

MORTGAGE BANKERS ASSOCIATION

White Paper

Commercial

Securities & Exchange Commission's Regulation of Asset-Backed Securities

Interpretive Guidance on Regulated Disclosure for CMBS Servicing

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Introduction

On January 7, 2005, the SEC issued a final regulation to clarify the requirements for the registration, disclosure and reporting for asset-backed securities (ABS), by definition including all public deals in commercial and residential mortgage-backed securities (CMBS and RMBS).

The rule is significant to MBA members who are involved in the rapidly expanding ABS sector. The SEC's regulation affects all parties, including sponsors, issuers, servicers, trustees, as well as significant collateral contributors and sub-servicers in public CMBS transactions.

The regulation is robust and complex, covering all aspects of the ABS industry. Recognizing MBA's unique expertise in both the technology and servicing arenas and the need to better define the scope of the rule and its applicability to servicers, MBA has worked with the members, both CMBS and RMBS, on several initiatives to help inform and educate the real estate finance industry on the requirements of Regulation AB.

White Paper Development

The MBA created the Commercial/Multifamily SEC ABS Working Group ("Working Group") to address the issues that impact CMBS Servicers within Regulation AB. The Working Group consists of the top 10 CMBS servicing companies (based on 2004 CMBS servicing volumes), as well as other key CMBS Master Servicers, CMBS Primary Servicers, CMBS Special Servicers, and CMBS Trustees. These parties are all affected in some manner by the SEC Servicer definition in Regulation AB. Over 50 representatives of member companies have actively participated in the Working Group discussions.

The MBA hired Heil and Associates ("consultants") to assist the CMBS market in understanding Regulation AB as it applies to CMBS servicer disclosure and reporting. The consultants conducted a series of individual company interviews to understand the current Servicer processes and each company's individual interpretation of the impact of Regulation AB.

Participants provided responses to a series of MBA developed questions on CMBS servicer disclosure and reporting, and offered their thoughts as to how these items were perceived and practiced by the participants. The participants also provided additional commentary, opinions, and insights into the CMBS market, which have been incorporated throughout the white paper.

From the interviewees' responses, MBA and the consultants drafted the White Paper.

The draft White Paper was then circulated for an open comment period to all CMBS industry participants, including "Big 4" accounting firms, issuers, issuer's counsel, investors, investor's counsel, rating agencies, servicer's counsel, trustee's counsel, mortgage bankers, and other trade associations. MBA solicited feedback from over 125 market participants.

This final version of the White Paper incorporates the industry comments and feedback.

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SEC Regulation AB Overview

On January 7, 2005, the Securities and Exchange Commission (SEC) issued a final regulation to codify the requirements for registration, disclosure and reporting of asset-backed securities (Regulation AB). The regulation pertains to all publicly issued asset-backed securities (ABS), including both commercial mortgage-backed securities (CMBS) and residential mortgage-backed securities (RMBS) transactions.

Regulation AB directly impacts CMBS Servicer Disclosure and Reporting. One critical aspect of Regulation AB for CMBS Servicers is the government regulated disclosure requirements in the Prospectus. Prior to the issuance of Regulation AB, ABS market participants have relied upon industry standards to guide their disclosure practices. In the CMBS industry, dialog amongst market participants has driven disclosure of information deemed important to investors. To clarify the disclosure process, the SEC adopted a principles-based set of disclosure items for both Securities Act registration statements and Exchange Act reporting for ABS. These disclosure requirements represent a consolidation of the existing industry practice and some additional new items.

In the regulation Preamble the SEC noted *“we still do not believe it would be practical nor effective to draft detailed disclosure guides for each asset type that may be securitized.”*¹ The disclosure items are to serve as a concept or objective. *“The application of the particular concept must be tailored to the particular transaction and asset type involved and resulting determinations made by each industry as to the materiality of information disclosed.”*² Materiality is determined by the information a reasonable investor would consider important in making an investment in a particular type of asset-backed security.³

Regulation AB requires full compliance with the new disclosure regulation for any registered offering of asset-backed securities commencing with an initial bona fide offer after December 31, 2005. The regulation does have a transition period; the guidelines for compliance dates are provided as an exhibit.

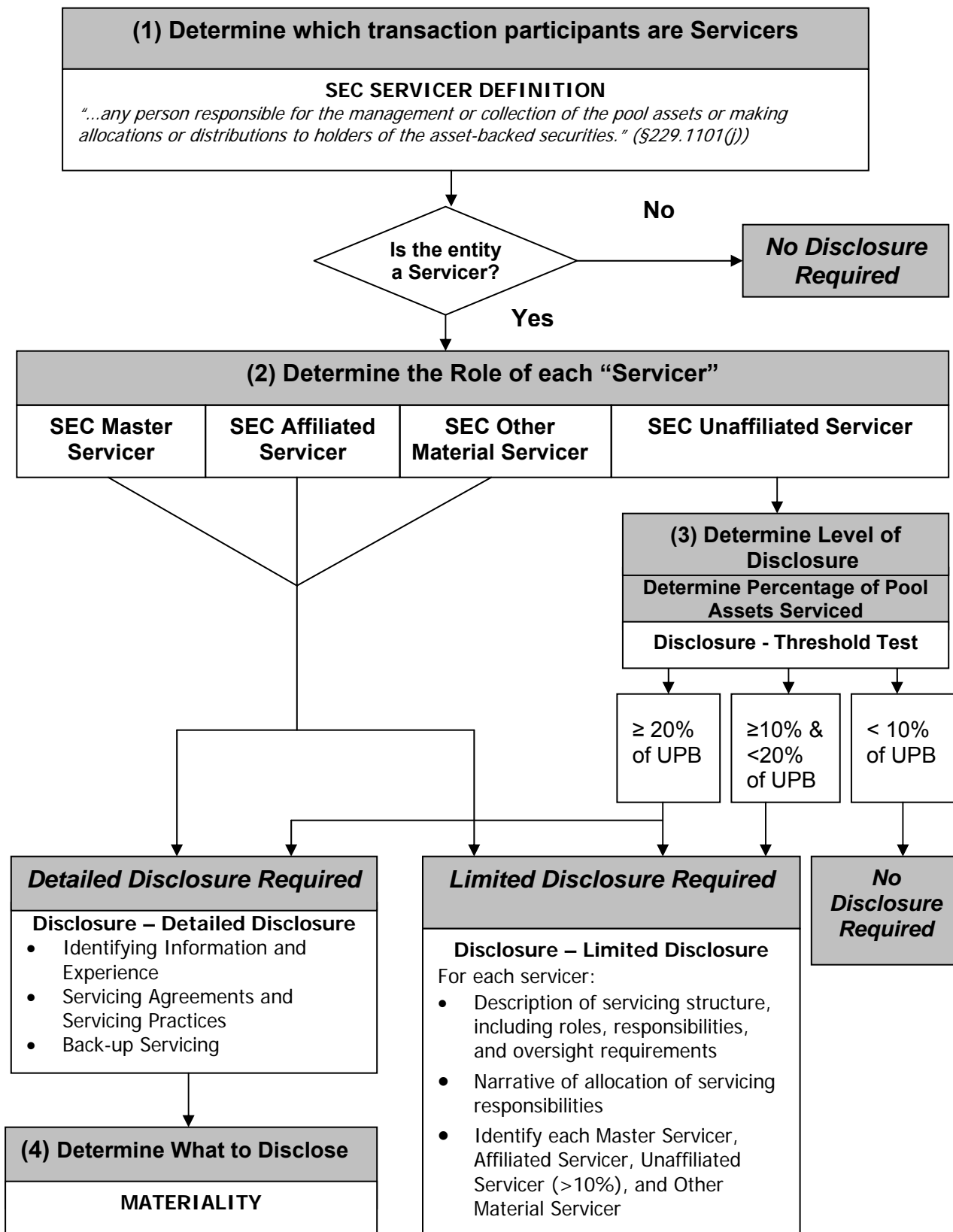
Regulation AB is available on the Internet at www.sec.gov/rules/final/33-8518.pdf

