Office of Thrift Supervision

FACT SHEET

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OTS Fact Sheet on Washington Mutual Bank

Institution Profile

- Total assets as of June 30, 2008: $307.02 billion
- Primary executive and business segment headquarters are located in Seattle, Washington.
- Branches: 2,239 retail branch offices operating in 15 states
- 4,932 owned and branded ATMs
- Employees: 43,198 at June 30, 2008

Recent Deposit Flows

- Because of adverse events in the financial markets, material outflows began on September 15, 2008. Coupled with further rating agency downgrades of Washington Mutual Inc. (WMI, the top-tier holding company) and Washington Mutual Bank (WMB or the Bank), the Bank experienced a net deposit loss of $16.7 billion through September 24, 2008.

Other Financial Details (as of June 30, 2008)

- Total deposits: $188.3 billion
- Brokered deposits: $34.04 billion
- Total borrowings: $82.9 billion primarily comprising Federal Home Loan Bank advances of $58.4 billion and $7.8 billion of subordinated debt
- Loans held: $118.9 billion in single-family loans held for investment - this includes $52.9 billion in payment option ARMs and $16.05 billion in subprime mortgage loans
- Home Equity Lines of Credit (HELOCs): $53.4 billion
- Credit Card Receivables: $10.6 billion

- Total loan servicing: $689.7 billion total loans serviced, including $442.7 billion in loans serviced for others and $26.3 billion of subprime mortgage loans
- Non-performing assets: $11.6 billion, including $3.23 billion payment option ARMs and $3.0 billion subprime mortgage loans

Institution History

- WMI is the top-tier savings and loan holding company and owns two banking subsidiaries, WMB and Washington Mutual Bank, fsb (WMBfsb), as well as nonbank subsidiaries.
- Since the early 1990s, WMI expanded its retail banking and lending operations organically and through a series of key acquisitions of retail banks and mortgage companies. The majority of growth resulted from acquisitions between 1996 and 2002. On October 1, 2005, the Bank entered the credit card lending business by acquiring Providian Financial Corporation. These acquisitions enabled WMB to expand across the country, build its customer base, and become the largest savings and loan association in the country.
- The Bank had four business segments: the Retail Banking Group, the Card Services Group, the Commercial Group and the Home Loans Group. WMB is a leading originator and servicer of both single- and multi-family mortgages and a major issuer of credit cards.

Recent Events

- *Changes in Business Strategy* - Beginning in late 2006 through today, WMB was proactively changing its business strategy to respond to declining housing and market conditions. Changes included tightening credit standards, eliminating purchasing and originating subprime mortgage loans, and discontinuing underwriting option ARM and stated income loans. Management reduced loans originated for sale and transferred held for sale loans to the held for investment portfolio. WMB was focusing on shrinking its balance sheet and developing a retail strategy through its branch operations.

- *Reduction of Overhead Expenses* - In December 2007, WMB announced the resizing of its Home Loans business including the elimination of approximately 2,600 employee positions, closure of approximately 190 home loan centers and sales offices, and closure of nine loan processing and call centers.

- *Maintaining Capital* - In late 2006 and 2007, WMB began to build its capital level through asset shrinkage and the sale of lower-yielding assets. In April 2008, WMI received $7.0 billion of new capital from the issuance of common stock. Since December 2007, WMI infused $6.5 billion into WMB. WMB met the well-capitalized standards through the date of receivership.

- *Operating Losses* - WMB recorded a net loss of $6.1 billion for the three quarters ended June 30, 2008. In the second quarter of 2008, WMB management disclosed that the Bank's credit quality had deteriorated and it might incur up to $19 billion in losses on its single-family residential mortgage portfolio. WMB increased its loan loss provisioning in response to the deteriorating housing market. Loan loss provisions increased from $1.6 billion in the fourth quarter of 2007, to $3.6 billion in the first quarter of 2008 and $6.0 billion in the second quarter of 2008.

- *Deposit Outflows* – Since July 2008, the pressure on WMB increased market conditions continued to worsen. Significant deposit outflows began on September 15, 2008. During the next eight business days, WMB deposit outflows totaled $16.7 billion, shortening the time available to augment capital, improve liquidity, or find an equity partner. Given the Bank's limited sources of funds and significant deposit outflows, it was highly likely to be unable to pay its obligations and meet its operating liquidity needs.

- *Receivership* - With insufficient liquidity to meet its obligations, WMB was in an unsafe and unsound condition to transact business. OTS placed WMB into receivership on September 25, 2008. WMB was acquired today by JPMorgan Chase. The change will have no impact on the bank's depositors or other customers. Business will proceed uninterrupted and bank branches will open on Friday morning as usual.

OTS Enforcement Actions

- October 17, 2007 – Issued a Cease and Desist Order related to deficiencies in Bank Secrecy Act/Anti-Money Laundering (BSA/AML) programs
- October 17, 2007 – Assessed Civil Money Penalties (CMPs) related to violation of flood insurance regulations
- November 14, 2007 – Initiated a formal examination of the appraisal process to assess the validity of a complaint filed by the New York Attorney General's (NYAG) Office
- February 27, 2008 – Issued overall composite ratings downgrade and received a Board resolution in response to the supervisory action
- June 30, 2008 – Issued Memorandums of Understanding to WMI and WMB
- September 19, 2008 – Issued overall composite ratings downgrade

OTS Profile
Established - 1989
Thrift institutions supervised as of June 30, 2008 - 829
Thrift industry assets supervised as of June 30, 2008 - $1.51 trillion
OTS employees - 1,055
Washington Mutual Bank assessment revenue – 12.2 percent of 2008 OTS budget

Business Publications

0 Comments

Washington Mutual to Acquire PNC's Residential Mortgage Business

Business Wire, Oct 2, 2000

Business Editors

SEATTLE--(BUSINESS WIRE)--Oct. 2, 2000

Transaction to Make Washington Mutual Nation's Third Largest

Mortgage Originator and Fourth-Largest Servicer of Home Mortgages

In a major step that expands its home loan origination and servicing business nationally, Washington Mutual (NYSE:WM) today announced the signing of a definitive agreement to acquire the residential mortgage business of the PNC Financial Services Group for approximately $605 million in cash subject to customary closing adjustments. The acquisition further diversifies Washington Mutual's mortgage operation geographically and enhances the company's already strong position in the home loan business, making it the country's third-largest mortgage originator and fourth-largest servicer of residential mortgages, based on data for the first half of 2000.

Under the terms of the agreement, Washington Mutual will pay a premium of $212 million over the agreed-upon fair-market value of PNC's equity, which was $393 million at June 30, 2000. The purchase price represents a multiple of approximately 9.4 times the adjusted net income for the PNC Financial Services Group's residential mortgage business for the 12 months ending June 30, 2000. The mortgage servicing rights being acquired are valued at 2.27 percent of the $85 billion mortgage servicing portfolio of PNC.

As a result of the transaction, which will be accounted for as a purchase, Washington Mutual expects to record total intangible assets or "goodwill" of $249 million, which includes $37

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million of acquisition-related expenses. The vast majority of this goodwill is tax deductible. The acquisition is expected to be accretive to both cash and reported earnings per share by 2002.

With the completion of this transaction - - and the recently announced agreement to acquire Bank United of Texas - - Washington Mutual would manage a mortgage servicing portfolio of approximately $291 billion, based on June 30, 2000 data. In addition, PNC's significant fixed-rate origination capacity will complement Washington Mutual's adjustable-rate mortgage focus. Over the past three years, PNC's mortgage originations have averaged $20.0 billion. Washington Mutual generated mortgage originations totaling $39.4 billion for the 12 months ended June 30, 2000.

"In one move, we have greatly accelerated Washington Mutual's progress in achieving one of its key business initiatives: combining the strengths of a portfolio lender and mortgage banker to enhance our capacity to originate loans throughout the entire interest-rate cycle and to do so through a broad national footprint," said Kerry Killinger, Washington Mutual's chairman, president and CEO.

"PNC Mortgage is a terrific match for our company in a business that will increasingly require just this sort of scale, breadth and flexibility to deliver shareholder value in the future."

The transaction will not only complement Washington Mutual's already substantial penetration in its key markets in the West, but will offer Washington Mutual significantly broader distribution in highly attractive Midwestern and Northeastern markets. Based on originations for the first half of 2000, the combined entity would hold the No. 1 mortgage-market-share position in the states of California, Connecticut, Illinois, Massachusetts, Oregon, Pennsylvania and Washington. The combined entity would also possess a top-five-market-share position in the nation's five largest mortgage origination states: California, Florida, Illinois, New York and Texas.

PNC announced its plans to explore a potential sale of its residential mortgage business in July, citing the significant capital investment that would be needed to meet the accelerating scale requirements of the business.

"Washington Mutual provides the scale that will be required to compete effectively in the mortgage business of the future," said James E. Rohr, president and chief executive officer of The PNC Financial Services Group. "We will continue to deliver a full line of residential mortgage products to PNC's customers through an agreement with Washington Mutual, and are committed to working with them to maintain the high level of service that PNC's customers expect from us."

Killinger added that PNC's fixed-rate origination capacity should enhance Washington Mutual's ability to generate additional fee income from gain-on-sale and loan servicing activities. In addition, the transaction adds a mature correspondent business that complements Washington Mutual's retail and wholesale brokerage distribution channels. It also further broadens Washington Mutual's capabilities with the addition of a private mortgage conduit business that includes a master-servicing portfolio of approximately $36 billion.

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"PNC Mortgage not only enhances our competitive position in the marketplace, it enables us to build upon an already strong foundation of scale, efficiency and premier service," Killinger concluded.

Washington Mutual said that it plans to undertake a comprehensive review of the combined operations to determine the optimal combination of sales, service and administrative resources, with resulting cost synergies ranging from $60-65 million.

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STRAT. + Comm NPV

Washington Mutual

MEMORANDUM

DATE: June 1, 2004
TO: Board of Directors
FROM: Kerry Killinger
RE: Strategic Direction

INTRODUCTION

2004 marks the fifth year of the current five-year plan. In 1999, we developed a plan to increase shareholder value by growing a national consumer banking and mortgage lending franchise. Five years ago, we had just over 1,000 financial centers (predominantly located in the Pacific Northwest and California), with total deposits of $81 billion, consumer loans of $8.5 billion and annual mortgage originations of $40 billion. By the end of 2004, we will have about 1,948 financial centers, $165 billion of deposits, $40 billion of consumer loans and annual mortgage originations of approximately $224 billion.

In this five-year plan, we set out several financial targets. The most important targets included achieving an average ROE of 20% and an EPS growth rate of 13%. Secondary targets included maintaining a NPA ratio of less than 1%, maintaining a tangible common equity ratio of at least 5%, and achieving a 45% operating efficiency ratio.

Financial performance over the five-year period is expected to modestly under-perform the long-term financial targets. Prior to revisions in our 2004 Financial Plan for recent increases in interest rates, both ROE and EPS growth exceeded target. However with revisions based on a 4.75% 10-year Treasury yield in 2004 (versus 4.00% in the Plan), EPS growth over the five-year period is expected to reach 11% and ROE will average close to 20%. Over this five-year period, it is expected that the NPA ratio will have averaged 0.8%, the tangible common equity will have averaged 5.12% of assets, and the operating efficiency ratio will have averaged 52%. It should be noted that we did achieve our 45% efficiency ratio target for several quarters during the period.

Reflecting back over the past five years, there were several notable strategic successes for our retail banking group. The acquisitions of Dime Savings and Bank United helped expand our consumer banking franchise. We also had successful de novo market entries into Las Vegas, Phoenix, Atlanta, Denver, and Chicago. Our award-winning advertising drove in net customer growth of close to three million banking households. We introduced the Occasio store designs and opened nearly 500 new stores. Our brand position and name recognition grew throughout the nation.

We were also successful in expanding our home lending franchise. The acquisitions of PNC Mortgage, Fleet Mortgage, Home Side Lending, and North American Mortgage were augmented with de novo growth. Our national market share of mortgage originations and servicing increased from about 3% in 1999 to close to 10% in the first quarter of this year.

#1.5bil investment 01 - 600 02 $1.[illegible]bil 03 - $1.3bil.

Finally, we expanded our multi-family lending business, becoming the national market leader, with a market share exceeding 10% in all of our West Coast markets.

On the challenge front, we experienced ongoing regulatory, compliance, and technology issues. These were primarily centered in our home lending business and were caused by rapid growth, attempts to develop cutting edge technology solutions, and a series of refinancing booms which delayed our ability to complete the acquisition integrations. We also needed to develop the capacity to manage complex MSR and pipeline hedging. And we needed to replace some management personnel and bring in several new executives to help manage a much more complex company.

Overall, shareholders did very well over this five-year period. The share price increased from $17.06 (split adjusted) on December 31, 1999 to $ 43.90 per share on May 31, 2004. This increase, combined with increasing cash dividends, provided a total compounded annual return of 28% per year versus -6% for the S&P 500 over the same period.

Our overall assessment is that shareholders and other constituencies benefited from the successful execution of this five-year plan.

NEW FIVE-YEAR PLAN

Following is a broad framework for a new five-year strategic plan. As always, we will adjust the plan for significant changes in the financial environment and new opportunities and threats that inevitably occur over a five-year period.

We believe that successful execution of this plan has the potential to create significant value for our shareholders. We also believe that the risks inherent in the plan are reasonable and can be appropriately managed.

Mission

WaMu is better positioned than any company in America to build a nationwide network of stores serving every day, average consumers with attractively priced financial services. We take care of these customer's needs for checking, savings, investments, insurance, home loans, home equity loans, credit cards and small business needs. The market is huge and we have a head start over competitors who have traditionally had difficulty effectively serving this customer base. Our keys to success are focus, driving world class efficiency, maintaining a friendly service culture and crisp execution.

strengths?

Test: 1) doing few things
2) World class Efficiency
3) friendly service
4) Execution - quick turn times

Accordingly, our mission is to create one of the nation's leading retailers of financial services to consumers and small businesses. By providing products and services which offer great value and friendly service, by attracting and retaining the best and brightest employees in our industry, and by helping our communities prosper, we will achieve our mission and, thereby, create significant long-term value for our shareholders. We will pursue our corporate mission by adhering to our corporate values of integrity, respect, teamwork, innovation, and excellence.

Long-Term Financial Targets

Our primary financial targets for the next five years will be to achieve an average ROE of at least 18% and average EPS growth of at least 13%. We believe achievement of these targets will likely result in above-average performance and could place us in the top one-third of financial industry competitors. For a perspective, median ROE and EPS growth for the S & P Financial Index was 15% and 10%, respectively, over the past five years ('98 – '03). The preliminary 2005-2009 plan suggests average ROE and earnings per share growth meeting these targets, although 2005 is expected to be another difficult year. Both 2004 and 2005 are severely impacted by the sharply higher interest rate environment and its effect on the mortgage business.

Q, 20.8 to 28%

It should be noted that purchase accounting and the creation of goodwill on the Dime acquisition reduced ROE by about 3%. This, along with our expectation of higher interest rates caused us to revise our long-term ROE target to 18%. It is also noted that long-term earnings growth is the key to creating shareholder value. As has been the pattern in the past, we anticipate a certain amount of year-to-year earnings volatility driven by changes in interest rates and other non-controllable factors. As Exhibit A illustrates, even with our forecasted 2004 results, the current five-year period's volatility is significantly lower than that of the prior five-year period.

Very illustrative - Around 13% Growth Target

Secondary financial targets include achieving an operating efficiency ratio of 45% by 2009, maintaining a tangible equity ratio of at least 5% and maintaining average annual net charge offs of 0.25% over the period.

In summary, despite our greatly increased size and a relatively low inflation environment, we are maintaining a robust average earnings growth target over the five-year planning period.

WaMu in 2009

— WSA [illegible]

Before digging into the details, let's visualize the size and scale of Washington Mutual at the end of 2009. We hope to see assets grow by at least 10% per year, reaching about $500 billion in 2009. We see this annual asset growth being funded about 50% by deposits and 50% by collateralized borrowings such as FHLB advances and repurchase agreements. We will strive to keep annual asset and deposit growth to plus or minus 5% around the 10% growth target (5% to 15% asset growth range).

We assume, as a rough approximation, that capital will be deployed 40% through cash dividends, 10% through share repurchase and 50% through retention to support balance sheet growth. Our basic plan assumes neither acquisitions nor the raising of additional capital.

We expect our balance sheet growth to be driven by 1) consumer loans, 2) multi-family loans, 3) residential non-prime, and 4) adjustable rate mortgage loans. Because percentage growth in consumer, multi-family, and residential non-prime loans will be especially strong, we expect to slightly increase the percentage of our balance sheet made up of these higher yielding loans.

per Store TT
590 st. TT.
375 new

We expect to increase our financial center store system by at least 250 stores per year, reaching close to 3,100 stores by 2009. We believe that continued new store growth is critical to our ability to meet our financial targets and build long-term franchise value. We will focus our new store growth in existing markets and may open in two or three new urban markets over that five-year period. Excluding any stores we may close in non-footprint markets, our home loan center system will expand by about 25 locations annually over the next five years, and we should end 2009 with approximately 500 stores concentrated in markets where we have banking stores. We will more closely align home loan centers and financial centers in 2005 and beyond which may affect the projected growth number for home loan centers over the next five years. Combining all stores, we expect to increase our store total from 2,400 by the end of this year to about 3,600 by 2009.

As indicated with our financial targets, our goal is to increase EPS by at least 13% per year on average. Based on our five-year financial forecast, we hope to achieve absolute earnings of about $7 billion and EPS of just over $8.00 in 2009. This translates into average EPS growth of 18% over the period off of our depressed 2004 starting point.

Assuming a $40 per share stock price at year end 2004, a 40% cash dividend payout over the five-year period, and the successful attainment of our growth forecast, total shareholder return over this period could reach 19% per year if our stock sells at ten times earnings in 2009. While our business model, which will continue to include cyclical mortgage banking components, may continue to produce a below average price/earnings multiple, some expansion could occur if we bring down our cost base and demonstrate best-in-class execution over the next five years. Expansion of the price/earnings multiple to 12 would result in a 23% annual total shareholder return. We believe returns in this range will compare very favorably to the S&P 500 and most financial services companies.

In a consolidating industry, it is appropriate to continually assess if shareholder value creation is best achieved by selling for a short-term change of control premium or to continue to build long-term value as an independent company. We believe remaining an independent company is appropriate at this time because of the substantial growth opportunities we see ahead. We are especially encouraged with growth prospects for our consumer banking group. We would also note that our stock is currently trading at a price which we believe is substantially below the intrinsic value of our unique franchise. This makes it even more important to stay focused on building long-term shareholder value, diligently protecting our shareholders from inadequate unsolicited takeover proposals and maintaining our long held position of remaining an independent company. comments from investors

Retail Banking Strategy

Our strategy over the next five years is to more fully penetrate our existing markets through the opening of at least 250 new retail banking stores per year and to improve the cross sales of products to all of our customers. We believe market demand is sufficient to support the new store growth. The states in which we operate are some of the most populated and fast growing states in the country. While we may wish to enter two or three additional markets over the next five years, our existing footprint states appear to provide plenty of growth opportunities for Washington Mutual. Attached in Exhibit B is a summary of current and projected market shares for key products and services. You will note that, given our 2.7% assumption for average growth in the bank deposit market, we need to achieve increased market share in deposits and consumer loans in order to meet our asset and deposit growth targets. By 2009, we need to increase our share of deposits from 4.5% to 5.8%, and our share of consumer loans (Home Equity 2nds) from 5.6% to 7.3% in our current and planned footprint states. We believe these growth targets are aggressive, but attainable if the overall deposit and consumer loan markets continue to grow at reasonable rates.

The summary operating tactics required to achieve our overall strategy for our Consumer Banking Group over the five-year period include the following:

- We will continue our program to open at least 250 new banking stores per year over the next five years.
- We will initially seek to drive in about $13 billion of deposit growth per year, rising to about $18 billion per year by the end of the five-year plan. We expect retail deposits will contribute about 4/5 of the deposit growth on average, with the balance coming from wholesale deposits. Deposit distribution will be primarily through the financial centers, but augmented by wholesale deposit taking, Internet, and call center sales. Emphasize internet
- We will continue to lead with our Free Checking and Platinum accounts. Our goal is to drive in at least 750,000 net new accounts per year.
- We will continue to focus on our cross selling efforts with a goal of increasing our products and services cross sales ratio from the current 5.7 to 7.0.
- We expect consumer lending to continue to show high growth over this period, averaging at least 15% per year. The key product will be home equity loans and we expect that portfolio to grow by approximately $10 billion per year.
- We plan to aggressively promote Free Checking for small businesses throughout this period. Our recent national launch of this product has been successful and we look to add net growth in total business checking of about 240,000 accounts per year.
- how work? We will focus our distribution of insurance and securities products through a force of licensed bank personnel. By 2009, we expect to have 1,500 licensed bank personnel selling these products, up from only 75 today.
- We intend to maintain limited distribution of insurance and securities products through Series 7 licensed financial consultants. We have not been particularly successful in leveraging this distribution force over the years and have achieved mixed financial results. However, these services are important for maintaining overall relationships with our wealthier customers.
- We are examining strategic alternatives for our mutual fund complex. Our fund complex has had good performance and grown over the past few years, but at around $20 billion of assets under management, it is a small player in the mutual fund industry. We also face management succession issues in our investment management company. Finally, we will continue to carefully monitor changing regulatory and enforcement actions in the mutual fund industry.

- We intend to launch a WaMu credit card product in 2005. Marketing will be focused on existing WaMu customers. We will carefully manage credit and anticipate balances increasing to about $2.3 billion at the end of the five-year planning period.

Mortgage Banking

Over the past five years, we worked to create scale and a leading market position. Through a series of acquisitions, we created a very broad-based mortgage banking operation serving all channels of delivery (retail, wholesale, correspondent, Internet, call centers, affinity groups and financial centers), with a broad set of products over a wide geography. While this strategy helped us claim leading market share, it also ballooned our cost structure and limited our ability to focus on value-added activities. The inherent cyclicality and rapid shifts in market size and competition which characterize the mortgage banking business also added enormous volatility to our earnings, due to MSR management, the variability in the amount of gains on mortgage sales, and the difficulty in managing the business to match expenses with falling revenues during periods of rising interest rates.

As our 2004 and 2005 projections demonstrate, our business has embedded volatility driven by the effects of interest rate cycles on mortgage banking earnings and the inherently high volatility of some key parts of the mortgage banking business model, such as MSRs. This is in contrast to the relative stability we experience in our retail banking and commercial businesses. Although we are taking further actions to reduce volatility in our mortgage business, we have concluded that we cannot eliminate all of the volatility in our business without hurting the fundamental profitability of the company. The inescapable fact is that there is volatility in the mortgage banking business and investors need to understand that our earnings can be volatile at certain points in the cycle and that short-term volatility is not a reflection on operating performance, but an expected part of our business strategy. We intend to clearly communicate this to the investment community.

That doesn't mean we're "giving up" on reducing the volatility in the mortgage banking business by any means. We are working right now on plans to "right size" the interest rate driven variability of our mortgage banking model to find that "sweet spot" that creates the mixture of net income and volatility that delivers the highest total shareholder return to our investors over the period.

Over the next five years, we believe it is appropriate for us to narrow our focus in the mortgage area and take advantage of our unique strengths rather than trying to spread ourselves too thin. In other words, our strategy is shifting from being a national market share leader to a focused national mortgage lender emphasizing areas of strategic advantages.

We believe we have several key strategic advantages:

- Because of our balance sheet size, we can portfolio more loans than most major competitors.
- By bringing the management of the consumer banking and mortgage banking operations together and integrating parts of the organization, we have a good chance of cracking the code of cross sales to mortgage customers.

- By focusing our retail mortgage activities in footprint states (those states where we have a retail banking franchise), we will be able to leverage the WaMu brand and marketing spend and focus on customers with a high propensity to purchase our products.
- Our retail home loans sales force is one of the most productive in the industry.
- We have a robust data base which should allow us to use customer data to improve credit decisioning and MSR prepayment management.
- We have good experience in managing non-prime residential loans.

Due to these advantages, we will refine our mortgage strategy to focus on retail mortgage origination in our footprint states. Wholesale and correspondent will be nationwide and retooled to deliver higher margin products. Instead of maximizing national market share, our goal will be to maximize *profitable* market share in footprint states. We do not have market share as a goal, but we do expect our share of market in footprint states to gradually increase from 10.8% in 2004.

- We view the retail and wholesale origination channels to be the key to building a sustainable home lending franchise. Correspondent lending, on the other hand, has little franchise value and should be utilized on an opportunistic basis to originate higher margin products or during those parts of the cycle when we want to acquire MSR assets.
- While we hope to improve the economics of mortgage servicing rights by increasing cross sales to those customers, there is little evidence to suggest that we can do this effectively in geographic areas other than where we have a retail banking presence. As such, we will focus on maximizing our servicing market share in those footprint states in which we have a retail banking presence.
- Our goal over the next five years is to increase the cross sell ratio of mortgage customers from 2.86 relationships (excluding Long Beach Mortgage & Specialty Mortgage Finance) to 3.6. Key products for sale to mortgage customers include home equity loans and checking accounts.
- We must significantly reduce the cost of originating mortgages by adopting automated underwriting and other loan fulfillment processes. Our multiple origination platforms have led to very poor efficiency. Our goal is to increase automated underwriting to 80% or more, which we expect to have a positive affect on the cost of origination. The prime residential mortgage business has very thin margins and it is essential to become a low cost originator. We have a long way to go in becoming an industry leader in efficiency.
- Our mortgage servicing portfolio is approximately $723 billion. While our servicing portfolio will probably increase gradually, we anticipate that a growing percentage of the serviced loans will be portfolio loans versus loans serviced for others. It is also critical that we become an industry leader in loan servicing efficiency. Due to maintaining two servicing systems we are currently incurring above-average servicing costs. Our goal is to decrease the cost of servicing a loan from today's $106 to $80 by 2009. Our conversion to a common servicing system in the middle of 2004 will aid in this effort and additional operational excellence initiatives will be required.
- MSR assets provide modest returns (averaging about 9-13% ROE over the cycle) and extraordinary volatility. MSRs are highly sensitive to minor changes in interest rates and technical market factors, and despite the best efforts of our Treasury team, never perfectly match up to hedge performance. The accounting for these assets exacerbates their effect on reported earnings. The result is quarterly and annual earnings volatility

which investors (and management) find troublesome. In addition, high levels of MSR assets as a percentage of capital cause rating agency and regulatory concerns. We are actively pursuing a number of potential methods for gradually reducing our exposure to MSRs, including selling off IO tranches, decreasing core servicing fees, decreasing excess servicing fees and selling off non-strategic loan servicing (in non-footprint states). Our goal is to reduce MSR balances to a level that produces acceptable levels of quarterly and annual volatility without reducing net income excessively.

Multi-Family Lending

Our strategy is to be the nation's dominant multi-family lender. We pioneered the development of low-cost, highly efficient and standardized underwriting, processing, and servicing for small multi-family loans in select urban markets. These capabilities catapulted us into the No. 1 position in the industry. We intend to leverage our leadership position in key markets in footprint states by originating both adjustable-rate and fixed-rate multifamily products. We will generally retain adjustable rate products in our portfolio and sell the fixed-rate products to the secondary markets. We expect our strategic partnership with Fannie Mae to significantly increase the origination of adjustable rate multi-family loans over the next five years. We anticipate annual portfolio growth of about $6 billion over this period. - whole comml area

issue - limits w/ Larger borrowers

Non-Prime Residential Mortgages

Our non-prime residential activities currently include originations through Long Beach Mortgage, our purchased portfolio of non-prime residential loans (SMF portfolio), and loans originated through our home loans group. Loans of this type held in our portfolio currently total approximately $60 billion. Our SMF and Long Beach activities have provided excellent risk-adjusted returns over the past several years, consistently exceeding our 20% return thresholds. However, the bulk of our non-prime loans have been originated through the home loans channel with uniform pricing and terms that did not reflect their true risk profile. opportunity for improvement

Through Long Beach Mortgage, our origination market share of non-prime residential mortgages is currently around 4%. Long Beach has focused its past distribution through the wholesale channel. Over the next five years, we will seek to carefully increase our national origination market share of non-prime mortgages. To accomplish this, we will need to develop a retail distribution to complement the existing wholesale distribution, focused primarily in our footprint states. We may also leverage the Bank's financial center system to distribute some non-prime residential mortgages.

Over time, we plan to increase the percentage of non-prime residential loans originated by Long Beach which are held in portfolio. To maximize this flexibility, we may seek to make Long Beach a subsidiary of our federal association.

We believe there is a good opportunity to expand the origination of non-prime residential first and second mortgages through both our consumer banking and home loan stores. Automated underwriting tools and risk-based pricing should help us increase the returns on non-prime loans originated through these channels. Because of the growing importance of non-prime lending, we are in the process of developing a comprehensive non-prime lending policy for the entire complex.

Industry Leading Efficiency

To achieve our financial targets, it is essential that we become best-in-class operators in each of our businesses. We have significant work to do to accomplish this objective. While we made good progress in improving our efficiency ratios in 2000 and 2001, the last couple of years were challenging because of mortgage banking acquisitions and a rapid escalation in corporate support activities. It is imperative that we complete those acquisition integrations and focus on bringing best-in-class efficiencies in all areas of the organization.

As a general rule, we will seek to achieve 5% productivity improvements in all areas of the organization each year over the next five years. Our overall plan is to grow our asset base and revenues by approximately 10% per year while limiting our expense growth to about 5%. While these are very ambitious goals (over the past five years the top ten banks have produced productivity gains that averaged 0.7%), our efficiency ratio is currently higher than almost all of our peer banks so we believe that there is significant opportunity for us to produce productivity gains for an extended period.

We intend to migrate the excellent work which has been done in attacking the $1 billion in cost savings into an ongoing commitment to improving productivity. We have the key tools in place with Operational Excellence and will charge the Operating Forum (group of senior leaders headed by Craig Chapman) with driving consistent oversight of productivity improvements. It is important that we establish best-in-class benchmarks for efficiency for each business unit and corporate support group and to drive efficiency improvements on a comprehensive, company-wide basis. This will be a multi-year effort of historic proportions, and will require fundamental shifts in the company's processes, organizational structure and culture. The dislocations will be severe and many of our employees will be unhappy with this shift and resistant to necessary change. We will focus on open and regular communication with our employees to help them see that this approach to productivity is necessary for the success and independence of the company and not a passing "fad."

Our long-term target is to improve the operating efficiency ratio to 45% from the current level of about 60%. As we gain traction on productivity enhancements, it is possible we can reduce the efficiency ratio even further. As an aside, the efficiency ratio is volatile because of changing revenue sources, such as margin and gains on sale. Accordingly, we will also target improving the ratio of operating expenses to average assets from today's 2.8% to 2.2% by 2009.

Diversification

We have been engaged for some time in a discussion internally and with you about the benefits and costs of further diversification of our business lines, balance sheet and income statement. The more deeply we have looked into this question, the more we have come to the conclusion that our current business model is likely to deliver higher total shareholder returns over the next five years than any more diversified model that could be reasonably achieved by our company over that period. This is a function both of our confidence that a combination of balance sheet growth, management focus and high productivity can drive very strong earnings for the company in its current configuration and of our conclusion that any effort at business line diversification over the next five years, whether organic or based on acquisitions, would be unlikely to materially change our risk/return profile or price/earnings multiple, given our enormous size and the predominance of mortgage-related assets on our balance sheet.

So over the next five years our watchwords will be "narrow and focused" rather than "broad and diversified." We will put all our efforts into ~~our core~~ businesses of 1) retail banking for the broad middle market, including consumer and small business deposits and consumer lending; 2) mortgage banking, with a concentration on our ~~retail footprint and the generation~~ of assets for our balance sheet; 3) and the commercial group's growing multifamily, commercial real estate and non-prime mortgage lending lines.

As I mentioned earlier, this does mean that we will be willing to accept some more of the earnings volatility inherent in our mortgage-driven business model than we might experience if we were a more "fully" diversified commercial bank. On the other hand, we will not be exposed to some of the risks taken by diversified companies. One only needs to look at the financial and reputational penalties being paid by money-center banks for some of their diversified activities to see that diversification itself brings risks. Focus also means that our management team and employee base can concentrate on innovative approaches to the businesses they know best and put all their energies into the task that will have the greatest impact of all on our five-year shareholder return and our longer-term financial and competitive success —creating a best-in-class culture of productivity and efficiency.

Enterprise Risk Management

Over the past couple of years, we have greatly improved the overall measurement and management of our enterprise risk management. With the expected implementation of the Basel II requirements, effective measurement and management of enterprise risk become even more important.

For Washington Mutual, we expect our key risks to continue to center on interest rate risk and credit risk. As we balance these risks, we intend to generally take on less interest rate risk (by reducing exposure to the MSR asset) and more credit risk (with more home equity, Alt A and non-prime residential loans) over the next five years. Regarding credit risk, we are targeting a 0.25% average annual charge-off. Based on long-term historical averages and our projected change in asset mix, the worst-case and best-case charge-off ratios we could expect to encounter at any point during the five-year plan should run from a maximum of 0.60% to a minimum of 0.15%. It is noted that charge-offs in the past couple of years have averaged only 0.10% (excluding WM Finance). Our goal over the next five years is **not** to minimize credit risk but to achieve annual credit charges within the targeted range and to average 0.25%. We plan to gradually increase our risk exposure to the targeted levels. This will entail gradual increases in home equity, Alt A, non-prime residential and multi-family lending portfolios.

We will maintain appropriate loan loss reserves relative to the anticipated credit charges. Based on probable loan portfolios, we will likely maintain loan loss reserves of about three to four times expected annual charge-offs.

Regarding interest rate risk management, we will continue to experience margin variations because of the re-pricing lag of our adjustable rate mortgage assets when interest rates change. Our targeted net interest margin over the five-year period is 3%, and we expect the range of the margin to be 2.8% to 3.2% in a normal, upwardly-sloping yield curve. A dramatic flattening of the yield curve would push the margin below 2.8%; however, the cost of reducing interest rate risk beyond this amount is prohibitively expensive and not recommended.

We also encounter significant interest rate risk with the management of MSRs. Because this asset must be continuously marked to market, it can fluctuate in value by over $1 billion in a short period of time. Much of this fluctuation can be hedged, but there is no such thing as a perfect hedge. Accordingly, the best risk mitigation strategy may be to simply limit the size of the asset. We are analyzing what MSR balance will deliver the optimal level of earnings and lower volatility; as a placeholder we believe a target for net MSR to tangible equity of 25% - 35% may be reasonable. In comparison, Wells Fargo's net MSR was equal to 25.1% of tangible equity and Countrywide's was equal to 72.9% at the end of March.

Other keys risks for the organization are reputation and operational risk. We believe the execution of the new five-year plan will reduce both of these risks from what was incurred with the rapid expansion of the past five years. By focusing on our core businesses and operating predominantly in our footprint states, we should be in an improved position to assess and manage these risks.

Technology

We will need to continue to invest heavily in technology. To achieve our desired 5% per year improvement in productivity, we will need continuous improvements in all of our key operating systems. We do not plan to develop any leading-edge technology, but will rely primarily on large, stable platforms. We expect our core banking deposit system to support our growth over the next five years.

We do anticipate making significant investments in front-end and middleware systems that will allow us to better connect all of our legacy systems at point-of-sale and other customer interaction points.

Lessons learned from the past five years are that we will insist on all acquisitions being fully integrated into the complex within a few months or deliberately left to operate separately on a permanent basis; that we will not develop any cutting-edge new technology platforms; that we will improve the documentation and change management processes for all new systems and applications; and that we will closely monitor the total capital expenditures through corporate prioritization processes.

Acquisitions and Divestitures

The financial services industry continues to go through significant consolidation. Most financial services companies have limited opportunities to grow revenues and, thus, are looking for cost savings initiatives to help fuel earnings growth. Acquisitions are an obvious way to achieve cost efficiencies. For Washington Mutual, we believe we can meet our financial targets without making any acquisitions as long as we achieve our annual productivity improvement targets. As such, we will review acquisitions on an opportunistic basis, but do not feel compelled to acquire.

Priorities for acquisitions include branch delivery systems (which would aid in growing our consumer bank), multi-family originators and non-prime origination businesses. At present, our relatively low price/earnings multiple makes stock-based acquisitions very challenging from a financial standpoint and large cash transactions put pressure our capital levels. We do not believe that acquisitions are required to expand our product lines as quality products can often be achieved at very attractive economies of scale through other parties. As such, we do not feel compelled to acquire credit card or insurance companies for access to these products.

Regarding divestitures, businesses which are not viewed as core currently include homebuilder finance, commercial banking and mutual fund management. In assessing these businesses, we will review return on common equity, earnings growth potential, management distraction, new capital requirements, and possible sales prices.

Key Challenges

Following are the key challenges we will face in executing our strategic plan:

Competition will be intense in all business lines. In retail banking, Wells Fargo, Wachovia, and Bank of America are expected to be keen competitors. They are all currently focused on the consumer market, have improved their operating efficiencies, and have greatly improved customer service. We do expect this competition to make it more difficult to achieve the same new customer growth that we experienced during the past five years. However, we continue to believe that our value propositions will result in achieving our growth targets.

In the mortgage banking business, top competitors are Countrywide, Wells Fargo, and, to a lesser degree, Chase, Citigroup, and Bank of America. Countrywide is arguably the strongest competitor at this time because of system stability, strong profitability, excellent risk management and aggressive growth plans. Countrywide has publicly stated its desire to increase national market share from 10% to 30% over the next five years. Rather than competing with them everywhere in the country, we believe we will be best served by focusing on our footprint states and with portfolio products which emphasize our much stronger balance sheet.

In the multi-family lending area, our primary competitors are smaller independent banks around the country. Only Citigroup and ABN AMRO-LaSalle among the larger banks have any significant share. Another potential competitor in this space over the next five years could be Countrywide, which could copy the consumer mortgage-inspired operational and credit model we use. We have a clear head start in achieving excellent efficiency in standardizing the approaches to distributing multi-family loans. We do not see another national competitor at this time impacting our growth.

plans $100 bil to 200 bil
pretax ~~to~~ $2 bil to $6 bil

In the non-prime residential area, key competitors are Ameriquest, Option One, New Century, HSBC/Household, Wells Fargo, and Countrywide. GE Capital recently entered this business through an acquisition and several Wall Street firms are increasing their commitment as well.

Another challenge concerning us is the rapid escalation in **housing prices**. Fueled by improving employment and very low interest rates, housing prices over the past 12 months have increased at unsustainably high levels. We need to carefully watch all key markets around the country, and while we are not alarmed at this point, the possibility of housing price declines is greater than normal. The most probable scenario is for a flattening in housing prices around most parts of the country, but it is possible that higher priced homes will come under pressure in certain communities.

We believe our franchise is capable of very strong asset generation, but **deposit growth** is less certain because of competitive pressures and cyclical factors causing deposits to grow and then stabilize or contract. Our five-year plan assumes 2.7% average industry deposit growth over the next five years and we intend to grow at a rate close to 10%, and therefore will need to increase our share of deposits in order to reach our plan. Even if we attain our deposit growth goals, we will have significant wholesale borrowings through the FHLB and Wall Street sources. While most of these borrowings are collateralized, it is possible that market disruptions or political pressures could impact access to borrowed funds.

Another important challenge is to maintain a **growth orientation** in a post Sarbanes-Oxley environment. Boards and management have simply become much more risk-averse in this new era. Increasing oversight by boards has led management to spend a larger percentage of their time on risk aversion rather than growth initiatives. In Washington Mutual's case, there has been a significant escalation in the resources devoted to enterprise risk management without a corresponding increase in growth initiatives. We believe it is important for the Board and management to consistently balance appropriate risk management with a focus on growing the business. We believe the pendulum has swung a little too far to the side of risk management over the last couple of years. It is important that we all focus on growth initiatives and risk taking. Above average creation of shareholder value requires significant risk taking.

Community Commitment

We will maintain our commitment to returning 2% of pretax profits back to the communities we serve through grants, sponsorships and various programs designed to support our education and affordable housing initiatives. We expect to meet or exceed the $375 billion ten-year commitment we made to support lending in low-to-moderate income neighborhoods.

Preliminary Plan for 2005

Our 2004 financial plan was built on an assumption of a 4.0%, ten-year Treasury yield. This appeared reasonable and even conservative throughout the first three months of the year when interest rates fell to as low as 3.7%. In the second quarter, ten-year interest rates jumped to 4.85% and this will have a huge impact on our 2004 results if rates remain at these levels over the balance of the year.

Higher interest rates are leading to greatly reduced gain on sales of mortgages and pressures on our margins. These tidal wave impacts are overshadowing our efforts to reduce costs and grow other sources of income. We are also facing increased hedging costs for our MSR asset (due to negative convexity) and unusual volatility in MSR hedge performance. Overall, it is shaping up to be one of the most difficult years in many years. We appear to be on plan in managing the things we can control. But the impact of changing interest rates could reduce 2004 earnings per share significantly below our previous target of $4.40, which assumed a 4.0% ten-year Treasury yield. Our current assessment is that earnings per share may come in closer to $3.55 if the ten-year Treasury yield remains at the 4.75% level.

We expect to enter 2005 with mixed momentum. We would expect 2005 earnings per share to increase to about $4.25 with a 4.75% ten-year Treasury yield. On the plus side, we should have excellent asset growth, low credit costs, good non-mortgage-related fee income growth and declining expenses. On the negative side, gains on mortgage loan sales will continue to be low, loan servicing income will be low (because of increased hedging costs) and the margins will still be pressured by increasing interest rates.

In line with our five-year plan, the following are the assumptions we are using in our planning process for 2005. We believe these assumptions are sound and achievable.

- Open 250 new banking stores in existing markets. No new market entries in 2005.
- Increase net checking accounts by at least 750,000.
- Increase banking fee income by 10%.
- Increase deposits by $13 billion.
- Increase consumer loan balances by $10 billion.
- Increase non-prime residential first mortgage portfolio by $3.5 billion.
- Increase multi family loan balances by $6 billion.
- Increase residential mortgage portfolio (primarily option ARMs) by $25 billion.
- Increase securities licensed bank personnel from about 75 to about 1,000.
- Increase assets under management in the WM Group of Funds from $20 billion to $25 billion.
- Open 30 new home loan centers (15 Johnson Development Centers & 15 regular HLCs) not including potential closures.
- Complete the $1 billion cost save initiative.
- Originate $223 billion of residential mortgages (including Long Beach).
- Increase the loan servicing portfolio to about $740 billion, but reduce the MSR asset by an amount sufficient to bring MSR related volatility down to more acceptable levels. Note that net MSR balances will go up in any event if interest rates rise due to mark-to-market.

By executing these priorities, we should be able to battle the higher interest rates and a lower mortgage market and still achieve EPS growth in 2005. Not only will it likely be a difficult operating environment, but a very challenging year due to modest margin compression, reduced gain-on-mortgage sales and the increased costs to hedge the MSR asset. We will strive to reach EPS targets, which will range from around $3.57 if the ten-year Treasury yield averages 5.25% and the yield curve flattens to around $4.77 if the ten-year Treasury yield averages 4.00%.

While the environment could change dramatically with a change in interest rates, we have assumed the following in our planning:

- The mortgage origination market will contract from about $1.9 trillion in 2004 to $1.7 trillion in 2005.
- The economy will perform well, growing at an approximately 4% annual rate.
- Housing will remain solid but prices will be flat, reflecting higher interest rates and a pause after hyper growth in 2003 and 2004.
- Regulators will remain cautious, but generally supportive. We do not anticipate significant changes other than the implementation of Basel II.
- Somehow, we will get through SOX 4044 certifications.
- Accounting policies will remain relatively constant, after a busy year of adopting FAS 133 and changing the accounting for mortgage gains.
- Competition will remain fierce. Large commercial banks will stay focused on the consumer market and the mortgage industry will go through a price war until excess capacity is reduced.

Overall, 2004 and 2005 will be challenging years for WaMu. Despite our efforts to reduce cyclicality, we are still impacted significantly by interest rates and the mortgage market. We believe we are making excellent progress in improving the core franchise and operating efficiencies. But it will take an improved environment for these efficiencies to be reflected in strong earnings. It is also noted that our earnings performance in 2004 and 2005 will likely under-perform major commercial bank's earnings growth. The likely environment of higher interest rates and a strong economy are generally beneficial to commercial banks but negative to mortgage banks. Because of our above-average exposure to declining mortgage banking and little exposure to improving commercial and industrial lending, we will likely produce growth below that of the banking industry.

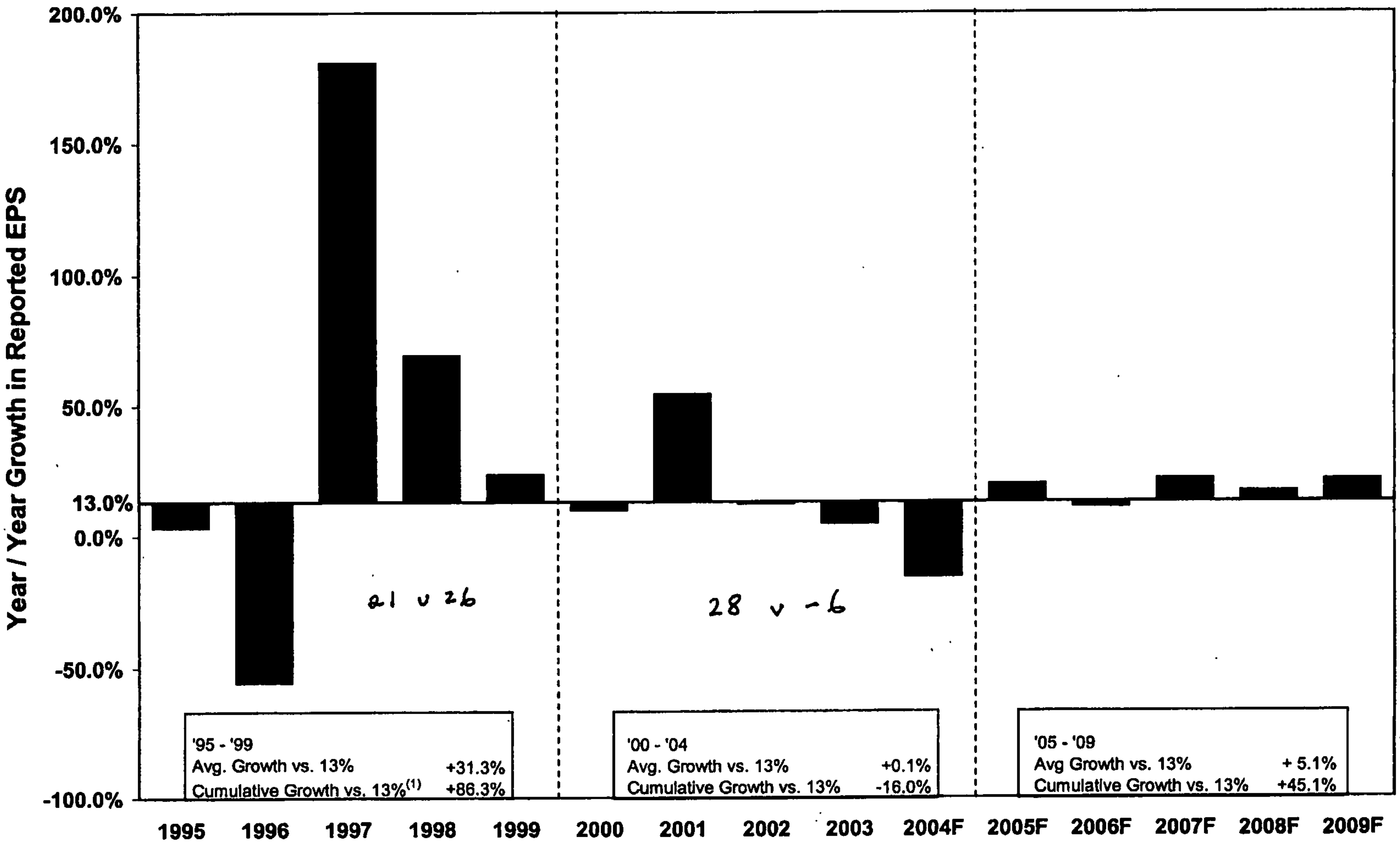
Being out of cycle with major commercial banks is nothing new for Washington Mutual. This is an inevitable outcome of our strategy. In prior periods, we added greatly to shareholder value by repurchasing our stock at depressed levels and re-issuing those shares through acquisitions at higher price levels. We intend to opportunistically repurchase our stock if Wall Street presents us an attractive buying opportunity.

Human Capital

We have the deepest pool of talent in the history of the Company. While there are always opportunities to increase talent, the combination of recruiting in several key executives, plus the maturing of our talent management program, has given us good bench strength in most areas. We do have some near-term concerns with senior management retention. Increasing interest rates reduce expected earnings. Despite terrific efforts to reduce costs and expand revenues, it is possible that our pay programs will produce below-average results. Many of our senior leaders are recognized as top performers in the industry and are being heavily recruited by competitors. We need to maintain competitive pay programs and adjust the plans as appropriate to reflect changing market conditions.

It is also noted that our people have been working extraordinarily hard over a long period of time. Keeping up with rapid growth, the re-fi boom of 2001 and 2002, the 2003 and 2004 cost cutting initiatives and the various compliance requirements have left many people very tired. Add the rumors of a potential sale of the Company with the cost cutting initiatives and the inevitable outcome is more uncertainty and reduced employee morale. We need to come out of the Board strategic planning session with a clear agreement on strategy, a commitment to executing the strategy as an independent company, and a robust communications plan for both internal and external audiences.

Exhibit A
Reported EPS Growth 1995 - 2009



89 - 94 18.4 v 5.4

(1) Cumulative Growth vs. 13% compounded annual EPS growth

(2) 2004 - 2009 is based on the WaMu Long Range Forecast

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June 30, 2004

MEMORANDUM FOR: Lawrence Carter, Examiner-in-Charge

FROM: Zalka A. Ancely, Examiner Z

SUBJECT: Washington Mutual Bank, FA (#08551)
Washington Mutual Bank, FSB (#11905)
Examination as of March 15, 2004

During the examination, memorandums were issued to management presenting Criticisms, Recommendations, and Observations. A summary of the asset quality (and related) memorandum's and management responses are as follows:

Joint Memo #1 - Counterparty Risk Management

- *Violation of Regulation F – Interbank Liabilities:* Criticism that a Regulation F - Interbank Liability Policy has not been annually approved by the Board of Directors as required by regulation. Also, there has been no quarterly monitoring of the capital levels of correspondent banks with significant exposures. Management **agrees** with the criticism. By July 31, 2004 a formal policy will be reviewed and approved by the Board and quarterly monitoring of substantive correspondent bank exposures will begin with 2nd quarter 2004 financial data.
- *Global Review of Counterparty Risk:* Recommendation to perform a global review of counterparty risk throughout the organization, including identifying all counterparties, determining the level of risk and the adequacy of monitoring, and determining if the function should be centralized within Counterparty Risk Credit Management. Management only **partially agrees** with the recommendation. Management agrees to centrally monitor and manage counterparty credit risk throughout the organization. A formal review to identify all substantive counterparty risk elements will be started by July 31, 2004 and a comprehensive policy established and implemented by December 31, 2004. The response is acceptable.
- *Counterparty Risk Policy:* Recommendation to amend the Counterparty Risk Policy to include quarterly report of top 25 counterparty exposures, together with a summary of management's analysis of their credit risk, and to report any material violations of approved limits. Management **agrees** with the recommendation and the policy will be updated by December 31, 2004. Appropriate risk-based reporting will be developed including updated Board disclosure by October 31, 2004.
- *Annual Review of Counterparties:* Recommendation to complete and document annual reviews of approved counterparties using a risk-based approach. Management only **partially agrees** with the recommendation in that the finding indicates there is no effective system to track and report exceptions to the annual review requirements. Management indicates that in April 2004, phase-one of the web-based credit platform was released to house all counterparty credit reviews, related entity information, credit lines, exposures, ratings, and financial information. The new platform has the functionality to track and report review exceptions. Nevertheless, the credit review process will be addressed within the full review and implementation of the revised policy by December 31, 2004. The response is acceptable.
- *Unlimited Exception to Policy Authority For the Chief Credit Risk Officer:* Recommendation to amend the policy to require that all policy exceptions above a certain threshold be reported to an appropriate committee in a

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timely manner. Management **agrees** with the recommendation and exception thresholds and required notification and reporting will be included in the revised policy by December 31, 2004.

- *Excel and Web-Based Credit Exposure Models:* Recommendation to complete the independent validation, parallel testing, and full implementation of these models by December 31, 2004. Management **agrees** with the recommendation. Validation of the credit exposure models will be done by July 31, 2004 and implementation sometime in July/August 2004.

Joint Memo #2 – Credit Scoring SUCCESS Model for Consumer Loan Product

Repeat finding in that three of the four items noted in the prior examination Joint Memo #6 had not been adequately addressed, but Internal Audit had closed the items. The repeat items pertain to inadequate vintage analysis, dual scorecard validation, and portfolio chronology log. Overall credit quality of the home equity loan products remains good, but inadequate scorecard monitoring and validation may have led to some deterioration in quality for recent volume.

- *Vintage Analysis and Dual Score Validation for the SUCCESS Scorecard:* Recommendation to follow up with additional analysis of the deterioration in the ability of the custom score to rank-order risk. Analysis should be followed up to ensure that no changes to score cuts or pricing are necessary. Management only **partially agrees** with the recommendation in that the model is in process of being redeveloped and through-the-door and approved FICO scores and CLTVs have continued to improve and portfolio performance has not shown deterioration. Management will implement an automated centralized credit scoring and portfolio-monitoring package in the Enterprise Modeling and Decision Systems organization under Corporate Credit Risk Management and enhance its vintage MIS reporting during the 2nd quarter of 2004. At the same time, management is moving aggressively forward with the redevelopment of the SUCCESS model with completion scheduled for August 2004. However, the overall targeted completion date is December 31, 2004. The response is acceptable.
- *Portfolio Chronology Log:* Recommendation to enhance the portfolio chronology log. Management **agrees** with the recommendation and set a targeted completion date of July 31, 2004.

Joint Memo #3 – Residential Real Estate Appraisal Operations

- *One-to-Four Residential Appraisal Compliance Review:* Recommendation that USPAP compliance at WAMU is an ongoing issue that needs improvement. Management **agrees** with the recommendation and provided July and August target dates for specific actions, however overall target date is April 1, 2005 (next exam timeline).
- *Standard 3 Technical Review (Report):* Recommendation to update the report used for reviewing residential appraisals to address the current sales history reporting requirements of USPAP and overall appraisal compliance with USPAP. Management only **partially agrees** with the recommendation in that an Appraisal Procedures Bulletin was communicated and distributed to all reviewers to include a three year sales history. While not currently updated, the form will be updated by July 15, 2004. The response is acceptable.
- *Appraisal Assignment/Engagement Request Form:* Recommendation that the owner's estimate of market value should be eliminated from the request form in order to prevent appraiser independence from being compromised. Management only **partially agrees** with the recommendation since it has historically had little significance for appraisers and there is seldom market foundation for the estimate. Nevertheless, target date of August 15, 2004 provided by management to make system enhancement to eliminate the estimate of value from the engagement letter. The response is acceptable.
- *Automated Valuation Model (AVM) and Taxed Assessed Value (TAV):* Observation that AVM and TAV documentation in loan files is minimal, but the information is electronically stored on the OptisValue system. Interagency working group concluded an institution must have a process to validate and test each type of AVM used and its credibility; and, validate and test the TAV process for the validity and accuracy of the results in each county in which it is used. Based on the review at this examination, what WAMU is doing is adequate, but management must continue to validate the AVM/TAV process on a regular basis to ensure the results of the

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process are credible. Management **agrees** with the observation. Plans are to increase AVM audits to quarterly, AVM testing will still be yearly, and TAV audits will occur twice during 2004.

Joint Memo #4 - Commercial Real Estate Appraisal Operations

- *Quality Assurance Report:* Recommendation to ensure that quality assurance reports comply with policy review criteria and review ratings reported for appraisers and reviewers in all production offices, since not all appraisers and production offices were reviewed in the 4th quarter 2003. Management only **partially agrees** with the recommendation in that the current guidelines were not finalized until January 2004 and the Commercial Appraisal Department quality assurance group was not fully staffed in the 4th quarter of 2003. Management established a target date of September 30, 2004 to achieve the required level of reviews. The response is acceptable.
- *Appraisal Engagement Contract (Letter of Engagement):* Recommendation to revise the Appraisal Engagement Contract to include both the intended use of the appraisal and the intended users of the appraisal report. Management **agrees** with the recommendation and set a target date of June 30, 2004.
- *Complete Summary Report (CSR):* Recommendation to revise this report form to include the definition of market value, a more comprehensive scope of work section, and the certification page must include the appraiser's license number, State, and expiration date. Management **agrees** with the recommendation and set a target date of June 30, 2004.
- *Use of an Obsolete Internal Evaluation Form:* Recommendation to ensure the evaluation forms used to estimate market value for SFR interim construction loans comply with TB 55a requirements. Examiners noted isolated use of obsolete form by a single individual at NOC in Dallas. Management **agrees** with the recommendation and a corrective procedures memo was distributed during the exam with no further actions required.
- *Discounted Appraisals and the Calculation of Supervisory LTV Ratios:* Observation that there is an outstanding issue from prior examination concerning requirement to use discounted appraisals for projects involving five or more units for tracking supervisory LTV exceptions. On May 14, 2003, management had formally requested the OTS to adopt guidance to clarify the issue in connection with revolving lines of credit secured by subdivisions with five or more unsold units. Interagency appraisal working group has not provided a response and has extended the estimated completion date to September 30, 2004. **No management response was required.**
- *Multi-family Appraisal – Automating Appraisal Project:* Observation that WAMU has initiated a project to automate part of the multi-family appraisal process. Management must ensure that for federally related transactions, all appraisals shall, at a minimum, conform to USPAP requirements. Management indicated that the project is specifically designed to meet all requirements of USPAP and FIRREA. **No management response was required.**
- *Multi-family Review Sampling Proposal:* Observation that the Commercial Appraisal Department proposes to reduce the level of multi-family appraisal reviews from 100 percent to 25 percent for those prepared by internal staff appraisers in established markets with loan requests of $3 million or less and LTV's of 60 percent or less. Management requested OTS to review and comment on the proposal. OTS voiced no regulatory concern with the proposal as presented. **No management response was required.**
- *Draft – Appraisal Review Guidelines for Commercial Mortgaged-Backed Securities (CMBS) Loans:* Observation that the Commercial Appraisal Department has developed a proposed matrix for administrative, technical, field, and post closing review of appraisals for CMBS loans. Management requested OTS to review and comment on the proposal. OTS voiced no material concerns or objections to the proposed matrix. **No management response was required.**

Joint Memo #5 - Long Beach Mortgage Company Intercompany Line of Credit

- *Overline Documentation:* Recommendation that all out-of-formula situations be documented, documentation should clearly stipulate the reason for noncompliance, how/when cured, and be reported to the CPC. Management only **partially agrees** with the recommendation since overline and out-of-formula are not the same and the loan was never "overline", meaning in excess of committed line of credit. However, management does acknowledge that the loan was out-of-formula four times since the prior examination, but was cured within the

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allowed one-day cure period; therefore, additional reporting and documentation was not deemed necessary. Management agreed to document all out-of-formula situations on the borrowing base certificates and to report these to the CPC if they exceed the allowed one-day cure period. A summary of out-of-formula situations will also be included on the credit requests and annually reported to the CPC. The target date for completion is May 31, 2004. The response is acceptable.

- *Borrowing Base Certificates – Ensuring Data Accuracy:* Recommendation to implement a procedure to review collateral information provided by the Custodian to ensure the information is accurately reflected on the borrowing base certificates. On February 11, 2004 the Custodian had incorrectly included ineligible mortgages in the borrowing base and an out-of-formula situation occurred without management's knowledge. Management **agrees** with the recommendation with a targeted completion date of May 31, 2004.
- *Annual Due Diligence Review:* Recommendation to obtain and review LBMC's policies and procedures on an annual basis to augment the arms-length nature of the affiliated relationship. Management **agrees** with the recommendation and will include the most recent lending and investment policies in the underwriting files by June 30, 2004.
- *Certification of Borrowing Base Certificates:* Recommendation to ensure that all proper signatures are obtained on required documentation. The review found that required individuals do not consistently sign the borrowing base certificates. Management **agrees** with the recommendation and hard signatures by facsimile or courier will be obtained by May 17, 2004. Management will also work with the legal department to establish procedures to allow for electronic submission of borrowing base certificates.

Joint Memo #6 - Middle Market Business Lending Portfolio

- *Monitoring Lending Policy Exceptions:* Criticism that numerous credits were extended with exceptions to underwriting standards and there is no method to monitor the exceptions. Management **agrees** with the criticism. New Credit Standards are being developed and a Credit policy and Credit Standards Exception Report will be developed to track, trend, and report true exceptions. Target date is December 31, 2004.
- *Formal Goals and Objectives:* **Repeat** Recommendation to develop formal written Front-End Guidance for the middle market business lending segment of the bank. Management **agrees** with the recommendation and the targeted date for completion is September 30, 2004.
- *Loan Covenant Compliance Monitoring:* Recommendation to develop a system-wide automated system for monitoring loan covenant compliance to be used by all Commercial Banking Centers (CBCs). Management **agrees** with the recommendation with a targeted date of September 30, 2004 to determine what process or system to be utilized, and March 31, 2005 as a targeted implementation date.
- *Collateral Examination Process:* Recommendation to develop procedures for responding to collateral examination findings and how to resolve any differences should they occur. Management **agrees** with the recommendation and an e-mail will be distributed by June 30, 2004 to reiterate the process and need to follow up by the Regional Manager and Credit Administration to resolve issues.
- *Tracking Reports For Trailing Documents:* Recommendation to develop procedures to ensure all CBC's adhere to internal guidelines established for addressing and clearing exception items that remain outstanding. Management **agrees** with the recommendation and revised procedures are targeted for September 30, 2004 addressing post closing exception items to strengthen management review and ensure resolution.

Joint Memo #7 - Small Business Lending Review

Repeat finding in that management has yet to develop sound credit administration policies for this small business lending segment. Although the consolidated portfolio is quite small at $217 million outstanding and another $221 million committed but unfunded, management is projecting a six-fold increase in lending volume to $360 million in 2004.

- *SBL Lending and Credit Administration Policies and Procedures*: **Repeat** finding that is elevated to a Criticism that management has yet to develop sound credit administration procedures and underwriting policies for SBL.

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SBL policies have been in flux for the last two examinations. Management **agrees** with the criticism and the targeted completion date for revised credit standards is August 31, 2004.

- *Internal Loan Grades and Corporate Credit Review:* Criticism that assigned loan grades do not accurately reflect the risk evident in the portfolio and there is a need to complete a corporate credit review for this area. Management **agrees** with the criticism and the Small Business Credit team will work with Corporate Credit to establish a methodology for assigning risk grades at origination and several outside vendors are being reviewed regarding portfolio management products to score the portfolio on a quarterly basis. A corporate credit review of the portfolio is scheduled for September 2004. Targeted completion date is December 31, 2004.
- *Management Information Systems:* Recommendation to develop reports that will fully compare the quality of newly originated loans with those originated in prior periods. Management **agrees** with the recommendation and is working to refine the existing production reports and portfolio MIS to ensure use of vintage analysis and detail of credit characteristics. Targeted completion date is September 30, 2004.
- *2004 Front End Guidance:* Recommendation to expand the front-end guidance for SBL to include how a six-fold increase in lending will be generated, business channels to be used, types of loans, staffing requirements, credit administration procedures, and monitoring tools. Management **agrees** with the recommendation and the 2005 front-end guidance will include more detail guidance regarding small business segment. Targeted completion date is March 31, 2005.
- *FDIC/DFI Loan Sample Review For Acquired SBL Portfolio:* Observation that 13 of the 15 loan files requested for review were not provided during the loan review time frame. Although a written response was not required, management responded they would enhance the communication and coordination for sending and receiving loan files. **No management response was required.**

Joint Memo #8 – Loans to "Higher-Risk Borrowers"

The current level of subprime/"higher-risk" assets approaches 200 percent of WMI's Tier 1 capital, and, except for the $20 billion limit established for Specialty Mortgage Finance, the Board of Directors have not formally approved any limits for this credit concentration. There is no comprehensive, enterprise-wide monitoring, measuring, or reporting on the level of "higher-risk" assets, nor has management adopted a definition of the characteristics of a "higher-risk borrower".

- *Definition of "higher risk":* Recommendation to specifically define "higher risk" residential and consumer borrowers for all single-family residential and consumer product types and origination sources. Management **agrees** with the recommendation and set a target date of June 30, 2004.
- *Monitoring, Measuring, and Reporting the Level of "Higher-Risk" Assets:* Recommendation to measure, monitor, and report the level of loans to "higher-risk borrowers" by business line and legal entity and to aggregate the data. Management **agrees** with the recommendation and set a target date of September 30, 2004.
- *Concentration of Credit:* Recommendation to establish limits governing exposure to "higher-risk borrowers" by product type and expressed as a percentage of capital by legal entity. Management **agrees** with the recommendation and set a target date of September 30, 2004.

Joint Memo #9 - Subprime Lending Strategy

WMI continues to increase its exposure to subprime borrowers without an enterprise-wide, clearly articulated subprime lending strategy. There is a need to develop a clear strategy document to lay the foundation for agreement on WMI's role and positioning in the marketplace as a subprime lender.

- *Subprime Lending Strategy:* Recommendation to develop a subprime lending strategy document or policy, which includes appropriate segregation for FDIC- and OTS-regulated subsidiaries. Policies, procedures and standards should be updated to reflect the subprime lending strategy. Management **agrees** with the recommendation and the strategy will be created as a recommendation to the Board of Directors with a target date of October 31, 2004.

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Joint Memo #10 - Specialty Mortgage Finance

Significant growth in the SMF purchased subprime portfolio to $15.6 billion as of February 29, 2004. Also, the concentration limit was increased from $14 billion to $20 billion during review period.

- *Reliance On Ameriquest For Loan Purchases and Loan Servicing:* Recommendation to develop and implement a policy that identifies concentration limits and expands the analysis for SMF's counterparty relationships, especially with Ameriquest. Management **agrees** the SMF business is concentrated with Ameriquest. The Counterparty Credit team will undertake a full and complete review of this relationship. This independent credit analysis will be completed by July 31, 2004. Counterparty Cried twill also work closely with SMF management to review the entire business conducted with Ameriquest. A framework will be developed to manage this concentrated relationship will be completed by September 30, 2004.
- *Management Information Reports for SMF Activities:* Observation that reports could be enhanced to ensure that strong early warning monitoring capabilities are in place to support the management and growth of the SMF portfolio, including expanded use of industry comparisons and performance metrics. Management **agrees** with the observation and an ongoing review of pool data will be implemented by June 30, 2004.

Joint Memo #11 – Long Beach Mortgage Company Management Reporting

LBMC's reporting to WMI senior management needs improvement. Numerous errors in the internal LBMC reports were disclosed by our review this examination remains problematic.

- *LBMC Report Errors:* Recommendation to implement new oversight and review procedures to ensure the accuracy of future management reports, and to resolve discrepancy in delinquency numbers noted by the examiners. Management **agrees** with the recommendation. Controls over financial and management reporting to be established and differences resolved by August 30, 2004, including resolving discrepancy in delinquent numbers noted by the examiners. Comprehensive publication of reports by September 30, 2004.

Joint Memo #12 - Home Builder Finance

As of the date of this memorandum, management had not responded to the Findings Memo.

- *HBF Inventory and Renewal Monitoring:* Recommendation to establish a timeline for completion of inventory monitoring initiative and to track project or unit renewals required beyond initial maturities. Management ......
- *Eligibility and Portfolio Diversification Standards For Borrowing Base and Unsecured Facilities:* Recommendation to establish specific borrower eligibility criteria and concentration/diversification standards for unsecured and borrowing base facilities. Management ....
- *Credit Standards/Procedures For Borrowing Base and Unsecured Facilities:* Recommendation to expand credit policies and procedures to reflect actual lending practices and identify risk tolerances. Credit policies should also include minimum acceptable underwriting standards, terms, and conditions with clear and measurable credit criteria as advocated by the Interagency Real Estate lending Guidelines. Management ....
- *WL Homes, LLC Borrowing Base Line:* Recommendation to improve underwriting and handling practices for WL Homes, LLC. Management ....

Joint Memo #15 - Credit Scoring - SUCCESS and Transitional Proprietary Models

Management has elected to develop the bank's own scoring models for residential lending in addition to the SUCCESS scorecard used in consumer lending. With the assistance of the Portfolio Defense Group, the Proprietary Model (PM), and subsequently the Transitional Proprietary Model (TPM),

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was developed. Management is currently developing PM.2, which will eventually replace TPM. This finding provides additional comments to those offered in Joint Memo #2 – Credit Scoring SUCCESS model.

- *Policy Guidelines:* Recommendation to enhance and consolidate policy guidelines into a single policy governing the credit scoring function. Specific items were recommended for the consolidated policy, including the responsibility of the Board of Directors and senior management. Management only **partially agrees** with the recommendation in that they do not believe that specific approval authority for individual credit scoring models need to be approved by the Board of Directors. Nevertheless, management agrees that a single revised policy is appropriate and set a target date of September 30, 2004. The response is acceptable.
- *SUCCESS Model Definition of a "Bad" Account:* Recommendation to use a "two-track" approach to the "bad" account definition to differentiate the use for credit scoring models (60 days) versus Basel II purposes (90 days). Management already established a "two-track" approach for time horizon; credit scoring models (24 months) versus Basel II (12 months). Management **agrees** with the recommendation and will maintain a degree of independence for performance definitions and outcome periods between credit scoring models and Basel II implementation. Target date is September 30, 2004.
- *SUCCESS Dual Score Approval Matrices:* Recommendation to revise procedures for use of dual matrix scoring systems to require documentation of how matrix grades and score cuts are determined. Management **agrees** with the recommendation and will document the process in its policy by October 30, 2004.
- *TPM Definition of a "Bad" Account:* Recommendation to use a "bad" definition of 90 days or more past due for the TPM model, rather than the current definition of "an account which becomes REO", which is extremely restrictive and impacted by the bank's practice of selling loans before they migrate to REO. Management **agrees** with the recommendation with a targeted date of June 30, 2004.
- *TPM and Loan Purpose:* Recommendation to analyze and compare the performance of the two approaches being considered (separate models or separate approval grids) for different loan purposes (refinance, cash-out refinance, and purchases) that have different risk profiles and must be treated differently. Management **agrees** with the recommendation with a target date of September 30, 2004.
- *Model Development Timetable:* Observation that implementation and development timetables appear aggressive given the redevelopment of SUCCESS, development of PM.2, and new models planned for Small Business, Multi-Family, and Credit Cards all by the 2nd quarter of 2005. Management **agrees** with the observation and will create an overall project plan by August 31, 2004.

Joint Memo #19 - Corporate Risk Oversight

Since the initiatives for the Corporate Risk Oversight areas for both the Consumer and Commercial Group have not yet been implemented, our review of the effectiveness of the proposal was limited. Our review focused on those proposals that were initiated previously for the credit review function. Copy of this memo also goes to the Finance Committee.

- *Management Response to Corporate Risk Oversight Reports:* Criticism concerning pattern of untimely management responses to corporate credit reports. Requirement that a monitoring mechanism be implemented to enable the Finance Committee to track compliance with planned reviews, management responses, and corrective actions. Management **agrees** with the criticism and immediate action included several changes to assist the business units in providing timely responses. Changes include both a short-term action plan and long-term Global issues tracking mechanism under development in the Enterprise Risk Management Group. Targeted completion date is August 30, 2004.
- *2003/2004 Review Plan Objectives:* Recommendation for the Finance Committee to approve changes to plan objectives and scope of reviews. The department did not meet the initial Review Plan objectives for 2003 and many reviews were changed from a full Comprehensive Review to a Target Review with no rating assigned despite significant issues being disclosed. Management only **partially agrees** in that quarterly changes in risk profile and the Review Plan are communicated to the Finance Committee. Nevertheless, management agrees to

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enhance reporting structure to the Finance Committee and implement a process to elevate significant issues disclosed in target reviews and provide risk based rating for these issues. Targeted completion date is September 30, 2004. Response is acceptable.

- *Consumer Risk Oversight Proposal:* Recommendation to establish calendar dates when credit reviews are to be performed by the Consumer Risk Oversight group and incorporate these dates into the Review Plan for Finance Committee approval. Additionally, OTS commented that the goals and objectives for the consolidation of all QA functions and compliance testing is a significant undertaking. The transition plan and dates established for the realignment of the Consumer Risk Oversight area appear optimistic. Management **agrees** with the recommendation with a targeted implementation date of July 31, 2004. Monthly updated will be provided to the Finance Committee regarding progress with the transition plan.
- *Counterparty Risk Review:* Recommendation that a review of the counterparty risk area be conducted in 2004. Management **agrees** to conduct a review of counterparty risk with a targeted completion date of September 30, 2004.
- *Credit Review Function:* Observation that the credit review function has evolved with the formation of the Corporate Risk Oversight group and Problem Loan Review to supplement those reviews conducted at the NOC. With the corporate restructuring, corporate-wide Policy and Credit Standards should reflect the types of reviews being conducted and responsible party conducting these reviews for the corporation. **No management response was required.**

Joint Memo #20 – Third Party Originators (TPO) Performance Review Committee

WAMU acquires the majority of its home loans through mortgage brokers and correspondent lenders (Third Party Originator or TPOs). There are approximately 20,000 such TPOs and oversight of their performance is complex.

- *Scope of TPO Committee:* Recommendation to extend the scope of the TPO committee to include the Mortgage Banking Finance (MBF) lending program and incorporate information about brokers receiving credit from MBF into the Seller Tracking and Risk System (STARS). Management **agrees** with the recommendation and will evaluate the most effective approach for inclusion of this information. Targeted development date is November 30, 2004.
- *STARS - Correspondent Application Enhancement and Documentation:* Recommendation to enhance STARS-Correspondent to incorporate the reports required to support the TPO committee and to review documentation to ensure that a different person can perform the current inquiry function if necessary. Management only **partially agrees** with the recommendation due to the costs and likelihood of definitional and formatting changes in reports to support the TPO committee and determination it is more effective to generate the reports in a non-production analytics environment rather than hard coded into the application. Management agrees to sufficiently document the current inquiry process and the underlying data in STARS-Correspondent will be migrated to a non-production analytics environment by September 30, 2004. The response is acceptable.
- *STARS Post Implementation Review:* Recommendation to complete a post implementation review of STARS. Management **agrees** with the recommendation with a targeted completion date of December 31, 2004.

Joint Memo #22 - National Operations Center Recordkeeping

Transition of commercial real estate, multi-family, and commercial real estate construction servicing at the NOC is relatively complete, but considerable work still needs to be done on file documentation and inputting information in systems.

- *File Organization and Documentation:* Recommendation to organize files in a standardized fashion at the NOC and to inventory files to ensure critical credit information is contained therein. CRE, commercial construction, and HBF loan files were disorganized and lacked important credit information. Management only **partially agrees** with the finding in that they feel that the sampling of commercial construction files (three) did not

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adequately reflect the status of files. Management responded that the other files will be restacked by July 31, 2004 and a document level tracking system is planned for implementation by the 1st quarter of 2005. The response is acceptable.

- *CREAM and Filenet Loan Monitoring and Servicing Systems:* Recommendation to inventory the information contained within these systems, determine what information is needed for individual borrowers, and ensure the data is available. Information used to track and monitor borrowers on these systems is often incomplete. Management agrees with the recommendation with a targeted date of January 15, 2005.

Joint Memo #23 - Loan Pricing

- *Pricing of Saleable Fixed-Rate Loans:* Recommendation to reassess the loan pricing for loans originated through the correspondent and wholesale channels along with the profitability goals of these channels. Recent reports indicate that certain types of loans produced though the correspondent channel have been priced at a loss or unacceptably low profitability. Management only **partially agrees** with the recommendation in that these channels add value that is not captured in the gain on sale, such as captive reinsurance, servicing efficiencies, and reduced guarantee fees due to volumes delivered to GSEs. Management will continue to review both gain on sale and overall strategic value of these channels, and develop products that will enhance the profitability of these channels for saleable loans, such as new production compensation plan, ALT-A product, and AUS for Option ARMs, with a target date of December 30, 2004. The response is acceptable.
- *Product Lines:* Recommendation to simplify product lines and to automate much of the pricing rules now incorporated in the pricing manual. Currently the number of products approximates 190 and the pricing manual used to administer pricing for these products approximates 300 pages. Management **agrees** with the recommendation with a target date of December 31, 2004.

Joint Memo #24 - Mortgage Service Delivery

- *Customer Complaints:* Recommendation to develop a comprehensive report for customer complaints that is in one place. Management **agrees** with the recommendation and will look at technology, metrics, and the ownership of the function to continue to evolve this activity. Various interim target dates are established starting with working groups to evaluate current systems by 3rd quarter of 2004 and to begin implementation of refined process and reporting by 2nd quarter of 2005. (The response is also provided in Compliance Joint Memo #8 – Fair Lending Review).
- *Vendor Management:* Recommendation to enhance practices and processes for monitoring and assessing vendor performance, including "best practices". Management **agrees** with the recommendation and will establish a vendor management program for all of Service Delivery. Targeted completion date is December 31, 2004.
- *Default Management:* Recommendation to designate a regulatory compliance liaison for Default Management and to ensure that material strategies within Default Management are reviewed by the Regulatory Compliance Department. Management only **partially agrees** in that they feel that most of the items mentioned are already in place. Nevertheless, plans are to hire a Business Unit Compliance Officer responsible for monitoring and supporting all Service Delivery compliance operations, including Default Management. Target date to hire loan servicing Business Unit Compliance Officer is July 31, 2004. The response is acceptable.
- *MSD Regulatory Relations Department:* Recommendation to maintain a central repository of all documents pertaining to MSD and develop a comprehensive report that captures relevant internal and external audit review findings pertaining to MSD. Management **agrees** with the recommendation and will establish a central repository by July 31, 2004 and develop and implement a tracking tool by September 30, 2004. However, a corporate-wide, web-based issue control tool known as the Enterprise Risk Issue Control System (ERICS) is being developed with a target date of March 31, 2005.

Joint Memo #25 - Data Quality Initiative

- *Data Quality Pertaining to Mortgage Loans:* Recommendation to evaluate critical data information to ensure data integrity, including expanding the process to obtain current credit scores to include LSBO. Data in loan

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systems and databases appear to contain many errors and omissions; especially credit scores. Management only **partially agrees** in that there are some circumstances where the lack of credit scores is legitimate (foreign nationals, etc.), and that the process for capturing credit scores for LSBO loans has been in production for several years; therefore, expanding the credit score "refresh" is not required. However, management responded that a critical data element project for Consumer Group Lending is being re-initiated with interim step target dates of December 31, 2004 and overall completion date of October 31, 2005. The response is adequate.

OTS Memo #1 - Mortgage Banker Finance

- *Monitoring Reports on Subprime Credit Exposure:* Criticism that the ProMerit system needs to be enhanced to improve management reports related to the monitoring of subprime credit exposure. Management **agrees** with the criticism and the ProMerit system is to be upgraded by September 30, 2004.
- *MBF Policies and Procedures:* Recommendation that policies and procedures need to be enhanced concerning discussion of Early Purchase Facilities (EPF) and Flex-EPF programs and that management needs to be more proactive to ensure policies, procedures, and standards are current and reflect actual practices. Management only **partially agrees** with the recommendation because credit procedures for these programs were approved through a documented internal approval process. However, management states that the credit approval process took longer than optimally it should have; therefore, the approval process will be streamlined and staff added to the credit procedures team by June 30, 2004. Also, management states that credit procedures and portfolio management will be revised and enhanced by July 31, 2004. The response is acceptable.

OTS Memo #2 - Residential Quality Assurance

RQA reviews of newly originated loans indicated a high level of unacceptable credit quality ratings related to the number of critical errors found. Realignment of quality assurance functions that will be centralized into one group, Consumer Risk Oversight, is currently in process.

- *Update of Matrices Used by RQA and CRO to Track Findings and Corrective Actions:* Recommendation that Consumer Risk Oversight group or a third party should update matrices used to track findings and corrective actions rather than the respective channel management. Management **agrees** with the recommendation and a revised process is to be developed by June 30, 2004.
- *Outdated RQA Policies and Procedures Posted on the Intra-net:* Recommendation to update the RQA policies and procedures posted on the intra-net. Management **agrees** with the recommendation and new policies and procedures will be completed by September 30, 2004 as part of the consolidation of quality assurance functions into the Consumer Risk Oversight group.
- *Communication of Examination Findings:* Recommendation that all reports issued by the Consumer Risk Oversight group should be distributed to senior management and the Finance Committee and that the reports should be reviewed for accuracy and reflect any changes that may have been made to these reports. Management **agrees** with the recommendation and a schedule of reports with distribution lists will be developed by July 31, 2004.

OTS Memo #3 - Servicing Quality Assurance

SQA is now part of the Consumer Risk Oversight group. SQA performs monthly and quarterly reviews of compliance with investor servicing requirements for FHA and VA loans, loans serviced for government sponsored enterprises, private investors, and the owned portfolio.

- *Scope of SQA Reviews:* Recommendation that the scope of SQA reviews should be expanded to include key servicing functions not currently reviewed by SQA. Management only **partially agrees** with the recommendation in that loans serviced for GNMA are addressed in a government insured testing program.

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Nevertheless, management stated that the scope and testing programs for SQA reviews will be expanded and an early warning indicator system will be developed by March 31, 2005. The response is acceptable.

- *Washington Mutual Mortgage Securities Corporation (WMMSC):* Recommendation that the scope of SQA should be expanded to include a review of WMMSC's policies, procedures, and practices related to its responsibility for oversight and monitoring of third party servicers. Management **agrees** with the recommendation with a target date of December 31, 2004 for development and implementation of comprehensive testing programs for WMMSC, FHLB, and loans serviced by others. Additional staff is also being recruited.
- *Reporting of SQA Findings to Senior Management:* Recommendation that the timeliness of SQA reports needs improvement. Senior management executive summary reports and tracking reports issued by SQA have not been timely and have not been issued since November 2003. Management **agrees** with the recommendation and all outstanding reports and testing completed in June are to be published by July 15, 2004 and all future reports within 15 business days of completion of field testing.
- *Distribution Lists of Pertinent Reports:* Recommendation that SQA be on the distribution list for various reports that document concerns in the servicing area. Management **agrees** with the recommendation with a target date of July 31, 2004.

OTS Memo #4 – Washington Mutual Mortgage Securities Corporation (WMMSC)

WMMSC master servicing portfolio approximates $103 billion as of March 31, 2004. WMMSC performs master servicing functions for this portfolio, including overseeing and monitoring third party servicers. Internal audits disclosed continuing control deficiencies pertaining to Sporty, a network file server, that provides the operating platform for several separate applications/data bases. A Sporty second generation upgrade has been placed on hold, but a Sporty 1 G Remediation Project is currently being developed to address the internal audit issues.

- *WMMSC Policies, Procedures, and Practices:* Recommendation to amend policies to include verification of D&O liability insurance in on-site reviews of third party servicers and that blank fields on the Servicing Process Review forms should be completed. Also desk audits of third party servicers did not indicate that a depository rating/score was obtained as required by policy. Management only **partially agrees** with the recommendations with exception to a statement that "… the relevant data was obtained and reviewed, and that the data sources had simply been omitted." Instead, management indicated the statement should have correctly stated that "… the data was obtained, reviewed and is retained in the applicable files currently, however, the data sources were not listed on the review form." Nevertheless, management agreed to update the applicable policies and procedures, and the IDC rating will be verified for all new and already completed desk audits in 2004. Target completion date is August 31, 2004. The response is acceptable.
- *WMMSC Internal Controls:* Recommendation that management should continue to monitor the status, timeliness, and efficacy of corrective actions concerning internal control weaknesses still outstanding and the completion of the Sporty 1 G Remediation project. Management **agrees** with the recommendation and will continue to monitor the status, timeliness, and effectiveness of such actions with a targeted completion date of October 31, 2004.

OTS Memo #5 - SFR Loan Origination Quality

Past examinations concentrated on assessing underwriting analysis documented in loan files. Since prior examinations and internal reports have already established that underwriting concerns exist, file review was not conducted during the 2004 examination. For this examination, OTS concentrated on reviewing and assessing internal processes that may contribute to underwriting concerns.

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- *Consumer Group Goals:* Recommendation that the Consumer Group should establish and quantify goals with respect to desired asset quality and communicate the expectation to those involved in the production process. Management only **partially agrees** with the recommendation in that a target ratio of non-performing loans/total loans of less than 1 percent has already been established by Consumer Group Credit Risk Management. Nevertheless, by September 30, 2004 management will establish, quantify, and communicate a Consumer Group goal with respect to asset quality as part of the overall strategic objectives/goals. The response is acceptable.
- *Metrics Used to Monitor Performance in the Loan Fulfillment Centers:* Recommendation to track performance with sufficient detail and frequency to trace problems to specific channel and LFC and to effect the desired change in underwriting. Management **agrees** with the recommendation. Targeted completion date of July 30, 2004 for the identification of risk metrics and the establishment of risk tolerance and performance standards. Targeted completion date of September 30, 2004 for implementation of the revised performance measurement standards.
- *Incentive Compensation For Loan Fulfillment Centers:* Recommendation to enhance the incentive compensation plan for the LFCs manager position to more heavily emphasize credit quality concerns. Management **agrees** with the recommendation with various individual target dates from July 1, 2004 to January 1, 2005 pertaining to enhancing the incentive compensation plan.
- *Management Support For Loan Fulfillment Centers:* Recommendation that management should provide additional support to the LFCs to help implement policy and procedure changes, including the writing of desk procedures for each position in the LFCs and revise these desk procedures concurrently with each notice of a policy or procedural change. The timeliness and adequacy of training should also be reviewed. Management only **partially agrees** with the recommendation in that there are several techniques in place to lessen the impact of changes to both LFC management and staff, including following up large impact changes with meetings and training to ensure the changes are communicated to all applicable levels. Nevertheless, management provided a July 31, 2004 target date to, 1) continue to ensure all policies are rolled out with as much notice as possible, 2) utilize LFC team meetings to review and train on new policies and procedures, 3) continue to issue HLPAs weekly with a two week implementation window prior to effective date of changes, and 4) utilize channel management communication avenues to refresh and re-enforce communications on a monthly basis. The response is acceptable.

		2004 Findings Memos							
		Safety and Soundness							
	No	Topic	Issued To	Issued From	Status	Level of Concern	Response Requested	Response Received	Response Accepted
WMB	1	Call Report	Jay Ledwon	Stewart/Mann	Issued 5/21	R	N	NA	NA
	2	IRR-Contravention	Lobo/Mcarthy	Rook	Issued 5/20	C	Y		
	3	Single Family	Mark Hillis	Dong	Issued 5/20	R/R/O	Y	6/4: A/A/A	6/7
Joint	1	Counter-party Risk Management	Vanasek/Boyle	LeCong/Naylor	Issued 5/13	R/C/R/R/R/R	Y	6/2: PA/A/A/PA/A/A	6/8
	2	Credit Scoring SUCCESS Model	Tim Bates	Vance/Rokich/Nuxoll	Issued 5/10	R/R	Y	5/19:PA/A	6/8
	3	Residential Appraisals	Francois Madath	Thorvig/Bernd/Burr	Issued 5/14	R/R/R/O	Y	5/25:A/PA/PA/A	6/8
	4	Commercial RE Appraisal Ops	James Calderon	Thorvig/Bernd/Burr	Issued 5/13	R/R/R/R/O/O/O/O	Y	6/3: PA/A/A/nbc	6/8
	5	LBMC LOC	David Purcell	Ancely/Brady/Burr	Issued 5/13	R/R/R/R	Y	6/10: PA/A/A/A	6/21
	6	Middle Market Portfolio	Dan Gilbert	Hoskovec/Smieszek/Burr	Issued 5/20	C/R/R/R/R	Y	6/14: A/A/A/A/A	6/15
	7	Small Business Lending	Michele Kennedy	Hoskovec/Hickok/Burr	Issued 5/14	C/C/R/R/O	Y	6/2:A/A/A/A/A	6/8
	8	"High Risk Borrowers"	James Vanasek	Brady/Ancley/Burr	Issued 5/14	R/R/R	Y	5/25: A/A/A	6/4
	9	Subprime Strategy	James Vanasek	Carter/Kroemer/Ransom	Issued 5/14	R	Y	5/25: A	6/4
	10	Specialty Mortgage Finance	Chapman/K. Johnson	Henry/Brady	Issued 5/13	O/R	Y	6/16: A/A	6/22
	11	Longbeach Mortgage B&R	Gotshcall/K. Johnson	Bisset/Brady/Burr	Issued 5/14	R	Y	6/3: A	
	12	HBF	Frank Hattemer	Ball/Kodani/Burr	Issued 5/20	R/R/R/R	Y		
	13	MSR-follow up	Lowery/Dobrowoski	Archibald/Gershow	Issued 5/17	O/O/R/R/R	Y		
	14	MSR-Policy	Lowery/Dobrowoski	Archibald/Gershow	Issued 5/14	R/R	Y	6/8:A/A	
	15	Credit Scoring TPM	Tim Bates	Rokich/Nuxoll/Ancely	Issued 5/20	R/R/R/R/R/O	Y	6/2: PA/A/A/A/A/A	6/9
	16	IRR-MV	Steve Lobo	Diogo/Kirch/Rook	Issued 5/18	R/R	Y		
	17	IRR-NI	Lobo/McCarthy	Rook/Kirch	Issued 5/20	C/C/C/R/O	Y		
	18	Pipeline Management	Griffith/Kula/McCarthy	Miyasiro/Thorpe/Clute	Issued 5/20	R/R/R/R	Y		
	19	Corporate Risk Oversight	Melissa Martinez	Hedger/Knorr/Burr/Rudenick	Issued 5/17	C/R/R/R/O	Y	6/8: A/PA/A/A	6/8
	20	TPO Committee	Ann Tierney	Durbin/Rudenick/Burr	Issued 5/20	R/R/R	Y	6/3: A/PA/A	6/8
	21	IA	Reid Adamson	Costagna/Ragan	Issued 5/17	R/R/R/R/O	Y	6/2: A/A/A/A/A	6/3
	22	NOC Recordkeeping	Ken Hannold	Rudenick/Burr/Kodani	Issued 5/18	R/R	Y	6/2: PA/A	6/3
	23	Pricing	Megan Davidson	Orban/Franklin/Clute/Burr	Issued 5/20	R/R	Y	6/8: PA/A	6/15
	24	Loan Servicing Ops	Dyan Beito	Sinclair/Lim/Rudenick/Burr	Issued 5/20	R/R/R/R	Y	6/8: X/A/PA/A	6/15
	25	Data Quality	Anthony Meola	Durbin/Rudenick/Burr	Issued 5/20	R	Y	6/2: PA	6/15
OTS	1	MBF	Frank Hattemer	Santos	Issued 5/13	C/R	Y	6/8: A/PA	6/8
	2	RQA	Melissa Martinez	Melanson	Issued 5/14	R/R/R	Y	6/8: A/A/A	6/10
	3	Servicing Quality Assurance	Melissa Martinez	Sinclair/Lim	Issued 5/18	R/R/R/R	Y	6/8: PA/A/A/A	6/15
	4	WMMSC	Tammy Spriggs	Sinclair/Lim	Issued 5/18	R/R	Y	6/8: PA/A	6/15
	5	SFR Loan Origination Quality	Meola/Hillis	Durbin	Issued 5/12	R/R/R/R	Y	6/9: PA/A/A/PA	6/10

S & S Findings Memos: AQ Memos

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EXAMINER FINDING MEMOS
2004 Regulatory Examinations

STATUS		SAFETY & SOUNDNESS EXAMS	RESPONSIBLE MANAGER	FINDING* C	FINDING* R	FINDING* O	FINDING* REPEAT	OTS/FDIC APPROVED
		Joint Memos						
Completed	P	Joint Memo 1 - Counter-Party Risk	Hugh Boyle	1	5			✓
Completed	P	Joint Memo 2 - SUCCESS Credit Scoring Model	Tim Bates		2		1	✓
Completed	P	Joint Memo 3 - Residential RE Appraisal Operations	Francois Madath		3	1	1	✓
Completed	P	Joint Memo 4 - Com'l RE Appraisal Operations	Jim Calderon		4	4		
Completed	P	Joint Memo 5 - LBMC LOC	Dave Purcell		4			
Completed		Joint Memo 6 - Middle Market	Dan Gilbert	1	4		1	✓
Completed		Joint Memo 7 - Small Business Lending Review	Michele Kennedy	2	2	1	1	✓
Completed		Joint Memo 8 - Loans to Higher Risk Borrowers	Jim Vanasek		3			✓
Completed		Joint Memo 9 - Subprime Strategy	Jim Vanasek		1			✓
Exec Review		Joint Memo 10 - Specialty Mortgage Finance	Keith Johnson		1	1		
Completed		Joint Memo 11 - LBMC Books & Records	Troy Goschall/Keith Johnson		1			
Exec Review	P	Joint Memo 12 - HBF	Frank Hattemer		4			
Exec Review	P	Joint Memo 13 - MSR Follow-up	Hongqing Chen/Lowery/Marc Ma		3	2		
Completed		Joint Memo 14 - MSR Policy	Rob Miles/John Dobrowolski		2			✓
Completed	P	Joint Memo 15 - SUCCESS and TPM	Tim Bates		5	1		✓
Exec Review		Joint Memo 16 - IRR NPV	Steve Lobo		1	1		
Exec Review	D,P	Joint Memo 17 - NI Sensitivity	Steve Lobo / Michelle McCarthy	3	1	1		
[illegible]	P	Joint Memo 18 - Pipeline & Warehouse	Griffith / Kula / McCarthy		4			
Completed	P	Joint Memo 19 - Corporate Risk Oversight	Melissa Martinez	1	3	1		✓
Completed	P	Joint Memo 20 - TPO Oversight	Ann Tierney		3			✓
Completed		Joint Memo 21 - Internal Audit	Reid Adamson		4	1		✓
Completed	P	Joint Memo 22 - NOC	Ken Hannold		2			✓
Exec Review	P	Joint Memo 23 - Loan Pricing	Megan Davidson		2			IN REVISION
Completed	P	Joint Memo 24 - Mortgage Service Delivery	Dyan Beito		4			
Completed	P	Joint Memo 25 - Mortgage Loan Data Quality	Tony Meola / Mark Hillis		1			✓
		OTS Memos						
Completed	P	OTS Memo 1 - Mortgage Banker Finance	Frank Hattemer	1	1			
Completed		OTS Memo 2 - Consumer Risk Oversight	Melissa Martinez		3			
Completed	P	OTS Memo 3 - Servicing QA	Melissa Martinez		4			
Completed		OTS Memo 4 - WMMSC	Tammy Spriggs		2			
Completed	P	OTS Memo 5 - SFR Loan Origination Quality	Tony Meola / Mark Hillis		4			
Completed		OTS Memo 6 - Seller Credit Administration	Debbie Andres		2			
		FDIC-DFI Memos						
Completed		FDIC-DFI Memo 1 - Call Report	Jay Ledwon		1			NA
Exec Review	P	FDIC-DFI Memo 2 - Joint Policy Statement on IRR	Steve Lobo / Michelle McCarthy	1				
Completed		FDIC-DFI Memo 3 - SFR Underwriting	Mark Hillis / Tony Meola		2	1		✓
			TOTAL S&S FINDINGS	10	88	15	4	

P.B.A.

Updated: 6/24/2004 8:24 AM
Source: Regulatory Relations

Regulatory Relations Tracking Matrix

14/14

OTSWME04-0000005370

WASHINGTON MUTUAL BANK FA/FSB
OTS# 08551 & 11905
March 15, 2004

Summary of AQ Findings Memos

Date: 6-25-04
Prepared By:
Reviewed By:
Index #: 200-13a

Washington Mutual, Inc.
Washington Mutual Bank, FA
Finance Committee
Minutes

Date & Place: January 18, 2005
Washington Mutual Tower, 15th floor Boardroom
Seattle, Washington

Attendance:

Members Present:

Margaret Osmer McQuade
Phillip D. Matthews
Michael K. Murphy, Chair
Mary E. Pugh
William G. Reed, Jr.
William D. Schulte

Members Absent: Stephen E. Frank

Also Present:

Sean Becketti
Hugh F. Boyle
Thomas W. Casey
Craig J. Chapman
William W. Green, Jr.
Mark R. Hillis
Kerry K. Killinger
Melissa R. Martinez
Joseph P. Mattey
Michelle McCarthy
Anthony T. Meola
Stephen J. Rotella
Craig E. Tall
Susan R. Taylor, Secretary
James G. Vanasek

The Finance Committee of Washington Mutual, Inc. ("WMI" or the "Company") met concurrently with the Finance Committee of Washington Mutual Bank, FA ("WMBFA") on January 18, 2005. The meeting took place at the Company's boardroom in Seattle, Washington.

Mr. Michael K. Murphy, the Committees' Chairman, called the meeting to order at 10:00 a.m.

Minutes from December 21, 2004 Meeting
Upon a motion duly made by Ms. Pugh and seconded by Ms. Osmer McQuade, the minutes from the December 21, 2004 meeting were approved.

Mr. Murphy then noted that because Mr. Frank had not yet arrived due to his attendance at the Human Resources Committee meeting, he would like the order of the items on the agenda to shift to accommodate Mr. Frank's possible attendance towards the end of the meeting. The minutes below reflect the order in which items were presented and discussed.

WMI and WMBFA Finance Committee Charters

Ms. Taylor presented suggested changes to the charters for the Committee members to consider as part of their annual review of the charters. Upon a motion duly made and seconded, the Committees agreed to recommend the proposed changes to the full Boards for adoption.

Committee Checklist

Ms. Taylor reviewed the proposed checklist with the Committee for 2005.

WMBFA Credit Standards

Mr. Green reviewed the Credit Standards that were newly adopted or modified by the Credit Policy Committee during the fourth quarter of 2004.

Corporate Credit Highlights

Mr. Green reviewed the Corporate Credit Highlights for the fourth quarter of 2004, noting trends and implications. Several of the Directors asked questions of management concerning the outlook for credit quality and the implications of possibly increasing the concentration of loans to higher risk borrowers. Mr. Vanasek reviewed some of the economic factors that underlie both current borrower behavior and current lender decision making and product offerings. He described some of the possible scenarios that might result if economic factors, such as interest rates, employment rates or the housing market, should change. In response to a question from Ms. Pugh, Mr. Hillis described the progress made by the credit group with simplifying and automating the underwriting standards and process so that exceptions will be reduced. Mr. Hillis described some of the analytics and strategies used by the credit risk management group to assess and manage credit risk, including sales of problem loans. Mr. Meola commented on the advantages of the automatic decision process. Mr. Rotella stressed the importance of relying on the right tools and analytics to maximize our opportunity in this market. Mr. Vanasek noted that the proper provisions and limits will be necessary components of a successful strategy.

Corporate Risk Oversight Highlights

Ms. Martinez reviewed the contents of the presentation entitled, "Corporate Risk Oversight Highlights December 2004." She reported that although the Continuous Comprehensive reviews are in process, no ratings are being delivered to the Committee pending further review of the rating structure. Ms. Martinez reported on some of the comprehensive testing results, noting that results in multi-family lending and home loans are good, while issues remain in Long Beach Mortgage Company and the retail channel. In response to a question from Ms. Osmer McQuade, Ms. Martinez noted that compliance at Long Beach is improving now that staff turnover has decreased although there is still a lag due to training time. Overall compliance is progressing well. Ms. Martinez reported on the status of those corporate risk oversight examination matters requiring board attention. Ms. Martinez noted that there were no material issues regarding untimely or inadequate responses to report.

Fourth Quarter Allowance for Loan and Lease Loss Analysis
Mr. Green reported on the fourth quarter allowance for loan and lease losses ("ALLL"). There were no significant changes.

Status of Prepayment Methodology Project
Mr. Becketti told the Committee that he had been hired by the Company in July of 2004 to strengthen the prepayment modeling process and to develop proprietary models to replace the vendor designed models. He described the issues raised by the OTS in findings memos, including issues related to backtesting and the comparability of prepayment performance of portfolio loans compared to loans serviced by others. He reported that the staff in the department has tripled and that progress is being made, although certain issues are still outstanding. He explained that the old tools developed by vendors reflected industry average behavior, rather than the behavior of our customers, which differs from the average partially because of varying geography, products, acquisitions and policies. He reported on the progress now being made to develop proprietary models reflecting Washington Mutual loan experience. He discussed his meetings with the OTS and the concerns raised by them. He then left the meeting.

Single Family Residential Integrated Loan Servicing Strategy and Channel Profitability
Mr. Chapman reported on the progress made to identify the profitability of making single family residential loans by channel and product. He reported that pricing is now managed by channel and that the accuracy of assessing profitability continues to improve. Some of the costs, in particular, still need to be further refined. In response to a Director's question, Mr. Meola commented that Home Loan Center managers now have information on their center's profits and losses and that those figures are impacting compensation. In response to a question from Mr. Reed, Mr. Meola and Mr. Rotella both commented on the relative profitability of the correspondent and retail channels and some of the different challenges in each channel. Mr. Chapman then left the meeting.

WMI Key Non-Bank Subsidiaries Report
Mr. Meola reported to the Committee on the Company's insurance subsidiaries and their businesses. He described the businesses as generally falling into three categories: first, the captive mortgage reinsurance business, second, the flood and force placed reinsurance business and third, the traditional agency business for life and homeowners' insurance. Mr. Meola noted that Carl Formato manages the insurance business. Internal and external audits are clean and the business is stable. Mr. Meola then left the meeting.

WMI Common Stock Dividend
Mr. Casey asked the Committee to consider recommending a dividend payable on the Company's shares of 46 cents per share. He directed the Committee members' attention to the peer comparison in his materials, noting that the Company's dividend payout ratio is projected to return to the 45% target during the fourth quarter of 2005 given currently available information. In response to a question from Mr. Schulte, Mr. Casey noted that attention should be paid to clearly communicating and involving investors should any changes to our dividend policy be considered. Upon a motion duly made and seconded the Committee agreed to recommend approval of the proposed dividend to the full Board.

Washington Mutual Bank, FA Dividend
Mr. Casey asked the Committee to recommend to the full Board of WMBFA that a dividend of up to $250 million be paid to the holders of that company's common stock. Mr. Casey reviewed the company's available liquidity and noted that it was well capitalized. Upon a motion made by Ms. Osmer McQuade and seconded by Ms. Pugh, the Committee agreed to recommend to the full Board that the dividend be declared.

Asset Allocation Initiative – Higher Risk Lending Strategy
Mr. Vanasek presented the proposed Higher Risk Lending Strategy for the Committee's review and approval. He introduced Joseph Mattey, who has assisted with the development of the strategy. Mr. Vanasek reminded the Committee of some of the background behind the strategy being proposed, including the Board's discussions at its strategic planning retreat in 2004 regarding higher risk loans. He also noted some of the issues that were raised by the OTS and FDIC in 2004, as articulated in the 2004 Safety and Soundness Exam Joint Memos 8 and 9, including our agreement to: adopt a definition for "higher risk loans," monitor, measure and report on these loans, establish portfolio concentration limits as a percent of capital and seek the Board's approval on an overall strategy for this type of lending. Mr. Killinger arrived at this time. Mr. Vanasek then reviewed the proposed definition for what constitutes higher risk loans, referencing the materials provided to the Committee in advance of the meeting. Mr. Hillis reviewed the current and projected exposure for such loans for 2005, expressed both in total dollar terms and as a percentage of risk-based capital. In response to a question from Mr. Reed, Mr. Vanasek described some of the factors that were considered in assessing whether the projected credit risk exposure is appropriate. The net charge-off objectives and expected loss rates were then discussed. In response to a comment from Ms. Pugh, Mr. Hillis discussed tools for responding to the higher credit losses, including loan sales and pooled mortgage insurance. In response to a question from Mr. Matthews, Mr. Hillis and Mr. Mattey described the resulting credit profile forecast after adoption of the strategy. In response to a question from Ms. Pugh, Mr. Vanasek stated that the proposed capital concentration limit of 200% of total risk-based capital was self-imposed. Management and the Directors discussed the likelihood that credit losses would lag behind origination of these higher risk loans by several years. In response to a question from Ms. Pugh, Mr. Hillis noted that he would lead the newly formed Asset Allocation Committee. In response to a question from Mr. Schulte, Mr. Hillis reported that he believed we could staff the front line with people who will comply with the rules that may be established for

originating and servicing higher risk loans, and that these people will be overseen by the credit group. Mr. Matthews asked about the incremental profit to the Company expected from adopting this strategy. Mr. Casey committed to getting that information. Mr. Casey and Mr. Vanasek discussed the differences between the strategy being proposed and the business that Long Beach is currently engaged in, noting that the new strategy contemplates retaining more of the higher risk product as opposed to selling it. Mr. Casey noted the importance of proper pricing to the success of the strategy. Mr. Hillis reviewed the next steps to launch the strategy. He committed to report any deviation from the 200% limit to the Committee. After the conclusion of the presentation the Committee continued to discuss with management the implications of adopting the strategy and management's views of the strategy, including the timing, the pricing, the tools and support available and the associated risks. Upon a motion made by Ms. Pugh, seconded by Mr. Reed, the Committee approved the Higher Risk Lending strategy as presented.

Asset and Liability Management Reports

Ms. McCarthy reviewed the contents of the ALMP Reports. She handed out replacement pages entitled "Market Value Risk Management – Core MSR Risk Management Portfolio" and "Market Value Risk Management – Pipeline/Warehouse MSR Risk Management Portfolio." She noted that the Core MSR risk was measured using the levels approved at the December meeting. The report showed volatility risk that was partly offset by basis risk. She reported that the basis risk and yield curve risk measures for the pipeline/warehouse MSR were at a warning level as of year end. The warehouse of consumer home loans exceeds the aging limit. Ms. McCarthy reported that the management of this portfolio is improving. Ms. McCarthy also reported that the total MSR asset value for the Company is approaching the limit of 50% of tangible capital. She commented that this limit has no regulatory basis and should be considered.

There being no further business, the meeting was adjourned.

Attested to by:

____
Susan R. Taylor, Secretary

From: Rotella, Steve <steve.rotella@wamu.net>
Sent: Sunday, October 16, 2005 4:19 PM
To: Killinger, Kerry K. <kerry.killinger@wamu.net>
Subject: Re: Plan meeting

Thanks. Still not 100%. Hope to be better for our big week. To continue our email dialogue:
-I agree on retail. Our field culture and basic model is outstanding. If we can match it with a differentiated free checking offer, stronger brand governance, great marketing, stronger leadership and a more efficient infrastructure, we will add huge value. I can see it and am beginning to feel it, and appreciate your clarity of vision, which has helped a lot. We are at a critical time. I am driving this hard, but at all key points, will bring you in for your input, guidance, and buy in. I think this is a great opportunity for WaMu and a great example of how we can partner to accelerate progress.
-I also agree that mlf is a strong performer for us and we are well positioned. We should drive this business hard, but given the size of the industry it won't be the kind of long term contributor that other businesses can be. I think Al is there on the mass version of this and from my interactions with him, will not be a limiter with some coaxing.
-on Long beach, cost is important but as a wholesaler, what we pay to the broker (80-90 bps) and our sales people (80) are the big drivers. While we can drive efficiencies in ops cost, these are dwarfed by the above. Which is why I am pushing Craig harder on referrals from HL and heq, retention, and a phone/web based retail unit. You lose the 160-170 bps of cost and will drive the highest margin business possible. I am going to begin digging in here and sorting through the low earnings and high volatility that has been evident this year.
-on HL, we will end up with a 2006 bottom line, keeping msr at 200mm (this is subject to review) above 300mm. No doubt that doesn't feel good. Several thoughts:
-we do have to keep in mind the portfolio in place and being created that results in significant earnings. This will increase as we drive heq and subprime referrals. I don't think we would get these earnings without the prime biz.
-we have defined a "box" for this business that is brutal. If we asked our friend Angelo how successul he could have been if he could only be a prime lender (no alt a, no heq, no subprime) with no portfolio to smooth earnings, not to mention a business that has not focused on realtor connections, coops in NY, or retention (our rates are very low), he would tell you in his Bronx accent "fagget about it". I guarantee you that if we pulled out everything but prime and interpolated for size differences, their returns would not look good at all. I also know they would be better than ours, almost entirely due to an inefficient production platform. We did these kind of analyses all the time at Chase which led us to run as fast as we could into home eq, alt a, subprime (our investment banking brethren stopped us from going too far here). We viewed prime as a source of scale benefits in servicing for the other areas and a conduit of higher margin product and aimed to hold our prime servicing flat to down.
I feel strongly that where we need to land is a new home loans unit that includes prime, heq, and subprime. It is a far superior model. There are huge cost saves, it will drive higher cross sell, will align production with capital markets ala Lehman and Cntrywide and smooth earnings and be more comparable to other big players. I can cite many examples of waste and inconsistency as I examine these businesses.
I feel the only question is when not if, but would like your views. The timing is complicated by my feeling that David is too new to take on all this (I think he could easily take heq, but not lbmc right now) and Craig frankly shouldn't take on more. I have questions about his long term role with us.

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Well enough by email. I will get some time to kick this around.
PS much as the Rome trip entices me, there is too much going on right now, so I am going to pass.

Sent from my BlackBerry Wireless Handheld
-----Original Message-----
From: Killinger, Kerry K. <kerry.killinger@wamu.net>
To: Rotella, Steve <steve.rotella@wamu.net>
Sent: Sun Oct 16 08:36:06 2005
Subject: RE: Plan meeting
Steve,
This is a good recap. Thus you can see my wrist slicing comments on Friday.
I agree with your comments with a couple of twists. The retail group has plenty of upside, but the overall returns are pretty good. It will be important for us to preserve the strengths of the model which is our culture and being a mass market retailer with little market segmentation, while we attack the cost structure. If we do this correctly, we could emerge as the best in the country.
Regarding Commercial, returns on the multi family appear pretty good and it is hard to know if those returns could be even higher if they are pushed even further towards a mass marketing approach. Al will find it hard to let loose from his commercial real estate biases of doing one off deals. So he might be a limiter. On the other hand, Chapman creates a lot of challenges himself. I am not sure where truth is on this one.
Regarding Longbeach, I think there is a good opportunity to be a low cost provider and gain significant share when the industry implodes. I agree we shouldn't make life easier for Ameriquest. Regarding our own performance, I don't have a handle on how far away fom optimal we are performing. With loans being held, then sold, with residuals moving around, etc., I don't have a sense as to how we are really doing.
On the home loans group, we may have a broken business model. I was surprised to hear David present a plan with such poor returns and then say there may be another $50 million of upside. Compared to the capital and number of employees deployed, this is our poorest performing business by far. The reason I was trying to draw out thoughts around where on a good to bad scale the operating environment will be in 2006, was to assess the viability of our current business model. It makes sense to leverage the home loans distribution channels with home equity, sub prime and alt. A. But we don't necessarily need a prime home lender to be leaders in these product areas. Using a poor analogy, Delta, American and United all had flawed business models and they tried to compete with Southwest by bolting on their own versions of discount carriers. They could never compete because some competitors didn't have to overcome a flawed core model. There appear to be two things we can do to change our model: change our MSR hedging to better mirror Countrywide. And second, to fully embrace EDE or whatever technologies we can find to radically change the costs of delivering mortgages. I am troubled that our adoption of EDE so far has not radically changed how we underwrite loans. If we can't make a shift in our business model, we might be better off exiting the prime space. As I said before, the last thing we want to be is a Countrywide wanna be.
On the card business, it is still too early to assess if the numbers are going to be o.k.
Regarding the enablers, I agree that Deb was spot on. We should find ways to give her visibility in order to show all of the enablers what can be done. Maybe she should have a role at the senior managers meeting. Regarding Vanasek, I suspect there are some significant efficiencies to be had out of several areas. My guess is that most of these are in Melissa's world and perhaps in credit if we can get behind EDE.

I hope you're feeling better. See you tomorrow.
Kerry
-----Original Message-----
From: Rotella, Steve
Sent: Sat 10/15/2005 1:57 PM
To: Killinger, Kerry K.
Subject: Plan meeting
Despite the fact that I believe we are going to get our 2006 plan in shape, I left the plan meeting with a great deal of unease. .
-retail, for all the strength of the model and our field staff, is an under earning business with mediocre productivity. You are aware of the work underway to get better leadership, improve new stores, marketing, free checking etc. This actions will help. While the leadership search proceeds, I am knee deep here and pushing for more efficiency. . Lots of upside exists and we have great strengths to build on. But as I get deeper it exposes the spotty to weak talent pool down several levels. Lots to do here.
-i was annoyed by the commercial discussion. Keith's presentation was weak and inaccurate at times. I managed a subprime business and did not feel good about the answers we got. LBMC is also under earning, which Craig now acknowledges. Understanding margins are tight, I think we have favored share without proper balance to profits and have in fact fueled price irrationality by constantly supporting ameriquest's liquidity crises. This was one of my first real exposures to keith. Besides a weak presentation it is hard to get past a feeling that this guy is "oily". His comments about not losing any LCs for 18 months makes no sense unless we are paying too much. I suspect we are. And the comments about cost to originate were inconsistent with past info. I am also confused about how Craig views his key talent. Al is being castigated for not growing fast enough, yet all his metrics are superb and Craig said his 2006 plan was done and buttoned "as usual" yet keith's was described as " a train wreck" yet Keith is his number one guy. Craig's behavior was argumentative, and nearly insubordinate at times. I have an ongoing struggle with the lack of transparency and other difficulties with Craig. I plan to begin digging into more detail on LBMC.
-Home loans needs a lot of discussion. I share your concerns. I thought David did a decent job in discussing a tough topic after 8 weeks with us. The discussion reinforced several thoughts for me; we need to continue to drive to grow our way past prime sfr being such a big part of our business and reconsider how much growth we really want in this sector, and we (you, me, maybe Tom) need to brainstorm on our business model and how we organize around it. I think our focus needs to be on organic growth of home eq, and subprime, and greater utilization of HL as we know it today to facilitate that at lower acquisition costs and greater efficiency. There is a 50-100mm opportunity on the cost side across those three businesses and strong internal growth dynamics that we are missing. These three businesses have too many similarities to remain separate over the long term. I don't want to underplay the need for a serious discussion about the strategy in prime only, which is necessary, but I think our current business model is flawed. We should get an hour so so on this.
-the support units were a mixed bag. Deb was, as usual spot on, Tom was fine. I tried to be gentle with Jim, but I think we all saw gaps and anything but a scale oriented mind set. Probably not worth too much pushing on jim here, but the new guy needs to reexamine everything. Some of those fte numbers were outsized, particularly in compliance.
Lots to talk about. See you next week.

Sent from my BlackBerry Wireless Handheld

To: Michelle McCarthy
From: Dave Griffith
RE: Sub Prime Chronology

You've asked for a chronological recap of ERM market risk involvement with Longbeach and the sub prime conduit. I'm preparing this from memory and have not taken the time to go back to find specific memos, meeting notes and power point decks. I've assumed the intent is not to document the expression of our past concerns as it is to help prepare a frank "what we did right; what we could have done better" fashion.

(you may want to strip the first section out entirely if it's not relevant)

2004: I conducted an informal but fairly intensive market risk audit of Longbeach while I was reporting jointly to David Beck and Steve Lobo, shortly before coming over to your group. We had just undergone a management change in Home Loans and Longbeach was in the commercial group. Frank(?) Johnson was the new CEO. I borrowed Harrison Luvai from HL and sent him and Paul Herbst down there for three days with a list of questions and people to interview.

The climate was very adversarial. Dennis Lau was buying sub prime whole loan packages directly into the portfolio and outside any governance or reporting. He considered himself as reporting directly to Kerry.

We found a total mess. Rate locks were issued as faxed loan files arrived from brokers. There was no pricing discipline; if a broker needed a better price, they asked for it. Systems to track commitment were non existent and tracking didn't begin until underwriting approval. They were not hedging and basically they were just being pulled along by a bull market and wide spreads.

I prepared a summary report without the inflammatory language and make a presentation to MRC which was still pretty harsh. Tom was pretty upset and it may have played a role behind the scenes in moving Dick and Dave C into the LB picture. You never know.

Sept. 2005: At least one, possibly two reorgs later. Craig Chapman was running home loans and David had moved soley to Capital Markets. You and I joked a lot about my needing a bullet proof vest.

That's because we discovered WCC had plans to begin buying loans into an Alt A conduit in two weeks. At that time we neither offered nor had approval to offer Alt A's at the bank and no corporate approval for a conduit. There were risk

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systems and plans to build the financial reporting along the way. At that point WCC considered itself outside the bank's ALMP/governance and felt that the conduit was an extension of its business.

I objected, you backed me and all heck broke loose. But the non emotional result was that we passed the first program authority for the Conduit (exclusively Alt A at that point) with a $500m limit and a fairly conservative set of reporting requirements and exclusions. One of those exclusions was "no subprime".

At the same time I prepared a detailed set of steps needed for the business to have our support for full delegated authority. There was a huge burst of interest initially and then months of no progress until the conduit began to approach its limit. As they did, they came back to revisit the path to delegated and asked for an increase to $750mm and then about three months later another to $1billion.

I supported both increases because by then we has printed and distributed our first deal (a huge milestone) and had gone through a full reconciliation audit.

Subprime came along in early 06 with all the risk systems and reporting positioned as an extension of Alt A. Using the Alt A conduit template. MRC granted program authority of $500m with many of the same conditions we had used for Alt A. This time however we carved out the right for ERM to approve one-off additional increases on a case by case basis. You effectively delegated that to me and for most of the summer it wasn't an issue.

The business began to approach the $500m limit in September a month or so after George Davie (our sp trader) joined the firm. But we were already starting to see delays in deal issuance due to problems with servicing transfers. The story line at that time was that our servicing problems were tied to the big sale to Wells and impacted by the various. But the fact was that the deal planned for August had to be delayed.

After that deal had been priced ($300m) but before it had settled I began to engage in an almost daily dialogue with George about upcoming bids. He bid on a couple of pools with my assurance that if we won, I'd grant approval since it would take the total over the limit.

After we won a couple of those, the approved one-offs took us effectively to a $750 limit. I never saw the need to go back to MRC because we always had deal in the works that would bring us back down, we had a good dialogue underway and a lot of progress on the loan tracking. It helped that if anything George was as, if not more, concerned with the back office servicing transfers as I was.

Then in late Sept or early October a $500m pool from People's Choice came up. We had just finished due diligence on a deal scheduled for October but it had not yet traded. But we did know with reasonable certainty that the loans has been transferred correctly. Before approving that bid, I literally got Doug out of the shower at Cedarbrook to ask him bluntly if this was a compelling business opportunity. He thought it was.

So we went forward after joking with George that we were now intentionally feeding the pig to the python. If we had operational problems despite all the assurances that all was fine, we knew it would surface now. (This probably strikes a cord as I recall saying exactly that to you).

With perfect hindsight I should have asked you for permission to get on a plane to Jacksonville under the guise of learning about servicing transfers so that I could do our own dd. I thought about it but never asked figuring it was too far a field of market risk. Besides, at the same time, I was being pounded daily by Mr. Drastal saying "Cheryl has approved this".

As we know, the python spit out the pig. Our FPD problem which we had initially assigned to bad transfers and would self cure when we got the paperwork right turned out to be actual FPD's. But instead of finding that out in 60 days, it took us (and still might) 90 or more because of the continuing servicing issues. By year end we had to file an 8k (which no one has ever figured out to my knowledge) admitting that we has securitized delinquent loans.

To add insult to injury, we had a very tough time marketing the People's Choice loans because investors didn't like the name. The investors were right.

By Feb the FPD's and delinquencies were surging and the SubPrime conduit was shut down by agreement. That gave us time to bail the boat without new water pouring in. It remains effectively closed and as recently as this morning George is in no hurry to test the waters.

Unsaid in all this is why I supported full delegated authority which was granted in January. That was a philosophy change from traffic cop to facilitator which is certainly rooted in Ron's philosophy of delegation and my belief that the discipline of EC and the formal planning process should be enough. To make the business once again prove its case after the plan has been approved by the EC and the Board just doesn't seem right. After having been given top level authority to go out and build a sub prime conduit at the highest levels, it no seemed appropriate to say "well that's nice, but you've got to convince me too."

So I supported, designed and proposed the master authority tied to the plan concept.

Bottom line; biggest thing we did right was to slow them down and force proven successes before granting broader authority. We also built solid one:one dialogues which have resulted in straight talk because we're not the enemy.

Biggest mistake: not setting up tougher objective standards. We could have used the "ops risk is recognized as market risk" philosophy to have demanded objective evidence of progress and had we done so, the pain would be lower now.

From: Hillis, Mark R.
Sent: Wednesday, November 24, 2004 3:09 PM
To: Chapman, Craig J. <craig.chapman@wamu.net>
Subject: FW: LBMC Transfers of Piggiebacks from HFS to HFI!

Craig,

You know my thoughts on these high CLTV seconds. I know we are making huge improvements in LBMC, but if we are parking higher risk on the balance sheet, I'd like it to be focused on the following:

1) Sub Prime – lower LTV loans
2) Recourse/risk sharing to enable us to advance our SFR prime decisioning capabilities
3) MFL
4) Home Equity <90% CLTV

Please let me know your thoughts. I think it would be prudent for us to just sell all of these loans.

-----Original Message-----
From: Smith, Michael C.
Sent: Wednesday, November 24, 2004 11:29 AM
To: Hillis, Mark R.
Cc: Green Jr, Biff W.
Subject: LBMC Transfers of Piggiebacks from HFS to HFI!

Mark --

Just a heads-up that you may be getting some outreach from Carroll Moseley (or perhaps someone higher up in the chain) at Long Beach regarding their interest in exploring the transfer of what Carroll described as a small amount (maybe $10-20mm in UPB) of Piggieback "seconds" (our favorite toxic combo of low FICO borrower and HLTV loan) from HFS to HFI.

As Carroll described the situation, these are of such dubious credit quality that they can't possibly be sold for anything close to their "value" if we held on to them. So the proposal would be to write them down to near zero (maybe 5% of UPB?) but hold on to them (meaning an HFI classification) rather than sell them for practically nothing, and figure to earn more on the actual loans than their sale price would have fetched.

He acknowledged that they had already missed the Oct.25 deadline we'd agreed to earlier for submission of *any* request to transfer LB loans from HFS to HFI this quarter, and also pointed out that with a mega-writedown (not against the ALLL), their BV would produce nary a ripple in our reported numbers. However, I underscored that it wasn't just a question of timing, and that you had raised a number of serious issues in the LB QBR about the approvals not yet granted for this kind of a product to come into our portfolio. I urged him to reach out to you directly on these questions. (E.g., it's entirely possible we might want to make a business decision to keep a small amount of this crap on our books if it was already written down to near zero, but we would want all parties to be clear that no precedent was being set for the product as a whole, etc., etc.)

All of the above took place in an informal "back channel" phone call he placed to me in the interest of keeping clear communication channels open, but I was quite emphatic that this one would have to be considered, reviewed and decided well above my and his pay scale, as the expression goes.

Have a happy Thanksgiving (if I haven't just ruined it) MCS

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #218

Washington Mutual
Internal Audit Department

TO:	Keith Johnson, President & Chief Operating Officer, LBMC	DATE:	09/21/2005
FROM:	Becky Odlozil, Sr. Audit Manager Randy Melby, General Auditor	PHONE:	(214)492-4380
SUBJECT:	Review of Long Beach Mortgage	LOCATION:	4397ADTX

EXECUTIVE SUMMARY

Rating.....**OPPORTUNITIES FOR IMPROVEMENT**

Long Beach Mortgage Company (LBMC) is a non-bank subsidiary of Washington Mutual Inc. specializing in underwriting sub-prime mortgage loans secured by one-to-four family residences. Loans are originated through a broker network or purchased through a correspondent network. Historically, loan production was securitized with retention of the servicing rights. However, LBMC management made a recent strategic decision to hold a portion of the loans for investment. In the first quarter 2005, this restructure of the balance sheet began with an initial transfer of $1.8 billion from *loans held for sale* to *loans held for investment.*

Internal Audit evaluated the adequacy and effectiveness of internal controls over loan origination policies and procedures, related accounting, loan origination system data integrity, wire approvals, and monitoring of the collateral custodian relationship. The securitization process, balance sheet valuation, financial reporting process and servicing process as well as certain specific lending regulations covered in separate enterprise-wide audits were not included in the scope of this audit. The migration to a new loan origination system is currently under evaluation as an ongoing system development project managed by the IT Audit group. LBMC management anticipates full implementation of the new loan origination system by September 2006.

Over the past year, significant progress has been made in establishing adequate policies, procedures and ongoing sustainable processes. LBMC currently operates in a manually intensive processing environment resulting in an increased propensity for errors. LBMC management recognized this increased risk and the potential impact on loan quality, and embedded quality assurance initiatives into their process. They also formed a quality assurance group and stabilized staffing. While the improvements in the processes should ultimately result in an effective control environment, we found these processes were not consistently followed. The Opportunities for Improvement rating is primarily attributed to the following control weaknesses:

- Policies designed to mitigate the risk of the following predatory lending practices are not always followed.
  - Origination of loans providing no net tangible benefit to the borrower - In 24 out of 27 (88%) of the refinance transactions reviewed, policies established to preclude origination of loans providing no net tangible benefit to the borrower were not followed.
  - Loan flipping – In 8 out of 10 (80%) of the non-seasoned refinance loans reviewed, there was no evidence of the required History Pro report used to assist in the determination of loan flipping.

While predatory lending laws are specific to certain states, both state and federal regulators continue to scrutinize predatory lending practices particularly in the sub-prime industry. Failure to comply with policies designed to mitigate the risk of any lending practices which could be construed as predatory increases the company's regulatory, reputation and credit risk.

- Underwriting guidelines established to mitigate the risk of unsound credit decisions were not always followed, and the decisioning methodology was not always fully documented. The majority of exceptions resulted from using unverified income or the unsupported exclusion of debt items in the debt-to-income calculation.
- Controls within the loan origination system can be overridden to allow employees without documented authority to approve loans. Additionally, the Risk Level Authority Matrix used by management to document and grant lending authority commensurate with employees' job levels and experience is not kept up to date.
- The loan approval forms documenting the clearing of conditions were not fully completed in 60% of the files reviewed.
- Not all LFCs require secured card entry at the facility resulting in sensitive customer information, including credit reports and loan applications, not being adequately secured at these locations.

Management self-identified some of the control weaknesses, and remediation efforts for all issues are underway. These issues are being remediated through training, reinforcement of policies, creation of job aides to assist with underwriting decisioning and documentation, and random in-house audits. By October 2005, remediation plans are scheduled to be fully implemented. Management will validate the effectiveness of the remediation plans through a series of in-house audits which we be completed in the first quarter of 2006.

BACKGROUND

Long Beach Mortgage Company (LBMC) became a non-bank subsidiary of Washington Mutual Inc. in 1999. Operating as a separate legal entity, LBMC originates, purchases, and sells subprime residential mortgage loans secured by one-to-four-family residences. LBMC's borrower base consists of individuals who can not qualify for traditional "A" credit due to their credit histories or debt-to-income ratios.

Loans are originated through a broker network (wholesale loans) of 15,000 brokers or purchased from correspondent mortgage bankers (correspondent loans). The loan broker submits the loan file to Long Beach Mortgage Loan Fulfillment Centers (LFCs) where the loan is underwritten.

Historically, LBMC did not hold the loans in its portfolio but rather securitized them and retained the servicing rights. Pools are created by the Capital Markets Group that match the requirements of the proposed securitization. While the majority of loans originated will continue to be securitized, LBMC reallocated assets on the balance sheet resulting in an initial transfer of $1.8 billion from loans held for sale to loans held for investment. This transfer was completed in the first quarter 2005 with an ultimate goal of having $3.5 billion in loans held in investment.

OBJECTIVES AND SCOPE

The objectives of this audit were to evaluate the adequacy and effectiveness of the system of internal controls over loan originations at LBMC and to determine the adequacy of and compliance with related policies and procedures and applicable laws and regulations.

The scope consisted of interviews with management and review of:

- Loan origination policies and procedures, and related accounting
- Compliance with predatory lending regulations, the Fair Housing Act, Unfair or Deceptive Acts and Practices, and the National Flood Insurance Reform Act
- Underwriting guidelines
- Loan origination system data integrity
- Monitoring of the collateral custodian relationship
- Wire approvals
- A random sample of loans selected from 1st quarter 2005 originations

A separate audit of the LBMC default servicing functions is currently in process and will be reported separately. LBMC securitizations, balance sheet valuations and financial reporting processes are audited by the Treasury and Capital Markets Internal Audit group and were not included in the scope of this audit. Specific lending regulations covered in separate enterprise-wide audits, including Equal Credit Opportunity Act, Fair Credit Reporting Act, Home Mortgage Disclosure Act, Real Estate Settlement Procedures Act and Truth-In-Lending, were also not included in the scope of this audit.

Thank you for the cooperation received during the audit engagement. Please call if you have any questions or comments.

cc: Steve Rotella, Craig Chapman, Jim Vanasek, Mark Hillis, Melissa Martinez, Michael Giampaolo, Amy Marcussen, Larry Breitbarth, Matt Place

ATTACHMENT I
AUDIT ISSUES & MANAGEMENT ACTION PLANS

	AUDIT ISSUE	RISK	MANAGEMENT ACTION
1	***Predatory Lending Practices (Criticism)*** LBMC policies and procedures designed to prohibit the origination of refinance transactions for which a net tangible benefit to the borrower cannot be demonstrated are not always followed. LBMC procedures require the completion of a net tangible benefit worksheet for all refinance transactions. However, for 88% of the refinances selected for testing, the net tangible benefit worksheet was not fully completed or supported by information in the loan files. Although the net tangible benefit worksheet requires the signature of a second reviewer, no management sign off is required. Additionally, 80% of the non-seasoned refinances tested did not show evidence of the History Pro report, which is required by policy to mitigate the risk of loan flipping and predatory lending.	Refinancing loans for which a net tangible benefit to the borrower is not fully documented and supported puts the company at risk for noncompliance with state specific legislation governing predatory lending practices. Additionally, given the increased scrutiny on predatory lending by state and federal regulators, specifically in the sub-prime lending industry, the company risks reputation damage should their lending practices be construed as predatory in nature. Resulting loss of market share in an extremely competitive industry could occur and impede the company's ability to meet strategic initiatives.	Management completed additional programming which will print the net tangible benefit worksheet with each amendment to the loan and implemented a policy change to require an update of the worksheet to reflect changes to the terms of the loan. Additonally, policies regarding the use of History Pro were not clear at the time of release. Management has provided policy clarifications and training on the use of History Pro since the completion of this audit. Management will further address these policies within each LFC and provide additional training between August and October 2005. The effectiveness of the remediation efforts will be monitored through a series of in-house audits which will be completed in the first quarter of 2006.
2	***Underwriting Quality and Documentation (Criticism)*** Underwriting guidelines and policies established to mitigate the risk of unsound underwriting decisions were not always followed and the decisioning methodology was not always fully documented. We found exceptions to policy or were unable to verify compliance with policy due to missing documentation existed in minimum credit score requirements, applicant identification form, mortgage and rental credit history, consumer credit, capacity to repay, full documentation program, stated income program, verbal employment verification, age of documents, and verification of recording. A significant portion of the exceptions pertained to the debt to income calculation and were the	Failure to adhere to underwriting guidelines and policies compromises the underwriting process and could result in unsound underwriting decisions. The risks associated with unsound underwriting decisions include regulatory fines and criticisms, diminished loan quality, and reputation risk in the secondary market. Losses in the form of fines, penalties, reduced market value of the loans, and early payment default by the borrower could also result. Additionally, failure to adequately document and support the decision puts the company at risk for the appearance of non-compliance with policies and subjects the company to regulatory criticisms.	Management developed corrective action plans including system enhancements to prohibit less than the minimum credit scores, creation of job aides to assist with documenting decisioning, additional underwriter training to address the findings, and re-training on the use of established quality control checklists. On August 1, 2005, management rolled out the Underwriting Decision Summary Form which clearly documents the underwriter's decision. Additionally, all underwriters received training to reinforce guidelines regarding stated income and debt to income calculations. By October 2005, additional job aides addressing the components of the underwriting decision and along with training will be complete. The effectiveness of the remediation efforts will be

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AUDIT ISSUES & MANAGEMENT ACTION PLANS

	AUDIT ISSUE	RISK	MANAGEMENT ACTION
	result of using unverified income in the calculation or excluding certain undocumented debt items from the ratio. The details of exceptions on individual loans were provided to management.		monitored through a series of in-house audits which will be completed during the first quarter of 2006.
3	***Underwriter Approval/Condition Clearing (Criticism)*** Before funding, guidelines require the loans to be reviewed and approved by the designated level of authority and conditions cleared. However, these controls are not operating effectively. Although the company established the Risk Level Authority and Condition Clearing Matrix commensurate with employees' job title and experience, the loan origination system can be overridden to allow employees without designated authority to approve loans. Additionally, we found two employees granted authority in the matrix higher than their job title and experience would warrant. According to management these two cases resulted from input errors. Additionally, the matrix was not updated regularly to reflect new employees or delete employees no longer employed by LBMC. We also found the clearing of approval conditions to not be fully documented on the Loan Approval form in a significant portion of the loans tested.	Loans that are not originated in accordance with established guidelines governing designated levels of authority and condition clearing jeopardize the soundness of the underwriting process and puts the company at risk for losses through the origination of poor quality loans, errors and omission in the loan package.	By October 2005, management will add a quality control check to validate approvers in the Risk Level Matrix. Employees with lending authority will also supplement their initials with the use of a name stamp to avoid confusion due to illegible handwriting. Additionally, management will re-train on the completion of the Loan Approval forms. The effectiveness of the remediation efforts will be monitored through a series of in-house audits which will be completed in the first quarter of 2006.
4	***Pricing (Recommendation)*** Errors were found in pricing loans in 27% of the loan files reviewed. Determination of the loan price involves manual calculations, which increases the chance of errors. These errors were not documented as pricing exceptions, and accordingly were not approved or reported as such, and resulted in loans that may not be priced commensurate with the borrower's	Pricing loans outside of the established pricing guidelines puts the company at risk for pricing that may not be reflective of the borrower's credit risk classification and may be construed as discriminatory or predatory in nature subjecting LBMC to regulatory criticisms and fines.	Management previously addressed errors in pricing by implementing a pricing tool called "Flash Quote", which eliminates some of the manual calculations inherent in pricing loans. By August 1, 2005, all underwriters received refresher training in connection with the introduction of the Underwriter Decision Summary. Emphasis was placed on the use of the correct FICO score within this tool so that

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AUDIT ISSUES & MANAGEMENT ACTION PLANS

	AUDIT ISSUE	RISK	MANAGEMENT ACTION
	qualifications. Additionally, one loan contained a rate in the note which did not match the rate which was approved.		loans are priced accurately. The effectiveness of the remediation efforts will be monitored through a series of in-house audits which will be completed during the first quarter of 2006.
5	***Quality Assurance Initiatives (Recommendation)*** Although management addressed controls in the manually intensive environment by embedding quality control checks into loan processing, the pre-boarding checklists, DOCs Out and DOCs In checklists, and prefunding checklists were not always fully completed.	Failure to fully complete or fully document quality assurance checklists diminishes their effectiveness and puts the company at risk for non-compliance with regulations and underwriting guidelines, missing documentation, poorly documented underwriting decisions, the origination of poor quality loans, and could impede the efficiency of the origination loans. Regulatory criticisms, reduced gains on securitization, early payment default and a higher incidence of fraudulent and incomplete submissions could result.	By October 2005, management will provide re-fresher training to all functional roles within the LFCs and will monitor the effectiveness through in house audits which will be completed in the first quarter of 2006.
6	***Security of Borrower Information (Recommendation)*** Not all LFCs require secured card entry at the facility resulting in sensitive customer information, including credit reports and loan applications, not being adequately secured at these locations.	Failure to adequately secure customer information could result in misuse of the customers' personal data for fraudulent purposes and result in customer dissatisfaction, and liability on the part of LBMC should the customer incur losses. Additionally, given the increased attention from the public and media regarding consumer privacy issues, reputation damage could result should the company fail to protect sensitive customer information.	Management installed card entry at the Dallas LFC so that only authorized employees can enter the department. During nonbusiness hours, entry is limited to cleaning personnel who are bonded. Management is addressing secured entry for all LFC locations.
7	***Date Integrity - Input into LOS (Observation)*** The information in FiTech did not agree to information contained in the loan files for appraisal amounts (i.e., CVR report) in 27% of the transactions tested. Management was aware of the differences which resulted from issues with information received from the Optis Value system. The problems with the data received from Optis Value are corrected.	Failure to adequately support information input into FiTech could result in inaccurate pipeline management reporting. The pipeline reports are used for a variety of reasons including developing performance metrics, monitoring time that loans are in the pipeline in order to comply with regulations, populating the Loans-In-Process general ledger account, and inclusion of balances in the Corporate 10k reports. Inaccurate pipeline reporting could result in	Although the discrepancies resulted from data problems within the WaMu Optis Value system, management devised a form for employees to use to check the information input into FiTech. By August 2005, the use of the form will be fully implemented. The effectiveness of the remediation efforts will be monitored through a series of in-house audits which will be completed during the first quarter of 2006.

ATTACHMENT I
AUDIT ISSUES & MANAGEMENT ACTION PLANS

	AUDIT ISSUE	RISK	MANAGEMENT ACTION
		poor business decisions, regulatory non-compliance and inaccurate financial reporting.	
8	***Manager Approval for Wire Requests (Observation)*** Evidence of wire request authorization by a LFC Team Manager is not specified on the Funding Template and is not always evidenced as required by policy on the "Wire Funds Information Sheet." Several instances were found where the "Wire Funds Information Sheet" was approved by a level below that of an LFC manager or for which no authorization was evidenced. Although wire logs are received twice daily from the Funding Quality Control department and LFC managers are required to review the validation of the wires to the log, no evidence of review is required or maintained.	Unapproved or misdirected disbursement of loan proceeds puts the company at risk for losses and errors in the funding process which impedes operational efficiency and could result in customer dissatisfaction .	Management feels that notification by the Funding Quality Control department for wires that cannot be sent and the related reversal of the wire in the LOS along with the the wire logs prepared twice daily and sent to the LFCs mitigates the risk of unapproved wires. However, management will clarify through additional training, the applicable documents to be reviewed and signed by the Team Manager. The effectiveness of the remediation efforts will be monitored through a series of in-house audits which will be completed in the first quarter of 2006.

From: Carter, Lawrence D
Sent: Friday, August 13, 2004 12:53 PM
To: Finn, Michael E <finnme@office of thrift supervision.com>
Cc: Chow, Edwin L <chowel@office of thrift supervision.com>; Dyer, Nicholas J <dyernj@office of thrift supervision.com>
Subject: Craig Chapman

As you suggested, I contacted Craig Chapman yesterday to bring him up to speed on our findings and conclusions in the area of home lending. I also suggested to Craig that we talk regularly. Our next call is scheduled for 8/23 at 9 a.m. He will include Mark Hillis next time, who is the new chief credit officer over the home lending area. We will talk more about progress in moving forward in improving home lending operations. Mark has already put in place a lot of changes and should be able to provide some feedback on how those changes are taking hold.

Craig has been around the country visiting home lending and fulfillment offices. His view is that band-aids have been used to address past issues and that there is a fundamental absence of process. He indicated that Craig Davis had an approach of "mass customization," i.e., trying to make every loan they could rather than concentrating on a narrower, homogeneous product set of profitable products. Craig Chapman will be working to get more focused on a profitable product set and establish processes that can be carried out consistently across the various home loan and fulfillment centers. I advised Craig that he was on the right page and that execution of his plans should address our issues with underwriting inconsistencies and simplify the process of addressing our other issues with pricing and data integrity. Craig is well aware of channel pricing issues and risk-based pricing issues at the loan level. I reiterated to Craig the importance of addressing the need to identify and properly manage subprime lending activities head on. I told him thoroughly supporting capital allocation was critical in that we were requiring double risk weighting or more for many of our institutions who could not support lesser capital on their own. I told him we really would like to avoid dancing around the issue of using the term, "subprime," with which he wholeheartedly agreed.

Nick had received two "complaints" from competitors, on which I followed up with Craig: (1) WAMU qualifying borrowers at rates as low as 4-4.5 percent and (2) WAMU matching Countrywide's significant dropping of start (teaser) rates. Craig will follow up to see what WAMU has done in these two areas of underwriting and obtain supporting rationale as appropriate. He should be providing me a response by email.

I asked Craig whether the organizational structure would change now that he is in charge of mortgage banking, to which he responded "no." Essentially, Craig will manage the mortgage banking segment of the Consumer Group, even though Deanna still heads up that group. In other words, mortgage banking will not be moved to the Commercial Group nor, as best as I can tell, will Craig and Deanna's roles change as heads of the two main business segments.

I asked Craig about competition with Countrywide. He believes Countrywide has a very broad product set. He thinks Countrywide's service is as bad as WAMU's right now. He concedes Countrywide has better technology. Craig wants to improve WAMU's service in terms of turnaound times and become a low-cost producer of a narrower range of products. He believes WAMU would have a competitive advantage here.

In terms of losing people, Craig feels they have not really lost many individuals they did not want to lose anyway. Candidates for CFO are coming in next week. Morale is somewhat of an issue in the Loan Fulfillment Centers because that is where a lot of changes are occurring. Otherwise, he feels they are okay.

As an aside, as Nick already informed you, I am trying to set up a call for next Monday or Tuesday with Tom Casey to get his take on what BlackRock meant in their presentation as far as regulators impacting MSR valuation and hedging practices.

From: Rotella, Steve
Sent: Wednesday, February 16, 2005 3:31:27 PM
To: Meola, Tony T.
Subject: FW: Follow-Up on Credit Expansion Discussion wwith Diane

I am beginning to have some fun with this.

-----Original Message-----
From: Hillis, Mark R.
Sent: Wednesday, February 16, 2005 10:31 AM
To: Rotella, Steve
Subject: RE: Follow-Up on Credit Expansion Discussion wwith Diane

I do not agree. The grids and the BEDE engine do the following:

1) All products are eligible for approval. Today there is a 680 min FICO requirement for 5/1 IO loans. Under the BEDE grids (which are in production today), the 5/1 IO's, 7/1's, etc can be approved down to 620 automatically by the system. All Tim is saying is that given we are using a proprietary algorithm, we can't just say to the field that all 620's will be approved automatically. It is dependent on their overall credit profile, and the internal models use LTV and mortgage credit performance and large drivers of the score – something FICO does not.
2) The LTV approvals for solid customers are well above the levels approved today.
3) We also have an approved to component in the system. If a borrower applies for x amount at y LTV, we may in fact (and over $1B/month do), provide LTV guidance and loan amount guidance that exceeds their requests.
4) The BEDE system and these rules are operating today in the LFC's. John Schleck has seen the value, and it is significant, I just don't think Tim explained this well.

I will send more concrete information across. Please let me know if you want to discuss.

-----Original Message-----
From: Rotella, Steve
Sent: Wednesday, February 16, 2005 10:19 AM
To: Hillis, Mark R.
Subject: FW: Follow-Up on Credit Expansion Discussion wwith Diane

So, sounds like there isn't much new news after all. Do you agree?

-----Original Message-----
From: Meola, Tony T.
Sent: Wednesday, February 16, 2005 6:08 AM
To: Rotella, Steve
Subject: FW: Follow-Up on Credit Expansion Discussion wwith Diane

FYI

I Didn't think we had any "good news" items I was holding back from the field unfortunately I was correct.

-----Original Message-----
From: Bates, Timothy
Sent: Tuesday, February 15, 2005 7:33 PM
To: Meola, Tony T.
Cc: Ludlow, Diane L.; Hillis, Mark R.
Subject: Follow-Up on Credit Expansion Discussion wwith Diane

Tony,

Diane asked me to email you regarding progress on the discussion and request you made earlier today to assemble some examples of enhancements surrounding credit policy that will be welcomed by sales. We're still plugging through some analysis and verifying a few things with Ops folks, but here's a general sense of what we're going to provide.

The most significant enhancements are centered around expanded LTV and loan amount parameters based on our new underwriting grids; specifically, we will be able to auto-approve loans up to $1 mil at up to 90% LTV. Since the relief is primarily driven by the PM2 score with combinations of other factors such as Owner Occupied, Cash Out, and Number of Units, it's difficult to put a hard and fast statement out there about Fico. We have to do a little bit more analysis to provide the general Fico parameters, but we this should provide a general sense of what we're doing.

So, by tomorrow we should be able to provide a statement such as this: For loan amounts up to $1 million, and for Fico scores down to X (analysis due back tomorrow), Owner Occupied, 1 Unit and No Cash Out, we will go up to 90% LTV with an auto-approval. Also, on these same deals, we will also provide income and asset documentation relief to the borrower.

This would apply to the following products:

- 1 and 3 month Option ARM
- Flex 3 and 5
- 5/1 I/O

Do you want to provide this with a targeted implementation date or just take this to President's Club as an example of the expansion?

Hope this is what you're looking for- let me or Diane know if you have any questions or if you're looking for something different.

Tim Bates
Washington Mutual
Enterprise Modeling and Decisioning Systems
206 377 4919 voice
206 490 4427 facsimile
timothy.bates@wamu.net

From: Feltgen, Cheryl A.
Sent: Wednesday, June 14, 2006 1:07:03 PM
To: Pollack, Wayne A.
Subject: FW: FW: HEQ

Attachments: Picture (Metafile)

From: Hillis, Mark R.
Sent: Wednesday, June 14, 2006 7:32 AM
To: Feltgen, Cheryl A.
Cc: Myhre, Jennifer; Kido, Ken; Cathcart, Ron; Corcoran, James
Subject: FW: HEQ

Cheryl,

I wanted to weigh in on a couple of the items you've identified for the Equity expansion opportunities.

On the first two bullets, you are right on. We are tracking well toward a July 80/20 implementation and it is going well. Also, you guys did a nice job on the ERMC portfolio purchase decision, and that seems to be moving along well.

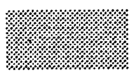
Regarding the next two items, I'm assuming you are looking at sub-prime second models for Longbeach. If not, we need to sit down and have a role clarity discussion. Our team is currently focused on several HE modeling initiatives to include higher risk lending and the next generational enhancement of our existing custom algorithms. We are in the final validation stages of a tool that will be implemented in October to swap-in much more of the 580-620 population and enhance our 620-660 approval rates. In the interim, we are adjusting our decision engine rules for a July roll out to allow for 580-620 and LT 80% CLTV loans to be referred to a manual "sub-prime" underwriting team that we are putting in place. Of course I still need to run this by the CPC for final approval.

On your bullet point for the opportunity we've done a very thorough scrub of our TTD population and we see this 580-620 segment as the biggest opportunity where we aren't lending today. Clearly, there are additional market opportunities through the capital markets side that you'll exploring.

Finally, on the collateral side we have some individuals who've done some really good work on AVM validations as well as the overall cascade logic that we utilize. We expect some nice quality enhancements and cost saves as this logic is implemented this summer.

In this expense environment, we need to make sure we have everyone focused on the right things, and to avoid duplication and/or overlap if it exists. If you see this differently, then let's sit down and discuss.

Let us know how we can further help. We've got good momentum going, as evidenced by our May jump in approval rates given the March rule and policy changes that we made. We are now seeing more of a bar-bell distribution starting to occur with more lending being done down in the lower score intervals. These further changes will enhance that considerably.



From: Kido, Ken
Sent: Tue 06/13/2006 3:18 PM
To: Myhre, Jennifer; Hillis, Mark R.
Subject: FW: HEQ

-----Original Message-----
From: Schneider, David C.
Sent: Tuesday, June 13, 2006 2:36 PM
To: Rotella, Steve; Kido, Ken
Subject: Fw: HEQ
Importance: High

An update on the HE issue.

-----Original Message-----
From: Feltgen, Cheryl A.
To: Schneider, David C.
Sent: Tue Jun 13 13:10:30 2006
Subject: FW: HEQ

David:

There are various activities that have been completed or are underway in connection with "expanding the home equity credit parameters":

* Our "80/20" program has all needed credit approvals. By the end of June, we will be able to offer a WaMu first/non-WaMu second and by the end of July, we will offer a WaMu first and a WaMu second. The later is dependent on Retail Bank systems (Visual Banker, Transact). We were able to work together to move it up in their technology queue from November to July. The program is 100% CLTV (previously only 95% was offered), $250,000 second, max combined loan amounts of $1.25 million, FICO down to 620.

* $4 billion home equity investment program approved with some delegated authority to Home Loans in the inaugural Enterprise Risk Management Committee last Friday. High CLTVs (up to 100%) and lower FICOs (down to 600) permitted with some concentration limits.

* Vijay Bhasin and team are building a subprime scorecard for EDE that will enable the greater understanding of the risk and return tradeoffs for subprime home equity

* Vijay Bhasin and team are working on the analytics necessary to identify the "sweet spot" in the FICO/LTV possible combinations for optimal risk and return. Mark Hillis has completed an analysis which I have seen which suggests the targeting of the lowest FICOs (580 to 620) in combination with the lowest CLTVs (less than 80%). Vijay's analysis will help us to confirm whether Mark's recommended approach is indeed the "sweet spot". Mark Hillis has not shared all the details of what he plans to do, but I believe he intends to present something to the Credit Policy Committee in July.

* Collateral risk is important for this product type and credit profile. Vijay will also be working on analytics to better assess collateral risk and hence identify opportunity.

We do see opportunity in continuing to expand the credit box for home equity. It is one of the elements of our effort to increase credit risk while achieving the appropriate risk-adjusted return.

Cheryl

From: Schneider, David C.
Sent: Monday, June 12, 2006 1:34 PM
To: Feltgen, Cheryl A.
Subject: FW: HEQ

From: Rotella, Steve
Sent: Monday, June 12, 2006 1:11 PM
To: Kido, Ken; Schneider, David C.
Subject: HEQ

Where are we in examining the possibility of expanding the home eq credit parameters?

From: Feltgen, Cheryl A. <cheryl.feltgen@wamu.net>
Sent: Sunday, February 5, 2006 2:54 PM
To: Joans, Michelle L. <michelle.joans@wamu.net>; Shaw, Robert H. <robert.shaw@wamu.net>
Subject: Fw: 80/20

Michelle and Bob:

See attached string of emails. Michelle, please contact Ralph Melbourne to understand exactly what is wanted to allow 80/20 in Retail and Wholesale. Then work to prepare request for approval. Bob, your help will be needed. Bob, note my comment below that I think we should raise the subject at the QBR meeting to assess the level of support we will receive from Hugh etal. Keep me advised of the progress and what you hear from various interested parties.. Thanks for your help.

Cheryl

Sent from my BlackBerry Wireless Handheld

-----Original Message-----
From: Meola, Tony T.
To: Schneider, David C.; Feltgen, Cheryl A.
Sent: Sun Feb 05 10:27:47 2006
Subject: Re: 80/20

Spot on, the issue is a role clarity - the consumer bank plays the role of portfolio manager as does alco and to a degree credit. There is no one decision maker in the world of heloc. We all think we "own it and thus there is no final say" that clarity would unlock this - very similiar to the underwriting debacle we sorted through. This is an endless voting process.

ATM

-----Original Message-----
From: Schneider, David C.
To: Meola, Tony T.; Feltgen, Cheryl A.
Sent: Sun Feb 05 10:23:14 2006
Subject: RE: 80/20

A few thoughts:

1. The process seems to be flawed when a product can be □tabled□ until next meeting. Why are we running the business based one meeting schedules? Also, I have no problem with credit expressing concerns about controls, etc. I do think, however, that their main job is to approve credit parameters. They should, of course, set the right expectations for control and I think it would be appropriate to request a final sign off that would allow credit to review the controls that are established by the business and ensure they are adequate.

2. I don□t understand the concerns from the retail bank. We are working with them on a number of projects and I assume this is aligned under Ralph and his team.

We need to decide soon that this will or will not be ok from a credit perspective.

ds

From: Meola, Tony T.
Sent: Sunday, February 05, 2006 6:06 AM
To: Feltgen, Cheryl A.; Schneider, David C.
Subject: RE: 80/20

The issue is pretty simple - we do not have an 80/20 capability at all on any jumbo product. While we did just get the capability on agency product for retailt, we process , close and deliver the product in Nexsta's name. Wholesale odesn't have it and Correspondent has not been approved yet, Hillis tabled it at the Credit committee as you know, I have kept it in the May release in spite of that . Let us deal with the system issue, we do a number of things today that our systems do not support (eg : Wholesale Equity Lending), that is a bit of a smoke screen in this history. Thanks Cheryl.

From: Feltgen, Cheryl A.
Sent: Sat 02/04/2006 9:28 PM
To: Schneider, David C.; Meola, Tony T.
Subject: RE: 80/20

David and Tony:

The whole subject of □80/20□ (and also 100% CLTV loans) is a complicated story at WaMu with a history (as Tony knows). . .the discussion of it stretches back for probably years. There has historically been some resistance from Enterprise Risk to aspects of it. Let me try to describe where we are now and what I think needs to be done to get to where I believe the two of you want to be.

On first mortgages:

We now have products with a 100% CLTV. Until late last year/early this year, the system would not support it and we finally now can support the conf FRM as a 100% CLTV. The conf Hybrid is approved and the system will be updated mid-06 to allow us to implement it. Option ARMs have a max CLTV of 95% and interest only has a max CLTV of 90%. Further, 100% CLTV opportunities, beyond what Fannie/Freddie permit, are now available in the Alt A product in the Correspondent and Retail channel, with Wholesale coming out with the implementation of Dorado.

On second mortgages:

In Correspondent, a proposal was presented at last week□s Consumer Credit Subcommittee to introduce a second that could go to 100% CLTV behind our Alt A first. The intent is to sell these loans to WCC for immediate securitization with minimal warehouse time. The vote was tabled until next month□s meeting. Further information was requested by Mark Hillis about controls and how issues would be managed. Mark Hillis and Jennifer Myhre also wanted to do a comparison to the controls that are being built in the Retail Bank for their new stand alone equity product originated for a secondary market execution. Despite the delayed vote, implementation is still on track for May 2006. We will work to cover all the bases before the next meeting to assure approval.

Beyond Correspondent, we have no system capability to process the seconds. Possible solutions might be to outsource to Nexstar as we do now for Retail/Consumer Direct. When/if we implement Palisades (still a long time from now), it has that capability. I understand also that MLCS can be made to include that functionality, but doesn□t have it today. If we wanted to make this a priority from a systems standpoint, other projects would need to be deferred to accommodate it, which could certainly be done. I don□t really control that.

As we progress our thinking on the 80/20s, there may be some resistance from the Retail Bank seeing our efforts as infringing on theirs. They are working on a stand alone equity product that would be originated through correspondents. It would be sold in the secondary market. They may expand beyond that in the future. (Note: there is currently a Board Policy that prohibits the holding of first/second 100% CLTV loans). Corporate Credit Risk has some concerns given the point in the housing cycle and given the pending interagency guidance on higher risk lending. These concerns can certainly be addressed, but it is an item to be aware of.

Tony, you have asked that my team develop credit/underwriting guidelines for 80/20 loans that would be originated in the Retail and Wholesale Channels. We can do that working with Ralph Melbourne and his Product Development Team. At the moment, I don□t see the development of guidelines as the constraint, but rather developing the system capabilities and making them a priority. I think it is typically Ralph and team (Krysti Kovarik) that leads that effort. We will be happy to help where we can.

We have the HL Quarterly Business Review with the Corporate Credit Risk team on Wednesday, February 15 from 3:00 to 4:30 p.m.. David is scheduled to attend with me. David, I think it would be good for us to raise the subject so that you can express your enthusiasm for the product and so that we can assess the support we will receive from Corporate Credit Risk. Tony, I had spared you from this meeting, but it might be good to have you on for at least part of the call as well, particularly to talk about this subject. As you may recall, we included it in the Front End Guidance that we reviewed with them, but really didn□t have time to discuss it.

Would welcome your thoughts. Thanks.

Cheryl

From: Schneider, David C.
Sent: Friday, February 03, 2006 10:34 PM
To: Meola, Tony T.; Feltgen, Cheryl A.
Subject: RE: 80/20

What is the answer?

From: Meola, Tony T.
Sent: Thu 02/02/2006 10:48 AM
To: Feltgen, Cheryl A.
Cc: Schneider, David C.
Subject: 80/20

Cheryl,

We continue to get pressure for the 80/20 product particularly in the jumbo arena, where are we on the 80/20? To date we have said we would consider it, Long beach has it, but we have been reluctant to grant it to homeloans. There maybe some systems issues, but I think we can side step them. This was a follow up to David□s Cedarbrook meeting.

From: Schneider, David C.
Sent: Friday, November 30, 2007 4:44:33 PM
To: McMurray, John; Killinger, Kerry K.; Rotella, Steve; Cathcart, Ron; Casey, Tom; Corcoran, James; Baker, Todd
CC: Beck, David; Berens, John; Woods, John F.
Subject: RE: Modifications

John,

Thanks for putting together this summary. I agree with your points and they are consistent with our current plans around this issue. As of this time, it is my sense that we need to be prepared to work all borrowers who are current and express a willingness to stay in their home. This will, by necessity, be a loan by loan process although we can streamline some of the activities required to execute a mod.

I also think it is clear that the economic benefit of providing modifications for these borrowers is compelling for the following reasons:

- None of these borrowers ever expected that they would have to pay at a rate greater than the start rate. In fact, for the most part they were qualified at the start rate
- We need to provide incentive to these borrowers to maintain the home - especially if the home value has declined
- When we booked these loans, we anticipated an average life of 2 years and never really anticipated the rate adjustments

All that said, we are doing the math to show breakeven points. My sense is that Mods are the best bet. In fact, this is what the investment community is saying through their support of the national efforts.

ds

From: McMurray, John
Sent: Friday, November 30, 2007 3:08 PM
To: Killinger, Kerry K.; Rotella, Steve; Cathcart, Ron; Casey, Tom; Schneider, David C.; Corcoran, James; Baker, Todd
Subject: Modifications

There have been numerous separate conversations over the past several days on modifications. These discussion have included the potentially material consequences on provisions and sale treatments. The purpose of this email is to briefly summarize the situation and advocate three recommendations.

I. **Political Reality.** The political reality of this situation is increasingly misaligned with economic and accounting realities.

A. Activist Agenda. The activists have their own agenda and have exploited this situation by out-lobbying banks and investors. In some respects, previous activist activities around expanding homeownership via more accommodating credit standards may have ironically contributed to the current situation. A common refrain I've heard from various activists is: "get 'em in, keep 'em in."

B. Existing Processes. Except for isolated (mostly subprime only) servicers, there were already robust processes for work-outs and modifications (see II.A . below). This fact was so poorly communicated by the industry that it now matters little from a political perspective.

C. Foreclosure Consequences. Another poorly communicated, or at least poorly understood, fact is that lender/investors do not benefit from a foreclosure.

II. **Economic Reality.** Modifications should be pursued to optimize the economic consequences for the affected parties (i.e. the borrower and lender/investor), whose interests are usually aligned in a default situation.

A. Existing Practice. For most, if not all, of the situations where a modification would make sense, loans were already being modified by mainstream servicers. Existing practice is to tailor the work-out or modification to the specifics of each situation thereby maximizing its chance of success.

B. No Panacea. The "one-size fits all" modifications being promoted in DC will likely be much less successful than advertised. Here are a few reasons where a modification many not be successful:

1. The loan was for a speculative purchase. These transactions were more prevalent in this cycle even though some consumers may have camouflaged the true nature of their transaction.

2. The consumer purchased a new property and cannot sell their previous property, which they no longer occupy.

3. The consumer has negative equity and does not wish to remain in the property.

4. The consumer can't afford any payment as the result of a job loss or other actuarial event. Some of these situations can be saved with a work-out plan, but a simple rate reduction isn't one of the approaches that typically works.

C. Economic Alignment. The approach John Woods described in Wednesday's MCR is the right one. We need to have a reliable model/approach for predicting which specific modifications are likely to be economically viable. An unviable modification where the consumer eventually defaults is adverse to the interests of all parties, including the consumer, the lender and the investor (for sold portfolios).

III. **Accounting Reality.** The accounting issues relative to modifications have been raised repeatedly. So far, however, those entities which need to provide relief (e.g., FASB, SEC) have not seemed anxious to do so.

A. HFI portfolio. The provision for anything we modify is generally going to be higher than had we not modified the loan.

B. Sold Portfolio. A misstep here could have catastrophic consequences with many sold loans coming back onto the balance sheet.

IV. **Recommendations.** My recommendations are outlined below. I believe that some of these approaches may already be embodied in the initiative underway, which was commissioned by Schneider and led by Beck.

A. Viability. We should seek to do only those modifications that will be economically viable because that's what's best for the affected parties (borrower and lender/investor).

B. Company Position. Wherever we ultimately land with regard to changes in our work-out and modification strategies, we should crystallize our internal and external positions on this high visibility issue to promote understanding and avoid being outmaneuvered by those with competing agendas.

C. Accounting & Economic Consequences. We should understand the accounting and economic consequences before committing to any large-scale modification program.

Hybrid ARM Lending Survey

1. Hybrid ARMs are offered to many different types of borrowers. Of your hybrid ARM[1] offerings, what percentage (and amount) is lent to subprime borrowers? What percentage (and amount) would be considered Alt-A? For the two groups, what percentage (and amount) includes a "below-market" introductory rate? A "market rate" for this purpose might be considered the current fully indexed rate on the loan if it were reset today according to the terms of the contract.

Answer:
- Hybrid ARMs with 2-yr or 3-yr introductory rates represented approximately 66% of subprime channel origination volume in 2006, none of which were considered Alt-A. The subprime channel does not offer Alt-A products, which represent approximately 13% of February 2007 total volume, down from 15% in January 2007. Alt-A Hybrid products with introductory rate periods of three years or less represent less than 1% of total Alt-A volume in February 2007.
- All (100%) of the hybrid ARM products have introductory note rates that are below their corresponding fully-indexed rate. However, these introductory rates are closely matched with their corresponding term in the market yield curve. Thus, we do not consider an introductory rate that is tied to the market yield curve but below the fully-indexed rate to be "below market".

2. What are the borrower qualification criteria for subprime and Alt-A Hybrid ARMs? Specifically, what is the interest rate used to calculate the DTI ratio and how does this rate relate to the initial note rate, the fully indexed rate and the lifetime maximum rate? What are the maximum LTV and DTI ratios allowed? Are taxes, insurance and other housing related expenses included in underwriting subprime and Alt-A Hybrid ARMs? How do lower credit scores, higher LTV ratios, stated income and credit history affect the qualification analysis?

Answer:
- The note rate is used to calculate the qualifying monthly payment and DTI ratios. Taxes, insurance and other housing related expenses as well as other debt payments are included in the monthly payment calculations for both disposable income and DTI requirements.
- For Subprime currently up to 100% LTV/CLTV with 50% DTI is allowed for Full Doc depending on FICO score. Up to 95% LTV/CLTV is allowed with 50% DTI for Stated Doc depending on FICO score. There are higher FICO score minimum requirements for lower Credit Grades and higher CLTV. Usually higher FICO score is required for Stated Doc than Full Doc.
- For Alt-A Full Doc programs, currently up to 97% LTV / 100%CLTV with 45% DTI is allowed depending on the FICO score. For No Income Verification, No Income No Ratio, and No Income No Asset only up to 95% LTV/CLTV is allowed.

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[1] In this document, Hybrid ARMs refers to hybrid adjustable rate mortgages for which the interest rate is fixed for a relatively short period such as two or three years.

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- Risk-based pricing is applied to all subprime and Alt-A Hybrid ARMs. Higher risk transactions require risk-adjusted pricing (mostly by Doc type, FICO score and CLTV). Additional risk-based pricing add-ons are applied for various layered risk such as Non-owner occupied and multiple unit housing. Risk-based pricing is reflected in the note rate and qualifying rate. Loans that are not approved using an automated underwriting system are evaluated and qualified by seasoned underwriters, who utilize all information provided by the applicant to determine qualification and reasonableness of stated income or stated assets.

3. Given your experience, what is the percentage of subprime and Alt-A hybrid ARM borrowers who (a) prepay by refinancing into loans classified as prime products (b) prepay by refinancing into another subprime or Alt-A hybrid ARM product, or (c) do not prepay. For each group, indicate whether those borrowers' credit scores improved or declined (and by how much) during the initial fixed-rate period.

Answer: With a subprime market share of less than 10%, WaMu does not have much experience with Hybrid ARM subprime borrowers refinancing with WaMu and we do not control the lender selected by mortgage brokers, who source almost all volume through our subprime channel. However, we have a program that assists subprime borrowers to receive prime products and pricing when inquiries occur. Most subprime borrowers payoff their loan prior to the expiration of the contractual term, frequently before or just after the end of the introductory fixed-rate period if a Hybrid ARM.

4. For subprime and Alt-A Hybrid ARMs originated through broker or correspondent channels, do the third party's underwriting standards vary from the guidelines you use for originating your own loans? In what ways? What is the usual compensation for third parties involved in originating subprime and Alt-A Hybrid ARMs versus subprime and Alt-A non-Hybrid ARMs? Is third party compensation influenced by the existence of a prepayment penalty on subprime and Alt-A Hybrid ARMs?

Answer:

- We currently do not have different underwriting standards for brokers. We have also tried to match the correspondent underwriting standards or what we purchase from them with our own underwriting guidelines.
-
- The YSP that brokers can earn is limited to 1% for subprime loans that do not have a 3 year prepayment penalty. Brokers negotiate rates, fees and points with the borrower, which the brokers can choose to have paid in the form of a YSP. In some cases, a prepayment fee is required in order for WAMU to recoup enough yield to cover the YSP in the event that the loan pays off early.

5. By product type, can you provide examples of Notes and any Riders, copies of Regulation Z, and RESPA disclosure statements provided to consumers when originating subprime and Alt-A Hybrid ARMs. Also, can you provide copies of any additional documentation distributed to or targeted to consumers that describes subprime and Alt-A Hybrid ARM terms. Please include sample solicitations and other marketing materials.

Answer: See attached documentation. We have provided copies of the ARM Program Disclosures, TIL Disclosure statements and the notes used in our subprime channel. We have also attached the ARM program disclosures and notes used for our Alt A Hybrids. We will be following up with the TIL Disclosure statements for the Alt A Hybrids and sample marketing materials.

6. Given the potential for payment shock associated with subprime and Alt-A Hybrid ARMs that have "below market" introductory rates, how does the institution determine a borrower's repayment ability once the rate and payment increases (particularly for borrowers with lower credit scores, high LTV ratios or high DTI ratios)?

Answer:

- WaMu does not directly evaluate a subprime borrower's ability to repay their Hybrid ARM loan after the introductory rate and term expire. Our underwriting process is consistent for prime and subprime originations, in which future events are not considered (changes in interest rates, household income or debt, sources of income, property values or other criteria used in the underwriting process). We perform employment verification, and check the reasonableness of the income on all applicants. We also have managed the risk of borrowers by other means such as eliminating layered high risk borrowers by FICO, CLTV, loan purpose and loan documentation type. Historically, we have found these factors to be far more predictive of loan performance than projected DTI ratios.

From: Joans, Michelle L.
Sent: Wednesday, March 1, 2006 6:56 PM
To: Gordon, Scott A. <scott.gordon@wamu.net>
Subject: Re: Tommy Ramirez

Especially wo MI!
Michelle Joans
Washington Mutual Bank, FA
Manager, Credit Policy
206-490-5552
CSQ 608

-----Original Message-----
From: Gordon, Scott A.
To: Joans, Michelle L.
Sent: Wed Mar 01 15:46:35 2006
Subject: RE: Tommy Ramirez

I'm not sure Cheryl and/or David have the authority to put these loans in the portfolio. Rick Ellson would need to agree - based on previous experience it will be a very difficult to sell him on the concept.

Scott Gordon
Home Loans Credit Product Management
415.336.6425

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-----Original Message-----
From: Joans, Michelle L.
Sent: Wednesday, March 01, 2006 3:44 PM
To: Gordon, Scott A.
Subject: Fw: Tommy Ramirez

What do you think of Cheryl's comment about no MI??? I wanted to say, no way.
Michelle Joans
Washington Mutual Bank, FA
Manager, Credit Policy
206-490-5552
CSQ 608

-----Original Message-----
From: Feltgen, Cheryl A.
To: Joans, Michelle L.
Sent: Wed Mar 01 15:37:27 2006
Subject: Re: Tommy Ramirez

Thanks, Michelle. Look forward to getting the material. You guys can send it to me in an attachment. I will synch up my laptop in my room and then take it with me to the meeting. As to partners, I think where we are headed is that we would keep this in the portfolio since it is likely unsaleable by the time we are done. I think Tommy wants us to do this without MI.

Cheryl

-----Original Message-----

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From: Joans, Michelle L.
To: Feltgen, Cheryl A.
Sent: Wed Mar 01 15:19:32 2006
Subject: RE: Tommy Ramirez

Should have something to you in an hour or so - I am hoping that Ernie's email provided some of the background you were seeking - Scott and Ernie are in a much better position to talk to you about the past, as there is an extensive past as you might sense from the passion in Ernie's response! (-:

I think you will find that our summarized feedback will describe where we might be able to offer more and quite frankly, where those loans are now on a system that will enable us to allow DU EA approvals.

This pilot is a jumbo inner city affordable product, combining all the features of our lending up to $650k and > 95% LTV. We agreed to allow the use of DU and at the time could not allow DU EA due to system issues. DU EA (Desktop Underwriter Expanded Approval) is virtually Alt A or A- lending.

Other influences:

Our MI partners. Only one stepped forward and recently PMI was interested. This is another area we could explore and maybe negotiate more expansive guidelines but everyone has to be clear that this is not all up to us, we have external partners to deal with.

From: Feltgen, Cheryl A.
Sent: Wed 03/01/2006 1:23 PM
To: Joans, Michelle L.
Subject: RE: Tommy Ramirez

Thanks, Michelle. I am meeting with David, Tony and Wayne in a few hours this afternoon. Send things to me so that I can read in the body of the email. I need to know what we have allowed Tommy to do in the past, the details of the pilot and most importantly what it is that we would recommend we do in the future. Can you send me again the details of the DU EA? I am not sure I really understand the implications of what you described below. Steve Rotella obviously now has a feeling that we have taken forever and not provided much to Tommy and his team. Whether that is true or not, Steve has put us in a position that we will have to offer up something. I look forward to receiving the information. Thanks.

Cheryl

-----Original Message-----
From: Joans, Michelle L.
Sent: Tuesday, February 28, 2006 8:15 PM
To: Feltgen, Cheryl A.
Subject: Re: Tommy Ramirez

I will be in early and plan to have something waiting for you. Can you provide any insight into David's comment about a broken process. We created a product eclusively for this loan consultant and what he wants is an alt a like product. Can you open attachments or do you want everything in the body of the email.

1. Ability to make fico exceptions locally - we talked about this a little bit and I am all for pushing authority to the loan level. Not sure about the request though, the example provided appears to be around the 680 for low doc, the uw can go to 660, so is this request that they can go further locally and up to 80 points below the requirement? This is an extreme exception and again brings us into alt a territory. If we decide to do this, we need to address it for the entire country from a fairlending perspective I would expect. Then, where we reqiure 680, is a 600 ever acceptable?

2. They want us to accept cash on hand. We do to a certain extent but this is really an issue for investors as assets from the borrower or the borrower's investment is a critical factor. Tomorrow I will give you the facts of the program.

3. I had sent you an outline of this program. During the last review it was determined that being able to us DU EA would bring a significant lift and we are very close to working this out. Before they got off to an alt a type product, everyone acknowledged that the loans were being approved under DU EA. We are overcoming system issues to get this done.

I have not idea what the comment about realtor broker fees is about. I will follow up with Scott and Ernie, do you have any ideas?

These loans are generally over 80% and subject to MI - a significant factor.

Michelle Joans
Washington Mutual Bank, FA
Manager, Credit Policy
206-490-5552
CSQ 608

-----Original Message-----
From: Feltgen, Cheryl A.
To: Joans, Michelle L.; Shaw, Robert H.; Mortensen, Ernie
Sent: Tue Feb 28 18:34:24 2006
Subject: Fw: Tommy Ramirez

See attached and my earlier email. I need as much of what I asked for as you can possibly put together in time for my meeting with David , Steve and Tony tomorrow. Thanks.

Cheryl

-----Original Message-----
From: Schneider, David C.
CC: Feltgen, Cheryl A.; Meola, Tony T.; Pollack, Wayne A.
Sent: Tue Feb 28 16:53:18 2006
Subject: Re: Tommy Ramirez

Having sat through the wholesale meeting and seeing this from steve, my conclusion is that there is a broken process. We have all been in place long enough to recognize that we can no longer blame the old team. Let's have the 4 of us get together tomorrow (say late afternoon at 5) to discuss. Does that time work?

-----Original Message-----
From: Rotella, Steve
To: Schneider, David C.
CC: Feltgen, Cheryl A.; Meola, Tony T.
Sent: Tue Feb 28 15:18:45 2006
Subject: Tommy Ramirez

I had a meeting with Tommy and his crew and want to express my views about the work they do and why the company is not meeting their needs and what I think we must do.

David and Cheryl, you are just getting to know these guys, but besides the volume tsunami they produce, they are intertwined in their community and have produced great quality for us. Further, they live our values and are not price conscious I met them last year and was so impressed, I suggested we use them to spawn similar operations in Hispanic communities across the US if possible using them to model, train, and certify the work. Frankly not much has happened.

We should fall all over ourselves to have a business segment that attracts minorities, is almost all Option Arms, is not price driven, delivers great quality, and is oriented to the average guy, our market.

So here I was again a year later withan expectation that they wanted the world. The usual list of demands from whiny mortgage LCs!!?? Nope, a short and I think largely reasonable list of asks that I want to quickly discuss, resolve, and move on. What frustrates me a bit, is if any group has earned some flexibility, these guys have, yet they can't seem to get the process and organization to act without getting "muscle" (read me) involved, which I don't mind.

So what do they want?

1. Flexibility to have their local underwriters go below 660 (to 600) on FICO rather than the cumbersome process of sending these off to other "senior" credit people. This seems ok to me with a good governance process and a random QA process. Again these guys are serious players and deserve flexibility.

2. The ability to count assets in the underwriting that are not in a financial institution at time of the process, but would be a contingency at closing to be in Wamu.

3. Some changes to the 97 product we rolled out that has been a flop. We set a 150mm max test and the criterea have blunted any action. Also the ability to have realtor broker fees on these.

I would like a quick discussion with you when you return on these and assuming some agreements, a call with Tommy and crew after. Thanks.

Mary, would you set up a 1/2 call with David, Cheryl, and Tony. Thx.

Sent from my BlackBerry Wireless Handheld

From: Pohlmann, Andrew P.
Sent: Tuesday, June 6, 2006 11:52 AM
To: Perry, Rich <u158466@wamu.com>
Subject: FW: Option ARM Sales Mastery Program

Who can I contact to get enrolled in the HLC manager version of this training program?

AP

-----Original Message-----
From: e-Flash
Sent: Monday, June 05, 2006 1:12 PM
Subject: Option ARM Sales Mastery Program

e-FLASH Washington Mutual

Subject: 06.05.06 - Option ARM Sales Mastery Program

To: Retail Production Sales (including Emerging Markets and Banking)
From: Steve Stein

Over the last month, you've heard the details of our refined business model from David Schneider and me. I want to thank you for attending the Production meetings in May, asking questions and working together to support this strategy.

We are beginning to focus on higher-margin products like our flagship product, the Option ARM. This is a fantastic product for almost any borrower. To help our sales force feel more comfortable with selling the Option ARM to a wide variety of borrowers, we are rolling out a comprehensive skills assessment and training initiative. The program was reviewed with all managers on my June 2 conference call.

This initiative is not about selling the Option ARM to everyone. We will always stay true to our values, and provide the right loan for every customer. This is about helping our sales force identify when the Option ARM might be a good choice for the customer, and how to explain the features and benefits of the product effectively. Through the skills assessment, training, role playing and a best-practices selling tips video, I think this Retail sales team will be unstoppable with the Option ARM.

HLC Managers will be proxy enrolled for the Talent Builder curriculum end of day June 6. This will give managers a week to get familiar with the training before Loan Consultants, Associate LCs, and Banking LCs are proxy enrolled end of day June 13.

The Option ARM is our product and we can sell it better than anyone. I have great confidence that we'll improve our Option ARM market share quickly, like the experts we are.

Thank you in advance for attending training and supporting this product.

Washington Mutual, Inc. Internal Use Only

From: e-Flash <e-Flash@wamu.net>
Sent: Monday, July 3, 2006 5:47 PM
To:
Subject: 2006 Option ARM Blitz - Quarterly Incentive Campaign
Attach: Retail LC 3-Mo Production_vSFR 6-28.xls

e-FLASH Washington Mutual

Subject: 07.03.06 - 2006 Option ARM Blitz - Quarterly Incentive Campaign

To: Retail Production, including Emerging Markets
From: Steve Stein

You've seen and heard a lot recently about our refined business model and focus on higher margin products, especially Option ARMs. To further drive this focus, I'm pleased to announce the 2006 Option ARM Blitz - Quarterly Incentive Campaign. This will allow eligible Loan Consultants to earn 5 additional basis points on all Option ARM volume funded during the 3rd quarter 2006.

Summary of how it will work:

- Goal: Challenge each Retail Loan Consultant to increase individual product mix percentage funded of Option ARMs by 10 incremental percentage points (or more). Each month during the quarterly campaign – July, August, and September (the measurement months) – the Retail Loan Consultant's individual product mix percentage will be compared independently against the baseline product mix percentage.
- Participants: Tier 3 and higher Retail Loan Consultants in the Retail Loan Consultant position effective 3/1/06. (Banking Loan Consultants and Associate Loan Consultants are ineligible. Tiers 1 & 2 Retail Loan Consultants are not eligible in any given month when at Tiers 1 or 2. However, should he/she subsequently achieve Tier 3, 4, or 5 status during any campaign month, he/she will be eligible for that month.)
- Products: 1 & 3 month MTA & COFI Option ARMs
- Baseline: Loan Consultant's average product mix percentage of Option ARM volume funded during March, April, and May 2006, as queried from FDM.
- Tier achievement: Tier achievement will be determined by the monthly Tier Report produced by the Enterprise Incentive Reporting team.
- Award: 5 additional basis points (in addition to basis points awarded under the 2006 Retail Loan Consultant Incentive Plan) will be earned by eligible participants on all Option ARM volume funded for each given campaign month (July, August, September) if, during such month:
  - The Retail Loan Consultant is Tier 3 or higher, and
  - The Retail Loan Consultant achieves a minimum of 10 incremental percentage points increase in desired product mix when compared against the baseline percentage.
- Reporting: Results from a given month during the campaign will be published via eFlash by the 15th of the following month. For example, July results will be available by August 15th.

For example:
A Loan Consultant funded $2.5M in Option ARM volume for the three months of March, April, and May and had $10M in total product fundings for the same time period, as reflected in data queried from FDM. His/her baseline would be 25% ($2.5M divided by $10M). If, during the month of July, he/she achieves tier 3 or higher and his/her product mix of Option ARMs is 35% (or more) then he/she will earn an additional 5 basis points on all July Option ARM fundings. If this same Retail Loan Consultant achieves 35% (or higher) product mix of Option ARMS in August (or September), then he/she would again earn 5 bps on all Option ARMs that fund in the given month where all criteria for the payout are met.

Calculation specifics:

The calculation of Option ARM product mix percentage will be based on SFR volume only (Equity products not included) for the baseline periods as well as the measurement periods. The baseline percentage for each Loan Consultant is defined in the attached list. The Option ARM product mix percentage for each of the measurement months will be calculated by Finance based on volume funded for the month as posted in FDM by the first business day of the following month (i.e./ all July fundings posted by August 1st will be July's full month's fundings for calculation purposes).

When earned, the additional 5 basis points will be paid 30 days after the measurement month's end. For example, incentive earned on July Option ARM fundings would be paid at the end of August. The incentive will be paid on a normal month-end paycheck. For Retail Loan Consultants in a partnership, the partnership will be considered to be a solo participant. If the partnership earns the additional 5 bps in any given month of the campaign, the award will be split per the applicable basis point commission split as reported in the partnership agreement. Incentive costs will be charged to the originating HLC's cost center.

This is a brief summary of the program. Full details, including all applicable conditions, will be provided in the 2006 Option ARM Blitz – Quarterly Incentive Campaign Program Document, which I encourage you to refer to.

<u>Following is a selection of material to help kick off your efforts:</u>

Once you click through to any given section, look for other Option ARM marketing available to you in that section.

Presentation:	PowerPoint presentation for Realtors *eMarketing Tools/Presentations 18176*
Consumer Flier:	Promote 1% start rate *Fliers/Consumer 19023*
Matrix:	Product matrix *Printed Collateral/Brochures and Fact Sheets 18060*
Brochure:	Rack-size brochure that provides in-depth descriptions of each of the four payment options and contains the Option ARM Sample Statement *Printed Collateral/Brochures and Fact Sheets 18077*
Ad:	Monthly ad targeting First Time Homebuyers *Ads/Consumer AD-080*

I'm excited about the focus of this campaign and look forward to seeing the results. Let's go out and make it happen!

From: e-Flash <e-Flash@wamu.net>
Sent: Thursday, August 17, 2006 6:08 PM
To:
Subject: Option ARM Parameter Enhancements

e-FLASH Washington Mutual

Subject: 08.17.06 Option ARM Parameter Enhancements

To: Production and Operations - Consumer Direct, Wholesale, and Retail (including Banking and Emerging Markets)
From: Steve Stein, Arlene Hyde, and John Schleck

PURPOSE

This communication announces the following enhancements to the Option/Flex ARM Products:

- Attached properties (including condos and co-ops) are allowed to higher loan amounts.
- Certain eligibility parameters have been enhanced for low doc second homes.

OPTION/FLEX ARM PARAMETER ENHANCEMENTS

The Option/Flex ARM Enhancements described below are effective on August 21, 2006. All impacted systems will be updated as of this date.

One unit attached properties are now allowed on Option/Flex ARM loans up to $3 million. Product parameters (LTV, CLTV, FICO) will be the same for detached and attached properties for each tier as listed in the Product Parameter pages of the PPG. This change includes the following:

- 1 & 3 month MTA and COFI Option ARM and Flex 5 Option ARM products
- Full and Low Doc
- 1-unit owner-occupied properties and 1-unit second homes
- Purchase, limited cash-out refinance and cash-out refinance transactions
- All attached property types, including 1-unit co-ops

Since product parameters for Option/Flex ARM co-ops up to $3 million will now match the 1-unit product parameters for other attached properties (such as condos), separate Option/Flex ARM Co-op Product Parameter pages will no longer be published in the PPG. A note will be added to the standard Option/Flex ARM Parameter Pages as a reminder of the co-op policy.

PARAMETER ENHANCEMENTS

Option/Flex ARM product parameters have been enhanced to allow greater flexibility. The impacted parameters are Low Doc 1-unit second homes on Purchase and Limited Cash-out Refinance transactions.

Low Doc 1-unit Second Homes (Standard Parameters)

Max Loan Amount	Current LTV	New LTV	Current LTV/CLTV	New LTV/CLTV	FICO
$1.5 million	70%	75%	70%/70%	75%/75%	640
$3.0 million	65%	70%	65%/70%	70%/70%	680

NEW APPLICATIONS AND PRE-LOCKS

- The enhancements are available for all new applications and Wholesale pre-locks received on August 21, 2006.
- Expired locks that relock on August 21, 2006 will follow standard relock policy.

PIPELINE LOANS
All pipeline loans as of August 21, 2006 may be eligible for approval under the new enhancements. Standard change request processes apply.

Questions concerning this communication should be directed to your manager. An HLPA is to follow.

From: e-Flash <e-Flash@wamu.net>
Sent: Friday, August 18, 2006 4:47 PM
To:
Subject: Option ARM Sales Mastery Program Added to New Hire Training

e-FLASH Washington Mutual

Subject: 08.18.06 - Option ARM Sales Mastery Program Added to New Hire Training

To: Managers - Retail Production Sales (including Emerging Markets and Banking)
From: Allen Myers, Home Loans Training

In June, the Option ARM Sales Mastery Program was launched with the goal of increasing knowledge and skills of our sales force in selling the Option ARM, including explaining the product effectively and identifying when the product would be a good fit for a potential borrower.

Effective August 7, 2006 we have extended this initiative to include all new hires in Loan Originator positions by adding the Option ARM Sales Mastery Program to the following mandatory training curricula, available in Talent Builder:

- Power Pac and New Loan Consultant Retail Training Curriculum
- Banking Loan Consultant (BLC) Curriculum
- Associate Loan Consultant Program e-Learning Curriculum

New Loan Originators participating in these training curricula will complete the Option ARM Sales Mastery Program after attending the workshop component of their specific curriculum. Through skills assessment, training, role playing and a best-practices selling tips video, continuing this approach is geared to increase sales performance of the Loan Consultants.

Action Required:
As HLC Managers, you will register new Loan Consultants, Associate Loan Consultants, and Banking Loan Consultants into the appropriate new hire training curriculum referenced above. The Option ARM Sales Mastery Program is automatically included in the curriculum. A critical component to the success of this program is the role play and presentation activities. Remember, you are still responsible for administering, providing feed-back and determining ultimate qualification for each of your Loan Originators.

If you have any questions regarding training, please e-mail us at HomeLoansTraining@wamu.net, and for other training information for Home Loans, visit our website at Home Loans Training.

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Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #375

From: e-Flash <e-Flash@wamu.net>
Sent: Thursday, August 31, 2006 1:31 PM
To:
Subject: Consumer Direct Pricing Improvements

e-FLASH Washington Mutual

Subject: 08.31.06 Consumer Direct Pricing Improvements

To: Consumer Direct
From: Mary Ann Kovach

Introducing....the pricing specials for September:

The specials for September will focus on three of our higher margin products; Jumbo Fixed, Option Arm, and Nonprime Loans. These specials are in line with our direction to originate high margin products.

1) Option Arms – waive all **closing costs** with the exception of $295 appraisal deposit. Collect $295 appraisal deposit at application. Customer is responsible for paying per diem interest, mortgage tax stamps and escrows.

2) Jumbo 15/30 Fixed – reduce the **rate** by an 1/8th (.125%)

3) Nonprime – reduce the **discount** by .50

Price Specials will be in effect from Friday, September 1st through Saturday, September 30th. Also, Price Specials are not applicable for Employee Loans.

Loan Consultants must complete a pricing exception form and have their Sales Manager approve the form for each loan where the Price Special will be used.

Reminder: All previously announced pricing specials expire on August 31, 2006.

Please contact your manager, should you have any questions.

Washington Mutual, Inc. Internal Use Only

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #376

From: e-Flash <e-Flash@wamu.net>
Sent: Thursday, October 12, 2006 3:12 PM
To:
Subject: Fall Kickoff Classic-Revised October Price Specials
Attach: Consumer Direct HL 4th QTR Sales Contest 09.06 v2.pdf

e-FLASH Washington Mutual

Subject: 10.12.06 Fall Kickoff Classic-Revised October Price Specials

To: Consumer Direct
From: Mary Ann Kovach

Fall Kickoff Classic

It was brought to my attention that the October Price Specials included in the Fall Kickoff Classic e-flash announcing the contest, were not consistent with the New October Price Improvements e-flash I sent out on 9/28. I apologize for any inconvenience this has caused. Please review the corrected Price Specials on page 2 of this e-flash. See your manager if you have any questions.

Welcome to the Fall Kickoff Classic Contest! Consumer Direct will be hosting the 4th Quarter Fall Kickoff Classic beginning October 1, 2006, which includes weekly contests, a quarterly contest and some great awards!

Weekly Contests

For the 13 weekly contests, the Loan Consultant from each Sales team, who accumulates the most points receives an IncentOne Gift Card with a face value of $100.00.

Option ARM applications	"Touchdown"	(7 Points)
Jumbo-fixed applications	"Field Goal"	(3 Points)
Equity applications	"Field Goal"	(3 Points)
Nonprime applications	"Field Goal"	(3 Points)

In the event of a tie, dollar units will be used to decide the winner.

4th Quarter Contest

At the end of the 4th Quarter, Grand Prize awards will be issued to the top 15 Loan Consultants, Top 3 Sales Managers and Top Site Manager based upon total funded Option ARMs, Jumbo-fixed, Equity, and Nonprime units.

Loan Consultants

Loan Consultants will be ranked based on total Option ARM, Jumbo-fixed, Equity and Nonprime units funded during the quarter.

Ranked 1-5	$1000.00 IncentOne Gift card
Ranked 6-10	$500.00 IncentOne Gift card
Ranked 11-15	$250.00 IncentOne Gift card

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #377

Sales Managers

Sales Managers will be ranked based on average fundings for Option ARM, Jumbo-fixed, Equity and Nonprime for Loan Consultants on their teams during the quarter.

1st place	$1000.00 IncentOne Gift card
2nd place	$500.00 IncentOne Gift card
3rd place	$250.00 IncentOne Gift card

Site Managers

Site Managers will be ranked based upon unit fundings for Option ARM, Jumbo-fixed, Equity and Nonprime within their site for the quarter and the overall winner will be awarded a $1000.00 IncentOne Gift card.

We've announced some great pricing specials for October to get you off to the right start for our Fall Kickoff Classic Contest.

1. Option Arms – we will continue to waive all closing costs and we will not be collecting the $295 appraisal deposit at application. Customer is responsible for paying per diem interest, mortgage tax stamps and escrows.
2. Jumbo 15/30 Fixed – reduce the rate by 1/8th (.125%).
3. **Fixed Rate Loans Over $200,000 – reduce the rate by 1/8th (.125%) (ICO loans are not eligible)**

Price Specials cannot be combined.

Price Specials are not applicable to ICO, Nonprime or Employee Loans.

Go out and make your coach proud this quarter! Originate an Option ARM and score a touchdown or originate a Jumbo-fixed, Equity or Nonprime and score a field goal. Bring home a victory and you will win some great prizes!

Please contact your manager, should you have any questions.

From: e-Flash <e-Flash@wamu.net>
Sent: Monday, November 13, 2006 6:07 PM
To:
Subject: Consumer Direct November Pricing Improvements

e-FLASH Washington Mutual

Subject: 11.13.06 Consumer Direct November Pricing Improvements

To: Consumer Direct
From: Mary Ann Kovach

We've clarified the fees that will be waived on the November Pricing Improvements Please note the changes, which are highlighted in red. The following price specials are available in November:

1. **Option ARMS – $1,000 off closing costs for loans under $300,000.**

   Option ARM loans over $300,000—Waive all fees.

   We will not be collecting the $295 appraisal deposit at application. Customer is responsible for paying per diem interest, mortgage tax stamps, and escrows. This Price Special is not applicable to Nonprime **or Prime Texas loans.**

2. **Alt A 10/20—waive all WaMu Fees for loans under $300,000.**

   We will not be collecting the $295 appraisal deposit at application. Customer is responsible for paying per diem interest, mortgage tax stamps, escrows and title. This Price Special is not applicable to Nonprime **or Prime Texas loans.**

   Alt A 10/20 loans over $300,000—waive all fees.

   We will not be collecting the $295 appraisal deposit at application. Customer is responsible for paying per diem interest, mortgage tax stamps, and escrows. This Price Special is not applicable to Nonprime **or Prime Texas loans.**

3. **5/1 Jumbo I/O—waive all WaMu Fees for loans under $500,000.**

   We will not be collecting the $295 appraisal deposit at application. Customer is responsible for paying per diem interest, mortgage tax stamps, escrows and title. This Price Special is not applicable to Nonprime **or Prime Texas loans.**

   5/1 Jumbo I/O loans over $500,000—waive all fees.

   We will not be collecting the $295 appraisal deposit at application. Customer is responsible for paying per diem interest, mortgage tax stamps, and escrows. This Price Special is not applicable to Nonprime **or Prime Texas loans.**

4. **Nonprime—** *Applies ONLY to Nonprime to Nonprime (existing LBM or SMF customers – existing Prime customers do not receive)*—**Reduce the discount by .50%.**

5. **Conventional Fixed Rate Loans Over $300,000. Reduce the rate by 1/8th (.125%). This Price Special is not applicable to Nonprime or Prime Texas loans.**

- Price Specials are not applicable on Employee Loans.

- Price Specials will be in effect 11/1/06 – 11/30/06.
- Loan Consultants must complete a pricing exception form and have their Sales Managers approve.
- Please contact your manager, should you have any questions.

Feb 24, 2005

TO: Executive Committee

FROM: Jim Vanasek

SUBJECT: Critical Pending Decisions

We have come to a critical point with respect to decisions about credit exposure for the balance of this year and on into '06. The recent concern about asset growth has lead to considerable discussion about options involving higher risk exposure in a variety of products to include more LBMC loan retention (over and about the $5bn already in the plan), retention of 80/20 Piggyback seconds originated through LBMC etc.

From a risk perspective we are in a classic bind. In the current environment the assets that we seem to be able to grow most readily with reasonable spreads are those assets with higher risk profiles – Option ARM's, sub-prime, interest-only, and 100% LTV. While our '05 Plan contemplated a significant increase in sub-prime assets, it did not include all the products currently up for discussion.

More importantly the Finance Committee only approved the '05 Plan based upon assurances from Credit that the contemplated exposures were reasonable and could be managed. My interpretation of the Committee's reaction was that they have healthy concern about where we might be in the economic cycle and whether it makes sense to significantly expand our higher risk exposure at this point in time.

Almost concurrent with that Finance Committee meeting, the OTS expressed concern about deterioration in credit terms in home equity lending. Our historic conservative posture with respect to home equity allowed us to deflect that discussion, but obviously any move to retain sub-prime, 100% LTV seconds would fly in the face of their concerns.

But what about our own management view of the market? Kerry and Bill have both repeatedly expressed concerns about the housing market and the possibility that we are in the latter stages of the cycle. We have seen home prices in places like Las Vegas increase 47% in one year. That being the case, the appropriate question is how much additional risk do we want to take on at this time? On the one hand, we need asset growth and the likely products to produce that growth are higher risk, and on the other, we have an instinctive caution about the super heated housing markets on both coasts where we are most heavily exposed.

This unreconciled issue lurks behind many of our conversations. Tom fears that we will not have asset growth sufficient to fully leverage the capital that we are generating. Others fear that we cannot make the plan. My credit team and I fear that we are considering expanding our risk appetite at exactly the wrong point and potentially walking straight into a regulatory challenge and criticism from both the Street and the Board. Said another way I fear that the timing of further expansion into higher risk lending beyond what was contemplated in the '05 Plan and most especially certain new products being considered is ill-timed given the overheated market and the risk higher interest rates. There is considerable anecdotal information suggesting that people are speculating heavily on further price increases in housing. Consumer debt levels are a national concern. A few of you have privately expressed concerns that you have about the situation but are reluctant to bring the discussion into the open.

The most immediate issues have to do with specific new high risk loan products. The more significant risk is the '06 Plan that we will have to take to the Board in June. If we meet the '05 Plan objectives for higher risk lending, we will have maxed out our current limit tied to capital. At this time we do not have an adequate feel for the regulatory reaction should we attempt to increase that limit. Sooner rather than later we risk hitting the wall with either OTS or the Board on this issue. And the issue will not limited to higher risk lending, it will be wrapped together with neg am and payment shock if my read of the regulatory environment is correct.

There are no easy answers about the situation in which we find ourselves, but I feel compelled to bring issue forward and place it on the table for discussion.

One other observation, several of you have looked at the current losses and concluded that there is no real problem at this point in time. Some have questioned the 25bps as an average target charge-off ratio, pointing out correctly that commercial banks operate at higher charge-offs levels with no problem whatsoever. From my perspective one of our advantages from the standpoint of the stability of our stock price has been our credit performance. If losses were to double to 15 bps, the institution is still very adequately reserved and by no means in jeopardy but that does not mean that the Street will not react negatively and the same is true for the bank regulators. We certainly can move to higher loss levels safely (assuming adequate margins), but the question will be how quickly and how well we have prepared our constituencies for that change. It also depends upon the timing and market conditions.

So we come down to the basic question, is this the time to expand beyond the "05 Plan and/or to expand into new categories of higher risk assets? For my part I think not. We still need to complete EDE, reduce policy exception levels, improve the pricing models, build our sub-prime collection capability, improve our modeling etc. We need to listen to our instincts about the overheated housing market and the likely outcome in our primary markets. We need to build further credibility with the regulators about the control exercised over our SFR underwriting and sub-prime underwriting particularly in LBMC.

I fully recognize the challenge that this creates particularly in '06. It means we must put on the table the possibility of slower asset growth, tighter NIM, deployment of excess capital etc.

I raise these issues not for the purpose of challenging any member of the Executive Committee, but rather to encourage healthy discussion and debate. There is no question that the Street demands growth but equally there is no question that we need to ensure that the growth is prudent.

WaMu

Enterprise Risk Management Committee
December 15, 2006
WMC 32, Boardroom 2:00 – 4:00
Phone 877-921-4307, Passcode 825867

Attendees

Voting Members:

Ron Cathcart (Chair)	Al Brooks	Tom Casey	Fay Chapman
James Corcoran	Deb Horvath	Steve Rotella	Benson Porter
Joe Saunders	David Schneider		

Non-Voting Members:

Hugh Boyle	Cheryl Feltgen	Mark Hillis	Michelle McCarthy
Richard Lewis	Randy Melby	Robert Williams	Marc Wright

Other Participants:

Tom Henning (secretary)	David Beck	Youyi Chen	Ramon Gomez
Ann Tierney	Tom Morgan	Cynthia Abercrombie	Joe Mattey
John Stewart			

Agenda

Topic	Presenter	Objective	Time
1. Review Prior Meeting Minutes	Tom Henning		5 Min
• October 4, 2006		Approve	
• October 10, 2006			
• Outstanding Action Items		Update	
2. Approve Policies & Standards:			
• None			
3. Approve Home Loans CDO Proposal	David Schneider/David Beck	Approve	30 Min
4. Approve Enterprise Risk Management 2007 Plan	Hugh Boyle/Michelle McCarthy	Approve	30 Min
5. Review Data Management Program Presentation to the Board	Tom Morgan	Review	10 Min
6. Update on Compliance Review Results Reporting	Richard Lewis	Review	15 Min
7. Corporate Credit Review Organizational Update	Cynthia Abercrombie	Review	15 Min
8. Discuss Compliance with FFIEC Guidance on Authentication in an Internet Banking Environment	Deb Horvath	Review	10 Min

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #422

Enterprise Risk Management Committee Minutes
October 4, 2006

The Enterprise Risk Management Committee (ERMC or Committee) for Washington Mutual, Inc. and Washington Mutual Bank met on October 4, 2006 in the Board Room of the Washington Mutual Center, Seattle, WA.

Voting Members Present:

Ron Cathcart (Chair)	Al Brooks	Tom Casey	Fay Chapman
Deb Horvath	Benson Porter	David Schneider	

Non-Voting Members Present:

Hugh Boyle	Chaomei Chen *	Mark Hillis	Richard Lewis
Michelle McCarthy	Randy Melby	Marc Wright	Robert Williams

Other Participants Present:

Karin Znamirovschi (Secretary)	Cynthia Abercrombie	Amy Alexander*
Robert Collins	Thomas Henning	Robert Shaw

* Attended by telephone

A quorum being present, Mr. Cathcart called the meeting to order at 8:04 a.m.

The June 28th meeting minutes were approved as presented, and the prior meeting action items reviewed.

Value at Risk Limit Adjustment

Ms. McCarthy reviewed with the Committee the Change to Value at Risk Limit and Annual Review and Approval of the Asset and Liability Management Policy presentation. The proposed change to the Policy adjusts the existing one quarter, two standard deviation confidence Value at Risk limit for Market Value Managed businesses (the "quarterly" limit) from the existing $700 million to $500 million. The adjustment reflects the reduction in risk exposure caused by the sale of $2.6 billon of the Mortgage Servicing Rights portfolio in July 2006. An additional related limit was also proposed of $230 million calculated based on a 10 day, 99% confidence Value at Risk (the "10 day" limit). This measurement approach is the regulatory standard and is expected to be the basis of market risk capital for these assets beginning in 2008. It is the short term intention to utilize both limits in parallel, and consider retiring the quarterly based limit in 2007.

Ms. McCarthy and the Committee further discussed the current low utilization of the limit and the rationale for the proposed new level.

The Committee voted on and recommended that the Boards of Directors' Finance Committees of Washington Mutual, Inc. and Washington Mutual Bank, and the Board of

Enterprise Risk Management Committee Minutes
October 4, 2006

Directors of Washington Mutual Bank fsb approve the adjustment of the quarterly limit and the adoption of the 10 day limit.

Operational Risk Management Policy Annual Approval

Ms. McCarthy reviewed with the Committee the revised Operational Risk Management Policy. The Policy includes three key revisions:

- Proposes an Operational Risk Economic Capital limit of 18% of available financial resources, and further proposes requiring that the Enterprise Risk Management Committee establish a targeted level of Operational Risk Economic Capital on at least an annual basis.
- Streamlines the Operational Risk Management Committee membership and meetings and changes the name to Operational Risk Committee. The Committee will approve Operational Risk Standards and oversee implementation of the Operational Risk Framework set forth in the Policy and associated standards.
- Establishes governance over Operational Risk Economic Capital Model changes.

The Committee engaged Ms. McCarthy in a discussion of the readiness of the Company to establish an Economic Capital limit and the timing given the continuing development of the Basel II compliance program. Upon further discussion and clarification, the Committee determined that the Policy should be submitted to the Audit Committee without the proposed Economic Capital limits. The Economic Capital limits will be re-presented after further planned development of the Basel II measurement methodology.

The Committee voted on and recommended that the Boards of Directors Audit Committees of Washington Mutual, Inc. and Washington Mutual Bank, and the Board of Directors of Washington Mutual Bank fsb approve the Policy as amended to exclude the Operational Risk Economic Capital limit.

Corporate Credit Review Policy Approval

Mr. Boyle and Ms. Abercrombie presented to the Committee the Corporate Credit Review Policy. The Policy establishes an independent Corporate Credit Review function reporting to the Chief Credit Officer. The function focuses on only the credit aspects of lending versus the previously combined credit and compliance reviews performed by the former Corporate Risk Oversight Department. This function performs various testing activities to provide an independent assessment of credit risk and quality and to ensure lending and credit risk management practices are consistent with corporate business strategies and risk tolerance objectives.

Mr. Cathcart further clarified the role of the function as a back-end oversight and detective control that places responsibility for complying with lending policies and standards with the business units. This arrangement compliments the Chief Credit Officer's responsibility to set credit risk strategy. Mr. Boyle further noted that this group

Enterprise Risk Management Committee Minutes
October 4, 2006

would not oversee the counterparty credit risk function which reports directly to Mr. Boyle. Counterparty credit oversight will be provided by Audit Services.

The Committee voted on and recommended that the Boards of Directors' Finance Committees of Washington Mutual, Inc. and Washington Mutual Bank, and the Board of Directors of Washington Mutual Bank fsb approve the Policy as presented.

Enterprise Fraud Management Standard Approval

Mr. Hillis presented to the Committee the Enterprise Fraud Management Standard of the Operational Risk Management Policy. The Standard sets forth the framework, delegation of authority, and oversight authority for fraud management at WaMu. The Standard was created in line with industry best practice and in response to regulatory criticism. It allows management to leverage best practices across the organization and increases management's ability to understand the nature and amount of fraud risk. The Standard assigns responsibility to the Operational Risk Committee for subsequent approvals of the Standard and monitoring compliance.

The Committee voted on and approved the Standard as presented.

Basel II Data Management Gaps and Data Governance as an Emerging Risk

Ms. McCarthy, Ms. Alexander, and Mr. Collins reviewed with the Committee the Basel II Data Governance Project presentation. Basel II requires data integrity checks as a basic element of any Basel II compliance program. Demonstrating control over the data is a requirement for receiving program certification from the regulators. Data integrity is further an overall Operational risk concern, beyond Basel II requirements.

The project created data standards, identified gaps against the standards, notified the data element owners, and initiated issue tracking and resolution. In response to the results, a permanent data integrity resource was hired to carry on the verification of data integrity controls for Basel II data and to broaden the verification of data integrity controls to reduce operational risk. Analysis of the gaps identified two root causes, examples of which were discussed: a lack of accurate system mapping, and poor control over process changes that impact downstream data users.

The Committee discussed the broader data management issues within the Company, including establishing data ownership over all data elements, and similar data management efforts that could be leveraged for best practices.

Mr. Melby discussed with the Committee the Data Governance – Emerging Risk Issue which is included in the third quarter Audit Services report to the Audit Committee. The issue notes data ownership and stewardship as an enterprise issue, and that recent audit reports have highlighted the need for enhanced data governance. Audit Services referenced a core team tasked with developing a proposal for a cross-functional Data

Enterprise Risk Management Committee Minutes
October 4, 2006

Governance structure that leverages the existing Basel II effort. Audit Services is recommending to the Audit Committee that it receive periodic progress updates.

2007 Business Unit Risk Strategy Overviews

Ms. Znamirovschi introduced the 2007 Business Line Risk Management Overviews. The Overviews are a preliminary assessment of the elements of risk in the 2007 Plan, and a summary of the associated risk management strategies and initiatives. The Overviews will be further supplemented by a quantification of the credit risks and concentration limits for each business line in Front End Guidance which will be presented at the October 12 and 13 Monthly Business Review.

The Chief Risk Officers of each business, with Robert Shaw substituting for Cheryl Feltgen of Home Loans, presented their business line Risk Strategy Overviews, focusing on the 2007 initiatives and responded to questions from the members.

October 2006 ERM Board Report

Mr. Cathcart introduced to the Committee the ERM Board Report which will be delivered to the Board of Directors at the October 17 meeting. The members were invited to review the report and provide questions and comments to the report writers. Mr. Cathcart committed to scheduling an abbreviated Enterprise Risk Management Committee meeting to further to discuss the report and respond to members' questions prior to the Board meeting.

There being no further business to discuss, the meeting adjourned at 10:00 a.m.

Respectfully submitted:

Ronald Cathcart, Chairman	Karin Znamirovschi, Secretary

Enterprise Risk Management Committee Minutes
October 10, 2006

A special session of the Enterprise Risk Management Committee (ERMC or Committee) for Washington Mutual, Inc. and Washington Mutual Bank met on October 10, 2006 in the Board Room of the Washington Mutual Center, Seattle, WA. The meeting was called to review the October 2006 Enterprise Risk Management Board Report prior to submission to the Board.

Voting Members Present:
Ron Cathcart (Chair) Tom Casey Deb Horvath Benson Porter
Steve Rotella

Non-Voting Members Present:
Hugh Boyle Cheryl Feltgen Mark Hillis Richard Lewis *
Michelle McCarthy Randy Melby Marc Wright

Other Participants Present:
Karin Znamirovschi (Secretary) Thomas Henning

* Attended by telephone

A quorum being present, Mr. Cathcart called the meeting to order at 11:05 a.m.

Enterprise Risk Management Board Report

The individual sections of the Enterprise Risk Management Report to the Board of Directors of Washington Mutual, Inc, and Washington Mutual Bank were presented and discussed. The member's questions were responded to and revisions agreed to.

There being no further business to discuss, the meeting adjourned at 12:05 a.m.

Respectfully submitted:

Ronald Cathcart, Chairman Karin Znamirovschi, Secretary

Enterprise Risk Management Committee
December 15, 2006
Prior Meeting Action Items

Meeting dated October 4, 2006:

Action	Responsibility	Status
Provide the Committee further analysis on the state and MSA credit concentration limits with the objective of determining whether the current limits are prudent and appropriate.	Hugh Boyle	**Completed** - Subsequent to the meeting, the Chief Enterprise Risk Officer arbitrated an agreement between the Chief Executive Officer, business line Presidents, and Chief Risk Officers. The recommended 50% and 25% state and MSA limits were subsequently presented to and approved by the Finance Committee. Further analysis will be performed during the 2007 planning cycle to determine whether the limits should be lowered.
Schedule an abbreviated Enterprise Risk Management Committee meeting for further discussion of the Enterprise Risk Management Board report.	Ron Cathcart/Karin Znamirovschi	**Completed** - A meeting was conducted on Tuesday October 10th.
Michelle McCarthy to convene a meeting with Deb Horvath, Tom Casey, and other subject matter experts from their areas to discuss data governance issues and share best practices from their remediation programs and approaches.	Michelle McCarthy	**Completed** – Meetings conducted.

Meeting dated October 10, 2006:

Action	Responsibility	Status
Schedule for a future meeting an overview presentation on the Risk Control Self Assessment Process, how it is used within each business line, and how it is linked to the SOX 404 process.	Michelle McCarthy	**Completed** – Presentation materials on this topic have been created and were presented at a CFMC offsite. We are also including these hierarchies in Finance's Enterprise Hierarchy Initiative. A presentation to ERMC is no longer required.

WaMu

ABS CDO Business Proposal

ERMC Meeting Recommendation

Capital Markets Portfolio Management

December 15, 2006

WaMu

Business Components for Approval

ERMC Recommendation

WaMu Capital Markets Portfolio Management is requesting approval to establish a CDO Asset Management Group. The Group will manage the issuing of cash flow arbitrage CDO securities (cash, synthetic, and hybrid), including acquiring underlying collateral assets and hedge the warehouse risks in the ramp up period, partially retain the preferred shares (equity tranche), and will manage the CDO assets. WaMu Capital Corp will expand its broker-dealer business to underwrite and distribute the CDO securities.

1. Warehouse Limit: $2 billion in aggregate cash securities with delegated authority vested with the portfolio management division; $2.5 billion with delegated authority vested with the head of Capital Markets and the HL Chief Risk Officer
2. Warehouse underlying collateral mix: 25% non-investment-grade (rated BB+ and below)
3. Warehouse financing: Internal funding through treasury. Business retained the option to use an external dealer if conditions warrant
4. Underlying collateral types: Include RMBS, HEL, CMBS, CDOs of the foregoing asset types and no more than 15% of other asset classes ("Other Assets"), which are either (a) approved and listed on the bank's ALMP, or (b) are, in the opinion of the bank's legal counsel, permissible under applicable provisions of the Home Owners Loan Act, the Federal Deposit Insurance Act and FDIC and OTS regulations, in each instance, with authority delegated to HL Chief Risk Officer, the head of Corporate Credit, the head of Capital Markets and the head of the Market Risk Management to determine the amount (not to exceed the 15% limitation in the aggregate) and specific types of Other Assets
5. Equity Retention: less than 50% of total equity value, subject to independent auditors' true sale opinion on a deal by deal basis (FIN 46R, page 24)
6. Market Risk Limit: Aggregating risk position (DV01 and VaR) into existing Capital Markets limit allowance; Portfolio Managers are to follow existing mandatory ERMC/MRC risk management and reporting processes
7. ABS CDO warehouse accumulation will not commence until a robust derivatives capability has been established

WaMu

Endorsements/Clearances

The following business and functional leaders have reviewed and endorsed ERMC approval of this CDO proposal:

- **Presenters:**
  Home Loans Capital Markets - David Beck
  Home Loans Risk Management - Cheryl Feltgen

- **Endorsements/Clearances:**
  Credit - Hugh Boyle
  Market - Michelle McCarthy
  Compliance - Richard Lewis
  Legal - Carey Brennan
  Finance - Steve Fortunato
  Controller - John Woods

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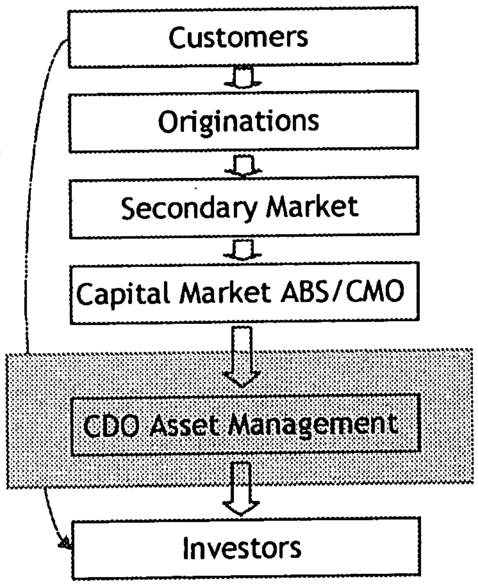
ABS CDO

- The efficient distribution of credit risks is a strategic imperative for WaMu. The ABS CDO business model empowers our best execution efforts by improving the pricing, liquidity, and distribution of credit structure securities
- Year to date, nearly 60% of our Long Beach ABS mezzanine securities were sold to CDO asset managers for resale to end investors
- The ABS CDO business has three distinct income streams
  - Underwriting and Distribution: 25 bps at deal closing
  - Asset Management Fee **(new business):** 35 bps per annum (2% NPV)
  - Return on retained equity piece (1% to 2% of UPB): 20%
- The investment on ABS CDO infrastructure will enable future ALM initiatives such as reducing the tangible common equity ratio target through synthetic balance sheet securitization
- The ABS CDO business is a natural extension of our existing business that offers significant additions to our shareholder value



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CDO Revenue

Revenue Sources

The ABS CDO business model enhances WaMu best execution efforts by improving the pricing, liquidity and distribution of credit structure securities

The ABS CDO business has four distinct income streams

- Underwriting and distribution fee — 25 bps at closing
- Asset management fee — 35 bps per annum (2% NPV)
- Return on retained equity — 20%
- Warehouse income — 100 bps

Pro Forma Projection

3- Year Pro Forma Projection

Without balance sheet deals

$ MM	Year One	Year Two	Year Three	Total
Numbers of Deals	3	4	4	11
Issuance	1,500	3,000	4,000	8,500
Retained Equity	34	68	90	191
Total Retained Equity	34	101	191	191
Under-writing Fee (Retained)	1.9	6.0	8.0	15.9
Warehouse Income	1.9	3.8	5.0	10.6
Management Fee	2.6	10.5	18.0	31.1
Retained Equity Income	3.4	13.5	29.3	46.1
Deal Cost	(4.5)	(9.0)	(12.0)	(25.5)
Total	5.3	24.8	48.3	78.3

Assumptions

Underwriting Fee	0.25%	50% retained at year one; 80% retained for years 2 and 3
Management Fee (per annum)	0.35%	Includes both senior and subordinate management fees
Deal Cost	0.30%	25 bps in underwriting / distributing fee and 5 bps other
Retained Equity	45%	25% to 49% target range, actual limitation is subject to review
Capital Allocation	100%	Subject to review by ERMC
Return on Retained Equity	20%	Typically higher return on hybrid and synthetic deals

WaMu ABS/SF CDO Underlying Collateral & Approval Status

	Approved Or Not		Conditions and Limitations
Asset-Backed Securities			
Consumer finance-related instruments:	Yes	1	In all cases, investment is subject to ALM Policy limits.
Auto (loan or lease)	Yes		
Credit Card	Yes		ALM Policy limits include three-part test ("CIM"):
Student Loan	Yes		A. Corporate Debt Security
Manufactured Housing	Yes		B. Investment Grade
Equipment Leases	Yes		C. "Marketable"
Entertainment Royalties (as collateral)	Conditionally		
Small Business Loans	Yes		If not CIM, then "pass-through" analysis is needed: underlying
Mutual Fund Fees	Conditionally		asset must be one in which the bank can legally invest.
Health Care cash flows (as collateral)	Conditionally		In certain cases, 30 days advance notice may be required.
Home Equity Loans/Lines of Credit	Yes		
ABS NIM	Conditionally	2	Pass-through analysis will most likely be required
PIK Interest on ABS and MBS	TBD	3	Most often seen in subordinate tranches. Pass-through analysis likely required
Stripped MBS and Other RMBS derivatives	Conditionally	1	In all cases, investment is subject to ALM Policy limits.
Commercial Mortgage-Backed Securities			
Conduit	Yes	1	In all cases, investment is subject to ALM Policy limits.
Large Loan	Yes		"Pass-through" analysis is easy because bank has clear
Credit Tenant Lease	Yes		authority to invest in underlying assets, but 30 days advance
Residential Mortgage-Backed Securities			notice to OTS and FDIC required if WM has control of issuer
			after issue of securities..
Residential A	Yes		
Residential B&C	Yes		
CDO (Cash)			
ABS CDO (Cash)	Yes	1	In all cases, investment is subject to ALM Policy limits.
Non-mortgage CDO (Cash)	Yes		ALM Policy limits include three-part CIM test or
Trust Preferred CDO (Cash)	Yes		alternative "pass-through" analysis (see above)
CLO (Cash)	Yes		
All above CDO/CLOs but non-cash (Hybrid / Synthetic)	TBD		Must show authority to hold asset (CIM, pass-through ABS or loan) or issue guarantee (not insurance) during ramp-up and investment period. Legal researching
ABX	Yes	1	Subject to Safety and Soundness requirements & ALM or Credit Policy
Credit Linked Notes	TBD	1	Subject to Safety and Soundness requirements & ALM or Credit Policy
Credit Derivatives (Synthetic Securities / CDS, Total Rate of Return Swaps)	TBD	1	Subject to Safety and Soundness requirements & ALM or Credit Policy
Other Debt/Loans			
Investment Grade Corporate Bonds (include REIT debt)	Yes	1	In all cases, investment is subject to ALM Policy limits.
High Yield Bonds	NO	x	
Leveraged Loans	TBD	4	Subject to Safety and Soundness requirements & ALM or Credit Policy
Variable Funding Notes	Yes	1	Subject to Safety and Soundness requirements & ALM or Credit Policy
Emerging Market Debt	Conditionally	x	In all cases, investment would be subject to ALM Policy limits.
Project Finance Debt	Conditionally		Subject to Safety and Soundness requirements & ALM or Credit Policy
New Investment			
ABS CDO Equity	TBD		

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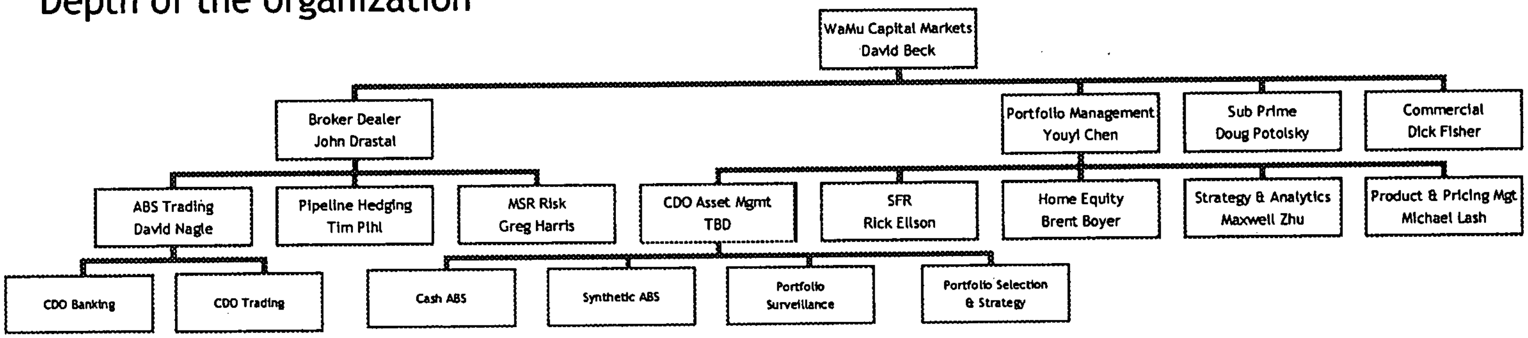
Organizational Structure

WaMu Advantages

Breadth of product

Depth of the organization



Functional Roles

CDO Asset Manager	Internal
Research, Modeling, & Analytics	Internal
Technology Support	Internal
Finance / Valuation	Internal
Underwriting / Distribution	Int/External
Trustee Services	External
Accounting / Audit	Int/External
Legal	Int/Internal

Time line

ALCO Approval	Oct-06	✓
HL POG Initial Gateway	Nov-06	✓
HL POG Approval Gateway	Nov-06	✓
HL POG Plan Gateway	Dec-06	
ERMC Approval	Dec-06	
HR Review and Approval	Dec-06	
OTS	Dec-06	
Hiring process for CDO Managers	Dec-06	
HL POG Implementation Gateway	Jan-07	
MRC on credit derivatives	Jan-07	
VC on credit derivatives and valuation	Feb-07	
1st deal to market	Apr-07	

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Organization and Infrastructure

Infrastructure	Requirements	Current Status/Plan
CDO Asset Management Business Unit	Need to recruit a CDO Asset Management team and reassign some existing portfolio management resources	Engage HR after ERMC approval
Research, Modeling, and Analytics	Need dedicated subject matter experts. Hire analysts to work with asset managers on asset surveillance and performance tracking	Current research is being performed using existing resources. Wait for ERMC approval to proceed with next steps
Legal and Compliance	Legal Department to select external counsel with extensive knowledge of CDO business development	Engaged external counsel after ALCO approval
Underwriting and Distribution	Leverage existing capabilities. Identify a wall-street partner for structuring and distributing assistance in year one	Will begin negotiations after ERMC approval and designation of a business lead
Finance and Accounting	Need dedicated accounting and valuation support	Accounting engaged in preliminary discussions. Need for dedicated valuation resources has been identified.
Market Risk and Credit Risk	Utilize the existing infrastructure and support in the pipeline and warehouse risk management area. Working to enhance trade capture and risk management systems to enable handling of synthetics ABS products such as CDS	ERMC 12/15/2006 agenda
IT Support	Need dedicated systems support and enhanced analytics. Important requirement for obtaining favorable agency rating on asset management capabilities	A dedicated resources have been identified. Will commit resources after ERMC approval

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Risks and Mitigation Strategies

Risk Factors	Risk Effects	Mitigating Measures
Financial risk	Unexpected credit loss will cause the write-down of the retained equity piece. WaMu would be expected to retain less than 50% of the equity tranche. Equity tranche ~4% deal. Potential reputational risk with investors.	Third-party investors hold over 50% of the equity. Asset knowledge and expertise are competitive advantages.
Credit Risk	Exposure to the credit spreads during the ramp-up period, and very limited credit spread risk tolerance during the reinvestment period (3 to 5 years for managed CDOs).	The ramp-up period can be relatively short; approximately two months. ABX can be used to hedge and lock-in credit spreads
Market Risk	Lower rates/spreads during the investment/revolving period will reduce the equity returns. Potential mismatch in asset and liability durations	Considerable amount of risk is transferred to CDO investors. Swap can be embedded in the structure to mitigate asset and liability duration mismatch
Legal, Regulatory and Compliance Risks	CDOs differ from the traditional ABS/CMO transactions. Documentation, rating agency analysis, investor reporting, and transaction monitoring are significantly different	The market is well established. Extensive research and selection of experienced legal counsel will facilitate managing legal, regulatory and compliance risks
Operational Risk	New systems and processes will be introduced (as listed on p. 13)	HL POG Gateway in place to guide the process. The CDO Asset Management team will work within the framework of the Operational Risk Management Policy
Model and Valuation Risk	Asset valuation and modeling are complex and require strong analytical systems infrastructure and software resources	Working with leading software systems provider and partnering closely with TSG. Enhancement in research and analytics necessary for CDO also should benefit the management of other products in WaMu's portfolio
Liquidity Risk	Limited liquidity for deteriorating equity in particular	Partnership with a strong underwriter and securities broker dealer in the beginning. Expand WCC's overseas distribution capacity where strong investor demand for CDOs exists

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CDO Legal, Compliance, and Regulatory Overview

Legal

CDOs are mature products with well defined and well understood documentation and execution patterns. The actual mix of legal documents such as indentures, offering memoranda, special purpose entity organizational documents, trusts, distribution agreements, listing agreements, etc. vary from deal to deal, depending on the deal's nature and scope. In the case of a new program such as WaMu's CDO business, legal will require additional lead time for drafting and negotiating documents and setting up initial arrangements, but the disclosure risks and related transaction management processes are virtually indistinguishable from those that WaMu performs well with respect to its securitizations of home mortgages, credit cards, or commercial mortgages.

For WaMu, the key legal analysis arising from the CDO project are based on the need to address banking and regulatory law because the intended business will be conducted through the thrift and its operating subsidiaries. The legal questions outlined immediately below this paragraph, and those set forth under the "Regulatory" heading further below in this document, are being managed by a legal team coordinated by Richard Careaga.

- Potential Banking Powers limitations arising from
  - Asset types
  - Asset management powers
    - Upon launch
    - Future needs as number and nature of WaMu CDOs evolves.
- Affiliate transactions
  - Address investment manager separation
    - Fiduciary role is a first time issue
    - Maintaining a demonstrable separation of investment manager

CDOs issued by special purpose vehicles (SPVs) are most commonly formed offshore to assure pass-through treatment of proceeds from CDO collateral and to avoid subjecting foreign investors to U.S. taxation. In connection with WMB's CDO program, WMB will acquire assets (e.g., RMBS, other ABS, CDS or other Authorized Assets as defined by the ALMP), - and restructure the combined cashflows into different classes of securities ranging, for example, from AAA to subordinate and non-rated classes. At this time, we expect that a subsidiary of WMI will be created to act as the Asset Manager for the CDO program, and will provide these services to WMB pursuant to a services agreement.

