Nareit

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Jan 16. 2024

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E–218
Washington, DC 20219

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Mr. James P. Sheesley
Assistant Executive Secretary
Attention: Comments/Legal OES (RIN 3064–AF29)
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Notice of Proposed Rulemaking for Amendments to the Regulatory Capital Rule (Docket ID OCC–2023–0008, Docket No. R-1813)

Ladies and Gentlemen:

Nareit is the worldwide representative voice for REITs[1] and listed real estate companies with an interest in U.S. real estate and capital markets. Nareit's members are REITs and other real estate businesses throughout the world that own, operate and finance residential and commercial real estate. Nareit's Mortgage REIT (mREIT) Council ("mREIT Council" or "Council"), which includes both residential and commercial mREITs, advises Nareit's leadership on mREIT matters.

On behalf of Nareit, I am happy to transmit this comment from Nareit's mREIT Council responding to the federal bank regulators (the Agencies) proposal to amend the risk-based capital requirements for U.S. banks, commonly referred to as the Basel III Endgame Proposal (Proposal).

The Council's comment sets forth the perspective of the Council's members, primarily exchange-listed mREITs, on the Proposal. These mREITs have deep experience and a proven track record of raising and deploying private capital for U.S. single and multi-family housing and other commercial real estate. In recent decades, U.S. mREITs, which frequently finance mortgage asset purchases with short-term repurchase agreements, have funded millions of U.S. single and multi-family homes and other commercial properties, year after year.

The attached Comment sets forth the Nareit mREIT Council's concerns that the Proposal, as drafted, includes features and provisions that would adversely impact the financing of commercial and residential real estate broadly, and that would dramatically increase costs and burdens for mREITs and many other

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Washington, D.C. 20006-5413
202-739-9400

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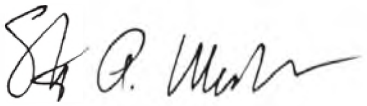
borrowers. Many of these troubling features are among the so-called gold-plated provisions of the Proposal that exceed the international Basel standard. As the Council's comment notes, some of these features have been specifically rejected by U.S. trading partners, including the EU, UK and Canada. Accordingly, the Council urges that this Proposal be reconsidered by the Agencies and that the specific provisions discussed in the Council's comment be omitted from any final rule.

Nareit and its mREIT Council members would be happy to discuss the attached comment with you and your staff. Please feel free to contact me (swechsler@nareit.com; (202) 739-9406), or Victoria P. Rostow, Nareit Senior Vice President, Regulatory Affairs and Deputy General Counsel (vrostow@nareit.com; or (202) 739-9431) with any further questions that you may have.

Respectfully submitted,



Steven A. Wechsler
President & CEO, Nareit

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Ladies and Gentlemen:

Nareit[1] is the worldwide representative voice for real estate investment trusts (REITs) and publicly traded real estate companies with an interest in U.S. real estate and capital markets. Nareit advocates for REIT-based real estate investment with policymakers and the global investment community. Nareit's Mortgage REIT (mREIT) Council (mREIT Council, or Council), which includes both residential and commercial mREITs, advises Nareit's leadership on mREIT matters.

Nareit's mREIT Council appreciates the opportunity to comment on the Proposal to amend the risk-based capital requirements for U.S. banks, commonly referred to as the Basel III Endgame Proposal (B3E, or Proposal)[2], which has been jointly proposed by the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the Agencies).

Today, publicly traded mREITs play a consequential role in the real estate capital markets by providing financing and liquidity to fund mortgages and other mortgage-related loans for residential and

[1] Approximately 150 million Americans live in households that benefit from ownership of REITs through stocks, 401(k) plans, pension plans, and other investment funds. REITs own more than $4 trillion in gross assets across the U.S. and U.S. listed REITs have an equity market capitalization of about $1.17 trillion.

[2] The Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, and Federal Deposit Insurance Corporation, "Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity," Federal Register (Sept. 18, 2023), available at https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-largebanking-organizations-and-banking-organizations-with-significant; Board of Governors of the Federal Reserve System, " Regulatory Capital Rule: Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15)," Federal Register, September 1, 2023, available at https://www.federalregister.gov/documents/2023/09/01/2023-16896/regulatory-capital-rule-risk-based-capital-surcharges-for-global-systemically-important-bank-holding.

