MORTGAGE BANKERS ASSOCIATION

April 24, 2014

Honorable Janet L. Yellen
Chair
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
(Docket No. R-1466)

Honorable Thomas J. Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
250 E Street, SW
Washington, DC 20219
(Docket ID OCC-2013-0016)

Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
(RIN No. 3064-AE04)

Re: Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring

Ladies and Gentlemen:

The Mortgage Bankers Association[1] (MBA) appreciates the opportunity to supplement its prior comment letters[2] on the proposed *Liquidity Coverage Ratio (LCR): Liquidity Risk Measurement, Standards, and Monitoring*[3] (Proposed Rule). In part, this letter is in response to the April 9, 2014 MBA meeting (Meeting) with regulatory staff working on the LCR from the Board of Governors of the Federal Reserve, Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (collectively, the Agencies). MBA greatly appreciated the opportunity to discuss our concerns about the Proposed Rule with Agency staff. This letter builds on the Meeting by presenting

[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 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 Web site: www.mortgagebankers.org.

[2] Mortgage Bankers Association, Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring (January 27, 2014); Mortgage Bankers Association, Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring (January 31, 2014).

[3] 78 Fed. Reg. 71818 (November 20, 2013).

recommendations for those areas of the Proposed Rule that would benefit from greater clarification or modification in order to avoid unintended consequences.

Special Purpose Entities (SPEs)

In establishing the 100 percent outflow rate for credit facilities and liquidity facilities for SPEs, the Agencies provided the following commentary:

> …. given SPEs' sensitivity to emergency cash and backstop needs in a short-term stress environment, such as those experienced with SPEs during the recent financial crisis. During that period, many SPEs experienced severe cash shortfalls, as they could not rollover debt and had to rely on borrowing and backstop lines.[4]

While some SPEs have experienced such difficulty, the above generalization is not applicable to conventional commercial real estate loans with a SPE structure. During the MBA Meeting, Agency staff indicated that SPEs for bank commercial real estate loans were inherently different than SPEs for certain structured financial categories that, in the past, were focused on higher risk activities.

Within the commercial real estate setting, SPEs are a tool used mostly by real estate developers and owners ("Sponsor") of operating commercial real estate properties to isolate tort risk, facilitate cleaner ownership structures among various individuals and entities, and to make their projects attractive to commercial lenders. The use of a single purpose entity enhances the "financeability" of a real estate project because it gives the lender greater comfort that the primary asset—the real estate project itself—will be shielded from many events that might prevent the lender from foreclosing on its loan.[5] In cases when the commercial real estate property is not structured as a SPE, banks can accomplish a similar purpose by including language in their lending documents that attempts to insulate the borrower from non-property impacts in a manner similar to a SPE. Because it is an established and accepted approach, the SPE structure is preferred by banks. In addition, for commercial real estate loans, SPE's are typically passive, with the borrower (Sponsor), not the SPE, making the operational decisions for the property. Although the SPE structure is used to create a remote structure for financial soundness purposes, most commercial real estate loan documents have provisions in which the borrower would have liability if certain loan terms were violated. The SPE does not shield the borrower from malevolent acts, should the bank repossess the property.

Given that the SPE structure is beneficial to and is a fundamental element of commercial real estate lending, MBA strongly encourages the Agencies to specify its proposed treatment of commercial real estate loans with SPE structures. This can be addressed in two ways:

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[4] 78 Fed. Reg. at 71839
[5] Effective Use of Special Purpose Entities. David J. Sewell, (July 2006).

(1) Creating a specific carve-out for commercial real estate loans from SPE outflow requirements by creating a new commercial real estate loan structure.

(2) In the SPE definition, describe the categories of SPEs that are excluded or included in the Proposed Rule.

For the first option, language would be added to the Proposed Rule that would create a new category for commercial real estate lending. Such an approach was taken in an industry proposal that was submitted on March 13, 2014.[6] This approach creates a commercial land facility, which excludes commercial real estate lending from the SPE outflow rules.

The second option would address the definition of a SPE. Two approaches could be taken in this instance. The SPE definition could be expanded to include an "exempted" category of SPEs that would not be subject to the Proposed Rule's SPE requirements. Such a category would include commercial real estate lending. Such exclusion could be created similar to the regulated financial company definition that has language that states, "A regulated financial institution does not include"[7] With this exclusion, these SPEs would default to the outflow rate that reflects the borrower's ownership structure, like other non-SPE structures. These borrowers would likely fall in the 10 percent outflow rate for wholesale borrowers. However, for construction lending, MBA will offer a further refinement to this recommendation in the next section.

Alternatively, the SPE definition could be changed to "covered" or "included" SPEs that would list the SPE structures that would be subject to the 100 percent outflow rate described later in the rule. Such an approach was employed for listing the types of companies that would qualify as a "regulated financial institution" on page 71858 of the Proposed Rule. SPE structures not identified as covered or included SPEs would not be subject to the Proposed Rule's SPE requirements. Similar to the above, the outflow rate for non-listed SPEs would default to the category of the borrower's organizational structure.

