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Non-Agency MBS Strategy | Special Report

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Non-Agency MBS Loan Repurchases:
Practical Considerations

Earlier this month, a law firm, Gibbs & Bruns LLP, announced that its clients had issued instructions to the trustee of approximately $26 billion of Countrywide non-Agency residential mortgage-backed securities to investigate, and potentially demand repayment of, ineligible mortgages in the pools backing the transactions. According to media reports, the trustee indicated that it does not intend to follow the instructions for a variety of technical reasons. Yet the potential impact of forced repurchases of mortgages that violated representations and warranties has attracted the focus of an increasing number of market participants. In this brief report, we look at some of the significant and perhaps insurmountable practical challenges faced by investors in putting a meaningful number of loans back to a seller. Our analysis is based on the Gibbs & Bruns announcement.

Excluding two private transactions, more than 229,000 loans ($50.3 billion) were sold into 55 deals, subject to the Gibbs & Bruns announcement. Of these loans, 43,380 ($12.1 billion) are currently delinquent, and 34,788 have already paid off with a loss (See Figure 1 or Appendix A for transaction-level summary)[1]. We will assume that these two groups are the population most likely to be examined for material adverse breaches of representations and warranties. We will also assume any such examination would include the following steps: obtaining all origination, credit and servicing files; re-underwriting the loans; causing the related trustee(s) to send notices to the sellers for repurchases or consideration; allowing cure periods for loans still outstanding; receiving rebuttals; and ultimately seeing repurchases of some percentage of the identified loans. We believe that the entire process would take at least two years and could potentially take much longer. We estimate that without litigation, the cost could range from $24 million to $88 million, and with litigation could be substantially higher. Of course more generally, given these hurdles, investors' objectives may be to achieve some sort of negotiated settlement in a shorter period of time.

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[1] Special thanks to Scott Gimpel and Charles Shuey for their contribution to this analysis.

Figure 1: Status Summary Of Loans Securing 55 Transactions

	Number of Loans	$ Amount (bln)
Total Issued	229,385	50.3
a. Total Outstanding	118,671	26.2
b. Delinquent Loans [1]	43,380	12.1
c. Current Loans	75,291	14.1
d. Total Amount Paid Off	110,714	24.1
e. Paid Off With Loss Reported	34,788	6.8
Delinquent or Paid Off with Loss (b + e)	**78,168**	**18.9**

[1] 30-day or worse using OTS

Source: RBS, LoanPerformance, Gibbs & Bruns LLP

Figure 2 shows our cost estimates by individual step, which we describe in more detail below:

Figure 2: Estimated Time & Cost of Claims Process (assume 78,200 loans)

	Time (mos)	Cost ($millions)
1. Origination/Servicing File Obtained	6-9	4-8
2. Loan re-underwritten	16-18	20-80
4. PSA Cure Period For Outstanding Loans	3	---
5. Rebuttal or Repurchase	0 to no limit	0 to no limit
Total	**25 - no limit**	**$24-88 low-end, no limit high-end**

Source: RBS

1 **Origination/Servicing File Retrieval:**

- To re-underwrite the loans, investors must receive copies of the origination documents. Absent of specific contractual requirements, servicers are likely to resist a request to copy and deliver large numbers of loan files even when such requests are received from trustees in their capacity as owners of the loans. Assuming some accommodation is reached, investors would need to execute appropriate confidentiality agreements, a process that could take days, weeks, or months, depending on the motivation and incentives involved. Servicers may require reimbursement for the upfront costs of copying and delivery.

- Assuming that investors are able to convince trustees and servicers to send the required documents, the next challenge would be to securely transfer and store files with confidential consumer information. Unless such files can be delivered electronically, tens of thousands of loan files would likely require several thousand boxes, creating a massive logistical shipping exercise. Securely storing the information would pose substantial difficulties, particularly if the claims process were outsourced to expert third-parties with limited storage space.

- To the extent that these hurdles are passed, we estimate that the time involved for this step would conservatively be six to nine months. A low-end estimate of $50-100 to process, ship and securely store each set of loan files would put the total cost in the range of $4 million - $8 million.

2 **Loan Re-underwriting**

- A review would typically be done to compare each loan file against applicable underwriting guidelines, screen for compliance issues, and assess the validity of the appraisal (which might entail obtaining historical valuations or field reviews that try to estimate or validate actual value at origination). The file would be examined for compliance with any and all applicable representations and warranties (e.g., to ensure that the loan was covered by required insurance policies, the lien position is proper, and the occupancy status was correct). The representation and warranty most frequently cited as a basis for repurchase request relates to the absence of fraud in the origination and underwriting of the loans.

