# It's Sunday Again: It Must Be Business-As-Usual™
## Don't Blame Hank: Give Him The Tools To Get It Done!™

[**New FAS 5 Solution**: Quarantined Built In Equity - Shared Appreciation Modifications™
There is No Reason for Massive Write-Downs or Principal Forgiveness Losses When we can Quarantine It, and Infuse Borrower Affordability at the Same Time!]

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Another Sunday Shocker or Business-As-Usual?

Dateline: September 19-20, 2008. OK, it's official: The United States changes the rules every Sunday. Well, it certainly seems that way based upon the case-by-case actions taken by the Treasury, the "Fed" and the administration starting at least last March (with the Bear Stearns take-under). If you add the SEC into the mix, we can trace that concept back to July 2007 (with the suspension of the "up-tick" rule).

This weekend, Treasury Secretary Henry Paulson, after consensus with the highest powers of the United States government and Congress, announced another historical change in the mortgage finance industries. They proposed that the Treasury have the authority *to purchase mortgage-related assets and establish a temporary guaranty program for the U.S. money market mutual fund industry*. Section 6 of the proposed legislation asks for the following authority:

> "The Secretary's authority to purchase mortgage-related assets under this Act shall be limited to $700,000,000,000 outstanding at any one time"

In A New York Minute: The New World Order:

Now, the world knows what New Yorkers mean when they say, "In a New York Minute." In lock step with Secretary Paulson's announcement, the last remaining historic investment banks, JP Morgan and Goldman Sachs immediately filed applications to become commercial bank holding companies. Their applications were immediately approved with a waiver of the normal process including the public comment period.

Extraordinary times require extraordinary measures. Authority is a prerequisite to responsibility.

Goldman Sachs Bank USA will be the 4th largest banking holding company in the USA. These new bank holding companies will now be subject to Federal banking regulations and restrictions. We can expect the level of leverage and profits to fall dramatically until the next generation of morphing begins. Look offshore to find the DNA of the next generation of investment banks. Let's hope we can find a source and system for enhanced and healthy securitization. However, in our search for certainty and security, we must be cautious not eliminate (tradable) diverse risks or diverse products that align various risks with price and return. If we do, we will do long term damage to economic prosperity.

Private equity and foreign sovereign funds will become major saviors. We should expect equity to buy at a discount the mortgage assets purchased by the government at a discount. This will be the largest transfer of value in our history.

Secretary Paulson Rises to the Occasion:

In reaction to the stock market meltdown of this past week, even the little-old-lady-from-Pasadena was screaming from her roof-top for help from the mortgage meltdown. Secretary Paulson again, stepped-up to the plate and said the system is broke, and we must all fix it. The pain has reached levels that no diverse interests can stand it any longer. Change is about to take hold. It must.

There are many causes for the meltdown, and each must be identified. This time, the Secretary identified the heart of the matter as the *condition of illiquidity* in mortgage assets, and the capital (and credit) markets. Any risk or stress assessor on Wall Street will now tell you that *events of illiquidity in periods of fallen prices* were effectively left out of the loan (securitization and portfolio) product risk modeling (Risk Magazine, various). The occurrence of RahC (randomly activated hidden contingencies) has crippled the world mortgage and financial markets. "Modeling" has (also) failed us. There is plenty of blame to go around, and it is necessary and proper to assess blame as a tool of analysis in searching for a comprehensive solution. But wrongly assessing blame to one group over another will corrupt the foundation of the solution. We must all resist the easy broad brushed blame game. For example, it's easy and vogue to blame the credit rating agencies. But they were contractually obligated to use the *then* tools and best practices to review and assess mortgage assets and portfolios (and internal and external credit enhancements) pursuant to the strict scope of engagement rules. It is a disservice to over-blame the credit rating agencies, as it is a disservice to over-blame the risk modelers, or any other group. The lack of properly aligned and comprehensive incentives, the lack of a systemically seated minimum "certainty" safety-net, backed by insurance, guarantees and access to government funds, and the failure of a simplified, cohesive, and comprehensive system of regulations and regulators, predestined collapse for a shadow banking system (www.shadowbanking.com) high on the new drug of securitization. The contractual, tax and revenue service rules behind securitization also

