



Risk Finance International

FraudGUARD[®] Insurance

2010

Demand drivers

Competitive pressures previously permitted correspondent banks and brokers freedom over loan origination practices.

“At some of our most sophisticated financial firms, risk management systems did not keep pace with the complexity of new financial products. The lack of transparency and standards in markets for securitized loans helped to weaken underwriting standards.”

Financial Regulatory Reform: A New Foundation 2009

Today’s scarce capacity allows warehouse and wholesale lenders the ability to regain control over lending quality as is required by investors and regulators.

Simple, uniform, impartial, outsourced RM approach and clarity of insurance coverage ensures consistent loan quality and value to the secondary market

Process and Benefits

Loan application received by correspondent or broker

File submitted to wholesale for review

FraudGUARD run by wholesale

Loans scores > 600.

Loan funded.

Loans scores < 600.
Variance cleared or loan returned to broker for more info.

Loan automatically qualifies for cover with 600 score

Loan notified to insurers

Loan protected against loss from borrower misrep

Premium per loan
Limit per loan with aggregate limit per bank or business channel

“Increased standardization in a securitization transaction creates additional liquidity in the market because the due diligence process required to make an investment decision becomes more efficient.

One of the areas where standardization is especially crucial is in the representations and warranties that issuers provide to investors, which help ensure that the mortgage loans in a given pool are of a certain quality.”

ASF Project RESTART - ASF Model RMBS Representations and Warranties RFC JULY 15, 2009

Reps and warrants in Loan Sale Agreements are becoming standardised, however capital to support R&W's is required.

“Moody's will not rate transactions where the loan level R&W provider has been assessed as "unacceptable" by Moody's or where the R&W provider does not have a sufficient net worth”

Moody's Criteria for Evaluating Representations and Warranties in U.S. Residential Mortgage Backed Securitizations Nov 24th 2008

Admin fee charged to correspondent or broker

Correspondent relieved of misrep repurchase liability in loan sale agreement

Liability transferred to consortium of (min) A rated insurance capacity

Expert third party due diligence is required by rating agencies in order to provide a rating to a residential mortgage backed security

“Going forward, Moody's will not rate a U.S. RMBS transaction unless there has been a TPR that at least meets our minimum sample size. If the minimum sample size is met, but the sample size is still less than Moody's target sample size or if the TPR findings are poor, Moody's may decide i) that more credit protection is needed to achieve a given rating level, ii) to assign a lower rating or iii) to decline to rate the transaction.”

Moody's Criteria for Evaluating Independent Third-Party Loan Level Reviews for U.S. Residential Mortgage Backed Securities (RMBS) Nov 24th 2008

FraudGUARD used to screen every loan in the pool

Exceeds ratings agency minimum and target sample size

Information assymetry is seen as a key friction of the securitisation of mortgage loans

“An overarching friction which plagues every step in the process is asymmetric information: usually one party has more information about the asset than another.

...

In particular, the originator has an information advantage over the arranger with regard to the quality of the borrower.”

Understanding the Securitization of subprime mortgage credit Adam B. Ashcraft, Senior Economist, Financial Intermediation. Federal Reserve Bank of New York 2007

Uniform independent due diligence on every loan

Guarantee of due diligence quality backed by insurers

Reduced QC costs for secondary market while guarantee in place

Cost benefits passed back to originator either with direct pricing or preferential liquidity

“The effectiveness of a bank's risk management practices ... directly influences the regulatory assessment of capital adequacy.” -

FDIC - Economic Capital and the Assessment of Capital Adequacy

“Under the AMA, a bank will be allowed to recognise the risk mitigating impact of insurance in the measures of operational risk used for regulatory minimum capital requirements.”

Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework - June 2006

Insurance provides recognised contingent capital alternative to risk capital

3 year non cancellable coverage window for covered loans

Loan loss reserve release

Released capital deployed in the business

Lack of notification requirement ensures smooth transition of policy benefit. Mortgage owner suffering the loss can claim directly under the policy until the limit per loan or aggregate is exhausted.

Loan sold

Cover automatically transfers with loan ownership

No notification requirement

Servicer claims directly against the policy on behalf of investors

A simple claims process enhances the value of the product to the original insured by creating a direct recoverable for the investor community

Loan becomes delinquent within 36 months of origination

Fraud Suspected and notified to insurers

Foreclosure completed

Owner at time of foreclosure makes claim

Proof of loss submitted to RFI

Claim paid

“Any doubt in an insurer's commitment as a result of financial constraints, but also due to business practices could have a significant negative impact .”.

