



Methodology

*Rating U.S. RMBS Servicing Advance
Transactions*

APRIL 2011



Insight beyond the rating.

CONTACT INFORMATION

U.S. STRUCTURED FINANCE

Sagar Kongettira

Vice President
U.S. Structured Finance - RMBS
Tel. +1 212 806 3266
skongettira@dbrs.com

Quincy Tang

Senior Vice President
U.S. Structured Finance - RMBS/Covered Bonds
Tel. +1 212 806 3256
qtang@dbrs.com

Claire J. Mezzanotte

Managing Director
U.S. Structured Finance - ABS/RMBS/Covered Bonds
Tel. +1 212 806 3272
cmezzanotte@dbrs.com

U.S. STRUCTURED FINANCE - OPERATIONAL RISK

Kathleen Tillwitz

Senior Vice President
U.S. Structured Finance - ABS/RMBS/Covered Bonds
Tel. +1 212 806 3265
ktillwitz@dbrs.com

Stephanie Whited

Vice President
U.S. Structured Finance - ABS/RMBS/Covered Bonds
Tel. +1 347 226 1927
swhited@dbrs.com

GLOBAL STRUCTURED FINANCE - RESEARCH, MODELING AND SURVEILLANCE

Jan Buckler

Senior Vice President
Structured Finance - ABS/RMBS/Covered Bonds
Tel. +1 212 806 3925
jbuckler@dbrs.com

Related Research:

- Legal Criteria for U.S. Structured Finance Transactions dated September 2009
- Rating U.S. Residential Mortgage-Backed Securities Transactions dated April 2009

DBRS is a full-service credit rating agency established in 1976. Privately owned and operated without affiliation to any financial institution, DBRS is respected for its independent, third-party evaluations of corporate and government issues, spanning North America, Europe and Asia. DBRS's extensive coverage of securitizations and structured finance transactions solidifies our standing as a leading provider of comprehensive, in-depth credit analysis.

All DBRS ratings and research are available in hard-copy format and electronically on Bloomberg and at DBRS.com, our lead delivery tool for organized, Web-based, up-to-the-minute information. We remain committed to continuously refining our expertise in the analysis of credit quality and are dedicated to maintaining objective and credible opinions within the global financial marketplace.

This methodology replaces and supersedes all related prior methodologies. This methodology may be replaced or amended from time to time and, therefore, DBRS recommends that readers consult www.dbrs.com for the latest version of its methodologies.



Rating U.S. RMBS Servicing Advance Transactions

TABLE OF CONTENTS

Executive Summary	4
Introduction	4
Rating Methodology	5
Credit Enhancement	12
Financial Structure	16
Legal Criteria	16
Appendix 1: Beta Distribution - Representing A Numerical Distribution	18



Executive Summary

Servicing advance transactions, in which mortgage servicers securitize their rights to reimbursement for advances made to residential mortgage-backed security (RMBS) trusts, are becoming a more common financing type within the U.S. RMBS sector. Their increased use partly reflects the financial strain advancing responsibilities are placing on servicers as a greater portion of residential mortgages have become delinquent. While servicers are obligated to advance missed payments to RMBS trusts monthly, full reimbursement of these advances may take months or, in some cases, years depending on the reimbursement method. As a result, securitizing advance receivables can be a useful source of funds enabling servicers to meet future advance obligations.

DBRS analyzes both qualitative and quantitative factors when rating U.S. servicer advance transactions which include the following:

- Operational expertise and financial condition of the servicer;
- Historical advance recovery rates of the servicer;
- Transaction capital structure, proposed ratings and credit enhancement;
- Cash flow analysis;
- Legal structure and opinions.

In this report, we introduce the basic mechanics of servicing advance transactions and provide the analytical details of DBRS's methodology for rating such transactions.

Introduction

SECURITIZING SERVICING ADVANCES

In U.S. RMBS transactions, mortgage servicers are responsible for making certain payments (known as "advances") for the benefit of RMBS security holders when borrowers fail to make loan and other payments. Advance types include principal and interest (P&I), tax and insurance (T&I, also known as escrow advances) and corporate payments which are costs associated with foreclosing on and liquidating mortgage collateral. The servicer remits P&I advances monthly to RMBS trustees and makes T&I and corporate payments as needed to secure and preserve the mortgage collateral. RMBS transaction documents specify which collections (pool-wide or loan-specific) are used to reimburse servicers for each advance type. The obligation to reimburse servicers for advances from designated collections generally falls ahead of payments to RMBS security holders and other transaction participants. This enables servicers to securitize their rights to advance reimbursements (such rights are known as "receivables") at high rating levels. Strong ratings can be achieved as long as certain conditions, legal and structural features and overcollateralization levels are in place.

Servicing advance transactions issued in recent years have included term notes and variable funding notes (VFNs) issued under Rule 144A of the Securities Act. The notes generally pay variable interest and have legal final maturities of up to 10 years from issuance. While existing servicing advance transactions exhibit a certain degree of uniformity, rating such transactions is a dynamic and highly servicer- and transaction-specific process.

RATING METHODOLOGY SUMMARY

Although servicers are reimbursed for advances before RMBS security holders are paid as outlined in a transaction's legal documents, servicing advance transactions are not without risk. Important credit con-



siderations include which collections are designated to pay servicing advance note holders and whether they are subject to unexpected delays, reductions or interruptions. Such risks can materialize from a servicers' financial condition and operational procedures as well as from poor RMBS pool performance or nuances in the RMBS transactions ("RMBS Trusts") that generate the advance receivables pledged to the servicing advance trust. Servicing advance transactions also contain liquidity risks which are two-fold: (1) reimbursements of servicing advances are non-interest bearing while servicing advance securities are interest bearing, and (2) a timing mismatch exists between expected remittances to the servicing advance trustee and note holder payment obligations. DBRS's rating methodology for servicing advance transactions addresses credit and liquidity risks by incorporating the following elements:

- Reviewing the servicers' financial condition, operational procedures, performance metrics, historical advance recovery rates and legal documents of RMBS Trusts that generate advance receivables;
- Evaluating proposed advance rates by applying stresses to the timing and cumulative recovery of advances pledged as receivables, taking into account the results of the servicer operational review, the servicing advance transaction's other forms of credit enhancement and incorporating the stressed recoveries as well as security repayment obligations in the cash flow analysis; and
- Ensuring the servicing advance transaction meets DBRS's legal structure and other criteria consistent with individual rating levels.

Rating Methodology

DBRS's rating methodology for servicing advance transactions is consistent with its broader methodology for rating RMBS and other structured finance transactions (see DBRS's methodology reports entitled *Rating U.S. Residential Mortgage-Backed Securities Transactions*, April 2009 and *Legal Criteria for U.S. Structured Finance*, September 2009). How these considerations relate to servicing advance transactions, as well as criteria unique to such deals, are discussed herein.

In addition to considerations DBRS addresses when rating RMBS deals, our rating methodology for servicing advance transactions focuses on credit and liquidity risks. Credit risk principally relates to delays in the receipt of recoveries which can stem from the legal and flow of funds framework imbedded in RMBS and servicing advance transactions as well as the servicers' unique operational and financial risks. DBRS's operational risk group undertakes a targeted review focusing on the servicer's financial condition as well as its stop-advance procedures, cash management and reporting capabilities especially as they relate to advances and reimbursements and historical advance recovery rates. DBRS's legal review seeks to ensure remittances to the servicing advance transaction are not at risk of disruption upon the occurrence of a servicer bankruptcy or transfer.

Liquidity risk is introduced mainly from the negative interest carry on the advance receivables and timing mismatch between the receivable cash flow and note payment obligations. The negative interest carry arises because servicers are not paid interest on advances while the notes bear interest, often at variable rates based on the one month London Interbank Offered Rate (LIBOR). Although we describe credit and liquidity risks separately, these risks overlap and have the potential to be mutually reinforcing. DBRS is very mindful of this potential when rating servicing advance transactions. For this reason, certain elements of its review may require more or less emphasis depending on the circumstances of the particular deal and servicer under review.