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commercial real estate borrowers and by acquiring mortgages and mortgage-related loans. In addition to providing long-term funding for homeowners and commercial property owners, mREITs may originate and service loans, and perform related mortgage activities, including securitizations and the restructuring of troubled credits. Most mREITs focus on funding either residential real estate or commercial real estate, although some mREITs operate in both markets and a few mREITs own and operate real estate while also holding mortgages. As of Dec. 31, 2023, there were forty-one exchange-listed mREITs in the FTSE Nareit All REITs Index, including 21 that provide financing for primarily residential real estate, with a cumulative equity market capitalization of $60 billion.

As permanent sources of capital to the housing finance sector, residential mREITs invest in a broad array of residential mortgages and mortgage related instruments. Commercial mREITs have become increasingly important sources of financing for multifamily housing and other community development activities. mREITs efficiently raise private capital for single-family and multifamily housing without reliance on insured deposits, raising more than $156 billion in permanent capital for investment in residential real estate between 2005 and 2023.

Many residential mREITs focus their activities on mortgage-backed securities (MBS) issued by Fannie Mae, Freddie Mac and Ginnie Mae (agency MBS).[3] Some residential mREITs focus on non-agency MBS issued by banks and other financial institutions, also referred to as Private Label Securities (PLS). Collectively, residential mREITs play a vital role in residential finance by investing in, financing, and managing Agency RMBS and non-Agency securities. mREITs have enabled home ownership for millions of American families over many years. Nareit estimates that as of 2023 Q3, mREIT investments support one million single-family mortgages. Because mREITs typically reinvest principal repayments, the impact of mREIT mortgage investments over time is far greater.

Nareit's mREIT Council supports the Agencies' efforts to ensure the safety and soundness of the banking system and appreciates the need for periodic revisions to the risk-based capital framework that is the foundation of these efforts. However, the Council believes that the current Proposal would negatively impact the capital markets in which both residential and commercial mREITs operate. Moreover, the Council believes that several provisions of the Proposal, addressed below, would perversely operate to curtail the availability credit to commercial, multifamily, and single-family residential real estate borrowers.

Nareit's mREIT Council also shares concerns that have been voiced by a wide range of stakeholders[4] that the overall economic impact of this Proposal, which many predict would raise bank capital levels by as much as 16%, has not been adequately assessed. The Council shares the concerns that insufficient

[3] Fannie Mae and Freddie Mac are referred to in this letter as GSEs and MBS issued by them are referred to as GSE RMBS or GSE securities.

[4] See, e.g., The U.S. Chamber of Commerce Comment (Nov. 14, 2023) available at https://www.reit.com/sites/default/files/2023-11/Chamber%20Coalition%20Letter%20%2811-14-23%29.pdf; Business Roundtable Comment, (Dec. 21, 2023) available at https://s3.amazonaws.com/brt.org/2023.12.21BRTComments_Basel-III.pdf; BPI, SIFMA, FSF and American Bankers Association available at file:///C:/Users/nareit/Downloads/OCC-2023-0008-0047_attachment_1.pdf

attention has been paid to the direct and indirect costs of Proposal on the banking system as a whole and on bank customers, including homeowners and other property owners.

With respect to the specific real estate capital markets that mREIT operate in, the Council agrees with the concerns that have been expressed by many stakeholders and trade groups focused on residential and commercial real estate finance that the Proposal would have an overall negative impact on the availability of credit for commercial and residential real estate and thereby add greater uncertainty and volatility to these markets at a time when such concerns are already heightened. Accordingly, Nareit's mREIT Council joins the Real Estate Roundtable, CREFC, the U.S. Chamber of Commerce, SIFMA and many others in urging that the Agencies further evaluate the costs and benefits of the Proposal and reconsider both its broad and specific economic impacts.

However, the Council's focus in the comment that follows is on specific features of the Proposal that Council members believe will most directly impact the business and operations of U.S. mREITs. We note that many of these troubling provisions of the Proposal are among subset of features that have been referred to as the "gold-plated" Basel III Endgame provisions, referring to aspects of the Proposal that are stricter, or more stringent, than the international Basel standards. As noted in the comment that follows, many of these provisions, which would significantly increase the costs and availability of banking services provided to mREITs and other borrowers, have been specifically rejected by U.S. trading partners such as the UK, EU and Canada.

