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MORTGAGE BANKERS ASSOCIATION

September 15, 2016

Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities [RIN 7100 AE 53]

Mr. Frierson:

The Mortgage Bankers Association[1] (MBA) appreciates the opportunity to comment on the Board of Governors of the Federal Reserve System's (Board) Capital Requirements for Supervised Institutions Significantly Engaged in Insurance Activities advanced notice of proposed rulemaking (ANPR).[2] The ANPR addresses approaches to regulatory capital requirements for depository institution holding companies significantly engaged in insurance activities (covered institutions) and nonbank financial companies that have been classified as systemically important insurance companies (SIICs). The Board is inviting comment on two approaches to consolidated capital requirements for these institutions - an approach that uses existing legal entity capital requirements as building blocks for covered institutions and a consolidated approach for SIICs.[3]

Because the ANPR is highly conceptual, with the Board requesting responses to a host of threshold questions, MBA's comments will focus on the general contours for the regulatory regime that are best suited for the insurance industry. Fundamentally, MBA is concerned that

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

[2] 81 Fed. Reg., p.38631, June 14, 2016.

[3] 81 Fed. Reg., p.38631.

the proposed rule's imposition of different capital regimes for covered institutions and SIICs would result in different capital treatment across the applicable insurance groups. In fact, the ANPR is silent about harmonizing the capital requirements that are created by the methodologies. Accordingly, MBA strongly supports the building block approach for both SIICs and covered institutions. In addition, another guiding principle to MBA's response to the anticipated Notice of Proposed Rulemaking that will follow the ANPR will be to examine how the building block approach impacts the competitive balance between insurance companies that are and are not covered by the rule – both SIICs and covered institutions.

Commercial Real Estate Mortgages and Securities are an Important Investment Category for Life Insurance Companies

Life insurance companies have a long track record of originating commercial and multifamily mortgages. Life insurance companies use mortgages as a means of investing the premiums they receive from insurance contracts and annuities, with the long-term nature of their commercial and multifamily mortgage assets being well aligned with the duration of their insurance and other liabilities. Another factor for life insurance company demand for commercial mortgages is the soundness of this investment. The most recent life insurance company delinquency data, second quarter 2016, collected by MBA for commercial and multifamily mortgages indicates that the 60-plus day delinquency rate was 0.11 percent. For a long-term perspective, the American Council of Life Insurers reports that the 60-plus day delinquency rate for commercial and multifamily mortgages held by life companies has been below 0.5 percent since the third quarter of 1998, or nearly twenty years.

In recent years, the strong performance and attractive yields of commercial and multifamily mortgages, coupled with increases in the amount of funds companies have to invest, have resulted in increased lending by life insurance companies. At the end of the first quarter of 2016, life insurance companies held $409.3 billion in mortgages (primarily commercial mortgages) in their General Accounts, which represents 10.3 percent of the General Account total, clearly indicating their importance as an investment category.

Life insurance companies also play a vital role as providers of real estate capital to the commercial/multifamily real estate industry. In fact, for first quarter 2016, life insurance companies accounted for 13.9 percent of the $2.86 trillion in commercial/multifamily mortgage debt outstanding. Commercial real estate lending serves as an important investment category for life insurance companies as well as an important source of capital to the commercial/multifamily finance industry.

Finally, in addition to commercial real estate mortgages, life insurance companies have also been significant investors in commercial mortgage-backed securities (CMBS). At the end of 2014, life insurance companies held $134 billion in private label CMBS, which made up five percent of the total bond portfolios held by life companies.

The ANPR Should Preserve the Existing Capital Treatment of Commercial/Multifamily Mortgages and CMBS

MBA supports the Board's objective for the capital frameworks to be "...appropriately tailored to the business of insurance."[4] Taking into account the fundamental difference in the business model of insurance companies versus other Board-supervised institutions is a crucial element of the rulemaking process. Moreover, it is the only way to ensure a workable and meaningful capital standard and to avoid unintended consequences.

We believe that this objective should also be applied to the capital treatment of commercial/multifamily mortgages and CMBS for insurers. These are important investment categories for life insurance companies. As such, MBA strongly recommends that the final capital regime instituted by the Board take these important investment categories into consideration and preserve their current capital treatment (see building block approach below).

For life insurance company commercial/multifamily mortgages, the current capital regime[5] has been carefully calibrated to reflect their general risk and underwriting characteristics. This calibration effort involved a sophisticated econometric analysis of life company commercial/multifamily mortgage performance and underwriting data. Introducing an alternative capital regime for commercial/multifamily mortgages would disregard the sophisticated calibration of the existing capital regime. Consequently, MBA would strongly oppose the replacement of current capital regime. Our concern is that a consolidated approach (see consolidated approach below), which would require risk factors to be applied to commercial/multifamily mortgages, could differ from the existing life insurance company capital framework. This would produce capital requirements that are not reflective of the actual risks associated with commercial/multifamily mortgages and CMBS investment categories. MBA would strongly oppose such an outcome.

