NAHB
National Association of Home Builders

Housing Finance & Regulatory Affairs
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January 16, 2024

Ann E. Misback
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
RE: Docket No. R-1813, RIN 7100-AG64

James P. Sheesley
Assistant Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RE: RIN 3064-AF29

Chief Counsel's Office
Attention: Comment Processing,
Office of the Comptroller of the Currency
400 7th Street SW
Washington, DC 20219
RE: Docket ID OCC-2023-0008

RE: Regulatory Capital Rule: Amendments Applicable to Large Banking Organizations and Banking Organizations with Significant Trading Activity

Dear Sir/Madam,

The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Federal Reserve), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the federal banking regulators) have proposed to revise substantially capital requirements applicable to large banking organizations and to banking organizations with significant trading activity. These proposed reforms would finalize the Basel III capital framework adopted by the federal banking regulators for the U.S. banking system in July 2013 with a phase-in period for large institutions that began in January 2014 and a phase-in period for small, less complex banking institutions that began in January 2015. The proposed revisions are being referred to as the "Basel III Endgame." The proposed approach would be more risk-sensitive than the current U.S. standardized approach, incorporating additional credit-risk components such as loan-to-value (LTV) and occupancy in risk weights for mortgage loans. Certain provisions that apply currently only to banks with total assets greater than $250 billion will apply to banking organizations with total assets of $100 billion or more and their subsidiary depository institutions. By all accounts, it will significantly increase the capital levels required for banks with assets greater than $100 billion.

NAHB is a Washington DC-based trade association representing more than 140,000 members involved in the development and construction of for-sale single-family homes, including homes for first-time and low- and moderate-income home buyers, as well as the construction, ownership and management of multifamily rental housing, including affordable rental housing. NAHB and its members have a strong interest in supporting a banking system that offers home builders and home buyers access to affordable financing in all geographic areas and economic conditions.

Banks play a key role in residential mortgage lending and financing for residential housing production, including affordable housing. NAHB is concerned overly onerous capital requirements could unnecessarily limit banks' ability to finance housing activities. The current housing affordability crisis is a direct result of a lack of an adequate housing supply. Changes in regulations that restrict the liquidity of banks to provide financing for acquisition, development, and construction activities for single-family and multifamily housing and/or permanent financing for home buyers and rental property owners will limit housing supply and thus exacerbate this nation's affordable housing crisis.

Background

Basel III was the response by the international banking regulators to the global banking crisis that led to the Great Recession beginning in 2007-2008. The initial text of Basel III was issued by the international Basel Committee on Banking Supervision (BCBS) in December 2010 and provided a framework of global regulatory standards for bank capital adequacy and liquidity. The framework adopted by the U.S. federal banking regulators generally was consistent with that issued by the BCBS and included relevant provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), which was enacted in July 2010 to protect consumers and taxpayers from another financial crisis.

The proposed Basel III Endgame (the proposal) was issued soon after the March 2023 failures of Silicon Valley Bank, Signature Bank of New York and First Republic Bank. Federal Reserve Vice Chair for Supervision, Michael Barr, has acknowledged the impact of those failures on the proposal's intent to better align capital requirements with the myriad of risks that banks face.

The proposed Basel III Endgame has been denounced consistently by stakeholders in the U.S. who cite significant increases in banks' capital requirements that will make it harder and more expensive for consumers, businesses and investors to obtain financing from banks. It is estimated even by the drafters of the proposal that it would require all banks to hold increased levels of capital and it is probable it would reduce lending capacity and trading activities at all banks.

The federal banking regulators acknowledge in the proposal that the revisions would increase capital requirements "in the aggregate," but they expect the benefits of strengthened capital for large banking organizations to outweigh the costs. Further, where the proposal notes an action would result in an increase in capital requirements, the simple justification by the regulators is the increase will enhance the resilience of the banking system. Many would counter that the banking system has proven to be well-capitalized and resilient since the previous capital requirements of Basel III and implementation of Dodd-Frank.

In addition to concerns with the specific regulatory capital changes that are proposed, there is a high level of consternation at how the federal banking regulators arrived at the recommended revisions. The analysis for such substantial reforms is lacking when it should be in-depth and transparent. There is no analysis showing that the regulators considered how the increase in capital requirements would increase costs for consumers, how much financial activity would migrate to nonbanks, and other significant impacts the proposal would have on consumers, the banking industry and the housing market. In fact, they have said they will continue to conduct their analysis during the public comment period and include it in the final rule, which precludes stakeholders from reviewing it and commenting.

An example of the "analysis" in the proposal stated that the new rules will "result in a modest reduction in bank lending with possible implications for economic growth." This assessment is deemed significantly inadequate.

