

NOVASTAR FINANCIAL, INC

Corporate Governance Guidelines

1. Introduction

- a. The corporate governance policies of NovaStar Financial, Inc. are designed to ensure that the business of NovaStar is conducted and managed to ensure it meets its goals, one of which is to promote high ethical conduct among the employees and directors of NovaStar. This section is included to provide an overview of NovaStar's corporate governance.

2. Size of the Board

- a. The Articles of Incorporation and Bylaws of NovaStar provide that the number of directors shall be determined by the Board and may not be less than three and no more than fifteen.

3. Criteria for Membership and Selection

- a. It is the policy of NovaStar to maintain standards for director qualifications. The Board of Directors must be comprised of a majority of independent directors as described by the Non-Management Director Independence Standards adopted by the Board of Directors. The Board, with the assistance of the Nominating & Corporate Governance Committee, will determine at least on an annual basis whether each director is independent. Only those directors who do not have any of the categorical relationships that preclude them from being independent within the meaning of such standards and who the Board of Directors affirmatively determines have no relationships that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director, are considered to be independent directors. The Board expects that all future non-employee candidates for director will satisfy the independence requirements. In addition, absent unusual circumstances, NovaStar shall not have more than two management directors on the Board.
- b. The Board, with the assistance of the Nominating & Corporate Governance Committee, will determine at least on an annual basis whether each director satisfies the criteria necessary to be deemed a "financial expert". The Nominating & Corporate Governance Committee will evaluate each outside director against the established criteria and will present the findings and recommendations to the Board. The Board will then make a formal determination on whether a director can be deemed a "financial expert".
- c. Board members will serve on no more than four boards of public companies while serving on the NovaStar Board. Members of the Audit Committee may not serve on more than three public company audit committees, including NovaStar's.
- d. The Board requires that each of its members possess unquestionable integrity and character. The Nominating & Corporate Governance Committee will assist the Board in identifying other appropriate skills and characteristics required for Board membership. In evaluating

current and prospective members, the Nominating & Corporate Governance Committee will consider and assess issues and factors regarding an individual's education, business experience, accounting and financial expertise, age, diversity, reputation, civic and community relationships, knowledge and experience in matters impacting the industry of NovaStar.

- e. The Nominating & Corporate Governance Committee is responsible for recommending any changes in Board memberships and identifying and recommending director prospects for nomination to the Board annually or as vacancies occur. The Board is responsible for nominating individuals for election to the Board.
- f. The Board must elect the Chairman of the Board and Chief Executive Officer based on criteria that it deems to be in the best interests of NovaStar and its shareholders. The Board shall elect the Chairman and Lead Independent Director by secret ballot. The Lead Independent Director shall be elected annually upon a majority vote and will have a maximum tenure of three (3) years.

4. Lead Independent Director

- a. The Lead Independent Director will be designated by all independent directors. The Lead Independent Director will assist the Chairman of the Board with board-related matters and will act, as necessary, as a liaison between the independent directors and the Chairman of the Board. The Lead Independent Director also will preside at any meetings of non-employee directors.
- b. In addition, the Lead Independent Director specific duties and responsibilities are as follows:
 - i. Approve an appropriate schedule of NovaStar's Board meetings, seeking to ensure the independent directors can perform their duties responsibly while not interfering with the flow of NovaStar's operations;
 - ii. Review agendas for the Board and Committee meetings;
 - iii. Assess the quality, quantity and timeliness of the flow of information from NovaStar's management that is necessary for the independent directors to effectively and responsibly perform their duties, and although NovaStar's management is responsible for the preparation of materials for the Board, the Lead Independent Director may specifically request the inclusion of certain material;
 - iv. Whenever appropriate, direct the retention of consultants who report directly to the Board;
 - v. Assist the Board and NovaStar's officers in assuring compliance with and implementation of the Corporate Governance Guidelines and be principally responsible for recommending revisions to the Corporate Governance Guidelines;
 - vi. Coordinate an agenda for the Board's independent directors;
 - vii. Evaluate, along with the members of the Compensation Committee and the full Board, the Chief Executive Officer's ("CEO") performance and meet with the CEO to discuss the Board's evaluation; and

- viii. Review the membership and performance of the various Board Committees and Committee Chairs.
- c. The performance of Lead Independent Director shall be evaluated each year by the Board. Where the Lead Independent Director is not sufficiently active or successful in providing meaningful leadership for the Board, he or she shall be replaced.

