THE HOUSING POLICY COUNCIL, EDWARD J. DEMARCO

Proposal and Comment Information

Title: Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations with Significant Trading Activity, and Optional Adoption for Other Banking Organizations, R-1887

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Submitter Information

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Please find attached The Housing Policy Council's comment to Regulatory Capital Rules: Regulatory Capital and Standardized Approach for Risk-Weighted Assets [Docket No. R–1888] RIN 7100–AH21.

June 18, 2026

Chief Counsel's Office
Attention: Comment Processing
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Benjamin W. McDonough
Secretary
Board of Governors of the Federal Reserve System
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Jennifer M. Jones
Deputy Executive Secretary
Attention: Comments—RIN 3064–AG23 and Comments/Legal OES—RIN 3064–AF29
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Re: Regulatory Capital Rules: Regulatory Capital and Standardized Approach for Risk-Weighted Assets (Docket ID: OCC–2026–0034; Federal Reserve Docket No. R–1888, RIN 7100–AH21; FDIC RIN 3064–AG23); and Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations With Significant Trading Activity, and Optional Adoption for Other Banking Organizations (Docket ID: OCC–2026–0265; Federal Reserve Docket No. R–1887, RIN 7100–AH20; FDIC RIN 3064–AF29)

Dear Sir or Madam:

The Housing Policy Council ("HPC")[1] appreciates the opportunity to comment on two notices of proposed rulemaking jointly issued by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation (the "Agencies") to modify and modernize the regulatory capital requirements for banking organizations (collectively the "Proposed Rules"). HPC members have a direct interest in the Proposed Rules as they

[1] The Housing Policy Council is a trade association comprised of the leading national mortgage lenders and servicers; mortgage, hazard, and title insurers; and technology and data companies. Our interest is in the safety and soundness of the housing finance system, the equitable and consistent regulatory treatment of all market participants, and the promotion of lending practices that create sustainable homeownership opportunities in support of vibrant communities and long-term wealth building for families. For more information, visit www.housingpolicycouncil.org.

address the risk weights for residential mortgages, the treatment of mortgage servicing assets, warehouse lines of credit, the securitization of mortgages, and the treatment of mortgage insurance.

One rule ("Standardized Rule")[2] would revise the standardized approach that is applicable to banking organizations with less than $700 billion in assets, other than banks that have elected to use the community bank leverage ratio framework. The other rule (the "ERBA Rule")[3] would remove the standardized approach and replace the existing advanced approaches calculation applicable to Category I and II banking organizations with a new expanded risk-based approach.[4]

As discussed below, the Proposed Rules represent a profound improvement in the capital treatment of mortgage-related assets. The Proposed Rules better align the minimum required capital with the risk of the exposure. Furthermore, the Proposed Rules will promote a more level playing field across mortgage market participants, bank and non-bank alike, which we believe will encourage greater competition that benefits consumers through better services and lower costs.

I. Executive Summary

The Proposed Rules would establish a capital framework for residential mortgages that better aligns the risk of these assets with the capital charge. Most importantly, the Proposed Rules would replace the fixed 50 percent risk weight on prudently underwritten residential mortgages with a variable risk weight tied to the mortgage exposure, as reflected in the loan-to-value ("LTV") ratio. One HPC member estimates that this change could "potentially unlock over $600 billion in additional bank lending capacity for residential real estate lending."[5] Another member has said, "the materially lower [risk-weights] under [the Basel capital rule] should significantly incentivize banks to hold mortgage loans on balance sheet."[6]

The Proposed Rules also would remove the requirement for banking organizations to deduct mortgage servicing assets from regulatory capital. This change will eliminate one key regulatory impediment to greater bank participation in the servicing of mortgage loans. Furthermore, the Proposed Rules would lower the capital costs associated with securitizations and introduce a new credit risk mitigant, which could facilitate greater issuance of private label mortgage-backed securities and certain types of credit risk transfer securitizations, respectively.

There are, however, areas for improvement in the treatment of mortgage exposures in the Proposed Rules that would be consistent with the Agencies' stated objective to "improv[e] the calibration

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[2] Regulatory Capital Rules: Regulatory Capital and Standardized Approach for Risk-Weighted Assets (91 Fed. Reg. 15332, March 27, 2026).
[3] Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations with Significant Trading Activity, and Optional Adoption for Other Banking Organizations (91 Fed. Reg. 14952, March 27, 2026).
[4] Category I standards apply to U.S.-domiciled bank holding companies identified as global systemically important BHCs and their depository institution subsidiaries. Category II standards apply to banking organizations with at least $700 billion in total consolidated assets or at least $75 billion in cross-jurisdictional activity and their depository institution subsidiaries.
[5] PennyMac Policy Pulse, April 2026, https://www.pennymac.com/assets/documents/policy-pulse-april-2026.pdf.
[6] J.P.Morgan Securities, LLC. *Basel III Endgame – A Positive Ending? Implications of Basel III for Securitized Products* (March 20, 2026).

and risk sensitivity of risk weights that are particularly material to covered banking organizations' lending activities."[7] We recommend that the Agencies:

- Reduce the risk-weight for mortgage servicing assets;
- Provide capital relief for the existence of private mortgage insurance by considering it in the LTV calculation of a mortgage exposure;
- Revise the definition of "eligible guarantor" to permit an insurer to meet the investment grade debt requirement at the holding company level and permit monoline mortgage insurers to provide capital relief on mortgage exposures;
- Retain the current definitions of "commitments" and "unconditionally cancellable";
- Reduce or eliminate the proposed credit conversion factor in ERBA for commitments that are unconditionally cancellable; and
- Revise the proposed definition of a securitization.

We address areas of agreement and offer suggestions for refinements according to the order in which the item appears in the Proposed Rules, with the exception of the discussion of modifications to the definition of an Eligible Guarantor, which we discuss within the General Risk Weight section addressing mortgage insurance.[8] Areas addressed generally apply across the Standardized Rule and the ERBA Rule. Where an issue is relevant to only one Proposed Rule, we specify the relevant Rule in the section and recommendation.

