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MORTGAGE BANKERS ASSOCIATION

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RE: Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity
Docket ID OCC–2023–0008; RIN 3064–AF29; R–1813, RIN 7100–AG64

Dear Sir/Madam:

The Mortgage Bankers Association[1] (MBA) appreciates the opportunity to comment on the notice of proposed rulemaking (NPR) issued by the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC) and the Board of the Governors of the Federal Reserve System (the Board) (jointly, "the Agencies"). The NPR is intended

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 300,000 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 to 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 more than 2,200 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

to implement the final components of the Basel III standards to which the U.S. banking system has been gradually transitioning over many years.

MBA represents over 2,200 member companies, including bank and non-bank lenders, servicers and sub-servicers, mortgage insurance companies, title insurers, and vendors in both the residential and commercial markets. MBA and its members have substantial concerns that, without significant changes, the NPR will undermine real estate finance market stability, further diminish housing affordability and reduce the opportunities that consumers have to access mortgage credit – particularly among first-time homebuyers and in communities that are traditionally underserved.

I. Background

On July 27, 2023, the Agencies published the long-awaited Basel III "Endgame" NPR, which would substantially revise the capital requirements applicable to banking organizations (defined to include traditional savings and loan holding companies and U.S. intermediate holding companies of foreign banking organizations) with $100 billion or more in total consolidated assets and their depository institutions (referred to as "large banking organizations"), as well as firms with significant trading activities. The Agencies state that the NPR is intended to: (i) improve the calculation of risk-based capital requirements to better reflect the risks; (ii) reduce the complexity of the regulatory capital framework; (iii) enhance the consistency of requirements among banking organizations; and (iv) facilitate "more effective supervisory and market" assessments of capital adequacy.

II. Process and Analytical Concerns

MBA supports regulatory capital requirements that are tailored to ensure that banks hold enough capital to serve as a cushion against losses under stressed financial conditions, thereby reducing the likelihood of bank failures and protecting the financial system. However, we caution against excessive or mis-calibrated capital requirements – both overall and for certain asset classes – that will impede economic growth, undermine stability and competition in the housing sector, and drive banks away from supporting certain key sectors of the economy.

In recent years, bank origination of single-family residential mortgages and holdings of mortgage servicing rights (MSR) have been declining, in large part due to capital rules that have made mortgages unattractive to hold and service.[2] MBA strongly cautions against adoption of certain provisions of the NPR that would result in further bank withdrawal from the mortgage market. Our concerns are amplified by the fact there is little economic impact analysis to support the need for many of these provisions.

[2] See Appendix A

At the macro level, it is unclear what specific problem the NPR is trying to solve, considering that the Federal Reserve and the U.S. Treasury have repeatedly stated that the overall U.S. banking system is strong. Prior to releasing the Basel III "Endgame" framework, the Basel Committee on Bank Supervision stated that this final phase of revisions was intended to be capital neutral. However, for reasons not well-explained, the NPR effectively increases capital requirements at large banks by an estimated 15 to 20 percent – large enough to impact credit availability economy-wide, as well as impact which lines of business banks choose to support – with implications for the entire mortgage market.

While the NPR represents a substantial change for all affected banks, the impact on banks between $100B and $700B in assets (often referred to as category 3 and 4 banks) is particularly acute. These banks would no longer be able to opt out of certain provisions of the capital rules and would be subject to much of the capital framework currently applicable only to the Global Systemically Important Banks ("G-SIBs"). According to the Agencies, the goal is to establish a single and consistent regulatory framework for all banks with assets of $100B or more. This ignores the principle of tailoring that has repeatedly been endorsed by Congress – most recently in the Economic Growth, Regulatory Relief, and Consumer Protection Act in 2018 – and results in the imposition of substantial regulatory adjustment costs on banks that will inevitably be passed on to borrowers, including small businesses.

Most of the previous proposed capital rules implementing the Basel framework were unanimously approved by the Banking Agencies and involved at least one quantitative impact study (QIS). Any major change in bank capital policy warrants thorough analysis of its potential economic costs – especially when the policy change directly impacts everything from the cost of funds for our largest financial institutions to the costs for ordinary Americans looking to purchase a home. The lack of independent and original analysis conducted prior to the release of such a consequential regulatory sea change is extremely troubling.

The NPR ignores the significant difference between banks over $700B in assets and banks between $100B and $700B, especially as it relates to the ability to absorb these proposed changes. At the very least, the Agencies should consider a sliding scale of implementation of the proposals for banks between $100B - $700B vs. Banks with assets over $700B. Not doing so could place many regional banks in the position of having to comply with costly and complex new rules that could have a significant impact on their ability to serve borrowers in a cost-efficient manner.

III. Summary of Key Mortgage Market Recommendations

The Agencies express support in the NPR for homeownership and state that they "do not intend the proposal to diminish home affordability or homeownership opportunities, including for low- and moderate-income (LMI) home buyers or other historically underserved

markets." Unfortunately, key provisions in the NPR would undermine that objective and need to be reconsidered and/or modified.

MBA is particularly opposed to the following provisions of the NPR that would directly impact the mortgage market; each is described in greater detail below:

- the revised risk weighting for residential and commercial mortgages held on a bank's balance sheet;
- the proposed revision of the cap on MSR holdings that can be reflected in capital for all large banks; and
- the increase in the capital conversion factor for any unused portion of a warehouse facility.

We are concerned that these provisions would further increase the risk of banks exiting (or at the very least, further reducing their participation in) the mortgage lending and servicing market. Our recommendations offer fixes to the proposed capital rule and address long-standing problems with the current rules that will strengthen the stability of our housing finance system by incenting large banks to increase their direct and indirect role in residential finance.

MBA specifically recommends the following changes to the overall U.S. bank capital framework that would improve mortgage market participation, liquidity, and resilience, and help ensure the continued flow of mortgage credit while reducing costs for consumers:

- Single Family Residential Mortgage Risk Weights: adopt the Basel III recommended risk weights by LTV and remove the 20 percentage point add-on ("gold plating"); provide credit for private mortgage insurance (PMI) on high loan-to-value (LTV) loans held on a bank's balance sheet;
- Mortgage Servicing Rights: retain the current 25 percent cap on MSRs that can be reflected in regulatory capital for category 3 and 4 banks; lower the current punitive 250 percent risk weight assigned to MSRs for all banks;
- Warehouse Lending: preserve the current credit conversion factor on any unused portion of a warehouse line and reduce the current 100 percent risk weighting on warehouse lines; and
- Commercial Lending: refrain from including an expanded definition of defaulted real estate exposures or define "obligor" to mean only the legal owner of the real estate.

Although we focus our comments on the proposals that directly impact the residential and commercial mortgage market, MBA is very concerned about the overall impact of the proposed changes on the economy. This letter also addresses several additional topics that indirectly impact the mortgage market and expresses support for comments submitted by other stakeholders.

IV. Provisions Directly Impacting the Mortgage Market

A. Revised Risk Weights for Regulatory Real Estate Exposure

(i) 1-4 Family Residential

The NPR revises the current risk weight assigned to residential mortgages held on a large bank's balance sheet based on LTV ratios and the loan's dependence on cash flow from the underlying real estate.[3] Under the NPR, LTV ratio would be calculated as "the extension of credit divided by the value of the property at the time of origination."

Without supporting impact analysis, the Banking Agencies chose to "gold plate" the Basel framework risk weights for home mortgages by adding twenty percentage points across the board and removing any credit for the risk mitigation provided by private mortgage insurance. As a result, large banks will face higher capital requirements than those imposed under the current applicable rules for loans with LTVs greater than 80 percent.