preordained failure to mortgage pools in times of foreseeable defaults for any reason, but specifically in times of falling prices and events of illiquidity. The inability to allow en mass or preset contractual loss mitigation solutions (including deferments, modifications, short sales, short payoff refinances, etc.) is just plain silly (www.shiloloans.com). There is nothing wrong with a more profitable shadow mortgage banking model per se. In fact, the economy can and does benefit from more shadow banking. This time, it needs to be supported by industry and/or government with minimum transparency, liquidity, and credit safety belts. The fact that the Shadow Banking System's model was neither federally insured nor able to use the Federal Discount Window makes it vulnerable to market extremes and unnecessary loss and asset devaluation severities. It is simply not healthy to continue to ignore or deny that our secondary market system is lacking a certainty safety-net for the non-conforming (non-agency) loan and commercial paper markets. Moreover, homeowners must have access to new "affordability" models that pay for higher risk with "non-cash burdened" risk mitigation devices and methods.

We should consider tradable insured investment funds that supply minimum funds to satisfy the concomitant risks aligned in that fund while building fund equity, such as Foreclosure Mortgage Insurance Investment Funds™ (FMII™). For more information go to www.foreclosuremortgageinsurance.com. We should also consider amending our new HR 3221 law to include properly aligned incentives and protections from liability for all market participants including borrowers, and extending the voluntary principal forgiveness modification (and short pay refinance) opportunities. Lenders are not keen on losing principal and incurring risk without sharing in the upside SAM (shared appreciation mortgage). Let's refine that concept and offer a new version of principal reduction where lenders would not necessarily lose principal from forgiveness, but quarantine principal (to levels which build in equity) to allow for a more "affordable" monthly payment for the borrower, but maintain the right of the Lender to share in the appreciation over time (i.e.: QbieSam™ or Quarantined Built In Equity Shared Appreciation Mortgage™ (www.qbiesam.com)). For a discussion of principal reduction modifications, see the June 2008 webinar discussion between Richard Ivar Rydstrom, Chairman of CMIS, and Wilbur Ross, Chairman of WL Ross & Co. LLC, at the Executive Leadership Summit of the Coalition for Mortgage Industry Solutions (CMIS) at Dickstein Shapiro in Washington DC. For further information contact the American Legal & Financial Network (AFN), Matt Bartel, Chief Operating Officer, at mbartel@e-afn.org.

The Secretary is correct. Illiquidity must be reversed systemically, and immediately. Secretary Paulson said, "These illiquid assets are choking off the flow of credit that is so vitally important to our economy. When the financial system works, as it should, money and capital flow to and from households and businesses to pay for home loans, school loans and investments that create jobs. As illiquid mortgage assets block the system, the clogging of our financial markets has the potential to have significant effects on our financial system and our economy." When the money flow stops, the system collapses on uncertainty and insecurity. Events of illiquidity are now a reality that must be reversed with no time for delay.

My sense of these events this weekend is the Secretary is dead serious and things will change and fast. The proposed law that he submitted should be entitled: *"Give Me Full Powers, Authority & Responsibility: Step Aside & I'll Fix It Already."* Frankly, he's the best person for the job. He has proven that he will step up to bat and swing. At a time when the voice of change begs for leadership, he has appeared. Solutions take leadership. The industry must take voice and step up to meet the challenges voiced by Secretary Paulson. We need leadership that can change the framework and mindset of our government and industry policy makers "from temporary for some" - to "comprehensive for all." While many association leaders are noticeably silent, or announce polite little tidbits of *conditional* support with their show-me attitudes, few leaders take a stand. It's time for us all to stand up and participate. One leading voice of change has found its rightful place on the shoulders of William Leroy, the President of AFN who has feverously supplied the framework and forum for diverse discussion and dialogue for new best practices in the mortgage, financial and legal fields. The experts in the trenches must step-up and offer their ideas on what must be fixed in their respective segments of the industry. Although interim and emergency fixes are necessary, we do not want more temporary, non-comprehensive band-aids. That will only breed more uncertainty and systemic insecurity.

