

**JOINT CMSA/MBA CMBS LOAN DOCUMENT INTEGRITY TASK FORCE
FINAL REPORT AND RECOMMENDATIONS¹
JUNE 2001**

INTRODUCTION

In response to growing concern in the CMBS marketplace regarding post-closing document deficiencies and incomplete mortgage loan files in securitized commercial mortgage loan pools, the CMSA and MBA sanctioned the formation of a Joint CMBS Loan Document Integrity Task Force. The Task Force was comprised of 95 volunteers from across the industry representing over 60 organizations including Originators, Issuers, Master Servicers, Primary Servicers, Special Servicers, Trustees, Custodians, Credit Rating Agencies, Industry Service Providers as well as Subordinate and Senior CMBS Investors. This cross-functional group was charged with identifying and recommending changes to current industry practice, which would lead to increased cooperation throughout the industry, improved loan documentation quality and decreased risk to Investors.

Using a June 2000 proposal (drafted by a separate group of Trustees and Custodians) as a base, the Task Force met regularly, resulting in the issuance of a Preliminary Report in January 2001. Additional research and analysis incorporated the comments received regarding the Preliminary Report.

This report contains the Task Force's findings and recommendations, which are being submitted to the Governing Boards of both the CMSA and the MBA for approval. While the most comprehensive and easiest solution to the loan document integrity matter could have been handled by establishing standard PSA provisions, it would have significantly delayed implementation and offered no guidance for existing transactions. Consequently, the Task Force recommended the establishment of industry-wide "Best Practices" that can be updated for future developments. By allowing incorporation of the Best Practices by reference, it will allow all parties to each transaction to continue with their individual negotiations of issues against the backdrop of a base standard adopted by the industry.

THE ISSUE

In every CMBS securitization there are a number of critical documents that must be delivered to the Trustee for each loan deposited in the pool. Some of these documents, such as the Promissory Note with endorsements, are required to be delivered prior to or in conjunction with the closing of the securitization. Other documents, such as the recorded Mortgage/Deed of Trust, Assignments of Mortgages, and final Title Policy, are usually required to be delivered to the Trustee after closing by a date specified in the applicable Pooling and Servicing Agreement (the "PSA"). In most instances, the PSA requires the Trustee to issue a Final Certification with a report listing all document exceptions. Depositors are then required to "cure" all document exceptions within a specified time frame.

¹ Capitalized terms, unless otherwise defined, are defined in Exhibit 1 - Definitions

In 1999, subordinate tranche Investors began to focus on document exceptions and found that costs incurred in curing document defects were being passed on to the Trust thereby reducing their expected return. Examples included the costs associated with tracking down recorded documents or recording documents that were not already of record. There was also a concern about the possibility of significant delays and expenses in processing foreclosures, as there had been in the case of certain Servicing Events. Focused by these Investor concerns, the Rating Agencies also examined the issues and began to raise their own questions.

In reviewing securitizations, Investors and Rating Agencies found what they considered to be an unacceptable lack of focus by the industry on curing defects. The PSAs stated that the documents be delivered in a set timeframe. The Subordinate Investors, on this basis, pushed to have loans with on-going document defects removed from the pools. Traditionally, most PSAs required that the defect needed to be material and adverse before a repurchase could be requested. Subordinate Investors argued that without a complete loan file, there would be a material and adverse impact on the loans. Sellers took the contrary position, that missing documents did not have a material and adverse impact without an actual loss. In effect, they argued that, no performing loan should ever be required to be repurchased for defective documentation. This position was supported by many of the Interest Only ("I/O") holders who would clearly suffer a loss if performing loans were removed prematurely from the pool.

As a result of this controversy, participants in new CMBS transactions have begun modifying PSAs to protect their respective positions. PSAs, which had previously been fairly consistent, have begun to be increasingly complex and harder to administer. Clearly there was a growing need for the industry to identify and address the issue of loan document integrity.

