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Criteria:

Revised Guidelines For U.S. RMBS Loan Modification And Capitalization Reimbursement Amounts

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Standard & Poor's Ratings Services has concluded the criteria review process initiated by its June 18, 2007, Request For Comment and revised its guidelines for residential mortgage loan servicers' loan modification practices and the manner of reimbursement of capitalized loan amounts in U.S. residential mortgage-backed securities (RMBS) transactions. The objective of these guidelines is to delineate practices that do not adversely affect Standard & Poor's rated RMBS transactions. The terms initially capitalized in this article are defined in the "Definitions" section at the end of these guidelines. This article supersedes "Criteria: Request For Comment: Revised Guidelines For U.S. RMBS Loan Modifications And Capitalization Reimbursement Amounts," published June 18, 2007, on RatingsDirect and on Standard & Poor's Web site at www.standardandpoors.com.

Summary Of Guidelines

The framework outlined in these guidelines provides the market with a transparent, consistent, and fundamental way of assessing Loan Modification and Capitalization Reimbursement Amount risks in U.S. RMBS transactions. The assumptions reflect the potential increase in the use of Loan Modifications as a loss mitigation strategy in the mortgage loan servicing industry and address how Loan Modifications may be consistent with the asset and cash flow parameters of securitized transactions.

Standard & Poor's considers the potential risks and benefits associated with Loan Modifications and incorporates such considerations when reviewing proposed transactions and available credit support, as further described in this article. The key aspects of the guidelines include:

1. Standard & Poor's will consider the impact of Loan Modifications in our review of credit support and proposed structures.
2. Once a loan that has experienced a Loan Modification (a modified loan) passes the Loan Modification Performance Test, the loan may be excluded from any Loan Modification Limit calculation.
3. As long as the rated securities are outstanding, any amendments to provisions relating to Loan Modifications should be subject to Rating Agency Notification, which should be expressly stated in the transaction documents.
4. The delinquency trigger calculation should include modified loans for 12 months after the loan has been modified. After 12 months, the borrower should be classified as per the appropriate payment status (i.e., current, 30+ days delinquent, 60+ days delinquent, 90+ days delinquent, etc.).
5. If the delinquency trigger does not include modified loans, Standard & Poor's will revise the delinquency trigger threshold appropriately, on a case-by-case basis to account for all or a portion of the modified loans.
6. The cumulative loss trigger calculation should include any interest and principal amounts that have been forgiven as part of a Loan Modification.

7. If the cumulative loss trigger calculation does not include interest and/or principal forgiveness, Standard & Poor's will revise the cumulative loss thresholds appropriately, on a case-by-case basis to account for possible debt forgiveness.
8. Remittance reports should include additional information and calculations relating to Loan Modifications and Capitalization Reimbursement Amounts.
9. The transaction documents may allow a servicer to reimburse itself for Capitalization Reimbursement Amounts from either amounts received on the related modified loan only, or principal remittance amounts from the related loan group.
10. In cases where the servicer reimburses itself solely from the related modified loan, the overcollateralization definition should exclude any Capitalization Reimbursement Amounts.
11. In cases where the transaction documents allow for Capitalization Reimbursement Amounts to be paid from total principal and interest collections, the credit enhancement requirement may be adjusted accordingly.

Purpose Of Loan Modifications

The primary purpose of Loan Modifications is to assist distressed borrowers who are unable to meet their mortgage obligations. Therefore, a Loan Modification, as opposed to a refinancing, enables a servicer to change the terms of a loan to better enable the borrower to stay current or cure a delinquency or default without retiring the existing loan. Loans can be modified by extending the amortization terms, adding balloon payments, decreasing the mortgage rates, forgiving principal or interest payments, and extending the fixed-rate period of a hybrid adjustable-rate mortgage (ARM) loan, among other things.

