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# Structured Finance

RMBS/Netherlands
New Issue

# PEARL Mortgage Backed Securities 1 B.V.

## Ratings

| Class | Amount (m) | Final Maturity | Rating | Note Type |
|---|---|---|---|---|
| A | 1,000.0 | Sep 2047 | AAA | 98.65 |
| B | 13.7 | Sep 2047 | BBB- | 1.35 |

1 CE at closing. There is no reserve fund at closing.


## Analysts

Nicolas Ardoint
+44 20 7417 4369
nicolas.ardoint@fitchratings.com

Allen Twyning
+44 20 7417 3551
allen.twyning@fitchratings.com

## Performance Analytics

Louise van der Boon
+44 20 7417 4354
louise.vanderboon@fitchratings.com


## Related Research

- "*Dutch RMBS Default Model 2004*", 1 September 2004;
- "*Dutch RMBS Performance Bulletin 2005*", 1 November 2005;
- "*Legal Issues in Dutch RMBS*", 13 June 2002;
- "*Rating European Mortgage Loan Servicers – the Netherlands Market Addendum*", 26 November 2004;
- "*A Guide to Cash Flow Analysis for RMBS in Europe*", 20 December 2002;
- "*Fitch Issuer Report Grades*", 25 November 2004;
- "*Fitch Issuer Report Grades May 2006 Update*", 5 June 2006.

Closing occurred on 18 September 2006. No presale report was previously issued.

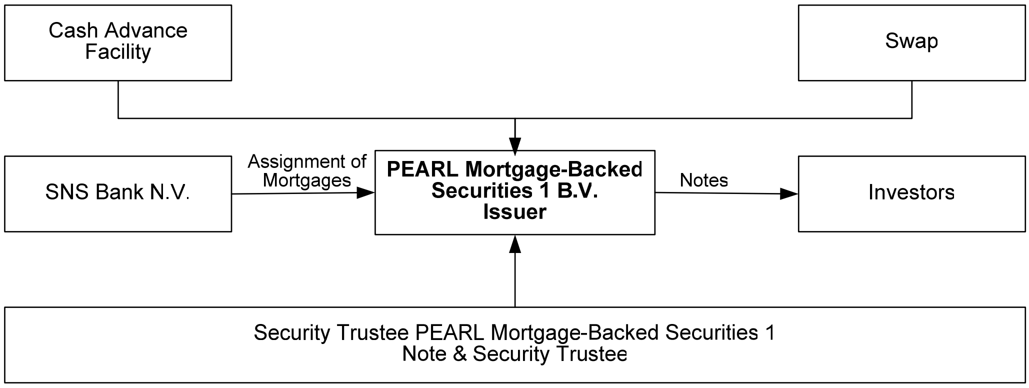

## Summary

This EUR1.013 billion transaction is a true sale securitisation of mortgage loans originated in the Netherlands by SNS Bank N.V. ("SNS Bank" or "the seller" rated 'A+/F1') and covered by the Nationale Hypotheek Garantie ("NHG"). This is the 12th RMBS transaction to be originated by SNS Bank but the first to solely comprise NHG-guaranteed loans. Fitch Ratings has assigned ratings to the notes issued by PEARL Mortgage Backed Securities 1 B.V. ("PEARL" or "the issuer") as indicated at left. The ratings are based on the quality of the credit portfolio, available credit enhancement, the underwriting and servicing capabilities of SNS Bank, the cover provided by the NHG guarantee as well as the sound legal and financial structure of the transaction. The ratings address the likelihood of investors receiving full and timely interest payments in accordance with the terms of the underlying documents: payment of interest on each payment date and ultimate repayment of principal on the class A and B notes by legal final maturity in September 2047.


## Credit Committee Highlights

- Repeat structure and established underwriter: the Hermes transactions have been performing in line with expectations. Arrears have been higher than the average for Dutch RMBS transactions, as reported by Fitch's Dutch 60+ delinquency index, but seem to be decreasing.
- The weighted average original loan to market value ratio ("WA OLTMV") of the portfolio is rather high, at 88.9%, but the pool is moderately seasoned (32 months on average). 53.90% of the portfolio consists of interest-only mortgages, which carry balloon repayment risk, 20.90% of investment-based mortgages and 24.24% of savings mortgages. Roughly 7% of the borrowers are assumed by Fitch to be self-employed.
- The transaction features a substitution period running through to the payment date falling in September 2015, during which time principal receipts may be reinvested in substitute mortgage receivables. During this period, principal collections may be used to redeem the notes only to the extent that they are not applied to the purchase of substitute mortgages. Substitutions are subject to criteria to prevent any deterioration in the credit quality of the portfolio.
- All mortgages benefit from a NHG guarantee; Fitch accounted for the guarantee as per its methodology and based on SNS's pay-out history on NHG-guaranteed loans. The agency has also taken into account the commitment from the sellers to repurchase mortgages if the Stichting WEW (the entity responsible for administering the NHG programme) fails to (fully) indemnify owing to an error or omission in the origination and underwriting process.

**Structure Diagram**




Source: Transaction documents

- No reserve fund was funded at closing. Therefore, the class B notes do not benefit from any credit enhancement. This class of notes has been tested appropriately in the agency's modelling to account for the specific risk it bears.

- The interest rate swap guarantees excess spread of 25bp on the non-defaulted principal balance of the mortgages after note interest and senior expenses (including servicing fees).

- Legal ownership of the mortgage loans is transferred using the new silent assignment law.

## Credit Portfolio

The characteristics and stratification figures of the provisional portfolio are detailed in *Appendix 3*.

### Loan Types

#### *Interest-Only Mortgages*

The borrower repays the mortgage in full at maturity. Mortgage loans that exceed a loan-to-foreclosure-value ("LTFV") of 75% have a compulsory life insurance policy covering at least the excess over the 75% threshold.

#### *Savings Mortgages*

These mortgages consist of an interest-only loan linked to a savings policy. The premiums payable vary so that the capital generated by the savings policy is targeted to equal the amount payable by the borrower on maturity of the mortgage loan (i.e., 100% target capital).

Some of the savings mortgages contain alternative savings mortgages, whereby the borrower has the option to switch between savings and investment schemes on each interest reset date.

#### *Investment Mortgages*

The borrower repays the principal in full at maturity using funds that have been accumulated through investments. There are three alternatives for this type of mortgage loan, but the mortgage loans sold and assigned to the issuer will be in the form of the "first alternative". In this case, the borrower pays no principal prior to maturity of the mortgage loan, but undertakes to invest an agreed amount, on an instalment basis, in certain investment funds selected by the borrower from among a range of investment funds offered by SNS Beleggingsfondsen N.V.

