MORTGAGE BANKERS ASSOCIATION

Statement of
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On Behalf of the Mortgage Bankers Association

U.S. House of Representatives
House Financial Services Committee

"Prioritizing Main Street: Evaluating the Impact of Capital Proposals on Economic Growth and American Communities"

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Committee on Financial Services
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Introduction

Chairman Hill, Ranking Member Waters, and other members of the Committee, thank you for the opportunity to testify today on behalf of the Mortgage Bankers Association (MBA)[1]. My name is Bob Broeksmit, and I serve as MBA's President and Chief Executive Officer. I am a Certified Mortgage Banker (CMB), and I have more than 40 years of experience in real estate finance.

Over the course of my career, I have held positions in virtually all aspects of the mortgage business, from loan processing and underwriting to secondary marketing and servicing, including as President of the B.F. Saul Mortgage Company (Chevy Chase Bank) and Executive Vice President of Mortgage Lending at Capital One Financial Corporation. These experiences give me a unique perspective on the complexity of the banking and mortgage finance ecosystem and how capital standards influence banks' participation in lending and servicing.

Background

MBA was glad to see the direction of the notice of proposed rulemaking (NPR) issued jointly by the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Federal Reserve ("the Agencies") on March 19. My comments today will focus on key technical elements such as the appropriate capital treatment of mortgage servicing assets (MSAs) and the broader application of these reforms across the banking system. MBA stands ready to continue our work with the Agencies on a final framework that best supports sustainable commercial, multifamily, and residential mortgage lending and servicing, "warehouse"[2] financing, and continued access to affordable home financing offered by both depositories and independent mortgage banks (IMBs).

MBA supports regulatory capital requirements that are appropriately calibrated and tailored to the actual risk posed. While strong capital reduces the likelihood of bank failures that threaten broader financial stability, excessive capital requirements can reduce economic activity, misallocate banks' asset mix, and negatively affect the cost of, and access to, credit.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 275,000 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 2,000 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

[2] Warehouse mortgage lending is a short-term, revolving line of credit provided by banks to non-depository mortgage originators. It enables lenders to fund home loans at closing before selling them on the secondary mortgage market. This crucial, low-risk financing typically lasts ten to twenty days, providing liquidity to lenders to enable efficient, high-volume operations.

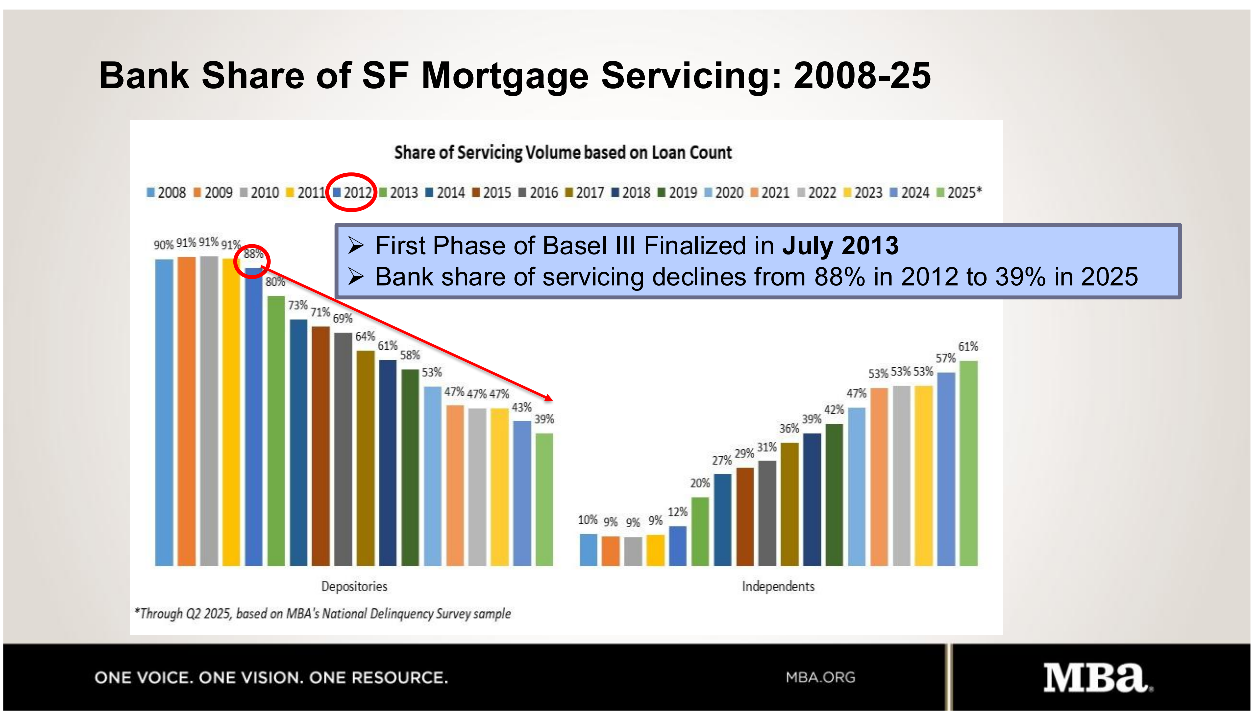
This is why MBA has strongly urged the engaged regulators to amend certain capital standards that assign excessive risk weights to residential and commercial mortgages held on balance sheets, MSAs, warehouse lines of credit, and acquired member asset loans under the Federal Home Loan Banks' (FHLBs) Mortgage Partnership Finance (MPF) program. We have also urged the regulators to improve the capital treatment of off-balance sheet commitments, private mortgage insurance (credit enhancement), securitizations, and credit risk transfer.

