

Structured Finance

Reverse Mortgage Criteria

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Subscription Information

Hong Kong, (852) 2533-3535

London, (44) 171-826-3510

Melbourne, (61) 3-9631-2000

New York (1) 212-438-7280

Tokyo, (81) 3-3593-8700

Web Site

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The Rating Process for Reverse Mortgage Transactions

The rating process begins when a banker or issuer contacts Standard & Poor's to discuss a proposal. For new issuers, initial conversations take place six to eight weeks prior to the scheduled pricing of a transaction. Issuers with existing reverse mortgage securitizations typically begin discussions three to four weeks before a planned issuance. This beginning phase usually takes place through a conference call or brief meeting, where an overview of the transaction is presented. The purpose of this first stage is to identify any unusual or complicated operations, as well as structural, credit, or legal issues that may need to be ironed out before a formal rating process can begin. If no such complication exists, the rating process proceeds according to an agreed-upon time schedule. Issuers customarily sign a rating contract at this time.

Review of the Originator's and Servicer's Operations

When the issuer decides to proceed, a complete analysis of the transaction begins. Rating analysts meet on-site with management of the originator or seller of the receivables. This exercise enables analysts to expand their understanding of the issuer's strategic and operational objectives. It also provides a more defined level of familiarity with underwriting policies, contractual breach procedures, and operational controls.

Generally, the review includes:

- A financial and corporate overview of the originator and servicer as presented by senior management;
- A discussion of the originator's and servicer's history in the reverse mortgage business and strategic plan; and

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- A meeting with senior management and key personnel from pertinent areas, such as underwriting, loan disposition, computer systems utilized by the company, internal audit, finance, and sales and marketing.

In addition, a detailed discussion of the characteristics of the obligor base, the repayment pattern of the obligors, and the performance history of the assets, as well as an examination of prior transactions, is typically undertaken. These discussions are often complemented by walk-through tours of the originator and servicer.

Analysts perform a review of all new issuers. For frequent issuers, analysts usually perform these reviews annually, or more frequently if circumstances have changed, for example, due to significant procedural or technological enhancements.

It is important to note that the review does not include an audit. Instead, the rating is based on the representations of the various parties to the transaction, including the issuer and its counsel, the investment banker and its counsel, and the issuer's accountants. More details on the underwriting and servicer review criteria can be found in the "Issuer and Servicer Reviews" section.

Collateral, Legal, and Structural Analysis

The analysis focuses primarily on the legal, collateral, and structural characteristics of the transaction. The legal criteria for structured finance ratings were developed in the early 1980s for mortgage-backed securities (MBS). The fundamental tenet of this criteria is to isolate the assets from the credit risk of the seller.

The collateral analysis involves an in-depth review of historical asset performance. Analysts collect and examine years of data on the performance variables that affect transaction credit risk.

The structural review involves an examination of the disclosure and contractually binding documents for the transaction. The criteria cover many aspects of the structure, from the method of conveyance of receivables to the trust, to the method of security payment and termination. The analysis also considers the payment allocation and what is being promised to securityholders.

The prospectus for publicly rated transactions is prepared by the issuer's counsel before a transaction is priced. However, the underlying documentation determines whether the structure will afford interest as promised and ultimate principal payments. The most important of these documents is the pooling and servicing agreement. All new issuers generally submit the first draft of the pooling and servicing agreement. This draft should be substantially complete, as significant subsequent changes to the agreement may cause a delay in the rating of the transaction.

Rating Committees

A team of analysts is assigned to each transaction. After the team performs its review of the issuer's operations and analyzes the collateral, a committee of appropriately trained and experienced analysts is assembled to determine whether the transaction has sufficient enhancement for the desired rating. Analysts ordinarily present the credit and structural aspects of a transaction to a rating committee before a transaction is priced.

The transaction team is responsible for ensuring that all pertinent information is presented to the rating committee. The committee presentation includes information gathered from the review of the originator and servicer, collateral, cash flows, enhancement recommendations, and information on the legal and structural characteristics of the transaction, which will be compiled into a confidential presentation. Once the rating committee meets and makes its decision, the results will be conveyed to the banker. A rating letter is issued at closing. For public ratings, a credit analysis is normally disseminated.

Rating Surveillance

After a rating is assigned, it is monitored and maintained by the surveillance process. The purpose of surveillance is to ensure that the rating continues to reflect the performance and structure of the transaction as it was analyzed at transaction closing. Performance information is disclosed in a report prepared monthly by the servicer of the transaction. Before a transaction's closing date, analysts review the data itemized in the servicing report to ensure that all necessary information is included.

The surveillance process encompasses monitoring issue performance and identifying those issues that should be considered for either an upgrade or a downgrade. The surveillance function also encompasses tracking the credit quality of all entities that may be supporting parties to the transaction, such as liquidity enhancers. Analysts review performance data periodically during the course of the transaction and contact the issuer and trustee if ratings change. For changes to public ratings, a press release is normally disseminated.

Standard & Poor's must be informed of any changes concerning the original structure of the transaction, including management, credit policy, system changes, or any change in the status of the original parties involved in the transaction. All information will be used as part of normal surveillance maintenance for the transaction.

Collateral Descriptions for Reverse Mortgage Transactions

A reverse mortgage is a nonrecourse first lien mortgage loan, typically given to a borrower who is age 62 or older, that requires no repayment until the sale of the property. Each reverse mortgage is secured by a specific property and contains standard contractual mortgage terms, conditions, and default remedies. Types of reverse mortgages (RMs) made by lenders include:

- A series of periodic, typically monthly, loans that are made to borrowers;
- A lump sum payment that is made to the borrower on an interest accruing basis;
- A line of credit that is extended, subject to an agreed upon upper limit on the cumulated reverse mortgage to house value ratio; and
- Various combinations of the three types mentioned prior. By way of illustration, XYZ Mortgage Co. agrees to lend \$60,000, at an interest rate of 9.5% per annum, which is 50% of the property value at the time the loan is closed.

One of the positive attributes of a reverse mortgage, as compared to a conventional home mortgage, is that the homeowner is not required to repay any of the accumulated interest or principal until the loan is due. A reverse mortgage can be repaid at any time but requires no repayments until the sale of the property. A sale occurs at the earlier of the death of the homeowner, a move, or lastly, demand for repayment following a contractual breach. In the meantime, the borrower continues to occupy and own the property assuming all responsibilities and benefits of ownership of the principal residence. Contractual breach occurs if the mortgagor fails to fulfill his or her obligation of paying property taxes, maintaining insurance, occupying the property, and keeping the home in good repair.

Funds from a reverse mortgage are used to provide the borrower with cash or a life annuity. Use of reverse mortgage funds is varied. The major use of these funds for low income retirees is as an income supplement. Borrowers in the middle income bracket typically use these funds for a major purchase or significant vacation. A small amount of borrowers use these funds for estate planning through tax planning and gift giving.

Issuer and Servicer Reviews

Mortgage Servicing and Underwriting

At issuance of the securities, representations and warranties are made concerning the payment status of each asset and compliance with the characteristics for eligible collateral as prescribed by a particular issue. Generally, the servicer or originator is obligated within 90 days to repurchase assets showing defects in documentation. Alternatively, other eligible collateral may be substituted for defective assets. Defects appearing thereafter also may cause assets to be repurchased or substituted. The master servicer or, if no master servicer is designated, the servicer, takes ultimate responsibility for overall servicing performance.

Servicing functions include disbursing mortgagor payments, monitoring tax and insurance payments, maintaining escrow accounts, investor reporting duties, and foreclosing and selling properties subsequent to a contractual breach of the borrower. Accurate servicing and accounting records should be maintained and certificates of audits forwarded to the trustee.

Unless the servicer has an unsecured short-term debt rating of ‘A-1’ or higher, collections on pledged assets will be remitted immediately to the trustee or maintained in fully insured custodial accounts. Additional liquidity support may be obviated if the servicer is rated in the highest short term rating category.

No servicer may resign from servicing pledged assets unless these activities are no longer legally permissible or unless an alternative servicer has been appointed. In the event servicing is transferred, compensation to the successor is limited to the original amount as specified in the legal documents governing the transaction.

Servicer and Originator Eligibility

Quality of underwriting and servicing of the mortgages underlying pass-through certificates is integral to credit quality and performance. Therefore, analysts will review all elements of a company’s business related to the origination and servicing of reverse mortgages before determining whether that entity is eligible to participate in transactions. The review takes place regardless of whether or not the originator or service, as a company, has a financial rating.

When determining the eligibility of an originator and servicer, several key areas are analyzed. The following is listed according to procedural review rather than importance. First, the management team and organizational structure is reviewed to determine the direction of future growth. Second, loan production functions including production sources are reviewed. Third, to assess an originator's loan portfolio quality, its underwriting and appraisal policies are evaluated. Guidelines that deviate significantly from the rating standards may result in higher credit enhancement levels for an issue since lax underwriting may increase risk of loss. For reverse mortgages this refers to the appraisal policies and practices of an originator. In extreme cases, Standard & Poor's will decline to rate an issue if mortgage originators' practices are imprudent.

Fourth, the company's secondary marketing functions are reviewed for risk tolerance. Fifth, a servicer's capabilities and portfolio are reviewed. Originators and servicers are typically approved seller/servicers for either Fannie Mae (FNMA), or the U.S. Department of Housing and Urban Development (HUD).

Characteristics of a company's servicing portfolio are good indicators of servicing quality. The total portfolio is analyzed for loan type, property type, average loan size, borrowers ages and genders, and geographic distribution. In addition, the servicer's foreclosure and real estate owned (REO) procedures and performance are carefully reviewed.

Data processing capabilities are important in assessing the servicer's abilities. The system's ability to service various loan types and its capacity to meet current and future servicing volume also are reviewed.

Originator and Servicer Review

As previously mentioned, a review of the company is conducted and is summarized into five functional areas: management and organization, loan production, underwriting and quality control, secondary marketing, and loan administration. The emphasis of the review is placed on the underwriting and loan administration areas since these areas have the greatest impact on the ultimate performance of the loans. An increase or reduction to credit enhancement levels may be assessed pursuant to this evaluation. The specific increase or reduction percentage is determinant upon evaluation of the level of risk the company adds or diminishes to the transaction.

Prior to the on-site review, a questionnaire is sent to the company for completion. This questionnaire includes operational policies, procedures, and performance results (*see appendix B*). The review begins by meeting with management to become familiar with the company's organizational structure, the experience of key managers, and the company's overall plan for growth, new products, new markets, and employee

training. Management should have a well defined business strategy, which has been successfully executed. The company is evaluated, in part, on its orientation to operating and financial risk and its reaction to market variables. Procedures for all areas should be well documented, with all the necessary controls, licensing, and insurance coverages in place.

Loan Origination

In analyzing an originator's production capabilities, the volume of loans originated and acquired for the past five years is reviewed. In addition to examining total volume, it is necessary to evaluate production categorized by property type, age, gender, marital status, loan amount, geographic distribution, and loan to value ratio. This information helps determine the company's level of experience with various loan products. Production also should be reported by loan type, (fixed- versus adjustable-rate mortgages) as well as by product type (line of credit, lump sum payment, monthly payments, or a combination of these types). This information gives further insight into the company's experience with various loan types. It also may illustrate the extent to which it has operated prudently in the past.

The sources of production are also reviewed including loans originated versus loans purchased, the percent from wholesale correspondents, and brokers, as well as the geographical distribution of the production. Reviewing the source of production is necessary for several reasons. A geographic distribution indicates the company's familiarity with the laws of various states. Geographic dispersion aids in diversification of the company's production risk and servicing portfolio exposure.

Similarly, if a large portion of its production has been acquired, the company's approval process for each correspondent and broker is carefully reviewed. The company must also track the performance of loans purchased from various correspondents and brokers. All third party originators should be included in a quality control review at least annually. Also, an annual re-certification should be performed where the originators financial position, insurance coverages, and performance is reviewed. If loans from a particular correspondent or broker default frequently, then the company should do a closer screening of its loans, possibly modify its commitment with the correspondent or stop buying loans from that correspondent entirely.

Underwriting and Quality Control

The company's underwriting guidelines and quality control procedures are carefully evaluated. Underwriting, quality control, and loan production should have segregated reporting lines. To ensure that underwriting guidelines are being adhered to, an independent audit team of the company should reunderwrite at least 10% of

production or a statistical sampling having a 95% confidence level. Also included in the quality control audit should be a reappraisal or field review performed on at least 10% of the file audit. The quality control audit reports and findings are carefully reviewed.

Standard & Poor's also monitors underwriting guideline changes. The specific underwriting guidelines used to originate the collateral should be disclosed in the prospectus. Underwriters' track records should be monitored the same way as correspondents' and brokers' loan quality. Exception approval policies are reviewed as well as the frequency and type of exceptions being made. These exceptions should be tracked by the company. Likewise, the suspension and declination rates per underwriter and originator should be closely monitored. Lending authority limits should be in place based on experience and capability of the underwriters.

When underwriting a reverse mortgage, the lender considers the age and gender of the borrower, the interest rate on the mortgage, and the home value. Lenders make reverse mortgages based on assumptions relating to these components. First, the lender estimates the borrowers repayment rate based on the expected remaining life span of the borrower and the lender's move rate experience. Then a home value appreciation rate is applied to the current value of the home to determine what the property will be worth upon repayment of the loan.

Based on given interest rates, the lender then determines how much money will be lent to the borrower. The higher the interest rate the lower the amount of funds a lender can lend to a borrower, since the interest will accrue faster and may exceed the home value prior to repayment. Therefore, the older the borrower, the higher the original loan to value ratio due to the expected earlier repayment. The point at which the principal outstanding together with accrued interest exceeds the home value is where the potential for a loss or point of diminished return occurs. This point is known as the cross-over point (*see "Credit Analysis"*). Lenders make loans based on loan characteristics so that repayment occurs prior to the cross-over point.

The borrowers age must be substantiated by acceptable documentation and occupy the property as his or her principal residence. Acceptable forms of documentation include: birth certificate, driver's license, passport, and certificate of naturalization. All lenders must maintain the name of a third party contact whom the lender can contact if the borrower cannot be reached. Through the annual occupancy certification, the borrowers will be asked to confirm that this individual is still the appropriate contact.

The appraisal process is of particular importance when originating a reverse mortgage. Therefore, the appraiser approval process and monitoring will be reviewed thoroughly. The criteria for property valuations for all first lien reverse mortgage loans requires a 1004 Uniform Residential Appraisal Report or a form 2055 with an interior and exterior inspection.

Alternative forms of collateral valuations are presently being utilized in the residential mortgage market. Usually the alternative forms of collateral valuation are less comprehensive and may or may not require an on-site inspection depending on other characteristics of the loan application. Loan to value restrictions are generally used as offsetting factors for the increased risk of using an alternative valuation method of the subject property. Automated collateral systems and alternative collateral methods must be evaluated prior to inclusion of those loans in transactions to be rated.

All borrowers must hold title to the entire property that secures the mortgage loan. Any outstanding liens against the property must have been paid in full at the loan closing, and the title evidence must show the reverse mortgage is in first lien position. Title insurance is required for each reverse mortgage. In addition, the title policy must make no exceptions for negative amortization resulting from the capitalization of interest, compounded interest, the capitalization of the payments to the borrower, lien priority for loan advances, or the lack of a stated mortgage term.

The property must be covered by hazard insurance, including flood where applicable. The amount of coverage required must equal 100% of the replacement value of the home. The policy should either include provisions for inflation adjustments or provide for claims to be settled on a replacement cost basis. In addition, all policies, must have a mortgagee clause so that the servicer is notified of any nonpayment of the insurance premium.

