NCSHA
National Council of
State Housing Agencies

January 16, 2024

The Honorable Martin Gruenberg
Chair
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429

The Honorable Michael Barr
Vice Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave. NW
Washington, D.C. 20551
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The Honorable Michael Hsu
Acting Comptroller
Office of the Comptroller of the Currency
400 7th Street SW
Washington, D.C. 20219

Re: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity

Dear Chair Gruenberg, Vice Chair Barr, and Acting Comptroller Hsu:

The National Council of State Housing Agencies (NCSHA),[1] on behalf of the nation's state housing finance agencies (HFAs), welcomes the opportunity to comment on the agencies' July 27 Notice of Proposed Rulemaking (NPR) Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity, more commonly referred to as the Basel III Endgame.

NCSHA appreciates the need to maintain strong capital standards for large banks, particularly following the failure of several regional banks in Spring 2023. However, the NPR includes several proposals that would reduce liquidity in the housing finance market while doing little to address the weaknesses that caused the recent failures.

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[1] NCSHA is a nonprofit, nonpartisan organization. None of NCSHA's activities related to federal legislation or regulation are funded by organizations that are prohibited by law from engaging in lobbying or related activities.

Specifically, the NPR would increase capital standards for single-family mortgage loans with higher loan-to-value (LTV) ratios. This will lead inexorably to less mortgage lending to low- and moderate-income households and other underserved populations.

In addition, the NPR would reimpose a 10 percent cap on the amount of mortgage servicing rights (MSRs) that can count toward a large bank's tier one common equity. This would make loan servicing more expensive and result in a less competitive market.

We ask that neither of these proposals be included in the final rule.

We also suggest two changes to the Basel capital standards that will foster more affordable housing lending and development while posing little risk to the health of the banking system. Specifically, we ask that regulators eliminate the disparity in risk weights between municipal general obligation bonds and municipal revenue obligation bonds (which include tax-exempt housing bonds) and reduce the risk weighting for Low-Income Housing Tax Credit (Housing Credit) properties from 100 percent to 50 percent.

Reject Increased Risk Weights for Residential Mortgages

Current regulations assign prudently underwritten mortgage loans a risk weight of 50 percent and all other primary mortgage loans a weight of 100 percent. The proposed rule would establish a tiered system in which the risk weighting for loans would increase for mortgages with higher LTV ratios. Loans with an LTV ratio between 90 and 100 percent would be assigned a risk weighting of 70 percent. The Bank Policy Institute has noted that, in some cases, the risk weighting for home purchase mortgages under the proposed rule could increase from 50 percent to 90 percent.

The proposed new risk weighting would make it substantially more costly for banks to originate high LTV loans, resulting in fewer home purchase options for low- and moderate-income families. This cuts directly against recent steps taken by banking regulators – and the Biden Administration – to increase housing supply and affordability and address inequities in the housing market. For example, it would undermine Community Reinvestment Act regulation changes federal banking regulators finalized just last year to encourage banks to better serve lower income and underserved home buyers in their communities. The proposed risk weighting would likely have a disproportionate impact on borrowers of color, who historically are more likely to need a high-LTV loan to purchase a home.

In addition to having a chilling effect on affordable home lending, requiring higher risk weights for loans with higher LTV ratios may not even achieve the rule's stated goal of protecting banks against increased risk. Generally, the size of a loan's down payment is of minimal predictive value regarding the loan's future performance. Overall, the best predictor of a loan's future performance is whether it is carefully underwritten, considering multiple factors.

The impact of higher risk weights is compounded by the fact that the NPR does not take private mortgage insurance (PMI) coverage fully into account when considering a loan's risk weighting. PMI is a valuable tool that has allowed responsible borrowers who cannot afford a large down payment to acquire an affordable home loan. It also protects lenders against losses. While it is true that some PMI providers experienced severe stress during the housing crisis, the industry has since rebounded and significantly improved its financial health.

All private mortgage insurers are subject to strict capital standards through the Federal Housing Finance Agency's Private Mortgage Insurer Eligibility Requirements ("PMIERs"). According to a recent analysis, private mortgage insurers held 69 percent more capital than required under PMIERS as of the third quarter of 2023. Despite this, the banking regulators propose a risk weighting for loans with LTVs above 90 percent and PMI coverage that is more than three times higher than the risk weighting FHFA assigns similar loans securitized by Fannie Mae and Freddie Mac. We believe this is excessive and unnecessary.

Reverse 10 Percent Cap on Mortgage Servicing Rights as Tier 1 Capital

Under the initial Basel III requirements, which were finalized in 2013, mortgage servicing rights (MSRs) could only account for 10 percent of a financial institution's Tier I capital. Any additional MSRs must be deducted from the firm's equity and would be assigned a costly 250 percent risk weighting, up from 100 percent previously. This initially applied to all banks covered under Basel. In 2019, banking regulators adjusted the rule to allow MSRs to account for 25 percent of a bank's Tier 1 assets. This increase did not apply to those large banks designated as global systematically important.

