



Via Electronic Mail

July 12, 2004

Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549-0609  
Attention: Jonathan G. Katz, Secretary

Re: File Number S7-21-04

Dear Ladies and Gentlemen:

The Mortgage Bankers Association (MBA)<sup>1</sup> appreciates the opportunity to comment on the Proposed Rule on Asset-Backed Securities (Proposed Rule) published by the Securities and Exchange Commission (the Commission) in the May 13, 2004, Federal Register. Our members are keenly interested in the Proposed Rule as it pertains to their roles as servicers, depositors, issuers, special servicers, and trustees in mortgage securitization transactions. Furthermore, our members frequently invest in both commercial mortgage-backed securities (CMBS) and residential mortgage-backed securities (RMBS).

As the Commission notes, of the hundreds of billions of asset-backed securities (ABS) issued, the majority are mortgage-backed securities. During 2003, an estimated \$98.7 billion of CMBS were issued and \$586 billion of RMBS (exclusive of agency guaranteed securities) were issued. As of 2003, there were approximately \$348 billion of CMBS

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<sup>1</sup> The Mortgage Bankers Association is the national association representing the real estate finance industry, an industry that employs more than 400,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership prospects through increased affordability; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate finance professionals through a wide range of educational programs and technical publications. Its membership of over 2,700 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies, Wall Street conduits, and others in the mortgage lending field. For additional information, visit MBA's Web site: [www.mortgagebankers.org](http://www.mortgagebankers.org).

outstanding and \$750 billion of private label RMBS outstanding. Of the top 100 CMBS issuers for 2003 and of the top 25 RMBS issuers for 2003, all are MBA members.<sup>2</sup>

MBA commends the Commission for undertaking an initiative aimed at clarifying and formalizing the requirements for the registration, disclosure, and reporting requirements for asset-backed securities (ABS). We believe the fragmented guidance in this area has created challenges and risks for ABS issuers and investors and that a well-conceived, cohesive, and formalized framework will be to the advantage of all parties involved in the ABS market. Consequently, we support the Commission's efforts to develop such a framework.

However, as currently drafted, we are concerned that the Proposed Rule could have the unintended effect of constricting the market to the disadvantage of investors and borrowers. Specifically, we believe aspects of the Proposed Rule could reduce the selection of ABS and mortgage products by driving away current and potential participants by increasing their reporting compliance costs, as well as their perceived and real exposures to liability for making incorrect or incomplete reporting decisions.

We are aware that other industry associations are addressing their concerns with the Proposed Rule. In particular, we would like to acknowledge that we are familiar with the letter that will be filed with the Commission by the American Securitization Forum (ASF) through our members who are members of ASF. MBA concurs with the comments in the ASF letter to the extent they pertain to mortgage securitizations and are not inconsistent with our letter. In fact, we endorse most of the recommendations in the ASF draft letter we have seen to date.

Our main concerns with the Proposed Rule relate to the proposed examination level attestation engagement on compliance with specified servicing criteria and the extensive disclosure requirements imposed, as explained below.

## **I. MBA Primary Concerns with the Proposed Rule**

### **A. Proposed Examination Level Attestation Engagement**

#### **1. "Responsible Party"**

The Commission proposes to address weaknesses in the current "modified"<sup>3</sup> reporting system by requiring a "Responsible Party" (RP) to render an assertion regarding

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<sup>2</sup> Source: Inside Mortgage Finance, *The 2004 Mortgage Market Statistical Annual*, "Top Non-Agency MBS Issuers in 2003" at p. 15, and Mortgage Bankers Association 2003 Membership Directory for RMBS and MBA Commercial Real Estate Finance for CMBS statistics.

<sup>3</sup> As discussed in I.E. of the Proposed Rule, Ongoing Reporting Under the Exchange Act, "...the Commission staff has allowed modified Exchange Act reporting by ABS issuers." Those modifications include: "A modified annual report on Form 10-K is required with two items being most important: A

compliance with specified servicing criteria set forth in §229.1120, in a report to be filed as an exhibit to the report on the Form 10-K (10-K). Under the Commission's proposal, the RP would be the depositor (as the statutory issuing entity) or the servicer,<sup>4</sup> whichever party signs the 10-K. The same entity that signs the 10-K would also be required to sign the assertion of compliance with the servicing criteria and the Section 302 certification pursuant to the Sarbanes-Oxley Act. MBA strongly opposes the proposed RP as a single party role because it would reduce market competition and innovation by limiting the freedom companies currently enjoy to negotiate transaction terms and conditions.

Currently, the depositor or the master servicer will sign the 10-K and/or the Section 302 certification. With increased scrutiny and potential sanctions imposed against depositors for not completing the 10-K in a timely and accurate manner, it is the depositor that is most vulnerable and at risk for any problems that may arise. Consequently, the depositor typically requests the right to complete the 10-K to ensure its timely and accurate delivery. By contrast, either the depositor or the servicer signs the Section 302 certification based on deal negotiations and the relationships of the parties; thus, the parties completing these documents today are often not the same.

Under the Proposed Rule, however, the depositor or the servicer would be forced to assume responsibility for signing all three documents. In many circumstances, neither party would willingly accept the RP role without significant additional compensation or indemnifications from the party performing the function or activity that is the subject of the reporting obligation. If acceptable terms could not be agreed to, the transaction would either falter or fail, depending upon whether replacement participants could be found. Ultimately, investors and borrowers would suffer, as fewer market participants would translate into increased transaction costs, fewer available ABS products and services, and less available mortgage capital.

The Commission has identified several major concerns with the current reporting system that can be addressed in a more effective manner than by requiring one party to sign the assertion of compliance with servicing criteria, the 10-K, and the Section 302 certification. Specifically, the Commission believes the current system is inadequate because it involves: (1) inconsistent and inappropriate application of tests of servicing compliance by servicers and their independent accountants under the USAP<sup>5</sup> and other programs; (2) limited or nonexistent tests of critical servicing activities; and (3) gaps in reporting servicing compliance where significant servicing functions are performed by

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servicer's statement of compliance with its servicing obligations; and a report by an independent public accountant regarding compliance with particular servicing criteria."

<sup>4</sup> If multiple parties were involved in servicing the pool assets, the master servicer (or entity performing the equivalent functions), would be the "servicer" as defined in the Proposed Rule.

<sup>5</sup> A USAP report consists of an entity's assertion of compliance with the minimum servicing standards set forth in MBA's publication, the Uniform Single Attestation Program for Mortgage Bankers, and an independent accountant's opinion thereon.

unaffiliated servicers and other parties. In our estimation, these inadequacies are due to deficiencies in attestation engagements, rather than to the fact that different parties are signing the 10-K and reporting on servicing compliance.

Consequently, we believe the appropriate solution is to improve the design of required attestation engagements. In this regard, we believe the Commission's reporting framework, with some modification as described on the following pages, would address noted deficiencies in the current reporting system. We believed unaffiliated servicers' assertions of compliance with specified servicing criteria, combined with their compliance statements on transaction requirements under §229.1121, would provide investors with significant assurances regarding the reliability and integrity of the servicing of ABS collateral.

We recommend therefore, that the Commission permit the depositor or servicer (or master servicer in situations where there are multiple servicers) to report on servicing compliance as agreed by those parties.

## 2. Reasonable Reliance and Assessment of Compliance

The Commission has proposed that the RP<sup>6</sup> be required to exercise judgment in determining the type and extent of testing necessary to render an opinion on compliance with the proposed servicing criteria in §229.1120 of the Proposed Rule. Under this approach, the Commission would permit the RP to "reasonably rely" on different forms of assurance for the purpose of "assessing" unaffiliated servicers' compliance with the proposed servicing criteria. Given overlapping servicer roles and other factors, we believe this reporting framework would be impracticable within the context of the MBS market.