5. Committees of the Board

- a. The Board has established an Audit Committee, a Compensation Committee and a Nominating & Governance Committee to assist in fulfilling its obligations and responsibilities. Members of all committees will be independent (i.e. non-management) and will meet criteria established by the New York Stock Exchange and all applicable laws and regulations. Separate charters, responsibility policies and self-evaluation practices will be established for each committee.
- b. The Nominating & Corporate Governance Committee recommends Board committee assignments and committee chairs on all active committees of the Board, and recommends committee members to fill vacancies on committees as necessary.
- c. The Committee Chairperson, in consultation with the Committee members, will determine the frequency and length of the meetings of the Committee. All Committee meetings shall be open only to members of the Committee and employees or other persons invited, except where otherwise specified by the Chairperson. Furthermore, Board Committees will meet only as required by the purposes of each Committee and the duties of the Committee members. At each meeting of the Board, Committee Chairpersons will present reports to the full Board.
- d. Each committee will have a Chairperson. In general, the Chairperson shall be responsible for the overall activities of the Committee and for achieving the Committee's purposes. The Chairperson of each Committee, in consultation with the appropriate members of management and staff, will develop the Committee's agenda, which will be circulated in advance of the meeting.

5. Meetings and Access to Management

- a. The Board generally meets in formal sessions five times per year. Directors are expected to participate in all Board meeting and meetings of committees on which they serve. Members are also expected to spend sufficient time to prepare for meetings. The Chairman of the Board will prepare the agenda for each Board meeting, taking into account suggestions from Board members and the lead independent Board member in particular.
- b. The agenda and as much information and data as is relevant to the Board members' understanding of the matters to be discussed at an upcoming Board meeting and that is practical to provide must be distributed to all members of the Board in advance of the meeting. Senior management is expected to update the Board on any significant developments or matters between Board meetings. The Board recognizes that the Board's proceedings and deliberation, including those of its committees, are confidential, and that

each director shall maintain the confidentiality of information received in connection with her or his service as a director.

- c. The Board has open and complete access to other managers and as necessary and appropriate, independent advisors. The Board may arrange to meet with managers at any level without senior management present. The Board welcomes the regular attendance of senior management at Board meetings, and the Chief Executive Officer is encourage to invite any other employees to Board and committee meetings who can provide additional insight and expertise into matters being discussed by the Board and the committees.
- d. The independent directors will meet in executive session, with no management directors or management present, at least three times each year. It is expected that executive sessions will occur at the end of regular scheduled Board meetings. The lead independent director or, in her/his absence, the Chair of the Corporate Governance and Nominating Committee, will chair the executive sessions.

6. Director Compensation

- a. Maintaining the independence in fact and appearance for our non-management Board members is critical. Non-management members of the Board of Directors are paid an annual base fee plus meeting attendance fees. The non-management members also receive equity based compensation as outlined in the Company's annual proxy statement. Generally, it is NovaStar's policy to pay non-management members of the Board fees that are commensurate with fees paid to Board members of entities that are similar to NovaStar. Generally, NovaStar's policy is to refrain from entering contracts with Board members and their immediate family members or providing support directly or indirectly to other organizations with whom a Board member may be affiliated. In the event NovaStar deems it appropriate to enter transactions with a Board member or a member of their immediate family, the terms of the transaction must be made in the ordinary course of business and on substantially the same terms as those prevailing at the time of comparable transaction with a non-affiliated person. The Board will evaluate each of these transactions when the independence of the director is determined.

7. Director Orientation and Continuing Education

- a. NovaStar provides ongoing orientation and continuing education for all members of the Board. New members are provided with a detailed orientation session within their first six months on the Board. Continuing education consists primarily of presentations from senior management regarding NovaStar's strategic plans, significant accounting and financial issues, unique transactions, compliance and risk management techniques. Internal audit and external accountants and consultants will make additional presentations when deemed necessary and appropriate.