¹ Preamble, §I(C), Federal Register, page 1509.

² Id.

³ See TSC Industries, Inc. v. Northway, Inc., at 449; and Basic, Inc. v. Levinson, at 231. See also the definition of “material” in Securities Act Rule 405, which states: The term “material,” when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered.

Process Flow for Servicer Disclosure



(1) Determining Which Transaction Participants are Servicers

SEC Servicer Definition

The SEC definition of Servicer is:

“any person responsible for the management or collection of the pool assets or making allocations or distributions to holders of the asset-backed securities.”⁴ (“SEC Servicer”)

The SEC Preamble for Regulation AB noted that *“information relating to the quality of servicing of the underlying assets is relevant to assessing how the asset pool is expected to perform and the reliability of the allocation and distribution functions.”⁵* The Preamble states that *the role of an issuer of an asset-backed security is passive in nature. It is the “Servicer” who is often affiliated with the sponsor that is responsible for payment collection from obligors, administration of pool assets, calculation of the flow of funds (waterfall), preparing distribution reports and disbursing funds to the Trustee.* The SEC’s definition of Servicer is *“designed to capture the entire spectrum of activity to include both collection and asset maintenance activities as well as cash flow allocation and distribution functions for the asset-backed security.”⁶*

The SEC recognized that *in many transactions, multiple entities are used to perform these different servicing functions.* Commentary provided by the industry attempted to persuade the SEC to create separate definitions for different aspects of the servicing function such as Master Servicer, administrator, primary Servicer, Special Servicer, affiliated Servicer and unaffiliated Servicer. The SEC noted *there is not a uniform differentiation of servicing functions consistent across all asset classes or even within the same asset class.⁷* Similar to their concerns about establishing asset-specific disclosure rules, they believe it would not be *“appropriate to establish rigid definitions that may not encompass future changes to market practice involving servicing.”⁸*

Interpretive Guidance

The SEC Servicer definition is broader than the CMBS industry uses today. This SEC broader definition includes CMBS Master Servicers, CMBS Primary Servicers and CMBS Special Servicers; and may include CMBS Trustees, and CMBS Vendors and Subcontractors.

⁴ §229.1108(b)-(d), Federal Register, page 1601.

⁵ Preamble §II, Federal Register, page 1511

⁶ Preamble §III(B)(3)(d), Federal Register, page 1535.

⁷ *Id.*

⁸ *Id.*

CMBS Master Servicers

CMBS Master Servicers meet the SEC Servicer definition. Master Servicers are responsible for management and collection of pool assets. Therefore, the CMBS Master Servicer will meet the SEC Servicer definition.

CMBS Primary Servicers

CMBS Primary Servicers may have two distinct and different roles in a transaction:

- “Full” Primary or Sub-Servicer
- “Limited” Primary or Sub-Servicer

CMBS Primary Servicers participate in transactions with a variety of roles and varying levels of responsibility. Whereas the typical model for CMBS sub-servicing calls for “full” servicing by the Primary or Sub-Servicer (i.e., cashiering, escrow administration, investor reporting and asset management functions), there are also a small but growing number of “limited” servicing arrangements in the CMBS market. These “limited servicing” arrangements are similar to the non-cashiering correspondent arrangements between life companies and smaller mortgage bankers.

CMBS “full” Primary Servicers meet the SEC Servicer definition. The SEC intended to capture the parties performing asset maintenance in the Servicer definition. Primary Servicers performing loan servicing functions, such as cash processing, remittances, asset management, and investor reporting are SEC Servicers.

CMBS “limited” Primary Servicers may not meet the SEC Servicer definition. In these limited servicing arrangements, the Primary Servicer’s responsibilities are typically limited to performing property inspections and collecting operating and financial statements for transmittal to the master. In these scenarios, the Master Servicer handles all cashiering, escrow administration, and special borrower requests. The Master Servicer makes all the final decisions and approvals in this instance. In Exhibit D, the members stated that third party CMBS Vendors and Subcontractors who performed the same functions as the “limited” Primary Servicers were deemed not a SEC Servicer. Though the specifics of each arrangement should be separately evaluated, this model raises the question of whether a CMBS “limited” Primary Servicer rises to the SEC Servicer definition for reporting purposes.

CMBS Special Servicers

CMBS Special Servicers meet the SEC Servicer definition. They perform workouts or foreclosure of non-performing loans in a pool, an important part of asset management on behalf of the trust and the investors.

CMBS Trustees

In some instances, CMBS Trustees will meet the SEC Servicer definition. CMBS Trustees who perform any of the following will be considered SEC Servicers:

- develop cash flow models
- perform bond calculations
- and/or generate waterfall calculations

Trustees who only perform administrative functions, such as allocation and distribution of funds as directed by the Servicer, will not be considered an SEC Servicer.

