MORTGAGE BANKERS ASSOCIATION

Statement of
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The Mortgage Bankers Association (MBA)[1] appreciates the opportunity to comment on the issues raised by the Financial Institutions and Monetary Policy Subcommittee's September 14, 2023, legislative hearing entitled, *"Implementing Basel III: What's the Fed's Endgame?"* MBA strongly opposes key elements of the proposal, which, absent significant revisions, our industry fears will increase borrowing costs and reduce credit availability.

Background

On July 27, 2023, the Federal Reserve, Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (Banking Agencies) issued a Notice of Proposed Rulemaking (NPR) to update capital requirements for banks with assets of $100 billion or more. The so-called "end game" proposed rules complete U.S. regulators' implementation of the Basel III standards and ostensibly make changes in response to the recent large bank failures. The proposed changes effectively increase capital requirements at larger banks by an estimated 15 to 20 percent – large enough to impact credit availability economy-wide, as well as which lines of business banks choose to support – with potential implications for the entire mortgage market.

The new rules will impact more than three dozen large U.S. banks, including more than two dozen regional banks that support the mortgage market and are not currently subject to the heightened capital standards on U.S. "GSIBs" (Globally Systemically Important Banks), i.e., the eight largest banks. These large banks play a critical role in the mortgage market as lenders, mortgage holders, servicers, aggregators, and providers of warehouse and mortgage servicing rights (MSRs) financing – functions that could be impaired if this rule is not changed.

MBA believes that the NPR poses unwarranted risks to the U.S. economy, to housing and real estate markets specifically, and contradicts many of the Biden Administration's policy goals, including those pertaining to affordable housing (both ownership and rental), fostering bank competition over consolidation, and the closing of significant

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 390,000 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 more than 2,200 companies includes all elements of real estate finance: independent mortgage banks, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, credit unions, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

racial homeownership and wealth gaps. It is still unclear how the NPR interacts with other regulatory proposals,[2] and how these rules collectively could stunt economic growth and credit access needed to support the creation of more affordable ownership and rental housing from the largest providers of capital in the country.

It is also unclear what specific problems the NPR is trying to solve, considering that the Federal Reserve and U.S. Treasury have consistently stated that the banking system is strong. For example, capital ratios of large banks operating in the U.S. have more than doubled since the Great Financial Crisis, and more than a decade of real-life experience has demonstrated that banks have adequate capital to withstand significant economic shocks. In fact, recent stress test results confirm that the banking system is safe and well-capitalized.

The proposed rule also lacks the robust economic impact analysis that usually accompanies such a significant change in bank capital standards – a scant fifteen pages of impact assessment out of nearly 1,100 pages. We believe the analytical shortcomings were a significant factor in the remarkably close votes at the FDIC and Federal Reserve Board prior to the NPR's issuance. Most of the previous proposed capital rules implementing the Basel framework were unanimously approved by the Banking Agencies and involved at least one quantitative impact study (QIS) – and when warranted, multiple rounds of QIS. Any major change in public policy warrants a reasonable consideration of its effects and impacts – especially when the policy change directly impacts everything from the cost of funds for our largest financial institutions to the costs for ordinary Americans looking to purchase a home. The lack of independent and original analysis conducted prior to the release of such a consequential regulatory sea change is extremely troubling.

The Banking Agencies have stressed the fact that they provided an extended comment period (120 days), as well as a three-year implementation phase-in, to ameliorate the harsh impact of the proposed changes. However, an elongated timeline does not change nor mitigate the fundamentally harsh impact of the recommended changes. Prior experience with major changes in capital rules suggests that market pressure will force banks to start complying with the new requirements long before the rule is finalized. This puts a high stakes premium on getting the final rule right.

[2] e.g., the *Community Reinvestment Act* (CRA) final rule, proposed Financial Stability Oversight Council (FSOC) designation guidelines, the Banking Agencies' long-term debt requirements proposal for large banks, and the Basel Liquidity Coverage and Net Stable Funding Ratios.

Provisions Directly Impacting Real Estate Finance

The proposal increases the risk weighting on certain single-family mortgage loans held by the covered banks – a provision that goes beyond the Basel III Accord – that in turn could make homeownership less attainable to first-time homebuyers and low- and moderate-income borrowers, many of whom are minority borrowers, with smaller down payments.

Single Family Residential Mortgages

The NPR assigns higher risk weighting to "regulatory" residential mortgages[3] based on a loan's loan-to-value (LTV) ratio and depending on whether the loan is dependent on the cash flows generated by the real estate.[4]

Proposed risk weights for regulatory residential real estate mortgages that are not dependent on the cash flows of the real estate.

LTV Ratio	< 50	50-60	60-80	80-90	90-100	>100
Current U.S. Rules	50%	50%	50%	50% (with MI)	50% (with MI)	50% with MI)
Basel R/W	20%	25%	30%	40%	50%	70%
NPR R/W	40%	45%	50%	60%	70%	90%
NPR v Basel	+100%	+80%	+67%	+50%	+40%	+28.5%

Proposed risk weights for regulatory residential real estate mortgages that are dependent on the cash flows of the real estate.

