August 31, 2017

Mr. Benedetto Bosco
Chief, Capital Policy
Federal Deposit Insurance Corporation
550 17th Street NW, Room NYA-8054
Washington, DC 20429-0002

Re: Mortgage Servicing Rights under the Basel III Accord

Dear Mr. Bosco:

I am part of a group that is scheduled to meet with you and several others on September 11. I was part of another group that met with you and others in your office on March 27 in which we discussed our concerns regarding the treatment of mortgage servicing rights (MSRs) under the Basel III Accord (the Regulation).

I am writing in advance of our meeting to again share the concerns of our Executive Management and Board of Directors regarding the treatment of MSRs under the Regulation's risk-based capital standards. We believe that this regulation, generally imposed on U.S. financial institutions by an international regulatory body, is impeding mortgage lending in the United States, is detrimental to the servicing of mortgages by regulated depository institutions (banks) and should be modified or repealed.

First, let me briefly introduce our company. Founded in 1921 in Seattle, Washington as Continental Mortgage and Loan, HomeStreet Bank has been in the business of originating and servicing mortgage loans on residential and commercial real estate for nearly 100 years. We are now a $6.4 billion asset diversified community bank operating under a Washington State commercial bank charter in seven Western states and Hawaii. One of our main lines of business is retail origination and servicing of conventional single-family mortgages in both conforming and non-conforming loan amounts, as well as FHA-insured and VA-guaranteed mortgage loans. The majority of these loans are securitized and sold into the secondary market through Fannie Mae, Freddie Mac and Ginnie Mae. Total single-family mortgage loan production by HomeStreet in 2016 was over $9 billion.

Mortgage loan origination and servicing have been core businesses for HomeStreet for many decades. HomeStreet is currently the number one originator of purchase

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mortgages in Washington, Oregon and Idaho. Our credit quality is very sound; total delinquencies were never over 3.0 percent of our serviced portfolio at the depth of the Great Recession, and currently stand at approximately 1.2 percent (including foreclosures). We accomplish this while also providing a significant amount of mortgage financing to low and moderate income groups. We have achieved an "Outstanding" Community Reinvestment Act rating every year since Congress enacted the law in 1977. In short, we have built our business around outstanding customer service and the prudent extension of mortgage credit to all socio-economic segments in our markets for nearly a century.

At year-end 2016, our single family mortgage servicing portfolio totaled approximately 85,000 loans with a balance of just under $20 billion. Our mortgage servicing business is integral to our retail mortgage loan origination and retail deposit businesses. Many of our customers have had numerous mortgages with HomeStreet over a long period of time. Many repeat customers come to HomeStreet for "local" servicing, and their expectation is that the servicing of their mortgage loan will not be transferred to a servicer other than HomeStreet.

It has long been our strategy to originate mortgages and keep the borrowers as customers; we do not like to sell our customers. We sold approximately $3.0 billion of Fannie Mae servicing in 2014, which we did not want to do. Rather, we did it as part of preparing for Basel III implementation. We received very negative reaction from many customers whose servicing was transferred to another servicer. We do not want to have to do that again.