SERVICING ADVANCE RECOVERIES

Servicers are not responsible for supplying credit enhancement to RMBS deals although they do aid liquidity by advancing missed payments to RMBS Trusts each month. Servicing advances include P&I, T&I and corporate expenses required to protect the value of and rights to the mortgage collateral. Servicers receive reimbursements for advances either monthly from general pool cash flows (pool-level) or periodically upon liquidation of or future payments on the related mortgage loan (loan-level). Reimbursement methods for specific advances are outlined in pooling and servicing agreements (PSAs) or similar binding documents containing the legal provisions for RMBS Trusts.

Aside from monthly servicing fees which are not pledged to servicing advance deals, servicers are not otherwise compensated for their costs associated with advances, including accrual of interest on advances. As a larger percentage of serviced loans fall delinquent and advancing obligations increase, servicers are exploring additional funding sources. Securitizing servicing advance reimbursements is one such source.

In addition to RMBS legal document provisions, another important factor in determining reimbursement timing, particularly for loan-level recoveries, is the length of time it takes the servicer to foreclose on and liquidate mortgage collateral. This is because unless delinquent borrowers recommence loan payments or the loan is modified, recoveries primarily stem from liquidation and mortgage insurance proceeds. Therefore, recoveries related to mortgages in which foreclosure takes place via a judicial procedure (judicial foreclosure) will take longer to realize than for mortgages in which foreclosure is a more procedural exercise (non-judicial foreclosure)¹. Due to their wide variation in recovery timing, DBRS reviews recovery rates by reimbursement type and foreclosure method.

RATING APPROACH

DBRS's rating approach for servicing advance transactions incorporates three main components: (1) reviewing the servicer's financial condition, operational procedures, performance metrics, RMBS Trust legal documents and actual advance recoveries, (2) evaluating proposed credit enhancement levels by analyzing and applying rating-dependent haircuts to servicer-specific advance recovery rates to account for credit risks and further discounting expected cash flows to cover note debt service payments and (3) ensuring the servicing advance transaction meets DBRS's minimum legal criteria.

The above steps are not undertaken in isolation of one another. Rather, DBRS's analysis accounts for the inter-dependent nature of these factors which may necessitate additional structural safeguards and/or overcollateralization to overcome unique servicer- or transaction-driven risks at particular rating levels. For example, if the servicer review uncovers unusual operational concerns or poor performance metrics, DBRS may employ a larger than normal haircut to recovery rates depending on the degree of concern and desired rating for the servicing advance notes. It is possible that some concerns are not surmountable at particular rating levels. The remaining sections of this report address each of the three components of DBRS's rating approach.

SERVICER REVIEW

To identify and minimize credit risk within servicing advance transactions, it is critical to view the servicer, RMBS Trusts and servicing advance transaction holistically since their interrelation influences future advance recoveries. Upon issuance of servicing advance notes, the servicer sells existing advance receivables to the trust and provides various representations and warranties concerning the receivables to the trust. The servicer is responsible for tracking and remitting recoveries to the servicing advance trustee. Any cash flow reductions or delays can stem from servicer-related events such as widespread servicing transfers, servicer bankruptcy or insolvency or from idiosyncrasies in the RMBS Trust provisions and poor collateral performance. Additionally, the revolving nature of the receivables requires reliance

1. Foreclosures are carried out in one of two ways depending on the jurisdiction of the property, usually at the state level. Some require the lien to be transferred via court proceedings in which the lien holder seeks to terminate the borrower's right of redemption. Other states specify that title can be transferred outside of court (non-judicial).



on a servicer's business practices, collection, advance and remittance policies. Specific areas of DBRS's servicer analysis include reviewing the servicer's financial condition, operational procedures, performance trends and actual recovery rates; assessing servicer-event risk; and reviewing RMBS Trusts' and servicing advance transaction's legal documents. All of these factors directly affect timely remittance to servicing advance trustees for payments on the notes.

FINANCIAL CONDITION

DBRS reviews the servicer's financial condition to assess the likelihood of a servicing transfer, servicer bankruptcy or other potential interruption in cash flow to the servicing advance trustee. Furthermore, DBRS's financial review assesses whether the servicer has sufficient resources, considering the proceeds of the servicing advance financing, to make future advances. These advances generate new receivables to keep the notes adequately collateralized, as receivables are paid down.

As a part of its general RMBS rating methodology, DBRS undertakes in-depth reviews of mortgage servicers. Aspects of its methodology with particular relevance to servicing advance transactions may include:

- Company ownership structure
- Corporate rating of any parent company (if applicable)
- Internal and external audit results
- Revenue sources including servicing fees and lines of credit
- Costs to service
- Litigation (past, present and expected)
- Existing business strategy and strategic initiatives
- Recent or planned mergers or acquisitions
- Recent or planned transfer of servicing rights
- Securitization history and future plans
- Management experience

As mentioned previously, many risks within servicing advance transactions have the potential to be mutually reinforcing, and this is particularly true for the servicer's financial condition. Any financial stress identified can elicit servicing advance transactional problems either immediately, as in the case of a servicer bankruptcy, or lead to a slow degradation of recoveries which, if left un-remedied, can impair its ability to service its notes. Therefore, the servicer's financial condition weighs on all other aspects of DBRS's analysis including evaluation of proposed credit enhancement and minimum structural safeguards and is a critical element in DBRS's analysis.

SERVICER EVENT RISKS

Directly related to the servicer's financial condition are certain servicer event risks. DBRS identifies two types of servicer event risks: servicing transfers and servicer bankruptcy. DBRS's rating approach encompasses several necessary components, including legal criteria, structural protections and credit enhancement features, to guard against and protect note holders in the case of such events.

Servicing Transfer Risk

A potentially serious concern for the servicing advance transaction is the removal of the servicer and a failure of the successor servicer to adopt all of the servicer's responsibilities, principally the obligation to remit reimbursements to the servicing advance trustee. Therefore, DBRS carefully reviews RMBS Trust and servicing advance legal documents concerning servicer events of default (EOD) and other circumstances that could lead to a servicing transfer and assesses the potential effects on the servicing advance transaction.

Generally, servicer EODs (which may have specified cure periods) under RMBS Trusts include failure of the servicer to remit required funds to the RMBS trustee; failure to observe or perform covenants in agreements; voluntary or involuntary bankruptcy, insolvency or receivership; or failure to remit advances



as required in the trusts. EODs can also arise due to breaching collateral performance or rating triggers. DBRS looks for RMBS Trusts to call for an immediate termination of the servicer upon an EOD and the trustee to act in the capacity of successor servicer, adopting all responsibilities under the RMBS Trust, unless and until it appoints a successor which would assume all such responsibilities.

DBRS believes a servicing transfer on a small portion of the RMBS Trusts is a surmountable risk to the servicing advance transaction, if the servicer has an ample amount of other RMBS Trusts from which to generate high-quality receivables, in order to sufficiently overcollateralize the notes. This may arise if a nominal percentage of the servicer's deals contain performance triggers and the triggers are breached. On the other hand, transfer of servicing rights on the bulk or all of the servicer's mortgages pledged to the servicing advance trust is a potentially severe situation. Under this scenario, the risk of large-scale cash flow interruption to the servicing advance transaction escalates. DBRS generally looks for the servicing advance documents to contain a provision that EODs on a specified number of RMBS deals and/or deals representing a percentage of receivables trigger an EOD under the servicing advance transaction. The servicing advance EOD initiates amortization of the notes (if they have not already entered the amortization period) or possibly – generally at note holder direction – full acceleration. This, together with other early amortization triggers, which include failure to maintain minimum overcollateralization rates (which are tied to minimum standards for eligible receivables), helps unwind the servicing advance deal swiftly prior to further cash flow deterioration. Lastly, and most importantly, as described in the Legal Criteria section, the “true sale” of the receivables to the servicing advance special purpose entity ensures the assets, and any proceeds therefrom, are properly segregated from the servicer's assets and obligations for the benefit of the note holders irrespective of any servicing transfer.

