American Bankers Association

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May 12, 2014

The Honorable Jacob J. "Jack" Lew
Chairperson, Financial Stability Oversight Council
Secretary, United States Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Lew:

I am Jeff Plagge, Chairman of the American Bankers Association, and President and CEO of Northwest Financial Corp, a $1.5 billion, two bank holding company in Arnolds Park, IA. We are a privately held organization. On behalf of the ABA, I commend the Financial Stability Oversight Council on statements in its annual report and its recent public session concerning the large volume of mortgage servicing rights (MSRs) that have been acquired by non-bank firms. I offer an additional solution which will diminish the transfer of MSRs from federally supervised banks to less regulated non-bank mortgage servicing companies.

We agree with the Council's concerns that MSRs are being drained from the banking industry because of regulatory arbitrage. As your report notes, many non-bank mortgage servicers are not currently subject to prudential standards such as capital rules, liquidity requirements, and risk management oversight, which are intended to maintain safety and soundness. The Council's recommendations to strengthen prudential and corporate governance standards for non-banks are critically important to protect against future financial instability.

However, your report neglected to recognize the threshold issue: the increase in capital requirements for MSRs at institutions subject to Basel III is a significant factor driving MSRs to companies with lesser regulatory burdens and costs. The Basel III treatment of MSRs was advocated in large part by foreign regulators whose banks hold few, if any, of these assets. As a result, the effects on their banks will be minimal, while many U.S. banks are being forced to divest MSRs because of significant changes in capital costs. It makes little sense to focus only on improving prudential standards in the lesser regulated and supervised segment of the servicing industry to which assets are flowing, and not address the cause of that outflow. At the end of the day, consumers are not going to be well served by forcing servicing away from the banks that originated these mortgages. Our customers always prefer that we are the entity that handles the servicing of their mortgage. We are where the customer relationship resides and where problems can quickly be resolved.

Under Basel III, bank MSRs includable in regulatory capital decrease from 100 percent of Tier 1 capital to 10 percent of common equity tier 1 (CET1)—a significantly narrower category of capital than Tier 1. The new rules also impose an overall limitation of 15 percent of CET1 on the combined balance of includable MSRs, deferred tax assets, and investments in the common stock of unconsolidated financial institutions. Finally, MSRs that are not deducted from CET1 are subject to a 250 percent risk weight. These abrupt and punitive changes are causing a divestiture of MSRs by banks which will accelerate over the next 18 months.

To avoid these adverse consequences, ABA has offered a proposal that would reduce the extent of the MSRs outflow, and would address the systemic concerns identified by the Counsel in a minimally disruptive manner. We recommend that the MSR deduction threshold be increased from ten to twenty-five percent of CET1, and that MSRs be eliminated from the fifteen percent aggregate deduction. A twenty-five percent threshold, although still a significant restriction compared to previous capital treatment, would help to preserve the viability of mortgage lending and servicing at numerous banks that are essential to the well-being of the communities they serve. Our proposal would also lessen disruption to existing customer relationships and would stem the troubling outflow of servicing to entities that are less regulated and less likely to serve borrowers as well as highly-regulated banks.

Thank you for your consideration of our recommendations, and I urge that you support a Basel rule change to prevent MSRs being stripped from banking industry.

Sincerely,

Jeff L. Plagge
Chairman, American Bankers Association and
President and CEO
Northwest Financial Corp.
Arnolds Park, IA

cc: Hon. Janet L. Yellen, Chairman, Board of Governors of the Federal Reserve System
Hon. Thomas J. Curry, Comptroller of the Currency
Hon. Richard Cordray, Director, Bureau of Consumer Financial Protection
Hon. Mary Jo White, Chairman, Securities and Exchange Commission
Hon. Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation
Hon. Mark P. Wetjen, Acting Chairman, Commodity Futures Trading Commission
Hon. Melvin L. Watt, Director, Federal Housing Finance Agency
Hon. Debbie Matz, Chairman, National Credit Union Administration
Mr. S. Roy Woodall, Jr., Independent Member with Insurance Expertise, Financial Stability Oversight Council