



**MBA CONFERENCE CALL ON  
SECTIONS 1122 AND 1123 OF  
SEC REGULATION AB, *Asset-Backed Securities*  
Monday, August 8, 2005**

**MINUTES**

List of Participants: See attached.

**I. Welcome & Introductions**

At 3:00 p.m. ET, on August 8, 2005, Alison Utermohlen, Staff Representative to MBA's Financial Management Committee, began the call by thanking members for their participation. After some preliminary remarks, she explained that she, Kathy Gibbons, Staff Representative to MBA's Secondary & Capital Markets Committee, and Vicki Vidal, Staff Representative to MBA's Loan Administration Committee, would be speaking for themselves and therefore that their remarks regarding the proper interpretation of new SEC Regulation AB, Asset-Backed Securities, might not reflect the views of the SEC. She noted that MBA's primary purpose in sponsoring the call was to provide an informal forum for members to exchange information about Reg AB and to identify ways MBA can assist them in their efforts to comply with it.

**II. Objectives of Call**

Ms. Utermohlen mentioned that the more specific objectives of the call were to: (1) review the requirements of Section 1122, Compliance with applicable servicing criteria, and Section 1123, Servicer compliance statement, of Reg AB; (2) review differences/similarities between the SEC designed attestation engagement in Section 1123 and the MBA's Uniform Single Attestation Program (USAP); (3) discuss questions raised by members about these sections; (4) identify issues of particular concern and confusion requiring further discussion; and, finally (5) decide upon a course of action for addressing open issues.

**III. Descriptions of Sections 1122, Compliance with applicable servicing criteria, and 1123, Service compliance statement**

In keeping with the first objective of the call, Ms. Utermohlen read from some talking points she had prepared. The talking points are incorporated in this section, as follows:

**A. SEC Objective in Developing Attestation Engagement**

As noted in the first column of page 1571 of the final rule (at <http://www.sec.gov/rules/final/33-8518.htm>), the modified reporting system has not required audited financial statements for the issuing entity in the annual report on Form 10-K, but instead generally has required an assertion

by the servicer and an attestation by an independent public accountant regarding compliance with servicing criteria. This framework recognizes that: (1) audited financial statements generally are not relevant to securitization structures, as there are no financial statements, per se, to audit, and (2) investors' assessments of ABS are significantly affected by their assessments of the servicing of the underlying assets. The SEC therefore sought to improve upon the current modified reporting system which makes sense within the context of ABS.

In considering possible improvements to the current system, the SEC decided to build upon a foundation established by MBA's USAP which provides a reasonable framework for reporting but has certain notable deficiencies. For example, and as mentioned in the rule, the scope of the USAP is limited, both in terms of the servicing that it is intended to address and the number of servicing criteria that are required to be tested. These deficiencies have resulted in inappropriate applications of the program to servicing of a wide range of non-mortgage assets and inconsistent testing of the servicing criteria with the result that reporting under the USAP has been inconsistent, both in terms of content of the reports and of the entities that file reports.

#### B. Major Requirements under Sections 1122 and 1123

The SEC decided to address this situation by developing its own attestation engagement, which is very similar in nature to the USAP although it is far more expansive in terms of the servicing criteria that must be tested. Pursuant to Section 1122, the annual report on 10-K must include as exhibits reports from each party participating in the servicing function that assesses compliance with the servicing criteria.

Each such report must contain four statements:

- (1) A statement of the party's responsibility for assessing compliance with the servicing criteria applicable to it.
- (2) A statement that the party used the servicing criteria to assess compliance with the applicable servicing criteria.
- (3) The party's assessment of compliance with the applicable servicing criteria as of and for the period ending the end of the fiscal year covered by the Form 10-K report. The report must include disclosure of any material instance of noncompliance identified by the party.
- (4) A statement that a registered public accounting firm has issued an attestation report on the party's assessment of compliance with the applicable servicing criteria as of and for the period ending the end of the fiscal year covered by the report on Form 10-K.

