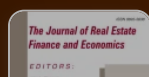


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Mortgage Prepayment and Default Behavior with Embedded Forward Contract Risks in China's Housing Market

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mortgage banks charge the same rate to all mortgage borrowers. This inefficiency in risk sharing between mortgage borrowers' groups in the forward and spot housing markets leads to mispricing in secondary mortgage sales and mortgage-backed security trading.

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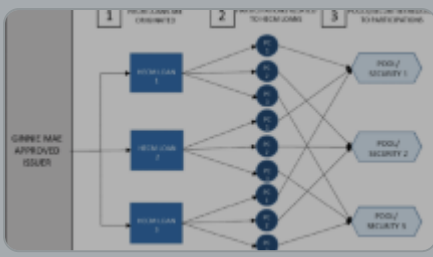
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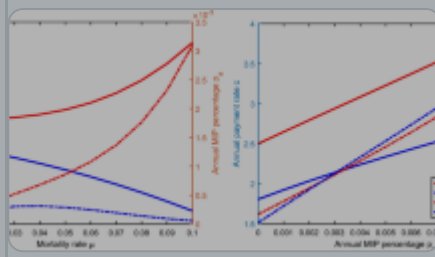
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Notes

1. As of March 2007 the exchange rate of Chinese Yuan (CNY) is one U.S. dollar – 7.74 CNY

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stratified choice-based sampling of mortgages across loan status cells. The weight is commonly defined as the inverse of the probability that the loan is being selected from a cell in which it was sampled.

7. Since 2006, the China Banking Regulatory Commission has established a series of rules for building up the personal credit system and regulating pre-sale practices.
8. Typically one cannot estimate directly which default option is in the money without knowing the entire path of individual house values. However, we can use the initial loan-to-value ratio and the diffusion process of house prices to estimate the critical value for a borrower to exercise the put option, known as the probability of negative equity.

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