

Asset Disposition

The Potential Privatization of Federally Funded Loan Portfolios

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PURPOSE

This paper offers key considerations should the United States (U.S.) Government seek to adjust its role in federal lending by selling, securitizing or exploring other options to access capital markets for parts of the federal loan portfolio.

THE OPPORTUNITIES

The sale and securitization of federal loan portfolios represent opportunities and risks. Opportunities may include the following.

REDUCE DEBT EXPOSURE

Reduce the U.S. Government's debt exposure by transferring risk to the private sector.

LEVERAGE PRIVATE SECTOR CAPABILITIES

Harness the private sector's origination and liquidity capabilities. For example, with a direct interest in avoiding defaults, private financial entities may have incentive to boost the quality of loan counseling, servicing, and work with borrowers to bring delinquent accounts current.

ENABLE REALLOCATION OF RESOURCES

Dispose of debt from select loan programs and re-invest in other programs that the Government deems as providing the greatest economic or social returns.

DEVELOP A SUSTAINABLE FUNDING MECHANISM

Establish infrastructure to access capital markets, enabling the U.S. Government to create a self-funding mechanism to finance the pipeline of loans and achieve policy objectives through an efficient execution process.

ADDRESS GOV'T ROLE IN LENDING

Address the perceived or real notion that the Government is profiting from federal loans at the expense of consumers.

MARKET TIMING

Inability to attract significant buyer demand to sell the assets at their fair market value.

MARKETING

Inability to achieve a competitive bidding process.

TRANSACTION COSTS

Proceeds of the sale are diminished after considering the costs of the sale.

COMPETITIVE POSITION

Inability to leverage the Government's unique ability to enforce payment, and bear the risk of borrower default. The Government has a variety of collection tools that are not available to the private sector such as salary/tax offsets, and the ability to withhold future benefits.

FUTURE FLEXIBILITY

Difficulty changing the terms of the loans, if needed, especially if a change in the terms results in a violation of the purchase contract.

PERCEPTION

Private investment companies, such as those who contributed to the 2008 global financial crisis, may benefit at the expense of borrowers.

CONSUMER IMPACT

Adverse impacts to borrowers, such as changes to forms or contact methods, sharing of consumer information, failure to send deferral forms to borrowers, and erroneous demands for early payments.

Discussion of these potential opportunities should also include consideration of the following risks and mitigation strategies to address these risks.

MITIGATING FINANCIAL AND REPUTATIONAL RISKS

While the financial and reputational risks associated with the sale or securitization of loans to private investors are real, they can be mitigated by thorough due diligence, planning and meticulous sale design and execution. Risk mitigation strategies include the following.

MARKET TIMING

- Perform extensive due diligence to gauge buyer demand.
- Consider selling tranches in a gradual manner to test market appetite.

MARKETING

- Structure the sale to appeal to a wide-array of investor types and to the most aggressive investors of capital.
- To accommodate public policy interests while maximizing net asset value, consider developing hybrid and non-standard risk sharing mechanisms to provide asset disposition alternatives.
- Implement procedures to help ensure that quality information is provided timely to all interested parties.

TRANSACTION COSTS

- Minimize transaction costs by selecting an experienced and trusted transaction advisor.
- Offset transaction costs by reducing administrative costs associated with servicing and collection.

COMPETITIVE POSITION

- Counterbalance the Government's superior collection tools (e.g., IRS Tax Offset) by strategically capitalizing on the quality of servicing and liquidating practices in the private sector.
- Leverage incentives to improve loan origination and documentation (i.e., loans can be sold at a higher price if screening and documentation meet private sector standards).
- Obtain valuable information about the condition of loan portfolios, identifying areas of improvement for servicing the remaining portfolios.

FUTURE FLEXIBILITY

Carefully design the sale terms, soliciting input from relevant stakeholders, where appropriate.

PERCEPTION

Develop due diligence procedures to vet bidders, reducing the likelihood of bad actors benefiting from the sale at the expense of borrowers and improving the protection of borrowers post-transaction.

CONSUMER IMPACT

- Develop incentives for good behavior and disincentives for bad behavior for private sector participants via sale terms and conditions and/or oversight mechanisms.
- Build servicing requirements into the sale terms, potentially requiring that the loans continue to be serviced through existing government contracts (with reimbursement from the acquiring entity) to provide the government with continued insight and monitoring capabilities.

HOW CAN GUIDEHOUSE HELP?

Guidehouse brings a fundamental understanding of the asset disposition lifecycle, including servicing, transaction structuring, accessing capital markets, review of bidder qualification, and marketing. Our Financial Services practice combines both private sector insights and public sector expertise through our broad footprint working within the Federal Government. Our team of financial product specialists have subject matter specialty in virtually all consumer asset classes and considerable experience and specialty in securitization and financing transactions throughout their lifecycles.

