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DEFINITION OF  
SUBPRIME LENDING  
DISSEMINATION BRANCH  
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Attn: 1550-0023

Dear Sir or Madam,

I am writing in response to the request for comments in connection with proposed changes to the Thrift Financial report effective March 31, 2001, published in the Federal Register August 4, 2000. Specifically my comments are directed to the definition and collection of information as it relates to Subprime lending.

First, in the interest of fairness to all institutions one must develop an objective standard as to what is a subprime loan and who is a subprime borrower. Second, and equally important, it must be determined at what point do we determine whether the loan or the borrower is subprime? Just at the time of origination or later when additional information and payment history has been obtained? Third, it should be established, to what extent does the presence of collateral and type of collateral influence the definition of subprime?

The definition of subprime is of particular concern. In my opinion the standard needs to incorporate credit history, debt to income ratios and collateral in the definition. While there may be more simplistic approaches to the reporting of the information they suffer as the name implies from their simplicity. Failing to consider each of these elements in the definition will not differentiate between the degrees of risk in all institution portfolios. A matrix should be developed to provide definitions of subprime for different types of loans. (For example in the residential area the matrix could incorporate a borrowers credit score, debt to income ratio and equity in the residence in defining subprime. This may mean that a borrower with a better credit score and worse debt to income ratios and less equity in the collateral might be considered subprime; while a borrower with a worse credit score better repayment ability and more equity should be considered not subprime.) This is exactly what the rating agencies and the capital markets consider when determining the level of risk in a particular portfolio and that risk is measured on an individual loan level basis. Perhaps a study could be done on the minimum credit score and debt to income ratios for traditional FNMA mortgages for the last 3-5 years to establish the benchmarks for subprime mortgages. Similarly studies of minimum scores could be done for automobile and credit card lending for a similar period.

Fairness dictates that every institution be placed on a level playing field for this additional information. If a local lending institution makes a loan to an individual that exhibits a weakness within the matrix they too should have to report this loan as subprime regardless of the rate of interest or purpose of the loan. If the purpose of this information is to evaluate risk no institution should be exempt from reporting these loans. To impose a minimum threshold is to ignore the fact that an institution may have some of this risk just below the reporting requirement and some other risks which when aggregated are more of a safety and soundness danger than the TFR reveals.

The issue of when we determine if a loan or a borrower is subprime is also very important. I believe a periodic assessment should be done of a person's credit, both within and outside the institution. This assessment could be as simple as obtaining a new credit score from a national repository as well as considering a borrower's payment history within the institution. To the extent new information is obtained about a borrower's repayment ability or the value of any collateral this too could be incorporated.

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The reason I advocate periodic assessment of the borrower's credit is that it does not seem logical that an institution which is currently making a loan to a borrower might be required to report a loan as subprime while another institution which has an outstanding loan to the very same borrower is not reporting their loan as subprime. Clearly the borrower's repayment ability is the same with each institution. Conversely, if a borrower obtained a loan some time ago when their credit history was impaired and they now are paying on time consistently their bills, should they forever be classified as subprime? If a different institution were to make a loan subsequently to this individual they wouldn't have to report theirs as a subprime loan.

Finally, it certainly seems logical that different definitions need to be established for subprime depending on the existence and nature of one's collateral. While persons credit and repayment ability are not different dependent on the type or amount of collateral; their willingness to pay and the exposure of loss to the institution is very collateral dependent. This is very evident in situations where a borrower has filed for bankruptcy but continues to pay his mortgage or car payment after the filing. In fact a number of borrowers who file for bankruptcy never become delinquent on their mortgages and the first time the mortgagee learns of the borrowers credit problem is upon receipt of notice of the bankruptcy filing.

The level of equity would also seem to need to be included in the definition of subprime. Again while the credit and capacity of the borrower is not effected by their equity in an asset; the willingness to pay is proportional to equity in the asset. This has been documented in a number of studies by the GSE's where they have reviewed the default propensity of similar borrowers at different equity levels in their property. Beyond a certain level, the incidence of defaults rises exponentially as equity decreases.

In conclusion, I caution that whatever definition is adopted that one is mindful of the effect any such definition will have on the availability of credit to consumers. While an under inclusive definition may pose a danger between examinations of an institution an over inclusive definition may have an unintended chilling effect on lending.

Respectfully submitted,

A handwritten signature in cursive script that reads "Edwin Furtado". The signature is written in black ink and includes a small circular mark at the end of the last name.

Edwin Furtado