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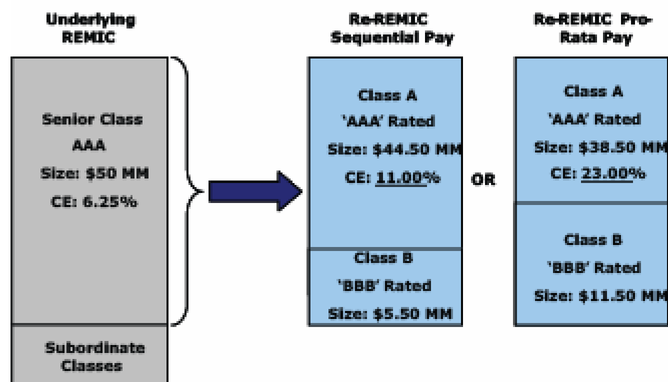
A CLOSER LOOK AT RATING TRIPLE-A RE-REMICS

In the June 16, 2008, U.S. Structured Finance Newsletter, DBRS introduced the concept of RMBS re-securitization (Re-REMIC) as a restructuring tool. This newsletter addresses how such restructuring differs from a Collateralized Debt Obligation (CDO) and provides a closer look at DBRS's approach in analyzing these transactions.

Typically, a Re-REMIC is viewed as a pass-through of interest, principal and losses from one or more underlying certificates to a newly-created Re-REMIC trust. Recent Re-REMICs, frequently backed by AAA-rated underlying certificates, often employ a simple A/B (or senior/subordination) structure, with Class B providing additional credit enhancement (CE) to Class A via subordination. The B class is designed to protect the A class if the underlying REMIC bond experiences write-downs that exceed its original AAA CE. The recent surge in re-securitization is driven by the desire to create securities with increased credit support to ensure rating stability and improved liquidity.

Currently, a frequent topic of discussion among market participants is how rating a AAA Re-REMIC differs from that of a CDO. Unlike a traditional RMBS CDO in which the ratings of the CDO classes were highly dependent on the ratings of the pledged RMBS bonds (often lower-rated BBBs), DBRS gives no consideration to the ratings of the underlying certificates in its Re-REMIC analysis. Instead, DBRS re-rates each underlying bond through a credit and cash flow analysis. As a result, each Re-REMIC class may only be eligible for a AAA rating if the class does not suffer any principal write-downs and interest shortfalls after applying the expected losses and cash flow assumptions under DBRS's AAA rating stresses.

DBRS's analysis indicates that a Re-REMIC generally creates less dollar-for-dollar AAA rating issuance as a result of the re-tranching (see example in Graph 1 below). In other words, the resulting Class B often carries a lower rating (generally from "A" to "BBB") than the underlying REMIC certificate (originally AAA-rated). Further, DBRS does not give any diversity benefit to Re-REMICs of more than one underlying class. On the contrary, DBRS may apply diversity penalties to Re-REMICs consisting of multiple underlying bonds from a single originator or vintage.



DBRS has rated AAA Re-REMICs in both sequential and pro rata pay structures. The sizing of Class A is highly dependent on the pay structure. In a sequential pay, Class B does not receive any principal until the Class A is paid in full; this ensures increasing credit support for Class A. In a pro rata structure, Class B pays down concurrently with Class A, which results in an erosion of support for Class A, and therefore requires a much larger Class B size as credit enhancement. Graph 1 depicts the sizing difference for a typical sequential and pro rata structure backed by the same underlying AAA certificate. In addition, DBRS uses Intex to apply dynamic cash flow assumptions (i.e., fast/slow prepayment speeds, up/downward interest rates stresses) to achieve the most conservative ratings for both Re-REMIC classes.

DBRS's Re-REMIC approach is an extension of its standard rating methodology available at www.dbrs.com, which includes a review of collateral quality through a default frequency and loss severity analysis on each underlying deal, cash flow modeling, operational risk assessment and legal structure.

For more information on the process used by DBRS to analyze Re-REMICs, please contact Quincy Tang at qtang@dbrs.com, Bernard Maas at bmaas@dbrs.com or Sagar Kongettira at skongettira@dbrs.com.

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