



# **U.S. Subprime Rating Surveillance Update**

Glenn Costello  
Managing Director

July 2007



## **Agenda**

Rating Actions And The July 2007 'Under Analysis' List

Risk Factors Affecting Performance and Ratings

Going Forward



## **Agenda**

Rating Actions And The July 2007 'Under Analysis' List

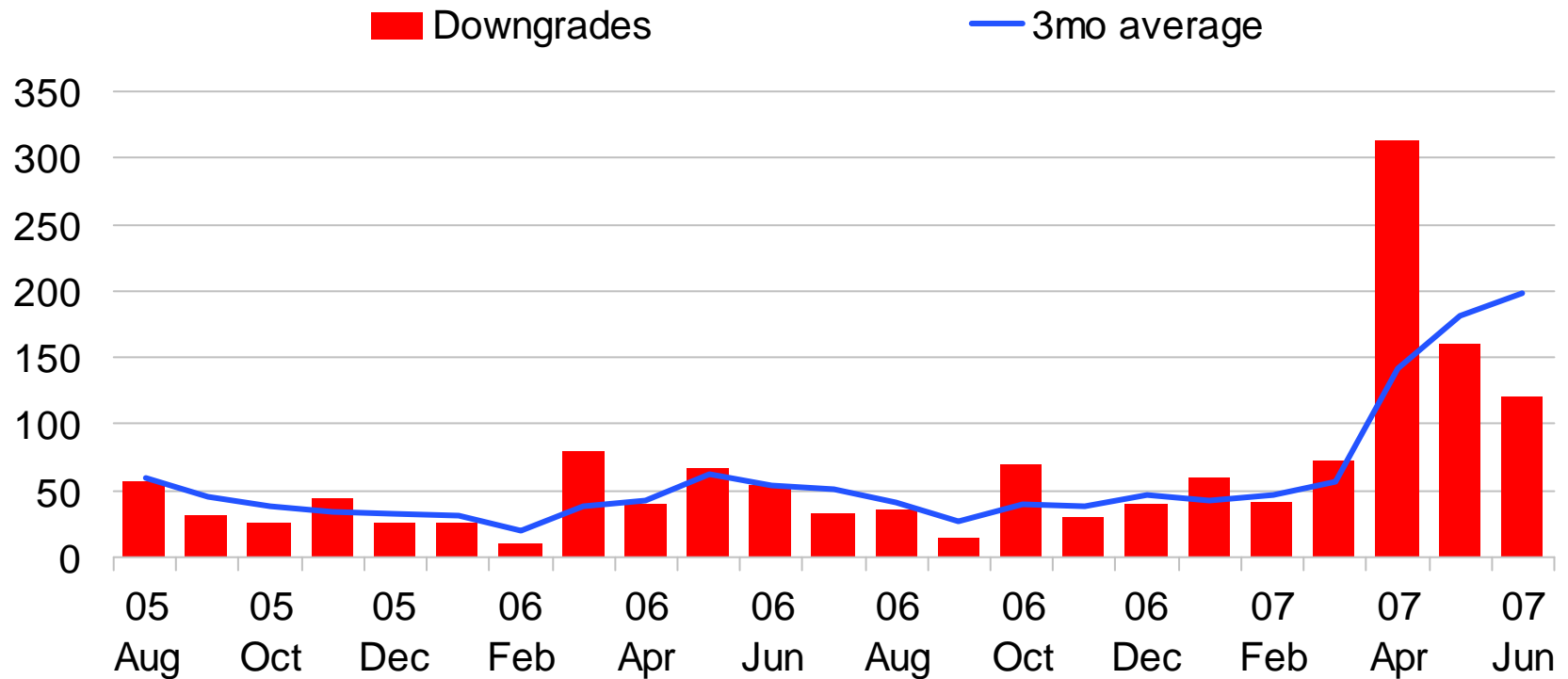
Risk Factors Affecting Performance and Ratings

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# Fitch Downgrade Actions Accelerated In 2007

## # Tranches Downgraded each Month



Source: Fitch



## Understanding Fitch SMARTView

- > Each month, monitoring criteria determines deals that are selected for review
- > The 'Under Analysis' deals are posted on the website and a press release is issued. All other deals are marked as not being selected for review that month
- > 'Under Analysis' is not the same as 'Rating Watch'. Whole deals are placed under analysis, and only after analysis is completed are individual tranches upgraded/downgraded/put on 'Watch', or affirmed
- > Separate lists are posted for subprime and Alt-A/prime
- > Fitch's goal is to process all deals under review within 30 days



## The July 2007 Subprime 'Under Analysis' List

170 Transactions

- > Vintage Distribution: 2006 – 106; 2005 – 27; Older - 37
- > Ratings Distribution by # Tranches (2005 and 2006 Deals):
  - AAA: 611
  - AA/A: 812
  - BBB: 339
  - BB/B: 126
- > We anticipate most action will be around 'BBB' which represent about 1.7% of our portfolio by balance.



## Enhanced Selection Criteria For SMARTView

- > Deals from 2H 2005 and 2006
- > Loss expectation of 8% or greater; Estimated 'BBB' Loss Coverage estimate less than 1.25
- > Revised loss forecasting assumptions:
  - Increased default rate expectation for performing loans (~16%) to reflect early performance
  - Loss severity based on deal history, approximately 40% but ranging from 30% to 65%
- > Default expectations for delinquent loans remain at 40% for loans in the 30-59 day bucket, 60% for loans in the 60-89 day bucket, 70% for loans over 90 days, 80% for loans in foreclosure and 100% for loans in REO



## Next Steps On 'Under Analysis' List

- > Additional Assumption Changes:
  - Higher default rates post ARM reset, as much as 150% higher
  - Slower voluntary prepay speeds; sensitivity analysis
- > Generate cash flows and loss coverage levels on each deal
- > Rating Committees
- > Rating action announcements with detailed assumptions and expected losses, along with key risk factors





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## Review of Risk Factors

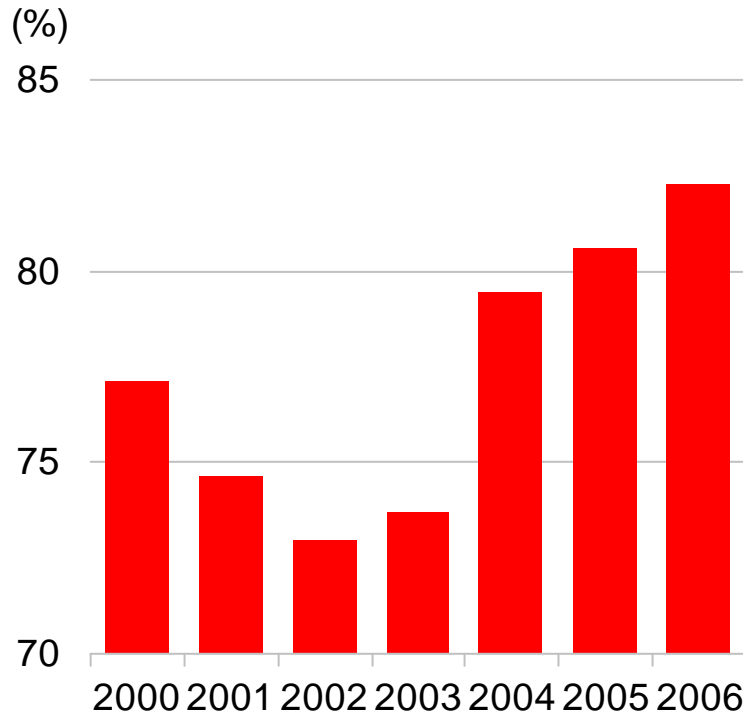
- > Collateral Attributes
- > Home Prices
- > ARM Resets
- > Prepayment Rates



