

The Simple Supervisory Formula Approach (SSFA) and Its Impact on the Securitization Market

DRAFT

The two primary concerns regarding the impact of the Simple Supervisory Formula Approach on Securitizations are:

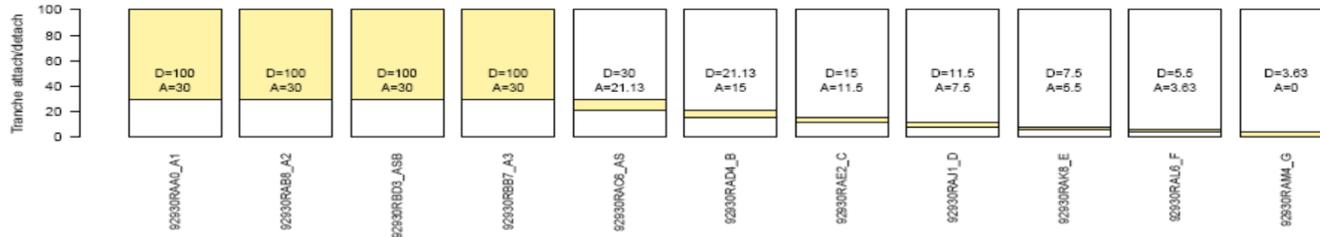
- Because it focuses on the credit enhancements provided by deal structure (attachment and detachment points) without adequately taking into consideration the quality of the underlying collateral (particularly for deals without seasoned collateral) it incentivizes bank dealers to create deals backed by lower quality collateral and for bank investors to hold bonds backed by lower quality collateral.
- The reason is that bonds backed by lower quality collateral will tend to have higher levels of credit enhancement and hence lower RWAs under the SSFA approach than the RWAs of same or similarly rated bonds backed by higher quality collateral which will tend to have lower levels of credit enhancement.

CMBS

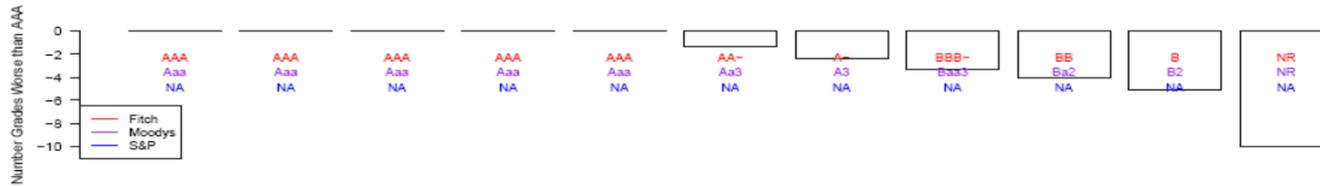
WFRBS 2012-C9

WF-RBS Commercial Mortgage Trust, Deal = WFRB12C9, Type= CMBS

Cusip Attachment/Detachment Points



Agency Rating



RWA, via RBA and SSFA



Compare two bonds, the AA-/Aa3 rated tranche off WFRBS 2012 C9, a recent good quality CMBS 2.0 deal, versus the lower rated A-/A3 rated tranche off Northstar 2012-1 As, a deal backed by riskier bridge loans.

Because the AA-/Aa3 rated tranche is backed by better quality collateral, it has a lower attachment point of 15% (detachment point is 21.13%). As such its' RWA is 111%.