II. Discussion

A. Mortgage Servicing Assets

- ***HPC supports the elimination of the capital deduction thresholds for Mortgage Servicing Assets ("MSAs") in the Proposed Rules.***

- ***HPC recommends the Agencies lower the standardized risk weight for MSAs. HPC bank members support a risk weight of 100 percent.***

HPC agrees with the removal of the deduction thresholds for MSAs. This revision is a significant improvement over the current approach and would remove a disincentive for mortgage origination and servicing by banking organizations even if the thresholds weren't immediately binding on most banks. As explained in this section, we also recommend reducing the 250 percent risk weight assigned to non-deducted MSAs, with HPC bank members supporting a risk weight of 100 percent.

Following the Great Financial Crisis ("GFC"), the Agencies followed the Basel III framework and adopted a 250 percent risk weight on non-deducted MSAs.[9] A 250 percent risk weight implies capital

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[7] 91 Fed. Reg. at 15332.

[8] Our recommendation to amend the first criterion of the Eligible Guarantor definition is applicable to both the General Risk Weight exposures and to Guarantees and Credit-Derivatives under Credit Risk Mitigation.

[9] Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-weighted Assets, Market Discipline and Disclosure

needed to absorb a loss event of up to 20 percent (at 8 percent capital). The Proposed Rules retain the 250 percent risk weight currently applied to non-deducted MSAs, but the Agencies are seeking comment on the appropriate risk weight. This capital charge overstates a banking organization's exposure to capital-loss outcomes from its MSA exposures.

MSAs constitute a unique banking book asset that makes the establishment of an appropriate capital charge more complicated than for more traditional credit-risk assets. MSAs face market risk from changes in interest rates and borrower prepayment characteristics and credit risk from borrower non-payment. These risks are primarily transmitted through market driven MSA valuation sensitivity, elevated operational expenses from servicing costs, and liquidity and funding dynamics associated with servicing advances.

When interest rates rise, mortgage prepayments decline and their duration extends, increasing the value of the servicing strip. Yet, when rates fall, prepayments rise and the value of the servicing strip may be extinguished if the loan is refinanced. Banks can effectively hedge much of these risks through common financial instruments. These hedges are governed by clearly defined and prescriptive management-approved strategies, and their efficacy can be observed and tested in various ways.

MSAs are also sensitive to the credit performance of the underlying mortgages. As delinquencies increase, the cost to service the loan increases, often substantially, yet the fee income stops with the cessation of borrower mortgage payments (although partial or full reimbursement can be realized depending on the holder of the note and the presence of any credit risk mitigant). With a deterioration in credit performance, MSA values decline and operational demand for the servicer increases, with the latter aspect observed through earnings rather than through realized MSA losses. Banks are not able to hedge their MSA exposures to offset an increase in credit default rates. However, higher default risks are reflected in MSA prices through higher discount rates that incorporate stress risk.

As with mortgage exposures, for which the Agencies have introduced more granular risk weights in the Proposed Rules, MSAs have different sensitivities based on the profile of the underlying mortgage exposure. In the current market, most MSAs are associated with mortgage-backed securities issued by Fannie Mae and Freddie Mac (the "GSEs") or guaranteed by Ginnie Mae. Given differences in the average credit profile of the underlying mortgages across these segments, exposure to one or the other can result in significantly different risk sensitivities. HPC believes a well-calibrated MSA risk weight should be conservative enough to capture a range of capital depletion sensitivities and bank-level variation in MSA portfolio composition in one capital charge. It should also be sensitive to the exposure profile and give credit to banks for effective risk management. HPC therefore recommends that the Agencies determine an MSA risk weight based on a typical bank MSA portfolio rather than a *pro forma* worst quality portfolio.

Capital rules for MSAs should correlate with the risk of the asset, which has declined for banks since the 250 percent risk weight was adopted. This crisis era risk-weight calibration for MSAs was

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Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule (78 Fed. Reg. 62018, October 11, 2013). Prior to 2013, the Agencies set the risk weight for MSAs at 100 percent, albeit on 90 percent of the fair value of the exposure (see section 475 of the Federal Deposit Insurance Corporation Improvement Act of 1991, codified at 12 U.S.C. 1828 note and implemented in the 2013 U.S. Basel III rules (see 78 Fed. Reg. at 62069)). As the Agencies have noted, when factoring the remaining 10 percent of MSA fair value, this treatment equated to a risk weight of up to 215 percent for MSA exposures. See the Agencies' *Report to the Congress on the Effect of Capital Rules on Mortgage Servicing Assets* (June 2016).

established when valuation and risk management systems were less mature and when the aftermath of the housing crisis was still working its way through the financial system. Since then, critical changes in how banks manage the risks associated with these assets have reduced the risk of capital depletion from their MSA exposures.

Critically, the Agencies have updated and modernized the supervisory framework that governs how banks mitigate their exposure to these risks, including through the application of financial hedges.[10] The updated guidance reflects years of post-financial-crisis supervisory experience, which has sharpened the focus on risk-based application, materiality, and outcomes-based assessment. These refinements in supervisory evaluation have resulted in effective financial management practices that have reduced bank sensitivity to losses on MSA positions.

COVID presented a severely adverse market risk event to test MSA valuations, asset performance, and aggregate net losses. During this period, prevailing interest rates changed dramatically. Between 2020 and 2025, across eight large banking organizations, gross MSA fair values changed by more than $30 billion on an absolute basis against average MSA fair value balances of approximately $25 billion. Yet, during that period, the net residual losses, which account for financial hedges, were approximately $97 million, or roughly 0.4 percent of the asset base.[11] Isolating just the initial market shock reflected in the second and third quarter of 2020, the fair value on MSAs declined $2 billion or 12 percent against average MSA exposures; however, the losses net of active hedges were only $35 million. Outside the initial COVID shock, repeated multi-billion-dollar repricing events translated into limited residual net losses. These outcomes demonstrate that MSA risks were effectively managed in a supervised environment during a period of market stress with minimal capital loss.