Within the mortgage banking industry today, many – but not all - master servicers require copies of the USAP from unaffiliated primary servicers as a condition of doing business. Aside from deficiencies in the design of the USAP, this system ensures that servicers throughout the MBS market can satisfy reporting requirements by incurring the cost of one engagement. However, given the Commission's expressed concerns about deficiencies in the USAP, we believe that the adoption of the Proposed Rule would effectively put an end to the practice of relying on USAP reports, as RPs and their accountants would seek more substantial means of obtaining assurance regarding unaffiliated servicers' compliance with servicing standards.

If the practice of sharing the USAP were discontinued, the Commission's approach could lead to circumstances in which different RPs could place potentially conflicting demands on the same unaffiliated servicers in an attempt to meet their different

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<sup>6</sup> Pursuant to MBA recommendation in the "Responsible Party" section of this letter, the RP for the purpose of signing an assertion of compliance with servicing criteria would be either the servicer or the depositor, as agreed to by those parties. We use RP in this section I.A.2. of this letter to refer to the party that agrees to sign the assertion of compliance with the servicing criteria.

thresholds of “reasonable reliance.” For example, one RP could require a SAS 70 Report from an unaffiliated servicer while another RP could require a report on agreed upon procedures from the same unaffiliated servicer. In that case, the unaffiliated servicer would be faced with absorbing the costs of two separate engagements or, possibly, relinquishing their servicing to competitors.

This scenario would likely occur within the MBS market, as many companies are primary servicers to many different master servicers. In addition, because master servicers can be primary servicers to one another on different transactions, particularly within the CMBS market, master servicers that are RPs could determine they are unable to assert compliance with the servicing criteria without first obtaining some form of assurance as to compliance from the other. As they could not instantaneously provide assertions to each other, one would be forced to report late or, alternatively, they would have to render blind and simultaneous opinions on each other’s compliance.

Another troublesome aspect of the proposed reporting framework is that it presumes that RPs would be able to assess unaffiliated servicers’ compliance with the proposed criteria in a variety of ways. However, most forms of information that RPs could demand would not provide information relative to servicers’ compliance with all of the proposed criteria. For example, an unaffiliated servicer’s SAS 70 report might reveal an abundance of information regarding controls over reported asset balances, but little to no information regarding whether the servicer’s asset substitutions are made in accordance with specific transaction documents, as requested in §229.1120(d)(4)(iii).

Consequently, we believe many RPs would default to requiring unaffiliated servicers to provide them with a report on compliance with the proposed servicing criteria. However, that scenario would present another set of challenges because many RPs could find themselves in the impossible position of evaluating or “assessing” numerous unaffiliated servicers’ reports at the same time or within a few short days<sup>7</sup>, to determine whether any reported noncompliance is “material” to the RP’s assertion of compliance.

For these reasons, MBA recommends that the Commission delete the requirement that RPs must “assess” compliance with unaffiliated servicers’ compliance with the servicing criteria. Consistent with this recommendation, we also recommend that the concept of “reasonably rely” be removed from §229.1120 of the Proposed Rule.

In lieu thereof, we recommend that the Commission impose a requirement that master servicers and each unaffiliated servicer that meets certain requirements provide the RP with attestation reports on compliance with the servicing criteria, pursuant to the Proposed Rule. Although we initially determined that unaffiliated servicers that meet the 10 percent threshold for submitting compliance statements should be required to submit

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<sup>7</sup> The Proposed Rule would require the period to be covered by the attestation engagement to be a full fiscal period, consistent with the period covered by the USAP. As most companies are on a calendar year basis, unaffiliated servicers’ reports would likely be completed and furnished to RPs within a week or two prior to the March 31<sup>st</sup> filing deadline, consistent with current practice under the USAP.

reports on compliance with the criteria, we are concerned that this threshold may be overly burdensome or inappropriate in certain circumstances. For example, it might be inappropriate if an unaffiliated servicer is performing very limited but important servicing functions, as is the case with many special servicers.

We are also concerned about the prospect of requiring some servicers to incur the significant cost of hiring an independent public accountant to render an opinion on their assertion of compliance with the proposed servicing criteria. Our members indicate that the costs of such engagements generally run into the tens of thousands of dollars, and can involve hundreds of man-hours in terms of staff support in connection with the engagement. Consequently, while we believe that our recommended reporting system would be far more practicable than the Commission's proposed system, we believe the question of which unaffiliated servicers should be required to furnish RPs with attestation engagement reports requires careful consideration.

In this regard, we would like the opportunity to explore our proposed approach and possible "attestation reporting thresholds" with Commission staff.

### 3. Proposed Servicing Criteria

The Commission has developed a list of proposed servicing criteria that would form the basis of the proposed examination level attestation engagement. Of these criteria, which are found in proposed §229.1120(d), approximately one half are taken, in whole or in part, from criteria currently found in MBA's USAP. Consequently, while we feel comfortable with most of those criteria, we have concerns with some of the additional criteria, as explained below.

As the Commission is aware, most of the MBA's USAP criteria are "stand alone" criteria as MBA was advised by the AICPA<sup>8</sup> 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.

By contrast, many of the Commission's proposed new criteria are not "stand alone" requirements, but instead, require testing back to transaction documents. Generally, we are concerned that these criteria will greatly increase the cost of servicers' attestation engagements, for potentially limited additional benefit to investors. In fact, investors

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<sup>8</sup> American Institute of Certified Public Accountants.

could be disadvantaged if testing to transaction documents resulted in reportable noncompliance in attestation reports where the noncompliance has no relevance to their transactions. Investors could be confused by the Commission's proposed approach if they were to receive "clean" compliance reports from servicers based on the investor's ABS collateral (i.e. with no noted noncompliance with transaction documents), and at the same time receive an attestation report indicating noncompliance with the criteria as it relates to other investors' transaction documents.

For these reasons, we recommend that the Commission revise its proposed criteria to eliminate, or reduce, criteria that require testing back to transaction documents. We recommend that the Commission consider replacing those criteria with other "stand alone" criteria that would present "minimum standards" for the purpose of reassuring investors. We believe that stand alone criteria would serve the Commission's primary objective of providing investors with assurances regarding servicing of ABS collateral while reducing the likelihood of reported noncompliance related to transaction documents that the investors have no involvement or interest in. Moreover, unaffiliated servicers' reports on compliance with stand alone criteria under §229.1120 would be a good complement to their statements on compliance with transaction documents under §229.1121.

We also seek the Commission's confirmation that the current practice of sending negative confirmation letters is sufficient to obtain assurances regarding compliance with §230.1120(d)(4)(v) related to the obligor's records. As the obligor is a separate entity, negative confirmation letters have been the traditional means by which agreement between the servicers' and obligors' records have been tested under the USAP. We recommend that the Commission acknowledge that this practice would continue to be acceptable under its proposed attestation engagement.

Finally, we would recommend the deletion of servicing criteria in §229.1120(d)(3)(D)(ii), (iii) and (iv), as those are trustee rather than servicer functions.

#### 4. Summary of MBA Recommendations

In summary, MBA recommends that the Commission modify the proposed attestation engagement to:

- Permit the party that signs the assertion of compliance with servicing criteria under §229.1120 to be either the depositor or the servicer, as negotiated by those parties;
- Eliminate the requirement that the party signing the assertion of compliance must "assess" compliance with unaffiliated servicers' compliance with the servicing criteria, and that the concept of "reasonably rely" be removed from §229.1120 of proposed Regulation AB. In this regard, the words "assess," "assessing," and "assessment" should be deleted in §229.1120(a)(1-3);

- Eliminate servicing criteria in §229.1120(d)(3)(D)(ii), (iii) and (iv) as those are trustee rather than servicer functions;<sup>9</sup>
- Require master servicers to furnish copies of their attestation engagement reports. Furthermore, require unaffiliated servicers that meet certain – as yet undefined - requirements to furnish the RPs with copies of their attestation engagement reports;<sup>10</sup>
- Revise §229.1120(a) to require that the party that signs the assertion of compliance with servicing criteria attach an exhibit to their assertion that includes:
  - (1) *A statement of the responsible party’s responsibility for collecting each required unaffiliated servicer’s report on compliance with the servicing criteria;*
  - (2) *A statement that the responsible party is responsible for attaching an exhibit listing all required unaffiliated servicers’ reports, and for providing explanations if they are not attached;*
  - (3) *A statement that the responsible party is responsible for listing any material noncompliance reported by unaffiliated servicers.*
- In line with the concept of the RP not assessing compliance, MBA recommends revising §229.1120(c), to clarify that the RP is not required to “...describe in the report on Form 10-K any material impacts or effects that have affected or that may reasonably be likely to affect pool asset performance, servicing of the pool assets or payments or expected payments on the asset-backed securities **related to noncompliance reported by unaffiliated servicers.**” (emphasis added);
- Clearly note that the RP, if designated as the master servicer, is not required to alter its compliance statement to reflect any deficiencies reported by an unaffiliated servicer; in other words, each servicer report on compliance with the servicing criteria stands alone and should not be commingled into a single report;
- Revise the language in #5 of the proposed Sarbanes-Oxley 302 certification (Fed Reg at 22697 of the preamble<sup>11</sup>) in accordance with our recommendations set forth above to remove the words “assessment” and “reasonably relied;+” and

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<sup>9</sup> See MBA argument in this letter under “Definition of Servicer.”

