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Proposal: 1411 (7100-AD70) - Credit Risk Retention

Subject: Credit Risk Retention - Reg RR

Comments:

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Proposal: Credit Risk Retention
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July 27, 2011 Office of the Comptroller of the Currency CREDIT RISK RETENTION Docket Number OCC-2011-0002 Fourteen Comments Federal Register /Vol. 76, No. 83 / Friday, April 29, 2011 / My first comment: On page 11 of the proposal you say that "As noted above, the proposed rules generally would apply the risk retention requirements of section 15G to a sponsor of a securitization transaction (and not the depositor for the securitization transaction)." You also say, "As permitted by section 15G, §l.13 of the proposed rules permit a sponsor to allocate its risk retention obligations to the originator(s) of the securitized assets in certain circumstances and subject to certain conditions. The proposed rules define the term originator in the same manner as section 15G, that is, as a person who, through the extension of credit or otherwise, creates a financial asset that collateralizes an asset-backed security, and sells the asset directly or indirectly to a securitizer (i.e., a sponsor or depositor). Because this definition refers to the person that 'creates' a loan or other receivable, only the original creditor under a loan or receivable- and not a subsequent purchaser or transferee-is an 'originator' of the loan or receivable for purposes of section 15G.48" It seems that this language takes the responsibility for retention from the depositor and assigns it to the originator. My question is when would an originator not be a depositor? We are a small credit union - $45,000,000 in assets. We generally sell all our thirty year mortgages - which is about ten or fifteen mortgages per year - to PHH to avoid ALM issues. To my knowledge PHH keeps all the mortgages in their own portfolio and services them. However, what if we were to sell our thirty year mortgages to a third party that packages them into an ABS? It seems that from this language above, since the third party to whom we sold the first mortgages became a sponsor, that third party as a sponsor can require our credit union be responsible for retention. I don't see why we should be responsible for retention when we are not selling them to a third party with the intent that they be packaged into an ABS. That is the sponsor's decision, not ours. I think you should exempt federally regulated financial institutions that sell less than $5,000,000 in mortgages per year from this retention requirement and require the sponsor to be responsible for the retention; or to make that a contractual decision between the sponsor and the seller. You should require that a securitizer cannot put a loan into an ABS until it has notified the originator that the loan is being placed into an ABS and that the originator will be responsible for retention and the amount of that retention.

The originator should then have the right to purchase the loan back if it so desires. The securitizer must also be responsible for advising the originator from time to time, at least monthly, of the amount of loan balances outstanding which it has placed with the securitizer for packaging into an ABS, the delinquency statistics on those loans, and the amount of retention required to be held against that book of loans. I would think that this will be needed under GAAP for proper booking by those responsible for retention. My Second Comment: Request for comment115. Are the proposed credit history standards useful and appropriate indicators of the likelihood that a borrower might default on a new residential mortgage loan? These standards are much too strict. They will result in a lot of automatic turn downs, especially among the poor. Common underwriting standards allow an applicant to explain a thirty or sixty day delinquency. Then the underwriter has the authority to forgive that infraction or turn down the loan. Even the best people from time to time are found to be thirty days behind through no fault of their own. For example, a common problem is with hospital bills. The insurance company does not pay all that was expected of them. The hospital sends the item to a collection agency that puts the bill on a credit report. The patient may not find out about it until they apply for a loan. What is a 'debt obligation?' Nothing in the proposal defines the term 'debt obligation.' It is not uncommon to find past due library fines and unpaid parking tickets on a credit report. Are they debt obligations? Can you imagine telling someone they are automatically turned down for their mortgage because they forgot to return "War and Peace" to their local library six months ago. I would suggest that you define debt obligation as any debt the payment of which is enforceable by a signed written contract between the debtor and creditor. However, even with that, it won't be long before libraries start having people electronically sign disclosures covering late fees when applying for a library card. My Third Comment: Your auto loan requirements ignore the fact that mortage payments are usually the joint responsibility of two people, based on their combined income. Your guidelines for the auto loans requires that the entire mortgage payment be added into the DTI ratio of the borrower. That is a deal breaker in many cases for otherwise good borrowers. It is not uncommon in consideration of an auto loan for a lender to assign responsibility for only 50% of the mortgage payment to the applicant when the mortgage was based on joint income. My Fourth Comment: STRAIGHT LINE DEPRECIATION "The Federal banking agencies have found that, in supervising credit risk for such highly depreciable assets as automobiles, a fixed payment amount helps ensure that a borrower will have the ability to repay a loan over the life of the credit. Therefore, the proposed rules require qualifying automobile loans to provide for a fixed interest rate. In addition, under the proposal, the monthly payment must be calculated using straight-line amortization for the term of the loan, not to exceed five years, with the first payment due within 45 days of the closing date. The proposed rules also prohibit loan terms that permit a borrower to defer repayment of principal or interest." Regulation Z requires that loan disclosure calculate the APR using simple interest. Credit unions use simple interest in applying the monthly portions of principal and interest on auto loans. While the payment remains the same each month, the amount applied to principal increases as the amount applied to interest decreases monthly. Please insure that straight line depreciation simply means that the payment amount must not change from month to month; that it is permissible under such straight line depreciation for the amount applied to principal and interest monthly vary as the balance of the loan decreases. The proposal then makes this comment about Commercial Loans: "(3) Loan payments required under the loan agreement are: (i) Based on straight-line amortization of principal and interest that fully amortize the debt over a term that does not exceed five years from the date of