The CPA's report must also be filed as an exhibit to the 10-K.

In addition, and pursuant to Section 1123, a separate servicer compliance statement, signed by the authorized officer of such servicer, to the effect that:

- (1) A review of the servicer's activities during the reporting period and of its performance under the applicable servicing agreement has been made under such officer's supervision.
- (2) To the best of such officer's knowledge, based on such review, the servicer has fulfilled all of its obligations under the agreement in all material respects throughout the reporting period or,

if there has been a failure to fulfill any such obligation in any material respect, specifying each such failure known to such officer and the nature and status thereof.

In terms of which entities must comply with Sections 1122 and 1123, it is interesting that they may not be the same.

For example, under Section 1122 (page 1574 first column), reports are required by a “party participating in the servicing function,” which is defined as *any entity* that is performing activities that address the servicing criteria, unless such entity’s activities relate only to 5% or less of the pool assets. However, some servicing functions (as defined by the SEC and described in the servicing criteria in Section 1122) could cover all assets included in a transaction. In that instance, an assessment of compliance and a CPA attestation report would be required.

By contrast, under Section 1123, statements are required from *each servicer* that meets the SEC definition of servicer in 1101(j) and the criteria in Item 1108(a)(2)(i) thru (iii) of Reg AB. As indicated in the last column of page 1569 of the rule, “If multiple servicers are involved in servicing the pool assets, separate compliance statements are required from each servicer that meets the criteria in [Item 1108...] of Reg AB (i.e. master servicer, each affiliated servicer and each unaffiliated servicer that services 10% or more of the pool assets).”

Thus, it would appear that fewer reports on servicer compliance will be required under Section 1123 than statements on compliance with applicable servicing criteria under Section 1122.

It is worth noting also that compliance statements under Section 1123 will be required of any party participating in the servicing function, even though the party may not meet the definition of a servicer in Reg AB. For example, trustees or third party vendors that perform “activities that address the servicing criteria” may be required to report under Section 1123 if they meet the 5% threshold for reporting.

#### C. 10-K Filers Responsible for Disclosing Absent Reports and Material Noncompliance

Finally, in terms of reporting, the person that signs the Section 302 certification must certify in paragraph 5 of the certification that all required reports and statements under Sections 1122 and 1123, respectively, have been included as exhibits to Form 10-K, except as otherwise disclosed. Consequently, the party signing the certification will need to obtain reports and statements from all parties responsible for reporting under Sections 1122 and 1123. The party signing the certification will also need to disclose any reports and statements that are missing as well as all material instances of noncompliance noted in reports that are received. [See first column of page 1573] [See also first column of page 1576]

The Section 302 certification must be signed by a: (1) senior officer in charge of securitization of the depositor if the depositor is signing the Form 10-K report or (2) senior officer in charge of the servicing function if the servicer is signing the Form 10-K report (i.e. the senior officer of the master servicer if there are multiple servicers).

#### D. Effective Dates

Reg AB provides for a transition period, depending upon the date of any registered offering. Effectively, however, for purposes of Sections 1122 and 1123, the first reports will be due with the first 10-K filings in 2007, as such reports are intended to cover a fiscal year, as the rule is effective beginning 1/1/06. The Transition guidance is found on pages 1580 and 1581 of the rule.

#### IV. Contrast of SEC Engagement and USAP

Next, Ms. Utermohlen explained that the SEC attestation engagement is substantially similar to the MBA's USAP with some key differences. She mentioned, for example, that the servicing criteria in the SEC engagement are far more extensive than those in the USAP. In addition, many of the SEC's criteria require testing back to transaction documents, whereas most of the USAP criteria are "stand alone" criteria. Consequently, compliance under the SEC engagement is judged in relation to specific investor requirements whereas compliance under the USAP is judged primarily in relation to stand-alone criteria. She explained that the AICPA had impressed upon MBA during drafting of the 1995 USAP that the USAP standards had to "stand alone" to ensure, among other things, that investors would have a clear understanding of the scope of engagements.<sup>1</sup> In addition, the SEC engagement provides a 5% servicing activities threshold for reporting whereas the USAP contains no reporting requirements.