Next, DBRS looks to additional structural protections within the servicing advance deal. These may include the provisions that (1) the servicer (and, significantly, any successor servicer) comply with prescribed standards such as adhering to advancing requirements of the RMBS Trust and remitting advance recoveries to the servicing advance trustee and (2) the advance rate decreases upon various performance deterioration events which further collateralizes the notes, among other possibilities. Such advance rate triggers must be instituted before the servicer's financial or operational condition deteriorates significantly or before a servicing transfer is realized in order to earmark extra collateral for the benefit of note holders. A breach of such requirements generally initiates principal amortization of the notes.

Servicer Bankruptcy Risk

Many of the same principles apply to servicer bankruptcy risk. First, it is helpful to recall that receivables are defined as the right to reimbursement from the RMBS Trust for advances previously made but not yet reimbursed. To address the unique risk of cash flow interruption in the event of a servicer's voluntary or involuntary bankruptcy, DBRS's legal criteria has two components. Firstly, the trust needs to be structured as a special purpose entity (SPE) established for the sole purpose of owning and controlling the receivables and using the proceeds to pay the notes. Secondly, the receivables must be transferred to the servicing advance SPE, via a “true sale” as evidenced by a counsel opinion. The true sale is intended to segregate the rights of the note holders to the receivables if the servicer enters bankruptcy.

It is worth summarizing that the servicing advance deal structure should ensure the note holders have the sole rights to the receivables and the receivables are of sufficient quantity and quality to repay the notes even under severe servicer event risks.

Other Servicer Event Risk Safeguards

In addition to the above legal criteria and structural features which legally segregate the receivables from the assets of the servicer and wind down the notes upon an EOD, DBRS looks to fully-funded reserve accounts to ensure debt service payment during the period of servicing transition or other potential cash flow interruption. The size of the reserve fund depends on the specific circumstances within each deal and the outcome of DBRS's servicer review but generally covers 1-6 months of interest and, after the revolving period, a portion of principal payments on the notes.



Furthermore, DBRS views favorably inclusion of language in RMBS Trust legal documents acknowledging the ability of the servicer to enter into a servicing advance facility. DBRS views this as an indication of the intent of all parties, including a successor servicer, to cooperate fully with the obligations to remit reimbursements to the servicing advance trustee.

LEGAL DOCUMENT REVIEW

A critical step in DBRS's rating methodology is to review legal documents for RMBS Trusts (the sources of receivables) initially and potentially pledged to the servicing advance trust. DBRS's primary objective is to identify how the advance reimbursement process is intended to operate at the RMBS Trust level for all the trusts relating to the servicing advance deal. DBRS takes this into account when evaluating advance rates. Sources of reimbursements may include loan payments and prepayments, insurance and liquidation proceeds, late collections and modifications, depending on deal provisions and type of recovery.

Methods of reimbursement are specified in RMBS Trust legal documents generally in the servicing section covering withdrawals from the collection account. Typically, servicers are reimbursed for advances in one of two ways, (1) monthly from general pool collections on the pool of mortgages (pool-level recovery) or (2) from subsequent collections on the related mortgage loan which can include late collections and insurance and liquidation proceeds once the loan is liquidated (loan-level recovery). Though variations exist, P&I recoveries commonly are pool-level, while T&I and corporate are loan-level. Even loan-level advances often can be reimbursed from the general pool collections upon servicer certification that advances on a particular loan are "non-recoverable" from anticipated liquidation or insurance proceeds. Despite these general practices, DBRS is mindful that care must be taken in the legal document review to identify the exact source of reimbursement. For non-recoverable advances, pool-wide collections may be available either at the time an advance is deemed non-recoverable or when the loan is liquidated which may delay the recovery substantially. Additionally, though typically not specified in legal documents servicers frequently recover any previously unreimbursed advances of all types when a mortgage loan is modified. This is because servicers often capitalize outstanding advances in the mortgage balance upon loan modification. Each nuance can greatly influence recovery timing and can help explain apparent idiosyncrasies in actual recovery data.

The pace of pool-wide advance recoveries depends to a large degree on prepayments relative to the amount of advances made, while the timing of loan-level recoveries reflects cure rates, the proportion of loans modified, foreclosure and liquidation timelines. In the absence of modifications and late collections, recoveries for loan-level advances would be near zero in the first one to two years post advance. Additionally, for pool-level advances, servicers may only be able to reimburse outstanding advances from amounts held for future distribution. For these reasons, DBRS employs lags when stressing recoveries as described in the Advance Rate section below. Recovery timing, particularly for loan-level advances, is also related to the proportion of loans in judicial and non-judicial states. Furthermore, expected recovery rates can vary significantly across servicers or even among different mortgage loans managed by the same servicer due to variations in RMBS document provisions and pool delinquency rates as discussed in more detail in the Operational Procedures section.

Repayments to servicers for prior advances are commonly referred to as "top of the waterfall" obligations within individual RMBS Trusts. More accurately, such repayments generally occur prior to application of the trust waterfall. The RMBS Trust flow of funds commonly calls for a servicer to deposit all pool collections, minus the monthly servicing fee, in a trust-designated collection account within 1-2 days of receipt. The servicer then withdraws funds from the collection account to reimburse itself for prior advances. Such reimbursements are then remitted to the servicing advance trustee. In some cases, reimbursements are remitted by the servicer to the distribution account held by the RMBS trustee which then remits them to the servicing advance trustee. In either case, the multi-step remittance process should occur within a maximum of 33 days – the servicer remits all receipts to the collection account within 1-2 days and from the collection account to the servicing advance reimbursement account, in some cases daily, but in all cases no later than the monthly servicer remittance date. DBRS reviews the flow of funds within and between the servicer and trustees to determine the expected remittance timeframe.



Often, servicing advance transaction documents spell out standards the servicer is obligated to employ consistent with or over and above specifications within the RMBS Trusts. Such standards may include applying advance reimbursements in a “first in first out basis”, identifying advances pledged to the servicing advance trust on its system and remitting reimbursements to the servicing advance trustee daily. Servicing advance transactions also may incorporate specified standards for “eligible” RMBS Trusts and/or receivables. Standards may relate to minimum pool balances, loan performance trends and advance-to-expected liquidation recovery ratios and generally are designed to achieve two objectives: ensuring RMBS Trusts can (1) create new, high quality receivables in order to adequately collateralize the notes as receivables are repaid and (2) reimburse existing receivables timely and in full. Furthermore, eligible receivables should only include assets over which the servicer holds a valid legal title and for which the servicer represents that no liens or encumbrances exist against the assets and that assets are serviced in accordance with its standard servicing practices. Furthermore, due to their low recovery rate, DBRS generally does not consider advances on second liens eligible advances and further seeks to ensure that reimbursements for any advances made to second liens will not have superior priority to reimbursements for first lien mortgages. Ineligible receivables or receivables from in-eligible trusts are not included in total assets when calculating overcollateralization tests.

OPERATIONAL PROCEDURES

A servicer’s practices surrounding advances, including stop advance and non-recoverable advance procedures as well as its cash management and reporting capabilities, have significant influence over its ability to fully and timely remit the appropriate payments on receivables to the servicing advance trustee. As part of its operational evaluation, DBRS reviews the servicer’s:

- Cash management procedures and systems
- Advance tracking and reporting
- Advance methods
- Stop-advance calculations and procedures
- Non-recoverable advance calculations and practices
- History of non-recoverable or non-customary advances

Servicers must have appropriately segregated funds and maintained a detailed record of accounts enabling DBRS to verify its capacity to track advances and recoveries on a loan level basis within individual trusts. Furthermore, the servicing system should identify advances from those trusts related to the servicing advance transactions enabling the servicer to better track recoveries pledged to the advance facility. While servicing advance trustees generally do not verify the recovery amounts due from the servicer each month, the servicer, nonetheless, must identify on its system which recoveries it keeps versus those due for remittance to other parties. Likewise, the servicer must be able to demonstrate its calculations to outside parties if, for example, it remits amounts in error and attempts to recoup such advances. Lastly, some transactions require advances to be reimbursed on a first-in first-out basis, and a servicer’s system must be capable of supporting this method.

DBRS also reviews a servicer’s stop advance and non-recoverable advance practices. As mentioned previously, non-recoverable loan-level advances often can be recovered from the general pool cash flows. However, one risk is that servicers routinely advance P&I to RMBS Trusts and pay other expenses beyond the ability of the pool-wide cash flows to make up for such payments. Therefore, DBRS evaluates servicers’ stop advance practices including specific factors imbedded in the analysis as well as when the analysis is undertaken.

