

Servicer Evaluation: Pepper Australia Pty Ltd.

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Servicer Evaluation: Pepper Australia Pty Ltd.

Opinion

Ranking: **STRONG**

The **STRONG** overall ranking on Pepper Australia Pty Ltd. as a residential subprime loan servicer in Australia reflects Pepper's specialized skills to service nonconforming and subprime loans.

In addition, the overall ranking reflects Pepper's following key strengths:

- Its clearly defined business strategy and robust business model.
- Its well-established position as a primary servicer of subprime residential mortgage loans, with a high degree of industry knowledge and proficiency in the Australian servicing market.
- A strong, experienced senior management team that leads a well-qualified and skilled workforce.
- Its well-defined and structured corporate governance, risk-management and compliance practices, underpinned by strong risk management tools and senior management oversight.
- A solid proprietary loan processing and servicing infrastructure, which provides Pepper with an end-to-end integrated approach to loan origination, servicing, and management.

Standard & Poor's Ratings Services considers that Pepper has maintained a track record in managing and servicing its lending portfolio as well as demonstrated continuous progress, improvement, and development in a broad range of areas across its business.

Outlook

The outlook for the overall ranking is 'Stable.' This outlook reflects our opinion that Pepper during the medium term will likely continue to execute on its clearly defined strategy and sound business model, which we believe could establish it as a key player in Australia's subprime and nonconforming residential lending market.

Profile

Pepper was incorporated in Australia in August 2000 as a limited liability company. The company's head office is in Sydney, and it has additional offices in Melbourne, Perth, and Brisbane. Pepper holds an Australian Financial Services Licence and an Australian Credit Licence.

Pepper is a specialty mortgage finance company that provides home loans to consumers who fall outside the lending criteria of traditional bank and nonbank lenders. In particular, Pepper advances residential mortgage loans to borrowers who are self-employed or who use nontraditional documentation to verify their income, borrowers who have had prior episodes of credit impairment, and other borrowers who may not meet the requirements of traditional lenders.

Pepper has developed an extensive distribution network of accredited mortgage brokers and financial planners, as well as a competitive range of products that have helped it to grow its business. Mortgage brokers and financial planners are responsible for the origination of approximately 94% of loans, and mortgage managers account for 6%

of originations. Pepper's loan-servicing philosophy is based on achieving defined customer service standards, supported by an ongoing process-improvement program.

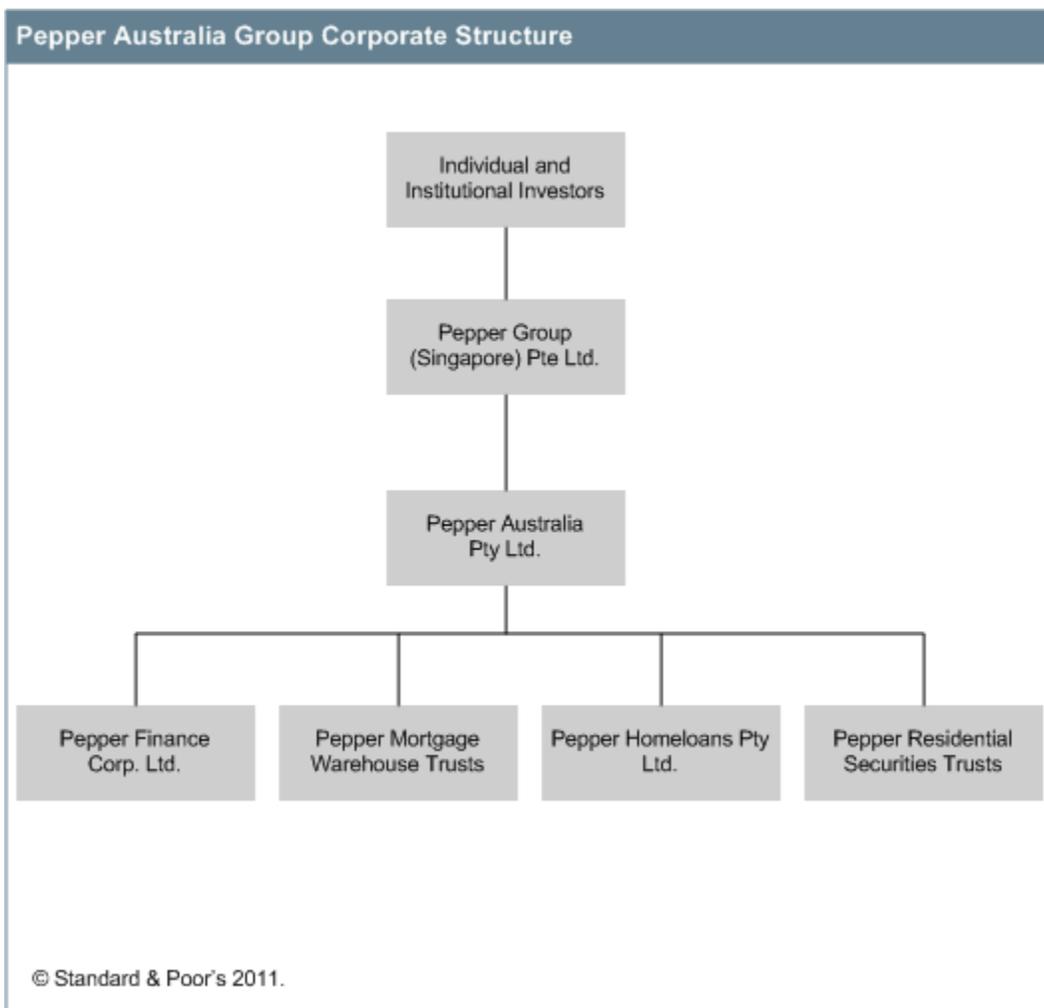
Pepper forms part of the Pepper Australia Group of companies that trade under the name Pepper HomeLoans. Pepper is the holding company and main operating entity for the group's Australian activities. A separate division, responsible for loan servicing, has been created to separate the servicing functions from the rest of the businesses operations.