Basel III proposals

Bank capital rules should be recalibrated for the current marketplace, rather than the pre-crisis market. As banking regulators contemplate finalizing the Basel III "Endgame" rule, it is important that the following considerations be specifically addressed to ensure liquidity and more robust lender participation in the mortgage origination and servicing market:

Reduce the punitive 250% risk weight for MSAs

The current 250% risk weight assigned to MSAs has played a key role in banks' retreat from the mortgage origination and servicing market, reducing competition for consumers and removing a bank bid for MSAs, in turn reducing liquidity and increasing mortgage rates. The current 250% risk weight was adopted in 2013 under the Basel III framework in reaction to the 2008/2009 financial crisis, a 150% increase from the previous 100% level. As MBA noted at that time and has done so repeatedly since then, there was no articulated rationale or empirical analysis provided by regulators to justify the significant increase in risk weight for MSAs. We believed then (and continue to do so now) that the current punitive treatment of MSAs was erroneously based on uncertainty, rather than any demonstrated loss behavior relating to the asset itself.



In fact, the regulators noted in a 2016 Report to Congress[3] that MSAs played an extremely limited role in the collapse or failure of banks during the crisis. We are encouraged that current regulators seem to be willing to address this continued unjustified post-crisis treatment of MSAs by specifically asking for input on the “appropriate risk weight” for MSAs in the NPR. MBA strongly believes that bringing the risk weight for MSAs back to the pre-crisis 100% will ensure that the U.S. capital framework does not continue to punish banks that want to originate and service mortgage loans.

MBA believes that any number above a 100% risk weight on MSAs overstates the risk posed by the asset in today’s servicing environment, and therefore, we recommend a 100% risk weight that properly aligns regulatory capital with empirical evidence of risk relating to the asset.

RWA Comparison Demonstrates Conflicting Risk Weighting Relative to Risk

Assigning Risk Weighting of 250% on MSA assets is inconsistent with underlying risks when compared to other balance sheet positions which have equal, greater or unspecified risk characteristics:

Product	Price Risk	Credit Risk	Prepay Risk	RWA	Risk Types
GNMA MBS	✓	X	✓	0%	• Duration & Convexity (Prepay) • No Credit risk
FNMA/FHMC MBS	✓	X	✓	20%	• Duration & Convexity (Prepay) • No Credit Risk
Mortgage Loans (Performing)	✓	✓	✓	50%	• Duration & Convexity (Prepay) • Credit Risk (Collateralized)
Home Equity Loans	✓	✓	✓	100%	• Duration Risk • Credit Risk (Uncollateralized)
Commercial Loans	✓	✓	✓	100%	• Spread Duration Risk • Credit Risk (Collateralized)
All other assets listed on the bank’s statement of financial condition without a specified risk	?	?	?	100%	• Unspecified Duration Risk • Unspecified Credit Risk
HVADC	✓	✓	✓	130%	• Credit Risk
Mortgage Servicing Asset	✓	X	✓	250%	• Duration & Convexity (Prepay) • No Credit Risk