### Substitution

The transaction structure includes a substitution period up to and including the payment date falling in September 2015, during which time principal receipts may be reinvested quarterly in substitute mortgage receivables. Substitution is subject to certain conditions that aim to preserve the credit quality of the transaction, including:

- no notification event has occurred (see *Legal Structure* below);

- no more than 2.25% of the outstanding principal amount of the mortgage loans is more than 60 days in arrears;

- there is no debit balance on the principal deficiency ledger ("PDL");

- substitution will not cause the WA LTFV of the loans in the portfolio to exceed 100.6% (which would be a 1% increase from the level at closing);

- substitution will not cause the proportion of interest-only mortgages in the portfolio to exceed 56.9% of the portfolio (which would be a 3% increase from the level at closing);

- the aggregate amount of substitute mortgages is limited to 20% per year of all mortgage receivables outstanding at the beginning of any yearly period;
- there has been no failure to repurchase by the seller; and
- the ratings of the notes will not be adversely affected by the substitution.

## Origination and Servicing

SNS Bank is part of SNS REAAL, the sixth-largest financial institution in the Netherlands. The SNS Group was formed in 1990 and merged with the REAAL Group in 1997. SNS Bank has more than 180 branches throughout the Netherlands, as well as over 425 franchise branches. It continues to open branches in the north and west of the Netherlands and its strategy is to focus solely on Dutch retail banking.

### Origination

Fitch met key staff in the underwriting and servicing departments of SNS Bank in August 2005 to review the origination, underwriting and administration processes. The agency also received further information in the form of answers to a questionnaire sent to the origination and underwriting department at SNS; it also called senior management to update the information already obtained.

The bank had a 9.1% share of the Dutch mortgage market by outstanding loan balance as at August 2006. Traditionally based in the south and east of the country, SNS Bank's recent strategy has been to continue its expansion in the northern and western regions. It offers a full range of retail services to its customers. Roughly 23% of mortgage loans are originated through branches and roughly 77% via intermediaries, such as real estate agents and insurance intermediaries.

Both branches and intermediaries have access to a mortgage front office system, where they carry out standard underwriting checks – including consultation of the national credit register (Bureau Krediet Registratie or "BKR"), affordability calculations and verification of compliance with the standard underwriting criteria. Front offices have mandates for applications that comply with the standard conditions and pass the checks successfully: they can inform the client of the positive outcome of the application, subject to conditions being in place (proof of income, valuation report, insurance requirements). However, the loans will be disbursed only after a satisfactory review by the central middle-office department, which verifies the work done by the front offices on every single application. It also checks that the file contains all the required documents. Fraud checks are carried out at several stages, against both fraud databases and the records of SNS's internal fraud department.

Applications that do not match the standard criteria can be underwritten solely by the central middle-office department.

The main underwriting criteria and general conditions are detailed below.

- The maximum LTFV is 125%. Interest-only loans may only be taken out for an amount equivalent to a 75% LTFV; borrowers may extend the loan up to a 125% LTFV by taking out an additional portion covered by a combined life and capital insurance policy.
- The maximum debt-to-income ("DTI") ratio – the proportion of the borrower's income that may be used to pay interest and principal on the mortgage – can vary from 20%-36% depending on the borrower's income; the income considered is net of other financial commitments recorded either at SNS or the BKR database.
- self-employed borrowers must present three years of audited accounts as proof of income.
- a full valuation report is required for all existing properties; local tax assessments are accepted for applications involving LTFVs of less than 50%.

A credit-scoring system is also in place and backs the underwriting process at SNS; however, no formal underwriting criteria are defined in respect of the results given by the scoring system.

### *Servicing*

SNS Bank currently services mortgages from a single centralised service centre. All collections are made via direct debit and reminder letters are automatically issued to borrowers after loans fall 10 and 20 days overdue, respectively.

SNS has recently categorised borrowers into different risk profiles, according to internal default probabilities and loss severity considerations; borrowers with a high risk profile are actively contacted very early in the process, when their repayments are between 10 and 20 days overdue, whereas lower-risk profiles may be called after 55 days in arrears. Recent changes to the process also include a much tighter arrears management timeline:

- after 45 days, overdue files are transferred to the administration and support department responsible for the arrangement of private sales and foreclosures, and a "last notification" is sent out;

- after 58 days overdue, delinquent borrowers are advised to sell the property privately;
- after 65 days overdue, the foreclosure process is initiated.

On the basis of this information, Fitch believes that SNS Bank is a sound originator and an effective servicer of Dutch residential mortgages.

## Cash Bond Administration

The cash bond administration ("CBA") function for this transaction will be carried out by SNS Management. SNS Management has, since the first transactions, been involved in the management of the Hermes series and Provide Lowlands, among other deals.

The team in charge of the CBA function comprises four people including the team leader. The administrators have an average of five years' experience in the securitisation industry while the team leader has seven years' experience. New joiners are trained internally through informal training programmes and on the job.

Each step in the administration process is reported and tracked through a detailed checklist. Every step in the process must be signed off by the administrator and is reviewed by the team leader. The different steps of the process are cross-referenced many times to make sure that each document is filed. File reviews are performed regularly to detect and locate any problems.

At closing of the transaction, closing wires will be sent containing all the details of the cash flows. SNS checks the transaction triggers within the reporting activity. Since there is no specific modelling team in SNS management team, rating triggers are input manually and the other triggers are hard-coded in the system. IT systems are programmed so that they automatically detect and flag further advances.

In 2004, a risk self-assessment was performed for all the staff involved in securitisation transactions. KPMG performs yearly audits on the statutory account of the SPVs. The internal audit department periodically performs operational audits, the last one at the beginning of this year.

The cash reconciliation process is currently manual; a new system to automate the process is under review, to be implemented in 2007.

Fitch is satisfied that SNS Asset Management meets the necessary requirements for providing adequate cash/bond administration services to the transaction.

## NHG Guarantee Programme

In 1960, the Dutch government introduced the "municipal government participation scheme" (i.e. the municipality guarantee) to promote home ownership among lower-income groups. Under this system, both the state and municipalities guaranteed residential mortgage loans that fulfilled a set of defined criteria.

Since 1 January 1995, a central, privatised entity, the WEW, has been responsible for granting and administering the NHG guarantee programme.

The WEW finances itself via a one-off upfront charge to the borrower of 0.28% of the mortgage loan amount. If it were unable to meet its obligations under the guarantee scheme, it would receive liquidity support from the central government and the participating municipalities in the form of a subordinated interest-free loan.

