June 28, 2004

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th and C Streets, NW
Washington DC 20551

Reference Number: Consolidated Reports of Condition and Income, 7100-0036

Dear Ms. Johnson,

MidFirst Bank, OTS Docket 14191, appreciates the opportunity to respond to the Joint Notice and Request for Comment regarding the Proposed Agency Information Collection Activities published in the April 29, 2004, *Federal Register*. As explained in the paragraphs that follow, MidFirst Bank has significant concerns with the Schedule PD reporting rules as proposed for delinquent FHA and VA loans (herein referred to as GNMA loans). Specifically, MidFirst believes that the reporting changes fail to accomplish the intended goals, and could cause those who review the TFR to misjudge the credit risk associated with the assets of the reporting thrifts.

Risk of Misperception

Presumably, a primary objective of the proposal is to more clearly convey the credit profile of reporting institutions. However, the proposed methodology, which would combine government-backed and non-government backed loans, does not achieve this goal and could have severe consequences. It is our opinion that combining loans which are wholly insured or partially guaranteed by the U.S. Government with loans that do not have government backing produces a total that is not truly meaningful to readers of the reports and serves to artificially inflate the perceived credit risk of an institution. The risk-based capital calculation confirms the difference between the risk profiles of GNMA and conventional loans. GNMA loans retain the lowest possible loan risk weighting of 20% whether they are current or delinquent, whereas the risk weighting for qualifying conventional loans doubles from 50% to 100% when they become delinquent. By producing a combined total of government-backed and non-government-backed non-performing loans, the proposed reporting format could confuse some readers by implying that all such loans are similar.

Proponents of the change would point to the separate reporting line that captures the subset of past due loans that have government backing. However, it seems reasonable to assume that many readers, including the press, will focus on “headline” numbers such as the total amount of past due loans without giving consideration to the offsetting amount of government-backed loans. This significantly increases the risk that customers, rating agencies, analysts, the press and business partners could incorrectly perceive a negative or adverse financial condition.

The consequences will be particularly problematic for institutions reporting delinquent GNMA loans on schedule PD for the first time, as a significant increase in delinquent loan volume could be reported. Suddenly including these loans as delinquent in a public forum could unnecessarily alarm readers of this information. Such negative reactions could be difficult to overcome.

The potential cost associated with the proposed change could be significant. Adverse reporting in the press could have a significant impact on depositor confidence and result in a loss of deposits for institutions with large GNMA portfolios. Rating agencies may downgrade affected thrifts’ ratings. Institutional lenders may be discouraged from providing funding sources to affected thrifts. The possible results of these occurrences could be liquidity concerns and increased funding costs. Any one of these events would necessitate additional marketing and public relations expenditures to explain the issue and mitigate the damage caused by the proposed reporting change.

Reporting Inconsistency

A stated objective of the proposed reporting change is to ensure consistency in reporting for delinquent GNMA loans. However, the proposed reporting change does not accomplish this goal. Within the published discussion of the proposed reporting changes, the Agencies acknowledge the need for an exception in TFR and Call report instructions prior to the implementation of FAS 140. The need for this exception was due to the potential inconsistency in treatment for serviced loans in foreclosure status which were bought out of GNMA pools by institutions in order to avoid the continuation of monthly advances on those loans and those loans in foreclosure status which remained in the GNMA pool. The agencies go on to say this exception is no longer necessary as a result of the FAS 140 requirement for delinquent GNMA loans to be rebooked as assets as soon as the repurchase option becomes unconditional. The justification for removing the exception seems to be founded on the premise that all delinquent GNMA loans are required to be rebooked. This is not the case.

The FAS 140 requirement for rebooking delinquent loans only applies to assets actually transferred by an institution into GNMA pools upon issuance of the pool. Rebooking assets that become unconditionally eligible for repurchase by the issuer/transferor is essentially a reversal of the sale recognition at the time the pools were issued. Servicers that purchase GNMA servicing from the original GNMA pool issuer/transferor are not required to rebook delinquent GNMA loans because there was no sale to reverse as a result of the repurchase. Because the rebooking of delinquent loans pursuant to FAS 140 does not apply to all GNMA servicers, extinguishing the exception in the TFR and Call report instructions will not eliminate inconsistency in the reporting of delinquent GNMA loans

MidFirst appreciates the Agencies' objective to achieve consistency in reporting. However, by not recognizing the distinction between transferor loan servicers and non-transferor loan servicers consistent with SFAS 140, the proposed rule would actually result in less consistent reporting. As a result, MidFirst believes the exception in the current TFR and Call report instructions should continue.