It's not like Hank Paulson is afraid to act. September 14, 2008 was yet another Sunday shocker. Weekend deals to save major concerns have become business-as-usual in DC and Wall Street. Most recently, AIG and Lehman Brothers were on the soup line hoping the Fed would make its balance sheet available, without success. Lehman then filed for bankruptcy, and AIG attempted a private funding deal for some $75-$90 billion, which (apparently) fell through (9/16/08 2:22pm (EST)). AIG has reported $150 billion of repo (repurchase) exposure. AIG then entered into a deal after late night negotiations on September 16, 2008 with the Federal government for an $85 billion secured bridge loan in return for dilutive warrants (for an 80% stake), allowing AIG to sell assets and raise critical capital to avoid bankruptcy without triggering credit default swap exposures. Bank of America took-over Merrill Lynch without yet digesting Countrywide. Is this a perfect storm or a global climate change? Where is Toni Moss when we need her?

Should we be surprised that this has become our going-concern best practice in the mortgage and financial industries? On September 7, 2008, Secretary Paulson was again guiding the federal government to take control through a conservatorship of mortgage giants Fannie Mae and Freddie Mac. The AP reported that officials announced that the executives of both institutions had been replaced. Herb Allison, a former vice chairman of Merrill Lynch was selected to head Fannie Mae, and David Moffett, a former vice chairman of US Bancorp was picked to head Freddie Mac. The GSE regulator, Jim Lockhart, (former Director of OFHEO, Office of Federal Housing Enterprise Oversight), is now the Director of the new independent regulator, the Federal Housing Finance Agency, FHFA. For more information go to www.ProCouncil.com, and click on Articles.

The SEC and the "Temporary Naked Short Selling Ban" vs. "The Up Tick Rule":

We were forewarned over the summer of 2007 when the mortgage meltdown manifested itself in the markets and put the breaks on liquidity and securitization shortly after the SEC suspended the "uptick rule" allowing naked short selling. The severity of that warning was confirmed when rumor had it that Bear Stearns was to file bankruptcy that Monday, March 17, 2008, but the Fed invoked an arcane regulation which effectively "forced" the take over of Bear Stearns by suitor JP Morgan Chase. To add fuel to the fire, on July 9, 2007 the SEC eliminated the so called "Up Tick Rule" which normally does not allow traders to bet on the down tick (or engage in naked short selling). As a result, hedge funds and Wall Street investment banks, issuers (and others) bet on the down, that subprime mortgage investments would devalue and incur great losses. As their own loan portfolios lost value or went bankrupt, some investment banks continued to sell loan portfolio investments, and great monies were made shorting same; some would say accelerating the losses.

Again, Secretary Paulson appeared and guided the team to a solution and created guarantees from albeit the unknowing taxpayer to the tune of $29 billion (or more), and changed the rules overnight to grant access to the Federal Discount Window (and to Investment Banks going-forward). The collateral was in amounts and quality which remain secret, uncertain, and unknown. Maybe we should call the Bear-Stearns move what it was: a take-under and lateral pass. Over that infamous weekend the Fed, JP Morgan Chase and Bear Stearns agreed to a $2 per share buyout (later increased to $10); against a then recent $84 per share book value. As late as January 2007, Bear Stearns had a $171 share price. JP Morgan Chase paid $236 million (with the downside "put option" guarantee or backing of the Fed), including an option on the building. The building was said to be worth more than the deal price alone.

In another temporary emergency move this week, the SEC has chosen to set a ban on naked short selling on specific issues only for a limited time, instead of reinstating the up tick rule which it suspended in July 2007 prior to the summer meltdown. The ban is set to expire on October 2, 2008. The lack of expanding open interest is evidence that this move has caused money to sit on the side lines instead of jumping in. Can you blame the big money? Would you knowingly jump in front of an oncoming fright train? A temporary ban does not serve to create certainty, it creates uncertainty. The SEC must immediately reinstitute the "up tick rule" to add certainty and integrity back to the marketplace.