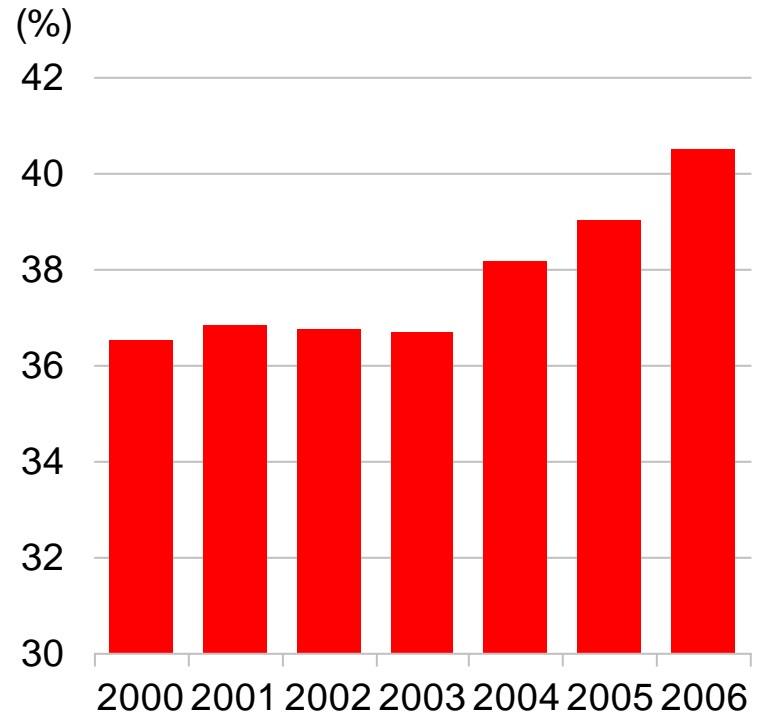
# Loans Became Riskier as Rates Rose

## Collateral Attributes by Vintage

### Combined-Loan-to-Value Ratio



### Debt-to-Income Ratio

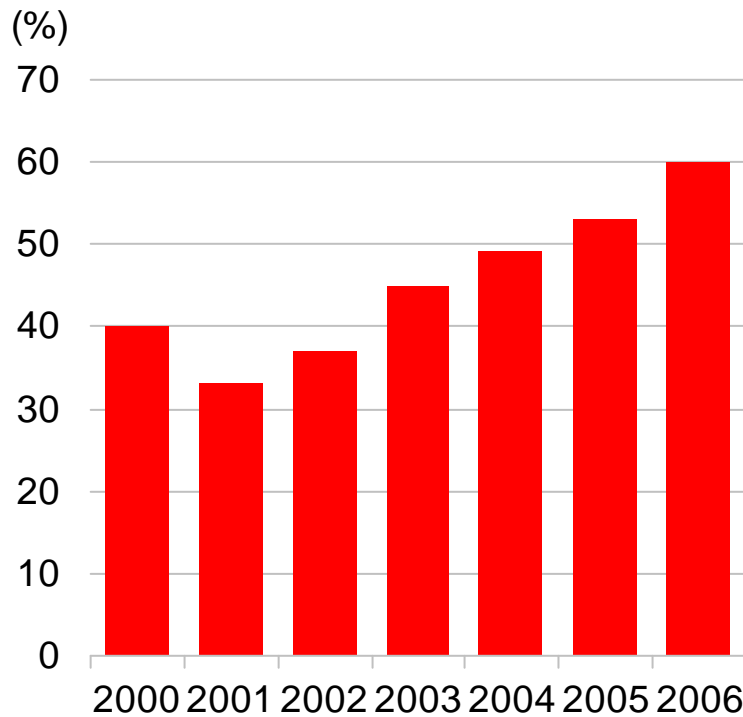


Source: LoanPerformance, Fitch

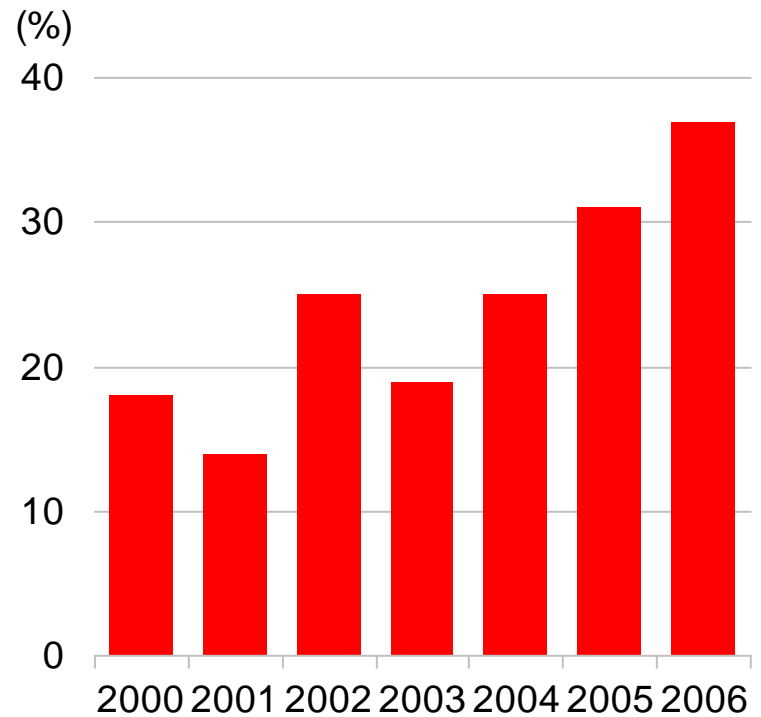


# Loans Became Riskier as Rates Rose (cont.) Collateral Attributes by Vintage

## Limited Borrower Documentation



## “Piggy-Back” 2<sup>nd</sup> Liens



Source: LoanPerformance, Fitch



# Affordability Product Features Driving Early Default

## Collateral Attributes by Vintage

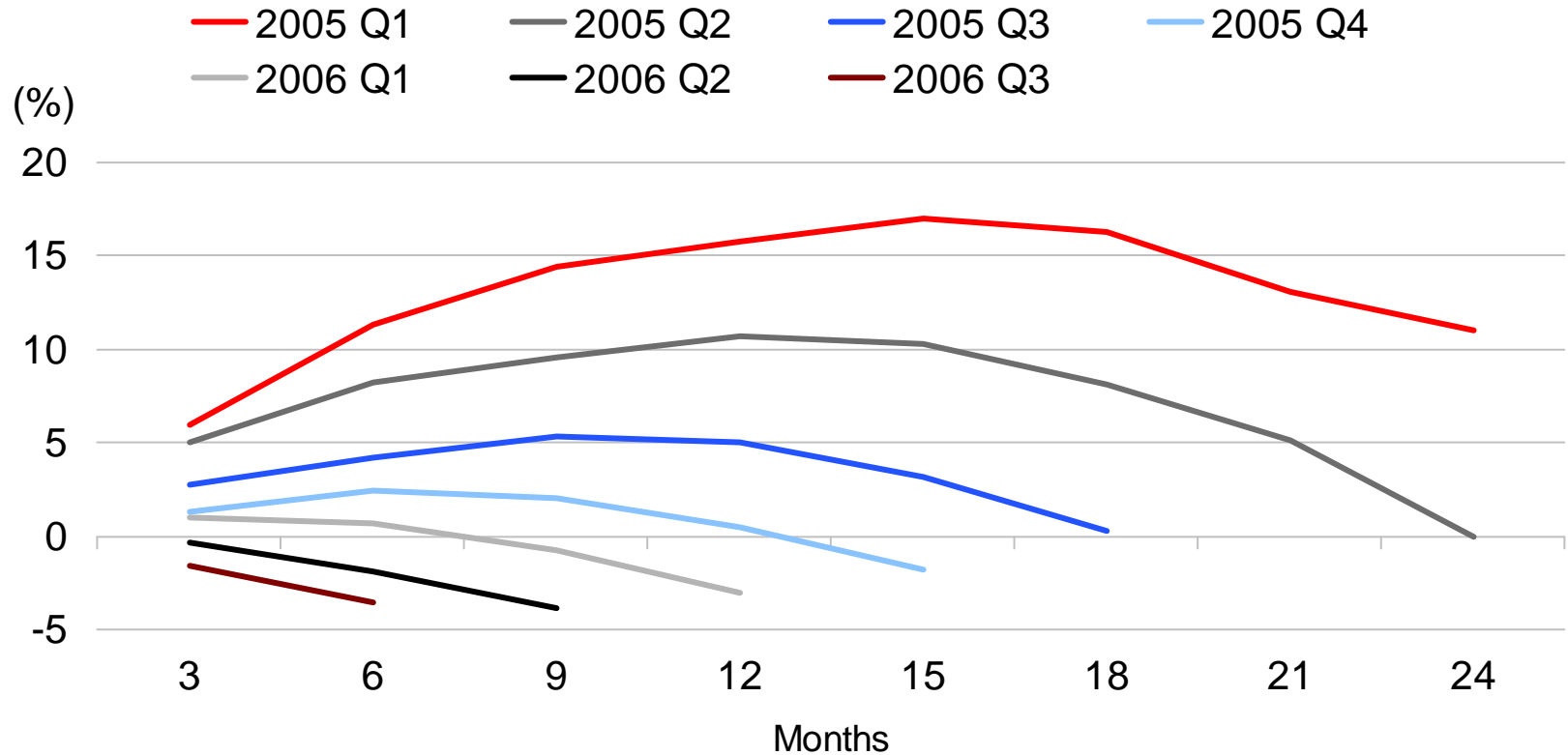
Vintage	Avg. mtge bal.	FICO	LTV (%)	CLTV (%)	Low/ no doc (%)	Purchase (%)	DTI (%)	Calif. WAC	
<b>Mortgages that defaulted by month 12 (90+ days delinquent)</b>									
2007	270,752	631	83	94	67	66	43	35	8.59
2006	233,209	617	82	90	56	56	43	33	8.49
2005	183,836	604	82	88	48	51	42	23	7.80
2004	160,052	593	82	85	44	42	41	19	7.86
<b>Mortgages that performed through month 12 (never 90+ days delinquent)</b>									
2007	196,856	626	81	86	43	35	42	24	8.09
2006	207,210	626	80	86	43	41	42	27	7.96
2005	193,338	628	81	85	41	39	41	31	7.13
2004	172,595	625	81	84	38	35	40	33	7.08

