FEDERAL HOME LOAN BANK OF CHICAGO, ALEXANDRA ROMO

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

Comment ID: FR-2026-0007-01-C49

Submitter Information

Organization Name: Federal Home Loan Bank of Chicago

Organization Type: Company

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Submitted Date: 06/15/2026

Comment letter attached.

FHLBANKS
LENDING THAT POWERS COMMUNITIES

June 11, 2026

Via Electronic Submission

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

Benjamin W. McDonough, Secretary,
Board of Governors of the Federal Reserve System,
20th Street and Constitution Avenue NW,
Washington, DC 20551

Jennifer M. Jones, Deputy Executive Secretary,
Federal Deposit Insurance Corporation, 550 17th Street NW,
Washington, DC 20429

Re: Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations with Significant Trading Activity, and Optional Adoption for Other Banking Organizations (OCC: Docket ID OCC-2026-0265, RIN 1557-AF52); (Federal Reserve: Docket No. R-1887, RIN 7100-AH20); (FDIC: RIN 3064-AF29)

Regulatory Capital Rules: Regulatory Capital and Standardized Approach for Risk-Weighted Assets (OCC: Docket ID OCC-2026-0034, RIN 1557-AF49); (Federal Reserve: Docket No. R-1888, RIN 7100-AH21); (FDIC: RIN 3064-AG23)

Ladies and Gentlemen,

The Federal Home Loan Banks ("FHLBanks"), including The Federal Home Loan Bank of Chicago ("FHLBank Chicago") in its role operating the Mortgage Partnership Finance Program ("MPF Program"), appreciate the opportunity to comment on the interagency proposed rulemaking *Regulatory Capital Rules: Regulatory Capital and Standardized Approach for Risk-Weighted Assets and Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations With Significant Trading Activity, and Optional Adoption for Other Banking Organizations,* both issued on March 19, 2026 (collectively the "Proposed Rule"). The Proposed Rule issued by the Office of Comptroller of Currency, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System (the "Agencies") proposes to revise aspects of the existing Basel III endgame capital framework. We commend the Agencies for reconsidering aspects of the current capital framework that have constrained bank participation in residential mortgage origination and servicing.

The current risk-based capital framework applied to depository institutions has contributed to a significant shift in mortgage origination and servicing activity away from regulated banks and toward non-depository institutions over the last 13 years. Your efforts to recalibrate capital requirements represent a constructive step toward restoring balance and decreasing regulatory burden on community banks. Improved alignment of risk-based capital requirements with the actual credit risk exposures of depository institutions will encourage and increase responsible bank participation in housing finance, increase competition across the mortgage ecosystem, and strengthen the resilience of the broader economy, ultimately to the benefit of consumers through increased competition and more mortgage liquidity.

Introduction

The FHLBanks support the Proposed Rule's removal of the requirement to deduct Mortgage Servicing Assets ("MSAs") exceeding specific thresholds from Common Equity Tier 1 ("CET1") capital. This has long been a deterrent for banking organizations to increase mortgage lending activity and retain MSAs to benefit their customers. Removing this deduction will help banking organizations compete with non-bank mortgage lenders that have become the largest mortgage servicers over the last decade.

In addition, the FHLBanks support a reduction in the 250% risk weight that is currently applied to MSAs. The 250% risk weight is a further deterrent for depository institutions to originate and retain mortgage servicing assets. Based on the historical performance of MSAs, a risk weight of 100% would be sufficient and appropriate to address safety and soundness while incentivizing depository institutions to originate mortgage loans and retain customer relationships through mortgage servicing.

The FHLBanks also support the Proposed Rule's risk-weights for residential mortgages based on Loan-To-Value ("LTV"), applied to all banks regardless of asset size. This again aligns capital requirements with risk exposures and rewards prudent underwriting practices while leveling the playing field for smaller community banks.

The FHLBanks also support the recognition of Private Mortgage Insurance ("PMI") as a significant risk mitigant that should be factored into calculations of risk-weighted assets. We believe the amount of PMI should be included in determining the total outstanding amount of the loan when calculating the LTV ratio, subject to a reasonable haircut. This would better recognize that even during the financial crisis, PMI providers paid a significant number of claims that reduced the overall loss exposure for mortgage investors.

As discussed below in greater detail, the MPF Program stakeholders respectfully request the Agencies also evaluate capital treatment of Credit Enhancement ("CE") Obligations retained by FHLBank Members when they originate and sell mortgages to their FHLBank under the Federal Housing Finance Agency's ("FHFA") Acquired Member Assets regulation ("AMA Regulation") (12 C.F.R. 1268 et. seq.)[1].

