NEW BANKING INDUSTRY INDEX SHOWS IMPROVEMENT… IS YOUR PORTFOLIO READY FOR THE RIDE?

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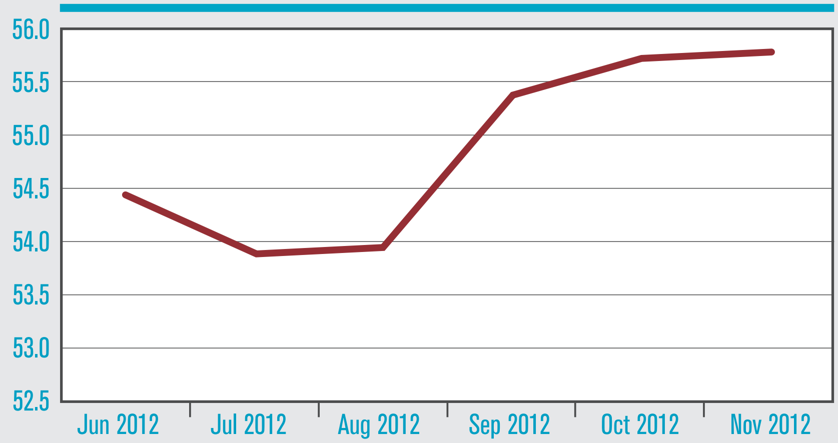
In July 2012, in partnership with VantageScore Solutions, *American Banker*, the leading information resource serving the banking and financial services community since 1836, launched the Index of Banking Activity.

Compiled from surveys of executives at hundreds of financial institutions across the U.S., the Index is an industry bellwether that tracks 16 distinct business indicators, such as volume of deposits, loan applications and loan delinquencies, and how they change month over month. Measurements of each of these components are combined into a single Composite Index, in which readings above 50 indicate business expansion, and those below 50 signal contraction. To learn more about the Index and its component measurements, read articles about the Index of Banking Activity on VantageScore.com.

FIGURE 1
INDEX OF BANKING ACTIVITY COMPOSITE INDEX



Source: American Banker and VantageScore Solutions

With the Index less than a year old, it's too early to analyze it for patterns such as seasonality or correlations with larger economic trends. Nevertheless, Figure 1 shows an interesting and encouraging upward climb.

What does this have to do with secondary market participants and portfolios of securitized or whole loans? Hint: It has to do with a new tracking tool now available to secondary market participants. Technology now allows a borrower's credit score performance and other risk indicators to be obtained and tied to the specific loan within a mortgage portfolio throughout the loan's lifecycle. Beyond a borrower's credit score, investors are now able to use such risk factors as collateral values, status and level of other debt obligations, and service providers also are delivering cash flow and deal structure intelligence.

For example Equifax, one of the national credit reporting companies, as part of its ABS Credit Risk Insight suite of solutions including Credit Risk Insight Pre-Bid, Post-Bid and Surveillance, provides investors with up-to-date VantageScore® credit scores as a leading indicator of mortgage default and as a tool for improved risk management.

TransUnion, one of the other national credit reporting companies, and CoreLogic® have anonymously matched Consumer Risk Indicators, including VantageScore credit scores, with a high degree of quality to the LoanPerformance Securities Database, which is the mortgage industry's largest repository of non-agency mortgage-backed securities (MBS) and

FIGURE 2
A SIMPLE VALUE PROPOSITION: UNDERLYING BORROWER CREDIT CAN MAKE TWO "SIMILAR" MORTGAGES PERFORM DIFFERENTLY.

BORROWER A		BORROWER B	
House A current value:	$180,000	House B current value:	$180,000
Outstanding mortgage amount:	$150,000	Outstanding mortgage amount:	$150,000
Origination credit score:	700	Origination credit score:	700
Updated credit score*:	620	Updated credit score*:	730
Other mortgage debt* (e.g., silent seconds & HELOCs):	$100,000	Other mortgage debt* (e.g., silent seconds & HELOCs):	None
Available non-mortgage credit*:	$60,000	Available non-mortgage credit*:	$80,000
Utilized non-mortgage credit*:	$50,000	Utilized non-mortgage credit*:	$10,000
Currently delinquent on non-mortgage debt*:	Yes	Currently delinquent on non-mortgage debt*:	No

*Additional Insight gained from Consumer Risk Indicators

Source: TransUnion

asset-backed securities (ABS) data.