Accordingly, as the Agencies move forward, the Council strongly urges that the Agencies eliminate the troubling provisions of the Proposal that are addressed below, which the Council believes will specifically and negatively impact commercial real estate funding activities and mREIT operations. Below is a summary of the Council's concerns with these provisions, which are elaborated in the comment that follows:

- The Proposal's "gold-plated" surcharges to residential mortgage would limit credit for U.S. homebuyers and should be eliminated;
- The Proposal's mandatory minimum haircuts for uncleared securities transactions are unjustified and should be eliminated;
- The Proposal's treatment of GSE securities would impair liquidity in the market for these securities, further increasing housing finance costs;
- The Proposal's stringent securitization framework would hamper mortgage-related securitization activity;
- The Proposal would adversely impact other real estate lending activities.

Discussion

The Proposal's "Gold-Plated" Surcharges to Residential Mortgage Exposures would Limit Credit for U.S. Homebuyers

Departing from the Basel standard approach, the Proposal would impose a 20% surcharge on residential mortgage exposures, resulting in credit-risk-capital requirements for residential real estate exposures that would be twice as large as the Basel standard. The mREIT Council is concerned about the impact of these higher gold-plated risk weights on residential mortgage markets and the residential borrowers that they serve, and questions the need for these, especially considering the persuasive analysis published by the Urban Institute[5] and others[6] suggesting that these surcharges are not justified by careful analysis of recent U.S. borrower and default data.

The mREIT Council believes that this departure from the international standard with respect to U.S. residential mortgage activity is unwarranted and will negatively impact a broad range of bank customers, especially homebuyers in low-moderate income brackets. As FDIC Board Member Jonathan McKernan predicted, these higher risk weights would likely "lead to an increase in interest rates for low- and moderate-income and other historically underserved borrowers who cannot always afford a 20% down payment, making it that much harder for these families to achieve homeownership."[7] He also predicts that "[l]arge banks generally would see an increase in the capital requirement on mortgage loans to borrowers who cannot afford a 20% down payment."[8]

The Proposal's Treatment of GSE Securities would Impair Liquidity in the Market for these Securities, further increasing Housing Finance Costs

The market for GSE RMBS has long been closely linked to U.S. Treasury markets, [9] and liquid, deep and stable markets for GSE RMBS serve U.S. housing policy and the overall financial system by promoting predictable and stable mortgage markets. GSE securities thus are treated as government securities for many purposes, and given their favorable risk and liquidity profile have had similar margining requirements as government securities.[10] The Council is concerned that the Proposal fails to recognize

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[5] The Urban Institute, Bank Capital Notice of Proposed Rulemaking A Look at the Provisions Affecting Mortgage Loans in Bank Portfolios (Sept. 18, 2023) available at https://www.urban.org/research/publication/bank-capital-notice-proposed-rulemaking
[6] Bank Policy Institute, What the Basel Proposal Means for Mortgage Lending (Sept. 2023) available at https://bpi.com/the-basel-proposal-what-it-means-for-mortgage-lending/.
[7] Statement by Jonathan McKernan, Member, FDIC Board of Directors, on the Proposed Amendments to the Capital Framework (July 27, 2023) available https://www.fdic.gov/news/speeches/2023/spjul2723c.html#_ftnref10
[8] Id.
[9] Transcript of Federal Reserve Board Chair Powell's Press Conference, March 15, 2020, available at https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20200315.pdf
[10] See, e.g., FINRA Rule 4210, Margin Requirements (2022); and New York Federal Reserve Bank, Treasury Markets Practice Group, Best Practices for Treasury, Agency Debt and Agency MBS Markets (July 2019) available at https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/TMPG_BestPractices_071119.pdf

the nature and risk profile of GSE securities, and in so doing, risks disrupting the mortgage market liquidity that the GSE's were created to promote.