Recent analysis from staff of the Board of Governors of the Federal Reserve System (the "Board") provides modeled support for a lower MSA risk weight. Board staff evaluated MSA sensitivity to default and prepayment across large banks.[12] For a severely adverse scenario, the Board projected MSA valuation declines of approximately 14 to 20 percent resulting from an increase in prepayments. As the authors note, and as we argue, a bank is better able to mitigate declines in MSA values due to prepayments.

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[10] "Supervisory Guidance on Model Risk Management", SR Letter 26-2 (Board of Governors of the Federal Reserve Board); OCC 2026-13 (Office of the Comptroller of the Currency); and FIL-15-2026 (Federal Deposit Insurance Corporation).

[11] Data derived from audited quarterly and annual financial disclosures, including earnings releases and Forms 10-Q and 10-K across eight large banking organizations: Wells Fargo & Company, JPMorgan Chase & Co., U.S. Bancorp, PNC Financial Services Group, Truist Financial Corporation, Fifth Third Bancorp, Citizens Financial Group, and Regions Financial Corporation. Between Q1 2020 and Q4 2025 (the COVID and post-COVID period), mortgage markets moved rapidly across multiple interest rate regimes, with mortgage rates falling to historic lows near 2.6 percent in early 2021, then reversing sharply and increasing by more than 500 basis points to near 8 percent by late 2023. Unemployment rose from approximately 3.5 percent at the end of 2019 to approximately 14.8 percent by April 2020, while servicers faced severe operational strain from implementing new borrower assistance and loss mitigation programs in real time. Servicing costs increased materially, advance balances and related funding needs rose, and firms were required to manage those pressures within existing supervisory, liquidity, and governance frameworks. The eight banks evaluated represented a large majority of bank-serviced UPB at year-end 2025. The absolute change in fair value captures the gross movement in fair values during the period. Cumulative gross fair value changes (which nets quarterly fair value gains and losses) before hedges was +$11bn during the same period.

[12] Ronel Elul, Karen Pence, Ben Ranish, and Michael Suher, *Mortgage Servicing Right Valuation Under Stress*, FEDS Notes (June 4, 2026), available at https://www.federalreserve.gov/econres/notes/feds-notes/mortgage-servicingright-valuations-under-stress-20260604.html.

Losses from an increase in credit default rates, which cannot be hedged, were projected at 5 to 13 percent, or 8 percent when controlling for pandemic-era home price gains. A 13 percent loss scenario equates to an approximately 160 percent risk weight. For the scenario that strips out home equity gains, an 8 percent loss equates to a 100 percent risk weight. Thus, the Board's analysis provides a reasonable basis for a material reduction in the risk weight.

Banks have demonstrated the ability to identify, measure, govern, and mitigate material interest rate and prepayment risk to MSA valuations under regulatory supervision. With these risks effectively contained, the residual risk from an increase in credit defaults on the underlying mortgage exposures should be the basis for a standardized risk weight.

Based on observed experience and updated modeled stress scenarios, combined with the updated and modernized supervisory framework for MSA risk management, HPC bank members support a risk weight of 100 percent.

B. Risk Weights for Residential Mortgage Exposures

- ***HPC supports the LTV-based approach to setting risk weights for residential mortgages.***

Consistent with the Basel framework[13], the Proposed Rules would tie the risk weights for residential mortgage exposures[14] to the LTV ratio on a mortgage at the time of origination, with life-of-loan adjustments to the amortized loan amount. HPC supports the LTV-based approach to setting risk weights for residential mortgage exposures.[15] Tying risk weights to LTVs will improve the risk sensitivity of the risk weights and reduce the capital charge for most bank-held mortgages. Additionally, under the LTV-based approach, the capital charge on a loan further decreases as a borrower makes payments on the loan and the LTV ratio declines, which supports an originate-to-hold mortgage lending model.[16] The LTV-based approach also has the benefit of being relatively straightforward to implement.

[13] Basel Committee on Banking Supervision. *Basel III: Finalising post-crisis reforms* (December 2017) at 21; available at: https://www.bis.org/bcbs/publ/d424.pdf.

[14] A residential mortgage exposure would continue to be defined as an exposure that is primarily secured by a first or subsequent lien on a one-to-four family residential property or an exposure with an original and outstanding amount of $1 million or less that is primarily secured by a first or subsequent lien on a residential property that is not one-to-four family.

[15] The Federal Housing Finance Agency established such a more granular risk-based calibration for the GSEs under the Enterprise Regulatory Capital Framework first finalized in 2020 (see 12 C.F.R. Part 1240). Compared to the Proposed Rules, the ERCF prescribes a more detailed and prescriptive calculation for risk weight for mortgage exposures based on the characteristics of the loan at origination and the "value" of the property securing it as it changes over time, subject to certain adjustments.

[16] 91 Fed. Reg. at 15136.

C. The Treatment of Mortgage Insurance

- ***Residential Mortgage Exposure LTVs should be adjusted when private mortgage insurance is present.***

The Proposed Rules would continue to recognize private mortgage insurance ("PMI") as an eligible form of credit enhancement for residential mortgage loans with an LTV of 90 percent or more for purposes of determining if the mortgage is prudently underwritten.[17] However, the Proposed Rules do not provide capital relief when PMI is present. We recommend that the Agencies recognize PMI in the determination of the risk weight of residential mortgage exposures by adjusting LTVs for loans that carry PMI.

The United States has a unique mortgage industry that is unlike the mortgage business conducted in other Basel member countries. Deviation from international standards is appropriate in the case of mortgage insurance. Mortgage insurance is an established and regulated feature in the U.S. conventional conforming mortgage market and is the predominant form of risk transfer used by the GSEs on high LTV exposures (as required by their charters).

