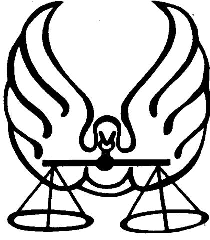

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Executive Director:
John E. Lind

19 February 2010

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: RIN # 3064-AD55
12 CFR Part 360

Dear. Mr. Feldman,

I am writing in regard to this ANPR because I serve as a consultant to a number of institutional investors which have social concerns in addition to investment concerns. Over the past year we have had 13 meetings with eight major servicers of residential housing loans handling about two thirds of all U.S. housing loan servicing. Our concern has been that these servicers provide loan modifications to keep as many troubled borrowers in their homes as possible and thus prevent price declines and community deterioration while still providing the maximum return to the owners of the loans.

We have been particularly concerned with the adequacy of the servicing of loans that were securitized and serviced for others. As the OCC-OTS Mortgage Metrics Reports (pp. 25 and 33, Third Quarter 2009) have shown with the comparison between the servicing treatment of portfolio loans and privately securitized loans, the modifications of the privately securitized loans have much greater re-default rates that those of the portfolio loans. These differences arise because of the servicers concerns regarding the possible limitations imposed by the Pooling and Servicing Agreements of the securitizations and the additional costs to the servicer. Thus it is out of these discussions with bank servicers that I make these comments. I believe that the proposed regulations could have a significant positive impact upon the servicing of loans that have been securitized. These regulations would push the present re-REMICs market as well as prevent non-transparent securitizations in the future.

A concern of mine is the need for adequate funding of servicers to provide the necessary loan modifications. In our discussion with primarily subprime servicers, it was obvious that they could charge the additional work required for a good loan modification, while they sold off any other servicing for loans like FHA to other servicers because FHA did not provide enough servicer funding to cover their work. Servicing costs per loan of subprime servicers were shown to be about 10 times the cost for prime servicers according to Mortgage Servicing News (February 2010).

I will now proceed through the questions raised in the ANPR, singling out those to which I can comment meaningfully on the basis of our discussion with servicers and further analyses. **These comments are totally those of this author and not those of any of the investors for whom I consult.**

General Questions:

1. and 2. I am not qualified to comment on questions 1 and 2.

> However, a major concern that cannot easily be dealt with by the FDIC is the question of **piggyback loans** and their modification. With 80-20 or 80-10-10 loans, there are respectively two or three owners of the different parts of the total. This does distribute the risk to the owner/investors, but results in great difficulty in modifying a troubled loan. If the closed end second lien is securitized, it is securitized separately from the first lien. Any home equity line (HELOC) is often with the originating and servicing bank's retail banking department, which is separate from the mortgage operations. The latter can lead to conflicts of interest between different departments within the banking institution. A practical solution would be to require disclosure of the front end housing debt-to-income ratio of the borrower in the first lien securitization information.

Capital Structure:

3. Should certain capital structures be ineligible for the future safe harbor? Yes, leveraged tranches do introduce market risks and reduce the need for quality loan production.

4. For RMBS specifically, . . . , should the capital structure of the securitization be limited to a specific number of tranches? I do believe that the excessive numbers of tranches lead to a hindrance in providing transparency for the investor. However, I cannot comment meaningfully on what the upper limit on the number should be. In reading Addendum A to his ANPR, FDIC is setting conditions to provide a safe harbor for the total of all tranches of the issued RMBS, rather than just specific tranches. In this case, a small number of tranches is advisable. The result will be more, but smaller issues of securities compared to what has been the case until now.

5. Should there be limits to the number of tranches that can be used for other asset classes? Yes, because including other asset classes, while distributing risk, makes the securitization less transparent for investor evaluation.

6. Should re-securitizations be required to included adequate disclosure of the obligations including structure and quality supporting each of the underlying securitizations . . ? Yes, such information would cause the rating agencies to be able to better evaluate the re-securitization and rate it, even if the investor in the security does not itself make a separate evaluation. I believe re-securitizations should be avoided as much as possible as seen by the present development of a re-REMICs market to untangle the confused structure and separate out the higher quality from the lower quality securities.

