



## **WHITE PAPER**

### **Article III Language**

#### **I. Underwriting File**

As part of the servicing transfer process, the Depositor should deliver the “underwriting file” to the Servicer. The “underwriting file” consists of all relevant servicing or loan documents and records in the possession of the Depositor or the Sellers that relate to the Mortgage Loans and that are not required to be a part of a Mortgage File in accordance with the definition thereof. This file is frequently difficult to find after closing, but can be critical to understanding the loan. Of particular importance is the delivery of all credit memorandum and underwritten financial information including third party reports such as environmental reports and appraisals. Ideally these reports should be delivered in Excel format to permit easy access by multiple parties in the transaction (such as the Master Servicer, Special Servicer and Directors Certificateholders). A standard form checklist should be developed by the MBA to be attached.

#### **II. Responsibility for Monitoring and Pursuing Breaches of Material Breaches**

Most PSAs require that upon the discovery that a Mortgage Loan Seller has materially breached its representations and warranties contained in the Mortgage Loan Purchase Agreement or that any document required to be included in the Mortgage File is missing or materially defective, the defaulting Mortgage Loan Seller is required (if such breach or defect remains uncured) to repurchase such Mortgage Loan or substitute another qualifying mortgage loan in its place. In many cases, however, the PSA does not specify the party or parties to the PSA responsible for (i) determining whether a material breach of the Mortgage Loan Seller’s representations and warranties has occurred or (ii) pursuing a repurchase claim against the Mortgage Loan Seller with respect to such a material breach.

It is therefore recommended that the term sheet for the securitization and the PSA should reflect the parties’ agreement on the appointment of (i) the party or parties to the transaction who will be responsible for making a determination that a material breach of the Mortgage Loan Seller’s representation and warranty has occurred (which may be in accordance with an objective standard agreed upon by the parties to the transaction) and should be pursued and (ii) the party or parties to the transaction who will be responsible for commencing the appropriate enforcement actions against the defaulting Mortgage Loan Seller in order to enforce the remedies available under the Mortgage Loan Purchase Agreement and the PSA.

#### **III. Waiver of Fees**

Many PSAs empower the Master Servicer (with respect to performing loans) or the Special Servicer (with respect to specially serviced mortgage loans) to waive the payment of default charges or

certain other fees otherwise payable by a borrower under a mortgage loan. The circumstance under which Master Servicers or Special Servicers may waive such charges or fees varies. These provisions are usually found in sections of the PSA which relate to the collection by the Master Servicer or the Special Servicer of payments and other amount due in respect of the mortgage loans. PSAs also typically contain separate and distinct sections, which provide for restrictions on the ability of the Master Servicer or the Special Servicer (as applicable) to waive or amend provisions of the mortgage loans (e.g., the payment of default charges or other fees by the related borrower) without the Master Servicer or the Special Servicer (as applicable) first obtaining the consent of the other.

The Task Force noted that in many cases, the provisions of PSAs which empower the Master Servicer or the Special Servicer to waive default charges or other fees otherwise payable by a borrower on the one hand, and the provisions of PSAs which restrict the ability of the Master Servicer or the Special Servicer to waiver or amend the mortgage loans on the other hand, are either inconsistent or difficult to reconcile. The Task Force also observed that in many cases, the circumstances under which such default charges and other fees were permitted to be waived were not clearly delineated. Additionally, the Task Force discussed the specific issues pertaining to the ability of the Master Servicer or the Special Servicer to waive charges and fees that would otherwise be payable to the other party, and the conflicts potentially raised under such circumstances.

Accordingly, the Task Force recommends that the applicable parties to the transaction should, well in advance of closing, agree upon the extent of, and the conditions restricting, the respective rights of the Master Servicer and the Special Servicer to waive any charges, fees or expenses otherwise payable by the borrower under a mortgage loan to either the Master Servicer or the Special Servicer. The Task Force further recommends that the PSA for the transaction should clearly reflect the parties' agreement on these issues, and that such provisions should be housed in a single section of the PSA, or alternatively, that proper and complete cross-referencing to the appropriate sections of the PSA should be employed.