The Proposed Rules imply an outdated assessment of the mortgage insurance industry to bar mortgage insurers[18] and to exclude mortgage insurance coverage from the calculation of LTV-based risk weights for mortgage exposures. The Agencies should recognize the significant changes in the oversight and operation of mortgage insurance companies since the financial crisis as a predicate for relieving this effective PMI limitation. While it is true during the 2008 financial crisis three mortgage insurance companies were placed into receivership by their state insurance regulators and are not approved to write new business, they continue to this day to pay claims, collect premiums, and provide critical credit risk protection. In the past fifteen years, U.S. mortgage insurers, working with FHFA and the GSEs, have implemented enhancements that address prior vulnerabilities. As a result, the industry is better capitalized, more diversified, and its policyholders operate with greater certainty as to the payment of claims. Key changes include:

- Adoption of Private Mortgage Insurer Eligibility Requirements ("PMIERs") by the GSEs.[19] PMIERs are operational and capital standards that require mortgage insurers to have adequate liquidity and claims-paying capacity during periods of economic stress in order to be approved to insure loans purchased by the GSEs. These requirements also stipulate certain business and quality control practices that reinforce the role of insurers to perform pre-endorsement reviews on GSE

[17] 12 C.F.R. Part 208, Appendix C. ("A loan-to-value limit has not been established for permanent mortgage or home equity loans on owner-occupied, 1- to 4-family residential property. However, for any such loan with a loan-to-value ratio that equals or exceeds 90 percent at origination, an institution should require appropriate credit enhancement in the form of either mortgage insurance or readily marketable collateral.")

[18] See 12 CFR 217.2. A guarantor is not an "eligible guarantor" if the guarantor's creditworthiness is positively correlated with the credit risk of the exposures for which it has provided guarantees, or if it is an insurance company that is a monoline insurer.

[19] Press Release, FHFA, *Fannie Mae and Freddie Mac Update Their Private Mortgage Insurer Eligibility Requirements* (September 27, 2018), available at: https://www.fhfa.gov/news/news-release/fannie-mae-and-freddie-mac-update-their-private-mortgage-insurer-eligibility-requirements.

underwriting and credit quality. Even though banks are not party to these requirements, they would nonetheless benefit from the standards and the associated prudent business practices required.

- Implementation of a standard insurance contract or "master policy" that bolsters the dependability of the private mortgage insurance industry.[20] This master policy includes increased clarity of terms that enforce the reliability and predictability of insurance claim payments to lenders when mortgages default.
- Implementation of rescission relief principles for the master policy, in which mortgage insurers provide certainty to their GSE counterparties on claim payments, based on consistent borrower payment performance as evidence of loan quality. Existing bank supervisory practices could consider the use of a robust master policy and rescission framework as a counterparty risk management tool.

During the past decade, U.S. mortgage insurers have also developed more diversified and durable funding structures. Beginning in 2016, the industry began ceding significantly more of their risk-in-force to affiliated and non-affiliated reinsurers through credit-risk transfer structures. Prior to the financial crisis, mortgage insurers typically retained most of the premium revenue and associated risk of loss. The mortgage insurer business model has evolved to underwrite, insure, and *distribute* risk. Mortgage insurers now access global markets and diversified capital sources through capital markets transactions and reinsurance excess of loss transactions. In 2024, on average, mortgage insurers ceded just under a third of their written premiums, with more than half of that risk transferred to unaffiliated insurers.[21] The share of risk transfer to unaffiliated insurers has also increased as the global reinsurance market has developed capacity and demand for exposure to U.S. mortgage credit. Notably, mortgage insurers now regularly issue forward-placed insurance contracts to traditional reinsurers that provide coverage for policies to be written over the next year. As such, even when the insurer writing mortgage credit protection is a so-called monoline, the capital supporting them is not.

Both GSEs, as well as FHFA, recognize the credit protection afforded by mortgage insurance and adjust required capital to take this benefit into account. Empirical evidence justifies this approach. Recently, a report prepared by Milliman, Inc. documented the reduction in loss severity to the GSEs associated with private mortgage insurance.[22] The report found that the presence of PMI significantly reduced GSE credit losses for owner-occupied, first-lien single-family mortgages, based on the loan performance of over 90 million loans purchased by the GSEs from 2000 to 2025. The Milliman report quantified the reduced credit losses attributable to mortgage insurance for mortgage loans originated under both the lenient underwriting standards of the late 2000s (i.e., crisis vintages originated between

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[20] Press Release, FHFA, *FHFA Announces Overhaul of Fannie Mae and Freddie Mac Mortgage Insurance Master Policy Requirements* (December 2, 2013), available at: https://www.fhfa.gov/news/news-release/fhfa-announces-overhaul-of-fannie-mae-and-freddie-mac-mortgage-insurance-master-policy-requirements.

[21] AM Best, *Reinsurance Market for US Mortgage Credit Risk Matures* (September 3, 2025).

[22] Milliman, Inc. *Calculating the historical benefit of private mortgage insurance: An empirical assessment of realized GSE mortgage losses across LTV cohorts from 2000 through 2025* (May 2026), available at: https://sg.milliman.com/en-GB/insight/calculating-the-historical-benefit-of-private-mortgage-insurance.

2005-2009), as well as for high-LTV loans originated under more traditional lending standards. The report found that PMI reduced GSE net realized loss severity on high-LTV loans to below the gross loss severity observed in the 60%–80% LTV cohort (which did not have PMI), with the net loss severity for crisis-era vintages commensurate with gross severity for an even lower LTV cohort.[23]

In sum, the mortgage insurance industry today is more resilient and operates with more rigorous, transparent standards than existed previously. We recommend that PMI be credited in the calculation of risk weights for first-lien, owner-occupied bank mortgage exposures in light of the aforementioned changes in the mortgage insurance industry since the financial crisis, the statistical evidence demonstrating the credit risk reduction afforded by mortgage insurance, and the fact that mortgage insurance is recognized as a significant credit risk mitigant by the GSEs and their federal regulator.

