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2008 Mortgage Market and the State of Credit Risk

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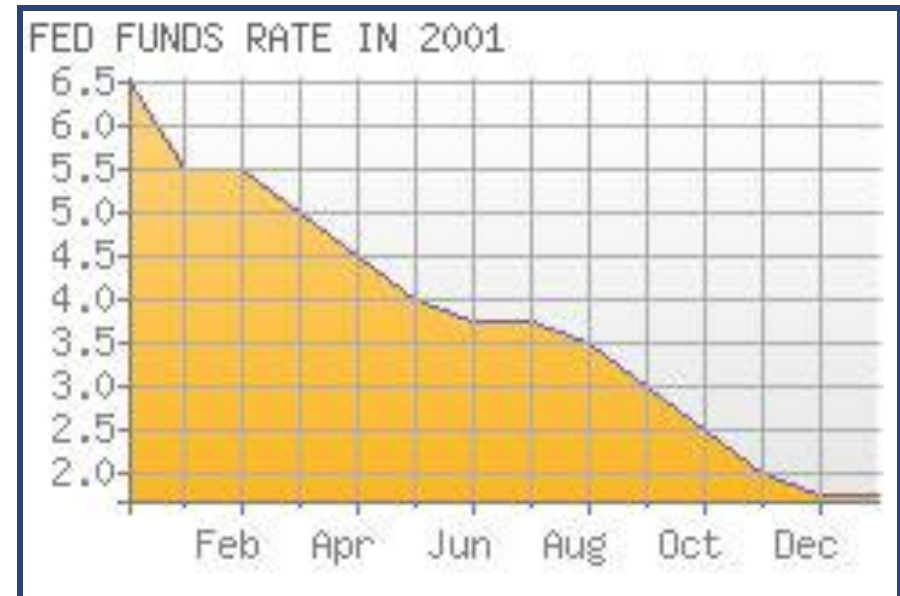
EVP Risk Management and Operations

PMI Mortgage Insurance Co.



- How did we get here?
- What have we learned?
- Key Takeaways and Best Practices

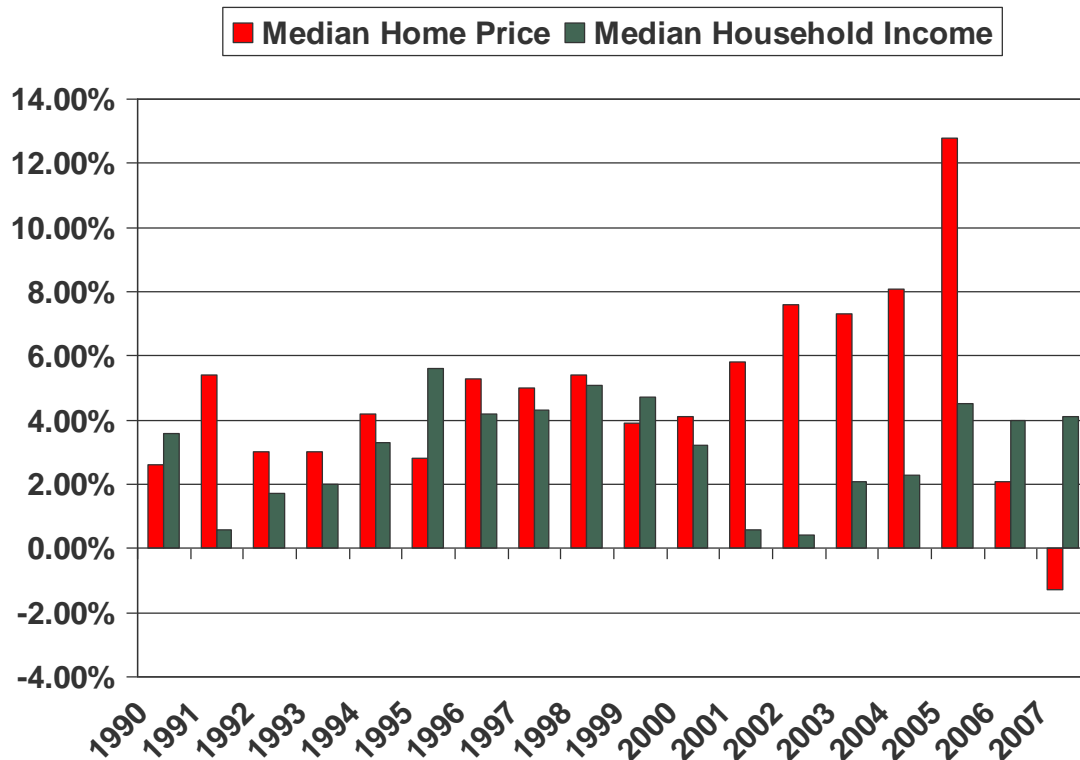
- US Federal Reserve Bank slashed benchmark interest rate 11 times
- Low interest rates sparked record demand for homes
- Prices rose rapidly
- Lenders offered niche products more widely, including:
 - » Piggybacks
 - » Payment Option ARMs
 - » Interest Only
 - » Stated income
 - » No money down
 - » Subprime
- Borrowers added to debt by tapping into home equity