Reputational Risk in the context of A.M. Best's Rating Analysis, Michael Zboron, 2006

Alignment of interest between Insured and Insurer operates more efficiently where both parties agree to an impartially designed and administered product.

Claims handled by product design co ensures contract performance

Consortium of leading international insurers to provide strongest available capacity

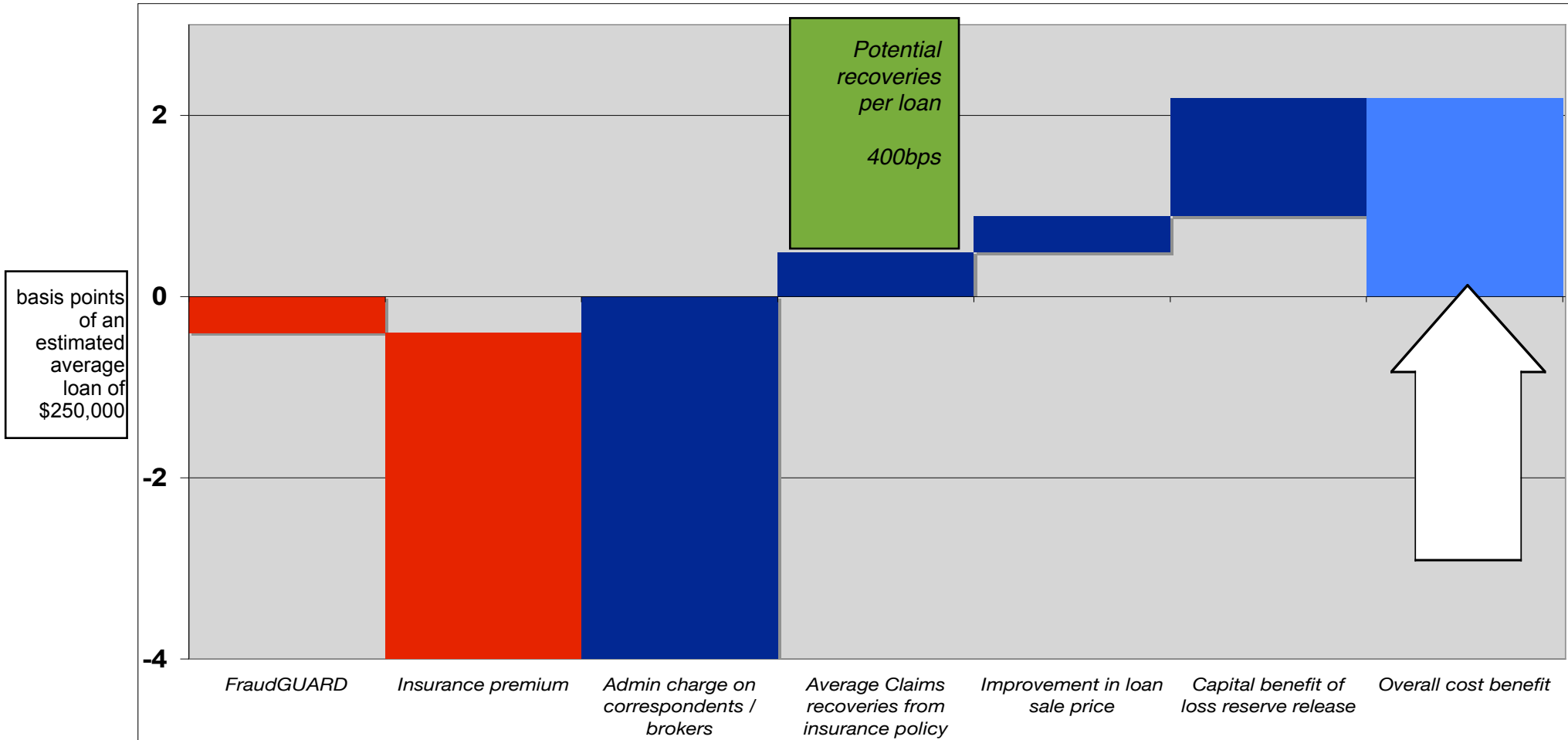
Mortgage Industry led product design



Risk Finance International

Warehouse Economic Value

Cost benefit per loan of improved loan quality and risk transfer.



basis points of an estimated average loan of \$250,000

\$10 - 0.4 bps

pricing is for illustration only. insurance premium for individual clients based on historical and expected claims example cover limit \$100,000 per loan

