



**Where are we
now, and how did
we get here?**

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Managing Director, Clayton



Where we are now

- The market is seized
- Non-conforming securitizations are down 82% from December 2006 to August 2007
- Risk is no longer predictable and mis-priced
- Non-conforming MBS mark to market: a “falling knife”
- Rating agencies, lenders and vendors testifying before Congress and the New York Attorney General



How did we get here?

- We all got complacent
- Models are only as good as the assumptions we use
- Layered risks were ignored
- We're shocked — *shocked* — to learn borrowers and brokers don't always tell the truth
- Securities were purchased based on the ratings
- Distance from borrower to investor grew, then disconnected



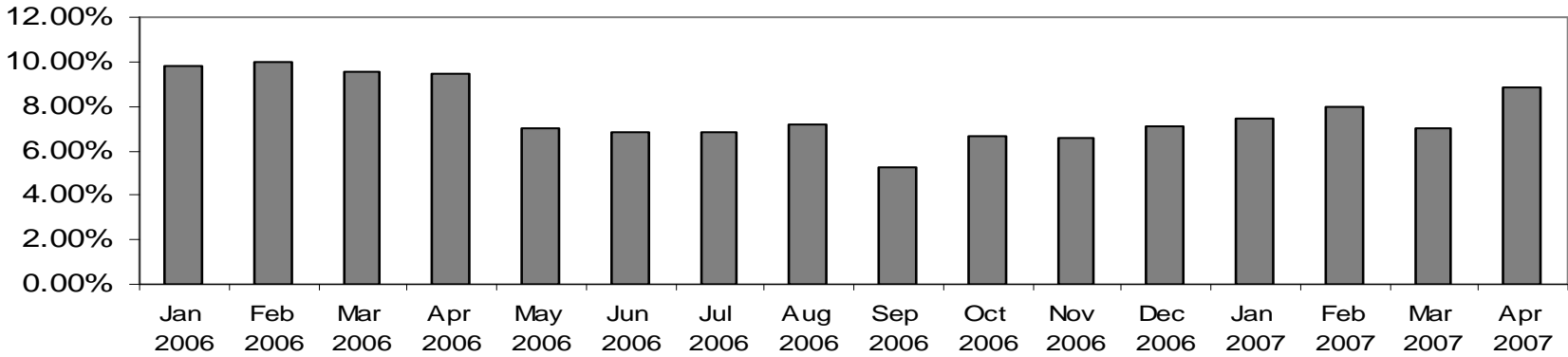
Near-Term Challenges

It's not over yet...

