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September 10, 2002

Information Collection Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552

Re: "TFR Revisions, OMB No. 1550-0023"

Dear Sir or Madam:

The Coalition for Savings Associations appreciates the opportunity to comment on the federal banking agencies' (hereinafter collectively referred to as "the Agencies"¹) Notice of Proposed Rulemaking ("NPR") concerning the Proposed Agency Information Collection Activities; Comment Request, Vol. 67 Federal Register No. 134, p. 46250 (7/12/02). The Coalition is composed of savings and loan holding companies ("SLHCs") whose subsidiaries engage in an array of financial activities, including a wide range of consumer lending.

On January 31, 2001, the Agencies issued a directive to their examining personnel establishing new standards for examination and supervision of financial institutions with subprime lending programs. The Agencies, as part of that directive, defined the characteristics of a subprime program. At that time it was feared by the Coalition members that the definitions would impose a rigid and artificial class of "subprime" borrowers resulting in a dramatic decrease in available regulated credit to millions of consumers. Because the definition was part of an examination guidance, there was no opportunity for public comment.²

¹ The Agencies include the Office of the Comptroller of the Currency, Treasury, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and the Office of Thrift Supervision.

² The Coalition did respond to the Guidance by sending a letter on April 30, 2001, to all of the Members of the House Financial Services Committee and the Senate Committee on Banking, Housing and Urban Affairs. The Coalition felt a compelling need to get its opposition on record since there was no opportunity to comment on the guidance.

The NPR for proposed agency information collection activities published in the Federal Register on July 12, 2002, provided that banking institutions that have 25% or more of their Tier 1 capital in subprime lending programs must file additional loan information in their quarterly Call Reports or TFRs to their regulators. For the purposes of applicability of the proposed disclosures, the definitions of "subprime" and "program" issued as part of the January 2001 guidance are adopted in the NPR. This is a notable and important component of the NPR as it represents the first time that a definition of "subprime" would be included as part of a federal regulation.

This procedural tack by the Agencies is an even more egregious violation of due process than the original guidance wherein no comments were sought. By "piggy-backing" the definitions onto a rulemaking regarding disparate proposals, the Agencies attempt to give the "subprime" definition in the guidance the authority of federal regulation without ever exposing it to the glare of public comment. This significant policy action cements the creation of a federal standard defining subprime lending that already has and will continue to shrink credit to many low and moderate-income individuals. A move of this magnitude without express Congressional approval is unwarranted.

According to the definition folded into the NPR from the guidance, "subprime borrowers," are those whose credit history includes one or more of the following:

- Two or more 30-day delinquencies in the last 12 months, or one or more 60 day delinquency in the last 24 months;
- Judgment, foreclosure, repossession, or charge-off in the prior 24 months;
- Bankruptcy in the last 5 years;
- Relatively high default probability as evidenced by, for example, a credit bureau risk score (FICO) of 660 or below (depending on the product/collateral), or other bureau or proprietary scores with an equivalent default probability; and/or;
- Debt service-to-income ratio of 50% or greater, or otherwise limited ability to cover family living expenses after deducting total monthly debt service requirements from monthly income.

A conservative interpretation of the definitions would suggest that a borrower that meets any one of the five criteria could be classified as subprime. These definitions radically expand the universe of "subprime" borrowers. Using only one of the five criteria, (the FICO score), as many as 50% of U.S. adults would be deemed "subprime" borrowers. Credit bureau data indicate that approximately 30-35% of the U.S. adult population has a FICO score of 660 or below. In addition, approximately 10-15% of the adult population has no FICO score, meaning they too could be deemed "subprime." If the four other evaluation criteria are added to the FICO score test, the percentage of American adults who could be classified as "subprime" could well exceed 50%. For specific demographic groups, including many urban and rural populations, the statistics are considerably higher.

Now that all of the members of the Coalition have undergone examinations under the guidance, it is readily apparent that the initial worst fears of the Coalition regarding the application of the guidance's definitions of "subprime" and "program" have been realized. We warned in our letter to legislators when the guidance was released that under the rigid standards, lending institutions would be severely penalized for lending in the subprime market by being compelled to dramatically raise their capital and reserve levels. In fact, the guidance instructed examiners to expect capital levels to be increased anywhere from 150% to 300%. We also warned that this enormous universe of "subprime" consumers would see regulated credit availability shrink and the costs of that limited credit skyrocket. After undergoing the examination process under these standards, the members of the Coalition can attest that these predictions unfortunately have come to fruition.