Additionally, DBRS takes into account RMBS Trust provisions regarding advance reimbursement priority and timing of reimbursement for non-recoverable advances. Specifically, when liquidation proceeds (for loan-level recoveries) and deal cash flows (for pool-level recoveries) are not sufficient to cover all outstanding advances every month, the priority of advance reimbursement is important factor determining recovery timing.



Servicers exhibiting less stringent stop-advance and non-recoverable advance practices and/or RMBS Trusts with looser recovery standards may warrant lower advance rates, longer recovery delay assumptions and/or larger reserve funds.

It is important to verify that a servicers' written policies, procedures and servicing platforms fully mirror and support the provisions within the RMBS Trust and servicing advance documents. Inadequate technology or contradictory policies may prevent servicers from properly carrying out its responsibilities. DBRS seeks to verify a servicer's practices and capabilities during its operational review.

PERFORMANCE TRENDS

When reviewing servicing advance transactions, DBRS analyzes a servicer's performance trends, focusing on receivables generated from trusts pledged or potentially pledged to the servicing advance notes. The metrics DBRS reviews are listed below. The results, combined with a servicer's actual recovery rates, enable DBRS to evaluate proposed advance rates and other structural enhancements.

- Delinquency, roll and cure rates
- Foreclosure timelines separately for judicial and non-judicial states
- REO timelines
- REO (and other disposition method) recovery rates
- Loan modifications
- Modification recidivism rate

Sources for loan-level reimbursements include liquidation and insurance proceeds as well as future payments on delinquent loans. When these proceeds are recovered partly depends on a servicer's foreclosure and Real-Estate Owned (REO) liquidation timelines, REO (and other disposition methods) recovery rates and insurance claim rescission and curtailment rates. Some factors might delay recoveries, while others may reduce them. Longer-than-normal foreclosure timelines, for example, may signal enhanced risk of non-recoverable advances which could delay or curb recoveries depending on a servicer's non-recoverable advance practices and recovery methods discussed above. Furthermore, viewing pool specific delinquency, cure and roll rates and REO recovery rates will let one know whether future loan payments are capable of fully reimbursing servicers for previous advances, regardless of whether reimbursements are pool- or loan-based. For example, cure rates reflect the percent of loans reinstating and lead to faster recoveries for loan-level advances than loan liquidation. This holds true for loan modifications, too, if a servicer is reimbursed for previous advances when it modifies mortgages.

On the other hand, pools with high percentages of delinquent loans may not have sufficient cash flow to fully reimburse servicers each month for pool-level advances. Recall that stop advance analyses consider whether liquidation proceeds are sufficient to recover advances made for a particular loan, they do not consider whether the timing of pool cash flows match reimbursements of advances. Non-reimbursed advances typically roll to the next collection period. When collections do not keep pace with monthly advances, pool-level recoveries lag considerably depending on the priority of advance reimbursements as discussed above. To address this risk, servicing advance transactions may include pool eligibility tests. For example, new receivables from pools breaching delinquency thresholds or having lower than specified current (i.e., non-delinquent) loan balances may be ineligible as additional collateral. Additionally, DBRS reviews monthly delinquency rates, advance/reimbursement cash flows as well as ratings on senior-most classes for participating trusts when analyzing servicing advance transactions.

While a servicer's performance trends certainly influence existing recovery rates, detecting deteriorations in a servicer's performance trends early can signal future reductions or delays in recoveries where none exist currently. For this reason, the performance trend review component is valuable when assigning new ratings as well as analyzing existing servicing advance transactions. Furthermore, incorporating performance trends in the servicing advance transaction's structure, for example, by designing performance-based advance rate reduction triggers that reduce advance rates upon deterioration, are often a



positive feature and can help prospectively add collateral to support the notes before cash flows from designated pools are constrained. Performance triggers may deem a trust ineligible or decrease the advance rate for receivables related to the trusts in which its foreclosure and liquidation timelines extend beyond specified periods and advance-to-expected REO recovery ratios breach particular levels.

ACTUAL RECOVERY RATES

An important component in DBRS's rating approach is its review of servicer's actual recovery rates by advance type and recovery method. This step can be thought of as the bridge between the servicer review and credit enhancement evaluation, because actual recovery rates largely reflect the risks described in the servicer review section and are the starting point for arriving at appropriate credit enhancements detailed below. To analyze a servicer's recovery rates, DBRS requests servicers provide cumulative monthly advance recoveries each period following the month the advance was made for each advance type broken out as shown below. Individual transactions, however, may necessitate grouping advance rates differently and will be determined on a case-by-case basis.

P&I pool level	Total
P&I loan level	Judicial and Non-Judicial
T&I pool level	Total
T&I loan level	Judicial and Non-Judicial
Corporate pool level	Total
Corporate loan level	Judicial and Non-Judicial

Credit Enhancement

The basic forms of credit enhancement in servicing advance transactions are overcollateralization, reserve funds and interest rate derivatives. Overcollateralization levels are designed to partially offset the credit and liquidity risks within servicing advance transactions and takes the form of advance rates which trim the amount of securities issued relative to a given pool of specified receivables at each rating category. Alternatively, overcollateralization can be viewed as the receivables needed to back a pre-determined amount of securities.

While overcollateralization is a central credit enhancement feature in servicing advance transactions, it should not be viewed in isolation from other types of credit enhancement available to and safeguards built into the transaction. Furthermore, issuers often aim to maximize advance rates by employing other enhancements and/or safeguards. Because structural features and credit enhancement often are interdependent, DBRS assesses whether and to what degree they can offset overcollateralization. The ability to replace overcollateralization depends on considerations described throughout this methodology report. Furthermore, certain minimal standards should be met which are in addition to, not a replacement of, other forms of credit enhancement.

ADVANCE RATES

Stressing advance recoveries to arrive at advance rates for the receivables helps ensure sufficient cash flows are available to make timely security payments and is a central aspect of DBRS's rating analysis. Unless DBRS's review exposes unusual risks, it will use the servicer's actual recovery rates as the basis when evaluating proposed advance rates for the servicing advance transaction. However, if recoveries deviate from industry standards reflecting unique servicer or collateral risks or DBRS expects a servicer's recoveries to materially weaken, DBRS first haircuts actual recovery rates prior to applying the stresses outlined below. Deviation or deterioration can arise from unique servicer risks, RMBS Trust and servicing advance provisions or from economic influences.



The next steps involved in establishing advance rates include (1) applying rating-dependent stresses to the servicer's actual (or adjusted) advance recovery rates to account for the credit risks identified in the servicer review and (2) undertaking a cash flow analysis using the stressed recoveries to account for liquidity risks stemming from the mismatch between the receivables cash flow and security debt service obligations.

Credit Risk: Stressing Recovery Rates

DBRS applies the following haircuts and assumptions to actual advance recoveries to achieve a stressed recovery rate.

- **Step 1. Calculate stressed recovery rates using historical data.**

Assume a beta distribution² of the servicer's actual historical cumulative recovery rates and apply DBRS confidence levels by rating category and the notes' maturity date to achieve a stressed recovery rate.

- **Step 2. Calculate stressed recovery rates using a weighted historical data.**

Given the continuously deteriorating recovery rates observed in recent months, DBRS applies a heavier weighting as illustrated in the table on page 14, on advances made in the recent past and repeats the same stress described in Step 1. The weighting is intended to capture any weakening trend in recoveries experienced in the current environment.

Months to Current	Weighting (%)
Month 1 to 12	40%
Month 13 to 24	30%
Month 25 to 36	20%
Month 37 to 48	10%

- **Step 3. Application of Most Conservative Results between Step 1 and Step 2**

DBRS takes the more conservative stressed cumulative recovery rates in each period from the weighted and non-weighted data set stresses described above. In the current environment, the results from the weighted stress will likely be the dominant stress. When the deteriorating trend reverses, DBRS expects the non-weighted historical data set stress to drive the shape of the recovery rates.