Given the many ways in which a loan can be modified, and the potential impact on investors in securitized transactions, Standard & Poor's is sensitive to the balance between the negative impact of Loan Modifications, i.e., the potential reduction in payments received from the borrower and available to pay investors, and the potential positive impact, i.e., the potential decrease to borrowers' foreclosure frequency, voluntary prepayment rates, and ultimate loss severity on the loans.

Investors may benefit from Loan Modifications, as they have the potential to minimize losses. In the past several years, residential mortgage loan servicers have not applied this loss mitigation strategy very often. Many servicers have, historically, used refinancing as an alternative to Loan Modifications. However, this is expected to change with slowing home price appreciation and the rise in the number of borrowers falling behind or potentially falling behind on their mortgage obligations.

Guidelines

Loan modifications

Our analysis and assumptions will consider any Loan Modification Limit and potential Loan Modifications when we review the proposed structure and credit support. Potential Loan Modifications that may be considered in our analysis include, among other things, mortgage rate reductions, interest or principal forgiveness, extensions of fixed-rate periods of hybrid ARMs, and changes in loan type from adjustable rate or payment option ARM to fixed rate. Our analysis may also consider reductions to the foreclosure frequency calculations for successful Loan

Modifications and increases to the loss severities for failed Loan Modifications. In addition, we may incorporate historical servicer recidivism rates related to Loan Modifications into our assumptions and may consider the impact of Loan Modifications in our review of credit support and proposed structures.

The modified term of the loan should not exceed the legal final maturity date of the rated securities.

Furthermore, for transactions where a Loan Modification Limit is specified, once a modified loan passes the Loan Modification Performance Test, the loan may be excluded from the Loan Modification Limit calculation. This feature will allow the Loan Modification Limit to be replenished, if applicable, as the servicer completes successful Loan Modifications.

In addition, as long as any rated securities in a particular transaction remain outstanding, any amendments to provisions relating to Loan Modifications should be subject to Rating Agency Notification, which should be expressly stated in the transaction documents.

Delinquency trigger calculations

Loan Modifications are typically used when a borrower is in default (i.e., 60+ days delinquent for purposes of calculating triggers) or reasonably likely to default. Although it is proper to include a defaulted loan in computing the delinquency trigger, a modified loan may not be currently included in these calculations. If a modified loan is not included in the delinquency trigger calculation, the delinquency calculation may be less indicative of the transaction's health. As a result, the transaction may pass the delinquency trigger when a step-down may not be warranted.

For this reason, a modified loan should be included as part of the delinquency trigger calculation until the borrowers show their ability and willingness to pay according to the terms of the modified loan. For 12 months after the modification date, the loan should be included in the delinquency trigger calculation. However, after the 12-month period, the loan should be classified by its delinquency status (i.e., current, 30+ days delinquent, 60+ days delinquent, 90+ days delinquent, etc.). As such, the loan should only be included in the delinquency trigger calculation if it is classified as 60+ days delinquent.

If a borrower received a trial modification period, this may be counted towards fulfilling the 12-month period described above and in the Loan Modification Performance Test. If a loan is classified as 60+ days delinquent at the time the loan is modified, the loan should not be duplicated in the 60+ days delinquency trigger calculation when the modified loan is included.

If the delinquency trigger does not include modified loans, Standard & Poor's will revise the delinquency trigger threshold appropriately, on a case-by-case basis to account for all or a portion of the projected loan modifications.

Cumulative loss trigger calculations

As debt forgiveness would result in a permanent reduction in the principal balance of the related loan, principal that is forgiven under a Loan Modification should be included in the calculation of the cumulative loss triggers, along with any interest that is forgiven. If the cumulative loss trigger calculation does not include interest and/or principal forgiveness, Standard & Poor's will revise the cumulative loss thresholds appropriately, on a case-by-case basis to account for possible debt forgiveness.