Source: RBS, Intex

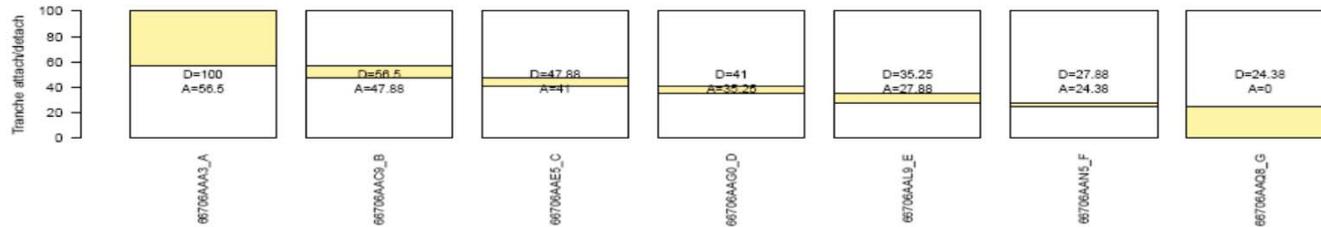
DRAFT

CMBS

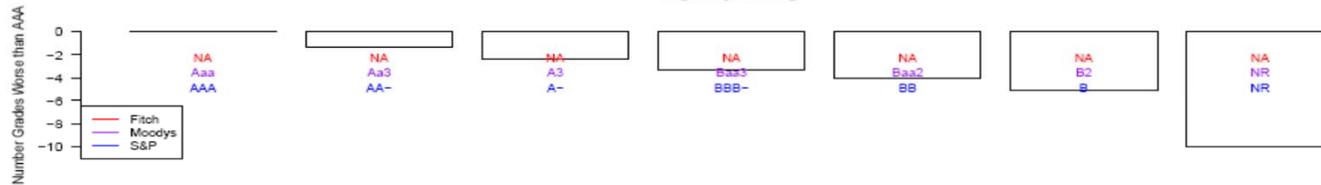
NRF 2012-1

Northstar Mortgage Trust, Deal = NSMT1201, Type= CMBS

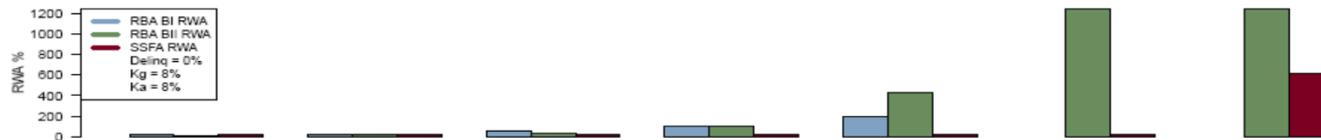
Cusip Attachment/Detachment Points



Agency Rating



RWA, via RBA and SSFA



In contrast, the lower rated A-/A3 tranche off the riskier quality deal has an RWA of 20%, *less than one fifth the capital* required of the higher rated tranche backed by higher quality collateral because it has a high attachment point (greater credit enhancement) of 41% (detachment point is 47.88%).

In addition because the second tranche is off a lower rated tranche backed by lower rated collateral it will tend to offer a higher yield in the market. The combination of higher yield and lower capital requirement will boost the ROE of bank investors' tending to attract them to the bond backed by this lower quality collateral.

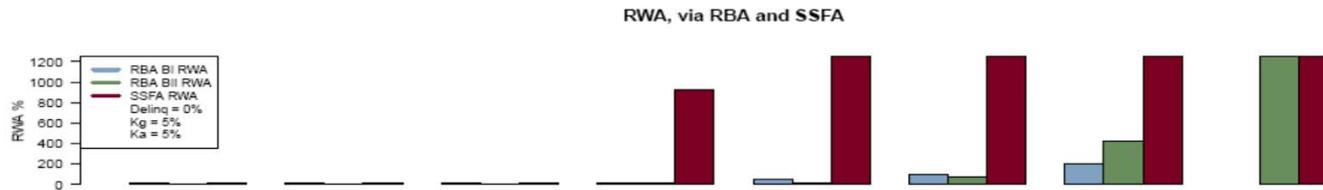
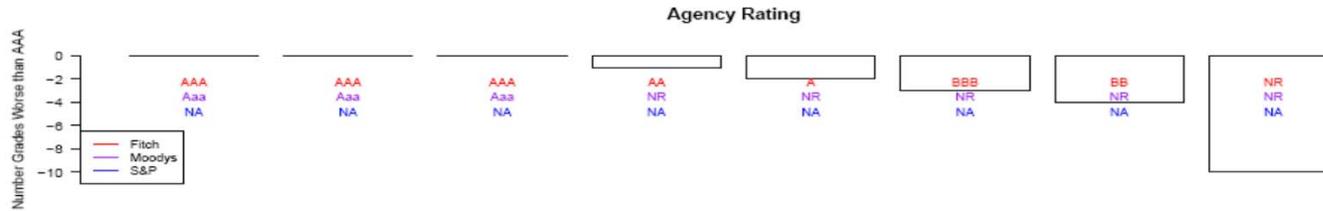
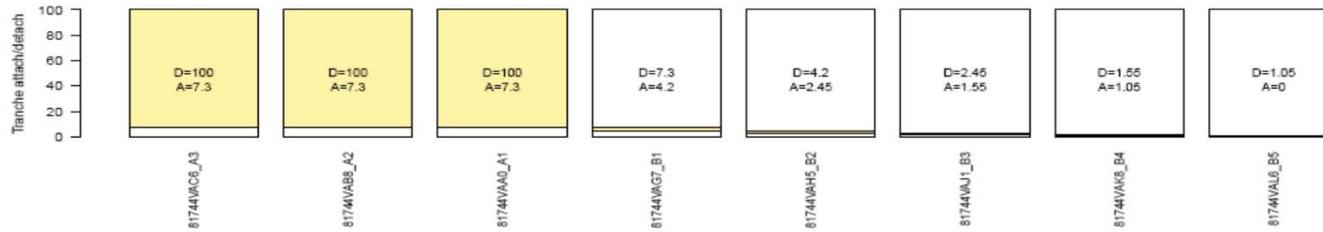
Source: RBS, Intex