Pepper is a wholly owned subsidiary of Pepper Group (Singapore) Pte Ltd, a Singapore-incorporated holding company owned by a group of private individual and institutional co-investors.

The management team and shareholders have extensive domestic and international experience in originating and servicing residential mortgage books.

The corporate structure of the Pepper Australia Group is detailed in chart 1.

Chart 1



Pepper has been a regular issuer of RMBS since 2003. It has completed eight residential mortgage-backed securities

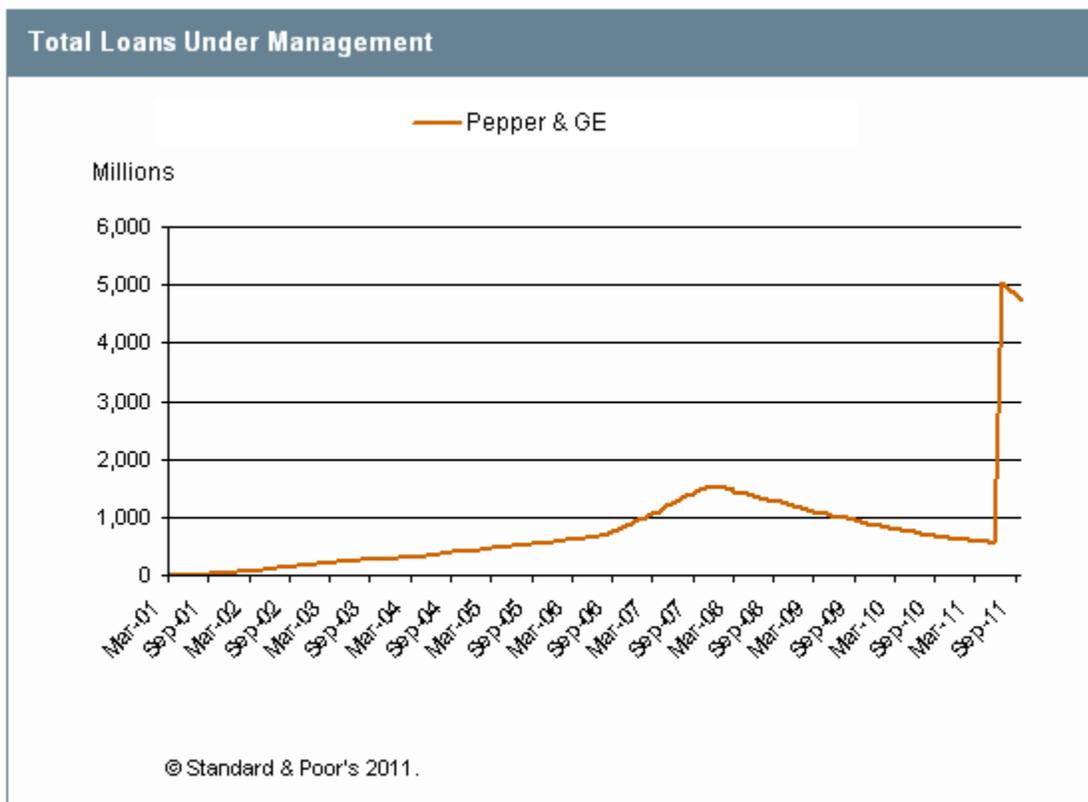
(RMBS) issues in the Australian market totaling A\$2.5 billion via its Pepper Residential Securities (PRS) program.