Secondary Marketing

Imprudent marketing policies can quickly deteriorate a company's financial strength. The five main areas within secondary marketing: pricing, pipeline management, trading and hedging, securitization, and document delivery are reviewed. The review covers the procedures for setting prices, how pricing is derived, and once decided upon, how prices are disseminated to branches and third party originators. Within pipeline management, the tracking of rate lock offerings are reviewed and the lender's capabilities of tracking rate locks commitments outstanding. The process for tracking loans in the pipeline, the average closure rate, and sample position and inventory reports are reviewed.

Trading and hedging functions are emphasized in the review due to the potential exposure these practices and policies may place on the company. Trading authorities, how trading activity is monitored and accounted for, the types of hedging vehicles utilized, and the overall hedging strategy are encompassed in the review. The company's experience issuing securities in the secondary market, its funding facilities, the type of investor commitments utilized, and its mark to market forward valuation practices are carefully analyzed. Good tracking procedures for documents outstanding from

county recorders, title companies, and production offices, as well as documents sent to the custodian or investor, are essential controls within the document delivery area.

Loan Administration

A company's servicing capabilities and its servicing portfolio are also evaluated. The portfolio is analyzed in part by loan type, property type, average loan size, move rate, average servicing fee, geographic concentrations, weighted average maturity, and the weighted average coupon. The company's last five years' foreclosure and loss numbers on a static pool basis are analyzed. Specifically for reverse mortgages, this information should be presented on a static pool basis to include repayment rates by move out and mortality. Move rates should be presented by males, females, and couples, and by age. Mortality should be displayed by gender and age.

The company's payment disbursing, loan accounting, and investor reporting procedures are reviewed. Payment procedures are examined to ensure that the necessary steps are being taken to disburse mortgagor payments accurately and promptly. In reviewing procedures, analysts will be especially concerned about the servicer's ability to perform its duties according to the pooling and servicing agreement governing the pass-through certificates. Foreclosure procedures are reviewed to ensure they comply with standard pass-through servicing procedures. The servicer must track force-placed insurance policies and maintain sufficient errors and omissions and fidelity bond coverage.

Servicers are typically either approved servicers for FNMA or are HUD approved mortgagees. If a servicer is an approved lender, the most recent audit report from the agency and an accountant's opinion that the servicer is in compliance with the Uniform Single Audit Program for mortgage bankers will be requested.

The company's data processing capabilities, such as total capacity, current level of capacity, disaster recovery plans, contingency plans, system security and back-up facilities, are also examined. Other required information includes the number of loans serviced per employee, the cost to service, and the overall size and experience of the servicing staff.

Operational Benchmarks

When determining originator eligibility, general operational benchmarks are used to evaluate the company. It must be kept in mind that these are benchmarks, and individual circumstances must always be considered.

Management and Organization

The company must be operating for at least 3 years with the product being securitized and show adequate financial performance. Companies originating new product types, extensive experience with other products will be considered as a compensating factor. Compensating factors include management's experience in the industry that may have been acquired at another institution. Operating experience is determined from a combined experience approach between management experience and company history, and includes the following factors:

- Long and short term goals are reviewed relative to performance;
- Management team averages 15 years of industry experience and at least 3 years of product specific experience;
- Policy and procedure manuals exist for all operational areas;
- Systems capabilities are adequate for the institution's volume and expected near-term volume;
- Limited or informal training is provided to the institution's employees;
- No material lawsuits are outstanding against the institution;
- A disaster recovery plan is in place covering systems and site; and
- Fidelity Bond and Errors and Omissions coverage are in force and conform to industry standard.

Loan Originations

Among the factors considered in reviewing loan originations are the following:

- No one seller should provide over 10% of the institution's total volume;
- Internal controls must be present for approving and monitoring broker/correspondent sellers;
- Underwriting guidelines should be well documented;
- Underwriters should have experience with the product being originated;
- Lending authority limits are in place and are varied based on underwriter experience;
- A second look decline process should be in place for those loans denied by underwriting;
- A formal exception approval process must be present. Total exceptions of loan approvals should not exceed 10% of total production;
- An appraiser approval process should be in place and monitoring of the quality of appraisals should be conducted by either in-house appraisers or by outsourced quality control appraisers;
- Appraisal variance between the quality control findings and originations should not allow for a difference of greater than 10%;

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- Quality Control must be conducted monthly and contain a random sample of at least 10% or a statistical sample having a confidence level of at least 95%; and
 - Ten percent of the 10% Quality Control audit should have field reviews performed on them.

Loan Servicing

Factors reviewed in the loan servicing include:

- Procedures are in place to monitor and control disbursements to borrowers;
- Customer service representatives are trained and/or experienced in dealing with the elderly;
- Procedures are incorporated whereby the nonpayment of taxes and/or insurance result in a notification to the servicer;
- Upon repayment liens are released within state specific requirements;
- Procedural controls are in place for fund transfers;
- There is a separation between investor reporting personnel and those preparing the account reconciliation;
- State specific foreclosure procedures and timeframes are on the servicing system;
- Property inspections are ordered monthly for loans in foreclosure and REO; and
- Internal controls are present for REO listing agreements, signing sales contracts, and repair orders.

Servicer and Master Servicer Responsibilities

When the loan becomes due, the home is sold, the reverse mortgage is repaid from the proceeds of the sale and any excess value of the home belongs to the homeowner or the homeowner's estate. Normally the servicer would be notified of the death of the mortgagor as a consequence of estate settlement. Orderly estate settlement obliges the executor to discharge the servicer's obligation prior to settlement of the estate. The right of the servicer to receive principal and interest when due under the reverse mortgage is limited to the realized value of the property at such time.

Primary servicer responsibilities include:

- Disbursing monthly payments to mortgagors;
- Remitting funds from custodial account to certificate account held by the master servicer or trustee;
- Monitoring or disbursing property insurance and real estate tax payments;
- Reporting monthly all loan activities to master servicer or trustee as applicable;
- Sending an annual occupancy certification to the borrowers;
- Following up on contractual breaches;
- Initiating foreclosure proceedings when necessary and in a timely manner;
- Marketing and selling REO properties;

- Preparing timely release of liens; and
- Providing an annual statement to the borrowers.

The role of a master servicer can vary depending upon the deficiency of the underlying servicer. If the concern of the underlying servicer is one of financial strength, the master servicer's role would be one of back-up servicing. In such situations, it would be expected that the underlying servicer would fail in the near future and a mechanism would need to be in place whereby the transfer of servicing would be efficient. If upon a servicer evaluation, the underlying servicer is found to have operational deficiencies, the role of the master servicer is one of management. The goal of the master servicer in these situations would be to assure that proper servicing of the mortgage loans is taking place. Given the different goals arising from the different concerns, the required functions of the master servicer in each of these situations would be different.

In situations where the underlying servicer has operational deficiencies, the master servicer will supervise or take whatever actions are necessary to ensure that the servicing of the mortgage loans is in accordance with the requirements under the pooling and servicing agreement. On a monthly basis the master servicer is receiving and reviewing for accuracy an update of loan level data on the mortgage loan assets including balance information and remittance report information. Importantly, the master servicer must track the collection of funds flowing from the sub-servicer's custodial accounts to the certificate account from which the certificate holders are paid. To accomplish this, the master servicer must ensure orderly receipt of the subservicer's monthly remittance and servicing reports. The master servicer should have the authority to remove and replace any underlying servicer that is not performing optimally.

The master servicer should also be performing due diligence reviews on the underlying servicer. The reviews may vary in scope from focusing on delinquency performance to onsite due diligence encompassing all functional areas of a servicer. These are valuable tools, allowing the master servicer to ensure its servicers are in compliance with its servicer requirements and those of the pooling and servicing agreements. Equally important, it allows the master servicer to act proactively detecting any potential problems before they have a chance to escalate.

To accomplish these goals, the underlying servicer needs to provide the following to the master servicer on a monthly basis:

- Trial balance information on a loan-by-loan basis;
- Aggregate advancing amounts;
- Aggregate reporting and distribution amounts to investors;
- The servicer's remittance and servicing reports;
- Monthly status of delinquency, foreclosure, and REO amounts; and
- USAP and financial statements.

When there is a serious financial concern regarding an underlying servicer, in addition to the responsibilities as outlined above, the additional need of an efficient transfer of servicing must also be considered. The master servicer must be named as the subsequent servicer should the underlying servicer default in its obligations. To effectuate such a transfer the underlying servicer and the master servicer need to understand any conversion requirements prior to closing. Monthly delivery of loan level data ensures the master servicer's ability to acquire the responsibilities and obligations of the underlying servicer. Monthly custodial, servicing, and escrow account status information needs to be updated to the master servicer. On a loan level basis, data on the mortgage loan assets with regards to balance and remittance report information should be disclosed to the master servicer.

The master servicer is also expected to follow up on a monthly basis with the underlying servicer with regards to their defaulted loan servicing activities. This oversight function ensures timely collection efforts and foreclosure activities are consistently applied to the underlying collateral. To accomplish this, besides having the monthly status reports regarding delinquency, foreclosure, and REO amounts, such reports need to include the comments from the mortgagors and the collections/loss mitigation staff.

This ability to transfer servicing from one to the other should be able to take place upon 24-hour notification. The master servicer must be evaluated and found acceptable to Standard & Poor's. All servicer responsibilities pursuant to the pooling and servicing agreement are assumed by the master servicer at that point.

Servicing Fee

The servicer's fee should cover its servicing and collection expenses and be in line with industry norms for securities of similar quality. The monthly servicing fee must be at least \$15 per loan per month. This minimum is established so that a successor servicer may be obtained should a servicing transfer occur. Since the servicing fee is calculated based on a certain dollar amount per contract, the fee will increase as a percentage of assets due to amortization of the pool. This is an important consideration when assessing available excess spread to cover losses and fund any reserve account.

Accounting Reports

Independent accounting reports should be provided at least annually. The reports should state whether the servicer is in compliance with the transaction documents and whether its policies and procedures were sufficient to prevent errors. Exceptions, if any, should be listed.

Resignation of a Servicer

To ensure continuity, the transaction documents should provide that a servicer is not allowed to resign unless it is no longer able to service under law or finds a successor. No resignation should become effective until a successor or the trustee, as successor, has assumed the servicer's responsibilities. The trustee generally has the power to replace the servicer if the servicer is not performing its servicing functions adequately.

Pass-throughs are sometimes issued so that the master servicer is the only servicer. This is usually the case when the issuer and the servicer are one—for instance, if the issuer is a major bank and all the loans in the pool are originated and serviced by that bank. Regardless of whether the master servicer is a separate entity, the main concern is that the servicing activity at the loan and security level is conducted properly by a qualified institution. In either case, the master servicer is responsible for paying various pool expenses and making sure funds are disbursed to the trustee on a timely basis.

Credit Analysis of Reverse Mortgage Transactions

The maximum principal advance a lender is willing to make to a homeowner is based upon the age of the homeowner, the interest rate of the loan, and the appraised value of the home at origination. The relationship of these components is dynamic. While the bond is outstanding borrowers age, interest accrues, and home value fluctuates. The point at which the principal outstanding together with accrued interest for a loan exceeds the home value is where a loss or point of diminished returns occurs. Such point is known as the cross-over point (*see chart 1*).

Appreciation

Future home appreciation is the primary determinant of total cash received upon sale of the property. Home value appreciation affects loan profitability. As interest accrues, the probability of recovering both the outstanding balance and accrued interest charged on the loan will be largely affected by the value of the home. It is the value of the home that determines the maximum amount that can be collected at loan repayment.

Reverse mortgages are originated at unusually low loan to values to ensure that the house price, even with a modest appreciation, will remain above the accrued loan amount for a long period of time. In the case of a single mortgage, this is important because the lender would want to have the mortgage repaid before the cross-over point. For a pool of mortgages, this is also critical because the full amount of the accrued loan balance can only be applied to pay down the pool when the appreciated house price is greater than the accrued loan amount. When the appreciated house price falls below the accrued loan amount, the pool balance will be paid down only to the house price. In the late stages of a reverse mortgage securitization, if house price appreciation is less than the accrued loan amount, the security may not be paid off.

Repayment Rate

The repayment rate is a combination of mortality and the move-out rate. Recent developments and expectations as to future developments in health care for elderly persons, mobility of elderly households, regional differences in availability of health-care, and gender differences with respect to health risk and life expectancy are material in forming expectations as to the occurrence of repayment rates. Rapid progress in health sciences or increased availability of healthcare could prolong the lives of borrowers or postpone relocation of borrowers into long term care facilities. The availability of home nursing care could cause borrowers who would otherwise relocate to remain in their homes, delaying the occurrence of a repayment rate. If a borrower continues to occupy a mortgaged property longer than expected thus delaying repayment the amount owed on the related mortgaged loan at maturity may exceed the value of the mortgaged property.

By way of illustration, older homeowners will receive higher advances since there is a shorter expected term to repayment, thereby the interest due on the outstanding balance of the loan will have less time to accrue. In chart 2, if a borrower repays at scenario I, early in the life of the loan, home value exceeds total due on the loan. Therefore, the loan will be repaid in full. In scenario II, when repayment occurs later, total due on the loan exceeds the home value. Therefore, a loss will occur since loan proceeds will not be sufficient to cover the total due on the loan.

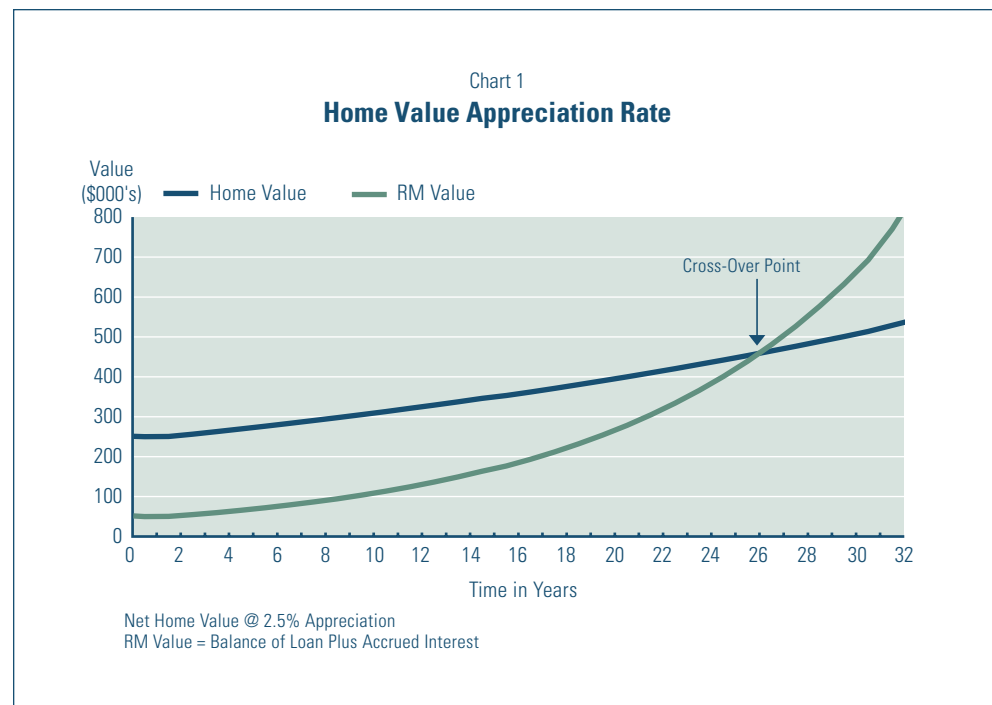


Chart 2
Repayment Rate

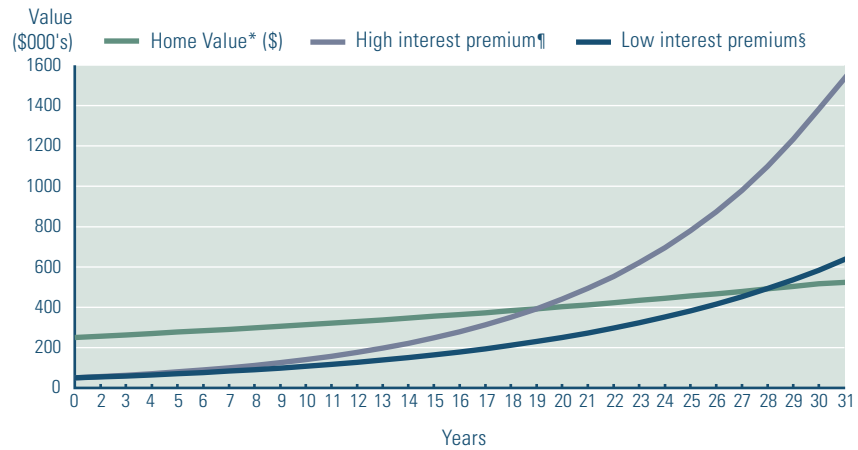


Net Home Value @ 2.5% Appreciation

M Value = Balance of Loan Plus Accrued Interest

The graph illustrates that if a home owner repays at point I, the full balance plus accrued

Chart 3
Credit Analysis and Performance Statistics



*Net home value at 2.5% appreciation. ¶Balance plus premium (high interest rate).