Why would the government take such extreme measures? How bad is the financial crisis?

How Much More Financial Pain is in The System?

When free markets allow "5 million homeowners" (9/19/08 Paulson, Press Room) to incur delinquency, default, or foreclosure and potentially become homeless, and the

broad economy is threatened with recession (or worse), and the money and capital flow freezes (worldwide), capitalism falls to its knees begging for refinement.

Some estimate that we have seen over $1.1 trillion in asset destruction as a result thus far. The International Monetary Fund (IMF) estimates some $950 billion in net-worth erosion from the credit crunch. The difference is $150 billion, from high-yield bonds. Billionaire Wilbur Ross estimates that lenders have lost some $13 trillion in lending capacity (if $1 of equity supports $12 of assets). Mr. Ross also estimates that home property values in the United States have fallen from its $20 trillion peak at least 10% if not 15% or more. For every 10% home price decline, $2 trillion is lost in the personal net worth (wealth) of the American people ($7/$100). For each $2 trillion of price decline, $140 billion is lost in consumer spending (or 1% of the GDP of America).

Citi Bank lost $176 million in credit card securitizations (Q2) as reported on 8/4/08 by Erik Schatzker of Bloomberg. Like mortgages, predictable credit card receivables are securitized into tradable (debt) bonds. Citi had some $9B in such write-downs on previous deals, as Bank of America and JP Morgan each carry about $3B in securitized credit card debt as of March 2008.

With gas, oil and product prices rising, consumers are strapped with credit card debt in amounts that cause homeowners to choose between paying their mortgage or their credit cards (and auto payments). As consumers support about 70% of the American GDP, and incomes have not kept pace with prices, consumers are on the brink of default and financial ruin. The delay to implement (en mass) sensible mortgage loan (or principal) modifications, and consumer credit card modifications that maintain FICO scores, may have caused another buildup of potential defaults, delinquencies, foreclosures or repossessions, especially as 1.7 million to 2.0 million ARMs are expected to reset to unaffordable monthly payments, in 2008-2009. We are in the midst of a very serious U.S. and world economic crisis in want of new (creative) solutions.

Government Response:

To date the government has proposed new Treasury authority to purchase mortgage-related assets and establish a temporary guaranty program for the U.S. money market mutual fund industry, consolidated the regulators, granted authority to Investment Banks to use the Discount Window, created facility auction funds, lowered interest rates, caused an historic take-under, and used conservatorship to take-over the GSEs. Additionally, on July 28, 2008, Treasury Paulson, the FDIC, and four major banks, announced their support to create a "Covered Bond" market that would help create liquidity. Covered bonds are mortgage debt that remains on the balance sheet of the issuer (bank or special purpose entity). Covered bonds should attract more investment monies as they provide the investor dual recourse from the "cover pool" and the "issuer." Although the new U.S. covered bond device is a critical part of the overall solution, private label securitization and/or new credit enhancement products must return or be introduced into the market for the real estate market to recover. The U.S. Treasury reports that during the 2005 to 2007HI private label securitization exceeded or was equal to funding by GSE (MBS).

During such periods FHA remained fairly constant and insignificant. Balance Sheet Lending was about the same as the GSE (MBS) and private label securitization until 2007H2 and 2008Q1, where it decreased significantly. But private label securitization fell significantly in 2007H2 and almost ceased to exist by 2008Q1. This is the problem. Private label securitization or the liquidity that it supplied the mortgage finance industry has all but dried up. Investors are not willing to put money into the securitization vehicles as it exists today for fear that they will lose their money with little or no recourse. During 2005, 2006, and 2007H1, private label securitization exceeded $1 Trillion ($1.2T). Now it is almost non existent. For more information and the official Press Releases and Guidelines, visit www.ProCouncil.com and click on Covered Bonds (or www.USCoveredBondCouncil.com).