HOW CAN GUIDEHOUSE HELP? (CONT.)

Guidehouse also brings deep regulatory knowledge, and leading knowledge of consumer lending, having worked with clients across the lending value chain. In summary, we bring:

Financial Services Experience: Guidehouse is a recognized leader in global capital markets transactions. We provide integrated services across all aspects of the capital markets industry, with extensive and in-depth knowledge of financing transactions involving all major asset types and classes.

Our professionals have extensive experience in the execution of timely, efficient, and well-controlled securitization transactions. As a leading market provider of capital markets funding transactions across multiple industry sectors, our team is well equipped to handle the demands required for both public and private securitization transactions. Our experience and knowledge allows us to keep you fully informed of market events and any proposed regulations that could affect your transaction, and allows us to add value throughout your transaction process to deliver high-quality analytical services for each transaction.

Proven Approach to Transaction and Due Diligence Services: Our approach is rooted in best practices. By incorporating these best practices throughout the transaction lifecycle, organizations can expedite execution while also achieving stakeholder objectives.

| | PRE-TRANSACTION | | | TRANSACTION EXECUTION | | POST-TRANSACTION |
|---|--|--|-------------------------------|---|--|--|
| | Strategy | Structuring | Support | Evaluate | Negotiate & Close | Support & Exit |
| DEVELOP AN EFFECTIVE & TRANSPARENT TRANSACTION PROCESS | Strategy & Market Assessment Program/Process Design & Assessment Marketing Strategy | Regulation/Legal Compliance Transaction Structuring | Document & Records Management | Document & Records Management | Transaction Document Review Regulatory Compliance Reporting & Monitoring Document & Records Management | Exit Strategy Assessment Regulatory Compliance Reporting & Monitoring |
| MANAGE COUNTERPARTY RISK | Due Diligence Strategy Assessment Investor/Vendor Qualification Criteria Development | | | Due Diligence Investor Qualification Vendor Qualification | Advertisement on Negotiation Strategy | Counterparty Reporting & Monitoring |
| CAPTURE VALUE | Stakeholder Analysis & Management / Program Monitoring / Asset/Operations Portfolio Analysis / Lessons Learned | | | | | |

We apply our asset transaction and due diligence approach to support large scale asset disposition programs. For example, Guidehouse helped with the design and management of an agency's structured transaction program, supporting the execution of 28 transactions in excess of \$20 billion. Furthermore, over the last 20 years, Guidehouse has managed over \$5 trillion in securitizations.

AUCTION SALE ACTION PLANNING CAPABILITIES:



AUCTION SALE ACTION PLANNING CAPABILITIES: (CONT.)

Guidehouse can help conduct an analysis on loan portfolios, with a focus on developing recommendations for the disposition of the assets. From a compiled database for assets targeted for sale, Guidehouse provides data analytics reports that can improve the facilitation of asset sales by describing overall portfolio stratifications and potential disposition strategies. Guidehouse can implement a loan-level econometric model that projects prepayments and cash flows for loans. Once the team has identified the assets for inclusion in the sale, Guidehouse works to prepare the asset files. Guidehouse can develop a comprehensive database with relevant data element fields to validate the data by utilizing automated testing, data analysis, and comprehensive statistical sampling. With the complete database of loan level information and stratifications, Guidehouse creates pools of loans that maximize proceeds. Guidehouse regularly considers number of asset characteristics in the formulation of our recommended pools to help ensure prospective investors are bidding on pools with attractive attributes. The loan due diligence files are uploaded into a transaction platform that serves as a centralized system where potential bidders can view due diligence files and data tapes. Additionally, the platform provides for a secure and streamlined bidding platform. Guidehouse develops marketing materials and investor outreach strategies, which include direct advertising, institutional investor contact, and/or a bidders' conference to promote the asset sale.



OPERATING MODEL

Designing an efficient target operating model to meet ongoing securitization requirements.



CAPITAL OPTIMIZATION

Modifying the business model for Dodd Frank Retention requirements.



CONTRACTING

Changes to vendor relationships, new deal parties, Reps & Warranties, & other new contracts.



MODELING

Created appropriate collateral reporting & cash flow modeling capabilities.



SYSTEMS

Assessing data requirements against existing IT capabilities to support disclosures & ongoing reconciliations.



OPERATIONS

Cash flow collections, loss mitigation, practices, performance tracking & attribution. Enhancing processes to monitor & match.



FINANCIAL REPORTING

Assessing the impact of transfers, consolidation & interest income.

AUCTION SALE ACTION PLANNING CAPABILITIES: (CONT.)

