

NOVASTAR FINANCIAL, INC.
Compensation Committee Charter

I. Mission

The Compensation Committee (the “Committee”) of NovaStar Financial, Inc. (“NovaStar” or the “Company”) is a standing committee of the Board of Directors (the “Board”). The purpose of the Committee is to fulfill its responsibilities relating to:

- i. Reviewing and approving the compensation structure for the Chief Executive Officer (“CEO”) and the President.
- ii. Approving the compensation structure for senior management in accordance with guidelines established by the Committee.
- iii. Producing an annual report on executive compensation for inclusion in the Company’s annual proxy statement.

II. Organization and Authority

- A. The Compensation Committee shall be comprised of at least three members of the Board, and the members shall meet the independence, experience, and expertise requirements of the New York Stock Exchange, Section 16 of the Securities Exchange Act of 1934, Section 162(m) of the Internal Revenue Code (“Code”) and other applicable laws and regulations (including the Sarbanes-Oxley Act of 2002).
- B. The members of the Committee shall be appointed by the Board and shall serve for such term or terms as the Board may determine. The members of the Committee may be removed by the Board in its discretion.
- C. The Compensation Committee shall have the authority, to the extent it deems necessary or appropriate, to elect, retain, terminate and approve the fees and other retention terms of external legal, accounting, search firms, compensation consultants or other advisors without seeking the approval of management or the Board.
- D. The Compensation Committee may form and delegate authority to subcommittees, comprised of one or more members of the Committee, as necessary or appropriate. Each subcommittee shall have the full power and authority of the Compensation Committee.

III. Responsibilities

The Committee shall have the following duties, responsibilities and authority:

A. Communication and Assessment

- 1) Meet as often as the Committee determines is necessary to fulfill its duties and responsibilities, but not less frequently than quarterly.
- 2) Regularly report to the Board on the Committee's activities.
- 3) Annually review and evaluate its own performance.
- 4) Review and assess the adequacy of this Charter annually and recommend any proposed changes to the Board for approval.

B. CEO, President, Senior Management and Executive Compensation

- 1) Annually review and approve corporate goals and objectives relevant to the compensation of the CEO and the President, evaluate the CEO's and the President's performance in light of those goals and objectives, and provide a report thereon to the Board.
- 2) Annually review and determine the base salary, incentive compensation and long-term compensation for the CEO and the President, and report the Committee's determination to the Board. In determining long-term incentive compensation of the CEO and the President, the Committee will consider the Company's performance, relative shareholder return, the value of similar incentive awards to executives with comparable responsibilities at comparable companies, the awards given to the CEO and the President in past years and any other factors the Committee deems appropriate.
- 3) Annually review and approve base salary, incentive compensation and long-term incentive compensation for senior management.
- 4) Review the Company's policies regarding the tax deductibility of compensation paid to the company's executive officers for purposes of Section 162 (m) of the Code, including establishing performance goals and certifying that performance goals have been attained.
- 5) Provide and approve the annual report of the Committee on executive compensation for inclusion in the Company's proxy statement or annual report on Form 10-K in accordance with applicable rules and regulations.
- 6) In consultation with the CEO, review, at least annually, succession planning and management development activities and strategies regarding the CEO and other members of senior management, and discuss the Company's overall management resources.
- 7) Maintain a formal policy for the selection of key executives and for succession planning during emergencies and in the event of retirement.

C. Employee Compensation Strategies and Agreements

- 1) Annually review employee compensation strategies, benefits and equity programs.
- 2) Review, approve and recommend to the Board, as appropriate, any new incentive compensation plans, including equity-based plans.
- 3) Review and approve employment agreements, severance arrangements and change in control agreements and provisions when, and if appropriate, as well as any special supplemental benefits.