Home
Loan and
Investment Bank, F.S.B.
"A Federal Savings Bank"

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Executive Vice President
Legal Counsel

Manager
Dissemination Branch
Records Management and Information Policy
Office of Thrift Supervision
1700 G.Street, NW
Washington, DC 20552
Attention Docket No. 2000-15

Dear Manager,

I am writing in response to the request for comments regarding the proposed rule regarding capital treatment of certain recourse obligations, direct credit substitutes and securitized transactions. Specifically I would like to comment on the proposal as it relates to Representations and Warranties.

As an individual who has the duty to review loan purchase and sale contracts provided by a number of purchasers we are particularly anxious for guidance as to which type of language in these contracts will result in recourse obligations to our institution. Increasingly we are presented with contracts which in our opinion transfer significant risk of loss to our institution if the contract language is not altered. In some cases we have been unable to execute such contracts as no common ground could be reached with investors as they found our position unreasonable since they were purchasing loans from a number of other depository institutions which had not raised similar concerns.

Among the issues of greatest concerns are:

1 Variation in appraised value. Many contracts require that we warrant that the value of the collateral on the appraisal in connection with the loan be correct within a certain tolerance (usually 10%). We believe such language warranting the specific value, even within a tolerance, is not acceptable and constitutes a recourse obligation to the institution. We do not believe a representation that the appraisal was done in conformity with some industry standard would constitute recourse.

We have also encountered language that the purchaser has a period of time to conduct a reappraisal and can then require repurchase of the loan within some timeframe if the appraisal does not meet their standards. We believe such language should be treated as a recourse obligation until such time as the period for repurchase has expired.

2. Delinquency of Payment. Many contracts require the seller to repurchase a loan if the customer's first payment to the buyer becomes delinquent. We believe that this language represents a recourse obligation until such time as the period for repurchase of any such loan has expired. We believe if the contract requires buyer to notify seller of the existence of any such loan within a certain number of days following the default by the borrower, the recourse obligation ceases as to any loan for which seller has not been so notified.

In addition, we have seen a number of contracts which require that the seller represent that they know of nothing which would cause the loan to become delinquent or to adversely effect the marketability of the loan. We believe such language to constitute recourse without some limiting language by the seller to the effect that "other than disclosed to buyer in the file or otherwise in writing". This would seem to limit buyers' ability to require repurchase of a delinquent loan when the facts were previously disclosed to buyer.

3. Fraud. We do not believe a representation that there has not been any fraud in connection with the loan on the part of the borrower to constitute recourse. As long as the institution has an established underwriting process and undertakes reasonable precautions in connection with the origination of the loan it does not appear that such a representation should be recourse.

4. Environmental hazards. A number of contracts including those involving residential dwellings are requiring representations relating to environmental conditions of the collateral. In a residential setting it is entirely impractical to obtain an environmental assessment on each property. We believe a representation which is limited to the effect that seller has no knowledge of any such hazard should insulate the institution from repurchase and thus should not constitute a recourse obligation. In fact one could argue that in most circumstances the risk of loss in a residential setting is so small that such a representation absent the limiting language would not be recourse.

The last issue for which we would like to provide comment relates to premium refunds in a number of purchase agreements. We do not believe the existence of a premium refund obligation should provide a recourse obligation to the institution. Generally speaking the premium received is a small percentage of the loan sold. It seems inappropriate that a loan sold for a one-point premium would be charged to the capital of the selling institution even using low level recourse rules. In addition, the refund does not provide credit support for the whole transaction but merely for those loans which pay off within the stated time period.

We believe the better treatment of premium refunds is to require the establishment of a reserve in connection with the premium received based on estimates of prepayments during the recapture period. For example if one were to receive $10,000 of premium from a loan sale that $1,000 be set aside as a reserve for expected recapture of premium during the recapture period, based on the seller's experience in similar transactions. The risk of loss in these transactions is really no different than when one purchases an interest only strip. If the underlying loan pays early the asset disappears. What should happen is that the valuation of the asset reflect reasonable expectation of the performance of the underlying collateral.

Thank you for the opportunity to express my opinion of the proposed regulation. Please advise if you have any questions.

Sincerely,

Edwin Furtado