HPC recommends that the Agencies adopt a severity-based approach that:

(1) reduces the mortgage exposure's original LTV based on the coverage amount provided by the PMI;
(2) appropriately discounts that coverage for instances where PMI is no longer present at the credit event that triggers a claim; and
(3) limits exposures eligible for PMI capital relief to those at or below 100 LTV.[24]

In the preamble to the Proposed Rules, the Agencies solicit comment about whether it would be appropriate to recognize only a portion of contractual PMI coverage to account for the possibility that mortgage insurance might not provide protection in all relevant stress events.[25] The capital framework for the GSEs, the Enterprise Regulatory Capital Framework ("ERCF"), assesses such a haircut to the capital reduction benefit provided by PMI, though it is significantly lower than the "50 percent" suggested in the Proposed Rules. For the GSEs, performing loans generally require a 14.2 percent counterparty haircut against the capital relief determined under ERCF.[26] As such, the magnitude of PMI capital relief provided by the ERCF is multiplied by 85.8 percent to account for counterparty non-payment. The empirical analysis recently published by Milliman found that mortgage insurance paid 97 percent of claims on crisis-vintage loans originated between 2005 and 2009.[27]

HPC agrees that a haircut on PMI coverage is appropriate for a banking framework that provides capital relief for PMI. However, the Agencies' citation of the 2007-2009 performance of PMI is not

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[23] Id.
[24] A maximum LTV at origination of 100 is approximate to the maximum 97 LTV permitted by Fannie Mae. See Fannie Mae Eligibility Matrix at https://singlefamily.fanniemae.com/media/20786/display.
[25] See 91 Fed. Reg. at 15350 (Standardized Rule), 91 Fed. Reg. at 14971 (ERBA Rule): "In recognition that private mortgage insurance may not provide protection under all relevant stress events, what are the advantages and disadvantages of recognizing a portion (such as 50 percent) of the value of the private mortgage insurance in determining the total outstanding amount of the loan in the calculation of the LTV ratio?"
[26] Neither ERCF, nor the GSE, nor FHFA disclose which of the eight prescribed counterparty ratings apply to the six approved national mortgage insurers that write policies for GSE-purchased loans. However, HPC understands from its mortgage insurer members that they are likely rated at Counterparty Rating 4 (see 12 CFR 1240.33(e)(3)(ii)). At this level, for a performing 30-year mortgage product and high mortgage concentration risk, the prescribed haircut is 14.2 percent.
[27] See Milliman. Counterintuitively, 97% payout for crisis vintage is higher than 93% payout for more normalized vintages. This reflects that severity rates on the latter vintages were low enough that they did not require an MI to pay the full contractual claim amount to satisfy that coverage.

consistent with the historical data, as the Milliman analysis demonstrates. Therefore, if the Agencies impose a PMI haircut, we recommend they do so not as a counterparty risk mitigant *per se* but instead as a PMI "realization rate." A realization rate appropriately considers a range of scenarios whereby PMI present at origination is not present at the event of default that gives rise to a claim. This is particularly appropriate to maintain a simplified approach in the bank capital framework, as we do not recommend the Agencies tier capital relief based on the terms of the PMI coverage (e.g., cancellable, subject to an amortization feature, etc.). A single realization rate can account for instances when PMI lapses, for example due to the discovery of material underwriting faults, PMI cancelation, loan amortization, or mortgage insurer failure. The empirical crisis-era results and ERCF's conservative haircut of 14.2 percent should anchor an appropriate number for the Agencies to consider.[28]

We offer below a severity-based approach for the Agencies to consider for calculating a PMI benefit. This approach considers PMI coverage depth and applies a realization rate haircut to determine the mortgage exposure risk weight in accordance with the proposed LTV cohorts.

Example: Consider an 85 LTV loan at origination with 12 percent first-loss PMI coverage and subject to a 15 percent realization rate haircut. The 12 percent PMI coverage would be reduced by the realization rate (1 minus 15 percent), which reduces the 12 percent coverage to 10.2 percent. The 85 LTV loan is effectively reduced to a 76.3 LTV equivalent after PMI (85 percent * 100 percent minus 10.2 percent PMI coverage). The associated LTV-based risk weight is therefore reduced from 45 percent (per the Standardized Rule) to 35 percent with PMI.[29]

HPC PMI Adjusted Risk Weight Examples Across High-LTV Cohorts

	85% OLTV	90% OLTV	95% OLTV	97% OLTV
Origination LTV	85.00%	90.00%	95.00%	97.00%
Pre-Credit Enhancement RW	45.00%	45.00%	55.00%	55.00%
PMI Coverage*	12.00%	25.00%	30.00%	35.00%
Realization Rate Haircut*	**15.00%**	**15.00%**	**15.00%**	**15.00%**
Adjusted LTV (Net Bank Exposure)**	76.33%	70.88%	70.78%	68.14%
Effective RW Reduction	10.00%	10.00%	20.00%	20.00%
Adjusted Risk-Weight	**35.00%**	**35.00%**	**35.00%**	**35.00%**

* Illustrative, not prescriptive coverage level and haircut assumptions

** Adj_LTV = OLTV x (1-(PMI Coverage*(1-Realization Rate Haircut))

[28] Insurance operates differently from traditional counterparty exposure. In the event a mortgage insurer does fail, existing insurance policies remain in force and claims continue to be paid out of available reserves, even if the insurer is placed in run-off. Nonetheless, HPC acknowledges that payment timing is a critical element of effective credit risk transfer and is an important consideration in capital conservation for the Agencies in crediting capital relief for PMI coverage. While claim realization remained high during the GFC, the timing of certain claim payments was extended in some cases due to insurer-specific stress dynamics. The implementation of PMIERs liquidity requirements, master policy clarity, recission relief, and the development of risk transfer have improved both the certainty and expected timing of claim payments under stress.

[29] One of HPC's members, Arch Capital Group Ltd., has developed an alternative approach to recognizing PMI coverage. Arch's alternative would similarly reduce the LTV by the PMI coverage percentage; however, the realization rate would be applied to the associated risk weight benefit rather than to the coverage amount. As a result, the end risk weight for an exposure would move dynamically instead of aligning to the fixed risk weights prescribed in the Proposed Rules.