- **Step 4. Capping the stressed recoveries.**

DBRS caps the stressed cumulative recovery rates derived from Step 3 at the notes' maturity date by applying rating-specific multiples to the actual average recovery rates (base case) to account for non-recoverable and unrecoverable advances. Multiples for AAA rated notes range from 4.0-6.0 times the base case figure which is dependent on the quantitative and qualitative factors described herein. Additionally, DBRS assumes at the base case, that at least 2.00% of the loan-level advances are unrecoverable or non-recoverable.

- **Step 5. Delay the stressed recoveries.**

DBRS delays the stressed recovery rates at a minimum by the number of months specified in the table below. DBRS assumes a negligible amount of recoveries to occur during these periods. Recoveries are applied using a linear increase from 0% in month 1 to the stressed recovery rates at the terminal delay period as illustrated in the below table. Further delays may be added to the stressed recovery curves based on the review of the servicer's state-level liquidation timelines, state concentrations in the underlying RMBS transactions, servicer's current foreclosure process and financial condition. For pool-level advances, the recovery delays will be determined on a case by case basis and is based on a review of pool level prepaids, delinquency trends and any nuances in the sources of reimbursement.

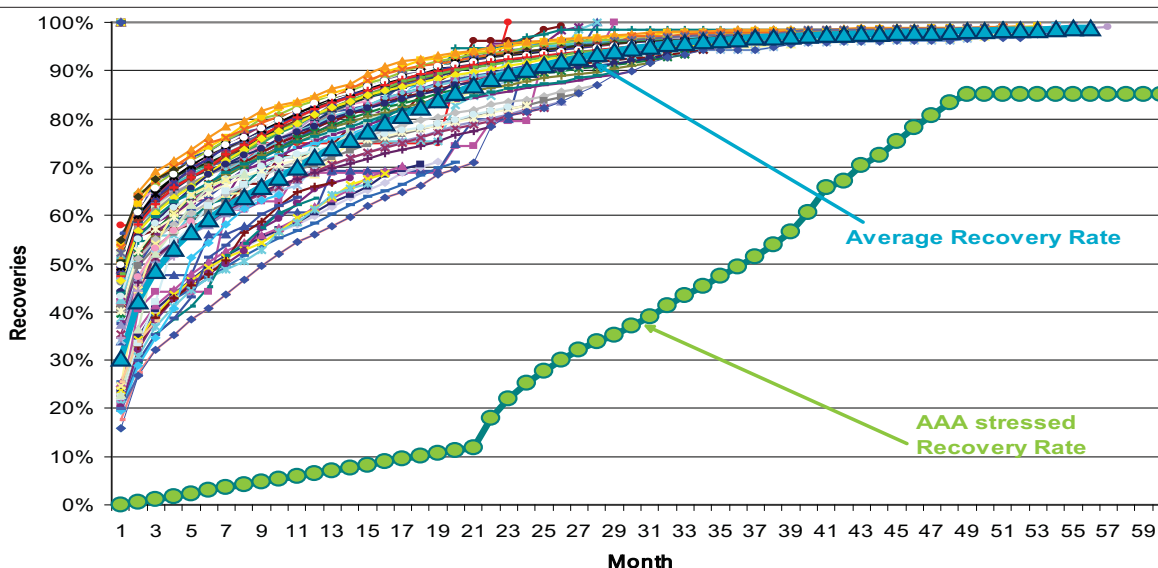
2. A full description of the beta distribution is in Appendix 1 of this report



Recovery Delay for Loan-Level Reimbursements		
Rating Level	Loan Level Judicial	Loan Level Non Judicial
AAA	20	15
AA	18	13
A	16	11
BBB	14	10
BB	12	9
B	10	8

Exhibit A below demonstrates an example of DBRS’s stressed recoveries using the above haircuts compared with typical recoveries.

Exhibit A: Sample Actual and Stressed Advance Recovery Rates at the AAA Rating Level



Source: DBRS

The combined recovery rate stresses are designed to provide a cushion in the event of a servicing transfer or upon servicer bankruptcy filing. They are also intended to cover systemic risks including flow of fund provisions within the RMBS Trust and proposed servicing advance transaction, servicer operational risks, deterioration in RMBS collateral and foreclosure and liquidation timelines. DBRS views positively transactions that employ automatic advance rate reduction triggers upon breach of certain performance levels or other events. Such triggers are most useful if they are initiated before the servicer or transaction exhibit severe or even mild strain. This helps ensure the servicer is capable of carrying out the required steps in supporting the transaction.

DBRS reviews the actual receivables pledged to the servicing advance deal, including initial receivables, and considers them when evaluating proposed advance rates. Furthermore, accounting for a servicer’s historical non-recoverable advance rates and the securities’ rating level, DBRS may assume a certain percentage of pool-level receivables are deemed non-recoverable and treats them like loan-level recoveries.

LIQUIDITY RISK: CASH FLOW ANALYSIS

Generally, servicing advance notes have monthly interest payments (often floating rate) and interim revolving periods during which time principal on the notes does not amortize. However, most servicing advance transactions call for principal payment upon specified early amortization events or EOD and have legal



final maturities up to ten years from issuance to provide flexibility in fully paying down the notes.

DBRS undertakes a detailed cash flow analysis ensuring monthly debt service coverage for the notes. To establish advance rates for each advance type, using Intex, DBRS analyzes debt service coverage (1) assuming collateral receipts equal those after applying the credit stresses listed above and (2) monthly payments reflect the actual amount and order of debt service, incorporating interest rate stresses for floating rate notes (described in detail below), as well as expenses and fees (integrating any capped amounts) outlined in the servicing advance trust documents. The advance rate equals the highest possible advance rate that avoids interest or post-final maturity principal shortfalls. A reserve fund is used to cover any otherwise shortfall amount, accounting for the reserve fund balance and replenishment priority as outlined in the documents. Shortfalls above the reserve fund necessitate a lower advance rate, larger reserve fund or other possible solution.

For floating rate notes, DBRS addresses the risk that the floating rate index rises substantially increasing interest obligations on the notes. When evaluating proposed advance rates, DBRS applies a similar interest rate stress both linearly and based on the forward curves, as it does on RMBS trusts³. In some cases, particularly in low interest rate environments, DBRS may apply more severe stresses to account for the possibility of rapid and severe interest rate bounces.

DBRS expects the servicing advance transaction to incorporate frequent and regular tests to ensure minimum overcollateralization levels are maintained throughout the life of the notes. DBRS also looks to specified remedies when overcollateralization falls below minimum levels such as pledging additional high-quality collateral and/or early note amortization.

Additionally, because higher servicing fees and other expenses, which are paid ahead of advance recoveries, may be permitted under a bankruptcy proceeding, DBRS may further reduce recoveries for servicers under particular financial strain. This may be necessary because the servicing fee takes higher priority than advance reimbursements. The reduction reflects the amount of increase in servicing fee and/or higher permitted legal expenses.

RESERVE FUNDS

DBRS looks for a fully funded reserve account, held in the name of the trustee, upon note issuance and the priority of payments to specify use of the reserve fund as needed for security payments and reserve fund replenishment, as needed, ahead of extraordinary expenses and other non-debt service payments. The reserve fund is an important source of liquidity to avoid disruption of payments on the notes, which is especially critical in the event of a servicing transfer or other cash flow interruption events.

DERIVATIVES

Inclusion of interest rate derivatives such as caps and swaps can help alleviate the negative interest carry between the receivables and floating rate notes. Similar to its methodology employed in rating RMBS transactions, DBRS incorporates the derivative's amortizing notional schedule and strike/cap rates into its cash flow analysis to simulate the revenues expected from the derivative. DBRS also accounts for this in its cash flow analysis by calculating payments/receipts based on the derivative's notional amount. Derivative counterparties are expected to either maintain minimum credit ratings as specified in DBRS's legal criteria or within 30 days of a rating downgrade post additional acceptable collateral, provide a guarantee from a provider rated the minimum level or assign its obligations to a counterparty meeting the minimum criteria⁴.

ADDITIONAL STRUCTURAL FEATURES

Additional safeguards can include strict receivable eligibility requirements, dynamic advance rates and frequent overcollateralization tests. Breach of any of the above generally calls for posting additional

3. For more information, please refer to "Rating U.S. Residential Mortgage-Backed Securities Transactions" on www.dbrs.com.

