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Downey Savings Fax Cover Sheet

Date: 5/23/01

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Name: Manager, Dissemination Branch
Information Management and Services Division

Firm: Office of Thrift Supervision

Facsimile Number: 202-906-7755

From: Lillian Gavin - 949-509-4590

Number of pages being sent (including this cover): 3

Regarding: Docket No. 2001-14 - Capital: Qualifying Mortgage Loan, Interest Rate Risk Component, and Miscellaneous Changes.

Please disregard the letter previously sent via fax on Docket No. 2001-14 due to a typographical error.

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Lillian E. Gavin
Executive Vice President

VIA FACSIMILE

May 14, 2001

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

Attention: Docket No. 2001-14

Re: Capital: Qualifying Mortgage Loan, Interest Rate Risk Component, and
Miscellaneous Changes

Ladies and Gentlemen:

Downey Savings and Loan Association, F.A. ("Downey Savings") is a federal association headquartered in Newport Beach, California, with assets of \$11 billion. Downey Savings welcomes the opportunity to comment on the proposed changes to the Office of Thrift Supervision ("OTS") capital regulations. Overall, Downey Savings is pleased that the OTS is taking appropriate steps to align its capital regulations more closely to those of the other banking regulators. Our comments on the proposal are detailed below.

- **One to four-Family Residential Mortgage Loan** - We concur that the loan to value (LTV) ratio is an appropriate standard to apply when evaluating credit risk and determining capital levels commensurate with such risk. We also concur with the OTS' proposal to revise its definition of qualifying mortgage loan to include all loans with LTV ratios below 90 percent, thereby subject to a 50 percent risk weight. The proposal is consistent with existing regulatory guidance set forth in OTS Regulations Section 560.101 (Real Estate lending standards). Given the definition's reliance on LTV ratio, it appears appropriate that the OTS give consideration to other types of credit enhancement such as cash collateral and irrevocable letters of credit to determine the LTV ratio and required capital. Likewise, and also consistent with the Real Estate lending standards, the qualifying mortgage definition should explicitly consider the effect of mortgage insurance when determining LTV ratio and overall credit risk. That is, if mortgage insurance lowers the loan's effective LTV ratio to below 90 percent, then the loan, absent other factors such as 90-day delinquency, should be risk weighted at 50 percent as well.
- **Reevaluation of loan collateral** - Savings associations are required to maintain capital levels and loss allowances commensurate with the risk of their loan portfolio. Admittedly, credit risk changes throughout the life of the loan as real estate markets and economic conditions fluctuate. With some exceptions (as noted below), capital requirements should be based on the LTV ratio at origination, as loss allowances are intended to capture subsequent changes in credit risk. Periodic reevaluations of the loan collateral should only be an option to savings associations when an increase in the

Downey Savings and Loan Association, F.A.

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Manager, Dissemination Branch
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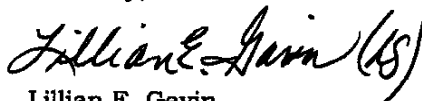
loan principal balance (whether the result of subsequent advances or negative amortization) triggers a higher capital requirement. As for the timing of these reevaluations, it would appear appropriate to limit them to no more frequently than once a year. Finally, if reevaluations are also required in a declining real estate market, it is also appropriate to establish the original collateral value as the lowest value required when determining the LTV ratio for risk-based capital purposes. This is consistent with historical regulatory treatment.

- Loans with negative amortization features - Downey Savings, like many OTS regulated lenders in the West Region, originates adjustable rate mortgage loans with negative amortization features. When the capital regulations were initially drafted and released, the OTS considered and, at that time, dismissed the need for a higher risk-based capital requirement for these loans. Nonetheless, the proposed change in regulation (and attendant regulatory perspective and application) appears appropriate. We acknowledge that negative amortization and the resulting increased LTV ratio may indicate increased credit risk exposure thereby requiring higher capital allocations. Therefore, we concur with your proposal to require a 100 percent risk weight to loans that negatively amortize to an LTV ratio of 90 percent or more regardless of the reason that caused the negative amortization, as the resulting credit risk exposure is the same.

Finally, we concur with the OTS' proposal to eliminate (1) the capital deduction for nonresidential and land loans with high LTV ratios and (2) the interest rate risk component of the risk-based capital regulations. In addition, we concur with the proposed increase in the risk weight to all stripped, mortgage-related securities.

We appreciate the opportunity to comment on the proposed changes to the regulations.

Sincerely,



Lillian E. Gavin
Executive Vice President
Director of Compliance
and Risk Management