December 15, 2023

Hon. Jerome Powell
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Mr. Michael Hsu
Acting Comptroller
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

Hon. Michael Barr
Vice Chairman of Supervision
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Dear Chairman Powell, Acting Comptroller Hsu, and Vice Chairman Barr:

We write to express our concern regarding the capital requirements for mortgage loans contemplated by your July proposal to implement the Basel Committee's Endgame standards.

To improve the risk sensitivity of the bank capital framework, the U.S. bank regulators worked closely with their international counterparts through the Basel Committee to develop updated mortgage capital requirements that are better aligned with the latest evidence of the underlying risk. These Endgame mortgage capital requirements vary by loan-to-value ratio (LTV) but generally are lower or the same as the current U.S. mortgage capital requirements that were adopted in 1989.

Your proposal does not adopt the Endgame mortgage capital requirements. You instead contemplate adding a significant surcharge to these requirements, such that many mortgage loans will see an increase in required capital. No loss history or other evidence was offered to support this approach.

We have two primary concerns. First, by increasing the capital requirement for mortgage loans with higher loan-to-value ratios, your proposal could increase borrowing costs for all borrowers, but more damaging for low- and moderate-income and other historically underserved borrowers who cannot always afford a 20% down payment. That will make it that much harder for these families to achieve homeownership.

Second, by capitalizing mortgage loans far in excess of the underlying risk, your proposal would needlessly make portfolio lending an uneconomic business for large banks. That will not only have an adverse impact on banks' businesses and diversification, but also will continue to increase risk to financial stability by pushing mortgage lending out of banks and concentrating it in non-banks, in particular the $8 trillion monoline government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac.[1]

[1] : Fin. Stability Oversight Council, Statement on Activities-Based Review of Secondary Mortgage Market Activities 2 (2020) ("The Enterprises' credit risk requirements, however, likely would be lower than other credit

Relatedly, current regulations allow a bank to consider the risk-reducing effects of private mortgage insurance (PMI) when determining the loan's LTV and its qualification as a prudently underwritten mortgage and thereby qualifying for a lower risk weight. By disallowing these adjustments, your proposal would further exacerbate the concerns above. We urge you to reconsider and provide an appropriate level of credit for private credit enhancement in the form of private mortgage insurance and credit risk transfer when calculating the capital charges associated with these mortgages. We see this as an important tool in fostering access to credit for underserved borrowers who often lack large downpayments while helping manage and mitigate financial institutions' overall mortgage credit risk exposure.

Moreover, we are concerned that just as your proposal disincentivizes banks from offering mortgages to be held on balance sheet, it simultaneously disincentivizes banks from originating mortgages for sale via agency or non-agency securitization. This derives from the disproportionate impact of the proposed operational risk charge on fee-based income businesses such as mortgage origination and distribution. This aspect of your proposal is likely to further push agency-eligible borrowers to non-bank originators and the GSEs, thereby reducing consumer choice and competition, but it could have an even more severe adverse impact on borrowers ineligible for agency securitization due to income verification requirements under the CFPB's ability-to-repay regulations. These "non-QM" borrowers could include many gig-economy and self-employed workers who may find their options for reasonably priced mortgages even more diminished if they continue to exist at all. We thus strongly encourage you to consider adjusting the income calculation under the operational risk component, including but not limited to the calibration of the operational risk component's internal loss multiplier. These changes would help to prevent a resulting adverse impact on mortgage origination and servicing.

Finally, we agree that your July proposal should not apply to community banks. However, in our view, there is a compelling case for extending an option to community banks to elect into these more risk-sensitive, empirically supportable, and modernized Endgame mortgage capital requirements should they wish to do so.

In conclusion, to mitigate risks to financial stability and preserve access to credit for borrowers including underserved borrowers, it is critical that the capital requirements for mortgage loans are consistent with the actual risk on these exposures. To that end, we urge you to (a) adopt the Endgame mortgage capital requirements based on LTV as finalized by the Basel Committee, (b) drop the so-called 20% surcharge imposed by your proposal, (c) restore appropriate credit for private mortgage insurance, and (d) reconsider the impact of the operational risk component on mortgage securitization markets for agency and non-agency borrowers. This approach would broadly be more consistent with the capital requirements developed by the Federal Housing Finance Agency for Fannie Mae and Freddie Mac, providing for greater alignment in regulatory treatment by large institutions irrespective of charter type which should remain a key goal of the post financial crisis regulatory framework.

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providers across significant portions of the risk spectrum and during much of the credit cycle, which would create an advantage that could maintain significant concentration of risk with the Enterprises."); Id. ("The alignment of market participants' credit-risk capital requirements across similar credit risk exposures would mitigate risk to financial stability by minimizing market structure distortions.").

The U.S. bank regulators played a central role in the development of these requirements through multiple administrations. The Endgame mortgage capital requirements appropriately provide a more granular treatment of mortgage credit risk exposures that are empirically derived and defensible, whereas, your proposal does the opposite. Indeed, Urban Institute experts have published research that the Endgame mortgage capital requirements are generally aligned with the underlying risk on mortgage exposures.[2] We strongly encourage you to carefully consider all of these recommendations, along with the various stakeholder comments you receive with an eye to maintaining a deep, liquid, and competitive market for mortgages, in which banks can prudently participate in helping American homeowners achieve the dream of sustainable homeownership.

Sincerely,

Bill Hagerty
United States Senator

Thom Tillis
United States Senator

JD Vance
United States Senator

Katie Boyd Britt
United States Senator

M. Michael Rounds
United States Senator

Kevin Cramer
United States Senator

Mike Crapo
United States Senator

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[2] https://www.urban.org/research/publication/bank-capital-notice-proposed-rulemaking%5D