

Meeting Between Staff of the Federal Reserve Board, Federal Deposit Insurance Corporation, and Representatives of Various Regional Banking Organizations
April 26, 2018

Participants: Juan Climent and Noah Cuttler (Federal Reserve Board)

Ben Bosco (Federal Deposit Insurance Corporation)

Steve Gannon and Eric Schuppenhauer (Citizens); Matt Farrell, Deron Smithy, and Tom Speir (Regions); Jim Cirolì and Brian Boike (Flagstar); Hal Johnson and Cindy Powell (BB&T); Mike Abarca and Mark DuHamel (Huntington); Tom Esposito, Chris Lightcap, and David Jarow (M&T); Nicholas Podsiadly (Fifth Third); Michael Flynn (Goodwin Procter LLP)

Summary: Staff of the Federal Reserve Board and Federal Deposit Insurance Corporation met with representatives of several regional banking organizations to discuss the notice of proposed rulemaking on Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996. In particular, the topics of discussion included the treatment of mortgage servicing assets.

MSA Risk Weighting Summary

- 1) The proposed 250% risk weighting for MSA assets, without any regard for the composition of those MSA assets being serviced (ex. Agency vs. Non-Agency), nor the risk management practices of the institutions holding those MSA assets, is overly punitive.
 - a. Risk weightings are typically based on a given asset's perceived credit risk; for GSE servicing that risk is born by the borrower, the private mortgage insurer and the GSE; for government servicing (Ginnie Mae), the credit risk rests with the borrower and the government entity guaranteeing or insuring the loan.
 - b. Other asset classes which can exhibit similar price volatility to MSA assets carry a much lower risk weighting (GSE MBS securities are 20% RWA, and the price sensitivity to interest rates on a 30yr Treasury bond might not be too different from an MSA asset, and those Treasury bonds receive a 0% RWA).
 - c. Arguably the greatest risks to holding MSA assets are prepayment risk and operational risk; institutions with these assets often manage these risks in a variety of ways including hedging strategies and/or holding reserves; both of these strategies already consume capital.
 - d. For organizations already below the existing 10% CET1 cap, a move to 250% risk weighting without any regard to the composition of the MSA assets being serviced, or the organization's track record managing comparable risks, is punishing.
- 2) Non-banks are not held to the same standard and on-going regulatory oversight as banks; as a result, MSA asset concentration continues to move to non-banks. The growing concentration of non-bank servicers/lenders has the potential to create more instability/cost to both borrowers and the government in the event of non-bank failures given liquidity and/or prolonged stress scenarios.
 - a. See **Liquidity Crises in the Mortgage Market**, (March 2018, You Suk Kim, Steven M. Laufer, Karen Pence, Richard Stanton, Nancy Wallace).
 - b. Non-bank servicers may have difficulty obtaining funding in severe downturns. They rely on short term funding (warehouse lines of credit) to fund on-going servicing operations (servicing advances of principle, interest, taxes, insurance); an economic shock or prolonged stress scenario can cause that funding to dry up which may negatively impact both borrowers and the government.
- 3) A healthy and competitive MSA asset market is a benefit to the consumer; the elimination or reduction of banks in this MSA asset space reduces consumer choices and may ultimately harm them by driving up servicing and/or mortgage origination costs.
- 4) 250% risk weight on MSAs has the potential to create an uneven playing field between bank and non-bank servicers which may negatively impact the current functioning of the Agency model, the availability of credit to customers, and liquidity and efficiency in the mortgage markets more broadly.
- 5) Recent FRB policy emphasizes the need for tailoring regulatory policy for assessing, mitigating and regulating risk. Governor Quarles stated in his April 18 testimony to the Senate Banking Committee:

"Efficiency of supervision and regulation means that if we have a choice between two methods that are equally effective in achieving a supervisory goal, we should strive to choose the one that is less burdensome. That can take many forms, including focusing the most stringent of supervisory standards and practices on the riskiest firms, as well as refining the calibration of specific requirements to make them more aligned with their original intent. I also believe that there are additional tailoring opportunities with respect to large firms that are not G-SIBs to ensure that applicable regulation matches their risk."