INSIDE MORTGAGE FINANCE'S

Inside B&C Lending

ElectronicEdition

An In-Depth Report On The Dynamic Subprime Mortgage Business

INSIDE MORTGAGE FINANCE'S
Inside B&C Lending
Electronic Edition
Your Best Source of News and Data on the Subprime Mortgage Business
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Inside This Issue…

Subprime Mortgage Debt Outstanding Continues to Decline

Subprime servicers' portfolios have taken a hit this year, posting unprecedented declines. And with subprime originations stalling, it could be a long time before subprime servicing portfolios increase.

Meanwhile, sources suggest that Fannie Mae is considering buying a major subprime servicer.

Volume in the portfolios fell for a second consecutive quarter, according to estimates by *Inside B&C Lending*. The volume of subprime mortgages serviced in the second quarter of 2007 dropped 8.3 percent compared to the previous quarter, to an estimated $1.00 trillion.

The decline follows a 0.9 percent decrease in the first quarter and marks the first time this decade that subprime mortgage debt outstanding has decreased in two consecutive quarters. In fact, before this year, the last time subprime mortgage debt outstanding fell at all was in 2002. At that time, the volume serviced was half of what it is currently.

Subprime servicing is unlikely to grow any time soon, as subprime originations continue to decline. They fell 39.2 percent in the second quarter of 2007, compared with the already dismal results reported in the previous quarter. The subprime volume serviced in the second quarter of this year is also down 20 percent from year-ago levels.

In addition, foreclosures are rising and borrowers are refinancing out of subprime adjustable-rate mortgages.

However, while the overall sector is in decline, nine of the top 20 subprime servicers posted gains compared to the previous quarter as the remaining volume consolidated.

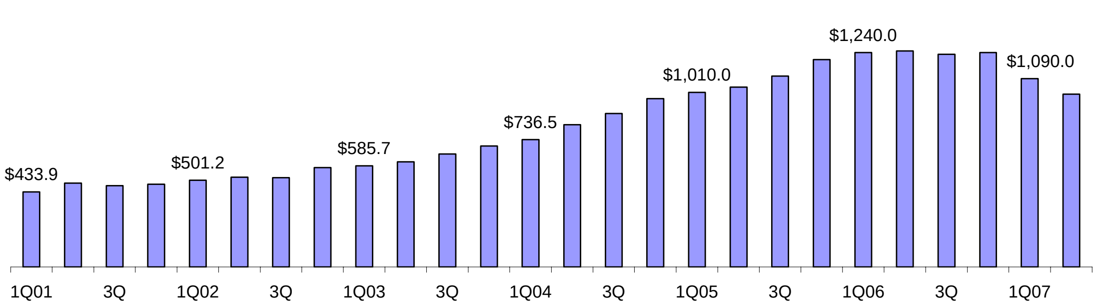
Countrywide Financial remained the top subprime servicer in the second quarter, and managed to increase its portfolio slightly. Countrywide's subprime servicing portfolio hit $125.81 billion in the quarter, up 0.5 percent from the previous quarter and 8.8 percent higher than year-ago levels.

(continued on page 3)

Top 20 B&C Servicers in 2007

(For 6 Months - Dollars in Billions)

		Servicing Volume			Mkt	Growth	
Rank	*Lender*	*2Q07*	*1Q07*	*2Q06*	*Share*	*1Q07-2Q07*	*2Q06-2Q07*
1	Countrywide Financial, CA	$125.81	$125.14	$115.62	12.6%	0.5%	8.8%
2	Chase Home Finance, NJ	$81.65	$83.13	$78.41	8.2%	-1.8%	4.1%
3	Option One Mortgage, CA	$65.25	$66.24	$74.06	6.5%	-1.5%	-11.9%
4	Home Loan Services (Merrill Lynch), PA	*$55.00*	$52.58	$44.20	5.5%	4.6%	24.4%
5	Ocwen Financial Corporation, FL	$53.12	$42.89	$46.39	5.3%	23.9%	14.5%
6	Wells Fargo Home Mortgage, IA	$52.19	$52.39	$47.20	5.2%	-0.4%	10.6%
7	HomEq Mortgage Servicing, CA	$50.19	$45.49	$42.30	5.0%	10.3%	18.7%
8	HSBC Finance, IL	$48.20	$47.80	$39.81	4.8%	0.8%	21.1%
9	Residential Capital LLC	$48.04	$54.31	$55.17	4.8%	-11.5%	-12.9%
10	Litton Loan Servicing, TX	$46.44	$47.92	$46.10	4.6%	-3.1%	0.7%
11	Ameriquest Mortgage, CA	*$46.00*	$56.10	$71.03	4.6%	-18.0%	-35.2%
12	Washington Mutual, WA	$45.83	$47.40	$41.93	4.6%	-3.3%	9.3%
13	CitiMortgage, NY	$43.12	$40.46	$40.78	4.3%	6.6%	5.7%
14	Saxon Mortgage, VA	$38.12	$29.32	$26.40	3.8%	30.0%	44.4%
15	Carrington Mortgage Services, CA	*$30.00*	*$35.00*	$39.70	3.0%	-14.3%	-24.4%
16	Wilshire Credit, CA	*$28.00*	$28.37	$20.24	2.8%	-1.3%	38.4%
17	EMC Mortgage Corp, TX	$22.51	$22.64	$20.36	2.3%	-0.6%	10.6%
18	American General Finance, IN	$18.48	$18.23	$18.46	1.8%	1.4%	0.1%
19	NovaStar Financial, KS	$15.45	$16.24	$15.89	1.5%	-4.9%	-2.8%
20	Nationstar Mortgage (Centex), TX	$10.77	$10.66	$10.19	1.1%	1.0%	5.7%
	Total for Top 5 Servicers:	$380.8	$370.0	$358.7	38.1%	2.9%	6.2%
	Total for Top 10 Servicers:	$625.9	$617.9	$589.2	62.6%	1.3%	6.2%
	Total for Top 20 Servicers:	$924.2	$922.3	$894.2	92.4%	0.2%	3.3%
	Total B&C Servicers:	*$1,000.0*	*$1,090.0*	*$1,250.0*	100.0%	-8.3%	-20.0%