We do not recommend the bank capital rules prescribe specified PMI coverage levels in order to enable a new bank-insurance market to develop based on the economics of risk reduction.[30] Finally, for any approach that provides capital relief for PMI, we recommend that the Agencies avoid prescribing MI-specific counterparty requirements in the capital rule. Instead, such criteria are better specified and examined within supervisory guidance for bank counterparty oversight.

- ***Amend the definition of Eligible Guarantor.***

The Proposed Rules maintain the definition of Eligible Guarantor, which include a three criteria test that requires that the Guarantor (1) at the time the guarantee is issued or anytime thereafter, to have issued an unsecured debt security without credit enhancement that is investment grade; (2) maintain creditworthiness that is not positively correlated with the credit risk of the exposures for which it has provided guarantees (i.e., no "wrong-way risk"); and (3) not be an insurance company engaged predominately in the business of providing credit protection (e.g., no monoline insurers). The Agencies solicited public comment about the first criterion of this definition but not the other two. HPC recommends that this first criterion be amended for all credit risk mitigation activities, and the second and third criteria should be amended to facilitate PMI capital relief on mortgage exposures, per the prior discussion.

Pursuant to the Agencies' posed question, the first requirement should be modified to permit an insurer to meet the investment grade debt issuance requirement at the parent or holding company level. Such a refinement reflects organizational arrangements where an affiliate itself may not have investment grade debt issued and outstanding but nonetheless is determined by the banking organization to be investment grade. Retaining the definition's requirement for an investment grade counterparty standard, while allowing the investment grade debt test to be satisfied at the parent level, preserves the ostensible purpose of the requirement (i.e., indicating counterparty strength and sophistication) while better reflecting how insurance holding company groups operate in practice.

The other two criteria of the Eligible Guarantor requirement reflect an inconsistent application of capital treatment across bank exposures to the mortgage ecosystem. The wrong-way risk test and monoline prohibition effectively bar U.S. mortgage insurers from providing mortgage credit support to banks. Mortgage insurance exposures are directionally correlated with mortgage credit performance; however, this correlation is inherent to first-loss credit protection structures and does not undermine their effectiveness. While we understand the Agencies' concern about concentrated risk in this industry, banks already have significant exposure to such concentrated risk within their mortgage exposures. For example, banks have trillions of dollars of exposure to the GSEs and rely effectively on the guarantees from those two private monoline issuers, receiving a favorable 20 percent risk weight on their exposures.[31]

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[30] Loans sold to the GSEs that have PMI must satisfy minimum coverage levels prescribed in the GSE seller guides (and are specifically considered in the ERCF). These PMI coverage levels increase with LTV and are calibrated to reduce the loss-given default, or loss severity, borne by the GSEs (see Fannie Mae Selling Guide: B7-1-02, Mortgage Insurance Coverage Requirements (08/07/2019); Freddie Mac Guide: Chapter 4701: Mortgage Insurance. See also 12 CFR 1240.33(e)(2)(iii)).

[31] 12 CFR 217.32(c).

Mortgage insurance companies specialize in assessing and managing mortgage credit risk, which we would argue makes them a more, not less, effective counterparty for bearing that risk. The relevant consideration is the capacity and timing of performance under stress, which has been materially strengthened post-GFC through an improved capital framework and expanded risk transfer structures. Across the entire housing finance ecosystem, the successful use of credit risk transfer to encourage various, diversified types of capital participation and asset-level risk oversight improves the strength and resilience of the system, underpinning a more durable through-the-cycle finance system.

D. Commitments

The Proposed Rules make multiple changes to capital rules that affect financial "commitments." Specifically, the Proposed Rules introduce a new definition of what constitutes a commitment and the portion of the commitment that is unconditionally cancellable. The Proposed Rules also introduce revised credit conversion factors ("CCF") for off-balance-sheet exposures: 10 percent on commitments that are unconditionally cancellable (for large banking organizations subject to ERBA), and 40 percent on commitments that are committed but undrawn. We recommend adjustments to the definition and to the CCF on cancellable commitments. Absent our recommended changes, HPC believes the proposed treatment would lead to higher system-wide costs for mortgage lending without risk justification for the higher capital charges.

Mortgage-related funding activities would be affected by the proposed changes. Mortgage warehouse lines economically resemble revolving facilities, even as they are structured as a type of repurchase agreement. Mortgage warehouse lending is a highly secure, heavily collateralized, and short-term financing mechanism. These commitments are generally backed by mortgages that are pre-sold for eventual GSE or Ginnie Mae securitization – meaning, the majority of loans on warehouse lines are delivered to agency MBS. For standard mortgage loans, mortgage notes financed by a warehouse facility remain on the line for less than a month before being sold into the secondary market. Since mortgage origination volume is irregular through the quarter and over the year, mortgage banks that make use of these warehouse funding lines operate with significant undrawn capacity, which is drawn down and paid off in short periods, as described above. The capacity on a commitment for mortgage funding needs to be sufficient to accommodate the natural cycle of originations, with monthly and seasonal spikes in volume.

When banks structure these funding arrangements as corporate exposures, they lend at a small discount to the collateral's value – reflective of the short duration of exposure, the high quality of the collateral, and their perfected interest in the reference note. These drawn amounts carry corporate exposure risk weights under bank capital rules that are far higher than the risk weight on a prudently underwritten mortgage that would constitute the collateral on the draw (the discrepancy would increase under the Proposed Rules for most bank mortgage exposures). If a corporate borrower were to fail, a lending bank would take possession of the mortgage collateral at a *more* favorable capital treatment than the corporate exposure which that collateral secures. For this component of these common financing arrangements, the capital framework is already disconnected from the economic risk by requiring twice as much capital for drawn amounts. Adding new definitional uncertainty and more capital-intensive conversion factors would exacerbate this dynamic.