- Depending on the scope of the review, supplemental tools might be required to determine whether additional debt held by the borrower at the time of origination was disclosed on the application, to examine the servicing system's collections and payment histories, and to compare average compensation levels for certain professions in order to validate disclosed income on stated income loans.

- The goal of the review would be to identify ***material adverse*** breaches. Since there is no bright line definition of materiality, there may be relatively little incentive for the parties to reach agreement .

- Industry sources estimate that one person can complete around four re-underwriting applications per day, or 20 applications per week. Therefore if we assume a re-underwriting staff of 50 people, 78,200 applications would take at least 78 weeks or 18 months to complete. The task could be completed more quickly with more staff, but expertise in the space of re-underwriting loans is limited. Expert third parties may be reluctant to accept this type of project, wishing not to offend servicers and banks that may be their customers in other businesses that they conduct.

- The cost of re-underwriting one loan might range from $250 to $1000 or more, implying that re-underwriting 78,200 loans could cost at least $20 million - $80 million. This cost would typically be borne by the investors bringing the claims. They may only be able to recoup these costs from the seller if the claims are successful.

3 **Repurchase Notice Sent:** For every material breach identified, a notice would be sent to the securitization parties describing the loan and the breach (including documentation). Under most pooling and servicing agreements, the seller/issuer is only required to act upon repurchase requests received from the trustee or master servicer.

4 **PSA Cure Period:** Once notified, for loans still outstanding, the seller would typically have from 60 to 120 days (dependent on PSA language) during which rebuttal can be issued or the loan cured or repurchased. If the loan has already been paid off at a loss, it would not be uncommon for investors to seek compensation for that loss, though the seller may raise objections by claiming they had no time to cure the deficiency or repurchase the loan.

5 **Rebuttal or Repurchase Occurs:** There are no specific pooling and servicing timelines in play once a rebuttal is issued. As such, the process can go back and forth interminably. Time and cost are therefore difficult to estimate in this period, as litigation may or may not take place. Sometimes the eventual solution seen in the non-agency sector is a negotiated dollar settlement among the parties rather than loan buybacks (with requirement that the investors or trustee/master servicer rescind the applicable repurchase requests).