Subprime Mortgage Debt Outstanding

(Dollars in Billions)

Notes: Subprime mortgage and home equity lenders were asked to report their servicing volume as of June 2007. When available, earnings reports or public documents were used to confirm volume. Estimates of individual firms are by Inside B&C Lending based on publicly available data. Estimates are in italics. B&C mortgages are defined as less than A quality, non-agency loans secured by real estate.

Source: Inside B&C Lending, Copyright 2007

Subprime Servicers…

Fifth-ranked subprime servicer Ocwen Financial posted major increases in its subprime servicing portfolio, up 23.9 percent on the quarter and 14.5 percent compared to 2006. Morgan Stanley's Saxon Mortgage also significantly increased its subprime servicing portfolio, up 30.0 percent on the quarter and 44.4 percent from 2006.

And Carrington Mortgage Services acquired bankrupt subprime lender New Century Financial's servicing portfolio during the second quarter.
This week, Fitch Ratings placed NovaStar Financial's subprime servicer rating on negative watch. The rating service said the move reflects the "increasingly challenging operating environment" in the subprime market.

"Fitch believes NovaStar's financial flexibility is under significant strain, similar to many other independent seller/servicers," the rating service said.

Fitch noted that the subprime market is currently mired by "significant disruption in the secondary mortgage market and the resultant decline in liquidity."

Fannie Eyes Litton

Responding to pressure to help out the troubled subprime mortgage market -- and taking advantage of the current depressed pricing for mortgage-related firms -- Fannie Mae reportedly is looking to buy Litton Loan Servicing.

As first reported in affiliated publication *Inside the GSEs*, sources close to Fannie recently confirmed that the government-sponsored enterprise is in fact looking at acquiring the so-called "special servicer" based in Texas that specializes in servicing subprime mortgages and loss mitigation. Litton is owned by C-Bass, a major subprime mortgage securitizer that is undergoing serious financial strain.

By acquiring Litton, Fannie Mae would gain the ability to handle and work out a variety of troubled mortgages, particularly subprime loans. But the GSE also would be moving directly into the mortgage servicing business, an activity that would compete with many of its customers in the primary mortgage market.

"It's hard to believe that Fannie would be looking to acquire someone like Litton unless it had the blessing of the Office of Federal Housing Enterprise Oversight," said one GSE observer, adding that both Fannie and Freddie have been under pressure from regulators to do more to help the subprime mortgage market.

Legally, neither Fannie nor Freddie is prevented from engaging in mortgage servicing, although the GSEs' charters suggest their activities should be limited to the secondary market. And in the past there have been strong mortgage industry objections when either Fannie or Freddie has engaged in primary market activities.

But given the current capital markets crisis, where both investors and lenders are looking for any kind of relief from the problems associated with a meltdown of the subprime mortgage market, complaints about Fannie moving into the servicing business may be muted.

Litton was the 10th largest subprime servicer in the country as of June 30, with $46.44 billion in subprime servicing volume. ✦

Subprime Contagion Hits Top-Ranked Countrywide

Recent suggestions that Countrywide Financial, the top-ranked subprime lender and number one overall lender, could go bankrupt, put a whole new face on the subprime market's problems.

A report last week by Merrill Lynch raised the possibility that Countrywide could face bankruptcy as liquidity dries up. Analysts have since rebutted the suggestion and the lender has flexed its financing muscles – and received a reassuring $2 billion equity investment from Bank of America.