CMBS Vendors and Subcontractors

In some instances, a CMBS Vendor or Subcontractor may meet the broad SEC Servicer definition. The MBA SEC ABS Working Group attempted to develop some industry consensus regarding potential servicing activities performed by an affiliated or unaffiliated third party to determine which Vendor or Subcontractor activities might meet the SEC Servicer definition.

The Working Group concluded that certain activities and roles may lead to a determination that a CMBS Vendor or Subcontractor meets the SEC Servicer Definition. Activities and roles may include among other things:

Activities	Roles
Bond Calculation & Cash Flow	Authority to Make Decisions
Cash Processing	Give Final Approval
Reporting – IRP Package	Conduct the Final Review
Workouts or Foreclosures	Analysis and Determinations

For example, the Working Group opined that a CMBS Vendor or Subcontractor may be considered a SEC Servicer if the entity performs financial statement analysis, and such analysis is not subject to additional substantive review and approval by (a separate) Servicer. In contrast, the Working Group concluded that a Vendor should not be considered a SEC Servicer if that Vendor solely performs data-entry functions, or performs well-defined calculations that do not require the exercise of professional business judgment, or which are subject to subsequent, substantive review and final approval by (a separate) Servicer, then such Vendor should not be considered a SEC Servicer.

The Working Group's product from discussions on who may constitute a Servicer, based on the SEC Servicer definition, is attached as Exhibit D.

Evaluation

As a note, each entity participating in a CMBS transaction must be reviewed on a case-by-case basis and in light of the principles set out in Regulations AB, in order to determine whether or not such entity rises to the level of a SEC Servicer.

Determination:

Is the entity a Servicer?

No – then no Regulation AB Servicer disclosure is required.

Yes – move to the next step, which is to **Determine the Role of each “Servicer”**.

(2) Determining the Role of each Servicer

SEC Servicer Roles

Each Servicer that meets the SEC Servicer definition falls into one of four SEC Servicer roles:⁹

- i. Master Servicer
- ii. Affiliated Servicer
- iii. Unaffiliated Servicer
- iv. Other Material Servicer

Figuring out the role of each Servicer is important because the level of disclosure required is partially determined by the SEC Servicer role. The Regulation AB Preamble describes different activities associated with each of these servicing roles. The following table presents the SEC Servicer roles and comments offered in the Preamble regarding those roles. The number in parenthesis in column 2 references the Federal Register page.

SEC Servicer	Regulation AB Servicer Role
Master Servicer	<ul style="list-style-type: none"> • Oversee the actions of other Servicers. (1535) • May perform the allocation and distribution functions. (1535) • May sign Exchange Act Reports (otherwise, depositor signs). (1510)
Affiliated Servicer	<ul style="list-style-type: none"> • May be responsible for primary contact with obligors and collection efforts. (1535) • Collect payments from obligors of the pool assets, carry out the other important functions involved in administering the assets and to calculate and pay the amounts net of fees due to the investors that hold the asset-backed securities to the Trustee, which actually makes the payments to investors. (1511) • May be affiliated with the issuer, depositor, sponsor, or underwriter. (1535)
Unaffiliated Servicer	<ul style="list-style-type: none"> • May be responsible for primary contact with obligors and collection efforts. (1535) • Collect payments from obligors of the pool assets, carry out the other important functions involved in administering the assets and to calculate and pay the amounts net of fees due to the investors that hold the asset-backed securities to the Trustee, which actually makes the payments to investors. (1511) • Not affiliated with any transaction party listed under Affiliated Servicer. (1535)
Other Material Servicer	<ul style="list-style-type: none"> • Responsible for calculating or making distributions to holders of the asset-backed securities, performing work-outs or foreclosures, or other aspect of the servicing of the pool assets or the asset-backed securities upon which the performance of the pool assets or the asset-backed securities is materially dependent. (§229.1108(a)(1)(iv))

Importantly, the SEC has clarified that it is their intention to capture “...all entities with a role in the servicing function that may materially impact performance of the pool

⁹ §229.1108(a)(2)(i)–(iv), Federal Register, page 1604.

assets...” (i.e., the mortgage loans), regardless of whether such entity is in contractual privity with the Issuer.¹⁰ In other words, an entity does not have to be party to the Pooling and Servicing Agreement (PSA), or to a Sub-Servicing Agreement, in order to be captured in the SEC Servicer definition.

Interpretive Guidance

The following table relates the CMBS Servicer Roles with their corresponding SEC Servicer Roles.

SEC Servicer Role	CMBS Servicer Role
Master Servicer	
Affiliated Servicer	CMBS Sponsor-Affiliated Primary Servicer
Unaffiliated Servicer	CMBS Non-Sponsor-Affiliated Primary Servicer CMBS Vendor/Subcontractor
Other Material Servicer	CMBS Special Servicer CMBS Trustee

Master Servicer

The SEC intended for each transaction to recognize the role of a “master servicer;” one entity with general oversight of all the parties in the transaction. In CMBS transactions, the Working Group participants raised questions about the SEC definition for a Master Servicer. Some members of the Working Group felt that the SEC definition did not accurately reflect the CMBS Master Servicer role; that CMBS Master Servicers do not typically act in the role of general oversight of all servicers in the transaction (as defined by the SEC to include CMBS Primary Servicers, CMBS Special Servicers and CMBS Trustees). Some of the Working Group argued that the SEC Master Servicer definition is not synonymous with the roles attributed to CMBS Master Servicers in current PSAs.

With the various Working Group viewpoints on the SEC definition as it pertains to role of CMBS Master Servicers, the White Paper remains inconclusive on the answer of whether CMBS Master Servicers should be considered SEC Master Servicers.

It is important to note that even if CMBS Master Servicers are not deemed SEC Master Servicers, their role will fall under the definitions of SEC Affiliated Servicer and SEC Unaffiliated Servicer, making them subject to SEC disclosure requirements.

On each transaction, the CMBS Master Servicer should review its actual role in the transaction and the SEC Master Servicer definition to determine if the entity’s role rises to the SEC definition.

¹⁰ Preamble §III(B)(3)(d), Federal Register, page 1535.

Affiliated Servicer

Affiliated Servicers are companies under common control of a parent company and linked to the Sponsor(s). The SEC defines a Sponsor as “*the person who organizes and initiates an asset-backed securities transaction by selling the transferred assets, either directly or indirectly, including through an affiliate, to the issuing entity.*”¹¹ **In CMBS transactions, the SEC Sponsor definition may include: Mortgage Banker, Originator, Issuer and/or the Depositor.** If the Primary Servicer is corporately linked to the Sponsor, for example, and has the same parent company as the Sponsor (or the Sponsor itself is the parent company), then the Primary Servicer would be considered an SEC Affiliated Servicer. SEC Affiliated Servicers are CMBS Primary Servicers that are related to the Sponsor.