Appendix A: Status Summary of Loans By Transaction

		Number of Loans Outstanding			Number of Loans Paid Off		Delinq Outstanding Or Paid Off With Loss			
Transaction [1]	Total at Issuance	a. Total	b. Delinq Loans [2]	c. Current Loans	d. Total	e. Paid Off with Loss	Total number (b + e)	Unit % of Issuance	Amount ($mln)	Dollar % of Issuance
CWALT 2005-20CB	6,544	3,656	490	3,166	2,888	150	**640**	10%	118	10%
CWALT 2005-21CB	4,222	2,325	306	2,019	1,897	89	**395**	9%	70	10%
CWALT 2005-41	2,040	568	300	268	1,472	190	**490**	24%	191	24%
CWALT 2005-56	6,596	2,768	1,361	1,407	3,828	825	**2,186**	33%	886	34%
CWALT 2005-74T1	572	379	109	270	193	35	**144**	25%	83	22%
CWALT 2005-81	2,608	1,415	698	717	1,193	336	**1,034**	40%	407	43%
CWALT 2005-AR1	3,479	962	523	439	2,517	781	**1,304**	37%	322	42%
CWALT 2005-J9	915	436	71	365	479	35	**106**	12%	27	10%
CWALT 2006-20CB	2,739	1,445	479	966	1,294	328	**807**	29%	180	32%
CWALT 2006-41CB	5,135	3,495	768	2,727	1,640	227	**995**	19%	248	22%
CWALT 2006-HY12	1,962	1,209	417	792	753	221	**638**	33%	248	31%
CWALT 2006-J7	901	548	259	289	353	103	**362**	40%	152	43%
CWALT 2006-OA11	3,056	1,695	987	708	1,361	418	**1,405**	46%	620	50%
CWALT 2006-OA16	3,127	1,818	1,033	785	1,309	474	**1,507**	48%	685	51%
CWALT 2006-OA17	4,019	2,419	1,353	1,066	1,600	593	**1,946**	48%	835	52%
CWALT 2006-OA19	3,245	2,021	1,191	830	1,224	433	**1,624**	50%	644	53%
CWALT 2006-OC1	5,456	2,105	912	1,193	3,352	1,102	**2,014**	37%	482	40%
CWALT 2006-OC2	3,432	1,032	636	396	2,400	883	**1,519**	44%	382	46%
CWALT 2006-OC4	2,318	915	510	405	1,403	611	**1,121**	48%	285	50%
CWALT 2006-OC6	2,433	1,103	654	449	1,330	658	**1,312**	54%	343	55%
CWALT 2006-OC8	6,927	3,628	1,950	1,678	3,299	1,489	**3,439**	50%	894	51%
CWALT 2007-17CB	3,090	2,408	387	2,021	682	78	**465**	15%	126	17%
CWALT 2007-23CB	4,815	3,340	768	2,572	1,475	185	**953**	20%	236	23%
CWALT 2007-24	893	565	287	278	328	171	**458**	51%	271	49%
CWALT 2007-5CB	7,174	5,129	1,312	3,817	2,045	447	**1,759**	25%	428	27%
CWALT 2007-OA7	1,847	1,202	644	558	645	281	**925**	50%	420	54%
CWHL 2004-22	1,245	377	85	292	868	32	**117**	9%	58	9%
CWHL 2004-HYB9	1,561	507	115	392	1,054	49	**164**	11%	72	10%
CWHL 2005-14	358	216	28	188	142	7	**35**	10%	21	10%
CWHL 2005-18	767	530	68	462	237	18	**86**	11%	44	11%
CWHL 2005-2	3,759	902	368	534	2,857	157	**525**	14%	190	15%
CWHL 2005-HYB9	3,042	1,544	484	1,060	1,498	307	**791**	26%	276	24%
CWHL 2006-3	2,723	1,044	651	393	1,679	358	**1,009**	37%	402	38%
CWHL 2006-HYB2	1,728	900	320	580	828	222	**542**	31%	201	30%
CWHL 2006-HYB5	998	523	230	293	475	159	**389**	39%	199	37%
CWHL 2006-J2	316	189	33	156	127	10	**43**	14%	22	13%
CWHL 2006-OA5	3,337	1,515	878	637	1,822	448	**1,326**	40%	570	42%
CWHL 2007-12	666	513	46	467	153	8	**54**	8%	30	7%
CWHL 08-3R [1]	920	648	97	551	272	20	**117**	13%	68	12%
CWHL 2007-16	1,296	849	140	709	447	44	**184**	14%	99	13%
CWL 2005-AB5	2,845	1,259	722	537	1,586	539	**1,261**	44%	327	47%
CWL 2005-IM3	3,869	982	658	324	2,887	895	**1,553**	40%	451	41%
CWL 2006-16	2,187	1,168	714	454	1,019	340	**1,054**	48%	249	50%
CWL 2006-21	5,525	3,379	2,079	1,300	2,146	799	**2,878**	52%	624	57%
CWL 2006-25	7,651	4,932	3,058	1,874	2,719	1,013	**4,071**	53%	893	58%
CWL 2006-26	5,935	3,889	2,316	1,573	2,046	727	**3,043**	51%	663	55%
CWL 2006-8	11,268	5,694	3,442	2,252	5,574	1,855	**5,297**	47%	970	49%
CWL 2006-9	2,890	1,332	667	665	1,558	617	**1,284**	44%	281	47%
CWL 2006-ABC1	1,596	637	445	192	959	347	**792**	50%	218	55%
CWL 2006-S10	33,161	16,804	818	15,986	16,357	4,214	**5,032**	15%	303	19%
CWL 2006-SPS2	11,490	2,214	405	1,809	9,276	6,063	**6,468**	56%	303	61%
CWL 2007-5	5,592	3,810	2,473	1,337	1,782	692	**3,165**	57%	737	61%
CWL 2007-7	5,893	3,963	2,228	1,735	1,930	792	**3,020**	51%	599	54%
CWL 2007-BC1	2,522	1,513	852	661	1,009	314	**1,166**	46%	277	55%
CWL 2007-S3	14,700	8,252	555	7,697	6,448	2,599	**3,154**	21%	180	26%
Total	**229,385**	**118,671**	**43,380**	**75,291**	**110,715**	**34,788**	**78,168**	**34%**	**18,912**	**38%**

[1] Performance data for CWHL 07-13, backing the CWHL 08-3R re-remic, was used in analysis. CWALT 06-37R & CWHL 06-R2 were excluded.

[2]) 30-day or more delinq, OTS status

Source: RBS, LoanPerformance, Gibbs & Bruns LLP

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