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You can love it or hate it. You can feel it's anti-American. You can object to the losses to shareholders or equity holders. You can object to the taxpayer holding the bag. You can claim that it will threaten capitalism. You can swear that printing more money (selling more bonds) will cause a depression; or if the Fed pays for it, inflation will become a threat, or if Treasury pays for it, the dollar may stabilize. You can opine that if banks "hold the cash" generated by the Paulson plan and buy Treasuries, the system will remain clogged, or you can believe that competition will cause the banks to put that money to use and lend. You can point out that credit default swaps and interest rate derivatives and the cost of money will not release the high risk priced in, for months and months to come. But you can't fault a leader for stepping up to the plate and putting out fires when the tree's ablaze. We have problems. Serious problems. The problem is (already) upon us. Illiquidity is the *terrior* (expression of the true characteristic of the region) of the severity of the problem. We are in the waterfall of financial destruction. When problems of this magnitude exist, certain radical and immediate steps are necessary. A surgeon will sometimes have to remove a cancer to buy time for a longer term solution. Short term or "temporary" solutions are certainly not the preferred method of solving problems on the vast scale that face us presently, but not mitigating certain immediate threats will act to worsen the problem. Whether action should have been taken by government officials sooner and in a more comprehensive manner, are answers that will serve us going-forward in the long term, but what is needed now is immediate interim actions, paralleled with long term solutions. The Secretary has offered some of both at this point, but we desperately must have in place a comprehensive and coordinated solution when we finally look up and see the wake of financial destruction in our rear view mirror. We are in a storm, within a financial climate change.

What Has The Industry Done?

Not much. The voices of the industry have been dangerously silent. The author and the Coalition for Mortgage Industry Solutions along with billionaire Wilbur Ross spoke out for principal forgiveness modifications in June 2008. William Leroy (of AFN) spoke out for new best practices along with NACTT and S&P. Hope Now and the ASF have introduced new guidelines. However, more creative products must be introduced into the

marketplace that offer enhanced "affordability" on a monthly cash basis for the borrower. New and creative funds must be brought to market to allow trading of the risks inherent in the failure and success of the housing market, including mortgage assets. Enhanced and refined loan modification devices must be developed and delivered to market with government blessings, and without the same restrictions that crippled our ability to realize effective loss mitigation and modifications to date. New and certain safety-nets must be added to the capital and securitization markets. New Covered Bonds must take hold as recently cleared by Secretary Paulson (and other government leaders). Liquidity must be returned to the markets. But critically, the securitization markets must return with new products, especially private label jumbo products. Certainty must be the norm, but without the elimination or over-regulation of diverse products that align various risks with price and return.

New Solutions: Housing and Economic Recovery Act of 2008:

As of September 2008, it is fair to say that many lenders, servicers and investors are either starting to accept or will consider principal reduction or forgiveness mortgage loan modifications. The new law, known as the Housing and Economic Recovery Act of 2008 was signed by President Bush on July 30, 2008 which starts the refinance boom projected from 2008-2012 with $300 billion in FHA insurance guarantees for lenders, servicers and investors who voluntarily accept principal reduction loan modifications. These devices will or should greatly lower monthly payments for borrowers in trouble, in return for sharing the risk of gain or loss (or upside appreciation gain) on the eventual sale, transfer or refinance of the debt or home. However, many lenders are objecting to the voluntary program as lacking incentives and protections for the lender, in part because the law allows the borrower and government to share in the future appreciation, but not the lender, and the law fails to clarify or protect the lender from reimbursement claims from HUD and FHA, typically from insurance claims on bad loans. Congress should consider amendments and changes to the law to include more incentives that trigger more immediate effective or en mass modifications.

Common Loss Mitigation & Mortgage Loan Modification Solutions:

In addition to the industry objections to the new law, there is uncertainty as to whether a Servicer/Lender has requisite authority to implement such voluntary principal forgiveness modifications in type, amount or number under its Pooling & Servicing Agreements (P&S), Revenue Procedure 2008-28, REMIC rules under IRC 860 et. seq., Financial Accounting Standards Board Statement 140 (plus 114, 118, 155, 156, 157, 159, 133, 134, 147, 149, 115, 107), etc., ASF Guidelines, Hope Now Guidelines, S&P Guidelines, NACTT Guidelines, Income Tax Regulations §1.671-5(m), and other authorities or best practices which are not yet comprehensively consistent. For a list and links to the actual mortgage industry Best Practices and official Guidelines, visit www.ProCouncil.com and click on [New Best Practices] or July 15, 2008, Public Comment Filed by Richard Ivar Rydstrom re Rev Proc 2008-28.

