

August 2, 1999

Mr. Mark Kinsey  
Acting Director  
Office of Federal Housing Enterprise Oversight 1700 G Street, N.W.  
Washington, D.C. 20552

Dear Mark:

Thank you for the opportunity to meet with you and your colleagues to discuss the OFHEO risk-based capital rule.

The Federal Housing Enterprises have and continue to play an important role in the housing and mortgage markets and we appreciate the role of the OFHEO in preserving the safety and soundness of the Federal Housing Enterprise system. At the same time, we are concerned that in application the OFHEO risk-based capital test may lead to misallocation of resources and a decline in innovation within the secondary market.

Just as is the case with the Enterprises and OFHEO, management at Countrywide is intimately involved with the complex issues relating to effective management of interest rate, credit, and operational risk. We believe that a stress test exercise, as called for in the enabling statute, is a valuable risk management tool. It is certainly useful for evaluating performance in extreme scenarios and serving as an adjunct to other risk management tools such as Value at Risk analysis and duration and convexity calculations.

However, there are certain issues related to implementation of the risk-based capital rule with which we are concerned and they are as follows:

1. There is a risk of compounding low probability assumptions, resulting in extreme capital requirements on certain lines of business, such as high LTV lending. This could result in raising the bar of home ownership to minorities and low-income families.
2. Incorporating modifications into the risk-based capital model to take into account additional data, or new programs, may be a cumbersome process, resulting in a barrier to continuing innovation in the secondary market.
3. The stress test methodology is unable to capture the essential dynamic nature of the hedging process. In our own hedging activities, Countrywide maintains a strict daily regimen of monitoring and managing our risk exposures. Hedge positions and potential exposures are monitored on a daily basis and adjusted as needed.

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4. Fannie Mae and Freddie Mac have been leaders in the development and application of risk management tools in the mortgage industry. It would not be desirable to incent them to reduce or divert this effort in favor of managing to the OFHEO model.

One way to blunt many of these issues is to place the responsibility for carrying out stress tests directly on the Enterprises. Freddie and Fannie would be responsible for building and implementing stress test models. The OFHEO model could be used to evaluate both the assumptions and results of the Enterprises analyses. This approach would be consistent with the regulatory trend in risk management oversight.

These are some of my impressions and ideas, which I would like to discuss further with you next week.

I look forward to our meeting.

Regards,

[signed Angelo R. Mozilo]

Angelo R. Mozilo

cc: Jeff Speakes