§Balance plus premium (low interest rate).

From a cash flow perspective, the repayment rate is the most important variable of the security. A slow repayment rate in the early years of the transaction could cause substantial buildup of negative amortization thereby putting at risk the eventual payoff of the security. While to a different degree move out and mortality are both actuarial events, they are stressed separately to determine the enhancement level of the security. A probability calculation is performed to determine the stress scenarios of move out and mortality.

Interest Rate

Reverse mortgage interest rates are usually higher than equivalent rates for traditional mortgages mainly due to lack of competition and borrower willingness. RM loans are typically variable rate loans. The higher the interest rate of the RM, the less money a lender can advance to a borrower since the interest will accrue faster and may exceed the value of the home prior to repayment. In a rising interest rate environment, the likelihood of not collecting all of the accrued interest on a given loan is greater since the balance may grow faster than the home's value. An increase in interest rates results in a significantly greater accrued interest component. In addition, the more frequent the compounding of interest, the earlier the cross over point occurs. Chart 3 illustrates how a RM interest rate effects the cross over point.

Structural Considerations for Reverse Mortgage Transactions

Rating Pass-Throughs

The mortgage pass-through certificate, a forerunner of other types of mortgage securities structures such as collateralized mortgage obligations, retains a dominant position in the marketplace. Conventional pass-through issuances backed by insurance, as well as senior/subordinated and stripped mortgage pass-throughs, hold benefits for certain private sector issuers and investors.

Mortgage pass-throughs are certificates representing interests in a pool of loans compiled by an issuer. Cash flow from monthly principal and interest payments on the mortgages, up to a pass-through rate, is “passed through” to certificateholders until all loans in the pool are fully paid off. The pass-through rate represents the interest on the underlying loans minus a servicing fee and any excess interest, which may result from the mortgage rate being above market rates. Because of prepayments and possible loan liquidations, payments to investors are likely to vary from month to month. To the investor, a pass-through performs like a single mortgage in terms of its payment characteristics; yet, it also provides the benefits of a diversified underlying asset base as well as the structural support of an active trustee and credit enhancement.

Since a pass-through issuance constitutes a sale of assets, it is neither debt nor a pledge of assets. For the issuer, loan sales require recognition of gains (or losses) on loans with above (or below) market rates. Thus the advantages of pass-through issuances vary depending on the originator’s market segment and the then-prevailing interest rate environment. For instance, during periods when rates surge, pass-through issuance experiences a relative lull because lenders mostly have loans with below-market rates in their portfolios.

Pass-throughs rely on cash flow from collateral to pay investors and represent ownership of underlying mortgages. As pass-throughs are the property of investors, the concept of an issuer default is inapplicable.

The following sections discuss in detail Standard & Poor’s approach to rating pass-through certificates. Consistent with rating any mortgage securities, potential loss exposure, corresponding loss protection, and the legal infrastructure of the issue is assessed. It is possible to quantify potential loss exposure in the underlying whole loan pool by applying its cash flow model based on empirical data.

Review of the credit enhancements chosen by the issuer is guided largely by a “weak link” approach. This means that no security can obtain a rating higher than the lowest rating on each of the transaction’s material components. The basis for this approach stems from the crucial role these components play in the security’s credit rating. A high degree of confidence that all elements of the structure will perform as legally promised must exist.

Letters of Credit and Corporate Guarantees

Credit supports can include corporate parental guarantees and letters of credit (LOCs) from entities rated at least as high as the pass-through issues. Guarantees and LOCs will pay upon loan defaults regardless of the cause of the default. These credit supports have no exclusions.

Pools covered by corporate guarantees and LOCs are susceptible to the rating downgrade of the enhancement provider. If the parent or LOC bank is downgraded, the rating of the pass-through certificates may also be lowered if another credit support is not substituted at that time.

Pass-through certificate issuers, with parent companies rated at least ‘AAA’, may use the corporate guarantee coverage for both liquidity and losses due to foreclosure. This coverage is technically a limited guarantee, meaning the parent will cover losses only up to the amount required.

Issuers may choose letters of credit as the sole source of credit loss protection. This option is rare due to the relatively high cost of obtaining letters of credit and the limited number of providers (banks and insurance companies) with long-term debt rated ‘AAA’. The letter of credit must be unconditional, irrevocable and transferable.

Spread Account Criteria

Excess interest, known as spread, is the interest generated by a loan that exceeds the pass-through rate, servicing fees, and any fees of a transaction that are paid out of interest. Standard & Poor’s model quantifies the uncertain cash flow that is deposited in a spread account. The model stresses interest accrued by slowly reducing the balance of the pool, minimizing appreciation, and by compressing the interest rate differential. For a detailed explanation of the application of excess interest, see the section *Cashflow Analysis*. For a description of eligible account criteria, see the section *Legal Considerations*.

The Weak Link Approach

Regardless of what type of structure is employed, when rating mortgage backed securities it is important to look not only at the amount of credit protection, but also the source of credit protection. Loss assumptions (cashflow structures) or over-collateralization percentages determine the amount of credit protection needed. Credit protection, however, can be provided from a variety of sources. In many cases, there may be more than one source of credit protection. It is the analyst's task to determine the likelihood of payment from each source.

Although the amount of credit protection may seem sufficient to cover the perceived degree of risk, such coverage is only as good as the credit strength of the provider. A "weak link" approach is used in rating mortgage backed securities. That is, the rating reflects the lowest credit strength of the different sources of protection. A pass-through certificate for which credit protection included a letter of credit from a 'AAA' bank and special hazard insurance from an 'AA' insurer would be rated 'AA', while a senior/junior pass through that relied solely on a subordinated pool of mortgages could be rated 'AAA', provided that the appropriate level of loss coverage was provided.

The weak link approach also applies on an ongoing basis in monitoring all rated issues. Ratings on the securities will change to reflect the rating of the credit provider. For example, a 'AAA' rated pass-through which relies on a 'AAA' rated letter of credit provider for its rating would be downgraded if the letter of credit provider's rating was downgraded.

Payment Structures

The Pass-Through Structure

The primary structure for reverse mortgages is a pass-through, which essentially gives investors an equity interest in the assets. The structure establishes a trust (a special purpose entity, or SPE) as the issuer, and assets are sold into the trust. Thus, the pass-through is not a debt obligation of the issuer. The investor buys a share of the asset pool. Cash flow from the assets is "passed through" to the investor. Interruptions in the promised cash flow stream of the assets are guarded against by credit enhancements, equity contributions, reserves, or a combination thereof. Pass-throughs may be issued as single-class or multiple-class structures.

Flow of funds

It is critical that the trust indenture prescribe how cash flow, liquidation proceeds of assets, or draws on credit supports be applied. Moreover, it is important that no entity (borrower, trustee, issuer, servicer) have discretion as to the use of such

proceeds or draws. The trust indenture is a contract between the parties and binding on all.

The flow of funds is structured to ensure that the amounts projected by a transaction in its cash flow analysis to meet payment obligations to investors are indeed available. There are two structures that fulfill this objective. They are the fast pay (closed flow of funds) and cash release (open flow of funds) with an asset maintenance test. Typically, for this product fast pay structures are predominantly reviewed. In the fast pay structures, excess cash flow (generally excess interest from high coupon loans) is used to redeem obligations. In the cash release scenario, excess cash flow is generally released to the residual interest holder. The ability for the remaining assets to fulfill payment obligations to the investors is a condition precedent to this release of surplus assets.

Fees and compensation

In pass-through structures, ongoing fees and compensation (typically those of the trustee and servicer) are to be capped or subordinated to debt service. They may be received from gross revenues as a fixed percentage of assets or liabilities outstanding. They also may be confined to investment earnings of specified funds. In either case, demonstration of sufficient coverage of fees is warranted.

Special Hazard

The location of the properties securing the loans also affects the level of risk in terms of special hazards to which areas of concentration may be subject. An assessment of the special hazard risk also is necessary in the determination of total loss coverage. Special hazard coverage normally is provided to insure against losses not covered by standard hazard policies, including those caused by earthquakes, flood, vandalism, or mudslides.

To protect bondholders from potential losses resulting from natural disasters, subordination or an insurance policy may be used, or a reserve account needs to be funded from either excess spread or cash. If such reserve is funded from excess spread, then the required amount can be attained within a two-year period due to the low original weighted-average loan to value ratios. The required coverage amount is dependent upon whether the structure promises timely interest or ultimate interest.

For timely interest structures, the amount required equals the greater of:

- One percent of the pool balance;
- Two times the largest loan balance; or
- The amount representing the highest single zip code.

For ultimate interest structures, the required amount equals the greater of :

- The amount representing the highest single zip code, or
- Based upon a cash flow analysis, one percent of the maximum amount the bond balance achieves.

Swap Criteria

When the issuing SPE's other assets also are a supporting rating, the issue credit rating addresses the credit risk of the swap counterparty, the other assets, and the transaction's structure. Each element affects the issuing SPE's ability to provide transformed cash flows to holders of the rated securities in a full and timely manner.

In many of these transactions, as well as in most asset- and mortgage-backed issues, the counterparty does not expect to take the credit risk of the issuing SPE's other assets. Therefore, the counterparty desires a swap contract that deviates as little as possible from the market standard. Investors in rated securities, however, also need reasonable assurance that the swap counterparty will not cause an early termination of the swap. An early termination of the swap may result in a termination payment by the issuing SPE to the swap counterparty out of funds that otherwise would be payable to the holders of the rated securities.

Analysts will assume that the issuing SPE would not have an incentive, or the ability, to terminate the swap agreement absent a default on its other assets, and then only if it is in the best interests of investors and is generally subject to their vote. The criteria for securities in which the swap counterparty and the issuing SPE's other assets are supporting ratings, as the criteria apply to specific sections of the International Securities Dealers Association's 1992 agreement, are discussed below. These criteria are applicable to synthetic securities and asset- and mortgage-backed transactions. The provisions of the 1992 agreement that are not referenced below are acceptable provided that they are not modified.

ISDA Cross-References

Section 2. Payments.

Netting. The 1992 agreement allows for the party that owes a higher swap payment to the other party to make a net payment to the other party. It does not apply to swapped currency payments. The parties should elect that netting across different series will not apply to vehicles that can issue multiple classes or series of securities and use the same master agreement, to avoid netting across different classes or series. Further, the swap agreement for each class or series must be written as a separate agreement. For a given series, payment netting for that series is acceptable. The parties also should elect that netting will not apply when there are timing gaps between swap payments by the counterparty and the issuing SPE, to avoid the potential for confusion.

These gaps generally occur in structures that issue rated securities that pay interest or principal more or less frequently than does the issuing SPE's other assets.

Deduction or Withholding for Tax. The 1992 agreement also requires a party to gross up its swap payment if an indemnifiable tax is imposed on the payment. As in the previous criteria, this definition should not be limited to an indemnifiable tax but should include any withholding taxes. Otherwise, treatment of withholding taxes on swap payments is generally broader than it has been in the past.

If a withholding tax already applies to the swap payments to be made by either the swap counterparty or the issuing SPE at the time the transaction closes, the swap counterparty will be required to continue to accept swap payments from the issuing SPE that are net of tax and make payments to the issuing SPE that are grossed up for tax. If a third party, such as a guarantor or insurer, guarantees the swap counterparty's obligations under the swap agreement, the terms of the guarantee also should provide that swap payments are grossed up for tax.

If no withholding tax currently applies to swap payments, analysts will, in general, require both:

- An issuing SPE swap tax opinion stating that, under current law, no such tax applies and that there is no pending legislation to create such a tax; and
- A swap counterparty/guarantor tax opinion to the same effect.

This requirement regarding pending legislation arises from a concern that an issue could be adversely affected shortly after its sale date as a result of pending laws that could have been discovered before issuance. Standard & Poor's ratings do not address change-in-law risk, and its criteria recognize that it is up to the parties to fashion the remedies for the eventual imposition of taxes.

A variety of remedies for this are acceptable provided that the risks are properly disclosed to investors. Therefore, the swap counterparty can select one of the following options before a rating is assigned to a transaction to address future imposition of, or an increase in, withholding taxes on swap payments made by itself or the issuing SPE:

- The swap counterparty can gross up payments to the issuing SPE to take into account withholding tax and accept payments from the issuing SPE grossed up for withholding tax. In most cases, however, the issuing SPE will not have the funds to gross up its swap payments to the counterparty. Under this option, if the issuing SPE is able to make grossed-up payments, the swap counterparty will not have the right to terminate the swap if a withholding tax is imposed unless it makes a termination payment to the issuing SPE equal to the principal and accrued interest on outstanding rated securities minus proceeds from the sale or liquidation of the issuing SPE's other assets. In this event, the formula for calculating the termination payment (*see section 6(e) below*) will have to be amended accordingly. If the counterparty knows that the issuing SPE will not be able to make grossed-up payments,

as is ordinarily the case for an issuing SPE, one of the remaining options should be selected.

- The swap counterparty can gross up payments made to the issuing SPE to take into account withholding tax and accept payments from the issuing SPE net of tax.
- The swap counterparty can make payments to the issuing SPE net of withholding tax and accept payments from the issuing SPE net of withholding tax.
- The swap counterparty can terminate the swap. It will not be obligated to make investors whole, however, as in the first option. The swap counterparty or the issuing SPE will be owed a termination payment (*see section 6(e) below*).

If an option will cause investors in rated securities to receive lower payments from the issuing SPE, the transaction documents should adequately disclose that investors' payments from the issuing SPE may be affected if a withholding tax is imposed on swap payments and the counterparty is not obligated to gross up payments to the issuing SPE, or that the counterparty has the right to terminate the swap if a withholding tax is imposed on payments by the issuing SPE to the swap counterparty.

The documents also should provide that if the swap is terminated, proceeds from the sale of the issuing SPE's assets may not be sufficient to repay the full principal amount plus accrued interest on the outstanding rated securities. In addition, the documents should adequately disclose that part or all of the proceeds from the sale or liquidation of the issuing SPE's assets may be used to make the termination payment due to the swap counterparty.

Section 3. Representations.

In an effort to facilitate standardization of the swap agreement, and to allow for proper due diligence, representations may be included in the swap agreement. Breach of these representations by the issuing SPE, however, should not constitute an event of default or give the swap counterparty the right to terminate the swap agreement in most circumstances.

