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October 13, 2016

Federal Housing Finance Agency
Office of Financial Analysis and Modeling
400 7th Street S.W., 9th Floor
Washington, D.C. 20219

Re: Single Family Credit Risk Transfer Request for Input

Dear Sir or Madam:

400 Capital Management LLC ("400CM"), an investment management firm established in 2008 with a focus on credit in various structured products markets including residential mortgages, welcomes the opportunity to submit this letter in response to the request of the Federal Housing Finance Authority ("FHFA") for input regarding Front-end Credit Risk Transfer ("CRT") transactions. 400CM has been an active investor in the various CRT structures and is pleased to share our perspective. We are supportive of the front-end CRT effort and encourage FHFA to focus on the following key aspects when evaluating various front-end CRT structures:

Key Recommendations:

I. **Enforce lender "skin-in-the-game"** - Lenders under the current structure still adopt an "originate-to-distribute" model in which there is no true credit recourse back to the lenders. It allows for misaligned incentives to reward lenders for volume of loans originated and not for quality. The consequences of such model for our economy have been severe as observed in the last economic downturn. We believe enforcing lenders to retain credit risk in their own loan production realigns the interests in structured finance towards long-term, sustainable lending.

The gap in available capital to fund the risk retention component can be bridged by allowing investment capital to be raised for pari-passu participation alongside the lenders. Under such structure, the participation for lenders will effectively function as an "earnout" and the initial

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capital outlay burden can be minimized. Such "earn-out" will be capitalized on the lender's balance sheet as a GAAP asset and any impairment or credit adjustments should flow through the lender's income statement, thus functioning as real "skin-in-the-game" to originator shareholders.

The relatively low barrier to entry from the lender's perspective allows for potential structures that can be replicated and scaled across multiple lenders. Furthermore, we believe such structures will allow for fair competition among lenders of all sizes and do not discriminate small-to-medium sized lenders versus larger counterparts, thus ensuring a level playing field.

In addition, we know such transactions will appeal to institutional investors that currently are not involved with existing CRT securities. New capital, separate from allocated capital into the traditional fixed income credit/structured credit markets, is available in scale that would further help the FHFA achieve its goal of broadening the investor base for CRT.

II. **Develop ability to conduct CRT on a forward basis** – While there has been tremendous progress in the development in CRT over a very short period of time, all structures that have been executed to date have been spot market transactions and the Enterprises are taking large amounts of exposure to market volatility. Development of CRT in which credit risk can be sold on a forward basis similar to how the Enterprises are able to access the funding markets ahead of time through To-be-announced ("TBA") trades should ease the volatility in execution experienced in capital market transactions and allow the Enterprises to maintain continuity in pricing while protecting the taxpayers' interests.

III. **Refrain from taking on further counterparty credit exposure** –Some non-fully funded front-end CRT options that have been mentioned in the *Single Family Credit Risk Transfer Request for Input* document contemplate Enterprises taking on further counterparty exposure to parties such as mortgage insurers or lenders. The Enterprises already have large amounts of exposure to those parties in the form of traditional mortgage insurance to the mortgage insurers and Representations and Warranties ("R&W") exposure to the lenders. We believe there is significant concentration

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and reimbursement risk associated with such approaches and that they are not optimal for the future of the housing finance system. We urge FHFA to only consider fully funded options when it comes to evaluating front-end CRT options.

We appreciate the opportunity to provide the foregoing comments in response to FHFA's Request for Input and would be pleased to participate in further discussions with FHFA on this topic. If you have any questions, please do not hesitate to contact me via telephone at (212) 612-3120 or via email at chentemann@400capital.com.

Sincerely,

Chris Hentemann
Managing Partner, Chief Investment Officer