RESEARCHING SUBPRIME RESIDENTIAL
LOAN SECURITIZATIONS

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As issues around predatory lending have generated an increasing amount of interest in the practices of subprime lenders, there is a corresponding interest in one of the most popular sources of liquidity not only for subprime lenders but for any lender in the market, and that is the practice of asset securitization. Very simply, this is the rather complex process of pooling similar assets and converting a stream of future payments to a present-day cash value, with a corresponding issuance of securities that are sold to investors who provide this cash at the time of securitization.

The key component to the success of a securitization is the legal separation of the loans in a pool from the entity that originated those loans. Without this, the originator – who is often also the servicer – could go into bankruptcy and the loans would be part of the bankruptcy estate, thus collapsing the entire structure of the securitization. Investors would not buy securities collateralized by loans that are not separated from the originator, in terms of ownership, control, and management. Thus the loans are isolated in a trust under the tightly scripted management of a trustee, who acts as a fiduciary for the investors in the trust.

To achieve this separation, loans are always transferred into a trust via a Special Purpose Entity (SPE) established for the sole purpose of "cleansing" the loan pools. After origination, loan pools may pass through a number of separate entities, but a bankruptcy-remote SPE will always be the last entity in the chain of title prior to the pool being sold into a trust.

Where to Learn the Basics
A good place to start is a publication by The Bond Market Association called "An Investor's Guide to Asset-Backed Securities". While there are many good books that address this topic in varying levels of complexity and detail (see the "Resources" section at bottom), this offers a concise description of securitization transactions and the parties involved, and applies to the securitization of assets such as home equity loans and mobile-home loans as well as auto loans and credit card debt, among others. This publication can be found at the following link to The Bond Market Association's website:

http://www.bondmarkets.com/publications/mbspubs.shtml.

For a quick description of SEC filings, go to the SEC's website to obtain a list of corporate filings as well as explanatory text. You can find this at the following link:

http://www.sec.gov/info/edgar/forms/edgform.htm

The following two sections briefly review relevant SEC filings and the parties to a securitization transaction. We will then walk through a recent securitization to see the process in action.

SEC Filings

For asset-backed securities collateralized by home-equity loans, the most commonly used SEC filings for tracking public issuances are:

a) the Prospectus and Prospectus Supplement (form 424B) – typically filed in the name of the Depositor (see next section), which is oftentimes a subsidiary or affiliate of the loan originator, these are the basic documents for investors to evaluate all aspects of a securitization and the parties involved. They contain a great deal of specific information about the loans in the pool, the chain of title of the loans, the underwriting criteria of the lender/purchaser of the loans, the performance of past loans, servicing information, and representations and warranties, among other valuable information.

b) the Pooling and Servicing Agreement (filed on form 8k, generally a few days after the prospectus) **-** this document outlines the legal responsibilities of the trustee, the servicer, and the bond insurer if one is utilized in the transaction, and is filed in the name of the trust or by the Depositor. Sometimes the 8k – which reports material events – containing the Pooling and Servicing Agreement will also include other relevant documents, such as the Underwriting Agreement between the trust and the investment bank selling the securities, the Subsequent Transfer Agreement, or the Trust Indenture.

c) The Annual Report (10k) – required by the SEC within three months after a fiscal year-end, this is a public company's annual report to their shareholders. If any of the parties to a securitization are publicly traded, reviewing the information in this document is essential. Quarterly reports (10q) are also useful, and must be filed within 45 days of the end of each quarter. Sections that are useful here are those dealing with liquidity and capital requirements, portfolio performance, significant acquisitions or dispositions, and exhibits that may contain the full text of loan agreements. Note also that every public company lists their subsidiaries at the end of their annual report.

   Another useful disclosure in either the 10k or the quarterly filing will be ***warehouse loan agreements*** **or** ***repurchase agreements*** entered into by the loan originator; these provide originators with capital to fund loan originations until a specific loan pool is securitized or sold. If the originator you are researching is a publicly-traded company, these agreements are typically disclosed in the Exhibits section of the annual or quarterly report, as are modifications or amendments to the agreements.