<sup>10</sup> Note MBA’s request to discuss with the Commission staff the circumstances in which unaffiliated servicers should provide attestation engagement reports.

<sup>11</sup> That language reads as follows: “This report discloses all material instances of noncompliance with the servicing criteria as provided in Item 1120 of Regulation AB based on an assessment of compliance with such criteria. [In giving the certifications above, I have reasonably relied on information provided to me by the following unaffiliated parties ...”]

- Consider replacing transaction based criteria in §229.1120(d) with stand alone criteria.

In conclusion, we believe our recommended approach of requiring RPs to furnish investors with unaffiliated servicers' attestation reports would be more practicable to implement than the Commission's proposed reporting approach. We would request the opportunity to discuss our thoughts with Commission staff on which unaffiliated servicers should be required to furnish attestation reports under our approach.

## B. Definitions

### 1. Definition of Asset Backed Security

#### a. Passive Nature of the Issuer (Item 1101(2)(ii))

§229.1101(c)(2)(ii) of the Proposed Rule requires that in order to qualify as an "asset-backed security" the activities of the issuing entity be limited to "passively owning or holding the pool of assets, issuing the asset-backed securities...and other activities reasonably incidental thereto."

MBA appreciates that the Commission needs to distinguish between securities backed by assets that are set aside to generate income and securities backed by assets that can be altered in fundamental ways requiring a different registration and disclosure regime. However, the reference to passive activities is of concern to us.

MBA requests that the Commission reconsider whether to include the passive ownership restriction. We recommend that it should be removed for the following reasons:

- The issuing entity under the Proposed Rule is not permitted to be an investment company under the Investment Company Act of 1940, and cannot actively manage the pool assets, and therefore, the passive ownership restriction is unnecessary;
  - The term "passive" is vague and could restrict the issuing entity or other participants in the ABS transaction from undertaking activities on behalf of the trust;
  - Particularly in the context of CMBS transactions, the Pooling and Servicing Agreement must allow the issuer, servicer or other entities to permit certain changes to the assets, such as the assumption by new entities of leases on
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space or the improvement of the assets to accommodate new uses; failure to permit this flexibility would be problematic for protection of the value of the assets.

The investor has a need to know the parameters within which decisions will be made on the use of the assets. Those parameters should be specified clearly in the Pooling and Servicing Agreement. However, activities and decisions of an active nature must be made and should not trigger concern that the pool assets are being managed in a manner that is inappropriate.<sup>12</sup>

b. Disqualification of Series Trusts (Footnote 63)

MBA requests that the Commission clarify its comments made in footnote 63 (Fed Reg at 26657) that a “so-called ‘series trust’ would not qualify as an asset-backed security.” By way of describing such instruments, the Commission indicates “under a series trust, the same trust will hold multiple pools of assets and will issue multiple classes of securities, some of which are backed by one pool while others are backed by other pools. Id.

It is our understanding that it has become commonplace in mortgage-backed securities transactions for the structure of a deal to include “directed classes” that draw the cash flows from underlying pieces of other deals. For example, a REMIC trust could be formed with groups of investors receiving the cash flow from discrete pools among the trust assets, while other groups of investors receive the cash flows from tranches of previously issued REMICs. In addition, for tax purposes, some REMICs are structured with multiple tiers, referred to as “double REMICs” or multiple tiered REMICs.

MBA believes that the Commission has no interest in limiting the availability of ABS shelf registration for transactions that involve directed collateral or necessary tax structuring. If that is correct, then the language in footnote 63 should be revised to clarify what the Commission intends to disqualify as “series trusts.”

2. Definition of “Servicer” (Item 1101(j))

Proposed §229.1101(j) defines a servicer as “...any person responsible for the management or collection of the pool assets or making allocations or distributions to holders of the asset-backed securities.” Moreover, the definition of servicer: “... does

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<sup>12</sup> In the context of governing REMIC tax law, MBA has worked with members of Congress and other industry associations to introduce “The Real Estate Mortgage Investment Conduit Modernization Act of 2004.” The purpose of the legislation is to update the parameters applicable to management of assets within a REMIC and to allow decisions to be made as necessary to meet foreseeable changes in commercial circumstances without running afoul of REMIC restrictions. The objective is to improve the quality of the REMIC and the management of the assets for the benefit of investors. MBA believes it necessary for the Commission to add another layer of legal considerations regarding what constitutes “passivity” in its rules.

not include a trustee for the issuing entity or the asset-backed securities that makes allocations or distributions to holders of the asset-backed securities if the trustee receives such allocations or distributions from a servicer.” *Id.* MBA believes the Commission’s definition of “servicer,” is unclear and too inclusive.

Servicers are responsible for the management, collection and allocation of cash payments on the pool assets at the loan level, but are not typically responsible for “distributions to holders of the asset-backed securities,” a function performed by the trustee.

The trustee is typically responsible for all bond-level calculations and distribution of funds to the investors. The MBA approves of the Commission’s decision to specifically exclude the trustee from the definition of servicer. It is important to clearly define each party’s role in the transaction. However, based on the proposed regulation language, the definition includes a large portion of the trustee’s job responsibilities. The current definition will lead to confusion for the servicer, trustee and investor on each party’s role in the transaction.

To more accurately reflect the practices of the market, MBA would suggest that the Commission strike a portion of the proposed definition of “servicer” that actually describes the role of the trustee. MBA would remove the offered language, “distributions to holders of the asset-backed securities,” and would instead define the “servicer” as: *“any person responsible, pursuant to the transaction documents, for the management, collection or allocation of pool assets received from the obligor.”*

The Commission does include in the definition of servicer the special servicer. It is important to note that in a CMBS transaction, there is always a named master servicer and a named special servicer. So, in each transaction there are at least two servicers participating in separate roles (in addition to any possible primary servicers). MBA requests that the Commission make a clear distinction between the servicers’ roles by using the word “*servicers*” instead of servicer to more accurately reflect the transaction parties.

Finally, we recommend that the Commission include definitions of the terms “primary servicer,” “master servicer,” “unaffiliated servicer,” “affiliated servicer” and “special servicer” in the Proposed Rule for clarification purposes. Specifically, we would recommend that the following definitions be added:

Primary Servicer – A servicing entity that is responsible, pursuant to the transaction documents, for collecting cash on pool assets from obligors and managing pool assets.

Master Servicer – A servicing entity that is responsible, pursuant to the transaction documents, for collecting cash and data from primary servicers for the purpose of providing that cash and data to trustees for distribution to investors.

Affiliated Servicer – A servicer named in the transaction documents that is a subsidiary or legal affiliate of the issuer or the master servicer.

Unaffiliated Servicer – A third party servicer named in the transaction documents, that is not a subsidiary or legal affiliate of the depositor or the master servicer.