NAHB Comments

The importance of adequate and appropriate capital for U.S. financial institutions cannot be overstated, but the detrimental impact of a regulation that requires banks to hold excessive capital is difficult to calculate. NAHB believes the Basel III Endgame proposal has many flaws. In particular, NAHB is concerned about negative consequences for the availability and cost of home mortgage loans. The home builder community depends on home buyers having access to financing. We are concerned the proposal will create disincentives for depository institutions to offer mortgage loans. This likely will cause banks to increase the cost of mortgage financing or exit mortgage lending and related activities, reducing mortgage options for borrowers. Actions that make mortgage loans more expensive or reduce their availability will harm home builders, home buyers, homeowners, and the housing economy.

While the proposal would have a direct impact on the cost and availability of mortgage loans originated by individual banks, the proposal's full impact would extend to the broader mortgage market.

NAHB is concerned the proposal's suggestion to increase risk weights and capital requirements on residential mortgage loans, mortgage servicing assets (MSAs) and warehouse lines of credit would have a chilling effect on banks' interest in engaging in these lines of business. Mortgage lending has shifted significantly from banks to independent mortgage banks (nonbank lenders) since the 2008 housing market crisis leading to the Great Recession. In large part, this shift has been attributed to the increased regulation of banks under the Basel III rules effective in 2014 that imposed increased capital requirements on mortgage loans, MSAs, and warehouse lines of credit making these assets less attractive to banks. The likely impact of further increases to risk weights and capital requirements, as proposed in the Basel III Endgame Notice of Proposed Rulemaking, would include banks exiting the mortgage business or originating primarily mortgage loans with large downpayments and high credit scores; reducing their holdings in MSAs; and reducing warehouse lines of credit to nonbank lenders.

Mortgage Loans

The Basel III Endgame proposal would change the risk weights on residential mortgage loans making banks hold more capital against mortgage loans in their portfolios. Currently, residential mortgage loans on both owner-occupied and investor properties have a 50 percent risk weight. The Basel III Endgame proposal would assess risk weights based on the LTV ratio and owner occupancy status with the proposed risk weights beginning at 40 percent for LTVs of 50 percent or lower up to 90 percent for LTVs greater than 100 percent. Investor loans would have risk weights beginning at 50 percent for LTVs of 50 percent or lower and go as high as 125 percent for LTVs greater than 100 percent. While the risk weights on loans with LTVs of 80 percent or lower would remain at 50 percent or less, higher capital requirements would be imposed on loans with LTVs greater than 80 percent. Risk weights for all LTVs are 20 percent higher than the risk weights required by the BCBS.

The federal banking regulators have provided no transparency as to how they arrived at the particular proposed risk weights and why each proposed risk weight LTV category is 20 percent higher than the risk weight recommended by the BCBS. Neither does the proposal consider the effect of private mortgage insurance on risk mitigation for LTVs greater than 80 percent.

In addition to the assigned risk weight based on a loan's LTV, the federal banking regulators have determined that mortgage loans pose an "operational risk" to banks and have proposed that capital requirements for lending activities would be determined by a combination of credit risk and operational risk. As proposed, in addition to the risk weights of each loan, a capital charge driven by net interest income and fee income associated with mortgage lending would be added. This can become particularly high when a bank originates mortgage loans for sale to Fannie Mae and Freddie Mac and operational risk capital is calculated on interest income prior to the sale and fee income when the loan is sold.

The credit risk weights and operational risk costs on mortgage loans combined with the stress capital buffer that is required for all banking organizations add up to excessive capital being held to protect banks from risk attributed to mortgage lending. NAHB believes this is excessive in light of the fact that since the Great Recession many flaws in the mortgage finance system have been addressed through enhanced mortgage underwriting standards and elimination of deceptive mortgage product features by Dodd-Frank. We are concerned that banks will reduce mortgage lending and focus on less capital-intensive lines of business.

NAHB urges the federal banking regulators to consider the following when drafting a final rule:

- Eliminate the 20 percent increase above the Basel III recommended risk weights by LTV;
- Eliminate the operational risk capital requirement added to the credit risk weight charge on loans that generate interest and/or fee income for a banking organization;
- Recognize the value of credit risk mitigation provided by private mortgage insurance;
- Include transparent analysis for how the credit-risk fees were determined; and
- Higher risk weights for loans with LTVs above 80 percent will have a detrimental effect on banking organizations' willingness to originate and hold these mortgage loans, therefore curtailing lending to low- and moderate-income borrowers.

Mortgage Servicing Assets

Banks would be disincented from holding MSAs if the Basel III Endgame is finalized as proposed. The Basel III requirements that took effect in 2014 allow banks with assets greater than $250 billion to count only 10 percent of their MSAs toward their required regulatory capital and assign a risk weight on the MSAs of 250 percent. Banks with assets less than or equal to $250 billion can count up to 25 percent of their MSAs toward regulatory capital, but the risk weight still is 250 percent.