This new law is supporting a short payoff refinance solution concept, allowing troubled borrowers to refinance their mortgages for less than the amount due on the loan. For more information on short payoff refinance solutions, go to www.ShortRefinance.com. Other common solutions offered by law, practice or the industry are: Loan Forbearance Agreement, Repayment Plan, Modification, FHA Partial Claim Loan, Deed In Lieu of Foreclosure and Short Sale. For a list of all of the loss mitigation solutions and tax aspects of forgiveness of debt, short sales, and short payoffs, obtain the public outreach booklet, 13 Solutions to Default & Foreclosure™ on the Help4ThePeople™ site: www.Help4ThePeople.com.

Financial Accounting Standards Board (FASB) Update:

FAS 140: As of August 2008, The Financial Accounting Standards Board (FASB) postponed the implementation of FAS 140 by one year. FAS 140 (*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities-a replacement of FASB Statement No. 125* (Issue Date 9/00)), would "consolidate securitization qualified special-purpose entities (QSPE) - including mortgages, credit card, student and retail auto loans. Losses and valuations would be brought (back) to the balance sheets and potentially adversely impact capital and regulatory requirements, financial ratios, financial covenant performance and dampen credit markets, trigger more write downs, and impede liquidity."

FAS 157: On November 15, 2007 FAS Rule 157 (FAS Statement No. 157, *Fair Value Measurements*, (Issue Date 09/06)) was to mandate the reporting of the "Fair Value Measurements" method, but instead the Board delayed the implementation date for one more year to November 15, 2008. *Fair Value Measurements* relate to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. It is argued that the reporting of losses from write-downs to fair value have been delayed or underreported on the balance sheet and income statement, adding to the "uncertainty" and problems in the industry. The billions in write-downs already taken by the banks and insurers have restricted the ability banks and lenders to loan, and insurers to issue policies going forward. But are these losses or write-downs from "marking to market", "marking to model", or actual losses from actual (forced) "sales"? Fair Value will also and currently does touch, the reporting of derivatives and embedded derivative transactions under FAS Rule 133 and FAS Rule 155, as well as Stock Options (Rule 123R), and Securitization (and Servicing Rights) under FAS Rule 156.

How will these rules change the reporting and 'losses' estimated in the marketplace today? The argument for Fair Value includes the concept that the current "historical cost" balance sheet reporting does not accurately reflect a company's current economic state. The counter arguments include the uncertainty of how to value assets and liabilities that have no current active market. Presently "earnings" as reported in the income statement drive the markets. The change to "Fair Value" may shift focus from the income statement to the balance sheet. We may also see some more uncertainty in the pricing of mergers and acquisitions ("M&A") as Fair Value acquisitions would require more balance-sheet reporting of present value of contingent payments based upon assumptions of the "likelihood of materializing" and lessen the expensing of after close

payments. Fair Value may require marking debt to market. This may affect financing growth with debt unless an offsetting hedge against same is also disclosed on its balance sheet. Interest (ownership) in other companies may allow for enhanced mark to market balance sheet reporting of same over historical cost (www.MarketDevaluation.com ).