- ***The Agencies should retain the current definitions of "commitments" and "unconditionally cancellable."***

Currently, a "commitment" is defined for purposes of the capital rules as any *legally binding* arrangement that *obligates* a banking organization to extend credit or to purchase assets.[32] Moreover, such an arrangement is treated as a commitment even when the banking organization has the unilateral right to cancel the arrangement at any time. The Proposed Rules would revise the definition of commitment to include any contractual arrangement under which a banking organization and an obligor agree to the terms applicable to one or more future extensions of credit, purchases of assets, or issuances of credit substitutes by the banking organization.[33]

The Proposed Rules also state that a contractual arrangement (as opposed to a legally binding arrangement under the current definition) to extend credit, purchase assets, or issue credit substitutes, but which does not obligate the banking organization to do so, is a commitment that is unconditionally cancellable. This change removes the current bright-line criteria for determining a commitment and would cause confusion as to what constitutes a commitment as opposed to agreed-upon contractual terms to extend future credit. As a result, under the proposed definition, an ERBA bank could be required to hold capital against an unenforceable obligation that does not meet the common law standards to be considered a contract and which the bank has deliberately structured in order to give it discretion to advance or withhold funds.

The ambiguity created by the new definition would affect mortgage warehouse agreements that may be treated as corporate exposures or off-balance sheet securitizations, depending on the structure. The Agencies stated that they are maintaining the exposure calculation methodology for securitization exposures.[34] Under that definition, the exposure amount for an off-balance sheet securitization is the notional amount of the exposure.[35] The new proposed commitment definition could create uncertainty as to the value of that notional exposure. By potentially scoping in future extensions of credit that are not legally enforceable, it could increase the required capital for these exposures.

HPC supports maintaining the current definitions of "commitment" and "unconditionally cancellable." As currently proposed, the rules could require banking organizations to hold capital against arrangements that are not commitments – e.g., legally non-binding – and could discourage banking organizations from offering or discussing in detail future liquidity with customers, which could hamper system resiliency.

- ***The ERBA credit conversion factor for unconditionally cancellable commitments should be reduced or should remain at 0 percent.***

For unconditionally cancelable commitments, the CCF would be increased from 0 percent to 10 percent under the ERBA Rule but remain at 0 percent under the Standardized Rule. The Agencies justify

[32] See 12 CFR 217.2 "Commitment."
[33] Excluded are pre-approval letters for residential mortgage loans, credit card offers, or other offers that have not yet been agreed upon by both parties to the transaction (see 91 Fed. Reg. 15342 and 91 Fed. Reg. at 14977).
[34] 91 Fed. Reg. at 15356 and 91 Fed. Reg. at 14997.
[35] 12 CFR 217.42(c)(3).

the change in ERBA as a recognition that banking organizations may choose not to exercise a cancellation right for business reasons and may even extend credit when obligors are under economic stress to preserve a customer relationship.[36] The Agencies acknowledge that this change could lead to adjusted pricing or terms for certain credit products, particularly revolving credit facilities.[37]

The cancellable portion of a mortgage warehouse commitment can comprise a significant portion of the warehouse line's capacity. In particular, cancelable commitments constitute an important source of funding for seasonal demand. Imposing a CCF will add new capital charges on the lending bank that will be passed through to their mortgage bank customers and ultimately increase consumer borrowing costs. Similar concerns are present in consumer-facing home equity lines of credit, which have been treated as unconditionally cancelable commitments under the current capital rules. We are not aware of an observed loss event in mortgage warehouse lending that has demonstrated a need for this higher charge. Banks already hold significant capital against both drawn and committed-but-undrawn lines. Furthermore, the bank capital framework already accounts for both committed and cancelable notional exposures to funding commitments through the supplementary leverage ratio (SLR).[38]

These commitments are an essential source of liquidity for mortgage lenders and should not be subject to a material additional capital charges.[39] The Agencies should reduce the CCF for unconditionally cancelable commitments under ERBA or keep it at 0 percent. Were the Agencies to finalize this CCF as proposed, banks and their customers would either absorb the cost of the higher capital charge, or they might instead change how they structure their funding arrangements in order to manage closer to the capacity permitted under the committed but undrawn portion of the line. Either outcome is negative for the housing finance system. Curtailing capacity would reduce liquidity and resiliency in the system and could make non-banks more susceptible to funding challenges in times of mild market stress, when adding capacity could be more challenging.

E. Credit Risk Mitigation

- ***HPC supports the introduction of prepaid credit protection as a credit risk mitigant.***

The Proposed Rules introduce a new concept of prepaid credit protection, which can serve as a credit risk mitigant for all types of exposures, including synthetic securitizations. HPC supports the introduction of a new class of credit risk mitigants to facilitate capital relief on risk transfer structures that meaningfully transfer the risk on the underlying exposure. The GSEs have developed effective credit risk transfer instruments and markets through synthetic securitizations like those contemplated by this new criterion. Consistent with our recommendations around the introduction of capital relief for mortgage exposures that carry PMI, a bank capital framework that encourages diverse and specialized forms of private capital to share in the risk exposure makes for a more resilient and dynamic mortgage finance

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[36] 91 Fed. Reg. at 14978.
[37] Id.
[38] 12 CFR 217.10(c)(2)(viii).
[39] As the Agencies acknowledge in the preamble to the ERBA Rule, "Banking organizations are significant funders of nonbank mortgage lenders via warehouse lines of credit." 91 Fed. Reg. at 15135.

ecosystem, reducing systemic risk while meeting the Agencies' objective to encourage greater bank participation in traditional lending activities.