Loans less than EUR250,000 (in 2006) qualify for an NHG guarantee provided that the borrowers meet certain other criteria, as detailed below:

- their gross DTI should not be more than 35.1% (for borrowers under 65 years of age);
- the guarantee must be used to purchase a property in the Netherlands;
- the applicant for whose benefit the guarantee is given must be the owner-occupier;
- the relevant mortgage loan must be secured by a first-ranking or first- and sequentially lower-ranking mortgage right;
- if the mortgage right is combined with a life insurance policy, the rights under the policy must be pledged to the lender;
- the borrower must ensure that the property is adequately insured against fire damage and their death for the term of the loan; and
- they must not have any outstanding arrears or loss registrations with the BKR, the Dutch credit agency.

Under the NHG guarantee, the lender is responsible for ensuring that an application meets the scheme's terms and conditions. If it qualifies, various reports are produced that are used to process the application, including the form that will eventually be signed by the lender and forwarded to the NHG to register the mortgage and establish the guarantee. If a loan is not underwritten or serviced correctly or if dossier information is missing, WEW may pay out less than the claimed amount or reject the claim altogether.

### NHG Guarantee Cover

The scheme covers any losses mortgage lenders incur on a guaranteed loan after the sale or foreclosure of the related property. This coverage extends to outstanding principal, unpaid accrued interest and repossession costs, among others, including:

- unpaid premiums for maintenance insurance;
- unpaid premiums for life insurance;
- costs of cleaning the property, urgent maintenance and repair;
- (legal) costs resulting from the foreclosure process; and
- the costs of an independent valuer.

However, the guarantee amortises on a monthly, 30-year annuity basis, creating a potential shortfall in protection.

### Claiming under the NHG Guarantee

When arrears on a guaranteed loan have built up to four months, the sellers must inform WEW in writing of the missed payments (including the guarantee number, borrower's name and the total amount of outstanding payments). WEW may then approach the lender and/or the borrower to attempt to resolve the problem. If no agreement can be reached, WEW will review the situation with the lender to maximise potential proceeds from the sale of the property, including exploring the possibility of a private sale rather than a public auction. WEW's permission is required for a private sale. A forced sale of a mortgaged property is only permitted where the borrower is seven or more monthly instalments in arrears, unless WEW has agreed otherwise.

If a loss arises after a private or forced sale, the lender must make a formal request to WEW for payment within three months. The request must include all the necessary documents relating to the original loan and the NHG guarantee. After receipt of a claim and all the supporting details, WEW must make payment within two months. If it fails to do so, providing that the request is valid, WEW must pay interest for late payment.

Fitch has analysed the terms of the NHG guarantee and given credit to NHG-guaranteed loans. WEW payout ratios on the loss amount were stressed based on historical data provided by SNS, the guarantee's amortisation profile, and the underwriting and servicing quality of the originator. Payment by the WEW is assumed to occur six months after the foreclosure period – in other words, 18 months after the first missed payment.

## ■ Legal Structure

PEARL, the issuer, is a special-purpose company incorporated under the laws of the Netherlands with limited liability as a B.V. and is registered with the Commercial Register of the Chamber of Commerce of Amsterdam. Its shares are owned by Stichting Holland Euro-Dominated Mortgage-Backed Series (Hermes) Holding, established under the laws of the Netherlands as a foundation.

SNS Bank used the silent assignment law to transfer the legal title of the mortgage receivables at closing. Under the terms of this law, the legal ownership of the receivables can be transferred by registering a deed of assignment with the relevant tax authorities, but without having to notify the borrowers of the assignment. In addition, the mortgages and other rights of the issuer are pledged to the security trustee via various pledge agreements.

The mortgage deeds related to the mortgage receivables provide that, before assignment, the mortgage rights not only secure the loan held by the issuer, but also any other liabilities that the borrowers may now, or in the future, owe to the seller ("bank mortgages").

The wording of the mortgage deeds related to loans originated before the end of 2005 stipulates that, upon assignment, the mortgage right will follow the receivable if this is stipulated in the deed of assignment and that, in this event, the mortgage right will no longer secure the other claims of the seller. The majority of the loans from the provisional pool were originated before the end of 2005.

The conditions applicable to mortgage loans originated as of the end of 2005 provide that, in the event of assignment, the mortgage right will partially follow the receivable and will be co-held, pro rata, by the seller and the issuer. Although it is entitled to a pro rata share of the proceeds in the event of foreclosure, the seller has agreed with the issuer that any such proceeds will be applied in priority to the outstanding balance of the foreclosed loan held by the issuer. Where the agreement is found not to be enforceable, the seller has undertaken to compensate the issuer. Mortgage loans to be acquired during the substitution period are likely to include loans originated after the end of 2005.

### Notification Events

Notification events relate, among other things, to a breach of obligations under the documents of the seller or a severe economic deterioration on the part of the seller. Notification events include where:

- a seller payment default is not remedied within 10 business days of receiving notice from the issuer or trustee;
- the seller fails to fulfil or comply with any of its obligations;
- the seller takes any corporate action, or steps are taken against it for its dissolution, liquidation, legal demerger, emergency regulations or bankruptcy; or
- SNS Bank's rating falls below 'BBB'.

### Representations and Warranties

The mortgage sale agreement contains representations and warranties given by the originator in relation to the pool of mortgages. No search of title will be conducted by the issuer or the trustee; instead they will rely on the representations and warranties noted below. If there is a breach of any of the representations or warranties, which cannot be rectified, the seller will be required to repurchase the loan(s) in question.

Specifically, the representations and warranties include (but are not limited to) the following:

- the seller has full right and title to, and the power to sell and assign, the mortgage receivables;

- each mortgage loan was originated by the seller in accordance with its standard underwriting criteria and procedures;

- all mortgage rights and rights of pledge granted to secure the mortgage receivables constitute valid mortgage rights ("*hypotheekrechten*") and rights of pledge ("*pandrechten*"), and have been entered into the appropriate public register;

- each mortgage receivable is secured on residential property located in the Netherlands;

- each property was valued by an independent, qualified valuer: for loans with a loan-to-market-value ("LTMV") less than 50%, a local tax assessment can be used to determine the value of the property;

- all mortgage rights are first priority;

- each of the mortgage loans meets the mortgage loan criteria as set out in the mortgage receivables purchase agreement;

- the mortgage conditions provide that all payments by the borrower should be made without any deduction or set-off;

- each mortgage receivable together with the mortgage right and the right of pledge, if any, securing that receivable constitutes a legal, valid, binding and enforceable obligation of the relevant borrower;

- each of the mortgage loans with a tenor exceeding 30 years has a combined capital and life insurance policy attached;

- the mortgage conditions state that the loan becomes due and payable if an attached life and capital insurance policy pays out;

- no arrears in excess of one month exist at closing;

- the borrower has made at least one monthly payment under the mortgage loan;

- each loan benefits from the NHG guarantee, all conditions applicable to the NHG guarantee at the time of origination of the loan were complied with, and the seller is not aware of any reason why any claim made in accordance with NHG requirements should not be met in full and in a timely manner.

