



**MBA CONFERENCE CALL ON  
SECTIONS 1122 AND 1123 OF  
SEC REGULATION AB, *Asset-Backed Securities*  
Monday, August 23, 2005**

**MINUTES**

List of Participants: See attached.

**I. Welcome & Introductions**

At 3:00 p.m. ET, on August 23, 2005, Alison Utermohlen, Staff Representative to MBA's Financial Management Committee, began the call by thanking members for their participation.

After introductions, she noted that the primary purpose of the call was to continue an earlier discussion, held during a MBA sponsored call on August 8, 2005, of Sections 1122, "Compliance with applicable servicing criteria," and 1123, "Service compliance statement," of SEC Regulation AB, *Asset-Backed Securities*. More specifically, she said the call was intended to give members the opportunity to continue their discussion of the 5% threshold reporting requirement under Section 1122, and to consider additional issues associated with: (1) application of the 10% threshold under Section 1123; (2) the servicing criteria in Section 1122; (3) testing at a "platform level"; 4) judging material noncompliance and other matters. She said the call would conclude with a discussion of what MBA should do to address outstanding issues.

She then briefly summarized the August 8 call for the benefit of members who did not participate in it.

**II. Major Issues Discussed on August 8**

A. Implications of Section 1122 to USAP

In summarizing the previous call, Ms. Utermohlen reiterated that:

- MBA efforts to update the USAP have been discontinued
- MBA has no plans at present to withdraw the USAP
- The USAP is not being sold by MBA due to poor sales; however, electronic copies are being made available to all interested parties free-of-charge
- MBA is taking a 'wait and see' attitude before making any decisions about the USAP

Relative to the last point, she said MBA has decided to wait until the effects of Reg AB are better known before making any decisions about the USAP, and that any future decision to withdraw or revise the USAP will reflect market conditions as well as MBA member concerns and interests.

#### B. Application of the 5% Threshold for Reporting under Section 1122

Ms. Utermohlen explained that most of the remainder of the call on August 8th focused on the application of the 5% threshold for reporting under Section 1122.

She said the conversation focused on how a “static” calculation, based on the UPB of the loans serviced at the closing of a transaction<sup>1</sup>, might affect servicers that assume servicing subsequently (via sales, mergers and acquisitions, and outsourcing arrangements). Various examples of servicing transfers were described, with members questioning when, and if, a party assuming servicing after the closing of a transaction might be responsible for reporting under Section 1122. Questions were raised also about the potential implications of the threshold calculation for third party vendors, under either a static or dynamic calculation, including how the calculation would work for parties that perform a minor role in the servicing activities.

Ms. Utermohlen noted that the August 8 call did little to address member questions about the 5% threshold. Consequently, she said the next part of the call would begin with an open discussion of that aspect of Reg AB. She then referred everyone to a list of discussion questions which was attached to the agenda.

### III. Open Discussion of Issues

#### A. Application of 5% Threshold under Section 1122

**QI:** How common are transfers of servicing (due to sales, mergers or contracts to outsource the servicing) from parties named in transactions to third party entities that are not named in the transactions after the closing of the transaction in: (1) commercial ABS deals? (2) single-family residential ABS deals?

**Member Response:** Several participants noted that it is quite common for servicing to change hands after the closing of a transaction. One member stated that their company has assumed the servicing portfolios of several companies it has acquired in recent years.

Someone else noted that, on the single family side, servicing rights can change hands shortly after the closing of a transaction as servicing often transfers from correspondent lenders to other entities a few months after that date. In addition, the servicing on 60 to 90 day delinquent loans is often transferred to “special servicers” after the closing of a transaction.

Another participant noted that Reg AB could encourage greater transfers of servicing by entities that want to avoid the reporting responsibilities of Sections 1122 and 1123.

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<sup>1</sup> MBA minutes to a call with an attorney-advisor at the SEC indicated that the 5% threshold should be calculated based on the UPB of the underlying loans at the closing of the transaction.

Katie Schwarting, MBA, asked: Are special servicers furnishing third parties with USAP Reports<sup>2</sup> today”?

Someone said it would be unusual for a special servicer’s USAP Report to be filed with a Form 10-K today. Nevertheless, it is common that the special servicer is obligated to provide its USAP report to the party that retained the special servicer even though that USAP may not be filed.

