



September 25, 2017

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

The Honorable Janet L. Yellen  
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

Mr. Keith Noreika  
Acting Comptroller of the Currency  
Office of the Comptroller of the Currency  
400 7<sup>th</sup> Street, N.W.  
Washington, D.C. 20219

Re: Changes to U.S. Regulatory Capital Framework: Pause in Basel III Transaction Periods

Dear Chairman Gruenberg, Chair Yellen, and Acting Comptroller Noreika:

Fremont Bank, a \$3.8 billion California state chartered commercial bank in the San Francisco Bay Area (and its holding company, Fremont Bancorporation) supports the Agencies' proposal to pause the Basel III transition period (Transition Proposal) to facilitate the proposal, review, and promulgation of amendments to the risk-based capital standards to address certain problems, most notably the provisions affecting Mortgage Servicing Assets (MSAs). 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. This would result in deductions being taken at the 100% level and the capital risk weighting for MSAs being raised from 100% to 250%.

Fremont Bank is concerned that these deductions could be fully phased in before the agencies have finalized the rulemaking 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 Transition Proposal freezing the Basel III implementation and the additional proposal to review and revise the capital standards applicable to MSAs sometime during 2018. 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. In light of the announcement that the Agencies are actively considering amending the capital treatment of MSAs, Fremont Bank believes it is appropriate to freeze the current transition period for all banks until rules reducing unneeded complexity are proposed and finalized.

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

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 nearly \$11 billion and it has provided a strong source of stabilizing fee income. While the Bank has been careful and very conservative in not over-valuing this intangible asset, it has now reached the 10% of capital threshold for its MSAs, making it extremely interested in and supportive of the current Transition Proposal and the re-evaluation of related capital standards in 2018.

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.

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.


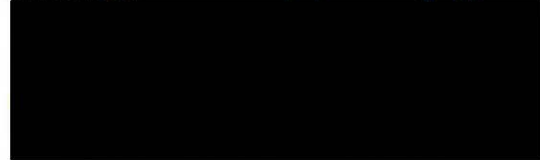
With the transfer of servicing out of the institution, Fremont Bank would be losing one of its two primary relationships with retail customers (deposit and mortgage loan relationships). The Bank would also be losing a safe and sound earning asset and its natural hedge to the loan production side of the business. The punitive capital treatment, 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 under the current capital rules, which will only become more severe if allowed to phase in completely with a 100% deduction above the 10% of capital threshold and 250% 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 recommends that as a minimum reform, the MSA deduction threshold be increased from 10% to at least 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 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)).

Sincerely,

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