[1] A FHLBank Member selling mortgage loans to its local FHLBank is referred to as Participating Financial Institution ("PFI") under the AMA Regulation.

A refinement of bank capital requirements to more accurately reflect the risk profile of these exposures would address a frequently cited friction point impacting the effectiveness of community mortgage banking operations and enhance liquidity for FHLBank Members, in direct alignment with the scope of the Agencies' efforts.

MPF Credit Enhancement Overview

CE Obligations arise under the MPF Program in connection with true-sale mortgage transactions conducted pursuant to FHFA's AMA Regulation. Under the MPF Program, a FHLBank Member sells loans to its FHLBank, resulting in the loans being removed from the Member's balance sheet, while it retains a contractual CE Obligation to the FHLBank loan purchaser. The CE Obligation is at all times secured by a first lien security interest in the related FHLBank Member collateral held by the FHLBank purchaser. Over 30 years, the actual credit losses borne by the aggregate CE Obligations under the MPF Program has been minimal. Nevertheless, under the regulatory capital rules, retained CE Obligations are typically treated as securitization exposures, including synthetic securitizations, subject to the Simplified Supervisory Formula Approach ("SSFA"), gross-up approach or a 1,250% risk weight where data or slotting requirements are not met[2]. SSFA and gross-up approaches typically result in a risk-weight of or approaching 1,250%. This treatment results in a disproportionate level of required capital when considering the true credit risk retained by the FHLBank Member.

The March 19, 2026, proposal preserves this securitization framework through the Securitization Standardized Approach ("SEC-SA"), while eliminating the gross-up approach, which in practice further limits calculation flexibility for community banks participating in the MPF Program.

The FHLBanks believe modest, targeted adjustments, consistent with the Agencies stated goals, could better calibrate capital to the actual risk of MPF CE Obligations under the MPF Program, without weakening prudential standards.

MPF Program Background

For nearly 30 years, the MPF Program has provided a reliable and competitive source of secondary mortgage market liquidity to FHLBank Members, enabling depository lenders to originate residential mortgages, sell them to their regional FHLBank at a competitive execution, and typically retain servicing to maintain strong ties to customers within their communities. Various MPF products are currently offered by the FHLBanks of Boston, Chicago, Dallas, Des Moines, Pittsburgh and Topeka. The Mortgage Purchase Program ("MPP"), operated by FHLBank Indianapolis and FHLBank Cincinnati, and the Mortgage Asset Program ("MAP"), operated by FHLBank New York, have worked similarly with the same mission focus and benefit for their Members, although the structure of the MPP and MAP products regarding credit enhancement is different. Across all programs, the significant majority of active FHLBank Member Participating Financial Institutions ("PFIs") are smaller community bank institutions that would otherwise struggle to access the secondary mortgage market through other outlets such as Fannie Mae or Freddie Mac – the Government Sponsored Enterprises ("Enterprises").

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[2] e.g., 12 C.F.R. §§ 3.43, 217.144, 324.43.

The MPF Program's share of the overall mortgage origination market is small (~1%) and does not pose a systemic risk to the financial stability of the U.S. mortgage market. Even though the total volume of MPF loans is small, its penetration into the community bank customer base is deep. Since 2024, 792 PFIs across six FHLBank Districts have utilized the MPF Program for mortgage funding and liquidity in all fifty states and three territories. With a median asset size of $496 million, the significant majority (73%, based on a review of Home Mortgage Disclosure Act data) of PFIs are smaller, community-based depository institutions that generally rely on the MPF Program as the primary or only investor channel supporting residential mortgage lending operations. The substantial majority of PFIs and loan volume in the MPF Program comes from smaller financial institutions with less than $10 billion in assets.

A key feature of the MPF Program is credit risk sharing, which requires PFIs delivering mortgage loans to retain a limited, fully collateralized CE Obligation in a second loss position within a defined loss sharing waterfall structure. The MPF Program's risk sharing structure has incentivized PFIs to deliver high credit quality, well underwritten loans, as a result of the CE Obligation. As a result, they maintain significant "skin in the game" for the loans they sell to their FHLBanks.

MPF Program Credit Risk Sharing & Historical Results

Mortgages sold under MPF product guidelines generally follow conforming underwriting standards similar to mortgage loans sold to the Enterprises. These structural characteristics substantially reduce the risk borne by participating FHLBanks relative to the full mortgage portfolio.