DRAFT

RMBS

SEMT 2012-4

Sequoia Mortgage Trust, Deal = SQMT1204, Type= Other
Cusip Attachment/Detachment Points



Similar effects can be seen in the RMBS and other markets.

Compare the much higher RWA (929%) of the AA rated B1 bonds (attachment 4.2%, detachment 7.3%) off the high quality Sequoia RMBS deal (Kg=5%).

Source: RBS, Intex,

DRAFT

RMBS

SLFMT 2012-2A

Springleaf Mortgage Loan Trust, Deal = SPGL1202, Type= Other
Cusip Attachment/Detachment Points



almost 50 times as much as the 20% RWA for the AA rated M1 tranche (attachment 37.58% and detachment 45.73% of the riskier collateral Springleaf deal (even with a higher Kg of 8% to reflect the riskier collateral)).

Source: RBS, Intex

DRAFT

Other Concerns:

- Because the SSFA rule allows banks to also adopt a Supervisory Formula Approach (SFA) approach subject to regulatory approval, this has the potential to create an unlevel playing field between large and small banks.
- The capital requirement for bonds under the SFA tends to be lower than the capital requirement for the same bonds under the SSFA. Given the complexity and cost of adopting the SFA approach this could give a competitive advantage to larger more well financed banks.
- Capturing delinquencies: there are differences across vendors in the delinquency data both because of the timeliness of updates as well as differing definitions of historic credit metrics. This however could be address through tighter definitions.

Invitation to Consider a Derivatives Transaction: This communication is prepared by the sales and trading desk and is marketing material and/or trader commentary. It is not a product of the research department. This material constitutes an invitation to consider entering into a derivatives transaction under U.S. CFTC Regulations §§ 1.71 and 23.605, where applicable, but is not a binding offer to buy/sell any financial instrument. The views of the author may differ from others at The Royal Bank of Scotland plc, The Royal Bank of Scotland N.V. and/or RBS Securities Inc. (collectively "RBS").

Copyright ©2012 RBS Securities Inc. All rights reserved. RBS Securities Inc. member (<http://www.finra.org>) / SIPC (<http://www.sipc.org>), is a subsidiary of The Royal Bank of Scotland plc. RBS is the marketing name for the securities business of RBS Securities Inc.

The author of this material is an economist, desk strategist, salesperson or trader and will be compensated based in part on the author's own performance, the firm's performance and the performance of the sales or trading desk for which the author works. It is not considered research and is not a product of any research department. RBS Securities Inc. is not, by making this material available, providing investment, legal, tax, financial, accounting or other advice to you or any other party. RBS Securities Inc. is not acting as an advisor or fiduciary in any respect in connection with providing this information, and no information or material contained herein is to be construed as either projections or predictions. Past performance is not indicative of future results. RBS Securities Inc. transacts business with counterparties on an arm's length basis and on the basis that each counterparty is sophisticated and capable of independently evaluating the merits and risks of each transaction and that each counterparty is making an independent decision regarding any transaction. Counterparties must make their own independent decisions regarding any securities, financial instruments or strategies mentioned herein. This material is intended for institutional investors only and should not be forwarded to third parties.