#### IV. **Servicing Standard**

The defined term "Servicing Standard" should universally include servicing in accordance with the "terms of the Mortgage Loans, the PSA and applicable law." Unfortunately, many forms of the PSA exclude these criteria from the defined term and then include the requirements separately in the body of the document. (Stating that the Servicer will service "in accordance with the Loan Documents, the terms of this Agreement and applicable law, and to the extent consistent with the foregoing, the Servicing Standard.") The problem this creates is that the "terms of the Mortgage Loans, the PSA and applicable law" must then be incorporated separately each time the Servicing Standard is referenced. This is frequently forgotten in the drafting process.

#### V. **Taxes, Insurance**

Pooling and Servicing Agreements inconsistently distinguish Servicer procedures for payments that are made out of escrows and payments that are made by the Borrower directly. Payments from escrow accounts are made by the Servicer and advanced if the escrows are not sufficient. This is generally done by the due date for such payment (or at least prior to the penalty date or cancellation date with respect to insurance premiums). Non-escrowed payments are advanced in accordance with the Servicing Standard. The Servicer will not know until after due date for non-escrowed loans that payment has not been made. Frequently, there can be a lag between payment and

the posting of the payment by the relevant taxing authority. Accordingly, the Servicer in accordance with the Servicing Standard may make a late payment. Otherwise the Servicer could be advancing (and accruing advance interest) on payments that have already been made by the Borrower. In addition, PSA's inconsistently provide for maintenance of insurance policies and force placed insurance. The escrow account provisions in the loan documents can conflict with the force placed insurance provisions in the PSA. When this occurs, the Servicer will force place insurance in accordance with the Servicing Standard. With respect to flood insurance, some PSA's require the Master Servicer to obtain (or required the borrower to obtain) flood insurance if the mortgaged property is in a flood zone. FEMA maps are periodically redrawn. Accordingly, the timing of obtaining such insurance should be left to the Servicing Standard.

## **VI. Deposits into the Collection Account/Distribution Account**

Pooling and Servicing Agreements (PSAs) are inconsistent with respect to funds required to be deposited into the Collection Account. Specifically, PSAs often require certain fees, such as late payment fees, to be either (i) deposited and withdrawn as additional servicing compensation or (ii) retained by the Servicer. As a practical matter most Servicers prefer to simply retain additional compensation. This is especially true if Primary Servicers are entitled to the fees. Accordingly, each PSA should clearly state that the Servicer is obligated to deposit into the Collection Account all amounts received in respect of a loan except for funds being retained by the Servicer as additional servicing compensation.

The Collection Account is normally defined as an account established and maintained "by the Servicer." Because the Collection Account is often a group of accounts maintained by the Servicer and multiple Subservicers, the language needs to define the Collection Account as an account "establish and maintained by, or on behalf of, the Servicer."

Finally, the current market forms of PSA provide for deposits and withdrawals from the Collection Account, each Distribution Account and the Interest Reserve Account (if applicable) all covered in two sections; one for deposits and one for withdrawals. It would make the document clearer if each account were handled in a separate section.

## **VII. Priority of Withdrawals**

PSAs differ with respect to whether the section addressing permitted withdrawals from the certificate account and/or distribution account establishes a priority for withdrawals. As a practical matter, priorities are not appropriate as the timing of withdrawals lend themselves to differing priorities at different times (for example, payment of a Trust expense might be required at any time during a month). In addition, each list of permitted withdrawals should include a catch-all for "any amounts permitted to be withdrawn pursuant to the Agreement." Frequently, PSAs attempt to limit withdrawals with respect to expenses to specific cross-references to other sections in the PSA. What happens, as a practical matter, is a Trust paid expense is added at the end of the negotiation process deep in the document, but the section addressing permitted withdrawals is never amended. Accordingly, the expense is authorized, but no mechanism exists to get the funds out of the Collection Account.