Reporting

Standard & Poor's encourages transparency in the market and standardization of reporting for consistency and comparison purposes. To further these efforts, the servicer remittance and trustee reports should indicate:

- In the aggregate and by modification type, the percentage (by current loan balance) and number of loans that were modified in the current period;
- In the aggregate and by modification type, the cumulative percentage (by original loan balance) and number of loans modified since the closing date;
- The amount of principal forgiveness for the current period;
- The cumulative amount of principal forgiveness since the closing date;
- The percentage of modified loans that are included in the delinquency trigger calculation;
- The percentage of modified loans that have passed the Loan Modification Performance Test;
- The delinquency status for all loans modified since the closing date;
- Whether the loan is in a trial modification period or has been permanently modified;
- When the trial period ends;
- The number of times the loan has been modified;
- The date of the most recent Loan Modification;
- The number of modifications made during the past 12 months;
- The percentage of modified loans that are current versus in default;
- The modified rate and the rate the borrower was supposed to have paid;
- The amount of capitalized reimbursement amounts that the servicer repaid itself in the current period; and
- The cumulative amount of capitalized reimbursement amounts that the servicer repaid itself since the closing date.

Standard & Poor's will consider the information supplied in the remittance reports for ongoing surveillance purposes.

Outstanding transactions

To foster consistency and transparency and appropriately gauge the health of existing transactions, Standard & Poor's believes that modified loans should be included in the reporting guidelines for outstanding transactions.

Capitalization of unreimbursed advances

In many U.S. RMBS transactions, the servicer remits Principal and Interest (P&I) Advances to the trustee to the extent that the servicer reasonably believes that such cash advances can be repaid from future payments on the related mortgage loan. These cash advances are only intended to maintain a regular flow of scheduled interest and principal and provide liquidity to the transaction and are not intended to serve as credit enhancement.

The servicer may also remit Taxes and Insurance (T&I) Advances to the trustee related to any payment due representing the aggregate of all payments of taxes and insurance. Advances for taxes are intended to maintain the perfection of the priority lien status, and advances for insurance are intended to protect the asset against a loss in value due to property damage.

In most U.S. RMBS transactions, servicing agreements permit the servicer to be reimbursed for advances at the top of the transaction waterfall from late payments from the related mortgagor, and from all liquidation proceeds and other payments or recoveries (including insurance proceeds and condemnation proceeds) for the related mortgage loan, unless the advance is deemed a Nonrecoverable P&I Advance or Nonrecoverable Servicing Advance (both of which may be reimbursed from the total proceeds collected from all mortgage loans).

In some transactions, servicers have been reimbursed for Capitalization Reimbursement Amounts at the top of the transaction waterfall from total P&I collections. If total P&I collections from all loan groups are used to reimburse servicers, the issuer may have less cash available to pay interest and principal to the rated securities. In certain stress scenarios, this practice could result in a shortfall of current interest due on the securities.

To mitigate the potential negative impact of permitting these reimbursements from total P&I collections, servicers may be reimbursed for Capitalization Reimbursement Amounts in two ways. The servicer may reimburse itself for Capitalization Reimbursement Amounts from either the principal remittance amounts (and not the interest amounts) from the related loan group, or solely from amounts received on the related modified loan.

Because Capitalization Reimbursement Amounts are owed to the servicer and are not available to provide credit support to the securities, in cases where the servicer chooses reimbursement solely from the related modified loan, the overcollateralization definition should exclude any Capitalization Reimbursement Amounts. As the loan's principal balance will be increased by the Capitalization Reimbursement Amount, overcollateralization may be inflated.

Transactions that contain variations of the proposed guidelines will be reviewed by Standard & Poor's on a case-by-case basis. Credit enhancement will be assessed based on the features of the structure proposed.

Definitions

60+ Days Delinquent:

For any distribution date, the aggregate Stated Principal Balance of the mortgage loans that are 60 or more days delinquent in payment of principal and interest for that distribution date, including mortgage loans in foreclosure and REO, plus the aggregate Stated Principal Balance of the mortgage loans that have been modified during the preceding 12-month period.

