

Repurchases, Buybacks and Indemnifications: Business and Accounting Considerations

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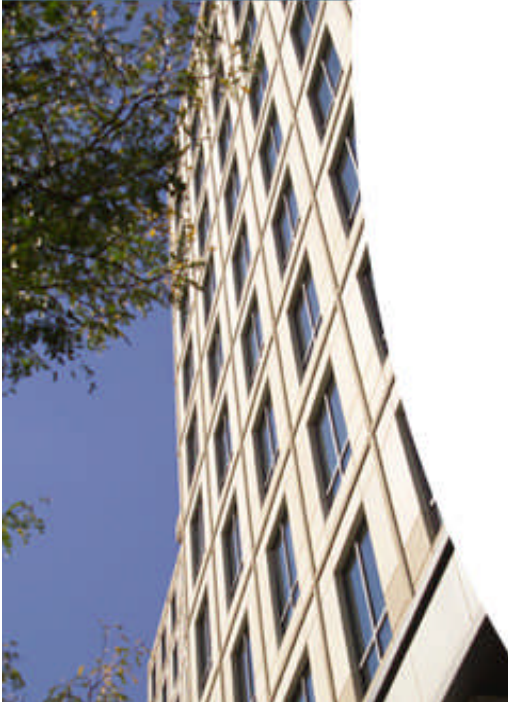
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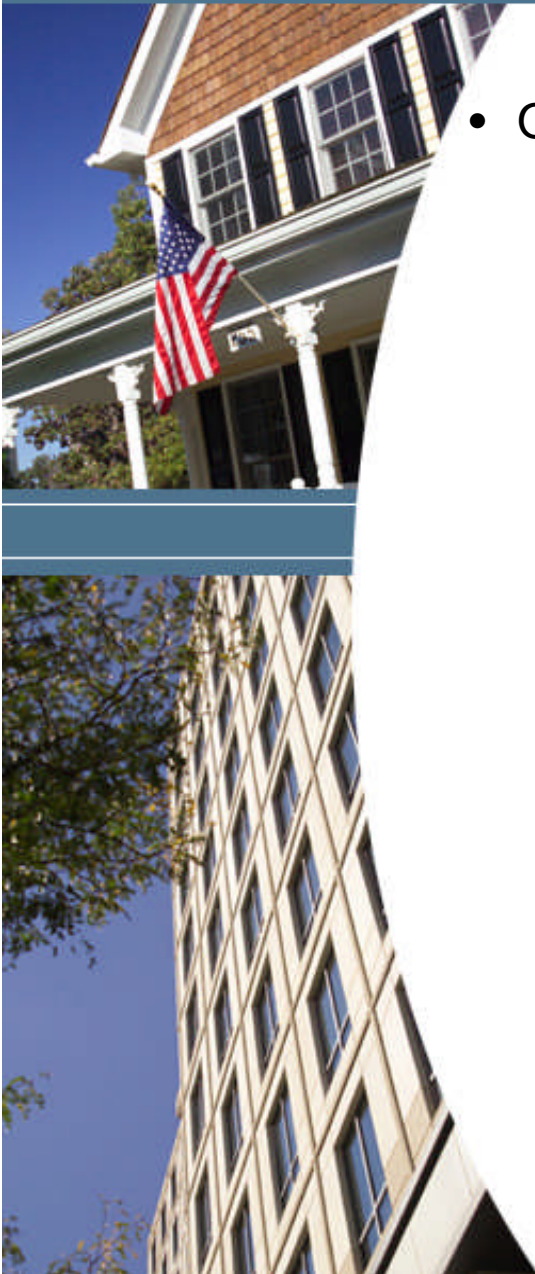
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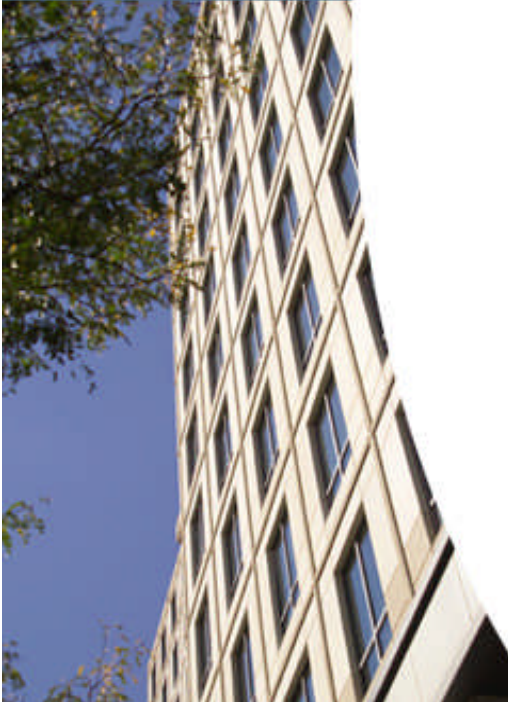
- Business Considerations
- Accounting & Financial Disclosure Considerations