\$90 - 3.6 bps

\$100 - 4 bps

discretionary charge by warehouse to cover RM costs

\$12 - 0.5 bps

loss ratio from insurance pricing model – adjusted for time loans held

\$10 - 0.4 bps

minimum expected uplift from trading desk interviews

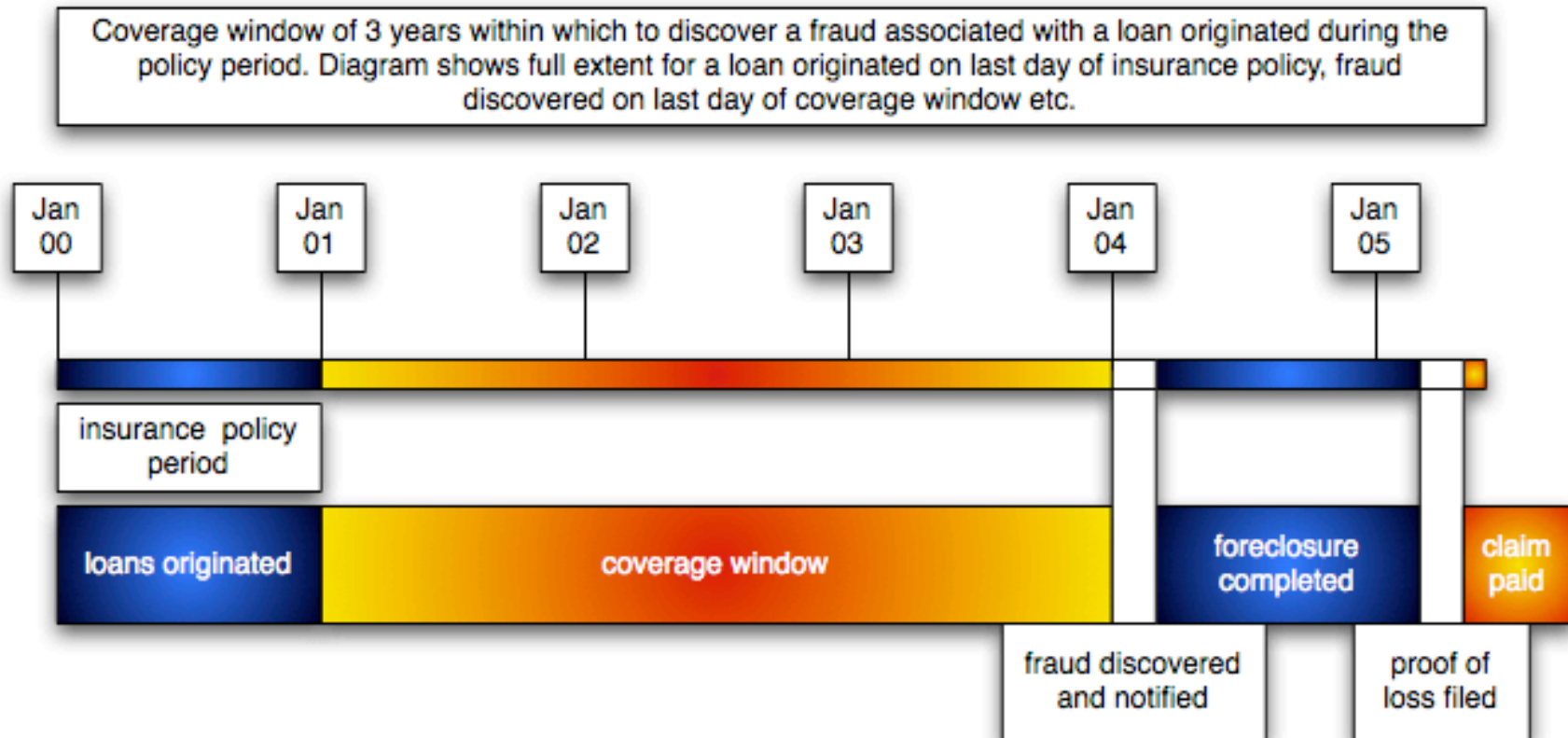
\$32.50 - 1.3 bps