LTV Ratio	< 50	50-60	60-80	80-90	90-100	>100
Current U.S. Rules	50%	50%	50%	50% (with MI)	50% (with MI)	50% with MI)
Basel R/W	30%	35%	45%	60%	75%	105%
NPR R/W	50%	55%	65%	80%	95%	125%

For conventional single-family home loans, current U.S. standards apply a 50% risk weight for "well underwritten" mortgages – typically Qualified Mortgage (QM) loans, and with mortgage insurance if the LTV exceeds 80%. There is no distinction between owner-occupied versus income-producing property. The international Basel framework

[3] Defined as a first-lien residential mortgage.

[4] The NPR assigns risk weightings depending on whether the loan is (i) secured by a property that is either owner occupied or rented; (ii) made in accordance with prudent underwriting standards (iii) applied by a bank using underwriting policies that account for the ability of the borrower to repay based on clear and measurable underwriting standards; and (iv) the property is valued in accordance with the proposed requirements included in the proposed LTV ratio calculation.

has instead used graduated risk weights by LTV. For reasons not yet fully explained, the Banking Agencies chose to “gold plate” the Basel risk weights for home mortgages by adding twenty percentage points across the board and providing no credit for private mortgage insurance. As a result, large banks will face higher capital requirements than those imposed under the current applicable rules for loans with LTVs greater than 80%. In addition, the GSIBs – which had used internal models for their risk weighting – likely will face higher capital requirements across the board for mortgages.

This could impact larger banks as lenders (and buyers) of CRA-eligible mortgages and aggregators of conforming mortgages, as well as their participation in originating and buying jumbo mortgages. It will also significantly reduce the amount of high-LTV (low-down payment) affordable lending held on the balance sheet of these banks, thereby putting more pressure on the GSEs and Ginnie Mae - and in particular, FHA - to carry the market for low-down payment homebuyers. Despite significant interest in the banking community to bridge access and affordability gaps in home ownership, the proposed capital treatment will only make these aspirations more difficult to achieve.

The failure of the proposal to provide any credit whatsoever for private mortgage insurance effectively defeats the purpose of that insurance and significantly increases costs for homebuyers. For a given mortgage loan with an LTV higher than 80 percent carried on a large bank’s balance sheet covered by a private mortgage insurance policy, the bank would be subject to at least a 60 percent risk weight to cover the risk of credit losses on that loan (a cost that is generally passed on to the consumer), even though the bank would ultimately be insured against all such credit losses. However, to ensure the loan remains eligible for potential sale in the secondary market, the bank would typically nonetheless require that the borrower carry a mortgage insurance policy. As a result, the borrower is hit twice on the same transaction – they must bear the cost of a monthly mortgage insurance premium and the additional cost passed through by the bank because of the capital treatment that ignores that mortgage insurance.

A capital regime that recognizes the mitigation of credit risk provided by private mortgage insurance is not only far more efficient, but also reduces costs and improves affordability for first-time and underserved homebuyers who cannot make a 20 percent down payment.

Commercial Mortgages

While the NPR maintains the current risk-weighting standard for statutory multifamily mortgages, it proposes a striation of risk-weightings for current commercial mortgages based upon the loan-to-value (LTV) ratio. The proposal changes how a defaulted mortgage is defined, including exposure to the borrower.

Proposed risk weights for commercial real estate mortgages that are dependent on the cash flows of the real estate[5]

Current R/W Standard	NPR R/W Standard
Statutory multifamily mortgages.[6] An FDIC-supervised institution must assign a 50% risk weight to a statutory multifamily mortgage.	No change
Current Commercial Loans (not statutory mortgages). *100%*	LTV[7] less than or equal to 60% - R/W 70% LTV greater than 60% but less than or equal to 80% – R/W 90% LTV greater than 80% – R/W 110%
Other Commercial Loans (not within definition of CRE) *150%*	No change
Non-current commercial (90 days or more past due and not otherwise guaranteed or secured) – 150%	Changes how defaulted mortgage is defined. For commercial mortgages, the bank must analyze exposure to the borrower. 150% RW is assigned to any defaulted loan and essentially all other

[5] For commercial owner-occupied loans: LTV less than or equal to 60% - lesser of 60% or R/W applicable to borrower and LTV greater than 60% - R/W appliable to borrower

[6] In general, a "statutory multifamily mortgage" is a loan secured by a first lien on a multifamily residential property that meets the following criteria: Made in accordance with prudent underwriting standards; Amortization must occur over not more than 30 years; Minimum original maturity for repayment of principal must not be less than 7 years; Loan principal at origination does not exceed: 80% of the property value for a fixed rate loan and 75% of the property value for a variable rate loan; and DSCR of at least 1.20 for fixed rate loans and 1.15 for variable rate loans.