The proposed higher risk weight on high-LTV loans would negatively impact large banks as lenders (and buyers) of CRA-eligible mortgages and aggregators of conforming mortgages, as well as reduce their participation in originating and buying jumbo mortgages. The proposal could also significantly reduce the amount of high-LTV (low-down payment) affordable lending held on the balance sheet of these banks, and negatively impact banks' ability to cater to underserved borrowers through the use of lending products such as Special Purpose Credit Programs (SPCPs). Despite significant interest in the banking community to bridge access and affordability gaps in homeownership, the proposed revision will only make these aspirations more difficult to achieve, while placing a heavier burden on Fannie Mae and Freddie Mac (the GSEs) and Ginnie Mae to support these markets. Moreover, the additional capital penalty for holding high-LTV loans directly contradicts the Agencies' policy objectives embodied in the recent major revision to the Community Reinvestment Act rules.

The Agencies acknowledge that they do not intend for the proposed risk weights to have "unintended impacts on the ability of otherwise credit-worthy borrowers who make a smaller

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[3] Regulatory residential mortgages that are not dependent on cash flows from the underlying RE

LTV Ratio	<50	50-60	60-80	80-90	90-100	>100
B3E Proposed RW	40%	45%	50%	60%	70%	90%

Regulatory residential mortgages that are dependent on cash flows from the underlying real estate

LTV Ratio	< 50	50-60	60-80	80-90	90-100	>100
B3E Proposed RW	50%	55%	65%	80%	90%	125%

The proposed risk weights are higher than the Basel III recommendation. According to the Agencies, this would create a level playing field for large banks and community banks, because without the change, community banks would be subject to higher marginal funding costs on residential real estate and retail credit exposures. While we support efforts to "mitigate potential competitive effects" between large and small banks, we believe that the better approach would be to allow smaller banks to use the same non-gold-plated risk weights in the Basel framework, rather than increasing the risk weights for mortgages held by large banks.

down payment to purchase a home," and therefore, proffer several alternatives. One such alternative suggests a 50 percent risk weight for high-LTV loans if they are originated pursuant to prudent underwriting standards and through a home ownership program designed to provide a public benefit, including "risk mitigation features such as credit counseling and consideration of repayment ability." Today, banks originate prudently underwritten high-LTV loans with or without the use of specific public benefit programs. Requiring that high-LTV loans receive a 50 percent risk weighting only if originated under a particular program would narrow the scope of prudently underwritten high-LTV loans that receive the 50 percent risk weight.

Another suggested alternative would be to generally retain the current 50 percent risk weight for prudently underwritten mortgages (without relying on LTV or dependency upon cash flow generated by the underlying real estate). Under this alternative, mortgages that do not meet the prudently underwritten requirements would be assigned a 100 percent risk weight. MBA appreciates the Agencies' efforts to suggest alternatives to the gold-plated LTV grid, but we believe that the proposed alternatives would result in capital requirements higher than proposed in the Basel framework, which is unwarranted based on the underlying credit risk. In short, this is a prescription for further bank retreat from the mortgage market.

While both current capital rules and the NPR give credit for private mortgage insurance (PMI) in determining whether a loan is "prudently underwritten," the NPR crucially does not recognize the significant value of PMI in reducing risk severity on high-LTV (low down payment) loans. The failure to give any credit whatsoever for PMI effectively defeats the purpose of that insurance and significantly increases costs for homebuyers. For instance, under the NPR, loans with LTVs above 80 percent and less than 90 percent would be assigned an initial 60 percent risk weight to cover the risk of credit losses on that loan even if PMI reduced the loss exposure well below the 80% level. In effect, the borrower pays for the same risk twice – in the cost of the PMI premiums and the additional cost passed through by the bank because of the higher capital charge.

A capital regime that recognizes the mitigation of credit risk provided by PMI provides banks with appropriate incentives to reach first-time and underserved homebuyers who cannot make a 20 percent down payment.

Recommendation:

MBA recommends that the Agencies refrain from the proposed gold-plating, and instead, adopt the risk weighting promulgated by the Basel III framework. Further, the rules should provide credit for private mortgage insurance by assigning the next lower risk weight in the LTV grid for loans with MI. Under this approach, high-LTV loans with PMI would continue to meet the "prudently underwritten" standards and be assigned a preferential risk weight. To address the Agencies' concern about the possible "competitive advantage" this

recommendation could create between large and smaller banks, small banks should have the option to apply the same risk weights. The chart below summarizes our recommendation:

MBA recommended risk weights for regulatory residential real estate mortgages (regardless of whether the mortgage is dependent on the real estate cash flow)

LTV Ratio	< 50	50-60	60-80	80-90	90-100	>100
Current U.S. Capital Framework	50%	50%	50%	50% (with MI)	50% (with MI)	50% (with MI)
Basel III Recommendation	20%	25%	30%	40%	50%	70%
MBA Recommendation	20%	25%	30%	40% 30% with MI	50% 40% with MI	70% 50% with MI

(ii) Commercial

Expanded Definition of Defaulted Real Estate Exposures

Background

The Agencies propose a new definition of "defaulted real estate exposures" that is broader than the current capital rule and requires banks to evaluate certain loan assets at the borrower/obligor level rather than the asset/exposure level. The NPR requires that an elevated risk weight be assigned to "defaulted" real estate exposures and states that – in addition to default of the loan itself in question – a real estate exposure is considered defaulted if either (i) the obligor has any credit obligation with the bank that is in default[4] or (ii) the bank determines that the obligor is unlikely to pay its credit obligations (based on a determination that the obligor is in default on a credit obligation with any creditor). This means that current real estate loans could be treated as defaulted exposures even if their repayment is not suspect and would require elevated risk weights until they no longer meet this expanded definition.

MBA opposes the expansion of the definition of defaulted real estate exposures and urges the Agencies to preserve the treatment of defaulted real estate loans under the current capital rule.

Nature of Commercial Transactions

At a broad level, there are two types of commercial mortgages secured by income-producing properties and made and held by insured institutions – mortgages made to and backed by single-purpose bankruptcy-remote entities that own the income-producing property (including

[4] Default is described in the NPR as 90 days or more past due or in nonaccrual status.

multifamily) and mortgages made to other corporate entities or individuals with broader sets of assets and collateralized by the income-producing property.

On a dollar basis, the overwhelming majority of commercial real estate loans are made non-recourse (secured only by the property) to a bankruptcy-remote special purpose entity with no other real estate obligations. In these cases, evaluating default at the exposure level and the obligor level is the same. As the NPR states concerning residential loans, "…most obligors of residential real estate exposures do not have additional real estate exposures**.** Therefore, determining default at the exposure level would account for the material default risk of most residential mortgage exposures."[5]

The default status of mortgages made to single-purpose, bankruptcy-remote entities that own income-producing properties should be entirely dependent on the status of that particular loan.

Mortgages backed by income-producing properties made to other corporate entities or individuals should have similar treatment. Although the borrower may have assets and obligations in addition to the collateralized property, the performance of the subject loan will still be dependent on the collateralized property. Should the borrower default or face challenges on other obligations, the lien ensures that the collateralized property's cash flows and value will determine the repayment of the subject loan.

The default status of mortgages made to individuals or corporate entities with broader sets of assets and collateralized by income-producing properties should be entirely dependent on the status of that particular loan.

Operational Concerns

The NPR is unclear as to whether the "obligor" is defined only as the legal borrower and owner of the property – a special purpose entity in many commercial real estate transactions.[6] If the final rule defines "obligor" broadly to include a parent company, members or partners of the legal owner, or other related parties, the expanded default treatment would be non-sensical in these cases. The mortgage-holder has a direct lien on the underlying property, meaning other obligations of parties of the transaction cannot interfere with the mortgage-holders' access to the underlying collateral's cash flows and value.