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CDO Legal, Compliance, and Regulatory Overview

Regulatory

John Robinson is working to arrange a meeting with the OTS examiners in Seattle during December 2006 to introduce the CDO concept and WaMu's plans for this new business. The goal is to give the OTS a sense of WaMu's intended direction and next steps in the development of the CDO initiative. Additionally, we intend to ask for the OTS's views on the initiative and solicit their advice regarding potential concerns or roadblocks. WaMu attendees at the OTS are meeting are expected to be limited to a small group comprised of members from Regulatory Relations and a senior representative from the business and legal. The OTS meeting is expected to touch on the following issues:

- Description of the business fit for the CDO initiative
- Authority for the business
- Explain WaMu's conclusions regarding
  - -Primary reliance on pass-through authority
  - -Plan to monitor proposed asset mix to ensure continued ability to rely on pass-through authority or alternative analysis
  - -Where the bank is taking risk and what are the corresponding controls and mitigants
- Identify FDIC-insured banks or thrifts that have taken similar steps in the creation of CDOs
  - -Be ready to compare and contrast business models and approaches
- Provide details regarding proposed underlying assets and CDO structures
- Describe internal review and governance processes
- Address capital impact on bank
  - -Cash flow model
  - -Balance sheet model
  - -Capital treatment of retained pieces

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CDO Legal, Compliance, and Regulatory Overview

Compliance

CDOs are highly transparent structures. A collateral manager's ability to acquire assets for a CDO is subject to rating and limited by detailed investment criteria defined in the post-closing deal's indenture and offering documents. Trades are modeled for compliance with applicable deal parameters and indenture limitations before the trade is executed in close coordination with the deal trustee's administrative agent. The focus of these compliance checks include extensive coverage and asset-quality tests tailored to the deal's parameters set forth in the deals indenture and offering documents.

CDO trading activity and deal performance is reported monthly to investors by the trustee in highly detailed reports. Monthly performance reports cover, among other things, portfolio composition, trading activity, deal performance, a full balance sheet and an income statement describing sources and uses of cash.

CDO investors are highly sophisticated users of monthly trustee reports and review them with rigor. Rating agencies supplement deal level transparency (CDOs are generally private transactions and performance report distribution is limited to actual or potential investors) by aggregating deal information and reporting on the CDO market in general. Rating agency reports customarily provide extensive deal-, asset- and vintage-level data as well as sector comparisons.

CDO infrastructures and systems, often developed jointly with the trustee, include a compliance reporting component that enables systems-based monitoring and surveillance. This system-based access is augmented by close collaboration with the trustee who acts in a fiduciary capacity for the benefit of investors. WaMu's CDO business leaders have interviewed and held extensive discussions with leading CDO trustees. Compliance has attended many of these presentations. Compliance is highly confident that the systems used by these trustees offer compliance monitoring and surveillance tools that reflect the state of the art in the industry. Furthermore, trustees compete in the maintenance and enhancement of compliance tools and Compliance expects that WaMu will continue to benefit from these developments.

Legal has been closely involved in the development of the proposed program, identifying and resolving potential regulatory requirements or obstacles and developing expertise in credit default swaps and other derivative instruments. Legal is planning to assign two attorneys to support the program full-time during 2007 deal cycles and as needed at other times.

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Counterparty Risk in Credit Default Swaps

Counterparty Risk in Pay-As-You-Go (PAUG) CDS Transactions

The ability to meet the obligations of the notes in the CDO is dependent upon the receipt of payments from the counterparty under the credit default swap

To manage this risk exposure, the standard industry practice includes:

(1) factor in the appropriate risk of the counterparty into the pricing / valuation model

(2) include counterparty rating triggers that would require the counterparty to

- (a) collateralize potential reimbursable amounts
- (b) assign its position at its own cost to a qualified third party
- (c) obtain a qualified credit support provider once the rating of the counterparty fell below specified thresholds

(3) employ the use of an escrow account which would hold potential reimbursable payments until the end of the transaction

In addition to common industry practice, the CDO Manager will comply with all policies and standards set by Corporate Credit

Standard Practices

Short-term debt rating by Moody's of at least "P-1" or long-term senior unsecured rating by Moody's of at least "A3" and, if rated "A3" by Moody's, such rating is not on watch for downgrade, and an issuer credit rating by S&P of at least "A+"

Corporate Credit Standards (WaMu CCS 510)

Must be a WaMu approved Counterparty

Within Maximum Potential Exposure (MPE) and Notional limits

Operations Systems

Description	System	Availability
Structuring	Rating Agency Models	Dec - 06
Software for Managing & Monitoring CDOs	CDO Sentry	Jan - 07
Interest Rate Derivatives	Summit	✓
CDS	Summit	Jan - 07
CDO	Summit	Jan - 07
Accounting - External	Trustee Servicer	✓
Accounting - Internal	CDO Sentry / Intex Desktop	Jan - 07
Trade Record	Bloomberg	✓
Valuation - CMO	CDO Sentry / Intex Desktop	Jan - 07
Valuation - ABS	CDO Sentry / Intex Desktop	Jan - 07
Valuation - CDO	CDO Sentry / Intex Desktop	Jan - 07
Valuation - Residual	CDO Sentry / Intex Desktop	Jan - 07

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CDO Risk Capital Requirements

Regulatory (Basel II)

- Unrated tranches
  - 100% capital through deduction from Tier 1 and Tier 2 *or*
  - Application of Supervisory Formula Approach (SFA)
- The SFA approach is extremely data intensive but can result in a lower (than the 100% requirement implied by deduction) capital requirement for unrated tranches. The approach requires:
  - PD and LGD ratings for the instruments within the securitization structure
  - Lower and upper bounds of loss levels
  - Basel II capital for the underlying instruments, if unsecuritized and in whole-loan form
  - Granularity parameters
  - Etc.
- Externally rated tranches have capital requirements prescribed from a ratings-based approach
  - AA requires 0.64% capital
  - A requires 0.96% capital
  - A- requires 1.6% capital
  - BBB requires 4.8% capital
  - BB- requires 5.2% capital, etc.
- Regulatory risk-based capital requirements (Basel I and Basel II) recognize retained vs. sold risk positions in synthetic securitization structures. *However, regulatory leverage ratio requirements do not recognize synthetic securitization structures.*

Economic Capital

- For unrated tranches, 100% capital requirement initial assumption; this is considered a good assumption for an equity tranche
- A more precise measure is dependent on deal-specific information. For example:
  - Tranche thickness with lower and upper loss levels
  - Granularity of securitization structure (number of loans in the structure)
  - Loss correlation in underlying instruments
  - Expected loss levels for underlying instruments
- Given economic capital's definition of a 1-year loss at a 99.89% confidence level:
  - Most equity tranches will have capital levels near 100% of the tranche value
  - Application of the more advanced, data intensive approaches makes the most sense for mezzanine, unrated tranches
- For rated tranches, the ratings based approach within Basel II is a reasonable approximation
- Economic capital recognizes retained vs. sold risk positions in synthetic securitization structures.

CDO Risk Capital Requirements
John Stewart
Nov 21, 2006

100% capital deduction from tier 1 and tier 2, and 100% economic capital allocation for retained equity shares will be assumed at the start

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Appendix

Collateral

And

Model Portfolios

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CDO Collateral - Model Portfolios

CDO Collateral - Model Portfolios

ABS cash, synthetic, and hybrid CDOs vary extensively in terms of collateral mix, bond eligibility criteria, reinvestment periods, and deal constraints on the quality and composition of the underlying collateral

In an actively managed portfolio, a CDO manager must manage the collateral substitutions, subject to collateral quality tests and eligibility criteria set forth in the indenture

The following three slides demonstrate the vast array of characteristics that are used to define individual ABS CDO Model Portfolios

These portfolio characteristics are deal-dependent and are created based on

- Investor demand
- Rating agency limitations
- Prevailing market spreads

WMI will be a minority holder of the Preference Shares (equity)

WMI's risk appetite should be balanced with external investors' risk appetite and return demands

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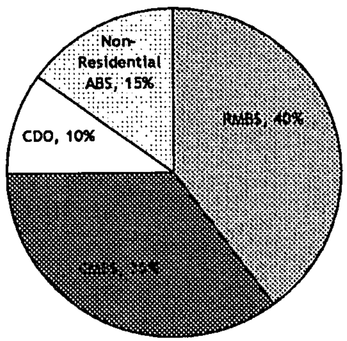
CDO Collateral Mix

Collateral Concentration Changes

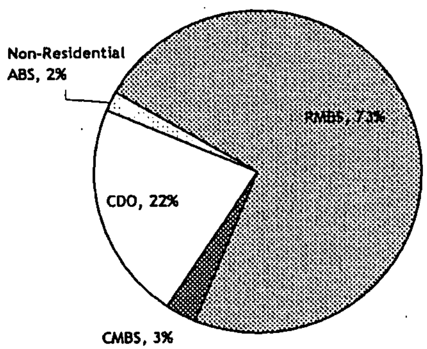
Collateral composition of ABS CDO has moved toward a higher concentration of RMBS, HE, and CDO

High Grade (HG) ABS CDO Collateral Distribution

2003 Vintage



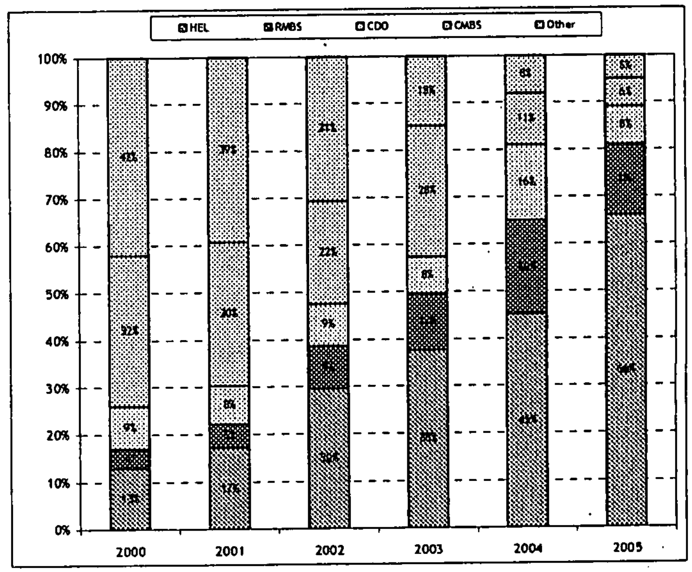
2005 Vintage



Source: Citigroup

Mezzanine SF CDO Collateral Distribution

Year	HEL	RMBS	CDO	CMBS	Other
2000	13%	4%	9%	32%	42%
2001	17%	5%	8%	30%	39%
2002	30%	9%	9%	22%	31%
2003	38%	12%	8%	28%	15%
2004	45%	20%	16%	11%	8%
2005	66%	15%	8%	6%	5%



Source: Credit Suisse

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ABS CDO Asset Diversification / Correlations

Moody's Asset Correlation

For structured finance cash flow CDO transactions, Moody's Asset Correlation parameter is used instead of Moody's Diversity score to measure the diversity/concentration/correlation of collateral

The Asset Correlation is calculated based on

- Common default probability
- Common recovery rate
- Expected number of assets
- Distribution of Key Agents
  - Number of issuers/servicers
  - Percentage of concentration of issuers/servicers
- Geographic concentration of assets

A maximum level for the Asset Correlation is usually specified in the indenture as part of the collateral quality tests

The normal Asset Correlation for structured finance CDO transactions ranges from 20%-32%

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CDO Collateral Mix

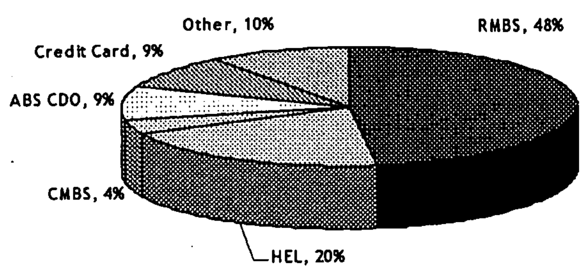
Sample Asset Portfolio - Asset Type and Rating Breakdown

Drivers of Asset Type and Rating Allocations

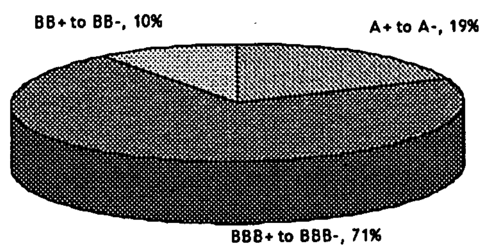
- Market supply and investor demand
- Rating agency models
- Target equity return

Asset Type	A+ to A-	BBB+ to BBB-	BB+ to BB-	Total
RMBS	8%	36%	4%	48%
HEL	2%	16%	2%	20%
CMBS	1%	2%	1%	4%
ABS CDO	3%	5%	1%	9%
Credit Card	3%	5%	1%	9%
Other	2%	7%	1%	10%
Total	19%	71%	10%	100%

Sample Portfolio Asset Allocation



Sample Portfolio Rating Allocation



Confidential Treatment Requested by JPMC

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CDO One Year Time Line

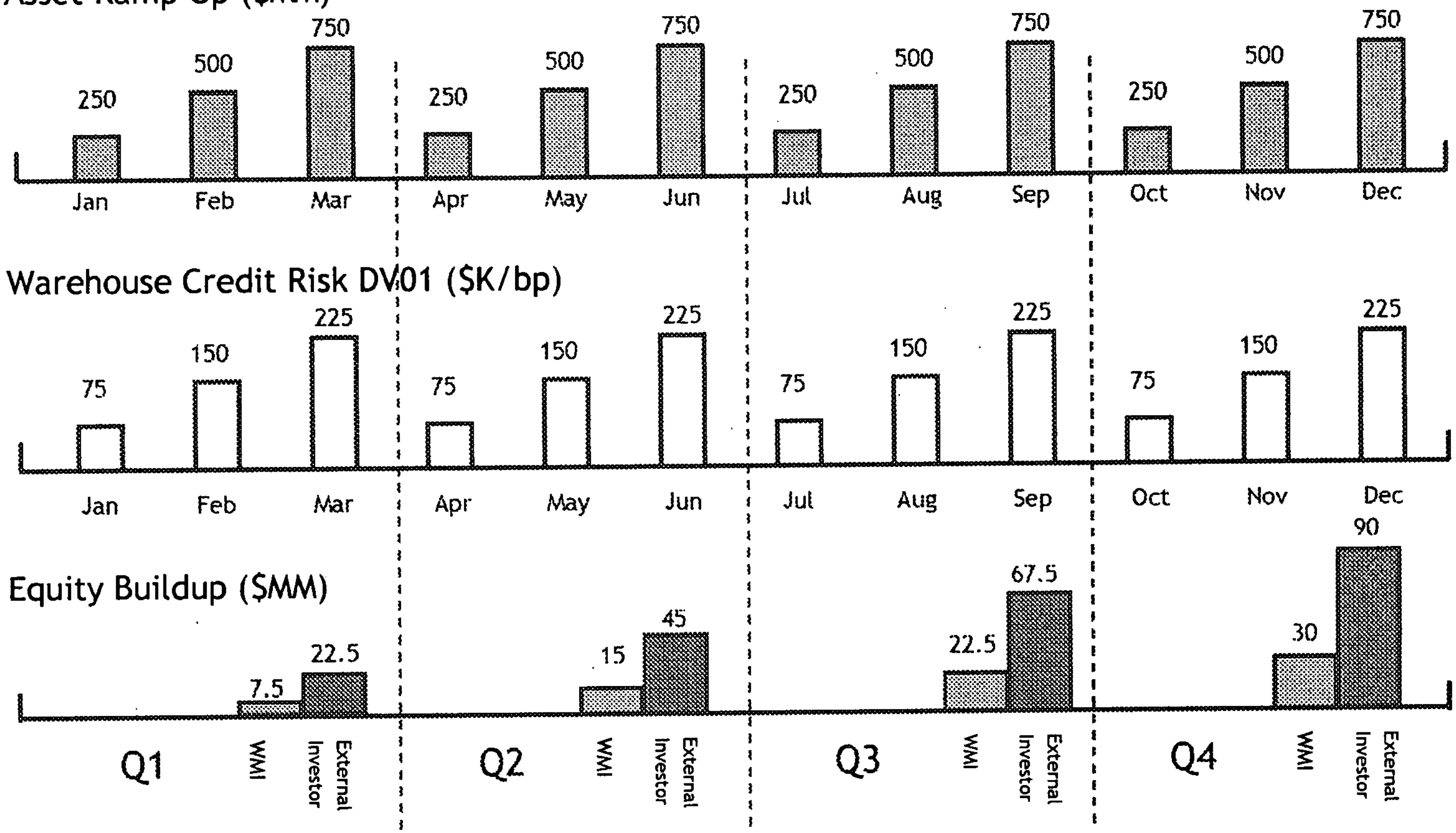
CDO Position Risk Time Line - One Year

WaMu and external investors share moderate mark-to-market risks as demonstrated below

Asset Ramp Up ($MM)

Warehouse Credit Risk DV01 ($K/bp)

Equity Buildup ($MM)



Assumptions: $750 MM deal per quarter, 3 year spread duration, 4% equity and 25% retention rate.

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CDO Ramp-Up

Typical Terms for CDO Asset Accumulation

70-90% of the CDO assets are expected to be purchased (or committed for purchase) by the closing date. The CDO asset managers and traders within the CDO Asset Management unit will select and purchase assets based on relative value and constrained by:

- Asset "bucket" limitations as prescribed by rating agencies and investor appetite
- Aggregate asset limits imposed by ERM

Weekly reports will be produced to verify compliance with binding constraints. This will be supplemented by independent oversight.

Warehouse Limit Proposal

- $2 billion in aggregate cash securities, authority delegated to the portfolio management division; $3 billion delegated authority to the Executive of Capital Markets, the Home Loans Chief Risk Officer and the Executive of Market Risk Management
- No more than 25% non-investment grade (rated BB+ and below)

Utilization of credit derivatives and interest rate derivatives solely to mitigate in-warehouse risk

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Warehouse Funding

Typical Terms for Warehousing

During the ramp-up, the warehoused CDO assets will expose WaMu to credit and interest rate risk. The assets can be funded internally or externally via a dealer warehouse facility.

Utilizing dealer warehouse, the credit and interest rate risk can be transferred in whole or in part (see CS presentation in Appendix II). This has significant drawbacks:

- loss of carry
- less control over asset selection
- business is subject to dealer's liquidity risks

Proposal

- The warehouse will be funded (on balance sheet) by Treasury through FTP with 1-month rate and the asset risks will be hedged by the CDO Asset Management unit
- The business will retain the option to use a dealer warehouse if conditions warrant. Daily P&L reports will be provided and risk limits established as with any other market value book.

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CDO Reinvestment Period

Typical Terms for CDO Reinvestment Period

During the reinvestment period, the CDO Management Unit will reinvest funds received by the CDO issuer in excess of interest payments to security holders in additional collateral subject to eligibility criteria and limitations applicable to each CDO transaction.

- Interest Coverage and Overcollateralization tests
- Collateral quality tests
- Concentration limits as set forth in the indenture

Equity returns may be reduced if spreads during the reinvestment period are tighter than during the ramp-up and/or basis risk increases.

Proposal

- Retention of equity amount no more than FIN 46's threshold for consolidation (< 50%)
- Valuation assumptions and procedures subject to valuation committee approval

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FIN 46R

When would FIN 46R require a collateral manager to consolidate a CDO?

FIN 46R requires a test (*primary beneficiary test*) to determine whether the collateral manager is required to consolidate a CDO

The FIN46R test is a cash flow scenario analysis to identify if the collateral manager's interest (management fees, equity securities*) absorbs the majority of the expected losses, expected residual returns or both of the CDO.

As equity securities ownership is a variable input into the FIN46R test, Portfolio Management recommends the equity securities holdings to be equal to or less than the maximum equity ownership allowed under FIN 46(R) while not consolidating the CDO.

Portfolio Management believes 20-25% equity ownership, based on similar CDO structures, would not require consolidation.**

Excerpt from D&T Securitization Accounting Manual - July 2005

"If the collateral manager has only a 20 percent holding in the unrated equity securities, it is fairly unlikely that the collateral manager's total holding represents a majority of the CDO's expected losses or expected residual returns, unless its management fees absorb a significant amount of the entity's variability."

Source

1. Deloitte Securitization Accounting - The Ins and Outs (And Some Do's and Don'ts) of FASB 140, FIN46R, IAS39 and More, July 2005

Assumes Collateral Manager does not retain mezzanine or senior securities, this is consistent with Portfolio Management recommendation for CDO security retention.

** In order to ensure compliance with FIN 46R, every CDO structure would require an independent primary beneficiary test to determine actual threshold for equity ownership to maintain off balance sheet accounting (no consolidation).

Enterprise Risk Management: Review of 2007 Plan

Enterprise Risk Management Committee Presentation

December 15, 2006

Overview

At the previous 2006 Board meetings, we communicated a high level Credit Risk Strategy and Bank-wide framework for risk appetite and combined this Enterprise Risk framework with our strategic efforts to remix our balance sheet.

In the third quarter we worked collaboratively with the business segments and finance to establish 2007 forecasts for utilization of Economic Capital, Credit Concentrations, and Model Portfolio Composition. Limits, performance targets and triggers were established.

Today, we share 2006 results as of 11/30/06 and review the ERM implications of the 2007 plan.

Portfolio Risk Allocations

April 2006 Board Discussion

At the target A- threshold, we have about $2.8 Billion more Credit Economic Capital to deploy

Bank-wide risk appetite

Target Risk shares established by Risk Type

Allocation of Risk Budget by Type of Risk

Market	Credit	Operational
35%	55%	10%

August 2006 Discussion

Clearly delegate credit authority

Allocation of Credit Risk Budget to Business Units

Home Loans	Retail Bank	Card	Commercial

Prevent unwanted build-up of concentrations

Concentration Limits

Geographic
High CLTV
Consumer Loans to Higher Risk Borrowers
Commercial Higher Risk Loans

Today's Discussion

Prevent unwanted build-up of concentrations and provide early warning of potential problems

2006 Results and 2007 Plan

Concentration Limits
Performance Forecasts
Economic Capital Utilization

Credit Risk Concentration Limits

Confidential Treatment Requested by JPMC

Credit Concentration Limits and Current Utilization

- Consistent with our strategic plan we are increasing credit risk in our 2007 business plan. These limits, and utilization there-under, will be monitored and actively managed through the Enterprise Risk Committee.

Credit Risk

	Consumer Loans		Commercial Loans	
	Consumer Loans to Higher Risk Borrowers (FICO)	Consumer Loans with High Combined LTV (CLTV)	Geographic Concentrations Single State / Single MSA	Higher Risk Commercial Loans
11/06 Levels:	15.2% (Total)	6.0% ≥ 90 (w/o MI)	46.2% in a single state (CA) 20.5% in a single MSA (LA)	1.0% DSCR < 1.15 0.45% LTV > 75
2007 Plan Levels:	22.9% (Total)	7.3% ≥ 90 (w/o MI)	48.2% in a single state (CA) 21.4% in a single MSA (LA)	1.7% DSCR < 1.15 0.4% LTV > 75
Trigger: 85% of Limit or as states	21.3%	8.5% ≥ 90 (w/o MI)	48% in a single state (CA) 24% in a single MSA (LA)	1.7% DSCR < 1.15 0.9% LTV > 75
Limit:	**25% (Total)**	**10% ≥ 90 (w/o MI)**	**CA ≤ 50%** **No MSA > 25%**	**2% DSCR < 1.15** **1% LTV > 75**

* As a percentage of total Held-For-Investment Portfolio and Credit Card on a Managed Receivable basis.

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Portfolio Performance

Portfolio Performance

- Economic drivers are consistent with assumptions in the 2007 Business Plan.
- Provision and chargeoff expenses are expected to increase in 2007 as we return to more normalized credit conditions and implement a planned shift to a more credit-intensive asset mix.
  - Provision is expected to increase $300MM over 2006 to $1.1B
  - NPAs are expected to increase $3.0-3.5Bn
  - NPA will be ≤1% based on $350.6Bn in assets forecast for 2007
  - Charge-offs are expected to increase $145MM to $660MM

Business Unit	Provision $millions		NPA $millions		Chargeoffs $millions	
	2006 Expected	2007 Forecast	2006 (Nov-06)	2007 Forecast	2006 (Nov-06)	2007 Forecast
Card (GAAP basis)	750	603	-	-	-284	-373
Commercial [1]	-79	40	112	-	-6	-6
Home Loans (LBMC, Sub-Prime/HEL Conduit, MBF)	187	272	328	-	-120	-143
Retail Bank (SFR, originated HEL/HELOC, Small Business, Consumer)	169	210	1,722	-	-106	-138
Corporate Support and Other	-177	33	-	-	0	0
Foreclosed Assets	-	-	476	-		
Total WMI	**850**	**1,158**	**2,638**	**$3-3.5B**	-516	-660

[1] Commercial - includes $4MM for CCBI; Corporate Support and other $35MM

Credit Mix Shifts Expected in 2007

- Commercial Lending will expand higher margin lending through its Multi-Family "Proceeds" product; anticipate other credit intensive enhancements to existing products and programs. Also expect to see continuing deterioration of Debt Service Coverage due to interest rate environment and impact on Net Operating Income (NOI)
- Home Loans will continue to expand its higher margin offerings and Capital Markets instruments including:
  - Expansion of Subprime and Alternative product offerings
  - New higher margin product innovations – such as Roswell (1st lien with a HELOC that is self-restoring as 1st lien balance is paid down)
  - Introduction of higher margin Collateralized Debt Obligation (CDO) including residual retention
- Card Services does not expect significant changes in credit mix in 2007. They do expect weaker performance in early 2007, but expect it to improve over '07.
- Small Business Lending also expects its credit mix to remain fairly stable in the coming year. It is a relatively new business expecting significant growth in 2007 and correspondingly its use of credit economic capital will more than double.

Managing the Credit Shifts

- Board limits and triggers, as well as other Credit limits (model portfolio concentration limits and performance forecasts) are monitored monthly by Business Risk Committees and further by Corporate Credit Risk Management in Quarterly Credit Reviews
- Business unit Risk Committees monitor performance to Board and other limits and manage trigger events. Trigger events are communicated to Credit and Enterprise Risk Committees and monitored for action.
- The Credit Risk Management Committee (CRMC) monitors cross-business performance, reviews and addresses business unit performance when enterprise limits are at risk.
- Enterprise Risk Management Committee (ERMC) will review and resolve cross-business issues related to concentration limit trigger events where more than one business is driving high utilization and allocation is at issue.
- Will continue build-out of sub-limits in 2007

(Note: see Appendix for business unit detail)

Market Risk & Operational Risk

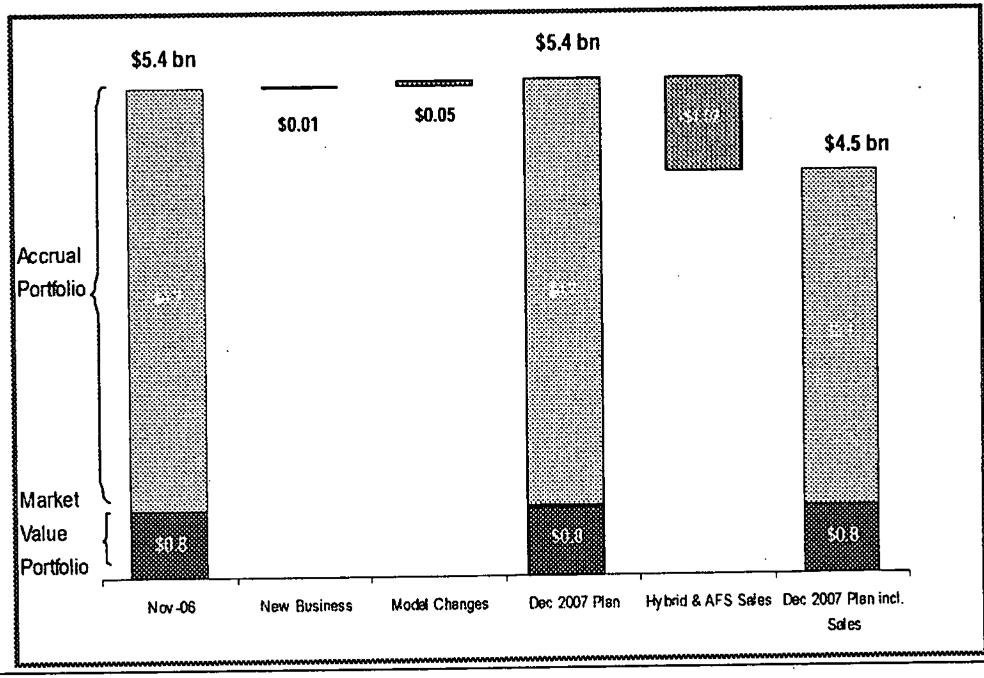
Market Risk Shifts Expected in 2007

Market Value Businesses

- Utilization of the current 10 day Value at Risk ("VaR") limit of $230 million has ranged from 25% to 50%
- The 2007 does not create large shifts in VaR; we estimate the plan would increase utilization by 4% or $10 million
- We expect VaR utilization to rise by about 14% when we introduce additional spread risk factors by mid-2007 as the sub-prime and Alt-A spread risk that is increased by the plan is more volatile
- Finally, the addition of prepayment model variability risk to our VaR calculation will increase utilization by about $17 million or 7%
- In total, utilization of the VaR limit should increase by about 25% in 2007

Accrual Businesses

- The market risk of the accrual books is not significantly changed in the plan, but is expectedly to decrease modestly
- The recent approval to sell Hybrid ARM loans and sell AFS securities should reduce market risk economic capital by over **6%** of total economic capital, moving market risk to below its target level as a percent of economic capital



Operational Risk Shifts Expected in 2007

- By decreasing activity in traditional business such as 30 year Fixed rate mortgages, and increasing activity in items where we are still building systems and capabilities (such as the Conduit and the Collateralized Debt Obligation businesses), we would expect the plan to increase operational risk
- However, we expect Operational Risk Capital to decrease as we improve our measurement capabilities by
  - Reducing use of external data and replacing it with WaMu-specific operational risk scenarios
  - Reducing the businesses' operational risk capital utilization when their controls and capabilities improve
  - Removing expected losses from the Operational Risk Capital calculation as we are able to prove they are steady and already appear in budgets
- Netting these two effects, we expect a modest decrease in Operational Risk Capital utilization in the 2007 plan

Economic Capital

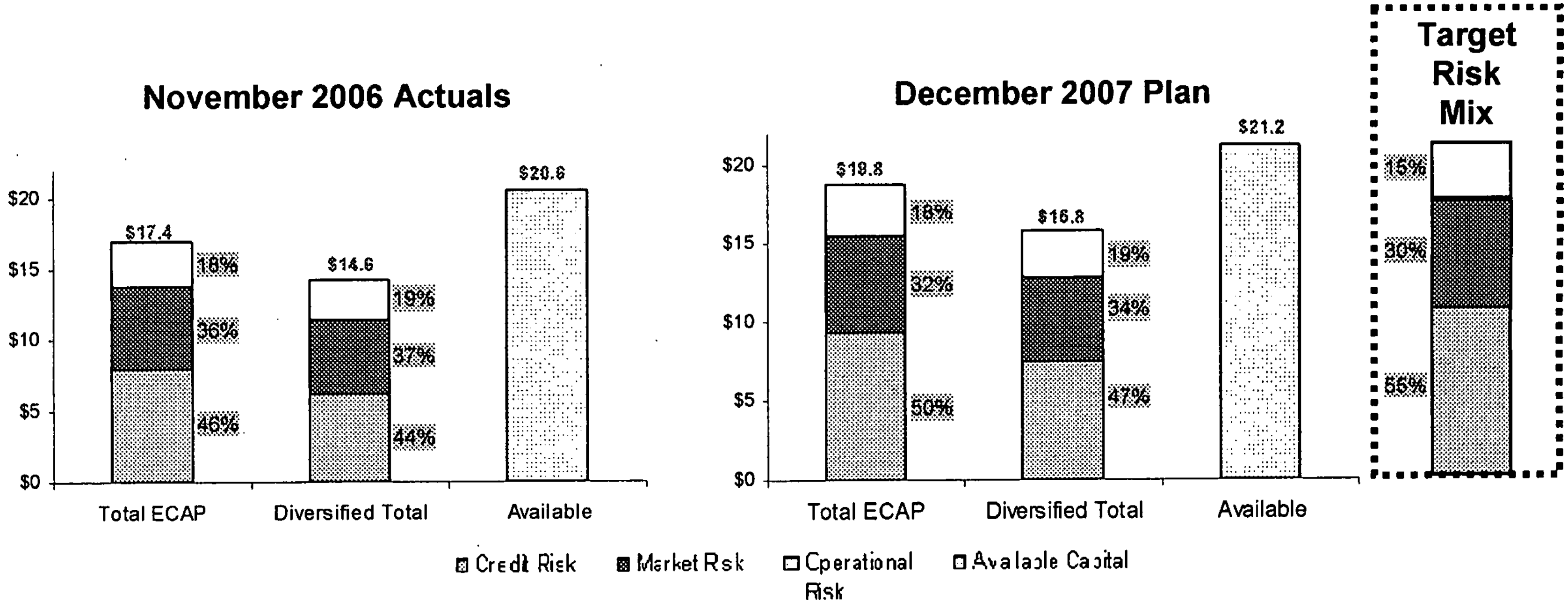
Economic Capital Trends

- Total deployment of economic capital as a percent of available financial resources (dominated by tangible equity) is projected to increase from 71% in Nov. 2006 to 75% in Dec. 2007*
  - Economic capital increases $14.6 to $15.8 BN
  - Available financial resources increases $20.6 to $21.2 BN*
- Key driver is a shift to higher credit risk assets within projected balance sheet growth at the same time that capital composition is tightly managed; credit risk increases from 44% to 47% of total economic capital
- Trends in total economic capital as well as economic capital composition are consistent with strategic goals
- Key drivers:
  - Credit risk: Declining Prime SFR balances, with increasing balances in higher credit risk assets including Credit Card, Small Business Lending, Commercial Real Estate, and Home Equity Loans and Lines of Credit
  - Market risk: Similar aggregate risk profile as current state; minor increase in required economic capital due to portfolio growth and inclusion of potential model risk capital; note that subprime residuals are included in credit risk for economic capital purposes
  - Operational risk: Assumed similar risk profile as current state; increasing economic capital scales with key income and expense drivers

*It is noted that projections of available financial resources in Dec. 2007 including tangible equity are preliminary

Current & Dec. 2007: Capital Required vs. Available

Economic Capital Required and Available
Nov. 2006 and Dec. 2007



Notes: 1) Available capital in 2007 is based on a rough approximation driven by balance sheet size.
2) The December 2007 Plan does not incorporate our current asset sale initiative.

Appendix

Key Credit Risk Concentration Limits—Conceptual Design

Concentration Limits

- Credit concentration limits reinforce and efficiently drive business unit credit risk appetite consistent with the Company's strategic plan.
- Transparent, well communicated credit concentration limits foster improved risk-vs-return planning and should be formally reviewed and ratified/changed annually consistent with the Strategic Plan.
- The credit concentration limits below are among the most important in framing credit risk appetite.

Credit Risk

	Consumer Loans		Commercial Loans	
Key Risks	Consumer Loans to Higher Risk Borrowers (FICO)	Consumer Loans with High Combined LTV (CLTV)	Geographic Concentrations	Higher Risk Commercial Loans
	"Higher Risk Borrowers" are all loans originated through sub-prime programs, 1st Lien SFR prime and Home Equity products < 620 FICO at origination, and 2nd Lien Home Equity, Credit Card and other unsecured products < 660 FICO at origination.	High LTV/CLTV lending can expose the bank to higher levels of loss frequency and severity, particularly during a housing market downturn.	Economic drivers (e.g., employment, available housing stock and home price determinants) are shared within individual geographic regions (e.g., Cities, States). Overexposure to any one particular market could have a significant negative effect on overall frequency and severity of losses.	"Higher Risk Commercial Loans" are those with Debt Service Coverage Ratios (DSCR) lower than 1.15x or LTV Ratios greater than 75%.

Proposed Credit Concentration Limits and Current Utilization

Concentration Limits

- The credit concentration limits below are designed to be consistent with the Strategic Plan of enhancing our overall returns, in part, by reallocating the balance sheet towards more credit intensive assets.
- Also consistent with our Strategic Plan, the geographic concentration limits are designed to encourage diversification of our California exposure, reinforcing our nationwide franchise.

[Note: The proposed geographic concentration limits should be considered target limits and will be reviewed within the context of the 2007 business plan.]

Credit Risk

	Consumer Loans		Commercial Loans	
	Consumer Loans to Higher Risk Borrowers (FICO)	Consumer Loans with High Combined LTV (CLTV)	Geographic Concentrations	Higher Risk Commercial Loans
April 30th Levels*:	15.9% (Total)	3.4% ≥ 90 (w/o MI)	45.4% in a single state (CA) 20.9% in a single MSA (LA)	0.4% DSCR < 1.15 0.1% LTV > 75
Proposed Limit*:	**25% (Total)**	**10% ≥ 90 (w/o MI)**	**CA ≤ 50% No MSA > 25%**	**2% DSCR < 1.15 1% LTV > 75**
	Not more than 25% of the total Held-For-Investment (HFI) portfolio can be in Consumer Loans to Higher Risk Borrowers.	Overall, Loans with Combined Loan-To-Value rates of 90% or higher are limited to 10% of the total HFI portfolio unless they have Mortgage Insurance (MI). [Note: this limit is subject to the Supervisory LTV limit of 100 % of total capital]	Geographic Concentrations are limited so that no more than 50% of the total HFI portfolio is in California and no more than 25% in any single MSA.	Not more than 2% of the total HFI portfolio can be to Commercial borrowers whose Debt Service Coverage Ratio (DSCR) is lower than 1.15X or 1% to those whose LTV is above 75%.

* As a percentage of total Held-For-Investment Portfolio and Credit Card on a Managed Receivable basis.

Recommendation Approved 7/18/06

Credit Risk Concentration Limits:

- ***Consumer Loans to Higher Risk Borrowers***
  - *All loans originated through the sub-prime programs, SFR prime and 1st Lien Home Equity products < 620 FICO at origination, and 2nd Lien Home Equity, Credit Card and other unsecured products < 660 FICO at origination.*
  - *Limit of 25% of total HFI loans**
- ***Consumer Loans with High Combined LTV (CLTV)*****
  - *Limit of 10% of HFI loans* at a CLTV greater than or equal to 90 unless insured.*
- ***Geographic Concentration***
  - *Limit of 50% of total HFI loans* in any one state (e.g., California)*
  - *Limit of 25% of total HFI loans* in any one metropolitan area (e.g., Los Angeles)*
- ***Higher Risk Commercial Loans***
  - *Limit of 2% of total HFI loans* to commercial borrowers with a Debt Service Coverage Ratio (DSCR) below 1.15X.*
  - *Limit of 1% of total HFI loans* to commercial borrowers with an LTV greater than 75%.*

*HFI loans are defined as all HFI loans in portfolio plus all additional managed credit card loans.

**This limit on Consumer Loans with High CLTV is in addition to the existing regulatory-based limit specified in Credit Policy 408, which restricts Supervisory LTV Exception loans to at most 100% of capital.

Data Management Program

Tom Casey
Debora Horvath
Tom Morgan

December 19, 2006

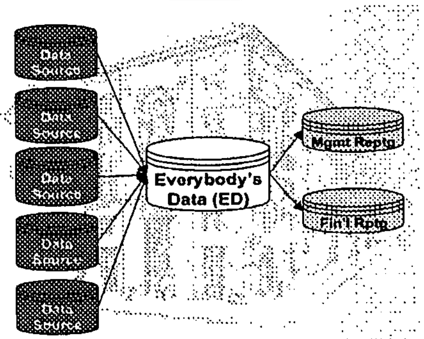
Data Management Problem Statement

WaMu lacks a standard, enterprise approach to data management, which has resulted in higher total cost of ownership, competing versions of the "truth" and lost opportunities for competitive decision making.

Poor Data Management Impacts Speed of Delivery, Quality, Cost, and Risk Resulting in Loss of Competitive Edge

Evolution of Data Management at WaMu

Past

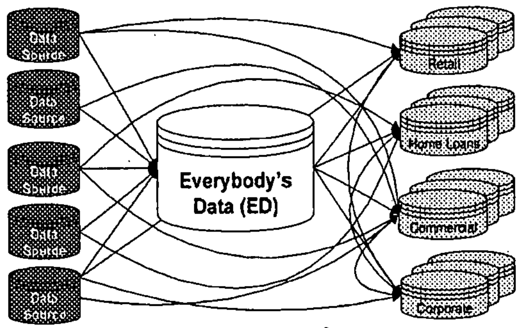


History of Data Management

- The existing data warehouse (ED) was launched within the Finance organization in the early 1990s to provide a common financial reporting framework.
- Reporting was one-dimensional since WaMu was viewed as a single segment.
- As a result of acquisitions -- PNC, Fleet, Dime -- WaMu's reporting environment became more complex over time with the need to support multiple segments.

Basic

Present

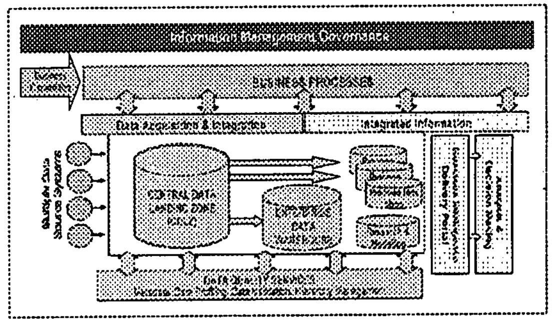


Today's Data Issues

- Through our growth, we have developed over 160 databases supporting various business segments.
- Business decisions often rely on data gathered from multiple sources.
- Users mistrust data that is not controlled within their own segments.
- There is no enterprise-wide data inventory to know what is available.
- SOX 404 compliance and accurate financial and non-financial disclosures are achieved within required timeframes but only with numerous manual reconciliations and work-arounds.

Evolved

Future State



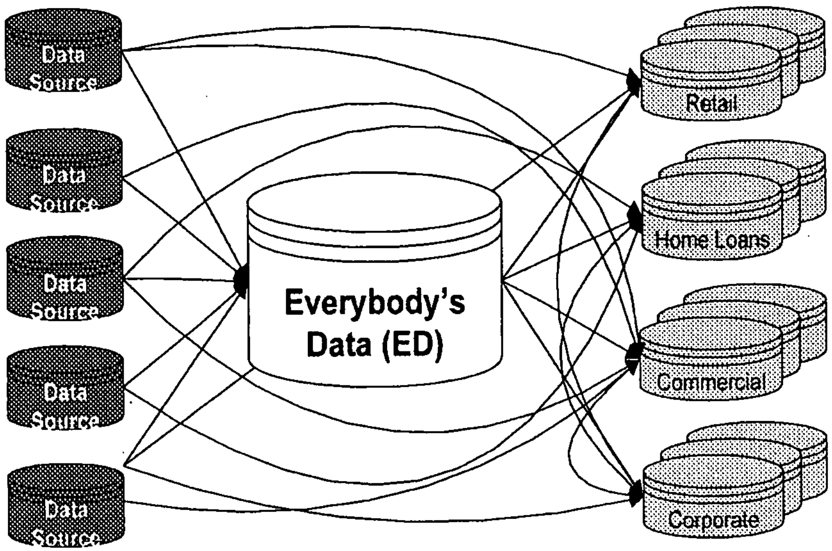
Future State Vision

- Enable better business decisions with timely, accurate data.
- Drive consistent data definitions and controls around data usage through Enterprise Data Governance.
- Increase cross-sell revenue opportunities through a single view of customer relationships across segments.
- Drive cost savings and reduce risk with a unified data environment: clear roles, consistent tools and standards; and repeatable, scalable processes.

Designed

Today: Current State Need for Data

Relevant Issues	
Multiple, redundant data stores	Lack of Data Governance
Manual reconciliation & validation	Complicated processes, lack of clear roles
Redundant data extracts	Difficulty in finding relevant data



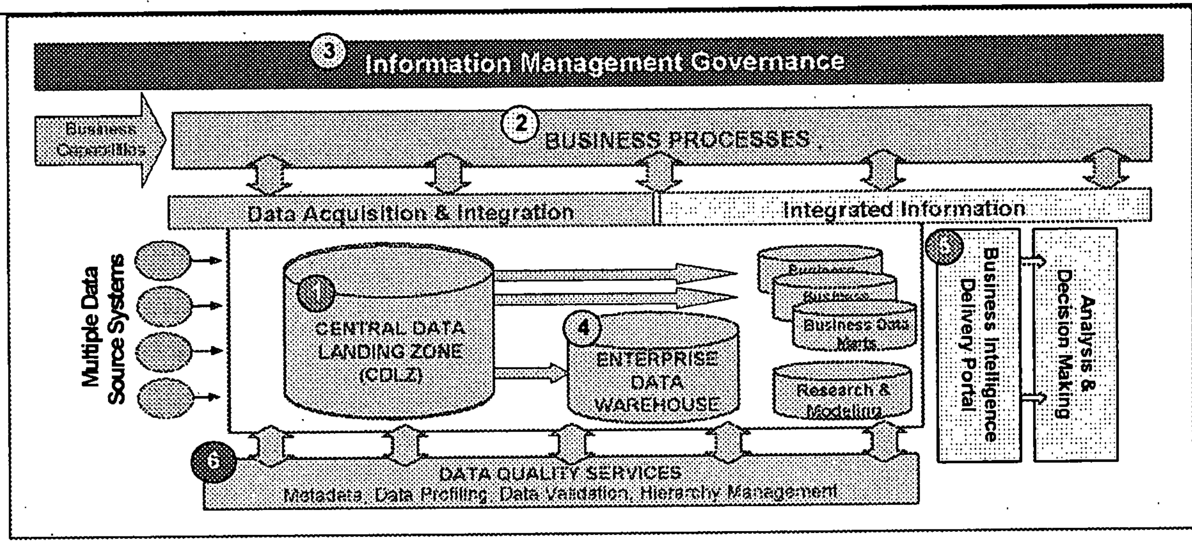
Business Impact
Fragmented data ownership and accountability.
Higher risk of data inconsistency, with potential impacts to valuations and business decisions: **Actual Losses** • Incentive Overpayment of Long Beach loans that were originated but not closed: 2.5M (200K per month) over 2 years, 2005-2006 • Basis Floater: inconsistent prepayment data led to misfit of prepayment model; correction led to downward revaluation of asset $42M in 2006 **Near Misses** • $90M service fee error in 2004 • $130M MSR valuation change in 2005
Lack of enterprise insight into customer relationships, service, and profitability
Complexity of data movement increases effort and risks to enhance, retire, or add applications
Manually intensive reconciliations increase labor costs and reduce overall data quality

Data Management Roadmap

Conduct Strategic Planning Gain Executive Approval	Finalize Roadmap Begin Program Execution	Continue Program Execution
2005	**2006**	**2007 - 2008**
✓ Conduct Voice of the Customer ✓ Identify & Prioritize Business Drivers ✓ Develop Strategy for Future State ✓ Develop Phased Program Plan Gain Executive Committee Approval	✓ Launch Data Mgmt Program ✓ Launch Technology Data Governance ✓ Partner with Business Initiatives to Drive Early Value ✓ *Deposit Data Repository (Fraud)* ✓ *Commercial Data Warehouse* ✓ *Siebel Analytics* ✓ Begin Building Technical Foundation ✓ *Central Data Landing Zone (CDLZ)* ✓ *Metadata Program (Data Dictionary)* *Expense $ 3.8M* *Capital $ 6.0M*	➢ Launch Enterprise Data Governance ➢ Continue to Partner w/ Business Initiatives ➢ *Synergy Program* ➢ *Direct Marketing Re-Platform* ➢ *Enterprise Hierarchy Initiative* ➢ Continue Building Technical Foundation ➢ *Enterprise Data Warehouse* ➢ *Data Quality Services* ➢ Develop Core Data Processes ➢ Conduct Training & Awareness *Expense $10.2M* *Capital $17.3M*

Business Priorities Drive Future State Data Management

Data Management: Integrated Program View



2006 | 2007 | 2008

1 Build CDLZ, Populate w/ First Sources | Continue to Add Sources & Functionality to CDLZ

2 Ongoing Alignment w/ Business Initiatives in Support of Business Processes

3 Launch Data Governance (Technology) | Launch Information Management Governance (Enterprise)

4 Select Vendor & Build Data Warehouse | Populate Warehouse w/ Integrated Data

5
- Begin Delivery of Integrated Data
- Rationalize & Migrate Legacy Data Systems

6 Build Data Quality Services in Phased Approach | Mature & Measure Data Quality Services

Information Management Governance

Executive Steering Committee

Tom Casey
Ron Cathcart
Fay Chapman
Deb Horvath
Steve Rotella

Information Mgmt Governance Committee

Tom Morgan – Chair
Melba Bartels – Finance
Carey Brennan - Legal
Jonathan Calvert – Marketing
Jeff Deuel - Commercial
Michele Grau-Iversen – Card Svcs
Pia Jorgensen - TSG
Michelle McCarthy – Ent Risk Mgmt
Randy Melby – Audit
Mike Reynoldson - HR
Maureen Shafer – Home Loans
Conrad Vasquez – Retail
John Woods – Finance

Tom Casey | **Deb Horvath**

Program Office
Program Lead - TBD
PMO Support

Data Stewardship
BUSINESS / OPERATIONS
"Process Ownership"

- Business Data Stewardship
- Business Process Stewardship

Data Architecture
BUSINESS / TSG
"Design Ownership"

- Hierarchy Mgmt & Entity Relationship

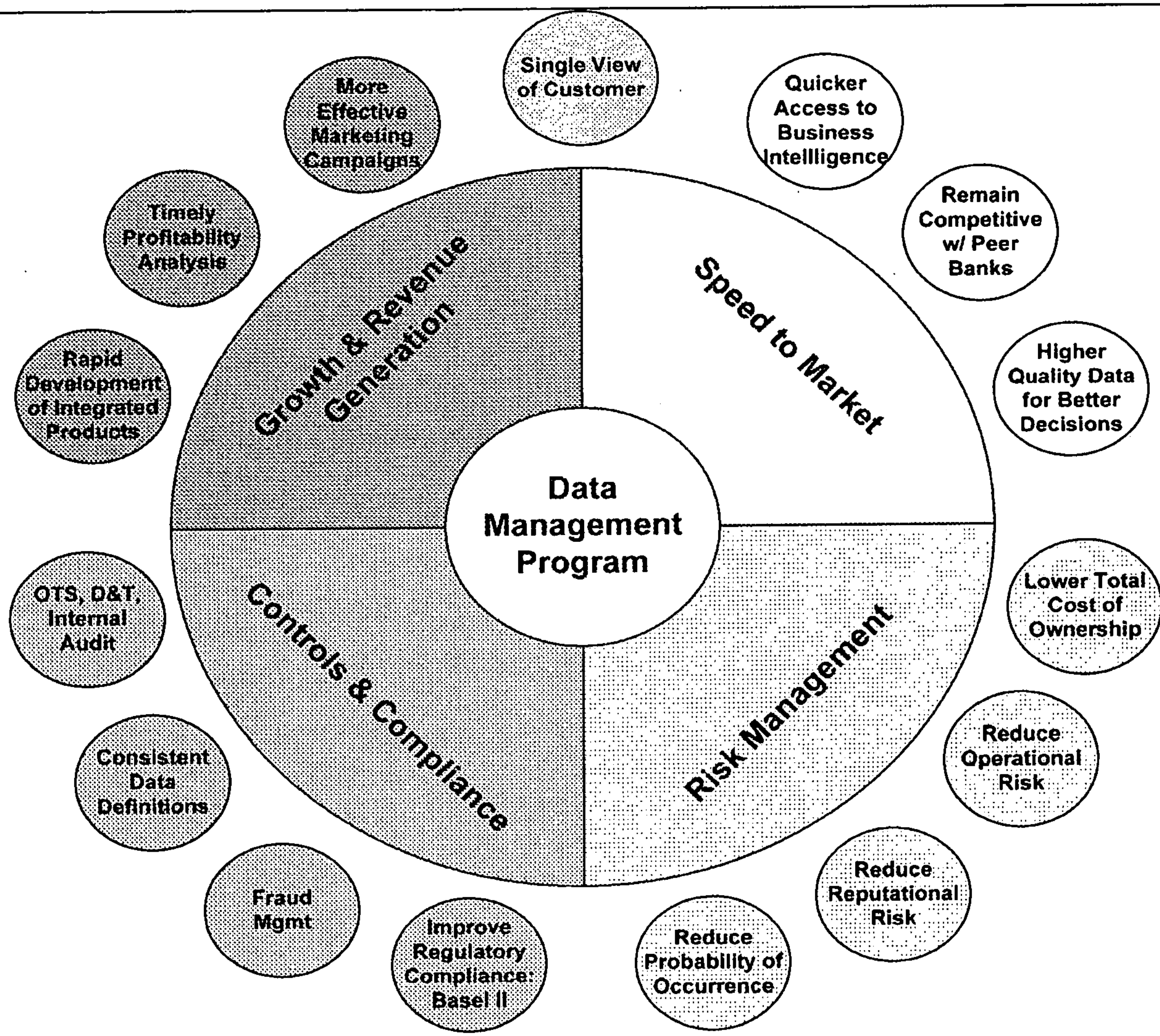
Data Custodianship
TSG
"Utility Ownership"

- Systems Design Flows
- Data Integrity & Security
- Standard Tools & Platforms

Requirements & Guidelines → **Based on Business Data Architecture Requirements & Guidelines**

Confidential Treatment Requested by JPMC

Data Management: Benefits to WaMu



Next Steps & Milestones

- Launch Information Management Governance – January 2007
- Identify and Prioritize Top 50 Business Processes – February 2007
- Identify Key Data Fields Required by Top Processes – Q2-Q3
- Establish Business Line Accountability for Data Stewardship – Q2-Q3
- Continue Execution of Enterprise Data Management Initiatives – 2007
  - Select Vendor for Enterprise Data Warehouse – January 2007
  - Launch Next Phase Data Quality Services – May 2007
  - Data Warehouse in Production – June 2007

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Corporate Compliance Review Update to ERMC

December 15, 2006

Overview

Corporate Compliance Review (CCR) tests loan originations for Home Loans mortgages, home equity loans and lines, and Commercial loans. The full testing and reporting cycle has been completed for July through September fundings. In addition, Card Services Compliance identifies issues through various detective controls, and Retail Bank Compliance performs targeted testing of new high-risk deposit accounts. This report highlights key issues identified in the reviews that are of concern to Compliance management.

- Home Loans Mortgages: Eighteen of the 90 compliance requirements tested had error rates above tolerance levels in September. These errors span seven federal and one state regulation. Of the 18 above-tolerance issues, 6 affect only a small proportion of customers.
- Home Equity: Five of the 77 compliance requirements tested had error rates above tolerance levels in September. These errors span two federal regulations and one state regulation. Of the five above-tolerance issues, 3 affect only a small proportion of customers.
- Commercial Lending: No error rates were above tolerance in September for the Commercial Group.
- Card Services: The number of unresolved compliance issues at continues to be low. In addition, their severity and the number of customers affected do not warrant escalated attention.
- Retail Bank: Compliance testing of new high-risk deposit accounts (including Non-Resident Aliens and Small Business) for adherence to the USA PATRIOT Act Customer Identification Program did not reveal any significant findings in the most recent testing period.

Some of the above-tolerance issues show favorable error rate trends or are only marginally above tolerances, and are not considered by Compliance management to warrant ERMC attention. However, the three above-tolerance issues summarized in this report are sufficiently material or persistent to warrant ERMC awareness. Each has had persistently high error rates and involve regulatory requirements that apply to essentially all funded or nonfunded loans of the affected business units. If not corrected, they could result in regulatory criticism or other enforcement action. Remediation of each is in process, but continued focus on execution is needed to ensure that the fixes are effective.

Process Change Note: Corporate Compliance Review will be changing to a quarterly review cycle in 2007, from the current monthly cycle, with increased use of risk-targeted reviews. This change is being made to increase the cost effectiveness and risk focus of the program.

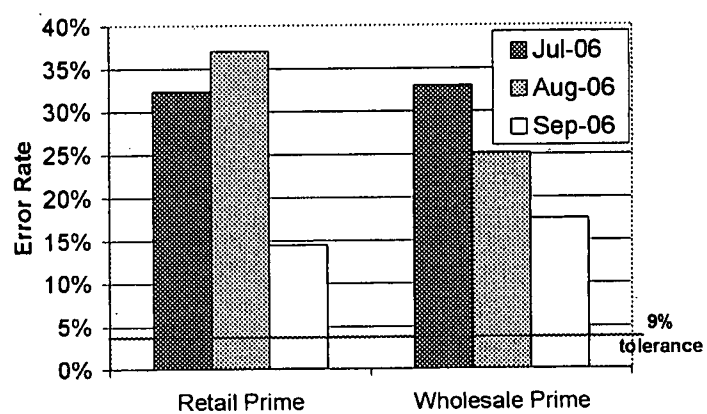
Risk Issue: Good Faith Estimate (RESPA) – Customary lender, broker, escrow, and/or title fees not disclosed correctly on GFE.

Risk to WaMu: Per VOCALS, upfront accurate fee disclosure is our Home Loans customer's primary concern. Inaccurate disclosure may cause customer dissatisfaction, increased complaints, and reputation damage. Also, there is a potential for regulatory criticism if not corrected.

Cause: Failure to follow established policies and procedures, coupled with a lack of systemic controls to drive results.

Remediation Status: Retail and Wholesale processes as well as automated controls recently have been modified to further reduce the error rates. That being the case, CCR trend reports published in early 2007 should reflect the positive impact of these system updates. Furthermore, the long-term solution is being built into the new LOS for each channel.

Home Loans - Good Faith Estimate



Risk Issue: Adverse Action Notices are incomplete, inaccurate or missing (ECOA & FCRA)

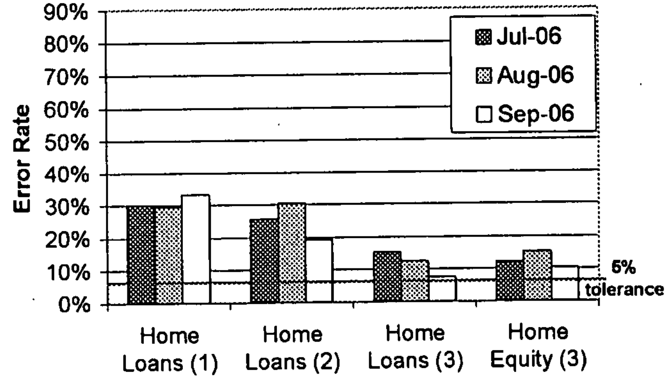
Risk to WaMu: There is a potential for regulatory criticism if not corrected. In addition, inaccurate notification to customers may result in reputation damage and an increase in customer complaints.

Cause: Underwriters not accurately completing this information on the Notice. Error rates are above tolerance in all Home Loans channels.

Remediation Status: Extensive ECOA and FCRA training conducted in all LFCs in August 2006. Underwriting has reissued policies and procedures, implemented a second review program, and conducts internal self-monitoring.

Note: Other adverse action notice requirements also have above-tolerance error rates, but affect much more limited customer populations and, thus, pose substantially less risk.

Home Loans/Home Equity - Non-Funded Adverse Action Notices



Legend
(1) Incomplete or inaccurate bureau information (FCRA)
(2) Inaccurate reasons for action taken (ECOA)
(3) Missing or inaccurate notice (ECOA)

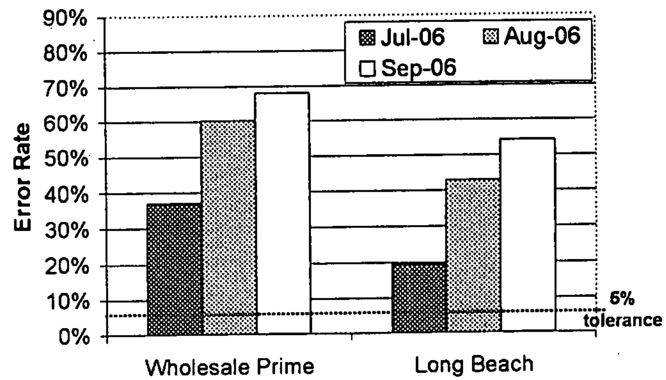
Risk Issue: FACT Act – Notice to Home Loan Applicant and Credit Score Disclosure missing or inaccurate.

Risk to WaMu: New regulatory requirement, expected to be examined by OTS in 2007. Potential regulatory criticism if not corrected.

Cause: The Wholesale vendor solution (Dorado) was attempted in June 2006, but was unsuccessful. In addition, as a separate issue, the vendor was not displaying or capturing required ("5th factor") information correctly. For LBM, errors resulted from inaccurate system programming. A vendor solution for Retail, Emerging Markets and CD was implemented successfully in February 2006, and error rates for those channels are now within tolerance.

Remediation Status: For Wholesale, all systematic programming corrections were implemented in October. For LBM in November, 50% of the system defects were resolved and the remaining 50% will be resolved with a December system fix. Additionally, these requirements are being built into the LOS for each Channel.

Home Loans - FACT Act



Washington Mutual

CORPORATE COMPLIANCE REVIEW

SUMMARY TREND REPORT

July - September 2006

PAGE	CONTENTS

Report Date: November 2006

Washington Mutual

CORPORATE COMPLIANCE REVIEW

SUMMARY TREND REPORT
SCORECARD

Number of Compliance Requirements with Error Rates Above Tolerance *Based on Three Month Overall Error Rates*								
Division/Channel	Funded Review				Non Funded Review			
	High	Medium	Low	Total	High	Medium	Low	Total
Home Loans	2	8	1	11	0	8	0	8
Banking (BLCs)	6	2	5	13	0	8	0	8
Consumer Direct	0	4	1	5	0	8	1	9
Long Beach Mortgage	1	5	1	7	0	6	0	6
Retail Banking	1	6	2	9	0	8	0	8
Wholesale	1	6	2	9	0	8	0	8
Home Equity	1	1	0	2	0	3	0	3
CLPC	1	1	1	3	0	3	0	3
FC	0	3	0	3	0	3	0	3
Commercial	0	1	0	1	NA	NA	NA	NA
CRE	0	3	0	3	NA	NA	NA	NA
MFL	0	0	0	0	NA	NA	NA	NA

Washington Mutual
CORPORATE COMPLIANCE REVIEW

Highlighted items are those discussed in the Corporate Compliance Review Update to ERMC

SUMMARY TREND REPORT
Errors Over Tolerance

DIVISION	REVIEW TYPE	CATEGORY	EVENT DESCRIPTION	RATING	July Cited	July Applies	July %	August Cited	August Applies	August %	September Cited	September Applies	September %	3 Month Total Cited	3 Month Total Applies	3 Month Total %
Commercial	Funded	FLOOD DISASTER PROTECTION ACT	Flood Hazard Determination not obtained prior to funding.	Medium	7	101	6.9%	5	106	4.7%	5	110	4.5%	17	317	5.4%
Home Loans	Funded	FAIR CREDIT REPORTING ACT	Notice to Home Loan Applicant and Credit Score Disclosure was missing from the file or inaccurate (Applies to approved, declined and counter-offered loans) (FACT Act)	Medium	119	742	16.0%	223	756	29.5%	266	763	34.9%	608	2261	26.9%
		HIGH COST/PREDATORY	NTB Test Insufficient Information and/or Documentation (Missing Source Documents) to determine whether benefit or no benefit	Medium	14	73	19.2%	3	72	4.2%	3	67	4.5%	20	212	9.4%
		HOMEOWNERS PROTECTION ACT (HPA)	No evidence of HPA disclosure for Fixed Rate Loan missing inaccurate or incomplete	Medium	3	21	14.3%	7	23	30.4%	2	21	9.5%	12	65	18.5%
			HPA Amortization Schedule not in file or referenced as being provided. (Fixed rate Loans).	Medium	2	20	10.0%	0	15	0.0%	1	19	5.3%	3	54	5.6%
		REGULATION X	The Submission checklist and/or evidence of required broker/builder services missing from file	Medium	1	8	12.5%	1	15	6.7%	2	13	15.4%	4	36	11.1%
			IEAD/AATB not in the file or is inaccurate.	Medium	22	312	7.1%	25	331	7.6%	31	309	10.0%	78	952	8.2%
			Customary lender/broker/title/escrow fees not disclosed on the GFE	Low	176	805	21.9%	180	808	22.3%	95	813	11.7%	451	2426	18.6%
		REGULATION Z	NORTC dates were missing or incorrect	High	10	442	2.3%	9	373	2.4%	14	466	3.0%	33	1281	2.6%
		STATE SPECIFIC	Broker Pre-App DisclosureFee Agreement not signed by broker and applicants (or written statement of no separate fee agmt). Also, broker fees disclosed on final HUD_1 not equal or less than disclosed on GFE	High	3	12	0.25	1	9	11.1%	1	13	7.7%	5	34	14.7%
			Initial 1003 not signed by broker (NY Only)	Medium	2	11	18.2%	0	9	0.0%	1	13	7.7%	3	33	9.1%
		USA PATRIOT Act	Customer Identification Program (CIP) documentation is not in the file, incomplete, inaccurate or unsigned	Medium	49	821	6.0%	44	820	5.4%	53	822	6.4%	146	2463	5.9%
	Non-Funded	FAIR CREDIT REPORTING ACT	Notice of Action Taken did not completely identify FCRA name, address or phone number when credit history was reason for adverse action	Medium	40	133	30.1%	50	170	29.4%	46	139	33.1%	136	442	30.8%
			Counteroffer reason does not properly identify reporting agency if reason is credit related	Medium	20	64	31.3%	14	39	35.9%	8	49	16.3%	42	152	27.6%
			Notice of Action Taken did not reflect the FCRA box checked when applicable	Medium	41	194	21.1%	59	209	28.2%	34	188	18.1%	134	591	22.7%
		REGULATION B	NOIA missing from file or insufficient	Medium	15	33	45.5%	27	57	47.4%	19	47	40.4%	61	137	44.5%
			Counteroffer disclosure missing inaccurate or insufficient.	Medium	56	107	52.3%	36	80	45.0%	15	82	18.3%	107	269	39.8%
			Notice of Action Taken does not accurately / consistently state reasons for action taken	Medium	78	305	25.6%	95	313	30.4%	77	402	19.2%	250	1020	24.5%
			Bank Creditor information not provided on Notice of Action Taken (Bank, LFC address, phone number)	Medium	56	327	17.1%	38	339	11.2%	36	425	8.5%	130	1091	11.9%
			Notice of Action Taken missing from the file or insufficient	Medium	101	663	15.2%	84	673	12.5%	50	663	7.5%	235	1999	11.8%
Home Equity	Funded	FLOOD DISASTER PROTECTION ACT	Flood Hazard Determination not obtained prior to funding.	Medium	579	820	70.6%	9	835	1.1%	1	618	0.2%	589	2273	25.9%
		STATE SPECIFIC	Evidence of Texas 12-day cooling off period not in file or insufficient	High	0	2	0.0%	0	1	0.0%	2	10	20.0%	2	13	15.4%
	Non-Funded	REGULATION B	Counteroffer disclosure missing inaccurate or insufficient.	Medium	12	18	66.7%	7	17	41.2%	7	19	36.8%	26	54	48.1%
			NOIA missing from file or Insufficient	Medium	2	7	28.6%	1	1	100.0%	0	0	NA	3	8	37.5%
			Notice of Action Taken missing from the file or insufficient	Medium	33	272	12.1%	39	256	15.2%	23	224	10.3%	95	752	12.6%

* Events displayed are based on the overall 3 month percentage over tolerance

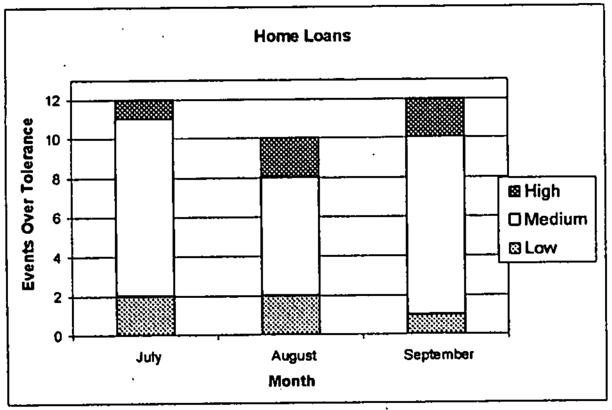
Washington Mutual

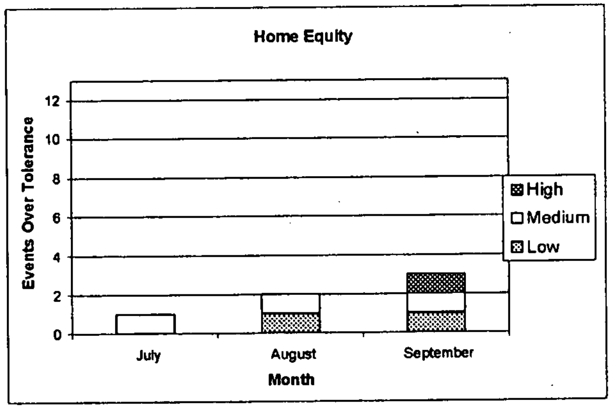
CORPORATE COMPLIANCE REVIEW

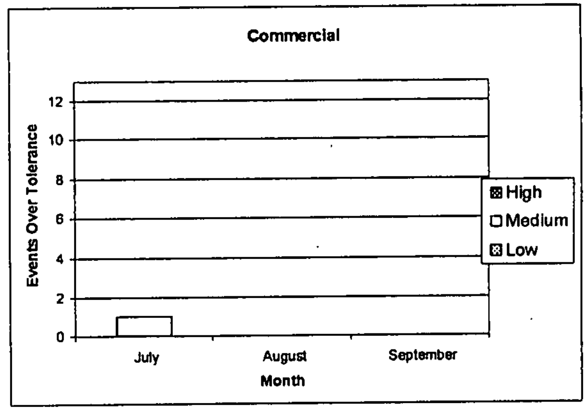
SUMMARY TREND REPORT
FUNDED TREND ANALYSIS

Funded Trend Analysis- Number of Events Over Tolerance By Month

Division	July				August				September				October				November				December			
	High	Medium	Low	Total	High	Medium	Low	Total	High	Medium	Low	Total	High	Medium	Low	Total	High	Medium	Low	Total	High	Medium	Low	Total
Home Loans	1	9	2	12	2	6	2	10	2	9	1	12												
Home Equity	0	1	0	1	0	1	1	2	1	1	1	3	Will be available once reviews are completed											
Commercial	0	1	0	1	0	0	0	0	0	0	0	0												







Washington Mutual

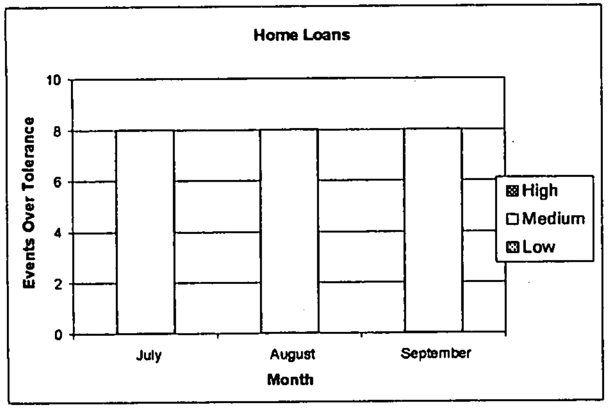
CORPORATE COMPLIANCE REVIEW

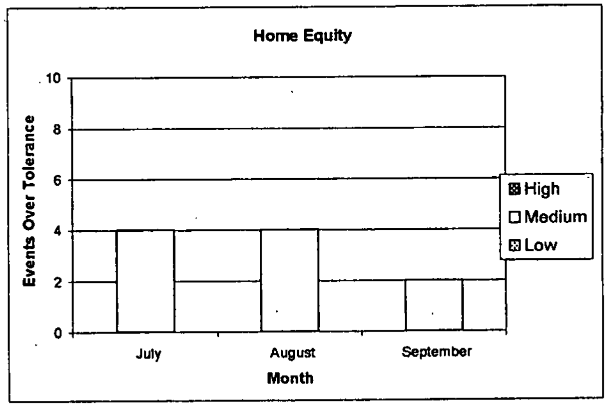
SUMMARY TREND REPORT
NON-FUNDED TREND ANALYSIS

Non-Funded Trend Analysis- Number of Events Over Tolerance By Month

Division	July				August				September				October				November				December			
	High	Medium	Low	Total	High	Medium	Low	Total	High	Medium	Low	Total	High	Medium	Low	Total	High	Medium	Low	Total	High	Medium	Low	Total
Home Loans	0	8	0	8	0	8	0	8	0	8	0	8												
Home Equity	0	4	0	4	0	4	0	4	0	2	0	2												

Will be available once reviews are completed





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CORPORATE COMPLIANCE REVIEW

SUMMARY TREND REPORT
Percent of Loans with Findings

Percentage of Loans with one or more Compliance Errors *Based on Three Month Overall Results*		
Division/ Channel	**Funded Review**	**Non Funded Review**
Home Loans	61%	31%
Banking (BLCs)	77%	35%
Consumer Direct	42%	33%
Long Beach Mortgage	59%	27%
Retail	54%	31%
Wholesale	81%	36%
Home Equity	37%	17%
CLPC	30%	15%
FC	41%	20%
Commercial	11%	NA
CRE	26%	NA
MFL	7%	NA

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Corporate Credit Review
Organizational Update

Presented to

Board of Directors' Finance Committee

of Washington Mutual Bank and Washington Mutual, Inc.

December, 2006

WaMu

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Corporate Credit Review
Role and Responsibilities

Corporate Credit Review is responsible for providing an independent assessment of credit risk and credit quality for the Board of Directors and Senior Management to ensure that lending and credit risk management practices are consistent with corporate business strategies and risk tolerance objectives. Activities include:

- Independent credit risk reporting framework which supports the enterprise risk governance structure and the proactive identification and monitoring of credit risk and credit quality throughout the enterprise
- Analysis of credit risk trends that may adversely affect portfolio performance and credit quality
- Independent review and analysis of risk rating accuracy and timeliness, risk rating migration, and risk rating methodologies including the evaluation of the Bank's internal risk rating processes
- Tracking of credit risk issues that exceed agreed upon risk tolerance performance benchmarks. This includes tracking and testing the remediation plans established by the business to ensure resolution of the identified risk.
- Evaluation of credit risk mitigation and default management activities including Special Assets and problem loan management
- Review and evaluation of business compliance with and effectiveness of the Bank's internal policies, procedures, business strategies and risk tolerance levels, applicable laws and regulations

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Value Add Proposition

Corporate Credit Review fulfills the regulatory requirement and mandate for an independent internal asset review function and is designed to be leveraged by the business line and integrated with the various business quality assurance processes. In addition, Corporate Credit Review supports the Chief Credit Officer's governance structure by focusing on the proactive identification of emerging risk issues throughout the enterprise through the following value add orientation:

- Data and analytically driven approach
- Risk based annual review plan
- Indepth assessment and review of each business line or credit portfolio focused on key risk drivers unique to that business line or portfolio
- Partnership and collaboration with the business to create a consistent view of credit risk
- Understands, anticipates, and communicates industry trends in various portfolios
- Subject matter expertise, and knowledge base regarding credit related Regulatory developments and Basel II

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Methodology and Performance Metrics

Consistent with the strategic plan and the Bank's efforts to expand credit exposure, Corporate Credit Review is mandated in its role to ensure there is a risk based methodology and performance metrics driven approach to monitoring and measuring credit risk and adherence to the bank risk strategy. Activities are managed using a risk based annual review plan that determines review intervals and priorities. Corporate Credit Reviews primary activities include:

Targeted Reviews:

Limited in scope with a focus on specific factors that may contribute to potentially higher risk. Targeted reviews are conducted on an as needed basis where emerging risk issues have been identified, or to evaluate changes in credit related activities, and/or portfolio risk management and oversight activities. (Example: Long Beach EPD/FPD, and Commercial Group Data Integrity and Quality Issues).

Portfolio Risk Reviews:

Focused on specialized credit risk management activities on non-homogenous portfolios. These portfolios are not subject to the continuous testing process but are reviewed periodically on a quarterly, semi-annual, or annual risk-based review cycle with review ratings assigned based on a comprehensive assessment of credit risk that includes credit quality, credit risk management, portfolio oversight and compliance with regulations and internal policy. Ratings are consistent across all review types: Satisfactory, Satisfactory with Qualification, Requires Improvement, and Unsatisfactory. Portfolios included in this review type include:

- Mortgage Banker Finance
- National SBA Lending
- Community Lending and Investment
- Special Assets
- Card Services
- Large Borrower s
- Home Builder Finance
- Wind down portfolios
- Small Business Lending
- Appraisal Valuation (Consumer and Commercial)
- National Operations Center (Royal Ridge)
- Construction Lending

Post-Funding Testing Oversight:

Oversight of continuous transactional testing for all homogenous type portfolios performed by the Chief Risk Officers testing teams who provide weekly and monthly feedback to the business unit. The reviews are designed to provide immediate feedback on transactional defects and elevate systemic risk issues that may materially impact liquidity or salability of portfolio assets within 30-days of loan origination.

- Home Loans Group
- Specialty Lending
- Retail Lending Group
- Multi-Family Lending
- Commercial Mortgage Lending

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Revised Post-Funding Testing Event Codes

Working with the Chief Risk Officers, their business unit risk teams, and legal this process was repositioned. The process refinements implemented not only enhanced efficiency, but developed and established materiality thresholds and layered risk elements. Risk events were reduced from 578 events to 199 events. The Chief Risk Officers were given responsibility for the day to day execution of the testing activities.

Event Definitions	
Primary Events	These are the credit exceptions that are deemed to be material and high risk events.
Secondary Events	A sub-set of primary events which are designed to provide the business with granularity on the key risk drivers of primary events. If more than one secondary event rolls up to the same primary event it is only counted as one primary. If the secondary events have different severity levels, the higher level event rolls up to the primary.
Severity Level Definitions	
High Severity Level	Material collateral, credit, and documentation errors that directly impact loan performance, enforceability, and/or salability. This definition includes fraud and material misrepresentation. Must be immediately addressed by management with an associated action plan.
Medium Severity Level	Collateral, credit and documentation errors considered non-critical in isolation, but have the potential to cause a material impact when combined with other risk factors. These exceptions create the need to review for potential impacts to the performance of the credit and/or salability. These errors are considered noteworthy to management and when each occurs at a rate over a predetermined materiality threshold they are deemed to be material and require management's attention and the establishment of an action plan.
Materiality and Layered Risk	
Materiality Threshold	Given that even a single citing of a High event is considered material and results in an Unsatisfactory rating for the loan under review, there is no materiality threshold relating to High events. Effectively, the threshold for materiality is 0%. Each medium event is assigned a materiality threshold ranging from 2% to 5%. Medium events impact the "Satisfactory", "Satisfactory with Qualification", and/or "Requires Improvement" loan ratings if the error rate on that specific medium event is over the materiality threshold. This is based on the last reported trailing three month performance data relating to the respective channel.
Layered Risk	There are six medium severity primary events that are identified as layered risk events. In the event an individual loan is cited with any combination of three or more of these layered risk issues a high severity event is triggered. These will be used for the purpose of calculating the individual loan rating.

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Revised Post-Funding Testing Event Codes

Each loan that is reviewed in the post-funding testing activity is assigned one of four possible ratings: Satisfactory, Satisfactory with Qualification, Requires Improvement, or Unsatisfactory. Performance benchmarks (risk tolerance thresholds) have been set to track and report origination performance in the respective business lines.

Individual Loan Rating Definitions	
Unsatisfactory	A loan is rated "Unsatisfactory" when it is cited with one or more High events.
Requires Improvement	A loan is rated "Requires Improvement" when it is cited with two or more Medium events that are over the stated materiality threshold, but no High events.
Satisfactory with Qualification	A loan is rated "Satisfactory with Qualification" when it is cited with one Medium event that is over the stated materiality threshold, but no High events.
Satisfactory	A loan is rated "Satisfactory" when it is not cited with any High event or any Medium event that is over the stated materiality threshold.

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Summary

- Corporate Credit Review is an integral part of the Bank's enterprise risk governance structure with a focus on the independent assessment and proactive identification of credit risk issues throughout the enterprise.
- Elevation of issues to Executive Management and the Board are focused on those high and medium risk issues that may impact one of the following:
  - Liquidity and Salability of portfolio assets
  - Regulatory risk
  - Credit practices when inconsistent with established corporate business strategies and credit risk tolerance objectives
- Corporate Credit Review is a uniquely qualified group of professionals with a broad spectrum of financial services product knowledge, experience, and professional certifications including: Professional Risk Managers, Certified Risk Professionals, and OCC, OTS, FDIC and Federal Reserve Bank experience.

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MEMORANDUM

DATE: **December 8, 2006**

TO: **Board of Directors' Finance Committee of Washington Mutual Bank and Washington Mutual, Inc.**

FROM: **Hugh Boyle, Chief Credit Officer**
Cynthia Abercrombie, Senior Credit Risk Officer

RE: **Organizational Update**

In June 2006, Corporate Risk Oversight & Compliance became separate Organizations reporting to two separate Senior Executives, Hugh Boyle, Chief Credit Officer and Richard Lewis, Chief Compliance Officer, respectively. Both Senior Executives report to the Chief Enterprise Risk Officer.

Alignment of the newly created Corporate Credit Review function under the Chief Credit Officer preserves the independent credit risk focus of the group on a firm wide basis.

Corporate Credit Review (CCR) has responsibility for providing an independent assessment of credit risk and credit quality for the Board of Directors and Senior Management to ensure that lending and credit risk management practices are consistent with corporate business strategies and risk tolerance objectives. Corporate Credit Review is an integral part of the Bank's enterprise risk governance structure with a focus on the independent assessment and proactive identification of credit risk issues throughout the enterprise. In addition, Corporate Credit Review fulfills the regulatory requirement for an independent internal asset review function.

To ensure greater effectiveness, the day to day execution of credit risk management and asset quality is delegated to the Chief Risk Officers. Chief Risk Officers received a turn-key operation including skilled resources, a centralized post-funding testing group within their Division, and a quality control process.

Transition of Activities to Chief Risk Officers

- Completed Phase I and Phase II transition of Post funding testing and risk rating activities to the Chief Risk Officers.
    - Developed an open communication protocol with each Chief Risk Officer (CRO) group;
    - Transitioned the Post Funding Review Process (and seasoned loan review in the Commercial portfolio) to the Chief Risk Officer organization:
        - Established minimum testing criteria
        - Revised the event codes incorporating a Primary and Secondary structure as well as a multi-layered component

- Established Materiality Thresholds that more appropriately define the risk of the event
- Developed definitions for Loan Level Ratings
- Defined the Performance Benchmarks for the Loan Level Ratings
- Provided training in three phases that included web cast presentations, job aids and detailed instructions

- Transitioned the Change Request Summary "CRS" Approval Process to the Chief Risk Officer organization;
- Transitioned ownership of Commercial risk rating development to the Chief Risk Officer organization, with Corporate Credit Review maintaining oversight;
- Transitioned ownership of the Mortgage Banker Finance risk rating development to the Home Loans Chief Risk Officer organization, with Corporate Credit Review maintaining oversight.

Roles and Responsibilities

At the direction of the Chief Enterprise Risk Officer and the Chief Credit Officer, Corporate Credit Review is responsible for providing management and the Board of Directors with an independent, objective, accurate, and timely assessment of credit risk and credit quality. This includes:

- Independent credit risk reporting framework which supports the enterprise risk governance structure and the proactive identification and monitoring of credit risk and credit quality throughout the enterprise.
- Analysis of credit risk trends that may adversely affect portfolio performance and credit quality;
- Conducting early warning activities to identify and assess potential emerging credit risk exposures in the Bank's portfolios;
- Analysis and oversight of post-funding testing results;
- Evaluation of credit quality and underlying trends;
- Evaluation of risk mitigation and default management activities including Special Assets and problem loan management;
- Independent review and analysis of risk rating accuracy and timeliness, risk rating migration, and risk rating methodologies including evaluation of the Bank's internal risk rating process;
- Development of an annual Corporate Credit Review plan, principal activities and report timeframes to focus on the evaluation and assessment of the critical risk elements of the Bank's credit related activities and emerging credit risk issues. This includes assessment of compliance with and effectiveness of the Bank's credit risk management and portfolio oversight processes, internal policies, procedures, laws and regulations;

- Quarterly, semi-annual, or annual credit risk reviews and credit related processes that are not included in post-funding testing activities (MBF, HBF, CL&I, Special Assets, Appraisal, Large Borrower Relationships, and Card Services, etc.);
- Development and measurement of key risk performance indicators and a risk reporting framework to support governance and monitoring.
- Development and maintenance of an appropriate organizational structure including staffing levels;
- Providing the Finance Committee of the Washington Mutual Bank Board of Directors and Senior Management with objective, accurate, and timely information regarding the Company's adherence to its credit strategies and risk tolerance objectives;
- Ensuring the qualifications and training of personnel are commensurate with the requirements necessary to perform CCR activities.

Credit Review Value Add Proposition

Corporate Credit Review supports the Chief Credit Officer's governance structure by focusing on the proactive identification of emerging credit risk issues throughout the enterprise, utilizing robust metrics and meaningful analytics to identify and assist the business in mitigating portfolio credit risk for the organization. Credit risk exposure is determined relative to the business line or credit portfolio being reviewed, in addition to the entire corporation.

This oversight function is carried out through review and oversight of the post-funding testing activities performed by the Chief Risk Officers, the completion of targeted reviews of emerging credit risk issues, reviews of various credit support functions, and quarterly, semi-annual, or annual portfolio risk reviews.

The Corporate Credit Review Value Add Orientation:

- Is based upon a data and analytically driven approach
- Utilizes a risk based annual review plan
- Indepth assessment and review of each business line or credit portfolio focused on key risk drivers unique to that business line or credit portfolio
- Provides a partnership and collaboration with the business to create a consistent view of credit risk
- Is focused on fulfilling the Regulatory requirement for an independent internal asset review function
- Is designed to be leveraged by the business line and integrated with the various business quality assurance processes
- Corporate Credit Review understands, anticipates, and communicates industry trends in various portfolios
- Provides subject matter expertise, and stays abreast of credit related Regulatory developments and Basel II.

- Corporate Credit Review professionals have worked across a broad spectrum of Financial Services products. Our team members have performed numerous Credit reviews across virtually every asset class (prime and sub prime) including:
  - Commercial Real Estate
  - Credit Cards
  - Construction Lending
  - Asset Based Lending
  - Appraisal (Consumer and Commercial)
  - Loans and Lines
  - Mortgage (Prime and Sub prime)
  - Auto
  - Timeshare
  - Small Business
  - Syndications/Participations
  - Agriculture Loans
  - Troubled Asset Disposition
  - Commercial & Industrial
  - Leasing
  - Student Lending
  - Home Equity

Professional Certifications

We encourage our Credit Risk professionals to attain specialized certifications as a way to enhance our skills and demonstrate our commitment to providing clients with the highest level of service and collaboration. Our diverse team has the following professional certifications:

- Commissioned Bank Examiner (OCC, OTS)
- Professional Risk Manager
- Certified Risk Professional
- Credit Business Analyst
- Certified Fraud Examiner
- Project Management Professional
- Certified Public Accountant
- Six Sigma Experience
- Chartered Robert Morris Associate

In addition to these certifications, a number of the team members hold advanced degrees (MA, MS, PhD, and MBA) in specialized disciplines. The breadth and depth of the Credit Risk team's experience and professional certifications, ensures that there is a robust corporate level credit review of the business.

Methodology and Performance Metrics

Consistent with the strategic plan and the Bank's efforts to expand credit exposure, Corporate Credit Review is mandated in its role to ensure there is a risk based methodology and performance metrics driven approach to monitoring and measuring credit risk and adherence to the bank risk strategy. Corporate Credit Review activities are managed using a risk based approach determining review intervals or priorities. The review schedule is set forth in the Annual CCR Review Plan. The Plan is reviewed and approved by the Chief Credit Officer and the Chief Enterprise Risk Officer. CCR evaluates the risk profile of each credit portfolio on a quarterly basis to determine any material shifts in credit risk strategy and identify any emerging risk issues which would create the need to reprioritize or change the annual Plan. The risk assessment is based on a combination of indicators, including, but not limited to the following:

- A comparison of Front End Guidance/Quarterly Credit Risk Review objectives to actual results
- Portfolio performance/risk rating migration trends
- Credit attribute root cause analysis (post-funding testing results)
- Economic and/or product type impact on the risk profile of the portfolios
- Changes within the loan servicing organization or significant changes to investor requirements

CCR delivers on this mandate and the Annual Review Plan through the use of three primary review activities:

- **Targeted Reviews:** A Targeted Review is limited in scope with a focus on specific factors that may contribute to potentially higher risk. Targeted Reviews are conducted on an as needed basis where emerging risk issues have been identified. A targeted review focuses on specific higher risk portfolios, specific segments of portfolios, or specific processes. Targeted reviews may also be considered for areas/departments involved in credit related activities, and/or portfolio oversight, that are not directly responsible for managing assigned credit portfolios.
- **Portfolio Risk Reviews:** CCR provides quarterly, semi-annual, or annual portfolio risk reviews to the Chief Risk Officers outlining identified key risk areas. The CRO's have the opportunity to provide feedback on the review. The final report, with Business Unit and CRO response, is issued to the Head of the Business, the Chief Enterprise Risk Officer, the Chief Credit Officer, Internal Audit, and other Business Unit management as appropriate. The Chief Credit Officer, Credit Risk Management and the Chief Enterprise Risk Officer are briefed on any significant risk issues by CCR Senior Managers.

Both Targeted Reviews and Portfolio Risk Reviews are developed utilizing a documented Review Plan which includes; a specific scope and focus, risk based sampling methodology, assessment of risk rating accuracy and timeliness, policies and procedures adherence, credit quality, credit risk management assessment, and Regulatory adherence. Review ratings are assigned by CCR based on a comprehensive assessment of credit risk that includes analysis of pertinent data from both internal and external sources. Ratings are consistent across all review types: ***Satisfactory, Satisfactory with Qualification, Requires Improvement, and Unsatisfactory***.

- **Post-Funding Testing Oversight:** Homogenous and non-homogeneous (MFL/CML) loan portfolios are subject to post-funding testing performed by the Chief Risk Officer of each line of business.

  CCR conducts an independent assessment of the post-funding transactional loan testing completed by the Chief Risk Officer teams to ensure the integrity of the testing system and methodology, and appropriate reporting of risk errors and events. The following business Units are part of this oversight activity: Home Loans, Retail Bank, and Commercial (multifamily lending and commercial real estate). Each Channel has a separate sampling methodology focusing on a number of risk events, categorized by the following: ***credit evaluation, operational evaluation/process, and collateral.***

  Utilizing this approach, emerging risk issues surface quickly, providing the organization with meaningful and timely information through weekly loan level detail and monthly trending reports. This information and reporting assists the Chief Risk Officers and business units in developing remediation plans with assigned responsibility and target dates for completion.

Working closely with the various Chief Risk Officers we reassessed the post-funding testing events, eliminated the confusion caused by the previous low risk events, and created materiality thresholds and layered risk elements in the process. The new process elevates those high and medium risk issues that can materially impact liquidity and salability of portfolio assets. Performance metrics have been agreed to by each business unit's Chief Risk Officer and integrated into business management of these products.

Revised Post-Funding Testing Event Codes

The process refinement efforts in this area have been exhaustive taking four months to complete and implement. Working with the Chief Risk Officers:

- The previous event coding was reduced from 578 events to 199 events, 42 of which are defined as primary events.
- Post funding testing event codes were revised incorporating a Primary and Secondary event structure as well as a Layered risk component.
- Each loan that is reviewed is assigned one of four possible ratings (Satisfactory, Satisfactory with Qualification, Requires Improvement or Unsatisfactory); and performance benchmarks (risk tolerance thresholds) have been set to track and report origination performance in the respective business lines.

Event Definitions	
Primary Events	These are the credit exceptions that are deemed to be material and high risk events.
Secondary Events	A sub-set of primary events which are designed to provide the business with granularity on the key risk drivers of primary events. If more than one secondary event rolls up to the same primary event it is only counted as one primary. If the secondary events have different severity levels, the higher level event rolls up to the primary.
Severity Level Definitions	
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Materiality and Layered Risk	
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Layered Risk	There are six medium severity primary events that are identified as layered risk events. In the event an individual loan is cited with any combination of three or more of these layered risk issues a high severity event is triggered. These will be used for the purpose of calculating the individual loan rating.

Individual Loan Rating Definitions	
Unsatisfactory	A loan is rated "Unsatisfactory" when it is cited with one or more High events.
Requires Improvement	A loan is rated "Requires Improvement" when it is cited with two or more Medium events that are over the stated materiality threshold, but no High events.
Satisfactory with Qualification	A loan is rated "Satisfactory with Qualification" when it is cited with one Medium event that is over the stated materiality threshold, but no High events.
Satisfactory	A loan is rated "Satisfactory" when it is not cited with any High event or any Medium event that is over the stated materiality threshold.

Debt Capacity Error Event Coding

The following is an example of the *Debt Capacity Error* primary and secondary event coding. In this example the Primary Event is shaded. All of the Secondary Events which provide further granularity on the issue are also provided. Let's focus on Secondary event code #1013905 and see how the citing of that event makes it through the system and gets reported to the business.

- When reviewing a file, the Analyst refers to the Desk Aid to view the Test Criteria and applies the test criteria to the loan. If the Analyst discovers a finding they apply the applicable Event Code to the finding.

All DTI related Event Codes

Secondary Event Codes rolling up to Primary …

	A	B	C	D	E
1		EVENT TYPE	CODE	DESCRIPTION	Home Loans Test Criteria
2	1	*Primary*	1013900	Debt Capacity or Debt Ratio Error	Review and compare credit report and application for inconsistencies and accuracy and calculate debt to income ratio. Verify payments on the loan approval, credit report, and other documentation are taken into consideration in the Debt to Income Ratio, such as paystub or divorce decree debts. Check the accuracy of the PITI using the correct qualifying rate and escrows as indicated on final HUD 1 and compare to final approval AUS for inconsistencies and calculate debt to income ratio for acceptance.
3	2	*Secondary*	1013902	There was an error in the calculation of income, but did not result in a final debt ratio that exceeded guidelines	Recalculate income from paystubs, W2's, VOE, bank statements or tax returns and compare to underwriter's calculation/approval for accuracy. Review per tolerance of Channel being reviewed.
4	3	*Secondary*	1013903	There was an error in the calculation of income that resulted in a debt ratio that exceeds guidelines	Recalculate income from paystubs, W2's, VOE, bank statements or tax returns and compare to underwriter's calculation/approval for accuracy. NOTE: If does not exceed guidelines cite 1013902.
5	4	*Secondary*	1013904	Income was used to qualify that did not meet guidelines, and if removed would not result in a debt ratio that exceeds guidelines	Review income source documents for adherence to program parameters and/or guidelines. Confirm bonus or OT had sufficient history confirmed to use. Confirm commission, self-employed, or 2nd job time is sufficient to use income. NOTE: If income is removed, and recalculated debt ratio exceeds guidelines cite 1013905.
6	5	*Secondary*	1013905	Income needed to qualify did not meet guidelines and if removed results in a debt ratio that exceeds guidelines	Review income source documents for adherence to program parameters and/or guidelines. Confirm bonus or OT had sufficient history confirmed to use. Confirm commission, self-employed, or 2nd job time is sufficient to use income. If income is removed, determine if debt ratio exceeds guidelines.
7	6	*Secondary*	1013914	Liabilities shown on the application or elsewhere in the file were not all used in the submission to AUS	Compare liabilities on the application, credit report and /or bank statements to the AUS findings. N/A for LBMC
8	7	*Secondary*	1013915	There was insufficient documentation for the exclusion of debts	Compare documentation, approval conditions for clarification and documentation on removal of debts from final debt to income ratio (ie: If another party pays the debt but it is not properly documented OR student loan deferment not properly documented). NOTE: If debts required to be paid off at closing, but not documented, cite 3071900.
9	8	*Secondary*	1013919	An error in the debt calculation was identified and when calculated correctly the debt to income exceeds bank maximum	Review and compare credit report and application for inconsistencies and/or inaccuracies and calculate debt to income ratio. Cite this event if the tolerances are exceeded
10	9	*Secondary*	1013920	An error in the debt calculation was identified and when calculated correctly the debt to income does not exceed bank maximum	Review and compare credit report and application for inconsistencies and/or inaccuracies and calculate debt to income ratio. Cite this event if the tolerances were not exceeded

Figure 1: Debt Capacity Error, Primary and Secondary Event Codes

- The Analyst enters the applicable Event Code into the Database.
- Once entered, the Event Code becomes eligible for the Weekly Report, which is pulled from the database.
- The Event Codes are reported to the business via the Weekly Report. See Circle A (figure 2, next page).

Washington Mutual

SPECIALTY LFC WEEKLY FINDINGS REPORT

REPORT DISTRIBUTION DATE: 7/3/06 LFC RESPONSE DATE: 7/10/06
REPORT DATE: 07-03-06
RELATIONSHIP MANAGER: David Viesbrock

LFC: Stockton, Long Beach

HIGH AND MEDIUM EVENTS

LFC RESPONSE

Loan Number	Borrower Name	Date Funded	CRO Rating	SEC Rating	Process Category	Sub Category	Event Code	Event Description	Supplemental Description	Concur Yes/No	Field Response	Response Date
0698079902	SAUL MADRIGAL	12-May-06	High	4	CREDIT EVALUATION	DEBT CAPACITY	193000	Documentation found in the file did not support stated income and Risk Mitigation or Loss Detection confirmed misrep.	Misrepresentation of the borrower's stated income was confirmed by the Risk Mitigation Department.] | The application states borrower has been self-employed for three years, two months, however the LBMC credit report reflects employment information with Affina reported 02/06(occupation unknown) and Brake Parts Inc. since 1991 reported as recent as 01/05. Both of these jobs are reported during the same period of time the borrower has	YES	LFC CONCURS WITH FINDINGS. UNCORRECTABLE ERROR. FINDINGS WERE REVIEWED WITH THE EMPLOYEE WHO SIGNED OFF ON THE CONDITION, SLC, AND THE AUDIT PROCESS THAT SHOULD HAVE BEEN FOLLOWED. EMPLOYEE WAS COUNCELED	07/13/2006
			Medium	3	CREDIT EVALUATION	DEBT CAPACITY	1013905	Income needed to qualify did not meet guidelines and if removed results in a debt ratio that exceeds guidelines	Using the income verified on Transcripts from IRS and the stated room rent to be received the income would change from $5,564.00 per month down to $4,013.95 causing the ratios to exceed guidelines at 65.44/65.44:	YES	LFC CONCURS WITH FINDINGS. UNCORRECTABLE ERROR. FINDINGS WERE REVIEWED WITH THE EMPLOYEE WHO SIGNED OFF ON THE CONDITION, SLC, AND THE AUDIT PROCESS THAT SHOULD HAVE BEEN FOLLOWED. EMPLOYEE WAS COUNCELED	07/13/2006

A

B

Figure 2: Detail Weekly Report

- Business Concurs or does not Concur with finding and sends Responses. See Circle B in (figure 2, above).
- If the business does not concur with the Event Code decision, an arbitration process begins with the business providing a basis for their non concurrence.
- The Arbitration Process ends in one of two outcomes. Business unit provides documentation supporting non-concurrence which would remove the event from any future reporting; or, the documentation is not sufficient and the event is included in the reporting.
- The Monthly Report is sent to the CRO and the business unit officers.

JPM_WM02657052

Post Funding Performance Benchmarks

The following is an example of the post funding performance benchmark scorecard from the Home Loans Credit Review Trending Report. Performance metrics have been agreed to by each business unit Chief Risk officer and integrated into business management of these products.

Home Loans

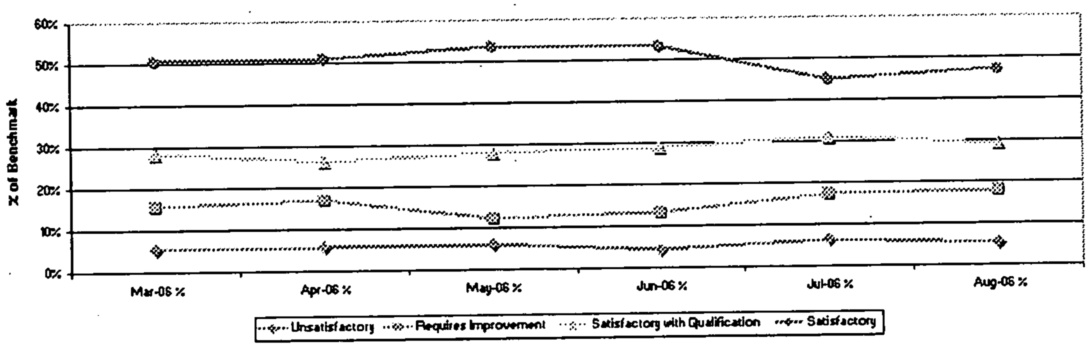
WaMu SCORECARD

HOME LOANS CREDIT REVIEW

HOME LOANS

	Benchmarks	Jun-06 #	Jun-06 %	Jul-06 #	Jul-06 %	Aug-06 #	Aug-06 %	Total	Total %
LOAN REVIEW RATINGS									
Unsatisfactory	</= 2.5%	40	4.4%	58	6.4%	50	5.3%	148	5.4%
Requires Improvement	</= 10%	123	13.5%	157	17.4%	168	18.0%	448	16.3%
Satisfactory with Qualification	</= 20%	265	29.0%	281	31.2%	274	29.3%	820	29.8%
Satisfactory	>/= 80%	486	53.2%	406	45.0%	443	47.4%	1335	48.5%
SAMPLE									
Sample Requirement		875		900		875		2,650	
# of Loans Reviewed		914		902		935		2,751	

Benchmark Trending



- Home Loans Benchmark Trending is inclusive of post-funding performance of loans originated through the Retail Home Loans, Wholesale, Consumer Direct, and Long Beach Mortgage origination channels.
- Unsatisfactory loan ratings coming out of the prime channels (subprime issues are addressed in the Appendix) are being driven largely by documentation issues that have an adverse impact on the security instruments and appraisal issues that could impact values. Examples would include: Security instrument (Notes, Deeds of Trust) that are inaccurate or missing; and or, appraisal discrepancies relating to a property type that may not be acceptable to the Bank, or comparable sales that are not within the same market or inappropriate to support the underlying collateral in a transaction These findings have been used as a basis for providing training and counseling to the accountable staff.
- The Requires Improvement and Satisfactory with Qualification loan ratings in the prime channels are being driven largely from errors impacting the evaluation of the credit and the ultimate loan decision as well as errors relating to the accuracy of information stated on the applications. Examples would include: the lack of

proper verification of income, employment, and/or other borrower assets that would provide additional strength to support the credit decision. A remediation plan is being developed.

WaMu

Risk Rating Administration

Corporate Credit Review provides Basel II support through our Risk Rating Administration group. As WaMu's riskr ating systems evolve, the group will be responsible for ensuring that the developed Basel II risk rating systems are performing as intended and that risk ratings are timely and accurate. These activities include:

- To meet Basel II requirements, CCR is aligned to provide independent oversight due to its own independence from all in-house designers and developers (system and model designers) and raters (ratings and parameter assigners in the risk rating process).
- This effort will include a comprehensive, coordinated, and independent review process to ensure that ratings are accurate and that the rating system is performing as intended.
- In large part this oversight will entail checking and confirming the work of others and ensuring that the rating system's components work well together.

Management Activities

Other activities in which Corporate Credit Review participates include:

- Credit Risk Management Committee
- Senior Loan Committee
- Front End Guidance Meetings
- Quarterly Credit Risk Review Meetings
- Problem Loan Reporting
- Other management activities as requested

Appendix: Annual Review Plan

Review Program Components	Review Frequency	Review Schedule															
		2006				2007											
		Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Commercial																	
Commercial Real Estate Lending	Semi-Annual		•		•			•						•			•
Commercial Mortgage Lending	Quarterly		•					•						•			•
Multifamily Lending	Quarterly		•				•			•			•			•	
CL&I Investments/Loans	Quarterly	•		•			•			•			•			•	
Large Borrower	Quarterly		•			•			•			•			•		
Wholesale	Semi-Annual						•							•			
Portfolio Management (NOC)	Annually					•											
Special Assets	Annually		•														
Real Estate Collateral Valuation	Annually			•													
National SBA Lending	Annually						•										
Wind-Down Portfolios	Annually							•									
Home Loans																	
Mortgage Banker Finance	Quarterly	•			•			•			•			•			•
Long Beach - Originations	Quarterly		•			•			•			•			•		
Sub-Prime Conduit - Purchased Loans	Quarterly		•			•			•			•			•		
Home Loans - Originations	Quarterly		•			•			•			•			•		
National Home Builder Finance	Semi-Annual	•						•						•			
Retail Bank																	
Retail Lending - Originations	Quarterly		•			•			•			•			•		
Small Business Lending	Semi-Annual		•				•						•				
Real Estate Collateral Valuation	Annually			•													
Specialized																	
Card Services - Originations	Quarterly		•			•			•			•			•		
Automated Decisioning - EDE	Annually						•										
Clayton Management	OTS Request					•								•			

Washington Mutual

FFIEC
Strong Authentication Update

December 2006

Washington Mutual

Strong Authentication Guidance

PURPOSE

- In October 2005, the Federal Financial Institutions Examination Council (FFIEC) issued guidance for "Authentication in an Internet Banking Environment". This guidance specifically addresses the need for risk-based assessments, customer awareness, and security measures to authenticate customers accessing Internet-based services. This guidance applies to all retail and commercial customers. Although the guidance is focused on the risks and risk management techniques associated with the internet delivery channel, the principles are applicable to all forms of electronic banking activities. (1)

KEY POINTS (2)

- The agencies consider single factor authentication, as the only control mechanism, to be inadequate for high risk transactions involving access to customer information or the movement of funds to other parties.

- Financial Institutions offering Internet-based products and services to their customers should use effective methods to authenticate the identity of customers using those products and services.

- The authentication techniques employed by the financial institution should be appropriate to the risks associated with those products and services.

- Where risk assessments indicate that the use of single-factor authentication is inadequate, financial institutions should implement multi-factor authentication, layered security, or other controls reasonably calculated to mitigate those risks.

OTS DIRECTION for WaMu

The OTS has stated they expect Washington Mutual to be in *substantial* compliance with the guidance by December 2006. "Substantial" compliance for WaMu has been defined as stronger authentication measures in production for Personal Online Banking and Commercial Online Banking, and the remaining In-Scope sites having formal project plans in place by 12/2006, with a planned production implementation no later than 12/2007.

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(1) "Electronic Banking" includes telephone banking.

(2) OTS October 12, 2005 memo, referencing FFIEC "Authentication in an Internet Banking Environment Guidance, Summary of Key Points".

Strong Authentication Program
Executive Dashboard
12/12/2006

Washington Mutual

Program	Metric	Status	Trend *	Problem Statement	Corrective Action
Program Goals • Identify the universe of electronic banking sites impacted by the FFIEC guidance • Perform a risk assessment to determine if sites are in scope of the FFIEC Guidance • Document in scope electronic banking sites and report on compliance • Implement Program Governance Model • Initiate Strong Authentication tracking for relevant sites Program Objectives: • Reduced risk exposure • Program Governance and Oversight • Consolidated reporting of program to the OTS	***Scope***	G	Steady		
	Schedule	R	Problem	Currently, Personal Online Banking and Commercial Online Banking are targeted to be compliant by 1/31/2007 and 3/31/2007 respectively.	Work with the OTS to validate Personal Online Banking dates are considered adequate. Initiated a QuickValue to evaluate expediting compliance for Commercial Online Banking.
	Resource	G	Steady	Program Governance Structure needs to be formalized.	Assigned a dedicated Program Manager to facilitate reporting and tracking of Strong Authentication Program initiatives.
	Quality	G	Steady		
	Overall Health	Y	Problem	WaMu will not be in compliance with FFIEC Guidance by the 12/31/2006 date. Additionally, 10 other sites are considered within scope of the FFIEC Guidance and need to be compliance by EOY 2007.	Implemented Program Governance Model to track and report on compliance status of all 12 in-scope sites. Communicated requirements to all Lines of Business and corresponding TSG representative. Secured Executive Sponsorship and support of the Strong Authentication compliance initiatives.

Executive Summary

RESULTS

- Enterprise Strong Authentication solution selected and approved in 2005
- Personal Online Banking is on track for compliance with FFIEC Guidance by 1/31/2007 - >90% of high risk transactions coded; customer challenge Q&A in full progress.
- Interim solution identified for Commercial Online Banking using tokens and internal ACE server
- Inventory and Risk Assessment of in-scope sites has been completed
- Strong Authentication Working Group established under the auspices of the Corporate Information Security Committee
- Business and Technology representatives have been identified for each in-scope site.
- Program Manager has been assigned

NEXT STEPS

- Deliver OTS PERK items to include: Summary; Project Plans; Inventory; Risk Assessment; and Status Reports
- Establish Architectural Lead
- Schedule regular status meetings
- Update the Access Management Policy to include Strong Authentication requirements for go-forward compliance
- Develop status report format and frequency

WHAT'S WORKING

- Executive Sponsorship has been secured
- Compliance requirements communicated
- Work teams identified and mobilized

CHALLENGES

- Prioritization of resources and projects to achieve compliance milestones
- Consistent status reporting
- Competing priorities

Washington Mutual

In-Scope Applications

Internet Facing Application Name	Line of Business	Type of Customer	Planned Solution to provide Strong Authentication	Planned Date of Compliance
On-Line Banking (POB)	Corporate Support	Retail	RSA Adaptive	1/31/2007 – >90% of high risk transactions coded; customer challenge Q&A in full progress.
ATM Network	Retail	Retail	Multi-layer sufficient – Card and PIN authentication in place.	Completed Multi-layer sufficient – Card and PIN authentication in place.
Kana Response	Retail	Retail	RSA Adaptive solution utilized to secure access to Kana.	1/31/2007
ECC IVR	Retail	Retail	RSA Adaptive	4Q07
Commercial Online Banking	Commercial	Commercial	Partial – Tokens to be fully deployed by EOY 2006	3/31/2007. Looking at option to improve schedule
Framework	Commercial – CCB	Employee, 3rd party, Commercial	RSA Adaptive won't work for 3rd party access and a Strong Auth solution will be implemented as part of the integration project in 2007.	7/31/2007
Framework - Integrated Cash Management System	Commercial – CCB	Commercial	Strong Auth will be implemented as part of the integration project.	7/31/2007
Mortgage Banker Finance Web	Home Loans	Mortgage Warehouse funding, Commercial Type	RSA Adaptive	10/31/2007
Customer Service IVR	WMCS	Retail, Employee	RSA Adaptive	2007
wamurealrewards.com	WMCS	Retail, Employee	Hosted by Vendor (Maritz)	2007
wamucanhelp.com	WMCS	Retail	Hosted by Vendor (Online Resources)	2007
wamucards.com (OLA)	WMCS	Retail	RSA Adaptive	2007

Washington Mutual

Talking Points: Steps Taken To Date

12/05 – 12/06

- CIS worked with WaMu Online Banking Team to identify a workable solution that could be leveraged across the enterprise – RSA Adaptive Authentication.

- CIS worked with the Commercial Online Banking team to identify a short-term solution (RSA Tokens) that could be leveraged for commercial customers only.

- CIS formed a Strong Authentication Working Group comprised of key senior business and technology managers to ensure ongoing focus during 2006 and 2007.

- CIS developed an initial inventory of sites and performed an initial risk assessment based on guidance criteria. Based on the risk assessment of 99 WaMu-owned sites, 12 sites have been identified as In-Scope for compliance to the strong authentication guidance.*

- Business/BSP's have identified a representative for each identified site who will manage the implementation of stronger authentication. A Strong Authentication Program Manager has also been assigned to oversee status and reporting to ensure plan progression and on-time compliance.

- CIS has ensured all 12 site representatives are aware of project plan deliverable dates, requirements for 07 compliance, and WaMu's enterprise solution for stronger authentication.

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* "Risk assessment criteria", per Guidance is, a) type of customer (Retail, Commercial), b) allows the movement of funds, c) allows access to non-public customer information, d) ease of using communication method, and e) volume.

Washington Mutual

Talking Points: Steps To Be Taken in the Future

1/07 – 12/07

- Deliver documents pertaining to Strong Authentication for inclusion in the Preliminary Exam Review Kit for OTS. Documents include Summary of Current Status, Project Plans, Inventory and Risk Assessment, and Status Reports to Senior Managers.
- Establish architectural lead to evaluate solution and address enterprise implementation strategy, working with site representatives to ensure consistent technical approach for compliance.
- Program Manager to maintain ongoing project statuses from site representatives to ensure satisfactory progression.
- Hold regularly scheduled meetings with the Strong Authentication Working Group to address issues and Program status.
- CIS to develop Strong Authentication Policy to ensure new or modified Internet-based sites meeting the criteria for stronger authentication are developed and delivered in compliance.
- Keep ERMC and OTS informed of Program status and direction as requested.

The Asset-Liability Management Committee

October 25, 2006

Agenda

The Asset-Liability Management Committee
Wednesday, October 25, 2006
WMC 33 Vashon
9AM – 11AM (PST)

	Time
1. Approve Minutes (Separate Document)	9:00 – 9:05
2. Economic Backdrop and Analytics Update	9:05 – 9:30
– 2007 Plan Overview	
3. Business Line Topics:	
– Home Loans: CDO Proposal (David Beck)	9:30 – 9:45
– Home Loans: SFR Portfolio (David Beck)	9:45 – 10:00
4. Corporate Topics:	
– AFS Portfolio Update	10:00 – 10:15
– Capital Projections	10:15 – 10:30
– Return Rates on Products – Industry Analysis	10:30 – 10:45

From: Cathcart, Ron
Sent: Wednesday, February 14, 2007 6:43:18 PM
To: Boyle, Hugh F.
Subject: RE: Initial Option Arm NPA Results

Oh dear...

From: Boyle, Hugh F.
Sent: Wednesday, February 14, 2007 2:16 PM
To: Cathcart, Ron
Subject: FW: Initial Option Arm NPA Results

Hugh F. Boyle
Credit Risk Management
Washington Mutual
Tel: 206 500 4198

From: Mark, James
Sent: Tuesday, February 13, 2007 4:49 PM
To: Ellson, Richard W.; Liu, Michael; Chan, Susan; Jackson, Melissa; Dooley, James; Smith, Michael C.; Coultas, Dave; Potolsky, Doug; Boyle, Hugh F.
Subject: Initial Option Arm NPA Results

Below are the initial bid results from the 1st Quarter Option Arm NPA sale. This pool was 240MM that was made almost entirely of loans 2 payments delinquent or greater. Further, 86.5% of this pool was in foreclosure status.

Clearly the initial pricing on this pool is lower than what has been experienced in the three prior Option Arm NPA pools.

Some of the major reasons mentioned by the bidding participants for the pricing deterioration were the increase of supply in the market place (1.9BB out for bid this week alone), longer foreclosure timelines given continued deterioration of housing market, and capacity concerns is some of the participant's warehouse. One participant mentioned recent litigation against a Option Arm originator (Chevy Chase) as a reason for backing off their bid (below is a link).

http://www.baltimoresun.com/business/investing/bal-bz.chevy19jan19,0,4783281.story?coll=bal-investing-headlines

From a collateral standpoint, this pool was inferior from prior pools given its delinquency profile and a large percent of loans in excess of 1MM (16.75%).

<< OLE Object: Picture (Metafile) >>

EMC was the only bidding participant that had levels that exceeded the Hold/Sell threshold (at 95%+). It was decided not to invite back another participant if their initial pricing did not exceed the Hold/Sell level.

EMC is currently unaware that they are not in a completive auction. It is imperative that continues to be the case.

Once we get EMC's final level we will assess whether it make sense to sell the entire pool to them or potentially carve out some assets that we feel are undervalued.

If we decide not to sell any of the pool, we have communicated to them that we will reimburse them $150 per file.

James Mark
Washington Mutual
Sub-Prime Capital Markets
206-302-4186

WaMu

Audit Report
AUDIT SERVICES

Disclosure Management

December 28, 2007

Executive Committee Owner:
Tom Casey, Chief Financial Officer
Ron Cathcart, EVP - Chief Enterprise Risk Officer
Stewart Landefeld, Chief Legal Officer (Interim)
Steve Rotella, President & COO

Business Process Owner:
Nancy Barnett, Sr Mgr-HR Comm & Marketing
George Boa, Chief Risk Officer- Commercial
Chaomei Chen, Chief Risk Officer-Card Svcs
Cheryl Feltgen, Chief Risk Officer-Home Loans
Diana Graham, Chief Risk Officer - Retail Bank
Karen Horn, Sr Mgr-Internal Communications
Sophie Hume, Assistant GC-Team Lead
Elizabeth Hutchinson, Sr Mgr-Corp Media & Issues Mgm
Alan Magleby, Div Exec-Investor Relations
Pradeep Narayan, Sr Mgr-Enterprise Risk Process
Ann Shannon, Sr Mgr-Technology Comm
Glen Simecek, Group Mgr-Treasury

From:
Monica Hira, Senior Audit Manager
Erin Dunlap, Audit Director

Copy:
Melissa Ballenger, Div Exec-Corp Controller
Kristina Bennett, (Additional Report Distribution)
Alfred Brooks, President Commercial Group
James Corcoran, President-Retail Banking
Daryl David, Chief HR Officer
Barry Davis, (Additional Report Distribution)
Deloitte, LLP
Alan Elias, Sr Mgr Communications
Alan Gulick, Sr Mgr Communications
Thomas Henning, FVP - Enterprise Risk Governance
Debora Horvath, Chief Information Officer
James MacKenzie, Group Mgr-Accounting
Michelle McCarthy, Div Exec-Market Risk Mgmt
Thomas McGovern, Additional Report Distribution
Randy Melby, Div Exec-General Auditor
Adam Nelsen, (Additional Report Distribution)
Sheri Pollock, Sr Mgr Communications
A Rodriguez, Div Exec-Communications
Daysi Rojas, (Additional Report Distribution)
David Schneider, President - Home Loans
Anthony Vuoto, President WM Card Services
Maynard Wagner, (Additional Report Distribution)
Frank Whitemaine, (Additional Report Distribution)

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #474

Report Rating:
SATISFACTORY WITH QUALIFICATION

Executive Summary

The Corporate Disclosure Committee (CDC) established Disclosure Standards in September 2004. The Standards require review of all external and broad internal WaMu (the Company) communications containing material disclosure first by the business segment or corporate support group (collectively, Business Units) and subsequently by representatives of Legal and Financial Reporting ('Corporate Review')

In September 2005, Audit Services performed an audit of External and Broad Internal Disclosure at the request of the CDC. This report was rated as Opportunities for Improvement and identified issues related to lack of process ownership, disclosure training, and documentation.

The issues noted in the prior audit were enterprise-wide and the Legal Department took the lead on developing a robust process over external and broad internal communications. A project team consisting of members from Legal and Corporate Communications was formed to address the issues raised by Audit Services. The CDC approved the project team's recommendations in December 2006, which resulted in decentralization of the processes and establishing accountability at the Business Unit level.

A Communication Lead was designated within each Business Unit as a single point of contact. The Communication Lead is responsible for review and approval of external and broad internal communications, obtaining Corporate Review and approval, establishing and maintaining documented disclosure processes within their group, adhering to document retention requirements, ensuring that Business Unit managers and employees receive appropriate training, attending Regulation FD / Disclosure training and coordinating such training for others as appropriate.

Prior to transferring responsibility to the Communication Leads, the project team enrolled employees involved in preparing, approving, or presenting communications containing material disclosure in an online Disclosure Standards training course.

By taking the actions above, the project team created a sound disclosure management framework which sought to ensure that the Company's disclosures are appropriately vetted within the necessary control environment. The results of the current audit reflect meaningful improvements to disclosure processes since 2005. However, we identified opportunities to enhance the existing control environment to facilitate adherence to the Disclosure Standards and Disclosure Policy. These relate to Disclosure Standards training, obtaining approvals from the Corporate Review groups, and maintaining an Authorized Spokespersons list.

The following issues represent a medium level of risk to the Company if not addressed appropriately:

- Business Unit Communication Leads do not consistently track and monitor employees' Disclosure Standards training. There is no guideline or enforcement of a time requirement for training completion.
- Business Units did not obtain Corporate Review for some material communications sampled, resulting in one instance of erroneous disclosure to an external audience.
- There is no method for tracking Authorized Spokespersons. As a result, it is not possible to determine if all Authorized Spokespersons have attended Company-sponsored Regulation FD / Disclosure training as required by the Disclosure Policy.

Management concurs with these findings and has developed action plans to resolve the issues listed in this report by February 29, 2008. Audit Services will complete a follow-up audit of the action plans upon remediation. A description of audit objectives and scope, and a list of issues are included in the following sections of the report.

Background

Disclosure Standards were developed to ensure that material information communicated to external audiences, or disseminated on a broad internal basis, is thoroughly and consistently reviewed. The Standards apply to all business units within the Company and are supported by the CDC.

The CDC is responsible for overseeing compliance with the disclosure control requirements of the federal securities laws, including the Sarbanes-Oxley Act. The CDC has responsibility over the Disclosure Standards. Legal is responsible for reviewing, maintaining and posting the Disclosure Standards.

Audit Objective and Scope

The audit objective was to assess the adequacy and effectiveness of the Company's Disclosure Policy and Disclosure Standards and to assess Business Unit compliance with these policies and standards. Audit Services evaluated the controls that enable accurate and appropriate disclosures, including review and approval procedures, disclosure training for employees, and oversight by the Corporate Disclosure Committee.

The audit scope included external and broad internal communications of the Company and all of its subsidiaries between April 1, 2007 and September 30, 2007 for the following Business Units:

Retail Banking and Financial Services Group, Home Loans Group, Commercial Group, Card Services Group, Corporate Legal, Corporate Communications (Internal & External), Corporate Investor Relations, Treasury/Capital Markets, Enterprise Risk Management, Technology, Marketing, Human Resources and Audit Services

The audit scope excluded the 10K, 10Q, earnings release, 8K, and miscellaneous SEC filings since these disclosures are evaluated within a separate auditable unit.

Applicable Laws and Regulations

SEC Regulation Fair Disclosure prohibits selective disclosure. Material nonpublic information about the Company cannot be provided to any select party or group, such as investors, analysts, or investment bankers, to the exclusion of others.

The SEC has suggested, but not required, that companies form disclosure committees responsible for considering the materiality of information and determining disclosure requirements on a timely basis.

Audit Issues

The audit team and management discussed and agreed upon the action plan(s) and completion date(s) listed below. Definitions for issue ratings are included at the end of this report.

No:	Rating:	Issue Summary:	Due:	Owner:
1.0	Medium	**REPEAT ISSUE** - There is no process in place for Business Unit Communication Leads to track and monitor employees' disclosure training.	02/29/2008	N. Barnett, G. Boa, C. Chen, C. Feltgen, D. Graham, K. Horn, S. Hume, E. Hutchinson, P. Narayan, A. Shannon, G. Simecek

Audit Issue:
There is no process in place for Business Unit Communication Leads to track and monitor employees' disclosure training. In addition, there is no guideline or enforcement of a time requirement for training completion.
According to the Disclosure Standards, Communication Leads have responsibility for attending Regulation FD/Disclosure compliance training and for ensuring that managers and employees receive appropriate training. Regulation FD / Disclosure training records reflect that 38% of Communication Leads have not completed this Company-sponsored training. Additionally, approximately 47% of Level 1-6 employees as of 09/30/07 have not completed the Disclosure Standards Awareness course. For non-Level 1-6 employees identified by Communication Leads as having a regular role in material communications, 65% have not completed an online Disclosure Standards course.
Impact:
Disclosure training not obtained by impacted employees increases the risk of improper disclosure which could potentially lead to regulatory investigation or reputation damage.
Action Plan:
Action plan: The Legal Department will review the Disclosure Standards to ensure appropriate guidance regarding acceptable timeframe for completing the online education is included. To ensure each Communication Lead can more efficiently meet the Disclosure Standards requirement of completing Reg FD training, the Legal Department will develop an online Reg FD training course and proxy enroll all current Communication leads and ensure they complete the course.

Business Unit Communication Leads will monitor level 1-6 employees within their business units to ensure Disclosure Standards Awareness training completion. A training status report will be developed to allow Communication Leads to monitor training completion from Learning Central. Utilization of this training status report will be individually tracked for each business unit via separate issues in ERICS.

No:	Rating:	Issue Summary:	Due:	Owner:
2.0	Medium	**REPEAT ISSUE** - Required approvals from Legal or Financial Reporting were not obtained prior to publication.	01/31/2008	K. Horn, A. Magleby

Audit Issue:
Approval from Legal and Financial Reporting were not obtained for one communication, resulting in erroneous disclosure to an external audience. In addition, Financial Reporting approval was not obtained for two broad internal communications containing material financial disclosure.
Impact:
Lack of proper review and approval of communications prior to dissemination may result in the disclosure of erroneous or restricted information which could potentially lead to regulatory investigation or reputation damage.
Action Plan:
Approval for all communications containing material disclosure will be obtained from Legal and Financial Reporting. Business Unit Communication Leads have provided a business unit specific management action plan for obtaining appropriate approval. These specific management action plans will be individually tracked via separate issues in ERICS.

No:	Rating:	Issue Summary:	Due:	Owner:
3.0	Medium	A method for tracking all Authorized Spokespersons does not exist.	01/31/2008	S. Hume, E. Hutchinson

Audit Issue:
A method for tracking all Authorized Spokespersons does not exist. As a result, it is not possible to determine if all Authorized Spokespersons have attended Company-sponsored Regulation FD / Disclosure training as required by the Disclosure Policy. This may result in violation of company policy.
Audit Services noted that there is no record of completion of Regulation FD / Disclosure training for one member of the Executive Committee, who is an Authorized Spokesperson as defined by the Disclosure Policy.
Impact:
Without a method for tracking Authorized Spokespersons, WaMu is unable to determine if appropriate training was provided to employees who may speak on behalf of the Company. Without training, disclosure of inappropriate or restricted information may occur which could potentially lead to regulatory investigation or reputation damage.
Action Plan:
Corporate Communications will compile an initial list of Authorized Spokespersons. Subsequently, the Legal Department will review and update the list of Authorized Spokespersons on a quarterly basis via coordination with Business Unit Communication Leads. The Legal Department will develop an online Regulation FD training module to more efficiently administer and track Regulation FD training for the Authorized Spokespersons.

No:	Rating:	Issue Summary:	Due:	Owner:
4.0	Low	**REPEAT ISSUE** - Approvals and supporting documentation for material disclosure are not consistently maintained by the Business Units.	01/31/2008	K. Horn, S. Hume, G. Simecek, E. Hutchinson, C. Chen

Audit Issue:
Approvals and supporting documentation for material disclosure are not consistently maintained by the Business Units. The Disclosure Standards require Business Units to retain Legal and Financial Reporting approval and supporting documentation for material disclosure for five years.
Of the disclosures sampled, 19% of relevant communications did not evidence approval by Legal, and 33% lacked evidence of Financial Reporting approval. Overall, 30% of communications requiring some form of Corporate Review (either Legal or Financial Reporting) lacked evidence of appropriate approval. Supporting documentation was not maintained for 11% of relevant communications.
Impact:
Failure to maintain disclosure documentation may result in the inability to support disclosures in the event of litigation, audits, or regulatory exams.
Action Plan:
Approvals and supporting documentation for material disclosure will be maintained for one year. Business Units have provided group-specific action plans to address the issue.

No:	Rating:	Issue Summary:	Due:	Owner:
5.0	Low	The Corporate Disclosure Program Statement has not been updated. There is no method to facilitate periodic review of the Disclosure Policy and Disclosure Standards by the CDC.	01/31/2008	S. Hume

Audit Issue:
The Corporate Disclosure Program Statement has not been updated since inception and does not reflect the current status of the Corporate Disclosure Committee (CDC) and Program. Furthermore, there is no method to facilitate periodic review of the Disclosure Policy and Disclosure Standards by the CDC.
Impact:
If the Corporate Disclosure Program Statement and related Policy and Standards are not current, disclosures which are not in alignment with company policy may occur.
Action Plan:
Corporate Disclosure Program Statement review and updates will be addressed by the CDC by end of January 2008. Additionally, Disclosure Policy and Disclosure Standards review will be added to the annual CDC calendar to facilitate annual review of the Policy and Standards.

Improvement Considerations

Documentation: Regularly update and maintain key documentation such as the Disclosure Standards, Communication Lead Review Matrix, and disclosure training materials. In addition, the Disclosure Standards may be enhanced to provide users of the procedures with a clear understanding of specific roles and responsibilities.

Definitions

Issue and report ratings are based on the auditor's judgment. In determining the report rating, the auditor will consider the following guidelines.

Report Ratings

Satisfactory	The overall system of risk management and internal control is effective and well-documented. Few minor control deficiencies exist with minimal resulting exposure. Business risk has been managed at an acceptable level. Repeat findings, if any, are not significant and non-compliance with regulatory requirements results in minimal exposure.
Satisfactory with Qualification	The overall system of risk management and internal control is generally adequate and functions effectively; however, isolated control deficiencies require management attention. While these isolated deficiencies create some exposure, business risk has been managed at an acceptable level. Repeat findings, if any, are not significant and non-compliance with regulatory requirements is isolated.
Requires Improvement	The overall system of risk management and internal control has deficiencies related to multiple business activities. Exposure is considerable and immediate corrective action is essential in order to limit or avoid considerable losses, reputation damage, or financial statement errors. Repeat findings are significant or non-compliance with regulatory requirements is substantial.
Unsatisfactory	The overall system of risk management and internal control has major weaknesses resulting in unacceptable level of risk. Exposure is considerable and immediate corrective action is essential in order to limit or avoid considerable losses, reputation damage, or financial statement errors. Repeat findings are significant or non-compliance with regulatory requirements is substantial.

Issue Rating

	High	Medium	Low
Impact	Affects the overall control environment and the achievement of relevant key business objectives	Could affect the overall control environment and the achievement of relevant business objectives if left uncorrected	Not severe enough to affect the overall control environment or the achievement of relevant business objectives
Exposure = (Impact X Probability)	Considerable exposure to financial statement errors, losses, reputation damage, fines and penalties, or loss of business	Moderate exposure to financial statement errors, losses, reputation damage, fines and penalties, or loss of business	Minimal exposure to financial statement errors, losses, reputation damage, fines and penalties, or loss of business

From: Stack, Fergal
Sent: Tuesday, February 27, 2007 2:47:20 PM
To: Fortunato, Steve
Subject: FW: Option ARM

fyi

From: Stack, Fergal
Sent: Tuesday, February 27, 2007 9:42 AM
To: Chen, Youyi; Griffith, David
Cc: Murray, William; Strausbaugh, Rebekah; Jurgens, Rolland
Subject: RE: Option ARM

Thanks Youyi

To provide additional comments if you can incorporate
1) origination month is Jan and Feb 2007 only
2) future intent for these loans is to change as of which date? We will clearly need the specific loan characteristics to automate upfront designation.
3) the upfront designation is defined with rules in HI. We need to include the technology owner (Name?) to ensure this is done and the time required. [it may also be worth taking a look at what the current rules state and how much of that is automated upfront designation]
4) the transfer to hfs will not occur by Feb 28th, and the approvals will not be in place by Feb 28th, so this is a March issue
5) who are required approvals. Policy currently states that ALCO approval is the defining moment. Who else will be approving.
6) clear communication of what business/market circumstances have changed since Dec 31st to redesignate the loans. This needs to be detailed formalized documentation both by Business and for ultimate Approvals.
7) Valuation of these Option ARM loans...same drill as the hybirds...this is ultimately most complicated. Prior to moving the loans to HFS a formal approved Pricing Valuation framework must be in place (and based on expected sale execution).

Hope this helps tee up the issues from a Finance perspective.

From: Chen, Youyi
Sent: Tuesday, February 27, 2007 8:20 AM
To: Stack, Fergal; Griffith, David
Subject: RE: Option ARM

I am to suggest keeping one more bucket: 3-4 units. I will send a note out shortly.

Again, this is to suggest KEEPING the following (therefore sell everything else)

1. Super Jumbo of size greater or equal to 3 MM
2. Advantage 90 loans (high LTV)
3. Foreign Nationals
4. FICO less than 620 (except employee loans)
5. 3 – 4 units

From: Chen, Youyi
Sent: Tuesday, February 27, 2007 10:25 AM
To: Griffith, David
Cc: Stack, Fergal
Subject: RE: Option ARM

David,

We sell all 295+ margin and other OA and COFI, and KEEP the 4 categories going forward due mostly to non-salable reasons.

Youyi

From: Griffith, David
Sent: Tuesday, February 27, 2007 10:03 AM
To: Chen, Youyi
Cc: Stack, Fergal
Subject: RE: Option ARM

Youyi – In order to craft the approval we will need another level of precision. If the intent is to sell all of the loans in each category we should state so with an estimate of dollar amounts. Is the intent to sell all of the Advantage 90's and all of the sub 620 FICO's? If not we need to specify those where we no longer have the intent and ability to hold. ERM and HL Finance will need to monitor exactly what loans are transferred and we'll need enough detail to do so.

I noticed you dropped Employee Loans. Was that intentional?

Also, is this population exclusively Option ARMS? We are also currently directing super jumbo hybrids to portfolio.

I'll go over the NII calculation with HQ if that's ok with you. Am I right that it's $335m annualized? That's almost 10bps off of NIM.

From: Chen, Youyi
Sent: Monday, February 26, 2007 4:59 PM
To: Griffith, David
Subject: FW: Option ARM

David,

Attached is some NII analysis on the impacts. The pretax is about - $ 100 MM.

Let's talk tomorrow AM.

Youyi

<< File: Book8.xls >>

From: Chen, Youyi
Sent: Monday, February 26, 2007 6:09 PM
To: Griffith, David
Subject: FW: Option ARM

David,

We are still reconciling the numbers on the NII impacts. What are your thoughts on following criteria that we are to bring to MRC?

6. Super Jumbo of size greater than 3 MM
7. Advantage 90 loans (high LTV)
8. Foreign Nationals
9. FICO less than 620 (non-salable)

Also, please see my email to Fergal on some of the detailed background on this issue.

Regards,

Youyi

From: Chen, Youyi
Sent: Monday, February 26, 2007 6:04 PM
To: Stack, Fergal

Cc: Murray, William; Jurgens, Rolland; Strausbaugh, Rebekah; Beck, David; Fortunato, Steve
Subject: RE: Option ARM

Fergal,

We intend to stop transferring high margin 295BP+ option ARM and COFI ARM production into portfolio starting Jan 1st, 2007. As a result, we need to direct all the future rate locks of these loans from HFI to HFS. We will get a MRC vote on this decision very soon. We expect this decision to remain for the foreseeable future (i.e. Q2, and remaining of 07 will be HFS unless this strategy is revised)

The remaining HFI criteria for the option ARM and COFI ARM is expected to be as follow (under review, and subject to MRC approval)

10. Super Jumbo of size greater than 3 MM
11. Advantage 90 loans (high LTV)
12. Foreign Nationals
13. FICO less than 620 (non-salable)

As the change is happening within the quarter, and some of the loans have been directed to HFI already, we would need Steve, you and John Wood to review and sign off to let us transfer back to HFS those (mostly) high margin option ARM that are either locked or closed to HFI in Q1-07 already (about $1.3 billion and growing, as of last week).

As to what lead to the above recommendations, you are right, it's driven by combination of overall balance sheet strategy, credit out look, and current option and COFI ARM market conditions.

As you know, capital market portfolio management is regularly reviewing the balance sheet strategy with the senior management and ALCO in particular. We will always discuss with your team on new portfolio strategies.

Regards,

Youyi

From: Stack, Fergal
Sent: Monday, February 26, 2007 5:40 PM
To: Stack, Fergal; Chen, Youyi
Cc: Murray, William; Jurgens, Rolland; Strausbaugh, Rebekah
Subject: RE: Option ARM

And what are the facts and circumstances to take this action...net interest margin, credit....

Is it possible that there will be more transfers in Q2, Q3, Q4 etc..this is a sensitive accounting topic with SEC and others

Thanks

From: Stack, Fergal
Sent: Monday, February 26, 2007 2:26 PM
To: Chen, Youyi
Cc: Murray, William; Jurgens, Rolland; Strausbaugh, Rebekah
Subject: Option ARM

If we are intending to transfer from hfi to hfs can you answer following questions

1) what population are proposed being transferred...I have seen it may be only 2007 originated loans? What changed since Jan and Feb that changes the companies intent by Feb 26th.
2) what is intent on other option Arm loans (2007 originated and prior year originated)
3) what is intent for future originations of option Arms ie March and Q2 originations
4) what is likelihood of ongoing transfers for option arms

In general do you have the intent rules on what goes to HFS versus HFI under current infrastructure?

HISTORICAL PERSPECTIVE HL - UNDERWRITING

Providing a Context for Current Conditions, and Future Opportunities

Overview

Home Loans Credit and Underwriting

Credit Risk Management is driving towards a vision of increasing the organizations Net Interest Margin and an emphasis on Credit becoming a significant component of Shareholder value. As such, our organization has been focused on improving Underwriting and Origination quality and consistency to enable our ability to expand into new and more profitable market niches. Specifically, we have been supportive of both SMF and LongBeach expansion given their ability to demonstrate excellent origination, pricing and account management discipline. We have also been focused on identifying and targeting several other areas of credit expansion to include near-prime HELOC borrowers and expansion in our Multi-Family base. Credit Risk Management also supported and drove strategies to enable expansion into Alt-A and Option ARM lending for our Correspondent channel.

Our Home Loans prime organization has jeopardized our ability to enable these margin improvements through disciplined credit expansion due to the inconsistency, and poorly disciplined processes that have also eroded organizational credibility with external parties including Rating Agencies, GSEs, and our Thrift Regulators.

As mentioned, Credit and Underwriting within the Home Loans organization has been an area of noted interest by many. Internally, our Executive Leadership has been focused on improving on eliminating Regulatory criticisms, and our Risk Management team has driven hard for the application of consistency and discipline in the origination process. Further, rating agencies have been pushing for originator reviews driven by performance fluctuations as well as information gathered in prior visits. This paper provides a context for the historical conditions, key events, and management decisions that have led to our current condition, and how that may impact our ability to be successful in achieving the mission described above.

Our Home Loans channel emerged as essentially the combination of a collection of different originator's platforms, policies and cultures. As such, Credit Policy and Underwriting began as a combination of highly ineffectual, outdated and inconsistent policies and strategies. This led to the inability for our organization to establish the foundation for developing a consistent and discipline origination culture. As early as 1999 (Check the date and provide references – Bill Longbrake may know this), the OTS began raising concerns regarding the consistency, independence and quality of our Home Loans origination process. Prior to this, Washington Mutual had no Credit Risk Oversight function in place in any of its core business units with the exception of WMF. These primary concerns resulted in the hiring of the organizations first Chief Credit Risk Officer, Jim Vanasek in 1999.

With Jim's arrival, he recognized quickly that there was no Credit expertise in Home Loans and Consumer risk products. Therefore, he began the process of identifying, selecting and developing a core team of seasoned credit risk professional.

Historical Perspective

1999-2003

The new Credit Risk Team began the process of working with key business units to identify issues, concerns and opportunities for applying advance Credit Risk tools and systems. During this review, the team noted the following major weaknesses:

- No data reporting to review portfolio performance
- No forecasting of expected losses or delinquencies
- Legacy credit systems were essentially a combination of poorly implemented Third Party tools far from best proactive
- No collections workflow systems
- No adaptive control systems
- No linking of credit fundamentals, models, and expectations to strategic objectives and planning

The team began working quickly to first develop a unified data infrastructure to identify opportunities for improvement. Many such opportunities were identified early within the Retail Banking organization, and key strategies began to take place.

First, the Credit Risk team embarked on developing enhanced reporting capabilities. Second, it spearheaded the launch of a development cycle of a front-end decisioning system, proprietary models, and adaptive control systems.

Once the team was well underway in this development, the team looked toward other business units that might benefit from the investments being made in these systems. At this point in our history, the team began the process of attempting to work with the Home Loans organization to leverage these Enterprise capabilities.

Numerous attempts were made to demonstrate the benefits of the systems, and the opportunities for the Home Loans organization. At each point, the Home Loans Executive Management team rejected all such solutions, and stated that they would build all of this within the Optis application. The Optis platform was essentially two main components. Optis .1 which focused on the origination platform, embedded a series of tools that were hard coded, inflexible, and very difficult to change. Optis .2, led to significant investment write-offs as an approach to building systems around the end-to-end origination process.

Following on the path of these challenges, the Credit Risk team implemented Quarterly Business Reviews for all units to provide updates on core portfolio performances, expectations, and risk mitigating strategies.

SECTION III

Regulatory History

Key weaknesses identified by Regulatory Bodies

Andy, please fill out this section.

SECTION IV

2003-2004

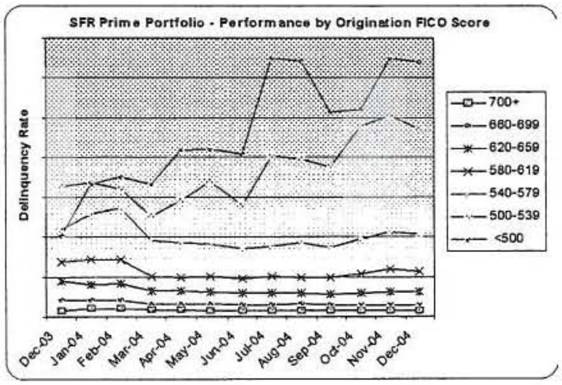
Key Events and Decisions Leading to Today's Environment

With the Optis disaster, key financial misses and tremendous Regulatory scrutiny, the core Home Loans Executive Staff was dismissed and replaced.

Deanna Oppenheimer was given responsibility for the Home Loans organization in addition to Retail Banking. With this appointment, Deanna and Jim began to insert members from the Corporate team directly into the Home Loans Credit operation.

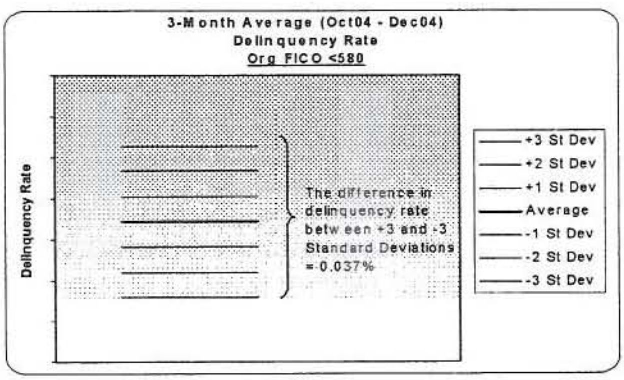
Parallel to these management changes, the organization identified a mandatory $1B expense cutting exercise. These cuts were distributed amongst all areas of the corporation, but fell heavily on the Home Loans organization. On the credit front, significant cuts were mandated in the Appraisal, Credit and Underwriting organizations. These cuts were mandated in the face of over 56 (check this Andy) core Regulatory concerns and criticisms with the Credit organization as the principle owner required to fix these challenges.

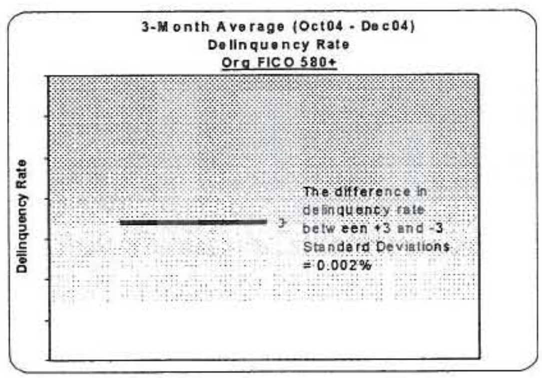
Early on, the team had noted an absolute absence of underwriting standards which began to drive up Non-Performing loans to an accelerated level. The primary driver for these poor performances was the continued underwriting and retention of loans that fell into low credit quality segments with no credit quality floors and an absence of pricing differentiation. This led to profitability challenges of sub-prime borrowers originated at prime prices without a clear financially viable exist strategy. In essence, this created a cross-subsidization of our prime borrowers as originators attempted to focus on a wide range of borrowers without being held accountable for profitability.



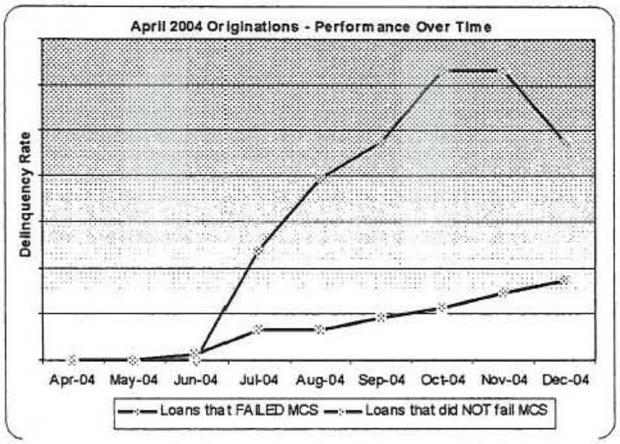
The graph below shows the delinquency rate of our SFR Prime portfolio over the past 13 months by origination FICO score. The lower the FICO score, the worse the performance of the loan. In fact, as of December 2004, loans originated with FICO scores less than 580 have a delinquency rate more than five times as large as those originated with FICO scores greater than 580.

Not only is overall performance worse for lower credit quality loans, but the *volatility* of performance is also much greater. The graph to the left shows *average* performance by origination FICO; in fact, the performance of some loans is much worse than average. In addition to average delinquency rate, the following two graphs show the standard deviation of performance over the past three months for loans with origination FICO score less than 580 and those with origination FICO scores greater than 580:



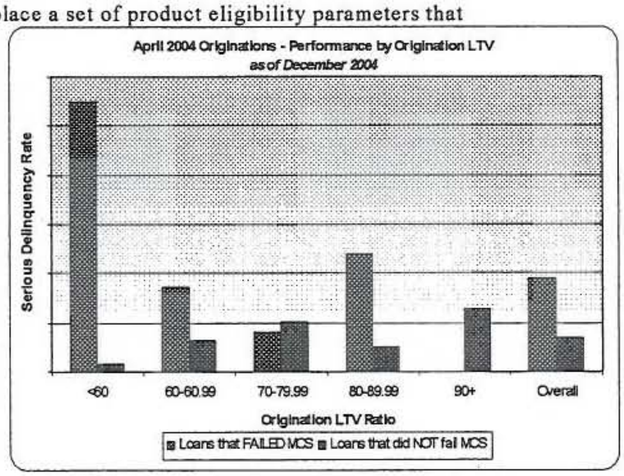


The standard deviation is a measure of the amount of variation in performance. From the graphs above, it is clear that the variability in performance is significantly higher for low credit quality loans than it is for higher credit quality loans. The difference in delinquency rate between +3 and -3 standard deviations for loans with origination FICO score less than 580 is more than 18 times as large as the difference for loans with origination FICO scores greater than 580, indicating that some loans will take even more time and resources to service than the average poor credit quality loan. Lower credit quality loans contribute disproportionately to delinquencies and losses. This is one reason that the Minimum Credit Standards (MCS) were put into place. These loans also contributed greatly to the pool of NPA's that were sold over the course of the last six quarters.



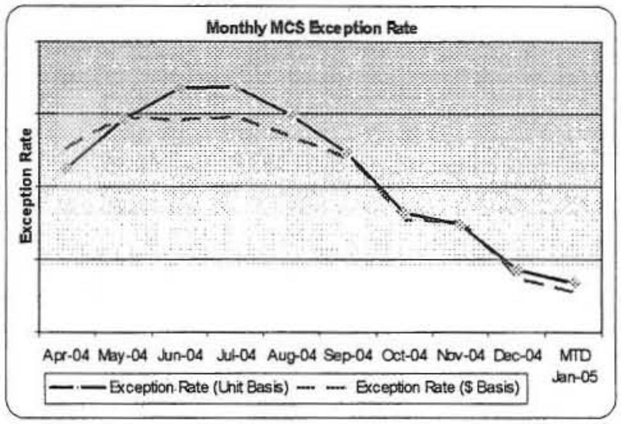
The graph to the left shows the delinquency rates for loans originated in April of this year (the first month that the MCS were rolled out). Even after only nine months in our portfolio, the difference in performance between loans that failed the MCS and those that did not is clear – the loans that did not meet the MCS are contributing disproportionately to the delinquency in our portfolio. Though the performance of MCS failures improved slightly between November and December, as of December 2004, loans originated in April 2004 that failed the MCS still have a delinquency rate three times that of originations that did not fail the MCS. Additionally, as of December, loans that did not meet the MCS have a serious delinquency rate (4+ Payments Past Due) that is six times the serious delinquency rate of loans that did not fail the MCS.

Prior to the introduction of MCS, we had in place a set of product eligibility parameters that attempted to achieve levels of credit performance by limited Loan Amounts and LTVs. In 2004, the Credit team began to reverse this strategy with significant expansions in allowable loan amounts and LTVs to reduce the amount of the parameter exceptions – up to 20% at one point - while attempting to gain a small degree of control of borrower credit quality with very low hurdles for minimum credit quality. (540 Minimum FICO in most instances) Furthermore, Credit spearheaded the development and introduction of the Exception pricing tool, moving it much closer to point-of-sale for speed and accuracy as well as moving the exception pricing surcharge rate from over 60% to almost 0.



Questions have been raised regarding whether low loan to value (LTV) ratios can be considered compensating factors for applicants with FICO scores below the Minimum Credit Standards In order to address this question, we looked again to April 2004 originations. The graph to the right shows the performance of MCS exceptions and non-exceptions (originated in April) as of December 2004 by LTV ratio. Not surprisingly, the MCS failures tend to perform worse than originations that were not MCS exceptions across all origination LTV ranges. The biggest difference in performance is actually within the lowest origination LTV range (<60%), where MCS exceptions have a serious delinquency rate (4+PPD) 32 times the seriously delinquency rate of loans that did not fail MCS. This indicates that from a performance standpoint, lower exposure is not a compensating factor for lower credit quality.

We have made significant progress over the past few months in eliminating exceptions to the Minimum Credit Standards, as shown in the chart to the right. In fact, the percentage of MCS exception approvals and commitments has been less than 1% so far in January.



By not looking the deals that don't make sense, we will have greater consistency and efficiency, and will be able to focus more time on our core customers and enhance our product offerings in core areas.

Making these changes to our business today will create long-term, lasting benefits. Not only will we see better profitability through lower costs and predictable credit performance, but we will have more satisfied customers because we will be able to decision their loans quickly and efficiently.

As a next step on the horizon, our team began an exercise, while simultaneously slashing expenses, to implement key control mechanisms. The first of these began with the introduction of Minimum Credit Standards in (Andy provide the date, and also list other key underwriting enhancements from our document).

Credit Risk also noted many areas for loosening of credit standards. In fact, the team made several key enhancements to underwriting standards that significantly benefited the Sales Organization, and would provide Sales opportunities well in excess of the 4-5% of expected volume loss from the introduction of the standards.

Several attempts were made to enforce these standards, and loopholes continued to emerge that were exploited by the sales team. The Credit Risk team, then worked with the business to eliminate sub-prime loans from the origination process as well to reduce volatility and ensure adequate returns were realized within the portfolio.

Any attempts to enforce more disciplined underwriting approach were continuously thwarted by an aggressive, and often times abusive group of Sales employees within the organization.

In mid 2004, a leadership flip-flop occurred, putting Craig Chapman in charge of the Home Loans organization.

During several key Home Loans Executive Staff meetings, several key mandates were set:

- Achieve an 80% decisioning automation rate and corresponding reduction in underwriting personnel by 2Q '05.
- Immediately implement a version of Risk Based Pricing

This first initiative demanded a core rethinking of our origination strategy. Essentially, to meet this and other efficiency targets, the organization would require undergoing a fundamental cultural shift from one of mass customization in the Home Loans origination process, to one where products and processes were much simpler. It also required the design of key collateral and Customer segments that would not fit into the model due to the costly nature of underwriting these loan types, or the challenge in selling and securitizing product sets.

The Credit team then worked to design a set of "In the Box" criteria, to enable the strategic goals. During these design sessions, the team also wanted to begin focusing on areas of credit expansion that made sense to again hopefully make this more palatable for the Sales Organization. (Elizabeth, insert the "In the Box" document here.) In fact, it was noted that the areas for expansion, were far more significant than the areas of proposed reduction.

Throughout the year, the Credit team attempted to provide a balance between the reduction of highly volatile assets and the need to continue to grow. (Alan, insert the application rate improvement rate).

In order to begin implementing these cultural changes, the Credit team was instructed to begin implementing the box specifically with 5/1 IO loans to allow no exceptions. We believe that this and the introduction of a very limited Risk Based Pricing initiative led to much of the noise we are hearing today. This form of Risk Based Pricing was significantly constrained by an Optis .1 change implementation restrictions. The strategy employed was essentially Capital Markets not Credit driven and only incorporate a single FICO adjustment for Low Doc loans. A more optimal Risk Based Pricing framework should incorporate much broader differentiation by credit quality and LTV to eliminate some of the pricing subsidization charges to our best Customers, and requiring higher risk borrowers to pay an appropriate rate given likely volatility and performance. Enabling this broader pricing vision will also serve us well as we focus on NIM expansion.

Towards the end of the year (Elizabeth and Alan, add the BEDE engine and rules key features and benefits here)

Comment [u1]: I would portray B-EDE as a start on our effort to introduce Streamlined Doc in a way that we do not get hit in Capital Markets executions or portfolio performance with the surcharges/risk of our current Low Doc program, while moving toward the 80 percent auto-decisioning rate.

SECTION V

Key Concerns and Opportunities

Home Loans Credit and Underwriting

Credit believes that the Sales force does not recognize the historical context, need for change, and significant credit enhancements given to the Sales team by the Credit Risk team. Clearly, our team wants nothing less than the organization to grow and prosper. We believe strongly that the Sales team is clearly one of the biggest key's to this success. However, we do not feel that leadership is providing the necessary catalyst to bring the teams together in a partnership approach to solving the organizations long-term issues.

The following bullets summarize the key concerns of the credit risk organization:

- The aggressiveness of the Sales team, and in many cases inappropriate, rude and or insulting behavior towards Underwriting staff is infectious and dangerous.
- A lack of a fundamental understanding by many Loan Consultants as to what constitutes an acceptable credit is lacking

- The organization is at significant risk in its Option ARM and Hybrid portfolios of payment shock created by abnormally low Start, or teaser rates, and aggressively low underwriting rates. The Executive team agreed to and implemented a process for managing these concerns based upon an algorithm and process recommended by Credit. Unfortunately, the process agreed to has disintegrated into an ad-hoc decision making process without any clear rational or alternative process for the future. Credit has been open to, and has provided recommendations for, alternatives if the existing process creates too much near term turmoil. We face some additional challenges as these procedures were shared earlier with Regulators with the full commitment of Executive Management for immediate implementation. It is our contention that in the upwardly sloping rate environment and likely housing appreciation flattening, we are putting borrowers into homes that they simply cannot afford. This is not only a Washington Mutual challenge, it is likely to be an industry challenge as many borrowers will likely be unable to refinance themselves into loan structures with payment amounts near their current levels.

- We need our Sales team to partner effectively with other groups to assist in driving operational efficiencies and excellence. These disciplines will enable a much broader ability to expand credit and opportunity for the Sales team in the near, intermediate and long-run. A reversion to an undisciplined Sales culture and high degrees of underwriting "customization" will subject the organization to significant Regulatory scrutiny that may impact the ability of the organization to meet its 5-year Strategic Plan.

Most importantly however, we know that all of the change cannot occur at once thereby risking the retention of large numbers of our Sales force. However, we believe that Executive Management can quickly engage in quelling the "noise" in the Sales force by educating them on the tremendous efforts that Credit Risk has done to provide tools to enable them and the organization to succeed. Further, Executive management should be very clear about what constitutes acceptable levels of credit characteristics for the prime SFR portfolio.

From: Schneider, David C.
Sent: Thursday, February 28, 2008 8:01 PM
To: Alexander, Elinor A. <elinor.alexander@wamu.net>
Subject: FW: 2008 Leadership Bonus
Attach: 2008 Leadership Bonus Charts Final2-21-08.xls

Please print

From: David, Daryl D.
Sent: Thursday, February 28, 2008 11:22 AM
To: Baker, Todd; Cathcart, Ron; Horvath, Debora; Rotella, Steve; Brooks, Alfred R.; Corcoran, James; Schneider, David C.; Casey, Tom; Landefeld, Stewart M.; Vuoto, Tony
Cc: Killinger, Kerry K.
Subject: 2008 Leadership Bonus
Importance: High

EC,

This week the HR Committee approved the formula and measures for the 2008 Bonus plan. I wanted to bring you up to date since we last discussed this at the EC meeting on the 19th. The key points are:

1. The changes I described for Senior Leaders down through level 8 remain as was presented. A full communication to all participants will begin roll out next week. Your HR person will be able to help you handle any questions.

2. The corporate measures and weights stay the same. There were some slight adjustments to the goal numbers in the payout grids based on our updated plan. I have attached the final grids for you to review.

3. We will be filing an 8K disclosure describing the plan to the shareholders next week. The disclosure covers the measures, weights and how the committee will determine the final rating. Please see the text below. If you have any questions, let me know.

For the 2008 Bonus Plan the Committee selected the following performance measures and relative weights:

- *The Company's 2008 net operating profit, weighted at 30%, calculated as operating profit before income taxes and excluding the effects of (i) loan loss provisions other than related to our credit card business and (ii) expenses related to foreclosed real estate assets;*
- *The Company's 2008 noninterest expense, weighted at 25%, calculated to exclude expenses related to (i) business resizing or restructuring and (ii) foreclosed real estate assets;*
- *The Company's 2008 depositor and other retail banking fees, weighted at 25%; and*
- *The Company's 2008 customer loyalty performance, weighted at 20%, based upon a proprietary rating system designed by the Company and an outside vendor.*

In evaluating Company financial performance, the Committee may adjust results to eliminate the effects of charges for discontinued operations, extraordinary items and items of gain, loss or expense determined to be extraordinary or unusual in nature or infrequent in occurrence or related to the disposal of a segment or a business or related to a change in accounting principle.

In light of the challenging business environment and the need to evaluate performance across a wide range of factors, the Committee will take a three-step approach to determine actual annual cash bonus payments. Accordingly, after the end of 2008, the Committee will exercise its discretion under the 2008 Bonus Plan to determine the final cash bonus payouts for each executive officer, including the Named Executives, by:

1) *reviewing and considering performance results for the four pre-established Company performance measures noted above;*
2) *reviewing other appropriate factors and measures of Company financial performance; in particular, the Committee will subjectively evaluate Company performance in credit risk management and other strategic actions that impact overall corporate profitability; and*
3) *evaluating each executive's individual performance during 2008 to determine whether it is appropriate to adjust the executive's final bonus payout from the amount that would be payable based solely on the Committee's assessment of Company performance under steps (1) and (2) above.*

Daryl David

WaMu®

February 25, 2008

Credit Risk Overview

Report to the Board of Directors

John McMurray
Chief Credit Officer

WaMu

Background

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Credit Risk

- Credit Risk is the risk of an obligor or counterparty defaulting
- We are exposed to credit risk through various activities, including:
  - Lending
  - Investing
  - Deposit taking
  - Contracting

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Basic Terms of Business

- Borrower types
  - Consumer
  - Commercial
- Counterparty/Sponsor support
  - With or without recourse
  - Guaranty
- Unsecured or Secured; if secured:
  - Real property
  - Personal property
- Pricing
  - Risk-based
  - Average

Why We Take Credit Risk

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Rationale for taking credit risk includes:

- ***Return***. We generally earn an expected return for retaining credit risk.
- ***Earnings***. Taking credit risk is one of the primary ways financial institutions generate earnings.
- ***Diversification***. We realize diversification benefits since this risk is not highly correlated with other risks we face (primarily interest rate risk).
- ***Prerequisite***. We cannot participate in most transactions without being exposed to some credit risk.

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Risk Transfer & Retention

Loan/Transaction - Level Measures	Portfolio - Level Measures	Retained Risk Positions
· Credit Policy · Collateral Evaluation - appraisal - AVM, other · Underwriting, Rating & Scoring - AUS - traditional · Insurance - loan (e.g. PMI) - hazard (including flood) · Credit Review / QC - consumer - commercial · Surveillance - performance monitoring - re-underwriting/rating/scoring - marketing collateral to market · Line Management · Loss Mitigation & Workout	· Insurance - pool - bond · Non-recourse Sales - card - GSE - private MBS/ABS - whole loan · Risk-based Pricing · Reserves · Diversification - geographic - temporal - amplitudinal - sourcing - product - broker/counterparty/sponsor - offsetting positions & risks	· Whole Loans - HFS inventory - HFI portfolio · Rep & Warrant - general - EPD · Interest "Strips" - MSRs - spread accounts (card) - residuals (card, mortgage) · Reinsurance · Counterparty

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Drivers of Credit Risk

- Market Environment
  - Collateral prices (typically real estate prices)
  - Market prices (often interest rates)
  - Competitor offerings & actions
  - Macroeconomic conditions
  - Consumer & business sentiment
  - Demographics
- Collateral Characteristics / Quality
  - Value
  - Condition
  - Marketability / Liquidity
  - Type
- Borrower/Counterparty Characteristics / Quality
  - Target customer
  - "Ruthlessness" (default, prepayment, other)
  - Concentrations (loans to one borrower)
  - Credit (history, obligations)
  - Capacity (income/profitability, reserves/liquid assets, net worth/leverage)

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Drivers of Credit Risk

(continued from the previous page)

- Manufacturing Quality
  - Process
  - Adverse selection potential
  - Data integrity

See appendix for more complete list of transaction quality elements

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Geographic Concentrations & Home Prices

Nonresidential Credit Exposures

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- Card
  - Losses are very sensitive to unemployment
  - Losses will be higher than recent lows, but within expectations provided that economic conditions (unemployment) remain benign
  - Securitization is a key risk
  - More pricing and line management alternatives
- Commercial RE
  - Still performing well
  - Delinquencies and losses increasing though still within expectations
  - Our MF should be less vulnerable than other Commercial RE
- Small Business
  - Balances are relatively low ($1.4B drawn, $1.4B open to buy)
  - Delinquencies and losses have been well above expected levels
  - Multiple actions underway to address adverse performance; new volume down significantly

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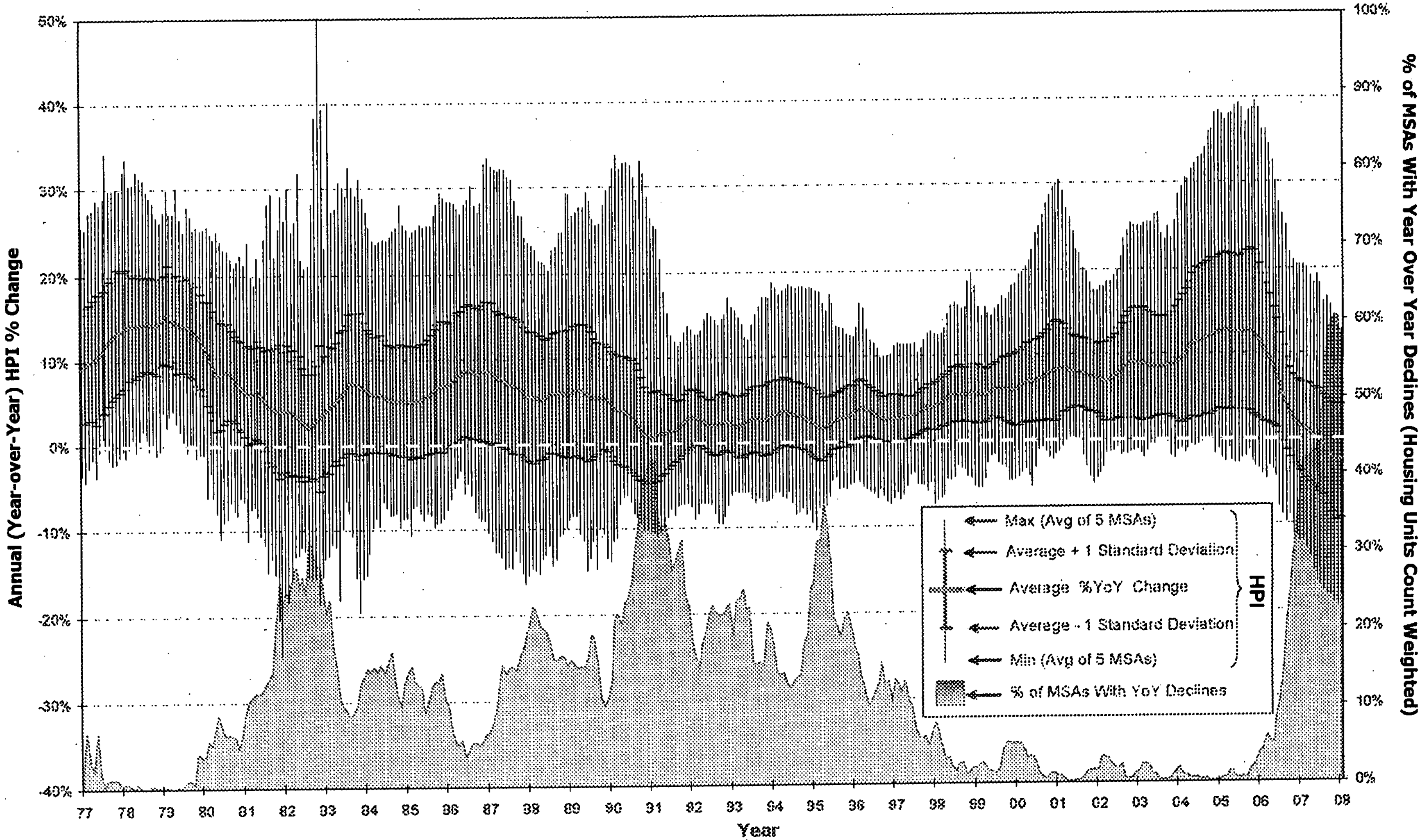
Housing Values - MSA Level

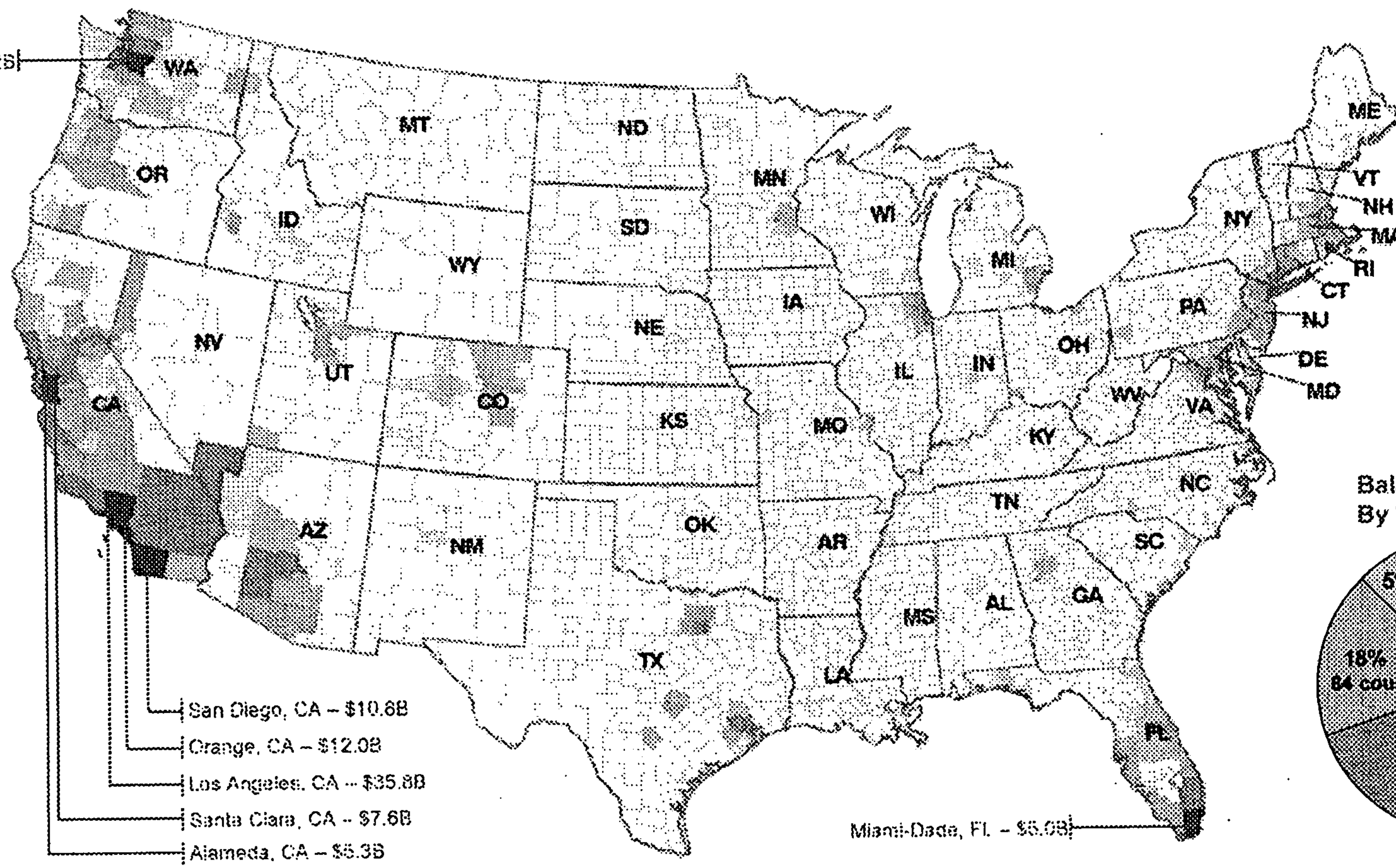
FARES Single Family Residence Home Price Index[1] (January 2008)



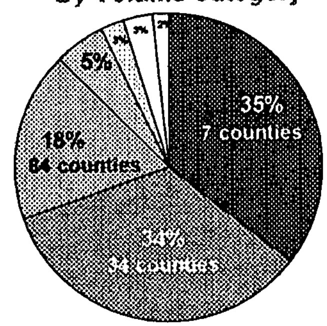
(1) Source: First American Real Estate Solutions. All statistics are weighted by MSA-level housing unit count.

WaMu Real Estate Loan Exposure[1] by County
HFI Portfolio

WaMu



Balance Distribution By Volume Category



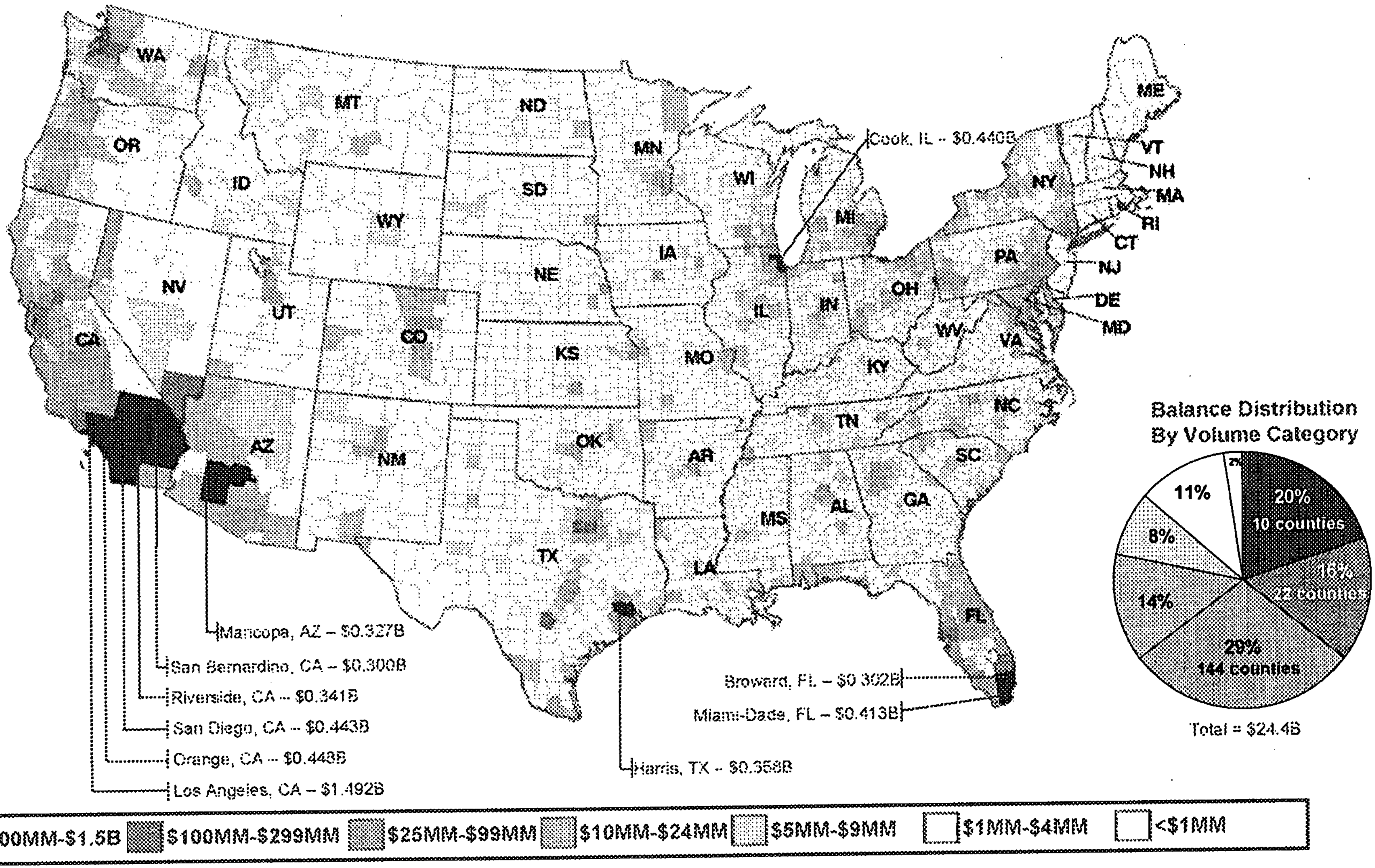
Total = $229.9B

$5.0B-$36B | $1.0B-$4.9B | $0.25B-$0.9B | $0.1B-$0.24B | $50MM-$99MM | $10MM-$49MM | <$10MM

(1) Includes SFR Prime, SMC, Commercial, & Home Equity loans. Does not include Other Consumer products. Excludes accounting adjustments and loans with invalid county designations totaling $5.5 billion.

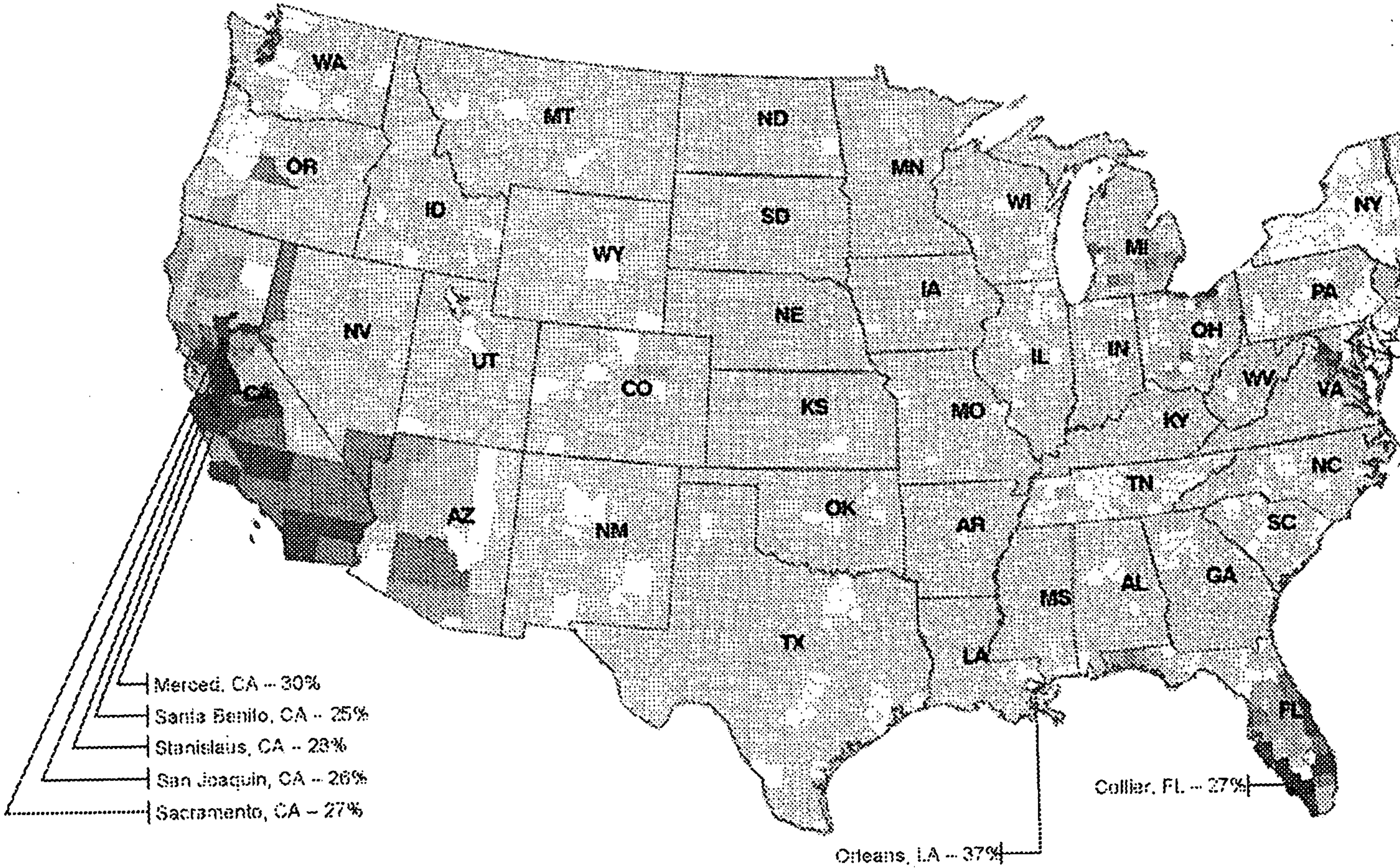
WaMu Card Loan Exposure[1] by County
HFI Portfolio

WaMu

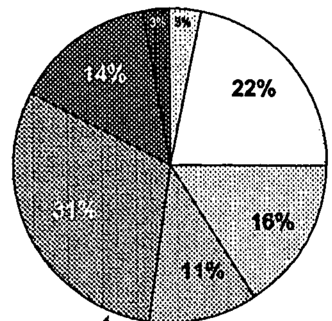


(1) Card Services on a Managed basis. Excludes accounting adjustments and loans with invalid county designations totaling $2.6 billion.

Cumulative Home Price Depreciation (Peak to Jan 08) WaMu
FARES County-Level HPI Data



WaMu Real Estate Loan Balance Distribution by Cumulative HPD Category

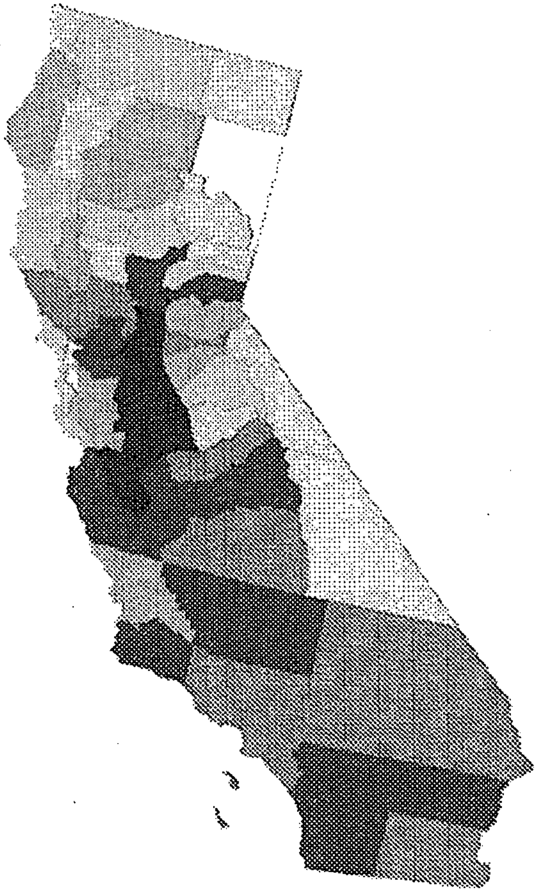


Almost half of our RE portfolio is in areas where prices have already declined by more than 15%

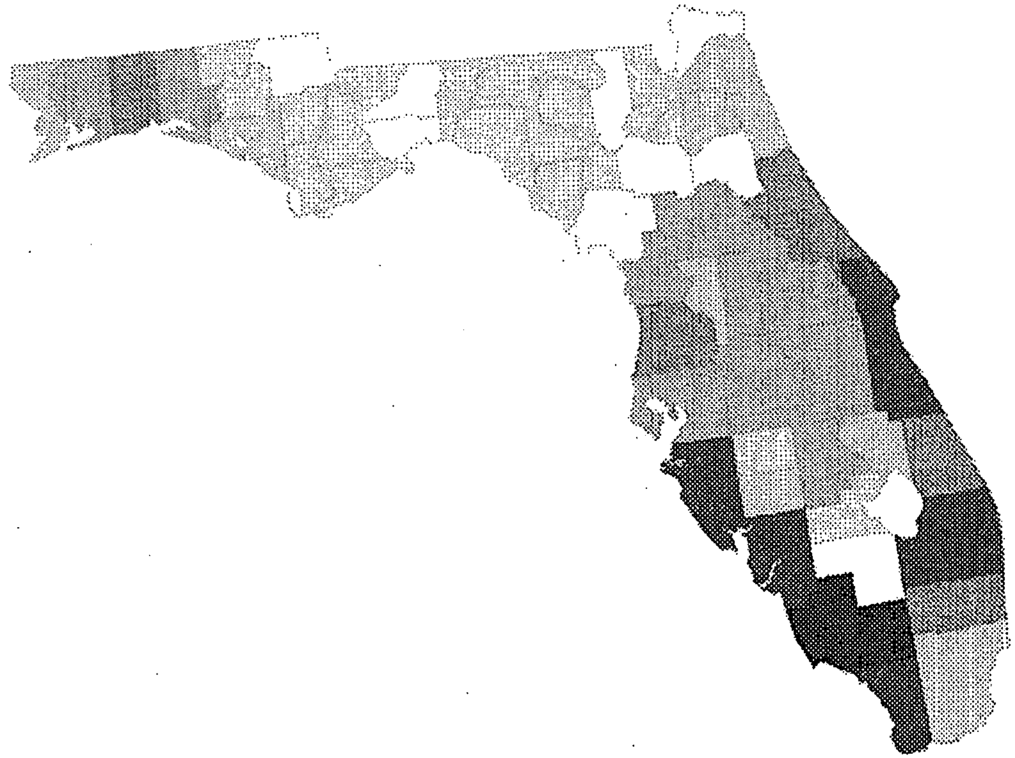
25.1%-30.0% | 20.1%-25.0% | 15.1%-20.0% | 10.1%-15.0% | 5.1%-10.0% | ≤5.0% | - N/A

Cumulative Home Price Depreciation (Peak to Jan 08) WaMu
FARES County-Level HPI Data

California



Florida

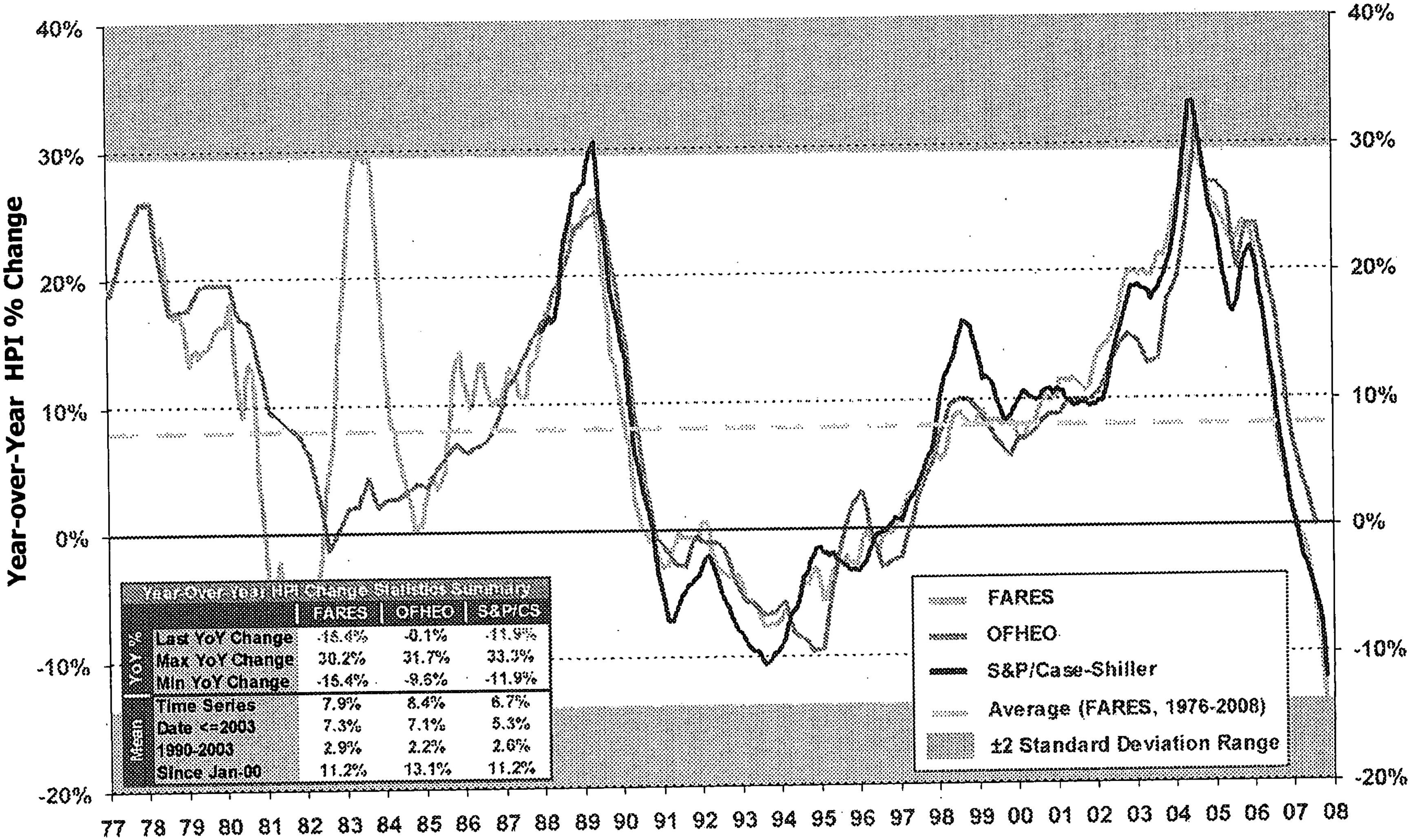


25.1%-30.0% | 20.1%-25.0% | 15.1%-20.0% | 10.1%-15.0% | 5.1%-10.0% | ≤5.0% | - N/A

WaMu

MSA Examples – YoY HPI Change

Los Angeles-Long Beach-Glendale, CA



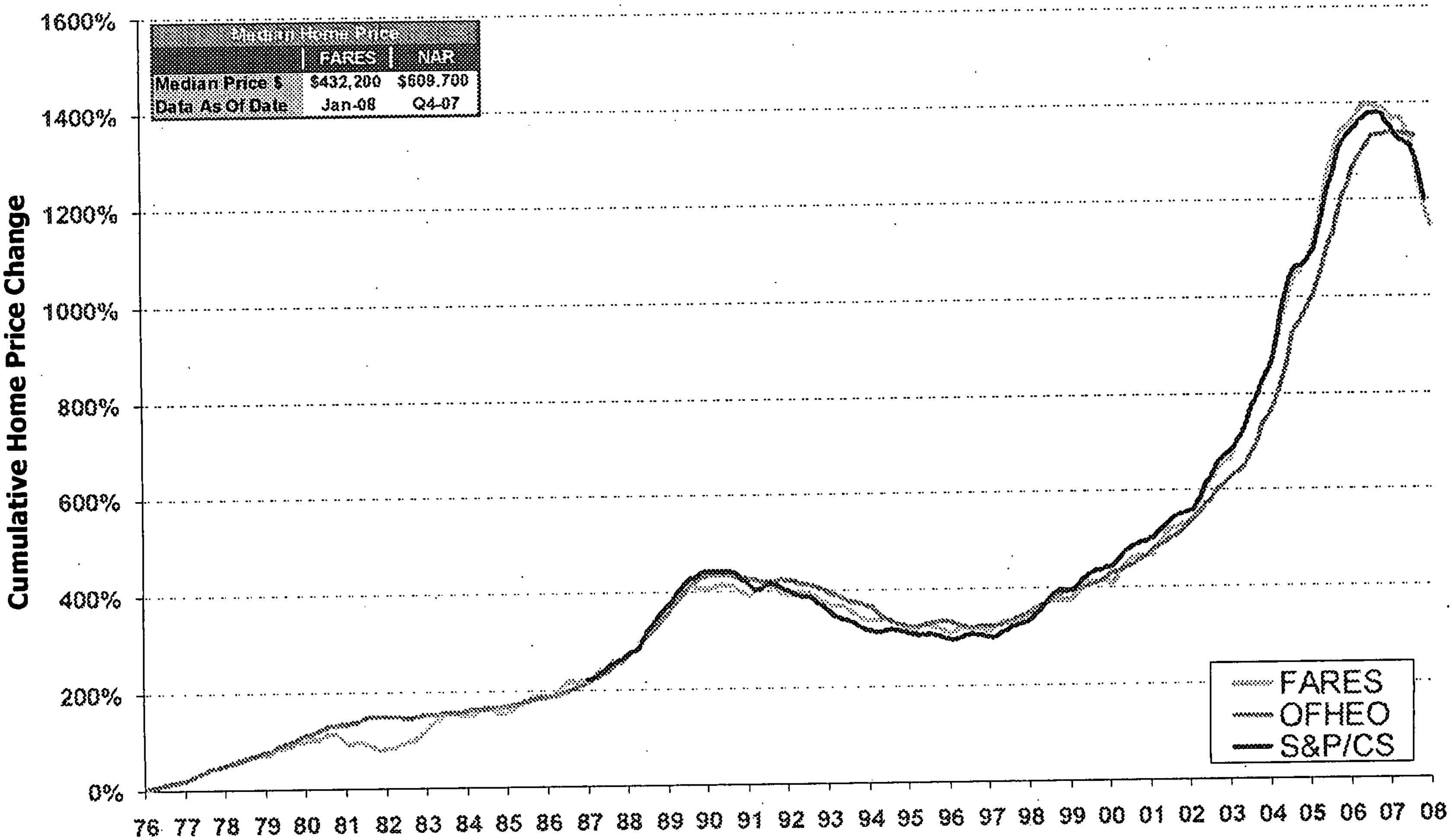
Year-Over-Year HPI Change Statistics Summary

		FARES	OFHEO	S&P/CS
YoY %	Last YoY Change	-15.4%	-0.1%	-11.9%
	Max YoY Change	30.2%	31.7%	33.3%
	Min YoY Change	-15.4%	-9.6%	-11.9%
Mean	Time Series	7.9%	8.4%	6.7%
	Date <=2003	7.3%	7.1%	5.3%
	1990-2003	2.9%	2.2%	2.6%
	Since Jan-00	11.2%	13.1%	11.2%

MSA Examples – Cumulative Appreciation

WaMu

Los Angeles-Long Beach-Glendale, CA



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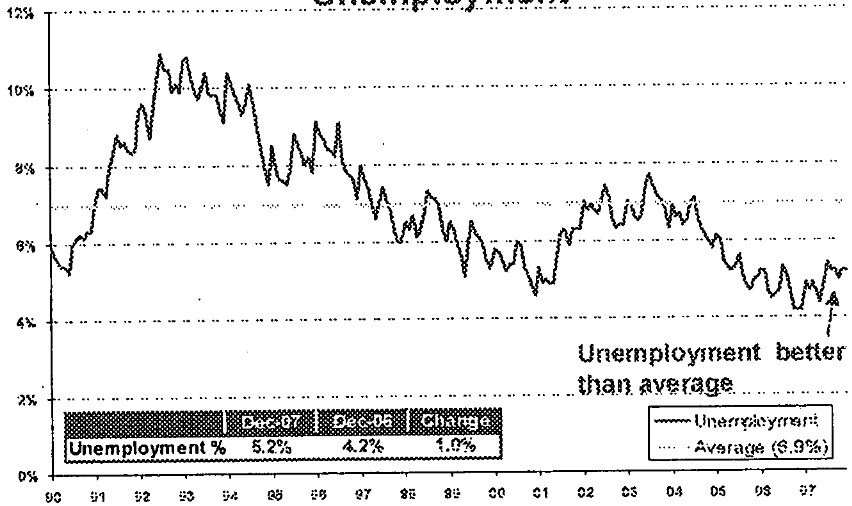
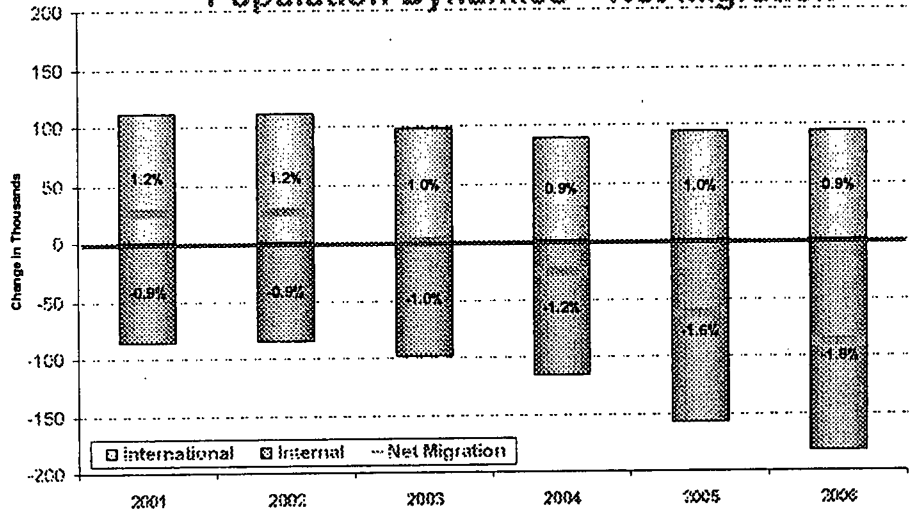
MSA Examples – Economy

Los Angeles-Long Beach-Glendale, CA

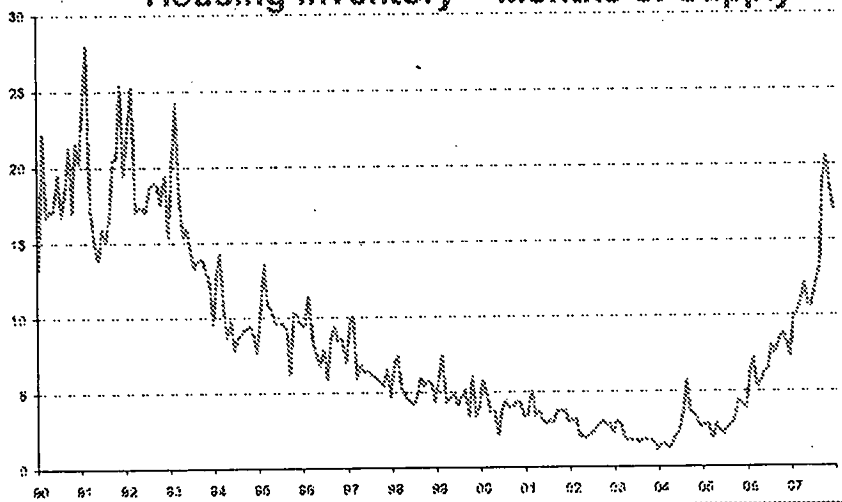
Unemployment



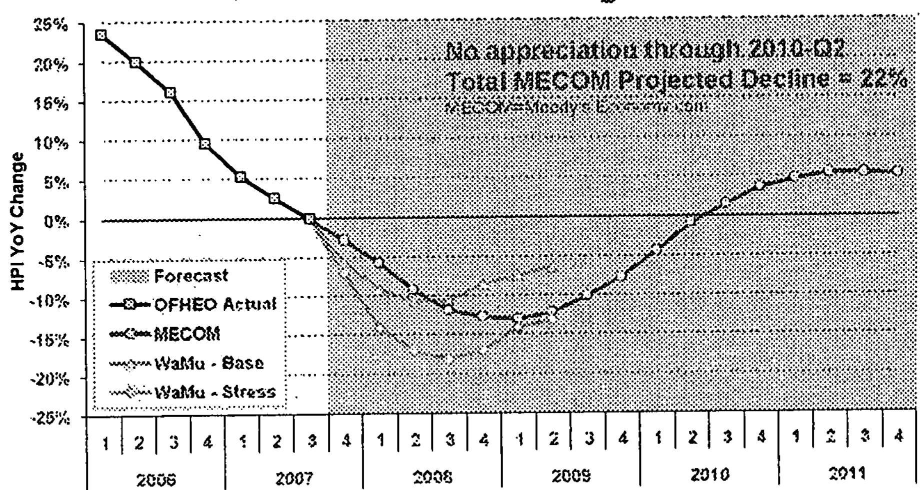
Population Dynamics – Net Migration



Housing Inventory – Months of Supply



OFHEO HPI YoY Change Forecast



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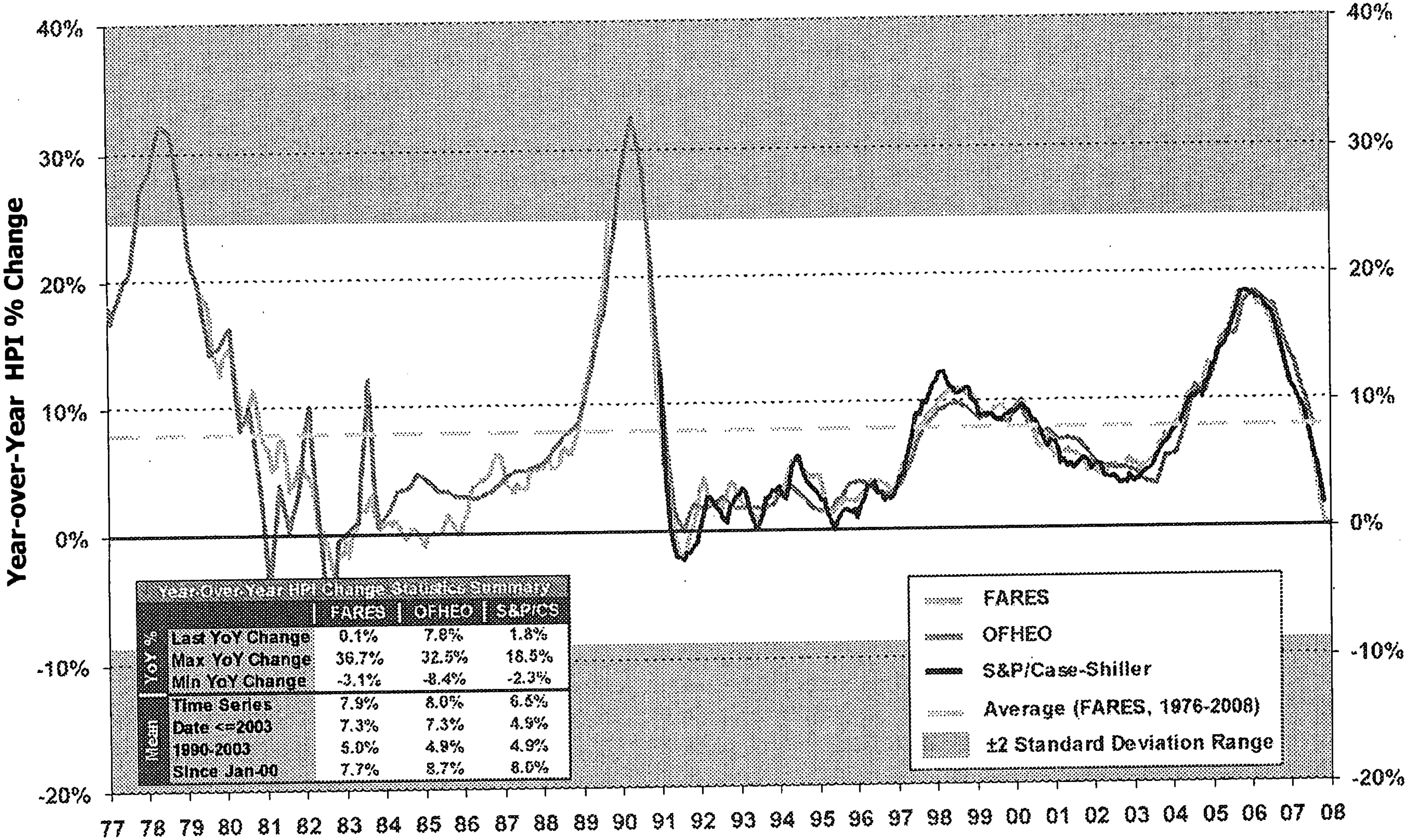
MSA Examples – YoY HPI Change
Seattle-Bellevue-Everett, WA



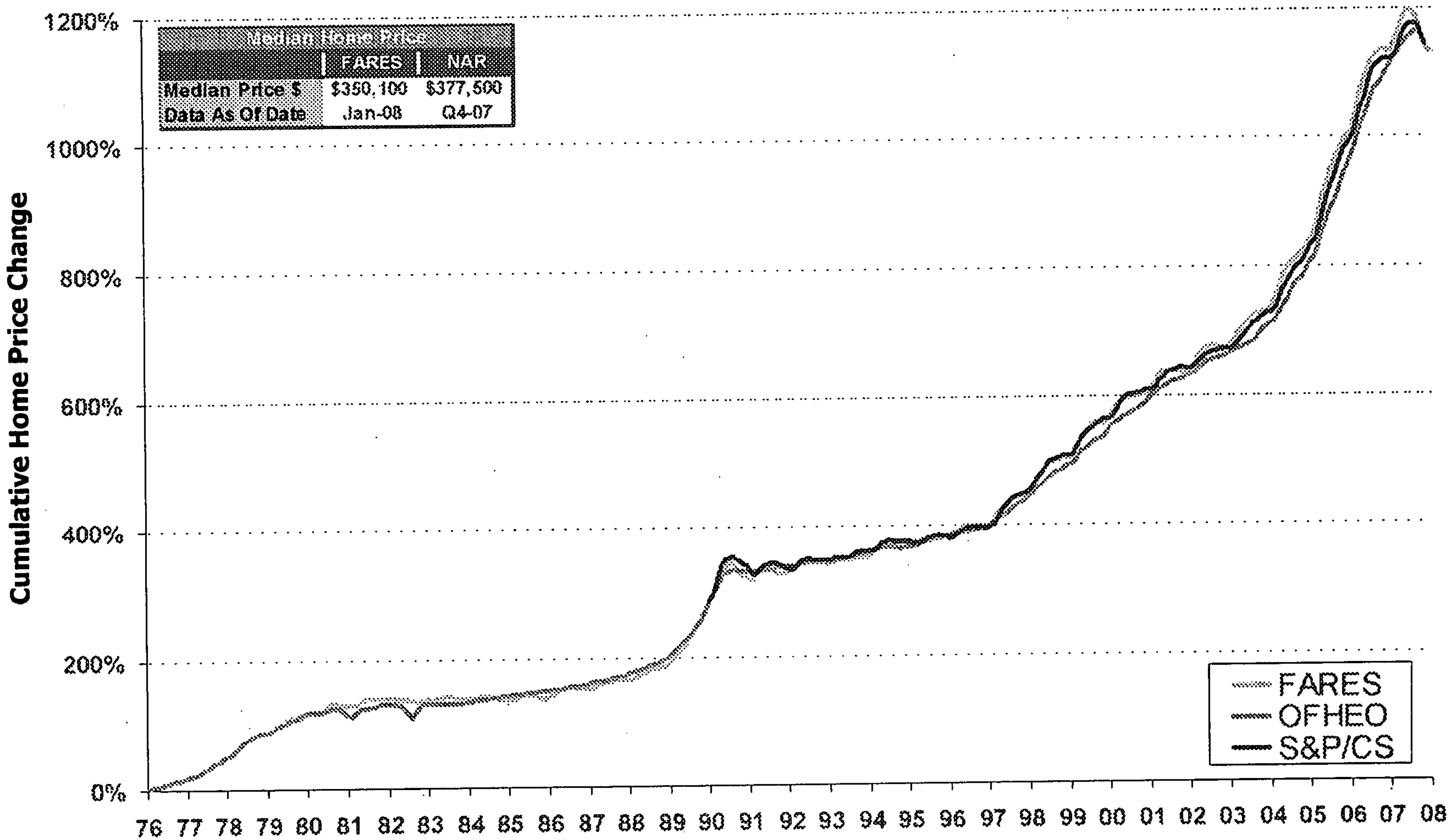
Year-Over-Year HPI Change Statistics Summary

		FARES	OFHEO	S&P/CS
YoY %	Last YoY Change	0.1%	7.8%	1.8%
	Max YoY Change	36.7%	32.5%	18.5%
	Min YoY Change	-3.1%	-8.4%	-2.3%
Mean	Time Series	7.9%	8.0%	6.5%
	Date <=2003	7.3%	7.3%	4.9%
	1990-2003	5.0%	4.9%	4.9%
	Since Jan-00	7.7%	8.7%	8.0%

MSA Examples – Cumulative Appreciation WaMu

Seattle-Bellevue-Everett, WA

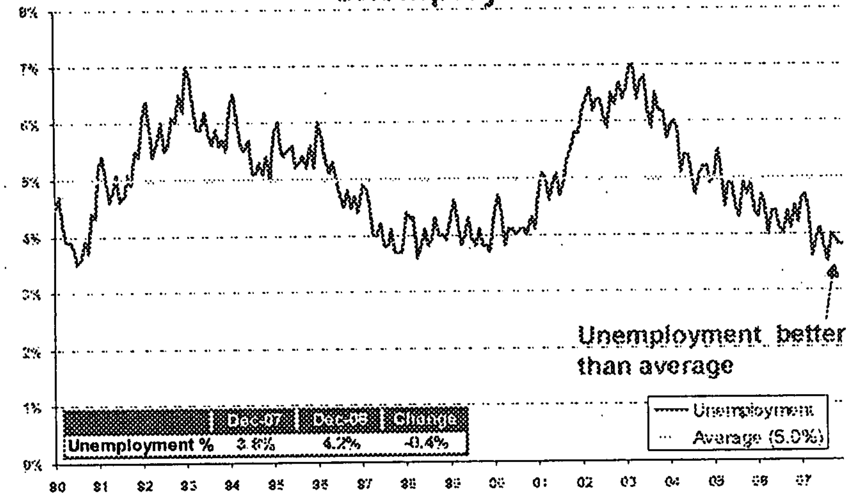
Median Home Price	FARES	NAR
Median Price $	$350,100	$377,500
Data As Of Date	Jan-08	Q4-07



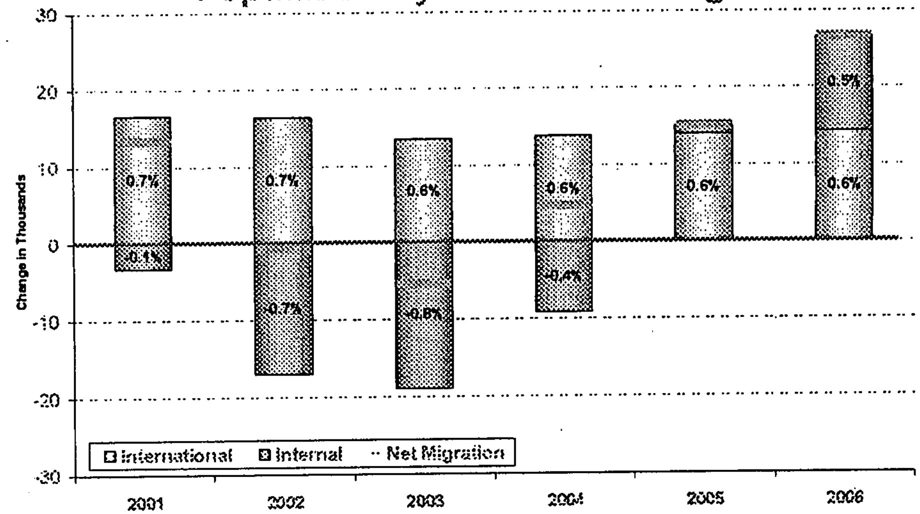
WaMu

MSA Examples – Economy
Seattle-Bellevue-Everett, WA

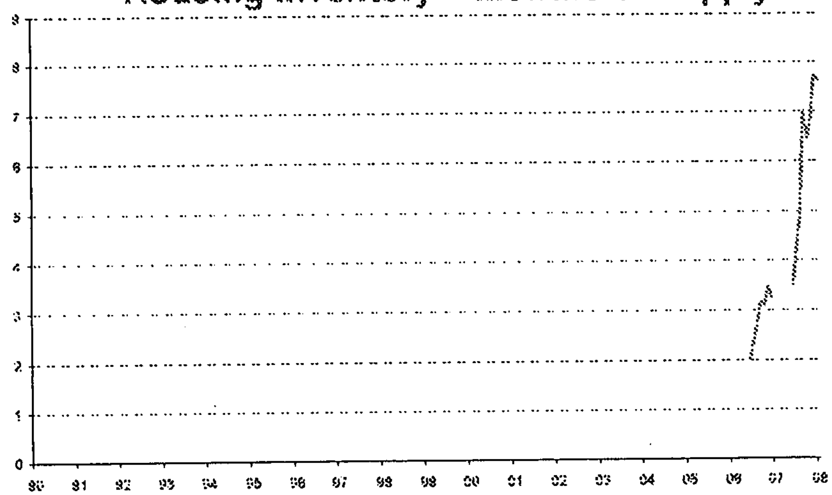
Unemployment



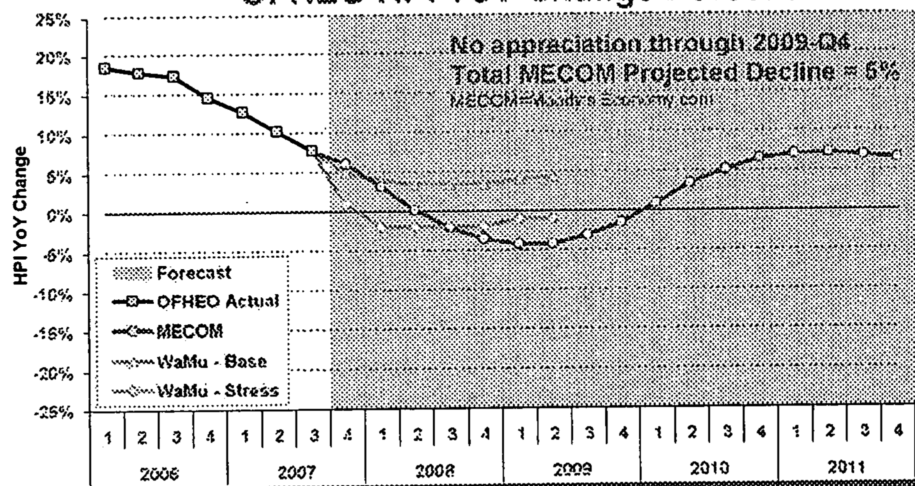
Population Dynamics – Net Migration



Housing Inventory – Months of Supply



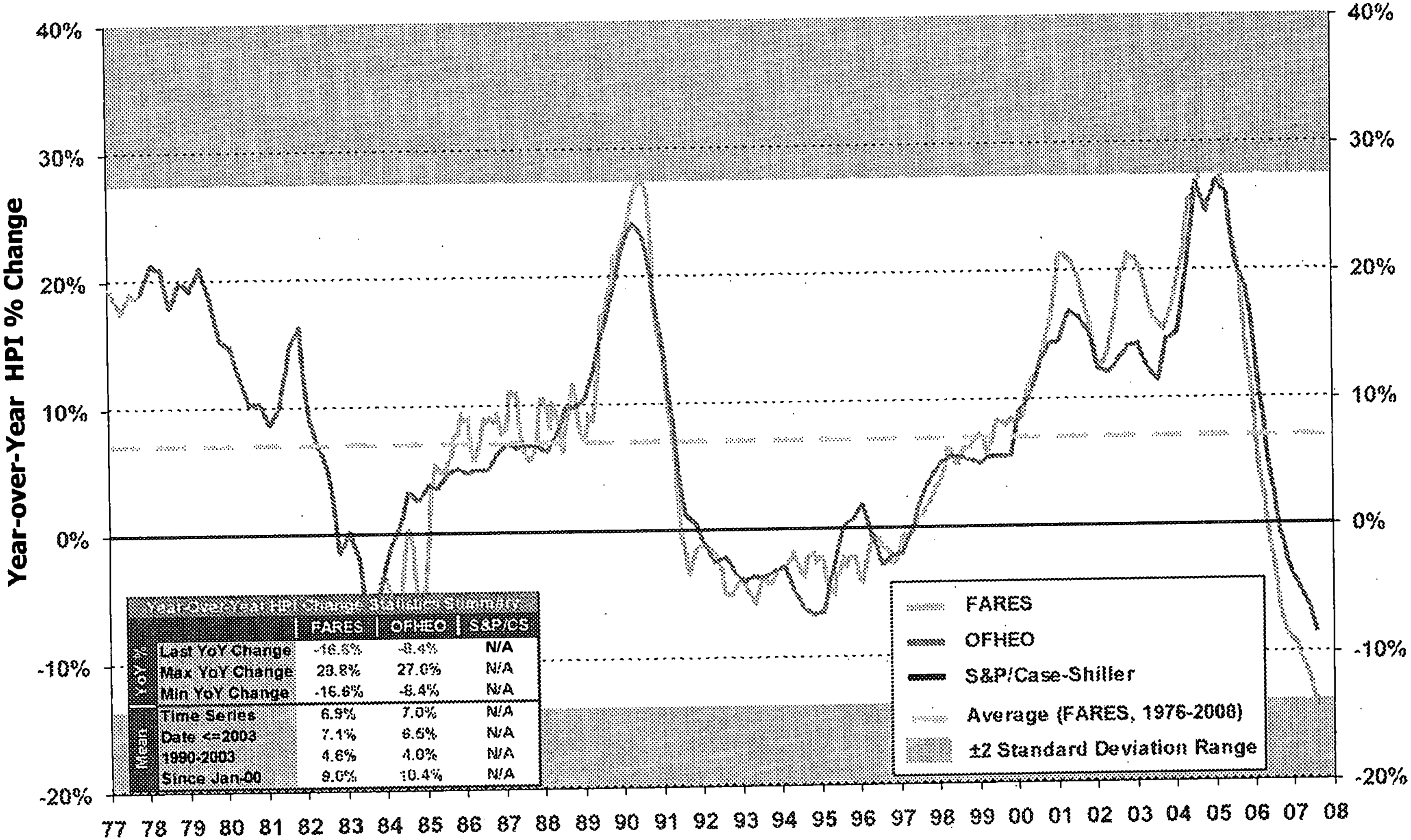
OFHEO HPI YoY Change Forecast



WaMu

MSA Examples – YoY HPI Change

Sacramento--Arden-Arcade--Roseville, CA



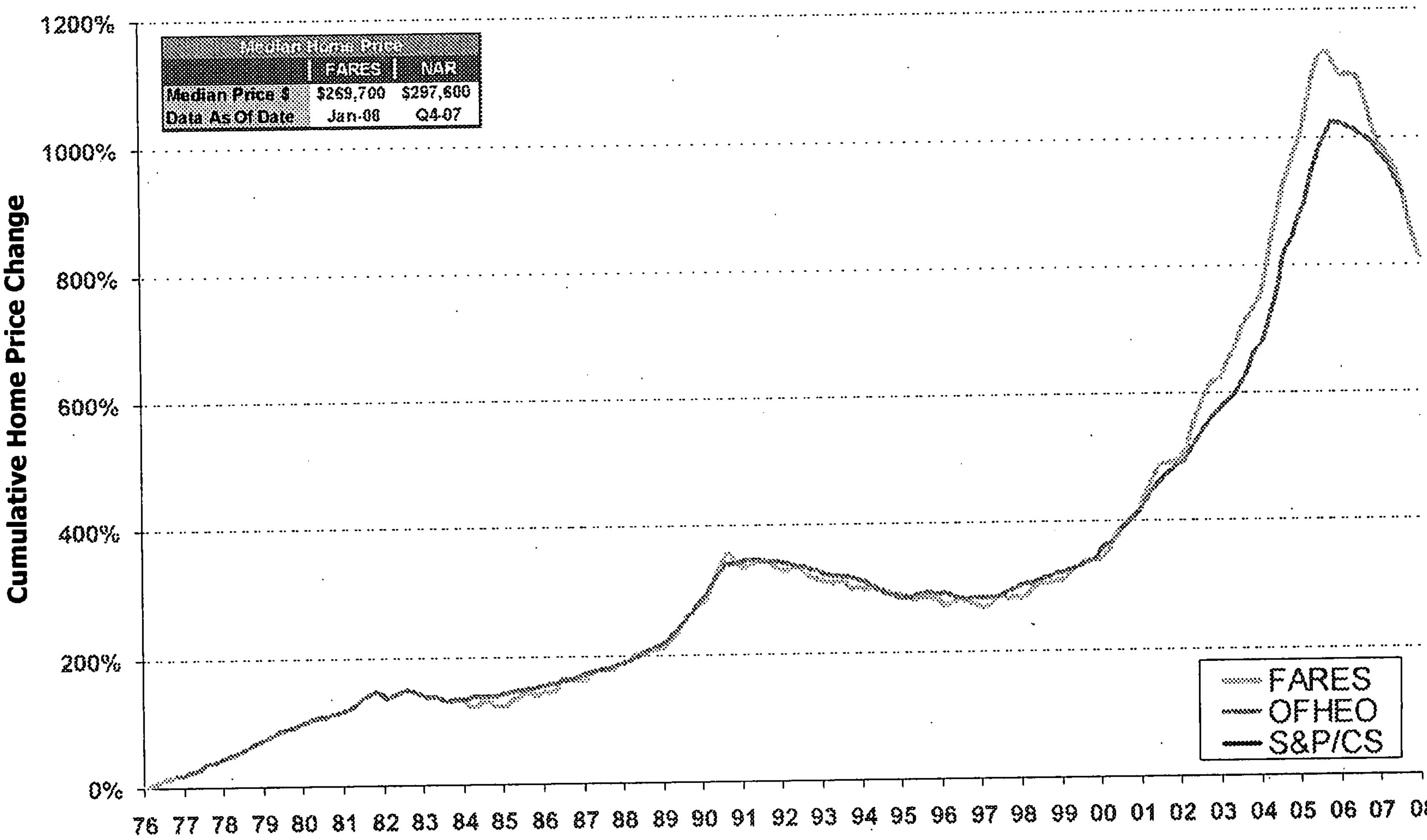
		FARES	OFHEO	S&P/CS
YoY %	Last YoY Change	-16.6%	-8.4%	N/A
	Max YoY Change	28.8%	27.0%	N/A
	Min YoY Change	-16.6%	-8.4%	N/A
Mean	Time Series	6.9%	7.0%	N/A
	Date <=2003	7.1%	6.6%	N/A
	1990-2003	4.6%	4.0%	N/A
	Since Jan-00	9.0%	10.4%	N/A

MSA Examples – Cumulative Appreciation

WaMu

Sacramento--Arden-Arcade--Roseville, CA

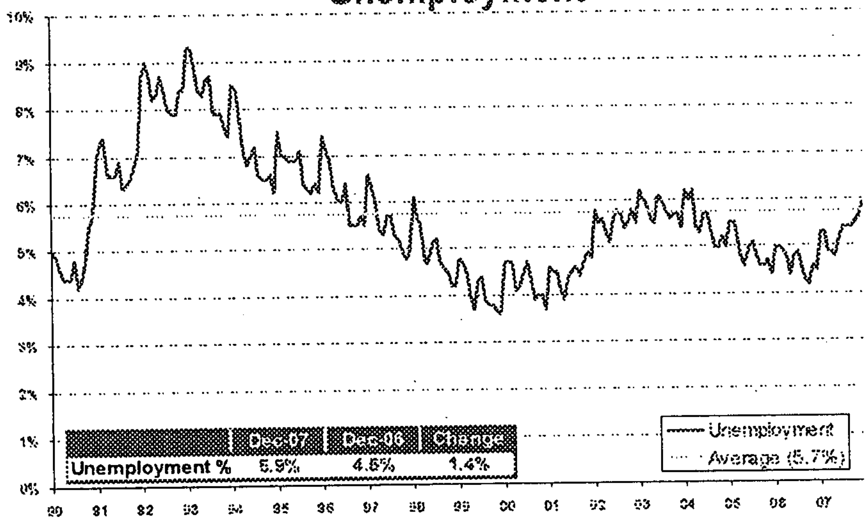
Median Home Price	FARES	NAR
Median Price $	$269,700	$297,600
Data As Of Date	Jan-08	Q4-07



WaMu

MSA Examples – Economy
Sacramento--Arden-Arcade--Roseville, CA

Unemployment



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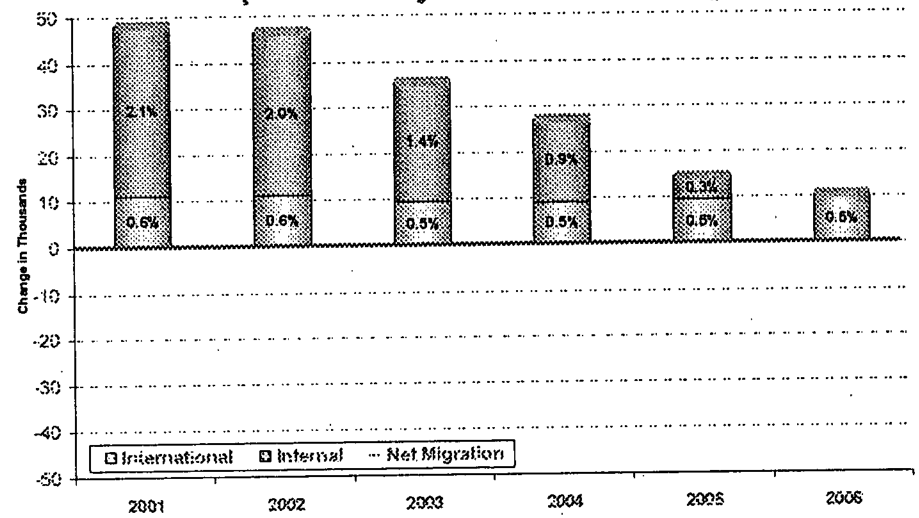
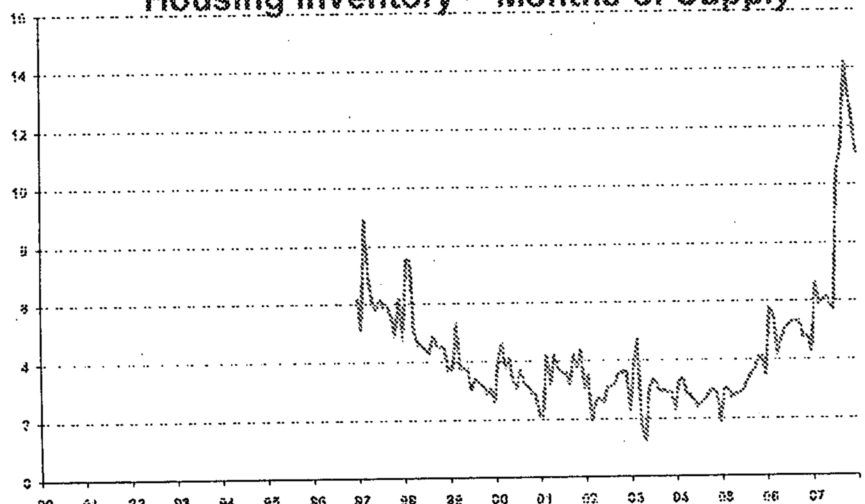
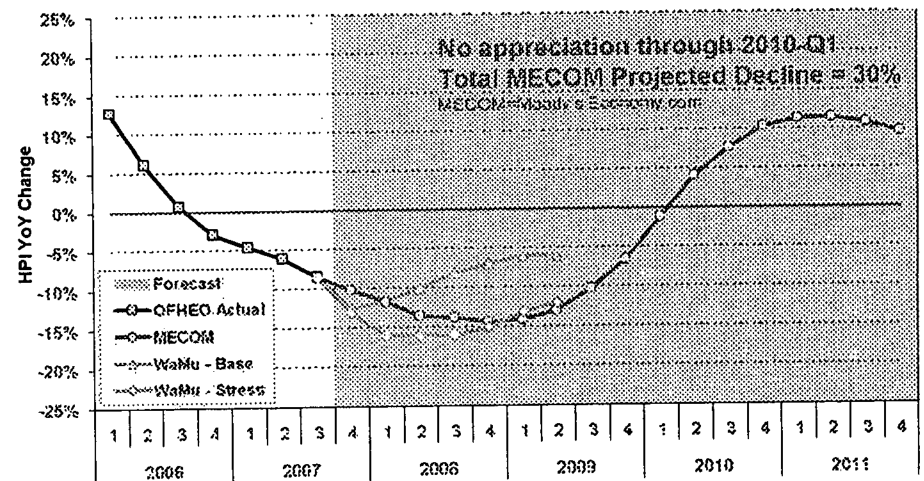


Housing Inventory – Months of Supply



OFHEO HPI YoY Change Forecast



Key Prerequisites for a Peak in Mortgage-Related Losses/NCOs

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- ***Liquidity Improvement***. Financial markets begin to provide liquidity for Jumbo and otherwise non-conforming loan products. Otherwise, there will continue to be fewer potential homebuyers in major areas of the country, especially where we have high concentrations. *Current Outlook: liquidity continues to be extremely constrained.*
- ***Prepayments Rebound***. Loans typically terminate in full payoff of the loans, leaving fewer loans outstanding for subsequent potential default. Prepayments have been suppressed by weak home sales and lack of refinancing opportunities, leaving more cumulative loss potential on our books. *Current Outlook: Prepayment outlook is mixed depends upon loan type and borrower attributes.*
- ***Rate of House Price Declines Bottoms Out***. Declining home values have increased loss frequency and severity. The acceleration of loss rates are unlikely to abate until the rate of decline in home prices slows. *Current Outlook: prices continue to decline, especially where we have high concentrations.*
- ***Economy Stabilizes***. More homeowners are losing their jobs as the deflation of housing markets and disruptions in financial markets ripple through the economy. Resumed strength in employment growth and a halt to the uptrend in unemployment would be welcome signs of stabilization. *Current Outlook: recession probability has increased.*

Federal Policy Initiatives

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Initiatives:

- Federal Reserve Actions
  - 125 bp cut in Fed funds target
  - Term Auction Facility
- Fiscal Policy Actions
  - Tax rebate for households
  - Business tax changes
- Regulatory/Other Changes
  - FHA expansion
  - Increase in GSE conforming loan limits

Expected Impact is Minimal:

- Increase in NIM
- Reduction in ARM and HELOC payment/accrual rates
- Delay in Option ARM recasts
- Reduction of ARM payment shock
- Prepayment of low credit risk loans, including those that meet the new GSE conforming limits

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Portfolio Performance & Provision

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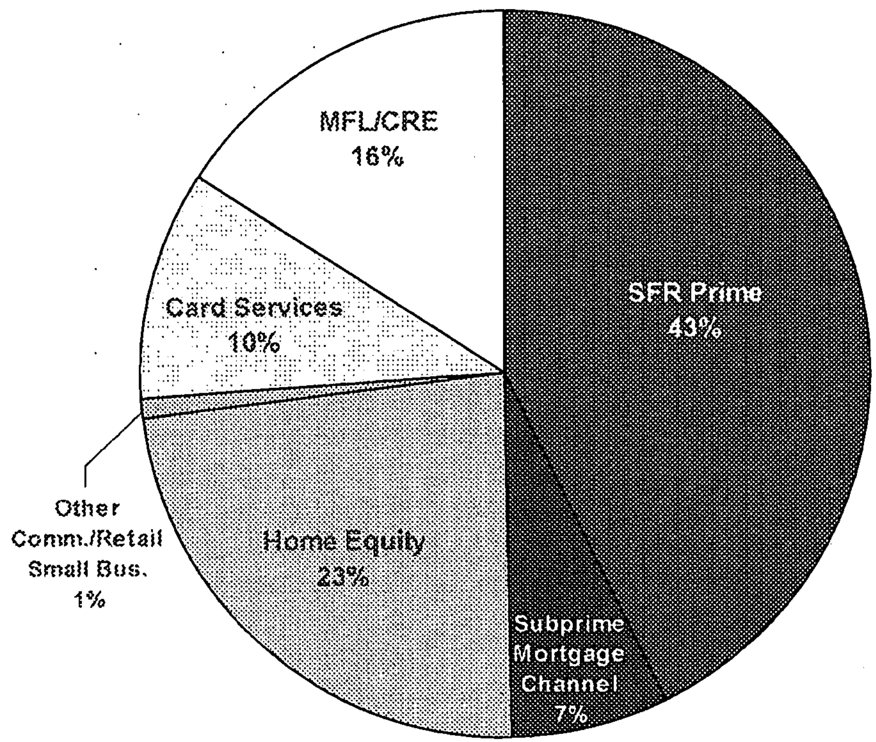
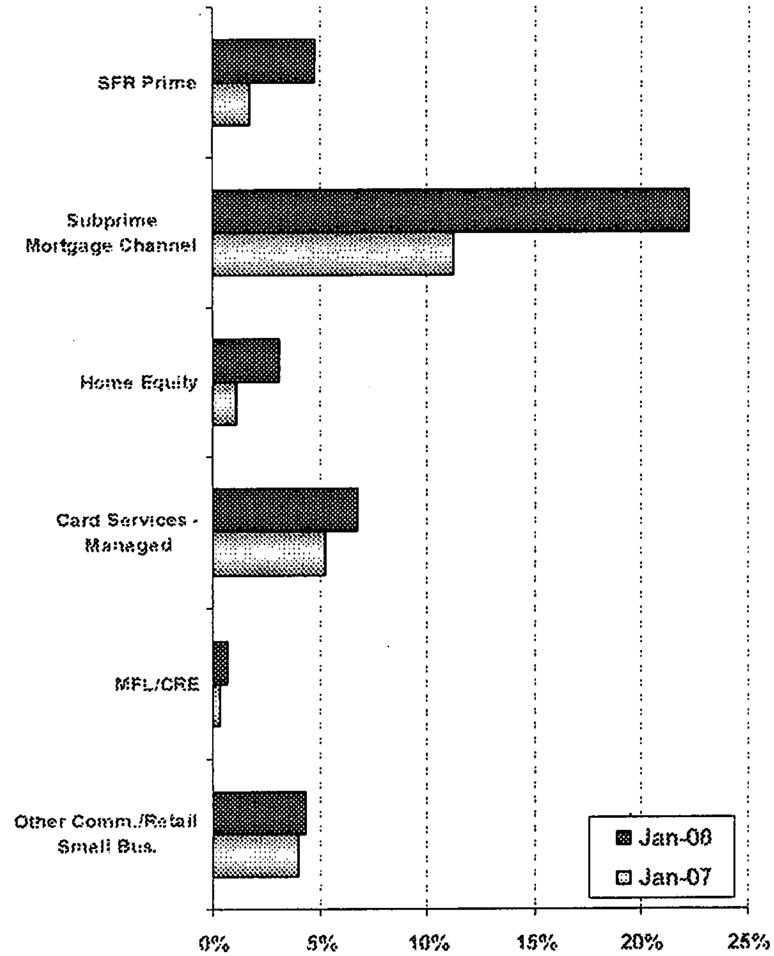
Confidential Treatment Requested by JPMC

Portfolio Summary

Composition



Total Delinquency



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Mortgage Concentration at Top 20 Banks

Sorted by Total Mortgage Concentration; Source: FBR report dated 02-06-2008

Institution	Ticker	Market Cap	As % of Common Tangible Equity: Home Equity	1st Liens	Total Mortgages
Washington Mutual	WM	18,962	457%	910%	1366%
Northwest Bancorp, (MHC)	NWSB	1,400	146%	649%	795%
TCF Financial	TCB	2,788	262%	469%	732%
Webster Financial	WBS	1,810	283%	435%	718%
National City	NCC	11,398	352%	364%	716%
Citigroup Inc.	C	148,290	198%	486%	684%
Countrywide Financial	CFC	4,396	269%	398%	668%
Sovereign Bancorp, Inc.	SOV	6,292	152%	516%	668%
First Horizon	FHN	2,794	365%	217%	583%
Huntington Bancshares	HBAN	5,168	295%	270%	565%
Bank of America	BAC	199,838	148%	391%	538%
SunTrust Banks, Inc.	STI	23,807	210%	315%	524%
Wells Fargo & Company	WFC	111,045	243%	250%	493%
Regions Financial	RF	17,847	165%	246%	410%
U.S. Bancorp	USB	58,752	150%	235%	385%
PNC Financial Services	PNC	22,649	170%	200%	369%
Citizens Republic	CRBC	1,087	145%	221%	366%
M&T Bank Corporation	MTB	10,337	154%	201%	355%
Associated Banc-Corp	ASBC	3,670	164%	165%	329%
Fifth Third Bancorp	FITB	14,947	170%	148%	318%

Environment & Concentrations Drive Portfolio Performance

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- **Adverse Environmental Conditions.** This cycle has been especially severe as a result of several unique circumstances, including:
  - Guideline Expansion: prior to the recent melt-down in the capital markets, industry guidelines expanded beyond what had existed in previous cycles.
  - Home Prices: house price patterns in recent years departed substantially from historical norms.
  - Liquidity: the continuing absence of liquidity in the primary and secondary markets is without precedent.
  - Negative Feedback Loop: many of these conditions are self-reinforcing thereby further worsening the environment
- **High Product and Geographic Concentrations.** We're heavily concentrated in several key dimensions:
  - Residential Mortgages: we're highly exposed to this asset class, which has performed very poorly in this cycle.
  - High Risk Products: within residential, we generally retained higher risk products (e.g., Option ARMs, 2nd Liens, Subprime, Low Doc), which are also particularly impacted by current primary market liquidity conditions.
  - Geography: we're heavily exposed in highly stressed markets such as California and Florida

Other Issues Affecting Portfolio Performance

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- **Portfolio Management Choices.** Some choices have benefited and others have exacerbated our ongoing results, including:
  + Loan Sales: we sold greater than normal proportions of 2006 and 2007 originations
  + Guidelines: we tightened guidelines earlier than other lenders
  + Residuals: we sold and wrote down mortgage residuals aggressively
  – Credit Enhancements: we generally have not used credit enhancements for the retained risk portfolio
  – Line Management: while ahead of most banks, in early stages and needs to be even more aggressive in Home Equity and Small Business

- **Manufacturing Defects.** While our guidelines were generally managed more conservatively than industry leaders, manufacturing quality was inconsistent with established standards.