Source: Fitch, LoanPerformance



# Home Price Growth Turned Down Sharply...

## California Home Price Inflation by Origination Quarter

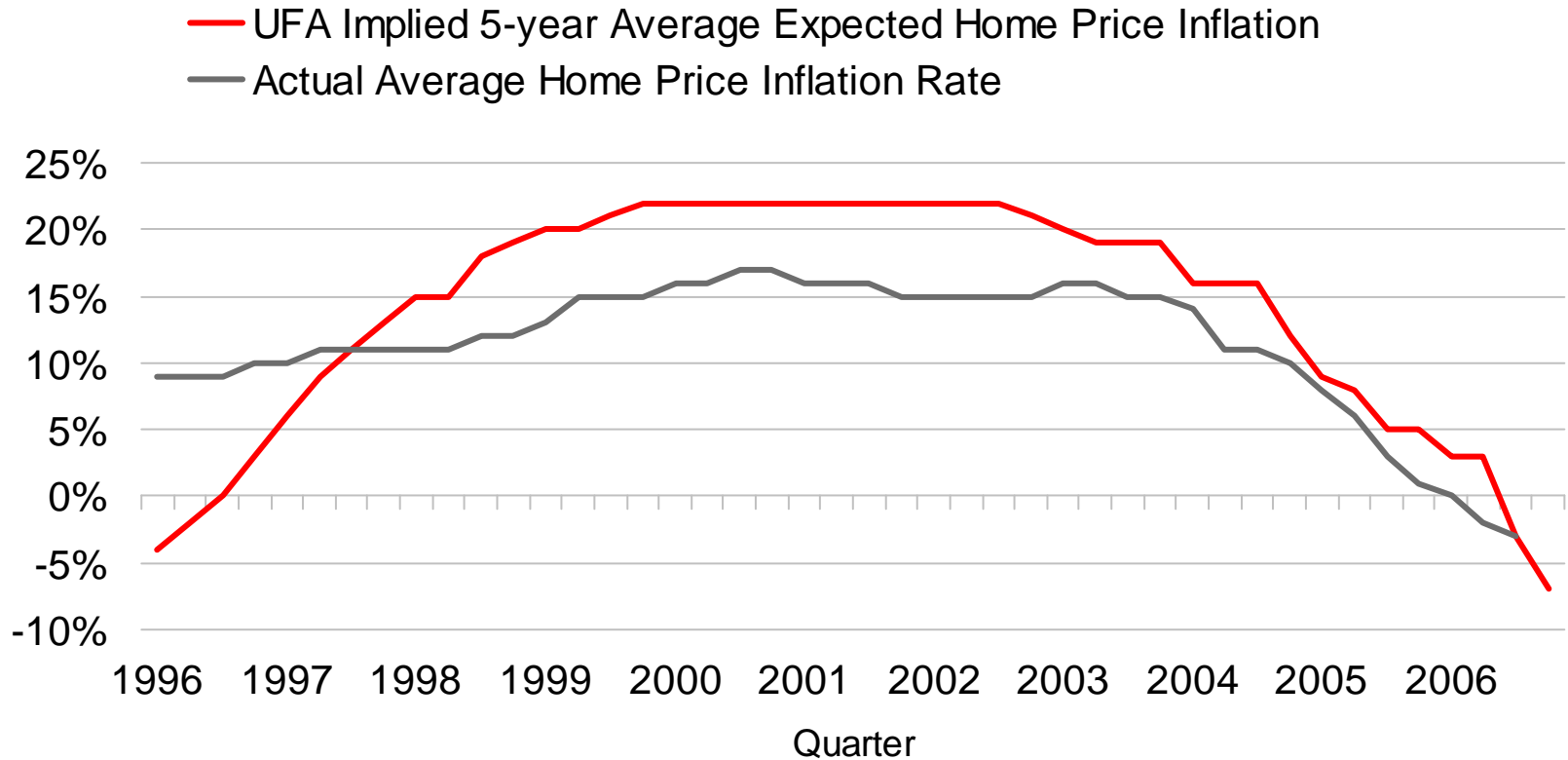


Source: Fitch, CSW



## ...And Continued Home Price Weakness Is Expected

### UFA Regional Risk Multiplier Implied Growth vs. Actual – Calif.



Source: Fitch, OFHEO



## ARM Resets Without Home Price Growth will Increase Defaults

Reset date	Jul 07	Aug 07	Sep 07	Oct 07	Nov 07	Dec 07
Balance (USDbn)	20.8	26.2	34.2	20.9	35.3	28.7
Coupon	7.1	7.2	7.1	7.2	7.2	7.3
Adjusted coupon	9.6	9.6	9.4	9.5	9.5	9.7
FICO	623	628	623	628	626	623
LTV	81.9	82.0	81.2	81.6	81.4	81.0
Combined LTV	86.7	88.0	86.9	86.2	87.3	87.3
Full doc %	59.3	55.2	54.8	52.6	55.1	54.6
HPI (1Q07)	2.9	2.8	4.5	2.4	1.8	2.3
CPR	35.6	32.0	31.1	30.2	27.6	27.3
60+DQ	12.2	12.5	11.9	12.3	12.8	12.5