To alter the current capital treatment for either commercial/multifamily mortgages or CMBS investment categories could result in reduced investment allocations to these sectors with corresponding detrimental consequences for both the life insurance and commercial real estate finance industries.

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[4] 81 Fed. Reg., p.38632.

[5] The capital framework that was developed by the National Association of Insurance Commissioners applies risk-based capital (RBC) to each loan in a life company's commercial and multifamily real estate loan portfolio based upon the loan's debt service coverage ratio (DSCR) and loan to value ratio (LTVR). The capital regime has seven RBC categories, five for performing loans, a category for loans past due and a category for loans in default. For the five categories of performing loans, the RBC charges are based upon which category in a grid (CM1-CM5) that it falls within based upon the combination of the loan's LTVR and DSCR.

The Building Block Approach

The building block approach uses "...aggregate capital resources and capital requirements across the different legal entities in the group to calculate combined qualifying and required capital. A firm's aggregate capital requirements generally would be the sum of the capital requirements at each subsidiary."[6] Importantly, the ANPR calls for capital requirements to be based upon the following: "The capital requirement for each regulated insurance or depository institution subsidiary would be based on the regulatory capital rules of that subsidiary's functional regulator— whether a state or foreign insurance regulator for insurance subsidiaries or a federal banking regulator for IDIs [Insured Depository Institutions]."[7] By reference to "functional regulator", the building block approach would potentially preserve the existing capital treatment for life company investments in commercial real estate mortgages and CMBS, which we believe is the appropriate and necessary outcome.

However, the building block approach calls for the consideration of a "scalar." The intent of the scalar is described as follows: "Scalars may, for example, be appropriate to account for differences in stringency applied by different insurance supervisors, and to ensure adequate reflection of the safety and soundness and financial stability goals, as opposed to policyholder protection, that the Board is charged with achieving."[8] To the extent that a scalar is incorporated into the building block approach, MBA strongly recommends that the scalar be calibrated in a manner that would not create a disincentive for any insurance company to invest in commercial/ multifamily mortgages and CMBS.

Consolidated Approach

The consolidated approach "would categorize insurance liabilities, assets, and certain other exposures into risk segments; determine consolidated required capital by applying risk factors to the amounts in each segment; define qualifying capital for the consolidated firm; and then compare consolidated qualifying capital to consolidated required capital."[9] In the ANPR the Board describes the primary weaknesses of the consolidated approach:

> The key weaknesses of the CA [consolidated approach] include the following: (1) The initially simple design of the CA would result in relatively crude risk segments and thus limited risk sensitivity, and (2) substantial analysis would be needed to design a set of risk factors for all the major segments of assets and insurance liabilities of supervised institutions significantly engaged in insurance activities.[10]

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[6] 81 Fed. Reg., p.38633.
[7] 81 Fed. Reg., p.38633, "{Insured Depository Institutions]" inserted for clarity.
[8] 81 Fed. Reg., p.38634.
[9] 81 Fed. Reg., p.38635.
[10] 81 Fed. Reg., p.38636.

MBA shares the Board's concerns with the consolidated approach and believes that it represents a blunt instrument for assigning capital charges to insurance companies. The building block approach sums the existing capital structure for each insurance company business line, which is far less disruptive than the consolidated approach. Moreover, MBA reiterates its fundamental concern that covered institutions and SIICs should not be subject to different capital regimes. This would result in different capital structures, which could negatively influence the competitive environment for covered institutions and SIICs. Consequently, MBA strongly recommends for the consolidated approach to be withdrawn.

Conformance with the State Regulation of Insurance Companies

Prior to implementing a new capital regime, MBA strongly recommends that the Board coordinate closely with the National Association of Insurance Commissioners (NAIC) to ensure that the proposed rule does not contradict existing state-level insurance laws and regulations. In order to reduce insurance company compliance costs and to ease potential regulatory uncertainty, the Board should identify and eliminate potential conflicts with state-level laws and regulations in the final rule.

Commercial Real Estate Regulatory Environment

Importantly, MBA has ongoing concerns about the cumulative impacts of the new Dodd-Frank and Basel III regulatory regimes for all commercial real estate capital sources. MBA strongly recommends that the Board, in coordination with the other prudential regulatory agencies, perform a comprehensive review of existing and pending regulations to eliminate conflicts among regulations and eliminate unwarranted barriers to commercial real estate capital formation.

MBA greatly appreciated the opportunity to comment on the ANPR. If you have any questions regarding this letter, please contact George Green at ggreen@mba.org or (202) 557-2840.

Sincerely,

David H. Stevens, CMB
President and Chief Executive Officer