Building "The Best" MBS Market

- Give borrowers the best deal
- Give lenders security and stability
- Create liquid stable market & contribute to development of financial sector
- Contribute to macroeconomic stability and growth.
- Build independent institutional framework that will stand the test of time

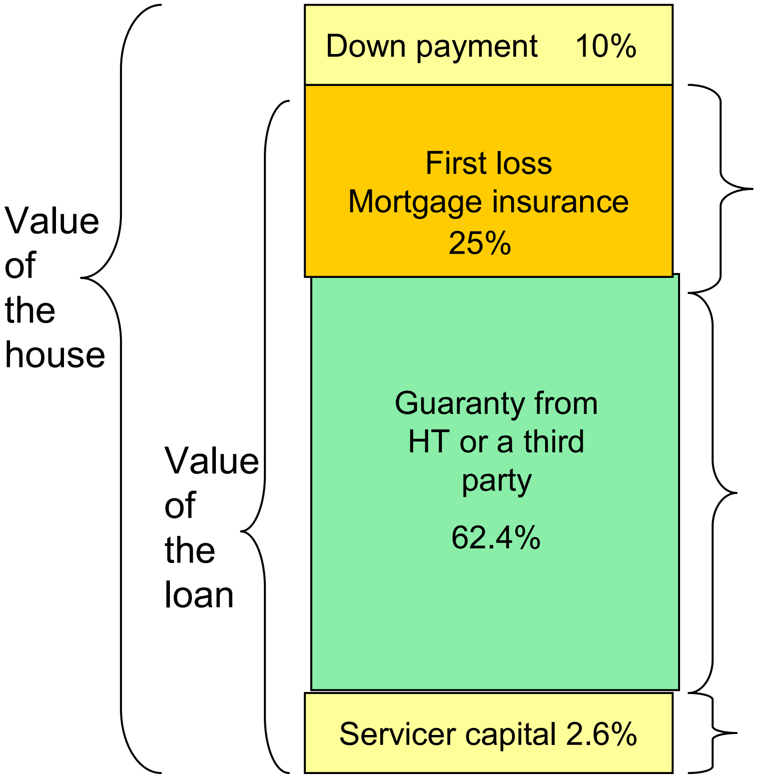
Highlights of Benefits of Proposal

- Super-standardized mortgage = easier to issue, lower rate for borrowers, & most liquid secondary market
- Domestic currency based system = mobilizes domestic savings & less exposed to international currency risk.
- Creates valuable new financial instrument that develops financial markets
- Good counter-cyclical properties... borrowers can redeem mortgages at at the lower of par or market price
- Creates strong primary & secondary housing market

Our Solution: Architecture Overview

- All players solvent, no surprises
  - Isolate risks in best place to deal with them
  - Become the source of truth for mortgage and bond data
- Insurance Waterfall structure
  - Sofol and Surety: timely payment of interest and principal
  - SHF/MI Industry: traditional mortgage credit insurance
  - US/Multilateral Agencies: reinsurance and country risk
- Borrower gets a market rate based on bond pricing
- Borrower pays servicing and insurance margin separately
- Loan is assumable
- Loan is cancelable at the lower of market or par
- **<u>BOTTOM LINE</u> = Approach is based on the combination of global best practices and internationally available capital and systems**

Credit Enhancement Structure
(at loan level)



- Provided by SHF and/or MI industry
- Embedded liquidity facility to provide cash for timely bond payments

- Assumes HT has a local currency "AAA" rating
- The value of the house will serve as collateral for the guarantor, bond holder looks to trust
- Annual excess servicing is swept to cover liquidity and credit needs

- Calculated by applying a 4% capital requirement to a 65% investor risk, which works out to 2.6% of the house value