Relative Growth Rates – Home Prices & Incomes

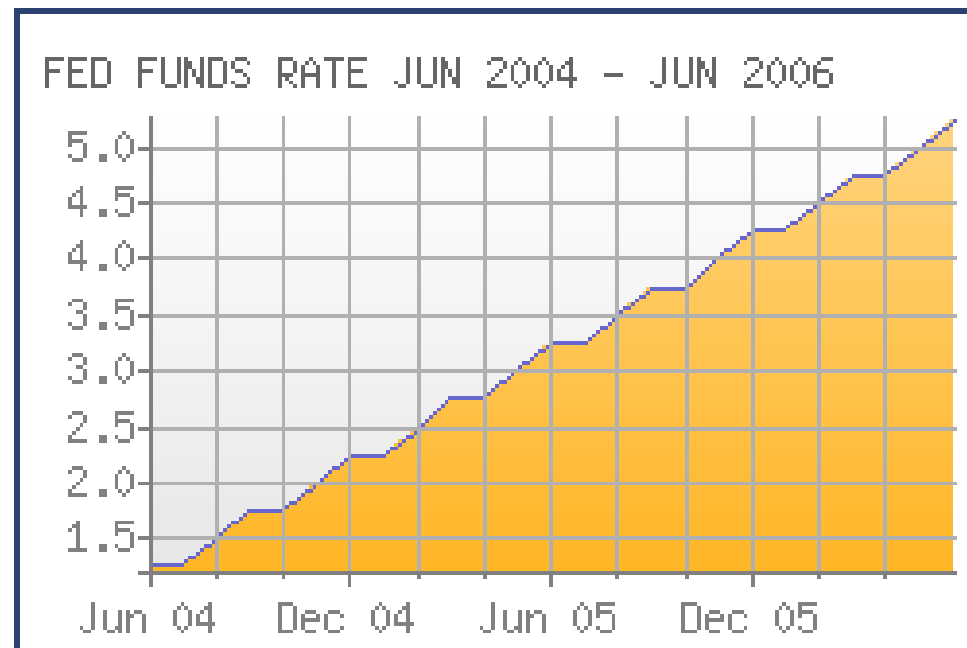
During the housing boom, home prices increased much faster than incomes.

This divergence was not sustainable over the long term and collapsed in late 2005.