In terms of their similarities, the SEC and USAP engagements are "examination level" attestation engagements written pursuant to the American Institute of CPAs (AICPA) Statements on Standards for Attestation Engagements (SSAE) No. 10, Compliance Attestation. As such, and unlike "agreed-upon procedures engagements"<sup>2</sup>, both programs require the exercise of judgment in determining the nature and extent of testing necessary to assess (by management) and attest to (by auditors) compliance with the servicing criteria in each program. Both programs, for

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<sup>1</sup> MBA's comment letter on the proposed Reg AB includes the following: "As the Commission is aware, most of the MBA's USAP criteria are "stand alone" criteria as MBA was advised by the AICPA during the drafting of the current Program (rev. 1995) that transaction specific criteria would, among other things: (1) increase the likelihood of reportable exceptions that may be irrelevant to investors under other transaction documents; (2) introduce greater subjectivity into testing of compliance by requiring independent accountants to interpret contract language; and, (3) raise doubts among users about the nature of testing to be performed under engagements. Primarily for these reasons, we were told that the criteria had to stand alone or, alternatively, that we should develop an agreed upon procedures engagement which, as the Commission is aware, sets forth specific criteria that are "agreed to" by the servicing entity and identified users of the reports."

<sup>2</sup> A brief comparison of these engagements is found in a June 1994 AICPA Journal of Accountancy article *The Meaning of Compliance Attestation*: "In examination engagements, clients engage CPAs to form opinions about an entity's compliance with specified requirements. CPAs then determine the nature, timing and extent of procedures needed to form such opinions. The procedures may differ significantly from what clients and others users expect. In agreed-upon procedures engagements, however, users and CPAs agree on the procedures, reducing the potential for misunderstandings about the nature or extent of the accountant's work. Another benefit of such engagements is the cost frequently is less than that of examination level engagements since agreed-upon procedures generally can be as limited and focused (or as extensive) as users desire."

example, involve testing at a “platform” level<sup>3</sup>, as opposed to testing at the specific pool level. Also, both programs require the exercise of judgment by the auditor in rendering decisions about material noncompliance with the servicing criteria.

Furthermore, as “examination level” attestation engagements as opposed to “agreed upon procedures engagements,” management and CPA reports are not restricted to specific users. Consequently, reports prepared pursuant to the SEC engagement are not withheld from interested investors. Both engagements are also intended to cover a full fiscal year and both contain the same general reporting requirements (e.g. representations and an assessment from management and a CPA attestation report).

## **V. Open Discussion of Questions Raised by Members**

The following questions were then raised and discussed:

*Question 1: Are mortgage servicers going to be required to report under the USAP as well as the SEC engagement?*

Ms. Utermohlen explained that prior to the release of the proposed Reg AB, MBA had been engaged in an effort to revise and update the USAP and to separate it into two programs: a USAP for servicing residential mortgage loans and a USAP for servicing commercial/multifamily mortgage loans. However, the MBA suspended work on the project after learning of the SEC’s plans to supersede the USAP with its own engagement for issuers of publicly traded ABS.

MBA’s decision to do so was predicated on a belief that the USAP will be phased out of usage if reports based upon the SEC engagement become the reports of choice among investors and other users due to: (1) deficiencies cited by the SEC about the USAP in Reg AB, and (2) the fact that issuers of publicly traded securities may not want to incur the costs of two separate reports in the future.

She noted, however, that MBA has not withdrawn the USAP but that it is no longer being sold by the Association due to poor sales. Instead, MBA is making electronic versions of the program available upon request at no charge to those who request it. MBA recognizes that for the time being many entities must still comply with the USAP because investors in non-SEC transactions may still require it.