For all of the above situations, this new requirement would be problematic, unworkable, and place significant cost and operational burdens on banks. Banks do not have a system or framework in place to track all debt obligations of their borrowers and any parent companies/owners of the borrower. Creditors do not notify other creditors of a default or cure event, nor is there a uniform national data repository for real estate loan status, including defaults and cures. Even if the Agencies require banks to share information, it will necessitate

[5] 88 Fed. Reg. 64050 (September 18, 2023)
[6] The NPR also does not address how real estate exposures with a guarantor in place are treated. MBA recommends that the Agencies clarify that banks only look at other credit obligations of the legal owner of the real estate and not the guarantor of the loan. A guarantor is merely a backstop for the primary obligation of the borrower.

a significant operational build for reporting and would not cover non-bank loan information, negating the whole purpose of a cross-default risk-weight rule.

For residential loans, the Agencies even state in the NPR that "evaluating defaulted residential mortgage exposures at the obligor level may be difficult for banking organizations to operationalize, for example, if there are challenges collecting information on the payment status of other obligations of individual borrowers."[7] This is also true for commercial real estate loans.

Furthermore, in the case of income-producing commercial property, a default on one loan is not necessarily a strong indicator of default on other loans by the same obligor. Commercial real estate is unique and impacted by many factors, including geographic location and type, and a default on an office building in San Francisco will not necessarily lead to a default on a multifamily property in Dallas.

Recommendation:

MBA strongly urges the Agencies to refrain from including an expanded defaulted real estate exposures definition in the final rule. If the Agencies finalize the NPR to include the expanded default concept for some types of real estate loans, MBA recommends that the definition of "obligor" be limited to the legal owner of the real estate (and not the parent company, members, or partners of the borrower, etc.).

B. Mortgage Servicing Rights – CET 1 Cap and Risk Weighting

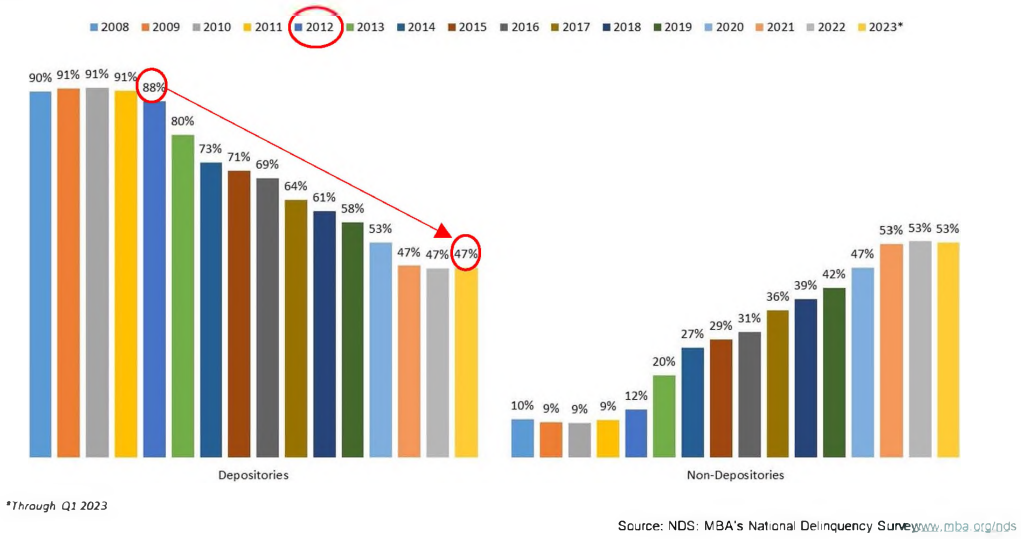
Current rules allow category 3 and 4 banks to include up to 25% of threshold items (including MSRs)[8] in the calculation of common equity tier 1 (CET1) capital.[9] In aligning the definition of capital for all large banks, the Agencies propose lowering the 25% cap to 10% for individual threshold items and apply the 15% aggregate deduction rule to category 3 and 4 banks.

The NPR does not address the current punitive 250% risk weight on MSRs that has been cited by many analysts – including the Financial Stability Oversight Council – as a primary contributor to banks' exodus from the mortgage servicing market.[10] In 2012, the year

[7] 87 Fed. Reg. 15698 (March 18, 2022).
[8] Threshold items include: MSRs, temporary difference DTAs that the banking organization could not realize through net operating loss carrybacks, and investments in the capital of unconsolidated financial institutions.
[9] Under the current capital rule, Category 1 and 2 banks must deduct from CET1 capital amounts threshold items that individually exceed 10 percent of the bank's CET1 capital minus certain deductions and adjustments. These banks must also deduct from CET1 capital the aggregate amount of threshold items not deducted under the 10 percent threshold deduction but that nevertheless exceeds 15 percent of the banking organization's CET1 capital minus certain deductions and adjustments. In effect, MSRs are subject to a 15% combined DTA/MSR/unconsolidated financial institutions cap. Under a 2017 rule that MBA advocated for, Category 3 and 4 banks were allowed a 25 percent cap on threshold items and exempted from any aggregation.
[10] FSOC_20230421_Minutes.pdf (treasury.gov): page 7.

before the current rules were put in place, banks held 88% of all servicing assets; today they hold only 47%.

Who Are the Mortgage Servicers?



By lowering the CET1 cap on MSRs to 10% for all Category 3 and 4 institutions, the NPR will likely encourage many of these banks to resume their exit from the servicing market with significantly harmful downstream impacts on the mortgage market and consumers. MBA has long advocated for a reduction in the punitive risk weight assigned to MSRs under Basel III, and we continue to urge the Agencies to work with industry to understand the implications of such punitive treatment.[11]

MSRs play a key role in enabling banks and independent mortgage bankers (IMBs) to provide mortgage credit to their community. The servicing business is not just about collecting and advancing payments but also establishing and deepening relationships with borrowers. These relationships help banking institutions strengthen their ties with the communities they serve and enable them to be a better resource to the local economy. These relationships are especially meaningful during distressed times, such as the recent pandemic, when banks' ability to understand and address the needs of their existing borrowers became a useful tool in helping consumers navigate the unprecedented impact of the pandemic on household finances. Therefore, we caution against rules that would further restrict or shrink the mortgage servicing relationships these institutions have with their borrowers and communities.

The impact of the NPR's MSR provisions is not limited to the large banks directly covered under the rule. Because the mortgage origination business involves the production of an MSR asset with every loan that is manufactured and sold, the NPR will impact IMBs, community banks, credit unions, and – most importantly – their borrowers. The value of the

[11] For many years, MBA has been urging the Agencies to amend Basel III rules for all banks and increase the cap to 50%, eliminate the 15% aggregate cap for threshold items, and reduce the risk weighting of MSRs to 130%.

MSR asset is embedded as an interest rate "strip" – a portion of a borrower's note rate. When servicing assets are attractive and in high demand, the price of the mortgage is bid up, and the servicing strip and note rate to the borrower is reduced.

The NPR will produce the opposite result. By making the capital treatment for servicing assets even more unattractive, banks will further reduce their appetite for mortgage servicing, resulting in declines in MSR values and higher interest rates for borrowers.

MBA is concerned that the Agencies continue to take the erroneous and outdated position that MSRs are extremely risky and difficult to value. In fact, the NPR reiterates the Agencies' assertion in their 2016 report to Congress on the MSR capital rules ("the 2016 Report"),[12] that "the high level of uncertainty regarding the ability of banking organizations to realize value from these assets, especially under adverse financial conditions" is justification for the punitive treatment of MSRs under the capital rules.

