



SEC Regulation AB as a Servicing Quality Assurance Tool

What is Regulation AB?

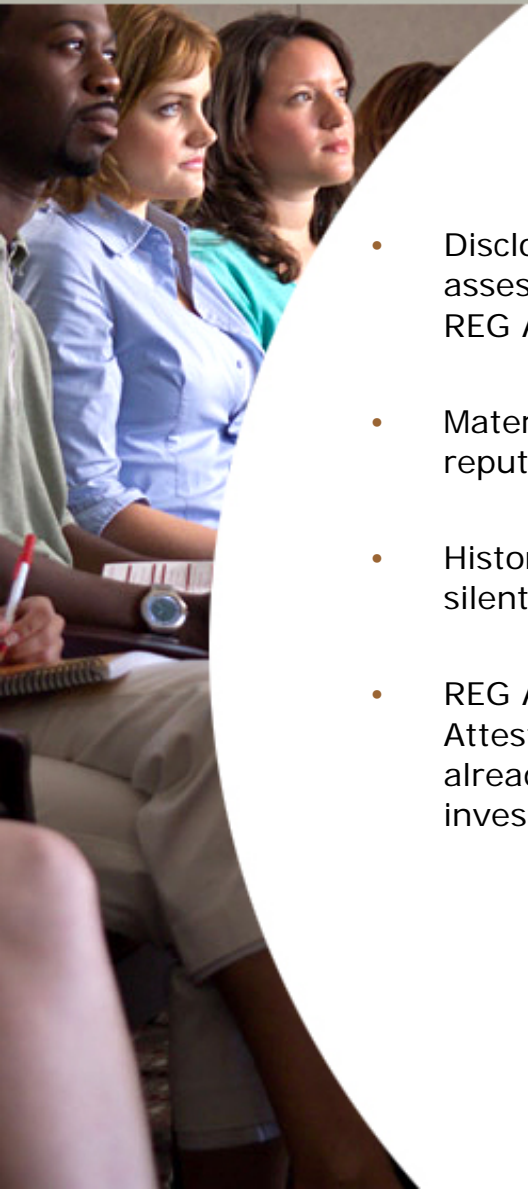


- In May 2004, the Securities and Exchange Commission (the “SEC”) proposed changes to the rules governing the issuance of asset-backed securities (“ABS”).
- Previously, a registrant or investor seeking to understand the applicable requirements had to review and assimilate a large body of information including informal guidance and periodic letters issued by the SEC.
- This was time consuming and led to common problems in the industry.
- The SEC sought to address the situation through Regulation AB covering four primary areas: clarification of registration and eligibility, more substantial disclosure requirements, streamlining of communications, and consolidation of reporting.
- REG AB was implemented for all asset back securities issued on or after January 1, 2006.

REG AB Reporting


- **Distribution Reports of Form 10-D**
 - Distribution and Pool Performance Information
 - Legal Proceedings
 - Sales of Securities and Use of Proceeds
 - Defaults Upon Senior Securities
 - Submission of Matters to a Vote of Security Holders
 - Significant Obligors of Pool Assets; Significant Enhancement Provider Information
 - Other Information
 - Exhibits
- **Annual Reports on Form 10-K**
 - Certifications under Section 302 of the Sarbanes-Oxley Act
 - **Assessment and Attestation of Servicing Compliance**
 - **Report on Compliance with Servicing Criteria (Item 1122)**
 - Servicing Criteria
 - Identification of inapplicable criteria
 - Disclosure of material instances of noncompliance
 - Attestation Report on Assessment of Compliance
 - Servicing Compliance Statement (Item 1123)

REG AB as a Quality Control Tool?



- Disclosure of material instances of noncompliance and the attestation report on assessment of compliance presents the need for on-going quality control to the REG AB 1122 criteria.
- Material instances of noncompliance are public record and can cause reputational and financial risk to an organization.
- Historically, ABS transaction agreements deferred to FNMA guidelines and were silent on many aspects of mortgage servicing and default.
- REG AB's 1122 servicing criteria is very similar to the Uniform Single Attestation Program and can complement traditional quality control programs already in place for FHA/VA, FNMA, and FHLMC while filling the gap for private investors/securities.

REG AB 1122 Servicing Criteria Focus

- 
- Escrow Administration
 - Funds Processing
 - Investor Reporting
 - Bank Account Reconciliation
 - Default Loan Servicing
 - Collateral Documentation
 - Adjustable Rate Mortgages
 - General Servicing Responsibilities