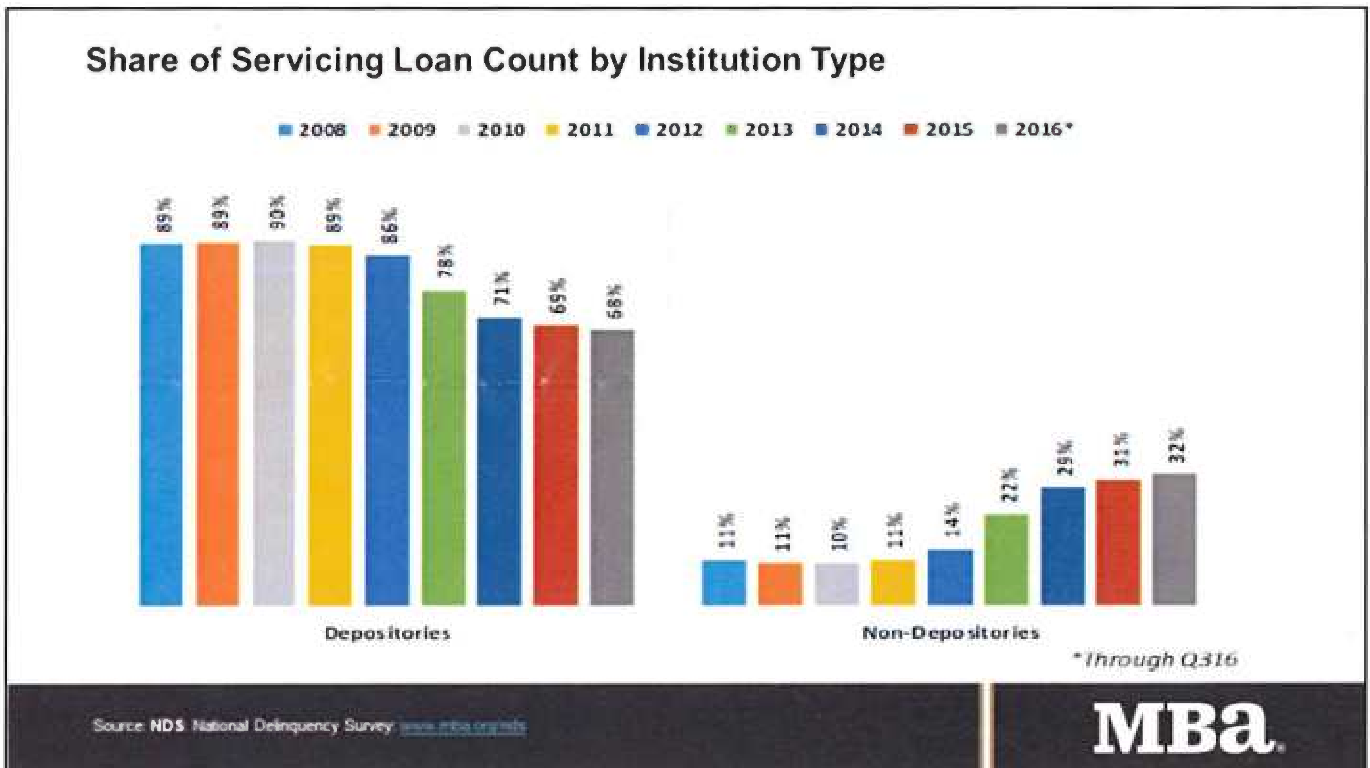
The punitive treatment of MSRs under the Regulation undermines the value of MSR assets at all U.S. banks, with adverse impacts on the entire mortgage finance chain. As you know, the Regulation increases the risk-weighting of MSRs held by banks from 100 percent to 250 percent. It also decreases the cap on MSRs that a bank may hold on its balance sheet from a 50 percent common equity component of Tier I capital to a stringent 10 percent limit, with MSR assets above the limit deducted from regulatory capital. In addition, MSRs, deferred tax assets and equity interests in unconsolidated financial entities are limited, in aggregate, to 15 percent of Tier I capital before they must be deducted from regulatory capital. This unnecessarily punitive treatment of MSRs has transformed them into one of the most capital intensive asset classes in the entire Basel III framework, despite the lack of any linkage between banks with MSRs and the causes of the financial crisis that Basel III is intended to address.

We at HomeStreet believe that origination and servicing of mortgage loans is a primary function of banks, and we believe these services provide great value to our customers and communities. The Basel III capital rule threatens that business at HomeStreet, and at many other banks as well. When fully implemented next year, the Regulation will decrease the Return on Equity of our mortgage servicing business to a level that will force us to question the wisdom of continuing to invest capital in that business (See attached "Capital Requirements & ROE"). Possible outcomes of that analysis may

include (1) sharply curtailing our mortgage origination and servicing business, (2) selling a large portion of our MSRs to institutions not regulated as banks, or (3) exiting the mortgage servicing business.

As you know, MSRs are not widely utilized outside the United States, but they are a vital component of the American housing finance system's ability to provide a 30-year fixed rate mortgage. The punitive treatment of MSRs, combined with the sharp increase in mortgage servicing costs over the past several years, has forced many community and regional banks to significantly scale back mortgage loan servicing, or to exit the servicing business altogether. This directly impacts consumers, as the servicing rights to their mortgage loans are often sold to entities not regulated as banks and are far removed from their communities. We have already seen instances of poor to improper servicing of mortgages by non-bank servicers, resulting in harm to consumers. Recent examples of harm to borrowers include inaccurate disclosure of related party services and improper administration of loan impound accounts.