More than 15 years after the Great Financial Crisis, the mortgage servicing market has changed significantly. Today, the MSR asset is a well-managed and controlled asset, and holders of MSRs engage in various activities – including hedging and regular marking-to-market – to better manage volatility and greatly reduce any asserted riskiness of the asset.

While the process of selling MSRs may take longer than some other asset classes, this is a byproduct of the processes that have been put in place to protect borrowers, guarantors and investors. For instance, the process includes the time that is needed to obtain Ginnie Mae, Fannie Mae or Freddie Mac approval for the sale, as well as the regulatory requirement to send letters to borrowers from both the transferor and the transferee alerting them to the change in servicers. Furthermore, the sale process includes buyer due diligence as well as physical and electronic transfers of files and information. These required and prudent procedures that accompany the sale of the asset should not be used as a reason or justification to punish holders of the asset.

Great strides have been made over the last several years to better understand, control, and manage MSRs. This has not only reduced the risk of the asset class but has also improved the ability of banks to value the asset, resulting in a well-functioning and actively traded market for MSRs. Even as the Agencies raised questions and concerns in the 2016 Report about the riskiness and liquidity of MSRs, they did acknowledge that of the 518 banking institutions that failed between 2007 and 2015, 66 had MSRs on their books at the date of failure, and "problems with MSRs" was identified as a significant factor leading to the failure of only one institution and as contributing to the failures of three others. It is therefore unclear why the Agencies continue to take the same position on MSRs years later, despite clear evidence of improvement in the management of, valuation of, and active market for

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[12] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, National Credit Union Administration, Report to the Congress on the Effect of Capital Rules on Mortgage Servicing Assets (June 2016). The Report notes that other countries have adopted mortgage finance systems that do not create a considerable volume of MSRs. In discussions with supervisory authorities from those other countries, the U.S. regulators discovered that their supervised firms have negligible ratios of MSRs to CET1 capital. The regulators further explained in the report that it was quite likely that these negligible amounts were attributable to U.S. operations of foreign banks or associated with acquisitions.

the asset. It is also extremely difficult to understand how the Agencies could determine that certain assets with "unspecified credit risks" be risk weighted lower than MSRs.[13]

The negative impact of the current punitive risk weight on MSRs coupled with the proposed changes in the NPR on liquidity in the market for all players (banks and IMBs) cannot be overemphasized. For instance, in addition to forcing banks to reduce their MSR holdings, these rules could also result in banks pulling back from lending against the MSR asset. Inevitably, the overall effect would be increased costs for all borrowers.

Recommendation:

MBA strongly recommends that the Agencies:

- retain current rules with respect to the 25% cap on MSRs that can be included in CET1 capital for category 3 and 4 banks, with no aggregation for threshold items that can be counted in CET1;
- reduce the current 250% punitive risk weight assigned to MSRs to no more than 130% as MBA has been advocating for many years; and
- apply this recommended risk weight for MSRs to all banks, regardless of size, given that the characteristics of the asset do not change regardless of who owns it.

We encourage the Agencies to take a more analytical approach to assigning risk weights to mortgage servicing rights. To do this, the Agencies must consider the fact that while servicing rights for some asset classes may not be liquid and easy to convert to cash in times of distress, as we note above, this is not the case for the MSR marketplace, which has evolved substantially over the past 15 years.

C. Warehouse Lines – CCF and Risk Weighting

Banks serve the real estate finance market through direct lending to borrowers and also — just as critically — by providing very useful funding for mortgage banking activities that IMBs engage in through warehouse lines of credit. IMBs rely on warehouse lines of credit – a contractual arrangement between the bank and an IMB to provide financing -- to fund their mortgage origination and certain servicing activities. These bank financing commitments support more than 60 percent of single-family mortgage origination, representing an important and growing share of the market over the past decade. Warehouse lending has become one of the most important sources of liquidity for the U.S. housing market. We urge the Agencies to carefully examine the impact of certain provisions of the NPR that could impair the supply of warehouse credit.

[13] See Appendix A.

(i) Credit Conversion Factor

The unused portion of a warehouse line of credit, which is an off-balance sheet commitment[14] by the bank, is currently subject to credit conversion factors (CCF) intended to capture the risk of future draws against a bank's commitment to provide credit to the IMB borrower. Under current rules, the applicable CCF for such commitments ranges between 0%-100%, depending on maturity of the facility and whether it is unconditionally cancelable by the bank. Current CCF is 0% for an unconditionally cancelable commitment; 20% for the unused portion of a 12-month facility that is not unconditionally cancelable; 50% for the unused portion of the facility if maturity is greater than 12 months; and 100% if the facility is fully utilized. The typical IMB/bank arrangement is a 12-month commitment that is not unconditionally cancelable, resulting in a 20% CCF under current rules.

The NPR would retain the existing definition of a commitment but revises the applicable CCF for commitments. Under the NPR, the CCF for an unconditionally cancellable facility would increase from 0% to 10%, and the CCF for the unused portion of a not unconditionally cancellable commitment (i.e., the typical IMB facility) would increase from 20% to 40%, regardless of maturity. Other than making it more costly for banks to provide this very important and useful product to IMBs, it is difficult to understand the justification for the proposed change.

Because mortgage markets can experience significant demand volatility, IMBs secure funding facilities from multiple warehouse lenders and pre-position the additional liquidity to support potential spikes in application volume. Similarly, banks offer lines of credit to finance MSRs and mortgage servicing advances – a critical need to support servicing loss mitigation activities. The proposed doubling of the CCF could make this additional liquidity – which served the market well during the recent pandemic refinance boom and forbearance wave – prohibitively expensive for banks to offer and their IMB customers to maintain. As a result, the NPR's CCF provisions applied to warehouse lines would make the U.S. housing finance market less resilient, not more resilient.

(ii) Warehouse Line Risk Weighting

A warehouse commitment is a relatively low margin, low credit-risk business with modest returns for banks. The proposal to double the CCF on the unused portion of this business - the portion that is in fact not earning any profit or income for the bank – would result in rules that make it unattractive for banks to continue to offer this product, thus making it more difficult for IMBs to obtain the necessary funding that has facilitated the majority of single-family mortgage originations over the past decade, thereby allowing IMBs play the important role that they do today in the mortgage finance system. MBA has advocated for years that the Agencies revise the current framework to reduce the 100% risk weight on warehouse

[14] A legally binding arrangement that obligates a banking organization to extend credit or to purchase assets. A commitment can exist even when the banking organization has the unilateral right to not extend credit at any time.

lines to better reflect the low risk in warehouse lending.[15] Mortgages financed by the facility generally remain on the line for two weeks before being sold. That advance is risk weighted at 100% under current rules. That same loan, if held on the bank's balance sheet would be risk weighted at only 50%, despite a much longer duration exposure to credit risk. Moreover, should the IMB counterparty fail, the warehouse banker can immediately take possession of the collateral and experience a reduced risk weight. Ironically, under current rules the only time a well-underwritten single-family loan has a 100% risk weight is the two-week period it sits on the warehouse line.

As a general matter, a warehouse commitment is akin to a repurchase transaction because the bank provides funding for the IMB's loan origination and takes possession and control of the financial collateral until the funding is repaid by the IMB. In effect, the bank is able to quickly turn the collateral into cash in the event of IMB default prior to repayment, thereby mitigating any exposure risk and facilitating rapid recovery. That should give the warehouse facility (i.e., repo line) a very minimal capital requirement because the bank is able to net the collateral against the funded amount. Therefore, there is no reason why the risk weight assigned to a warehouse line should be higher than that of the financial collateral backing the line, especially because a warehouse line functions in substance as a repo transaction.[16]

Recommendation:

The proposed increase in the CCF, coupled with the current capital treatment that applies an unnecessarily high 100% risk weight to the warehouse line, would make warehouse lending an unattractive line of business for banks. MBA is concerned that if warehouse lenders are required to hold more capital, they could either decide to exit this line of business or charge IMBs more. Regardless of the outcome, it would mean a higher cost of credit for all borrowers. Retaining the current CCF and lowering the risk weight on warehouse lines will increase the capacity of banks to fund more loans, thereby providing much-needed support to the real estate finance market and ensuring the continued flow of mortgage credit.