4. For more information, please refer to "Legal Criteria for U.S. Structured Finance Transactions" on www.dbrs.com.



collateral. Each feature should facilitate early-detection and rapid-remediation. The intent is to ensure high-quality and sufficient amounts of receivables are ring fenced within the trust to protect note holders and should occur prior to any servicing transfer, servicer bankruptcy filing, etc. which likely would impair or prevent full reparation.

Financial Structure

BOND STRUCTURE AND FLOW OF FUNDS

Servicing advance notes often are issued under master trusts and enable issuance of additional series with equal payment priority. Typically, interest is due monthly and, absent of an event of default, principal amortization commences after a revolving period in which new receivables are added to the trust. Once amortization begins, funds that would have been used to buy new receivables prior to amortization are instead redirected to pay note principal. Due to the revolving nature of the receivables, minimum over-collateralization tests are established for each advance reimbursement type. This dampens the effect of dramatic shifts toward delayed recovery advances following note issuance. While notes often accelerate only upon consent of the majority (or other threshold) of holders or servicer bankruptcy, the trustee may also have the ability to liquidate the collateral to pay off the notes in full. The longer final maturity helps alleviate risks that the receivables' liquidation value plummets and/or recoveries are significantly delayed during a servicer event and allows for extra time to wrap up a servicing transfer or insolvency event.

Similar to RMBS Trusts, the priority of payments within servicing advance transactions include obligations to pay interest and principal, any counterparties and certain expenses and fees. Payments under servicing advance transactions may also include reserve fund replenishment and purchasing additional receivables and/or paying down VFNs to achieve the targeted OC level. The OC test is measured on each funding and note payment date. Commonly, there is a revolving period in which new receivables are added to the trust. Therefore, term notes (as opposed to any VFNs which can be paid down prior to amortization) only begin receiving principal upon a scheduled amortization date or upon early amortization or an EOD. DBRS reviews the payment priority within each servicing advance transaction and models the payments as appropriate in its cash flow analysis.

Legal Criteria

DBRS ensures that the servicing advance transaction's legal and bond structure conform to its overall structured finance criteria. As part of the rating analysis, DBRS examines the transaction and its documents in its entirety in order to determine that the legal elements are appropriate for the desired rating.

LEGAL CRITERIA

A servicer in serious financial difficulty may voluntarily file for bankruptcy or, in some cases creditors may file a petition to place the servicer into bankruptcy involuntarily. The effect of the filing is an automatic stay preventing creditors from collecting from the servicer and preventing the commencement or continuation of any action to obtain property from the servicer. Avoidance of bankruptcy risk is a central concern in all structured financing, and DBRS's legal criteria, therefore, begins with a review of the bankruptcy considerations. Bankruptcy risks arise in three ways: (1) upon transfer of the assets from the servicer to the special purpose entity (SPE), (2) by the formation and conduct of the SPE, and (3) from the SPE's relationships with third parties such as trustees and financial institutions.



In addressing the first element listed above, significant care must be taken to ensure servicing advance note holders are secured creditors only of the SPE and that if the servicer or its parent becomes a debtor under the bankruptcy code, neither the receivable assets will be included in the servicer's bankruptcy estate nor will the servicing advance note holders be treated as creditors of the servicer. In other words, the note holders have the sole rights to the receivables and they are not reliant upon any of the servicer's other assets for repayment. A true sale of the receivables from the servicer to the SPE (either in a single or two-step process), as evidenced by a true sale opinion by an experienced securitization counsel, must be conducted to remove the receivables from any potential bankruptcy estate. At a minimum, the opinion should state that upon bankruptcy of the servicer a court would determine that (1) the transfer of receivables would be characterized as a true sale for bankruptcy purposes, (2) the receivables would not form property of the servicer's estate per Section 541 of the Bankruptcy Code and (3) collections on the underlying assets would not be stayed per Section 362(a) of the Bankruptcy Code. Furthermore, to guard against the court's discretionary powers to apply the doctrine of substantive consolidation which in extraordinary circumstances allows creditors of each entity to reach the assets of the entire consolidated estate, DBRS requests a legal opinion that the SPE and its assets would not be consolidated with the servicer's assets.

To address the second component above, SPEs can be arranged under various legal structures such as grantor and owner trusts, limited liability partnerships or corporations or real estate mortgage investment conduits (REMICs). Regardless of the legal structure, the SPE must achieve bankruptcy remoteness, not only from the servicer as discussed above, but when it and its assets are remote from any party to the transaction or claimants thereof. The SPE's ability itself to enter bankruptcy must also be limited. This can be achieved by limiting the activities and powers of the SPE which should have an identity and director independent from the servicer. Likewise, DBRS requests any third-party agreements contain non-petition clauses in which third parties agree not to petition the SPE into bankruptcy.

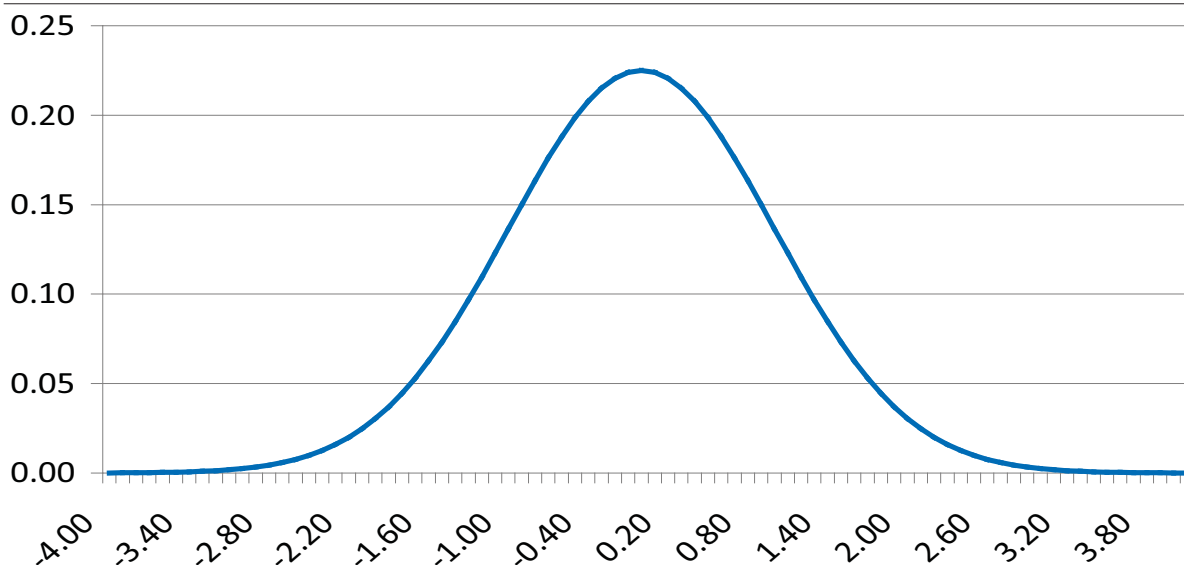
Lastly, certain minimum standards must be met by indenture trustees and their rights to the SPE assets. DBRS's criteria includes the terms that: indenture trustees meet eligibility standards such as minimum ratings and be legally entitled to act in all relevant jurisdictions, indentures stipulate the indenture trustee cannot resign until a replacement acceptable to DBRS has assumed its responsibilities, and the SPE grant a security interest in all its assets for the benefit of the security holders as evidenced by a counsel opinion that all necessary steps have been taken to perfect the trustee's security interest in the assets (including the trust accounts). To control the quality of the assets pledged to the trust, asset eligibility criteria should include, among other standards, that the servicer has a valid and clear lien to the receivables and the receivables are enforceable obligations of the RMBS Trusts. Furthermore, while DBRS insists that security holders have a right of enforcement regarding terms and covenants in the indenture, in practice this right is difficult to exercise. Therefore, this right must extend to the trustee which is authorized to bring action on behalf of security holders.



Appendix 1: Beta Distribution - Representing A Numerical Distribution

It is common in many disciplines to encounter data that is “normal” and therefore can be easily represented adequately by parameters such as mean (μ), variance (σ^2), and standard deviation (σ). The normal curve displays the traditional bell shape and traveling outwards from the mean by the indicated number of standard deviations encompasses the familiar areas listed below.