Escrow Administration – Quality Control

Reg AB 1122 Section	Reg AB Category	SEC Requirement	Quality Control Testing Opportunity
(d) (4) (x)	Pool Asset Administration	Regarding any funds held in trust for an obligor (such as escrow accounts): (A) Such funds are analyzed, in accordance with the obligor's pool asset documents, on at least an annual basis, or such other period specified in the transaction agreements; (B) Interest on such funds is paid, or credited, to obligors in accordance specified in the transaction agreements; (C) Such funds are returned to the obligor within 30 calendar days of full repayment of the related pool asset and state laws.	Sample accounts for timeliness, frequency, and accuracy of the Escrow Analysis, Payment of IOE funds, Escrow surplus and payoff refunds
(d) (4) (xi)	Pool Asset Administration	Payments made on behalf of an obligor (such as tax or insurance payments) are made on or before the related penalty or expiration dates, as indicated on the appropriate bills or notices for such payments, provided that such support has been received by the servicer at least 30 calendar days prior to these dates, or such other number of days specified in the transaction agreements.	Sample accounts for timeliness and accuracy payments disbursed from escrow while validating reasons for penalites paid from escrow.
(d) (4) (xii)	Pool Asset Administration	Any late payment penalties in connection with any payment to be made on behalf of an obligor are paid from the servicer's funds and not charged to the obligor, unless the late payment was due to the obligor's error or omission.	**same as above
(d) (4) (xiii)	Pool Asset Administration	Disbursements made on behalf of a customer are posted within two business days to the obligor's records maintained by the servicer, or such other number of days specified in the transaction agreements.	Sample the same accounts to ensure the disbursements are recorded timely on the Servicer's servicing system
(d) (1) (ii)	General Servicing Consideration	If any material servicing activities are outsourced to third parties, policies and procedures are instituted to monitor the third party's performance and compliance with such servicing activities.	Vendor Oversight & Controls
(d) (2) (iii)	Cash Collection and Administration	Advances of funds or guarantees regarding collections, cash flows or distributions, and any interest or other fees charged for such advances, are made, reviewed and approved as specified in the transaction agreements.	Validation of controls when advancing escrow

Funds Processing – Quality Control

Reg AB 1122 Section	Reg AB Category	SEC Requirement	Quality Control Opportunity
(d) (4) (iv)	Pool Asset Administration	Payments on pool assets, including any payoffs, made in accordance with the related pool asset documents are posted to the applicable servicer's obligor/mortgagor records maintained no more than two business days after receipt, or such other number of days specified in the transaction agreements, and allocated to principal, interest, and/or other items (i.e. escrow) in accordance with the related pool assets.	Sample payments and payoffs for timeliness of receipt and application while validating the accuracy of the payment's T&I and P&I split on the servicer's system
(d) (2) (i)	Cash Collection and Administration	Payments on pool assets are deposited into the appropriate custodial bank accounts and related bank clearing accounts no more than two business days of receipt, or such other number of days specified in the transaction agreements.	Sample the same accounts for timeliness and accuracy of the payment's deposit and T&I and P&I split within the custodial account
(d) (2) (iv)	Cash Collection and Administration	Verify that all T&I and P&I accounts are segregated, and funds are not co-mingled.	Validation of the same P&I and T&I accounts
(d) (2) (v)	Cash Collection and Administration	Each custodial account is maintained at a federally insured depository institution as set forth in the transaction agreements.	Validation of the same P&I and T&I accounts

Investor Reporting – Quality Control

Reg AB 1122 Section	Reg AB Category	SEC Requirement	Quality Control Opportunity
(d) (3) (i)	Investor Remittances and Reporting	Reports to investors, including those to be filed with the Commission, are maintained in accordance with the transaction agreements and applicable Commission requirements. Specifically, such reports: (A) Are prepared in accordance with timeframes and other terms set forth in the transaction agreements; (B) Provide information calculated in accordance with the terms specified in the transaction agreements; (C) Are filed with the Commission as required by its rules and regulations; and (D) Agree with investor's or the trustee's records as to the total unpaid principal balance and number of pool assets serviced by the servicer.	<p>Sample specific pools for end to end QC for timeliness and accuracy of reporting to the investor</p> <p>Confirmation with Investor's records</p>
(d) (3) (ii)	Investor Remittances and Reporting	Amounts due to investors are allocated and remitted in accordance with timeframes, distribution priority and other terms set forth in the transaction agreements.	Sample same pools for end to end QC for timeliness and accuracy of disbursements made to the investor
(d) (3) (iii)	Investor Remittances and Reporting	Disbursements made to an investor are posted within two business days to the servicer's investor records, or such other number of days specified in the transaction agreements.	Sample same pools for end to end QC for timeliness and accuracy of disbursements made to the investor
(d) (3) (iv)	Investor Remittances and Reporting	Amounts remitted to investors per the investor reports agree with cancelled checks or custodial bank statements.	Sample same pools for end to end QC for timeliness and accuracy of disbursements made to the investor
(d) (4) (iii)	Pool Asset Administration	Any additions, removals or substitutions to the asset pool are made, reviewed and approved in accordance with any conditions or requirements in the transaction agreements.	Sample changes made to pool for timeliness and accuracy
(d) (2) (iii)	Cash Collection and Administration	Advances of funds or guarantees regarding collections, cash flows or distributions, and any interest or other fees charged for such advances, are made, reviewed and approved as specified in the transaction agreements.	Validation of controls when advancing principal and interest
(d) (2) (ii)	Cash Collection and Administration	Disbursements made via wire transfer on behalf of an obligor (mortgagor) or to an investor are made only by authorized personnel.	Timeliness, accuracy, and controls for internal and external wires