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[3] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office 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). The Report notes that other countries have adopted mortgage finance systems that do not create a considerable volume of MSRs. In discussions with supervisory authorities from those other countries, the U.S. regulators discovered that their supervised firms have negligible ratios of MSRs to CET1 capital. The regulators further explained in the report that it was quite likely that these negligible amounts were attributable to U.S. operations of foreign banks or associated with acquisitions.

Eliminate the 25% cap on MSAs that can be included in Common Equity Tier 1 (CET1) Capital

The current framework caps the amount of MSAs that can be included in CET1 capital. At the very least, MBA has long advocated for an increase in the cap. Therefore, we are very encouraged by the proposed elimination of the cap in the NPR and fully support such a change. It is important to stress, however, that elimination of the cap is only one half of the solution to the current problem of banks' pullback from the mortgage origination and servicing business. Eliminating the cap on MSAs that can be included in CET1 capital removes a binding constraint on MSA growth for a significant number of banks. For many more banks, however, the 250% risk weight on MSAs remains the primary capital barrier to expanding their participation in mortgage servicing. As noted above, the punitive 250% risk weight assigned to MSAs is a major deterrent for banks that want to hold the asset, and therefore must be addressed in conjunction with the elimination of the cap.

Addressing both the 250% risk weight and the 25% cap jointly would ensure that banks are able to view the mortgage market as a core strategy, and not just a product, allowing them to maintain the vital customer relationships that play a significant role in strengthening ties with the communities they serve. MBA fully supports the proposed elimination of the current 25% cap and urges that this action be tied to a reduced risk weight for MSAs.

Single-Family Residential Real Estate

Reduce the 100% Risk Weight on Warehouse Lines of Credit

The current capital framework assigns a 100% risk weight to warehouse lines of credit. Bank warehouse lines are a critical source of support for the U.S. mortgage market, providing funding to companies that originate more than 60% of single-family mortgages. When capital requirements are set too high, warehouse lenders are unable to supply the necessary liquidity to meet spikes in demand, thereby increasing the cost of lending to all borrower segments. Given the short duration of warehouse credit exposures and the banks' ability to take possession of the underlying collateral if needed, the capital treatment of residential mortgage loans held on a warehouse line should be reduced and assigned the same risk weight as the mortgages collateralizing the warehouse line.

Residential Mortgage Risk Weights and Private Mortgage Insurance (PMI)

MBA supports the proposed rule's approach to risk weighting single family mortgages held in portfolio based on their loan-to-value ratio. Risk weights for mortgage loans can and should more accurately reflect real-world credit performance and avoid unnecessary "gold-plating" or other measures that might make homeownership less attainable for first-time or low- to moderate-wealth borrowers. We support the adoption of more granular risk weights by LTV, and that provide appropriate credit for PMI commensurate with the coverage level provided on the loan. The agencies should also consider reducing the 1250% risk weight for the retained risk portion of MPF mortgages sold via the FHLBs.

Commercial Multi-Family Real Estate

We appreciate the Agencies taking a common-sense approach to the capital framework and removing a provision from the 2023 proposal that would have expanded the definition of "defaulted real estate exposures" and required a bank to automatically treat, from a capital perspective, all loans made to a borrower as defaulted when any loan (made by any creditor) to that borrower went into default. Regulators recognized that the proposal ran counter to market conventions and was unduly burdensome, unworkable, and would have curtailed depository lending in the commercial real estate market.