Unaffiliated Servicer

Unaffiliated servicers are CMBS Primary Servicers who are not affiliated with the Sponsor(s). In CMBS transactions if an entity is unaffiliated with the Sponsor(s) and meets the SEC Servicer definition, such as some CMBS Primary Servicers and possible CMBS Vendors or Subcontractors, then the entities are considered unaffiliated Servicer(s). Unaffiliated Servicers are subject to a threshold test to determine the level of disclosure (explained below).

Other Material Servicer

The SEC definition of Other Material Servicer includes the CMBS Special Servicers and sometimes the CMBS Trustee. CMBS Special Servicers are responsible for, among other things, performing work-outs or foreclosures. CMBS Trustees typically perform the calculation and distribution of funds to the investors. In limited instances where the CMBS Trustees only perform administrative functions, such as allocation and distribution of funds as directed by the Servicer, they will not be considered an SEC Servicer.

Evaluation

Because an entity does not have to be party to the transaction documents in order to be captured in the SEC Servicer definition, it is important to evaluate the actual roles of the various parties, in order to make a reasonable determination as to whether or not such parties are in a position to “materially impact” the performance of the loans. While it is the belief of the MBA that the most “servicing” roles in the CMBS industry are well understood by the relevant parties, it is also recognized that the industry continues to evolve. Accordingly, each transaction must be independently evaluated, including the “titles” given to the various entities, and whether or not the entity is a party to specific contracts, will not necessarily govern the final determination.

¹¹ §229.1101(l), Federal Register, page 1602.

Determination:

Who are the other parties associated with the transaction (is the entity related to a Sponsor)? As a Servicer, what is the SEC defined role in the transaction?

SEC Master Servicer – entity must offer both limited and detailed disclosure.

SEC Affiliated Servicer – entity must offer both limited and detailed disclosure.

SEC Unaffiliated Servicer – entity must determine the level of disclosure based on a threshold test.

SEC Other Material Servicer – entity must offer both limited and detailed disclosure.

(3) Determining the Level of Disclosure

Threshold Test

Determining the level of SEC Servicing disclosure requirements is based on the SEC Servicer role; a threshold test (for Unaffiliated Servicers); and materiality.

If an entity meets the SEC Servicer definition and is serving in the SEC defined role of Master Servicer, Affiliated Servicer or Other Material Servicer, both limited and detailed disclosure are required.¹² There is no threshold test required.

SEC Servicer Role	Limited	Detailed
Master Servicer	Yes	Yes
Affiliated Servicer	Yes	Yes
Other Material Servicer	Yes	Yes

If an entity meets the SEC defined role of Unaffiliated Servicer, a threshold test is applied to determine the level of disclosure required. The threshold test is based upon a percentage: the Unaffiliated Servicer's unpaid principal balance (UPB) as a calculation of the total UPB of the entire pool of assets.¹³ The SEC followed up with the ABS industry participants, offering clarification that the determination date for the UPB is based on the balances in the transaction as of the cut off date.¹⁴

SEC Servicer Role	No Disclosure Required	Limited Disclosure Required	Detailed Disclosure Required
Unaffiliated Servicer	Less than 10% of the UPB of the pool assets at cut off date	10% or more of the UPB of the pool assets and less than 20% of the UPB of the pool assets at cut off date	20% or more of the UPB of the pool assets at cut off date

Determination:

For SEC Unaffiliated Servicers, what is the percentage of the asset pool's UPB that you service? Does it rise to the level of requiring disclosure?

¹² §229.1108, Federal Register page 1604-1605.

¹³ §229.1108, Federal Register page 1604-1605.

¹⁴ SEC contacted MBA offices by telephone to offer clarification as to how to calculate the threshold test.

(3) Determining the Level of Disclosure

Limited Disclosure

SEC explains that limited disclosure requires “a clear introductory description of the roles, responsibilities and oversight requirements of the entire servicing structure and the parties involved. In addition to an appropriate narrative discussion of the allocation of servicing responsibilities...”¹⁵

Limited disclosure also provides in the Prospectus an overview of the all of the servicing participants in the transaction. In the document the Depositor must identify each SEC defined:

- Master Servicer
- Affiliate Servicer
- Unaffiliated Servicer that services 10% or more of the UPB of pool assets
- Any Other Material Servicer (as defined in this paper, CMBS Special Servicers and CMBS Trustees who perform bond calculations)¹⁶

Interpretive Guidance

Interviewed CMBS Servicers noted that information that’s currently disclosed in transaction documents should meet the requirement for limited disclosure. Included is:

- company contact information,
- length of time servicing commercial mortgage loans,
- size and composition of CMBS servicing portfolio, all servicing portfolios

A generic example of current CMBS disclosure language that’s disclosed in transaction documents is presented below.

Sample of Current Generic CMBS Disclosure Language

ABC Servicing, Inc. will act as Master Servicer under the pooling and servicing agreement. The master Servicer’s principal place of business is 123 Main Street, New York, NY 10016. As of (date), ABC Servicing, Inc. was named the master Servicer on (number) CMBS transactions encompassing (number) loans with a legal balance of \$ billion. The portfolios include office, retail, multifamily, hospitality, industrial and other types of income producing properties in the United States.

While the limited disclosure information will be relatively unchanged from current industry practices, the inclusion of the Affiliated Primary Servicers, and Unaffiliated Primary Servicers and Vendors or Subcontractors meeting the threshold test, will increase the number of parties offering disclosure information in the Prospectus.

¹⁵ §229.1108(a)(1), Federal Register, page 1604.

¹⁶ §229.1108(a)(2), Federal Register, page 1604.

(3) Determining the Level of Disclosure

Detailed Disclosure

The SEC identified SEC Servicer roles that require an additional level of disclosure. The SEC categorized the detailed servicing information to be disclosed into three general categories:¹⁷

- Identifying information and experience
- Servicing agreements and servicing practices
- Back-up servicing

The table below graphically depicts the regulation for detailed disclosure.