### Repurchase of Mortgage Receivables

Under the mortgage receivables purchase agreement, the seller is required to repurchase a mortgage receivable if:

- the seller agrees with a borrower to grant a further advance;

- there is a breach of any of the representations and warranties as set out above;

- under the terms of a savings plus mortgage loan, the borrower has requested that accumulated premiums from a savings insurance policy be transferred into another investment under the savings mortgage loan; or

- the seller agrees with a borrower to amend the terms of a mortgage loan, which thereby ceases to meet the criteria set out in the mortgage receivables purchase and/or servicing agreements.

- if it appears that the loan no longer benefits from the NHG guarantee for its full amount as a result of an action that a seller or the servicer has taken or omitted to take, or if a seller fails to submit a claim under the guarantee despite being entitled to do so.

## Financial Structure

The class A and B notes will receive floating-rate interest in arrears at a margin over three-month Euribor. The first interest payment date will fall in December 2006. The first optional redemption date to repay the notes is September 2026. From September 2026 onwards, a step-up margin will apply if the notes are not called.

All amounts of interest, prepayment penalties and principal payments received by the seller are passed monthly to the collection account, held in the name of PEARL, with SNS Bank. If SNS Bank breaches its notification triggers, the borrowers will be notified and will make payments directly into the collection account. Under a guaranteed investment contract ("GIC"), monies deposited in the collection account will receive interest equivalent to three-month Euribor less a margin, payable quarterly.

If SNS Bank as seller collection account provider is downgraded below 'F1', it will, within 30 days, either: (i) ensure that a third party rated at least 'F1' guarantees its obligations as seller collection account provider; (ii) transfer to the escrow account, opened in the name of the issuer for this purpose, an amount equal to the highest single amount received since closing on the floating-rate GIC account during any single mortgage calculation period; or (iii) any other actions agreed by Fitch.

If SNS Bank, as GIC provider, is downgraded below 'F1' it will, within 30 days, either be replaced by or obtain a guarantee from a third party with a suitable rating, provide collateral to guarantee its obligations or find another appropriate solution acceptable to Fitch to maintain the then-outstanding ratings of the notes.

### Interest Priority of Payments

Revenue payments, which include interest on the mortgage loans, will be allocated, prior to enforcement, in the following priority of payments:

1. the issuer's senior fees and expenses (including those payable to the trustee, company administrator, servicer and paying agent);
2. repayment of any drawings made from the cash advance facility;
3. payments due under the swap agreement;
4. interest due on the class A notes;
5. amounts to be credited to the class A PDL until zero;
6. interest due on the class B notes;
7. amounts to be credited to the class B PDL until zero;
8. any swap counterparty default payment;
9. any gross-up or other amounts due under the cash advance facility agreement; and
10. amounts due on the deferred purchase price instalment.

### Principal Redemption

The class A and B notes will be redeemed sequentially. Notably, however, during the substitution period that runs through to the payment date falling in September 2015, only the principal collections that are not applied to the purchase of substitute mortgages may be used to redeem the notes.

On each optional redemption date, i.e. any quarterly payment date from September 2026, the issuer will have the right to sell all the mortgages to the seller or a third party and to use the proceeds of any such sale to redeem the outstanding class A notes and B notes, provided that all such notes can then be redeemed, and not only a portion thereof.

If the call is not exercised, the notes will receive three-month Euribor plus a step-up margin (increased from the level at closing).

The notes are subject to provisions that allow for redemption on the occurrence of certain tax events that affect the financial position of PEARL.

Following an enforcement event, when the trustee will declare the notes to be due and payable, all available funds will be allocated sequentially to interest and principal payments due on the class A and B notes after certain senior third-party expenses.

### Interest Rate Risk

At closing, PEARL entered into an interest swap agreement with SNS Bank, under which it will be obliged to pay SNS Bank, quarterly, the scheduled interest income due on the mortgage loans and the GIC, less: (i) a margin of 25bp; and (ii) certain senior expenses (including the servicing fee). SNS Bank, as swap counterparty, will be obliged to make scheduled interest payments on the notes insofar as they are backed by non-defaulted mortgage loans.

If SNS Bank's Long-term rating is downgraded below 'A' and its Short-term rating below 'F1', it will, within 30 days, either be replaced, obtain a guarantee from a third party with a suitable rating, provide collateral to guarantee its obligations or find another appropriate solution acceptable to Fitch to maintain the then-outstanding ratings on the notes.

### Reserve Fund

There will not be any initially funded reserve fund in this transaction.

### Cash Advance Facility

A cash advance facility equal to 2.25% of the current note balance will be provided by SNS Bank to cover any shortfalls in interest due on the notes. The cash advance facility will amortise in line with the notes, but will never be lower than 1% of the original notes balance. The cash advance facility will be provided for a term of 364 days, which can be extended at the discretion of the provider.

If SNS Bank is downgraded below 'F1', an appropriately rated substitute replacement cash advance provider must be provided within 30 days. If SNS Bank is not replaced within that period and the rating of the notes suffers materially adverse effects, the issuer will draw on the undrawn portion of the cash advance facility.

## ■ Credit Analysis

Fitch's methodology for assigning credit ratings to Dutch residential mortgage transactions in general is described in *Appendix 2*. The following section details the agency's particular areas of focus and concern with regard to PEARL, as well as outlining the factors incorporated into its analysis to deal with these concerns. For more information, please see the special report *"Dutch RMBS Default Model 2004"*, dated 1 September 2004 and available at www.fitchratings.com.

### Fitch Default Model Output

| Rating Level | WAFF[1] (%) | WARR[2] (%) | WARR (with NHG)[3] | MVD[4] |
|---|---|---|---|---|
| AAA | 16.51 | 60.68 | 93.03 | 40.61 |
| AA | 13.21 | 66.41 | 94.33 | 35.05 |
| A | 9.90 | 72.03 | 102.50 | 29.48 |
| BBB | 6.60 | 77.75 | 102.55 | 23.70 |
| BB | 3.30 | 83.26 | 102.64 | 17.91 |

Recovery time (years): Interest accrued on contractual rate for 1 year
Foreclosure cost: fixed EUR 5,000 and 6% of the value of the property after the application of indexation and MVDs.
[1] Weighted Average Foreclosure Frequency
[2] Weighted Average Recovery Rate
[3] Weighted Average Recovery Rate for year 1. Due to possible amortisation risk in the NHG guarantee this percentage can decrease over time. This has been accounted for.
[4] Market Value Decline
Source: Fitch

### Default Probability

#### *Affordability*

No borrower affordability measure, such as an income multiple or DTI ratio, was available for the pool on a loan-by-loan basis. Fitch therefore made a general assumption of a 35% DTI ratio for all loans in the pool. This figure, which falls at the higher end of SNS Bank's underwriting criteria, and is in line with the maximum acceptable ratio under the NHG criteria, equates to affordability class 3 in the agency's model. According to Fitch's default probability matrix, which is determined by affordability and LTV, the default probability for the average borrower in income class 3 would range from 4.5% to 22.5% in a 'AAA' scenario.