Commercial Mortgage Risk Weights for Large Banks

We also appreciate the NPR's proposed tailoring of risk weights for the largest banks for loans backed by income-producing properties based on the loan-to-value (LTV) ratio of the loan. This will appropriately tie capital to loan risk. One concern we have is that the highest band of LTVs in the proposal (> 80%) would receive a risk weight of 110% – higher than the current risk weight of 100%. To be considered for LTV-based risk weighting, loans must meet the regulators' guidance as prudently underwritten. In addition, signs of weakness in a loan's performance (e.g., being 90 days or more delinquent) would trigger elevated risk weights through other means. As a result, the Agencies should set the top tier risk weight for these loans at 100% to match current practice.

Commercial Mortgage Risk Weights for Category 3 and 4 Banks

In contrast to the approach for larger banks, the NPR proposes to assign a single 95% risk weight to all commercial real estate exposures treated as corporate exposures, without LTV- or cash-flow-based differentiation. To best promote parity on risk weights for comparable exposures, the Agencies should consider two steps. MBA recommends that the 95% risk weight be lowered, and that regulators consider granting these banks the ability to use the external ratings-based approach (ERBA) risk weights for income-producing CRE loans even if they do not fully adopt ERBA. Doing so would allow banks, outside the largest, that specialize in conservative commercial real estate lending to "show their work" to regulators as a route to achieving more tailored risk weights.

Modified or Restructured Commercial Mortgages

The Agencies' Basel III Proposal more appropriately aligns commercial real estate risk by allowing calibration based on an individual loan's LTV. Though this is a positive development, the Agencies also note that a modified or restructured loan receives higher risk weights, regardless of its current conditions. In their 2023 *Policy Statement on Prudent Commercial Real Estate Loan Accommodations and Workouts*[4] regulators reiterated that "The Agencies have found that prudent CRE loan accommodations and workouts are often in the best interest of the financial institution and the

[4] https://www.federalregister.gov/documents/2023/07/06/2023-14247/policy-statement-on-prudent-commercial-real-estate-loan-accommodations-and-workouts

borrower." We therefore ask the Agencies to establish that modified loans that have performed for more than 12 consecutive months should be eligible for calibration based on their LTV.

Multifamily Mortgages

Multifamily mortgage loans have a strong history and were among the best-performing bank loans during the Great Financial Crisis ("GFC"). Legislators recognized the important role of multifamily loans in 1991 when they established a special, lower risk weight for "statutory" multifamily loans. Given this experience, we ask the Agencies to consider steps that can be taken to ensure loans backed by multifamily rental properties are afforded capital relief. Low-Income Housing Tax Credit (LIHTC) investments, given their strong performance and outsized community impact, should likewise be granted a 50% risk weight.

Changes to Capital Rules

For years, MBA has called for changes to the capital rules that have discouraged bank participation in the origination and servicing of mortgage loans. These rules have resulted in reduced competition, limited consumer choice of lenders, and reduced credit availability for both commercial/multifamily real estate and aspiring homeowners. In short, MBA supports rules that ensure a mortgage marketplace in which all lenders can readily choose to participate – e.g., depositories, IMBs, and other market participants alike. This holistic approach supports broad mortgage market liquidity and gives borrowers a robust choice of lenders when making the important decision of homeownership.

As noted above, the current capital rules were developed in the immediate aftermath of the GFC. While some of the regulators' assumptions were undoubtedly reasonable, some of the rules that were adopted were an overreaction and not based on any empirical data or analysis.

Moreover, significant reforms have been made in the residential mortgage finance market in the last few years, including the Ability-to-Repay (ATR)/Qualified Mortgage (QM) regime. This has effectively eliminated the ability of lenders to originate residential mortgages with risky features, such as negatively-amortizing loans, interest-only loans, and no-documentation loans. The regulatory framework, however, continues to penalize banks that want to hold MSAs and provide the necessary financing through warehouse lines to market participants that originate and service the majority of U.S. residential mortgage loans.

Conclusion

Once again, I appreciate this opportunity (on behalf of the MBA) to comment on the U.S. regulatory capital framework and how it impacts the U.S. real estate finance market – as well as the related policies under discussion that may impact the health of our country's housing and real estate ecosystem and the macroeconomy.

Our association and its members look forward to continuing to work with the Agencies and members of this Committee to serve as a resource as important discussions regarding the bank capital rules continue.

I look forward to answering any questions you may have.