However, Countrywide could be planning to significantly reduce its subprime originations. The lender said it "materially tightened" its underwriting standards for subprime mortgages and expects that 90 percent of the loans it originates will be eligible for purchase by Fannie Mae or Freddie Mac or will meet its bank's investment criteria.

Meanwhile, the suffering continues. Lenders that accounted for 25.7 percent of the subprime production in 2006 have ceased operations, according to estimates by *Inside B&C Lending*.

And many of those that persist have scaled back operations. But subprime lending aspirations look to be futile at this point, as the secondary market has stopped buying subprime mortgages, making lending virtually impossible.

Lehman Brothers closed BNC Mortgage, its subprime lending unit this week. The investment bank said it will continue to make loans through Aurora Loan Services, its Alt A unit, but the move effectively scuttles a previous plan to merge the two units.

The closure will cost 1,200 employees their jobs and cost Lehman $52 million in losses. BNC was the 10th-ranked subprime lender through two quarters of this year.

The investment bank said “market conditions have necessitated a substantial reduction in its resources and capacity in the subprime space.” Lehman acquired BNC in 2004.

A number of other Wall Street firms continue to operate subprime lending platforms, at least for the moment. These include Bear Stearns’ EMC Mortgage, Merrill Lynch’s First Franklin Financial, Morgan Stanley’s Saxon Mortgage, Deutsche Bank’s MortgageIT, Barclays’ EquiFirst and Credit Suisse’s Lime Financial.

Also this week, Accredited Home Lenders ceased lending and laid off 1,600 of its 2,600 employees. The move certainly throws a kink into the already contentious negotiations between the lender and private-equity firm Loan Star Funds, which until recently hoped to acquire Accredited.

“We believe that the streamlining of our operations and significant curtailment of new loan originations are required to preserve liquidity during the current and anticipated market conditions, and are also designed to position Accredited to compete in the mortgage market when it functions more rationally,” James Konrath, the lender’s chairman and chief executive officer, said.

The 17th-ranked subprime lender through two quarters in 2007, Accredited said it will close its 60 retail branch locations. The move is curious, as most subprime lenders looking to restructure have maintained their retail presence but ceased wholesale lending.

Accredited, however, said it will continue to operate five of its 10 wholesale divisions and will resume wholesale lending when market conditions improve. Additionally, the lender will continue to operate its servicing unit.

Accredited said its restructuring and a recent trade of $1 billion of the lender’s loan inventory with a right to repurchase will enable the lender to operate until market conditions improve and it can resume loan origination operations. The lender said it expects to maintain its three warehouse credit facilities with a total capacity of $1.6 billion for originations.

Lone Star and the lender entered a “definitive merger agreement” in June, with the private-equity firm offering to purchase Accredited for $400 million, but the deal stalled. Earlier this month, Accredited announced that it received regulatory approval from states representing over 95 percent of its loan production volume for 2006, thereby satisfying one of the primary conditions to close the sale.

However, Loan Star has yet to close the deal and instead has extended the sale’s deadline, most recently to Aug. 28.

NovaStar, Delta Slash Workforce

NovaStar Financial, meanwhile, laid off 500 employees late last week, cutting its workforce by 37 percent. The lender stressed that it continues to meet all of its loan commitments, and its servicing and portfolio management organizations will not be affected by the reduction.

However, included in the cuts was David Pazgan, the president and CEO of NovaStar Mortgage, the lender’s wholesale division. The lender said it has currently halted wholesale lending but will “follow through” funding loans already approved through the wholesale channel.

Lance Anderson, president of NovaStar, said wholesale lending hampered the lender’s profitability. “For now, we believe this is the right thing to do economically,” he said. “Our retail channel will be the dominant source of new loans in the coming months.”

And Anderson pinned the layoffs on pricing the lender is receiving in the secondary market.

“During this challenging time in the housing market, NovaStar continues to honor its commitments while taking steps to adapt to industry-wide credit conditions and disruptions in the capital markets,” he said. “Our decision to reduce employment is painful but is required by market conditions and financial discipline.”

Delta Financial cut 20 percent of its workforce this week. Delta, the 22nd-ranked subprime lender through two quarters this year, eliminated 300 jobs.

“This workforce reduction is an unfortunate byproduct of the current times we are in,” said Hugh Miller, the lender’s president and CEO. “Delta remains committed to weathering this current market downturn and taking advantage of the reduced number of competitors when the market stabilizes.”

Eric Wasserstrom, an analyst at UBS, said as investors flee from purchasing subprime mortgage-

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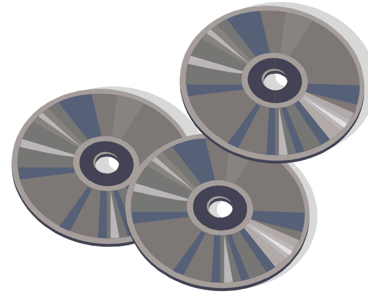

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backed securities, more lenders will falter. "A lot of institutions have limited capacity to put that on their own balance sheets," he said. "I think that many originators have too benign an expectation for what the next several quarters hold."