Experience in Competitive Bid Disposition Process for Performing and Non-Performing Assets:

Guidehouse has an understanding of the requirements to conduct transactions. Asset sale expertise is essential to providing thoughtful and relevant non-pooled loan asset portfolio analysis and recommendations. The Guidehouse team delivers “in the market” specialty in portfolio analysis and has a profound understanding of US finance markets through our current role as Ginnie Mae’s Securitized Transaction Financial Advisor (STFA) for the Multiclass Securities Program and as FHA’s Transaction Specialist (TS) for its Single Family Loan Sale Program.

New Issuer Considerations: With extensive experience working with private loan issuers, Guidehouse can help new issuers of asset backed securities think through the necessary securitization requirements before going to market. We help provide deal structure, operational and ongoing issuance guidance to our clients.

| DEAL STRUCTURE CONSIDERATIONS | OPERATIONAL CONSIDERATIONS | ISSUANCE AND ONGOING PROCESS |
|---|---|--|
| Economic Structuring <ul style="list-style-type: none"> • Funding options; liability and waterfall structure • Overcollateralization and reserve funding • Market and investor benchmarking; public vs. private deal considerations | Accounting & Valuation <ul style="list-style-type: none"> • ASC 810 - on/off balance sheet • ASC 860 - transfer accounting; gain/loss on sale • Loan and security accounting operations; valuation considerations • Disclosures and SEC reporting considerations; SOX controls | REG AB & Investor Reporting <ul style="list-style-type: none"> • REG AB compliance • Liability balances, asset performance, payment history reporting • “Agreed Upon Procedures” reports required for issuance |
| Collateral Selection <ul style="list-style-type: none"> • Loan file reviews and loan selection • Portfolio performance and diversification; seasonality, concentrations, loss, delinquency history | Technology <ul style="list-style-type: none"> • Loan level data aggregation and verification • Vendor considerations • Model maintenance and validation • Loan servicing system and investor reporting considerations | Investor Marketing <ul style="list-style-type: none"> • Marketing materials; investor roadshow |
| Regulatory <ul style="list-style-type: none"> • Risk retention considerations; Dodd-Frank compliance • Risk weighted asset considerations • CCAR modeling and documentation | Legal, Tax, Compliance <ul style="list-style-type: none"> • Underwriter selection; preparation of offering documents • CFPB regulations, fair lending, and compliance programs • Tax structuring considerations | Loan Pipeline & Platform <ul style="list-style-type: none"> • On-going lending practices and loan selection process • Flexible deal structures to meet market demand |

Guidehouse helps new issuers understand and develop solutions to common challenges they will face before going to market. Guidehouse has the knowledge and experience developing forward-looking financial and operating models to assist with:

- the implementation of the necessary components needed in securitizations;
- helping businesses navigate ever-changing regulatory requirements;
- performing ongoing due diligence of counterparties;
- assisting with the creation of appropriate cash flow modelling and collateral reporting;
- confirming that the appropriate controls are designed and operating effectively for the data systems involved in transactions;
- and assessing the overall financial and accounting impact of transferring assets.

REGULATORY CONSIDERATIONS FOR SECURITIZATION TRANSACTIONS

Guidehouse regularly assists clients with the implementation of key regulatory requirements related to due diligence, including Regulation AB II, and Credit Risk Retention for asset backed securitization transactions. As the regulation environment evolves, it is crucial that all clients are kept up-to-date on the specific legal changes and requirements. We help develop the necessary tools and resources to successfully implement and comply with regulatory requirements.

Due Diligence

What: On August 2017, 2014 the SEC adopted amendments to rules and forms that apply to 1) Nationally Recognized Statistical Rating Organizations ("NRSROs"), and 2) Providers of Third Party Due Diligence Services.

Key Provisions: The results and findings of Third Party Due Diligence Services must be disclosed by the Issuer of EDGAR via form AB-15G and by the Third Party Due Diligence Provider to the NRSRO along with a personal certification via form ABS Due Diligence-15E.

Current Status: Effective as of June 15, 2015

Regulation AB II

What: On August 27, 2014, the SEC unanimously voted to adopt final rules known as "Regulation AB II" that, among other things, expanded disclosure requirements and modified the offering and shelf registration process.

Key Provisions: Changes impact four key areas: 1) Changes to the eligibility requirements for shelf registration of ABS; 2) Changes to the prospectus and its distribution; 3) New asset-level disclosure requirements (for some asset classes) - both at the time of offering and on an on-going basis; and 4) Changes with respect to Exchange Act reporting (Forms 10-D and 10-K).

Current Status: Compliance was required by November 23, 2015 for all provisions, except asset-level disclosures. Asset-level disclosures are required as of November 23, 2016.