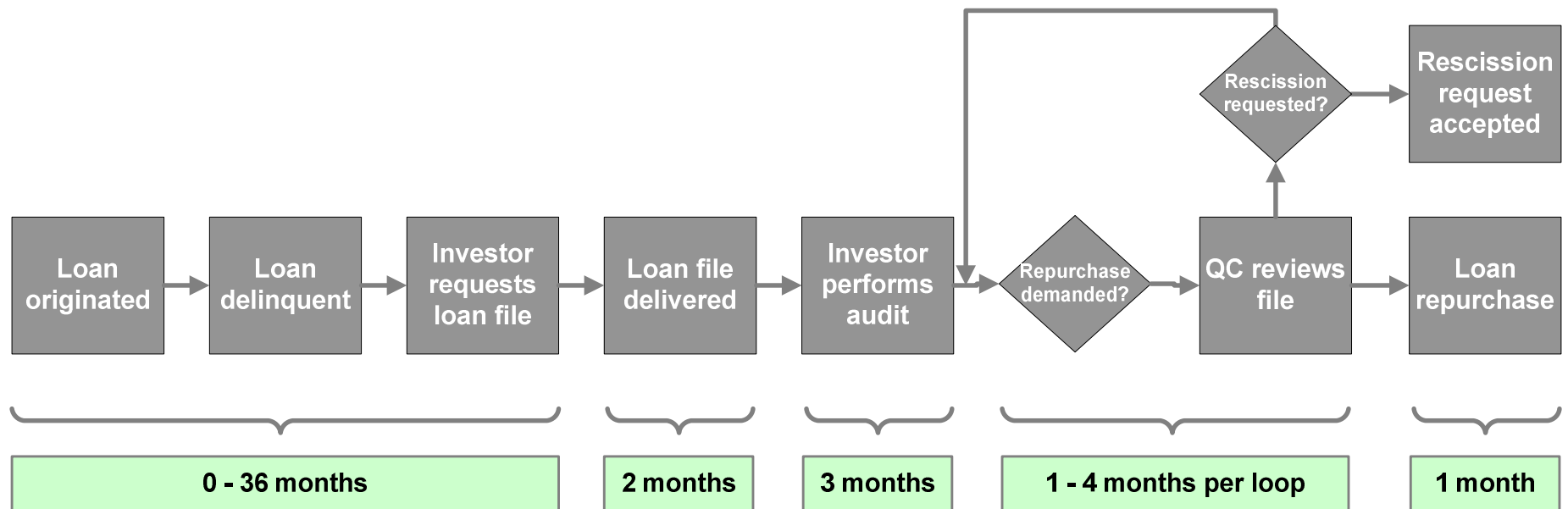
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- Following the credit cycle, representation and warranty (R&W) loan repurchase claims have again ramped up and related losses are becoming increasingly material to financial institutions.
 - » Mortgage banking entities that sell loans with recourse have exposure to:
 - Standard representations & warranties (i.e. underwriting deficiencies, missing documentation)
 - Fraud
 - Early payment default
 - Early payoffs
 - Specifically identified indemnifications
 - Additional exposures arising from MHA and other government-supported loan modification programs