Laurie Goodman, UBS co-head of global fixed-income research, added that she thinks the subprime problems are far from over. "Subprime is going to take a very, very long time to come back and will never come back to what it was," she said. ✦

Fannie Mae Adopts Subprime Guidance, Freddie to Follow

Fannie Mae last week adopted federal regulators' recently issued subprime guidance, in a move required by the government-sponsored enterprise's safety and soundness regulator. Fellow GSE Freddie Mac said it will soon follow suit.

However, a lenders' organization charged that Fannie's policy statement is too vague – like the guidance itself.

Fannie adopted the guidance following a directive of the Office of Federal Housing Enterprise Oversight. In Lender Letter 03-07, the GSE said it will apply the guidance to "short term adjustable-rate mortgages, as defined by the seller, that are identified by the seller as subprime." The guidance will apply to such ARMs sold to Fannie in bulk or via private label securities.

If a loan failing to comply with the guidance makes it to Fannie, the GSE said "appropriate action will be taken," possibly including requiring the lender to buy back the mortgage. Fannie said loans with application dates of Sept. 13 and beyond must be in compliance.

Freddie Mac spokesman Brad German said the GSE is "on track" to adopt the guidance shortly after Labor Day. However, he would not discuss whether Freddie's implementation would differ from Fannie's.

In its announcement of the adoption, Fannie stressed certain aspects of the guidance, including reminding lenders to avoid practices that constitute predatory lending. Fannie also highlighted the ability-to-repay requirement.

"Underwriting standards should confirm that the borrower has a reasonable ability to make the mortgage payments and is likely to do so in a manner that will enable him or her to successfully maintain homeownership," Fannie said.

The GSE also noted that subprime prepayment penalties should not extend beyond the initial reset date and that such borrowers should have a "reasonable period of time" to refinance without penalty. Echoing the regulators' guidance, Fannie said 60 days prior to the reset data constitutes "reasonable."

Like the guidance, Fannie will not require escrows for subprime ARMs, but the GSE said it "advocates" them. If the lender does not require an escrow for taxes and insurance, Fannie said it "encourages" lenders to disclose to borrowers that payments for taxes and insurance are required and could be substantial.

Fannie will require an additional representation and warranty for the subprime ARMs subject to the guidance, confirming that the loans comply with the guidance. Significantly, the rep and warranty applies even to lenders that are not directly subject to the guidance.

Fannie also acknowledged federal regulators' "statement on working with borrowers" issued earlier this year and confirmed that it requires servicers to work with borrowers to avoid foreclosure.

Anne Canfield, executive director of the Consumer Mortgage Coalition, said the lender group will send a letter to OFHEO questioning Fannie's adoption of the guidance. She said it is unclear what mortgages Fannie will apply the guidance to, because the guidance and Fannie's announcement are both vague.

Collateral Characteristics

During a recent conference call with investors, Enrico Dallavecchia, Fannie's executive vice president and chief risk officer, detailed the characteristics of Fannie's current subprime holdings. He said Fannie holds or guarantees $5.1 billion of subprime loans, accounting for 0.2 percent of its single-family mortgage credit book.

Dallavecchia said more than 60 percent of the subprime mortgages are fixed-rate. And the weighted average of regional loan-to-value ratio for the mortgages is 79 percent with only 8 percent above 90 percent LTV.

The GSE also holds $47.2 billion in private-label securities backed by subprime loans, accounting for about 2 percent of Fannie's total single-family MBS holdings. Dallavecchia said $46.9 billion of the MBS is currently rated AAA by at least two rating services. ✦

MBA Ramps up Rhetoric Regarding Subprime Turmoil

There was plenty of blame to go around as the Mortgage Bankers Association led a discussion about the subprime market for congressional staffers this week in Washington, DC.

MBA economist Jay Brinkman reviewed the events that led to the current situation, where even the top-ranked overall lender, Countrywide Financial, is considered vulnerable. He said lenders that made the worst loans have been punished by the market, but suggested that the problems are far from over.

Mortgage-backed securities analyst Andrew Davidson, president and founder of Andrew Davidson & Co., said the securitization industry's penchant for transferring risk and recent lack of diligence caused the collapse of under-funded subprime lenders and subprime MBS issuance. He said subprime lenders had too little financial interest in the performance of their loans and investors had too little involvement in how the loans were made.

Doug Duncan, the MBA's chief economist, also addressed the mortgage market's problems this week, suggesting that MBS investors are to blame for most troubled subprime lenders' issues.

"The point of divergence between perception and reality is the shutdown of the asset-backed securities market relative to the underlying credit performance of mortgages," he said. "It's irrational in that the ABS produced today certainly have economic value, and yet no one will make a purchase."