#### *Repayment Type*

53.90% of the pool consists of interest-only mortgages that carry a balloon repayment risk. Loans that exceed an LTFV of 75% have a compulsory life insurance policy covering at least the excess over the 75% threshold, thus reducing the balloon repayment risk. Fitch has increased the default probability for interest-only loans by 20% to account for the additional risk.

The pool also includes investment mortgage loans (20.90%), which carry a higher risk because of both residual set-off risk and the uncertainty of the yield on the underlying investment vehicle. Fitch has increased the default probability for investment loans by 10% to account for this additional risk.

Savings mortgages (24.24%) have not been penalised, as the accumulated savings will match the loan balance at maturity. Moreover, the sub-participation structure allows the ruling out of set-off risk for savings mortgages: amounts accumulated under a savings policy will be placed by the savings provider with the issuer (with a participation granted to the savings policy provider). This means that funds accumulated to date on the savings policy are immediately available to the issuer to repay the savings mortgage loan on maturity.

#### *Borrower Profile*

Fitch believes that self-employed borrowers have a greater probability of defaulting on their mortgage loan than employed borrowers who are paid a regular monthly salary. It can be assumed that around 7% of this pool relates to loans to self-employed borrowers, in line with the proportion of self-employed borrowers on the whole NHG portfolio of SNS. Fitch has increased the default probability on these loans to account for this risk.

### Recoveries

#### *Indexation*

In its analysis, Fitch reappraises the original value of each property as a function of the current house price index. The agency applies a 50% indexation credit for appreciation of property values, but will discount 100% for depreciation.

#### Market Value Decline ("MVD")

To estimate recoveries on the mortgage loans, Fitch examined house price movements in the Netherlands by province from 1982 to 2005.

After a period of steady house price growth, price increases have slowed since 2001 and higher-valued properties have suffered a decline. Fitch takes account of these trends and the inherent price volatility in its MVD analysis.

#### *Recovery Rate*

To determine the recovery rate, Fitch uses the lesser outcome of the following two formulae:

- the current loan balance, plus carry costs, divided by the current loan balance; or
- the indexed property value net of foreclosure costs (based on Fitch's indexation methodology, whereby 50% credit is given for property price appreciation) is reduced by the MVD amount and is divided by the current loan balance.

#### *Credit Given to the NHG Guarantee*

In the calculation of its WARR, Fitch accounted for the benefit provided by the NHG guarantee. Based on the historical pay-out SNS has received from the Stichting WEW, Fitch's calculation assumes that a certain percentage of the loan balance remaining after the liquidation of the property will be indemnified by the WEW. In the percentage used, the agency also accounted for the repurchase commitment from the sellers, who will buy back the loan for the remaining balance and accrued interest if the WEW does not fully pay off the loan.

#### Cash Flow Analysis

To evaluate the contribution of structural elements such as excess spread, the liquidity advance facility and other factors, Fitch modelled the cash flows from the mortgages based on the WAFF and the WARR provided by the loan-by-loan collateral analysis.

The cash flow model assumes that defaults are spread over the first five years of origination immediately after closing. It also simulates the cost of carrying written-off loans until recoveries are received after the assumed 12 months in a high prepayment and high Euribor-index environment. Recoveries realised from the liquidation of the property are assumed to arise 12 months after the first arrears; the WEW is assumed to pay the claim 18 months after the first arrears.

The swap, excess spread, and the cash advance facility are modelled and used to cover losses and carrying costs.

The class B notes do not benefit from any credit enhancement. Should losses occur in excess of the guaranteed excess spread paid by the swap on a given period, the class B notes would suffer a loss. However, given SNS's commitment to repurchase defaulted loans that are not fully indemnified by the WEW, the only losses that can be expected under a 'BBB-' scenario would be those arising from the realisation of the amortisation risk under the guarantee. Fitch has accounted for this risk in the calculation of its recovery rate and has tested several default distributions in its modelling.

The cash flow test showed that each class of rated notes could withstand loan losses at a level corresponding to the related stress scenario without incurring any principal loss or interest shortfall.

### ■ Set-Off

In most Dutch mortgage transactions there is a risk that borrowers may seek to set off certain amounts owed to them against amounts due from them in relation to the mortgage loan. Set-off is specifically precluded in the terms and conditions of the mortgage loans, but a lack of legal precedent makes it uncertain whether such a set-off waiver would be enforceable if the borrower were to contest it in court.

The primary set-off risk relates to insurance mortgages and stems from the possibility that, in the event of a default by the insuring entity such that a capital sum is not received from the relevant policy when due, the borrower may seek to avoid repaying the mortgage loan. The justification for this is that the sums due from the policy were specifically earmarked to repay the loan and the borrower should not, therefore, have to pay from his or her own funds merely because the policy provider defaulted. The risk of set-off is greater for the hybrid mortgage loans with a savings component than other types of insurance mortgages since, under these hybrid mortgages loans, (part of) the premium can be invested in a savings fund that "imitates" a savings insurance policy and the risk is not mitigated by the sub-participation structure.

For set-off claims to be valid, the borrower would generally need to prove that he/she had a legal claim against the defaulting entity that existed before the provider defaulted. Where the borrower brings a policy to the table from a provider that is independent of the seller, and the mortgage product has been marketed as one where the provider and seller are two independent entities, the claim for set-off will be weaker.

Fitch believes that the combination of legal provisions and pledge agreements in the transaction provides some comfort in addressing this risk. The likelihood of set-off succeeding is further reduced because a number of obstacles to its validity must be overcome. Any definitive rulings in this regard would be reviewed by Fitch, and their impact on the transaction assessed.

However, even if set-off were ruled invalid, the borrower would probably have limited alternative funds with which to repay the mortgage loan if the policy providers defaulted, thereby increasing the risk of default on the loan. Consequently, Fitch gives no credit to policies that have accrued when assessing loss severity.

For further analysis in relation to set-off matters, refer to the agency's report "*Legal Issues in Dutch RMBS*" dated 13 June 2002 and available at www.fitchratings.com.

