WORLD SAVINGS®

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May 11, 2001

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

Attn: Docket No. 2001-14

World Savings Bank, FSB, Oakland, California ("World") appreciates the opportunity to comment on the OTS' proposal to revise the capital regulations to conform more closely to those of the other banking regulators. We strongly endorse the proposal to increase the loan to value (LTV) ratio from 80% or less to under 90% to qualify for the 50% risk weight for risk-based capital purposes. In addition, although we believe it could have added value, because no other bank regulators have adopted an interest rate risk component in their risk-based capital regulations, we concur in OTS' proposal so to delete it.

Increasing the LTV for Qualifying Mortgage Loans

Under current OTS regulations, a mortgage loan qualifies for the 50% risk weight if its LTV is 80% or less at origination (Section 567.1). The OTS is proposing to increase the LTV of a mortgage loan that qualifies for the 50% risk weight ("qualifying mortgage loan" or "qualifying loan") from 80%, or less, to less than 90%. This proposed change would put OTS-regulated savings institutions on a more equal footing with other banking organizations. OTS-regulated institutions should not be disadvantaged relative to other insured institutions in the mortgage business, and we agree with this change.

In addition to the LTV increase, the OTS is proposing to change the date of the test for qualifying mortgage loans from the date of origination to the current date, i.e., change the test from the original LTV to the current LTV. Using the current LTV will ensure the appropriate risk weight on loans where the balance has increased (or decreased), including loans with negative amortization, loans with seconds or equity lines of credit (ELOCs) added, loans refinanced with cash out, or loans refinanced or modified with transaction costs added to the existing balance. World agrees that a current LTV measure is more appropriate when the maximum LTV on a qualifying mortgage loan is set at under 90% rather than 80% or less.

However, the proposal is silent on the frequency of the measurement of the current LTV for risk- weighting determination purposes. OTS should clarify the measurement frequency in the final regulation. One possibility is to determine the current LTV each

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quarter, because the Thrift Financial Report (TFR) reports asset balances in each risk-weight category.

Value Reassessment

OTS requests comment on whether a savings association should be permitted to use a current value to determine whether a mortgage meets the definition of a qualifying loan. Before making our recommendation, we would like to provide some background on this topic.

During the life of a residential mortgage loan, its balance normally changes month to month. Usually, the balance decreases due to amortization. However, the balance can occasionally increase, usually only for limited periods of time, on loans that allow negative amortization. Also during the life of a loan, the property's value usually changes. Over the long term in most geographic markets, values go up gradually, although they can spike in hot markets or decline temporarily due to recessions or market corrections. The upshot is that a mortgage's LTV changes continually throughout the life of the loan.

While the new loan balance is recorded every month, the new property value is usually captured only under certain circumstances. Here are two examples:

- It is common to update the value of a property when a borrower applies to refinance the loan or to add a second or an equity line of credit (ELOC) behind the first.
- Mortgage insurance can be discontinued if a new valuation results in a current LTV below 80%.

Thus, at the present time, except in the special circumstances noted above, most ongoing LTV calculations are based on the current loan balance divided by the original property value.

Ideally, institutions would update both loan balances and property values every quarter in their risk-based capital calculation. However, at the present time, the technology does not exist to update property values quarterly on a cost-effective basis. A reasonable alternative is to perform value reassessments for individual loans or groups of loans where their LTV has likely gone above or below 90%. Two examples are: qualifying loans with negative amortization whose LTVs based on the original value are approaching 90%, or loans with original LTVs of 90% or more where the security properties have experienced value appreciation such that the updated LTV will likely be below 90%.

World recommends that OTS allow savings institutions to use current property values to determine whether a loan meets the definition of a qualifying loan. In particular, institutions should be allowed to perform value reassessments of properties securing individual loans or groups of loans where the expected current LTV is close to 90%. OTS should not require institutions to update the property values on all the mortgages held in portfolio on a quarterly basis, as this is not practical.

There is a risk that institutions will use current updated property values to game the proposed regulation. For example, when property values are updated, only those that have increased might be used, while those that have decreased would not be used. OTS should make it clear in the final regulation that such gaming would not be tolerated. In addition, the examination process should review institutions' processes for reassessing property values to assure reasonable and consistent methodologies are being applied.

Utilization of Credit Enhancements

Mortgage insurance rules and practices have been firmly established for many years. Extending credit enhancement opportunities beyond existing mortgage insurance opens up a plethora of issues including how to establish that a guarantor is sound, what kind of credit coverage is supplied, and how the overall credit risk to the banking system might change. As a consequence, we believe the existing mortgage insurance rules should not be changed, and OTS should not allow any other credit enhancement mechanisms or types of guarantors. However, if OTS decides to expand the allowable types of credit enhancements and credit enhancement organizations, we suggest that the following principles should be followed to ensure that credit enhancements are meaningful:

- The guarantee should be done on a loan by loan basis, rather than on a pool or some other basis. It is important that credit enhancements be applied on a loan by loan basis, since that is where the risk lies. Allowing credit enhancements to be applied on a pool or other basis could enable institutions to manipulate the results and could lead to a higher overall credit risk within the banking system.

- Guarantors should have adequate strength and independence. Guarantor strength is obviously necessary to ensure that losses can be mitigated in difficult credit environments. Furthermore, there should be complete independence between the guarantor and the insured institution in order to ensure that the risk inherent in high LTV loans is fairly evaluated at arms length.

Deleting the Interest Rate Risk Component of Risk-Based Capital

OTS proposes to delete § 567.7, which provides for an interest rate risk component of risk-based capital in the form of an explicit capital deduction from total capital for institutions with above-normal levels of interest rate risk. In practice, however, other banking agencies never adopted a similar interest rate risk rule, the Acting OTS Director twice waived the effective date of the rule, and the OTS rule has never gone into effect. Therefore, we concur with the proposal that § 567.7 be deleted.

Sincerely,

Dan R. Dixon
Group Senior Vice President