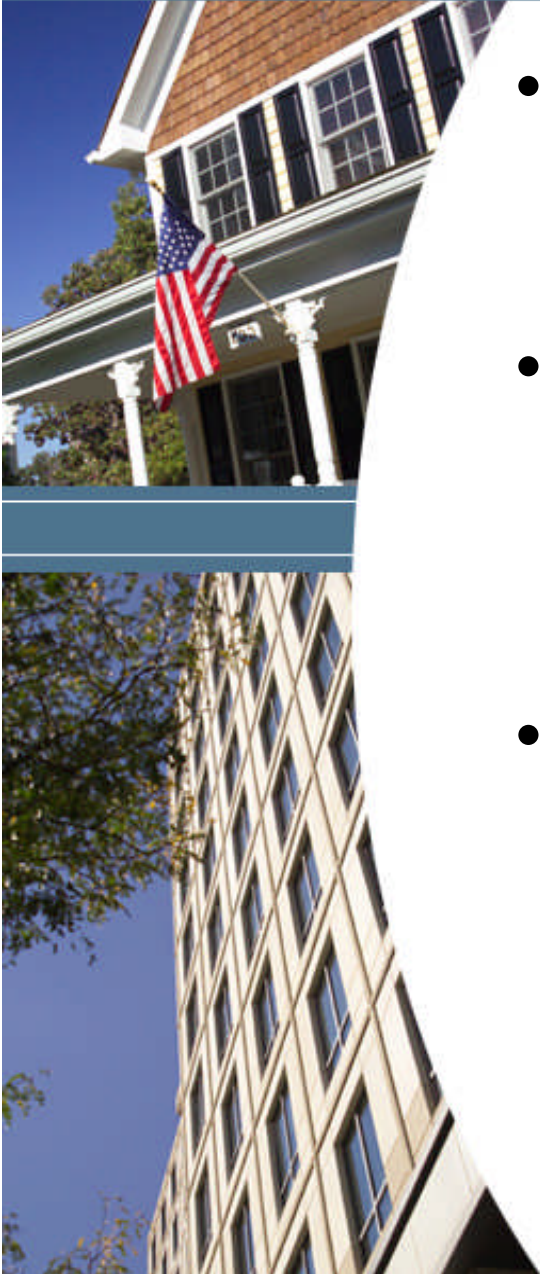
- Observations on the current environment:
 - » Loose enforcement of underwriting standards from '03 to '07
 - » Agency/investor investments in resources to identify loans eligible for repurchase
 - » Increased MI policy rescissions and MI claim rejections
 - » Impacts from foreclosure moratoriums, loss mitigation activities and loan modifications
 - » New repurchase exposures emerging from Making Home Affordable and other government loan modification programs
 - » Diminished ability to recover losses from correspondents and contract underwriters
 - » Strategic business considerations in some cases driving investor repurchase claim volumes and acceptances of rescission requests
 - » Litigation and/or negotiated settlements being pursued