assumes a 20% ROC on 6.5 bps loss reserve release

\$54.70 - 2.2 bps

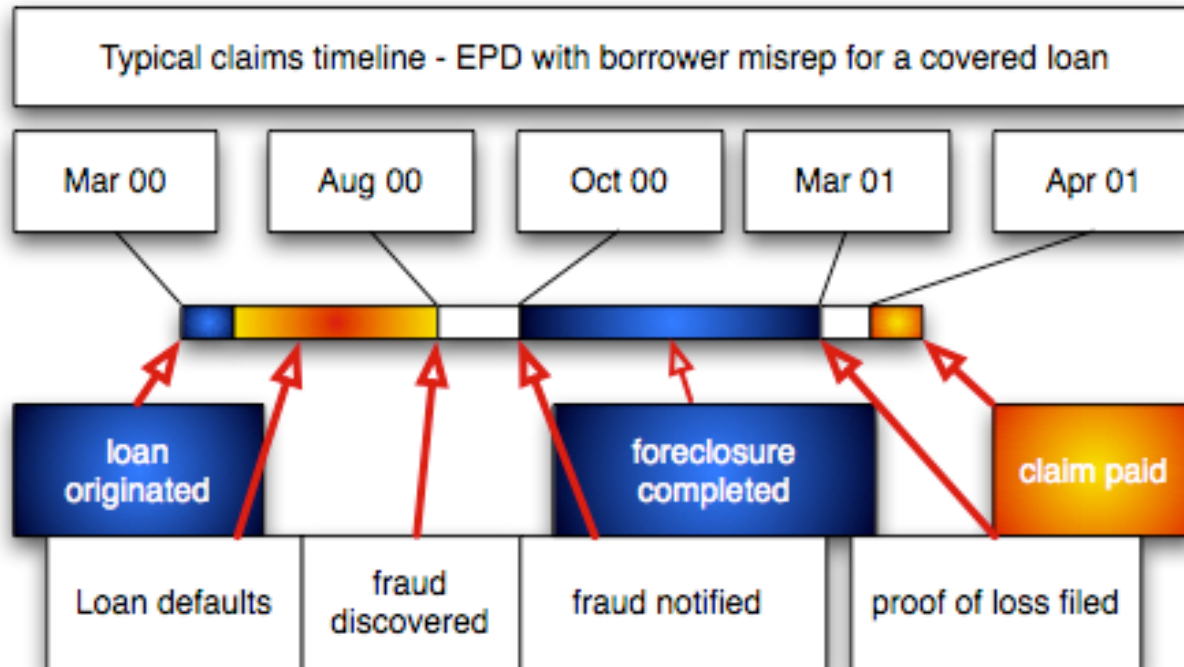
Coverage Window

Fraud discovered on a loan originated and notified during the policy period which has a FraudGUARD® score of 600 or higher for a coverage window of 3 years from the month the loan closed:



Example Claim timings

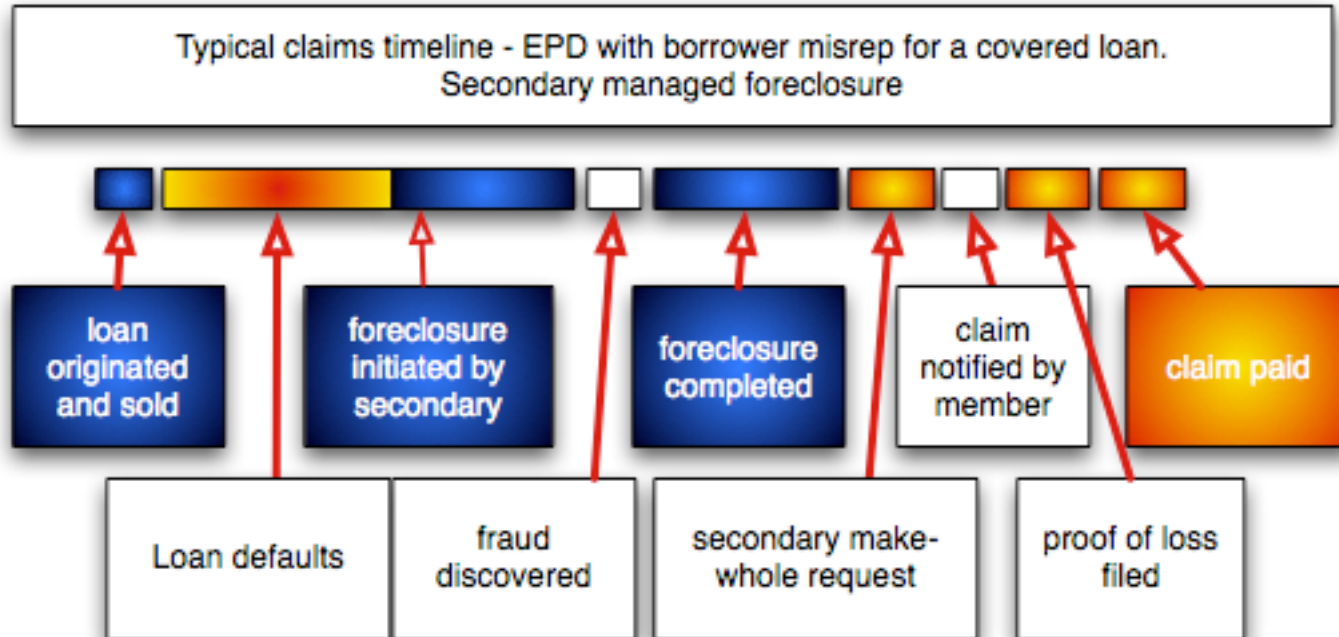
1



- Loan originated and sold to secondary
- Borrower defaults
- Secondary engages put back through breach of performance reps/warrants
- Loan repurchased
- Fraud discovered
- Claim notified
- Foreclosure initiated
- Proof of loss filed
- Claim paid

Example Claim timings

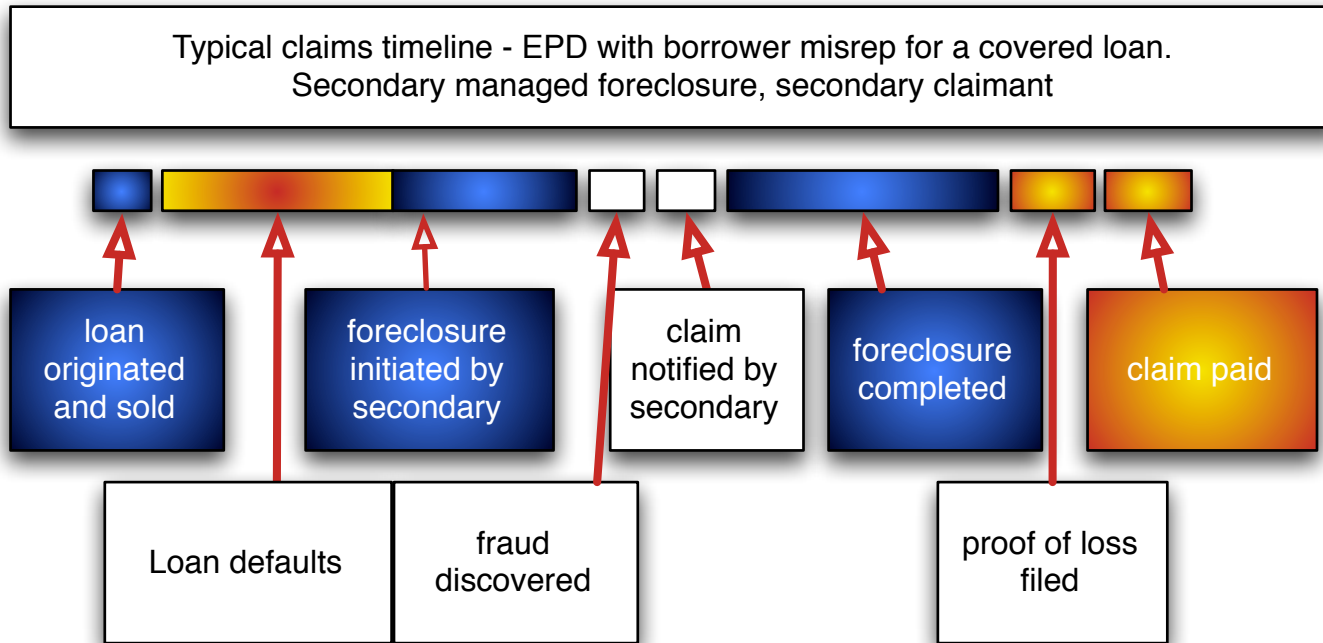
2



- Loan originated and sold
- Borrower defaults
- Secondary initiates foreclosure
- Fraud discovered
- Make-whole request from secondary
- Claim notified by originator
- Proof of loss filed
- Claim paid

Example Claim timings

3



- Loan originated and sold
- Borrower defaults
- Secondary initiates foreclosure
- Fraud discovered
- Claim notified by secondary
- Foreclosure completed
- Proof of loss filed
- Claim paid directly to secondary