## ■ Performance Analytics

This is the 12th publicly rated residential mortgage-backed transaction originated by SNS Bank. Fitch affirmed its ratings on Hermes I (upgrading class C), Hermes II (upgrading classes B and C), Hermes III (upgrading classes B and C), Hermes IV (upgrading classes B and C), Hermes V (upgrading class B), Hermes VI, Hermes VII and Hermes VIII on 1 September 2004 and affirmed its ratings on Hermes VII on 31 October 2005.

The Hermes transactions have performed in line with expectations. The arrears shown in the Hermes transactions (chart below in *Appendix 1*) are higher than the overall Dutch index. This could be explained by the way SNS Bank defines arrears, which are calculated on the basis of the oldest monthly payment missed. For example, a missed payment in January, where payments were made for the months of February and March, would still equal 90 days in arrears for this borrower, whereas other originators would report this as 30 days in arrears. Taking this into account, Hermes V and Hermes IV show the highest delinquency figures, with, respectively, 1.91% and 1.47% of loans more than 60 days in arrears. However, these delinquencies now seem to have followed a downward trend for several months.

Fitch will monitor the transaction on a regular basis and as warranted by events. Its structured finance team ensures that the assigned ratings remain, in Fitch's view, an appropriate reflection of the issued notes' credit risk.

Details of the transaction's performance are available to subscribers at www.fitchratings.com.

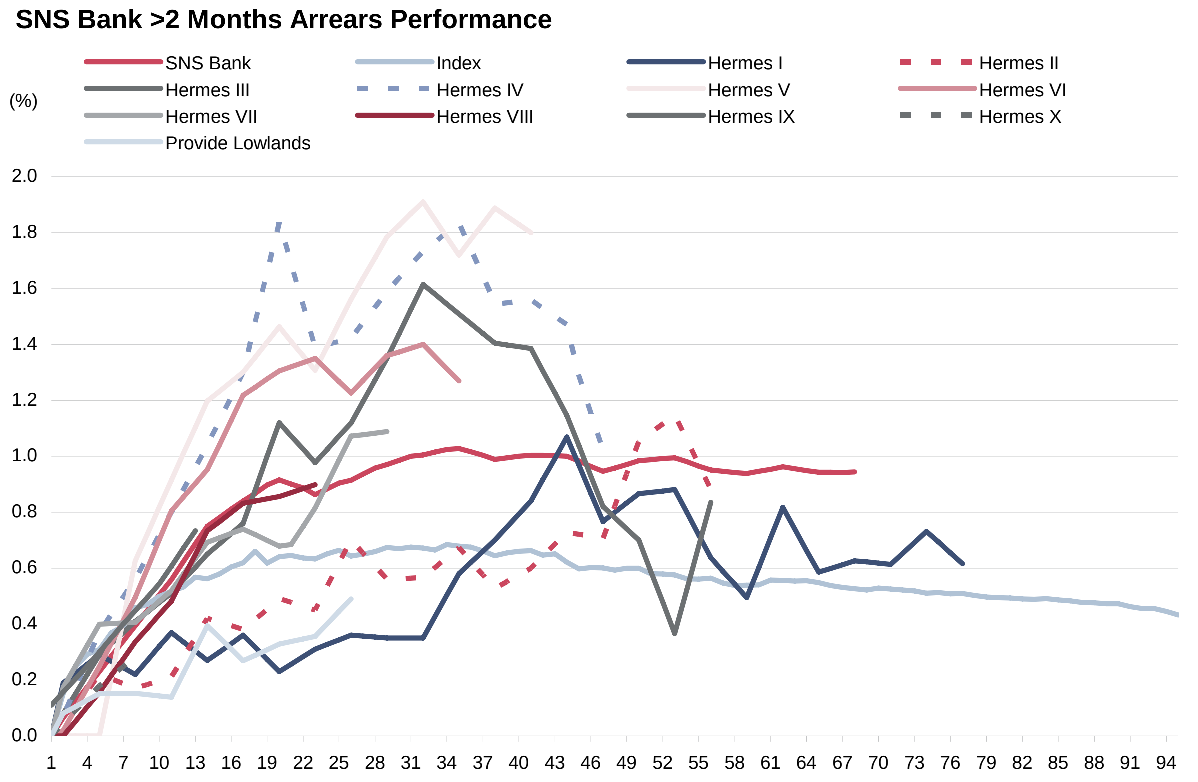
For more information on Dutch RMBS performance please see the special report "*Dutch RMBS Performance Bulletin 2005*", dated 1 November 2005 and available on www.fitchratings.com.

### Issuer Report Grade

Fitch has recently introduced Issuer Report Scores as part of an ongoing effort to improve the transparency of transaction performance to investors. Transactions are scored on a system ranging from one star (meets basic requirements) to five stars (outstanding). The Hermes transactions were upgraded to five stars in the May 2006 update – Hermes provides very good, user-friendly reporting in all areas and meets Fitch's published reporting standards in most areas.

For further information on the agency's issuer report scores, please see the reports "*Fitch Issuer Report Grades*", dated 25 November 2004 and "*Fitch Issuer Report Grades May 2006 Update*", dated 5 June 2006, both of which are available at www.fitchratings.com.

## Appendix 1: Performance of the Hermes Series of Transactions



Source: Fitch

## Appendix 2: Rating Methodology

To determine the appropriate levels of credit enhancement, Fitch analyses the collateral for Dutch residential transactions using a loan-by-loan mortgage default model (see Research *"Dutch RMBS Default Model 2004"*, dated 1 September 2004, available on www.fitchratings.com). The model subjects the mortgage loans to stresses resulting from its assessments of historical home price movements and mortgage defaults in the Netherlands. Fitch's study showed that a borrower's LTV, reflecting the size of their downpayment and their willingness to pay, and a borrower's DTI or income multiple, reflecting their ability to pay, to be the key determinants of default probability in the Netherlands.

### Default Probability

Generally, the two key determinants of default probability are the borrower's willingness and ability to make their mortgage payments. The willingness of a borrower to pay is usually measured by the LTV. Fitch's model assumes higher default probabilities for high LTV loans and lower default probabilities for low LTV loans. The main reason for this being that in a severe negative equity situation, borrowers in financial distress but with equity in their homes (low LTV loans) have an incentive to sell and maintain/protect their equity, eliminating the need for the lender to repossess the property. However, the Netherlands is characteristically a high-LTV market due to current tax incentives for such borrowing. Fitch takes this into account and places a greater emphasis on affordability when determining default probability.

