

# U.S. Structured Finance Newsletter

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## MORTGAGE SERVICER RISK

As delinquency and foreclosure rates continue to rise on subprime mortgage loans and more servicers are experiencing financial difficulties, many investors are becoming concerned about servicer risk. For servicers, the cost of servicing has been increasing steadily due to the high-touch nature of handling severely delinquent loans and the expenses associated in complying with regulatory requirements and liquidating real estate owned (REO) properties. Even though some of these costs can be defrayed through outsourcing and recoverable advances, it can still be very expensive for servicers who need to borrow money in order to operate. In addition, with the large number of servicers being acquired by third parties, investors are uncertain about the long-term commitment of some purchasers. As a result, the industry is trying to determine which servicers have the ability to survive the current economic environment without compromising deal performance.

While many factors need to be considered in order to determine the likelihood that a servicer will remain in business and continue service appropriately, strong financial wherewithal is a significant component. The chart below lists the top subprime servicers by portfolio size and rating category. Surprisingly, servicers with low or no corporate credit ratings make up a significant portion of the list. Even though many other items affect a servicer's ability to perform including management experience, staffing, technology, controls and litigation, parental commitment and profitability are key drivers to success.

### Top Subprime Mortgage Servicers (in \$ billions)

Servicer	Subprime Portfolio	As of Date	Parent/Rating
Citi & Ameriquest	\$ 117	12/31/2007	Citigroup/Aa3/AA-
Countrywide	\$ 113	12/31/2007	Baa3/BBB+ (BOA buying)
Chase	\$ 74	12/31/2007	Aa2/AA-
Option One	\$ 55	12/31/2007	WL & Ross/NA
Ocwen	\$ 53	12/31/2007	B2/B-
Wells Fargo	\$ 52	12/31/2007	Aa1/AA+
Home Loan Services	\$ 47	12/31/2007	Merrill Lynch/A1/A+
HomEq	\$ 47	11/31/2007	Barclays/Aa1/AA
Litton	\$ 46	9/30/2007	Goldman Sachs/Aa3/AA-
WaMu	\$ 44	12/31/2007	Baa3/BBB
Homecomings/GMAC-RFC	\$ 44	9/30/2007	GMAC/B2/B
Saxon	\$ 34	6/30/2007	Morgan Stanley/Aa3/AA-
SPS	\$ 30	12/31/2007	Credit Suisse/Aa2/A+
EMC	\$ 21	9/30/2007	Bear Stearns/Baa1/AA-
New Century	~\$ 15	2/1/2008	Carrington/NA
Fremont	~\$ 13	2/1/2008	Ca/D
NationStar	~\$ 9	2/1/2008	Fortress/NA
Accredited	\$ 7.6	2/1/2008	Lone Star/NA

Source: Credit Suisse.

In an effort to increase profitability, many companies have raised the servicing fees for special-servicing situations where they are trying to get severely delinquent loans to re-perform from 50 basis points (bps) to anywhere between 100 bps and 135 bps. In addition, some servicers have stopped advancing for subprime loans once they become 60 days past due. Furthermore, the government's push for modifications has allowed servicers to convert a large portion of their delinquent portfolios into performing loans which are less expensive to service.

DBRS recognizes the difficulties servicers are facing in the current economic environment and believes that servicing quality may be compromised when a servicer's financial stability or parental commitment is in jeopardy. In addition, ultimate investor losses can vary based on servicer performance and the incentive structure in a transaction. As a result, DBRS factors servicer quality and stability into all of the deals that it rates. Furthermore, DBRS believes that recent acquisitions have shown that servicing is still attractive to strategic buyers with most of the servicing transfers being successfully completed in a timely manner. Additionally, government intervention in the subprime mortgage industry has boosted investor confidence and alleviated the fear of a total collapse of the mortgage market which may encourage more players to invest in the servicing industry. DBRS will continue to monitor the industry for further developments regarding mortgage servicer risk and its impact on investor losses.

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