January 15, 2002

Mr. Alfred Pollard, General Counsel
Office of Federal Housing Enterprise Oversight
Fourth Floor 1700 G Street, NW
Washington, DC 20552

Dear Mr. Pollard;

On behalf of Self-Help Ventures Fund, we would respectfully like to comment on OFHEO's proposed amendments and technical revisions to the Risk Based Capital Rule. As we have expressed in previous commentary, our concern is to ensure that the Enterprises' efforts to increase homeownership are not negatively affected by overly restrictive capital requirements.

The amendments include several very positive adjustments that better align capital requirements to risk. Reduced haircuts and the extended phase-in period make significant progress in better attributing value to system-wide capital. The recognition of partial recovery in the event of counterparty default is also a signficant advance. The additional flexibility to allow certain unrated seller/servicers to qualify for higher-rated treatment is a very positive adjustment. It is clear that OFHEO has carefully considered and evaluated information from many sources to ensure that the Risk Based Capital Rule more equitably addresses a variety of risk-sharing options.

At the same time, we recommend additional considerations that we believe will maintain capital integrity without having the detrimental impact that excessive capital requirements may have on the affordable housing mortgage market. First, we recommend that you consider further haircut reductions, particularly in the BBB category. Second, we suggest that you encourage the Enterprises to seek innovative risk-sharing arrangements to expand homeownership opportunities by allowing prudent flexibility in evaluating counterparty credit enhancements.

As background, Self-Help is one of the nation's oldest and largest Community Development Financial Institutions (CDFI's). Under our "Community Advantage" program, we have delivered over $1.3 billion in purchase mortgages for low-wealth families to Fannie Mae over the last 3 years. This national demonstration is a ground-breaking $2 billion experiment among Fannie Mae, Self Help and the Ford Foundation to expand homeownership opportunities for low-wealth and low-income households. Now into our third year, this program has been a resounding success. We have financed over 21,000 low- and moderate-income households' home purchases, helped facilitate changes

in Fannie Mae's approach to affordable lending. The University of North Carolina has developed in-depth research on our program so that results can be shared with the industry. Losses to date have been less than 0.1% of loans made.

This model program is only possible because Fannie Mae accepts full recourse from Self-Help on otherwise non-conforming mortgages. Our recourse is supported by a $50 million grant from Ford and additional organizational net worth of over $100 million. Despite our capital strength, we are unrated, in large part because the rating agencies have not established criteria for rating CDFI's. As a result, our recourse would fall in the BBB category.

While the effective amount of this haircut has been reduced from the original rule, it still appears excessive both from the standpoint of the appropriateness of the BBB-rated default projections and from the standpoint of Self-Help (an unrated seller/servicer) and our value as a counterparty. Both of these points are discussed in more detail below.

First of all, the haircut appears excessive from the standpoint of the benchmark BBB historical default data. While your model assumes BBB default rates of 40%, there is substantial data to support reducing this default rate to 30% or lower. Consider *financial industry* bond experience during the 1980's – more relevant than using all industrial bonds – and especially appropriate because it corresponds with the actual event of the mortgage loan stress-test benchmark. Even the worst performing 5–year cohort of 1980-1985 bonds shows a BBB default rate of 10.7%, almost 4 times lower than in your model. This data also supports lower default assumptions for A- and AA-rated counterparties. Self-Help supports appropriate further reductions in haircuts for all these categories. However, it is in the BBB category where the model most exaggerates the default probability relative to the data:

10-year cumulative default rate by rating	1980-85 financial inst. 5-year cohorts	RBC Rule (& revision)	Gap from 1980-1985 cohorts
AAA	0%	5%	
AA	7.5%	12.5%	1.67 times
A	6.6%	20%	3.03 times
BBB	10.7%	40%	**3.74 times**

Source: Moody's

Even if you choose to use the more conservative Depression-era benchmarks, the average performance of the worst 5-year cohorts supports a 26.86% default rate for Baa- rated institutions – still substantially lower than the proposed 40%. The technical revisions make strides in better aligning AA default rates with AAA. However, in your revisions, the BBB default rate remains at 8 times the AAA default rate (while the 5-year cohort depression area data suggests only a 5.5 times higher cumulative default rate). A multiple of 5.5 times AAA would suggest a BBB default rate of only 27.5%:

10-year cumulative default rate by rating	Worst 5-yr cohort group '28-'32	Default rate relative to AAA	RBC "Rule" default rate (& revision)	Default rate relative to AAA
AAA	4.89%	N/A	5%	N/A
Baa	26.86%	**5.5 times**	40%	**8 times**

Source: Moody's

As noted in your revisions, "The relationship between AA and AAA defaults is particularly relevant because most Enterprise counterparty and security exposures are either AAA – or AA-rated. An excessive differential …would create inappropriate business incentives for the Enterprises." We very strongly support technical changes that reduce the capital requirements for the AA insurers, but particularly ask that you better adjust the alignment of BBB to the AAA rating as well to enable us and other unrated seller/servicers to provide mortgage financing to low and moderate income households.

The second basis for our concern that the capital requirement is still too high is because of Self-Help's unique program. Because we cannot obtain a rating, we would fall into the BBB category. However, with $50 million in capital support from the Ford Foundation, plus another $100 million in additional equity (for a debt to equity ratio of 3.5:1), we have a significant amount of capital to back our credit-enhancement. Furthermore, we have established a loss reserve from interest spread on the loans (average of 75 basis points/year). Our contract with Fannie Mae establishes further safeguards: we must meet net worth requirements and we maintain a collateral account held by Fannie Mae equal to 1% of the outstanding principal balance of the loans on which we have recourse. In addition to capital, we bring other risk mitigation tools to demonstrate how this type of lending can be done safely and soundly – for example, appropriate risk pricing, aggressive loss mitigation, limitations on third-party originations, accepting only purchase money mortgages. While we do expect losses to grow due to seasoning of the portfolio, these tools have helped keep our loan losses low.

In your July 19 Regulation, you state "OFHEO further notes that the Enterprises' affordable housing programs are currently well-run and the Enterprises effectively mitigate increased risk associated with high LTV loans with credit enhancements." We believe this is an excellent description of the Fannie Mae/Self-Help partnership. Yet, if we were to propose this program today, we might expect a different outcome based on the Risk Based Capital Rule. The Rule hits hardest the people we are trying to serve - the lowest-wealth households - through a compounding effect: high mortgage default rate and loan loss severity assumed for higher LTV loans in the stress-case, causing the Enterprises to seek counterparty risk-sharing arrangements; deep discounts for those counterparties – particularly for unconventional (but not necessarily high-risk counterparties); further magnified by a factor of 30% for operational risks. The resulting capital costs could prove to be cost prohibitive for the segment of the market we serve, making our program non-viable and disadvantageous when compared to AAA-rated counterparties. Yet our borrowers do not necessarily have the option of turning to AAA-rated counterparties. Unfortunately, the only options for these borrowers often rests in the sub-prime and predatory lending market, or in the deferral of homeownership altogether.

We want to ensure that the RBC evaluation is flexible enough to give full value to our credit enhancement and other similarly innovative arrangements. This flexibility is particularly critical in the area of affordable lending where options are so limited. In your amendments, you indicate flexibility will exist for certain unrated seller/servicers and you

provide a clear example of a DUS seller/servicer using a fully funded reserve account mechanism. We support this flexibility and encourage you to build in the flexibility to evaluate various credit enhancement structures of unrated seller/servicers.

In summary, we fully appreciate how essential capital adequacy is to the sustainability of homeownership financing. We applaud the amendment and technical corrections you are proposing to make to the Rule. We hope you will carefully consider further reductions in haircuts, particularly for BBB- (and un-) rated seller/servicers, which we recommend not to exceed a 30% default rate. And we encourage you to continue to empower the Enterprises to seek innovative ways to expand homeownership in a safe and sound manner by allowing for flexibility.

Thank you for the opportunity to comment on the proposed Risk Based Capital Rule and the amendment.

Sincerely,
(signed by)

Martin D. Eakes
CEO