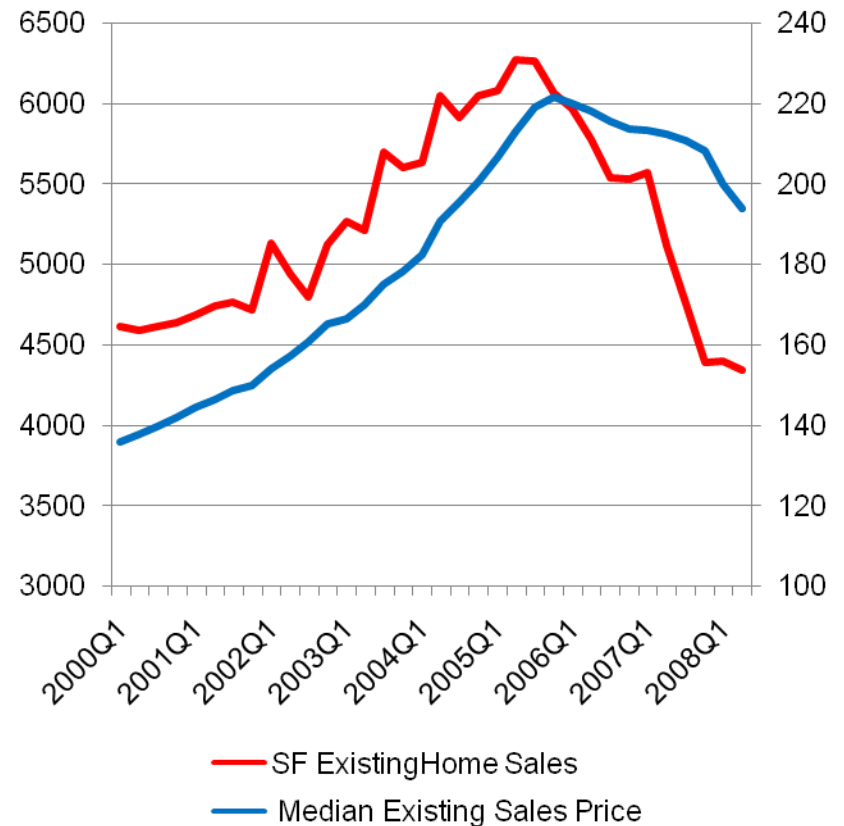


The Tipping Point: 2005-2006

- FRB raises interest rates 17 times to 5.25%
- Subprime borrowers who got 3/27s and 2/28s at the height of the boom begin to see resets, resulting in higher payments
- Home price appreciation slows and turns negative in some areas
- Defaults on subprime mortgages increase



- Home sales plunged from record highs, while excess supply of homes increased dramatically
- Home price appreciation rapidly declines in many major MSAs across the country and declines on a national basis
- Delinquency and foreclosure rates rise to record levels
- Mortgage credit standards tighten significantly and lending levels plummet
- FRB lowers federal funds rates from 5.25% to 1.50%
- Congress passes the largest financial rescue measure since the Great Depression



What Have We Learned?

Key Takeaways and Best Practices

Back to Basics

Successful credit risk management requires a balance of good credit sense and appropriate use of modeling and reporting

Creating and reinforcing a strong corporate credit culture will eliminate undesirable behavior:

- » Encourage training to look for “red flags”
- » Build sales incentive goals that increase focus on quality production
- » Increase corporate awareness through feedback & reporting on fraud
- » Ensure consistent ramifications for noncompliance with standards of conduct

Fraud remains a large industry concern

FBI SARs related to Mortgage Fraud have risen 173% from 2004 to 2007. Over 46,700 were filed in 2007!

- » Prevent fraud at origination:
 - Utilize fraud detection software tools in underwriting
 - Strengthen application processes
 - Make optimal use of fraud databases & watch lists
 - Perform due diligence on key business partners
- » Identify fraud after origination:
 - Build quality control programs that track closing irregularities, EPDs, losses, etc.
 - Maintain effective Investigations units
- » Report fraud and pursue perpetrators

Consistent origination practices with appropriate checks and balances

- » TPO tracking for early payment defaults, QC results, repurchases, approval & suspense rates
- » Bench marking performance through scorecards & annual recertification:
 - Quality measurements for loan officers
 - LOS systems that identify red flags, provide security measures & guard against predatory lending

Adequate controls and cross-checks

- » Validate Social Security #'s
- » Verbal verification of employment
- » 4506T prior to closing

Robust Quality Assurance

- » Sample each underwriters' work with immediate feedback
- » Appraisal values confirmed by a second process
- » Written, enforced process for second review

Training and Ongoing Education

- » Formal fraud detection / red flag course scheduled routinely
- » Appraisal review courses required
- » Roundtable forums for continuous learning
- » Certification of Excellence