ThirdFederal®
SAVINGS & LOAN

October 2, 2012

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation,
550 17th Street, N.W.
Washington, D.C. 20429

Re: Basel III Capital Proposals

Ladies and Gentlemen:

Thank you for the opportunity to provide comment on the Basel III proposals[1] recently issued by the Federal Reserve Board, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation (collectively the "Agencies").

Third Federal Savings & Loan Association of Cleveland is an $11 billion thrift with 22 full-service branches in Northeast Ohio, eight lending offices in Central and Southern Ohio, and 17 full-service branches throughout Florida, in addition to lending in 10 other states.

The thrift was founded in 1938, and as a savings and loan. Our primary lines of business are residential mortgage lending and savings products, such as certificates of deposit, savings and checking accounts.

Third Federal is a mortgage lender that focuses on providing outstanding customer service by originating one- to two-family residential mortgage loans to well-qualified applicants based on sound credit, income and appraisal policies and practices. We have prudently managed our credit risk based on the concept of knowing our borrowers and focusing on credit practices, documentation standards, and underwriting concepts that have proven to be predictive of borrower success. We have not adopted Agency (Fannie

[1] The proposals are titled: *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, and Transition Provisions*; *Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements; and Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rules; Market Risk Capital Rule.*

Mae and Freddie Mac) Standards for analysis and documentation of mortgage loans as it is our belief, and our historical performance would support, that these requirements result in additional time and cost for both the bank and the applicant and that such additional time and cost do not appreciably improve our credit decisioning.

We appreciate the opportunity to comment on the recent Basel III proposals in light of our business practices.

Residential Mortgage Exposures:

1. While we would generally agree with and support the approach that those types of residential mortgage loans with higher credit risk features should have a higher risk based weighting (such as those with pay-option features, negative amortization or balloon payments); the determination of a specific risk weight based on a single factor such as the proposed loan-to-value ratio does not recognize that many lenders (including Third Federal) have originated loans to hold in portfolio and adjust loan criteria (such as credit or income standards) when there is a higher loan-to-value ratio to maintain a consistent performance level and probability of default.

   For example, when Third Federal approves a residential mortgage loan with a loan-to-value ratio of 85 percent, we require higher credit standards to offset the additional risk of the lower down payment or equity.

   Also, as noted later in this comment, we feel that the Agencies should carefully consider and define what constitutes "documented, verified income."

   We believe that prudently underwritten loans with a low probability of default should receive the same 35 percent risk-based weighting.

2. It is our feeling that mortgage insurance should be included in the determination of the loan-to-value exposure. Prudently used, mortgage insurance provides a viable alternative for many first-time home buyers to purchase homes with lower personal contributions. Again, used in conjunction with appropriate credit and income qualifications, the use of mortgage insurance does not increase the overall level of credit risk.

   We believe that mortgage insurance should be considered when calculating the appropriate loan-to-value ratio and what the corresponding risk weighting should be.

3. The proposal permits that a banking organization that holds a residential mortgage in first-lien position and junior-lien mortgage on the same residential property with no intervening lien to treat both as a combined category 1 exposure. However, each of the mortgages must have the characteristics of a category 1

mortgage. If one of the mortgages is a category 2, then the combined exposure would be treated as a category 2 exposure.

4. It is also our feeling that automatically reclassifying a well-qualified first mortgage as a category 2 loan because the junior-lien is a category 2 exposure, unnecessarily penalizes the institution for that portion of the exposure that meets the criteria for category 1. The additional dollars at risk for a junior-lien mortgage that does not meet the category 1 criteria would already require a higher level of capital to reflect the potential additional risk, but the primary loan (which could be significantly larger than the junior-lien) would continue to represent no additional risk than any similarly underwritten and documented category 1 loan.

5. We believe that each loan should be risk weighted based on its own characteristics and a loan should not be reclassified merely because another loan on the same property has a different risk profile.

Loan-to-Value (LTV) Ratio:

- The proposal indicates that the LTV ratio would equal the loan amount divided by the value of the property. The value of the property is further qualified to be the lesser of the acquisition cost (for a purchase transaction) or the estimate of the property's value at origination.