FASB & IFRS International Convergence: Thomson Reuters in its SEC/GAAP Watch on September 8, 2008, reported the following update regarding "Action Alert No. 08-36: FASB to Converge Going Concern Guidance under GAAP with IFRS:

> The Financial Accounting Standards Board decided at its August 27, 2008, weekly meeting that the guidance under U.S. generally accepted accounting principles should converge with the international rules for an auditor's evaluation of an entity's ability to function as a going concern and the events that occur between the date of a financial statement and the issuance of the audited statement for that period. The FASB announced the decision in Action Alert No. 08-36. As a result of the decision, the rules under U.S. GAAP would converge with the International Accounting Standards Board's (IASB) International Accounting Standard (IAS) 1, Presentation of Financial Statements, and IAS 10, Events after the Balance Sheet Date, and be supplemented by the disclosure requirements in the American Institute of Certified Public Accountants' (AICPA) Statement on Auditing Standards (SAS) No. 1, Codification of Auditing Standards and Procedures, and AU Section 341, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern." The Board also decided that the guidance should be consistent with AU Section 560, "Subsequent Events."
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> **While the FASB wants to get rid of the remaining differences between U.S. GAAP and IFRS, it doesn't want the revised guidance to address differences in refinancing of short-term obligations and curing breaches of borrowing.** The FASB's research staff will produce a draft of the converged guidance that will be voted on by the Board members. An exposure draft of the proposed changes will then be released for a 60-day comment period." (Emphasis added)

We remain in a state of uncertainty on the authority, laws, regulations, guidelines and generally accepted accounting principles. Someone must step up and break the deadlock. It is time for a leader to appear.

Is the Paulson Plan A Good One?

Is Secretary Paulson's most recent sweeping plan a good one?

The plan is a necessary first step, and addresses several key issues that must be included in any successful plan. However, the plan should be amended to include or allow for the interim and long term authority and protections necessary for solutions that address how we can reach true and immediate "affordability" and foreclosure protection for borrowers. Frankly, it should include broad authority stated expressly and in principle-based terms, that allows for any plans that could reach true affordability and protections for borrowers including authority and protections for lenders, servicers, conduits (REMICs), issuers, MBS pools, Covered Bond pools, and all other participants (or products) that (should and must) co-exist in the mortgage finance, mortgage asset and

securitization industries. That will include, but not be limited to the relaxation or suspension of any and all IRS/Treasury rules (Revenue Procedure 2008-28, IRC 860 et seq., Income Tax Regulations), Best Practice Guidelines (Hope Now, ASF), and Pooling and Servicing Agreements that restrict the ability to modify or replace mortgages or loans in securitized pools. Express authority must allow for immediate and voluntary principal forgiveness and quarantined principal modifications, overriding laws, regulations, guidelines, or FASB/IFRS rules.

With that said, the proposed legislation grants sweeping powers and authority to the Treasury Secretary. For example, Section 2 grants the following powers:

> "(5) issuing such regulations and other guidance as may be necessary or appropriate to define terms or carry out the authorities of this Act."

We need a relaxation of certain rules, regulations, and guidelines to (legally) allow for the immediate solution that is necessary to reach true borrower affordability. That is not to say that we do not have to totally revamp the outdated regulatory system, and impose needed regulation appropriately, we do. But to allow for modifications including principal forgiveness or quarantined principal modifications we must remove the shackles, not tighten them. So by granting the powers in item (5), we must expect the regulations to remove or relax certain legal restrictions that are precluding immediate, en mass or effective mortgage and consumer credit modifications.

Section 3 of the proposed law should add the following:

> (3) Necessary authority and protections for reaching true borrower affordability
> (4) Necessary authority and protections for reaching en mass or efficient mortgage and consumer credit modifications; including in bankruptcy.
> (5) Necessary authority and protections for reaching liquid capital markets.
> (6) Necessary authority and protections for reaching new internal and external credit enhancements

Sec. 5. Rights; Management; Sale of Mortgage-Related Assets states:

> "(a) Exercise of Rights.--The Secretary may, at any time, exercise any rights received in connection with mortgage-related assets purchased under this Act.
> (b) Management of Mortgage-Related Assets.--The Secretary shall have authority to manage mortgage-related assets purchased under this Act, including revenues and portfolio risks therefrom.
> (c) Sale of Mortgage-Related Assets.--The Secretary may, at any time, upon terms and conditions and at prices determined by the Secretary, sell, or enter into securities loans, repurchase transactions or other financial transactions in regard to, any mortgage-related asset purchased under this Act.
> (d) Application of Sunset to Mortgage-Related Assets.--The authority of the Secretary to hold any mortgage-related asset purchased under this Act before the termination date in section 9, or to purchase or fund the purchase of a mortgage-

> related asset under a commitment entered into before the termination date in section 9, is not subject to the provisions of section 9."

