October 11 Rating Actions Related to 2006 Subprime First-Lien RMBS

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SUMMARY

Moody's conducted a full review of all subprime first lien-backed securities rated in 2006. The review was primarily a response to the continued increase in mortgage default rates for the 2006 vintage, new forecasts related to home price depreciation, and new insights into mortgage servicers' readiness to modify loans[1].

- The review resulted in the affirmation of 1,519 **Aaa**-rated securities and 643 **Aa**-rated securities within the subprime first lien-backed 2006 vintage but also produced negative rating actions on 3,083 tranches. These actions were announced on October 11, 2007.
- The rating affirmations impacted $278 billion of securities, 64% of all subprime first lien-backed securities that Moody's rated in 2006 by original dollar amount.
- The negative rating actions reflected downgrades of $33 billion of securities, and reviews for downgrade of an additional $23 billion, 8% and 6%, respectively, of the Moody's-rated 2006 vintage.
- Moody's does not expect significant further downgrades for the 2006 vintage, provided that U.S. home price depreciation does not exceed our current assumptions and the U.S. economic environment does not change significantly.

ABOUT MOODY'S RECENT RATING CHANGES

Moody's review of all subprime, first lien-backed securities rated in 2006 resulted in the following rating actions, announced on October 11, 2007.

- ***Moody's affirmed the Aaa ratings*** on $256 billion of securities (1,519 securities) rated in 2006 that were backed by subprime first lien mortgages. This represents 74.2% of all **Aaa**-rated securities in the 2006 vintage by original dollar amount.
- ***Moody's affirmed the Aa ratings*** of $21 billion of securities (643 securities) rated in 2006 that were backed by subprime first lien mortgages. This represents 52.0% of all **Aa**-rated securities in the 2006 vintage by original dollar amount.
- ***Moody's took negative rating actions*** on $57 billion of securities originated in 2006 that were backed by subprime first lien mortgage loans (13.4% of the Moody's-rated 2006 vintage) as detailed herein:
    - ***2,506 tranches ($33.4 billion) were downgraded***
      (7.8% of the original dollar amount for the Moody's-rated 2006 vintage)
      --Of these, 323 tranches ($3.8 billion) were left on review for possible downgrade and are now rated **B3**.

1 See "Moody's Subprime Mortgage Servicer Survey on Loan Modifications," Moody's Structured Finance, September 21, 2007.

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- ***577 tranches ($23.8 billion) were placed on review for possible downgrade***
  (5.6% of the original dollar amount for the Moody's-rated 2006 vintage)
  -- Of these, 48 ($6.9 billion) are **Aaa**-rated tranches and 529 ($16.9 billion) are **Aa**-rated tranches.

We note that the mortgage foreclosure process can be quite lengthy and therefore loan pool losses may not materialize for a long time. In our rating actions of October 11, Moody's has expressed its forward looking opinion of the projected losses for 2006 first lien mortgage-backed securities.

As a result, Moody's expects limited future downgrades within the 2006 subprime first lien vintage, provided that U.S. home price depreciation remains at or below our current assumption of 10.5% from peak to trough and the U.S. economic environment does not change significantly. Moody's view on the likelihood of further rating changes among 2006 subprime, first lien-backed securities is as follows:

- **Aaa-rated securities**

  Ratings on **Aaa**-rated securities have been stable and Moody's expects continued stability. Over 97% of the original dollar volume of subprime first lien-backed securities rated **Aaa** in 2006 have seen no rating actions. 2.3% are currently on review for possible downgrade and we do not expect downgrades lower than three notches to **Aa3**.

  Our analysis takes into account the sequential pay nature of the structures that allow the **Aaa**-rated securities to get all collateral payments during the earlier years of the deal, which de facto increases the level of enhancement available to them.