  Historically, Third Federal has not consistently maintained the acquisition cost in our servicing system. While this information has and is available at the time of origination and is used in making our credit decision, there are loans held in portfolio that were originated over the years using three different origination systems of which two are no longer active. We are concerned that the inability to consistently derive this ratio would adversely impact us.

  For capital purposes, we would represent that the consistent use of the appraised value would provide a more consistent methodology for deriving this ratio and would eliminate any possible manipulation of the acquisition price.

- Additionally, if a loan is originated using one of the Agency automated models and the valuation requirement permits the originator to rely on a Property Inspection Waiver (PIW) in lieu of an appraisal, and the loan resides on our books over a quarter-end; how would the requirement that the LTV ratio "must" be based on an appraisal be evaluated.

  We believe the Agencies should carefully consider an appropriate measurement methodology for these types of loans.

Definitions:

Additionally, when the rules are finalized, we believe that considerable effort should be made to carefully and thoroughly define and clarify the terms used in the rule to ensure banks can address regulatory expectations and concerns. Carefully defining the terms used throughout the regulation will help to avoid differences in interpretation and enforcement. Specifically, we would recommend that the following terms be fully defined:

Residential Mortgage Exposures

- "Category 1 residential mortgage exposure would mean a residential mortgage exposure with the following characteristics: … The terms of the mortgage provide for regular **periodic payments** that do not: Result in an increase in principal balance; …"

  The final rule should clarify whether or not an interest-only loan, with no scheduled principal reduction during an initial period, then fully amortized over the remaining term, and not resulting in a balloon payment would satisfy this requirement as having "periodic payments."

- "Category 1 residential mortgage exposure would mean a residential mortgage exposure with the following characteristics: …Resulted in a conclusion that the borrower is able to repay the loan using: …The determination of the borrower's ability to repay is based on **documented, verified** income: …"

  The final rule should clarify the use and terms of the words "documented" and "verified." In the mortgage industry, these terms are often used interchangeably. If by "documented" the intent is to require that the prospective lender obtain current income documentation such as recent pay stubs, and tax returns, or W-2, then we support the proposal. As to the term "verified," it is unclear whether or not the intent is to require that lenders in all situations conduct an independent third-party verification of that information such as with the applicant's employer or the Internal Revenue Service – or if the term merely supports the term "documented." By way of example, if we obtain current pay stubs and tax returns, have we both documented and verified the information since we would have tangible evidence of the applicant's earnings, and ensured the amounts reported on the application is correct? Or is the intent that although we have the documentation of the applicant's income, we would still need to conduct additional third party verification?

- Within the definition of a category 1 residential mortgage exposure, the proposal indicates, "Took into account all of the borrower's obligations, including for mortgage obligations, principal, interest, taxes, insurance, and assessments…" while later within the same definition, "For a first-lien home equity line of credit

ThirdFederal
SAVINGS & LOAN

(HELOC), the borrower must be qualified using the principal and interest payments based on the maximum contractual exposure under the terms of the HELOC …"

As a point of clarification, is the intent that for a first-lien HELOC, the borrower would need to be qualified (since we assume this would be classified as a mortgage obligation) with a principal and interest payment based on the maximum contractual obligation **PLUS** the taxes, insurance, and assessments?

Grandfathering Existing Portfolios

Finally, as drafted, there is no provision made for existing mortgage loans originated under the existing capital rules. The absence of "grandfathering" provisions for existing portfolios, originated at a time when the new rules did not exist, would put additional capital burdens on us. Third Federal, and we would believe other financial institutions, would be adversely impacted and may potentially improperly classify loans in our existing portfolio due to lack of supporting documentation. Applying a set of standards not in place at the time of origination would appear to retrospectively attempt to "re-evaluate" the risk presented by specific credits. We would recommend that existing portfolios be grandfathered and allowed to apply the existing risk-based weighting.

Third Federal Savings & Loan Association of Cleveland appreciates the opportunity to comment on this very important rule making. Should you have any questions regarding our comments, please contact the undersigned at jennifer.rosa@thirdfederal.com

Sincerely,

Jennifer L. Rosa
Public Relations Manager
Third Federal