MORTGAGE BANKERS ASSOCIATION

April 09, 2019

Office of the Comptroller of the Currency
Legislative and Regulatory Activities Division
400 7th Street SW., Suite 3E-218, Mail Stop 9W-11
Washington, DC 20219
Docket ID OCC–2017–0018; RIN 1557–AE10

Federal Deposit Insurance Corporation
Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
550 17th Street NW
Washington, DC 20429
RIN 3064 AE-59

Board of Governors of the Federal Reserve System
Ann E. Misback, Secretary
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket No. R–1576; RIN 7100 AE-74

Re: Regulatory Capital Rule: Capital Simplifications for Qualifying Community Banking Organizations

The Mortgage Bankers Association (MBA)[1] appreciates the opportunity to comment on the recent Notice of Proposed Rulemaking[2] issued by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve (collectively "the agencies") that would provide a simple measure of capital adequacy for qualifying community banking organizations (the "Proposal"). The Proposal implements Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (the "Act"). Congress directed the agencies to develop a community bank leverage ratio (CBLR) framework to implement the provisions of Section 201 of the Act.

Background on the Act and the Proposal

As a result of the recent financial crisis, in 2013, the agencies (pursuant to the requirements of Basel III) revised the regulatory capital rule framework for banking organizations with the goal of "strengthening" applicable capital requirements in order to ensure sound and high quality capital in the banking system. This revision introduced more stringent and complex rules on regulatory

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 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 over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage-lending field. For additional information, visit MBA's website: www.mba.org.

[2] Capital Simplifications Proposal for Qualifying Community Banking Organizations under Section 201 of the under Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 - A Proposed Rule by the Comptroller of the Currency, the Federal Reserve System, and the Federal Deposit Insurance Corporation on 02/08/2019.

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capital requirements for banks, and the impact on community banks was overwhelming. In fact, the costs and burdens associated with compliance for community banks severely outweighed any perceived benefits for the agencies. In response to industry feedback, the agencies published the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPA) joint report to Congress in March of 2017, indicating intent to simplify the capital rules for community banks in order to reduce regulatory burdens for these entities – while still maintaining safety, soundness and quality of capital in the banking system. In September 2017, the agencies published a proposal to simplify certain aspects of the regulatory capital rules for non- advanced approaches banking organizations.[3] This proposal is currently awaiting finalization[4].

In 2018, Congress enacted the Act, under which Section 201 provides a simplified process of regulatory capital calculation for certain community banks. This provision would essentially allow a qualifying community bank opt out of the regulatory capital rule requirements under Basel III, and instead, adopt a new simplified community bank leverage ratio (CBLR) framework to be developed by the agencies. This framework would establish an acceptable CBLR level, which if exceeded by a community bank, would allow the bank to be considered as having met: *(i) The generally applicable leverage and risk-based capital requirements under the agencies' capital rule; (ii) the capital ratio requirements in order to be considered well capitalized under the agencies' prompt corrective action (PCA) framework (in the case of insured depository institutions); and (iii) any other applicable capital or leverage requirements*. In essence, such a community bank would no longer be subject to the capital requirements of Basel III.

In addition to developing the new CBLR framework, the Act also directs the agencies to develop procedures for addressing situations where a qualifying community bank falls below the CBLR level after previously exceeding the level. Furthermore, Section 201 defines CBLR as the ratio of the bank's CBLR tangible equity to its average total consolidated assets, both as reported on the bank's applicable regulatory filing; and gives the agencies authority to develop guidance that will determine whether a community bank that is eligible to opt into the CBLR framework could be disqualified based on the existence of certain enumerated factors relating to risk profile - such as the bank's off-balance sheet exposures, trading assets and liabilities, total notional derivatives exposures, and any other factors the agencies may deem to be appropriate.