Outflow Rate for Commercial Real Estate Construction Loans

Construction lending is a large and important bank lending category. At year-end 2013, bank holding companies with assets greater than $30 billion (40 banks) had dispersed a total of $75.4 billion for the construction loans on their books.[8] Given this amount of bank construction funding, we strongly urge the Agencies to implement an outflow methodology that closely resembles a bank's monthly aggregate construction loan

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[6] Commercial Real Estate Finance Council, National Apartment Association, National Multifamily Housing Council, The Real Estate Roundtable, Re: Liquidity Coverage Ratio: Liquidity Risk Measurement, Standards, and Monitoring (OCC Docket ID 2013 – 0016; FRS Docket No. R-1466; FDIC RIN 3064-AE04), (March 13, 2014).
[7] 78 Fed. Reg. at 71858
[8] Compiled from Federal Reserve Y-9 Filings.

funding. Falling short of this imperative would require banks to report potentially distorted construction outflow amounts, which would similarly impact the LCR for banks. Such a condition could negatively impact bank pricing of construction loans and capital allocations to this asset class. Since banks are the largest provider of construction loans, these distortions could have broader unintended economic ramifications.

MBA is concerned that a static outflow rate for construction lending that is determined by the borrower's ownership category in no way reflects how banks actually fund construction loans. In addition, construction loans are fundamentally different from other credit facilities because funding is contingent on construction milestones being met and verified work in place. Because of this, it is difficult for a bank to estimate at any time the amount of the next funding request, the final agreed to funding amount to be dispersed to the borrower, or when it will occur. Consequently, we believe for construction lending, it is appropriate to have the outflow rate, to the extent possible, reflect the actual monthly loan payments made to the borrower, not a generic outflow requirement dictated by the borrower's organizational structure, which is irrelevant for determining the pace of construction draws.

Instead, MBA supports a methodology that is linked closely to the bank's actual aggregate construction loan payments that can be readily obtained from existing required reporting. We believe that a bank should use the actual construction funding level provided to borrowers from the prior month as the outflow rate for the current month. We believe that this is a reasonably close proxy to a bank's actual construction loan funding experience as it is based on a portfolio of loans at different stages of completion, and is far more precise than the Proposed Rule's static outflow requirement that is determined by the borrower's organizational structure. This approach has the additional benefit of relying on existing Federal Reserve Y-14 reporting, which will greatly reduce bank implementation and compliance costs. The outflow methodology in the Proposed Rule imposes significant implementation and compliance costs on banks.

While MBA's strong preference is for the preceding outflow methodology for construction lending, our members report that, on average, construction loans are typically funded at a rate of approximately 5 percent per month, which if necessary, could be used to establish a reasonable construction lending outflow rate.

Additional LCR Concerns

Based upon the Meeting and subsequent analysis of the Proposed Rule, MBA offers the following observations regarding the concerns raised in its January 31, 2014 letter:

1. **Identified Company** - MBA greatly appreciates the guidance provided by Agency staff during the Meeting regarding the discretion that the Agencies would employ to deem a company an "identified company". The Proposed Rule

identifies the following organizational structures for higher outflow treatment:[9] …regulated financial company, investment company, non-regulated fund, pension fund, or investment adviser…[10] For certain organizational structures not included in the preceding list, the Proposed Rule[11] provides the Agencies with discretion to deem them an identified company and subject them to the same outflow rate as the preceding organizational structures. During the Meeting, we appreciated the Agency staff indication that this discretionary authority would typically be employed to identify <u>individual</u> companies that have been intentionally structured to circumvent their inclusion in the preceding listing of organization structures. Thus, this discretionary authority is intended to be employed to identify individual companies that warrant higher outflow treatment, not broad categories of organizations or institutions, such as REITs.

2. **Mortgage Servicers** – MBA sought clarification as to whether the activities associated with mortgage servicing would result in non-bank mortgage servicers, including the Fannie Mae Delegated Underwriting and Servicing Program (DUS), being classified as financial entities, thus attaching them to a higher outflow rate than non-financial entities or wholesale customers. Based upon the Identified Companies discussion above, MBA does not believe that the Agencies would deem non-bank mortgage servicers as an identified company, which will then allow them to be treated as a wholesale borrower for outflow purposes.

3. **Escrow Deposits** – MBA would like to reiterate the clarification that it sought in its January 31, 2014 letter regarding whether escrow deposits placed in banks by unaffiliated servicers would be considered operational deposits or non-operational deposits for the purpose of the LCR calculation. We believe that such a clarification should be guided by the Proposed Rule's language for defining an operational deposit: "…primary purpose of obtaining operational services…"[12]. MBA notes that because escrowed tax and insurance payments are paid on a prescribed schedule, banks can precisely calculate their cash flow requirements and set the appropriate reserves for these escrow categories.

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[9] The borrower categories with lower outflow rates than the listed organizational structures include: affiliated depository institutions, retail customers or counterparties, wholesale customer or counterparty, see 78 Fed. Reg. at 71862

[10] 78 Fed. Reg. at 71862

[11] 78 Fed. Reg. at 71857. (defining Identified Company as "any company that the [AGENCY] has determined should be treated the same for the purposes of this part as a regulated financial company, investment company, non-regulated fund, pension fund, or investment adviser, based on activities similar in scope, nature, or operations to those entities").

[12] 78 Fed. Reg. at 71858

MBA greatly appreciated the opportunity to meet with Agency staff on the Proposed Rule. We encourage Agency staff to respond to this letter with any questions or clarifications that they might have to George Green at ggreen@mba.org or (202) 557-2840.

Sincerely,

David H. Stevens
President and Chief Executive Officer