## VIII. Due on Sale/Assumption

In a typical PSA(s), the section addressing enforcement of due on sale clauses and assumption agreements has become one of the most highly negotiated sections of the PSA. The roles of the Servicer (including any Primary Servicer), Special Servicer, Directing Certificateholder and the Rating Agencies appear to vary from deal to deal. The two driving factors appear to be (i) what role the Directing Certificateholder wants itself and its appointed Special Servicer to play in the underwriting and approval of assumptions and (ii) what loans the Rating Agencies specifically want to review before an assumption (or waiver of the due-on sale) is approved.

While the various roles should be the subject of party preferences, PSAs have routinely poorly defined who is responsible for what. If the Special Servicer must approve an assumption, the PSA should clearly state who is responsible for the primary underwriting of the transaction and who is responsible for closing the transaction. The party responsible for underwriting, in general, should also close the transaction and should have the stated responsibility of obtaining any Rating Agency no downgrade letter. There should be absolute clarity on each point. If a Directing Certificateholder must give consent, the time period for its review should be clearly stated.

With respect to Rating Agency “no downgrade” letters, the requirement to obtain the “no downgrade” letter should match the Rating Agencies’ policies on issuing letters and the Mortgage Loan Documents. Frequently, however, PSAs contain requirements for obtaining “no downgrade” letters that do not match current Rating Agency pronouncements, and when asked for a “no downgrade” letter under these circumstances, the Rating Agency might conclude one is not necessary and decline to provide one. The result is that the Servicer has an obligation under the PSA to obtain a “no downgrade” which it may not be able to satisfy. In addition, fees charged by the Rating Agencies should have a clear source of payment. If the Loan Documents require Borrower payment, it should be a condition to closing for the Borrower to pay the fee. Some PSAs now require the Servicer to collect the fee from the Borrower as a condition to approval, whether or not the Borrower is required to pay the fee pursuant to the Loan Documents. If the Loan Documents are not clear, or do not require the Borrower to pay, the source of the payment should be clearly identified (typically, the Borrower, Mortgage Loan Seller or the Trust).

## IX. Defeasance

The Task Force observed that the provisions of many Pooling and Servicing Agreements that relate to administration of defeasances do not clearly designate the party responsible for purchasing the securities comprising the defeasance collateral. The Task Force concurred that under most circumstances, the related mortgage borrower would appropriately be charged with purchasing the defeasance collateral.

The Task Force also noted that Pooling and Servicing Agreements frequently provide for defeasance requirements, which are in addition to the requirements for defeasance contained in the related mortgage loan documents. The Task Force acknowledged the value of requiring these items where (i) such additional requirements provide for additional REMIC or grantor trust safeguards, (ii) such additional requirements do not otherwise contravene the related mortgage loan documents or (iii) there are reasonable grounds (whether in the related mortgage loan documents or otherwise) for the Master Servicer to require these additional items of the related mortgage borrower. Where such additional items are to be required in connection with a defeasance, the Pooling and Servicing Agreement should clearly provide for the party responsible (e.g., the related borrower, mortgage loan

seller, depositor or the trust) for payment of the costs and expenses related to obtaining such additional items.

The PSA should also provide instructions for how to deal with loans that do not provide that additional requirements may be imposed for defeasance other than those requirements described in the loan documents.

#### **X. Annual Statement as to Compliance Reports by Independent Public Accountants**

It is recommended that both the Master Servicer and the Special Servicer should provide annual statements as to compliance and annual reports from their accountants. This practice is followed under most securitizations, but there are some that don't require the Special Servicer to provide such information unless it is specially servicing loans under the securitization. Such a practice leaves the securitization vulnerable to the possibility of not discovering that a Special Servicer doesn't comply with required soundness and performance standards until a need arises to transfer a specially serviced loan to the Special Servicer. This risk can be minimized by having the Special Servicer provide compliance and accounting reports are provided annually.