Special Servicer – In a CMBS context, a special servicer is an entity under contract with an issuer or depositor, pursuant to the transaction documents, to perform certain, specific servicing functions, such as foreclosure, workouts and default servicing.

There is considerable confusion as to whether the disclosure, certification and other reporting obligations described in the Proposed Rule apply to outsource companies, vendors, and other contractors including “subservicers.”

Currently, some companies outsource a portion of their servicing work to unaffiliated companies or vendors that perform specific, highly specialized functions. Some examples of the work performed include, physical inspection of the collateral; payment of tax bills; monitoring collection of insurance policies; and collection and spreading of financial numbers on the obligor’s financial statement. The companies performing the work are under contract with the servicer and serve as an agent or contractor for the servicer. Typically, the outsourcing company is not considered a “servicer” and the servicer carefully monitors their work product.

A subservicer has a significantly different meaning for the residential and commercial mortgage servicing markets and the use of the term in the preamble to the Proposed Rule is confusing. In a RMBS context, a subservicer often refers to a mortgage servicer under contract with a primary servicer to perform highly specialized activities for the primary servicer or substantially all of the primary servicer’s servicing functions for one or more pool assets. In sum, subservicers in the residential servicing context are contractors to primary servicers. The master servicer and primary servicers – and not the subservicers –are contractually responsible to the issuer or depositor.

In a CMBS context, a subservicer is designated by the issuer or depositor as a servicing entity under contract with the master servicer to be the primary servicer for one or more pool assets. It is our understanding that the Commission is not proposing to subject subservicing contractors, vendors and outsource companies to the Proposed Rule. In order to avoid any confusion between a servicer (a party named in the transaction documents) and an outsourcing company or subservicing contractor (a party that is not named in the transaction documents), MBA requests:

- avoiding the use of the term “subservicer;” when referring to a servicer that is named in the transaction documents and
- clarifying that outsource companies and vendors are not disclosing parties under the Proposed Rule. Specifically, MBA suggests the following language:

*“Outsourcing companies, who serve as agents of the servicer and who perform a particular function designated to the servicer, are not included in the definition of servicer.”*

3. Definition of “Delinquent” (Item 1101(d))

The Proposed Rule places limitations on the amount of delinquent assets that can be included in an ABS. Specifically, delinquent assets cannot constitute 50 percent or more of the dollar volume of the original asset pool at the time of issuance of an ABS and in addition, cannot constitute 20 percent or more of the dollar volume of the original asset pool at the time of ABS issuance if shelf registration is to be used. The Commission defines a delinquent asset as “any portion of a contractually required payment [that] is 30 days or more past due.”<sup>13</sup> The Proposed Rule states further that “a pool asset that is more than one payment past due cannot be characterized as not delinquent if only partial payment on the total past due amount had been made unless the obligor had contractually agreed to restructure the obligation, such as part of a workout.”<sup>14</sup>

(a) OTS/FFIEC Definition of Delinquency: There are numerous definitions of “delinquency” in the financial services industry due to the variety of loan products offered. It is, therefore, important to ensure that the Commission’s definition of “delinquency” and use of the phrase “30 days or more past due” is not overly restrictive and in conflict with current industry methodology for calculating delinquencies based on the type of assets being securitized.

The Commission does not clearly define when a loan is delinquent due to the use of inconsistent terminology. Under the Proposed Rule, it is unclear whether a loan is considered 30 days past due using the actual number of calendar days; based on the loan being “not more than one payment past due;” or whether the Commission is suggesting either methodology is acceptable. Of course the two methodologies produce different results. If the former test were used, a loan would be considered “delinquent” if a borrower paid his January installment on January 31<sup>st</sup>, but would not be considered delinquent if he paid his February installment on March 2nd. If the latter test were used, a loan would be delinquent if payment was received after February 1 for a January 1 due date based on the conclusion that the borrower is not “more than one payment past due” if only the February payment now remains unpaid. The latter test is used by the Office of Thrift Supervision (OTS) and the Federal Financial Institutions Examination Council (FFIEC).

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<sup>13</sup> Id. at 26723.

<sup>14</sup> Id.

We suggest that the Commission clarify that it will accept the OTS/FFIEC methodology for calculating “delinquency” for purposes of the delinquency concentration thresholds and disclosure requirements. Under the OTS/FFIEC methodology, a closed-end monthly amortizing loan is considered “past due” when either principal or interest is unpaid for 30 calendar days or one calendar month. Thrift Financial Report (TFR) Instruction Manual, “Schedule PD – Consolidated Past Due and Nonaccrual” (June 2003) and FFIEC Call Report Instructions, Schedule RC-N. The TFR and FFIEC Call Reports effectively allow either a monthly cycle or a 30-calendar day approach. The OTS/FFIEC methodology, however, favors the concept that monthly amortizing assets will not be considered past due unless the loan remains unpaid by the close of the next month’s scheduled due date (i.e., two payments due and unpaid). Thus, a payment due January 1, that remained unpaid on January 31 would not be considered 30 days or a full month past due. The loan, however, would be considered past due if the January payment were not received on February 1<sup>st</sup>.

The OTS and FFIEC go further to provide guidance on how to handle payments scheduled other than monthly and open-end loans. When a loan is scheduled for payment other than monthly the OTS applies a 30-calendar day methodology. In the case of home equity loans and other open end plans, the OTS deems a loan past due when the borrower has not made the minimum payment for two or more billing cycles. The OTS/FFIEC methodology reflects the concept of a “billing or payment cycle” and does not assume that payments are always tied to a fictitious 30-day calendar month. We ask that the Commission clarify that the OTS/FFIEC methodology for calculating when a loan is 30 days past due be specifically permitted, along with the *de minimis* exception suggested below.

(b) *De minimis* Deficiencies: It is common in the residential mortgage context to provide a *de minimis* shortfall exemption to the classification or treatment of a loan as delinquent. Many servicers provide that a payment that is short \$25<sup>15</sup> or less, for example, will not be considered delinquent under the assumption that the borrower made a transcription error in writing the check, requesting a money order or obtaining a bank check. When a payment is short for this amount, the servicer generally will advance the due date, rendering the loan “current” for all purposes, including whether to impose a late fee, report to credit repositories or take further collection or loss mitigation action. The shortfall is credited to the escrow account in the case of an escrowed loan or, in the case of a non-escrowed loan, added to the amount owed at the next installment or added to the amount due at pay-off. It is important to note that the waivers are not necessarily “contractual” but are a function of the “order of payments” provision of the mortgage/note. The current definition of “delinquency” is too encompassing and

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<sup>15</sup> Freddie Mac, for example, provides that servicers may deem the borrower current by shorting the borrower’s escrow account if a payment is short \$25 or less. See, *Freddie Mac Single-Family Seller/Servicer Guide, Volume 2*, Chapter 51.18 (2004).

would capture these situations that do not affect the true performance of the loan and/or are immaterial shortfalls of principal or interest. *MBA recommends providing a de minimis exemption to the definition of a delinquency.*

(c) Partial Payments: Treatment of Late Fees and Other Fees: It is important that the definition of delinquency specifically relate to the non-payment of contractually required principal or interest and not servicer-related fees, such as late fees, return check fees, assumption fees, attorney's fees, inspection fees, escrow advances or other fees that are generally collected in future installments, at pay-off or over time (e.g., escrow shortages and deficiencies over \$50 are required under the Real Estate Settlement Procedures Act to be collected over a 12- month period). The Commission's definition is overly broad because it references partial payment without further clarification. Most residential notes define a mortgage *payment* to include interest, principal, escrow amounts, late fees and other fees. From an investor's standpoint, however, it is the principal and interest to which the investor is entitled. The current definition appears to capture situations where the borrower does not pay certain servicing fees/costs with the subsequent installment payment or upon reinstatement.

