



Loan Repurchases and Sagas: Recent Developments

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Loan Repurchases: Recent Developments and Sagas – The good ‘ole days

- 2003-2005:
 - Frothy Market with Strong Volume and Execution
 - MLPA’s Continually Updated and Strengthened by Investors; Subject to Little or No Legal Review by Originators
 - Strong Originator Volume and Revenue, Combined with Rising Property Values, Masks Most Issues

Loan Repurchases: Recent Developments and Sagas – Approaching Storms

- Late 2005: The Storm Approaches
 - Fed Slams on Brakes and Raises Short Term Rates: Mortgage Volume Drops and Housing Prices Weaken
 - FAS 140: FASB's attempt to provide more guidance on appropriate accounting treatment for securitizations and other off balance sheet arrangements
 - Reg AB: SEC introduces more uniform disclosure rules into the asset backed market
 - Limitations on Percentage of Pool that can be delinquent
 - Expanded disclosures for 20%+ originators
 - Uncertainty Created by Foregoing Combined with Traditional End of Year Decrease in Whole Loan Demand Further Depresses Pricing

Loan Repurchases: Recent Developments and Sagas – 2005 Year End Situation

- 2005: Year End (particularly November and December) sees spike in repurchase demands from Wall Street
 - Source of Claims is Largely EPD Claims
 - MLPA's Provide Broad Rights to Investors with Little Contractual Obligation to Timely Notify Originators or Mitigate Losses
 - Originators Cash Flows Heavily Squeezed: Infrastructure Scaled for 2005 Volume Combined with increasing repurchase demands, declining volumes and revenue

Loan Repurchases: Recent Developments and Sagas – 2006 Conditions

- 2006 Headlines and Public Statements
 - H&R Block: Reports \$131.4 Million Loss in Recent Quarter (largest in 17 years) due to defaults
 - ECC Capital: “Overall results were negatively impacted by an increase in repurchase claims related to whole loans sales made in prior period...We’ve resold a large portion of these repurchased loans, but at a significant discount to par.”
- What Else: liquidity is very tight, execution remains poor, warehouse interest income low -- originators licking their wounds

Loan Repurchases: Recent Developments and Sagas – EPDs

- Principal EPD Issues:
 - Underwriting/Credit Quality: Originators not adapting policies to changing market and products
 - Hand Off: Servicing transfer handled poorly resulting in lack of timely borrower communication; significant issue in subprime
 - Servicer Expertise: lack of expertise by new servicer with product type
 - Information Systems: failure to provide accurate information to new servicer (e.g., filling S/S number in borrower telephone fields)

Loan Repurchases: Recent Developments and Sagas -- The 2006 Hang Over

- Investor Response:
 - Buy it all back – aggressive pursuit of repurchase claims
 - If you can't, give us some of the equity in your company
- Originator Response
 - Traditional Response
 - Reprice Loans and pay balance due (i.e., spread between original price and reprice amount)
 - Repricing driven by lack of capacity to warehouse non-performing loans and lack of servicing expertise
 - Little senior management or outside counsel review
 - New Response
 - Get real
 - Heavy push back on repurchase claims: servicing logs to outside counsel
 - Senior management and outside counsel now involved – some litigation has arisen in more extreme cases

Loan Repurchases: Recent Developments and Sagas - Fall Out

- Fall Out
 - Many originators (particularly subprime) have closed doors
 - Originators revisiting and negotiating MLPA's
 - Requiring investors to provide early notification of EPD Loans and to timely make repurchase claims
 - Equivalent information needed for Reg AB
 - Active participation in selection of servicers
 - More focus on investor (what is their reputation for handling repurchases?) and servicing transfer mechanics
 - Originators revising L/O compensation plans to track profitability and performance

Loan Repurchases: Recent Developments and Sagas – Fall Out

- Fall Out: Accounting
 - Increase in loan loss and loan repurchase reserves
 - Sale or Financing: scale of repurchases has led at least one big 4 accounting firm to question whether FAS 140 permits sale treatment
 - Repurchase based upon performance introduces recourse
 - True sale opinions from outside counsel being required in some cases
 - Impact of treatment as a financing
 - Going concern qualifications
 - Delay in audit completion
 - Impact on regulators, investors and warehouse lenders
 - Other debt covenants; opportunities for hedge funds

Loan Repurchases: Recent Developments and Sagas – Going Forward

- Going Forward
 - MLPA’s matter
 - Understand loan level and entity level representations and remedies
 - Know Your investor: history and reputation for repurchase claims; who is their servicer
 - Accountant: consider need for national vs regional firm
 - Continued audit delays
 - You are not alone
 - Keep constituents notified
 - Don’t be bashful – investigate and dispute (where appropriate) repurchase claims
 - Seek global settlements for all EPD issues
 - USPTO Filing: insurance for EPD claims

THANK YOU.

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