Business Strategy and Growth

Pepper seeks to be the leading provider of specialist residential nonconforming and subprime mortgage solutions to clients in the Australian market. It aims to do this while generating superior returns on equity for its shareholders. The underlying objective is to build high-yielding and -performing loan portfolios that are resilient to the peaks and troughs of business, economic, and interest-rate cycles. The principles behind this are to originate quality loans that will perform through economic and market downturns, and to deliver value to shareholders.

Chart 2 shows the growth in Pepper's loan portfolio since its inception in 2001.

Chart 2



Pepper has deliberately slowed new loan origination volume since August 2007 because of instability in the external market. However, it has continued to place an emphasis on maintaining operating stability, elevating risk-management methodologies, furthering technology initiatives, further developing its employees, and developing additional business lines.

Since mid-2008, Pepper has increased its focus on third-party servicing. It has been servicing third-party portfolios, including transitioning these portfolios from other originators, across a diverse range of asset types. This strategy has broadened Pepper's revenue sources and allowed it to maintain its operational capacity in an environment in which mortgage originations and volumes were decreasing. As part of its ongoing business strategy, Pepper plans to

continue to seek out third-party servicing opportunities and back up servicing opportunities.

Pepper has also been active in portfolio acquisitions, with its first being completed in 2010. In May 2011, Pepper signed agreements to acquire an approximately A\$5 billion residential mortgage portfolio originated by GE Capital Australia and New Zealand. Pepper intends to utilize the acquisition of the GE home loan portfolio to assist its development into various segments of the prime residential lending market in Australia and New Zealand. It also intends to leverage its acquisition to drive economies of scale and technology enhancements across its various platforms.

Management And Organization

Ranking: STRONG

We have raised the ranking for management and organization to STRONG from ABOVE AVERAGE.

