MORTGAGE BANKERS ASSOCIATION

July 17, 2023

Attn: Eric Froman, Office of General Counsel, Treasury
Financial Stability Oversight Council
1500 Pennsylvania Avenue, NW
Room 2308
Washington, DC 20220

Re: Authority to Require Supervision and Regulation of Certain Non-bank Financial Companies (RIN 4030-[XXXX]) (88 Fed. Reg. 26,234-26,244, April 28, 2023);

Analytic Framework for Financial Stability Risk Identification, Assessment, and Response (RIN 4030-[XXXX]) (88 Fed. Reg. 26,305-26,311, April 28, 2023)

Dear Mr. Froman,

The Mortgage Bankers Association[1] appreciates the opportunity to comment on the Financial Stability Oversight Council's ("FSOC") proposed revision to its interpretive guidance (the "Proposal") related to the designation of non-bank financial companies as systemically important financial institutions ("SIFI"), as well as the proposed analytic framework FSOC would use to examine potential risks to the financial stability of the United States.

Executive Summary

MBA represents over 2,200 member companies, including bank and non-bank lenders, servicers and sub-servicers in both the residential and commercial markets. MBA supports FSOC's goal to ensure healthy and stable financial markets, however as further outlined below, MBA recommends FSOC incorporate several improvements to the proposal and the framework when considering designation of a non-bank financial firm as a SIFI:

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 390,000 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 2,200 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.

- Include consideration of the costs and benefits of non-bank SIFI designation;
- When assessing systemic risk, consider and address whether existing regulations are driving core banking activities outside the banking regulatory perimeter;
- Before proceeding with designation, look first to the tools of existing regulatory entities and other federal programs/agencies; and
- In pursuing designation, adhere to statutory process requirements.

In proceeding with a non-bank SIFI designation, FSOC should conduct a deep and thorough analysis, including weighing the cost and benefit of such designation to the U.S. financial system as a whole and the likelihood the financial company in question will experience material financial distress as a result of the designation. To the extent that FSOC is concerned with core banking activities taking place outside of the established "regulatory perimeter" of prudential bank regulation, FSOC should reconsider the regulatory environment that has discouraged traditional depository institutions from competing in the space. As a general matter, FSOC should consider less costly alternatives to designation of a non-bank financial entity – especially where such an entity is already subject to regulation by an FSOC-constituent member and the perceived risk to financial stability associated with that entity can be, or perhaps already has been, adequately addressed through targeted programmatic changes by that regulator.

If FSOC nonetheless determines that an entity designation is appropriate, MBA urges FSOC to impartially follow the statutorily-prescribed process and fact-finding exercise preceding designation without any predetermined outcome in mind. Additionally, the decision to initiate a first-level review of a particular entity for potential designation should be made following a full vote of FSOC members. Each of the above recommendations are explored in greater detail below.

FSOC Should Consider the Costs and Benefits of Non-Bank SIFI Designation

FSOC's proposal eliminates any evaluation of the costs and benefits of non-bank designation and dispenses with assessing the likelihood that a firm would experience material financial distress. These provisions contravene clear congressional intent to tread lightly with respect to entity designation.[2][3] They also demonstrate a profound abdication of FSOC's primary mandate to *evaluate* risks to the financial stability of the United States using the ample tools at its disposal and run contrary to the requirement of a cost/benefit analysis that the United States District Court for the District of Columbia in *MetLife*[4] affirmed. Eliminating these essential pieces of the decision-making process may lead to regulatory outcomes that are arbitrary and capricious, and troublingly suggests that FSOC's

[2] Economic Growth, Regulatory Relief, and Consumer Protection Act, Section 401
[3] Of note, even today's largest non-bank mortgage servicer has balance sheet assets well below the original asset threshold Congress established for banks in 2010, at least eight times smaller than the current bank asset threshold established by Congress in 2018, at least twenty times smaller than any of the non-bank entities FSOC has previously attempted to designate, and at least one hundred times smaller than the balance sheet assets of their largest counterparties, Fannie Mae and Freddie Mac.
[4] *Metlife, Inc. v. Fin. Stability Oversight Council*, 177 F. Supp. 3d 219 (D.D.C. 2016)

intention is to fast-track designation of a non-bank financial company before any legitimate fact finding or analysis has occurred.

When Assessing Systemic Risk, FSOC Should Consider and Address Whether Existing Regulations are Driving Core Banking Activities Outside the Regulatory Perimeter

The responsibility of FSOC is to assess the potential for systemic risk, especially that which might not be captured within the purview of its individual constituent regulatory agencies. However, the proposed framework is incomplete in that it does not require the agencies to examine why certain core banking activities have left the regulatory perimeter in the first place, and whether existing rules may be a factor.