- **Data Challenges.** As a result of manufacturing quality and integration issues, data quality is poor; consequences include:
  – Measurement is less precise and the processes that depend on them are less effective
  – Models built using the data are less reliable

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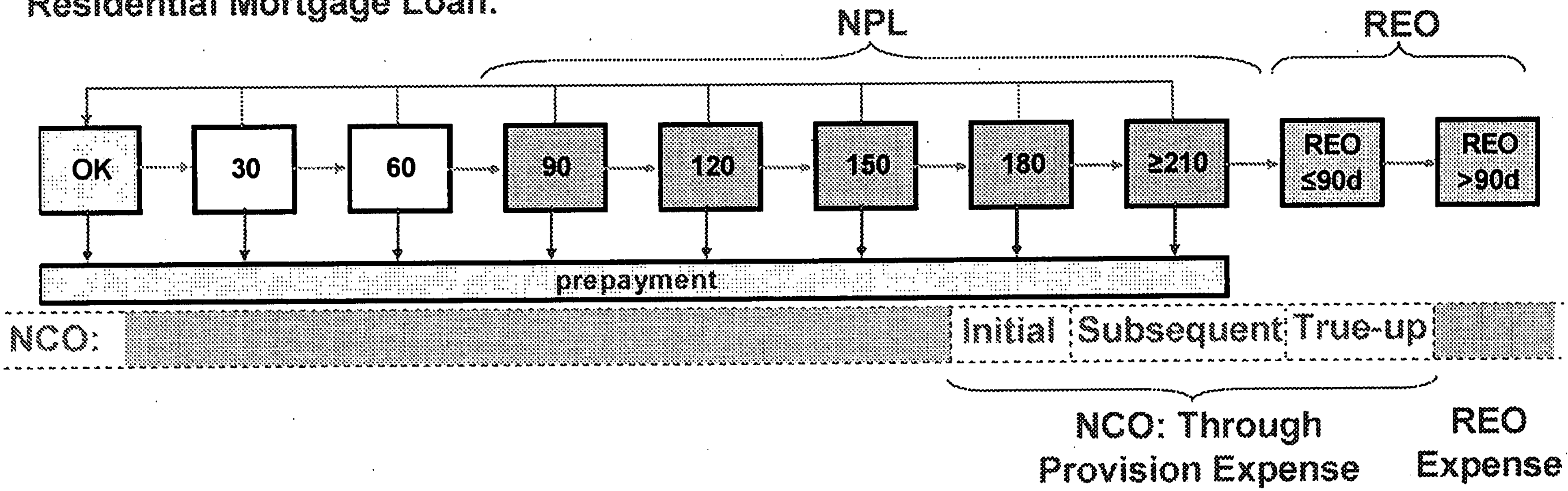
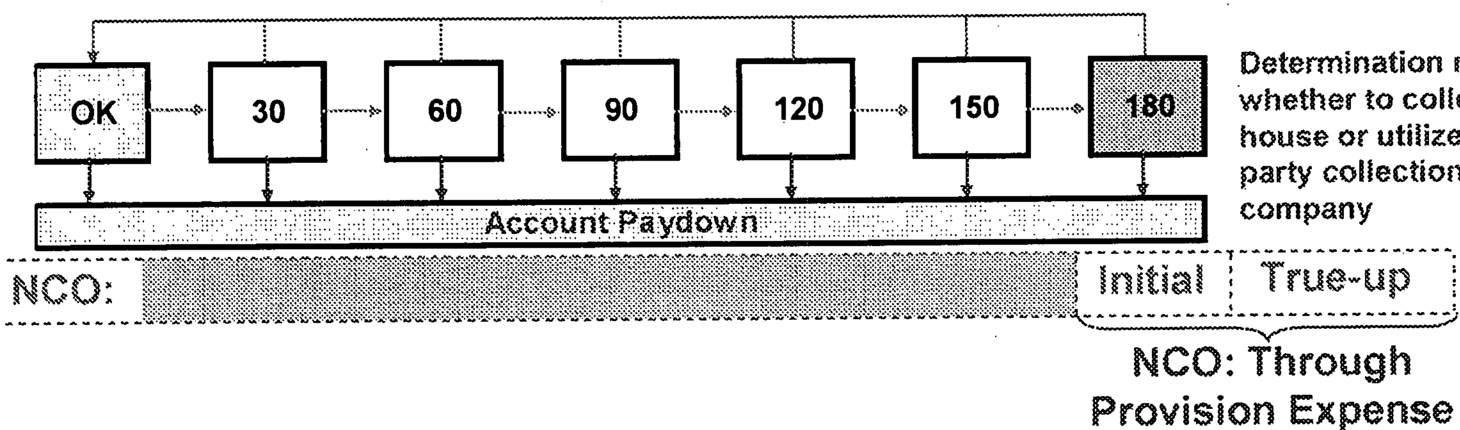
Consumer Transition Timelines

Residential Mortgage Loan:



Credit Card:



Determination made whether to collect in-house or utilize a 3rd party collection company

Confidential Treatment Requested by JPMC

Impact of Prepayments on Losses[1]

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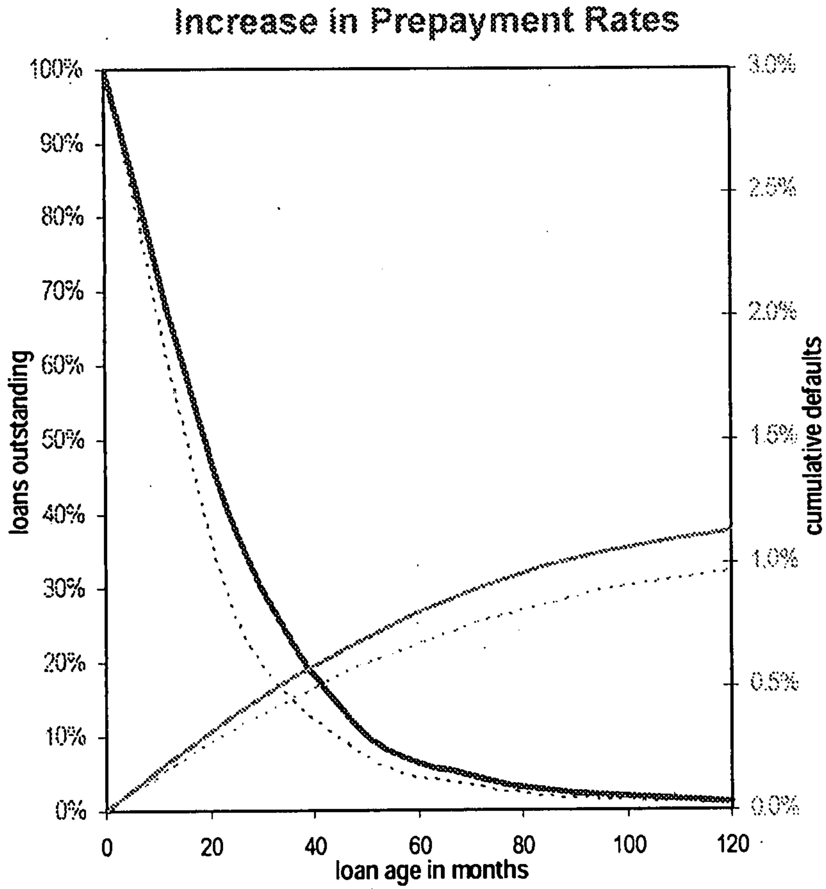

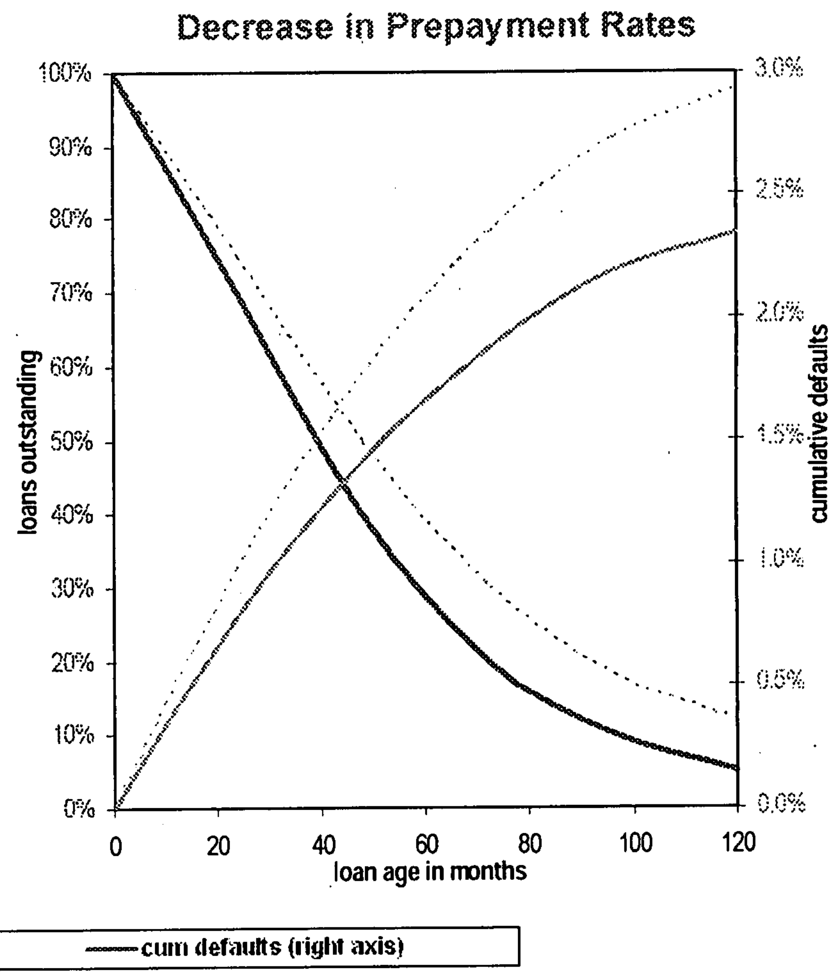

(1) For illustrative purposes only. Assumes all other factors held constant. Numbers do not represent actual default or pool factor figures.

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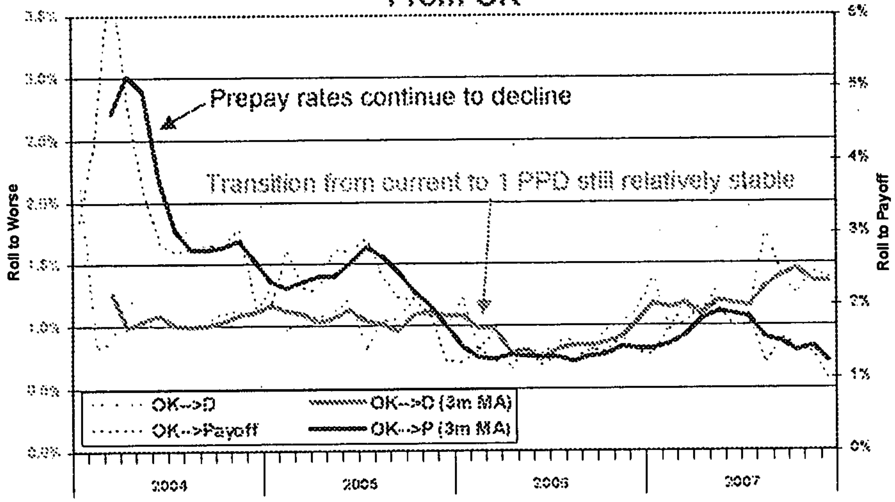
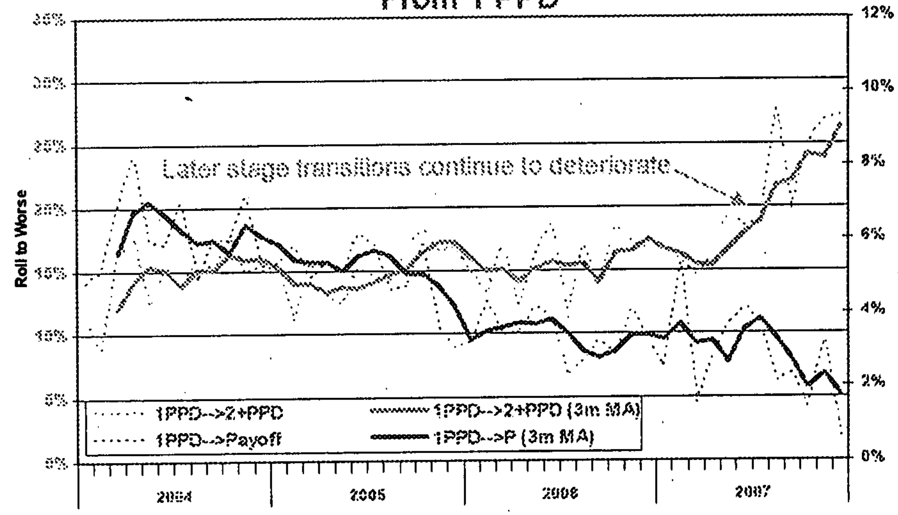
Loan Transition Time Series

5/1 Prime Hybrid ARM HFI Port – One Month Roll Rates

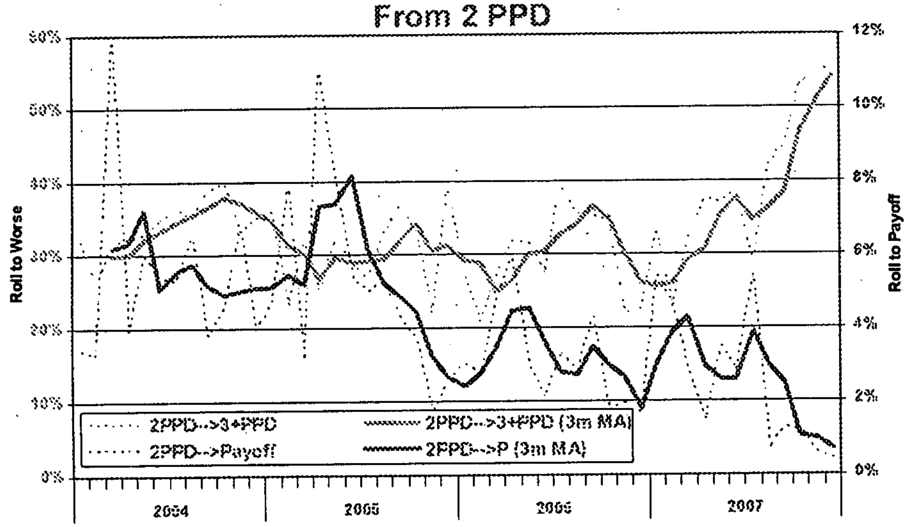
From OK



From 1 PPD



From 2 PPD



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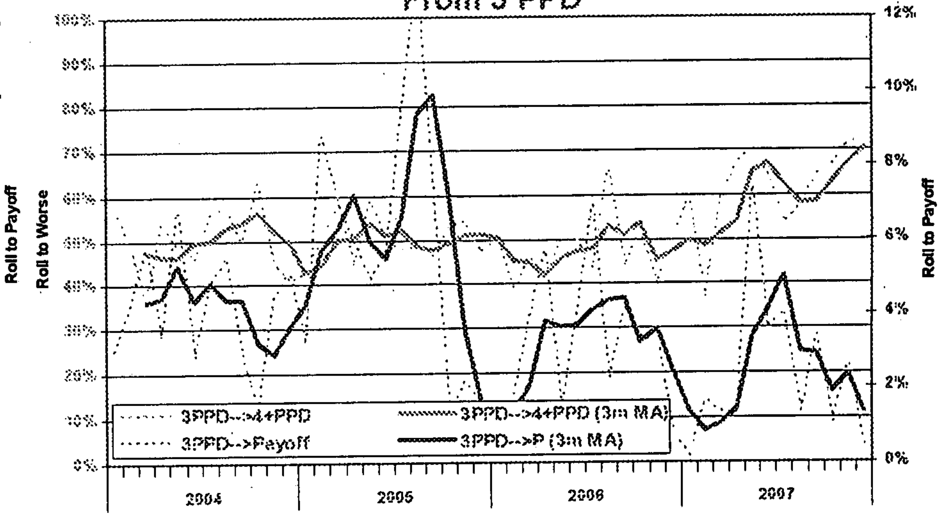
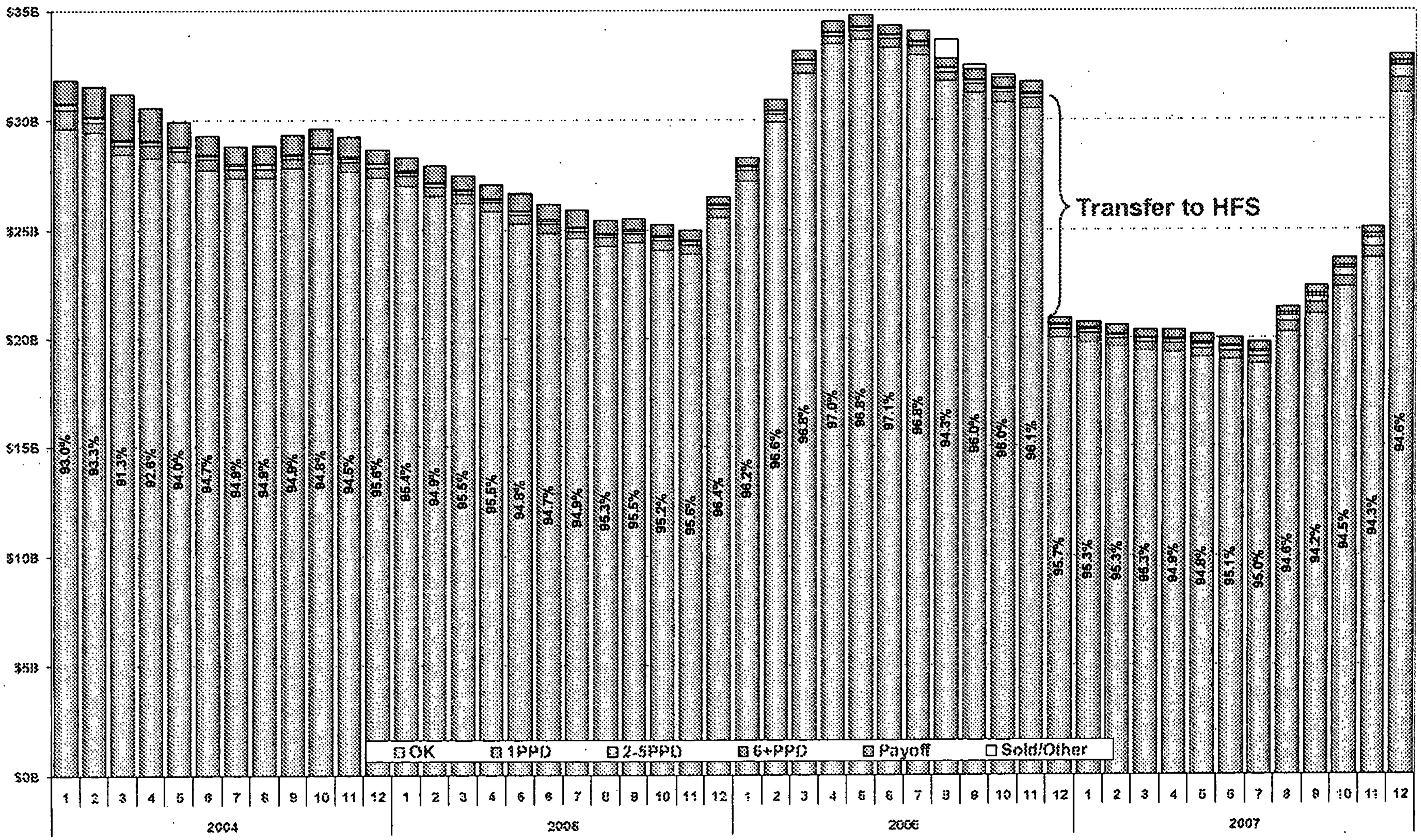


Loan Transition Time Series

WaMu

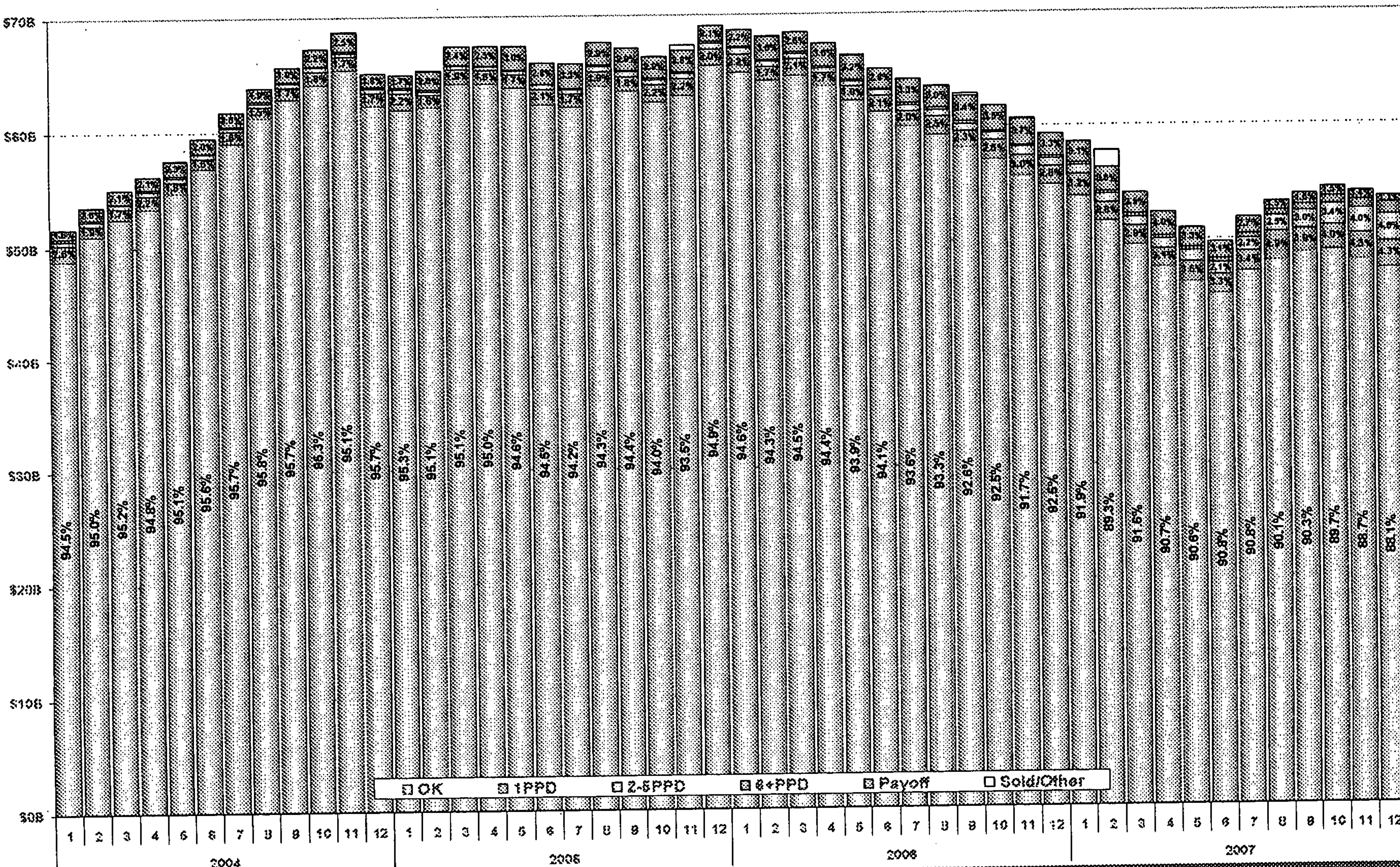
5/1 Prime Hybrid ARM HFI - Month Ahead Portfolio Status



Loan Transition Time Series

Option ARM HFI - Month Ahead Portfolio Status

WaMu



WaMu

ALL, NCOs & Provision

ALL Basics

- *ALL*. Allowance for Loan Losses (reserve) is an estimate of incurred losses.
- *NCOs*. Net charge-offs deplete the ALL balance.
- *Provision*. The ALL needs to be replenished (as a result of charge-offs) and may be increased (if incurred loss expectations are higher) through the provision.
- *Transfer*. ALL adjustment, typically as a result of loans moving from HFI to HFS (usually card).

NCO Considerations

- *Accuracy*. Measurement of NCOs must be accurate as these are the basic building blocks for any estimate or forecast of future NCOs, provisions, and ALL requirements.
- *Current Provision Forecast*. The primary change between the previous and the current provision forecast is an update of Home Loans' NCO forecast, which was revised from $2.9B to 4.9B.
- *Lags*. There are a number of lags built into the NCO process and forecast, including home price indexes, property valuations for NPL loans and transition rate assumptions.
- *Infrastructure*. As the volume of NCO activity has accelerated from a standstill to warp speeds, the infrastructure has proven to be inadequate.

WaMu

Provision Roll Forward

	2006	2007	2008	2008 Update
Beginning ALL (Reserve)	$ 1,695	$ 1,630	$ 2,580	$ 2,571
Net Charge-offs	(510)	(1,592)	(3,830)	**(5,200) to (6,200)**
Transfer (Card Securitization)	(370)	(579)	(125)	(100) to (200)
Provision	816	3,121	7,600	10,500 to 12,500
Ending ALL (Reserve)	$ 1,630	$ 2,580	$ 6,225	$6,500 to $9,000
Coverage Ratio	3.2	1.6	1.6	1.2 to 1.5
Coverage Ratio (Q4 NCO annualized)	3.0	0.9	1.5	1.0 to 1.5
Q4 NCO	(136)	(747)	(1,033)	

	Q1 2008	Q1 2008 Update
Beginning ALL (Reserve)	$ 2,580	$ 2,571
Net Charge-offs	(917)	**(1,200) to (1,400)**
Transfer (Card Securitization)	(35)	0 to 50
Provision	1,900	2,000 to 3,500
Ending ALL (Reserve)	$ 3,528	$3,200 to $4,500
Coverage Ratio	1.0	0.6 to 1.0

Change between the previous and the current provision forecast is an update of Home Loans' NCO forecast, which was revised from $2.9B to 4.9B

WaMu

Provision Volatility

We expect actual provisions and the provision outlook to remain volatile as a result of multiple factors, including:

- Environmental uncertainties
- NCO
  - Absolute levels
  - Process changes
- ALL
  - Recalibrations
  - Potential upward adjustment of cap on Qualitative
  - Reconciliation with Home Loans
  - Introduction of new approach
- Card securitization

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S&P Levels

- Widely used external benchmarking tool
- An important instrument internally, given our data and modeling limitations
- Generates a spectrum of cumulative loss forecasts associated with different rating levels
- Recent internal and external news indicate an acceleration of the timing and increase in the level of expected cumulative losses (i.e. we may be experiencing something worse than a BB event).

WaMu

S&P Levels Output

Portfolio	Vintage	Balance Oct '07[2]	S&P LEVELS 'B'		S&P Levels 'BB'	S&P Levels 'BBB'	S&P Levels 'A'
		($mm)	(%)	($mm)	($mm)	($mm)	($mm)
SubPrime Mortgage		**19,643**	**9.8%**	**1,916**	**2,538**	**3,395**	**4,187**
	2004 & Earlier	4,723	2.7%	128	211	335	460
	2005	4,762	6.7%	317	459	658	858
	2006 or 2007	10,158	14.5%	1,471	1,868	2,402	2870
Home Equity		**59,015**	**3.9%**	**2,281**	**3,416**	**4,867**	**5,998**
1st Lien		15,823	0.5%	85	134	201	271
	2004 & Earlier	7,119	0.2%	14	24	38	53
	2005	2,755	0.9%	25	35	49	64
	2006 or 2007	5,949	0.8%	46	75	114	153
2nd Lien		**43,192**	5.1%	**2,195**	**3,281**	**4,666**	**5,727**
	2004 & Earlier	10,458	1.2%	121	230	393	533
	2005	9,671	5.7%	554	808	1,127	1376
	2006 or 2007	23,064	6.6%	1,520	2,244	3,146	3817
Prime Mortgage		**109,946**	**2.2%**	**2,422**	**3,551**	**5,091**	**6,651**
Option ARM		54,893	3.5%	1,918	2,761	3,908	5,053
	2004 & Earlier	17,106	1.3%	229	355	544	740
	2005	13,226	3.5%	467	696	1,007	1317
	2006 or 2007	24,560	5.0%	1,222	1,710	2,358	2997
Other		55,053	0.9%	504	790	1,183	1,598
	2004 & Earlier	23,149	0.4%	81	140	229	329
	2005	8,131	1.0%	77	128	197	271
	2006 or 2007	23,773	1.5%	345	522	756	998
Home Loans & Home Equity		**188,604**	**3.5%**	**6,619**	**9,505**	**13,352**	**16,836**

Plan to update with Jan data

Actions Underway or to Consider

WaMu

- Temper Pervasive Themes
  - Customer Service
  - Efficiency
- Continue to implement aggressive Line Management
- Clarify Asset Strategy
- Establish and follow a Geographic Strategy
- Strengthen NCO Processes and Infrastructure
- Revamp ALL approach for residential mortgages
- Fortify Pricing Strategies

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Appendix

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Manufacturing Quality

supplement to section one (Background)

- Manufacturing Quality; Transaction elements
  - Basic transaction terms (recourse, guaranty, security)
  - Sourcing (retail, wholesale, correspondent, bulk)
  - Insurance (placement & availability of both loan and hazard)
  - Adverse selection potential
  - Equity (LTV, CLTV, lien position)
  - Collateral valuation method (appraisal, AVM, PIW)
  - Documentation (employment, income, assets)
  - Loan size
  - Loan purpose (purchase, rate refinance, cash-out refinance)
  - Property type (SFR, condo, 2-4, multifamily, office, hotel, ...)
  - Occupancy (owner, second, investor)
  - Maturity & amortization type (30 vs. 15 yr, IO, negative amortization)
  - Seasoning (age of the loan and delinquency history)
  - Product type (fixed vs. ARM, Neg Am vs. IO vs. Amortizing, ...)
  - Number of borrowers per loan
  - Utilization for "revolving" obligations
  - Call protection (prepayment penalties, yield maintenance)

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Credit Performance Outcomes

(in $ Millions)

SFR Prime	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Jan-08
Outstanding Portfolio Balance	$123,179	$101,562	$95,522	$90,593	$106,003	$112,614	$112,194
Total Delinquencies	$1,449	$1,661	$1,730	$2,164	$3,086	$4,703	$5,310
Total Delinquency Rate	1.18%	1.64%	1.81%	2.39%	2.86%	4.18%	4.73%
Non Performing Loans	$603	$667	$731	$1,038	$1,496	$2,358	$2,707
Non Performing Loan Rate	0.49%	0.66%	0.77%	1.15%	1.39%	2.09%	2.41%
Net Charge-offs	$15	$20	$35	$21	$52	$100	$97
Annualized Net Charge-off Rate	0.05%	0.07%	0.14%	0.09%	0.20%	0.36%	1.03%

Subprime Mortgage Channel	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Jan-08
Outstanding Portfolio Balance	$21,245	$20,700	$20,360	$20,457	$19,996	$18,617	$18,166
Total Delinquencies	$1,883	$2,172	$2,289	$2,680	$3,495	$3,963	$4,047
Total Delinquency Rate	8.86%	10.49%	11.24%	13.10%	17.48%	21.29%	22.28%
Non Performing Loans	$1,122	$1,282	$1,503	$1,707	$2,356	$2,721	$2,789
Non Performing Loan Rate	5.28%	6.19%	7.38%	8.34%	11.78%	14.61%	15.35%
Net Charge-offs	$47	$48	$40	$92	$145	$273	$132
Annualized Net Charge-off Rate	0.91%	0.92%	0.77%	1.79%	2.85%	5.73%	8.64%

Home Equity	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Jan-08
Outstanding Portfolio Balance	$52,842	$52,882	$53,374	$55,776	$59,120	$60,966	$61,146
Total Delinquencies	$462	$589	$634	$778	$1,154	$1,708	$1,898
Total Delinquency Rate	0.87%	1.11%	1.19%	1.40%	1.95%	2.80%	3.10%
Non Performing Loans	$161	$231	$297	$378	$533	$835	$978
Non Performing Loan Rate	0.30%	0.44%	0.56%	0.68%	0.90%	1.37%	1.60%
Net Charge-offs	$6	$11	$26	$52	$101	$244	$113
Annualized Net Charge-off Rate	0.04%	0.09%	0.20%	0.38%	0.70%	1.62%	2.22%

Home Loans SFR Prime includes SFR Prime, Custom and Builder portfolios
Subprime Mortgage Channel includes Purchased SMF, Long Beach Mortgage, HEL Subprime, and HEL Purchased portfolios
Home Equity includes HEL and HELOC portfolios; excludes Other Consumer portfolio

Confidential Treatment Requested by JPMC

WaMu

Credit Performance Outcomes

(in $ Millions)

Card Services	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Jan-08
Outstanding Portfolio Balance	$21,921	$23,518	$23,628	$24,987	$26,227	$27,239	$27,047
On Balance sheet Delinquencies	$206	$289	$244	$291	$299	$379	$369
On Balance sheet Rate	2.34%	2.66%	2.57%	2.93%	3.41%	4.29%	4.51%
Managed Delinquencies	$1,212	$1,234	$1,216	$1,277	$1,503	$1,762	$1,829
Managed Rate	5.53%	5.25%	5.15%	5.11%	5.73%	6.47%	6.76%
On Balance sheet Net Charge-offs	$27	$19	$30	$34	$36	$30	$40
On Balance sheet Net Charge-off Rate	1.19%	0.79%	1.13%	1.35%	1.57%	1.35%	5.46%
Managed Net Charge-offs	$311	$331	$367	$392	$413	$464	$197
Managed Annualized Net Charge-off Rate	5.71%	5.81%	6.21%	6.40%	6.38%	6.92%	8.70%

MFL/CRE	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Jan-08
Outstanding Portfolio Balance	$33,046	$36,684	$36,031	$35,999	$39,001	$41,126	$41,552
Total Delinquencies	$123	$169	$131	$190	$280	$233	$291
Total Delinquency Rate	0.37%	0.46%	0.36%	0.53%	0.72%	0.57%	0.70%
Non Performing Loans	$58	$71	$87	$101	$151	$168	$174
Non Performing Loan Rate	0.17%	0.19%	0.24%	0.28%	0.39%	0.41%	0.42%
Net Charge-offs	$0	$0	-$1	$2	$0	$5	$1
Annualized Net Charge-off Rate	0.00%	0.00%	-0.01%	0.02%	0.00%	0.05%	0.03%

Other Comm./Retail Small Bus.	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Jan-08
Outstanding Portfolio Balance	$2,004	$1,929	$1,984	$2,005	$2,030	$2,031	$2,104
Total Delinquencies	$62	$70	$80	$84	$77	$91	$92
Total Delinquency Rate	3.11%	3.63%	4.05%	4.19%	3.79%	4.48%	4.35%
Non Performing Loans	$43	$42	$52	$50	$40	$38	$38
Non Performing Loan Rate	2.15%	2.19%	2.64%	2.50%	1.95%	1.89%	1.81%
Net Charge-offs	$5	$7	$6	$12	$16	$28	$12
Annualized Net Charge-off Rate	1.06%	1.40%	1.26%	2.46%	3.10%	5.61%	6.77%

MFL/CRE includes MFL and CRE portfolios; excludes Other Commercial/Retail Small Business

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FACT SHEET 12 - Securitizations

WaMu could not execute any new securitizations after the secondary market disruption occurred in 2007. The bank had previously securitized nonconforming mortgage loans and credit card loans. Asset securitization had been an important source of funding, and the loss of access to this market had a negative impact on the bank's liquidity.

During 2006 and 2007, WaMu sold loans and retained servicing responsibilities as well as senior and subordinated interests from securitization transactions. WaMu received servicing fees equal to a percentage of the outstanding principal balance of mortgage loans and credit card loans being serviced. Generally, WaMu also received the right to cash flows remaining after the investors in the securitization trusts have received their contractual payments.

The allocated carrying values of mortgage loans securitized and sold during the years ended December 31, 2007 and 2006 were $82.58 billion and $110.08 billion, which included loans sold with recourse of $6 million and $959 million during the same periods. The allocated carrying values of credit card loans securitized and sold were $10.65 billion and $7.11 billion during the years ended December 31, 2007 and 2006.

WaMu realized pretax gains of $484 million and $1 billion on mortgage loan securitizations during 2007 and 2006. Pretax gains realized on credit card securitizations were $533 million and $279 million during 2007 and 2006.

WaMu did not issue any new nonconforming mortgage or credit card securitizations in 2008 because of continued market illiquidity, deterioration in the financial condition of the bank, and the poor performance of WaMu's outstanding securitizations.

The table below summarizes the size of outstanding mortgage securitizations and the performance of the underlying loans as of March 31, 2008*:

Type	Number	UPB	30 pd	60 pd	90 pd	Foreclosure	REO	Total Delinquency
Subprime	46	$28.9B	6.17%	4.01%	6.11%	12.93%	8.94%	38.16%
Prime/AltA	200	$98.6B	3.01%	1.22%	1.25%	2.25%	0.84%	8.57%

*Source: March 2008 Securitization Report to the Market Risk Committee. Non-Prime delinquencies based on OTS method. Prime/Alt-A delinquencies based on MBA method.

Total delinquencies on subprime mortgage loans were extremely high, at 38.16 percent. Total delinquencies on Prime/AltA securitized loans were 8.57 percent, more than twice the industry average of 4.21 percent.

As of March 2008, there were 22 WaMu credit card securitizations outstanding with a principal balance of approximately $16.9 billion. The annualized net charge-off rate on managed credit card balances (on-balance sheet plus securitized credit card loans) as of June 30, 2008 was 10.78 percent, compared to 6.40 percent a year earlier. Managed credit card balances greater than 30 days past due increased from 5.11 percent to 7.11 percent over the same period.

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Washington Mutual

March 17, 2008

Darrel W. Dochow
Regional Director, West Region
Office of Thrift Supervision
2001 Junipero Serra Boulevard, Suite 650
Daly City, CA 94014-1976

Dear Mr. Dochow:

On behalf of the Board of Directors of Washington Mutual Bank, this letter responds to your February 27, 2008 letter advising the Board of revisions to our supervisory ratings and requesting a Board Resolution. The Board understands and shares your concerns as they are outlined in your letter. The events in the credit markets over the last eight months have been truly extraordinary, have adversely affected Washington Mutual Bank in significant ways, and require extraordinary actions on our part to ensure the continued safety and soundness of the Bank.

While we have already taken a number of important steps to manage these risks, we also recognize the need for further steps as market conditions continue to deteriorate. As you know from our discussions last week, we are currently embarked on actions that we have every reason to believe will put Washington Mutual Bank in a position to withstand the current pressures on earnings, capital and liquidity as well as foreseeable continued market deterioration. As additional assurance of the Board and management's commitment to manage these risks, the Board has unanimously adopted a Board Resolution to take appropriate action as you have requested. A certified copy of that Board Resolution is enclosed.

The Board is actively involved with and monitoring the progress of management execution of these actions. We will also continue to keep you apprised of our progress and appreciate any assistance the Office of Thrift Supervision can provide as we drive these actions towards a successful conclusion.

Sincerely,

Kerry Killinger

Kerry Killinger, Chairman

OFFICIAL FILE COPY
OTS/WEST

Enclosure

Corporate Executive Offices
1301 Second Avenue
Seattle, WA 98101

WASHINGTON MUTUAL BANK
CERTIFICATE OF SECRETARY

I, William L. Lynch, Secretary of Washington Mutual Bank (the "Association"), a federal savings bank duly authorized and existing under the laws of the United States of America, hereby certify that, at a meeting duly called and held on March 17, 2008, the Board of Directors of the Association duly adopted the following resolutions:

RECITALS

A. The Board of Directors ("Board") of Washington Mutual Bank ("Association") received a letter from the Regional Director of the Office of Thrift Supervision ("OTS") dated February 27, 2008 ("Ratings Letter'), notifying the Board of the decision of the OTS to adjust the Association's composite rating, and ratings with respect to components of the composite rating, including Asset Quality, Earnings and Liquidity;

B. The Association's financial strength and safe and sound operation is of vital importance to the Association and its continuing success;

C. The Ratings Letter asks the Board to send to the OTS a duly certified Resolution of the Board committing to take appropriate action to ensure that weaknesses and concerns are promptly addressed;

D. At its meeting on Monday, March 17, 2008, Management presented to the Board an outline of initiatives to address the weaknesses that the Ratings Letter identified as to Asset Quality, Earnings and Liquidity.

NOW THEREFORE BE IT RESOLVED

1. The Board endorses undertaking those strategic initiatives to improve Asset Quality, Earnings and Liquidity; and further commits to take appropriate further actions as required to address those weaknesses and concerns raised in the Ratings Letter; and

2. The Board hereby authorizes and directs management to implement and report to the Board on the implementation of its initiatives to address the concerns raised by the Ratings Letter.

IN WITNESS WHEREOF, I have hereunto subscribed my name this 19th day of March, 2008.

William L. Lynch, Secretary

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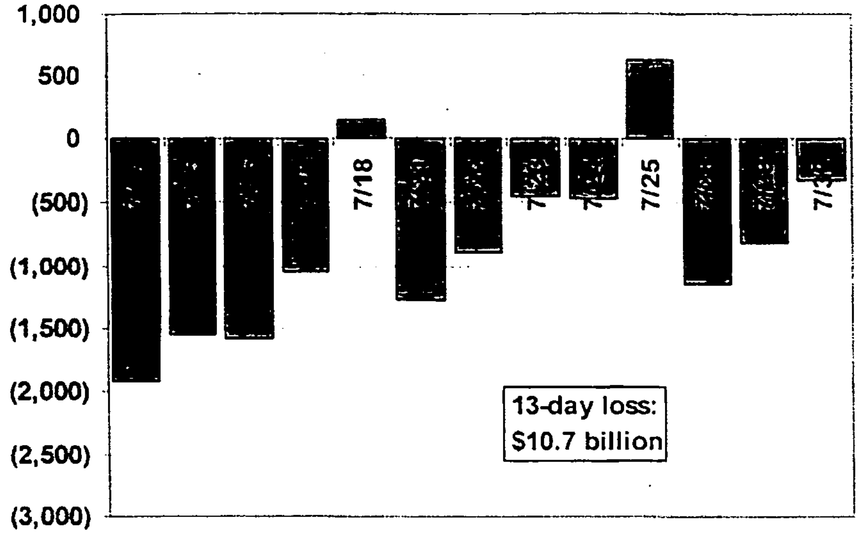
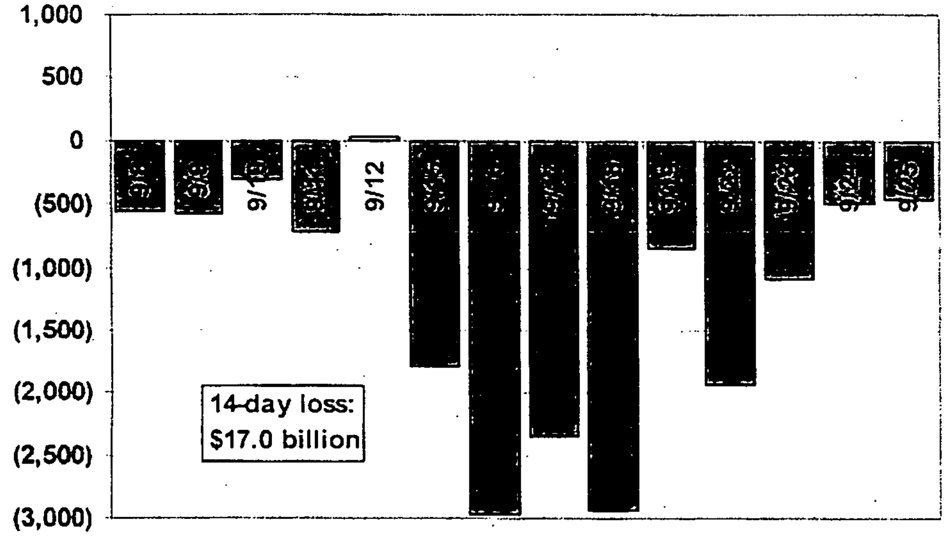
Daily Retail Deposit Change

$ Millions - Post IndyMac



Daily Retail Deposit Changes

$ Millions - Post MOU and Market Panic



WAMU BANK
SUPERVISORY TIMELINE
(2000 / 2001 / 2002 / 2003 / 2004 / 2005 / 2006 / 2007 / 2008)

01/05/00	Transmitted Report of Examination (ROE) for 09/20/99, WMBFA ratings 2/222223 as of 09/20/99, 2/222222 as of 08/24/98, and 2/222222 as of 06/02/97. Examination was conducted concurrently with the safety and soundness examinations of WMBFA's sister banks, WMB and WMBFSB and their holding company, WM Inc. Key issue identified – Interest Rate Risk has increased as measured by both the OTS and internal model, this risk worsened to the category of 'significant risk' and a '3' rating for sensitivity to market risk has been assigned accordingly.
01/14/00	Capital Distribution (February Dividend) – WMBFA not to exceed $275 million and WMB not to exceed $65 million.
	OTS no objection letter issued - Acquisition of Alta Residential Mortgage, Inc. and its wholly owned subsidiary, ARMT, Inc. through the merger of Aristar Financial Resources, Inc. with and into Alta; merger was effective on 02/01/00.
	Approved WM to establish a new subsidiary, WMFS Insurance Services of Nevada, Inc. 01/28/00 - recd copy of FDIC approval dated 01/26/00.
01/16/00	Washington Mutual Inc. reported record earnings for the fourth quarter and full year 2000, and the company's chief executive said the Seattle-based company is looking for acquisitions and markets to expand into in 2001.
04/13/00	Capital Distribution (May Dividend) – WMBFA not to exceed $575 million and WMB not to exceed $90 million.
04/19/00	Washington Mutual Inc. reported record first-quarter net income, boosted its dividend by a penny a share and said it will buy back as many as 55 million shares of stock. The Seattle-based savings bank and financial services company earned $458.5 million, or 83 cents a share, compared with year-ago first quarter earnings of $444.1 million or 76 cents a share.
05/11/00	WAMU's wholly owned subsidiary, Marion holdings, inc., to engage in new activities: a limited liability company (LLC Op Sub) and a registered Investment Company (the "RIC Op Sub"). The new activities will be conducted through two operating subsidiaries, a limited liability company and a registered investment company. The limited liability company will invest in first mortgage residential and commercial loans, mortgage-backed securities, or ownership interests in lower-tier subsidiaries that own such assets. Approved 06/02/00.
05/16/00	OTS began field visit to WMBFA on 04/24/00, objective of the visit was to assess the status of the corrective actions promised as a result of the examinations of WMBFA and its holding company, Washington Mutual Inc. Overall, OTS concluded that management has been responsive to the issues that were raised at the prior examination.
05/18/00	Information Technology Field Visit for 04/24/00. The scope and objectives of review focused on management's corrective actions related to the findings contained in the OTS IT Report of Examination dated September 7, 1999. Management's corrective efforts on the 1999 OTS IT examination findings progressed according to plan.
05/19/00	Special Compliance Examination field visit for 04/24/00, purpose was to determine progress made in addressing outstanding issues from the prior compliance examination, to determine what changes in structure and procedures have occurred since the prior examination, to gain an understanding of the current compliance structure, and to lay the groundwork for the full-scope compliance examination that will commence in the fourth quarter of this year.

07/12/00	Capital Distribution (August Dividend) – WMBFA not to exceed $350 million and WMB not to exceed $30 million.
07/19/00	Washington Mutual Inc. reported record second-quarter earnings and raised its dividend by a penny a share. The Seattle-based company, the nation's largest savings institution and one of its largest banking companies, earned $490.8 million, or 92 cents a share, up from $452.7 million or 78 cents a share a year ago. The median of analyst estimates was 83 to 84 cents a share.
08/03/00	WMB to establish an operating subsidiary, Washington Mutual Life Insurance Company (WMLICC), to engage in insurance activities. Approved 06/14/02.
08/04/00	OTS began field visit to WMBFA on 07/17/00, objectives of the visit was to continue OTS assessment of the status of the corrective actions promised as a result of the examinations of WMB FA and its holding company, Washington Mutual Inc. (WMI). Additionally, OTS planned on following up on discussions regarding interest rate risk policy changes that we had during the April 2000 visit. WM management has addressed or continued to address identified issues.
	Information Technology Field Visit for 07/17/00. The scope and objectives of review focused on management's corrective actions related to the findings contained in the OTS IT Report of Examination dated September 7, 1999; assessed the progress of corrective actions taken by management to address those issues disclosed in the OTS IT Report of Examination and the December 6, 1999, Examination Deficiencies and Recommendations supplemental document; and assessed the status of management's follow-up actions on two transactional web sites (eCharge and WM Financial). Overall, management's corrective efforts on the 1999 OTS IT examination findings are considered satisfactory.
08/25/00	Special Examination for 07/24/00. The purpose of this special examination was to continue gathering information about operations and the structure of the organization and to plan logistics for the upcoming compliance examination. One issue that was still outstanding from the prior special examination dealt with variations in the mortgage products available from the two origination channels.
10/06/00	Approved "November Dividend" - WMBFA not to exceed $500 million, WMBFSB not to exceed $7 million, WMB not to exceed $50 million.
10/10/00	WAMU, New American Capital, Inc., and WMBFA filed application to acquire and effect mergers with Bank United Corp. and its subsidiaries, BNKU Holdings, Inc. and Bank United. Approved 01/16/01.
10/17/00	Washington Mutual, Inc. (NYSE:WM) today announced third-quarter earnings of $452.5 million or 86 cents per diluted share, versus third-quarter 1999 earnings of $470.0 million or 83 cents per share. Earnings for the first nine months of 2000 were $1.40 billion or $2.60 per diluted share versus $1.37 billion or $2.37 per diluted share for the same period in 1999.
11/07/00	Information Technology Field Visit for 10/16/00. The scope and objectives of our review focused on preplanning for the IT examination starting November 27, 2000 and management's corrective actions related to the findings contained in the OTS IT Report of Examination dated September 7, 1999. Overall, management's corrective actions on the 1999 OTS IT examination findings are considered satisfactory. Management continue to make progress according to plan.
11/17/00	Recommendation to Close Preliminary Inquiry Involving Washington Mutual Bank. In November 1999, West Enforcement & Litigation opened a preliminary inquiry into matters related to a low document mortgage-lending program used by WAMU in Florida. Two concerns – 1) possible fraud in loan applications submitted by a series of loan brokers to WAMU under the low doc program; disposition – OTS was not able to proceed because the brokers who submitted the applications were neither independent contractors of WAMU nor had sufficient contacts with the institution to bring them

	within the category of persons participating in the conduct of WAMU's affairs. 2) West Appraiser Darryl Washington determined that a WAMU approved appraiser in Florida had submitted several flawed appraisals that went undetected in the low doc program, disposition – WAMU immediately removed the subject appraiser from approved list, and filed a compliant promptly against the appraiser with the FL BREA.
11/22/00	WMBFA filed notice that the institution intends to acquire five additional subsidiaries from PNC Bank, NA (PNC Mortgage Corp. of America, PNC Mortgage Partners Corp., PNC Mortgage Securities Corp., Fairway Drive Funding Corp., and PNC Mortgage Funding Corp.). OTS issued no objection letter dated 12/19/00.
11/29/00	Establish Three New Lower-Tier Subsidiaries In Connection With The Reorganization Of An Existing Subsidiary, FA California Aircraft Holding Corp.; New Subsidiaries: WM Aircraft Holdings, LLC; Sound Bay Leasing LLC; And Interim Series E LLC. Approved 12/19/00.
01/10/01	WM filed a CRA-related application on 10/10/00, it proposed to acquire Bank United Corp. OTS expressed no objection to the institution's request based on its CRA performance.
01/11/01	Capital Distribution (February Dividend) No Objection Letter – WMBFA intends to pay a cash dividend not to exceed $250 million and WMB intends to pay a dividend not to exceed $95 million, such dividends will be paid on or after 02/15/01.
01/16/01	Washington Mutual Announces Record Fourth-Quarter and Annual Earnings; Increased Cash Dividend.
01/18/01	Capital Distribution - Dividend on Series C and D preferred stock to be issued in connection w/bank united acquisition/tender offer -- $4.6 million.
	Nation's Largest Thrift, Washington Mutual, Selected by Fannie Mae as Delegated Underwriting and Servicing -- DUS – Lender.
01/22/01	Washington Mutual Received Regulatory Approval on Bank United Acquisition; Office of Thrift Supervision Approves Merger.
02/01/01	Washington Mutual Completed Acquisition of PNC Mortgage. On 11/22/00 HellerEhrman Attorneys notified OTS of WMBFA's intention to acquire certain subsidiaries from PNC Bank, NA. OTS issued no objection letter dated 12/19/00.
02/07/01	Washington Mutual Completed Bank United Tender Offer.
02/08/01	Bank United Shareholders Approved Merger with Washington Mutual.
02/09/01	Washington Mutual and Bank United Holding Companies Merged; Banking Subsidiaries Expected to Merge on Tuesday 02/13/01.
02/13/01	Washington Mutual Completed Merger with Bank United.
02/14/01	OTS issued No Objection Letter – WMBFA intends to pay a quarterly cash dividend not to exceed $4.6 million on its outstanding C and D preferred stock. Such dividend will be paid on or after March 30, 2001.
03/16/01	To issue up to $2 billion of sub debt notes over a period of approx 18 months. 8/30/02 - inst requesting six-month ext of time to issue sub debt as part of the bank's global note program; 10/23/02 - request granted until 4/12/03 to issue sub debt. 6/13/03 - request for waiver of certain provisions of OTS securities offering regulation; granted 7/9/03. 8/25/05 - recd ltr re: pricing supplements for WAMU global note program. 5/2/06 - recd copies of preliminary pricing supplements 4/26/06, term sheet, and pricing supplement 4/27/06 - each relating to $1 billion senior floating rate notes due 5/2/09. 8/1/08 - inst has determined that it is unlikely to issue sub debt to be included as supplemental capital under 12 CFR 563.81; application withdrawn.
	Capital Distribution - Cash dividend not to exceed $150 million; will be declared on 4/17/01 and paid on or after 5/15/01.
03/20/01	Transmitted Report of Examination (ROE) Information Technology for 11/27/00, WMBFA and

	WMBFSB. FDIC and State of Washington participated. Rating: Satisfactory (2) – Audit, Management, Acquisition and Management, and Support and Delivery.
03/31/01	Deloitte & Touche Independent Accountant's Report on WMBFSB. No significant issues.
04/02/01	Washington Mutual to Acquire Fleet Mortgage.
04/05/01	Transmitted Report of Examination (ROE) for 11/27/00, WMBFA ratings 2/222223 as of 11/27/00, 2/222223 as of 09/20/99, and 2/222222 as of 08/24/98. Key issue identified – Interest Rate Risk remained 'Significant'.
04/11/01	No Objection Letter – WMBFA cash dividend not to exceed $150 million, will be declared on 04/17/01 and paid on or after 05/15/01.
04/12/01	OTS issued no objection letter in responds to notice filed by Jacob A. Scholl, Esquire on behalf of WMBFA advising its intent to issue up to $2 billion of subordinated notes over a period of approximately eighteen months as part of a global note program that will include offerings of certain registered and exempt debt instruments by WMBFA and WMB.
04/17/01	Washington Mutual announced record quarterly earnings of $641.0 million or $1.15 per diluted share, up 40 percent from first-quarter 2000 earnings of $458.5 million or 83 cents per diluted share. Earnings for the first quarter of 2001 include partial quarter results from the former mortgage operations of The PNC Financial Services Group, Inc. and Bank United Corp., which were acquired this year by Washington Mutual on Jan. 31 and Feb. 9, respectively.
04/20/01	WM announced that it proposes to sell up to $1 billion of Trust Preferred Income Equity Redeemable securities to qualified institutional buyers pursuant to Rule 144A.
04/26/01	WM announced the company has priced $1 billion of Trust Preferred Income Equity Redeemable Securities (PIERS), and provided the underwriter with a 30-day option to purchase up to an additional $150,000,000. WM announced the company has established a US $15,000,000,000 Global Bank Note Program (the "Program") for its two main banking subsidiaries, Washington Mutual Bank, FA (WMBFA) and Washington Mutual Bank (WMB).
05/16/01	OTS approved Fleet Mortgage Reinsurance Company acquisition. WMBFA intends to acquire four subsidiaries under a stock purchase agreement with Fleet National Bank and FleetBoston Financial Corporation. The subsidiaries to be acquired are Fleet Mortgage Corp., Fleet Securities Corp., Fleet Mortgage Insurance Agency Corp., and Norstar Mortgage Corp.
05/18/01	Capital Distribution - Qtrly dividend not to exceed $4.2 million to be paid on or after June 29, 2001.
05/24/01	WM Director's Report April 2001. Topics – WMI key highlights, management comment, financial highlights and trend analysis. WMBFA and WMB subsidiary highlights.
	OTS issued no objection letter to WM 04/30/01 letter notifying OTS of the intent of WMBFA to acquire Fleet Mortgage Corporation and its subsidiaries expected to close on 06/01/01.
05/31/01	WM provided written response to the 11/27/00 Safety and Soundness Reports of Examination of WMBFA, WMBFSB, and WMB. Examinations were conducted concurrently by OTS, FDIC, and State of Washington, Department of Financial Institutions.
06/01/01	WM announced the company has completed its acquisition of Fleet Mortgage Corp., a unit of FleetBoston Financial Corp. (NYSE:FBF).
06/15/01	Capital Distribution ("August dividend") - $675 million. No objection letter issued on 07/12/01.
06/25/01	WM announced a definitive agreement to merge with Dime Bancorp, Inc. (NYSE: DME - news) in a transaction currently valued at $5.2 billion in stock and cash.
07/17/01	WM announced record quarterly earnings of $798.2 million for the second quarter of 2001, up sharply

	from second-quarter 2000 earnings of $490.8 million.
07/31/01	ROE Regular Compliance for 10/30/00. Compliance Rating 3 as of 10/30/00, 2 as of 07/20/98 and 2 as of 04/29/96. CRA Rating Outstanding as of 10/30/00, 07/20/98 and as of 04/29/96.
08/17/01	Capital Distribution - Proposed cash dividend: $4.2 million on its outstanding series c and series d preferred stock to be paid in September 2001.
	Report of Compliance Examination for 10/30/00. Compliance Rating 3 as of 10/30/00, 2 – as of 07/20/98, 2 – as of 04/29/96. CRA rating - Outstanding as of 10/30/00, 07/20/98 and 04/29/96. Key recommendation – A plan for implementing a Broad-approved centralized corporate compliance oversight program.
08/27/01	WMBFA to pay quarterly cash dividend not to exceed $4.2 million on its outstanding Series C and D preferred stock, will be paid in September 2001.
09/05/01	Acquisition Of Dime Bancorp, Inc. by Washington Mutual, Inc. and The Merger Of The Dime Savings Bank Of New York, FSB, into Washington Mutual Bank, FA. Comment period extended to 10/31/01. At request of Acorn, NY, in light of the disruptions caused by the Sept. 11 terrorist attack. Comments received 10/01/01 from CRC and fwd. to WAMU for response by 10/31; response recd on 10/31/01; 11/08/01 - processing suspended pending resolution of the protest issues; a formal meeting is scheduled for 11/15/01, 01/04/02 - acquisition of Dime Bancorp, Inc. by Washington Mutual, Inc. 01/07/02 - Merger of the Dime Savings Bank Of New York, Fsb, Into Washington Mutual Bank, FA.
09/06/01	Washington Mutual Home Loans and Insurance Services Group announced today it will offer a new portfolio product, the 5/1 CMT Interest Only loan.
09/14/01	Capital Distributions - November dividend $2 billion.
10/16/01	WM announced record third-quarter earnings of $832.3 million or 94 cents per diluted share. Earnings for third-quarter 2000 were $452.5 million or 57 cents per diluted share.
10/19/01	OTS WM Home Loans and Insurance Services Group: Operations and Risk Management – Pre-qualification and application date proposal. Discussed with OTS current/future control environment, proposed pre-qualification program, application date definition, and next steps.
	OTS five week field visit commenced 09/17/01, objectives were 1) to meet with senior management of various operational groups regarding current structure and status of their departments, 2) to review the status of corrective actions in response to exceptions and recommendation made at the prior examination, and 3) to prepare and present to management the pre-examination package for the upcoming full scope examination in February 2002.
10/29/01	WM Response to October 30, 2000 Compliance ROE. Key issues – Corporate Compliance Program, Fair Lending Program, Flood Disaster Protection Act, Late Payment Fees, Home Mortgage Disclosure Act, Residual Income, Minimum Loan Amounts, OPTIS Prequalification Features, Customer Referrals, Comparative File Reviews, Right of Rescission, ARM Notices, and Customer Complaints.
11/06/01	WM Compliance Update. Objective – To provide an overview of the Home Loans Group's commitment to fair lending in under-served communities.
11/08/01	New Activity - To Establish "WMHLI Transfer Interim LP" As A Subsidiary.

	OTS performed a field visit at WMBFA during 09/17/01. Accomplished objectives were as follows -
	• Met with senior management of the various operational groups for presentations regarding the current structure and status of their departments. These meetings were significant principally because of the integration of Bank United and PNC subsequent to the conclusion of our 2000 examination. • Reviewed the status of corrective actions in response to exceptions and recommendations made at the prior examination. • Prepared and presented to management the pre-examination package for the upcoming full scope examination in February 2002.
11/16/01	Capital Distribution - $4.2 Million Dividend On Series C and D Preferred Stock.
	Acq/Merger Bif Acq - Washington Mutual Bank, FA Sale Of Its Five Branch Offices located in Midland and Stanton, TX, to Community National Bank. Approved 01/17/02.
12/06/01	OTS Update – WM Home Loans & Insurance Services Group. Topics – Acquisition Overview, Loan Servicing (WM Platform Assessment, Loan Servicing & Consumer Direct Business Integration Plan), and Operations (Bank United & PNC Mortgage, Fleet, Optis, and North American Mortgage).
12/11/01	WM signed a definitive agreement to acquire for cash the operating assets of HomeSide Lending, Inc., the U.S. mortgage unit of the National Australia Bank Limited.
12/13/01	Capital Distribution - Proposed Cash Dividend: $1,200.
12/19/01	Interagency Report Of Examination of Vital Processing Services LLC issued. Federal Reserve Board, FDIC and OCC assisted.
12/21/01	WM to issue up to $1.5 billion in sub debt to be included in WAMU's capital; sole purchaser of the debentures was Washington Mutual Inc. 03/24/03 - Inst requests that the offering period be extended until 04/22/04 and it be permitted to issue sub debt to new American Capital, Inc., as well as to Washington Mutual, Inc. 04/09/03 - request granted. Approved 04/22/02.
	WM announced receipt from the Office of Thrift Supervision (OTS) of approval of the company's acquisition of Dime Bancorp Inc. (NYSE:DME) through the merger of Dime Bancorp with and into Washington Mutual. The merger is scheduled to close on Jan. 4, 2002.
01/07/02	Washington Mutual Completed Acquisition of Dime Bancorp.
01/08/02	WM to acquire a new operating subsidiary, Stockton plaza, inc., in connection with the acquisition of certain assets of HomeSide lending, Inc. OTS issued no objection letter dated 02/05/02.
01/15/02	Washington Mutual Caps Most Profitable Year with Record Quarterly Earnings; Board Increases Cash Dividend.
01/18/02	Quarterly cash dividend not to exceed $4.2 million on its outstanding Series C and D preferred stock.
01/23/02	WM Quarterly Regulatory Meeting. Topics – Strategic Overview, Loan Serving Update, Credit Update, 2002 Business Plan, Acquisition and Integration Update (Fleet Mortgage, Dime Bancorp, Midland Region Divestiture, and HomeSide Lending), and Compliance Update.
	WM's OTS Qtrly Progress Report – Home Mortgage Disclosure Act reengineering project and progress toward implementing a corporate wide compliance program and fair lending program. Corporate Compliance Department ability to complete all targeted tasks was impacted by repercussions of 9/11 tragedy, Dime acquisition, and personnel extensive turnover.
01/24/02	OTS approved establishment of the new operation subsidiary, WMHLI Transfer Interim LP under

	WMBFA for the sole purpose of facilitating the consolidation of assets of WM Home Loans, Inc. with and into WMBFA.
01/30/02	OTS performed a field visit at WMBFA and WMBFSB during 09/17/01 through 12/14/01. Scope and objectives were focused on management's corrective actions related to the findings contained in the OTS IT ROE dated November 27, 2000 and obtained an update on IT activities to prepare for the 2002 IT examination. Overall management's corrective actions on the 2000 OTS IT examination findings were considered satisfactory. Key issue - The inaccurate transfer of data between service providers after the PNC conversion resulted in unwarranted delinquency notices for unpaid property taxes being issued to approximately 55,000 borrowers. Inadequate vendor oversight by Washington Mutual management and inaccurate data from service providers caused the tax reporting problems. Management has taken appropriate steps to resolve the issue.
02/05/02	Corporate Technology Briefing Book to OTS. Current year business plan, description of lending business philosophy, new businesses entered, significant initiatives and projects, current status of regulatory issues, current budget and operating performance, and listing of all policies and procedures.
02/06/02	Compliance Field Visit. OTS performed a field visit at WMBFSB during 11/05/01; WM has not established a compliance management program and a fair lending program appropriate to its size complexity, and activities.
03/01/02	Washington Mutual Completed Acquisition of HomeSide Lending
03/22/02	Special Compliance Examination. OTS performed compliance field visit for WMB from 02/25/02 through 03/22/02. Reviewed progress in the implementation process of the Corporate Compliance Program as required in the Compliance Report of Examination dated October 30, 2000. OTS was not able to draw a conclusion as to the quality of the programs being developed for Compliance and Fair Lending in response to the OTS request. OTS was able to conclude the implementation process will take a longer period than management anticipated and that there will continue to be compliance weaknesses inherent with a decentralized approach.
04/01/02	CRA Performance Evaluation for 10/30/00. WMB FSB, Lending Test – Outstanding, Investment Test – High Satisfactory, Service Test – Highly Satisfactory, and WMB FA Lending Test – Outstanding, Investment Test – High Satisfactory, Service Test – Outstanding.
04/09/02	Special Compliance Examination. OTS reviewed the progress in the implementation process of the Corporate Compliance Program as required in the Compliance Report of Examination dated October 30, 2000. Field visit performed from 02/25/02 through 03/22/02.
04/16/02	Washington Mutual Announced Record Quarterly Earnings; Board of Directors Increased Cash Dividend.
	WM Compliance and Fair Lending Programs Update provided to OTS. Copies of program statements, executive summary, actions take to –date and status reports with timelines.
04/18/02	WM Quarterly Regulatory Meeting. Topics – Strategic Overview, Market Risk Strategy, Technology Solutions Strategy, Loan Serving Update, Credit Update, Acquisition and Integration Update, and Credit Risk Update.
05/17/02	Capital Distribution not to exceed $4,200,000 on preferred stock Series C and D (June 2002 dividend).
5/24/02	OTS approved the establishment by WMBFA of an operating subsidiary (Washington Mutual Life

	Insurance Company) that would be a California insurance company acting as a reinsurer for credit life and mortgage.
06/06/02	WM to issue capital distribution of $125 million in sub debt, that were originally issued by the dime savings Bank of New York, FSB.
06/14/02	Capital Distribution - payment of $1.4 billion cash dividend (August cash dividend) on the institution's outstanding common stock.
06/19/02	WM Director's Report May 2002. Topics – WMI key highlights, management comment, financial highlights and trend analysis. WMBFA and WMB subsidiary highlights.
07/16/02	Washington Mutual Announced Record Quarterly Earnings; Board of Directors Increased Cash Dividend.
08/07/02	Transmitted Report of Examination (ROE) Information Technology for 02/25/02. Federal Deposit Insurance Corporation (FDIC) and the State of Washington participated. Satisfactory Rating – Audit; Management; Acquisition and Development; and Support and Delivery.
08/08/02	Transmitted Report of Examination (ROE) for 02/25/02, WMBFA ratings 2/223223. WMBFSB ratings 2/232122. HC Rating S as of 02/25/02, S as of 11/27/00 and S as of 09/20/99. Federal Deposit Insurance Corporation (FDIC) and the Department of Financial Institutions, State of Washington (DFI) participated. WMBFA Key deficiencies and requested corrective actions included: 1) WM growth created significant challenges to management and resulted in substantial increases in a variety of risks; 2) significant number of customer errors and led to a very high level of clearing and suspense items; and 3) lack of implementation of a risk management function for the MSA commensurate with its enhanced size and complexity. WMBFSB Key deficiency was continued deterioration in asset quality; problem asset categories had worsened and asset quality was considered less than satisfactory.
08/12/02	To acquire WM mortgage Reinsurance Company and merge it with WMBFA's PMI reinsurance subsidiary, home loan reinsurance company (formerly Fleet Mortgage Reinsurance Company). Approved 09/30/02.
08/16/02	WAMU capital distribution in an amount not to exceed $4,200,000 September dividend.
08/27/02	OTS WM Risk Management & Operational Update. Topics covered – Compliance Overview; Servicing and Product Operations; Capital Markets/Risk Management; Credit Card Proposal; and WMBFSB 2Q Earnings/Portfolio Changes.
08/29/02	HomeSide acquisition -- 2 op. Subs: Sr investment and HS lending. 10/10/02 - filed an amendment -to establish HomeSide trust as an interim measure to facilitate transfer of assets/ liabilities of SR investment, Inc. And HomeSide Lending, Inc. to WMBFA; 10/23/02 - No Objection.
09/05/02	A Delaware single-member limited liability company "APB LLC Op Sub"; 10/3/02 - recd copy of FDIC's approval letter dated 10/2/02. Washington limited liability company - "APB Development LLC Op Sub"; 10/3/02 - recd copy of FDIC's approval letter dated 10/2/02. Approved 10/08/02.
09/11/02	Information Technology Field Visit Memo. Field visit performed at WMBFA from 07/15/02 through 08/23/02. Objective of review was to review the status of the North American Mortgage Company and HomeSide integration project. Overall, project management and control reports for the aforementioned was considered satisfactory.
09/12/02	Targeted Compliance Examination. Primary purpose of the examination was to review progress management has made in implementing a Corporate Compliance Program, as required in the

	Compliance Report of Examination dated October 30, 2000, and reinforced in the OTS letter of February 6, 2002, to the Board
09/12/02	Special Compliance Examination. Primary purpose of the field visit was to establish the scope of the upcoming, targeted compliance examination.
09/13/02	Capital Distribution - quarterly cash dividend for the 4th qtr of $1.5 billion.
09/24/02	WM Director's Report August 2002. Topics – WMI key highlights, management comment, financial highlights and trend analysis. WMBFA and WMB subsidiary highlights.
10/01/02	Washington Mutual Completed Acquisition of Remaining Assets of HomeSide Lending, Inc.
10/08/02	OTS approved WMBFA established two wholly owned operating subsidiaries, Second and Union LLC .
10/15/02	Washington Mutual Announced Strong Third Quarter Earnings; Company Continues Steady Growth; Board of Directors Increases Cash Dividend.
10/17/02	WM Quarterly Regulatory Meeting. Topics – Strategic Overview, Banking and Financial Services Review, Loan Serving, Compliance Update, Market Risk, Credit Update, and 3Q02 Financial Performance.
11/15/02	Capital Distribution - cash dividend not to exceed $4.2 million on its outstanding, Series C and D preferred stock to be paid on December 2002.
12/20/02	Capital Distribution - 1st qtr dividend not to exceed $1.5 billion.
12/27/02	WM Compliance Improvement and Fair Lending Program Status Reports. WM call centers issues continued, delinquency performance acceptable, unit cost increased, reconciliations over 90 days within tolerance levels, and taxes paid prior to delinquency date were at 99.7%.
	WM Home Loans & Insurance Services Group OTS Executive Briefing. Key Issues – Longer hold time and abandonment rates in call centers, Acceptable delinquency versus all industry benchmarks, Unit cost increased as a result of several one time charges, Reconciliations over 90 days within WM's tolerance and risk levels, and Taxes paid prior to delinquency date were at 99.7%.
12/31/02	OTS West Region WAMU Risk Assessment - Overall Corporate Risk somewhere between moderate and moderately high; WMBFA risk – moderate; WMBFSB – moderate; HC – moderately high. Strategic risk – moderate; reputation risk – moderately high; credit risk – moderately low; market/IRR risk – moderately high; liquidity risk – moderately low; operational risk – moderately high; and compliance risk – moderately high.
01/14/03	Transmitted Report of Examination (ROE) for 11/12/02. OTS performed a targeted compliance examination of Washington Mutual Bank, FA and Washington Mutual Bank, FSB (Washington Mutual) from November 12, 2002, through December 19, 2002, in Seattle, WA. A primary objective of the field visit was to review progress management has made in implementing a Corporate Compliance Program, as required in the Compliance Report of Examination, dated October 30, 2000, and reinforced in the OTS letter of February 6, 2002, to the Board. OTS found the institution has made satisfactory progress in complying with the February 6, 2002, requests of OTS and has established a process for the continuing implementation of a Regulatory Compliance and Fair Lending Program (compliance program) to ensure compliance with all laws, rules, and regulations applicable to its business..
01/23/03	Washington Mutual's record quarterly EPS driven by record loan volume, strong account and deposit growth; Board of Directors increases cash dividend. Earnings for 2002 were a record $3.90 billion, or $4.05 per diluted share versus $3.11 billion, or $3.59 per diluted share in 2001.
01/23/03	Quarterly Regulators Meeting – topics covered: Strategic Overview, 4th Quarter Financial Update, 2003 Financial Plan, Credit Update, Corporate Governance, Compliance Scorecard, and Enterprise Risk

	Management.
02/05/03	WAMU 01/13/03 extended field visit memo issued. All issues from the prior examination have been satisfactorily addressed.
03/17/03	Washington Mutual Bank, OTS approved capital distribution not to exceed $1,700,000,000 (2ND QTR 2003) on 04/08/03.
04/15/03	Washington Mutual, Inc. announced record earnings of $1 billion, or $1.07 per diluted share, for the quarter ended March 31, 2003, up 8 percent on a per share basis from $956 million, or 99 cents per diluted share for the same period a year ago.
04/17/03	Quarterly Regulators Meeting – Topics covered: Strategic Overview, 1st Quarter Financial Update, Credit Risk Reports, Technology Solutions Group Update, Customer Service/Loan Servicing Update, Compliance Progress Report, and Enterprise Risk Management Report.
05/29/03	WMBFA filed an application for issuance of subordinate debt securities of up $5.0 billion over a period of approximately twenty-four months. WMBFA's application included a request that OTS waive certain regulatory requirements.
06/02/03	WAMU to issue sub debt up to $5 billion approved on 07/15/03.
06/11/203	Notice filed by Washington Mutual Bank, FA advising that it intends to acquire Washington Mutual Asset Securitization Corp. from its sister bank, Washington Mutual Bank.
06/17/03	Capital distribution of $2,000,000,000 (3rd qtr dividend).
06/27/03	Formal investigation is initiated into the apparent sale of non-public customer information to unaffiliated third parties by at least four, perhaps more, employees of the thrift. The investigation will seek to determine if more employees, in other locations, were involved. Investigation continues as of 08/2004. The formal investigation established the nature and extent of violations and appropriate enforcement actions have been taken against the culpable institution-affiliated parties involved. The investigation was authorized to be closed 04/18/08 (Action Canceled/Terminated).
07/09/03	OTS granted a wavier on Washington Mutual Bank, FA Global Note Program of certain provisions of the OTS Securities Offering Regulation.
07/11/03	Washington Mutual responded to findings relating to WM Mortgage Reinsurance Co.'s non-compliance with the condition of approval issued by OTS on May 16, 2001 for WMBFA's acquisition of Fleet Mortgage Reinsurance Company, Inc. OTS required action: 1) WM Mortgage Reinsurance Company is to immediately cease engagement in the unapproved activity; 2) Quantify the extent of the noncompliant activity, including dollar amount, and an assessment of the risk to WMBFA; 3) provide management's plan to 'undo' the reinsurance of PMI that is not permissible and the status of those plans; and 4) provide management plans to ensure compliance with the approval conditions in the future.
07/15/03	Washington Mutual, Inc. announced record earnings of $1.02 billion, or $1.10 per diluted share, for the quarter ended June 30, 2003, up 9 percent on a per share basis from $990 million, or $1.01 per diluted share for the same period a year ago.
07/15/03	WAMU provided an update to OTS on the actions that management has accomplished and continues to champion in strengthening its Regulatory and Fair Lending Compliance Management Programs at WMBFA and WMBFSB.
07/16/03	OTS approved 05/29/03 WMBFA's application, including waivers noted.
07/17/03	OTS approved WMBFA requested a waiver of Item 15 of Form 1344 relating to Issuance of subordinated debt securities by Washington Mutual Bank, FA approved by OTS on 07/16/03.
08/18/03	Capital Distribution: Not to exceed $4.2 million on its outstanding Series C and D preferred stock.
08/22/03	Transmitted Report of Examination (ROE) for 03/17/03, ratings 2/222223. Federal Deposit Insurance

	Corporation (FDIC) and the Department of Financial Institutions, State of Washington (DFI) participated. Key deficiencies and requested corrective actions included: (1) Continue to build infrastructure – data, systems, metrics, reporting, staff, organizational structure, and processes – to foster strong risk management structure and culture. Be selective in acquisitions given the potentially severe impact a major acquisition could have on already overtaxed units; (2) Focus extra attention on HLIS activities – especially single-family residential mortgage underwriting, correspondent and wholesale channel management, pipeline and warehouse management, recourse administration, and quality assurance; (3) Continue to dedicate resources to building and strengthening Enterprise Risk Management and Corporate Credit Risk Management – these functions should conduct intensive and frequent reviews of higher risk areas of concern and ensure enterprise-wide risk management standards are in place; and (4) Continue execution of ongoing compliance and risk management initiatives.
08/22/03	Transmitted Regular IT Examination for 03/17/03. Federal Deposit Insurance Corporation (FDIC) and the State of Washington participated. Satisfactory Rating – Audit; Management; Acquisition and Development; and Support and Delivery.
08/26/03	Washington Mutual, the nation's leading retailer of consumer financial services, opened a record-setting 49 retail banking de novo stores in August.
09/19/03	WAMU notified OTS on 3rd qtr anticipated earnings to be between $900 million and $1 billion. The institution has lots of people working on improvements in internal controls over mortgage pipeline and warehouse. Additionally, there is significant risk in the loan documentation at Long Beach Mortgage.
09/22/03	Capital Distribution: Not to exceed $1,500,000,000 4th qtr dividend.
09/25/03	WMBFA and New American Capital Inc., WMBFA holding company requested approval of the acquisition of Washington Mutual Bank FSB through a merger of an interim federal savings association subsidiary (WM 2003 Interim FSB) of WMBFA.
10/03/03	OTS discussed with WAMU in more depth the negative gain on sale of loans to be reported for Q3 2003, including the extent of the loss and the market and operational weaknesses contributing to the loss. Additionally, discussed in more depth WAMU's recent decision to cease securitization activity at Long Beach Mortgage Company (LBMC).
10/08/03	During the first nine months of 2003, the West Region received a total of 2,232 written complaints concerning WAMU. Majority of complaints were in the loan servicing area regarding misapplied loan payments; nonpayment of taxes or insurance from a customer's escrow account; payoff related problems; amounts of escrow collected and escrow accounting related concerns; and foreclosure notices being incorrectly received by customers.
10/08/03	Washington Mutual's (WM) Multi-Family Lending Continues Expansion Eastward. WM will open three new Multi-Family Lending offices by the end of 2003 in Boston, Miami and Washington DC.
10/21/03	Washington Mutual, Inc. announced earnings of $1.03 billion, or $1.12 per diluted share, for the quarter ended Sept. 30, 2003, up 10 percent on a per share basis from $981 million, or $1.02 per diluted share for the same period a year ago.
10/23/03	Quarterly Regulators Meeting – topics covered: Strategic Overview, Retail Consumer Strategy, Long Beach Mortgage Update, 3rd Quarter Financial Review, and Credit Update.
11/03/03	09/03 WAMU Regulatory Performance Objectives Status (WAMU Report)
	1) Improve SFR underwriting and oversight of correspondent & wholesale lending channels – Capability and resources exist; however progress has been slowed or delayed. 2) Improve pipeline and warehouse risk management practices - Capability and resources exist; however progress has been slowed or delayed. 3) Improve market risk management practices – Satisfactory progress toward resolution

	in a reasonable timeframe. 4) Continue to improve the Compliance & Fair Lending Programs - Satisfactory progress toward resolution in a reasonable timeframe. 5) Improve Long Beach Mortgage Securitization Practices – High probability that current target date will not be met; significant concern may exist; or negative events may have occurred due to lack of reduction.
11/7/03	The OTS approved an H(e)1-S application, whereby WMBFA will acquire WMBfsb. Following the acquisition, WMBFA will contribute approximately $37 billion of investment securities to WMBfsb. The corporate reorganization is being done primarily for tax savings within the Washington Mutual organization. It was anticipated that this transaction would be consummated in the first quarter of 2004.
11/13/03	Washington Mutual, Inc. (NYSE:WM) filed today its Quarterly Report on Form 10-Q with the Securities and Exchange Commission, which included the correction of an error in its accounting for certain components of Bank Owned Life Insurance (BOLI). The adjustment in accounting treatment for BOLI is not expected to have a material effect on earnings in the fourth quarter of 2003 or future periods, according to the company.
11/14/03	Capital distribution: Quarterly cash dividend of $4.2 million on its outstanding Series C and D preferred stock to be paid in December 2003.
12/19/03	Capital distribution: 1st qtr dividend not to exceed $425,000,000 approved.
12/23/03	Notice of Acquisition of Subsidiary – Washington Mutual Bank, FA (the "Association"), Stockton, California, plans to acquire an additional operating subsidiary, Aristar Management, Inc. on or after January 8, 2004.
12/9/03	OTS met with WAMU personnel to discuss findings of the recently completed field visit that commenced on 10/14/03.
12/29/03	Letter from OTS to WAMU reminding them of their obligations to provide information to the examination staff.
1/22/04	Quarterly Regulator's Meeting: discussed (1) findings from the 4th quarter 2003 field visit; (2) reorganization of the "risk management" function; (3) an update on compliance with Sarbanes Oxley; (4) review of financial statements for the 4th quarter of 2003; and, (5) credit risk.
2/1/04	Washington Mutual Bank, fsb, and its subsidiary, WMF Utah Holding Corp., became subordinate organizations of WMBFA through a reorganization (from ROE as of 3/15/04).
2/2/04	Transmitted Report of Examination for the field visit that commenced on 10/14/03 examination. The field visit was conducted concurrently with the FDIC and the State of Washington Department of Financial Institutions. The field visit focused primarily on assessing the impact of certain significant events, planning for the 2004 examination, and following up on Long Beach Mortgage Company (LBMC) securitization process issues from the 2003 examination (at the time, LBMC was a holding company affiliate of WAMU). We focused secondarily on evaluating progress on corrective actions promised in response to the 2003 examination, and on assessing the condition of the OTS-regulated entities to determine if any examination ratings needed to be changed. The examiners concluded that the institutions were basically sound, but expressed concern regarding: (1) the recent organizational realignment; (2) deteriorating earnings; and, (3) capital levels (core and risk-based capital slipped slightly below the internal targets of 5.5 and 11.0 percent, respectively, for WAMU at 9/30/03); and (4) weaknesses with the institution's servicing platform.
3/3/04	Transmitted IT Report of Examination for 10/14/03 examination. The limited IT examination work was conducted concurrently with OTS safety and soundness examiners, and personnel from the FDIC and State of Washington Department of Financial Institutions. The purpose of the on-site field visit was to

	meet with management to obtain an update on operations and technology, perform a limited review of management corrective actions to the 2003 IT Report of Examination findings, provide input to the risk assessment and supervisory strategy, and plan for the 2004 IT examination. Findings discussed in the examination report included: (1) the discontinuation of the Optis initiative (single-family servicing platform); and (2) certain outsourcing initiatives.
4/22/04	Quarterly Regulator's Meeting: discussed (1) the 1st quarter 2004 financial results; (2) update on compliance and credit; and, (3) an update on compliance with Sarbanes Oxley.
7/1/04	Examination exit meeting (examination begun 3/15/04)
7/22/04	Quarterly Regulator's Meeting: discussed (1) the Bank's proposed five-year plan --- 2005-to-2009; (2) 2nd quarter 2004 financial results; (3) update on the IT environment; (4) ERM update; and, (5) an update on the Fidelity Conversion.
9/13/04	Transmitted Report of Examination (ROE) for comprehensive 3/15/04 examination, rated 2/222223, of WAMU. Compliance was rated "2". IT was rated 2/22232. The examination was performed concurrently with examinations of Washington Mutual Bank, fsb and WMI, the insured institution's top-tier holding company. Additionally, the Federal Deposit Insurance Corporation (FDIC) and the Department of Financial Institutions, State of Washington, performed a concurrent safety and soundness examination of Washington Mutual Bank, a state-chartered, commercial bank subsidiary of WMI. Key findings and corrective actions listed among in the ROE included: (1) infrastructure weaknesses due to past rapid growth and the failure of the institution to fully integrate past acquisitions; (2) continued weaknesses in single-family loan underwriting; (3) the need to develop a high risk/subprime lending strategy for the Bank; (4) weaknesses with market risk management practices, including interest-rate risk modeling and mortgage pipeline and warehouse risk management practices; and, (5) concern regarding the consolidation of the Residential Quality Assurance unit with other functions within Enterprise Risk Management.
9/13/04	Memo closing the 3/15/04 IT Report of Examinations for Washington Mutual. The OTS IT examiners conducted concurrently the IT examinations of Washington Mutual Bank, FA and Washington Mutual Bank, fsb with the OTS safety and soundness / compliance examination report as of 3/15/04.
10/21/04	Quarterly Regulator's Meeting: discussed (1) 3rd quarter 2004 financial results; (2) TSG (Technology Solutions Group) update; and, (4) ERM update.
11/10/04	Transmitted CRA Report of Examination (ROE) as of 7/14/03. CRA was rated "Outstanding". All three tests (the Lending Test, the Investment Test, and the Service Test) were rated "Outstanding".
12/7/04	Closing meetings (12/7/04 and 12/9/04) with senior management pertaining to the field visit that commenced on October 18, 2004.
12/21/04	Mr. Stephen Rotella hired as President and Chief Operating Officer (from 3/13/06 ROE)
1/1/05	The State of Washington chartered Washington Mutual Bank was merged into Washington Mutual Bank, FA. As a result of the merger, the former state-chartered institution ceased to exist as a separate legal entity.
1/20/05	Quarterly Regulator's Meeting: discussed (1) the Bank's proposed strategy; (2) 2004 financial results and 2005 outlook; (3) update on ERM; and, (4) the Bank's retail banking strategy.
2/7/05	Transmitted Report of Examination for the field visit that commenced on 10/18/04 examination. The field visit was conducted concurrently with the FDIC. The State of Washington declined to participate given the impending merger of the state-chartered institution, Washington Mutual Bank, into WAMU. The field visit focused primarily on assessing management's progress in addressing issues noted in the

	Matters Requiring Board Attention section of the March 15, 2004, Report of Examination. The examiners concluded that the institution had made satisfactory progress in addressing the concerns identified during the previous examination; however, the examiners identified concerns in the following areas: (1) the use of an automated valuation methodology (appraisal finding); (2) the increasing level of credit risk, without adequate oversight; (3) the lack of adequate profitability analysis (specifically Option ARMs); (4) weaknesses with Corporate Credit Risk Oversight;
2/8/05	Transmitted IT Report of Examination for 10/18/04 examination. No material concerns were identified.
2/28/05	Press release: WAMU announces new retail leadership; adds new senior manager to home loans team; Michael Amato and Ken Kido to head retail.
4/12/05	Letter from OTS to WAMU reiterating our understanding that the institution would maintain its core capital ratio above 5.5 percent.
4/21/05	WAMU advised OTS staff that the institution's past due loans would increase significantly as a result of amendments to the institution's TFR (GNMA buy-backs will be required to be reported as past due). Based on March 31, 2005 data, past due loans would increase from $1.2 billion to $2.7 billion as a result of this reclassification.
4/21/05	Quarterly Regulator's Meeting: discussed (1) the overall condition of the Bank; (2) the first quarter 2005 financial results; (3) update on the home loans group; (4) update on ERM; and, (5) an update on TSG (Technology Solutions Group).
6/1/05	Press release: WAMU drops annual fee on personal equity manager product, adds longer-term feature, making it one of the most flexible home equity and mortgage products currently available.
6/6/05	Press release: WAMU announces it will acquire Providian Financial; strategically compelling fit for both companies (three releases that day regarding proposed acquisition).
6/29/05	Examination closing meeting; Report of Examination transmitted 8/29/05
6/30/05	Press release: WAMU announces new president of its Home Loans Group (per 3/13/06 ROE, David Schneider was hired effective 8/8/05).
7/21/05	OTS examiners met with WAMU to discuss the need to resolve our concerns regarding SFR underwriting.
8/4/05	Press release: OTS deems WAMU's application to acquire Providian complete.
8/24/05	Press release: Bank regulator approves Washington Mutual's acquisition of Providian; transaction scheduled to close October 1.
8/29/05	Transmitted IT Report of Examination for 3/14/05 examination. The OTS IT examiners conducted concurrently the IT examinations of Washington Mutual Bank, FA and Washington Mutual Bank, fsb with the OTS melded safety and soundness / compliance examination report as of 3/14/05.
8/29/05	Transmitted Report of Examination (ROE) for comprehensive 3/14/05 examination, rated 2/222222. Compliance was rated "2". The examination was concurrent with examinations of Washington Mutual Bank, fsb, an operating subsidiary of the Bank, and WMI, the insured institution's top-tier holding company. The Federal Deposit Insurance Corporation (FDIC) participated as the back-up regulator. Key findings and corrective actions listed among in the ROE included: (1) the need for strong support of ERM by senior management and the Board of Directors; (2) continued weaknesses in loan underwriting; (3) concerns regarding Corporate Risk Oversight; (4) the need to enhance oversight over the Bank's "High-Risk Lending Strategy", particularly as it relates to the acquisition of Providian; (5) weaknesses with oversight of the Mortgage Banker Finance division; (6) appraisal weaknesses; (7) concern regarding compensation for loan underwriters; (8) concern that the Bank's home equity lending

	was inconsistent with Interagency Guidance relating to this type of lending; (9) weaknesses with the Bank's fair lending program; and, (10) exceptions with the Loans-to-one-borrower report.
8/31/05	Press release: Washington Mutual's focus on seamless integration of Providian; Providian shareholders approve acquisition.
10/3/05	Press release: WAMU completes acquisition of Providian Financial (effective 10/1/05).
10/20/05	Quarterly Regulator's Meeting: discussed (1) the overall condition of the Bank; (2) the third quarter 2005 financial results; (3) an update by the COO, Steve Rotella (planning regarding the acquisition of Card Services and the introduction of David Schneider); (4) update on home loans; (5) update on the Commercial Group; and, (6) an update on ERM.
10/21/05	Press release: WAMU names John F. Woods Controller.
10/27/05	Press release: WAMU hires new Chief Enterprise Risk Officer (per 3/13/06 ROE, Ronald Cathcart was hired effective 12/1/05, to replace EVP James Vanasek, who retired at the end of 2005).
12/8/05	Transmitted IT Report of Examination for 10/3/05 examination. No material concerns were identified.
12/14/05	OTS met with CEO Kerry Killinger and COO Steve Rotella to discuss the findings of the 10/3/05 field visit.
12/21/05	Press release: WAMU realigns prime and subprime residential lending under one management team; move part of ongoing efforts to serve customers better; improve operating efficiencies.
1/1/06	The Bank transferred the Mortgage Banker Finance Group and holding company affiliate LBMC from the Commercial Group to the Home Loans Group. The reorganization effectively placed all of the Bank's SFR lending operations under one group (see ROE dated 3/13/06, transmitted on 8/30/06).
1/10/06	WAMU advised the OTS that its fourth quarter earnings would be at the low end of (or below some) market analysts' expectations due to higher loss provisions at Long Beach Mortgage and mortgage servicing asset valuation adjustments….Long Beach experienced a sharp rise in early payment defaults during the fourth quarter resulting in an estimated repurchase of $600 million in whole loans that were sold into the secondary market. WAMU switched to whole loan sales, instead of securitizations, in the second half of 2005 for Long Beach and sold an estimated $13.2 billion into the secondary market. By comparison, Long Beach loan repurchases were $100 million in 2003, $30 million in 2004, and $40 million for the first 9 months of 2005 primarily on securitizations that do not have the same early payment default provision found in the whole loan sales.
1/19/06	Quarterly Regulator's Meeting: discussed (1) the overall condition of the Bank; (2) update on Card Services; (3) update on ERM; (4) financial review (4th quarter 2005); and, (5) the Bank's retail banking strategy.
2/1/06	Letter from Darrel Dochow (OTS) to WAMU confirming our agreement that WAMU "super risk weight" certain higher-risk assets.
2/2/06	Transmitted findings of 10/3/05 field visit. The FDIC did not participate. Areas reviewed during the examination included: (1) SFR underwriting; (2) appraisal weaknesses; (3) Corporate Risk Oversight; (4) Fair Lending; (5) Basel II progress, with specific emphasis of the economic capital allocation model; (6) Enterprise Risk Management; and, (7) the integration of Providian into WAMU. Overall, the examiners concluded had made progress in each of the areas reviewed, though further progress was deemed warranted.
2/15/06	Letter from John Robinson (WAMU) confirming our agreement that WAMU "super risk weight" certain higher-risk assets.

2/15/06	Press release: WAMU consolidates home loan support offices.
2/28/06	8K filed: merger of LBMC into WAMU (from WMI) as of 3/1/06.
3/29/06	Press release: Frank Vella joins WAMU as new division head for small business banking.
4/10/06	8K filed: WAMU named James B. Corcoran Retail Banking President on April 4, 2006, effective may 15, 2006.
4/20/06	Quarterly Regulator's Meeting: discussed (1) the overall condition of the Bank; (2) the first quarter 2006 financial results; (3) economic capital update; and, (4) an update on ERM.
4/23/06	Press release: WAMU to acquire Commercial Capital Bancorp. Inc.; deal to strengthen WAMU's commercial and retail banking businesses.
5/16/06	Press release: WAMU enhances its home equity line of credit product to provide greater payment flexibility; allows consumers to make interest-only payments on a fixed-rate loan option.
6/21/06	Memo from Kerry Killinger regarding a change in the Bank's strategic direction. Points made by Kerry Killinger included: • Our Home Loans Group should complete its repositioning within the next twelve months and will be in position to profitably grow its market share of Option ARM, home equity, sub-prime and Alt-A loans. We should be able to increase our share in each of these categories to over 10%, although Alt-A will take longer because of our low starting market share. • We are refining our Home Loans business model to significantly curtail low-margin Government and conventional fixed rate originations and servicing, and significantly increasing our origination and servicing of high-margin home equity, Alt A, sub-prime and option ARMs. Action steps include merging Long Beach sub-prime and the prime business under common management, merging correspondent activities into our conduit channel, exiting Government lending, curtailing conventional fixed-rate production, expanding distribution of targeted high-margin products through all distribution channels and potentially selling MSRs related to low-margin/high-hedge cost products. • To accomplish our desire to reduce interest-rate risk and to increase credit risk, we are embarking on a gradual remixing of our balance sheet. This remixing will also have the benefit of better utilizing our economic capital. In 1995 *(2005?)*, prime single-family loans represented 36% of our balance sheet. Within three years, we expect this to decline to 26%. Making up the balance will be home equity at 19% versus 15%, sub-prime home loans at 10% versus 6%, credit card receivables at 3% versus 2%, and multi-family at 11% versus 8%.
7/19/06	Press release: WAMU to sell $140 billion in mortgage servicing and Milwaukee servicing operations to Wells Fargo.
7/25/06	Press release: WAMU to sell mutual fund subsidiary to the Principal Financial Group.
8/19/06	Press release: WAMU chairman and chief executive Kerry Killinger says the federal guidance on nontraditional mortgages will have a "limited" effect on its payment-option ARM lending program.
8/23/06	Press release : OTS approves WAMU acquisition of Commercial Capital Corp, Inc.
8/30/06	Transmitted Report of Examination (ROE) for comprehensive 3/13/06 examination, rated 2/222222. Compliance was rated "2". The examination was concurrent with examinations of Washington Mutual Bank, fsb, an operating subsidiary of the Bank, and WMI, the insured institution's top-tier holding company. The Federal Deposit Insurance Corporation (FDIC) participated. Key findings and corrective actions listed among in the ROE included: (1) concern that the number of management changes could pose short-term transition risk; (2) weaknesses with fraud management; (3) weaknesses in subprime

	underwriting at LBMC (prime underwriting was rated marginally satisfactory); (4) violations of RESPA Section 8 and Reg X, regarding reimbursement of unearned fees; (5) the need to ensure ERM's effectiveness and the adequacy of resources for this department; (6) the need to enhance monitoring of the Bank's high-risk-lending strategy; (7) the need to enhance the credit scoring model development and monitoring processes; (8) errors on the LTOB report; (9) the need to enhance monitoring reports for one-to-four lending, including the mortgage banker finance group; (10) appraisal weaknesses; and, (11) servicing weaknesses.
8/30/06	Transmitted IT Report of Examination for 3/13/06 examination (rating of 2 / 2222). No material concerns were identified.
9/29/06	Press release: Statement from David Schneider, President, Home Loans, regarding interagency guidance on nontraditional mortgages.
10/2/06	Press release: WAMU completes acquisition of Commercial Capital Bancorp.
10/6/06	OTS met with WAMU to discuss REIT preferred stock.
10/12/06	OTS met with WAMU to discuss NTMP guidance.
10/19/06	Quarterly Regulator's Meeting: discussed (1) the overall condition of the Bank; (2) the third quarter 2006 financial results; (3) economic capital update; (4) update on ERM; (5) discussion of retail banking strategy; and, (6) an update on home loans group.
10/19/06	WAMU announcement: "the federal guidance on nontraditional mortgages will have a "limited" effect on its payment-option ARM lending program……based on preliminary analysis and initial discussions with our regulator, the Office of Thrift Supervision, while we expect some changes, the impact on the origination of the option ARM products in our Home Loans group appears limited."
	OTS examination commenced
1/8/07	Approved Dividend Quarter (Q) 1 $3 billion (B)
1/11/07	IT Limited Thrift Examination transmitted: Scope focused on management corrective action to the March 13, 2006, IT Report of Examination. Corrective action found satisfactory, and the timeline for compliance with CEO Memo 228-Interagency Guidance on Authentication in an Internet Banking Environment was on track.
1/23/07	OTS/Treasurers interim meeting
1/23/07	Approved Operating Subsidiary - Thackerey
1/30/07	Discuss Nontraditional Mortgage Guidance Action Plan
2/1/07	Quarterly Treasurers Meeting
2/1/07	Quarterly Regulators Meeting • Q4 06 net income $1.058B, improved NIM offset partially by weak performance by home loans due to subprime loan performance. • Repurchased $3B of common shares in 2006. Projected to repurchase $4.2B in 2007. • 2007 forecast net income of $3.8B • Enterprise Risk Management (ERM) – Consistent with our strategic plan we are increasing credit risk in our 2007 business plan to be monitored and actively managed through the ERM committee. Consumer loans to high risk borrowers 15.2% at 11/06 to increase to 22.9% in 2007 plan; Consumer loans with high LTV 6% at 11/06 to increase to 7.3% in the 2007 plan; • single state concentrations increased from 46.2% to 48/2% and • single MXA from 20.55 to 21.4%.

WaMu Timeline

	FDIC Supervisory Strategy – FDIC focus on Basel II, Market Risk Amendment and VAR methodology, SFR Lending and Non-traditional Mortgage Guidance, and general interest rate risk.
2/1/07	Approved March Preferred Dividend $4.2 Million (M)
2/21/07	Project Thackeray Update (see Treasurer's meeting)
2/22/07	OTS update meeting; Robinson, Dochow, Carter
3/5/07	Current Litigation Meeting
3/8/07	Exam Exit Meeting
3/15/07	OTS Basel II Schedule meeting
3/21/07	OTS Q1 2007 Exam Exit Meeting
4/17/07	St Stated Income-Reporting, Analytics and Risk Management

4/19/07	Quarterly Regulators Meeting
	• Q1 2007 Net income $784 million (M)
	• Improved margin and higher credit card income offset by subprime losses.
	• $273 M below projected NI for the Quarter
	• NIM improved 21bps driven by asset repricing and lower interest cost of deposits.
	• Subprime gain on sale and residual write-down deteriorated due to wider credit spreads and increased delinquencies.
	• Higher provision expense due to increased charge-offs on sub-prime and HE loans.
	• Loans HFS declined due to $17.8B hybrid sale, SFR balance decrease in line with decision to hold fewer loans in portfolio in the current flat rate environment. Credit Card on balance sheet receivables decreased due to an increase in Q1 07 securitization of $1.2 B.
	• Increased Cash Dividend to $0.55.
	• Subprime-Integrating products originated through the sub-prime channel into prime channels.
	• Dedicated sales force solely focused on retail bank mortgage volume.
	• Subprime market is experiencing massive market dislocation.
	• Subprime production; stated income reduced from 52% Jan 06 to 25% March 07.
	• Nontraditional Mortgage Guidance
	  o Moving towards underwriting at fully indexed, fully amortized rate, including full negative amortization.
	  o Enhancing risk management and disclosures.
	• Proposed Subprime Statement
	  o Moving away from 2/28 to longer fixed term period
	  o Implementing retention and loan modification programs
	• ERM top 5 Risk Issues
	  o Housing Market Deterioration
	  o Volatility of Credit Card Markets
	  o Business model stress-shift from portfolio lender to gain on sale
	  o Data Governance and integrity
	  o Increased intensity of regulatory and legislative oversight

4/20/07	OTS/Internal Audit Investigation
4/23/07	OTS/Capital Restructuring Meeting
4/24/07	Monthly OTS Update Meeting, Dochow/Franklin

4/24/07	Quarterly Basel II Conference Call
4/26/07	BSA/AML Weekly Status Meeting
4/26/07	Exam Update meeting-Deloitte and OTS
5/1/07	Basel II Kickoff Meeting
5/1/07	Approved Q2 Common Dividend $3 B, Preferred Dividend $4.2 M
5/9/07	BSA/AML Weekly Status Meeting

5/14/07	OTS Quarterly Treasurer's meeting (filed paper document)
	• Balance sheet reductions and Project Thackeray reduced Q1 funding needs
	    o Thackeray – complex transaction with Barclay's Bank $6.25B 3 year funding complete 3/27/07
	• Wholesale funding declined from $143B on 12/06 to $116B on 3/07
	• $1B Senior Note issued
	• March covered bond issue postponed
	• WaMu master note trust $1.1B AAA , $150M A, with $700 M Credit Card conduit increase
	• Forecast Q2 funding needs remain limited
	    o No WMI funding needs in 07, next Senior bank debt maturity forecast Q3 07
	    o FHLB advance pay-downs continue
	    o WM master note trust 3yr $875N AAA, $125M BBB Credit Card Securitization to sett Mid May
	    o Brokered Retail deposits likely to remain stable
	• 2007 Funding Outlook
	    o Subordinate debt removed from forecast
	    o $2 to $4B senior debt needs in 2007
	    o FHLB advances expected to decline $15 to $20B by year end
	• Q1 Capital Outlook
	    o Repurchased $2.8B common stock
	    o Exercised call option to retire $400M trust preferred
	    o WMB upstreamed $3B excess Capital by dividenting to WMI
	• Q2 Forecast Capital Activity
	    o Continue to retire inefficient trust preferred
	    o $500M WM Preferred Funding LLC issue in May
	    o Excess Capital available at WMB
	• 07 Capital Strategy
	    o Continue optimizing Tier 1 Capital base
	    o Limited growth makes any new capital issue "nice" but not required

5/14/07	OTS/Rotella Update meeting
5/15/07	Discuss Status of NTM Guidance and Proposed Subprime Lending Guidance
5/15/07	Long Beach Mortgage FPD/EPD Review with OTS
5/16/07	BSA/AML Weekly Status Meeting
5/17/07	OTS Exam Status update ALLL
5/24/07	Compliance Limited Examination Transmitted – Overall we found WaMu had established an effective fair lending risk monitoring and management program for residential lending. Four of 14 comparative review found that corrective action at a transaction level would be appropriate. Management's prompt response in taking corrective action for the affected borrowers is a positive step in limiting the

	institution's fair lending risk.
5/25/07	Monthly OTS Update Meeting-Dochow/Franklin
6/14/07	BSA/AML update
6/20/07	Follow up Committed Capital Term Sheet
6/20/07	OTS Exit Meeting – C-2, A-2, M-2, E-2, L-1, S-2, Compliance-2, IT-2, WMI-Satisfactory
6/20/07	Monthly OTS Update Meeting-Dochow/Franklin
7/23/07	Approved Operating Subsidiary Pike Holdings
8/1/07	Approved Common Dividend $1B in connection with elimination of North American Capital Inc. (NACI) as a holding company.
8/15/07	Approved 5 new Operating Subsidiaries including 4 foreign entities

8/16/07	Quarterly Treasurer's Meeting
	• Capital Forecast-see below
	• Debt Schedule and Forecast-see below
	• Funding Review
	  o Funding Diversification
	    ▪ FHLB advances declined from $25B to $21B
	    ▪ Brokered CDs declined from $32B to $25B
	    ▪ Covered Bond issue in May 2007 of $2B
	    ▪ WaMu Master Note Trust 3yr, $875M AAA and $125M BBB.
	  o Major Market disruption
	    • Little or no liquidity across most asset classes
	    • Liquidity remains limited and volatile
	    • WaMu has adequate Liquidity
	      o Substantial FHLB capacity-$43B
	      o Repo and Broker CD capacity
	      o Minimal debt maturities, $1.5B in Nov
	      o Credit Card Asset Backed Securitizations expected to issue in Q3
	      o Enhanced monitoring, 12 month liquidity forecast and weekly liquidity reports
	• NACI Elimination Update
	• Pike Street Holdings Update
	• Q3 Capital Strategies
	  o Remove plans for Share Repurchases in Q4 08
	  o Retain Capital in WMB except for that needed by WMI for common dividends

8/27/07	1/8/07 examination concluded
8/27/07	Approved Operating Subsidiary MergeCo
9/10/07	Discuss McKell vs WaMu
9/17/07	1/ 1/8/07 Report of Examination transmitted, with a composite rating of "2", camels ratings of 2,2,2,2,1,3 and compliance 3. The summary highlighted management's long term strategic plan of reducing market risk while reducing reliance on lower yielding SFR first mortgages by replacing those with higher yielding, though higher risk assets such as multifamily, credit card, and home equity loans. The strategy is being pursued more cautiously, particularly with regard to subprime lending, where there has been deterioration. The report highlighted the following Matters Requiring Board Attention (MRBA): • Continued weaknesses in subprime SFR lending which is a repeat MRBA. Board to ensure

	underwriting deficiencies are reduced to tolerance levels agreed upon in management's to Asset Quality Findings Memo 3. • A Cease and Desist Order (C&D) was issued covering the required Bank Secrecy Act (BSA)/Anti Money Laundering (AML) Corrective Actions and the Board is to ensure the requirements of the C&D are fully complied with. • Civil Money Penalties were imposed for violations of the National Flood Insurance Protection Act. Board to ensure that the management and system deficiencies that resulted in the violations are corrected and the necessary flood insurance is obtained. • Board to ensure that management implements a comprehensive compliance framework, and that the compliance management function receives appropriate support, leadership, and resources. • Continue to monitor and receive reports on the status of Enterprise Risk Management to ensure its effectiveness and that appropriate resources and support are provided to the function. ERM should provide an important check and balance on profit-oriented units and, therefore, warrants strong Board commitment and support.
9/18/07	Discuss Transland MBF
9/18/07	OTS Basel II September Kickoff meeting
9/19/07	Overview of Consumer Complaints
9/20/07	Up to marketing update
9/21/07	Monthly OTS update meeting-Dochow/Franklin
9/21/07	Discussion on new Subprime Report for OTS
9/26/07	Fair Lending Review
10/02/07	1-8-07 IT Examination Completed-Findings transmitted in the type 16 ROE of 9/18/07.
10/16/07	Score Assisted Underwriting Overview meeting
10/13/07	WaMu announces closure of its Mortgage Banker Finance, Conduit, and Correspondence Loan divisions. Residential loan origination will now be concentrated in branch system.
10/14/07	Initiated a formal examination of the appraisal process to assess the validity of a complaint filed by the New York Attorney General's (NYAG) Office. No examination report was issued on this matter.
10/17/07	Assessed $60,445.00 Civil Money Penalties (CMPs) related to violation of flood insurance regulations
10/17/07	OTS/HFI Transfer Valuation Meeting
10/17/07	Ca Card Services Fraud Overview
10/18/07	Quarterly Regulators Meeting • Q3 07 Net Income $210 M $620 M below plan • Reflects accelerated credit pressures and freeze of secondary market • Provision expense increased • $147 M valuation loss on $17 B loans transferred to HFI • $104 M permanent impairment on AFS securities • Widening spreads and credit deterioration also drove write-downs on commercial loan residuals and trading securities • MSR performance improved • Cash increased by $7B to bolster liquidity position, primarily from FHLB • Declared Cash Dividend of $0.56/Share • Residential Portfolio consists of

- $19.8B subprime portfolio in run off mode
- $58.4B Home Equity high credit quality, largely second lien,
- $106.8 SFR Prime High quality primarily option arms and hybrids

- Significant changes to guidelines in all segments
  - Tightened underwriting standards on Prime SFR, Home Equity, Subprime, and for all products.
  - Prime SFR 90% max Cumulative Loan to Value (CLTV), reduce non-full doc eligibility to loans with CLTV 80%, Fico under 680 require 65% CLTV or lower, No exceptions for borrowers with FICO below 620.
  - Home Equity max CLTV 85% in CA, FL, AZ, and NV, CLTV>65% requires Fico>680,
  - Subprime Eliminate Stated Income and Limited Doc Loans, Eliminate 2/28 and 3/27 loans, Max CLTV 90%, Eliminate Piggyback seconds
  - All Products Enhance declining market policy to include a CLTV reduction by 5% if high risk market
- Credit Risk profile of new originations stronger under new guidelines. Sept 07 originations combined with CLTV>80% = 23% vs 28% in Jan and the portfolio avg, Fico <660 =9% vs 14% in January and 22% for portfolio avg, >80%<660 = 3% in Sept vs 6% in Jan. and 7% portfolio.
- Customer outreach: Expand relationships with local agencies, dedicate 1-800 number and email box where customers can make direct contact, dedicated leadership team with $100K budget. Establish early loss mitigation department for subprime, create NPA early loss mitigation department for subprime,
- BSA/AML Enforcement Action: On 9/25/07 OTS delivered C&D draft with the final order delivered 10/15/07, with 3/31/08 deadline for full compliance.
- ERM
  - Critical Environment Elements: Home Price Appreciation (HPA) indices show dramatic drop in home price year over year change in Jan 07. Subprime Credit Default Swap index shows significant investor sentiment that subprime mortgage holders will suffer increased financial losses from these investments with decline in the index beginning mid June 2007.
  - Held For Sale (HFS) to Held for Investment Loans (HFI): The balance of HFS assets was reduced from $41.7B (4Q06) to $8.5B (3Q 07) through sales, redirection of originations, and transfers from HFS to HFI. Transfers included $14.4B SFR, $1.4B Subprime, and $1.3B Commercial.
  - Subsequent to 12/31/05, WaMu reduced its reliance on Federal Home Loan Bank (FHLB) advances in favor of finding through Covered Bonds and retail deposits. FHLB advances declined from 22% of funding sources at 12/31/05, to 7% at 6/30/07 but went back up to 17% at 9/30/07 as Commercial and Escrow Deposits declined.
  - ERM top 5 Risk Issues have changed since last Quarter
  - Q3 ERM Top 5 Risks
    - Housing Market Deterioration

	▪ Volatility of Credit Card Markets ▪ Business model stress-shift from portfolio lender to gain on sale ▪ Data Governance and integrity ▪ Increased intensity of regulatory and legislative oversight o Q4 ERM Top 5 risks ▪ Accelerated Deterioration of US Markets remains #1 ▪ #2 is now "Withdrawal of liquidity from the secondary markets ▪ #3 is now Compliance Process Deficiencies ▪ #4 is now External Fraud ▪ #5 is now Data Integrity • Overview of WMI consolidated Portfolio o Total NonPerforming Loans (NPL) portfolio has risen from less than 1% at 1/06 to 2.2% at 9/07. Portfolio charge-offs have risen from 0.15% o 0.78% in the same period. o ALLL was \$1.6B at 6/30/07, \$1.9B at 9/30/07
10/25/07	Quarterly Treasurers Meeting Liquidity Update; debt issuance, collateral expansion • Self-imposed liquidity requirements have been established for 1 day, 7 day, 3 month, 6 month, and 12 month periods. Excess liquidity forecast as of 9/30/07 indicated that excess liquidity for 3 month period of \$14 billion was short of target of \$25 billion. The shortfall is expected to be cured by on-going reallocation of collateral to increase FHLB borrowing capacity to \$35 to \$40 billion by yearend. • WMB's stress case scenario projects that its "Total Excess Liquidity" will range between \$32 billion and \$38 billion from Q4-2007 through Q4-2008. Over this time period, total assets are projected to grow from \$322.8 billion at 9/30/2007 to \$357.7 billion at 12/31/2008. Most of the growth is projected to be funded with an increase in FHLB advances. Total FHLB advances are projected to increase from \$53.2 billion at 9/30/07 to \$84.4 billion at 12/31/08. WaMu Preferred Funding and planned future capital activity • WMI successfully priced and issued \$1 billion in a Preferred Funding LLC transaction in October 2007. • Planning \$500 million WMI sub debt in October. The sub debt was priced last week with a 7.25% coupon and will settle next Tuesday. • Planning \$500 million Cayman Preferred Funding in Nov/Dec • Planning \$500 million DRD Preferred in Nov/Dec • NACI will be merged out of existence on November 1, 2007. NACI transaction eliminates \$950 million of subdebt at WMB. WMB's capital will be augmented in Q4-2007 with: (1) up to \$1.465 billion in Tier-1 Capital (consisting of net proceeds from: (a) \$1 billion of WMB preferred stock issued, and (b) potential issuance of \$500 million preferred stock, and (2) \$500 million in Tier 2 capital (subordinated debt). Bagley Phase II • WaMu expects to hand deliver an application to OTS on Monday, 10/29/07 for Project Bagley Phase II. • Will move \$15 billion commercial loans held in a trust from WMB to WMBfsb through a

	complex transaction. This will increase WMBfsb's QTL from 66% to approximately 88% to 92%. WMBFSB projects a common stock cash dividend of $2.6 billion in Q4-2007 to be paid to WMB in connection with the Bagley II transaction. AFS Investment Securities Portfolio • As of 10/11/2007, the market value of the securities portfolio was $25,197,000, which was $669 million less than the book value. The book yield of the portfolio of 5.64% is 33 basis points below the current market yield of 5.97%. • WMI has been changing the mix of the portfolio toward more positive convexity and long-term call instruments. • By rating, 88% of the investments are rated AAA, 6% are rated AA, 4% are rated A, and 3% are rated BBB. • Nearly 40% of the entire securities portfolio is Agency backed. • The subprime portion of the investment portfolio totals $722 million, or 2.9% of the entire investment portfolio.
10/31/07	Approved Dividend of $1 B
11/07/07	O OTS Flood Update Meeting
11/14/07	M Meeting to Discuss Appraisal Review with OTS
11/15/07	Update on BSA Roadmap
11/16/07	OTS Meeting, HL Business Update and Underwriting Changes
11/20/07	HFS to HFI Transfer Review with OTS and Deloitte
11/20/07	Repurchase Reserves Update
11/26/07	Repurchased Home Loan Valuation, $45.6 million Locom on $5.6 billion portfolio
11/27/07	Monthly Update meeting Dochow/Franklin
11/27/07	Dochow/Franklin Meeting with Rotella
11/27/07	VAR Model Update Miyashiro/Chararat
11/30/07	OTS Basel II Exit Meeting for September 12, 2007 Field Visit • Our reviews to this point have been limited to monitoring the development of the different approaches to measure risk and quantify the required capital to support this risk within the Basel II framework. • From what we've seen, by and large the models developed appear to follow industry-accepted approaches for quantifying operating and market risk and the various parameters required under the AIRB approach. • During our review, we have also shared with you some of our preliminary impressions and suggestions for improving the market risk model. • 2008 Qualification Exam to commence April 7, 2008 - Early review of HELOC/HEL and credit card models to start 2/11/08
12/4/07	Discuss Capital Projections
12/6/07	Meeting discuss adding Home Loan Servicing Transaction Data to Monitoring Environment- Johnson/Franklin/Hendriksen/Fiene/Dick Stephenson
12/14/07	OTS Monthly Update Meeting-Franklin/Dochow
12/31/07	Approved Ops Sub Unified 1st Tier Sub

1/07/08	Target examination of Home Loans, Commercial lending, and certain aspects of operations commences.
1/17/08	OTS Senior managers, exam team and FDIC representatives attend quarterly regulators meeting with WMB Executive management.
1/24/08	WMB provided OTS a copy of the Simpson Thatcher work plan for the internal review of the NYAG appraisal allegations
	OTS met with Simpson Thatcher, the law firm conducting the internal investigation for Washington Mutual related to appraisal outsourcing by the Bank. Simpson Thatcher acknowledge that both outsource providers raised appraisal independence concerns and that their investigation identified substantive criticisms with the process including the significant input that the production force had on the composition of the WaMu preferred appraisal panel, and subsequent panels, and the inadequate supervision, monitoring and control of the process by appraisal management. Overall however, Simpson Thatcher concluded that there was no merit to the allegations contained in the NYAG complaint and that they found no systematic effort to subvert the independence of the appraisal process, no motive or intent to do so, and finally no opportunity. OTS investigation was still in process.
2/1/08	FDIC informed OTS that they would like to have an FDIC Ombudsman discuss with WMB management what happened to certain deposits of a former customer of failed bank, Columbia Savings and Loan Association. Columbia merged with Washington Mutual Bank, via American Savings Bank, back in 1991. No one at WaMu has been able to assist the customer; therefore, the Ombudsman got involved.
	WR Director instructs exam team to Assess CAMEL ratings and to make any changes necessary by 3/31/08.
2/6/08	Attended Quarterly Treasurer's meeting. Exam and Appraisal review team met with management to discuss broker/borrower provided appraisals
2/19/08	Exam team and WR Director meet to discuss suggested changes to CAMEL Ratings
2/25/08	New York Attorney General, Fannie and Freddie, and OFHEO announced new appraisal guidelines that primarily resulted from the allegation of appraisal misconduct at WMB.
2/26/08	Management agreed to discontinue stated income lending for HELOCs given the obvious deterioration in portfolio quality and because the exam team had indicated that our conclusion would be that the program be discontinued.
	Stephen I. Chazen was elected to the Board of Directors of Washington Mutual Bank (the "Bank") by the unanimous vote of the other members of the Board. The Board also appointed Mr. Chazen to the Audit, Compliance and Finance Committees of the Board.
2/27/08	WR Director issues letter downgrading WMB Composite rating to "3" and requires a Board resolution to address deteriorating conditions. Exam team met with treasury personnel to request that more conservative stress scenarios be added to existing internally derived stress scenarios.
2/28/08	CEO Killinger met with OTS Director to discuss the condition of the Bank, examination concerns, and the prospects of raising capital.
	DOJ contacts WMB in regards to the complaint against WaMu on Soldier/Sailor Relief Act. DOJ subsequently coordinates with OTS on exam procedures on this issue.
	Examiners provided a second request for documents and information related to OTS special investigation into NYAG appraisal allegations.
3/5/08	Examiners met with Home Loans management to provide their view of stated income lending in general. With WR Director's approval, examiners inform management that unless they could provide analytics that supported why remaining stated income products being offered should continue being made, our exam conclusion would indicate that this product should be discontinued.

3/6/08	WR Director and exam team briefed the DC office (and subsequently FDIC WR management) that ALLL provisions would increase significantly due to a continuing downward trend in home prices and growing delinquencies and charge offs. This also means a loss for 2008 and projected for 2009. Management engaged Lehman and Goldman to explore capital and investor options. OTS DC staff alerted FDIC DC staff which led to coordinating a deposit download request for contingency planning purposes.
3/7/08	Victor Villarreal of the FDIC DRR group arrived at the Bank to make the deposit download request for contingency planning purpose.
3/10/08	In response to communications with DC FRB counterparts, OTS DD Ward instructed WR management and WMB exam team to encourage WMB management to provide the FRB SF with any information that they might need to ensure discount window access.
	After various discussions with the WMB exam team, management issues a new policy eliminating low doc (stated income) lending in all but the GSE saleable "doc relief" loan program.
3/12/08	OTS Director and senior staff met with WMB CEO and senior staff to discuss the Bank's liquidity position, particularly uninsured and other "at risk" deposits.
3/13/08	WMB exam team updated WR and DC management on liquidity and provided the initial series of detailed liquidity monitoring reports and related data. GAO staff requested 2006 and 2007 balance sheet and income statement data for WMB, Citi and AIG in conjunction with their audit activity regarding issues relating to the development of Basel II.
	Moody's Investors Service downgraded the senior unsecured rating of Washington Mutual, Inc. to Baa3 from Baa2. Washington Mutual Bank's long term deposit rating was downgraded to Baa2 from Baa1. Washington Mutual Bank's bank financial strength rating at C- and short term rating at Prime-2 were affirmed. Moody's placed a negative outlook on all Washington Mutual (WaMu) entities.
	Fitch places WM covered bonds program on rating watch negative on downgrade of WMB to 'BBB'.
3/17/08	WMI announced that on March 14, 2008, the United States Court of Federal Claims published its written decision in the case of Anchor Savings Bank, FSB vs. The United States of America, awarding Washington Mutual Bank $382.0 million for damages, and an additional amount for taxes that will be determined by the court.
	WMB board passes resolution to address the Bank's deteriorating financial condition.
3/18/08	WR Director and exam team update DC management on results of 3/17/08 Board meeting discussion.
	COO Polakoff directs other regions to provide the WaMu exam team with examiners to perform a more detailed analysis of Liquidity, including all relevant agreements that could negatively impact liquidity.
	WMB management provides DC management with a listing of the Bank's top 30 depositors per an earlier request.
3/19/08	In light of the failure of Bear Stearns, the WMB exam team provides OTS management information on the Bank's credit exposure to Lehman, Merrill, and Morgan Stanley which approximated $250.0 million.
	OTS formally request mortgage loan servicing data as a part of our ongoing supervisory process to conduct a nationwide horizontal review. The goal is to have a detailed, current, and on-going picture of mortgage loan performance and loan modification efforts.
3/20/08	DC policy staff had a meeting via conference call to discuss proposed changes to Unfair and Deceptive Practices rules.
3/24/08	Out of region examiners begin assisting WMB exam team in doing a detailed analysis and monitoring of Liquidity, including a review of all relevant contracts and agreements that might contain triggers which could negatively impact the Bank's liquidity position.
	WR Director provided DC management the latest info on the Bank capital raising efforts based on an

	update received from WMB executive team. April 4, 2008, was scheduled for a subsequent update by WMB's board to OTS DC and WR management.
3/26/08	Exam team hold exit meeting for the Commercial Group review, no significant findings.
	Exam team request updated financial projections from management, FDIC in attendance.
3/31/08	FinCen informs OTS that our referral regarding WMB Bank Secrecy Act issues was referred to their Office of Enforcement because they determined that the imposition of civil enforcement remedies under the Bank Secrecy Act may be warranted.
	WR briefed OTS COO on the status of the examination.
4/1/08	OTS COO (Polakoff), Deputy Director (Ward), and WR Director (Dochow) met with the Board to direct them to raise capital given the increasing losses at the Bank.
4/2/08	WR Director informed onsite FDIC examiners that OTS had a telephonic discussion with WMB's Board on 4/1/08 where they heard from OTS that they needed to take action to ensure the safety and soundness of the banks and sufficiency of capital. The board authorized Rotella and Casey to start meeting with a number of large current shareholders who signed confidentiality agreements to obtain additional capital above what the private equity companies proposed. Management appeared confident that capital was available. OTS Wash DC briefed FDIC DC on 4/2/08.
4/3/08	Examiners had mid-exam update meeting with Home Loans management. Discussions included primary findings of recurring concerns regarding stated income lending in all HL portfolios and generally unsatisfactory underwriting overall.
	Examiners requested documents from the Bank to facilitate the FDIC contingency planning efforts.
4/4/08	Examiners requested a deposit download at the request to the FDIC contingency planning group.
	WR provides DC the Bank's revised liquidity stress analysis with additional stress conditions requested by WR management including: a $19 billion deposit run off among retail, custodial and commercial accounts, plus a reduction in Fed Funds capacity and 400 bp increase in the FHLB haircut. Also included was new info on several items such as clarification of what the FHLB's can do upon a "material adverse change" indicating that potential exists for a much worse event should the FHLB of SF triggers an early amortization of outstanding balances or immediate repayment upon default stemming from a material adverse change. Management reports that they are very close to signing a deal to raise additional capital approximating $4.9 billion. OTS encourages management and the Board to raise all that is possible in this transaction. Management agrees with OTS to keep JP Morgan offer open.
4/7/08	WMB announces their exiting the wholesale lending channel including the closure of related loan offices.
4/8/08	WMB announces a $7.0 billion + capital raising.
4/15/08	Annual shareholders meeting – some shareholders and employees were extremely critical of management and the Board for the condition of the bank and suggested a number of changes. Mary Pugh resigned as Finance Committee Chairman.
4/17/08	WR management and examiners attend Quarterly regulators meeting.
	Michella Alban – Home Loans Legal Officer, and Adam Ellis- Home Loans Appraisal Manager. We learned subsequently that Mr. Ellis was retained in a different capacity.
	COO Rotella informs the exam staff that 3 individuals were terminated related to the NYAG appraisal allegations: Cheryl Feltgen - Chief Credit Officer for Home Loans
4/23/08	Exam team requests an appraisal sample related to the appraisal investigation. Discussed the Bank's rights under applicable regulation to cancel HELOC lines of credit with CERO Cathcart and John Robinson, Regulatory Relations Exam team met with HL management to get more detail analysis of the root cause of mounting losses.

4/24/08	Examiners completed detailed analysis of liquidity related instruments/contracts that could potentially negatively impact the Bank's liquidity position.
	WMB announces the termination of Cheryl Feltgen and Michella Albon from the Home Loans group.
5/5/08	FDIC provides a revised capital analysis indicating that the Bank needed an additional $5 - $7.0 billion in capital
5/8/08	Temporarily discontinued weekly liquidity reports to DC due to recent capital infusion
5/14/08	Examiners and WR management attend quarterly Treasurer's meeting.
5/15/08	Internal reorganization at WMB moves the Compliance and Regulatory Relations functions from ERM to the Legal Department.
5/16/08	Onsite examiners discontinued sending liquidity reports to DC because of the recent capital infusion but continued to monitor liquidity.
5/19/08	FDIC DRD staff informs that the download of WMB deposit data was successful.
5/21/08	Moody's Investors Service (Moody's) downgraded the rating of the Covered Bonds (approximately $6.0 billion) issued by WM Covered Bond Program (the Program) to **A2**, on review, with direction uncertain from **Aa1** under review for possible downgrade. The downgrade of the Covered Bond rating follows the recent downgrades of the long-term deposit ratings of Washington Mutual Bank (the Sponsor) to **Baa2** (stable outlook).
5/28/08	Examiners held general discussion with D&T audit manager. Exam team met with WMB attorneys to discuss internal review of alleged fraud by WMB loan consultants. MOU and ROE required an in depth investigation into the validity of the allegations and extent on any problem.
5/29/08	Onsite FDIC examiner inform OTS examiners that they are classifying all subprime loans "substandard" regardless of payment status and as such, would downgrade the Bank's asset quality component from "3" to "4".
6/2/08	WMB issues a press release indicating that, to further strengthen corporate governance and to listen to corporate shareholders, effective July 1, independent director Stephen E. Frank would assume the role of Board Chair while Kerry Killinger would continue to lead the company as Chief Executive Officer and serve as a Director. The Board also adopted a majority voting standard and made several changes to the composition and leadership of certain of its Board Committees: (1) the Board appointed Orin C. Smith, retired Starbucks CEO, to serve as Chair of the Finance Committee, (2) recently elected director David Bonderman, managing director of TPG Investors, would serve as Vice Chair of the Finance Committee, in addition to being a member of the Corporate Development committee, (3) the Board appointed Thomas C. Leppert, Dallas Mayor and former chairman and CEO of The Turner Corporation, to serve as Chair, and (4) the Board appointed Regina T. Montoya to serve as Chair of the Corporate Relations committee. She also continued in her role as a member of the Finance Committee. In addition, the company launched a search for individuals with extensive financial services and strong leadership experience to further fortify WaMu's Board of Directors as new independent directors.
	WR Director and examiners discuss WMB at high risk briefing
6/4/08	WR Director and exam team held conference call with Director Frank, Chairman of the audit committee to express our concerns and provide examination findings as well as to discuss the effectiveness of the audit committee, ERM, internal audit, and the management team.
6/9/08	Examiners notified that WMB appraisal issue would likely remain a separate investigation; as such, findings and conclusions would likely be handled separately outside of the current comprehensive examination.
	OTS approves application filed April 24, 2008, for payment of a dividend to Washington Mutual, Inc., consisting of the stock of WM Mortgage Reinsurance Company ("Captive"). WM Mortgage Reinsurance Company is considered a non-includable subsidiary of WMB for purposes of determining

	the bank's regulatory capital. As such, the distribution of Captive to WMI will have no impact upon WMB's regulatory capital.
	WMB reports that its exposure to Fannie and Freddie is limited to equity securities approximating $282.0 million with a mark to market loss approximating $49.0 million
6/10/08	OTS suspends the Basel II qualification exam given that WMB delayed their qualification efforts to be consistent with other institutions that were required to be Basel II compliant.
	Examiners became aware that Management had used approximately $1.4 billion in recent capital proceeds to pay down holding company debt. Management subsequently directed to discontinue this activity.
	Examiners held Sensitivity to Market Risk exam exit with executive responsible for this area; onsite FDIC examiner in attendance.
6/11/08	OTS DC analyst indicates that WMI stock tanking early already down 13.17% trading at $5.82 its lowest level since 1992 and inquired whether upcoming news caused a significant swing from the previous day's late rebound. WR director indicated that it was likely due to rumors about the possibility of an upcoming MOU in that both OTS and WMB were being asked for comment in this regard by the media.
	WMB issues a press release indicating "while it is the policy of Washington Mutual not to comment on speculation and market rumors, the company released the following statement to address recurring speculation about regulatory activity: "Neither our primary federal regulator, the OTS, nor any other bank regulatory agency has taken any enforcement action against WaMu that we have not previously disclosed. Further, the company is not currently in such discussions with any regulatory agency."
	OTS examiners held exit meeting with executive responsible for Enterprise Risk Management; onsite FDIC examiner in attendance.
6/12/08	Held exam exits meetings for Capital, Earnings, and Liquidity as well as for Home Loans for the executives responsible for those areas; onsite FDIC examiner in attendance.
	Management provides the examiners a draft of their new Long Range Forecast, recently approved by the Board
6/16/08	Examiners held Compliance exit meeting
6/18/08	Exam team met with COO Rotella to discuss Operation Restart, initiated in May 2008, wherein Management identified about $1.0 billion in run-rate NIE saves and [5,400+] in headcount reductions. Phase II was initiated in mid May 2008 with the majority of savings centered on Home Loans, Retail Bank, Technology, and Real Estate. WMB issued a press release on 6/19/08 regarding a number of changes intended to improve expense management, increase efficiency, and accelerate return to profitability by: (1) eliminating some positions that don't support mission critical activities, (2) eliminating positions that supported Home Loans functions that were discontinued, and (3) centralizing some support functions such as in Technology, Human Resources, and Enterprise Operations. About 1200 positions would be eliminated
6/20/08	Examiners discuss with COO Steve Rotella our concern that certain MSR hedging personnel were being terminated as a cost cutting measure, particularly since this area was recently a high risk area.
	Examiners with WR Director present discussed their examination findings with CEO Kerry Killinger, COO Steve Rotella and Acting General Counsel Stewart Landefeld today since the CEO would not be available at the formal management exit scheduled July 1, 2008. Examiners disclosed that composite would remain "3" but that Asset Quality and Management ratings were being downgraded (343432). WR Director informed WMB management that additional enforcement action was likely given the condition of the Bank.
6/23/08	Examiners met with Home Loans management to inquire about ongoing hedging of Mortgage Servicing

	Rights because we received anecdotal information that certain WMB personnel responsible for hedging were being laid off. We expressed concern that management must maintain competent personnel to continue to manage this asset. Management stated that key individuals were being maintained.
6/24/08	Exam team provided the 6/20/08 management meeting agenda to DC management along with all the examination findings memos.
6/25/08	WR Director met with CEO Killinger who agreed to infuse additional capital into WMB but indicated that the Bank was wary of creating a tax issue or rating agency discomfort. Mr. Killinger indicated that the bank would bring in approximately 400 people to clear the backlog of Alerts and SAR filings. He also asked if there was anyway to avoid a MOU given the capital infusion as well as the following actions: a plan to increase liquidity sources to \$60.0 billion by June 30th versus \$37.0 billion at March 31st, accelerating loan loss provision asked for by examiners, discontinuing many lending areas where underwriting was criticized by examiners, and cutting approximately \$1.0 billion in expenses to accelerate return to profitability. WR Director indicated that as a "3" rated institution, enforcement action would be necessary. Mr. Killinger asked about the status of the appraisal review; to which, WR Director indicated that the review was still in process.
6/26/08	WMB applied to issue another \$3 billion in sub debt under its Global Note Program over the next two years. They anticipate issuing only \$2.25 billion, but applied for \$3 to give them additional flexibility. WR Director opined that while some use of the global note program makes sense, the dynamics have changed sufficiently at the company so that we should require a clear indication of ability to service, representation of no adverse impact on rating agency ratings, and have their plan showing attainment of profitability and maintenance of sufficient capital under the credit cost stress scenarios
6/27/08	WMB informs WR Director that they are near a deal to sell about 45 Chicago area branches and all Chicago deposits and all Colorado deposits and branches to U S Bank. This will likely be announced with earnings on July 16. WMB had previously closed about 60 Chicago area branches and with the sale will be out of that market and Colorado in terms of retail presence. They will also close about 100 other stores in other states with the largest number in any one market being about 30 in the west Florida/Tampa area.
	WMB executives meet with OTS DC management to discuss exam findings and to discuss whether enforcement action was necessary. DC management confirmed that enforcement action was necessary.
7/1/08	Examiners conducted the formal management exit meeting to discuss all examination findings with the executive management team.
	WMB management indicated that per their discussion with Moody's, the rating agency was taking no action at this time, and confirmed that assuming earnings are finalized at the level discussed with them the previous day, they would affirm both WMB and WMI ratings and Stable outlook immediately after WMB's earnings release.
	Examiners expressed concern to WMB management about their recent buyback of holding company debt because this depletes capital although debt was repurchased at a discount.
	WR Director discusses with WMB management the need for WMI to infuse at least another \$2.0 billion into the Bank.
7/3/08	Exam team asked to provide a list of provisions to be considered for inclusion in the MOU.
7/7/08	Exam team provided suggested requirements to be included in the MOU.
7/10/08	Examiners inform WMB management of conclusion that the Bank failed to comply with certain aspects of the Compliance C&D.
7/11/08	IndyMac Bank is placed in receivership
	WR updates DC on upcoming 2Q08 earnings announcement that WMB would report on July 22, 2008,

	including a higher loss expectation of $3.3 billion loss versus about $1.1 billion in the first quarter. The difference resulted from a dramatic increase in ALLL provision (approximately $3.5 billion planned amount was increased to $5.9 billion in response to examination plus a little more). Total assets are down to about $309 billion.
7/14/08	Examiners attend earnings update meeting with WMB executives
7/15/08	OTS West Region management and examiners met with Board to present examination findings and conclusions, including the decision to downgrade Capital to "4", Asset Quality to "4", and Management to "3" while maintaining a Composite "3". The FDIC indicated that they considered the Bank a borderline "3" composite. OTS also informed the Board of a pending enforcement action related to the condition of the Bank. IN addition to the significant deterioration in the Bank's financial condition, other significant findings included continuing concerns with respect to underwriting of SFR loans, particularly related to stated income lending, problems in the home loan appraisal process, continuing compliance management concerns, particularly in BSA/Anti Money Laundering concerns; and ineffective enterprise risk management function, deficiencies in ALLL and reserve methodologies, and less that satisfactory Board and management oversight.
	David Bonderman, new director at WAMU representing TPG, asked the WR Director whether TPG's arrangement can be clarified/altered on their rebuttal of control to allow the observer who joins him at board meetings to ask questions and/or participate in discussions but continue to not vote, and whether WAMU management could, if they choose, contact some of the TPG related staff/companies for advice and counsel. This would be solely at WAMU management's initiation.
	DC management requested that the examiners follow up on reports from the FDIC regarding complaints from branch customers that IndyMac official checks are being sent for collection by WaMu which could mean no access by customers to deposited funds for 8 weeks. DC also asked for clarification whether the checks were from the former FSB or the new conservatorship FSB. If from the latter, the holds would appear to be inappropriate. Clarification from WMB was requested.
7/17/08	OTS West Region receives independent complaints regarding WMB holding checks drawn on IndyMac Bank (in receivership) for eight weeks. WMB confirmed that extended holds were in effect due to the receivership. WR Director instructed WMB to honor IndyMac check in accordance with regulatory requirements for check hold procedures. WMB indicated the Bank issued new guidance to branches to comply.
7/18/08	OTS receives a letter explaining the scope of a consulting agreement whereby Mckinsey and Company would provide consulting services, the goal of the project was to build on WMB's initial transformation results achieved in Project Restart to create a go-forward environment where WMB's executives will drive performance through enhanced accountability and decision making while preserving the best elements of WMB's culture and values.
7/19/08	In response to OTS findings that WMB did not comply with terms of certain requirements of the compliance (BSA) C&D, management provided a legal response from Wilmer Hale opining that the Bank was in compliance. OTS disagreed with this response
	Management provided capital projections for WMB that accompany the LRF Income reflecting a $2 billion infusion of capital from WMI to WMB which is expected to occur before the earnings announcement scheduled for the following week.
7/21/08	WMB informed WR Director that their attempt to sell all Chicago deposits and certain offices plus all Colorado branches to US Bank was off. As negotiations neared the end, US Bank upped the anti by asking for a letter of credit given their perception of WMB as being named on a list of banks for possible take over etc. WMB thought that the requirement for a letter of credit, if made public, might cause further headline risk.

	WMB informs WR Director that WMI infused $2.0 billion into the Bank
	Received FDIC 7/21/08 letter which contained their thoughts on conditions that should be included in any enforcement documents, which included a requirement that WMB needed an additional $5.0 billion in capital.
7/22/08	WR Director responds to FDIC 7/21/08 letter which contained their thoughts on conditions that should be included in any enforcement documents.
	Moody's Investors Service placed the ratings of WMI (senior unsecured rating of Baa3) and WMB (financial strength rating of C-, long term deposit rating of Baa2, and short term rating of Prime-2) under review for downgrade. The review follows WMB's reported $3.3 billion loss for the second quarter of 2008.
	Met with WMB regarding liquidity position given concern that upcoming earnings announcement could cause new deposit outflows on top of post IndyMac outflows. Management reported building cash reserves in anticipation with existing $8 billion cash and expected $13 billion by the end of the week. They are also increasing their collateral at the FED. They currently have $8 billion in borrowing capacity at the FED and will have $15 billion by the end of the week. They ran various deposit decrease scenarios and opined that a $25.0 billion decrease by month end would be serious. Although they have $60 billion in borrowing capacity, the FHLB is not in a position to fund more than about $4 to $5 billion a week which would leave them relying on the FED and Cash Reserves. Ability to draw down FHLB advances also limited by the ability of the FHLB's ability to place large sums of paper in the capital markets in order to fund WMB advance requests.
	WMB has $19.7 billion in what they consider susceptible uninsured deposits.
7/23/08	WR Director and exam team met with management to discuss recent earnings call and recent steps to improve liquidity.
7/24/08	Examiners met with management to discuss the post earnings announcement impact on liquidity and need to shore up deposit outflow.
	"Gimme Credit Research Brief", reports that "many of WaMu's unsecured creditors are quietly reducing their exposure to the troubled bank, increasing its relative reliance on insured deposits and FHLB borrowings". This is being evidenced in the credit default market.
	OTS DC concerned about increasing widening of spreads for credit default swaps related to WMI debt. Management opined that much of this was due to speculators in these instruments
7/25/08	FRB informed WR Director that they would be sending an examiner from their Credit monitoring department to monitor liquidity and related credit/collateral.
	WMB expresses concern about the impact on yield from maintaining higher levels of liquid assets. OTS tells management that it best to maintain excess liquidity in the short term and to take necessary steps to increase deposits to recapture funds lost. Also OTS tells management to ensure that the company implements effective media/press/investor plans as we understand that they have hired firms to advise them in that regard.
	NY Post reports inquires of WMB about whether FHLB- SF has a blanket lien on WMB assets reportedly based on sources within FHLB and WMB's "regulator".
7/28/08	FRB examiner Patrick Loncar arrived to monitor WMB's liquidity.
	WMB looking into restructuring large deposits at WMB by using both the WMB and WMBfsb charters to increase FDIC coverage
7/30/08	Examiners participate in a conference call update with DC senior management regarding exam findings, MOU, financial projections, and liquidity.
7/31/08	WMB reports first positive deposit flow post IndyMac closure.
8/1/08	OTS Director and senior OTS management, FDIC director and senior staff met with CEO Killinger and

	members of his executive team who presented WMB's long term forecast. Apparently, FDIC indicated to WMB that they put little credence in their plans
	WR Director informed by OTS DC senior management that per FDIC Chairman, FDIC has a ratings difference with OTS. WR Director indicated that per onsite FDIC examiner, the FDIC was only contemplating a ratings difference. WR FDIC director indicated that the region had not yet reached a decision but that the LIDI group was contemplating a downgrade; he also indicated that he thought the FDIC EIC has stated that the FDIC would rate the bank a "4" at the 7/15/08 board meeting; however, WR OTS director indicated that this was not the case. Based on a subsequent discussion between WR Director and WR FDIC Director, the FDIC was still pondering their CAMELS rating so a rating difference did not yet exist between OTS and FDIC.
	FDIC EIC indicated that FDIC DC senior management may have instructed WMB CEO to find a merger partner.
8/4/08	FRB credit examiner Julie Plock joins FRB examiner Patrick Loncar onsite.
	Exam team met with WR Director to discuss WMB rating and info package to be sent to DC.
	Examiners resumed the more extensive Weekly liquidity reports to DC including the most recent asset quality information available (in addition to daily liquidity reports).
8/5/08	The FRB declines WMB for the 84 day TAF borrowing facility that began that week.
8/6/08	WMB reports that FHLB SF would likely implement 400 bp across the board haircuts that would lessen liquidity availability. In addition, given the recent post IndyMac deposit runoff, the 3 and 6 month liquidity projections for the stress scenario fell below the Bank's minimum target levels.
	Discussions with FDIC EIC indicated that he was now thinking of rating Liquidity a "4" based on recent post IndyMac deposit runoff, tightening of lending policy by the FHLBSF, and per him, a call from the Fed to the FDIC Chairman expressing concern about WaMu's liquidity. He acknowledged that his position from a few weeks ago of a "3" rating for Liquidity has changed as a result of these factors. He mentioned that he may also get guidance to rate Capital a "4" and Management a "4", however, his indication seemed to be that he is already backing the "4" liquidity rating, but will go along with "4" Capital and Management ratings if that is the decision of FDIC management.
8/8/08	Executive management update by CFO, Treasurer, and CCO on loss tracking, earnings and post IndyMac deposit runoff. Management indicated that most of the runoff ($6.6B) came from uninsured accounts and approximately a third of that was from accounts over $500.0 million. Deposit losses were heavily concentrated in Southern California which was hardest hit; however, current deposit trends were stable. RD Dochow stressed the need to shore up liquidity and strongly indicated that management should pursue regaining deposits lost in the post IndyMac runoff.
	FRB examiners conclude onsite visit
8/13/08	OTS examiners met with Treasurer and his staff to register concern that the bank was not aggressively increasing liquidity via deposits and the need to bring liquidity back in line with internal targets in stress scenarios. Examiners again reiterated what they and WR Directors had indicated earlier, that management should be less concerned about the effect of excess liquidity on NIM that they should be about the potentially fatal impact that could result from future liquidity runs. Management also expressed concern regarding negative impact that higher rates could have on headline risk but agreed to be more aggressive in deposit gathering.
8/14/08	WMB provides updated LRF showing $2.0 billion capital infusion in July 2008 and no other capital raise necessary through 2010; updated earnings projections indicating return to positive earnings in 2Q09; potential $600M debt for equity swap, and TPG investors agreement term sheet.
	Management provided updated cumulative loss tracking report indicating that losses were tracking within loss projections.

8/18/08	WR director and exam team update DC management on WMB.
	WMB completes DC's (Sharon Stark) request for option ARM data.
8/19/08	WMB provides positive and negative events that could impact capital in the near future, the impact of which, were essentially neutral.
	WR management and exam team discuss ratings and FDIC suggested ratings.
8/20/08	OTS examiners provide assessment of FDIC's capital analysis to WR Director.
	WMB reports significantly reduction is SFR loan production.
	Deposit runoff post IndyMac approximates $9.3 billion
	OTS examiners provide assessment of FDIC's capital analysis to WR Director
8/21/08	WMB management provides information on office closures related to Hurricane Fay.
	WMB reports minimal exposure to FNMA and FHLMC subsequent to the government takeover of these entities.
	WMB stressed projected earnings by $300 and $500 million per quarter but still indicate compliance with well capitalized standard through 2010
8/22/08	DC Senior management updates OCC Director on WaMu.
	WR Director discussed OTS ratings with WR FDIC management.
8/23/08	Management finally begins the 5 day deposit special that OTS had been strongly encouraging for some time.
8/26/08	WMB management and OTS and FDIC Examiners discuss most recent earnings projections.
8/27/08	Examiners have updated discussion with management on Loss Model.
	Exam team received FDIC's most recent Capital assessment from DC management.
8/28/08	Examiners provide DC and WR management with an update of most recent earnings projections.
	OTS Examiners and WR management participate in a conference call with FDIC examiners and FDIC WR management to discuss FDIC's assessment that Capital is inadequate.
9/3/08	Examiners WR management and FDIC representatives attend Quarterly Treasurer's meeting.
	Provided initial assessment of FDIC's capital analysis to DC per S. Polakoff's request
9/5/08	WR FDIC informs WR OTS that they are proceeding with problem bank memo and OTS informs FDIC that OTS will respond. Also OTS indicates that MOU and Killinger resignation will be announced on 9/8/07.
	WMB provides PERK material for 4Q08 exam work.
9/7/08	WMI/WMB MOU signed by directors, Alan Fishman approved as CEO by directors, and Kerry Killinger resigns as CEO.
	WSJ and Seattle Times reports Mr. Killinger's resignation prior to the public announcement on 9/8/08
9/8 /08	OTS Director informs Secretary Paulson, Director John Dugan, Director Sheila Bair, and Fed Govs Don Kohn and Randy Kroszner that WMB/WMI MOU was effective 9/7/08.
	OTS receives the FDIC's final memo recommending a "4" rating for WMB, the region required to respond in 3 days.
	WMB announces Alan Fishman as WMB as CEO.
	WMB ROE uploaded to system.
9/9/08	Weekly Liquidity report sent to DC.
9/10/08	During FHLB SF presentation at WR managers meeting, it was discussed whether a blanket lien on WMB's assets would give FHLB managers more assurance to continue lending to the Bank. They indicated that it would and in the following week, this was accomplished.
	WMI contributes $500M to WMB increasing pro forma capital ratios to 7.55 percent leverage and 13.19 percent risk based.

	FRB examiner Loncar requests a copy of the MOU and we indicated he would have to go through official channels.
	Field Examiners provided WR Director with a summary of differences with the FDIC's capital analysis.
9/11/08	Today's liquidity meeting noted: •Anecdotal information from the branches today suggests that deposit withdrawals remain higher than normal; most withdrawals were in increments greater than $50,000. •Post-IndyMac plans have been reinitiated in the branches, which include: emphasis on FDIC insurance education; waiver of penalties if customers restructure deposits to increase insurance coverage (with multiple account owners, etc); waiver of penalties if customers bring back official checks at a later date and redeposit the funds; distribution of flyers outside of downtown Seattle branches advertising the current 5% CD special •An 8 month CD special at 4.25% will replace the current 5% 13 month special beginning on Saturday •The negative headlines have not directly impacted other funding sources so far •Fishman, Rotella, Casey and McMurray are meeting with S&P today. The meeting was scheduled for next week, but was rescheduled because of this week's events. •Management is considering a third quarter pre-earnings announcement next week to attempt to calm the market. They are discussing this with S&P. They expect an earnings announcement to cause Fitch to downgrade the <u>holding company</u> credit rating to BBB-. The bank rating is expected to stay unchanged (BBB), although the outlook will likely change to "Negative." This will be a change from prior practice by Fitch, which has generally given the bank and the HC the same credit rating.
	Moody's downgraded the long-term deposit and issuer ratings of Washington Mutual Bank to Baa3 from Baa2. The bank's financial strength rating was downgraded to D+ from C-, base line credit assessment (BCA) to Ba1 from Baa2, and short term rating to Prime-3 from Prime-2. Washington Mutual Inc.'s senior unsecured rating was downgraded to Ba2 from Baa3. The rating action concludes the review that was initiated on July 22, 2008. The outlook is negative
	Fitch made the following downgrades for WMI: (1) long-term IDR to 'BBB-' from 'BBB' and (2) short-term IDR to 'F3' from 'F2. For WMB Fitch affirmed long-term IDR at 'BBB" but short-term IDR downgraded to 'F3' from 'F2'. The Rating Outlook is Negative.
9/12/08	OTS responds to FDIC's capital assessment.
9/15/08	WMB responds to S&P. The change in Standard & Poor's ratings for Washington Mutual announced today brings S&P's ratings in line with those announced last week by Moody's; however, it's important to note that S&P attributed its action to worsening market conditions, and not to any material change in the evaluation of Washington Mutual's financial condition. S&P's ratings for Washington Mutual Bank remain investment grade.
	Branches in the Midwest and west reported continued higher than normal activity after the market closed today because of increased press and network news coverage of Lehman, AIG, etc.
9/16/08	WMB reported increasing customer traffic in branches due to the frenzied broadcast media. The Suzi Orman segment on the Today show created increased consumer concern. She indicated that she was working with the FDIC to insure accurate information was distributed and then noted that the leading indicator of a bank failure is the stock price declining. • More customers are requesting cash withdrawals and Financial Center Managers are discussing the risk of carrying large amounts of cash and encouraging customers to either accept a cashier's check or a wire for safety. • Management working closely with the retail operations and treasury teams to insure adequate cash levels given market conditions.

	• Reports received yesterday (Monday) noted that the FDIC Call Center and CNBC questioned whether the language employed in the Master Account Agreement application for WaMu's POD accounts clearly establishes a pay-on-death arrangement as required by FDIC deposit insurance regulations. WMI legal has spoken with the FDIC and the FDIC confirmed that it does indeed meet the requirements. We have been told that the FDIC has provided this clarification to its call centers.
	OTS updates FDIC regional management on current liquidity situation.
	West Region OTS and FDIC present the WMB rating difference to FDIC Board.
	Increasing Deposit Outflows essentially wipe out recent inflows that OTS had strongly encouraged.
9/17/08	FDIC requests WMB's consolidated tax returns.
9/18/08	OTS receives a customer complaint regarding WMB not setting up accounts properly to facilitate insurance of accounts which were discussed with management.
	WMB reports high traffic in branches and continuing branch closings and reported available liquidity at $33.3 billion.
	WMB updated DC Management on Liquidity: Funding Plans - the trajectory of deposit outflows looks like it will be IndyMac ($9.5B) + 70%, or a total outflow $16-$17B over three weeks (including what has already happened). They are borrowing $8.5B from FHLBs over the next two weeks. FHLB SF now has a blanket lien and has assured WMB that they will not have any additional cuts in capacity. WMB will also be getting $2B in proceeds from discount note maturities and sales. Repo market is shut down. Repo collateral is being shifted to SEA FHLB. • Treasury Manager thinks that liquidity at the end of the quarter will be $13B, or $3B in excess cash and $10B in FHLB capacity. • M&A - Casey, Fishman, and a rep from Goldman gave an update on M&A activity. JP Morgan is expected to complete due diligence by today or tomorrow. Citi is expected to complete due diligence tomorrow. Also one other party (missed the name) is looking into acquiring a minority interest. Goldman thinks a deal could be done by Sunday.
	OTS downgrades WMB's composite rating to "4" (343442).
9/19/08	Daily Liquidity report provided to WR and DC senior management.
	John Robinson, Regulatory Relations, request that the FDIC inform OTS of their plans to send in two DRR examiners, Ken Parker and Eric Piscini, to gather IT information.
	Liquidity projected at $29.8 billion by WMB.
	FRB will keep on primary credit with same haircuts and pricing, but prefers that WMB not bid in the Monday 28 day TAF program and instead use the Discount window. Also FRB will use $1.5 billion of the pledged collateral toward intraday transactions.
	FDIC corresponds that Advances still available from the FHLBs and the situation is not dire.
	FHLB –SF reports that their accountants, PWC requires them to follow FAS 157 fair value accounting for the collateral of problem banks and that WAMU was a problem bank. That means they look to observable sales of option arms and they found some at fire sale prices of 35 cents on the dollar that they will have to use. On that basis they are out of collateral and gave advances yesterday only because of the blanket lien. FHLB of SF told management this late last night. FHLB of SF told OTS that they might be able to lend $1 to $2 billion more if it was a bridge to getting a deal done. OTS management encouraged FHLBs to continue lending.
9/20/08	Gail Patelunas, FDIC, informs Scott Polakoff that the FDIC is sending two DRR examiners to WMB.
	Daily Liquidity report provided to WR and DC senior management.
9/22/08	Daily Liquidity report provided to WR and DC senior management.

	Darrel Dochow asked FDIC to coordinate DRR efforts through onsite OTS examiners.
	Peter Frielinger, Treasury Manager and Robert Williams, Treasurer, met with both the FRB and the FHLB SF.
	In implementing a $1.5 billion daylight overdraft limit for WMB, the FRB incorrectly posted the $2 B discount window repayment against the collected balance, not the ledger balance. And since PSR (Payments System Risk) balance monitoring uses the Collected Balance not the ledger balance, this caused all of the morning's wires to get sent to a rejection cue. Apparently some counterparties were aware of the rejections. The error has been fixed and the wire cue has been cleared out, and all of this morning's wires have been sent out.
	FDIC DRR examiners Ken Parker and Eric Piscini along with OTS IT Manager Sandy Chan met with CIO Deb Horvath to discuss access to WMB systems.
	Management reported a slowing of customer traffic in branches and a slowing of outflows to more normal levels.
	Net FRB collateral determined to be $7.4 billion.
	WMB projected ending available liquidity to be $28.0 billion; however, they estimated $9.4 in FRB availability or $2.0 billion more that estimated by the FRB. FDIC projected $20.8 billion in liquidity because they reduced the amount ($8.5 billion) reportedly available from FHLB-SF to $1.0 billion.
	Onsite examiners provided West Region ERC with an update on WMB's deteriorating liquidity situation.
9/23/08	Daily Liquidity report provided to WR and DC senior management.
	FDIC requested that OTS directs the Bank to only borrow short term advances to avoid prepayment penalties; which we communicated.
	WMI ROE Uploaded to OTS System.
	WMB Treasury personnel respond that the Bank has potential saleable assets, but none that can be sold in short order. Assets potentially include loans, CMBS, corporate and municipal bonds, as well as REIT asset currently in a Special Purpose Entity that could be dissolved under certain supervisory actions.
	Latest FRB projection indicates that WaMu liquidity would reach "0" by 10/9/08 assuming approximately $2.0 billion runoff per day.
	WaMu projects available liquidity at $23.6 billion
	Notified WMI via hand carried letter that the holding company rating was downgraded to "4", which differed from the ROE's "3" rating, based on WMI's condition at 6/30/08.
	Downgraded WMBfsb to "4" based on condition of parent.
9/24/08	Daily Liquidity report provided to WR and DC senior management.
	FDIC reports to OTS that while deposit outflows are declining they are not stabilized and that FHLB-SF is "day to day" with respect to future advances.
	S&P Lowers Washington Mutual Inc's ratings to "B-" from "BB-"; S&P affirms the "BBB-/A-3" rating on Washington Mutual Bank as the breadth of the deposit franchise , the capital position and loss reserve coverage remain adequate in light of the high level of mortgage loan asset quality pressures.
	WaMu submits a presentation on potential recapitalizations options.
	FDIC informs JP Morgan that they had won the bid for WaMu
9/25/08	Daily Liquidity report provided to WR and DC senior management. Available liquidity projected at $13.1 billion (subject to FHLB continuing to fund).
	Total deposit outflow (including commercial) from 9/8/08 to 9/24/08 is $18.7 billion.
	Net consumer noninterest and small business outflows from 7/14/08 to 9/25/08 total $19 billion.
	The FHLB of San Francisco notifies WaMu that it is near its limit on advances. WaMu believed that they had another $5 billion in capacity.

WaMu Timeline

	The FRB of San Francisco moves the bank into the secondary credit category.
	FHLB-SF limits WMB advance availability to $500.0 million.
	OTS directs WaMu to dissolve the WM preferred Funding REIT.
	At FDIC's Request, OTS examiners directed WMI management to dissolve Preferred Funding REIT (a special purpose entity), forfeit all rights to the approximately $9.0 in loan collateral, and assign the collateral loans to WMB for inclusion in the receivership transaction.
	WaMu placed into receivership; sold to JP Morgan Chase.
	JP Morgan raises $7.0 billion from private investors pursuant to the WaMu purchase.
	FDIC asks if OTS found any violations of law in connection with the Appraisal Investigation. Examiners referred them to West Region Counsel, Jim Hendriksen.
9/26/08	JP Morgan raised an additional $3.5 billon in the open market or $2.5 billion more than planned, related to the WaMu deal. Its stock increased 6.8 percent from 9/24/08 price of $40.50.
	FDIC asks if OTS removed the Board Audit and Finance Committee notebooks from the examiner library and were informed that we had not. It was determined that Regulatory Relations staff had removed them the evening of 9/25/08. They were returned upon our request.

Accepted

Washington Mutual

WMBFA, WMBfsb
March 15, 2004
Safety & Soundness Examination
OTS MEMO 5

DATE: May 12, 2004
TO: Tony Meola, EVP, Production
Mark Hillis, Deputy Chief Credit Officer
FROM: Bill Durbin, OTS
SUBJECT: SFR Loan Origination Quality
CC: Deanna Oppenheimer, President WAMU Consumer Group

BACKGROUND INFORMATION

Several of our recent examinations concluded that the Bank's single family loan underwriting was less than satisfactory due to excessive errors in the underwriting process, loan document preparation, and in associated activities. Similar findings noted in internal audits and quality control reports supported our examination conclusion. The overt causes for past underwriting concerns were many, but included: (1) A sales culture focused heavily on market share via loan production, (2) extremely high lending volumes fueled by the low interest rate environment, and (3) a less than optimal organizational structure that included multiple loan origination platforms, in part due to recent merger activity, and a variety of origination procedures that varied by origination office (i.e., loan fulfillment center (LFC)).

During our review period, management began several initiatives aimed at correcting the overt causes of underwriting deficiencies discussed above. Specifically, initiatives are underway to simplify the origination structure by reducing origination platforms from nine to two while developing a single origination model to be implemented in all LFCs. Other current initiatives to improve underwriting quality include: (1) de-emphasizing the Bank's position as the pricing leader with more emphasis on maintaining manageable capacity and originating higher quality loans, and (2) installing Credit Risk Teams in LFCs aimed at increasing the credit risk management group's influence over underwriting while reducing the influence of production management. Since these and other management initiatives are in process, we cannot yet opine on their effectiveness; however, the steps taken are considered appropriate and should eventually have a positive impact on underwriting. Given the breadth of changes being made such as:,(1) computer system changes (loan origination platforms and termination of OPTIS.2) and (2) restructuring and consolidation of the loan fulfillment centers, with its attendant relocations and staff reductions, the near term result may be an environment where other types of errors may become prevalent. As such, we encourage heightened management oversight of all ongoing initiatives and careful consideration of findings discussed in this memorandum.

Our past reviews concentrated on assessing underwriting analysis documented in loan files. Since prior examinations and internal reports have already established that underwriting concerns exist, we decided to forego some file review at this examination to instead concentrate on reviewing and improving internal processes that may contribute to underwriting concerns. The following discussions relay our findings with respect to these processes.

EXAM FINDINGS DEFINITIONS

Observation: A weakness identified that is not of regulatory concern, but which may improve the bank's operating effectiveness if addressed. *Observations* are made in a consultative role. They may be presented to management either verbally or in writing, but will generally not be included in the Report of Examination. Examiners will rarely request a written response during the examination. *Observations* may or may not be reviewed during subsequent examinations.

Recommendation: A secondary concern for which immediate corrective action is left to management's discretion. A *Recommendation* can become a *Criticism* in future examinations should risk exposure increase significantly or other circumstances warrant. They may be included in the Report of Examination and are generally mentioned in Exit and Board Meetings. Examiners will usually request a written response from Management during the examination. Management's actions to address *Recommendations* are reviewed at subsequent or follow-up examinations to assess any changes in risk exposure.

Criticism: A primary concern that if left uncorrected, the Agencies may consider stronger action. *Criticisms* are often summarized in the "Matters Requiring Board Attention" or "Examination Conclusion and Comments" section of the Report of Examination; warrant increased attention by Senior Management and the Board of Directors; and typically require a written response. They are subject to formal follow-up by examiners.

Last Revised: 06/10/2004 10:24 AM

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #648

OTSWME04-0000004883

EXAM FINDING 1	☐ Observation* ☑ Recommendation* ☐ Criticism*

Topic: Consumer Group Goals

Finding: The Consumer Group's overall goals do not expressly state a goal with respect to the desired quality of loan originations/acquisitions. We believe that this issue is of sufficient materiality, complexity, and duration that it should be clearly stated as a goal with quantified expectations of those involved in the origination process.

Action: Establish and quantify a Consumer Group goal with respect to desired asset quality and communicate this expectation to those involved in the production process.

☐ Repeat Finding — **Management Response Requested** ☑ Yes ☐ No

MANAGEMENT RESPONSE ☐ Agree ☑ Partially Agree ☐ Disagree **Enter Target Date: [9/30/04]**

Management Response: Indicate whether you agree, partially agree, or disagree. If you agree, provide an anticipated target date for implementation.

Partially Agree: The response should clearly define that portion of the finding or recommended action disagreed with as well as the portion agreed to.

Disagree: The response should clearly define WHY there is disagreement with the finding or recommended action, and outline any mitigating circumstances or alternative course of action to be pursued.

RESPONSE (succinct response to finding / action)

Management agrees it is important to have specific goals and targets for portfolio performance. Consumer Group Credit Risk Management has established a target Non-performing Loan/Total Loan ratio of less than 1% as a target performance level. Management needs to communicate this target broadly as part of the overall Consumer Group strategic objectives/goals.

CORRECTIVE ACTION (provide specific action steps planned, the assigned responsible manager, and target dates for each)

1. Management will establish, quantify, and communicate a Consumer Group goal with respect to desired asset quality as part of the overall strategic objectives/goals.
   a. Manager Accountable: Mark Hillis, Chief Credit Officer, Consumer Group
   b. Target Date: 9/30/04

EXAM FINDING 2 ☐ Observation* ☑ Recommendation* ☐ Criticism*

Topic: Metrics used to monitor performance in the loan fulfillment centers.

Finding: There are 16 measures of performance in the Home Loans Production Scorecard (11 for the Correspondent channel). Only one of these, the Optimal Performance Score, measures overall quality. (The Optimum Performance score is obtained quarterly for most LFCs but is not available for the Correspondent channel.) In addition, the measurement of Home Mortgage Disclosure Act (HMDA) performance is not measured by LFC; rather, this is measured only by loan channel. The current performance measurements do not appear to be either sufficiently detailed or sufficiently frequent to effectively monitor and promote desirable loan origination and acquisition quality.

Action: Track performance with sufficient detail and frequency to effect the desired change in underwriting. Ideally, performance measures should be provided monthly and in sufficient detail to trace problems to the specific channel, and LFC.

☐ **Repeat Finding** **Management Response Requested** ☑ **Yes** ☐ **No**

MANAGEMENT RESPONSE ☑ **Agree** ☐ **Partially Agree** ☐ **Disagree** **Enter Target Date: [9/30/04]**

Management Response: Indicate whether you agree, partially agree, or disagree. If you agree, provide an anticipated target date for implementation.
Partially Agree: The response should clearly define that portion of the finding or recommended action disagreed with as well as the portion agreed to.
Disagree: The response should clearly define WHY there is disagreement with the finding or recommended action, and outline any mitigating circumstances or alternative course of action to be pursued.

RESPONSE (succinct response to finding / action)

The Risk Oversight team will work with the Home Loans team, to further refine risk metrics that are used to evaluate and manage: Credit, Compliance and Data Integrity risk elements in conjunction with ongoing process refinements. Management is supportive and has requested continuous feedback to support business execution and risk management activities. The Risk Oversight Group is in process of developing testing capabilities to provide monthly feedback for all LFC's.

CORRECTIVE ACTION (provide specific action steps planned, the assigned responsible manager, and target dates for each)

1. Identification of risk metrics will be performed in collaboration with Home Loans.
   a. Manager Accountable: Melissa Martinez, Risk Oversight & Compliance
   b. Target Date: 7/30/04

2. Establishment of risk tolerance and performance standards will be developed in collaboration with Home Loans.
   a. Manager Accountable: Melissa Martinez, Risk Oversight & Compliance
   b. Target Date: 7/30/04

3. Full implementation of revised performance measurement standards will be implemented no later than September 30, 2004.
   a. Manager Accountable: Melissa Martinez, Risk Oversight & Compliance
   b. Target Date: 9/30/04

EXAM FINDING 3	☐ Observation*	☑ Recommendation*	☐ Criticism*

Topic: Incentive compensation for loan fulfillment centers

Background:

The incentive compensation plan with respect to managers incorporates four performance measures including: (1) productivity, (2) customer service, (3) management objectives, and (4) quality. This discussion primarily focuses on the quality measure that generally accounts for 20.0 to 40.0 percent of incentive compensation. Within the quality measure, there are four components: (1) HMDA results, (2) Optimum Performance review results [1], (3) RQA review results, and (4) percentage of unsaleable loans. The plan indicates that one or two of these components may be used in determining the quality portion of incentive compensation; however, in practice, only two measures are used: HMDA and Optimum Performance review results. Both components are currently used for each consumer direct, wholesale and retail LFC. As expressed in the plan, the program can generate the following compensation for various levels of achievement in the Optimum Performance reviews.

RPI Category	RPI Score	Minimum Incentive Award as a % of Salary	Maximum Incentive Award as a % of Salary
Unsatisfactory	Below 60%	0%	0%
Unsatisfactory	60% to 69%	1.1%	2.6%
Marginal	70% to 79%	1.3%	3.0%
Satisfactory	80% to 89%	1.5%	3.4%
Commendable	90% to 100%	1.7%	3.8%

The foregoing assumes: (1) the quality portion of the incentive compensation plan ranges from 20% of the total (the minimum incentive assumption) to 40% (the maximum incentive assumption), (2) an Optimum Performance score of 80% equates to achieving 100% of the goal, and (3) two measures are used for quality, HMDA and Optimum Performance score.

In practice, we were informed that some channels use a minimum standard of 70.0 percent for the quality portion of an incentive award, notwithstanding the provisions in the plan. One channel augments the core results with a portion of the Management Objective component of the incentive plan.

Finding: We do not believe that the current incentive compensation program for SFR loan underwriting provides effective incentive to maximize satisfactory or superior loan quality. This results in part from the fact that credit and underwriting quality does not appear to be sufficiently weighted in determining incentive compensation. In addition, the plan allows for significant tailoring by LFC management and is not consistently applied across channels and LFCs. Further, current methodology makes it difficult to trace responsibility and appropriately affect incentive compensation. These findings pertain primarily to the LFC manager position, but are generally applicable to other positions in the LFC.

The Optimum Performance or RPI score is an average of the score for three components: compliance, underwriting, and process. An LFC could perform at an unacceptable level in one component but qualify for an incentive compensation award because performance in the other components is better. (For example, one LFC scored 65 for credit but received an 82 overall and would thus have earned more than 100% of its incentive plan target for quality even though its credit quality performance was unsatisfactory.)

The HMDA quality measure is not available by LFC; instead, the incentive compensation for the LFCs is based on the performance for the entire channel. As a consequence, the LFC managers can influence, but not control, their ability to meet the incentive compensation standard for HMDA quality.

Action: Management should consider enhancing the incentive compensation plan with respect to the loan fulfillment center manager position to more heavily emphasize credit quality concerns. Our recommendations include: (1) Revising the incentive compensation plan to track quality performance using only items that can be measured at the LFC level; (2) Measuring performance based on four criteria: quality of compliance, documentation, underwriting, and data quality, including rate lock quality; (3) Working with the Consumer Risk Oversight Group to obtain performance measures in the four categories; (4) Establishing minimums in each category that reflect an acceptable level of quality, or that temporarily

[1] Optimum Performance results are also referred to internally as a Risk Performance Indicator (RPI) score. This score is determined as a result of file reviews conducted by one of the quality control functions within the Bank (separate from RQA). The score is a composite measure of file review results that assess compliance, processes, and credit quality.

EXAM FINDING 3	☐ Observation* ☑ Recommendation* ☐ Criticism*

accept a lesser level but reward progress toward an acceptable level; (5) Establishing a level and range of reward that provides a meaningful incentive to achieve excellent quality in loan origination and acquisition, and disincentives for poor quality; and (6). Centrally administering or overseeing the quality portion of the incentive compensation to ensure the objectives of the program are being met in all channels and LFCs.

In addition, review the quality aspects of the incentive compensation plans with respect to other positions affecting loan quality and, where appropriate, revise the plans to serve as an effective incentive to improve performance.

☐ Repeat Finding — Management Response Requested ☑ Yes ☐ No

MANAGEMENT RESPONSE ☑ Agree ☐ Partially Agree ☐ Disagree **Enter Target Date: [1/01/05]**

Management Response: Indicate whether you agree, partially agree, or disagree. If you agree, provide an anticipated target date for implementation.

Partially Agree: The response should clearly define that portion of the finding or recommended action disagreed with as well as the portion agreed to.

Disagree: The response should clearly define WHY there is disagreement with the finding or recommended action, and outline any mitigating circumstances or alternative course of action to be pursued.

RESPONSE (succinct response to finding / action)

Washington Mutual management is in agreement with the recommendations for Exam Finding 3 and will take steps as defined below to comply with actions as stated. Target implementation dates are defined below.

CORRECTIVE ACTION (provide specific action steps planned, the assigned responsible manager, and target dates for each)

1. Identify existing credit quality performance measure(s) to be used within the LFC Incentive Plan management plan as part of the management objective component of the plan.
   a. Manager Accountable: Mark Hillis, Consumer Credit Risk Oversight
   b. Target Date: 8/31/04

2. Utilize the management objective component of LFC management plan to focus on credit quality measure (Measure as identified in corrective action #1). This will result in 6.3% of management pay linked to credit quality.
   a. Manager Accountable: John Schleck, Kim Yezbak and Arleen Scavone, LFC Sr. Leaders
   b. Target Date: 10/1/04

3. Increase incentive weight of existing quality measures for LFC management from 25% to 35%. This coupled with corrective action #2 will result in 15% of LFC management pay linked to quality.
   a. Manager Accountable: Peggy Ohlhaver, Consumer Rewards
   b. Target Date: 10/1/04

4. Risk weight the Optimum Performance or RPI components: compliance, underwriting, and process to better reflect impact of achievement.
   a. Manager Accountable: Peggy Ohlhaver, Consumer Rewards
   b. Target Date: 7/1/04

5. Working with Consumer Credit Risk Oversight, establish agreed upon achievement thresholds for existing quality measures within the LFC plan and revise incentive tables.
   a. Manager Accountable: Peggy Ohlhaver, Consumer Rewards
   b. Target Date: 10/1/04

6. Establish strategy for identifying credit quality metric accountability, tracking and incentive link for the four areas identified within the exam findings: quality of compliance, documentation, underwriting and data quality, including rate lock quality.
   a. Manager Accountable: Mark Hillis, Consumer Credit Risk Oversight & Tony Meola, Production (for rate lock quality)
   b. Target Date: 1/1/05

7. Launch study to identify drivers and accountability of quality excellence in loan origination and acquisition and determine appropriate incentive link.
   a. Manager Accountable: Peggy Ohlhaver, Consumer Rewards
   b. Target Date: 7/1/04

8. Centralize oversight of LFC quality metrics to the Consumer Credit Risk Oversight function.
   a. Manager Accountable: Mark Hillis, Consumer Credit Risk Oversight
   b. Target Date: 8/31/04

EXAM FINDING 4	☐ Observation*	☑ Recommendation*	☐ Criticism*

Topic: Management Support for the Loan Fulfillment Centers

Finding: LFCs are inundated with changes in loan origination procedures and policies, to the extent that they have difficulty complying with the changes.

Action: Management should provide additional support to the LFCs to help them implement policy and procedure changes as expected. One suggestion is to write model desk procedures for each position in the loan fulfillment centers and to revise these desk procedures concurrently with each notice of a procedural or policy change. When the LFC receives notice of a new policy or procedure, it should also receive a revised desk procedure for each affected position in the LFC. This will improve compliance with standards in the LFC and promote consistency among the LFCs, a stated management expectation. The timeliness and adequacy of training should also be reviewed.

☐ **Repeat Finding** **Management Response Requested** ☑ **Yes** ☐ **No**

MANAGEMENT RESPONSE ☐ **Agree** ☑ **Partially Agree** ☐ **Disagree** **Enter Target Date: [7/31/04]**

Management Response: Indicate whether you agree, partially agree, or disagree. If you agree, provide an anticipated target date for implementation.

Partially Agree: The response should clearly define that portion of the finding or recommended action disagreed with as well as the portion agreed to.

Disagree: The response should clearly define WHY there is disagreement with the finding or recommended action, and outline any mitigating circumstances or alternative course of action to be pursued.

RESPONSE (succinct response to finding / action)

Partially Agree: Although we agree that there has been a large amount of changes in policies and procedures and it is difficult at times to comply/keep up with changes, we do feel that change is relative to the nature and the core of our business. In addition, there are several techniques in place to lessen the impact of changes to both LFC management and staff, including following up large impact changes with meetings and training to ensure the changes are communicated to all applicable levels.

CORRECTIVE ACTION (provide specific action steps planned, the assigned responsible manager, and target dates for each)

1. Continue to work with Policy Administration to ensure all policies are rolled out with as much notice as possible, and channel managers will ensure that LFC management has input on policy changes as needed.
   a. Manager Accountable: Arleen Scavone, John Schleck, Kim Yezbak
   b. Target Date: 7/31/04

2. Utilize Loan Fulfillment Center management facilitate twice daily/weekly team meetings to review and train on new policies and procedures.
   a. Manager Accountable: Arleen Scavone, John Schleck, Kim Yezbak
   b. Target Date: 7/31/04

3. Continue to issue HLPAs developed by the Policy Administration group weekly (each Friday) with a two week implementation window prior to effective date of a change.
   a. Manager Accountable: Arleen Scavone, John Schleck, Kim Yezbak
   b. Target Date: 7/31/04

4. Utilize channel management communication avenues to refresh and re-enforce policy communications on a monthly basis.
   a. Manager Accountable: Arleen Scavone, John Schleck, Kim Yezbak
   b. Target Date: 7/31/04

Washington Mutual

WMB
March 15, 2004
Safety & Soundness Examination
FDIC-DFI MEMO 3

DATE:	May 20, 2004
TO:	Mark Hillis, Deputy Chief Credit Officer
	Tony Meola, EVP, Production
FROM:	Trina Dong, FDIC and Erin Burr, DFI
SUBJECT:	Single Family Residential Review
CC:	

BACKGROUND INFORMATION

FDIC and State examiners reviewed a sample selection of 220 loans during this examination, primarily loans originated in 2003: 75 brokered loans, 65 loans originated in house, 20 subprime/niche loans, 20 low doc, 20 custom construction, 10 residential lot loans, and 10 advantage 90/high LTV loans. **The loan file review reflected inconsistencies in underwriting and documentation practices, particularly in the brokered channel. Additionally, examiners noted that Washington Mutual's SFR portfolio has an elevated level of risk due to a significant volume of potential negative amortization loans, high delinquency and exception rates, and a substantial volume of loans with higher risk characteristics, such as low FICO scores** (see Joint Memo #8).

EXAM FINDINGS DEFINITIONS

Observation: A weakness identified that is not of regulatory concern, but which may improve the bank's operating effectiveness if addressed. *Observations* are made in a consultative role. They may be presented to management either verbally or in writing, but will generally not be included in the Report of Examination. Examiners will rarely request a written response during the examination. *Observations* may or may not be reviewed during subsequent examinations.

Recommendation: A secondary concern for which immediate corrective action is left to management's discretion. A *Recommendation* can become a *Criticism* in future examinations should risk exposure increase significantly or other circumstances warrant. They may be included in the Report of Examination and are generally mentioned in Exit and Board Meetings. Examiners will usually request a written response from Management during the examination. Management's actions to address *Recommendations* are reviewed at subsequent or follow-up examinations to assess any changes in risk exposure.

Criticism: A primary concern that if left uncorrected, the Agencies may consider stronger action. *Criticisms* are often summarized in the "Matters Requiring Board Attention" or "Examination Conclusion and Comments" section of the Report of Examination; warrant increased attention by Senior Management and the Board of Directors; and typically require a written response. They are subject to formal follow-up by examiners.

EXAM FINDING 1 ☐ Observation* ☑ Recommendation* ☐ Criticism*

Topic: Inconsistent Underwriting and Documentation Practices

Finding: The loan file review of WMB's portfolio revealed the following inconsistencies.

- A substantial number of loans (17 of 75 brokered loans, 9 of 65 originated in house, and 8 of 20 low doc loans) granted to borrowers with derogatory credit ratings or with higher risk characteristics were graded a "0" or "prime." The assigned credit classification is inconsistent with the bank's policy and credit grading guidelines. As a result, these loans were not accurately priced for risk as loans with 2-4 credit codes (niche loans) which are priced at a premium rate. Additionally, the inconsistency in credit grading resulted in an inaccurate level of loan loss reserve for the niche portfolio.
- The full doc loans in the brokered portfolio (21 of 75 loans reviewed) were not fully documented and did not meet the criteria for appropriate verifications. Missing employment, asset, and income verifications were noted in the review.
- FICO scores were not consistently reported on the Loan Approval Summary Sheet for a majority of the loans reviewed. The underwriting guidelines specify which score to use when multiple credit reports were obtained, but it has not been applied uniformly.
- There is often lack of support for income calculations in the underwriting analysis, especially when multiple credit applications are in the file.
- Some of the title policies for the NegAm loans have the insurance amount of 110% of the original loan

EXAM FINDING 1 ☐ Observation* ☑ Recommendation* ☐ Criticism*

balance and some have 100% of the loan amount.

During the examination, management began several initiatives to enhance the credit culture and correct underwriting deficiencies through the implementation of minimum credit standards, Credit Risk Teams, and a proprietary credit scoring model (version 2). However, examiners cannot yet opine on the effectiveness of these initiatives.

Action: Develop a process and system to ensure that underwriting guidelines are consistently applied.

☐ Repeat Finding Management Response Requested ☑ Yes ☐ No

MANAGEMENT RESPONSE ☑ Agree ☐ Partially Agree ☐ Disagree **Enter Target Date: [12/31/04]**

Management Response: Indicate whether you agree, partially agree, or disagree. If you agree, provide an anticipated target date for implementation.

Partially Agree: The response should clearly define that portion of the finding or recommended action disagreed with as well as the portion agreed to.

Disagree: The response should clearly define WHY there is disagreement with the finding or recommended action, and outline any mitigating circumstances or alternative course of action to be pursued.

RESPONSE (succinct response to finding / action)

Management agrees with the Recommendation. As noted above, Consumer Credit Risk Management, in collaboration with the Consumer Group Production channels, have developed and begun several initiatives to enhance credit culture and correct underwriting deficiencies. In addition, the credit class 2-4 program has been eliminated effectively Q3 '04. This coupled with Credit Risk Team (CRT) monitoring, training, and control should also add to the improvement of these processes and overall quality. Please Note: FICO score discrepancies are predominantly caused by inefficiencies in our loan origination systems which cause loans to be manually boarded and may, in some cases, result in a new credit score to be drawn which could conflict with the score used at origination and underwriting.

CORRECTIVE ACTION (provide specific action steps planned, the assigned responsible manager, and target dates for each)

1. MINIMUM CREDIT STANDARDS PROJECT: Consumer Credit Risk Management implemented the new Minimum Credit Standards, which supplements the existing underwriting process for loans that receive a WaMu AUS-Refer. These Standards include a FICO/LTV-CLTV Matrix that determines which underwriting path a loan will follow. Loans falling below the matrix that may present an unacceptable level of risk will be quickly passed on to a credit approver with the appropriate level of authority and experience to explore all options prior to a decision being rendered. All AUS-Referred loans, however, will be reviewed in accordance with manual underwriting credit guidelines, regardless of the FICO score. This policy is currently in effect and applies to all loan applications or loan submissions made on or after April 1, 2004.

2. CREDIT RISK TEAMS (CRTs): These teams of senior underwriters who are managed outside the fulfillment operation are being deployed in all Loan Fulfillment Centers (LFCs). Four pilot sites have been operating since May 17 and CRTs will be operational in all LFCs by July 31 and fully implemented by the end of the third quarter. These teams in addition to handling more complex and high risk transactions will also monitor the performance of all credit approvers in the centers. A new Residential Lending Authority Policy and Performance Improvement Plan will be introduced in June and all credit grantors will be re-certified by year end. **Responsible Manager: Barry Wolfgram, Consumer Credit Risk Management. Target Date: 12/31/2004**

3. PROPRIETARY CREDIT SCORING MODEL (version 2): The Enterprise Modeling and Decision Systems group is currently redeveloping the Home Loans Proprietary Model (PM2). The PM2 is expected to be significantly more robust in risk prediction than the Transitional Proprietary Model (TPM) that is currently in place and will be much more reliant on credit file information than its predecessors. The development is based on WaMu's new credit file attribute superset, which consists of approximately 490 different credit attributes in addition to the added incremental predictivity of application attributes, loan purpose, and other significant characteristics. The PM2 is scheduled to be completed in 3rd quarter 2004.

   As a result, enhanced services should be able to be offered more confidently to lower-risk borrowers, improving service and pull-through rates for more desirable risk profiles. At the higher risk end of the spectrum, more accurate identification of risky loans and associated automation to achieve "quicker no's" on these loans will assist in fewer opportunities for errors associated with manual processes. **Responsible Manager: Tim Bates, Corporate Credit Risk Management. Target Date: 9/30/2004**

EXAM FINDING 2	☐ Observation*	☑ Recommendation*	☐ Criticism*

Topic: Underwriting for Low Documentation Loans

Finding: The bank's underwriting guidelines indicate that the low doc loan program is designed to expedite processing of low risk loans. **Eight of the 20 low doc loans reviewed were to borrowers with credit scores lower than 660 who had major derogatory ratings or current past due problems listed on their credit reports. Granting loans to these borrowers would appear contrary to the low risk characteristics.** Additionally, no compensating factors were noted in the underwriting analysis when approving such loans.

Limited income or employment verification within this loan program was also noted, as verification is not required for low doc loans according to the bank's underwriting guidelines. The applicants may qualify using stated income and verify their own employment. However, such guidelines appear contradictory to the low risk criteria.

Action: Reevaluate the documentation and underwriting guidelines and establish acceptable credit quality and underwriting parameters for the low doc loan program that are consistent with the low risk characteristics.

☐ Repeat Finding — Management Response Requested ☑ Yes ☐ No

MANAGEMENT RESPONSE ☑ Agree ☐ Partially Agree ☐ Disagree **Enter Target Date: [12/31/04]**

Management Response: Indicate whether you agree, partially agree, or disagree. If you agree, provide an anticipated target date for implementation.

Partially Agree: The response should clearly define that portion of the finding or recommended action disagreed with as well as the portion agreed to.

Disagree: The response should clearly define WHY there is disagreement with the finding or recommended action, and outline any mitigating circumstances or alternative course of action to be pursued.

RESPONSE (succinct response to finding / action)

Management agrees with the Recommendation. In order to further drive credit quality consistency and acceptable level of risks on Low Doc transactions we will monitor their performance and reevaluate the documentation and underwriting guidelines and establish acceptable credit quality and underwriting parameters for the Low Doc Loan Program that are consistent with the low risk characteristics.

CORRECTIVE ACTION (provide specific action steps planned, the assigned responsible manager, and target dates for each)

1. Thus far all of our analyses conclude that Low Doc loans significantly outperform Full Doc loans. This is also seen when comparing the other Low Doc qualifying criteria (CLTV, DTI, etc.). These loans are sent through our predictive models (LPRM) which show these to have lower loss expectations. Overall NPL rate from Low Doc loans with FICOs less than 660 is 1.00% compared to Full Docs with FICOs less than 660 which have a rate of 1.64%. The Credit Information and Analytics team will continue to monitor these through regular audit reports that screen for high risk Low Doc loans. The results will then be communicated to National Underwriting for review and to implement necessary corrective actions. **Responsible Manager: Alan Newstead, Consumer Credit Risk Management. Target Date: 09/30/04**

2. National Underwriting will use these reports to evaluate, control, and improve the underwriting process for Low Doc loans. Consumer Credit Policy will review and revise the applicable sections of the Conventional Underwriting Guideline, the Home Loans Online Lending Manual, and the Product and Pricing Guide to ensure all areas of evaluating the applicant are addressed. Also included in this review will be the overall credit review process, income and asset analysis, and the documenting of the risk decision. In addition, the sections regarding Verbal Verifications of Employment will be reviewed to ensure that they provide clear and concise direction when verbally verifying self employed applicants, as well as those borrowers with unusual income sources.

   Following the review and necessary revision, National Underwriting will drive the operational execution with the new Credit Risk Teams (CRTs) who will oversee and monitor the implementation of the new policy and training. **Responsible Manager: Barry Wolfgram, Consumer Credit Risk Management. Target Date: 12/31/04**

EXAM FINDING 3 ☑ Observation* ☐ Recommendation* ☐ Criticism*

Topic: Risk in SFR Portfolio

Finding: **Our review, as well as that of Corporate Credit Review identified that Washington Mutual's held-for-investment SFR portfolio has an above average risk profile: higher delinquencies and exception rates, 69% of WMI's SFR portfolio has the potential to negatively amortize; and 17% of WMI's SFR portfolio, or 135% of Tier 1 Capital, reflects current FICO scores less than 620.**

WMB's SFR loans with the potential NegAm feature represent 96% of the Option ARM loans or 74% of the SFR portfolio in 2003, an increase from 88% of the Option ARM loans or 38% of the SFR portfolio in 2002. These loans increase credit risk in a rising interest rate environment due to borrowers' uncertain ability to service a higher monthly payment, a potential increase in principal balance, and potential LTV concerns. The September 2003 internal analysis concluded that NegAm loans make up a significantly larger proportion of loans in the lower FICO bands, have higher delinquencies, and higher current LTVs than the loans in the rest of the portfolio.

WMI's loans with FICO scores less than 620 totaled approximately $19 billion, or 135% of WMI's Tier 1 Capital. Loans in this category show a higher delinquency rate compared to the rest of the portfolio. Of the $19 billion, approximately $1.98 billion is currently more than 30 days past due, which represents 85% of the $2.33 billion delinquent loans for the entire SFR portfolio.

The June 2003 Credit Review Report concluded that the level of Washington Mutual's non-performing loans is considered high and the probability of improvement in overall performance is not likely. Additionally, the review identified excessive error rates in documentation.

Action: Monitor the effectiveness of management's new initiatives: the establishment of minimum credit standards, formation of Credit Risk Teams, and launching of a new proprietary credit scoring model. Measure the underwriting quality that results from the above initiatives and take corrective action if necessary to enhance the process.

☐ Repeat Finding — Management Response Requested ☐ Yes ☑ No

MANAGEMENT RESPONSE ☑ Agree ☐ Partially Agree ☐ Disagree — Enter Target Date: [N/A]

Management Response: Indicate whether you agree, partially agree, or disagree. If you agree, provide an anticipated target date for implementation.
Partially Agree: The response should clearly define that portion of the finding or recommended action disagreed with as well as the portion agreed to.
Disagree: The response should clearly define WHY there is disagreement with the finding or recommended action, and outline any mitigating circumstances or alternative course of action to be pursued.

RESPONSE (succinct response to finding / action)

Management agrees with the Observation and is carefully monitoring the progress and effectiveness of the noted initiatives. As discussed in the Management Response for Finding 1, the establishment of Minimum Credit Standards, the formation and implementation of the Credit Risk Teams, and the launch of the new proprietary credit scoring model are currently in progress and should result in overall underwriting quality improvements.

Regarding the SFR loans with the potential NegAm feature, the Credit Information and Analytics group currently runs stress testing for NegAm and potential NegAm loans. The greatest risk to the organization is not a rising rate environment, but a declining housing price environment. The multiple stress tests that are performed, however, indicate that while the losses could be much greater than what we currently are experiencing, our loan loss reserve is adequate to cover those possible losses.

For the proportion of the total HFI population mentioned with FICOs less than 620, about $1 billion (or 5%) were originated by acquired institutions and about $3 billion (or 15%) have LTVs less than 60 percent. A small amount of the acquired is less than 60 CLTV (about $127 million). Thus, of the population:

- 4% Acquired and >60 LTV
- 14% Not Acquired and < 60 LTV
- 1% Acquired and <60 LTV

Please note that the establishment of the Minimum Credit Standards will sharply reduce the highest risk tail, in addition to assisting in the improvement of underwriting quality, as will the elimination of credit classification codes 2-4.

With regard to the section of the June Credit Review Report stating that the probability of improvement is not likely; the reference is misleading. Without the changes to the front-end, CRT implementation and active portfolio management

EXAM FINDING 3	☑ Observation*	☐ Recommendation*	☐ Criticism*
(loan sales), this would be true. There has been significant improvement in default servicing management and oversight. In early 2004, Consumer Credit Risk Management began working with the Default Servicing group to focus on improving and reducing the outstanding balance of Non-Performing Loans (NPLs). The reduction in NPLs has been principally achieved with the quarterly sale of Non-Performing and Sub-Performing loans; this is not the long-term strategy for managing NPLs. The Default Collections team has implemented a focused calling campaign on the asset portfolio. Delinquent loans are called on by the fifth business day of the month, the right party contact rate is improving, and we are seeing deeper penetration within the portfolio. Performance is monitored and measured each month with a comparison to prior year's performance. Considerable improvement has shown in the following areas with an overall reduction in delinquency: • Cure Ratio of 4+ Payment DQ – As of April 2004 Cure Rate was 12.2% in comparison to the average cure rate of 6.3% in 2003. • 3 – 4 Payment Roll Rates - The level of loans rolling from 3 to 4 payments delinquent was 41.4% in April 2004 in comparison to the 2003 average of 55.1%.			

CORRECTIVE ACTION (provide specific action steps planned, the assigned responsible manager, and target dates for each)

As stated in Finding 1, the following are the corrective actions as they relate to Minimum Credit Standards Project, Credit Risk Teams, and proprietary credit scoring model (version 2):

1. MINIMUM CREDIT STANDARDS: This policy is currently in effect and applies to all loan applications or loan submissions made on or after April 1, 2004.

2. CREDIT RISK TEAMS: Four pilot sites have been operating since May 17 and additional expansion to more sites will take place through June 14. CRTs will be operational in all fulfillment centers by the end of July and fully implemented by the end of the third quarter. A new Residential Lending Authority Policy and Performance Improvement Plan will be introduced in June and all credit grantors will be re-certified by year end. **Responsible Manager: Barry Wolfgram, Consumer Credit Risk Management. Target Date: 12/31/2004**

3. PROPRIETARY CREDIT SCORING MODEL (version 2): The Enterprise Modeling and Decision Systems group is currently redeveloping the Home Loans Proprietary Model (PM2). **Responsible Manager: Tim Bates, Corporate Credit Risk Management. Target Date: 9/30/2004**

WASHINGTON MUTUAL BANK FA/FSB
OTS# 08551 & 11905
March 15, 2004

SFR ORIGINATION MEMOS
OTS 5, FDIC/DFI 3

Date: 5/04
Prepared By: OTS/FDIC DFI
Reviewed By:
Index #: 202a 4

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WaMu®

This presentation was posted to BoardVantage on March 18, 2008, and replaces and supplants all prior versions.

Summary of Management's Action to Address OTS Concerns

March 11, 2008

OTS Concerns:

- Rapidly increasing levels of Nonperforming and Classified assets.
- Potentially Insufficient ALLL

WaMu Response:

- In recent quarters, we have been provisioning at twice the rate of charge-offs and anticipate doing so as necessary to ensure an adequate ALLL. This is resulting in a significant build-up of ALLL.
- Project Olympic anticipates either strategic options or a $3 to $4 billion increase in capital during early 2Q08, resulting in capital levels sufficient to absorb expected provisioning and losses during 2008/2009.

[redacted]

OTS Concerns:

- Substantial loan loss provisions caused earnings losses in 2007 and will result in continued losses in 2008.

WaMu Response:

- Continued actions to reduce expenses
- Project Olympic anticipates $3 to $4 billion increase in capital during early 2Q08. An increase in capital permits Company to remain above well-capitalized even with earning losses during 2008 and 2009.
- Expected return to profitability in 2009 with adequate provisions in place.

[redacted]

<u>OTS Concerns</u>:

- Liquidity has become more stressed due to market disruption, deteriorating financial condition and rating agency downgrades.
- Increasing funding costs and contraction of available funding sources.

<u>WaMu Response</u>:

- Project Olympic anticipates $3 to $4 billion increase in capital during early 2Q08. An increase in capital will strengthen balance sheet for counterparties.
- Active management of balance sheet expected to result in modest balance sheet shrinkage in 2008/2009.
- Temporary dividend reduction until earnings and capital levels recover.
- Collateral initiatives
- Stress tests indicate continued excess liquidity even in face of 2-notch downgrade from current position.

[redacted]

OTS Concerns:

- Ineffective BSA program due to internally identified weaknesses in several required program elements. OTS issued a Consent Order.
- Need a more disciplined framework for the identification and management of compliance risks.
- Ineffective monitoring processes on Commercial serviced loans resulting in properties with inadequate insurance.

WaMu Response:

- Management is executing a comprehensive program to strengthen the Bank Secrecy Act program and address the Consent Order. Board has been monitoring action plans in response to Matters Requiring Board Attention and Consent Order.
- Corporate Compliance initiated a significant effort to improve the program. On track to meet committed timeframes.
- Management implemented actions to address flood compliance issues and secured appropriate coverage for all inadequately insured loans.

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Washington Mutual

WMBFA
March 14, 2005
Safety & Soundness Examination
OTS MEMO 4

DATE:	May 20, 2005
TO:	Michelle White, Appraisal and Performance Engineering
FROM:	Bruce Thorvig, Regional Appraiser, OTS
SUBJECT:	Residential Real Estate Appraisal Operations
CC:	Mark Hillis, Chief Credit Officer
	Ken Kroemer, FDIC

BACKGROUND INFORMATION

The primary focus of the review of the Residential Appraisal Department included following-up on prior examination findings, review of one-to four-family residential appraisals and evaluations, appraiser assisted automated valuation model (AAAVM), and policy and procedures. Single-family residential appraisals and evaluations have been reviewed for reasonableness of value and compliance with Uniform Standards of Professional Appraisal Practice (USPAP), Part 564 of the OTS Regulations, and the bank's written appraisal policy and procedures.

Two criticisms have been identified. The first criticism, which is a repeat finding (Exam Finding 3 in Joint Memo #3), addresses the Appraisal Assignment/Engagement Request form, which includes the owner's estimate of market value. The second criticism addresses weaknesses identified in the AAAVM process. During a meeting held on May 10, 2005, appraisal management agreed to delete the owner's estimate of market value from the Appraisal Assignment/Engagement Request form and to address the weaknesses identified in the AAAVM process.

EXAM FINDINGS DEFINITIONS

Observation:	A weakness identified that is not of regulatory concern, but which may improve the bank's operating effectiveness if addressed. *Observations* are made in a consultative role. They may be presented to management either verbally or in writing, but will generally not be included in the Report of Examination. Examiners will rarely request a written response during the examination. *Observations* may or may not be reviewed during subsequent examinations.
Recommendation:	A secondary concern requiring corrective action. A *Recommendation* can become a *Criticism* in future examinations should risk exposure increase significantly or other circumstances warrant. They may be included in the Report of Examination and mentioned in Exit and Board Meetings. Examiners will request a written response from Management during the examination. Management's actions to address *Recommendations* are reviewed at subsequent or follow-up examinations.
Criticism:	A primary concern requiring corrective action. *Criticisms* are often summarized in the "Matters Requiring Board Attention" or "Examination Conclusion and Comments" section of the Report of Examination; warrant increased attention by Senior Management and the Board of Directors; and require a written response. They are subject to formal follow-up by examiners and, if left uncorrected, may result in stronger action.

EXAM FINDING 1	☐ Observation	☐ Recommendation	☑ Criticism

Topic: Appraisal Assignment/Engagement Request Form

Finding: The review of single-family appraisals and evaluations noted that numerous Appraisal Assignment/Engagement Request forms continue to provide the appraiser with the owner's estimate of market value. **The owner's estimate of market value should be eliminated from the request form in order to ensure that appraiser independence is not compromised.**

Recent guidance on this issue is included in the "Interagency Statement on Independent Appraisal and Evaluation Functions" dated March 22, 2005. The statement reaffirms, "the information provided by the regulated institution should not unduly influence the appraiser or in any way suggest the property's value." In addition, this issue is addressed in the May 16, 2005, interagency guidance on "Credit Risk Management Guidance for Home Equity Lending." The guidance on collateral evaluation management states that management should "Ensure that an expected or estimated value of the property is not communicated to an appraiser or individual performing an evaluation."

This represents a repeat finding from the prior examination. This matter was an incorrectly closed issue that had not been adequately corrected (Issue 04-SS-0011).

Action: The owner's estimate of market value should be eliminated from the Appraiser Assignment/Engagement Request form. Andy LaPlante, Regulatory & Investor Liaison, indicated at our May 10, 2005, meeting that by May 20, 2005, the owner's estimate of market value would be blocked out on the request form.

We request that Quality Assurance follow up after May 20, 2005, to ensure that Appraiser Assignment/Engagement Request forms actually sent to appraisers no longer provide the owner's estimate of value. Documentation of this follow-up should either be provided to examiners while still on-site or kept available for future examiner review.

☑ **Repeat Finding** **Management Response Requested** ☑ **Yes** ☐ **No**

MANAGEMENT RESPONSE ☑ **Agree** ☐ **Partially Agree** ☐ **Disagree** **Enter Target Date: [N/A]**

Management Response: Indicate whether you agree, partially agree, or disagree. If you agree, provide an anticipated target date for implementation.

Partially Agree: The response should clearly define that portion of the finding or recommended action disagreed with as well as the portion agreed to.

Disagree: The response should clearly define WHY there is disagreement with the finding or recommended action, and outline any mitigating circumstances or alternative course of action to be pursued.

RESPONSE (succinct response to finding / action)

Management agrees that this issue was incorrectly closed as it had not been adequately corrected as previously committed to. The "Owner's Estimate of Value" field was not removed from the Appraiser Assignment/Engagement request form by the time this issue was initially closed. Management was unable to implement the appropriate OptisValue updates to correct this issue during 2004 due to a mandatory OptisValue systems freeze between June and October, followed almost immediately by the annual, end of year Sarbanes-Oxley (SOX) required systems freeze.

On 5/20/05 the "Owner's Estimate of Value" field was successfully removed from the "Appraisal Assignment" form and is no longer viewable by the appraiser, therefore ensuring the appraiser independence is not compromised going forward.

CORRECTIVE ACTION (provide specific action steps planned, the assigned responsible manager, and target dates for each)

1. The field in question was eliminated on 5/20/05. Documentation demonstrating completion has been provided to examiners. **Responsible Manager: Michelle White, Target Date:** N/A

EXAM FINDING 2	☐ Observation*	☐ Recommendation*	☑ Criticism*

Topic: Appraiser Assisted Automated Valuation Model (Desktop Evaluation Report)

Finding: **Our review of appraisals completed using Appraiser Assisted Automated Valuation Models (AAAVMs) or Desktop Evaluation Reports noted significant technical documentation weaknesses in the process.** The AAAVM process needs improvement to address material appraisal documentation deficiencies in order to comply with Uniform Standards of Professional Appraisal Practice (USPAP). In 2004, staff appraisers completed over 44,000 AAAVMs. None of the 18 appraisals sampled were fully USPAP compliant. Of the 11 AAAVMs that may involve value issues, WMBFA responded that 2 represented significant risk, 4 may or may not represent significant risk and the remaining 5 represented no risk.

The quality assurance review of AAAVMs was inadequate. Appraisal management agreed that quality assurance procedures did not include the review of AAAVMs. Reviews by the quality assurance group may have identified the documentation deficiencies noted during the examination.

Action: Management must review the AAAVM process and address the appraisal documentation deficiencies. The Desktop Evaluation Report form will require some modification. Staff appraisers must be provided with additional training on the appraisal development and reporting standards of USPAP. Most importantly, the AAAVM process must be monitored and the quality assurance function must be expanded to include an on-going review of Desktop Evaluation Reports.

During a May 10, 2005, meeting with appraisal management, Michelle White, Appraisal and Performance Engineering, agreed that documentation weaknesses existed and that the appraisal department will address them. Future reviews by the quality assurance teams will include AAAVMs in their review.

☐ Repeat Finding   **Management Response Requested** ☑ **Yes** ☐ **No**

MANAGEMENT RESPONSE ☑ **Agree** ☐ **Partially Agree** ☐ **Disagree** **Enter Target Date: [3/31/06]**

Management Response: Indicate whether you agree, partially agree, or disagree. If you agree, provide an anticipated target date for implementation.

Partially Agree: The response should clearly define that portion of the finding or recommended action disagreed with as well as the portion agreed to.

Disagree: The response should clearly define WHY there is disagreement with the finding or recommended action, and outline any mitigating circumstances or alternative course of action to be pursued.

RESPONSE (succinct response to finding / action)

After additional investigation, management concludes that while not achieving complete compliance with USPAP, none of the AAAVMs sampled posed a significant risk.

CORRECTIVE ACTION (provide specific action steps planned, the assigned responsible manager, and target dates for each)

1. Appraisers will be provided with additional training on the appraisal development and reporting standards of USPAP. **Responsible Manager: Michelle White**
   a. A communication will be issued to all Appraisers completing AAAVMs with instruction to include the source of the definition of market value and the correct, USPAP compliant wording regarding the use of extraordinary assumptions on all AAAVM assignments. **Target Date: 6/30/05**
   b. Develop training material content for all applicable employees on the appraisal development and reporting standards of USPAP, with special emphasis on USPAP as it applies to AAAVM. **Target Date: 7/31/05.**
   c. Rollout training through Breeze; include automated tracking of employee completion. **Target Date: 8/31/05**
   d. All applicable Appraisers will complete this new training by end of October and documentation will be compiled to demonstrate all applicable Appraisers have completed the training. **Target Date: 11/30/05**

2. Residential Appraisal Quality Assurance will be expanded to include a quarterly review of the AAAVM product. **Responsible Manager: Michelle White**
   a. Develop a checklist for the QA review of AAAVMs. **Target Date: 6/30/05**
   b. The first sample of AAAVM appraisals will be pulled for QA review in August. **Target Date: 8/31/05.**
   c. Incorporate AAAVM sampling into standard quarterly sampling query. **Target Date: 10/31/05**
   d. AAAVM sample will be analyzed following the October quarterly sampling query with the results of the QA Analysis published and issued to Appraisal Production by end of year 2005. This ongoing process will continue with a sample of AAAVMs being drawn every quarter thereafter and the results communicated to Appraisal Production within 90 days of quarter's end. **Target Date: 12/31/05**

3. The AAAVM/Desktop Evaluation form will be reviewed and revised for enhanced USPAP compliance. **Responsible Manager: Michelle White**

EXAM FINDING 2	☐ Observation* ☐ Recommendation* ☑ Criticism*
	a. Revised form will require appraisers to manually add precise statements regarding 1) the source definition of market value, 2) use of extraordinary assumptions, and 3) the inclusion of thorough analysis and appraisal methods to support the final estimated appraised value within the completed AAAVM assignment (See related item #1 above). **Target Date: 6/30/05** b. Development of business requirements for the automated form revision. **Target Date: 9/30/05** c. Development of implementation plan with TSG. **Target Date: 01/31/06** d. Programming, implementation, and roll out of new form to Appraisers. **Target Date: 3/31/06**

WMB
March 13, 2006
Safety & Soundness Examination
OTS MEMO 2

DATE: May 23, 2006
TO: Michelle White, Mortgage Appraisal
FROM: Bruce Thorvig, Regional Appraiser, OTS
SUBJECT: Residential Real Estate Appraisal Operations
CC: Hugh Boyle, Chief Credit Officer
Cathy Doperalski, Regulatory Relations
Steve Funaro, FDIC

BACKGROUND INFORMATION

The primary focus of the review of the Mortgage Appraisal Department (Residential Appraisal Oversight, Production and Administration) included following-up on prior examination findings, review of one-to-four-family residential appraisals and evaluations, sample review of Desktop Evaluations (Appraiser Assisted Automated Valuation Model – AAAVM), policy and procedures, and appraiser independence. Samples of single-family residential appraisals and evaluations were reviewed for reasonableness of value and compliance with Uniform Standards of Professional Appraisal Practice (USPAP), Part 564 of the OTS Appraisal Regulations, and the bank's written appraisal policy and procedures.

Appraisal Quality Assurance estimates that WMB performs approximately 60,000 AAAVM services in a typical year. WMB performs these appraisal services using a Desktop Evaluation. The Desktop Evaluation is an appraisal that, when completed by a licensed appraiser, must comply with USPAP standards and OTS appraisal regulations.

One criticism has been identified. While OTS recognizes appraisal management's ongoing improvements to the AAAVM (Desktop Evaluation) process since the prior exam, weaknesses were identified in compliance with USPAP standards and the bank's procedures for using Desktop Evaluations. The examination findings were discussed with Mortgage Appraisal management and Regulatory Relations on May 9, 2006. Appraisal management concurred with OTS findings and agreed to address the identified weaknesses.

EXAM FINDINGS DEFINITIONS

Observation: A weakness identified that is not of regulatory concern, but which may improve the bank's operating effectiveness if addressed. *Observations* are made in a consultative role. They may be presented to management either verbally or in writing, but will generally not be included in the Report of Examination. Examiners will rarely request a written response during the examination. *Observations* may or may not be reviewed during subsequent examinations.

Recommendation: A secondary concern requiring corrective action. A *Recommendation* can become a *Criticism* in future examinations should risk exposure increase significantly or other circumstances warrant. They may be included in the Report of Examination and mentioned in Exit and Board Meetings. Examiners will request a written response from Management during the examination. Management's actions to address *Recommendations* are reviewed at subsequent or follow-up examinations.

Criticism: A primary concern requiring corrective action. *Criticisms* are often summarized in the "Matters Requiring Board Attention" or "Examination Conclusion and Comments" section of the Report of Examination; warrant increased attention by Senior Management and the Board of Directors; and require a written response. They are subject to formal follow-up by examiners and, if left uncorrected, may result in stronger action.

EXAM FINDING 1 ☐ **Observation** ☐ **Recommendation** ☑ **Criticism**

Topic: Appraiser Assisted Automated Valuation Model (AAAVM) Services

Finding: Appraisal deficiencies identified included non-compliance with both USPAP standards and the bank's procedures for using Desktop Evaluations. During the prior examination, we also identified significant technical USPAP documentation issues in all Desktop Evaluations sampled.

Although our current review noted that process improvements were made to address our prior examination concerns, **the AAAVM process is still not at a satisfactory level. While value conclusions were generally within a reasonable range of value, none of the currently reviewed Desktop Evaluations**

EXAM FINDING 1 ☐ Observation ☐ Recommendation ☑ Criticism

were in full technical compliance with USPAP because the Desktop Evaluation forms were revised since the prior examination to a format that is not USPAP compliant.

We believe a fully effective internal control and appraisal quality assurance process would have prevented a noncompliant form from being disseminated to appraisers.

Our review of twenty-five Desktop Evaluations (AAAVMs) identified the following weaknesses:

(1) Inconsistencies were found in the entire sample of 25 desktop evaluations (form content deficiencies) related to identifying the type of appraisal and reporting option (a Desktop Evaluation cannot be both a "Restricted Use Appraisal Report" and a "Summary Appraisal Report"),
(2) Use of a Restricted Use Appraisal Report option for loans greater than $250,000. This report generally does not contain sufficient information to enable the intended users of the appraisal to understand the report properly or contain sufficient information and analysis to support the institution's decision to engage in the transaction,
(3) Appraisers not completing the Desktop Evaluation in compliance with the bank's Desktop Evaluation procedures (also identified by AQA),
(4) Instances of inadequate support for value conclusions or differences between a recent sale of the subject property and the appraised value, (also identified by AQA) and
(5) Four instances of the appraiser not signing the certification page in compliance with USPAP (also identified by AQA).

Action: Management must address the weakness identified and continually review the AAAVM process:

(1) The Desktop Evaluation form will require modification to ensure compliance with USPAP and to clarify which appraisal option (Summary Appraisal Report or Restricted Use Appraisal Report) is being used. Restricted Use Appraisal Reports will generally not be appropriate for a federally related transaction with a loan amount greater than $250,000.
(2) Staff appraisers must be continuously trained and counseled as to the proper use of the Desktop Evaluation to achieve reasonable value conclusions that are supported by an appraisal that complies with all USPAP standards and OTS appraisal regulations.
(3) AQA must continue to evaluate the AAAVM process during their monthly quality assurance review process. Quality Assurance must ensure that Desktop Evaluations meets all USPAP development and reporting requirements (Refer to USPAP Standards 1 and 2 for specific standards). We expect self-identification of documentation and value issues. AQA must also ensure that the appraiser feedback process is effective in reducing documentation exceptions.

We expect the AAAVM process to improve to the point that technical documentation exceptions and deficiencies are reduced to an acceptable level.

☐ Repeat Finding Management Response Requested ☑ Yes ☐ No

Washington Mutual

MANAGEMENT RESPONSE ☐ Agree ☒ Partially Agree ☐ Disagree **Enter Target Date: [10/31/06]**

Management Response: Indicate whether you agree, partially agree, or disagree. If you agree, provide an anticipated target date for implementation.
Partially Agree: The response should clearly define that portion of the finding or recommended action disagreed with as well as the portion agreed to.
Disagree: The response should clearly define WHY there is disagreement with the finding or recommended action, and outline any mitigating circumstances or alternative course of action to be pursued.

RESPONSE (succinct response to finding / action)

Management agrees that the Desktop Evaluation form currently in use is not in full technical compliance with the USPAP standards for a "Restricted Use Appraisal Report" and would require modification to resolve the three (3) noted inconsistent statements within the form, should Washington Mutual choose to continue offering the AAAVM service. Management does not agree that the Restricted Use Appraisal Report is inadequate as it has been used, or do the relatively minor inconsistencies within the form indicate an ineffective internal control or quality assurance process. This is clearly evidenced by the following:

- *<u>The staff-prepared AAAVMs adequately support the lending decisions</u>*: The AAAVM is adequate in those limited circumstances where it was relied upon for lending decisions because reports are completed only by staff appraisers, staff appraiser files are the property of Washington Mutual, and are available for review should any additional information be necessary to support the lending decision. Washington Mutual staff appraisers have completed AAAVM training and are subject to continuous evaluation, training and performance counseling.

EXAM FINDING 1 ☐ **Observation** ☐ **Recommendation** ☑ **Criticism**

- *Self identification of errors*: With the exception of the form inconsistency, all deficiencies noted by the OTS in the individual Appraisal Reports had already been identified by Washington Mutual's internal quality control process. Additionally, both the Internal Quality Assurance and OTS reviews concluded that the AAAVM values were within a reasonable range.
- *Relative risk of the AAAVM product*: In 2005, the AAAVM represented 3.2 percent of all completed appraisal service orders, and is predominately used for transactions at or below $250,000 (the "de minimis"). For March 2006, 90 percent of the AAAVM orders were at or under the de minimis level. Further, the appraisal transition history for 2005 shows that approximately 43 percent of all AAAVM services required an upgrade to a traditional appraisal service in order to close the loan; therefore the AAAVM product had a limited impact on credit decisions as a whole. Given the inefficiency of the product as an alternative appraisal service, its 2006 volume has declined by 50% when compared to 2005 levels.

In the interest of efficiency, Washington Mutual has decided to discontinue the use of the AAAVM Service. It is scheduled to be discontinued, first by the Retail Banking/Consumer Lending area (which uses 99% of the total AAAVM products) in July 2006, then by the entire organization in October 2006.

CORRECTIVE ACTION (provide specific action steps planned, the assigned responsible manager, and target dates for each)

1. The use of AAAVMs will be discontinued in the Retail Banking/Consumer Lending division in July 2006. **Responsible Manager: Michelle White, Target Date: [7/31/06]**
2. As of 7/17/06, any AAAVM order to support a lending decision for a loan of $250,000 or more will be modified to an order for a 2055 (exterior inspection). **Responsible Manager: Michelle White, Target Date: [7/17/06]**
3. The AAAVM will be discontinued entirely in October, 2006. **Responsible Manager: Michelle White, Target Date: [10/31/06]**

Sent: Monday, May 22, 2006 11:06:37 PM

From: Feltgen, Cheryl A.
To: Bull, Sushuma R.
Cc:
Subject: FW: Meeting with the OTS regarding residential appraisal services at Washington Mutual

Forgive me for not copying you. Hope the meetings are going well with the vendor. When will be ready to have a definitive discussion about our internal org structure?