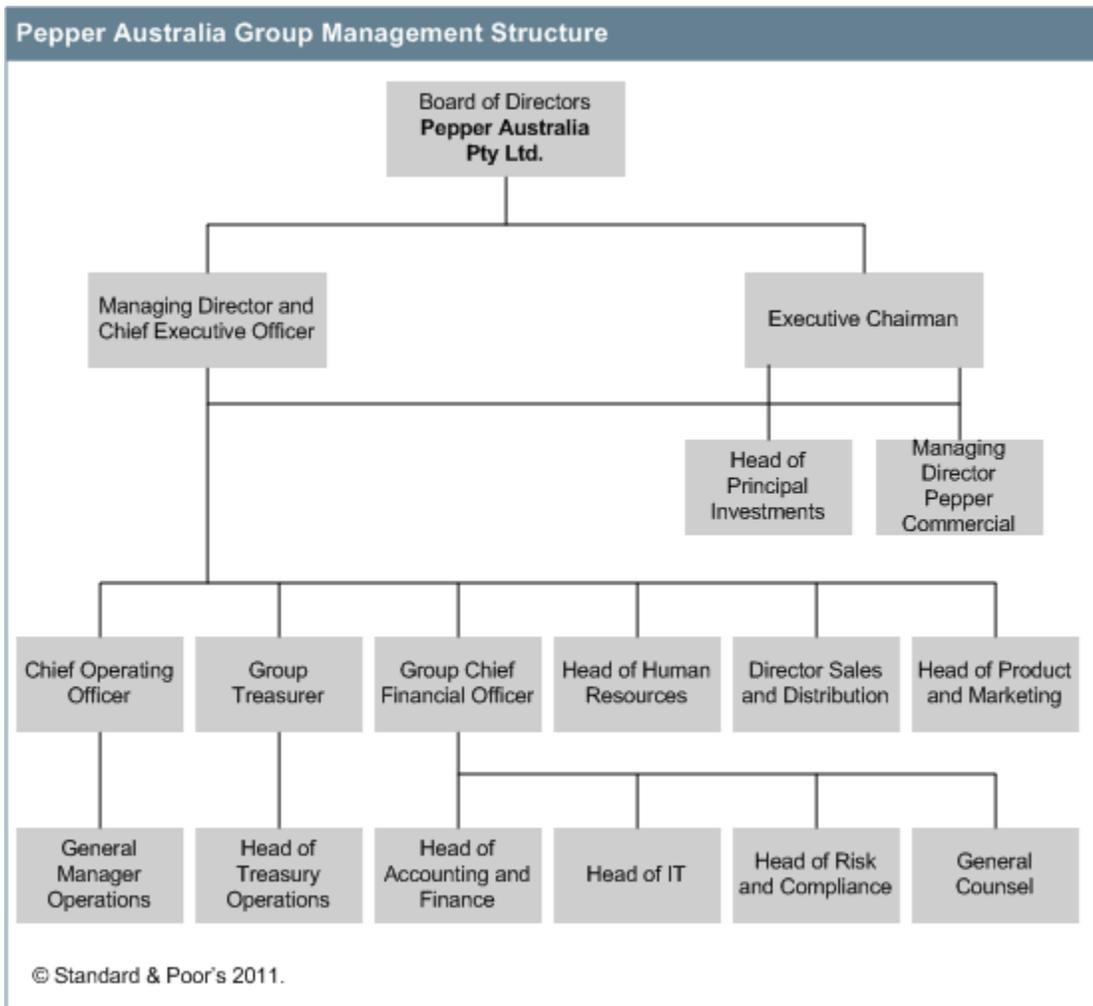
Management and Organizational Structure

In Standard & Poor's opinion, Pepper has a good corporate governance structure; it is managed by an experienced and independent board of four directors and four nonexecutive directors. The board is supported by a well-documented corporate governance statement that outlines roles, responsibilities, and the composition of each subcommittee. It also sets out the frequency of meetings, provides a set agenda, and requires minutes to be documented. These practices are consistent with what we would expect from a servicer with prudent governance practices.

Pepper has a simple and logical management and organizational structure, which reflects its business model. There is an appropriate separation of the functional responsibilities that are associated with originating, underwriting, and servicing residential nonconforming and subprime mortgage loans. The structure also lends itself to allow for effective communication between management and staff.

The management and organization structure of Pepper is outlined in chart 3.

Chart 3



The board of directors and key members of the senior management team have extensive experience in residential nonconforming and subprime mortgage origination and servicing in Australia, and various offshore markets. The management team has the following attributes:

- Senior managers average more than 22 years of industry experience and over seven years of company tenure; and
- Middle managers and team leaders average more than 17 years of industry experience.

Pepper has approximately 86 full-time equivalent employees throughout Australia. Most of these employees are based in Sydney, with others in the Melbourne, Brisbane, and Perth sales offices who oversee broker relationships across all Australian states.

Compliance with defined servicing standards and achievement of financial targets are integral to the key performance measures and incentive schemes of each business unit. These are aligned with the company's overall high-level key performance measures.

Pepper implemented a cultural transformation to further improve its business and performance culture. This has involved improving staff training and an ongoing career-development program. Pepper also has enhanced

performance assessment procedures, and established a well-defined set of corporate values that are linked to the company's vision and strategy.

Overall staff turnover is with industry norms, at 17% between Jan. 1 and Oct. 1, 2011. For the calendar year 2010, the rate was 17%. We believe this reflects Pepper's continued focus on enhancing its sound people strategy.

Risk Management and Compliance Framework

In Standard & Poor's opinion, Pepper's risk-management and compliance framework is robust and an entrenched part of its management practice. Pepper's risk-management and compliance framework progression adopts AS/NZS 4360:2004 and ISO 31000:2009 risk-management standards. Risk and compliance management are Key Performance Indicators (KPI) for all staff.

A risk-management committee meets at least monthly and reports directly to the board. It comprises the functional heads of all business units.

