What went wrong with mortgage ABS?

• Mortgage broker, mortgage banker, appraiser, investment bank, risk assessor – all paid on flow – with little recourse.

• Product proliferation and underwriting gone mad – 0 down, option ARMs, CDO's, CDO^2, etc.

• Greed, short-termism and excessive risk taking at the height of the bubble – late 2005, 2006 and early 2007 saw the worst underwriting – highest property values and lax underwriting.

• Risk assessment lacking – market was not mature enough for the complexity – some did not understand the leverage and optionality inherent in ABS structure. Given complexity, many relied on ratings alone with dire consequences. Economic feedback loops make default experience worse.

Typical ABS Transaction

Mortgage Pool

Collections paid to bondholders from 'AAA' down

'AAA' bonds

'AA' bonds

'A' bonds

'BBB' bonds

Overcollateralization

Excess spread

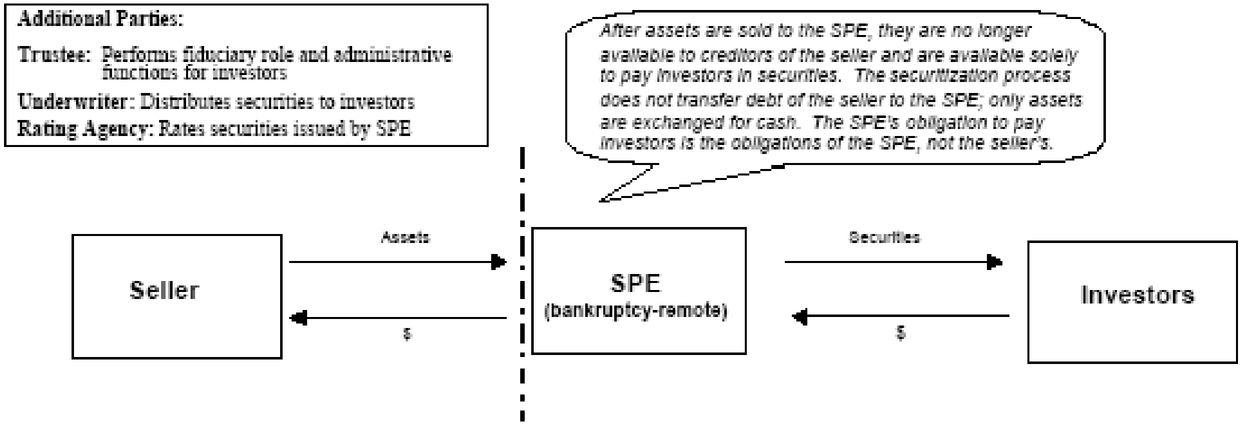
Losses allocated from bottom up

If there are any losses on the pool, they would first be allocated to excess spread. If losses are greater than the available excess spread, they would then be allocated to overcollateralization. If the losses are greater than the combined excess spread and overcollateralization, they would then be allocated to the bonds.

During the following month, excess spread is used to build back overcollateralization.

