

Announcement: Moody's updates its key assumptions for rating structured finance CDOs

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New York, December 11, 2008 -- Moody's Investors Service has announced that it has revised and updated the key modeling parameter assumptions it uses to rate and monitor ratings of CDOs backed by structured finance securities ("SF CDOs"). This revision affects the three key parameters in Moody's model for rating SF CDOs: asset correlation, default probability, and recovery rate.

These changes are in response to weak performance of certain structured finance asset classes over the past two years, the limited near-term opportunities for consumers and corporates to refinance debt, and the increasingly negative credit outlook for the global economy.

As a result of the revised assumptions, Moody's anticipates that a large number of existing SF CDO ratings will be downgraded by approximately three notches and will remain on review for possible further downgrade. Ratings of a small number of tranches may be downgraded by more or less than three notches, or not at all, depending on numerous factors, including their vintage, current rating, portfolio composition, and credit enhancement. Moody's expects to complete these rating actions before year-end.

For rating SF CDOs, Moody's currently uses a Gaussian copula model, incorporated in its public CDO rating model CDOROMv2.4, to generate a portfolio loss distribution. The asset correlation, default probability, and recovery rate parameters used in that model have been revised as described below.

Asset Correlations

When rating SF CDOs, Moody's employs a tree framework for asset correlations and assigns each asset into one of the branches on the tree, as described in Moody's Rating Methodology paper, "Moody's Revisits its Assumptions Regarding Structured Finance Default (and Asset) Correlations for CDOs," published on June 27, 2005. While Moody's will continue to use this correlation tree framework, the existing parameters have been revised, resulting in asset correlations that are approximately two to three times higher than their current values.

In light of the systematic seizure in the housing market and the credit markets in general, Moody's has made the following primary changes in asset correlations:

- Increasing the base global and meta sector asset correlations
- Creating a single RMBS category that includes prime, Alt-A, and subprime RMBS securities, which all have experienced substantial credit performance deterioration
- Reducing diversification credit for SF CDOs that have a high concentration in one type of structured finance assets
- Combining the current Commercial Real Estate and Corporate meta sectors into a single meta sector and introducing a real-estate add-on factor to increase the cross-sector correlation between real-estate related assets
- Increasing the penalty for geographic concentration
- Reducing the vintage diversification benefits and allocating vintage concentration penalty to all sector and geography levels
- Assuming higher asset correlation for highly-rated structured finance assets than for lowly-rated assets

Default Probability

Moody's will also now apply resecuritization stress factors to default probability assumptions for structured finance asset collateral underlying both new and existing SF CDO transactions. The resecuritization stress addresses the leveraged rating impact on SF CDOs of changes in their underlying collateral performance and had previously been applied only to new ratings.

Moody's will group the stress factors into two categories depending on the assets underlying the CDO that is being rated. The first category includes US RMBS, EMEA non-conforming RMBS, Manufactured Housing ABS, Franchise Loan ABS, and Mutual Fund Fee ABS. Other underlying assets included in this category are SF CDOs and corporate synthetic CDOs. For securities in this first category, a multiplier of 4 will be applied to the default probability for all rating categories except Aaa, for which a factor of 12 will be applied.

The second category is comprised of asset classes that have historically had more stable performance, such as ABS backed by auto loans, credit card receivables, student loans, EMEA RMBS other than for non-conforming RMBS, CMBS, and CLOs. For this second category, a stress multiplier of 2 will be applied to all rating categories except Aaa, for which a factor of 6 will be applied. Generally speaking, asset classes not mentioned above will be classified in the second category.

For more information about the loss assumptions underlying Moody's ratings on RMBS tranches included in SF CDOs, please refer to a Moody's Special Report, "Subprime RMBS Loss Projection Update: September 2008" and a press release titled "Moody's Updates Loss Expectation on US Jumbo Securitized Mortgage Pools," both published on September 18, 2008, and a press release titled "Moody's revising Alt-A lifetime loss expectations," published on November 17, 2008.

Recovery Rates

Moody's has also revised and updated its recovery rate assumptions for structured finance assets. Moody's original methodology applies a set of fixed recovery rate assumptions that are based on the assets' original rating and tranche size as a percent of the capital structure. Recent data from the credit crisis suggest that very low recovery rates should be expected for some structured finance assets and unstable recovery rates for others. Instead of assuming fixed recovery rates, Moody's will now use a floating recovery rate model based on a beta distribution that has its mean set to the assumed recovery rate level, as specified in Moody's structured finance recovery rate tables. Furthermore, Moody's will

use an asset's current rating instead of its original rating to determine the mean recovery rate.

Updated Public Model

Moody's also announced that it will soon release its updated public CDO rating model CDOROM2.5, along with user guide, which incorporates and explains in detail these new parameters in rating and monitoring ratings of SF CDOs.

Moody's ratings are determined by a committee process that considers both quantitative factors, such as those described above, and qualitative factors. The rating outcome may differ from the model output. This press release updates the modeling parameters in Moody's current SF CDO methodology, which appears in the following publications. The publications can be found at www.moody.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies subdirectory:

"Moody's Approach to Rating Multisector CDOs," published on September 15, 2000

"Moody's Approach To Rating Synthetic Resecuritizations," published on October 29, 2003

"Moody's Revisits its Assumptions Regarding Structured Finance Default (and Asset) Correlations for CDOs," published on June 27, 2005

"Moody's Modeling Approach to Rating Structured Finance Cash Flow CDO Transactions," published on September 26, 2005

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