Cheryl

From: Feltgen, Cheryl A.
Sent: Monday, May 22, 2006 7:35 PM
To: Schneider, David C.; Cathcart, Ron
Cc: White, Michelle; Ludlow, Diane L.; Boyle, Hugh F.; Fierling, Jennifer; Domer, Jake; Zarro, Michael R.; Doperalski, Cathy L.
Subject: Meeting with the OTS regarding residential appraisal services at Washington Mutual

Michelle White and I attended a meeting last week with OTS representatives, Bruce Thorvig (appraisal expert) and Ben Franklin. Bruce had specifically requested the meeting as part of the OTS review now in process to get an update on Project Cornerstone. We provided an update on our current plan to outsource the residential appraisal function to two large national firms, First American and LSI. It was a very positive meeting. Bruce had helpful and appropriate items for us to consider as we take the next steps. He encouraged us to have a contingency backup. He inquired as to how we would select the appraisers for a given region. He emphasized that the appraisal review and quality assurance functions are critical. He encouraged us to have continuous due diligence with the vendors to be certain that they are meeting our service level agreements.

We promised to spend further time with Bruce and others as the details of our plan regarding oversight, controls and service levels are more precisely defined. Bruce's concluding remark was: "How could I not be supportive of your plans? Everyone is outsourcing." There are still many details we appropriately should review with the OTS, but I believe that we have endorsement of our direction.

Not discussed at this specific meeting, but identified during the OTS review of appraisal services, the OTS will likely issue a "criticism" for the new version of the AAAVM form which is not USPAP compliant.

Cheryl

Ms. Cheryl A. Feltgen
Senior Vice President
Chief Risk Officer, Home Loans Division
Washington Mutual
1201 Third Avenue
WMT2026

EXHIBIT
WE-07-010
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Washington Mutual

Residential Appraisal Department Review
CCVRM: February 2007

Introduction

The Corporate Collateral Valuation Risk Management (CCVRM) department reviewed the structure and operating policies, standards, and guidelines of the Appraisal Business Oversight (ABO) department to identify valuation and compliance risks and familiarize themselves with changes in operations progress on updating policies and procedures. This initial review did not involve comprehensive file reviews or a detailed analysis of existing processing controls. It relied on the stated processes, procedures, and interviews with management and observable trends in appraisal activity.

The areas of concern have not been fully vetted with business line management. They will be the focus of CCVRM department follow-up on the higher risk areas.

Contents

Based on this initial review, there are XXX areas of concern. Embedded within these areas are observations, which are offered to assist with productivity and efficiency:

- Changes in the third-party review processes increased collateral risk dramatically over the last six months.
- Appraisal standards and processes, despite full outsourcing of the function remain undefined.
- Vendor management requirements remain loosely defined
- Sales force influence over the appraisal function is unreasonable and imprudent.
- Appraisal quality reporting, remains closely held information with little in the way of action plans to improve quality or monitor adverse trends.

The primary function of the Appraisal Business Oversight Department is to provide oversight of all appraisal services processed through WaMu's Collateral Management System (CMS), OptisValue, and provided by two national appraisal management companies. Additional vendors are under consideration. Expansion to REO, Servicing appraisal needs is a natural extension of the process. This extension is under discussion.

The Appraisal Business Oversight Department took over complete appraisal operations during the third quarter of 2006, when all management, staff, and coordination functions within the Appraisal Production Department were outsourced through the Cornerstone project. The department's mission started as a "work in progress" with sales focused forces challenging prudent credit risk for control. A large number of the department's practices were not developed and tested in advance, but were created on the fly in response to complaints from loan consultants and channel managers swelled. Further, some current department processes were created or agreed to by the Vendor Management team to assure sales approval, and were not created in the best longer term interests of WaMu.

To the credit of ABO department managers, they appreciate this issue and are working define in actual department processes in writing, and to resolve any conflicts between policies and actual processes. Some of the new processes were instituted by leaders outside of the department, without a full assessment of the risks. The ABO managers will have to work diligently to unwind the damage done and re-establish appropriate controls and processes.

ABO has three primary customers and consumers represent an indirect customer these groups often have competing interests.

Sales: Timely completion of low cost appraisal services that facilities rapid credit decisions. Valuations should be reasonable and reliable. Illegitimately, Sales also desires: 1) high valuations and the delivery of values that meet its and the customers' expectations, 2) problematic property characteristics should be ignored to facilitate rapid credit decisions, and 3) appraiser selection to ensure they can influence items 1 and 2.

Underwriting : Expects reasonably credible valuations with specific property characteristics or appraisal content effectively disclosed to prevent underwriting and securitization errors, and improving product selection. Underwriting at WaMu, with the exception of sub-prime lending does not review the appraisal for concerns, unless they are triggered to do so. Effectively calling out these property concerns allows them to be addressed. Legitimately, underwriters may second guess the appraisal and require additional comparables or appraisal services to resolve poor quality appraisals. This can also occur illegitimately, if the underwriter is not qualified to conduct the evaluation.

Credit Risk: Sufficient appraisal quality controls to assure an appropriate risk of repurchase liability, loss severity, and maintenance of WaMu's positive reputation in the secondary market with its associated premium pricing. Illegitimately, credit risk could require excessive risk mitigation controls, or neglect their responsibility to safeguard the bank's capital and shareholder value. Credit risk must strike a balance of control vs. efficient high volume growth.

Consumers : Desire high valuations, but deserve reasonably credible valuations with an accurate presentation of their property's condition. This is important to prevent equity stripping, fraud activity and the decimating of neighborhood property values by illegal flipping and the high foreclosure rates associated with targeted fraud activities. The appraisal is a check against the reasonableness of the negotiated sales price and helps borrowers objectively evaluate their equity position.

You will also see certain words highlighted throughout this report (i.e. organizational chart). Clicking on the highlighted word will link you to an additional supportive document.

We have given each issue a "rating" to identify the magnitude or risk involved in each item.

Level 1 (high risk) – These issues are of the utmost of concern. They involve additional risk to the bank and provide definite indications of compromising safety and soundness.

Level 2 (medium risk) – These issues are of moderate concern, individually. They involve internal policy contradictions and possible appraiser influence issues.

Level 3 (low risk) – These are minor exceptions issues.

Level 4 (observation) – These are business suggestions.

(See full rating definitions within the appendix on page XX.)

Third Party Appraisal Risk Control Process

Current processes to mitigate the risk from third party provided appraisals deliver poor mitigation for the collateral risks entering the loan application process.

- Value cuts and rejections are weakly are clearly below historical trends.
- Contractual requirements for within state licensing of reviewers have been suppressed to meet business Service Level Agreements (SLAs) demands.
- Number of field reviews has fallen to extremely low levels to meet business turn time demands and reduce value cuts or rejections, which also impair origination rates.

This broken process may be contributing to the increasing incidence of mortgage fraud within the bank.

Appraisals from brokers represent one of the highest collateral risks the bank faces because the broker controls the ordering process and can use appraisers who only deliver the values and appraisal content they need to complete the loan request. This circumvents appraiser independence controls that are typically stronger for retail lending production at insured financial institutions.

The Third Party Originated appraisal review process seeks to strike an efficient balance between the costly alternative of 100% desk or field review on all appraisals vs. no review at all. The bank is placed at a disadvantage for obtaining the loan if it delays its approval or cuts the value on the appraisal. The broker will simply take the application elsewhere. The key is an efficient process that flags the appraisals needing more scrutiny and adjusts their values or rejects them out right, allowing the low risk appraisals to flow through for an automatic approval. An efficient system will monitor and minimize through a feedback loop:

- False positives where appraisal approval is slowed down unnecessarily do to an inaccurate risk assessment.
- False negatives where an appraisal is auto approved, but the overvaluation risk is intolerable.

Field reviews are used as the final word to confirm false positive and false negative rates. The level of field reviews, the percentage of value cuts and appraisal rejections is a mark of the health and effectiveness of the third party appraisal control practices, particularly when risk has remained at, or risen slightly from historical levels.

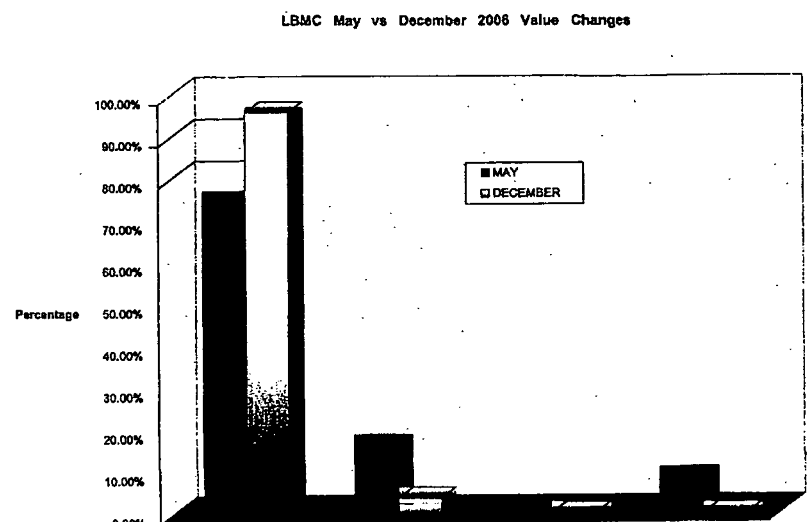
The cost of false positives is typically a lost business opportunity to originate a loan. The cost of a false negative can be increased loan repurchases from investors, fraud events, and eventually higher loss severity. The bank can also jeopardize its reputation by becoming an unwitting facilitator of mortgage fraud and the adverse impacts that practice can have on neighborhoods, typically those that are already economically disadvantaged.

Previously, false positive risk was mitigated with low cost administrative reviews performed typically by local staff appraisers who considered the risk report generated by the screening process. This allowed the false positives to be manually approved quickly increasing response time (4 hours on average). Those, which required additional scrutiny, were sent for a more in-depth review by a local appraiser. Appraisal Field Analysts could assess the risk and needs based on their local knowledge or phone calls to local peer appraisers to 1) assign a desk or field review, 2) reject the appraisal outright, or 3) conduct a review themselves to correct deficiencies depending upon what was expedient and prudent.

The risk presented by the new process can be seen in the dramatic shift in value cuts and rejections. Based on the emerging trends CCVRM conducted small-targeted reviews of the highest risk appraisals to ensure the fraud tools remained effective predictors of risk and assess the extent of overvaluation if any.

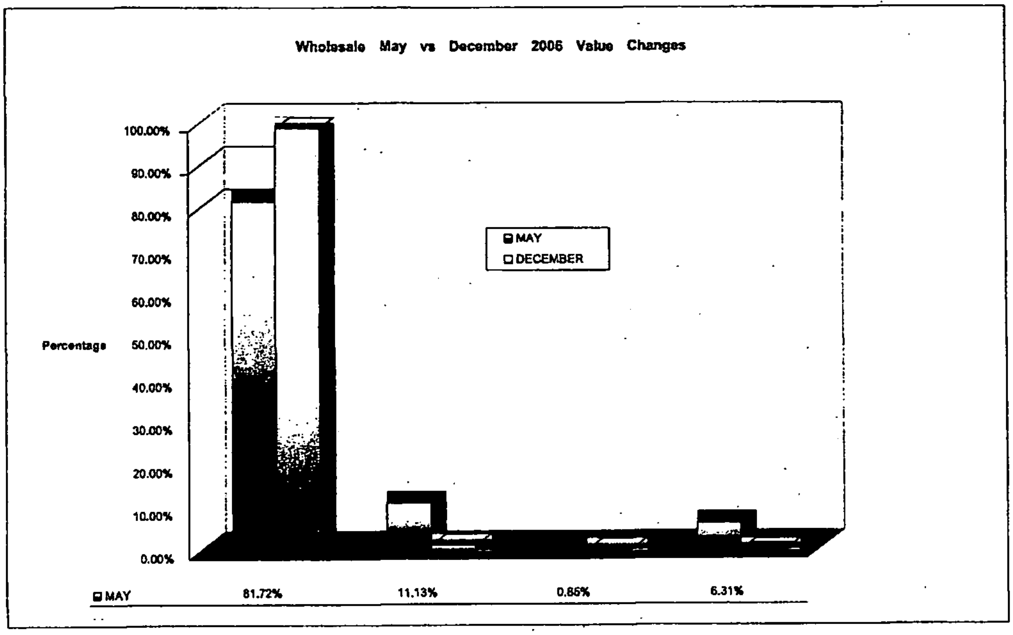
The charts on the following page show the trends in collateral risk mitigation efforts. The degree of mitigating value cuts and rejections has fallen considerably.

For Long Beach the sub-prime lending operation and the highest risk wholesale channel, the percent by number receiving a value cut or a rejection was 4% in December 2006 vs. 25% in May 2006 before the outsourcing.



	No Change In Value	Value Decreased	Value Increased	Report Rejected
■ MAY	74.69%	16.41%	0.50%	8.40%
□ DECEMBER	96.01%	3.83%	0.15%	0.00%

For Wholesale Prime the percentage by number receiving a value cut or rejection decision was 1% vs. 17% for the same period.

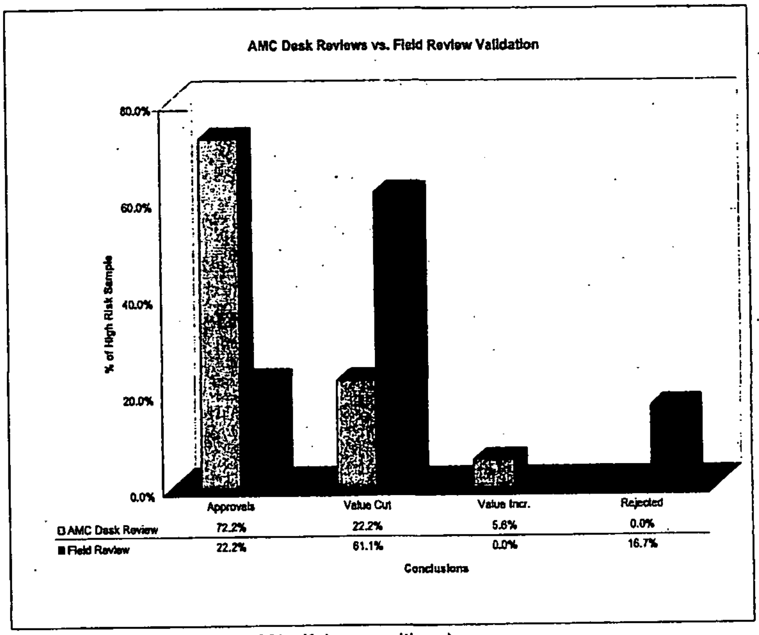


Washington Mutual

Residential Appraisal Department Review
CCVRM: February 2007

Targeted testing by CCVRM on the highest risk Long Beach appraisals showed the ineffectiveness of the out-of-state desk review process. Two small samples were drawn to investigate the disturbing trends: 1) Eighteen of the highest risk appraisals approved in October 2006 were subjected to field reviews; and 2) 37 randomly selected high risk appraisals with F Score¢â of 11-25 were reviewed by CCVRM appraisal staff.

The field review validation sample was selected to dramatize the risk. It is only reflective of the risk in the higher risk appraisals. The opposing AMC completed 10 of the new field reviews. To keep costs down CCVRM staff local to the markets completed the other eight and the sample was concentrated on the highest risk appraisals from known appraisal fraud areas. Nearly, 78% were scored highest risk by CoreLogic, a "25"; which implies a 47% chance of a 20% overvaluation. This risk level is known prior to assigning the appraisal for review.



The results are highlighted below:

- AMC Desk Review process approved or increased the value of the appraisals 78% of the time.
- Comparatively, field reviews concluded, "approved " for 22% (false positives).
- None of the desk reviews recommended rejection and 17% of field reviews did.
- Value cuts from the field reviews ranged from 12%-50% with an average decrease of 25%.

For the 37 high-risk appraisals, CCVRM reviewers concluded that 78% of the approved appraisals were unacceptable. Comparatively, all but 1 of the 37 appraisals (98%) was approved unchanged by the AMC based review processes.

Fraud rings seek the least controlled environments to operate in. The lack of effective controls will mark the bank as an easier target and escalate the fraud volumes. Regulatory guidance requires prudent assessment and management of the risks present in wholesale mortgage operations.

High-risk appraisal approval orders coming through are a relatively small portion of the population to the population of orders coming through. Those scored 7-25 represent just slightly more than 2% and 8% of requests for wholesale prime and sub-prime (LB), respectively. False positives are less common in the high-risk appraisal scores, but do occur. Case in point the 22% approved above by field reviews, above. The risk profile has remained stable between the 2nd and 4th quarter of the year yet value cuts and rejections have fallen dramatically. This risk profile can be viewed on page X of the appendix.

Issue 1 Level 1 maintenance of an effective and efficient appraisal review and approval function: Based on the lack of value cuts and rejections, the decline in field reviews and the dramatized risk being allowed through the system, a more effective process needs to be built that balances quick response with prudent controls.

Recommendation : Many different approaches to resolving the risk problem may exist. The ABO team needs to develop a product or process with the vendors to ensure reviews are effective at identifying the risk and rejecting or cutting valuations as appropriate. Success in resolving this issue should be measured by value cuts and rejections meeting or exceeding pre-outsourcing levels. Analysis should include the depth of cuts and the correlation between appraisal risk scores and results. Conclusive assessment will require periodic testing of the rates for false positives and false negatives and the appropriateness of review decisions.

The revised TPO process must address the effectiveness of reviews both desk and field. It needs to ensure appraisers with local expertise, resources are engaged to review moderate or higher risk appraisals, and that these reviews are effective. Local reviews may adversely affect turn time and business origination goals. To mitigate this impact the strategy should involve either

1) Additional risk screening tools that leverage LTV, FICO, Broker rating, an evaluation of the appropriateness of comparable sales or subject sales history;
2) Administrative style reviews from the vendors to route appraisals to desk or field review and pass along areas of concern as necessary; Or
3) A combination of both of these strategies.

The following are the sub-issues to the larger goal of an effective review and approval process for TPO appraisals.

Issue 2 Level 1 An effective risk screening and routing process is needed. A replacement service for the "administrative reviews" was not developed during the cornerstone project. Therefore, all appraisals hitting the risk trigger were routed to desk technical reviews. Out-of-state appraisers typically perform these reviews. Out-of-state appraisers lack geographic competency and local data sources to verify information in the appraisal. Out-of-state appraisers defer heavily to the subject appraiser's work having limited tools or knowledge to question the information.

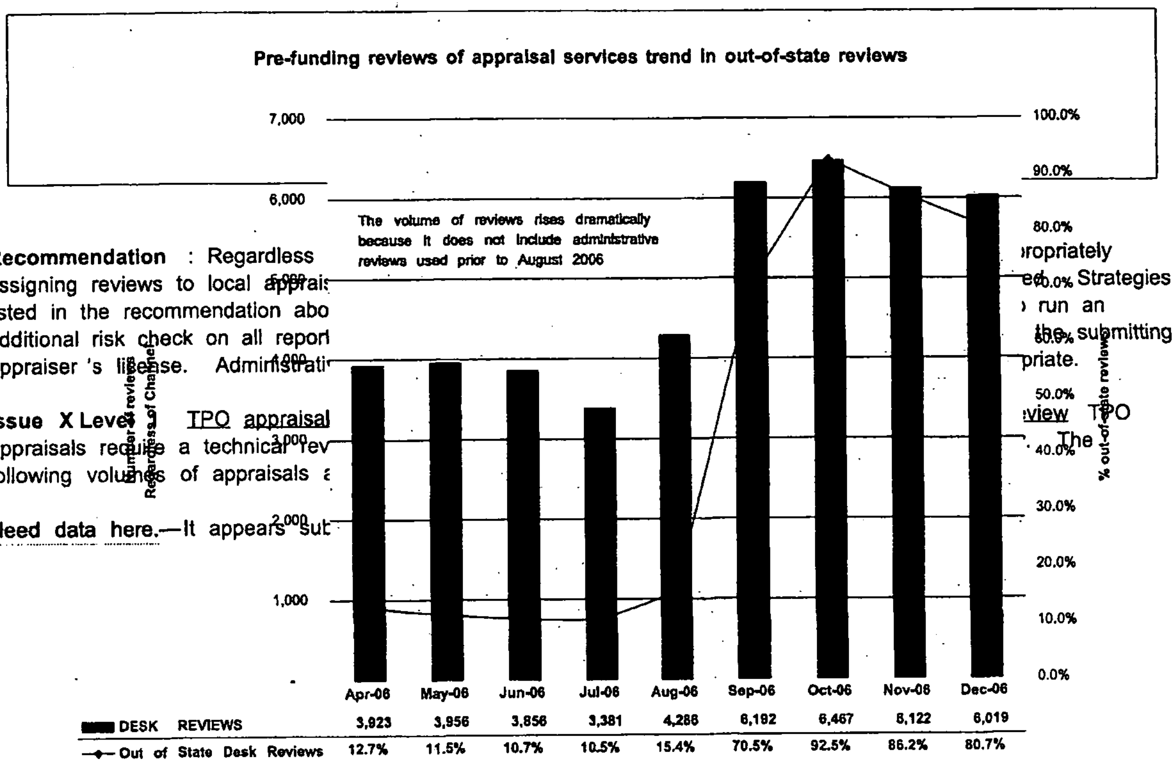
Recommendation : The administrative review service should be reconsidered as a tool to ensure proper ordering and routing of review assignments. At a minimum, transactions of moderate or high risk should receive desk or field reviews by competent appraisers with sufficient resources to question, evaluate, and re-appraise the subject property as may be necessary.

Issue 3 Level 1 Geographic Competency: ABO suspended the requirement for appraiser geographic competency to ensure business expectations for turn time could be met.

The table to the right shows the volume of out-of-state appraisers completing desk reviews. As the vendors add staff, the percentage is declining, slowly from its high of 95%.

The out-of-state reviewers make extraordinary assumptions that they can rely on the work of the subject appraiser and that they do not have the data sources or local market knowledge to question the appraiser's conclusions. This discredits the review. The dramatic rise in out-of-state reviews coincides with the drop in value cuts and rejections presented earlier. Fees for the reviews remain the standard desk review rates although their scope and effectiveness is significantly reduced. The table that follows presents the trend in out-of-state reviews for TPO and non-TPO appraisals

Standard 3 technical desk reviews are being submitted where the appraiser is not licensed in the state in which the property is located. The appraisers do not have geographic competency to produce these reviews (violation of USPAP ethics provision) and they are attempting to limit the scope of the review below that of a standard 3, thus giving the bank a false level of security.



Recommendation : Regardless ... ropriately
assigning reviews to local apprais... ed. Strategies
listed in the recommendation abo... run an
additional risk check on all report... the submitting
appraiser 's license. Administrati... priate.

Issue X Level 1 TPQ appraisal ... view TPO
appraisals require a technical rev... The
following volumes of appraisals a...

Need data here.—It appears sub...

OTSWMEN-0000000281

Issue 4 Level 2 Appraisal risk information is not available to the reviewers. Currently, the appraisal risk scores and reports generated to route the appraisals for review are not passed to the appraisers evaluating the review, nor are they used to route the appraisal beyond ordering a review. To assign reviews to desk or field inspection the vendors do not run their own fraud or risk screens. The reviewers have no insight into the risk already identified by the bank.

The risk screen vendor has resisted training AMC staff in their tool and the information is not passed with the order.

Recommendation : The risk screen information should be shared with the reviewers and operational obstacles between the vendors and the risk screen providers broken down. The bank may be held accountable for knowing of the flaws, yet facilitating the lending transaction anyway. Risk screen information needs to be used proactively to reduce risk.

Issue 5 Level 2 Field reviews occur below historical rates and do not reflect the risk in the transaction. Field reviews are appropriately reserved for the highest risk transactions. For the 2nd Quarter of 2006, field reviews were applied to xx% of the TPO generated appraisals and XX% of these resulted in value cuts or appraisal rejections. For the 4th quarter, less than xx% of TPO generated appraisals receive field reviews and these xxx field reviews have cut values or rejected the appraisal x times or x%.

Appraisal Quality Assurance, or the ABO management team at large, have not adequately addressed the lack of credible results from these reviews. It appears that sales demands to reduce value cuts and rejections and to speed response time have been met at the expense of appraisal quality and collateral valuation risk.

Issue 6 Level 2 Threshold review services should be effective. While the higher risk lies in the reviews of third party appraisals, threshold reviews, similarly suffer from a lack of meaningful mitigation for the risk. High loan amount appraisals from retail or banking channels are not risk scored, but similarly require a meaningful review of the appraisal. The chart above covers reviews conducted for the retail mortgage lending channels for 1st and 2nd lien mortgages.

Recommendation : To the extent possible, the revised review process for third party appraisals should be extended to threshold reviews to make them more effective and meaningful.

According to XXXXXXX, Appraisal Business Oversight (ABO) recognizes this risk. They have been working to create alternatives for the wholesale process. The deficient process has operated since September 2006 with an average monthly flow of around *25,000* appraisal approvals. CCVRM has not reviewed the proposal. Timing of deployment or the effectiveness of the strategy is not vetted with CCVRM.

Issue 8 Level 2 / **Level 3** —Depends on results RFTs should be subject to Compliance and TPO like risk assessment : Although a small portion of the completed appraisal orders (3-4%) are reviews for transfer (RFTs), they represent appraisals from third parties, as well. They also carry additional regulatory requirements because they are appraisals performed for others. Formal instructions to vendors on how to address the added RFT compliance considerations have not been issued. RFTs required both a valuation risk assessment and a compliance assessment.

FIRREA requirements for accepting appraisals prepared for other regulated financial institutions and financial services institution include:

1. the appraiser was directly engaged by the financial service company or regulated financial institution
2. the appraiser has no direct or indirect interest in the property or transaction
3. the existing appraisal remains valid
4. the appraisal conforms to the institution's and regulatory requirements and guidelines

The regulatory commentary suggests that the engagement letter serves as evidence that the appraisal was not ordered directly. WaMu has traditionally used the listing of the client in the certification section of the appraisal to validate direct ordering. WaMu also relies upon the appraiser certifications regarding their interest in the property. Since USPAP will allow a financial interest if the appraiser discloses it, the process for accepting a transferred appraisal should include looking for a statement of interest or no interest in the appraisal. These two practices should continue to be acceptable, especially if heightened risk assessment processes are used.

For compliance purposes the bank should ensure, the RFT is not used by the sales force to directly order an appraisal.

The following are the testing results based on a random 300 Appraisal sample of completed December 2006 RFT services:

Percent with in FIRREA compliance XX%
Ineligible appraisers
Evidence of Direct ordering
Percent with no compliance concerns:

Comparatively the RFT risk profile from HistoryPro and History Pro Review is presented below along side that of Wholesale Prime and Sub-prime appraisals. [remove if not available, by time of publishing.]

	RFTs	Prime	Sub-prime
% Very high risk 11-25			
% High Risk 7-10			
% Moderately High Risk 2-6			
% No hit			
Subtotal Pecent			
Extrapolated Average Monthly volume			

Clearly the RFTs represent less risk than the direct wholesale prime or sub-prime populations, however the risk exists and a rational process to address it should be adapted along side revisions to the existing TPO review process. If an administrative review service is offered or even just a hierarchy of local desk and field reviews, it can increase the response to loan consultants and make their sales efforts more effective on good quality applications.

Recommendation : The same risk tools used for broker provided appraisal should be applied to RFTs. At a minimum, instructions to AMCs and their reviewers should include the FIRREA requirements in specific common language instructions. Periodic testing for direct ordering concerns will need to follow this minimum requirement.

1. ensure Washington Mutual is not listed as the client,
2. ensure that there is no disclosure of a financial interest direct or indirect in the subject property by the appraiser,
3. ensure that the appraisal under review is no older than policy allows (provide actual days per channel credit policy).
4. Confirm the appraisal is not completed by an appraiser on the ineligible appraiser list. (If more than 2-4 are found in sample)

Periodic targeted testing to ensure the RFT was not directly ordered by sales or fulfillment personnel should be conducted. Timing of the reviews should be driven by the risk identified at the last testing and the abnormal rise in RFT use by individual loan consultants. The compliance or FIRREA review requirements do not need to be completed by a credentialed appraiser.

Lastly, RFTs should be considered in the TPO review process and existing tools leveraged to increase the speed to approval and the effectiveness of reviews.

Appraisal standards, guidelines, and processes

Issue 8 Level 2 The residential appraisal manuals and policies have not been updated for the change in appraisal operations. With the transition from a staffed appraisal production department to a completely outsourced operation, the February 2006 Residential Appraisal Manual, located on the Residential Appraisal SharePoint , is outdated. Therefore, currently, there is not a single document defining the roles and responsibilities of ABO and the AMCs. Any procedural changes made today are distributed as "operational guidelines " and go through the same approval process as the CUG and HLPAs. According to Jill Petersen, a new procedures manual is in draft form. Effort on this revision is stalled with the anticipated revised corporate policies, standards and governance process.

Recommendation : Establish new Business Unit Standards & Guidelines to document new processes and requirements. These will facilitate discussions and development of the corporate level policies, standards, and metrics to be used to measure business line adherence to the new policy. It will provide a structure to help the ABO team resist the pressures from the business lines to curb quality standards in favor of short term loan origination gains.

The Business Unit Guidelines should include:

- Appraisal ordering process
- Process for the selection of Appraisal Management Companies and/or individual appraisers
- Validation process for selecting new vendors, due diligence procedures
- Appraiser Trainees appropriate use
- How geographic competency is assured beyond state licensing
- Guidelines regarding the service level types ordered and changes permitted after the service has been placed with a vendor
- Process for using a prior service
- Statements as to how appraisal fees are handled and monitored
- Guidelines regarding the process for value arbitrations (ROVs)
- Guidelines for reviewing appraisal services not *ordered* by WAMU (RFTs, Wholesale)
- Guidelines for evaluating Vendor performance for Service, Quality, and Process adherence
- Guidelines for appraisal quality assessment (acceptable/unacceptable definitions and examples, sub-criteria for evaluating the appraisal
- Audit process of the following vendor management functions
    - Appraiser Independence
    - Fee changes
    - Service type changes
    - Appraisal product quality
    - Multiple Appraisal Service orders
    - Appraiser competency (geographic, complexity, market value)

Page X of the Appendix contains more detailed recommendations for these areas

Vendor Expectations and Monitoring

A strong vendor oversight process requires clearly defined expectations, monitoring of those expectations and negative consequences for not meeting expectations and as appropriate positive consequences for exceeding expectations. ABO was placed at the mercy of its two vendors at the start of the outsourcing with limited leverage to establish strong, objective criteria. ABO was further embattled internally by vendor relations and strategic sourcing which failed to respect their credit risk authority or expertise in the field. ABO is recovering from the assaults on its authority, and inappropriate demands of sales. Recognizing the difficult position the new department was immediately thrust. The following issues should be addressed to regain its authority and protect the banks asset quality.

Issue 9 Level 1 Vendor quality and procedure expectations are not clearly defined after nearly 6 months of outsourcing, this is in spite of a search for a third or replacement vendor, currently underway.

Examples of minimal expectations include the following:

<u>Quality guidelines</u>

- Reasonable range of valuation cuts and rejections over all and by channel and risk level
- Reasonable range of appraisals submitted in a non-IA ready format.
- Expected level of unacceptable appraisals, 3%
- Expected level of individual appraisal characteristics that are unacceptable, for example:
    - inadequate subject sales price, sales history, or reconciliation, should not exceed 5-10% or
    - inadequate comparable selection or reconcilement with the appraised value should not exceed 10-20%
- Tolerance level for appraisers without geographic competency for the appraisals they complete (FNC monitoring tools needed to establish or at a minimum a list of appraisers and their geographic areas of coverage from the vendors.)
- Tolerance for manufactured homes processed as site built or modular homes
- Tolerance for failure to identify and message ineligible collateral types
- Tolerance for appraisals using trainees and to what extent they may be used.

<u>Procedure expectations</u>

- All appraisals should be locked from editing between appraiser and AMC as well as from AMC to WaMu.
- Ineligible appraisers should be blocked from providing work, tolerable error rate 0.25%
- No inappropriate messages should be passed to appraisers.
- Use of trainees to complete specified portions of the appraisal should be clearly documented
- Expected deviations from contracted fees 1-3% over all orders per month.
- Expected appraisal upgrades.
- Tolerable volume of duplicate appraisal orders for the same loan number and property address
- Tolerable volume for assigning appraisers specifically requested by WaMu sales or fulfillment team to the 0%
- Provision of appraisals in non-AI ready format 2-3%
- Appropriate upgrading of reviews to higher levels based on risk and complexities of the property

Other guidelines specifically associated with the revised processes, message log maintenance, adherence to escalation procedures or any other features that ABO needs to ensure the vendor follows

This high level monitoring of vendor performance is required under Thrift Bulletin 82a. How the monitoring is to be conducted is not specified, it should be effective.

Recommendation : Develop an effective vendor monitoring and management process that balances production, quality and processes.

Issue 1X Level 1 Assigning work to vendors needs to consider SLA performance, Quality, and Process compliance, not merely SLA performance. Assigning work to vendors has been based upon that vendor's SLA performance or turn time, complaints from the loan originators and requests for special arrangements have influenced which vendors are engaged and to whom they assign work. Quality has not been a ranking factor for vendors.

Recommendation : The process needs to be balanced with SLA, quality and meeting procedural expectations. It also needs to be objective, so it can have the best motivational and control power. A matrix approach may provide a good 1-2 page scorecard that can clearly show how the vendor is performing. Formal processes for considering and effecting corrective action for substandard behavior need to be established. Under the old staff and fee panel based system the appraisal department was criticized for measuring and tracking SLA performance, but failing to provide measures of quality. Reports concerning fee changes, appraisal quality and were under development prior to the outsourcing.

Issue 1X Level 1 Fee Exception Controls. OptisValue automatically prompts payment for a specific transaction as soon as the order has been completed. The payment system is automated. Work is delivered and queued for payment. Fees are set based on tables within OptisValue and these are based on the negotiated rates. However, since the outsourcing the vendors have been given the ability to raise their own fees on a transactional level.

The appraisal management companies are free to increase their fees for appraisals without any Bank staff approval. The vendor is required to place a message in the message log to inform the lending office/processing of the change in fee and reason. This provides an opportunity to stop the fee increase at the discretion of lending. It also provides notice to correct the good faith estimate GFE and prep borrower expectations. Invoices are reconciled by a group under Jill Peterson, the appraiser profile team (Teri Jackson). Legitimate reasons for fee increases include:

- Hard to reach property;
- Complex properties;
- Nonstandard addenda required.

Non-standard addenda are such items as a rent schedule, or property operating income statement. These are required for certain loan programs.

The message log/e-mail systems require expensive manual review to extract the reasons for the adjustments. No process is established to extract this information.

The vendors are not subject to set limits on fee exceptions, accptable ranges or expected results. Fee variance and monitoring reports are developed on an adhoc basis. There is no efficient data collection around the reasons for fee increases, if adverse trends with minority groups are economically disadvantaged areas emerged, the investigation of the reasons we would be highly mannual. No validation of the appropriateness of th increase or the reason for it has been noted.

Recommendation : In the short term fee variance reports should be generated by property type, adenda requirements, value ranges, location (state, county, city or zip code) to gain a sense of expected results and set expectations for the vendors. Other legitimate reasons for exceptions may exist and the list should be expanded to capture all scenarios.

Longer term, reasons for fee changes need to be coded within OptisValue to facilitate 1) post completion and payment analsys and 2) automated exception processing and approval by ABO staff for fees outside of the normal or expected ranges. ABO current staffing may not facilitate 100% review of fees changes during processing and still meet the high service levels expected for the allow prompt completion of appraisal services. If this is the case, post completion analysis must be more robust to compensate for the weaker front-end controls.

To the degree the appraisal service fee was charged to the borrower at closing and reimbursed to WaMu, any credits or fees from the vendor to compensate for errors need to be paid to the borrower. Establishing a process to ensure these payments are prompt and accurate is critical to maintaining RESPA compliance.

ABO plans to include fee audits in the Appraisal Quality assessment. Given the limited volume transactions reviewed for quality assessment, this control is an ineffective alternative to more robust post completion monitoring. Targeted testing of a sample of transactions with fee changes may provide a more meaningful result and be consistent with the weaker front end controls.

Issue 1X Level 2 <u>Secure Submission of Appraisers' Work</u>: When an appraisal report is submitted into OptisValue, it is currently running automated critical checks (i.e. a search for missing fields on the appraisal; incorrect form type submitted) and risk checks (business defined rules increasing the risk of the transaction). These checks are based on the ability to accurately capture the data from the submitted appraisal. Both Appraisal Management Companies are currently submitting their appraisal reports in multiple formats (i.e. AI ready vs. .pdf). This does have an adverse affect on the integrity of the data captured, therefore increasing the risk to the Bank, as pdfs go through our OCR (optical character recognition) process, which is not only an added expense for WaMu; however is not as accurate or complete as it is a <u>manual</u> extraction of data with limited fields extracted.

- Appraisals sent into OptisValue from the AMC are in a locked format and cannot be altered; however currently not all appraisals sent to the AMC by the individual appraiser are in a secured format. According to Jill Petersen, ABO has already identified some appraisals that appear to have been altered by the AMC rather than the signing appraiser. Appraisal industry blogs and watch groups have also identified the practice.

- AMCs are submitting their reports in multiple formats, which results in a loss of data integrity and increasing costs.

Recommendation : Require AMCs to submit their appraisal reports in AI format or in another electronic data stream that could capture and analyze all data submitted. If appraisals are provided in non AI format the vendor should be required to update the missing data with an electronic update to OptisValue at their expense. Vendors should be given a tolerance for this behavior and compliance within that tolerance monitored.

Issue 1X Level 4 AMC indemnification was a cornerstone of the outsourcing project. A process for collecting reimbursements for poor quality appraisals in loans that are repurchased and resold, processed through foreclosure and REO loss has not been developed.

Recommendation : A method for acquiring these indemnifications should be developed.

Excessive Sales Force Influence Over Appraisal Production

The prohibitions regarding undue pressure on appraisers and the appraisal management company need to be reiterated through the process to the vendors and the sales force, with violations of independence recorded, tracked and corrected through the managers overseeing those employees. Support from senior channel management, the Chief Risk Officer, and AMC management is needed to communicate a consistent and compliant message. Vendor management and strategic sourcing recommendations should receive review and approved by the Appraisal Business Oversight manager or her designee.

These forces have placed pressure on the ABO staff and they need organizational support to send a message of appropriate behavior and practices.

Issue 1X Level 1 <u>Value shopping and duplicate order processing</u>: Previously, when a duplicate order was placed in OptisValue, the order was halted in an exception queue that was manually researched by the appraisal staff coordination team, resulting in either a manual cancellation of the order or a manual push to process the order. This control minimized the practice of placing multiple orders in attempts to gain higher values. There are legitimate reasons for duplicate orders to be placed however, the control to objectively distinguish theses was eliminated and control over duplicate ordering was granted to lenders and loan processing personnel.

The ordering process now consists of OptisValue running an "existing appraisal" search for all new orders by both property address and loan number. If the system finds any current appraisal service previously completed, the originator/processor is prompted with a pop up message indicating a duplicate order was found including all pertinent information (service type, effective date, value, previous CVR, etc.) After reviewing the previous service, the originator receives three options that they must choose from:

"Accept Existing Order" "Cancel New Order" "Submit New Order"

If "submit new order" is chosen, the order is processed and is automatically assigned to the original AMC, if applicable. Each AMC does run a duplicate screening on their end and if they have concerns as to why a new order was placed; it is the AMC's responsibility to contact Lending with questions. No monitoring or performance indicators are established to assess the vendor's effective management of the process, they are fee to process duplicate orders and receive duplicate payment.

The appraisal order will proceed through an automated path without intervention from ABO. ABO does not police this process during production. Effectively, this allows for an unlimited number of new orders to attain a desired value.

According to Jill Petersen, it appears the number of multiple services being placed is significantly rising. The Risk Analytics Manager is currently running reporting to check the number and type of multiple services that are ordered, along with the outcome.

Recommendation : The revised controls are considerably weaker since they can be abused by the sales force. Robust monitoring is needed to identify value shopping behavior and minimize over valuation risk, particularly in a declining value environment.

1. Assuming staffing to prevent duplicate ordering is not available through the bank, the vendor's behavior must be monitored and evaluated to ensure they overcome their natural incentives to process duplicate orders. Vendor guidelines on this issue need to be established, performance needs to be monitored, and performance outside of tolerance should incur penalties.

2. The full control of ordering now provided to the lenders and loan processing personnel should be curtailed with improved business rules to disallow certain transactions that may be indicative of value shopping and force ABO approval. Examples of orders that raise the most concern include:

   - Ordering of an equal service value, for example a second 2055 exterior or second 1004w/cost interior appraisal. If both are completed two competing CVRs will be issued and there are no controls to ensure the highest quality appraisal is used. Processors and loan consultants can use their discretion regarding which should be used, selecting the highest value or the CVR with less conditions requiring underwriter review.

- ROV requests on exterior only appraisals should normally be rejected and an order for a higher level appraisal service placed. These decisions should be automated or default to the ABO Vendor Relationship Managers.

- More than 1 completed ROV service. Although not established in policy, the ABO team would like to limit ROV services to 1. Therefore approval to proceed would be a prudent control.

- RFTs ordered after another type of appraisal service was completed. It is suspicious that the appraisal done by another lender would materialize after an internally derived service failed to meet the value expectation.

These orders should trigger closer scrutiny and require ABO approval to proceed. The person placing the order should be informed that the order has exceeded one of these limits and requires ABO approval. It should fall to a queue that is monitored and manually cancelled or pushed to the vendors as appropriate.

Monitoring of multiple orders is challenged by weak controls over the loan numbers provided manually through OptisValue please see related data stewardship concerns.

Issue 1x Level 2 /**Level 3** Missed sales price / value cut revisions during processing at the vendors is not efficiently monitored. When a value comes in below sales price or a review cuts the appraised value of the subject property it is reviewed by the vendor business managers. The VBM will review the report with the appraiser and either the appraiser or the VBM will amend the value if appropriate. These activities can occur prior to submission of the final work product in OptisValue. The vendors may have tracking of these interations, but aside from notifying the loan consultant of an issue no record of the discussion is created.

As this process has developed, it is common to see within OptisValue two identical services completed by the same appraiser, one at the original value and one at a revised value. This contributes to the escalation of multiple services. The vendor business managers turn to the appraiser first for corrections, but are licensed appraisers who will issue a technical review to conclude at the purchase price if the value can be reasonably supported.

The E-flash outlining this process was issued by Rich Perry, Mgr-Channel Strategic Support - Retail Production on October 20, 2006 In addition, Sushuma Bull further clarified that the vendor hired business managers would also attempt to resolve value reductions in a similar manner in her October 20, 2006 announcement of the vendors business managers and ABO Vendor Relationship Managers. **[To Donnie-pdf of Eflashs for embedding]**

Appraisers are provided the sales contract and price negotiated between the two parties. Since, normally this contract is negotiated between a willing buyer and seller and are normally arms length transactions, without contrary evidence and contradictory comparable properties, it would be uncommon for the concluded appraised value to be less than the sales contract price. It can occur and appraisers must feel comfortable turning in objective, substantiated opinions.

Recommendation : To assess the appropriateness of the process and prevent excessive abuse of appraisers monitoring of results is necessary. Training on appropriate behavior and discussions by the VBMs and ABO VRMs need to be instituted to prevent undue influence upon appraisers. Concerns are mitigated by the high caliber of the ABO VRM appraisers and several of the VBMs are former WaMu staff appraisers who were well versed in appropriate and inappropriate behavior. That said training and monitoring remain important to protect WaMu 's reputation and the reliability of appraisal reviews. As Fair Lending seeks to develop a risk assessment for appraisal, monitoring of these interactions will become increasingly important.

Issue 1x Level 2 /**Level** 3 Sales personnel are encouraged to contact the vendors to arrange a reassignment of the appraisal to another appraiser. Several HLPA's issued at the start of the outsourcing process recommended that vendors be contacted directly concerning an appraiser reassignment. The reassignment was left to the vendors discretion. These HLPA's were 06-197, 06-249

Recommendation : Appraiser selection by sales personnel is forbidden under regulatory guidance. There are few scenarios where re-assignment is appropriate from sales personnel. 1) a reconsideration of value to isolate the initial appraiser from perceived pressure, 2) Appraiser / borrower relationships that would appear improper or invite unprofessional conflicts. Each case should be rare handling these events through WaMu appraisal business oversight would be ideal. However, if ABO staffing will not support this function vendors must be trained in the appropriate scenarios and courses of action to address these requests and provided a means to track them and report them back to ABO for corrective action with the WaMu lending personnel. The HLPA should be corrected with a broader communication concerning appropriate and inappropriate requests to AMCs and the appraisers.

Issue 1X Level 3 Special instructions passed to appraisers: During the appraisal order process, lending personnel can provide free form text comments regarding how the appraisal should be processed, special contact information, or special loan program requirements for the appraisal. This information is passed to the vendors and may be passed on to the appraisers. LSI has represented that it does not pass the comments along if they are prohibited by regulatory guidance. EAppraiseIT has not offered such screening services. Historically, appraiser pressure has been high through this method of communication, requests for a specific value, requests for a specific appraiser, or now a specific vendor. With the addition of pre-structured comments for the most common legitimate messages the use of the field and the abuse of the field have both fallen. Pressuring comments are now less than 1%.

The vendors also represent that requested appraisers are not considered when assigning the appraisal.

In depth monthly/Quarterly reviews would not be necessary if the vendors agreed to block inappropriate messages as originally planned in the outsourcing project. Then all that would be required is monitoring of the vendors and ensuring they properly screened the comments.

Recommendation : Require all vendors to monitor and block inappropriate information from the special instructions field or any other free form text that may be passed to the vendors through the order system. Conduct at least semi annual targeted testing to verify the vendor's representations. To the degree that prohibited information can be sent to the vendor and used, such as a request for a specific appraiser, semi-annual targeted testing should include verification that such a request disqualified the use of that appraiser and this fact was communicated back to the lender overstepping the bounds.

Appraisal Quality Reporting

Currently, the QA process has not changed from the way it was managed prior to the outsourcing. Per Jill Petersen, the QA process will be moved under the management of Pam Jarnigan and the procedures, roles and responsibilities will be defined by 2nd quarter 2007. The team is conducting baseline reviews on a limited volume of appraisals and is developing base line samples for wholesale, retail, and technical reviews. Expansion of their review role to cover some process expectations such as fee exceptions, special instructions, and appraisal processing have been under development.

The QA process prior to outsourcing lacked effective reporting and tracking of results, baseline sampling and trends, performance metrics, and accountability for results. It was plagued with adhoc requests and diversions which prevented it from providing a clear and trendable report on appraisal quality. In the interim, the QA team continues to audit for appraisal quality only. The outsourcing function has only increased the importance of quality assurance monitoring and reporting. QA results and monitoring is critical to meeting outsourcing requirements under Thrift Bbulletin 82a.

It is clearly a department in transition and these recommendations are intended to guide its development.

- Appraisal quality assurance reviews exceptions with the vendors, but action plans are not published or available to show proactive identification and remediation of risk.

- A formal sampling plan has not been developed that covers the most significant risk areas. Sampling and testing continue based on low volumes of appraisals and evidence of comprehensive coverage has not been provided.

- No quality reports have been issued to corporate credit and vendor efforts to improve quality are not tracked.

- Vendor expectations and ranking have not been established based on appraisal quality results.

- Additions to the ineligible appraiser list have slowed as the appraisal quality assurance team has been re-building its processes.

- Appraisal quality definitions for acceptable and unacceptable appraisals and review criteria should be formally approved by Corporate Credit Risk. This is similar to how Corporate Credit Review provides minimum standards to the Commercial Chief Risk Officer and the Commercial Business Line.

- These criterial also are not alligned with the activities of the loan review functions in the bank an effort to align these criteria

The pre-outsourcing definitions are attached in the appendix for reference on page x

Issue 1X Level 1 Currently, QA procedures specifically relating to the new business model and working with Appraisal Management companies have not yet been defined.

Recommendation: A Quality Control Plan needs to be developed, along with specific audit/review procedures, which would include the plan for onsite audits of the vendors.

Level 2 Quality Assurance reports through Jill Petersen, who has 4 relationship managers also reporting to her. While the volume of transactions these relationship managers sheppard through to completion should be low, they are the escalated transactions, presumably containing the highest collateral risk. Relationship managers are empowered to change values and complete appraisal services as needed. The quality assurance team reports to Jim Dillon and Pam Jarnigan and would have occasion to report on the adequacy of the relationship manager's work.

In addition, the ABO team is significantly vested in maintaining sufficient vendor capacity to meet business SLA requirements. This focus can create bias to create or enforce quality standards. It places the entire ABO team in a conflict of interest, one that can be overcome with established vendor quality and performance expectations and monitoring of these metrics.

Recommendation: ABO and the Chief Risk Officer should review its reporting structure and look to align the appraisal review expertise with other review function units giving them a degree of separation from appraisal production. If appraisal quality assurance is retained within ABO, it should at least report to a manager that does not oversee production.

However, currently, there are limited managerial choices for switching the reporting structure to be more independent. In addition, needed changes are being planned and executed under Jill Petersen's direction these changes may be critical to producing the reporting and transparency into appraisal quality. The conflict should be recognized and tempered with additional controls, oversight, or re-assignment of production oriented ABO personnel.

Issue 1X Level 4 Criteria for reporting is inconsistent with the Credit Risk Oversight Events (Corporate Credit Review (CCR). See a sample of criteria in the appendix on page x.

Recommendation : These should be aligned to facilitate broader publication of results and a clear understanding of the appraisal quality trends. It would help alleviate misconceptions from the other review groups and communicate efforts to improve the problems observed by the other review groups.

HERE Starts what has not yet been moved to the new headings above.

Residential Appraisal Department Overview

The primary function of the Appraisal Business Oversight Department is to provide oversight of all appraisal services processed through WaMu's Collateral Management System (CMS), OptisValue, and provided by two national appraisal management companies.

The Appraisal Business Oversight Department took over complete appraisal operations during the third quarter of 2006, when all management, staff, and coordination functions within the Appraisal Production Department were outsourced through the Cornerstone project. However, for a full understanding on the department, it is critical to appreciate that the mission of the department started as a "work in progress" and continues largely with that legacy at present. But that is meant that a large number of the departments practices weren't developed and tested in advance, but were created on the fly in response to complaints from lenders as to the issues related to the outsource plan. Further, some current department processes were created or agreed to by the Vendor Management group to assure customer approval, and were not created in the best interests of the profession.

To the credit of ABO department managers, they appreciate this issue and are working to define in writing department processes, and to resolve any conflicts between policies and actual processes. Nevertheless, this will take some time and quite a diligent effort. Consequently, the actual performance of the department cannot be compared to written policies, since so many items will have to be addressed in arrears now that leaders outside the department have already instituted them, sometimes. Any ABO analysis should therefore be considered a "work in progress," given the situation.

The ABO department includes a total of 30 employees. Based on an organization chart dated 11/01/06, the employee breakdown is as follows:

- 1 Senior Manager Appraisal Oversight
  - 1 Business Ops Analyst
- 1 Manager Appraisal Operations
  - 4 Relationship Managers
  - 2 Credit Policy Specialists
  - 2 Credit Policy Analysts
  - 1 Manager Credit Operations Strategy
    - 7 Appraiser Review Analysts
  - Manager of Credit Policy
- 1 Manager Credit Operations Strategy
  - 1 Credit Ops Strategy Analyst
  - 1 Business Data Analyst
- 1 Manager of Technology
  - 1 Credit Ops Strategy Analyst
  - 1 Credit Systems Manager
    - 1 Business Data Analyst
    - 2 Technology Analysts

1 Manager of Risk Analytics

Summary of Concerns

OLD LIST

- As stated early is this report, ABO is a group operating as a start-up unit, but from a distinct disadvantage. That is, they did not actively manage the transition process from internal staff to Vendors. This management was mainly done by the Vendor Management group, often without documentation, nor with any consideration of appraisal quality or professional requirements. The motivation of Vendor Management was solely "noise reduction" for concerns of lenders during the transition. Now, ABO is in the process of backtracking to try to document what they had little involvement with. Unfortunately, any changes at this point would not be supported by lending since they would be viewed as hindering the speed of the process. Therefore, ABO operates in a very informal environment with few document able processes, and less oversight of the vendors.

- **Issue Level 1**
  - Correspondent lending, SMF, and the REO/Loss Mitigation department are not following the residential ordering process via OptisValue.
  - It appears the number of multiple services being placed is raising, significantly. According to Jill Petersen, Lending is really pushing on completing a new appraisal in search of a higher value vs. ordering an ROV with the AMCs.
  - Standard 3 technical desk reviews are being submitted where the appraiser is not licensed in the state in which the property is located.
  - CoreLogic 's report/recommendation is being transmitted from OptisValue to the AMC; however, the AMC is not passing this information along to their individual assigned appraiser. Therefore, CoreLogic is not fully being utilized and those high-risk transactions that indicate a field review is necessary are not taken into consideration when determining the level of review being completed.
- **Issue Level 2**
  - The current Residential Appraisal Manual is outdated and has not been updated since the outsourcing project. Therefore, there is not a single document defining the roles and responsibilities of ABO and the AMC.
  - The Quality Assurance Employees, along with the four production related Relationship Managers, are all reporting to the same individual.
  - Without specific guidelines for fee increases, the Bank is not ensuring compliance with Fair Lending issues. There is no check in place to ensure what is being requested/reason for increase is what actually matches the characteristics of the submitted appraisal.
  - Currently not all appraisals sent to the AMC by the individual appraiser are in a secured format and could potentially be altered.
  - ABO is currently not completing any upfront-added checks on reports submitted by trainees.
  - There is a lack of geographic competency in the standard 3 desk reviews being completed today. Reviews are being performed outside of the reviewer's typical service area, many of which are completed by an out-of-state appraiser, not actually licensed in that area
  - Currently, QA procedures specifically relating to the new business model and working with Appraisal Management companies have not yet been defined.
- **Issue Level 3**
  - The current ABO work structure does not align with HR guidelines stating Manager Titles should have a minimum of four direct reports. There is a very uneven balance of direct reports within their structure.
  - Although assigning of all appraisal orders is an automated process, it is based on a manually set up profile within OptisValue.
  - Lending does still have the ability to enter free form text and request a specific appraiser for a transaction, risking appraiser independence.
  - The responsibility of all fee increases and due date extensions is that of the AMC providing the service.
  - AMCs are submitting their reports in multiple formats, which results in a loss of data integrity and increasing OCR costs.
  - ABO is not auditing fees to ensure payment is correct and due to the automated payment system, we have no upfront way of preventing incorrect payments.

Review Process

INCOMPLETE, JUST MOVED PROCESS ITEMS

The Corporate Collateral Valuation Risk Management (CCVRM) department was created in early October. At that time, a team was formed within CCVRM to collaborate with ABO. The first task given to this team was to garner knowledge about the ABO division. The goal was to gather information pertaining to:

- ABO organization structure
- ABO policies and procedures
- Operational guidelines
- Appraisal process
- Review guidelines
- Quality Assurance (QA) process

In order to fulfill these tasks, we took a variety of steps including several phone meetings with ABO. We started with an initial conference call on December 11, which included Tom Westerfield, Donnie Gill, and Jill Petersen of ABO. This meeting was used to introduce the new CCVRM department, explain our roles and responsibilities, and begin to gather documentation such as the organizational charts and policies. The second meeting took place by conference call on December 15 and included the same three individuals. The goal of this meeting was to capture the remainder of the process information for the department. The last call took place on January 2 and was between Tom Westerfield and Pam Jarnigan. This meeting was scheduled to garner information around the current and planned changes in the appraisal oversight and quality assurance processes.

WMB, WMBfsb
January 8, 2007
Safety & Soundness Examination
OTS ASSET QUALITY MEMO 2

DATE:	April 5, 2007
TO:	David Schneider, EVP, President – Home Loans
	Cheryl Feltgen, SVP, Chief Risk Officer – Home Loans
FROM:	Bruce Thorvig, Regional Appraiser
	Scott Shambaugh, Examiner
SUBJECT:	Appraisal Operations
CC:	Cathy Doperalski, FVP, Regulatory Relations
	Tina Tran, Regulatory Relations

BACKGROUND INFORMATION

Office of Thrift Supervision (OTS) appraisal regulations are included in 12 CFR Part 564 – Appraisals. The regulation prescribes minimum standards for the performance of real estate appraisals in connection with federally related transactions under the jurisdiction of the OTS. Appraisals must conform to generally accepted appraisal standards as evidenced by the Uniform Standards of Professional Appraisal Practice (USPAP). In addition, the regulation sets forth the responsibilities of management to develop, implement and maintain appraisal policies to ensure that appraisals reflect professional competence and to facilitate the reporting of estimates of market value upon which the institution may rely on to make lending decisions. Management must develop written appraisal policies that will ensure that adequate appraisals are obtained and proper appraisal procedures are followed consistent with the requirements of part 564.

Appraisal Business Oversight (ABO) is in the process of updating the department's appraisal policy and procedures following the reorganization of the appraisal operations and the final phase of the Appraisal Outsourcing Initiative, which was completed on November 6, 2006. During the interim, ABO has continued to provide documentation to the vendors through various means, including weekly Ops Meetings, on requirements and other WaMu standards that will be incorporated into the Vendor Procedures Manual.

During the examination, twenty appraisals from LBMC and thirty-four appraisals from WaMu Home Loans were reviewed in detail for reasonableness of the value conclusions and compliance with OTS appraisal regulations, USPAP, secondary market appraisal guidelines, and the bank's internal appraisal policies and procedures. We have identified certain areas of the appraisal and review process in need of improvement. Primary appraisal issues (red flags requiring attention by the underwriter or review appraiser) included seller paid closing costs and concession, misstatements/contradictions, inadequate/incomplete explanations and support for the value conclusion, reconciliation of the sales comparison approach, and weakness in the appraisal review process. Two memorandums were provided to ABO management detailing the results or the OTS appraisal review. Findings were discussed with ABO management and regulatory relations on April 4, 2007.

EXAM FINDINGS DEFINITIONS

***Observation*:**	<u>A weakness identified that is not of regulatory concern, but which may improve the bank's operating effectiveness if addressed.</u> *Observations* are made in a consultative role. They may be presented to management either verbally or in writing, but will generally not be included in the Report of Examination. Examiners will rarely request a written response during the examination. *Observations* may or may not be reviewed during subsequent examinations.
***Recommendation*:**	<u>A secondary concern requiring corrective action</u>. A *Recommendation* can become a *Criticism* in future examinations should risk exposure increase significantly or other circumstances warrant. They may be included in the Report of Examination and mentioned in Exit and Board Meetings. Examiners will request a written response from Management during the examination. Management's actions to address *Recommendations* are reviewed at subsequent or follow-up examinations.
***Criticism*:**	<u>A primary concern requiring corrective action</u>. *Criticisms* are often summarized in the "Matters Requiring Board Attention" or "Examination Conclusion and Comments" section of the Report of Examination; warrant increased attention by Senior Management and the Board of Directors; and require a written response. They are subject to formal follow-up by examiners and, if left uncorrected, may result in stronger action.

EXAM FINDING 1	☐ Observation ☑ Recommendation ☐ Criticism
Topic:	Updating and revision of appraisal policy and procedures
Finding:	Appraisal Business Oversight has not completed updating and revising the operation's appraisal policy and procedures and on-line appraiser guidance following the reorganization of the appraisal operations and the final phase of the Appraisal Outsourcing Initiative.
Action:	Policies, procedures and controls must be updated and revised to ensure that appraisals reflect professional competence and to facilitate the reporting of estimates of market value upon which the institution may rely on to make lending decisions. Management must develop written appraisal policies that will ensure that adequate appraisals are obtained and proper appraisal procedures are followed consistent with the requirements of part 564. The appraisal manual (dated 2/21/06) and other information located on the appraisal website www.wamuappraisal.com should also be updated to reflect current policy and procedures.

Management Response Requested ☑ Yes ☐ No

WaMu

MANAGEMENT RESPONSE ☐ Agree ☐ Partially Agree ☐ Disagree **Enter Target Date: [ ]**

Management Response: Indicate whether you agree, partially agree, or disagree. If you agree, provide an anticipated target date for implementation.

Partially Agree: The response should clearly define that portion of the finding or recommended action disagreed with as well as the portion agreed to.

Disagree: The response should clearly define WHY there is disagreement with the finding or recommended action, and outline any mitigating circumstances or alternative course of action to be pursued.

RESPONSE (succinct response to finding / action)

CORRECTIVE ACTION (provide specific action steps planned, the assigned responsible manager, and target dates for each)

1.
2.
3.

Washington Mutual, Inc. – Confidential

EXAM FINDING 2	☐ Observation* ☑ Recommendation* ☐ Criticism*

Topic: Appraisal issues (red flags) requiring further attention by the underwriter or review appraiser

Finding: Certain areas of the appraisal and review process are in need of improvement. Primary appraisal issues (red flags requiring further attention by the underwriter or review appraiser) identified included: incomplete analysis or explanation of seller paid closing costs and concessions; misstatements/contradictions regarding property descriptions, market trends, correct selling price of the subject property, property address and taxes, and rental information; inadequate/incomplete explanations and support for the value conclusions, inadequate reconciliation of the sales comparison approach; and weakness in the appraisal review process such as: an inadequate appraisal review checklist for LBMC underwriters, vendor quality assurance not adequately identifying appraisal issues/weaknesses, not elevating an administrative review by underwriters to a higher level of review by an appraiser when appropriate, not obtaining a field review when a review required a value change, and inappropriate geographical selection of review appraisers.

Action: Complete the process of updating and revising the appraisal policy and procedures and develop controls to better ensure that the appraisal and appraisal review process are effective in identifying primary appraisal issues, inadequate/weak appraisals, and unsupported value conclusions. Also, ensure that procedures are implemented to strengthen and improve the appraisal review process of LBMC and WaMu Home Loans in identifying and preventing the noted weaknesses.

Management Response Requested ☑ Yes ☐ No

WaMu

MANAGEMENT RESPONSE ☐ Agree ☐ Partially Agree ☐ Disagree **Enter Target Date: [ ]**

Management Response: Indicate whether you agree, partially agree, or disagree. If you agree, provide an anticipated target date for implementation.
Partially Agree: The response should clearly define that portion of the finding or recommended action disagreed with as well as the portion agreed to.
Disagree: The response should clearly define WHY there is disagreement with the finding or recommended action, and outline any mitigating circumstances or alternative course of action to be pursued.

RESPONSE (succinct response to finding / action)

CORRECTIVE ACTION (provide specific action steps planned, the assigned responsible manager, and target dates for each)

1.
2.
3.

Washington Mutual, Inc. – Confidential

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

--x

THE PEOPLE OF THE STATE OF NEW YORK by ANDREW M. CUOMO, Attorney General of the State of New York,

Plaintiff,

-against-

FIRST AMERICAN CORPORATION and FIRST AMERICAN EAPPRAISEIT,

Defendants.

--x

COMPLAINT

Index No.

1. This action is brought by Plaintiff, the People of the State of New York, by Andrew M. Cuomo, Attorney General of the State of New York ("Attorney General"), based upon the Attorney General's authority under Article 22-A of the General Business Law, Section 63(12) of the Executive Law, and the common law of the State of New York.

2. Plaintiff, complaining of the above-named defendants, alleges upon information and belief as follows.

THE RELEVANT ENTITIES

3. First American Corporation ("First American") is, according to its 2006 annual report, "America's largest provider of business information." It earned $8.5 billion in revenues in 2006. First American operates in five primary business sectors: Title Insurance and Services, Specialty Insurance, Mortgage Information (including real estate appraisal services), Property Information, and Risk Mitigation and Business Services. It does business in New York both directly and through its subsidiaries.

4. First American provides real estate appraisal services to savings and loans, banks, and other lending professionals through its wholly owned subsidiary, First American eAppraiseIT ("eAppraiseIT"), an appraisal management company headquartered in California and Massachusetts. eAppraiseIT conducts business and appraises real estate in the state of New York.

5. Washington Mutual, Inc. ("WaMu") is the country's largest savings and loan, with assets totaling $346 billion. In the first three quarters of 2007, WaMu originated $116 billion in residential mortgage loans. WaMu is eAppraiseIT's largest client.

PRELIMINARY STATEMENT

6. In this era of widespread mortgage loan defaults and home foreclosures, the independence and integrity of the real estate appraisers who determine the value of home loan collateral is of enormous importance. Real estate appraisals are intended to provide borrowers and lenders with an independent and accurate assessment of the value of a home. This ensures that a mortgage or home equity loan is not under-collateralized, which in turn protects borrowers from being over-extended financially and lenders and investors from loss of value in a foreclosure proceeding.

7. First American recognizes and touts the central role it plays, through its appraisal management company eAppraiseIT, in protecting homeowners, business customers, and the entire financial market. As First American explains in its 2006 Annual Report:

> Appraisals are used to establish a property's market value; therefore, inaccurate or fraudulent appraisals damage the entire market and have negative economic effects that are far reaching. First American's third-party, unbiased valuations – including insured valuations – are a resource real estate and lending professionals can turn to for accuracy that benefits not only the homeowner and lender, but our nation's

economy.

Value to Consumers: Homeowners, who place a large investment in their property, can be particularly victimized by appraisal fraud. First American's warranted valuations, which are supported by our third-party perspective and backed by more than a century of integrity, virtually eliminate risk from this type of fraud.

Value to our Business Customers: Inaccurately appraised properties that make their way into lender portfolios increase the opportunity for foreclosures. Our national services provide our mortgage lender customers with a welcomed resource for unbiased appraisals that satisfy increased regulatory concerns, help to accurately determine value, and mitigate default risk.

8. Despite these representations, First American and eAppraiseIT have abdicated their role in providing "third-party, unbiased valuations" for eAppraiseIT's largest client, WaMu. Instead, eAppraiseIT improperly allows WaMu's loan production staff to hand-pick appraisers who bring in appraisal values high enough to permit WaMu's loans to close, and improperly permits WaMu to pressure eAppraiseIT appraisers to change appraisal values that are too low to permit loans to close. eAppraiseIT compromises its independence even while publicly touting that independence, and despite myriad warnings from its senior management team about the illegal collusion inherent in the compromises it is making. Instead of preserving its independence, which would have protected consumers and business customers alike, eAppraiseIT chose to protect only itself. And senior executives at First American, though warned by eAppraiseIT's senior management of its compromised independence, nonetheless directed eAppraiseIT to continue its wrongful conduct.

9. This wrongful conduct constitutes a deceptive, fraudulent, and illegal business practice. It violates New York law as well as federal law and regulations.

JURISDICTION

10. The State of New York has an interest in the economic health and well-being of those who reside or transact business within its borders. The State also has an interest in assuring the presence of an honest marketplace in which economic activity is conducted in a competitive manner, without fraud, deception, or collusion, for the benefit of marketplace participants. The State also has an interest in upholding the rule of law generally. The conduct of First American and eAppraiseIT injured these interests.

11. Thus, the State of New York sues in its sovereign and quasi-sovereign capacities, as *parens patriae*, and pursuant to Executive Law § 63(12), General Business Law §§ 349 *et seq.* and New York common law. The State sues to redress injury to the State, and to its general economy and residents, as well as on behalf of: (1) persons who obtained mortgages, home equity loans, or refinanced their homes with WaMu and as to whose homes eAppraiseIT conducted the real estate appraisal; and (2) persons who bought WaMu loans secured by mortgages that were improperly appraised by defendants. The State seeks disgorgement, restitution, damages including costs, and equitable relief with respect to defendants' fraudulent, deceptive, and otherwise unlawful conduct.

FACTUAL ALLEGATIONS

I. The Real Estate Mortgage Industry

A. Background

12. Most people interested in purchasing or refinancing a home ("borrowers") seek a financial institution (a "lender") to lend them money on the most favorable repayment terms available. Traditionally the lender, as part of agreeing to loan the funds, wanted to ensure that the borrower was able to repay the loan and that the loan was adequately collateralized in case

the borrower defaulted. The borrower and the lender had a common interest in accurately valuing the underlying collateral because both wanted to be sure the borrower was not paying too much for the property and would be able to meet the repayment terms, or that – in the event of default and foreclosure – the property value could support the loan.

13. Today, the landscape of the mortgage industry is quite different from this traditional model. Rather than holding the mortgage loans, lenders now regularly sell these mortgages in the financial markets, either directly or to investment banks or Government Sponsored Enterprises ("GSEs"), such as the Federal National Mortgage Association ("Fannie Mae") or the Federal Home Loan Mortgage Corporation ("Freddie Mac"). The loans are then pooled together, securitized, and sold to the general public as mortgage backed securities. The money that the lender receives for the sale of the mortgage loans or bonds is then used to finance new mortgages, increasing the lender's profits and aiding its stock price. Today, the vast majority of mortgage loans are sold to investment banks or GSEs, leaving the original lender holding far fewer mortgages in its portfolio.

14. This reconfiguration of the way that mortgages are held has transformed the incentives in the industry. Specifically, it has the effect of making the lender less vigilant against risky loans since any risk is quickly transferred to the purchasers of the loans. Moreover, as the lender does not hold many of its loans in its portfolio, the lender's interest in ensuring the accuracy of the appraisal backing the loan is severely diminished. Even worse, because lenders' profits are determined by the quantity of loans they successfully close, and not the quality of those loans, there is an incentive for a lender to pressure appraisers to reach values that will allow the loan to close, whether or not the appraisal accurately reflects the home value.

15. Further jeopardizing the process, mortgage brokers and the lenders' loan production staff (also known as "loan origination staff") are almost always paid on commission. Thus, the income of these individuals depends on whether a loan closes and on the size of the loan. Accordingly, brokers and loan production staff have strong personal incentives to pressure appraisers to value a home at the maximum possible amount, so that loans will close and generate maximum commissions. For these reasons, mortgage brokers and lenders frequently subject real estate appraisers to intense pressure to change values in appraisal reports.

16. The investment banks and GSEs also have an interest in inflating (or at least in not questioning) the value of the pooled loans. The values of these loans serve as a basis for the value of their securities. As such, the higher the value of the loans closed, the greater the value for which the securities are sold on the secondary market.

17. Thus, the only parties under the current system who want an accurate appraisal are the borrowers and the investors in the asset-backed securities market. Neither of these parties, however, has any contact with, or control over, the appraisal process.

B. Federal and State Laws Require Appraisal Independence

18. Because of the importance of appraisals in the home lending market, state and federal statutes and regulations require that appraisals be accurate and independent. The Uniform Standards of Professional Appraisal Practice ("USPAP") are incorporated into federal and New York law. <u>See</u> 12 C.F.R. § 34.44; 19 NYCRR § 1106.1. USPAP requires appraisers to conduct their appraisals independently: "An appraiser must perform assignments with impartiality, objectivity, and independence, and without accommodation of personal interests. In appraisal practice, an appraiser must not perform as an advocate for any party or issue." USPAP

Ethics Rule (Conduct).

19. Federal law sets independence standards for appraisers involved in federally-regulated transactions. <u>See</u> 12 U.S.C. §§ 3331 *et seq.* The Code of Federal Regulations provides that an in-house or "staff" appraiser at a bank "must be independent of the lending, investment, and collection functions and not involved, except as an appraiser, in the federally related transaction, and have no direct or indirect interest, financial or otherwise, in the property." 12 C.F.R. § 34.45. For appraisers who are independent contractors or "fee" appraisers, the regulation states that "the appraiser shall be engaged directly by the regulated institution or its agent, and have no direct or indirect interest, financial or otherwise, in the property transaction." 12 C.F.R. § 34.45.

20. In 2005, federal regulators including the OTS [Office of Thrift Supervision] published "Frequently Asked Questions on the Appraisal Regulations and the Interagency Statement on Independent Appraisal and Evaluation Functions." With regard to appraisal independence, the document provides:

> 3. *Who should be considered the loan production staff for purposes of achieving appraiser independence? Could loan production staff select an appraiser?*
>
> *Answer:* The loan production staff consists of those responsible for generating loan volume or approving loans, as well as their subordinates. This would include any employee whose compensation is based on loan volume. Employees responsible for the credit administration function or credit risk management are not considered loan production staff. **Loan production staff should not select appraisers.**
>
> * * *
>
> 5. *When selecting residential appraisers, may loan production staff use a revolving pre-approved appraiser list, provided the*

350

list is not under their control?

Answer: Yes, loan production staff may use a revolving, board-approved list to select a residential appraiser, provided the development and maintenance of the list is not under their control. **Staff responsible for the development and maintenance of the list should be independent of the loan production process. . . . Further, there should be periodic internal review of the appraiser selection process to ensure that appropriate procedures are being followed and that controls exist to ensure independence.** (Emphasis added).

21. New York law incorporates USPAP and requires that a State-certified or State-licensed appraiser may not accept a fee for an appraisal assignment "that is contingent upon the appraiser reporting a predetermined estimate, analysis, or opinion or is contingent upon the opinion, conclusion or valuation reached, or upon the consequences resulting from the appraisal assignment." N.Y. Exec. Law § 160-y; 19 NYCRR § 1106.1.

II. Appraisal Management Companies Create the Appearance of Appraiser Independence

22. In response to these rules and the threat of stricter federal enforcement, in Spring 2006, WaMu attempted to insulate itself by hiring two Appraisal Management Companies ("AMCs") – eAppraiseIT and its top competitor Lender's Service, Inc. ("LSI") – to oversee the appraisal process. These companies provide the appearance of a structural buffer between the banks and the appraisers that eliminates potential pressure or conflicts of interest. In theory, an AMC selects appraisers independently, serves as the appraisers' sole contact, and communicates the unbiased results to the lending institution. In this way, structurally, a lending institution would be much less able to improperly influence an appraisal.

23. eAppraiseIT publicly claims on its website that it provides just such a firewall

between lenders and appraisers, and that "customers can be assured that Uniform Standards of Professional Appraisal Practice (USPAP) and Financial Institutions Reform Recovery and Enforcement Act (FIRREA) guidelines are followed and that each appraisal is audited for compliance."

III. First American and eAppraiseIT Violate Appraiser Independence Requirements by Permitting WaMu's Loan Origination Staff To Select Appraisers Who Provide Higher Appraised Values

24. Despite their claims of independence from their lender clients, First American and eAppraiseIT violate federal and state independence requirements with regard to appraisals performed for WaMu, and in doing so deceive borrowers and investors who rely on their proclaimed independence.

25. WaMu retained eAppraiseIT in Spring 2006, after WaMu decided to close its internal appraisal office and terminate its staff appraisers. WaMu quickly became eAppraiseIT's largest client, providing nearly 30 percent of its business in New York. Over the course of the business relationship, eAppraiseIT conducted more than 260,000 appraisals for WaMu, receiving over $50 million from WaMu.

26. Initially, eAppraiseIT employed a combination of in-house staff and third-party fee appraisers, including some "preferred appraisers" identified by WaMu, to conduct appraisals of residential property for WaMu. eAppraiseIT also hired approximately 50 former WaMu employees as staff appraisers and Appraisal Business Managers ("ABMs") and – at WaMu's request – gave the ABMs the authority to override and revise the values reached by third-party appraisers. One-third of eAppraiseIT's staff appraisers are former WaMu employees, and all of the ABMs are former WaMu employees. eAppraiseIT's President advised the leadership of First

American that "we have hired and on boarded many of Wamu's regional mangers and appraisers last week. They will be instrumental in our relational and operational success with the sales force."

27. Under contractual arrangements between WaMu and eAppraiseIT, WaMu can challenge an appraiser's conclusions by requesting a "reconsideration of value" ("ROV") when WaMu disagrees with an appraised home value set forth in an appraisal report. Practically speaking, this permits WaMu to ask eAppraiseIT to reconsider and raise the value assigned to a home. Throughout the business relationship, WaMu has frequently ordered ROVs from eAppraiseIT.

28. By email dated September 29, 2006, a WaMu executive wrote to eAppraiseIT's senior executives to define the responsibilities of eAppraiseIT's ABMs as to ROVs and value disputes:

> . . . the four appraisers/reviewers would be directly involved in escalations dealing with: ROVs, Valuation issues where the purchase price and appraised value differ with no reconciliations/justifications by the appraiser, Value cuts which we continue to receive from your third party reviewers (Wholesale), **proactively making a decision to override and correct the third party appraiser's value or reviewer's value cut**, when considered appropriate and supported . . .

In this way, from the outset, WaMu sought to use eAppraiseIT to ensure that appraisals did not come in lower than WaMu wanted.

A. Summer - Fall 2006: WaMu is Dissatisfied with the Values Provided by eAppraiseIT's Independent Appraisers; First American and eAppraiseIT Try to Satisfy WaMu's Concerns

29. Almost immediately after WaMu retained eAppraiseIT to provide appraisals in early Summer 2006, WaMu's loan production staff began complaining that the appraisal values provided by eAppraiseIT's appraisers were too low. It was clear, and eAppraiseIT well understood, that WaMu's dissatisfaction was largely due to the fact that eAppraiseIT's staff and fee appraisers were not "hitting value," that is, were appraising homes at a value too low to permit loans to close.

30. For example, on August 9, 2006, eAppraiseIT's President told WaMu executives that "We need to address the ROV issue . . . . Many lenders in today's environment . . . have no ROV issue. The value is the value. I don't know if WAMU production will go for that . . . . The Wamu internal staff we are speaking with admonish us to be certain we solve the ROV issue quickly or we will all be in for some pretty rough seas."

31. A week later, on August 15, 2006, eAppraiseIT's Executive Vice President advised eAppraiseIT's President that WaMu's loan officers would often pressure WaMu's internal appraisal field managers for an "extra few thousand," or "tell[] them specifically what they needed," or would "ask for several ROVs on the same property." eAppraiseIT's Executive Vice President explained that "[h]aving loan officers ask for a few thousand dollars because it is within the range is something we do not currently do for any client. . . . It is also direct pressure on the appraiser for a higher value without any additional information."

32. Yet only a month later, on September 14, 2006, eAppraiseIT's Executive Vice President proposed a solution that appeared to capitulate to these demands for an "extra few

thousand": he wrote "it looks like our potential 'raise the value' policy by [an eAppraiseIT manager's] group might help a lot on the small value changes. . . . [W]e are studying allowing [the manager's] group a little flexibility to raise the value 5% with a cap of $50k if it is fully justified."

33. Complaints and pressure from WaMu's loan origination staff were not empty threats. On October 5, 2006, in response to "complaints from the WaMu production team – particularly in Northern California," eAppraiseIT prepared a "WaMu Improvement Implementation Plan." The plan was unsuccessful, however. By December 2006, WaMu had reassigned all of its Northern California appraisal work to LSI.

34. During this period, First American was seeking additional business from WaMu in other areas. But WaMu expressly conditioned giving any future business to First American on success with eAppraiseIT. By email dated September 27, 2006, a First American senior executive advised other senior executives at First American and eAppraiseIT about a conversation he had with the President of WaMu Mortgage about long-term business prospects. The First American executive explained that:

> [WaMu] and I discussed our long-term relationship including the money we have on deposit there and our other current business relationships. I told him we would like to expand those relationships. And in exact terms, we would like one half of their flood business, which they currently give 100% to [Corporation A] and their tax business is divided 3 ways among [3 corporations] and that we would like to take [Corporation A's] tax business.

According to the First American executive, WaMu responded as follows:

> He said that if the appraisal issues are resolved and things are working well he would welcome conversations about expanding our relationship including tax and flood.

Thus, First American knew that WaMu would provide it with new business only if the "appraisal issues" – including WaMu's complaints that eAppraiseIT's appraisers did not provide high enough values – were "resolved."

35. By December 2, 2006, eAppraiseIT noted internally that ". . . we know [WaMu is] going to complain about the excessive number of low values because the majority of orders are not going to [WaMu's] preferred appraisers."

36. On December 18, 2006, one eAppraiseIT executive told others that WaMu had advised him that its criticism was based on the fact that "values are coming in lower with EA [eAppraiseIT]" than with LSI, the competitor appraisal management company that WaMu had also retained to provide appraisals. According to this executive, WaMu maintained that "They also see more Wamu preferred appraisers doing work for LSI and they think that is why they aren't having as many value issues with them. . . . The [WaMu] managers indicated that if the loan consultants had a choice they would prefer to use LSI over eAppraiseIT because they feel they will have less problem with the values."

B. Winter 2007: First American and eAppraiseIT Agree to "Roll Over and Just Do It" and Accept WaMu's Corrupt Proven Appraiser List

37. In February 2007, WaMu directed eAppraiseIT to stop using its usual panels of staff and fee appraisers to perform WaMu appraisals. Instead, WaMu's loan origination staff demanded that eAppraiseIT use a Proven Panel of appraisers selected by the loan origination staff, who were chosen because they provided high values.

38. By email dated February 22, 2007, eAppraiseIT's President explained to senior executives at First American WaMu's motives for demanding the Proven Panel:

> We had a joint call with Wamu and LSI today. The attached document

> outlines the new appraiser assigning process. In short, we will now assign all Wamu's work to Wamu's "Proven Appraisers" . . . . We will pay their appraisers whatever they demand. **Performance ratings to retain position as a Wamu Proven Appraiser will be based on how many come in on value, negating a need for an ROV.** (Emphasis added).

39. eAppraiseIT's senior management was well aware of the threats to appraiser independence inherent in allowing WaMu's loan production staff to select the appraisers on the Proven Panel based on whether the appraiser "came in on value," and raised these concerns with First American's senior management. eAppraiseIT executives warned of their "concern regarding the proven list" and "concerns about over-valued properties."

40. These concerns were warranted. eAppraiseIT knew that WaMu's Proven Appraiser List would be composed of appraisers who had been hand-picked by the loan origination staff because they brought in high appraisal values. Indeed, when eAppraiseIT received email requests to add particular appraisers to the panel, the email chains often showed that the requests came directly from WaMu's loan origination staff. Further, a WaMu Vice President in the Appraisal Oversight group explained, in an email to eAppraiseIT about an ROV for a "low value," that "This is an example of the issue that has caused sales pushing for a 'proven appraiser' process."

41. In February 2007, eAppraiseIT simply capitulated to WaMu's demands. In an email on February 22, 2007, eAppraiseIT's President told senior executives at First American "we have agreed to roll over and just do it." He explained that "we were willing to live with the change if they would back us up with the appraisers and tell them that simply because they are rated as Gold Preferred does not mean that they can grab all the fees. They agreed." In other words, for the right price in fees, eAppraiseIT was willing to go along with the Proven Panel.

Indeed, eAppraiseIT's President suggested to WaMu

> that if this the case we should have Wamu write the introduction letters to their appraisers, set the stage and let us do our magic . . . . I assured her the noise from retail will stop . . . . She brought up the fact that Wamu knows this means little money to no money for EA and LSI and they will fix that in the near future. But for now they need to stop the noise or none of us will be around. I believe her.

42. eAppraiseIT agreed to the Proven Panel with full knowledge that WaMu's loan production staff was selecting appraisers that would "hit value" and provide higher appraisals. In an email dated March 1, 2007, eAppraiseIT's President told WaMu executives:

> Recently, we have been notified that Lending would like us to use more of their "Proven Appraisers" versus appraisers off our pre-selected appraiser panel. It seems the amount of Reconsideration of Value (ROV) requests associated with our appraisers far exceeds those initiated when a WaMu proven appraiser completes a file. Said differently, **Wamu proven appraisers bring the value in a greater majority of the time** with minimal involvement of the vendor, sales and Appraisal Oversight. **I am fine with that, of course, and will happily assign Wamu orders to Wamu proven appraisers instead of eAppraiseIT's approved panel appraiser whenever possible.** (Emphasis added).

With this email, eAppraiseIT's President "happily" agreed to compromise the company's independence and violate the laws governing appraiser independence.

43. On March 5, 2007, WaMu confirmed the primary role of its loan origination staff in picking appraisers in a follow-up email, in which it explained that the

> Proven Appraiser List is being created. This will replace the WaMu preferred list. **The initial list of names will be provided by lending** with a minimum of two appraisers per area/county. The list will then be reviewed and approved by the Appraisal Business Oversight Team and will be checked against our most recent ineligible list. Final list will be provided to VMC's [vendor management companies]. Majority of work must be assigned to the appraisers on the Proven Appraiser List on a Priority Basis. (Emphasis added).

44. eAppraiseIT knew that the "review and approval" role of WaMu's Appraisal Oversight team described above was a fig leaf, because WaMu's Appraisal Oversight team deferred to WaMu's loan production staff. For example, in March 2007, upon learning that WaMu's loan production officers were pressuring eAppraiseIT to reach a predetermined value for a particular appraisal, the Appraisal Oversight Vendor Relations Manager told eAppraiseIT to "stop coming to me for approval" and to work the issue out with the lending staff. In other words, WaMu's Appraisal Oversight group provided no oversight at all.

C. Spring 2007: First American and eAppraiseIT Knew That The Proven Appraiser List Was Illegal

45. As it became increasingly apparent to eAppraiseIT that WaMu's loan production staff was hand-picking the appraisers that eAppraiseIT was required to use based on the values the appraisers provided, eAppraiseIT began to consider the legal implications of this arrangement. eAppraiseIT's Executive Vice President analyzed the federal guidelines and regulations on appraiser independence and selection of appraisers by loan production staff, and advised eAppraiseIT's President that "Based on this, I think WAMU's new initiative is way over the line. It is even possible that the current arrangement crosses the line." In response, eAppraiseIT's President wrote: "Bingo!" and explained that since the federal government enforced appraiser independence rules variably in different regions of the United States, and that "it boils down to who has juice with whom at the regulatory level." In response, the Executive Vice President warned "it may be that the OTS [federal Office of Thrift Supervision] is OK with WAMU's current way (maybe) but the new way seems to be quite a stretch."

46. On April 4, 2007, eAppraiseIT's Executive Vice President wrote an email to senior eAppraiseIT executives regarding eAppraiseIT's legal liability for using WaMu's Proven

List. He explained that appraiser independence is initially

> the lender's responsibility since the OCC [Office of the Comptroller of the Currency]/OTS only pertain to lenders. **However, we as an AMC need to retain our independence from the lender or it will look like collusion. Imagine a simple mortgage broker saying he will give us the work if we use his "proven" appraiser. We say no. This is very similar to that except they are very big. . . .**
>
> So the push back to WAMU needs to be (assuming we want to do this some day), eAppraiseIT needs to choose the appraisers, not WAMU. Where it gets really clear that eAppraiseIT is NOT choosing is the proven idea because they always go first and MUST be selected unless there is a specific reason why not. **eAppraiseIT is clearly being directed who to select. The reasoning that there are fewer ROVs is bogus for many reasons including the most obvious – the proven appraisers bring in the values.**
>
> Fun, eh?? (Emphasis added).

47. Yet, despite this clear articulation of what eAppraiseIT should do, by one of the company's most senior executives, eAppraiseIT did not "push back." It agreed to use the WaMu Proven Appraiser Panel, acceding to WaMu's demands for complete control over the Proven Panel and the reconsideration of value process.

48. On April 17, 2007, eAppraiseIT's President wrote to senior executives at First American, describing the issues with WaMu as follows:

> In short, the issues are using their designated appraisers as mandated by the WaMu production force at 20% gross margin and bypassing our panel. **We view this as a violation of the OCC, OTS, FDIC and USPAP influencing regulation.** (Emphasis added).

49. In support of his conclusion that using the WaMu panel violated federal regulations and USPAP, eAppraiseIT's President attached to his email a memorandum to WaMu that was prepared by eAppraiseIT's Executive Vice President. At the outset of the memorandum, eAppraiseIT summarized the guidelines regarding appraiser independence,

stating:

> The various regulatory boards including OTS, OCC, FDIC and others prepared a list of frequently asked questions on Independent Appraisal and Evaluation Functions on March 21, 2005. These FAQs should be reviewed in conjunction with prior guidelines published in 1994 and 2003. I have included the 2005 FAQs at the end of this document. We assume that you are very familiar with these documents.
>
> We want to focus on appraiser independence. All three documents address and re-address this issue. In the section titled Independence of the Appraisal and Evaluation Function, the 1994 and 2003 document states, "Because the appraisal and evaluation process is an integral component of the credit underwriting process, it should be isolated from influence by the institutions's loan production process." This is reinforced in the Selecting Individuals to Perform Appraisals or Evaluations section from the 2003 document. It states that it is important to ensure that the program is safeguarded from internal influence and interference from an institution's loan production staff. Individuals independent from the loan production area should oversee the selection of appraisers and individuals providing evaluation services.

50. eAppraiseIT's memorandum then applied the appraiser independence guidelines to the WaMu Proven Panel and concluded that:

> Based on our conversations we have had with the WAMU oversight as well as the questions and answers initiated by our competitor LSI, **it is our interpretation that the loan production staff has a great deal to do with selecting appraisers. The PAL [Proven Appraiser List] has been selected by the loan production staff and the continued use of these appraisers is being monitored by the loan production staff.** For example, on the LSI question #1 "Does WAMU want to be updated transactionally on every order we can not assign to a PAL?", WAMU's answer is "Yes, we need a short sentence in the message log so that we can monitor, – AND most important - lending can see why you didn't assign to a PAL service provider. Not using a PAL appraiser will be an issue so we need to ensure we've covered our bases as to why they're not utilized." **This appears to be directly in contradiction to the interagency guidelines unless you have a different interpretation.**
>
> * * *
>
> This produces the following challenge – eAppraiseIT is operating

> under what appears to be a mandate from WAMU in utilizing PAL selected appraisers (and this selection is coming from the loan production staff). We are then asked to rep and warrant this work. We are concerned about this arrangement from a risk perspective . . . ." (Emphasis added).

51. As demonstrated by this memorandum, First American and eAppraiseIT knew that complying with the WaMu Proven Panel violated appraiser independence regulations. However, eAppraiseIT did not stop conducting appraisals for WaMu using the tainted Proven Panel. To the contrary, First American's Chief Operating Officer, who sits on First American's Compliance Committee, testified under oath that his reaction to the April 17 email and the attached memorandum was that "I don't recall anything unique about this email."

52. Again, on April 17, 2007, eAppraiseIT's Executive Vice President wrote to eAppraiseIT's President and Chief Operating Officer regarding eAppraiseIT's legal liability:

> OTS and OCC only control lenders. However, there is the legal concern about collusion. For example, let's say it is discovered that a lender (loan officer at a lender) is being collusive with an appraiser that is on OUR (WAMU) panel. That is, our reps and warrants apply. Then we are liable I would say because we have gone along with it. . . .
>
> In addition, I think it will tarnish our reputation in the appraisal community because we are allowing WAMU to pick appraisers based on their loan officers. It makes us look complicit. So [it] may not be actionable legally but would hurt our reputation. So those are two bad things off the cuff. There may be more if we think about it and use creative paranoia.

53. On April 17, 2007, eAppraiseIT emailed its staff appraisers to explain why the staff appraisers had been removed from the WaMu Proven List. In these messages, eAppraiseIT's ABMs acknowledged that WaMu loan origination staff were now choosing the appraisers for their loans:

> I thought I [sic] pass on my thoughts regards the recent message that we all received for [sic] Peter last weekend. I will be glad to tell you what I know. I have been told that the lending folks at Wamu and [sic] were unhappy with the AMC's and felt they were not receiving a good level of appraisal work. They therefore decided to construct their own appraisal panel, now known as the wamu proven panel, and instructed the AMC's to utilize appraisers from this panel whenever possible. The end result is that if you are not on this proven panel it is very unlikely you will receive wamu work.

No independent appraiser could misread this message: if you want to do work for WaMu, you will have to satisfy the "lending folks at Wamu."

54. Even beyond picking the Proven Panel, WaMu's loan officers at times also directly selected specific individual appraisers on the panel to conduct their appraisals. On April 19, 2007, eAppraiseIT's Chief Operating Officer wrote in an email to eAppraiseIT's President and Executive Vice President:

> Evidently, we do get calls/emails from the WaMu Oversight Group to select a specific appraiser for an order. Now, normally, this would not be a concern since the group is separate from [WaMu] lending. However, Vicky [at eAppraiseIT] is also receiving a copy of an email from the LC [WaMu Loan Consultants] to Oversight requesting the appraiser selection – then the subsequent email from Oversight directing the assignment change."

55. By April 2007, WaMu had complete control over eAppraiseIT's appraiser panel. On April 26, 2007, eAppraiseIT's President wrote an email to senior management at First American regarding WaMu. In the email, eAppraiseIT's President discussed the Proven Panel and eAppraiseIT's reputational risk:

> Sales is the driving force behind the Proven Appraiser List (PAL) which is questionable from regulatory perspective. We are required to use these appraisers at 80/20% fee splits. This is dilutive to our P&L. Even with the implementation of such, we are still finding that we are being questioned surrounding what appraiser was assigned the order. **We feel our reputation in the industry is being tarnished by the**

> **implementation of the Proven List since Production selects the appraiser.** (Emphasis Added).

56. Yet First American and eAppraiseIT continued to comply with WaMu's demands and agreed to use the Proven Panel selected by WaMu loan production staff.

57. On May 11, 2007, eAppraiseIT's Executive Vice President wrote to eAppraiseIT's President that "currently WAMU is controlling the appraiser panel. They are selecting the appraisers and calling them 'proven' appraisers. These appraisers are being chosen by their sales force. First American eAppraiseIT (FA eAppraiseIT) is obligated to use these appraisers." According to eAppraiseIT's Executive Vice President, WaMu was using a Proven Panel because of the "low values" from eAppraiseIT's appraisers.

D. Spring 2007: First American and eAppraiseIT Attempt to Stop Warranting WaMu's Appraisals Because They Know They Have Illegally Compromised Appraiser Independence

58. On April 26, 2007, eAppraiseIT informed WaMu that effective May 1, 2007, it would no longer "be warranting appraisals as performed by the Wamu selected Proven Appraiser List (PAL) appraiser on originations. . . . The new, verbal requirements to utilize Wamu's panelists falls outside the spirit and letter of our agreement as it relates to Warranties. . . ."

59. This was a dramatic departure from eAppraiseIT's regular practices. On its website, eAppraiseIT claims that: "All of First American eAppraiseIT's traditional appraisal products come standard with one of the industry's strongest warranties. Our warranty coverage includes foreclosure loss incurred due to fraud or gross negligence. First American eAppraiseIT's commitment to appraisal quality means our customers don't need to go through the lengthy and difficult process of filing a claim against our Errors and Omissions policy, in the event they suffer a loss due to appraisal error. Of course, the policy is there for that purpose, but

our warranty presents a much simpler way to recover losses due to appraisal fraud or gross negligence."

60. eAppraiseIT threatened to stop warranting WaMu appraisals because eAppraiseIT's management knew that it had compromised its appraiser independence by using the WaMu Proven Appraiser List. eAppraiseIT's Chief Appraiser has testified that the threat to stop warranting was based on the risks inherent with WaMu's choice of such a "limited" panel.

61. eAppraiseIT's senior managers acknowledged these risks internally to one another. As eAppraiseIT's Executive Vice President explained in an email to other members of senior management while discussing a particular reconsideration of value: "The original appraiser was a WAMU proven appraiser coming in $750,000 higher than the eAppraiseIT review appraiser. This is a good example of why we currently have stopped rep and warrants and our concerns about over-valued properties."

62. In response to the above email, eAppraiseIT's Chief Operating Officer wrote that "In addition to this example, we are also seeing what appears to be a higher incidence of Threshold Reviews [mandated for properties worth over $1 million] coming in with a lower value than the original appraisal. I think this supports our concern regarding the proven list."

63. On April 30, 3007, eAppraiseIT's President wrote to his Chief Operating Officer, regarding the warranting of appraisals from WaMu's Proven Panel:

> I have given serious thought to your suggestion on Friday regarding an addendum to section B of the contract striking our quality control efforts and warranty coverage on appraisals performed by an appraiser off the Wamu Proven Appraiser List (PAL). Would you draft something that stipulates this? Again, this new requirement violates the spirit of our agreement where we agreed to aggressively QC and warrant appraisals as performed by our own panel. **Using Loan Officer's favorite appraiser is obviously something we will not**

> **stand behind from a quality and risk perspective.** (Emphasis added).

64. Nevertheless, eAppraiseIT continued to perform appraisals for WaMu, and continued to tout its independence.

65. The New York Attorney General issued a subpoena to First American on May 5, 2007.

66. On May 15, 2007, eAppraiseIT's Chief Operating Officer in an email wrote to eAppraiseIT's President regarding WaMu's Appraisal Oversight group: "I think this proves the point that . . . Oversight continues to buckle when confronted with direct and unrelenting pressure from lending."

67. Although eAppraiseIT repeatedly told First American that WaMu's loan origination staff illegally selected and controlled its Proven Appraiser List and that, in some instances, loan officers were directly selecting specific appraisers, First American instructed eAppraiseIT to continue the business relationship with WaMu. By email dated May 17, 2007, First American's Chief Operating Officer instructed eAppraiseIT's President and Executive Vice President to continue the relationship with WaMu and to "design a model that predominantly leverages their panel but doesn't violate our independence **which is probably easier said than done but there should be a way to figure it out.**" (Emphasis added).

68. On May 29, 2007, eAppraiseIT's Executive Vice President summarized the problems in the eAppraiseIT/WaMu business relationship in a letter to a senior executive at WaMu as follows:

> In the first quarter of 2007, the sales group of WAMU began to insist they choose the appraisers mostly due to their concerns about 'low values.' eAppraiseIT encouraged WAMU to resist these pressures if

> possible. However, WAMU decided to go with what came to be called the "proven" list of appraisers recommended by sales. . . .
>
> The use of the "proven panel is challenging for eAppraiseIT in two ways: A. Financially – The proven panel is paid a minimal of 20% more than the eAppraiseIT panel. B. Risk Management – the possibility of collusion between the loan officers and appraisers is increased when eAppraiseIT does not control the selection. In addition, eAppraiseIT is concerned with any possible lender pressure or perception of lender pressure when the only way to get on the WAMU "proven" panel is through the loan officer.

69. Despite this articulation of the "possibility of collusion," nothing changed between the parties, except cosmetically, and they continued in this corrupt business relationship. On June 7, 2007, a WaMu executive directed eAppraiseIT to change the name of the Proven List for the following reasons: "Name change from "proven appraiser" and/or use of the moniker "PAL" list is discontinued, under direction of the WaMu legal department. We are utilizing a more generic term acceptable w/in regulatory guidelines and industry standards." The Proven Appraiser Panel was renamed the "WaMu Select" panel, and eAppraiseIT accepted the name change while doing nothing to solve the regulatory violations.

IV. First American and eAppraiseIT Permit WaMu's Loan Origination Staff to Remove Appraisers From the Proven Appraiser Panel and to Improperly Communicate Directly With eAppraiseIT Appraisal Business Managers

70. As discussed above, First American and eAppraiseIT permitted WaMu's loan origination staff to select a Proven Appraiser List of appraisers and to control the Proven Panel. In addition, First American and eAppraiseIT permitted WaMu's loan origination staff to remove appraisers from the Proven Panel on the grounds that such appraisers consistently valued properties lower than WaMu's desired target amount, had a high rate of reconsideration of value requests, or performed desk reviews that reduced another appraiser's value for a given property.

71. In one specific example, in or about December 2006, a particular appraiser ("Appraiser A") was approved to be an appraiser on the Proven Panel. From January 25, 2007 through May 7, 2007, Appraiser A conducted five appraisals for eAppraiseIT with respect to WaMu properties. For each appraisal, WaMu requested a reconsideration of value. In each instance, Appraiser A refused to increase the value.

72. Shortly thereafter, Appraiser A was removed from the Proven List and placed on the WaMu inactive list. He was then told by a WaMu sales assistant that he was removed from the panel because he did not increase values in response to these reconsiderations of value. This same WaMu sales assistant told Appraiser A that many appraisers who had previously been removed from WaMu's list of active appraisers for conducting fraudulent appraisals were being reinstated on WaMu's Proven List in order to help ensure that appraisals would come in at sufficiently high value to permit the loans to close.

73. On May 30, 2007, Appraiser A wrote to eAppraiseIT regarding the WaMu Proven Panel. In the email, Appraiser A wrote that: "We continued to provide this high level of service when eAppraiseIT took over as appraisal management. With no explanation or warning, I was removed from the assignment rotation in mid April of this year. I respectfully ask to be re-instated as an active preferred appraiser."

74. Following receipt of Appraiser A's email, on May 30, 2007, an eAppraiseIT Appraisal Specialist wrote to eAppraiseIT's Executive Vice President, Chief Operating Officer and Chief Appraiser:

> I was working with two good, solid long-time wonderful appraisers in NY and CT until right after the WaMu Proven Panel was formed. They were both removed very soon after for no apparent reason. **We were having value issues, however, I felt their work was very**

defendable and supportable, and kept copious notes on our dealings. They have continued to keep in touch with me, in order to find out why they were removed from the panel. (Emphasis added).

75. On May 31, 2007, eAppraiseIT's Chief Appraiser replied:

> First he was on the Master List so put on WAMU Proven and then as the list went around he was REMOVED. The probability that a loan officer requested him to be removed is pretty high I think because that is what they did with the Master List; they sent it out to Lending to choose.

76. To date, Appraiser A remains off the Proven Panel.

77. Another appraiser ("Appraiser B") conducted hundreds of appraisals for WaMu loans through eAppraiseIT from January 2007 through April 2007. During this period, Appraiser B received 102 Reconsideration of Value requests.

78. On April 3, 2007, in an email Appraiser B wrote to eAppraiseIT the following:

> I WAS JUST MADE AWARE FROM ONE OF YOUR COMPETITORS (LSI) THAT I MAY BE ON A BLOCKED LIST FROM WAMU. THIS MAY HAVE SOMETHING TO DO WITH THIS APPRAISAL IN QUESTION FOR WHICH I THOUGHT WAS BEING TAKEN CARE OF AND IN PROCESS OF BEING RESOLVED. CAN SOMEONE HELP ME OUT HERE AS THIS IS IMPORTANT TO US TO KEEP THE RELATIONSHIP WITH WAMU THROUGH EAPPRAISEIT. WHAT IS GOING ON AND WHAT CAN I DO TO CLEAR THIS FILE UP????? (Capitals in original).

79. A senior appraiser employed by Appraiser B argued to eAppraiseIT that he was removed because WaMu did not like it when he reduced appraisal values after desk reviews. He wrote: "After reviewing appraisals over the past few months, many of which are fraudulent, with inflated unsupported values, it is disturbing that WaMu's focus and concern is misplaced with the review process."

80. To date, Appraiser B is still on the WaMu removed list.

81. Similarly, on April 17, 2007, a third appraiser ("Appraiser C") wrote to eAppraiseIT that:

> This is the second Wamu Appraisal quality assurance issue I have received from Wamu in the past 2 months. Both as a result of an appraisal I completed that did not come in to their predetermined value for a "valued" Wamu client. **I was pressured for 2 weeks to change both my value and the conditions of my appraisal report . . . both of which were violations of USPAP, FANNIE MAE and the Supplemental Standards I am required to observe and am bound by my license to complete.** Since that time, I have been singled out by WaMu and have been pressured on every appraisal I have completed that did not reach a pre-determined value. I feel that Wamu is in process of "blacklisting" me as an approved Wamu appraiser by going after each appraisal I complete and looking for violations." (Emphasis added).

82. Appraiser C wrote this email after having been pressured and harassed to increase values on two appraisals, after WaMu had requested ROVs and she had declined to increase the values. Shortly after her refusal to increase these values, she received two "Unacceptable Appraisal Notifications" from WaMu. After having been harassed and targeted with "unacceptable" strikes, she withdrew from WaMu's panel in order to avoid being removed against her will.

83. Senior executives at eAppraiseIT acknowledged that WaMu was targeting their appraisers. On May 23, 2007, eAppraiseIT's Chief Operating Officer wrote to eAppraiseIT's Executive Vice President that " It was disturbing to find out from [WaMu] that we receive three times the number of strike letters as LSI – and we're getting less volume. This indicates to me that they have targeted our "non-proven" appraisers – and are somewhat biased against EA in their work."

84. Further, eAppraiseIT permitted loan officers at WaMu to communicate directly

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with eAppraiseIT's ABMs and Appraisal Specialists by telephone and email, to discuss appraisal values. Indeed, eAppraiseIT permitted loan officers at WaMu to pressure eAppraiseIT ABMs and Appraisal Specialists about appraisal values even after an initial appraiser has considered a value reconsideration request and refused to change the value.

85. eAppraiseIT permitted these improper practices because WaMu is a large client that demanded the right to have these contacts. And eAppraiseIT's ABMs had the authority to change a final appraisal value only because WaMu had demanded, in September, 2006, that ABMs be permitted to "proactively mak[e] a decision to override and correct the third party appraiser's value or reviewer's value cut."

86. Further, email exchanges between WaMu and eAppraiseIT show that WaMu repeatedly pushed eAppraiseIT's ABMs to increase appraised values so that loans could close. For example, in one exchange with an eAppraiseIT review appraiser, a WaMu loan officer wrote that "Basically, if we don't get at least the appraised value of $3,650,000 . . . we lose the deal." (Ellipses in original). Earlier that day, this loan officer told eAppraiseIT that "if we don't have a definitive $$ appraised value then the borrower will go to another lender with a higher appraised value of $4mm. Please . . . at least . . . keep this value at the original appraised value of $3,650,000." (Ellipses in original).

87. On May 23, 2007, eAppraiseIT's Chief Appraiser described these comments as "a clear picture of Lender Pressure on behalf of WaMu."

88. eAppraiseIT received other communications from WaMu in which WaMu attempted to influence the appraised values of specific properties. For example, on May 24, 2007, eAppraiseIT's Chief Operating Officer wrote to eAppraiseIT's President that: "We have

received in the past, and now most recently with the Sag Harbor event (which incidentally just happens to be a New York property), communications where it could be viewed that EA did experience some level of influence to increase a value beyond that which we concluded in our own analysis was not supported."

89. eAppraiseIT's internal appraisal log entries indicate that its Review Appraisers and ABMs increased property values on appraisal reports after being told by WaMu loan origination staff that such increases would help loans to close. For the period of November 2006 to May 2007, there were 8 desk reviews performed by ABMs and 1 desk review performed by the Appraisal Specialist relating to properties in New York, all of which were for WaMu. The appraised values were increased in each of the 9 desk reviews completed, as follows: from $825,000 to $850,000, $230,000 to $240,000, $415,000 to $420,000, $1,550,000 to $2,270,000, $720,000 to $730,000, $535,000 to $556,000, $580,000 to $587,000, $500,000 to $525,000.

90. This level of contact between WaMu's loan production staff and eAppraiseIT's ABMs is prohibited by USPAP's independence requirements and by state and federal law.

FIRST CAUSE OF ACTION
(Fraudulent or Illegal Business Practices – Executive Law § 63(12))

91. The acts and practices alleged herein constitute conduct proscribed by § 63(12) of the Executive Law, in that defendants engaged in repeated fraudulent or illegal acts or otherwise demonstrated persistent fraud or illegality in the carrying on, conducting on transaction or a business.

SECOND CAUSE OF ACTION
(Deceptive Acts or Practices – General Business Law § 349)

92. The acts and practices alleged herein constitute conduct proscribed by § 349 of

the General Business Law, in that defendants engaged in repeated deceptive acts or practices in the conduct of its business.

THIRD CAUSE OF ACTION
(Unjust Enrichment)

93. By engaging in the acts and conduct described above, defendants unjustly enriched themselves by receiving payment for independent, accurate, and legal appraisals, but failing to provide such appraisals.

WHEREFORE, plaintiff demands judgment against the defendants as follows:

A. Enjoining and restraining First American and eAppraiseIT, their affiliates, assignees, subsidiaries, successors and transferees, their officers, directors, partners, agents and employees, and all other persons acting or claiming to act on their behalf or in concert with them, from engaging in any conduct, conspiracy, contract, agreement, arrangement or combination, and from adopting or following any practice, plan, program, scheme, artifice or device similar to, or having a purpose and effect similar to, the conduct complained of above.

B. Directing that First American and eAppraiseIT, pursuant to Article 22-A of the General Business Law, § 63(12) of the Executive Law and the common law of the State of New York, disgorge all profits obtained, including fees collected, and pay all restitution, and damages caused, directly or indirectly by the fraudulent and deceptive acts complained of herein;

C. Directing that First American and eAppraiseIT pay plaintiff's costs, including attorneys' fees as provided by law;

D. Directing such other equitable relief as may be necessary to redress First American and eAppraiseIT's violations of New York law; and

E. Granting such other and further relief as may be just and proper.

Dated: New York, New York
November 1, 2007

ANDREW M. CUOMO
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By: ______________________________
Nicole Gueron
Deputy Chief Trial Counsel

Of Counsel:
Christopher Mulvihill
Assistant Attorney General

Chow, Edwin L

From: Dochow, Darrel W
Sent: Wednesday, November 07, 2007 11:02 AM
To: Dochow, Darrel W; Thomas, Randy W; Chomicz, Susan L; Hendriksen, James A; Franklin, Benjamin D; Johnson, Mark W
Cc: Polakoff, Scott M; Ward, Timothy T; Bowman, John E; Chow, Edwin L; Petrasic, Kevin; Quigley, Lori G; Messett, Brian C
Subject: RE: Assertion

Hello All:

Given the new news this morning, I believe that OTS needs to open up its own special investigation.

WAMU executives have talked with both Freddie and Fannie today and both GSEs have confirmed they will continue to buy loans from WAMU. The GSEs have also agreed to have a special examiner review the appraisal issue in their conversations with NYAG Cuomo. The GSEs have not seen the subpoena yet.

WAMU started their own special investigation a few days ago when this broke by the special unit under Chief Counsel Faye Chapman using some internal audit staff.

Darrel

From: Dochow, Darrel W
Sent: Wednesday, November 07, 2007 7:40 AM
To: Thomas, Randy W; Chomicz, Susan L; Hendriksen, James A; Franklin, Benjamin D; Johnson, Mark W
Cc: Polakoff, Scott M; Ward, Timothy T; Bowman, John E; Chow, Edwin L
Subject: RE: Assertion

Jim Hendriksen, Mark Johnson and Ben Franklin:

The OTS has received a similar allegation as to the one by NYAG Cuomo relating to LSI and WAMU in Arizona. I am thinking that we ask for a formal investigation by the WAMU special investigative unit of this and the NYAG allegations and have the investigation report(s) shared with us and we meet with the investigators. We simultaneously open up a special investigation so that we can interview folks directly etc if necessary. As you recall, the special investigation unit reports to the Chief Counsel and the Board, so independence is good. This is similar to how we have handled some previous situations.

Lets discuss today between meeting breaks

Darrel

From: Thomas, Randy W
Sent: Wednesday, November 07, 2007 7:09 AM
To: Dochow, Darrel W; Chomicz, Susan L
Cc: Polakoff, Scott M; Ward, Timothy T; Bowman, John E
Subject: Assertion

Darrel and Susan: Below this introduction, I have cut and pasted from 2 emails that I received yesterday as Ombudsman from an individual who asserts that he has knowledge of "massive mortgage fraud" in connection with appraisals performed on behalf of Wamu. He has consented to me using his name and passing his information on to Supervision and Enforcement. I am expecting to receive at least another email from him with additional details when he returns to his office.

I initially advised him to contact the FBI. He emailed back and said that he has been in contact with the FBI, but there seems to be no action taken and no communication back from the FBI.

I will keep you posted as I receive additional information from him.
Randy

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From: Polakoff, Scott M
Sent: Saturday, November 17, 2007 1:22 PM
To: Reich, John M <reichjm@office of thrift supervision.com>
Subject: Re: Draft of Proposed Action Plan for Washington Mutual, eAppraiseIT, and LSI Special Examination

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John - I'll take a good look at the plan and give you my thoughts. Also, I have learned that the next FFIEC meeting occurs at the same time as our all-managers conference. I haven't seen an agenda for the ffiec meeting yet but the timing is identical to our Gallup briefing. We have been unsuccessful in trying to move Gallup.

Would you like me to represent you at the ffiec? If not, who would you want to accompany you as I need to let the ffiec folks know.

Thanks

Scott

Scott Polakoff

Sent from my BlackBerry Wireless Handheld

----- Original Message -----
From: Reich, John M
To: Polakoff, Scott M
Sent: Fri Nov 16 22:27:53 2007
Subject: Fw: Draft of Proposed Action Plan for Washington Mutual, eAppraiseIT, and LSI Special Examination

Scott,

This appears to be a comprehensive (and impressive) review schedule. It doesn't appear, on the surface anyway, to leverage off of WaMu's own review. Do you think we might be totally reinventing the wheel and possibly taking too long to complete our review?

John

Sent using BlackBerry

----- Original Message -----
From: Chow, Edwin L
To: Polakoff, Scott M; Ward, Timothy T; Bowman, John E; Quigley, Lori G; Chomicz, Susan L
Cc: Reich, John M; Russell, Robert W; Dochow, Darrel W; Johnson, Mark W; Hendriksen, James A; Franklin, Benjamin D; Thorvig, Bruce L; Archibald, Robert D; Henry, David R; Shambaugh, Scott E

Sent: Fri Nov 16 19:05:26 2007
Subject: Draft of Proposed Action Plan for Washington Mutual, eAppraiseIT, and LSI Special Examination

Hello everyone,

Darrel asked that we share with you the latest draft of the proposed action plan for the WaMu special examination for your review and input.

We welcome your suggestions and any available staff resources from Washington DC and/or the other regions that may have specialized appraisal expertise. To date, the West has committed Bruce Thorvig (Examiner, MAI Appraiser, and national appraisal expert) and Scott Shambaugh (examiner and former appraiser) to this assignment under the coordination of Assistant Director Mark Johnson , WaMu EIC Ben Franklin, WaMu LPM Bob Archibald, and Regional Enforcement Counsel Jim Hendriksen (who will be in charge of the special 407m investigation and legal/enforcement work). The proposed scope of work in this draft plan is very extensive and we are still in the process of refining it, as well as estimating the additional resources and timeline that will be necessary to complete this work.

On-site work on this special examination began earlier this week at WaMu, and Jim Hendriksen has also started a review of the eAppraiseIT and LSI documents.

Let us know if you have questions or comments.

Thanks, Edwin

<<Appraisal Review Final Draft.doc>>

OTS ENFORCEMENT
Status of Formal Investigations
(as of 12/15/2008)

Name of Institution	Location	OTS #	Authorized	Prima Facie Case Memorandum	Current Status

Redacted by the
Permanent Subcommittee on Investigations

Quigley_Lori-00231631_001

Redacted by the
Permanent Subcommittee on Investigations

Washington Mutual Bank	Henderson, NV	08551	11/27/2007 WE-07-010	10/03/2008	Investigation completed; examination focused on the issue of whether thrift personnel improperly exerted pressure or otherwise acted to compromise the independence or results of residential mortgage appraisals provided to the institution by third-party contract appraisal management companies; institution placed into receivership and acquired by JP Morgan Chase on 09/25/2008; draft recommendation memorandum submitted to Deputy Director and Chief Counsel Bowman on 10/03/2008 (recommendation prepared while WAMU was an open institution); meeting held with Chief Counsel Bowman to discuss memorandum; Enforcement attorney Ellett will be setting up meeting with OCC to discuss OTS investigation.

Redacted by the
Permanent Subcommittee on Investigations

Redacted by the
Permanent Subcommittee on Investigations

Federal Deposit Insurance Corporation
Division of Supervision and Consumer Protection
San Francisco Regional Office
25 Ecker Street Suite 2300
San Francisco, California 94105
415.546.0160

State of Washington
Department of Financial Institutions
Division of Banks
PO Box 41200
Olympia, Washington 98504-1200
360.902-8704

Board of Directors
Washington Mutual Bank
1201 Third Avenue
Seattle, Washington 98101

Subject: Joint Visitation Dated October 14, 2003

Members of the Board:

We enclose the October 14, 2003, joint visitation report of Washington Mutual Bank. FDIC Examiner Kenneth J. Kroemer and State Examiner John Ransom prepared the visitation report. The purpose of the visitation was to review management's progress towards addressing examination findings resulting from the March 17, 2003, safety and soundness and information technology Reports of Examination and to prepare for the upcoming examinations that are scheduled to begin on March 15, 2004. In addition, three issues that arose since the examination were explored and discussed with management. These issues included the unanticipated negative gain on loan sale incurred by the company's consolidated mortgage banking operation during the third quarter of 2003, the disclosure of unsatisfactory underwriting practices at affiliate Long Beach Mortgage Company, and the realignment of management and the business units.

The examiners concluded that:

- Management's progress toward addressing safety and soundness and information technology examination findings is satisfactory.
- Financial performance was marred by problems during the third quarter, but the bank's financial condition remains satisfactory.
- Issues in the mortgage banking operation impacted the quality of earnings and the effectiveness of management.
- The culture, practices, and systems at Long Beach Mortgage Company are inconsistent with the lending activity of the bank.
- The abandonment of Optis 0.2 represents a significant management/technology failure.

We understand that a major corporate reorganization is in process and plans are being or have been implemented to address mortgage banking weaknesses, practices at Long Beach Mortgage Company, and information technology strategies.

The Board is encouraged to review the visitation report, although no formal response is requested. If you have any questions, please contact Assistant Regional Director J. George Doerr or Senior Examiner Stephen P. Funaro of the FDIC at (206) 284-1112 or Program Manager Michael Abe of the State of Washington Department of Financial Institutions at (360) 902-8704.

Sincerely,

Nancy E. Hall
Regional Director
Federal Deposit Insurance Corporation

David G. Kroeger
Director of Banks
State of Washington
Department of Financial Institutions

LETTER

Background

The FDIC and Washington State Department of Financial Institutions (DFI or State) visited Washington Mutual Bank (WMB) from 10/14/2003 to 12/11/2003. The visitation was conducted concurrently with representatives of the Office of Thrift Supervision (OTS). The purpose of the visitation was to perform an interim assessment of WMB's financial condition and performance, follow up on outstanding issues from the 3/17/2003 examinations, and prepare for the 3/15/2004 examination. In addition, three issues that arose since the examination were discussed with management:

- The unanticipated negative gain on loan sale incurred by Washington Mutual Inc.'s (WMI) consolidated mortgage banking operation during the third quarter of 2003;
- The disclosure of unsatisfactory underwriting practices at sub prime lending affiliate Long Beach Mortgage Company, Inc. (LBMC); and
- The resultant realignment of management and the business units.

Summary

Like WMI, WMB's financial performance during the third quarter of 2003 was marred by problems, but the bank's condition remains satisfactory. Issues in WMI's mortgage banking operation and at LBMC impacted the quality of earnings, adequacy of capital, contingent liquidity, and the effectiveness of management throughout the entire organization. A major corporate reorganization is in process that is intended to address outstanding issues.

Management's progress toward addressing Examination Findings from the 3/17/2003 examination was reviewed and found to be satisfactory.

Redacted By The Permanent Subcommittee on Investigations

REPORT

Redacted By The Permanent Subcommittee on Investigations

Redacted By The Permanent Subcommittee on Investigations

LONG BEACH MORTGAGE COMPANY
LBMC is a non-bank affiliate of WMB and WMBFA. It securitizes and sells sub prime residential loans originated through brokers.

An internal residential quality assurance (RQA) report for LBMC's first quarter 2003 sub prime lending product was issued as of 7/31/2003. It concluded that 40% (109 of 271) of loans reviewed were considered unacceptable due to one or more critical errors. This raised concerns over LBMC's ability to meet the representations and warranty's made to facilitate sales of loan securitizations, and management halted securitization activity. A separate credit review report was completed by Corporate Credit Review on 8/29/2003 that reached similar conclusions and disclosed that LBMC's credit management and portfolio oversight practices were unsatisfactory.

The inability to securitize and sell new loan production caused LBMC's warehouse to increase by approximately $1 billion per month to $5 billion at the end of November 2003. The increase was funded through borrowing lines from affiliates and other creditors. LBMC President Troy Gotshall stated that he hoped a $3 billion securitization and sale transaction could occur during January. Unless a sale transpires soon, liquidity will be strained. One element of LBMC's contingent liquidity plan includes the potential sale of warehouse loans to the insured institutions.

A review of loans in the mortgage pipeline and warehouse commenced under the direction of EVP and Senior Legal Counsel Fay Chapman to determine the extent of the problems. Approximately 4,000 of the 13,000 loans in the warehouse had been reviewed by the end of November 2003; of these, approximately 950 were deemed saleable, 800 were deemed unsaleable (saleable as scratch and dent with a haircut), and the remainder contained deficiencies requiring remediation prior to sale.

It was reported separately that of 4,500 securitized loans eligible for foreclosure, 10% could not be foreclosed due to documentation issues.

President Gotshall stated that the problems were largely attributable to management's decision to integrate LBMC's sub prime loan origination and servicing operations into WMI's prime home lending program. This integration began in 2000 and continued through 2002. It now appears that some loans originated and securitized during that period may not have meet the representations and warranties made in the pooling and servicing agreements and therefore are contingent liabilities to LBMC since they could be put back by the investors. EVP Fay Chapman acknowledged the potential contingent liability, but stated that management has not quantified the exposure. The outstanding principal balances of loans securitized and sold during this time period totals approximately $11 billion.

Senior Vice President (SVP) John Robinson was appointed to LBMC's three member board of directors in December 2003. The other members are Chief Financial Officer Tom Casey and EVP Craig Chapman. The board met on 12/05/2003; the prior meeting was back in July. SVP Robinson acknowledged that oversight of LBMC had been inadequate. The culture, practices, and systems at LBMC are inconsistent with the lending activity of WMB, and it remains to be seen if LBMC can be effectively assimilated into WMI.

Status of Findings from Prior Examinations

Management continues to monitor examination findings and responses through a "findings matrix" which is also used as the response to the Report of Examinations. Internal Audit reviews the responses to determine if the responses are sufficient to "close" the issue. We worked jointly with the OTS to review management's progress in addressing the findings.

Management has implemented action plans to address the Examination Findings from the 3/17/2003 examination. Satisfactory progress was noted, although many action plans are still in process. Internal Audit had not yet assessed the status of all of management's responses; this should be completed in the first quarter of 2004 and will be reviewed during the 2004 examination.

2004 Safety and Soundness Examination

The 2004 examination is scheduled to commence on 3/15/2004, and the onsite planning phase will begin on 2/17/2004. Coordinating efforts are underway for the joint examination of WMB and concurrent examinations by the OTS of WMI, WMBFA, and Washington Mutual Bank, fsb. In addition, joint Information Technology and concurrent Compliance examinations will be conducted.

A joint entry request package, or PERK, was presented to the bank in December 2003. The FDIC, State, and OTS continue to work together to present a joint request package to eliminate duplications and ease the burden of data collection.

Information Technology
The visitation included an Information Technology (IT) component. WMI's IT environment includes over 200 application systems, many of which were not integrated after acquisition. Many of these systems are relatively unique to WMI and operate in diverse locations with a variety of operating systems, application systems, and disaster recovery plans.

This visitation disclosed that management has made notable progress in addressing the Examination Findings from the 2003 IT examination. However, the issues encountered in the mortgage banking operation during the third quarter had a clear IT component and demonstrated the potential impacts of the current IT environment. Management announced its decision to abandon Optis 0.2 at the end of the visitation. The abandonment of Optis 0.2 represents a significant management/technology failure. Management has a plan to address mortgage technology needs, but until the plan is implemented, IT exposure will remain high.

Visitation Findings

Visitation findings were discussed with SVP Robinson and Vice President Wedell on 12/9/03, and will be presented to executive management at the 1/22/04 Quarterly Regulators Meeting.

WMB, FA/fsb (08551/11905)
Field Visit 10/14/03

FOIC WRITEUP/LETTER DRAFTS

Ede

4

Marshall, Penny D

From: Dochow, Darrel W
Sent: Monday, February 13, 2006 8:38 AM
To: Marshall, Penny D
Subject: FW: LBMC EDP Impact

Sensitivity: Private

This has the numbers for LBMC repurchases.

-----Original Message-----
From: Dochow, Darrel W
Sent: Friday, January 20, 2006 8:27 AM
To: Finn, Michael E
Cc: Carter, Lawrence D; Franklin, Benjamin D; Kuczek, Richard A
Subject: LBMC EDP Impact
Sensitivity: Private

Mike:

Attached is the one page table highlighting the financial impact of the LBMC repurchase matter. See particularly the box toward the bottom labeled "Summary". It shows that a $20 million earnings hit came from a net settlement with Bear Sterns where WAMU decided to not repurchase the loans, but let Bear Sterns keep them at a reduced price. These were primarily 2nd lien loans where the servicing had already been transferred to Bear Sterns. The second line item is a $12.8 million LOCOM adjustment from a repurchase in December. The third line is an additional reserve of $39.5 million, but actually approximately $4 million already existed, so the total additional income impact was $35.5 million, for a total $68 to $69 million actual income impact net of the approximate $4 million reserve, or $72.3 million gross. Additional reserves are expected in January when the last two whole loan sales work through their EDP recourse period.

Of the loans repurchased so far, we were told that approximately 60% have cured.

The primary reasons for the problem were as discussed at yesterday's quarterly meeting:

- Servicing lapse in not focusing on having the first payment after sale be current
- Rise in interest rates during this time period that motivated purchasers to put back all they could
- General lower quality 2005 production due to economy and lowered standards up to time of the exam
- WAMU divisions not communicating well enough between themselves on implication of whole loan sales vs securitizations

The $4.749 billion in loans on LBMC books at 12/31/05 are largely comprised of the same 2005 vintage production that was sold in the whole loan sales and are now subject to the increased repurchases. One difference, however, is that loans going into the HFI portfolio must meet the same screens as loans acquired through the Specialty Mortgage Finance channel. Thus, they tend to have somewhat better performance. Management is balancing the probability that these loans will perform worse than expected and priced for, versus the increased income they generate, (plus portfolio taint considerations) in considering whether to sale some or all of the portfolio.

Total higher risk loans (1st with FICO below 620 and 2nds, credit cards and HELOCs with FICO below 660, plus all LBMC and Specialty Mortgage Finance loans, aggregated $34.832 billion at 12/31/05 or 133% of consolidated WMI total risk based capital. Their internal limit is 200%.

WAMU scan -
}MC EDP Impact.pd

OFFICIAL FILE COPY
OTS/WEST

Q4 2005 EPD Financial Impacts

Long Beach Mortgage Company Q4, 2005 Repurchase Horizon

$ in millions

Investor Name	WaMu Deal Name	Lien	EPD Measurement Date	Deal UPB	Repurchase UPB	Repurchase Rate	Estimated Write-down Price (bps)	Estimated Reserve Impact
EMC - Bear Sterns				$1,531.8	$33.1	2.2%	45.02	($20.0)
Lehman High LTV	WLS LB_0510	1st	10/31/2005	$629.1	$46.7	7.4%	92.58	($3.7)
CSFB	WLS LB_0508	1st	09/30/2005		$40.6		80.46	($8.2)
CSFB	LBMLT 2005-WL2	1st	09/30/2005		$30.7		89.50	($3.8)
				$2,788.2	$71.3	2.6%	83.24	($11.9)
CSFB	WLS LB_0513	1st	12/31/2005		$10.7		93.30	($0.8)
CSFB	WL3	1st	12/31/2005		$61.4		85.00	($9.8)
				$2,233.8	$72.1	3.2%	85.20	($10.7)
Goldman Sachs	WLS LB_0512	2nd	10/31/2005	$392.8	$20.8	5.3%	66.00	($7.3)
Goldman Sachs	WLS LB_0514	2nd	11/30/2005	$250.6	$15.2	6.1%	84.00	($2.6)
Goldman Sachs	WLS LB_0515	1st	12/31/2005	$1,999.2	$125.8	6.3%	97.00	($5.0)
Lehman	WLS LB_0517	2nd	01/31/2006	$309.7	$18.8	6.1%	84.00	($3.2)
Lehman	WLS LB_0516	1st	01/31/2006	$3,100.0	$195.1	6.3%	97.00	($7.8)
	Total 2005 Estimated Impact			$13,235.3	$598.8	4.5%	84.41	($72.3)

Summary

($20.0)	12/05 Loss on sale - EMC deal
($12.8)	repurchase complete in 12/05
($39.5)	additional reserve required @12/31/05
($72.3)	Total Q4, 2005 financial impact

Note: Repurchase estimates for measurement dates later than 12/31/05, were based upon assumptions from recent repurchase activity

- Total Income Statement impact, as of 12/31/05 was approximately $69M, comprised of the following:
  - $20M loss on sale related to sale of NPA's to EMC
  - $13M mark to market on WLS LB_0510, WLS LB_0508 and WLS LB_0513, which were repurchased and in the warehouse at 12/31/05
  - $36M increase in repurchase reserve for EPD's, net of partial use of existing reserve of $4M, for remaining estimated liability as of 12/31/05.
- Total Repurchase Reserve, as of 12/31/05 consists of the following:
  - $40M reserve for EPD's
  - $16M reserve for breaches of reps and warrants

Coordination of Expanded Supervisory Information Sharing and Special Examinations

Objectives

- Establish fundamental expectations for enhanced coordination and cooperation of supervisory efforts by the Federal banking agencies (Agencies) to ensure that the FDIC is able to fulfill its responsibilities to protect the deposit insurance funds in the most efficient and least burdensome manner possible.
- Confirm the understanding of the Agencies as to the examinations, reports, meetings, examination personnel, and other supervisory information the FDIC will have access to relating to the FDIC's responsibilities.
- Confirm the understanding of the Agencies as to the general circumstances in which the FDIC will conduct Special Examinations of insured depository institutions (IDIs) under 12 U.S.C. § 1820(b)(3).

Key Principles

- Consistent with fundamental principles of safety and soundness, the Agencies are committed to promoting the most effective and efficient bank supervision process possible, minimizing the duplication of effort, ensuring consistent regulatory conclusions or communications to IDIs, and reducing overall costs associated with bank supervision.
- The OCC, FRB and OTS are committed to providing the FDIC information on and access to IDIs that represent a heightened risk to the deposit insurance funds and selected Large IDIs. For the purposes of this document, Large IDIs are defined as selected IDIs within the OCC's Large Bank Program, selected IDIs that are part of the FRB's Large Complex Banking Organization program, and certain identified large thrifts supervised by OTS.
- To the fullest extent possible, the FDIC should continue to rely on the results of the work performed by the primary bank supervisors in assessing the condition of individual institutions.

IDIs Coordination Components

<u>IDIs that Represent a Heightened Risk</u>

- The FDIC is authorized to conduct "Special Examinations" of IDIs under 12 U.S.C. § 1820(b)(3) that represent a heightened risk to the deposit insurance funds when the Board of Directors of the FDIC deems such an examination necessary to determine the condition of the IDI for insurance purposes. The FDIC's Board of Directors' will delegate this responsibility to the FDIC Division of Supervision for IDIs that represent a heightened risk to the deposit insurance funds.
- On a quarterly basis, representatives of the OCC, FRB and OTS will meet with representatives of the FDIC to discuss the risk profile, current condition, and status of identified supervisory matters requiring attention of IDIs that represent a heightened risk to the deposit insurance funds.
- For purposes of this document, the following institutions will be assumed to represent a heightened risk to the deposit insurance funds under 12 U.S.C. § 1820(b)(3):

- IDIs with a composite rating of 3, 4 or 5; and
- IDIs that are undercapitalized as defined under Prompt Corrective Action.

- The following principles underlie the exercise of this "Special Examination" authority:
  - All Special Examination activities will be conducted in a manner to minimize costs to the industry, regulatory burden and duplication of effort;
  - FDIC staff will meet and coordinate with the appropriate Agency prior to engaging in any Special Examination activity. The FDIC shall, to the fullest extent possible, conduct Special Examination activities concurrently with the appropriate Agency's regularly scheduled examinations; and
  - The FDIC will not prepare a separate Report of Examination, or other similar report to bank management, except where an enforcement action by the FDIC is anticipated.

<u>All IDIs</u>

- On an ongoing basis, the OCC, FRB and OTS will provide the FDIC with access to supervisory information, including risk assessments, supervisory plans, reports of examination and other documents related to selected IDIs. Similarly, the FDIC will provide access to the same types of supervisory information, if any, to the OCC, FRB and OTS.
- In addition to the situations falling under the Special Examination authority discussed above, the FDIC may seek participation in examinations or meetings with senior bank management of IDIs that exhibit material deteriorating conditions or other adverse developments that could result in the institution becoming troubled in the near term. In the event the staffs of the FDIC and the appropriate Agency cannot agree, the two agencies' representatives to the FFIEC Supervision Task Force will determine whether such a material deteriorating condition or adverse development exists within a given IDI. In the event the two representatives cannot agree, the Chairman of the FDIC and the principal of the relevant Agency (or the Governor that is a member of the FFIEC in the case of the FRB) will determine whether such a material deteriorating condition or adverse development exists.
- Differences in CAMELS ratings between the FDIC and the appropriate Agency will be communicated consistent with current procedures. For all ratings differences, any final decision by the FDIC to depart from the appropriate Agency's assigned rating will be made by senior management of the FDIC's Division of Supervision after discussion with and consideration of information supplied by the appropriate Agency's senior supervisory management.

<u>Large IDIs</u>

- On an ongoing basis, the OCC, FRB and OTS will provide the FDIC with access to supervisory personnel and information, including risk assessments, supervisory plans, reports of examination and other documents related to Large IDIs. Similarly, the FDIC will provide access to the same types of supervisory information, if any, to the OCC, FRB and OTS.
- On at least a quarterly basis, representatives of the OCC, FRB and OTS will meet with representatives of the FDIC to discuss the risk profile, current condition, and status of identified supervisory matters requiring attention of all Large IDIs.
- In addition, the FDIC will establish a dedicated examiner program with respect to the eight largest banking organizations (collectively as "Largest Banks," individually as an "Assigned Institution"). The dedicated examiner program will work within existing supervisory

programs of the appropriate Agencies so as to avoid, to the fullest extent possible, any increase in regulatory burden or duplication of effort.

- The person designated as dedicated examiner will be the FDIC's primary point of contact with Agency supervisory personnel as it relates to the supervision of the Assigned Institution. Agency supervisory personnel are expected to keep the dedicated examiner informed of all material developments in the supervision of the Assigned Institution and will invite the dedicated examiner to observe and participate in certain examination activities to ensure the FDIC has an understanding of the supervisory issues and risk management structure of the Assigned Institution.
- The FDIC will fully participate in the review and assessment of the risk of the credits within the Shared National Credit Program in Large IDIs and other depository institutions.
- When the Agencies agree that participation by the FDIC is appropriate to evaluate the risk of a particular banking activity to the deposit insurance funds, the FDIC dedicated examiner and other staff, as appropriate, should participate with the appropriate Federal banking agency in selected supervisory reviews of that activity, including meetings with bank management relating to those reviews. In the event Agencies' staff cannot agree, the respective Agencies' representatives to the FFIEC Supervision Task Force will determine whether FDIC participation is appropriate. In the event the two representatives cannot agree, the Chairman of the FDIC and the principal of the relevant Agency (or the Governor that is a member of the FFIEC in the case of the FRB) will resolve the dispute.

Washington Mutual

David C. Schneider
President,
Home Loans

March 29, 2006

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G. Street, NW
Washington, DC 20552
Attention: Docket Number 2005-56
Regs.comments@ots.treas.gov

Re: Proposed Guidance – Interagency Guidance on Nontraditional Mortgage Products
70 FR 77249 (December 29, 2005)

Dear Sir or Madam:

Washington Mutual Bank appreciates the opportunity to comment on the Interagency Guidance on Nontraditional Mortgage Products (the "Guidance") that has been proposed by the federal banking and credit union agencies (the "Agencies"). Our comments on the Guidance are based upon the experience that we have gained from providing alternative mortgage products such as our "Option ARM" for over twenty years. They are presented below in two parts. First, we provide general comments regarding the application, interpretation and possible implementation of the Guidance. These comments track the outline of the three specific areas that are the focus of the Guidance. Second, we respond to specific questions asked in the preamble to the Guidance with regard to comprehensive debt service qualification standards.

I. General Comments:

Washington Mutual Bank agrees that different mortgage products pose different risks for lenders and that lenders should have appropriate robust underwriting and risk management standards to address these different risks. Washington Mutual Bank also agrees that lenders should provide timely and clear disclosure to consumers of the terms of the mortgage products that they offer. We support the Guidance to the extent that it will advance these principles in an effective manner and without unnecessarily harming the mortgage markets.

We are concerned that some parts of the Guidance as proposed will discourage or prevent responsible lenders from continuing to offer important mortgage products that have provided consumers the substantial economic and personal benefits of homeownership.

Washington Mutual Tower
1201 Third Ave.
Seattle, WA 98101
phone 260.490.3859

We also believe that the Agencies' concerns with respect to consumer protection would be more effectively advanced by amending Regulation Z and other regulations that apply to all mortgage lenders.

A. Overview of Guidance

Guidance Should Not Cover Home Equity Lending

The Agencies should make clear that the Guidance does not amend the recent guidance on home equity lending. Home equity lines of credit and junior lien home equity loans should be specifically excluded from the guidance.

Guidance Should Not Disfavor Alternative Mortgages

We are concerned that the Guidance's focus on interest-only ("IO") and payment option mortgage products and the use of the term "non-traditional mortgages" to describe these products reflect a concern by the Agencies that these products are more risky or less consumer friendly than other mortgage loans. Washington Mutual Bank and other institutions have been successfully offering payment option mortgages for more than 20 years through different interest-rate and economic cycles. Contrary to the Guidance's assertion, these mortgages have been tested in a "stressed environment." In fact, these mortgages have been considered more safe and sound for portfolio lenders than many fixed rate mortgages.

In addition, these mortgage products, when prudently underwritten, have provided substantial economic benefits to consumers by allowing borrowers to manage their cash flow by, e.g., using funds that might otherwise go to their mortgage payment to pay down other debt or to make other investments. Prudently underwritten alternative mortgage products have also allowed some borrowers who might otherwise have been precluded from participating in the housing market to purchase homes.

The need for lenders to develop such products and the benefit to consumers of such products were recognized by Congress in enacting the Alternative Mortgage Transaction Parity Act of 1982. In proposing the Guidance, the Agencies have not cited any past problems with these products to challenge this Congressional support for payment option or IO mortgages. While we understand the Agencies' heightened interest in these products as they take on new features and are offered by a broader array of lenders to a broader population, we are concerned that the worst-case scenarios assumed by the Agencies in the Guidance will cause examiners to discourage institutions from offering such products. To address these concerns, we recommend that the Guidance 1) not discourage lenders from offering these products; 2) refer to such products as "alternative mortgages," the term used in federal law and hereafter in this letter; and 3) not be based on theoretical worst-case scenarios.

Guidance Should Not Be Prescriptive

The Guidance appears to impose new specific mandates on federally regulated institutions offering these products, as opposed to providing general guidance to examiners and their regulated entities on how such products can be offered in a safe and sound manner. We recommend that the Guidance not prescribe certain practices and that the use of "should" in the Guidance does not mean "must," especially in the Guidance's discussion of "Recommended Practices."

Guidance Should Allow For Flexible Implementation

In addition, the statement in the Guidance calling for its consistent implementation is contrary to the notion of regulatory guidance and could mean that experienced providers of alternative mortgages would be subject to the same examination scrutiny as institutions that have not offered these products in the past. The risk with such a dictate is that valuable products offered by experienced lenders that have not posed safety and soundness problems will be taken away from the consumer. The Guidance should explicitly recognize that experienced institutions' proven safety and soundness practices are "best practices" and will not need to be changed or modified because of the Guidance.

We understand that the Agencies may have concerns that new entrants to the alternative mortgage market may not have the underwriting or portfolio and risk management expertise that experienced lenders may have. Such concerns are best addressed on an institution-specific basis as a supervisory matter, not by imposing new restrictions on all regulated entities and their affiliates as if the Guidance were a regulation. At the end of the day, the case-by-case evaluation by examiners is critical. Examiners should understand the need to apply the Guidance flexibly and with good judgment.

Guidance Does Not Cover All Lenders

The call for consistent application also is not possible given that the Guidance would apply only to federally regulated entities and their affiliates. Consumer finance companies, mortgage banks, and other state-regulated lenders and brokers not affiliated with federally regulated entities, many of which are new to offering alternative mortgages, would not be subject to the Guidance. If the Guidance unnecessarily restricts federally regulated entities from offering these products, it will place such entities at a competitive disadvantage in a very competitive mortgage marketplace. Thus, unnecessary restrictions actually do a disservice to safety and soundness.

New Types of Controls for Monitoring Third Parties Should Not Be Required

We are also concerned that the Guidance requires a lender to impose additional controls regarding its loan consultants and third party originators that are specific to alternative mortgages to ensure that the loan originators' practices are consistent with the lender's policies and procedures. While a lender is responsible for the acts of its own employee loan consultants, it is virtually impossible for a lender to control the practices of mortgage brokers or correspondent lenders. A large lender may deal with literally thousands of mortgage brokers and hundreds of correspondent lenders each year and any single broker or correspondent may deliver only a small number of loans to the lender. Although such a lender may re-underwrite a broker originated loan and provide its own program disclosures to the broker's customer if the loan will close in the lender's name, the lender cannot effectively or economically monitor the sales practices of each of the brokers with whom it does business.

The lender is even further removed from a correspondent lender's practices. A correspondent sells a loan that it has closed in its own name and with its own funds to a lender/purchaser. In some cases, the correspondent will underwrite the loan to the lender/purchaser's guidelines and in other cases the correspondent will underwrite the loan to general investor guidelines. A lender/purchaser will confirm that the loans it purchases are acceptable to it from an underwriting perspective, but it is impossible for a lender/purchaser effectively or economically to monitor the sales practices of all of the correspondents from which it purchases loans. While lenders can provide training and materials explaining their products to mortgage brokers and correspondents, lenders should not be expected to monitor the interaction between a third party and its customer.

B. Loan Terms and Underwriting Standards

Underwriting Should Not Be Based on Future Scenarios

We agree that when a loan is underwritten, the borrower must have a demonstrated capacity to repay based upon information available at that time. Washington Mutual's Responsible Mortgage Lending Principles provide that we only make and purchase mortgage loans where the borrower has a demonstrated ability to repay. With such underwriting, a well-informed consumer is in the best position to make the decision regarding which mortgage product best suits his or her needs and to assess the risks associated with his or her situation in the future, not banks or regulators.

The Guidance, however, could be read to require lenders to forecast a borrower's capacity to repay based on information unknown about a borrower at the time of origination, such as a borrower's payment patterns, a borrower's future income, a borrower's ability to refinance the loan, and interest rate projections. Such scenario-based underwriting is not a best practice used by experienced lenders of these loans. Not only is such underwriting highly speculative, but it could unnecessarily exclude qualified borrowers. Such a practice also imposes an additional level of subjectivity to the underwriting process. Underwriting should only use information available at the present time and not be based on forecasts or possible future scenarios.

Specific Underwriting Criteria Should Not Be Prescribed

The Guidance recognizes that lenders use a number of factors in underwriting alternative mortgages. Experienced underwriters of such products use a borrower's credit score in combination with other key underwriting criteria, such as the loan's loan-to-value ratio ("LTV"), the borrower's debt-to-income ratio ("DTI"), the loan's purpose, the amount of loan documentation, and the type of loan appraisal. The Guidance should avoid prescribing specific criteria for different loans types and purposes, and would better capture industry practices and promote responsible innovations if it addressed the broader issue of borrower ability and willingness to pay (which we discuss in further detail below). In other words, the Guidance should not affect an institution's business model and pricing strategy with regard to such products as long as the products are fairly offered to consumers and are safe and sound.

C. Portfolio and Risk Management Practices

Concentration Limits Should Not Be Prescribed

We also oppose the Guidance's insistence that concentration limits be set for certain loan types, for loans with certain characteristics, and for loans acquired through third parties. We agree that concentrations should be monitored for riskier exposures and that some level of portfolio diversification is necessary. This monitoring can be done in the form of concentration triggers that result in a management response, rather than limits set down as part of board policy. These concentration triggers should be based on each institution's portfolio and business model. The goal should be risk diversification in areas where pricing may not compensate for risk in stressed scenarios. The key point is to set up controls so that portfolio concentrations are monitored.

D. Consumer Protection Issues

We agree that it is important that consumers understand the terms and features of the mortgages that they are considering. We also agree that consumers find it beneficial to have such information early in their search for the appropriate mortgage loan. Alternative mortgage loans are already subject to disclosure requirements under Regulation Z which applies to all individuals or businesses that regularly extend consumer credit that is subject to a finance charge. The Guidance calls for only regulated lenders to provide information specific to alternative mortgages that is similar but not identical to the disclosures required under Regulation Z. The different disclosure standards may very well cause more consumer confusion at the time of application rather than less. We believe that any new disclosure requirements should be addressed within the framework of the existing regulatory requirements so that consumers receive consistent disclosures from as many types of lenders as possible.

While we comply with the current legal requirements, we also want to ensure that our mortgage customers understand the features of the loan products that they are considering when they are shopping for a mortgage. To that end, we and other lenders have developed disclosures for specific types of alternative mortgage products beyond the disclosures required by law.

We support the recommendation in the Guidance encouraging lenders to "provide consumers with information at a time that will help consumers make product selection." To effectuate this goal, we recommend that the Federal Reserve Board update its *Consumer Handbook of Adjustable Rate Mortgages* ("CHARM") booklet to include a discussion of alternative mortgage products. The CHARM booklet is provided to the consumer at the time the consumer begins shopping for a mortgage loan. A revised CHARM booklet would provide some consistency in the description of the advantages and risks of alternative mortgage products that would help the consumer shop for a mortgage loan.

We are concerned that including recommended consumer practices in the Guidance, along with a discussion of laws that prohibit unfair or deceptive acts or practices, could have unintended consequences. Some people could interpret the recommendations to mean that lenders who have not been following the Guidance's practices have engaged in unlawful activities. We do not believe that this would be a correct interpretation of the law or that the Agencies intend such an interpretation. If the Agencies do include a discussion of consumer protection issues in the Guidance, then the Guidance should be explicit that failure by a lender to follow the recommended practices does not mean that the institution is engaging in unfair or deceptive acts or practices.

<u>II. Responses to the specific questions posed by the Agencies:</u>

Our comments in Part I above touched on many of our concerns with the Guidance. In Part II of our letter, we provide specific answers to the questions posed by the Agencies in the preamble to the Guidance.

(1a) ***Should lenders analyze each borrower's capacity to repay the loan under comprehensive debt service qualification standards that assume the borrower makes only minimum payments?***

No. As noted above, we strongly disagree with the use of any scenario-based analyses in underwriting as the result would be inconsistent underwriting standards over time. In addition, the modeled relationship among losses and certain factors may change with different scenarios. Forecasting models based on future scenarios may conflict with forecasting models based on historical performance, resulting in dissonance in the qualification and pricing determinations at the underwriting stage.

The Guidance suggests three scenarios for calculating payment behavior (of increasing conservatism). More conservative scenarios could be prudent for determining portfolio management strategies and for evaluating portfolio risk under stressed conditions (e.g., capital adequacy). However, to underwrite using a measurement of payment capacity based upon a worst-case scenario of significant negative amortization restricts credit to consumers that could realize tangible economic benefits from these more affordable loan products.

(1b) ***What are current underwriting practices and how would they change if such prescriptive guidance is adopted?***

A borrower is able to qualify for a loan based upon several determinants of the borrower's ability and willingness to pay. Factors such as credit score, LTV, and DTI are predictive of a borrower's ability to pay, with credit score and LTV factors historically being much stronger predictors than DTI. An assessment of willingness or incentives to pay based upon personal credit history and loan type is also an important factor that is considered in the underwriting process.

Industry practice for calculating DTI on nontraditional mortgage products is as follows: For IO loans, a DTI is calculated for borrowers based upon the IO loan payments at the starting interest rate (fixed for a specified time period, usually 5 years). For payment option loans, a borrower's DTI is calculated based upon the fully indexed rate assuming that payments are fully amortizing. These types of mortgages do introduce greater uncertainty about the borrower's ability to make increased monthly payments, say at the expiration of an IO period or the recast of a payment option loan. It is important to note, though, that the borrower's capacity to repay is analyzed based upon information available at origination.

For a payment option loan, the calculation of DTI based on the potential payment shock from negative amortization would be highly speculative. This would require a long-term forecast of interest rates to calculate the negative amortization resulting from a borrower making only minimum payments. While such an analysis is important for portfolio management and determining capital adequacy, it is inappropriate to use in lending decisions. Such underwriting could exclude otherwise qualified borrowers, especially if the forecasts are conservative with respect to credit risk.

It is also generally recognized that certain loan purposes do not provide strong incentives for repayment when compared to a first lien on a primary residence. Examples of loan purposes with lower repayment incentives mentioned in the Guidance include loans for non owner-occupied investor loans and simultaneous second-lien loans with high combined LTVs.

Finally, underwriting payment option mortgages with a reduced initial interest rate spread for riskier borrowers is recognized as a sound practice. This underwriting decision is made at the transaction level using policies that are part of risk-based pricing. However, such policies cannot be made uniform across institutions, as different features of a product may be used to mitigate risk.

(2a) What specific circumstances would support the use of the reduced documentation feature commonly referred to as "stated income" as being appropriate in underwriting nontraditional mortgage loans?

For "stated income" loans, other compensating factors such as a lower LTV, a high FICO score, or good liquidity are used to mitigate the risk. Advertised low-doc programs such as stated income loans provide homeownership opportunities for borrowers who might have difficulty verifying income (such as business owners or borrowers with commissioned, seasonal, or non-documented incomes). The increased risk with such loans is recognized and compensated for with other factors and possibly increased pricing.

However, low documentation does not imply increased risk in the case of "efficiency process programs" where borrowers have income or asset verification waived due to the quality of their credit, presence of sufficient cash reserves, or other compensating factors. Such recommendations are often the output of automated underwriting models that are standard in the industry, such as Desktop Underwriter (Fannie Mae), Loan Prospector (Freddie Mac) or DAX (S&P).

(2b) What other forms of reduced documentation would be appropriate in underwriting nontraditional mortgage loans and under what circumstances?

The mortgage industry offers various forms of low-doc options, such as stated income verified assets ("SIVA"), stated income stated assets ("SISA"), or no income no assets ("NINA") where no income or asset information is provide in writing or verbally. The appropriateness of such low-doc programs in conjunction with alternative mortgages would depend upon the individual circumstances of each borrower and whether the low-doc option was offered to the borrower for efficiency based upon their excellent credit standing or sought by the borrower.

(2c) Please include specific comment on whether and under what circumstances "stated income" and other forms of reduced documentation would be appropriate for subprime borrowers.

If a subprime channel were to offer reduced documentation mortgage loans, then these loans should be priced and offered according to the assessed credit risk of each borrower and transaction. Such mortgages are not necessarily inappropriate or predatory for subprime borrowers. The offering of such loans to subprime borrowers should be recognized as risk-layering and underwritten accordingly.

(3) Should the Guidance address the consideration of future income in the qualification standards for nontraditional mortgage loans with deferred principal and, sometimes, interest payments? If so, how could this be done on a consistent basis? Also, if future events such as income growth are considered, should other potential events also be considered, such as increases in interest rates for adjustable rate mortgage products?

Future events such as projected income growth or interest rate forecasts should not be included in the underwriting or loan approval decision. As noted above, basing DTI on forecasted interest rates brings in an unnecessary level of subjectivity into the underwriting process and may disqualify otherwise qualified borrowers. Allowing for the consideration of future income, say for a new graduate that may realize a substantial increase in income versus an individual with a steady but constant income, could also open an institution to uncertain legal risk.

Instead, the projection of future income is a factor the borrower may want to consider in choosing a loan. Borrowers must decide based on their expectations of future income and other factors, such as the planned length of stay in their homes, whether a loan product is appropriate for them. If after a borrower takes an IO or payment option loan, he or she realizes that this choice provides an uncomfortable level of uncertainty in payments, then the borrower will likely have options to refinance at a fixed rate to mitigate this risk. It is a best practice for institutions to monitor payment patterns and negative amortization and to offer constructive options to borrowers as a part of active account management.

This concludes our comments on the Guidance. Again, we appreciate the Agencies providing us the opportunity to present our concerns and to provide information on how we offer alternative mortgages. If you have any questions regarding our comments, please feel free to contact me at 206-490-3859.

Sincerely,

David C. Schneider
President
Home Loans

Since maintaining a sufficient level of capital is critical for an association to maintain operations, you should appropriately weigh the importance of capital on the viability of the association when formulating the composite rating. You should also consider the association's dividend payout policy and practice. You should rate an association's capital adequacy considering all criteria cited in the UFIRS statement.

PCA Levels

In general, an association in any of the three lower-tier Prompt Corrective Action (PCA) categories warrants a 4 or 5 Capital component rating. A capital rating of 4 is appropriate if the association is undercapitalized or significantly undercapitalized but asset quality, earnings, or interest rate risk problems will not cause the association to become critically undercapitalized in the next 12 months. Also, a capital rating of 4 may be appropriate for an association that does not have sufficient capital based on its capital level compared with the risks present in its operations, even though the association may meet the minimum regulatory requirements.

An association warrants a 5 rating if it is "critically undercapitalized," or has significant asset quality problems, negative earning trends, or high interest rate risk exposure that will cause the association to become critically undercapitalized within the next 12 months.

See the Capital Chapter of this Handbook for more detailed instructions for reviewing capital adequacy.

Asset Quality

An accurate evaluation of an association's asset quality can be one of the most important products of the examination. The asset quality rating reflects the extent of credit risk associated with the loan and investment portfolios, real estate owned, other assets, and off-balance-sheet risks as well as the association's ability to manage those risks. The evaluation of an association's asset quality is dependent on the association's policies and procedures relating to loan underwriting and asset procurement, the proper monitoring and classification of assets, the nature of the risk inherent in the association's portfolios, and the adequacy of the association's valuation allowances.

When asset quality is in doubt because of excessive or inadequately controlled risk, the association's asset quality component rating should reflect this concern. In order to attain a 1 or 2 Asset Quality component rating, an association must fully control its credit risk. If an association has a high exposure to credit risk, it is not sufficient to demonstrate that the loans are profitable or that the association has not experienced significant losses in the near term. Management must demonstrate that it has identified credit risks, measured the potential exposure to loss, established systems to monitor such risk on an ongoing basis, and has taken adequate steps to limit and control those risks. Otherwise, a significant supervisory concern will exist relative to the association's asset quality.

Management

This rating reflects the capability of the board of directors and management, in their respective roles, to identify, measure, monitor, and control the risks of an institution's activities and to ensure a financial

Review of Securitization
WAMU Examination of March 5, 2007

Scope of Review

Our review of the bank's securitization activities in 2006 (WMB, WMB-FSB, and Long Beach Mortgage Corporation) included the following (credit card securitization activity was not part of the scope of this review):

- Existing internal controls over the securitization process.
- Best execution procedures.
- Monitoring of Counterparty Risk.
- Monitoring of performance and triggers of issued securities
- Valuation of residuals retained by the bank.
- Validation of assumptions and models used in the valuation of residual pieces (Intex and WSA).
- Policies and procedures for the securitization process including cleanup call options.
- Internal Audit of the securitization processes.
- Review of Basis Floater Interest Only (BFIO) instruments retained by the bank. Review of hedging strategies will be performed under the Hedging Program (R. Miyashiro).
- Follow up on 2006 Examination Findings Memo 17.
- Certification of loan pools (GNMA) was not included in the scope of this review due to low activity in 2006.
- Loan repurchase activity, recourse on securitizations, and profitability was performed by examiner S. Bielik – refer to ***Programs*** *572*. & 575

Overall Conclusions

- For the year ended December 31, 2006, the bank securitized mortgage loans with an aggregate UPB of $110.0 billion, a $20.8 billion decline when compared to the $130.8 billion securitized in 2005. Mortgage loans sold with recourse during the same periods totaled $959 million and $2.02 billion, respectively. The bank realized pre-tax gains of $1.0 billion[1] on mortgage loans securitization; slightly higher gain than the $949 million reported in 2005.
- The level of repurchased loans was low relative to the overall volume of mortgage loan securitization. The low level of repurchases and/or losses from repurchasing prime → activities is attributable to management's success in remitting loans repurchased from the investors to the originating mortgage broker/correspondent institution.

[1] Source: 10-k as of March 01, 2007(page 107).

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #868

- Oversight of the securitization process is adequate. The Market Risk Committee (MRC) replaced the ASOC as the committee ultimately responsible for the oversight of the securitization area. The MRC has delegated to the Valuation Committee (VC) the responsibility of monitoring the valuation methodology used for retained interests (models and assumptions). All securitization channels report to the MRC on a monthly basis on securitization activity and any noteworthy governance/compliance, market, credit, and operational risks.
- Management implemented the recommendations made by the examiners during the prior examination and securitization reporting is currently satisfactory and consistent across the three divisions engaged in securitization of mortgage loans (WMMSC, LBMC, and Commercial Real Estate).
- The market value of WMB's consolidated holdings of residual interests totaled $2.3 billion, or 12.37 percent of WMI Tier I capital at March 31, 2007. Of this total, $383.4 million pertain to the securitization of mortgage loans and the remaining amount pertains to the securitization of credit card receivables. Noteworthy is the 44.6 percent decline in residual interests at the LBMC. The decline is attributable primarily to higher delinquencies and adjustments to prepayment and home price appreciation (HPA) assumptions used in the Intex model to derive fair market value.

in value of

- At March 31, 2007, the Basis Floater Interest Only (BFIO) portfolio had an estimated fair value of $201 million, a 60.0 percent decline over the $502 million reported at December 31, 2005. The decline is attributable to changes in market conditions as well as in the internal valuation methodology. The decline in the BFIO asset and; consequently, the bank's lower exposure to this asset is consistent with management's strategy. Management had indicated during the prior examination its willingness to reduce the bank's exposure to BFIO primarily due to the difficulty in hedging and managing this asset.

portfolio runoff

- The overall system of internal controls for the loan securitization area is generally satisfactory. Based on our review, management has implemented appropriate processes to ensure that the securitization activity complies with internal policies, procedures, and regulatory requirements.
- Policies and procedures governing this area are adequate. During the examination, management revised the Loan Purchase, Sale, and Securitization Standard to incorporate examiner recommendations pertaining to cleanup call options.
- A perceived weakness in the system of internal controls is the out-of-cycle condition of the internal audit of the Loan Purchase, Sale, and Securitization area. Audit Services indicated that the out-of-cycle condition is due to the department's modification of its annual audit process (risk approach versus cycle methodology) but that there were mitigating circumstances for the cycle override of this area. These included the satisfactory audit of this area in February of 2005, the experience level of the staff involved in this process, the absence of known issues in this area since the last audit, and the stability of the processes for this area since the last audit date.

referred to IAD review

Overview

Washington Mutual Bank (WMB) has three divisions that engage in securitization activities: Washington Mutual Mortgage Securities Corp. (WMMSC), Long Beach Mortgage Corporation (LBMC) and the Commercial Group. The following is a synopsis of these units/divisions.

WMMSC is the division[2] responsible for the securitization of mortgage loans originated and sold into the securitization by WMB and Washington Mutual Bank, FSB (WMB-FSB). Within WMMSC there is the Conduit Unit that is charged with the purchase, typically in bulk, of subprime and Alt-A mortgage loans from brokers and correspondent entities. Furthermore, WMMSC serves as the master-servicer for the majority of the loan pools supporting the securities sold.

Long Beach Mortgage Corporation (LBMC) is the division responsible for the origination and securitization of sub-prime mortgage loans under the shelf registration of LBMC. Mortgage loans originated under the LBMC name are acquired through its broker network. Beginning in 2007, Wamu will securitize all loans originated through LBMC using the Wamu Asset Acceptance Corp. (WAAC) shelf registration. The new trusts are designated as Wamu Asset-E Certificates, Wamu Series 200X-HEX Trust. The first transaction using the new designation closed in January 2007 and used the ticker 2007-HE1. This will also be used for Wamu conduit and sub-prime conduit securitizations. The changes are a result of the consolidation of Long Beach Mortgage Corp. into WMB.

The Commercial Group securitizes commercial real estate loans originated through the bank's retail channel (no delegated underwriting). The group sells its securitizations to both private and government sponsored entities (GSE). Sales to GSE are done primarily to Fannie Mae and it involves an exchange of whole loans for MBS. Under certain programs (WamuPlus), the bank is liable for losses up to 3% of the principal balance of loans sold. On sales to private investors, the bank may retain unrated residual interests and/or portions of the B tranche.

Securitization Oversight

The Market Risk Committee (MRC) is responsible for establishing guidelines, procedures, and limitations for the securitization activities of Washington Mutual Inc. (WMI) and its subsidiaries. Additionally, the committee is responsible for ongoing transaction monitoring to ensure that securitization activities comply with established parameters. The MRC has delegated to the Valuation Committee (VC) the responsibility of monitoring the valuation methodology (models and assumptions) used for retained interests.

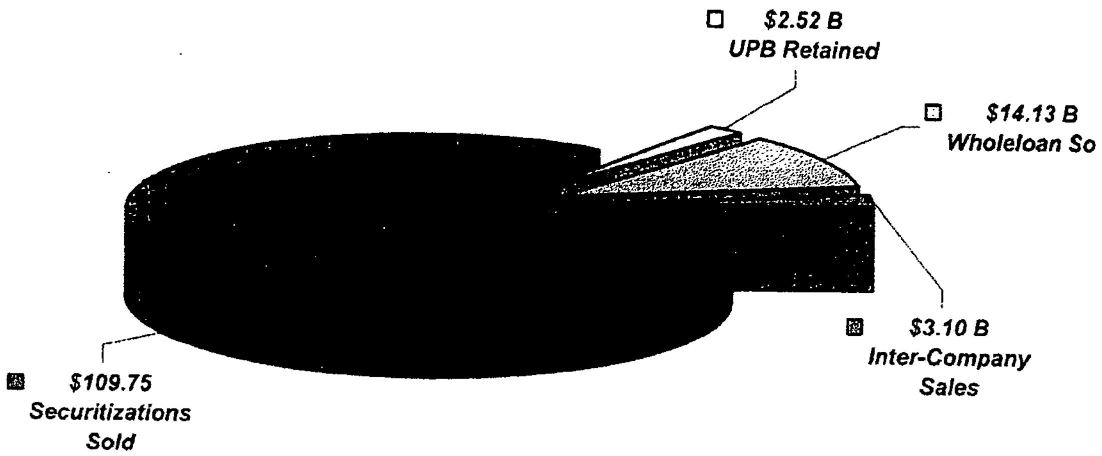
All securitization channels (prime, subprime, and commercial real estate) report to the MRC on a monthly basis on securitization activity for the prior month. Information provided include: securitization volumes, delinquency status by portfolio segment, losses, rating agency actions on outstanding issues, outstanding classes that fail loss-severity test (predicts

[2] Both WMMSC and LBMC ceased existing as separate legal entities when these WMI subsidiaries were integrated into Washington Mutual Bank (WMB).

downgrades), and outstanding repurchase demands. The channels also discuss with the committee any noteworthy governance/compliance, market, credit, and operational risks.

Mortgage Loan Lending Activity

The following graph depicts mortgage loan lending activity and securitization activity in 2006.



Source: PERK Response Q101-105

In 2006, WMB, WMB-FSB, and LBMC originated mortgage loans with an aggregate unpaid principal balance (UPB) of approximately $129.7 billion. As shown in the graph above, the majority of the mortgage loan production (approximately $110 billion) was securitized and sold to government sponsored entities (GSE) and private investors, whereas $3.1 billion was sold inter-company. The fair market value of the mortgage servicing receivable asset (MSR) booked associated with the retained servicing rights amounted to $2.2 billion.

Securitization Activity

For the year ended December 31, 2006, the bank securitized mortgage loans with an aggregate UPB totaling $110.0 billion, a $20.8 billion decline when compared to the $130.8 billion for 2005. Mortgage loans sold with recourse during the same periods totaled $959 million and $2.02 billion, respectively. The bank realized pre-tax gains of $1.0 billion[3] on mortgage loans securitization; slightly higher gain than the $949 million reported in 2005.

[3] Source: 10-k as of March 01, 2007(page 107).

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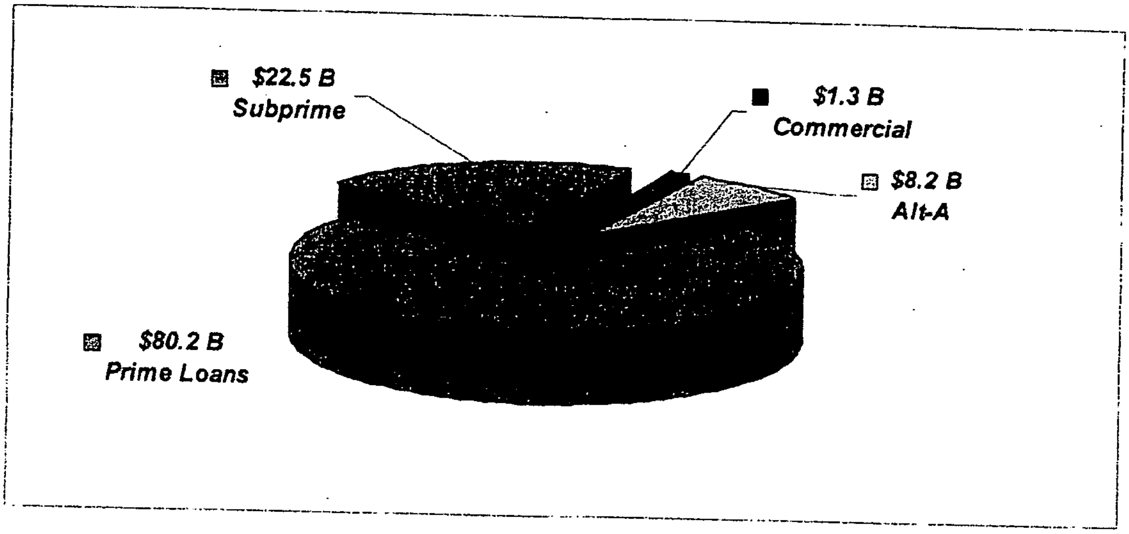

As shown in the graph above, prime 1-4 single-family mortgage loans accounted for the majority of the securitized loans at approximately $80.2 billion, or 71.47% of total securitization in 2006. Non-traditional mortgage loans such as subprime and Alt-A represented 20.05% and 7.30% of total securitizations, respectively. Commercial real estate securitization totaled $1.3 billion, or 1.18% of total securitization volume in 2006. Of the total amount securitized, WMB retained $2.52 billion (2.24% of total securitizations), of which only $187 million were subprime loans.

The following tables provide details for prime, subprime, and commercial real estate securitizations in 2006:

	Prime				
Data	FHLMC	FNMA	GNMA	Private	Grand Total
Sum of UPB Sold	30,011,081,003	9,840,988,799	2,508,641,181	44,380,286,006	86,740,996,988
Sum of UPB Retained	**1,087,811,289**	-	-	**590,935,664**	**1,678,746,953**
Sum of Loans/MBS BV-Sold	29,852,208,325	9,784,424,714	2,518,348,991	44,164,750,937	86,319,732,968
Sum of Loans/MBS BV-Retained	1,086,869,595	-	-	586,458,498	1,673,328,094
Sum of Gain/(Loss)	161,852,087	38,696,417	17,691,129	346,108,126	564,345,759
Sum of Gain/(Loss) 316	11,179,825	3,605,488	-	(12,342,370)	2,442,943

WMB sold approximately 49% of the production of prime mortgage loans to government sponsored entities and the remaining 51% to private investors. WMB booked MSR with a total FMV of $1.8 billion. Gain on sale amounted to $566.8 million (does not reflect impact of hedging gains and/or losses).

In 2006, there were 128 securities reviewed by Fitch, Moody's, and S&P. Upgraded classes totaled 164, affirmed 965, ratings watch negative classes 9, and only 4 classes were downgraded. Class downgrades are generally anticipated by management as it monitors performance and conducts stress-scenario analyses to determine which classes may be in line for downgrades.

Sub-Prime					
Data	FHLMC	FNMA	GNMA	Private	Grand Total
Sum of UPB Sold				22,526,363,992	22,526,363,992
Sum of UPB Retained				-	-
Sum of Loans/MBS BV-Sold				22,447,651,221	22,447,651,221
Sum of Loans/MBS BV-Retained				186,581,539	186,581,539
Sum of Gain\(Loss)				271,358,159	271,358,159
Sum of Gain\(Loss) 316				11,141,373	11,141,373

Production and securitization of subprime loans totaling $22.5 billion was sold in its entirety to private investors with WMB retaining approximately $187 million in subordinated and/or residual pieces. Gain on sale amounted to $282.5 million, not taking into account the impact of hedging activities.

In the first quarter of 2007, management transferred approximately $1.7 billion of originated subprime loans in the Held for Investment (HFI) portfolio. Management indicated that due to the uncertainty in the subprime market at the time, the sales execution would have been poor. Subsequently, management sold the loans in question. The transfer of he loans into HFI received OTS approval.

In the first quarter of 2007, Fitch downgraded 23, affirmed 91 and upgraded three classes from the 21 Long Beach RMBS issues. The downgrades affected approximately $213.7 million of outstanding certificates and reflected the continued deterioration in the relationship between credit enhancement and loss expectations. The monthly losses in the downgraded issues exceed the available excess spread; thus, resulting in substantial deterioration of the Over Collateralization (OC). In the most severe examples (2001 vintage), the OC has been depleted and the subordinate certificates have incurred principal write-downs.

In 2006, there were 223 rating agency determinations for Long Beach issues/deals: 70 downgrades, 137 affirmed and 16 upgraded classes. Class downgrades are generally anticipated by management since it monitors performance and conducts stress-scenario analyses to determine which classes may be in line for downgrades.

Commercial R.E.					
Data	FHLMC	FNMA	GNMA	Private	Grand Total
Sum of UPB Sold		-		484,513,001	484,513,001
Sum of UPB Retained		810,309,344		26,847,300	837,156,644
Sum of Loans/MBS BV-Sold		-		496,231,582	496,231,582
Sum of Loans/MBS BV-Retained		795,370,392		17,523,207	812,893,599
Sum of Gain\(Loss)				15,270,161	15,270,161
Sum of Gain\(Loss) 316		-		-	-

During 2006, the bank, through its commercial real estate loan group, originated approximately $1.3 billion in commercial real estate. The loan production consisted overwhelmingly of loans secured by multi-family properties. The majority of these loans were originated by the bank's retail channel, although the bank purchased approximately $200 million from third parties. Dick

Fisher, SVP Commercial Loan Group, indicated that purchased loans were re-underwritten pursuant to Wamu's standards for these loan types.

The overall production of commercial real estate loans declined precipitously in 2006 from a $9.9 billion production in the prior year due primarily to the lack of demand in the market for the type of product that the bank was willing to originate. According to SVP Dick Fisher, Commercial Real Estate Group, management projects a $8.3 billion securitization volume of 2007: $7.0 billion in Private Label securities, $1.1 billion under the WAMU Plus program, and $200 million under the FNMA DUS program.

During 2006, no commercial real estate security was downgraded by the rating agencies. For the same period, S&P, Fitch, and Moody's upgraded 7, 15, and 13 securities, respectively.

I/O and Option ARM

In 2006, the bank originated approximately $20.1 billion in Option ARM loans, issued 18 securities and sold $11.8 billion to private investors and $5.5 billion to GSE. The bank sold the remainder loans on a whole-loan basis to both private investors and GSE. For the same period, the bank originated $20.2 billion in mortgage loans with interest-only features. Securitization of this loan type sold to private investors amounted to $9.4 billion while the remainder was sold on a whole-loan basis to private investors and GSE.

While securities may have unique features, each structure has senior and subordinate pieces. Typically, the senior structure has several levels of Class A certificates, which are AAA rated, and are supported by the subordinate Class B certificates. The latter certificates are rated AA to BBB. Additionally, each issue may have an interest-only class or interest- and principal-only components (identified as Class X). Furthermore, each securitization has a residual class identified as the R Class that is intended for cleanup calls (not traded)

Wamu occasionally retains the basis I/Os (X Class) and the subordinate B Class certificates associated with option ARM securities. The bank refers to these pieces retained as "residual interests."

Residual Interests

(Millions)	**12/31/05**	**12/31/06**	**3/31/07**
Reserve Accts. (CC)	$10,372	$434,442	$448,027
Credit Enhan. (CC)	$1,803,413	$1,464,511	$1,432,333
LBMC[4]	**$71,496**	**$149,155**	**$82,657**
WMMSC NIM (sub)	$0	$34,161	$36,142
Providian Master Note	$85,100	$85,419	$85,290
Credit Enhancements	**$216,404**	**$138,114**	**$215,491**
Other Reserve Accts.	$19,889	$20,657	$38,861
WMB Consolidated	**$2,135,249**	**$2,326,460**	**$2,338,799**

[4] LBMC's residual interests and NIM pieces are held in the "trading" portfolio.

The bank typically provides some form of credit enhancement when issuing securities for sale to private investors. These credit enhancements may include spread accounts, over-collateralization, interest-only strips, and retained subordinated interests. Collectively, these credit enhancements are referred to as "residual interests." Current bank policy limits residual interests to 25.0% of Tier 1 Capital. At March 31, 2007, total residual interests represented 12.37% of WMI's Tier 1 capital, well below the 25% internal policy limit.

This reviews focused on the residual interests held by the WMB and its affiliates and associated with the securitization of mortgage loans. The review of residual interests pertaining to the securitization of credit card receivables was performed separately.

As shown in the table above, the market value of WMB's consolidated holdings of residual interests totaled $2.3 billion at March 31, 2007. Of this total, only $383.4 million pertain to the securitization of mortgage loans. The remaining amount pertains to the securitization of credit card receivables. Noteworthy is the 44.6 percent decline in residual interests at the LBMC level from $149.2 million to $82.7 million. The decline is due primarily to the $88.0 million write-down on subprime residuals due to higher delinquencies, adjustments to prepayment and home price appreciation (HPA) assumptions used in the Intex model to derive fair market value.

Basis Floater Interest Only (BFIO)

BFIO is a byproduct of Option ARM securitization created by structuring the security in a way that, for a designated tranche (or tranches), WMB pays the investors 1-month LIBOR while collecting from the borrower an interest rate coupon based on MTA plus a margin. This cash flow mismatch creates significant basis risk. The BFIO is also highly susceptible to prepayment risk. Management hedging strategies to mitigate exposure to interest rates and basis risk include the buying and selling of Eurodollar futures. Management has acknowledged the difficulty in hedging this asset due the low predictability of Option ARM prepayments and the illiquidity of the basis swaps market. Refer to workpaper ***221P-63* through *221P-78*** for a more detailed discussion of BFIO.

The following table shows the changes in the BFIO portfolio in terms of Fair Value and the underlying notional unpaid principal balance (UPB):

BFIO ($MM)	Value	Change	Notional UPB	Change
12/31/2005	$502		$24,809	
12/31/2006	$238	($264)	$14,994	($9.815)
03/31/2007	$201	($37)	$13,061	($1,932)

At March 31, 2007, the BFIO had an estimated fair value of $201 million. This represents a 60.0 percent decline over the $502 million reported at December 31, 2005. During 2006, the fair value declined by $264 million, or 53.0 percent. Changes in the valuation methodology during 2006 resulted in a negative impact of $117 million, of which, $115 million was due the implementation of the new prepayment model that resulted in increased prepayment projection. The remaining $2 million impact resulted from the change in the 1-year CMT curve model based on constant spread to LIBOR.

The decline in the BFIO asset and; consequently, the lesser exposure to this asset is consistent with management's strategy. The reduction was accomplished by changing the structure of Option ARM deals to be MTA based instead of LIBOR based. During the prior examination, management indicated that the bank planned to reduce exposure BFIO due primarily to the difficulty in hedging and managing this asset.

On a quarterly basis (the first month end of each quarter), management surveys brokers for price indications on the BFIO portfolio. The Retained Interests Valuation group sends an email request to each broker that was a co-lead in the deal at issuance. Washington Mutual Capital Corp. ("WCC") was the lead broker-dealer on all deals, but since WMB owns WCC, the latter is excluded from the price indication process. Because of this fact, each deal typically only has 1 to 2 broker indications.

Brokers send back dollar price indications and management compiles and reviews the information and unreasonable changes from month to month or absolute levels discussed with the brokers. Management averages the final prices and compare on a deal by deal basis, as well as total portfolio value. The final BFIO Attribution Report is compiled and distributed daily.

Securitization Process/Internal Controls

Refer to workpaper ***221P-8*** for a discussion of the bank's internal controls surrounding securitization activities. These include compliance with Reg AB, Data Verification Process, Best Execution Analysis, Counterparty Risk, and Residual Valuation Process.

Counterparty Risk

John Morris, OTS Examiner, performed a review of counter-party risk. ~~was performed by examiner John Morris~~. Based on conversations with Mr. Morris and Wamu personnel, there are not any material concerns in this area. Monitoring of counter-party risk by management is adequate. See ***221P-29***.

Internal Audit

On April 26, 2007, the examiners met with Audit Services (AS) to discuss the 23-month out-of-cycle condition of the Loan Sales and Securitization area. The Loan Sales and Securitization area was last audited in May of 2005 and the next audit is scheduled for March 31, 2008. The three-year period between internal audits is outside the required interval under the cycling approach used by the internal audit department for units, such as the one in question, with **high-risk** ratings. Erin Dunlap, Audit Division Manager, and John Vandermeulen, Senior Audit Manager, provided the responses to the examiners' inquiry.

AS's explained the out-of-cycle status by indicating that the department had modified its annual audit process in accordance with its new audit plan cycle methodology (implemented January 1, 2007). Under the new methodology, the area in question is to be audit in March of 2008, a three-year cycle versus the 15-month interval required for high-risk areas. The AS indicated that the new policy allows for sufficiently justified and approved cycle overrides and that, as communicated to the Audit Committee, a transition period is required to fully implement the new three-year risk based audit cycle methodology.

The AS pointed out some mitigating circumstances for the cycle override of this area including: (1) the satisfactory audit of this area in February of 2005 and the experience level of the staff involved in this process, (2) the absence of known issues in this area since the last audit, and (3) the stability of the processes for this area since the last audit date. Moreover, the AS indicated, several peripheral areas have been or are in the process of being audited and no material concerns were noted.

The examiners believe that a three-year interval between internal audits may be inappropriate given the high volume activity in the securitization area (in excess of $100 billion/year) and the high-risk nature of this operation. The need for timely audits is further accentuated by the findings of our review of the MRC minutes of December 2006 and January 2007, which seem to indicate that there were data integrity issues surrounding the creation of securitization trusts, resulting in loan repurchases from those securitization trusts. According to Tom Lehman, root causes stemmed from the relocation of the transaction management group (Project Scarlet) and the simultaneous replacement of key systems (Sporty and Conduit database). Another concern arises from the lack of internal audit review of WMMSC Master Servicing operation, which provides servicing for all the loans sold into the securitization Trusts. The untimely internal audit of this area was pointed out as a concern Fitch's report as of August 14, 2006 (see Program 576).

The examiner communicated these concerns to the examiner responsible for the review of the internal audit area. (John Morris)

Clean-up Call Options

Regulation 12C.F.R.567.1 establishes certain requirements for clean-up calls on securitizations in order for institutions to avoid implicit recourse treatment. In general terms, clean-up calls are recourse for regulatory purposes unless it involves 10% or less of the original pool balance and are exercisable at the option of the bank/affiliates. The fact that the bank holds the residual piece(s) does not insulate the bank from implicit recourse determination if the bank provides post-sale credit support (although it plays a role determining under which circumstances purchasing assets from a trust at greater than FMV may not constitute implicit recourse). Further, the bank must exercise the cleanup call for legitimate business reasons other than to provide credit support to third party investors (key criterion for determining implicit recourse). Non-compliance with regulatory requirements could taint other existing securitizations and the bank could be required to bring back onto its books said securitizations and; consequently, have an impact on capital requirements.

In 2006 and the early part of 2007 WaMu requested and obtained a waiver from the OTS to exercise clean-up call options on three LBMC securitization deals. The OTS cleared WaMu's request for the agency's concurrence that the exercise of those cleanup calls in a securitization under the set of established facts provided by WaMu in its letters of December

21, 2006 and February 13, 2007 and subsequent conversations. The OTS concluded that the deals in question did not constitute implicit recourse and did not trigger recourse treatment for other securitizations under the same shelf registration. This supervision policy decision was consistent with the supervisory determination by the West Region on this matter.

Subsequently, management requested from the OTS a blanket waiver for these types of transactions and the OTS agreed[5] to grant a blanket waiver if the bank would commit to revise the Loan Purchase, Sale and Securitization Standard in order for the standard to incorporate clear and precise guidance for the exercise of clean-up call options. The OTS's concurrence assumes that the economic valuations that support the fair market value calculations are economically sound that these valuations are scrutinized during the examination process to ensure that, in exercising the calls, WaMu has not provided additional credit support to third-party investors. If examiners conclude that the valuations are not economically sound or are not adequately documented and supported, the OTS may revisit this concurrence, conclude that WaMu has provided implicit recourse and require WaMu to bring the assets in outstanding securitizations back onto its balance sheets and hold risk based capital for those assets.

The examiners reviewed the language that WaMu plans to include in the Loan Purchase, Sale and Securitization Policy with regard to securitization clean-up calls. The language satisfies OTS requirements.

Profitability

In 2006, WMB's mortgage banking division incurred losses totaling $89.2 million. The poor performance derives primarily from the losses incurred by three business segments: Retail ($146.8 million), LBMC ($132.9 million), and Servicing ($106.8 million). Profitability is discussed under the Mortgage Banking: Profitability Program 572.

Reporting/Findings Memo 17

During the 2006 examination, the examiners issued a findings memo (OTS Memo 17) stating that (1) management was not reporting to oversight committees as required by policy and (2) there were inconsistencies in reporting by the three main loan groups (single-family, subprime, and commercial real estate). Our review disclosed that management has taken appropriate corrective actions. See ***221P-17***.

Policies and Procedures

The Loan Purchase, Sale, and Securitization Standard governs the securitization activities. This Standard is contained within the ALM Policy. During the examination, management revised this standard to include certain language pertaining to cleanup calls as recommended by the examiners. Overall, this Standard provides adequate guidance to the securitization process.

[5] Blanket waiver provided via letter from Darrel Dochow, DRD.

	Washington Mutual Bank Docket No.: **08551** Exam Date: **March 5, 2007**	Date: Prepared By: Reviewed By: Index #:	2210-1

SUMMARY OF REVIEW

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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, vs. ANGELO MOZILO, DAVID SAMBOL, AND ERIC SIERACKI, Defendants.	Case No. CV09-03994 VBF AJWx **COMPLAINT FOR VIOLATIONS OF THE FEDERAL SECURITIES LAWS** **DEMAND FOR JURY TRIAL**

Plaintiff Securities and Exchange Commission ("Commission") alleges as follows:

JURISDICTION AND VENUE

1. This Court has jurisdiction over this action pursuant to Sections 20(b), 20(d)(1), 20(e) and 22(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. §§ 77t(b), 77t(d)(1), 77t(e), and 77v(a), and Sections 21(d)(1), 21(d)(2), 21(d)(3)(A), 21(e), and 27 of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. §§ 78u(d)(1), 78u(d)(2), 78u(d)(3)(A), 78u(e) & 78aa. Defendants have directly or indirectly made use of the means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange in connection with the transactions, acts, practices and courses of business alleged in this complaint.

2. Venue is proper in this district pursuant to Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), and Section 27 of the Exchange Act, 15 U.S.C. § 78aa, because defendants reside and transact business within this district and certain of the transactions, acts, practices and courses of conduct constituting violations of the federal securities laws alleged in this complaint occurred within this district.

SUMMARY

3. This matter involves a disclosure fraud by the three most senior executives of Countrywide Financial Corporation, a mortgage lender formerly based in Calabasas, California, and insider trading by Countrywide's former chairman of the board and chief executive officer, Angelo Mozilo.

4. From 2005 through 2007, Mozilo, along with David Sambol, chief operating officer and president, and Eric Sieracki, chief financial officer, held Countrywide out as primarily a maker of prime quality mortgage loans, qualitatively different from competitors who engaged primarily in riskier lending. To support this false characterization, Mozilo, Sieracki, and Sambol hid from

investors that Countrywide, in an effort to increase market share, engaged in an unprecedented expansion of its underwriting guidelines from 2005 and into 2007. Specifically, Countrywide developed what was referred to as a "supermarket" strategy, where it attempted to offer any product that was offered by any competitor. By the end of 2006, Countrywide's underwriting guidelines were as wide as they had ever been, and Countrywide was writing riskier and riskier loans. Even these expansive underwriting guidelines were not sufficient to support Countrywide's desired growth, so Countrywide wrote an increasing number of loans as "exceptions" that failed to meet its already wide underwriting guidelines even though exception loans had a higher rate of default.

5. Countrywide was more dependent than many of its competitors on selling loans it originated into the secondary mortgage market, an important fact it disclosed to investors. But Mozilo expected that the deteriorating quality of the loans that Countrywide was writing, and the poor performance over time of those loans, would ultimately curtail the company's ability to sell those loans in the secondary mortgage market. Mozilo and the company's chief risk officer warned Sambol and Sieracki about the increased risk that Countrywide was assuming. Thus, each of the defendants was aware, but failed to disclose, that Countrywide's current business model was unsustainable.

6. Mozilo, Sambol, and Sieracki were responsible for Countrywide's fraudulent disclosures. From 2005 through 2007, these senior executives misled the market by falsely assuring investors that Countrywide was primarily a prime quality mortgage lender which had avoided the excesses of its competitors. Countrywide's Forms 10-K for 2005, 2006, and 2007 falsely represented that Countrywide "manage[d] credit risk through credit policy, underwriting, quality control and surveillance activities," and the 2005 and 2006 Forms 10-K falsely stated that Countrywide ensured its continuing access to the mortgage backed securities market by "consistently producing quality mortgages."

7. In fact, the credit risk that Countrywide was taking was so alarming to Mozilo that he internally issued a series of increasingly dire assessments of various Countrywide loan products and the risks to Countrywide in continuing to offer or hold those loans, while at the same time he, Sambol, and Sieracki continued to make public statements obscuring Countrywide's risk profile and attempting to differentiate it from other lenders. In one internal email, Mozilo referred to a particularly profitable subprime product as "toxic," and in another he stated that the company was "flying blind," and had "no way" to predict the performance of its heralded product, the Pay-Option ARM loan. Mozilo believed that the risk was so high and that the secondary market had so mispriced Pay-Option ARM loans that he repeatedly urged that Countrywide sell its entire portfolio of those loans. Despite their awareness of, and Mozilo's severe concerns about, the increasing risk Countrywide was undertaking, Mozilo, Sambol, and Sieracki hid these risks from the investing public.

8. Defendants misled investors by failing to disclose substantial negative information regarding Countrywide's loan products, including:

- the increasingly lax underwriting guidelines used by the company in originating loans;
- the company's pursuit of a "matching strategy" in which it matched the terms of any loan being offered in the market, even loans offered by primarily subprime originators;
- the high percentage of loans it originated that were outside its own already widened underwriting guidelines due to loans made as exceptions to guidelines;
- Countrywide's definition of "prime" loans included loans made to borrowers with FICO scores well below any industry standard definition of prime credit quality;
- the high percentage of Countrywide's subprime originations that had a loan to value ratio of 100%, for example, 62% in the second quarter of 2006; and

- Countrywide's subprime loans had significant additional risk factors, beyond the subprime credit history of the borrower, associated with increased default rates, including reduced documentation, stated income, piggyback second liens, and LTVs in excess of 95%.

Mozilo, Sambol, and Sieracki knew this negative information from numerous reports they regularly received and from emails and presentations prepared by the company's chief credit risk officer. Defendants nevertheless hid this negative information from investors.

9. During the course of this fraud, Mozilo engaged in insider trading in Countrywide's securities. Mozilo established four sales plans pursuant to Rule 10b5-1 of the Securities Exchange Act in October, November, and December 2006 while in possession of material, non-public information concerning Countrywide's increasing credit risk and the risk that the poor expected performance of Countrywide-originated loans would prevent Countrywide from continuing its business model of selling the majority of the loans it originated into the secondary mortgage market. From November 2006 through August 2007, Mozilo exercised over 5.1 million stock options and sold the underlying shares for total proceeds of over $139 million, pursuant to 10b5-1 plans adopted in late 2006 and amended in early 2007.

DEFENDANTS

10. **Angelo Mozilo**, age 70, is a resident of Thousand Oaks, California. Mozilo was a founder of Countrywide and was its chairman and chief executive officer ("CEO") from its formation in 1969 until Countrywide was acquired by Bank of America in 2008.

11. **David Sambol**, age 49, is a resident of Hidden Hills, California. He was Countrywide's president and chief operating officer ("COO") from September 2006 until its acquisition by Bank of America in 2008. Sambol was Countrywide's executive managing director, business segment operations from April 2006 until September 2006, and executive managing director and chief of mortgage banking

and capital markets from January 2004 until April 2006. Sambol was a member of the Countrywide board of directors from 2007 until July 2008. Sambol also held executive positions at certain Countrywide subsidiaries, including Countrywide Bank.

12. **Eric Sieracki**, age 52, is a resident of Lake Sherwood, California. Sieracki was Countrywide's chief financial officer ("CFO") from the first quarter of 2005 until its acquisition by Bank of America in 2008.

RELATED PARTY

13. **Countrywide Financial Corporation**, a Delaware corporation, was a mortgage lender based in Calabasas, California. During all times relevant to this complaint, its stock was registered pursuant to Section 12(b) of the Exchange Act and was listed on the New York Stock Exchange, and, until the demise of the Pacific Stock Exchange, it was listed on that Exchange as well. On July 1, 2008, Countrywide merged with Bank of America and is now a wholly owned subsidiary of Bank of America. Countrywide's remaining operations and employees have been transferred to Bank of America, and Bank of America ceased using the Countrywide name in April 2009. On July 1, 2008, the NYSE filed a Form 25 to deregister and delist Countrywide's common stock, and on July 22, 2008 Countrywide filed a Form 15 deregistering its common stock under Section 12(g) of the Exchange Act.

FACTS

14. From 2005 through 2007, in Countrywide's periodic filings with the Commission and in other public statements, Mozilo, Sambol, and Sieracki held Countrywide out as primarily a maker of prime quality mortgage loans, qualitatively different from competitors who engaged primarily in riskier lending. To support this false characterization, the proposed defendants hid from investors that Countrywide was engaged in an effort to increase market share and sustain

revenue generation through unprecedented expansions of its underwriting guidelines, taking on ever-increasing credit risk.

A. **Countrywide's Business**

15. Countrywide originated, sold, and serviced both prime and subprime (which Countrywide's periodic filings referred to as "nonprime") mortgage loans. By 2005, Countrywide was the largest U.S. mortgage lender in the United States, originating over $490 billion in mortgage loans in 2005, over $450 billion in 2006, and over $408 billion in 2007. Countrywide recognized pre-tax earnings of $2.4 billion and $2 billion in its loan production divisions in 2005 and 2006, respectively, and a pre-tax loss of $1.5 billion in its loan production division in 2007.

16. Countrywide pooled most of the loans it originated and sold them in secondary mortgage market transactions. Countrywide sold the pooled loans either through whole loan sales or securitization. In whole loan sales, Countrywide sold the loans to investors and recorded gains on the sales. In securitizations, Countrywide sold interests in the pooled loans, i.e., mortgage-backed securities. Countrywide's loan sales were run out of its capital markets division. In 2005, Countrywide reported $451.6 million in pre-tax earnings from capital market sales, representing 10.9% of its pre-tax earnings; in 2006, it recognized $553.5 million in pre-tax earnings from that division, representing 12.8% of its pre-tax earnings, and in 2007 it recognized a mere $14.9 million in pre-tax earnings from that division, reporting a pre-tax loss overall.

17. Historically, Countrywide's primary business had been originating prime conforming loans that were saleable to the Government Sponsored Entities ("GSEs"). In the fiscal years 2001, 2002, and 2003, Countrywide's prime conforming originations were 50%, 59.6%, and 54.2% of its total loan originations, respectively. In 2003, United States residential mortgage production reached a record level of $3.8 trillion. Countrywide experienced record earnings in that year,

with net earnings of $2.4 billion, an increase of $1.5 billion, or 182%, over 2002. In 2004, in a market where originations were declining overall, Countrywide maintained net earnings of $2.1 billion, and increased its market share from 11.4% to 12.7%.

18. Countrywide achieved this result in large part by moving away from its historical core business of prime mortgage underwriting to aggressively matching loan programs being offered by other lenders, even monoline subprime lenders. As a result, as reported in Countrywide's periodic filings and reflected in the chart below, in 2004, 2005, and 2006, Countrywide wrote more non-conforming, subprime, and home equity loans than in any prior period:

	2001	2002	2003	2004	2005	2006
Prime Conforming	50%	59.6%	54.2%	38.2%	32%	31.9%
Prime Non-Conforming	16.5%	24.5%	31.4%	38.7%	47.2%	45.2%
Home Equity	6.8%	4.6%	4.2%	8.5%	9.0%	10.2%
Nonprime (Subprime)	7.8%	3.7%	4.6%	11.0%	8.9%	8.7%
FHA/VA	18.9%	7.6%	5.6%	3.6%	2.1%	2.8%
Commercial	0.0%	0.0%	0.0%	0.0%	0.8%	1.2%

19. In 2004, Countrywide's reported production of conventional conforming loans dropped to 38.2%, its production of subprime loans had risen to 11%, its production of home equity loans had risen to 8.5%, and its production of conventional non-conforming loans had risen to 38.7%. By 2006, Countrywide had turned its prior business model on its head: a mere 31.9% of its originations were conforming, 45.2% were non-conforming, 8.7% were subprime, and 10.2% were home equity.

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B. Countrywide's Deceptive Description of Its Loans

20. Countrywide's Form 10-Ks deceptively described the types of loans upon which the Company's business depended. While Countrywide provided statistics about its originations which reported the percentage of loans in various categories, such as those noted in the table in paragraph 18, the information was misleading because its descriptions of "prime non-conforming" and "nonprime" loans in its periodic filings were insufficient to inform investors what types of loans were included in those categories. "Prime" loans were described in Countrywide's 2005, 2006, and 2007 Forms 10-K as follows:

> Prime Mortgage Loans include conventional mortgage loans, loans insured by the Federal Housing Administration ("FHA") and loans guaranteed by the Veterans Administration ("VA"). A significant portion of the conventional loans we produce qualify for inclusion in guaranteed mortgage securities backed by Fannie Mae or Freddie Mac ("conforming loans"). Some of the conventional loans we produce either have an original loan amount in excess of the Fannie Mae and Freddie Mac loan limit for single-family loans ($417,000 for 2006) or otherwise do not meet Fannie Mae or Freddie Mac guidelines. Loans that do not meet Fannie Mae or Freddie Mac guidelines are referred to as "nonconforming loans."

21. Nothing in that description informed investors that Countrywide's "prime non-conforming" category included loan products with increasing amounts of credit risk. While guidance issued by the banking regulators referenced a credit score ("FICO score") at 660 or below as being an indicator of a subprime loan, some within the banking industry drew the distinction at a score of 620 or below. Countrywide, however, did not consider **any** FICO score to be too low to be categorized within "prime." Nor did Countrywide's definition of "prime" inform

investors that its "prime non-conforming" category included so-called "Alt-A" loan products with increasing amounts of credit risk, such as (1) reduced or no documentation loans; (2) stated income loans; and (3) loans with loan to value or combined loan to value ratios of 95% and higher. Finally, it did not disclose that Pay-Option ARM loans, including reduced documentation Pay-Option ARM loans, were included in the category of prime loans. Moreover, to the extent these extremely risky loans were below the loan limits established by the government sponsored entities that purchased these loans ("GSEs"), they would have been reported by Countrywide as prime conforming loans. In 2005 and 2006, Countrywide's Pay-Option ARMs ranged between 17% and 21% of its total loan originations. It maintained the majority of these loans in the held for investment portfolio at Countrywide Bank.

22. Significantly, the Countrywide periodic filings do not define "nonprime" in any way, and Countrywide's periodic filings failed to disclose that loans in the category of subprime were not merely issued to borrowers with blemished credit, but that this category included loans with significant additional layered risk factors, such as (1) subprime piggyback seconds, also known as 80/20 loans; (2) reduced or no documentation loans; (3) stated income loans; (4) loans with loan to value or combined loan to value ratios of 95% and higher; and (5) loans made to borrowers with recent bankruptcies and late mortgage payments.

23. By increasing its origination of non-conforming and subprime loans between 2003 and 2006, Countrywide was able to originate many more loans in those years and increase its market share, even as the residential real estate market declined in the United States. As of December 31, 2003, based on its own internal estimates, Countrywide had an 11.4% share of the United States mortgage market. By September 30, 2006, it had a 15.7% share of the market. While Countrywide boasted to investors that its market share was increasing, company executives did not disclose that its market share increase came at the expense of prudent

underwriting guidelines. As a result, Countrywide's share price rose from $25.28 on December 31, 2003 to $42.45 on December 29, 2006, the last trading day of that year.

C. Countrywide's Market Strategy Caused it To Take On Increasing Credit Risk

1. Countrywide's Undisclosed Expansion of Underwriting Guidelines and the Matching Strategy

24. By the end of 2006, Countrywide's underwriting guidelines were wider and more aggressive than they had ever been. The company's aggressive guideline expansion was deliberate, and began as early as 2003. Indeed, from January 2003 until well into 2006, Countrywide's credit risk management department ("Risk Management") spent approximately 90% of its time processing requests for expansions of Countrywide's underwriting guidelines.

25. Countrywide's "matching strategy," also known as the "supermarket strategy," was a key driver of the company's aggressive expansion of underwriting guidelines. The strategy committed the company to offering any product and/or underwriting guideline available from at least one "competitor," which included subprime lenders. Thus, if Countrywide did not offer a product offered by a competitor, Countrywide's production division invoked the matching strategy to add the product to Countrywide's menu. For example, if Countrywide's minimum FICO score for a product was 600, but a competitor's minimum score was 560, the production division invoked the matching strategy to reduce the minimum required FICO score at Countrywide to 560.

26. The impact of the matching strategy was intensified by Countrywide's "no-brokering" policy, which precluded Countrywide's loan officers from referring loan applicants to other brokers and/or institutions. Prior to its implementation, loan officers could engage in a practice known as "brokering," in which the loan officer would refer those borrowers deemed too risky for Countrywide to another

lender, which in turn paid a commission to the Countrywide loan officer. The no-brokering policy increased the incentives for Countrywide's retail sales force to be aggressive in finding ways for Countrywide to underwrite a loan, regardless of whether the loan satisfied the underwriting guidelines Countrywide repeatedly touted to investors.

27. Mozilo, Sambol, and Sieracki knew that the company was taking on increased risk of defaults and delinquencies as a result of its widened underwriting guidelines and matching strategy, yet Countrywide's periodic filings concealed the unprecedented expansion of underwriting guidelines and the attendant increased credit risk.

2. <u>Exception Loans Magnified Countrywide's Credit Risk</u>

28. Though Countrywide proclaimed in its Forms 10-K for 2005, 2006, and 2007 that it managed credit risk through its loan underwriting, the company's increasingly wide underwriting guidelines and exceptions process materially increased Countrywide's credit risk during that time. Countrywide used an automated underwriting system known as "CLUES" to actually underwrite loans. The CLUES system applied the principles and variables set forth in the Countrywide underwriting manuals and its loan program guide. CLUES applied a device known as the "underwriting scorecard," which assessed borrower credit quality by analyzing several variables, such as FICO scores, loan to value ratios, documentation type (*e.g.*, full, reduced, stated) and debt-to-income ratios. These variables were weighted differently within the scorecard, depending upon their perceived strength in predicting credit performance. In underwriting a loan, Countrywide loan officers entered an applicant's information into CLUES, which would (1) approve the loan; (2) approve the loan with caveats; or (3) "refer" the loan to a loan officer for further consideration and/or manual underwriting.

29. The CLUES program typically did not "reject" a loan if a requirement of Countrywide's guidelines had not been met or if CLUES calculated that the loan

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presented an excessive layering of risk. Instead, CLUES "referred" the loan, indicating that the loan application would have to be reviewed manually prior to approval. In these circumstances, to proceed with the loan, the loan officer would request an "exception" from the guidelines from more senior underwriters at Countrywide's structured lending desk ("SLD"). Countrywide's level of exceptions was higher than that of other mortgage lenders. The elevated number of exceptions resulted largely from Countrywide's use of exceptions as part of its matching strategy to introduce new guidelines and product changes.

30. Further, the actual underwriting of exceptions was severely compromised. According to Countrywide's official underwriting guidelines, exceptions were only proper where "compensating factors" were identified which offset the risks caused by the loan being outside of guidelines. In practice, however, **Countrywide used as "compensating factors" variables such as FICO and loan to value, <u>which had already been assessed by CLUES in issuing a "refer" finding</u>**. Countrywide underwriting manuals were amended to explicitly prohibit this practice in mid-2007, but this serious deficiency was in place from early 2006 through early 2007, when a large volume of obviously deficient exception loans were originated by Countrywide.

D. <u>Countrywide's Business Model Became Unsustainable</u>

31. As described above, Countrywide depended on its sales of mortgages into the secondary market as an important source of revenue and liquidity. As a result, Countrywide was not only directly exposed to credit risk through the mortgage-related assets on its balance sheet, but also indirectly exposed to the risk that the increasingly poor quality of its loans would prevent their continued profitable sale into the secondary mortgage market and impair Countrywide's liquidity. Rather than disclosing this increasing risk, Mozilo, Sambol, and Sieracki gave false comfort, again touting Countrywide's loan quality. For example, Countrywide stated in its 2005 Form 10-K: "We ensure our ongoing access to the

secondary mortgage market by consistently producing quality mortgages. . . . We make significant investments in personnel and technology to ensure the quality of our mortgage loan production." A virtually identical representation appears in Countrywide's 2006 Form 10-K. Accordingly, Countrywide's failure to disclose its widening underwriting guidelines and the prevalence of exceptions to those guidelines in 2005 and 2006 constituted material omissions from Countrywide's periodic reports.

E. <u>Mozilo, Sambol, and Sieracki Were Aware of the Increased Credit Risk Created By Expanded Underwriting Guidelines and Exception Loans</u>

32. Countrywide's increasingly wide underwriting guidelines materially increased the company's credit risk from 2004 through 2007, but this increased risk was not disclosed to investors. In 2007, as housing prices declined, Countrywide began to suffer extensive credit problems as the inherent credit risks manifested themselves.

1. <u>The September 2004 Warning</u>

33. The credit losses experienced by Countrywide in 2007 not only were **foreseeable** by the proposed defendants, they were in fact **foreseen** at least as early as September 2004. Risk Management warned Countrywide's senior officers that several aggressive features of Countrywide's guidelines (*e.g.*, high loan to value programs, ARM loans, interest only loans, reduced documentation loans, and loans with layered risk factors) significantly increased Countrywide's credit risk.

34. Countrywide was taking on more risk as a direct result of the lower credit quality of the loans it was originating. Countrywide's strategy of reducing risk through loan sales was being frustrated as the company produced smaller percentages of loans eligible for sale on a nonrecourse basis (e.g., FHA, VA and conforming loans), and larger percentages of loans (e.g., subprime and

nonconforming loans) where it retained credit risk in the form of residual interests. By September 2004, defendants knew the following trends:

- 66% of Countrywide's production was conforming in July 2003, but conforming originations **had fallen** to 35% by July 2004;

- 21% of Countrywide's production was nonconforming in July 2003, but non-conforming originations **had risen** to 40% by July 2004; and

- 2% of Countrywide's July 2003 production was subprime, but subprime originations **had risen** to 10% by July 2004.

35. The credit risk described in the September 2004 warning **worsened** from September 2004 to August 2007. Risk Management continuously had discussions with Countrywide's loan production division, which reported to Sambol, about the credit concerns identified in the September 2004 warning. In fact, Risk Management conducted studies to identify relationships among certain credit variables and their effect upon the probability that a loan would go into serious delinquency or default. One finding of these studies, the results of which were shared with Sambol and Sieracki, was that the less documentation associated with a loan, the higher the probability of default. Nevertheless, Countrywide continued to expand its underwriting guidelines, and to liberally make exceptions to those guidelines, through the end of 2006. These facts were never disclosed to investors.

2. <u>Credit Risk Management Repeatedly Alerted the Defendants to Increases in Credit Risk</u>

36. Both Sambol and Sieracki were members of the Countrywide credit risk committee. The credit risk committee had quarterly meetings. At these meetings, the members were provided with detailed presentations highlighting Countrywide's increased credit risk. For example, at an April 6, 2005 meeting of the credit risk committee attended by Sambol, McMurray reported that (1)

Countrywide non-conforming loans originated in May 2002 were twice as likely to default as loans originated in January 2000; (2) the risk of home equity lines of credit defaulting had doubled over the past year, mainly due to the prevalence of reduced documentation in those loans; and (3) Countrywide was now a leader in the subprime market in four of six categories, whereas in December 2004 Countrywide had only been a leader in two of six categories.

37. Similarly, Sieracki attended a June 28, 2005 meeting at which the chief operating officer noted that Countrywide was taking on "too much" balance sheet risk in home equity lines of credit ("HELOCs") and subprime loans, and had taken on "unacceptable risk" from non-owner occupied loans made at 95% combined loan to value ratios, which were an exception to Countrywide's then-existing underwriting guidelines. Risk Management also reported at that meeting that non-conforming loan programs accounted for 40% of Countrywide's loan originations and that subprime production had tripled, rising from 4% to 14% of total production. Finally, at that same meeting, Risk Management reported to the committee on evidence of borrowers misrepresenting their income and occupation on reduced documentation loan applications, and the increasing credit risks associated with Pay-Option ARM loans, for example, negative amortization, payment shock, and the necessity of raising the initial interest rate to reduce the speed of negative amortization on the loans.

38. Sambol and Sieracki also learned of the risks associated with the company's aggressive guideline expansion in meetings of other company committees. For example, Sieracki was a member of the asset and liability committee, and Sambol attended certain of its meetings. If a proposed guideline expansion had a modeled expected default rate in excess of 8%, the proposal had to be submitted to this committee for approval. All proposed expansions to Countrywide's subprime menu from late 2005 through 2006 presented an expected default rate in excess of 8% and required approval of that committee. In June

2005, Sambol and McMurray engaged in a lengthy email exchange regarding the impact of Countrywide's underwriting guideline expansion related to requests for subprime product expansions that had been taken up by the asset and liability committee in the first and second quarters of 2005. In that exchange, McMurray warned Sambol that "as a consequence of [Countrywide's] strategy to have the widest product line in the industry, we are clearly out on the 'frontier' in many areas." McMurray went on to note that the frontier had "high expected default rates and losses."

39. Additionally, proposals with high expected defaults or that were otherwise controversial were referred to the Countrywide responsible conduct committee for approval. Sambol was a member of this committee, which had repeatedly approved guideline expansions. For instance, in late 2006 Countrywide's production divisions proposed expanding Countrywide's guidelines to match certain guidelines offered by Bear Stearns and Lehman Brothers, programs that were known within Countrywide as "Extreme Alt-A." Risk Management was concerned about the risks associated with these guidelines, and referred the request to the responsible conduct committee. Sambol, in his capacity as a member of that committee, approved the expansion.

40. Finally, both Mozilo and Sambol were aware as early as June 2006 that a significant percentage of borrowers who were taking out stated income loans were engaged in mortgage fraud. On June 1, 2006, Mozilo advised Sambol in an email that he had become aware that the Pay-Option ARM portfolio was largely underwritten on a reduced documentation basis and that there was evidence that borrowers were lying about their income in the application process. On June 2, 2006, Sambol received an email reporting on the results of a quality control audit at Countrywide Bank that showed that **50%** of the stated income loans audited by the bank showed a variance in income from the borrowers' IRS filings of greater

than 10%. Of those, 69% had an income variance of greater than 50%. These material facts were never disclosed to investors.

3. Warnings Regarding the Matching Strategy

41. McMurray repeatedly provided explicit and ominous warnings about Countrywide's matching strategy. In a June 25, 2005 email to Sambol concerning guideline expansion and the company's growing credit risks, McMurray addressed the matching strategy and explained that "because the matching process includes comparisons to a variety of lenders, our [guidelines] will be a composite of the outer boundaries across multiple lenders[,]" and that because comparisons are only made to competitor guidelines where they are more aggressive and not used where they are less aggressive, **Countrywide's "composite guides [sic] are likely among the most aggressive in the industry."** (emphasis added.)

42. On November 2, 2006, McMurray sent an email to Countrywide's chief investment officer ("CIO"), which the CIO forwarded to Sambol, stating that the matching strategy had caused Countrywide to cede its underwriting standards to the most aggressive lenders in the market. In the email, McMurray asked: **"Do we want to effectively cede our policy and is this approach "saleable" from a risk perspective to those constituents who may worry about our risk profile?"** (emphasis added.)

43. In a November 16, 2006 email to Sambol, McMurray complained about guidelines and products being introduced in contravention of credit policy. As an example, McMurray cited the fact that Extreme Alt-A loans were being offered by the loan production divisions, even though that program had not been officially approved in the guideline review process. The proposed guidelines would have permitted 100% financing, layered with additional credit risk factors such as stated income, lower than average FICO scores, or non-owner occupied investment properties.

44. In a February 11, 2007 email to Sambol, McMurray noted that the production divisions continued to advocate for, and operated pursuant to, an approach based upon the matching strategy alone, and repeated his concern that the strategy would cause Countrywide's guidelines to be a composite of the riskiest offerings the market. Additionally, McMurray warned that, "**I doubt this approach would play well with regulators, investors, rating agencies etc.** To some, this approach might seem like **we've simply ceded our risk standards and balance sheet to whoever has the most liberal guidelines.**" (emphasis added.)

4. Warnings Regarding Guideline Expansion and Disruptions in the Secondary Market

45. By no later than 2006, Mozilo and Sambol were on notice that Countrywide's exotic loan products might not continue to be saleable into the secondary market, yet this material risk was not disclosed in Countrywide's periodic filings.

46. In September 2006 Mozilo wrote an email to Sambol warning that he believed that the Pay-Option loan was "mispriced" in the secondary market and that the pricing spread could disappear quickly if there were a negative event in the market. On February 2, 2007, Risk Management warned Sambol that guideline expansions could disrupt the secondary market for subprime mortgage backed securities ("MBS"). Later in that quarter, the MBS market for subprime loans experienced a disruption that forced Countrywide to write down loans that it had previously intended to sell into that market. Then, in August 2007, the entire market for MBS experienced a severe disruption, which effectively crippled the ability of Countrywide, as well as other mortgage lenders, to sell non-GSE securitizations into the secondary markets and contributed to Countrywide's liquidity problems.

5. Warnings Regarding 100% (a.k.a. 80/20 loans) Financing

47. The seriousness of Risk Management's warnings on guideline expansion and the consequences of Countrywide's failure to heed such warnings are vividly demonstrated by the company's experience with "80/20" subprime loans. An 80/20 subprime loan is a loan where a borrower with a subprime FICO score simultaneously takes out two loans to purchase a home: a first lien loan (typically 80% of the purchase price), and a second lien loan (typically 20% of the purchase price). As a result of having 100% financed the purchase, the borrower has no initial equity in the home. Pursuant to Risk Management's "Policy on High Risk Products," subprime 80/20 loans could not be originated via the exceptions process, and could only be originated if Countrywide could totally extinguish the credit risks (*e.g.*, residual interests or corporate guarantees) resulting from such loans. But the policy was ignored by the production divisions.

48. Mozilo knew of the risks Countrywide incurred by originating subprime 80/20 loans and repeatedly questioned the wisdom of continuing to offer the product. Mozilo became concerned about the loans in the first quarter of 2006, when HSBC, a purchaser of Countrywide's 80/20 loans, began to contractually force Countrywide to "buy back" certain of these loans that HSBC contended were defective. On March 28, 2006, Mozilo sent an e-mail to Sambol and others, directing them to implement a series of corrective measures to "avoid the errors of both judgment and protocol that have led to the issues that we face today caused by the buybacks mandated by HSBC." Mozilo further stated that the 100% loan-to-value (also known as 80/20) subprime product is "**the most dangerous product in existence and there can be nothing more toxic** and therefore requires that no deviation from guidelines be permitted irrespective of the circumstances."

49. Then, in an April 13, 2006 email, Mozilo informed Sambol, Sieracki, and others that there were numerous issues that they must address relating to the 100% subprime second business in light of the losses associated with the HSBC

buyback. One issue in particular that Mozilo identified was the fact that the loans had been originated "through our channels with disregard for process [and] compliance with guidelines." Mozilo went on to write that he had **"personally observed a serious lack of compliance within our origination system as it relates to documentation and generally a deterioration in the quality of loans originated** versus the pricing of those loan [sic]." Mozilo noted that, **"[i]n my conversations with Sambol he calls the 100% sub prime seconds as the 'milk' of the business. <u>Frankly, I consider that product line to be the poison of ours</u>.**" (emphasis added.)

50. Furthermore, in an April 17, 2006 email to Sambol concerning Countrywide's subprime 80/20 loans, Mozilo fumed:

> In all my years in the business I have never seen a more toxic prduct. [sic] It's not only subordinated to the first, but the first is subprime. In addition, the FICOs are below 600, below 500 and some below 400[.] With real estate values coming down...the product will become increasingly worse. There has [sic] to be major changes in this program, including substantial increases in the minimum FICO. . . . Whether you consider the business milk or not, I am prepared to go without milk irrespective of the consequences to our production.

51. Echoing Mozilo's criticisms of the 80/20 product, in April 2006 Risk Management recommended increasing the minimum FICO score on the product by 20 points. Sambol, then still the head of the production divisions, opposed this recommendation, and noted that such an increase would make Countrywide uncompetitive with subprime lenders such as New Century, Option One, and Argent.

52. On December 7, 2006, Mozilo circulated a memorandum drafted for him by McMurray to the board of directors and all Countrywide managing

directors, including Sambol and Sieracki. In the memorandum, Mozilo made the following observations, among others:

- Countrywide had expanded its subprime underwriting guidelines in every conceivable area, lowering minimum FICOs, raising maximum loan size and LTV, and making interest only, stated income, and piggyback second loans available to subprime borrowers;
- Countrywide expected that subprime loans originated in 2006 (the "2006 Vintage") would be the worst performing on record, driven by wider guidelines and the worsening economic environment, which included rising interest rates and declining home values;
- the percentage of 60- and 90-day delinquencies in the 2006 Vintage (at 8.11% and 4.03% respectively), exceeded the percentages from each of the previous six years, and the company expected these percentages to rise; and
- 62% of Countrywide's subprime originations in the second quarter of 2006 had a loan to value ratio of 100%.

53. In April 2006, Mozilo wrote that no premium, no matter how high, could justify underwriting a loan for a borrower whose FICO score was below 600. Yet Countrywide failed to disclose to investors the serious deficiencies in its underwriting of these "toxic" loans.

6. <u>Warnings Regarding Exception Loans</u>

54. Mozilo, Sambol, and Sieracki were aware of significant lapses in Countrywide's underwriting processes and the resulting risk to Countrywide. On May 22, 2005, McMurray warned Sambol of the likelihood of significantly higher default rates in loans made on an exception basis: "[t]he main issue is to make sure everyone's aware that we will see higher default rates." McMurray explained that

"exceptions are generally done at terms more aggressive than our guidelines," and continued that **"[g]iven the expansion in guidelines and the growing likelihood that the real estate market will cool, this seems like an appropriate juncture to revisit our approach to exceptions."** (emphasis added.) McMurray also warned that increased defaults would cause repurchase and indemnification requests to rise and the performance of Countrywide-issued MBS to deteriorate.

55. The poor quality of the loans originated through the exception process became even more obvious in the first quarter of 2007. In fact, in materials distributed at a March 12, 2007 meeting of the credit risk committee attended by Sambol and Sieracki, Risk Management reported that nearly 12% of the loans reviewed by Countrywide in an internal quality control process were rated "severely unsatisfactory" or "high risk." The causes for such a rating included findings that such loans had debt-to-income, loan to value, or FICO scores outside of Countrywide's already wide underwriting guidelines. By the second quarter of 2007, Risk Management began to report a serious deterioration in the performance of exception loans.

56. In a December 13, 2007 memo that was sent to Mozilo in his capacity as Countrywide's chairman of the board, Countrywide's enterprise risk assessment officer noted that:

> Countrywide had reviewed limited samples of first- and second-trust-deed mortgages originated by Countrywide Bank during the fourth quarter of 2006 and the first quarter of 2007 in order to get a sense of the quality of file documentation and underwriting practices, and to assess compliance with internal policies and procedures. The review resulted in . . . the finding that **borrower repayment capacity was not adequately assessed by the bank during the underwriting process** for home

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> equity loans. More specifically, **debt-to-income (DTI) ratios did not consider the impact of principal [negative] amortization or an increase in interest.**
> (emphasis added)

57. These material deficiencies in Countrywide's underwriting were never disclosed to investors in Countrywide's Forms 10-Q or 10-K for 2005 through 2007.

F. Pay-Option Arms and the Discrepancy Between the Internal and External Portrayals of Credit Risk

1. The External Story

58. Countrywide began originating Pay-Option ARM loans in 2004; by the second quarter of 2005 21% of Countrywide's loan production was Pay-Option ARMS. Pay-Option ARMs allowed borrowers to choose between four payment options: (1) a minimum payment which was insufficient to cover accruing interest; (2) an interest-only payment; (3) a fully amortizing payment with a 30 year pay-off; and (4) a fully amortizing payment with a 20 year pay-off. If the minimum payment was selected, then the accruing interest would be added to the loan's principal balance, a phenomenon known as negative amortization. Countrywide's Pay-Option ARM loans typically allowed for negative amortization until the principal balance reached 115% of the original loan balance, at which time the payment would reset to the amount necessary to repay principal and interest in the term remaining on the loan. This resulted in a much higher monthly payment and "payment shock" to many borrowers. Even if the borrower never reached the 115% threshold, the loan would typically reset after five years to a fully amortizing payment. Because Countrywide began to offer Pay-Option loans in 2004, Countrywide's first wave of automatic resets were scheduled to occur in 2009. Unlike many other loans that Countrywide originated, most of the Pay-Option loans were held for investment by Countrywide Bank.

59. Countrywide publicly heralded Pay-Option loans as a safe product offering. For instance, in its 2006 Form 10-K, Countrywide proclaimed that it had "prudently underwritten" its Pay-Option ARMs. On May 31, 2006, Mozilo gave a speech in which he stated, "Pay-Option loans represent the best whole loan type available for portfolio investment from an overall risk and return perspective," that, "[t]he performance profile of this product is well understood because of its twenty year history, which includes stress tests in difficult environments[,]" and that Countrywide "actively manages credit risk through prudent program guidelines…and sound underwriting."

2. **The Internal View**

60. Contrary to such public statements extolling the virtues of the Pay-Option ARM product, Mozilo, along with several of Countrywide's senior executives, had concluded that the product's risks to the company were severe, and they were scrambling to identify ways to mitigate them. Sambol and Sieracki were aware of these concerns.

a. **Negative Amortization and Payment Shock**

61. In June 2005, Risk Management warned senior executives, including Sieracki, that action was needed to address the increasing pace of negative amortization and the potential for payment shock associated with Pay-Option ARMs. Specifically, in a June 28, 2005 meeting of the credit risk committee, which was attended by Sieracki, Risk Management recommended that the rate used to calculate the minimum payment on Pay-Option ARMs ("start rate") be raised to reduce negative amortization and the severity of payment shock. Risk Management explained that while the start rate remained constant at 1%, short term rates (upon which borrowers' fully amortizing payments were based) had risen steadily, thereby increasing the pace of negative amortization and the severity of the resulting payment shock.

62. At a June 22, 2006 credit risk committee meeting, attended by Sambol and Sieracki, Risk Management noted that the median time to reset on the pay option loans was getting shorter as negative amortization was accruing at a faster than expected pace.

b. <u>Mozilo's Pointed Concerns About Pay-Option ARMs</u>

63. On April 4, 2006, Mozilo received an e-mail regarding Pay-Option loans which informed him that "72% of [Pay-Option] customers chose Minimum Payment selection in February 06, up from 60% in August 05." In response to this information Mozilo sent an email to Sambol that reflected how well he understood the negative ramifications of the information for Countrywide: "Since over 70% have opted to make the lower payment it appears that **it is just a matter of time that we will be faced with much higher resets and therefore much higher delinquencies.**"

64. About six weeks later, on May 18, 2006, Mozilo sent another e-mail to Sambol and Sieracki again sounding the alarm about the Pay-Option portfolio. Stating that "the Bank faces potential unexpected losses because higher [interest] rates will cause the loans to reset much earlier than anticipated and as a result causing mortgagors to default due to the substantial increase in their payments," Mozilo directed the management team to reduce "balance sheet risk" by refinancing Pay-Options into interest-only loans and improving consumer education about the consequences of resets. Mozilo concluded his e-mail by stating that "there is much more that we can do to manage risk much more carefully during this period of uncertainty both as to the rate environment and untested behavior of payoptions." The very next day, May 19, 2006, Mozilo wrote another email to Sambol and Sieracki, noting that Pay-Options loans presented a long term problem "unless [interest] rates are reduced dramatically from this level and there are no indications, absent another terrorist attack, that this will happen."

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c. **<u>Mozilo's Concerns Mount</u>**

65. Mozilo received more dire news regarding the Pay-Option loan portfolio in June 2006. On June 1, 2006, **one day** after he gave a speech publicly praising Pay-Option ARMs, Mozilo sent an email to Sambol and other executives, in which he expressed concern that the majority of the Pay-Option ARM loans were originated based upon stated income, and that there was evidence of borrowers misrepresenting their income. Mozilo viewed stated income as a factor that increased credit risk and the risk of default. In his email, Mozilo reiterated his concern that in an environment of rising interest rates, resets were going to occur much sooner than scheduled, and because at least 20% of the Pay-Option borrowers had FICO scores less than 700, **borrowers "are going to experience a payment shock which is going to be <u>difficult if not impossible</u> for them to manage.**" Mozilo concluded that the company needed to act quickly to address these issues because "[w]e know or can reliably predict what's going to happen in the next couple of years." Mozilo directed Countrywide Bank to (1) stop accumulating loans with FICO scores below 680 unless the loan-to-value ratio was 75% or lower, (2) assess the risks that the Bank faced on loans with FICO scores below 700 and determine if they could be sold out of the Bank and replaced with higher quality loans, and (3) take a careful look at the reserves and "begin to assume the worst."

66. On July 10, 2006, Mozilo received an internal monthly report, called a "flash report," that tracked the delinquencies in the Pay-Option portfolio, as well as the percentage of borrowers electing to make the minimum payment and the amount of accumulated negative amortization on each loan. Mozilo learned that from September 2005 through June 2006, the percentage of Pay-Option borrowers choosing to make the minimum payment had nearly doubled, from 37% to 71%. Mozilo believed that these statistics were significant enough that he requested that the company include a letter in bold type with every new Pay-Option loan to

inform borrowers of the dangers of negative amortization and to encourage full payment.

67. About a month later, on August 16, 2006, Mozilo received an e-mail from a fellow member of Countrywide's board of directors, asking whether the company anticipated any significant problems with the Pay-Option portfolio. Mozilo responded by reiterating the ongoing concerns he had shared with senior management earlier in 2006. By this point in time, over 75% of the Pay-Options borrowers were opting for the minimum payment, which, along with rising interest rates, continued to accelerate negative amortization. Mozilo explained that, as a result, the loans would reset much faster than the borrowers expected with accompanying payment shock. The only solution, Mozilo wrote, was to refinance the loans before reset, but this would be difficult in light of decreasing home values and rising interest rates. Mozilo wrote that only "unlikely" events, such as a dramatic rise in home values or a dramatic drop in interest rates, would alleviate future payment shock.

d. Internally, Mozilo Urges Selling the Pay-Option Portfolio

68. Mozilo met with Sambol the morning of September 25, 2006 to discuss the Pay-Option ARM loan portfolio. The next day Mozilo sent an e-mail to Sambol and Sieracki expressing even greater concern about the portfolio. In that e-mail, Mozilo wrote:

> **[w]e have no way, with any reasonable certainty, to assess the real risk of holding these loans on our balance sheet.** The only history we can look to is that of World Savings however their portfolio was fundamentally different than ours in that their focus was equity and our focus is fico. In my judgement, as a long time lender, I would always trade off fico

> for equity. The bottom line is that <u>**we are flying blind**</u> on how these loans will perform in a stressed environment of higher unemployment, reduced values and slowing home sales. (emphasis added)

69. In his September 26, 2006 email Mozilo further stated that "**pay options are currently mispriced in the secondary market, and that spread could disappear quickly** if there is an foreseen [sic] headline event such as another lender getting into deep trouble with this product or because of negative investor occurance [sic]." (emphasis added.) He urged that the "timing [wa]s right" to sell Countrywide Bank's portfolio of loans. To mitigate these anticipated losses, Mozilo proposed that the Bank "sell all newly originated pay options and begin rolling off the bank balance sheet, in an orderly manner, pay options currently in their port[folio]."

70. McMurray responded to Mozilo's September 26, 2006 email, agreeing that Countrywide "should be shedding rather than adding Pay Option risk to the portfolio." In the fall of 2006, Countrywide's CIO went further, and recommended to Mozilo, Sambol, Sieracki, and others that <u>all</u> Pay-Option ARMs be sold from Countrywide Bank because Countrywide was not receiving sufficient compensation on these loans to offset the risk of retaining them on its balance sheet.