Parties to the Transaction

Typical roles of the participants in a securitization are as follows, all of which are spelled out in each respective Prospectus Supplement:

a) **Seller** – Oftentimes the Seller is also the originator of the loans in a given portfolio, but over the past few years there has been a rise in the number of mortgage capital divisions of banks and investment banks that buy loan portfolios from the originator and who are shown as Seller in the respective prospectus filings. This is often the first entity to sell a portfolio of loans to either the Depositor (see next) or the trust.
b) **Depositor** – A bankruptcy-remote Special Purpose Entity (SPE) established for the sole purpose of buying portfolios and selling them into trusts to establish the "true sale"of the loans. The Depositor sells the securities issued by the Trust to investment banks (the Underwriters), and is why you will most often find the Prospectus and Prospectus

Supplement filed with the SEC in the name of the Depositor (see the "Resources" section below for a listing of SPE's and their affiliations).

c) **Trust** – The trust is another Special Purpose Entity whose sole purpose is to hold the loan portfolio described in the associated prospectus. The Trust is also considered the Issuer of the bonds or certificates eventually purchased by investors, but frequently the sponsor of the securitization will be referred to as the issuer.
d) **Trustee** – As the fiduciary representing the bondholders, the trustee is the legal holder of the loans in a trust.
e) **Underwriter** – Simultaneous with a trust's purchase of a loan pool from the Depositor, the trust issues bonds or certificates to the Depositor representing ownership interests in the trust; the Depositor has an agreement to sell these securities to the Underwriters, who are investment banks that will then re-sell the securities to investors. The dollar allocation of each underwriter's share of securities is spelled out in the Prospectus Supplement.
f) **Servicer** – Oftentimes the loan servicer is also the originator, but in the past few years the use of sub-servicers or specialty servicers has become commonplace. Popular specialty servicers include Ocwen Federal Bank, Litton Loan Servicing, and Fairbanks Capital Corporation. Among lenders, Option One and Countrywide are doing more sub-servicing on behalf of trusts or other lenders.
g) **Certificate or Bond Insurer** – Many loan originators do not have the credit rating or financial capacity that would automatically garner a high credit rating, and therefore their pools of loans need credit enhancement. This often comes in the form of a surety bond by bond insurers such as MBIA, Ambac Assurance, Financial Security Assurance, or Financial Guaranty Insurance Corporation, and lowers the cost of the securitization and the return demanded by investors in the bonds or certificates being offered.
h) **Rating Agencies** – Before an asset-backed issuance is priced, the structure of the deal and the participants are reviewed by credit rating agencies Standard and Poor's, Moody's, or Fitch IBCA to assess the relative level of risk posed by for investors. This assessment is carried out according to each rating agency's guidelines for the specific type of transaction under consideration. Standard and Poor's has their rating criteria for subprime mortgage transactions available at their website under the "Structured Finance" section (see "Resources" below).

Practical Applications

So how do you put this knowledge into practice? Assume someone asks you to find out if Household Finance is securitizing their loans, and if so, which Household entities are involved. Following would be a basic analysis to answer these questions:

I. Does Household Finance securitize their loans:

a) Go to http://www.10kwizard.com and do a keyword search on the phrase "Household Finance" in the 'Word Search' section, then under 'Form' section specify a search on Form 424B5 filings. You can also tailor the date range of your search if necessary.
b) The most recent 424B5 mentioning Household Finance was filed January 9, 2003 by Household Finance, Inc. Use this information to obtain the full-text document for free on the SEC EDGAR database: http://www.sec.gov/edgar/searchedgar/companysearch.html .
c) At the EDGAR search site, enter "Household Finance" in the 'Company Name' box, then click on "Household Finance" at the following screen; the next screen will give a list of filings by this particular entity. Look for the 424B5 filed January 9, 2003 in this list of filings.

d) If you are interested in knowing what other entities securitize loans originated by Household Finance, refer back to the results page on 10kwizard.com. The second most recent 424B5 filing was by GS Mortgage Securities Corp on December 27, 2002. Follow the steps outlined in "b" and "c" above, only enter GS Mortgage Securities in the EDGAR search box for the filing. This will take you to a prospectus supplement outlining a $295m securitization of loans originated by Household Finance and subsequently purchased for securitization by an affiliate of Goldman, Sachs & Co., who is the sole underwriter of the issuance.

II. What is the profile of the loans included in the securitization and which Household entities are involved?

a) A prospectus supplement and prospectus are meant to give investors all the information they need to make an informed decision about whether to buy the securities in question. Thus the index to the prospectus supplement is your roadmap to every securitization transaction (the prospectus is a more generic form and the supplement applies to specific pools).

b) In every prospectus supplement there is a section describing in tabular form the loan pool being securitized, including a breakdown of loans by fixed vs. adjustable, by state, by interest rate, by loan balance, first vs. second lien, prepayment penalty periods (if any), and FICO score distribution, among others descriptive categories.