The Task Force noted that the current Uniform Single Attestation Program for Mortgage Bankers (USAP) is designed primarily for the residential, rather than the commercial segment of the market. The MBAA is currently working on producing a recommended commercial USAP.

#### **XI. Property Inspections**

The Task Force noted that the format used to report information on property inspections varies widely within the industry, which can result in a lack of uniformity of treatment of the different properties securing loans in a mortgage pool. To ensure greater uniformity of the information provided in property inspection reports, the Task Force recommends that property inspectors be encouraged to use the MBA/CMSA property inspection form for reporting information on commercial properties.

#### **XII. Default Interest and Late Charges**

The Task Force has observed that some PSAs don't clearly distinguish between the meanings of the terms "default interest" and "late charges" or "late payment charges." Default interest is customarily understood to refer the increase in the rate of interest payable on a defaulted mortgage above the rate payable when it is not in default. Late charges and late payment charges refer to charges imposed on borrowers for making late payments. Some agreements use the term "penalty charges" to refer exclusively to late payment charges, while others use the term to include default interest.

For transactions in which default interest, but not late payment charges, is used to repay the Trust for interest paid on servicing advances, it is important that the PSA clearly distinguish between default interest and late payment charges. Although there is a degree of variation among transactions, late payment charges often are not used to offset interest paid on servicing advances on the theory that late payment charges are meant to compensate Servicers or Special Servicers for the cost of chasing after borrowers for late payments.

In order to avoid unnecessary disputes during the drafting process, it is advised that the servicing rights bid letter specify the meanings of default interest and late charges and whether none, either or both are to be used to offset interest paid on servicing advances.

In addition, for PSAs that provide that the Master Servicer receives late payment charges and/or default interest on non-specially serviced loans and the Special Servicer receives such charges on specially serviced loans, there can be uncertainty as to which party is entitled to receive such charges for loans that are non-specially serviced when such charges come due, but have become specially serviced by the time such charges are collected. The Task Force recommends that when this occurs, such charges be allocated between the Master Servicer and the Special Servicer based on the time the loan was master serviced or specially serviced. In addition, in cases in which a loan has become specially serviced while late payment fees and default charges due to the Master Servicer for such loan have not been paid, the Task Force recommends that such fees due the Master Servicer not be waived by the Special Servicer unless the Master Servicer agrees or unless all late payment fees and charges (including those due to the Special Servicer) are waived. This is consistent with the principle that the Master Servicer and Special Servicer, respectively, should not waive fees to which they are not entitled.

### **XIII. Initial Transfer of Loans to Securitization Trust**

The Task Force has noted that the transfer of loans from mortgage loan sellers to the securitization trust is often more time consuming and costly to Servicers than need be because information about the loans is often incomplete. As a result, Servicers are often unaware of important characteristics of the loans when they begin to service them. The Task Force believes that mortgage loan sellers should have greater responsibilities for providing required information about the loans and should provide more assistance in informing borrowers of the transfer of ownership of the loans to the trust. The Task Force recommends that the PSA require mortgage loan sellers to represent that they have provided all material information about the loans, perhaps in the form of a loan summary sheet (to be an exhibit to the PSA) that would accompany each loan as part of the mortgage loan file. In addition, the Task Force recommends that mortgage loan sellers be required to represent that they have provided notice of the transfer to all ground lessors and that they have transferred all lockboxes and other accounts relating to the loans to the trust. Finally, mortgage loan sellers should be required to include pre-signed “hello/goodbye” letters in the mortgage loan files they deliver so as to save Servicers the time and expense of having to follow-up with mortgage loan sellers to get them signed.

### **XIV. Lockboxes**

In order to make servicing transfers more efficient, and to the extent not already incorporated in the PSA, the Task Force recommends that PSAs (and if applicable any related subservicing agreement) specifically require the depositor or loan seller to require the departing Servicers (or Subservicer) to notify banks that hold lockboxes and bank accounts established pursuant to the PSA of the transfer of control of such accounts to successor Servicers. Mortgage loan sellers should also include this provision as part of their interim servicing agreements.