Credit Risk Retention

What: Credit Risk Retention requirements ("CRR") of section 15G of the Securities Exchange Act of 1934 as added by section 941 of the Dodd-Frank Rule (the "Rule").

Key Provisions: Requires that sponsors hold not less than 5% of the credit risk of all ABS securitization transactions. Sponsors must disclose their methodologies and assumptions used to calculate the amount of eligible horizon residual interest in accordance with fair value standards.

Current Status: The final rule became effective December 24, 2015, one year after publication in the Federal Register for residential mortgage-backed securitizations, and effective December 24, 2016, two years after publication for all other securitization types.

UNDERSTANDING OF STAKEHOLDERS' COMPETING OBJECTIVES:

As a result of the breadth and depth of our asset disposition lifecycle experience, we understand the key stakeholders and their objectives, as summarized in the table below. We help execute complex asset transactions, implementing strategies to balance these competing stakeholder objectives with efficiency.

UNDERSTANDING OF STAKEHOLDERS' COMPETING OBJECTIVES:

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KEY STAKEHOLDER OBJECTIVES

| Stakeholder | Market Stabilization | Maximize Value | Minimize Financial & Reputational Risk | Execute Transactions Consistently | Increase Transparency & Auditability | Manage Compliance & Investment Requirements | Manage Compliance & Investment Requirements | Increase Unleveraged Business Participation |
|--------------------------|----------------------|----------------|--|-----------------------------------|--------------------------------------|---|---|---|
| Asset Seller | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | |
| Regulatory Bodies | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ |
| Oversight Bodies | ✓ | ✓ | ✓ | ✓ | ✓ | | | ✓ |
| Public | ✓ | ✓ | ✓ | ✓ | ✓ | | ✓ | ✓ |
| Asset Buyer | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | |
| Borrower/ Asset End User | ✓ | | | | ✓ | | ✓ | |
| Peer Organization | ✓ | ✓ | ✓ | ✓ | ✓ | ✓ | | |

✓ indicates a key stakeholder objective

Our team brings relevant and diverse perspectives to execute effective transactions while managing stakeholder communications and conflicting interests. For example, our team includes former senior regulators, industry executives, and experienced risk and industry consultants. We are fully aware of the oversight, governance, and transparency requirements of managing highly visible and heavily scrutinized programs. We have both worked for regulators, such as the Consumer Financial Protection Bureau (CFPB), and on behalf of those who are regulated.

Audit Focus: Our audit focus allows us to support our clients with development of programs that are transparent, efficient and auditable. We understand that our clients' asset disposition programs are highly scrutinized by a variety of stakeholders including the U.S. Government and Accountability Office (GAO), agencies' Office of Inspector Generals (OIGs), and Congress. We provide our clients with the ability to promptly respond to requests as they arise, maximize recoveries, and deliver on their missions.

CASE STUDY #1

Department of Housing & Urban Development (HUD), Federal Housing Administration (FHA), Transaction Specialist Services

- Since September 2014, Guidehouse has served as a Transaction Specialist team member, facilitating the sale of single-family defaulted mortgage loans under the Single Family Loan Sale (SFLS) program.
- Our trusted support spans strategy (e.g., asset portfolio analytics, program design and assessment, marketing strategy, investor qualification criteria development), structuring and due diligence (e.g., loan due diligence, transaction structuring, bid evaluation model), bid day execution (e.g., receipt of bids, investor qualification, negotiation strategy), and post transaction support (e.g., exit strategy assessment, regulatory compliance reporting and monitoring, claim payments and settlement, and post-sale reporting).
- Our support has enabled HUD to execute whole loan sales while maximizing recoveries to FHA's insurance fund, reducing claim costs, and minimizing the time assets are held.

Ginnie Mae, Securitized Transaction Financial Advisor (STFA) Services

- Since 2011, Guidehouse has served as Ginnie Mae's Securitized Transactions and Financial Advisor (STFA). Guidehouse has been the single consistent stakeholder in all issued Multiclass transactions, providing highly complex securitized mortgage, mortgage derivative, and mortgage related product specialty.
- We deliver an integrated team of both public sector and commercial resources. Our multi-disciplinary approach allows us to develop innovative solutions that address business, tax and accounting issues.
- Our extensive transactional experience and knowledge of the Ginnie Mae environment allows us to support financial innovation while maintaining a focus on potential risks to Ginnie Mae. Guidehouse has supported Ginnie Mae in a number of efforts related to product-type innovation. Our assessment findings and recommendations have enabled Ginnie Mae to evaluate the current performance and market perception of the Ginnie Mae MBS and multiclass programs.

Our intimate understanding of the transaction lifecycle, regulatory requirements, and historical relationships with market participants, and unique audit focus distinguish us as a trusted advisor. We welcome the opportunity to share additional insights.

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