Duncan said investors have "overreacted" by avoiding purchasing subprime MBS. He added that portfolio lenders are best-positioned to survive.

"The portfolio lenders have a significant advantage – you control the funding source and are not subject to someone else's decision to make credit available," he said.

The MBA's outreach follows a hearing earlier this month at the National Conference of State Legislators' annual meeting. David Kittle, the MBA's vice chairman, testified before the NCSL's Committee on Labor and Economic Development at the hearing on "the future of the nation's middle class."

Kittle said "99.75 percent of homeowners are not at risk of foreclosure."

He said among current homeowners, including those without mortgages, 4.9 percent are subprime borrowers with adjustable-rate mortgages. He said 10.13 percent of the subprime ARMs are seriously delinquent or in foreclosure and half of the borrowers will find a solution that avoids a foreclosure sale. He added that subprime delinquencies were higher in 2000 and 2002 than they were in the first quarter of this year.

Kittle also called on states to support the creation of national uniform lending standards.

However, two public policy institutes, the New America Foundation and the Center for Social Development, suggested that states could do more to limit predatory lending. The groups said "subprime loans often include predatory features such as unnecessary expenses and provisions that have the potential to strip equity."

The groups called for states to enact strong anti-predatory lending laws and a state-level Community Reinvestment Act to "expand the pool of mortgages in underserved communities."

The federal CRA requires financial institutions to reinvest in the communities from which they receive deposits. The groups noted that Illinois, Massachusetts and New York have enacted state-level CRA legislation, covering state-chartered banks, in an effort to expand investment in low-income communities. ✦

SEC Reportedly Investigating Firms' Subprime Activity

The Securities and Exchange Commission is reportedly investigating how large investment banks account for losses on subprime mortgage-backed securities and related assets.

Reached last week, Cheryl Scarboro, associate director of the SEC's division of enforcement, declined to comment or confirm the investigation, first reported by the *Wall Street Journal*.

Analysts suggest the investigation is routine, but reportedly it targets significant MBS issuers and underwriters: Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch, and Morgan Stanley. The SEC has broad supervisory powers over the investment banks, as part of its consolidated supervised entities (CSE) program.

In testimony last month before the House Financial Services Committee, Erik Sirri, director of the SEC's division of market regulation, said the SEC has supervisory power over the CSEs similar to that of the Federal Reserve's oversight of bank holding companies.

The SEC is reportedly looking at how the investment banks apply markdowns for losses on subprime mortgage assets. Recent turmoil in the subprime sector has significantly devalued subprime MBS, which the banks are major investors in.

Some have suggested that while the banks require their brokerage clients to mark down the assets, the investment banks have not employed similar markdowns to the MBS they hold. Recent quarterly reports filed with the SEC by the investment banks, which are required to list “material events,” barely mention subprime exposure or losses.

Sirri said the CSEs are subject to a number of requirements under the SEC’s supervision, including monthly computation of a capital adequacy measure consistent with Basel II, maintenance of substantial amounts of liquidity at the holding company, and documentation of a comprehensive system of internal controls.

In late June, the SEC said it was conducting investigations related to collateralized debt obligations. And in what could be a precursor to what the investments banks could face, the SEC last week filed financial fraud charges against First BanCorp. The SEC alleged that former senior management at the Puerto Rico-based bank holding company “concealed the true nature” of more than $4 billion worth of transactions involving subprime mortgages.

First BanCorp paid a $8.5 million civil penalty and consented to being permanently enjoined from violating the antifraud, reporting, books and records and internal control provisions of federal securities laws. However, First BanCorp did not admit to or deny the SEC’s charges.

At the time, the SEC said it will continue to pursue mortgage securities-related misconduct. “The SEC’s division of enforcement has focused significant resources on disclosure and accounting issues relating to the mortgage industry, and we encourage market participants who believe they have securities-related issues in this area to contact us as soon as possible,” Scarboro said.

The SEC’s action against First BanCorp was a follow-up to similar action and a $25 million penalty against Doral Financial last year. The SEC said First BanCorp aided and abetted Doral, which is also based in Puerto Rico.

According to the SEC’s complaint, First BanCorp purchased subprime mortgages from Doral Financial, earning more than $100 million in net interest income in the process. The SEC said Doral improperly recognized income on the transactions.

According to the SEC, the sales were not true sales under generally accepted accounting principles because Doral agreed to extend the recourse provision from the 24-month period included in the written agreements to full recourse for the duration of the mortgages. The SEC noted that its investigation is ongoing.

Sirri previously noted that the SEC is concerned about how investment banks manage their subprime exposure. “Financing arrangements for certain exposures through repurchase facilities and derivative transactions serve not only to increase the amount of leverage in the system, but may also bring risk back to regulated financial institutions in ways that can be challenging for the firms to measure and manage,” he said. ✦

Subprime ARM Disclosures Available for Comment

Federal regulators recently unveiled two proposed disclosure formats designed to inform consumers about the risks and benefits of certain subprime adjustable-rate mortgage products.