This anomalous treatment of GSEs is reflected in the Proposal's minimum haircut requirement for GSE securities, a feature of the Proposal that raises additional concerns addressed below. This requirement of the Proposal, if adopted, would treat GSE securities as corporate exposures rather than sovereign exposures, treatment that is inconsistent with current margining practice and without justification in terms of risk exposure. The credit risk profile of Agency RMBS is comparable to U.S. Treasuries, and Agency RMBS markets have long exhibited pricing and liquidity characteristics comparable to 10-year Treasuries. There is no justification to treat GSE securities less favorably than securities issued by Ginnie Mae for purposes of margining requirements.

The Council notes that the Proposal's treatment of GSE securities under the minimum haircut provisions is neither fully explained nor supported by data on loss history. Moreover, this treatment, which would increase borrowing costs for conforming loan homebuyers, is contrary to a range of policy initiatives underway by policymakers, lawmakers and regulators to increase the availability of housing funding to borrowers served by conforming loans and expand the pool of investors in these securities as the Federal Reserve reduces its balance sheet.

Further, the Proposal, as currently drafted, does not appear to treat GSE Uniform Mortgage-Backed Securities (UMBS) as fully fungible. UMBS were developed under the direction of the Federal Housing Finance Agency in 2019, to permit Fannie Mae and Freddie Mac to issue a single (common) mortgage-related security, to increase liquidity in the TBA market and thus make homeownership more affordable. Contrary to this important innovation, the Proposal would treat Fannie Mae securities, Freddie Mac securities, and UMBS as separate issues, effectively undermining the impact of the liquidity improvements generated by the UMBS innovation. This would both increase the regulatory capital required for banks' mortgage holdings and raise borrowing costs for homebuyers.

As the Agencies move forward, the Council suggests that commensurate with its actual risk profile and historic practice, GSE debt be treated as a sovereign exposure for purposes of any margining requirements and that all UMBS TBA and UMBS-compliant pools/MBS should be treated as exposures to a single issuer.

The Proposal's Mandatory Minimum Haircuts for Uncleared Securities Transactions are Unjustified and Should be Eliminated.

The Proposal would impose minimum collateral haircuts for non-centrally cleared securities financing transactions—including bilateral repo transactions—between banks and non-bank financial institutions. mREITs make use of bilateral repo financing to expand their ability to fund residential and commercial real estate. Under the Proposal's treatment, unless a bilateral repo transaction is secured by collateral

having value at least equal to the bank's exposure *plus* the minimum haircut, the collateral would be completely ignored for purposes of determining counterparty credit risk.[11]

Further exacerbating the impact of the Proposal's mandatory minimum haircuts, as noted above, the Proposal's treatment of GSE securities in this context as a corporate exposure, rather than a government exposure, compounds the adverse effects of these mandatory minimum haircuts for mREITs and other mortgage market participants.

The mREIT Council questions the justification for these punitive mandatory minimum haircuts, which would impose cost and complexity on banks and other mortgage market participants. Bilateral repo transactions typically require that the underlying collateral be priced daily and that borrowers post additional margin in the event of collateral downturns, which mitigates bank counterparty exposure. As such, the purpose of these mandatory minimum haircuts is not clear. The Council also notes that this mandatory minimum haircut provision was specifically rejected by the regulators in the EU, UK, Canada and Japan.

In addition to imposing substantial costs on bilateral repo borrowers, this mandatory minimum haircut provision would impose recordkeeping, governance and administrative burdens on banks, which would be required to continuously monitor and document counterparty collateral and collateral management. This would greatly impair the viability of this business line for regulated banks.

Because the Council believes that the costs and burdens of these mandatory minimum haircut provisions are considerable and the benefits have not been persuasively stated, the Council urges the Agencies to eliminate this provision from any final rule.

The Proposal's Stringent Securitization Framework Would Hamper Mortgage-related Securitization Activity

The Proposal would require large banks to set capital requirements for securitization exposures using the SEC-SA framework, which is the least risk-sensitive and most restrictive of the two Basel standard approaches[12] and would increase the capital requirements for most exposures to securitizations, including commercial mortgage-backed securities ("CMBS") and CRE collateralized loan obligations ("CLOs"). This securitization activity is critical to U.S. housing and commercial real estate finance. SIFMA estimates that over $1.5 trillion in mortgage-backed securities were issued in 2022 alone. Roughly 70 percent of home mortgage debt is securitized, and studies suggest that homebuyers and other

[11] The Basel III Endgame proposal provides for banks to calculate counterparty credit risk under two methods, the standardized approach ("CCR-SA") and the extended risk-based approach ("CCR-ERB"), and to apply the lower output of the two calculations when determining its overall RWA. The minimum haircut floor is a feature of CCR-ERB. It is expected that the CCR-ERB will be the lower output calculation under almost any scenario.