- **Aa-rated securities**

  No downgrades have been taken on **Aa**-rated securities. Although approximately 40% of **Aa**-rated securities are currently on review for downgrade, the resulting rating actions for the vast majority of them are expected to be limited to three notches or less. In other words, if the ratings migrate at all, they are likely to migrate within the **Aa** grade or to the **A** grade.

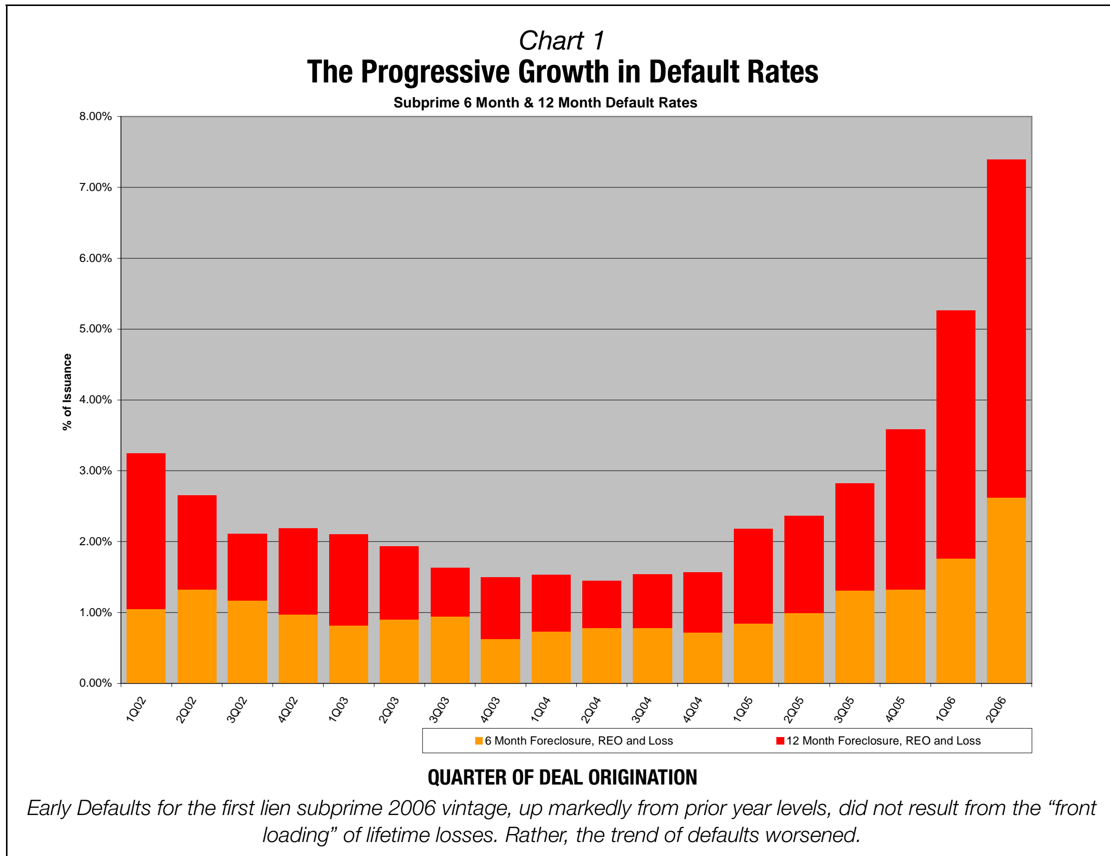
Summary of Cumulative 2006 Vintage Rating Actions

Subprime 1st Lien Downgrades and "On Review" as of October 11, 2007

By Original Rated Volume		By # of Tranches		By # of Deals	
Volume ($bil)	% of Rated	Number	% of Rated	Number	% of Rated
$57.2	13.4%	3,087	48.0%	396	92.1%

Moody's believes that there are benefits in conducting broad-based reviews of entire vintages as was the case with the 2006 vintage subprime first lien-backed securities. First, to the extent that there exist systemic issues in the marketplace that have an impact on all outstanding deals from a vintage, undertaking a broad-based review or "sweep" allows us to benchmark the performance of transactions against peers and to be more consistent in how we evaluate the impact of the systemic issues. In addition, taking broad rating actions in the wake of a broad-based review helps to minimize speculation that may occur - and may disrupt the market - if investors try to predict potential future rating actions based on actions taken on a deal-by-deal or shelf-by-shelf basis.