With respect to residential mortgage lending, banks' share of origination and servicing volume has consistently declined during the fifteen years following the global financial crisis. Some of the decline may reflect a re-assessment of the economic returns available in mortgage lending and a shifting of resources into business lines that have better prospects. However, in discussions with our bank members, it clearly also reflects regulations specific to banks which reduce the returns on capital from mortgage lending. For example, the Basel capital framework's punitively high 250% risk weight on mortgage servicing rights (MSRs), coupled with a strict cap on the ratio of MSRs to Tier 1 capital, has significantly altered the economic incentives for banks to service mortgage loans for others. In a mortgage market dominated by securitization, MSRs are critically important. An excessively high risk weighting has discouraged banks from originating mortgages for securitization and retaining the servicing asset.

In response to this move away from mortgage servicing by banks, non-bank servicers, which are subject to the same national consumer protection standards, have increased their share of the servicing market. FSOC has recognized this and called for the relevant federal agencies (the Federal Housing Finance Agency (FHFA) and the Government National Mortgage Association (Ginnie Mae)) and state regulators to heighten scrutiny of the largest non-bank servicers. Those regulators have already done so, most recently moving to significantly increase capital and liquidity requirements and moving non-bank mortgage lenders increasingly toward bank-style capital requirements, despite starkly different sources of funding and risk.

This example highlights what is the critical question: if bank regulations are so punitive that they discourage banks from effectively competing in markets for core banking services, shouldn't FSOC first re-examine the regulatory regime that caused this change? The FSOC designation framework should require this analysis before "extending the regulatory perimeter" to nonbank entities that are serving a market from which banks have pulled back. This is particularly important in the mortgage market, where banks should be able to leverage their lower cost of funds, preemption of many state laws, and access to the payments system and liquidity backstops. If policymakers are concerned about the growth of nonbank market shares for traditional banking services, they should first examine whether existing rules are impeding banks' ability or desire to serve those markets.

Ultimately, the real estate finance system is healthiest, and consumers win, when multiple actors utilizing a range of business models and strategies compete on a level playing field. Simply imposing higher costs across the system will only burden prospective homeowners with higher prices and fewer choices at a time of constrained housing affordability.

Before Proceeding with Designation, FSOC Should First Look to the Tools of Existing Regulatory Entities

In her opening comments at the April 21, 2023 FSOC meeting, Treasury Secretary Janet Yellen noted that, "importantly, [FSOC] does not broadly prioritize one type of tool over another," and that FSOC will often "determine that a risk should be addressed by existing regulators … in instances where systemic risks emanate from widely conducted activities" and where the entity is within the jurisdiction of a regulator with adequate prudential or supervisory authorities.[5] We agree with this analysis and encourage FSOC to follow Secretary Yellen's guidance.

FSOC has a considerable number of tools in its arsenal other than SIFI designation to address a perceived market risk. These alternative tools likely offer the opportunity to address the root causes of the perceived risk in a more surgical manner and one that is less costly to the broader marketplace.

There are several examples of residential and commercial non-bank sectors that are subject to robust regulation and oversight that warrant consideration by FSOC in the process of SIFI designation. The non-bank mortgage servicing sector is one excellent example of a market subject to both prudential and programmatic federal government regulation. Non-bank mortgage servicers of all sizes are extensively regulated with respect to capital, net worth, and liquidity requirements from Fannie Mae and Freddie Mac, as dictated by FHFA, as well as Ginnie Mae and the Federal Housing Administration (FHA). Importantly, these standards, as noted above, have increased sharply over the past 15 years. Nonbank mortgage servicers must also comply with unique state licensing and business conduct regulations, undergo examinations in every state where they do business, and meet counterparty requirements from warehouse lenders. In addition, they are subject to the same consumer protection laws as banks and credit unions, enforced by the Consumer Financial Protection Bureau (CFPB) and state attorneys general.

At the federal level, Ginnie Mae in particular has a variety of programmatic levers available to reduce liquidity risk, including not only capital and liquidity standards, but also the ability to modify mortgage servicing advance obligations, lower the barriers to entry for new market

[5]https://home.treasury.gov/news/press-releases/jy1431

participants, and improve access to private financing for non-bank mortgage servicers using MSRs and servicing advances as collateral.