Going forward, issuers may have to consider renegotiating their contracts to permit them to furnish investors in non-public transactions with reports based on the SEC engagement only.

*Question 2: If the USAP is effectively embedded in the SEC engagement, can USAP and SEC reports be produced based on the performance of the SEC engagement?*

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<sup>3</sup> Reg AB contains the following explanation of testing at a “platform” level: “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 servicing 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.” (see III. D.7.c.iii. on page 1573 of the Jan 7, 2005, Federal Register Vol. 70, No. 5)

Ms. Utermohlen noted that while the servicing criteria in the USAP are similar to those in the SEC engagement, in many instances they are not the same. She mentioned, for example, that she did not believe the SEC engagement contains a criterion relating to the payment of interest on escrow balances. Consequently, the performance of the SEC engagement (as defined) would not provide all the assurances required by the USAP engagement.

*Question 3: Have servicers received guidance from accounting firms?*

One participant noted that their accountants' proposal includes one fee for auditing their financial statements, rendering assertions of management's compliance under the SEC and USAP engagements, as well as other items. This prompted another participant to ask: But would your auditors be performing one attestation engagement or two? The first participant said that they have gone back and forth with their auditors and that it is not clear how they would be structuring their testing.

*Question 4: The SEC rules apply only until a deal is delisted which generally is within one year of the transaction date. Consequently, is it not true that reports would still be required to be prepared pursuant to the USAP for deals that have been delisted?*

Several members noted that while it is true that deals that are delisted may still be subject to reporting under the USAP based on transaction documents, it is likely that servicers will be subject to reporting under the SEC engagement on an ongoing basis as new deals are listed. Consequently, several people agreed that whether or not a deal is delisted may not have any bearing on whether the servicer/servicers in the deal should continue to engage their CPAs to provide them with attestation reports under the SEC engagement.

*Question 5: How is the 5% threshold to be calculated for the purpose of determining which parties are subject to reporting under Section 1122? The following response includes a lot of additional questions raised regarding the 5% threshold.*

Ms. Utermohlen noted that this question was addressed by Jennifer Williams, attorney-advisor at the SEC, during a conference call sponsored by the MBA on March 1, 2005. Ms. Williams said that the 5% threshold should be calculated based on the UPB of the underlying assets as of the closing date.

A number of participants mentioned, however, that this definition raises additional questions; for example, is it subject to change as events occur such as transfers of servicing as a result of sales or in outsourcing arrangements?

One participant said they had scratched their heads on this one, but that they could not imagine that it would not be subject to recalculation over the life of a deal, even if the deal spans a year or less. They said they have not received guidance on this matter from their auditors.

Ms. Utermohlen noted that a strict interpretation of Section 1122, combined with Ms. Williams response that the 5% threshold is to be calculated on the closing date, would indicate that if a third party is participating in the servicing function<sup>4</sup> at that date, they should comply with the reporting requirements of that section. She noted that the guidance in Section 1122 also indicates that a party performing a servicing function for all assets within a pool would be subject to reporting under that section even if the function is very limited. She also said that it is important to note that a party that is subject to reporting under Section 1122 may not meet the definition of “servicer” in Reg AB for the purpose of meeting other requirements, such as disclosure regarding servicers and servicer compliance statements.

Another participant asked: If the reporting requirements under Section 1122 apply to “any party participating in the servicing function” when do they apply to a specialty servicer, vendor or third party outsourcer?

Yet another participant asked: Is it clear that any and all parties are subject to reporting? They said they are leaning on the fact that vendors are accountable to the “responsible” party (i.e. party named in the transaction documents) and therefore that the responsible party only is subject to reporting under Section 1122. Someone else noted that this could mean that servicers named in the transaction documents would be 100% responsible for reporting on compliance with servicing functions performed by third parties.