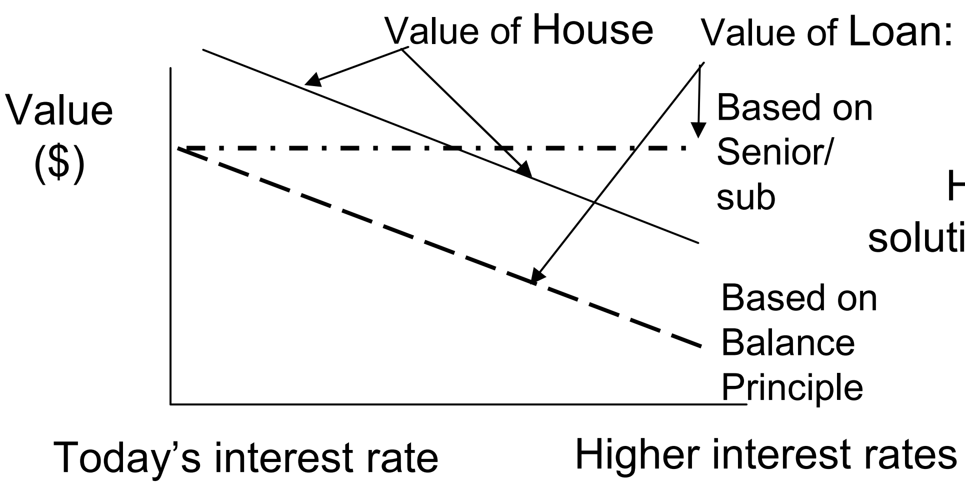
- Based on the principle that each loan will have enough support to guarantee bond holders will not run a credit risk

Waterfall Structure of Trust

- Each Sofol puts in 2.6% of loan into trust as capital
- Each Sofol contributes 50bp per annum on outstanding loans
- Each Sofol gets a return on its capital of regular interest plus bonus if there are no losses, expect 25-30% returns
- If a loan goes past due, the originating Sofol will have incentives to make the trust whole by:
  - First, the annual excess return on that loan is lost
  - Second, the annual excess return of other Sofols is lost, which triggers a loss of origination privileges
  - Third, the capital account will be debited, when this is drawn down, servicing of the Sofol's portfolio of loans will be auctioned
- Capital of remaining Sofols will make up any remaining deficiency along with Bond liquidity insurance

Prepayments

- Balance Principle causes the investor and not the Sofol to bear interest rate risks (including prepayments)
- Borrowers have the option to refinance at the lower value of par or market
  - This reduces the value of the loan when interest rates rise
  - This reduces the cost of the loan when interest rates fall
- Buyback possibilities improves credit in all interest rate environments



HT solution

- When interest rates increase, borrowers can buy bonds at a discount to pay off their loan; refinancing a smaller loan at the new rate.
- When rates decrease, they can refinance again to lower interest

Benefits

- Borrowers insulated from risk through term, fixed rate, assumable loans
- Creates large liquid market because bonds managed through transparent simple system with trusted qualified agent
  - Supports loan level insurance. Similar to FHA role.
  - Supports one “pool-type” of insured homogeneous loans vs. numerous pools with significant differences in their characteristics
  - Supports Mortgage Insurance and Servicing released economic models
- Provides new capital market that has positive implications for Central Bank’s ability to conduct monetary policy
- Improves stability of currency and interest rates
- Favorable counter-cyclical properties because borrowers can re-purchase mortgage at going market price
- Enhances primary & secondary housing market which leads to enhanced labor mobility and efficient use of housing stock
- Socializes mortgage credit availability rather than risk

The “Best” Model for Emerging Markets

- Basle II risk capital guidelines
  - Article 22.4 of UCITS directive
  - Lowest risk capital weighting will rule the roost
- Central Bank “repo-ability” provides liquidity(see Fed and ECB)
- Consumers and bondholders will choose the winner
- Standardized and transparent loans and bonds = the best
- System should have macro economic stabilizers built in
- Extra Balance Sheets are unnecessary and a potential source of risk
- Deposit based systems are fraught with risks in volatile rate scenarios
- Inflexible Bond based systems do not scale up

Danish System: High Credit Quality

- AAA ratings from Moodys, S&P
- There has never been a default
- Danish MCI's have implicit government backing through strong regulation by
  - Mortgage Credit Act
  - Danish Financial Supervisory Authority / Finanstilsynet
  - Danmarks Nationalbank
  - Denmark's title registration system
- Principal of balance keeps MCI's honest
- Late 80's housing collapse showed system's strengths
- Compares favorably to other European models
  - See Moody's May 2002 report
  - See MOW's September 2003 report
  - See BIS March 2004 Quarterly Review

US vs Danish MBS: Differences

- Transparency of loans to bonds and information search costs
- Regulatory and Ratings Issues
- Credit, Delinquency and Foreclosure Issues
- Externalities through linkage mechanism to Capital Markets
- Premium vs. Discount Origination (the Shark)
- Socialization of Credit Risk or Credit Availability
- Conflict of interest between bond holders and issuers/insurers
- Mortgage insurance through balance sheet or monoline providers
- Vertical integration or atomization of skills (separate origination, financing, securitization, trading, investing, servicing, master servicing and special servicing functions)