RBS Securities Inc., its affiliates, and/or any of their respective employees, clients and officers, including persons involved in the preparation or issuance of this material, act as a market maker for or deal as principal in the financial instruments mentioned and may have a long or short position in, or engaged in transactions in, these financial instruments. As part of the sales or trading desk, the author may have consulted with the trading desk while preparing this material and the trading desk may have accumulated positions in the financial instruments or related derivatives products that are the subject of this material. Accordingly, information included in or excluded from this material is not independent from the proprietary interests of RBS Securities Inc., which may conflict with your interests.

Except as to securities issued by the U.S. government and debentures issued by government-sponsored enterprises, RBS Securities Inc. does not permit the author of this material to hold, or engage in transactions in, the securities or other financial instruments discussed herein in any personal account of the author or a member of the author's household.

Certain transactions, including those involving futures, options, derivatives and high yield securities, give rise to substantial risk and are not suitable for all investors. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from any investments discussed herein. Unless otherwise specifically stated, all statements contained herein (including any views, opinions or forecasts) are as of the date indicated only, and are subject to change without notice. Changes to assumptions made in the preparation of such material may have a material impact on returns. RBS Securities Inc. does not undertake a duty to update this material or to notify you when or whether the analysis has changed. While the information contained in this material is believed to be reliable, no representation or warranty, whether express or implied, is made and no liability or responsibility is accepted by RBS Securities Inc. or its affiliates as to the accuracy or completeness thereof, except with respect to any disclosures relative to RBS Securities Inc. and/or its affiliates and the author's involvement with an issuer that is the subject of this material.

RBS Securities Inc. makes no representations that this material or any information contained herein are appropriate for use in all locations or that transactions, securities, products, instruments or services discussed herein are available or appropriate for sale or use in all jurisdictions, or by all investors or counterparties. Investors who receive this material may not necessarily be able to deal directly with RBS Securities Inc. and should contact the RBS Securities Inc. entity or affiliate in their home jurisdiction unless governing law permits otherwise. Those who utilize this information do so on their own initiative and are responsible for compliance with applicable local laws or regulations.

This material is made available in the European Economic Area ("EEA") by The Royal Bank of Scotland plc, which is authorized and regulated by the Financial Services Authority (FSA). RBS Securities Inc. distributes this material in the U.S. With respect to the execution of interest rate derivatives, credit derivatives and foreign exchange transactions, RBS Securities Inc. generally acts as agent for RBS which will be the principal in such transactions.

This website and its contents have not been reviewed by any regulatory authority in Hong Kong. RBS Securities Inc. does not conduct, nor holds itself out as conducting a business in investment advisory or dealing services in Hong Kong, nor any other regulated activity. It holds no Hong Kong regulatory licenses.

This material is distributed in Singapore by The Royal Bank of Scotland plc (Singapore branch), Level 26, One Raffles Quay, south Tower, Singapore 048583, which is regulated by the Monetary Authority of Singapore. In Singapore, this material is intended solely for distribution to institutional investors, accredited investors, and expert investors as defined under the (Singapore) Financial Advisers Act, Chapter 110. Persons receiving this material in Singapore should contact The Royal Bank of Scotland plc (Singapore branch) in respect of any matters in connection with the material.)

Both RBS Tokyo and RBSSJ are regulated by Japanese Financial Services Agency. This Material is provided for information only and it does not constitute an offer or a solicitation to deal in any specific products or to enter into any legal relations, nor an advice or a recommendation with respect to such products. Clients should independently evaluate particular investments before dealing in any products herein referred to. Persons obtaining this information through RBSSJ website are limited to Professional Investors (as defined in Article 2-31 of Financial Instruments and Exchange Law) only. The access to the website is provided by RBS Tokyo Branch (RBS Tokyo) or RBS Securities Japan Limited (RBSSJ) to their respective Clients in Japan who are classified as Professional Investors. However some Material is intended to be provided only to Qualified Institutional Investors (as defined in Article 10 of Cabinet Office Ordinance concerning Definitions provided in Article 2 of Financial Instruments and Exchange Law).

RBS Securities Inc. is exempt from the requirement to hold an Australian Financial Services License under the Corporations Act 2001 of Australia in respect of these financial services, and that RBS is regulated by the SEC under US laws, which differ from Australian laws.

The views expressed in this publication accurately reflect the author's personal views about the subject financial instruments and issuers, and no part of the author's compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained herein.

DRAFT