One member said that a third party would be responsible for reporting if they are fulfilling the servicing function exactly as described in the SEC engagement. For example, if a servicing criterion relates to the actual PAYMENT of taxes, then the criterion would relate to the servicer, not to the tax outsourcer if the outsourcer performs services related to making tax payments but does not actually make the payments. Another participant offered a second example: They said that the servicer is still responsible for the lock box service if it is being performed in-house or if it has left the servicer’s facility.

Further conversation ensued about the responsibilities of servicers vis a vis third party servicers (with whom they have contracted to perform certain servicing functions), with one member noting that even though third party servicers are performing functions that touch on many of the SEC’s servicing criteria, the party responsible for approving transactions is the servicer, not the third parties.

Ms. Utermohlen noted that questions relating to scope of reporting, and responsibilities for reporting, under the USAP were addressed by management and their auditors. For example, in a situation involving a servicer and third party performing servicing on behalf of the servicer, management and their auditors would determine what the third party servicer must provide the servicer in order for the servicer’s auditor to get the necessary level of comfort in order to opine on the servicer’s compliance with the standards.

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<sup>4</sup> As defined in Section 1122, a party participating in the servicing function is “...any entity that is performing activities that address the servicing criteria, unless such entity’s activities relate only to 5% or less of the pool assets.” See page 1574 of Federal Register/Vol. 70, No. 5/Friday, January 7, 2005.

One member asked: Has anyone approached their vendors about reporting under Section 1122? It was generally agreed that most vendors are unfamiliar with Reg AB and therefore not aware of its potential implications to them.

*Question 6: Is the depositor or master servicer responsible for determining which parties are responsible for reporting under Section 1122 since the signer of the 10-K is responsible for disclosing whether all required reports have been received?*

Several people agreed that Section 1122 requires the signer of the 10-K to make a determination that all required reports have been received. They also agreed that this would be a difficult task given current uncertainties regarding which parties are responsible for reporting under that section.

One member said they thought it had been made clear that the SEC wants a one time determination of who is responsible for reporting at closing.

Others said that – in that case – different parties could reach different conclusions regarding reporting when the servicing changes hands after the closing date. For example, if at the transaction date Party A is determined to be responsible for servicing 50% of the pool assets, it would be required to report under Section 1122. However, if Party A thereafter sells its servicing to Party B, would both parties be required to report, or would only Party A or Party B?

In another example, if at the transaction date Party A is determined to be responsible for servicing 5% of the pool assets, it would be required to report under Section 1122. However, if Party A thereafter contracts with Party B to perform the servicing, is only Party A subject to reporting, or is Party B subject to reporting also?

Speaking as an investor, one participant noted that they believe investors would want to know when servicing changes hands. They said they thought it made sense for the 5% threshold be calculated annually, by auditors, at the end of each fiscal year.

Another person responded saying that because many deals delist within a year, that an annual recalculation would not make sense.

Someone then asked: Is it true that most deals delist within a year? One participant said they do not delist because it makes it easier for their broker/dealers if they do not do so. Most other participants, however, agreed that they delist within a year or less of the deal.

Several people again acknowledged that most servicers that are involved in servicing ABS will likely have to report under the SEC engagement on an ongoing basis as new deals are entered into all the time.

Ms. Utermohlen said she had raised some of these questions with the SEC and that the SEC had said they would consider them and respond when they could. She said she would notify the group when, and if, she received a response.

Near the scheduled end of the call, Ms. Utermohlen noted that the group had touched on most of the questions included as an attachment to the agenda, with the exception of questions relating to the definition of “platform level” for the purpose of testing under Section 1122. She said that she would include those questions on an agenda for a follow-up conference call later in the month.

As no further questions were raised, she thanked the members for their participation in the call and said MBA staff would be back in touch with them to suggest a date and time for their next call and to distribute copies of the minutes of the meeting.

The call adjourned at 4:30 p.m. ET.