019
Black	95%	95%	70%	72%
Hispanic	90%	91%	68%	70%
White	80%	80%	69%	71%
Low-Moderate Income	87%	90%	69%	70%

[2] A recent report by the Urban Institute using data from the Panel Study of Income Dynamics found that among first-generation renter households with incomes up to 120% of the area median income (AMI), roughly two-third are Black or Hispanic. Mehrotra *et al., First Generation Homebuyers Face Significant Obstacles to Homeownership,* https://www.urban.org/urban-wire/first-generation-homebuyers-face-significant-obstacles-homeownership-help-programs-can (2023).
[3] CFPB, *Market Snapshot: First Time Homebuyers,* https://files.consumerfinance.gov/f/documents/cfpb_market-snapshot-first-time-homebuyers_report.pdf (2020
[4] CFPB, *An Updated Review of the New and Revised Data Points in HMDA,* https://files.consumerfinance.gov/f/documents/cfpb_data-points_updated-review-hmda_report.pdf; ; CRPB, Introducing New and Revised Data Points in HMDA, https://files.consumerfinance.gov/f/documents/cfpb_new-revised-data-points-in-hmda_report.pdf Tables 6.5.2a and b

Middle Income	83%	85%	70%	71%
High Income	80%	80%	68%	70%

As this table indicates, while there is little variation in LTVs among refinance mortgages, for home purchases there are large differences in the median CLTV for Black and Hispanic homebuyers compared to White homebuyers, and for homebuyers in LMI neighborhoods compared to those in high income neighborhoods. It stands to reason that this would be even more true for first-time homebuyers so that not just the median Black, Hispanic, or LMI first-time homebuyer but substantially all such homebuyers would be adversely affected by the proposed increase in the risk weight for higher LTV loans. Indeed, The Bank Policy Institute has estimated that 38% of loans to LMI borrowers would receive a risk weight of at least 70%, vs. 17% of the loans to non-LMI borrowers. In addition, 52% of mortgage loans to Black borrowers would receive a risk weight of at least 70%, vs. 22% of the loans to white borrowers

We note that these data precede the almost 50% increase in home prices that occurred between 2020 and 2023 in the wake of the pandemic.[5] That increase has made achieving homeownership even more challenging for LMI individual and persons of color and made it even more likely that they will need a higher LTV loan to become homeowners.

(2) **The proposed mortgage capital requirements are particularly problematic given the evidence showing that higher LTVs are not a strong predictor of risk**.

As currently proposed, portfolio mortgage lending would decrease for mortgages with LTV ratios above 80% as banks maximize their return on capital under the proposed differential risk weights. While the effects would fall disproportionately on LMI and minority borrowers, the rationale for tying risk weights to LTVs is faulty. The driver of mortgage credit risk is defaults. The proposal states, "LTV ratios can be a useful risk indicator because the amount of a borrower's equity in a real-estate property correlates inversely with default risk and provides banking organizations with a degree of protection against losses."[6]

The correlation between equity and default risk is spurious. Low equity relative to property value, i.e. high LTV, is not a sufficient condition for default. Recent research finds that only 6 percent of defaulting mortgage borrowers did so solely because of being underwater on their mortgage.[7] High LTVs also are not, in general, a necessary condition for a high probability of default. The same research finds that 70 percent of borrowers default solely because of a life shock, while only 24 percent default because of a life shock and being underwater. Additional recent research confirms that the driver of mortgage default is financial shocks--a loss of income or a spike in expenses.[8]

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[5] *See* FRED, S&P Case-Shiller U.S. National Home Price Index

[6] Federal Register/ Vol. 88, No. 179/Monday, September 18, 2023/Proposed Rules/64044.

[7] Ganong, Peter, and Pascal Noel. 2023. "Why Do Borrowers Default on Mortgages?" *Quarterly Journal of Economics*, Vol 138, Issue 2, pp. 1001-1065. Why do Borrowers Default on Mortgages?* | The Quarterly Journal of Economics | Oxford Academic (oup.com)

[8] Low, David. 2023. "What Triggers Mortgage Default? New Evidence from Linked Administrative and Survey Data." *Review of Economics and Statistics.* What Triggers Mortgage Default? New Evidence from Linked Administrative and Survey Data | The Review of Economics and Statistics | MIT Press

There are more effective methods to increase the probability of banks being able to absorb losses than a clunky correspondence between LTV ratios and risk weights. These methods have recognized the primary role of the real driver of losses, financial shocks, and have already been adopted with much success.