Detailed Disclosure Servicing Functions¹⁸

Identifying Information and Experience
Length of time servicing assets.
General discussion experience in servicing assets of any type.
Detailed discussion of experience in and procedures for servicing assets of the type included in the transaction.
Any material change to policies and procedures in servicing assets of the same type during the past three years.
Size, composition and growth of the portfolio of serviced assets of the type to be securitized.
Prior securitizations of the same asset type that have defaulted or experienced an early amortization or other performance triggering event because of servicing.
Extent of outsourcing of servicing activities utilized.
Previous disclosure of material noncompliance with servicing criteria with respect to other securitizations.
Financial condition of servicing organization to the extent it could have a material impact on pool performance. Not general financial information.
Servicing Agreement and Servicing Practices
Terms of the servicing agreement.
Servicing duties.
File servicing agreement as an exhibit.
Description of servicing practices.
Manner in which collections on assets will be maintained.
Extent of commingling of funds.
Terms regarding advancing of funds including interest or other fees charged and terms of recovery.
Statistical information regarding past advance activity.

¹⁷ §229.1108(b)-(d), Federal Register, page 1605.

¹⁸ *Id.*

Servicing Agreement and Servicing Practices – con’t
Process for handling delinquencies and losses.
Ability to waive or modify any terms, fees, penalties or payments.
Custodial Requirements.
Back-up Servicing
Terms regarding Servicer removal, replacement, resignation or transfer.
Arrangements and qualifications required for a successor Servicer.
Process for transferring servicing.
Provisions for payment of expenses associated with servicing transfer or additional fees charged by successor Servicer.

Detailed disclosure should be limited to information that is material and relevant, based on information that “a reasonable investor would find material in considering an investment in the asset- backed securities and the servicing and administration of the pool assets and the ABS.”¹⁹

Additional Detailed Disclosure Items in Regulation AB pertaining to Servicer disclosure are presented as exhibits. They include:

- Legal Proceedings²⁰
- Affiliations and Certain Relationships and Related Transactions²¹

Interpretive Guidance

The following tables indicate Regulation AB disclosure requirements for CMBS transaction participants. Disclosure requirements are based on the SEC Servicer role. For SEC Unaffiliated Servicers, a threshold test is required to determine the level of disclosure required.

SEC Servicer Role	CMBS Servicer Role	Limited	Detailed
Master Servicer	Master Servicer	Yes	Yes
Affiliated Servicer	Primary Servicer	Yes	Yes
Other Material Servicer	Special Servicer or Trustee	Yes	Yes

SEC Servicer Role	CMBS Servicer Role	Percentage of Pool Serviced		
		< 10% of UPB	≥10% - <20% UPB	≥ 20% UPB
Unaffiliated Servicer	Primary Servicer	None	Limited	Detailed
Unaffiliated Servicer	Vendor/Subcontractor	None	Limited	Detailed

¹⁹ Preamble §III(B)(3)(d), Federal Register, page 1536.

²⁰ §229.1117, Federal Register, page 1611.

²¹ §229.1119, Federal Register, page 1611-1612.

Servicer Disclosure Items

The CMBS Working Group interviewees responded to a survey regarding Servicer disclosure items. They were asked to indicate the format that they intended to use for each disclosure item (narrative, tabular, etc); other parties to which they currently provide this information; and the level of effort involved with disclosing each item. The results of this survey are provided in the exhibits.

CMBS Servicing Duties and Procedures to be Disclosed

The CMBS Working Group interviewees were asked their opinion of which servicing duties are most important to an investor. As it pertains to CMBS servicing functions, interviewed Servicers believe that CMBS investors are primarily concerned with the following duties/procedures. The interviewees felt that material information about the following servicing functions should be disclosed:

Servicing Function	Description
Cash Management	Payment processing and custodial account management.
Servicer Advancing	Master Servicer's advancing capabilities and financial strength.
Property Protection	Pay property protection expenses (taxes, insurance) on time from escrow accounts.
Investor Remittance	Ensure that the CMBS trustee receives accurate monthly remittances to be able to make correct distributions to CMBS bondholders.
Investor Reporting	Provide the trustees with updated data files and other required reports.
Bondholder Calculations	Calculate the amount allocated to bondholders for all classes of the transaction.
Bond/Collateral Analysis	Provide monthly updated data files to CMBS analytic providers. Provide data to the bondholders in the CMSA IRP standard format. ²²
Risk Management	Monitor maturing loans, and loans that have been placed on watch list.
Event Risk	Answering investors' ad hoc requests for information about event risk i.e. deals with loan level exposure to terrorist activities, natural disasters, etc.

²² The Commercial Mortgage Securities Association's (CMSA) Investor Reporting Package® (IRP) is a standardized format for reporting on CMBS deals.

The Regulation states, and Servicers interviewed consistently backed the idea that information about servicing activities should remain principles-based and not specific. CMBS Servicer information provided on any SEC disclosure item should be material to the transaction and asset type, and must be considered on a case-by-case basis for each transaction.

Evaluation

While the SEC has outlined the limited and detailed disclosure requirements, the final determination of the material items to disclose rests with each Servicer based on their unique business structure and servicing practices. In each transaction, Servicers should evaluate the information being offered for disclosure and ensure its relevancy and materiality to the transaction and its investors.

Determination:

Is the Servicing entity required to offer detailed disclosure? If yes, then how to determine what information should be disclosed?

Answer: Detailed disclosure is based on materiality.

(4) Determine What to Disclose

Materiality

The Regulation AB Preamble notes that in determining what information to disclose, that the information should be deemed material.²³ Disclosure based on materiality is an attempt to balance the investors' need for more information transparency with the need to mitigate the possibility of immaterial or inapplicable information.²⁴

Materiality is based on the viewpoint of the reasonable investor and “whether there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision.”²⁵

- The SEC Regulation AB Preamble indicates that the transaction documents should not include excessive disclosure, nor are they required to include any competitively sensitive information.²⁶
- Understanding the material aspects of the entire servicing function is important to understanding how servicing may impact expected performance of the pool.²⁷

Interpretive Guidance

Servicers interviewed discussed the concept of materiality when determining which CMBS servicing business processes should be required to be disclosed under Regulation AB. To determine if a servicing activity is material to the CMBS investor, questions such as these can be asked:

- Will disclosing the information about a Servicer's business processes impact a reasonable investor's decision to buy or sell a bond?
- Is the servicing activity significant enough to impact the performance of the securities?²⁸

Most servicing organizations interviewed expressed concern about the depth of information that may be required to be disclosed. As an example, Servicers have volumes of operating procedures, which are modified from time to time. CMBS Servicers' policies and procedures potentially contain information that is immaterial; too voluminous; and sensitive, competitive proprietary information about the Servicer's business practices. Offering large volumes of information discussing how CMBS Servicers perform specific servicing processes would provide minimal additional value

²³ Preamble §III(B)(1), Federal Register, page 1531.