A review will be undertaken to determine whether or not investors are protected from termination events resulting from facts that could have been discovered by the counterparty before entering into the swap. Therefore, some issuing SPE representations may be accepted even if breach of those representations would enable the counterparty to terminate the swap agreement. The likelihood that the issuing SPE's representations may be inaccurate is the key factor in determining whether they will be acceptable. In most cases, the swap counterparty should derive significant comfort from the issuing SPE's status as an SPE created for the transaction at hand.

Basic Representations

Part (a) of Section 3 of the 1992 agreement pertains to certain basic representations:

- Status,
- Powers,
- No violation or conflict,
- Consents, and
- Binding obligations.

As an SPE, the issuer typically is not an operating company, but a bankruptcy-remote, structured vehicle that is completely dependent on third parties to perform certain functions. The failure to perform these functions could cause the issuing SPE to breach the basic representations in part (a) of this section of the 1992 agreement. As a general matter, the structure will be reviewed to ensure that the proper parties—a manager or administrator—are in place to perform activities needed by the issuing SPE and that the issuing SPE has the ability to pay for the necessary services.

The analyses and ratings, however, do not address the likelihood or ability of these parties to perform as contracted. Their failure to do so should not cause the swap to terminate in most circumstances, which will be reviewed. The swap counterparty, as a participant in the transaction, is in the best position to assess the likelihood that the manager or administrator will comply with their respective undertakings in the documents.

Therefore, these representations can be included in the swap agreement for due diligence purposes. However, breach by the issuing SPE should not constitute an event of default or give the swap counterparty the right to terminate the swap agreement unless the likelihood of breach is commensurate with the transaction's issue credit rating.

Other Representations

For representations concerning the absence of certain events [Section 3(b)], the absence of litigation [Section 3(c)] and the accuracy of specified information [Section 3(d)], breach of these representations by the issuing SPE should not constitute an event of default or give the swap counterparty the option to terminate the swap. These representations involve facts that the swap counterparty should have had the opportunity to review for accuracy before entering into the swap agreement with the issuing SPE. Therefore, the swap counterparty will need to perform due diligence to assure itself that these issuing SPE representations are accurate.

The payor tax representation [Section 3(e)] and the payee tax representation [Section 3(f)] will be reviewed on a case-by-case basis. When necessary, legal comfort as to the accuracy of the representations may be required. In structures that allow for multiple issuances, payor and payee representations will be revisited before each issuance.

Section 4. Agreements.

Parts (a) through (d) of this section obligate both parties to agree to:

- Furnish specified information,
- Maintain authorizations,
- Comply with laws, and
- Notify the other party that it breached a payee tax representation under Section 3(f) when the breach occurs.

In general, the issuing SPE's failure to comply with these agreements should not constitute an event of default or give the swap counterparty the right to terminate for the reasons stated above (*see Section 3; Representations; Basic representations*). It is, however, recognized that there will be circumstances in which the breach of certain agreements by the issuing SPE should enable the swap counterparty to terminate the swap. These agreements generally will be reviewed on a case-by-case basis.

Concerning payment of stamp tax [Section 4(e)], a local tax opinion confirming whether any stamp duty or other documentary tax will be payable by the issuing SPE may be required. If so, the issuing SPE should be able to meet this expense.

Section 5. Events of Default and Termination Events.

(a) Events of Default

- (ii) **Breach of Agreement.** For the reasons stated above (*see Section 3; Representations*) the issuing SPE's breach of representations or identified agreements will not be acceptable events that give the swap counterparty the option to terminate the swap agreement unless the rating would not be affected by breach of these representations and agreements that may cause the swap to terminate (or the likelihood of termination is a factor in the rating).
- (iii) **Credit Support Default.** The 1992 agreement provides that a credit support default can lead to an event of default under the swap agreement. This provision should be removed from the agreement when the swap counterparty's obligations under the swap agreement are not supported by another entity because it is not relevant in these transactions.
- (iv) **Misrepresentation.** Under this provision, a misrepresentation by either party or its credit support provider, other than a misrepresentation relating to payor or payee tax representations [Sections 3(e) or 3(f)] would enable the other party to declare the swap in default under Section 5(a)(iv). Given the rationale for removing representations from the default and termination events under the swap agreement, as explained above, this provision should be modified to address only those representations with which Standard & Poor's is comfortable. The counterparty is urged to perform whatever due diligence is necessary to become comfortable with the transaction.

(v) Default Under Specified Transaction. This provision allows the nondefaulting party to terminate the swap if the other party defaults under a specified swap or transaction whether or not the swap or transaction is a part of the current swap agreement. Allowing the swap to default for this reason can be used to create a cross default. As noted below, cross-default provisions are not appropriate in structured finance transactions. (In the 1987 agreement, this section is called default under specified swaps. The same comments apply.)

(vi) Cross Default. The cross-default provision enables a party to declare the swap in default if the other party or its credit support provider defaults on obligations in excess of an agreed-upon threshold amount. Because particular categories of debt of an entity may be rated differently (for example, senior debt, subordinated debt, preferred stock, etc.) and structured transactions rely on the credit quality of particular assets, this provision should be removed from the swap agreement.

The risk of different ratings on different categories of debt also applies to an issuing SPE with deeply subordinated instruments outstanding, on which the relevant creditor has agreed not to enforce its claim upon a default.

Nonetheless, this arrangement could inadvertently trigger the cross-default provision. Cross-default provisions may be acceptable in insured transactions in order to give the insurer more control over the structure.

(vii) Bankruptcy. Under this provision, if a party becomes bankrupt, the other party can declare the swap in default. As it applies to the issuing SPE, this provision generally is acceptable because the issuing SPE is usually structured to be an SPE. A bankruptcy or downgrade of the swap counterparty or its guarantor or insurer, on the other hand, would cause the transaction's issue credit rating to be lowered accordingly.

Clause (2) of this provision, presents an issue because it refers to a party's insolvency, inability to pay its debts, failure to do so, or admission in writing that it cannot pay its debts as they become due. This clause could be triggered by an issuing SPE that has subordinated debt outstanding (rated or unrated) because credit losses on the underlying collateral may cause technical payment default or losses on the subordinated debt. Many transactions use subordinated debt to provide credit support to more senior rated debt. In that event, the definition of bankruptcy in clause (2) should be removed from the swap agreement so that the swap continues even if the issuing SPE is technically insolvent because it cannot pay its subordinated debt, as anticipated by the structure of the transaction.

(b) Termination Events

- (ii) Tax Event. Under this provision, the affected party has the right to terminate the swap. The affected party is the party that is obligated to pay tax or receive a payment net of tax if an indemnifiable tax is imposed on a party's swap payments or is the party that will receive swap payments net of this tax from the other party because a tax is imposed and neither party is obligated to gross up its payments under the swap agreement. This right to terminate the swap should be removed when the swap counterparty is obligated to pay gross and accept net or is otherwise obligated to continue the swap (see Section 2; Payments; (d) Deduction or Withholding for Tax). It may be retained when the swap counterparty has not obligated itself to continue the swap.
- (iii) Tax Event Upon Merger. Under this provision, the burdened party has the right to terminate the swap. The burdened party is the party required to pay an amount relating to an indemnifiable tax or receive a payment net of this tax because it or the other party merged and there is no obligation on the burdened party to gross up the swap payments to take this tax into account. This provision should be removed when the swap counterparty is obligated to pay gross and accept net (*see Section 2. Payments. (d) Deduction or Withholding for Tax*). In all other cases, it may be retained.
- (iv) Credit Event Upon Merger. Under this provision, the nonaffected party has the right to terminate the swap if the affected party, its credit support provider, or any entity specified by the affected party merges, which does not constitute merger without assumption under Section 5(a)(viii), and the resulting entity is materially weaker than the affected party, its credit support provider, or other specified entity. If the issuing SPE is not the affected party and is the only party with the right to terminate the swap, the swap agreement can retain this provision. The swap counterparty should not be concerned with its inability to terminate the swap in an issuing SPE merger. The issuer, as an SPE, will be prohibited from merging when doing so would materially prejudice investors.
- (v) Additional Termination Event. Any additional termination events will be reviewed to ensure that they comply with criteria within the context of the transaction. In general, there will be very few transactions in which additional termination events would be appropriate. (This provision appears only in the 1992 agreement. The 1987 agreement, however, also allows the parties to agree to additional termination events.)

Section 6. Early Termination.

- (a) **Right to Terminate Following Event of Default.** The basic agreement allows the nondefaulting party to terminate the swap following an event of default under the swap agreement by the other party. The ability to terminate the swap immediately or automatically after such default should be removed from the agreement in certain circumstances. This provision is generally included to buttress netting in several jurisdictions.

Most transactions will waive netting across different swap agreements and, consequently, this provision should not be necessary. One important reason for this criterion is that in structures where a guarantor or insurer guarantees the swap counterparty's obligations under the swap agreement, automatic early termination may not allow enough time to access the guarantee or insurance policy.

- (b) **Right to Terminate Following Termination Event**
 - (ii) **Transfer to Avoid Termination Event.** This provision is acceptable as long as both parties have the right to transfer and any successor counterparty to which the counterparty has transferred its obligations under the swap agreement has a rating at least equal to the then current rating on the issue.
- (e) **Payments on Early Termination.** Provided that the swap counterparty is not otherwise obligated to pay a different amount when the swap terminates (for example, as a result of tax events), the termination payment agreed upon by the issuing SPE and the counterparty will generally be accepted. Market quotation should be the first alternative for payment measure, with a provision for loss if market quotation is not available. Either is acceptable as the payment method. Previous criteria required market quotation and loss primarily to avoid a situation in which the issuing SPE would owe a termination payment to a defaulting swap counterparty. The change in termination payment calculations largely reflects the recognition of market convention and that the possibility of two-way payments promotes greater market liquidity, which could have beneficial effects on swap pricing and the availability of replacement swap counterparties.

Ranking

Although the 1992 agreement does not stipulate any sharing of proceeds resulting from selling or liquidating the issuer's assets upon a swap termination, Standard & Poor's continues to be concerned with the relative rights of the counterparty and investors in the event of termination. In the context of structured transactions, Standard & Poor's has sought to balance these rights to provide for the fair expectations of the transaction participants.

Therefore, in all circumstances other than default on the issuer's other assets, the general view is that the swap counterparty should share *pari passu* and *pro rata* in all proceeds from selling or liquidating such assets. Thus, the swap counterparty's termination payment will be added to the amount due to investors. This sum will then be shared by the counterparty and investors on a *pro rata* and proportionate basis. In the event that default on the issuer's assets caused the swap to terminate, the swap counterparty can rank ahead of investors in receipt of its termination payment. Like other modifications to the 1992 agreement, provisions for ranking should be addressed in the schedule and confirmation.

Section 7. Transfer.

This section prevents the parties from transferring their rights under the swap agreement to a third party without the prior written consent of the other party to the swap agreement. As under the previous criteria, this section should be modified so that the issuing SPE can assign or mortgage all of its benefit and interest in the swap agreement to a trustee in the context of the structured transaction and so that the issuing SPE may transfer its interest in the swap agreement to avoid a tax event or illegality in its current jurisdiction. Swap counterparties will generally only be allowed to be released from their obligations under the swap agreement after they assign the agreement to an entity with a rating at least as high as that currently assigned to the transaction.

Section 9. Miscellaneous.

b) *Amendments.* Any amendments to the swap agreement reviewed in advance for possible rating action.

Section 10. Multibranch parties.

Each party should represent that it is not a multibranch party for purposes of the swap agreement.

Cashflow Analysis for Reverse Mortgage Transactions

Base Assumptions

Sufficiency of asset cash flow to meet full and, if applicable, timely payment of obligations to the investors may be demonstrated via cash flow simulations. In cash flow analysis, it is necessary to determine that the probability of the stream of income from the collateral is of sufficient strength for the desired rating on the bonds or certificates.

A key area of focus in rating reverse mortgage transactions is the valuation of the collateral cash flow. In any pass-through transaction, the cash flow generated by the mortgage collateral is the primary source of funds from which securityholders will be paid. The actual cash flow on an individual reverse mortgage will generate is uncertain. On any mortgage payment date, the reverse mortgagor, may:

- Make no payment;
- Move, sell the home, and remit funds due up to the value of the home;
- Die, the estate sells the home, and remit funds up until the value of the home; or
- Default, in which case there will be a call on the loan and the servicer will proceed with default remedies.

Credit enhancements and various structural techniques are used to mitigate the uncertainty associated with reverse mortgage payments.

Bond Value

Repayment rates (comprised of mortality and move out) are important determinants in the profit/loss realized on a reverse mortgage. In general, loans that repay at a higher rate are more likely to be profitable than loans that repay at a slower rate. The longer the loan is outstanding, the greater the likelihood that the balance together with accrued interest may outgrow the home value.

The date that a reverse mortgage will be repaid is unknown. Instead, for each mortgage there is some probability of repayment in each month. Since we know that repayment will occur when either the mortgagor dies or when they move out, we have assumed that the probability of repayment in any year is the sum of the probability that the mortgagor will die in that year plus the probability that they will move out.

Mortality

The probabilities of death depend only on the age and gender of the mortgagors and are calculated from the applicable 1983 Group Annuity Mortality Table (GAM83). These tables show the probability of mortality at any particular age given that the individual has survived to that age. Based on the age and gender composition of the pool of loans, we determine at a particular confidence level for each rating category how many people will survive another year. If there are co-borrowers, the age of the youngest borrower is used in the cash flow assumption. Each person in the pool is then aged one year and this process is repeated for the life of the pool, obtaining an annual mortality rate for each year. Using these rates, a corresponding number of people are randomly selected to die each year at a certain confidence level for each rating category.

Move Out

Unlike probabilities of death for which external references exist, the move out probabilities need to be estimated by using the originator's own data. Estimates of the move out probabilities are needed for three different categories of mortgage holder: single males, single females, and couples. For each category, the move out probabilities are estimated on an age-specific basis, meaning that the probability of move-out varies from age to age (e.g., the estimated move-out probability for a male at 77 may be somewhat different than the probability of a male a year younger or older). Just as in the mortality rate, the actual number of people allowed to move—and therefore pay off their loan—is minimized to a probability that adheres to each rating category tolerance.

Basis Risk

When a transaction contains mortgage loans whose rate is different from that which the certificates accrue, basis risk occurs. The changing spread between the two rates may cause shortfalls in the cash flow needed to pay the bonds. To date, this risk has been addressed by generally assuming a fixed spread between the two rates for the term of the deal. This approach by definition is less precise, as spreads will move over time.

The new approach provides for and estimates the future volatility in spreads using Markov chain Monte Carlo (MCMC) simulations, overlaid onto an autoregressive

(AR) time series model that is fitted to a stationary time series. By definition, a stationary time series has a constant mean over time, finite second moment, and an autocovariance function that is independent of time (Brockwell and Davis, 1991). This last point means the covariance for any given lag is constant.

Interest rate data are not stationary, but can be made stationary by differencing; then, the AR model is fit to the differenced series. The fitted AR model has a constant variance, which represents the interest rate volatility. The Markov chain approach allows the volatility to vary based on a likelihood of transitioning among different levels of volatility. Therefore, interest rate data over a long historical period can be included in the modeling without overstating the volatility by appropriately weighting the scenarios.

As an example, an appropriate government rate within a country is used as a benchmark against which all other rates for that country are modeled. The 91-day Treasury bill rate is the benchmark for U.S. rates. Benchmarking ensures that the results are consistent across the spectrum of rates and avoids unrealistic inversions. For each rating category, two paths from the simulations are used representing a low-rate and a high-rate scenario. For higher ratings, simulated paths closer to the extremes are used.