8. Annual Performance Evaluation of the Board

- a. Annually, the Board of Directors must complete a self-evaluation to determine whether it and its committees are functioning effectively.

- b. The Corporate Governance and Nominating Committee is responsible for conducting the annual survey and overseeing the self-evaluation by the directors of the Board's performance and will report and discuss its findings and conclusions to the Board.

9. Responsibilities

- a. Ultimately, all of the business of NovaStar is managed under the direction and oversight of the Board of Directors. The Board appoints the Chief Executive Officer of NovaStar and its senior management team, who are responsible for the day-to-day business management. Each member of the Board is responsible for overseeing management, exercising its business judgment, acting in good faith and taking actions that are in the best interest of NovaStar's shareholders.
- b. In fulfilling its responsibilities, the members of the Board are expected to:
 - represent the collective interest of all NovaStar's stakeholders,
 - maintain a high level of integrity on an individual and collective basis,
 - apply themselves to understanding the business of NovaStar, its industries and significant risks,
 - review and monitor the long-term strategies, plans goals and business objectives of NovaStar as presented by senior management,
 - evaluate the financial performance of NovaStar on a regular basis,
 - conduct objective and thorough reviews and assessments of the Chief Executive Officer of NovaStar,
 - devote sufficient time to Board and committee meetings and related activities,
 - abide by the NovaStar Code of Conduct,
 - conduct management succession planning and review, and
 - evaluate the overall performance and effectiveness of the Board.

10. Performance of the President and Chief Executive Officer and Management Succession

- a. The Compensation Committee will conduct an annual review of the respective performances of the Chief Executive Officer and prepare a separate performance report for each of them. The reports of the Committee will be presented to the full Board in order to ensure that the Chief Executive Officer are providing the best leadership for Novastar.
- b. The Compensation Committee is responsible for ensuring that NovaStar has appropriately planned for management succession. The Compensation Committee will maintain a formal policy for selection of key executives and for succession during emergencies and in the event of retirement.

11. Ethics and Conduct

- a. NovaStar has adopted a Code of Conduct. The Code applies to all employees of NovaStar and its subsidiaries, directors, temporary workers, independent contractors and consultants when engaged by or representing NovaStar. No waiver of strict compliance with this Code

by a Senior Vice President or officer of equal or higher level or a director shall be considered or granted except as provided by the Board of Directors. In the event their ultimate responsibility to the NovaStar's shareholders requires consideration of such a waiver, the Board of Directors may prospectively grant by resolution a limited waiver of this Code, provided that this waiver will not cause a violation of any applicable law, regulation or stock exchange rule. Any amendments to or waivers from this Code that are granted by the Board shall be promptly disclosed to shareholders.

- b. A committee consisting of the company's senior officers in charge of Human Resources, the Internal Audit Department, and others as management may direct, shall meet at least annually to review the administration of the Code of Conduct, and recommend to management any amendments that may be necessary to assure its continued effectiveness, communication and enforcement. Any amendments, following approval by the Board of Directors, shall be communicated to all employees, officers and directors.

12. Loans to Directors and Officers

- a. NovaStar will not make any personal loans to directors and executive officers or their family members unless such loans constitute home improvement or manufactured home loans (as defined in section 5 of the Home Owners' Loan Act (12 USC 1464)), consumer credit (as defined in section 103 of the Truth in Lending Act (15 USC 1602)), or an extension of credit under an open end credit plan (as defined in section 103 of the Truth in Lending Act (15 USC 1602)) or a charge card (as defined in section 127(c)(4)(e) of the Truth in Lending Act (15 USC 1637(c)(4)(e)) and provided that such loans or extensions or credit are:
 - (A) made or provided in the ordinary course of the consumer credit business of the NovaStar;
 - (B) of the type that is generally made available by NovaStar to the public; and
 - (C) made by NovaStar on market terms, or terms that are no more favorable than those offered by NovaStar to the general public for such extensions of credit.
- b. NovaStar will not make any personal loans or extension of credit to independent directors which would be authorized under Section §12.a of these Corporate Governance Guidelines if such grant of a personal loan or extension of credit would conflict with categorical standards of independence adopted by NovaStar.