Due to the existing quagmire of conflicting laws, regulations, and guidelines, we must give some entity the authority and power to untangle this mess – and fast. Although the above powers are a sweeping statement of power, we must take the leap of faith that Secretary Paulson will use it, and use it well within the checks and balances that must be built within. We are on the forefront of a potential financial and societal collapse and a new financial world order. We must give our most experienced and brightest the authority and power to move broadly and swiftly, or we can not hold them responsible. Our system is such that no centralized entity is directly holding this responsibility. Secretary Paulson is right to propose broad and immediate authority. It is subject to oversight, so let's give Secretary Paulson the authority and powers he needs to make real change, real fast, before the wave of financial destruction engulfs us.

Specific & Immediate Solution

**New FAS 5 Solution: Quarantined Built In Equity - Shared Appreciation Modifications™**

**QbieSam™**

*** There is No Reason for Massive Write-Downs or Principal Forgiveness Loss, When We Can Quarantine It!**

*** There is No Reason Why We Cannot Reach True Monthly Affordability for Borrowers!**

Instead of wading in the quagmire of the slippery slope of FAS 157 "Fair Value", which will cause more bank write-downs and more restrictions on the ability to lend, we should use FAS 5 (Accounting for Contingencies) with the solutions articulated by billionaire Wilbur Ross regarding principal forgiveness modifications, and QbieSam™ or Quarantined Built In Equity Shared Appreciation Modifications™ (www.qbiesam.com)) as offered by the author, which preclude an event of actual principal loss forgiveness at the outset resulting in a very small net present value discount for the foreseeable loss of principal over the expected (longer) life of the loan (modification). This would allow for "true affordability" for borrowers as the monthly payments would be based on the much lower un-quarantined principal amounts and allow lenders, insurers, and borrowers to share in the total upside of appreciation over time, which may result in a 100% recovery for all parties. There is no reason why we must have a modification plan that would require the lender to realize a loss at the outset, along with the assumption of additional FHA insurance risks and costs. Lenders are not motivated to volunteer into such a plan, but a quarantined principal plan would give lenders the necessary incentives to participate. There is no more time for delay. En mass or extremely effective mortgage and consumer credit loan modifications (www.sdirt.com) must occur immediately. There should be no adverse tax, liability, legal or credit (FICO) consequences for all parties to mortgage and consumer loan modifications, whether tied to a securitized pool or not. **We must untangle the unintelligible, un-reconciled web of restriction, now.**

Although, the Treasury will initially obtain the toxic mortgage assets, whether it should continue to hold them, or manage them is another question. Whether the Treasury should assign certain functions to third parties or create a new entity such as a resolution trust or other entity, remains in dispute. In response to this weekend's new proposed solution, Senator Hillary Clinton suggested that Congress approve an entity similar to the depression era, Homeowners Loan Corp (HOLC) to conduct all of the "modifications" and loss mitigation workouts. The Dems are also looking for approval for Bankruptcy Judges to perform modifications and the administration is holding fast against it. We should empower all avenues of resolution. At the recent AFN Leadership Conference in Tahoe in July 2008, the author suggested the following:

> We are in the grips of a housing and mortgage finance crisis, wherein the posture of our publicly stated goals has now caught up with, and are now reminiscent of the extreme measures taken by the 1933 Homeowners Loan Corp (HOLC) government interventions. Public policy is now compelled to accept the challenge to reduce the burden on borrowers and increase liquidity and credit in the mortgage and finance markets. Free market capitalism may be forced to make another historic move away from the conceptual purism of free open markets to something more refined like, free but responsible open markets. Should we? Can we? And how do we embrace this? Is it a threat to any self interest or profession? No, it is not if we embrace it in search of comprehensive solutions for all diverse self interests.

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