origination; and ." With regard to commercial loans, the regulation does require straight-line amortization of principal and interest. I have not done commercial loans. You might ask commercial loan issuers if their software allows for equal payments to both principal and interest over the life of the loan. It probably does for commercial loans. However, that is not the case with standard auto loan software, especially in credit unions, as I mentioned above. My Fifth Comment: If the statute prohibits the loans from exceeding five years, you cannot squeeze 60 payments into five years unless the first payment is due within thirty days of loan origination. This will be the end of the 60 month auto loan for anyone whose first payment is more than 30 - 31 days from the origination date. While the maturity of the loan may not exceed five years, you can be sure that the payments will exceed five years because a lot of
people send their payment in a little late every month. We'll let the securitizers worry about that. My Sixth Comment: Dealer Imposed Fees. "4. Loan-to-Value "Limitations relative to the amount financed are critical for automobile lending because the collateral is subject to such rapid depreciation. Therefore, under the proposed rules, an originator must document that, at the time of the closing of the automobile loan, the borrower tendered a minimum down payment from the borrower's personal funds and trade-in allowance, if any, that is sufficient to pay (1) the full cost of vehicle title, tax, and registration fees, as well as any dealer-imposed fees, and ." "Dealer imposed fees" is nebulous. Mechanical break-down insurance, credit life and disability, life-time warranty and repair programs are all voluntary, not dealer "imposed." Clarify whether you want such voluntary options to fall under the definition of 'dealer imposed fees'; or if they are otherwise to be excluded from the
actual price of the car. It is not uncommon for GMAC or similar lenders to charge a $500 lease/loan preparation fee. My Seventh Comment: Title holding states. Page 47 of proposal. "In addition, under the proposed rules, the transaction documents must require that the originator, subsequent holder of the loan, or any agent of the originator or subsequent holder maintain physical possession of the vehicle title until the loan is repaid in full and the borrower has satisfied all obligations under the loan agreement." This was obviously not written by someone familiar with auto financing. To my knowledge, very few states require the first lien holder to hold the title to vehicles. Nearly every state sends the title to the registered owner. In non-title holding state, lenders can have the title sent to the lender if the lender submits the proper paperwork to have this done. A title is not required in the event of default and repossesson in most states. The repossession agency simply applies for a 'repossession title' by submitting a copy of the security agreement to the appropriate secretary of State. Only a few states still require the lien holder to hold the title. To require every vehicle securitized in an ABS to have a title held will do very little to expedite or insure the integrity of the pool of loans in the ABS. You should simply ask for a copy of the title to be kept with the loan documents. That insures that the purchaser actually did apply for the title on the used car. We have hired a service that contacts members to insure they send us a copy of the title, which often takes ten to fourteen days to receive from the Secretary of State. My Eighth Comment: "The proposed rules also prohibit loan terms that permit a borrower to defer repayment of principal or interest." This makes good sense. However, someone will fall behind in payments. At that time, a month or two extension will keep the borrower on track to pay back the entire debt. Such a short extension is preferable to a repossession. Repossessions are always money losers. My Ninth Comment: In an age when borrowers are accustomed to putting no money down and financing 115% of the price of the vehicle, this regulation is