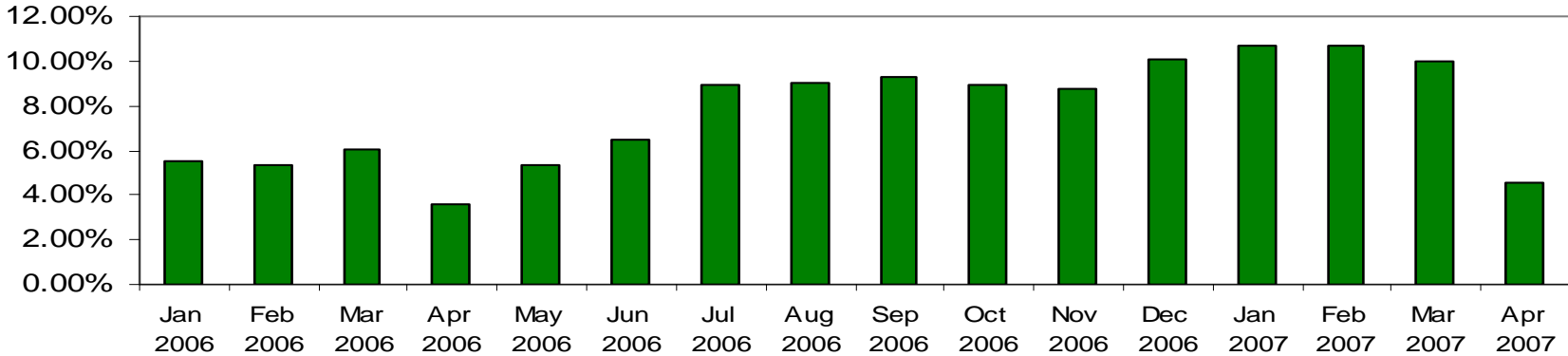
- **Quality of loans still an issue**

No Significant Change in Loan Quality

% of Subprime Originations with FICO≤600, Low or No Doc, ARM



% of Alt-A Originations with FICO≤650, Low or No Doc, ARM



Source: Clayton

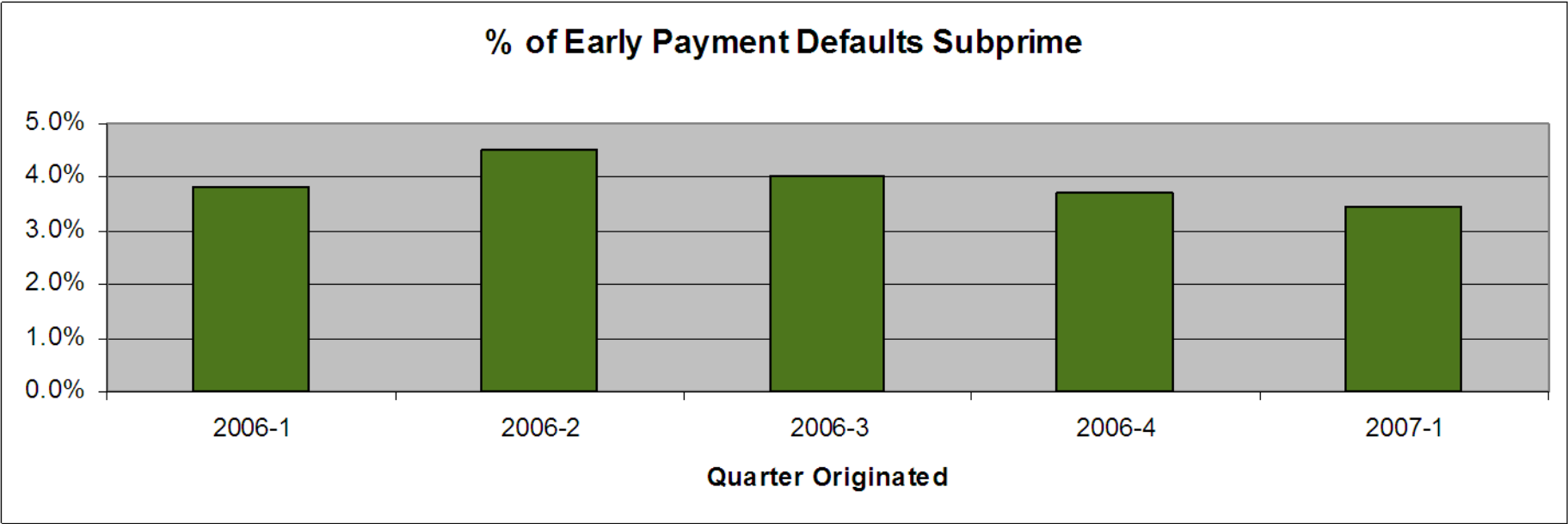


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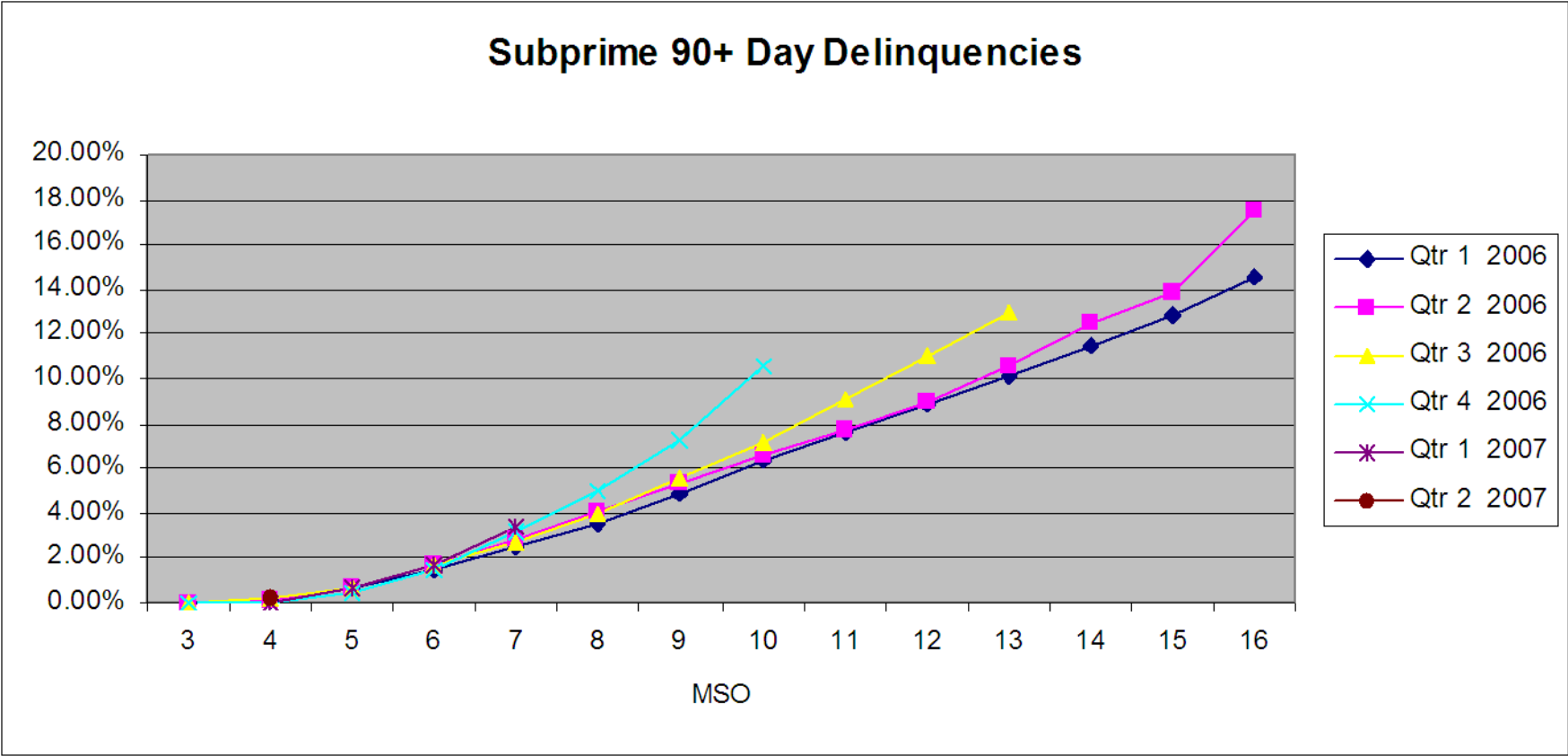
- Quality of loans still an issue
- **2007 Subprime MBS looks just like 2006**