Normal Curve



Boundaries	Area Enclosed
$-\sigma \leq x \leq \sigma$	68.2%
$-2\sigma \leq x \leq 2\sigma$	95.4%
$-3\sigma \leq x \leq 3\sigma$	99.7%

If the data is not normal, the mean and standard deviation alone are not sufficient to adequately represent the underlying function. Via introduction of additional, easily derived parameters, the Beta Distribution provides for a more accurate fit in cases where the data is more concave or convex. It can be noted that setting the additional parameters, α and β to unity, the Beta Distribution devolves into the normal distribution.



The table below indicates various shapes that may be captured by adjustment of α and β .

α	β	Plot Description
=1	=1	uniform [0,1] distribution
<1	<1	U shaped plot
=1	>2	strictly convex
=1	=2	straight line
=1	$1 < \beta < 2$	strictly concave
>2	=1	strictly convex
=2	=1	straight line
$1 < \alpha < 2$	=1	strictly concave

The calculation method for deriving the four parameters, mean, variance (which is the square of the standard deviation), α and β are presented below first for data whose range is bounded by the [0,1] interval.

for [0,1]

$$\mu = \frac{\sum_{i=1}^N x_i}{N}$$

$$\sigma^2 = \frac{\sum_{i=1}^N (x_i - \mu)^2}{N}$$

$$\alpha = \mu \left[\frac{\mu(1-\mu)}{\sigma^2} - 1 \right]$$

$$\beta = (1-\mu) \left[\frac{\mu(1-\mu)}{\sigma^2} - 1 \right]$$

When the data lies outside the [0,1] interval, an adjustment to the mean and the variance must be made before calculation of α and β where the actual interval is observed to be [low,high] or simply [l,h]

for [l,h]

$$\hat{\mu} = \frac{(\mu-l)}{(h-l)}$$

$$\hat{\sigma}^2 = \frac{\sigma^2}{(h-l)^2}$$

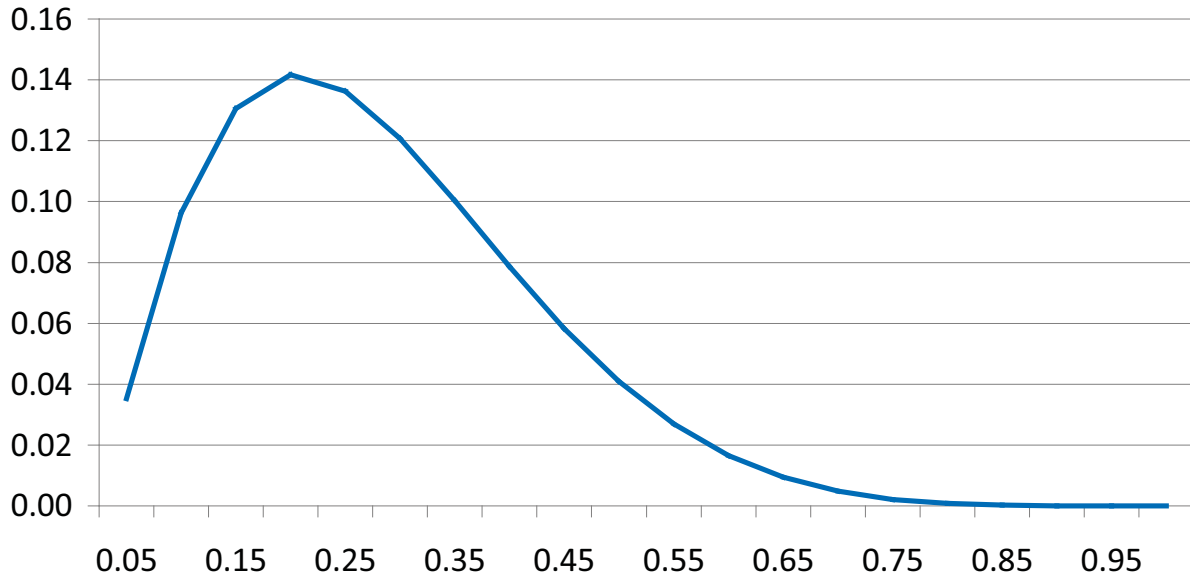
$$\hat{\alpha} = \hat{\mu} \left[\frac{\hat{\mu}(1-\hat{\mu})}{\hat{\sigma}^2} - 1 \right]$$

$$\hat{\beta} = (1-\hat{\mu}) \left[\frac{\hat{\mu}(1-\hat{\mu})}{\hat{\sigma}^2} - 1 \right]$$

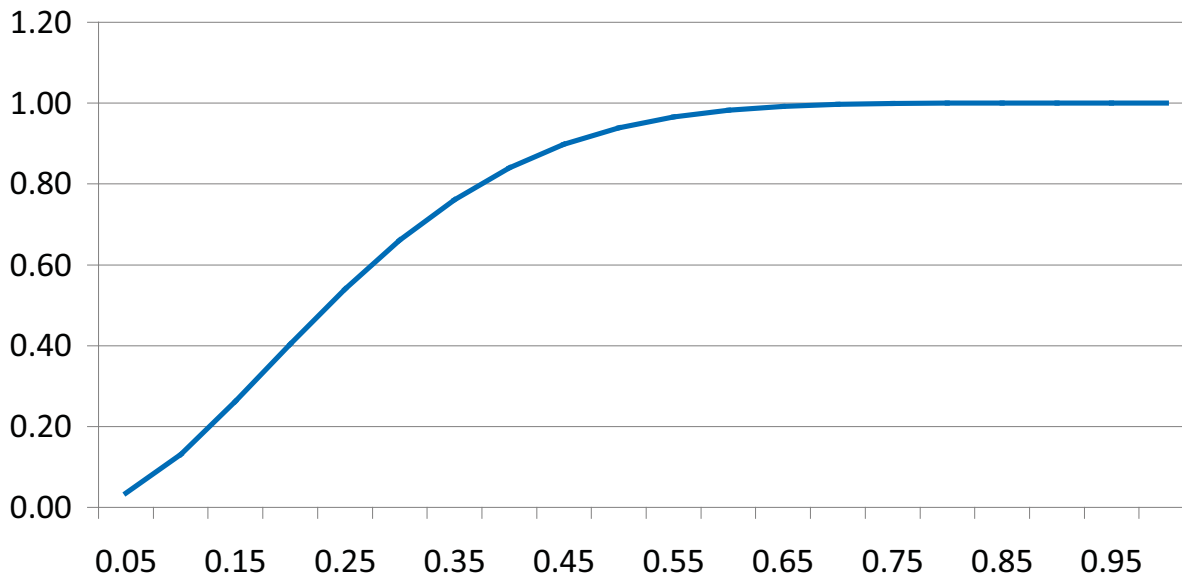


Using $beta(\mu, \sigma^2, \alpha, \beta)$ or $beta(\hat{\mu}, \hat{\sigma}^2, \hat{\alpha}, \hat{\beta})$ thus enables the underlying data to be represented with greater accuracy as demonstrated pictorially below.