In response to the directives under Section 201, the agencies issued the Proposal seeking feedback on 26 listed questions. While we acknowledge the importance of feedback responding to all the listed questions in the Proposal, this comment letter will focus on providing comments on two specific issues that we have identified currently as being the most important for which feedback must be provided on behalf of our members; and strongly recommends that these issues be

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[3] Pending the issuance of final rules addressing the complexities of the regulatory capital rules for community banks, the agencies decided to provide some immediate relief by issuing a "pause" in the transition provisions for some of the regulatory requirements that would be addressed by the simplification proposal. The pause would be in place until the proposal is finalized. MBA fully supported the pause and stressed its importance as a necessary step to avoid a "cliff effect" of full implementation on January 1, 2018 while the Agencies continue to review and work on simplifying the onerous Basel III MSA rules. But for this pause, many small banks would likely have further reduced or exited the mortgage servicing business, and this would have resulted in irreparable harm to those banks, and probable negative impacts to their customers as well.

[4] MBA submitted comments on this proposal, and has sent in several letters to the agencies requesting status on finalization.

addressed prior to finalizing the Proposal. However, if we determine at a future date that there is a need to provide additional feedback (or provide direct response to any of the questions in the Proposal), MBA will submit additional letters to the agencies for consideration at that time.

The Proposal provides a CBLR framework that consists of an alternative methodology for community banks to measure capital adequacy, which would simplify regulatory requirements and provide significant regulatory burden relief for qualifying entities that choose to opt into the framework. In order to balance the simplicity of the framework with the agencies' goals of safety and soundness, the Proposal specifically notes (as also provided in the Act), that (i) the framework will be available only to community banks with less than $10 billion in assets; (ii) the framework will not operate to reduce the amount of capital that is currently held by a qualifying institution; (iii) a qualifying institution will be disqualified from opting into the simplified CBLR framework, and will continue to be subject to the generally applicable capital requirements, if such an institution has a high risk profile; and (iv) the agencies will continue to maintain the supervisory actions that are applicable under the PCA framework or other statutes and regulations based on the capital ratios and risk profile of an institution.

II **Establishing Eligibility for the Framework**:

To implement Section 201 of the Act, the Proposal establishes the following essential details and definitions:

- **Qualifying Community banking organization**: a depository institution (or holding company) with less than $10 billion in total consolidated assets with limited amounts of off-balance sheet exposures, trading assets and liabilities, <u>mortgage servicing assets (MSAs)</u>, and deferred tax assets (DTAs) arising from temporary differences that a banking organization could not realize through net operating loss carrybacks (temporary difference DTAs). This would not include an advanced approaches banking organization.

- **CBLR tangible equity**: total bank (or holding company) equity capital, prior to including minority interests, and excluding accumulated other comprehensive income (AOCI), DTAs arising from net operating loss and tax credit carryforwards, goodwill, and other intangible assets (other than MSAs), each as of the most recent calendar quarter and calculated in accordance with a qualifying community banking organization's regulatory reports. Average total consolidated assets would be calculated in a manner similar to the current Tier 1 leverage ratio denominator in that amounts deducted from the CBLR numerator would also be excluded from the CBLR denominator.

- **CBLR calculation**: the ratio of tangible equity capital (CBLR tangible equity) divided by average total consolidated assets.

- **Established/Acceptable CBLR**: <u>greater than 9%</u>.

- **Election to use the CBLR framework**: a community banking organization with greater than 9% CBLR, and that meets other requirements of a "qualifying community banking organization," may elect to use the CBLR framework.

- **CBLR reporting**: since CBLR calculation would require significantly less data than for calculating the generally applicable capital requirements, the agencies expect that a CBLR banking organization would report its CBLR and other relevant information on a simpler regulatory capital schedule. Thus, the Proposal includes an illustrative CBLR reporting schedule that reflects potential reduced reporting requirements for an institution

III Comments on the Proposal

This section provides input and feedback on three specific questions within the proposal, as well as comments on an issue that is not included in the agencies' questionnaire in the Proposal.

a. The agencies should eliminate the proposed qualifying criterion for MSAs.

As noted above, Congress directed the agencies to establish guidance (based on enumerated factors relating to an institution's risk factors) that would disqualify a community bank from being able to opt into the CBLR framework. Essentially, an institution with a high risk profile would be ineligible to opt into the CBLR framework, regardless of other qualifying attributes. In furtherance of this mandate, the Proposal provides that a community bank will not be eligible to opt into the CBLR framework unless it meets a list of risk profile criteria – one of which is that its <u>MSAs must be 25% or less of CBLR tangible equity</u>.