In an attempt to cover all possible rate scenarios, data from 1973 through the present are included in the modeling. However, the oil crisis of 1973-1974 and the deregulation of the U.S. banking industry in the early 1980s resulted in two highly volatile periods that are not likely to be repeated in the future. Therefore, without some form of weighting, the high volatility of these periods would make its way into the AR model and increase the estimated variance to levels that are unlikely to recur, resulting in overly stressful interest rate assumptions in the cash flow analysis. In order to more reasonably weight the volatility experience, an MCMC model is overlaid onto the AR model.

Based on the data, a probability-transition matrix is developed for three volatility states. Associated with each state is a different value of the standard deviation for the AR model. As the rates are simulated, there is a small likelihood of being in a state of relatively high volatility. Similarly, a probability-transition matrix for different levels of rates is developed. This checks the simulation at each step in the process. If the move from the current rate to the next is unlikely, then there is a small chance that the new value will be accepted. In this way, the combined MCMC and AR model (MCMC/AR) method allows the volatility to vary from time to time and tests the reasonableness of a resulting jump. The simulation results are ordered, and select percentiles are used for different rating scenarios. For example, the extremes are used for 'AAA', while the 2.5 and 97.5 percentiles are used for noninvestment-grade scenarios.

Estimation Of Rates Relative To The Benchmark

To determine the levels for other interest rates, linear regression models are fit to these data. A regression of another rate on the benchmark rate provides a model to estimate the other rate given a specific value for the benchmark. This modeling is independent of the benchmark simulations. Once the linear regression models are fit, specific rate scenarios can be estimated using the low- and high-rate scenarios from the simulations as inputs to the linear regression models.

In order to ensure that the rated securities will be paid in accordance with their terms even in an adverse interest rate environment, Standard & Poor's uses cash flow tests to determine whether each transaction can withstand basis risk in combination with losses. Table 1 illustrates some of the assumptions made in the model.

Collateral Value

Since senior citizens generally do not modernize and make capital improvements as frequently as the general population, it may be inaccurate to predict that homes owned by reverse mortgage obligors would appreciate at the same rate as general population homes. Also, when the homeowner no longer has equity in the home, there is little incentive to make repairs and improvements.

Table 1
Average Spreads

Six-month LIBOR (US) to one-month LIBOR (US) (%)					
Month range	AAA spread	AA spread	A spread	BBB spread	Non-investment grade spread
1 - 36	0.26	0.27	0.28	0.29	0.30
37 - 72	0.23	0.25	0.26	0.27	0.29
73 - 108	0.18	0.24	0.25	0.26	0.28
109 - 144	-0.15	0.21	0.22	0.24	0.26
145 - 180	-0.22	0.08	0.15	0.17	0.21
181 - 216	-0.70	-0.37	-0.01	0.22	0.27
217 - 252	-0.85	-0.46	-0.05	0.18	0.30
253 - 288	-0.75	-0.54	-0.21	0.09	0.22
289 - 324	-0.71	-0.55	-0.28	0.01	0.21
325 - 360	-0.93	-0.76	-0.50	-0.12	0.27
Fixed Spread	0.14	0.21	0.24	0.26	0.29

House Price Appreciation

Cash flows are run assuming an appreciation rate of home values such that the rate assumed is minimized to a probability that adheres to a rating category tolerance. This is derived in the following way.

First, for example a 'AAA' rated class, the 'AAA' market value decline (MVD) is applied to the entire pool over a three year period. Selecting the 34% 'AAA' MVD after three years results in property values at 66% of those used in underwriting the reverse mortgages. To determine the annual depreciation rate which will compound to 0.66 we solve

$$(1+i)^3 = 0.66$$

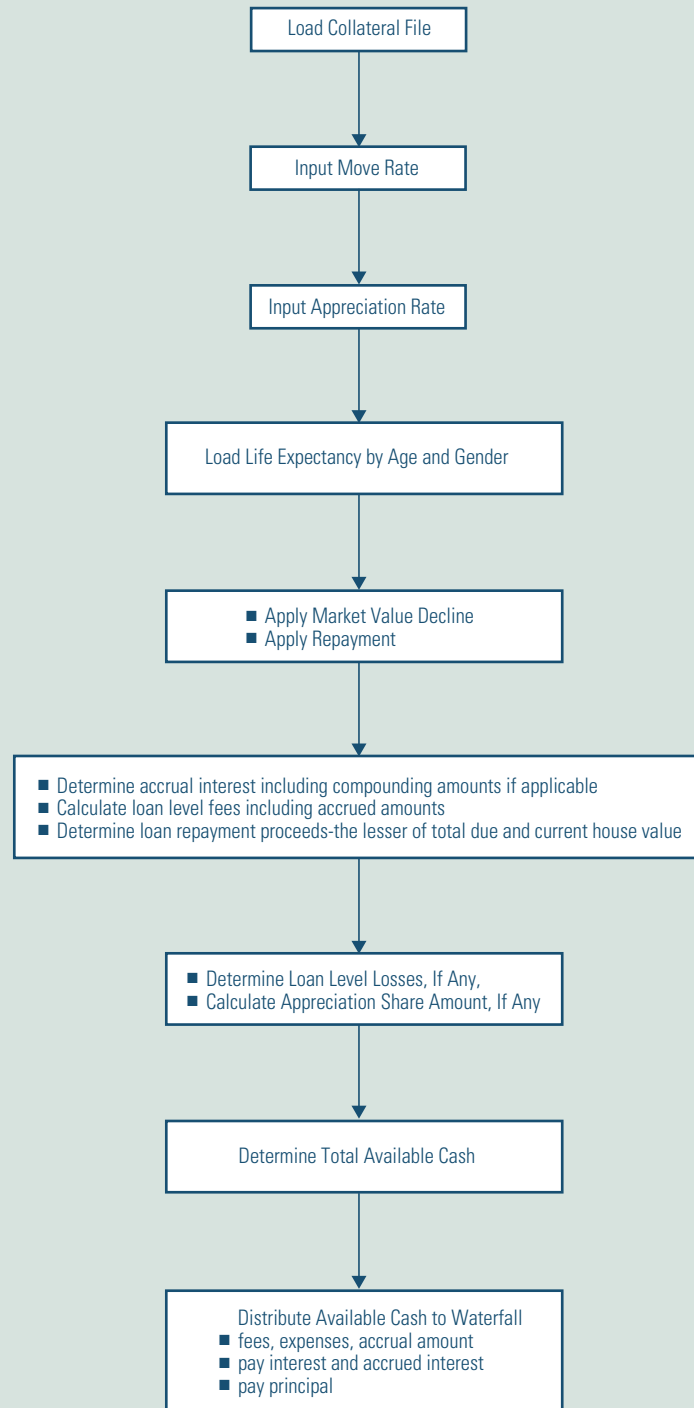
which yields an annual rate of -12.93%. We then solve for the appreciation needed for the next 27 years to pay off the notes. The probability of the actual appreciation rate being slower than the stressed appreciation rate for 27 years consecutively is calculated. The probability must be within the rating category tolerance.

Market Value Decline

Standard & Poor's market value decline assumptions are depicted in table 2.

Occupancy	Rating	—Type of Unit (%)—		
		Single Family Detached	SFA, 2 Family, Low Rise Condo	High Rise Condo, 3-4 Family
Owner occupied	AAA	34	36	38
	AA	32	34	36
	A	28	30	32
	BBB	23	25	27
	BB	22	24	26
	B	22	24	26
Non-owner occupied	AAA	38	40	42
	AA	36	38	40
	A	32	34	36
	BBB	27	29	31
	BB	26	28	30
	B	26	28	30

Chart 1
Model Flow Chart—Loan Level Procedure



Data Requirements

There are three type of data sets required from the issuer/originator to effectively analyze a reverse mortgage pool:

- *Housing Market Price Trends* of the communities where the underlying properties reside;
- *Move-out Rate Experience* for males, females, and couples by age; and
- *Collateral Loan Pool* of reverse mortgages.

The house price market trends and move-out rate data sets are used to determine the rates applied for each rating category based on the geographic, age, and gender composition of the pool. The collateral loan pool of reverse mortgages, in conjunction with the desired stressed variables for the rating tolerance level, is then run through a simulation model that adheres to the waterfall of the desired structure.

To facilitate the rating process, analysts will request detailed data about loans in a mortgage pool. These data include the mortgage's current loan balance, property home value/appraisal, loan type, interest rate and associated index, gender and age of borrower(s), loan payment characteristics including line-of-credit cash accounts and payment structures, loan fee(s), appreciation share percentages, intended loan purpose, geographic location, and property type. It is important to note that specifically organized schedules of information are relied on for pool credit analysis. The burden of organizing the information falls on the issuer or its investment banker due to the volume of rating requests Standard & Poor's receives. Pool data is received in electronic form. The file layout for this information is listed in appendix D.

Model Flow Chart

The reverse mortgage model calculates the payment structure for each loan and aggregates repayment amounts on a monthly basis. After all loans are processed each month, the available cash is then distributed based on the waterfall. Chart 1 illustrates the flow of this procedure.

Based upon this cash flow analysis the point in time where the rated security is paid off is further evaluated. The number of survivors based upon the original pool is determined. The resulting number of survivors must adhere to the rating category mortality tolerance test.

Legal Considerations for Reverse Mortgage Transactions

This section discusses the critical legal issues raised by reverse mortgage loan transactions. The section sets forth the major legal concerns found in most structured financings, as well as the legal issues related to reverse mortgage loan transactions.

Structured financings are rated based primarily on the creditworthiness of isolated assets or asset pools, whether sold, contributed, or pledged into a securitization structure, without regard to the creditworthiness of the seller, contributor, or borrower. The structured financing seeks to insulate transactions from entities that are either unrated and for whom it is impossible to quantify the likelihood of a potential bankruptcy, or that are rated investment grade but wish a higher rating for the transaction. A worst-case scenario assumes the bankruptcy of each transaction participant deemed not to be “bankruptcy-remote” or that is rated lower than the transaction. Most legal concerns are resolved by analyzing the legal documents and, where appropriate, receiving opinions of counsel that address insolvency, as well as security interest and other issues. Understanding the implications of Standard & Poor’s assumptions and criteria enables an issuer to anticipate and resolve most legal concerns early in the rating process.

General Overview

Reverse mortgage loans are originated or transferred into a securitization structure by banks or other financial institutions, insurance companies or non-bank corporations. Some of the legal issues raised by these transactions differ depending on whether the entity transferring the loans is a nonbank corporation that is eligible to become a debtor under the U.S. Bankruptcy Code (a “Code transferor”), a bank, other financial institution, or insurance company that is not eligible to become a debtor under the Bankruptcy Code (a “non-Code transferor”), or an entity subject to the Bankruptcy

Code (such as a “municipality” or “public purpose entity”), but which is deemed by to be bankruptcy-remote in that the bankruptcy or dissolution of such entity for reasons unrelated to the transaction structure is deemed unlikely to occur (an “SPE transferor”). Unless otherwise indicated, an entity either selling, contributing, depositing, or pledging assets for purposes of securitization, including the originator of the assets and any intermediary entity participating at any level in a structured transaction as a transferor of assets, is referred to as a transferor.

Securitizations by Code Transferors

General

When a transferor of assets in a structured transaction is a Code transferor, as a general matter, a pledge of the assets by the transferor as collateral for the rated securities being issued in the transaction will not ensure that holders of the rated securities would have timely access to the collateral if the transferor became the subject of a proceeding under the U.S. Bankruptcy Code. Although, as a matter of law, a creditor ultimately should be able to realize the benefits of pledged collateral, several provisions of the Bankruptcy Code may cause the creditor to experience delays in payment and, in some cases, receive less than the full value of its collateral. Under Section 362(a) of the Bankruptcy Code, the filing of a bankruptcy petition automatically stays all creditors from exercising their rights to pledged collateral. The stay would affect all creditors of the transferor. A bankruptcy court could provide relief from the stay under certain circumstances, but it is difficult to estimate the likelihood of relief from the stay. Moreover, in most cases, it would be difficult to estimate the duration of the stay.

Similarly, according to Section 363 of the Bankruptcy Code, under certain circumstances a bankruptcy court may permit a debtor to use pledged collateral to aid in the debtor’s reorganization or, according to Section 364, to incur debt that has a lien on assets that is prior to the lien of existing creditors. Under Section 542, a secured creditor in possession of its collateral may be required to return possession of this collateral to a bankrupt debtor.

As a result, in the case of structured transactions involving the transfer of assets by Code transferors, the existence of strong assets alone to secure the rated securities cannot determine the issue credit rating of these securities. The structure of the transaction should provide the means by which the assets would be available to make interest payments on the rated securities in a timely manner and to ensure ultimate recovery of principal upon maturity, notwithstanding the insolvency, receivership, or bankruptcy of the transferor.

In general, the desired structure is achieved by having all assets held by any Code transferor transferred to a “bankruptcy-remote,” special-purpose entity (SPE), which, in turn, either functions as an “intermediate SPE” and transfers the assets to an “issuing SPE” that issues the rated securities in a “two-tier transaction” or functions itself as an issuing SPE and directly issues the rated securities in a “one-tier transaction.”

To ensure that a given transaction structure, whether two-tier or one-tier, provides for the timely availability of assets to pay the holders of the rated securities, each transfer of assets in a securitization transaction is analyzed to determine whether each transfer constitutes a sale or a pledge, the nature of each transaction party’s property rights in any assets, and whether third parties (that may be unrated or that are “non-bankruptcy remote”) have retained rights that may impair timely payment on the rated securities. Depending upon the transaction structure (as discussed below), certain requirements including, but not limited to, the delivery of opinions of counsel regarding these issues should be met.

Two-Tier Transactions

In the typical two-tier transaction, the rated securities are issued by an issuing SPE. In the “first tier,” each Code transferor holding assets (which, in general, has either originated the assets or purchased the assets in a chain of transfers from the “originator”) either sells the assets to an intermediate SPE or makes a capital contribution of the assets to the intermediate SPE. The intermediate SPE is usually a wholly owned subsidiary of one of the transferors. In the “second tier,” the intermediate SPE deposits or sells the assets to the issuing SPE or borrows from the issuing SPE and pledges the assets to the issuing SPE to secure the loan. The issuing SPE then issues the rated securities and uses the proceeds of the rated securities either to purchase the assets from the intermediate SPE (if the second-tier transfer constitutes a sale) or to make a loan to the intermediate SPE (if the second-tier transfer constitutes a pledge). The intermediate SPE uses the proceeds of the sale or loan to purchase the assets from the transferors.

In a two-tier transaction, in which the transferors are Code transferors, the following interrelated criteria apply.

First Tier: True Sale

First, to avoid the risk that a court, in the event of the bankruptcy of any Code transferor, would deem any of the assets transferred in the chain of transfers to the intermediate SPE to be part of the transferor’s bankruptcy estate (and thus subject to the automatic stay), it is generally the case that each transfer of assets from any Code transferor (through all intermediaries that are Code transferors) to the intermediate SPE must be a “true sale,” as further described below. In this regard, each transfer of assets in the full chain of transfers from each Code transferor to the

intermediate SPE is subject to review in terms of the factors courts generally consider in determining whether a transfer is a true sale or a secured loan.

In particular, in this regard, whenever it is necessary that a transfer qualify as a true sale, the transfer must be examined for any arrangements by which the transferor retains a subordinated interest in the assets, whether the interest is in the form of a subordinated note or subordinated certificates that are being issued in the transaction. Depending upon the circumstances, a transfer that incorporates subordinated interests may be characterized as a secured loan transaction, rather than a true sale.