For example, FSOC could direct Ginnie Mae to take steps to mitigate the obligation its issuers currently have to indefinitely advance timely principal & interest payments to Ginnie Mae MBS investors regardless of whether they are actually collected from borrowers (i.e., so-called "scheduled/scheduled" remittances). After all, particularly in the Ginnie Mae context, servicing advance risk is fundamentally a question of timing – specifically, the lag time between two existing sets of government guarantee programs. FHA, the Department of Veterans Affairs (VA) and the Department of Agriculture (USDA) guarantee or insure the lender against losses on individual mortgage loans, while Ginnie Mae guarantees timely principal and interest payments to investors. Such an action to limit, mitigate, or modify the timing of servicing advance obligations would minimize the risk any issuer presents to the broader financial marketplace. It could also encourage new, smaller Ginnie Mae issuers to enter the market, thereby further reducing market concentration. Modifying servicing advance requirements is not without precedent, as Fannie Mae and Freddie Mac acted at FHFA's direction to cap seller-servicer remittance obligations during the height of the COVID-19 pandemic.

Another opportunity would be to direct FHFA to modify the current procedure of reimbursing mortgage servicers for advances of taxes and insurance (i.e., "T&I") to better align with the timing in which they are paid. This could eliminate or mitigate the financial burden on nonbank mortgage servicers to carry this category of receivable. Clearly, many options are available that could be implemented with program changes or by rule, rather than by legislation.

Life insurance lending and servicing are another example of a non-bank financial sector with significant regulation and oversight and FSOC would be remiss not to rely upon the tools of the individual state regulators that have a unique perspective and unparalleled expertise. Many life insurance companies participate in commercial lending and are regulated by the individual states in which they are licensed to sell insurance. Each state insurance regulator is also a member of the National Association of Insurance Commissioners (NAIC) which is an organization that sets standards and best practices for the insurance industry, including capital standards, investment guidelines, financial oversight and more.

Although FSOC's recent action indicates a desire to expedite the path to entity-based designation, the process should ensure that the tools of the primary regulatory entity and other federal agency programmatic changes are exhausted first. This approach will ensure root causes are addressed by the regulatory entities with the specialized expertise and tools to address most of the risks directly and at lower cost to the institutions and the market.

In Pursuing Designation, Statutory Process Requirements Should Not be Sidestepped

The Dodd-Frank Act is prescriptive as to the process FSOC must follow when considering the designation of a non-bank financial company.[6] FSOC must provide to a non-bank financial company written notice of a proposed determination to designate, including an explanation of the basis of the proposed determination. Upon receiving this written notice, the target non-bank may request an opportunity for a written or oral hearing before FSOC to contest the proposed designation. Additionally, FSOC is required to consult with the primary regulatory agency of the entity under consideration for designation.

Congress established statutory process requirements for a reason – to provide an opportunity for fact finding and due process. These should not be considered perfunctory steps, and the findings that emerge from them should be accorded due consideration.

In recent months, CFPB Director Rohit Chopra, a constituent voting member of FSOC, has repeatedly mused publicly about which types of entities he feels should be designated as SIFIs[7]. These comments suggest a plan to back into his desired answer before any required analysis or consultation with a primary regulator or other federal agencies takes place, which calls into question the integrity of the entire designation process.

Should FSOC consider designation of a non-bank financial company that is principally engaged in an activity within the field of expertise of one of the FSOC-constituent members, that member should be consulted in the process, and any conclusions resulting from that consultation should be made part of the public record. FHFA makes sense as the primary regulator to consult in the case of mortgage servicing, given its status as an FSOC-voting member and the preeminent role it plays in setting standards for the GSEs which flow through much of the market. It is also best positioned to understand the risks associated with a particular non-bank mortgage servicer. Ginnie Mae, which has been consulted with in prior FSOC deliberations, should also be part of this process.

Importantly, the decision to initiate even a first-level review of an entity for potential designation is a very consequential step and in of itself, with significant market implications for publicly traded companies or private companies with public investors, which may need to disclose the information under SEC requirements. As such, this initial review should require a full, public vote of the FSOC voting members, rather than rely on the discretionary judgment of FSOC staff.

In the alternative, where a full vote of the FSOC principals is not feasible, the decision to initiate first-level entity review should receive a full vote of the FSOC Deputies Committee, which itself includes representation for all voting members of FSOC. Absent this additional

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[6] Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 113(a)(2)(K)
[7] https://nationalmortgageprofessional.com/news/chopra-nonbanks-mortgage-servicers-may-also-pose-systemic-risk

transparency, FSOC opens itself up to reasonable criticism that its actions – both the decision to initiate review as well as its ultimate conclusion – are made in an arbitrary manner.

Conclusion

MBA appreciates your consideration of its comments with regard to the proposed interpretive guidance and analytical framework and supports the goals of FSOC to ensure a safe, stable, and sustainable financial services marketplace. Should you have any questions or wish to discuss any aspects of these comments, please contact Matt Jones ((202) 557-2933 or mattjones@mba.org) or Justin Wiseman ((202) 557-2854 or jwiseman@mba.org).

Sincerely,

Robert D. Broeksmit, CMB
President and Chief Executive Officer
Mortgage Bankers Association