NEW SOUTH
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34

October 3, 2000

Manager, Dissemination Branch
Information Management and Services Division
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552

Dear Manager,

This is in response to the request for comments in connection with proposed changes to the Thrift Financial Report effective March 31, 2001, as published in the Federal Register August 4, 2000. The following comments are specifically directed to the definition of subprime lending as outlined in the Federal Register.

Per the Register, the definition states "Subprime loans are extensions of credit to borrowers who, at the time of the loan's origination, exhibit characteristics indicating significantly higher risk of default than traditional bank lending customers". This proposed definition contains several phrases that can create significant problems for both lenders and borrowers. Each phrase with which there is concern is dealt with below.

First, the term "significantly" is highly subjective. What is significant for one institution is not necessarily significant for another. This alone could potentially create a great deal of disparity from institution to institution and, in some cases, could cause institutions having capital difficulties to apply a more liberal standard to the word "significantly", thus increasing their risk without adequate regulatory disclosure.

The phrase "higher risk of default" is troublesome in that, frequently, borrowers who utilize government lending programs, such as FHA, VA or Housing Authority programs, would, under this definition, be classified "subprime". Should such definitions include these types of loans and such loans become subjected to higher capital requirements by the institution's regulatory authority, government lending programs could suddenly evaporate for the very borrowers those programs were intended to assist. Perhaps a better wording might be to define loans with a higher risk of loss, rather than default. Afterall, is it not the potential of loss to the institution that creates a greater risk and not mere default? Perhaps loans that are covered under insurance and guarantee programs, both private and government, could be exempt from the definition in addition to the change in reference from "default" to "loss".

Finally, the definition contains the phrase "traditional bank lending customers". This phrase could result in institutions narrowing their lending base to customers whose profiles mirror that of it's own traditional customer base, thus preventing any significant entry into a broader credit market such as those currently encouraged by the Community Reinvestment Act. This decline in available credit to borrowers outside an institution's "traditional" customers is counter productive to public policy and fairness to all potential borrowers.

In further response to your request for comments, below is a discussion of each item on which the Register specifically requested comment.

1) *Should all individual subprime loans be reported in the proposed new TFR items or should only those subprime loans that are held in a segregated portfolio or program be reported? Do you foresee any difficulties in reporting individual subprime loans or segregated groups of subprime loans?*

Such segregation could be manipulated by institutions merely by classification and, therefore, could negate the effectiveness of any reporting requirement. The difficulties lie within both the definition and the retroactive nature of the proposal since an extensive review of each loan on the books would be required.

2) *Based on the proposed definition of subprime loans above, approximately what percentage of your savings association's loan portfolio would currently be categorized as subprime? Using your association's own internal definition of a subprime loan, what percentage of your loan portfolio does your savings association currently classify as subprime? Please indicate whether these percentages are based on an individual subprime loan approach or a segregated portfolio or program approach. To the extent possible, provide percentages for your association's loan portfolio under both approaches.*

It is difficult to respond to this question due to the definition proposed and due to the extensive review required to respond in an appropriate and meaningful manner.

3) *What criteria does your association use to determine which loans are subprime? Are the criteria the same for all type of loans, e.g., mortgage, automobile, and credit cards? If not, how do they differ?*

Any classification would be based on numerous criteria including risk of loss, primarily based on a combination of factors such as mortgage insurance on the loan, loan to value and credit factors.

4) *In defining subprime loans, which factor(s) listed below are the best indicators of a higher risk of default?*

(a) *Higher loan fees*

This does not necessarily indicate a subprime loan.

(b) *Higher interest rates. For example, should all loans made at a contract rate 200 basis points above the rate that is offered to a traditional savings association customer for the same type of loan be included as subprime loans?*

No, interest rates are a factor influenced by individual markets, credit risk, collateral risk, mortgage insurance, etc., and should not be used to determine subprime loans.

(c) *Debt-to-income ratios. For example, should a loan to a borrower with a specific debt-to-income ratio above a stipulated level automatically be a subprime loan?*

No. Frequently, borrowers under government programs have higher debt to income ratios but should not be considered subprime.

