

## **In A Troubled Market, Mortgage Servicers Must Have Solid Practices To Resolve Problem Loans**

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NEW YORK (Standard & Poor's) July 14, 2008--The disruptions in the U.S. mortgage markets have many market participants asking about the best practices residential loan servicers should follow to manage the mounting delinquencies and foreclosures. When assigning and surveilling rankings on servicers, Standard & Poor's Ratings Services will more closely examine certain practices we believe are important for prudent mortgage servicing in today's climate--namely, procedures governing the oversight of first-lien mortgages in bankruptcy, foreclosure, and various stages of loss mitigation, as well as processes for monitoring tax payments and insurance coverage for subordinate-lien mortgages.

Standard & Poor's recently sent its first-half 2008 Servicer Evaluation Analytical Methodology (SEAM) questionnaire to the mortgage servicers we rank to request specific data that we use to assign and surveil our rankings on these companies. We will be focusing on these practices when conducting site visits and reviewing SEAM data submissions to determine how servicers are managing the rise in troubled mortgages and to gauge their ability to maintain the level of service required for their rankings.

### **Thorough Escrow Analysis Is Crucial For Loans In Bankruptcy**

The recent sharp rise in bankruptcy filings and the federal bankruptcy courts' growing reluctance to take servicers' claim filings at face value--as evidenced by a number of recent rulings against them--underscore the importance of servicers' processes for managing loans in bankruptcy. We believe the **Bankruptcy Code of Best Practices** that the National Association of Chapter 13 Trustees recently adopted is in line with our criteria and provides a sound framework upon which servicers can model their policies and procedures in this key area.

In our view, it's important for servicers to thoroughly analyze amounts in escrow at least annually to account for payments they make after the borrower's bankruptcy filing. We will look to see that servicers itemize any existing escrow

shortfalls at the time of a bankruptcy filing in their proof-of-claim submissions and omit them from the borrower's post-petition payments, and that they conduct ongoing escrow analysis for all payments the borrower makes after the initial filing. In our view, these measures help prevent large escrow deficits from accumulating over the course of the debtor's bankruptcy plan, which can make the loan payments unaffordable again when the borrower comes out of bankruptcy.

We also believe it's important for servicers to clearly itemize each amount due from a borrower when submitting proofs of claim and to retain as much evidence as possible of items, such as taxes and insurance, that the servicer pays on behalf of the borrower and any other expenses it incurs. We have observed that a bankruptcy judge may partially or totally dismiss claims if a servicer fails to provide detailed accounts of such payments and expenses, which may in turn cause losses to investors.

Finally, we expect all highly ranked servicers to accurately process any payments the trustee has made on the debtor's behalf, including payments to cover delinquencies before the bankruptcy filing and monthly payments after the bankruptcy plan is in place. We expect servicers to pay special attention when assessing late fees and prioritizing the application of pre-petition arrears (payments past due before the bankruptcy filing).

#### Quality May Trump Speed When Resolving Foreclosures

Recent experience has shown that when scoring attorneys and other third-party vendors handling foreclosures, timeline management and speed of processing shouldn't be the sole or overriding measures of performance: in our view, servicers should also assess their vendors' ability to maintain complete and accurate documentation, such as performing the necessary research to secure evidence of the servicer's beneficial ownership of the mortgage loan on behalf of investors. If necessary, servicers should also consider amending their scoring methods for evaluating attorneys and other third-party providers to balance measures of timeline management with metrics that address the quality of the vendor's work, such as the percentage of foreclosure actions that are contested on substantive or procedural grounds.

Standard & Poor's will be giving more weight to how servicers monitor their attorneys and other default management vendors and how they score their success as part of our upcoming site visits and ranking updates. We'll also be looking at servicers' processes for ensuring timely and effective

communication of data with their attorneys and other default management vendors.

#### New Loss Mitigation Metrics Will Address Servicers' Responsiveness To Borrowers

We will be incorporating new fields into the next release of our SEAM questionnaire to capture servicers' overall responsiveness to borrowers and their loan counseling representatives, in addition to the number and success of their loss mitigation plans. These metrics will include the average time to respond to a borrower's initial request for a loan modification, the average time to review the borrower's financial information, and the average time between this review and the servicer's final decision. We expect our higher-ranked servicers, in particular, to track such data, which we'll use to establish acceptable thresholds for our ranking criteria going forward.

#### Tax And Insurance Tracking Are Key For Subordinate Liens

In today's fiscal climate, municipalities are increasingly looking to monetize unpaid taxes through lien auctions or securitizations, and a growing number of speculators are reportedly purchasing these subordinate liens. Thus, we expect our higher-ranked servicers to have processes in place to actively track insurance coverage and tax payments on the collateral for all loans, regardless of their lien position, using either in-house personnel or third-party vendors.

We also expect highly ranked servicers to be vigilant in guarding against preemption of their liens, which can happen if the government claims and sells the mortgaged property to recover unpaid county or municipal taxes. Equally important is ensuring that loan collateral has proper insurance coverage that continues to include its investors' insurable interest.

#### Our Ranking Process Will Keep Evolving

Standard & Poor's will review the incoming responses to our first-half 2008 SEAM questionnaire with a focus on these practices, and we will be adding various new fields to more accurately capture these areas in the version we release for the second half of the year. We will continue to adapt our approach to evaluating mortgage servicers to address the demands of a changing market and keep the industry informed of these developments.

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