January 16, 2024

The Honorable Jerome Powell
Chair
Federal Reserve System
20th and Constitution Ave. N.W.
Washington, D.C. 20551

The Honorable Philip Jefferson
Vice Chair
Federal Reserve System
20th and Constitution Ave. N.W.
Washington, D.C. 20551

The Honorable Michael Barr
Vice Chair for Supervision
Federal Reserve System
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The Honorable Michelle Bowman
Governor
Federal Reserve System
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The Honorable Lisa Cook
Governor
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The Honorable Adriana Kugler
Governor
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The Honorable Christopher Waller
Governor
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The Honorable Martin Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.,
Washington, D.C. 20429

The Honorable Travis Hill
Vice Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.,
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The Honorable Jonathan McKernan
Director
Federal Deposit Insurance Corporation
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The Honorable Michael Hsu
Director, Acting Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th St. S.W.,
Washington, D.C. 20219

The Honorable Rohit Chopra
Director
Consumer Financial Protection Bureau
1700 G St, N.W.
Washington, D.C. 20552

Dear Regulators:

Today, the Housing Policy Council[1] submitted a detailed letter outlining our concerns with the treatment of mortgage loans in the proposed Basel III endgame rule. In this letter I will not repeat all of the concerns raised in our comment letter. Rather, based on my experience as a former Acting Director of the Federal Housing Finance Agency (FHFA) and member of the Financial Stability Oversight Council (FSOC) during the Great Financial Crisis, I am writing to share with you three broad policy concerns I have with the proposed rule, especially as it relates to the residential mortgage market.

First, a contributing cause of the Great Financial Crisis was the enormous capital arbitrage in mortgage credit among US-regulated financial institutions. Fannie Mae and Freddie Mac (the GSEs) operated their credit guarantee business with a fraction of the capital required of banks for the same credit risk. The outcome of this arbitrage wreaked havoc on our economy, homeowners, and taxpayers.

Since then, my successors at FHFA spent years carefully analyzing mortgage credit risk and finalizing a risk-based capital rule for the GSEs based largely upon the US bank regulatory standards derived from the Basel framework. This rule was carefully researched and documented, and subject to multiple

[1] HPC is a trade association comprised of the nation's leading mortgage lenders, servicers, mortgage insurers, and title and data companies. HPC advocates for the mortgage and housing finance interests of its members in legislative, regulatory, and judicial forums. Our interest is in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promoting of lending practices that create sustainable home ownership opportunities leading to long-term wealth-building and community-building for families.

rounds of public comment. Importantly, it substantially closed the pre-Great Financial Crisis capital arbitrage between banks and the GSEs.

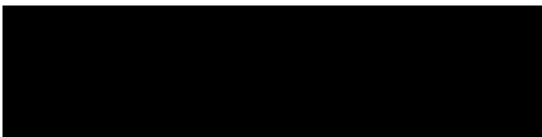
With your proposal, that capital arbitrage re-emerges in both a domestic and international dimension. Domestically, the risk weights and general capital treatment of mortgage credit risk for banks will again be substantially greater than for the GSEs and will shift more of that risk onto the GSEs. The proposal also opens an arbitrage in mortgage credit between US and international banks because the framework requires significantly more capital for large US banks than the international standard requires.

Second, the lack of coordination among FSOC member agencies in the regulation of capital and liquidity requirements for banks and nonbank mortgage market participants will exacerbate the liquidity risks that have become a regular part of FSOC's annual reports. The decline in direct lending and servicing of residential mortgages by banks does not mean they are not critical players in the underlying cash flows supporting the $14 trillion residential mortgage market. Banks are the predominant providers of liquidity to nonbank financial institutions, and thus are integrally connected to the underlying credit and liquidity risks in the market. The risk-based capital framework for large banks needs to reflect a greater consideration of these interconnections. Doing so will reduce liquidity risk and systemic risk.

Lastly, the proposed framework misses a fundamental evolution in banking. Banks are no longer simply the direct providers and holders of credit risk. They can, and should, facilitate the distribution of credit risk through a variety of risk transfer mechanisms. For more than ten years now, the FHFA has directed and overseen the GSEs' creation and growth of a credit risk transfer market, which reduces the GSEs' systemic risk. Yet, the proposed bank capital framework fails to give appropriate capital relief to banks that distribute credit risk via reinsurance, mortgage insurance, and various capital market transactions. Granting such relief would reduce the concentration of such risk on bank balance sheets, broaden the pool of capital to both evaluate and hold such risk, expand bank lending, and reduce overall capital costs.

Thank you for considering these concerns. I would be glad to discuss any of them with you.

Yours truly,



Edward J. DeMarco
President
Housing Policy Council