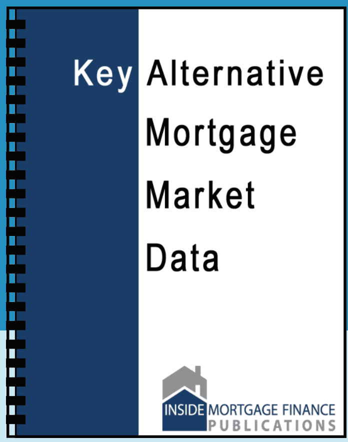
Institutions are not required to use either of the two proposed “illustrations of consumer information for subprime mortgage lending,” which regulators published in the Aug. 14 *Federal Register*.

“Use of the proposed illustrations is entirely voluntary,” said the agencies – Office of the Comptroller of the Currency, Office of Thrift Supervision, Federal Reserve, Federal Deposit Insurance Corp., and National Credit Union Administration. “There is no agency requirement or expectation that institutions must use the illustrations in their communications with consumers.”

But the proposed samples are intended to help lenders make the kind of disclosures recommended by the recently issued interagency guidelines on subprime lending.

The interagency guidance, effective July 10, addresses questions related to certain nonprime ARM products with discounted or low teaser rates. Loan products that have the potential for payment shock have been blamed for the high rates of default and foreclosure that have led to the collapse of the subprime market.

The guidance urges institutions to make sure that disclosures to consumers, including mortgage advertisements, oral statements, and promotional materials, provide clear and balanced information about



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the loan product being offered.

Disclosures must include information about payment shock, prepayment penalties, balloon payments, the cost of reduced-documentation loans, and escrowing for taxes and insurance. They must be provided in a timely manner and help consumers choose the loan that best meets their needs, the regulators said.

The regulators' first proposed sample comes in a ready-to-use format. Lenders may delete or modify the language on prepayment penalties or other sections to reflect the actual terms the lender is currently offering. Adopting the sample minimizes the hassle of implementation, regulators said.

The second proposed sample is a numerical chart showing the potential consequences of payment shock from a loan with a discounted interest rate for the first two years. The chart compares payments on a comparable fixed-rate mortgage and a seasoned hybrid ARM.

Lenders can satisfy the subprime statement's disclosure recommendations by simply providing consumers with a modified facsimile of the original in a timely manner, the regulators said. The final illustrations will be posted on agency Web sites for downloading and reproduction. The comment period closes Oct. 15.

Vague and Inconsistent

Meanwhile, Laurence Platt and Kristie Kully, partners with the Washington law firm K&L Gates, contend that the subprime guidance is vague and inconsistent.

"It remains unclear when the requirements in the subprime guidance actually apply in terms of the type of borrower or the type of loan," the attorneys said in a recent client alert. "Further, assuming the subprime guidance applies to a particular borrower or loan, it is often unclear what the guidance actually requires."

They note that while the guidance does not appear to prohibit stated income or reduced documentation loans outright, it does not clarify what, or how many, mitigating factors are necessary to justify such characteristics.

The guidance also says borrowers with ARMs should be provided a reasonable period of time prior to the reset date to refinance without penalty. However, the attorneys note that the regulators are not requiring lenders to waive contractual terms regarding prepayment penalties on existing loans.

Surprisingly, the attorneys found that the subprime guidance veers from previously issued guidance on nontraditional mortgage products.

"Although addressed in the regulators' nontraditional mortgage guidance, the subprime guidance does not address circumstances in which the payment amount using a fully-indexed rate for an ARM loan is substantially greater than the payment amount calculated based on a 30-year fixed-rate product," the attorneys said. "The nontraditional mortgage guidance recognized that lenders should be allowed, in those instances, to use a 'credible market rate' to qualify the borrower. It is unclear whether the regulators' subprime guidance allows institutions to use a credible market rate to underwrite a borrower under those circumstances." ✦

Industry Split on What the Fed Should do with HOPEA

The Federal Reserve's revision of regulations under the Home Ownership and Equity Protection Act currently stands as the only planned federal regulatory response to the problems in the subprime market, but just what the regulator plans to do with HOEPA remains to be seen.

The regulator recently called for concerns and suggestions on the HOEPA rules, which currently apply only to high-cost mortgages. The Fed has been under pressure from Congress to use its powers more broadly to identify and prohibit unfair and deceptive lending practices. While lawmakers may still decide on a legislative response, the Fed said it will use HOEPA to strengthen regulation of the subprime market by the end of the year.

The Consumer Mortgage Coalition blamed thinly capitalized institutions for the subprime market debacle and called on the Fed to set minimum capital requirements for mortgage brokers and lenders, just like the requirements that apply to regulated banks.

"Appropriate capital requirements act as a discipline which will lead to greater responsibility," the CMC said. The Fed, however, should also act with caution, it added.