71. Mozilo never became comfortable with the risk presented by the Pay-Option loan. Indeed, on January 29, 2007, Mozilo wrote an email in which he instructed the president of Countrywide Bank to "to explore with KPMG the potential of selling out (one time transaction because of the tarred reputation of Payoptions) the bulk to the Payoptions on the Bank's balance sheet and replace them with HELOCS." Then, on November 3, 2007, Mozilo instructed the president of the Bank and Sambol that he did not "want any more Pay Options originated for the Bank. I also question whether we should touch this product

going forward because of **our inability to properly underwrite these** combined with the fact that these loans are inherently unsound unless they are full doc, no more than 75% LTV and no piggys" (emphasis added). Finally, on November 4, 2007, Mozilo advised the president of the Bank and Sambol that "[p]ay options have hurt the company and the Bank badly. . . . World Savings culture permits them to make these loans in a sound manner and our culture does not . . . . fico scores are no indication of how these loans will perform."

72. Despite the repeated warnings of Mozilo, McMurray, and the CIO, the Pay-Option ARMs were never sold, and the clearly identified risks to Countrywide were not disclosed to investors. Mozilo recognized as early as August 2006 that Pay-Option ARM loans were one of the "only products left with margins [profit]."

G. Mozilo, Sambol, and Sieracki Were Responsible for Countrywide's Periodic Filings

73. Mozilo, Sambol, and Sieracki each bore responsibility for Countrywide's periodic filings. In April 2004, Countrywide promulgated a set of written "Disclosure Controls and Procedures ("Disclosure Guidelines")" which established the procedures governing the preparation of the company's periodic reports. The Disclosure Guidelines were revised in December 2005 and again in September 2006. The Disclosure Guidelines established a disclosure committee at Countrywide, which Sieracki joined at least as early as December 2005. The Disclosure Guidelines required Countrywide "to disclose on a timely basis any information that would be expected to affect the investment decision of a reasonable investor or to alter the market price of the Company's securities." Countrywide's financial reporting staff was required to:

> seek input from and discuss with the Divisional Officers information pertaining to the past and current performance and prospects for their business unit, known trends and uncertainties related to the business

> unit, [and] significant risks and contingencies that may affect the business unit. . .

The Disclosure Guidelines also required that Countrywide's accounting division, among others, assist the officers involved in the preparation of the company's periodic reports in gaining a reasonable understanding of the applicable rules and regulations, including the disclosure requirements set forth in Regulation S-K and the relevant SEC staff guidance and interpretive materials.

74. The preparation of the periodic reports at Countrywide began with a review of the pertinent report from the prior period. The senior vice president for financial reporting circulated to the head of each Countrywide division (1) a memorandum setting forth Countrywide's disclosure obligations and (2) a template ("MD&A Questionnaire") that contained questions concerning the applicable officer's division and that portion of the prior period's filing that concerned the officer's division.

75. Starting in the first quarter of 2006, the MD&A Questionnaire for credit risk management was sent to McMurray and solicited information pertaining to a number of topics related to credit risk, including (1) changes in the management of credit risks, (2) environmental risks and uncertainties, (3) deterioration in loan quality and (4) changes in underwriting guidelines.

76. After circulating the draft MD&A Questionnaires to the divisions, the financial reporting group compiled them and generated the first draft of the periodic report, which was reviewed and edited by the chief accounting officer and the deputy CFO. The revised draft then went to the legal department and the senior managing directors responsible for signing sub-certifications, as well as Sieracki, Sambol, and Mozilo.

77. From the certifiers and the senior officers, the draft went to the board of directors. When all of the certifications had been compiled, Sieracki and Mozilo were notified and they signed Sarbanes-Oxley certifications. Sieracki also signed

all of the Forms 10-Q and 10-K starting in the first quarter of 2005 and throughout 2007. Sambol signed the Forms 10-Q for the third quarter of 2006 and all of the quarters in 2007, as well as the Form 10-K for the year ended 2007. Mozilo signed the Forms 10-K for the years ended 2005, 2006, and 2007.

H. Sambol and Sieracki Refused Suggestions to Disclose Countrywide's Increased Credit Risk

78. Sambol and Sieracki actively participated in decisions to exclude disclosures regarding Countrywide's widened underwriting guidelines in the periodic filings. Throughout 2006, McMurray unsuccessfully lobbied to the financial reporting department that Countrywide disclose more information about its increasing credit risk, but these disclosures were not made.

79. In January 2007, McMurray sent an email to Sieracki, which he subsequently incorporated by reference in his MD&A questionnaire, explaining that Countrywide's delinquencies would increase in the future due to a weakening real estate market and what McMurray characterized as credit guidelines that were "wider than they have ever been." On January 29, 2007 McMurray provided Sambol and others with an outline of where credit items impacted Countrywide's balance sheet. McMurray then forwarded the email to the financial reporting staff, and specifically requested that a version of the outline be included in the 2006 Form 10-K. The information was not included in the 2006 Form 10-K.

80. In August 2007, McMurray exchanged a series of emails with the managing director of financial reporting suggesting revisions to the Form 10-Q for the second quarter of 2007. McMurray again specifically asked financial reporting to include information regarding widened underwriting guidelines in the prospective trends section of the Form 10-Q for the second quarter of 2007. In response, the managing director of financial reporting wrote back to McMurray, stating that he did not make McMurray's changes because he "**expect[ed] those**

changes to be <u>trumped</u> by certain reviewers." One of those reviewers was Sambol.

81. When McMurray's request that Countrywide disclose its widened underwriting guidelines was not included in the draft filing, he sent a "qualified" certification to the company's Sarbanes-Oxley officer, along with an email articulating his concerns. That email was forwarded to the deputy CFO, who then spoke with McMurray about his concerns. She took his suggestions to Sieracki and Sambol, who directed her not to include them in the Form 10-Q.

82. Despite McMurray's repeated requests, Countrywide never made any disclosures in its Forms 10-Q or 10-K for 2005, 2006, or 2007 about the unprecedented expansion of its underwriting guidelines.

I. <u>Mozilo, Sambol, and Sieracki Made Affirmative Misrepresentations to Investors</u>

83. As set forth in detail above, Mozilo, Sambol, and Sieracki were all aware that Countrywide had increasingly widened its underwriting guidelines year after year from 2004 through 2006, and that Countrywide Bank's held for investment portfolio included loans that were underwritten based on reduced documentation, with loan to value ratios above 95%, and with subprime FICO scores. Despite that knowledge, Mozilo, Sambol, and Sieracki failed to include these material facts in Countrywide's Forms 10-K and 10-Q for 2005, 2006, and 2007. Indeed, Mozilo, Sieracki, and Sambol each made public statements from 2005 through 2007 that were intended to mislead investors about the increasingly aggressive underwriting at Countrywide and the financial consequences of those widened underwriting guidelines.

1. <u>Misrepresentations in Countrywide's Periodic Reports</u>

84. From 2005 through 2007, all of the proposed defendants participated in preparing Countrywide's periodic reports. These documents contained misrepresentations as follows:

85. First, Countrywide's Forms 10-K for 2005, 2006, and 2007 stated that Countrywide "manage[d] credit risk through credit policy, underwriting, quality control and surveillance activities" and touted the Company's "proprietary underwriting systems . . . that improve the consistency of underwriting standards, assess collateral adequacy and help to prevent fraud." These statements were false, because defendants knew that a significant portion of Countrywide's loans were being made as exceptions to Countrywide's already extremely broad underwriting guidelines.

86. Second, Countrywide stated in its 2005 Form 10-K: "We ensure our ongoing access to the secondary mortgage market by consistently producing quality mortgages. . . . We make significant investments in personnel and technology to ensure the quality of our mortgage loan production." A virtually identical representation appears in Countrywide's 2006 Form 10-K. These statements were false, because, as set forth in detail above, Mozilo, Sambol, and Sieracki were aware that Countrywide was originating increasing percentages of poor quality loans that did not comply with Countrywide's underwriting guidelines.

87. Third, the descriptions of "prime non-conforming" and "subprime" loans in Countrywide's Forms 10-K were misleading because they failed to disclose what types of loans were included in those categories. The definition of "prime" loans in Countrywide's 2005, 2006, and 2007 Forms 10-K was:

> Prime Mortgage Loans include conventional mortgage loans, loans insured by the Federal Housing Administration ("FHA") and loans guaranteed by the Veterans Administration ("VA"). A significant portion of the conventional loans we produce qualify for inclusion in guaranteed mortgage securities backed by Fannie Mae or Freddie Mac ("conforming loans"). Some of the conventional loans we produce either have an original loan

amount in excess of the Fannie Mae and Freddie Mac loan limit for single-family loans ($417,000 for 2006) or otherwise do not meet Fannie Mae or Freddie Mac guidelines. Loans that do not meet Fannie Mae or Freddie Mac guidelines are referred to as "nonconforming loans.

88. Nothing in that definition informed investors that Countrywide included in its prime category loans with FICO scores below 620. Nor did the definition inform investors that the "prime non-conforming" category included loan products with increasing amounts of credit risk, such as (1) reduced and/or no documentation loans; (2) stated income loans; or (3) loans with loan to value or combined loan to value ratios of 95% and higher. Finally, it did not disclose that Countrywide's riskiest loan product, the Pay-Option ARM, was classified as a "prime loan," and to the extent that the loan amount was below the loan limits established by the GSEs, would have been reported in Countrywide's Forms 10-K as a prime conforming loan. Significantly, in 2005 and 2006, Countrywide's Pay-Option ARMs ranged between 17% and 21% of its total loan originations, the majority of which were held for investment at Countrywide Bank.

89. Fourth, the Countrywide periodic filings noted that Countrywide originated "non-prime" loans, but failed to disclose that these loans were not merely issued to borrowers with blemished credit, but also included significant additional risk factors, such as (1) subprime piggyback seconds, also known as 80/20 loans; (2) reduced documentation loans; (3) stated income loans; (4) loans with loan to value or combined loan to value ratios of 95% and higher; or (5) loans made to borrowers with recent bankruptcies and late mortgage payments.

90. Finally, Countrywide's 2006 Form 10-K contained the misrepresentation that "[w]e believe we have prudently underwritten" Pay-Option ARM loans -- despite Mozilo's resounding internal alarms regarding these loans

and his and Sambol's knowledge that a significant percentage of borrowers were misstating their incomes on stated income loans.

2. Mozilo and Sambol Made Additional Affirmative Misstatements to Investors

91. Mozilo and Sambol made affirmative misleading public statements in addition to those in the periodic filings that were designed to falsely reassure investors about the nature and quality of Countrywide's underwriting.

92. Mozilo repeatedly emphasized Countrywide's underwriting quality in public statements from 2005 through 2007. For example, in an April 26, 2005 earnings call, Mozilo falsely stated that Countrywide's Pay-Option portfolio at the bank was "all high FICO." In that same call, in response to a question about whether the company had changed its underwriting practices, Mozilo stated, "We don't see any change in our protocol relative to the quality of loans that we're originating."

93. In the July 26, 2005 earnings call, Mozilo claimed that he was "not aware of any change of substance in [Countrywide's] underwriting policies" and that Countrywide had not "taken any steps to reduce the quality of its underwriting regimen." In that same call, Mozilo touted the high quality of Countrywide's Pay-Option ARM loans by stating that "[t]his product has a FICO score exceeding 700. . . . the people that Countrywide is accepting under this program . . . are of much higher quality. . . that [sic] you may be seeing . . . for some other lender." On January 31, 2006, Mozilo stated in an earnings call "It is important to note that [Countrywide's] loan quality remains extremely high."

94. On April 27, 2006, Mozilo stated in an earnings call that Countrywide's "pay option loan quality remains extremely high" and that Countrywide's "origination activities [we]re such that, the consumer is underwritten at the fully adjusted rate of the mortgage and is capable of making a higher payment, should that be required, when they reach their reset period."

These statements were false when made, because on April 4, 2006, Mozilo wrote of the bank's pay-option portfolio, "[s]ince over 70% [of borrowers] have opted to make the lower payment it appears that **it is just a matter of time that we will be faced with much higher resets and therefore much higher delinquencies.**"

95. Then, on May 31, 2006, at the Sanford C. Bernstein Strategic Decisions Conference, Mozilo addressed investors and analysts and made additional false statements that directly contradicted the statements he was making internally within Countrywide. Specifically addressing Pay-Option loans, Mozilo told the audience that despite recent scrutiny of Pay-Option loans, "Countrywide views the product as a sound investment for our Bank and a sound financial management tool for consumers." At the May 31 conference, Mozilo added that the "performance profile of this product is well-understood because of its 20-year history, which includes 'stress tests' in difficult environments."

96. Mozilo's statements at the Sanford Bernstein Conference were false, because at the time that he made them he had just written to Sambol and Sieracki in a May 19, 2006 email that **Pay-Option loans would continue to present a long-term problem "unless rates are reduced dramatically from this level and there are no indications, absent another terrorist attack, that this will happen.**" Moreover, on June 1, 2006, Mozilo advised Sambol in an email that he knew that the Pay-Option portfolio was largely underwritten on a reduced documentation basis, and believed there was evidence that borrowers were lying about their income in the application process. Mozilo concluded: (1) in an environment of rising interest rates, borrowers would reach the 115% negative amortization cap sooner than they expected; (2) **borrowers would suffer payment shock because of the substantially higher payments upon reset, particularly those with FICO scores below 700 who "are going to experience a payment shock which is going to be difficult if not impossible for them to manage"; and (3) "we know or can reliably predict what's going to happen in the next couple**

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of years" so the company must act quickly to address these issues. In addition, Mozilo failed to disclose that by the time he made the statement about the 20-year history of pay-options, the history that he was referring to, that of World Savings, no longer provided him any comfort about the future performance of the portfolio.

97. At a Fixed Income Investor Forum on September 13, 2006, Mozilo upheld Countrywide as a "role model to others in terms of responsible lending." He went on to remark that "[t]o help protect our bond holder customers, we engage in prudent underwriting guidelines" with respect to Pay-Option loans. These statements were false when made because:

- On July 10, 2006, after reviewing data on an internal flash report, Mozilo learned that, from September 2005 through June 2006, the percentage of Pay-Option borrowers choosing to make the minimum payment had nearly doubled, from 37% to 71%. This was the key metric by which Mozilo measured the performance of the Pay-Option portfolio;

- On August 16, 2006 Mozilo received an e-mail asking whether the company anticipated any significant problems with the Pay-Option portfolio. Mozilo responded that rising interest rates would cause the loans to reset much faster than the borrowers expected with accompanying payment shock. The only solution, Mozilo wrote, was to refinance the loans before reset, but this would be difficult, in light of decreasing home values and rising interest rates. Only unlikely events, such as a dramatic rise in home values or a dramatic drop in interest rates, would alleviate future payment shock; and

- On September 26, 2006 Mozilo advised Sambol and Sieracki in an email that "[w]e have no way, with any reasonable certainty, to assess the real risk of holding [Pay-Option] loans on our balance sheet. The only history we can look to is that of World Savings however their portfolio was fundamentally different than ours in that their focus was equity and our focus is fico. In my judgement, [sic] as a long time lender, I would always trade off fico for equity. The bottom line is that **we are flying blind** on how these loans will perform in a stressed environment of higher unemployment, reduced values and slowing home sales." (emphasis added)

98. In the January 30, 2007 earnings conference call, Mozilo attempted to distinguish Countrywide from other lenders by stating "we backed away from the subprime area because of our concern over credit quality." On March 13, 2007, in an interview with Maria Bartiromo on CNBC, Mozilo said that it would be a "mistake" to compare monoline subprime lenders to Countrywide. He then went on to state that the subprime market disruption in the first quarter of 2007 would "be great for Countrywide at the end of the day because all of the irrational competitors will be gone."

99. Sambol also made misleading statements that were designed to reassure investors. For example, at a May 24, 2005 investor day presentation, Sambol reassured analysts that Countrywide addressed the higher credit risk associated with adjustable rate mortgage programs by requiring different underwriting criteria such as "higher credit scores or lower loan to value ratios." At the September 13, 2006 Fixed Income Investor Forum, Sambol downplayed Countrywide's participation in originating subprime loans by falsely stating that Countrywide had been "on the sidelines" of the risky subprime market.

100. The statements in Countrywide's periodic filings and statements by its chief executives were materially false when made, because Mozilo and Sambol were well aware that Countrywide had increasingly widened its underwriting guidelines year over year from 2004 through 2006, and Countrywide's loan quality had deteriorated as a result.

J. <u>Countrywide's Collapse</u>

101. In the first quarter of 2007, subprime 80/20s experienced high levels of defaults and delinquencies, which caused severe disruptions in the secondary market for subprime loans. On January 31, 2007, two members of Countrywide's Risk Management participated in the annual meeting of the American Securitization Forum ("ASF"), which was attended by sophisticated investors who purchased mortgage backed securities in the secondary market. They reported

back in a February 2, 2007 email, which was forwarded to Sambol, and noted that, "[t]he obvious big topic of concern was 2006 vintage performance, both prime and nonprime. **All recognize that 80/20's (and the layered risk on top of them) are definitely the main culprit** and are concerned that the rating agencies sized it wrong. All want to know when we are pulling back guidelines…and why we haven't already." (emphasis added.) They went on to note that, **"[i]nvestors believed that 100% financing and layered risk is the driver."** (emphasis added.)

102. One of the Countrywide employees attending the conference observed that higher than expected losses on 80/20 loans caused investors to fear increasingly high losses and the possibility that their investments, which, in many cases, had received AAA ratings, would be downgraded. The secondary market for 80/20 loans essentially evaporated after the conference. In 2007, as a result of the increasingly risky loans that it had been underwriting, Countrywide began to report extensive credit problems. In May 2007, Countrywide disclosed in its Form 10-Q for the first quarter of 2007 that its consolidated net earnings for the quarter were $434 million, a 37% **decrease** from net earnings in the first quarter of 2006. Countrywide indicated that its first quarter results had been negatively impacted by higher delinquencies related to its subprime lending, which had caused the company to (1) take a write down of $217.8 million due to its inability to sell certain of its subprime loans into the secondary market; (2) reduce the estimated value of its retained servicing rights by $429.6 million; and (3) increase its allowance for loan losses on loans held for investment by $95.9 million.

103. Then, on August 9, 2007, Countrywide disclosed in its Form 10-Q for the second quarter of 2007 that its consolidated net earnings for the quarter were $485 million, a 33% net decrease from the second quarter of 2006. Countrywide attributed the decline to credit-related costs, specifically, a $417.2 million impairment loss on its retained interests, including $388.1 million related to home

equity loans, and a $231 million increase in its allowance for loan losses. On July 24, 2007, in the earnings release teleconference, Countrywide disclosed for the first time that its definition of "prime" loans included loans made to borrowers with FICO scores as low as 500, and that 80% of its portfolio of Pay-Option loans held for investment were underwritten based upon reduced documentation. After the disclosures regarding its credit risk on July 24, 2007, Countrywide's share price dropped from the previous day's close of $34.06 to $30.50 on July 24, an 11% decline.

104. Concurrent with its rising credit losses, Countrywide experienced a liquidity crisis in August 2007. Revenues from Countrywide's capital markets loan sales and securitizations had dropped from $553.5 million in pre-tax earnings in 2006 to $14.9 million in 2007, and Countrywide found itself unable to access the short term credit markets by issuing commercial paper. As a result, on August 16, 2007, Countrywide announced that it had drawn down its entire $11.5 billion credit facility to supplement its cash position. Following that announcement, the ratings agencies downgraded Countrywide's securities, and Countrywide's stock declined from $21.29 per share to $18.95, another approximately 11% decline.

105. On August 23, 2007, Countrywide announced that Bank of America had invested $2 billion in Countrywide in exchange for non-voting preferred securities.

106. On October 26, 2007, Countrywide reported a quarterly loss of $1.2 billion. The company's Form 10-Q, filed on November 9, 2007, disclosed that Countrywide had taken a $1 billion impairment loss on its loans held for sale and mortgage backed securities, and had taken $1.9 billion in credit charges related to its allowance for loan losses and its provision for representations and warranties on loans it had securitized and sold. In the October earnings call, Mozilo nevertheless assured investors that the company would return to profitability in the fourth quarter of 2007 - a representation that caused Countrywide's share price to rise from its

previous day's close of $13.07 to $17.30 after the call, despite its poor performance in that quarter.

107. Thereafter, Countrywide's share price continued to trend downward, driven in part by bankruptcy rumors, until it closed at $8.94 on December 31, 2007. Then, on January 8, 2008, Countrywide's shares dropped 28%, from $7.64 to $5.47, again on rumors that the company intended to file for bankruptcy. On January 11, 2008, prior to reporting its year-end 2007 results, Countrywide announced that it was being acquired by Bank of America in an all stock transaction estimated to have an approximate value of $4 billion.

108. On March 29, 2008, in its Form 10-K for the year ended December 31, 2007, Countrywide disclosed that the contraction of the secondary market for its loans had increased its financing needs because it was required to hold loans for longer periods pending sale and certain loans had become unmarketable and had to be held for investment. In response to these funding needs, Countrywide disclosed that it had: (1) speeded integration of mortgage banking activities into Countrywide Bank to reduce its dependency on the secondary markets; (2) taken a $2 billion infusion from Bank of America in exchange for shares of preferred stock; (3) drawn down an $11.5 billion credit line to maintain liquidity; and (4) revised its product offerings and underwriting guidelines, such that the majority of its loan production was again eligible for sale to the government sponsored entities.

K. <u>Stock Sales of Mozilo and Sambol</u>

109. Both Mozilo and Sambol realized profits on sales of Countrywide stock in 2005, 2006, and 2007, through stock sales pursuant to various 10b5-1 plans. From May 9, 2005, when the Form 10-Q for the first quarter of 2005 was filed, through the end of 2007, Mozilo exercised stock options and sold the underlying shares for total proceeds of at least $260 million, and Sambol exercised stock options and sold the underlying shares for total proceeds of at least $40 million.

L. Mozilo, Sambol, and Sieracki Participated in Several Offerings of Countrywide Securities While the Misleading Periodic Reports Were Outstanding

110. On February 9, 2006, Countrywide filed a registration statement on Form S-3ASR that registered a then indeterminate amount of common stock, preferred stock, stock purchase contracts, stock purchase units, and debt securities of Countrywide. Thereafter, Countrywide filed 180 prospectus supplements identifying the securities it was offering for sale, including a Post-Effective Amendment to that Form S-3ASR dated October 30, 2006. On November 16, 2007, Countrywide filed a registration statement on Form S-3ASR that registered $2 billion worth of Series A Floating Rate Convertible Senior Debentures and $2 billion worth of Series B Floating Rate Convertible Senior Debentures. Sieracki, Sambol and Mozilo signed all of these offerings, each of which incorporated one of the false Form 10-Ks by reference.

M. Insider Trading By Mozilo

111. Mozilo also engaged in insider trading in Countrywide securities. Mozilo established four sales plans pursuant to Rule 10b5-1 of the Exchange Act in October, November, and December 2006 while in possession of material, non-public information concerning the operations and financial condition of Countrywide.

C. Countrywide's Insider Trading Policy

112. During the relevant period, Countrywide had an insider trading policy in effect, dated as of June 24, 2005, which prohibited trading in Countrywide securities on the basis of material non-public information. The policy included a section entitled "Material Information" that stated:

> 3.2 Material Information
>
> U.S. federal securities laws prohibit transactions while aware of material nonpublic information. "Material" information means information relating to the

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> company with publicly traded securities, which, if publicly disseminated, would likely affect the market price of any of its securities, or which would likely be considered important by a reasonable investor in determining whether to buy, sell, or hold such securities.

In addition, the policy included a section regarding 10b5-1 sales plans that stated:

> 4.3 <u>10b5-1 Trading Arrangements</u>
>
> A. Section 10b5-1 of the Exchange Act creates an exception to the prohibition against trading while in the possession of material nonpublic information. In order to take advantage of the exception set forth in Section 10b5-1 of the Exchange Act, Directors and Executives Officers must enter into a 10b5-1 Trading Plan; provided that such Trading Plan:
>
> i. specifies the amount of shares to be purchased or sold and the price at which and the date on which the shares are to be purchased or sold; <u>or</u>
>
> ii. includes a written formula or algorithm, or computer program, for determining the amount of shares to be purchased or sold and the price at which and the date on which the shares are to be purchased or sold; <u>or</u>
>
> iii. does not permit the individual to exercise any subsequent influence over how, when or whether to effect purchases or sales; provided, in addition, that any other person who, pursuant to the contract, instruction, or plan, did exercise such influence must not be aware of the material nonpublic information when doing so; <u>and</u>
>
> iv. was acknowledged by Countrywide in writing and pre-cleared by the Office of the Chief Legal Officer.

113. Mozilo knew about and understood the Countrywide insider trading policy. In addition, prior to the execution of each 10b5-1 sales plan, Countrywide's legal department was required to review and approve the sales plan

and Mozilo was required to orally represent to Countrywide's general counsel that he was not in possession of material non-public information.

2. Mozilo Established His 2006 10b5-1 Sales Plans While In Possession of Material, Nonpublic Information

114. As set forth in section E. above, in 2006, Mozilo possessed material non-public information regarding the characteristics and performance of Pay-Option ARM loans as well as increasing credit risks associated with this product. None of this information was disclosed to the public prior to the establishment of Mozilo's sales plans in October, November, and December 2006.

115. As set forth in section F. above, in 2006, Mozilo learned of red flags concerning Countrywide's expanded underwriting guidelines and concluded that certain of Countrywide's mortgage loans would have a future detrimental financial impact on the company. In response to this information, beginning in early 2006, Mozilo raised his concerns with other members of senior management and instructed them to take action to mitigate risks associated with lower quality loans.

116. While in possession of this material, non-public information, Mozilo established four different Rule 10b5-1 plans.

117. On October 27, 2006, Mozilo established a sales plan that directed his broker to exercise 3,989,588 stock options and sell the underlying shares on specific days set forth in the plan beginning on November 1, 2006 and ending no later than October 5, 2007 (the "October 2006 Plan").

118. Mozilo gave final approval to create the October 2006 Plan during a meeting with his financial advisor on September 25, 2006, one day before sending an e-mail to Sambol and Sieracki, as described in paragraphs 68 and 69 above, that stated among other things, that "**we are flying blind on how these loans will perform in a stressed environment of higher unemployment, reduced values and slowing home sales.**" (emphasis added).

119. Also on October 27, 2006, Mozilo established a sales plan in the name of the Mozilo Family Foundation, a charitable organization that he chaired, that directed the broker to sell 91,999 shares of Countrywide stock held by the Foundation: 23,000 shares to be sold on November 1, 6, and 16, 2006 and 22,999 shares to be sold on November 21, 2006 (the "Foundation Plan").

120. On November 13, 2006, Mozilo established a sales plan for the Mozilo Living Trust, a revocable trust created for the benefit of his family, that directed the broker to sell 100,000 shares of Countrywide stock in lots of 25,000 shares on November 16, 21, 29, and December 4, 2006 (the "Trust Plan").

121. On December 12, 2006, Mozilo established a sales plan that directed his broker to exercise 1,389,580 stock options and sell the underlying shares on specific days set forth in the plan beginning on January 5, 2007 and ending no later than December 14, 2007 (the "December 2006 Plan").

122. Mozilo executed the December 2006 Sales Plan five days after he circulated a memorandum, described in paragraph 52 above, to all managing directors and the board of directors that analyzed subprime mortgages.

123. On February 2, 2007, Mozilo amended the December 2006 Plan ("February Amendment") by directing the exercise of an additional 2,467,777 stock options and selling the underlying shares on the schedule already set forth in the December 2006 Plan.

124. From November 2006 through October 2007, Mozilo exercised over five million stock options and sold the underlying shares pursuant to the four sales plans, realizing gains of over $139 million.

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FIRST CLAIM FOR RELIEF

FRAUD IN THE OFFER OR SALE OF SECURITIES

Violations of Section 17(a) of the Securities Act

(Against All Defendants)

125. The Commission realleges and incorporates by reference ¶¶ 1 through 124 above.

126. Defendants, and each of them, by engaging in the conduct described above, directly or indirectly, in the offer or sale of securities by the use of means or instruments of transportation or communication in interstate commerce or by the use of the mails:

a. with scienter, employed devices, schemes, or artifices to defraud;

b. obtained money or property by means of untrue statements of a material fact or by omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or

c. engaged in transactions, practices, or courses of business which operated or would operate as a fraud or deceit upon the purchaser.

127. By engaging in the conduct described above, Defendants violated, and unless restrained and enjoined will continue to violate, Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a).

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SECOND CLAIM FOR RELIEF

FRAUD IN CONNECTION WITH THE PURCHASE OR SALE OF SECURITIES

Violations and Aiding and Abetting Violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder

(Against All Defendants)

128. The Commission realleges and incorporates by reference ¶¶ 1 through 124 above.

129. Defendants, and each of them, by engaging in the conduct described above, directly or indirectly, in connection with the purchase or sale of a security, by the use of means or instrumentalities of interstate commerce, of the mails, or of the facilities of a national securities exchange, with scienter:

a. employed devices, schemes, or artifices to defraud;

b. made untrue statements of a material fact or omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

c. engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon other persons.

130. By engaging in the conduct described above, Defendants violated, and unless restrained and enjoined will continue to violate, Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5.

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THIRD CLAIM FOR RELIEF

VIOLATIONS OF COMMISSION PERIODIC REPORTING REQUIREMENTS

Aiding and Abetting Violations of Section 13(a) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13 thereunder

(Against All Defendants)

131. The Commission realleges and incorporates by reference ¶¶ 1 through 124 above.

132. Countrywide violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder, by filing with the Commission annual reports on Form 10-K for fiscal years 2005, 2006, and 2007 and quarterly reports on Form 10-Q for each quarter in 2005, 2006, and 2007 that were materially false and failed to include material information necessary to make the required statements, in light of the circumstances under which they were made, not misleading.

133. Mozilo, Sambol, and Sieracki knowingly provided substantial assistance to Countrywide in its violation of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder in connection with Countrywide's annual reports for fiscal years 2005, 2006, and 2007 and its quarterly reports for each quarter in 2005, 2006, and 2007.

134. By engaging in the conduct described above and pursuant to Section 20(e) of the Exchange Act, 15 U.S.C. § 78t(e), Mozilo, Sambol, and Sieracki aided and abetted Countrywide's violations, and unless restrained and enjoined will continue to aid and abet violations, of Section 13(a) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13 thereunder.

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FOURTH CLAIM FOR RELIEF

CERTIFICATION VIOLATIONS

Violations of Rule 13a-14 of the Exchange Act

(Against Defendants Mozilo and Sieracki)

135. The Commission realleges and incorporates by reference ¶¶ 1 through 124 above.

136. Mozilo and Sieracki violated Rule 13a-14 by signing the certifications included with Countrywide fiscal year 2005, 2006, and 2007 Forms 10-K, certifying, among other things, that the forms fully complied with the requirements of the Exchange Act and fairly presented, in all material respects, the financial condition and results of operations of the company, when, in fact, the reports contained untrue statements of material fact and omitted material information necessary to make the reports not misleading.

137. By engaging in the conduct described above, defendants Mozilo and Sieracki violated Exchange Act Rule 13a-14, 17 C.F.R. § 240.13a-14. Unless restrained and enjoined, defendants Mozilo and Sieracki will continue to violate Rule 13a-14, 17 C.F.R. § 240.13a-14.

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that the Court:

I.

Issue findings of fact and conclusions of law that the defendants committed the alleged violations.

II.

Issue judgments, in a form consistent with Fed. R. Civ. P. 65(d), permanently enjoining Defendant Mozilo and his agents, servants, employees, attorneys, and those persons in active concert or participation with any of them, who receive actual notice of the order by personal service or otherwise, from violating Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rules 10b-5 and 13a-14 thereunder, and from aiding and abetting violations of Section 13(a) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13 thereunder.

III.

Issue judgments, in a form consistent with Fed. R. Civ. P. 65(d), permanently enjoining Defendant Sambol and his agents, servants, employees, attorneys, and those persons in active concert or participation with any of them, who receive actual notice of the order by personal service or otherwise, from violating Section 17(a) of the Securities Act, and Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and from aiding and abetting violations of Section 13(a) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13 thereunder.

IV.

Issue judgments, in a form consistent with Fed. R. Civ. P. 65(d), permanently enjoining Defendant Sieracki and his agents, servants, employees, attorneys, and those persons in active concert or participation with any of them, who receive actual notice of the order by personal service or otherwise, from violating Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rules 10b-5 and 13a-14 thereunder, and from aiding and abetting violations of Section 13(a) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13 thereunder.

V.

Enter an order, pursuant to Section 21(d)(2) of the Exchange Act, 15 U.S.C. § 78u(d)(2), prohibiting defendants Mozilo, Sambol, and Sieracki from acting as officers or directors of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act, 15 U.S.C. § 78l, or that is required to file reports pursuant to Section 15(d) of the Exchange Act, 15 U.S.C. § 78o(d).

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VI.

Order defendants Mozilo and Sambol to disgorge all ill-gotten gains from their illegal conduct, together with prejudgment interest thereon.

VII.

Order defendants Mozilo, Sambol, and Sieracki to pay civil penalties under Section 21(d)(3) of the Exchange Act, 15 U.S.C. § 78u(d)(3).

VIII.

Order defendant Mozilo to pay a civil penalty under Section 21A(a) of the Exchange Act, 15 U.S.C. § 78u-1(a).

IX.

Retain jurisdiction of this action in accordance with the principles of equity and the Federal Rules of Civil Procedure in order to implement and carry out the terms of all orders and decrees that may be entered, or to entertain any suitable application or motion for additional relief within the jurisdiction of this Court.

X.

Grant such other and further relief as this Court may determine to be just and necessary.

DATED: June 4, 2009

Lynn M. Dean

JOHN M. McCOY, III
SPENCER E. BENDELL
LYNN M. DEAN
SAM PUATHASNANON
PARIS WYNN
Attorneys for Plaintiff
Securities and Exchange Commission

DEMAND FOR JURY TRIAL

Plaintiff hereby demands trial by jury.

DATED: June 4, 2009

Lynn M. Dean

JOHN M. McCOY, III
SPENCER E. BENDELL
LYNN M. DEAN
SAM PUATHASNANON
PARIS WYNN
Attorneys for Plaintiff
Securities and Exchange Commission

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

September 17, 2010

Honorable Carl Levin
Chairman
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Enclosed please find a signed copy of a revised and much-strengthened memorandum of understanding among the FDIC and other bank regulators which will greatly enhance our ability to continually access and monitor information related to our risks as deposit insurer. I believe this is a very strong agreement and one which we accomplished due in no small part to the work of your Subcommittee in identifying weaknesses in the supervisory processes leading up to the failure of Washington Mutual. I appreciate and applaud your leadership and support for a strengthened MOU.

Best Regards,

Sheila

Sheila C. Bair

Board of Governors of the Federal Reserve System | Federal Deposit Insurance Corporation | Office of the Comptroller of the Currency | Office of Thrift Supervision

Interagency Memorandum of Understanding on Special Examinations

This Memorandum of Understanding ("MOU"), dated as of July 14, 2010, is made and entered into by and among The Federal Deposit Insurance Corporation ("FDIC" or the "Corporation"), the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("FRB"), and the Office of Thrift Supervision ("OTS") (the OCC, FRB and OTS collectively, the "Agencies;" and separately, the "PFR") This MOU concerns the implementation of Section 10(b)(3) of the Federal Deposit Insurance Act that provides that examiners appointed by the Board of Directors of the Corporation "shall have power, on behalf of the Corporation, to make any special examination of any insured depository institution whenever the Board of Directors determines a special examination of any such depository institution is necessary to determine the condition of such depository institution for insurance purposes."

I. Objectives

The Objectives of this MOU are to:

(1) Facilitate the FDIC's implementation of its special examination authority under Section 10(b)(3) of the Federal Deposit Insurance Act ("FDI Act");

(2) Establish arrangements for coordination and cooperation between the Agencies and the FDIC, consistent with the respective authorities of each.

(3) Avoid unnecessary duplication of effort; and

(4) Facilitate the ability of the FDIC and each of the Agencies to effectively and efficiently carry out their respective responsibilities.

II. IDI Coverage

Under this MOU, Special Examinations may be made by the FDIC with respect to the insured depository institutions ("IDIs") defined in this Part II of this MOU ("Covered IDIs"):

(1) IDIs with composite PFR ratings of "3", "4" or "5", and IDIs that are undercapitalized under Prompt Corrective Action standards ("Problem IDIs").

(2) IDIs that have a heightened risk to the Deposit Insurance Funds defined as follows: (a) CAMELS 1- or 2-rated institutions that fall under FDIC's large bank deposit insurance pricing method if their initial assessment rate ("IAR") is in the top 66 percent of the IAR range;[1] and (b) small institutions that are CAMELS 2-rated and the FDIC's Statistical CAMELS off-site Rating ("SCOR") indicates their probability of downgrade is 50 percent or greater or their rank according to the FDIC's Growth Monitoring System ("GMS") is in the 98 percentile. ("Heightened Insurance Risk IDIs"). For the purposes of this section II(2), "Large Institutions" are IDIs with assets of $10 billion or more, and "Small Institutions" are IDIs with assets of less than $10 billion. The FDIC will provide the PFR access to SCOR and GMS.[2]

(3) Large, complex IDIs, consisting of (a) mandatory Basel II "Advanced Approach" institutions as may be determined from time to time, and (b) IDI subsidiaries of any non-bank financial company or large interconnected bank holding company that are subject to heightened prudential standards recommended by the Council under Section 115(a)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 as may be agreed upon from time to time by the FDIC and the relevant PFR.("Large IDIs").

(4) IDIs that are affiliated with entities that have had greater than $5 billion of borrowings under the FDIC TLGP program ("TLGP-IDIs").

III. Guidelines for the Conduct of Special Examinations

(1) In making Special Examinations, the FDIC's focus will be on gathering and evaluating information obtained by the FDIC from the Agencies, State banking regulators, IDIs, and other sources that is necessary for insurance purposes, namely information to determine the risk that is presented to the Deposit Insurance Fund (DIF), price deposit insurance, assess the probability of default, estimate any potential loss to the DIF, develop contingent resolution plans, and such other matters that are necessary for deposit insurance purposes.

(2) In making Special Examinations, the FDIC shall use the reports of examination made by the PFR and any appropriate State regulator, other information available from the PFR and State regulator, and information provided by other Federal or State agencies to the fullest extent possible, without limiting the authority of the FDIC referenced in section III(4) to make Special Examinations of IDIs both covered and uncovered by this MOU. The FDIC will notify the PFR before the FDIC obtains any information directly

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[1] The IAR range contemplated under this MOU is 10 basis points to 50 basis points. Under this formula an IDI is a Covered IDI for two calendar quarters following the last calendar quarter in which the IDI was a Covered IDI as determined under section II(2)(a) above. Should the FDIC modify the IAR range in the future the Agencies and FDIC will jointly confirm that the top percentage of the IAR range stated in section II(2) remains appropriate.

[2] The FDIC will provided advanced notice of any modifications of the SCOR and GMS models affecting the thresholds in section II(3) and confirm that the thresholds remain appropriate.

from an IDI, explaining why additional information beyond what is currently available from the PFR is needed.

(3) At Large IDIs and TLGP-IDIs, the FDIC will establish a continuous on-site full-time Staff presence with the number of staffers depending on the size of the IDIs. To meet its staffing needs, it is the intention of the FDIC to assign up to no more than (a) five full-time on-site staffers at IDIs with U.S holding companies that have total assets of $750 billion or more, and (b) three full time on-site staffers for Large, Complex IDIs with U.S. holding companies that have total assets of less than $750 billion. Additional full-time on-site staffing shall be subject to mutual agreement between the FDIC and the PFR. The FDIC also may determine, based on particular events or specific circumstances, that required information is not available from the PFR, and that it is necessary to be on-site to gather such information, and that additional staff is temporarily needed on-site in order to obtain such information.

(4) The Agencies recognize that the FDIC Board of Directors has the authority under Section 10(b)(3) of the FDI Act to direct the making of Special Examinations in situations covered and not covered by this MOU.

IV. Coordination and Information Sharing

(1) FDIC will, to the fullest extent possible, without limiting the authority of the FDIC referenced in section III(4) to make Special Examinations of IDIs both covered and uncovered by this MOU, conduct special examinations of any covered IDI in accordance with this MOU, provide the PFR with reasonable prior notice of any proposed Special Examination activities, coordinate its work with the relevant PFR, and avoid unnecessary duplication of activities. The FDIC will notify the relevant PFR prior to conducting a Special Examination under Section 10(b)(3) of the FDI Act of a covered or uncovered IDI outside of the provisions of this MOU explaining the reasons for such a Special Examination. In the case of such a Special Examination, the FDIC and the PFR will use their best efforts to coordinate, cooperate, share and use information in accordance with Section IV of this MOU.

(2) One FDIC on-site examiner will be identified as the point of contact for the PFR. ("FDIC Contact")

(3) One PFR on-site examiner will be identified as the point of contact for the FDIC. ("PFR Contact")

(4) The FDIC will inform the PFR Contact on an on-going basis of the FDIC's special examination planning and scoping activities, as well as any significant changes thereto, and will provide reasonable prior notice to the PFR Contact of any unscheduled special examinations of the IDI and of meetings with the Board of Directors and board committees of the IDI. The FDIC Contact and the PFR Contact may also agree on other types of meetings for which notice would be provided. The FDIC will also provide the PFR on an ongoing basis, through the PFR Contact, with access to results of FDIC Special Examinations, including material deposit insurance related issues and risk assessments, and other FDIC Special Examination information prepared by the FDIC.

(5) The PFR will inform the FDIC Contact on an on-going basis of the PFR's examination planning and scoping activities, as well as any significant changes thereto, and will provide reasonable prior notice to the FDIC Contact of any unscheduled special examinations of the IDI and of meetings with the Board of Directors and board committees of the IDI. The PFR Contact and the FDIC Contact may also agree on other types of meetings for which notice would be provided. The PFR will also provide the FDIC on an ongoing basis, through the FDIC Contact, with access to supervisory information prepared by the PFR, including risk assessments, supervisory plans, and reports of examination prepared by the PFR.

(6) The FDIC Contact may request to participate in examinations and meetings with IDI personnel conducted by the PFR. The PFR Contact and FDIC Contact shall consult regarding such requests. In the event the PFR declines the request, the FDIC Contact shall provide reasonable prior notice to the PFR Contact before proceeding separately to conduct any Special Examination activities or meetings.

(7) The PFR Contact may request to participate in examinations and meetings with IDI personnel conducted by the FDIC. The FDIC Contact and the PFR Contact shall consult regarding such requests.

(8) On an on-going basis, no less frequently than quarterly, representatives of the FDIC will meet with appropriate representatives of the PFR to discuss the risk profile, current condition, identified supervisory matters, and material deposit insurance related issues and risk assessments with respect to Covered Institutions. On a quarterly basis, FDIC will share lists of all IDIs meeting the criteria specified in II(1)-II(4), above.

V. CAMELS Rating Differences

Differences in CAMELS ratings between the FDIC and the appropriate PFR will be communicated by the FDIC Contact to the PFR Contact in writing, including an explanation of the basis for the FDIC's position. In the event those officials are unable to resolve the ratings disagreement, the matter shall be referred to the Director of the FDIC Division of Supervision and Consumer Protection (the "Director") (or other officer of the Corporation designated by the Chairman of the FDIC) and the appropriate senior-most supervision official of the PFR for resolution. Any decision by the FDIC to depart from the appropriate PFR's assigned rating will be made by the Director of the FDIC Division of Supervision and Consumer Protection (or other officer of the Corporation designated by the Chairman of the FDIC) after consultation with the Chairman of the FDIC.

Federal Deposit Insurance Corporation

BY: Sheila C Bair

Office of the Comptroller of the Currency

BY: John C Dugan

Board of Governors of the Federal Reserve System

BY: Daniel K Tarullo

Office of Thrift Supervision

BY: John C Bowman

TESTIMONY OF VICKIE A. TILLMAN,
EXECUTIVE VICE PRESIDENT,
STANDARD & POOR'S CREDIT MARKET SERVICES,
BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS,
INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES
UNITED STATES HOUSE OF REPRESENTATIVES

SEPTEMBER 27, 2007

Mr. Chairman, Members of the Subcommittee, good afternoon. I am Vickie A. Tillman, Executive Vice President of Standard & Poor's ("S&P") Credit Market Services, and head of Ratings Services, our nationally recognized statistical rating organization ("NRSRO"). I appreciate the opportunity to appear before you today. I especially appreciate your invitation because I believe it is important to clarify the role of rating agencies such as S&P in the financial markets, the rigor S&P applies in fulfilling that role, and our overall record of delivering unbiased opinions on creditworthiness. To that end, I also welcome the opportunity to address some questions that have been raised about how we have served the market in the midst of unprecedented conditions in the subprime mortgage market and the credit crunch and pressure on the economy that have followed.

I want to assure you at the start of my testimony that we have learned hard lessons from the recent difficulties in the subprime mortgage area. While we fully agree with Secretary Paulson's observation last week that "the subprime mortgage market improved access to credit and homeownership for millions of Americans," it appears that abuses may have occurred in the origination process. We support Congress' efforts to investigate those abuses and to prevent their recurrence. For our part, we are taking steps to ensure that our ratings — and the assumptions that underlie them — are analytically sound in light of shifting circumstances. As I am sure you know, and as my testimony will set forth in some detail, S&P began downgrading some of its ratings in this area towards the end of last year and had warned of deterioration in the subprime sector long before that. Nonetheless, we are fully aware that, for all our reliance on our analysis of historically rooted data that sometimes went as far back as the Great Depression, some of that data has proved no longer to be as useful or reliable as it has historically been. Additionally, the collapse of the housing market itself has been both more severe and more precipitous than we had anticipated. As I will describe in more detail later, we have taken a number of steps in response to enhance our analytics and process and continue to look for ways in which to do still more.

Our reputation and our track record are the core of our business, and when they come into question, we listen and learn. We take our work seriously, very seriously, and at no time in our history more than now, as I speak to you.

In my testimony I would like to address four broad topics:

- First, the nature of S&P's ratings and their role in the capital markets;
- Second, S&P's approach to rating residential mortgage-backed securities ("RMBS"), including mortgage securities backed by subprime mortgage loans;
- Third, a number of the questions that have been raised in the press and elsewhere related to ratings, including:
    - Questions as to whether payment of fees by issuers presents a conflict of interest that could compromise analytical independence;
    - Questions as to whether S&P is somehow involved in "structuring" RMBS and other structured finance transactions;
    - Questions about the appropriateness of our ratings because securities backed by subprime collateral sometimes receive 'AAA' ratings; and
    - Questions about whether S&P has acted too slowly in responding to the deterioration of the subprime mortgage market.

- Fourth, steps we have taken in light of the Credit Rating Agency Reform Act passed by this body in 2006.

Ratings and Their Role In The Capital Markets

I would like to begin today by discussing the nature of our credit ratings, as it appears from numerous press reports that this matter is sometimes misunderstood. At their core, S&P's credit ratings represent our opinion of the likelihood that a particular obligor or financial obligation will timely repay owed principal and interest. Put another way, we assess the likelihood, and in some situations the consequences, of default — nothing more or less.

When we issue a rating on a particular security we are expressing our view that the security shares similar credit characteristics to those securities that have, in the past, represented a particular range of credit risk. A bond that we rate as 'BBB' has received the lowest of our so-called "investment grade" ratings; one rated 'BB' has received the highest non-investment grade rating. "Investment grade" securities are those securities that certain regulated investors may legally purchase. On S&P's ratings scale, such securities are those rated at the 'BBB' level or higher. Since we began rating RMBS in the late 1970's, only 1.09% of those securities rated by us 'BBB' have ever defaulted. For 'BBs' this number is 2.11%. Thus, when we rate securities, we are *not* saying that they are "guaranteed" to repay but the opposite: that some of them *will* likely default. Even our highest rating — 'AAA' — is not a guarantee or promise of performance. 'AAAs' do default and have defaulted, although rarely.

Another misconception about ratings relates to their purpose and use. Ratings speak to one topic and one topic only — credit risk. As we have repeatedly made clear in public statements, including statements to the SEC, testimony before Congress, and innumerable press releases, ratings do *not* speak to the likely market performance of a security. Thus, ratings clearly do not address:

- Whether investors should "buy", "sell" or "hold" rated securities;
- Whether any particular rated securities are suitable investments for a particular investor or group of investors;
- Whether the expected return of a particular investment is adequate compensation for the risk;
- Whether a rated security is in line with the investor's risk appetite;
- Whether the price of the security is appropriate or even commensurate with its credit risk; or
- Whether factors other than credit risk should influence that market price, and to what extent.

I want to be clear. Ratings matter; as the individual who oversees S&P's ratings business I would be the last person to suggest to you that they do not. But in the current climate, it is especially important to bear in mind just what it is we do and that other developments also affect market perceptions and behavior. The current credit crunch is very real, but we certainly have not witnessed widespread defaults of mortgage-backed securities. This dynamic and its relationship to the nature of ratings was recently recognized by one of Europe's top regulators, Mr. Eddy Wymeersch, Chairman of the Committee of European Securities Regulators and also Chairman of Belgium's Banking and Financial Commission. According to Mr. Wymeersch:

> "[t]he press and general opinion is saying it's the fault of the credit rating agencies . . . Sorry, the ratings are just about the probability of default. Nothing more. Now we have a liquidity crisis and not a solvency crisis."

Though they may move more slowly than market prices, ratings are not designed to be static. Our view of an RMBS transaction evolves as facts and circumstances develop, often in ways that are difficult to foresee. We issue ratings and, as new information becomes available with the passage of time, we either affirm those ratings — *i.e.*, leave them unchanged — upgrade them, downgrade them, or put them on CreditWatch, which is a warning to the market that the rating is subject to change after a pending review. To make such decisions, we perform surveillance on our ratings. I will discuss our surveillance process in greater detail a little later on, but the three important points here are:

- That we have a team and process in place whose responsibility it is to monitor developments and bring about ratings changes to reflect those developments as appropriate;
- Changes in RMBS ratings are not based on speculation or market sentiment; and
- Such changes are often based upon events which were not predictable.

To cite only a few recent examples on this last point, the level of early payment default trends in recent subprime loans is unprecedented; so is the fact that, while individuals who purchased homes have generally paid their mortgages before paying off their credit cards, that now appears no longer to be true to the extent it once was; so is the reality that, while individuals who live in homes they purchase historically repay the mortgages on these homes more regularly than those who live elsewhere, that long-standing pattern now appears of questionable validity in a striking number of cases. These are ahistorical behavioral modes, ones of particular import at a time of a substantial fall in real estate prices, and ones that, together with other factors, required downgrading some RMBS ratings even though no substantial amount of pool losses have occurred.

I said earlier that we have made repeated statements about the nature and role of ratings. To the extent those efforts have failed to communicate sufficiently clearly about that topic, we view this hearing, and this process overall, as an opportunity to begin to rectify that. We recognize that we bear primary responsibility for getting the message out. We are making, and will continue to make, every effort to do so.

S&P's Rating of Securities Backed By Mortgage Loans, Including Subprime Loans

Our ratings of residential mortgage-backed securities, particularly RMBS backed by pools containing subprime mortgage assets, have recently received a significant amount of attention. S&P has been rating RMBS for thirty years and has developed industry-leading processes and models for evaluating the creditworthiness of these transactions. As a result, S&P has an excellent track record of assessing RMBS credit quality. For example, S&P's cumulative U.S. RMBS default rate by original rating class (through September 15, 2007) is as follows:

Initial Rating	% of Default
AAA	0.04
AA	0.24
A	0.33
BBB	1.09
BB	2.11
B	3.34

Default statistics are the critical measure of ratings analytics because, as I explained earlier, at their core ratings speak to the likelihood of timely repayment, not other market factors, such as supply and demand, that may go into the pricing of securities. Moreover, these default numbers for our RMBS ratings are lower, in some cases materially lower, than the long-term default rates for similar ratings issued on corporate bonds.

While evaluating the credit characteristics of the underlying mortgage pool is part of our RMBS ratings process, S&P does not rate the underlying mortgage loans made to homeowners or evaluate whether making those loans was a good idea in the first place. Originators make loans and verify information provided by borrowers. They also appraise homes and make underwriting decisions. In turn, issuers and arrangers of mortgage-backed securities bundle those loans and perform due diligence. They similarly set transaction structures, identify potential buyers for the securities, and underwrite those securities. For the system to function properly, S&P relies, as it must, on these participants to fulfill their roles and obligations to verify and validate information before they pass it on to others, including S&P. Our role in the process is reaching an opinion as to how much cash we believe the underlying loans are likely to generate towards paying off the securities eventually issued by the pool. That is the relevant issue for assessing the creditworthiness of those securities.

As a practical matter, S&P's analysis of an RMBS transaction breaks down into the following categories:

The LEVELS® Model The first step in our analysis is evaluating the overall creditworthiness of a pool of mortgage loans by conducting loan level analysis using our Loan Evaluation and Estimate of Loss System (LEVELS®) Model. This model is built on, and reflects, our analytical assumptions and criteria. S&P's criteria do not dictate the terms of the mortgage loans; those terms are set by the originator in the underwriting process. S&P collects up to seventy different types of inputs, including, but not limited to: the amount of equity a borrower has in the home; the loan type; the extent of income verification; whether the borrower occupies the home; and the purpose of the loan. This analysis allows us to quantify multiple risk factors, or the layered risk, and allows us to assess the increased default probability that is associated with each factor. Based on the individual loan characteristics, the LEVELS® model calculates probabilities of default and loss realized upon default. The assumptions and analysis embedded in the LEVELS® model are under regular review and are updated as appropriate to reflect our current thinking about rating residential mortgages.

As part of our commitment to transparency, S&P makes its LEVELS® model available to investors who wish to license it. The vast majority of those involved in issuing RMBS have access to LEVELS® and use it regularly. We also publicly announce any changes to our LEVELS® model in a timely manner. In other words, our basic criteria is out there every day, subject to criticism and comment.

<u>The SPIRE® Model</u> Another important aspect of our rating process is assessing the availability of cash flow, which comes from the monthly payments generated by the mortgage loans, to timely pay principal and interest. To do this, we use our Standard & Poor's Interest Rate Evaluator (SPIRE®) Model. The model uses the S&P mortgage default and loss assumptions (generated by the LEVELS® model) as well as interest rate assumptions. Like the LEVELS® model, our SPIRE® model reflects our analysis and assumptions and is regularly reviewed and updated as warranted.

Also like our LEVELS® model, our SPIRE® model is publicly available, used extensively by market participants, and subject to market comment and review every day.

Review of Originator and Servicer Operational Procedures S&P also reviews the practices, polices, and procedures of the originators and servicers primarily to gain comfort with the ongoing orderly performance of the transaction. For an originator, the topics we review include, but are not limited to: loan production practices; loan underwriting; and quality control practices and findings. S&P may adjust its credit support calculation based on the underwriting employed at origination.

Review of Legal Documents S&P also reviews, with the assistance of internal and external counsel, the legal documents of the securities to be issued, and, where appropriate, opinions of third-party counsel that address transfer of the assets and insolvency of the transferor, as well as security interest and other legal or structural issues. S&P reviews the underlying documentation in order to understand the payment and servicing structure of the transaction.

Credit Enhancement Any description of our ratings of RMBS would be incomplete without discussing the critical concept of credit enhancement. Credit enhancement is the protection (*i.e.*, additional assets or funds) needed to cover losses in deteriorating economic conditions, sometimes referred to as "stress". Sufficient credit enhancement allows securities backed by a pool of subprime collateral to receive what might otherwise be considered high ratings. One form of credit enhancement, although there are several, would occur if the pool has more in collateral than it issues in securities, thereby creating a cushion in the pool. We refer to this form of credit enhancement as "overcollaterization," and it is a key component in our ratings analysis. It provides protection against defaults in the underlying securities. That is, if the pool ends up experiencing losses, it should still generate enough cash from which to pay the holders of the securities. I will discuss credit enhancement in more detail later in my testimony.

The Rating Committee After reviewing the relevant information about a transaction, including information related to credit enhancement, the lead analyst then takes the transaction to a rating committee. As with all S&P ratings, structured finance ratings are assigned by committee. Committees are comprised of S&P personnel who bring to bear particular credit experience and/or structured finance expertise relevant to the rating. The qualitative judgments of committee members at all stages of the process are an integral part of the rating process as they provide for consideration of asset and transaction specific factors, as well as changes in the market and environment. Personnel responsible for fee negotiations and other business-related activities are not permitted to vote in ratings committees and vice versa.

Notification and Dissemination Once a rating is determined by the rating committee, S&P notifies the issuer and disseminates the rating to the public for free by, among other ways, posting it on our Web site, www.standardandpoors.com. Along with the rating, we frequently publish a short narrative rationale authored by the lead analyst. The purpose of this rationale is to inform the public of the basis for S&P's analysis and enhance transparency to the marketplace.

Surveillance After a rating has been issued, S&P monitors or "surveils" the rating to review developments that could alter the original rating. The surveillance process seeks to identify those issues that should be reviewed for either an upgrade or a downgrade because of asset pool performance that may differ from original assumptions. The surveillance function also monitors the credit quality of entities that may be supporting parties to the transaction, such as liquidity providers. Analysts review performance data periodically during the course of the transaction, and as appropriate present that analysis to a rating committee for review of whether to take a rating action. The rating committee then decides whether the rating change is warranted. For changes to public ratings, a press release is normally disseminated.

S&P's Commitment to Constant Improvement

While our ratings process is the product of three decades of analytical experience and excellence, we are always looking for ways to enhance that process and our analytics. This is a hallmark S&P principle and is especially true when, as with recent subprime loans, developments indicate that historically-rooted behavioral patterns that have served as solid foundations for analysis may lack their prior value.

By now there is no doubt that subprime loans made from late 2005 through at least early 2007 are behaving very differently from loans in prior periods, even when the loans share the same basic credit characteristics. For example, for years a primary indicator of a borrower's credit has been so-called FICO credit scores. FICO scores are provided by another independent market participant and are an industry standard. In recent loans, we are seeing borrowers with high FICO scores behaving in a manner consistent with how materially lower FICO borrowers have historically behaved. Similarly, as I observed earlier, there are a number of other ahistorical anomalies that make more problematic applying a number of historically-rooted assumptions about the behavior of borrowers. At the same time, these behaviorial shifts appear *not* to be occurring in loans generated in 2004 and most of 2005, which include many of the same type of subprime characteristics present in the more recent loans. We are still gathering data to analyze the causes for these inconsistent market dynamics.

In response to these developments, and as part of our constant commitment to enhancing our analytical processes, S&P has already initiated a number of steps:

- We have significantly heightened the stress levels at which we rate and surveil transactions to account for deteriorating performance as evidenced by data we have received. We have also increased the frequency of our review of rated transactions;
- We are modifying (and will soon be releasing) our LEVELS® model to incorporate these new stress levels and other changes recently made to our ratings assumptions, as announced in our July 10, 2007 press release;
- We recently acquired IMAKE consulting and ABSXchange. These services have long provided data, analytics and modeling software to the structured finance community and we feel they will further enhance our in-depth surveillance process;
- We have also undertaken a survey of originators and their practices, particularly with respect to issues of data integrity. We are in the process of compiling the results of this survey and will publish those results when finalized; and

- We have hired a Chief Compliance Officer to augment our internal control procedures.

In addition to these steps, we continue to look at areas in which we can further enhance our analysis and processes. Some of the areas include:

- Our policies and procedures to protect against conflicts of interest;
- The quantity and quality of data available to us; and
- Modification of our analytics to reflect changing credit behaviors.

S&P's Response To Various Questions

Some have raised questions about ratings and the ratings process in recent months in light of the turmoil in the subprime mortgage market. As I have previously said, we are well aware that certain historically-rooted assumptions we made in determining which RMBS ratings to issue do not, in retrospect, appear to have remained as relevant as they previously have been. Whether that is because of factors unique to the period immediately prior to and after 2006 or whether we must change those assumptions on a long-term basis is a subject of robust and continuing examination and re-examination at S&P.

At the same time, some of the questions recently put to S&P reflect a fundamental misunderstanding of what ratings are or are based on inaccurate or, in some cases, incomplete information. Let me now address those questions.

The "Issuer Pays" Model Does Not Compromise the Independence and Objectivity of Our Ratings

A number of commentators have asked whether payment of fees by issuers and/or their representatives presents a conflict of interest that compromises the independence and objectivity of ratings. Skeptics question whether, in pursuit of fees, S&P and other major rating agencies may give higher ratings than they otherwise would. Not only is this not true at S&P, but this line of questioning ignores the significant benefits of the "issuer pays" model to the market.

S&P currently makes all of its public ratings available to the market free of charge in real time. When a rating is assigned or changed, the announcement is made on our Web sites — www.sandp.com and www.ratingsdirect.com — and a press release is provided to news outlets and other media. Today there are approximately 9 million current and historical ratings available on RatingsDirect. In addition, as many as 1.3 million active ratings are available for free on www.sandp.com. The benefits to the market are obvious: any and all interested market participants can access the same information at the same time. It creates a level playing field and a common basis for analyzing risk. It also leads to higher quality ratings as our analysis is subject to market scrutiny and reaction every day from every corner of the capital markets.

This type of free, public disclosure and transparency is only possible under the "issuer pays" model. Developing and maintaining models and hiring experienced and skilled analytical talent is costly. Without payment by issuers, those costs would have to be covered by subscription fees, an approach with several insurmountable problems. A subscription model would severely limit the transparency and broad (and free) dissemination of ratings, as access would necessarily be expensive and exclusive to subscribers. Not only would this result in less, not more, information in the market, but it would also take away an important check on ratings quality — the constant scrutiny of a broad market. Moreover, because subscription fees would necessarily be significant (given the breadth of our ratings coverage and the depth of our analysis), many investors, including the vast majority of individual investors, simply would not be able to afford access to ratings information. The likely result would be one of two equally harmful outcomes: either (i) these investors would have no meaningful access to ratings information; or (ii) a ratings black market would develop in which S&P's intellectual property — its ratings analysis — would be misused or resold in a manner all too consistent with the pervasive misuse of other intellectual property and with the same destructive impact.

As noted, some have questioned whether the "issuer pays" model has led S&P and others to issue higher, or less rigorously analyzed, ratings so as to garner more business. First and foremost, there is no evidence — none at all — to support this contention with respect to S&P. This is not surprising since it would be clearly against S&P's self-interest as well as its cornerstone principles.

Indeed, what evidence there is on the subject shows the opposite.

1. Consider, for instance, the performance of our RMBS ratings. As reflected in the chart below, in every year from 1994 through 2006, upgrades of U.S. RMBS ratings significantly outpaced downgrades by multiple factors — about 7:1 on average. The ratio was even higher from 2001-2006. That is to say, after S&P initially provided its ratings in this area, actual performance of the rated transactions led to upgrades far more often than downgrades as time passed.

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
% of Ratings Upgraded	6.81	2.54	1.38	2.54	2.20	2.78	10.08	10.21	9.24	12.82	10.74	7.91	3.79
% of Ratings Downgraded	2.21	1.70	1.18	1.25	1.28	0.54	1.93	1.05	0.98	0.85	0.45	0.64	1.04

If, as some claim, S&P deliberately issued high ratings to please those who paid for them, one would expect that the initial (allegedly inflated) ratings would require downward adjustment to reflect actual performance. Similarly, one would expect default rates on our RMBS ratings to be higher — indeed, materially higher — than the statistics I cited earlier. But, over the years, the opposite has emphatically been the case.

2. Similarly, if S&P put revenue ahead of analytical rigor, we would not refuse to rate, as we have, transactions that do not meet our criteria. A recent highly publicized example occurred in Canada where significant amounts of asset-backed commercial paper became illiquid. The paper had not met S&P's minimum criteria and so we did not rate it. These are not the actions of an agency that would rate every deal that reaches our door.

3. The primacy of our reputation has been recognized by independent sources. A report prepared by two Federal Reserve Board economists found "no evidence" that rating agencies acted in the interest of issuers due to a conflict of interest. After detailed study, the report concluded that "rating agencies appear to be relatively responsive to reputation concerns and so protect the interests of investors." *See* Daniel M. Covitz & Paul Harrison, *Testing Conflicts of Interest at Bond Ratings Agencies with Market Anticipation: Evidence that Reputation Incentives Dominate* (Dec. 2003) at

http://www.federalreserve.gov/pubs/feds/2003/200368/200368pap.pdf.

The real question is not whether there are potential conflicts of interest in the "issuer pays" model, but whether they can be effectively managed by S&P and other credit rating agencies. Mr. Erik Sirri, director of the SEC's Division of Market Regulations, recently testified at a congressional hearing that the conflicts raised by this long-standing business model are indeed manageable. As Mr. Sirri testified:

> "Typically, [rating agencies] are paid by the underwriter or the issuer. That presents a conflict. But we believe that conflict is manageable. Credit rating agencies should have polices and procedures in place, and they should adhere to those policies and procedures when they evaluate deals."

S&P maintains rigorous policies and procedures designed to ensure the integrity of our analytical processes. For example, analysts are not compensated based upon the amount of revenue they generate. Nor are analysts involved in negotiating fees. Similarly, individuals responsible for our commercial relationships with issuers are not allowed to vote at rating committees. These policies, and others, have helped ensure our long-standing track record of excellence. As previously noted, our track record speaks for itself. Moreover, the Credit Rating Agency Reform Act of 2006, and the SEC's implementing regulations, give greater assurance that those policies will be enforced.

S&P Does Not "Structure" Transactions

Similar misunderstandings have led some to question whether rating agencies "structure" transactions, thereby threatening ratings independence. These questions are particularly troubling as they give false and negative impressions about a practice that benefits the markets — the open dialogue between issuers and ratings agencies.

It is true that our analysts talk to issuers of RMBS transactions as part of the ratings process, as they have traditionally had discussions with corporate issuers with respect to rating their non-structured securities. This dialogue provides benefits to the marketplace. Critical to our ability to rate transactions is a robust understanding of those transactions. Reading documents and reviewing the results of modeling are important, of course, but so is communication with the people responsible for the transaction itself. Through dialogue with issuers and their representatives our analysts gain greater insight into transactions to be rated, including any modifications to those transactions that may occur as the process goes forward. This dialogue promotes transparency into our ratings process, a virtue we believe in, and one that regulators have consistently espoused.

Nor does the dialogue amount to "structuring" by S&P, even in cases where the discussion is about the effect different structures may have on ratings. S&P does not tell issuers what they should or should not do. Our role is reactive. Using our models with set publicly available criteria, issuers provide us with information and we respond with our considered view of the ratings implications. In the process, and as part of our commitment to transparency, we also may discuss the reasoning behind our analysis. Those who question this practice ignore that the ratings process is not and should not be a guessing game. Without informed discussion, issuers would be proposing structure upon structure until they stumbled upon the structure that best matches with their goals. That certainly would not make the markets more transparent and efficient.

Nor should anyone view as suspicious the fact that some issuers structure transactions so as to achieve a specific rating result. Indeed, a variety of potential structures could merit a particular result. Our role is to come to a view as to the structures presented, but not to choose among them. Again, we do not compromise our criteria to meet a particular issuer's goals. As noted, we make criteria publicly available. If we were not applying our criteria to particular transactions, it would be readily apparent to the market and would immediately diminish the credibility — and thus the value — of our ratings business.

Credit Enhancement — How Securities Backed By Subprime Mortgages Can Receive, and Merit, Investment Grade Ratings

A potentially incomplete understanding of the ratings process has also led to questions about how a pool of subprime mortgage loans can support securities with investment grade, even 'AAA' ratings. The answer lies in the concept of credit enhancement.

As discussed earlier, credit enhancement — additional assets or funds — affords protection against losses in deteriorating conditions. When an issuer comes to us with a pool of subprime loans to be used as collateral for an RMBS transaction, S&P is well aware, of course, that all of this collateral is not likely to perform from a default perspective like 'AAA' securities. Nonetheless, the pool of collateral loans *will* yield *some* amount of cash, even under the most stressful of economic circumstances.

A key component of our analysis is looking at the pool of collateral to determine how much credit enhancement — extra collateral, for example — would be needed to support a particular rating on the securities to be backed by that collateral. To do this, we analyze the expected performance of the collateral in stressful economic conditions. To determine the amount of credit enhancement that could support an 'AAA' rating, we use our most stressful economic scenario, including economic conditions from the Great Depression. The stress scenarios are then adjusted for each rating category. Thus, if our analysis of a particular collateral pool's expected performance indicates that the pool would need 30% credit enhancement to support an 'AAA' rating, the issuer would have to have 30% additional collateral above and beyond the value of the securities issued in order for the securities issued by the pool to have enough credit enhancement for an 'AAA' rating. To put it in more concrete terms, if the pool was comprised of, for example, $1.3 million in collateral, it could only issue $1 million in 'AAA' rated securities in this scenario. This way, if the collateral performs poorly — and thirty percent in losses is very poor performance — there will still be sufficient collateral to cover losses incurred upon loan defaults. This credit enhancement figure would, of course, be lower for ratings other than 'AAA', as those ratings address the likelihood of repayment in less stressful economic environments. For example, the issuer might be able to issue $1.2 million in 'BBB' rated securities backed by the same collateral pool. Thus, it is not the case that through securitization, poor credit assets magically become solid investments. Rather, it is because, in our example, a pool has $1.3 million in collateral to support $1 million in securities that it may receive an entirely appropriate 'AAA' rating on those securities.

S&P Has Been Warning the Market, and Taking Action, in Response to Deterioration in the Subprime Market Since Early 2006

Others have questioned whether S&P has acted quickly enough in response to the deteriorating subprime market. Again, we believe these questions result from an incomplete understanding of the facts. S&P has spoken out — and taken action — early and often on subprime issues.

For some time S&P has been through our publications repeatedly and consistently informing the market of its concerns about the deteriorating credit quality of RMBS transactions. For example:

- In a January 19, 2006 article entitled *U.S. RMBS Market Still Robust, But Risks Are Increasing And Growth Drivers Are Softening*, we said: "Standard & Poor's expects that some of the factors that drove growth in 2005 will begin to soften in 2006 . . . . Furthermore, Standard & Poor's believes that there are increasing risks that may contribute to deteriorating credit quality in U.S. RMBS transactions; it is probable that these risks will be triggered in 2006."

- On May 15, 2006, in an article entitled *A More Stressful Test Of A Housing Market Decline On U.S. RMBS*, we reported on the results of our follow-up analysis to our September 2005 housing-bubble simulation. We stated: "[t]he earlier simulation had concluded that most investment-grade RMBS would weather a housing downturn without suffering a credit-rating downgrade, while speculative-grade RMBS might not fare so well . . . . In the updated simulation . . . [S&P used] more stressful macroeconomic assumptions [which] lead to some downgrades in lower-rated investment-grade bonds."

- On July 10, 2006, in an article entitled *Sector Report Card: The Heat Is On For Subprime Mortgages*, we noted that downgrades of subprime RMBS ratings were outpacing upgrades due to "collateral and transaction performance." The article also identifies "mortgage delinquencies" as a "potential hot button," and notes that such delinquencies "may become a greater concern for lenders and servicers."

- On July 17, 2006, we noted a 38% increase in downgrades in U.S. RMBS, a significant number of which came from the subprime market. *Structured Finance Global Ratings Roundup Quarterly: Second-Quarter 2006 Performance Trends.*

- On Oct. 16, 2006, in our *Ratings Roundup: Third-Quarter 2006 Global Structured Finance Performance Trends*, we reported a 15% decline in upgrades for U.S. RMBS while the number of downgrades more than tripled compared to the same period in 2005. We also noted that the quarter's ratings actions among RMBS transactions had set a record for the most performance-related downgrades.

- Then on December 8, 2006, in an article entitled *Credit Trends: 2007 Global Credit Strategy: Asset Class Outlook*, we informed the market of our view that "[c]redit quality in the RMBS sub-prime market has been under scrutiny this year. Standard & Poor's RMBS surveillance group sees the environment ahead as portending greater downgrade potential along with lower upgrade potential." We also stated that "the jump in third-quarter downgrade activity for the sub-prime market raises some risk flags for this segment; with 87 third-quarter downgrades adding to the 46 downgrades of the second quarter and 34 in the first."

- On January 16, 2007, in an article entitled *Ratings Roundup: Fourth-Quarter 2006 Global Structured Finance Performance Trends*, we stated: "Rating activity among subprime transactions has started to shift to being predominantly negative from being predominantly positive. . . . We expect this trend in subprime rating performance to continue during 2007."

- Ten days later on January 26, 2007, in our *Transition Study: U.S. RMBS Upgrades Are Down And Downgrades Are Up In 2006*, we reported that for 2006 "[d]owngrades overwhelmed upgrades for subprime mortgage collateral" and that we expected "losses and, therefore, negative rating actions to continue increasing during the next few months relative to previous years."

- Our statements to the market continued throughout the first half of 2007. On March 22, 2007, in an article entitled *A Comparison Of 2000 and 2006 Subprime RMBS Vintages Sheds Light On Expected Performance*, we stated: "[w]hile subprime mortgages issued in 2000 have the distinction of being the worst-performing residential loans in recent memory, a good deal of speculation in the marketplace suggests that the 2006 vintage will soon take over this unenviable position."

- In an April 27, 2007 article entitled *Special Report: Subprime Lending: Measuring the Impact*, we stated: "The consequences of the U.S. housing market's excesses, a topic of speculation for the past couple of years, finally have begun to surface. . . . Recent-vintage loans continue to pay the price for loosened underwriting standards and risk-layering in a declining home price appreciation market, as shown by early payment defaults and rising delinquencies."

- Then on June 26, 2007, in an article entitled *Performance of U.S. RMBS Alt-A Loans Continues To Deteriorate*, we reported: "The most disconcerting trend is how quickly the performance of these delinquent borrowers has deteriorated. We continue to see migration from 60-plus-day to 90-plus-day delinquencies within the 2006 vintage, suggesting that homeowners who experience early delinquencies are finding it increasingly difficult to refinance or work out problems, as opposed to being able to 'cure' falling behind on payments."

None of these warnings were hidden by S&P and I will gladly provide the Subcommittee with these documents. In addition to these warnings, we also took action in response to subprime deterioration. For example:

- On June 1, 2006, almost sixteen months ago, we tightened our criteria through changes in our LEVELS® model targeted to increase the credit enhancement requirements for pools with subprime loans. In announcing these changes to the market, we specifically identified subprime loans, such as "[l]oans with simultaneous second liens (especially those with very low FICO scores)", as loans "much more likely to default than non-second-lien loans with similar FICO scores."

- Then in February 2007, we took the unprecedented step of placing on CreditWatch negative (and ultimately downgrading) transactions that had closed as recently as 2006. As we informed the market in the accompanying release: "Many of the 2006 transactions may be showing weakness because of origination issues, such as aggressive residential mortgage loan underwriting, first-time home-buyer programs, piggyback second-lien mortgages, speculative borrowing for investor properties, and the concentration of affordability loans." In a February 16, 2007 Los Angeles Times article, S&P's announcement was described as "'a watershed event' because it means S&P is now actively considering downgrading bonds within their first year." *See S&P to Speed Mortgage Warnings*, Los Angeles Times, Feb. 16, 2007.

- We continued taking downward action through the Spring. In May we announced that "Standard & Poor's Ratings Services took 103 rating actions affecting 103 classes of residential mortgage-backed securities (RMBS) transactions backed by subprime, closed-end second-lien, and Alt-A loan collateral originated in 2005 and 2006; we lowered 92 ratings . . . and placed 103 ratings on CreditWatch negative . . . . These rating actions were due to collateral performance." We also noted that "[m]ost of the transactions affected by CreditWatch placements (and no downgrades) have not experienced significant losses. The placement of our ratings on CreditWatch when a transaction has not experienced significant losses represents a new methodology derived from our normal surveillance practice."

- On June 22, 2007, we announced further ratings actions in an article entitled *133 Subordinate Second-Lien, Subprime Ratings From 2006, 2005-Vintage RMBS On Watch Neg, Cut*. We explained that "[t]he downgrades and CreditWatch placements reflect early signs of poor performance of the collateral backing these transactions."

- Then in July of this year, we again took action in response to increasingly bad performance data, including loss levels that continued to exceed historical precedents and our initial expectations. Specifically:

- We increased the severity of the surveillance assumptions we use to evaluate the ongoing creditworthiness for RMBS transactions issued during the fourth quarter of 2005 through the fourth quarter of 2006 and downgraded those classes that did not pass our heightened stress test scenario within given time frames.

- In addition, we modified our approach for ratings on senior classes in transactions in which subordinate classes have been downgraded.

- We also announced that, with respect to transactions closing after July 10, 2007, we would implement changes that would result in greater levels of credit protection for rated transactions and would increase our review of lenders' fraud-detection capabilities.

No one can see the future. The point of these articles and actions, however, is to highlight our reaction to increasing subprime deterioration — looking, as we always do, to historical or paradigm-shifting behaviors to help analyze long-term performance. Consistent with our commitment to transparency we repeatedly informed the market of our view that the credit quality of subprime loans was deteriorating and putting negative pressure on RMBS backed by those loans. And, consistent with our commitment to analytical rigor, we revised our models, took action when we believed action was appropriate, and continue to look for ways to make our analytics as strong as they can be.

Impact of The Credit Rating Agency Reform Act of 2006

Earlier this year, the Credit Rating Agency Reform Act of 2006 took effect. As a result, over the past few months, S&P has been actively engaged in the process of implementing the requirements of the Commission's new Rules regulating NRSROs under the Act.

On June 25, 2007 we filed our application to register as an NRSRO. The application includes, among other things, our procedures and methodologies for determining ratings;

credit ratings performance measurement statistics; and information related to our ratings analysts and the largest users of our credit ratings. In addition, the application includes a description of our policies for preventing the misuse of material, non-public information and addressing and managing potential conflicts of interest. We also hired a Chief Compliance Officer who is responsible for administering and overseeing these policies and procedures and ensuring compliance with applicable securities laws.

Additionally, S&P has continued its ongoing efforts to develop and streamline internal record-keeping policies and procedures in order both to ensure the integrity of the ratings process and to satisfy Commission requirements that records be available for inspection. We recently received a notice of examination from the Commission seeking the production of a substantial amount of documents that may relate to the issue of the potential conflict of interest discussed above. We are in the process of complying with this notice.

S&P supported final passage of the Credit Rating Agency Reform Act and remains committed to that Act's stated goal of improving ratings quality for the protection of investors and fostering oversight, transparency and competition in the credit rating industry. Given that we are relatively early in the process of seeing this new law fully implemented, we would respectfully urge you to allow the Commission to proceed with its task of enforcing the provisions of the new law and the regulations so recently adopted before Congress proposes any further actions.

Conclusion

I thank you for the opportunity to participate in this hearing. Over the past several decades, S&P's consistent approach has been to evolve our analytics, criteria, and review processes when appropriate, and you can expect that same approach in light of new consumer credit behaviors in all markets, including residential mortgages. Let me also assure you again of our commitment to analytical excellence and our desire to continue to work with the Subcommittee as it explores developments effecting the subprime market. I would be happy to answer any questions you may have.

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Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #963

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----- Original Message -----

From: Greg Lippmann <greg.lippmann@db.com>

At: 8/28 17:32:17

Structured Complacency

Credit markets are sanguine. Structured credit is proliferating. Could the first fact be related to the second?

Yes, we say. There?s no end of explanation for the mysterious willingness of bond buyers and bank-loan investors to accept persistently modest returns over riskless government yields. Liquidity has been superabundant, hedge-fund assets are on the prowl, yield thirst goes unslaked?all these causes are put forward. We are about to suggest another explanation for the bewildering complacency of lenders. Spreads are tight in part because of the growing number of collateralized debt obligations (CDOs). What these entities share is a strong propensity to buy and a low propensity to sell. A new fact commands the attention of lenders and borrowers: Financial engineering is displacing credit analysis.

Definitions are in order. A CDO is a debt-acquisition enterprise. It raises money from investors. It acquires assets with the proceeds?bonds, bank loans, mortgages, asset-backed securities, etc. It can buy floating-rate assets or fixed-, senior claims or subordinated. In 2005, no less than $250 billion of CDOs came into the world, 59% more than in analysis, we venture the following capsule distinction: financial engineering is the science of structuring cash flows; credit analysis is the art of getting paid.

The liabilities side of a CDO balance sheet is what gives the structure its distinctive investment personality. The liabilities are layered. Field-strip a typical $100 million CDO and you find, first, a large swath of ?senior? liabilities, say $70 million worth, rated triple-A; a $20 million ?junior? slice rated single- or double-A; a $3 million mezzanine piece rated triple-B; and $7 million of unrated equity.

The top-rated assets are not inherently triple-A. Their strength derives rather from the vulnerability of the assets underneath. The equity tranche is most exposed; to it goes the first loss. When it has borne all it can bear (i.e., $7 million), the next loss goes to the mezzanine tranche and the next to the junior slice. Only after all of these levees are breached--$30 million worth?do losses cut into the value of the senior segment.

The various segments are priced according to their risk, with the senior-most yielding a few dozen basis points over Libor and the equity segment returning 1,000 basis points over (or more). The cost to create such a structure runs to about 1.5% of the balance-sheet footings. Included are legal, rating and origination expenses. Annual management fees may run to 50 basis points. Although some CDOs are ?static??the assets with which they are seeded are the ones they keep?some latitude for the managers is increasingly the norm.

Our ?typical? CDO is known as a ?cash? CDO. It is not to be confused with a ?synthetic? CDO. Like the cash variety, a synthetic CDO raises money from investors. Then it sells credit protection to other investors, in the shape of credit default swaps (CDS). The cash CDO earns income from the securities it holds. The synthetic CDO earns income from the premium it writes.

In a few short years, these derivative structures have marginalized the vast corporate bond market. Companies still issue public debt, but Wall Street is trading less and less of it. The charm of the old corporate arena?with its generously separated bids and offers and its personable, richly compensated sales people?proved its undoing. The advent of price transparency through the TRACE reporting system bathed the marketplace in sunlight. Blinking, the salespeople watched quotations tighten and commission income dwindle.

?Banks that trade corporate bonds have been required to report transactions to TRACE since 2002,? Bloomberg noted in a May 9 report on the historic shift from cash transactions to derivative ones (?Derivatives Make Nich Carraway, Corporate Bond Traders Obsolete,? is the headline). ?The system now provides prices and the amount of bonds exchanged in each trade on 29,000 securities with in 15 minutes of a deal, according to NASD. With the data available, there?s little need for guidance from analysts or salespeople.?

Observe, please, the analytical leap implied in the final three words of the quotation: ?analysts or salespeople.? Why should price transparency make analysts obsolete? Hypothesis No. 1: Because, in an efficient market, a security?s price is the unfailing measure of its value. Hypothesis No. 2: Because, on Wall Street, the analysts are paid out of the big fat commission pot. We lean toward No. 2.

Credit risk is ever present. Where it resides is the timely question. Once upon a time, before ?disintermediation,? the risk of default or nonpayment lay with the banks. It was the banks? business to know more about their borrowers than anyone else. Come the junk-bond revolution, the risk migrated out of the banks and into the securities markets. Now comes the derivatives boom. Who are the keepers of the flame of credit analysis in 2006?

We?re not sure?and neither is the International Monetary Fund. ?[R]ating agencies have played a significant role in the acceptance of new products by investors, with the analysis and rating of structured products heavily reliant on sophisticated quantitative modeling,? says IMF?s 2006 Global Financial Stability Report (see Chapter 2, ?The Influence of Credit Derivative and Structured Credit Markets on Financial Stability?). ?Not surprisingly. The development of structured credit markets has coincided with the increasing involvement of people with advanced financial engineering skills required to measure and manage these often complex risks. In fact, for many market participants, the application of such skills may have become more important than fundamental credit analysis.? This provocative thought is developed in a one-sentence footnote, as follows: ?Discussions with market participants raised questions as to whether the increased focus on ?structuring? skills, relative to ?credit? analysis, may itself present a concern.?

Emphatically, the rating agencies are on the job. Since a CDO without a triple-A-rated senior tranche would be unmarketable, their imprimatur is indispensable. For Moody?s Corp., the sole publicly traded rating business, derivatives are the wave of the future?and of the present, besides. In the first quarter, structured finance generated revenues of $176 million, nearly double the contribution of old0line corporate debt ratings.

Colleague Ian McCulley was unable to elicit from any agency just what this booming business entails. But he did catch up with a junior analyst at one ratings shop, who described his work in monitoring as many as 20 CDOs a day. (Both the analyst?s name and his employer?s are being withheld to protect the innocent.) ?Basically,? says our source, ?I go through what they buy and sell each month. And I go through all of their ratios. And I check to see if they have synthetics,? e.g., credit default swaps. It?s all in an Excel model. The CDOs he checks are actively managed. Interestingly, some of them invest in the tranches of other CDOs, and they are called ?CDO squared.? It?s no easy matter to rate these exotica, even with the help of a complex model developed for the purpose by Moody?s. Our admittedly green contact says he doubts that many people really understand what these structures own, how their assets are correlated or what might happen to them in the liquidation portion of a credit cycle.

A skeptical friend of ours applauds the bank-loan-holding CDOs. Michael Lewitt, president of Harch Capital Management, Boca Raton, Fla., is the manager of 150 bank loans (which constitute a collateralized loan obligation, or CLO, a species of CDO). He contends that the loan structures do work?and Lewitt, in his professional capacity, is a hard man to please. Yes, he readily acknowledges, credit spreads are too tight, but ?even if a loan defaults, you still get recoveries of 95 cents on the dollar, or even over par, so you are OK.? Lewitt is here referring to senior loans. Beware, he says, the second-lien kind, which are really ?just bonds, and that?s where you will have some real capital impairment.?

Our investigation leads usto the same conclusion, though most lenders and borrowers are wondering less about capital impairment than about what took them so long to see the beauty of junior bank claims. Among these merits is the east of early call (at the borrower?s behest and with fewer of the costs and restrictions typically associated with calling a corporate bond) and the fact that they pay a floating, not a fixed, rate of interest. Their issuance is soaring. According to Steven Miller, manageing director of S&P?s Leveraged Commentary and Data Group, $16 billion of second-lien paper came to market in 2005, 35%more than in 2004. And while junk-bond issuance last year totaled $75 billion, less will be sold this year. ?Furthermore,? colleague McCulley observes, ?second liens are tailor-made for the current state of the financial world; hedge funds absorb 37% and CLOs 48% of second lien issuance nowadays. Libbey Inc., the Toledo, Ohio, glassmaker profiled in the April 21 issue of Grant?s, is among the companies that has recently forsaken the junk market for the second-lien market; it expects to tap it any day.?

What?s there to be afraid of? a practitioner we know rhetorically asks: ?For a deal that has locked in its liability costs for in the market that would bring back credit spreads to more natural levels.?

Be careful what you wish for, we say. The financial engineers are up in the driver?s seat of credit, a fact that ought to worry everyone except distressed investors. ?[F]or some mezzanine structured credit products,? the aforementioned IMF paper speculates, ?zero recovery rates are much more likely than on similarly rated corporate bonds, yet the resulting default probabilities and expected losses are mapped into traditional corporate bond ratings that tend to be in the 40%-60% range.?

No default epidemic is imminent, our friend Lewitt asserts. Yet, he points out, something is bound to interrupt the present idyll. Something ?systemic? is his nomination. ?These hedge funds are not a sign of health and this equity day trading is not a sign of health. And having a credit market priced on a non-credit basis?meaning priced off quantitative and arbitrage bases and not on credit fundamentals?is not a healthy thing.?

Credit markets ought to be priced on the basis of credit, of course?and, one day, most assuredly, they will be again.

English Majors? Revenge

Collateralized debt obligations are only baffling most of the time. Gibberish, the technical literature may be, but a determined reader can make out the occasional familiar English word or phrase. One such word is ?assumption.? It turns out to be of critical importance to understanding how these complex structures are designed, priced and sold.

Now begins another voyage of discovery. The destination: The land of the CDOs. The missions: Understanding. We write on behalf of all who stand suspicious but mute before the mathematical guardians of this $1 trillion market. Do you, Mr. or Ms. Former English Major, suspect that there is a fly in the derivatives ointment but are afraid to express a doubt in the company of quants? We are going to arm you with the facts.

By way of background, the housing market is only as strong as the mortgage market. And the mortgage market, these days, is only as strong as the CDOs into which are packed hundreds of billions of dollars of housing-related debt (prime and subprime, ?cap corridor bonds,? Alt-A-pass-through hybrids and others you may not want to ask about just now). And the CDOs are only as viable as their equity base.

In previous issues, Grant?s has described these securities and the risks that unsuspecting investors may run in holding them. This time out, the focus is on the junior-most portion of the CDO liability structure, i.e., the equity tranche. It?s the equity that bears the first loss or, if all goes according to plan, earns the highest return. You can?t sell a CDO without some sliver of equity?and sliver is the word. High-grade deals are leveraged at 100:1 on up. Buyers of this derivatives dynamite are said to include hedge funds as well as institutions in Japan, South Korea and Southeast Asia.

In March, Moody?s performed the signal public service of compiling actual returns on equity portions of 66 ?terminated? CDOs (i.e., entities that, for one reason or another, had reached the end of their useful lives). It found that returns ranged from a negative 82% to a positive 99% and that the median return was very close to zero. The

Moody?s analysts were not dogmatic, however, because they could not be sure what investors had paid for the securities they were examining: ?Unfortunately, the pricingof equity is the result of a highly private, sometimes complex negotiation.? In a follow-up study of the equity tranches of 10 terminated structured-finance CDOs, Moody?s last month found that returns had ranged from a negative 59.1% to a positive 70.1%, with the average at a negative 8.4%.

A curious layman will now begin to appreciate the significance of the word ?assumptions? in the context of expected CDO returns (especially when pricing is as transparent as a curtain of lead). With enough of the right kind of assumptions, the equity-tranche buyer can sleep the sleep of the confidently misinformed.

But such self-delusion will be a little harder to achieve since publication of a July 26 report by Deutsche Bank entitled, ?High Grade ABS CDOs? (in which ABS stands for ?asset-backed securities?). The analysis calls into question the premises on which such derivatives are built and sold. ?Modeling assumptions that simplify actual cash flows are commonplace in the world of structured finance,? the authors note. ?However, while these adjustments are unlikely to significantly impact the debt, they can have significant consequences on equity returns?especially within a structure that is leveraged 100 to 200 times.?

And what might these dubious assumptions be? Asset and liability cash-flow mismatch, is one. Something having to do with a five- to seven-day ?trustee period? at the time of issuance is another, and ?risk mismatch in 2004 CDOs? is a third. A fourth involves the universal impulse to reach for yield: ?In the current relatively tight spread environment,? the report says, ?collateral managers have increasingly turned to higher yielding alternative prime mortgage products to add additional yield to the CDO portfolio.?

These are, or have been, the best of times for housing, the Deutsche Bank authors observe. Drawing comfort from past performance, investors have come to regard ?the structures and the various modeling assumptions that are embedded within them? with unwarranted confidence.

Especially is confidence unwarranted at a time of elevated leverage.

?I don?t want to suggest that anything malicious and underhanded is going on here,? Anthony Thompson, managing director and head of U.S. asset-backed security and CDO research for Deutsche Bank, tells colleague Dan Gertner. ?I think the reality is that a lot of the CDO architecture and technology was created 10 to 15 years ago when spreads were wider, leverage was lower and where you didn?t have to be so meticulous with your assumptions.? Buyers of these equity pieces are not necessarily the world?s most sophisticated modelers of structured finance securities, Thompson adds. ?I would make the point that mortgages are complicated still to most of the world. Mortgages levered 200 times are even more complicated.?

By tweaking some standard assumptions to make them conform with the 2006 marketplace, the Deutsche Bank study adjusts an ?idealized? expected return of 19% to a more realistic 10.2% return. Note well, however, as the authors add, that CDOs are built on many assumptions. They acknowledge that they examined ?but a few pieces of the complex CDO puzzle.?

Come the next bear market in mortgage debt, many more assumptions will certainly come in for reappraisal. Knowing only this much, the detached and calculating English major might well be able to sweep up astonishing bargains.

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Examination Report for
Moody's Investor Services, Inc.
("Moody's")

1. Introduction

On August 31, 2007, the Staff in the Commission's Office of Compliance Inspections and Examinations ("OCIE"), Division of Trading and Markets ("Trading & Markets") and Office of Economic Analysis ("OEA") (collectively "the Staff") initiated an examination of Moody's, and two other credit rating agencies. The focus of the examinations was Moody's activities in rating subprime residential mortgage-backed securities ("RMBS") and collateralized debt obligations ("CDOs") linked to subprime RMBS.[1] Specifically, key areas of review included:

- the NRSROs' ratings policies, procedures, and practices, including gaining an understanding of ratings models, assumptions, criteria and protocols;
- the adequacy of the disclosure of the ratings process and methodologies used by the NRSROs;
- whether the NRSROs complied with their ratings policies and procedures for initial ratings and ongoing surveillance;
- the efficacy of the NRSROs' conflict of interest procedures; and
- whether ratings were unduly influenced by conflicts of interest related to the NRSROs' role in bringing issues to market and the compensation they receive from issuers and underwriters.

The examinations also included a review of whether there were any errors in ratings issued as a result of flaws in ratings models used as a result of a press report indicating errors in one firm's model.[2] Initial observations as a result of this aspect of the examinations are included in this report.

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1 Beginning in 2007, delinquency and foreclosure rates for subprime mortgage loans in the United States dramatically increased, creating turmoil in the markets for RMBS backed by such loans and CDOs linked to such loans. As the performance of these securities continued to deteriorate, the three NRSROs most active in rating these instruments downgraded a significant number of their ratings. The NRSROs' performance in rating these structured finance products raised questions about the accuracy of their credit ratings generally as well as the integrity of the ratings process as a whole.

2 See Sam Jones, Gillian Tett, and Paul J. Davies, *Moody's Error Gave Top Ratings to Debt Products*, Financial Times, May 20, 2008, at 1.

The examination review period generally covered January 2004 through the present. The firms under examination became subject to the provisions of the Credit Rating Agency Reform Act of 2006 (the "Rating Agency Act"), which amended the Securities Exchange Act of 1934 ("Exchange Act"), and the Commission's rules when they registered with the Commission as NRSROs in September 2007. Although Moody's was not subject to legal obligations applicable to NRSRO during most of the review period, the Staff nonetheless sought to make relevant factual findings and observations with respect to the activities of Moody's in rating subprime RMBS and CDOs during the period, as well as to identify possible areas for improvement in their practices going forward.

Over 50 Commission Staff participated in the examinations of Moody's, and two other credit rating agencies. The examinations included extensive on-site interviews with the rating agencies' staff, including senior and mid-level managers, initial ratings analysts and surveillance analysts, internal compliance personnel and auditors, personnel responsible for building, maintaining and upgrading the ratings models and methods used in the ratings process, and other relevant rating agency staff.

In addition, the Staff reviewed a large quantity of the rating agencies' internal records, including the written policies, procedures and other such documents related to initial ratings, the ongoing surveillance of ratings, and the management of conflicts of interest, and the public disclosures of the procedures and methodologies for determining credit ratings. The Staff also reviewed deal files for subprime RMBS and CDO ratings, internal audit reports and records, and other internal records, including a large quantity of email communications records (the rating agencies' produced over two million emails and instant messages that were sorted, analyzed and reviewed using software filtering tools). Finally, the Staff reviewed the rating agencies' public disclosures, filings with the Commission and other public documents.

2. The Ratings Process

The Rating Agency Act expressly states that the Commission has no authority to regulate the "the substance of the credit ratings or the procedures and methodologies" by which any NRSRO determines credit ratings.[3] As part of this examination, however, the Staff necessarily sought to develop an understanding of the quantitative analysis used to rate the RMBS and CDOs that have been subject to such dramatic and widespread change.

Moody's rates RMBS and CDO transactions by first assessing the underlying collateral and then assessing the deal structure. For RMBS collateral assessment, Moody's uses the Moody's Mortgage Metrics Model ("M3") to quantitatively arrive at initial loss coverage numbers.[4] Moody's then looks at qualitative factors, such as the originator and servicer,

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3 15 U.S.C. 78o-7(c)(2).

4 Presently, Moody's evaluates over 50 different characteristics of each loan in a pool, through its M3 model, examples of which are: credit bureau scores, which is an indicator of a borrower's past credit performance; loan-to-value ratio, which reflects the amount of equity borrowers have in

and makes adjustments to the initial loss coverage numbers to arrive at the final loss coverage numbers.[5] For CDOs, Moody's uses its proprietary CDOROM model for projecting expected loss. For cash flow CDOs, the results of the CDOROM model runs are processed by Moodys' proprietary CDOEdge model in order to assess the portfolio.[6] In this second stage, Moody's arrives at an estimate of credit enhancement for excess spread through models which project cash flows for the proposed capital structure. Results from the collateral and cash flow models are reviewed through the rating committee approval process before a final rating is issued.

M3 was not available to rate subprime securities until December 2006. Prior to that date, Moody's used a system of "benchmarking" to rate subprime RMBS wherein a subprime mortgage pool currently being evaluated was compared to several subprime pools previously rated by Moody's.[7] This process resulted in an initial rating number after which several "hits" or adjustments could be applied, depending on the pools characteristics, to arrive at the final loss coverage numbers.[8]

As part of the ratings process during this period, Moody's will on occasion revise its ratings methodology. Many of the changes Moody's made were incremental and did not affect the overall rating. Moody's transitioned incremental changes over a short period of time. If a deal was in-house and had been priced, the old methodology would apply, and the deal would be rated under the former methodology. When a change to the methodology would affect a rating, Moody's generally published a Request for Comment notifying the market of the potential change and indicating that it would implement the change at a later date.

3. Increase in Number and Complexity of RMBS and CDO Deals

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their homes; how fully buyers have documented their income and assets; whether the property will be owner occupied; and, whether the loan is for purchase or refinance.

5 Moody's review of the originator, servicer, and master servicer is a significant element of Moody's rating process as each can greatly influence loss levels depending on their relative strength or weakness. The originator or servicer can increase or decrease loss levels separately by up to a total of 20%.

6 For synthetic CDOs, Moody's analysts employ the CDOROM model, a simulation tool designed to determine the expected loss for each tranche. The CDOROM model runs a minimum of one million Monte Carlo simulations using the potential asset pools allowed under a CDO's covenants. For cash CDOs, the CDOROM model is generally employed to generate expected loss figures for potential collateral pools, which are then run through the firm's CDOEdge model, which applies a correlated binomial method (incorporating default correlation assumptions) to a proposed deal structure in order to generate projected payment waterfalls, in order to generate cash flow models for various scenarios.

7 The subprime pools had either the same originator or a comparable originator.

8 For example, if a bucket in a pool had a high percentage of interest only loans a hit would be applied to the expected loss number for that bucket.

From 2002 to 2006, the volume of structured finance deals rated by Moody's increased substantially, as did the revenues Moody's received from rating those deals. The structured products Moody's was asked to evaluate became increasingly complex, with many employing derivatives such as credit default swaps to replicate the performance of mortgage backed securities. Further, the loans made to retail borrowers being securitized evolved from 30-year fixed rate instruments to newer products such as second lien and adjustable rate mortgages. The increasing number and complexity of deals may have compromised various aspects of Moody's ratings operations for structured finance, as discussed in greater detail below.

a. Revenue, Deal, and Staffing Levels

From 2002 to 2006 the volume of RMBS deals rated by Moody's increased by 137%, and the number of CDO deals rated by Moody's increased by 700%. Correspondingly, the revenue Moody's derived from RMBS deals increased from $61.8 million in 2002 to $168.9 million in 2006 and CDO revenue increased from $11.7 million in 2003[9] to $91.2 million in 2006.

For the RMBS group, contemporaneous staffing increases appear roughly in line with volume increases (Moody's increased RMBS staff by 114% as volume increased by 137%).[10] For CDOs, however, Moody's staffing increases do not appear to have kept pace with volume increases (Moody's increased CDO staff by 24% as volume increased by 700%).[11]

b. Impact on the Ratings Process

The Staff believes that the deal and staffing levels during the review period may have impacted various aspects of the ratings process. For instance, several CDO memoranda reviewed by the Staff indicate that ratings were issued notwithstanding one or more unresolved issues. For example, the rating committee memorandum for the Costa Bella CDO, Ltd. deal stated that for one issue involving the collateral manager, "We didn't ha [sic] time to discuss this in detail at the committee, so they dropped the issue for this deal due to timing. We will need to revisit in the future."[12] Another potentially unresolved issue was described as "poorly addressed – needs to be checked in the next deal"[13] and "WARR- don't ask ☺)".[14]

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[9] Moody's was unable to produce CDO revenue for 2002 due to a transition of accounting systems.

[10] In 2002 RMBS lead analysts were responsible for monitoring their rated transactions. See MIS-OCIE-RMBS-28799. The tabulation of Moody's RMBS personnel for 2002 does not include the Group Managing Director or Senior Managing Director and the tabulation for 2006 does not include the Group Managing Director.

[11] In 2002, CDO lead analysts were responsible for monitoring their rated transactions. Senior Associates, of which there were nine, provided monitoring support.

[12] See MIS-OCIE-RMBS-26801.

[13] Id.

The Staff believes that the increase in the number and complexity of deals may have impacted Moody's subprime RMBS and CDO ratings operations, as is discussed in more detail below.

The Staff recommends that Moody's periodically evaluate if it has sufficient staff and resources to manage its volume of business and meet its obligations under the Rating Agency Act.

Moody's Response: Moody's agrees with the Staff's recommendation and will periodically evaluate staffing levels.

4. Disclosure of the Rating Process

The requirements of the Rating Agency Act specifically address the importance of disclosure. An NRSRO is required to disclose publicly the procedures and methodologies it uses in determining credit ratings.[15] Form NRSRO requires that this disclosure be a general description; but sufficiently detailed to provide users of credit ratings with an understanding of the processes employed in determining credit ratings, including among other things, the quantitative and qualitative models and metrics used to determine credit ratings. Moody's explained to the Staff that, prior to being registered as an NRSRO, it disclosed its ratings process during the review period. It appears, however, that certain significant aspects of the rating processes and the methodologies used to rate RMBS and CDOs were not always disclosed, or were not fully disclosed, as summarized below.

New or revised rating methodologies and policies that are deemed material are often first approved internally and then published as a Request for Comment from the market before being implemented.[16] In the RMBS group incremental changes to the ratings methodology or process are approved through RMBS chair meetings. Moody's states that it uses press releases and web postings to publicly disclose modifications to its rating methodologies and related practices, procedures and processes.[17] However, Moody's does not consolidate its methodologies for rating subprime RMBS or CDO transactions in one location.

As such, the Staff had difficulty locating the disclosure of certain aspects of Moody's ratings process. Moreover, Moody's does not publish (or publish before implementation) all incremental changes to its methodology. For example, the Staff found emails where

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14 "WARR" stands for weighted average rate of return. See MIS-OCIE-RMBS-26798.

15 Section 4(a)(1)(B)(ii) of the Exchange Act.

16 Moody's Report on the Code of Professional Conduct, April 2006.

17 Moody's Code of Professional Conduct, June 2005.

Moody's made changes to assumptions before the market was notified of the changes.[18] Additionally, the Staff found emails evidencing Moody's analysts utilizing an unpublished model to assess data.[19]

The Staff recommends that Moody's conduct a review of its current disclosures of its processes and methodologies for rating RMBS and CDOs to assess whether it is fully disclosing its ratings methodologies and meeting the requirements of the Rating Agency Act and Form NRSRO. Further, the Staff recommends that Moody's review whether its policies governing the timing of disclosure of a significant change to a process or methodology are reasonably designed to comply with these requirements.

Moody's Response: Moody's generally agrees with the Staff's recommendations and is currently taking steps to improve disclosure of the ratings process, including the drafting of unified methodologies.

5. Written Policies and Procedures for Rating RMBS and CDOs

As of September 2007, NRSROs are subject to a requirement to make and retain certain internal documents relating to its business, including procedures and methodologies used to determine credit ratings.[20] Prior to this, Moody's ratings policies are described in its Code of Professional Conduct, Report on the Code of Professional Conduct, Analyst Handbook – Rating Practices and Procedures, and Moody's Best Practices for the Conduct of Moody's Structured Finance Rating Committees. While these documents, taken as a whole, provide a general guideline for an analyst to follow when rating structured finance products, they were not specific to any type of structured finance product, such as RMBS or CDOs.

The Staff recommends that Moody's conduct a review to determine whether its written policies and procedures used to determine credit ratings for RMBS and CDOs are fully documented in accordance with the requirements of Commission Rule 17g-2.

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18 Email chain ending with email from Ariel Weil, Associate Vice President/Analyst, Term RMBS, Moody's, to Kelly Slicklein, Associate Director, Investor Services Group, Moody's (Nov. 29, 2007, 20:08 GMT). See also email chain ending with email from Yuri Yoshizawa, Group Managing Director, US Derivatives, Moody's, to Yvonne Fu, Team Managing Director, US Derivatives, Moody's (Apr. 24, 2007, 18:50 GMT). See also email from Ariel Weil, Associate Vice President/Analyst, Term RMBS, Moody's, to Mark DiRienz, Team Managing Director, Term ABS, Moody's (Feb. 7, 2007, 20:54 GMT). See also email form Karen Ramallo, Associate Analyst, Term RMBS, Moody's, to Odile Grisard Boucher, Associate Analyst, Term RMBS, Moody's (Nov. 15, 2006, 19:10 GMT).

19 Email chain ending with email from Karen Ramallo-Rodriguez, Associate Analyst, Term RMBS, Moody's, to Denise Person, Vice President/Senior Criteria Officer, Term RMBS, Moody's (Sept. 24, 2007, 18:26 GMT). Moody's states that it does not publish all criteria changes, particularly those they consider incremental or non-material.

20 Rule 17g-2 under The Exchange Act. 17 CFR 240.17g-2.

Moody's Response: Moody's generally agrees with the Staff's recommendation and will conduct a review to ensure that its policies and procedures are properly documented in accordance with the Commission's rules.

As a result of a May 20, 2008, Financial Times article detailing a coding error in the model Moody's utilized to rate constant proportion debt obligations ("CPDOs")[21] the Staff expanded the scope of its exam to review Moody's policies and procedures for addressing the discovery of errors in its models and methodologies.[22] The Staff found that while Moody's does have policies and procedures that emphasize the importance of providing accurate ratings with integrity, it does not have policies and procedures that provide guidance on the process that should be followed when errors are discovered in its models, methodologies, or other aspects of the ratings process.

The Staff recommends that Moody's develop policies and procedures to address the detection of errors with its models, methodologies, or other aspects of the ratings process. The Staff also recommends that Moody's develop policies and procedures for the reporting of discovered errors in its models, methodologies, or other aspects of the ratings process.

Moody's Response: Moody's responded that it has instituted numerous remedial measures to address this issue, including implementing new policies and procedures, and establishing a taskforce to initiate a thorough review of all existing structured finance models.

6. Integrity and Accuracy of the Information Provided to Moody's

There is no requirement under the federal securities laws that an NRSRO verify the information contained in RMBS loan portfolios presented to it for rating. Additionally, NRSROs are not required to insist that issuers perform due diligence, and they are not required to obtain reports concerning the level of due diligence performed by issuers.

The Staff notes that pursuant to its policies, procedures, and public pronouncements, Moody's did not engage in any due diligence or otherwise seek to verify the accuracy and quality of the loan data underlying the RMBS pools it rated during the review period. In fact, the Code of Ethics for Moody's clearly states that Moody's is under no obligation to perform, and does not perform, due diligence.[23] Moreover, it states that the assignment of a rating is not a guarantee of the accuracy, completeness, or timeliness of the

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21 CPDOs are a type of credit derivative sold to investors looking for long term exposure to credit risk on a highly rated note. Investors buy notes issued by a special purpose vehicle ("SPV").

22 The Staff also noted potential conflicts of interest with respect to this issue. These are addressed more fully below.

23 See Moody's Code of Conduct, p 7, dated June 2005 and updated October 2007 (stating Moody's has no obligation to perform, and does not perform, due diligence with respect to the accuracy o f the information it receives or obtains in connection with the rating process).

information relied on in connection with the rating.[24] Moody's solely performed loss and cash flow analyses on the data presented to it. Moody's generally did not verify the integrity and accuracy of such information as, in Moody's view, due diligence duties belonged to the other parties in the process. Moody's also did not seek representations from sponsors that due diligence was performed.

Moody's has taken, or announced, measures designed to improve the integrity and accuracy of the loan data they receive on underlying RMBS pools:

- Moody's announced that it was considering enhancements to its RMBS securitizations that would include the engagement by issuers of independent third parties to randomly sample, for due diligence, the greater of 10% or 200 loans for all subprime transactions.

- In addition, in an agreement with the New York State Attorney General, Moody's agreed to develop and publicly disclose due diligence criteria to be performed by underwriters on all mortgages comprising RMBS, and to review those results prior to issuing ratings.[25]

7. Documentation of Significant Steps and Participants in the Rating Process

a. Documentation of Significant Steps in the Ratings Process

An NRSRO is required to retain internal records, including non-public information and workpapers, used to form the basis of a credit rating it issued (Exchange Act Rule 17g-2(b)(2)). Prior to implementation of this requirement, Moody's policy was to retain records related to the credit analysis and rating process for certain time periods as identified in its record retention schedule.[26]

The Staff reviewed 50 RMBS and 51 CDO deals to determine if Moody's followed the policies and procedures for rating RMBS and CDOs and its file maintenance and recordkeeping policy. Moody's policies and procedures call for a rating committee memorandum and addendum to be produced for each transaction rated by Moody's. The information required in the rating committee memorandum and addendum includes the date the rating committee convened; the names of the rating committee attendees; the name of the committee chair; the type of rating action and type of instrument under consideration; the rating recommendation and rationale; the rating committee outcome and vote tally; quantitative analysis, and supporting materials.[27]

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24 Id.

25 http://www.oag.state.ny.us/press/2008/june/june5a_08.html

26 Moody's record retention policy did not apply to procedural or methodological policies governing the credit ratings process as a whole. MIS-OCIE-RMBS-28424-28483.

27 See Moody's Best Practices for the Conduct of Moody's Structured Finance Rating Committees, at 5 (May 2006). See MIS-OCIE-RMBS-312, 397, 430. In May of 2006 Moody's added the

For RMBS transactions, most of the ratings memoranda and addenda contained the minimum required information under Moody's policy. However, the Staff found that the level of detail provided as to how the committee arrived at its rating levels was inconsistent.[28] Often boxes on the addendum were checked without explanation despite fields requiring explanation, contained an inadequate explanation, or in some cases were not checked at all.[29]

The level of documentation of Moody's CDO ratings process varied widely across the deals reviewed by the Staff. Only 15 included all of the four basic required pieces of documentation: a rating committee memorandum, a rating committee addendum, a monitoring committee memorandum, and a monitoring committee addendum. For 16 of the deals reviewed, no monitoring documentation was produced.[30] Additionally, the rating committee memoranda featured significant variation in the topics covered and amount of information presented. For instance, over half of the rating committee memoranda included a section on the collateral manager, however, the level of detail provided in this section varied greatly.[31] Almost all of the rating committee memoranda included a modeling assumptions section, however, the level of detail provided varied greatly. While a small number of memoranda had detailed discussions of the collateral manager, the majority of memoranda including this section either contained a very brief summary or essentially included the section only as a placeholder (i.e., the section included the name of the collateral manager followed by blank fields for items such as "location," "contact," "key personnel," etc.). The majority of the ratings committee memoranda also included an "Issues" section. The level of detail in this section also varied greatly, ranging from detailed listings of rating committee concerns and issuer/underwriter responses to short lists without any indication of resolutions. To the extent that they were provided to the Staff, the surveillance and monitoring memoranda,

requirement that the committee chair be identified in all memoranda as well as the committee outcome. Compare MIS-OCIE-RMBS-312, with MIS-OCIE-RMBS-397, and 430.

28 For instance, one initial rating committee memorandum contained only three sentences that merely state a base description of the loan pool and there is no way to discern how the rating committee arrived at its results, GSAMP 2006-S1, MIS-OCIE-RMBS-28730; others did not discuss the rating rationale in sufficient detail. See e.g. Long Beach Mortgage Loan Trust 2006-2, MIS-OCIE-RMBS-28621-28625.

29 For example, the "Key variable(s) voted upon" sections of the addenda were often left blank or contained a generic term like "ratings."

30 These numbers are based on the Staff's review of the documentation provided by Moody's. Approximately three months after the delivery of the majority of the requested transaction materials, Moody's provided an index that confirmed the Staff's findings as to the extent of documentation. See MIS-OCIE-RMBS-32168-32171.

31 While a small number of memoranda had detailed discussions of the collateral manager, the majority of memoranda including this section either contained a very brief summary or essentially included the section only as a placeholder (i.e., the section included the name of the collateral manager followed by blank fields for items such as "location," "contact," "key personnel," etc.).

like the rating committee memoranda, also varied in the amount of information provided, with sections of some memoranda essentially serving as placeholders. Finally, many of the rating committee or monitoring memoranda did not contain a narrative discussing the ratings committee decision or underlying rationale.[32]

The Staff's findings with respect to deal files it reviewed are corroborated by other internal discussion by Moody's. For example, the Derivatives Group was aware that "delinquencies on adherence to the document retention policy had increased" and sent out an email to the Derivatives Group noting this issue.[33] Moody's, however, has subsequently stated that it is in the process of implementing automated committee memorandum and other document retention procedures which will address these issues.

Ultimately, the Staff found that Moody's failed to retain or document certain significant steps in the rating process, which made it difficult for the Staff to assess compliance with its rating policies and procedures, and to identify the factors that were considered in developing a particular rating. This lack of documentation would similarly make it difficult for the Moody's internal compliance staff or internal audit staff to assess compliance with the firm's policies and procedures.

b. Documentation of Participants in the Ratings Process

An NRSRO is also required to make and retain records of the identity of any credit analyst that participated in determining the rating and any person that approved the rating before it was issued (Exchange Act Rule 17g-2). This requirement is intended to assist the Commission in monitoring whether the NRSRO is following its procedures and methodologies for determining credit ratings and whether the NRSRO is complying with procedures designed to prevent the misuse of material nonpublic information by identifying the persons with the best information as to how the credit rating was determined. Prior to this, Moody's policy required that the rating committee attendees and rating rationale be a part of the rating committee memorandum.[34]

For the subprime RMBS and CDO transactions reviewed by the Staff, the Staff found that, at times, in both the initial ratings memoranda and addenda the vote tally was incomplete with either a generic "agreed with levels" type comment in the field for "Key variable(s) voted on" accompanying the vote tally or no indication of the vote tally at

32 In many cases, the sole documentation of the decision-making process is in the addenda section labeled "RC Outcome," with checkboxes for "RC Recommendation accepted" and "RC Outcome differed from Recommendation." In several cases where the latter box was checked, no explanatory narrative was provided.

33 Email from Gus Harris, Senior Managing Director, New Products Group, Moody's, to 'SFG/Derivatives – US' listserv, Moody's (May 18, 2007, 22:16 GMT).

34 <u>See</u> Moody's Best Practices for the Conduct of Moody's Structured Finance Rating Committees, at 5 (May 2006). <u>See</u> MIS-OCIE-RMBS-312, 397, 430.

all.[35] The Staff also found that like the initial rating committee memoranda, the majority of surveillance memoranda failed to record the voting results.

The Staff recommends that Moody's conduct a review of its current policies and practices for documenting the credit rating process to review whether they are reasonably designed to ensure compliance with Rule 17g-2 and to address weaknesses in the policies or in adherence to existing policies that result in gaps in recording the voting in the credit rating process.

Moody's Response: Moody's generally agrees with the Staff's recommendation and will continue to monitor to ensure compliance with its recordkeeping requirements.

8. Surveillance Practices

Under the Rating Agency Act, an NRSRO is required to disclose publicly the procedures and methodologies it uses in determining credit ratings. In addition, Section 4(d) of the Rating Agency Act states that an NRSRO must maintain adequate financial and managerial resources to produce credit ratings with integrity.

Moody's does not have written policies and procedures for the surveillance of subprime RMBS and CDO bonds, although it publishes criteria that describe the methodologies under which such bonds are monitored.[36] For both RMBS and CDO Moody's uses automated surveillance tools that on a monthly basis flag for review securities whose performance indicates that their current credit rating may not be consistent with the current estimated expected loss.[37] Aside from its monthly outlier screening, Moody's also regularly performs ratings sweeps by issuer and/or origination year, where Moody's looks at each outstanding deal individually.

Once a rated instrument is selected based on the automated surveillance tools, a Moody's surveillance analyst will further investigate the status of the transaction and present findings to a ratings committee. If the rating committee believes that a rating may need to be adjusted, then the securities are placed on review for a potential downgrade or upgrade.[38]

It appears that Moody's regularly performed RMBS and CDO surveillance during the exam time period. However, while Moody's publishes criteria that describe its

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35 See e.g. Long Beach Mortgage Loan Trust 2006-2, MIS-OCIE-RMBS-28621-28631.

36 From 2003-2007, Moody's released three comprehensive publications that detail how Moody's monitors RMBS transactions.

37 For RMBS the surveillance process is based on a review of collateral performance, for CDO it is based on the ratings of the individual assets comprising the collateral pool.

38 For CDO Moody's follows a very similar process; however, surveillance analyst analyze different metrics.

methodology for the surveillance of RMBS and CDO bonds, Moody's does not have internal written procedures documenting the steps staff should undertake for surveillance of RMBS and CDO bonds.

The Staff recommends that Moody's develop RMBS and CDO surveillance policies and procedures. The Staff also recommends that Moody's conduct a review to determine if adequate resources are devoted to surveillance of outstanding RMBS and CDO ratings.

Moody's Response: Moody's agrees with the Staff's recommendations and informed the Staff that it is implementing, or has implemented, global procedural and structural changes that address the Staff's recommendations. Among these policies and changes is the building out of its compliance function to facilitate surveillance policy development.

9. Management of Conflicts of Interest

a. "Issuer Pay Model"/Fee Discussions

Moody's uses the "issuer pays" model, in which the sponsor or other entity that issues the security is also seeking the rating. Under Exchange Act Rule 17g-5(b)(1), it is a conflict of interest for an NRSRO being paid by issuers or underwriters to determine credit ratings with respect to securities they issue or underwrite. Section 15E(h) of the Exchange Act requires an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed to address and manage conflicts of interest. Such policies and procedures are intended to maintain the integrity of the NRSRO's judgment. Avoiding a conflict of interest prevents an NRSRO from being influenced to issue a more favorable credit rating in order to obtain or retain business of the issuer or underwriter.[39]

In order to manage this conflict of interest, in October of 2007 Moody's established a policy to restrict analysts and their immediate managers from participating in fee discussion with issuers.[40] Moody's has also organized its rating group as a separate organization within a larger company.[41] However, Moody's does not actively monitor employees' compliance with the prohibition against analysts from participating in fee discussions.

The Staff found multiple communications that indicate that analysts are aware of the firm's fee schedules, and actual (negotiated) fees. There does not appear to be any internal effort to shield analysts from emails and other communications that discuss fees and revenue from individual issuers. In some instances, analysts discuss fees for a rating. For instance, one analyst wrote to his manager "in the past it took us 2 – 3 months to rate one [a type of deal], so I assume fees should be much higher than for typical

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39 See Release No. 34-55857 and Exchange Act Rule 17g-5.

40 Moody's Code of Professional Conduct (October 2007).

41 In 2007, Moody's Corporation effected a separation at the corporate level between its credit rating business, Moody's, and its non-ratings product and service business, Moody's Analytics.

reperforming deal."[42] Another analyst wrote to his manager asking about whether the firm would be charging a fee for a particular service, and what the fee schedule would be.[43] In addition, there were indications that analysts were involved in fee discussions with employees of the firm's billing department.[44] The Staff is concerned that analysts could be influenced in their ratings by their awareness of the amount of fees charged to issuers.

b. Business considerations in the Ratings Process

As a result of a May 20, 2008, Financial Times article detailing a coding error in the model Moody's utilized to rate CPDOs, Moody's began a review by outside counsel surrounding the issue. As a result of that investigation, Moody's reported to the Staff that a European CPDO rating/surveillance committee had knowledge that Moody's had issued ratings on certain CPDO securities in 2006 using a model that contained a coding error.[45] The coding error resulted in most of those securities receiving a rating several notches higher than if the model had not contained the coding error. In January of 2007, a CPDO committee first became aware that the ratings were several notches higher than they should have been. Despite this fact, the committee agreed to continue to maintain the higher unwarranted ratings for several months until the securities were eventually downgraded for performance reasons. Members of the committee, all analysts or analytical managers, considered the rating agency's reputation when deciding not to downgrade the securities and make the coding error public.

Moody's recently informed the Staff that as a result of these findings, it has implemented, or plans to implement several global procedural and structural changes that address the issues identified. The Staff is still reviewing the facts related to the CPDO ratings.

The Staff recommends that Moody's continue to review its practices, policies and procedures to further mitigate and manage the "issuer pays" conflict of interest. In particular, the Staff recommended that Moody's consider steps that would insulate or prevent the possibility that considerations of market share and other business interests could influence ratings or ratings criteria.

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42 Email from Gulmira Karaguisiyeva, Analyst, Term RMBS, Moody's, to David Teicher, Team Managing Director, Term RMBS, Moody's (May 9, 2007, 13:46 GMT).

43 Email from Zhiqin (James) Huang, Analyst, Term RMBS, Moody's, to Mark DiRienz, Team Managing Director, Term ABS, Moody's (May 7, 2006, 13:38 GMT).

44 Email from Gulmira Karaguisiyeva, Analyst, Term RMBS, Moody's, to Joy Mayo, Manager, Middle Office, Moody's (Aug. 23, 2007, 23:10 GMT).

45 The Staff met with Moody's and outside counsel conducting the investigation on June 27, 2008, to discuss the CPDO coding error and the progress of the investigation. Moody's represented that the investigation into this matter will be completed in mid-July 2008.

Moody's Response: Moody's agrees with the Staff's recommendation and will continue to review its practices and procedures to further mitigate and manage the "issuer pays" conflict of interest.

c. Analyst Compensation

Moody's has a policy that generally provides that an analyst may not be compensated or evaluated based upon the amount of revenue that the rating agency derives from issuers or issues that the analyst rates or with which the analyst regularly interacts.[46] While Moody's does not compensate its analysts based on the deals they rate or the ratings provided, like all employees, the amount of an analyst's bonus is tied to the overall success of the company.

d. Securities Transactions by Employees

Moody's has adopted a policy to prohibit employees and their immediate family members from owning any security that is subject to a credit rating of a team on which such employees are members to guard against potential insider trading.[47] Furthermore, Moody's has implemented procedures to monitor employees' ownership of securities of issuers or obligors rated by groups within the company with whom an employee is not affiliated.[48] Managers are required to review all trades of Moody's employees that report directly to them and raise all potential conflicts of interest or violations with the Legal department or Ratings Compliance department.[49] The Staff found Moody's employee securities transaction program to be adequate.

The Staff has recommended that Moody's conduct a review of its policies and procedures for managing the securities ownership conflict of interest to determine whether they are reasonably designed to ensure that its employees' personal trading is appropriate and does not violate Rule 17g-5.

Moody's Response: Moody's agrees with the Staff's recommendation and will continue to review its policies and procedures for securities trading and ownership to ensure compliance with Rule 17g-5.

10. Internal Audit

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46 See Section 2.11 of the Moody's Code of Professional Conduct.

47 See Moody's Revised Securities Trading Policy and Reporting Procedures (November 2005).

48 Moody's employees must report all the securities holdings of the employee and/or members of his/her immediate family, upon initiation of employment and periodically thereafter, as well as records of securities transactions that the employee and immediate family members engage in. An employee's compliance with the transaction reporting requirement can be achieved by ensuring that his/her employer receives duplicate copes of brokerage statements and trade confirmations.

49 Section 3 of Appendix A to the Revised Securities Trading Policy and Reporting Procedures (November 2005).

Historically, Moody's employed an outside firm, KPMG, to perform its audits. In addition, at least since 2006, Moody's has performed internal audits to evaluate ratings group's compliance with its best practices, its electronic storage requirements, securities trading restrictions, and the Moody's Code of Conduct.[50] The auditors evaluate the adequacy of implementation of internal controls designed to address these areas. The auditors perform a risk assessment to determine where to perform their audits based upon a number of factors, including the type of debt and geographic location of the group within Moody's responsible for rating an issue. For example, RMBS securities in Europe may be audited in one year, in the U.S. in the next, and in Asia in the year after that, meaning that a specific group in a particular geographic area is audited once every three years.

During the period reviewed by the Staff, Moody's conducted three internal audits related to the RMBS and CDO rating process.[51] The internal audit reviews discovered, among other things, certain non-compliance with document retention policies, over-reliance upon individuals for technological expertise to test software, and lack of adherence to the rating committee guidelines (inquiries about committee member conflicts, no documentation of majority vote, lack of rating committee memo, missing rating letter, empty electronic document management system ["EDMS"] folder, two models not filed on EDMS or CDO Edge, and a lack of documented re-prioritization of deal monitoring). In the Staff's opinion, the most significant finding arising out of the internal audit performed in 2006 for the U.S. Derivatives Team in Structured Finance revealed that derivative models are not formally reviewed and/or validated by management before they are posted for general use. For one deal, the analyst used a banker's proprietary model, without any form of review of the model to determine whether it was reliable or consistent with Moody's methodology. The auditors recommended that management implement a review process to periodically assess the integrity of the models used in support of the rating. Moody's was unable to demonstrate evidence of its management's follow-up on the recommendations of the auditors. The Staff believes that Moody's should be able to provide records of such follow-up as part of an examination of the internal audit record.

The Staff recommends that Moody's review whether its internal audit functions, particularly in the RMBS and CDO ratings areas, are adequate, and whether it provides for proper management follow-up.

Moody's Response: Moody's agrees with the Staff's recommendation and will review the adequacy of its internal audit functions and will develop procedures that address management follow-up.

11. Conclusion

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50 Moody's provided no records of any audits performed prior to 2006.

51 See 2006 U.S. Derivatives Monitoring Internal Audits; 2006 U.S. RMBS Internal Audit; and 2006 U.S. Derivatives Team Structured Finance Internal Audit.

The Staff intends to send a deficiency letter to Moody's outlining its findings and recommendations. The Staff will request that Moody's provide a written response within 30 days outlining any remedial action planned or already taken to address the findings and recommendations in the letter. Moody's will be asked to include in its response a timetable for implementing the proposed remedial action. The letter will also request that Moody's send OCIE a written confirmation in 12 months detailing the status of implementation of each remedial action.

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FOIA CONFIDENTIAL TREATMENT REQUESTED BY MOODY'S INVESTORS SERVICE

March 11, 2008

By Federal Express

Matthew Daugherty,
Office of Compliance Inspections and Examinations,
United States Securities and Exchange Commission,
100 F Street, N.E.,
Washington, D.C. 20549.

Re: Moody's Investors Service

Dear Mr. Daugherty:

I write on behalf of Moody's Investors Service ("Moody's") in response to the Staff's letter to Raymond W. McDaniel dated February 20, 2008. Moody's understands that the Staff's requests are being made pursuant to the Staff's authority under the Credit Rating Agency Reform Act of 2006. Enclosed is a CD-ROM, bearing bates number MIS-OCIE-RMBS 0028537, containing a spreadsheet comprised of twelve worksheets that respond to Requests 1, 2, and 4-9. The name of each worksheet indicates the Request to which it responds. The information contained in the spreadsheet was compiled by Moody's employees for the purpose of responding to this request. Moody's is preparing a response to a portion of Requests 8 and 9 relating to RMBS rating and surveillance personnel, and Request 10.

For its response to Request 3, Moody's refers the Staff to Moody's Form 10-K for the fiscal years 2004 through 2007 at pages 79, 74, 63, and 76 respectively. Moody's Form 10-K reports revenue by business unit for a three year period, including Structured Finance, Corporate Finance, Financial institutions and Sovereign Risk, and Public Finance.

Moody's is producing these documents in compliance with the Credit Rating Agency Reform Act of 2006 and applicable rules promulgated thereunder. Under 15 U.S.C. § 78o-7(m)(1), Moody's production of these documents "does not constitute a waiver of, or otherwise diminish, any right, privilege, or defense" that Moody's "may otherwise have under any provision of State or Federal law, including any rule, regulation, or order thereunder."

The enclosed documents contain confidential and proprietary commercial and financial information concerning Moody's and its affiliates, as well as confidential information concerning the clients and employees of Moody's. Accordingly, Moody's hereby requests, pursuant to Rule 83 of the SEC's Rules on Information and Requests, 17 C.F.R. § 200.83, and for reasons of business confidentiality and personal privacy, that the enclosed documents, and this letter, not be disclosed in response to any request made under the Freedom of Information Act, 5 U.S.C. § 552 (1994) ("FOIA"). The foregoing request also applies to any transcripts, notes, memoranda, tapes or other materials of any sort that are made by, or at the request of, the SEC and incorporate, refer or relate to any of the matters contained in the enclosed documents or this letter.

If the enclosed documents or this letter become the subject of a FOIA request, please call the undersigned at (212) 558-3269 and we will provide further information in support of Moody's request for confidential treatment. Although we make this request in the name of Moody's, we do not intend to waive the right of any client or employee of Moody's separately to request such confidential treatment. We also request that at the conclusion of this investigation, all copies be returned to me at the above address.

Very truly yours,

Stephen Ehrenberg

(Enclosure)

cc: Freedom of Information Act Officer
(United States Securities and Exchange Commission)
(without enclosures)

Annual Gross Revenue - RMBS Ratings

Year	Gross Revenue
FY02*	$ 61,801,000
FY03	$ 75,964,289
FY04	$ 109,121,344
FY05	$ 167,509,541
FY06	$ 168,916,978
FY07	$ 114,381,512

* 2002 Gross Revenue includes revenue from Servicer Quality Ratings ("SQR") which is not likely to exceed 2003 SQR revenue of $643,356.

Annual Gross Revenue - ABS CDO Ratings*

Year	Gross Revenue	
FY02**	$	-
FY03	$	11,730,234
FY04	$	22,210,695
FY05	$	40,332,909
FY06	$	91,285,905
FY07	$	94,666,014

* Revenue figures provided are for CDOs containing Asset Backed Securities, which may include RMBS.
** Revenue figures are not readily available for 2002 due to transition of accounting systems.

Number of RMBS Rated 2002-2007

Month	RMBS Rated
Jan-02	33
Feb-02	36
Mar-02	60
Apr-02	43
May-02	37
Jun-02	57
Jul-02	40
Aug-02	42
Sep-02	63
Oct-02	45
Nov-02	39
Dec-02	49
Jan-03	41
Feb-03	50
Mar-03	57
Apr-03	62
May-03	60
Jun-03	63
Jul-03	51
Aug-03	64
Sep-03	70
Oct-03	67
Nov-03	61
Dec-03	77
Jan-04	50
Feb-04	66
Mar-04	94
Apr-04	79
May-04	82
Jun-04	106
Jul-04	80
Aug-04	99
Sep-04	103
Oct-04	82
Nov-04	85
Dec-04	104
Jan-05	72
Feb-05	76
Mar-05	101
Apr-05	87
May-05	109
Jun-05	112
Jul-05	87
Aug-05	120
Sep-05	128
Oct-05	93
Nov-05	112
Dec-05	128
Jan-06	79

Feb-06	110
Mar-06	124
Apr-06	99
May-06	107
Jun-06	144
Jul-06	82
Aug-06	97
Sep-06	134
Oct-06	96
Nov-06	102
Dec-06	115
Jan-07	82
Feb-07	108
Mar-07	121
Apr-07	88
May-07	96
Jun-07	98
Jul-07	52
Aug-07	27
Sep-07	21
Oct-07	24
Nov-07	11
Dec-07	16

Number of ABS CDOs Rated 2002-2007*

Month	CDOs Rated
Jan-02	0
Feb-02	4
Mar-02	4
Apr-02	2
May-02	7
Jun-02	6
Jul-02	1
Aug-02	2
Sep-02	3
Oct-02	4
Nov-02	4
Dec-02	8
Jan-03	2
Feb-03	3
Mar-03	3
Apr-03	2
May-03	7
Jun-03	3
Jul-03	9
Aug-03	7
Sep-03	3
Oct-03	6
Nov-03	7
Dec-03	5
Jan-04	3
Feb-04	4
Mar-04	9
Apr-04	7
May-04	5
Jun-04	4
Jul-04	6
Aug-04	6
Sep-04	4
Oct-04	13
Nov-04	12
Dec-04	16
Jan-05	5
Feb-05	2
Mar-05	11
Apr-05	16
May-05	9
Jun-05	14
Jul-05	21
Aug-05	12
Sep-05	6
Oct-05	8
Nov-05	14
Dec-05	23
Jan-06	13

Feb-06	5
Mar-06	21
Apr-06	11
May-06	34
Jun-06	29
Jul-06	33
Aug-06	28
Sep-06	35
Oct-06	54
Nov-06	39
Dec-06	58
Jan-07	20
Feb-07	34
Mar-07	73
Apr-07	39
May-07	34
Jun-07	35
Jul-07	24
Aug-07	13
Sep-07	2
Oct-07	5
Nov-07	3
Dec-07	0

Permanent Subcommittee on Investigations

Document originally produced in excel format; reformatted/margins modified for readability and printing purposes by the Subcommittee. Original document retained in the Subcommittee files.

* Figures provided are for CDOs containing Asset Backed Securities, which may include RMBS.

Derivatives Rating and Surveillance Analysts 2007

Employee Name	Job Title	Primary Responsibility*
Ang,Kai C	Associate Analyst	Ratings
Araya,Rodrigo	Senior Vice President	Ratings
Beauchesne,Herve-Pierre	AVP-Analyst	Ratings
Bharwani,Pooja	VP-Senior Analyst	Ratings
Brennan,James	VP-Senior Analyst	Ratings
Bunja,Rudolph	Senior Vice President	Ratings
Burger,David	VP-Senior Analyst	Ratings
Cai,Gong	Senior Associate	Surveillance
Chan,Caroline	Senior Associate	Surveillance
Chen,Alena	Associate Analyst	Ratings
Chen,Karie	Analyst	Surveillance
Choi,Eun J	Senior Vice President	Ratings
Crousillat,Cesar	VP-Sr Credit Officer	Ratings
Espinoza,Oswald	Senior Associate	Surveillance
Fan,Hui	Associate Analyst	Ratings
Forster,Yehudah	VP-Senior Analyst	Ratings
Fratantaro,Annette C	Senior Associate	Surveillance
Fu,Yvonne F	Team Managing Director	Ratings
Gollins,Karen E	Associate Analyst	Surveillance
Gottesman,Craig J	Senior Associate	Surveillance
Green,Claudia N	VP-Senior Analyst	Ratings
Grossmann,Philip S	Senior Associate	Surveillance
Hallenbeck,Peter W	AVP-Analyst	Ratings
Ham,David	VP-Sr Credit Officer	Ratings
Harrington,William J	Senior Vice President	Ratings
Hart,Joy N	Associate Analyst	Ratings
Hu,Jian	SVP-Issuer Relations	Ratings
Jiang,Ivan X	VP-Senior Analyst	Ratings
Kaltsas,Dimitri	Associate Analyst	Surveillance
Kharnak,Elina	VP-Senior Analyst	Ratings
Kim,Jun P	AVP-Analyst	Ratings
Koller,Ainat	Senior Associate	Surveillance
Kolmanovskaya,Elina	VP-Senior Analyst	Ratings
Kumar,Harsh	Associate Analyst	Ratings
Lai,Shan	Associate Analyst	Surveillance
Lama,Sange	Senior Associate	Surveillance
Lasseron,Arnaud H	VP-Senior Analyst	Ratings
Leibholz,Maria	VP-Sr Credit Officer	Ratings
Li,Carissa H	Associate Analyst	Ratings
Li,Connie H	Senior Associate	Surveillance
Lioce,Stephen G	VP-Sr Credit Officer	Ratings
Mahdavi,Yasmine	AVP-Analyst	Ratings
May,William	Team Managing Director	Ratings
Miagkova,Maria V	VP-Senior Analyst	Ratings
Mogunov,Leonid	VP-Senior Analyst	Ratings
Nazarian,Danielle	Senior Vice President	Ratings
Nikulin,Evgeny	Analyst	Ratings
Olson,Ruth E	VP-Senior Analyst	Ratings
Ouzidane,Rachid	Analyst	Surveillance

Park,John	Senior Vice President	Surveillance
Paroda,Prashant	AVP-Analyst	Ratings
Patel,Rahil	Senior Associate	Surveillance
Polansky,Jonathan	Team Managing Director	Surveillance
Putney,Abraham B	AVP-Analyst	Ratings
Remeza,Algis	VP-Sr Credit Officer	Ratings
Sam,Shiou Lin	Associate Analyst	Ratings
Sava,Suzanna	AVP-Analyst	Ratings
Schoellig,Gregory	Statistical Analyst	Surveillance
Sethi,Shana	Associate Analyst	Surveillance
Shrestha,Abiskar	Associate Analyst	Surveillance
Sieczkowski,Christopher R	Associate Analyst	Surveillance
Sieler,Julien	AVP-Analyst	Ratings
Sun,Yu	VP-Senior Analyst	Ratings
Tepper,Evan	Analyst	Surveillance
Torres,Ramon O	VP-Sr Credit Officer	Ratings
Tzianetopoulou,Theodora	Associate Analyst	Ratings
Veliev,Oktay	Associate Analyst	Ratings
Veluri,Sindhu M	Associate Analyst	Ratings
Wang,Fei Fern	AVP-Analyst	Ratings
Wang,Qi	Analyst	Surveillance
Wyszomierski,Teresa	VP-Sr Credit Officer	Ratings
Xu,Min	AVP-Analyst	Ratings
Yerynovska,Oksana	VP-Senior Analyst	Ratings
Yoshizawa,Clara	Group Managing Director	Ratings
Yu,Wai-Yin A	AVP-Analyst	Ratings
Zhang,Hongfei	Senior Associate	Surveillance
Zhu,Qian	AVP-Analyst	Ratings

* This list includes all analysts assigned to the U.S. Derivatives Group. Analysts are not dedicated to rating or monitoring ABS CDOs in particular. Analyst responsibilities have been temporarily shifted to rating or surveillance as needs arise.

RMBS Rating and Surveillance Analysts 2007

Employee Name	Job Title	Primary Responsibility
Agarwal,Navneet	VP-Senior Analyst	Surveillance
Bains,Karandeep S	Associate Analyst	Surveillance
Bekiroglu,Arif K	Analyst	Ratings
Bergman,Aron	Analyst	Surveillance
Bessermann,Gregory Elie	Analyst	Surveillance
Branton,Mark K	Senior Associate	Surveillance
Chang,Kai-Ling	Associate Analyst	Ratings
Chatterjee,Debashish	VP-Senior Analyst	Ratings
Dang,JingJing	Associate Analyst	Surveillance
De Gaetano Polverosi,Maria I	AVP-Analyst	Surveillance
Drucker,Michael P	AVP-Analyst	Ratings
Fabrikant,Bruce D	Senior Vice President	Ratings
Fellows,Eric	VP-Sr Credit Officer	Ratings
Fried,Ilana J	Senior Associate	Surveillance
Fustar,Stephanie E	Analyst	Ratings
Gemson,Gregory	AVP-Analyst	Ratings
Genis,Peter	Associate Analyst	Ratings
Grisard Boucher,Odile	Analyst	Surveillance
Hannoun-Costa,Ola	Senior Associate	Surveillance
Huang,Zhiqin	Analyst	Ratings
Joseph,Jayesh	Associate Analyst	Surveillance
Kanef,Michael	Group Managing Director	
Karaguishiyeva,Gulmira N	Analyst	Ratings
Kelbaugh,Kathryn E	VP-Senior Analyst	Ratings
Kornfeld,Warren	Team Managing Director	Ratings
Kothari,Deepika	AVP-Analyst	Ratings
Liu,Qingyu	Analyst	Ratings
Lynn,Alexandra	Associate Analyst	Ratings
Markowitz,Murray R	VP-Senior Analyst	Ratings
Peng,Rui-Dan	AVP-Analyst	Ratings
Ramallo,Karen A	Analyst	Surveillance
Riggi,Marjan	VP-Sr Credit Officer	Ratings
Rocco,Joseph	Associate Analyst	Surveillance
Sanchez,Alda Fiorella	Associate Analyst	Surveillance
Shrivastava,Amita	Analyst	Ratings
Singhania,Gaurav	Analyst	Ratings
Swanson,Todd	Analyst	Ratings
Teicher,David L	Team Managing Director	Ratings
Tobey,Amelia	VP-Senior Analyst	Surveillance
Weil,Ariel	AVP-Analyst	Ratings
Zhang,Yi	VP-Senior Analyst	Ratings

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Mari Maloney
Chief Compliance Officer
Ratings Services
Global Regulatory Affairs

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mari_maloney@sandp.com

March 14, 2008

Via E-Mail and Federal Express

Matthew Daugherty
Office of Compliance Inspections and Examinations
United States Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-8041

Dear Mr. Daugherty,

I write in response to Mr. Meehan's letter of February 20, 2008 to provide the information requested therein in connection with your office's ongoing examination of Standard & Poor's (S&P). The text of those questions is reproduced below, along with our responses. Per our discussions, and consistent with our prior submissions in this examination, the following information reflects our information for U.S. ratings. The data has been provided as it is maintained in the ordinary course, where possible, and, where not, it has been derived from S&P's records.

1. The annual total gross revenue for providing credit ratings on RMBS transactions for the period 2002-2007.

Table 1
U.S. RMBS - Gross Rating Revenues
($ thousands)

	2002	2003	2004	2005	2006	2007
Initial Rating[1]	55,147	90,606	128,073	158,598	176,995	127,726
Surveillance[2]	1,938	8,081	8,982	10,350	13,757	10,175
Total Revenue	57,085	98,687	137,055	168,948	190,752	137,901

1 Gross amount billed for new ratings of RMBS.
2 Gross amount billed for surveillance of ratings of RMBS after their first year of issuance. These figures include surveillance of pre-2002 ratings. From 2003 forward, this amount includes pre-paid surveillance fees for subsequent years.

2. The annual total gross revenue for providing credit ratings on RMBS CDO transactions for the period 2002-2007.

Table 2
U.S. CDOs of RMBS - Gross Rating Revenues
($ thousands)

	2002	2003	2004	2005	2006	2007
Initial Rating[3]	9,296	12,621	24,829	41,008	88,934	74,231
Surveillance[4]	888	2,095	3,520	6,444	9,864	16,427
Total Revenue	10,184	14,716	28,349	47,452	98,798	90,658

3. The annual total gross revenue for providing credit ratings on all transactions for the period 2002-2007.

Table 3
U.S. Ratings and U.S. Structured Finance Ratings
Annual Net Revenues Earned and Reported[5]
($ thousands)

	2002	2003	2004	2005	2006	2007
Structured Finance	183,955	237,958	311,773	410,322	614,960	561,400
All Ratings[6]	516,856	640,871	742,108	884,257	1,121,678	1,157,043

3 Gross amount billed for new ratings of CDOs that are generally backed by RMBS collateral.
4 Gross amount billed for surveillance of ratings of CDOs of RMBS after their first year of issuance. These figures include surveillance of pre-2002 ratings. From 2003 forward, this amount includes pre-paid surveillance fees for subsequent years.
5 Represents net revenue (including surveillance) reported on an earned basis.
6 Represents U.S. ratings services included in the NRSRO.

4. **The total numbei .RMBS transactions for which S&P pı ıd a credit rating for each month during the period 2002-2007.**

Table 4
Number of U.S. RMBS Transactions Rated

	2002	2003	2004	2005	2006	2007
January	48	56	69	93	96	106
February	43	71	86	106	146	147
March	66	86	123	115	168	149
April	56	84	99	103	116	128
May	53	78	106	129	131	141
June	60	89	140	144	180	131
July	47	79	106	98	98	67
August	57	96	116	143	110	53
September	87	115	141	165	175	44
October	58	88	126	120	149	53
November	60	90	99	149	130	24
December	78	108	133	181	140	22

5. **The total number of RMBS CDO transactions for which S&P provided a credit rating for each month during the period 2002-2007.**

Table 5
Number of U.S. CDO of RMBS Transactions Rated

	2002	2003	2004	2005	2006	2007
January	0	2	1	6	14	16
February	4	3	4	2	5	23
March	2	1	5	18	23	67
April	0	1	8	11	14	40
May	3	5	4	8	36	36
June	7	2	4	11	24	31
July	1	6	6	14	32	24
August	1	4	4	12	26	16
September	2	1	3	6	29	10
October	3	4	14	11	42	7
November	3	5	7	19	33	6
December	8	6	19	21	65	0

6. The total numbe. .MBS transactions under surveillanc 5&P at the end of each month during the period 2002-2007.

Table 6
Number of RMBS Transactions Under Surveillance

	2002	2003	2004	2005	2006	2007
January	3,707	4,050	4,291	4,688	5,673	6,710
February	3,736	4,102	4,355	4,730	5,796	6,847
March	3,791	4,167	4,245	4,799	5,915	6,961
April	3,839	4,216	4,203	4,806	6,025	7,064
May	3,850	4,093	4,272	4,920	6,125	7,142
June	3,851	4,146	4,280	4,980	6,212	7,254
July	3,845	4,172	4,314	5,058	6,273	7,285
August	3,877	4,224	4,367	5,167	6,268	7,286
September	3,930	4,119	4,418	5,263	6,411	7,328
October	3,954	4,182	4,519	5,368	6,487	7,367
November	3,969	4,240	4,549	5,422	6,587	7,314
December	4,021	4,327	4,646	5,588	6,647	7,317

7. The total number of RMBS CDO transactions under surveillance by S&P at the end of each month during the period 2002-2007.

Table 7
Number of CDO of RMBS Transactions Under Surveillance

	2002	2003	2004	2005	2006	2007
January	37	71	110	191	326	661
February	38	75	113	192	332	672
March	43	75	119	209	351	725
April	43	76	125	221	365	765
May	45	79	128	230	398	813
June	51	84	133	236	419	844
July	53	86	139	249	452	864
August	55	94	143	263	477	887
September	56	95	146	270	498	902
October	60	99	155	282	529	913
November	62	103	164	290	569	918
December	70	108	183	315	641	921

8. Total number of onnel, identified by name and title, as d to providing initial credit ratings of RMBS and RMBS CDO transactions at year end for the period 2002-2007.

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2007	
RMBS Analysts	
Name	**Title**
Ahn (Liu), Laura	Associate Director
Albergo, Leslie	Senior Director
Alizadeh, Rasool	Rating Analyst
Arne, Errol	Director
Barash, Henry	Rating Specialist
Barnes, Susan	Managing Director
Bartl, Timothy	Research Assistant
Beauchamp, Kyle	Associate Director
Bergeland, Regina	Associate Director
Bergey, Kent	Associate Director
Bergman, Matthew	Associate
Bliss, Brendan	Senior Research Assistant
Boardman, Jeremy	Senior Research Assistant
Bruzese, Frank	Senior Research Assistant
Cao, Becky Hui	Director
Christensen, Peter	Rating Analyst
Conon, Jonathan	Rating Analyst
Consul, Manish	Associate
Deasy, Christopher	Director
Dougherty, Michael	Associate
Epstein, Ken	Associate Director
Fitter, Jenine	Director
Ghose, Ryan	Senior Research Assistant
Gleeson, Michael	Associate Director
Glehan, David	Director
Goldenberg, Mark	Director
Graham, Peter	Rating Analyst
Grow, Brian	Senior Director
Grundy, James	Associate
Guinyard, Anthony	Associate

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Name	Title
Hahn, Song	Associate
Hall, Daniel	Rating Specialist
Hansen, Justin	Director
Hierl, Jonathan	Senior Research Assistant
Hinman, Carissa	Rating Analyst
Hopkins, Amanda	Rating Specialist
Huang, Peng	Research Assistant
Johnson, Kimberly	Associate
Kahan, Jack	Rating Analyst
Kennedy, Martin	Senior Director
Kim, Jong Wan	Associate
Kimmel, George	Director
Koniowka, Gregory	Associate Director
Kostiw, Karen	Director
Kramer, Andrew	Research Assistant
Kumar, Rohit	Associate Director
Larkin, Daniel	Rating Analyst
Lim, Kwang Yi	Associate Director
Listner, Michael	Associate Director
Losice, Abraham S.	Managing Director
Lukacsko, Eric	Director
Mahdavian, Sharif	Director
Manasseh, Rani	Rating Analyst
Mason, Scott	Senior Director
McDermott, Gail	Managing Director
Morrison(Clements), Julia	Associate
Neary, Rebecca	Associate
Niemy, Todd	Director
Osterweil, Terry	Senior Director
Parker, Samuel	Director
Perelmuter, Monica	Director
Polizzotto, John	Director
Reiss, Nancy	Senior research Assistant
Ren, Chuye	Associate
Rossman, Ann	Associate
Samuels, Amy	Associate Director
Sang, John	Rating Analyst
Schneider, Jeremy	Associate
Shaikh, Waqas	Director
Sharma, Sudhir	Associate
Siber, Matthew	Senior Research Assistant
Skuthan, Natalia	Associate
Smith, Kevin	Research Assistant
Solar, Mona	Director
Steers, Bridget	Associate Director
Stock, Michael	Senior Director
Tegan, Daniel	Associate
Tencer, Steven	Director
Tillen, Bonnie	Managing Director

S

Name	Title
Tillis, Lisa	Associate
Uppuluri, Sai	Director
Valente, Michael	Associate Director
VanKirk, Spencer	Senior Research Assistant
Vonderhorst, Brian	Senior Director
Wang, David	Associate Director
Wang, Elaine	Research Assistant
Warrack, Thomas	Managing Director
Watson, Jeff	Director
Weller, Brian	Rating Specialist
Wray, Michael	Rating Analyst
Yioupis, Leonidas	Associate
Zimmerman, Allen	Associate
Criteria	
Name	**Title**
Gillis, Thomas	Managing Director
Parisi, Frank	Managing Director
Additional Resources From Structured Finance	
Name	**Title**
Anagnostos, Helen	Associate Director
Maciaszek, Matthew	Associate Director
McGinnis, Peter	Director
Long, Russell	Managing Director
Fazio, Angelo	Senior Director
Legal	
Name	**Title**
Abrams, Natalie	Associate General Counsel
Byrnes, Bernard C.	Assistant General Counsel
Coleman, Maureen N.	Associate General Counsel.
Dawson, Petrina R.	Sr. Managing Director & General Counsel
IT Group	
Name	**Title**
Blaivas, Victoria	Senior Consultant
Garg, Anoop	Senior Consultant
Gimpelevich, Svetlana	Analyst-Systems/Sr
Hager, Aaron	Analyst-Systems/Sr
Karkhanova, Lyudmila	Mgr- Systems
Momin, Naushad M	Mgr- Systems
Rassadzin, Ilia A	Analyst-Systems/Sr
Saftoiu, Elena	Senior Director-Application Development
Ungureanu, Victoria	Analyst-Systems/Sr

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2007	
CDO Analysts	
Name	Title
Albulescu, Henry	Managing Director
Bentham, Milbert	Director
Berrouet, Louis-Daniel	Associate
Billick, Nicole	Associate Director
Bruslanova, Natalia	Director
Bryan, Andrea	Managing Director
Carelus, Jean-Baptiste	Director
Chang, Jenny	Associate
Chay, Kyu	Director
Cheng, Loming (Lois)	Rating Specialist
Cheng, Kenneth	Director
Chery, Sulexan	Senior Research Assistant
Chinn, Vanessa	Rating Analyst
Chiriani, Robert Jr.	Senior Director
Cho, Jai Ho	Director
Cilento, Jenna	Research Assistant
Compton, Adrian	Associate Director
Cuddy, Daniel	Research Assistant
DeDiego Arozamena, Alfredo	Senior Director
Dennis, Alex	Research Assistant
Detweiler, John	Director
Fink, Gwen	Associate
Galgano, Philip	Managing Director
Gatmaitan, Joshua	Associate Director
Ghetti, Belinda	Senior Director
Guarnuccio, Keith	Senior Director
Halprin, James	Senior Director
Harris, John	Director
Hennessey, Julia John	Research Assistant
Horn, Carol	Associate Director
Hu, Bujiang	Director
Jordan, Pat	Managing Director
Kalinauskus, Paul	Associate
Kambeseles, Peter	Managing Director
Kato, Clara Akiko	Associate
Kaur, Manjeet	Senior Director
Khakee, Nik	Managing Director

Name	Title
Kim, Jeong	Director
Kurtas, Erozan	Associate Director
Lam, Jonathan (Chifai)	Director
Lee, David	Rating Analyst
Leong, William	Associate
Llanos, Michael	Rating Analyst
Loken, Andrew	Rating Specialist
Long, Russell	Managing Director
MacDonald, Benjamin	Associate
Maciaszek, Matthew	Associate Director
Martin, John Trevor	Research Assistant
McCarthy, John	Director
McCutcheon, Erin	Associate
Mejia-Barros, Griselda	Rating Analyst
Meng, Jerry	Director
Meyer, R. Christopher	Director
Mooney, Shannon	Rating Specialist
Moy, Edward	Director
Neilson, Francesca	Director
Newman, Debroah	Associate
Nicholson, Boris	Senior Research Assistant
Nolan, Katarzyna	Associate Director
O'Brien, John	Director
O'Keefe, Brian	Managing Director
Omer, Farooq	Director
Parchment, James	Associate Director
Pedvis, Andrew	Senior Director
Radziul, Robert	Senior Director
Richards, Tara	Rating Specialist
Sachse, Sarah	Rating Specialist
Scaturro, Peter	Research Assistant
Schiller, Ross	Associate Director
Sehnert, M. Scott	Director
Sprinkle, Lauren	Rating Analyst
Sriram, Jag	Associate Director
Tagliaferro, John	Research Assistant
Tang, Ming	Associate Director
Tesher, David	Managing Director
Trant, Brian	Rating Analyst
Upton, Daniel	Research Assistant
Volpe, Ryan	Research Assistant
Widernik, Anna	Director
Wolf, Zackary	Associate Director
Wong, Eileen	Associate Director
Wong, Elwyn	Managing Director
Yagoda, Brian	Associate
Yang, Julia (Tingli)	Associate Director
Zhao, Bruce	Associate Director

Criteria	
Name	**Title**
Gillis, Thomas	Managing Director
Quantitative Group	
Name	**Title**
Bassignani, William C	Managing Director - Proj Execution
Morokoff, William J	Managing Director - Quant
Polizu, Cristina	Managing Director - COE
Sargsyan, Eduard	Director - COE
Watson, Robert	Director - COE Quant
Legal	
Name	**Title**
Coleman, Maureen N	Associate General Counsel
Dawson, Petrina R	Sr. Managing Director & General Counsel
Kirschner, Rhonda G	Assistant General Counsel
Manzi, Rosaleen M	Managing Director and Assoc. General Counsel
Silverberg, Michael	Assistant General Counsel

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2007	
RMBS Surveillance	
Name	**Title**
Avant-Koger, Paula	Rating Analyst

[11] Supported data collection efforts for surveillance.

Name	Title
Boccanfuso, Francesca	Research Assistant
Bruzzese, Peter	Associate Director
Chin, Jimmy	Associate - COE Data
Davey, Scott	Associate Director
Elder, James	Associate
Giudici, Andrew	Director
Graffeo, Michael	Rating Analyst
Hyun, Catherine	Associate
Joyce, Kristy Marie	Research Assistant
Keenan, Matthew	Associate
Mahabir, Lal	Director
Pollsen, Robert	Director
Rao, Asha	Senior Research Assistant
Rivera, Jessica	Rating Specialist
Rivera, John	Associate Director
Romero, Cesar	Associate
Rozek, Aleksandra	Associate
Sawyer, Ola	Associate
Schuk, John	Associate
Warner, Ernestine	Senior Director
Young, Steven	Research Assistant
Criteria	
Name	**Title**
Gillis, Thomas	Managing Director
RMBS New Issue[12]	
Name	**Title**
Bartl, Timothy	Research Assistant
Bliss, Brendan	Senior Research Assistant
Ghose, Ryan	Senior Research Assistant
Graham, Peter	Senior Research Assistant
Hinman, Carissa	Rating Analyst
Huarg, Peng	Research Assistant
Kramer, Andrew	Research Assistant
Smith, Kevin	Research Assistant
Wang, Elaine	Research Assistant
SF Information Tech	
Name	**Title**
Aptekar, Yeugene	Developer - Applications
Blaivas, Victoria	Senior Consultant
Saftoiu, Elena	Senior Director-Application Development
Data[13]	
Name	**Title**
Dunn, James	Associate - COE Data
Houston, Gail	Manager

[12] Additional resources from this group assisted with RMBS Surveillance during peak periods.

[13] In addition to the personnel listed above, 8 people employed by an affiliate assisted in data management efforts for RMBS surveillance in 2007.

Name	Title
Li, Eric	Temp - Assistant
Lopez, Yasmin	Data Manager
Thornton, James	Manager

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2007	
CDO Surveillance Group	
Name	**Title**
Anderberg, Stephen	Senior Director
Cullen, Brian	Rating Analyst
Davis, Christopher	Associate
Gutierrez-Pagaduan, Heidi	Senior Research Assistant
Hu, Daniel	Senior Research Assistant
Joy, Sampson	Rating Analyst
Kobylinski, James	Associate Director
Lewison, Martin	Associate Director
Maglia, Anthony	Associate (Program)
Miraj, Nikhil	Associate (Program)

21 In addition to the personnel listed above, 39 people employed by an affiliate assisted in data management efforts for CDO surveillance in 2006.

Name	Title
Mistry, Samir	Associate (Program)
Muthukrishan, Ramki	Director
Rajan, K.P.	Associate Director
Scanlin, Kate	Associate Director
Shah, Niyati	Rating Analyst
Stewart, Ian	Rating Analyst
Subramanian, Jay	Associate
Walsh, Tim	Associate
Zhang, Jennifer	Associate
CDO Group	
Name	**Title**
Chay, Kyu	Director
Compton, Adrian	Associate Director
Kalinauskas, Paul	Associate
Kato, Akiko	Associate
Loken, Andrew	Rating Specialist
Mooney, Shannon	Rating Specialist
Song, Helena	Associate Director
Sprinkle, Lauren	Rating Analyst
Trant, Bo	Rating Analyst
DeDiego Arozamena, Alfredo	Senior Director
Ghetti, Belinda	Senior Director
Guarnuccio, Keith	Senior Director
Hu, Bujiang	Senior Director
Radziul, Robert	Senior Director
Criteria	
Name	**Title**
Gillis, Thomas	Managing Director
Data[22]	
Name	**Title**
Damiano, Salvatore S	Assoc Director-COE Data
Jarvis, Arnold	Research Analyst
Laino, Bobby	Research Analyst
Notarstefano, Robert	Director-COE Data
Serrano, Julio A	VP-COE Data
Proj. Mgmt.	
Name	**Title**
Adams, Latoya S	Analyst-Business Sr COE
Liu Myers, Alice T	Assoc Director-COE Strgy & Pmo
Tomlinson, Sandra L	VP-COE Strgy & Pmo
Quantitative Group	
Name	**Title**
Sargsyan, Eduard	Director-COE

[22] In addition to the personnel listed above, 67 people employed by an affiliate assisted in data management efforts for CDO surveillance in 2007.

SF Information Tech	
Name	**Title**
Balagurusamy, Srinivasan	Analyst-Systems/Sr
Blaivas, Victoria	Senior Consultant
Chen, John I	Senior Director-Application Development
Kostiw, Jeff	Senior Director, Structured Fin Tech
Moloksher, Nikolay	Senior Consultant
Momin, Inayat	Director-Application Development
Qian, Guoliang	Senior Consultant
Saftoiu, Elena	Senior Director-Application Development
Subramanyam, Tirunelveli K	Developer-Application Lead
Thangaraj, Solomon	Director-Application Development
Vega, Juan C	Senior Director-Structured Fin App

10. All current written policies and procedures, and any supporting documentation of reviews, audits or surveillance related to Rule 17g-5(c)(1), prohibiting an NRSRO from issuing a credit rating where the person soliciting the credit rating was the source of 10% or more of the total revenue of the NRSRO during the most recently ended fiscal year.

Rule 17g-5(c)(1) became effective as of June 18, 2007. As of December 31, 2006, the then-most recently ended fiscal year, no issuer was the source of more than 2.68% of the total revenue for the NRSRO. As of December 31, 2007, no issuer was the source of more than 2.74% of the total revenue for the NRSRO. Because there is no issuer that even approaches the threshold set forth in the rule, no written policies are currently in place. At the conclusion of this fiscal year, this issue will be revisited and appropriate written policies and/or procedures will be adopted if necessary.

* * *

Standard & Poor's requests confidential treatment of all information and/or documents that S&P provides to the Securities and Exchange Commission (the "SEC") in connection with this examination, including this letter and all of the information submitted herewith. This confidential treatment request is made under the SEC's confidential treatment procedures (17 C.F.R. § 200.83), under the Freedom of Information Act (5 U.S.C. § 552), and for reasons of privacy and business confidentiality, among others.

S&P expects this confidential treatment request to cover all information and/or documents that S&P may provide to the SEC in connection with the examination, as well as any subsequent requests that the SEC or any employee of the SEC (or any other government agency) may make in connection with the examination, together with any memoranda, notes, transcripts or other writings of any sort whatsoever that are made by, or at the request of, any employee of the SEC (or any other government agency) that incorporate, include or relate to any such information or documents (collectively, the "Confidential Information").

In accordance with 17 C.F.R. §200.83 and other applicable laws and regulations, S&P requests that all such Confidential Information be kept in a non-public file and that only members of the SEC or its staff have access to it. Should the SEC receive any request for the Confidential Information, under FOIA or otherwise, S&P requests that the undersigned immediately be notified of such request, and be furnished with a copy of all written materials pertaining to such request (including, but not limited to, the request and any agency determination relating thereto).

S&P expects to be given . portunity to submit written substantiati. 'the request for confidential treatment, if such substantiation is deemed necessary, as provided for in 17 C.F.R. §200.83(d). S&P further expects that, if the preliminary decision of the SEC is that confidential treatment is not warranted, in whole or in part, it will be given ten (10) calendar days from the date of the preliminary decision to submit supplemental arguments in support of the confidential treatment request, as provided for in 17 C.F.R. §200.83(e) (1). In addition, S&P expects that it will be given ten (10) calendar days from the date of the SEC's final decision to release all or part of the Confidential Information to enable S&P to pursue any remedies that may be available to it, as provided for in 17 C.F.R. §200.83(e)(1). For either a preliminary decision or final decision, S&P requests that you telephone the undersigned and send the decision by facsimile rather than relying upon the United States mail for the required notice.

In producing the enclosed information, S&P does not intend to waive any objections to the scope of the examination nor in any way to waive any applicable privileges or protections, including, but not limited to, those arising under the attorney-client privilege, the attorney work-product doctrine, the self-evaluative privilege, and any privileges and protections that may apply under the First Amendment of the United States Constitution or any similar state-law protections and privileges.

Sincerely,

/s/ Mari B. Maloney

Mari B. Maloney

55 Water Street
New York, NY 10041
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U.S. STRUCTURED RATINGS FEE SCHEDULE

RESIDENTIAL MORTGAGE-BACKED FINANCINGS AND RESIDENTIAL SERVICER EVALUATIONS

OVERVIEW

This fee schedule applies to both insured and uninsured Residential Mortgage-Backed Financings issued by corporations and financial institutions domiciled in the United States and collateralized by mortgages on U.S. properties as well as ranking for Residential Mortgage Loan Servicers. Separate fee schedules are available for the following types of structured financings:

- Asset Backed Obligations
- Commercial Mortgage-Backed Financings
- Real Estate Companies
- Collateralized Debt Obligations

Please note that in the case of unique structures or securitizations involving new issuers and new product types, Standard & Poor's reserves the right to quote a fee for the analytical work performed. In addition, legal fees are charged for special research associated with such new issuers, products or structures are in addition to Standard & Poor's fees and will be billed separately.

Standard & Poor's performs an independent and objective analysis. The rating, which results from the analytical process may or may not be consistent with the expectations of the issuer. The fee for services is not contingent upon the issuer's acceptance of the assigned rating.

FEE QUOTATIONS

If you have any questions about this fee schedule or require additional information, please contact:

General Fee Inquiries	Ratings Fee Services	(877) 727-8647
Susan Barnes	Managing Director	(212) 438-2579
Thomas Warrack	Managing Director	(212) 438-2634
Brian Vonderhorst	Director	(212) 438-8457
Leslie Albergo	Director	(212) 438-2381
Peter D'Erchia	Managing Director, Global Practice Leader, Surveillance	(212) 438-2438

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #991

FEE SCHEDULES

RESIDENTIAL MORTGAGE-BACKED FINANCINGS

Initial Rating Fee

The initial rating fee is based on the collateral and structure, i.e. senior/subordinated pass-throughs or excess spread and subordination structures. The fees below apply to public issues and private placements with pool balances below $1 billion.

	Basic Fee	Minimum Fee	Maximum Fee
Pass-Throughs:			
First-Lien Prime Jumbo & Alt. A Senior/Sub. Structure	3.0 basis points	$ 40,000	$ 100,000
First-Lien Prime Jumbo & Alt. A Sr./Sub., Excess Spread Structure	3.25 basis points	$ 40,000	$135,000
First-Lien Subprime	3.25 basis points	$ 40,000	$135,000
2nd-Lien: CES, HELOC, High CLTV	3.25 basis points	$ 40,000	$135,000
Agency CMOs	3.0 basis points	$25,000	$85,000

Deals with Multiple Credit Supported Structures will be charged a surcharge of $25,000, per additional structure.

Other:			
Reverse Mortgages	4.0 basis points	$ 75,000	$ 135,000
Tax Liens	4.0 basis points	$ 75,000	$ 135,000
Servicer Advances	4.0 basis points	$ 75,000	$ 135,000
Construction Loans	4.0 basis points	$75,000	$135,000
Scratch -n- Dent –			
Re-performing	4.0 basis points	$ 75,000	$135,000
Document Deficient	4.0 basis points	$ 75,000	$135,000
Outside of the Guidelines	3.25 basis points	$ 50,000	$135,000
Non-Performing	4.0 basis points	$ 75,000	$135,000
Net Interest Margin (NIM)	One S&P Rated U/L	$ 60,000	
Net Interest Margin (NIM)	One S&P Non-Rated U/L	$100,000	

Large Balance Transactions:

First-Lien Prime Jumbo & Alt. A Senior/Sub. Structure

$1.0 billion ≤ rated amount < $1.5 billion	$108,000 cap
$1.5 billion ≤ rated amount < $2.0 billion	$123,000 cap
$2.0 billion ≤ rated amount < $2.5 billion	$148,000 cap
$2.5 billion ≤ rated amount < $3.0 billion	$158,000 cap
$3.0 billion ≤ rated amount < $3.5 billion	$173,000 cap
$3.5 billion ≤ rated amount < $4.0 billion	$183,000 cap
$4.0 billion ≤ rated amount < $4.5 billion	$198,000 cap
$4.5 billion ≤ rated amount < $5.0 billion	$223,000 cap

$5 billion ≤ rated amount -- $248,000 cap

First & Second- Lien, Jumbo, ALT A & Subprime structures requiring Excess Spread analysis.

$1.0 billion ≤ rated amount < $1.5 billion	$143,000 cap
$1.5 billion ≤ rated amount < $2.0 billion	$148,000 cap
$2.0 billion ≤ rated amount < $2.5 billion	$158,000 cap
$2.5 billion ≤ rated amount < $3.0 billion	$163,000 cap
$3.0 billion ≤ rated amount < $3.5 billion	$178,000 cap
$3.5 billion ≤ rated amount < $4.0 billion	$183,000 cap
$4.0 billion ≤ rated amount < $4.5 billion	$198,000 cap
$4.5 billion ≤ rated amount < $5.0 billion	$223,000 cap

$5 billion ≤ rated amount -- $248,000 cap

Complex Net Interest Margin (NIM) Transaction

Seasoned Collateral

Fees to rate NIMS supported by seasoned transactions:

Generally a fee of $10,000 to $15,000 per S&P rated underlying deal or $20,000 to $30,000 per S&P non-rated deal is charged, plus a fee of $75,000 for the new NIMS rating.

NIMS with Multiple U/L Deals

In additional to the standard fee of $60,000 for one underlying deal, deals with multiple underlying deals will be billed as follows:

The 2nd and 3rd deal will be billed at an additional $25,000 per deal.
The 4th and 5th deal will be billed at an additional $15,000 per deal.
Deals with greater than 5 underlying deals will be determined on a case-by-case basis.

NIMS with Multiple Rated Classes
For the standard $60,000 NIM fee, S&P will rate deals with up to 2 different rating categories. For deals with 3 or more rating categories S&P will charge an additional $10,000 fee per additional rating category.

SECONDARY MARKET RATING FEES

Wrapped Transactions

The fee to analyze the insurance capital charge for wrapping an existing Standard & Poor's rated certificate is $2,500. In the case of tranches or transactions that have not previously been rated by Standard & Poor's, a fee of three (3.0) basis points is charged for analyzing capital charge requirements, with a minimum fee of $15,000.

Subordinated Class Ratings

In the case where subordinated classes are rated subsequent to the initial rating of the senior classes, an additional fee is assessed. Fees generally are in the range of three (3.0) basis points with minimums dependent on size and timing of transactions.

Re-REMIC Transactions

Currently, Re-REMICs consist of three distinct types of transactions each with a different structure, rating methodology and fees.

(1) Traditional Re-REMICs involve the rating on a pool of outstanding Standard & Poor's rated single-family mortgage certificates all of which have the same rating. The fees for traditional Re-REMICs are three (3.0) basis points on the total dollar amount of certificates issued with a minimum fee of $25,000 and a maximum fee of $150,000 with a break-up charge equal to 50% of the fee.

(2) Re-REMICS consisting of certificates that are non-rated by Standard & Poor's or are a mix of ratings (i.e. "AAA", "AA", or "A" etc) can only be rated by the RMBS group based on a current collateral tape with current (no more than 90 days old) FICO scores. Fees for this type of Re-REMIC are three (3.0) basis points on the total collateral analyzed with a minimum fee of $50,000 and a maximum fee of $250,000 for pools of $2.0 billion or less with a break-up charge equal to 50% of the fee. Fees for larger transactions are determined on a case-by-case basis.

(3) Re-REMICS or mixed certificates similar to (2) above that do not have current tapes available must be submitted to Standard & Poor's CDO group for rating.

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RMBS SURVEILLANCE FEES:

Standard & Poor's surveillance fees for all transactions, including those that utilize bond insurance, and except for U.S. Reverse Mortgages, Tax Lien Transaction and other types of transactions listed below, are charged at the time of the initial rating based on the term of the collateral. The schedules are presented below.

Up front Surveillance Fee Schedule:

Less than or equal to 15-year term (1 loan group):	$ 6,000
Greater than 15-year term (1 loan group):	$ 8,000
Multiple Loan Groups (regardless of term):	$10,000
NIMS	$ 4,000

Annual Surveillance Fee Schedule:

U.S. Reverse Mortgages	$2,500
Tax Lien Transactions	$2,500

Fees for the surveillance of the following types of transactions are negotiated on a case-by-case basis. These include:

- Advance Backed Notes
- Construction Loan Backed Notes
- Mortgage Risk Transfers
- Re-REMICs (underlying transactions not previously rated by S&P)

Amendment Fees:

A fee is charged for the review of certain types of amendments or changes to existing transactions. Generally, the fee ranges from $ $1,500 to $10,000, but is not limited to these amounts. The following is an example of such changes and the related fee:

Replacement of existing deal participants with successors such as the trustee, servicer, depository institution, liquidity provider, credit support provider, etc.	$1,500
Changes to definitions or clauses	$2,500
Substitution of form of credit support, changing to newly assessed credit support amount or minor changes or corrections needed to obtain intended structure.	$5,000
Restructuring of security	$10,000

Generally the fee is applied per deal. The fee is negotiable for a series of transactions where the amendment or change is the same.

RMBS SERVICER EVALUATIONS

Standard & Poor's Residential Servicer Evaluation provides a comprehensive assessment of a firm's operational capabilities as a residential servicer. Standard & Poor's requires a periodic review and ranking of servicers. A servicer must be included in Standard & Poor's Select Servicer List in order to participate in a Standard & Poor's rated transaction. In order to do so a servicer must achieve a minimal ranking of Average with a Stable outlook. The initial fee for this evaluation is $35,000 to $45,000 plus reimbursement of actual travel expenses incurred, plus printing expenses if copies of the report are requested.

An evaluation assessment fee $35,000 to $45,000 (plus any applicable printing expenses if copies of the report are requested) will be charged annually thereafter on each anniversary of the initial evaluation.

The McGraw-Hill Companies

STANDARD & POOR'S

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U.S. STRUCTURED RATINGS FEE SCHEDULE

COLLATERALIZED DEBT OBLIGATIONS
Amended 3/7/07

OVERVIEW

This fee schedule applies to both insured and uninsured Collateralized Debt Obligations rated in the United States. Separate fee schedules are available for the following types of structured financings:

- Asset Backed Obligations
- Residential Mortgage-Backed Financings
- Commercial Mortgage-Backed Financings
- Real Estate Companies
- New Assets

Please note that in the case of unique structures or securitizations involving new issuers and new product types, Standard & Poor's reserves the right to quote a fee for the analytical work performed. In addition, legal fees are charged for special research associated with such new issuers, products or structures are in addition to Standard & Poor's fees and will be billed separately.

Standard & Poor's performs an independent and objective analysis. The rating that results from the analytical process may or may not be consistent with the expectations of the issuer or arranger. The fee for services is not contingent upon the issuer's or arranger's acceptance of the assigned rating.

PRIMARY CONTACTS

Patrice Jordan	Managing Director	Global Practice Leader, Global CDOs	(212) 438-2501
David Tesher	Managing Director	Cash Flow and Market Value CDOs	(212) 438-2618
Andrea Bryan	Managing Director	Synthetic CDOs	(212) 438-2409
Nik Khakee	Director	Operating Companies and SIVs	(212) 438-2473
Peter Kambeseles	Managing Director	Client Value Manager	(212) 438-1168
Elwyn Wong	Managing Director	Client Value Manager	(212) 438-2460
Peter D'Erchia	Managing Director	Global Practice Leader, Surveillance	(212) 438-2438

If you have any questions about this fee schedule or require additional information, please contact the Client Value Managers.

CASH FLOWS CDOs

Initial Rating Fee

The initial rating fee for CBO/CLOs is 3.5 basis points of the Commercial Paper issuance plus basis points for each term issuance based on the principal amount rated. Costs for direct expenses and legal review (external legal fees will be up to $25,000) will be charged in addition to the rating fee. Minimum and maximum fees are as follows:

Basic Fee	3.5 basis points of the CP issuance plus 7 basis points of the term notes
Minimum Fee	$ 150,000
Maximum Fee	$ 500,000

A surcharge may be imposed on "first time" deals and deals that are unusual/new from a criteria perspective. Additional analysis for credit estimates, credit estimate surveillance, correlation analysis, etc., will be charged separately and are not included in the above fees.

Standard & Poor's reserves the right to charge a fee upon commencing each phase of the rating process. The three major phases are as follows:

Phase I	Preliminary review of the structure, manager and credit.
Phase II	Structural, cash flow, credit and legal review. Convene ratings committee. On-site sponsor/manager review.
Phase III	Final structural, cash flow, credit and legal review. Decision made on transaction ratings.

Annual Surveillance Fee

Standard & Poor's charges an annual surveillance fee of $35,000 to $50,000 annually or an up-front fee representing the present value of such fee.

Amendment Fees

A fee will be charged for amendments that require significant review of documentation, cash flow or collateral analysis.

Cancellation/Break-up Fee

Standard & Poor's charges a minimum break-up fee of $25,000. Additional fees will be assessed based on the interim fee for each phase detailed above. Each phase may be assessed at 33% of the overall transaction fee.

COMMERCIAL REAL ESTATE CDOs and ReREMICS (EXCLUDING SYNTHETIC CDOs)

Initial Rating Fee

The initial rating fees for Commercial Real Estate CDOs (excluding Synthetic CDOs) and ReREMICs is 7 – 10 basis points for each issuance based on the total ramped-up pool balance.

Basic Fee	7 – 10 basis points
Minimum Fee	$ 250,000
Maximum Fee	$1,750,000

In addition to the initial rating fee, costs for determining credit assessments for real estate collateral not possessing a Standard & Poor's credit rating or credit estimate will be charged and vary depending on collateral complexity.

Costs for legal review (external legal fees) will be charged in addition to the rating fee and vary depending on deal complexity.

A surcharge may be imposed on "first time" deals and deals that are unusual/new from a criteria perspective. Additional analysis for credit estimates, credit estimate surveillance, correlation analysis, etc., will be charged separately and are not included in the above fees.

Standard & Poor's reserves the right to charge a fee upon commencing each phase of the rating process. The three major phases are as follows:

Phase I	Preliminary review of the structure, manager and credit.
Phase II	Structural, cash flow, credit and legal review. Convene ratings committee. On-site sponsor/manager review.
Phase III	Final structural, cash flow, credit and legal review. Decision made on transaction ratings.

Annual Surveillance Fee

Standard & Poor's charges and annual surveillance fee of $20,000 - $50,000 annually or an up-front fee representing the present value of such fee.

Cancellation/Break-up Fee

Standard & Poor's charges a minimum break-up fee of $25,000, plus any work performed on credit estimates. Additional fees will be assessed based on the interim fee for each phase detailed above. Each phase may be assessed at 33% of the overall transaction fee.

Amendment Fees

A fee will be charged for amendments that require significant review of documentation, cash flow or collateral analysis.

CMBS SERVICER EVALUATIONS

Standard & Poor's Commercial Servicer Evaluation provides an objective assessment of a firm's operational capabilities as a commercial servicer. Standard & Poor's requires a periodic review and ranking of servicers. A servicer must be included in Standard & Poor's Select Servicer List in order to participate in Standard & Poor's rated transaction. In order to do so a servicer must achieve a minimal ranking of Average with a Stable outlook. The initial fee for this evaluation is $35,000 -$55,000 plus reimbursement of actual travel expenses incurred, plus printing expenses if copies of the report are requested.

An evaluation assessment fee of $35,000 - $55,000 (plus any applicable printing expenses if copies of the report are requested) will be charged annually thereafter on each anniversary of the initial evaluation.

COMMERCIAL REAL ESTATE CDO ASSET MANAGER EVALUATION

Standard & Poor's Commercial Real Estate CDO Asset Manager Evaluation provides an objective assessment of a CDO asset manager's operational capabilities as a commercial asset manager for select commercial real estate CDOs. A Commercial Real Estate CDO Asset Manager must be qualified in order to participate in a Standard & Poor's rated transaction.

The initial fee for this evaluation is $10,000, plus reimbursement of actual travel expenses incurred. An evaluation assessment fee of $10,000 will be charged annually thereafter on each anniversary of the initial evaluation.

SYNTHETIC CDOs

Initial Rating Fee

The initial rating fee for each issuance of Synthetic CDOs depends on the following factors, among other; rated volume, type of collateral, liability rating and tenor, portfolio turnover, etc. Costs for direct expenses and legal review will be charged in addition to the rating fee. Minimum and maximum fees are as follows:

Minimum Fee	$ 30,000
Maximum Fee	$750,000

A surcharge may be imposed on "first time" deals and deals that are unusual/new from a criteria perspective. Additional requirements such as credit estimates, credit estimate surveillance, correlation analysis, etc., will be charged separately, and are not included in the above fees.

Standard & Poor's reserves the right to charge a fee upon completion of each phase of the rating process. The three major phases are as follows:

Phase I	Preliminary review of the structure, manager and credit.
Phase II	Structural, cash flow, credit and legal review. Convene ratings committee. On-site sponsor/manager review.
Phase III	Final structural, cash flow, credit and legal review. Decision made on transaction ratings.

Annual Surveillance Fee

For static pools, Standard & Poor's charges an annual surveillance fee of up to $15,000, or an up-front fee representing the present value of such fee. For managed pools, Standard & Poor's charges an annual surveillance fee that ranges from $10,000 to $50,000, or an up-front fee representing the present value of such fee.

Amendment Fees

A fee will be charged for amendments that require significant review of documentation, cash flow or collateral analysis.

Cancellation/Break-up Fee

Standard & Poor's charges a minimum break-up fee of $25,000. Additional fees will be assessed based on the interim fee for each phase detailed above. Each phase may be assessed at 33% of the overall transaction fee.

PROGRAM SET-UP FEE FOR MULTI-ISSUANCE VEHICLES

A Program Set-Up fee of $50,000 will be charged at the time of set-up for new synthetic vehicles.

Amendment Fees

A fee will be charged for amendments and collateral additions/removals that require significant review of documentation and/or collateral analysis.

MARKET VALUE CDOs

Initial Rating Fee

The initial rating fee for Market Value CDOs is 7 - 8 basis points for each issuance based on the total issuance amount. Costs for direct expenses and legal review (external legal fees will be $25,000) will be charged in addition to the rating fee. Minimum and maximum fees are as follows:

Basic Fee	7 - 8 basis points
Minimum Fee	$150,000
Maximum Fee	$500,000

A surcharge may be imposed on "first time" deals and deals that are unusual/new from a criteria perspective. Additional requirements such as credit estimates and credit estimate surveillance, correlation analysis, recovery analysis, etc., will be charged separately, and are not included in the above fees.

Standard & Poor's reserves the right to charge a fee upon completion of each phase of the rating process. The three major phases are as follows:

Phase I	Preliminary review of the structure, manager and credit.
Phase II	Structural, cash flow, credit and legal review. Convene ratings committee. On-site sponsor/manager review.
Phase III	Final structural, cash flow, credit and legal review. Decision made on transaction ratings.

Annual Surveillance Fee

Standard & Poor's will assess an annual surveillance fee of $35,000 or an up-front fee representing the present value of such fee. Standard & Poor's reserves the right to negotiate significantly higher fees for certain structures.

Amendment Fees

A fee will be charged for amendments that require significant review of documentation, cash flow or collateral analysis.

Cancellation/Break-up Fee

Standard & Poor's charges a minimum break-up fee of $25,000. Additional fees will be assessed based on the interim fee for each phase detailed above. Each phase may be assessed at 33% of the overall transaction fee.

Redacted By The Permanent Subcommittee on Investigations

DATE: 04/27/2007
TIME: 18:44:24 GMT
AUTHOR: Yoshizawa, Yuri
RECEIPIENT: Kimon, Noel
CC: Harris, Gus
SUBJECT: TMD Comp

[redacted] = **Redacted by the Permanent Subcommittee on Investigations**

Noel,

I've attached a comparison of US Derivatives TMD comp (with each other and with [redacted]). After the planned increase for Rudy, the difference in Base/Target compensation between [redacted] and [redacted] shrinks from $42k to $20k. That said, including the equity that they received for this past year, the difference is really $139k.

In the spreadsheet, I have a proposal that I've already discussed with Gus, for a slight ($15k) increase to total comp for [redacted] that will increase the gap between him and [redacted] but only to the point where there is still a gap between him and [redacted], which we believe is appropriate. Gus and I spoke with [redacted] earlier this week regarding the transition of HG ABS CDOs to [redacted] and regarding our expectations of what he needs to work on (i.e., efficiency, delegation of responsibilities and knowledge transfer to team leaders, interaction with bankers, flexibility, etc.). We would propose that if we agree to give him the increase, that we wait for a few months to see whether he shows improveme

Current

Name	Title	Base as of 4/26/2007	Target as of 4/26/2007	Total Comp 4/26/2007	[redacted]	Base as of 07/1/2007	Target as of 7/1/2007	Total Comp 7/1/2007	[redacted]	2007 Equity - Total Grant Value	Total Comp including 2007 Equity	[redacted]
[redacted]	SVP	235,597	107,641	343,238	[redacted]	255,000	109,794	**364,794**	[redacted]	192,259	**557,052**	[redacted]
[redacted]	TMD	265,000	120,000	385,000	[redacted]	265,000	120,000	**385,000**	[redacted]	310,834	**695,834**	[redacted]
[redacted]	TMD	286,140	131,250	417,390	[redacted]	286,140	131,250	**417,390**	[redacted]	396,747	**814,137**	[redacted]
[redacted]	TMD	291,200	131,250	422,450	[redacted]	291,200	131,250	**422,450**	[redacted]	430,766	**853,216**	[redacted]
[redacted]	TMD	305,550	155,800	461,350	[redacted]	305,550	155,800	**461,350**	[redacted]	476,125	**937,475**	[redacted]

Proposal

Name	Title		Base	Target	Total Comp	[redacted]	2007 Equity - Total Grant Value	Total Comp including 2007 Equity	[redacted]
[redacted]	SVP		255,000	109,794	**364,794**	[redacted]	192,259	**557,052**	[redacted]
[redacted]	TMD		**275,000**	**125,000**	**400,000**	[redacted]	310,834	**710,834**	[redacted]
[redacted]	TMD		**290,000**	131,250	**421,250**	[redacted]	396,747	**817,997**	[redacted]
[redacted]	TMD		291,200	131,250	**422,450**	[redacted]	430,766	**853,216**	[redacted]
[redacted]	TMD		305,550	155,800	**461,350**	[redacted]	476,125	**937,475**	[redacted]
		Additional Funds:	**######**	**5,000.00**	**######**				

STANDARD
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Standard & Poor's Global Compensation Guidelines 2007/2008

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The McGraw-Hill Companies

S&P Senior Analytical Incentive Plan ("SAIP") for Ratings Analytical Personnel

SAIP Objectives:

- Attract, motivate and retain superior analytical talent.
- Encourage individual and collective performance towards the achievement of specific, measurable goals.
- Provide appropriate compensation levels to maintain the highest standards of analytical quality.

Eligibility is limited to:
Senior credit rating analytical staff in Structured Finance, C&G and the Quants: Managing Directors, Directors, Associate Directors, Associates, Associate General Counsels and Assistant General Counsels of Standard & Poor's Ratings Services, provided they are employed as such by September 30th.

SAIP Global Guidelines for Performance Year 2007 (as a % of the employee's base salary as of December 31st)

Level	Breakthrough	Exceptional	Target	Requires Improvement
A24	0% to 120%	0% to 90%	0% to 60%	0%
A23	0% to 110%	0% to 83%	0% to 55%	
A22	0% to 100%	0% to 75%	0% to 50%	
A21	0% to 70%	0% to 55%	0% to 35%	
A20	0% to 60%	0% to 45%	0% to 30%	

The guidelines are broad to provide flexibility for managers to ensure that incentive payouts appropriately reflect distinctions in employee performance and contribution to business unit, department and company success.

Overall, Breakthrough performers are expected to earn at least 1/3 more than Exceptional Performers, and Exceptional Performers are expected to earn at least 1/3 more than Target Performers.

Employees who receive an overall PMP rating of Requires Improvement are not eligible to receive an incentive payout for that performance year.

Any exception requests must be submitted to the S&P Compensation Council by the global unit head during the first week of February. Requests for adjustments post-process will not be accepted.

All payout recommendations require the approval of the S&P Compensation Council and by McGraw-Hill senior management.

Long-Term Stock Incentives: Executives

Recommend Values: Managers are to recommend 2008 long-term incentive awards in terms of US-dollar values. On the April 1st award date, McGraw-Hill's Executive Compensation specialists will convert the dollars to stock option grants and RPS/PSU Awards based on the stock price, option fair value, and on the mix of equity vehicles at each grade level.

- Rounding: Recommendations should be made in increments of US$1,000.
- Currency Rates: Recommended LTI amounts made in US$ will be converted to local currency in SPECS to facilitate Total Direct Compensation comparisons.

Fair Value: The McGraw-Hill Controller's Office will utilize an option valuation model to determine the "Fair Value" of a stock option on the grant date. The option exercise price, and the RPS/PSU award date value, will be the closing fair market value on the award date.

2008 LONG-TERM INCENTIVE GUIDELINES BY PERFORMANCE RATING

- ***Awards for Grade Level 23 through 27 will be delivered as 25% options and 75% RPS/PSU.***
- Compensation Decision Makers are to make recommendations in terms of values; McGraw-Hill Executive Compensation will calculate the conversion on the award date.

Grade Level	Target Achievement	Exceptional Achievement	Breakthrough Achievement
24	up to $75,000	up to $105,000	up to $135,000
23	up to $55,000	up to $77,000	up to $100,000

STANDARD & POOR'S

Standard & Poor's Ratings Services

S&P US
2008 Base Salary Ranges
Ratings Services Analytical Positions Only

Job Title	Grade Level	Minimum	Midpoint	Maximum
Managing Director	A24	$154,500	$225,800	$297,300
Sr Director	A23	$133,700	$199,100	$264,500
Director	A22	$113,000	$172,300	$231,800
Associate Director	A21	$95,100	$136,800	$178,500
Associate	A20	$71,200	$106,900	$142,700

The salary ranges above are to be referenced for analytical positions in Ratings Services only (i.e., Structured Finance and C&G). If your positions are not covered by the salary ranges for Ratings Services roles please reference your merit increase budget, each employee's relative performance, and local market insights.

PAULSON & CO. INC.

"The Subprime Mortgage / Credit Crisis"

John Paulson
President

Investment Management

1251 Avenue of the Americas
50th Floor
New York, NY 10020
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CONFIDENTIAL

January 25, 2010

LEGAL DISCLAIMER

This document does not constitute an offer to sell or a solicitation of an offer to buy any securities, and may not be relied upon in connection with any offer or sale of securities. This document should be read in conjunction with, and is qualified in its entirety by, information appearing in the Confidential Private Offering Memorandum (and a Limited Partnership Agreement for domestic partnerships), which should be carefully reviewed prior to investing. Past performance is not necessarily indicative of future performance, and although the Advantage Funds may invest in some of the same securities as the Merger Funds, the broader strategy may result in performance that is different from that of the Merger Funds.

An investment in a hedge fund is speculative and involves a high degree of risk, which each investor must carefully consider. An investor in hedge funds could lose all or a substantial amount of his or her investment. Returns generated from an investment in a hedge fund may not adequately compensate investors for the business and financial risks assumed. While hedge funds are subject to market risks common to other types of investments, including market volatility, hedge funds employ certain trading techniques, such as the use of leveraging and other speculative investment practices that may increase the risk of investment loss. Products may involve above-average risk. Risks associated with hedge fund investments include, but are not limited to, the fact that hedge funds can be highly illiquid; they are not required to provide periodic pricing or valuation information to investors; they may involve complex tax structures and delays in distributing important tax information; they are not subject to the same regulatory requirements as mutual funds; they often charge higher fees and the high fees may offset the funds' trading profits; they may have a limited operating history; they can have performance that is volatile; they may have a fund manager who has total trading authority over the fund and the use of a single adviser applying generally similar trading programs could mean a lack of diversification, and consequentially, higher risk; they may not have a secondary market for an investor's interest in the fund and none may be expected to develop; they may have restrictions on transferring interests in the fund; and may effect a substantial portion of their trades on foreign exchanges.

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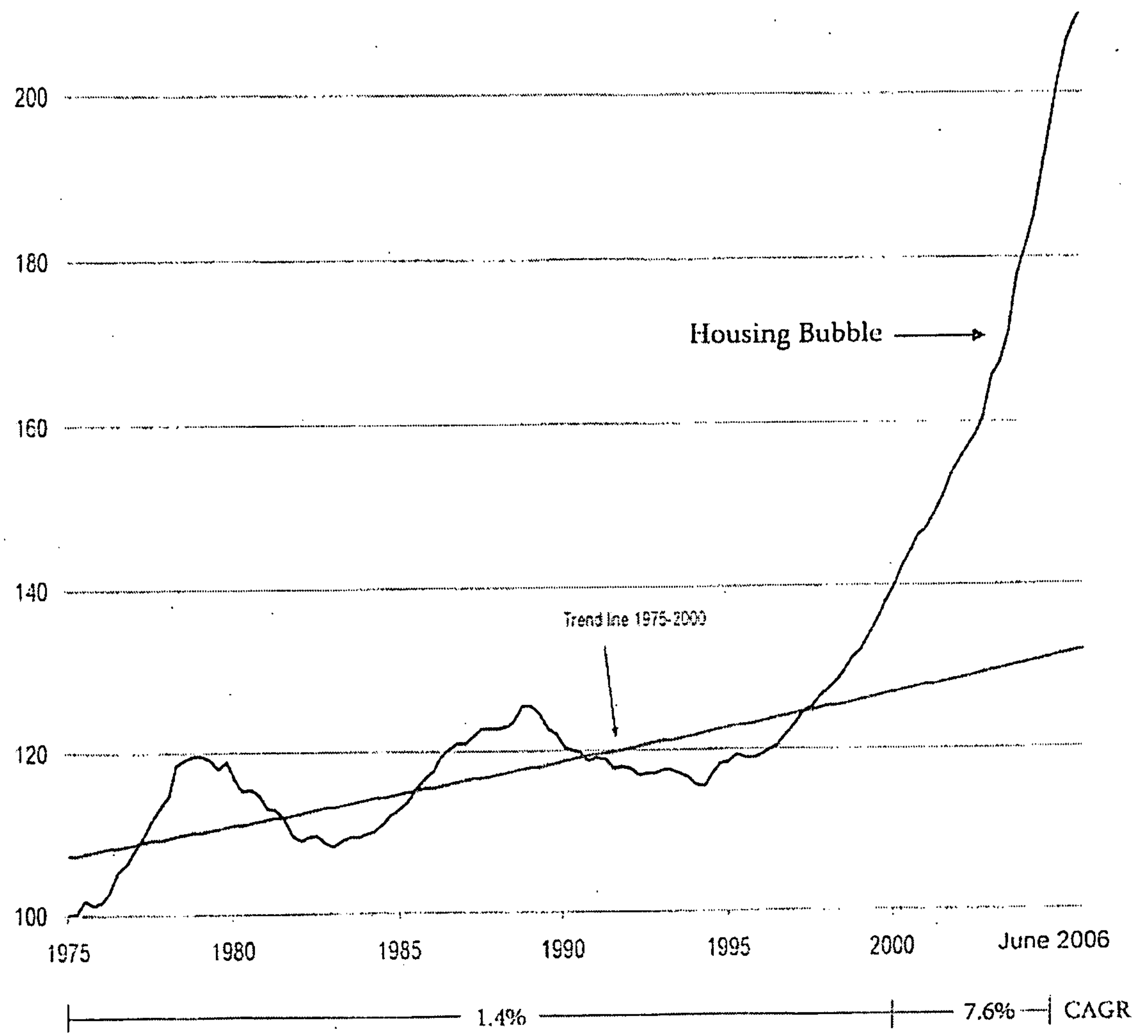
ESTIMATION OF HOUSING BUBBLE: Comparison of Recent Appreciation vs. Historical Trends

Real Home Price Index (1975 = 100)



Source: Office of Federal Housing Enterprise Oversight, Bureau of Economic Analysis

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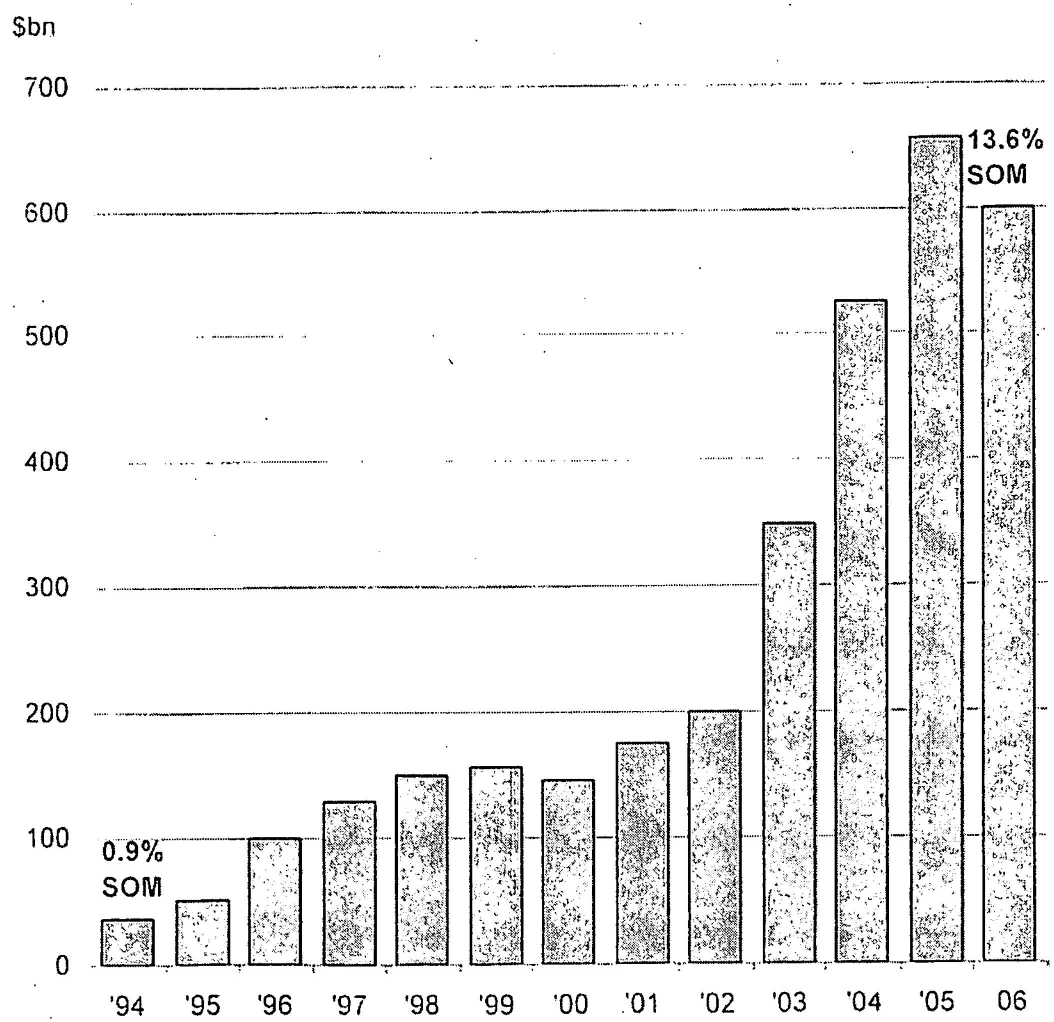
MORTGAGE SUBPRIME ORIGINATION



Source: Lehman Brothers

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60 DAY+DELINQUENCY AND FORECLOSURE

	2006	2007	% Change YoY
January	5.6%	9.4%	68.6%
February	5.8%	9.9%	71.9%
March	5.8%	10.4%	79.0%
April	5.6%	10.7%	91.3%
May	5.9%	11.3%	92.0%
June	5.8%	12.2%	109.7%
July	6.0%	13.4%	121.7%
August	6.5%	14.8%	127.4%
September	6.8%	16.3%	139.3%
October	7.4%	18.1%	145.3%
November	8.0%	19.9%	150.5%
December	**8.6%**	**22.0%**	**155.2%**

Source: LoanPerformance

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Fact Sheet for Three Examples of Failed AAA Ratings

	Vertical ABS CDO 2007-1	Fremont (GSAMP Trust 2007-FM2)	Delphinus CDO 2007-1, Ltd.
Type	Hybrid CDO	RMBS	Hybrid CDO
Size	$1.5 billion	$1 billion	$1.6 billion
Underwriter	UBS	Goldman Sachs	Mizuho
Initial Rating Date; S&P **Moody's**	4/10/2007 4/26/2007	02/28/2007 03/08/2007	08/02/2007 07/31/2007
# AAA tranches	3	5	7
First downgrade; S&P **Moody's**	11/14/2007 10/25/2007	10/17/2007 12/04/2007	12/21/2007 11/07/2007
First downgrade AAA; S&P **Moody's**	11/14/2007 10/25/2007	08/20/2008 10/23/2008	12/21/2007 01/18/2008
Current rating of AAA; S&P **Moody's**	Withdrawn Withdrawn	4 out of 5: CCC 4 out 5: Caa3 and below	Withdrawn Withdrawn

Source: Prepared by the Subcommittee based on information from S&P and Moody's websites, February 22, 2011. The sizes are all approximations.

From: Gutierrez, Michael
Sent: Sunday, October 01, 2006 12:04 PM
To: Mackey, Robert
Subject: RE: REO DATA

I agree

-----Original Message-----
From: Mackey, Robert
Sent: Saturday, September 30, 2006 2:10 PM
To: Gutierrez, Michael
Subject: RE: REO DATA

may I also recommend that if we bring Anne on board we could have her do some of this important data collecting and analysis for us while we get her up to speed.

-----Original Message-----
From: Gutierrez, Michael
Sent: Saturday, September 30, 2006 2:07 PM
To: Mackey, Robert; Koch, Richard; Highland, Edward; Frie, Steven
Subject: RE: REO DATA

Good questions all of which we should discuss further

-----Original Message-----
From: Mackey, Robert
Sent: Saturday, September 30, 2006 11:06 AM
To: Gutierrez, Michael; Koch, Richard; Highland, Edward; Frie, Steven
Subject: RE: REO DATA

The numbers are alarming, yet very consistent (gross, net, and loss severity). Is there a way we could dig a little deeper into several of the clients responses to determine liquidation costs, REO, handling costs etc. to "back into" potential *overzealousness* on the front end? Should the loss severity percentage become more important in our analysis?

-----Original Message-----
From: Gutierrez, Michael
Sent: Friday, September 29, 2006 4:48 PM
To: Koch, Richard; Highland, Edward; Frie, Steven; Mackey, Robert
Subject: RE: REO DATA

You hit it right on the head - Ernestine told me that broken down to loan level what she is seeing in losses is as bad as high 40s -low 50s % I'd love to be able to publish a commentary with this data but maybe too much of a powder keg

I'm still at a loss over what to talk about at the RMBS Hot Pockets in October

-----Original Message-----
From: Koch, Richard
Sent: Friday, September 29, 2006 3:50 PM
To: Highland, Edward; Gutierrez, Michael; Frie, Steven; Mackey, Robert
Subject: RE: REO DATA

No, I think it is telling us that underwriting fraud; appraisal fraud and the general appetite for new product among originators is resulting in loans being made that shouldn't be made.

Hey Mike, if Spitzer could prove coercion this could be a RICO offense!

-----Original Message-----
From: Highland, Edward
Sent: Friday, September 29, 2006 2:40 PM
To: Gutierrez, Michael; Frie, Steven; Koch, Richard; Mackey, Robert
Subject: RE: REO DATA

Is this telling us the foreclosure expense, winterizing, etc. is running at 40%?

Edward B. Highland, Jr.
Director
Standard and Poor's
55 Water Street
42nd Floor
New York, NY 10041-0003

Tel 212-438-1287
Fax 212-438-2662

Edward_Highland@sandp.com
www.stardardandpoors.com

-----Original Message-----
From: Gutierrez, Michael
Sent: Friday, September 29, 2006 12:20 PM
To: Frie, Steven; Koch, Richard; Mackey, Robert; Highland, Edward
Subject: FW: REO DATA

Gents:

Take a look at these stats - I find them most interesting!!

-----Original Message-----
From: Moskowitz, Gregg
Sent: Friday, September 29, 2006 10:52 AM
To: Gutierrez, Michael
Subject: REO DATA

<< File: lossseverity.xls >>

Gregg Moskowitz
Senior Research Assistant, Structured Finance Ratings
Standard & Poor's
55 Water Street (42nd Floor)
New York, NY 10041-0003
☎ (212)438-1838
🖷 (212)438-2662
🖳 Gregg_Moskowitz@standardandpoors.com

From: Pollsen, Robert
Sent: Tuesday, February 14, 2006 11:13 AM
To: Agbabiaka, Taoheed; Avant-Koger, Paula; Clarke, Lisa; Davey, Scott; Giudici, Andrew; Graffeo, Michael; Joyce, Kristymarie; Liu, Shawn; Mahabir, Lal; Rao, Asha; Recentes, Darwin; Rivera, Jessica; Rivera, John; Rocha, Martha; Warner, Ernestine; Young, Steven 2/13/2006; Albergo, Leslie; Kostiw, Karen; Mcdermott, Gail; Osterweil, Terry; Stock, Michael; Warrack, Thomas

Subject: U.S. HOUSING MARKET - Looming "reset problem" - article in Barron's 2/13/2006...

Coming Home to Roost By JONATHAN R. LAING (from ***Barron's*** 2/13/2006)
THE RED-HOT U.S. HOUSING MARKET MAY be fast approaching its date with destiny. Indeed, inside the mortgage trade, much anxiety is being focused on a *looming "reset problem." Over the next two years, monthly payments on an estimated $600 billion of mortgages to borrowers with checkered or no credit histories -- the "sub-prime" market -- may zoom as much as 50% higher, as the two-year teaser rates on hybrid adjustable-rate loans expire and interest payments hit their fully indexed levels.*
In the past, such resets caused little disruption. For one thing, the sub-prime market was strikingly smaller. Only $97 billion of such mortgages were originated in 1996, compared with a mammoth $628 billion last year and $540 billion in 2004, according to the trade publication Inside B&C Lending. Sub-prime loans outstanding now account for more than 10% of the total U.S. mortgage debt of $8.4 trillion.
Moreover, the reset triggers on sub-prime mortgages have dramatically shortened, with the loosening in underwriting standards. ***During the past two years, "affordability" products, as the industry has dubbed them, have migrated from prime to sub-prime borrowers***. Sub-prime borrowers used a variety of products, including:
Hybrid ARMs, with low teaser rates in the early years.
"IO Mortgages," which, in their early years, charge interest only and require no repayment or amortization of principal.
"Stated Income" or **"No Doc" Loans**, requiring no verification of a borrower's income.
Option ARMs, which give borrowers the option of making smaller than normally required monthly payments, with the unpaid portion being added to principal.
Piggy-Back Mortgages, in which the borrower received a first mortgage of, say, 80% of a home's value, plus a credit line to cover his down payment on a new home.
Surging property values in much of the country in the past four years helped bail out many sub-prime borrowers, letting them refinance their loans as painful resets loomed. Many borrowers not only refinanced old debt at attractive teaser rates, but also sucked additional equity out of their homes with cash-out refinancings, to pay off higher-rate credit-card debt. Meanwhile, delinquency rates and credit losses remained artificially low. A tapped-out borrower always could sell his home into a soaring real-estate market to pay off his mortgage debt and regroup.

But now *the refi window may be closing for the sub-prime crowd*. The Fed's hikes in short-term interest rates have pushed up fully indexed ARM rates. At the same time, evidence is mounting that home-price appreciation is slowing or, in a few areas, reversing. And the secondary market in mortgage-backed securities, which provides some 90% of the liquidity in the sub-prime market, is starting to balk at the easy lending practices in this sector.

Various doomsday scenarios are being posited. A New York hedge-fund manager heavily playing the short side of sub-prime mortgage securities foresees a coming spiral in delinquencies, foreclosures and credit losses from tapped-out sub-prime borrowers facing monthly payments they can't meet. A deadly feedback loop impends in which forced home sales will diminish collateral values, which, in turn, will foster yet more delinquencies and forced sales. Before the crisis runs its course, the deflationary contagion will infect all manner of homes, from high-end to starters, says this bear.

To be sure, this prediction is both apocalyptic and self-serving. Market shifts usually tend to unfold slowly enough to let players adjust. "I just don't see any coming collapse in the sub-prime market as long as the U.S. economy and job growth stays strong and interest-rate increases remain subdued," insists Doug Duncan, chief economist of the Mortgage Bankers Association in Washington. Echoes Guy Cecala, publisher of Inside B&C Lending: "People have been crying wolf about the looming sub-prime reset crisis for two years and nothing has happened. Lending standards are now being tightened up, so I expect we'll muddle through."

Perhaps so. But significant sticker shock impends for sub-prime borrowers. Say they are paying a fixed teaser rate of 7% (typical of what the 2004 and 2005 cohort of sub-prime borrowers had to pay while borrowers with good credit got fixed rates of 5%). Come reset, typical contracts call for a floating rate of 600 basis points, or six full percentage points over the six-month London interbank offered rate, a money-market benchmark. Six-month LIBOR has risen to around 4.7%, which means that *the borrower would face more than a 50% jump in mortgage interest expense to 10.7%*, subject to certain temporary caps on the permissible jump in interest rates.

The shock will be even greater for the sub-prime borrowers who are facing not only a jump from a fixed to a floating rate, but also the burden of amortizing principal after two years of interest-only payments. And for many, the interest- rate reset and IO expiration will occur on the same day -- a reflection of the "risk layering" prevalent in the sub-prime market over the past two years.

Of course, if sub-prime borrowers have enough untapped equity in their homes, they will be able to refinance their loans on somewhat similar terms -- the new teaser rates have risen to only 7.5% -- and roll the dice for another two years.

But Glenn Costello of Fitch Ratings estimates that at least a quarter of all sub-prime borrowers facing resets may have precious little equity left, even with the huge surge in home prices in the past two years. Many piggy-backed loans to borrow the down payment on their homes, in addition to taking on a conventional mortgage. "For some borrowers, there will just be no loan-to-value gap left," Costello contends.

In recent months, mortgage underwriting standards have indeed begun to tighten, mostly at the instigation of the secondary market, where the bulk of all sub-prime mortgages trade as securities. Investors seem to have lost much of their zest for IOs and hybrid ARMs. Risk layering is also being discouraged. Reset periods are also being extended out to five years to avoid future refinance jam-ups like what now looms in the next two years.

Even more ominous for the sub-prime borrowers with more than $600 billion or mortgages resetting in the next two years would be new standards for "nontraditional" mortgage products that have been jointly proposed by a number of federal regulators (the Office of the Comptroller of the Currency, the Federal Reserve, the FDIC, the Office of Thrift Supervision and the National Credit Union Administration).

The regulators want lenders to qualify borrowers, based on the full payments they will incur once teaser rates expire or full principal amortization on the loans begin. The prevailing practice in the sub-prime industry, however, considers only initial monthly payment levels.

Deutsche Bank Securities analyst Eugene Xu illustrates the impact such standards, if eventually implemented, would have on sub-prime borrowers hitting the refi window.

A household making $60,000 a year, with a total debt-to-income ratio of 40%, currently could qualify for a $288,000 hybrid ARM, paying a fixed interest-only rate of 7.5% for the first two years, followed by 28 years of floating rates. But if the underwriting standard were based on the current fully indexed 10.7% rate, the applicant would qualify for a loan of just $192,000.

These days, many sub-prime lenders are offering 40-year fixed-rate mortgages to reduce monthly payments. But even under this scenario, our hypothetical borrower would be able to obtain only a $234,000 loan at the prevailing sub-prime rate of 9% , says Xu. "The implication of all this is that many sub-prime borrowers who took out loans in recent years may not be able to refinance unless their income increases or interest rates drop significantly," he observes dryly. In other words, the American Dream of home ownership could turn into a Roach Motel nightmare.

Of course, the proposed standards are likely to be watered down. And if U.S. home prices keep rising smartly, the refinance crisis in the sub-prime market could be largely avoided. Industry economists from Freddie Mac to the National Association of Realtors all think that a 5% to 7% rise in housing prices is easily doable this year, if not the double-digit surge of 2005.

SOME SIGNS OF PRICE WEAKNESS are already apparent. Inventories of unsold homes are building in areas that led the recent price boom, such as Southern California and the East Coast. In many areas, affordability indexes (which measure the ability of a family with the median income for that area to buy a home selling at the median price there) are at two-decade lows. Sales of used or "existing" homes have sunk for three consecutive months, according to the National Association of Realtors, even though that trade group's national figures showed that home prices in December were an extraordinary 12.7% above the year-earlier level.

Richard DeKaser, senior vice president and chief economist of Cleveland-based National City (ticker: NCC), has more than an academic interest in what's happening in housing. National City is not only a top-10 originator and servicer of prime mortgages, but it also owns a major sub-prime lending concern, First Franklin. These days, his attention is riveted on National City's quarterly survey "Home Prices in America." As of 2005's third quarter, the latest period for which data are available, it showed 38% of the U.S. housing market at an "extreme" overvaluation level of 30% or higher. The champ, or chump: Naples, Fla., where National City believes homes are 84% overvalued.

Experience in the 299 metropolitan areas covered in the survey shows that such levels of overvaluation are typically followed by price declines of about 15% that take an average of three years to unfold. If systemic and not merely localized, he asserts, any correction this time around could have nasty side-effects: "Individuals will suffer a wealth decline and spend less freely. Lenders will suffer elevated loans losses and credit conditions will tighten. Mortgage-backed securities will lose value and consumer confidence and home building will decline."

The survey's models and methodology are more sophisticated than many such valuation studies. Home-price-to-local-income ratios are only one element examined. The survey also makes adjustments for such factors as population density (in- or out-migration from an area can have a big impact of home prices), mortgage rates, relative income levels (rich folks will allocate more of their income to luxury homes as real income rises). The study also uses a local adjustment factor for home-price-to-income ratios. For example, Santa Barbara, Calif., and Honolulu always boast higher ratios than other metro areas, presumably because of such pluses as their stunning climes.

One ray of hope: The level of overvaluation is so high and has been for so long that DeKaser is beginning to doubt his models' current relevance and predictive value. "I worry that the massive secular shift from fixed-rate loans to ARMs and the greater purchasing power that homebuyers consequently have may have skewed our findings some," he says.

Another positive: Delinquency and foreclosure rates in the sub-prime market certainly evidence few signs of stress. According to Loan Performance, a San Francisco statistical service, just 2.43% of homes bought with sub-prime loans were in foreclosure in November. That was materially lower than the 4.38% reported three years earlier. Serious sub-prime delinquencies had likewise fallen over the three years through November, to 5.3% from 8.16%.

But these figures ignore several important realities. First, nearly all the $1 trillion in outstanding sub-prime loans were made in the past two years, to buy homes or refinance older debt. Such loans typically must age a year or more before repayment problems crop up.

Likewise, the low interest rates and looser lending standards available in the past two years have afforded all but the most busted-out sub-prime borrowers the ability to refinance on easy terms.

Of course, the huge levitation in home prices in 2004 and 2005 also did wonders for default and delinquency levels. Borrowers who couldn't afford their monthly payments were able to resolve their debt problems by merely selling their homes, sometimes even booking a profit in the process. This was especially true in overheated markets like California, which accounts for about 30% of sub-prime mortgage debt.

Deutsche Bank's Eugene Xu looked at mortgage-loss severity rates provided by Loan Performance on a range of loans between prime and sub-prime loans that defaulted over the past three years. All had first liens on the underlying properties and had original loan-to-value ratios of 75% to 85%. They were of superior quality, in other words, to many of the sub-prime mortgages outstanding today.

What he found was revelatory. In areas with moderate home-price gains over the past five years, such as Jackson, Tenn., Memphis and Indianapolis, which had compound price appreciation of less than 4%, loan-loss severity clocked in at more than 35% of the outstanding balance.

In contrast, areas such as Santa Barbara and San Diego, which saw huge annual price growth of over 16.4%, showed minimal loan losses of under 3%. "Sure other factors enter into loss severities such as closing costs and loan size, but previous price appreciation is the primary determinant," he asserts. "Thus, loss severities in key, overheated markets like California and New York could skyrocket by eight-to-10 fold even if home prices growth just moderates markedly rather goes negative."

Modern-day sub-prime lending burst onto the scene only in the mid-'Nineties, pushed by upstart lenders enticed by wide margins and fat fee income. Industry growth surged until a liquidity crisis erupted in 1998 in the U.S. credit markets, following the Russian ruble crisis and the collapse of the Long Term Capital Management hedge fund. Dozens of sub-prime lenders were driven out of business and hideous loan performance made road kill of outfits like the Money Store.

But the industry has roared back, riding the tidal wave of home-price appreciation that sub-prime loans have, in turn, helped foster. In recent years, a number of blue-chip companies such as Citigroup (C), General Electric (GE), Wells Fargo (WFC), H&R Block (HRB), Countrywide Financial (CFC) and HSBC (HBC) have muscled into the industry, mostly by buying existing players and letting them operate independently.

The sub-prime lending crowd has been rocked by more than its share of scandals since the turn of the millennium. Just last month, privately held Ameriquest settled with 49 states for $325 million. Among other things, it had been charged with systematically abusing customers by steering them into higher-cost loans and leaning on appraisers to inflate home appraisals so it could make larger loans.

Shortly after they're originated, nearly all sub-prime loans are packaged into securitizations and sold to public investors. As result, sub-prime offers the best of all worlds in most credit environments. Borrowers assume the bulk of the interest- rate risk by taking out ARMs and can be a source of fat fee income. Meantime, all or most of the credit risk on the loans is shifted to the investors in securitizations.

Obviously, any smash-up in the sub-prime market would hurt lenders. Some such as New Century Financial (NEW) are set up as real-estate investment trusts and, as such, retain some of their securitizations and those of other players. Origination volume is also likely to drop, which would hurt lenders with costly infrastructures that can't be downsized easily in the face of lower volumes. Still, most of the major sub-prime lenders are small cogs in much larger corporate structures. And industry giant Ameriquest is privately held.

In a bad market, most of the blood would spilled in the lower-ranking tranches of sub-prime mortgage-backed securities, bonds rated triple-B minus and below. That's because the overcollateralization and excess interest margin (the difference between the interest thrown off by the pool and the interest promised the holders of the different tranches in the securitization) afford only about 7% to 8% loss protection to triple-B holders.

Any shortfall in interest payments and mortgage-principal loss above that level would eat away at their returns. In these securitizations, interest and principal payments cascade down from the higher to lower tranches. Priority of losses moves in the opposite direction from residual tranches and double-B bonds upward.

The aforementioned New York hedge-fund manager is busily shorting triple-B and triple-B-minus tranches in sub-prime securitizations by buying credit protection on them in the credit-default-swap market. The fund is also short various collateralized debt obligations, an estimated $50 billion or so invested mostly in the junior tranches of sub-prime securitizations. "These CDOs...could get completely wiped," the manager says. The cascade on interest and principal repayments from the securitizations above them might slow to a trickle.

The liquidity of the sub-prime market depends on continued purchases by CDOs of the randier tranches of sub-prime securitizations. Should this funding dry up, the sector's financing structure could seize up. And that would spell big trouble not only for sub-prime borrowers, but for the entire U.S. housing market...and economy.

From: Seeking Alpha [account@seekingalpha.com]
Sent: Sunday, March 25, 2007 2:50 PM
To: james_grundy@sandp.com
Subject: Asset Manager Sy Jacob's Subprime Longs and Shorts

Asset Manager Sy Jacob's Subprime Longs and Shorts

Judy Weil submits: Annotated article summary from this weekend's Barron's. Receive all our Barron's summaries by **signing up here**:

Slow-Motion Train Wreck Picks Up Speed by Sandra Ward

Summary: Barron's interviews Sy Jacobs, founder and investment manager of Jacobs Asset Management, whose annual returns have averaged 16.4% since the fund's inception in 1995. Jacobs predicted the subprime breakdown in 2005, and cautions that subprime problems are not contained, and will strike all credit classes. His longs and shorts:

- NovaStar Financial (NFI) and New Century Financial (NEWC.PK) -- he's still short. Jacobs expects Fremont General (FMT) to be flayed by regulators due to its lax standards and incompetence.
- Bankrate (RATE) -- short. Its client base of mortgage brokers and backers are rapidly disappearing.
- Credit-rating agencies like Moody's (MCO) and McGraw-Hill (MHP) [owner of Standard & Poor] have high collateralized debt obligations, residential mortgage-backed securities and subprime holdings that account for 30-40% of their operating profits. Congress could come down hard on agencies who should have been more vigilant.
- He's long on financials that are sensitive to short-term interest rates but not to credit, because he believes the Fed will start cutting rates as the housing crisis deepens. One example: Annaly Capital Management (NLY).
- Residential mortgage REIT Anworth Mortgage (ANH) should rise from $9 to $16 as funding costs shrink while ARM assets rise.
- Opteum (OPX) -- ALT-A fears have made this stock oversold. Book value is $7.85/share, while shares are at $4.50. Citibank (C) took a 7.5% stake for 150% of book at year-end 2006.
- Origen Financial (ORGN) -- the only remaining player in manufactured-housing finance. With the end of the housing boom and a possible decline in home ownership, manufactured housing should benefit.

Related Links: Seeking Alpha's Housing Bubble and Real Estate Market Tracker * It's Time To Regulate the Subprime Loan Business * Subprime Mortgage Bust Could Create Ad Trouble for Google

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DATE: 03/26/2007
TIME: 14:34:26 GMT
AUTHOR: Brennan, James
RECEIPIENT: Patrick Brennan
CC:
SUBJECT: RE: barron's article; deacon, not sure if you saw this but this guy talks about short on moody's and s&p

Lovely, with the UNC loss yesterday and this crap below, the only thing that could make me feel better is a massive round of layoffs in the Lehman investment banking division.

Jim

James M Brennan
Moody's Investors Service
Phone: 212-553-1407
Fax: 212-298-6735

-----Original Message-----
From: Patrick Brennan [mailto:patrick@boyarvalue.com]
Sent: Monday, March 26, 2007 10:09 AM
To: Brennan, James
Subject: barron's article; deacon, not sure if you saw this but this guy talks about short on moody's and s&p

Slow-Motion Train Wreck Picks Up Speed

Interview With Sy Jacobs, Founder and Investment Manager, Jacobs Asset Management

By SANDRA WARD

PEOPLE WHO READ OUR FOURTH OF JULY 2005 interview with Sy Jacobs would hardly be surprised by the current meltdown in the subprime loan market. And it should come as no surprise that Jacobs, with a 23-year history of covering the financial markets, predicted the debacle. He has also shined as the principal of the $222 million Jacobs Asset Management in Manhattan, which includes a $45 million private-equity fund. Last year, his market-neutral financial fund gained 16.8% after fees, compared with 13.8% for the S&P 500. Since the fund's start nearly 12 years ago, it has returned 16.4%, on average, versus 11% for the S&P. He sees the debacle deepening, but spies opportunities, as well, in the adversity.

Barron's: Nearly two years ago, you saw the day of reckoning coming for subprime mortgage lenders.

Jacobs: When we spoke in 2005, I was worried about what was brewing in subprime, given the loosening in underwriting standards and the extension of credit to those with little equity and the inability to pay the loans back unless housing prices continued to rise. I'm surprised how long it has taken to unravel, but it has. Michael Farrell at Annaly Capital Management has been calling it the slow-motion train wreck, and the fact that it went on for another year or two since we spoke only makes it worse because the credit markets accepted more and more risk and got thinner and thinner margins while the party was still going on. The events of the past two weeks would tell you that the train wreck is accelerating and is turning into a contagion. Subprime will bring down mortgage lending, housing and, in turn, the economy and the market.

Some insist the problems in the subprime market are manageable.

The problems in subprime are not self-contained. It is a pinprick to a larger problem, and it needs to be looked at that way. The notion that subprime home-equity lending is somehow ring-fenced because it is only 12% of total mortgage loans outstanding and won't affect the rest of the mortgage and housing market is absurd. First of all, subprime lending was over 20% of 2006's volume. That tells you it was growing rapidly as a percentage of the mortgage business when it hit the wall.

Sy Jacobs

It also tells you that the subprime borrower was increasingly the marginal buyer of housing and tilted the supply and demand of housing that resulted in such big increases in home prices until late last year.

How will the problems spread?

Mostly through housing. This year is going to be much worse than 2006 for mortgage and housing credit, and 2006 already laid the mortgage industry low. Nearly $700 billion of mortgages reset this year and nearly half of that is subprime. Remember 2004, when our esteemed former Federal Reserve chairman, Alan Greenspan, was exhorting us to take out adjustable-rate mortgages, the federal-funds rate was only 1% and had nowhere to go but up? Prime refinancing volume peaked in 2004, and the most popular loan product at that time was a 3/1 adjustable-rate mortgage, three years fixed and adjustable every year after that. Those are resetting this year after 17 quarter-point increases in the fed-funds rate. The subprime home-equity market peaked in 2005, and the most popular product from that year was a two-year-fixed, 28-year-floating mortgage. It resets this year, and now credit spreads are widening, Freddie Mac [ticker: FRE] is going to stop buying as much subprime, as are the capital markets in general, and a lot of capacity is exiting through bankruptcy courts.

The remaining players left standing are raising credit standards and cutting loan products and raising coupons on the products they continue to make. Housing hasn't bottomed, and it is just getting going to the downside.

How bad is the credit crunch?

It is spilling into the secondary market in the sense that credit spreads in the secondary market have widened in the past few weeks. We're seeing a reversal in the appetite for risk that we've seen for the past several years. Credit will get more expensive across asset classes, and that's another way in which the subprime contagion will spread.

Are you hanging on to your subprime shorts, or have you moved on?

In subprime, the decline has been vicious already, and we are starting to look elsewhere for that kind of juicy downside. NovaStar Financial [NFI] is down from 39 to 6 since we last spoke, and we are still short. We are still short some others, and I think New Century Financial [NEW] is very likely going to zero. Another that has more downside is Fremont General [FMT], which we've been short for two to three years already. Fremont is a little more complicated, but if you read the cease-and-desist order that the regulators issued to them two weeks ago, and which started its stock crashing, it is hard to see how they don't eventually seize the bank. They as much as call Fremont's management incompetent and order them to stop doing business in subprime. Their losses from the loans they've made -- and they made $31 billion last year -- are going to be huge. Another part of their business is condo and construction lending, and the regulators criticized them for lax controls in this area and inadequate reserves, as well. By the time they take proper reserves on those loans and because of the losses they'll experience getting out of subprime, we see them as capital-deficient. Given the criticism of management by the regulators in this cease-and- desist order and the probable desire to make an example of someone, I don't see the regulators being lenient with them, and I don't see how they will avoid getting seized and wiping out equity holders.

Some of these names have been bouncing back on capital infusions. Does that throw a wrench into your thinking at all?