Accepted Servicing Practices:

For any mortgage loan, those mortgage servicing practices employed by the servicer in servicing similar mortgage loans for its own portfolio giving due consideration to customary and usual standards of practice of prudent mortgage lending institutions that service mortgage loans of the same type as that mortgage loan in the jurisdiction where the related mortgaged property is located. For publicly issued securities, the servicer should be in compliance with Section 1122 of Regulation AB.

Advances:

Both P&I Advances and Servicing Advances.

Capitalization Reimbursement Amount:

On any distribution date, the amount of advances that were added to the Stated Principal Balance of the mortgage loan in association with a Loan Modification.

Loan Modification:

A permanent change in one or more of the terms of an executed mortgage loan document where the borrower may become delinquent or is delinquent, in default, in foreclosure, or where the borrower is in bankruptcy; including any Preemptive Loan Modifications.

Loan Modification Limit:

The percentage of the cutoff date loan principal balance (including the principal balance of Prefunded Loans) that may be modified by the servicer.

Loan Modification Performance Test:

Is satisfied when, following a Loan Modification, a borrower makes their cumulative scheduled monthly payments for the 12-month period immediately after the loan modification date.

Nonrecoverable P&I Advance:

Any P&I Advance previously made or proposed to be made related to a mortgage loan or REO property that, in the good faith business judgment of the servicer using Accepted Servicing Practices, will not or, in the case of a proposed P&I Advance, would not ultimately be recoverable from related late collections, insurance proceeds, or liquidation proceeds on that mortgage loan or REO property.

Nonrecoverable Servicing Advance:

Any Servicing Advance previously made or proposed to be made for a mortgage loan or REO property that, in the good faith business judgment of the servicer using accepted servicing practices, will not or, in the case of a proposed Servicing Advance, would not ultimately be recoverable from related late collections, insurance proceeds, or liquidation proceeds on that mortgage loan or REO property.

Preemptive Loan Modifications:

A Loan Modification that is made by the respective servicer before the loan becomes delinquent, in default, in foreclosure, or where the borrower is in bankruptcy.

Prefunded Loans:

Loans that are purchased by the seller after the closing date with proceeds previously deposited in a prefunding account and later added to the assets of the issuer.

P&I Advance:

For any mortgage loan or REO property, any advance made by the servicer on or related to any payment date representing the aggregate of all payments of principal and interest, minus the servicing fee, that were due during the related due period on the related mortgage loan and that were delinquent, plus certain amounts representing assumed payments not covered by any current net income on the mortgaged properties acquired by foreclosure or deed in lieu of foreclosure.

Rating Agency Notification:

Written notification to Standard & Poor's of amendments or modifications to the transaction documents.

REO:

Real estate owned.

Servicing Advance:

T&I Advance and the reasonable "out-of-pocket" costs and expenses incurred by the servicer in the performance of its servicing obligations (including the reasonable fees of counsel) in connection with a default, delinquency, or other unanticipated event, including, but not limited to, the cost of the inspection, preservation, restoration, and protection of a mortgaged property; any enforcement or judicial proceedings, including foreclosures, related to a particular mortgage loan; the reasonable fees in connection with the management and liquidation of any REO property (including default management and similar services, appraisal services, and real estate broker services); and locating documents missing from the mortgage file or servicing file. Servicing Advances also include any reasonable

out-of-pocket cost and expenses (including legal fees) incurred by the servicer in connection with executing and recording instruments of satisfaction, deeds of reconveyance, or assignments of mortgage to the extent not recovered from the mortgagor.

Stated Principal Balance:

An amount equal to the unpaid principal balance of a mortgage loan as of the related distribution date.

T&I Advance:

For any mortgage loan or REO property, any advance made by the servicer for any payment date representing the aggregate of all payments of taxes and insurance that were due during the related due period on the related mortgage loan or REO property, plus certain amounts representing assumed payments not covered by any current net income on the mortgaged properties acquired by foreclosure or deed in lieu of foreclosure.

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