Securitization

Basic Securitization Structure

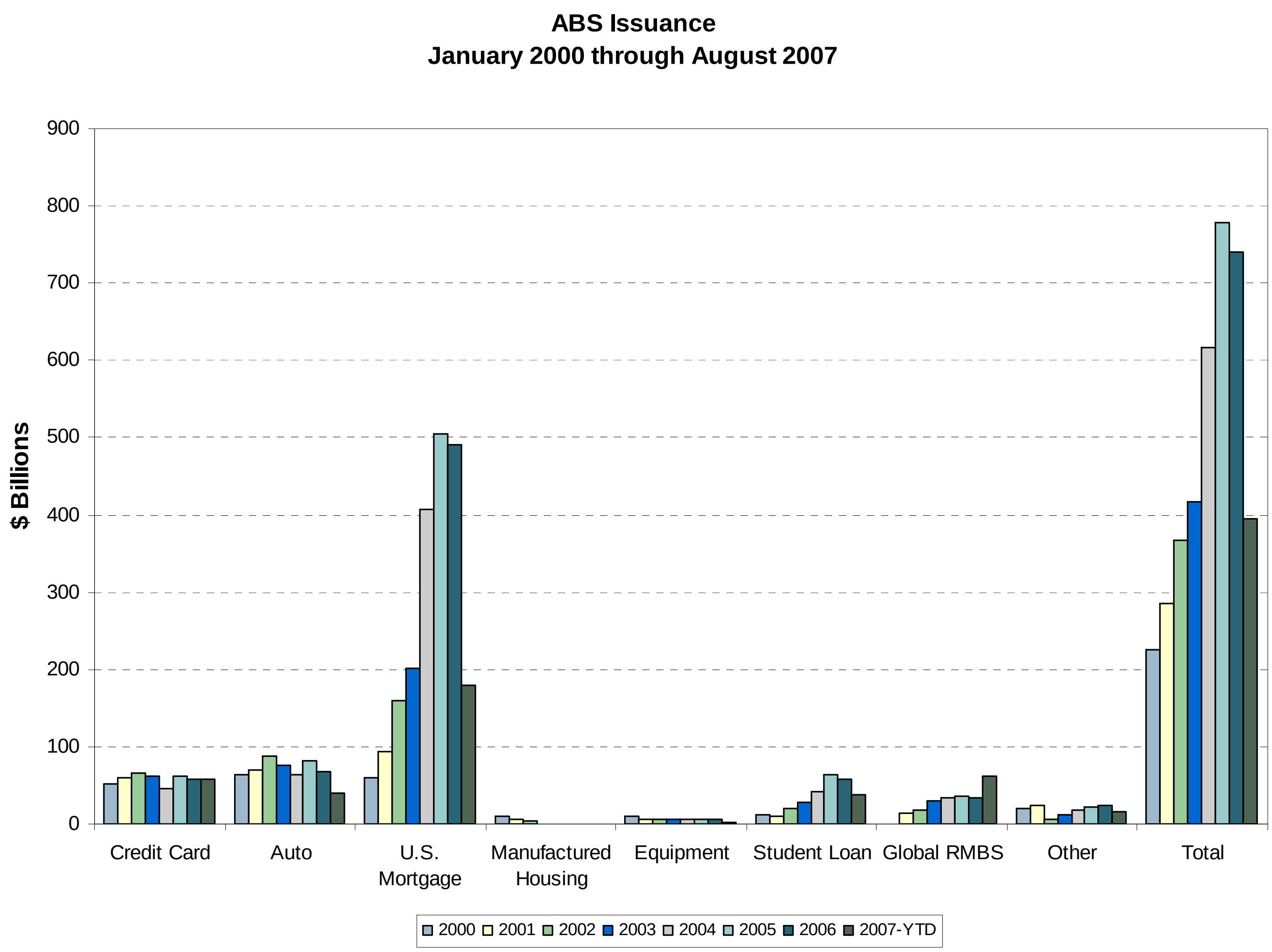


Example: Following is a general description of the securitization process, using mortgages and mortgage-backed securities as an example. Although there may be additional steps involved in a securitization, we describe here the basic process:

1. Seller (typically a mortgage lender) extends mortgage loans to borrowers.
2. Seller and a trustee representing investors create an entity (an "SPE").
3. Seller then sells a group, or "pool" of assets (mortgage loans) to the SPE into which the loans are deposited. The payment it receives in exchange for the loans replenishes the funds used to make the original loans. Those funds now are available to the lender for other uses, including making loans to other potential homeowners.
4. Based on the income stream expected from the mortgages held in the SPE, the SPE issues securities. The monthly principal and interest to be received from the mortgage borrowers will be used to make monthly principal and interest payments to investors in the issued securities. The securities that the SPE issues are called "mortgage-backed securities" ("MBS") because they are backed by the pool of mortgage loans that the SPE holds.
5. The securities then are sold into the marketplace to investors.