Workshops with managers, team leaders, and staff across each business unit identify, document, assess, evaluate and treat risks within each business unit. Pepper utilizes RISK360® risk-management software to manage its risk registers. Pepper conducts a formal annual review of the risk registers.

Audit and Quality Assurance

Pepper has developed a solid internal audit program, which is underpinned by internal controls and a quality-assurance assessment. Quality-assurance results are tied into KPIs and affect staff performance evaluations. The results are also used to identify training and development needs or additional risks.

This self-control assessment is completed by all business unit managers or team leaders on a regular basis, using a risk-based approach. The risk and compliance manager conducts independent reviews on completed assessments as well as an additional random sample to provide monitoring and oversight of the process. The internal audit framework gives priority to the areas of highest risks and is based on Pepper's risk registers. The internal audit reports are discussed at the risk-management committee and reported to the board.

In addition, Pepper continues to further develop its internal audit framework through the utilization of external and internal subject matter experts.

The board audit committee oversees audit activity within Pepper. The board audit committee is responsible for appointing an external auditor and defining the audit scope of the external audit program with the external auditors.

Technology

Pepper continues to include key IT architecture investment strategies in its business objectives. Pepper has made a substantial investment in IT, and utilizes the following loan servicing platform and processing system:

- Next Gen, a loan-origination portal to manage receipt of online broker lodgments as well as loan application assessment, approval and settlement workflow.
- ARM.net, a bespoke version of ARM designed to support Pepper's loan origination, underwriting and servicing business. Controls are embedded in the system workflow.

The current servicing platform infrastructure will likely allow Pepper to achieve further scalability and efficiencies in its operations, which should help it maintain a competitive position in its specialist niche lending market.

In addition, Pepper has a structured query language (SQL)-based data warehouse that enables comprehensive data analysis and reporting across all of the company's asset portfolios.

Training Programs

Pepper provides substantial training and personal development programs for its employees. It has a detailed induction program and documented position descriptions. A buddy system is used for all new staff members to ensure that a best-practice culture is immediately adopted.

In-house competency-based regulatory and compliance training is compulsory for all Pepper employees. Training is tracked via a training register that is maintained by human resources.

Formal appraisals are performed twice yearly for all employees to assess performance against objectives that are set on an annual basis and to identify personal development paths or training needs. These are complemented by less-formal monthly reviews.

Policies and Procedures

Pepper has well-documented policies, business processes, and system manuals that cover all aspects of loan servicing. These include credit, business process, loan documentation, collections and litigation, complaints procedures, accounting and investor reporting, and system usage. Training manuals supplement the procedure manuals and user guides.

Pepper has thorough controls for developing, drafting and disseminating its policies and procedures to its staff, including electronic storage on an intranet site.

Loan Administration

Ranking: STRONG

Standard & Poor's has raised the ranking for loan administration to STRONG from ABOVE AVERAGE.

Pepper, as of Sept. 30, 2011, was servicing more than A\$1.597 billion nonconforming and subprime residential mortgage loans, and A\$3.909 billion prime loans.

Loan Servicing Philosophy

Pepper adopts a loan-servicing philosophy that is based on providing superior customer service to borrowers, and producing and maintaining the best-performing residential nonconforming and subprime mortgage loan portfolios in Australia.

Standard & Poor's believes the company's high levels of internal controls and astute processing, underwriting and servicing performance objectives are aligned with its servicing philosophy.

Processing and Servicing Technology

In Standard & Poor's opinion, Pepper continues to operate effective processing and servicing systems. These use a combination of vendor and proprietary systems. The company's technology architecture is scalable to accommodate growth.

Pepper has completed the conversion of its ARM system to the latest version of the Microsoft.net platform. The ARM.Net application is a fully integrated workflow-based financial product management and servicing system that

brings enhanced functionality to the operational areas of the business:

- It enables the business to internally customize end-user function and user access, extending system flexibility to fit business requirements; and
- It provides the business with increased flexibility and independence from developers of the system when creating workflow, templates, and reporting production.

A key strength of Pepper's loan-servicing platform is the fully integrated workflow-based loan-servicing platform, which provides full end-to-end servicing capabilities. The system and supporting applications (processing and data warehouse) provide an extremely flexible and scalable platform that supports product development and ongoing process improvements, and allows Pepper to achieve defined service standards as well as related quality and performance measures.

