May 20, 2014

The Honorable Thomas J. Curry
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, DC 20219

The Honorable Janet L. Yellen
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

The Honorable Martin J. Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Treatment of Mortgage Servicing Assets in Regulatory Capital

Dear Chair Yellen, Comptroller Curry, and Chairman Gruenberg:

The Independent Community Bankers of America (ICBA)[1] would like to express its continued concern about the implementation of Basel III regulatory capital standards on community banks and the adverse impact of those standards on mortgage servicing assets (MSAs) held in community bank loan portfolios. Community banks are simple, straightforward, local lenders whose main purpose is to provide meaningful and impactful banking services that strengthen and grow their communities. Through customized mortgage lending activities that provide much needed mortgage credit tailored to specific residential and commercial borrower needs, community banks across

[1] The Independent Community Bankers of America®, the nation's voice for nearly 7,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services.

With nearly 5,000 members, representing more than 24,000 locations nationwide and employing more than 300,000 Americans, ICBA members hold more than $1.2 trillion in assets, $1 trillion in deposits, and $750 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

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the United States are acting as key economic drivers in rural and underserved communities that are untouched by the larger regional and money center banks. The implementation of harsh, radical, and damaging penalties on the MSAs of community banks serves to greatly diminish the value of community banks as they are forced to severely limit the number of mortgages they service.

As you are well aware, the advent of new capital regulations stemming from the adoption of Basel III in the United States will bring a reduction in the amount of MSAs permitted in community bank servicing portfolios from the current 100% ceiling of tier 1 capital to a new ceiling of 10% of common equity tier 1 capital, resulting in a much narrower measurement of regulatory capital. Any amounts above the ceiling are directly deducted from regulatory capital through immediate write-offs. Additionally, amounts not written off are subject to a new 250% risk weight versus today's current risk weight of 100%. There is an additional ceiling on MSAs imposed when those assets, combined with certain deferred tax assets and investments in the common stock of other financial institutions, exceed 15% of common equity tier 1 capital. Similar to the 10% limitation, any amounts above the ceiling are directly deducted from regulatory capital through immediate write-offs.

These new burdensome prohibitions on regulatory capital are sending a clear message to community banks that they should not be servicing the mortgages they originate for their customers. However, regulators should not be penalizing community banks for providing a meaningful and much needed service for their customers simply because they are viewed as intangibles. Rather, the agencies should be encouraging community banks to retain the servicing rights of the loans they originate. Community banks are uniquely adept at providing a level of customer service that takes into account the financial condition of the borrower and their ability to meet the required loan covenant and payment obligations. Larger mortgage servicers, increasingly becoming composed of non-bank servicing organizations, view mortgage servicing as a commodity business that is driven by economies of scale with large volumes and minimal ongoing investment. This business model results in poor customer service and conflicts of interest particularly when local economies experience a housing downturn. This is because larger mortgage servicers are often less sensitive to the needs of the community and less sympathetic if risk mitigation is required.

ICBA is concerned that regulators have failed to properly recognize that mortgage servicing and the presence of MSAs on community bank balance sheets acts as a natural hedge to the risks associated with rising interest rates. Severely limiting the ability of a community bank to grow and manage a reasonably-sized portfolio of MSAs exposes the institution to heightened interest rate risk, which must be managed either through extensive asset-liability management strategies that may impose limits on the types of lending products that can be offered to the bank's customers or through the use of interest rate derivatives that bring less than optimal solutions at significant cost.

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ICBA has previously proposed[2] and continues to support a community bank exemption from the Basel III treatment of MSAs. Specifically, ICBA believes that financial institutions in the United States with consolidated assets of $50 billion or less should be allowed to continue to be subject to the current MSA regulatory capital risk weights and deduction thresholds for these institutions. Institutions at this level of consolidated assets did not contribute to the recent financial crisis of 2008 and 2009 and have continually managed a strong financial condition in the face of challenging credit conditions and significant economic headwinds that limit their ability to generate reasonable returns for their shareholders.

If the agencies do not quickly and thoroughly address the limits on mortgage servicing imposed under Basel III, the task of the mortgage servicing function and the associated MSAs will move from community banks to non-bank mortgage servicing firms that are much less regulated with financial interests that may not always be aligned with the owner of the loan and the associated security interests. As Comptroller Curry acknowledged in a recent speech to the state banking commissioners, the migration of banking activities from regulated institutions to nonbank firms should not occur to avoid the provisions of Basel III.[3] ICBA shares Mr. Curry's concerns and feels that the agencies should make every effort possible to ensure that community banks are able to retain mortgage servicing.

ICBA encourages the banking agencies to actively work together to seek a comprehensive and fair solution to this problem that focuses on the importance of recognizing the value provided to local communities through community bank mortgage servicing and preserving the valuable relationships maintained between community banks across the United States and their customers. If you have any questions or would like additional information, please do not hesitate to contact me at (202) 659-8111.

Sincerely,

/s/

Camden R. Fine
President and CEO

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[2] Please see ICBA's letter to the agencies dated October 22, 2012 on the Basel III regulatory capital standards joint proposal.
[3] Remarks by Comptroller Curry before the Conference of State Bank Supervisors, May 14, 2014