Since taking effect, Basel III has been criticized as causing banks to reduce their holdings of MSAs and drive more servicing to nonbanks. However, under the Basel III Endgame proposal, the capital requirement for MSAs is made more onerous and NAHB believes it would make MSAs even more unattractive to large banks. The Basel III Endgame proposal would align the treatment of MSAs at the large regional banks with the lower 10 percent cap currently applicable only for Global Systemically Important Banks (GSIBs). NAHB believes this would reduce demand for MSAs, impacting the liquidity and value of MSAs not just for banks but for all market participants. This is significant to the housing industry for many reasons.

A portion of the interest rate on a mortgage loan includes the value of servicing the mortgage. When the servicing asset is in demand, this means the underlying mortgages are in demand. This increases the price of the servicing asset and reduces the interest rate on the underlying mortgage to the borrower. If the demand and value of MSA falls because there is less interest by banks due to the unattractive treatment of servicing assets, interest rates to borrowers will increase.

Additionally, a reduced interest in MSAs by banks will increase holdings of MSAs by nonbanks that are vulnerable to any reduction in liquidity and value of these assets.

For most nonbanks, MSAs are the dominant asset.[1] Nonbanks rely on the cash flow from servicing the mortgages to collateralize the purchase of MSAs. If the value of MSAs falls, nonbanks have less valuable collateral for borrowing to service the mortgage loans. A loss in value and subsequent loss of liquidity of MSA holdings by nonbanks could hurt homeowners and taxpayers during an economic downturn when nonbanks would rely on the liquidity and value of MSAs to provide access to capital to support struggling and delinquent homeowners and advance payments to investors in mortgage-backed securities when payments have not been received by delinquent homeowners. Since many nonbanks are servicers of mortgages guaranteed or insured by Fannie Mae, Freddie Mac, the Federal Housing Administration, the United States Department of Agriculture and the Veterans Administration, it is possible to see a scenario in which nonbanks lacking access to adequate capital to keep borrowers from foreclosure and advance payments to investors in Fannie Mae, Freddie Mac and Ginnie Mae mortgage-backed securities (MBS) would put taxpayers at risk.

NAHB urges the federal banking regulators to consider the following when drafting a final rule:

- Retain the current 25 percent cap on MSRs as a percentage of regulatory capital; and
- Reverse the recent bank exodus from mortgage servicing by lowering the current punitive 250 percent risk weight assigned to MSRs for ALL banks.

Warehouse Lines of Credit

The Basel III Endgame's proposed treatment of warehouse lines of credit is a particularly negative component of the proposal for mortgage lending. Warehouse lending is the dominant source of liquidity for nonbanks.[2] While the risk weights proposed for mortgage loans and MSAs would drive mortgage lending away from banks to nonbanks, banks would be discouraged from providing essential capital to nonbanks to support their origination activities. The level of capital proposed for warehouse lines of credit is egregious in light of how these lines of credit are collateralized.

The nonbank share for originations for Fannie Mae, Freddie Mac and Ginnie Mae has been rising steadily since 2013[3], standing at 81 percent in October 2023. Nonbanks require a funding source to originate mortgage loans. Without a deposit base, nonbanks borrow funds from banks through a warehouse line of credit to finance mortgage loans at the settlement table and pay off those lines when the loans are sold to investors. This is generally a very short period of time.

Currently, a bank providing a warehouse line of credit to a nonbank will be assessed a capital charge of 20 percent, i.e. a credit conversion fee (CCF) on the unused portion of the line of credit. Under the proposal, a warehouse line of credit is not considered "unconditionally cancelable" and therefore the CCF would be increased to 40 percent, making it extremely capital intensive and potentially driving banks away from this

[1] Jim Parrott and Laurie Goodman. September 18, 2023. Bank Regulators Are Taking Too Narrow a View of Mortgage Risk.
[2] Ibid.
[3] Urban Institute, November 2023. *Housing Finance at a Glance*. Page 12.

important line of business. The expense becomes more onerous because the bank is holding capital against the unused portion of a line of credit, yet not making any interest or fee income on this portion of the credit line.

Warehouse lines of credit are collateralized by the mortgage loans funded by the line and the bank providing the line of credit is holding the loans on its balance sheet for the period of time the credit is outstanding. However, the entire line of credit is risk-weighted at 100 percent rather than the risk weight of the underlying mortgage loans. NAHB believes this is another deterrent to warehouse lending that is a critical need by providers of a large segment of mortgage originators.

The market liquidity and stability provided by warehouse lines of credit would be in jeopardy if they become too expensive for banks to maintain.

NAHB urges the federal banking regulators to consider the following when drafting a final rule:

- Preserve the current 20 percent CCF on any unused portion of a warehouse line; and
- Reduce the current 100 percent risk weighting on warehouse lines to align with the risk weight of the underlying mortgage collateral.

Conclusion

Thank you for your consideration of NAHB's comments and recommendations. If you have questions, please contact Becky Froass, Senior Director, Financial Institutions and Capital Markets, at 202-266-8529 or email rfroass@nahb.org.

Sincerely,

Jessica R Lynch

Jessica R. Lynch