The system workflow is based on loan queuing, tasking, and status recognition. It is configured to reflect the process flows, tasking, servicing standards, controls, and separation of functional responsibilities. It also allows staff to access authorizations prescribed by Pepper. Strict controls are embedded in the system workflow. The ARM system architecture is structured according to the client relationship management tool and the workflow manager. The ARM system is also compliant with the LIXI (Lending Industry XML Initiative) programming language. This enables efficient interfacing with third-party systems if required.

System-generated instructions and associated documents are issued to solicitors, valuers, and originators. Template documents are automatically produced by the system when relevant tasks are reached in the process. In addition, Pepper can track the status of loan documentation through the panel solicitors' Web site.

Pepper in December 2011 began using a broker module as part of Phase 2 of its Next Gen application-processing system. Standard & Poor's sees this as an example of Pepper's willingness to improve its processes. The new broker module encourages all introducers to submit loan applications electronically and allows for more oversight of the status of loan applications, with strict security access and administration.

Standard & Poor's believes that Pepper maintains comprehensive business continuity and disaster recovery plans. These plans are tested on an annual basis. Testing involves validation of the business continuity strategy and testing the restoration of all critical processes. Pepper has established a formal disaster recovery site and data centre, which it tests regularly. The backup site contains 100 operational workstations. Pepper began replicating real-time data to the disaster recovery site in March 2008.

Data Processing and Integrity

In Standard & Poor's opinion, Pepper continues to maintain appropriate data-processing procedures to support its loan-servicing platform and servicing process.

A key strength of Pepper's loan-servicing system is the strict controls and security features, such as verification checks. These features complement the manual verification, validation, and quality-assurance procedures. The loan-servicing system also contains verification rules to ensure that certain fields are completed before the status of a loan can change.

All loan applications are reviewed for completeness and compliance with Pepper's stringent information requirements. Standard identification procedures are completed for all borrowers and are matched to the relevant application details.

The loan-servicing system creates an automatic audit log for each task, which is reviewed to ensure that all tasks have been completed. Security features prevent specified tasks from being deleted. Flags generate alerts when tasks are incomplete, and prompt for manual review and follow up.

"Welcome packs" are sent to borrowers when a loan is settled, and welcome calls made after settlement to confirm the accuracy of the information relating to each borrower and the loan repayment arrangements.

Accounting and Investor Reporting

Pepper has sound reporting capabilities through a data warehouse that uses SQL reporting techniques. Next Gen and ARM provide direct data feeds into the data warehouse. This boosts data accuracy.

SQL reporting techniques provide the company with additional operational benefits that include:

- The ability to interrogate data and customize reports;
- Multiple report output formats;
- Combining data from multiple data sources; and
- The development of additional internal reporting.

The IT team remains responsible for the creation and amendment of existing reports, and is able to quickly create customized reports. A comprehensive range of reports is produced daily, monthly, and on an ad-hoc basis. These cover loan origination, servicing, arrears, and the status of each portfolio. Reports are disseminated electronically and in hard copy.

Document Custody

Pepper Finance Corporation Limited is the lender of record and holds legal title to all mortgage loans originated under the Pepper HomeLoans lending program. An independent custodian holds all security documents on behalf of Pepper.

System-generated template loan documents are automatically transferred to solicitors and from the solicitor to the custodian after settlement. Pepper maintains a security document-tracking log to monitor the location of security documents and to ensure the timely lodgment of documents by solicitors with the custodian. The loan-servicing system automatically flags accounts and sets follow-up tasks if the custodian has not received the security packets within the specified post-settlement period. The custodian is notified of whole loan sales or securitization of loans to record the beneficial ownership of each loan.

All documentation and correspondence is imaged as part of a customer-based electronic storage and retrieval system. All system-generated template documents, notices, emails, spreadsheets, faxes, and correspondence are retained, and form part of the electronic file for each customer. A paper file is also created for ease of use by servicing staff and mirrors the progress of a loan through each task in the process.

Client Relations

Pepper's call center forms the primary support point for brokers and borrowers. The call center operates on an in- and out-bound basis. The call center also supports "white label" programs through separate telephone numbers to differentiate between each program.

Pepper provides its broker network with access to forms, guidelines, manuals, and calculators through its password-protected corporate Web site. Brokers are also notified of changes to policies and procedures by email and

through newsletters promoting new products and other related information. The broker network is ultimately responsible for managing relationships with borrowers.