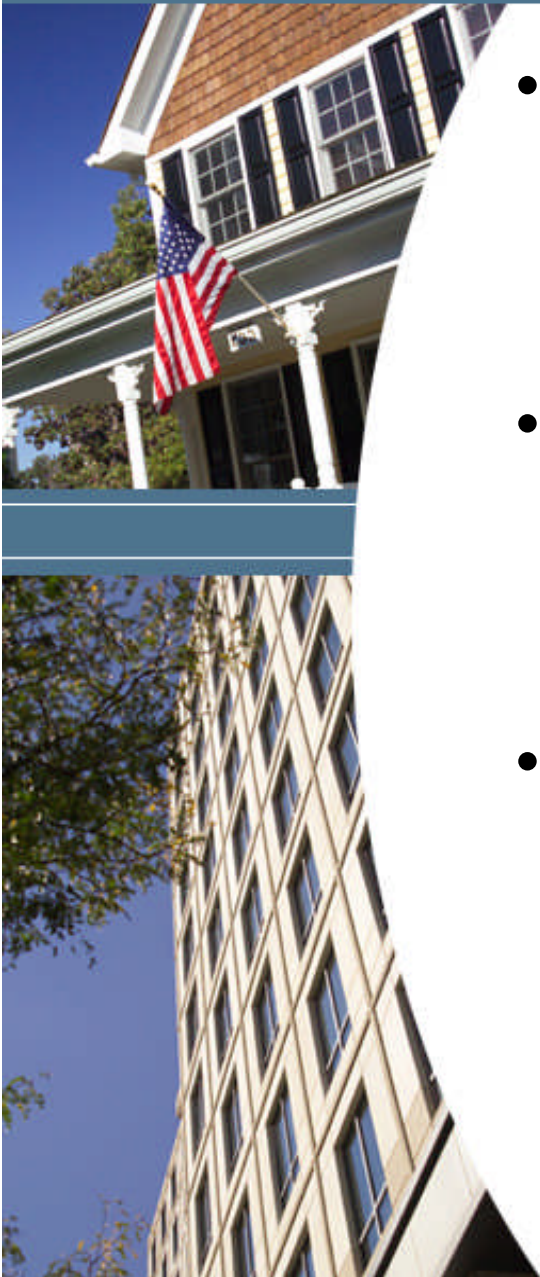
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- Responding to repurchase risk:
 - » Responses to increased repurchase risk should include enhancing key controls designed to mitigate key risks:
 - Credit risk committees to develop credit policy standards, establish reserve policies and monitor recourse violations
 - Aggressive management of the appeal process
 - Formalized repurchase demand management process
 - Escalation procedures for aged repurchases
 - Tracking of recourse provisions to third parties and application of contractual obligations
 - Aggressive REO Management
 - Tracking and monitoring of loss by loss component to better understand controllable vs. uncontrollable losses
 - Strengthening of R&W contractual provisions on future loan sale and securitization transactions

Typical repurchase demand timeline



The timeline from investor audit to loan repurchase can commonly exceed 240 days – further compounding losses.

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- At sale, representation and warranty (“R&W”) provisions require the transferor to record a recourse liability at fair value.
 - Similarly, accounting for business combinations under FAS 141R (ASC 805) require R&W reserves to be recorded at fair value at acquisition.
 - Fair value for R&W obligations should be measured in accordance with the fair value framework (“exit price”) established in FAS 157 (ASC 820), an “expected loss” model.

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- After sale, a loss contingency may be required to the extent probable and reasonably estimable losses exceed the repurchase liability, an “incurred loss” model.
 - If a mortgage loan is reacquired for an amount (typically par plus accrued interest) greater than fair value, the difference is charged off against the repurchase liability/reserve.
 - Reacquired loans with evidence of credit deterioration between origination and repurchase may be subject to SOP 03-3 (ASC 310-30).

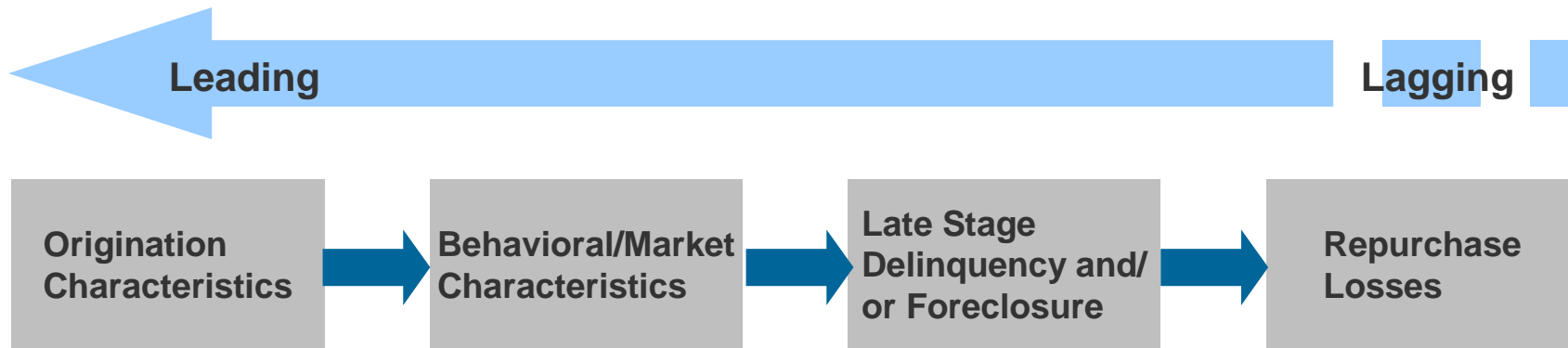
Why is it difficult to forecast repurchases?

