S&P Ratings on US Subprime Mortgage and Related Securities: Key Facts

1. Market valuations vs defaults

Recent events in global debt markets have been characterized by a broad reassessment and repricing of credit risk by investors, not by an upsurge in defaults "Investors are Finally Remembering What 'Risk' Means", 24 August 2007. A Standard & Poor's credit rating is an opinion about the probability of a security or debt issuer defaulting. It is not a form of investment advice and does not address the market valuation of a bond. Between July 1 and August 24, 2007, S&P received reports of only three defaults from approximately 15,000 current first lien subprime mortgage tranches rated by S&P globally.

2. S&P actions on subprime since 2005

Standard & Poor's has been expressing its concerns about the weakened subprime bond market over the last two years and has been taking action over this period, including adjusting its criteria and assumptions, downgrading ratings when appropriate, and publicly commenting on the risks associated with these securities.

As early as April 2005, we communicated our concerns to the market about new "affordability" mortgage products. In mid-2006, after identifying a number of issues related to the performance of subprime loans, we changed our assumptions about future losses and required an increase in credit support for subprime mortgage bond ratings issued from July 2006.

We issued a number of rating actions on subprime mortgage securities in the months preceding our announcement, in July 2007, of a wider set of actions on our subprime ratings.

3. Timing of S&P recent subprime rating actions

Our opinions are based on facts, not market sentiment:

- We took the decision to downgrade a number of late 2005 and 2006 US subprime mortgage securities in July 2007, because at that date these transactions were sufficiently seasoned to provide us with evidence about delinquency, default and loss trends that indicated weak future credit performance.

- Current losses on subprime mortgage pools backing these securities are low by historical standards (0.3% as of July 2007), but Standard & Poor's – on the basis of performance data now emerging on these pools – is anticipating that ultimate losses will increase substantially. That is why we have taken action now to adjust our rating opinions, ahead of a significant rise in losses on the underlying mortgages.

4. Extent of S&P recent subprime rating actions

Our rating actions to date affect a small part of the market for mortgage-backed securities and CDOs:

Our July 2007 downgrades affect around 1% (by value) of the US subprime first lien mortgage tranches we rate:

- 85% of the ratings downgraded were BBB and below (ie, the weakest quality subprime securities)
- no AAA ratings on these securities were downgraded
- between July 1 and August 24, 2007, S&P received reports of only three defaults from approximately 15,000 current first lien subprime mortgage tranches rated by S&P globally (two of the defaulted tranches were issued in 2002, the other was issued in 2004).

In July and August 2007 we also downgraded ratings on 6% of mortgage securities backed by closed-end second lien loans, and 0.2% of Alt A mortgage securities.

Our subsequent review of CDOs with exposure to the mortgage securities we downgraded has resulted, to date, in 173 securities being downgraded – representing less than 1% (by value) of Standard & Poor's rated US CDO notes outstanding:

- 23 of these ratings were downgraded from AAA (and of these, 17 were lowered by one notch), out of a total of around 4,500 US CDO tranches publicly rated AAA by S&P

5. Performance of ratings

Ratings should be judged on their record of assessing probability of default (which they specifically address), not the market value of securities (which they explicitly do not address).

The track record of our structured finance ratings as assessments of default risk remains excellent:

- Since 1978, the average five-year default rate for investment grade structured securities is less than 1%; for speculative grade securities it is over 15%.

- The average one-year default rates since 1978 were near zero (0.04%) for investment grade securities and 2.33% for speculative grade securities.

- By comparison, the issuer-weighted five year default rates for investment grade corporate issues is 1.3% and 20.5% for speculative grade issuers.

Standard & Poor’s ratings on corporate and structured securities are comparable at each rating level in terms of default probability (which is what our ratings address and which is demonstrated by our default studies). However, they may have very different market characteristics (liquidity, volatility etc), which are not addressed by our ratings.