



Genworth<sup>SM</sup>  
Financial

# FIABCI Young Members' Conference

REITs, Mortgage Insurance and  
Mortgage Backed Securities (MBS)

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# An evolving mortgage market ...

## Yesterday

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- Small market ... limited impact on P&L and balance sheet for banks
- Limited competition
- Limited focus on funding efficiency
- Low risk appetite for lenders
- Limited integration of primary market with secondary market
- Basel 1

## Today

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- Expanding market ... significant impact on P&L and balance sheet for banks
- Growing competition ... efficiency of operations is key
- Increased focus on funding efficiency
- Greater risk appetite for lenders (new products, new borrowers, new loan purposes)
- Mortgage assets increasingly leveraged for capital market transactions
- Basel 2 from 2008 ... risk transfer may create capital benefits

# In the new environment important lessons have been learned from the sub-prime crisis

- In today's environment, mortgage assets are increasingly leveraged in capital markets and risk transfer transactions
- Following the sub-prime crisis, investors, providers of credit protection, and capital markets players are placing increasing focus on precise assessments of collateral risk, with important consequences for lenders:
  - Underwriting and Risk Management processes will be increasingly under scrutiny
  - Standardised, rules-based credit processes are likely to be rewarded in capital markets ... judgemental processes penalised
  - Capacity to document loans' characteristics will be critical ... data limitations will need to be removed
  - Lenders will increasingly need to disclose their market strategy to external counterparties ... quality and depth of disclosure is likely to pay off

# Mortgage Insurance: definition

- A form of insurance coverage that protects lenders or investors from losses arising from borrowers' default on residential mortgages according to the formula:
  - $\text{Losses} = (\text{Residual debt} + \text{past due interests} + \text{credit recovery expenses}) - \text{Value recovered from the property}$
- Consistent with the minimum requirements set by Bank of Italy requirements for guarantees for “Credito Fondiario” and by the new Basel 2 / CRD legislation:
  - Credit Protection must be direct
  - Losses stemming from borrowers' default explicitly covered
  - Guarantee cannot be cancellable and conditional on events different than borrowers' default
  - Timely claim payment

# How Genworth Financial's Mortgage Insurance product works

## Bank of Italy requirement

“Risk mitigation products for retail mortgages must provide a level of coverage that ensures that the ratio between the loan and the sum of (property value and insurance coverage) does not exceed 80%”

## Credit protection provided by Genworth Financial

LTV	Mortgage Insurance coverage as a % of loan
100%	25.00%
95%	19.74%
90%	13.89%
85%	7.35%

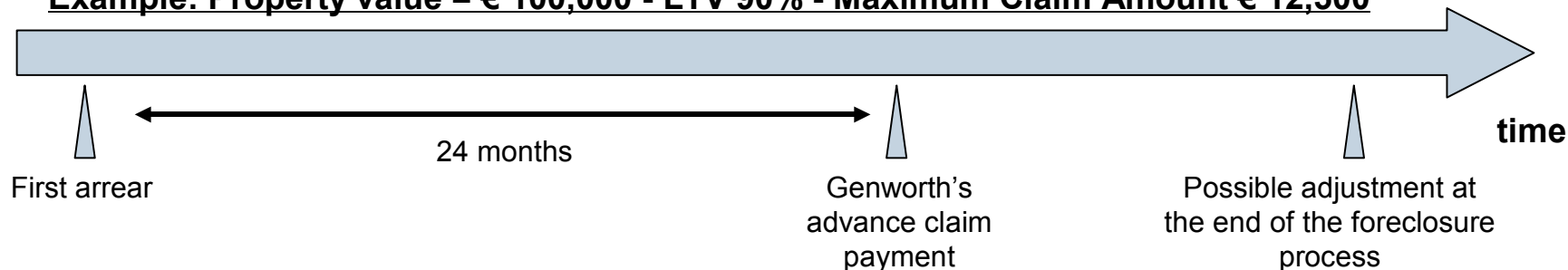
## Example: mortgage to purchase € 100,000 property

Loan amount (€)	Genworth Financial's maximum claim amount
100,000	25,000
95,000	18,750
90,000	12,500
85,000	6,250

In the case of **constant coverage**, the maximum claim amount remains constant over the entire life of the loan

# The claim payment process

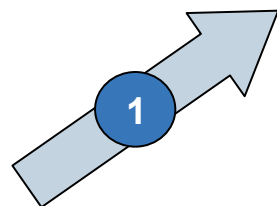
**Example: Property value = € 100,000 - LTV 90% - Maximum Claim Amount € 12,500**