Source Fitch, LoanPerformance





## ARM Resets Without Home Price Growth Will Increase Defaults (cont.)

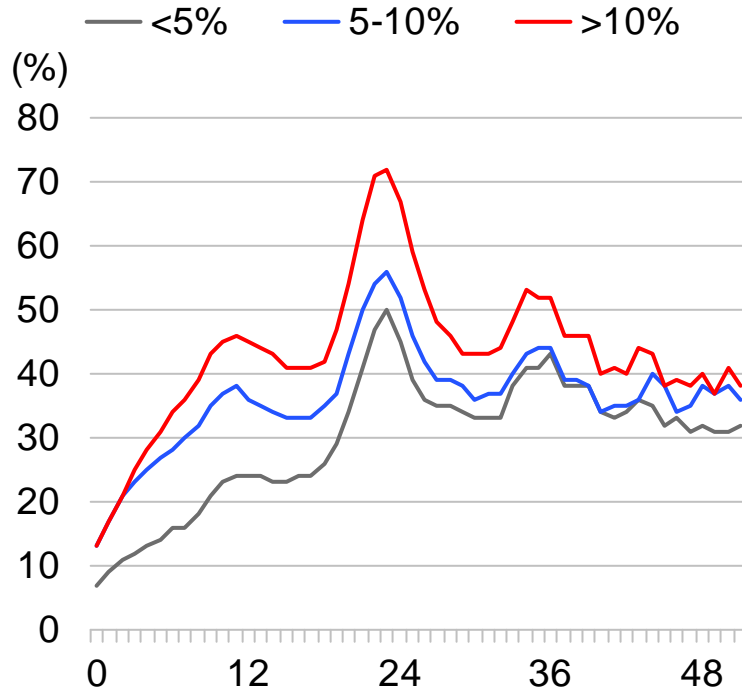
Reset date	Jan 08	Feb 08	Mar 08	Apr 08	May08	Jun 08
Balance (USDbn)	18.6	31.0	29.4	21.5	26.5	42.3
Coupon	7.3	7.6	7.8	7.9	7.6	8.1
Adjusted coupon	9.7	9.9	9.9	10.3	9.9	10.3
FICO	628	627	621	621	624	618
LTV	81.2	81.0	80.5	80.6	80.8	80.7
Combined LTV	87.0	86.9	85.8	85.3	87.0	85.3
Full doc %	52.5	48.7	53.3	50.7	54.7	67.0
HPI (1Q07)	1.2	0.6	2.1	0.5	0.4	0.6
CPR	28.2	26.8	28.5	29.5	27.1	25.8
60+DQ	12.5	14.7	13.7	15.3	14.9	14.7

Source Fitch, LoanPerformance



## Slower Prepayments and Failed Triggers Will Mitigate Bond Default Risk

### CPR by Annual HPI%



Historical scenario <sup>a</sup>	BBB BreakLoss (%)
<5% HPI	10.97
5-10% HPI	7.95
>10% HPI	5.32

<sup>a</sup> Assumes CPR and delinquency exhibited by States with the indicated annual HPI since 2001

Performance by State, Grouped by Annual Home Price Appreciation Since 2001  
Source: LoanPerformance/Case Schiller Weiss



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## Going Forward

- > SmartView list will show additional deals 'Under Analysis' each month. The current 'Under Analysis' list represents about 40% of Fitch-rated subprime deals from 2006 and 2H 2005.
- > We will provide detailed discussion of our actions
- > We will report on the effectiveness of our assumptions as conditions develop, and take additional actions as warranted.



Derivative **Fitch**

Quantifying All Sides of Risk

# Structure Finance CDO Rating Actions and Methodology Update

July 18, 2007

Kevin Kendra  
Managing Director  
Derivative Fitch  
U.S. Structured Credit

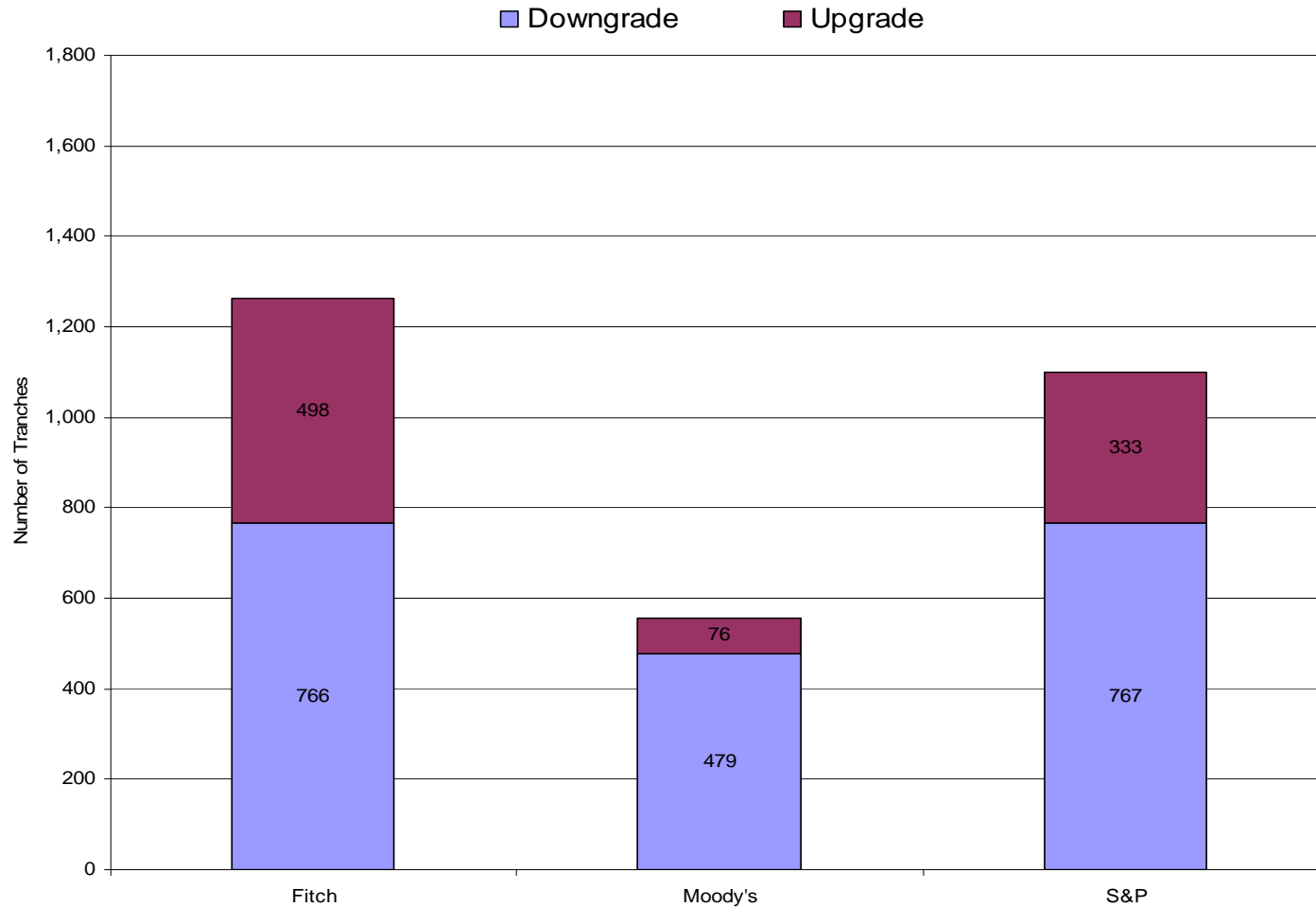
## Role of RMBS Ratings in SF CDOs

- > Measure portfolio credit quality
  - Use asset ratings as measure of default probability in CDO analytics
  - Use weighted average rating factor as parameter in portfolio reinvestment guidelines
  - Use asset rating changes to discount the value of lower rated assets “haircut” in overcollateralization (OC) and interest coverage (IC) tests
- > Derivative Fitch uses ratings from all three agencies
  - Derivative Fitch first defers to their Fitch RMBS group for credit quality
  - If not rated by Fitch, Derivative Fitch uses the lower of Moody’s and S&P public ratings

## 2007 RMBS Rating Actions

- > Analysis of Rating Actions by Rating Agency
- > Analysis of Downgrades by RMBS Vintage
- > Analysis of 2006 Vintage RMBS Downgrades