ANALYSIS

Few would dispute that the growing number of document defects in CMBS securitizations indicated that a better industry-wide process was needed. The industry's recent increased focus has resulted in a marked decrease in document defects. Several of the groups responsible for clearing these past exceptions have reported that in the vast majority of cases, the final Basic Documents were of record although the Trustee did not have possession of the recorded document. Once the final Basic Documents were obtained, the Transfer Documents were easily completed and submitted for recording.

Unfortunately, two situations have been discovered that creates additional concern. First, there are isolated cases where the loan documents were truly defective (as opposed to merely missing). These true "defects" require significant work to cure the issue. Second, there are cases where the loan documents is missing or requires re-execution and the original parties are no longer available. These situations, while relatively isolated, have potential significant impact and made it abundantly evident that new document delivery practices were needed.

The Task Force began by examining the usual PSA document delivery requirements to determine if the correct documents were being required. The Task Force agreed with the document requirements listed in most PSAs; it was, however, concerned whether the Trustee and Servicer had adequate information to determine if a loan file was complete. For example, PSAs often state that a document must be delivered only if the loan structure required it; yet, loan structures are rarely

defined for the Trustee or Servicer. Thus, document defects are often only identified when a loan defaults and is delivered to the Special Servicer.

The recording delays in some jurisdictions are legendary. While many jurisdictions complete the recordation or filing process in a timely manner, others still have excessive processing delays. In addition, there are frequent cases where incorrect documents have been sent to the wrong party for correction resulting in the document being lost – the Seller has no way of knowing that the document is not in the process of being recorded. Obviously, this negatively impacts the preparation and recordation of Transfer Documents.

The recording process is further complicated by the multiple hand-offs of each document that is sent through several parties in the course of being recorded and delivered to the Trustee. Ineffective communication results in the documents being delayed along the way with no effective method of tracing where the process has been interrupted.

Finally, the Task Force determined that the current PSA document reporting requirements are thoroughly inadequate. Trustees are currently required to report exceptions only at the beginning of the securitization and at the first year anniversary. Typically there is no effective requirement for periodic reporting, tracking and correction of outstanding exceptions. Furthermore, many Sellers find that the reports are not always sent to the parties charged with clearing the exceptions.

While each document defect is curable, the pervasive industry-wide lack of attention on the issues has created a potential avalanche of defective loan files. Having identified the issues, the Task Force turned to developing a more efficient and effective document delivery infrastructure. After 7 months of regular meetings, the Task Force determined that the document delivery infrastructure is so dynamic that it is addressed most effectively by establishing Best Practices. These Best Practices will permit the industry to continue developing new solutions without having to re-craft PSAs. It will establish a template against which all parties in a particular securitization could negotiate for different standards based on its organization's particular needs. And, the Best Practices may also provide an objective industry-accepted benchmark for parties to measure effective compliance in existing securitizations.

BEST PRACTICES

The Task Force has developed a set of Best Practices that incorporate their findings. The Best Practices, in addition to this report, include:

- Definitions (Exhibit 1)
- Closing Checklist (Exhibit 2)
- Core Documents (Exhibit 3)
- Timelines (Exhibit 4)
- Remedy Levels (Exhibit 5)

These Loan Document Integrity Best Practices are the baseline of operations and represent the best processes for the good of the industry as a whole. Use of these Best Practices remains the choice of the participants in the securitization. On-going work by the Task Force will continue to refine and expand these Best Practices.

RE-ENGINEERED PROCESS

Listed below are explanations for each of the changes to the document delivery infrastructure that are adopted into the Loan Document Integrity Best Practices.