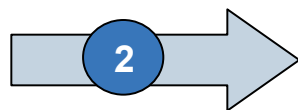
	<b>Case 1</b>	<b>Case 2</b>	<b>Case 3</b>
Residual debt	(80,000)	(80,000)	(80,000)
Interests	(10,000)	(10,000)	(10,000)
Credit Recovery Expenses	(10,000)	(10,000)	(10,000)
Property value	<u>70,000</u>	<u>90,000</u>	<u>100,000</u>
Total net loss	(30,000)	(10,000)	0
Genworth's claim	<u>12,500</u>	<u>10,000</u>	<u>0</u>
Net loss for the lender	(17,500)	0	0

# Why Mortgage Insurance?

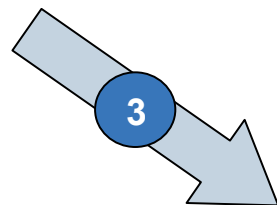
Lender transfers credit risk to mortgage insurer to achieve one or more of the following benefits



Reduced expected losses (especially on riskier products, such as High Loan-to-Value mortgages)



Capital advantages under Basel 1 ... expected to continue under Basel 2

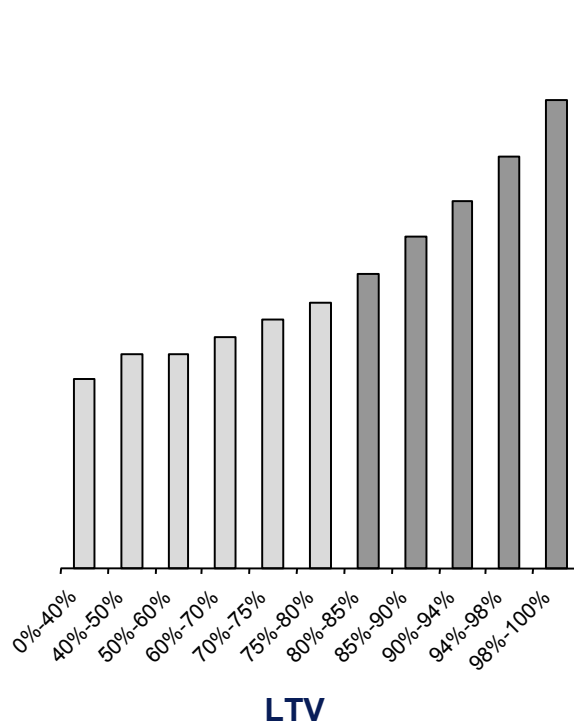


Better execution in securitisation transactions (reduced cost of funding, lower reserve requirements, etc.)

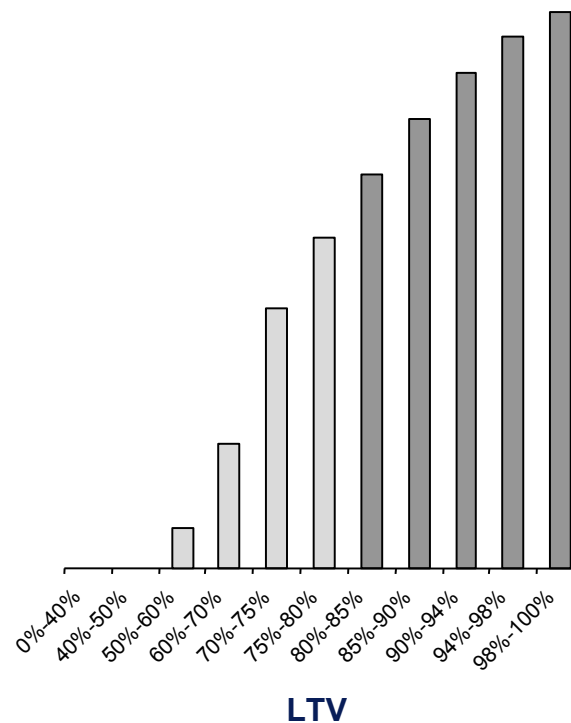
Moreover, through partnership with a mortgage insurer, lender can get access to intellectual capital in the areas of Underwriting, Risk Management, Product Development and Management and Market Intelligence, thanks to the mortgage insurer's exposure to multiple lenders and geographical segments