These solutions facilitate greater transparency among securitized loan portfolios, and more powerful risk management processes. The availability of loan-level tracking of credit score and risk fluctuation enables secondary market investors to measure, leverage and properly price mortgage-backed securities as default risk moves up and down. Post origination, the value of RMBS securities are now much better understood, representing a significant breakthrough for investors.

More specifically, the benefits to this breakthrough include the ability to benchmark deals, monitor changes in collateral and borrower health, and even determine the impact of strategic defaults. Consider Figure 2, which demonstrates how risk can change dramatically post origination. Pay particular attention to the borrowers' credit scores.

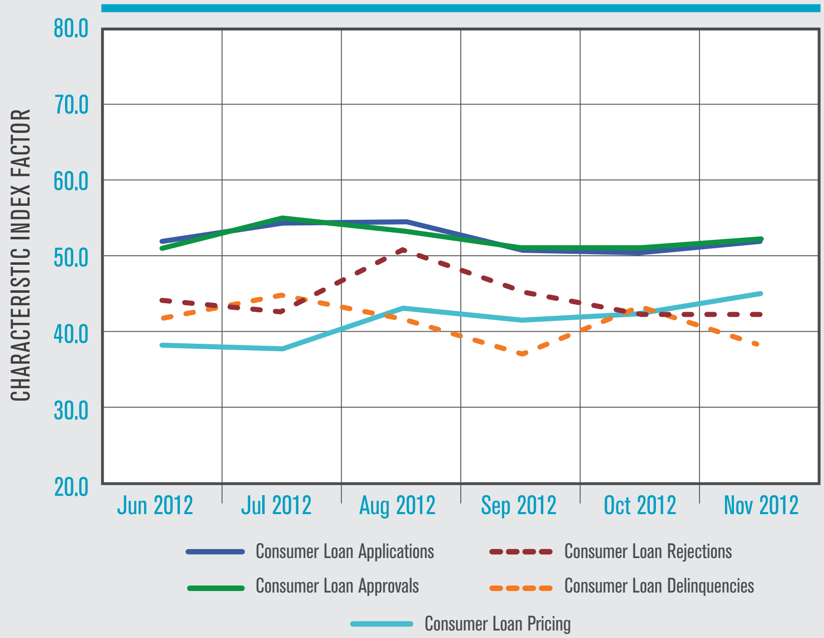
Of course…there is a caveat.

A credit score model used should be validated on an annual basis to ensure that its predictiveness hasn't deteriorated as a result of changes in the economy, such as those reflected in the Index. The VantageScore model differs from other credit scoring models in that it is validated annually—and the results are made public.[1] The VantageScore model is also the leading model used in the valuation of previously issued private label mortgage-backed securities.

As overall systemic risk increases or decreases, default probabilities for each credit score value can change. In fact, default rates at all score intervals rose dramatically as the economic crisis hit. As the economy improves, the probability of default associated with a particular credit score value decreases as we're now seeing in many sectors, including the mortgage market.

These improvements also are apparent within the characteristics that make up the Index of Banking Activity. Figure 3 illustrates how a number of consumer-credit characteristics from the Index trended over the past six months.

FIGURE 3
INDEX OF BANKING ACTIVITY: CONSUMER CREDIT CHARACTERISTICS



Solid lines represent positive market characteristics, for which higher values indicate improvement in the banking sector (e.g., loan applications). Dashed lines represent negative characteristics, for which values decrease as market conditions improve in the banking sector (e.g., loan rejections). Note that the positive consumer indicators were all trending (slightly) upward for the last Index reporting period, while negative indicators were trending more decidedly downward.

From an investor's standpoint, this is good news—particularly as uncertainty in the regulatory climate is expected to become clearer. These conditions are supporting early signs that the non-agency market for new issuance is beginning to show life and the availability of loan level data, previously unavailable, adds new dimension to understanding the underlying value of a security after issuance.

New insight into loan-level data may have a profound impact on the securitization market, but it is not a panacea. Understanding the borrower behaviors that underlie credit scores is essential when utilizing this new technique.

The sentiment among investors is that purchasing a non-agency security, based on what limited information is available in the prospectus, is over. Indeed, with greater understanding of loan-level risk, many of the misfortunes of the past can be avoided on the downside and many investment opportunities can be reaped on the upside because the market now can avail itself of early indication.

More information about the VantageScore model is available at www.VantageScore.com.

Information and studies that leverage the VantageScore model for secondary market participants and investors in RMBS are available on both the Equifax and TransUnion websites.

[1] Validation results broken down into industry sectors including Auto Finance, Credit Card, and Mortgage are available at *www.vantagescore.com/research*.