2007 Subprime looks just like 2006



Source: Clayton

2007 Subprime looks just like 2006



Source: Clayton



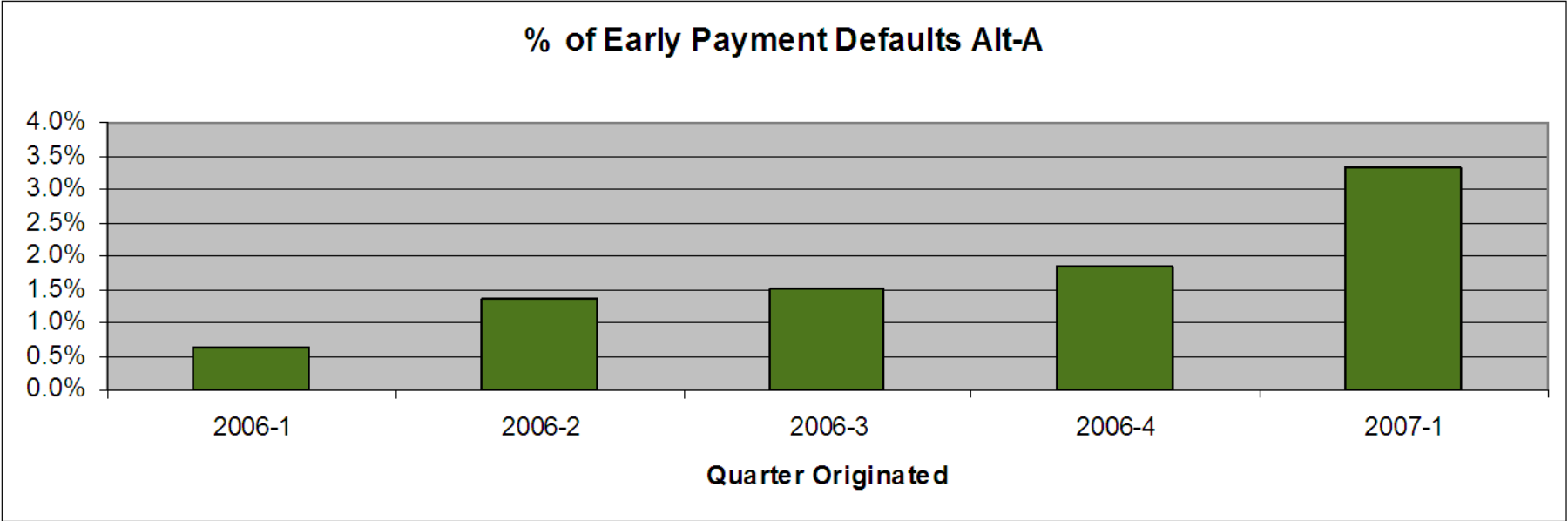
Near-Term Challenges

It's not over yet...