Under broader HOEPA oversight, lenders could be exposed to substantial liability, and the Fed should adopt bright-line rules to help lenders avoid such liability, the group said. The CMC warned that excessive liability could cause lenders to limit or restrict their product offerings.

Furthermore, the CMC said, the Fed should not do anything to make it more difficult for troubled borrowers to refinance.

The soon-to-merge American Bankers Association and America's Community Bankers also urged the Fed to develop a bright-line definition of "subprime" rather than use the definition in the recently issued interagency subprime lending guidelines.

"We believe that a definition that focuses on the characteristics of subprime lending practices that have contributed to the problems in the subprime market will work best," they said.

Meanwhile, the Conference of State Bank Supervisors echoed some of the trade associations' sentiments and called on the Fed to create specifications for a "standard subprime loan."

The CSBS said a standard subprime loan would have "terms and characteristics that are most conducive to long-term and sustainable homeownership."

"This standard mortgage loan would be a 30-year fixed-rate, fully amortizing, full documentation loan," the CSBS said. Borrowers should be allowed to opt-out of the standard only after independent financial counseling for another loan product, the group explained.

Both the CMC and the Consumer Bankers Association called on the Fed to use its Truth-in-Lending-Act authority, not HOEPA, to implement new disclosure requirements.

The ABA and ACB said any guidance or regulation should apply not only to the banking industry but to non-bank lenders, servicers, brokers, and others involved in the mortgage lending business, as well.

The Mortgage Bankers Association agreed that it is unnecessary for the Fed to extend new standards to all market sectors, and any standards should apply only to areas where borrowers need greater protection.

The group also advised the Fed to "surgically" target unfair and deceptive practices. Imprudent use of HOEPA authority could raise lenders' liability risk, increase consumer costs, and restrict borrowers' access to mortgage credit.

Ultimately, the MBA warned, a less-than-prudent approach could lead to a credit crunch and spook investors. It urged the Fed to "take a balanced approach in devising new regulations so that the cure is not worse than the disease."

Meanwhile, a coalition of 44 nonprofit groups, private firms, and public agencies in California urged the Fed to act quickly and decisively to "save borrowers in the future."

They recommended that prepayment penalties on subprime loans be deemed unfair and deceptive by definition. If the Fed does not prohibit them outright, the group suggested disallowing prepayment penalties after an interest-rate reset, creating a 90-day window for refinances, or adding a weighting for prepays to HOEPA's points-and-fees calculation.

The group also called for requiring escrows for taxes and insurance on subprime loans and prohibiting stated income or low-doc for certain mortgage loans, including higher-risk loans.

Stated-income loans should be subject to HOEPA independent of the fee and annual percentage rate triggers to prevent brokers and lenders from inflating loan amounts, the coalition added. Lenders should also be required to underwrite all loans based on the fully-indexed rate and an amortizing schedule, and to analyze borrowers' ability to repay.

The National Community Reinvestment Coalition also called for similar restrictions and prohibitions but reiterated its position that "the most effective response to predatory lending is comprehensive Congressional legislation."

It expressed support for legislation pending in the House and the Senate, which would impose good faith and fair-dealing duties on appraisers, brokers, and other market participants. ✦

Product Proposed to Hedge Against Home Prices

Subprime lending volumes surged in recent years in part due to home price appreciation. However, with home prices dropping in some states and expected to continue to fall, some subprime borrowers have been unable to tap increased home equity to avoid foreclosure.

Ralph Liu, chairman and CEO of Advanced e-Financial Technologies, suggests he has a solution for subprime borrowers facing home price depreciation. He created products he suggests could boost subprime originations and reduce delinquencies.

AeFT is pushing property derivative-based mortgages it branded "SwapRent." The company has produced residential and commercial real estate index derivative products since 2001.

Liu said subprime borrowers with adjustable-rate mortgages could convert their mortgages, either through a refinance or a conversion with the existing lender, to a SwapRent product. The products allow

Subprime Mortgage Rates

IBCL Composite	8/24/2007 30yr FRM	8/24/2007 2yr ARM	8/10/2007 30yr FRM	8/10/2007 2yr ARM	7/27/2007 30yr FRM	7/27/2007 2yr ARM
"A-" Credit (85% LTV, 620-580 FICO)	10.42%	10.07%	10.57%	10.34%	11.10%	11.85%
"B" Credit (80% LTV, 579-560 FICO)	10.68%	10.34%	10.81%	10.52%	12.30%	12.80%
"C" Credit (75% LTV, 559-540 FICO)	10.51%	10.23%	11.23%	10.96%	10.28%	10.03%

IMF Composite	30yr FRM	1yr ARM	30yr FRM	1yr ARM	30yr FRM	1yr ARM
Conventional FRM	6.500%	5.250%	6.458%	5.563%	6.583%	5.688%
FHA-insured FRM	6.500%	7.000%	6.438%	6.917%	6.688%	6.875%