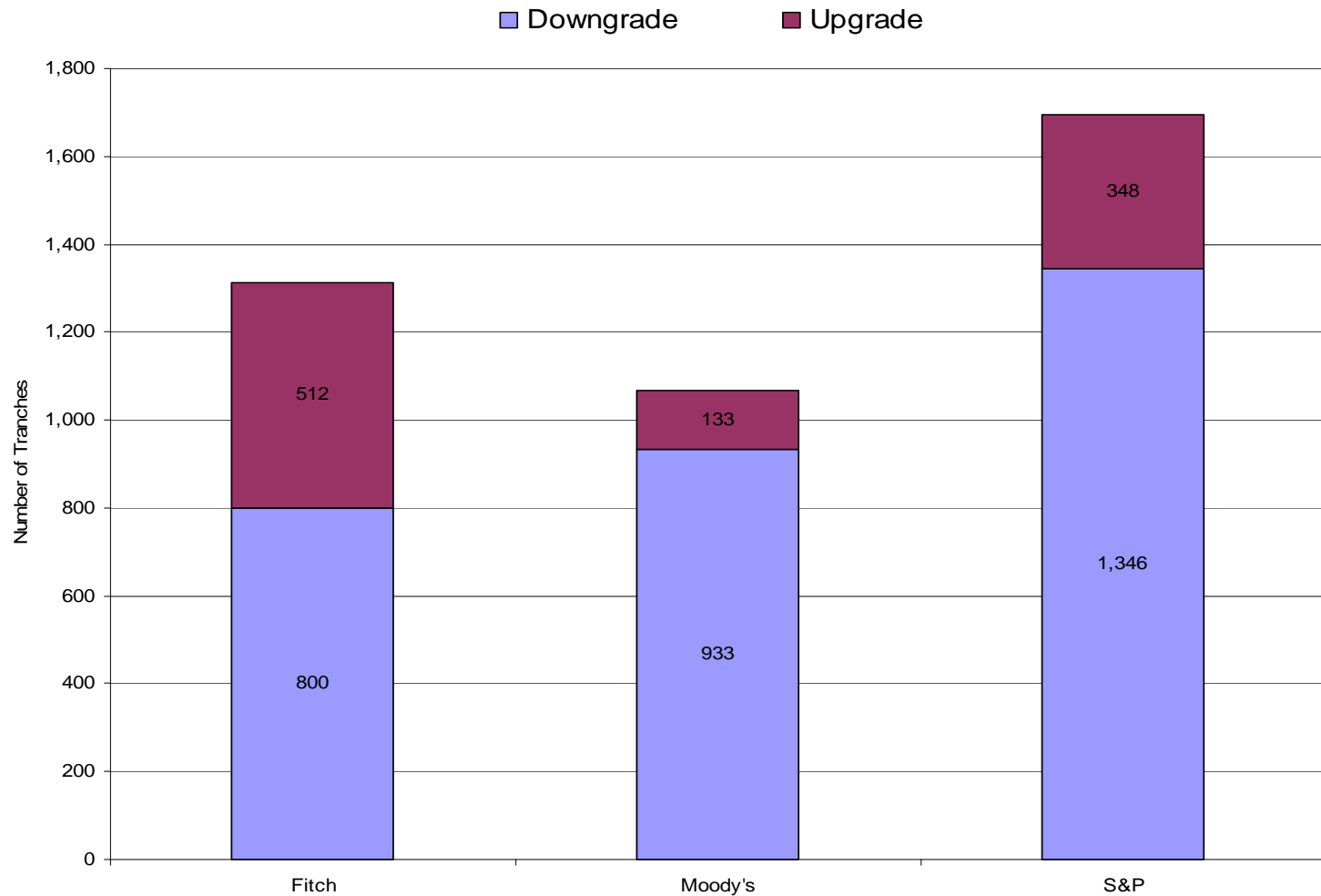
# RMBS Rating Actions through June 2007



Source: Intex, Fitch, S&P, Moody's

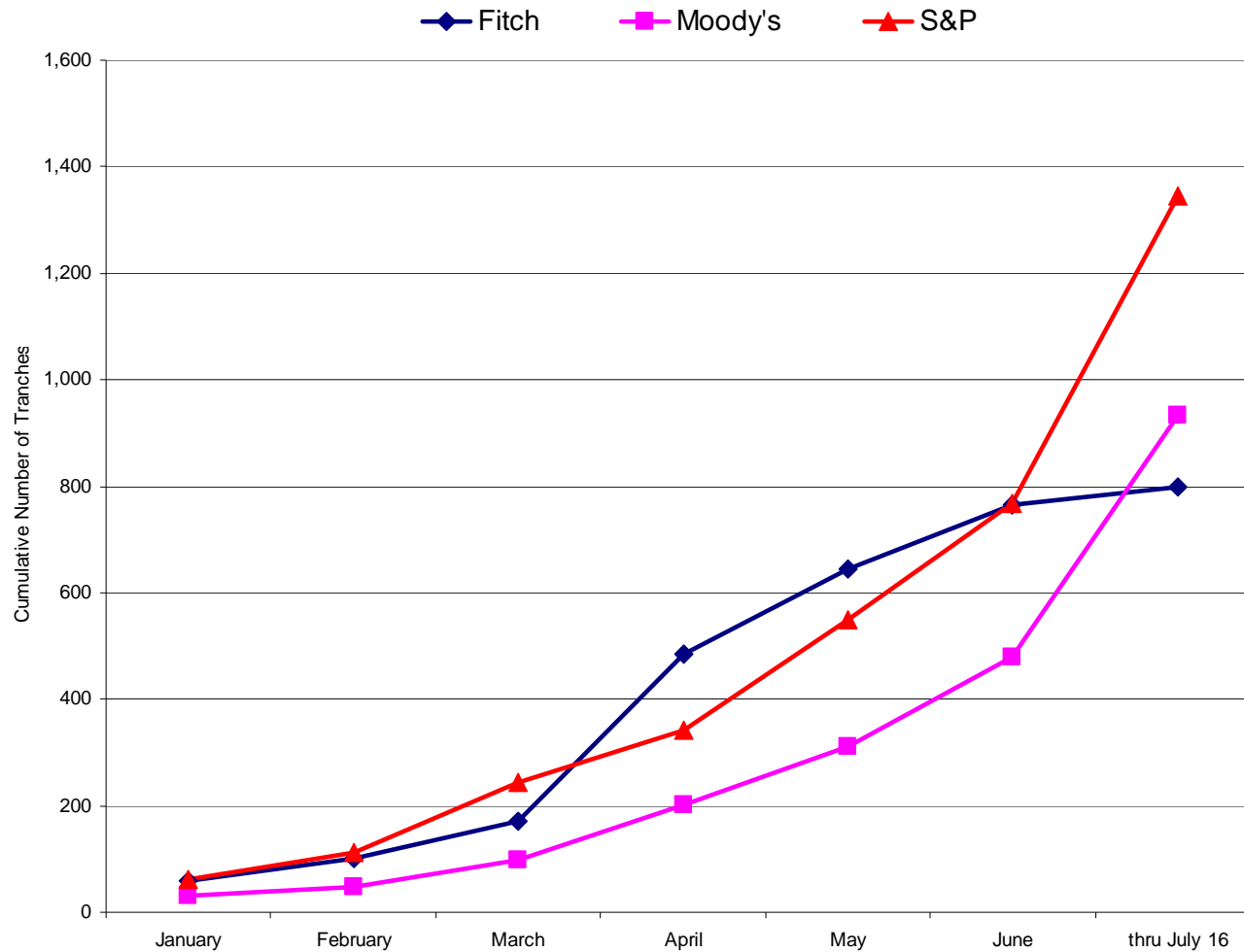


# RMBS Rating Actions through July 16, 2007



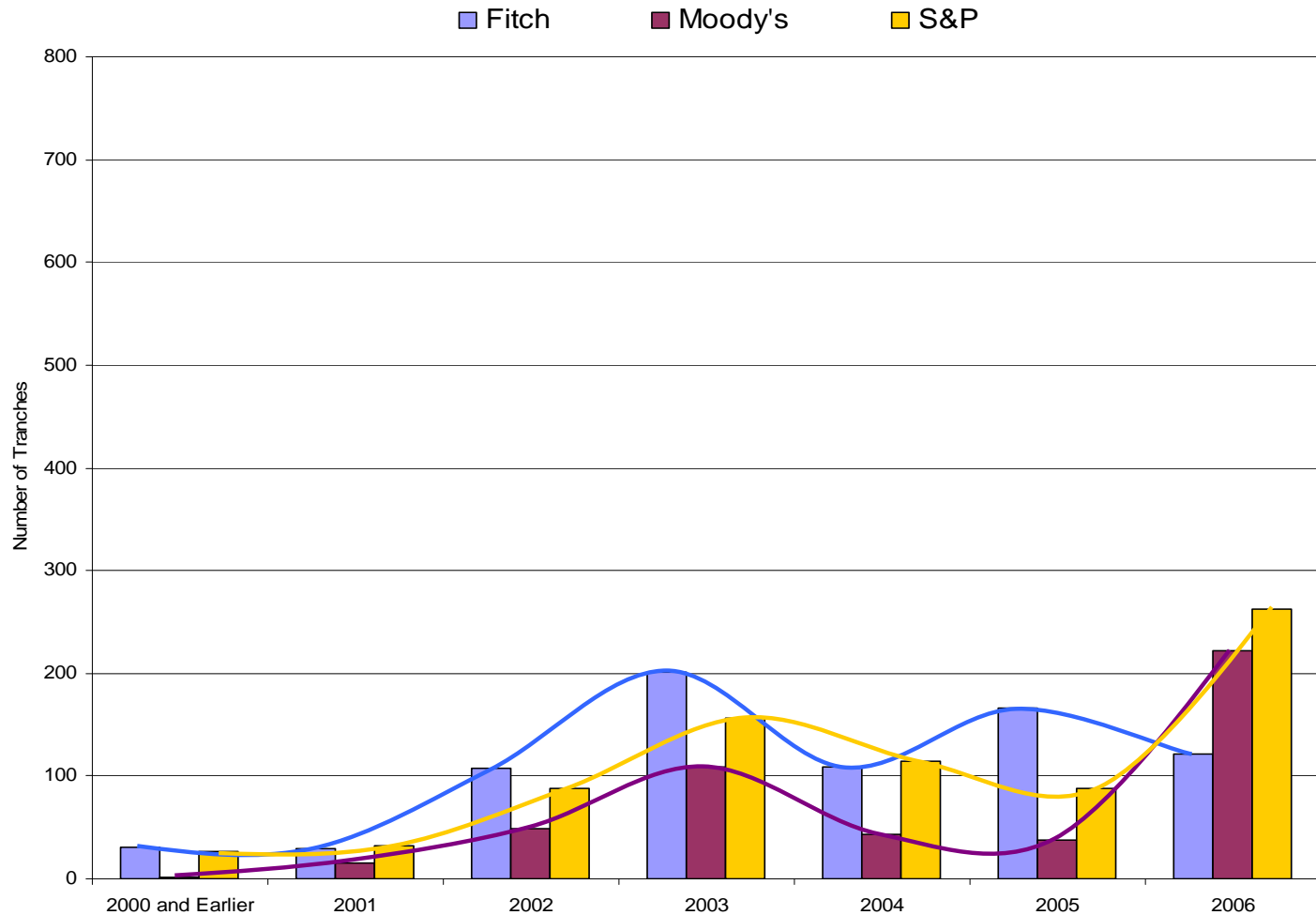
Source: Intex, Fitch, S&P, Moody's

# Cumulative Number of Downgrades by Month



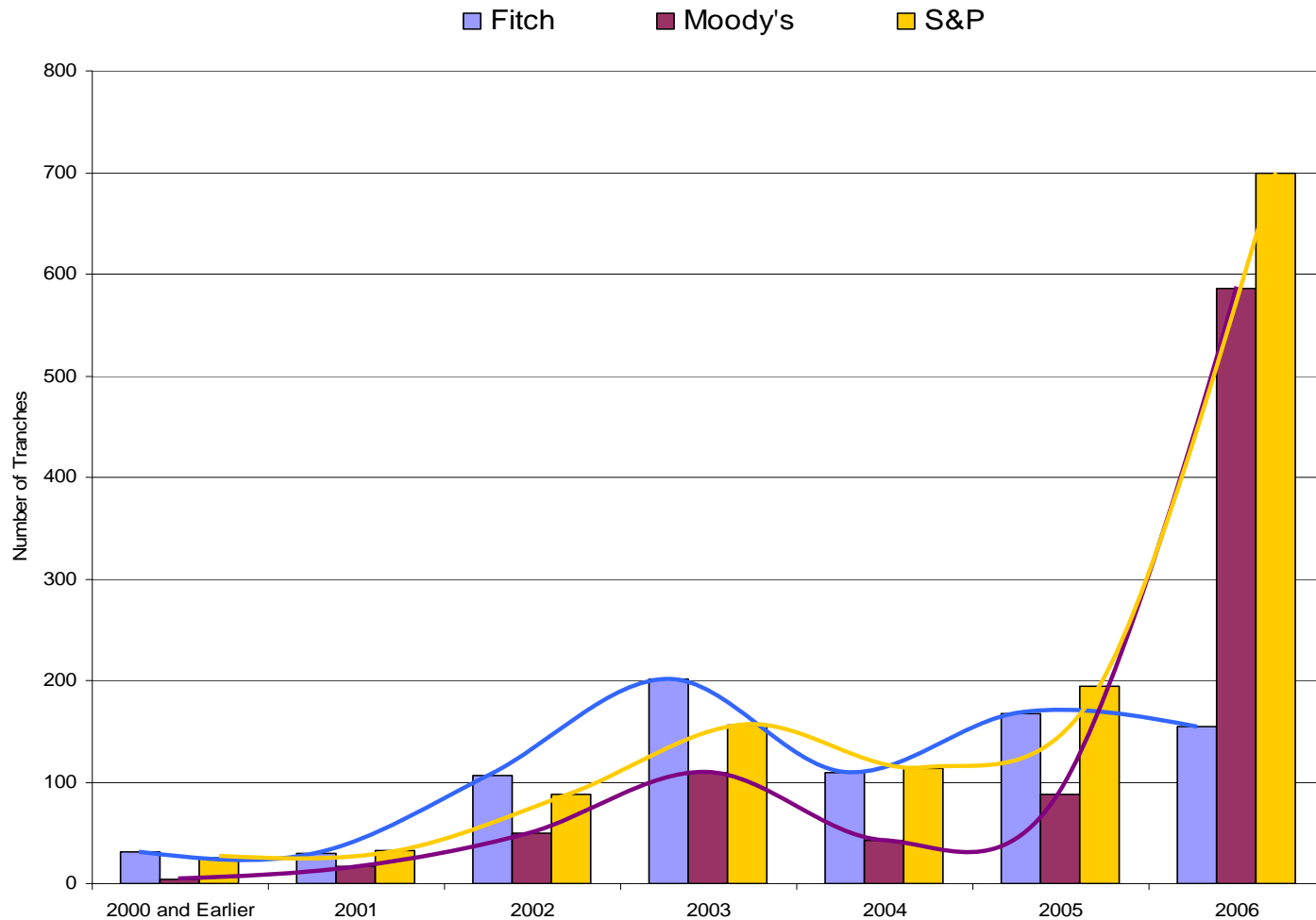
Source: Intex, Fitch, S&P, Moody's

# 1H 2007 RMBS Downgrades by Agency and Vintage



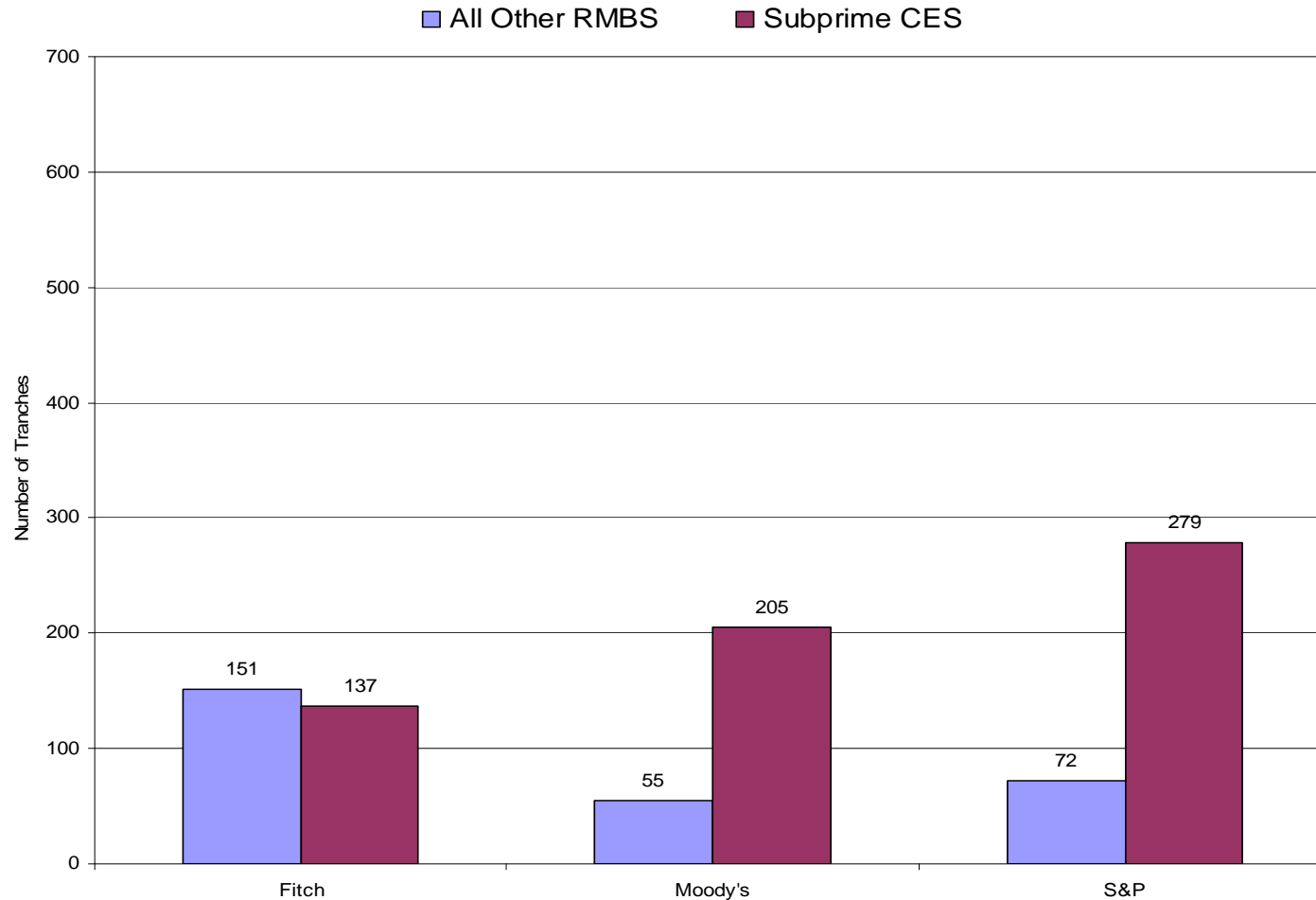
Source: Intex, Fitch, S&P, Moody's

# YTD 2007 RMBS Downgrades by Agency and Vintage



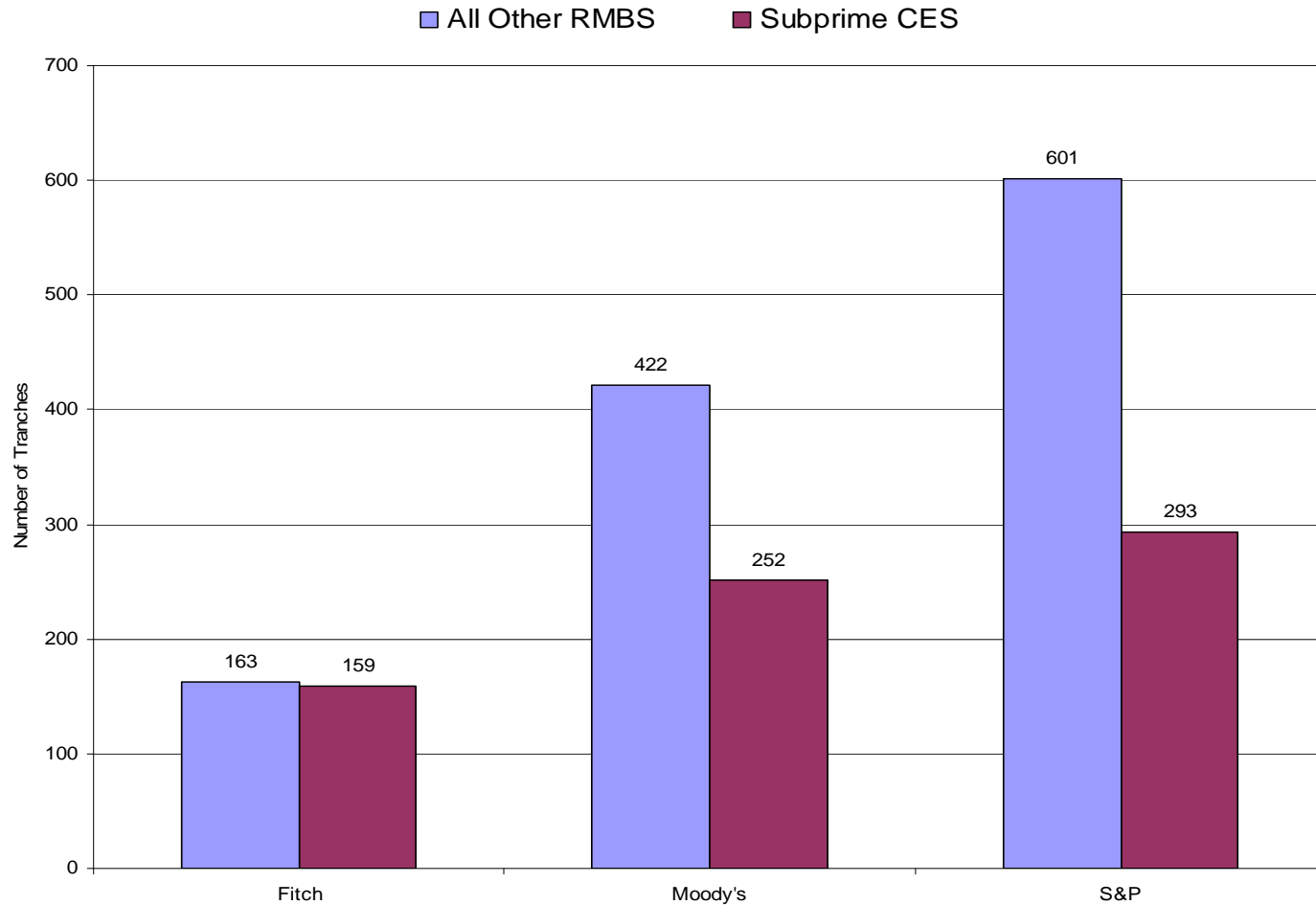
Source: Intex, Fitch, S&P, Moody's

# 2005 and 2006 Vintage RMBS Downgrades by Type through 1H 2007



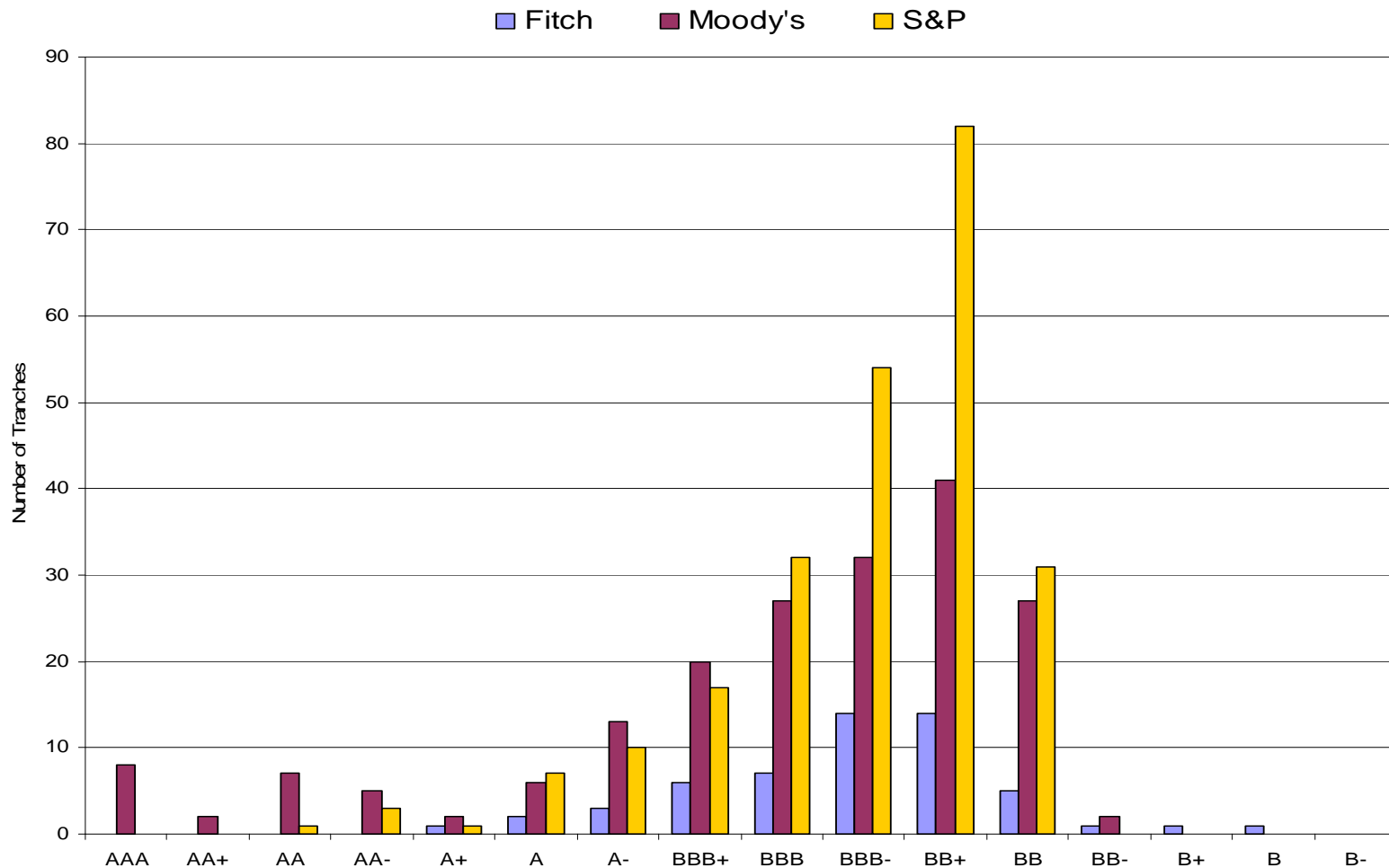
Source: Intex, Fitch, S&P, Moody's

# 2005 and 2006 Vintage RMBS Downgrades by Type through July 16, 2007



Source: Intex, Fitch, S&P, Moody's

# Number of 2006 Subprime CES Downgrades by Original Rating Category (through 1H 2007)



## Magnitude of 2006 Subprime CES Downgrades by Original Rating Category (through 1H 2007)

Original Rating	Fitch	S&P	Moody's