(3) **Additional evidence suggest that Higher LTV loans have become even less of a risk concern due to recent innovations in servicing practices.**

Recent evidence suggests that higher LTV loans have become even less of a risk concern due to three evidence-based improvements made to loss mitigation programs that aid borrowers who fall behind on their mortgage. With those improvements in place, despite a nationwide economic shutdown, post-pandemic mortgage default and foreclosure rates have remained remarkably low.

First, experience has established that providing a delinquent homeowner with a reduction in their monthly principal and interest payment is the most effective countermeasure to avoid foreclosure, and that such payment reductions are more effective than reaching a pre-determined affordability target (i.e. debt-to-income ratio) or loan-to-value ratio.[9] Moreover, recent research indicates that reducing monthly payments by between 20% and 30% is optimal—payment reductions of less than 20% are insufficient, whereas payment reductions in excess of 30% provide little marginal reduction in redefault rates.[10] In response, both the GSEs' and FHA's loss mitigation programs aimed at assisting borrowers facing financial hardship have been structured to reduce monthly payments by 20% to 25%.[11] While the details of bank loss mitigation programs are not publicly available, it would stand to reason that those programs also target a 20% to 25% payment reduction.

Second, mortgage lenders have concluded that mortgage delinquency itself is a sufficient indicator of financial hardship, eliminating the need for collecting income or hardship documentation from borrowers. Missed mortgage payments result in considerable negative consequences for the borrower's credit score, which significantly reduces any incentive a borrower might have to purposely miss payments just to receive a payment reduction. Moreover, collecting documentation from borrowers slows the processing time of delinquent loans, which allows arrearages to build and increases the cost of providing loss mitigation. Requiring documentation also leads to fallout among borrowers and processing errors, both of which can lead to unnecessary foreclosures. For these reasons, both the GSEs and FHA "streamlined" their loss mitigation programs during the pandemic by removing any borrower documentation

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[9] Ganong, Peter, and Pascal Noel. 2020. "Liquidity vs Wealth in Household Debt Obligations: Evidence from Housing Policy in the Great Recession." *American Economic Review*, 110 (10):3100-3138.

[10] Huff, Ryan. 2023. "Assessing the Effectiveness of Payment Reduction on Preventing Borrower Re-default for Mortgages." *Milliman White Paper*.

[11] The Fannie Mae and Freddie Mac Flex Modification targets a 20% reduction in principal and interest, as per F-1-27: Processing a Fannie Mae Flex Modification (05/10/2023) and Guide Section 9206.10 (freddiemac.com). FHA modifications target a 25% reduction in principal and interest, as per FHA Single Family Housing Policy Handbook (hud.gov).

requirements and are now in the process of removing documentation requirements from their standard loss mitigation options.[12] It is likely that banks have done the same.

Third, the experience of the post-Great Recession period led to the understanding that foreclosures are costly for *all* parties involved—the borrower, the mortgage servicer, the mortgage guarantor/insurer alike—and therefore all parties have an economic incentive to keep the borrower in their home. During the post-Great Recession period the Home Affordable Modification Program (HAMP) was the main government loss mitigation program. HAMP included a net present value (NPV) test, whereby the borrower only received a HAMP modification if the modification would result in a higher NPV for the mortgage holder compared to not modifying the mortgage.[13] However, based on the post-Great Recession experience, mortgage servicers and the housing agencies, which guaranty or insure most mortgage debt, have concluded that the cost of foreclosures far outweighs the cost of providing loss mitigation, rendering NPV tests unnecessary. As a result, none of the loss mitigation measures in place today require any NPV calculations.[14] Banks bear the credit risk for loans held on portfolio, and therefore would have the same economic incentive to provide loss mitigation alternatives that keep borrowers in their homes.

The COVID-19 pandemic provides ample evidence that the lessons learned during the post-Great Recession period have resulted in more effective loss mitigation programs. Despite a nationwide economic shutdown and sharp increases in unemployment and healthcare and other expenses, serious delinquency rates and foreclosure rates remain relatively low. Moreover, data on forbearance uptake and forbearance exits indicate that borrowers who had loans held in bank portfolios or private-label securities (PLS) took forbearance and exited forbearance into loss mitigation solutions at rates similar to borrowers with agency-backed loans.