A loan that is otherwise considered current in the payment of principal and/or interest should not be considered delinquent--potentially for the entire life of the loan--if servicing fees remain outstanding (this is especially relevant to the securitization of re-performing assets or seasoned loans). The Federal Trade Commission (FTC) and other regulators are placing considerable pressure on servicers not to consider borrowers delinquent if the only amount remaining unpaid is attributable to late fees or other fees, despite the servicer's contractual right to collect them when incurred. The Commission's policy should not penalize servicers for abiding by FTC policies or waiving servicer-related costs for consumers. *We believe the Commission should clearly state that "partial payments" refer only to partial payments of contractually required principal and interest, and specifically provide for the de minimis exemption described above.*

#### 4. Definition of "Non-Performing" (Item 1101(g))

The Commission provides that no non-performing assets can be included as part of the asset pool at the time of the proposed offering. A loan would be "non-performing" under the Proposal if the pool asset "meets the requirements in the transaction agreements for when a pool asset should be charged-off; or the pool asset meets the charge-off policies of the sponsor."<sup>16</sup> The Commission, however, asks further if assets should be deemed non-performing at the 90th or 180th day of delinquency. MBA would oppose a specific timeline because in many situations such timeline would be inconsistent with current bank and thrift regulatory treatment of nonaccrued loans and charge-offs. The industry needs to be able to use long-standing definitions of charge-off and non-accrual

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<sup>16</sup> *Id.* at 26724.

in the market, whether from the FFIEC or the sponsor/issuer. In many cases, where loss mitigation (formal or informal) is performed, a delinquent loan is not placed into nonaccrual status, written down or charged off. Imposing a separate more stringent standard on issuers and sponsors would lead to confusion, risk of error, and the burden of multiple classifications for each asset.

MBA is also concerned with the last sentence of §229.1101(g), which states:

“A pool asset that is more than one payment past due cannot be characterized as not non-performing if only partial payment on the total past due amount has been made unless the obligor had contractually agreed to restructure the obligation, such as part of a work-out plan.”

This language is inconsistent with the core definition of “non-performing” asset as a charged-off asset. We suggest that this language be removed as it creates confusion as to whether a two-month delinquency is considered a “non-performing” asset. We would oppose this more restrictive definition.

#### 5. Definition of “Originator” Needed (Item 1109)

§229.1101 does not provide a definition of “originator”, making it unclear which entity is to provide the disclosures required in §229.1109. It could be asserted that a number of different entities “originated” a mortgage, including the entity that processed the loan, closed the loan in its name, provided funds for closing the loan, sold the loan to the sponsor or established the underwriting standards pursuant to which the loan was ultimately approved. Item 1109 requires information about the originator’s underwriting criteria aimed at providing the investor information “material to an analysis of the performance of the pool assets.” This would appear to suggest that the originator should be the entity that established the underwriting standards.

To provide clarity, we suggest that a definition of originator be included in the Proposed Rule. The ASF has suggested a definition that MBA endorses, which focuses on the entity whose underwriting criteria are ultimately used to approve the loan. That definition follows:

*Originator means, as to any of the receivables or other financial assets underlying the asset-backed securities, the person whose underwriting or credit-granting criteria were applied in making the decision to approve the asset prior to funding, and that agreed to fund or purchase the asset.*

#### 6. Disclosures for Issuing Entities (Item 1106):

§229.1106 of the proposal calls for the disclosure of the price paid for assets being securitized and other information concerning the purchase. We believe that this information is not relevant to investors and would be considered proprietary information

by the issuing entity. We do not see how the price paid by the issuer for the assets would influence the price investors would pay for the securities. We respectfully ask that you delete §229.1106(i).

C. Breadth of Disclosures Mandated by the Proposed Rule

1. General Comments

In general, MBA believes that the trend toward increased disclosure for CMBS and RMBS transactions has been good for the development of the market and for all of its participants, from originators to investors. Without the role played by the Commission and the existence of its centralized facilities for registration, the market would not have developed with the health and integrity we have all seen in the growth of the ABS volume.

MBA would like to point out, however, that it is largely in response to market demand, and not to specific Commission requirements, that the current ABS disclosure practices have developed. Issuers whose documents did not include access to useful information did not receive the maximum value for their securities. Eventually, customary disclosures beneficial to, and demanded by, the investor community evolved. As discussed further in our letter, while MBA commends the Commission for its codification of the requirements for ABS transactions, there are instances where the Commission should allow the market to define its needs if it has not already done so.

MBA agrees with the Commission's concept of a principles-based approach. Because we agree that this is the appropriate method, we have significant concerns about the specificity and breadth of the required disclosures. That specificity undermines the principles-based approach and we hope our comments will assist the Commission in striking a difficult balance.

The detail described in the preamble and included in the proposed language for the Proposed Rule raises concerns that the Commission wants to see disclosures so extensive that only the most sophisticated institutional investors would be in a position to evaluate them. There are frequent references in the Proposed Rule to a materiality standard for determining the need for disclosures. However, none of the transaction parties are the final arbiters of materiality. The Commission's reference to specific static pool data, along with the requirements of §229.1100 and §229.1107, will cause the transaction parties to respond with disclosure because the Commission has asked for it. The fact that the Commission includes a particular item is sufficient to place transaction participants on notice that prudence would direct them to assemble relevant information, whether it is important or not. We fear that in some instances more disclosure will not always provide better information.

Disclosure for asset-backed securities was the basis for a study<sup>17</sup> undertaken in 2002 by the Commission and other federal agencies to recommend disclosure appropriate for Fannie Mae and Freddie Mac mortgage-backed securities. The disclosure, which existed at that time for ABS, was in part, a product of the interaction of issuers and the Commission. However, the disclosure had evolved primarily as a result of market forces. In preparing the study referenced, the Commission considered the value of certain disclosure items included here. We note, in particular, that the report did not include the disclosure of points in its recommendations for Fannie Mae and Freddie Mac MBS. As discussed below, we hope the Commission will reconsider the need for this and other mortgage loan data.

MBA believes that it is appropriate for the Commission to continue to allow the market to determine what information is material to investors with codification and requirements to follow that market selection. Our specific concerns follow.

## 2. Static Pool Data and Sponsor Disclosure (Item 1104)

The Proposed Rule would require an extensive amount of disclosure concerning the sponsor. In addition to the standard identification and description of the sponsor's securitization program and role, the Commission would require that sponsors supply static pool data for the preceding three-year period.

The static pool data in periodic increments would be required to demonstrate the delinquency and loss experience for the sponsor's portfolio of assets similar to those to be securitized. In addition, the Commission also asks that the static pool data be broken down and presented according to a list of examples in Item 1104, and with reference to numerous pool characteristics as specified in Item 1110 (b) and (c). The Commission states, "...selection of factors should result in disclosure of material information." We are not sure that it would be possible for a compliant sponsor to avoid covering many, if not all variables. The result would be disclosure of so much information that it would be difficult to distinguish what is material. Certainly the information would only be material to those with the technology and the sophistication to store it and dissect it.

MBA requests that the Commission eliminate the specific requirement for static pool data and the specific time period included in the Proposed Rule. One reason for our request is the view of our CMBS members that static pool data would not be relevant or helpful in evaluating pool assets consisting of properties with specific and often distinctive characteristics.

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<sup>17</sup>Staff Report: Enhancing Disclosure in the Mortgage-Backed Securities Markets, issued by the Interagency Task Force of the Securities and Exchange Commission, The Department of the Treasury, and the Office of Federal Housing Enterprises Oversight, January 2003.

Production of large volumes of static pool data may confuse investors. There is no standard format for the disclosure of extensive static pool data. For example, there is no agreement as to whether inclusion by reference to a website would be sufficient, or whether data, which would be voluminous, should appear in the prospectus documentation. Legal liability for errors that could exist inadvertently is an unresolved issue. Moreover, the market has not standardized which variables should be presented through static pool data.

The encompassing reason for our request to delete static pool data disclosure is our belief that the Commission does not need to require static pool data now. In the years that ABS disclosure has evolved, market competition has formulated the disclosure that is expected by investors; and sponsors have met that market demand. The same will occur with regard to static pool data. As we understand it, some sponsors currently provide static pool data. If investors want the information, eventually static pool data disclosure converging on truly material variables will emerge as standard.