The migration of MSRs from regulated to non-regulated institutions is illustrated in the following chart from the Mortgage Bankers Association. It clearly demonstrates the change in share of MSRs held by depository and non-depository institutions from 2008 through the third quarter of 2016:



The migration of MSRs to non-depositories started in 2012 for various reasons, and it gained momentum in 2013 as banks started to prepare for full implementation of the Regulation. We believe this migration of MSRs is a disturbing and potentially dangerous trend. Mortgage servicers must be highly liquid and well capitalized to be able to make required advances during down market cycles. Not only do depositories usually have ready access to capital and liquidity that non-depository companies do not, but depository institutions are subject to oversight by prudential regulators. We believe that, to the extent that MSRs migrate away from banks, it poses risks to consumers and is potentially destabilizing to the entire mortgage finance system.

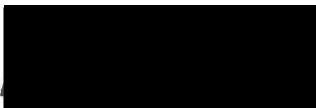
We believe that great performance, balance sheet strength and the quality of customer service should be the drivers by which servicers gain market share, not by the imposition of excessive capital standards on MSRs at depository institutions. We also believe that American banks should not be put at a competitive disadvantage by an international accord that discriminates against an asset that is generally unique and integral to the American mortgage finance system.

The Basel III Accord poses a serious threat not only to HomeStreet's mortgage servicing business, but also to the mortgage origination and servicing businesses at all regulated institutions. We urge the bank regulatory agencies to rescind the Basel III treatment of MSRs and return to the treatment under the previous regulation. Alternatively, the agencies could exempt banks under $250 billion in assets from the Regulation. That would be consistent with the intent and spirit of Basel III, which was specifically intended for SIFIs.

The migration of MSRs from regulated to non-regulated institutions continues as banks prepare for full implementation of the Regulation in January, and we at HomeStreet feel a great sense of urgency as we do our capital planning for next year. Failure to act by the end of the year will result in full implementation of the Regulation, with even more banks curtailing or ceasing their mortgage servicing businesses. The result of this would be further limits on the availability of mortgage credit, higher costs to consumers, and recurring instances of damage to consumers as a result of over-extended non-bank servicers.

We respectfully request your support in making changes to the Regulation prior to year-end.

Very truly yours,



Richard W.H. Bennion
Executive Vice President
HomeStreet Bank

Capital Requirements & ROE: Balance Sheet Management Implications

Although the P&L impact of the change in MSR Fair Value can be offset through an effective hedge strategy, current Capital Rules overlook this effective Risk Management approach and impose Capital Requirements that force regulated Banks to consider the Return of MSRs vs other classes.

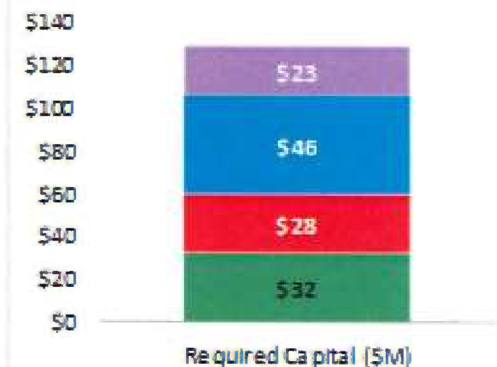
Example of Basel III Impact on Capital Requirements

Example Bank	Metric
Asset Size	$6.0B
Tangible Equity (TE)	$600M
Capital Ratio	10%
MSR Asset Size	$200M
MSR Asset / TE	33%*
3 Year Ave Return on Assets	5.25%

Required Capital Scenarios

- Capital Buffer*
- Basel III Threshold Impact
- Basel III 250% Risk Weighting Impact
- Pre-Basel III

* Although the P&L impact of a change in the Asset value can be hedged, no such opportunity exists to hedge the associated Capital, and as a result a bank would maintain a Capital Buffer to ensure it maintains sufficient Capital Ratios



Return on Equity and Strategic Balance Sheet Management Implications

Required Capital Scenario	3 Yr Return on Equity	Implications
Pre-Basel III	39.8%	Attractive returns, Mortgage Servicing and related Mortgage Lending Platform are viewed as core businesses.
+ Basel III 250% Risk Weighting Impact	21.3%	High end of acceptable return targets, still attractive.
+ Basel III Threshold Impact	12.0%	Marginal returns, essentially at or below the Cost of Capital.
+ Capital Buffer	9.9%	Inferior returns, lower than Cost of Capital. Strong consideration to explore alternative investment options.

[HomeStreet]