From:	Vernon Tanner
To:	thirdpartylending
Subject:	comments and feedback
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Attachments:	image001.png

Comment on:
Financial Institution Letters / FIL-50-2016 / July 29, 2016

Please see my comments in **RED** below each question. Thank you.

Questions:

Third-Party Lending Definition and Scope of Guidance

1. The Proposed Guidance defines third-party lending as "a lending arrangement that relies on a third party to perform a significant aspect of the lending process." Does the proposed definition appropriately capture the various types of financial institution lending through relationships with third parties?

In some ways, the initial definition at the top of page two appropriately describes various types of lending relationships. Please refer to comments in #2 below.

2. Is the scope of the definition (and therefore, the scope of the guidance) appropriate, too broad, or too narrow?

As detailed in #4 below, the descriptions of various types of lending relationships do not accurately or adequately describe mortgage lending relationships. That in turn creates significant problems in the scope of this guidance.

It is difficult to overstate the significant differences in the levels of responsibility a Bank has when it conducts business through the Correspondent channel, versus the Wholesale channel. These differences are confirmed by numerous and long-standing legal and regulatory definitions, including the definition of loan originator, creditor, etc., according to Reg Z, RESPA, and the assignee liability prescribed by TRID.

As important as it is to make clear and accurate distinctions between Correspondent and Wholesale mortgage lending relationships, it is even more important to make clear distinctions between mortgage lending relationships and other third party lending relationships such as dealer paper, payday lending, delegated underwriting, etc. Otherwise, the guidance is essentially a "one size fits all" approach that fails to match levels of responsibility and due diligence. This results in some areas being excessively burdensome for no reason, and others excessively light.

Because the Regulatory scope and supervisory expectations are prescribed according to the definitions laid out in this document, it is strongly recommended that this proposal make additional distinctions in its definition of third party lending.

3. The proposed third-party lending definition also describes examples of services performed by a third party. Do those services appropriately reflect services being provided, and may be reasonably

expected to be provided in the future, by third parties?

The definition appropriately describes services of some third party lenders, but not mortgage lending relationships. Please refer to #1 and #2 above.

4. The Proposed Guidance outlines three categories of third-party lending arrangements: originating loans for third parties; originating loans through third parties or jointly with third parties; and originating loans using platforms developed by third parties. Do those examples appropriately capture the various types of arrangements? Are the respective descriptions of those arrangements appropriate?

The respective description of those arrangements are appropriate many types of relationships, but not mortgage lending relationships. Specifically, the first paragraph titled, "Insured institutions originating loans <u>for third parties"</u> and the third paragraph titled, "Insured institutions originating loans <u>using platforms developed by third parties</u>" are problematic:

<u>The first paragraph</u>:

Describes a bank that uses its own funds to originate a loan: 1) for an entity that lacks the necessary license, charter, or the ability to export interest rates. 2) the bank holds those loans only for a short period of time before selling them to the third party entity, which typically secures the ultimate funding source.

This is not an accurate description of a bank that originates a mortgage loan in its own name, using its own funds, then sells it to a mortgage investor in an arms-length secondary market transaction - even when that correspondent investor provided underwriting services to the bank. This is commonly referred to as the correspondent channel. It is inaccurate because both the originating bank and the correspondent investor have their own licenses and their own sources of funds. Originating banks usually sell the mortgage loans they originate to correspondent investors, simply because they do not want the interest rate risk of a 30 year fixed rate loan on their books. This should not be misconstrued that the correspondent investor that buys the loan is the entity that secures the "ultimate funding source". The originating bank is the ultimate funding source as proven by the fact that banks sell some loans and retain others. Whether or not the originating bank retains or sells the loan is not the definitive factor in determining the ultimate funding source.