- 1. Loan Structure** The Task Force recommends that each Seller be required to deliver a Loan Closing Checklist which a) lists a common set of documents for each loan, b) identifies which of these common documents are part of the loan structure and c) describes the relationship of these documents to the various properties. The Task Force further recommends that this Closing Checklist be a condition precedent to deposit a loan into a CMBS securitization. The Closing Checklist is intended to be the base from which the Trustee, Servicer and Special Servicer build their loan records. While the final Closing Checklist has not yet formally approved by the Task Force, a sample Checklist is available for review and comment (Exhibit 2). Lenders are advised to direct their Closing Agents to use the Checklist in the form finally adopted by the Task Force. In addition, Closing Agents should be instructed to organize and deliver the documents numbered and in the order of the Closing Checklist. Follow-up documents should be forwarded with a condensed Checklist and Acknowledgement for the documents being delivered. Changes to the Closing Checklist must be noted separately.
- 2. Core Documents** The Task Force developed an expanded list of documents that should be delivered to the Trustee because they may impact the Servicer's ability to realize upon the collateral. These Core Documents (Exhibit 3) must be tracked for each loan in future CMBS securitizations. For each of these documents, the Trustee must compare the documents received against the requirements listed on the Checklist. The Trustee's reporting must contain fields for all "check listed" documents, even those that are not required for a particular loan. In these cases, the Trustee will note that the document is not required according to the Checklist. As it is unrealistic to anticipate the loan structure of all loans, the Task Force has added the flexibility of designating additional documents as Core Documents based on their use in Lender programs or for property types.
- 3. Critical Documents** In evaluating the risk of missing documents, four documents were uniformly determined to be so critical that absence of any of these documents should prevent the loan from being deposited. While certain segments of the market sought additional documents to be designated as critical, the Task Force chose to keep a narrow focus leaving open the option of negotiating for a more comprehensive up-front review if desired. The Critical Documents include, as previously mentioned, the Closing Checklist, the Note with endorsements, all Letters of Credit which are for the benefit of the Lender or which are collaterally assigned to the Lender and are included in the loan summaries delivered to Investors, and Ground Leases. For certain document categories, the Task Force identified alternatives that would be acceptable for delivery.
- 4. Document Conditions** Each document has two condition levels. First, the Trustee must review the document to determine if it is an original or a copy. Second, the Trustee must determine if it is in its preliminary form (i.e. unrecorded documents or title commitments) or its completed form (i.e. recorded documents or final policy). The Task Force focused first on situations where a document was missing. Because of the increased risk associated with a missing document, the Task Force places strong emphasis on these situations and recommends that the loan be removed from the securitization if the Seller cannot deliver **at least a copy** of each required document. By ensuring that there was a complete copy of all mortgage documents, the Servicer will have the basics to proceed in the event that legal action needs to be taken.

Historically, the PSAs require originals or clerk-certified copies of most documents. The Task Force has determined that this standard is excessive for recorded or filed documents and that either a copy of the recorded document or other proof of recordation is sufficient. By expanding this standard, the Seller will be able to more easily comply without weakening the Servicer or Special Servicer's ability to enforce loans.

5. **Delivery Deadlines** The Task Force determined documents in a mortgage file could generally be divided into three categories: a) Critical Documents that are essential to the obligations of the loan are required at securitization in order for a loan to be deposited, b) Basic Documents are the operative loan documents that outline the structure of the loan and its components (these documents are often delivered in a preliminary form followed by the recorded or final form several months later), and c) Transfer Documents are those that transfer the rights in the Basic Documents to the Trust. The Transfer Documents are dependent on the completed Basic Documents. Consequently, the Task Force recommends separate deadlines for delivery of the final Basic Documents and the final Transfer Documents. By establishing multiple deadlines, the Seller can better focus their curing efforts.
6. **Remedies for Non-Compliance** Issuers argued that while there may be a need to implement some type of remedy for non-compliance, the current use of Repurchase as the only remedy was excessive and premature in the vast majority of cases. Subordinate Investors countered that Sellers would not have a compelling reason to cure exceptions unless there was a significant incentive to perform. The Task Force explored various options and identified a series of interim risk-mitigation remedies (Exhibit 5) that would allow Sellers time to cure exceptions while insuring the Subordinate Investor against loss. The remedies arise when Sellers fail to meet document delivery requirements by the designated deadline.