## **XV. Ongoing Surveillance Fees**

Many PSAs are silent as to which party is responsible for paying ongoing rating agency surveillance fees. PSAs should make clear which party is responsible for paying such fees, regardless of whether they are reimbursable as a trust fund expense.

## **XVI. Reporting**

PSAs often require Servicers to provide reports on CMSA recommended forms, which are changed from time to time. In particular, the information required to be provided on watchlists often is increased. This can obligate Servicers to produce reports that include information that the Servicers don't have or have the right to require from borrowers. The Task Force recommends that PSAs provide that any proposed changes in the Servicer's reporting obligations be acceptable to the Servicer. In addition, it is recommended that securitization program operators make any changes to Servicer reporting obligations programmatically across all their deals and not on a deal-by-deal basis and that individual Certificateholders not be given the option of approving or disapproving proposed changes in the content of CMSA reports produced for their transactions. The Task Force believes it would prove to be unduly expensive, ultimately unworkable and counter to the goal of greater standardization to have different transactions within a securitization program requiring different reporting requirements based on different versions of CMSA reports.

The Task Force has found that timing issues are presenting tremendous challenges to Servicers. Often, PSAs require Servicers to produce reports within 48 hours of receiving underlying information. If Subservicers are involved, the effective time period may be only 24 hours. These extremely tight deadlines are straining Servicers' abilities to produce reports within the time periods required. The Task Force recommends that parties to PSAs be as flexible as possible (in light of investor expectations and requirements) in setting deadlines for Servicers to produce reports and give due consideration to Servicers' estimations of the time it actually takes to process information and produce reports. In particular, where PSAs allow Certificateholders or other interested parties to require Servicers to produce non-recurring, ad hoc reports, it is recommended that any deadlines for the production of such reports be flexible enough to allow Servicers to obtain information that may not be immediately available. This can be accomplished by including language that the Servicer will produce such reports by such deadline or "as soon as practicable thereafter consistent with the Servicer's customary business practices and in light of the need to obtain and process necessary information."

## **XVII. Insurance**

Almost all PSAs require Servicers to make sure that mortgaged properties are insured as required under the applicable loan documents. To the extent that loan documents allow lenders to require additional insurance, PSAs require Servicers to require insurance consistent with applicable servicing standards. Many loan documents simply require borrowers to maintain "all risk" insurance, however, all risk policies can vary enormously and have a wide variety of exclusions. The result may be that Servicers believe certain risks should be covered that are not covered by an all risk policy, while borrowers insist that they are only obligated to maintain policies that are designated as "all risk" insurance policies. The recent experience with terrorism coverage has highlighted the potential for this problem. Where possible, it is

recommended that loan documents for mortgages to be securitized specifically identify that risks that must be covered by all risk insurance policies and describe exclusions which are unacceptable. In light of current events, it is recommended that coverage for terrorism and other exclusions from coverage specifically be addressed. In addition, general liability insurance frequently can not be force placed or such insurance can be commercially unreasonable to obtain (from a cost perspective). The PSA's should not require obtaining insurance in such circumstances.

### **XVIII. Subservicers**

In general Subservicers should not have the ability to execute documents in the name of the Trust. The power of attorney to execute documents in the name of the Trustee should be exercisable by the Master Servicer. Documents should be submitted by the Subservicer to the Master Servicer for execution. In limited circumstances, a Primary Servicer becomes a Subservicer by the Master Servicer assuming the obligations of the Mortgage Loan Seller under an existing primary servicing agreement. If such agreement exists and permits the Primary Servicer to act on behalf of the Trustee after securitization, the PSA should clearly state that such Primary Servicer must be given a power of attorney and appropriately limit the liability of the Master Servicer and Trustee for its use by the Primary Servicer.