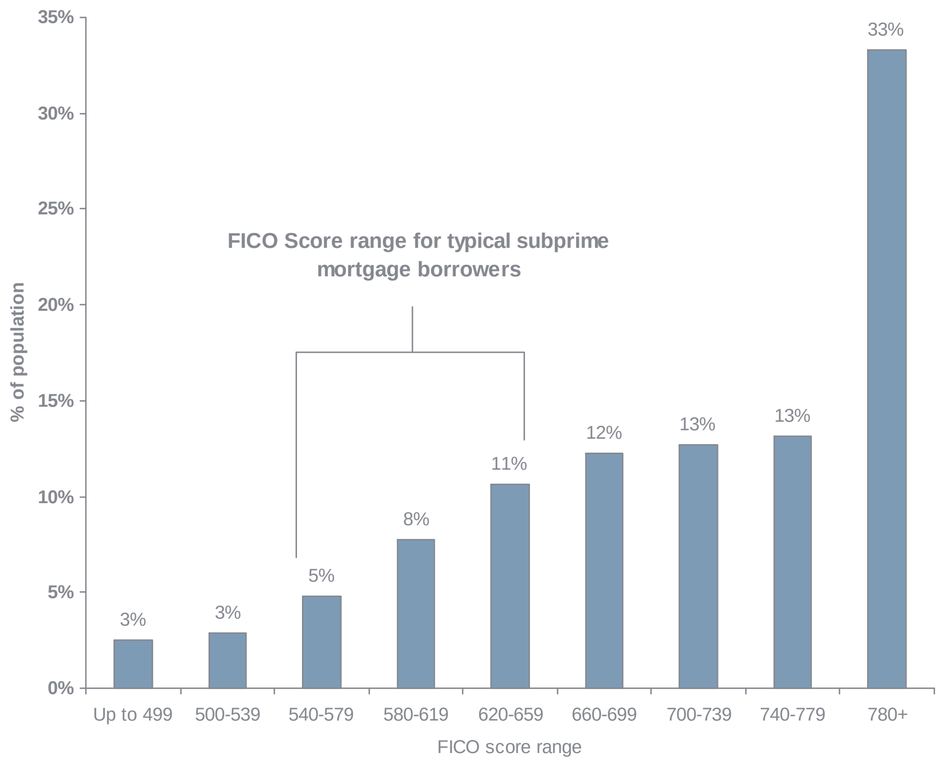
Source: The Bond Market Association, International Swaps & Derivatives Association, Securities Industry Association. "Special Purpose Entities (SPEs) and the Securitization Markets. February 1, 2002