AAA	-	-	2.0
AA+	-	-	-
AA	-	-	3.0
AA-	-	5.0	3.0
A+	5.0	-	-
A	7.0	4.0	5.0
A-	5.5	4.2	4.5
BBB+	7.2	4.6	6.3
BBB	4.7	4.2	6.3
BBB-	4.3	3.7	6.1
BB+	4.9	4.1	6.1
BB	5.8	-	5.8
BB-	1.0	4.1	4.0
B+	7.0	-	-
B	6.0	-	-



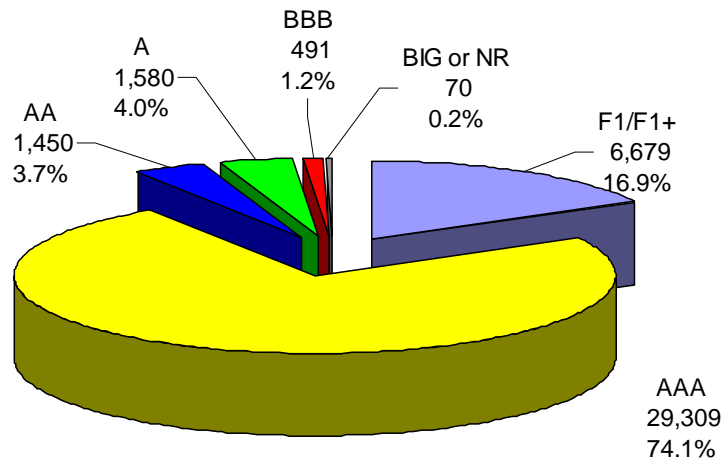
# Structured Finance (SF) CDO Exposure to Subprime RMBS

- > Overview of Fitch-rated SF CDOs
- > Overview of Rating Watch Process
- > SF CDO Rating Methodology Changes
- > Outlook for SF CDOs in 2H 2007

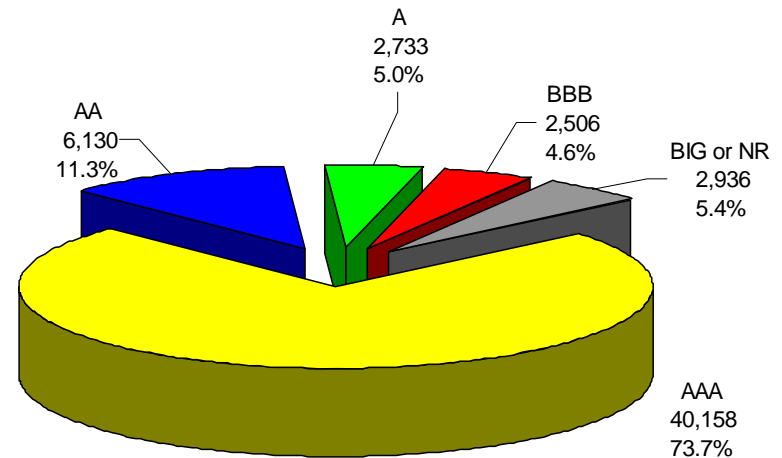
## Overview of Fitch-rated SF CDOs

- > Fitch rates 160 mezzanine SF CDOs totaling approximately \$54.4 billion
- > Fitch rates 41 high-grade SF CDOs totaling approximately \$39.6 billion

**High-grade SF CDO Note Rating Distribution (\$MM and %)**



**Mezzanine SF CDO Note Rating Distribution (\$MM and %)**



## SF CDO Rating Watch Process

- > Fitch placed 8 classes from 4 SF CDOs on Rating Watch Negative (RWN) on June 22, 2007.
- > Fitch placed 33 classes from 19 SF CDOs on RWN on July 12, 2007.
- > Derivative Fitch's Rating Watch Process
  - Screen portfolios for portfolio credit migration