requiring borrowers to come up with at least 40% of the purchase price of an auto. That won't happen. It requires a 20% down payment, plus 10% (roughly) to cover taxes, title and license, and 10% (roughly) for add-ons such as mechanical break-down insurance, credit life and disability insurance. You might as well simply prohibit ABS secured by autos. This provision will have the same effect. When I started in the business in 1968 and even a Cadillac cost only $3,500, it was not uncommon for people to find 20% for a down payment. Not today. It is really rare for a borrower to have any down payment. People are accustomed to 100% financing. Very few auto loans will be securitized, thus impeding liquidity available for additional auto loans. My Tenth Comment:
Model year and current model year. Page 84 of proposal. "(6) If the loan is for a vehicle other than a new vehicle, the term of the loan (as set forth in the loan agreement) plus the difference between the current model year and the vehicle's model year does not exceed five years." This is very problematic. If you go to http:/ /ww w. edmunds.com/futuremodels/2012/ you will see the estimates of the 2012 model change over dates for over 300 models of cars and trucks. There is no set date for every model to change nor any reason for a requirement for manufacturers to publish or adhere to a particular model year change date. Consequently, since model years change any time throughout the year, with the majority changing mid-year; and since in my forty years of financing autos I have never seen a model year change over schedule published, might I suggest that you simply choose a date which the originators and securitizers are mandated to use for purposes of this provision. Otherwise they will be required to call manufacturers and dealers on the date a loan was made and ask if the new model for that particular car was introduced on the date the loan was issued. How would they document that model year change over date? From my experience, I would suggest that you use August 15th as the model year change over date for all vehicles for purposes of this provision and disregard the actual model year change over date. Keep it simple. My Eleventh Comment: 116. Are there additional or different standards that should be used in considering how a borrower's credit history may affect the likelihood that the borrower would default on a new mortgage? To my knowledge, the best predictor of default is the level of unsecured debt to income. As a rule of thumb, we have found that: Unsecured Debt Ratio: 30% or higher Danger. Bankruptcy likely. 21% to 29% High Risk. Stop. Look carefully. 11% to 20% Medium Risk. Slow down and look. 0% to 10% Low Risk. Go ahead. Probably not a bankruptcy threat. My Twelfth Comment: 117(a). Should the Agencies include minimum credit score thresholds as an additional or alternative QRM standard? I would not recommend establishing a threshold that gives a green light to avoiding standard underwriting provisions. Nor would I consider a threshold below which someone should not be approved for a mortgage. That might disenfranchise the poor. The credit scores are good but in themselves should not approve or disapprove an applicant. My Thirteenth Comment: 118. The Agencies request comment on the appropriateness of the safe harbor that would allow an originator to satisfy the documentation and verification requirements regarding a borrower's credit history by obtaining credit reports from at least two consumer reporting agencies that compile and maintain files on consumers on a nationwide basis. I think this safe harbor, as stated, is very appropriate and easonable. My Fourteenth Comment: Page 89: "3. Analyzing a Borrower's Employment Record a. When analyzing the probability of continued employment, lenders must examine: i. The borrower's past employment record ii. Qualifications for the position iii. Previous training and education, and iv. The employer's confirmation of continued employment." Strike 3aii, and iii from the regulation. What in the world makes a loan underwriter qualified to determine whether someone is fit for their job they are holding down. That is

their employer's responsibility. All the underwriter should concern themselves with is how long has someone been employed in their position and the prospect of their continued employment. 3aiv. This question is presently on most employment verifications. Often it is left unanswered. As an employer, I would not answer it. The employer would be cutting their own throat. It could be used against them by the employee if the employee were discharged or laid off.

Cordially submitted by:
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Union