The first paragraph also does not describe how the same Bank that originates loans then sells them in through the correspondent channel, may also acts as a loan broker. The same bank may receive loan application packages from consumers and broker them for compensation to another lender/creditor that actually makes the loan. This is commonly referred to as the wholesale channel. Banks often choose the wholesale channel because they do not have the necessary license for certain loan programs, but the wholesale lender/creditor does. For example; banks that originate Conventional loans in the correspondent channel are licensed to do so and they have their own sources of ultimate funding. But they will broker loans out to others through the wholesale channel if they themselves aren't licensed to originate VA and FHA loans directly. The definition in the first paragraph seems to only describe situations where the third party entity (the wholesale/investor) doesn't have a license – not situations where it is the bank without one.

These two mortgage lending channels (correspondent and wholesale) are very different functions

with very different levels of responsibility, and therefore very different levels of due diligence. Thus, if it was the FDIC's goal to describe relationships between banks and Correspondent or Wholesale mortgage companies in these definitions, a clear distinction must be made between them. These two functions should also be clearly separated from whatever other type of lending relationship is being described in the first paragraph (such as dealer paper).

The third paragraph:
It seems redundant and conflicting, if not incorrect – especially as it pertains to a Bank's mortgage lending activity. As you know, there are few, if any community banks that have their own end-to-end lending platforms or loan operating systems (LOS) that produce loan closing documents for any type of loan. Instead almost all Community Banks rely on third party vendors. The use of a third party vendor's LOS does not constitute a lending relationship whatsoever. LOS vendors strictly provide a mechanical/IT function much like software for the Bank's financial statements, or call reports, or HMDA data. Therefore, it is not necessary to address it in a third party lending guidance because there is no lending relationship, and these relationships are already addressed in the existing third party vendor management literature.

Perhaps more importantly, if both the first and third paragraphs are intended to address mortgage lending relationships, then the sentence in the third paragraph which states, "Most often, loans generated through this model are retained by the bank.", is in direct conflict with the sentence in the first paragraph which states, "Often, the insured institution does not retain significant amounts of loan volume generated,….".

Thus, because the use of a third party's LOS: A) does not create a lending relationship, B) has already been adequately addressed, in other Regulatory literature, and C) conflicts with language in the first category, it is inappropriately addressed in this document. At the very least, it should clearly state this does not apply to loan platform systems used to produce loan documents.

Potential Risks
5. The Proposed Guidance notes the numerous risks that may arise from use of third parties and outlines those that may be associated with third-party lending programs in particular. While recognizing that not all risks can be outlined, does the Proposed Guidance reasonably identify and describe the risks that warrant emphasis for third-party lending arrangements? If not, which additional risks should be addressed?
The guidance very accurately describes the risks involved in third party lending arrangements.

Third-Party Lending Risk Management Program
6. The Proposed Guidance outlines expectations for establishing a third-party lending risk management program, including expectations around strategic planning policy development, risk assessment, due diligence and ongoing oversight, model risk management, vendor oversight, and contract structuring and review. Are these the appropriate elements for an adequate risk management framework?
Most are, some are not. The key sentence in the second paragraph, "The program and policies should be commensurate with the significance, complexity, risk profile, transaction volume, and number of third-party lending relationships." is inconsistent with two of the mandates in the *Due*

Diligence and Ongoing Oversight section – despite the fact that the sentence is essentially repeated in the second paragraph of that section.

The first inconsistency is the mandate that the ongoing oversight should include an audit or other independent verification of third party activities. Specifically as this pertains to a Community Bank and its mortgage lending relationships, it is unnecessary and cost prohibitive to hire an outside independent auditor to verify a mortgage investor or creditor/lender activities – especially when those activities are already well established by Community Banks' long standing relationships, much less by the very nature of what they do. At the very least, a clarification that allows for the independent review can be performed by another bank employee that is not a mortgage lender is needed.