III. Who are the parties involved in the GS Mortgage Securities pool?

a) Issuer/Trust Name – GSAMP Trust 2002-HE2
b) Originators – various Household affiliates, which in turn purchased the loans from Household's correspondent lenders
c) Depositor – GS Mortgage Securities Corporation
d) Underwriter – Goldman, Sachs & Co.
e) Trustee – Deutsche Bank National Trust Company
f) Servicer – Litton Loan Servicing LP
g) Bond Insurer – Ambac Assurance Corporation

The loans included in this pool were thus originated by (typically) smaller lenders around the country who have loan sale agreements with Household Finance, which bought the loans after they were closed and funded by the smaller originators in their own name. Once the loan pool was aggregated, Household Finance sold the pool to Goldman, Sachs affiliate GS Mortgage Securities, which in turn sold the pool to the trust administered by Deutsche Bank National Trust Company.

Resources

1) Investment banks and their affiliated Special Purpose Entities (SPE's) that are commonly utilized as Depositor of loans into home equity-backed trusts:
   - Bank of America Securities - *Asset-Backed Funding Corporation*
   - Bear Stearns - *Bear Stearns Asset Backed Corporation*
     Structured Asset Mortgage Corporation
   - Credit Suisse First Boston - *Asset-Backed Securities Corporation*
   - Deutsche Bank - *Ace Securities Corporation*
   - Goldman, Sachs - *GS Mortgage Securities Corporation*

- ➢ Greenwich Capital - *Financial Asset Securities Corporation*
- ➢ Lehman Brothers - *Lehman ABS Corporation*
  Structured Asset Securities Corporation
- ➢ Merrill Lynch - *Merrill Lynch Mortgage Investors, Inc.*
- ➢ Morgan Stanley - *Morgan Stanley Dean Witter Capital, Inc.*
  Morgan Stanley ABS Capital, Inc.
- ➢ Salomon Smith Barney - *Salomon Smith Barney Mortgage Securities*
  Salomon Brothers Mortgage Securities VII, Inc.
- ➢ Wachovia Securities - *Residential Asset Funding Corporation*

2) To obtain corporate filings with the Securities and Exchange Commission (SEC):

   http://www.sec.gov/edgar/searchedgar/companysearch.html

   http://www.edgaronline.com

   http://www.10kwizard.com - this is a great site for quick key-word searches, but requires registration and fee-based document retrieval and organization. It's just as easy to get the documents themselves from EDGAR once you have found where to look.

4) For specific information regarding asset-backed securities:

   http://www.absnet.net - great site for staying abreast of asset-backed securitization information. Must register and the premium service is fee-based, but the free information gives a good map of what's happening in all sectors of the ABS industry.

   http://www.bondmarkets.com - home page of The Bond Market Association. For a good primer on asset securitization, open their publication called "Asset-Backed Securities" (see link under "Where to Learn the Basics" above.) For an informative look at this issue from the industry's viewpoint, this site also provides copies of letters from TBMA to New York State regulators concerning proposed predatory lending standards for the secondary market at the following link under the heading "Subprime and Predatory Lending": http://www.bondmarkets.com/regulatory/mbs.shtml.

   http://www.standardandpoors.com - for asset-backed securitization information, go to the "Structured Finance" sections. Included are reviews of servicers as well as quarterly updates on new securitizations that give summaries of average FICO scores, LTVs, and type of loan, i.e. fixed vs. adjustable. S&P also publishes their criteria when reviewing subprime securitizations on this site.

   http://www.moodys.com - gives some basic information for free, but must subscribe for more extensive data and reports.

   http://www.fitchibca.com - like Moody's, must be a subscriber for anything beyond very basic information.

   There are good texts available on these topics as well that are typically available in university bookstores:

   a) Asset-Backed Securities (1996), Arnand K. Battacharya and Frank Fabozzi (editors)
   b) Issuer Perspectives on Securitization (1999), Frank Fabozzi (editor)

5) To research debtor/creditor relationships, Uniform Commercial Code (UCC) filings with each state's respective Secretary of State provides a glimpse into who is financing whom. The best (free) place to do this is each state's respective Secretary of State website, and there is no better open-records policy than that of Florida. If you are interested in companies that happen to do business in Florida, this website is http://www.sunbiz.org. A listing of all Secretaries of State can be found at the website of the National Association of Secretaries of State: http://www.nass.org/sos/sos.html .

   For a quick nationwide search, use a database provider such as Westlaw or Lexis. This can be especially useful because each successive purchaser of a loan pool in a securitization transaction files a UCC-1 (financing statement) showing the seller of the loans as a debtor and the purchaser as a secured party. Thus each respective trust will file a UCC-1 showing the Depositor as a debtor and the trust as a secured party, and the Depositor will file a UCC-1 showing the Seller as a debtor and the Depositor as a secured party.

   UCC filings are also helpful when assessing what sources of capital lenders are utilizing for their loan originations. While a UCC-1 and its attachments do not usually include loan documents or loan information, they can tell you what financial relationships exist and are particularly useful for researching private companies that do not file with the SEC.