MBA recommends that the Agencies:

- retain the current 20% CCF for the unused portion of a warehouse facility, regardless of maturity; and
- reduce the current 100% risk weight on warehouse lines to make it consistent with or mirror the risk weight of the financial collateral securing the line.

[15] The fact that the loan is already discounted against the underlying collateral through the advance rate provides protection for the bank. In addition, the bank's ability to sell the collateral in case of default makes it clear that warehouse lending is collateral lending and not cash flow lending, and therefore, a low-risk business for the bank.
[16] See Appendix B for more detailed analysis on the justification for reduced risk weight on warehouse lines.

V. Other Provisions

A. Operational Risk

Under the current capital framework, category 1 and 2 banks are able to use internal models to determine the amount of capital that can be held against the operational risks of their activities – i.e., the risk of loss resulting from inadequate or failed internal processes, such as mismanagement and fraud, or from failed systems and external shocks, like a cyberattack. The NPR would retain the antiquated Basel definition of operational risk but replace the current internal-models-based calculation for credit and operational risk with a new "expanded risk-based approach" (ERBA), and also make it applicable to category 3 and 4 banks. The revised operational risk capital framework in the NPR accounts for much of the increase in capital requirements and introduces significant complexities in the calculation of capital, especially for category 3 and 4 banks.

MBA is particularly concerned about the significant impact of the operational risk proposal on mortgage activities of banks. While we do not disagree that operational risk is inherent in banking products, processes, and systems, we urge the Agencies to pause and take the time to analyze some of the unintended consequences of the proposed changes and the impact they could have on mortgage banking activities.

The proposed operational risk changes would further diminish the attractiveness of MSRs for banks. It is important that the Agencies consider the cumulative effect of their rules on MSRs, and how they could make it extremely difficult for banks to continue to hold or lend against the MSR asset.

As stated, MSRs are currently assigned a punitive 250% risk weight -- much higher even than junk bonds and some other assets that clearly would be considered riskier than MSRs. With the application of the operational risk provisions on fee-based services, income generated on the MSR asset will be included (under the services component of the business indicator) in the calculation of the bank's operational risk charge. This results in a double charge on the MSR – at creation and on the future income it generates – effectively increasing the already punitive 250% risk weight on MSRs to a much higher number.

MBA urges the Agencies to seriously consider recommendations that have been put forward by many commenters (such as the Bank Policy Institute/American Bankers Association joint comment letter on the NPR) that address in greater detail the unintended consequences of the application of the operational risk proposal, especially as they impact loan sales and mortgage servicing activities of affected banks.

B. Procyclicality

The NPR would use a three-year rolling average to compute the inputs to the business indicator for purposes of calculating the bank's fee income/loss under the operational risk rules.[17] This would create a major issue for the mortgage banking business because of the highly cyclical, rate-sensitive nature of the business. When interest rates are low, refinancing and origination activities spike, and when interest rates rise (such as in the current environment), purchases and refinancings can dry up quickly. The volatility that exists in the mortgage banking business would make it difficult to obtain an accurate picture of a bank's business indicator for purposes of obtaining the input required to calculate the business indicator component. The Agencies intend for the three-year average formula to capture a bank's "activities over time and help reduce the impact of temporary fluctuations." In the mortgage banking business, the timing of these fluctuations is hard to predict and the volatility is not a function of anything the lender is able to control. MBA believes, therefore, that the application of the three-year average formula to the mortgage banking business would create exactly the opposite of what the Agencies intend to achieve.

MBA suggests that as part of the recommended QIS, the Agencies engage with industry stakeholders to assess the most workable approach for achieving the intended goal under this proposal. In effect, any final rule should reflect the result of such QIS.

C. Fannie Mae and Freddie Mac (GSEs)

(i). Treatment of GSE Debt Posted as Collateral

Under the current capital framework, GSE debt posted as collateral against either derivatives or securities financing transactions (SFTs) receives a preferential treatment similar to sovereign debt because of the recognized low risk and government support of GSE debt. The NPR would retain the preferential 20% risk weight for GSE debt, and some of the other preferential treatment of GSE debt and securities under the current framework but proposes to revise the preferential treatment of GSE debt posted as collateral to align with the current treatment of corporate debt, despite their different risk profiles. This change would effectively result in an increase in the applicable capital charge for transactions involving GSE debt as collateral. The Agencies do not provide a rationale for proposing this change, which we believe could have a negative impact on demand for GSE debt. We urge the Agencies to retain the current rule, which takes into account the actual risk profile of GSE debt and treats such debt similarly to a sovereign exposure for purposes of any margining requirements.

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[17] For instance, in calculating the three-year average for a business indicator input reported at the end of the third calendar quarter of 2023, the values of the item for the fourth quarter of 2020 through the third quarter of 2021, the fourth quarter of 2021 through the third quarter of 2022, and the fourth quarter of 2022 through the third quarter of 2023 would be averaged.

(ii). Treatment of GSE Uniform Mortgage-Backed Securities (UMBS)

The NPR proposes to interfere with the treatment of GSE UMBS as fully fungible. The framework would treat Fannie, Freddie and UMBS as separate securities issues, in contradiction to the goals of the GSEs in creating the UMBS program. The UMBS program was developed under the direction of the Federal Housing Finance Agency in 2019, permitting Fannie Mae and Freddie Mac to issue a single (common and fungible) mortgage-related security in order to increase liquidity in the TBA market and, as a result, make homeownership more affordable. The NPR would undermine this important innovation, which we believe would have a significant negative impact on the liquidity improvements that have occurred since the creation of the UMBS program. The resulting increase in the regulatory capital required for banks' mortgage holdings as a result of the proposed change would raise borrowing costs for homebuyers without providing any benefit to the Agencies. We recommend that the Agencies refrain from making the proposed change and instead continue to treat all UMBS TBA and UMBS-compliant pools as exposures to a single issuer.

We strongly urge the Agencies to consider comments submitted by other commenters (including the National Association of Real Estate Investment Trusts (NAREIT)) that provide more detailed analysis and recommendations on the two issues addressed in this section.

D. Credit Risk Transfer (CRT)

MBA is concerned about some of the unintended consequences of proposals in the NPR that would impact CRT transactions. MBA cautions that some of these proposals could interfere with legitimate market activities, thereby resulting in increased costs for borrowers. For instance, the NPR contains proposals that would make CRT transactions less attractive to both investors and market makers. To the extent that these proposals make it more costly for banks to engage in CRT transactions, the impact on market activities would trickle down through the system in the form of higher costs that are eventually passed down to borrowers. Therefore, MBA recommends that the Agencies carefully review industry comments (such as comments from the Structured Finance Association (SFA) that analyze this issue in greater detail and provide valid recommendations for the final rules.