No. People are bottom-fishing.

Where else do you see opportunities from the fallout in subprime?

We are still short Bankrate [RATE]. We were painfully early on Bankrate, judging from the fact the stock went from 20 at the time we spoke two years ago to 39 now. But we actually think our original thesis is unfolding now and see Bankrate as a play on mortgage velocity, which is coming down. Organic growth has all but stopped, as you can see from the deceleration of their page-view growth, but they have made some acquisitions. They've surprised on the upside with earnings expectations because they raised prices aggressively for advertising on their site with Internet banner ads and click-throughs. We think the price increases on ad rates are unsustainable. Their customers are mortgage brokers and mortgage bankers. These mortgage bankers and brokers will go out of business in droves in 2007. You could see big revenue disappointments at Bankrate, which won't go over well with the stock trading at 30 times 2007 estimates.

Slow-Motion Train Wreck Picks Up Speed -- Part II

Interview -- Part I <http://online.barrons.com/article/SB117469260899347441.html?mod=article-outset-box>1

Where else do you see trouble brewing?

A secondary way we've found to play the demise of subprime and its fallout is by shorting the credit-rating agencies: Moody's [MCO] and McGraw-Hill [MHP], which owns Standard & Poor's. Standard & Poor's is 44% of McGraw-Hill's revenue and 76% of their operating profits. By our calculations, Standard & Poor's is over 100% of McGraw-Hill's profit growth because the rest of their businesses haven't been growing. Moody's and Standard & Poor's have been major beneficiaries of the wild growth in the structured-finance business such as CDOs [collateralized debt obligations] and RMBS [residential mortgage-backed securities] and subprime. The bulls would say that only 7% of their business is subprime. But when you add CDOs and RMBS and subprime together, all of which we think is driven by the home-equity business, the number jumps to roughly 20% of the rating agencies' revenue.

Revenues per deal on these three segments -- CDO, RMBS and subprime -- are three to four times that of the rating agencies' lower-growth and lower-margin corporate-finance business, which is rating corporate bond offerings. The areas we are focused on are contributing more like 30% to 40% of operating profits at Moody's and Standard & Poor's, and most of the growth in earnings. Subprime issuance is going to shrink dramatically this year, and a big chunk of CDO volume is backed by subprime assets, and so the rating agencies' entire structured-finance operations should see a big drop in growth this year, especially in their high-margin areas, and that's underappreciated by the stock market.

In light of the fact that Moody's is trading at 25 times estimates of 14% earnings growth and McGraw-Hill is trading at 22 times estimates of 16% earnings growth, and we see both missing their estimates this year and possibly showing little if any earnings growth, those multiples could get hurt badly. Besides the earnings risk, there is great regulatory and legislative risk here. When Barney Frank and

DATE: 10/19/2006
TIME: 13:37:00
AUTHOR: Ben Katzburg
RECEIPIENT: Grant Bailey, Vadim Verkhoglyad
CC:
SUBJECT:

More Home Loans Go Sour --- Though New Data Show Rising Delinquencies, Lenders Continue to Loosen Mortgage Standards

By Ruth Simon
1155 words
19 October 2006

The Wall Street Journal
D1
English

MORTGAGE lenders are making it easier to get loans even as the housing market cools -- and as the number of borrowers struggling to make their payments continues to rise, new studies show.
In the latest sign that a cooling housing market and weaker credit standards are beginning to take their toll on borrowers and lenders, the number of past-due mortgages continued to rise in the three months ended Sept. 30, according to data from Equifax Inc. and Moody's Economy.com Inc.
The increase is particularly notable because bad loans normally climb when the economy weakens and job losses rise, leaving more borrowers unable to make their monthly payments. By contrast, the latest increase appears to be more closely tied to looser lending standards, borrowers tapping their equity and slowing home-price growth.
"We're seeing rises in delinquencies and loan losses that are unrelated to what's going on in the job market," says Mark Zandi, chief economist of Moody's Economy.com. "It's very unusual."
Some 2.33% of mortgages were delinquent at the end of the third quarter, the highest level since 2003, according to Equifax and Moody's Economy.com. Among the areas that saw the biggest jump in the delinquency rate since the end of last year were Stockton and Merced, Calif., and Las Vegas-Paradise, Nev. Delinquency rates were highest in McAllen-Edinburg-Mission, Texas; Brownsville-Harlingen, Texas; and Detroit-Livonia-Dearborn, Mich.
A separate report released yesterday by the federal Office of the Comptroller of the Currency found that lenders continued to ease credit standards over the past year.
To be sure, mortgage delinquencies have been at low levels in recent years, and the recent uptick only brings them closer to historical averages. The seasonally adjusted mortgage-delinquency rate reached its most-recent peak of 2.53% in the first quarter of 2002, according to Equifax and Moody's Economy.com.
The latest news comes amid increasing concerns that lenders have been loosening their standards in an effort to boost loan volume as refinancings and home purchases wane. In a speech to the American Bankers Association this week, Comptroller of the Currency John Dugan noted that bank regulators have seen a "significant easing" of mortgage lending standards this year, even though banks normally tighten standards when the housing market cools. "We don't want to see the lending decisions bankers make today result in excessive foreclosures -- and reduced affordable housing credit -- tomorrow," he said.
The Comptroller's report found that competitive pressures are driving many banks to further loosen their credit standards. More than one-third of the lenders relaxed their standards for home-equity loans in the 12 months ended this March, according to bank examiners, while less than 5% tightened their

standards.

Over the same period, 26% eased their mortgage-lending standards, most often by increasing the use of nontraditional mortgage products. These include loans that allow borrowers to pay interest and no principal in the early years or make a minimum payment that can lead to a rising loan balance. Yesterday, regulators released a booklet designed to help consumers understand these exotic mortgage products.

"We have reason to believe that the amount of easing we saw back in March is continuing," says Kathryn Dick, deputy comptroller for credit and market risk at the OCC. Federal bank regulators have been stepping up their scrutiny of residential mortgage lending by large banks, she says, with a particular focus on banks that lend heavily in cooling housing markets.

There are signs that some lenders are beginning to pull back. Last week, New Century Financial Corp. said it would begin tightening lending guidelines for adjustable-rate mortgages sold to "at-risk"

DATE: 09/06/2006
TIME: 20:40:46
AUTHOR: Markowitz, Murray
RECEIPIENT: Moody's - SFG/Mortgage Pass Through
CC:
SUBJECT: Article re: NegAms & Origination Practices

For your reference, this Barron's piece from last weekend is a predecessor/sort-of companion piece to much-traveled Jesse Eisinger piece from last Wednesday's WSJ:
===================================
Monday, August 21, 2006

The No-Money-Down Disaster
By LON WITTER

A HOUSING CRISIS APPROACHES: According to the Commerce Department's estimates, the national median price of new homes has dropped almost 3% since January. New-home inventories hit a record in April and are only slightly off those all-time highs. Existing-home inventories are 39% higher than they were just one year ago. Meanwhile, sales are down more than 10%.

Although the stocks of new-home builders are down substantially, the stock market and many analysts are ignoring other implications of the housing news. In the latest Barron's Big Money Poll of institutional investors, not a single money manager ranked problems in the housing market among the factors likely to lead to a sharp selloff in stocks in the next 12 months (see "Headed for Dow 12,0001," May 1, 2006). Most experts still predict a 2%-6% rise in housing prices for the year.

These experts and analysts are basing their predictions on a possible increase in wages, inflation and GDP growth. They are overlooking the fact that by any rational valuation there has been no support for the run-up in housing prices since 2001, when the wealth of the middle class was battered by a bear market. Since then, inflation has been low, and wages practically stagnant. Housing prices, on the other hand, are through the roof.

Extrapolating housing prices from their current level based on wages and inflation is like saying a $100 Internet stock with no cash flow and negative earnings will rise as long as it is able to narrow the loss. The analysis ignores the fact that the stock never should have been trading at $100 in the first place.

By any traditional valuation, housing prices at the end of 2005 were 30% to 50% too high. Others have pointed this out, but few have had the nerve to state the obvious: Even if wages and GDP grow, the national median price of housing will probably fall by close to 30% in the next three years. That's simple reversion to the mean.

A careful look at the reasons for the rise in housing will give a good indication of the impact this drop will have on the stock market. They include, in chronological order: The collapse of the Internet bubble, which chased hot money out of the stock market; rock-bottom interest rates; 50 years of economic history that suggested housing never goes down, and creative financing.

The first three factors might not be enough to cause a crash, except that together they led to the fourth factor. Irresponsible financing causes bubbles. It causes individuals to buy houses they can't afford. It causes speculation to run wild by lowering the bar to entry. Finally, it leads individuals who bought houses years ago at reasonable prices into the speculative borrowing trap. The home-equity credit line has supported American consumer spending, but at a steep price: Families that tapped into their home equity with creative loans are now in the same trap as those who bought homes they couldn't afford at the top of the market.

The cost and risk of adjustable-rate financing can be devastating. Consider a typical $250,000 three-year adjustable-rate mortgage with a 2% rate-hike cap. If the monthly payment now is $1,123, after the first adjustment, the monthly payment is $1,419. After the second adjustment, the monthly payment is $1,748, a $625-per-month increase. That's $7,500 more per year just to maintain the same mortgage. If you think high gas prices are biting the consumer, consider the cost of mortgage adjustments.

Some more numbers:

• 32.6% of new mortgages and home-equity loans in 2005 were interest only, up from 0.6% in 2000

- 43% of first-time home buyers in 2005 put no money down
- 15.2% of 2005 buyers owe at least 10% more than their home is worth
- 10% of all home owners with mortgages have no equity in their homes
- $2.7 trillion dollars in loans will adjust to higher rates in 2006 and 2007.

These numbers sound preposterous, but the reasoning behind them is worse. Lenders have encouraged people to use the appreciation in value of their houses as collateral for an unaffordable loan, an idea similar to the junk bonds being pushed in the late 1980s. The concept was to use the company you were taking over

DATE: 03/19/2000
TIME: 18:52:38
AUTHOR: Gerst, Catherine
RECEIPIENT: Clarkson, Brian
CC:
SUBJECT: TR: my departure

Just so you know.

-----Message d'origine-----
De: Gerst, Catherine
Date: dimanche 19 mars 2000 19:51
À: Perry, Debra (Moody's)
Objet: my departure
Critère de diffusion: Confidentiel

Dear Debra,

as per your suggestion I sent you this morning a series of e-mails illustrating some of the daily difficulties I may have experienced as the manager of the Paris Office. However those were just small examples, and I believe it is important to give you the big picture.

The big picture is as follows. I'm leaving Moody's because I am incomfortable with:
the lack of a strategy I can clearly understand, other than maximize the market share and the gross margin with insufficient ressources;
the lack of definition of the local MDs role: does Moody's want executants of policies decided in London or NY (which is fine, but then the MDs should not be neither responsible neither accountable for any result or replication of those strategies), or MDs participating to the strategy and decision process and having a certain degree of autonomy (and would therefore be legitimately responsable in their markets)? I several times raised this issue because I needed to understand what the company was expecting from me. But I could never get an answer.
the structural lack of ressources in any place of Moody's, that renders the daily life extremely difficult;
the lack of an adequate chain of decisions, that makes any move extremely long and painful, and generally results in losses of any kind (it took 1 year to implement the RoR policy, 9 months to put in place a new product -the custodian rating-, 8 months to obtain an authorization to sign a contract for Cades, resulting in th loss of a big and recurrent amount of monney for Moody's, etc....). I consider Moody's can not afford such delays in an extremely rapidly moving world, where competition goes much quicker.
the lack of transparency in the decision process, particularly from a budget standpoint.
the lack of real integration

From: Warrack, Thomas
Sent: Saturday, May 07, 2005 8:44 AM
To: Deasy, Chris; Osterweil, Terry; Barnes, Susan
Cc: Vonderhorst, Brian; Solar, Mona; Stock, Michael
Subject: RE: 2005-S2

Chris thanks very much for quick analysis.
Mona as Terry states, this certainly highlights issues with our multiples.
Thanks, Tom

-----Original Message-----
From: Deasy, Chris
Sent: Friday, May 06, 2005 4:18 PM
To: Osterweil, Terry; Warrack, Thomas; Barnes, Susan
Cc: Vonderhorst, Brian; Solar, Mona; Stock, Michael
Subject: RE: 2005-S2

If there are any objections, please let me know by 10:30 Monday morning or I will approve the structure.

-----Original Message-----
From: Osterweil, Terry
Sent: Friday, May 06, 2005 3:56 PM
To: Deasy, Chris; Warrack, Thomas; Barnes, Susan
Cc: Vonderhorst, Brian; Solar, Mona; Stock, Michael
Subject: RE: 2005-S2

Considering that the shortfalls that occur when we use 8.25 and the associated multiples are not outrageous and that when we use 8.01 and the same multiples it works, I would recommend approving their structure.

P.S. Using a higher multiple with a lower "B" and getting a worse structure (because the other levels are higher) is ridiculous. And ridiculous is my tempered word. This shows that we are not truly assessing the risks correctly.

-----Original Message-----
From: Deasy, Chris
Sent: Friday, May 06, 2005 3:14 PM
To: Osterweil, Terry; Warrack, Thomas; Barnes, Susan
Cc: Vonderhorst, Brian; Solar, Mona
Subject: RE: 2005-S2

If I use 8.00 this is what I get (keep in mind that 8.00 moves us to a new column on the multiples sheet and due to the way the multiples sheet works we are actually worse off than we were at 8.25):

Rating	OC %	Int shortfall	Prn shortfall	Def Crv

AAA	-0.14%	424,437	258,546	PASS
AA	-2.37%	7,077,245	4,309,949	PASS
A	-2.36%	6,999,251	4,284,821	PASS
BBB	-1.66%	5,132,060	3,017,173	PASS
BBB-	-1.10%	3,586,782	2,005,871	PASS
BB	1.08%	-	-	PASS

If I only go down to 8.01 to keep us in the same column on the multiples sheet, it passes:

Rating	OC %	Int shortfall	Prn shortfall	Def Crv
AAA	0.15%	-	-	PASS
AA	0.29%	-	-	PASS
A	0.48%	-	-	PASS
BBB	0.37%	-	-	PASS
BBB-	0.41%	-	-	PASS
BB	1.58%	-	-	PASS

So, a 'B' number somewhere between 8.01 and 8.25 works. Please let me know what you want me to tell Nomura.

-----Original Message-----
From: Deasy, Chris
Sent: Friday, May 06, 2005 2:58 PM
To: Osterweil, Terry; Warrack, Thomas; Barnes, Susan
Cc: Vonderhorst, Brian; Solar, Mona
Subject: RE: 2005-S2

using 8.25 we get the following shortfalls with their proposed structure:

Rating	OC %	Int shortfall	Prn shortfall	Def Crv
AAA	0.08%	-	-	PASS
AA	-0.04%	112,683	77,761	PASS
A	-0.35%	985,728	643,587	PASS
BBB	-0.30%	883,464	549,812	PASS
BBB-	-0.27%	845,359	487,518	PASS
BB	1.20%	-	-	PASS

-----Original Message-----
From: Osterweil, Terry
Sent: Friday, May 06, 2005 2:16 PM
To: Warrack, Thomas; Barnes, Susan
Cc: Vonderhorst, Brian; Deasy, Chris; Solar, Mona
Subject: RE: 2005-S2

I would approve the structure they are proposing. This structure is basically taking <1.00% from the "BB" class and 1.00% from the "AA" class and putting that in the

"AAA" instead. There will be more excess now with lower class rates. If we want to satisfy our curiosity, why don't we go down 75 bps. on the single "B", use the same multiples to get the other rating levels, and see if the proposed structure works or is at least close.

Does Mike have any initial results from his groups analysis to possibly justify an interim approval on this deal prior to a new second lien methodology being approved.

-----Original Message-----
From: Warrack, Thomas
Sent: Friday, May 06, 2005 1:52 PM
To: Barnes, Susan; Osterweil, Terry
Cc: Vonderhorst, Brian; Deasy, Chris; Solar, Mona
Subject: FW: 2005-S2

Terry & Susan,

Rob, makes some good points below and clearly would like to have us on the deal but the difference is still significant.
At a minimum since he claims the numbers got 76 bp better in the LEVELS model we could have gone down a bit further.

Do you want this deal to be re-reviewed or are we going to live with not rating it?

Thanks, Tom

-----Original Message-----
From: Gartner, Robert [mailto:rgartner@us.nomura.com]
Sent: Friday, May 06, 2005 1:21 PM
To: Warrack, Thomas
Subject: 2005-S2

Good afternoon Tom. We have been trying to work with Chris Deasy to get to a structure which works for us but without much success. Mona called me about a week ago and told me that, while S&P is working on it, the new model will not be ready for this deal. The S2 is a significantly better collateral pool than the S1 and I do not feel we are getting proper credit for it under the current approach.

	S1	S2
FICO	681	690
CLTV	96.4	95.8
Stated/stated	11.7%	5.1%
No Doc	7.4%	8.2%
Investor	14.3%	14.9%
3&4 family	10.7%	6.8%
<620 FICO	6.1%	5.4%
621-640 FICO	13.8%	8.5%

Using the existing S&P levels model, the single B loss coverage improved by 0.76% between S1 and S2. By Nomura's model, it improved by 1.10%. The levels we received from Chris improved by just 0.50%. The loss coverages are shown below.

	S1	S2
AAA	40.50	38.25
AA	29.25	27.75
A	23.25	21.75
BBB	17.75	16.75
BBB-	16.00	15.25
BB	12.50	11.90
B	9.00	8.50

Below is another set of data we provided to Chris as well. As I mentioned in our discussions, I have been focusing on reducing layered risk. Not only does the S2 have a lower percentage of risky loans but the layered risk has been significantly lowered in those loans as well. As you can see in the table below, the S2 loans, in every risk category, have higher FICO, lower CLTV and less common risk factors.

		FICO	CLTV	>95	<640	Stated/stated	No Doc	3&4 family	Investor
Investor	S1	707	93.8	25.7	3.3	17.5	8.5	37.2	100.0
	S2	715	91.0	3.0	3.2	8.0	7.0	21.1	100.0
2-4 family	S1	696	95.0	41.7	8.9	18.0	8.4	55.0	36.5
	S2	702	94.4	32.7	6.4	10.1	6.1	40.9	30.8
Stated/stated	S1	687	94.6	43.7	9.4	100.0	0.0	14.3	21.5
	S2	699	93.8	36.0	3.6	100.0	0.0	8.9	23.5
NINA	S1	709	93.5	31.8	0.0	0.0	100.0	12.6	16.7
	S2	719	92.5	32.2	3.2	0.0	100.0	5.3	12.6

Unfortunately, the structure which has been approved by S&P is significantly worse than the ones approved by Moody's and Fitch. I have provided the approved S&P and Moody's/Fitch structures below.

	S&P	Moody's/Fitch
AAA	70.00	79.25
AA	13.10	6.50
A	6.60	5.50
BBB	4.70	5.25
BBB-	1.30	1.25
BB	4.30	2.25
OC target	2.65	2.95

The 2.95 target was from Fitch (Moody's approved 2.65). Our analyst here seemed confident Fitch would do 2.65 as well but we haven't asked yet. Fitch did not rate our initial deal but Moody's did. Their levels have clearly improved dramatically from the first deal.

The difference in economics to Nomura is between 3/8 and 1/2 point so it is a significant amount. It is difficult for me to justify to my management why I would include S&P if it means that much to our bottom line. Based on levels we have seen, we asked Chris if S&P could approve the following structure. It would only gain back about 40% of the difference in economics but would allow me to convince my management that we are supposed to keep S&P on the deal. Based on my calculations, this improvement would require less than 0.50 improvement in the base case loss coverage. Chris has told me this structure is not possible.

AAA	72.10
AA	12.00
A	6.50
BBB	4.60
BBB-	1.30
BB	3.50

OC Target	2.65

My desire is to keep S&P on all of my deals. I would rather not drop S&P from the upcoming deal, particularly if it ends up being for only a single deal until the new model is in place. Can you please review the approval process on this deal? If you are comfortable that the approved structure is the best S&P can do at this time, I will live by that decision. Thanks for your time and effort. I look forward to speaking with you soon.

Rob

DATE: 04/13/2007
TIME: 15:45:45 GMT
AUTHOR: Karaguishiyeva, Gulmira
RECEIPIENT: Grisard Boucher, Odile; Agarwal, Navneet; Weil, Ariel;
CC: Ramallo, Karen; Milano,Christopher
SUBJECT: RE: Call for tomorrow and Loan Level 1st Lien Data

New Century has an Alt-A platform but we never seen their ALt-A CES

60/20 is for subprime CES.

My recomendation would be to apply new Joe's approach and hit 15% for NC. We use 15% originator factor for NC.

Gulmira Karaguishiyeva, CFA
Structured Finance
Moody's Investors Service
Harborside Financial Plaza 5, Suite 2400
Jersey City, NJ 07311-3988
Ph: 201-395-6354
Fax: 212-298-6329

-----Original Message-----
From: Grisard Boucher, Odile
Sent: Friday, April 13, 2007 10:26 AM
To: Agarwal, Navneet
Cc: Karaguishiyeva, Gulmira; Ramallo, Karen; Milano, Christopher
Subject: FW: Call for tomorrow and Loan Level 1st Lien Data

FYI, follow-up on committee last night. We are running the pool per Joe's instructions and also based on the first lien information we received late last night. If New Century collateral is in effect prime, should we drop the levels of 60/20 on that subpool?

We should receive information on EPD later today.

-----Original Message-----
From: DellaValle.Patrick [mailto:Patrick.DellaValle@SunTrust.com]
Sent: Thursday, April 12, 2007 9:04 PM
To: Grisard Boucher, Odile; Ramallo, Karen; Teicher, David
Cc: Scalzetti.David; Brian Haklisch
Subject: Call for tomorrow and Loan Level 1st Lien Data

Odile and David,

Attached please find loan level 1st lien Information.

SunTrust is disconcerted by the dramatic increase in Moody's loss coverage levels given initial indications and the positive feedback received from you, Karen, and David after the STICS presentation. These levels indicate that this program has not received credit for the collateral selection and due diligence process. Our entire team is extremely concerned, and we would like to set up a call first thing tomorrow morning with you as well as David to discuss the situation. Each of the other agencies reduced their initial levels, and the material divergence between Moody's levels and the other agencies seems unreasonable and unwarranted given our superior collateral and minimal tail risk. Attached also please find the levels from S&P. We would like to discuss the bond sizes for our structure on tomorrow's call along with the following topics:

1. Ratings on other Second Lien Transaction of weaker collateral

2. Wealth of Data provided

3. MBIA attachment of A.

4. Enhanced level of diligence

5. 44% remaining EPD

6. SunTrust making all reps and warrants

7. New Century collateral is from their Home123 channel: Prime

8. Significant less barbelled pool compared to market

Please let me as soon as soon as you can coordinate your colleagues' schedules, as we would like to discuss these issues as early as possible.

Thank You,

Patrick

Patrick DellaValle

SunTrust Capital Markets

303 Peachtree Street, MC 3950

Atlanta, GA 30309

404.813.0013 [office]

404.813.0000 [fax]

Patrick.DellaValle@suntrust.com <mailto:tPatrick.DellaValle@suntrust.com>

DATE: 02/20/2007
TIME: 23:22:23 GMT
AUTHOR: DiRienz, Mark
RECEIPIENT: Robert.B.Miller
CC:
SUBJECT: Re: Thanks for your help

Hi Bob. Sorry I missed you - I did not want to bother you on your cel during your dinner meeting. I spoke to Osmin earlier and confirmed that Jason is looking into some adjustments to his methodology that should be a benefit to you folks. I would expect that he has spoken to his counterpart on your side by now with his progress. I think he is going to committee it tomorrow morning.

-----Original Message-----
From: Robert.B.Miller@chase.com <Robert.B.Miller@chase.com>
To: DiRienz, Mark
CC: raj.m.kothari@jpmchase.com <raj.m.kothari@jpmchase.com>
Sent: Tue Feb 20 16:58:45 2007
Subject: Thanks for your help

Appreciate your help with the Chase seasoned collateral dilemma. Like i said, normally wouldn't bother you, but the optics here are difficult. There's going to be a three notch difference when we print the deal if it goes out as is. I'm already having agita about the investor calls I'm going to get.

If you get a chance to call back tonite, please call the desk at 212-834-2050 and ask for me or Raj. Just in case, my cell is 845-641-1313 - but I have an event this evening and may have a tough time taking calls.

Bob Miller
Home Equity Trading
212-834-2428

DATE: 05/23/2007
TIME: 09:40:36
AUTHOR: Lasseron, Arnaud
RECEIPIENT: Fu, Yvonne
CC: Chen, Karie; Kolchinsky, Eric
SUBJECT: Re: Lancer II: (partial) feefback from committee

On the 1st point note though that they have 3 other deals under way (incl one closing Friday) that they are cloning on this deal so will be hard to resist on the other ones if we give up on this one. Given that, pls confirm.

-----Original Message-----
From: Fu, Yvonne
To: Lasseron, Arnaud
CC: Chen, Karie; Kolchinsky, Eric
Sent: Wed May 23 09:31:36 2007
Subject: Re: Lancer II: (partial) feefback from committee

Arnaud, both Bill's articles only address IR and currency swaps. I agree that what the committee was asking is reasonable, but given the other modeling related issues and the time line for closing, I propose we let them go with the CDS Cp criteria for this deal.

Karie, on the modeling side, what is the difference between current and covenant levels? If they are passing with 1.5x and current level, the most we should as is for them to move the covenant levels closer to current levels.

I might be able to get out for a few mins if you need me to be on the call. Thanks.

-----Original Message-----
From: Lasseron, Arnaud
CC: Chen, Karie; Kolchinsky, Eric; Fu, Yvonne
Sent: Tue May 22 22:35:24 2007
Subject: Re: Lancer II: (partial) feefback from committee

Eric and Yvonne:

Before you reply to Vab's email below, just to clarify, the committee has asked that the downgrade trigger rating levels in his CDS Schedule comply with Bill Harrington's paper dated 2002 and Vab is opposing to us that he doesn't need to b/c, according to him, such paper was superseded by Bill Harrington's paper dated May 2006. Our understanding and what we have replied to him is that the May 2006 paper applies to hedges such as interest rate, currency or cash flow swaps not to CDS but he doesn't agree. Pls let us know should we be wrong. Thanks.

-----Original Message-----
From: Vaibhav-V.Kumar@ubs.com <Vaibhav-V.Kumar@ubs.com>
To: Lasseron, Arnaud
CC: Chen, Karie; Kolchinsky, Eric; Fu, Yvonne; Lirenn.Tsai@ubs.com <Lirenn.Tsai@ubs.com>; Phillip.Azzollini@srz.com <Phillip.Azzollini@srz.com>; rvillani@tpw.com <rvillani@tpw.com>; Leahy, Jim
Sent: Tue May 22 22:14:48 2007
Subject: RE: Lancer II: (partial) feefback from committee

this makes no sense - we comply with your criteria published in May 2006

bottom of the page it says

As such, it will supplant Moody's current framework, as contained in "Swaps in

European Term Securitisations", May 21, 2002 and "Moody's Approach for Rating

Thresholds of Hedge Counterparties in CDO Transactions", October 23, 2002.

Yvonne / Eric - you need to discuss this ASAP with our external counsel (Rob @ Thatcher), deal counsel (Phil @ SRZ), and Lirenn if Moodys is going to make us comply with criteria from 2002 for this transaction when you have published criteria from 2006 that supplants this.

We are closing a transaction on Thursday and need to print a final OM.

From: Lasseron, Arnaud [mailto:Arnaud.Lasseron@moodys.com]
Sent: Tuesday, May 22, 2007 10:07 PM
To: Kumar, Vaibhav-V
Cc: Chen, Karie
Subject: Re: Lancer II: (partial) feefback from committee

It's not ok. The rating levels in the schedule need to comply with the published criteria that we emailed to you. This is a comment from the committee.

-----Original Message-----
From: Vaibhav-V.Kumar@ubs.com <Vaibhav-V.Kumar@ubs.com>
To: Lasseron, Arnaud
CC: Chen, Karie
Sent: Tue May 22 21:44:47 2007
Subject: RE: Lancer II: (partial) feefback from committee

please call me 212-713-4972 re: this issue or tell me if you are ok with the below: We are waiting on these to print our OM tonight

---

From: Kumar, Vaibhav-V
Sent: Tuesday, May 22, 2007 9:43 PM
To: 'Lasseron, Arnaud'
Cc: 'Chen, Karie'
Subject: RE: Lancer II: (partial) feefback from committee

here's Moodys paper from 2006

page 13 is the table

"Second Trigger" - Baa1 or below

The language as is complies with your criteria

From: Kumar, Vaibhav-V
Sent: Tuesday, May 22, 2007 9:40 PM
To: Lasseron, Arnaud
Cc: Chen, Karie
Subject: RE: Lancer II: (partial) feefback from committee

this is from 2002 - this can't be the latest criteria?

From: Lasseron, Arnaud [mailto:Arnaud.Lasseron@moodys.com]
Sent: Tuesday, May 22, 2007 9:36 PM
To: Kumar, Vaibhav-V
Cc: Chen, Karie
Subject: RE: Lancer II: (partial) feefback from committee

What question is your answer below trying to reply to? If it is replying to our request that the schedule "is drafted so that actions need to be taken when failing the above ratings" and should be changed to when reaching the ratings, our comment still stands. Please see attached paper summarizing our criteria thereon.

-----Original Message-----
From: Vaibhav-V.Kumar@ubs.com [mailto:Vaibhav-V.Kumar@ubs.com]
Sent: Tuesday, May 22, 2007 6:55 PM
To: Lasseron, Arnaud
Cc: Chen, Karie
Subject: RE: Lancer II: (partial) feefback from committee

updated Schedule attached which should take care of this

CDS, page 21 of the Schedule:
- the second level says P2 or A3, it should be "AND".
- we will send you our published paper, so far it is drafted so that actions need to be taken when failing the above ratings. Whereas it should be when they reach these ratings.

IF UBS DOESN'T HAVE THE REQUIRED RATINGS AND DOES NOT TAKE ONE OF THE REQUIRED ACTIONS, IT IS A DOWNGRADE EVENT, WHICH IS AN ATE.

- as discussed, please make sure to add "and not on watch for downgrade" next to the Aa3 rating in the 1st level.
- as discussed, please make sure to delete "any other action that satisfy the RAC".
- ATE: as discussed with Yvonne last week, pls remove "or such other action as shall satisfy the RAC".

From: Lasseron, Arnaud [mailto:Arnaud.Lasseron@moodys.com]
Sent: Tuesday, May 22, 2007 4:36 PM
To: Kumar, Vaibhav-V
Cc: Chen, Karie
Subject: Lancer II: (partial) feefback from committee

Vab:

Please find below partial feedback from the committee:

- Deep Discount securities:
. The committee is fine with the definition you sent over, except that you need to specify that there should be no upfront payments under the unhedged Long CDS for the Matrix to be used, if there were any upfront payments under the unhedged Long CDS, one must look directly to the FMV of the Reference Obligation.

. The committee re-confirmed that the A1-A3 column must be conformed to our criteria (and the deal you copied it from): 3.00%, 3.00% and 2.00%.

- please add language in the Indenture to the effect that whenever there is a public rating from Moody's required, it has to address the full amount of principal and interest promise.

- Securities managed by the CM, your request for 2.5%, FOR THIS DEAL, the committee is fine with this provided that any reinvestment with optional redemption proceeds must comply with the 2% limitation (and of course the 6 months). Please revise the definition to specify accordingly.

- VFN: the eligible investments that are used in the Class A1S Prepayment Account must mature overnight as the need for the VFN cash related to the CDS payments is not tied to the distribution date as in the Indenture. Please revise the VFN, particularly section 2.7(c) and (e) accordingly.

- VFN:
As per our prior comments dated 5/2/07, "reimbursements must go back to the source (i.e., if PP was used then reimbursements must go back to PP and not Interest Proceeds)." The committee confirms that Phil's answer is not addressing their concern which is the Interest Shortfall Reimbursements.

- TRS: we are still discussing and we'll get back to you later on the below:
"-under the Schedule for the TRS, make sure default under TRS does not subordinate payments to the CDO under TRS
-are there downgrade triggers and replacement requirements for MLI (TRS Counterparty)?
-if MLI defaults/CDS terminates, MLI will still be on the hook and this shall not be an Additional Termination Event (ATE)."

CDS, page 21 of the Schedule:
- the second level says P2 or A3, it should be "AND".
- we will send you our published paper, so far it is drafted so that actions need to be taken when failing the above ratings. Whereas it should be when they reach these ratings.

- as discussed, please make sure to add "and not on watch for downgrade" next to the Aa3 rating in the 1st level.
- as discussed, please make sure to delete "any other action that satisfy the RAC".
- ATE: as discussed with Yvonne last week, pls remove "or such other action as shall satisfy the RAC".

Cash Flow Swap documents:
- in what circumstances can the CPTY walk away?
- we're continuing to review the blacklines you sent yesterday.

Indenture:
- use of the Ramp-Up Par Amount for purposes of calculating compliance with the EC: committee is fine with this provided that you specify in the document that this is only for reporting purposes and not when determining compliance when reinvesting proceeds of an Optional Redemption (which should use current par).

We'll get back to you on a couple of other points once the committee has reached a decision.

Note that in addition to the above, we will continue to review the revised drafts of the documents that we haven't yet commented on and therefore may have further comments.

When sending the next draft of the Indenture, could you make it cumulative against the 4/19/07 draft please.

Thanks.

The information contained in this e-mail message, and any attachment thereto, is confidential and may not be disclosed without our express permission. If you are not the intended recipient or an employee or agent responsible for delivering this message to the intended recipient, you are hereby notified that you have received this message in error and that any review, dissemination, distribution or copying of this message, or any attachment thereto, in whole or in part, is strictly prohibited. If you have received this message in error, please immediately notify us by telephone, fax or e-mail and delete the message and all of its attachments. Thank you. Every effort is made to keep our network free from viruses. You should, however, review this e-mail message, as well as any attachment thereto, for viruses. We take no responsibility and have no liability for any computer virus which may be transferred via this e-mail message.

From: Arne, Errol
Sent: Thursday, February 23, 2006 9:43 AM
To: Kennedy, Martin; Mason, Scott; Osterweil, Terry
Cc: ResidentialPools; Mahdavian, Sharif; Uppuluri, Sai; Cao, Becky; Alizadeh, Rasool
Subject: Request for prioritization

Gentlemen,

Bear Stearns is currently closing three deals this month which has 40 year mortgages (negam) which will have a 30 year bond maturity. On all 3 deals they have already sent us cashflows last week for us to review (as Spire is not ready for this pertaining to negam). There was some discrepancy in that they were giving some more credit to recoveries than we would like to see. After a conference call with Becky Cao and Jeff Maggard and Jenn Schneider it was agreed that for the deals this month we were OK and they would address this issue for deals going forward.

(the deals are SAMI 2006-AR1-me; SAMI 2006-AR2-Sharif; and GP 2006-AR1-Sai).

Bear, and I know they are very late in the process, have sent over the final collateral tapes for each deal so that we can 'confirm' original levels we gave out. They are waiting for us to get back to them and they will turn over cashflows 'in an hour'. My question to you is can we move this up the priority flag pole as they will need to send over these flows and we need to sign-off by tomorrow.

If the analyst is running the levels and they see that the levels are not going to change, does this need to go to committee or can they take it to a chair, even off committee hours, so that we may let Bear know the levels are confirmed and they can get started on sending over flows for our review. If levels have changed- different story- needs to be taken back to committee but the analyst assigned should contact me (on any of the deals) so that this way I can give Bear a heads up that levels will be changing. Thanks.

Please advise as the timetable is very short. Thanks again.

Errol

Errol Arne
Standard & Poor's
55 Water Street
New York, NY 10041
Phone: (212) 438-2089
Fax: (212) 438-2661
Errol_Arne@standardandpoors.com

DATE: 06/28/2007
TIME: 17:43:16 GMT
AUTHOR: Bharwani, Pooja
RECEIPIENT: Li, Frank; Kolchinsky, Eric; Fu, Yvonne
CC: Awasthi, Maneesh; Hersch, Jessica
SUBJECT: RE: CV4 - Post Reinvestment

Frank,

This is an issue we feel strongly about and it is a published Moody's criteria.

We are making an exception for this deal only. As we understand the manager will covenant to the Class B Effective Date level - 1%. Going forward this has to be effective date level.

I would urge you to let your colleagues know as well since we will not be in a position to give in on this issue in future deals.

Regards,
Pooja

-----Original Message-----
From: Li, Frank [mailto:frank.li@citi.com]
Sent: Thursday, June 28, 2007 12:27 PM
To: Bharwani, Pooja; Kolchinsky, Eric; Fu, Yvonne
Cc: Awasthi, Maneesh ; Hersch, Jessica
Subject: RE: CV4 - Post Reinvestment

I just spoke to Yvonne. She will check with you and Eric to see if the latest proposal is acceptable to you. That's Effective Date Level - 1%.

Please let us know. Thanks.

-----Original Message-----
From: Bharwani, Pooja [mailto:Pooja.Bharwani@moodys.com]
Sent: Thursday, June 28, 2007 12:21 PM
To: Li, Frank [CMB-GFICC]; Kolchinsky, Eric; Fu, Yvonne; Natcharian, Matthew; Kraez, Kathleen
Cc: Awasthi, Maneesh [CMB-GFICC]; Hersch, Jessica [CMB-GFICC]
Subject: RE: CV4 - Post Reinvestment

Will dial-in in 5 minutes.

Pooja Bharwani
VP-Senior Analyst
Moody's Investors Service | 99 Church Street | New York, NY 10007
Tel: 212 553 7135 | Fax: 212 298 6462
pooja.bharwani@moodys.com

-----Original Message-----
From: Li, Frank [mailto:frank.li@citi.com]
Sent: Thursday, June 28, 2007 12:16 PM
To: Bharwani, Pooja; Kolchinsky, Eric; Fu, Yvonne; Natcharian, Matthew; Kraez, Kathleen

Cc: Awasthi, Maneesh ; Hersch, Jessica
Subject: RE: CV4 - Post Reinvestment

Conference Dial-in Numbers
Toll free: 1-866-548-4717
Toll: 1-719-785-9434
Participant Passcode: 654061

Please call in now. Both Citi and Babson are available now to talk about this.

-----Original Message-----
From: Bharwani, Pooja [mailto:Pooja.Bharwani@moodys.com]
Sent: Thursday, June 28, 2007 12:13 PM
To: Li, Frank [CMB-GFICC]; Kolchinsky, Eric; Fu, Yvonne
Cc: Awasthi, Maneesh [CMB-GFICC]
Subject: RE: CV4 - Post Reinvestment

Can we get a dial-in?

Thanks.

-----Original Message-----
From: Li, Frank [mailto:frank.li@citi.com]
Sent: Thursday, June 28, 2007 11:56 AM
To: Kolchinsky, Eric; Bharwani, Pooja; Fu, Yvonne
Cc: Li, Frank ; Awasthi, Maneesh
Subject: CV4 - Post Reinvestment

Eric, Pooja,

I went back to Babson and effective date level is still totally unacceptable to them as they don't understand the rationale behind the criteria. We have run the model and showed you the results that are passing. Please give a call to Matt at Babson directly to discuss this:

Matt: mnatcharian@babsoncapital.com
Tel: 413-226-1672.

You can call me and I can loop Matt in. As we are printing Offering Circular shortly, your immediate attention is greatly appreciated.

Thank you.

Frank Li, CFA
Global Structured Credit Products
Citigroup Global Capital Markets, Inc.
390 Greenwich Street, 4th Floor
New York, NY 10013
Tel: (212) 723-6173
Fax: (646) 291-5391
frank.li@citigroup.com

From: Meyer, Chris
Sent: Sunday, April 23, 2006 6:52 PM
To: Williams, Geoffrey; Gerst, David
Cc: Egol, Jonathan; Tourre, Fabrice; Yukawa, Shin; Ghetti, Belinda; Guarnuccio, Keith
Subject: RE: ABACUS 2006-12 - Writedowns immediately prior to Stated Maturity

Geoff,

This language is actually one of the areas that we felt failed to meet our counterparty criteria. For example, setting aside the amount being posted, the rating trigger is not even remotely correct and it only pertains to CDO Reference Obligations. I understand from my colleagues that they are unaware of this type of language (i.e., taking into account market pricing) being approved. This is especially surprising given that Belinda, a Team Leader regarding criteria as it relates to Synthetic CDOs, probably should have been involved in the approval of languge that would result in a deviation from our core criteria.

Chris

-----Original Message-----
From: Williams, Geoffrey [mailto:Geoffrey.Williams@gs.com]
Sent: Sun 4/23/2006 6:23 PM
To: Meyer, Chris; Gerst, David
Cc: Egol, Jonathan; Tourre, Fabrice; Yukawa, Shin; Ghetti, Belinda; Guarnuccio, Keith
Subject: RE: ABACUS 2006-12 - Writedowns immediately prior to Stated Maturity

See 10.3(f) of the Indenture of this transaction. This was negotiated with S&P in connection with our last transaction, ABACUS 2006-8.

From: Meyer, Chris [mailto:christopher_meyer@standardandpoors.com]
Sent: Sunday, April 23, 2006 6:18 PM
To: Williams, Geoffrey; Gerst, David
Cc: Egol, Jonathan; Tourre, Fabrice; Yukawa, Shin; Ghetti, Belinda; Guarnuccio, Keith
Subject: RE: ABACUS 2006-12 - Writedowns immediately prior to Stated Maturity

Geoff,

I'm unaware of market related information ever being used to determine the amount that should be posted in connection with Writedowns of any kind. Given that Belinda, Keith Guarnuccio and I are highly involved with issues relating to PAYGOs, we'd be most interested in knowing where we've approved this type of language -- since this would be a significant departure from our current criteria. As you point out, it is a conservative position for S&P to take, but it is one we've taken with all Dealers. Since time is of the essence, this may be another issue that we table for 2006-12, but would have to be addressed in future trades.

Regards,
Chris

-----Original Message-----
From: Williams, Geoffrey [mailto:Geoffrey.Williams@gs.com]
Sent: Sun 4/23/2006 3:25 PM
To: Meyer, Chris; Gerst, David
Cc: Egol, Jonathan; Tourre, Fabrice; Yukawa, Shin; Ghetti, Belinda
Subject: RE: ABACUS 2006-12 - Writedowns immediately prior to Stated Maturity

Chris -- we're happy to build in the appropriate 1 year / 3 year CDO language that you describe in your first point below. However, we are not going to be able to accommodate your second request. We drafted this language in the spirit of the clause that we recently incorporated (and had approved by both you and Moody's) into our cds confirm which governs the amount that must be posted given an implied writedown of a CDO reference obligation. The premise is that market information is very relevant in determining whether or not a reference obligation that has sustained writedowns is expected to write back up and I do not see why this methodology is relevant only in determining the amount that should be posted under the cds.

I would add that this scenario is very different from an optional redemption as you point out below since the optional redemption is at Goldman's option and a stated maturity is not. We therefore cannot settle for the most conservative alternative as I believe you are suggesting.

David -- can you please point Chris to language he is looking for on his third point?

Let us know if you have any questions. Thanks. Geoff.

From: Meyer, Chris [mailto:christopher_meyer@standardandpoors.com]
Sent: Saturday, April 22, 2006 6:03 PM
To: Gerst, David
Cc: Egol, Jonathan; Tourre, Fabrice; Williams, Geoffrey; Yukawa, Shin; Ghetti, Belinda
Subject: RE: ABACUS 2006-12 - Writedowns immediately prior to Stated Maturity

David,

I've had an opportunity to review the proposed language this afternoon.

1. Clause (b) -- the one calendar year "cure period" is only applicable to non-CDO Reference Obligations in this case, the RMBS and CMBS Reference Obligations). For CDO Reference Obligations, our criteria is that we'll deem a Reference Obligation, which has experienced a Writedown, to be "defaulted" (a) after one year if the Reference Obligation is undercollateralized by more than 25% and (b) after three years if the Reference Obligation is undercollateralized by 25% or less.

2. Clause (A) -- I'm a little confused. I thought the proposal put forth on Wednesday was that to the extent there was any Writedown which (per our tests) hadn't been deemed permanent, then Goldman would reimburse the full amount of the Writedown. The current formula suggests Goldman may pay an amount less that the full amount of the Writedown. I was expecting to see language similar to the Optional Redemption Reimbursement Amount, which addresses the exact same concern in the context of when Notes are optionally redeemed.

If you can direct me to the specific location in the Schedules of the Basis Swap and Put that contain the identical language to Part 1.3(v) of the CDS Schedule, I would appreciate it.

Chris

-----Original Message-----
From: Gerst, David [mailto:David.Gerst@gs.com]
Sent: Fri 4/21/2006 9:30 AM
To: Meyer, Chris
Cc: Egol, Jonathan; Tourre, Fabrice; Williams, Geoffrey; Yukawa, Shin
Subject: ABACUS 2006-12 - Writedowns immediately prior to Stated Maturity

Chris,

Below is our proposed language to determine how much Goldman has to pay the Issuer if a writedown occurred shortly before maturity of the Notes.

On the Stated Maturity for any Series of Notes, if (i) any such Series of Notes maturing on such date has an ICE Currency Adjusted Aggregate Outstanding Amount Differential greater than zero and (ii) an ICE Reference Obligation Notional Amount Differential is greater than zero with respect to one or more Reference Obligations (a) that remain in the Reference Portfolio at such time of determination, (b) with respect to which the ICE Reference Obligation Notional Amount Differential was equal to zero on the day that was one calendar year prior to such Stated Maturity, (c) that, at the time of such Stated Maturity, has an Actual Rating above (1) if rated by Moody's, "Ca" (2) if rated by S&P, "CC" or (3) if rated by Fitch, "CC" and (d) with respect to which no Credit Event (other than a Writedown) has occurred at any time on or prior to such Stated Maturity, Goldman will pay to Counterparty an amount, if greater than zero, equal to the lesser of (A) the aggregate of the difference, determined for each such Reference Obligation, of (i) the ICE Reference Obligation Notional Amount Differential of such Reference Obligation and (ii) if greater than zero, the ICE Reference Obligation Notional Amount of such Reference Obligation less the related Current Dollar Price and (B) the ICE Currency Adjusted Aggregate Outstanding Amount Differential of each Series of Notes for which the Stated Maturity is such date.

Also, please note that Section 7.10 of the Indenture (issuing ordinary shares) and the Basis Swap and Put Schedules (regarding Bankruptcy) address your concerns as previously drafted. Let me know if you need me to point you to the appropriate provisions.

Thanks,

David

From: O'Brien, John
Sent: Wednesday, May 03, 2006 9:01 AM
To: Rashid, Malik
Subject: RE: Broadwick Funding.

Sure. Call me when you're free.

John

-----Original Message-----
From: Rashid, Malik
Sent: Tuesday, May 02, 2006 9:32 PM
To: O'Brien, John
Subject: RE: Broadwick Funding.

John,

Let's re-group on this tomorrow at a time that suits you; I realize that the closing date is coming soon. I apologize for not being able to partake in the call today; issues cropped up in nearly every transaction I'm currently staffed on.

Malik

-----Original Message-----
From: Meyer, Chris
Sent: Monday, May 01, 2006 9:08 PM
To: O'Brien, John
Cc: Rashid, Malik
Subject: RE: Broadwick Funding.

John,

I'm not sure what they are talking about in terms of the modeling based solution, but I'm not sure how you can model the counterparty risk with respect to Writedown Reimbursement Amounts. In addition, you can tell them that if the are referring to ABACUS 2006-12, which closed lastThursday, that is the last trade that will not be required to post Writedowns (unless they can demonstrate conclusively that our concern is otherwise dealt with in the structure). It was a known flaw not only in that particular ABACUS trade, but in pretty much all ABACUS trades (which between the three of us were all rated by the same person...who neglected to catch other important criteria issues...or ignored them after being told to correct them by Team Leaders and business managers). The ABS desk at Goldman has already been told that the all of the de-linking criteria would need to be addressed in future ABACUS trades, and this includes posting of Writedown Amounts.

In terms of the CSA and opinion language, they do have a point...if we indeed have RAC. Nevertheless, I always copy and past the description of the opinion from the counterparty criteria article and ask why they can't include the language. It's very generic and doesn't ask them to speak to any details.

It looks like swap termination payments to the swap counterparty are netted senior out of the Synthetic Security Counterparty Account. Is this the case?

I'm not sure if this helps. At this point, I'm not thinking all that clearly.

Regards,
Chris

-----Original Message-----
From: O'Brien, John
Sent: Mon 5/1/2006 5:55 PM
To: Meyer, Chris
Cc: Rashid, Malik
Subject: FW: Broadwick Funding.

Chris - Would really appreciate any/all guidance on this you can offer. Trying to wrap this up as soon as possible.

Thanks,
John

-----Original Message-----
From: Bieber, Matthew G. [mailto:matthew.bieber@gs.com]
Sent: Monday, May 01, 2006 5:23 PM
To: Rashid, Malik
Cc: O'Brien, John; Kim, Jeong-A
Subject: RE: Broadwick Funding.

Malik thanks for the feedback -

1. GS has not agreed to this hold back provision in any of our previous transactions (including the ABACUS deal that just closed last week) - and we cannot agree to it in this deal. We'd discussed the modeling based solution with respect to this counterparty risk back on April 13th - and it was ultimately communicated to us the following week there would be no changes in this transaction on this point.

2. I agreed with your long term rating comment (BBB+) as well as the 10 day delivery of the opinion. I thought this was reflected in the document - but I assure you it will be so in the next deal.

3. In terms of timeliness - the CDO holds the collateral and as soon as there is a termination and the appropriate termination payments have been made - the lien that the synthetic security counterparty has on the collateral is released to the trustee. this is outlined in section 12.2 of the indenture. Is there specific language you'd like to see here? if so, I'd be happy to review and try and incorporate, where appropriate.

4. Given that the CSA is will be subject to RAC, S&P will have ability to refview the opinion and to the extent it is not satisfactory, act accordingly. We cannot agree to specifically enumerate the carve outs at this time, due to the fact that there may be changes in case law, market practice, etc. that would have an impact on the opinion between now and the time when any opinion would be required.

From: Rashid, Malik [mailto:malik_rashid@standardandpoors.com]
Sent: Monday, May 01, 2006 4:53 PM
To: Bieber, Matthew G.
Cc: O'Brien, John; Kim, Jeong-A
Subject: RE: Broadwick Funding.

Matt,

I realize that GS abd the CDO group have differences in opinion over certain provisions, but I understand from conversations on Friday and today that the group reiterates their view. Below are our comments from our review of the revised CDS documents circulated on 4/21. This reflects the latest feedback from the CDO group related to the downgrade/posting provisions for this specific transaction, and you'll find that these are repetitive from our last set of comments on the CDS.

Malik

-->

1. To de-link GS's counterparty risk with respect to reimbursements, Writedown amounts need to be posted for one year as long as its rating is below AA- or A-1+. This posting for one year should remain and should not be extinguished if the swap terminates early as a result of GS being the defaulting/affected party. Writedowns can be considered permanent after the expiration of one year.

2. On p.5 of the Schedule:

- the second level rating trigger should be A-2 or BBB+, not BBB-.

- It looks like GS is choosing to remain in the swap by posting when its rating falls below the second level rating trigger. The opinion with respect to the collateral should be delivered within 10 days, not 30.

- Re: my earlier comment on the opinion addressing the timeliness issue - because this is a situation where Party A's credit rating is low, there is greater concern over the CDO's ability to avoid loss arising from exposure to Party A credit risk. While the CSA does speak to Party B's rights as Secured Party, we need more comfort that the CDO terminate the CDS (when the need arises) and liquidate the collateral to make itself whole in a timely manner without undue delay.

- Also on the opinion, we are not certain as to what "customary and usual assumptions, carveouts, and exceptions" mean. Our concern is whether such language limits the opinion's scope. We're trying to de-link GS's credit risk so it can choose to remain in the CDS regardless of what its rating is, so we'd like to make sure that the opinion's description today does not limit its scope.

-----Original Message-----
From: Bieber, Matthew G. [mailto:matthew.bieber@gs.com]
Sent: Monday, May 01, 2006 3:14 PM
To: O'Brien, John
Cc: Kim, Jeong-A
Subject: RE: Broadwick Funding.

ok. the sooner the better. just a reminder - we cannot agree to holding write downs in the deal for a year or any short term rating triggers.

From: O'Brien, John [mailto:john_o'brien@standardandpoors.com]
Sent: Monday, May 01, 2006 2:58 PM
To: Bieber, Matthew G.
Cc: Kim, Jeong-A
Subject: RE: Broadwick Funding.

Matt - Malik will be sending you comments to the last draft of the swap later today.

Regards,
John O'Brien

-----Original Message-----
From: Bieber, Matthew G. [mailto:matthew.bieber@gs.com]
Sent: Monday, May 01, 2006 9:48 AM
To: O'Brien, John; Kim, Jeong-A
Cc: Mangalgiri, Vickram S.; Mishra, Deva R.
Subject: Broadwick Funding.

John and Jeong-A

Hope the weekend and vacation was enjoyable. As discussed last week, I'd like to finalize all outstanding points on Broadwick Funding by the end of the day this Wednesday. To that end, would you please let me know when its most convenient for you to discuss any remaining comments you have to the documents over the next day or so? Additionally, it appears we'll be slightly increasing the size of the S Note in the transaction by approx. $1.5mm. Look forward to hearing from you.

Best Regards,
Matt

DATE: 05/20/2007
TIME: 15:15:39 GMT
AUTHOR: Kolchinsky, Eric
RECEIPIENT: Fu, Yvonne; Yoshizawa, Yuri
CC:
SUBJECT: Re: Paper on inter-CDO correlations - update from ABS Steering Committee

Ok, but I'm not sure this will solve the communication problem. In the UBS case, the analysts were informed about the look through by the new deal staffing email and Yuri's email, below (in addition to the numerous discussions in sterring comm).

Unfortunately, our analysts are owerwhelmed and I'm concerned that the communication to the bankers will "2x and one notch" without any of the subtelties which we ascribe to the approach. I still get routinely asked for which tranches do we use the sequential life...

Thank you
Eric

-----Original Message-----
From: Fu, Yvonne
To: Kolchinsky, Eric; Yoshizawa, Yuri
Sent: Wed May 23 08:08:53 2007
Subject: RE: Paper on inter-CDO correlations - update from ABS Steering Committee

I think it should still be mentioned in the internal communication to give analysts better guidance. The current practtice is quite varied as the analysts do not seem to know what to do even in the cases for which you have communicated with the banks,i.e. UBS. I will send a revised one to both of you.

-----Original Message-----
From: Kolchinsky, Eric
Sent: Wednesday, May 23, 2007 7:56 AM
To: Yoshizawa, Yuri; Fu, Yvonne
Subject: Re: Paper on inter-CDO correlations - update from ABS Steering Committee

Yuri/Yvonne

In that case, should we exclude any mention of the one notch rule from the general communication? Instead, we should give comm chairs the discretion to apply the rule as they see fit. In this way, there is less of a chance of it getting back to the bankers as a "general rule". They are more likely to know it as something that only applies, as a concession, on the deal that they are working on.

Thank you very much
Eric

-----Original Message-----
From: Yoshizawa, Yuri
To: Kolchinsky, Eric; Fu, Yvonne
Sent: Tue May 22 23:02:49 2007
Subject: Re: Paper on inter-CDO correlations - update from ABS Steering Committee

We need to find a way of positioning the 1 notch as our way of "grandfathering"

Yuri Yoshizawa
Moody's Investors Service
(212) 553-1939

Sent From My Blackberry

6 1

-----Original Message-----
From: Kolchinsky, Eric
To: Fu, Yvonne; Yoshizawa, Yuri
Sent: Tue May 22 23:00:12 2007
Subject: Re: Paper on inter-CDO correlations - update from ABS Steering Committee

Yvonne

Looks good generally, two comments however.

1. The one notch rule. I understand the impetus, but it may be problematic in the long term. I think that any stress levels that we implement now will be percieved by the market as being close to the final. They have been asking for certainty in their ability to ramp and structure deals.

If we give a one notch leeway with 2x now and end up with 2x in the long term without the extra room -- I think that bankers will be upset. Instead of dealing with the problem now, we will have to deal with it when we implement the final methodology. I think that we would be better off doing 2.5x with one notch now and go to 2x without. That way we can at least give them a trade-off.

2. We should be clear that the 2x should apply to the underlying vs the MAC.

3. Could you add that this should apply to cdo buckets in abs cdos as well?

Thank you very much
Eric

-----Original Message-----
From: Fu, Yvonne
To: Kolchinsky, Eric; Yoshizawa, Yuri
Sent: Tue May 22 22:16:56 2007
Subject: Fw: Paper on inter-CDO correlations - update from ABS Steering Committee

I am planing on sending this to the group. Please let me know if you are ok with it - don't worry about spelling errors as I will do a spell check before sending!

DRAFT

2007 Operating Plan

Public Finance, Global Structured Finance and Investor Services

Brian Clarkson
February 20, 2007

Moody's Investors Service

1:19 AM

2006 Overview

- 2006 was a record year in Global SFG & PFG (including ISG and KIS) with combined revenues of $1,036.4B
  - Global SFG revenues were $860.4MM exceeding prior year by 25% and budget by 18%
  - PFG revenues were $112.5MM a drop from prior year by 4% but exceeding budget by 2%
  - Global ISG Products & Research exceeded prior year by 12% and was flat compared to budget
- Contribution margin for the group was 83%, equal to prior year and exceeding budget of 80%
- Issuance exceeded our expectations in almost all sectors especially in US RMBS (HE), Global CDOs, US CMBS and EMEA Securitisation
- New ratings products introduced in the market are estimated to have generated $78.6MM in revenues
- Our non-ratings new products generated $7.4MM of revenues
- For 2007, we are forecasting **13%** revenue growth (12% Pre-FX)

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2007 Operating Plan

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Challenges for 2007 - Downside

- Interest rate increases in the US
- Price pressure, particularly in AFG, PFG, synthetic CDO's, and in emerging markets as more and more deals become commoditized. Additional pressure from issuers such as JP Morgan, Morgan Stanley, CSFB, Deutsche Bank
- Managing customers' expectations and demand for real-time data in external PFG products (QRate, MFRA
- Competitive issues (ex. Rating inflation, successful rating shopping, notching below investment grade for mono-line insured deals, etc.)
- Managing customers' expectations and demand for real-time data
- Greater than expected decline in RMBS issuance due to expansion of GSE activity, declining home values which may limit refinancing activity, and issuer consolidation
- Increased "rating shopping" by market participants
- Past and future issuer consolidations
- Financial stability of the "Big 3" automakers may reduce issuance
- ABCP programs from the same sponsor are combined into larger programs capping fees
- Credit stress or greater than anticipated issuance decline in US RMBS or US corporate loan sectors leads to decreased US CDO issuance or greater issuance of synthetic transactions
- Leveraged loan issuance declines significantly reducing supply of assets for EMEA CDOs
- Higher than expected rating transition in Home Equity and RMBS
- Technology constrains growth of new ratings and non-ratings products and does not keep pace with business growth, resourcing, business lines

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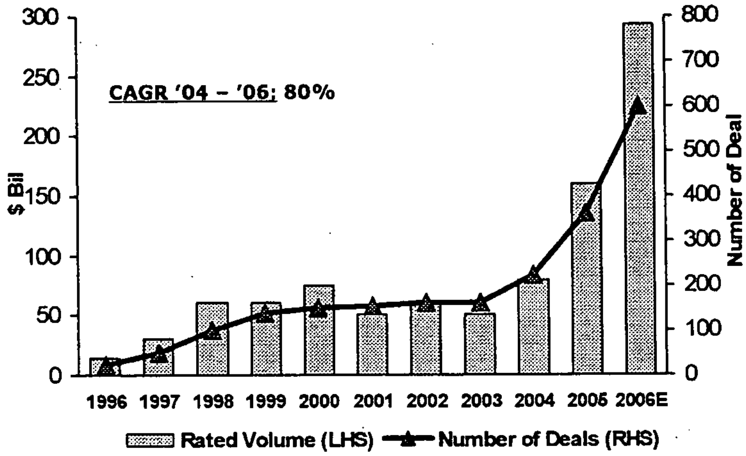
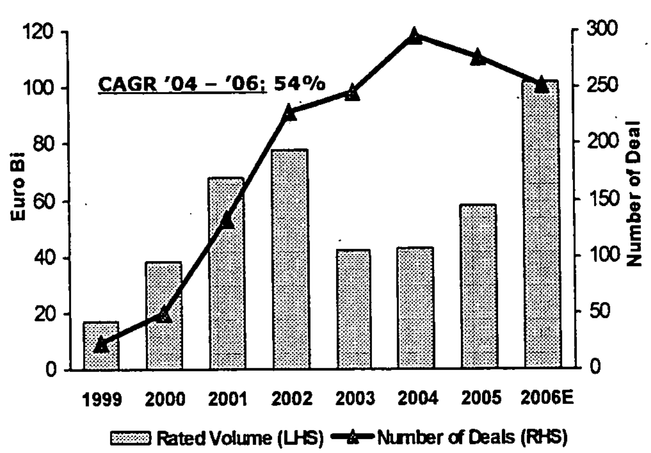
Operating Risks

- Under resourced growth in new and existing businesses
- Intermediary Rating Shopping
- Market Pricing Pressure and Issuer Consolidation
- Turnover and Retention
- Credit Quality Shifts/Monitoring Challenges
- Competition
- Technology limitations

CDO Issuance Volumes for 2006 Continued to be Strong both in the US and Globally



Source: Moody's. Represents volume rated by Moody's alone. Excludes CRE CDOs



Source: Moody's. Represents all volume rated by Moody's and other publicly rated deals.

- Strong historical performance by CLOs and record issuance of RMBS and Home Equity into Resecuritization CDOs were the main drivers of the growth in these two leading CDO sectors
- Issuance driven by demand for and development of new types of structures in the market, increased liquidity and the application of the CDO technology to new asset classes
- Moody's has kept its market coverage in the mid- to high-90's

Moody's Investors Service

2007 Outlook for Global Derivatives Market

- Moody's is well-positioned to capture global CDO issuance business and we expect momentum to continue into 2007
- The continued need of investors, issuers, intermediaries, and regulators to mitigate and transfer risk will fuel expansion; and create new investment products
- Credit derivatives growth will moderate, but remain robust.
  - Market outlook for US CDOs range from 10% to 26% growth in 2007
  - Market outlook for Cash EMEA CDOs is for 25% growth in 2007
- The market's rapid growth does suggest the possibility of a correction.
  - A correction would slow growth more than anticipated, and for a longer period. However, increasing liquidity and innovation should support longer term growth.

Potential Risks to the Derivatives Business

- Ability to attract and **retain** skilled analytical resources to support volume and innovation is increasingly difficult given competitive pressures in the market. Derivative analysts are contacted frequently by the market
- Downturn in housing market could effect growth for Resecuritization CDOs, which currently represent approx. 55% of the U.S. CDO business. Downturn in corporate credit quality would also have an impact on CLO, the second largest CDO business
- Increased scrutiny by press and regulators as spotlight is focused on the global CDO market. Underperformance of underlying securities and resulting underperformance of CDOs would have a material negative impact
- As transactions become increasingly complex, Moody's is faced with the challenge of keeping its technology current to meet demands of the business (e.g., computing capacity, speed, other tools

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FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Division of Insurance and Research

June 4, 2007

TO: Stephen P. Funaro, Dedicated Examiner

CC: Paul H. Kupiec, Associate Director, DIR
John H. Corston, Associate Director, DSC

FROM: Daniel A. Nuxoll, DIR

SUBJECT: ALLL Modeling at Washington Mutual

Summary

Washington Mutual does not currently have data that permit to track charge-offs back to individual loans.

Consequently, Washington Mutual uses the Loan Performance Risk Model to establish reserves for its single family housing loans. The model was developed by a vendor on data for mortgages that were part of private-label securitizations, and Washington Mutual has calibrated the model to reflect its own experience. The calibrations for the various portfolios are based on very limited data usually the portfolio at a single date. These exercises attempt to produce forecasts of key aspects of portfolio performance at horizons from 18 to 36 months. Recently, Washington Mutual decided to set reserves sufficient to cover losses that occur within the next 36 months.

Despite the calibration, the model does not fit some aspects of the data. Probably the most significant problem is that the model estimates prepayment rates for option ARMs that are much too high. The dataset used to develop the model does not include any significant data on option ARMs, so there is reason to believe that the model might not adequately measure the risk of option ARMs. These mortgages constitute over half of the prime mortgage portfolio held for investment.

Details

Overview

Washington Mutual (Wamu) uses different methods for reserving for different parts of their portfolio. I focused on the single family mortgage models which are adaptations of the Loan Performance Risk Model (LPRM). Wamu uses the prime version of that model for its prime portfolios (single family mortgages, home equity loans, and home equity lines of credit) and the subprime version for Long Beach Mortgage Company (LBCM) and the Specialty Mortgage Finance (SMF). These models are designated by the bank[1] as Tier 1 models because

[1] Throughout this memo, the institution is referred to as bank, although all data refers to the parent of the two thrifts.

they are used for portions of the portfolio that were responsible for more than $50 million of reserves. There are two additional Tier 1 models—credit cards and multifamily housing loans.

As shown in Table 1, the Tier 1 models account for over $200 billion (95%) of the balances in the held for investment portfolio and almost $1.2 billion (92%) of the reserves. The mortgage models for single family mortgages account for over $170 billion (78%) of the portfolio and $700 million (55%) of the reserves.

Table 1

Portfolio	Balance $billion	Reserve $million
Single Family Residential	97.3	199
Specialty Mortgage Finance	14.2	196
Long Beach Mortgage Company	4.1	84
Home Equity Loans	21.3	106
Home Equity Lines of Credit	33.2	126
Multifamily Lending	29.8	84
Credit Cards	9.4	399
Other	10.2	107
Total	219.5	1,301

Source: Calculated from the March 2007 ALLL/Provision Recommendation and Q1 2007 Summary, Exhibits 1 and 2.[2]

In addition to the numbers for these model-driven (allocated) reserves, the bank also holds an additional (unallocated) reserve of 14% of the allocated reserves. Unallocated reserves are driven by a scorecard of macroeconomic factors. For example, one factor in the scorecard is the "Market/Industry/Financial Services Sector Conditions." These are identified as being a moderate concern mostly because of decelerating pace of house price appreciation. According to the scorecard, if this factor is a moderate concern, the bank holds an additional 5% unallocated reserves. Other factors in the scorecard account for another 9%.

These numbers are for the consolidated entity. The vast majority of the reserves are held by the two insured entities, but this memo focuses on the consolidated entity because the most detailed reporting is available on this level.

General Methodology for the Mortgage Portfolio

Wamu does not have a good clean database of charge-offs. A validation study of LPRM observed,

[2] The numbers in exhibits 1 and 2 of this memo do not agree with the text of the memo, although they agree with the other exhibits in the memo.

> However, the available data does not include separate measurement of actual losses on such static pools; net charge-off historical data is available only in more aggregate form, with commingling of losses from pools outstanding at the beginning of any given period with losses from loans subsequently acquired into the portfolio.
>
> Furthermore, portfolio management activities for SFR and SMF loans have changed substantially over the last several years… Since the end of 2002, SFR loans that have entered non-performing loan (NPL) status have been reviewed for possible sale, and about $1-1/2 billion were sold. These NPL sales have markedly transformed the timing and magnitude of actual net charge-offs in the period from their initiation to now. Given management plans for less NPL sales activity in the future, a structural change in charge-off patterns is anticipated.[3]

The validation study noted that these complications prevented the bank from computing a clean database to validate the LPRM. The same considerations would clearly prevent the bank from developing its own charge-off model based on the internal data.

Portfolio Defense, a consulting company hired by Wamu to evaluate its methodology recommended,

> Ultimately, if more extensive and better quality Bank mortgage account-level loss data becomes available, we would recommend considering a migration from an LPRM-based process to an internally developed process, using Bank data. At the least, such an approach could be tested and the results compared.[4]

The use of LPRM to set reserves must be interpreted in the light of these data limitations.

The bank recognizes that LPRM data might not be representative of its current mortgage portfolio, so the bank has calibrated LPRM to its own internal data. That calibration is discussed more extensively after the more general discussion of the model. After the model has been calibrated, the model is validated again. Wamu staff has also assured us that the bank tracks the performance of the model; we requested a copy of the regular tracking report but have not received it yet.

Calibration, validation, and performance tracking are all complicated by the issue of the relevant horizon. The bank has commissioned studies by Portfolio Management Associates, a consulting firm, that examine the timing of losses. I received copies of the studies on home equity and subprime lending.

These studies explicitly recognize that "impairment events" such as the loss of a job or a medical problem might not be observable to the bank. These events eventually are discovered, often when the loans become delinquent. In order to analyze the timing of losses, the studies examined all loans that became were sold out of REO and their status prior to entering REO.[5] There are multiple observations of the loan's status prior to the loss, so each observation is weighted by the number of total observations for each loan. There is also a problem of

[3] "Validation of LPRM for SFR and SMF," April 2005. Two bullets have been combined in this quotation.
[4] Portfolio Defense, "Review of ALLL Estimation Methodology and LPRM Calibration Process," January 2006.
[5] The studies on home equity and subprime use slightly different definitions of the final loss confirmation. The subprime study uses the date of sale out of REO, and the home equity study uses the date that property entered REO which typically four months before the sale of the property.

truncation because newer loans have not had sufficient time to suffer losses. Consequently, the two studies consider older vintages and give more credence to the oldest vintage.

Based on these studies, Wamu has decided to use a 36-month horizon for both types of loans. The data suggest that over 90% of the losses in the home equity portfolio occur within that horizon, and almost 90% of the losses in the subprime horizon occur within that horizon.[6] The studies show that the timing of losses differs significantly by delinquency status; there is some variability for different products and vintages, but that is relatively small compared to the variability by delinquency status. Wamu decided that using different horizons based on delinquency status would introduce "operational complexity that would increase operational risk."[7]

Wamu currently uses a four-year horizon for the SFR (prime mortgage) portfolio, a one-year horizon for cards, and a three-year horizon for subprime mortgages, home equity loans, and multifamily housing loans.

Loan Performance Risk Model

There are four versions of the LPRM: prime, subprime, alt-A, and seconds. The LPRM was developed on data from securitizations of mortgages originated by a wide variety of lenders. Over 90% of the data for each of the four models are for mortgages originated between 1997 and 2003. Two components of the LPRM are relevant to the Wamu ALLL process. One component is the transition component and the second is the loss given default component.

The Transition Component

The transition component uses a Monte Carlo simulation of interest rates and house price appreciation to estimate the possible outcomes for a portfolio of mortgages within a specific horizon. The model estimates the delinquency status of the mortgage (current, 30 days past due, 60 days past due, 90 days past due as well as whether the mortgage has been paid off (prepaid), foreclosed or gone to REO. The model also considers the possibility that the house has been short sold or sold out of REO. It does not consider partial prepayments. Each of these possible statuses is a function of the current status, so the model essentially estimates a roll-rate matrix which reports the probability that a mortgage with a specific status will migrate to another status.

The model was built using data on mortgages that were part of private-label securitizations.[8] The prime version of the model has been built on a dataset of approximately 1.1 million mortgages, while the subprime version uses data from approximately 3 million mortgages. Over the 90% of the mortgages used for both models were originated between 1997 and 2003.

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[6] The timing difference discussed in the previous note means the studies are not completely comparable.

[7] The same phrase is used in "Use of a 3 Year LoSWss Horizon for Subprime ALLL: Recommended Response to Results of the Loss Materialization Timing Study," August 2006, and "Loss Horizon for Home Equity ALLL: Recommended Response to Results of the Loss Materialization Timing Study," February 2007.

[8] Private-label securitizations are those not done by Fannie Mae or Freddie Mac.

The model uses loan level data and includes most variables that are widely used in the mortgage industry, including original loan-to-value, FICO score, documentation type, and occupancy status.

Several variables are noteworthy. LPS uses only the FICO score at origination. Wamu follows LPS and does not use a refreshed FICO score.

LPS does update estimates of loan to value using the housing price appreciation index from OFHEO. The model assumes that the future changes in house price appreciation are uncorrelated with past changes, so it assumes that large increases in house prices are equally likely to be followed by above average increase in prices as a below average increase in house prices.[9] This means that sustained periods of above average house appreciation are improbable. In fact, these periods are clearly evident in the OFHEO data.[10]

Wamu apparently recognizes this problem and has augmented the LPS model by using a mixture model of house price appreciation. The bank has estimated a logit model for sustained downturns in the housing market. (Staff was not sure, but they thought that the model specified a severe downturn as a 15% decline in prices in a two-year period.) The model is run on the CBSA/MSA level and the key variables are unemployment rates relative to the long run average, changes in payroll employment, and past house price acceleration. The model has two different means—one for a period of normal behavior in house prices and the other for the severe declines.

It should also be noted that most of the sample is from 1997 and later. Virtually none of the data is drawn from an episode of severe house price depreciation. Even introductory statistics textbooks caution against drawing conclusions about possibilities that are outside the data. A model based on data from a relatively benign period in the housing market cannot produce reliable inferences about the effects of a housing price collapse.

LPS also includes a payment shock variable which equals the percentage increase in payments. Less than 25% of the loans used to construct the model were adjustable rate mortgages (ARMs), and some of those were hybrid ARMs. However, few, if any, were option ARMs. For hybrid ARMs, payments are determined by a fixed interest rate for an initial period ranging from two to seven years. After the initial period, interest rates are adjustable, and payment shocks can approach 30%. In contrast, option ARMs generally have a minimum payment that is insufficient not only to repay principle but also insufficient to pay all the interest. At the recast date, payments must cover both, and payments can escalate much more than 100%.[11] Consequently, the model was developed on data that did not include payment shocks as large as those that could be faced by option ARM borrowers.

The same issue discussed above with respect to house price appreciation also affects the estimation of the effects of payment shock. The model cannot reliably estimate the effects of 100% payment shocks based on data in which virtually none of shocks exceed 30%.[12]

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[9] The model uses a five-factor model of house price appreciation to capture correlations across regions. Each area has its own mean, and changes in the five factors are assumed to be i.i.d.

[10] The autocorrelation in the index for the national index is 0.64; the autocorrelation in the California data exceeds 0.80. LPS staff stated that the next version of LPRM will deal with this issue.

[11] These loans typically include caps on payment increases that spread the payment shocks out.

[12] This definition of payment shock is not documented; but LPS staff confirmed this definition during the course of a phone meeting conducted for another examination. During that conversation, LPS staff also confirmed that the

The Loss Given Default Component

There are two versions of the LPRM loss given default (severity) component—one is an accounting model and the other is a statistical model. Wamu is using the statistical model but is not considering interest lost because of delays in recoveries. The model estimates severity as a function of a number of variables including original combined loan to value, loan characteristics, and original FICO. The model updates the estimated collateral value based on the simulated house price index. The model includes idiosyncratic movements in house prices so it does not assume that prices move in lockstep with regional indices.

Calibration and Validation

The LPRM is calibrated for different mortgage portfolios. Most of the work has been done on the transition component of the model, but some work has been on the severity component. At this point, there is a separate calibration for Option ARMs, for prime mortgages that are not Option ARMs, for home equity loans (HELs) originated by the bank, purchased home equity loans, home equity lines of credit (HELOCs), and for LBCM 1st liens and SMF 1st liens.

Table 2 reports the studies on LPRM that were available. Most of these studies reported the results for the loans held for investment as of a specific date over a defined horizon. The table reports that most the horizons in these studies were shorter than the horizons which are used for reserving purposes which are either 36 or 48 months. Wamu has only recently adopted these horizons used for reserving, and the bank should consider redoing its calibration and validation studies for these longer horizons.

The studies on the single family residential portfolio use data from 1999, occasionally presenting results from 2003 as well. The bank uses data from this period because this is the latest period for which there is data with 24 months of performance history. After 2001, the bank began a program of actively selling non-performing loans, so the timing and magnitude of losses were considerably different than they were for earlier periods. That program has been modified, and the bank believes that the performance of the 1999 sample is more comparable to that of the present portfolio.

Table 2

Portfolio	Study	Sample	Horizon
Single Family Residential	Phase 1 Calibration	January 1999*	24 months
Single Family Residential	Phase 1 Validation	January 1999 January 2003	24 months
Option ARMs (SFR)	Phase 2 Calibration	January 1999	24 months
Other Mortgages (SFR)	Phase 2 Calibration	January 1999	24 months
Specialty Mortgage Finance	Phase 1 Calibration	January 2003	24 months
Specialty Mortgage Finance	Phase 2 Calibration	January 2003	36 months

development data included virtually no option ARMs or payment shocks in excess of 100%. They also agreed that inferences about the model did not produce reliable estimates of the effects of very large payment shocks.

Long Beach Mortgage Company	Phase 2 Calibration	January 2003**	36 months
Home Equity Loans	Validation	November 2003	18 months
Home Equity Lines of Credit	Validation	November 2003	18 months

* The document refers to calibrations done on January 2003 data, although no results are reported.
** Securitized loans

<u>The Transition Component</u>

The LPRM has a number of "dials" that can be set to match the forecasts to the actual data. The calibration documents generally compare the calibrated to the uncalibrated version of the model, and there are some clear differences. For example, the phase 2 calibration study on prime mortgages reports that the roll rate from current to 30 days past due is decreased for all prime loans. That study reports that calibration reduces the roll-rate from current to 30 days past due from 1.12% to 0.52%.[13]

These documents are vague about the procedures used to set these dials, although they state that the dials were set to improve measures of goodness of fit. The studies consider the differences between the forecasted and the actual values of:

1. the sum of the percentages of loans resolved by sales out of foreclosure or REO
2. the sum of the percentages of loans that 90 or more days delinquent, loans that are in foreclosure or REO, and loans that have been resolved by sales out of foreclosure or REO (90+ day or worse).

The studies seem to concentrate most heavily on the squared value of the second criteria, although the studies discuss almost the entire roll rate matrix.

The studies include results based on a Monte Carlo simulation of these time series of house prices and interest rates. However, the model was consistently evaluated with the forecasts based on the actual historical values of house price appreciation and interest rates. This approach produces forecast errors result that do not result from unexpected changes in economic conditions, but rather from the strengths or weaknesses of the model.

The studies revealed a number of anomalies that were not eliminated by calibration. First, in all the studies, loans that were delinquent were much more likely to be 90+ days delinquent at the end of horizon than forecast. For example, in the phase 1 calibration study for single family mortgages, the LPRM forecasted that 0.6% of the loans that were past due 30 days in January 1999 would be 90+ days delinquent two years later; the actual number is 2.5%. Almost all the actual rates are at least twice as large as the forecasted rates. However, because delinquent loans are a small part of the portfolio (the forecasts are dominated by the current part of the portfolio), the aggregate forecasts of the percentage of loans that will be 90+ days delinquent are fairly accurate.

Second, the first calibration study of the prime mortgage portfolio showed that the LPRM forecasts of prepayments are much larger than the actual prepayments. According to the LPRM, over 52% of the current loans would have prepaid within two years, but in fact, only 31%

[13] The roll-rates reported in this paragraph are for 24 months, so the rate represents the percentage of mortgages that are current that will become 30 days past due in 24 months. This is not the usual roll-rate which uses a one-month horizon.

6

prepaid. The errors for delinquent loans were similar. The second calibration study located the problem in the option ARM portion of the portfolio. According to the LPRM, 66% of the option ARMs that were current should have prepaid within two years, but only 32% did. In contrast, LPRM forecasted that about 30% of the other prime mortgages that were current would prepay within two years, and 35% did. Again, the errors for delinquent loans were similar. The prepayment rates in other portfolios do not match exactly, but they are much more accurate than that for the option ARM mortgages. Again, these exercises compare calibrated models to actual data.

One can only conjecture about the reasons for the large difference between actual and forecasted prepayments for option ARMs. As discussed above, the data used to develop the LPRM contains virtually no option ARMs so the estimates of option ARM behavior are not statistically reliable. This might be a concern if the borrowers for option ARMs differ from the borrowers for other loans. If people choose to use an option ARM because they face severe financial constraints, then these borrowers could be more risky. FICO scores, CLTV values, and the other conventional measures used by the LPRM might reflect some of that difference, but there is no reason to believe that these data capture all the differences.

The differences between the forecasted and actual prepayments might indicate that the borrowers who utilize this particular type of loan are less able to refinance than those that choose other loans. Possibly, they cannot afford the payments that would be required if they were to refinance to another loan.

There is some other evidence on whether option ARM borrowers are more financially constrained. First, option ARMs were marketed as "affordability product." Wamu's own website states a number of reasons that borrowers should consider an option ARM; two of the first three are "To minimize your house payment to pay off other debt" and "To maximize your buying power." Second, the percentage of loans that negatively amortize is high and has been increasing. The rate has steadily increased from 69.7% of the eligible loans in March 2006 to 83.9% in March 2007.

In addition, phase 2 of the calibration for prime loans provided some evidence. As part of that exercise, Wamu reported the results of using the option ARM calibration and the calibration for other loans on the same data which happened to be the non-option ARM portfolio. The calibration for Option ARMs estimated 1.20% would become 90+ days past due or worse, while the calibration for other loans forecasted 0.80%. (The actual percentage was 0.81%.) The difference suggests that for this portfolio, the estimated rate of 90+ days past due or worse would be 40 b.p. higher if the loans were option ARMs.

Again, this explanation is conjectural, but there is some evidence consistent with it.

The evidence does suggest that Wamu should be cautious about using the model to evaluate the risks of option ARMs. Moreover, the evidence suggests that these loans are relatively risky.

As of March 2007, Wamu had $57 billion of option ARMs in a $95 billion portfolio of held for investment prime mortgages.

The validation exercises also compared the accuracy of the model by segmentation. The bank considered loans going to REO and segmented four different variables: initial delinquency status, initial FICO score, estimated combined LTV, and initial loan age. As a result of this exercise, the bank did not identify any issues. There are differences, but it is difficult to assess the significance of these differences. For example, over 8% of the loans that were 25 months or older eventually went into REO, but the model estimates that less than 7% would have gone into REO.

The Loss Given Default Component

In general, the calibration and validation exercises offer little detail about the actual severity numbers, so the adequacy of the loss given default component of the model is difficult to assess. The Phase 2 calibration study for prime loans does include a chart that compares actual losses to forecast losses for about 3500 loans. The Phase 2 calibration study for subprime loans shows that the model generally produces forecasted severities that are higher than those actually observed. The LPRM estimated severities do not depend heavily on the horizon, but the actual severities are increasing with time. The validation study for HELs and HELOCs does not show a consistent relationship between the historical data and the LPRM forecasts. The forecasts for HEL 1st and HELOC 2nd liens are higher than the actual severities, while LPRM generally forecasted lower losses given default than were actually realized for HEL 2nd and HELOC 1st liens. These differences can be large; for example, the projected severity at 18 months for 1st lien HELs is 35%, but the actual loss given default is 13%.

On the whole, the various studies do not suggest that the bank believes there is any urgency to recalibrate the severity component. The studies were done on sales out of REO, so they omit the other available methods of collecting on foreclosed loans. In addition, for some of these portfolios, there is very little data—the validation exercise for 1st lien HELs based its severity estimates on only 13 observations.

Documentation Used in this Memorandum

This list includes only that documentation that provided the information in this memorandum. It does not include background information or other documents.

Meeting

Meeting with a Washington Mutual team led by Joe Mattey, Chief Risk Officer , Washington Mutual Home Loans, May 9, 2007

Validation and Calibration Documents

Calibration of LPRM v3.1 for SFR and SMF, April 2005
Validation of LPRM v3.1 for SFR and SMF, April 2005
Validation of LPRM v3.1 for HEL and HELOC Loan Portfolios, after July 2005
Phase II Calibration of LPRM for Prime Portfolios, after April 2006
Calibration of LPRM for Subprime Portfolios, after April 2006

Other Documents

Use of a 3 Year Loss Horizon for Subprime ALLL: Recommended Response to Results of the Loss Materialization Timing Study, August 2006

Loss Horizon for Home Equity ALLL: Recommended Response to Results Loss Materialization Timing Study, February 2007
Negative Amortization Snapshot: March 2007
Credit Risk Review: March 2007
Untitled charts showing balance, loss factors, and net charge-offs

Consultant Documents

Review of ALLL Estimation Methodology and LPRM Calibration Process—Portfolio Defense, January 2006
Loss Materialization Timing Study Final Report [for subprime mortgages]—Portfolio Management Associates, August 2006
Home Equity Loss Materialization Timing Study Final Report—Portfolio Management Associates, February 2007

Loan Performance Documents

Risk Model 3.1.5 Technical Document, August 2005

AKIN GUMP
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STEVEN R. ROSS
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sross@akingump com

February 24, 2011

VIA HAND DELIVERY
The Honorable Carl Levin
Chairman
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
199 Russell Senate Office Building
Washington, DC 20510

Re: Moody's Investors Service: Response to Follow-Up Questions

Dear Chairman Levin:

On behalf of our client, Moody's Investors Service ("Moody's"), we respectfully submit this letter in response to the Committee's recent follow-up questions.

In response to the Committee's question about certain RMBS transactions, from April 2007 through the first week of July 2007, Moody's rated 284 deals containing the following number of RMBS tranches:

	Tranches	Deals
April 2007	1,386	88
May 2007	1,511	96
June 2007	1,379	98
July 1, 2007 – July 6, 2007	29	2

In addition, your staff asked to be further informed regarding Moody's acquisition of underlying loan data that was used to create its model. Moody's obtained data for the purpose of model development through the operation of a consortium, rather than by purchase. Moody's was developing a unique version of its Moody's Mortgage Metrics model for use with respect to the subprime market ("M3 Subprime"). For the purpose of obtaining loan level data to use in M3 Subprime, Moody's, during 2006, formed a consortium of a number of banks and mortgage institutions. The participating institutions, which included the most active participants in the market, agreed to and did, submit to Moody's loan level data concerning mortgages they had originated. Throughout 2006 Moody's received data from the participating institutions.

Moody's utilized a number of these data collections in the development of M3 Subprime, which Moody's began to use as an input to the rating process in late 2006.

The acquisition of these databases was in addition to the data obtained on a regular basis by Moody's for the purposes of RMBS surveillance (which included loan level performance data).

As we described in our February 17, 2011 response, models are tools sometimes used in the process of analyzing credit risk, but Moody's ratings reflect the collective opinion of a rating committee as to the relative creditworthiness of the issuer or obligation.

The information provided today is confidential and proprietary in nature, and therefore we ask that it be kept confidential by the Committee and its staff. We also ask that the Committee staff provide us with notice and an opportunity to be heard before the Committee discloses any non-public information from this letter to third parties. Please let us know if you have any questions.

Sincerely,

Steven R. Ross
Counsel for Moody's Investors Service

cc: The Honorable Tom Coburn, Ranking Minority Member

DATE: 11/13/2000
TIME: 16:03:32 GMT
AUTHOR: Siegel, Jay
RECEIPIENT: Clarkson, Brian
CC:
SUBJECT: RE: MIC analytic software + Investment in analytics

Just got back today, here are some initial thoughts, I might want to follow-up in a few days when I've slept on it.

As you know, I don't think we need to spend a lot of $ or resources to improve the model from an analytic perspective; but I'd need to defer to people more in the loop (looks like you're that person) on whether the marketing component mandates some announcement of model and data improvement.

1. I think the 3 key issues on the "A" market are credibility of analytics (with the threshold for credibility being a lot lower than the need to out-do the MIs' and GSEs' models and certainly lower than the need to improve on FICO as a borrower quality tool (I assume you heard that this was one of the original objectives, right? else I can fill you in)), transparency, and either ease of use (if we share the model with the outside) or prompt and intelligent response (if we continue to have a reason to run the pools ourselves). I don't think these objectives require a huge expenditure if properly staffed and managed.

2. We need to decide again a key issue -- whether pools that are the same to our model will get different credit support levels based on subjective analysis of originators. If yes, this is another reason not to try to further refine the modelling - it would all wash out in the subjective adjustment. If no, we ought to share the model with the bankers and originators and reassign staff to other product types.

3. Make sure you talk to Noel and maybe Fons about the decision to buy the data; I was invited to the original meeting so that the powers that be (at the time) could understand the data originally used. I felt that the arguments for buying the data and re-inventing the model were not persuasive, and left that meeting believing that Noel and Jerry F. felt the same way. The most convincing argument for buying the data was that it would be a cornerstone for marketing, that S&P touted the size of their database as a competitive advantage and that this was why they had the market share advantage. HOWEVER:

a. Your market participant intelligence seems much better than what I believe was just anecdotal presumption for S&P's market share.

b. There are at least a dozen players out there (Fannie& Freddie, the large originators, the seven large Mortgage Insurers) who will always be able to outspend and "out-data" us, our ability to create a market-necessary model is very limited. Our sole advantage is our objectivity (hence the FHLBs use S&P's system and not the originators').

c. The data in question likely does not reflect a major stress situation (in contrast to what we had the last time), not sure that our Aaa levels would be much helped by slicing and dicing the performance of mortgages during a real estate boom.

4. The issue of whether people leave committees understanding the rating conclusions and being able to defend them is an issue you and I discussed in the past; your criticism is on point.

-----Original Message-----
From: Clarkson, Brian
Sent: Friday, November 03, 2000 9:46 AM
To: Zhai, David; Stesney, Linda
Cc: Gupta, Pramila; Silver, Andrew; Bankole, Ed; Kanef, Michael; Kirnon, Noel; Adler, Michelle; Eisbruck, Jay; O'Connor, Michael; Siegel, Jay (MOODY'S)
Subject: RE: MIC analytic software + Investment in analytics

I have a wild thought also -- lets not even consider BUYING anymore data, programs, software or companies until we figure out what we have and what we intend to do with what we have. From what I have heard and read so far we have approaches (MBS, Tranching and Spread) few use or understand (let alone being able to explain it to the outside) and new data that we are unable to use. We want more data when most of the time we rate MBS deals using arbitrary rule of thumb?!! (i.e. earthquake coverage and hard floors made up by one person). And from what I have heard from market participants during the last few weeks the reason(s) we are not viewed as a player in the MBS market have little to do with anything set forth below. The reason the competition spends more is because they have a larger revenue base to absorb the expense. I suggest we spend less time asking for more data and software

(I have not seen anything that sets forth the gains in revenue from such spending -- it is easy to ask for $$ -- much harder to justify it against competing projects) and more time figuring out how to utilize what we have by way of good analysis, a solid approach to this market a proper staffing model. I look forward to hearing all of your thoughts on how to resolve the issues in this market.

-----Original Message-----
From: Zhai, David
Sent: Wednesday, November 01, 2000 3:10 PM
To: Stesney, Linda
Cc: Gupta, Pramila; Silver, Andrew; Adelson, Mark; Bankole, Ed; Kanef, Michael; Kirnon, Noel; Clarkson, Brian; Adler, Michelle
Subject: MIC analytic software + Investment in analytics

(1) MIC Software

There is a software called LPS by MIC selling for about $70,000 per year. We considered the option to buy it a few months back. This again was the money issue that Noel/Mark decided not to buy the piece prior to the spin-off. Therefore we only bought the raw data just for the re-modeling purpose.

In addition, The current functionality of the software is not as comprehensive as we desire, e.g., a black/closed box with no flexibility in getting loan-level statistics. Customization of it will cost us more money. In fact, even MIC's sales manager did not recommend that we buy the software because she thinks it was still premature.

I think the should add some value to our rating process if money is not an issue anymore. It will help our regular research, i.e., comparing pool performances. In addition, maybe we should consider INTEX software platform as well since it will boost ou

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February 17, 2011

VIA HAND DELIVERY
The Honorable Carl Levin
Chairman
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
199 Russell Senate Office Building
Washington, DC 20510

Re: Moody's Investors Service: Response to Follow-Up Question

Dear Chairman Levin:

On behalf of our client, Moody's Investors Service ("Moody's"), we respectfully submit this letter in response to the Committee's recent follow-up question about Moody's use of models. Specifically, your staff asked to be informed how underlying loan data has been used with respect to models.

Over the years, Moody's has developed a number of quantitative models which may be used as one of several inputs in the rating process for a wide variety of structured finance products. It is important to emphasize that Moody's credit ratings themselves are not derived solely from application of a mathematical process, or a "model." Models are tools sometimes used in the process of analyzing credit risk, but the credit rating process always involves much more, including the exercise of independent judgment by the members of the rating committee. Each rating reflects the collective opinion of a rating committee, and not the opinion of an individual analyst, as to the relative creditworthiness of the issuer or obligation.

Moody's ratings take into account qualitative as well as quantitative factors and are intended to reflect the exercise of the rating committee members' judgment about the expected creditworthiness of an obligation or entity. One quantitative factor considered by rating committee members includes historical, both recent and longer-term, performance of similar assets. Models, based on historic performance of the same or similar asset class, are one such input. The predicted impact of newer asset formulations and more recent market performance are elements that are brought to bear in the individual and collective exercise of judgment by the members of a rating committee.

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With respect to previously-rated RMBS, Moody's generally receives, as part of the surveillance process, updated loan performance statistics on a monthly basis for the collateral pools of the transactions it has rated. As loan performance reflected by the monthly surveillance data began to deteriorate, Moody's sought to include an awareness of that information in the ratings process for newly-issued structured finance products. For example, the lead analyst for a particular transaction is often invited to participate in surveillance rating committees for that transaction to provide added perspective on the deal, and to gain an understanding of developing performance trends. This coordination between the surveillance and original rating functions facilitates a broad internal understanding and the best possible use of the most relevant performance data.

In addition, the actual recalibration of a statistical model requires a significant quantum of data. In constructing and estimating a model, a large amount of data representing a significant time period is assembled, cleaned and prepared. Loan performance information from new loan product types may be taken into consideration once there is sufficient history available that meets all necessary requirements, including the quality and breadth of the data. Until such time as reliable performance data becomes available and can be incorporated into a quantitative model, Moody's rating committees account for new loan product types through analyst judgment about the likely impact of such products on a given loan pool. This is but one of the reasons that rating committees utilize the output from a model as only one of many factors to consider when exercising their judgment. Rating committee members were aware of what was being seen in the data collected as part of the surveillance process and could incorporate that knowledge in the committees' considerations.

The information provided today is confidential and proprietary in nature, and therefore we ask that it be kept confidential by the Committee and its staff. We also ask that the Committee staff provide us with notice and an opportunity to be heard before the Committee discloses any non-public information from this letter to third parties. Please let us know if you have any questions.

Sincerely,

Steven R. Ross
Counsel for Moody's Investors Service

AKIN GUMP
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February 17, 2011
Page 3

cc: The Honorable Tom Coburn, Ranking Minority Member

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WRITER'S DIRECT NUMBER

(212) 701-3693

February 10, 2011

Re: Standard & Poor's

Dear Laura:

I write regarding your request for a summary of the data that Standard & Poor's purchased in connection with the development of its RMBS collateral model (known as LEVELS). I understand that the Subcommittee is preparing a final memorandum following up on the Chairman's April 23, 2010 memorandum to the members of the Subcommittee, and that you are seeking to verify information concerning the data that S&P purchased regarding RMBS collateral.

S&P purchased loan-level performance data with regard to residential mortgage loans on an ongoing basis for use in developing its criteria with regard to rated RMBS securities, and specifically with regard to S&P's expected performance of the loans backing such securities. As requested, a summary of the times such data was purchased follows:

Year Purchased	Approximate Number of Loans	Summary of Loan Characteristics
2000	166,000	Primarily first lien, fixed rate, prime.
2002	643,000	Expanded to include ARM loans and hybrid loans.
2003	269,000	Conforming residential mortgages in connection with developing criteria for use with pools of conforming loans.

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1128

Year Purchased	Approximate Number of Loans	Summary of Loan Characteristics
2005	2.9 million	First and second lien loans, including prime, subprime, Alt-A, High LTV and HELOC loans.

These data sets were not direct inputs into the LEVELS model at any time, but rather were the subject of research and analysis toward the development of S&P criteria. As Scott Mason described during his interview by your Staff, the criteria development process involves more than the quantitative analysis of historical data. S&P reviews that data and applies the judgment and experience of its analysts to form opinions about possible future performance, taking into account the specific characteristics of the loans under review. S&P also purchased other data sets for different purposes, including data from millions of loans for development of criteria regarding housing prices.

Accordingly, it is not accurate to say, as the April 23, 2010 memorandum does on pages 7 and 10, that "S&P's models did not contain adequate data" for various types of subprime mortgages. Indeed, S&P's models do not "contain" historical data at all, but instead incorporate and apply S&P's *criteria*, and that criteria was not driven by any particular data set of historical loan information.

The data sets purchased by S&P over this time period were the subject of an ongoing research effort toward the development of an econometric equation for predicting potential mortgage defaults, but the results of those efforts were deemed to be insufficiently reliable to be incorporated into S&P's models. For example, an equation that was developed, in 2004, from the data set of 643,000 loans resulted in *lower* predicted defaults for ARM and hybrid loans than for fixed-rate loans – i.e., the equation predicted that such loans were less risky than fixed-rate loans – a result that was considered counter-intuitive and unreliable.

In its decision not to adopt such an equation as part of its criteria, S&P chose *not* to do precisely what the April 23, 2010 memorandum says it did: it chose *not* to incorporate in its models an equation driven directly and solely by historical data, because S&P did not believe that the equation adequately predicted how certain types of mortgages, such as adjustable rate and hybrid mortgages might perform.

The testimony that the Subcommittee received from S&P's former employee Frank Raiter is inaccurate and unreliable on this subject. Mr. Raiter testified that a version of the LEVELS model was introduced in 2002 or 2003 "based on approximately 650,000" loans. We believe Mr. Raiter is referring to the 2002 data set identified above, but no equation derived using that data set was ever implemented in the LEVELS model for the reasons described above.

Delivery of the 2.9 million data set for analysis did not occur until after Mr. Raiter retired from S&P and he had no involvement in, or access to, that data or any analysis of it. Although an econometric equation of the type considered in 2004 was never deemed appropriate for S&P criteria, S&P continued its concerted efforts to analyze that data, both by employing external consultants and dedicating resources within Standard & Poor's to analyze the data for criteria development.

While it is true, as S&P has said previously, that some loan data – such as borrower FICO scores – has turned out recently to be less predictive of defaults than it had been historically, the analysis of historical data was only one of many factors that S&P took into account in developing opinions about future performance. More fundamentally, the extent and impact of the housing market collapse in 2007 was more severe and precipitous than S&P, like so many others, anticipated.

Sincerely,

S. Penny Windle

Laura E. Stuber, Esq.
Counsel
Permanent Subcommittee on Investigations
199 Russell Senate Office Building
Washington, DC 20510

<u>BY E-MAIL</u>

STANDARD & POOR'S

Standard & Poor's LEVELS®

Scott Mason
Standard & Poor's

February 2010

The McGraw-Hill Companies

What Does LEVELS Do?

- LEVELS analyzes a loan, or pool of loans
- Provides an assessment of Foreclosure Frequency, Loss Severity, and Credit Enhancement

STANDARD & POOR'S

Foreclosure Frequency – Key Drivers

- Loan-to-Value (LTV)
- Occupancy Status
- Property Type
- Loan Purpose
- Loan Balance
- Loan Type
- FICO Score
- Documentation

STANDARD & POOR'S

Loss Severity – Key Drivers

- Loan-to-Value (LTV)
- Assumed Market Value Declines (MVD)
- Housing Volatility Index
- House Price Index
- Foreclosure Timelines

STANDARD & POOR'S

Credit Enhancement

Foreclosure frequency x loss severity = loss coverage

Foreclosure Frequency	=	The ratio of loans in a pool expected to default
Original Home Value less Market Value Decline	=	Market Price
Loan Balance less Market Price	=	Market Loss
Market Loss + Foreclosure Costs	=	Total Loss ($ amount)
Loss Severity %	=	Total Loss / Loan Balance

STANDARD & POOR'S

LEVELS – Criteria Updates

- S&P is committed to continually updating the methodology and assumptions upon which its RMBS ratings are based.
- Since 2001, S&P has updated its LEVELS model 18 times.

STANDARD & POOR'S

LEVELS 5.4.2 – March 27, 2001

- Incorporated updated or new rating criteria for simultaneous second lien mortgages, hybrid adjustable-rate mortgage loans and subprime loans
- Included an updated version of Standard & Poor's Economic Index, adjusting for projected real estate price fluctuations

STANDARD
&POOR'S

LEVELS 5.4.2(a) – July 10, 2001

- Updated base case foreclosure frequency based upon a review of a sampling of loans

STANDARD & POOR'S

LEVELS 5.5 – April 3, 2002

- Included criteria revisions and several model performance enhancements, including the new Standard & Poor's House-Price Volatility Index

STANDARD & POOR'S

LEVELS 5.6 – December 1, 2003

- **Updated data requirements to include:**
  - Asset verification
  - Appraisal types
  - Automated Valuation Model use and type
  - Self-employed borrower
  - NextGen FICO
  - Indicate High Cost or Covered Loan
  - Manufactured Housing Property type field added
- **Housing Volatility Index Updated**
- **New Manufactured Housing assumptions built into the model**

STANDARD & POOR'S

LEVELS 5.6 Continued

- **Revised Loss Severity Model with benchmarks for:**
  - Time to initiate foreclosure
  - Time to foreclose
  - Bankruptcy delays
  - Eviction delays
  - Preservation costs
  - Legal costs
  - Amounts escrowed for taxes and insurance
  - Brokerage cost; and
  - Appraisal and lien search

STANDARD & POOR'S

LEVELS 5.6(a) – September 1, 2004

- **Instituted new foreclosure frequency multiples**
  - Foreclosure frequency multiple calculation was refined

STANDARD &POOR'S

LEVELS 5.6(b) – February 1, 2005

- Updated foreclosure frequency and loss severity assumptions for ARM loans
- Updated foreclosure frequency assumptions for interest-only loans

STANDARD & POOR'S

LEVELS 5.6(c) – August 1, 2005

- Incorporated Option ARM (Negative Amortization) assumptions
- New adjustments to loss coverage for small pools
- Adjusted LTV's of loans to account for curtailments to non-seasoned loans

STANDARD
&POOR'S

LEVELS 5.6(d) – March 1, 2006

- Incorporated a discount to the amount of home price appreciation indicated by the Housing Price Index
- For Option ARM loans that have experienced negative amortization, the original balance of the loan will be used to calculate adjusted LTV

STANDARD & POOR'S

LEVELS 5.7 – July 1, 2006

- Adjusted foreclosure frequency on first lien loans with simultaneous second liens, based on loan level analysis
- Increased the base case foreclosure frequency for loans with a high probability of default due to increased risk layering
- Adjusted foreclosure frequency multiples
- Updated Housing Volatility Index assumptions

STANDARD
&POOR'S

LEVELS 6.0 – June 1, 2007

- Incorporated into LEVELS the ability to analyze Closed End Second lien loans and loans with Combined Loan to Value ratio (CLTV) up to 100
- CLTV used for foreclosure frequency calculation rather than LTV
- For a first lien loan with a simultaneous second lien, CLTV is used to calculate foreclosure frequency

STANDARD & POOR'S

LEVELS 6.1 – November 12, 2007

- **Reduced reliance on FICO score as a predictor of default**
- **Increased foreclosure frequency assumptions for the following:**
  - two-year hybrid ARMS
  - low FICO and High CLTV purchase money loans
  - stated income and no income documentation loans
- **Updated Housing Volatility Index adjustments**

STANDARD & POOR'S

LEVELS 6.2 – January 9, 2008

- Loans coded with unknown appraisal type assessed a 100% loss severity
- Adjusted the primary mortgage insurer ratings affecting loss severity:
  - **10 = Mortgage Guaranty Insurance Corp. (MGIC) from AA downgrade to AA-**
  - **16 = MGIC Indemnity from AA downgrade to AA-**
  - **19 = Triad Guaranty Insurance Co. from AA downgrade to AA-**

STANDARD & POOR'S

LEVELS 6.3 – March 14, 2008

- Increased functionality with respect to home equity line of credit (HELOC) loans
- Adjustments to delinquency assumptions
- Updated loss severity assumptions based on certain state foreclosure timeline extensions
- Updated data regarding the rating levels of mortgage insurers
- Updated Housing Price Index

STANDARD & POOR'S

LEVELS 6.4.3 – July 14, 2008

- Adjusted the loan-level probability of default assumptions for certain loan types, including short-term hybrid adjustable-rate mortgage loans, interest-only mortgage loans, and mortgage loans that allow for negative amortization
- Updated Housing Price Index
- Revised the Housing Volatility Index
- Adjusted the impact of loan-to-value ratios and combined loan-to-value ratios on credit enhancement
- Revised loan-level adjustments for credit enhancement from the inclusion of primary mortgage insurance

STANDARD & POOR'S

LEVELS 6.5 – December 2, 2008

- Updated loan-level adjustments for primary mortgage insurance
- Updated corporate credit ratings for various primary mortgage insurers
- Updated foreclosure frequency adjustments for all document type codes
- New loss severity adjustments for loans to which an automated valuation model is the primary appraisal type
- Updated Housing Price Index
- New reports summarizing the originator and due diligence fields
- Added four fields relating to third-party due diligence

STANDARD & POOR'S

LEVELS 6.6 – March 31, 2009

- Added VantageScore as an acceptable borrower credit scoring model
- New documentation type code, "P," which indicates that employment was verified verbally, and income was verified by IRS transcripts through the use of IRS Form 4506T
- Updated foreclosure frequency adjustments for "C" and "V" documentation type codes
- Updated Housing Price Index
- Updated counterparty credit ratings for various primary mortgage insurers

STANDARD & POOR'S

LEVELS 7.0 – September 17, 2009

- **Revised credit enhancement adjustment factors to assess the risk in pools of mortgage loans based on loan and borrower characteristics relative to the archetypical pool**
- **Updated data requirements, including:**
  - Added required fields to analyze the flow of funds in a transaction structure
  - Updated to reflect the current corporate credit ratings of mortgage insurance companies
  - Added a requirement that the total debt-to-income ratio be provided for each loan

STANDARD & POOR'S

LEVELS 7.1 – February 11, 2010

- Revised 25 of S&P's state-specific assumptions with respect to timelines for foreclosing on a mortgage loan
- Updated Housing Price Index
- Updated counterparty credit ratings and capital adequacy ratios for affected primary mortgage insurers

STANDARD & POOR'S

Examination Report for
Standard and Poor's
Ratings Services, Inc.
("S&P")

1. Introduction

On August 31, 2007, the Staff in the Commission's Office of Compliance Inspections and Examinations ("OCIE"), Division of Trading and Markets ("Trading & Markets") and Office of Economic Analysis ("OEA") (collectively "the Staff") initiated an examination of S&P, and two other credit rating agencies. The focus of the examinations was S&P's activities in rating subprime residential mortgage-backed securities ("RMBS") and collateralized debt obligations ("CDOs") linked to subprime RMBS.[1] Specifically, key areas of review included:

- the NRSROs' ratings policies, procedures, and practices, including gaining an understanding of ratings models, assumptions, criteria and protocols;
- the adequacy of the disclosure of the ratings process and methodologies used by the NRSROs;
- whether the NRSROs complied with their ratings policies and procedures for initial ratings and ongoing surveillance;
- the efficacy of the NRSROs' conflict of interest policies and procedures; and
- whether ratings were unduly influenced by conflicts of interest related to the NRSROs' role in bringing issues to market and the compensation they received from issuers and underwriters.

The examinations also included a review of whether there were any errors in ratings issued as a result of flaws in ratings models used in response to a press report indicating errors in one firm's model.[2] Initial observations as a result of this aspect of the examinations are included in this report.

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1 Beginning in 2007, delinquency and foreclosure rates for subprime mortgage loans in the United States dramatically increased, creating turmoil in the markets for RMBS backed by such loans and CDOs linked to such loans (collectively "subprime RMBS and CDOs"). As the performance of these securities continued to deteriorate, the three NRSROs most active in rating these instruments downgraded a significant number of their ratings. The NRSROs' performance in rating these structured finance products raised questions about the accuracy of their credit ratings generally as well as the integrity of the ratings process as a whole.

2 See Sam Jones, Gillian Tett, and Paul J. Davies, *Moody's Error Gave Top Ratings to Debt Products,* Financial Times, May 20, 2008, at 1.

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1145

The examination review period generally covered January 2004 through 2007. The firms under examination became subject to the provisions of the Credit Rating Agency Reform Act of 2006 (the "Rating Agency Act"), which amended the Securities Exchange Act of 1934 ("Exchange Act"), and the Commission's rules when they registered with the Commission as NRSROs in September 2007. Although S&P was not subject to legal obligations applicable to NRSRO during most of the review period, the Staff nonetheless sought to make relevant factual findings and observations with respect to the activities of S&P in rating subprime RMBS and CDOs during the period, as well as to identify possible areas for improvement in their practices going forward.

Over 50 Commission Staff participated in the examinations of S&P, and two other NRSROs. The examinations included extensive on-site interviews with the rating agencies' staff, including senior and mid-level managers, initial ratings analysts and surveillance analysts, internal compliance personnel and auditors, personnel responsible for building, maintaining and upgrading the ratings models and methods used in the ratings process, and other relevant rating agency staff.

In addition, the Staff reviewed a large quantity of the NRSROs' internal records, including the written policies, procedures and other such documents related to initial ratings, the ongoing surveillance of ratings, and the management of conflicts of interest, and the public disclosures of the procedures and methodologies for determining credit ratings. The Staff also reviewed deal files for subprime RMBS and CDO ratings, internal audit reports and records, and other internal records, including a large quantity of email communications records (the NRSROs produced over two million emails and instant messages that were sorted, analyzed and reviewed using software filtering tools). Finally, the Staff reviewed the NRSROs' public disclosures, filings with the Commission, and other public documents.

2. The Ratings Process

The Rating Agency Act expressly states that the Commission has no authority to regulate the "the substance of the credit ratings or the procedures and methodologies" by which any NRSRO determines credit ratings.[3] As part of these examinations, however, the Staff necessarily sought to develop an understanding of the quantitative analysis used to rate the RMBS and CDOs that have been subject to such dramatic and widespread change.

S&P rates RMBS and CDO transactions by first assessing the underlying collateral and then assessing the deal structure. For RMBS, S&P utilizes its Loan Evaluation and Estimate of Loss System ("LEVELS") model as the basis for the foreclosure frequency and loss severity analyses of a deal's underlying collateral.[4] S&P evaluates cash flows in

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3 15 U.S.C. 78o-7(c)(2).

4 S&P developed the assumptions for the LEVELS model during the 1970's and 1980's, using empirical observations of mortgage default rate data going back at least as far as the Great Depression, which represented the "worst case scenario." As of March 14, 2008, LEVELS, included a total of 77 possible factors, 38 of which are required, related to the loans that are loaded

the Standard & Poor's Interest Rate Evaluator ("SPIRE") model. S&P uses its CDO Evaluator to estimate the gross level of defaults in proposed CDO asset pools.[5] When analyzing cash flow for CDOs, after the CDO Evaluator process, S&P runs a cash flow analysis in a proprietary cash flow model called Genesis.[6] Results from the collateral and cash flow models are subjected to the committee approval process before a final rating is issued.

S&P also used spreadsheets and other models outside LEVELS to rate non-routine loans until they could be incorporated into the RMBS model. For instance, as the market for non-first lien mortgages grew in the late 1990's and early 2000's, S&P developed more simplified spreadsheet-based models to accommodate the rating of pools of such loans until S&P was able to incorporate such modeling into the LEVELS in late 2007.[7]

3. Increase in Number and Complexity of RMBS and CDO deals

From 2002 to 2006, the volume of structured finance deals rated by S&P increased substantially, as did the revenues S&P received from rating those deals. The structured products that S&P rated became increasingly complex, with many employing derivatives such as credit default swaps to replicate the performance of mortgage backed securities. Further, the loans made to retail borrowers being securitized evolved from 30-year fixed rate instruments to newer products such as second lien and adjustable rate mortgages. The increasing number and complexity of deals may have compromised various aspects of S&P's ratings operations for structured finance, as discussed in greater detail below.

a. Revenue, Deal, and Staffing Levels

From 2002 to 2006, the volume of RMBS deals rated by S&P increased by 130%, and the number of CDO deals rated by S&P increased by over 900%.[8] Correspondingly, the revenue S&P derived from RMBS deals increased from $57 million in 2002 to $190.7

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into LEVELS. Loan level information in the tape that is analyzed by LEVELS includes the type of property securing the mortgage, whether the property is occupied, the level of documentation presented by the borrower, the type and term of the loan, and the ratio of the amount of the loan to the value of the residence.

5 CDO Evaluator is made publicly available.

6 The Genesis model is not publicly available. S&P, however, discloses the inputs and criteria used in this cash flow model. For a synthetic CDO there is no need for a cash flow model as payments from the credit default swap exactly equal what is due on liabilities and there is no additional risk aside from credit risk, which is modeled in Evaluator.

7 Representation by Frank Parisi, former Director, Structured Finance, S&P on May 27, 2008 teleconference with Commission Staff.

8 See Letter from Mari B. Maloney, Chief Compliance Officer, Ratings Services, Global Regulatory Affairs, S&P to Matthew Daugherty, Senior Special Counsel, OCIE, SEC (Mar.14, 2008). RMBS deals increased from 713 to 1,639 during that time. CDO deals increased from 34 to 343 during that time.

million in 2006 and CDO revenue increased from $10.1 million in 2002 to $98.7 million in 2006.

For the RMBS group, contemporaneous staffing increases appear roughly in line with volume increases (S&P increased RMBS staff by 168% as volume increased by 130%).[9] For CDOs, however, S&P's staffing increases do not appear to have kept pace with volume increases (S&P increased CDO staff by 119% as volume increased by over 900%).[10]

b. Impact on Ratings Process

The Staff believes that the deal and staffing levels during the review period may have impacted various aspects of the ratings process. For instance, an instant message exchange between the primary analyst on a CDO deal and a member of the deal's rating committee revealed the following:

- Shah: "btw - that deal is ridiculous"
- Mooney: "I know right…model def does not capture half of the…" "risk"
- Shah: "we should not be rating it"
- Mooney: "we rate every deal" "it could be structured by cows and we would rate it"
- Shah: "but there's a lot of risk associated with it - I personally don't feel comfy signing off as a committee member."[11]

In another example, an S&P Associate Director in the Global CDO Group writes to a Director in the Global CDO Group that "Rating Agencies continue to create and [sic] even bigger monster – the CDO market. Let's hope we are all wealthy and retired by the time this house of cards falters.;o)"[12]

The Staff also identified internal communications in structured finance groups other than RMBS and CDO that indicated various staffing issues during the review period. For instance, in one email the Managing Director of Global Real Estate Finance states that "[o]ur staffing issues, of course, make it difficult to deliver the value that justifies our

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9 RMBS staff increased from 31 to 83 during the time period.

10 CDO analytical staff increased from 36 to 79 between 2002 and 2006. S&P has indicated that the support from the Synthetic ABS group and quantitative group are particularly important for CDOs. If the Synthetic ABS group's staff is included in the number, the increase is from 36 to 88 (144%). If the quantitative group's staff is also included, the increase is from 36 to 99 (175%).

11 Instant message exchange between Shannon Mooney, Rating Analyst, Quantitative Support, Global CDO Group, S&P, and Rahul Dilip Shah, Associate, Analytical Pool, Global CDO Group, S&P (Apr. 5, 2007, 3:56 PM). Ellipses both in original and added.

12 Email from Chris Meyer, Director, Analytical Pool, Global CDO Group, S&P, to Belinda Ghetti, Director, Global CDO Group, S&P (Dec. 15, 2006, 8:31 PM).

fees"[13] and states in another email that "[t]ensions are high. Just too much work, not enough people, pressure from company, quite a bit of turnover and no coordination of the non-deal "stuff" they want us and our staff to do."[14] Similarly, an email from an Analytical Coordinator in the ABS Group states that [w]e ran our staffing model assuming the analysts are working 60 hours a week and we are short on resources. . . . The analysts on average are working longer than this and we are burning them out. We have had a couple of resignations and expect more. It has come to my attention in the last couple of days that we have a number of staff members that are experiencing health issues."[15]

The Staff believes that the increase in the number and complexity of deals may have further impacted S&P's structured finance ratings operations, as is discussed in more detail below.

The Staff recommends that S&P periodically evaluate if it has sufficient staff and resources to manage its volume of business and meet its obligations under the Rating Agency Act.

S&P's Response:

In its response,[16] S&P stated that it believes its staff increases between 2002 and 2006 were appropriate. S&P noted that it does not have a discrete pool of analysts who rate CDOs of RMBS deals. The staffing levels of CDO analysts noted in its March 14, 2008 letter, therefore, represent analytical staff that worked on any type of CDO, not just CDOs of RMBS. Moreover, it notes that the number of all CDO transactions increased more modestly between 2002 and 2006 than the number of RMBS-related CDOs. In making the case that staffing levels for CDOs were appropriate, S&P notes that including support from members of the Synthetic ABS Group and the additional quantitative support group, which are both important contributors to the CDO rating process decreases the ratio of deals to staff. However, S&P notes that, even without including such supporting staff, it believes that the ratio of deals per analyst that it had in the CDO Group in 2006, was an appropriate level.

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13 Email from Gale Scott, Managing Director, Global Real Estate Finance, S&P, to David Klein, Vice President of Finance, Structured Finance Group, S&P (Apr. 27, 2007, 1:13 PM).

14 Email from Gale Scott, Managing Director, Global Real Estate Finance, S&P, to Diane Cory, External Consultant, Structured Finance Group, S&P (May 3, 2006, 10:20 AM).

15 Email from Gail Mcdermott, Analytical Coordinator, ABS Group, S&P, to Abe Losice, Managing Director, RMBS Group, S&P (Dec. 3, 2004, 11:10 AM).

16 See Letter from Vickie A. Tillman, Executive Vice President, Ratings Services, S&P to A. Duer Meehan, OCIE, SEC (June 27, 2008).

S&P stated that it will take prompt steps to conduct a review of structured finance staffing levels and will continue to reevaluate its staffing levels to ensure that they are appropriate and in compliance with the Rating Agency Act.

4. Disclosure of the Ratings Process

The new requirements of the Rating Agency Act specifically address the importance of disclosure. An NRSRO is required to disclose publicly the procedures and methodologies it uses in determining credit ratings.[17] Form NRSRO requires that this disclosure be a general description but sufficiently detailed to provide users of credit ratings with an understanding of the processes employed in determining credit ratings, including, among other things, the quantitative and qualitative models and metrics used to determine credit ratings. S&P explained to the Staff that, prior to being registered as an NRSRO, it disclosed its ratings process during the review period. It appears, however, that certain significant aspects of the rating processes and the methodologies used to rate RMBS and CDOs were not always disclosed, or were not fully disclosed, as summarized below.

For RMBS and CDOs, if a material rating change is approved, S&P's policy is that its terms are communicated both internally and publicly.[18] When new criteria, or changes to existing criteria, are implemented, S&P may apply such changes prior to publication, depending on the circumstances.[19] In its review, the Staff observed a number of occasions where S&P implemented changes to its RMBS ratings criteria outside its SPIRE and LEVELS models without promptly publishing such changes.[20] In published documents, S&P states that when it assigns ratings to structured finance securities, it uses a general framework and established guidelines, as well as various quantitative techniques and models to enhance the rating committee's qualitative opinions. S&P states that these qualitative opinions are an integral part of its rating process.[21] Based on review of produced documents, it does not appear that S&P specifically disclosed which

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17 Section 4(a)(1)(B)(ii) of the Exchange Act.

18 See "Ratings Services, Criteria Process Guidelines," (Mar. 21, 2008) provided under cover of letter from Mari Maloney, Chief Compliance Officer, S&P, to Matthew Daugherty, Senior Special Counsel, OCIE, SEC (June 12, 2008). The guidelines, which contain a publication date of March 21, 2008, are a recently revised and updated version of S&P's criteria process.

19 Id. The guidelines do not provide guidance for such circumstances.

20 See RMBS Criteria Alert #64, dated March 24, 2004, RMBS Internal Analyst Alert #112, dated June 25, 2007, RMBS Criteria Alert, dated October 19, 2006, respectively. Examples include decreasing foreclosure frequency assumptions for pools of first lien 100% LTV loans made to borrowers with minimum FICO scores of 700, increasing AAA loss coverage by 1 basis point for every 1% of a mortgage pool with "non-standard" mortgage insurance, and increasing its foreclosure frequency assumptions for loans that came to S&P on the tape already more than 30 days delinquent.

21 See Principles-Based Rating Methodology for Global Structured Finance Securities," dated May 29, 2007.

out-of-model adjustments a ratings committee may use in determining the ratings for CDOs, or how much weight the rating committee gave to such factors.[22]

The Staff found several communications by S&P employees to outside parties related to the application of unpublished criteria, such as "not all our criteria is published. [F]or example, we have no published criteria on hybrid deals, which doesn't mean that we have no criteria"[23] and "[a]s I pointed out, there is [sic] many pieces of criteria that has [sic] not yet been published. Does that mean it is not criteria? No."[24] Another email states, "[O]ur published criteria as it currently stands is a bit too unwieldy and all over the map in terms of being current or comprehensive. It might be too much of a stretch to say that we're complying with it because our SF [structured finance] rating approach is inherently flexible and subjective, while much of our written criteria is detailed and prescriptive. Doing a complete inventory of our criteria and documenting all of the areas where it is out of date or inaccurate would appear to be a huge job - that would require far more man-hours than writing the principles-based articles."[25]

S&P indicated to the Staff that, as a general practice, it did not adjust an RMBS collateral or cash flow analysis based upon factors that were not incorporated into its LEVELS or SPIRE models.[26] However, the Staff observed instances in its deal files that demonstrated adjustments from its models. For example, one RMBS deal was characterized by two tranches that failed one of the cash flow stress tests, but was nonetheless given the rating under which the tranches failed.[27] In another deal, the margins/coupons in seven of the tranches are different than the structure run in SPIRE.[28] In addition, the Staff observed instances where S&P implemented changes to its ratings criteria which were not incorporated into its LEVELS or SPIRE models.[29]

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22 Qualitative factors which influence the rating committee's decision may result in changes to the structure of the deal or additions and/or modifications to covenants in the deal documents in order to mitigate risks which concern the ratings committee.

23 Email from Anna Widernik, Director, Analytical Pool, Global CDO Group, S&P, to Scott Farrell, Marathon Fund/Issuer (Aug. 31, 2006, 12:04 PM).

24 Email from Jean-Baptiste Carelus, Director, Global CDO Group, S&P, to Brian Rance, Freshfields Bruckhaus Deringer LLP/External Issuer Attorney (Dec. 15, 2006, 12:08 PM).

25 Email from Calvin Wong, Chief Criteria Officer, Structured Finance Surveillance Group, S&P, to Tom Gillis, Managing Director, Research and Criteria, S&P (Mar. 14, 2007, 6:45 PM).

26 Representation by Scott Mason, Director, RMBS Group, S&P, to SEC Staff on December 12, 2007.

27 The SPIRE output indicated "minor int SF ok, per TO." MLMI 2006-RM5. Staff from S&P indicated that the structure was allowed to pass because the interest shortfalls at the two tranches were *de minimis*. Representation by Scott Mason, RMBS Director on June 20, 2008.

28 See HASCO-2006-WMC1.

29 Examples include decreasing the LEVELS foreclosure frequency assumptions for pools of first lien 100% loan-to-value loans made to borrowers with minimum FICO scores of 700, and

The Staff recommends that S&P conduct a review of its current disclosures of its processes and methodologies for rating subprime RMBS and CDOs to assess whether it is fully disclosing its ratings methodologies, and is meeting the requirements of the Rating Agency Act and Form NRSRO. Further, the Staff recommends that S&P review whether its policies governing the timing of disclosure of a significant change to a process or methodology are reasonably designed to comply with these requirements.

S&P's Response:

S&P emphasized the transparency of its rating process by noting, among other things, that it "generally announces" all material changes to its criteria through formal publication. S&P has noted, that although it has developed unpublished criteria in the past, that it has recently formalized policies and procedures related to the publication of criteria. S&P further stated that it consistently publicly discloses the limits of its models. S&P further notes that rating committees are not limited to considering the results of the model outputs in arriving at a rating, because, among other things, S&P's rating models, including SPIRE, do not always consider all of S&P's rating criteria. S&P further noted that it does not, as a matter of routine, memorialize its decisions to adjust model outputs.

S&P stated that it will take prompt steps to conduct the review of the policies and procedures regarding disclosure of the RMBS and CDO rating process, and noted that it had already taken significant steps to enhance its criteria publication process.

5. Written Policies and Procedures for Rating RMBS and CDOs

a. General Policies and Procedures

As of September 2007, NRSROs became subject to a requirement to make and retain certain internal documents relating to its business, including procedures and methodologies used to determine credit ratings.[30] S&P has a public document known as the "U.S. Residential Subprime Mortgage Criteria," which pre-dates this requirement and serves as a guide to its subprime RMBS analytical process. With respect to CDOs, S&P published a "Global Cash Flow and Synthetic CDO Criteria" on March 21, 2002.[31] This document outlines the numerous components of the CDO cash flow and synthetic CDO ratings process including S&P's review of the CDO manager, the analysis of the

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increasing LEVELS AAA loss coverage by one basis point for every 1% of a mortgage pool with "non-standard" mortgage insurance. See RMBS Criteria Alert #64, dated March 24, 2004, and RMBS Criteria Alert dated October 19, 2006, respectively.

30 Exchange Act Rule 17g-2. 17 CFR 240.17g-2.

31 See S&P-SEC-002944. This document also is available on the S&P website.

transaction structure; the quantitative models used, and the surveillance process. This document was updated in 2004 and 2006.[32]

However, the Staff observed that S&P had a number of undocumented policies and procedures for rating RMBS and CDOs.[33] The Staff also observed that S&P's ratings policies and procedures that did exist were scattered among numerous documents, rather than in one consolidated location or document.[34] The non-standard nature of S&P's structured finance procedures, publication and disclosure policies over the review period may have impacted its compliance with the ratings process. For instance, in a communication related to upcoming NRSRO registration, the Chief Criteria Officer in the Structured Finance Surveillance Group at S&P states:

> "[O]ur published criteria as it currently stands is a bit too unwieldy and all over the map in terms of being current or comprehensive. It might be too much of a stretch to say that we're complying with it because our SF [structured finance] rating approach is inherently flexible and subjective, while much of our written criteria is detailed and prescriptive. Doing a complete inventory of our criteria and documenting all of the areas where it is out of date or inaccurate would appear to be a huge job - that would require far more man-hours than writing the principles-based articles."[35]

The Staff recommends that S&P conduct a review to assess whether its written policies and procedures used to determine credit ratings for RMBS and CDOs are fully documented in accordance with the requirements of Exchange Act Rule 17g-2.

S&P's Response:

S&P responded that it does not believe that it can or should prescribe fixed analytical steps that the analysts should follow for all structures that S&P might rate, because such rules could oversimplify the rating process and ignore the uniqueness of each deal. S&P notes that it has adopted several measures[36] to ensure consistency of criteria application

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32 See S&P-SEC-002864. S&P also publishes an "Introduction to CDOs and Standard & Poor's Global CDO Ratings." See S&P-SEC-003369. S&P also has published a "Global Synthetic Securities Criteria." See S&P-SEC-002736.

33 For instance ,S&P did not address the use of outside models, including the use of alternatives to the RMBS cash flow model, SPIRE, and the CDO cash flow model, Genesis.

34 See e.g. S&P Role of Rating Committee Chairperson (June 26, 2007), S&P Analytic Documentation Policy (June 26, 2007), and S&P Global Rating Services' Rating Decision-Making Standards Policy (April 3, 2007).

35 Email from Calvin Wong, Chief Criteria Officer, Structured Finance Surveillance Group, S&P, to Tom Gillis, Managing Director, Research and Criteria, S&P (Mar. 14, 2007, 6:45 PM).

36 These measures include encouraging analysts to engage in ongoing dialogue with their peers and supervisors, hiring experienced analysts, using "project leads" (senior analysts) on each deal, and providing internal guidance on how to apply new ratings approaches.

at the deal level, and does not believe that its approach prevents analysts from consistently applying its criteria.

While S&P does not agree with the Staff's findings on this point, S&P stated that will take prompt steps to review its policies and procedures to ensure that it has appropriately detailed policies and procedures to follow throughout the deal rating process.

b. Policies and Procedures Regarding Technical Errors

As a result of recent attention in the financial press regarding a rating agency's application of flawed rating models to constant proportion debt obligation ("CPDO")[37] deals, the Staff expanded the scope of its exams to review any assignments of erroneous ratings by S&P for any RMBS, CDO and CPDO ratings issued since 2004, as well as S&P's policies for dealing with the discovery of errors in the models and methodologies. In response, S&P indicated that a beta version of its CPDO Evaluator model contained a coding error that was discovered by surveillance in late 2007, which led the model to use a higher discount factor in assessing certain incoming and outgoing cash flows. According to S&P, the error was immediately corrected.[38] Following detection of the error, S&P reviewed the five CPDO transactions in which the beta version was used to make a public rating, and determined that none of the resulting differences in interest rates and discount factors between the erroneous model and corrected model merited a rating action. S&P identified its ratings and criteria committee processes, its transparency, and its surveillance process as "policies and practices" that further the goal of identifying errors.[39]

The staff recommends that S&P review its procedures to identify, correct and rectify errors in its ratings models and methodologies.

S&P's Response:

S&P noted that it already has begun the process of addressing the issue of policies and procedures to detect and disclose errors in the rating process by developing an internal review process for assessing model quality. The process will assess whether S&P's current models remain suitable for their intended use, and will consider all relevant aspects of the models under review.

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[37] CPDOs are a type of credit derivative sold to investors looking for long term exposure to credit risk on a highly rated note. Investors buy notes issued by a special purpose vehicle ("SPV").

[38] See Letter from Vickie A. Tillman, Executive Vice President, Ratings Services, S&P to A. Duer Meehan, Associate Director, OCIE, SEC (June 12, 2008).

[39] Id.

6. Integrity and Accuracy of the Information Provided to S&P

There is no requirement under the federal securities laws that an NRSRO verify the information contained in RMBS loan portfolios presented to it for rating. Additionally, NRSROs are not required to insist that issuers perform "due diligence," and they are not required to obtain reports concerning the level of due diligence performed by issuers.

The Staff notes that pursuant to its policies, procedures, and public pronouncements, S&P did not engage in any due diligence or otherwise seek to verify the accuracy and quality of the loan data underlying the RMBS pools it rated during the review period. In fact, S&P's Code of Ethics clearly states it is under no obligation to perform, and does not perform, due diligence. Moreover, it states that the assignment of a rating is not a guarantee of the accuracy, completeness, or timeliness of the information relied on in connection with the rating. S&P solely performed loss and cash flow analyses on the data presented to it; S&P generally did not verify the integrity and accuracy of such information as, in S&P's view, due diligence duties belonged to the other parties in the process. S&P also did not seek representations from sponsors that due diligence was performed.

S&P's Response to Staff's Observations:

S&P noted that Staff correctly observed that it does not undertake any duty of due diligence with respect to data submitted to it in the ratings process, relying instead upon issuers to provide accurate and complete information. S&P has committed, however, to enhance its process of collecting more information about originators' and issuers' processes to assess the accuracy and integrity of their data. Furthermore, S&P has taken, or announced, measures designed to improve the integrity and accuracy of the loan data it receives on underlying RMBS pools:

- S&P announced that it was considering enhancements to its RMBS securitizations that would include the engagement by issuers of independent third parties to randomly sample, for due diligence, the greater of 10% or 200 loans for all subprime transactions.
- In addition, in an agreement with the New York State Attorney General, S&P agreed to develop and publicly disclose due diligence criteria to be performed by underwriters on all mortgages comprising RMBS, and to review those results prior to issuing ratings.[40]

[40] http://www.oag.state.ny.us/press/2008/june/june5a_08.html

7. Documentation of Significant Steps and Participants in the Rating Process

a. Documentation of Significant Steps in the Ratings Process

As of September 2007, NRSROs are required to retain internal records, including non-public information and workpapers, used to form the basis of credit ratings it issues (Exchange Act Rule 17g-2(b)(2)). Prior to its registration as an NRSRO, S&P recordkeeping policies required that RMBS analysts maintain the essential documents related to a deal in the deal file.[41] The Staff reviewed 52 RMBS deals to determine if S&P followed the policies and procedures in the U.S. Residential Subprime Mortgage Criteria, its file maintenance and recordkeeping policy and other related polices. The Staff found that LEVELS output was missing from 14 deal files,[42] and SPIRE output was missing from nine deal files.[43] In addition, the Staff noted that 11 of the SPIRE outputs contained a different number of tranches, as well as different ratings and coupons than the corresponding information in the CORE form and ratings letter in apparent violation of S&P's record retention policy.[44] S&P also did not consistently document the rationale behind the application of adjustments made to the model output.[45]

With respect to CDOs, S&P required the maintenance of records related to the rating of all synthetic and cash flow CDO transactions, as mandated by S&P's CDO Filing Procedures.[46] Such documents are to be maintained in a file referred to by S&P as the

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41 See S&P Analytic Documentation Policy, dated June 26, 2007. See also Memorandum to RMBS Group from Support Staff, Re: Blue Files, dated November 2004 ("Blue File Memo"). Among the records that must be contained in the blue file are the rating letter and corresponding write up, the prospectus supplement, the prospectus supplement checklist, and the final LEVELS reports and cash flow reports (SPIRE).

42 See IXIS Real Estate Cap 2006-HE5, SASCO 2007-MLN1, ACE 2006-SL1, SABR-2006-WM2, Argent 2006-W5, Long Beach 2006-3, MASTR ABS 2006-FRE2, ACE 2006-FM2, Carrington 2007-RFC1, J.P. Morgan Mortgage Acquisition 2006-RM1, SABR-2006-NC2, SABR 2006-FR2, Soundview 2007-WMC1, Option One Mortgage 2006-2.

43 See MS ABS 2006-NC4, SABR-2006-FR3, SASCO 2007-MLN1, ACE 2006-SL1, GSAMP 2006-S2, Carrington 2007-RFC1, Terwin Mortgage 2006-6, SASCO 2006-ARSI, CWABS 2006-SPS1.

44 See SABR 2006-NC1, Long Beach Mortgage Loan Trust 2006-9, Carrington 2006-NC5, Soundview Home Loan 2007-WMC1, Option One Mortgage 2006-2, Citigroup Mortgage Loan Trust, C-BASS 2007-SL1, SABR 2006-NC1, ARSI 2006-M3, ACE 2006-FM2, Soundview 2007-WMC1.

45 For example, in approximately a third of the deals that the Staff reviewed, the tranche sizes that passed the cash flow stress test in SPIRE were different from the size of the tranches that were ultimately rated, as reflected in the CORE form and signed ratings letter. S&P explained that as long as the ratios between consecutive tranches (*e.g.* between the AAA & AA+ tranches, and between the AA+ and AA tranches, etc.) were consistent between the two forms, the SPIRE stress test would be valid regardless of the absolute size of the tranches. This policy was neither documented as a policy nor in deal files as a rationale for why the sizes were different.

46 See S&P-SEC-003421. The Staff notes that S&P adopted and/or updated its policies and procedures in June 2007 to comply with the Commission's new rules and regulations implementing provisions of the Credit Rating Agency Reform Act of 2006. One of these policies

"Short File."[47] The "Short File" for every rated CDO deal must contain a CORE form which includes a summary of the deal and contact information for deal participants. The CORE form must contain the signatures of the analyst and manager on the first page of the form. This file must also contain the Rating Asset Methodology Presentation ("RAMP"), which is a presentation prepared by the analyst for the rating committee.

The Staff reviewed the documents within 50 CDO "Short Files." Overall, the file contents and disclosures were in accordance with S&P's stated policies and procedures. However, the Staff noted some inconsistencies with respect to the actual review of the CDO manager for particular deals, given that in S&P's view the "collateral manager plays a paramount role in the [CDO] transaction's performance."[48] In addition, many of the RAMPs contained issues that were brought to the rating committees' attention with no documentation as to whether the issues were addressed, or if there was any resolution of the issues to the satisfaction of the analyst or the rating committee.[49] Some of the RAMPs contained summaries of the deal tranches which did not match the CORE form or the final rating letter.[50] In addition, some RAMPs appear to contain issues that went unresolved because of timing constraints or that were deferred to be resolved in future transactions.[51]

Ultimately, the Staff found that S&P failed to retain or document certain significant steps in the rating process, which made it difficult for the Staff to assess compliance with its rating policies and procedures, and to identify the factors that were considered in developing a particular rating. This lack of documentation would similarly make it difficult for S&P's internal compliance staff or internal audit staff to assess compliance with the firm's policies and procedures.

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and procedures was the "Analytic Documentation Policy", which now requires the names of the rating committee attendees and identification of the voting members.

47 Signed Rating Agreement; Signed Rating Letter; Ramps, CORE Form; Working Group List; Offering Circular or Memorandum (if any); and Confirm/Credit Swap Document (for synthetic trades, without OMs).

48 See "An Introduction to CDOs and Standard & Poor's Global CDO Ratings," dated June 8, 2007. S&P publishes reports on CDO managers and the performance of the CDOs it rates (known as CDO Manager Focus, CDO Manager Magnifier, and the European CDO Manager Briefing). The Staff noted that the depth and timing of the review of a manager associated with a deal appeared to vary greatly among deals.

49 See GSC ABS CDO 2006-4u; Independence VII CDO; Point Pleasant Funding 2007-1; Toro ABS CDO II; Magnolia Finance Series 2006-5B; ACA Aquarius 2006-1.

50 See Carina CDO; C-Bass CBO XIX; Cetus ABS CDO 2006-1; Delphinius CDO 2007-1.

51 See Duke Funding X; C-Bass CBO XIX.

b. Documentation of Participants in the Ratings Process

An NRSRO is also required to make and retain records of the identity of any credit analyst that participated in determining the rating and any person that approved the rating before it was issued (Exchange Act Rule 17g-2). This requirement is intended to assist the Commission in monitoring whether the NRSRO is following its procedures and methodologies for determining credit ratings and whether the NRSRO is complying with procedures designed to prevent the misuse of material nonpublic information by identifying the persons with the best information as to how the credit rating was determined.[52]

Prior to its registration as an NRSRO, S&P required the rating analyst and committee chair to sign the CORE Form, which documents, among other things, the rating committee members.[53] In its review of 52 RMBS deal files, the Staff discovered that 13 of the CORE forms retained in the deal files lacked the chair's identity,[54] and six of the CORE forms lacked the signatures of at least one of the non-chair committee members.[55]

For CDO transactions, the Staff observed five files that lacked proper documentation on the Committee/Authorizations section of billing form,[56] two files lacking a complete and accurate record of committee attendees on the front of the billing form when compared to the Required Committee Attendee Information page on the same form,[57] and five files manifested problems regarding the accuracy of the dates of ratings committees and notifications.[58]

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52 See Securities Exchange Act Release No. 55857, 72 FR 33564 (June 18, 2007) (S7-04-07).

53 See Blue File Memo, see also Roles and Responsibilities Policy Statement on commercial activities, dated June 26, 2007. Following the adoption of Regulation NRSRO, S&P required the names of all rating committee attendees and identification of the voting members to be recorded as well.

54 See SASCO 2007 MLN1, GSAMP Trust 2006-S2, SAIL 2006-1, SAIL Trust 2006-1, SABR 2006-WM2, MASTR ABS Trust 2006-FRE2, ACE Securities Corp Home Equity 2006-FM2, Carrington Mortgage Loan Trust 2007-FRC1, SASCO 2006-ARS1, CWABS Asset Backed Certificates Trust 2006-SPS1, SG Mortgage Securities Trust 2006-FRE2, IXIS Real Estate Capital Trust 2006-HE3, IXIS Real Estate Capital Trust 2007-HE1, Citigroup Mortgage Loan Trust 2006-HE3.

55 See ACE Securities Corp, Home Equity Loan Trust, 2006-NC2, GSAMP Trust 2006-S2, ACE Securities Corp. Home Equity Loan Trust, 2006-FM2, Carrington Mortgage Loan Trust 2007-RFC1, SG Mortgage Securities Trust 2006-FRE2, IXIS Real Estate Capital Trust 2007-HE1.

56 Norma CDO (no analyst signature); NovaStar ABS CBO (manager signature undated);, Duke Funding X (no chairperson listed on front of CORE form); Bayberry Funding Ltd. (person notified and committee attendees blank on front of CORE form); Jupiter High Grade CDO VII (manager signature undated).

57 GSC ABS CDO 2006-1c, Bayberry Funding Ltd.

58 Bering CDO I (committee date blank), Norma CDO (person notified blank); Jupiter High Grade CDO VII (committee date listed as 7/31/07 and notification date listed as 7/27/07); Ridgeway Court Funding II (committee date 4/13/07, sale date 6/28/07 on CORE Form. The RAMP was dated 4/13/07 but the capital structure on RAMP differs from the final ratings on the CORE form);

The Staff recommends that S&P conduct a review of its current policies and practices for documenting the credit rating process and the identities of RMBS and CDO ratings analysts and committee members to review whether they are reasonably designed to ensure compliance with Exchange Act Rule 17g-2 and to address weaknesses in the policies or in adherence to existing policies that result in gaps in documentation of significant steps and participants in the credit rating process.

S&P's Response:

S&P responded that it had polices and procedures in place to retain key analytical documents before registering as an NRSRO, and has enhanced additional policies and procedures to allow for a more thorough documentation and retention policy after registration, including its new Analytic Documentation Policy, released in June of 2007.

S&P stated that it would take prompt steps to review its documentation policies and procedures. S&P noted that it was working to establish a robust compliance program to monitor adherence to the requirements, including the enhancement of its ratings document repository, and that it has recently sought to enhance employee training in this area.

8. Surveillance Practices

Under the Rating Agency Act, S&P is required to disclose publicly the procedures and methodologies it uses in determining credit ratings. In addition, Section 4(d) of the Rating Agency Act states that a registered NRSRO must maintain adequate financial and managerial resources to produce credit ratings with integrity.

Generally speaking, for any particular RMBS or CDO transaction, the surveillance process consists of monitoring collateral performance through exception reports, periodic reports and event driven reviews, analyst recommendations, and committee determinations and publications.[59] The exception reporting process seeks to identify those transactions for which performance appears to be sufficiently out of line with initial expectations as to merit further analysis. S&P also conducts periodic reviews of RMBS and CDO transactions on a recurring basis regardless of whether the performance of those transactions has triggered an exception review.[60] Additionally, when outside events

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Costa Bella CDO (Notification date on CORE form 9/28/06 but committee meeting was dated 10/24/06. There was a note in the RAMP that the committee was reconvened 11/14/06 because the structure changed, but was not reflected in the CORE form).

59 As a general matter, upgrades are considered when the projected credit support percentage for a tranche is at least a minimum multiple (generally about two times) of the original credit support percentage required for a class which received a higher rating. In contrast, downgrades are considered when the projected credit support percentage for a class is below the original credit support percentage required for its current rating category.

60 See letter from Mari B. Maloney, Chief Regulatory Officer, S&P, to Matt Daugherty, Senior Special Counsel, OCIE, SEC (Mar. 31, 2008).

precipitate the review of a class of deals, the surveillance group conducts an event-driven review. Once a transaction has been identified for further review, the analyst conducts an analysis of the transaction to evaluate the adequacy of available credit support and presents findings to the committee for a possible ratings change.

The Staff requested various types of documentation relating to S&P's RMBS and CDO surveillance process, including copies of monthly periodic reports, exception reports, exception parameters, and guidelines governing communications between surveillance and ratings staff for the period between January 2005 and December 2007.[61] S&P stated it could not provide this type of documentation, explaining that no record of such reports existed because they were created and analyzed electronically, and that no such guidelines governing communications between surveillance and rating staff existed.[62] The Staff also noted internal communications by the surveillance staff which seem to indicate that S&P staff was aware of this data retention issue as far back as June 15, 2007.[63] As such, the Staff could not assess the information being generated by S&P's Surveillance Group during the review period.

Furthermore, in its review of internal S&P documents, the Staff found numerous statements related to surveillance procedures, resources and findings. For example, an S&P internal email from a Managing Director in the Structured Finance Surveillance Group noted:

> "I think the history has been to only re-review a deal under new assumptions/criteria when the deal is flagged for some performance reason. . . . The two major reasons . . . (i) lack of sufficient personnel resources and (ii) not having the same models/information available for surveillance to relook [sic] at an existing deal with the new assumptions (i.e. no cash flow models for a number of assets)."[64]

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61 See Letter from A. Duer Meehan, Associate Director, OCIE, SEC, to Mari B. Maloney, Chief Compliance Officer, Ratings Services, Global Regulatory Affairs, S&P (Apr. 28, 2008).

62 See Letter from Mari B. Maloney, Chief Compliance Officer, Ratings Services, Global Regulatory Affairs, S&P, to Matthew Daugherty, Senior Special Counsel, OCIE, SEC (May 5, 2008).

63 "If I were the S.E.C. I would ask why can [sic] you go back and run the report for each of the months using the same assumptions? In theory we should be able to do this." Email chain ending in email from Ernestine Warner, Director, RMBS Surveillance Group, S&P, to Andrew Giudici, Director, RMBS Surveillance Group, S&P (June 15, 2007, 9:05 AM).

64 Email from Roy Chun, Managing Director, Structured Finance Surveillance Group, S&P, to Tom Gillis, Managing Director, Research and Criteria, S&P (July 11, 2005, 8:09 PM). A similar email from the Director of the RMBS Surveillance Group noted similar issues: "He asked me to begin discussing taking rating actions earlier on the poor performing deals. I have been thinking about this for much of the night. We do not have the resources to support what we are doing now." "I am seeing evidence that I really need to add to the staff to keep up with what is going on with sub prime and mortgage performance in general, NOW." Email chain ending with email from Ernestine Warner, Director, RMBS Surveillance Group, S&P, to Peter D'Erchia, Global Practice Leader, Structured Finance Surveillance Group, S&P (Feb. 3, 2007, 12:02 PM).

The Staff is concerned about whether the "lack of sufficient personnel resources" drives surveillance policy.

The Staff also noted an email from the Director of the RMBS Surveillance Group which notes that S&P was concerned with reducing the number of exceptions in its reports which may indicate that the surveillance criteria used during part of the review period was inadequate:

> "I agree the percentages [of monthly surveillance alerts for May 2007] are too high. I was thinking that we would record the monthly change in exceptions. I think we changed the exception report process last month. . . . I believe there are less exceptions on this report."[65]

The Staff recommends that S&P conduct a review to determine if adequate resources are devoted to surveillance of outstanding RMBS and CDO ratings. This review should include, for example, whether S&P maintains adequate staffing and has adequate expertise dedicated to performing ongoing surveillance. The Staff also recommends that S&P ensure all its appropriate surveillance records are retained.

S&P's Response:

S&P responded that it understood Staff's findings to be based in part on the unavailability of S&P's historic monthly surveillance reports due to the fact it was not S&P's practice to print or electronically save these reports. It also stated that, following the recent deterioration in the U.S. housing market and performance of subprime loans, S&P had come to rely less on exception reports as a monitoring tools, and instead used vintage reviews of all transactions issued during the time period within a collateral group. The exception reports, therefore, would have flagged deals that were already subject to vintage reviews. Therefore, the adjustments to the exception report tool that were done in conjunction with the broad vintage-based reviews did not have the effect of decreasing the overall number of deals S&P was examining. S&P also noted that the RMBS surveillance group is kept up-to-date about new criteria and assumptions being applied to the initial rating of RMBS deals, but that such changes do not always implicate earlier vintage transactions, and therefore application of the new criteria may be inappropriate.

S&P stated that, although it disagrees with the Staff's findings on this point, it will nonetheless take prompt steps to conduct a review of its surveillance process and consider whether it maintains adequate staffing and expertise for its ongoing surveillance needs. S&P stated that it has already undertaken a number of steps to improve the effectiveness and speed of the surveillance process, including increasing resources, and ensuring separation between new rating and rating surveillance functions.

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65 Email chain ending in email from Ernestine Warner, Director, RMBS Surveillance Group, S&P, to Andrew Giudici, Director, RMBS Surveillance Group, S&P (June 15, 2007, 9:05 AM).

9. Management of Conflicts of Interest

a. "Issuer Pay Model"/Fee Discussions

S&P uses the "issuer pays" model, in which the sponsor or other entity that issues the security is also seeking the rating. Under Exchange Act Rule 17g-5(b)(1), it is a conflict of interest for an NRSRO being paid by issuers or underwriters to determine credit ratings with respect to securities they issue or underwrite. Section 15E(h) of the Exchange Act requires an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed to address and manage conflicts of interest. Such policies and procedures are intended to maintain the integrity of the NRSRO's judgment. Avoiding a conflict of interest prevents an NRSRO from being influenced to issue a more favorable credit rating in order to obtain or retain business of the issuer or underwriter.[66]

To manage this conflict of interest, S&P has established policies to restrict analysts and their immediate managers from participating in fee discussion with issuers.[67] S&P has established a policy that is designed, among other things, to prevent the flow of information about issuers, including sources of fee revenue among its numerous affiliates. S&P requires that ratings analysts must reach their analytic opinions independently from equity analysts and independent from any commercial relationship between S&P and any third party.[68] S&P also prohibits those that negotiate fees for an issuer to vote on a credit rating committee for that issuer and prohibits those that vote on a credit ratings committee for an issuer from being involved in negotiating fees for that issuer. S&P's policy also addresses several areas of potential conflict arising from the sales process, providing that S&P Ratings' employees may not jointly sell or call on ratings customers with other S&P employees or otherwise engage in cross-selling activity. However, S&P explicitly permits an analyst's manager to participate in internal discussions regarding which considerations are appropriate for determining a fee for a particular rated entity.[69]

Despite S&P's policies addressing the issue of fees, the Staff found multiple communications that indicate that analysts are at the very least aware of the firm's fee schedules, and actual (negotiated) fees.[70] There does not appear to be any internal effort

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66 See Securities Exchange Act Release No. 55857, 72 FR 33564 (June 18, 2007) (S7-04-07). And Exchange Act Rule 17g-5.

67 See S&P's Roles and Responsibility Statement.

68 S&P Analytical Firewalls Policy (November 2005).

69 See Guideline No. 5 to S&P's Roles and Responsibility Policy Statement. (June 2007).

70 In one instance a Managing Director and Client Value Manager in the RMBS group, distributed a negotiated fee schedule, a large percentage of the recipients were analysts. Email from Thomas Warrack, Managing Director and Client Value Manager, RMBS Group, S&P, to May Abraham, Associate Director, RMBS Group, S&P (Dec. 29, 2005, 5:29 PM). In another instance, an analyst is copied on an email communication to an issuer containing a letter confirming the fees for a transaction. Email from Mabel Rodriguez, Research Analyst, S&P Segment Operations Client Services, to Robert Perret, Wachovia, copying James Grundy, Associate Analyst, RMBS Group,

to shield analysts from emails and other communications that discuss fees and revenue from individual issuers.[71] In some instances, analysts discuss fees for a rating. For instance, a production manager in the RMBS group writes to several analysts: ". . . if you have not done so please send me any updates to fees on your transactions for this month. It is your responsibility to look at the deal list and see what your deals are currently listed at."[72] The Staff is concerned that analysts could be influenced when determining their ratings by the amount of fees paid by an issuer to S&P.

b. Revenue and Market Share

While the Staff did not identify any instances in which it appears a fee influenced the rating decision for a particular deal, the Staff identified a number of emails suggesting that S&P's development of ratings criteria did not always arise from the objective process described above. In fact, several emails indicate that across various areas in structured finance, the criteria development or amendment process was initiated by a concern about S&P's market share relative to other rating agencies, or a reaction to losing deals to other rating agencies. In most of these instances, it appears that S&P staff responsible for obtaining ratings business would notify other S&P employees, including those responsible for criteria development, about business concerns he or she had related to the criteria:

> "I am trying to ascertain whether we can determine at this point if we will suffer any loss of business because of our decision and if so, how much?" "Essentially, Joanne, Rosario and I ended up agreeing with your recommendations but the CDO team didn't agree with you because they believed it would negatively impact business."[73]

For instance, in one email chain related to Commercial Mortgage Backed Securities, after noting a change in a competitor's methodology an S&P employee states: "[w]e are

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S&P (Mar. 27, 2007, 4:02 PM). See also Email from Monica Perelmuter, Director, Subprime NIMs, RMBS Group, S&P, to Julia Clements, Associate Director, RMBS Group, S&P (Dec. 19, 2005, 1:08 PM).

71 An email communication from a Managing Director and Client Value Manager to at least one analyst, requests that the recipient(s) "Please confirm status codes as soon as possible on the below mentioned deals. Additionally, any fees that are blank should be filled in. All issuer/bankers should be called for confirmation." In the same email chain, this request is reinforced by a Managing Director who states "It is imperative that deals are labeled as to Flow or Pending, etc as accurately and timely as possible. These codes along with the fee and closing date, drive our weekly revenue projections . . ." Email chain ending with email from Thomas Warrack, Managing Director and Client Value Manager, RMBS Group, S&P, to Leslie Abergo, Director and Client Value Manager, RMBS Group, S&P (Aug. 24, 2005, 3:53 PM).

72 Email from John Polizzotto, Production Manager, RMBS Group, S&P, to Laura Ahn, Associate Director, RMBS Group, S&P (Jan. 31, 2007, 9:33 AM).

73 Email chain ending with email from Tom Gillis, Managing Director, Research and Criteria, S&P, to Gale Scott, Managing Director, Global Real Estate Finance, S&P (Nov. 9, 2004, 12:11PM).

meeting with your group this week to discuss adjusting criteria for rating CDOs of real estate assets this week because of the ongoing threat of losing deals."[74] In another email, following a discussion of a competitor's market share related to Net Interest Margin ("NIM") ratings, an S&P employee states "Relying on prepayment penalties and/or cap proceeds is more difficult to estimate and project, but those would be the assumptions that would have to be revisited to recapture market share from Fitch."[75] In another example, following a discussion of losing a bank rating, an S&P employee states "I had a discussion with the team leaders here and we think that the only way to compete is to have a paradigm shift in thinking, especially with the interest rate risk."[76]

The Staff recommends that S&P continue to review its practices, policies and procedures with respect to mitigating and managing the "issuer pays" conflict of interest. In particular, the Staff recommended that S&P consider steps that would insulate or prevent the possibility that considerations of market share and other business interests could influence ratings or ratings criteria.

S&P's Response:

S&P responded that its Analytic Firewalls policy strictly prohibits rating analysts discussing or negotiating fees with an issuer, but that analysts are not prohibited from knowing the amount of rating fees for a particular issuer or discussing such fees internally.[77] S&P also notes that while certain staff with a business interest may question the basis for a particular criterion out of competitive concern, the potential loss of business was not part of the consideration by analytical staff of whether to actually change models or methodologies. Moreover, S&P stated that its fees for certain asset types are determined by a mathematical formula, and that rating analysts have no discretion as to the amount or application of the fee.

S&P stated that it would take prompt steps to consider steps that would further insulate analysts from fee information. S&P noted that it has already undertaken steps to identify and mitigate potential conflicts, including the establishment of the Office of the Ombudsman, who will have oversight power and authority to escalate conflict of interest concerns to the McGraw-Hill's CEO, board of director or audit committee. S&P also noted that it has initiated an analyst rotation program and framework for "look back"

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74 Email from Gale Scott, Managing Director, Global Real Estate Finance, S&P, to Richard Gugliada, Global Practice Leader, Global CDO Group, S&P (Aug. 17, 2004, 6:14 PM).

75 Email from Monica Perelmuter, Director, RMBS Group, S&P, to Chris Deasy, Director, Asset-Backed Commercial Paper Group, S&P (Sept. 25, 2006, 6:50 PM).

76 Email from Yu-Tsung Chang, Executive Managing Director, Head of Ratings Services in Asia/Pacific, S&P, to Joanne Rose, Executive Managing Director, Structured Finance, S&P (May 25, 2004, 12:08PM).

77 The Staff notes that while analysts are not prohibited from discussing fees internally, they are indeed prohibited from discussing internally what factors would be appropriate to consider when determining an appropriate fee to assess for a particular rating.

reviews to ensure the integrity of prior ratings when an analyst leaves S&P to work for a firm with whom the analyst had significant contact before he or she departed.

c. Analyst Compensation

S&P has a policy that generally provides that an analyst may not be compensated or evaluated based upon the amount of revenue that S&P derives from issuers or issues that the analyst rates or with which the analyst regularly interacts.[78] While S&P does not compensate its analysts based on the deals it rates or the ratings provided, like all employees, the amount of an analyst's bonus is tied to the overall success of S&P.

S&P established annual Global Compensation Guidelines between 2005 and 2008. In those guidelines, S&P describes three basic forms of compensation: base salary, short-term cash incentives, and long-term cash incentives. The base salary guidelines describe concepts such as merit increases and promotion, both of which are exclusively tied to an employee's performance. The merit increases come out of a manager's merit increase pool, the source of which is not described in S&P's policies. An employee's base salary also may be adjusted to address an inequity or to maintain a competitive position compared to the external marketplace, cost-of-living, and the organization's financial results.

S&P also awards short-term cash incentives. Managers within a business unit have the responsibility to differentiate the rewards based upon performance. Therefore, a high performer in a profitable division is likely to earn more incentives than a high performer in an unprofitable business. S&P also awards long-term cash incentives, in the form of employee stock options. There is little guidance about appropriate awarding of these options, except that they are generally reserved for senior level employees and S&P provides a certain maximum amount of options that should be awarded in a given year.

d. Securities Transactions by Employees

Exchange Act Rule 17g-5 prescribes that NRSROs must maintain and enforce policies and procedures to manage the conflict of employees owning securities of rated issuers or obligors and prohibits analysts or other persons involved in the approval of credit ratings from owning securities of the entity subject to the analyst's credit rating.[79] S&P has adopted a policy to prohibit its analytical employees and their immediate family members from buying or selling any security of an issuer within the employee's primary area of analytical responsibility or that is rated by the employee's team. S&P imposes an additional restriction on structured finance analysts from buying or selling any security of an issuer related to entities rated by the structured finance group that have been identified as providing market sensitive information.[80] S&P also has adopted a policy that prohibits

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[78] See Section 2.11 of the S&P Ratings Services Code of Conduct (June 2007).

[79] See Exchange Act Rule 17g-5(b)(6) and Rule 17g-5(c)(2).

[80] See Section IV(F)(2) of Appendix 1 to the S&P Code of Ethics (February 2007).

an analytical employee from profiting from the sale of a security within 35 days of its purchase.[81]

S&P's Personal Security Trading System ("PSTS"), checks all S&P Ratings employees' requested transactions against a list of prohibited securities before forwarding the requested transaction on to a compliance examiner and business reviewer for final approval before an employee's transaction is "cleared" by S&P to be executed. S&P also uses its "Accu-rate" system to determine whether an analyst preparing to participate in a rating process is prohibited from doing so by reason of his or her ownership of a particular security. Moreover, S&P maintains relationships with a group of select broker-dealers that automatically report the securities transactions of employees to S&P.[82] If an employee holds an account with a broker-dealer that does not automatically report transactions to S&P, an employee is under the duty to self-report his or her transactions to S&P within ten days of the transaction.[83]

During the course of its examination, the Staff reviewed the emails and trading history of an S&P employee whose trading activity appears to present possible violations restricted security and short term trading restrictions. In this case, an analyst engaged in short-term trading on a number of occasions in his reported brokerage account. When the analyst learned of the new short-term trading policy, he stated his intention in an email to "quietly" move his money from his reported brokerage account, to a brokerage that did not participate in S&P's automatic reporting program, in order to engage in short term trading.[84]

Separately another S&P Analyst purchased shares of common stock of two investment banks who regularly participate in RMBS transactions.[85] The investment banks are not technically "issuers" of the RMBS transactions, nor are they included in the group of securities identified by the RMBS global practice leader as presenting a conflict. However, the Staff is nonetheless concerned that the trades may have violated the intent behind the policy restricting analysts' activity in "issuers" that their group rates because of the close association between the investment banks and a number of S&P-rated special purpose vehicles created for the purpose of issuing structure finance products.

The Staff recommends that S&P conduct a review of its policies and procedures for managing the securities ownership conflict of interest to determine whether such policies

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81 See Section IV(G) of Appendix 1 to the S&P Code of Ethics (February 2007). This short-term trading restriction went into effect on March 1, 2007.

82 See Section IV(C)(1) of Appendix 1 to the S&P Code of Ethics (February 2007).

83 See Section IV(C)(2) of Appendix 1 to the S&P Code of Ethics (February 2007).

84 Email from James Grundy, Associate Analyst, RMBS Group, S&P, to Alain Pelanne, Associate Director, Corporate & Government, Consumer Retail Healthcare, S&P (Mar. 5, 2007, 10:38 AM).

85 See Peter G. Graham trade confirmations from E*Trade showing that Graham bought C on July 26, 2007 and bought JPM on Jan. 24, 2008.

and procedures are reasonably designed to ensure that its employees' personal trading is appropriate and does not violate Exchange Act Rule 17g-5.

S&P's Response:

With respect to the issue of an employee's opening an undisclosed brokerage account for the purpose of engaging in short-term trading, S&P noted that the employee, James Grundy, did not disclose to S&P an account in a brokerage that Grundy identified in the relevant email to S&P. Subsequent examination of Staff confirmed that Grundy, in fact, opened an account at the non-participating brokerage. S&P acknowledged that, to the extent that such an account was opened, failure to report such account to S&P would have violated S&P's policies. In response to the issue raised by Staff regarding another employee's trading of a restricted issuer, S&P noted that the two common stocks noted, C and JPM, were not on the restricted list applicable to the employee, and therefore not in violation of S&P's policy.

S&P stated that it would take prompt steps to address any issues uncovered with respect the S&P's trading policy to the extent possible.

10. Internal Audit Program

The McGraw-Hill Companies, Inc. currently performs corporate-wide internal audits, including audits of the credit rating process.[86] S&P did not produce any examples of such audits, despite the Staff's request to see all audits of RMBS or CDO ratings services conducted between January 1, 2003 and November 30, 2007.[87]

Between 2003 and 2005, a member of its Global Regulatory Affairs Department performed file review of the structured finance group's ratings. S&P provided the Staff with copies of the review of the structured finance group's ratings and surveillance files conducted during that time period. The audit records demonstrate that the reviews were limited to evaluating the completeness of the ratings and surveillance files. S&P produced no audits performed in 2006 and 2007.

S&P's review of ratings and surveillance files was limited to a single page of factors, which did not vary between ratings and surveillance.[88] The factors were accompanied by a space to check "yes" or "no," with hand-written notes on the face of the checklist providing the only documentation of rationale behind a finding. S&P audit records

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86 S&P is a division of the McGraw-Hill Companies, Inc.

87 S&P represented to the Staff that it is in the process of developing and augmenting the S&P Compliance Department, as well as its internal audit program.

88 The factors reviewed included documents related to the key processes within the ratings and surveillance process, including analytical documents (*i.e.* LEVELS, CORE and SPIRE, etc.), the ratings/surveillance committee and appeal process, issuer notification of action, and rating dissemination.

revealed only four examples of the file reviewer's notifying management of the findings of the reviews and provided no examples of management's response to the reviews.[89]

The Staff recommends that S&P review whether its internal audit functions, particularly in the RMBS and CDO ratings areas, are adequate, and whether they provide for proper management's follow-up.

S&P's Response:

S&P noted that it had no formal internal audit program prior to its registration as an NRSRO, but that S&P did conduct periodic file reviews where it employed the checklist approach described by Staff. S&P noted that it has recently taken steps to provide greater and more in-depth oversight and monitoring, leading to a program that produces both formal audit findings and recommendations.

S&P also stated that it would take further steps to review the adequacy of its internal audit program. S&P stated that it is working to expand and formalize its compliance and monitoring program and working on procedures for monitoring adherence to its requirements. Among these procedures are: an email monitoring program, creation and implementation of a compliance monitoring database, in-person, onsite, internal reviews of policy compliance, and coordination with the internal audit department of McGraw-Hill. S&P also noted that it recently hired experienced staff to address these issues. S&P has also committed to re-evaluate and formalize S&P's oversight function, in a number of ways including, the engagement of an external firm to review S&P's compliance processes, the establishment of a board to handle all new Ratings' policies and procedures, and separating the quality and criteria governance responsibilities into two separate functions.

11. Conclusion

The Staff intends to send a deficiency letter to S&P outlining its findings and recommendations. The Staff will request that S&P provide a written response within 30 days outlining any remedial action planned or already taken to address the findings and recommendations in the letter. S&P will be asked to include in its response a timetable for implementing the proposed remedial action. The letter will also request that S&P send OCIE a written confirmation in 12 months detailing the status of implementation of each remedial action.

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89 Memorandum from Tonya Tullch, Compliance Officer, S&P to Tom Gillis, Managing Director, Research and Criteria, S&P (October 28, 2004), Memorandum from Tonya Tullch, Compliance Officer, S&P to Tom Gillis, Managing Director, Research and Criteria, S&P (January 22, 2003), Memorandum from Tonya Tullch, Compliance Officer, S&P to Tom Gillis, Managing Director, Research and Criteria, S&P (March 13, 2003), Memorandum from Tonya Tullch, Compliance Officer, S&P to Tom Gillis, Managing Director, Research and Criteria, S&P (May 9, 2003).

From: Mazataud, Paul
Sent: Tuesday, June 20, 2006 9:18 PM (GMT)
To: Kimon, Noel <Noel.Kimon@moodys.com>
Cc: Le Henaff, Anne <Anne.LeHenaff@moodys.com>; Levington, Gareth <Gareth.Levington@moodys.com>
Subject: My discussion with Pascale Viala (CIFG)

I had lunch with Pascale today.

Most of our discussion was about Cash CLOs. She said she has recently heard a lot of negative feedback on Moody's from several managers and bankers. She mentioned four points

1. **Shadow ratings**. Managers are not happy with Moody's shadow ratings. She said that this was their most important point. Unfortunately it is really hard to interpret this comment as she had never heard of the switch from MKMV to the new dedicated team. Consequently, I do not know if the criticisms were against the MKMV process or against the new process. Some of their comments seemed related to MKMV ("managers like to talk to persons who understand corporate credits").

2. **Resources**: Moody's does not have enough resources to rate CLOs. Moody's is too slow. Moody's does not understand that the time it takes to launch a CLOs is getting shorter and shorter. Moody's cannot cope with this more recent pace. (Note that this comment is consistent with what Uddjaval Desai from JP Morgan told us).

3. **Documentation review:** Moody's "requires" many more "structural features" than its competitors (Note that this comment is consistent with what John Convery from DB told us). I told her that all these "requirements" are described in public reports and are well accepted in the US market. She agrees with it but she says that it does not mean that European managers accept them.

4. **Managers are tired of large "grids".** They would rather prefer a model based test like what S&P and Fitch do. Pascale disagrees with these managers. As a wrapper, she hates that the credit quality of what she wraps is linked to a black box. Also, she hates the fact that the black box can change from time to time.

Because of these four points, she says that several managers are considering doing deals without Moody's. Mizuho (Harvest IV) is one of them. She encourages us to make sure that we pay a visit to large European CLO managers (note that we recently paid a visit to Mizuho).

A few other things she said:

a. The market does not like Moody's for CDO of ABS either because of our lower ratings on CMBS assets

b. She thinks that the European CRE CDO market will be big and worth investing in. However, she does not expect any deal to be launched before 2007.

c. She does not believe in the development of the project finance CDO market because of the low supply.

d. She considers that the synthetic market is quasi dead.

e. She recently recruited a senior person from S&P London (this lady will start at CIFG in early July).

f. She recommends that we hire senior persons of S&P and Fitch to address our resource problem. She sent me an email with three names she specifically recommends (two from S&P and one from Fitch).

I'll give you a call to propose an action plan.

Thanks,

Paul

From: Vonderhorst, Brian
Sent: Friday, January 19, 2007 9:38 AM
To: Warrack, Thomas; Barnes, Susan
Subject: FW: Panel questions

here are the proposed questions for the rating agency panel...2 moderators remember...

-----Original Message-----
From: Yalamanchili, Kishore [mailto:Kishore.Yalamanchili@blackrock.com]
Sent: Tuesday, January 16, 2007 6:24 PM
To: Glenn.Costello@fitchratings.com; Ross, Justin; mnelson@dbrs.com; scott_mason@sandp.com; Kornfeld, Warren; Vonderhorst, Brian
Cc: jross@americansecuritization.com
Subject: Panel questions

Here are the questions for our panel. I am sending them again as some of you might have not received all of them. We will have a followup call on Thursday morning.

Thanks

Josh's questions

1) What new model enhancements are being worked on?
2) What is work is being done to improve the transparency of the rating process for HELOCs and Fixed Rate 2nds
3) What adjustments outside of the models are being made to Loss Coverage Levels, (ie Adjustments for Reserves, Mtg History, Time Since Foreclosure and BK)
4) What is the Outlook/Consequence to deals where the Originator/Seller has gone Bankrupt. What Originator adjustments are being made to levels.
5) What is the approach to rating transactions with LPMI as a form of credit enhancement. What claims denial assumptions are made?

Kishore's questions

We have seen rapid weakness in collateral performance in 2006 in the home equity sector. In the past we witnessed similar detoriation in some auto pools soon after issuance. There were also cases of originator/servicer problems that finally culminated in them filing for bankruptcy. What are the steps you are taking to detect adverse changes in collateral , issuer or servicer either before deals are issued or on an ongoing basis after issuance?

As an investor, I believe that deal triggers are highly favorable to issuers/residual holders. We have seen cases where collateral pool may be performing poorly, yet the subordinate classes and residual holders received cash flows due to ineffective triggers. Some of you have put forward interesting proposals to address this. Going forward, how are you addressing this critical issue?

Frequently when talking to rating analysts regarding new issues, the analyst mentions the agency model's output without any explanation for some of the things we noticed in the deal. These items might actually merit a discussion as to how the agency accounted for them in the ratings process. What steps are you taking to better communicate and comfort investors about your rating process? In other wards, how do we break the "black box" that determines enhancement levels?

Declining home prices, EPDs, originator/issuers filing for bankruptcy or up for sale are some of the important trends in ABS sectors. How are you addressing these in your rating process in 2007? Are there other trends that investors should be aware of? Are there any significant changes in credit enhancement levels due to these trends?

We occasionally see deals put on credit watch and taken off watch list. Is there a method to these seemingly arbitrary actions? What are your policies regarding ratings changes, in particular, how often do you revise them? what are the triggers for revisions?

DATE: 07/16/2007
TIME: 18:02:02
AUTHOR: Snailer, Joseph
RECEIPIENT: Liu, Qingyu (Maggie); Wang, Jinyang; Arora, Rakesh
CC: Agarwal, Navneet
SUBJECT: RE: Notching Status

Thanks for asking - wouldn't want you all to do a bunch of work and have to re-do it.

-----Original Message-----
From: Liu, Qingyu (Maggie)
Sent: Monday, July 16, 2007 6:02 PM
To: Snailer, Joseph; Wang, Jinyang; Arora, Rakesh
Cc: Agarwal, Navneet
Subject: RE: Notching Status

I see. Thanks for the clarification.

-----Original Message-----
From: Snailer, Joseph
Sent: Monday, July 16, 2007 6:00 PM
To: Liu, Qingyu (Maggie); Wang, Jinyang; Arora, Rakesh
Cc: Agarwal, Navneet
Subject: RE: Notching Status

The ratings you are generating should reflect what we would have rated the deals when they were issued knowing what we knew then and using the methology in effect then (ie, using the OC model we built then). Let me know if you have any questions.

-----Original Message-----
From: Liu, Qingyu (Maggie)
Sent: Monday, July 16, 2007 5:18 PM
To: Wang, Jinyang; Snailer, Joseph; Arora, Rakesh
Cc: Agarwal, Navneet
Subject: RE: Notching Status

All,

I have a question when I am running the OC model especially models from the first half of 2006. Some deals in the first half of 2006 we already downgraded within last week or last month. If we were to rate the bonds using the OC model we built then, the bond probably would be a Ba level. However, given today's market condition, the bond we rated Ba then we already downgraded to B or Caa last week. Shall we still provide rating for those bond we did not rate then using the old methodology and the old loss coverage number?

Thanks,
Maggie

-----Original Message-----
From: Wang, Jinyang
Sent: Monday, July 16, 2007 10:18 AM
To: Snailer, Joseph; Arora, Rakesh
Cc: Liu, Qingyu (Maggie)
Subject: RE: Notching Status

Joe:

Maggie and her team have completed 21 deals from second half of 2006.

There are 47 deals from the first half of 2006 which they will complete by next Wednesday. 5 deals from Jan 2006 was completed during the previous study.

-Zoë

-----Original Message-----
From: Snailer, Joseph
Sent: Monday, July 16, 2007 9:30 AM
To: Wang, Jinyang; Arora, Rakesh
Subject: Notching Status

Could you let me know where we stand on the OC model runs? The weekly task force meeting is tomorrow and I would like to update them.

Thanks.

From: Kimon, Noel
Sent: Friday, June 1, 2007 1:50 PM (GMT)
To: Mirenda, Anthony (Tony) <Anthony.Mirenda@moodys.com>; Piels, Daniel <Daniel.Piels@moodys.com>; Duca, James <James.Duca@moodys.com>
Cc: Mazataud, Paul <Paul.Mazataud@moodys.com>; Adler, Michael <Michael.Adler@moodys.com>
Subject: RE: Financial Times inquiry on transparency of assumptions

Tighter spreads on recent deals also belie Paul's assertion. See below.

CMBS Market Tone Improves; Bond Spreads Tighten
Thursday, May 31, 2007
Commercial Real Estate Direct Staff Report
The CMBS market, after suffering nearly three straight months of spread widening, is starting to perk up substantially.
Last Thursday, a $3.2 billion transaction, Banc of America Commercial Mortgage Trust, 2007-2, saw its 30 percent subordination AAA bonds price at 30 basis points over swaps. That was a 1 bp tightening from the deal immediately preceding it, Morgan Stanley Capital I Trust Inc., 2007-IQ14.

The market's tone has continued to improve since then. Spreads on the secondary market tightened even more, with long AAA spreads at 25.5-33 bp, down from 27.5-35 bp a week earlier. And lower in credit, the tightening has been even more pronounced, with BBB bonds quoted at spreads of 175-195 bp over swaps, compared with 185-195 bp a week earlier.

Meanwhile, two new conduits were on the cusp of being priced, the $2.9 billion ML-CFC Commercial Mortgage Trust, 2007-7, and the $3.3 billion JPMorgan Chase Commercial Mortgage Trust, 2007-CIBC19. And both were seeing tight levels. Their super-senior AAA bonds were being shopped at 29-30 bp over swaps, while their BBB bonds were offered at 160-165 bp over swaps. That compares with a spread of 195 bp over swaps for the BBB bonds from Wachovia Commercial Mortgage Trust, 2007-C31, which priced on May 11.

The tightening was attributed to three key factors: investors might have decided they had overreacted in pushing spreads as wide as they did over the past few weeks; lenders have finally started to tighten their lending standards, and Moody's Investors Service last week reassured the market that it would not downgrade deals that were recently priced unless they had credit issues.

-----Original Message-----
From: Mirenda, Anthony (Tony)
Sent: Friday, June 01, 2007 9:44 AM
To: Piels, Daniel; Duca, James; Kimon, Noel
Cc: Mazataud, Paul; Adler, Michael
Subject: RE: Financial Times inquiry on transparency of assumptions

Noel, Jim,

While I have not been closely involved in this story, it seems clear from Dan's note that Paul Davies does not fully understand or is not convinced of our position. I understand that we have a solid story to tell here, if so it could be a good opportunity and time well spent to walk him through our messages and reinforce our arguments.

tony

-----Original Message-----
From: Piels, Daniel
Sent: Friday, June 01, 2007 7:33 AM
To: Duca, James; Kimon, Noel
Cc: Mazataud, Paul; Adler, Michael; Mirenda, Anthony (Tony)

Subject: FW: Financial Times inquiry on transparency of assumptions
Importance: High

Good Morning Jim and Noel,

Jim, by way of introduction, my name's Dan Piels and I handle SFG media relations in Europe. Paul Mazataud spent 20 minutes this morning speaking with Paul Davies, Financial Times Structured Finance reporter, providing guidance closely in line with what Noel and Brian outlined below.

Paul Davies has a copy of the CMBS Conduit Subordination Adjustment report and would like to discuss it further with you, Jim. While Davies acknowledged our arguments, he expressed scepticism that given the magnitude of the changes, they would not lead to more important adjustments of expected loss that would in turn lead to potential downgrades. Please advise as to your interest and availability to speak with him - his deadline is today and he's hoping to write an article this afternoon (London time). He's free after 9:30 AM New York time. Davies' tone this morning was friendly but critical. I look forward to hearing from you and would be happy to arrange a conference call.

Regards,

Dan

Daniel Piels
Rating Communications
Moody's Investors Service
daniel.piels@moodys.com
O: +44 20 7772 8727
M: +44 7920 801 833

-----Original Message-----
From: Clarkson, Brian
Sent: 25 May 2007 16:21
To: Kimon, Noel; Scholz, Detlef; Drevon, Frederic; Weill, Nicolas; Duca, James
Cc: Piels, Daniel; Mazataud, Paul
Subject: Re: Financial Times inquiry on transparency of assumptions

The only thing I would add is the frequency of monitoring and that when any deal nears the lower end of our expected loss assumption we would

Alert the market by putting the transactions on review for possible downgrade.

-----Original Message-----
From: Kimon, Noel
To: Scholz, Detlef; Drevon, Frederic; Clarkson, Brian; Weill, Nicolas; Duca, James
CC: Piels, Daniel; Mazataud, Paul
Sent: Fri May 25 11:12:26 2007
Subject: RE: Financial Times inquiry on transparency of assumptions

I guess that the stock answer would be that we do assess the impact of model adjustments and credit enhancement adjustments on the inventory of outstanding deals. Every rating we assign has a range of expected losses. Typically new issuances are close to the middle of that range. We do not downgrade until expected losses fall outside that range.

In assigning new ratings we are always reevaluating the assumptions that we make when assigning ratings. When there is a market shift, we want to evaluate that shift and incorporate that evaluation into our ratings as soon as possible. Gradual shifts typically would not result in adjustments to recently assigned ratings.

-----Original Message-----
From: Scholz, Detlef
Sent: Friday, May 25, 2007 10:53 AM
To: Kimon, Noel; Drevon, Frederic; Clarkson, Brian; Weill, Nicolas; Duca, James
Cc: Piels, Daniel; Mazataud, Paul
Subject: FW: Financial Times inquiry on transparency of assumptions

Heads-up/note on further question that the FT (Paul Davis) are pursuing: Why don't we reassess all outstanding bonds when we announce to change our model assumptions for future transaction? He is focussing on US CMBS's recent changes, but this question applies across the board. May I suggest to work on a joint response as this question will come up on Thursday?

-----Original Message-----
From: Piels, Daniel
Sent: 25 May 2007 16:28
To: Kolter, Daniel; Palimeri, Ifigenia; Philipp, Tad
Cc: Scholz, Detlef; Adler, Michael
Subject: Financial Times inquiry on transparency of assumptions

Please see below an email from Paul Davies, the FT structured finance reporter. Are we in a position to provide clarity on the transparency of assumptions? Is he referring to the report we put out in the US about phasing in an increase to CMBS conduit subordination? Please advise.

-----Original Message-----
From: Paul.J.Davies@FT.com [mailto:Paul.J.Davies@FT.com]
Sent: 25 May 2007 15:15
To: Piels, Daniel
Subject: Re: Breakfast meeting next week w/Brian Clarkson of Moody's

Of course, please invite him. I've never actually met him myself so would be good. I also want to talk either then or at another time, but soon, about transparency of not just methodology but also assumptions. The hook is the recent changes to CMBS in the US which mean that future ratings are not directly comparable to older ratings, while other ratings do not get re-assessed under new assumptions... This is a broad characteristic of the evolution of structured finance ratings I think and there are many other examples, so the questions are really about how and why in such situations the new standards are not applied retrospectively...

I am thinking of writing a piece about this and will be talking to other agencies also. Oh and by the way, I'll be stuck doing DIY all weekend!

Best regards

Paul J Davies
Capital Markets Reporter

Financial Times

0207 873 4838
Paul.J.Davies@ft.com

"Piels, Daniel" <
<Daniel.Piels@moo To: <Paul.J.Davies@FT.com><
dys.com> cc:

Subject: Breakfast meeting next week w/Brian Clarkson of Moody's

25/05/2007 12:41

Hi Paul,

Got any plans for the long weekend? Sadly, I'm not going anywhere.

Just to let you know, Paul Mazataud and Neal Shah, co-head of EMEA RMBS team will also be joining us on Thursday at 1 Lombard Street, as you indicated you wanted to talk about UK subprime.

I was also wondering if you would object to me inviting to the breakfast John Plender, the FT Insight columnist. He wrote a column this week about a stretched credit cycle that caught our attention. Is this amenable? If not, we're happy to arrange something separate with John. Please advise.

Regards,

Dan

Daniel Piels
Rating Communications
Moody's Investors Service
daniel.piels@moodys.com
O: +44 20 7772 8727
M: +44 7920 801 833

From: Momin, Inayat
Sent: Tuesday, July 12, 2005 2:03 PM
To: Jordan, Pat
Cc: Vega, Juan; Gillis, Tom; Gilkes, Kai; Cantor, David; Tesher, David; Carrier, Henry; Anderberg, Stephen
Subject: RE: Delay in Evaluator 3.0 incorporation in EOD/CDOi platform

Pat,

Thanks of the updates.
It would take 2 to 3 weeks for one fulltime resource to replace E2.4.3 with E3.0

Inayat

-----Original Message-----
From: Jordan, Pat
Sent: Tuesday, July 12, 2005 12:16 PM
To: Momin, Inayat
Cc: Vega, Juan; Gillis, Tom; Gilkes, Kai; Cantor, David; Tesher, David; Carrier, Henry; Anderberg, Stephen
Subject: RE: Delay in Evaluator 3.0 incorporation in EOD/CDOi platform

Inayat,

Thank you for the comparison reports. At this point we are not ready to proceed with E3, nor do we know when we will be. So please continue under the

the assumption that E2.4.3 will be the version available on the CDOi platform. Our goal is to determine what changes we want to make to the Beta E3, test the impact and decide if/when to proceed with a roll-out, but I'll be surprised if that all happens any sooner than September, and could take longer.

How long and how many resources will it take to replace E2.4.3 once we have decided on E3?

Pat

-----Original Message-----
From: Carrier, Henry
Sent: Tuesday, July 12, 2005 10:11 AM
To: Momin, Inayat
Cc: Vega, Juan; Gillis, Tom; Gilkes, Kai; Jordan, Pat; Cantor, David
Subject: RE: Delay in Evaluator 3.0 incorporation in EOD/CDOi platform

Inayat,

The decision to go to Evaluator 3.0 in EOD/CDOi platform is an analytical matter. Pat Jordan will make the final decision. Until further notice, assume that we are going with the older version.

Henry

-----Original Message-----
From: Momin, Inayat
Sent: Tuesday, July 12, 2005 10:05 AM
To: Carrier, Henry; Cantor, David
Cc: Vega, Juan
Subject: RE: Delay in Evaluator 3.0 incorporation in EOD/CDOi platform

Henry/ David:

Per your suggestion, a comparison report has been provided two weeks ago.
We would like to have a feedback on this, so that we can plan our work about switching to the v3.0 engine.
Please let us know if any decision has been made regarding switching to v3.0

Thanks,
Inayat

-----Original Message-----
From: Momin, Inayat
Sent: Tuesday, June 28, 2005 12:54 PM
To: Carrier, Henry; Cantor, David; Chen, John; Tomlinson, Sandra; Murray, Tom; Scanlin, Kate; Anderberg, Stephen; D'Erchia, Peter; Galli, Stephen; Gillis, Tom; Watson, Bob; Vega, Juan; Sargsyan, Eduard; Drexler, Michael; Jordan, Pat; Mydeen, Shaik

Subject: RE: Delay in Evaluator 3.0 incorporation in EOD/CDOi platform

All:

Here are the comparison reports. Please let us know when EOD should be switched to CDO Evaluator v3.0

Last 3 months historical numbers for the approved deals:
ROC numbers => \\nycsvr04\Group_Sfdb\EOD-ROC\ROC-Report\27-JUN-2005\ROC-HIST-Comp-2-5-2-Vs-3-0.xls
SDR numbers => \\nycsvr04\Group_Sfdb\EOD-ROC\ROC-Report\27-JUN-2005\SDR-HIST-Comp-2-5-2-Vs-3-0.xls

Current numbers for the approved deals using ratings as of June-24-2005:
ROC numbers => \\nycsvr04\Group_Sfdb\EOD-ROC\ROC-Report\27-JUN-2005\ROC-DAILY-Comp-2-5-2-Vs-3-0.xls
SDR numbers => \\nycsvr04\Group_Sfdb\EOD-

ROC\ROC-Report\27-JUN-2005\SDR-DAILY-Comp-2-5-2-Vs-3-0.xls

Thanks,
Inayat

-----Original Message-----
From: Carrier, Henry
Sent: Tuesday, June 21, 2005 5:55 PM
To: Jordan, Pat
Cc: Cantor, David; Chen, John; Tomlinson, Sandra; Murray, Tom; Scanlin, Kate; Anderberg, Stephen; D'Erchia, Peter; Galli, Stephen; Gillis, Tom; Watson, Bob; Momin, Inayat; Vega, Juan; Sargsyan, Eduard; Drexler, Michael

Subject: Delay in Evaluator 3.0 incorporation in EOD/CDOi platform

Pat,

Please forward this e-mail as appropriate.

As we discussed, I have asked Inayat Momin to delay the incorporation of Evaluator 3.0 (E-3) in the EOD/CDOi platform until you give us the ok. We will continue to use version 2.4. My understanding is that we need to address the impact of new default and correlation tables on existing ratings before we release E-3.

Inayat has offered to run previously approved deals for CDOi (about 150 US Cash deals, w/ bonds or loan portfolios) under both e2.4 and e3.0. This should help you assess the impact of the changes. He will run the two analyses for the latest 3 months. The noise form any data issue should be negligible.

Note that when we do decide to incorporate E3 in the platform, we will need time to reprocess all the deals and their reports. This may delay the launch. Further all deals and all their reports will show the results from E3.

Henry

Henry J. Carrier
Managing Director, Strategic Operations

Structured Ratings
Standard & Poor's Credit Market Services
55 Water Street
41st Floor
New York, NY 10041
Direct: 212-438-6635
Fax:: 212-438-0086
Main: 212-438-2000
henry_carrier@standardandpoors.com

From: Tesher, David
Sent: Monday, May 22, 2006 10:26 AM
To: Kambeseles, Peter
Subject: FW: Draft #2: E3 Surveillance Policy for Cash CDOs

What do you think before I send this out ...

-----Original Message-----
From: Anderberg, Stephen
Sent: Friday, May 19, 2006 5:24 PM
To: Jordan, Pat; Tesher, David; Inglis, Perry; Collingridge, Simon
Subject: Draft #2: E3 Surveillance Policy for Cash CDOs

Pat and David,

I've made changes to reflect our discussion this afternoon - let me know if I've failed to capture anything properly. I'll be in the all-day VCDS training session on Monday, Tuesday and Wednesday but will can stop by in the evening if you have any concerns.

Perry and Simon,

FYI, I'm forwarding this at Pat's request. Also, I apologize for stating the obvious but this needs to kept from Paul's eyes

Thanks!

Steve

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Prior to Transition Date (in preparation for final implementation of E3 for cash CDOs):

- A large majority of the pre- E3 cash flow CDOs will be run through E3 in batch processes to see how the ratings look within the new model
- In the US, the Primary side will handle batch runs for 2005 & 2006 deals; CDO Surveillance will produce batch runs for deals originated 2000 through 2004
- Ratings falling ***more than*** 3 notches +/- from the current tranche rating in the batch process will be reviewed in detail for any modeling, data, performance or other issues
- If any transactions are found to be passing/failing E3 by more than 3 notches due to performance reasons they will be handled through the regular surveillance

~~process to see if the ratings are stable under current criteria (i.e., if they pass~~ E2.4.3 using current cash flow assumptions the ratings will remain unchanged)

- If any transactions are found to be passing/failing E3 by more than 3 notches due to a model gap between E2.4.3 and E3, they will be reviewed by a special E3 committee, including representatives from the surveillance, primary CDO ratings and criteria groups.
- The special committee will review the "model gap" deals by looking at the results of cash flow analysis generated under both E2.4.3 and E3 as well as looking at other factors - structure, collateral, management, etc. - to determine whether or not an action will be required in connection with the E3 rollout
- Transactions failing E3 purely due to the change in modeling assumptions - i.e., not due to any structural, management or collateral weaknesses - will not have ratings adjusted by the special committee

For the synthetic CDOs, the pre-E3 transactions were run through E3 Low immediately before the release of the model to see if they fell within the "tolerance band" established for the pre-E3 deals under the new model. The 3 notch gap discussed above is the equivalent "tolerance band" for the cash flow deals.

Surveillance Policy for Cash flow CDOs Post Final E3 release (i.e., following the transition date and transition date steps taken above):

- Transactions rated under E2.4.3 will be monitored and placed on CreditWatch based solely on E2.4.3, and GROC will be generated for these deals under E2.4.3 for both surveillance and publishing purposes
- Cash flow runs for E2.4.3 deals will be generated, reviewed and taken to committee if (and only if) a transaction fails GROC under E2.4.3; the committees for these transactions will review cash flow runs generated under both models (E2.4.3 and E3.x). This is the only point in the surveillance process for which E3.x cash flow analysis will be generated for transactions rated with E2.4.3. The results from E2.4.3 will be used to arrive at the committee's rating decision, while the E3.x results will be reviewed on an ongoing basis to monitor the gap in results produced by the two models
- Although it is contemplated that transactions rated using E2.4.3 will continue to be monitored using E2.4.3 following the transition date, Standard & Poor's reserves the right to surveill its rated transactions using the appropriate model for its credit opinion, the performance of the transactions, or for any other reason
- Transactions rated under E3 will be monitored and surveilled using E3, and GROC will be generated for these deals under E3 for both surveillance and publishing purposes
- Transactions rated prior to the final transition date using E3 SDRs and E2.4.3 BEDRs will be monitored and surveilled using E3 SDRs and E2.4.3 BEDRs, and GROC will be generated for these deals using E3 SDRs and E2.4.3 BEDRs for both surveillance and publishing purposes

Thanks,

Steve

Stephen Anderberg
Director, Structured Finance Ratings
stephen_anderberg@standardandpoors.com

Standard & Poor's
55 Water Street, 41st Floor
New York, NY 10041-0003
(212) 438-8991
(212) 438-2664 fax

From: Parisi, Frank
Sent: Monday, March 12, 2007 10:13 AM
To: Griep, Cliff; Gillis, Tom; Barnes, Susan; Warner, Ernestine
Subject: RE: Comments on sub prime article

Cliff,

Thanks for your comments and thoughts. Clearly some are editorial and some relate to our criteria and policies; the former can be quickly addressed. To one of your specific points, Tom and I have been looking at the performance of the 2005 vintage as well, and it looks like that too may need to be addressed as you've suggested.

Thanks, Frank

> -----Original Message-----
> From: Griep, Cliff
> Sent: Monday, March 12, 2007 9:53 AM
> To: Gillis, Tom; Parisi, Frank; Barnes, Susan; Warner, Ernestine
> Subject: Comments on sub prime article
>
> We should lead with our projections for performance and the
> consequent ratings impact.
>
> I believe david wyss mentioned an actual decline in nominal
> home prices nationally has already occured. The article
> should incorporate.
>
> The statement of 2006 vintage being only 50 percent more
> risky than 2000 vintage mat understate the risk. We must
> cover the changes in product type, the interest rate risk in
> more detail, and the dramatuc increase in limited income
> documentation. Do we have any measure on historic performance
> of no doc lending in sub prime? Should we say more about the
> performance impact of confirmed seconds, or ltv?
>
> It would be helpful to compare market context. We currently
> have meaningful bankruptcies of sub prime lenders, large
> losses reported by some banks, the regulators forcing tighter
> underwriting standards, etc. This is all different than 2000.
>
> Hasn't loan purpose been more risky as well. Do we track
> speculative activity, for investment and second home on a
> macro level, and what is it telling us about comparisons?
>
> Can we size the payment shock exposure relative to payment or
> capacity?
>
> Our loss estimates are within the context of our criteria.
> Are we completely satisfied that our criteria captures all
> the relevant risk? Should we defend our criteria more explicity?
>
> Why did the criteria change made in mid 2006 not impact any
> outstanding transactions at the time we changed it,
> especially given the magnitude of the change we are

> highlighting in the article? Should we apply the new criteria
> now, given what we now know? If we did, what would be the impact?
>
> Why are we focused only on the 2006 vintage? Are we
> suggesting 2005 will not have issues?
>
> What are the a, aa, and aaa, levels of credit support for the
> first half 06 vintage? Should we mention these?
>
> I don't think the readers will understand what we mean when
> we say a single b scenario, or a bb scenario. We should explain this.
>
> We seem to disparage market views by using the terms
> "rhetoric" and "hype". We should simply state our views
> authoritatively without characterizing others.
>
> Several of the comparisons on the first page require
> clarification. I.e. Serious delinwquency in 06 vintage is
> compared to delinquency in 2000 vintage.
>
> We cite imprudent underwriting standards as a reason for the
> concern about 2006 vintage. What is our view of underwriting
> standards and how does this view impact our view and analysis?
>
> Given the overall projections, should we be taking more
> aggressive rating actions on bbb and speculative grade traunches?
>
> Were the criteria adjusted between 2000 and 2006 and are
> these criteria changes relevant? Should they be covered?
>
> Should we review our no doc lending criteria or are we
> satisfied it adequately captures the risk?
>
> Should we comment in greater detail on the changes in product
> mix between 2000 and 2005 and 6?
>
> Should we comment on the overall impact on servicing expected
> from the current developments, given new century, etc.
>
> Sent from my GoodLink synchronized handheld (www.good.com)
>

DATE: 05/15/2007
TIME: 17:16:08
AUTHOR: Dronov, Alexey (CALYON)
RECEIPIENT: May, William
CC:
SUBJECT: RE: Stratford CLO

Bill - the timing for Stratford has been pushed back one month, so we will be pricing the deal in june. Should we still use the old methodology?

Alexey Dronov - VP
Structured Credit, Derivatives & CDOs
Calyon Corporate & Investment Bank
1301 Avenue of the Americas
New York, NY 10019
212-261-7497 (Office)
617-448-2074 (Mobile)
alexey.dronov@us.calyon.com

From: May, William [mailto:William.May@moodys.com]
Sent: Wednesday, April 11, 2007 6:45 PM
To: Dronov, Alexey (CALYON)
Subject: RE: Stratford CLO

Alex,
Go ahead and use the old methodology.
Regards,
Bill

-----Original Message-----
From: Dronov, Alexey (CALYON) [mailto:Alexey.Dronov@us.calyon.com]
Sent: Wednesday, April 11, 2007 4:14 PM
To: May, William
Subject: RE: Stratford CLO

Bill,

We intend to price the Stratford deal in May but closing will be in June. Should we use the old methodology or the new one? I talked to Danielle Nazarian and Rudy Bunja about some of the LCDS features of the deal and they thought it would make sense to use the old methodology, but suggested that I double check with you. Thanks.

Alexey Dronov - VP
Structured Credit, Derivatives & CDOs
Calyon Corporate & Investment Bank
1301 Avenue of the Americas
New York, NY 10019
212-261-7497 (Phone)

617-448-2074 (Mobile)
alexey.dronov@us.calyon.com

From: May, William [mailto:William.May@moodys.com]
Sent: Thursday, April 05, 2007 3:15 PM
To: Dronov, Alexey (CALYON)
Cc: Dupont-Madinier, Cyprien (CALYON)
Subject: RE: Stratford CLO

Alexey,
Your analysts are:
Quant: Elina.kolmanovskaya@moodys....com <mailto:Elina.kolmanovskaya@moodys.com>. # is 553-7852.
Legal: mark.froeba@moodys.com <mailto:mark.froeba@moodys.com>. # is 553-4149.
Regards,
Bill

-----Original Message-----
From: Dronov, Alexey (CALYON) [mailto:Alexey.Dronov@us.calyon.com]
Sent: Monday, April 02, 2007 7:15 PM
To: May, William
Cc: Dupont-Madinier, Cyprien (CALYON)
Subject: Stratford CLO

Bill,

We are working on a 700M-1B CLO for Highland Asset Management. The deal is a standard CLO except that potentially the entire collateral pool can consist of LCDS. The AAA tranche will be a revolver like the A-2 tranche in the duane street deals I structured at Morgan Stanley. The manager will have the ability to block portions of the revolver to invest in LCDS on an unfunded basis, also like in the duane street deals. The timing for the deal is as follows:

pricing - beg of may
closing - end of may

Please let us know who will be working on the deal on your end.

Alexey Dronov - VP
Structured Credit, Derivatives & CDOs
Calyon Corporate & Investment Bank
1301 Avenue of the Americas
New York, NY 10019
212-261-7497 (Phone)
617-448-2074 (Mobile)
alexey.dronov@us.calyon.com

***********************************Calyon**********************************
*
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for the sole use of its addressee. If you are not the addressee, please
immediately notify the sender and then destroy the message. The
unauthorized disclosure, use, dissemination, or copying (either
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Reserved.
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From: Mcdermott, Gail
Sent: Thursday, December 09, 2004 6:07 AM
To: Jordan, Pat
Subject: FW: Staffing and Allocation

Per my voice mail this is the e-mail I was referring too.

Gail

-----Original Message-----
From: Mcdermott, Gail
Sent: Friday, December 03, 2004 11:10 AM
To: Losice, Abe; Jordan, Pat
Subject: RE: Staffing and Allocation

Thanks Abe, would ABCP needs be met by the changes stated in the chart below?

Pat and Abe,
The below allocation chart results either in a status quo of resources or a net reduction of staff to RMBS (see reasoning below). I am trying to put my hat on not only for ABS/RMBS but for the department and be helpful but feel that it is necessary to re-iterate that there is a shortage in resources in RMBS. If I did not convey this to each of you I would be doing a disservice to each of you and the department. As an update, December is going to be our busiest month ever in RMBS. I am also concerned that there is a perception that we have been getting all the work done up until now and therefore can continue to do so.

We ran our Staffing model assuming the analysts are working 60 hours a week and we are short resources. We could talk about the assumptions and make modifications but the results would be similar. The analysts on average are working longer than this and we are burning them out. We have had a couple of resignations and expect more. It has come to my attention in the last couple of days that we have a number of staff members that are experiencing health issues.

This shortage in staffing assumes that the only projects we work on next year are SPIRE and LEVELS maintenance. In reality there are other operational items that come up (NIKU, Documentum, Criteria Encyclopedia and CORE redesign) in addition to the exhaustive criteria list which has over 45 issues that need or should be addressed to keep us positioned at the forefront of the marketplace most notably Predatory Lending issues, cashflow criteria, Commercial criteria, etc. that do take up time.

I have also thought about our discussion with Joanne in terms of focusing on are top tier clients which is approximately 80% of our revenue. This would result in a reduction (+ or -) of $25 mil. dollars. If this is possible we would have to lay the ground work in terms of managing expectations since we are asked on a weekly basis (sometimes daily) from finance what are revenue estimate is.

My reasoning for stating that the chart results in a net reduction are as follows:

1. As Abe mentioned, some of the changes are on paper only. For example increasing Kanika, Monica and Justin's allocation would not result in productivity gains since they are working more hours in RMBS than their current allocation reflects;

2. We received authorization yesterday to hire replacements for Linda (AD) and Guy (Assoc.). We may downgrade the AD req. to an Associate req. depending on the pool of candidates. It will take a couple of years to get these replacements to be as productive as Linda and Guy.

3. Brian Grow will be leaving next year for Australia which will be a loss of 1FTE. Brian is one of our top ADs.
4. Mark Levin currently allocated 50% to RMBS posted for the commercial openings.
5. Increases of Smith, Devone, Goldenberg, from 50% to 100% and adding Rocha (if possible) will not fill the above voids.

I would like to make the following recommendations:

1 Consider asking if there are any existing reqs. in the department that have not been filled that could be allocated to ABS/RMBS.

2. Gail and Abe discussing further with Brian O'Keefe if there are any Directors currently available in CDOs to be allocated elsewhere (50%).

3. Discussing further whether there are any members of staff not being fully utilized.
4. Requesting adds to staff if #1 and #2 are not feasible.
5. Abe and I make a recommendation to Pat J. on the bullet points related to CDOs, surveillance and where to start the replacements/(new hires?) based on answers to #1-4.

Thank you for you attention to this matter.

Gail

-----Original Message-----
From: Losice, Abe
Sent: Friday, December 03, 2004 12:01 AM
To: Mcdermott, Gail; Jordan, Pat
Subject: Staffing and Allocation

Gail and Pat,

We have not yet reviewed the results of last week's meeting regarding staffing and allocation. Here are a list of issues that actions have been taken or questions are left open:

- Pat, you have reported to Peter that we will not currently allocate to CMBS Surveillance.
- I delivered to Kim the resumes of the applicants for the CMBS positions (Digney, Levin, Zuliani, and Homa).
- I reported to Diane Audino that we are not circulating the Associate posting for LASF and we will not allocate for it from ABS/ RMBS.
- We had discussed adding to the analytical pool currently. Resignations of Wu and Maurice in addition to transfer of Wrede could give rise to replacement reqs. How many are we authorized for? Are we adding above these 2 or 3 in recognition of having hired a small Associate class of '04? Would we hire directly for RMBS or would we hire for LOC, Synthetics, and Surveillance? How much has been shared with Debbie O'Connor's group?
- Stephanie Payne has declined. Only 2 of the '04 summer associates have agreed to join (Matt and Steve). In addition to only one hire from summer '03 (Nicole Billick) points to a lot of work for recruitment with low results. It will be a good test for us to go into the market at this time, away from on-campus recruitment at our targeted schools, and see if we can find comparable or at least acceptable candidates.
- There were discussions about Ravi Myneni and others, such as Chui Ng, in CDO. They could be immediately useful helping on ABCP.
- We talked about maintaining pool allocation to CDO of at least 2 FTE. Are we trying for that level for surveillance?

- I have started some notes for allocation of analysts. Some are just cosmetic changes to reflect reality. Some are ideas that have to be explored for feasibility. It is for review and discussion. It doesn't really reflect it, but it is meant to lead to flexibility in support of RMBS and ABCP.

<< File: Alloc_notes.doc >>
Thanks,

Abe

Abe Losice
Managing Director
Structured Finance
Standard & Poor's
55 Water Street, 40th Floor
New York, NY 10041

Phone: (212) 438-7326
Fax: (212) 438-2649
abe_losice@sandp.com

From: Diane Cory [ddcory@earthlink.net]
Sent: Wednesday, May 03, 2006 9:27 AM
To: Scott, Gale
Subject: RE: Change in scheduling/Coaching sessions/Other stuff

Importance: High

Gale,

Let's order "Coaching for Performance" by John Whitmore and "The Inner Game of Work" by Timothy Gallwey. Thanks!

Diane

>Diane,
>
>Which books should I order? I will do it now.
>
>Gale C. Scott
>Managing Director
>Global Real Estate Finance
>Standard & Poor's Rating Services
>55 Water Street, 41st Floor
>New York, New York 10041
>
>ph: (212) 438-2601
>fax: (212) 438-2659
>gale_scott@standardandpoors.com
>
>
>-----Original Message-----
>From: Scott, Gale
>Sent: Tuesday, May 02, 2006 8:12 PM
>To: 'Diane Cory'
>Subject: RE: Change in scheduling/Coaching sessions/Other stuff
>Importance: High
>
>
>Hi Diane,
>
>Thank you so much for contacting me about this. Swamped is a
>serious understatement. We spend most of our time keeping each
>other and our staff calm. Tensions are high. Just too much work,
>not enough people, pressure from company, quite a bit of turnover
>and no coordination of the non-deal "stuff" they want us and our
>staff to do......enough said.
>
>Of course you should go ahead and accommodate surveillance. Using
>part of the VCDS session to introduce some basics is a brilliant
>idea (Diane, what's wrong with us...why didn't we think of this).
>Then we can have more in depth training later in the summer as you
>suggest.

>I am available this Thursday from 12 noon to 3:00pm and then any
>time after 4:30pm for a call. Does anywhere in this timeframe work
>for both of you?
>
>Gale C. Scott
>Managing Director
>Global Real Estate Finance
>Standard & Poor's Rating Services
>55 Water Street, 41st Floor
>New York, New York 10041
>
>ph: (212) 438-2601
>fax: (212) 438-2659
>gale_scott@standardandpoors.com
>
>
>-----Original Message-----
>From: Diane Cory [mailto:ddcory@earthlink.net]
>Sent: Tuesday, May 02, 2006 5:18 PM
>To: Scott, Gale
>Subject: Change in scheduling/Coaching sessions/Other stuff
>Importance: High
>
>
>Dear Gale,
>
>Since I haven't heard from you regarding the coaching I am thinking
>you are totally swamped...and some things have changed since I sent
>you the proposal for the coaching sessions for the MD coaches.
>
>Daniel and I have been asked to facilitate a session for Global
>Surveillance on Thursday and Friday, June 1-2. We would like to
>accommodate them, if possible.
>
>Daniel is wondering if we might design part of the upcoming VCDS
>session in May to focus on coaching and take the group through some
>of the basics...would that help accomplish several things at once?
>(If you want to do this, we need to have you order the coaching books
>right away.) Then you and I can look at our schedules again and come
>up with a planning time and a two-day and a one-day session perhaps
>beginning at the end of August.
>
>Where's your thinking? Daniel and I are home most of this week and
>are happy to schedule a phone call with you.
>
>Hope you and your family are well. I have lots to share...
>
>Warm regards,
>Diane
>--
>Diane Cory
>
>Phone: (603) 642-6729
>Fax: (603) 642-6479
>

>U.S.A.
>
>---
>
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>---

--
Diane Cory

Phone: (603) 642-6729
Fax: (603) 642-6479

U.S.A.

From: Jordan, Pat
Sent: Tuesday, October 31, 2006 12:28 PM
To: Rose, Joanne; Veneable, Dawanna; Boyd, Sheila
Cc: Klein, David
Subject: A CDO Director resignation

Importance: High

Unfortunately, one of our excellent and market experienced Directors, Todd Jaeger, resigned Friday afternoon to join RBC Greenwich Capital.

"Stupid money", was being thrown at him by many many (I am not exaggerating) market participants, and he took RBC's offer b/c he knows the guyswho run the CDO group and is comfortable working for them. We have been aware of Todd's frustration with having to do high deal volume (10 in his pipeline regularly) on top of the things, such as developing our hybrid criteria, but b/c of our staffing shortage have been able to make only slow progress in reassigning more junior work.

While I realize that our revenues and client service numbers don't indicate any ill affects from our severe understaffing situation, I am more concerned than ever that we are on a downward spiral of morale, analytical leadership/ quality and client service. Anything that can be done to receive immediate approval for the recently requested adds to staff as well as Todd's replacement is needed asap. At the risk of stating the obvious, Todd, and Winnie Fong last month, are not sticking around for S&P bonuses. Reliable rumor has it that Todd was offered $500k for now to March (end of their comp year). And then given an indication to expect at least $800k for the next full comp year. I'm very much aware that we can't come close to matching this, but we must both continue to make market adjustments, and try to build a bench through hiring.

The market for anyone with CDO experience is so hot, that even our most junior staff are quickly (within 12-18 months) valuable to the market. We expect more resignations.

DATE: 07/09/2007
TIME: 12:04:56
AUTHOR: Jim Badenhausen
RECEIPIENT: Yoshizawa, Yuri
CC: Kimon, Noel; Clarkson, Brian; McDaniel, Raymond; Westlake, Lisa; Harris, Gus; Subprime Working Group - Craig Brown; Subprime Working Group - Michael Gross
SUBJECT: FW: CDO Surviellance Note 7_071.doc

Dear Yuri -

Thanks for sharing this draft of the CDO surveillance piece you're planning to publish later this week. We took a look at it over the weekend, and think there is alot of good information here. We did had a few reactions to the document - from an outsider's perspective - that we wanted to share with you as you continue to refine this in the days ahead.

- We thought it might be useful, at the outset, to provide an easily digestable overview of what you look at as part of your CDO surveillance - including the performance of underlying assets, the CDO structural features and the asset manager's decisions. This would be especially useful for the press and other less sophisticated audiences, although perhaps it could even be a helpful reminder for more sophisticated investors. Fitch has a slide like this, which you may have already seen, in the sub-prime/CDO presentation posted on their website (see the attached deck), and we've pasted the relevant slide below for easy reference.

- Presumably one of the most important parts of this document, given the current market environment, is the discussion of the factors that could lead to an upgrade/downgrade. And, as outsiders who aren't as familiar with CDOs and the surveillance process itself, we had a little trouble understanding the chart you've included here. We thought this section might benefit from a little more "user-friendly" context and explanation, to the extent possible, as it could help the press and other key constituencies understand the key drivers you look at in monitoring these securities.

- We also were wondering if it might be worthwhile to talk specifically about the surveillance of CDOs backed by RMBS's, given the scrutiny that they are under right now. For instance, in the attached deck posted on their website (and in the slide pasted below), S&P talks about their "integrated process for CDO and RMBS surveillance" and mentions that "prior to the release of RMBS rating actions we are fully aware of the exposures within our rated CDO transactions, and have made at least a preliminary assessment of any potential CDO rating impact." That could be a good message to put out into the marketplace, if Moody's CDO surveillance process works in a similar way.

- In the section about your CDO surveillance infrastructure, we were struck by the data point about the 26 professionals who are dedicated to monitoring CDO ratings. While this is, no doubt, a strong team, we wanted to at least raise the question about whether the company's critics could twist that number - e.g., by comparing it to the 13,000+ CDOs you're monitoring - and once again question if you have adequate resources to do your job effectively. Given that potential risk, we thought you might consider removing any specific reference to the number of people on the CDO surveillance team.

- There is quite a bit of talk here about Moody's "automated" surveillance systems, and they are obviously an important part of the surveillance process. But this also could be misconstrued by critics to make it sound like your surveillance system is on "autopilot." We were wondering if there is more you could say about the rigorous analysis that your analysts - and the ratings committees - do in this process.

- There are also several parts of this paper that make the CDO surveillance/monitoring process sound potentially slower than it no doubt is (e.g., "the ultimate decision to upgrade/downgrade is subject to additional analysis over a period of a few weeks to a few months"). Again, we are concerned that statements like this could be taken out of context by your critics and twisted to sound like evidence of a slow, ineffective monitoring process. Perhaps some of these turns of phrase could be reworked with those external audiences in mind.

Hope these thoughts are helpful. Let us know if you have any questions or would like to discuss this further.

Thanks.

- Jim, Michael and Craig

EXCERPT FROM FITCH PRESENTATION on SUB-PRIME/CDO'S (SLIDE 54)

CDO Surveillance Framework

Three Pillars of CDO Performance

§ Performance of Underlying Assets

o Primary CDO performance driver is the performance of the underlying assets

o Successful CDO surveillance must be able to measure and monitor performance changes

§ CDO Structural Features

o CDO structural features vary deal-by-deal

o Features may impact rating actions on specific CDO tranches

o Features may impact severity of rating actions on CDO tranches

§ Asset Manager's Decisions

o Asset Manager incentive or focus may change throughout the life of a CDO

o Successful CDO Surveillance must work with Asset Managers to:

§ Understand manager's view on asset selection

§ Understand manager's view of asset performance and trading strategy

§ Assess manager's ability to adjust to current market conditions

EXCERPT FROM S&P PRESENTATION on SUB-PRIME/CDO'S (SLIDE 26)

S&P Has an Integrated Process for CDO and RMBS Surveillance

. Standard & Poor's has an integrated surveillance process to ensure

the ratings on our rated RMBS bonds and CDO transactions reflect

our most current credit view

. CDO Surveillance is informed of RMBS Surveillance's current credit

opinion and outlook for rated transactions

. RMBS Surveillance is aware of RMBS exposure within Standard &

Poor's rated CDO transactions

. Prior to the release of RMBS rating actions we are fully aware of the exposures within our rated CDO transactions, and have made at least a preliminary assessment of any potential CDO rating impact

---

From: Yoshizawa, Yuri [mailto:Yuri.Yoshizawa@moodys.com]
Sent: Friday, July 06, 2007 5:47 PM
To: Kirnon, Noel
Cc: Clarkson, Brian; McDaniel, Raymond; Westlake, Lisa; Harris, Gus; Badenhausen, Jim
Subject: FW: CDO Surviellance Note 7_071.doc

FYI - This is a draft of the CDO surveillance piece that we'll be publishing next week and discussing as one part of the CDO portion of the teleconference. Along with finalizing this piece, we'll be working on the teleconference slides over the weekend and during the first couple of days of next week.

-----Original Message-----
From: Yoshizawa, Yuri
Sent: Friday, July 06, 2007 5:08 PM
To: 'Jeremy Gluck'; Polansky, Jonathan
Cc: Harris, Gus; Park, John
Subject: RE: CDO Surviellance Note 7_071.doc

My comments to the updated document.

Thanks.

> -----Original Message-----
> **From:** Jeremy Gluck [mailto:jandjgluck@sbcglobal.net]
> **Sent:** Thursday, July 05, 2007 2:03 PM
> **To:** Polansky, Jonathan
> **Cc:** Harris, Gus; Yoshizawa, Yuri; Park, John
> **Subject:** Re: CDO Surviellance Note 7_071.doc
>
> Sorry, looks like I sent the wrong version--there really is a conclusion in the attachment.
>
> ----- Original Message ----
> From: "Polansky, Jonathan" <Jonathan.Polansky@moodys.com>
> To: Jeremy Gluck <jandjgluck@sbcglobal.net>
> Sent: Thursday, July 5, 2007 10:31:57 AM
> Subject: RE: CDO Surviellance Note 7_071.doc

Jerry,

Were you going to write the conclusion or were you thinking that we'd take care of it? I'm new at this so i'm not sure what you've done in the past. (also wanted to make sure that you sent back you're final version because this one still had the notes of a conclusion from gus and not a conclusion). Thanks.

Jon

-----Original Message-----
From: Jeremy Gluck [mailto:jandjgluck@sbcglobal.net]
Sent: Thursday, July 05, 2007 1:17 PM
To: Polansky, Jonathan
Cc: Harris, Gus; Park, John; Yoshizawa, Yuri
Subject: Re: CDO Surviellance Note 7_071.doc

Thanks for everyone's quick comments. I've attached an updated draft. Let me know if you'd like me to make further changes.

Regards,
Jerry

----- Original Message ----
From: "Polansky, Jonathan" <Jonathan.Polansky@moodys.com>
To: Jeremy Gluck <jandjgluck@sbcglobal.net>
Cc: "Harris, Gus" <Gus.Harris@moodys.com>; "Park, John" <John.Park@moodys.com>; "Yoshizawa, Yuri" <Yuri.Yoshizawa@moodys.com>
Sent: Wednesday, July 4, 2007 10:54:34 AM
Subject: RE: CDO Surviellance Note 7_071.doc

Jerry,

My comments are attached (should incorporate John's and Gus' comments -John pls verify - I added the #s from Carie and Chris. Also, the original deal score explainatory paper is attached for reference - you'll see Gus' suggestion. Thanks.

Jon <<CDO Surviellance Note 7_07jp.doc>> <<Mdsr.pdf>>

-----Original Message-----
From: Harris, Gus
Sent: Wednesday, July 04, 2007 12:36 PM
To: 'Jeremy Gluck'
Cc: Park, John; Polansky, Jonathan; Yoshizawa, Yuri
Subject: CDO Surviellance Note 7_071.doc

<< File: CDO Surviellance Note 7_071.doc >>

My comments are attached. Thanks Jerry

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2007 Performance Management Process (PMP)

Review Period: 2007

General Information

Employee Information

D'ERCHIA	**PETER**	**J**
Last Name	First Name	Middle
MD-BUSINESS DEVELOPMENT	**CORPORATE & GOV'T RATINGS**	**NEW YORK, NY**
Title	Department	Location

Manager Information

MONTRONE, WILLIAM L	**MD-RATINGS C&G US PUBLIC FIN**
Manager Name	Title

Overview

Section I -Goals

Goal

Goal | CDO Initiative

Redacted by the Permanent Subcommittee on Investigations

Redacted by the
Permanent Subcommittee on Investigations

Summary Section

Overall Comments

Employee Comments

This may be the first time in my 26 year career with S&P that I have commented on a supervisor's performance evaluation. I do not agree with Joanne's overall evaluation of my 2007 performance.
In my mid-year review for 2007, Joanne states: "Peter is on track for a good performance year." My 2007 performance goals were being met through the first half of the year, as Joanne acknowledged, and after the mid-year, I continued to meet them.
Joanne's negative comments in this year-end review, such as I was "notably absent from many discussions" and that Joanne did not "feel [my] leadership", are the result of a disagreement she and I had over the subprime debt deterioration. In early July 2007, I strongly disagreed with Joanne about subprime debt deterioration. My professional assessment on that matter appears to have clouded her objectivity about my year-end performance.

Redacted by the
Permanent Subcommittee on Investigations

Redacted by the Permanent Subcommittee on Investigations

Even more offensive -- and flatly wrong -- is the statement that I am not working for a good outcome for
S&P. That is all I am working towards and have been for
26 years. It is hard to respond to such comments, which

I think reflect Joanne's personal feelings arising from
our
disagreement over subprime debt deterioration, not
professional assessment.
I do not accept the comment that I was not actively
engaged with direct reports or the broader
department.
My direct report evaluations have been stellar;
turnover
in my group is less that 1% over the last three
years;
and I have exceeded my revenue budget the last
seven
years. Such comments, and others like it, suggest
to me
that this year-end appraisal, in contrast to the mid-
year
appraisal, has more to do with our differences over
subprime deterioration than an objective
assessment of
my overall 2007 performance.

Mid-Year Review Date/Comments

Peter is on track for a good performance year. He
should continue to
try to work with the other members of the SFLT to
continue to improve
our surveillence functions.

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Permanent Subcommittee on Investigations

**Redacted by the
Permanent Subcommittee on Investigations**

Second Level Manager Comments

**Redacted by the
Permanent Subcommittee on Investigations**

Signatures

Employee:	PETER D'ERCHIA	Date	02/08/2008
Manager:	VICKIE TILLMAN	Date	02/08/2008
Second Level Manager:	VICKIE TILLMAN	Date	01/25/2008

DATE: 10/12/2007
TIME: 21:44:41 GMT
AUTHOR: Hu, Jian
RECEIPIENT: Carrafiello, Crystal; Steckert, Marianne; Yoshizawa, Yuri; Kolchinsky, Eric; Trefflich, Kara; Adler, Michael; Trier, Nathan; Fu, Yvonne; Cantor, Richard; Kanef, Michael; Teicher, David; Thomas, Julia; Adler, Michelle; Weill, Nicolas; Polansky, Jonathan; Robinson, Claire; Kornfeld, Warren; Leshko, Courtney; Jonas, Gregory; Liberman, Jessica; Harris, Gus; Park, John; Kirnon, Noel; Hemmerling, Brett; Osborne, Timothy; Mirenda, Anthony (Tony); Laserson, Fran; Huber, Linda
CC:
SUBJECT: RE: Fitch's teleconference presentation and questions from their Q&A

After S&P, Fitch is now also blaming fraud for the impact on RMBS rating, at least partially.

Fitch CEO says fraudulent lending practices may have contributed to problems with ratings

<javascript:void(0);>

594 words

12 October 2007

9:09:58 PM GMT

Associated Press Newswires </tools/sourceDetails.aspx?srcs=APRS>

English

Credit rating agencies, which guide investors about the risks of bonds, have come under scrutiny for giving their blessing to mortgage-backed securities that have since plummeted in value. Now, Congress, several states and the Securities and Exchange Commission are probing the agencies.

Stephen Joynt, chief executive of No. 3 player Fitch Ratings, said in a recent interview that the blame may lie with fraudulent lending practices, not his industry.

AP: Companies and other bond issuers pay you to rate their securities. One senator compared this to paying a movie critic for a review.

Joynt: For a long time it's been acknowledged that there's a potential for a conflict of interest in the business model that has issuers pay rating agencies.

Would you support changes to the system of being paid by the issuers?

I think it would be very difficult to change or transition away from that today. The reason (for) the original model to have the issuers pay was ... they wanted rating agencies to be capable of paying higher salaries for a more competent staff. I think that's still probably an important need.

Has the SEC been in contact with you?

We had a pretty extensive meeting with them several weeks ago. I think maybe 10 or 15 representatives came up and sat for maybe a four-hour meeting. We gave them a good update on our process of rating mortgage-backed securities, which is what they were interested in.

Your industry's taken heat for awarding high ratings to bond offerings backed by mortgages sold to people with poor credit. How did you determine your ratings?

We would have based it primarily on the best indicators like FICO scores. It turns out that (homeowners' credit scores) may not be the best indicators of the performance on this batch of **subprime** securities. It also may be true that some of the underlying information on some of the loans may have contributed to that performance, possibly by being fraudulent. Some have suggested that the incidence of fraud in the processing of more recent **subprime** mortgages, especially in the last year and a half, may have been far more extensive than we had seen in the past.

Did you make the right calls with the information you had?

We've recently gone back and reviewed all of the mortgage-backed securities for **subprime** that we rated in 2006 that people are questioning most, and we've reaffirmed all of our triple-A ratings just in the last several weeks. We've made some changes in double-A and single-A. There's certainly been deterioration in that.

It's not the first time rating agencies have grabbed headlines. In the days of the Enron scandal, the industry was also accused of missing the boat.

I wouldn't say that finding these particular two headlines and linking them is the way I would present our reputation or image in the market.

Is your industry being made a scapegoat?

Is there something we could have done different or better? We should focus on our primary job. That's our lead job, as contrasted with spending a lot of time and energy to put in place responses to the people who are offering critiques.

Did you do a better job than your competitors?

I can think of specific instances where we declined to rate certain things that the others did. Maybe they can think of the same instances for us.

7

Regards,

Jian Hu
Structured Finance - CDOs/Derivatives
Moody's Investors Service
Tel: 212.553.7855

-----Original Message-----
From: Hu, Jian
Sent: Wednesday, October 10, 2007 12:58 PM
To: Carrafiello, Crystal; Steckert, Marianne; Yoshizawa, Yuri; Kolchinsky, Eric; Trefflich, Kara; Adler, Michael; Trier, Nathan; Fu, Yvonne; Cantor, Richard; Kanef, Michael; Teicher, David; Thomas, Julia; Adler, Michelle; Weill, Nicolas; Polansky, Jonathan; Robinson, Claire; Kornfeld, Warren; Leshko, Courtney; Jonas, Gregory; Liberman, Jessica; Harris, Gus; Park, John; Kimon, Noel; Hemmerling, Brett; Osborne, Timothy; Mirenda, Anthony (Tony); Laserson, Fran; Huber, Linda
Subject: RE: Fitch's teleconference presentation and questions from their Q&A

Also, CreditFlux sent out an alert on a S&P conference yesterday:

S&P says it underestimated extent of fraud in subprime industry

News Digest, 9 October 2007

At a conference today, S&P said it underestimated the extent of fraud in the subprime industry. The agency's chief economist David Wyss said the US subprime housing crisis will not reach its peak until 2009. He said the extent of fraud in the subprime industry increased sharply in 2006. He added that US economic growth will lag at 2% in 2007 and 2008, down from 2.9% in 2006. Due to the subprime crisis, he said the US would contribute only 9% of world growth in 2007

Regards,

Jian Hu
Structured Finance - CDOs/Derivatives
Moody's Investors Service
Tel: 212.553.7855

-----Original Message-----
From: Carrafiello, Crystal
Sent: Wednesday, October 10, 2007 12:45 PM
To: Steckert, Marianne; Yoshizawa, Yuri; Kolchinsky, Eric; Trefflich, Kara; Adler, Michael; Trier, Nathan; Fu, Yvonne; Cantor, Richard; Kanef, Michael; Teicher, David; Thomas, Julia; Adler, Michelle; Weill, Nicolas; Polansky, Jonathan; Robinson, Claire; Kornfeld, Warren; Leshko, Courtney; Jonas, Gregory; Liberman, Jessica; Harris, Gus; Park, John; Kirnon, Noel; Hemmerling, Brett; Osborne, Timothy; Hu, Jian; Mirenda, Anthony (Tony); Laserson, Fran; Huber, Linda
Subject: Fitch's teleconference presentation and questions from their Q&A

A little intelligence from Fitch's recent teleconference that may assist in your preparation.

Slides from their presentation attached.

<< File: Fitch Slides.pdf >>

Some key points:

- A whole section is devoted to closed-end seconds, which they were just getting around to.
- They noted that they have chosen to take aggressive action to give the best estimate as to where they think the ratings are going, rather than engage in more mild, but serial downgrades, which does not serve the market
- They confirmed 100% of first-lien backed AAAs
- If I am interpreting the transition matrix on slide 17 correctly, about 11% of triple-B's downgraded went to single B and less than 2% to triple-C.
- They do not appear to have left any rating classes under review
- They indicated they will do another full review of the 2006 vintage in 6 months.
- They noted that they are likewise currently reviewing 1st half '07 deals.
- They focused solely on the RMBS and did not provide projections of likely CDO rating impact.