Beta Distribution

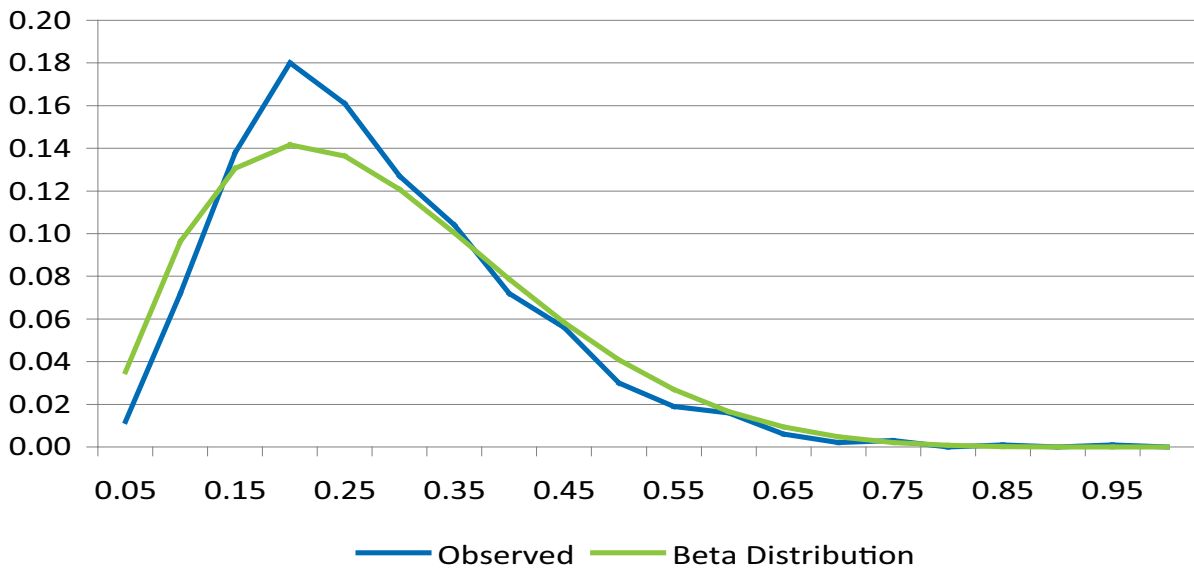
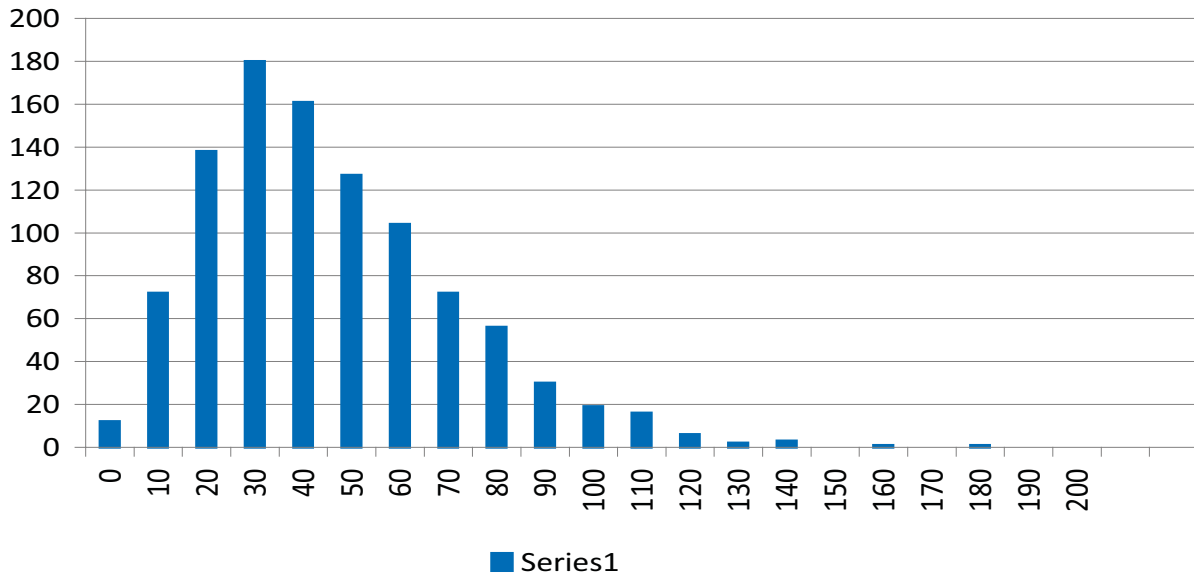


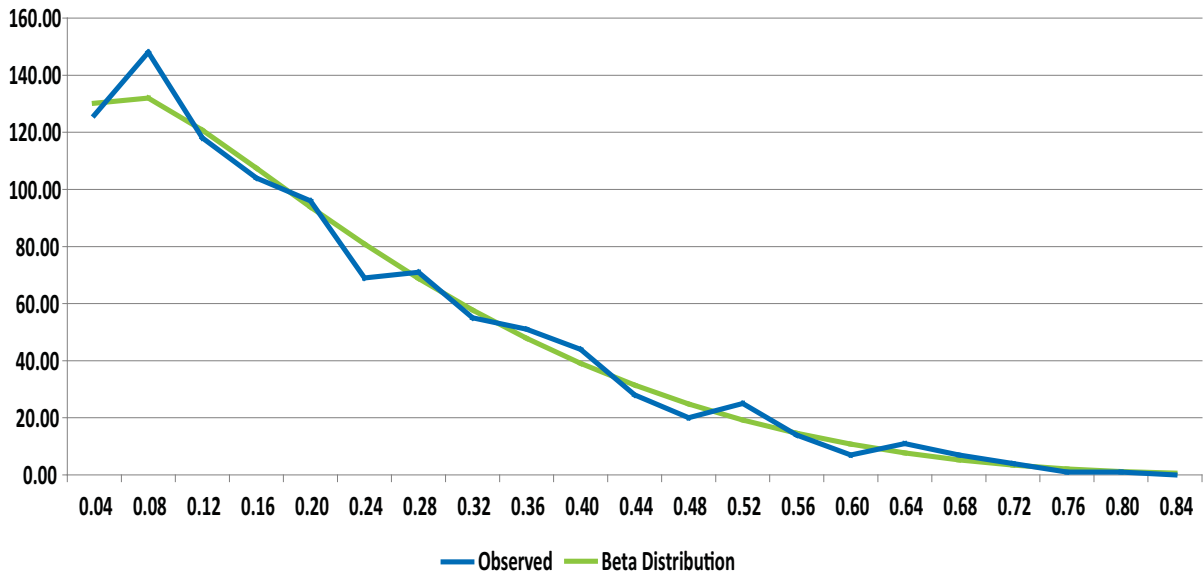
Cumulative Beta Distribution





EXAMPLES OF BETA FITTING





Copyright © 2011, DBRS Limited, DBRS, Inc. and DBRS Ratings Limited (collectively, DBRS). All rights reserved. The information upon which DBRS ratings and reports are based is obtained by DBRS from sources DBRS believes to be accurate and reliable. DBRS does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance. The extent of any factual investigation or independent verification depends on facts and circumstances. DBRS ratings, reports and any other information provided by DBRS are provided "as is" and without representation or warranty of any kind. DBRS hereby disclaims any representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability, fitness for any particular purpose or non-infringement of any of such information. In no event shall DBRS or its directors, officers, employees, independent contractors, agents and representatives (collectively, DBRS Representatives) be liable (1) for any inaccuracy, delay, loss of data, interruption in service, error or omission or for any damages resulting therefrom, or (2) for any direct, indirect, incidental, special, compensatory or consequential damages arising from any use of ratings and rating reports or arising from any error (negligent or otherwise) or other circumstance or contingency within or outside the control of DBRS or any DBRS Representative, in connection with or related to obtaining, collecting, compiling, analyzing, interpreting, communicating, publishing or delivering any such information. Ratings and other opinions issued by DBRS are, and must be construed solely as, statements of opinion and not statements of fact as to credit worthiness or recommendations to purchase, sell or hold any securities. A report providing a DBRS rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. DBRS receives compensation for its rating activities from issuers, insurers, guarantors and/or underwriters of debt securities for assigning ratings and from subscribers to its website. DBRS is not responsible for the content or operation of third party websites accessed through hypertext or other computer links and DBRS shall have no liability to any person or entity for the use of such third party websites. This publication may not be reproduced, retransmitted or distributed in any form without the prior written consent of DBRS. ALL DBRS RATINGS ARE SUBJECT TO DISCLAIMERS AND CERTAIN LIMITATIONS. PLEASE READ THESE DISCLAIMERS AND LIMITATIONS AT <http://www.dbrs.com/about/disclaimer>. ADDITIONAL INFORMATION REGARDING DBRS RATINGS, INCLUDING DEFINITIONS, POLICIES AND METHODOLOGIES, ARE AVAILABLE ON <http://www.dbrs.com>.



Insight beyond the rating.

www.dbrs.com

DBRS, Inc.
140 Broadway
35th Floor
New York, NY 10005
TEL +1 212 806 3277