Subprime Mortgage Volume Indicators

	Jul-07	Jun-07	May-07	Apr-07	Mar-07	Feb-07
Subprime MBS Issuance (Billions)	$10.16	$23.69	$29.11	$29.76	$40.97	$28.54
Non-Agency MBS Issuance (Billions)	$53.65	$86.98	$93.43	$78.05	$105.42	$93.65
Subprime Share	18.93%	27.23%	31.15%	38.13%	38.86%	30.47%
Subprime Originations (Billions)						
Countrywide Financial	$1.85	$2.19	$1.68	$1.68	$2.36	$2.59
NovaStar Financial	$0.33	$0.25	$0.26	$0.26	$0.31	$0.39

ABX Prices

	8/23/2007	8/9/2007	7/26/2007	7/13/2007	Historic High	Historic Low
ABX.HE.06-1 AAA	$97.68	$96.42	$97.86	$99.73	$100.38	$94.97
ABX.HE.06-1 BBB	$59.93	$63.53	$63.56	$82.05	$101.20	$56.83
ABX.HE.06-2 AAA	$94.50	$91.58	$95.26	$97.75	$100.12	$90.03
ABX.HE.06-2 BBB	$43.31	$45.06	$47.15	$61.00	$100.59	$41.42

Subprime Mortgage Stock Prices

	8/23/2007	8/9/2007	7/26/2007	7/13/2007	6/28/2007	YTD Change
NovaStar Financial (NFI)	$9.53	$5.53	$4.47	$7.65	$7.34	-70.2%
Ocwen Financial (OCN)	$9.04	$7.75	$10.86	$12.71	$13.60	-42.7%
Delta Financial Corp. (DFC)	$4.56	$4.88	$10.70	$11.76	$12.40	-50.9%
IBCL Composite	**$23.13**	**$18.16**	**$26.03**	**$32.12**	**$33.34**	-59.5%

Subprime Mortgage Performance

GMAC-RFC RASC Delinquency Rates	Jul-07	Jun-07	May-07	Apr-07	Mar-07	Feb-07
60-days delinquent	2.33%	2.01%	1.90%	1.65%	1.72%	1.95%
90-days delinquent	3.18%	2.82%	2.83%	2.48%	2.49%	2.61%
Foreclosure	6.49%	6.08%	5.41%	5.44%	5.23%	5.30%

MBS issuance from Inside Mortgage Finance MBS Database.
Subprime performance data are for all RFC RASC pools, by dollar volume of delinquent loans.
ABX data from Markit and CDS IndexCo.

borrowers to give up partial or the entire upside home price appreciation potential of their properties for a certain period of time to investors.

He provided the following example: After purchasing a $400,000 house, the borrower could enter into a two year SwapRent transaction and make weekly, biweekly, monthly or quarterly payments to an investor.

In turn, the investor would make funding-cost payments to the borrower based on an interest rate agreed upon by the borrower and investor. The SwapRent payments and funding cost payments could offset and be netted against each other so only a netted payment is to be paid.

At the end of the SwapRent contract, the house value could rise to $600,000 or drop down to $200,000, for example. The house's value could be determined by an appraiser or an index, to be agreed upon by the borrower and investor, but Liu suggested using an index to avoid any conflicts.

If the house is now worth $600,000, the $200,000 would belong to the investor and the borrower would have to borrow from the mortgage to pay the amount. Liu said the lender could increase the original mortgage amount or view it as a draw-down of the borrower's home equity line of credit.

If the house value drops to $200,000 at the end of the SwapRent contract, the investor would owe the borrower $200,000.

Liu said AeFT is currently pitching the products to lenders and Wall Street banks. He said the company is in "advanced discussions" with a few major banks and broker/dealers to license the products.

Liu said investors benefit from the products as well. "The property index linked structured notes allow investors, speculators and hedgers a way to easily express a view on the future directions of property values," he said.

The products offer a response to the problems surrounding subprime hybrid ARMs, Liu said, however, analysts suggest the products might not work well in the current environment. The products depend on home price appreciation, the same fuel that drove the use of subprime hybrid ARMs.

"In a normal environment, this new concept might get some traction," Tom Zimmerman, a UBS analyst, said. "But I suspect that for quite a while new derivatives, no matter how sound, will not find a good reception." ✦

B&C News Briefs

➔ The Homeownership Preservation Foundation said it fielded a record 30,078 calls from troubled homeowners in the second quarter of 2007. That's more than double its call volume in the first quarter of this year and more than six times the volume from the same quarter in 2006.

Surprisingly, problems with fixed-rate mortgages were as likely as concerns with adjustable-rate mortgages. Homeowners with ARMs represented 40 percent of calls in the second quarter of 2007, while those paying a fixed-rate accounted for 39 percent of calls.

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