7. Should securitizations that are unfunded or synthetic securitizations that are not based on assets transferred to the issuing entity or owned by the sponsor be eligible for expedited consent? No.

8. Should all securitizations be required to have payments of principal and interest on the obligations primarily dependent on the performance of the financial assets supporting the securitization? Yes, but in agreement with Addendum A (b)(1)(B)(ii) individual loans may be "guaranted, Insured or otherwise benefit from credit support at the loan level through mortgage and similar insurance or guarantees, including by private companies, agencies or other government entities or government sponsored enterprises or through co-signers or other guarantees."

At present, the GSEs, Ginnie Mae, mortgage insurers, etc. provide guarantees on the payments of principal and interest on a significant portion of the mortgage securities. Such guarantees permit these securities be held as high quality investments by pension funds, etc. Investors considered the guarantees of the GSEs to have the implied full backing of the Federal Government. Thus the present crisis started with the expanding market of private securitizations of subprime and other such loans, not the conforming prime loans.

However, this need for high quality paper does not mean that more risk could not be shared with the investor by guaranteeing only a percentage of their coverage of a given loan. Such an arrangement would require some thought as to how it might be achieved.

Should external credit support be prohibited in order to better realign incentives between underwriting and securitizing performance? Yes, if this means credit support to the securitization and not guarantees on the individual loans themselves. This would focus the investor more on the inherent quality of the securitized loans.

Disclosures:

9. . . . What data (are) most useful to improve transparence? In reading descriptions of the security, such as the SEC Form 424B5 prospectus, I find insufficient description of the layering of risks. For example, the distribution of credit scores is usually given separately from the distribution of LTVs, etc., but very little is given on the combinations such as low credit scores and high LTVs. An additional very important piece of information would be the front end debt-to-income (DTI) ratio of the borrower, which would provide information as to whether the loan was part of a piggyback package.

Perhaps one could argue that these combinations are implied by where such a loan might be in the tranche structure, but a more specific statement of it would be very helpful.

10 through 16. Since I am not involved with the purchase of these securities, I cannot comment in detail on these questions. However, as someone who is concerned about the quality and types of loans in these securitizations, I believe that tranche level reporting would be very helpful.

17. For RMBS, should disclosure of detailed information regarding underwriting standards be required? The SEC Form 424B5 should specify at the tranche level whether or not the loans in that pool tranche were fully indexed and had fully documented income data. Confirming that the loans are current with regulatory guidance seems difficult to me because of the gray areas in the guidance and tradeoffs in the underwriting. I would suggest instead that tranche level data on credit scores, income level relative median area (MSA) income level, LTVs, as well last loan type (hybrid, interest only, option ARM, jumbo, etc.) be provided, as well as their layering. Geographic distribution of the loans is also important as can be seen by the differences of loan delinquencies and foreclosures in CA and FL compared to TX in this present crisis.

18. I am not qualified to comment on relative costs.

Documentation and Record Keeping:

19. Authority of (RMBS) servicers to mitigate losses on mortgage loans consistent with maximizing the net present value of the mortgages. From my preparation of reports on the 8 major servicers, with which we have met in 2009, it is obvious that they tend to focus on the modification of loans held in portfolio. There are two reasons for this focus.

1. First, many of the portfolio loans are of poorer quality either because they could not be securitized or were acquired through an acquisition of another corporation with poorer underwriting standards.
2. Secondly, the servicer has total control over these portfolio loans and is not concerned about restrictions of pooling and servicing agreements (PSAs).

For the group of servicers reporting to the OCC and OTS Mortgage Metrics Reports[1], these reports show that the re-default rates on these portfolio loans are generally much lower than the re-default rates on loans held by private investors, which are serviced for others by the servicer. The presumptions are that the servicer's cost of the modification process is more than the servicer's cost of foreclosure and there maybe some limitations of the pooling and servicing agreements (PSAs).. In contrast, the value to the borrower and loan's owner of a modification may be greater than that of foreclosure, if the next present value is positive. See my discussion of servicer compensation under question 20.