The ability to pay is usually measured by the borrower's net income in relation to the mortgage payment. Historical data available show lower levels of default by Dutch borrowers compared with those in neighbouring countries. Base default probabilities are determined by using a matrix that considers each loan's affordability factor and LTV. The matrix classifies affordability into five categories, the lowest of which (class 1) encompasses loans with DTIs of less than 20% and the highest of which (5) encompasses all loans with DTIs exceeding 50%. A loan classified as affordability class 3, for example, would be allocated a base default probability of 4.5%-22.5%, depending on LTV.

### Adjustments

Fitch adjusts the base default rates on a loan-by-loan basis to account for individual loan characteristics of the collateral across all rating levels.

- **Repayment Type**

  **Savings Mortgages:** a borrower makes interest payments on a savings mortgage, but instead of making principal payments, contributions are made to a savings account. Funds accumulated in this account are then used to redeem the mortgage at maturity. To ensure that there are sufficient funds at maturity, the savings account earns the same rate of interest charged on the loan. However, there is still a risk to the third-party savings institution in this case. The way most transaction structures mitigate this risk is to have the monthly premiums made by the borrower passed through to the issuer by the insurance company, which purchases and accepts from the issuer a partial assignment in the mortgage. As long as this is the case, Fitch does not penalise savings mortgages.

  **Life Insurance Mortgages:** similar to the savings mortgages, a life insurance mortgage does not pay down any principal prior to loan maturity, at which point it is redeemed by the insurance policy. The yield on the policy can vary and will not necessarily equal the principal amount on the mortgage at maturity. Fitch increases default probability for life insurance mortgages, depending on how they are underwritten, the strengths of the insurer and the nature of the policy, owing to the increased market and third-party risk.

  **Investment Mortgages:** the investment mortgage is similar to the life insurance mortgage in concept (i.e., periodic contributions are made to an investment fund); but has a different choice of investment opportunities. Fitch increases the default probability according to the rating of the investment fund and/or the nature of the investment options.

  **Interest-Only:** Fitch generally increases the default assumptions for interest-only mortgages, whereby the mortgage is secured solely by the property value and principal is repaid by the borrower in one lump sum upon loan maturity, to take into account the potential payment shock to the borrower and the reliance on the borrower's equity in the property.

## Appendix 2: Rating Methodology (Continued)

- **Loan Purpose**

  Fitch believes that mortgage loans advanced to release equity in the home (equity refinance mortgages) are risky, as the homeowner is essentially borrowing back equity based on the property's price appreciation. Based on reviews of the issuer's appraisal process, as well as underwriting guidelines, if Fitch believes these loans have an increased likelihood of default, the base default probability will be adjusted by 10%-20%.

  Fitch assumes that a financially distressed borrower is more likely to default on a second home than a primary residence, and even more so on an investment property. Accordingly, base default rates are increased by 10%-25%.

- **Borrower Profile**

  Fitch increases default probability on loans to self-employed/self certified borrowers by 10%-30% to account for their lack of a fixed annual salary.

- **Arrears Status**

  When rating portfolios combining current and arrears mortgages, Fitch increases base default rates for mortgages in arrears by up to 90 days by 25%-75%, and those over 91 days in arrears (non-performing status) by 100%.

- **Underwriting Quality**

  Fitch's review and analysis of the origination process determines whether it decreases default rates by up to 25% or increases them by 0%-200%.

### Recoveries

To estimate loss severity on mortgage loans in the Netherlands, Fitch examined home price movements by separating the Netherlands into 12 regions. Worst-case MVDs were estimated, and then were generated for each rating level and by region.

As in its other European mortgage default models, Fitch increased MVDs for properties worth more than EUR500,000 by 10%–25%. Higher-value properties tend to have larger MVDs owing to the smaller marketplace for these properties and less precise pricing information for larger properties (given the less active market).

Fitch's model gives full credit for property price declines and 50% credit for property price appreciation. The agency calculates recoveries by reducing the indexed property valuation by the MVDs, repossession costs, and the costs to the servicer of carrying the loan from delinquency through to default.

On the basis of worst-case information gathered from Dutch mortgage lenders, Fitch assumes that repossession costs represent 6% of the value of the property at the time of possession plus a fixed amount of EUR5,000. To calculate carrying cost, Fitch assumes that the borrower does not pay interest for 12 months and that interest accrues during this period at the WA rate of interest.

## Appendix 3

### PEARL Mortgage Backed Securities 1 B.V.

| Originator | PEARL (NHG Guaranteed) | Hermes XI B.V. | Hermes X B.V. |
|---|---|---|---|
| **Closing Date** | September 2006 | February 2006 | September 2005 |
| **Total Issuance (EURm)** | 1,013.7 | 1,527.0 | 1,527.0 |
| **Final Ratings (%)** | | | |
| AAA | 98.65 | 94.95 | 94.95 |
| AA | | 2.35 | 2.35 |
| A | | 2.10 | 2.10 |
| A- | | 0.60 | 0.60 |
| BBB- | 1.35 | 1.85* | 1.85 (BBB)* |
| | | | |
| Initial Reserve (% of Initial Balance) | None | 1.85 | 1.85 |
| Target Reserve (% of Current Balance) | None | 1.85 | 1.85 |
| | | Triggers for amortisation | Triggers for amortisation |
| Swap + Excess Spread (“XS”) | Interest on the Notes – PDL + 25bp XS spread | Interest on the Notes – PDL + 45bp XS spread | Interest on the Notes – PDL + 45bp XS spread |
| Cash Advance | 2.25% of Current Notes Balance | 1% of Initial Notes Balance | 1% of Initial Notes Balance |
| | | | |
| **WAFF (%)** | | | |
| AAA | 16.51 | 17.74 | 18.25 |
| AA | 13.21 | 14.19 | 14.60 |
| A | 9.90 | 10.64 | 10.95 |
| BBB | 6.60 | 7.10 | 7.30 |
| BB | 3.30 | 3.55 | 3.65 |
| | | | |
| **WARR (%)** | | | |
| AAA | 93.03 | 56.79 | 56.68 |
| AA | 94.33 | 62.28 | 62.15 |
| A | 102.50 | 67.65 | 67.53 |
| BBB | 102.55 | 73.03 | 72.94 |
| BB | 102.64 | 78.28 | 78.19 |
| | | | |
| **Portfolio** | | | |
| Collateral Balance (Net of Savings) (EUR) | 1,013,700,000 | 1,759,056,981 | 1,500,000,000 |
| Pre-Funding Amount | 0 | 0 | 0 |
| Savings Amount | 17,634,169 | 5,656,226 | 8,678,020 |
| Number of Borrowers | | 9,331 | 8,240 |
| Average Current Balance | 146,108 | 188,518 | 182,039 |
| | | | |
| WA Seasoning (Months) | 32.0 | 15.2 | 19.0 |
| WA Term to Maturity (Years) | 26.9 | 28.3 | 28.1 |
| WA Interest Rate (%) | 4.34 | 3.93 | 4.08 |
| % Fixed/% Floating | | 44.3/55.7 | 46.6/53.4 |
| | | | |
| WA OLTMV (%) | 88.9 | 92.2 | 92.6 |
| WA DTI (%) | 35 (Assumed) | 35 (Assumed) | 35 (Assumed) |
| Self Certified (%) | 0 | 0 | 0 |
| Self Employed (%) | 7 (Assumed) | 7 | 11 |
| Construction Deposits (%) | 0 | 0 | 0 |
| Arrears (%) | 0 | 0 | 0 |
| | | | |
| **Mortgage Type (%)** | | | |
| Interest Only | 53.90 | 66.50 | 66.70 |
| Savings | 24.24 | 6.10 | 9.00 |
| Insurance | 0 | 0 | 0 |
| Repayment | 0.96 | 0.50 | 0.70 |
| Investment | 20.90 | 27.00 | 23.60 |
| Other | 0 | 0 | 0 |
| | | | |
| WA CLTMV (%) | 87.1 | 92.0 | 92.0 |
| WA CLTMV (Indexed Values) (%) | 83.0 | 88.4 | 88.6 |
| WA MVD (AAA) (%) | 40.61 | 40.96 | 40.66 |
| % Jumbo Properties (%) | 0 | 2 | 2 |