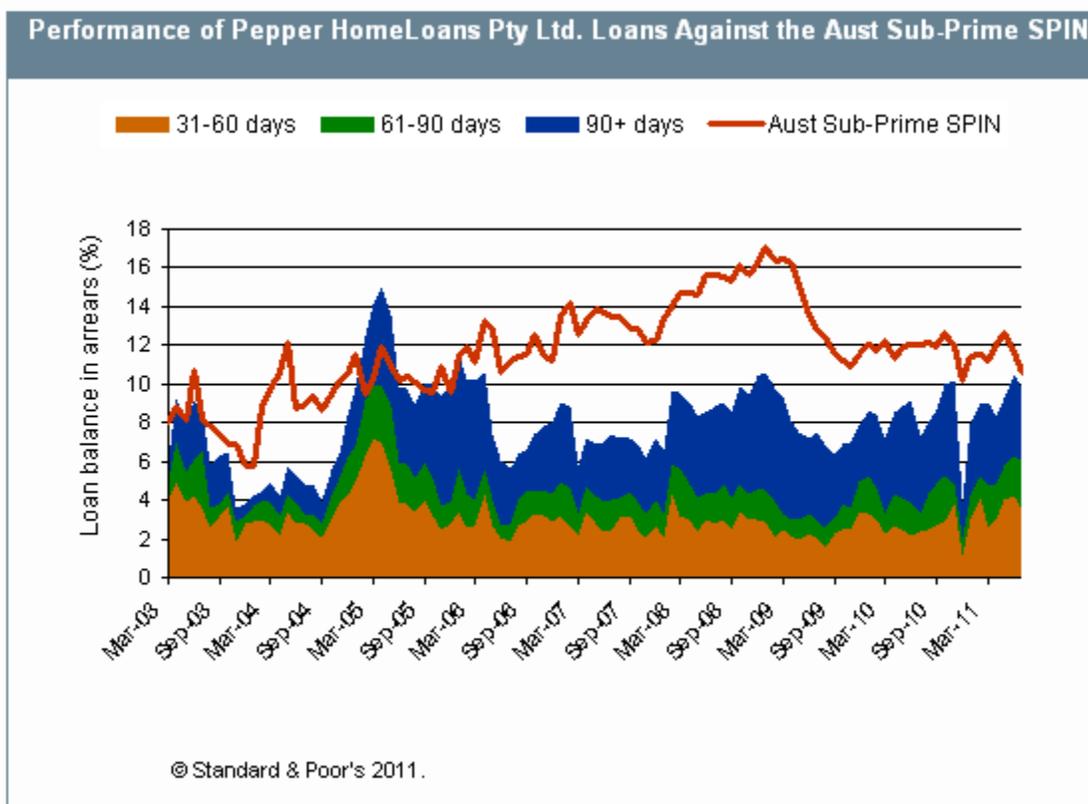
The broker network is supported by a team of business development managers who provide national coverage and are responsible for maintaining ongoing business relationships with brokers. The team provides regular product training to brokers and is supported by telemarketing personnel.

Pepper's corporate Web site provides existing and prospective investors in funding programs, collateralized by mortgages originated and serviced by Pepper, with password access to information on the status of the loan portfolios and issued securities.

Arrears Management

Pepper has sustained superior arrears-management and loss-mitigation strategies. It continuously amends workout strategies, policies, and procedures. The company's arrears portfolio performance compares favorably against Standard & Poor's Subprime SPIN index (see chart 4). Pepper measures and manages arrears on a missed-payments basis.

Chart 4



The objective of the arrears management team is to mitigate losses through early detection, quick response, and identifying and implementing optimum solutions. The arrears management team attempts to build rapport with customers experiencing loan account delinquency, and explores all avenues, including hardship arrangements. This approach is strengthened by ensuring the same collector is responsible for an account until the arrears are cleared or the property is repossessed.