The Coalition acknowledges that the NPR states that the list in the definition is illustrative rather than exhaustive, however, our members' experience in the examination process does not bear this out. Rather than exercising a bank-by-bank or loan-by-loan analysis in the examination process, this list has become a net for regulators to put loans into, regardless of the internal bank analysis of the loans. Furthermore, the definition would codify the applicability of FICO score analysis in categorizing borrowers. The Coalition is troubled by this step because it blesses the analysis of one private company (Fair Isaac) over the internal analyses of the institutions actually making the loans. This is especially concerning since few lenders use FICO scores as the sole criteria in credit decisions and many do not use the scores at all. In fact, because FICO scores can vary significantly over short periods of time, lending to people over the 660 threshold could be negatively impacted as well.

It is understandable that when examiners are given such explicit criteria, it is far less complicated simply to categorize a borrower as "subprime" if he or she meets one of the criteria rather than undertake the detailed analysis to determine that the borrower is not "subprime" or that the loan does not merit any special capital or loss allowance treatment. The members of our coalition, however, do undertake the detailed analyses to determine the risk exposures presented by their customers and often find that the consumers that would fall under the "subprime" definition of the guidance qualify for a wide range of preferred credit options.³

Bank examiners have categorized large portions of loans in portfolios as subprime under the January 2001 guidance and consequently required substantial increases in capital and loss reserves associated with the loans. These increases have fallen in line with the Agencies' expectations. The increased cost of doing business in what the Agencies have defined as the subprime market has caused many lenders to simply stop serving the market. This market consists of tens of millions of real people with real credit needs. The trends indicate that the shrinking of available credit to these consumers included in this arbitrarily defined universe of subprime could trigger a "credit crunch"

³ For example, it is ludicrous to assert that a borrower with a FICO score of 650 and an otherwise long and perfect repayment history is "subprime."

and force a large segment of the population into more costly and/or unregulated alternatives such as payday lenders or pawn shops. Essentially, the definition has had the result of regulatory redlining.

We do not dispute that the Agencies serve an important role in the supervision of the risk that institutions pose to consumers and the deposit insurance funds. However, taking the definition of "subprime" from what has turned out to be a disastrous examination internal guidance and "bootstrapping" it into the Code of Federal Regulations as part of bank disclosure requirements is a dramatic overreach by regulators. The overzealous regulation come at a very high cost – the economic vitality of low and moderate-income families. These families often need credit not only to finance purchases over time, but also to participate in many facets of the economy, *e.g.* making purchases on the internet, renting a car or booking air travel.

Soon after the January 2001 guidance was issued, Federal Reserve Board Chairman Greenspan commented, "Lenders and their supervisors should be mindful that in their zeal to make up for past excesses they do not overcompensate and inhibit, or cut off, the flow of credit to borrowers with credible prospects." Months earlier, Comptroller Hawke noted, "While there is clearly a need to address the real abuses that exist, there is also the need to preserve and encourage, to the greatest extent possible, consumer choice, and competition among responsible lenders in the provision of financial services to low and moderate-income families." In the current economic environment, which has been kept afloat due to consumer spending and the mortgage market, it is a mistake to ignore these admonitions for the sake of more easily categorizing and monitoring certain loans.

The definition of "subprime" found in the January 2001 guidance was not submitted for public comment prior to its implementation by examiners. The effect of the guidance was a significant policy shift in this country by the Agencies away from recognition of the increasingly sophisticated and detailed risk models that allow lending institutions to compete effectively for customers without assuming undue risk. This policy shift is one that affects the ability of a large segment of the U.S. population to obtain credit. It would seem that a decision to shut those people out of a competitive and well-regulated credit market by making it prohibitively expensive for institutions to serve those people is one that should not be made through the Agencies' imposition of arbitrary examination standards. Adoption of the "subprime" definition for the purposes of the current NPR on information collection activities represents codification of a policy position that has never come under the microscope of public hearings or comment.

We respectfully submit that examiners at the Agencies have for many years have had the tools with which supervise and correct the lending activities of financial institutions that pose specific threats to consumers and/or the deposit insurance fund. Continued usage of the January 2001 guidance on subprime lending programs and the codification of it definition in this NPR will only serve to impede the ability of many to obtain regulated credit on reasonable terms and stunt the growth of legitimate companies

that safely provide credit to those people on competitive terms.⁴ Accordingly, we urge that the Agencies abandon the usage of arbitrary standards in categorizing borrowers and withdraw the current NPR.

⁴ The Coalition also submits that the fact that the NPR would apply only to institutions with 25% or more of their portfolios in subprime programs is anti-competitive and fails to serve the stated purposes of proposal. If the Agencies want to get a more comprehensive understanding of what they define as the subprime market, it is important to use a much lower threshold so that bigger institutions with large subprime portfolios in terms of dollar amounts are included in the inquiry.

Again, we appreciate the opportunity to comment on the Notice of Proposed Rulemaking. If you have any questions regarding this comment or would like to discuss the matter, please do not hesitate to contact us.

Sincerely,

Timothy W. Jenkins
Executive Director
Coalition for Savings Associations

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