²⁴ *Id.*

²⁵ Preamble §III(B)(4), Federal Register, page 1539.

²⁶ Preamble §III(B)(3)(d), Federal Register, page 1536-1537.

²⁷ Preamble §III(B)(3)(d), Federal Register, page 1536.

²⁸ *Id.*

(if any) and may overwhelm CMBS investors. And, currently in the CMBS industry, knowledge of these operating procedures has not been considered material to the reasonable investor. Therefore, CMBS Servicers' should not include their entire set of policies and procedures in the transaction documents. CMBS industry standards will dictate which information from the policies and procedures will be required to be disclosed.

To date, CMBS issuer requirements regarding CMBS Servicer disclosure have been fairly consistent. The Servicers interviewed expressed hope that the industry will choose to adopt a consistent format for Regulation AB Servicer Disclosure that's material to CMBS investors. This will be beneficial to investors and Servicers alike.

Servicing business processes that should not be required to be disclosed

CMBS Servicers interviewed noted the ideas presented below govern what they perceive should not be required to be disclosed:

- Non-material items
- Inapplicable items
- Proprietary business processes

Non-material items

Interviewed CMBS Master and Primary Servicers consistently stated that disclosing the specifics of how they perform certain servicing activities should not be required to be disclosed, as it's not material.

Inapplicable items

Interviewees commented that the following disclosure items are inapplicable to the CMBS industry:

- Any reference to manual checks
- Any reference to external credit enhancement

Some disclosure items may be applicable to one Servicer role, but not another. For example, under Regulation AB, it probably wouldn't be material for a CMBS Trustee to disclose information regarding its CMBS portfolio size and composition to show strength in servicing the asset type(s), since CMBS Trustees typically do not perform asset management duties. Disclosing this information would however be potentially material from the CMBS Master Servicer(s), CMBS Primary Servicers, and CMBS Special Servicers.

Some disclosure items may not be applicable based on the CMBS process, the asset type and the requirements of the reasonable investor. Therefore, each SEC Servicer

should examine its own processes and information to make a determination if a specific disclosure item is inapplicable.

Proprietary business processes

CMBS Servicers interviewed stated that some aspects of their servicing procedures (see discussion above) and pricing methods are proprietary. If the information were shared with the industry, then the competitive business process would be stifled and ultimately the market would suffer.

CMBS Special Servicers who were interviewed maintain a set of procedures for managing and liquidating defaulted CMBS loans. Included are individual workout strategies, which must remain proprietary for the benefit of the CMBS investors. If this information were required by Regulation AB to be disclosed, and was subsequently discovered by a delinquent CMBS borrower, knowledge of the Special Servicer's procedures and workout strategies could undermine the Special Servicer's ability to cure, resolve or liquidate the problem asset.

- Since this would represent a material event that would negatively affect CMBS bondholders, it is imperative that a Special Servicer's internal policies and procedures and workout strategies not be required to be disclosed.

As a note, while proprietary business processes and strategies should not be disclosed, it is suggested that the Special Servicer provide a general overview of their procedures as material and as appropriate.

Format of Disclosure

In the Preamble, the SEC noted their concern that current disclosure has resulted in the inclusion of undue boilerplate language and a disproportionate emphasis on legal recitations of transaction terms in ABS filings; particularly Prospectuses and registration statements.²⁹ Disclosure may have been included from other filings or retained from prior filings without a consideration for its applicability or continued applicability with respect to the transaction in question. This results in a diminished usefulness for investors of the disclosure documents through the accumulation of unnecessary detail, duplicative or uninformative disclosure and legalistic recitation of transaction terms that obscures material information.

The SEC continues to seek a reevaluation by transaction participants of the manner and content of presented disclosure. They suggest that transaction participants should view the new disclosure regulation as an opportunity to evaluate whether there is information that has been included in registration statements and Prospectuses that is not required, not material and not useful to investors and therefore should be reduced or omitted.

²⁹ Preamble §III(B)(1), Federal Register, page 1532.

The SEC believes that even the most complex structure can be described clearly and accurately without resorting to overly legalistic presentations. They suggest participants focus on the use of tabular presentations, flowcharts and other design elements that aid understanding and analysis.³⁰

Interpretive Guidance

Industry consensus is needed in adopting suitable parameters for a CMBS definition of materiality and the SEC Servicer disclosure language requirements. It is suggested that the parameters take into account the current industry parameters for disclosure information and current language offered in the Prospectus.

³⁰ *Id.*

Additional Working Group Commentary

Requests for Additional Servicer Disclosure

The interviewees said that it's uncommon for CMBS investors or rating agencies to request that Servicers disclose additional information about their servicing activities.

Material information that CMBS investors need regarding Servicer activities is currently being disclosed in the Prospectus and PSA transaction documents.

Exceptions – additional investor requests for information

Interviewees from the Working Group mentioned a few exceptions where investors had additional questions about a CMBS Servicer's business practices. Most additional questions were generally transaction-specific to deals with exposure to uncommon property types.

Examples include experience servicing loans backed by health care properties, golf courses and credit tenant leases. It's unusual for these collateral types to be included in today's CMBS pools. If they are included, they rarely comprise a significant percentage of the deal.

Future Changes Impacting Disclosure

In general, most Servicers interviewed felt that future disclosure criteria would be dictated by both the SEC and issuers (often driven by investor requests). This is one way in which the CMBS industry continues to evolve. Currently, additional disclosure requests are first discussed broadly among all the transaction participants; then reviewed by each individual entity for relevancy; and finally, if appropriate, incorporated into the transaction documents.

Some Servicers interviewed mentioned outsourcing and insurance coverage as other topics impacting future disclosure.

Outsourcing

Some participants felt that the one of the biggest issues in the future that might require disclosure from each individual additional party could be the increase in outsourcing and offshoring of servicing and third party vendor activities.

Insurance Coverage / Carve outs

A few of the interviewees commented about insurance coverage for CMBS collateral. Insurance concerns are an example of the adjustments Servicers have accommodated in their disclosure information, as demanded by the investors.

They noted that enhanced insurance disclosure could be deemed material in certain cases. Recent natural disasters (Hurricanes Katrina, Rita and Wilma), the potential expiration of TRIA, and mold insurance have brought insurance issues to the forefront of the CMBS industry in terms of which risks are covered and based on timing, may require additional disclosure that is not typically required.