Chart 1
The Progressive Growth in Default Rates



Early Defaults for the first lien subprime 2006 vintage, up markedly from prior year levels, did not result from the "front loading" of lifetime losses. Rather, the trend of defaults worsened.

TRENDS BEHIND THE CHANGES

Moody's October 11 rating actions were a response to updated information in three areas: underlying loan defaults, projected home price depreciation, and servicers' readiness to modify loans. We explain these more fully herein:

- **Default Trends**

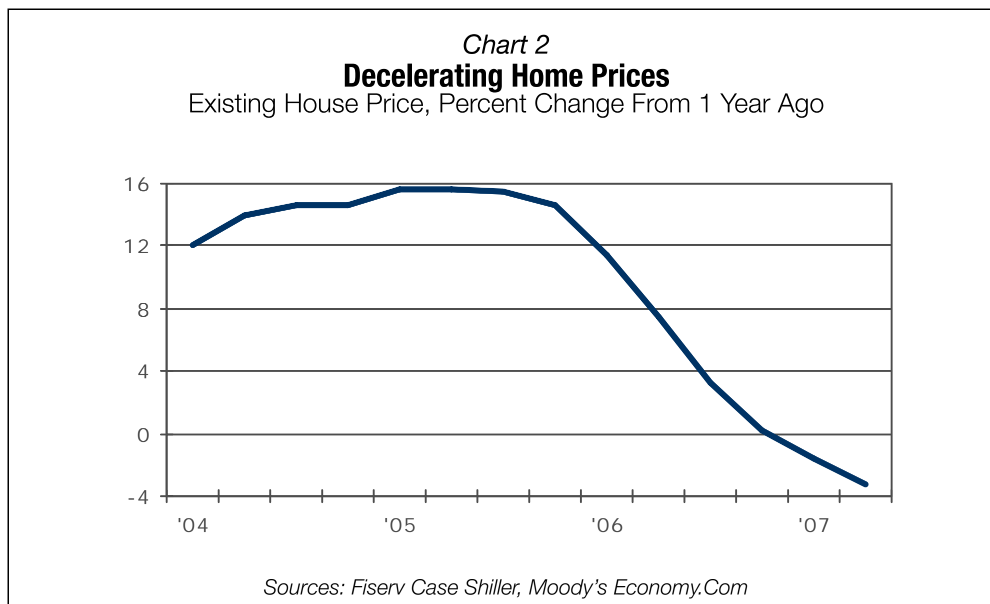
  Within the 2006 vintage loan pools, early payment defaults (defaults that occur within the first three to six months of a loan's origination[2]) rose to unprecedented extremes, reaching levels that exceeded both Moody's expectations as well as those of many market observers. Early defaults for the 2006 vintage pools are currently more than double those for the 2005 vintage and are significantly higher than during the U.S. housing market downturn of 2000.

  Moody's first noticed the significant rise in early defaults for the 2006 vintage in early 2007. At that time, we believed that this increase in early defaults could be the result of "front loaded loss curves" (that is, lifetime losses expected on the pools occurring earlier than is usual) and that the remainder of the pools might perform at more normal levels. In other words, we hypothesized that once the excess of early defaults for the subprime 2006 vintage were digested and reflected in deal performance then performance after this period would return to more typical patterns.

  This did not turn out to be the case. By August 2007 it was clear that the proportion of defaults occurring on the 2006 vintage during the second six months after loan origination had been, counter-intuitively, even more severe than in the first six months (see *Chart 1*). The related change to our default assumptions contributed to many of the recent downgrades.