[12] Compared to the current simplified supervisory formula approach ("SSFA"), the proposed securitization standardized approach ("SEC-SA") would, among other things, (1) require a higher supervisory parameter *p* factor for securitization exposures that are not re-securitizations (1 vs. 0.5) and (2) modify the definition of the W parameter on "delinquency".

commercial real estate borrowers have greatly benefitted from this securitization activity with lower interest rates.[13]

The Council shares concerns raised by the Real Estate Roundtable[14] and others that this stringent securitization framework would result in capital requirements that are not commensurate with actual risks posed by commercial real estate securitization activities and would provide disincentives to banks for participating in these activities, to the detriment of consumers, a range of businesses and other securitization market participants such as mREITs.

The Proposal would Adversely Impact other Real Estate Lending Activities

The Proposal also contains certain other provisions, which the Council believes would adversely impact commercial real estate financing activities, including the operations of mREITs. These provisions include:

- **Reserve Requirements Against Unused Portions of Warehouse Facilities.** The Proposal would require banks to reserve against *unused* loan facilities, which would increase borrowing costs for commercial real estate borrowers, without apparent commensurate benefit.
- **Universal Cross Default Provision**. The Proposal would require banks to place CRE loans from borrowers with any other delinquent credit obligation (defined as 90 days overdue) into non-accrual status. Moreover, the Proposal requests comment on whether this punitive treatment for commercial real estate borrowers, which is not adequately explained, should be expanded to the affiliates, e.g., the parent companies of borrowers and subsidiary SPVs.
- **Omission of Loan Splitting Treatment Option**. Although the international Basel standard offers banks the option of using the so-called "loan splitting" approach to determining risk weights for real estate, the Proposal omits this option. Under the Basel loan splitting approach, a risk weight of 60% or the risk weight of the counterparty, whichever is lower, is applied to that part of the commercial real estate exposure up to 55% of the property value, and the risk weight of the counterparty is applied to the residual exposure.[15]
- **Excessive Risk Weights for Certain Real Estate-related Activities.** The Council is also concerned that the higher risk-weights broadly assigned to all entities that are not publicly listed would penalize the treatment of MBS securities, commercial real estate subsidiary Special Purpose Entities (SPE), pension funds and other critical commercial real estate

[13] James Vickery and Joshua Wright, Federal Reserve Bank of New York, TBA Trading and Liquidity in the Agency MBS Market (May 2013) available at https://www.newyorkfed.org/medialibrary/media/research/epr/2013/1212vick.pdf
[14] The Real Estate Roundtable, Comment on Notice of Proposed Rulemaking for Amendments to the Regulatory Capital Rule (Jan. 16, 2024).
[15] See, CRE 20.86 available at https://www.bis.org/basel_framework/chapter/CRE/20.htm.

market activities. Additionally, the Council is concerned that the Proposal's treatment of mortgage servicing assets, and the omission of a provision to grandfather outstanding loans will further disadvantage both residential and commercial real estate borrowers.

Conclusion

The Council strongly urges that the provisions of the Proposal detailed above be eliminated as the Agencies move forward with its final rule. Additionally, because the Council shares concerns raised by other commercial real estate finance market participants and stakeholders that the Proposal fails to fully account for the impacts and costs of the Proposal on bank customers and other end-users of the banking system, the Council additionally urges the Agencies to reconsider both the broad and specific economic impacts of the Proposal.

The members of Nareit's mREIT Council appreciate the opportunity to express their views on this Proposal and would be happy to respond to questions related to our comment, or other matters. Please do not hesitate to contact Victoria Rostow, Nareit Senior Vice President, Regulatory Affairs and Deputy General Counsel with any questions that you may have (vrostow@nareit.com; (202) 739-9431).

Respectfully submitted on behalf of Nareit's mREIT Council,

Byron Boston
Chair, Nareit mREIT Council
President, CEO & Co-Chief Investment Officer, Dynex Capital