In the meantime, a requirement for disclosure of a sponsor's historical experience, for example, through static pool data will make it expensive for all sponsors to satisfy Regulation AB. However, for smaller company sponsors it could eliminate S-3 registration as an option. For investors, there is a different issue, which we raise for the Commission's consideration. While most investors, or their advisors, have the technical and analytical capability to download the static pool data, there are investors, particularly retail investors, who almost certainly cannot use the information at all.

Returning to a principles-based approach, sponsors have a responsibility to present information that would help an investor to detect important trends. The obligation of the sponsor is to provide investors with data that is relevant and material to trends or aberrations in collateral behavior. The Commission should allow the sponsor to determine the best way to provide the material information.

### 3. Disclosure of Pool Assets: Pool Characteristics (Item 1110)

§1110(b) establishes the disclosure requirements for pool characteristics. A significant portion of the proposed requirements is currently demanded by investors of MBS and is customarily supplied by issuers. However, the Commission is proposing new disclosures or codifying information that the mortgage industry has questioned in the past, including:

- disclosure of the "annual percentage rate." §229.1110(b)(3).
- disclosure of the number of points or other origination charges paid on the pool assets. §229.1110(b)(7)(v).

Disclosure of the APR: We respectfully request that the Commission eliminate the disclosure of the annual percentage rate found in §1110(b)(3) as irrelevant to investors.

The “annual percentage rate” is defined by the Truth-in-Lending Act and includes various upfront fees and charges that do not inure to investors.

Disclosure of Points/Fees: It is unclear why data on points and origination charges paid at origination are important to investors as these fees also do not inure to the investors’ benefit. It appears that this information is intended to delve into whether certain state “high cost loan” provisions have been triggered. For any rated transactions, the mortgage loans will be scrubbed by issuers and by the ratings agencies for compliance with state anti-predatory lending laws. Moreover, to the extent that §229.1110(a)(6) already requires disclosure of state and local laws having a material affect on the securities, this information is superfluous.

MBA also does not believe that disclosure of points and fees, even if obtainable, would be probative of prepayment speeds. In fact, the information, provided on an overall pool basis, could be misleading because there would be no way to trace if the points were attributable to bad credit or, for example, to a borrower’s desire to buy down the loan rate for lower monthly borrower costs.

From a compliance standpoint, it would be costly and time consuming to gather point and fee information on individual RMBS loans, which would be necessary to calculate the pool statistics. Lenders do not currently maintain this information in a manner that can be easily extracted if it is maintained at all. Moreover, the terms “points” and “origination charges” are open to various interpretations and could involve all items listed on a HUD-1, including settlement fees, transfer taxes, courier fees, appraisals and inspection fees, etc. As a result of these concerns, we respectfully ask that the Commission eliminate §1110(b)(7)(v).

#### 4. Disclosure of Servicing Practices (Item 1107)

The Commission proposes to enhance the amount and level of disclosure of servicing practices. More specifically, §229.1107 requires even more detailed information than is provided in a Pooling and Servicing Agreement (PSA). If this is the case, servicers would be significantly burdened by this requirement and would face greater costs and risk of liability for noncompliance. While the Commission attempts to limit the amount of information to be released by stating that only those practices that are material must be disclosed, the mere mention of the specific functional areas implies that they are material. The Commission’s detailed explanation of the type of information it seeks serves to reinforce this notion.

Our members have indicated that in order to avoid violating the disclosure requirements, they foresee attaching their policies and procedures manuals, which are viewed as highly proprietary. Servicers indicate that these manuals may constitute hundreds of pages and could add thousands of pages to a prospectus when multiple servicers are involved.

Of concern to the mortgage industry is the risk of liability associated with the detailed level of disclosure. Servicers are concerned that they will be placed at significant risk of noncompliance if they subsequently change their practices or waive certain requirements without disclosing these facts in the 8Ks. Servicers change their practices when necessary as federal and state laws change, court cases are rendered, and they become more sophisticated through technology and experience. The detailed level of disclosure being suggested by §1107 will translate into either inalienable servicing rights or staggering amounts of updating and due diligence to ensure that 8Ks appropriately represent changes in servicing practices, whether truly material or not. As with any compliance issue, the more information that must be updated, the greater the chance of unintentional error or noncompliance.

Unfortunately, at this time, we cannot estimate all the costs associated with the disclosure requirements and resulting updates and risks. Servicers believe it will dramatically alter ABS mortgage servicing and costs. Servicers indicate that the level of disclosure imposed by the Proposed Rule could limit the ability to sell servicing rights because it would effectively lock transferee servicers into the practices disclosed in the prospectus, a factor that will certainly decrease the value of servicing rights. The prospectus will also become a controlling document that must follow the servicing rights to new transferee servicers. Currently, the prospectus is not part of the servicing contract and is not monitored by the new servicer. The proposed disclosures could also have unintended consequences. Public access to proprietary information will eliminate competitive advantages for many and may increase the likelihood of private litigation by providing publicly available "discovery." As a result of the various concerns, we respectfully ask that the Commission reconsider the level of disclosure being suggested. Servicers should be permitted to summarize key provisions of the Pooling and Servicing Agreement rather than provide the granular level of detail being suggested.

5. Disclosures for Servicers (Item 1107)

a. 10 Percent Disclosure Threshold for Unaffiliated Servicers

The Commission proposes a 10 percent threshold for triggering disclosure regarding unaffiliated servicers. We believe that this threshold is appropriate if the level of servicing disclosure is reduced to reflect what is in the Pooling and Servicing Agreement. However, if the Commission continues to support the more granular set of disclosures proposed, we believe it is imperative that the Commission adopt a tiered approach to disclosure. We support the American Bar Association's recommendation in their comments to the Commission on this Proposed Rule for a two-tiered structure:

For servicers servicing at least 10 percent but less than 30 percent of the pool assets, the only mandated disclosure would be: 1) the identity of the servicer, 2) servicing rankings issued by a Nationally Recognized Statistical Rating

Organization (NRSRO) or a statement that no servicing rankings have been issued.

For servicers servicing 30 percent or more of the pool asset, the disclosure would include proposed §1107, as amended by MBA suggestions below, and the servicer's NRSRO rating agency rankings, if obtained.

Currently, the Commission does not offer language on how to calculate the servicing threshold(s) (i.e., the current 10% threshold). MBA recommends that the Commission define the thresholds to be the unpaid principal balance (UPB) for all the pool assets, recalculated on an annual basis. The UPB reflects the current outstanding balance of the pool assets and a review each year will allow the servicer to adjust the requirements for servicer certification based on the current status of the deal. For example, if all the loans managed by a primary servicer have paid off and the servicer is no longer actively servicing any of the loans, that servicer will no longer be required to provide disclosure information on a particular transaction. MBA would suggest the addition of the following language if the servicing disclosures are reduced as proposed by MBA: *"Each unaffiliated servicer that services 10% or more of the pool assets; which is calculated based on the current unpaid principal balance of all the pool assets as of transaction origination date and annually thereafter for the succeeding calendar year on December 31<sup>st</sup>."*<sup>18</sup>

Item §229.1107 specifically identifies which servicers are subject to disclosure, including master servicers, primary servicers, special servicers, affiliated servicers and each unaffiliated servicer that services 10% or more of the pools assets. These entities are parties to the transaction and specifically named in the prospectus. Unfortunately, the Proposed Rule continues by including within the scope of disclosures an extremely broad reference to "any other servicer ... [that] the asset-backed securities is materially dependent." The concept is overly broad and will lead to the servicer having obligations to obtain disclosure information from a company not actually directly affiliated with the specific pool assets. For example, CMBS transactions permit the splitting of a loan into pieces based upon one single mortgage, which then may be sold separately into multiple transactions. Each piece of the loan is interconnected by documents affecting the property (examples: intercreditor agreements, co-lender agreements, pari passu notes); however, the parties that are designated to service the different pieces of the loan can be separate and unaffiliated. The servicer of piece A could have no contractual relationship and leverage over the servicers of portion B, C and D to require