# 1. Reduced expected losses on riskier products: the example of High LTV mortgages

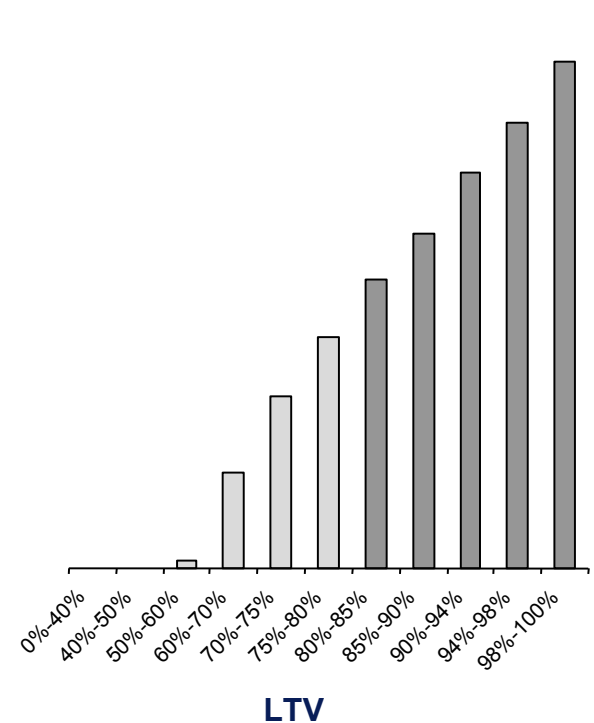
**Probability of Default**



**Severity**



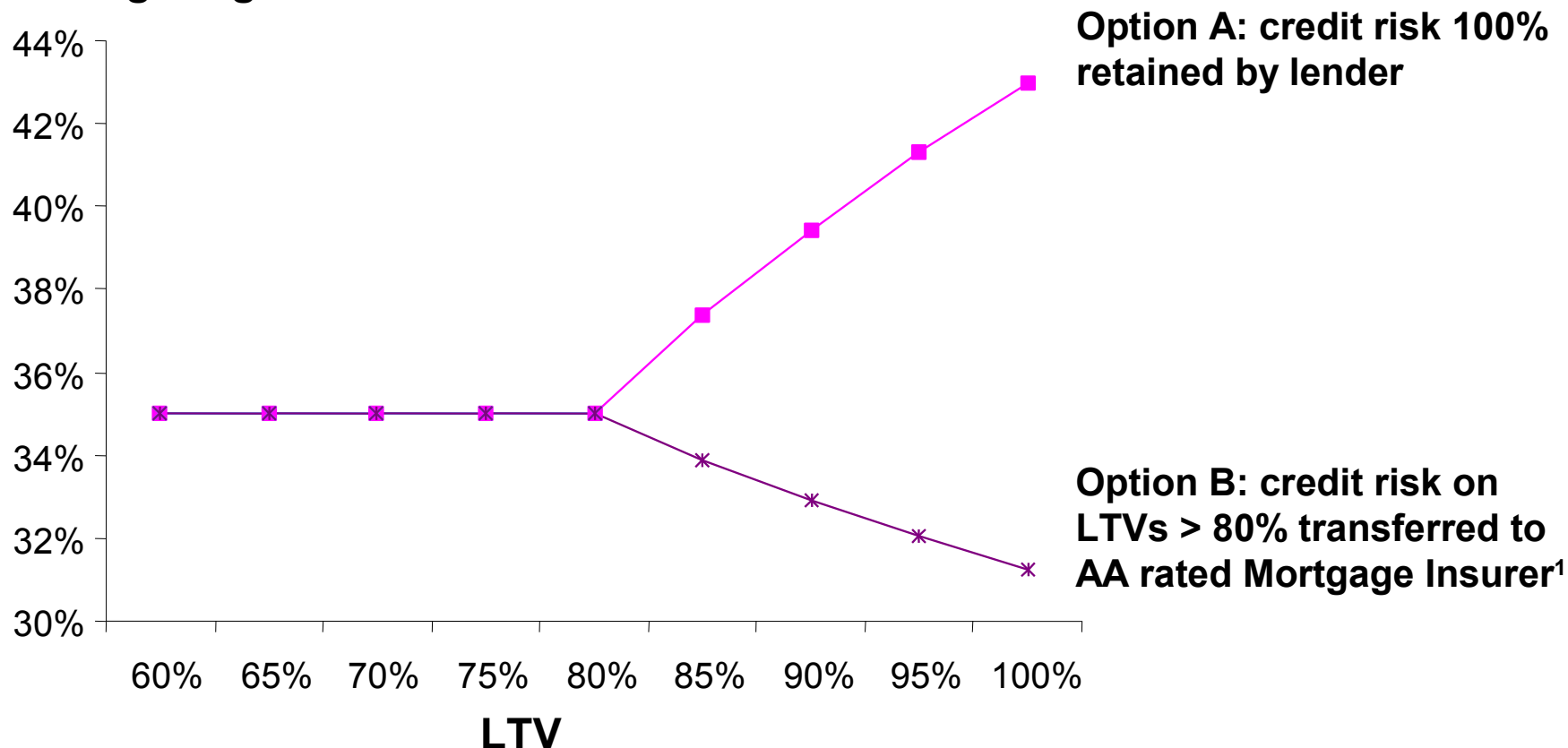
**Expected losses**



Source: Genworth Financial analysis based on Fitch Ratings data (Italian Residential Mortgage Default Model II – 2005)

## 2. Capital advantage under Basel 2: the example of the standardised approach

### Risk Weighting

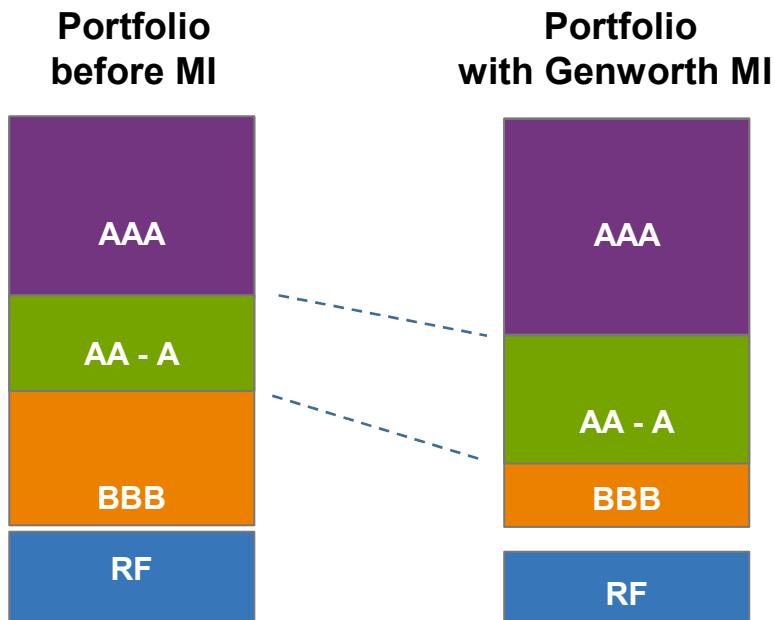


1 Based on substitution of 75% Risk Weighting (RW) for LTVs above 80% with the 20% RW associated with a AA rated corporate counterparty. Such substitution principle has been recognised in a number of European countries and is still awaiting regulatory recognition in Italy.

Please note: This calculation assumes full protection is provided and is therefore not subject to any haircuts, lenders should undertake their own assessment of the benefits derived from using Mortgage Insurance and, where appropriate, should seek independent advice.

### 3. Better execution in securitisation transactions

#### Execution Comparison



**Improved tranching creates cost savings in securitisation transactions**

#### Market Accepted CE Through MI

- **Reduces need for other credit enhancement provided by lender or structure**
  - Increases the senior tranches
  - Reduces funding costs of subordinated tranches... Improving all-in cost
  - Potential for reducing reserve fund... Subject to provided cover
- **GNW providing pricing/expertise benchmark**
- **Iterative pricing & cover levels evaluated to determine optimum execution structure**

#### GNW can assist Originators & I-Banks

- **Allows lenders to originate in new markets, new segments, new loan types**

**From Origination, To Structuring, To Distribution**

# Some information on Genworth Financial

- One of the main international insurance companies: over \$105 billion Assets, more than \$12 billion Market Cap; 7,000 employees and 15 million clients across the globe
- Genworth Financial is made up of 3 Business Segments:
  - Protection
  - Investments & Annuities
  - Mortgage Insurance
- The Mortgage Insurance business protects banks against the losses generated by borrowers' defaults. Typically we insure residential mortgages with over 80% Loan-to-Value
- Genworth Financial Mortgage Insurance Limited holds a “AA” rating, among the highest in the mortgage insurance industry

## Genworth Financial Mortgage Insurance Limited

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