(d) *Delinquency history. For example, if, at the time of the loan's origination, the customer had two or more payments that were 30 days past due in the last 12 months or had loans charged off in the last 12 months, would the loan be subprime? What type of delinquency history would constitute a subprime borrower in your association's view?*

Since multiple factors can impact an individual's delinquency history, this is an extremely unreliable indicator for subprime definition. Only excessive delinquency is considered to be indicative of a subprime borrower and only then when other compensating factors do not exist.

(e) *Loan-to-value ratio. Is there a loan-to-value ratio above which a loan secured by real estate would be considered subprime?*

Again, government programs historically have higher loan-to-value ratios. Does that alone indicate a subprime borrower? No.

(f) *Credit scores or other ratings. If your association uses credit scoring to determine whether a loan should be categorized as subprime, are the scores custom or generic scores?*

Credit scores are only a portion of the information gathered for a lending decision. Due to the "black box" nature and the volatility of such scores, these alone should not be used to determine whether a borrower is "subprime".

(g) *Bankruptcy status. For example, how far back in the customer's credit history would your association go to determine whether a bankruptcy should affect your categorization of a loan?*

This, in isolation, should not determine subprime borrowers.

(h) *Lack of credit history.*

This factor, if used, could result in a denial of credit to those most in need of establishing credit.

(i) *Other factors. Please identify any other factor that should be considered an indicator of a higher risk of default and explain why it should be considered.*

None of the factors noted above alone should be used to identify subprime borrowers. As previously stated, the view of default in the definition should not be used. Rather a determination based on risk of loss should be used to determine which loans are subprime.

5) *Should the definition of subprime be identical for all types of loans, or should it differ by type of loan, e.g., mortgage, automobile, and credit cards?*

No. Risk of loss should be used and this risk can vary greatly from loan type to loan type.

6) *Can your association determine from its records whether borrowers with subprime characteristic have credit support (e.g., public or private guarantees, co-signers, and insurance) on specific loans? If yes, do you categorize loans with such credit support as subprime loans?*

This addresses the primary issue at hand. These loans should not be classified as subprime.

7) *The proposed subprime loan definition relies on differences between traditional and "higher-risk" borrowers? How should the agencies take into account shifts in that difference (e.g., what happens if "traditional" lending standards drop)?*

As stated above – this could potentially limit credit availability to those most in need. Conversely, should an institution with adequate capital choose to extend credit to those customers, such "traditional" definitions could deteriorate thus creating greater risks to those institutions.

8) *Should the subprime loan definition distinguish between institutions that target higher risk borrowers as opposed to those institutions that serve a community in an economically disadvantaged area where the repayment ability of area borrowers can be or has been adversely affected?*

Such a distinction could create an unfair advantage to certain institutions while creating a standard that would be impossible to adequately monitor.

*9) Should there be a de minimus level of subprime loans below which reporting is not required?*

Yes.

*10) Should smaller savings associations be treated differently from larger savings associations from reporting purposes?* No.

*11) What types of loans or lending programs, if any, should be excluded from the definition of subprime loans or, if included in the definition, reported separately from other subprime loans? Please explain the reasons for the exclusions or separate reporting.*

As stated before, government programs and programs with mortgage insurance should be excluded. Risk of loss, rather than mere default, should be the barometer by which subprime loans are measured. This loss risk should be evaluated by multiple criteria, none of which in isolation should cause a subprime categorization.

*12) Should the proposed TFR items on subprime loans be treated as confidential for a limited period of time in order to give associations time to resolve issues surrounding which loans should and should not be reported as subprime?*

Absolutely.

We hope our comments prove helpful in resolving this extremely complex issue. We recognize the difficulty in defining subprime lending and encourage the regulatory authorities to weigh each item raised in order to fairly and equitably address the issue. In addition, such increased requirements are unnecessary and unwarranted given the current level of regulatory oversight. Further restrictions on an institution's ability to complete will not only harm these institutions but also decrease available credit in the marketplace for those very customers such regulations are intended to protect, driving them to unregulated entities for their credit needs. Protection of not only the financial health of the institutions is at stake but also the protection of the availability of credit for all potential borrowers.

Sincerely,

Cheryl R. Stone
Vice President and
Acting Controller