Ms. Schwarting asked: Which parties might be required to report under Reg AB that do not report now?

Several people responded that the answer would depend on several factors, including how the 5% and 10% thresholds are calculated under Sections 1122 and 1123, respectively.

Another participant observed that there is an interesting conundrum between what the party responsible for signing the 10-K (i.e. the “responsible party”) must do, and what they might be penalized for. For example, the responsible party must ascertain whether all reports (under Section 1122) and compliance statements (under Section 1123) that should have been prepared and submitted to them were, in fact, received. However, the responsible party may have limited ability to ascertain which parties were subject to reporting under these sections, especially if servicing of the pool assets transferred during the year.

**Q2:** How common are transfers of servicing (due to sales, mergers or contracts to outsource the servicing) from parties named in transactions to other parties that are also named in the transaction after the closing of the transaction in: (1) commercial ABS deals? (2) single-family residential ABS deals?

**Member Response:** Some conversation ensued about the circumstances in which servicing changes hands among different parties named in the deal documents. As an example, Ms. Schwarting offered that master servicers may buy other servicers out of transactions after the closing of CMBS transactions.

One participant said that there is often a two to three month delay in RMBS transactions between the closing of the transaction and the transfer of the servicing from the originating entity, or correspondent lender, to the entity that will perform the servicing.

A member offering the following example: Payments on collateral are received and processed during a October/December timeframe by an interim servicer who may not be named in the transaction documents, and in December the servicing is transferred to a servicer that is named in the transaction documents. They explained that this scenario is a reverse of the situations described in Q1 and Q1 above because it involves a party, not named in the documents, transferring servicing to a party that is named in the documents. They clarified that in this

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<sup>2</sup> The term “USAP Report” is defined as “The report that shall be furnished to investors upon completion of the USAP engagement and is comprised of management’s assertion (see Exhibit I) and the CPA’s report (Exhibit II).” (see Glossary in Appendix A of USAP).

“reverse” situation the interim servicer/s may be identified in the offering document (i.e. prospectus supplement) but not in the related Pooling and Servicing Agreement.

Someone then said they would expect that the SEC would want to receive an attestation engagement report from both sets of servicers (including the interim servicers), depending upon the time at which you calculate the 5.0%.

Another person agreed saying that it is clearly the intention of Section 1122 that all parties are subject to reporting if they are “participating in the servicing function.”

Yet another person said that if the interim servicers are named in the offering documents they would probably be subject to reporting under Section 1122.

Ms Utermohlen asked: Is it clear whether the interim servicers should file reports covering a fiscal year, or just the period for which they serviced the assets?

Someone said that if interim servicers are performing servicing throughout the year their attestation reports would probably cover a full year.

Some discussion ensued about the implications of interim servicers performing the servicing across years (e.g. from November through January), especially in connection with 34 Act reports (particularly Form 10-D) that rely solely or predominantly on information provided by the interim servicer.

Someone pointed out that the Regulation allows the trust to adopt a reporting year, and that the servicers’ reports should be consistent with that year.

**Q3:** For companies that typically delist after the closing of a transaction, is the 5% threshold for reporting a concern? If so, what are the concerns?

**MBA Response:** Someone noted that the response to this question depends upon when the 5% must be calculated. For example, if the 5% threshold is required to be calculated at the closing of the transaction, parties that meet the threshold at the closing would be required to file reports regardless of whether they delist during the year. However, if the 5% threshold is required to be recalculated over time, then it is possible that parties that delist might not be subject to filing reports.

One participant noted that the American Securitization Forum had raised a question regarding the calculation of the 5% threshold in a letter to the SEC. Ms. Utermohlen noted that MBA had raised the question informally with the SEC also.

Several people agreed that it makes sense for the registration and disclosure requirements of Reg AB to be tied to the “closing of transactions” but that a static calculation did not seem to make sense within the context of Section 1122.

Refer to attached scenarios for the following:

**Q4:** Under Scenario A, assume a servicer meets the 5% threshold for reporting at the closing of the transaction but later enters into a contract with a third party vendor/s to perform one or more of the functions identified in the servicing criteria after the closing of the transaction. In that instance, is the third party subject to reporting under Section 1122? If not, how is the servicer expected to assess (and the servicer's auditor to attest to) management's compliance with the function/s being performed by the vendor/s for the purpose of reporting under Section 1122?