Subprime Mortgage Issuance Has Dominated ABS Supply in Recent Years

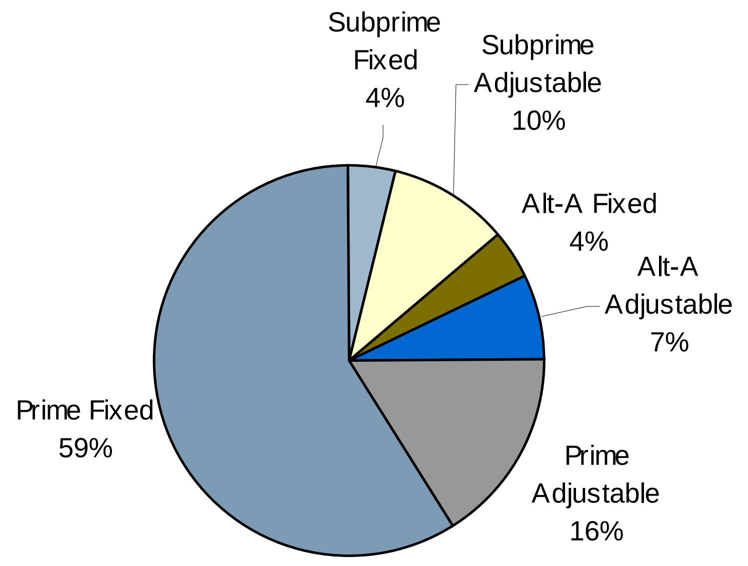


Subprime Mortgage Borrower Base Relative to General U.S. Population

U.S. FICO score distribution

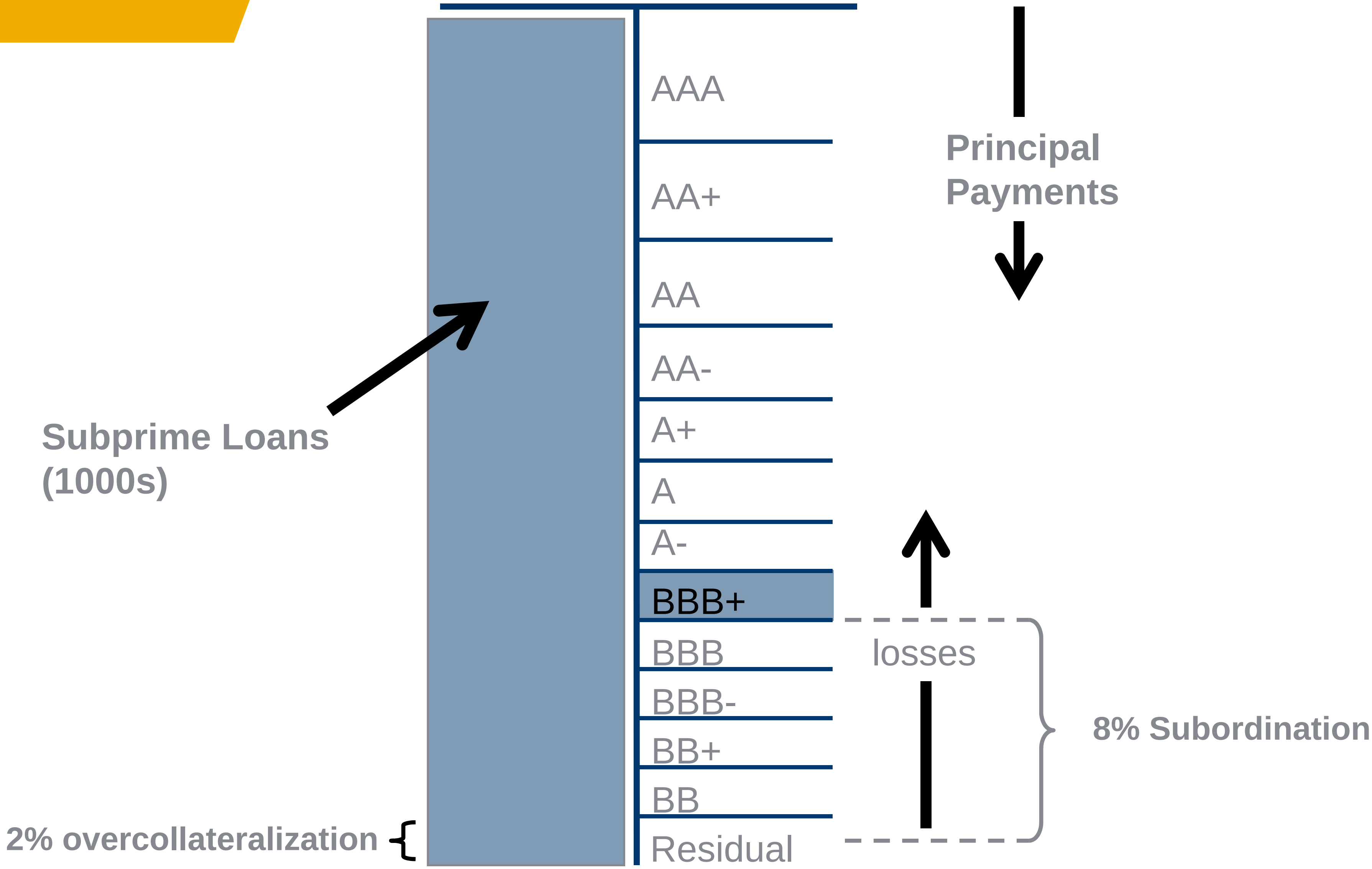


Current composition of U.S. mortgage debt



Mortgage Debt Outstanding - $10.0 Trillion

Securitization Provides Opportunity for Investors of Various Risk Appetites



PRESENTATION HEADLINE 00/00/2004 (OPEN VIEW/HEADERS AND FOOTERS)

ABS Looking Forward

• Prices in subprime / Alt-A's adjusted 9-12 months ago in market. Uncertain but severe losses ahead as defaults continue for next few years.

Subprime issuance shut down since Summer 2007. Other ABS greatly diminished issuance (credit cards and student loans).

• Massive downgrades still to come in subprime.

• Will take many years (5?) to rebuild market confidence in structured credit.

• Credit card ABS better protected than subprime was, but if we have a deep recession, there will be problems in lower rated tranches.

• Better understanding of structure and risks in ABS as market takes a "step back" to review risks.