  Compounding this were continuously worsening levels of serious delinquencies, that is, those loans that were 60 or more days delinquent, in foreclosure or being held as real estate owned.

2 Early defaulters are often borrowers who never intended to make regular payments, possibly because they intended to quickly sell or "flip" the property. When they are unable to sell the property, they often default on the loan. Early defaulters could also be borrowers that realized shortly after taking out the mortgage their inability to make the regular mortgage and other payments required of homeownership.



- **Economic Indicators**
  Also contributing to the recent rating actions was the prolonged weakness in home prices and the view of many economists that this weakness will continue through at least the end of 2008 and will result in significant peak to trough price declines. Specifically, Moody's Economy.com now forecasts that the peak to trough decline in home prices in the U.S. will average about 10.5%. This estimate is further supported by the accumulation of unsold house inventories that has not yet declined.

  Moody's current rating levels reflect these forecasts. If home prices decline within this range, we expect that current ratings will remain stable as explained earlier.

- **Servicer Modification Trends**
  The proportion of pending interest rate resets looming for the loans backing the 2006 vintage is significant and is a cause for concern. This is because performance could suffer significantly without proactive loss mitigation.

  Notably, among the loans scheduled to reset in the coming months are mortgages with higher loan-to-value ratios (LTVs) and weaker credit characteristics and that are therefore more vulnerable to interest rate resets.

  To understand the likely scope of modifications and the potential mitigating impact this may have on defaults arising from rate resets, Moody's surveyed major subprime mortgage servicers with the goal of assessing both their current modification rates for loans that are up for resets as well as their state of readiness for future months. Our conversations revealed that most servicers had only modified approximately one percent of their serviced loans that had experienced a reset in the months of January, April and July 2007.

  There may be numerous reasons for this trend, among them, the fact that the delinquency rate on loans that have reset is still relatively low. Servicers may be reluctant to modify loans prematurely. Servicers may be adjusting their strategy in the future assuming their state of readiness improves to perform the modifications if need be.

  Furthermore, servicers may be assessing whether the servicing fees they charge on securitized pools are sufficient to cover the costs related to the increased staffing required for extensive modification activity. There may also be conflicting incentives when servicers also hold a residual economic interest in the mortgages they service.

SURVEILLANCE APPROACH

When reviewing RMBS transactions, Moody's divides the mortgage loan pools into two segments: delinquent loans (those loans that were 60 or more days delinquent, in foreclosure or being held as real estate owned) and non-delinquent loans.

- ***When reviewing delinquent loans***, Moody's evaluates the likelihood that the property will be liquidated and the potential loss severity associated with the sale of the property.
- ***When reviewing non-delinquent loans***, Moody's is currently using more severe loss assumptions than we did when we initially rated the transactions in recognition of the continued decline in home prices, the tight lending environment and the use of aggressive loan underwriting standards at origination.

Once loss expectations are established for both the delinquent and non-delinquent portions of the collateral pools, Moody's attributes pool losses to tranches in light of the credit protection (over collateralization, subordination and excess spread) available to support each rated security.

For more details regarding the surveillance approach used, see the slide presentation from Moody's teleconference of October 12, 2007. RMBS and CDO Update (Rating Actions)

OUTLOOK FOR 2007 VINTAGE

Moody's is currently in the process of reviewing all of its ratings on subprime first lien-backed securities rated in 2007. This review mainly will be based on a re-running of the models used to initially rate the transactions but using our current published assumptions, which are generally more severe than those that were in effect when the transactions were originally rated. In addition, we will assess the available performance information for each transaction although such information is limited in light of the few months that have elapsed since closing. However, the available performance information indicates that serious delinquencies remain high for transactions issued in early 2007.

The review will likely be concluded and rating actions taken as warranted within the next two months.

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