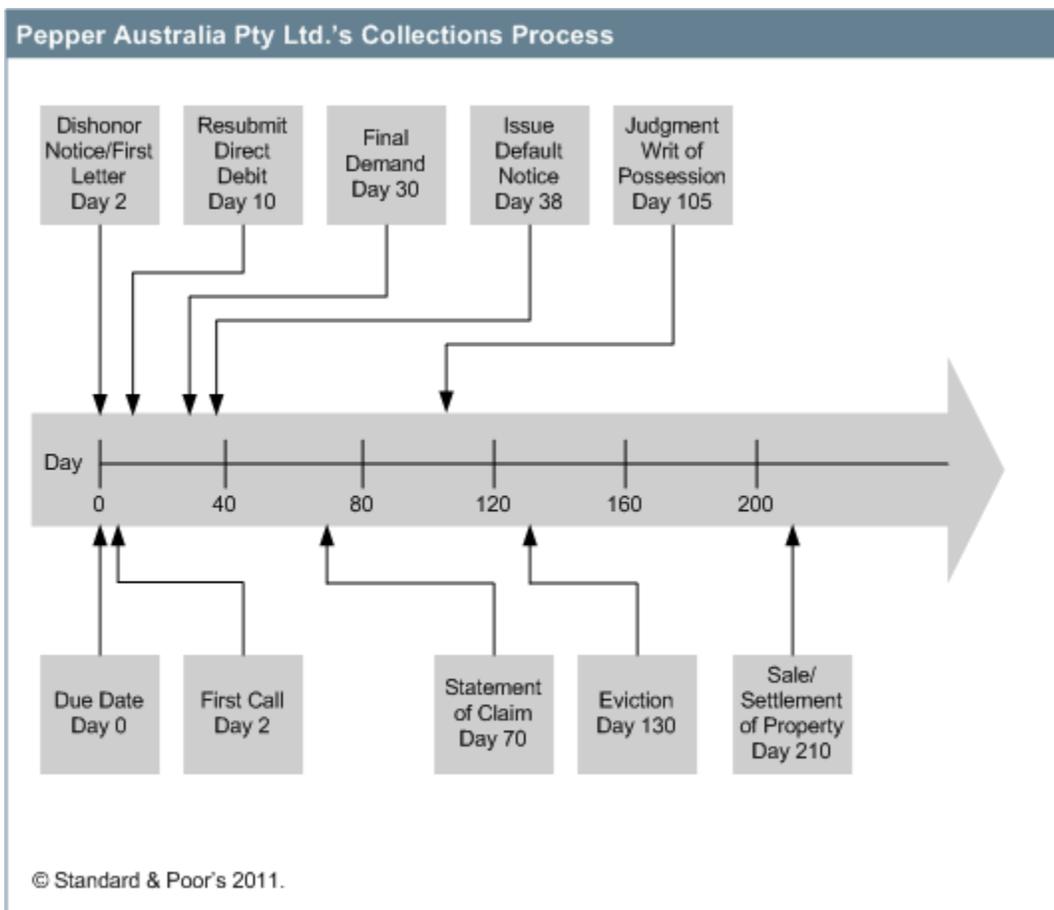
There are well-resourced customer service and arrears management teams, of five and 13 people, respectively, based in the north Sydney head office. They have extensive experience in managing and collecting nonconforming mortgages.

The team is supported by a fully integrated, end-to-end technology platform that has been specifically configured to meet Pepper's specific requirements for originating, underwriting, and servicing non-conforming mortgages. The system is flexible and provides for detailed diary notes to be entered relating to each account. The notes are referenced direct to accounts and automatically create actions for a defined user.

Well-documented policies and procedures are detailed in the business process. Collections and litigation manuals provide guidelines to staff on arrears management.

Chart 5 shows Pepper's collections process and provides an indicative timeline.

Chart 5



The arrears management system generates reminder, missed payment, and dishonor letters. Collection activity is monitored on a daily basis. A system-generated task is added to a collector's task list when the arrears status of a loan changes. Journal notes are maintained on the system. Senior collectors are aware of all serious arrears cases and oversee all workflow.

All information sourced from the arrears management system is done in real time. In addition, cyclical factors are

monitored to predict peak delinquency periods. An interactive Web site is also in place. Solicitors monitor outstanding litigation.

Financial Position

Ranking: SUFFICIENT

In Standard & Poor's opinion, Pepper's financial position is sufficient to sustain its residential subprime loan servicing operations at the current level for the next 12–18 months.

Related Criteria And Research

- Revised Criteria For Including RMBS, CMBS, And ABS Servicers On Standard & Poor's Select Servicer List, April 16, 2009
- Servicer Evaluation Criteria: Australia and New Zealand, Aug. 2, 2008

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