20. Loss Mitigation has been a significant cause of friction between servicers, investors and other parties to securitizations. I maintain that particular contractual provisions should be developed which compensate the servicer for the successful modification of a loan that provides a net present value for the owner of the loan that is greater than a foreclosure. Provisions of this type are present in some Pooling and Servicing Agreements (PSAs) of commercial mortgage securitizations (CMBS) where the servicer receives a percentage fee from the modified loan so long as it is performing.[2]

There should also be provision to provide servicers with compensation for interest expense for servicing advances as in CMBSs to permit servicers to take time to make an evaluation of the net present value of the loan modification.

Either constraints of volume of and/or types of modifications in the PSAs should be eliminated or, as in the case of CMBS, where the control of the trust is given to the junior most tranches still in the money. Thus in reply to the FDIC's sub-question, **the servicer should act to maximize the value for the most threatened class of investors, with that class providing the additional funding to the servicer. I believe this process is in turn to the best interest of all investors.**

Because to the large numbers of owners of RMBSs, the setting up of a controlling class representative or certificate holder may be impractical. As noted above in my introduction, subprime servicing per loan is of the order of ten times that of a prime loan so the additional cost must be borne by the classes most at risk.

Part of the present misalignment is caused by piggyback loans where the servicer often owns the second lien or HELOC and the first lien is securitized and is now serviced for others by the owner of the second. The most practical solution is to require the second to be written down the same as the first, as has been proposed by the regulators.

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[1] See for example *OCC and OTS Mortgage Metrics Report*, p. 33, Third Quarter 2009.

[2] See A Gelpeern and A. J. Levitin, "Rewriting Frankenstein Contracts: Workout Prohibitions in Residential Mortgage-Backed Securities", *Southern California Law Review*, **82**, III E, pp 1103-1105 (2009).

21. Should a servicer specifically be required to commence action to mitigate losses no later than a specified period? Considering how unprepared servicers were in 2009, requiring them to commence action in 90 days is a little short. However, if payments were provided as suggest in my answer to question 20 above, 120 days would probably be reasonable, especially if the servicers are guaranteed their advances.

22. To what extent does a prolonged period of servicer advances in a market downturn misalign servicer incentives with those of the RMBS investors? Since it is unlikely that control of the trust be by the most threatened class of investors, as proposed above, a limit should be placed on the length of time servicer advances to cover delinquent payments can be advanced, probably 120 days. To avoid using foreclosure recoveries to serve for repayment of advances, it would be preferable to provide a higher servicing fee based upon tranche risk level, so as to minimize the need for the use of foreclosure recoveries.

23. I am not qualified to comment on relative costs.

Compensation:

24. Should requirements be imposed so that certain fees in RMBS may only be paid out over a period of years? In connection with my answer to question 20, these fees should be paid out over a period of years and should vary with the problems that the economic situation of a particular time impose on the servicers. Since the average mortgage loan life is about 10 years, a period of 5 years might be reasonable since most of the problems of these loans will be within the first years after originations.

25. Should requirements be imposed in RMBS to better align incentives for proper servicing of the loans? Yes, compensation for servicers should take account of services provided and actual expenses and include incentives for loss mitigation actions to maximize the value of the financial assets in the RMBS, as described in my answers to question 20 and 22 above.

27. Should similar or different provisions be applied to compensation for securitizations of other asset classes? As can be seen from CMBS, at best similar compensation could be applied to other asset classes, but I have no expertise in other areas.

Origination and Retention Requirements:

28. For all securitizations, should the sponsor retain at least an economic interest in a material portion of the credit risk of the financial assets? First, What is the total burden this requirement would place on the originating/sponsoring insured depository (IDI)? This burden needs to be estimated in order to comment on this proposal. I will take as models that the volume of loans securitized in a given year declines linearly over either 10 or 20 years, and that the volume of loans securitized yearly remains constant from year to year. If the IDI must hold 5% of each year's securitizations and:

- If the refinancing rate is reasonable high so that all the loans are turned over within 10 years, then at steady state the sponsor/originator will hold a total equivalent to 27.5% of the annual production of securitized loans over the long term.