E. Redistribution of Risk Across the Entire Banking System

The Agencies have made a point of stressing that the NPR only impacts large banks. This ignores some of the unintended consequences and second order effects of the higher capital requirements that would result in redistribution of activities and risks across the entire banking system. As many regional banks start to exit some business lines because of the new capital requirements, such as providing warehouse lines of credit and MSR financing for IMBs, these businesses will still need a way to finance their mortgage origination, servicing and hedging activities, and will begin to look to the smaller banks that may not have either the expertise or the appropriate infrastructure in place to offer these

products. These smaller banks will incur significant costs by building out the infrastructure and staff training necessary for offering these products and be required to increase their risk management capabilities since they would be engaging in activities for which they lack expertise and training. While the costs are eventually passed down to their customers (IMBs and other bank borrowers), the risk that is now pushed down to the smaller banks could introduce significant new risks to the financial system and in fact, achieve results that contradict the intended goals of the NPR. In short, the higher cost of capital impact that would result from implementation of the final rule would impact all banks, including smaller banks.

Conclusion

MBA is concerned that the NPR will diminish access to mortgage credit and further reduce the affordability of housing for first-time homebuyers and underserved communities – outcomes that seem fundamentally at odds with key policy objectives of the current Administration. The Agencies should be taking steps that encourage banks to better support real estate finance markets, rather than proposing changes that do precisely the opposite during a time of constrained housing affordability.

We strongly urge the Agencies to consider the recommendations in this letter, consider the impact to the American dream of home ownership, and conduct a more rigorous and thoughtful impact analysis prior to the finalization of any new capital framework. Our recommendations provide targeted fixes to the proposed capital rule, and address long-standing problems with the current rules, that will strengthen the stability of our housing finance system by incenting large banks to increase their direct and indirect role in residential finance.

MBA appreciates the opportunity to comment and would like to ensure ongoing dialogue with the Agencies with respect to the NPR. Please do not hesitate to contact Pete Mills, Senior Vice President of Residential Policy, or Mike Flood, Senior Vice President of Commercial/Multifamily Policy, if you require additional information or would like to meet to discuss.

Sincerely,

Robert D. Broeksmit, CMB
President and Chief Executive Officer

Appendix A

Mortgage Servicing Rights

RWA Comparison Demonstrates Conflicting Risk Weighting Relative to Risk

Proposal for assigning Risk Weighting of 250% on MSA assets is inconsistent with underlying risks when compared to other balance sheet positions which have equal, greater or unspecified risk characteristics:

Product	Price Risk	Credit Risk	Prepay Risk	RWA	Risk Types
GNMA MBS	✓	X	✓	0%	• Duration & Convexity (Prepay) • No Credit risk
FNMA/FHMC MBS	✓	X	✓	20%	• Duration & Convexity (Prepay) • No Credit Risk
Mortgage Loans (Performing)	✓	✓	✓	50%	• Duration & Convexity (Prepay) • Credit Risk (Collateralized)
Home Equity Loans	✓	✓	✓	100%	• Duration Risk • Credit Risk (Uncollateralized)
Commercial Loans	✓	✓	✓	100%	• Spread Duration Risk • Credit Risk (Collateralized)
All other assets listed on the bank's statement of financial condition without a specified risk	?	?	?	100%	• Unspecified Duration Risk • Unspecified Credit Risk
HVADC	✓	✓	✓	130%	• Credit Risk
Mortgage Servicing Asset	✓	X	✓	250%	• Duration & Convexity (Prepay) • No Credit Risk

Summary of Bulk Servicing Transfers (>$1bb) by Institution Type for Q1-Q3 2023

Seller/Buyer	# Transfers	Total UPB
Seller Bank	**13**	**$ 60,148,853,434**
Buyer REIT	2	$ 5,440,675,133
Buyer IMB	8	$ 47,472,256,230
Buyer Bank	3	$ 7,235,922,071
Seller IMB	**89**	**$ 615,148,276,036**
Buyer REIT	30	$ 281,474,212,738
Buyer IMB	31	$ 186,071,865,621
Buyer Bank	28	$ 147,602,197,677
Seller REIT	**3**	**$ 21,879,549,977**
Buyer IMB	1	$ 5,103,541,066
Buyer Bank	2	$ 16,776,008,911
Grand Total	**105**	**$ 697,176,679,447**

Summary of Bulk Servicing Transfers (>$1bb) by Institution Type for 2022

Seller/Buyer	# Transfers		Total UPB
Seller Bank	**23**	**$**	**91,850,637,365**
Buyer Bank	5	$	15,928,010,505
Buyer IMB	14	$	62,748,901,584
Buyer REIT	4	$	13,173,725,276
Seller IMB	**138**	**$**	**754,782,384,536**
Buyer Bank	43	$	210,746,436,221
Buyer IMB	54	$	249,912,096,067
Buyer REIT	41	$	294,123,852,248
Seller REIT	**5**	**$**	**32,770,798,833**
Buyer Bank	2	$	19,157,278,667
Buyer IMB	1	$	9,125,464,872
Buyer REIT	2	$	4,488,055,294
Grand Total	**166**	**$**	**879,403,820,734**

The migration of Mortgage Servicing Rights from depository institutions to non-depositories in recent years continues. This disturbing trend will only get worse if the Agencies do not provide MBA's recommended relief on the current punitive treatment of MSRs.

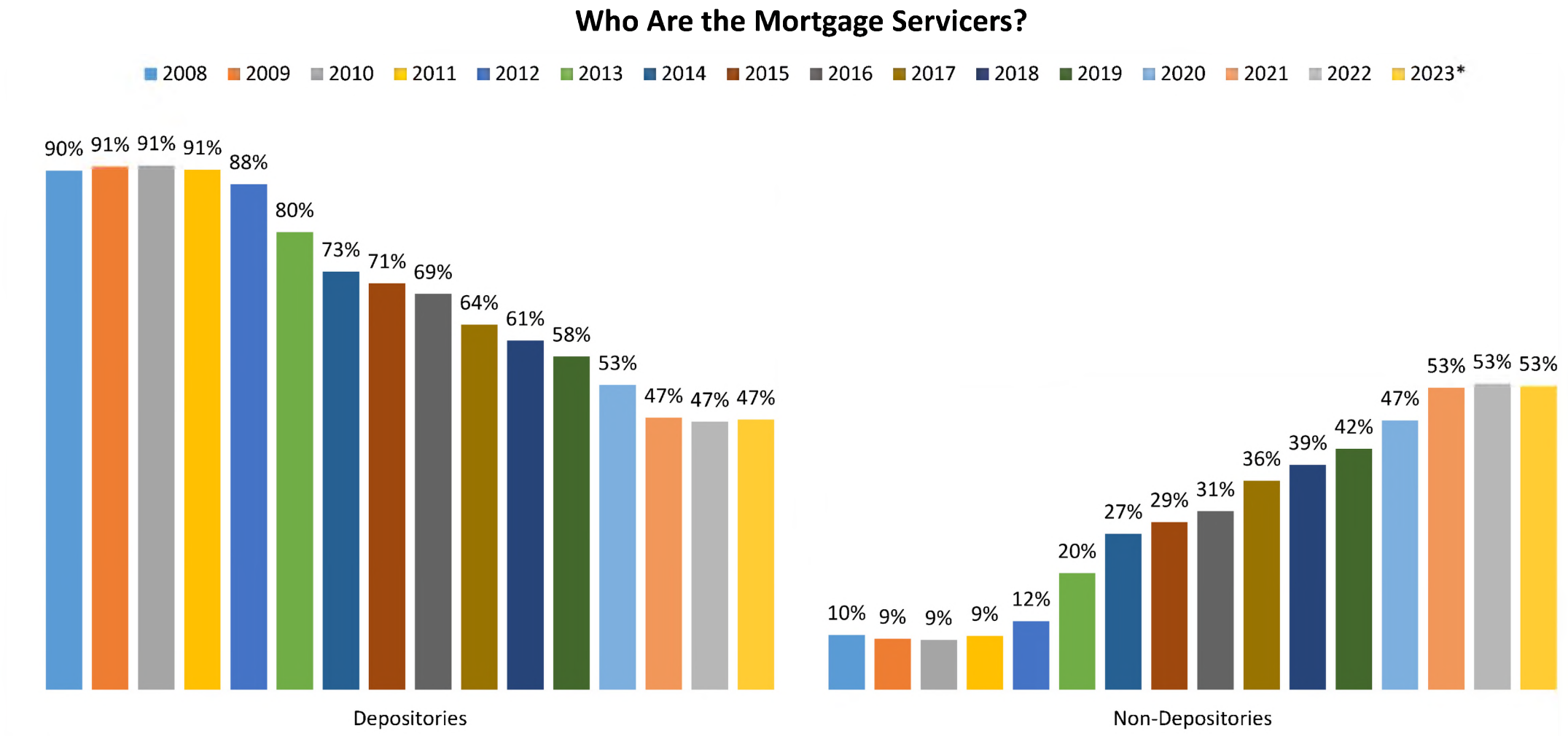
Bids for Ginnie sale:

	Bidder	Stipulations	Bid Multiple	Bid Price (bp) as of 2/XX/19	Internal Carrying Value (bps)	Gain/Loss in Price (bp)	Gain/Loss Pre-Tax	Broker fee	P/L Pre-Tax Net of Broker Fee
1	Non-Depository		3.75000	131.980	130.662	1.32	580,764	(515,790)	64,974
2	Non-Depository	No VA loan loss protection	3.72439	130.000	130.662	(0.66)	(292,001)	(515,790)	(807,791)
3	Non-Depository	Seller to buy out all 90+ dlq loans	3.72439	130.000	130.662	(0.66)	(292,001)	(515,790)	(807,791)
4	Non-Depository		3.50000	122.150	130.662	(8.51)	(3,752,204)	(515,790)	(4,267,995)
5	Bank		3.35000	116.920	130.662	(13.75)	(6,059,741)	(515,790)	(6,575,532)

Bids for Fannie/Freddie sale:

	Bidder	Bid Price (bp) as of 2/27/19	Internal Carrying Value (bps)	Gain/Loss in Price (bp)	Gain/Loss Pre-Tax	Broker fee	P/L Pre-Tax Net of Broker Fee
1	Non-Depository	127.00	121.033	5.966715698	5,904,116	(944,754.23)	4,959,362
2	Non-Depository	120.30	121.033	(0.733284302)	(725,591)	(944,754.23)	(1,670,345)
3	Non-Depository	118.00	121.033	(3.033284302)	(3,001,460)	(944,754.23)	(3,946,215)
4	Bank	113.90	121.033	(7.133284302)	(7,058,445)	(944,754.23)	(8,003,199)
5	Bank	113.08	121.033	(7.953284302)	(7,869,842)	(944,754.23)	(8,814,596)
6	Non-Depository	110.00	121.033	(11.037284300)	(10,921,486)	(944,754.23)	(11,866,240)

Changing Landscape on Mortgage Servicing



Through Q3 2023

Source: NDS: MBA's National Delinquency Survey: www.mba.org/nds

The grids above illustrate that banks are effectively exiting the mortgage servicing market. Clearly, the primary reason for this is the punitive capital treatment of MSRs under Basel III. This removes a bid from the market, negatively impacting liquidity and pushing MSRs from depositories to non-depositories. We believe that this migration of the mortgage servicing business away from banks is bad for the entire mortgage finance system.

Some banks have been in the mortgage origination and servicing business for almost 100 years, and are good at it. It serves as a natural hedge to loan production cycles, and as a foundational customer relationship with the bank. Banks selling off MSR's essentially cuts off these customer relationships and result in customer complaints and dissatisfaction.

The mortgage servicing business is not without risks, but banks are prudently managing the asset through various methods, including very effective hedge programs. As illustrated above other assets on banks' balance sheets that are far riskier than MSRs are assigned much lower risk weights – a result that is difficult to understand.

The current capital treatment of mortgage servicing assets under Basel III is punitive in the extreme, and just doesn't make sense. That the Agencies turn around the troubling trend of banks exiting the mortgage servicing business by reducing the risk weight on MSRs to MBA recommended 130%.

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Appendix B

Warehouse Lines of Credit

Recommended Reduced Risk Weight For Warehouse Lines[1]

The current capital framework assigns a 100 percent risk weight to warehouse lines – a change that occurred in 2014 from previous interpretations that assigned a 50 percent risk weight to warehouse lines structured as repurchase facilities. This 2014 capital guidance was led by the OCC pursuant to an accounting policy change that we believe ignores the substance of the transaction and focuses on the form to arrive at the conclusion that because the bank does not "own" for accounting purposes the collateral backing the line for GAAP purposes, the warehouse line cannot be assigned the same 50 percent weight as the collateral.

This change has caused strains in the market when IMBs are not able to respond efficiently to consumers when origination demand is high. Warehouse lenders are not able to supply sufficient lines of credit to even the strongest IMBs in a timely manner. As noted in the comment letter, the U.S. mortgage market experiences significant demand volatility. With bank warehouse lines providing funding for more than 60% of single family mortgage originations, it's important that capital requirements accurately reflects the underlying risk. If capital requirements are set too high, warehouse lenders may not be able to supply the necessary liquidity to meet spikes in demand, increasing the cost of lending to all borrower segments, but especially low-to-moderate income borrowers and first-time homeowners.

This document outlines the actual substance of the transaction, without requiring any change in the accounting treatment of the transaction under GAAP (ASC 860), in order to establish clearly why warehouse lines should not be assigned a worse risk weight than the collateral (mortgage loans) backing the line.

- **Bank as "owner' Of the Collateral**

Warehouse lines are generally backed by mortgages that are pre-sold to Fannie Mae, Freddie Mac (together "the GSEs") and Ginnie Mae for ultimate securitization, which then become GSEs/Ginnie securities (i.e., agency securities).

The warehouse lender/bank does not "own" the collateral for accounting purposes. However, for all other purposes, including most importantly, for the purpose of mitigating any loss on the warehouse line, the bank controls and is in possession of the collateral. As a matter of fact, when it is most important – if the IMB borrower fails - the bank is able to claim the collateral and turn it into cash to avoid losses on the warehouse line. Therefore, while the bank does not own the collateral for accounting purposes, the bank *controls* the collateral for the most important purpose – to mitigate any loss on the warehouse line.

There should be no question about whether the bank controls the collateral (and in effect, the cash) to the extent that the bank is in possession of the collateral while it is

[1] See attached PowerPoint for quick summary

on the line and is able to turn it to cash in the event of default. Hence, while the collateral is on the line, the bank **controls the cash** for all purposes, including for accounting and tax purposes.

The Agencies' position on disproportionate cash flow (i.e., the cash flow from the settlement not being shared pro rata between the bank and the IMB borrower) being a basis for supporting a 100% risk weight is incorrect. The cash flow is in fact shared pro rata relative to interest. The bank is a participant in the interest stream of the payment on the sold loans, and receives it's pro rata share of such interest when the IMB receives payment from the buyer. The bank does not claim to be involved in origination or any other expenses related to the loan that would necessitate an equal share in the cash flow. Prior to the IMB receiving the cash and making the agreed upon payments to the bank, the bank has control over the asset, and such control is extinguished once cash is received and the bank is repaid according to its participating interest in the transaction.

- **Underlying Mortgage Loans Are Financial Collateral**

The mortgage loans backing the warehouse facility should be treated as financial collateral, which would justify aligned risk weight for both the facility and the collateral. As noted above, the bank does not own the mortgage loans backing the line for accounting purposes, but has "control" of the collateral as well as the cash generated by the collateral (either through sale or by taking possession) until the loan is repaid. As a secondary market participant, like any correspondent buyer or any other downstream investor, the bank is not required to service the loan or have been involved in underwriting or making any credit decision on the loan to be determined to be in "possession" or in "control" of the collateral.

