April 20, 2000

Mr. Alfred Pollard
General Counsel
Office of General Counsel
Office of Federal Housing Enterprise Oversight
Fourth Floor
1700 G Street, NW
Washington, DC 20552

Re: Risk-Based Capital
65 Fed. Reg. 13251 (March 13, 2000)

Dear Mr. Pollard:

America's Community Bankers (ACB) is pleased to offer some further comments on the issues raised by the rulemaking on the capital standards to be applied to the secondary mortgage market government-sponsored enterprises. ACB represents the nation's community banks of all charter types and sizes. ACB members pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities. Since mortgage finance is a core business for ACB's members, and since the activities of the GSEs have such a significant impact on the mortgage market, the provisions of the final rule to be promulgated by the Office of Federal Housing Enterprise Oversight are of great interest to ACB.

ACB staff have reviewed the comments that have been filed with OFHEO, though the length and complexity of some of those submissions, including the two from the GSEs themselves, would require more time for a full analysis than the month allowed for providing these additional comments. Some common themes have emerged from the comment process and ACB is pleased to offer some further suggestions to OFHEO.

One threshold issue that has to be settled is that OFHEO must apply the statute as the Congress wrote it, not as some of the commenters would prefer the language to read. It is true that the methods of risk measurement, monitoring and management that are commonly used in the private sector have evolved since the early 1990s and that the Congress might well revise the statutory approach if the legislation were being developed currently. Nonetheless, OFHEO must deal with the statutory stress test as it is and make it operational. Comments proposing a value-at-risk approach instead of the stringent statutory stress test simply miss the point as far as offering useful insights to OFHEO in this rulemaking.

More useful is the general consensus that the regulatory-model-based approach proposed by OFHEO is indeed consistent with those statutory instructions. This has been agreed to by the GSEs themselves, and the issue at this point should be finding the most efficient way for OFHEO to apply its model to both GSEs in an even-handed way.

ACB strongly supports all efforts by OFHEO to secure the resources needed to exercise its vital oversight functions. ACB agrees that OFHEO should be the judge of the level of resources needed to ensure the adequate capitalization of the risks assumed by the GSEs and the appropriate scope of the financial research and examination capabilities for that purpose. ACB does agree with the GSEs that it is in everyone's interest for the oversight process to be handled in the most efficient manner possible. Thus, ACB suggested that it would be desirable for OFHEO to release the full specifications and computer code of its model so that the GSEs could rationally plan their operations and implement efficient capital management strategies.

ACB also believes that a reasonable and efficient approach to the quarterly application of the OFHEO-developed model to the data of the GSEs would be to task the GSEs with running that OFHEO stress test model internally each quarter under the supervision of OFHEO examination staff, with a report of the results to be immediately reviewed by the research and supervisory personnel at OFHEO. This would avoid the legitimate concerns of OFHEO over initial suggestions that the stress testing be done via an 'internal models' approach.

OFHEO correctly cited problems with achieving consistency between the two GSEs if a supposedly common stress test were to be run on two separate platforms. It would be next-to-impossible to ensure that each entity was handling the required test scenario in exactly the same manner. This would not be a concern if the model were clearly the same, with that assurance coming from the use of the OFHEO code for the core of the exercise, but simply run 'in house' by each GSE under 'laboratory controls'.

The benefit would be the speedier application of the test and the elimination of the data export/import lag. ACB is interested in these operating efficiencies strictly because ACB foresees significant challenges in calibrating the stress scenario to the somewhat broader range of activities and markets where the GSEs are currently and increasingly engaged. ACB feels that the allocation of effort, resources, and attention from OFHEO to adapting the stress test approach to these new areas should have the highest priority. The debate over the operational details of the way the OFHEO deals with the standard book of GSE business should be declared over. From a strategic perspective, the viewpoint taken originally by OFHEO has clearly, and quite rightly, prevailed.

Even within the standard book of first lien mortgage business, ACB agrees with several other commenters that it is important for OFHEO to undertake the recalibration of its benchmark loss and stress test scenario to reflect changes in underwriting standards to incorporate credit scoring and even mortgage scoring techniques. Obviously, this concern applies a fortiori to any significant move by the GSEs into subprime and junior lien, especially open-ended, credit extension. ACB suggested an approach whereby these lines of business are calibrated to equivalent first lien product at given loan-to-value ratios. Similar suggestions were made by other commenters. ACB recommends that the final rule indicate how and when these new components of the GSE book of business will be handled from a capitalization perspective. ACB understands that the issue of mission appropriateness is separate from this rulemaking.

ACB sees merit and significance in another common thread of the submissions: the suggestions for a revision of the treatment of the GSEs' multifamily loan portfolios. It would be reasonable for OFHEO to adopt a simplified approach as an interim measure and to focus research resources on how best to improve the collection of data on this book of business and how to recalibrate it to the benchmark loss experience. ACB anticipates that this component of the GSEs' activities will increase significantly under whatever may be the exact form of the revised housing goals that are currently under separate consideration by the Department of Housing and Urban Development, the sister mission regulator for the GSEs.

ACB also concurs with the suggestion from others that OFHEO reexamine the severity of the 'haircuts' that are given to the credit enhancements/support from GSE counterparties. ACB agrees that it is vital for the true level of support from these sources to be assessed in the determination of required GSE capital. However, the discounts do seem to be severe across the board and to be particularly severe in the cases of depository institutions and below-triple-A mortgage insurers.

ACB does not support a uniform 'rating' for all credit enhancements from approved private mortgage insurers, no matter what the differences in their financial condition. On the other hand, ACB also suggests that the relatively modest differences in claims paying capacity across PMI providers are not being correctly 'mapped' into projected levels of performance on financial guarantees written. ACB does agree that it is appropriate to generate incentives within the modeling process for credit-enhancing counterparties to secure the highest quality ratings. This can be achieved with more realistic performance differentials.

Finally, ACB would support a reexamination of the treatment of GSE operating expenses in the stress period. Some commenters noted that GSE operations would be curtailed in the stress scenario since it is assumed that no new business is being booked. Others noted that collection efforts would be far more extensive and costly since defaults on both underlying mortgages and financial guarantees would be far more frequent. Both points are valid. ACB would support more detailed analysis of the net impact of these opposing forces and application of the results in the model's specifications.

Overall, ACB has been impressed by the quality of the input generated by the comment process. ACB also expects that the development of the oversight procedures by OFHEO will be a process rather than an event. As noted above, ACB expects that OFHEO will continue its efforts to align the model and its benchmark loss approach to the current operations of the GSEs. ACB would be happy to continue its own dialog with OFHEO on these matters in an effort to ensure that OFHEO finds the most efficient way to meet the Congressional mandate in its oversight of these important mortgage market participants. If you have any questions on the views expressed in this letter, please contact the undersigned at (202) 857-3118.

Sincerely,

[Signed: Brian Smith]

Brian Smith

Director of Research & Policy Research

America's Community Bankers, 900 Nineteenth St., N.W., Suite 400, Washington, D.C. 20006

phone 202-857-3100 | fax 202-296-8716 | info@acbankers.org