Most interviewed Servicers were confident that the CMBS industry would be able to manage future disclosure requests and requirements. To date, the CMBS market has done a very good job of self-regulating, providing informal, unregulated disclosure of items deemed material by investors. Issuers and Servicers have largely met the demands of CMBS investors.

Exhibit (A)

SEC Regulation AB Compliance Dates

For shelf registration statements filed after August 31, 2005, the registrant must amend those registration statements in advance of any ABS offerings commencing after December 31, 2005. For shelf registration statements filed on or before August 31, 2005, the registrant must amend those registration statements in advance of any ABS offerings commencing after March 31, 2006. However, for offerings that require any new undertakings (i.e., undertakings required for static pool information provided on an issuer's website), the registrant must amend Part II of the registration statement in advance of any ABS offerings, including such offerings that occur before April 1, 2006. The registrant must comply with all the new ABS rules in the Prospectus supplement for offerings after December 31, 2005.

Exhibit (B)

Legal Proceedings

§229.1117, Federal Register Page 1611

In lieu of Item 103 of Regulation S–K, we are adopting, substantially as proposed, a more tailored disclosure item for material legal proceedings with respect to asset-backed securities. Under the final disclosure item, a brief description will be required regarding any legal proceedings pending against the sponsor, depositor, Trustee, issuing entity, Servicer meeting the thresholds of Item 1108(a)(3) of Regulation AB or 20% or more originator, or of which any property of the foregoing is the subject, that is material to security holders. Consistent with longstanding requirements under existing Item 103 of Regulation S–K, similar information will be required as to any such proceedings known to be contemplated by governmental authorities, *i.e.*, Master Servicer, each affiliated Servicer, each unaffiliated Servicer that services 20% or more of the pool assets and any other Servicer that performs a material aspect of the servicing of the pool assets.

Exhibit (C)

Affiliations and Certain Relationships and Related Transactions

§229.1119, Federal Register pages 1611-1612

As we (SEC) explained in the Proposing Release, there often can be several affiliations between parties in an ABS transaction. For example, the Servicer is often an affiliate of the sponsor. We are adopting as proposed a requirement to describe whether, and if so, how, the sponsor, depositor or issuing entity is an affiliate of any of the following parties: Servicer meeting the thresholds of Item 1108(a)(3) of Regulation AB, Trustee, originator of at least 10% of the pool assets, significant obligor, significant provider of enhancement or other support or other material party identified with respect to the transaction. Disclosure also will be required, to the extent known and material, of any affiliate relationships among any of the parties listed above.

We also are adopting disclosure requirements regarding material related party transactions between the sponsor, depositor or issuing entity and the above-referenced entities.

As under the proposal, two aspects of disclosure in this area are required. First, disclosure is required regarding whether there is, and if so, the general character of, any business relationship, agreement, arrangement, transaction or understanding entered into outside the ordinary course of business or on terms other than would be obtained in an arm's length transaction with an unrelated third party, apart from the asset-backed securities transaction, between the sponsor, depositor or issuing entity and any of the above referenced parties that either currently exists or that existed during the past two years that is material to an investor's understanding of the asset-backed securities. An instruction to the item clarifies that what is required is information material to an investor's understanding of the asset-backed securities, not a detailed description or itemized listing of all commercial relationships among the parties. Instead, the disclosure should indicate whether any relationships outside of the asset-backed securities transaction exists that meet the specified standard, including materiality to an understanding of the asset-backed securities, and the general character of those relationships. We have revised the disclosure item to clarify further the second aspect of the related party disclosure that we proposed and that will be required under the Item, which is disclosure regarding specific material relationships involving or related to the current ABS transaction and the pool assets. Unlike non-ABS or pool asset specific relationships the general character of which only need be described if outside the ordinary course of business or not on arm's length terms, there is no such limiter for relationships specific to the transaction, other than materiality. An ABS or pool asset specific transaction with a related party may still be material even if made in the ordinary course of business or on arm's length terms. For any ABS or pool asset specific transaction, the material terms and approximate dollar amount involved will need to be described, to the extent material.

Exhibit (D)

SEC ABS Regulation - CMBS Definition of Servicer Potential Servicing Activities List

SEC Definition of Servicer - "any person responsible for the management or collection of the pool assets or making allocations or distributions to holders of the asset-backed securities ... our definition of "Servicer" is designed to capture the entire spectrum of activity to include both collection and asset maintenance activities as well as cash flow allocation and distribution functions for the ABS." (Federal Register, page 1535)

Nos	Work Performed by a Third Party either affiliated or unaffiliated	Description of the Work	Servicer doing Servicing Activity as Defined by the SEC & Industry	Not a Servicer - instead another party or vendor - as defined by the SEC & Industry
1	Appraisals	Property evaluation and generate a report. Third party does not approve and/or make final decisions on the pool assets.		X
2	Assumptions - Borrower Request Underwriting	Underwriting package is created and given to the Servicer. Third party does not approve and/or make final decisions on the pool assets.		X
3	Bond Calculating Agent	Review of governing documents and tie out to initial cash flow and yield projections. Develop the reporting package and cash flow model. Review, monitor and reconcile the funds received from the Servicer, including validation of accuracy and completeness. Then monthly run the cash flow model and generate the waterfall and bond payments. Send the investors their payments, along with the reporting package.	X	
4	Borrower Billing Statement Printing	Administrative function - printing and mailing statements generated from data sent by Servicer.		X
5	Broker	Third party preparation of marketing on the property - typically a listing agent.		X
6	Defeasance	Borrower completes all the defeasance requirements and gives a package of information to the Servicer. Third party does not approve and/or make final decisions on the pool assets.		X
7	Document Custody	Administrative review of the mortgage file and issue certifications, process mortgage file releases to the Servicer, and maintains loan document files throughout the life of the trust.		X
8	Document Imaging	Document preparation, indexing and scanning into Servicer's system.		X
9	Easements - Borrower request underwriting	Underwriting package is created and given to the Servicer. Third party does not review and approve decisions on the pool assets.		X
10	Engineering and Surveys	Generating a report. Third party does not review and approve decisions on the pool assets.		X