Bank Account Reconciliation – Quality Control

Reg AB 1122 Section	Reg AB Category	SEC Requirement	Quality Control Opportunity
(d) (2) (vii)	Cash Collection and Administration	Reconciliations are prepared on a monthly basis for all asset-backed securities related bank accounts, including custodial accounts and related bank clearing accounts. These reconciliations: (A) Are mathematically accurate; (B) Are prepared within 30 calendar days after the bank cutoff date; or such other number of days specified in the transaction agreements; (C) Are reviewed and approved by someone other than the person who prepared the reconciliation; and (D) Contain explanations for reconciling items. These reconciling items are resolved within 90 calendar days of their original identification, or such other number of days specified in the transaction agreements.	Sample Custodial and Clearing Accounts for timeliness and accuracy of bank account reconciliations

Default Loan Servicing – Quality Control

Reg AB 1122 Section	Reg AB Category	SEC Requirement	Quality Control Opportunity
(d) (4) (vi)	Pool Asset Administration	Changes with respect to the terms or status of an obligor's pool asset (e.g., loan modifications or re-agings) are made, reviewed and approved by authorized personnel in accordance with the transaction agreements and related pool asset documents.	Sample completed loan modifications for accuracy, timeliness, and controls
(d) (4) (vii)	Pool Asset Administration	Loss mitigation or recovery actions (e.g., forbearance plans, modifications and deeds in lieu of foreclosure, foreclosures and repossessions, as applicable) are initiated, conducted and concluded in accordance with the timeframes or other requirements established by the transaction agreements.	Sample delinquent accounts for accuracy and timeliness of Loss mitigation options offered to the customer. Sample foreclosure referrals and foreclosure sales held for timeliness and accuracy.
(d) (4) (viii)	Pool Asset Administration	Records documenting collection efforts are maintained during the period a pool asset is delinquent in accordance with the transaction agreements. Such records are maintained on at least a monthly basis, or such other period specified in the transaction agreements, and describe the entity's activities in monitoring delinquent pool assets including, for example, phone calls, letters, and payment rescheduling plans in cases where delinquency is deemed temporary (e.g. illness, unemployment).	Sample delinquent accounts for accuracy and timeliness of collections activities such as telephone calls, letters, and Loss Mitigation efforts.
(d) (4) (xiv)	Pool Asset Administration	Delinquencies, charge-offs and uncollectible accounts are recognized and recorded in accordance with the transaction agreements.	Sample charge off's, REO's and Short Sales for accuracy and timeliness

Collateral – Quality Control

Reg AB 1122 Section	Reg AB Category	SEC Requirement	Quality Control Opportunity
(d) (4) (i)	Pool Asset Administration	Collateral or security on pool assets is maintained as required by the transaction agreements or related pool asset documents.	Sample accounts and Inventory documents while performing validation of documents to Servicer's system data
(d) (4) (ii)	Pool Asset Administration	Pool assets and related documents are safeguarded as required by the transaction agreements.	Obtain Fire Rating of building and building access security data/logs

Adjustable Rate Mortgages – Quality Control

Reg AB 1122 Section	Reg AB Category	SEC Requirement	Quality Control Opportunity
(d) (4) (ix)	Pool Asset Administration	Adjustments to interest rates or rates of return for pool assets with variable rates are computed based on the related pool asset documents.	Sample recent ARM resets and letters to the customer for timeliness and accuracy

General – Quality Control

Reg AB 1122 Section	Reg AB Category	SEC Requirement	Quality Control Opportunity
(d) (1) (i)	General Servicing Consideration	Policies and procedures are instituted to monitor any performance or other triggers and events of default in accordance with the transaction agreements.	Validation of self monitoring practices within the business
(d) (1) (iv)	General Servicing Consideration	A Fidelity Bond Insurance Policy and Errors & Omissions Insurance Policy is drafted in accordance with the Transaction Agreements and retained annually as proof of appropriate insurance.	Validation and accuracy of E & O coverage
(d) (2) (vi)	Cash Collection and Administration	Unissued checks are safeguarded so as to prevent unauthorized access.	Validation of Controls
(d) (4) (v)	Pool Asset Administration	The servicer's records regarding the pool assets agree with the mortgagor's records with respect to an obligor's unpaid principal balance.	Confirmation with Customer's records

What works best for your organization?



- Create a robust quality control program based upon the investors, products, customers, and market you serve.
- Eliminate redundancy and gaps between QC programs.
- Determine the adequate sample size and frequency of testing for your organization.
- Create the appropriate MIS to obtain targeted data for the applicable tests.
- Create reporting to management that clearly identifies risk and drives change.
- Work with your Servicing and Default areas to clearly understand the business and systems supporting each process.
- Always seek guidance from the Senior Management, Legal, Compliance, Internal Audit, and Certified Public Accounting firms used by your organization prior to implementing a such program.