MBA strongly opposes this proposed qualifying criterion for MSAs, and believes that its inclusion in the CBLR qualifying criteria is not necessary or required under Section 201, and in fact, works counter to the goal of creating a simplified methodology for calculating capital adequacy for qualifying community banks. Although Section 201 directed the agencies to include "such other factors as the appropriate Federal banking agencies determine appropriate" in the list of qualifying criteria, the inclusion of a limitation on MSAs is neither appropriate nor justifiable.

As the MBA has noted on several occasions to the agencies, the erroneous and outdated premise that MSAs are extremely risky and difficult to value has played a role in the draconian treatment that the asset has received over the last few years. In fact, in a report of the agencies to Congress on the MSA capital rules ("the Report"),[5] the regulators noted 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 MSA capital rules. We note that even if that was true many years ago, it has not been so for the last several years. MSAs are now better understood, better managed, and better controlled. Many holders of the asset have a better understanding of the asset and engage in various effective activities – including hedging – to

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[5] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Offices 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).

manage volatility and greatly reduce the inherent risk of the asset. The great strides that have been made over the last few years to better understand, control and manage MSAs have not only made the asset one with an extremely low risk level, but have also resulted in increasing the ability of banks to value MSAs, which has led to well-functioning markets for MSAs.

The Proposal should be revised to remove MSAs as one of the factors that relate to a high risk profile for purposes of disqualifying a community bank under the CBLR framework. There is no question that high off-balance sheet exposures, derivatives, trading assets and liabilities could contribute to a high risk profile for a company. On the other hand, there is no evidence or justification whatsoever for a conclusion that high MSA concentration contributes to a high risk profile for a company.

Moreover, there is no justification for the limit on MSAs concentration to no more than 25% of CBLR tangible equity. This limitation would operate to exclude many community banks with very low risk profile (i.e., very little trading assets and liabilities and off balance sheet exposures) from qualifying for the CBLR framework. As we have noted in the past, mortgage servicing is a very important line of business for many banks, particularly those banks that originate mortgages. In fact, mortgage loan origination and servicing are the primary businesses for many community banks. The servicing function – collecting payments, administration of impound accounts for taxes and insurance, as well as the extremely important functions of working with borrowers who encounter difficulties in meeting their obligations under the loan – is arguably the most important relationship a bank has with its customers. This relationship with customers plays a significant role in strengthening the relationships that banks have with the communities they serve. Thus, the Proposal could severely restrict or shrink how much MSAs these institutions can hold, thus imposing an undue burdensome and unnecessary limit on their ability to continue to provide the high-quality mortgage servicing that is central to their business models and valued by their customers. In fact, such a rule would be counter to the goal of reducing burdens and simplifying the capital rules for small community banks.

Therefore, MBA strongly recommends that the agencies eliminate the MSAs criterion from the list of qualifying criteria. In the alternative, the agencies could increase the MSAs concentration from 25% to at least 50%. This would allow a larger number of community banks with very low risk profiles but high MSAs concentrations to opt into the framework. These banks do not engage in risky activities, but should not be ineligible simply because they hold a large volume of MSAs in order to extend or strengthen the relationships they have with their mortgage borrowers. There is no indication of why the agencies chose to use 25% as the threshold for MSAs in the Proposal. Similarly, there is no evidence to show that a bank with MSAs of more than 25% of CBLR tangible equity has a high risk profile. In fact, this 25% limitation introduces an unnecessary complexity into a provision that is intended to establish simplicity and reduce unnecessary burdens for the smallest community banks. If this criterion is retained, it could result in either many otherwise qualified community banks not being able to opt into the CBLR framework, or community banks selling off their MSAs in order to qualify. Elimination of the criterion or increasing the cap to at least 50% will ensure that many qualifying community banks are eligible to opt into the framework and still be able to retain servicing that allows them continue to service their retail customer base.