**Member Response:** In considering Scenario A, a participant said that although Servicer D transferred some of the servicing activities to third parties (e.g. the tax and insurance monitoring), Servicer D is still responsible for the activities being performed by those third parties. Consequently, Servicer D should be held responsible and should be required to obtain whatever form of assurance they and their auditors deem necessary in order to render an opinion on compliance with the functions being performed by the third parties.

Someone else noted that a third party entity performing servicing functions could be involved in performing the same or similar functions for a multitude of other entities. In that case, should the vendor be exempt from reporting because they did not meet the 5% threshold for reporting at the closing of the transaction, or because they were not performing the function for all assets within a pool at that time?

Ms. Utermohlen observed that this question highlights an important nuance to consider in connection with Section 1122 relating to whether the numerical threshold or servicers' contractual obligations for reporting should control who must file reports. For example, because reporting under Section 1122 is based on a numerical threshold, if a servicer that meets the threshold for reporting at the closing of the transaction<sup>3</sup> but later contracts with a third party or parties to perform some of the servicing functions, should: (1) the servicer be deemed responsible for the third parties' compliance with the servicing function/s because the servicer met the reporting threshold; or (2) should the third parties be held responsible for reporting because they are entities "participating in the servicing function?"

One member noted that as a master servicer they are going to require attestation reports from all entities that service the loans, regardless of whether they meet the 5% threshold or not. The member said they are revising their contracts to incorporate this reporting requirement.

Another member said that it is impossible to know who should file reports under Section 1122 in these instances without further clarification and confirmation of the 5% threshold reporting requirement.

Someone noted that the clear intent of Section 1122 is to require those entities that are performing one or more of the servicing activities described in the servicing criteria to report, regardless of their contractual obligations. They noted that, unlike Section 1123 which is transaction based, the requirements for reporting under Section 1122 are based on performance

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<sup>3</sup> Consistent with the description of the application of the threshold in minutes to a MBA sponsored call on March 3, 2005.

of specified servicing activities. Consequently, it should be assumed that entities that perform those activities should file reports under Section 1122.

Ms. Utermohlen agreed but said that a static 5% threshold reporting requirement superimposed on top of the apparent intent of Section 1122 to capture all parties that are performing servicing activities is confusing and the source of the current debate.

**Q5:** Under Scenario B, assume two servicers that do not meet the 5% threshold for reporting at the closing of the transaction later meet the threshold as the result of a merger. In that instance, how is the reporting requirement in Section 1122 required to be met?

**Member Response:** Someone said that if the 5% threshold is truly a static concept then the combined entity in Scenario B would be off the hook in terms of reporting under Section 1122.

**Q6:** Under Scenario C, assume a servicer that meets the 5% threshold for reporting at the closing of the transaction later enters into a contract to outsource all or a portion of the servicing to a third party. In that instance, is the third party subject to reporting under Section 1122? If not, how is the servicer expected to assess (and the servicer's auditor to attest to) management's compliance with the servicing criteria being performed by the third party?

**Member Response:** A member noted the answer to this question cannot be known without clarification and confirmation of the 5% threshold for reporting.

**Q7:** Assume the same situation as in Scenario C but assume the servicer sells its servicing to a third party. What are the reporting responsibilities of the respective parties under Section 1122?

**Member Response:** A member noted that the relevant consideration is whether these parties are performing activities described in one or more of the servicing criteria in Section 1122.

Another participant disagreed saying that if an entity has control over a vendor, then the vendor should provide some form of assurance to enable the entity to assess the vendor's compliance with the servicing activity.

Some people said this interpretation would be inconsistent with the intent of Section 1122 which is intended to capture those parties that are participating in the servicing function, regardless of their contractual obligations.

**Q8:** Would it be reasonable for the industry to take the position that decisions regarding reporting responsibilities in the above-described scenarios should be decided by management in consultation with their auditors, as has been done under the USAP?

**Member Response:** There was some agreement that this would be reasonable provided the 5% threshold is – in fact – intended to be determined as of a point in time. If not, management and their auditors must abide by the requirements of the Reg.