The lowest level Remedy is an Officer's Certification to the Trustee. This involves an Officer of the Seller making a Certification as to the action that it has taken to date and attesting that the cure is obtainable within a reasonable period of time. The second level Remedy calls for an updated Officer's Certification and a loan-specific Indemnification for any costs that may be incurred as a result of the document defect. If the defect is still not cured, the Seller must provide an Indemnification from a credit-worthy entity. While these Indemnifications do not expand the coverage of the Indemnification provided in the PSA, the Task Force believes that the delivery of redundant loan-specific Indemnifications will focus the Seller with respect to specific defects and result in more timely resolution of the problem.

Repurchase remains a remedy but only where the risk of having the loan remain in the pool is no longer financially reasonable. Bearing in mind that the absence of Critical Documents would preclude the deposit of certain loans, Repurchase would be requested on **performing loans** only if a) the Seller failed to provide assigned Essential Letters of Credit or substitute Letters of Credit within a month of the Closing or b) the Seller failed to provide a minimum of a copy of any Core Document by the first anniversary. Repurchase could also be mandated when a loan is involved in a Servicing Event and the Controlling Servicer has determined that the defect will have a material and adverse impact on the loan. Rather than assuming that all defects carry equal weight, the Controlling Servicer will need to look at the situation to determine which documents materially and adversely affect the loan. And finally, Repurchase could also be

required if the Seller fails to provide one of the available lesser remedies when required. Extensions to the timelines may be granted by the Controlling Class to delay Repurchase.

This remedy schedule gives the Seller extended time to cure exceptions yet carries with it the risk a loan could become involved in a Servicing Event and that the cure period would be sharply collapsed. It remains, therefore, in the best interest of the Seller to cure the exceptions in a timely manner.

7. **Reporting requirements** All of these recommendations are for naught if the Trustees do not regularly update all parties on the status of the exceptions. In an effort to ensure that notification is effective, the Task Force recommends a) that the Notice Section of the PSA be expanded to include a Party who is responsible for curing exceptions for each Seller, b) that the reporting requirements be increased to a quarterly basis until all exceptions are cleared and c) that specific Notices be sent whenever critical deadlines are missed. It is believed that this increased focus will keep the cure process on track.
8. **Alternative Practices** In the course of their analysis, the Task Force identified a number of new concepts that merit further analysis including the use of a “book entry” monitoring system for recorded documents (e.g. “MERS” – Mortgage Electronic Registration System) and changes to the title requirements (such as the use of Master Title Policies with endorsement of recordation data.) These practices are currently being evaluated and may, if merited, be incorporated into the Best Practices in the future.

EXISTING SECURITIZATIONS

As a loan document integrity standard adopted industry wide, It is hoped that these Best Practices will serve as an effective guide to acceptable loan document practices for parties in existing CMBS securitizations. While not contractually binding, the Best Practices do provide an objective benchmark accepted by all segments of the industry as reasonable.

RECOMMENDATIONS

The Joint CMSA/MBA CMBS Loan Document Integrity Task Force recommends that the following be adopted by the governing boards of both the CMSA and MBA:

- Endorse the use of the Loan Document Integrity Best Practices by the industry. These Practices reflect definitions, timetables and remedies adopted by the industry as a whole. Participants in the securitization process should be encouraged to incorporate by reference the Best Practices into future CMBS transactions and be encouraged to follow the guidelines outlined in the Best Practices in order to improve the quality of commercial loan documentation in CMBS securitizations.
- Establish (by the CMSA Executive Board and the MBA's Asset Administration Committee) a Standing Loan Document Integrity Task Force responsible for monitoring the use of the Best Practices and adopting new developments into the Best Practices. This includes, but is not limited to, identifying other practices related to loan document integrity, defining additional alternative documentation and evaluating the impact of these Best Practices on securitizations over time.

The Joint Task Force hereby respectfully submits its Final Report for further action to the Governing Boards of CMSA and MBA.

On behalf of the Joint Task Force,

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