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<sup>18</sup> If a tier threshold is adopted, we suggest the following language: *"Each unaffiliated servicer that services 10% but not more than 30% of the pool assets; which is calculated based on the current unpaid principal balance of all the pool assets as of transaction origination date and annually thereafter for the succeeding calendar year on December 31<sup>st</sup>. Each unaffiliated servicer that services 30% of the pool assets; which is calculated based on the current unpaid principal balance of all the pool assets as of transaction origination date and annually thereafter for the succeeding calendar year on December 31<sup>st</sup>."*

compliance with the disclosure statement. We, therefore, suggest removal of this language<sup>19</sup>.

b. Clarification and Removal of Problematic Language (Item 1107)

In §229.1107, the Commission offers a list of information required for servicer disclosure. Section 1107(a)(2) Servicer Information and Experience is excessively broad. To date, servicers' policies and procedures have been treated in the industry as proprietary information, not typically shared amongst companies. Part of each company's competitive edge and profits is derived from its own established unique processes. Further, it is MBA's belief that the investor's review of the servicer's procedures is not of material value compared with the possible detriment and chilling effect to competition in the marketplace. Moreover, the open-ended nature of this Section, which references "information on factors related to the servicer that may be material to an analysis of the servicing of the pool assets....," is problematic and overly broad. MBA would strike portions of section (a)(2) and leave only the following language: *"Describe the general character of the servicer's business and state how long the servicer has been servicing the asset. Information regarding the size, composition and growth of the servicer's portfolio of serviced assets of the type to be securitized should be included."*

MBA requests that the phrase "servicer's portfolio" be further defined to avoid confusion on the type of information the servicer is required to provide. MBA suggests the following language: *"Servicing portfolio" is defined by asset type, e.g., CMBS, RMBS, or ABS.*

MBA would also suggest removing §229.1107(a)(3), requesting the servicer "describe any material changes to the servicer's policies and procedures" as part of the overall policies and procedures, which are also not of material value to the investors.

The Commission also requests information in §229.1107(a)(4) on the servicer's financial condition. MBA agrees the submission of some servicer financial information may be beneficial to investors, but we believe that an audited financial statement, which must be prepared by an accountant, is excessive as a minimum standard. MBA recommends that servicers be permitted to supply a statement of their compliance with specified capital requirements, such as the capital requirements of Fannie Mae/Freddie Mac. To the extent that servicers choose to submit an audited financial statement, MBA suggests that the Commission permit the use of a servicer's parent company's financial statement where the servicer is a wholly owned company. In some instances, the parent company information is a more accurate reflection of the financial stability and market view of the servicer. The financial statements should be based on the company's fiscal year-end financial reports.

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<sup>19</sup> The Commission also uses the same concept in the preamble section III(D)(5).

In §229.1107(b)(1), the Commission requires that the servicing agreement(s) be attached to the disclosure. Timing of the transaction affects the ability to disclose information on the parties in the deal as early as the completion of the prospectus. The PSA and Primary Servicing Agreements are typically not completed until after the prospectus has already been finalized and printed. Thus, it would require considerable alteration to business practices to finalize the Primary Servicing Agreements in time for attachment to the prospectus<sup>20</sup>. Moreover, while the PSA is offered as a public document once the transaction is completed, the Primary Servicing Agreements often contain the confidential pricing agreements between the master and primary servicers and are not considered public documents. MBA submits that the required disclosure of each separate agreement between servicers will hinder negotiations and industry competition. Therefore, MBA requests the Commission delete the requirement to attach the servicing agreements as an exhibit.

§229.1107(b)(8) requires disclosure of any other “material minimum servicing requirements.” It is unclear what type of information this best practices language will solicit. MBA requests either some examples of the type of information the Commission hopes to gather based on this section or removal of this language.

Finally, MBA objects to the use of the term “credit enhancement” to describe servicing advances anywhere in the regulation. The industry historically does not consider MBS servicing advances as credit enhancements and any association with this concept would cause significant changes to the current MBS business model. Unlike a true credit enhancement, servicer advances are refunded to the servicer at the top of the “waterfall” (cash disbursement), even prior to the investors receiving their funds. Further, the advances serve to provide liquidity as to the timing of payments, but at any time during the life of a transaction the servicer or trustee can make a determination of “non-recoverability” and cease making advances to the trust. This option is not permitted in a credit enhancement. As a result, servicing advances perform a different function and have embedded refund characteristics that credit enhancements do not.

## **II. Other Comments on the Proposed Regulation**

### **A. Miscellaneous Registration Issues**

#### **1. Forms: Presentation of Disclosure in Base Prospectuses and Prospectus Supplements (Preamble - (3)(b))**

MBA appreciates the decision of the Commission to utilize the existing registration Forms S-1 and S-3, with the requirements of Form S-3 registration permitting delayed shelf registration. The ASF is filing extensive comments on this subject and we support their recommendations. The ASF letter requests that the base prospectuses and forms

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<sup>20</sup> MBA has enclosed a timeline for both CMBS and RMBS to assist in illustrating our concern.

of prospectus supplements be permitted to describe and relate to multiple types of residential mortgage loans. For example, a base prospectus for RMBS should be permitted to include information about government loans, conventional loans, non-conforming products, ARMs, FRMs, Hybrids, current and seasoned product. The understanding is that the final prospectus supplement will include the data and will identify the mortgages in the related mortgage pool.

## 2. Loss of Shelf Registration

MBA requests that the Commission reconsider its proposal to render S-3 registration ineligible based on reporting noncompliance as described in the Proposed Rule. The Commission states in its preamble that "we do propose codifying that reporting obligations regarding other asset-backed securities transactions established by the sponsor and the depositor have been complied with for the prior 12 months for continued S-3 eligibility for new transactions."<sup>21</sup> While we understand from statements made by Commission staff speaking for themselves that noncompliance with periodic reporting requirements has been problematic, MBA suggests that the Commission seek to distinguish in its final rule between the abusers and those culpable of inadvertent omissions.

The plain reading of the Proposed Rule leads to an interpretation that a single incident of failure to comply with a reporting requirement by a depositor or sponsor would bar the sponsor from utilization of shelf registration. We do not believe that this draconian remedy is necessary to command the attention of the issuer community to the serious nature of their reporting obligations. While the Commission would no doubt exercise its best discretion in the case of a minor infraction, it is not clear to us that the Proposed Rule would allow for that discretion. Given that our members are involved in hundreds or even thousands of transactions for which periodic reporting is due, we request that the Commission work with the industry to develop an alternative remedy for reporting noncompliance.

## 3. Foreign ABS

The MBA supports the Commission in its efforts to clarify the process and to eliminate impediments to the shelf registration system for offerings of ABS by foreign issuers or those offerings backed by foreign financial assets. The MBA supports the ASF letter which states " Consistent with the framework of the federal securities laws generally, we believe that properly crafted disclosure regulations that address pertinent regulatory and other matters relating to the subject ABS and underlying assets should address any concerns that the Commission and its staff may have had historically with such shelf offerings."

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<sup>21</sup> Fed Reg at 26663

B. Other Disclosure Issues

1. General (Item 1100):

a. Presentation of Historical Data

The Proposed Rule calls for the presentation of delinquency information in 30-day increments until the assets are written-off or charged-off as “uncollectable.” Today mortgage delinquency experience is most commonly disclosed in three buckets, 31-60 days, 61-90 days and 91+ days. We respectfully ask that the Commission permit delinquencies lasting more than 90 days to be grouped together to reflect industry practice. Investors are very familiar with this presentation. Having a single bucket for those loans over 90 days delinquent also reflects the fact that the number of delinquencies drops dramatically after the 90<sup>th</sup> day and that some loans default and move to being considered “specially serviced;” thus further breakdown would not be very useful.

b. Issuer Reliance on Information Provided by Unaffiliated Third Parties

The Proposed Rule requires significant disclosure of a very detailed nature from a number of entities associated with the pool. This includes servicers, sponsors, originators, trustees, credit enhancers and significant obligors. These entities are generally unaffiliated with the issuer, yet the issuer must prepare the prospectus and other reports. Much information required from unaffiliated third parties is solely within the control of those parties and the issuer has no involvement in its preparation or control over the accuracy of its content. Therefore, we believe that §1100 of the Proposed Rule should be modified to add a section stating that the issuer is allowed to reasonably rely on any information provided by an unaffiliated third party for any of the initial disclosure or subsequently updated material filed with the Commission.