  - Screen portfolios for assets on RWN or 'Under Analysis'
  - Screen portfolios for 2006 vintage subprime CES RMBS exposure
  - Qualitatively assess impact on CDO structural features to various notes
  - CDO tranches placed on RWN as a result of credit committee process
- > The 23 SF CDOs with tranches placed on RWN will go through Fitch's full CDO rating review process

## SF CDO Review Process

- > Discussion with the CDO asset manager
  - Asset performance
  - Distressed asset expectations
  - Portfolio management strategy
- > Analysis and default modeling of the underlying portfolio
  - Stress default modeling for different prepayment assumptions
- > Analysis of CDO cash flows under stress scenarios
  - Vary default timing, interest rate and prepayment assumptions
  - Apply different stresses for different rating categories
- > Credit Committee

## SF CDO Rating Methodology Changes

- > 2005 and 2006 vintage subprime RMBS bonds are showing unprecedented rating performance as evidenced by the sharp increase in downgrade activity with less than 2 years of seasoning.
- > Derivative Fitch modified its CDO modeling assumptions by increasing default probability by 25% for all 2005 and 2006 vintage subprime RMBS bonds.
  - A new version of VECTOR incorporating these changes is under development

## SF CDO Outlook for Remainder of 2007

- > RMBS downgrades will continue to increase each month through 3Q 2007 and beyond
- > Future RMBS downgrades will have a direct impact on SF CDO ratings
- > Mezzanine SF CDOs
  - Tranches originally rated ‘BBB’ and lower to face continued downgrade pressure from downward portfolio credit migration
    - > CDO issued from 2002 from 2004 may be impacted sooner as they typically have exposure to both 2003-04 and 2005-06 subprime RMBS
    - > 2005 and 2006 CDO vintages at risk of further RMBS downgrades from bonds issued in the second half of 2006
- > High-grade SF CDOs
  - CDOs with larger exposures to 2006 vintage subprime CES are most at risk given the scope and relative magnitude of rating actions seen in this sub-sector



# Derivative Fitch

Quantifying All Sides of Risk

[www.derivativefitch.com](http://www.derivativefitch.com)

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