Timeliness of Losses	<ul style="list-style-type: none"> • Repurchase losses are often not realized until several years after origination
Data Availability	<ul style="list-style-type: none"> • Sufficient characteristic and performance data may not have been captured historically.
Characteristic Transparency	<ul style="list-style-type: none"> • Characteristics leading to repurchases are not readily available (e.g., fraud, value inflation, underwriting errors).
Current Market Issues	<ul style="list-style-type: none"> • Investors have become more aggressive in making R&W claims • MI companies have increased rescission rates and claim rejections • Foreclosure moratoriums, loan modification programs and backlogs caused by volume increases may cause a delay in R&W claims. • The ability to recover losses from correspondent originators or contract underwriters is greatly diminished in the current environment. • Investor repurchase claims may be driven by strategic business considerations such as relationships and future loan volume commitments. • New repurchase exposures emerging from Making Home Affordable and other government loan modification programs

Repurchases - Accounting Considerations (cont.)

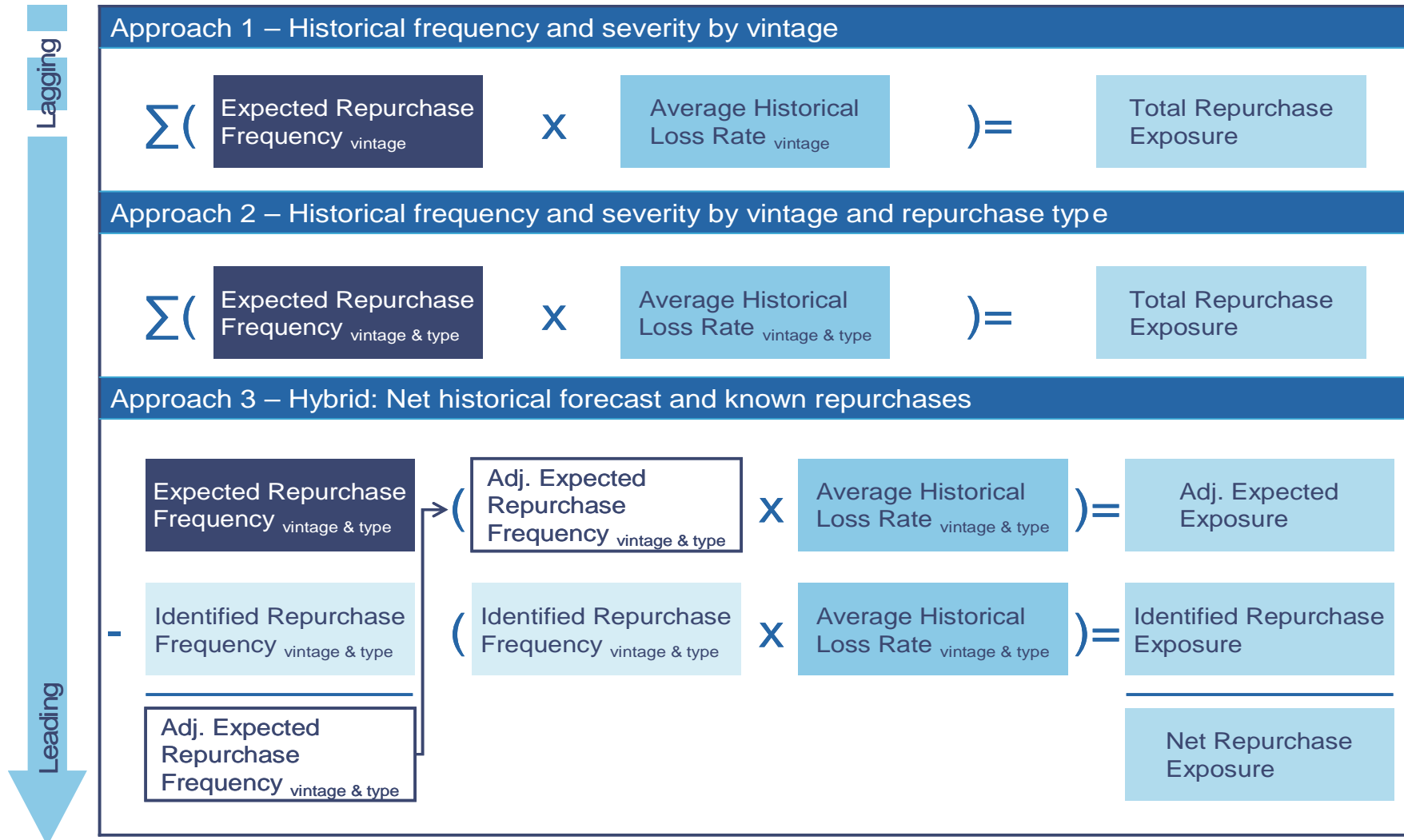



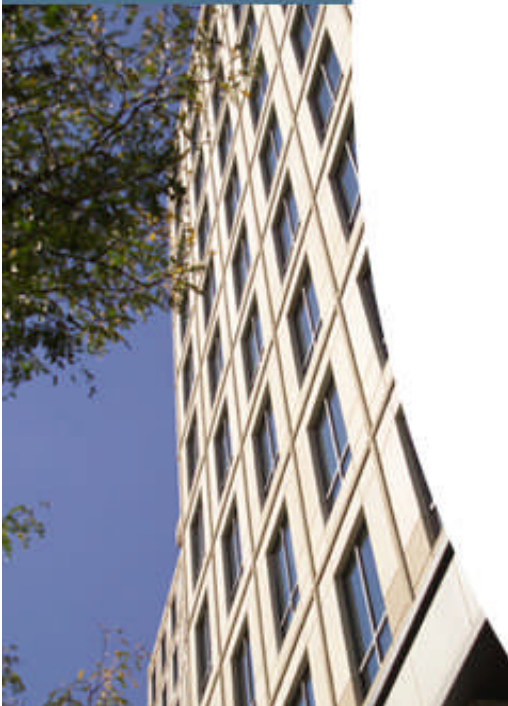
Forecasting accuracy is as much a function of the data availability and selection as the model design.