**III Request for Re-Proposal and Conclusion**

A. Request for Re-Proposal

The Commission has proposed an update and codification of more than a decade of its interpretative guidance on the registration, disclosure and reporting for ABS. MBA commends the Commission for an excellent Proposed Rule to serve as the basis for consideration by all segments of the ABS market. In view of the importance of the final rule, its complexity, and the impact it could have on ABS market dynamics and the way in which ABS are issued, *MBA requests that the Commission re-propose the ABS rule prior to issuance of a final rule.*

B. Request for “Grandfather” Provision

If the Commission elects to proceed directly to the issuance of a final rule, *MBA requests that the Commission clarify that registered transactions, including transactions eligible for future registration under existing shelf registrations, will be grandfathered.* We think that the open shelf registrations and the existing deals should not have to comply with the standards of the final rule.

C. Request for Implementation Lead Time

*MBA requests that, when the Commission issues a final rule, you consider the time reasonable for a transition to the newly codified registration and reporting protocol for ABS.* The various transaction parties will need a significant period of time to collect data, coordinate responsibilities, re-negotiate contracts and otherwise comply with the final rule. MBA suggests that the Commission provide an implementation or transition period of not less than one year from the date of publication of the final rule.

D. The Proposed Rule and Its Objective: MBA’s Conclusions

As the Commission points out in its Overview,

“Asset-backed securities and ABS issuers differ from corporate securities and operating companies...information about the transaction structure and the quality of the asset pool and servicing is often what is most important to investors.”

MBA agrees wholeheartedly with the Commission’s premise. ABS investors, by definition, are owners of assets managed by someone else with their income rights calculated and distributed by another entity. Investors need information about the assets and about the entities in control of those assets at the time of registration and on a periodic basis thereafter. MBA respectfully would add to the list of considerations that most investors are also interested in information clarity, as well as, price.

The Commission must strike a balance between asking for so much information that it is confusing or misleading, and failing to set the materiality standard that investors need. Reasonableness directs that there should be some limit to the information required and some consideration given to the cost of compliance.

The Commission notes in discussing the impact of the Proposed Rule that, “...if transactions in the private market for ABS...do not result in similar disclosures, issuers could...migrate to those markets...” Fed Reg at 26716. We see the potential for increased utilization of private placement type transactions if the final rule makes demands on transaction parties that tip the balance in the direction of private

placements. MBA makes no detrimental comment regarding those private transactions, but we believe that some shifting of the balance is necessary in the Commission's revision of the Proposed Rule to avoid a market change due to the requirements for ABS registration, disclosure and reporting.

We hope our letter is useful to the Commission in its deliberations on where the balance should be struck for mortgage-backed ABS. For example, we have made the case that our proposed approach for reporting compliance with servicing criteria would be more practicable than the Commission's proposed reporting approach given the overlapping roles of servicers, and other factors, within the MBS market. As another example, we ask that the Commission refrain from imposing a requirement for static pool data and instead, direct sponsors to provide relevant historical information on their portfolios. MBA believes that the market will clarify its appetite for static pool and other forms of data through the prices it will pay. Once a market standard emerges, the Commission can add a requirement.

MBA believes implementation of our recommendations would streamline the Proposed Rule without harming investors. In fact, we have tried to make the Proposed Rule function more efficiently, to the benefit of all. In closing, MBA again thanks the Commission for the opportunity to comment on the Proposed Rule which we fully expect to be the first step in the creation of a final rule to serve ABS investors and support the continuing development of a robust market.

Thank you for your consideration of our request.

Most Sincerely,

A handwritten signature in black ink, appearing to read "Jonathan L. Kempner". The signature is written in a cursive, flowing style.

Jonathan L. Kempner  
President and Chief Executive Officer

Enclosure

## Enclosure to MBA Letter Timeline of CMBS and RMBS Transactions

Relating to §229.1107(b)(1)

To assist in understanding MBA's concerns with regard to the ability to provide a copy of the servicing agreements as an exhibit to the Prospectus, we provide a brief overview of the timeline for closing CMBS and RMBS transactions:

1. Issuers assess product and relationship opportunities, and then establish a team to effectuate a transaction – each issuer offers a tentative pool of assets for the transaction
2. Issuers determine the depositor for the transaction
3. Depositor offers the pool of assets to the market, investors pledge to purchase the rated class of assets – the non-rated class investor chooses the special servicer
4. Depositor electronically sends the tentative list of the pool of assets on a “tape” to the potential master servicers (included on the tape are the list of possible primary servicers who will remain in the deal and continue to service some of the loans)
5. Each potential master servicer evaluates the tape to determine the value and submits a bid letter, offering a price to service the loans, to the depositor.
6. Depositor notifies one of the servicers that they have won the bid and will be named as the master servicer on the deal
7. The “red” prospectus (draft copy) is written and approved by all named parties, the depositor, issuers, master servicer, special servicer, trustee, and rating agencies (the primary servicers are not a signing party to the document)
8. Almost simultaneously, the issuers finalize the pool of assets and the “black” prospectus (final) is printed and disbursed to the investors.
9. The Pooling and Servicing Agreement (PSA) is drafted based on the special servicer provisions, trustee provisions, rating agency requirements, master servicer bid letter terms and the general industry standards for a transaction.
10. PSA is finalized by agreement of the named parties in the document – depositor, issuers, master servicer, special servicer, trustee, and rating agencies (the primary servicers are not a signing party to the document)
11. Master servicer completes negotiations with each individual primary servicer and finalizes the Primary Servicing Agreements.
12. Depositor offers the pool assets as securities to the market and files the official documents to complete the transaction with the Commission.

RMBS follows a similar process:

1. The owner of the assets to be securitized (the "Seller") identifies a tentative pool of assets for the transaction which may include assets originated by the Seller or assets acquired by third parties;
2. The Seller determines the underwriter and the depositor for the transaction. The depositor may be an affiliate of the Seller or an affiliate of the underwriter for the transaction;
3. The Seller electronically sends the tentative list of the pool of assets on a "tape" to the potential rating agencies to determine the credit enhancement levels necessary for the desired ratings of the securities, and the Seller then selects one or more rating agencies;
4. Each potential master servicer and trustee evaluates the tape to determine the value and submits a bid letter, offering a price to master service the loans or to act as trustee, to the Seller;
5. The Seller notifies the master servicer and the trustee that they have won the bid and will be named as the master servicer and the trustee on the deal;
6. The Seller determines which party or parties will act as servicer of the assets. The assets may be serviced by the Seller, the originator from whom the Seller acquired the assets or another party selected by the Seller;
7. The collateral term sheets (describing the material characteristics of the assets) and structural term sheets (describing the securities and the material characteristics of the transaction) are written and approved by the Seller, the depositor, underwriter and rating agencies;
8. The collateral term sheets and structural terms sheets are distributed to investors for feedback on potential deal structure and pricing;
9. The Seller and the underwriter finalize the pool of assets, transaction structure and terms of the securities;
10. The Prospectus is drafted and reviewed by all parties to the transaction including the Seller, depositor, underwriter, master servicer, servicers, trustee and rating agencies;
11. The Pooling and Servicing Agreement ("PSA") is drafted based on the final structure described in the Prospectus and also incorporates rating agency requirements and the general industry standards for a transaction.
12. The Prospectus is finalized and distributed to investors prior to the closing date;
13. The PSA and servicing agreements are finalized by agreement of the named parties in the document and rating agencies;
14. The Seller offers the pool of assets as securities to the market;
15. The Prospectus, PSA and other material documents are filed with the Commission