## B. Application of 10% Threshold under Section 1123

**Q9:** How are the issues the same, or different, for applying the 10% threshold for reporting under Section 1123, as compared to applying the 5% threshold for reporting under Section 1122?

**Member Response:** Several participants agreed that this question is reminiscent of the questions raised with regard to the 5% threshold; that is, the parties with responsibility for reporting will depend upon whether the threshold is a point in time calculation.

C. Interpretation of servicing criteria

**Q10:** Which servicing criteria are likely to apply to third party vendors named in the transaction at the closing of the transaction?

**Member Response:** Someone noted that Section 1122 requires that an entity assess compliance with all criteria unless the criteria relate to servicing activities that the entity is *not* performing. Any criteria that are not tested must be disclosed in the entity's report.

Someone then asked: if an entity is performing different servicing functions for different asset pools, is the entity responsible for disclosing which activities are relevant to different asset pools? A few people indicated that Section 1122 would not require this level of disclosure.

**Q11:** Assume a third party vendor meets the 5% threshold for reporting under Section 1122. In that case, must the third party vendor render an assessment of compliance, and the vendor's auditor attest to the accuracy of the assessment, relating to the general servicing criteria in that section? Or is the third party, and the auditor, responsible for reporting on compliance with the specific servicing function only?

**Member Response:** It was generally agreed that if a vendor is performing one or more specific functions, their attestation report would cover compliance with the criteria relating to those functions and would disclose that the vendor is not performing the functions described in the other criteria. However, if the vendor is performing different functions for different asset pools, management and their auditors should consider whether the vendor's report should also address compliance with the general servicing criteria.

D. Testing at a "Platform level"

**Q12:** Assume the assets backing an ABS are conforming, conventional loans. In that case, should the scope of testing include servicing of loans underlying Fannie, Freddie MBS?

**Q13:** Similarly, assume the assets backing an ABS are government loans. In that case, should the scope of testing including servicing of loans underlying Ginnie Mae MBS?

**Q14:** What other challenges are companies faced with in defining similar asset types for the purpose of determining the scope of testing under Section 1122?

**Member Response:** Ms. Utermohlen referred to page 1573 of the Reg (as published in the Federal Register, Vol. 70, No. 5, Friday, January 7, 2005) which describes the platform level as follows: “In light of current practice and servicers’ focus on overall compliance with standards at the platform level, we proposed to accept a “platform” level assessment for purposes of assessing servicer compliance. This means an assessment of compliance with respect to all asset-backed securities transactions involving the asserting party that are backed by assets of the type backing the asset-backed securities covered by the Form 10-K report.”

She noted that it has been her understanding that testing under the USAP generally has included testing of all loans being serviced, including loans serviced for the GSEs. She explained that the USAP is not transaction based, and that specific pool assets may, or may not, be included in the samples chosen for testing.

Someone asked whether an entity that has a mixture of non-conforming and conventional, conforming loans would have to divide their testing into two platform levels, one for each “asset type.”

Another participant said that the answer could depend upon the functions being performed for the different asset types; that is, if the functions are different, then the platforms might need to be different.

This prompted someone else to say: if you have different “platforms” for different asset types, would you be required to issue separate reports for each platform?

Another participant said: would it not be preferable to define your entire servicing function as one platform so that one report could be provided for all deals? They said their company believes “platform level” is consistent with servicing system so that if they have one servicing system they should have one testing platform.

Another member said they did not think the SEC was thinking in terms of servicing systems when they included the concept of a “platform level” for testing in Section 1122. Furthermore, they pointed out that a risk in defining “platform level” so broadly could be that noncompliance with a criterion relative to one asset type would have to be disclosed in the entity’s Section 1122 report covering all asset types.

Nevertheless, someone said, most companies utilize one servicing system to service all asset types so that if the system is defined as the platform, the servicing of all assets would be captured.

#### **IV. Adjournment**

Ms. Utermohlen suggested that further discussion of the platform level concept and other issues including judging material noncompliance be deferred until MBA’s next call. After participants agreed to a third call from 3:00 to 5:00 p.m. ET on Thursday, September 1, she thanked them for their participation and said she and Katie would be back in touch with an agenda for the next call. The call adjourned at 5:10 p.m. ET.