Of the 8.74mm borrowers who entered COVID-19 forbearance, only 2.2% (191,000) have lost their home in a distressed sale or are in active foreclosure.[15] Delinquency and foreclosure rates are at or below pre-pandemic levels.[16] Considering the breadth and depth of the economic consequences of the pandemic, this is a remarkable result—estimates of the number of avoided foreclosures range from hundreds of thousands to millions.[17] Notably, during the pandemic, the forbearance rate of borrowers with a loan held in a bank portfolio or PLS was similar to the forbearance rate for other high LTV loans (i.e. FHA and VA loans).[18] In other words, despite the fact that the CARES Act only mandated forbearance for federally-backed loans and did not apply to loans held in bank portfolios, banks made forbearance available to their borrowers anyway. Once their hardship was resolved, forbearance exit data indicates that borrowers with loans held

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[12] Sources: F-1-27: Processing a Fannie Mae Flex Modification (05/10/2023), Guide Section 9206.10 (freddiemac.com), and FHA Single Family Housing Policy Handbook (hud.gov).

[13] For a discussion of the HAMP MPV model, see, for example, Working Paper 11-1: The HAMP NPV Model – Development and Early Performance (fhfa.gov).

[14] Ibid.

[15] Source: ICE_MM_DEC2023_Report.pdf (blackknightinc.com).

[16] Source: Housing Finance Chartbook (urban.org).

[17] Sources: Normalizing Forbearance.pdf (urban.org) and U.S. Foreclosure Activity Drops To An All-Time Low In 2021 | ATTOM (attomdata.com). Fiscal stimulus and other government measures taken during the pandemic contributed to this outcome.

[18] Source: MBA September 2023 Loan Monitoring Survey. Data for loans held in bank portfolios or PLS are not reported separately.

in bank portfolios or PLS had access to and made use of the same loss mitigation options as borrowers with agency-backed mortgages. That is, borrowers with loans held in bank portfolios or PLS exited COVID forbearance through a payoff, a payment deferral (where the missed payments are moved to the end of a loan) or a loan modification at rates similar to borrowers with an agency-backed mortgage.[19] Thus, banks put in place similar loss mitigation options to the housing agencies, and then made those loss mitigation options similarly available to their borrowers as did the housing agencies.

(4) Given the potential negative impacts of the proposal on mortgage lending, the absence of transparency regarding the agencies' analysis is particularly concerning.

Given the adverse impacts, described above, of the proposed capital changes on mortgage assets, and particularly the impact on higher LTV mortgages, it is essential that the basis for such proposed changes be rigorously analyzed and accurately reflect the US mortgage market. This is particularly important given the numerous reforms in the US mortgage market that have significantly reduced the risk of loss from mortgages. However, the proposed rule fails to disclose this analysis, and the proposed new capital standards are contradicted by detailed analyses performed by federal housing regulators charged with this undertaking. These circumstances required that the proposal be withdrawn until such an analysis is performed, made public and tested to ensure its accuracy.

Characteristics of the US mortgage market provide safeguards often unavailable in other jurisdictions. A hallmark of the US market is the wide availability of a thirty-year fixed rate mortgage with the ability of the borrower to prepay, usually without penalty, and often refinance into a lower rate current mortgage. A second fundamental feature of the US market is the Dodd-Frank requirement the lenders determine the borrower's ability to repay the mortgage, using a fully amortizing payment and considering the risk of payment increase with any adjustable-rate mortgages. These features greatly reduce the risk that a borrower will not be able to afford a current or future mortgage payment.

The Basel III standards were issued in 2017, and the US mortgage market has continued to implement measures to reduce the risk of losses from mortgages, and especially for those with lower down payments. As discussed in section 3 above, a recent fundamental reform is the availability of the deferral of mortgage payments during periods of systemic and individual hardships. These loan modifications demonstrated their effectiveness in the COVID 19 crises, profoundly reducing the initial projected losses.

Evidence that the proposed mortgage risk weight increases overstate the risk is shown by the disparity in the proposed required capital for higher LTV mortgages under the proposal and the capital determined by the Federal Housing Finance Agency (FHFA). FHFA has conducted several iterations of its capital and pricing standards, with extensive public review and comment of these analyses. The proposed risk weighting under the proposal is more than three times the FHFA's risk weighting for >90 LTV loans in its current single-family pricing framework.[20]

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[19] Source: MBA September 2023 Loan Monitoring Survey.

[20] Federal Housing Finance Agency. (2023, May). Fannie Mae and Freddie Mac single-family mortgage pricing framework RFI.]

We commend the proposal for recognizing that the increased risk-weighting on higher LTV residential mortgages could have unnecessary harmful effects and inviting alternative risk-weighting regimes, including a possible 50% risk weighting for loans with safeguards.[21] Based on the reasons set out in this comment, we urge the replacement of the proposed risk weighting for higher LTV mortgages with such a regime that reflects the safety and importance of these mortgages for first-time home buyers and buyers of color.