- **Warehouse Lines Structured as Repo Transactions**

Warehouse facilities are generally structured as repo transactions, which would justify a lower risk weight. The bank receives collateral in exchange for short-term funding provided to the IMB. The bank is in possession of the collateral, which can be disposed of as the bank sees fit if there is a default. The bank holds on to the collateral until the IMB is ready to deliver the loan to the investor/purchaser in exchange for cash, which the bank uses to repay itself first, and then disburses the remaining to the IMB.

- **Comparability Between Warehouse Lines and Mortgage Loans Held by the Bank**

Under the current framework, mortgage loans originated and held on a bank's balance sheet are assigned 50 percent risk weight, even with the fact that such loans are subject to interest rate and credit risk for the period they are held by the bank, which would typically be months or years. On the other hand, a warehouse facility that funds the same types of originated mortgage loans is assigned double the risk weight.

With residential mortgage loans held on the balance sheet, banks assume interest rate and credit risks (such as the risk of consumer delinquency and default) for as long as the loans remain on the balance sheet. On the other hand, warehouse programs assume the role of an interim financier and the average time that a residential mortgage loan dwells on a warehouse facility is approximately 15-18 days—a very short term. In effect, the interest rate and credit risk that exists for loans held by the bank are minimal with warehouse lines because (1) the mortgage loans backing the lines are presold to the GSE's and Ginnie, and therefore, are on the line only for a very short period, i.e., the time it takes to settle the transaction and move them off the line; (2) the bank is repaid by the investor typically before the first payment is made by the consumer; and (3) during the short period that the loans are on the line, the bank is assured of collectability because of its ability to take control of the collateral and either deliver it to the investor, or hold it in portfolio at the lower risk weight. Once in portfolio, the loan is repaid according to its terms and if the borrower defaults, lender forecloses on the home. Given the multiple sources of repayment, we believe there is little justification for imposing a risk weighting that is twice that of the underlying collateral.

The Agencies should also note that once the pre-sold collateral backing the lines goes through the initial required sorting for pooling into GSEs or Ginnie securities (even before settlement), they are assigned even lower risk weighting because they have essentially been certified by a third-party custodian. In effect, the GSEs and Ginnie at that point (while the loans are still on the warehouse line and awaiting settlement) have essentially taken over the loans and the only thing remaining is payment to the IMB. The point is that, even while the collateral is still on the line, there is every assurance that the warehouse loan would be repaid once the initial sort is completed; it then becomes only a question of time. This further minimizes the risk of loss, and makes this a less risky transaction than the bank holding the same loan on its books.

In effect, a warehouse facility that is backed by mortgage loans does not carry any more risk factors than the same mortgage loans. In fact, the opposite is the case. Therefore, the capital treatment of a warehouse facility should be no worse than the treatment of residential mortgage loans held on ta bank's balance sheet.

Conclusion

In the current economic environment, maintaining the stability of the housing finance market is critical. We believe that reducing the risk weight assigned to mortgage warehouse facilities will help increase liquidity for the residential mortgage market, which will in turn help maintain the stability of the housing market, without negatively impacting safety and soundness of the banking system. Even with harsher capital rules over the last few years that continue to drive banks away from mortgage origination and servicing activities, banks have provided billions in liquidity to IMBs, which has been vital to facilitate home ownership for consumers, including LMI borrowers. In addition, losses to banks due to defaults in warehouse facilities over the years have been

extremely minimal - even in the wake of the Great Financial Crisis. Very few bank credit products have similar low risk performance.

Warehouse Facility

Factual Assessment Justifying Lower Risk Weight

1. Bank does not own the collateral for accounting purpose, but controls and is in possession of the collateral
2. Collateral is financial asset. Bank has control of the cash that would be generated by the asset while it is on the warehouse line.
3. Warehouse line is akin to a repo transaction. Bank provides funding and in exchange, takes possession of the loans until transaction settlement is complete.
4. Interest rate and credit risks are lower on warehouse facility than loans held directly by the bank.
5. A reduced risk weight would ensure that the banking system can support mortgage market liquidity through all cycles, whether or not banks choose to participate in the mortgage market as primary market originators or servicers

Typical Structure

1. IMB and bank enter into an agreement for warehouse line of credit.
2. Bank provides a not unconditionally cancellable 12-month commitment
3. IMB originates and funds 2 mortgage loans using the line of credit.; and pre-sells the loans to the GSEs
4. Bank automatically takes possession of the loans (risk weighted at 50%) while all parties wait for the settlement between the IMB and the GSEs (typically between 18 days and one month) and the IMB and the bank
5. If IMB fails prior to the settlement, bank sells the loan (already in its possession) for cash and mitigates its loss
6. If IMB does not fail prior to settlement, bank sells the loan back to the IMB; IMB delivers the loan to the GSE or other buyer; cash on sale is delivered to the bank; the bank pays itself off and then remits the difference to that IMB. Specifically, the warehouse lender sends the note to the investor under a bailee arrangement where the investor is notified that its secured interest is not released until the bank receives the cash and gives the investor the bank's wire instructions.
7. Payment retained by the bank consists of interest stream; IMB share of the sales proceed is greater because IMB recovers cost of origination and other expenses. Bank is only entitled to the contracted interest stream of the payment.
8. The entire transaction period is typically less than 3 months (from borrower application to loan sale).
9. The risk of loss (interest rate or credit) is much less in this transaction than where the bank directly holds mortgage loans on its balance sheet. This is because of the very short duration of the warehouse lending transaction, compared with the longer duration of holding loans on the balance sheet. Nevertheless, both transactions allow the bank to repossess collateral and sell them to recoup any losses in exactly the same way and through the same methods.

Economic Substance of the Transaction

- The bank is a secondary market participant that purchases whole loans (risk weighted at 50 percent) from the IMB borrower;

- The bank contracts servicing back to the originator to service the loans for the interim period that the bank owns/controls the loans;

- When the investor is ready to complete purchase of the loans, the bank sells the loans back to the originator who delivers the loans to the investor;

- The investor sends payment to the warehouse lender, who then remits to the IMB its share of the proceeds. If there is a shortfall on a given loan the warehouse lender can take excess proceeds from other loans to make up the difference, which creates another level of risk mitigant in the transaction.

This structure is supported by HUD, accounting firms and opinion letters. Furthermore, the bankruptcy court has recognized this same economic substance of the transaction in cases where a determination needed to be made on bank "ownership" of the collateral.

Comparability Between Warehouse Line and Mortgage Loans Held by the Bank

Warehouse Line – 100% risk weight		Loans Held on Balance Sheet – 50% risk weight	
Bank is a secondary market participant that purchases while loans	✓	Bank is a secondary market participant that purchases whole loans	✓
Bank controls, and is in possession of the loans/collateral	✓	Bank controls, and is in possession of the loans/collateral	✓
Collateral is on the line for a very short period – typically between 18 days and one month	✓	Loans are in portfolio for a longer period – typically 3 years	X
Bank is able to sell the loans at anytime prior to settlement to mitigate loss in the event of IMB failure	✓	Bank is able to sell the loans at any time to mitigate loss in event of borrower default	✓
Bank controls the cash from the sale of the loans in the event of IMB default prior to settlement	✓	Bank controls the cash from the sale of the loans in the event of borrower default	✓
Because of short duration, interest rate and credit risks are significantly lower	✓	Because of longer duration, bank is taking a higher interest rate and credit risk burden	X
Bank provides necessary liquidity in the mortgage lending market	✓	Bank provides necessary liquidity in the mortgage lending market	✓