

Risk Management – Controls and Recovery



Representations and Warranties

September 2006

Common Misrepresentations

Conduit (Prime/Alt-A), Subprime & Scratch & Dent

**Merriam-Webster
Dictionary Definitions:**

Representation: An incidental or collateral statement of fact on the faith of which a contract is entered into

**Warranty: 1) a collateral undertaking that a fact regarding the subject of a contract is or will be as it is expressly or by implication declared or promised to be
(2) A usually written guarantee of the integrity of a product and of the maker's responsibility for the repair or replacement of defective parts**

Conduit (Prime/Alt-A) and Subprime

- Occupancy
- Misrepresentation of Collateral
- Document Misrepresentation
 - Value
 - Income
 - Arm Riders
- Missing Documents
- Early Payment Default
- Disclosures

Scratch & Dent

- Document deficiencies
- Litigation
- Fraud
- Property Condition
- Property Taxes
- Uncollected or Incorrectly Calculated Prepayment Penalty
- Lien Position/Title Issues
- Cancelled MI

Discovery

Note: Ideal discovery time frame is 90-120 days of the closing date

“Purchase and Sale Agreement”

Generally this agreement stipulates that notice to the seller is required within 30 days of discovery. Review the agreement to ensure the timeline is met.

Informed Staff = Results

- Disseminate the common breaches of representation and warranties internally
- Reinforce the importance of timeline adherence
- Written work flow process
- Ensure tracking mechanism to track monetary and repurchase claims

Notification

Common notice methods but not limited to the following:

- 1) An agreement requiring buyer and seller signature
- 2) Claim form
- 3) Letter

“Notices” section of the “Purchase and Sale Agreement”

Generally this section provides the contact information for all claim notices.

Common items included in Notification:

- Closing or settle date of transaction
- Loan number and pertinent property and/or loan data
- Section and subsection of specific Representation and Warranty breached or reference to amendment
- Description of breach
- If cure in lieu of repurchase then state specifically how to cure and specify expected cure time frame
- If breach may not be cured then provide repurchase figures and expected repurchase date within contractual time frames (if stated in agreement). Updated repurchase figures should be provided before funding
- Enclose supporting documentation with notification

Tracking of Monetary and Repurchase Claims

Know the Firm's Exposure

- In-house Operating System must have tracking mechanisms for monetary and repurchase claims and cures to manage risk, prevent the sale of a defective loan into a security, agency, or as a whole loan.
- Servicing systems should have flags or warnings of pending repurchases.
- Department responsible for notifications and monitoring claims and cures should optimally maintain tracking in a system that is connected to the books and records database of the firm.

Suggested Tracking Data

- Date referred to responsible business unit
- Date of notification
- Brief description and expanded defect description
- Notice Days
- Cure Days
- Contact Information
- Comments
- Contract expiration
- Claim cure or repurchase expiration
- Aging data

Build an Internal Escalation Process

- Engage internal parties that facilitated the original trade/acquisition to assist or communicate the resolution of claims.
- Ask internally what the reporting business needs are and develop monthly reports.
- Develop seller reports to track/follow-up on outstanding issues.

Early Payment Default

Payment Delinquency and Contractually Protected Payments

- Prime Alt-A and Subprime trades generally have an amendment to the Mortgage Loan Purchase and sale agreement providing protection for early defaulted loans. Language may be negotiated per trade.
- First Payment Default is a pre-indicator of the borrowers' pay habit.
- First Payment Default may indicate underlining (undiscovered) credit issue.
- Protected payments can be a minimum of 1 30 day default up to 3 30 day payment defaults. Confirm the protected contractually language.
- In-house system should calculate/report delinquency for review and claim notice.
- Contractual claim notice requirement should be tracked to enable the purchaser to provide written notice in the specified time frame specified in the agreement.
- It is prudent for the purchaser to scrub loans for servicing or transfer issues prior to notice.
- Seller is contractually obligated to repurchase the loan in the specified time period stipulated in the amendment or agreement.

Alternatives to Early Payment Default Claims

- It is the investors' discretion to accept alternatives to repurchase based on their internal guidelines and/or policies.
 - Extension of the contractual period based on a specific number of payments for loan performance.
 - Indemnification with or without a deposit.
 - Scratch and Dent re-pricing level.

Remedies

- I. Cure**
- II. Repurchase**
- III. Indemnification (limited and subject to Firm policies)**