* Non-collateralised note
** Weighted Average Recovery Rate for year 1. Due to possible amortisation risk in the NHG guarantee this percentage can decrease over time. This has been accounted for.
Source: Transaction documents

## PEARL Mortgage Backed Securities 1 B.V.

RMBS/Netherlands

### Capital Structure

| Class | Rating | Size (%) | Size (EURm) | CE (%) | Interest Rate | PMT Freq | Maturity | ISIN/CUSIP |
|---|---|---|---|---|---|---|---|---|
| A | AAA | 98.65 | 1,000.0 | 1.35 | 3m Euribor + []% | Quarterly | Sep 2047 | XS0265250638 |
| B | BBB- | 1.35 | 13.7 | 0 | 3m Euribor + []% | Quarterly | Sep 2047 | XS0265252253 |

| | Size (%) | Size (EURm) |
|---|---|---|
| **Cash Reserve** | 0 | 0 |
| **Cash Advance** | 2.25 | 10.1 |
| **First Interest Payment Date** | Dec 2006 | |
| **Substitution End Date** | Sep 2015 | |
| **Step-Up Date** | Sep 2026 | |
| **Swap** | Pays senior expenses and interest on notes minus PDLs. | |
| **Excess Spread (Closing)** | 25bp | |


### Key Information

| | | Parties | |
|---|---|---|---|
| **Closing Date** | Sep 2006 | **Seller/Originator** | SNS Bank N.V. (A+/F1) |
| **Country of Assets** | The Netherlands | **Servicer** | SNS Bank N.V. |
| **Country of SPV** | The Netherlands | **Lead Managers** | UBS |
| **Bloomberg** | PEARL <MTGE> | **Trustee** | Stichting Security Trustee PEARL Mortgage Backed Series 1 |
| **Issuance Date** | | **Swap Counterparty** | SNS Bank N.V. |
| **Structure** | Pass through + Substitution Period | **Cash Advance Facility Provider** | SNS Bank N.V. |
| **Settlement** | Euroclear, Clearstream | **Floating Rate GIC Provider** | SNS Bank N.V. |
| **Listing** | Euronext Amsterdam N.V. | **Paying Agent** | ABN AMRO Bank N.V. |
| **Analyst** | Nicolas Ardoint | **Cash Collection Account Provider** | SNS Bank N.V. |

### Others (Summary)

| | |
|---|---|
| **Short-term Rating Triggers (Minimum)** | |
| Cash Advance Facility | F1 |
| Swap Agreement | F1 and A |
| Transaction Account Bank | F1 |

**Credit Enhancement**

Excess spread under the swap , subordination

**Credit Committee Highlights**

Repeat structure and established issuer, performance of transactions is sound

WA OLTMV is 88.9%, seasoning 32 months, interest-only loans are 53.9% of the portfolio, around 7% of self-employed borrowers

Substitution period running through to Sept 2015

All mortgages benefit from the NHG guarantee; credit given in accordance with the standard methodology.

No reserve fund; the class B does not benefit from any credit enhancement; appropriate tests have been made.

Swap pays servicing fees, interest on the notes minus PDLs and 25bp guaranteed excess spread

Use of new silent assignment law for transfer of mortgage loans

### Fitch Default Model Output

| Rating Level | AAA | AA | A | BBB | BB |
|---|---|---|---|---|---|
| **WAFF (%)** | 16.51 | 13.21 | 9.90 | 6.60 | 3.30 |
| **WARR (%)** | 60.68 | 66.41 | 72.03 | 77.75 | 83.26 |
| **WARR with NHG (%)** | 93.03 | 94.33 | 102.50 | 102.55 | 102.64 |
| **MVD** | 40.61 | 35.05 | 29.48 | 23.70 | 17.91 |

### Collateral

**Pool Characteristics**

| | | | |
|---|---|---|---|
| Original Principal Balance (EUR) | | **Regional Concentration (%)** | |
| Current Principal Balance (EUR) (Net of Savings) | 1,013,700,000 | Zuid-Holland | 13.97 |
| Savings Balance | 17,634,169 | Noord-Brabant | 7.43 |
| Average Current Loan per Borrower (EUR) | 146,108 | Gelderland | 18.06 |
| Number of Borrowers | 6,938 | **Lien Position (%)** | |
| Seasoning (Months) | 32 | First Ranking | |
| Loan to Value (LTV) (%) | | First & Subsequent Ranking | 100 |
| WA OLTMV | 88.9% | Jumbo (%) | 0 |
| WA CLTMV | 87.1% | | |
| WA CLT Indexed MV | 83% | **Payments** | |
| Mortgage Characteristics | | Payment Frequency | Monthly |
| Interest Only | 53.90 | Payment Method | Direct Debit |
| Savings | 24.24 | Performing Loans (%) | 100 |
| Insurance | 0 | WA DTI (%) | 35 (Assumed) |
| Repayment | 0.96 | | |
| Investment | 20.90 | Employment Status (% of Self-Employed) | App. 7 |
| Floating Rate Loans (%) | 61.6] | | |
| Fixed Rate Loans (%) | 38.2 | | |
| WA Interest Margin (%) | 4.34 | | |
| Interest Index (Euribor) | | | |

Source: SNS Bank/Fitch