[7] Per the NPR, LTV should be calculated using total outstanding amount of the loan and the value of the property at the time of origination.

	loans to the same borrower (even if current).
Pre-sold construction loans. 50% to a pre-sold construction loan unless the purchase contract is cancelled, in which case 100%.	No change
High-volatility commercial real estate (HVCRE) exposures. 150%	No change
New risk weight	***Acquisition, development, or construction (ADC) exposures that are not HVCRE.*** 100%

Macro Implications for Housing

The proposals in the NPR are critically important to the mortgage industry because the amount of capital a bank must maintain with respect to any loan is typically a significant – if not the most significant – factor in determining whether a business line provides an adequate return on capital to warrant participation. The NPR's increase in capital requirements will effectively impact decision making by banks regarding which lines of business they choose to withdraw from or support. Moreover, increases in capital standards of this magnitude will likely stunt macroeconomic growth and reduce banks' participation as single-family and commercial/multifamily lenders, servicers, and as providers of warehouse lines of credit and mortgage servicing rights financing. In recent years, bank origination of residential mortgages and MSR holdings have been declining, and the NPR would add a set of additional disincentives to this already constrained situation.

This is particularly true for MSRs, which under current rules already face a punitively high 250% risk weighting and require deductions from capital to the extent MSRs exceed 25% of Tier One Common Equity. The cap is 10% for GSIBs. The NPR would align the treatment of MSRs at the large regional banks with the lower 10% cap for GSIBs, making MSRs even more unattractive to those banks. This could reduce demand for MSRs, impacting liquidity and MSR values not just for banks but for all market participants.

Independent Mortgage Bank (IMB) lenders – which for several years have filled the gap originating residential mortgages and holding MSRs – rely on depositories for funding for their originations, financing their MSRs and servicing advances, hedging, and

securitization activities. The proposed capital changes in the NPR will most likely impact critically important bank funding for IMBs in a way that curtails the housing market.

Because the process of mortgage banking produces an MSR asset with every loan that is manufactured and sold, these changes in market dynamics will particularly impact IMBs, community banks, credit unions, and – most importantly – their customers. The value of the MSR asset is embedded as an interest rate “strip” – a portion of a borrower’s note rate. When servicing assets are attractive and in high demand, the price of the mortgage is bid up, and the servicing strip and note rate to the borrower is reduced. The proposed rule does the opposite – by making the capital treatment for servicing assets even more unattractive, banks will further reduce their appetite for mortgage servicing, MSR values will decline, and borrowers’ interest rates will be higher.

A further bank pullback from the mortgage market will also put more pressure – both market and regulatory – on IMBs to fill the gap. For example, MBA is concerned that the Federal Housing Finance Agency (FHFA) and Ginnie Mae – under pressure from the bank regulator members of FSOC – could seek to extend similarly punitive capital and liquidity standards to IMBs.

Furthermore, MBA continues to be concerned about the risk weighting assigned to warehouse lines, which do not correlate with the actual risks associated with the underlying mortgage loans backed by the lines. We believe that the higher overall capital requirements for larger banks – which are critical sources of warehouse lines for IMBs – could raise the costs or discourage banks from offering them altogether – to the detriment of the housing market.

Timing Implications

The Banking Agencies have consistently stressed the “generous” 120-day comment period and extended implementation timeframe provided by the NPR. Regardless of the extended implementation timeframe, equity markets will react immediately, and banks will respond to that pressure in real time, long before the final rule is fully phased in. Furthermore, the length of a timeline neither mitigates nor reduces the effect of a capital proposal once implemented. Similarly, the Banking Agencies have sought to minimize the overall impact of the proposal by noting that “most institutions” already meet the standards. However, no bank chooses to operate without an ample capital cushion, and the proposed rule will force all institutions to raise significant new capital to maintain their current buffers above their regulatory minimum.

Conclusion

MBA strongly opposes certain provisions of the proposal that undermine the mortgage market and takes exception to the extremely scant economic analysis regarding how the changes will affect the economy, single-family housing market, and commercial real estate finance markets.

Given ongoing affordable housing challenges, regulators should be taking steps that encourage banks to better support real estate finance markets. Instead, these proposed changes do precisely the opposite during a time of near record-low single-family delinquencies and pristine underwriting. This proposal also undermines several current policy objectives of the Biden Administration, including efforts to close the racial homeownership and wealth gaps, the provision of affordable housing (both ownership and rental), the promotion of competition over consolidation, and the upcoming unveiling of a final CRA rule.

Thank you in advance for your consideration of the views expressed within this written statement. As always, MBA stands ready to collaborate with members of this Subcommittee (and the full Committee) – on this and other policy proposals – to ensure a robust housing market that is accessible, affordable, and sustainable – and works to benefit all borrowers, renters, and other critical stakeholders.

I look forward to answering any questions you may have.