True Sale Opinion. To obtain legal comfort that each transfer of assets through the chain of transfers from any Code transferor through the first-tier transfer to the intermediate SPE constitutes a true sale, a “true sale opinion” will be requested for each transfer. The true sale opinion should state that the assets being transferred and the proceeds thereof will not be property of the transferor’s estate under Section 541 of the Bankruptcy Code or be subject to the automatic stay under Section 362(a) in the event of the bankruptcy of the transferor.

Sometimes, assets may pass through multiple owners before coming to rest in the intermediate SPE. In general, true sale opinions would be desirable for each transfer in the chain. However, in some cases, this request would be burdensome and add little real value. Therefore, in certain circumstances, true sale opinions for various transfers may be waived.

For example, in cases of “open market transfers,” the true sale opinion requirement for intermediate transfers may be waived. Transfers will be considered on a case-by-case basis to determine whether they are open market. As a general matter, if the transfer satisfies the following criteria, the transfer will be deemed to be open market:

- The transfer is an arm’s-length nonrecourse transfer between unaffiliated entities;
- The transferor received payment in full at the time of the transfer;
- The transferee is purchasing assets from multiple transferors; and
- The transferor does not receive, as payment, any securities issued in the rated transaction.

Depending on the type of transaction, additional factors will be considered in determining whether a transfer is open market. For example, in the context of most structured transactions, it is necessary that the transferee purchase the assets in the ordinary course of its business. Open market transfers are considered to be true sales for bankruptcy purposes and therefore may not require true sale opinions in connection with such transfers. In addition, some direct purchases by the intermediate SPE from unrelated parties may be viewed as open market transfers. In many instances, it may be difficult to determine whether a transfer was indeed an open market transfer. In these cases, a true sale opinion may be requested nevertheless.

Nonconsolidation

Second, under the equitable provisions of Section 105 of the Bankruptcy Code, a court has the power to substantively consolidate ostensibly separate but related entities and treat the assets and liabilities of the entities as if they belonged to one, thus enabling the creditors of each to reach the assets of the consolidated estate. Therefore, even if a first-tier transfer from a Code transferor constitutes a true sale, if the transferor becomes insolvent, property transferred to the intermediate SPE from the transferor may be deemed part of the transferor's bankruptcy estate, thereby jeopardizing timely payment to the holders of the rated securities.

Because of this possibility of substantive consolidation and the resultant risk that holders of the rated securities would not receive timely payment on their investment, it is requested that, in circumstances in which consolidation of the intermediate SPE where a Code transferor is a possibility, that a legal opinion be received stating that, if the Code transferor were to become insolvent, neither the intermediate SPE, nor its assets and liabilities, would be substantively consolidated with the transferor. In this regard, the facts and circumstances of the relationship between the intermediate SPE and other entities in a transaction in terms of the factors courts generally consider in determining whether two entities should be substantively consolidated should be examined. In addition, each SPE should adopt "separateness covenants" in the transaction documents and/or its charter and by-laws.

Nonconsolidation Opinion. As mentioned above, to obtain legal comfort in regard to consolidation in bankruptcy, in certain circumstances, analysts will request a "nonconsolidation opinion" to the effect that, in an insolvency of the relevant Code transferor, neither the intermediate SPE, nor its assets and liabilities, would be substantively consolidated with the transferor. Since an intermediate SPE may take a variety of different forms, for example, corporate, partnership, or limited liability company (LLC), the particular nonconsolidation opinions that will be requested in a given transaction will depend upon the type of entities involved and their relationship to one another. In general, the following nonconsolidation opinions are expected:

- If the intermediate SPE is a corporation, a nonconsolidation opinion stating that, under applicable insolvency laws, upon an insolvency of any entity owning 50% or more of the equity of the intermediate SPE corporation, the intermediate SPE corporation, or its assets and liabilities, would not be substantively consolidated with its 50% or more equity owner. (If all equity holders of the intermediate SPE are affiliates, the nonconsolidation opinion will generally be necessary irrespective of the proportionate ownership.)
- If the intermediate SPE is a limited partnership, a nonconsolidation opinion stating that, under applicable insolvency laws, in an insolvency of any limited partner holding a 50% or more percentage interest in the profits and losses of the intermediate SPE limited partnership or an insolvency of any general partner (that is not itself

an SPE) of the intermediate SPE limited partnership, the intermediate SPE limited partnership, or its assets and liabilities, would not be substantively consolidated with the general or limited partner. Furthermore, under the criteria, at least one general partner of an SPE limited partnership must be an SPE. Accordingly, as a general matter, a nonconsolidation opinion would be requested between the SPE general partner and its equity holders (if the SPE is a corporation) or partners (if the SPE is a partnership) as described above.

- If the intermediate SPE is an LLC, a nonconsolidation opinion stating that, under applicable insolvency laws, in an insolvency of any member or successor member (that is not itself an SPE), the intermediate SPE LLC, or its assets and liabilities, would not be substantively consolidated with the member or successor member. Furthermore, under the criteria, at least one member of a two or more member SPE LLC must be an SPE. Accordingly, if the SPE member is a corporation, analysts would, as a general matter, request the relevant nonconsolidation opinion. In connection with single-member LLCs, the criteria, at the time of publication, are still in the developing stage. Therefore, transferors intending to use a single-member LLC in a structured transaction are encouraged to check with Standard & Poor's regarding its single-member LLC criteria, including its opinion requirements.
- For two-tier transactions, if the second-tier transfer is structured as a true sale rather than a secured loan, the assets transferred to the issuing SPE in the second-tier true sale would not be part of the intermediate SPE's estate. Thus, possible consolidation of the intermediate SPE with its parent would not affect the transaction. In such circumstances, a nonconsolidation opinion between the Code transferor and the intermediate SPE will typically not be requested.
- If the parties propose an intermediate SPE that is not subject to the Bankruptcy Code, such as an insurance company or bank, or, if the intermediate SPE is an "orphan SPE" whose parent is an operating company, the need for nonconsolidation opinions will be addressed on a case-by-case basis. If the intermediate SPE is owned by a company established for the limited purpose of owning and providing management services to securitization vehicles, a nonconsolidation opinion will typically not be required, provided at least one nonconsolidation opinion with respect to such company's participation in a prior transaction has been received. Depending upon the circumstances, nonconsolidation opinions may be necessary between an intermediate SPE and certain indirect affiliates.

Second Tier: True Sale or First Priority Perfected Security Interest

Because the second-tier transfer in a two-tier transaction is from an SPE, the second-tier transfer does not need to be a true sale. A pledge of assets from a bankruptcy-remote entity provides sufficient comfort that the assets would be available to make timely payments on the rated securities. Therefore, in connection with the second tier in a

two-tier transaction, if the issuing SPE makes a loan secured by the assets to the intermediate SPE and obtains a first priority perfected security interest in the assets and the proceeds thereof, this will offer adequate comfort.

In addition, if the rated securities are debt of the issuing SPE, the “indenture trustee/custodian” must obtain a first priority perfected security interest in the assets and the proceeds thereof. Since the issuing SPE, like the intermediate SPE, is deemed to be bankruptcy remote, a pledge of assets from the issuing SPE, rather than a true sale, provides sufficient comfort that the assets would be available to make timely payments on the rated securities. The grant of a security interest serves to reduce the incentive of the equity holders to voluntarily file a bankruptcy petition against the issuing SPE (an integral component of SPE criteria).

If the second-tier transfer does not constitute a true sale, analysts generally request the parties to the transaction to take all necessary steps under the applicable laws to ensure that the issuing SPE or indenture trustee/custodian, as applicable, has a first priority perfected security interest in all of the assets and the proceeds thereof.

True Sale Opinion, Security Interest Opinion or Either/Or Opinion; Debt Security Interest Opinion. To obtain legal comfort that the issuing SPE in the second-tier transfer *either* purchases the assets and proceeds in a true sale from the intermediate SPE *or* obtains a first priority perfected security interest in the assets and the proceeds thereof, an opinion regarding the second-tier transfer will generally be requested. The opinion may be *either* a true sale opinion, similar to the true sale opinion given in connection with the first-tier transfer, *or* a “security interest opinion” to the effect that the issuing SPE has obtained, or will have obtained following the taking of certain actions required by the “transaction documents,” a first priority perfected security interest in the assets and the proceeds thereof, *or* an “either/or opinion” to the effect that the issuing SPE *either* (a) has purchased the assets and the proceeds thereof from the intermediate SPE in a true sale *or* (b) has obtained, or will have obtained following the taking of certain actions required by the transaction documents, a first priority perfected security interest in the assets and the proceeds thereof.

In addition, if the rated securities are debt of the issuing SPE, to obtain legal comfort that the indenture trustee/custodian has obtained, or will have obtained following the taking of certain actions required by the transaction documents, a first priority perfected security interest in such property and the proceeds thereof, a “debt security interest opinion” will generally be requested.

Criteria Relating to the Tax Status of the Issuing SPE

To obtain comfort that the assets would not be needed to pay taxes of the issuing SPE, thereby depleting the funds available to make payments on the rated securities, an “entity-level tax opinion” to the effect that the issuing SPE would not be subject to federal tax or to state or local tax in the applicable jurisdictions is typically necessary.

Without this opinion, additional credit enhancement might be required to cover any potential taxes of the issuing SPE.

One-Tier Transactions

Instead of the two-tier transaction discussed above, some transactions are structured with only one tier. In these transactions, the Code transferor does not use an intermediate SPE, but rather sells the assets and the proceeds thereof directly to an issuing SPE, which issues the rated securities. In a one-tier transaction from a Code transferor, the following interrelated criteria apply.

True Sale. First, it is generally necessary that a one-tier transfer of assets and the proceeds thereof from any Code transferor to an issuing SPE be a true sale.

True Sale Opinion. To obtain legal comfort that a one-tier transfer of assets and the proceeds thereof from a Code transferor to an issuing SPE constitutes a true sale, as a general matter, a true sale opinion with respect to the transfer will be requested. The true sale opinion should state that the property being transferred and the proceeds thereof will not be property of the transferor's estate under Section 541 of the Bankruptcy Code or be subject to the automatic stay under Section 362(a) in the event of the bankruptcy of the transferor.

Nonconsolidation. Second, because of the possibility of substantive consolidation in certain circumstances and the resultant risk that holders of the rated securities would not receive timely payment on their investment, it is generally necessary that, in circumstances in which consolidation of the issuing SPE with a Code transferor in a one-tier transaction is a possibility, assurance be received that if the Code transferor were to become insolvent, neither the issuing SPE nor its assets and liabilities would be substantively consolidated with the transferor.

Nonconsolidation Opinion. A nonconsolidation opinion to the effect that, in an insolvency of the Code transferor, neither the issuing SPE, nor its assets and liabilities, would be substantively consolidated with the transferor is generally requested. Since the issuing SPE may take a variety of different forms, for example, trust, partnership, LLC, or corporation, the particular nonconsolidation opinions that will be requested in a given transaction will depend upon the type of entities involved and their relationship to one another.

First Priority Perfected Security Interest

Third, in a one-tier transaction, if the rated securities constitute debt of the issuing SPE, it is generally necessary that the indenture trustee/custodian obtain a first priority perfected security interest in the assets and the proceeds thereof. Since the issuing SPE is deemed to be bankruptcy remote, a pledge of assets from the issuing SPE, rather than a true sale, provides sufficient comfort that such property would be available to make timely payments on the rated securities.

The parties to the transaction should take all necessary steps under the applicable laws to ensure that the indenture trustee/custodian has a first priority perfected security interest in all of the assets and the proceeds thereof.

Debt Security Interest Opinion. In a one-tier transaction, if the rated securities are debt of the issuing SPE, to obtain legal comfort that the indenture trustee/custodian has obtained, or will have obtained following the taking of certain actions required by the transaction documents, a first priority perfected security interest in such property and the proceeds thereof, a debt security interest opinion will be requested to that effect.

Criteria Relating to the Tax Status of the Issuing SPE

To obtain comfort that the assets would not be needed to pay taxes of the issuing SPE, thereby depleting the funds available to make payments on the rated securities, an entity-level tax opinion to the effect that the issuing SPE would not be subject to federal tax or to state or local tax in the applicable jurisdictions will be requested. Without this opinion, additional credit enhancement might be required to cover any potential taxes of the issuing SPE.

Criteria Relating of Preference and Avoidance of Transfers

Fraudulent Conveyance

In certain circumstances (for example, if the purchase price paid by an intermediate SPE for assets is less than the reasonably equivalent value of the assets, or where a transferor is insolvent or extremely financially distressed at the time of the transfer) there is a risk that the transfer would be voided as a fraudulent conveyance, either under Section 548 of the Bankruptcy Code or under applicable state law. If a transfer of assets were voided as a fraudulent transfer, the assets would not be available to make payments on the rated securities. Each transfer of assets in a structured transaction is subject to review to determine if there is a risk that the transfer could be voided under the theory of fraudulent conveyance.

Fraudulent Conveyance Opinion. If it is determined that a fraudulent conveyance risk exists in connection with any given transfer of assets in a transaction, a “fraudulent conveyance opinion” to the effect that the transfer and the related payments to the holders of the rated securities would not be recoverable as a fraudulent transfer under either Section 548 of the Bankruptcy Code or applicable state law will generally be requested. In addition, analysts may request that the facts assumed in a fraudulent conveyance opinion be verified with either audits or independent valuations of the assets.

Preferential Transfer

In other circumstances, there is a risk that the transfer would be voided as a preferential transfer under Section 547 of the Bankruptcy Code. If a transfer of assets were voided as a preferential transfer, the assets would not be available to make payments on the rated securities. Examples of preferential transfers include debt payments made that were not in the ordinary course of business or pledges of additional collateral to a creditor within the applicable preference period. Each transfer of assets in a structured transaction is subject to review to determine if there is a risk that the transfer could be voided under the theory of preferential transfer.

Preference Opinion. If it is determined that a preference risk exists in connection with any given transfer of assets in a transaction, a “preference opinion” to the effect that the transfer and the related payments to the holders of the rated securities would not be recoverable as a preferential transfer under Section 547 of the Bankruptcy Code will generally be requested.

Note: If, as a credit matter, the value of the assets is not relevant to the rating of a structured transaction (for example, the transaction is based on a total return swap or credit is not being given for recoveries on any underlying assets such as the underlying mortgaged properties), true sale opinions, security interest opinions, either/or opinions, or debt security interest opinions regarding such assets will generally not be necessary.

Securitizations by SPE Transferors and Non-Code Transferors

General

The previous section addresses the legal criteria for structured transactions in which the transferor of assets into the securitization structure is a Code transferor. The criteria for structured transactions involving Code transferors attempt to minimize the risk that the assets would not be available for timely payment on the rated securities should any of the Code transferors become a debtor in bankruptcy under the Bankruptcy Code.

This section addresses the legal criteria for structured transactions in which the transferor of assets into the securitization structure is either an SPE transferor or a non-Code transferor. Unlike Code transferors, “SPE transferors,” such as “municipalities” and “public-purpose entities,” while subject to the Bankruptcy Code, are deemed to be bankruptcy remote in that the bankruptcy or dissolution of such entities for reasons unrelated to the transaction structure is deemed unlikely to occur. “Non-Code transferors,” such as banks and insurance companies, while not deemed to be bankruptcy remote, are not eligible to become debtors under the Bankruptcy Code.

Because structured transactions involving either SPE transferors or non-Code transferors do not pose the same bankruptcy concerns as those involving Code transferors, the criteria for structured transactions involving these entities differ in detail, but not in purpose, from the criteria for Code transferors.