F. Securitizations

- ***HPC supports the lower risk weight floor in the SEC-SA framework for securitizations.***

Under the proposed SEC-SA model, the risk weight floor would be reduced from 20 percent to 15 percent, and the supervisory calibration parameter, p, (the "p-factor") would remain at 0.5.[40] HPC supports these changes to the new SEC-SA framework for securitizations. The lower risk weight floor better aligns to international standards prescribed by the Basel Committee – 15 percent for standard securitizations and 10 percent for certain types of securitizations that meet more conservative prescribed criteria – and will encourage a more level playing field across mortgage market execution channels, including the issuance of private label mortgage-backed securities.[41]

- ***HPC opposes the definitional change to traditional and synthetic securitizations.***

Under the technical modification to the Securitization Framework in the Proposed Rules, the definition of traditional and synthetic securitizations would be modified to "clarify that performance of the securitization exposure would depend 'solely' upon the performance of the underlying exposures."[42] While the Proposed Rules would continue to allow certain types of securitization transactions where a party provides a specified amount of credit protection, the constraints introduced by the addition of "solely" in the definition could immediately affect common forms of securitization that rely on additional types of sponsor support. It would also create confusion as to what types of credit protection will continue to be recognized. Originator or sponsor support arrangements are common in mortgage funding commitments structured as special purpose vehicles and treated by banks as securitization exposures. Mortgage banks may indemnify the trust for representation and warranty and document defects and provide circumscribed repurchase support to loans delivered into the trust that could run afoul of the Proposed Rules' more restrictive definition. Because the Proposed Rules do not expand on the Agencies' rationale for this change, we cannot comment on the underlying arguments. We support the approach proposed by the Structured Finance Association in its comment letter, namely, to delete the newly added word "solely" from the definitions of traditional securitization and synthetic securitization.

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[40] The p-factor is a securitization capital surcharge.

[41] Basel Committee on Banking Supervision, *Basel III Document: Revisions to the securitisation framework* (December 2014 – rev. July2016); available at: https://www.bis.org/bcbs/publ/d374.pdf. See also Regulation (EU) 2017/2401 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms.

[42] 91 Fed. Reg. at 14994 and 91 Fed. Reg. at 15353. "For example, a transaction would not satisfy this criterion if there is an expectation that any sources outside of the underlying exposures would fund the interest or principal payments due on the securitization exposures."

III. Conclusion

The U.S. mortgage finance system is one of the most regulated sectors of the financial economy. Mortgage lending and servicing activities are supported by myriad actors, both depository and not, monoline mortgage participants, and diversified financial institutions. A healthy market is a balanced market where similar risks incur similar regulatory treatment and competition generates innovation and efficiencies, which drive down costs and distribute risk across a broader array of risk takers.

Even with the migration of mortgage activity to non-bank firms, banks remain critical providers of mortgage liquidity and holders of mortgage risk. But the currently coarse capital treatment of mortgage exposures, the lack of relief for PMI, and punitive MSA capital charges put banks at a competitive disadvantage relative to their non-bank peers, both independent mortgage banks and the GSEs. The Proposed Rules go a long way toward putting banks on a more level playing field with other intermediaries. The adjustments discussed in our letter address remaining items to more fully accomplish that objective. If implemented, the Proposed Rules will result in more competition in the provision of mortgage products and lower costs for consumers, which will benefit the entire economy.

Yours Truly,

Edward J. DeMarco
President
Housing Policy Council

Appendix A: HPC Recommendations & Mapping to the Agencies' Questions

Capital Proposal Item	Affected Rule(s)	Agencies' Question	HPC Recommendation
Definition of Capital			
Removal of the Mortgage Servicing Asset Deduction			
Removal of the Mortgage Servicing Asset (MSA) Deduction	SR & ERBA	SA: 1 ERBA: 11	HPC supports the elimination of the capital deduction thresholds for Mortgage Servicing Assets in the Proposed Rules.
Maintain the 250 percent risk weight for Mortgage Servicing Assets	SR & ERBA	SA: 1 ERBA: 11	HPC recommends reducing the 250 percent risk weight assigned to non-deducted MSAs, with HPC bank members supporting a risk weight of 100 percent.
Calculation of Risk-Weighted Assets			
General Risk Weight Treatment			
Addition of LTV-Sensitive Risk Weights for Residential Mortgages	SR & ERBA	SA: 6, 7, 9 ERBA: 22, 23	HPC supports the LTV-based approach to setting risk weights for residential mortgages.
Recognition of Private Mortgage Insurance (PMI) in Residential Mortgage Risk Weights	SR & ERBA	SA: 8 ERBA: 21	HPC recommends that the Agencies adjust mortgage exposure LTVs when PMI is present. We support an approach that: 1) reduces the mortgage exposure's original LTV based on the coverage amount provided by the PMI; 2) appropriately discounts that coverage for instances where PMI is no longer present at the credit event that triggers a claim; and 3) limits bank exposures eligible for PMI capital relief to those at or below 100 LTV. HPC recommends the agencies exempt U.S. monoline mortgage insurers from the definition of Eligible Guarantor to permit PMI written by these insurers to reduce the effective LTV of a mortgage exposure.
Off-Balance Sheet Exposures			
Definition of Commitment	SR & ERBA	SA: 14, 44 ERBA: 30, 70	The Agencies should retain the current definitions of "commitments" and "unconditionally cancellable."
10% Conversion Factor – Unconditionally Cancelable	ERBA	SA: 15 ERBA: 31, 32	The credit conversion factor in ERBA for unconditionally cancellable commitments should be reduced or should remain at 0 percent.

Capital Proposal Item	Affected Rule(s)	Agencies' Question	HPC Recommendation
Credit Risk Mitigation			
Guarantees and Credit Derivatives: Eligibility for Look-Through Treatment	SR & ERBA	SA: 22 ERBA: 51	The Agencies should amend the definition of Eligible Guarantor to permit an insurer determined to be investment grade to meet the requirement at the parent company level that it have debt issued and outstanding that is investment grade.
Prepaid Credit Protection	SR & ERBA	SA: 31, 32, 33 ERBA: 58, 59, 60	HPC supports the introduction of prepaid credit protection as a credit risk mitigant.
Securitization Framework			
Definitions: Change to Paragraph (3): Securitization "Solely" Based on Underlying Exposures	SR & ERBA	SA: 36 ERBA: 62	HPC opposes the definitional change to traditional and synthetic securitizations.
Securitization Standardized Approach (SEC–SA): Risk Weight Floor of 15%	SR & ERBA	SA: 51 ERBA: 77	HPC supports the lower risk weight floor in the SEC-SA framework for securitizations.