- There was some discussion of how they look at home price appreciation and other statistics on a state-by-state basis and that next month they will be upgrading their model to take in differences by the top 50 US metropolitan markets.

Questions asked during the Q&A

- What is the rationale for reviewing the '07 transactions so soon after rating them?
- How can you square your assumptions on underlying home price appreciation with that reflected in the performance of the ABX?
- The 2005 vintage is just facing resets and we are already seeing significant deterioration in terms of delinquencies. What are your expectations on initial 90-day delinquencies and what type of roll-rates are you using from there?
- The availability of credit has changed substantially, impacting the ability to refinance. How have you adjusted your models to reflect this?
- The market's perception is that ratings continue to lag. Can you provide us confidence that, as you have stated, this is not just one in a "stair-step" approach to rating revisions?
- How do you see the performance of first liens without a second lien to first liens with a second lien?
- Where do you think we stand in terms of the ARM resets for RMBS?
- Do you believe that there is a high percentage of fraudulent loans, particularly among the second liens, and that after they are removed, the rest of the pool will perform better?
- Apparently another rating agency has said that they may have to take additional actions as the result of lower-than-expected levels of loan modifications. Does Fitch share that concern?
- Has your model factored in the impact of a recession and or are we likely to be on a similar call 6 months from now hearing "who knew we were going to have a recession?" How resilient would the triple-B's and below-investment-grade ratings be relative to the triple-A's?
- Is Fitch taking more actions because it is rating worse deals?
- How do the rating actions flow through to the mezzanine CDOs and is the way that you are looking at these loss projections different from the views of the CDO team?
- What is your thinking on the impact of foreclosure processing? Is the deluge problematic in terms of timelines and loss severities?
- How are you stress-testing the capacity of the servicers in your rating methodology for them?

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1238

Goldman Sachs Expected Profit from RMBS Securitizations

June 2005 - August 2007

Expected Settlement Date	Deal Size [Approximate]	Securitization	Certification	Expected Profit [Approximate]
June 29, 2005	970,327,831	GSAMP Trust 2006-NC2	Mortage Pass Through Certificates, Series 2006-NC2	3,000,000
December 29, 2005	752,357,110	GSAMP Trust 2005-HE6	Mortage Pass Through Certificates, Series 2005-HE6	1,000,000
February 17, 2006	936,138,197	GSAMP Trust 2006-HE1	Mortage Pass Through Certificates, Series 2006-HE1	1,000,000
February 23, 2006	972,554,859	FFMLT Trust 2006-FF3	Mortage Pass Through Certificates, Series 2006-FF3	2,000,000
March 29, 2006	809,746,321	GSAMP Trust 2006-HE2	Mortage Pass Through Certificates, Series 2006-HE2	2,000,000
March 30, 2006	1,509,335,061	GSAMP Trust 2006-FF4	Mortage Pass Through Certificates, Series 2006-FF4	8,000,000
April 27, 2006	486,629,500	GSAMP Trust 2006-S3	Mortage Pass Through Certificates, Series 2006-S3	2,000,000
April 28, 2006	60,030,000	GSMSC Pass-Through Trust 2006-2R	Pass-Through Certificates, Series 2006-2R	6,000,000
April 28, 2006	949,194,951	GSAMP Trust 2006-FM1	Mortage Pass Through Certificates, Series 2006-FM1	8,000,000
May 16, 2006	359,326,855	FFMLT Trust 2006-FF6	Mortage Pass Through Certificates, Series 2006-FF6	1,000,000
May 26, 2006	1,573,244,000	GSAMP Trust 2006-HE3	Mortage Pass Through Certificates, Series 2006-HE3	5,000,000
May 30, 2006	1,175,955,655	Wells Fargo Home Equity Asset-Backed Securities 2006-1 Trust	Home Equity Asset-Backed Certificates, Series 2006-1	1,000,000
June 9, 2006	651,018,182	GSAMP Trust 2006-S4	Mortage Pass Through Certificates, Series 2006-S4	6,000,000
June 30, 2006	992,270,000	GSAMP Trust 2006 HE-4	Mortage Pass Through Certificates, Series 2006-HE4	3,000,000
July 13, 2006	345,085,606	GSAMP Trust 2006-S5	Mortage Pass Through Certificates, Series 2006-S5	8,000,000
August 25, 2006	1,016,102,000	GSAMP Trust 2006-HE5	Mortage Pass Through Certificates, Series 2006-HE5	2,000,000
September 27, 2006	1,001,909,809	GSAMP Trust 2006-FM2	Mortage Pass Through Certificates, Series 2006-FM2	1,000,000
September 28, 2006	2,082,713,112	GSAMP Trust 2006-FF-13	Mortage Pass Through Certificates, Series 2006 FF-13	2,000,000
October 13, 2006	338,821,000	GSAMP Trust 2006-S6	Mortage Pass Through Certificates, Series 2006-S6	4,000,000
October 30, 2006	874,191,130	GSAMP Trust 2006-HE7	Mortage Pass Through Certificates, Series 2006-HE7	2,000,000
December 20, 2006	[Group I: 67,124,073] + [Group II: 337,355,439] = 404,479,512	GSAMP Trust 2006-S7	Mortage Pass Through Certificates, Series 2006-S7	7,000,000
December 20, 2006	751,921,900	GSAMP Trust 2006-FM3	Mortage Pass Through Certificates, Series 2006-FM3	1,500,000
December 27, 2006	1,028,228,000	GSAMP Trust 2006-HE8	Mortage Pass Through Certificates, Series 2006-HE8	2,000,000
January 25, 2007	720,760,000	GSAMP Trust 2007-FM1	Mortage Pass Through Certificates, Series 2007-FM1	1,000,000
January 31, 2007	292,722,704	GSAMP Trust 2007-H1	Mortage Pass Through Certificates, Series 2007-HE1	400,000
February 20, 2007	1,858,511,000	GSAMP Trust 2007-NC1	Mortage Pass Through Certificates, Series 2007-NC1	2,000,000
February 22, 2007	642,014,000	GSAMP Trust 2007-HE1	Mortage Pass Through Certificates, Series 2007-HE1	1,000,000
February 22, 2007	648,356,000	GSAMP Trust 2007-HE1	Mortage Pass Through Certificates, Series 2007-HE1	700,000
February 22, 2007	1,007,881,000	GSAMP Trust 2007-FM2	Mortage Pass Through Certificates, Series 2007-FM2	1,250,000
February 28, 2007	306,179,642	GSAMP Trust 2007-S1	Mortage Pass Through Certificates, Series 2007-S1	6,000,000
April 12, 2007	953,546,000	GSAMP Trust 2007-HE2	Mortage Pass Through Certificates, Series 2007-HE2	250,000
April 17, 2007	144,439,000	GSR 2007-HEL1	Mortage Pass Through Certificates, Series 2007-1	500,000
April 26, 2007	419,650,346	FFMLT 2007-FFB-SS	Mortage Pass Through Certificates, Series 2007-FFB-SS	3,000,000
August 30, 2007	700,500,000	GSAMP Trust 2007-HSBS	Mortage Pass Through Certificates, Series 2007-HSBC	15,000,000

Total Deal Value: $27,736,140,283

Total Profit Value: $109,600,000

Smallest Profit: $250,000

Largest Profit: $15,000,000

Average Profit: $3,131,428

Source: Goldman Sachs documents

Prepared by U.S. Senate Permanent Subcommittee on Investigations, February 2011

Net Revenues from ABS Products Backed by U.S. Residential Mortgages*

Business Unit	28-Feb-07	31-Mar-07	2007	2008	Total 2007-2008
ABS Secondary Trading	211,590,808	200,727,927	869,653,630	486,916,368	1,356,569,998
ABS Correlation Trading	60,566,887	77,304,095	308,550,000	95,848,354	404,398,354
CDO Primary Issue	(18,327,179)	(18,312,631)	(791,915,674)	(225,658,251)	(1,017,573,925)
ABS CDO Legacy[†]	-	-	-	(132,517,231)	(132,517,231)
RMBS	116,956,270	181,334,847	(459,859,880)	(2,994,238,224)	(3,454,098,104)
Special Products Group -- Asset Finance	614,876	476,984	7,493,385	(409,585,890)	(402,092,505)
Special Products Group -- Risk Trading	(18,317)	(9,539,371)	(119,881,710)	6,301,943	(113,579,767)
Winchester Capital	42,770,439	29,938,219	(609,538,301)	(489,032,940)	(1,098,571,241)
Total	432,480,963	480,242,701	(795,498,550)	(3,661,965,871)	(4,457,464,421)

* The information set forth herein does not reflect net revenues for CDO Secondary Trading. These data are not readily available because the trading book files used to derive the requested information combine CDO and CLO Secondary Trading, without providing separate breakouts for these assets.

† "ABS CDO Legacy" is a London-based Deutsche Bank account which purchased positions from CDO Primary Issue in September 2007.

2008 U.S. CDO Outlook and 2007 Review:

Issuance Down in 2007 Triggered by Subprime Mortgages Meltdown; Lower Overall Issuance Expected in 2008

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1 Jeremy Gluck contributed to this report as a research consultant. Suzanna Sava contributed data to this report.

CONTENTS:

1. SUMMARY

2008 OUTLOOK

To increase transparency on the macroeconomic and financial framework that underpins its risk assessments, Moody's has published a baseline outlook for the global economy, as well as three potential economic risk scenarios. These economic scenarios are intended to help Moody's analysts formulate the outlooks for their specific markets using a consistent set of assumptions that envisage various stressed economic and financial conditions.

The baseline outlook is inspired by major international organizations' economic outlooks. For 2008-2009, we assume robust yet more moderate global growth. However, it is also expected that there will be increased differentiation across geographies - specifically, a moderate downturn in the U.S. (and to a much lesser extent other mature market economies) and continued fast growth in emerging economies. This baseline outlook is affected by an unusually large degree of uncertainty, mostly related to the impact of credit tightening.

Moody's industry outlook for the mortgage sector in the U.S. is negative. Further declines in home prices combined with weaker economic fundamentals and credit tightening will continue to increase residential mortgage related delinquencies and losses for most of 2008.[2]

Moody's and other market participants currently project double-digit peak-to-trough home price declines, which are expected to contribute to further deterioration in the performance of subprime and Alt-A mortgage pools. As detailed in its updated loss projections for 2006 subprime loans, Moody's views on 2006 vintage subprime pools have become more bearish in recent months, with various stress scenarios resulting in a range of average projected losses, from 12% up to 24% depending on the scenario.[3] It is expected that during the coming year deteriorating performance will continue to affect the ratings of many subprime RMBS originated in 2006 and early 2007, which will in turn affect a significant portion of the structured finance CDO sector.

A major question mark for 2008 is a recovery in investors' confidence. A recovery is unlikely until the effects of the subprime crisis have been fully measured, especially the effects on financial institutions. The turn in the credit cycle and the projected increase in corporate default rates may also start affecting the performance of corporate issuers and therefore heighten investors' caution in CDOs backed by corporate credits.[4]

In addition to performance considerations, investor demand will also be driven by the market's capacity to respond to an increased desire for information transparency in terms of underlying collateral and structural risks, so that investors can focus on deep fundamental analysis and apply sound judgment. Lessons have also been learned through the crisis with respect to the robustness of certain structures exposed to large market-value or correlation risks.

In terms of new issuance, we expect minimal SF CDO issuance in 2008. Cash-flow CLO issuance will be increasingly active during the year, but a lot will be dependent on the conditions in the primary leveraged loan market and the arbitrage opportunity of structuring CLOs. We expect synthetic corporate CDO issuance to slow down substantially in 2008.

In terms of rating performance, we expect to see significantly negative rating activity on SF CDOs during 2008 given Moody's higher loss projections on subprime mortgages. In addition, continued concerns about the credit markets, rising default rates and an overhang from the supply pipeline are likely to keep the leveraged loan market in a state of volatility at least during the first half of 2008. Currently, we do not expect this volatility pressure to be sufficient to induce significant downgrades of CLO liabilities thanks to prudent modeling assumptions and numerous structural enhancements. The projected increase in the U.S. corporate default rate is also partly captured in the ratings of the corporate loans that back CLOs. Additionally, loan default rates have historically been lower than bond default rates and Moody's projected loan default rate is also lower than the projected corporate default rate.[5]

More generally, given that we believe the deterioration in corporate credit quality is likely to continue, the performance of synthetic arbitrage corporate CDO portfolios is expected to weaken. The reduction of risk linked to CDO maturity shortening should, nevertheless, continue to partially offset this trend. The performance of investment-grade CDO deals with significant exposures to financials and housing-related credits will also be tested.

2007 REVIEW

The Collateralized Debt Obligation (CDO) market in the U.S. was very active in terms of issuance throughout the first half of 2007. That was before the subprime market crisis and general credit turmoil of

2 Beyond the general macroeconomic outlook, Moody's will additionally present its Outlook for the general credit fundamentals of the major structured finance sectors as well as various CDO sub-sectors. The Outlooks are intended to cover a period of 12 to 18 months and will be updated periodically on an as-needed basis. Moody's currently assigns five categories of collateral performance Outlook: Positive, Positive/Stable, Stable, Stable/Negative, and Negative. For example, a Stable/Negative collateral performance outlook indicates that the asset class is not expected to perform as well over the next year as it is performing currently.

3 See "Moody's Updates Loss Projections for 2006 Subprime Loans," Moody's Structured Finance Special Report, January 2008.

4 See "Monthly Default Report - January 2008," Moody's Global Credit Research, February 12, 2008.

5 See Moody's Special Comment, "Syndicated Bank Loans: 2007 Default Review and 2008 Outlook," January 2008.

the second half. In terms of performance and structural challenges, 2007 proved momentous, probably the most important year thus far in the history of CDOs.[6]

The most significant development in 2007 was certainly the U.S. subprime mortgage fallout. A confluence of factors has led to unprecedented deterioration in the subprime mortgage market. Important factors include the extended period of global excess liquidity that preceded it, the loose underwriting and lending standards during the peak of the subprime market boom in 2006, and the dramatic slowdown in the U.S. housing market.

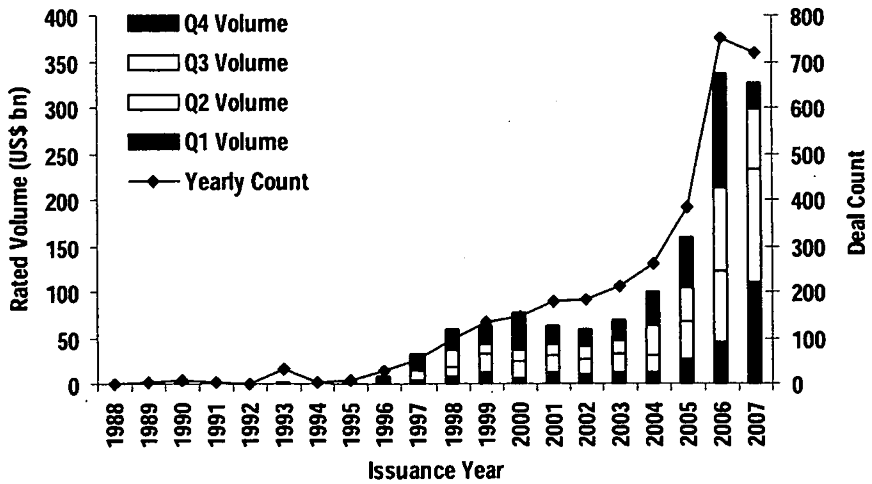
Those U.S. Structured Finance CDOs (SF CDOs) that were exposed to significantly deteriorated subprime RMBS assets experienced significant downgrade activity by year-end.[7] Uncertainty about the future performance of CDO assets and the complexity of CDO structures exacerbated illiquidity in the CDO market and heightened investors' caution toward structured finance products. As a result, we have seen a severe liquidity squeeze and drop in market value across virtually all structured asset classes, resulting in a significant amount of rating actions toward market-value structures.

In the U.S. leveraged loan market, activity set new records in the first half of the year as reflected in issuance amounts, leverage multiples, covenant restrictions and pricing levels.[8] The introduction of the LCDX in May 2007 was another significant development in the leveraged loan market. However, the underlying attractive conditions in the market driving these trends evaporated over the summer, and speculative-grade debt issuance, including leveraged loans, dropped precipitously after July. There was concurrently a significant increase in the collateralized loan obligation (CLO) risk premium, and, after several years of vigorous growth, the leveraged loan CLO market experienced a slowdown in issuance.

2. U.S. CDO ISSUANCE FELL FOR THE FIRST TIME SINCE 2002

U.S. CDO issuance, whether measured by number of transactions or the dollar volume of liabilities, fell in 2007 (*Figure 1*). This decline in rated volume was the first since 2002, while the CDO transaction count had not fallen since 1994. But the apparently modest slowing of annual issuance activity belies the sharp change in the market environment that occurred around the middle of 2007. For example, though annual CDO issuance (dollar volume of liabilities) declined by just 3.2%, 2007 H2 volume was fully 56.3% below that of 2006 H2.

Figure 1
U.S. CDO Rated Volume and Deal Count



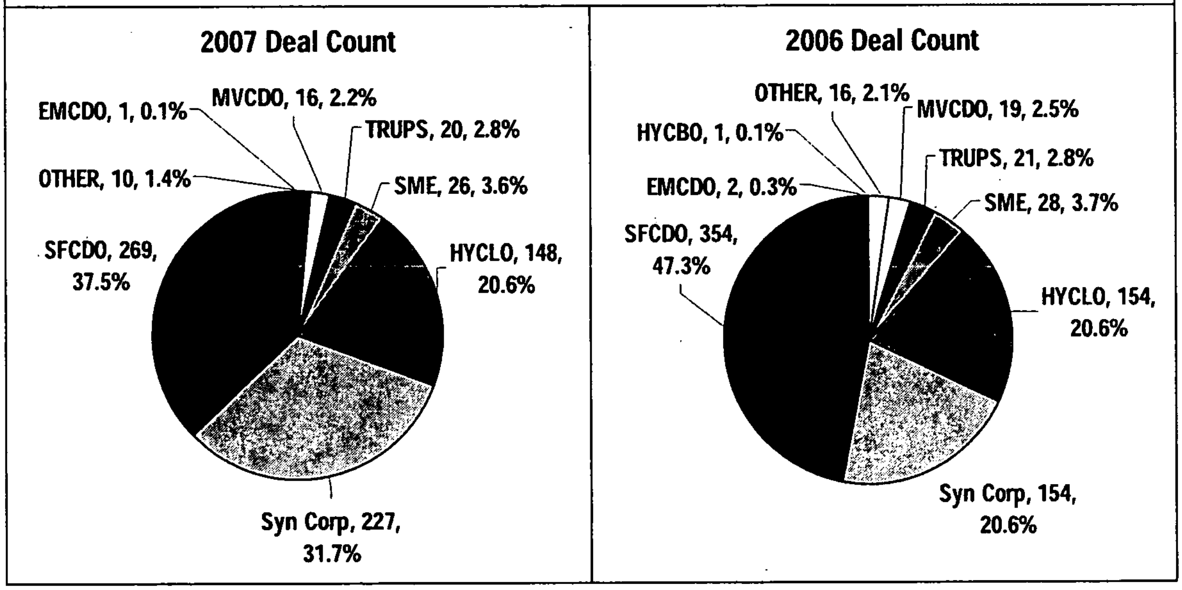
6 For 2007 review and 2008 outlook of EMEA CDOs, see "2007 Review & 2008 Outlook - EMEA Callateralised Debt Obligations: Strong First Half in 2007 Diluted by Global Credit Crisis; Lower Issuance Expected in 2008 Reflecting Continued Market Disruptions," February 4, 2008.
7 See "U.S. Subprime RMBS 2005-2007 Vintage Rating Actions: January 2008," February 2008, and "Structured Finance CDO Rating Surveillance Report: December 2007," January 2008.
8 See "2007 U.S. Cash-Flow CLO Review and 2008 Outlook," February 2008.

3. WHILE SLIGHTLY DOWN IN VOLUME, SF CDOS AND CLOS CONTINUED TO DOMINATE U.S. CDO ISSUANCE IN 2007

By CDO type, the composition in 2007 was not very different from the previous year (*Figures 2 and 3*). Structured Finance (SF) CDOs, synthetic corporate CDOs and CLOs (including HY CLOs and SME CLOs) again accounted for the vast majority of U.S. transactions in 2007 (about 90% by both transaction count and dollar volume of rated issuance). The most substantial change was that the proportion of SF CDOs within the overall CDO sector dropped both by transaction count and rated volume. Meanwhile, the share of CLOs remained largely unchanged (by deal count) or slightly higher (by dollar volume) compared to 2006, whereas the share of synthetic corporate CDO transactions rose sharply. In addition, the shares of Market-Value and TRUPS CDOs were largely similar (by deal count) between 2007 and 2006.[9]

Specifically, Moody's rated 269 SF CDO transactions totaling approximately US$159.8 billion in 2007, down more than 20% from the 354 SF CDO transactions totaling roughly US$200.6 billion rated in 2006. Moody's also rated 174 CLO transactions (including SME CLOs) totaling US$91.2 billion in 2007, compared to 182 transactions totaling US$87.2 billion rated in 2006. Additionally, *Figure 3* demonstrates that despite a decline in the number of CLOs in 2007, there was an increase in rated CLO volume, thanks to a few very large (multi-billion dollar) CLO deals rated during the year.[10]

Figure 2
Number of U.S. CDO Deals by Deal Type[11]

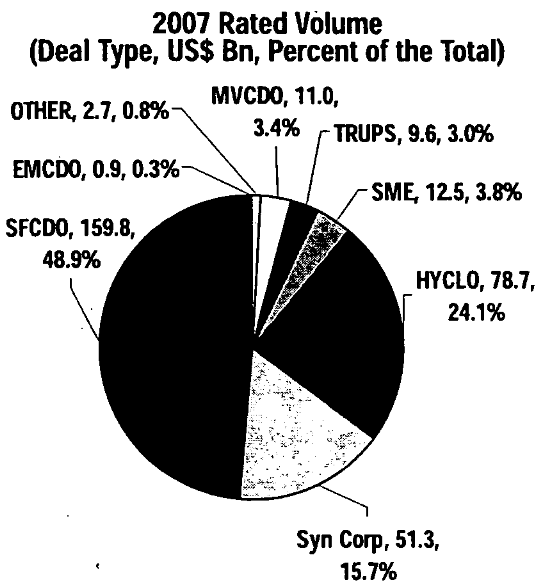


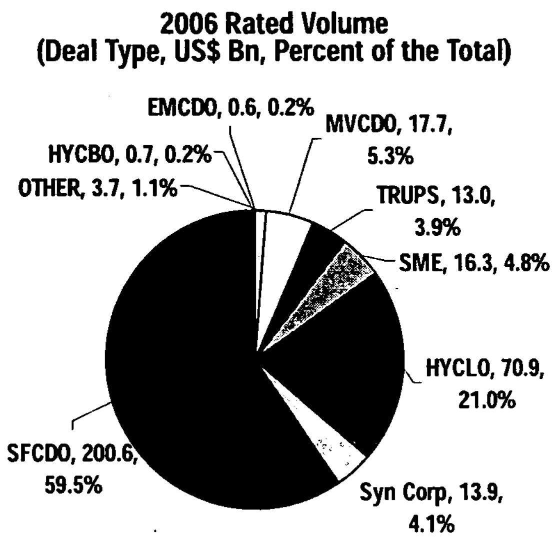
9 Rated synthetic CDO volumes can be misleading because transaction sponsors may choose to sell single tranches, or the entire capital structure of the transactions. In particular, the selling or retention of supersenior tranches greatly affects volume figures. The synthetic CDO transaction count rose by 32 percent.

10 See Moody's Special Comment, "U.S. CLOs 2007 Review and 2008 Outlook," February 2008.

11 Deal type notation: "EMCDO" stands for emerging-market CDO, "HYCBO" stands for high-yield collateralized bond obligations (CBO), "HYCLO" stands for high-yield collateralized loan obligations (CLO), "MVCDO" stands for market-value CDO, "SME" stands for small-medium enterprise loan CLOs, "SF CDO" stands for structured-finance CDO, "TRUPS" stands for CDO backed by trust preferred securities, "Syn Corp" stands for synthetic corporate CDO. The "OTHER" category includes collateralized fund obligation (CFO), ith-to-default, CDO backed by distressed debt, and catastrophic (CAT) bonds. In addition, Credit Derivative Product Companies (CDPC) are not included in the data sample of this report. Please see "2007 U.S. Credit Derivative Product Companies Review and 2008 Outlook," Moody's Structured Finance Special Report, March 2008.

Figure 3
Rated Volume of U.S. CDOs by Deal Type





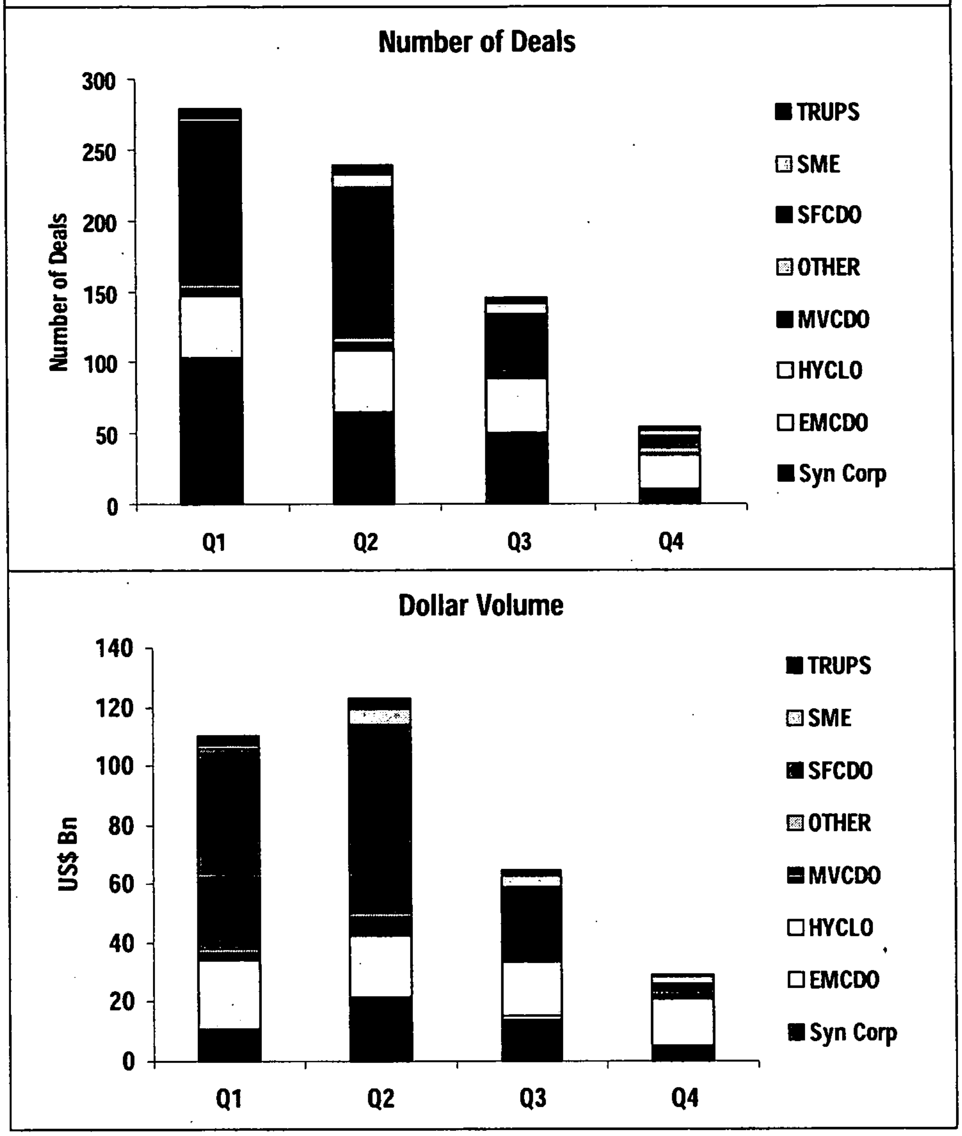
4. STRONG FIRST AND SECOND QUARTERS OFFSET DECLINES IN THE THIRD AND FOURTH QUARTERS OF 2007

The year 2007 saw a sea change for the CDO market. Moody's rated more than 100 SF CDO transactions in each of the first two quarters, but the number fell sharply to 40 in the third quarter and to just eight in the fourth quarter as the sheer speed and magnitude of the subprime mortgage fallout significantly weakened investors' confidence. In fact, the overall CDO market nearly seized up by the fourth quarter, during which Moody's rated just over 50 deals totaling US$28.9 billion, compared to 250 deals totaling US$124.2 billion in the fourth quarter of 2006. *Figure 4* depicts the drop in rated deals by quarter in 2007.

As a result, SF CDOs accounted for 56.8% of U.S. CDO issuance (by dollar volume) during 2007 H1, but only for 29.5% in 2007 H2. Though CLO volume was also adversely affected by the credit crisis, the strong historical performance of CLOs and lack of a direct connection to the mortgage markets kept issuance from contracting as sharply as that of SF CDOs. A consequence was a substantial increase in the share of CLOs within U.S. CDO issuance-from approximately 21.8% in 07H1 to 43.2% by 07H2 (and 62.9% in the fourth quarter) by dollar volume.

Figure 4

Number and Dollar Volume of U.S. CDO Deals Rated in 2007



5. UNPRECEDENTED SF CDO DOWNGRADES IN 2007 SHATTER HISTORICAL RECORD

As a result of the subprime mortgage crisis and its severe impact on the ratings of RMBS/HEL tranches purchased by SF CDOs (including CDOs of CDOs) and other CDOs, the scope and degree of CDO downgrades in 2007 was unprecedented (*Figure 5*). Moody's took a record 1,655 downgrade actions (including multiple rating actions on the same tranche during the year), roughly ten times the number of downgrade actions in 2006 and twice as many as in 2002, which had been the most volatile year for CDOs before 2007.

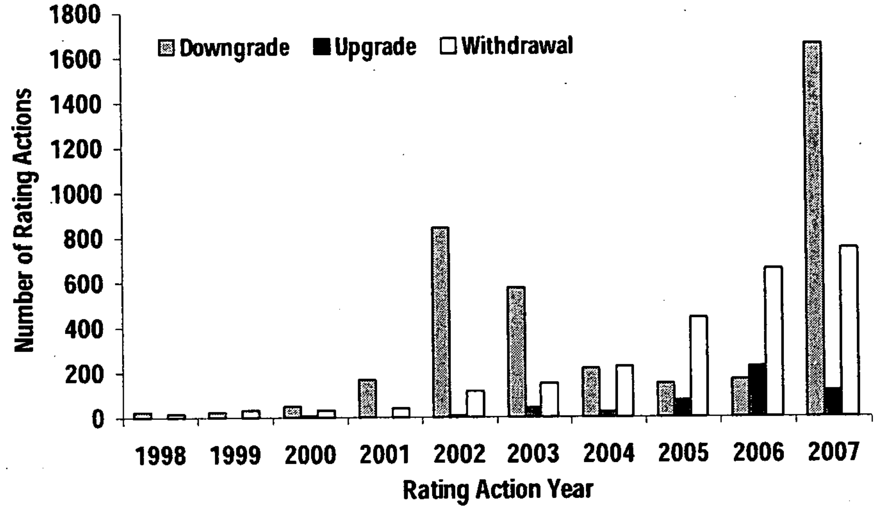
The magnitude of the downgrades was also large by historical standards. On average, tranches that were downgraded during 2007 had their ratings lowered by roughly seven notches, compared to a pre-2007 norm of around three or four notches. Interested readers can find more detailed statistics of SF CDO rating actions in the Moody's monthly publication, "Structured Finance CDO Rating Surveillance Brief."[12]

12 See for example, "Structured Finance CDO Rating Surveillance Brief: December 2007," January 17, 2008.

As difficult as the structured credit environment was in 2007, corporate credit performance was only modestly affected by the turmoil in the housing market during the year. The absolute number of CDO upgrade actions declined in 2007 vis-à-vis 2006 as concerns grew on the potential spill-over effect of the subprime mortgage crisis on the broad economy and the corporate sector (*Figure 5*). In addition to the subprime stress that dramatically affected SF CDOs, potential upgrades were limited by a declining number of older, deleveraging high-yield CBOs/CLOs.

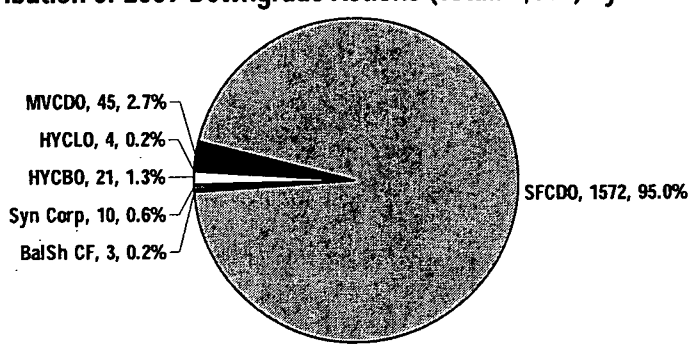
While the absolute number of withdrawals increased in 2007, the figure relative to beginning-of-year outstanding ratings declined in comparison to 2006. As noted below, some withdrawals (of Market-Value CDOs) were associated with negative credit developments. The number of CLO withdrawals also declined, partly because the incentive to refinance older CLOs diminished as credit spreads widened in mid-2007.

Figure 5
Number of U.S. CDO Rating Actions (Downgrades, Upgrades, and Withdrawals)



The vast majority (about 95%) of the downgrade actions in 2007 occurred with respect to SF CDOs (*Figure 6*).[13] Consistent with the development of the subprime mortgage problem, the downgrades were focused on the CDOs that purchased RMBS/HEL collateral from the 2006-2007 vintages (or that purchased other CDOs with such exposures). CDOs backed by earlier vintage subprime RMBS assets were not materially affected.

Figure 6
Distribution of 2007 Downgrade Actions (Total: 1,655) by Deal Type

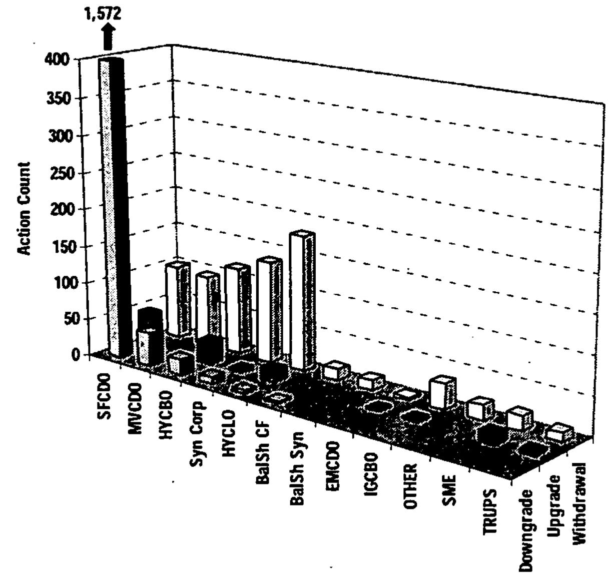


13 Multiple actions on the same tranche are counted separately. While the figures may be slightly different, our commentaries remain unchanged if the count and percentage are based on distinct tranches, which are used to compute rating action statistics in a monthly Special Report "Structured Finance CDO Ratings Surveillance Brief". In addition, Moody's will soon release its annual credit migration study for CDOs in a separate Special Report.

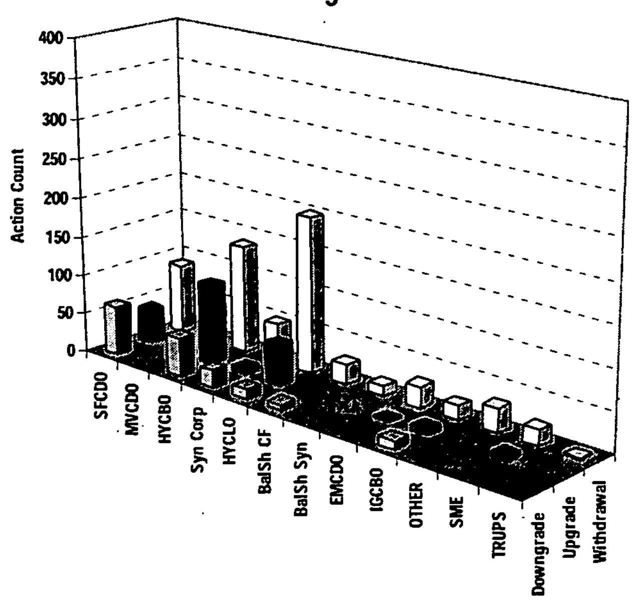
Though small in absolute number, a significant proportion of Market-Value (MV) CDO tranches-roughly 15% of the total outstanding at the beginning of July--were also downgraded. These transactions also came under stress during the credit/liquidity crisis in the second half of 2007. Those MV CDOs that held RMBS collateral were, of course, most sharply affected. The transactions were forced to at least partially liquidate assets in order to maintain required overcollateralization ratios in the highly illiquid environment of 2007 H2. The sales occurred at the same time that other entities, such as Structured Investment Vehicles ("SIV"), were liquidating similar instruments, putting further downward pressure on liquidation proceeds. Eighty-six tranches from five MV CDOs were completely liquidated during the year, contributing to an unusually large number of withdrawn ratings for these transactions (*Figures 7 and 8*).[14]

Figure 7
Number of U.S. CDO Rating Actions by Deal Type

2007 Rating Actions



2006 Rating Actions



14 Catastrophic risk (CAT) bonds in the "OTHER" category have become increasingly popular among investors due to the uncorrelated nature between natural catastrophic events and credit market cycles. Moody's rated eleven CAT bond transactions in 2006 and seven in 2007, compared to seven rated transactions in 2004 and three transactions in 2005. We expect CAT bond issuance to remain healthy in 2008.

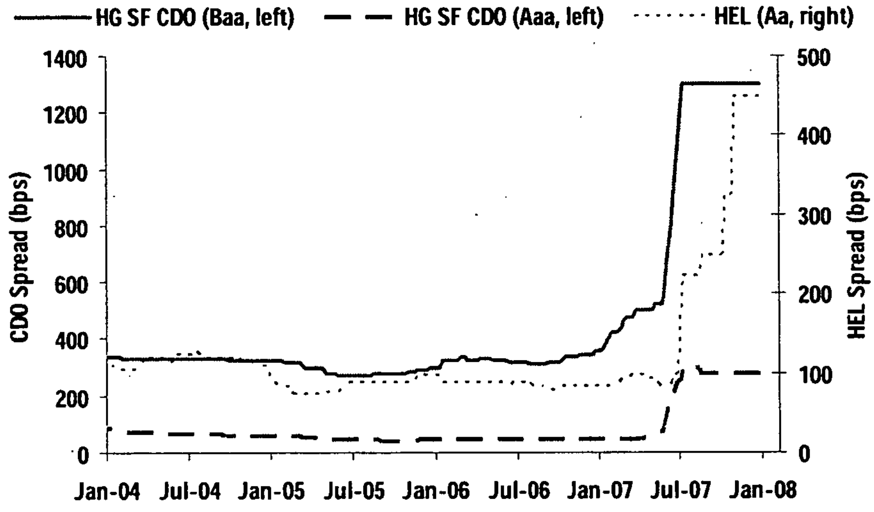
6. OVERALL U.S. FINANCIAL MARKET CONDITIONS REMAIN DIFFICULT HEADING INTO 2008

There is little expectation that CDO performance will quickly turn around in 2008. The difficult market conditions that prevailed during the second half of 2007 remain. While credit spreads have widened in general, the increases have been particularly sharp for CDO liabilities (*Figures 8-10*). The most notable jump has been in the spreads for SF CDO liabilities, which have more than tripled at the Baa level and increased more than five times at the Aaa level during the last year. Of course, spreads on the underlying HEL securities that have backed many of these transactions have also jumped (from 85 bps to 450 bps for Aa HEL securities), but not to the point where expected returns can foster significant market demand for SF CDO liabilities.[15]

Spreads for other CDO liabilities, such as those issued by CLOs and synthetic CDOs were significantly impacted by the spill-over effect of the subprime market crisis and increased sharply as well. On a relative basis, most of these increases were similar to those for SF CDO obligations while the spreads of the underlying corporate assets did not increase as much. For example, Aaa CLO spreads jumped from 24 bps to 95 bps from the beginning to the end of last year, whereas single-B leveraged loan spreads rose from roughly 270 bps to 350 bps during the same period.[16] In some cases, the relative increases in spreads such as those for Aaa-rated synthetic corporate CDO liabilities were even larger (leaped by more than six times) than for SF CDO liabilities.[17]

Figure 8

Spreads of High-Grade SF CDO Liabilities Compared with Spreads of HEL (Subprime RMBS) Securities in 2007

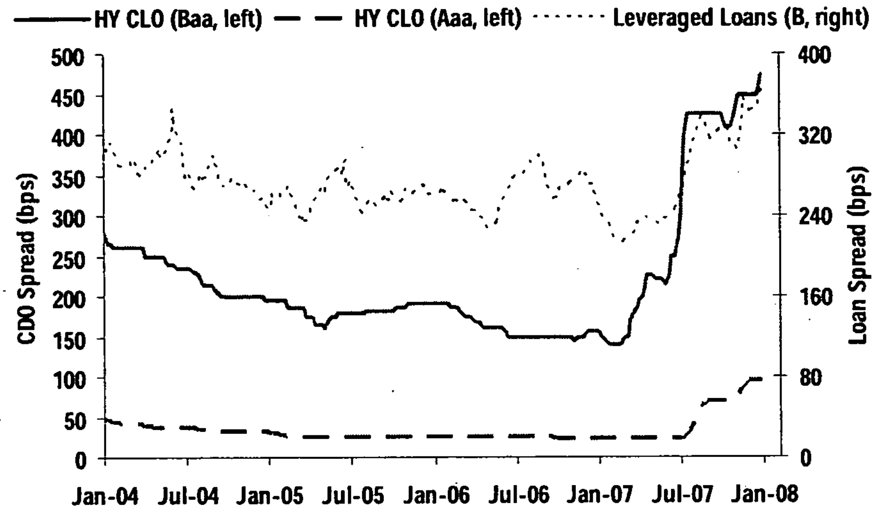


Source: JP Morgan

15 In the absence of a significant number of new SF CDO transactions, these liability spreads are best viewed as indicative, rather than well-defined averages.
16 The average rating of a CLO portfolio is in the single-B range.
17 The spreads on CDO liabilities have continued to rise in the first two months of 2008. As of February 22, 2008, the indicative spread of senior Aaa HG SF CDOs stood above 500 bps, whereas the spread of Aaa U.S. CLOs was about 185 bps.

Figure 9

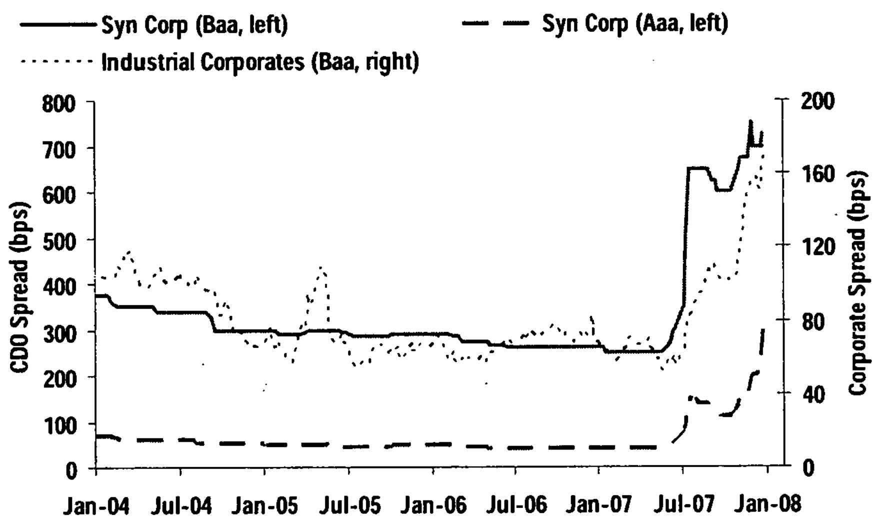
Spreads of U.S. CLO Liabilities Compared with Spreads of U.S. Leveraged Loans in 2007



Source: JP Morgan

Figure 10

Spreads of Synthetic Corporate CDO Liabilities Compared with Spreads of Industrial Corporates in 2007

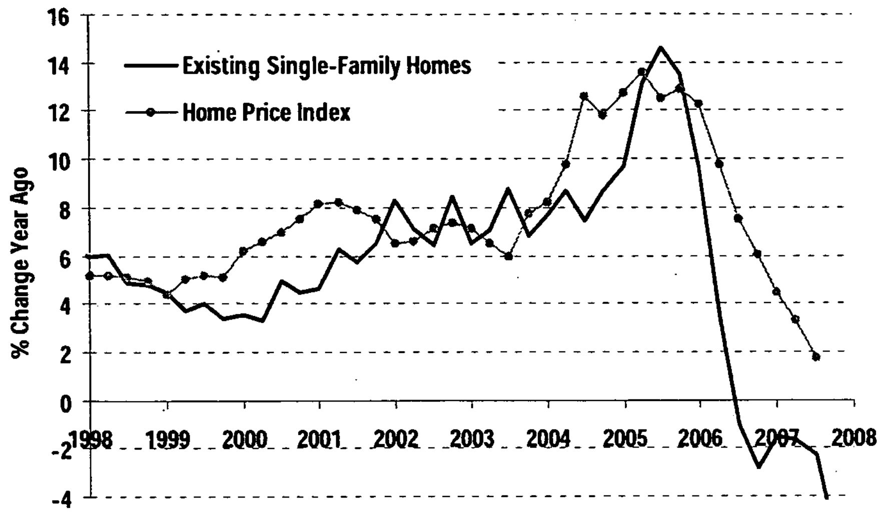


Source: JP Morgan

The real economy has already slowed and some analysts believe the U.S. has already entered a recession. In particular, both home sales and home prices have deteriorated to an extent not seen in decades (*Figure 11*). Delinquency rates for 2006 and 2007 mortgage loans continue to significantly exceed those of earlier cohorts (*Figure 12*).

Figure 11

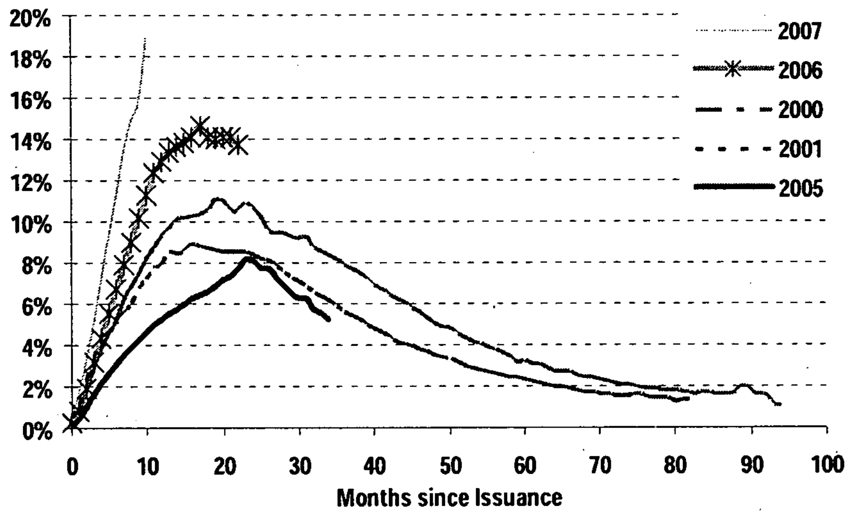
U.S Housing Market Condition Continues to Deteriorate



Sources: NAR (median sales price for existing single family homes), OFHEO (home price index)

Figure 12

2006/2007-Vintage Subprime Mortgage Delinquency Rates Continue Rising



Source: Moody's Investors Service

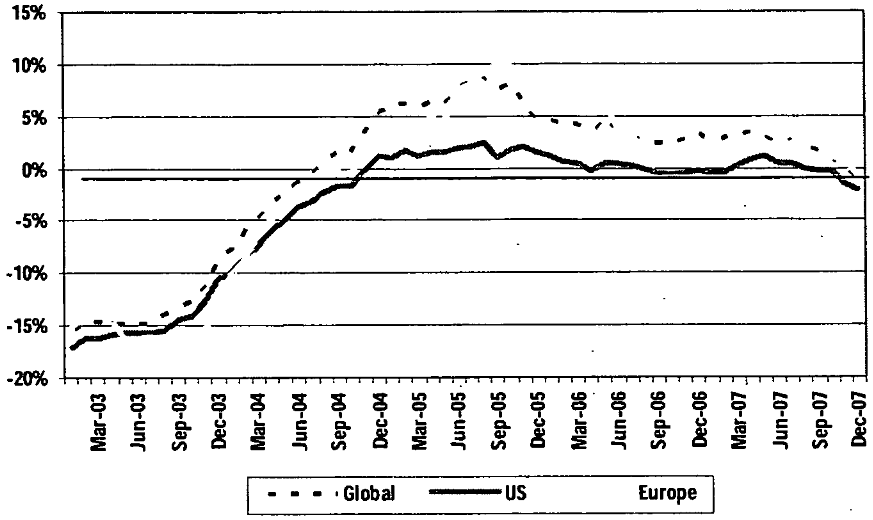
The slumping housing sector, its spill-over into financial markets and the slowing of the U.S. general economy have begun to have an adverse impact on Moody's corporate ratings. *Figure 13* shows that the 12-month trailing ratings drift (the difference between upgrades and downgrades relative to outstanding ratings) turned negative in the latter part of 2007.

Moody's anticipates a sharp rise in U.S. defaults during 2008 in comparison with recent years (*Figure 14*). Moody's baseline forecast is for an increase in the trailing 12-month speculative-grade default rate from just 0.9% in 2007 to 5.3%, a level slightly above the historical average of 4.7%, by the end of 2008.[18] Moody's pessimistic case contemplates default rates similar to the double-digit peaks that occurred during the 1991-1992 and 2001-2002 periods.

18 Moody's expects that the speculative-grade U.S. loan default rate will increase to approximately 3.0% from its current 0.1% by the end of 2008. See Moody's Special Comment, "Syndicated Bank Loans: 2007 Default Review and 2008 Outlook," January 2008.

Figure 13

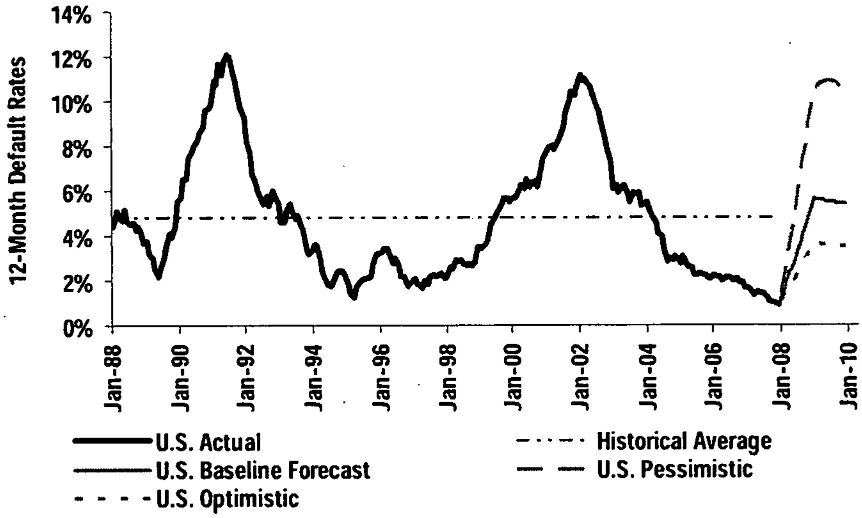
Corporate Credit Quality (Trailing 12-Month Rating Drift) Has Trended Lower



Source: Moody's Investors Service. Rating drift=(issuer upgrades-issuer downgrades)/Rated Issuers

Figure 14

12-Month U.S. Speculative-Grade Default Rate Is Expected to Rise to the Historical Average Level



Source: Moody's Investors Service

7. GENERALLY SLOWER ISSUANCE AND MORE NEGATIVE RATING ACTIVITY ARE EXPECTED IN 2008

ISSUANCE ACTIVITY OUTLOOK

The difficult market and real-sector conditions that are likely to prevail during 2008 will continue to pressure both CDO activity and performance. We anticipate declining activity across all CDO types with the sharpest downturn naturally in the SF CDO sector. The heightened asset price volatility in the current environment will also reduce the demand for market-value structures. Even sectors that have exhibited strong historical performance, such as CLOs and TRUPS CDOs, will slow in 2008.[19] We expect the bulk of issuance activity in 2008 to revolve around cash-flow CLOs and synthetic corporate CDOs.

If the credit environment improves somewhat in the latter part of the year, there may be pick-up in volume at that time. Also, the deterioration in capital experienced by a number of financial institutions as a result of mortgage-related losses could foster more balance-sheet CDOs. In addition, SME CLO balance-sheet transactions may rebound quicker than arbitrage CLOs as these balance sheet transactions are issued primarily as a source of funding rather than as a result of asset/liability arbitrage.

RATING PERFORMANCE OUTLOOK

CDO performance in general will continue to suffer in 2008, especially within the SF CDO subsector. Moody's has revised upward its subprime RMBS loss projections and has warned that even highly-rated RMBS tranches may be downgraded by several notches.[20] Such downgrades would put significant downward pressure on the ratings of SF CDOs. As a result, our 2008 outlook for the SF CDO collateral performance is negative with significant rating implications on SF CDO securities.

Though the projected increase in the U.S. corporate default rate is partly reflected in the ratings of the corporate instruments that back CLOs and synthetic corporate CDOs, the likelihood of continued negative ratings drift may pressure these CDOs' liability ratings. Still, we do not expect this pressure to be sufficient to induce significant downgrades of CLOs and corporate CDO liabilities. Indeed, existing corporate transactions with the ability to trade could benefit from wider spreads on collateral. Consequently, our 2008 outlook for CLO and synthetic corporate CDO collateral performance is stable/negative with limited rating implications.[21]

The rating outlook for MV CDOs backed by structured instruments continues to be negative in view of ongoing liquidity deterioration in the credit market. Market prices remain weak as a variety of institutions attempt to unload structured instruments, especially RMBS and CDOs with direct or indirect exposure to subprime mortgage assets. In addition, the heightened price volatility of leveraged loans has put pressure on MV CLOs. Therefore, we assign a stable/negative outlook for the MV CDO collateral performance with limited rating implications.

19 For the 2007 Review and 2008 Outlook of TRUPS CDOs, please see "The U.S. Trust Preferred CDO Sector Review and 2008 Outlook," March 2008.
20 See "Moody's updates loss projections for 2006 subprime RMBS," Moody's Announcement, January 31, 2008."
21 A stable/negative collateral performance outlook indicates that the asset class is not expected to perform as well over the next year as it is performing currently.

RELATED RESEARCH

1. "Structured Finance CDO Ratings Surveillance Brief, January 2008," Moody's Structured Finance Special Report, February 2008.

2. "Structured Finance CDO Ratings Surveillance Brief, December 2007," Moody's Structured Finance Special Report, January 17, 2008.

3. "2007 U.S. CLO Review and 2008 Outlook," Moody's Structured Finance Special Report, February 2008. (Forthcoming)

4. "The U.S. Trust Preferred CDO Sector Review and 2008 Outlook," Moody's Structured Finance Special Report, March 2008. (Forthcoming)

5. "2007 U.S. Credit Derivative Product Companies Review and 2008 Outlook," Moody's Structured Finance Special Report, March 2008. (Forthcoming)

6. "2007 Review & 2008 Outlook - EMEA Collateralised Debt Obligations: Strong First Half in 2007 Diluted by Global Credit Crisis; Lower Issuance Expected in 2008 Reflecting Continued Market Disruptions," Moody's International Structured Finance Special Report, February 4, 2008.

7. "Understanding the Consequences of ABS CDO Events of Default Triggered by Loss of Overcollaterlization," Moody's Structured Finance Special Report, January 7, 2008.

8. "Impact of Subprime Downgrades on OC-Linked Events of Default in CDOs," Moody's Structured Finance Special Report, November 1, 2007.

9. "U.S. Subprime RMBS 2005-2007 Vintage Rating Actions: January 2008," Moody's Structured Finance Special Report, February 1, 2008.

10. "U.S. Alt-A RMBS 2005-2007 Vintage Rating Actions Update: January 2008," Moody's Structured Finance Special Report, February 1, 2008.

11. "Moody's Updates Loss Projections for 2006 Subprime Loans," Moody's Structured Finance Special Report, January 30, 2008.

12. "Syndicated Bank Loans: 2007 Default Review and 2008 Outlook," Moody's Special Comment, January 2008.

Doc ID# SF125199

Dr. Ackermann	Dr. Börsig	Dr. von Heydebreck	Lamberti

Securitization Credit Report

CDO	Reason for Presentation: New	KWG 13: No	KWG 15: No

Borrower (full legal name incl. legal address and domicile country)	Gemstone CDO VII Ltd. ("Gemstone VII") Elizabethan Sq. George Town, Grand Cayman, Cayman Islands
Funding Beneficiary: (If other than borrower)	N/A
Asset Manager	HBK Investment LP ("HBK", "Company") 300 Crescent Ct., Suite 700, Dallas, TX
Sponsor	HBK Investment LP ("HBK", "Company") 300 Crescent Ct., Suite 700, Dallas, TX
Servicer Group:	HBK; Servicer Group ID:
Paragon Org ID	6909412; **Batch Code** 67; **SIC:** 6733
DB Business Entity	CDO group; **DB Booking Entity** DBAG NY/Cayman

Classification	Pass	**Authority**	SCO
LLP:	0	**Date:**	12/20/06
CA Review Date (new/previous)	3/07	n/a	
Rating Rev. date (new/previous)	3/07	n/a	

Asset Category	CDO: Structured Finance
Asset pool considered granular	yes
Weakest external rating of underlying assets	Ba2
Remaining average life of assets (yrs)	6.0

	LGD	DB FPD	S&P	Moody's
All Facilities	2	iBBB+		
Servicer Rating		iBBB-		
Counterparty PD rating :		iBBB+		

x **Securitisation hierarchy**	**Other hierarchy** see "ownership" for details
Borrower's majority owner / stake:	N/A

Transaction Type	Warehouse Line	**Holding Period**	Select	**Maturity Date**	3/07

Description:

1) **New:** US$1.078billion 4-month warehouse facility issued by DBAG Cayman to the Borrower to purchase a portfolio of primarily (85%-90%) RMBS securities. According to Exposure Management, 75-day VAR for the entire portfolio (considered as 100% cash assets) is 12%. Any warehoused collateral above $500m of this 1.078b total transaction size will be hedged with a 50% hedge ratio, with ABX.HE Baa2/Baa3. Total notional of cash and synthetic assets is capped at 1.078b. Maturity: 31 March 2007.

2) **New:** US$ 78 mm margin line (12% PFE) for up to $650m notional Pay-As-You-Go ("PAUG") Credit Default Swaps ("CDS"), referencing ABS securities. CDO (protection seller) will pay credit protection payments and DB London will pay CDS premiums. During the ramp-up period, any physical settlement amounts subsequent to credit events payable by the CDO will be settled by drawing under the RCL. After the closing of the CDO, the 23% PFE will be 4.3x collateralized by segregated note proceeds and/or liquidity equal to 100% of the CDS notional. Maturity: legal maturity of 40 years (3 year CDO revolving period plus maximum 37 year CDS tenor) and an expected maturity of ~8 years.

3) **New:** US$[200,000] futures clearing limit to hedge fixed rate assets in the portfolio. Maturity: 31 March 2007

4) **New:** US$4.5 mm margin lines (4.5% PFE) for repurchase obligation under which Borrower can borrow and short up to $100 mm notional treasuries and agencies securities. Maturity: 31 March 2007

Currency: EUR mn ($1 = €0.80)	Cash	Guarantee	Margin	Whole Loans	Total	Thereof committed	*Previous Total*
Tenor ≤ 1 year	€ 862.4		3.7		**€ 866.1**	862.4	*0*
1 < T ≤ 5 years							
5 < T ≤ 7 years							
7 < T ≤ 10 years							
Tenor > 10 years			62.4		**€ 62.4**	0	
Aggregate (By Type)	**€ 862.4**		**66.1**		**€ 928.5**	**862.4**	*0*
Previous Aggregate	*0*		*0.0*		*0.0*		
Utilisation	0		0.0		0.0		

Securitisation Limits to Servicer Group	**€ 979.1**
Direct Credit Limits to Servicer Group	**€ 100.4**

Settlement Limits

KWG13 Total

Variance from Credit Policy: none

Ownership / Shareholders / Management: The borrower is a Cayman Islands special purpose entity with a US co-issuer. Ordinary shares of the borrower are owned by the co-issuer and the ordinary shares of the co-issuer are held by a charity. At closing, the borrower will issue multiple tranches of CDO notes, distributed via a capital markets offering underwritten by DB, HBK will bear the first loss risk (up to 7.5% of the transaction size). The CDO will be backed by the collateral purchased during the warehouse period. HBK, the collateral manager of the CDO, is an investment management firm set up in October 1991 with approximately $11.0 billion in equity capital under management.

RAROC / Earnings: DB is expected to generate $[6.79] million in underwriting fees, in addition to an interest spread on the RCL (The CDO will be paying L+30 as warehouse interest). DB Fee is calculated based on sum of i) 0.75% x 350mm and ii) 0.65% of any excess investment grade notes over 350mm.

Key Figures – Portfolio Parameters	Expected	Limit
Portfolio Rating	Baa3/Ba1	Baa3/Ba1
Moody's Weighted Average Rating Factor	645	665
Moody's Correlation Factor	22.76%	24.26%
Weighted Average Life	5.0 years	6.0 years
Weighted Average Coupon (fixed collateral)	5.33%	5.18%
Weighted Average Spread (floating collateral)	2.13%	1.75%
% of below investment grades (MDY/S&P)	31.5% / 20.7%	
Synthetic security	55%	65%

Collateral Description

Lines are secured by a diversified pool of primarily RMBS securities carrying weighted average portfolio rating of Baa3/Ba1.

The lowest expected rating on underlying collateral at acquisition is BB/Ba2 (max 30%).

Guarantor: Up to $[80.9]mm joint & several recourse to:

- HBK Investments LP
- HBK Master Fund L.P. and

			- HBK Fixed Income Ltd

Recommendation:

We recommend approval to issue the US$1.078b RCL by DBAG Cayman to the Borrower to facilitate the execution, ramp-up, and placement of the structured finance cash flow CDO. HBK bears the credit risk on the underlying portfolio during the term of the RCL, to the extent of [$80.9m]. Under the terms of the Risk Sharing Agreement, HBK will reimburse the Borrower for any losses resulting from the sale of any portfolio assets (adjusted for mark-to-market gains or losses on the associated hedges) up to $[80.9]m. The warehouse net carry will not be paid to HBK until closing and will be used to offset any losses resulting from the sale of any portfolio.

The RCL will be repaid through the CDO note proceeds upon transaction close. Recommendation is based on

(i) DB's ability to terminate the ramp-up, if necessary,
(ii) DB will be closely monitoring the ramp-up process
(iii) experienced investment manager performing asset selection,
(iv) this is HBK's 8th CDO, their 5th with DB
(v) DB's right of refusal on assets/hedges prior to inclusion in warehouse,
(vi) The CDO group will be hedging any ramp-up over 500m with a 50% hedge ratio short of ABX BBB or BBB- indices, and
(vii) commitment by HBK to reimburse DB for any losses up to $[80.9]m at the time of collateral liquidation. DB shall earn LIBOR+0.30% on the warehouse loan during the warehouse period and structuring/placement fees of approximately $6.79million.

Risks/Mitigants:

Business Risk: The closing of the CDO could be impaired for reasons including:

1) Adverse Market conditions, such as market disruption or spread widening. This risk is mitigated by

(i) DB's right to terminate ramp-up upon adverse change in market conditions or to terminate the engagement letter at any time with ten days' notice.
(ii) high likelihood of CDO transaction completion given HBK commitment to purchase 100% of the Class E and Equity,
(iii) ability to net DB fee income to off-set Senior Note spread widening and maintain Subordinated Interests returns sufficient to close transaction. Based on sensitivity analysis, the spread on the Notes could widen approx 50 bps on average before the equity returns are no longer marketable.

2) Deterioration of the ramped-up assets preventing the portfolio to meet the rating agencies eligibility guidelines. Performance risk is limited considering

(i) the requirement that at least 70% of assets be rated Baa3 or greater, (174m of the ramp up so far is rated Ba1 or Ba2 by Moody's. This constitutes 17.4% of the transaction size, or about 24% of the current ramp-up).
(ii) relative short term warehouse facility and low rating migration risk of ABS,
(iii) none of the non-investment grade securities have been downgraded and all are of recent vintage, and
(iv) DB's veto right to refuse assets/hedges prior to inclusion in warehouse.

Downside scenario: Should the CDO fail to close, or is downsized, HBK will direct the sale of assets in the ramp-up portfolio and will bear first-loss risk in the losses incurred upon such sale up to $80.9m. In addition, all the carry on the collateral during ramp-up will be used to cover any losses should the CDO fails to close and HBK fails to reimburse the Borrower. The net carry is paid to HBK only at CDO Closing after all the losses, if any, have been paid. The net carry is expected be approx $[2]m. Note that the carry is not available to cover spread widening on the notes. Exposure Risk Management has calculated maximum unwind exposure amount of approximately $[120] mn ([12]%PFE) on the $1 bn warehouse if the transaction fails to close, i.e. 1.5x the recourse we have on HBK.

Financial/Hedging risk: DB is currently, or will be after closing of the CDO, a swap counterparty under the following facilities:

- Long CDS ($650mn notional), as DB can ramp-up up to 65% of synthetic ABS (i.e. CDO sells protection to DB);
- Repurchase Obligations to hedge the fixed rate assets. Fixed rate assets will be limited to 5% of the Transaction. During the warehouse period, exposure to fixed rate assets will be hedged using a combination of eurodollar futures, and shorted Agency securities. After the CDO closing, DB will not need enter into an interest rate swap with the CDO because the notional of the fixed rate assets approximately equal the size of the equity tranche.

Periodic payments under the cash waterfall are senior to AAA/Aaa rated Notes. To the extent that DB is not the sole defaulting or the sole affected party, termination payments in case of an Event of Default or a Termination Event (under the ISDA Master) will be paid to DB at least pari passu with interest on AA/Aa2 rated Notes and senior to principal on AAA/Aaa rated Notes. No Supplemental Indenture which adversely affects the rights and obligations of the CDS Counterparty will be effective without the prior consent of such counterparty.

Downgrade provisions linked to DBSI's rating possibly requiring action after a DBSI downgrade were approved by Treasury (see exhibit). Allowed mitigating actions are to either (i) deliver collateral, (ii) obtain a suitable guarantee, or (iii) assign the respective swap to a suitable 3rd party.

Operational / Management Risk: This is HBK's eighth CDO backed by structured product collateral. HBK is a qualified investment manager/sponsor, with a strong track record in fixed income management. HBK has $11.0 billion in equity capital under management. Since its inception in 1991, HBK Fund generated a compounded annual return of 14.55%, net of all fees and expenses. This is a revolving CDO, there is a 0.30% senior management fee, similar to Gemstone CDO II, IV and V. HBK's earlier CDOs are performing as expected, and the Portfolio Manager's experience in managing similar deals successfully is indicative of expected in-line performance of Gemstone CDO V.

CRM assessment:

Strengths:

- Short ramp-up period of 4 months, that limit risks of spread widening on the CDO liabilities and rating migration on the assets.
- Standard structure of the warehouse facility, for a HBK, a repeat CDO Manager (eighth CDO).
- HBK guarantee up to $80.9 mm (vs $120 mm PFE), collateralized by the carry on the underlying assets (approx $2 mn).
- HBK is committed to buy the Equity and BB tranche of the CDO, resulting in high likelihood of the CDO closing as well as strong incentives to select good assets.

Weaknesses:

- Concentration on RMBS assets (85%/90%), of which Subprime borrowers represent (48%).
- Relatively large bucket for non investment-grade ABS (30%). However, it includes only ABS originally rated to such level (no downgraded ABS).
- The new CDO will be the eighth transaction originated by HBK, but one of the first structured with a revolving period.
- Large bucket for long synthetic securities up to 100%. Recovery risk is mitigated by the "pay-as-you-go" structure.

- Breakage costs for both the Credit default and interest rate swaps are pari passu with the AA interest and senior to the AAA principal payments.

While large (i.e. $1bn), the warehouse facility is relatively standard for an ABS CDO with a large bucket for non-inv't grade bonds. Business is hedging all exposure over $500m with a 50% hedge ratio short of ABX BBB or BBB- indices. Netting of underwriting fees and reduction in equity returns protects against an average 50 bps spread widening, which is a significant cushion considering that the CDO is scheduled to price during the first quarter 2007.

No credit is given to the HBK recourse, given the hedge funds nature of the counterparty.

Batch Strategy: Exposure is consistent with the securitization batch strategy.

Signatures:

Abhayad Kamat **Global CDO Group /** **Vice President**	**Sourav Sen** **Global CDO Group /** **Associate**	**André-Louis Clémot** **CRM-SEC / Director**	

I. Transaction Description / Facility Description
Gemstone CDO VII has engaged HBK to manage a $1.078b revolving cash flow CDO securitization of a portfolio of primarily RMBS assets (the "Target Portfolio") with reinvestments in investment grade assets only. For HBK, the purpose of the transaction is to leverage its ABS portfolio rather than to do an arbitrage transaction.

Warehouse Facility:
HBK as agent for the Borrower pursuant to a Interim Collateral Management Agreement will purchase the Target Portfolio during the warehousing period. DB-issued RCL will finance the Borrower's purchase of the Target Portfolio during the ramp-up period prior to closing. Every bond purchased into the warehouse facility will be subject to HBK's credit process and DB will have the right of refusal on the assets and accompanying hedges prior to inclusion in the warehouse. The Borrower will pay DB Cayman's LIBOR funding costs plus 0.30% on the portfolio during the warehouse period.

Estimated Transaction Timing	
Ramp-up at pricing:	80%
Pricing:	February 2007
Closing:	3-4 weeks after pricing

The proceeds of the CDO notes must be sufficient to repay the full amount of the RCL and interest thereon to DB. In the event of a failure to close the CDO, HBK will direct the sale of the Target Portfolio to pay down the RCL. Under the warehouse terms, HBK will get all the gains and will bear up to $80.9m of the losses experienced on liquidation of the warehoused collateral. However, all the carry on the collateral will be put in reserve during the ramp-up to cover any losses should the CDO fails to close.

HBK and Gemstone CDO VII will enter into covenants that are standard for this type of transaction, including that HBK and Gemstone CDO VII will prepare CDO offering documents containing all required and appropriate disclosures. Also, DBSI has the right not to proceed with the offering or the financing of the securities if there is any material adverse change in
(i) the business operations or financial condition of HBK, or
(ii) a material portion of the warehoused collateral, or
(iii) for any other reason, subject to ten days' notice to HBK

CDO Exit:
Upon closing, Gemstone CDO VII will issue CDO notes representing an undivided interest in the assets. The expected CDO capital structure is shown in Exhibit C. HBK will purchase 100% of the Class E (Ba1/BB+) and the Equity; the Equity is expected to be around 7.5% of total deal size. Indicative equity price is [59.6]% and we expect no discount for BB as of now. No minimum IRR is guaranteed on the equity.

The CDO is structured as a revolving "cash flow" CDO with a 3 yr reinvestment period with reinvestments only in IG assets. Gemstone CDO VII will be subject to OC tests (based on par value of assets) and interest coverage tests (based on current interest).

DB, as the lead manager, will be responsible for placing the investment grade notes (triple-A to triple-B). Given the earlier success with HBK's deals, DB is confident that the Notes will be placed. The Class E and Equity has already been committed to by HBK, the Manager, and this alignment of interest with the investors will help in the marketing process.

Marketing:

This is the eighth structured product CDO on which HBK Investments is the collateral manager, an established manager in the CDO market. HBK and DB are looking to get in and out of the deal quickly within the next months. Gemstone VII being practically similar to, but larger in scale than, Gemstone V, we anticipate a very efficient transaction.

The transaction marketing materials, portfolio disclosure, breakeven default analysis and other transaction information is expected to be made available well within the time frame and investor meetings and conference calls will be arranged as needed.

The Class A Notes will be rated Aaa/AAA by Moody's and S&P and will be marketed to traditional CDO Class A Note buyers, including CP conduits, banks, high grade CDOs and insurance companies. The Class B, C and D Notes will be offered to existing ABS and CDO investors globally. Please note that Class E and Equity have been committed by HBK.

Given experienced manager, quick ramp-up, BB and equity commitment by manager, we are confident that all of the Notes will be fully subscribed.

LIBOR Swaps:
No interest rate swap is expected on the transaction since the exposure to the fixed rate assets will be approximately the same as the equity tranche thickness.

Credit default Swaps:
The CDO will sell protection to DB. The Credit events under the Pay-as-you-go CDS will be standard conditions:
(a) Failure to Pay Principal (by the scheduled termination date or final amortization date of the Reference Obligation);
(b) Writedown (any form of writedown (except implied writedowns)/applied loss/forgiveness/principal deficiency resulting in a reduction in the outstanding principal amount of the reference obligation or a reduction of the current interest payable on the reference obligation);
(c) Distressed Ratings Downgrade (Caa2 or below by Moody's or CCC or below by S&P or Fitch); and

If there is a VFN, the amount of synthetic CDS that exceeds the VFN will be invested in GIC or similar instrument earning approximately LIBOR-[0.06]%.

ISDA Credit Terms:
The swap counterparty will be a secured party under the indenture of CDO. Credit terms under the ISDA schedule are expected to be as follows:

(a) cross default will not apply to either party. However, Event of Default under the indenture is an ATE (see below).

(b) Bankruptcy definition (section 5(a)(vii)) is amended with respect to the CDO so that it will be a termination event if the CDO becomes unable to pay principal or interest on the Notes of the Controlling Class.

(c) Additional Termination Events are:
- (i) Redemption of all the CDO Notes,
- (ii) Event of Default under Indenture (after CDO closing),
- (iii) Cancellation Date or Event of Default under Credit Agreement (prior to CDO closing),
- (iv) Amendment of Indenture or Credit Agreement without DB consent,
- (v) Termination of Transaction pursuant to Indenture (applies only to the affected transaction)

(d) Change of manager is not a termination event, as it is governed by the indenture.

The swap will be subject to downgrade provisions requiring DBNY to deliver collateral upon a downgrade (as approved by Treasury).

II. DB Relationship:
DB client since 1992, HBK is important to Global Markets. Over time, DB has become one of HBK's largest trading counterparties. Apart from DB, they maintain prime brokerage accounts at other investment banks. As placement agent for the Gemstone CDO VII transaction, DB will generate $[6.8] million in placement fees in connection therewith. HBK is likely to repeat the issuance of this type of transaction in the future and DB should have a chance to benefit from additional structuring, placement and underwriting assignments.

III. Expected Collateral Description / Assessment:
The Portfolio will consist of a diversified pool of primarily investment grade asset backed securities. The collateral will comprise predominantly of floating rate assets. Anticipated pool composition is as follows. Assets are sourced from market or other HBK Funds. Assets are acquired subject to DB approval of asset as well as price of acquisition.

Moody's	Aaa	Aa1	Aa2	Aa3	A1	A2	A3	Baa1	Baa2	Baa3	Ba1	Ba2	
RMBS Midprime	2.83%				1.41%		0.77%	4.61%	1.74%	16.34%	5.38%	5.99%	39.07%
RMBS Subprime					0.82%			1.19%	3.70%	23.29%	7.81%	10.88%	47.70%
RMBS Prime												1.41%	1.41%
CDO			4.71%										4.71%
CMBS Conduit						2.36%	0.92%	0.16%					3.44%
Student Loans						1.88%	1.79%						3.67%
													0.00%
													0.00%
									5.45%	39.63%	13.19%	18.28%	100.00%

S&P	AAA	AA+	AA	AA-	A+	A	A-	BBB+	BBB	BBB-	BB+	BB	
RMBS Midprime	2.83%				1.41%	4.54%	3.90%	5.31%	8.36%	9.79%	2.94%		39.07%
RMBS Subprime					0.82%	0.47%		5.90%	11.19%	11.51%	8.00%	9.80%	47.70%
RMBS Prime										1.41%			1.41%
CDO			4.71%										4.71%
CMBS Conduit						2.36%	0.92%		0.16%				3.44%
Student Loans						3.67%							3.67%
													0.00%
													0.00%
									19.71%	22.71%	10.94%	9.80%	100.00%

The portfolio will be mostly comprised of real estate related securities (~93% including CMBS). The remaining will be comprised of consumer ABS and CDOs. No Corporate CDOs are anticipated. There will be no IOs or NIMs in the transaction. This portfolio will be revolving.

Due to the concentration in real estate assets, the portfolio will have relatively large exposure on mortgage servicers. Expected servicer concentrations are as follows:
15% or more allowance for [2]
7.5% to 15% allowance for [5]
less than 7.5% remaining
The servicer stratification is expected to be like that in Gemstone V: most servicers are expected to be at 7.5% or less, each, with the exception within their respective limits.

IV. Sponsor / Servicer Description and Assessment:
HBK will act as the collateral manager of the CDO. HBK is an investment management firm set up in October 1991 with approximately $11.0billion in equity capital under management. HBK employees over 260 individuals in five offices around the world. Their main office is in Dallas, Texas, and they maintain subsidiary offices in New York, London, Hong Kong and Tokyo. From inception through September, 2006, HBK Fund generated a compounded annual return of 14.55%, net of all fees and expenses.

Performance of the 4 CDO previously underwritten by DB:

Sandstone CDO

Collateral Quality Tests	Test Level	At Closing	As of 9/29/06*	P/F
Weighted Average Spread	2.87%	2.90%	2.78%	F
Weighted Average Coupon	5.27%	5.31%	5.85%	P
Diversity Score	11.0	11.9	11.5	P
Moody's WARF	470	446	426	P

* Note: Sandstone closed June 2004

Gemstone CDO II

Collateral Quality Tests	Test Level	At Closing	As of 9/29/06*	P/F
Weighted Average Spread	2.12%	2.16%	2.18%	P
Weighted Average Coupon	5.44%	5.55%	5.56%	P

Moody's WARF	664	646	646	P

* Note: Gemstone CDO II closed May 2005

Gemstone CDO IV

Collateral Quality Tests	Test Level	At Closing	As of 9/29/06*	P/F
Weighted Average Spread	1.81%	1.88%	1.85%	P
Weighted Average Coupon	5.21%	5.31%	5.27%	P
Moody's WARF	659	646	647	P

* Note: Gemstone CDO IV closed January 2006

Gemstone CDO V

Collateral Quality Tests	Test Level	At Closing	As of 9/29/06*	P/F
Weighted Average Spread	1.80%	1.90%	1.90%	P
Weighted Average Coupon	4.82%	5.02%	5.00%	P
Moody's WARF	626	609	609	P

* Note: Gemstone CDO V closed May 2006

V. Sensitivity Analysis:

Exposure Management has analyzed a potential exposure to loss on the inventory of bonds should the transaction fail to close as [12]% of the Target Portfolio This PFE is conservative and about [1.5]x higher than the guarantee provided by HBK.

Spread widening on the CDO Notes (without assuming spread widening on the underlying collateral) of up to 50 bps can be absorbed by:

- The $[6.8] million upfront fee due to DB as placement and structuring agent
- The L + 0.30% spread on the ramped-up portfolio, which may generate approximately $[0.4] mn of additional revenue over an average of half the warehouse period of 4 months
- A reduction of the expected return on equity from about [45]% down to [30]%, before HBK may lose its incentive to do the transaction.

Assuming an Equity price of [59.8]%, the following is the IRR table. The BB+ price is assumed for modeling purposes to be [100.0]%

	0.00%	0.25%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%	2.00%
Equity	47.9%	46.8%	45.5%	44.2%	42.9%	41.0%	38.3%	35.1%	31.4%

Gemstone VII CDO

Capital Structure		Size	Avg life	Base Spread	B/E Spread	Changes
Class A-1	AAA	$699.98	5.30	0.250%	0.42%	0.17%
Class A-2	AAA	$107.86	7.00	0.430%	0.73%	0.30%
Class B	AA	$69.03	7.30	0.600%	1.02%	0.42%
Class C	A	$48.54	7.30	1.600%	2.71%	1.11%
Class D	BBB	$64.71	7.30	3.750%	6.36%	2.61%
Class E	BB+	$23.73	8.00	6.500%	11.02%	4.52%
Equity	NR	$38.83	8.00	45.000%	30.00%	-15.00%
Total / Avg (1)	**A-**	$ 1,052.66	6.0	0.73%	1.23%	**0.506%**
Structuring Fees	**0.65%**	$6.786		Cushion (2)	$24.23	($0.00)
Ramp-up carry	**0.30%**	$0.41	**0.33**	**Break-Even Multiplier** (3)		**1.70x**

(1) Implied rating of the facility is the WARF of the CDO liabilities (using "B-" for unrated equity).
(2) Arbitrage Cushion = structuring fees + ramp-up carry + PV of reduction in ROE
(3) Stress factor applied to the spread of each tranche of the capital structure, resulting in a $0 cushion.

VI. Summary / Conclusion:

Approval of ramp-up facility is recommended on the basis of the short-term financing, the diversity of the portfolio, the large portion of investment grade quality of the collaterals, and the relatively good acceptance of the investment manager by the market (eighth CDO).

EXHIBITS
Table of Contents

EXHIBIT A: Risk Score Sheet

CDO Score Sheet - Version 4.3 - May, 15th, 2004

Credit Officer:	Andre Clemot	
Date:	20-Dec-06	
Borrower: Name & Country	Gemstone VII	Cayman Islands
Funding Beneficiary / SPV: Name & Country		
Type(s) of Facility:	warehouse facility	
Asset Type:	Diversified ABS	
CDO Type:	Cash Flow	
CDO Purpose:	Arbitrage	
Purpose of Financing	Financing	
Initial size & currency of asset portfolio:	mn 1,000 USD	Applicable initial WAL: 6.00 yrs
Initial size of exposure & currency/ PFE for derivatives	mn 1,000 USD	
Trustee / Custodian : Name & Country	Deutsche Bank Trust	United States

Note for data input:
Fill/Select these fields
These fields are calculated

Results

PD Rating	iBBB+
PD %	0.14%
LGD Rating	2
LGD %	10%
EL%	0.01%

PD Rating

	very good/ excellent	satisfactory	higher risk/ still acceptable	unknown/ n/a poor	
A Portfolio Manager Risk					
1 Name, Country & Rating (internal or external)	HBK Investment LP			United States	iBBB-
2 Total Assets under management		x			
3 Experience in specific asset class (number of CDOs managed)		x			
4 Performance of existing transactions	x				
5 Quality of management, systems, reputation		x			
B Asset Portfolio Risk					
6 Maturity of managed assets (WAL)		x			
7 Quality of underlying assets (WARF)	BB+				
8 Diversity & Granularity of asset pool - Concentration Risk		x			
9 Recovery Performance of asset class			x		
10 For Ramp-up facilities: Time to CDO closure		x			
C Structural Risks and Risk Mitigants					BBB+
11 Loss / Default coverage provided by credit enhancement					
12 Is legal structure of Funding Beneficiary bankruptcy remote?	Yes				
13 Overall documentation standards	x				
14 Hedging of Interest and F/X Risks	x				
15 Revolving Structure	Static				
16 Eligibility Criteria / Investment Guidelines	Tight				
17 Effectiveness of Performance Triggers, Tests, Covenants		x			

Comments:
Please provide any comments regarding PD section here!

Calculated PD Rating	iBBB+
Outvoting: If use explanation in "comments" box.	
Final PD Rating	iBBB+

LGD Rating

	very good/ excellent	satisfactory	higher risk/ still acceptable	unknown/ n/a poor	
D Structural Considerations					
18 Effect of Termination Triggers / Maturity of Financing		x			
19 Secondary market for asset pool			x		
20 Loss / Default coverage provided by credit enhancement (PD)		Rating range equivalent of:			BBB+
21 Documentation (Legal) & Structural Risk (PD)					
E Third Party Support					
22 Name, Country, Internal Rating (of supporting entity)					
23 Volume of third party support	mn	USD			

Comments:
Please provide any comments regarding LGD section here!

Please provide a 1, 2, 3, 4, 5 grade indicating the expected Loss Given Default (LGD) of the transaction.

LGD Rating :	2

EXHIBIT B
Portfolio Terms

EXPECTED PORTFOLIO TERMS

Key Figures –	Expected	Limit
% min Investment Grade	72% / 87%	70%
Moody's Weighted Average Rating Factor	662	682
Min Moody's Correlation Factor	22.76%	24.26%
Weighted Average Life	4.6 years	5.0 years
Weighted Average Coupon (fixed collateral)	5.33%	5.18%
Weighted Average Spread (floating collateral)	2.28%	2.13%
% min RMBS / CMBS	90%	85%
Discretionary Sales	n/a	20%
% max Fixed rate assets	6.1%	10%

EXHIBIT C

Expected Capital Structure

Summary Details of Expected Capital Structure

Class	Rating (Mdy's/S&P)	Tranche Size ($)	Tranche Size (%)	Average Life to Call (yrs)	Spread	Legal Final
Class A-1 (unfunded)	AAA/Aaa	699,975,705	64.90%	5.3	L + 0.2500% / L + 0.3200%	February 2047
Class A-2	AAA/Aaa	107,854,500	10.00%	7.0	L + 0.430%	February 2047
Class B	AA/Aa2	69,026,880	6.40%	7.3	L + 0.600%	February 2047
Class C	A/A2	48,534,525	4.50%	7.3	L + 1.600%	February 2047
Class D	BBB/Baa2	64,712,700	6.00%	7.3	L + 3.750%	February 2047
Class E	BB+/Ba1	23,727,990	2.20%	8.0	L + 6.500%	February 2047
Equity		64,712,700	6.00%			February 2047
Total		1,078,545,000	100.00%			

PORTFOLIO CHARACTERISTICS	Required		Required
Weighted Average Fixed Coupon (min)	5.18%	Weighted Average Life (max)	6.0 years
Weighted Average Floating Spread (min)	2.13%	% of Fixed rate assets (max)	10.0%
Weighted Average Moody's Rating (max)	Baa3/Ba1		
Weighted Average S&P Rating (max)	BBB-/BB+		

ONGOING FEES AND EXPENSES	
Senior Management Fee	0.30%

DATES AND TIMING	
Revolving Period	3 years

Preliminary and subject to change

Exhibit D

Collateral Manger Information

Overview

- HBK Investments L.P. ("HBK") is an investment management firm founded in October 1991 with equity capital under management of approximately $11 billion. HBK's structured finance team manages $5.0 billion in structured finance securities, including $3.0 billion of structured product CDOs, as of June 5, 2006[1]
- HBK's main office is in Dallas, Texas, with branch and subsidiary offices in New York, London, Hong Kong and Tokyo
- HBK employs 275 individuals in its five offices globally
- HBK's senior management team has been working together since 1994
- The firm strives to provide superior risk-adjusted rates of return with relatively low volatility and relatively low correlation to most major market indices
  - pursuing arbitrage opportunities from price disparities between related securities
  - "multi-strategy" approach with a sub-categorization of either "market neutral" or "absolute return"
- From inception through September, 2006, HBK generated a compounded annual return of 14.55%, net of all fees and expenses and assuming reinvestment of all distributions[1][2]
  - positive returns for every consecutive 12-month period in its history
- HBK currently manages seven ABS CDOs
  - CDOs as a term-financing source, not as a fee-generation arbitrage vehicle
  - performance snapshots of prior CDOs are provided in Section 2
  - all junior tranches of Sandstone CDO, HBK's first ABS CDO, are currently on upgrade watch by Standard & Poor's & Moody's

(1) Source: HBK
(2) Past performance is not indicative of future performance.

Business Units

HBK Investments L.P.

Credit: Corporate, Non-Corporate	Volatility, Quantitative and Other

- *Structured Products* – ABS, CMBS, RMBS, CDOs, structured notes and others
- *Emerging Markets* – fixed income and equity securities issued in countries other than G7 nations
  - sovereign and private issuers
- *Developed Markets – U.S. and International*
  - credit-driven investments in developed market corporate securities
  - IG, HY, par and distressed bank debt, trade claims, equity derivatives
  - seek best risk-reward opportunity within capital structure
- *Private Placements* – equity-linked privately negotiated investments in U.S. and non-U.S. companies
	- *Convertible Arbitrage* – US and International
	  - publicly traded equity derivatives in US, Japan, Europe and Asia
	  - convertible bonds, convertible preferred stock, warrants or options
	- *Volatility* – volatility relationships amongst options on equities and equity indices
	- *Quantitative Strategies*
	  - purchase and sale of stocks, related index products and exchange-traded products to take advantage of short-term and long-term statistical phenomena
	  - involves a highly diversified portfolio that is intended to control market exposure and exposure to variety of other factors
	- Insurance – insurance-related investments

Equity: Event or Spread Driven; Relative Value	Developed Markets Fixed Income Investments
- Risk arbitrage, intercapitalization and other event-driven strategies in different markets, including U.S., Europe and Asia - Securities of corporations involved in significant transactions – mergers, acquisitions, divestitures, tender offers, spin-offs and other similar corporate events - Price disparity between multiple share classes or positions in the capital structure - Relative value investments in two companies in same industry	- Government bonds, Agencies, MBS, ABS - Fixed income securities primarily in G-7 nations - Isolate mispricings that occur in various fixed income markets - Hedge foreign exchange and interest rate exposure

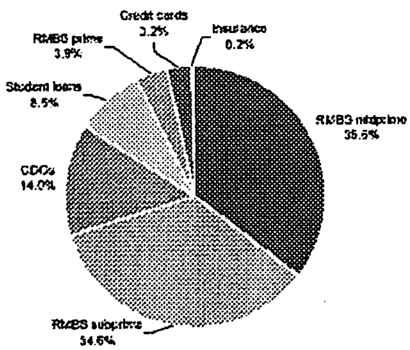
Structured Products Group

- HBK's Structured Products Group is one of the leading purchasers and long-term investors in credit sensitive mortgages
  - the group is responsible for managing the structured products portfolio, including RMBS and ABS, a component in HBK's overall strategy since 2002
- HBK's business model focuses on deriving returns from buy and hold income revenue instead of short-term trading
- HBK's investment model utilizes proprietary default, prepay, and severity loan level models to make investments in the residential market
- CDO program provides long-term committed financing to HBK
- HBK has retained 100% of the equity from CDO transactions resulting in strong alignment of interests between HBK and investors

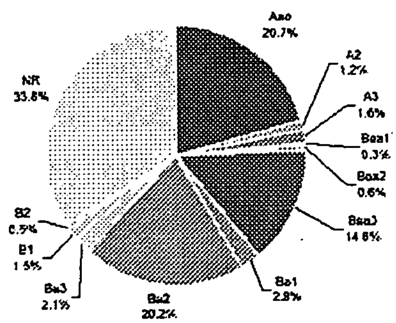
Structured Products Portfolio

- RMBS / ABS have been a component in HBK's overall strategy since 2002. HBK manages a structured products portfolio of approximately $5.0 billion, including $3.6 billion of structured product CDOs[1]
- HBK follows a buy-and-hold strategy for its ABS investments: HBK hedges the interest rate exposure and retains the credit exposure of its ABS portfolio
- Currently, there are only three downgrades[2] in HBK's ABS portfolio

Asset Type



Rating[3]



(1) As of November 1, 2006.
(2) Of the assets currently in the portfolio, not including assets that have paid down.
(3) A portion of the "NR" assets includes residuals.
Source: HBK

Exhibit E
Exposure Management Report

Weilong Li/NewYork/DBNA/DeuBa
12/08/2006 08:35 PM

To
Chehao Lu/NewYork/DBNA/DeuBa@DBAmericas
cc
Raquel Ajona/db/dbcom@DBAmericas, Sourav Sen/NewYork/DBNA/DeuBa@DBAmericas, Sajjad Cheema/NewYork/DBNA/DeuBa@DBAmericas, Tradelog NY/db/dbcom@DBAmericas
Subject
Re: G7 - PFEs

Hi Chehao,

Given the current BBB/BBB- spread widening environment, housing price downward trend, and increase in defaults and delinqencies, we calculated 2.5 month VAR of the warehouse facility as 12% (this is a bit more conservative compared to 10% for earlier deals)

based on the following assumptions:

1. The pricing of the warehouse occurs at least monthly, and the liquidation period is 45 days. If the price of the portfolio drops below par, DB would trigger the liquidation.

2. For BBB/BBB- rated RMBS, we assumed 200 bps move of credit spread over this period.

3. We also included default losses over this period which is around 1.5%.

The PFE is 23% for the PAUG CDS reached around year 3. DB is exposed to credit spread widening of the ABS securities. We have stressed BBB- spread to 900 bps level and BBB to 450 bps level.

The PFE for the interest rate swap is 1.2 MM reached in year 2. DB is exposed to rate decrease.

Please let me know if you have any questions.

Regards,

William

Weilong (William) Li
Exposure Management
Deutsche Bank AG.
60 Wall Street
New York, NY 10005

212-250-7998
weilong.li@db.com

Chehao Lu/NewYork/DBNA/DeuBa
12/05/2006 06:49 PM

To
Weilong Li/NewYork/DBNA/DeuBa@DBAmericas, Raquel Ajona/db/dbcom@DBAmericas
cc
sourav.sen@db.com
Subject
G7 - PFEs

William/Raquel,

please see below for the revised CA,

[attachment "Gemstone VII CA 12.05.06 (Increase).doc" deleted by Weilong Li/NewYork/DBNA/DeuBa]

Beginning Date	Ending Date	Swap Notional
2/18/2007	5/18/2007	35,250,000
5/18/2007	8/18/2007	35,250,000
8/18/2007	11/18/2007	35,250,000
11/18/2007	2/18/2008	35,250,000
2/18/2008	5/18/2008	35,250,000
5/18/2008	8/18/2008	35,250,000
8/18/2008	11/18/2008	35,250,000
11/18/2008	2/18/2009	35,250,000
2/18/2009	5/18/2009	33,210,744
5/18/2009	8/18/2009	32,628,099
8/18/2009	11/18/2009	32,482,438
11/18/2009	2/18/2010	21,120,868
2/18/2010	5/18/2010	11,798,554
5/18/2010	8/18/2010	8,011,364
8/18/2010	11/18/2010	2,621,901
11/18/2010	2/18/2011	0

thanks,
Che

Che Lu
Global CDO Group
Deutsche Bank Securities Inc.
212-250-7801

Weilong Li/NewYork/DBNA/DeuBa
10/23/2006 06:08 PM

To Andre-Louis Clemot/NewYork/DBNA/DeuBa@DBAmericas, Chehao Lu/NewYork/DBNA/DeuBa@DBAmericas
cc Raquel Ajona/db/dbcom@DBAmericas, Tradelog NY/db/dbcom@DBAmericas
Subject Re: Fw: Gemstone CDO VII - Credit Application(1)

Hi Andre-Louis,

The 2.5 month VAR of the warehouse facility is 10% based on the following assumptions:

1. The pricing of the warehouse occurs at least monthly, and the liquidation period is 45 days. If the price of the portfolio drops below par, DB would trigger the liquidation.

2. For BBB rated RMBS, we assumed 150 bps to 200 bps move of credit spread over this period.

3. We also included default losses over this period which is around 1.5%.

The PFE of PAUG credit swap is around 21% reached around year 3. DB is exposed to credit deterioration of the underlyings.

For the repurchase margin line, it is 4.5% if the securities are all 30 year treasuries, and 4% for the rest of the treasuries and agencies.

Please let me know if you have any questions.

Regards,

William

Weilong (William) Li
Exposure Management
Deutsche Bank AG.
60 Wall Street
New York, NY 10005

212-250-7998
weilong.li@db.com

- (1) -

Notes:///85256B8700617DBC/38D46BF5E8F08834852564B500129B2C/5905974E264849E985257210006E7320

Exhibit F

Treasury Approval of Downgrade Collateralization

EXHIBIT G
Highly Confident Memo

To	Credit Risk Management, NY
From	Global CDO Group
Subject	**Gemstone CDO VII – Structured Product CDO**
Date	December 20, 2006

This memorandum outlines our views on the availability of the capital markets for HBK Investments L.P.'s ("HBK") eighth structured product CDO, Gemstone CDO VII ("Gemstone CDO VII"), to finance the proposed $1.1 billion ABS/CMBS/RMBS warehouse facility (the "Facility") through the term CDO market.

The Facility will be used to purchase a portfolio of RMBS and ABS. The Target Portfolio will be selected by HBK subject to rating agency limitations and other constraints, such as collateral quality tests limiting asset concentration by asset class, by servicer ratings, by credit ratings and by geographic domicile.

The Global CDO Group successfully executed four HBK CDOs in the past. Sandstone CDO closed in 2004, Gemstone CDO II closed in May 2005, Gemstone IV closed in January 2006 and Gemstone V closed in May 2006.

HBK is an experienced structured product collateral manager, currently managing seven ABS CDOs and can successfully issue another ABS CDO transaction in the course of the coming months.

We are highly confident that the Facility will be taken out through the term CDO capital markets within the next 3-4 months. This is supported by the following:

- The successful execution of Sandstone CDO in 2004, Gemstone CDO II (closed in May 2005), Gemstone CDO IV (closed in January 2006) and Gemstone CDO V (closed in May 2006). HBK has also executed Gemstone CDO I, III and VI with Lehman.
- Deutsche Bank will get a commitment from HBK for 100% of the Class E and Equity issued by Gemstone CDO VII.
- The CDO's characteristics and investment guidelines are expected to be almost identical to HBK's recently-structured product CDO transaction that closed in May 2006 and was underwritten by DB.
- Transaction is a core source of financing for HBK's business, and HBK, as an investment manager, is committed to the transactions as evidenced by HBK's purchase of 100% of Equity in its past DB-underwritten CDOs – Sandstone CDO, Gemstone CDO II, Gemstone CDO IV and Gemstone CDO V.
- Ability to use some or all of the Deutsche Bank fee income to offset Senior Note spread widening and maintain Subordinated Interests returns sufficient to close transaction

DBSI will act as Structuring Agent and Lead Manager for Gemstone CDO VII and plans to bring it to market in March 2007.

Michael Herzig
Managing Director
Global CDO Group

Michael Lamont
Managing Director
Global CDO Group

V 5.1.

Securitization Credit Report

Date: dd/mm/yy

Dr. Ackermann | Dr. Banziger | Di Iorio | Dr. v. Heydebreck | Lamberti

CDO Report | CDO Scorecard | Waterfall Positioning | Review

Borrower (full legal name incl. legal address and domicile country)

Gemstone CDO VII Ltd.
("Gemstone VII")
Elizabethan Sq. George Town,
Grand Cayman, Cayman Islands

KWG 13	No	KWG 15	No
FED:	Pass	Authority	C2
SEC:	Performing	LLP:	None

Funding Beneficiary: n/a

select

select

Asset Category	CDO: Structured Finance
	Asset Pool considered to be GRANULAR
Weakest ext. rating of underlying assets	BB-
Remaining average life of assets (yrs)	< 5-7 years

Servicer Group:	HBK				
Paragon Org ID	6909412	Batch Code	67	SIC:	6733
DB Business	CDO	DB Booking Entity		DB London	
x Standalone Risk		Part of a different Group Report			
Borrower's majority owner / stake:	n/a				

CA Review Date (new/previous)	3/09	3/07
Rating Rev. date (new/previous)	3/08	3/07
Counterparty PD rating :	iAAA	

	Product Type	DB Facility iPD	Previous iPD	S&P	Moody's	Fitch
<Facility a>	Margin	iAAA	(iBBB+)	NR	NR	NR
<Facility b>	select	select	select	select	select	select
Servicer Ratings (internal PD / external)		iBBB-	(iBBB-)	NR	NR	NR

Deal/portfolio description (for margin: also state notional amount if alternative form of liquidity for ABCP): | **Holding Period** N/A. | **Maturity Date** dd/mm/yy

1) **Increase / Review:** US$ 150 (prev. $78 mm) margin line (23% PFE) for up to $650m notional Pay-As-You-Go ("PAUG") Credit Default Swaps ("CDS"), referencing ABS securities. CDO (protection seller) will pay credit protection payments and DB London will pay CDS premiums. The 23% PFE is 4.3x collateralized by a GIC account equal to 100% of the CDS notional. Maturity: legal maturity of 38 years (2 year CDO revolving period) and an expected maturity of ~7 years.

2) **Cancel:** US$1.078billion 4-month warehouse facility issued by DBAG Cayman to the Borrower to purchase a portfolio of primarily (85%-90%) RMBS securities. According to Exposure Management, 75-day VAR for the entire portfolio (considered as 100% cash assets) is 12%. Any warehoused collateral above $500m of this 1.078b total transaction size will be hedged with a 50% hedge ratio, with ABX.HE Baa2/Baa3. Total notional of cash and synthetic assets is capped at 1.078b. Maturity: 31 March 2007.

3) **Cancel:** US$[200,000] futures clearing limit to hedge fixed rate assets in the portfolio. Maturity: 31 March 2007

4) **Cancel:** US$4.5 mm margin lines (4.5% PFE) for repurchase obligation under which Borrower can borrow and short up to $100 mm notional treasuries and agencies securities. Maturity: 31 March 2007

Currency: EUR mn ($1 = €0.80)	Cash	Guarantee	Margin	Whole Loans	Total	Thereof committed	Syndication Reduction Target	Net Risk after Syndication
Tenor ≤ 1 year								
1 < T ≤ 5 years								
5 < T ≤ 7 years								
7 < T ≤ 10 years			120.0		120.0	0.0	0	120.0
Tenor > 10 years			120.0		€ 120.0	0.0	0	120.0
Aggregate (By Type)	0.0							
Previous Aggregate	*862.4*		*66.1*		*928.5*			
Utilisation	0		0.0		0.0			

Securitisation Limits to Servicer Group	€ 200
Direct Credit Limits to Servicer Group	€ 100.4

Settlement Limits | KWG13 Total

Variance from Credit Policy: none

Ownership / Shareholders / Management: The borrower is a Cayman Islands special purpose entity with a US co-issuer. Ordinary shares of the borrower are owned by the co-issuer and the ordinary shares of the co-issuer are held by a charity. At closing, the borrower will issue multiple tranches of CDO notes, distributed via a capital markets offering underwritten by DB. HBK will bear the first loss risk (up to 7.5% of the transaction size). The CDO will be backed by the collateral purchased during the warehouse period. HBK, the collateral manager of the CDO, is an investment management firm set up in October 1991 with approximately $11.0 billion in equity capital under management.

RAROC / Earnings: DB generated $4.7 million in underwriting fees, in addition to an interest spread on the RCL (The CDO will be paying L+30 as warehouse interest).

Key Figures – Portfolio Parameters	Expected	Limit	Collateral Description
Portfolio Rating	Baa3/Ba1	Baa3/Ba1	Lines are secured by a diversified pool of primarily RMBS

DBSI_00237689

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MTSS000011

Moody's Weighted Average Rating Factor	647	666
Moody's Correlation Factor	21.55%	23.06%
Weighted Average Life	4.0 years	5.0 years
Weighted Average Coupon (fixed collateral)*	5.38%	5.25%
Weighted Average Spread (floating collateral)*	2.44%	2.20%
% of below investment grades (MDY/S&P)	25.5%/6.6%	
Synthetic security	57%	65%
*subject to Coupon/Spread covenant vectors		

securities carrying weighted average portfolio rating of Baa3/Ba1.
The lowest expected rating on underlying collateral at acquisition is BB/Ba2 (max 30%).

Guarantor:

Risks/Mitigants:

Business Risk: The portfolio is concentrated on RMBS obligations, with 67.6%, 20.2% and 1.9% of the RMBS exposure represented by 2005, 2006 and 2007 vintages, respectively, which results in significant vintage risk. The current mix of the RMBS types are 53.0% Midprime, 35.3% Subprime and 1.4% Prime assets, totalling 89.6% RMBS (no limits on Subprime %). (RMBS accounts for ~90.0% of the initial collateral portfolio).

The initial % of below investment grade assets is 26.1%. The underlying RMBS collateral in the CDO may include up to 0% of IO obligations and up to 0% of Option ARMs/Neg Am, which are particularly exposed to reset risk. Collateralized debt obligations in this transaction will be limited to 10%.

Unsold tranche status
All unsold tranches have been taken back by HBK except for the Class A-1B($400mm). Currently, we are working with [redacted] to see if they will be interested to take the tranche.
The plan for distribution, if [redacted] decides not to take the tranche, will be a senior sequential repack. The Class A-1B will be broken into two tranches. DB will take the senior part (Class A-1B(I) $200mm) and HBK will take the bottom part (Class A-1B(II) $200mm). Once the repack is setup, then DB will try to syndicate the Class A-1B(I)

Repo to HBK
For now, HBK holds the $200mm of the Class A-1B through DB repo financing. The repo will be rolled on a weekly basis until [redacted] makes its final decision.

Financial/Hedging risk: The CDO can have up to 65.0% of synthetic asset. DB is currently buying protection from the CDO on a notional of $625.5 mm of credit default swaps (up to $650 mm). CDO Notes proceeds in an amount equal to the notional of the CDS were deposited in a segregated account and invested in a GIC with GE Funding Capital Market Services. Upon an credit event, proceeds from the segregated account will be applied directly to the payment of the settlement amount. Since the CDO uses the fixed cap version of the PAUG, the Available Funds Cap risk for the CDO is limited compared to cash RMBS exposures (the protection seller assumes the cap risk by netting the interest shortfall due to the protection buyer against and up to the CDS premium).

Operational / Management Risk: This is HBK's eighth CDO backed by structured product collateral. HBK is a qualified investment manager/sponsor, with a strong track record in fixed income management. HBK has $11.0 billion in equity capital under management. Since its inception in 1991, HBK Fund generated a compounded annual return of 14.55%, net of all fees and expenses. This is a revolving CDO, there is a 0.30% senior management fee, similar to Gemstone CDO II, IV and V. HBK's earlier CDOs are performing as expected, and the Portfolio Manager's experience in managing similar deals successfully is indicative of expected in-line performance of Gemstone CDO V.

CRM assessment:

Strengths:
- Exposure to the CDO is collateralized
- Experienced CDO Manager that invested in the equity tranche

Weaknesses:
- Concentration to the 2005 and 2006 vintage of the US RMBS market
- Large bucket for BB securities
- Large bucket for synthetic securities up to 65%.

Rating and LGD of the counterparty are upgraded to reflect the seniority of the post-closing positions in the CDO.

Batch Strategy: Exposure is consistent with the securitization batch strategy.

Signatures:

~~Abhayad Kamat~~
~~Global CDO Group~~ /
~~Vice President~~
KONSTANTIN KULEV
VICE PRESIDENT

André-Louis Clémot
CRM-SEC / Director

CDO Score Sheet Version 4.4, Dec. 22nd, 2006

Credit Officer:	Andre Cizmat		Note for data input:
Date:	29-Mar-07		Fill/Select these fields
			These fields are calculated
Borrower: Name & Country	Gemstone VII	Cayman Islands	
Funding Beneficiary / SPV: Name & Country			
Type(s) of Facility:	Margin		
Asset Type:	Diversified ABS		
CDO Type:	Other		
CDO Purpose:	Arbitrage		
Purpose of Financing	credit default swaps		
Seniority	Super-Senior (Senior to AAA)		
Initial size & currency of asset portfolio:	mn 650 USD	Applicable initial WAL:	8.00 yrs
Initial size of exposure & currency/ PFE for derivatives	mn 150 USD		
Trustee / Custodian : Name & Country	Deutsche Bank Trust	United States	

Results

PD Rating	iAAA
PD %	0.01%
LGD Rating	1
LGD %	5%
EL%	0.00%

PD Rating

	very good/ excellent	satisfactory	higher risk/ still acceptable	unknown/ n/a poor	
A Portfolio Manager Risk					
1 Name, Country & Rating (internal or external)	HBK Investments LP			United States	iBBB-
2 Total Assets under management		x			
3 Experience in specific asset class (number of CDOs managed)		x			
4 Performance of existing transactions	x				
5 Quality of management, systems, reputation		x			
B Asset Portfolio Risk					
6 Maturity of managed assets (WAL)		x			
7 Quality of underlying assets (WARF)	BB+				
8 Diversity & Granularity of asset pool - Concentration Risk		x			
9 Recovery Performance of asset class			x		
10 For Ramp-up facilities: Time to CDO closure					<< Please make a choice
C Structural Risks and Risk Mitigants					
11 Loss / Default coverage provided by credit enhancement					AAA
12 Modelling Approach	Waterfall: Reference to				
13 Rating Agency Methodology	Moody's and S&P				
14 Is legal structure of Funding Beneficiary bankruptcy remote?	Yes				
15 Overall documentation standards	x				
16 Hedging of Interest and F/X Risks	x				
17 Revolving Structure	Static				
18 Eligibility Criteria / Investment Guidelines	Tight				
19 Effectiveness of Performance Triggers, Tests, Covenants		x			

Comments:
Please provide any comments regarding PD section here!

Calculated PD Rating	IAAA
Overriding: If used, explanation in "Comments" section is required	
Final PD Rating	IAAA

LGD Rating

	very good/ excellent	satisfactory	higher risk/ still acceptable	unknown/ n/a poor	
D Structural Considerations					
20 Effect of Termination Triggers / Maturity of Financing		x			
21 Secondary market for asset pool			x		
22 Loss / Default coverage provided by credit enhancement (PD)			Rating range equivalent of:		AAA
23 Documentation (Legal) & Structural Risk (PD)					
E Third Party Support					
24 Name, Country, Internal Rating (of supporting entity)					
25 Volume of third party support	mn	USD			

Please provide a 1, 2, 3, 4, 5 grade indicating the expected Loss Given Default (LGD) of the transaction.

Comments:
Please provide any comments regarding LGD section here! :

LGD Rating :	1

GEMSTONE CDO VII CDO LTD. (the "Issuer")
CLOSING MEMORANDUM

TO:	**Brian Guerra**	Tel: 212.474.7370	Fax: 212.468.5246
	Bruce Vanmeter	Tel: 212.250.2515	Fax: 212.469.2966
	Jason Lowry	Tel: 212.588.5165	Fax: 212.446.1959
	Eric Martel	Tel: 214.758.6368	Fax: 214.979.8368
	Kevin Jenks	Tel: 212.588.7895	Fax: 212.446.1959
	Marco Lukesch	Tel: 212.588.5112	Fax: 212.446.1959
	Rachel Wish	Tel: 212.588.7889	Fax: 212.446.1959
	Peter Luebke	Tel: 212.250.6099	Fax: 212.468.5246
	Stephen T Hessler	Tel: 714.247.6294	Fax: 714.247.6475
	Susan Anderson	Tel: 714.247.6411	Fax: 714.247.6269
CC:	**Richard R Kim**	Tel: 212.250.3553	Fax: 732.578.2890
FROM:	**Abhayad Kamat**	Tel: 212.250.0526	Fax: 732.578.2890
	Sourav Sen	Tel: 212.250.0871	Fax: 732.578.2890
	Che Lu	Tel: 212.250.7801	Fax: 732.578.2890

CLOSING DATE: **March 15, 2007**

CLOSING LOCATION: Allen & Overy LLP
1221 Avenue of the Americas, 21st Floor
New York, NY 10020
(646) 344-6544 phone

TRANSACTION: Gemstone CDO VII Ltd.

CLIENT: HBK Investments L.P.

COLLATERAL: Structured Product Collateralized Debt Obligation

ISSUE:	$244,000,000	3m LIBOR + 0.21%	Class A-1a Floating Rate Notes
	$400,000,000	3m LIBOR + 0.35%	Class A-1b Floating Rate Notes
	$159,000,000	3m LIBOR + 0.47%	Class A-2 Floating Rate Notes
	$96,900,000	3m LIBOR + 0.68%	Class B Floating Rate Notes
	$68,300,000	3m LIBOR + 2.25%	Class C Floating Rate Deferrable Interest Notes
	$55,100,000	3m LIBOR + 4.75%	Class D Floating Rate Deferrable Interest Notes
	$18,700,000	3m LIBOR + 6.25%	Class E Floating Rate Deferrable Interest Notes
	$59,500,000	N/A	Preference Shares
TOTAL:	$1,101,500,000		

Transaction Closing Memorandum

Deutsche Bank

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
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DBSI_00133536
DB_PSI_00133536

REG S: Issuer: GEMSTONE CDO VII LTD / GEMSTONE CDO VII CORP

CUSIP	ISIN	Issue Description	Maturity
G37903AA2	USG37903AA26	Class A-1a Floating Rate Notes	12 December 2045
G37903AG9	USG37903AG95	Class A-1b Floating Rate Notes	12 December 2045
G37903AB0	USG37903AB09	Class A-2 Floating Rate Notes	12 December 2045
G37903AC8	USG37903AC81	Class B Floating Rate Notes	12 December 2045
G37903AD6	USG37903AD64	Class C Floating Rate Deferrable Interest Notes	12 December 2045
G37903AE4	USG37903AE48	Class D Floating Rate Deferrable Interest Notes	12 December 2045
G37903AF1	USG37903AF13	Class E Floating Rate Deferrable Interest Notes	12 December 2045

144A: Issuer: GEMSTONE CDO VII LTD / GEMSTONE CDO VII CORP

CUSIP	ISIN	Issue Description	Maturity
36868VAA4	US36868VAA44	Class A-1a Floating Rate Notes	12 December 2045
36868VAG1	US36868VAG14	Class A-1b Floating Rate Notes	12 December 2045
36868VAB2	US36868VAB27	Class A-2 Floating Rate Notes	12 December 2045
36868VAC0	US36868VAC00	Class B Floating Rate Notes	12 December 2045
36868VAD8	US36868VAD82	Class C Floating Rate Deferrable Interest Notes	12 December 2045
36868VAE6	US36868VAE65	Class D Floating Rate Deferrable Interest Notes	12 December 2045
36868VAF3	US36868VAF31	Class E Floating Rate Deferrable Interest Notes	12 December 2045

SOURCES OF FUNDS

Calculation of Issuance Proceeds

	Notional Amount	Issuance Price	Issuance Proceeds
Class A-1a	$244,000,000	100.0000000%	$244,000,000
Class A-1b	$400,000,000	100.0000000%	$400,000,000
Class A-2	$159,000,000	100.0000000%	$159,000,000
Class B	$96,900,000	100.0000000%	$96,900,000
Class C	$68,300,000	100.0000000%	$68,300,000
Class D	$55,100,000	100.0000000%	$55,100,000
Class E	$18,700,000	100.0000000%	$18,700,000
Preference Shares	$59,500,000	53.0617068%	$31,571,716
TOTAL:	$1,101,500,000		**$1,073,571,716**

Deutsche Bank

DETAIL OF WIRE REMITTANCES ON CLOSING DATE

I. Detail of Wire initiated by HBK

HBK Wire 1: to Trustee

- **Purchase of the Pref Shares**

Pref Shares Price	$ 31,571,715.55
minus Warehouse Carry and Hedge Gains	$ (6,402,985.19)
Total	$ 25,168,730.36

Wire Sender:	HBK Master Fund LP	
Payable to:	Deutsche Bank Securities Inc.	
In the Amount of:	**$25,168,730.36**	......(A)
Wire Instructions:	Deutsche Bank Trust Co America ABA# [redacted] Bene Name: NYLTD Funds Control – Stars West Bene Acct # [redacted] Ref: GEMSTONE VII CDO [redacted] Attn: Susan Anderson	

[redacted] = Redacted by the Permanent Subcommittee on Investigations

Note Proceeds to DB

Note Par	$1,042,000,000.00
MINUS: Discount	$ (3,390,856.80)
MINUS: DB underwriting fee	$ (4,792,792.70)
	$ 1,033,816,350.50

II. Detail of Wires initiated by Deutsche Bank Securities Inc.

DBSI Wire 1: to DBAG Cayman

- **To pay off net outstanding warehouse loan and unpaid interest:**

Wire Sender: Deutsche Bank Securities Inc.
Payable to: Deutsche Bank AG Cayman Islands Branch
In the Amount of: **$432,763,967.21**

Wire Instructions: Deutsche Bank Trust Company Americas, NY
ABA# [redacted]
Acct Name: FFC DB Loan Operations
Acct # [redacted]
Acct Name: Gemstone CDO VII

[redacted] = **Redacted by the Permanent Subcommittee on Investigations**

DBSI Wire 2: to Trustee

- **Remaining Portion of Proceeds from Sale of Notes MINUS outstanding warehouse loan and unpaid interest**

Wire Sender: Deutsche Bank Securities Inc.
Payable to: GEMSTONE CDO VII CDO LTD.
In the Amount of: **$ 601,052,383.29** ....**(B)**

Wire Instructions: Deutsche Bank Trust Co America
ABA# [redacted]
Bene Name: NYLTD Funds Control – Stars West
Bene Acct # [redacted]
Ref: GEMSTONE VII CDO [redacted]
Attn: Susan Anderson

CDO CLOSING CAN BE COMPLETED AFTER REMITTANCE OF ABOVE WIRES

Deutsche Bank

Trustee Details

Cash Account with CDO Trustee $19,143,328.79 ....(C)

Total Amount Received by the Trustee

Wire from HBK (A)	$25,168,730.36
Wire from DBSI (B)	$ 601,052,383.29
Cash Account with CDO Trustee (C)	$19,143,328.79
Total Amount Available with Trustee	**$645,364,442.44**

Transfers initiated by Trustee

Deposit to Synthetic Security Collateral Account (please wire to GE Funding Capital Market)	$614,827,780.20
Deposit to Uninvested Proceeds and Expense Account	$30,536,662.24

Deposit to Uninvested Proceeds and Expense Account	Details
Expense Account	$1,856,662.24
Uninvested Proceeds for settling trades	$28,680,000.00

Trustee Wire: to GE Funding Capital Market

- **Initial Deposit of $614,827,780.20 to the Initial Investment Agreement (GIC)**

Wire Sender: Deutsche Bank Trust Co America
Payable to: GE Funding Capital Market
In the Amount of: **$614,827,780.20**

Wire Instructions: TO: Deutsche Bank Trust Company Americas
New York, New York
ABA NUMBER: [redacted]
FOR GE CAPITAL CORP.
ACCOUNT NUMBER: [redacted]
REFERENCE: GE FUNDING CMS [redacted]

Redacted by the Permanent Subcommittee on Investigations

Note:
At Closing, the Aggregate Principal Balance of all Pledged Collateral Debt Securities *plus* the cash in the Synthetic Security Collateral Account should be equal to at least $1,100,000,000.

Deutsche Bank

Approved by: ______________________
Name: Richard Kim
Director
Deutsche Bank Securities Inc.

Approved by: ______________________
Name: Abhayad Kamat
Vice President
Deutsche Bank Securities Inc.

CONFIDENTIAL
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ABS CDOs Issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(e) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
Acacia 4 CDO	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal)	4/8/2004	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Redwood Wells Fargo Bank, National Association Walkers SPV Limited The Corporation Trust Company n/a Moody's Standard and Poor's E&Y US: Freshfields Bruckhaus Deringer LLP, Cayman: Walkers Freshfields Bruckhaus Deringer LLP US Fed. Tax: Chapman and Cutler, US: Tobin & Tobin Hunton & Williams to be identified	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y to be identified Moody's Standard and Poor's	310,000,000
Acacia 6 CDO	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Interest Rate Derivative Counterparty	11/9/2004	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Redwood Wells Fargo Bank, National Association Walkers SPV Limited Corporation Service Company n/a Standard and Poor's E&Y US: Freshfields Bruckhaus Deringer LLP, Cayman: Walkers Freshfields Bruckhaus Deringer LLP US Fed. Tax: Chapman and Cutler, US: Tobin & Tobin Hunton & Williams to be identified	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y to be identified Standard and Poor's	300,000,000

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ABS CDOs Issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(g) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
Acacia 7 CDO	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Interest Rate Derivative Counterparty	3/10/2005	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Redwood Wells Fargo Bank, National Association Walkers SPV Limited Corporation Service Company n/a Moody's Standard and Poor's E&Y US: Freshfields Bruckhaus Deringer LLP; Cayman: Walkers Freshfields Bruckhaus Deringer LLP US Fed. Tax: Chapman and Cutler, US: Tobin & Tobin Kennedy Covington to be identified	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y to be identified Moody's Standard and Poor's	300,000,000
Barramundi CDO I	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Asset Swap Counterparty Senior Loan Provider	12/12/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	CBASS The Bank of New York Maples Finance Limited n/a Deutsche Bank AG, London Moody's Standard and Poor's Deloitte & Touche US: Hunton & Williams, Cayman: Maples and Calder Skadden, Arps, Slate, Meagher & Flom Hunton & Williams Locke Liddell & Sapp Hunton & Williams	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	Deloitte & Touche Hunton & Williams Moody's Standard and Poor's	800,000,000
Blue Edge ABS CDO	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Senior Loan Provider Trustee	12/7/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel	Principal Capital Global Investors Deutsche Bank Trust Company Maples Finance Limited Donald J. Puglisi (State ID: 5107952) n/a Moody's Standard and Poor's E&Y US: Cadwalader Wickersham & Taft, Cayman: Maples & Calder Cadwalader Wickersham & Taft	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Cadwalader Wickersham & Taft Moody's Standard and Poor's	1,284,000,000

ABS CDOs Issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(e) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
			Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Mayer Brown Rowe & Maw Seward & Kissel Cadwalader Wickersham & Taft				
Bluegrass ABS CDO II	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Cayman SPV Administrator	4/14/2004	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Invesco Wells Fargo Bank, National Association Deutsche Bank (Cayman) CT Corporation n/a Moody's Standard and Poor's E&Y US: Orrick Herrington & Sutcliffe, Cayman: Walkers Orrick Herrington & Sutcliffe Clifford Chance US Kennedy Covington Orrick Herrington & Sutcliffe	– Credit Approval for Warehouse – Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Orrick Herrington & Sutcliffe Moody's Standard and Poor's	400,000,000
Carina CDO	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Interest Rate Derivative Counterparty Senior Loan Provider Cayman SPV Administrator Delaware SPV Administrator	11/1/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	State Street Global Advisors The Bank of New York Deutsche Bank (Cayman) Deutsche International Corporate Services (Delaware) FSA Capital Management Services Moody's Standard and Poor's E&Y US: Allen & Overy, Cayman: Turner & Roulstone Allen & Overy Goodwin Procter Gardere Wynne Sewell Allen & Overy	– Credit Approval for Warehouse – Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Allen & Overy Moody's Standard and Poor's	1,500,000,000
CBASS CBO XIII	Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal)	3/17/2005	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants	CBASS JP Morgan Chase Bank Maples Finance Limited The Corporation Trust Company n/a Standard and Poor's Deloitte & Touche		Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	Deloitte & Touche Hunton & Williams Standard and Poor's	493,250,000

ABS CDOs Issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(f) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
			Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	US: Hunton & Williams, Cayman: Maples and Calder Schulte Roth & Zabel Hunton & Williams Locke Liddell & Sapp Hunton & Williams				
Commodore CDO IV	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Senior Loan Provider Cayman SPV Administrator	8/19/2005	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Fischer Francis Investors Bank & Trust Company Deutsche Bank (Cayman) CT Corporation n/a Moody's Standard and Poor's PWC US: Orrick Herrington & Sutcliffe, Cayman: Walkers Orrick Herrington & Sutcliffe Dechert Nixon Peabody Orrick Herrington & Sutcliffe	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	PWC Orrick Herrington & Sutcliffe Moody's Standard and Poor's	400,000,000
Dalton CDO	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Senior Loan Provider	6/28/2007	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Dynamic Credit Partners Wilmington Trust Company Walkers SPV Limited Puglisi & Associates Rabobank Moody's Standard and Poor's Deloitte & Touche US: Allen & Overy, Cayman: Walkers Allen & Overy Orrick Herrington & Sutcliffe n/a Orrick Herrington & Sutcliffe	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	Deloitte & Touche Orrick Herrington & Sutcliffe Moody's Standard and Poor's	400,000,000

ABS CDOs Issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(g) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
Delta II	Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Interest Rate Derivative Counterparty Asset Swap Counterparty Trustee	7/15/2005	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Wharton Deutsche Trustee Company Limited Deutsche International Corporate Services (Ireland) Limited n/a n/a Moody's Standard and Poor's Irish Law: Matheson Ormsby Prentice England: Ashurst, US: McKee Nelson Speechly Bircham Ashurst to be identified		Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	to be identified Moody's Standard and Poor's	153,000,000
Diogenes CDO I	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Interest Rate Derivative Counterparty Asset Swap Counterparty Senior Loan Provider Delaware SPV Administrator	11/4/2005	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	State Street Global Advisors JP Morgan Chase Bank Maples Finance Limited Deutsche International Corporate Services (Delaware) XL Asset Funding Company Moody's Standard and Poor's E&Y US: Orrick Herrington & Sutcliffe, Cayman: Maples and Calder Orrick Herrington & Sutcliffe Goodwin Procter Gardere Wynne Sewell Orrick Herrington & Sutcliffe	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Orrick Herrington & Sutcliffe Moody's Standard and Poor's	400,000,000
Diogenes CDO II	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Interest Rate Derivative Counterparty Asset Swap Counterparty Senior Loan Provider	6/29/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel	State Street Global Advisors JP Morgan Chase Bank Maples Finance Limited Deutsche International Corporate Services (Delaware) Rabobank Moody's Standard and Poor's E&Y US: Allen & Overy, Cayman: Maples and Calder	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Allen & Overy Moody's Standard and Poor's	600,000,000

ABS CDOs issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(e) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
	Delaware SPV Administrator		Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Allen & Overy Goodwin Procter Gardere Wynne Sewell Allen & Overy				
Diogenes III	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Senior Loan Provider	8/3/2007	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	State Street Global Advisors The Bank of New York Maples Finance Limited Puglisi & Associates Rabobank Moody's Standard and Poor's E&Y US: Allen & Overy, Cayman: Maples and Calder Allen & Overy Goodwin Procter Gardere Wynne Sewell Allen & Overy	– Credit Approval for Warehouse – Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Allen & Overy Moody's Standard and Poor's	808,000,000
Dutch Hill Funding I	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Asset Swap Counterparty Cayman SPV Administrator	12/22/2005	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	TCW JP Morgan Chase Bank Deutsche Bank (Cayman) Donald J. Puglisi (State ID: 4063035, @ Corporation Trust Center) n/a Moody's Standard and Poor's Deloitte & Touche US: Linklaters, Cayman: Walkers Orrick Herrington & Sutcliffe Linklaters Gardere Wynne Sewell to be identified	– Credit Approval for Warehouse – Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	Deloitte & Touche to be identified Moody's Standard and Poor's	400,000,000
Dutch Hill Funding II	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty	6/2/2007	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants	TCW LaSalle Bank National Association Deutsche Bank (Cayman) Donald J. Puglisi (State ID: 4336910, @ Corporation Trust Center) n/a Moody's Standard and Poor's E&Y	– Credit Approval for Warehouse – Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Linklaters Moody's Standard and Poor's	399,000,000

ABS CDOs Issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(f) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
	Cayman SPV Administrator		Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	US: Linklaters, Cayman: Walkers Allen & Overy Linklaters Kennedy Covington Linklaters				
G Square Finance 2006-2	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Senior Loan Provider	11/30/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Wharton Asset Management HSBC Trustee Walkers SPV Limited n/a n/a Moody's Standard and Poor's n/a Cayman: Walkers England: Ashurst, US: McKee Nelson Speechly Bircham Ashurst Ashurst	– Credit Approval for Warehouse – Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	n/a Ashurst Moody's Standard and Poor's	1,014,000,000
Gemstone CDO II	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Interest Rate Derivative Counterparty Trustee Cayman SPV Administrator	5/3/2005	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	HBK Investments LP Deutsche Bank Trust Company Deutsche Bank (Cayman) The Corporation Trust Company n/a Moody's Standard and Poor's E&Y US: Orrick Herrington & Sutcliffe, Cayman: Maples and Calder Orrick Herrington & Sutcliffe Cadwalader Wickersham & Taft Seward & Kissel Orrick Herrington & Sutcliffe	– Credit Approval for Warehouse – Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Orrick Herrington & Sutcliffe Moody's Standard and Poor's	400,000,000
Gemstone CDO IV	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Interest Rate Derivative Counterparty	1/20/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies	HBK Investments LP Deutsche Bank Trust Company Deutsche Bank (Cayman) The Corporation Trust Company XL Asset Funding Company Moody's Standard and Poor's	– Credit Approval for Warehouse – Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Orrick Herrington & Sutcliffe Moody's Standard and Poor's	600,000,000

ABS CDOs Issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	Third Parties Retained to Perform Due Diligence (Roles)	Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
	Trustee Cayman SPV Administrator		Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	E&Y US: Orrick Herrington & Sutcliffe, Cayman: Maples and Calder Orrick Herrington & Sutcliffe Cadwalader Wickersham & Taft Seward & Kissel Orrick Herrington & Sutcliffe				
Gemstone CDO V	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Interest Rate Derivative Counterparty Trustee Cayman SPV Administrator	5/18/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	HBK Investments LP Deutsche Bank Trust Company Deutsche Bank (Cayman) The Corporation Trust Company XL Asset Funding Company Moody's Standard and Poor's E&Y US: Allen & Overy, Cayman: Maples and Calder Allen & Overy Cadwalader Wickersham & Taft Seward & Kissel Allen & Overy	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Allen & Overy Moody's Standard and Poor's	676,000,000
Gemstone CDO VII	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Trustee Cayman SPV Administrator	3/15/2007	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	HBK Investments LP Deutsche Bank Trust Company Deutsche Bank (Cayman) Donald J. Puglisi (State ID: 070220501) General Electric Capital Corporation Moody's Standard and Poor's E&Y US: Allen & Overy, Cayman: Maples and Calder Allen & Overy Cadwalader Wickersham & Taft Seward & Kissel to be identified	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y to be identified Moody's Standard and Poor's	1,101,500,000
GMAC RFC ABS CDO	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal)	6/30/2004	Collateral Manager Trustee Cayman SPV Administrator	GMAC-RFC Wells Fargo Bank, National Association Maples Finance Limited	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	Deloitte & Touche Orrick Herrington & Sutcliffe Standard and Poor's	300,000,000

ABS CDOs Issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(e) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
	Interest Rate Derivative Counterparty		Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	The Corporation Trust Company n/a Standard and Poor's Deloitte & Touche US: Orrick Herrington & Sutcliffe, Cayman: Maples and Calder Sidley Austin Brown & Wood Orrick Herrington & Sutcliffe Kennedy Covington Orrick Herrington & Sutcliffe				
Halcyon Securitized Products	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Asset Swap Counterparty Senior Loan Provider Cayman SPV Administrator	10/19/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Halcyon Securitized Products Investors LP The Bank of New York Deutsche Bank (Cayman) The Corporation Trust Company n/a Moody's Standard and Poor's Deloitte & Touche US: Skadden Arps Slate Meagher & Flom, Cayman: Turner & Roulstone Skadden Arps Slate Meagher & Flom Seward & Kissel Gardere Wynne Sewell Skadden Arps Slate Meagher & Flom	– Credit Approval for Warehouse – Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	Deloitte & Touche Skadden Arps Slate Meagher & Flom Moody's Standard and Poor's	400,000,000
Halcyon Securitized Products	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Senior Loan Provider Cayman SPV Administrator	5/17/2007	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Halcyon Securitized Products Investors LP The Bank of New York Deutsche Bank (Cayman) The Corporation Trust Company FSA Capital Management Services Moody's Standard and Poor's E&Y US: Skadden Arps Slate Meagher & Flom, Cayman: Turner & Roulstone Skadden Arps Slate Meagher & Flom Seward & Kissel Gardere Wynne Sewell Skadden Arps Slate Meagher & Flom	– Credit Approval for Warehouse – Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Skadden Arps Slate Meagher & Flom Moody's Standard and Poor's	500,000,000

ABS CDOs Issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(e) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
Hamilton Gardens	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Interest Rate Derivative Counterparty Senior Loan Provider Delaware SPV Administrator	9/21/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Rabobank International JP Morgan Chase Bank Maples Finance Limited Deutsche International Corporate Services (Delaware) Rabobank Moody's Standard and Poor's E&Y US: Allen & Overy, Cayman: Maples and Calder Allen & Overy Schulte Roth & Zabel Gardere Wynne Sewell Schulte Roth & Zabel	– Credit Approval for Warehouse – Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Schulte Roth & Zabel Moody's Standard and Poor's	500,000,000
Hamilton Gardens II	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Senior Loan Provider	8/15/2007	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Rabobank The Bank of New York Maples Finance Limited Puglisi & Associates Rabobank Moody's Standard and Poor's E&Y US: Allen & Overy, Cayman: Maples and Calder Allen & Overy Schulte Roth & Zabel Gardere Wynne Sewell Schulte Roth & Zabel	– Credit Approval for Warehouse – Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Schulte Roth & Zabel Moody's Standard and Poor's	400,000,000
Held 2006-1*	Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Asset Swap Counterparty Trustee	10/19/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel	Static Deutsche Trustee Company Limited Deutsche International Corporate Services (Ireland) Limited n/a n/a Moody's Standard and Poor's Irish Law: Matheson Ormsby Prentice Linklaters n/a Linklaters		Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	 to be identified Moody's Standard and Poor's	2,200,000,000

ABS CDOs Issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(e) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
			Counsel Providing 10b-5 Opinion	to be identified				

ABS CDOs Issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(e) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
Los Robles	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Interest Rate Derivative Counterparty Trustee Cayman SPV Administrator	8/10/2007	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Western Asset Deutsche Bank Trust Company Deutsche Bank (Cayman) Donald J. Puglisi (State ID: 4399801) Rabobank Moody's Standard and Poor's E&Y US: McKee Nelson, Cayman: Turner & Roulstone McKee Nelson Ropes & Gray Seward & Kissel to be identified	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y to be identified Moody's Standard and Poor's	750,000,000
Matrix 2007-1**		1/22/2007	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Faxtor Securities	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies		1,000,000,000
Mount Skylight	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Senior Loan Provider Trustee Cayman SPV Administrator Delaware SPV Administrator	5/24/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	TIAA Deutsche Bank Trust Company Deutsche Bank (Cayman) Deutsche International Corporate Services (Delaware) n/a Moody's Standard and Poor's E&Y US: Allen & Overy, Cayman: Walkers Allen & Overy Mayer Brown Rowe & Maw Seward & Kissel Allen & Overy	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Allen & Overy Moody's Standard and Poor's	1,000,000,000

ABS CDOs Issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(c) Third Parties Retained to Perform Due Diligence (Roles)	(e) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
Palisades CDO	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Cayman SPV Administrator	7/15/2004	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Western Asset Wells Fargo Bank, National Association Deutsche Bank (Cayman) CT Corporation n/a Moody's Standard and Poor's PWC US: Orrick Herrington & Sutcliffe, Cayman: Walkers Orrick Herrington & Sutcliffe Ropes & Gray Kennedy Covington to be identified	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	PWC to be identified Moody's Standard and Poor's	600,000,000
Pine Mountain CDO I	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Interest Rate Derivative Counterparty Senior Loan Provider Trustee Cayman SPV Administrator	11/8/2005	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Smith Breeden Associates Deutsche Bank Trust Company Deutsche Bank (Cayman) CT Corporation FSA Capital Management Services Moody's Standard and Poor's PWC US: Orrick Herrington & Sutcliffe, Cayman: Maples and Calder Orrick Herrington & Sutcliffe Paul Weiss Rifkind Wharton & Garrison Seward & Kissel Paul Weiss Rifkind Wharton & Garrison	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	PWC Paul Weiss Rifkind Wharton & Garrison Moody's Standard and Poor's	400,000,000
Pine Mountain CDO II	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Senior Loan Provider Trustee	11/16/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel	Smith Breeden Associates Deutsche Bank Trust Company Deutsche Bank (Cayman) Donald J. Puglisi (State ID: 4237656) FSA Capital Management Services Moody's Standard and Poor's PWC US: McKee Nelson, Cayman: Maples and Calder	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	PWC Paul Weiss Rifkind Wharton & Garrison Moody's Standard and Poor's	502,500,000

ABS CDOs Issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(e) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
	Cayman SPV Administrator		Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	McKee Nelson Paul Weiss Rifkind Wharton & Garrison Seward & Kissel Paul Weiss Rifkind Wharton & Garrison				
Pine Mountain CDO III	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Senior Loan Provider Trustee Cayman SPV Administrator	7/11/2007	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Smith Breeden Associates Deutsche Bank Trust Company Deutsche Bank (Cayman) Donald J. Puglisi (State ID: 4389585) FSA Capital Management Services Moody's Standard and Poor's PWC US: McKee Nelson, Cayman: Maples and Calder McKee Nelson Paul Weiss Rifkind Wharton & Garrison Seward & Kissel Paul Weiss Rifkind Wharton & Garrison	– Credit Approval for Warehouse – Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	PWC Paul Weiss Rifkind Wharton & Garrison Moody's Standard and Poor's	500,000,000
Sandstone CDO	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Interest Rate Derivative Counterparty Senior Loan Provider Trustee Cayman SPV Administrator	6/4/2004	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	HBK Investments LP Deutsche Bank Trust Company Deutsche Bank (Cayman) The Corporation Trust Company n/a Moody's Standard and Poor's E&Y US: Orrick Herrington & Sutcliffe, Cayman: Maples and Calder Orrick Herrington & Sutcliffe Cadwalader Wickersham & Taft Seward & Kissel Orrick Herrington & Sutcliffe	– Credit Approval for Warehouse – Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Orrick Herrington & Sutcliffe Moody's Standard and Poor's	307,400,000
Sharps CDO I	Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal)	12/15/2006	Collateral Manager Trustee Cayman SPV Administrator	Static Deutsche Bank Trust Company Maples Finance Limited		Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y McKee Nelson Standard and Poor's	350,000,000

ABS CDOs Issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(e) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
	Trustee		Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	The Corporation Trust Company n/a Standard and Poor's E&Y US: McKee Nelson, Cayman: Maples and Calder McKee Nelson n/a Seward & Kissel McKee Nelson				
Sharps CDO II	Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty	6/28/2007	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Static The Bank of New York Maples Finance Limited The Corporation Trust Company FSA Capital Management Services Moody's Standard and Poor's E&Y US: McKee Nelson, Cayman: Maples and Calder McKee Nelson n/a Dorsey & Whitney McKee Nelson	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y McKee Nelson Moody's Standard and Poor's	1,000,000,000
STACK 2005-1	Underwriter / Placement Agent / Structuring Agent Credit Default Swap Counterparty Asset Swap Counterparty Trustee	3/24/2005	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	TCW Deutsche Trustee Company Limited Maples Finance Limited n/a n/a Standard and Poor's E&Y US: Linklaters, Cayman: Maples and Calder, English Law: Linklaters Linklaters Linklaters Linklaters Linklaters		Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y Linklaters Standard and Poor's	1,000,000,000
Static Residential 2005-A	Underwriter / Placement Agent / Structuring Agent Credit Default Swap Counterparty	6/28/2005	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator	Static LaSalle Bank National Association Deutsche Bank (Cayman) Donald J. Puglisi		Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y McKee Nelson Moody's Standard and Poor's	1,000,000,000

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(e) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
	Asset Swap Counterparty Senior Loan Provider Cayman SPV Administrator		GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	n/a Moody's Standard and Poor's E&Y US: McKee Nelson, Cayman: Walkers McKee Nelson n/a Kaye Scholer McKee Nelson				
Static Residential 2005-B	Underwriter / Placement Agent / Structuring Agent Credit Default Swap Counterparty Senior Loan Provider Cayman SPV Administrator	10/27/2005	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Static LaSalle Bank National Association Deutsche Bank (Cayman) Donald J. Puglisi FSA Capital Management Services Moody's Standard and Poor's E&Y US: McKee Nelson, Cayman: Walkers McKee Nelson n/a Kaye Scholer McKee Nelson		Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y McKee Nelson Moody's Standard and Poor's	1,000,000,000
Static Residential 2005-C	Underwriter / Placement Agent / Structuring Agent Credit Default Swap Counterparty Senior Loan Provider Cayman SPV Administrator	1/20/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Static LaSalle Bank National Association Deutsche Bank (Cayman) Donald J. Puglisi FSA Capital Management Services Moody's Standard and Poor's E&Y US: McKee Nelson, Cayman: Walkers McKee Nelson n/a Kaye Scholer McKee Nelson		Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y McKee Nelson Moody's Standard and Poor's	500,000,000
Static Residential 2006-A	Underwriter / Placement Agent / Structuring Agent Credit Default Swap Counterparty	4/12/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies	Static LaSalle Bank National Association Deutsche Bank (Cayman) Puglisi & Associates FSA Capital Management Services Moody's Standard and Poor's		Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y McKee Nelson Moody's Standard and Poor's	1,000,000,000

ABS CDOs Issued by DBSI (between 2004 and 2008)

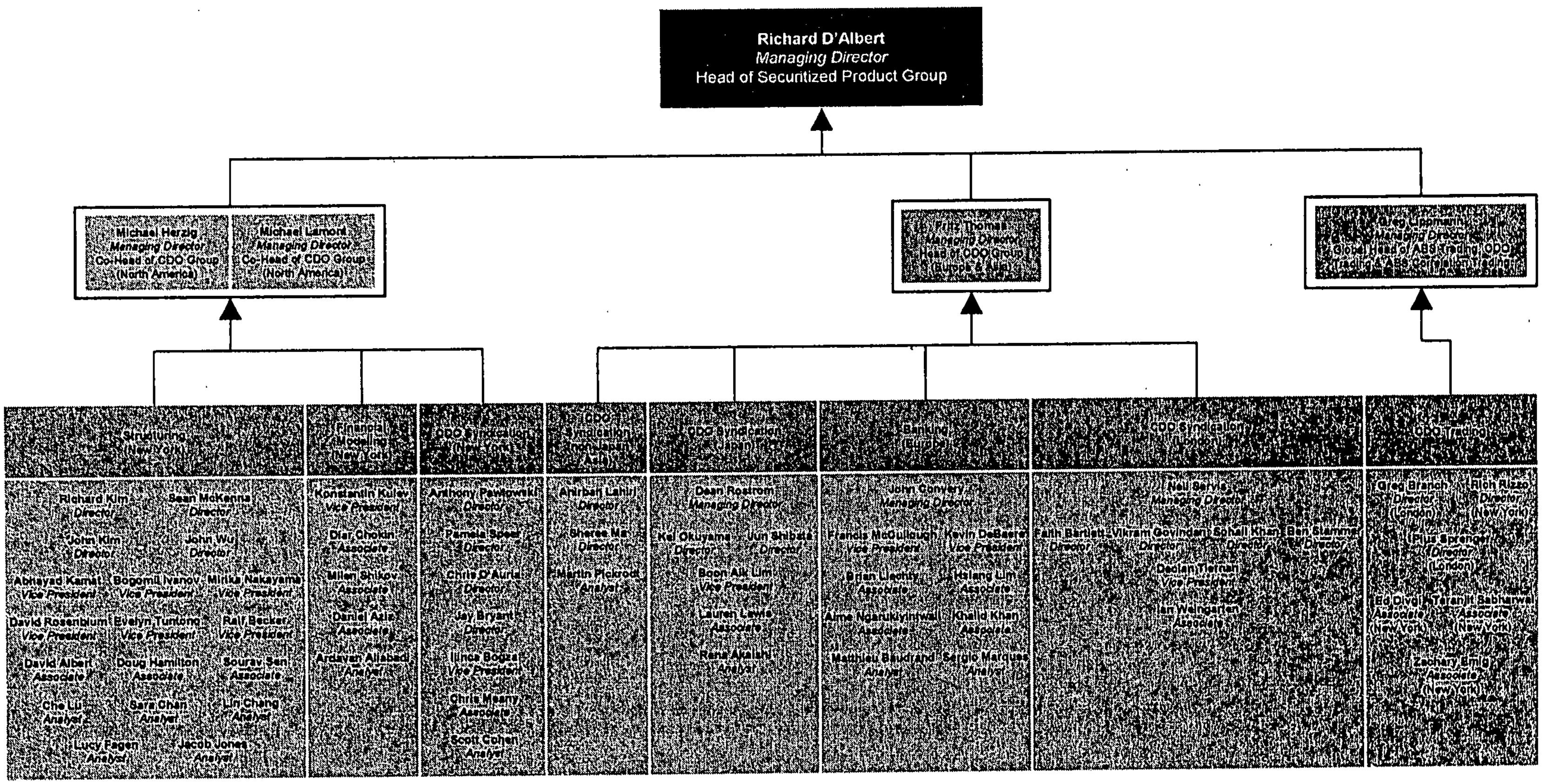
Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(e) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
	Senior Loan Provider Cayman SPV Administrator		Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	E&Y US: McKee Nelson, Cayman: Walkers McKee Nelson n/a Kaye Scholer McKee Nelson				
Static Residential 2006-B	Underwriter / Placement Agent / Structuring Agent Credit Default Swap Counterparty Senior Loan Provider Cayman SPV Administrator	8/22/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Static LaSalle Bank National Association Deutsche Bank (Cayman) Puglisi & Associates FSA Capital Management Services, XL Asset Funding Company Moody's Standard and Poor's E&Y US: McKee Nelson, Cayman: Walkers McKee Nelson n/a Kaye Scholer McKee Nelson		Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y McKee Nelson Moody's Standard and Poor's	1,000,000,000
Static Residential 2006-C	Underwriter / Placement Agent / Structuring Agent Credit Default Swap Counterparty Senior Loan Provider Cayman SPV Administrator	12/19/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Static LaSalle Bank National Association Deutsche Bank (Cayman) Puglisi & Associates Ambac Moody's Standard and Poor's E&Y US: McKee Nelson, Cayman: Walkers McKee Nelson n/a Kaye Scholer McKee Nelson		Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y McKee Nelson Moody's Standard and Poor's	750,000,000

ABS CDOs Issued by DBSI (between 2004 and 2008)

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(e) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
SYRAH 2004-10	Underwriter / Placement Agent / Structuring Agent Credit Default Swap Counterparty Interest Rate Derivative Counterparty Asset Swap Counterparty Delaware SPV Administrator	1/12/2005	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	Static Wells Fargo Bank, National Association Walker House Deutsche International Corporate Services (Delaware) n/a Standard and Poor's E&Y US: McKee Nelson, Cayman: Walkers McKee Nelson n/a Nixon Peabody McKee Nelson		Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	E&Y McKee Nelson Standard and Poor's	800,000,000
Tourmaline III	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Interest Rate Derivative Counterparty Senior Loan Provider	4/5/2007	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel Trustee Counsel Counsel Providing 10b-5 Opinion	BlackRock Wells Fargo Bank, National Association Maples Finance Limited The Corporation Trust Company Deutsche Bank AG, London Moody's Standard and Poor's Deloitte & Touche US: Skadden Arps Slate Meagher & Flom; Cayman: Maples & Calder Allen & Overy Skadden Arps Slate Meagher & Flom Kennedy Covington to be identified	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	Deloitte & Touche to be identified Moody's Standard and Poor's	1,500,000,000
Zais Investment Grade VIII	Warehouse Lender Underwriter / Placement Agent / Structuring Agent Trading Counterparty (selling assets to the deal) Credit Default Swap Counterparty Asset Swap Counterparty Senior Loan Provider Cayman SPV Administrator	3/23/2006	Collateral Manager Trustee Cayman SPV Administrator Delaware SPV Administrator GIC Provider Rating Agencies Accountants Issuer / Co-Issuer Counsel Initial Purchaser Counsel Collateral Manager Counsel	Zais Group JP Morgan Chase Bank Deutsche Bank (Cayman) The Corporation Trust Company n/a Moody's Standard and Poor's Deloitte & Touche US: Skadden Arps Slate Meagher & Flom, Cayman: Ogier Skadden Arps Slate Meagher & Flom Seward & Kissel	-- Credit Approval for Warehouse -- Warehouse Approval/Veto Rights Held by Trading Desk	Accountants (portfolio/modeling comfort letter) Counsels (10b-5 opinions) Rating Agencies	Deloitte & Touche Skadden Arps Slate Meagher & Flom Moody's Standard and Poor's	450,000,000

Deal Name	Deutsche Bank Role	Closing Date	Other Parties to the Transaction (Roles)	Other Parties to the Transaction (Names)	(d) Deutsche Bank In-House Due Diligence	(e) Third Parties Retained to Perform Due Diligence (Roles)	(e) Third Parties Retained to Perform Due Diligence (Names)	(f) Principal Balance of CDO Bonds Issued
			Trustee Counsel Counsel Providing 10b-5 Opinion	Gardere Wynne Sewell Skadden Arps Slate Meagher & Flom				

Deutsche Bank Global CDO Group
(as of September 2006)



Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1270

Confidential Treatment Requested by Deutsche Bank

DB_PSI_C00000001

Greg Lippmann@DBAMERICAS
07/14/2006 04:06 PM

To: Melissa Goldsmith/NewYork/DBNA/DeuBa@DBAmericas
cc:
Subject: Re:

I run secondary trades for all abs globally so not the structuring and purchasing of raw whole loans. But all trading post securitization in us and europe and all other types of abs-- credit cards autos etc etc. I also run all cdo trading -- abs backed, corporate, hy and emerging market. Also bespoke abs spoke aka "abs correlation". Lastly I am head of risk management for all new issue cdos so am involved in underwriting, structuring, marketing and hedging our wharehouse risk for new issuue cdos. Total reports roughly 15 in us and 10 in london. That enough?

Sent from my BlackBerry Handheld.

Melissa Goldsmith

From: Melissa Goldsmith
Sent: 07/14/2006 03:23 PM
To: Greg Lippmann
Subject: Re:

actually so i can explain who you are properly to him, you are the head of the trading desk of all abs subprime product as well
as secondary cdo's? or how do you describe your job. also, how involved are you in structuring cdo's of subprime:
jordan said you do that on your desk for bespoke pools but it's done on another desk for generic subprime?

sorry to be so annoying but i'd rather describe you accurrately than make something up.

Greg Lippmann/NewYork/DBNA/DeuBa

Greg Lippmann/NewYork/DBNA/DeuBa
07/14/2006 03:18 PM

To: Melissa Goldsmith/NewYork/DBNA/DeuBa@DBAmericas
cc:
Subject: Re:

Sure. Should be in at 7

Sent from my BlackBerry Handheld.

Melissa Goldsmith

From: Melissa Goldsmith
Sent: 07/14/2006 02:55 PM
To: Greg Lippmann
Subject: Re:

no--no worries! i left a voice message for him on his cell and haven't heard back. i'd imagine it's monday's business......maybe
we can call him very early monday, as he will be in london? let me know what works with you

Greg Lippmann/NewYork/DBNA/DeuBa

Greg Lippmann/NewYork/DBNA/DeuBa
07/14/2006 02:53 PM

To Melissa Goldsmith/NewYork/DBNA/DeuBa@DBAmericas
cc
Subject Re:

I remember now, sorry. Bit foggy from the trip. Cell iis 917.601.1916

Sent from my BlackBerry Handheld.

Melissa Goldsmith

From: Melissa Goldsmith
Sent: 07/14/2006 02:42 PM
To: Greg Lippmann
Subject: Re:

he's a senior pm and works closely w/louis bacon........some of the trades that mansfield's guys executed were from him, others were from other pm's
internally at moore. he's sort of changed roles a bit recently to working more on big picture strategic themes rather than trading more tactically;
and is working with louis a lot more than he used to.........

mansfield covers the execution desk.........

Greg Lippmann/NewYork/DBNA/DeuBa

Greg Lippmann/NewYork/DBNA/DeuBa
07/14/2006 02:37 PM

To Melissa Goldsmith/NewYork/DBNA/DeuBa@DBAmericas
cc
Subject Re:

Is he the guy who has done the index trade ie mansfields guuys?

Sent from my BlackBerry Handheld.

Melissa Goldsmith

From: Melissa Goldsmith
Sent: 07/14/2006 02:34 PM
To: Greg Lippmann
Subject: Re:

he's from moore.

Greg Lippmann/NewYork/DBNA/DeuBa

Greg Lippmann/NewYork/DBNA/DeuBa
07/14/2006 02:20 PM

To Melissa Goldsmith/NewYork/DBNA/DeuBa@DBAmericas
cc
Subject Re:

Yes. Where is he from again?

-----Sent from my BlackBerry Handheld.

Melissa Goldsmith

From: Melissa Goldsmith
Sent: 07/14/2006 11:39 AM
To: Greg Lippmann

greg: can we jump on a call w/richard monday morning?

rokurita@bbotg To: greglip@bbotg
cc:
Subject:
02/24/2006
08:33 AM

Message Sent: 02/24/2006 08:33:21
From: ROKURITA@BBOTG|ROCKY KURITA|DEUTSCHE BANK SECURI|1726|328663
To: GREGLIP@BBOTG|GREG LIPPMANN|DEUTSCHE BANK SECURI|1726|328663

gsc =

ACE 2005-HE5 M8 130 128 120 =

CSFB 2004-FRE1 B2 126 PASS !! pass =

HEAT 2005-9 M8 131 130 128 =

LBMLT 2004-3 M8 123 126 (THIS BOND BLOWS)pass(i disagree) =

POPLR 2004-4 B1 pass PASS pass =

Reply: =

Reply: =

OrgSmtpMsg.eml

From: GREG LIPPMANN (DEUTSCHE BANK SECURI) <GREGLIP@BBOTG>
Sent: Wednesday, May 11, 2005 4:29 PM
To: ROCKY KURITA (DEUTSCHE BANK SECURI) <ROKURITA@BBOTG>
Subject:

Message Sent: 05/11/2005 12:29:26
From: GREGLIP@BBOTG|GREG LIPPMANN|DEUTSCHE BANK SECURI|1726|328663
To: ROKURITA@BBOTG|ROCKY KURITA|DEUTSCHE BANK SECURI|1726|328663

alliance is looking to buy protection on 25-50mm baa2 hels. in addition, i have a bunch of hedge funds that are axed. all the real money flows are buying protection. we should get short.
Reply:
TRY HARD NOT TO SELL PROT TO ALLIANCE PLEASE...
Reply:
they are only going to us b/c we recommended the trade.
Reply:
GREAT

Greg Lippmann@DBAMERICAS

04/05/2006 05:17 PM

To: Richard R Kim/NewYork/DBNA/DeuBa@DBAMERICAS@DEUBAINT
cc: jordan.milman@db.com, michael.lamont@db.com, sean.mckenna@db.com
Subject: Re: ACA ABS CDO Portfolio

yikes didnt see that...half of these are crap and rest are ok...crap -- heat pchlt sail tmts

Greg H. Lippmann
Managing Director
Deutsche Bank Securities Inc.
3rd Floor
60 Wall Street
New York, New York 10005
Phone (212) 250-7730
Fax (212) 797-2201
Mobile (917)[redacted]

▬ = Redacted by the Permanent Subcommittee on Investigations

Richard R Kim/NewYork/DBNA/DeuBa@DBAMERICAS

04/05/2006 04:17 PM

To greg.lippmann@db.com, jordan.milman@db.com
cc michael.lamont@db.com, sean.mckenna@db.com
Subject ACA ABS CDO Portfolio

FYI
~15-17% Ba in the pool. What is your opinion of these credits?

----- Forwarded by Richard R Kim/NewYork/DBNA/DeuBa on 04/05/2006 03:14 PM -----

"Spilberg, Gregory" <gspilber@tiaa-cref.org>

04/05/2006 02:13 PM

To Richard R Kim/NewYork/DBNA/DeuBa@DBAmericas
cc
Subject ACA Portfolio

Attached is the ACA portfolio as requested. Please note that this portfolio information is confidential and by accepting the portfolio Deutsche Bank also agrees to keep the attached information confidential.

[attachment "Current Portfolio for Investors 3-29-06.xls" deleted by Greg Lippmann/NewYork/DBNA/DeuBa]

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1275

Greg Lippmann

06/26/2006
08:57 AM

To: BRADLEY.SCHWARTZ@jpmorgan.com@DEUBAINT
cc: Andrew G Isaacs/NewYork/DBNA/DeuBa@DBAmericas, David Ludlow/NewYork/DBNA/DeuBa@DBAmericas, "derek kaufman" <derek.kaufman@jpmorgan.com>, Pius Sprenger/DMGGM/DMG UK/DeuBa@DBEMEA
Subject: Re: Fw: JP Prop - Update

that should work...

Greg H. Lippmann
Managing Director
Deutsche Bank Securities Inc.
3rd Floor
60 Wall Street
New York, New York 10005
Phone (212) 250-7730
Fax (212) 797-2201
Mobile (917) [redacted]
BRADLEY.SCHWARTZ@jpmorgan.com

[redacted] = **Redacted by the Permanent Subcommittee on Investigations**

BRADLEY.SCHWARTZ@jpmorgan.com

06/26/2006 08:50 AM

To Greg Lippmann/NewYork/DBNA/DeuBa@DBAmericas
cc Andrew G Isaacs/NewYork/DBNA/DeuBa@DBAmericas, David Ludlow/NewYork/DBNA/DeuBa@DBAmericas, "derek kaufman" <derek.kaufman@jpmorgan.com>, Pius Sprenger/DMGGM/DMG UK/DeuBa@DBEMEA
Subject Re: Fw: JP Prop - Update

```
Thx for the feedback.  To the extent we can, I would like to  substitute
the 3 "good" names for the following

PCHLT 2005 -1 B2 (Baa2/BBB+)
JPMAC 2005-FRE1 M9 (Baa3/BBB-)
CWL 2005 BC5 M8 (Baa2/BBB+).



Bradley Schwartz
Managing Director
Proprietary Positioning and Principal Investments
270 Park Avenue
New York, New York  10017

212-834-5144
```

Greg Lippmann
<greg.lippmann@db.com>

06/23/2006 03:57 PM

To "derek kaufman" <derek.kaufman@jpmorgan.com>

cc

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1276

Andrew G Isaacs
<andrew.g.isaacs@db.com>,
"BRADLEY.SCHWARTZ"
<BRADLEY.SCHWARTZ@jpmorgan.com>,
David Ludlow <david.ludlow@db.com>,
Pius Sprenger
<pius.sprenger@db.com>
Subject
Re: Fw: JP Prop - Update

This is a good pool for you because it has a fair number of weak names but not so many that investors should balk (I wouldn't add more of these) and also has only a few names that are very good. The vast majority are average. In terms of optimizing, I guess you could get away with adding some more countrywide names which we think are mediocre (not all investors agree however), perhaps another Centex or People's Choice and reduce or remove the First Franklin, CBASS or POPLR names.

Weak names:

AABST 04-5 B2
AABST 05-3 B2
BAYV 05-C B2
INABS 05-C M8
PPSI 05-WHQ2 M8
PPSI 05-WHQ4 M8
SAIL 05-HE2 M8

The names above will give some investors concerns because they are weak, but since these are all Baa2 we should be ok. This might be smarter than putting in Baa3 off these pool and risking some investors passing.

Mediocre Names
CWL 05- 6 B
CXHE 05-C B2
ECR 05-3 M8
HEAT 05-3 B2
HEAT 05-5 M7
HEAT 05-8 B1
LBMLT 05-WL3 M9
PCHLT 05-4 M9

Good names
CBASS 05-CB2 B3
OOMLT 05-3 M8
POPLR 05-B M6

Also there is quite a lot of WMC paper. WMC trades well so should be easy to include in the pool, but the deals have among the highest concentrations of California loans.

------Original Message------

From: derek kaufman
To: Greg Lippmann
Cc: Andrew Isaacs
Cc: BRADLEY.SCHWARTZ
Cc: David Ludlow
Cc: Pius Sprenger
Sent: Jun 23, 2006 2:42 PM
Subject: Re: Fw: JP Prop - Update

Thanks. I'm very pleased we're getting so close.

Derek

|---------+--------------------------->
	Greg Lippmann
	<greg.lippmann@db
	.com>
	06/23/2006 02:40
	PM
---------+--------------------------->
>--
-----------------------------------|

|
|
| To: "derek.kaufman" <derek.kaufman@jpmorgan.com>
|
| cc: Andrew G Isaacs <andrew.g.isaacs@db.com>,
"BRADLEY.SCHWARTZ" <BRADLEY.SCHWARTZ@jpmorgan.com>, David Ludlow |
| <david.ludlow@db.com>, Pius Sprenger <pius.sprenger@db.com>
|
| Subject: Re: Fw: JP Prop - Update
|
>--
-----------------------------------|

2.5,2 and 1.5 enjoy yours as well.

Greg H. Lippmann
Managing Director
Deutsche Bank Securities Inc.
3rd Floor
60 Wall Street
New York, New York 10005
Phone (212) 250-7730
Fax (212) 797-2201
Mobile (917) [redacted]

= Redacted by the Permanent Subcommittee on Investigations

derek.kaufman@jpmorgan.com

06/23/2006 02:09 PM

To
Greg_Lippmann/NewYork/DBNA/DeuBa@DBAmericas

cc
Andrew G Isaacs/NewYork/DBNA/DeuBa@DBAmericas, "BRADLEY.SCHWARTZ" <BRADLEY.SCHWARTZ@jpmorgan.com>, David Ludlow/NewYork/DBNA/DeuBa@DBAmericas, Pius Sprenger/DMGGM/DMG UK/DeuBa@DBEMEA

Subject
Re: Fw: JP Prop - Update

Thanks very much -- do you have a rough sense of the overall delta of the A, AA and AAA tranches to the underlying names using these assu

----

Sent from my BlackBerry Handheld.

--

Greg Lippmann

08/04/2006
05:55 PM

To: "Borre, Michelle" <mborre@oppenheimerfunds.com>@DEUBAINT
cc:
Subject: Re: new list

i am in ny monday and london office wednesday and would be happy to discuss either day...quick thoughts: we can do 50 names (you already knew that secret) that said we wouldnt want quite so many sail (and you would b/c you want it to be more concentrated) so to start I would say max the sail out at 8-10 names and you have 12 so you would need to eliminate 2 of them. (note sail is among the widest spreads so these will likely be 350 area on baa3, another reason to include a lot of them or none of them)....you can certainly build a portfolio by picking only bad names and you have largely done that as Rasc ahl is considered bad as is freemont (bsabs fr, fhlt, jpmac fre, sabr fr, nheli fm deals) ace, arsi and lbmlt. NCHET is a middle tier name and bsabs and svhe (greenwich) are dealer rent a sheves so also lower middle tier.

also the 50 names, needs to be 50 separate securitizations wherease you have among your 50 deals many deals with two tranches....thus in looking at your list, you should start with a plan to use all baa3 (like you did last time) all baa2 or a mix...I would agree that the last time when you did all baa3 is probably the best route.

so from your 75, we are down to 46 separate securitizations.

remove 2 sail say sail 05-1 and 05-2 because they are the earliest and may have a bit more home price appreciation

we are now at 44 names

i would also eliminate deals that are already in your first trade so that you don't doubly lose if those underperform:

ace 05-he2 and 3, (also these are both a little older) I would replace both aces with two other ace say 05-he6 and he7 and add 06-he1 and 06-he2 too....since the ace name is not good and you want to be closer to your big sail position.

so now we are 46 nam es if you swap the 2 older ace for the 4 i mentioned here

similarly, you already have all three fhlt bonds i would roll up in these to 05-c, d, e

back to 46....

you have nchet 05-3 and 05-4, i would replace with nchet 06-2 (and keep 05-b,c,d and 06-1) and also add msac 06-nc1 b3 giving you 6 new century bonds

still at 46.

pchlt 05-2 also in the first deal so I'd remove it. In addition, its the only pchlt you have so better to add another nchet, ace etc...

down to 45

sabr you already have 05-fr2,3,4 so I would pair the 05-fr5 with the other freemonts you have like fhlt, jpmac etc....and maybe add in sabr 06-fr1

down to 43

looking at the sail, in additon to sail 05-1 and 2 which i removed for being old, 5,6 and 7 are all duplicates so I would add back in sail 06-3 and 06-4...again sail is among the very worst names and will trade really wide but we are building a wide pool....i think having 7 sails is enough but if you do the swaps I suggest you are at 9 sails and

down to 42 total names

Permanent Subcommittee on Investigations
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looking at the remainder from the top of the list down

arsi is a pretty weak name so I would add arsi 06-w1 and w5 to your 2,3 and 4

brings you back to 45 names (i think)

I would keep all the bsabs

i would remove the gsamp because it is a bit orphaned as the lone goldman sachs rent a shelf

down to 44

leave the jpmac as its freemont and will fit nicely with the fhlt (and other shelves to come)

Long beach is a weak name but you have only picked one relatively older one so I would remove it and either put in no long beach or use 06-1,2 and 3.

Lets assume none for the moment.

down to 43

I would add to the mabs 05-he1, the he2 and he3 deals

back up to 45

keep the nheli 05-fm b/c it fits with the other freemonts

i think the rasc ah deals are good to include and i would put in the ahl1 and ahl2 to join the ahl3 that you picked

brings you to 47

at this point we have

4 ace (probably enough could maybe add 1 more ace 06-he3)
5 arsi good amount
5 bsabs good amounts (this counts the bsabs fr in freemont)
8 fhlt (between fhlt, sabr,bsab jp and nheli)
3 mabs (could maybe add one or two here)
6 nchet (good number)
3 rasc ahl probably ok could maybe add another 1 or 2
9 sail (good number)
2 svhe (could add a few)

so I would suggest finding 3 more bonds that you find appealing I would look for in more or less this order

mabs
svhe
rasc
ace

which should be doable

Greg H. Lippmann

Managing Director
Deutsche Bank Securities Inc.
3rd Floor
60 Wall Street
New York, New York 10005
Phone (212) 250-7730
Fax (212) 797-2201
Mobile (917) [redacted]

[redacted] = Redacted by the Permanent Subcommittee on Investigations

"Borre, Michelle" <mborre@oppenheimerfunds.com>

08/04/2006 02:56 PM

To Greg Lippmann/NewYork/DBNA/DeuBa@DBAmericas

cc

Subject new list

Hi Greg- i took a quick pass at a new list- i want to get it down to 50. i can refine it further- but before i do are there any of these you would throw out? any thoughts on it? thx

have a good weekend. are you around to discuss pricing next week? i am in monday and wednesday...

Michelle

[attachment "2005-2006 Collateral Info MB.xls" deleted by Greg Lippmann/NewYork/DBNA/DeuBa]

LAW OFFICES
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KEVIN M. DOWNEY
(202) 434-5460
kdowney@wc.com

EDWARD BENNETT WILLIAMS (1920-1988)
PAUL R. CONNOLLY (1922-1978)

March 21, 2011

By Electronic Mail

David H. Katz, Esq.
Counsel
Senate Permanent Subcommittee on Investigations
199 Russell Senate Office Building
Washington, DC 20510

▬▬ = Redacted by the Permanent Subcommittee on Investigations

Re: Deutsche Bank

Dear Mr. Katz:

On behalf of Deutsche Bank, this is to provide information in response to requests made recently by the Subcommittee through you, including those reiterated in your March 16 email to me.

Follow-Up Production Related to Notional Spreadsheet

After DB's production on March 2, you inquired about the long position of DB's RMBS book. I told you that the numbers reflected in our chart did not reflect non-mortgage assets used to hedge mortgage assets, which assets had the effect of reducing the size of the long position. We agreed that DB would prepare a chart including such non-mortgage assets in its RMBS calculation for 12/31/07. A chart doing so is attached. The footnote to the chart is also important in understanding the notional position of the RMBS book at the time.

[redacted]

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1278

▬▬ = Redacted by the Permanent Subcommittee on Investigations

[redacted]

CDO and RMBS Fees

You had asked for more detail concerning the fees paid to DB for CDO and RMBS underwritings in 2006 and 2007.

For CDO transactions, the structuring and placement fees to which DBSI was entitled pursuant to letters of engagement for CDO transactions it arranged in 2006 and 2007 were generally within the range of .5% and 2.0% of the notional value of total issuance, although the fees that DBSI actually charged were sometimes discounted from these rates.

For RMBS transactions, DB's underwriting fees/underwriters compensation varied depending on the Bank's role in the offering.

For third-party RMBS offerings in which Deutsche Bank Securities Inc. ("DBSI") acted solely as the lead or co-lead manager, DBSI was typically compensated either (1) through a negotiated fee that ranged between 15 and 25 basis points (.15 and .25% of the notional value of the issuance) or (2) through the spread between the certificate price paid to the issuer and the price at which the certificates were sold to investors.

For example, in connection with the underwriting of POPLR 2006-D, the underwriting agreement provided that DBSI would purchase the publicly-offered bonds at a .25% discount off of the public offering price. The publicly-offered bonds had an aggregate principal amount of $347,766,000 and were priced at par in the initial distribution. DBSI underwrote 50% of these bonds while RBS Greenwich Capital underwrote the other 50%. DBSI's underwriting fees earned in connection with POPLR 2006-D would have been approximately $434,707. This is calculated by multiplying the portion of the principal amount purchased and resold by DBSI ($173,883,000) by the underwriting discount (.0025).

For Deutsche Bank's own shelf offerings (e.g. the ACE and DBALT offerings), DBSI did not earn a traditional underwriting fee. Instead, the Bank sought to profit through (1) the sale of servicing rights in connection with securitizations, (2) interest payments made to DBSP while the loans were owned by DBSP prior to securitization, and (3) investment earnings on the certificates retained by DBSI in its inventory.

I believe that this addresses the questions that we have recently discussed.

Please let me know if you are seeking anything additional or if you would like to discuss the above.

Very truly yours,

Kevin Downey

Kevin Downey

Enclosures

Senate Permanent Subcommittee On Investigations
RMBS Notionals, Including Non-Mortgage Hedges

RMBS	12/31/2007
Cash Bonds	
Gross Assets	166,108,401,773
Gross Liabilities	(25,776,021)
Net	**166,082,625,753**
Synthetics	
Gross Assets	57,124,947,630
Gross Liabilities	(117,851,884,240)
Net	**(60,726,936,610)**
Other	
NonMortgage hedges	(28,345,699,904)
Net	**(28,345,699,904)**
Grand Net	**77,009,989,238** [*]

[*] Certain RMBS products have significant large notional values and minimal market values (for example, interest only bonds). If the market value of these RMBS products, rather than the notional value, were used in this calculation, the Grand Net as of December 31, 2007 would be approximately $24 billion, rather than the much larger number reflected here.

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KEVIN M. DOWNEY
(202) 434-5460
kdowney@wc.com

March 2, 2011

David H. Katz, Esq.
Counsel
Senate Permanent Subcommittee on Investigations
199 Russell Senate Office Building
Washington, DC 20510

Re: Deutsche Bank

Dear Mr. Katz:

On behalf of Deutsche Bank, this provides information in response to the requests contained in your February 2, 2011 and February 23, 2011 emails to me.

First, in response to your February 2 email, attached is a spreadsheet showing the notional net position of various DB business units in mortgage assets as of various dates in 2007. These are the same dates and same business units whose net revenues were shown in our prior production of information. DB's Finance Department calculated the positions in mortgage assets only for these business units specifically in response to your request. (As you know, the units have other non-mortgage assets).

Second, below find responses to the questions posed in your February 23 email regarding ACE Securities Corp.:

- **Describe DB's ownership interest in or control of ACE including but not limited to whether ACE is a subsidiary, affiliate or other related entity.**

Deutsche Bank has no ownership interest in ACE Securities Corp. ("ACE"). All of the shares of capital stock of ACE are held by Altamont Holdings Corp., a Delaware corporation. Deutsche Bank Securities, Inc. ("DBSI"), however, is an administrative agent for ACE and in that role has authority to act on behalf of ACE in connection with offerings of asset-backed securities, including RMBS offerings.

- **DB's role in the creation or formation of ACE.**

Although no one involved in the formation of ACE is still employed by Deutsche Bank, our current understanding is that in 1998, Deutsche Bank hired the AMACAR Group, LLC ("AMACAR") to assist in the creation of ACE to act as a registrant and depositor in connection with RMBS offerings sponsored and/or underwritten by Deutsche Bank.

- **DB's financial relationship with ACE, including any compensation received by either entity and the amount(s) received.**

DBSI pays an annual management fee to AMACAR, which serves as the manager of ACE. Between 1998 and 2006, DBSI paid AMACAR an annual management fee of $10,000. Since 2006, DBSI has paid AMACAR an annual management fee of $20,000. Beyond the annual management fee, in its role as a depositor and issuing entity in connection with RMBS offerings, ACE purchased mortgages from DB Structured Products, Inc. ("DBSP") and sold RMBS certificates to DBSI as described more fully below.

- **Describe generally ACE's role and responsibilities as a depositor and issuing entity in connection with any RMBS deal underwritten by DB.**

ACE participated in many RMBS offerings as a depositor and issuer and acted as the registrant in connection with the shelf registration statements pursuant to which the securities were registered for public sale. ACE is a special purpose corporation incorporated in the State of Delaware on June 3, 1998. ACE's principal executive offices are located at 6525 Morrison Boulevard, Suite 318, Charlotte, North Carolina 28211.

As depositor and issuer, ACE participated in the formation of the RMBS offerings as follows. Generally, pursuant to the various mortgage loan purchase agreements between DBSP and ACE, loans were sold by DBSP to ACE. In connection with this sale, DBSP, ACE and the relevant trustees and servicers entered into a pooling and servicing agreement by which a common law trust was created. ACE would then "deposit" the mortgages loans into the trust and the trust would in turn issue RMBS securities to ACE. ACE would then sell those certificates to DBSI. ACE would then use the proceeds of the sale of the certificates to DBSI to pay for the mortgages acquired from DBSP. DBSI, as underwriter, would then sell the certificates to investors or retain them in its inventory depending on market conditions and demand.

Although in practical terms ACE performed the functions of an issuer, ACE was not technically the legal entity that issued the RMBS securities. Instead, the securities were issued by separate common law trusts that were created for each offering. The trusts were created by ACE (as noted above), together with DBSP, and the relevant trustees and servicers, pursuant to pooling and servicing agreements for each offering. For example, the ACE 2006-SL2 Trust is a common law trust formed under the laws of the State of New York pursuant to the pooling and servicing agreement for ACE 2006-SL2, dated March 1, 2006. The pooling and servicing agreement constituted the "governing instrument" under the laws of the State of New York.

- **In 2007 were any DB employees also employed by ACE? If yes, please provide the number.**

No. ACE did not employ any Deutsche Bank employees in 2007.

- **In 2006 – 2007 did ACE act as a depositor exclusively for DB RMBS deals?**

In most instances, between 2006 and 2007, ACE acted as the depositor for subprime RMBS offerings sponsored by DBSP and underwritten by DBSI. In a few instance, however, ACE acted as the depositor for RMBS offerings that were underwritten by DBSI but sponsored by firms that were not affiliated with Deutsche Bank.

- **In 2006 – 2007 did ACE act as an issuing entity exclusively for DB RMBS deals?**

Please see the answer above. ACE's activities as an issuer were identical to its activities as a depositor.

Please do not hesitate to contact me with any questions.

Very truly yours,

Kevin Downey

Kevin Downey

Attachment

Greg Lippmann
To: michael.lamont@db.com, richard.dalbert@db.com
cc:
Subject: Winchester Capital: Potential Barramundi Purchase: Lochsong Synthetic CDO

08/23/2006
06:49 PM

i was going to reject this because it seems to be a pig cdo position dump 60^ but then i noticed winchester is the portfolio selector......any idea ???

Greg H. Lippmann
Managing Director
Deutsche Bank Securities Inc.
3rd Floor
60 Wall Street
New York, New York 10005
Phone (212) 250-7730
Fax (212) 797-2201
Mobile (917) [redacted]

[redacted] = Redacted by the Permanent Subcommittee on Investigations

----- Forwarded by Greg Lippmann/NewYork/DBNA/DeuBa on 08/23/2006 06:49 PM -----

"Emilio, Grace \(C-BASS\)" <Grace.Emilio@C-BASS.COM>

08/23/2006 06:46 PM

To Bruce VanMeter/NewYork/DBNA/DeuBa@DBAmericas, "Deturo, Mac \(C-BASS\)" <Mac.Deturo@C-BASS.COM>, Doug Hamilton/db/dbcom@DBAmericas, "Emilio, Grace \(C-BASS\)" <Grace.Emilio@C-BASS.COM>, Greg Lippmann/NewYork/DBNA/DeuBa@DBAmericas, Hiroki Kurita/NewYork/DBNA/DeuBa@DBAmericas, Jordan Milman/NewYork/DBNA/DeuBa@DBAmericas, Lalantika Padmanabhan/NewYork/DBNA/DeuBa@DBAmericas, Michael Lamont/NewYork/DBNA/DeuBa@DBAmericas, Mike Li/db/dbcom@DBAmericas, "Pecache , Janice \(C-BASS\)" <Janice.Pecache@C-BASS.COM>, Peter Luebke/NewYork/DBNA/DeuBa@DBAmericas, Phillip Dominguez/db/dbcom@DBAmericas, "Pyne, Rob \(C-BASS\)" <Rob.Pyne@C-BASS.COM>, Rachel Wish/NewYork/DBNA/DeuBa@DBAmericas, "Rickert, Andy \(C-BASS\)" <Andy.Rickert@C-BASS.COM>, Sean McKenna/NewYork/DBNA/DeuBa@DBAmericas, "Silver, Erik \(C-BASS\)" <Erik.Silver@C-BASS.COM>, Stephen T Hessler/NewYork/DBNA/DeuBa@DBAmericas, Tasneem Selim/NewYork/DBNA/DeuBa@DBAmericas

cc

Subject Potential Barramundi Purchase: Lochsong Synthetic CDO

Please see attached marketing materials for Lochsong Synthetic CDO and let us know your thoughts for potential inclusion into the Barramundi warehouse.

We have an IOI (subject to credit) on $24MM of the Class C notes rated A2/A by Moody's and S&P. Price talk is currently at +130 and WAL of the bond is 6.2 years. The deal is scheduled to price the middle to end of next week (8/30 - 9/1).

Some deal specifics:
1. The deal is a static one - 97% of the referenced obligations have been identified thus far. It is anticipated that the remaining 3% will be identified within the next week before closing. The attached spreadsheet is a collateral list.
2. 100% of the collateral is synthetic - with 60% of the securities referencing CDO obligations and the remaining 40% referencing RMBS obligations
3. All ratings on the underlying referenced obligations have an explicit Moody's and/or S&P rating of at least A3/A-.
4. Waterfall is a modified sequential pay that allows the class C's to receive principal

on day 1.
5. Credit Events include:
a. Failure to pay principal
b. Writedown
c. Distressed ratings downgrade
d. Failure to pay interest (pertaining to the CDO portion of the portfolio)
6. Winchester Capital Principal Finance will serve as asset selector for the transaction and will be responsible for asset selection and surveillance of the portfolio.
7. Winchester is expected to take down 50% of the equity and Goldman is expected to take down the remainder.

Any additional questions, comments or concerns feel free to give a call. Thanks in advance.

Grace Emilio
C-BASS, LLC
Capital Markets Group
212.850.5061 Ph
212.850.7760 Fa
grace.emilio@c-bass.com

- -

Lochsong1.pdf	**Type:** application/octet-stream **Name:** Lochsong1.pdf
Lochsong2.pdf	**Type:** application/octet-stream **Name:** Lochsong2.pdf
Lochsong Collateral 2.xls	**Type:** application/vnd.ms-excel **Name:** Lochsong Collateral 2.xls

greglip@bbotg
08/30/2006
11:52 AM

To: bwickens1@bbotg
cc:
Subject:

Message Sent: 08/30/2006 11:52:55
From: GREGLIP@BBOTG|GREG LIPPMANN|DEUTSCHE BANK SECURI|1726|328663
To: BWICKENS1@BBOTG|BRADLEY WICKENS|SPINNAKER CAPITAL LT| |

where would you price CBASS 05-CB2 Baa3

its got good CE and has paid down/delvered alot but its not
performing well and i think it trades pretty expensive
Reply:
CBASS IS A T OP 3 NAME SO U R RIGHT THEY TRADE TIGHT....I ALSO
AGREE SOME OF THEM SEEM TO BE PERFORMING LIKE CRAP AND THEY HAVE
HAD A FEW DOWNGRADES ON THEIR 02-04 PAPER...THAT SAID I CAN PRO
BABLY SHORT THIS NAME TO SOME CDO FOOL THUS ILL OFFER U PROTECTI
ON AT 205....

OrgSmtpMsg.eml

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1280

greglip@bbotg To: bwickens1@bbotg
cc:
Subject:

09/01/2006
12:06 PM

Message Sent: 09/01/2006 12:06:01
From: GREGLIP@BBOTG|GREG LIPPMANN|DEUTSCHE BANK SECURI|1726|328663
To: BWICKENS1@BBOTG|BRADLEY WICKENS|SPINNAKER CAPITAL LT| |

can you price MBAS 2006-FRE1 M9 thanks
Reply:
THIS BOND HAS POOL ENHANCEMENT AND THUS ONLY .7% CREDIT ENHANCEM
ETN....THIS KIND OF STUFF RARELY TRADES IN SYNTHETIC MARKET AND
WILL BE TOUGH FOR US TO COVER I.E. SHORT TO A CDO FOOL. THAT SAI
D IF U GAVE US AN ORDER AT 260 WE WOULD TAKE IT AND TRY TO DUPE
SOMEONE. FOR YOU, I'LL MAKE THIS BOND 235-290 B/C OF THE LACK OF
LIQUIDITY IN POOL DEALS RATHER THAN A TIGHTER MARKET LIKE USUAL

AS A POINT OF REFERENCE WE WOULD DO MABS 06-FRE2 M9 AT 245

OrgSmtpMsg.eml

bwickens1@bbotg To: greglip@bbotg
cc:
Subject:
09/01/2006 12:04 PM

Message Sent: 09/01/2006 12:04:59
From: BWICKENS1@BBOTG|BRADLEY WICKENS|SPINNAKER CAPITAL LT| |
To: GREGLIP@BBOTG|GREG LIPPMANN|DEUTSCHE BANK SECURI|1726|328663

can you price MBAS 2006-FRE1 M9 thanks
Reply:
CRAP BOND...U R GOOD..
Reply:
maybe too crap to short

OrgSmtpMsg.eml

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1282

Melissa Goldsmith

09/21/2006
01:12 PM

To: Greg Lippmann/NewYork/DBNA/DeuBa@DBAmericas
cc:
Subject: Re:

gotcha. call me when you have a second.

Greg Lippmann/NewYork/DBNA/DeuBa

Greg Lippmann/NewYork/DBNA/DeuBa

09/21/2006 12:57 PM

To Melissa Goldsmith/NewYork/DBNA/DeuBa@DBAmericas
cc
Subject Re:

Right

Sent from my BlackBerry Handheld.

Melissa Goldsmith

From: Melissa Goldsmith
Sent: 09/21/2006 12:50 PM
To: Greg Lippmann
Subject: Re:

"we shorted" meaning we're short the credit as well?

Greg Lippmann/NewYork/DBNA/DeuBa

Greg Lippmann/NewYork/DBNA/DeuBa

09/21/2006 12:49 PM

To Melissa Goldsmith/NewYork/DBNA/DeuBa@DBAmericas
cc
Subject Re:

MSHEL 2006-1 B3 230 crap we shorted
FFML 2006-FF10 M9 245 ffml was top tier, fast becoming mid tier
GSAMP 2006-HE3 M9 265 this bond sukks but we are short 20MM
FFML 2006-FF1 M9 235 see above
GSAMP 2006-HE1 B1 240 better than other gsamo but tighter
ACE 2006-NC1 M9 248 ace is generally horrible and new century I mid tier.

Looks like you were well taken care of. Which I am happy about.

Sent from my BlackBerry Handheld.

Melissa Goldsmith

From: Melissa Goldsmith
Sent: 09/21/2006 12:46 PM
To: Greg Lippmann

MSHEL 2006-1 B3 230

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1283

FFML 2006-FF10 M9 245
GSAMP 2006-HE3 M9 265
FFML 2006-FF1 M9 235
GSAMP 2006-HE1 B1 240
ACE 2006-NC1 M9 248

Axel Kunde@DBEMEA

10/02/2006 04:57 PM

To: Sean Whelan/db/dbcom@DBAmericas
cc: Pius Sprenger/DMGGM/DMG UK/DeuBa@DBEMEA, Greg Lippmann/NewYork/DBNA/DeuBa@DBAmericas
Subject: Fw: King Street

Sean,

here is what we would like to propose:

King Street shorts the whole portfolio they have chosen at the protection offer level to us. They also buy the 25-35% AAA and the 35-100% Super Senior at current market levels, we underwrite all the other tranches between 3% and 25%, and King Street takes the 0-3% Equity which gets all residual cash flows. The economics in this trade are the same as in a publicly marketed full capital structure CDO whereas in fact King Street is doing their own private deal with us. There are a couple of things to note about full cap structure deals though:

1) It is almost impossible to place BBB risk and below without a manager, and even single-A is challenging
2) The portfolio which KingStreet selected with high concentrations in LBMLT, HEAT, INABS, AMSI/ARSI, RAMP/RASC, and CWL would be impossible to sell to the public
3) The structuring/placement fees on full cap deals are 1-1.5% of the portfolio notional, ratings are about 0.5% of notional, and there are administrative costs for the trustee
4) The ratings of the notes are supported by IC/OC triggers which divert cash flows away from the equity, and which we do not have in our trades.

So there is no way King Street could place the 3-25% risk on their portfolio in the market. However, we are willing to take the risk down, and in addition with a much simpler structure without IC/OC: We offer 15 bps on the 35-100, 45 bps on the 25-35, and we underwrite the 3-25 at the average portfolio spread. In return KingStreet pays us one year's protection premium on the portfolio notional upfront, i.e. roughly 2.5%. Part of this upfront payment covers our loss from underwriting the mezzanine tranches below market levels. The rest is for taking down the risk on an unsalable deal plus as a substitute for structuring/placement fees which KingStreet would have to pay on any other deal.

The economics of the trade for KingStreet are simple: Assuming an average portfolio spread of 250 bps, they pay us 2.5% upfront and 3% for the equity. At this spread the equity will return roughly 60% , i.e. 1.8% of portfolio notional p.a. Put differently: If all credits survive for the first 3 years King Street will have recovered their initial upfront payment plus the equity notional - the rest is upside. If reference credits were to default before year three the equity would nonetheless get all the XS income of the portfolio. But King Street would also receive protection payments from us for the defaulted credits. In addition, if spreads on Home Equity BBBs were to widen out King Street could sell protection on the single-name portfolio, thereby locking in a positive carry for the lifetime of the trade while still benefitting from the mezz protection they bought from us.

I think that's a very efficient way of executing a structured short on the Home Equity market, with very limited downside if nothing defaults (average portfolio spread on 22% of cap structure plus 2.5% upfront). Please let me know what they say.

Kind regards,

Axel.

Axel Kunde
Deutsche Bank AG, London
ABS Correlation Trading

Tel.: +44 207 545 7800
Mobile: +44 7795 122 235

----- Forwarded by Axel Kunde/DMGGM/DMG UK/DeuBa on 02/10/2006 18:04 -----

Sean Whelan/db/dbcom@DBAMERICAS
27/09/2006 19:52

To Greg Lippmann/NewYork/DBNA/DeuBa@DBAmericas
cc "Axel Kunde" <axel.kunde@db.com>, "Pius Sprenger" <pius.sprenger@db.com>
Subject Re: King Street

they want to short the market and are willing to pay the freight. in the correlation trade they are long idiosyncratic risk. they also ran breakevens- which they feel are high- 2 events virtually knock out the equity- for every subsequent event their max benefit is 1.8 mm. crude- but they would need 7 events to break even. (yes- this ignores spread widening on the remainder.)- they think a more efficient short is a bespoke trade. their ideal short would be the belly of the capital structure. when we last spoke about it, we told them the equity and the AAA were the parts we found difficult to place. they are willing to buy the equity and even the AAA's t get an efficient short of the belly-

Greg Lippmann/NewYork/DBNA/DeuBa
09/27/2006 02:31 PM

To Sean Whelan/db/dbcom@DBAmericas, "Pius Sprenger" <pius.sprenger@db.com>, "Axel Kunde" <axel.kunde@db.com>
cc
Subject Re: King Street

Whjat does thaty mean? Will they massively overshort vs 6x coupon??

Sent from my BlackBerry Handheld.

From: Sean Whelan
Sent: 09/27/2006 11:02 AM
To: Greg Lippmann
Subject: Re: King Street

Greg- I was not accurate- do not want to do a fully placed deal . they want to short the entire delta- thanks-

Greg Lippmann/NewYork/DBNA/DeuBa
09/27/2006 10:57 AM

To Sean Whelan/db/dbcom@DBAmericas, Axel Kunde/DMGGM/DMG UK/DeuBa, Pius Sprenger/DMGGM/DMG UK/DeuBa
cc
Subject Re: King Street

Which is it ? Magnetar is fully placed and talk to lamont. If they want to do our trade but short entire delta we can price that too.

Sent from my BlackBerry Handheld.

From: Sean Whelan

Sent: 09/27/2006 10:51 AM
To: Greg Lippmann; Axel Kunde; Pius Sprenger
Subject: King Street

Spoke with King Street this morning. rather than do the carry neutral correlation trade, the would like to pursue a bespoke or Magnatar type trade. They want more leverage and are willing to hold the equity in a 375mm type transaction, and short the rest of the capital structure . the 75 names we have can be used, or we can add if need be-thanks-Sean

Greg Lippmann

To: "Craig Carlozzi" <craig@mastcapllc.com>@DEUBAINT
cc: "Chris Madison" <chris@mastcapllc.com>
Subject: Re: subprime CDS

10/20/2006
06:36 PM

levels are basically unchanged: see comments below

FMIC 06-2 M8 - 135, Fieldstone likely to go bk or be bought by the street within 6 months so headline risk could make it a good short. Very low gross wac of 6.18 could lead to payment shock. 45% IO. Bond was shorted to us by an ABS Hedge Fund in full competiton at 135 on October 18.

ACCR 06-1 M8 - 130. One of the top / most respected names. The 2006 vintage seems to be worse / more similar to other shelves than prior ones (see recent new stories on LEND) and thus it is trading closer to other names than the 2005 cohort does. We shorted this very bond a bit above 100 over in competiton to a CDO manager on October 19 and thus can make this one a bit tighter. Moderately high FICO with low LTV and low California. On the other hand, 34% have second mortgages, only 57% Full Doc and 8% investor property.

LBMLT 06-5 M9 - 375. Long Beach is one of the weakest name in the market. We shorted this bond to a CDO in the mid-300s on october 13. Deal was done in late June before S & P changed their criteria on July 1. Lots of 40 year mortgages as evidenced by the 409 WAM. (360 being 30 year) Less than half the loans have full documentation and 10% are investor properties. This is a real pig.

LBMLT 06-2 M9 350. See above on Long Beach. This one is already performing poorly with substantial delinquencies. Further the FICO is less than the 06-5 and there are fewer full doc loans. This seems a better short than the 06-5. Only reasons I can think for my guys showing you a tighter level is that we are very short this one and that the June 06 deals have a taint that earlier months dont due to the theory that late June deals were crammed with bad stuff in order to beat the S & P revisions.

RASC 06-EMX2 M8 145. This was shorted to us at 145 on Sep 29. If anything the market is a bit wider since then. These trade somewhat tight because they have extremely low California percentages and decently high (64%) of full doc loans. 10% of the loans are second liens so that could make this a good short.

FFML 06-FF13 M9 270. A CDO got long this risk in competition at 240 on October 10 so this is a good level i.e. roughly 1 point bid /ask. The CDOs like First Franklin because of the high FICO scores, but I like shorting them becuase of the low enhancement, very high % of silent seconds and in this case large number of 40 year mortgages (421 WAM) especially coupled with the 30% IO, a 40 year mortgage is a another way of saying an IO in my view.

SAST 06-1 B2 200. No trading in this name recently. SAXON is one of the weakest originators/servicers. Loans don't look too bad though. On the other hand, 371 WAM is a bit high and 603 FICO is quite low.

CWL 06-BC3 M9 350. No trading in this name recently. Countrywide is a mid-tier issuer. Not much to say here other than low FICO. Some of the others might be more appealing.

Greg H. Lippmann
Managing Director
Deutsche Bank Securities Inc.
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Phone (212) 250-7730
Fax (212) 797-2201
Mobile (917) [redacted]

[redacted] = Redacted by the Permanent Subcommittee on Investigations

"Craig Carlozzi" <craig@mastcapllc.com>

10/20/2006 02:44 PM

To Greg Lippmann/NewYork/DBNA/DeuBa@DBAmericas

cc "Chris Madison" <chris@mastcapllc.com>

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1284

Subject subprime CDS

Greg,

Here are the tranches that Chris and I find the most attractive. We'd appreciate any thoughts you may have...

Thanks for your help,
Craig

Tranches:

FMIC 2006-2 M8 135, fieldstone likely to go bk or be bought by the street within 6 months so this could be a good short.

ACCR 2006-1 M8

LBMLT 2006-5 M9

LBMLT 2006-2 M9

RASC 2006-EMX2 M8

FFML 2006-FF13 M9

SAST 2006-1 B2

CWL 2006-BC3 M9

Craig Carlozzi, CFA
Senior Analyst/Partner
MAST Capital Management LLC

GREGLIP@bloomberg.net
12/04/2006 10:06 AM

Tomlee@contrariancapital.com
cc
bcc
SubjectRE:

=====Begin Message=====
Message#: 122868
Message Sent: 12/04/2006 10:06:17
From: GREGLIP@bloomberg.net|GREG LIPPMANN|DEUTSCHE BANK SECURI|1726|328663
To: mlee@contrariancapital.com| | | |
Subject: RE:

sure....this afternoon...u have picked some crap right away so u have figured it out

----- Original Message -----
From: Mark Lee <mlee@contrariancapital.com>
At: 12/04 10:00:21

That's great. We assumed that we were going to pick some that didn't make sense. If you want you can call me today and I will tell you how we are looking at this and why it is taking us some time.

-----Original Message-----
From: greglip@bloomberg.net [mailto:greglip@bloomberg.net]
Sent: Monday, December 04, 2006 9:59 AM
To: Mark Lee
Subject: Re:

lets work through amin the oomlt 06-2 is one of the worst deals ever so not sure that is going to be a good one to match up on...will be bac k on these.

----- Original Message -----
From: Mark Lee <mlee@contrariancapital.com>
At: 12/04 9:56:48

Could you give us quotes on the BBB- bond on the following deals?
Bear BSABS 06-HE8
Bear BSABS 06-HE7
Option One OOMLT 06-2
Ameriquest AMSI 06-R1

Also, I sent you our DB coverage last week. Where should we start for ISDA?

Mark Lee.
Portfolio Manager
Contrarian Capital
411 West Putnam
Suite 225
Greenwich CT 06830

P: (203) 862-8203
F: (203) 629-1977

This has been prepared solely for informational purposes. It is not an

Greg Lippmann/NewYork/DBNA/DeuBa@DBAMERICAS

12/08/2006 11:49 AM

Topfaulkner@psamllc.com
cc
bcc
Subjectother bonds

just traded these

ACCR 2006-1 M8 160
SAST 2006-2 B2 190
CWL 2006-BC2 M8 225
FMIC 2006-3 M8 180

Just offered these:

Deal	8-Dec
ABSHE 2006-HE5	300.00
ACE 2006-OP1	300.00
AMSI 2006-R2	450.00
ARSI 2006-W1	550.00
FFML 2006-FF8	325.00
FHLT 2006-2	435.00
GSAMP 2006-HE3	400.00
GSAMP 2006-NC2	525.00
HEAT 2006-7	460.00
JPMAC 2006-WMC1	325.00
LBMLT 2006-WL1	310.00
MSAC 2006-HE5	385.00
RASC 2006-KS3	460.00

your bonds

gsamp 06-nc2 m8 this is an absolute pig...see the m9 above will offer the m8 at 375
bsabs 05-he12 m7 225
rasc 05-ks8 m8 pass t his is a bad deal and we are already long it

Greg H. Lippmann
Managing Director
Deutsche Bank Securities Inc.
3rd Floor
60 Wall Street
New York, New York 10005
Phone (212) 250-7730
Fax (212) 797-2201
Mobile (917)[redacted]
greg.lippmann@db.com

[redacted] = Redacted by the Permanent Subcommittee on Investigations

GREGLIP@bloomberg.net

03/01/2007 05:42 AM

To JORIS1@bloomberg.net
cc
bcc
Subject

```
=====Begin Message=====
Message#: 118415
Message Sent: 03/01/2007 05:42:30
From: GREGLIP@bloomberg.net|GREG LIPPMANN|DEUTSCHE BANK
SECURI|1726|328663
To: JORIS1@bloomberg.net|JORIS HOEDEMAEKERS|OASIS CAPITAL (UK) L|
|
Subject:

JORIS-SORRY YOUR LIST GOT BURIED UNDER THE TO DO LIST HERE U
GO:
ABSHE 2006-HE1 M7    500 CRAP
DEAL
ACE 2005-RM2 M9
475
ACE 2006-HE2 M7      550 DEAL IS A
PIG !
BSABS 2006-HE3 M7
650
MLMI 2006-HE1 B1A
325
SAST 2005-2 B2
300
SAST 2005-3 B2
300
=====End Message=====
```

From: BRADLEY WICKENS (SPINNAKER CAPITAL LT) <BWICKENS1@BBOTG>
Sent: Thursday, June 8, 2006 1:26 PM
To: GREG LIPPMANN (DEUTSCHE BANK SECURI) <GREGLIP@BBOTG>
Subject:

Message Sent: 06/08/2006 09:26:11
From: BWICKENS1@BBOTG|BRADLEY WICKENS|SPINNAKER CAPITAL LT| |
To: GREGLIP@BBOTG|GREG LIPPMANN|DEUTSCHE BANK SECURI|1726|328663

what going on in housing, with these hawkish sounds and grwoth
concerns should be playing straight into our hands
Reply:
nothing....stuff is flat b/c the cdo machine has not slowed but
i am fieleding 2-4 new guys a day that are kicking the tires so
we probably dont go tighter...i remain convinced that the trade
will work and trying not to be too frustrated that it is not hap
peneing as soon as we would like given the moves in other market
s....
Reply:
honestly, i was always concerned about the CDO machine, which
is whi i stayed out at first. i think you can put this on in
september

From: GREG LIPPMANN (DEUTSCHE BANK SECURI) <GREGLIP@BBOTG>
Sent: Tuesday, August 29, 2006 5:25 PM
To: BRADLEY WICKENS (SPINNAKER CAPITAL LT) <BWICKENS1@BBOTG>
Subject:

Message Sent: 08/29/2006 12:25:20
From: GREGLIP@BBOTG|GREG LIPPMANN|DEUTSCHE BANK SECURI|1726|328663
To: BWICKENS1@BBOTG|BRADLEY WICKENS|SPINNAKER CAPITAL LT||

The JPMAC -05-FRE1 has very good step down CE lvls, maybe not

such no brainer short at 210

Reply:

WE MISSED THAT....

Reply:

its a minefield this market, CS has exactly the same view as

you, one day the music will stop.

Reply:

IT WILL..I DONT CARE WHAT SOME TRAINED SEAL BULL MARKET RESEARCH

PERSON SAYS THIS STUFF HAS A REAL CHANCE OF MASSIVELY BLOWING UP

AND ON MY SONS LIFE I HAVE BEEN SHORT 800MM TO 2.2BB CONTINUOSL

Y SINCE BEFORE I STARTED SPEAKING WITH U...THESE PEOPLE (AND ME

TOO I GUESS) HAVE NEVER SEEN A BEAR MARKET SO THEY CANT IMAGINE

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1290

Greg Lippmann/NewYork/DBNA/DeuBa@DBAMERICAS

03/04/2007 10:04 AM

To"Harvey Allon" <Hallon@Braddockfinancial.com>
cc
bcc
SubjectRe: A new take

Indeed. Speak when you land, safe comfortable flight.

Sent from my BlackBerry Handheld.

----- Original Message -----
From: "Harvey Allon" [Hallon@Braddockfinancial.com]
Sent: 03/04/2007 08:04 AM MST
To: Greg Lippmann
Subject: RE: A new take

Heading to airport. My issue with hpa is that it doesn't have much to do with the hpa in the locations where the subprime loans are concentrated. The stories from new construction areas for example are nightmares. -20% hpa is not uncommon.

From: Greg Lippmann [mailto:greg.lippmann@db.com]
Sent: Sunday, March 04, 2007 7:58 AM
To: Harvey Allon
Subject: Re: A new take

I remain firm in my belief that these are blowing up whether people like it or now and that hpa is far less relevant for subprime than these bulls think. Can't blame them because if this blows up lots of people lose their jobs so they must denyv in hope that that will help prevent the collapse. At this price I'm nearly just as short as I've ever been.

Sent from my BlackBerry Handheld.

----- Original Message -----
From: "Harvey Allon" [Hallon@Braddockfinancial.com]
Sent: 03/04/2007 07:55 AM MST
To: Greg Lippmann
Subject: RE: A new take

I see a problem with Glenn's theory in the first few sentences. "The problem with the early defaults is bad underwriting." No shit Sherlock!

From: Greg Lippmann [mailto:greg.lippmann@db.com]
Sent: Sunday, March 04, 2007 7:46 AM
To: Harvey Allon
Subject: Re: A new take

Did not, thanks. Working out sitter / time / venue for tomight now. Be back. Will read this now and be back soon.

Sent from my BlackBerry Handheld.

----- Original Message -----
From: "Harvey Allon" [Hallon@Braddockfinancial.com]
Sent: 03/04/2007 07:44 AM MST
To: Greg Lippmann
Subject: FW: A new take

Didn't know if you got this.

From: Dave Myers
Sent: Friday, March 02, 2007 10:30 AM
To: Kevin Ahern; Harvey Allon
Subject: A new take
Importance: High

From: Wachovia Structured Products Research [mailto:WBSP.Research@wachovia.com]
Sent: Thursday, March 01, 2007 5:14 PM
To: undisclosed-recipients
Subject: Glenn Schultz: U.S. Housing Outlook Update
Importance: High

U.S. Housing Outlook Update
First-Quarter 2007 Update

Executive Summary

On Nov. 14, 2006 we published our *Housing Outlook* and predicted that home price appreciation would be 3.0%–5.0%

over the next 3-5 years. Our forecast has not changed.

The Office of Housing Enterprise and Oversight (OFHEO) home price index released on March 1, 2007, follows the releases of both the existing home sales median price, a poor indicator of home prices, and the S&P Case-Shiller home price index, arguably one of the better indicators of home prices. The OFHEO home price statistics were released against the backdrop of increased market volatility and concern surrounding the subprime borrower or, more accurately, concern regarding subprime underwriting criteria. The housing bears will have to wait another day for their route; an event that will, in our opinion, never happen. Rather, we suggest that investors focus more on the fundamentals, namely low unemployment, strong personal income growth, the supply of housing and the quality of underwriting.

In this update, we examine recent home price statistics as well as the fundamentals that we believe provide a strong foundation to the U.S. housing market. In addition, we reiterate our belief that a homeowner will not default simply because home prices did not appreciate or modestly declined. Rather, as we stated in December 2006, the recent spate of delinquency and early default are a result of poor underwriting.

<<US_Housing_Outlook_Update_030107.pdf>>

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(704) 715-7936

Michael George/NewYork/DBNA/DeuBa@DBAMERICAS

06/23/2007 07:37 AM

To Greg Lippmann/NewYork/DBNA/DeuBa@D
cc
bcc
Subject Re: Bear: Will Provide $3.2B To Its Hig

Question is who else sells......the Europeans will just bury in their portfolios.....most of them are no where near as transparent as say Abbey was. Ralph's porfolio going to be a huge overhang on market.....why buy new issue when you can just to knock on the Bear HFs door and McGarrigal will have something for you !!!
Michael R George
Managing Director
Deutsche Bank
60 Wall Street
New York, NY 10013
+1-212-250-6819
+1-917-459-3207
Sent from my BlackBerry Handheld.

From: Greg Lippmann
Sent: 06/23/2007 06:59 AM EDT
To: Michael George/NewYork/DBNA/DeuBa@DBAmericas@DBAMERICAS@DEUBAINT
Subject: Re: Bear: Will Provide $3.2B To Its High-Grade Hedge Fund

Yup this is the beginning of phase 2 (the bulls still can't see it), sales by the longs and how do you think the foreign banks will feel when they see that the true mark for what they have is.......this could be the end of the cdo biz. I want to print 100% of verticals monday list. Please be involved.

Sent from my BlackBerry Handheld.

From: Michael George
Sent: 06/23/2007 04:12 AM EDT
To: Greg Lippmann/NewYork/DBNA/DeuBa@DBAmericas@DBAMERICAS@DEUBAINT
Subject: Re: Bear: Will Provide $3.2B To Its High-Grade Hedge Fund

Reading the Bear CFO's statement to the press........
'The market for CDOs will stabilise and then they'll resume asset sales"

How they expect this to happen with Ralphie Fund overhanging the market beats me....there's the 3.2bn from Bear...plus Citi's repo positions plus Bracaps.......market will continue to go down until prices reach a level attractive enuff to attract new capital.
Michael R George
Managing Director
Deutsche Bank
60 Wall Street
New York, NY 10013
+1-212-250-6819
+1-917-459-3207
Sent from my BlackBerry Handheld.

From: Greg Lippmann
Sent: 06/22/2007 11:24 PM EDT
To: Michael George
Subject: Fw: Bear: Will Provide $3.2B To Its High-Grade Hedge Fund

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1293

Sent from my BlackBerry Handheld.

From: Ted Meyer
Sent: 06/22/2007 05:30 PM EDT
To: Alan Cloete; Alex Crossman; Barry Bausano; Greg Lippmann; Joseph Randazzo; Matt Connolly; Michele Allison; Patrick McKenna; Philip Weingord; Renee Calabro; Richard Walker; Robert Khuzami
Subject: Bear: Will Provide $3.2B To Its High-Grade Hedge Fund

Bear: Will Provide $3.2B To Its High-Grade Hedge Fund
(Dow Jones 06/22 14:06:56)

NEW YORK (Dow Jones)--Bear Stearns Chief Financial Officer Sam Molinaro said Friday that the bank's financial condition remains strong, as it seeks to raise $3.2 billion to shore up its troubled hedge funds business.

In a conference call, Bear Steans' Molinaro said that the bank's financial condition remains strong and its has "ample liquidity" for the $3.2 billion loan extended to one of its troubled hedge funds. The bank is seeking to facilitate an orderly deleveraging of its hedge funds, which have experienced significant liquidity problems over the last few weeks.

While valuations have clearly been pressured over the past couple of weeks, he said Bear Stearns has more than adequate collateral to cover its liabilities.

But Molinaro pointed out that exact figures are difficult to gauge, given the "fluidity" of current market conditions.

Bear confirmed the financing Friday as the fund's managers struggled to settle their debts to a group of Wall Street lenders, including Deutsche Bank AG (DB), Merrill Lynch & Co. (MER) and Lehman Brothers Holdings Inc. (LEH).

Earlier this week, creditor Merrill Lynch was the first among creditors to seize collateral - much of it mortgage-backed debt - from Bear's internal hedge funds, the High Grade Strategies Fund and its High Grade Credit Strategies Enhanced Leverage Fund. Merrill held an auction of $100 million of seized assets Thursday.

Bear's intervention appears to have nipped further such action in the bud. Molinaro said Friday that "all of the threats of liquidations have been pulled while we're negotiating with counterparties." Earlier this week, creditors were circulating lists of assets for sale in an attempt to curb their exposure. Merrill went ahead and sold a fraction of its $850 million up for sale while Lehman Brothers put $400 million on the block Thursday, according to a source.

Nevertheless, he conceded that values of the collateral in two troubled hedge funds have been "beaten down" in the past couple of weeks.

"Some assets are being sold to dealers," Molinaro said, adding "the situation is fluid."

The deleveraging may take several months to complete, in a gradual process to avoid overburdening the market.

Bear is hoping that market conditions will stabilize in the meantime. It will take "several months to wind down the asset levels," he said.

Responding to a question about the covenants involved in the Bear Stearns loan, Molinaro said "we haven't completely drilled down on this issue" and that it will "take several months to work this out."

The executive said he didn't envisage any impact on Bear Stearns' reputation from the troubles of its hedge fund business.

Asked about the timeline of the deterioration, Molinaro said the funds recorded their first negative performance in March, after 40 quarters of profit.

The redemption requests started to arrive in April, and the pressure intensified from there. "I believe we closed the fund to redemptions in May," said Molinaro.

The losses multiplied as the values of the portfolios sank. The inability to satisfy margin calls triggered more declines, he said, describing the event as a "vicious circle."

--

Bear Puts Up $3.2B & Seeks To Explain Funds Slow-Motion Crash
(Dow Jones 06/22 17:20:31)

By Emily Barrett

NEW YORK (Dow Jones)--Bear Stearns Cos (BSC) stepped into the melee surrounding its troubled hedge funds business Friday with some urgent finances, and an attempt to explain how the slow-motion subprime landslide engulfed some of its most leveraged investments.

The damage control comes days after it emerged that two Bear hedge funds - the High Grade Structured Credit Fund and High Grade Structured Credit Enhanced Leverage Fund - were foundering on bad investments in the subprime mortgage market.

Wall Street banks were circling and Merrill Lynch (MER) was first to swoop, seizing around $1 billion in debt to auction in a fire sale.

In a conference call Friday, Sam Molinaro, Bear's chief financial officer, first sought to reassure investors of the bank's financial strength, observing that the investment bank can easily cover the $3.2 billion it plans to inject into one of the two troubled hedge funds - the High-Grade Fund. He also pointed out that the bank's mortgage business is in good health, and that Bear had no "material" lending exposure to the funds in the first place.

Bear Faces Criticism As Investors Mull Deal

Not all stock market observers are persuaded. Punk Ziegel analyst Richard Bove says Bear's loan is a poor use of investor funds. Shareholders are "faced with the fact that the company may be lending money at below the rate" it earns on capital invested into the fund, he said, noting that "there is no good way" to determine the value of the fund's assets.

"It is also important to understand that $3.2 billion, if this is the right number, is 24.8% of Bear Stearns common equity," Bove says. "This is no small bet."

That view was reflected in late trade. Shares in Bear Stearns closed down 1.4% at $143.75 on a day when broad concerns about the deterioration in securities tied to subprime mortgages pushed down the financial services sector and the main market indexes.

Only An Episode In Subprime Drama

It's becoming clear that Friday's action is only an episode in the drama that began back in March, and is far from over.

Back in February, as delinquencies mounted among subprime borrowers, and mortgage lenders started to fail, the securities that ultimately bundle these risky loans began to suffer. This had a knock-on effect on the riskiest layer of the debt structures held by investors such as the two hedge funds.

Molinaro conceded that the funds' investments recorded their first negative returns back in March. The first redemption requests from lenders came in April. Declining values triggered margin calls among lenders, which then created a "vicious circle," the executive explained.

"I believe we closed the fund to redemptions in May," he said.

Molinaro warned that the value of the funds' assets had taken a blow in recent weeks, and it may take months for the total debts to be unwound.

Investors Friday were hazarding predictions of their own, asking who might be next with an uncomfortable call to investors.

"It's not over," said Michael Cheah, portfolio manager at AIG SunAmerica

Asset Management in Jersey City, N.J.

"We have seen how an extremely experienced group of people in the mortgage-backed world could lose so much money," he said. "I would be shocked if they were the only ones."

Define "Orderly Deleveraging"

Bear is relying heavily on what it describes as an "orderly deleveraging" to clear the decks at the two funds - particularly the Enhanced Fund, whose fate remains unclear. Any sudden dumping of the riskiest assets on an already fragile market could send their value - the funds' collateral - into a nosedive.

The bank can most likely count on buyers in time, however. A senior merger arbitrage trader at a large New York hedge fund said he believed Bear would recover its loan in full "unless, of course, no one bids for these CDOs and the price plummets."

"But I think someone will buy them - the world has not changed that much," he said.

CDOs refer to collateralized debt obligations, complex structured products based on pools of assets - in this case, loans to borrowers with poor credit histories.

The bank's hopes for a tidy resolution met with bemusement from some market participants Friday. "Orderly is a pretty subjective term," said Derrick Wulf of Dwight Asset Management.

"More orderly than a fire sale? Sure," he said.

The bank has restored calm on this level - the threatened fire sales haven't materialized. Merrill went ahead and sold a fraction of the $850 million in collateral it reclaimed, while Lehman Brothers (LEH) put $400 million on the block Thursday, according to a source. Cantor Fitzgerald was said to have also sold $400 million.

Bear's intervention appears to have nipped such action in the bud. Molinaro said Friday that "all of the threats of liquidations have been pulled while we're negotiating with counterparties."

Ted Meyer
Director, Head of Media Relations - Americas
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ph: 212-250-7253
mo: 917-670-2192
ted.meyer@db.com

Greg Lippmann
09/20/2005
07:13 PM

To: ed.divgi@db.com
cc:
Subject: pFw: materials

▬▬ = Redacted by the Permanent Subcommittee on Investigations

please print me out 3 copies of each of these (and staple them)

Greg H. Lippmann
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3rd Floor
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Phone (212) 250-7730
Fax (212) 797-2201
Mobile (917)[redacted]

----- Forwarded by Greg Lippmann/NewYork/DBNA/DeuBa on 09/20/2005 07:13 PM -----

Greg Lippmann
09/19/2005 07:08 PM

To: Amin Arjomand/NewYork/DBNA/DeuBa@DBNA
cc:
Subject: materials

here is the bear case for the product

here is a way to do it with little to no negative carry

Greg H. Lippmann
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New York, New York 10005
Phone (212) 250-7730
Fax (212) 797-2201
Mobile (917)[redacted]

The Bear Case For Home Equity Mezzanines.ppt	**Type:** application/octet-stream **Name:** The Bear Case For Home Equity Mezzanines.ppt

Long Equity Short Portfolio Sep 2005.pdf	**Type:** application/octet-stream **Name:** Long Equity Short Portfolio Sep 2005.pdf

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1301

Shorting Home Equity Mezzanine Tranches

A strategy to cash in on a slowing housing market

Deutsche Bank

Strictly private & confidential

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Summary

- Investor expresses a bearish view on the subprime US RMBS market (or the US Consumer or US Home Prices) by shorting (or buying protection on) a selected basket of mezzanine Home Equity ABS credits
- We believe this product is the most efficient way to express these views; more efficient than shorting stocks of homebuilders, REITs, the S&P 500, etc. We are interested in hearing of other ideas
- Since Nov 2004, spreads for Baa3 assets have compressed from 350DM to 175DM and for Baa2 assets from 200DM to 130DM, but if anything, risk of a housing bubble / defaults has only increased with the continued proliferation of alternative mortgage products such as IOs, silent seconds and option ARMs. These products have become increasingly popular as home price increases continue to outstrip wage growth
- Though each deal has certain idiosyncrasies that on the margin make one deal better or worse, from a default perspective, the risk in the asset class remains a macroeconomic risk – e.g. all pools have thousands of loans and are geographically dispersed with similar credit scoring models and underwriting procedures across issuers with defaults ultimately driven by 3 things: home prices, interest rates (payment shocks and ability to refinance/move) and unemployment
- Historical data show that losses in subprime mortgage collateral are strongly negatively correlated with home price appreciation, both in default frequency and severity. In a scenario where home prices grow significantly slower than what has been seen in the past few years, especially in high growth states such as California and Florida, one may expect losses to be substantially higher than what has been experienced in the recent past. The result could be more dramatic should prices actually decline
- Rating agencies' rating models for subprime mortgage lending criteria and bond subordination levels are based largely on performance experience that has mostly accumulated since the mid-1990s, when the nation's housing market has been booming
- In a flat housing market, most subprime RMBS rated BBB- or BBB may come under severe stress. Dramatic spread widening, downgrades or even loss of principal and interest could result

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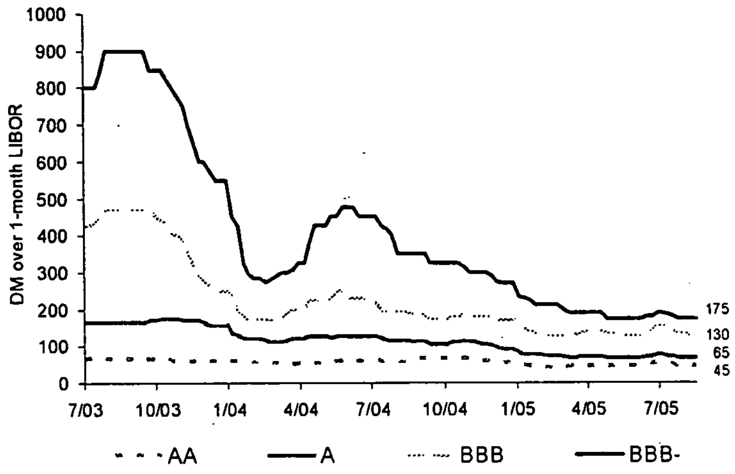
Spreads for BBB & BBB- home equity tranches have tightened since summer 2003



Deutsche Bank

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Over 50% of outstanding subprime mortgages are located in the MSAs with double digit 5-year average of annual home price growth rates

— — 5-yr annualized HPA rate —— Cumulative distribution of subprime mortgage outstanding

Deutsche Bank

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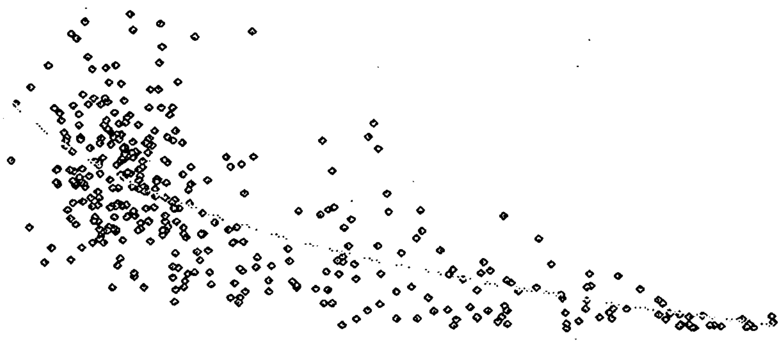
There is a strong negative correlation between home price appreciation and loss severity



Deutsche Bank

Loss severity ratios have been strongly negatively correlated with home price appreciation rates

- In the chart on the previous page
  - Defaults are defined as loans exiting pools when being more than 90 days in delinquency, in foreclosure or in REO
  - Only loans belong to pools where losses are reported by LoanPerformance are included but zero severity liquidations are also included
  - For each individual loans, if loss amount exceeds the outstanding balance, actual loss amount will be used (i.e. loss severity ratios above 100% are allowed.)

- Most MSAs with loss severity ratios above 60% are smaller ones with relatively few samples, such as Elmira, NY (75%), Terre Haute, IN (74%) Cumberland, MD-WV (73%) and LIMA,OH (72%). Larger MSAs with high loss severity ratios include Pittsburgh, PA (59%). Dayton, OH (56%), Indianapolis, IN (52%) and Cleveland-Elyria-Mentor, OH (49%)
- Some larger MSAs with high home price appreciation rates had very low loss severity ratios. These include Los Angeles (1%), Riverside-San Bernardino-Ontario, CA (2%), Nassau-Suffolk, NY (3%) and Fort Lauderdale-Pompano Beach-Deerfield Beach, FL (3%)

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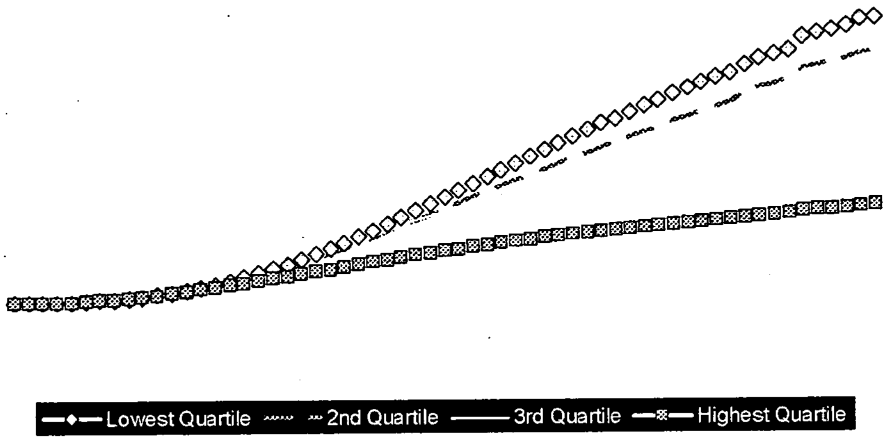
Defaults of subprime mortgages are also strongly negatively correlated with home price growth rates



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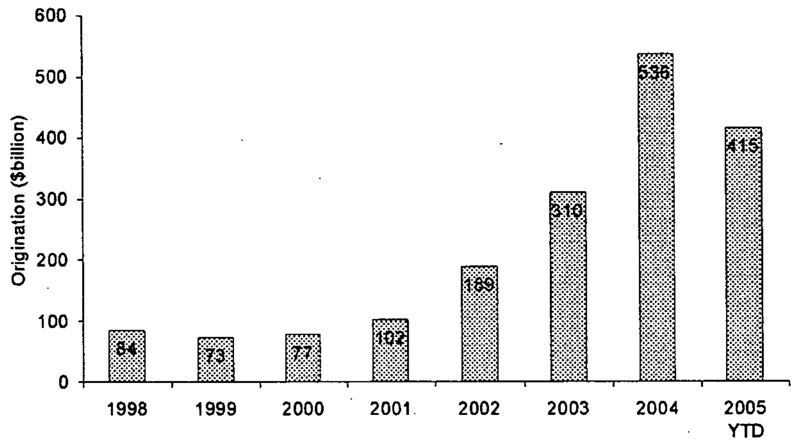
High HPA rates played major roles in good performance of subprime mortgages in past few years

As shown above

- Mortgages located in the quartile of MSAs with lowest home price growth have been three times as likely to default as those in the quartile of MSAs with highest home price growth
- Generally, MSAs with double-digit home price appreciation rates have been experiencing loss severity ratios less than 20%, many such MSAs had loss severity ratios less than 10%
- At the same time, MSAs with home price growth rates below 5%, on average, had loss severity ratios around 40%
- A majority of mortgages originated in the past few years are in areas with double-digit home price appreciation rates
- If home price appreciation rates slow-down to 5% p.a. for MSAs currently having double-digit rates, losses (both defaults and severity ratios) may increase substantially in these MSAs

HEL ABS sector has been experiencing fast growth in recent years



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Most top issuers are not regulated banks

Top 10 originator-issuer in 2004

Rank	Name	2004 Volume
1	Ameriquest / Argent	55.126
2	Countrywide	40.602
3	Lehman Brothers	27.336
4	GMAC-RFC	25.988
5	New Century	22.306
6	First Franklin	19.522
7	CSFB	18.152
8	Option One	17.528
9	Fremont	15.294
10	Washington Mutual	13.928

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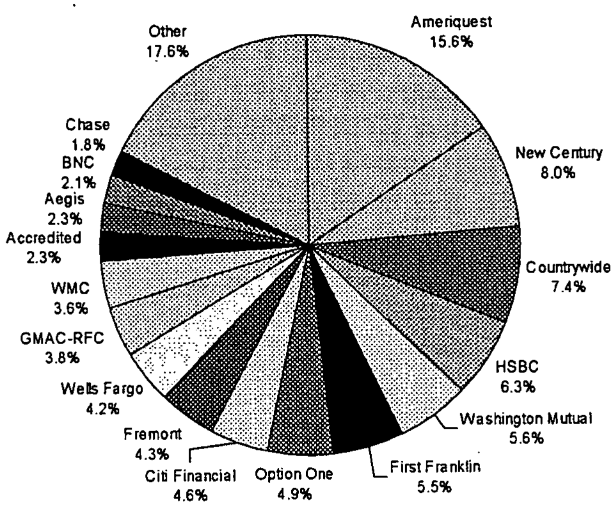
Top subprime mortgage lenders in 2004



Source: Inside Mortgage Finance Publications

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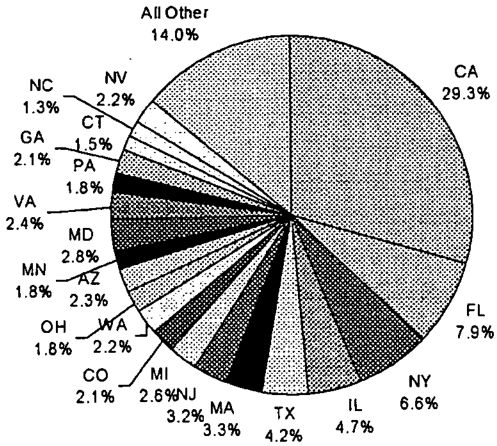
Subprime mortgages originated in 2004 by state



Source: Loan Performance

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Loan characteristics from major issuers' recent deals

Issuer	ARM %	Type	Loan Size ($)	WA FICO	FICO <560	WA CLTV	CLTV >80	IO	Piggy-back	Super States*	Low/No Doc	Invest
Ameriquest	82.1%	ARM	169,788	600	28.2	78.0	46.9	1.3	0.9	34.3	29.6	3.7
		Fixed	166,490	679	4.2	76.1	43.0	0.9	1.1	34.3	16.4	4.7
Argent	78.3%	ARM	187,054	603	25.3	85.3	66.4	0.0	10.2	43.6	50.7	8.6
		Fixed	168,356	632	10.6	78.2	44.4	0.0	5.3	53.2	26.1	5.3
Countrywide	81.6%	ARM	189,860	607	22.4	84.1	54.5	34.8	18.5	45.4	39.3	2.1
		Fixed	174,620	607	20.4	75.4	34.0	9.5	7.1	49.7	29.0	2.2
First Franklin	89.2%	ARM	206,112	654	2.9	91.7	76.5	52.8	16.9	43.9	29.7	1.8
		Fixed	140,583	652	3.8	89.6	71.3	6.4	4.0	23.8	37.9	0.6
Fremont	88.6%	ARM	225,543	616	19.4	84.5	63.8	21.7	41.0	43.9	35.8	7.9
		Fixed	217,161	629	10.8	76.9	40.7	0.0	12.1	38.7	29.8	6.6
Long Beach	91.3%	ARM	210,158	634	12.1	91.1	77.2	28.4	53.9	53.3	37.6	6.9
		Fixed	144,849	657	5.3	81.0	43.1	0.0	25.0	36.8	37.9	21.0
New Century	86.4%	ARM	206,019	622	17.5	86.0	67.8	22.4	25.5	52.3	53.2	9.3
		Fixed	155,331	628	11.8	76.5	38.6	0.0	8.1	46.2	35.6	6.8
Option One	69.8%	ARM	177,223	605	25.6	79.9	44.3	7.2	9.7	33.3	39.3	7.0
		Fixed	155,631	631	10.8	78.2	40.4	1.0	5.2	25.4	29.5	6.3
Park Place	80.6%	ARM	178,112	606	28.5	85.5	67.4	0.9	13.1	41.4	52.9	10.3
		Fixed	168,769	633	14.6	78.0	41.9	0.2	4.9	53.9	27.9	7.3
WMC	88.9%	ARM	248,523	636	10.9	83.9	45.4	30.1	14.6	66.6	52.0	5.1
		Fixed	188,502	641	7.4	78.4	39.5	0.0	4.5	50.2	41.2	7.6

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Typical home equity deals from major issuers

		Ameriquest 2005-R1	Long Beach 2005-1	New Century 2005-1	RASC 2005-KS1
Collateral	ARM %	81.36%	92.49%	81.57%	88.89%
	Average Balance	$173,130	$201,277	$187,239	$145,161
	WAC	7.65%	7.07%	7.06%	7.16%
	WA CLTV	78.96%	90.00%	84.47%	83.42%
	WA 1st Lien LTV	78.83%	80.51%	80.54%	80.53%
	Piggyback	0.98%	49.96%	20.62%	16.12%
	% CLTV >80	58.69%	84.12%	72.64%	73.82%
	WA DTI	41.28%	40.68%	40.62%	NA
	% DTI >40	65.35%	63.86%	61.16%	NA
	Owner Occ.	94.72%	91.25%	91.76%	94.38%
	% CA	18.47%	40.92%	37.92%	15.20%
	Avg. FICO	619	631	623	609
	IO%	0.00%	21.62%	16.97%	7.66%
Subordination	AAA	18.50%	19.80%	19.60%	19.50%
	AA	13.15%	12.40%	13.60%	12.75%
	A	7.75%	7.65%	8.15%	7.60%
	A-	6.75%	6.45%	7.05%	6.10%
	BBB+	5.20%	5.45%	5.55%	4.75%
	BBB	4.30%	4.45%	4.40%	3.55%
	BBB-	3.10%	3.45%	3.20%	2.55%

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Where do 2004 and 2005 vintage Baa3 tranches stand compared with performance of past vintages?