SPE Transferors

Municipalities are entities that would qualify as municipalities under Section 101(40) of the Bankruptcy Code. As such, municipalities are not “moneyed, business or commercial corporations[s]” under Section 303 of the Bankruptcy Code. Public-purpose entities, such as “501(c)(3) entities” under the Internal Revenue Code (IRC), state or municipal agencies, or state or municipally chartered corporations, are entities that are also deemed not “moneyed, business or commercial corporation[s]” under Section 303 of the Bankruptcy Code. According to Section 303(a) of the Bankruptcy Code, these entities may not be involuntarily filed into bankruptcy by their creditors, and, thus, their creditors would be unable to cause a timing delay on the rated securities or reach assets otherwise available to pay the rated securities by filing an involuntary bankruptcy petition.

Both municipalities and public-purpose entities may, however, voluntarily file bankruptcy petitions under the Bankruptcy Code, municipalities under Chapter 9 and public-purpose entities under either Chapter 7 (liquidation) or Chapter 11 (reorganization). In order to deem such entities to be bankruptcy remote, the likelihood that a municipality or public-purpose entity involved in a structured transaction would voluntarily file for bankruptcy protection is evaluated. This evaluation takes into account the entity’s need to have access to the financial markets on reasonable terms, the nature of its business, its ability to control spending or to raise revenues, and, in case of municipal entities, the necessity of the services provided to its citizenry and the purpose of the securitization.

Assuming that this evaluation leads to the conclusion that a municipality or public-purpose entity is unlikely to voluntarily file for bankruptcy protection, such an entity will be deemed bankruptcy remote. Interrelated criteria for structured transactions involving SPE transferors follows.

One-Tier Transactions

True Sale or First Priority Perfected Security Interest

An SPE transferor generally chooses a one-tier transaction structure and does not interpose an intermediate SPE between the SPE transferor and the issuing SPE. In such one-tier transactions involving SPE transferors, the transfer from the SPE transferor to the issuing SPE to constitute a true sale is not necessary. A pledge of assets from a bankruptcy-remote entity provides sufficient comfort that the assets would be available

to make timely payments on the rated securities. Therefore, rather than requiring a true sale, the issuing SPE can make a loan secured by the assets and obtain a first priority perfected security interest in the assets and the proceeds thereof.

In addition, if the rated securities are debt of the issuing SPE, the indenture trustee/custodian must obtain a first priority perfected security interest in the assets and the proceeds thereof. Since the issuing SPE, like the SPE transferor, is deemed to be bankruptcy remote, a pledge of assets and the proceeds thereof from the issuing SPE, rather than a true sale, provides sufficient comfort that the property and the proceeds thereof would be available to make timely payments on the rated securities. The grant of a security interest serves to reduce the incentive of the equity holders to voluntarily file a bankruptcy petition against the issuing SPE (an integral component of SPE criteria).

True Sale Opinion, Security Interest Opinion, or Either/Or Opinion; Debt Security Interest Opinion. To obtain legal comfort regarding the above, in a one-tier transaction involving an SPE transferor, one of the following is generally requested:

- A true sale opinion,
- A security interest opinion, or
- An either/or opinion in connection with such transfer.

In addition, if the rated securities are debt of the issuing SPE, to obtain legal comfort that the indenture trustee/custodian has obtained, or will have obtained following the taking of certain actions required by the transaction documents, a first priority perfected security interest in such property and the proceeds thereof, a debt security interest opinion to that effect will generally be requested.

Entity Status Opinion/Involuntary Filing Opinion. If the status of an entity as a municipality is unclear, to obtain legal comfort, an “entity status opinion” to the effect that the entity would be deemed to be a municipality under the Bankruptcy Code may be requested.

Similarly, if the status of an entity as one deemed not to be a “moneyed, business, or commercial corporation” is unclear, to obtain legal comfort, an “involuntary filing opinion” to the effect that the entity may not be involuntarily filed by its creditors under the Bankruptcy Code may be requested.

Criteria Relating to the Tax Status of the Issuing SPE. To obtain comfort that the assets would not be needed to pay taxes of the issuing SPE, thereby depleting the funds available to make payments on the rated securities, an entity-level tax opinion to the effect that the issuing SPE would not be subject to federal tax or to state or local tax in the applicable jurisdictions is generally requested. Without this opinion, additional credit enhancement might be required to cover any potential taxes of the issuing SPE.

Two-Tier Transactions

A municipality or public-purpose entity, as transferor of assets in a structured transaction, may choose, for accounting, tax or other reasons, a two-tier transaction structure in which it transfers the assets to an intermediate SPE, and the intermediate SPE transfers the assets directly to the issuing SPE, which issues the rated securities. In two-tier transactions involving SPE transferors, either tier would be permitted to constitute either a true sale or the grant of a first priority perfected security interest in the assets and the proceeds thereof to the intermediate SPE or the issuing SPE. If an SPE transferor chooses a two-tier transaction structure, the criteria for the second tier are identical to its criteria for a one-tier transaction involving an SPE transferor.

Non-Code Transferors

Neither banks nor insurance companies are eligible to become debtors under the Bankruptcy Code. As such, the various sections of the Bankruptcy Code discussed in Chapter One do not apply to asset transfers in structured transactions in which either a bank or an insurance company functions as the transferor.

Both banks and insurance companies may, however, become insolvent, and, therefore, unlike SPE transferors, are not deemed to be bankruptcy remote. As such, the criteria for structured transactions involving either banks or insurance companies as transferors are somewhat different from its criteria for SPE transferors, since in the case of banks and insurance companies, the criteria seek to insulate the structured transaction from the consequences of the bank's or the insurance company's insolvency, albeit not under the Bankruptcy Code.

FDIC-Insured Banks

Bank insolvency regimes vary, depending on whether the bank is a national or state-chartered financial institution and whether it is insured by the U.S. Federal Deposit Insurance Corp. (FDIC). Interrelated criteria for structured transactions involving "FDIC-insured banks" as transferors follows.

One-Tier Transactions. An FDIC-insured bank generally chooses a one-tier transaction structure and does not interpose an intermediate SPE between the bank and the issuing SPE. As a general matter, rather than a true sale, as described further below, the grant of a first priority perfected security interest in assets from an FDIC-insured bank as transferor in a one-tier transaction provides sufficient comfort with the timely availability of the assets to pay the holders of the rated securities.

Federal Deposit Insurance Act. Under Section 11(c)(3)(A) of the Federal Deposit Insurance Act (FDIA), the FDIC is authorized to accept appointment as receiver or conservator for an insured state depository institution. Also, under Section 11(c)(1) and (2) of the FDIA, the FDIC is authorized to accept appointment as conservator and is required to be appointed as receiver for a national bank. The criteria for

transactions in which either an FDIC-insured state-chartered bank or a national bank serves as a transferor addresses the powers of the FDIC under the relevant provisions of the FDIA should such bank become insolvent.

Unlike the Bankruptcy Code, the FDIA does not contain an automatic stay provision. However, the FDIC, in its capacity as receiver or conservator of the insolvent institution, has expansive powers, including the power to ask for a judicial stay of all payments and/or to repudiate any contract. To provide for greater flexibility in securitized transactions, however, the FDIC has stated that it would not seek to avoid an otherwise legally enforceable and perfected security interest so long as the following conditions are met:

- The security agreement evidencing the security interest is in writing, was approved by the board of directors of the bank or its loan committee (this approval is reflected in the minutes of a meeting of the bank's board of directors or committee), and has been, continuously, from the time of its execution, an official record of the bank (this condition, essentially codified in Section 13(e) of the FDIA, is based on the holding of the U.S. Supreme Court in *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447 (1942));
- The security agreement evidencing the security interest was undertaken in the ordinary course of business, not in contemplation of insolvency, and with no intent to hinder, delay, or defraud the bank or its creditors;
- The secured obligation represents a bona fide and arm's-length transaction;
- The secured party or parties are not insiders of or affiliates of the bank; and
- The grant of the security interest was made for adequate consideration.

Based on this advice, if a structured transaction involving the transfer of assets from an FDIC-insured bank complies with the above conditions, a security interest granted by the bank in the assets should not be avoidable in the event of the bank's insolvency.

Additional comfort comes from a letter written by the General Counsel of the FDIC, commonly referred to as the "Douglas letter," stating that the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), which revised federal law relating to bank conservatorships and receiverships, does not contain an automatic stay provision similar to that found in the Bankruptcy Code and that a secured creditor of an FDIC-insured bank for which a receiver had been appointed may, on the conditions set forth below, undertake to liquidate the creditor's properly pledged collateral by commercially reasonable self-help methods. The conditions include the following:

- That no involvement of the receiver was required;
- That there was a default, other than through an *ipso facto* provision; and
- That the transaction was an arms-length, bona fide transaction, not involving an affiliate or insider, which would pass muster under appropriate fraudulent conveyance law or other applicable law and which involved a legally perfected security interest enforceable under other applicable law.

However, the General Counsel also stated in the Douglas letter that if some action is required by the receiver or liquidation would require judicial action, then the claims process in FIRREA would have to be followed.

FDIC/D'Oench opinion. To obtain legal comfort regarding the above, in connection with the grant of a first priority perfected security interest in assets and the proceeds thereof from a bank governed by the FDIA directly to the issuing SPE in a one-tier transaction (in addition to a security interest opinion or either/or opinion discussed below), an “FDIC/D'Oench opinion” to the effect that the above listed conditions have been satisfied and, thus, such security interest would not be subject to avoidance if the FDIC were appointed as a receiver or conservator of the bank is generally necessary.

True Sale or First Priority Perfected Security Interest. Because of the FDIC advice stated above, in a one-tier transaction in which an FDIC-insured bank serves as transferor, the transfer to the issuing SPE is not necessary to constitute a true sale. A pledge of assets from an FDIC-insured bank provides sufficient comfort that the assets would be available to make timely payments on the rated securities.

Therefore, rather than requiring a true sale, the necessary comfort level can be achieved if the issuing SPE makes a loan to the bank and obtains a first priority perfected security interest in the assets and the proceeds thereof, enforceable notwithstanding the insolvency of the bank.

In addition, if the rated securities are debt of the issuing SPE the indenture trustee/custodian should obtain a first priority perfected security interest in the assets and the proceeds thereof. Since the issuing SPE is deemed to be bankruptcy remote, a pledge of assets and the proceeds thereof from the issuing SPE, rather than a true sale, provides sufficient comfort that such property and the proceeds thereof would be available to make timely payments on the rated securities.

True sale opinion, security interest opinion or either/or opinion; debt security interest opinion. To obtain legal comfort regarding the above, in a one-tier transaction involving an FDIC-insured bank, in addition to the FDIC/D'Oench opinion discussed above, a true sale opinion, a security interest opinion, or an either/or opinion will be requested.

In addition, if the rated securities are debt of the issuing SPE, to obtain legal comfort that the indenture trustee/custodian has obtained, or will have obtained following the taking of certain actions required by the transaction documents, a first priority perfected security interest in such property and the proceeds thereof, a debt security interest opinion to that effect will be requested.

Criteria Relating to the Tax Status of the Issuing SPE. To obtain comfort that the assets would not be needed to pay taxes of the issuing SPE, thereby depleting the funds available to make payments on the rated securities, an entity-level tax opinion to the effect that the issuing SPE would not be subject to federal tax or to state or

local tax in the applicable jurisdictions will be requested. Without this opinion, additional credit enhancement might be necessary to cover any potential taxes of the issuing SPE.

Two-Tier Transactions. An FDIC-insured bank, as transferor of assets in a structured transaction, may choose, for bank regulatory, accounting, tax, or other reasons, a two-tier transaction structure in which it transfers the assets to an intermediate SPE, and the intermediate SPE transfers the assets directly to an issuing SPE, which issues the rated securities. In two-tier transactions from FDIC-insured banks, either tier would be permitted to constitute either a true sale or the grant of a first priority perfected security interest in the assets and the proceeds thereof to the intermediate SPE or the issuing SPE. If an FDIC-insured bank chooses a two-tier transaction structure, the criteria for the second tier are identical to its criteria for a one-tier transaction involving an FDIC-insured bank.

Nonconsolidation. Regarding nonconsolidation, if a transaction from an FDIC-insured bank is structured as a one-tier (with a true sale) or a two-tier (with a true sale at the first tier and a first priority perfected security interest at the second tier), a nonconsolidation opinion between the FDIC-insured bank and the intermediate SPE or the issuing SPE may not be necessary, provided that the rated securities constitute debt of the issuing SPE and, in connection with the true sale opinion, two opinions are delivered: an “alternative security interest opinion” to the effect that, if a court did not consider the purported true sale transfer to be a true sale, it would be a grant of a first priority perfected security interest by the bank to the intermediate SPE or issuing SPE; and an FDIC/D’Oench opinion.

Non-FDIC-Insured Banks

Insolvency of a “non-FDIC-insured bank” is generally governed by state law, and it is beyond the scope of this publication to examine and differentiate state insolvency regimes for state-chartered non-FDIC-insured banks. The principles of securitization discussed throughout this publication and the criteria regarding other types of transferors, however, can be used to derive the criteria for structured transactions from non-FDIC-insured banks; that is, the assets should be sufficiently separated that, as a legal matter, in an insolvency of the non-FDIC-insured bank they are available in a timely manner to pay principal and interest on the rated securities. Legal opinions, regarding the treatment of the asset transfer in an insolvency of the non-FDIC-insured bank, including any possible stay on enforcement, avoidance, rejection, disaffirmance, or set-off issues generally are necessary.

Transactions With Comfort From State Banking Regulator. Because state laws governing state-chartered non-FDIC-insured banks differ, transactions structured from these banks tend to vary. If the state banking regulator in the state of incorporation of the non-FDIC-insured bank is able to issue comfort along the lines of the

FDIC regarding FDIC-insured banks, for example, that a first priority perfected security interest granted by the non-FDIC-insured bank would be respected by the state's banking regulator, notwithstanding the bank's insolvency, and a "non-FDIC-insured bank opinion" is received to that effect, a non-FDIC-insured bank may be able to structure a transaction *either* as a one-tier transaction (with either a true sale from the bank to the issuing SPE or the grant of a first priority perfected security interest from the bank to the issuing SPE), *or*, alternatively, as a two-tier transaction (with either tier structured as a true sale or a first priority perfected security interest). If the state banking insolvency law provides for an automatic stay, the transaction may need to be structured as a true sale. Alternatively, a secured loan transaction may be acceptable if the duration of the stay is specified by statute and the transaction includes a liquidity facility to cover the timing delay.

Opinion requirements. In these cases, the criteria and opinion requirements for transactions involving state-chartered non-FDIC-insured banks as transferors are the same as its criteria for transactions involving FDIC-insured banks as transferors (with the non-FDIC-insured bank opinion being required whenever an FDIC/D'Oench opinion would have been required for FDIC-insured banks).

Transactions Without Comfort From State Banking Regulator. If, on the other hand, no comfort from the appropriate state banking regulator is available, transactions from non-FDIC-insured banks would be required to be structured with a true sale, either as a two-tier transaction (with the first tier consisting of a true sale to an intermediate SPE that would not be consolidated with the non-FDIC-insured bank, and the second tier either as a true sale or the grant of a first priority perfected security interest), or as a one-tier transaction constituting a true sale.

Opinion requirements. In these cases, the criteria and opinion requirements for transactions involving state-chartered non-FDIC-insured banks as transferors are the same as its criteria for transactions involving Code transferors, including its requirement for comfort regarding nonconsolidation (*see Nonconsolidation below*) between the non-FDIC-insured bank and the intermediate SPE or the issuing SPE.