The second point that is of even greater concern: That institutions should conduct site inspections of third party vendors. This is not necessary, nor practical for a bank to incur the cost and spend time away from their business to travel across the country to visit their vendors. This is neither practical or necessary for Banks – nor their mortgage-related vendors. For example, Wells Fargo is far and away the nation's leader in VA/FHA loans. They cannot accommodate onsite visits from thousands of Community Banks across the country. To require on-site visits would essentially force Banks and Wells Fargo to discontinue their relationship, thus harm consumers

Both of these requirements are not in keeping with this document's repeated declaration a Bank's Third-Party Lending Risk Management Program be commensurate with the complexity, risk profile transaction volume and number of third party relationships as it pertains to mortgage lending partners. Placing a requirement or even expectation of on-site visits carte blanche as stated in this proposal, ignores the "commensurate with complexity…." language.

If both of these stated requirements are not removed in favor of far less burdensome ones that are feasible, then Community Banks that serve the homeownership needs of their CRA Assessment Areas will not be able to meet them. Instead, they will de-risk their product offering line by eliminating permanent mortgage loans – if not from their market entirely, then certainly leaving it only to large Banks. In no way does this serve the interests of consumers. In fact, the logical conclusion is that it will harm them by eliminating competition for big Banks.

Supervisory Considerations

7. The Proposed Guidance outlines some of the risk management areas examiners will consider when reviewing third-party lending relationships. These considerations include credit underwriting and administration, loss recognition practices, the applicability of subprime lending guidance, capital adequacy, liquidity and funding, profitability and budgeting, accounting and allowance for loan and lease losses maintenance, consumer compliance, programs for safeguarding customer information, and information technology. Are the considerations appropriate? Should additional considerations be addressed?

The following comments may be more appropriate for Examination Procedures section instead of here, but seems appropriate for both.

The stated Supervisory Considerations and Examination Procedures make sense, but should include a statement of reasonableness. This is particularly true in regards to the statement in the "Vendors Used by Third Parties" section under the umbrella of Third-Party Lending Risk Management Programs above.

This remains an area of great uncertainty. The question of how far down the analysis should drill to is a highly subjective matter. Will the FDIC be satisfied if the Bank concludes their analysis at their main vendors' vendors? What about those sub-vendors' vendors? And what about theirs, and so forth, and so on? Where is the getting off point? As worded in this document, the requirements are quite subjective. It is therefore recommended that additional language or clarity be added to ensure Banks can exercise prudent judgement in this regard, and avoid contentious discussions about what is reasonable and what is not.

8. The Proposed Guidance defines "significant" third-party lending arrangements as those, for example, that have a material impact on revenues, expenses, or capital; involve large lending volumes in relation to the bank's balance sheet; involve multiple third parties; or present material risk of consumer harm. The Proposed Guidance also states that institutions that have significant arrangements with third parties would be expected to oversee the third-party lending arrangements on an ongoing basis. Is the definition of significant arrangements reasonable and it is appropriate to expect ongoing monitoring of these arrangements?
This seems reasonable.

Examination Procedures
9. The Proposed Guidance indicates that institutions engaging in significant activity will generally receive increased supervisory attention. In this regard, the Proposed Guidance establishes a 12-month examination cycle for institutions with significant third-party lending programs, including for those institutions that may otherwise qualify for an 18-month examination cycle.[2] Is this an appropriate examination interval for these types of arrangements?
This seems reasonable.

10. The Proposed Guidance states that examiners will conduct targeted examinations of significant third party lending arrangements and may also conduct targeted examinations of other third parties, where authorized. As part of these reviews, the Proposed Guidance states that reviews of third parties should include transaction testing of individual loans to assess compliance with consumer compliance regulations, underwriting and loan administration guidelines, credit quality, appropriate treatment of loans under delinquency, and re-aging and cure programs. Is the proposed scope of third party lending arrangement reviews and transaction testing appropriate?
This seems reasonable.

Final Comment:
It is recommended that Examination Procedures take into account when a Bank engages in Mortgage Lending relationships with other FDIC insured institutions. Otherwise, the burden is wholly redundant on both parties, which in turn creates an unnecessary burden to duplicate the

work.

I invite the FDIC to reach out at the contact information provided for any additional conversation, comments, or clarification. Thank you.

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