March 10, 2000

Ms. Anne E. Dewey
General Counsel
Office of General Counsel
Office of Federal Housing Enterprise Oversight
Fourth Floor
1700 G. Street, NW
Washington, DC 20552

Re: Proposed Risk-Based Capital Standards
64 Fed. Reg. 18084 (April 13, 1999)

Dear Ms. Dewey:

Charter One Bank, F.S.B. is a major financial institution operating throughout the upper Midwest of the U.S., with 417 branch offices and a residential mortgage banking company headquartered in Richmond, Virginia, providing mortgage loans in 12 states. We also operate a non-prime residential mortgage lending operation in the same geographic footprint. We are in the top 30 mortgage servicers in the country, top 25 of retail residential producers, and an active seller of residential loans to agencies such as FNMA and FHLMC (the "GSE's").

We recognize the complexity of the statutory specifications for the risk-based capital requirements. We have, however, extremely serious reservations regarding their implementation. Our comments are specific to the requirements of risk-based capital as they apply to the new lines of business which the GSE's have either entered or have announced major plans to do so. Intended activities include alternate A; A-; sub-prime; and expansion of second mortgage lending to both the open and closed-end varieties. These new riskier businesses raise questions regarding the appropriate capital requirements for the GSE's in such an expansion.

It is well recognized that alternative A, A- and sub-prime lending are materially riskier than the traditional A-type lending historically undertaken by the GSE's. Recent concerns of the FDIC regarding the expansion of sub-prime lending by federally insured institutions are reflective of the obvious higher levels of default and other significant problems inherent in these loans. The extensive data base of GSE purchased loans, on whose characteristics OFHEO developed the required risk-based capital level, does not provide the necessary data to analyze risks associated with these type loans, nor did OFHEO attempt to do so. In particular, the lack of credit scores as part of the risk-based capital assessment is a major flaw in the model. The intent of the GSE's to expand in these businesses is clear, and yet the proposed capital regulation does not sufficiently address the inherent risks of doing so.

Sub and non-prime lending also carries with it inherently increased servicing risks. An important question which must be addressed is the efficacy of traditional A servicers in understanding the complexities associated with sub and non-prime servicing.

Our understanding is that the sub-prime loans will be commingled into the loan pools which contain A paper. The prepayment assumptions and loss experience may, as a result, be significantly different for these loan pools. Thus, the performance of securities sold by the GSE's may deteriorate unexpectedly given this incursion into sub and non-prime lending and higher capital levels may be required by the financial markets to assure the top grade investment credit rating.

The GSE's have also announced major expansion into second mortgage lending and where, once again, issues of increased servicing risks and lower loan performance over time exist, given potentially higher levels of default are areas of concern. Yet, there is no indication of utilization of FICO scores in the OFHEO model to reflect these concerns.

Our company's experience as a sub-prime lender has shown us that the nature of the risks associated with such lending cannot be calculated solely on the basis of the prior credit history, credit scores and traditional credit underwriting standards. We have found materially higher levels of fraud in such lending and higher levels of collateral valuation issues than any reliance solely on A credits and the experience of A credit lending would have projected. And, accordingly, we have provided reserves and evaluated our capital adequacy in light of such experience.

We believe that these two business areas require a risk-based capital "surcharge" to the regular risk-based capital calculation. The GSE's should provide their projections of delinquencies and default rates on these products for these new business ventures and OFHEO should assess those projections in light of OFHEO's own presumptions regarding capital adequacy. These higher losses inherent in this type of lending, plus the inherent uncertainty of these loss projections based on to-date limited experience should both be employed in determining an appropriate capital surcharge on top of the normal capital requirement.

The housing system in the United States has produced home ownership levels which are the envy of the globe. The benefits of the liquidity underlying the U.S. housing markets are well known and can hardly be understated. We believe, however, that these new lending areas of the GSE's represent major new risks which the proposed capital regulation is materially insufficient in addressing. Accordingly, we strongly believe that the proposed risk-based capital levels should be amended and a significant risk-based capital surcharge should be applied to these new activities for the next five years or until such time as the higher level of risk inherent in such activities can begin to be fully assessed.

Very truly yours,

[signed: John D. Koch]

John D. Koch
Executive Vice President

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