- Quality of loans still an issue
- 2007 Subprime MBS looks just like 2006
- **2007 Alt-A performing worse than 2006**

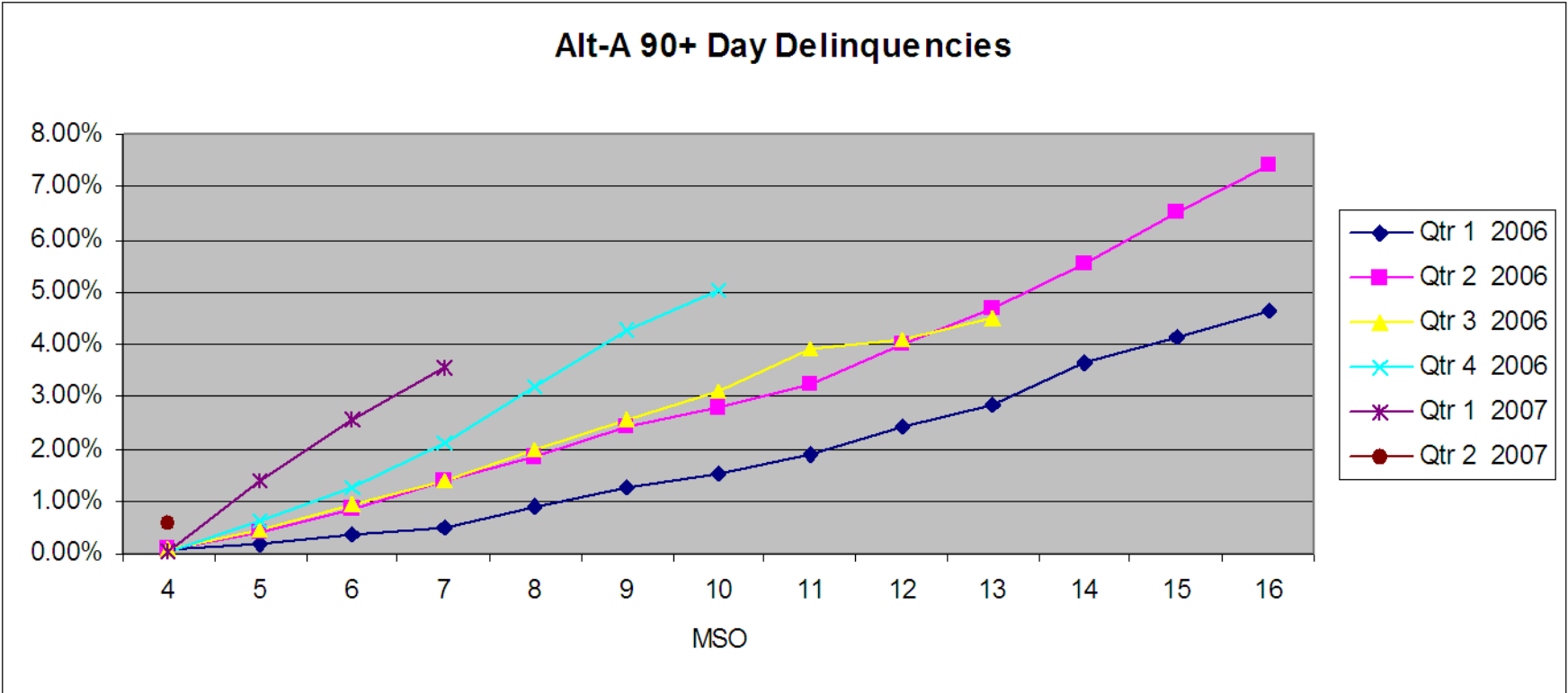
2007 Alt-A worse than 2006

% of Early Payment Defaults Alt-A



Source: Clayton

2007 Alt-A worse than 2006



Source: Clayton



Near-Term Challenges

It's not over yet...

- Quality of loans still an issue
- 2007 Subprime MBS looks just like 2006
- 2007 Alt-A performing worse than 2006
- **ARM resets are the next hurdle**



Resets: The Next Hurdle

- 40% of the Subprime ARMS that Clayton monitors will reset between now and 2Q08
- 16% of those are already 60+ days delinquent

Our experience? Four months after reset, the 60+ delinquent loans...

- 10% of loans liquidate at a loss
- 65% remain 60+ days delinquent
- Less than 20% are paid off

Source: Clayton 2002-2004 Subprime reset data

What will re-start this market?

“Insanity: doing the same thing over and over again and expecting different results.”

— *Albert Einstein*



Conclusion

“What doesn’t kill us makes us stronger.”

— *Friedrich Nietzsche*