Nos	Work Performed by a Third Party either affiliated or unaffiliated	Description of the Work	Servicer doing Servicing Activity as Defined by the SEC & Industry	Not a Servicer - instead another party or vendor - as defined by the SEC & Industry
11	Environmental Property Review	Generating a report. Third party does not review and approve decisions on the pool assets.		X
12	Financial Statement Analysis	Conducting analysis - the final adjustment, the approval and a final review.	X	
13	Financial Statement Spreading	Data collection and input done then given to the Servicer. Third party does not conduct analysis or make final decisions on the pool assets.		X
14	Flood	Generating a report. Third party does not review and make decisions on the pool assets.		X
15	Insurance reviews	Data collection, market research, assessment and report to the Servicer. Third party does not approve and/or make final decisions on the pool assets.		X
16	Lease Review and Approvals - Borrower Request Underwriting	Underwriting package is created and given to the Servicer. Third party does not review and approve decisions on the pool assets.		X
17	Letters of Credit	Monitor - administrative tracking expirations, credit of the issuing bank and the amount. Third party does not make decisions or execute the letter of credit requirements.		X
18	Lockboxes	Receipt and report of borrower collections. The third party does not calculate the payment or allocation.		X
19	New Loan Boarding and Setup	Administrative input of the loan information into the Servicer's system.		X
20	Payoffs	Calculation and draft quotes. Third party does not make approvals and/or execute the payoff process.		X
21	Property Inspections	Property review and generate a report. Third party does not approve and/or make final decisions on the pool assets.		X
22	Reconveyance Filing / Satisfactions	Worked performed by third-party to record and release satisfied mortgages.		X
23	Remittance	Cash processing - calculate and remit sums to Trustee/Investor	X	
24	Reporting	Compiling the pool asset information for the Investor Reporting Package (IRP) on a monthly basis	X	
25	Reserve Administration	Data collection and input done then given to the Servicer. Third party does not conduct analysis or make final decisions on the pool assets.		X
26	Special Servicer's Role	Responsible for non-performing loan workouts, foreclosures and liquidations.	X	
27	Special Servicing - Forensic Accounting	Research and fact gathering to report to the Servicer. Third party does not approve and/or make final decisions on the pool assets.		X
28	Special Servicing - Property Management	Day to day operations of a pool asset, with no major approval.		X

Nos	Work Performed by a Third Party either affiliated or unaffiliated	Description of the Work	Servicer doing Servicing Activity as Defined by the SEC & Industry	Not a Servicer - instead another party or vendor - as defined by the SEC & Industry
29	Sub-Servicing: Cashiering	Includes collection, payment application, remittance and reporting on cash.	X	
30	Sub-Servicing: Non-Cashiering	Generally limited to inspections, financial statement gathering and borrower request assistance.		X
31	Tax Service	Data collection, market research and report to the Servicer. Third party does not approve and/or make final decisions on the pool assets.		X
32	Treasury Functions	Remitting funds at the direction of the Servicer. There are no calculations done		X
33	Trustee - Annual SEC Filings	Prepare and send the annual SEC required filings		X
34	Trust Tax Administration	Administrative tax processing, validation and reporting REMIC to IRS		X
35	UCC Continuation Filing	Data collection, market research and report to the Servicer. Third party does not approve and/or make final decisions on the pool assets.		X

Exhibit (E)

Servicer Disclosure Items Survey Results

The interviewees responded to a survey regarding Regulation AB Servicer disclosure items. They were asked to indicate the format that they intended to use for each item (narrative, tabular, etc), other parties to which they currently provide this information, and the level of effort involved with disclosing each item.

Interviewees noted that they currently disclose these items to rating agencies, issuers, investors, internal and external auditors and other Servicers.

Servicer Disclosure Items	Format	Level of Effort Required				
		Low	Medium	High	No Answer	N/A
Identifying Information and Experience						
Length of time servicing assets	narrative	71.43%	14.29%	0.00%	14.29%	0.00%
General discussion experience in servicing assets of any type	narrative	71.43%	28.57%	0.00%	0.00%	0.00%
Detailed discussion of experience in and procedures for servicing assets of the type included in the transaction	narrative	57.14%	14.29%	28.57%	0.00%	0.00%
Any material change to policies and procedures in servicing assets of the same type during the past three years	narrative	57.14%	0.00%	42.86%	0.00%	0.00%
Size, composition and growth of the portfolio of serviced assets of the type to be securitized	tabular	42.86%	42.86%	0.00%	0.00%	14.29%
Prior securitizations of the same asset type that have defaulted or experienced an early amortization or other performance triggering event because of servicing.	narrative	42.86%	0.00%	14.29%	0.00%	42.86%
Extent of outsourcing of servicing activities utilized	narrative	57.14%	14.29%	14.29%	0.00%	14.29%
Previous disclosure of material noncompliance with servicing criteria with respect to other securitizations	narrative	71.43%	14.29%	0.00%	14.29%	0.00%
Financial condition of servicing organization to the extent it could have a material impact on pool performance. Not general financial information.	narrative	42.86%	28.57%	14.29%	0.00%	14.29%
Servicing Agreements and Servicing Practices						
Terms of the servicing agreement	Narrative	42.86%	28.57%	14.29%	0.00%	14.29%
Servicing duties	narrative	42.86%	42.86%	0.00%	0.00%	14.29%
File servicing agreement as an exhibit	narrative	57.14%	14.29%	0.00%	0.00%	28.57%
Description of servicing practices	narrative	42.86%	28.57%	14.29%	0.00%	14.29%
Manner in which collections on assets will be maintained	narrative	42.86%	28.57%	14.29%	0.00%	14.29%

Servicer Disclosure Items	Format	Level of Effort Required				
		Low	Medium	High	No Answer	N/A
Servicing Agreements and Servicing Practices – con’t						
Extent of commingling of funds	narrative	57.14%	14.29%	0.00%	0.00%	28.57%
Terms regarding advancing of funds including interest or other fees charged and terms of recovery	narrative	42.86%	28.57%	14.29%	0.00%	14.29%
Process for handling delinquencies and losses	narrative	14.29%	42.86%	14.29%	0.00%	28.57%
Ability to waive or modify any terms, fees, penalties or payments	narrative	42.86%	14.29%	14.29%	0.00%	28.57%
Custodial Requirements	narrative	28.57%	42.86%	0.00%	14.29%	14.29%
Back-up Servicing						
Terms regarding Servicer removal, replacement, resignation or transfer	narrative	42.86%	28.57%	0.00%	0.00%	28.57%
Arrangements and qualifications required for a successor Servicer	narrative	42.86%	28.57%	0.00%	0.00%	28.57%
Process for transferring servicing	narrative	42.86%	28.57%	0.00%	0.00%	28.57%
Provisions for payment of expenses associated with servicing transfer or additional fees charged by successor Servicer.	narrative	42.86%	28.57%	0.00%	0.00%	28.57%