Over time, CE Obligation requirements have varied based on requirements under the AMA Regulation and stress loss scenarios utilized within credit risk models. Despite variations in requirements, PFIs participating in the MPF Program have generally provided and collateralized $1.0 - $2.0 billion in CE Obligations at any given time over the last 20 years, in the aggregate. Strong overall credit performance and the FHLBanks' first loss position has resulted in very limited credit losses incurred by PFIs in their second loss position. Over the 29 years since MPF Program inception, the aggregate credit losses absorbed by PFIs has been minimal. Only $81 million in aggregate credit losses have been absorbed by CE Obligations, reflecting just 0.03% of the $271 billion in acquired conventional loans (PFIs have incurred only $40 million, with an additional $41 million absorbed by supplemental mortgage insurance purchased to support PFI obligations). During the years following the Great Financial Crisis, stress losses worked through the credit risk sharing structure, with aggregate losses to the PFI's CE Obligations reaching an annual peak of $12 million in 2012, reflecting less than 1% of the $1.6 billion in aggregate PFI CE Obligations in effect at the time. Since the 2012 peak, losses covered by PFI provided CE Obligations have declined, and have been nearly zero since 2020.

Despite limited occurrences of losses covered by PFI provided CE Obligation, the current framework often imposes dollar-for-dollar capital requirements for banks' overall CE Obligation, which is inconsistent with historical loss experience. The following sections outline current capital requirements and preliminary views on proposals for a rightsized solution while maintaining guardrails.

<u>Current Regulatory Capital Treatment</u>

Under current capital rules and the Proposed Rule, retained credit exposures arising from asset sales may be treated as recourse obligations, direct credit substitutes, or securitization exposures.

In practice, CE Obligations under the MPF Program are often considered "synthetic securitizations," subject to treatment comparable to subordinated tranches of securitization structures, even though they are created through a "true sale" that moves the loans off the PFI's balance sheet.[3]

PFI CE Obligations are a "mezzanine" credit enhancement in that losses must first exceed an FHLBank first-loss position before any PFI CE Obligation is affected. The CE Obligation is contractually capped, with the FHLBank retaining additional risk exposure beyond the CE Obligation. The SSFA framework explicitly recognizes attachment and detachment points when calculating risk-weighted assets[4], and therefore conceptually acknowledges the existence of the FHLBank first loss position.

However, due to low detachment points relative to standardized mortgage risk weights, the formula often defaults to the maximum 1,250% risk weight for CE Obligations under the MPF Program, notwithstanding strong historical performance.

This treatment creates a structural disincentive and limits FHLBank Members from participating in the MPF Program to their full potential. Over the last 10+ years, FHLBank Members have repeatedly expressed a desire to increase their participation by selling more MPF loans but are constrained by an outsized and persistent capital burden. In addition, the complexity associated with using the SSFA/SEC-SA framework, with the elimination of the gross-up method, may further limit bank participation.

To better align with the true risk profile of the CE Obligation, MPF Program stakeholders support targeted regulatory adjustments to align capital requirements with the risk exposure of the CE Obligation (rather than the broader mortgage pool) by recognizing the strong historical performance and infrequent and limited need for PFIs to absorb losses through market cycles. These adjustments would meaningfully reduce unnecessary capital friction for PFIs, enabling them to continue serving as critical providers of mortgage credit in the local markets that depend on them. Preliminary thoughts on adjustments to capital requirements are outlined within this letter.

The MPF Program supports several policy objectives, including maintaining community bank participation in mortgage lending, providing a much needed source of liquidity for

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[3] While there may be arguments that credit enhancement of true sale of financial assets should not create a synthetic securitization, we recognize that supervisory practice has evolved to treat the CE Obligations as synthetic securitizations.

[4] e.g., 12 C.F.R. §§ 3.43(b)(3), 217.144(b)(3), 324.43(b)(3).

community banks, diversifying the mortgage secondary market, enabling relationship-based servicing capabilities, and providing an important alternative to the Enterprise execution channels.

Resulting Capital Inefficiency

The current capital framework and the Proposed Rule create two structural problems. First, capital charges may approach the maximum loss exposure the PFI retains, creating a capital burden disproportionate to the underlying risk retained. As seen in the historical performance provided earlier, aggregate losses incurred by PFIs through CE Obligations peaked in 2012 but represented less than 1% of total CE Obligation outstanding. Even the worst performing vintages of loan originations (2006-2008) resulted in a small fraction of losses relative to the overall PFI CE Obligation.