- If refinancing rate is lower so that all the loans are turned over within 20 years, then at steady state the sponsor/originator will hold a total equivalent to 52.5% of a year's production
- If the IDI only needed to hold 5% of loans for the first 5 years after origination, then the amount held would stabilize at the equivalent of 20% of yearly production for loans turning over every 10 years and 22.5% of the yearly production turning over every 20 years.

Obviously these are examples of an oversimplified model, but they at least provide some ball-park numbers. Thus in the case of the loans in securities which turn over in only 10 years, there is little difference between the IDI holding them for only 5 years or for the full 10 years with the average holdings of the IDI being a about a quarter to the annual production. If the loans only turn over fully in 20 years, the IDI holdings for only 5 years is only 22.5% but the IDI holdings for the full life of the loans would be more than double that percentage or 52.5%. Obviously all these percentages would double if 10% of the securitizations were required to be held.

Since most problem loans should show themselves within 5 years, holding securities of these loans for only 5 years would not result in an undue burden on the IDI. Whereas, holding securities of these loans to term does raise the burden significantly in the times of a slow economy when loans are not turning over very rapidly. For this reason, I would support the IDI holding 5% or even 10% of the yearly securitized loans for only 5 years, so that the measure is not pro-cyclical.

If such a plan were instituted then the sponsor should retain a representative volume of the securitized loans with a bias proportional to some measure of the risk. If nothing else, that measure of risk could be a combination of the credit score of the borrower and the interest rate of the loan.

29. Should additional requirements to incentivize quality origination practices be applied to RMBS? Is the requirement that the mortgage loans included in the RMBS be originated more that 12 months prior to any transfer for the securitization an effective way . . .? While seasoning the loans for a year would help eliminate some of the initial poor underwriting, the present economic crisis shows that loans can present problems after several years of seasoning. Thus I personally believe that holding 5% of the loans for 5 years is a better approach and one that would also be more cost effective. The large IDIs probably hold loans for securitization for only about 3 months, so this requirement would add another 75% of their annual securitizations to their portfolios. If this is added to the requirements of question 28, then the holdings would total about 125% to 150% of annual securitizations.

30. Would the alternative . . .(for) a review of specific representations and warranties after 180 days and the repurchase of any mortgages that violate those representation and warranties better fulfill the goal of aligning the sponsor's interests toward sound underwriting? The introduction to this section suggests a contracting party would make this review. I am not qualified to make an evaluation of the cost of such a contractor, but such a contractor should be licensed to guarantee the performance of the work. I could not say whether the cost would be compensated by an increase in the price of the security as a result of this added warranty. However, a real problem with this approach of a review at 180 days is that the supervisory guidance is usually a year or two behind the market. Thus I would prefer the sponsor/originator to hold 5% or 10% of the originations to cover the loans for which the supervisory guidance will not come for another year or two.

31. Should all residential mortgage loans in an RMBS be required to comply with all statutory standards and guidance in effect at the time of originations? This question depends upon whether total pool or tranche data are available to the investor and the FDIC. If

tranche level data are provided, it would permit more rapid securitization by the originator of loans since fewer securitizations would be needed to cover their production of originations. For certain tranches, the originator/sponsor could specify that the loans complied with statutory and regulatory guidance, which if found to be untrue upon the IDI being taken over by the FDIC would remove them from the FDIC safe harbor. The more expensive alternative is given in question 30 above with a special contractor making the review.

32. I am not qualified to comment on relative costs
Additional Questions:

33. Do you have any other comments on the conditions imposed by paragraphs (b) and (c) of the sample regulatory text (Addendum A)? I have no further comments beyond those made in the answers to the above questions.

34. and 35. I have no particular expertise to comment on paragraphs (d) and (e).

I believe the FDIC has been in the forefront of handling the present crisis and that regulations such as those proposed in this ANPR are important to the development of the long-term stability of the economic system. I therefore appreciate this opportunity to make these comments and state again that they are my comments alone and do not represent the comments of any of the organizations for which I consult.

Sincerely yours,

John E, Lind, Ph.D.
Executive Director

Cc: Vidette Bullock Mixon, Director, Corporate Relations,
General Board of Pensions and Health Benefits, United Methodist Church

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