John McMurray/Managing Directors/CF/CCI
07/17/2006 04:22 PM

To Greg Hendry/Managing Directors/CF/CCI@Countrywide, Jie Ling/Accounting/CF/CCI@Countrywide
cc Clifford Rossi/Lending/Bank/CCI@Countrywide, Rod Williams/Managing Directors/CF/CCI@Countrywide
bcc
Subject Re: Disclosures of Credit Risk Management Policies

I'm a huge advocate of expanding our disclosures in this area, including adding information to the Qs ahead of the K. I'll check on doing something like Wells. In the meantime, can we please "beef up" our disclosures in the following areas?

Environmental Factors. Our credit disclosures need more information on the environmental factors that will affect performance. I've listed the major factors below and briefly explained why all are likely to increase our delinquencies, defaults and credit losses going forward.

House Prices. House price performance over the past few years has been a tremendous positive for credit risk. As we return to a more normal environment, or worse, we can expect to see delinquencies and defaults increase. Because conditions have been so favorable, the "reversion to the mean" may be especially abrupt causing delinquencies and defaults to increase dramatically.

Credit Guidelines. The industry has expanded credit guidelines very aggressively over the past several years. Some transaction combine risk factors or risk levels that were not seen in previous cycles. The delinquencies and defaults from these transactions will be higher.

Interest Rates. This is another environmental trend that's bad for credit. Until recently, interest rates have mostly declined. There's not much room for rates to decline further. I see this having an adverse effect on credit performance in at least two separate dimensions. One, borrowers with adjustable rate mortgages will see higher rates and higher payments. Two, we won't see as many prepayments (prepayments and defaults are inversely correlated).

Economy. The general economy, particularly employment, has been favorable in recent years. Here too, the probabilities seem skewed towards a worsening environment. Our statistical studies show a strong relationship between unemployment and serious delinquencies.

Commercial Exposures. We're increasing our exposure to commercial credit, which is much "lumpier" than residential. We should identify the major commercial credits (CRE, CWL, Reverse Repo, Builder Finance). We should also point out that, because each credit is large, the consequences of a default may be material. Some of the largest CWL accounts reach $1B in line size.

Operational Issues. There are operational considerations which affect our credit exposure. Following are two broad examples:

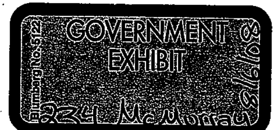
Loan Manufacturing. There are many steps in the loan manufacturing processes. To the extent any of these is not performed correctly, we will be exposed to unexpected losses.

Executions. The company participates in a variety of executions to sell and/or credit enhance loans. There are steps subsequent to loan manufacturing, which if not performed correctly, could create unexpected losses.

I'll have additional input later, but wanted to get this to you now. Let me know if you want to discuss any of this. Thank you.

Cliff & Rod, please feel free to add to or elaborate. Thanks.

Greg Hendry/Managing Directors/CF/CCI



Greg Hendry/Managing Directors/CF/CCI

07/15/2006 02:14 PM

To John McMurray/Managing Directors/CF/CCI@Countrywide

cc

Subject Disclosures of Credit Risk Management Policies

As we discussed last month, I am in the process of drafting more robust disclosures surrounding credit risk management and the allowance/provision for loan losses. An item disclosed by a competitor that we may be asked to include in our disclosure documents, relates to the sensitivity of the allowance to changes in estimates we make. Our good friends Wells Fargo show a range and discuss the changes in assumptions that can cause the allowance to move in that range. I suspect that there will be some push for us to provide such disclosure in our year-end disclosures. With that in mind: (1) does credit management perform any kind of sensitivity analysis in its valuations; and (2) if not, can this be done?

I would like to avoid a fire drill for all of us in February if we decide to disclose this number and would like to know what we would be able to provide so we can shape the disclosures proactively as opposed to having to fit into somebody else's model early next year. I would appreciate your feedback.

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Confidential Treatment
Requested by John McMurray

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