Issue of Concern: Deduction of Mortgage Servicing Assets that Exceed 10% of an Institution's Common Equity Tier 1

Under the proposed Basel III rule, institutions were required to deduct all mortgage servicing assets (net of deferred tax liabilities) that exceed 10% of its common equity tier 1 (15%, when aggregated with deferred tax assets and investments in common stock of an unconsolidated financial entity). In addition, the amount that is below the 10% threshold will receive a 100% risk weight (and eventually 250% beginning 2018). A mortgage servicing asset is the right by a bank to service mortgage loans owned by others. Institutions of all sizes sell mortgage loans they originate to third parties like Freddie Mac and Fannie Mae and retain the right to service those loans. They retain the servicing so the customer interfaces with the bank that originated loan rather than the third party that owns the loan.

Why it is an Issue:

- Servicing loans is a specialty of many banks, including many community banks, and the mortgage servicing asset oftentimes will exceed 10%.
- The deduction of mortgage servicing assets that exceed 10% of a bank's common equity Tier 1 capital combined with the high risk weight could severely impact some banks, perhaps even lowering their capital levels below well capitalized status.
- Based on the capital treatment, some banks may choose to exit the mortgage servicing business impacting long standing customer relationships and reducing fee income.

Final Rule

Similarly to the proposed rule, the final rule requires institutions to deduct all mortgage servicing assets (MSAs) (net of deferred tax liabilities) that exceed 10% of its common equity tier 1 capital and 15% when aggregated with certain deferred tax assets and investments in common stock of unconsolidated financial entities. However, the current requirement that imposes a 10% haircut on the fair market value of MSAs that are included in regulatory capital was eliminated. Therefore under the final rule, MSAs included in regulatory capital may be included at 100% of their fair value. A transition period for MSA deductions under the rule begins in 2015 for most banks.

The amount of MSAs not deducted from regulatory capital will be subject to a 250% risk weight beginning in 2018 (100% during transition period).