While LTV ratios and dependency upon cash flows of the real estate are useful risk indicators, the agencies recognize that banking organizations consider a variety of factors when underwriting a residential real estate exposure and assessing a borrower's ability to repay. For example, a banking organization may consider a borrower's current and expected income, current and expected cash flows, net worth, other relevant financial resources, current financial obligations, employment status, credit history, or other relevant factors during the underwriting process. The agencies are supportive of home ownership and do not intend the proposal to diminish home affordability or homeownership opportunities, including for low- and moderate-income (LMI) home buyers or other historically underserved markets. The agencies are particularly interested in whether the proposed framework for regulatory residential real estate exposures should be modified in any way to avoid unintended impacts on the ability of otherwise credit-worthy borrowers who make a smaller down payment to purchase a home. For example, the agencies are considering whether a 50 percent risk weight would be appropriate for these loans, to the extent they are originated in accordance with prudent underwriting standards and originated through a home ownership program that the primary Federal regulatory agency determines provides a public benefit and includes risk mitigation features such as credit counseling and consideration of repayment ability.

(5) **As written, the proposed rule sends a contradictory message to larger bank participants regarding mortgage lending and access given the recently finalized Community Reinvestment Act regulations.**

As written, the proposed capital rule will not affect all mortgage originations, but only originations of portfolio loans by banks with assets above $100 billion. The Urban Institute has analyzed the impact that the proposed rule would have on the subset of home purchase loans made by such banks and found that, "contrary to the intentions of the Community Reinvestment Act (CRA), the rule would "disproportionately disadvantage low- and moderate-income (LMI) borrowers and communities, as well as Black and Hispanic borrowers."[22] The Urban Institute report adds:

> There is a lot at stake here. Bank portfolios provide a home for loans that do not fit neatly into the credit boxes underwritten by the government-sponsored enterprises (GSEs), the

[21] F.R. September 18, 2023, p. 64048.
[22] Goodman & Zhu, *Bank Capital Notice of Proposed Rulemaking, https://www.urban.org/sites/default/files/2023-09/Bank%20Capital%20Notice%20of%20Proposed%20Rulemaking.pdf* at 10. The analysis find that while 24% of conforming home purchase bank portfolio loans had LTVs above 80%, 30% of conforming home purchase portfolio loans made to Black borrowers and 38% of such loans made to LMI borrowers had LTVs above 80%.

> Federal Housing Administration (FHA), or the Veterans Administration (VA). High-LTV mortgages are particularly important for first-time buyers, especially LMI borrowers and borrowers of color. Raising the capital charges on high-LTV loans raises the mortgage interest rates for the remaining borrowers least able to afford the increases. Raising the capital charges undercuts other federal efforts, including those to put more teeth in the CRA, as well as those encouraging lenders to develop special purpose credit programs.[23]

The last point warrants further elaboration. As the Agencies only recently observed in their rule overhauling the regulation governing CRA examinations and assessments, the Community Reinvestment Act "is a seminal piece of legislation" which is part of the fabric of laws "enacted in the 1960s and 1970s to address fairness and financial inclusion in access to housing and credit." At the core of the purposes of the multi-year process in which the Agencies engaged to issue this rule was the Agencies' desire "to strengthen the achievement of the core purposes of the statute"—that is, to strengthen "financial inclusion" and enhance "fairness in lending," recognizing that the CRA and the fair lending laws—including the Equal Credit Opportunity Act and Fair Housing Act of 1968—are, as the Agencies stated, "mutually reinforcing." Thus, to the extent that the proposed capital rule would decrease the availability and/or increase the price of higher LTV bank loans, it would directly undermine the goals to which the Agencies recommitted themselves in the CRA rule.

Conclusion

The Center for Responsible Lending thanks the Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation for providing the opportunity for public input on its proposed changes to the regulations governing capital requirements for larger banking institutions and institutions with significant trading activity. We believe that capital requirements play an important role in protecting the financial markets and taxpayers by ensuring that systemically important financial institutions are adequately capitalized to protect against the risks associated with their business activities. Our concerns outlined above, however, suggest that the proposed rule will undermine efforts to ensure responsible access to mortgage credit for a significant number of consumers without achieving any meaningful additional risk mitigation. Accordingly, we urge the agencies to reconsider the proposed capital requirements as they relate to mortgage lending, especially within the context of higher loan-to-value originations. Thank you again for the opportunity to share our initial concerns with the proposed capital rule's potentially negative impact on mortgage originations.

Sincerely,

The Center for Responsible Lending

[23] *Id.* at 1.