Historical Cumulative Net Loss Rate
as of May 2005

Vintage	ARM	Fixed Rate
2004	0.04%	0.06%
2003	0.41%	0.41%
2002	1.18%	1.40%
2001	2.69%	3.38%
2000	4.76%	5.27%
1999	5.33%	5.73%
1998	6.36%	5.63%

Average Baa3 First-Dollar Loss Rate
(Life-time cumulative net loss rate at which the Baa3 tranche starts to incur osses)

Vintage	FDL Rate
2004	7.76%
2005	7.35%

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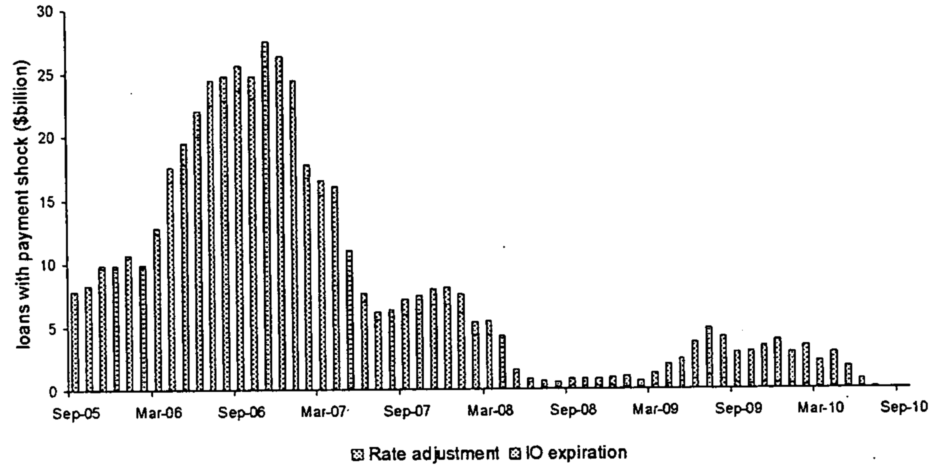
Nearly $440 billion subprime mortgages will be experience payment shocks in the next 3 years



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U.S. Residential Mortgage

Single family mortgages

- mortgages on single family (detached) houses
- not included: condos, town houses, co-ops, buildings with more than 1 units, commercial properties, etc.

2-4 family mortgages

- mortgages on residential buildings with 2 to 4 family units

Multi-family mortgages

- usually considered as commercial mortgages

Other residential mortgages

- condos, town houses, co-ops, etc.

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The US Residential MBS Market

Agency mortgages are mortgages that are in Ginnie Mae, Fannie Mae and Freddie Mac programs.

Typical Fannie Mae / Freddie Mac requirements

- balance limit: $359,650 for 2005 (single family house)
- loan priority: must be first-lien
- debt-to-income ratio limit:
  - 28% for mortgage debt
  - 33% for total debt
- cash-out not above 75% LTV (if refinance)
- loan-to-value ratio limit: 95%
- credit history: FICO score at least 720

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Residential Mortgages (continued)

- Conventional loans: fixed rate loans in Fannie Mae and Freddie Mac programs
- GNMA loans are not available to the general public
- Jumbo mortgage: a prime loan with a balance higher than the agency limit.
- Prime mortgages: mortgages that are either agency mortgages or jumbo mortgages.

Profile of traditional home equity product

- Low balance
- Second or third lien
- Credit score above 680
- Usually a refinancing to take out cash
- 15-year maturity (or shorter)
- Combined loan-to-value (CLTV) ratio less than 100
- Include home equity lines of credit (securitized separately)

Subprime (a.k.a. B&C) mortgages

- Often a first lien mortgage
- May be purchase, cash out, etc.
- May be used for cash-out purposes or debt consolidation
- Typical LTV around 80, may reach 100
- Often have piggy-back second lien loans
- Includes FHA Title 1 loans and other home improvement loan products

Products that may be riskier than traditional home equity/subprime mortgages have become popular

Because of the continued faster pace in home price appreciation compared with wage growth, lenders have developed a number of products to enable borrowers to qualify for mortgage payments and/or to pay minimal down-payment

- IO mortgages
  - Loan only pays interest in the IO period (usually 2 to 5 years)
  - At the expiration of the IO period, loan converts to fully amortizing loans
  - Payment shock at the expiration of the IO period may cause defaults to surge
- Silent second mortgages
  - A simultaneous pair of first and second lien loans are made at the origination (usually 80% LTV for the first lien and 10 to 20% LTV for the second lien)
  - Borrower pays little or no down-payment
  - Only the first lien mortgage shows up in a securitization and LTV appear to only be 80%. But the borrower's tendency to default is much high than a true 80% first lien mortgage.
- Option ARMs
  - Allow borrower to pay exceedingly low initial minimum payments
  - Indexed on moving Treasury average (MTA), LIBOR or COFI-11
  - Likely to have negative amortization
  - Recast of schedule at 5th anniversary may potentially cause significant payment shocks
- Stated-income mortgage loans
  - Income of the borrowers is not substantiated by the documentation, nor is it verified
  - Borrowers may inflate income to get loan approved
- 40-year mortgages
  - Lengthened amortization schedule to make monthly payment smaller
- High debt-to-income ratio loans
  - DTI for these loans may reach beyond 50%, leaving little for the borrower to pay other expenses

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Subprime mortgagors

- Demographically, this borrower is "middle America"
- Financially, this borrower
  - Has mismanaged his finances (past delinquencies, foreclosures or bankruptcies, low credit score)
  - Used excessive leverage (high DTI and/or LTV)
  - Is cash-strapped (large amount of cash-out refi.)
- While "riskier" than prime and jumbo borrowers, subprime borrowers
  - Are not directly impacted by stock market gyrations
  - Live in homes that are more liquid, less volatile

The channel of mortgage lending

- There are three major channels of lending mortgages
  - Retail – Loans are originated in branches of the lender. The lender controls most aspects of underwriting, including credit checking, income verification, appraiser selection, appraisal quality control, etc. The originator is more likely to have local market knowledge
  - Whole-sale – Loans are originated by brokers who have regular business relationships with the lender. The lender may have an approval process in accepting a broker to its network and may monitor the performance of a broker's origination. The lender controls some aspects of the underwriting process but relies on the broker to do others.
  - Correspondence – Loans are originated by non-affiliated brokers according to the lenders underwriting matrix. The lender is likely to re-underwrite the loan in most aspects.

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Income documentation and verification

- Full documentation, full verification
  - Last 2 years' W2s
  - Last 2 months' pay stubs
  - Letter from employer (verified by call)
  - Last 2 years' income tax returns (self-employed only)
  - Last 2 months' bank statements (verified by call)
- Partially (limited, light) documentation
  - Some of the documentations are deficient but usually one of income or employment proofs is available
- No income (stated income), no verification
  - Nothing is available

Appraisal process: the V in LTV

- Most used form of appraisals
  - Full appraisal (1004 appraisal)
  - Drive-by appraisal (2055 appraisal)
  - Broker price opinion (BPO)
  - Automated valuation model (AVM)
- Appraisers are paid on the case load, not value of the property
- Most of appraisers' business come from lenders
- Many lenders also employ in-house appraisers to control the quality of appraisals
- Even for purchase loans, an appraisal is needed to mitigate the risk of fraud

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Business models of subprime lenders

- Balance sheet lending
  - Pure lending on the company's own book is very rare for major lenders
- Whole-loan sales
  - Newer lenders mostly rely on whole-loan sales to dispose loans
  - Established lenders often engage in whole-loan sales when they see opportunities
  - Whole-loans sold will most likely be securitized by the buyer
- Securitization
  - Securitization are used for many purposes, the most common among them
    - Lower cost of funding
    - Raise leverage
    - Release regulatory capital
    - Managing risk

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What do credit ratings really mean?

- Most common approach by rating agencies
  - Establish a set of base case assumptions
    - Default (foreclosure) frequency
    - Loss severity ratio
    - Prepayments
    - Interest rate scenario
  - Establish AAA class stress assumptions
    - Default frequency for AAA, depend on the type of loans, may be 4 to 10 times of the base case
    - Moody's uses simulations to decide AAA credit enhancement (bonds should have no losses in 99.5% or more of the simulated cases)
    - Committee decisions are mostly involved in deciding the C/E

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What factors are used in deciding assumptions?

- Factors used in determining the base case assumptions include:
  - Borrower characteristics (income, credit history, etc)
  - Loan characteristics (LTV ratio, term, property type, purpose, occupancy, MI, etc)
  - Pool characteristics (concentration, etc)
  - Originator and servicer practices and loan programs
  - Macro and local economic consideration (employment, real estate market, etc.)

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Moody's typical loss severity assumption

Rating Level	Loss severity percent
Aaa	60.0%
Aa	55.0%
A	50.0%
Baa	45.0%
Ba	42.5%
B	40.0%

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Other issues rating agencies consider

- Mortgage insurance
  - The presence of MI will reduce loss severity
  - Rating agencies generally assume that the servicer won't be able to collect 100% of claims. A "haircut" is made to the mortgage insurance
  - Haircut is made according to the rating

Over-collateralization: the most basic credit enhancement

- A deal is over-collateralized when
  - The balance of the pool is larger than the aggregate balance of the bonds
  - Collection proceeds are first used to pay bonds' interest and principal
- Most mortgage ABS deals use some form of over-collateralization to enhance the credit for
  - Bondholder
  - Insurer
- The exceptions are
  - Whole-loan deals issued by GSEs
  - Some deals with issuer-guaranteed classes
- OC can be viewed as a special tranche that is the first loss piece for the deal

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Subordinate bonds act as cushion against losses

- In a senior-sub structure, in each period, senior bonds have the priority in
  - Interest payments
  - Principal payments
- Sub bonds' interest payment may or may not have priority versus senior bonds' principal payments

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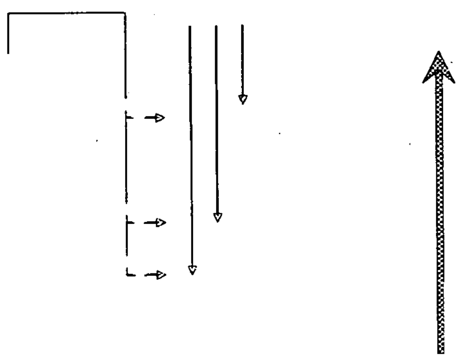
Typical home equity ABS structure: sequential with cross-over, OC turbo and step-down



- In the first few years, principal are paid sequentially among senior, mezzanine and subordinate tranches
- OC can be built up from the initial level by using excess spreads to pay down principal of bonds
- After the cross-over date, mezzanine and subordinate bonds start to receive principal simultaneously with senior bonds (provide no trigger event occurs)
- After the step-down date, part of OC is released (provided no trigger event occurs)
- An optional redemption (clean-up) call allows the servicer to call the deal when the collateral pool is below 10% of the original size.

Deals with multiple collateral groups: Y-structure

- A deal may have more than one group of collateral, each supporting its own sets of bonds
- Lower classes (or O/C) may receive cash from entire pool
- This structure enables the better performing group to aid the worse performing one
- Triggers are more complicated

Available funds cap: definition

- Maximum net WAC caps the coupon paid to bondholders
- Net WAC is gross WAC minus
  - Servicing fee
  - Trustee fee
  - Insurance premium (if any)
  - IO payment (if any)
- Designed to prevent bonds from defaulting because interest mismatch (as opposed to collateral performance)
- Capped-out amount is carried forward and may be recouped in the next month

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Greg Lippmann

To: "Richard Axilrod" <richard.axilrod@moorecap.com>
cc:
Subject: Re: Daily Update

08/26/2006
01:06 PM

Hear what you are saying and in a normal market your logic would be inarguable, but the demand for this crap is virtually entirely technically driiven, all cdos. And each person at the cdo table thinks someone else is the fool - cdo equity, ostensibly only two buyers one mutual funds in australia, hard to call them smart money, and one hedge fund in chicago, magnetar; who is actually putting on a bearish correlation trade; bbb sold mostly ponzi-like to other cdos with limited distribution in europe and asia (we sold our first BBB in thailand this week) again hard to call that smart money. Aa and Junior AAA sold mostly to high grade cdos and to a certain extent european and asian banks and lastly the senior AAA, this may ultimately break the cdo market. In 05 for a time, we sold EVERY SINGLE one to AIG. They stepped out of the market in march of 06 after speaking with me and our research people (and I don't doubt other dealers). Since then it has been more hit and miss for us. Sometimes we sell to European banks but often (and for the last 3 deals) we are forced to put it into our commerical paper conduit at 26 over. A correlation model would value this significantly wider. Why have we done this? It is not without reluctance and we are looking for ways to get out of this risk, but for now the view has been, we like the fees and the league table credit (and dammit we have a budget to make) and as the cp is a non mtm vehicle we can take some of this without caring that we are being picked off. That, at least at DB is nearing its end and from the guy at a delaer prop desk who we pitched yesterday on taking it, seems to be happening at other shops. He approached us in may with less than thrilling terms and we told him to pound sand. We asked him yesterday and he said we "were the tenth dealer to ask him in the last two weeks". As this piece is 65% of the cap strucutre, a move of 10 bps on this would take 1.3% out of the equity return. But the bigger question than spread is capacity for us to take this risk. If this crap all blows this 'super senior' could easily be worth. 60 cents on the dollar if not 10.

Another potential pin for the bubble would be a signifcant shift in enhancement levels either for cdos or home eq abs which could come due to continued housing news causing pr pressure on the agencies.

All that said, I do hear what you are saying and it is possible your view would/will be proven correct should the fundamentals of housing and abs trading continue to diverge.

On the other hand in regards to our/my view, I am encouraged that in spite of the virility of the cdo bid, there are numerous examples of bonds blowing up -- amsi 03-8 mv6 at 66, lbmlt 03-3 m4 at 30 oomlt 04-1, one bid 90 that tried to fade and us and 3 others at 85 (note option one is a top 5 name in abs) the tripling of serious delinq in sabr 05-op1 to over 6.5% since feb even though the avg mortgage age is now only 21 months ie hasn't reset yet, ace 06-fm1 m9 trading in a 275-325 market as more or less a new issue. What I'm saying is that there is plenty of fundamental evidence that bonds are blowing up even as the new issue and index market are remaining buoyant.

Sent from my BlackBerry Handheld.

----- Original Message -----
From: "Richard Axilrod" [richard.axilrod@moorecap.com]
Sent: 08/26/2006 11:41 AM
To: Greg Lippmann
Subject: RE: Daily Update

between now and december all measures of housing inflation go negative. if this thing doesn't work by year end it isn't going to

---

From: Greg Lippmann [mailto:greg.lippmann@db.com]
Sent: Friday, August 25, 2006 06:20 PM
To: Richard Axilrod
Subject: Re: Daily Update

Single Names Recap

Slow but not inert. 200MM in CDO ramp ups probably less than 100MM traded. There were 2 OWIC of hedge funds getting short. 50 MM of good Baa3 bonds, which traded between 190 and 220. Another of weaker 2006 names. These traded as wide as 325 and as tight as 260. We traded about 100MM all in private non comp situations except we did the 325 on the crappy 06 bond.

Index
Fairly active day for us with over 300MM in volume. There was some selling on the H and R Block / Option One News, but there were a few CDO rampups that were pre-hedged by buying the index (to protect the spread arb they buy the index now and if spreads tighten they have a profit on the index to replenish the lost arb from tighter spreads and if they widen the CDO arb is better offsetting the loss on the index trade) and as a result the index rallied 4-5bps.

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[redacted] = Redacted by the Permanent Subcommittee on Investigations

Greg Lippmann/NewYork/DBNA/DeuBa

08/24/2006 07:41 PM

To "Richard Axilrod" <richard.axilrod@moorecap.com>
cc
Subject Re: Daily UpdateLink

Daily Update
Single Names
Among the busiest days in the year with 6 official CDOs ramping up and numerous ones privately looking for collateral. We showed bids to 10 different CDOs and traded with 7 of them, total volume roughly 100MM . Continued tiering evident with the tightest names holding firm or tightening (a few seemed to widen 5 bps though in Baa2) with certain other weaker names actually widening out even with the robust volume. BBB- was in general stronger than BBB. There were also hedge funds looking to get short and we sold protection on 135MM to 3 accounts.

Similar to yesterday, another weak bond came out – OOMLT 04-2 M6 for which we bid 85 for and think traded around 90. Interestingly, Option One is considered among the very best names and the 04 collateral, due to robust home price appreciation, a fantastic vintage.

Tomorrow there are two CDOs ramping up but we'd expect the day to be relatively quiet.

Index

Yesterdays gap higher held as the market rallied roughly another basis point. Today was not quite as active as yesterday.

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Greg Lippmann/NewYork/DBNA/DeuBa

08/24/2006 07:52 AM

To "Richard Axilrod" <richard.axilrod@moorecap.com>
cc
Subject Re: Daily UpdateLink

Single Names

thursday preview
6 cdos looking for a total of 650MM today, if current trends persist, less than 325MM will actually trade. This is the first day this week with robust cdo demand. The beast is clearly not dead.

wednesday review:
only one cdo attempted to ramp today. we trade one bond with them, a sast in the low/mid 200s. We traded another 50MM with a few CDOs off market. We did not do any trades with the one large shorter who was in comp, but we had two of our guys come in to add to their trades for a total of 75MM. Also to show that this stuff can and does blow up, AMSI 03-8 MV6 was on a list from a CDO manager. We were the high bid at $66 but they did not sell as the investors in the CDO certainly don't realize the market on the bond and selling it would not only alert them, but also would cause some CDO triggers to fail shutting the equity off from cashflows.

Index
Wednesday
tremendous volume in the morning but flows were balanced and the market was largely unchanged...in the afternoon one large buyer came in lifting and the market rallied substantially, though two way flows were strong in the afternoon the market held it's gains and closed 5-6 tighter. We traded nearly 1BB on the day.

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━━ = Redacted by the Permanent Subcommittee on Investigations

Greg Lippmann/NewYork/DBNA/DeuBa

08/23/2006 11:00 AM

To "Richard Axilrod" <richard.axilrod@moorecap.com>
cc
Subject Re: Daily UpdateLink

8/22 Recap
Single Names

Monday
Extremely slow with virtually zero CDO activitiy. We did see one dealer prop desk do a large offer wanted (i.e. they bought protection / got short risk). We did a handlful of private trades both sides.

Tuesday
We did two large off market trades with CDOs, one for 80MM and the other for 200MM. In a similar manner we had 80MM shorted (protection bought) to us two hedge funds, making us 200MM shorter on the day.

Thus far wednesday sees only one CDO publicly looking for 50MM while one hedge fund is looking to short 120MM in comp. Note there are also about 200MM of cash bonds for sale today some of which are CDO looking to extend duration by selling seasoned bonds and buying new issues .

Index

Monday - Very slow, dealers still seem to be pushing the market lower. BBB- about 2 bps wider
Tuesday- Volume continues to be largely dealer to dealer. Traded lower in the morning but rallied a bit in the afternoon. Closed roughly flat. We are starting to see retail interest in trades between the two series or between different ratings.

Greg Lippmann/NewYork/DBNA/DeuBa

08/18/2006 05:27 PM

To "Richard Axilrod" <richard.axilrod@moorecap.com>
cc
Subject Re: Daily Update

8/18 cds recap
BWICs slow day just a few cdos attempting to ramp about 200MM wed bet less than 100MM traded 0that way. One hf attemped to short 150MM on owic. We taded some stuff in comp on boths side and also did a bunch of trades out of comp with cdo guys and hfs. Traded with two new equity hedge funds who I had pitched last week, each shorted us about 50MM mix of baa2 and baa3. Shorts to us were Baa2 from 110-155 and baa3 from 215-255.

Our total volume about 200MM.

ABX Flows:
**Mkt weaker by abt 2bps in BBB-s.
**Mkt was pushed lower by one dealer selling in size in the street.
** We did see retail buying around the 100-06/07 area in the BBB-.
**We saw some hedgies (whole loan traders, ARM traders) sell the index to hedge
----
Sent from my BlackBerry Handheld.

----- Original Message -----
From: "Richard Axilrod" [richard.axilrod@moorecap.com]

Sent: 08/17/2006 07:41 PM
To: Greg Lippmann
Subject: RE: Daily Update

i don't get the first snetence. the initials make no sense to me, but i would infer that the creators of cdos are buying protection?? are they always long the equity part?

From: Greg Lippmann [mailto:greg.lippmann@db.com]
Sent: Thursday, August 17, 2006 07:16 PM
To: Greg Lippmann
Cc: Richard Axilrod
Subject: Re: Daily Update

Richard,
8/17
Single Names
In publicly announced BWIC and OWIC we saw for the first time in memory more people looking to short CDS than to go long. The publicly announced attempted volume of CDO rampup was roughly 350MM, while on the short side it was 300MM (less volume but more people). On BWIC, very few Baa2 traded as the arb really doesnt work. In Baa3 the range was 185 to 225 depending on the name; again very few traded. We'd estimate less than half and perhaps less than 100MM of the 350MM traded. On the OWIC side the names selected were among the worst names in the market and we think little traded with many names being offered at 500 or wider. Off bid lists we worked with both CDO managers and hedge funds to do trades in specific names that fit our or their axes. Net net we got shorter by about 100MM evenly split between BBB and BBB- with a total volume of trades this way of roughly 300MM.

Index
Flows were verly light. Morning the market widened a bit and in the afternoon there was a small rally. On the day index 2 was unchanged as was BBB- of index 1. BBB of index 1 was down 1/32.

I may take tomorrow off but will be available on blackberry and cell phone but may not write an end of day summary. I will continue it next week.

Greg H. Lippmann
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Mobile (917) [redacted]

▬ = Redacted by the Permanent Subcommittee on Investigations

Greg Lippmann/NewYork/DBNA/DeuBa

08/16/2006 06:13 PM

To richard.axilrod@moorecap.com
cc
Subject Daily Update

Single Names:
Today there was 5 cdos ramping looking to get 500MM of collateral. Top tier names seem to have stopped trading as the

arb for them no longer works. Less than 50 % of the lists traded, thus we would guess in the absence of orders the street got shorter by 200MM via bid lists (we were shorted about 250MM from 3 hedge funds and privately shorted about 100MM to 3 cdos not on bid lists and also traded some bonds on the lists net probably we are a bit longer, really less short and still more than 1BB). Nearly the entirety of the volume was in mid tier names which tended to trade from 100 to 126 for Baa2 and 200-242 for Baa3. Anecdotaly, we continue to see the weakest names trading wider while the best ones stay flat or tighten in a bit with the mid tier ones a bit messier.

Here is a list of names we sent to one hedge fund who traded 10MM of the 6 highligted ones with us at the included levels.

[attachment "diverse basket august 15.xls" deleted by Greg Lippmann/NewYork/DBNA/DeuBa]

Index:

Over the last week the BBB and BBB- are wider by about 10 and 20 bps respectively from the tights. Similar to the rally which seemed to us to be on very small volume and driven by dealers covering their single name shorts into CDOs by lifting street offers, the decline in index prices has been on limited volume. There has been some hedge fund selling of the index but its been more limited than it had been the last few weeks, potentially an ominous sign should their interest become piqued aney. Thus the main driver behind the decline has been a lack of dealer sponshorship indicating perhaps that dealers are comfortable with the current state of the positions. We did see larger movement spost the housing numbers of the last two days than we had seen after previously similar negative economic numbers. We did see a few fast money accounts come in to cover a bit at the days lows.

abx 2

	market	spread	day change
BBB	100-7 / 13	127/121	-4/32
BBB-	100-5 / 11	237 /232	-10/32

abx 1

BBB	100-23 / 29	132/126	-2/32
BBB-	101-5/11	231/225	- 6/32

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From: ROCKY KURITA (DEUTSCHE BANK SECURI) <ROKURITA@BBOTG>
Sent: Thursday, May 12, 2005 7:08 PM
To: GREG LIPPMANN (DEUTSCHE BANK SECURI) <GREGLIP@BBOTG>
Subject:

Message Sent: 05/12/2005 15:08:14
From: ROKURITA@BBOTG|ROCKY KURITA|DEUTSCHE BANK SECURI|1726|328663
To: GREGLIP@BBOTG|GREG LIPPMANN|DEUTSCHE BANK SECURI|1726|328663

look. i know you think that i am an idiot and do not know how to trade in a bear market. i do not overestiamte the illiquidity in the market. i provide liquidity to investors b/c we have to support the larger franchise. i understand how the markets move. i got smoked in mmt and you seem to think that that i ahve not learned from my mistakes. we have to make money. customer happiness is a secondary goal but we cannot lose sight of the trading desks other role of supporting new issue and the customer fmachise. if we get hit, i will hit back bids to cut my losses. i am not a stubborn mule. here are the generic levels of wher we bid cash: a3 +80/75, baa1 +130/125 baa2 +140/135 baa3 +200/190

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1308

GREGLIP@bloomberg.net

02/01/2007 04:09 PM

To WBrown@Braddockfinancial.com
cc
bcc
Subject RE: FW: Spread Widening Commentary Part 2

=====Begin Message=====
Message#: 7592
Message Sent: 02/01/2007 16:09:32
From: GREGLIP@bloomberg.net|GREG LIPPMANN|DEUTSCHE BANK SECURI|1726|328663
To: WBrown@Braddockfinancial.com| | | |
Subject: RE: FW: Spread Widening Commentary Part 2

there are very few abs people on this loop as i dont want to scare the buyers of abs / cdo managers...i only send this to harvey b/c he is a personal friend...please please do not foward these emails outside of your firm...i do not want to be blamed by the new issue people for destroying their business...we will trade on 75 names..

----- Original Message -----
From: Wyck Brown <WBrown@Braddockfinancial.com>
At: 2/01 16:06:33

I'd definitely like to get your commentary...no complaining.

Brandon's last name is "Jundt" and I've cc'd him on this.

Bloomberg is probably best for both of us.

I'll get some names over as soon as I can. How many of the 125 names do you ultimately narrow it down to?

Harvey definitely listens to you and I don't know of anyone in this market whose opinion he values more highly. I think he likes to hear why I like any trades I do for Galena Street (I have to justify my paycheck), even if he already believes it is a good trade.

-----Original Message-----
From: greglip@bloomberg.net [mailto:greglip@bloomberg.net]
Sent: Thursday, February 01, 2007 1:58 PM
To: Wyck Brown
Subject: Re: FW: Spread Widening Commentary Part 2

good seeing you too.do u really want to be on my loop of negative news ?? only if you promise not to complain about how many negative stories i send out which are inconsistent with your worldview. if you still do, what is brandons last name / email and do u guys prefer on bloomb erg or email ? we can send you the net pnl of a trade that someone else did...i think if you pick 125 names i promise that i will give you my view on the ones that work best that also fit my book....as for harvey i am confident that if i tell harvey it is a great trade, he believes me, no?

----- Original Message -----
From: Wyck Brown <WBrown@Braddockfinancial.com>

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1309

At: 2/01 15:52:21

Greg, it was good to see you at ASF..I'd like to get the earlier publication you mention here and would very much appreciate it if you could add Brandon and my names to your commentary emails.

Brandon and I are putting together a list of names for the correlation trade. Can you show me an example, in terms of marks and profitability of what the trade would have looked like if we had put it on last September and kept it on till today? It will help me discuss the idea with Harvey in terms of $'s and cents.

Any suggestions you might have regarding that particular trade before we actually put it on, I'd appreciate discussing with you.

Thx.

-wyck

-----Original Message-----
From: harveyb@bloomberg.net [mailto:harveyb@bloomberg.net]
Sent: Thursday, February 01, 2007 1:36 PM
To: Wyck Brown
Subject: Fwd: Spread Widening Commentary Part 2

1
---- Original Msg from: GREG LIPPMANN, DEUTSCHE BANK SECURI At: 2/01 12:52:15

Here are some of my additional thoughts on the continued widening of the basis
between the abx and the single names.
Recently, I wrote in detail about this. If you don't have that and/or would like me to resend, please let me know. Here are some additional thoughts on this topic. As this basis continues to widen it is being driven by three things, fewer accounts looking to speculate in the indexes
from the long side given the price action (while at the same time, single
name cds demand to sell protection has not ebbed as the new issue cdo market remains robust) and it would seem increased dealer shorts for a trade or to hedge various wharehouses (cdos, residuals, whole loan pipelines etc). Most importantly perhaps though is the abs trading desk realization and unwillingness to take on an unpleasant single name / index
cds basis. As dealers buy protection on single name abs from cdos, typically they sell protection on the index. As most credits of the hundreds of mezz abs deals done in late 05/06 can be more or less 'mapped'
to specific index credits, we can assume for illustrative purposes that the only single names that exist are these 20. Let's say a dealer wants to
be flat abs risk and they have just sold protection to a hedge fund on the
06-2 BBB-, they will attempt to buy protection on each of the index constituents from cdos. 06-2 (06-1 and 07-1 are similar) is composed of 5
very tight credits that are in constant demand from cdos, 10 reasonable credits and 5 credits that are virtually shunned by cdo managers. Thus

the
dealer will find that he is unable to buy protection on these widest names
and will need to be long risk or flat risk but relative to the composition
of the index, be short risk on relatively good names and long risk on the
weak ones. As the basis between the worst 5 credits and the rest of the
market has continued to widen, dealers have become increasingly reluctant
to sell protection on the index because it is tantamount to selling
protection on names for which they would not eagerly offer single name cds
protection.

Does this mean that investors should buy protection on the index. In a
word, no. Buying protection on the index does get an investor 20% exposure
to weak names that they would have difficulty shorting in the single name
market, but the cost to this is two-fold: 1 - they also implicitly are
buying protection on the 20% of the market that trades tightest and on
which they might avoid buying protection. And, given the aforementioned
dealer reluctance to sell protection on the index, the basis between where
we would offer protection on all the single names in the index compared to
the index level has widened as well. Thus one can buy protection on single
names tighter than buying it in the index and pay less total carry while
retaining the substantial cheapest to deliver optionality of the single
names. We think an even better way to play this is to avoid the 5 best and
worst names and one can get the trade done at an even tighter level to the
index. Ignoring only the 5 widest bring the index/single spread to well
over 100bps.

This is because when we say you can buy protection on all 20 names x bps
tighter than the index, we are really saying you can buy protection on
each single name at a different level such that the average is an
attractive level compared to the index. Reading between the lines, we are
making some bonds much tighter than the index and others much much wider.
Further the bid ask on the widest ones, given our relative inability to
place them in cdos may be 100 or more bps. Thus if one was quoted say a
700-900 market in a bond, one might never consider trading that name, but
in essence by buying protection on the index instead of a group of
reasonable single names, that is what one is doing.

A final thought on the index vs single name. As the index market has
undergone substantial price declines, while cdo volumes have remained
high, the liquidity in the abx has dripped dramatically compared to the
single name market. At best screen markets are generally half point and in
many cases are a point, this is roughly the same as the single name market
for most credits. Further while the index market levels work for 10-25MM,
we have recently seen markets move 1/2 to 1 pt on very small volume.
In single names, we are comfortable showing levels on say 20 single name

credits where our quotes work for 5-20MM per name and 250MM total block trade (we have done even larger trades).

In sum, the widening in the single name market has been less than the more heralded move in the index and a convergence of this basis could occur while at the same time we remain convinced of the long run relative
attractiveness of being long single name protection over index protection
and the potential for excess returns from picking a more sensible basket of names than the highly divergent composition in the indexes.

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=====End Message=====

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Shorting Home Equity Mezzanine Tranches

A strategy to cash in on a slowing housing market

February 2007

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Summary

- Investor expresses a bearish view on the subprime US RMBS market (or the US Consumer or US Home Prices) by shorting (or buying protection on) selected Home Equity ABS credits
- We believe this product is the most efficient way to express these views; more efficient than shorting stocks of homebuilders, REITs, the S&P 500, etc. We are interested in hearing of other ideas
- Since 2003, spreads for Baa3 and Baa2 have compressed. But if anything, risk of a housing bubble / defaults has only increased with the continued proliferation of alternative mortgage products such as IOs, silent seconds, stated-income loans and option ARMs. These products have become quite popular as home price increases until very recently outstripped wage growth. The percentage of subprime mortgages originated that were IO mortgages grew from virtually zero in 2002 to around 30% in 2005 and 2006. The percentage of subprime mortgages originated that were stated-income mortgages grew from around 25% in 2000 and 2001 to over 40% in 2005 and 2006. Mortgages with 40 or even 50-year terms were recently introduced, and have quickly become popular in subprime lending.
- After a brief widening near the end of 2005, spreads for Baa2 and Baa3 home equity bonds tightened for most of the first half of 2006, reflecting strong demand from CDOs. Demand from CDOs is a result of worldwide excess capital chasing yieldy products. Such demand, may prove elusive in an adverse market environment. Spread tightening lost its momentum in April, as the CDO's arbitrage has been squeezed. In fact, spreads gradually widened out from May to August. As the housing data has become increasingly bearish, this widening trend accelerated in September with Baa3 spreads nearly 100 bp wider than the April tights. After a brief rebound in October, spreads resumed widening again in November and December.

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Summary (continued)

- It is increasingly evident that the housing boom in the past 10 years has come to its end. The Market Index from the National Association of Home Builders showed a steep decline in recent months to a level that hasn't been seen since 1991, when the nation was experiencing a housing recession. Other indicators such as housing starts and building permits have also seen steep declines in recent months. New and existing home sales indices from the National Association of Realtors, which had experienced virtually incessant rises in recent years, also have lost their momentum and have even dropped in recent months.
- Though each deal has certain idiosyncrasies that on the margin make one deal better or worse, from a default perspective, the risk in the asset class remains a macroeconomic risk – e.g. all pools have thousands of loans and are geographically dispersed with similar credit scoring models and underwriting procedures across issuers with defaults ultimately driven by 3 things: home prices, interest rates (payment shocks and ability to refinance/move) and unemployment
- Historical data show that losses in subprime mortgage collateral are strongly negatively correlated with home price appreciation, both in default frequency and severity. In a scenario where home prices grow significantly slower than what has been seen in the past few years, especially in high growth states such as California and Florida, one may expect losses to be substantially higher than what has been experienced in the recent past. The result could be more dramatic should prices actually decline
- Rating agencies' rating models for subprime mortgage lending criteria and bond subordination levels are based largely on performance experience that has mostly accumulated since the mid-1990s, when the nation's housing market has been booming
- In a flat housing market, most subprime RMBS rated BBB- or BBB may come under severe stress. Dramatic spread widening, downgrades or even loss of principal and interest could result. Already there have been a few 2005 and 2006 deals either downgraded or placed on downgrade watch. Previously, rating actions on structured products within two years of their issuance were virtually unheard of.

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The downside and upside of shorting subprime mortgage mezzanine bonds

- In a scenario where subprime mortgages perform well
  - Prepayments are likely to be fast.
  - Very little extension risk
  - If the underlying Baa3 bonds has an weighted average life of 2 to 4 years and the premium is 250 bp, the protection buyer may lose 5 to10% (2.5% x 2 to 4) of initial notional amount.
- A reasonable worst case scenario would be somewhat slow prepayments, but no defaults in the underlying bond. In that case the protection buyer may lose 15% of the notional balance or 6 years of protection payments.
- In a scenario where losses for subprime mortgages rise to above 9%
  - Protection buyers are expected to have a profit of 50% to 100% of the initial notional balance, less the protection premium paid. Higher losses are needed for Baa2 shorts to reach these profits.
- In the meantime, if the spreads for mezzanine bonds widen
  - Protection buyers may choose to unwind the position with a profit
  - The price sensitivity against spread change for a typical at-the-money CDS is about $40,000 per basis points spread widening per $100 million dollar notional.
- The long-run payoff is arguably somewhere between 6 and 10 to 1. The odds against a default may be much less.

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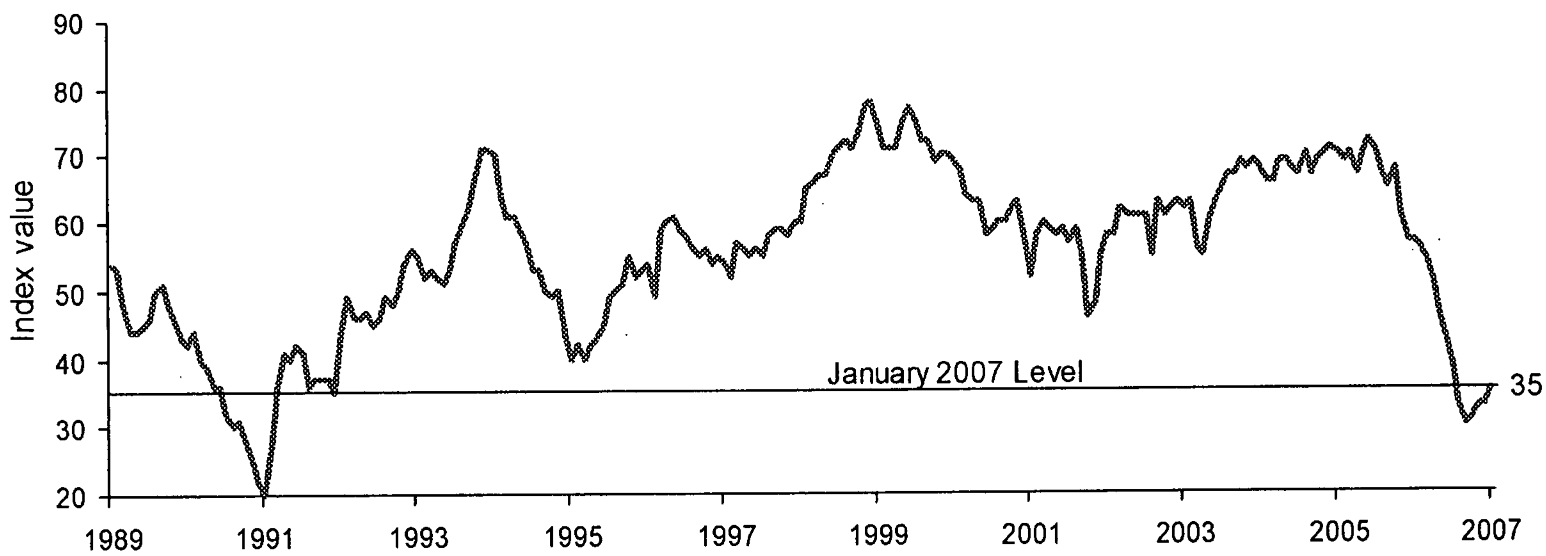
The National Association of Home Builders Market Index has dropped to a level unseen since early 1991

National Association of Home Builders Market Index



Source: National Association of Home Builders

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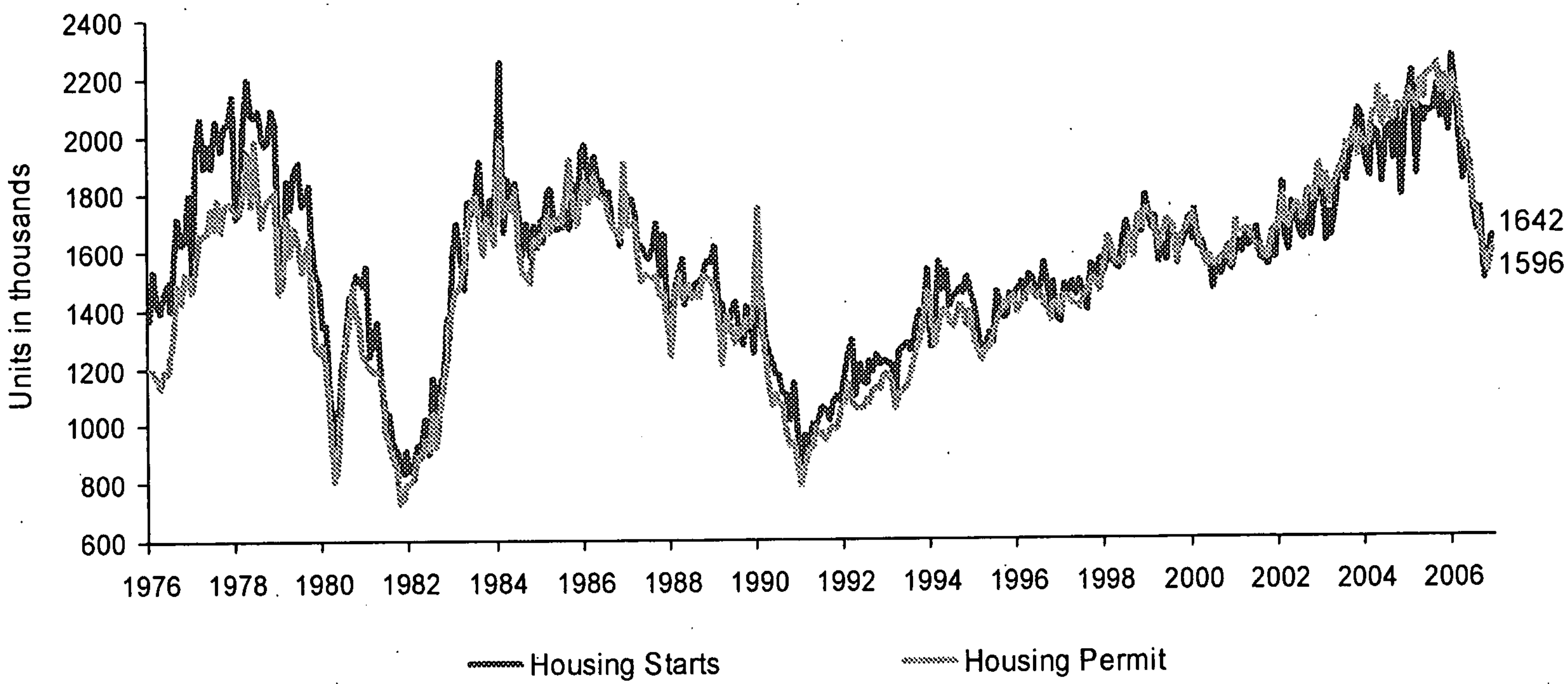
Both housing starts and building permits indexes have seen declines in recent months not experienced since 1990



Source: US Department of Commerce

Data as of end of December 2006

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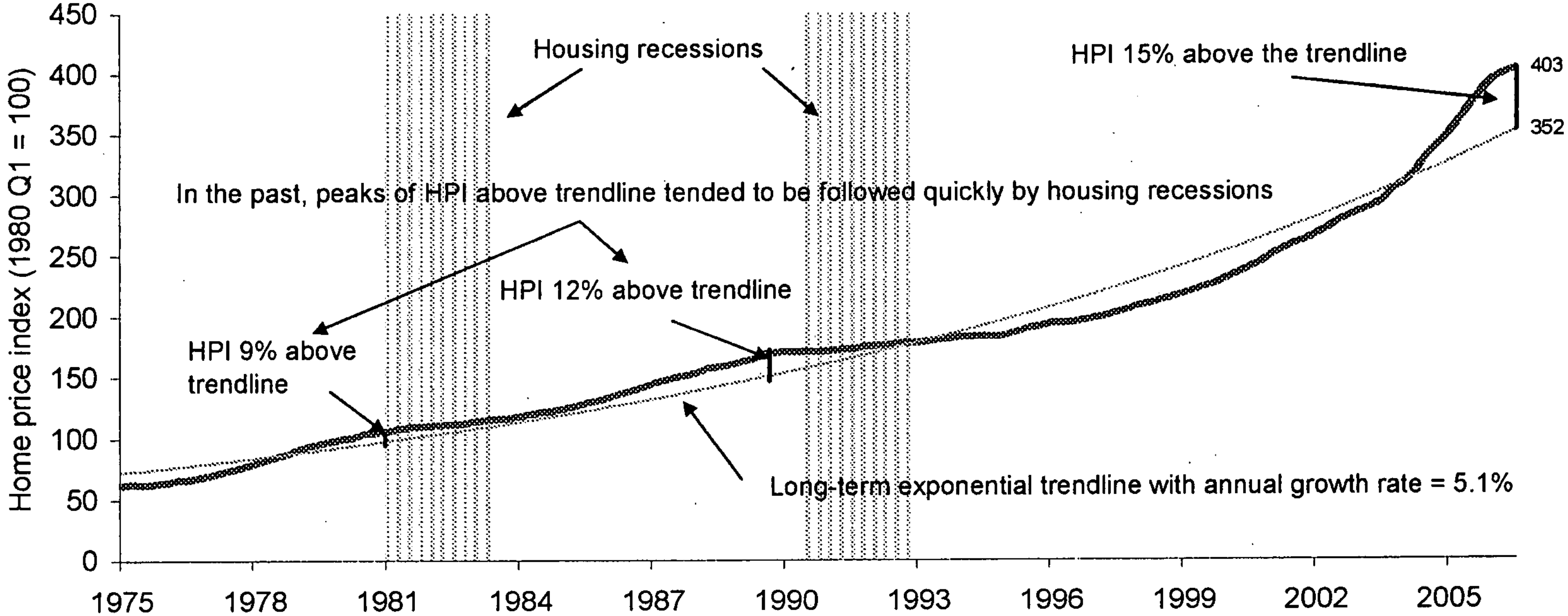
US Home price index in recent years has been above the long-term trend line

US Home Price Index



Source: Office of Federal Housing Enterprise Oversight, Deutsche Bank

Data as of end of Third Quarter 2006

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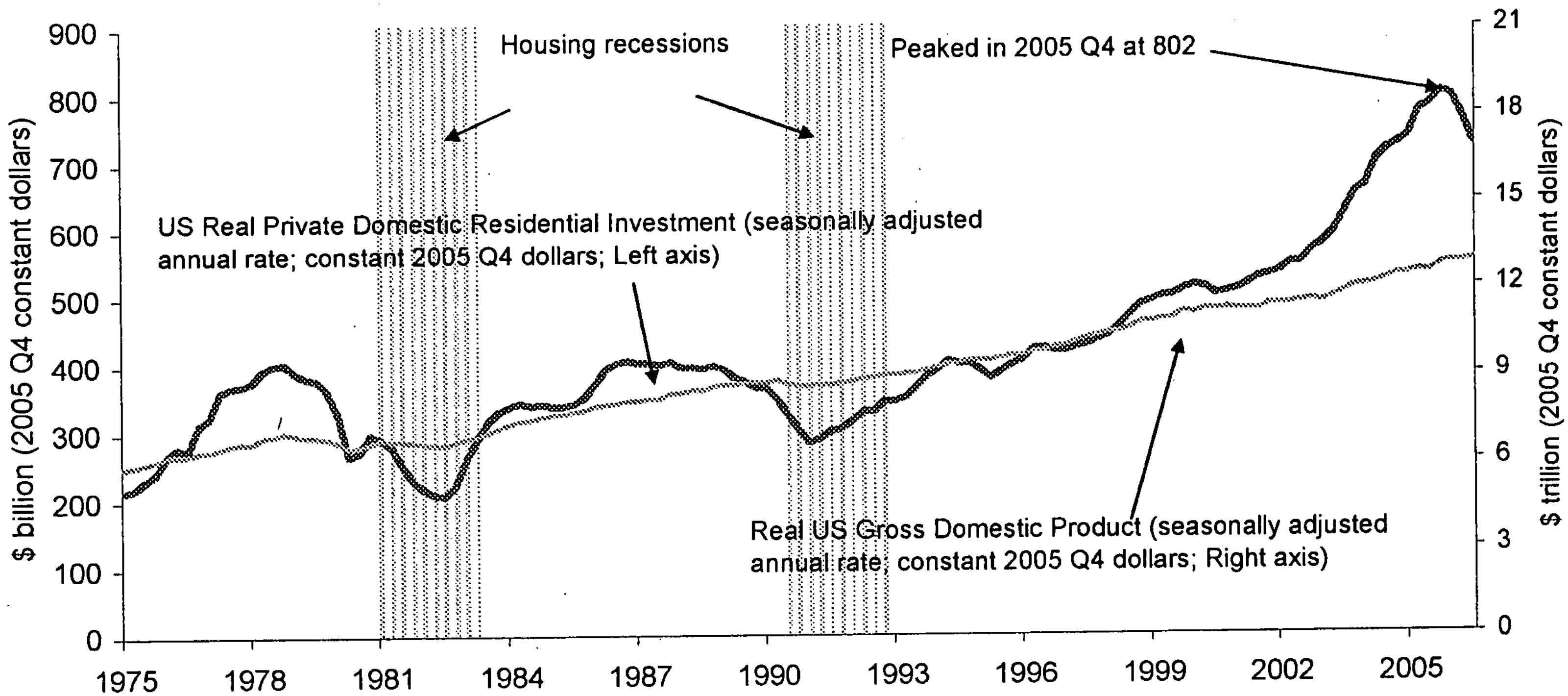
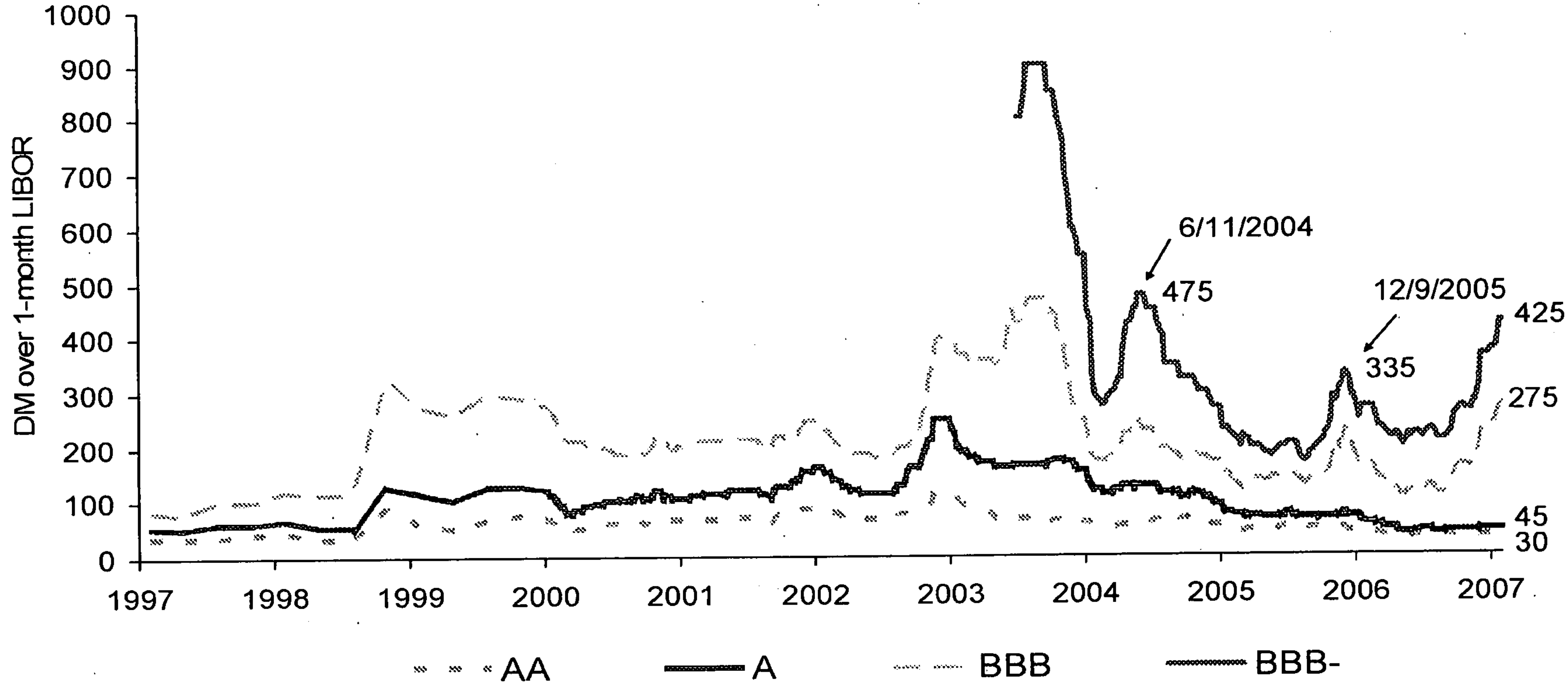
Investment poured into the residential market has dramatically increased during the last decade



Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Deutsche Bank

Data as of end of Third Quarter 2006

Generic new issue spreads for BBB & BBB- home equity tranches have tightened since summer 2003, but have widened somewhat in 4th quarter 2006

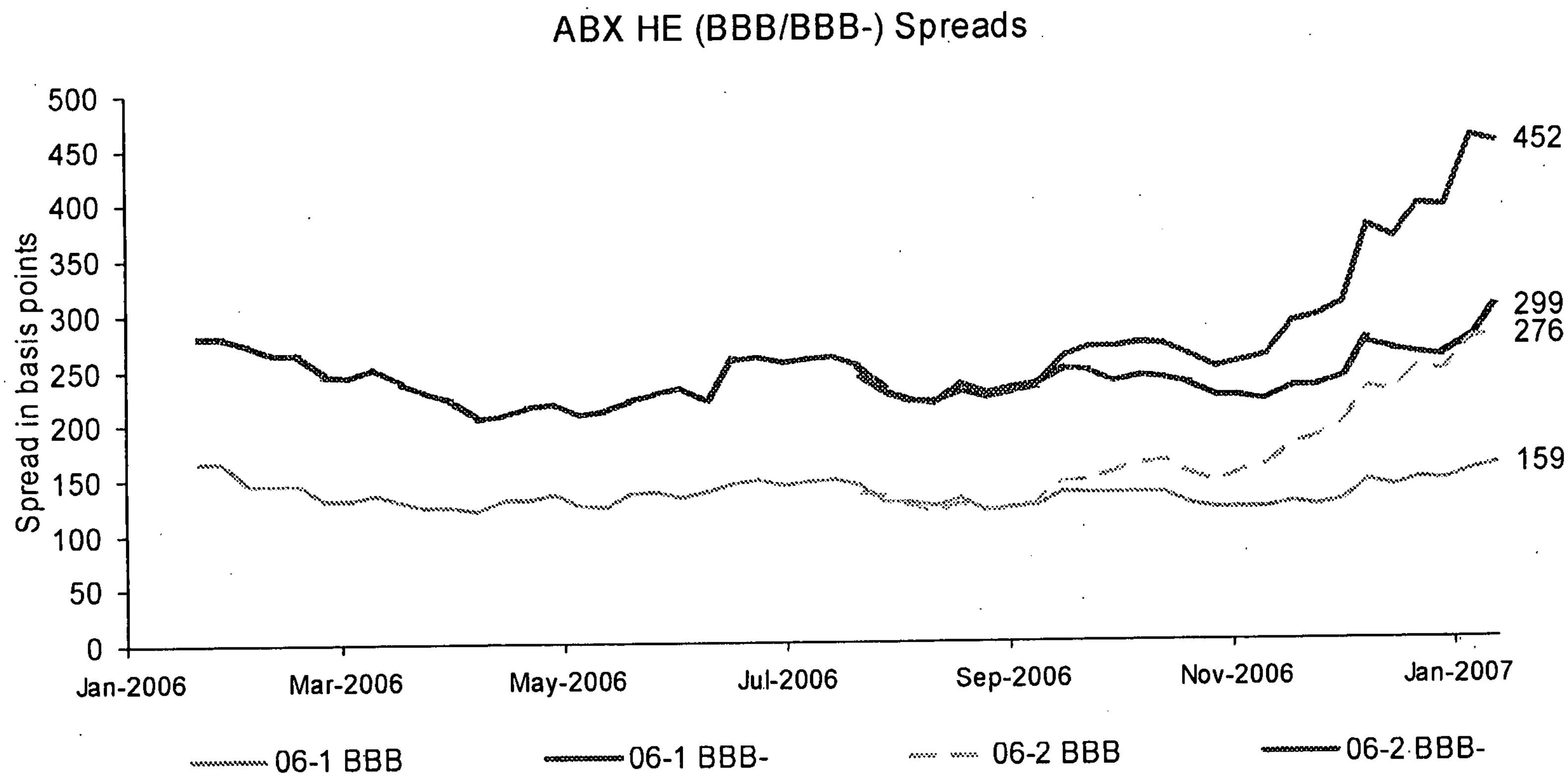


Note: Issuance of BBB- bonds was not common before 2003

Data as of February 2, 2007

Source: Deutsche Bank

ABX.HE BBB and BBB- indexes have widened in the face of deteriorating fundamentals, more than generic spreads



Note: Issuance of BBB- bonds was not common before 2003

Data as of January 12, 2007

Source: Deutsche Bank

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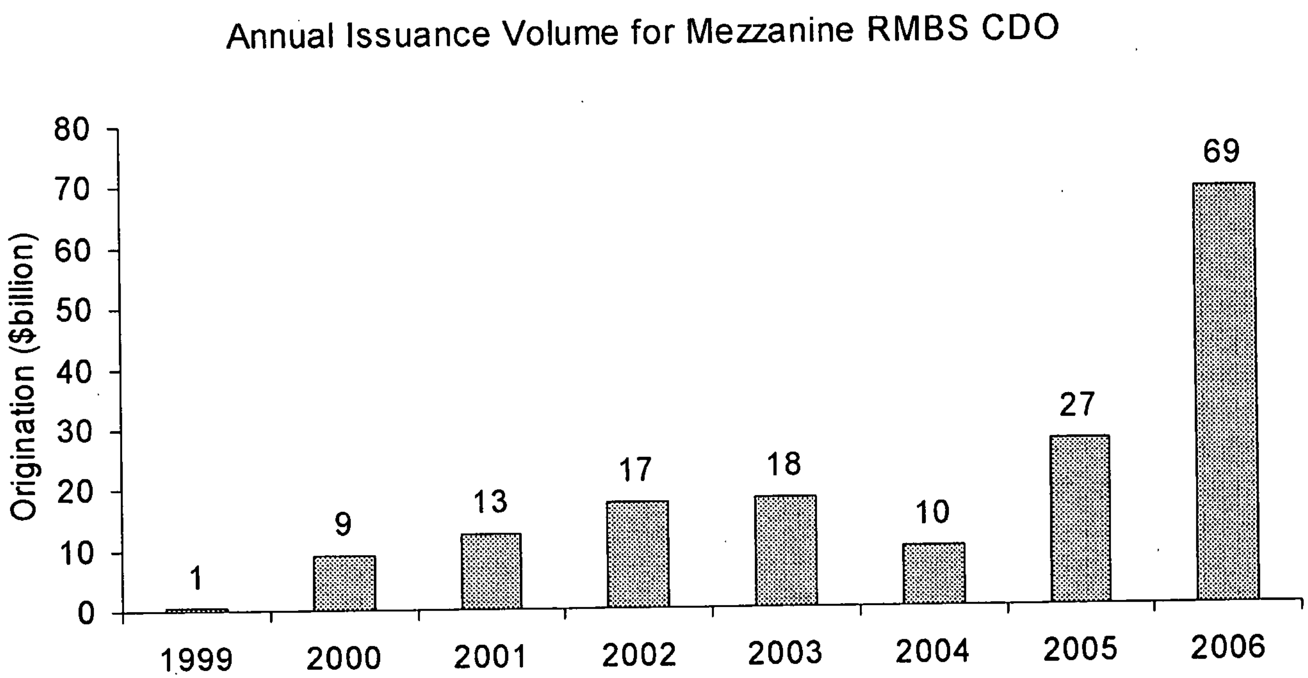
Hyperactivity in mezz CDO issuance kept mezzanine subprime mortgage spreads tight in most part of 2006



Source: MCM structured Finance Watch, Deutsche Bank

Data as of the end of 2006.

Issuance volume includes cash, hybrid and synthetic mezzanine RMBS CDO.

Typical ABS and CDO deal structures

ABS Collateral Pool	
Mortgage Loan #	5000
Average Loan Size	200,000
CLTV	85%
California Loan	30%
FICO	620
Interest Only	20%

ABS Capital Structure		
Tranche	**Thickness**	**Support**
AAA	80%	20%
AA	5%	15%
A	6%	9%
BBB+	2%	7%
BBB	1%	6%
BBB-	1%	5%
BB	1%	4%
O/C (Equity)	4%	0%

CDO Collateral Pool	
ABS bonds (mostly BBB or BBB-, 5-10% BB)	100 specific credits

CDO Capital Structure		
Tranche	**Thickness**	**Support**
AAA	80%	20%
AA	10%	10%
BBB	5%	5%
O/C (Equity)	5%	0%

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Historically, lifetime losses in subprime mortgages reached over 6%, even with the strong housing market

	Historical Cumulative Net Loss Rate as of December 2006								Initial % of Pool
Vintage	Dec-04	Mar-05	Jun-05	Sep-05	Dec-05	Mar-06	Jun-06	Sep-06	
ARM									ARM
2006							0.00%	0.02%	76.1%
2005			0.00%	0.01%	0.02%	0.04%	0.10%	0.18%	79.7%
2004	0.01%	0.02%	0.05%	0.10%	0.17%	0.27%	0.39%	0.53%	72.7%
2003	0.24%	0.34%	0.45%	0.56%	0.68%	0.81%	0.90%	0.98%	62.2%
2002	0.89%	1.05%	1.21%	1.39%	1.50%	1.67%	1.79%	1.82%	63.9%
2001	2.36%	2.55%	2.73%	3.14%	3.17%	3.34%	3.50%	3.63%	58.9%
2000	3.99%	4.35%	4.78%	5.17%	5.59%	5.77%	5.96%	6.13%	63.1%
1999	5.26%	5.45%	5.59%	5.74%	6.11%	6.41%	6.55%	6.59%	50.9%
1998	5.72%	6.27%	6.51%	6.63%	6.72%	6.78%	6.88%*	6.88%*	51.9%
Fixed Rate									Fixed
2006							0.00%	0.00%	23.9%
2005			0.00%	0.00%	0.01%	0.02%	0.06%	0.10%	20.3%
2004	0.02%	0.04%	0.07%	0.10%	0.14%	0.24%	0.39%	0.56%	27.3%
2003	0.25%	0.34%	0.44%	0.55%	0.65%	0.75%	0.87%	0.97%	37.8%
2002	1.11%	1.28%	1.46%	1.71%	1.86%	2.06%	2.22%	2.34%	36.1%
2001	2.89%	3.18%	3.42%	3.68%	3.87%	3.92%	4.11%	4.15%*	41.1%
2000	4.77%	4.89%	5.22%	5.43%	5.78%	5.91%	6.19%	6.52%	36.9%
1999	5.05%	5.35%	5.56%	5.64%	6.03%	6.09%	6.25%*	6.27%	49.1%
1998	5.56%	5.59%	5.68%	6.13%	6.33%*	6.48%*	6.58%*	6.63*%	48.1%

* *Re-estimated by Deutsche Bank to adjust for the effect due to optional calls on certain deals*

Source Moody's, LoanPerformance, Deutsche Bank

Cumulative loss data published by Moody's in December 2006

Deutsche Bank

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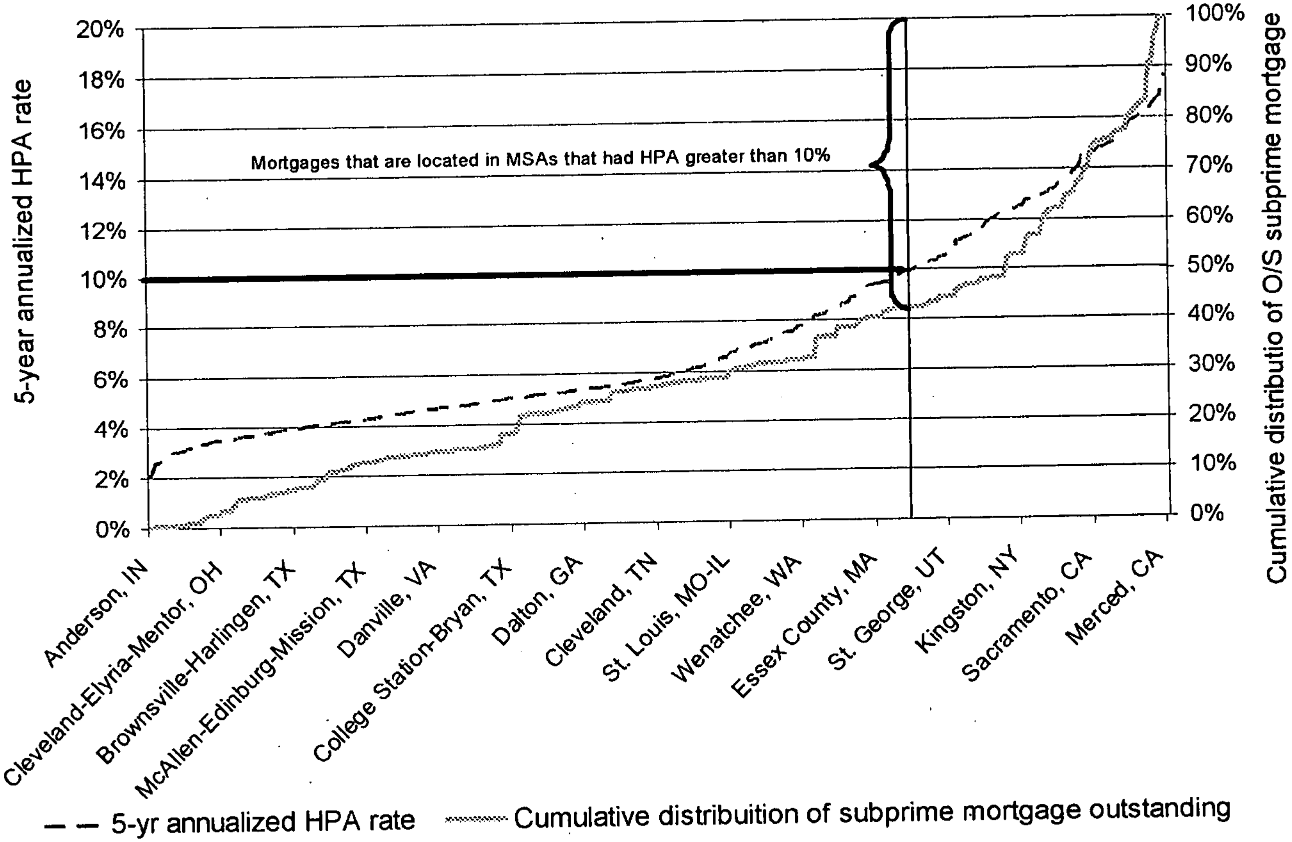
Nearly 60% of outstanding subprime mortgages are located in the MSAs with double digit 6-year average of annual home price growth rates



Source: LoanPerformance, OFHEO, Deutsche Bank

HPA data as of the end of Third Quarter 2006, mortgage data as of December 2006

Deutsche Bank

All numbers shown in this presentation are indicative and are based on a sample portfolio. Actual numbers will be different and will depend on the actual portfolios selected.

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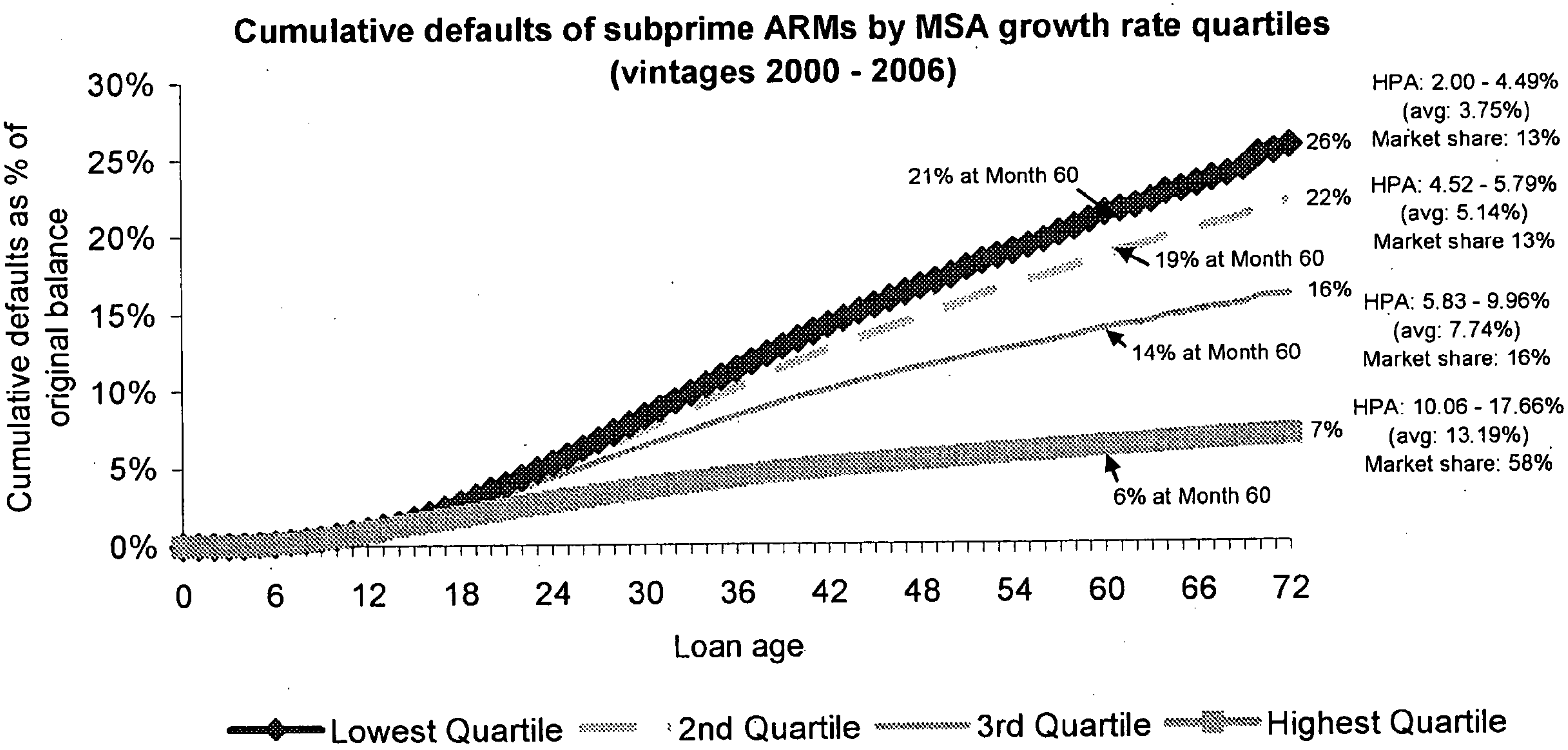
Defaults of subprime mortgages are also strongly negatively correlated with home price growth rates



Source: LoanPerformance, OFHEO, Deutsche Bank

HPA data as of end of the third quarter 2006, mortgage data as of December 2006

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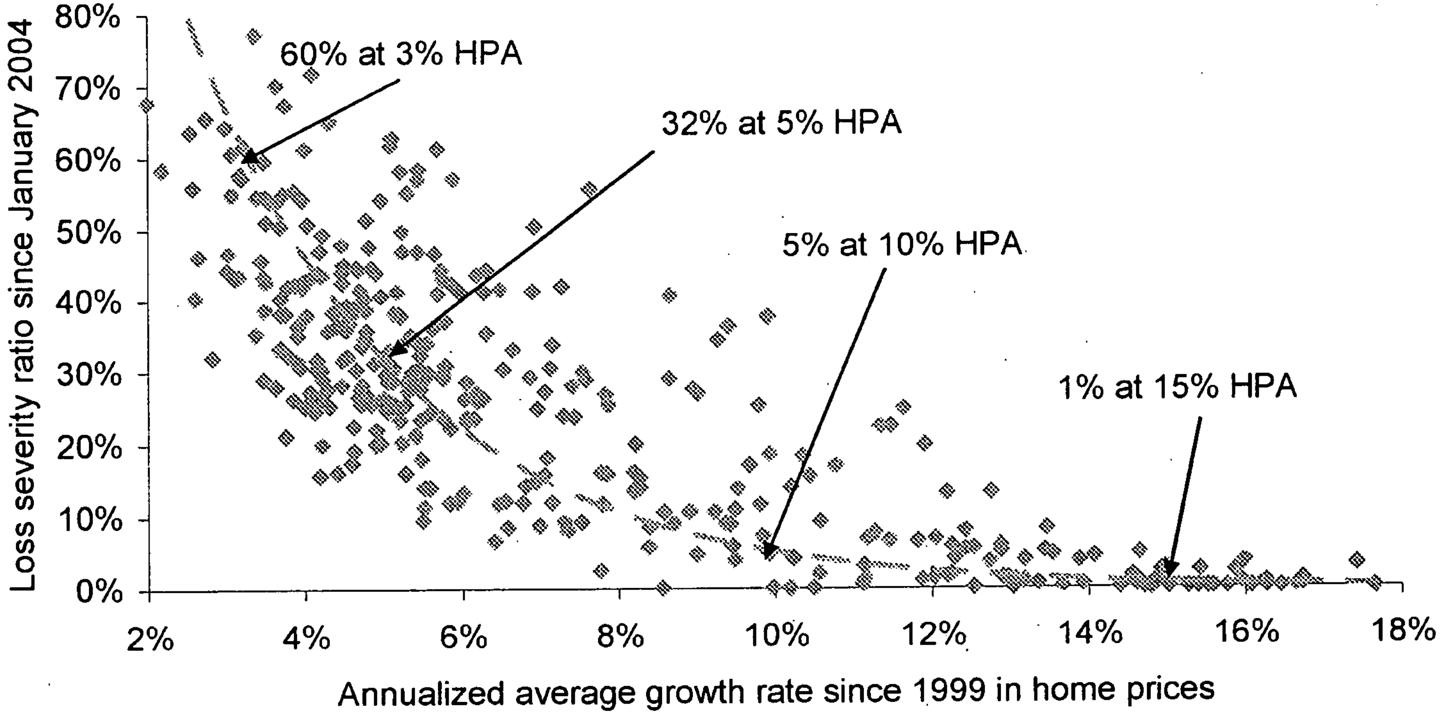
There is a strong negative correlation between home price appreciation and loss severity

Annualized home price appreciation rates since 1999 and loss severity by MSA



HPA data as of end of third quarter 2006, mortgage data as of October 2006

Note: See the next page for more details

Source: LoanPerformance, OFHEO, Deutsche Bank

Deutsche Bank

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Loss severity ratios have been strongly negatively correlated with home price appreciation rates

- In the chart on the previous page
  - Defaults are defined as loans exiting pools when being more than 90 days in delinquency, in foreclosure or in REO
  - Only loans belonging to pools where losses are reported by LoanPerformance are included but zero severity liquidations are also included
  - For each individual loan, if the loss amount exceeds the outstanding balance, actual loss amount will be used (i.e. loss severity ratios above 100% are allowed.)
- Larger MSAs with high loss severity ratios include Youngstown, OH-PA (70%), Fort Wayne, IN (64%), Pittsburgh (62%), Dayton, OH (61%), Cleveland (59%) and Indianapolis (55%). All had mediocre home price appreciation in the last 5 years.
- Some larger MSAs with high home price appreciation rates had very low loss severity ratios. These include Los Angeles (0%), Riverside-San Bernardino, CA (0%), Sacramento (0%), Fort Lauderdale (0%), Miami (1%), San Francisco (1%), Las Vegas (1%) and Washington, DC (1%)
- The loss severity ratios in the chart were calculated using first-lien subprime mortgages Originated between January 2000 and December 2004, with initial balance not exceeding $300,000, original LTV between 75 and 85 and defaulted between January 2004 and December 2006. Loss severity ratios for defaults before 2003 were generally higher.

All numbers shown in this presentation are indicative and are based on a sample portfolio. Actual numbers will be different and will depend on the actual portfolios selected.

High HPA rates played major roles in good performance of subprime mortgages in past few years

As shown above

- Mortgages located in the quartile of MSAs with lowest home price growth have been three to five times as likely to default as those in the quartile of MSAs with highest home price growth
- Generally, MSAs with double-digit home price appreciation rates have been experiencing loss severity ratios less than 20%, many such MSAs had loss severity ratios less than 10%. **The average loss severity ratio for loans located in areas with growth rate over 12% was 2%. By contrast, the average loss severity ratio for loans located in areas with growth rate between 2 and 6% was 35%, a 17-fold increase in loss severity.**
- A majority of mortgages by balance originated in the past few years are in areas with double-digit home price appreciation rates
- If home price appreciation rates slow-down to 4% p.a. for MSAs currently having double-digit rates, losses (both defaults and severity ratios) may increase substantially in these MSAs

Average jobless rates by states from 2001 to 2005 varied between 3 to 7%

Quartiles of 5-Year Average Unemployment Rate (2001-2005)

Lowest Quartile

State	Jobless rate	5-year HPA (CAGR)	6-year cumul. defaults	2005 Orig %
ND	3.37%	6.91%	12.62%	0.1%
SD	3.54%	5.58%	18.01%	0.1%
HI	3.64%	16.13%	5.10%	0.5%
NE	3.71%	3.98%	21.18%	0.3%
VA	3.72%	12.89%	8.40%	2.5%
VT	3.78%	10.66%	10.27%	0.1%
NH	3.98%	10.00%	6.95%	0.4%
DE	3.98%	11.29%	12.62%	0.3%
WY	3.98%	9.25%	11.70%	0.1%
IA	4.18%	4.33%	21.93%	0.5%
MD	4.29%	15.18%	8.52%	3.3%
MT	4.34%	9.28%	16.55%	0.1%
MN	4.36%	7.95%	12.89%	1.7%

Second Quartile

State	Jobless rate	5-year HPA (CAGR)	6-year cumul. defaults	2005 Orig %
ME	4.52%	10.09%	9.28%	0.4%
CT	4.58%	10.26%	9.98%	1.2%
OK	4.68%	4.85%	27.24%	0.7%
GA	4.74%	5.06%	25.04%	3.0%
FL	4.79%	16.28%	11.05%	10.3%
ID	4.80%	9.20%	20.21%	0.4%
AL	4.95%	5.42%	22.60%	0.8%
MA	4.96%	9.44%	7.46%	2.0%
NV	4.96%	15.41%	7.81%	2.0%
WI	5.01%	6.34%	17.08%	1.4%
UT	5.01%	5.93%	25.20%	0.9%
NJ	5.05%	13.09%	11.64%	2.9%

Third Quartile

State	Jobless rate	5-year HPA (CAGR)	6-year cumul. defaults	2005 Orig %
RI	5.06%	14.17%	5.66%	0.5%
IN	5.07%	3.19%	28.67%	1.6%
KS	5.14%	4.41%	19.71%	0.5%
AZ	5.23%	14.49%	9.49%	4.0%
AR	5.25%	5.76%	22.92%	0.4%
CO	5.26%	4.34%	19.30%	1.9%
MO	5.28%	5.92%	20.66%	1.8%
PA	5.29%	9.24%	19.01%	2.5%
TN	5.34%	5.07%	26.10%	1.7%
NM	5.46%	8.49%	21.18%	0.4%
WV	5.47%	6.14%	21.27%	0.1%
NY	5.66%	11.55%	12.02%	3.9%
OH	5.70%	3.44%	27.87%	3.0%

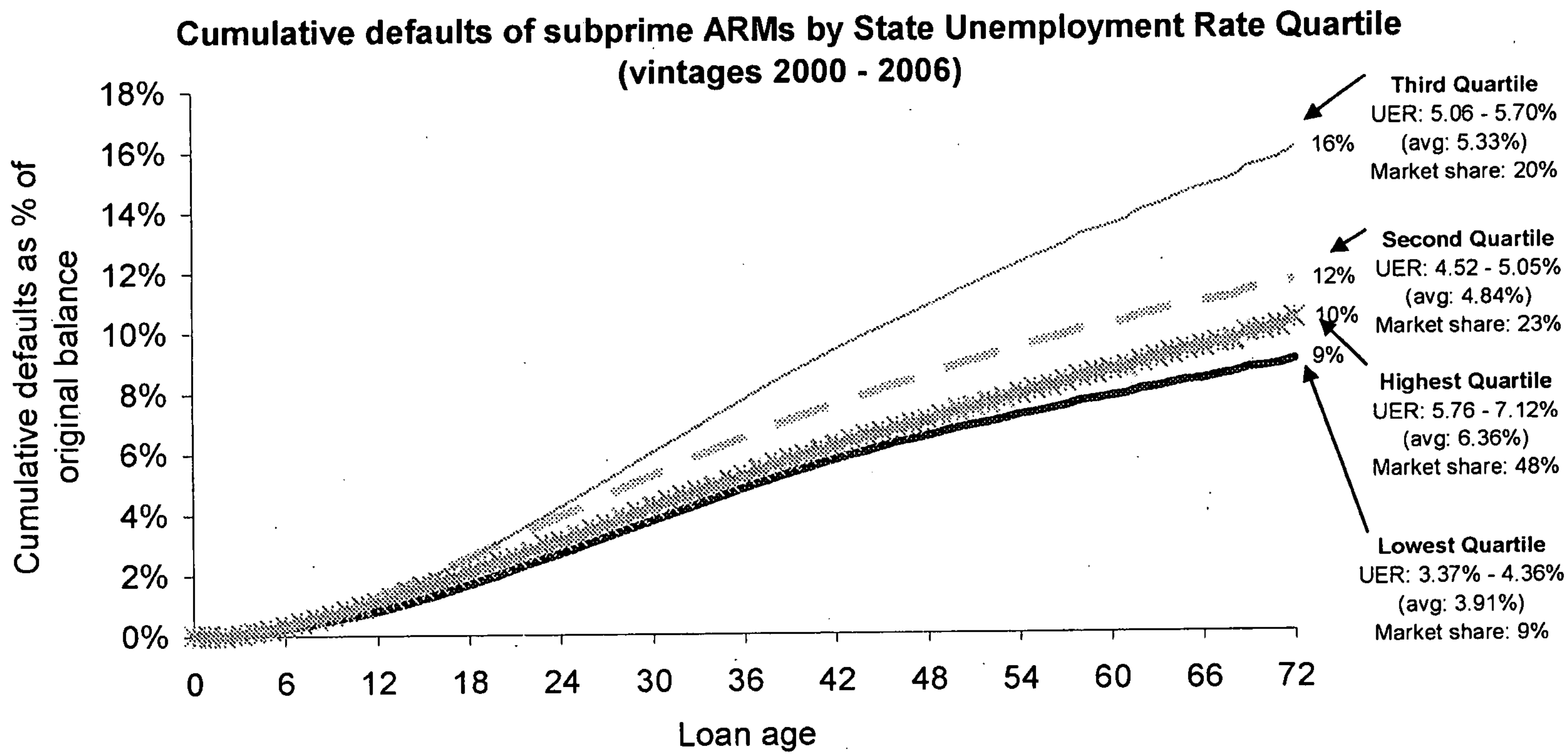
Highest Quartile

State	Jobless rate	5-year HPA (CAGR)	6-year cumul. defaults	2005 Orig %
KY	5.76%	4.55%	25.42%	0.7%
TX	5.88%	4.17%	25.99%	5.8%
NC	5.89%	5.13%	25.24%	1.8%
LA	6.10%	6.64%	22.43%	0.7%
IL	6.11%	7.38%	15.28%	5.0%
CA	6.12%	16.21%	4.56%	18.7%
SC	6.31%	5.63%	28.74%	0.9%
MI	6.46%	3.53%	20.19%	3.5%
WA	6.54%	9.89%	16.39%	2.3%
MS	6.58%	5.00%	29.69%	0.5%
DC	6.80%	17.08%	10.07%	0.2%
AK	7.02%	8.88%	12.30%	0.1%
OR	7.12%	10.37%	17.98%	1.2%

Source: US Department of Labor, Office of Federal Housing Enterprise Oversight, LoanPerformance and Deutsche Bank

Job data as of the end of 2005, HPA data as of end of second quarter, Default data as of end of August

The quartile of states with highest unemployment rates have not been the one with highest default rates



Source: LoanPerformance, OFHEO, Deutsche Bank

Data as of December 2006

Deutsche Bank

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Though jobless rates had an impact on subprime mortgage defaults, the pattern has not been nearly as clear as that of home price growth rates

As shown on the last page

- The quartile of the states with highest unemployment rates from 2001 to 2005, which includes California, has had fairly low cumulative default rates, compared with other quartiles
- This shows that, at least in the last six years, the job market has not been the most influential factor of subprime mortgage credit performance, good or bad
- The low defaults in the quartile of states with highest unemployment rates have largely been the result of California's strong housing market, which, despite a below average job market, has produced one of the lowest cumulative default rates

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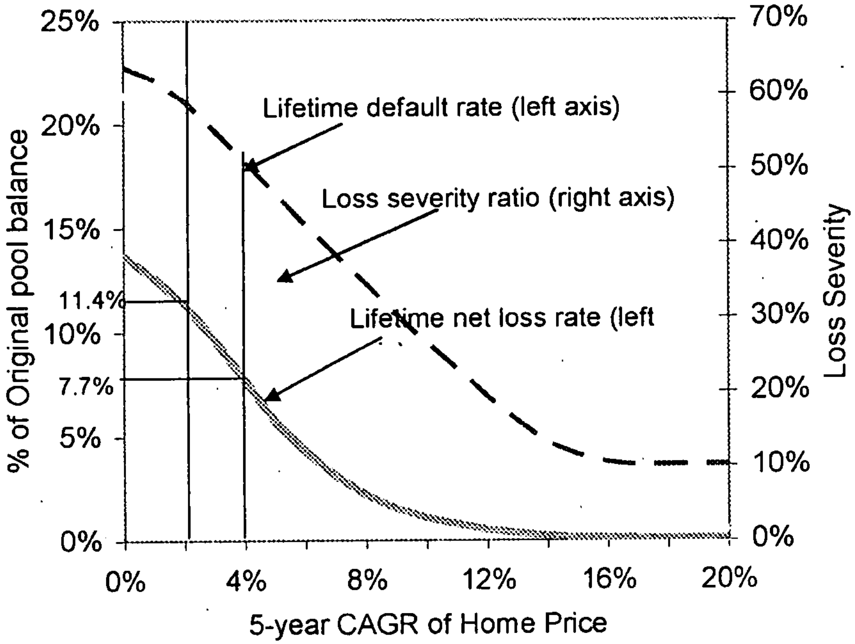
Lifetime net losses of subprime mortgage pools can potentially go to high teens if home prices flatten

Projected defaults, severity & net losses for typical subprime pools



- Given the strong historical correlation between home price appreciation and lifetime default rates, as well as that between home price appreciation and loss severity ratios, we can roughly project the relationship between home price appreciation and lifetime net loss rates
- The lifetime net loss rate is defined as the dollar amount of losses of mortgages in the pool net of recovery divided by the original pool balance. Therefore the lifetime net loss rate equals the lifetime default rate times the loss severity ratio
- As can be seen from the chart on the left, at 4% home price appreciation, we expect the net loss rate to be close to 10%, enough to wipe out most BBB- bonds. At 0%, net loss rates is expected to be in high teens, enough to wipe out almost all BBB bonds.
- The basic characteristics assumed in the model shown on the left are
  - FICO: 630
  - CLTV: 85
  - Full doc %: 60%
  - Unemployment rate: 5%
  - Balance: $200,000

Source: Deutsche Bank

Deutsche Bank

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How high can subprime mortgage losses go? Experience of Guardian S&L's securitizations

	Deal Name	Issue Date	Original Deal Size	Cumulative
1988	GSL 1988-01	Jun 88	88,599,160	1.38%
	GSL 1988-02	Aug 88	77,707,894	1.71%
	GSL 1988-03	Sep 88	70,558,507	3.83%
	GSL 1988-04	Oct 88	59,420,630	4.18%
	GSL 1988-05	Nov 88	62,365,902	4.29%
	GSL 1988-06	Dec 88	54,300,924	4.79%
	Weighted average			**3.15%**
1989	GSL 1989-01	Jan 89	63,536,170	4.56%
	GSL 1989-02	Feb 89	55,133,511	4.34%
	GSL 1989-03	Apr 89	129,304,085	4.46%
	GSL 1989-04	May 89	73,352,390	7.60%
	GSL 1989-05	Jun 89	66,110,704	6.00%
	GSL 1989-06	Jul 89	64,015,663	7.74%
	GSL 1989-07	Jul 89	64,012,175	9.48%
	GSL 1989-08	Aug 89	36,764,495	4.62%
	GSL 1989-09	Sep 89	71,197,617	10.14%
	GSL 1989-10	Oct 89	99,948,138	9.29%
	GSL 1989-11	Nov 89	100,031,457	10.78%
	GSL 1989-12	Dec 89	76,193,370	11.40%
	Weighted average			**7.70%**
1990	GSL 1990-01	Jan 90	106,434,749	13.29%
	GSL 1990-02	Feb 90	70,050,087	14.15%
	GSL 1990-03	Mar 90	85,734,389	15.20%
	GSL 1990-04	Apr 90	135,263,315	17.30%
	GSL 1990-05	May 90	113,828,957	16.52%
	GSL 1990-06	Jul 90	164,111,691	16.36%
	GSL 1990-07	Jul 90	125,697,495	18.88%
	GSL 1990-08	Sep 90	145,658,584	19.34%
	Weighted average			**16.69%**
1991	GSL 1991-01	Feb 91	184,575,305	18.48%
	GSL 1991-02	Mar 91	136,658,468	17.36%
	Weighted average			**18.01%**

Source: Moody's

Data as of August 2006

Deutsche Bank

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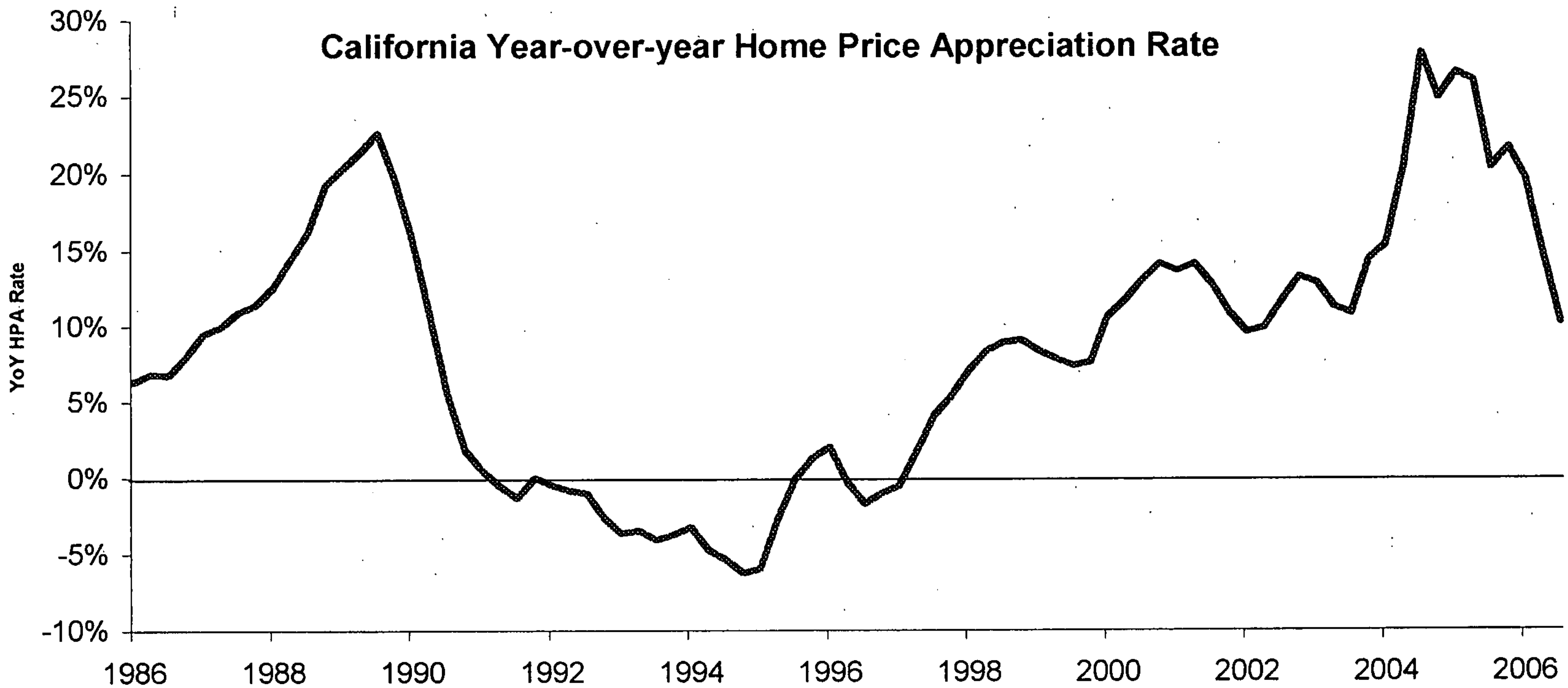
Is California housing market repeating itself?



Source: OFHEO, Deutsche Bank

Data as of end of Third Quarter 2006

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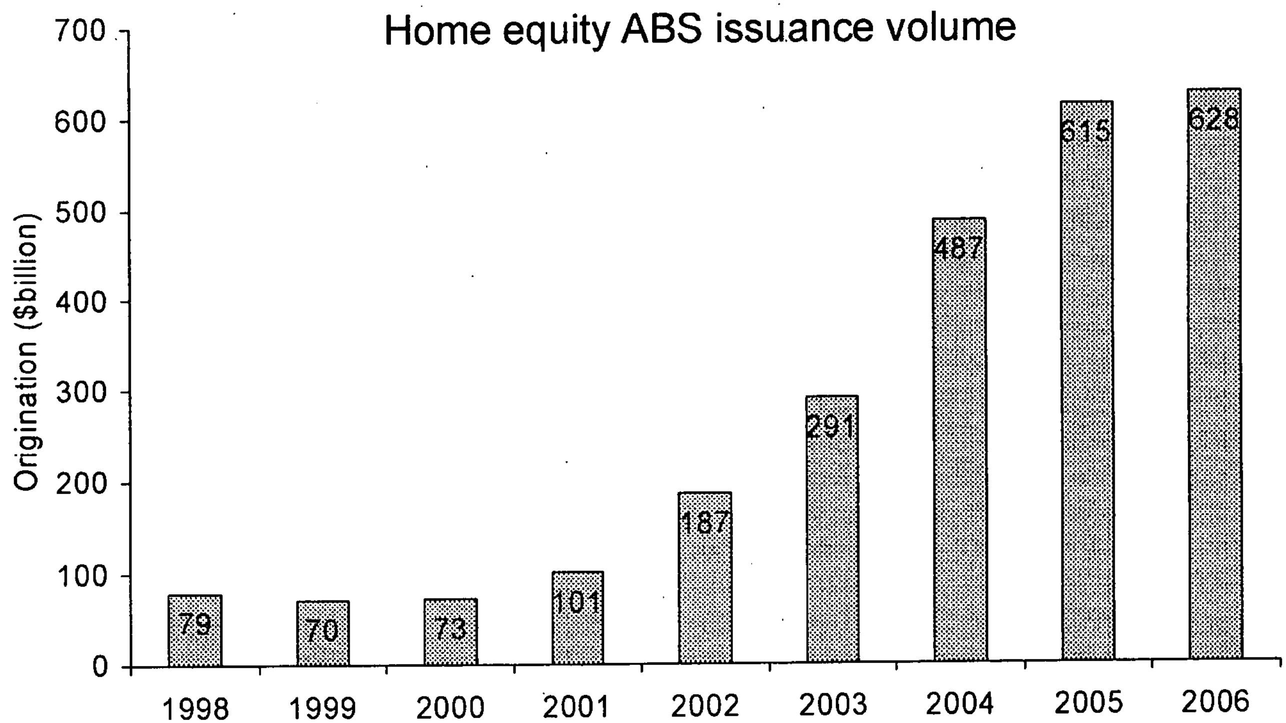
HEL ABS sector has been experiencing fast growth in recent years



Sources: Thompson Financial Securities Data, Deutsche Bank

** Data as of end of December 2006. ** Projected by Deutsche Bank*

Note: Thompson Financial Securities Data changed its criteria of home equity ABS in January 2006. The new criteria excludes certain deals with relatively high FICO scores. It also no longer include overseas mortgages securitized in the US as home equity ABS, as it used to do. As a result, issuance figures shown here are generally lower than what may have been previously shown.

Deutsche Bank

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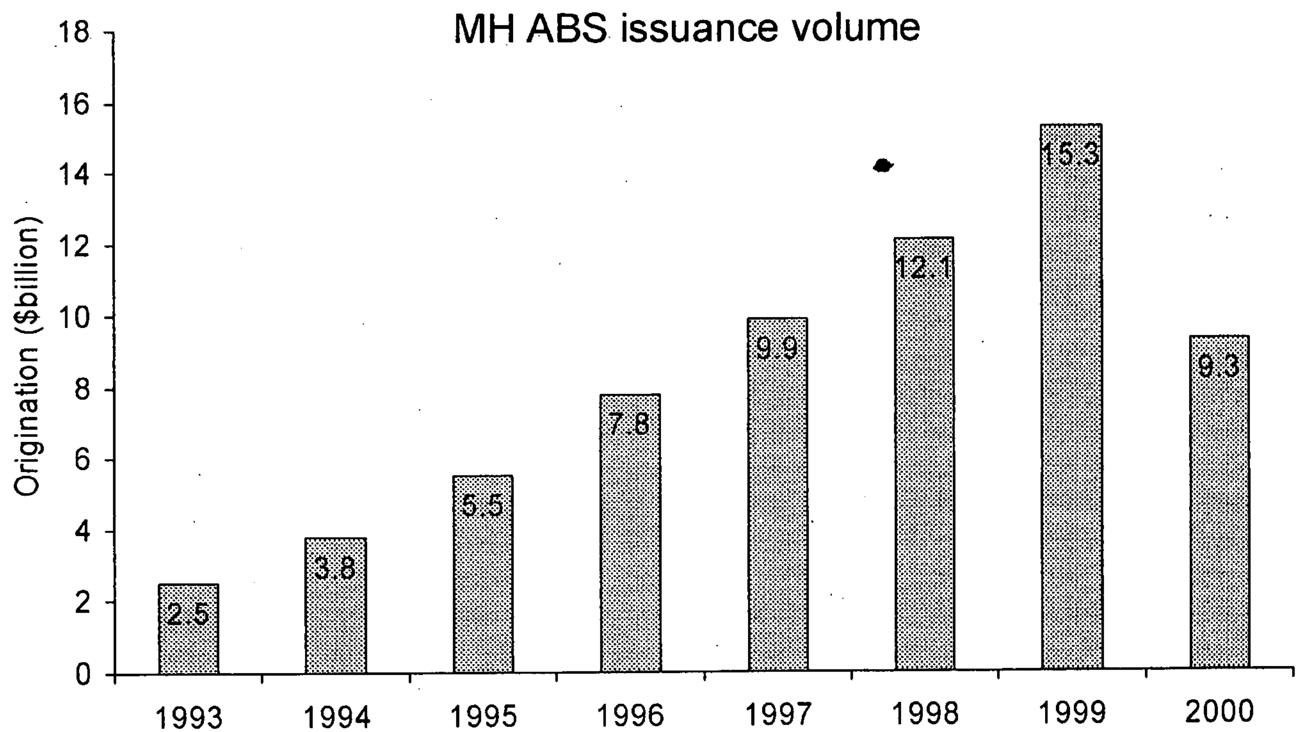
Deja-vu? MH had a similarly rapid (albeit milder) growth pattern



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What happened to MH bonds issued in 1998 through 2000 originally BBB rated?

As of October 2006

	1998-vintage	1999-vintage	2000-vintage
Originally rated Baa2/Baa3 (or BBB+/BBB/BBB-)			
Completely written off (i.e., zero recovery)	40%	88%	100%
Partially written off (more losses to come)	50%	12%	
Not yet hit by writedowns, but downgraded to below Caa or lower	10%		
Total	100%	100%	100%
Originally rated A2 (or A+/A/A-)			
Completely written off (i.e., zero recovery)	0%	50%	85%
Partially written off (more losses to come)	78%	38%	15%
Not yet hit by writedowns, but downgraded to below Caa or lower	22%	13%	
Total	100%	100%	100%

(1) Data reflect all deals from major issuers such as Bank of America, Bombardier, DFCS, GreenPoint, Green Tree (Conseco). IndyMac, Merit and Oakwood. Vanderbilt deals are excluded because the company has been buying out defaulted loans.

(2) We use Moody's rating when available; when Moody's ratings are not available, we use S&P's

Source: Moody's, S&P, Deutsche Bank

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Most top issuers are not regulated banks

Top 10 originator-issuer in 2005			
Rank	**Name**	**2005 Volume ($ million)**	**Market share**
1	**Countrywide (CWL / CWHEL / CPT)**	63,142	10.3%
2	Ameriquest (AMSI / ARSI / PPSI)	52,098	8.5%
3	Lehman Brothers (SAIL / LMT / LXS SASC)	43,871	7.1%
4	GMAC-RFC (RASC / RAMP / RAAC / RFMS2)	31,823	5.2%
5	New Century (NCHET)	31,208	5.1%
6	Option One (OOMLT)	24,730	4.0%
7	CSFB (HEAT / ABSHE / HEMT)	24,322	4.0%
8	WMC (GEWMC)	19,225	3.1%
9	Fremont (FHLT)	18,792	3.1%
10	Bear Stearns (BSABS)	17,161	2.8%

Companies in boldface fonts are regulated banks or affiliated with regulated banks.

Sources: Thomson Financial Data Servoce. Deutsche Bank

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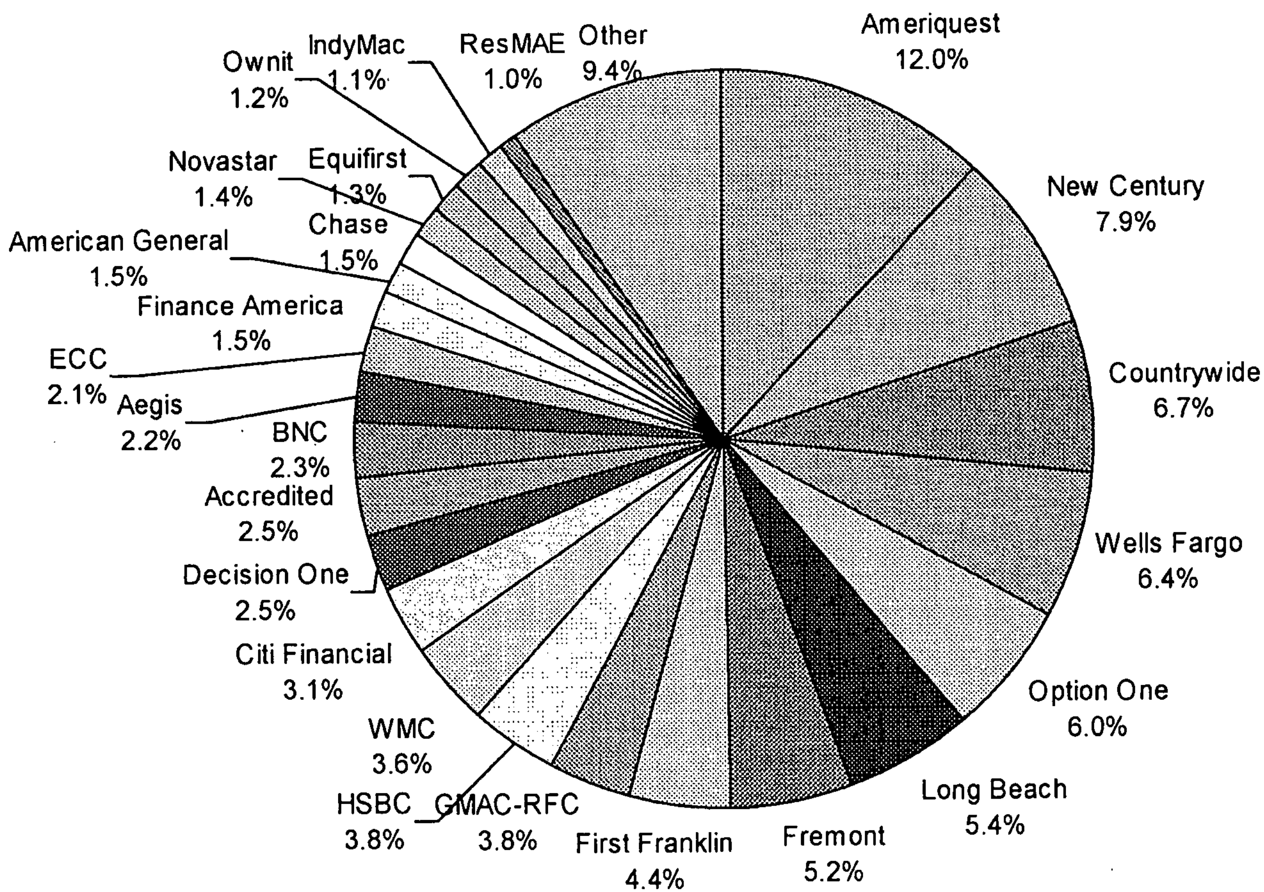
Top subprime mortgage lenders in 2005



Source: Inside Mortgage Finance Publications, Deutsche Bank

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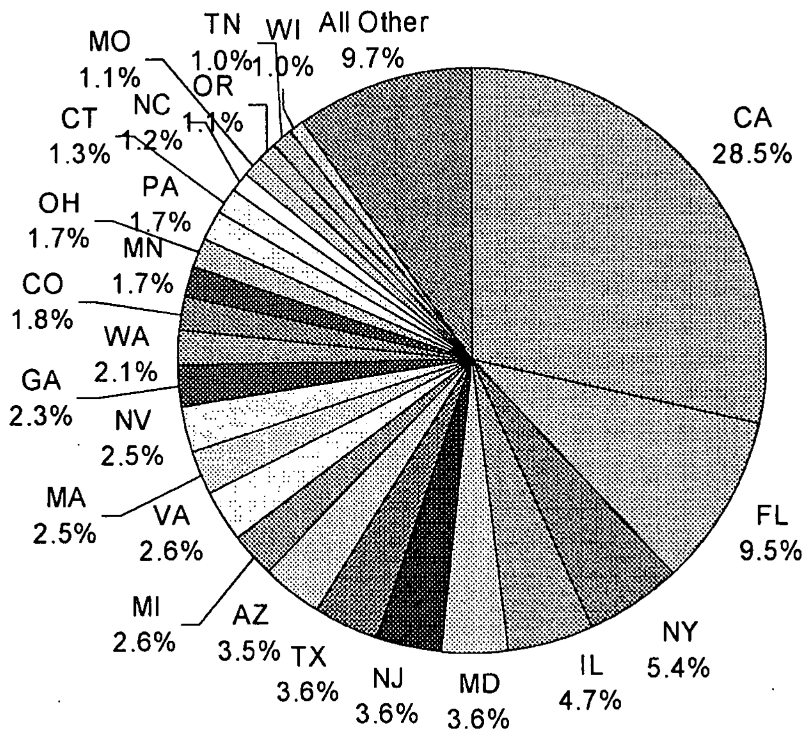
Subprime mortgages originated in 2005 by state



Source: Loan Performance

Deutsche Bank

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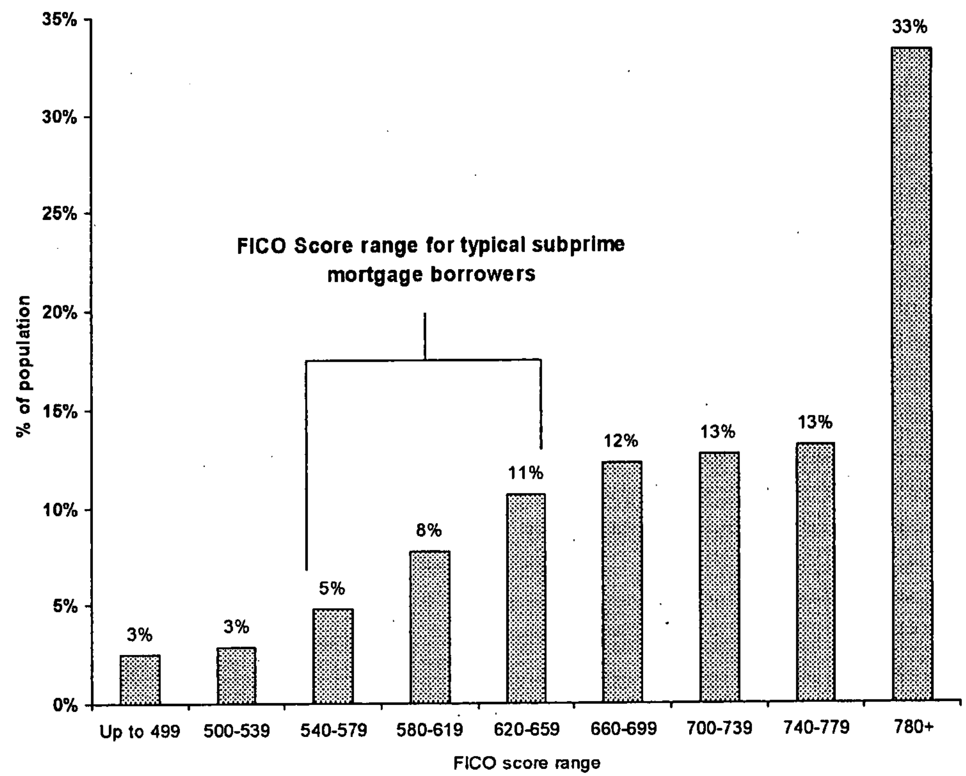
Subprime mortgage borrower base relative to general US population

- Subprime mortgage sector typically lends to borrowers better than the bottom 5% of US consumers but worse than the top 71%.
- Said another way the subprime mortgage universe 'attaches' at about 5% of US consumers and 'detaches' at roughly 29%. 5% and Below are not deemed suitable for traditional home equity ABS deals.
- About 71% of US consumers have better credit and are eligible for better financing terms from either Fannie Mae or Freddie Mac, or prime mortgage lenders.
- Although subprime mortgage borrowers are not exactly consumers with the worst credit, they form the top 81% of the bottom 29% of US consumers.
- FICO scores of the majority of subprime mortgage borrowers are below 650.

How do people score in the US?



Source: Fair Isaac Corporation

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How Fair Isaac views the risk of borrowers with various FICO scores

FICO Bucket	Share in 2005 subprime deals *	Fair Isaac risk rate **
Up to 499	0.12%	83%
500 - 549	11.67%	70%
550 - 599	22.89%	51%
600 - 649	33.69%	31%
650 - 699	22.44%	14%
700 - 749	7.61%	5%
750 - 799	2.44%	2%
800 and higher	0.13%	1%

* Based on LoanPerformance database. Alt-B deals are excluded.

** As defined by Fair Isaac, the percentage of borrowers in the cohort that will either default, file for bankruptcy, or become 90 days delinquent on at least one credit account in the next two years in a normal economic environment

Loans in recent vintage home equity deals are more risky with higher silent seconds, CLTV and IO, lower full doc and bigger payment shocks

Loan characteristics for subprime ARMs issued in 2004 through 2006

	2004				2005				2006		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3
WA FICO	611	617	618	616	618	622	623	625	627	624	620
WA LTV	82	82	82	81	81	79	81	81	81	81	84
WA CLTV	84	85	86	86	86	86	88	86	86	86	89
Silent seconds	12%	15%	24%	25%	27%	30%	34%	32%	24%	27%	27%
Interest-only	8%	11%	17%	19%	24%	29%	30%	30%	25%	16%	8%
40-year mortgage	0%	0%	0%	0%	0%	0%	4%	7%	17%	29%	36%
Full Doc	60%	61%	61%	58%	57%	57%	57%	55%	53%	55%	53%
Average loan size	172,791	178,595	182,621	188,126	193,661	194,398	203,971	209,096	212,335	214,478	217,741
CA %	33.4%	34.4%	34.5%	34.6%	34.3%	31.9%	32.1%	30.6%	31.4%	27.7%	26.6%
Initial WAC	7.31%	7.00%	7.11%	7.23%	7.12%	7.16%	7.14%	7.25%	7.69%	8.13%	8.34%
WA Margin	6.08%	5.82%	5.87%	5.90%	6.01%	5.88%	5.82%	5.84%	5.83%	6.04%	5.87%
6-Month LIBOR at issuance	1.18%	1.54%	1.97%	2.48%	2.45%	3.05%	3.50%	3.97%	4.39%	4.91%	5.40%
Fully indexed rate at issuance	7.26%	7.36%	7.84%	8.38%	8.46%	8.93%	9.32%	9.81%	10.21%	10.93%	11.26%
Difference between start rate and fully indexed rate at issuance	-0.05%	0.36%	0.73%	1.15%	1.34%	1.77%	2.18%	2.56%	2.52%	2.80%	2.92%

Source: Moody's, LoanPerformance, Deutsche Bank

Deutsche Bank

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Example: Borrower's debt-to-income ratio may grow dramatically after resets in a typical subprime loan

Mortgage maturity	360	months
Loan size	$200,000	
Teaser rate	7.50%	
Teaser period	24	months
IO period	60	months
Reset frequency	6	months
Initial DTI	40%	
Mortgage DTI	35%	
Current LIBOR	5.59%	
Initial periodic cap	3%	
Subsequent periodic cap	1.5%	
Margin	6%	
Assumed annual income growth	4%	
Growth rate of other debts	20%	

	Mortgage coupon	Monthly Payment	Payment shock	Mortgage DTI	Total DTI	Annual Income	Monthly payment for non-mortgage debts
At origination	7.50%	$1,250.00	N/A	35.0%	40.0%	$42,857.14	$178.57
After first reset	10.50%	$1,750.00	$500.00	45.3%	52.0%	$46,354.29	$257.14
After the second reset	11.59%	$1,932.33	$182.33	49.1%	56.2%	$47,272.28	$281.69
After expiration of IO	11.59%	$2,046.70	$114.37	47.1%	57.3%	$52,142.27	$444.34

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All numbers shown in this presentation are indicative and are based on a sample portfolio. Actual numbers will be different and will depend on the actual portfolios selected.

What does the payment shock mean to the borrower in the example?

- Borrower's mortgage debt-to-income ratio alone, which is assumed at 35% at the loan origination, will grow more than 10 points to 46% after the initial reset and to nearly 50% at the second reset.
- With a moderate growth assumption for the borrower's other debts, the borrower's total debt-to-income ratio can grow to nearly 60% at the expiration of the IO term.
- In order for the borrower to have the same (mortgage) debt-to-income ratio at the second reset (when the rate becomes fully indexed), the income needs to grow more than 19% annually.
- If home prices stop appreciating, the borrower, with LTV virtually unchanged in the existing loan and likely larger credit card and other debts incurred in the meantime, may find it difficult to refinance into another affordable loan.
- **According to a subprime mortgage servicer who has the top servicer rating from all rating agencies, in the past, about 50% of the borrowers who did not refi at the payment reset would default eventually.**

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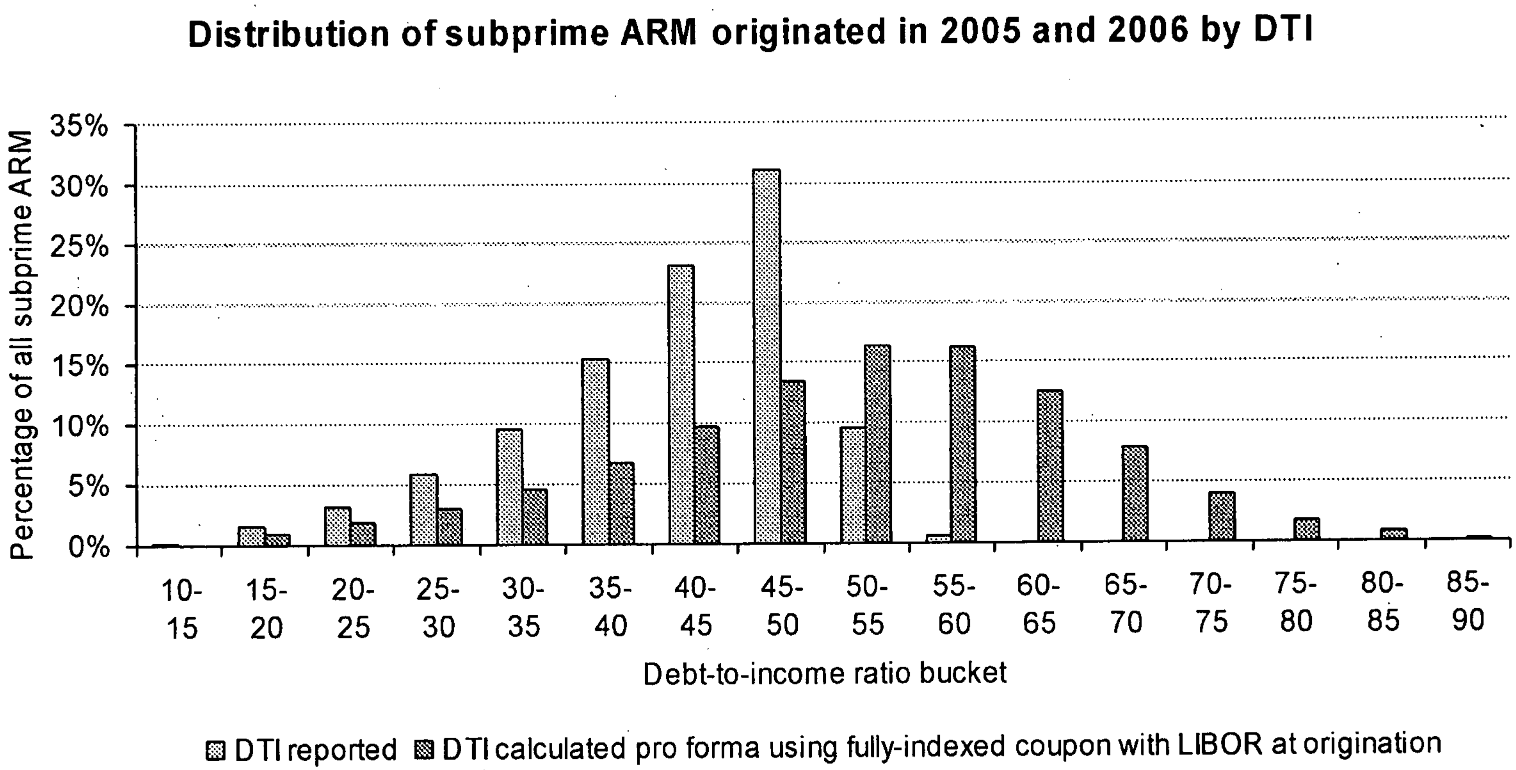
Debt-to-income ratios for subprime mortgage borrower would become dramatically higher if calculated using payments with fully-indexed coupons



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Loan characteristics from major issuers' recent deals[a]

Issuer	ARM %	Type	Loan Size ($)	WA FICO	FICO <560	WA CLTV	CLTV >80	IO	40-Year	Piggy-back	Super States[b]	Low/No Doc	Invest
Ameriquest	84.5%	ARM	209,680	652	2.3	91.6	75.2	51.3	15.4	43.6	58.0	42.2	3.4
		Fixed	144,031	646	5.7	83.5	52.7	13.2	9.6	13.6	40.5	27.8	3.3
Argent	87.7%	ARM	175,276	599	28.1	80.4	52.0	13.6	8.2	11.2	59.8	34.7	3.5
		Fixed	130,561	648	7.7	81.4	58.0	16.1	3.4	4.9	54.4	27.9	5.3
Countrywide	85.0%	ARM	224,679	617	19.7	88.0	72.4	21.5	11.4	33.0	69.6	47.8	9.6
		Fixed	149,125	624	15.9	81.0	53.5	5.8	7.7	8.5	58.3	23.7	5.9
First Franklin	66.9%	ARM	196,964	614	17.0	86.7	66.6	35.4	9.6	34.9	64.1	43.4	4.4
		Fixed	179,582	613	16.8	78.1	44.3	12.8	9.4	9.0	65.0	26.6	2.5
Fremont	89.0%	ARM	256,136	621	16.7	86.2	54.1	16.0	24.7	32.8	76.2	45.4	7.1
		Fixed	92,852	643	5.3	90.8	74.3	0.0	5.2	14.5	77.2	36.5	4.7
Long Beach	86.5%	ARM	233,398	634	10.2	91.5	77.7	8.9	50.4	56.2	70.0	56.5	11.4
		Fixed	106,838	643	5.4	87.0	62.7	0.0	15.4	18.2	62.5	37.9	6.5
New Century	80.3%	ARM	223,667	622	15.7	84.5	57.1	29.3	28.5	18.8	72.4	50.1	9.7
		Fixed	135,655	634	10.0	81.8	52.0	2.0	9.8	6.4	65.0	31.6	6.3
Option One	81.3%	ARM	224,695	613	17.5	86.4	62.8	20.4	22.5	31.6	64.9	45.3	8.1
		Fixed	126,584	634	7.8	83.2	54.8	4.2	12.4	15.4	65.8	35.7	5.1
RASC	79.7%	ARM	171,893	617	10.8	87.5	70.5	17.1	9.8	29.6	46.1	37.0	4.7
		Fixed	99,759	626	8.5	82.7	58.4	2.5	6.6	10.5	41.6	27.1	4.6
WMC	82.7%	ARM	265,670	639	9.3	82.9	34.8	18.7	53.4	11.8	80.2	60.1	4.2
		Fixed	91,806	649	2.9	90.2	70.7	0.0	14.0	1.3	76.1	55.4	3.3

Source: LoanPerformance, Deutsche Bank

a. Deals issued in 2006.

b. Super states are states whose home price index increased more than 10% YoY since the second quarter of 2001. These include AZ, CA, CT, DC, DE, FL, HI, MD, ME, NJ, NV, NY,OR, RI, VA and VT

Typical 2005-vintage home equity deals from major issuers

		Long Beach 2005-2		First Franklin 2005-FF6		New Century 2005-4		RASC 2005-KS11	
Collateral	ARM %	94.0%		89.8%		42.5%		62.7%	
	Average Balance	$193,360		$223,787		$205,009		$151,066	
	WAC	7.41%		6.69%		7.21%		7.51%	
	WA CLTV	90%		90%		87%		85%	
	WA 1st Lien LTV	83%		83%		81%		81%	
	Piggyback	39.6%		36.9%		29.0%		18.9%	
	% CLTV >80	78.2%		78.0%		69.0%		63.5%	
	WA DTI	NA		44.50%		41.00%		NA	
	% DTI >40	NA		70.80%		62.60%		NA	
	Owner Occ.	81.8%		97.2%		89.7%		93.6%	
	% CA	33.9%		41.6%		39.4%		9.1%	
	Avg. FICO	636		647		626		614	
	IO%	24.6%		63.2%		39.3%		10.9%	
Subordination (Class %)	Aaa	26.35%	(73.65%)	20.20%	(79.80%)	22.90%	(77.10%)	20.60%	(79.40%)
	Aa2	14.10%	(12.25%)	12.80%	(7.40%)	15.80%	(7.10%)	13.75%	(6.85%)
	A2	9.70%	(4.40%)	7.85%	(4.95%)	10.20%	(5.60%)	8.30%	(5.45%)
	A3	8.50%	(1.20%)	6.45%	(1.40%)	8.65%	(1.55%)	6.80%	(1.50%)
	Baa1	6.80%	(1.70%)	5.30%	(1.15%)	7.05%	(1.60%)	5.25%	(1.55%)
	Baa2	5.70%	(1.10%)	4.20%	(1.10%)	5.95%	(1.10%)	4.05%	(1.20%)
	Baa3	4.50%	(1.20%)	3.40%	(0.80%)	4.85%	(1.10%)	2.95%	(1.10%)
	Ba1	3.20%	(1.30%)	2.40%	(1.00%)				

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Typical 2006-vintage home equity deals from major issuers

		Long Beach 2006-WL1		Soundview 2006-OPT3		Morgan Stanley 2006-NC1		RASC 2006-KS4	
Collateral	ARM %	90.0%		84.9%		77.7%		86.5%	
	Average Balance	$207,619		$192,957		$202,198		$145,305	
	WAC	7.45%		8.58%		7.33%		8.43%	
	WA CLTV	92%		100%		81%		87%	
	WA 1st Lien LTV	80%		80%		80%		82%	
	Piggyback	57.5%		94.3%		NA		25.2%	
	% CLTV >80	80.0%		99.3%		45.1%		69.2%	
	WA DTI	NA		42.23%		40.69%		NA	
	% DTI >40	NA		64.84%		60.75%		NA	
	Owner Occ.	91.6%		94.1%		91.7%		94.1%	
	% CA	45.0%		22.1%		38.7%		10.9%	
	Avg. FICO	NA		602		620		623	
	IO%	7.2%		9.5%		26.2%		15.7%	
Subordination (Class %)	Aaa	23.35%	(76.65%)	23.70%	(76.30%)	21.10%	(78.90%)	22.00%	(78.00%)
	Aa2	16.40%	(6.95%)	15.45%	(8.25%)	14.55%	(6.55%)	14.65%	(7.35%)
	A2	10.90%	(5.50%)	9.95%	(5.50%)	9.50%	(5.05%)	9.05%	(5.60%)
	A3	9.40%	(1.50%)	8.30%	(1.65%)	8.05%	(1.45%)	7.40%	(1.65%)
	Baa1	8.00%	(1.40%)	6.70%	(1.60%)	6.65%	(1.40%)	5.90%	(1.50%)
	Baa2	6.75%	(1.25%)	5.35%	(1.35%)	5.40%	(1.25%)	4.50%	(1.40%)
	Baa3	5.75%	(1.00%)	4.25%	(1.10%)	4.35%	(1.05%)	3.50%	(1.00%)
	Ba1	4.70%	(1.05%)	3.45%	(0.80%)			2.80%	(0.70%)

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All numbers shown in this presentation are indicative and are based on a sample portfolio. Actual numbers will be different and will depend on the actual portfolios selected.

How do Baa2 and Baa3 tranches in a typical 2005-vintage subprime mortgage deal fare?

% for base case prepayment	Lifetime net cumulative losses when the tranche will be hit by principal writedown	Lifetime net cumulative losses when the tranche will be wiped out
For Baa2		
70%	12.11%	13.66%
80%	10.81%	12.36%
90%	9.82%	11.34%
100%	9.06%	10.55%
110%	8.46%	9.91%
120%	7.97%	9.39%
130%	7.57%	8.96%
For Baa3		
70%	10.06%	12.11%
80%	8.84%	10.72%
90%	7.93%	9.82%
100%	7.22%	9.06%
110%	6.66%	8.46%
120%	6.22%	7.97%
130%	5.86%	7.57%

Note: We used multiples of the prepayment and losses assumptions outlined in the prior pages and the forward LIBOR curves as of November 16, 2006. We chose Option One 2005-4 as our model transaction which has somewhat typical initial credit enhancement levels for Baa3 (3.85%), Baa2 (5.35%) and Baa1 (6.55%). **All step-down or step-up triggers in the deal structure are assumed activated for conservatism. If the triggers are not activated, the break points may be substantially lower.**

As shown, faster prepayments usually cause bonds to "break" at lower loss levels, since there is less excess spread.

Conversely, bonds "break" at higher loss levels under slow prepayments. However, under such a scenario, more borrowers will pay fully indexed rates longer (usually this is a sign that fewer borrowers are able to refinance). Therefore, the cumulative losses out of a pool could be higher.

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How do Baa2 and Baa3 tranches in a typical 2005-vintage subprime mortgage deal fare (continued)?

% for base case prepayment	Lifetime net cumulative losses when the tranche will be hit by principal writedown	Lifetime net cumulative losses when the tranche will have 30% principal writedown	Lifetime net cumulative losses when the tranche will be wiped out
For Baa2			
70%	12.11%	12.58%	13.66%
80%	10.81%	11.28%	12.36%
90%	9.82%	10.28%	11.34%
100%	9.06%	9.51%	10.55%
110%	8.46%	6.17%	9.91%
120%	4.24%	5.17%	9.39%
130%	3.13%	5.19%	9.39%
For Baa3			
70%	10.06%	10.67%	12.11%
80%	8.84%	9.42%	10.81%
90%	7.07%	7.56%	9.82%
100%	5.70%	6.42%	9.06%
110%	4.52%	5.27%	8.46%
120%	3.39%	4.50%	8.98%
130%	2.54%	4.43%	9.64%

Note: We used multiples of the prepayment and losses assumptions outlined in the prior pages and the forward LIBOR curves as of November 16, 2006. We chose Option One 2005-4 as our model transaction which has somewhat typical initial credit enhancement levels for Baa3 (3.85%), Baa2 (5.35%) and Baa1 (6.55%). **In this scenario, all step-down or step-up triggers in the deal structure are allowed to pass or fail based on the prepayment and default assumptions (and a 0% delinquency rate). This results in lower breakpoints than the initial enhancements under rapid prepayment scenarios because the subordination begins to pay down or be released *before* losses have hit the deal at the three year stepdown date.**

As shown, faster prepayments usually cause bonds to "break" at lower loss levels, since there is less excess spread.

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How do Baa2 and Baa3 tranches in a typical 2006-vintage subprime mortgage deal fare?

% for base case prepayment	Lifetime net cumulative losses when the tranche will be hit by principal writedown	Lifetime net cumulative losses when the tranche will be wiped out
For Baa2		
70%	14.57%	15.37%
80%	12.05%	12.89%
90%	10.38%	11.23%
100%	9.16%	10.01%
110%	8.19%	9.04%
120%	7.42%	8.27%
130%	6.80%	7.64%
For Baa3		
70%	13.28%	14.57%
80%	10.49%	12.05%
90%	8.92%	10.38%
100%	7.73%	9.16%
110%	6.80%	8.19%
120%	6.06%	7.42%
130%	5.47%	6.80%

Note: We used multiples of the prepayment and losses assumptions outlined in the prior pages and the forward LIBOR curves as of November 16, 2006. We chose Citigroup Mortgage Loan Trust 2006-NC1 as our model transaction which has somewhat typical initial credit enhancement levels for Baa3 (3.70%), Baa2 (4.80%) and Baa1 (5.50%). **All step-down or step-up triggers in the deal structure are assumed activated for conservatism. If the triggers are not activated, the break points may be substantially lower.**

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How do Baa2 and Baa3 tranches in a typical 2006-vintage subprime mortgage deal fare (continued)?

% for base case prepayment	Lifetime net cumulative losses when the tranche will be hit by principal writedown	Lifetime net cumulative losses when the tranche will have 30% principal writedown	Lifetime net cumulative losses when the tranche will be wiped out
For Baa2			
70%	14.57%	14.81%	15.37%
80%	12.05%	12.30%	12.89%
90%	10.38%	10.64%	11.23%
100%	9.16%	9.42%	10.01%
110%	5.70%	6.11%	9.04%
120%	4.23%	4.59%	7.70%
130%	3.14%	4.67%	7.43%
For Baa3			
70%	13.28%	13.68%	14.57%
80%	10.49%	10.94%	12.05%
90%	8.92%	9.35%	10.38%
100%	6.31%	6.89%	9.16%
110%	4.87%	5.49%	7.58%
120%	3.64%	4.20%	7.25%
130%	2.67%	4.51%	7.74%

Note: We used multiples of the prepayment and losses assumptions outlined in the prior pages and the forward LIBOR curves as of November 16, 2006. We chose Citigroup Mortgage Loan Trust 2006-NC1 as our model transaction which has somewhat typical initial credit enhancement levels for Baa3 (3.70%), Baa2 (4.80%) and Baa1 (5.50%). **In this scenario, all step-down or step-up triggers in the deal structure are allowed to pass or fail based on the prepayment and default assumptions, (and a 0% delinquency rate). This results in lower breakpoints than the initial enhancements under rapid prepayment scenarios because the subordination begins to pay down or be released *before* losses have hit the deal at the three year stepdown date.**.

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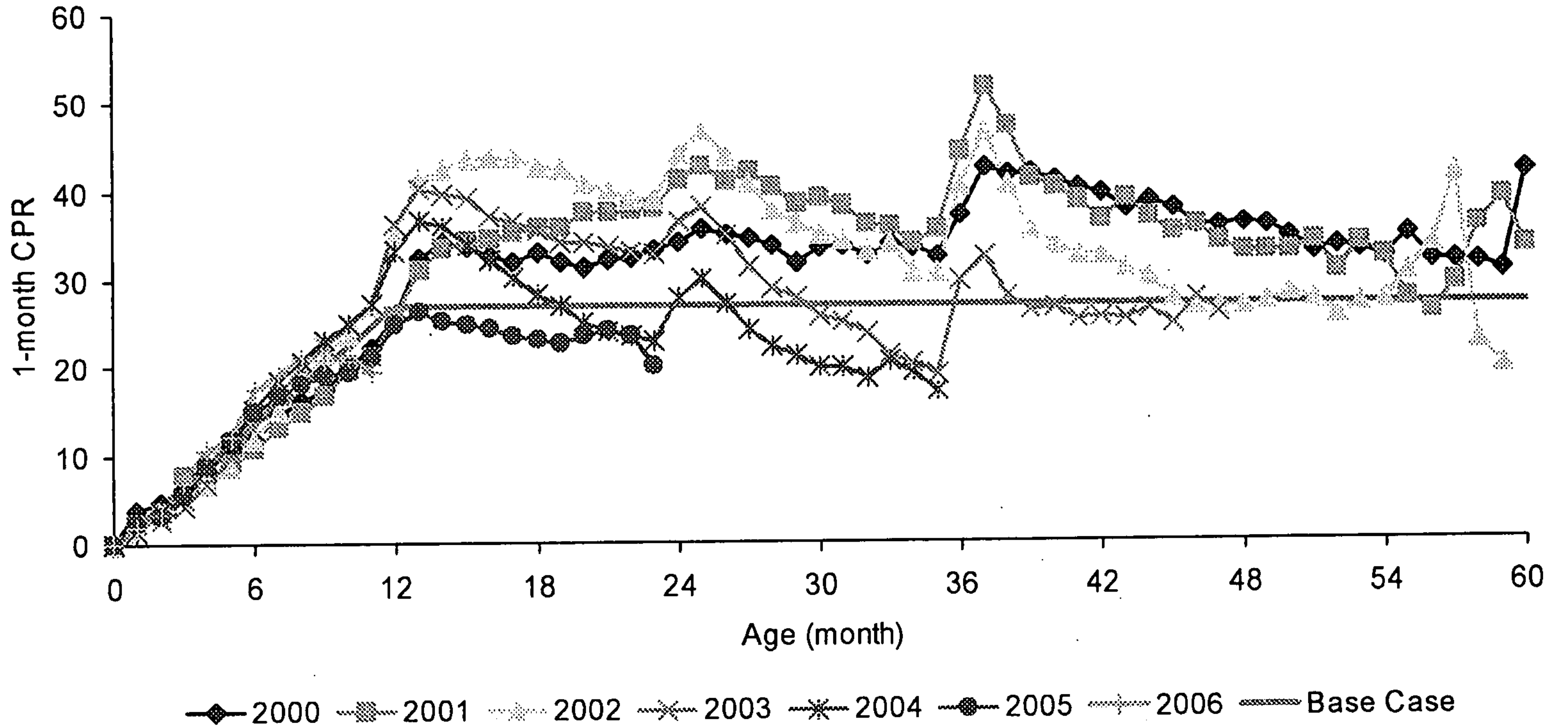
We assume base case prepayment assumption using historical prepayment data – fixed rate mortgages

Fixed rate historical prepayments and base case assumption



Source: Loan Performance, Deutsche Bank

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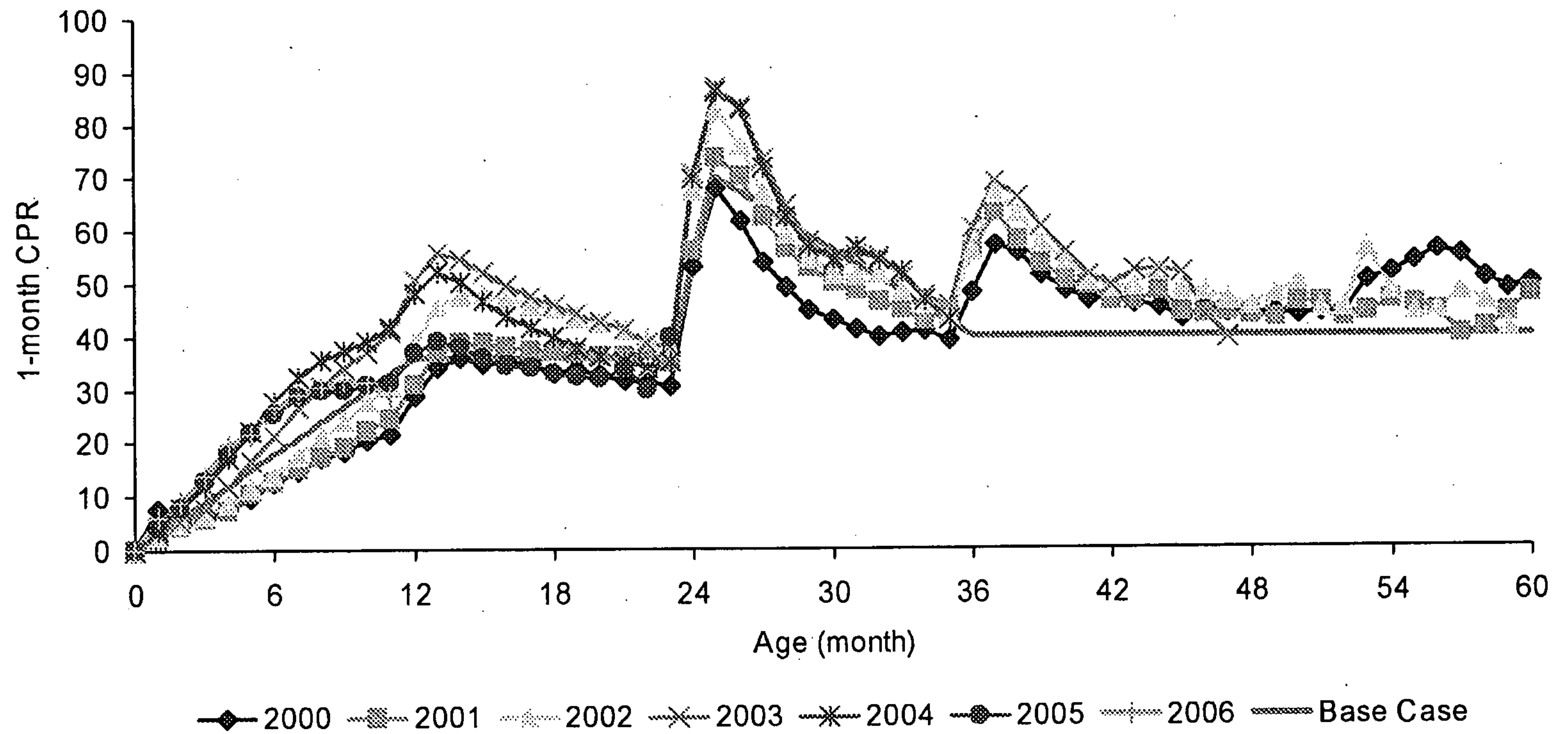
We assume base case prepayment assumption using historical prepayment data – ARMs

ARM historical prepayments and base case assumption



Source: Loan Performance, Deutsche Bank

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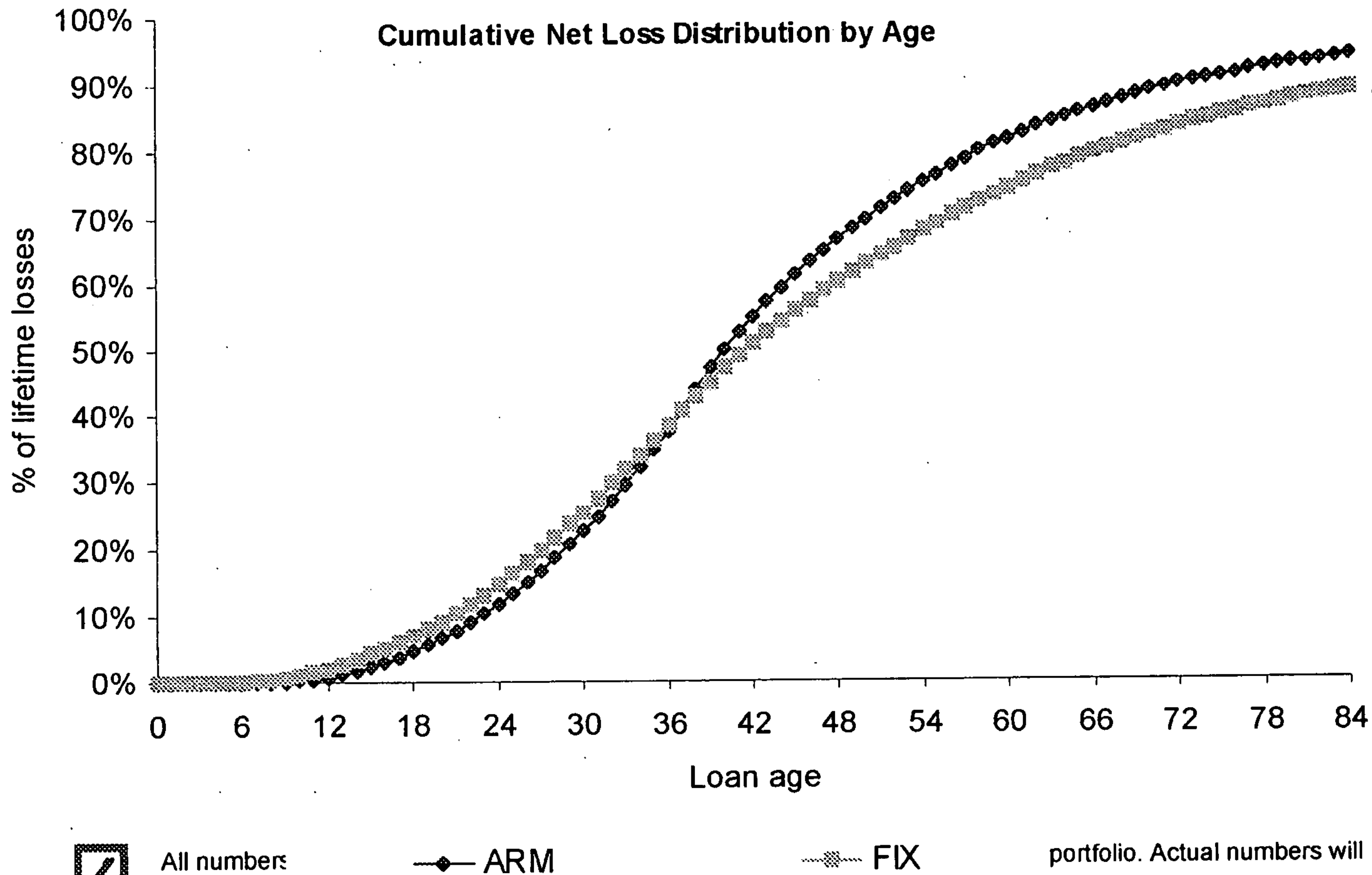
Most of losses in collateral happen between year 2 and year 4, especially after rate-adjustment induced payment shocks



All numbers … portfolio. Actual numbers will be different and will depend on the actual portfolios selected.

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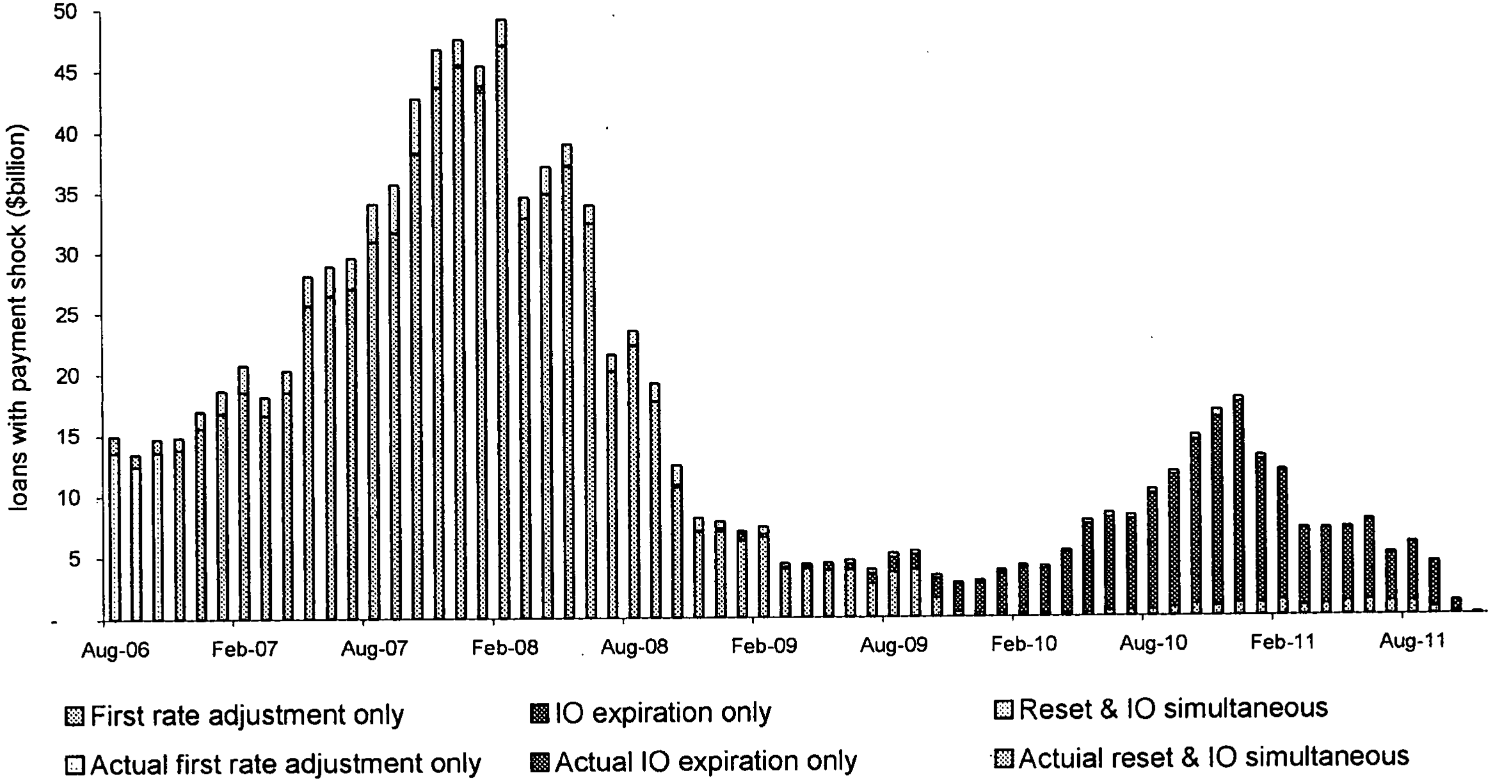
Nearly $783 billion subprime mortgages will experience payment shocks in the next 3 years

Estimated amount of current outstanding subprime mortgages with future payment shocks



Note: Securitized subprime mortgages only

Data as of October 2006

Sources: LoanPerformance, Deutsche Bank

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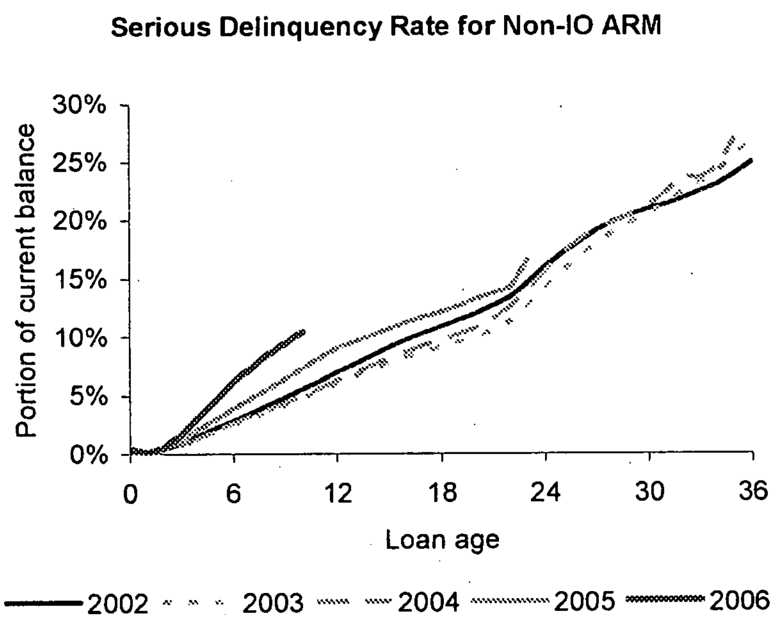
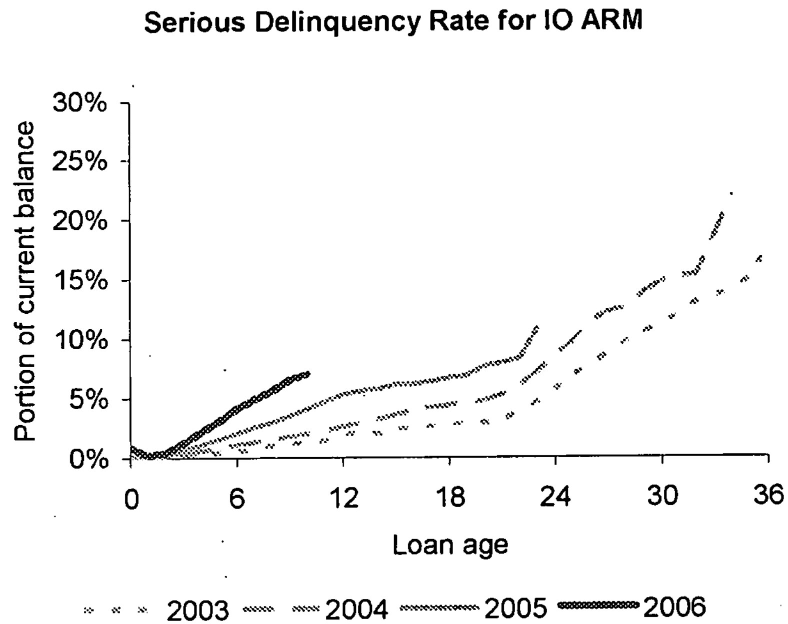
The 2005 and 2006-vintages have underperformed their predecessors





Note: There was virtually no subprime IO lending before 2003.

Data as of October 2006

Source: Loan Performance, Deutsche Bank

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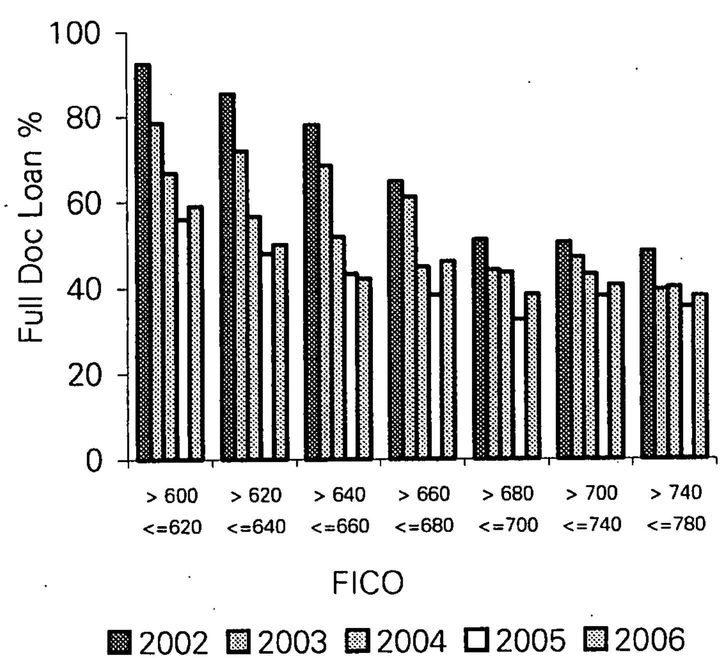
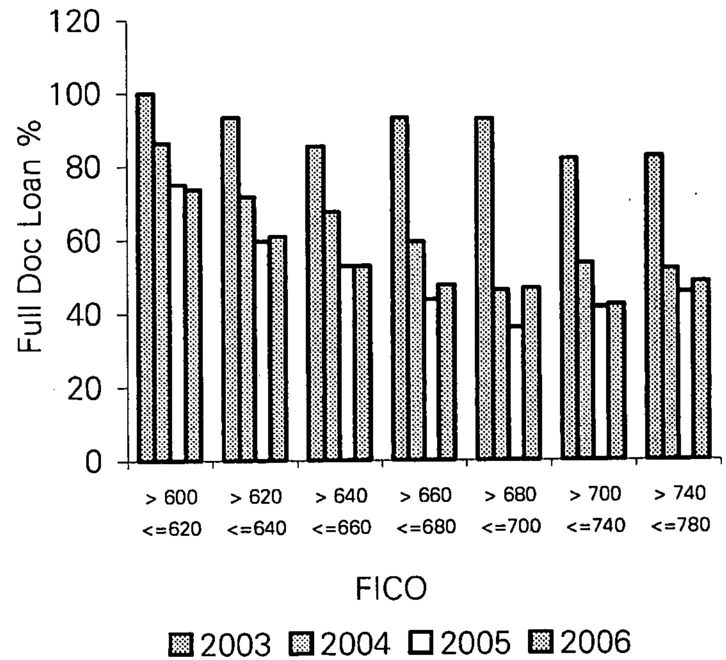
The 2005-vintage was most risk-layered

Non-IO ARM with CLTV 90-95 & DTI 40-45



IO ARM with CLTV 90-95 & DTI 40-45



Sources: LoanPerformance, Deutsche Bank

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Pay-as-you-go (PAUG) structure: the market's answer to challenges posed to ABS CDS

- The physical delivery and credit event-settlement are not required
  - Unlike corporate CDS, ABS CDS does not require physical delivery of the underlying bond from the protection buyer (who has effectively sold the underlying bond short). This helps to greatly neutralize the risk of a short squeeze.
  - Nor is cash settlement at the credit event mandatory. This would avoid either party from been trapped with artificially high or low quotes.
- The cashflow of the PAUG ABS CDS is dictated by the underlying bonds distribution cashflow, outstanding balance, and interest shortfalls or principal writedown, if any.
  - The underlying bond's balance, interest shortfall and principal writedown are calculated using rules set at the issuance. (See Appendix for typical bond payment structure.)
  - If the underlying bond is paid down, the notional amount for the CDS will decline accordingly.
  - If there is an interest shortfall in the underlying bond resulted from the available funds cap, premium payment for CDS will be reduced accordingly, subject to the ceiling of the premium size.
  - If there is an interest shortfall due to credit loss or there is a principal writedown, the protection seller will pay the protection buyer accordingly

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Deutsche Bank's counterparty will have stable counterparty risk while enjoy flexibility of assigning the contract to another broker-dealer

- A protection buyer will always have DB as the counterparty if the contract is initially made with DB
  - DB may hedge its position, but will never assign the contract to any third party
  - If the CDO is DB's counterparty, it is required to be fully funded in a separate offshore SPV
- However, the protection buyer can offload the position by
  - Unwind the contract with DB
  - Physically deliver the bond
  - Assign the contract to another broker dealer (effectively covering the short)

Appendix:

The underlying securities: subprime RMBS

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U.S. Residential Mortgage

Single family mortgages

- mortgages on single family (detached) houses
- not included: condos, town houses, co-ops, buildings with more than 1 units, commercial properties, etc.

2-4 family mortgages

- mortgages on residential buildings with 2 to 4 family units

Multi-family mortgages

- usually considered as commercial mortgages

Other residential mortgages

- condos, town houses, co-ops, etc.

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The US Residential MBS Market

Agency mortgages are mortgages that are in Ginnie Mae, Fannie Mae and Freddie Mac programs.

Typical Fannie Mae / Freddie Mac requirements

- balance limit: $359,650 for 2005 (single family house)
- loan priority: must be first-lien
- debt-to-income ratio limit:
  - 28% for mortgage debt
  - 33% for total debt
- cash-out not above 75% LTV (if refinance)
- loan-to-value ratio limit: 95%
- credit history: FICO score at least 720

Residential Mortgages (continued)

- Conventional loans: fixed rate loans in Fannie Mae and Freddie Mac programs
- GNMA loans are not available to the general public
- Jumbo mortgage: a prime loan with a balance higher than the agency limit.
- Prime mortgages: mortgages that are either agency mortgages or jumbo mortgages.

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Profile of traditional home equity product

- Low balance
- Second or third lien
- Credit score above 680
- Usually a refinancing to take out cash
- 15-year maturity (or shorter)
- Combined loan-to-value (CLTV) ratio less than 100
- Include home equity lines of credit (securitized separately)

All numbers shown in this presentation are indicative and are based on a sample portfolio. Actual numbers will be different and will depend on the actual portfolios selected.

Subprime (a.k.a. B&C) mortgages

- Often a first lien mortgage
- May be purchase, cash out, etc.
- May be used for cash-out purposes or debt consolidation
- Typical LTV around 80, may reach 100
- Often have piggy-back second lien loans
- Includes FHA Title 1 loans and other home improvement loan products

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Products that may be riskier than traditional home equity/subprime mortgages have become popular

Because of the continued faster pace in home price appreciation compared with wage growth, lenders have developed a number of products to enable borrowers to qualify for mortgage payments and/or to pay minimal down-payment

- IO mortgages
  - Loan only pays interest in the IO period (usually 2 to 5 years)
  - At the expiration of the IO period, loan converts to fully amortizing loans
  - Payment shock at the expiration of the IO period may cause defaults to surge
- Silent second mortgages
  - A simultaneous pair of first and second lien loans are made at the origination (usually 80% LTV for the first lien and 10 to 20% LTV for the second lien)
  - Borrower pays little or no down-payment
  - Only the first lien mortgage shows up in a securitization and LTV appear to only be 80%. But the borrower's tendency to default is much high than a true 80% first lien mortgage.
- Option ARMs
  - Allow borrower to pay exceedingly low initial minimum payments
  - Indexed on moving Treasury average (MTA), LIBOR or COFI-11
  - Likely to have negative amortization
  - Recast of schedule at 5th anniversary may potentially cause significant payment shocks
- Stated-income mortgage loans
  - Income of the borrowers is not substantiated by the documentation, nor is it verified
  - Borrowers may inflate income to get loan approved
- 40-year mortgages
  - Lengthened amortization schedule to make monthly payment smaller
- High debt-to-income ratio loans
  - DTI for these loans may reach beyond 50%, leaving little for the borrower to pay other expenses

All numbers shown in this presentation are indicative and are based on a sample portfolio. Actual numbers will be different and will depend on the actual portfolios selected.

Subprime mortgagors

- Demographically, this borrower is "middle America"
- Financially, this borrower
  - Has mismanaged his finances (past delinquencies, foreclosures or bankruptcies, low credit score)
  - Used excessive leverage (high DTI and/or LTV)
  - Is cash-strapped (large amount of cash-out refi.)
- While "riskier" than prime and jumbo borrowers, subprime borrowers
  - Are not directly impacted by stock market gyrations
  - Live in homes that are more liquid, less volatile

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The channel of mortgage lending

- There are three major channels of lending mortgages
  - Retail – Loans are originated in branches of the lender. The lender controls most aspects of underwriting, including credit checking, income verification, appraiser selection, appraisal quality control, etc. The originator is more likely to have local market knowledge
  - Whole-sale – Loans are originated by brokers who have regular business relationships with the lender. The lender may have an approval process in accepting a broker to its network and may monitor the performance of a broker's origination. The lender controls some aspects of the underwriting process but relies on the broker to do others.
  - Correspondence – Loans are originated by non-affiliated brokers according to the lenders underwriting matrix. The lender is likely to re-underwrite the loan in most aspects.

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Income documentation and verification

- Full documentation, full verification
  - Last 2 years' W2s
  - Last 2 months' pay stubs
  - Letter from employer (verified by call)
  - Last 2 years' income tax returns (self-employed only)
  - Last 2 months' bank statements (verified by call)
- Partially (limited, light) documentation
  - Some of the documentations are deficient but usually one of income or employment proofs is available
- No income (stated income), no verification
  - Nothing is available

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Appraisal process: the V in LTV

- Most used form of appraisals
  - Full appraisal (1004 appraisal)
  - Drive-by appraisal (2055 appraisal)
  - Broker price opinion (BPO)
  - Automated valuation model (AVM)
- Appraisers are paid on the case load, not value of the property
- Most of appraisers' business come from lenders
- Many lenders also employ in-house appraisers to control the quality of appraisals
- Even for purchase loans, an appraisal is needed to mitigate the risk of fraud

All numbers shown in this presentation are indicative and are based on a sample portfolio. Actual numbers will be different and will depend on the actual portfolios selected.

Business models of subprime lenders

- Balance sheet lending
  - Pure lending on the company's own book is very rare for major lenders
- Whole-loan sales
  - Newer lenders mostly rely on whole-loan sales to dispose loans
  - Established lenders often engage in whole-loan sales when they see opportunities
  - Whole-loans sold will most likely be securitized by the buyer
- Securitization
  - Securitization are used for many purposes, the most common among them
    - Lower cost of funding
    - Raise leverage
    - Release regulatory capital
    - Managing risk

What do credit ratings really mean?

- Most common approach by rating agencies
  - Establish a set of base case assumptions
    - Default (foreclosure) frequency
    - Loss severity ratio
    - Prepayments
    - Interest rate scenario
  - Establish AAA class stress assumptions
    - Default frequency for AAA, depend on the type of loans, may be 4 to 10 times of the base case
    - Moody's uses simulations to decide AAA credit enhancement (bonds should have no losses in 99.5% or more of the simulated cases)
    - Committee decisions are mostly involved in deciding the C/E

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What factors are used in deciding assumptions?

- Factors used in determining the base case assumptions include:
  - Borrower characteristics (income, credit history, etc)
  - Loan characteristics (LTV ratio, term, property type, purpose, occupancy, MI, etc)
  - Pool characteristics (concentration, etc)
  - Originator and servicer practices and loan programs
  - Macro and local economic consideration (employment, real estate market, etc.)

Moody's typical loss severity assumption on the underlying loans

Rating Level	Loss severity percent
Aaa	60.0%
Aa	55.0%
A	50.0%
Baa	45.0%
Ba	42.5%
B	40.0%

Source: Moody's Investor Service

Other issues rating agencies consider

- Mortgage insurance
  - The presence of MI will reduce loss severity
  - Rating agencies generally assume that the servicer won't be able to collect 100% of claims. A "haircut" is made to the mortgage insurance
  - Haircut is made according to the rating

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Over-collateralization: the most basic credit enhancement

- A deal is over-collateralized when
  - The balance of the pool is larger than the aggregate balance of the bonds
  - Collection proceeds are first used to pay bonds' interest and principal
- Most mortgage ABS deals use some form of over-collateralization to enhance the credit for
  - Bondholder
  - Insurer
- The exceptions are
  - Whole-loan deals issued by GSEs
  - Some deals with issuer-guaranteed classes
- OC can be viewed as a special tranche that is the first loss piece for the deal

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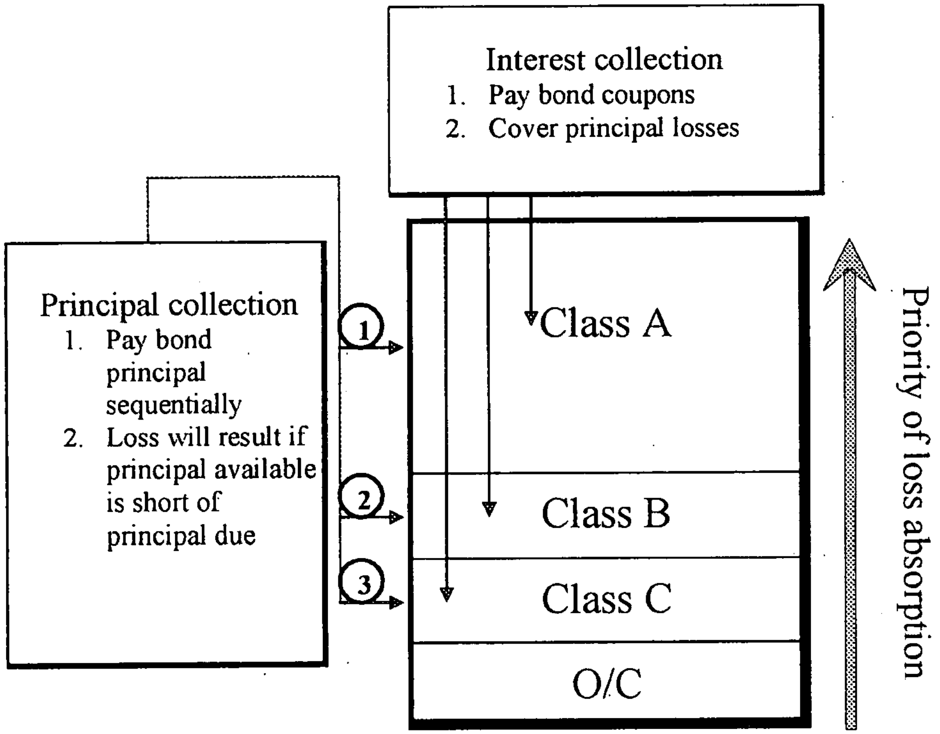
Subordinate bonds act as cushion against losses

- In a senior-sub structure, in each period, senior bonds have the priority in
  - Interest payments
  - Principal payments
- Sub bonds' interest payment may or may not have priority versus senior bonds' principal payments

Typical home equity ABS structure: sequential with cross-over, OC turbo and step-down



- In the first few years, principal are paid sequentially among senior, mezzanine and subordinate tranches
- OC can be built up from the initial level by using excess spreads to pay down principal of bonds
- After the cross-over date, mezzanine and subordinate bonds start to receive principal simultaneously with senior bonds (provide no trigger event occurs)
- After the step-down date, part of OC is released (provided no trigger event occurs)
- An optional redemption (clean-up) call allows the servicer to call the deal when the collateral pool is below 10% of the original size.

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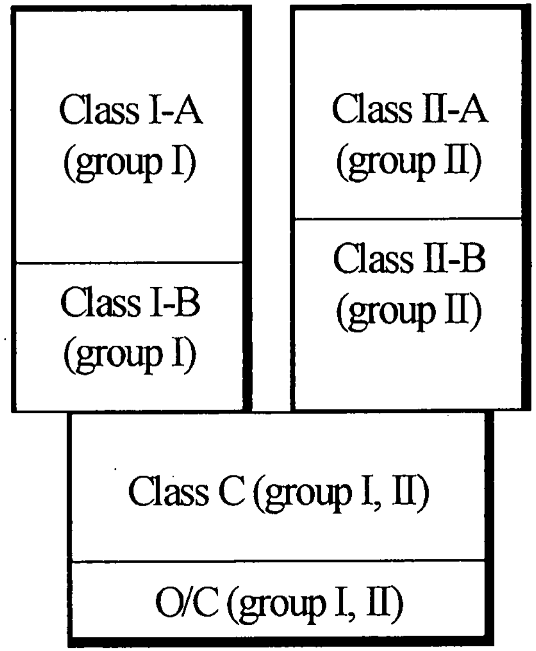
Deals with multiple collateral groups: Y-structure

- A deal may have more than one group of collateral, each supporting its own sets of bonds
- Lower classes (or O/C) may receive cash from entire pool
- This structure enables the better performing group to aid the worse performing one
- Triggers are more complicated



Available funds cap: definition

- Maximum net WAC caps the coupon paid to bondholders
- Net WAC is gross WAC minus
  - Servicing fee
  - Trustee fee
  - Insurance premium (if any)
  - IO payment (if any)
- Designed to prevent bonds from defaulting because interest mismatch (as opposed to collateral performance)
- Capped-out amount is carried forward and may be recouped in the next month

All numbers shown in this presentation are indicative and are based on a sample portfolio. Actual numbers will be different and will depend on the actual portfolios selected.

Rajeev Misra/DMGGM/DMG UK/DeuBa@DBEMEA

02/24/2007 05:31 AM

To Greg Lippmann/NewYork/DBNA/DeuBa@DBAmericas@DBAMERICA:
cc
bcc
Subject Re: Home Equity Risk

Thanks. Excellent summary.

Sent from my BlackBerry Handheld.

From: Greg Lippmann
Sent: 02/23/2007 08:58 PM
To: Anshu Jain
Cc: Rajeev Misra; Richard DAlbert; Alex Crossman; Mark Ferron; Jonathan Wills
Subject: Home Equity Risk

As per our conversation yesterday, here is an update of our Home Equity Exposure.

Trading Desk
Net Short

	BBB	BBB-	Total
2004	754MM	443MM	1.2BB
2005	1067MM	413MM	1.5BB
2006	1077MM	521MM	1.6BB
2007	34.5MM	83.5MM	0.17MM
Total	2.86BB	1.50BB	4.36BB

Recent changes:
Wednesday: short 3BB
Wednesday to Thursday increase: shorter by 800MM
Thurday to Friday: shorter by 300MM
Friday shorter by 500MM (we will offer this to CDO group)

CDO New Issue
Warehouses:
Total Notional 3.4BB
2.4BBHome Equity. Estimated Hedge Ratio 100%
200MM Prime Estimated Hege Ratio 20%
80MM CMBS Estimated Hedge Ratio 10%
600MM ABS CDOs 200%
73MM Other CDOs 20%

Internal Hedges within CDO Warehouse:
265MM ABS
134MM CDO (2X hedge ratio)

525MM delta of ABS Hedge

We have lowered (but not eliminated) the hedge ratio for deals in which we are confident of exectution for example Blackrock is roughly 1.2BB of the total exposure.

Target Hedge Net of internal Shorts 1.7BB in total
Actual Hedges1.2BB (480MM left to do):
2BB Super Senior with roughly 33 delta - 600MM
40MM Single Name CDS
550MM ABX
We will do 480MM more Single Name CDS

Recent Trades
2/22 100MM 06-1 BBB- 86.5
2/22 400MM 06-2 BBB 76.625
2/23 100MM 06-2 BBB- 66.00

CDO Unsold Inventory Mix of Managed and Unmanaged Target Hedge 280MM Actual Hedge 280MM
AA/A 35MM hedge ratio 2.25X
BBB 50MM hedge ratio 3.25X
BB 17MM hedge ratio 4.25X

Mortgage Wharehouse Lines
Roughly 2.5BB of Subprime. Callable in 45 days varying haricuts, in some cases to highly rated counterparties (1.6BB of total). We think the 200MM hedge that was put on in the last month is sufficient.

Current Markets
07-1 BBB 73-16 – 77-00 (1080/965)
07-1 BBB- 67-28 - 69-00 (1500/1450)
06-2 BBB 75-00 - 78-24 (1025/900)
06-2 BBB- 69-00 - 70-16 (1425/1375)
06-1 BBB 87-00 - 89-24 (690/575)
06-1 BBB- 84-00 - 87-00 (950/825)

Estimated basis between single names in index and index 4 pts. Note 06-1 consists of 20 credits issued in 2nd half 2005, 06-2 first half 06, 07-1 second half 06.

Greg H. Lippmann
Managing Director
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60 Wall Street
New York, New York 10005
Phone (212) 250-7730
Fax (212) 797-2201
Mobile (917) [redacted]
greg.lippmann@db.com

▬ = Redacted by the Permanent Subcommittee on Investigations

Sent from my BlackBerry Handheld.

jmilman@bbotg
11/08/2005
04:05 PM

To: greglip@bbotg
cc:
Subject: Fwd: Re: Fwd: DB ABS CDS COMMMENTARY: CDO OH BABY!
11/08/05

Message Sent: 11/08/2005 16:05:56
From: JMILMAN@BBOTG|JORDAN MILMAN|DEUTSCHE BANK SECURI|1726|328663
To: GREGLIP@BBOTG|GREG LIPPMANN|DEUTSCHE BANK SECURI|1726|328663

---- Original Msg from: IVELIN DOROVSKI, DEUTSCHE BANK AG At: 11/ 8 16:05=

thanks. you guys are remarking the cds accordingly, right?
----- Original Message -----
From: JORDAN MILMAN, DEUTSCHE BANK SECURI
At: 11/ 8 13:45

---- Original Msg from: ROCKY KURITA, DEUTSCHE BANK SECURI At: 11/ 8 8:0=
8
"CDO Oh Baby" by Vanilla Ice

Yo vip let's kick it!
C D O oh baby, C D O oh baby
All right, stop, collaborate and listen
Spreads are wide with a technical invasion
Home Eq Subs were trading so tightly
Until Hedge Funds Bot Protection daily and nightly
Will they stop? Yo I don't know

Turn up the Arb and let's go
To the extreme Macro Funds do damage like a vandal
Now, BBBs are trading with a new handle
Print, even if the housing bubble looms
There are never ends to real estate booms
If there is a problem, yo, we'll solve it

Check out the spreads while my structurer revolves it
C D O oh baby, C D O oh baby

ABS CDS Commentary 11/8/05
We continued to see wide prints in the CDS HEQ as Credit Long Dealers
=

continue to hedge/cover secondary cash positions, whole loan packages, CD=
O
equity, and synthetic longs. Baa2 HEQ CDS are printing north of +200 and =
Baa3
HEQ CDS are printing north of +325. When tabulating the total BWIC for

protection(Sellers of protection, which includes CDOs and Hedge Funds
unwinding), there will be over $1bln of credit risk that will leave the s=
treet
this week with focus on the Baa2/Baa3 part of the capital structure. We =
expect
spreads to stabilize or even tighten as a result. If spreads continue to =

widen,
it will show the depth of the short in the market and the staying power o=
f the
Hedge Fund and Dealer Bid for protection. To put the amount of risk that =
needs
to be digested in a different way, $1bln in Baa2 and Baa3 HEQ risk would =
be the

equivalent of over $20bln of cash new issue tranmsactions if the BBB stac=
k is 5%
of the capital structure. If the dealer communtity can short that risk a=
nd keep
begging for more, it would indicate the following:
A. Dealers have been on the wrong side of this spread move in much bigger=
size
than initially estimated.
B. There are much more hedge funds than we thought buying credit protecti=
on in
HEQ.

C. The technicals are overwhelming. Fundamentals are meaningless until sp=
reads
move significantly wider. Real money accounts did not participate at Baa3=

spreads of +375 last year.
D. The Hedge Funds are winning the battle against the CDOs
E. The market is going wider.

Other trends/observations:
-Single A/Baa1 HEQ CDS Spreads are leaking wider driven by Dealers that h=
ave

been lifted out of Baa2 and Baa3 protection by Hedge Funds. They seem to =
be
scrambling to buy anything to cover their risk. If spreads continue to wi=
den on
technicals, the credit curve will continue to steepen as Hedge Funds will=

continue to focus on buying protection on the more levered parts of the c=
ap
structure.
-We are seeing some Hedge Funds unwindind a small % of their short but th=
e

staying power and the discipline of the Hedge Fund community to leave in =
the
money trades on has been surprising. Many Hedge Funds believe that Baa3 H=
EQ can
take a principal loss.
-Rumors are that CDO Equity and Mez are struggling to get done.
-There are no less than 20 CDO transactions ramping up but spreads still =
widen.
Dealers are taking on tremendous warehouse risk amidst the tremendous vol=
atility

and spread widening. If the debt widens, dealers could be left holding a=
bag of
subprime HEQ risk just like they will be left holding keys to homes that=

default.

Recommendations:
-For investors long protection, take some chips off the table, particular=
ly in
Baa3 HEQ.
-Buy protection on BBB cards. Next shoe to drop?

-Sell protection on Baa2 and Buy Protection on Baa1 HEQ. The credit curve=
has
steepened dramatically over the past week.
-Buy protection on MEZ tranches of ABS CDO transactions. Sell protection =
on
single names or take down CDO Equity.
-Sell protection up the cap structure in virtually all asset classes. We =
view
these trades as funding trades more so than credit trades.

Deutsche Bank ABS CDS Axes 11/08/05

Deutsche Bank Securities Inc. has prepared this report based on
information it believes to be accurate but does not guarantee
its accuracy or completeness. ALL OFFERINGS ARE SUBJECT.
Please contact the desk at x7730.

HEQ GENERIC MARKETS.
CALL DESK FOR TERMSHEET DETAILS
NOTION BOND AVGL RATING BID/OFFER
10.000 HEQ 5.00 Aaa +13/+23
10.000 HEQ 5.00 Aa1 +27/+47
10.000 HEQ 5.00 Aa2 +29/+49
10.000 HEQ 5.00 Aa3 +33/+53
10.000 HEQ 5.00 A1 +57/+77
10.000 HEQ 5.00 A2 +62/+82
10.000 HEQ 5.00 A3 +67/+87

10.000 HEQ 5.00 Baa1 +155/+195
10.000 HEQ 5.00 Baa2 +200/+210
10.000 HEQ 5.00 Baa3 +300/+350

10.000 HEQ 5.00 Ba1 +700/+850
HEQ ISSUER SPECIFIC MARKETS.
TO ASSIGN A TRADE, PROVIDE COUPON & COUNTERPARTY, THEN WE WILL GIVE LEVEL=
S.
Use "RMBSPAUG.PDF" termsheet.
NOTION ISSUER AVGL RATING BID/OFFER

10.000 ABFC 5.00 Baa2 +200/+230
10.000 ABSHE 5.00 Baa2 +200/+230
10.000 ACCR 5.00 Baa2 +210/+240
10.000 ACE 5.00 Baa2 +200/+230
10.000 AMSI 5.00 Baa2 +210/+240
10.000 BSABS 5.00 Baa2 +210/+240
10.000 CBASS 5.00 Baa2 +190/+220

10.000 CWL 5.00 Baa2 +208/+238
10.000 CXHE 5.00 Baa2 +210/+240

10.000 ECR 5.00 Baa2 +215/+245
10.000 FFML 5.00 Baa2 +200/+230
10.000 FHLT 5.00 Baa2 +205/+235
10.000 GSAMP 5.00 Baa2 +200/+230
10.000 HEAT 5.00 Baa2 +200/+230
10.000 INABS 5.00 Baa2 +210/+240
10.000 LBMLT 5.00 Baa2 +200/+230
10.000 MABS 5.00 Baa2 +195/+235
10.000 MLMI 5.00 Baa2 +200/+230
10.000 MSAC 5.00 Baa2 +195/+230
10.000 NCHET 5.00 Baa2 +215/+245
10.000 NHEL 5.00 Baa2 +210/+240
10.000 OOMLT 5.00 Baa2 +195/+235

10.000 PCHLT 5.00 Baa2 +210/+240

10.000 PPSI 5.00 Baa2 +210/+240
10.000 RAMP 5.00 Baa2 +200/+230
10.000 RASC 5.00 Baa2 +200/+230
10.000 SABR 5.00 Baa2 +200/+230
10.000 SAIL 5.00 Baa2 +210/+240
10.000 SAST 5.00 Baa2 +205/+240
10.000 SVHE 5.00 Baa2 +200/+230
10.000 WFHET 5.00 Baa2 +190/+220
10.000 WMC 5.00 Baa2 +190/+220
NOTION ISSUER AVGL RATING BID/OFFER
10.000 ABFC 5.00 Baa3 +305/+345
10.000 ABSHE 5.00 Baa3 +305/+345
10.000 ACCR 5.00 Baa3 +315/+345
10.000 ACE 5.00 Baa3 +295/+350

10.000 AMSI 5.00 Baa3 +320/+355
10.000 BSABS 5.00 Baa3 +310/+340
10.000 CBASS 5.00 Baa3 +285/+335
10.000 CWL 5.00 Baa3 +300/+330
10.000 CXHE 5.00 Baa3 +305/+345
10.000 ECR 5.00 Baa3 +325/+365
10.000 FFML 5.00 Baa3 +290/+330
10.000 FHLT 5.00 Baa3 +305/+345
10.000 GSAMP 5.00 Baa3 +290/+350
10.000 HEAT 5.00 Baa3 +310/+350
10.000 INABS 5.00 Baa3 +320/+355

10.000 LBMLT 5.00 Baa3 +310/+350
10.000 MABS 5.00 Baa3 +300/+350
10.000 MLMI 5.00 Baa3 +305/+345
10.000 MSAC 5.00 Baa3 +300/+350

10.000 NCHET 5.00 Baa3 +325/+365
10.000 NHEL 5.00 Baa3 +320/+355
10.000 OOMLT 5.00 Baa3 +305/+345
10.000 PCHLT 5.00 Baa3 +320/+355
10.000 PPSI 5.00 Baa3 +305/+345
10.000 RAMP 5.00 Baa3 +300/+350
10.000 RASC 5.00 Baa3 +305/+345
10.000 SABR 5.00 Baa3 +310/+340
10.000 SAIL 5.00 Baa3 +320/+360
10.000 SAST 5.00 Baa3 +310/+350
10.000 SVHE 5.00 Baa3 +310/+350
10.000 WFHET 5.00 Baa3 +280/+330
10.000 WMC 5.00 Baa3 +290/+340

110805cds@2005-11-8-8.0.31.271249.xls

110805cds@2005-11-8-8.0.35.801977.pdf

OrgSmtpMsg.eml

rmbspaug@2005-10-21-7.58.29.713363.pdf

greglip@bbotg To: jmilman@bbotg
cc:
Subject: Re: DEEP SUB CASH HOMEQ BWIC TOMORROW AT 2PM

08/01/2006
01:46 PM

Message Sent: 08/01/2006 14:46:11
From: GREGLIP@BBOTG|GREG LIPPMANN|DEUTSCHE BANK SECURI|1726|328663
To: JMILMAN@BBOTG|JORDAN MILMAN|DEUTSCHE BANK SECURI|1726|328663

who has all this crap and let me know which ones to look at looks like a =
lot of
crappy deals....
----- Original Message -----
From: JORDAN MILMAN, DEUTSCHE BANK SECURI
At: 8/01 14:44:53

Deal Tranche Notional CUSIP MDY/S&P/F
AABST 05-5 B6 13.2000 00764MHR1 NR / BB+ / BB crap
AABST 05-5 B7 15.0000 00764MHS9 NR / BB / NR crap
ABSHE 05-HE3 M11 5.0000 04541GRE4 Ba2/ BB / BB
ABSHE 05-HE5 M11 4.7770 04541GST0 Ba2/ BB+ / BB+
ACE 05-HE5 B3 15.0890 004421RS4 NR / BB / NR crap
FHLT 05-D B3 7.2480 35729PMS6 NR / BBB-/ NR crap
FHLT 05-D B4 9.8350 35729PMT4 NR / BB+ / NR crap
LBMLT 04-4 B 9.9740 542514JF2 NR / BB+ / NR carp
LBMLT 04-4 M12 7.5000 542514JE5 NR / BBB-/ NR crap
LBMLT 05-WL1 B1 8.0000 542514LS1 Ba2/ BB+ / BB crap
LBMLT 05-WL1 M10 8.4850 542514LW2 Ba1/ BB+ / BBB- crap
MMLT 05-1 B2 5.0250 59001FCK5 NR / BB / NR crap
PPSI 04-WWF1 M11 5.0000 70069FEA1 Ba1/ BB+ / BB+ crap

OrgSmtpMsg.eml

GREGLIP@bloomberg.net Tochris@mastcapllc.com
cc
01/05/2007 01:52 PM bcc
SubjectRE: mroe bang for the bucl

=====Begin Message=====
Message#: 140546
Message Sent: 01/05/2007 13:52:10
From: GREGLIP@bloomberg.net|GREG LIPPMANN|DEUTSCHE BANK SECURI|1726|328663
To: chris@mastcapllc.com| | | |
Subject: RE: mroe bang for the bucl

LEAGUE TABLE, FEES, NEVER HAS ONE BLOWN UP YET..BUT ONE REASON THIS STUFF IS WIDENING IS I THINK DEALER HEDGING WHAREHOUSES WITH INDEX
----- Original Message -----
From: Chris Madison <chris@mastcapllc.com>
At: 1/05 13:37:12

That's crazy!!! Why aren't the dealers pulling the plug on the new CDO's....hasn't this widening scared the crap out of them that the counterparties will blow-up?

CBM

-----Original Message-----
From: greglip@bloomberg.net [mailto:greglip@bloomberg.net]
Sent: Friday, January 05, 2007 1:35 PM
To: Chris Madison
Subject: RE: mroe bang for the bucl

WALL STREET FIRMS DURING RAMP UP..100% LEVERAGE...NO MTM ITS ALL DEALER RISK
----- Original Message -----
From: Chris Madison <chris@mastcapllc.com>
At: 1/05 13:33:04

Dumb question....who provides the leverage for the CDO dopes that are levering up just the BBB and BBB- tranches? How much leverage are they getting? And are there any mark-to-market tests that threaten the solvency of the products?

CBM

-----Original Message-----
From: greglip@bloomberg.net [mailto:greglip@bloomberg.net]
Sent: Friday, January 05, 2007 11:37 AM
To: Chris Madison
Subject: mroe bang for the bucl

----

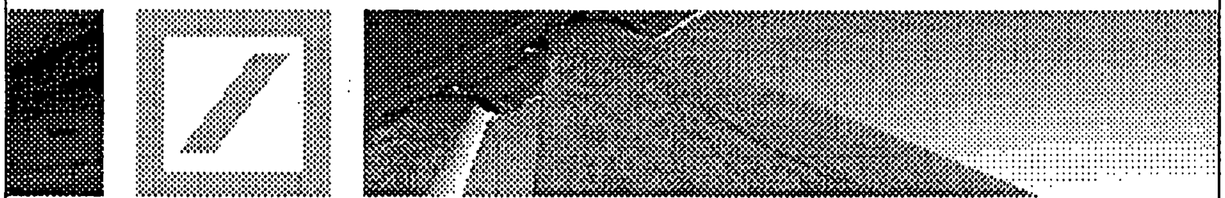
material impact on any returns detailed. Past performance is not indicative of future returns. Price and availability are subject to change without notice. Additional information is available upon request.

This has been prepared solely for informational purposes. It is not an offer, recommendation or solicitation to buy or sell, nor is it an official confirmation of terms. It is based on information generally available to the public from sources believed to be reliable. No representation is made that it is accurate or complete or that any returns indicated will be achieved. Changes to assumptions may have a material impact on any returns detailed. Past performance is not indicative of future returns. Price and availability are subject to change without notice. Additional information is available upon request.

=====End Message=====

CDO Primary Update Progress Report

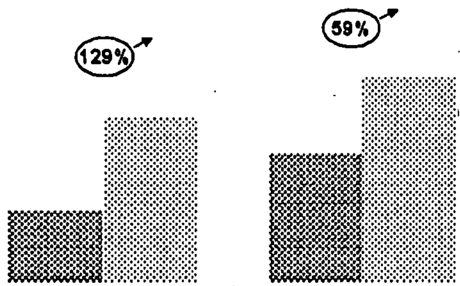
October 2006



A Passion to Perform. Deutsche Bank

CDO Primary Revenue Forecast and League Tables

EUR mm



Bookrunner - Global CDO's 7-Oct-06				
Rank	Lead Manager	Amount ($MM)	# Deals	Share (%)
1	Merrill Lynch	37,534.00	55	12.6
2	Citigroup	28,170.00	48	9.5
3	Deutsche Bank	20,805.90	38	7.0
4	Bank of America	17,358.70	42	5.8
5	Bear Stearns	16,672.80	32	5.6
6	Wachovia	15,393.90	37	5.2
7	Morgan Stanley	14,719.60	64	5.0
8	bxis	14,660.10	21	4.9
9	JPM	14,246.60	44	4.8
10	CS	14,015.70	22	4.7
	Total Eligible Issuance	296,914.80	628	

Commentary

- Ramped up volume in 2006, expected to close 50 deals by year end
- Pipeline for Q1 and Q2 2007 building
- Good diversity of product
  - Credit Opportunity Funds and long/short, relative value structures show best growth potential
  - CLO's (US and Europe) remain strong
- More deals done as hybrid/synthetic
  - Start – CDS of ABS
  - Long/Short – ABS/Credit
  - HYSTAR – HY CDS

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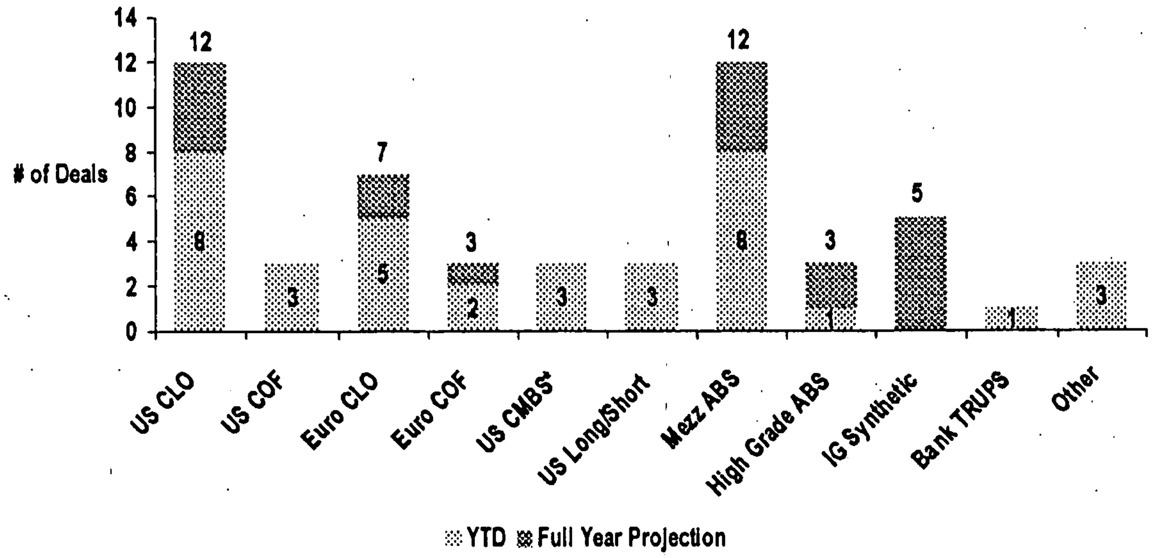
DBSI_PSI_EMAIL03970168

YTD CDO Volumes By Deal Type



**Part of CMBS Group*

Deutsche Bank

Current and Forward Pipeline By Transaction Type

Deal Name	Deal Type	Expected Size	Tranches To Be Offered	Expected Pricing
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
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Deutsche Bank

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Current and Forward Pipeline By Transaction Type (con't)

Deal Name	Deal Type	Expected Size	Tranches To Be Offered	Expected Pricing
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[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
		300		
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		1600		

Deutsche Bank

Top 20 CDO Salespeople By Region

Global

Top 20 Salespeople

Rank	Sales	PCs
1	Jaggi, Harsh	[redacted]
2	Steenberg, Mads	[redacted]
3	Palmer, Anthony	[redacted]
4	Freeland, Trevor	[redacted]
5	Frellich, Michael	[redacted]
6	George, Michael	[redacted]
7	Dhawan, Piya	[redacted]
8	Gaudry, Alain	[redacted]
9	Muschallik, Andre	[redacted]
10	Newell, Casey	[redacted]
11	Browneey, Paul	[redacted]
12	Cresswell, Robin	[redacted]
13	Oyagi, Takashi	[redacted]
14	Rogers, Brian	[redacted]
15	Ruhle, Stephanie	[redacted]
16	Karabelas, John	[redacted]
17	Kim, Christine	[redacted]
18	Stevens, Todd	[redacted]
19	Shohet, Victor	[redacted]
20	Oswell, Rupert	[redacted]
		124,923,101

PC's by deal

Deal Type	Deal	Total PCs
Credit Opps	McDonnell Loan Opps	[redacted]
ABS CDO	55gA Carina CDO	[redacted]
US CLO	McDonnell Gannet Peak	[redacted]
EUR CLO	Avoca CLO V	[redacted]
EUR CLO	Carlyle Group CELF III	[redacted]
ABS CDO	Start 06-A	[redacted]
US CLO	Guggenheim Sands Point	[redacted]
CSO	BOI Cameros III	[redacted]
US CLO	WR Huff 1776 CLO	[redacted]
US CLO	Fraser Sullivan CLO	[redacted]
Rel Val CDO	Rabobank Hamilton Gdns	[redacted]

North America

Rank	Sales	PCs
1	Jaggi, Harsh	[redacted]
2	Palmer, Anthony	[redacted]
3	Freeland, Trevor	[redacted]
4	Steenberg, Mads	[redacted]
5	George, Michael	[redacted]
6	Newell, Casey	[redacted]
7	Dhawan, Piya	[redacted]
8	Browneey, Paul	[redacted]
9	Oyagi, Takashi	[redacted]
10	Rogers, Brian	[redacted]
11	Ruhle, Stephanie	[redacted]
12	Karabelas, John	[redacted]
13	Cresswell, Robin	[redacted]
14	Gaudry, Alain	[redacted]
15	Kim, Christine	[redacted]
16	Frellich, Michael	[redacted]
17	Allard, Rob	[redacted]
18	Nathoo, Jamil	[redacted]
19	Blake, Peter	[redacted]
20	Zuurmond, Maarten	[redacted]
		98,261,431

PC's by deal

Deal Type	Deal	Total PCs
Credit Opps	McDonnell Loan Opps	[redacted]
ABS CDO	55gA Carina CDO	[redacted]
US CLO	McDonnell Gannet Peak	[redacted]
ABS CDO	Start 06-A	[redacted]
US CLO	Guggenheim Sands Point	[redacted]
US CLO	WR Huff 1776 CLO	[redacted]
US CLO	Fraser Sullivan CLO	[redacted]
Rel Val CDO	Rabobank Hamilton Gdns	[redacted]
ABS CDO	START 06-B	[redacted]
Rel Val CDO	56gA Dragones 2	[redacted]
US CLO	Aladdin Landmark VIII	[redacted]

Europe

Rank	Sales	PCs
1	Frellich, Mike	[redacted]
2	Steenberg, Mads	[redacted]
3	Muschallik, Andre	[redacted]
4	Gaudry, Alain	[redacted]
5	Jaggi, Harsh	[redacted]
6	Oswell, Rupert	[redacted]
7	Herbosch, Christopher	[redacted]
8	Diaz, Francisco	[redacted]
9	Dhawan, Piya	[redacted]
10	Schanila, Max	[redacted]
11	Stevens, Todd	[redacted]
12	Shohet, Victor	[redacted]
13	Thothadri, Ram	[redacted]
14	Bauermeister, Dieter	[redacted]
15	Abdulaal, Nabeel	[redacted]
16	Okuyama, Kei	[redacted]
17	Cresswell, Robin	[redacted]
18	Kim, Christine	[redacted]
19	Condoya-Delcroix, Ana	[redacted]
20	Mccormick, Jonathan	[redacted]
		43,113,753

PC's by deal

Deal Type	Deal	Total PCs
EUR CLO	Avoca CLO V	[redacted]
EUR CLO	Carlyle Group CELF III	[redacted]
CSO	BOI Cameros III	[redacted]
EUR CLO	Oak Hill ECP	[redacted]
EUR CLO	INVESCO Theseus	[redacted]
Credit Opps	Carlyle Group CECP	[redacted]
Credit Opps	ICG EuroCredit Tap	[redacted]
CSO	AIG CPPI	[redacted]
Synth CLO	Wincap Moorgate II	[redacted]
CSO	BOI Cameros II	[redacted]
ABS CDO	Prytania Danube	[redacted]

Deutsche Bank

DBSI_PSI_EMAIL03970172

From: Krishnamurthy, Ananth [ananth@3ainvestors.com]
Sent: Thursday, February 08, 2007 4:05 PM
To: Paolo Pellegrini
Subject: RE: Nice meeting you ...

I am back from the underground.

Crazy volatility, huh?

I know we are incredibly slow given the quick movements in the market.

I have been "intensely" looking at manager selection on this.

I want to confirm something with respect to Paulson's capabilities based on my conversations with you. The attached email is probably helpful as a context point.

Paulson projects defaults and loan performance at a LOAN LEVEL, using your default model incorporating (a) HPA forecasts for the individual loan's geography based on metropolitan area forecasts (using your own sources); and (b) using loan characteristics (all the typical variables from Loan Performance).

Then you aggregate across all the loans to create pool cash flows.

Then you run this through the ABS cash-flow engine (ie: intex).

What makes this hard is that there is no off-the-shelf way to do this and you had to write the code and the plumbing/interfaces.

This allows you for example to compare forecasts for two pools without using a higher level of aggregation. And allows you to compare tranches off two different deals to examine sensitivity to for example specific variables at a loan level.

-----Original Message-----
From: Paolo Pellegrini [mailto:Paolo.Pellegrini@paulsonco.com]
Sent: Sunday, January 14, 2007 4:23 PM
To: ananth@3ainvestors.com
Subject: RE: Nice meeting you ...

Ananth-

The probability of writedown of BBB (not just BBB-) RMBS bonds is bond-specific, although some key inputs are common.

The most important common input is home price appreciation (HPA) nationally, regionally and at the "metropolitan area" level. HPA drives individual loan prepayments, defaults and losses. Another common input is interest rates. Interest rates may affect home price appreciation and consequently, though indirectly, prepayments, defaults and losses. If interest rates result in positive HPA, they may also affect prepayments directly (refinance incentive) and default and losses indirectly (prepaid loans don't default). If interest rates do not result in positive HPA, their direct effect on prepayments and indirect effect on defaults and losses is less important (it is very difficult for subprime borrowers to refinance if their property has not appreciated).

Bond-specific inputs fall into two categories: collateral characteristics; and deal structure.

The most relevant collateral characteristics at origination are FICO, combined loan-to-value ratio (including simultaneous second-lien loans), level of documentation and geographic location (back to HPA). For seasoned collateral, performance after origination, in terms of prepayments, delinquencies, defaults and losses, provides additional insight.

The most relevant deal characteristics are overcollateralization, excess spread, step-down triggers and interest rate exposure. We focus primarily on overcollateralization and the so-called delinquency trigger. Excess spread (including the effect of unhedged interest rate
exposure) is more important for residual holders than for debt holders, given the timing of realization of losses. Also because of the timing of realization of losses, the cumulative loss trigger (the other step-down
trigger) is usually inconsequential.

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1331

We evaluate the prospects for home price appreciation with the help of our board of advisors. Not only do we believe that home prices are overvalued on most measures, but we also believe that the Federal Reserve will have to manage interest rates in order to restrain households' continuing equity extraction from their homes at the current unsustainable rate ($400 billion annualized as of the most recent quarterly reading). Even though subprime borrowers are suffering from excessive leverage and debt-service burden, mainstream borrowers still have enormous leverage capacity, predicated on arguably overvalued real estate holdings. Increasing leverage drives consumption and the trade deficit and leaves the dollar and U.S. long-term rates at the mercy of foreign investors' willingness to recycle export receipts into U.S. financial assets, a very unstable arrangement.

It is true that the market is not pricing the subprime RMBS wipeout scenario. In my opinion this situation is due to the fact that rating agencies, CDO managers and underwriters have all the incentives to keep the game going, while "real-money" investors have neither the analytical tools nor the institutional framework to take action before the losses that one could anticipate based the "news" available everywhere are actually realized.

If you want to discuss specific analyses of bond expected losses, we could set up a conference call for the week of the 22nd. I will be in Wyoming but I can do early calls before I go skiing.

Please let me know.

Paolo

-----Original Message-----
From: Krishnamurthy, Ananth [mailto:ananth@3ainvestors.com]
Sent: Friday, January 12, 2007 3:17 PM
To: Paolo Pellegrini
Subject: Re: Nice meeting you ...

We can do that. The core focus is what the logical underpinning - very granularly - is for a wipeout of the BBB-. In some sense it doesn't take much. But how plausible is it. Clearly the market is not pricing this scenario. It is looking for serial downgrades and pricing to next event, ie: just spread widening. Why does this disconnect exist?
Jacob, for example, would say - "the news is everywhere, why isn't this priced in already?"

-----Original Message-----
From: "Paolo Pellegrini" <Paolo.Pellegrini@paulsonco.com>
Date: Fri, 12 Jan 2007 15:11:39
To:<ananth@3ainvestors.com>
Subject: RE: Nice meeting you ...

I am out that week and back in the office on the 31st. Please let me know if you want to meet after the 31st. Thanks.

-----Original Message-----
From: Krishnamurthy, Ananth [mailto:ananth@3ainvestors.com]
Sent: Friday, January 12, 2007 3:08 PM
To: Paolo Pellegrini
Subject: Re: Nice meeting you ...

Hi - thx for getting back to me. I am keen to hear your thoughts on this. However, I am travelling next week. Can I circle up with you week of 22nd?

-----Original Message-----
From: "Paolo Pellegrini" <Paolo.Pellegrini@paulsonco.com>
Date: Fri, 12 Jan 2007 13:15:21
To:<ananth@3ainvestors.com>
Subject: RE: Nice meeting you ...

Ananth-

Sorry for the delay responding to you. I am available next week. We have our advisory board meeting on Tue pm and I will be in a better position to address your home price question after that. If you have anything specific that you want me to ask

of our board please let me know.
Otherwise, please suggest times that work for you on Thu (excl. 10-11 am0 or Fri.

Regards.

-----Original Message-----
From: Krishnamurthy, Ananth [mailto:ananth@3ainvestors.com]
Sent: Tuesday, January 09, 2007 4:12 PM
To: Paolo Pellegrini
Subject: RE: Nice meeting you ...

Hi - have read all the stuff.
I know market has moved nicely in your favor.
Kudos!

Would still be interested in continuing conversation.

My core focus in talking with you will be on your homeprice deterioration thesis. Seems like the market is not pricing in a washout of BBB-s. Worst quartile of the index still has a 500bps average spread. If it were pricing in a wipeout, it would be trading 30c on the dollar.

Let me know when you have some time to speak.

Thanks

Ananth

-----Original Message-----
From: Paolo Pellegrini [mailto:Paolo.Pellegrini@paulsonco.com]
Sent: Wednesday, December 20, 2006 7:22 AM
To: ananth@3ainvestors.com
Subject: Nice meeting you ...

Ananth-

I wish I had learned of your background and relationship with Jacob earlier in our conversation – I would have been a little more specific in my remarks.

Redacted by the Permanent Subcommittee on Investigations

With respect to Andy's comments that Intex makes modeling errors, I would note that he cites his experience working on busted manufactured housing deals five years back as the basis for his assessment. I think that Intex has come a long way in terms of quality control. Besides, as John was saying, in this market we can make good trading decisions with our existing analytics. However, we will hire more people with relevant experience including somebody who could focus on reverse engineering the Intex models as such effort becomes more relevant.

We have a very good relationship with Intex and have urged them to allow hosting of their data by 1010data and made some progress. Aside from being a cash flow engine, Intex is really a database partly overlapping with LoanPerformance, partly additive to LP with respect to loan prepayment terms including penalties. In the context of analyzing seasoned deals, of which we do not do much now but will in the future, cross-checking monthly data between LP and Intex will be valuable.

As for our research infrastructure, I am very happy with the choices we have made. I mentioned that we get loan data from LoanPerformance, historical and projected home price data from FISERV/Economy.com and deal data from Intex. Two decisions, however, put us ahead of the pack.
The first such decision was to host LP and FISERV on 1010data. The second was to forgo integration of the LoanPerformance RiskModel into our analytical platform and to develop instead our proprietary, and extremely parsimonious, prepayment, default and severity model. The use of 1010data enabled the second decision because it made possible to analyze historical data easily, quickly and with minimal initial setup time. Had we gone with LP RiskModel we would be stuck with a white elephant in the middle of a very deep river. Even with Andrew Davidson's more compact model, it will be a stretch to find a processing platform that can deliver meningful results in a reasonable timeframe (I guess

10+ parallel processors on PolyPaths).

I am sure John explained our various strategies, including reverse inquiry sponsorship of bespoke CDOs, both fully-capitalized and synthetically tranched. You might be interested in learning more.

Please say hello to Jacob and call me if you want to talk further.

Best regards.

Paolo M. Pellegrini
Vice President
Paulson & Co. Inc.
590 Madison Avenue, 29th Floor
New York, NY 10022
Phone: (212) 956-4129 (direct)
(212) 956-2221 (main)
(212) 977-9505 (fax)

Richard R Kim/NewYork/DBNA/DeuBa@DBAMERICAS

06/14/2007 09:22 AM

To Greg Lippmann/NewYork/DBNA/DeuBa@DBAMERICAS@DEUBAINT

cc michael.herzig@db.com

bcc

Subject Kleros 8

This along with our remaining held inventory if we can't sell away we repack into a CDO^2 balance sheet dump later this summer
Worst case we hold it but it is probably the lesser of two evils (the greater evil being our held START position)
Same thing on the Libertas bond

Greg Lippmann/NewYork/DBNA/DeuBa@DBAMERICAS

06/14/2007 09:20 AM

To Richard R Kim/NewYork/DBNA/DeuBa@DBAMERICAS@DEUBAINT

cc michael.herzig@db.com

Subject Re: Kleros 8(Document link: Richard R Kim)

ok and then what to you do with theirs?

Greg H. Lippmann
Managing Director
Deutsche Bank Securities Inc.
3rd Floor
60 Wall Street
New York, New York 10005
Phone (212) 250-7730
Fax (212) 797-2201
Mobile (917)[redacted]
greg.lippmann@db.com

▬ = **Redacted by the Permanent Subcommittee on Investigations**

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1337

Greg Lippmann/NewYork/DBNA/DeuBa@DBAMERICAS

12/04/2006 12:58 PM

To Kent Baum/SanFrancisco/DBNA/DeuBa@DBAmericas
cc
bcc
Subject Re: Losers

the abs are all in cdos...who owns the cdos, aaa (sliced of bbb abs) insurance company and german and asian banks....aa, european and asian banks and high grade cdos (can you say ponzi scheme) bbb more of the same and mezz cdos (every mezz cdo has 5-15% other mezz cdos) equity hedge funds and insurance companies in asia

Greg H. Lippmann
Managing Director
Deutsche Bank Securities Inc.
3rd Floor
60 Wall Street
New York, New York 10005
Phone (212) 250-7730
Fax (212) 797-2201
Mobile (917) [redacted]
greg.lippmann@db.com

[redacted] = Redacted by the Permanent Subcommittee on Investigations

Kent Baum/SanFrancisco/DBNA/DeuBa

12/04/2006 12:41 PM

To

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1339

Greg
Lippmann/NewYork/DBNA/DeuBa@DBAmericas

cc

Subject

Re: Losers(Document link: Greg
Lippmann)

Greg: So who in the public market owns all of these ABS securities that beginning to lose value?
Kent

Kent T. Baum
Client Advisor
Managing Director
Deutsche Bank Alex. Brown
A division of Deutsche Bank Securities Inc.
101 California Street, Ste. 4600
San Francisco, CA 94111
kent.baum@db.com
Tel: 415-617-2806
Fax: 415-617-4270
Toll Free: 1-800-334-2640, Ext. 2806

GREGLIP@bloomberg.net

02/27/2007 06:56 AM

ToWITTFAB.LNDB@bloomberg.net
cc
bcc
SubjectRe: Fwd: WSJ C1: Subprime Game's Reckoning DayRisky Lendding

=====Begin Message=====
Message#: 104008
Message Sent: 02/27/2007 06:56:53
From: GREGLIP@bloomberg.net|GREG LIPPMANN|DEUTSCHE BANK SECURI|1726|328663
To: WITTFAB.LNDB@bloomberg.net|FABRIZIO WITTENBURG|DEUTSCHE BANK AG, LO|1726|644694
Subject: Re: Fwd: WSJ C1: Subprime Game's Reckoning DayRisky Lendding

the other side is all cdos..so it is the cdo investors who r on the other side who buys cdos: aaa - reinsurance, ws conduits, european and asian banks, aa - high grade cdos, europoean and asian banks and insurers..some us insurers, bbb - ohter mezz abs cdos (i.e. ponzi scheme), european banks and insurers, equity some us hedge funds, asian insurance companies, australian and japanese retail investors through mutual funds
----- Original Message -----
From: FABRIZIO WITTENBURG, DEUTSCHE BANK AG, LO
At: 2/27 6:41:43

greg, have been sharing your update yday with the european and asian desks here....they're v interested....my question is, who is on the other side of the trade -- you mentioned reinsurance companies (bermuda, european?) and hedge funds (fixed income, macro?)....is much of the risk at banks (commerical/investment bank?)....great work! fabrizio

----- Original Message -----
From: GREG LIPPMANN, DEUTSCHE BANK SECURI
At: 2/27 11:37:45

----- Original Message -----
From: GREG LIPPMANN, DEUTSCHE BANK SECURI
At: 2/27 6:37:36

http://online.wsj.com/article_print/SB117254449192920225.html

"Subprime Game's Reckoning Day
Risky Lending Fallout
Threatens to Spread;
Uncertain ARM Strength
By KAREN RICHARDSON and GREGORY ZUCKERMAN
February 27, 2007; Page C1

The worst may be yet to come for mortgage lenders. And that could add to investor nervousness.

Shares of companies that specialize in lending to riskier borrowers or offer unconventional loans have tumbled because of concerns over how rapidly these mortgages are going sour.

If these so-called subprime borrowers continue to have problems paying their debts, the lenders that target them likely will have to boost how much money they set aside for bad loans, cutting into their bottom lines. That could mean even lower stock prices.

There also is a concern that if the real-estate market remains cool, some borrowers with better credit histories might also begin struggling to make payments on certain popular, but unorthodox, mortgages. These types of loans allow borrowers to skip monthly payments, carry low short-term teaser rates or don't require detailed financial documentation. If that happens, companies such as BankUnited Financial Corp. and Countrywide Financial Corp. could suffer.

When a company keeps its reserve low, it makes its earnings look better because it continues to increase its assets from loans it originates and sells off. That holds down expenses.

But when a company beefs up those reserves and the change hits its earnings, that can impair its ability to borrow the short-term funds needed to write new mortgages. Lenders need to set aside reserves to cover any possible losses when borrowers fail to make payments.

Subprime-mortgage lenders generally sell most of their loans to investors, but many keep some loans as investments. These portfolios have grown as the number of new mortgages has risen.

New Century Financial Corp. and NovaStar Financial Inc. hold billions of dollars of loans for investment. While they have been increasing their loan-loss provisions, delinquencies have been coming faster than anticipated.

NovaStar's reserves were 1.05% of its $2.1 billion in loans held for investment in the fourth quarter, up from 0.75% in the third quarter, but still ranked among the lowest in the industry, according to Zach Gast, an analyst at the Center for Financial Research and Analysis. New Century's ratio was 1.4% as of the third quarter. CFRA doesn't assign ratings on stocks.

Scott Hartman, chief executive of NovaStar, says the lender made a "substantial increase to our loan-loss reserve" in the past quarter, and that about half of those loans "tend to be of higher quality and generally performing very well."

New Century, which has said it will restate earnings for the first three quarters of 2006 to correct accounting errors regarding repurchased loans, declined to comment.

Subprime-mortgage lenders are likely to start reporting significant shortfalls in their loss reserves "as soon as the next several quarters," predicts David Honold, an analyst at Turner Investment Partners, which manages $23 billion and has avoided shares of subprime lenders. That is partly because some of the lenders could place into their investment-loan portfolio some poorly performing mortgages that they have bought back under terms of their sale agreement. That would require them to boost loan-loss reserves.

Subprime lenders already have seen their shares tumble -- NovaStar is off 50% and New Century is down 12% in the past 10 days -- and they could fall further if their credit-lines dry up because of poor loan-loss provisioning. NovaStar shares are trading at about 12 times estimated per-share earnings, but that valuation is likely to change as analysts adjust their projections to account for the company's steep fourth-quarter loss and poor earnings outlook. New Century shares also are trading at about 12 times estimated earnings for 2007.

Some investors urge caution about lenders that cater to borrowers with better credit but focus on mortgages that may suffer if weakness in housing continues, such as option adjustable-rate mortgages, or ARMs. These loans give borrowers multiple payment options, including a minimum payment that might not cover all of the monthly interest cost. The remainder of the interest payment is tacked onto the outstanding balance, causing it to rise.

About 59% of BankUnited's approximately $11.5 billion loan portfolio is made up of these loans and the bank is making more of them as it expands.

Countrywide has been cutting back on pay-option mortgages, funding just $2.7 billion in January out of a total $37 billion in new mortgages. Still, it has "significant exposure" to these risky loans, CFRA's Mr. Gast says. Countrywide declined to comment.

BankUnited acknowledges that borrowers are paying less of their monthly interest payments as interest rates have moved higher, and about 50% of the bank's loans have been made to residents of Florida, a weak real-estate market. And since BankUnited keeps about 70% of these loans in its own portfolio, if the borrowers run into problems it could hurt the company's earnings.

BankUnited shares, which fell 83 cents, or 3.2%, to $25.06 in 4 p.m. composite trading yesterday on the Nasdaq Stock Market, are trading at almost nine times its expected per-share earnings over the next year.

Under accounting rules, BankUnited counts the unpaid interest payments as revenue, however. So if a borrower pays the contractual minimum of $500 a month, rather than the $1,000 interest-only amount, the bank can count the remaining $500 as revenue. That is because it is assumed it will be repaid down the road. This revenue is a rising slice of its earnings, according to an analysis by Keefe, Bruyette & Woods.

Humberto Lopez, BankUnited's chief financial officer, says the bank focuses on borrowers with high credit scores who generally put down at least 20% of the purchase price on a home. "Our borrowers have the financial wherewithal, and they've earned the right to have options of payments," Mr. Lopez says. "We haven't seen any weakness in their ability to pay."
"

=====End Message=====

"GREG LIPPMANN, DEUTSCHE BANK SECURI" <greglip@bloomberg.net>

Sent by: greglip@bloomberg.net

02/20/2007 01:33 PM

To Michael Lamont/NewYork/DBNA/DeuBa@DBAmericas
cc
bcc
Subject Re: Fwd: how is the cdo machine doing these days? can u sti

thanks for the update...going to get a lot bumpier very soon....lets get the finkel deal out the door...
----- Original Message -----
From: Michael Lamont <michael.lamont@db.com>
At: 2/20 13:30:22

Good color I am out w a fever back tomorrow

After reflection I think the biggest issue for dealers are the cdo2. For the giant magnetar rmbs cdo deals the situation isn't great, but the aa/aaa/ss probably clear at a level, and the dealer can play games w the SS -- sell junior piece, keep 60-top, mark not observable, dealer takes down bbb and a, sticks equity to hedge fund like magnetar at equity floor, maybe loses 5-15 after fees. The bbb/a cdo2 backed by mid/late 2006 vintage are the lose your job problem I think, not sure how any deals will clear. And for hi grade abs cdos. ML did 26bln of hi grade last year, 25-35% cdo mostly aa some a. Say conservatively they have 10bln in ramp up so 3 bln of a/aa cdo, if the mkt starts to price their hi grade like cdo2 in addition to their cdo2 ramping of bbb/a (1bln?2bln? ramped) they will have an even worse problem. Same problem at citi--I think they are relatively ok on mezz abs risk but not on cdo2.

Calyon pulled out of ralph choffee mezz deal, won't do SS, we were next in line, ralph now coming to us. Calyon are rumored to have 12bln of risk on their lines At the same time cifg and mbia still writing tickets (mbia did a magnetar type deal last week, structural change to) get them in was oc test in principal waterfall not interest waterfall.
Sent from my Blackberry Wireless

Mr. Michael Lamont
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E-Mail: michael.lamont@db.com

▬ = Redacted by the Permanent Subcommittee on Investigations

----- Original Message -----
From: "GREG LIPPMANN, DEUTSCHE BANK SECURI" [greglip@bloomberg.net]
Sent: 02/20/2007 01:04 PM
To: undisclosed-recipients:;
Subject: Fwd: how is the cdo machine doing these days? can u still plac

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Sent From Bloomberg Mobile MSG

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1341

---- Original Message ----
From: DAVID HOMAN, MOORE CAPITAL MANAGE
At: 2/20/2007 11:20

how is the cdo machine doing these days? can u still place cdo paper? are they still ramping in this environment?
Reply:
GETTING SLOWER BUT NOT DEAD YET...2-5 RAMPING A DAY INSTEAD OF 10-15...HEARING OF MANY INVESTORS IN ASIA ESPECALLY SHUTTING DOW N POST HSBC NEWS BUT THE WINDOW IS NOT COMPLETELY SHUT YET (THEY MAY BE DEALS THAT WERE LARGELY RAMPED THAT R JUST FINISHING..)
Reply:
i hear rumors that ML, BS, GS, C have asked CDOs less than 50% ramped to basically stop ramping. Have you heard anything along these lines? What are the implications for mkt if this is true?

This has been prepared solely for informational purposes. It is not an offer, recommendation or solicitation to buy or sell, nor is it an official confirmation of terms. It is based on information generally available to the public from sources believed to be reliable. No representation is made that it is accurate or complete or that any returns indicated will be achieved. Changes to assumptions may have a material impact on any returns detailed. Past performance is not indicative of future returns. Price and availability are subject to change without notice. Additional information is available upon request.

Abhayad Kamat/NewYork/DBNA/DeuBa@DBAMERICAS

02/21/2007 09:08 PM

To Michael Lamont/NewYork/DBNA/DeuBa, michael.herzig@db.com, anthony.pawlowski@db.com, Ilinca R Bogza/NewYork/DBNA/DeuBa@DBNA@DEUBAINT
cc
bcc
Subject Fw: ** UPDATE $[1.1]BLN GEMSTONE VII ** REVISED TALK **

double digit PCs for BBBs?
i guess my original offer of 300 on single-As and 600 on triple-Bs is too low... what can we offer?

i would like these guys to push Asia sales on this..., but also as Ilinca said, the question arises why weren't they working on this thus far? the feedback they gave Ilinca is that all warehouses are shut down...

----- Forwarded by Abhayad Kamat/NewYork/DBNA/DeuBa on 02/21/2007 09:00 PM -----

Sheree Ma/db/dbcom@DBAPAC

02/21/2007 08:59 PM

To

Abhayad Kamat/NewYork/DBNA/DeuBa@DBAMERICAS

Permanent Subcommittee on Investigations
Wall Street & The Financial Crisis
Report Footnote #1342

cc

Anirban Lahiri/SP/DBAsia/DeuBa@DBAPAC, Ilinca R Bogza/NewYork/DBNA/DeuBa@DBNA, Ryan Lee/db/dbcom@DBAPAC

Subject

Re: Fw: ** UPDATE $[1.1]BLN GEMSTONE VII ** REVISED TALK **(Document link: Abhayad Kamat)

Hi,

Any special PC arrangements for these bonds pls?? Coz we are also pushing sales on Wharton BBB which is at similar pricing (flex available) and paying double digits PC....

Thanks
Sheree

Sheree Ma
Deutsche Bank AG

Hong Kong: +852 2203 8521
Mobile: +[redacted]
Email: sheree.ma@db.com

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Abhayad
Kamat/NewYork/DBNA/DeuBa@DBAMERICAS

02/21/2007 04:17
PM

To

Anirban Lahiri/SP/DBAsia/DeuBa@DBAPAC, Sheree
Ma/db/dbcom@DBAPAC

cc

Ilinca R
Bogza/NewYork/DBNA/DeuBa@DBNA@DEUBAINT

Subject

Fw: ** UPDATE $[1.1]BLN GEMSTONE VII ** REVISED TALK
**

here's the mktg book. thanks.

[attachment "Gemstone VII Debt Book 02.08.07 FINAL.pdf" deleted by Sheree Ma/db/dbcom]

----- Forwarded by Abhayad Kamat/NewYork/DBNA/DeuBa on 02/21/2007 11:15 AM -----

Abhayad
Kamat/NewYork/DBNA/DeuBa

02/21/2007 11:13
AM

To

Anirban Lahiri/SP/DBAsia/DeuBa, Sheree
Ma

cc

Ilinca R
Bogza/NewYork/DBNA/DeuBa@DBNA@DEUBAINT

Subject

Fw: ** UPDATE $[1.1]BLN GEMSTONE VII ** REVISED TALK
**

Guys,
we need help on selling the As and BBBs in the Gemstone CDO 7 transaction -- we have nearly 50% unsold on both tranches in the transaction. We have widened talk to 265 on the As and to 500 on the BBBs - see Ilinca's email below.

- i am also fwding you the latest HBK mktg book.
- any help from you on the As, BBBs and senior AAAs would be appreciated.
- on the senior AAAs, we are flexible to work with accounts at different subordination points and spread targets.

Here is a quick summary of the transaction and manager:
- this is HBK's eight CDO
- 2 year short revolving period -- can revolve in investment grade assets only
- 27% below IG bucket (BBs) but amortizations on this bucket are used to pay down notes -- no reinvestment in below IG bucket
- HBK retains entire BB and Equity, similar to what they have done in all their prior deals. HBK views their CDOs as financing trades, where they retain the equity and use the CDO to get levered returns.
- the 27% BB bucket is standard in their deals -- these are very similar to the C-BASS deals in the market...
- HBK's loan level analysis of RMBS pools is highly regarded in the market. HBK helps structure ~55% of the underlying RMBS in this transaction and retains the residual piece on those also.

- this CDO has pure sequential structure with OC and IC tests -- as opposed to most deals in the market which have pro-rata structure
- the BBB tranche has a turbo mechanic that helps it to pay down faster.

Are there any accounts that might be interested in this, given the good manager name, good alignment of interest with investors, sequential paydown structure, OC/IC tests, BBB turbo and wider price talk? any help appreciated.

thanks,
Abhayad

Abhayad Kamat
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----- Forwarded by Abhayad Kamat/NewYork/DBNA/DeuBa on 02/21/2007 10:39 AM -----

"ILINCA BOGZA, DEUTSCHE BANK SECURI"
<ibogza@bloomberg.net>

Sent by:
ibogza@bloomberg.net

To

undisclosed-
recipients:;

02/20/2007 03:17
PM

cc

Subject

** UPDATE $[1.1]BLN GEMSTONE VII ** REVISED TALK
**

** UPDATE GEMSTONE CDO 7, A $[1.1]BLN MEZZANINE ABS CDO MANAGED BY HBK

** EXPECTED PRICING FEB [21ST].

CLASS	RATING(M/S)	SIZE(MM)	SIZE(%)	WAL(YR)	PRICE TALK	IOI
A-1	Aaa/AAA	[716.0]	[65.0]	[3.2]	* CALL DESK *	---
A-2	Aaa/AAA	[87.0]	[7.9]	[5.3]	* NOT OFFERED *	---
B	Aa2/AA	[96.9]	[8.8]	[6.0]	L+ [0.62% AREA]	90%
C	A2/A	[68.3]	[6.2]	[6.3]	L+ [2.65% AREA]	75%
D	Baa2/BBB	[55.1]	[5.0]	[5.7]	L+ [5.00% AREA]	75%
E	Ba1/BB+	[18.7]	[1.7]	[6.3]	* CALL DESK *	---
SUB		[59.5]	[5.4]			

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