Second, the current capital framework and Proposed Rule reduce community bank capacity for mortgage lending. Community banks operate with relatively constrained capital resources and many lack the ability to access Fannie Mae or Freddie Mac directly (where capital requirements from loan sales can be lower). Capital inefficiencies associated with MPF Program participation therefore reduce mortgage origination activity, discourage servicing retention and further concentrate mortgage credit risk outside of the banking sector, often to the detriment of local consumers that community banks serve.

Recommendations on Adjustments to Address MPF Program Credit Enhancement

Given that most PFIs are small, community-based institutions, we believe a simplified approach to capital requirements would be most effective in addressing credit enhancement exposures in the MPF Program. Risk-weights applied should reflect the credit quality and historical performance of the underlying mortgages and the MPF Program, rather than securitization-style risk weights intended for complex capital markets structures.

For example, recognizing the second loss position of the CE Obligation and 30 years of historical loss experience of PFIs in the MPF Program, a reasonable risk-weighting approach could be a framework similar to the standardized approach for non-securitization off balance sheet exposures, applying an appropriate Credit Conversion Factor ("CCF") and risk weight to the CE Obligation. A 100% CCF and 100% risk weight would result in PFIs holding 8% of their credit enhancement exposure in capital. This percentage would cover the most stressful vintages of credit loss incurred as evidenced by historical stress loss data and modeled projections. Further, it would be consistent with the risk weighting applied to other credit-enhancing representations and warranties that are not securitization exposures.

The majority of the current aggregate CE Obligation outstanding of $1.6 billion is provided by bank institutions ($1.3 billion). Given the estimated $1.1 billion in nearly dollar-for-dollar capital allocated across bank PFIs providing CE Obligations, a change of this nature could free up to $1.0 billion of capital for these PFIs to deploy into new mortgage origination activity or other community lending efforts. This relief would be spread across the ~900 depository lenders currently providing credit enhancement, a material benefit given the size of institutions in scope. Accordingly, we respectfully request that the Agencies adopt the proposed 'FHLB credit enhancement' category confirming its 100 percent risk weight - please see proposed text at the end of this letter.

We appreciate the opportunity to share these recommendations and to illustrate the potential benefits to reform.

Broader Policy Benefits

Adopting the recommended reforms would support several regulatory objectives. First, it would strengthen community banking by improving capital efficiency for banks that would like to expand their participation in mortgage origination and servicing. These community banks are critical providers of mortgage lending solutions in rural and underserved areas. Second, these changes would encourage participation by community banks by providing a viable alternative to Fannie Mae and Freddie Mac as a source of liquidity and balance sheet management. This would support diversification in mortgage secondary markets, improving market resilience and potentially lowering rates for consumers. Additionally, safety and soundness would be maintained through capital requirements that reflect the risk borne by the community banks participating in mortgage lending activities. Finally, this approach would be consistent with and further the Administration's recent Executive Order to Promote Access to Mortgage Credit, which encourages federal regulators to tailor bank risk weights and reduce regulatory burdens that have lowered lender participation and restricted mortgage availability for low- and moderate-income or rural homebuyers.

Conclusion

The current regulatory capital treatment of mortgage-related activities produces a capital burden that can significantly exceed the economic risk retained by participating institutions. Aligning risk weights with residential mortgage exposures would better match capital requirements to actual risk while preserving prudential safeguards. The proposed changes to MSAs and residential loan holdings, along with our suggestions related to PMI and CE Obligations, help achieve the goal of making community banking more competitive and viable.

Such adjustments would support continued and even increased participation by community banks in mortgage lending, promote a more diversified and resilient mortgage finance system, and ultimately provide increased liquidity to consumers in local communities that such community banks serve. Now is the time to increase community bank participation in mortgage lending as those institutions serve consumers who are often left out of the mortgage market.

Sincerely yours,

Patrick Sullivan
Executive Vice President
Mortgage Partnership Finance Program Executive

Federal Home Loan Bank of Atlanta

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Recommended Changes to Proposal Text

Basel III Proposal

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(m) *FHLB credit enhancement.* Notwithstanding any other provision of this subpart, the risk weight for a credit enhancement provided by a [BANKING ORGANIZATION] pursuant to 12 C.F.R. § 1268.5 shall be 100 percent.

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Standardized Approach Proposal

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(m) *FHLB credit enhancement.* Notwithstanding any other provision of this subpart, the risk weight for a credit enhancement provided by a [BANKING ORGANIZATION] pursuant to 12 C.F.R. § 1268.5 shall be 100 percent.

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