b. The 9% CBLR established by the agencies is too high

Congress directed the agencies to develop a CBLR of not less than 8% and not more than 10% for qualifying community banks to correspond to the well capitalized category under the PCA capital framework. The Proposal establishes a CBLR level of greater than 9%. In effect, a qualifying institution with greater than 9% CBLR would be considered well capitalized and eligible to opt into the CBLR framework. In establishing a CBLR of greater than 9%, the agencies noted that "an 8 percent CBLR would allow more banking organizations to opt into the CBLR framework…" However, the assumption that a lower CBLR "could incentivize a large number of CBLR banking organizations to hold less regulatory capital than they do today" played a major role in setting this higher CBLR level. There is no evidence that an 8% CBLR would impact regulatory safety and soundness in the banking system, and thus, MBA strongly recommends that the agencies revise the proposed CBLR level, and establish an 8% CBLR. The greater than 9% CBLR would (as noted by the agencies) operate to exclude many qualified institutions from opting into the CBLR framework, thereby negating Congress' goal of making available a simplified regulatory capital framework for the smallest and least complicated community banks.

According to the agencies, in order to minimize the burden to institutions whose CBLR falls below the established level, and are therefore required to transition from the CBLR framework to the more complex risk-based capital requirements under the generally applicable capital requirements[6], the Proposal establishes CBLR levels to correspond with the various PCA capital categories. Hence, under the Proposal, a CBLR bank that has: 7.5% or greater CBLR would be considered adequately capitalized; less than 7.5% CBLR would be considered undercapitalized; and less than 6% would be considered significantly undercapitalized. In addition to being considered adequately capitalized, an institution with CBLR of 7.5% or greater would be considered to have met the minimum capital requirements under the agencies' capital rule.

It is difficult to understand how the agencies can justify a greater than 9% CBLR as a criterion for the framework, while establishing that an institution with a 7.5% or greater CBLR would be considered adequately capitalized and also considered to have met the minimum capital requirements under the agencies' capital rule. In essence, if the Proposal considers an institution with a 7.5% or greater CBLR to be adequately capitalized, there is no reason why a CBLR of greater than 8% could not be set as the established CBLR for the framework – in which case, an institution with CBLR of greater than 8% would be considered well capitalized. The agencies concede that the separation between the categories are large, but explain that it was done purposefully to avoid having a banking organizations face frequent changes to its PCA category without a corresponding change in its CBLR. While the Proposal goes on to explain why the agencies settled on a large differential between the well capitalized and adequately capitalized categories, we believe that the same explanations would hold true for a smaller gap between the well and adequately capitalized categories. In essence, there is no reason for the well capitalized category to be greater than 9% CBLR and the adequately capitalized category to be 7.5% or greater.

[6] Or qualifying institutions that simply decide to opt out of the CBLR framework.

While there could be some argument that the establishment of a separate PCA framework within the CBLR framework was not mandated by Congress, and might not even be necessary to achieve the goals of Section 201, the agencies have indicated that the framework would help reduce transition burdens for institutions. MBA appreciates the agencies' efforts to address anticipated burdens in this area, but recommends that the agencies reduce the gap between the well and adequately capitalized categories. Reducing the gap to establish a greater than 8% CBLR (corresponding to the well capitalized category in the PCA framework) would still achieve the agencies' stated goals of burden reduction, and in fact, allow more community banks qualify for the CBLR framework – without impacting the safety and soundness of the banking system.

Conclusion

MBA appreciates that the agencies are working to implement the provisions of Section 201. We believe that rules to implement the simplified capital requirements for the simplest and smallest community banks should align with the goal of Congress to eliminate burdens for these institutions. Thus, the Proposal should be revised to eliminate complex factors that would operate to eliminate many community banks from being eligible to opt into the CBLR framework – such as the MSAs criterion for the CBLR framework qualifying criteria as well as the established greater than 9% CBLR. We believe these factors are counter-productive, and introduce unnecessary burdens that the framework was created to eliminate. We strongly recommend that the agencies establish a greater than 8% CBLR and eliminate MSAs concentration as a qualifying criterion (or at the very least increase MSAs concentration from 25% to at least 50% as a qualifying criterion). This would ensure a balance amongst the following objectives of Section 201: maintaining strong capital levels in the banking system, ensuring safety and soundness, and providing appropriate regulatory burden relief to as many banking organizations as possible.

We look forward to working with the agencies as they continue to develop these important rules. Please feel free to contact Fran Mordi at (202) 557-2860 or fmordi@mba.org if you have any questions or wish to discuss any aspect of this letter further.

Sincerely,

Stephen A. O'C

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