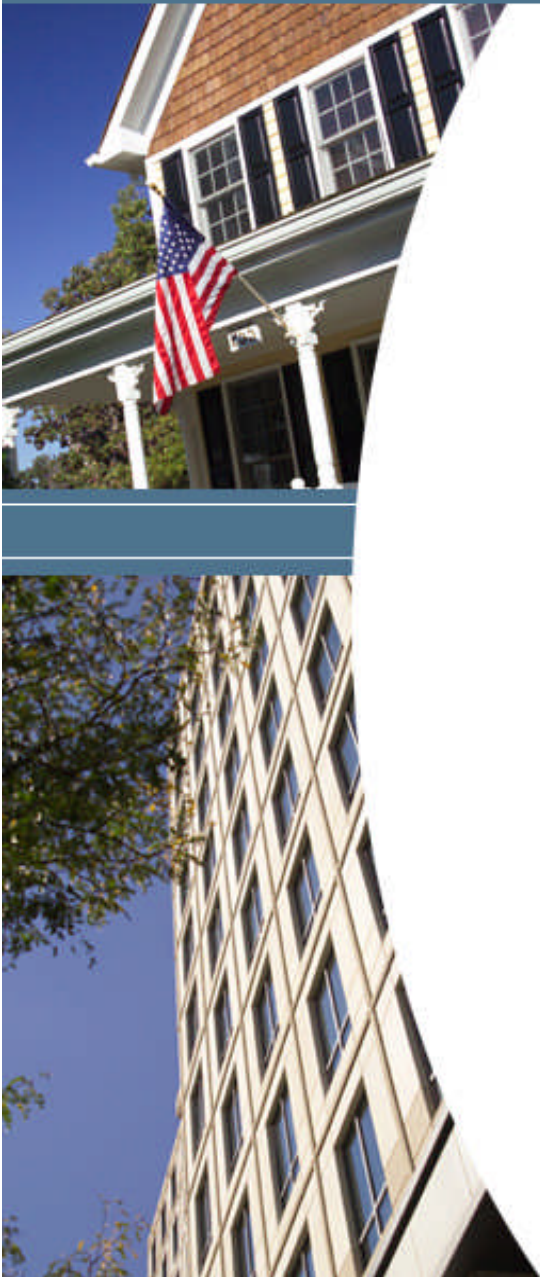


Characteristics			
-Origination FICO	-Bureau Refresh	-Serious Delinquency	-Repurchase events
-Origination LTV	-Behavioral Score	-Foreclosure	-Repurchase Losses
-Fraud Score	-Early stage delinquency	-Repurchase demands	
-Product Type	-MTM LTV	-Appraisal value	
-Housing Index	-Interest Rates		
-QC Findings	-Prepayments		

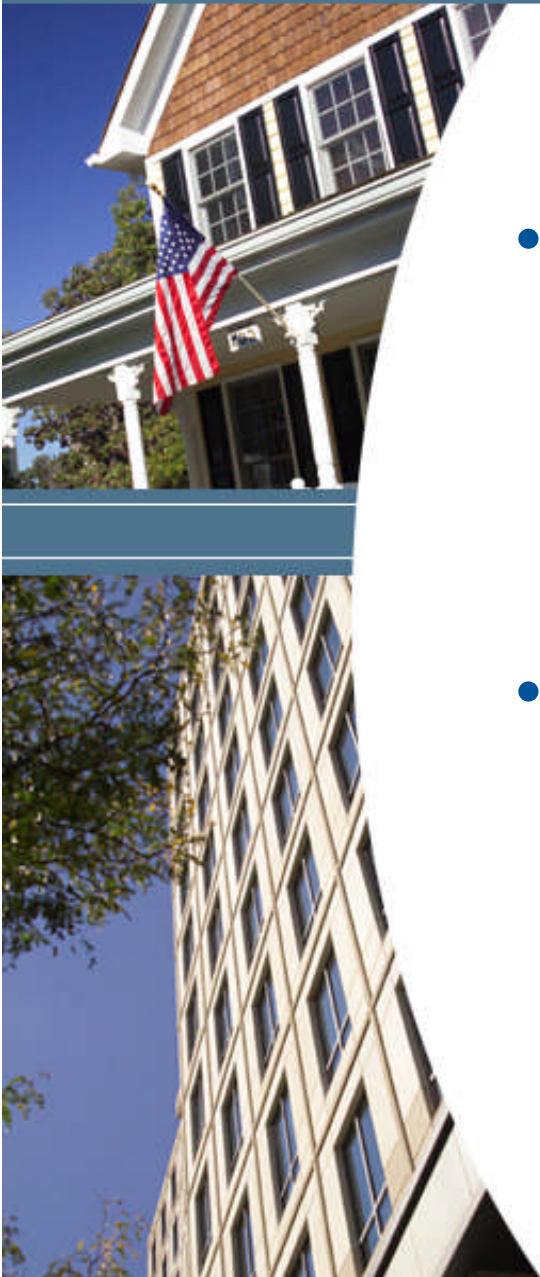
Illustrative Leading Indicator Approach



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- Commensurate with their increasing relative importance and materiality, there may be opportunities to strengthen financial disclosures for repurchase activity.
 - » Disclosures surrounding loan repurchase reserves are typically captured in the Accounting Policy, Contingency and Credit Risk sections of financial statement and MD&A. For many institutions, however, the level of historical disclosure has been limited based on materiality. When presented, common disclosures include:
 - Repurchase reserve accounting and reserve policies
 - Impact of loan repurchase activity on financial results for the period
 - Repurchase volumes for the period
 - Changes in repurchase reserve balances for the period

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- » The SEC Dear CFO letter released in August 2009, which focused on provisioning and allowance for loan losses released, further reinforces suggested disclosures for key risk concentrations and exposures and can also be relevant for loan repurchase exposure.
 - » Additional relevant disclosures for loan repurchase activity may include:
 - Methodologies, key assumptions and changes period to period in estimates of R&W repurchase reserves
 - Significant concentrations of repurchase risk and exposures
 - Business outlook disclosures related to potential adverse impacts to financial results from potential R&W repurchase exposures.

Thank You



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