Disincentive for Appropriate Economic Actions

If the exception was not extended, a non-transferor servicer would be required to report delinquent GNMA loans that are purchased from the pools as past due. Meanwhile, loans that are otherwise past due but are not purchased from the pools would not be subject to Schedule PD reporting. This would imply that delinquent loans purchased from the pools have a greater credit risk than delinquent loans which are not purchased from the pools. In reality, no additional credit risk is created when the loans are purchased from the servicing pools. In fact, the opposite is true. By purchasing a delinquent loan from a pool, the servicer is able to mitigate its ultimate loss on the loan, as the servicer is no longer required to advance interest to the investor.

Not extending the exception would create a significant disincentive (if not preclusion) for a non-transferor servicer to exercise the appropriate economic decision regarding delinquent GNMA loans being serviced. In other words, the servicer would have to weigh the economic benefits of purchasing the loans from the pools against giving a false impression to the public, including its customers, about inflated credit risk. Adoption of a reporting policy that creates a disincentive for institutions to make prudent economic decisions is contrary to the concept of safety and soundness.

Recommendations

In summary, MidFirst opposes implementation of the proposed rule change. We believe this rule change will create a misconception related to the credit risk of government insured assets, while not solving the problem of reporting inconsistencies. Further, if enacted, we believe this rule change is contrary to safety and soundness objectives because it creates a disincentive for institutions to take appropriate actions to mitigate credit risk by purchasing delinquent loans from GNMA pools.

MidFirst believes there are alternative solutions for meeting the stated objectives of the rule change while not creating the disadvantages discussed above. MidFirst's recommendations are as follows:

1. MidFirst suggests that the most effective solution would be to require that all defaulted GNMA loans (both in GNMA pools and out of GNMA pools) be reported separately from other defaulted loan types, most preferably in a memoranda format, regardless of whether the loans are required to be rebooked by FAS 140. In this scenario, institutions would not report GNMA loans on the existing lines of Schedule PD as is the proposed requirement, but would footnote delinquent GNMA loans. MidFirst also suggests that such memoranda reporting be suppressed from public disclosure. In this manner, the Agencies would receive the GNMA loan data for regulatory oversight purposes just as they do now through periodic monitoring of the institutions, but the risks associated with public disclosure would be prevented.

2. Should the Agencies decide to move forward with the reporting as proposed, MidFirst strongly recommends that the current exception be continued for non-transferors. Specifically, we recommend that delinquent loans which are not required to be rebooked under FAS 140, while still in GNMA pools, be excluded from reporting when purchased from GNMA pools and booked to an institution's balance sheet. Continuing this exception would prevent loans from becoming reportable solely because an institution appropriately purchases delinquent loans from GNMA pools to mitigate its losses. In effect, this would prevent the servicer from being "punished" for choosing the best economic result of mitigating servicing losses by buying the delinquent loans from the servicing pools.

3. If recommendation number 2, above, is not possible, at a minimum we would recommend that the disclosure of assets on schedule PD be segregated by government insured and non-government insured, rather than combined in any form of total as currently proposed. This would avoid the confusion of combining different types of past due assets that have very different levels of true credit risk and ultimately give a much clearer picture of an institution's financial condition than what is presently proposed.

4. For those impacted by the proposed rule that would not be subject to a reporting exception, MidFirst suggests granting the option of reporting GNMA loans on PD on a prospective basis, such that only GNMA pools originated after the effective date of the proposed reporting change would be subject to the new rule. As management teams developed GNMA loan origination strategies pursuant to safe and sound management oversight, various issues would have been considered and weighed. In part because of the regulatory guidance at the time, it was never contemplated that significant volumes of loans securitized and sold would be reported to the public as past due at some point after the sale. It would be extremely unfair to penalize management and institutions for pursuing an activity that was well conceived pursuant to existing regulatory guidance, especially given the risk exposure stemming from the activity has not changed.

5. Finally, MidFirst suggests that the effective date of any such reporting change be delayed for 12 months following the publication of the final reporting requirements. In this manner, managers would be afforded adequate time to modify strategies that are reportable under the proposed rule, thereby minimizing the associated risks. Such a delay also affords management adequate time to develop and implement strategies to explain the results to the public.

MidFirst thanks you for the opportunity to respond and would be glad to answer any questions you might have.

Sincerely,

Todd A. Dobson
Chief Financial Officer