The NPR would reinstate the MSR cap for all banks, not just the very largest. This change would reduce bank interest in purchasing MSRs, reducing liquidity in the MSR market and potentially impacting consumer service.

Furthermore, the reduced cap could impact liquidity for independent mortgage banks (IMBs). IMBs account for an increasing share of mortgage lending, particularly in communities of color, rural areas, and other underserved markets. IMBs often post their MSRs as collateral to secure warehouse financing from banks to pay for their loans. If the 10 percent cap is reimposed, banks will be less likely to accept MSRs as collateral, increasing the costs of lending for IMBs, costs that will mostly be passed on to homebuyers.

NCSHA asks that banking regulators maintain the 25 percent cap on MSRs as Tier 1 Capital for most banks. We also ask the regulators to consider reducing the risk weighting for MSRs that exceed the Tier 1 capital cap from 250 percent to 100 percent, to reflect improvements in the mortgage servicing industry in the wake of the housing crisis.

Lower the Risk Weight Standard for Housing Bonds

Tax-exempt private activity Housing Bonds have historically been HFAs' primary means of financing their affordable housing lending, and HFAs have utilized them to serve many of the borrowers and markets the CRA is intended to assist. HFAs utilize single-family Mortgage Revenue Bonds (MRBs) to help working families purchase their first homes. Through 2022, state HFAs have used MRBs to finance loans to help nearly 3.5 million working families purchase a home. The MRB program is well-targeted to assist those borrowers most in need. The national median income for MRB borrowers in 2022 was 20 percent lower than the national median income.

Through Multifamily Bonds, HFAs finance the development of affordable rental housing that would otherwise not have been built in the private market. In total, state HFAs have financed more than 13,500 properties across the country using Multifamily Bonds, providing affordable rental housing to nearly 2 million families. Multifamily Bonds also help to support the construction of properties financed by Housing Credits, many of which would not be built without the bonds.

Housing bonds are classified under Basel as municipal revenue obligation bonds, because the payments to investors come from the activities the bonds finance instead of a jurisdiction's general funds. MRB investors get paid through the principal and interest paid on mortgages funded by the MRB, and multifamily bond investors are paid through payments made from the property's owner. Current Basel guidelines require that Housing Bonds and municipal revenue obligation bonds be assigned a 50 percent risk weight compared to a 20 percent risk weight for municipal general obligation bonds.

The agencies have said in the past that the reason for this disparity is that revenue obligation bonds are inherently riskier because their repayment depends on the performance of a specific project and pose more relative risk than general obligation bonds. However, all investment-grade municipal bonds, including state HFA bonds, have demonstrated strong performance.

There appears to be no compelling reason to differentiate between municipal bonds and assign them different risk weights solely based on whether they are investment-grade general revenue or investment-grade obligation bonds. Therefore, we urge you to rescind the provision that would assign a 50 percent risk weight to all municipal revenue obligation securities, and instead adopt a system that would assign a 20 percent risk weight on all investment-grade municipal securities. This would reduce HFA borrowing costs and free up more money to support affordable housing options.

Reduce Risk Weighting for Housing Credit Properties

The Housing Credit, which is administered by HFAs in all but a few states and territories, is our nation's most effective tool for financing the development of rental housing affordable to low-income Americans. By providing an incentive for private sector investment, the Housing

Credit has financed more than 3.6 million apartments for low-income households, adding approximately 120,000 units to the inventory each year.

Large banks are among the most active Housing Credit investors. In addition to the potential tax savings, banks are attracted to Housing Credit investments because they often earn CRA credit. A 2014 publication from accounting firm Cohn Reznik reported that "Roughly 85 percent of the equity for all LIHTC investments comes from banks subject to the CRA."[2] An analysis of OCC data shows that 98 percent of national banks' LIHTC investments come from banks with assets greater than $50 billion.[3]

Current Basel standards assign banks a 100 percent risk weighting for Housing Credit financed properties, in line with other community development investments. While this makes sense intuitively, the strong performance of Housing Credit properties suggests a lower rating weighting is merited. Since 2002, the foreclosure rate on Housing Credit properties has generally remained below .1 percent. This includes during the Great Recession, when serious delinquencies in the multifamily market exceeded 4 percent.

Given the strong performance of Housing Credit properties, the critical role the program plays in financing affordable housing, and the acute shortage of affordable housing options our nation faces, a reduced risk weight is more than justified. We ask that regulators reduce the risk weighting for Housing Credit properties to 50 percent.

Thank you for your consideration. We would be happy to discuss these issues with you at your convenience.

Sincerely,

Garth Rieman
Director of Housing Advocacy and Strategic Initiatives

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[2] Copeman, Fred, "What Do Higher LIHTC Prices Mean for Syndicators?" *Affordable Housing News & Views*, June 1, 2014. https://www.cohnreznick.com/insights-and-events/insights/what-do-higher-lihtc-prices-mean-syndicators

[3] NAAHL analysis based on data from OCC. The FDIC and Federal Reserve Board do not publish comparable data for the banks they supervise.