Nonconsolidation. Although the doctrine of substantive consolidation is an equitable doctrine under the Bankruptcy Code and a bank is not eligible to become a debtor under the Bankruptcy Code, it would be legally possible for a state banking regulator, as the receiver or conservator for an insolvent bank, to administer jointly a substantively consolidated insolvency proceeding for the bank and another entity in which the bank holds a 50% or more equity or other interest. Based on this, if a first-tier transfer to an intermediate SPE from a non-FDIC-insured bank is structured as a true sale (and the second tier is a grant of a first priority perfected security interest), the facts and circumstances of the relationship between the intermediate SPE and the bank in terms of the separateness covenants will be reviewed to determine if there is a risk of substantive consolidation of the intermediate SPE, or its assets and liabilities,

with the bank. Because of the lack of legal certainty in analyzing consolidation in a bank insolvency, the structure may need to use an orphan SPE.

Nonconsolidation opinion. To obtain legal comfort regarding the above, if the first-tier transfer from a non-FDIC-insured bank is structured as a true sale (because the relevant bank regulator is unable to provide the comfort, as discussed above, that a grant of a first priority perfected security interest from the bank would be enforceable, notwithstanding the bank's insolvency), and it is determined that there is a risk of consolidation of the intermediate SPE, or its assets and liabilities, with its parent (whether the bank or another entity) a nonconsolidation opinion stating that, under applicable insolvency laws, upon an insolvency of the SPE's parent, the intermediate SPE, or its assets and liabilities, would not be substantively consolidated with the SPE's parent may be necessary.

If, however, a transaction from a non-FDIC-insured bank is structured as a true sale, and *both* an alternative security interest opinion to the effect that, if a court did not consider the purported true sale transfer to be a true sale, it would be a grant of a first priority perfected security interest by the bank to the intermediate SPE or the issuing SPE *and* a non-FDIC-insured bank opinion are received, a nonconsolidation opinion usually is not necessary.

Insurance Companies

Insolvency of an insurance company is generally governed by state law, administered by the insurance commissioner or superintendent of the state. Although the National Association of Insurance Commissioners has promulgated a uniform insolvency act, the act has not been enacted uniformly in all states, and it is beyond the scope of this publication to examine and differentiate state insolvency regimes for insurance companies. In addition, the act leaves broad discretion to state commissioners in the conduct of insolvency proceedings. The principles of securitization discussed throughout this publication and the criteria regarding other types of transferors, however, can be used to derive, in general, the criteria for structured transactions from insurance companies; that is, the assets should be sufficiently separated that, as a legal matter, in an insolvency of the insurance company they are available in a timely manner to pay principal and interest on the rated securities. Standard & Poor's will generally need comfort, including legal opinions, regarding the treatment of the asset transfer in an insolvency of the insurance company, including any possible stay on enforcement, avoidance, rejection, disaffirmance or set-off issues.

Transactions With Comfort From State Insurance Commissioner or Superintendent. Because state laws governing insurance companies differ, transactions structured from insurance companies tend to vary. If the state insurance commissioner or superintendent in the state of incorporation of the insurance company is able to issue comfort along the lines of the FDIC regarding FDIC-insured banks, for example,

that a first priority perfected security interest granted by the insurance company would be respected by the state's insurance commissioner or superintendent, notwithstanding the insurance company's insolvency, and an "insurance law opinion" is received to that effect, an insurance company may be able to structure a transaction either as a one-tier transaction (with either a true sale from the insurance company to the issuing SPE or the grant of a first priority perfected security interest from the insurance company to the issuing SPE), or, alternatively, as a two-tier transaction (with either tier structured as a true sale or a first priority perfected security interest).

Opinion requirements. In these cases, the criteria and opinion requirements for transactions involving insurance companies as transferors are the same as its criteria for transactions involving FDIC-insured banks as transferors (with the insurance law opinion being required whenever an FDIC/D'Oench opinion would have been required for FDIC-insured banks).

Transactions Without Comfort From State Insurance Commissioner or Superintendent. If, on the other hand, no comfort from the appropriate state insurance commissioner or superintendent is available, transactions from insurance companies would be required to be structured with a true sale, either as a two-tier transaction (with the first tier consisting of a true sale to an intermediate SPE that would not be consolidated with the insurance company, and the second tier either as a true sale or the grant of a first priority perfected security interest), or as a one-tier transaction constituting a true sale.

Opinion requirements. In these cases, the criteria and opinion requirements for transactions involving insurance companies as transferors are the same as its criteria for transactions involving Code transferors, including its requirement for comfort regarding nonconsolidation (*see Nonconsolidation below*) between the insurance company and the intermediate SPE or the issuing SPE.

Nonconsolidation. Although the doctrine of substantive consolidation is an equitable doctrine under the Bankruptcy Code and an insurance company is not eligible to become a debtor under the Bankruptcy Code, it would be legally possible for a state insurance commissioner or superintendent, as the receiver or conservator for an insolvent insurance company, to administer jointly a substantively consolidated insolvency proceeding for the insurance company and another entity in which the insurance company holds an equity or other interest.

Based on this, if a first-tier transfer to an intermediate SPE from an insurance company is structured as a true sale (and the second tier is a grant of a first priority perfected security interest), the facts and circumstances of the relationship between the intermediate SPE and the insurance company in terms of the separateness covenants will be used to determine if there is a risk of substantive consolidation of the intermediate SPE, or its assets and liabilities, with the insurance company. Because

of the lack of legal certainty in analyzing consolidation in an insurance company insolvency, the structure may need to use an orphan SPE.

Nonconsolidation opinion. To obtain legal comfort regarding the above, if the first-tier transfer from an insurance company is structured as a true sale (because the relevant insurance commissioner or superintendent is unable to provide the necessary comfort, as discussed above, that a grant of a first priority perfected security interest from the insurance company would be enforceable, notwithstanding the insurance company's insolvency), and it is determined that there is a risk of consolidation of the intermediate SPE, or its assets and liabilities, with its parent (whether the insurance company or another entity), a nonconsolidation opinion stating that, under applicable insolvency laws, upon an insolvency of the SPE's parent, the intermediate SPE, or its assets and liabilities, would not be substantively consolidated with the SPE's parent may be requested.

If, however, a transaction from an insurance company is structured as a true sale, and provides *both* an alternative security interest opinion to the effect that, if a court did not consider the purported true sale transfer to be a true sale, it would be a grant of a first priority perfected security interest by the insurance company to the intermediate SPE or the issuing SPE *and* an insurance law opinion, a nonconsolidation opinion may not be necessary.

Special-Purpose Entities

General

The legal criteria for securitization transactions are designed to ensure that the entity owning the assets required to make payments on the rated securities is bankruptcy remote, that is, is unlikely to be subject to voluntary or involuntary insolvency proceedings. In this regard, both the incentives of this entity, known as a special-purpose entity or an SPE, or its equity holders to resort to voluntary insolvency proceedings and the incentives for other creditors of the SPE to resort to involuntary proceedings are considered. The analysis also examines whether third-party creditors of the SPE's parent would have an incentive to reach the assets of the SPE (for example, if the SPE is a trust, whether creditors of the beneficial holder would have an incentive to cause the dissolution of the trust to reach the assets of the trust.)

The Characteristics of Bankruptcy Remoteness

In this regard, the following "SPE criteria," which an entity should satisfy to be deemed bankruptcy remote, has been developed. An entity that satisfies these criteria is regarded as being sufficiently protected against both voluntary and involuntary insolvency risks:

- Restrictions on objects and powers,
- Debt limitations,
- Independent director,
- No merger or reorganization,
- Separateness, and
- Security interests over assets.

Each of these characteristics is important to the overall concept of bankruptcy remoteness and, regardless of the specific organizational structure of the SPE, these elements should, generally, be treated in the relevant organizational documents. Their rationale is briefly explained below, while the precise terms of these criteria are found in the following section.

Restriction on Objects and Powers

The fundamental SPE characteristic is that the entity's objects and powers be restricted as closely as possible to the bare activities necessary to effect the structured transaction. The purpose of this restriction is to reduce the SPE's internal risk of insolvency due to claims created by activities unrelated to the securitized assets and the issuance of the rated securities.

In structured transactions, it is generally requested that the SPE embed in its organic document of establishment (articles/certificate of incorporation for corporations, deed of partnership/partnership agreement for limited partnerships, articles of organization for limited liability companies (LLCs) or deed of trust/trust agreement for trusts, etc.) an objects clause that constrains the SPE to those activities needed to ensure the sufficiency of cash flow to pay the rated securities and powers incidental to this purpose.

The organic documents are the preferred locus for this constraint (as well as the other SPE restrictions discussed below) for two reasons. First, these documents are publicly available and provide some measure of public notice of the restriction, rather than merely notice to the parties to a particular transaction. Second, an organic restriction is less likely to become lost in the corporate files and more likely to remind the management of the SPE to act in accordance with its charter. It is generally requested that, where possible, this limited objects clause, as well as the other SPE criteria, be reiterated in appropriate transaction documents.

In brief, the SPE should not engage in unrelated business activities unless the parties to a transaction are willing to allow the rating to reflect the effect of these activities on the entity's resources, cash flows, and the ability to pay the entity's obligations in a full and timely manner.

Debt Limitations

An SPE should be restricted from issuing other debt except in circumstances that are consistent with the rated issuance. For example, an SPE may issue multiple classes of debt as long as the classes all have the same issue credit rating and, if any class' rating is downgraded, the rating of the other classes will be similarly downgraded (or the SPE complies with Standard & Poor's segregation of assets criteria). In some cases, the SPE may be able to issue subordinated nonrecourse debt that is related to the rated issuance. Because creditors can file involuntary petitions against an entity, determining whether an entity is bankruptcy remote (thus an SPE) involves analyzing the likely creditors of the SPE and their incentives to reach the assets supporting the rated securities.

The thrust of additional debt criteria is to ensure that a holder of additional indebtedness would be unable to affect the creditworthiness of the SPE and would be unable or unwilling to file the SPE (because there is no recourse to the SPE and the holder is subordinated to the rated securities), or, alternatively, the risk to the SPE would be no greater than that posed by the original issue (because the additional debt is rated at least as high). In this regard, nonpetition language is sought in any agreement between the SPE and its creditors whereby the creditors agree not to file the SPE into bankruptcy and not to join in any bankruptcy filing.

The Independent Director

An SPE acts through its board of directors, general partner, management committee or managing member. For example, corporate activity is conducted at the direction and under the supervision of the board, although day-to-day management of the corporation is generally delegated by the board to the corporation's officers. The directors are elected by the shareholders, the corporation's owners.

Among the major decisions taken by the board of directors is the decision to file the corporation into bankruptcy, and it is this concern that prompts a request for the "independent director." In many structured transactions, the SPE is established by a non-SPE operating entity parent. This parent is, at times, either unrated or has an "issuer credit rating" below its SPE subsidiary. Moreover, the directors of the parent may well serve as the directors for the SPE. These interlocking directorates present a potential conflict of interest. If the parent becomes insolvent in a situation where the SPE is performing adequately, there may be an incentive for the parent entity to voluntarily file the SPE into bankruptcy and consolidate its assets with those of the parent. If the SPE has at least one director who is independent from the parent and this director's vote is required in any board action seeking bankruptcy protection for the SPE or the amendment of the organic documents of the SPE, the SPE is unlikely to voluntarily file an insolvency petition. It is requested that, where possible, the organic documents of the SPE recite that, in voting on bankruptcy

matters, the independent director take into account the interests of the holders of the rated securities, as well as those of the stockholders. This approach is designed to provide additional protection against the SPE being filed into bankruptcy. In cases where an SPE is a limited partnership or an LLC, it is requested that a general partner or a member be constituted as an SPE, usually a corporation, with an independent director.

No Merger or Reorganization

This requirement ensures that, while the rated securities are outstanding, the bankruptcy-remote status of the SPE will not be undermined by any merger or consolidation with a non-SPE or any reorganization, dissolution, liquidation, or asset sale. Also it is requested that the SPE not amend its organizational documents without prior written notice to Standard & Poor's.

Separateness Covenants

Separateness covenants are designed to ensure that the SPE holds itself out to the world as an independent entity, on the theory that if the entity does not act as if it had an independent existence, a court may use principles of piercing the corporate veil, alter ego, or substantive consolidation to bring the SPE and its assets into the parent's bankruptcy proceeding. The involvement of an overreaching parent is a threat to the independent existence of the SPE.

Piercing the corporate veil is the remedy exercised by a court when a controlling entity, such as the parent of an SPE, so disregards the separate identity of the SPE that their enterprises are seen as effectively commingled. The remedy is sought by creditors with claims against an insolvent parent who believe funds can be properly traced into the subsidiary. The alter ego theory is used when the subsidiary is a mere shell and all its activities are in fact conducted by the parent. Substantive consolidation is an equitable doctrine under the Bankruptcy Code that combines elements of both piercing the corporate veil and alter ego analyses. Successful motions for consolidation are based on this overly familiar relationship between parent and the subsidiary or partner and partnership.

An important element of the SPE analysis is the comfort that the SPE entity would not be consolidated with its parent. In this regard, the entity should observe certain separateness covenants, set forth in the following section. In addition, legal opinions to the effect that the SPE would not be consolidated with its parent are generally requested.

Security Interests Over Assets

There is a requirement that, in the case of the issuance of debt securities, the issuing SPE grant a security interest over its assets to the holders of the rated securities. In

connection with this grant, also a debt security interest opinion is necessary. This element helps analysts in reaching the conclusion that an issuer is in fact an SPE by reducing the incentives of the parent to involuntarily file the entity. By reducing the practical benefit of an insolvency filing, the likelihood of voluntary insolvency is decreased.

SPE Criteria

General SPE Criteria

Based on the principles discussed above, the following criteria have been developed to help determine that an entity is an SPE.

1. The entity should not engage in any business or activity other than those necessary for its role in the transaction.
2. The entity (and, as applicable, its partners, members, and affiliates) should not engage in any dissolution, liquidation, consolidation, merger or asset sale, or amendment of its organizational documents as long as the rated securities are outstanding, unless Standard & Poor's provides written confirmation of any outstanding ratings.
3. The entity should not incur any debt (other than indebtedness that secures the rated securities) unless the additional debt is rated by Standard & Poor's at least as high as the issue credit rating requested for the rated securities in a given structured transaction, all of the entity's debt meets the segregation of assets criteria, or the additional debt:
 - Is fully subordinated to the rated securities,
 - Is nonrecourse to the entity or any of its assets other than cash flow in excess of amounts necessary to pay holders of the rated securities, and
 - Does not constitute a claim against the entity to the extent that funds are insufficient to pay such additional debt.
4. The entity should be qualified to do business under the applicable law in the state in which any assets are located.
5. The entity (and, as applicable, the entity's partners, members, and affiliates) should agree to abide by the following separateness covenants:
 - To maintain books and records separate from any other person or entity;
 - To maintain its accounts separate from those of any other person or entity;
 - Not to commingle assets with those of any other entity;
 - To conduct its own business in its own name;
 - To maintain separate financial statements;
 - To pay its own liabilities out of its own funds;

- To observe all corporate, partnership, or LLC formalities and other formalities required by the organic documents;
- To maintain an arm's-length relationship with its affiliates;
- To pay the salaries of its own employees and maintain a sufficient number of employees in light of its contemplated business operations;
- Not to guarantee or become obligated for the debts of any other entity or hold out its credit as being available to satisfy the obligations of others;
- Not to acquire obligations or securities of its partners, members, or shareholders
- To allocate fairly and reasonably any overhead for shared office space;
- To use separate stationery, invoices, and checks;
- Not to pledge its assets for the benefit of any other entity or make any loans or advances to any entity;
- To hold itself out as a separate entity;
- To correct any known misunderstanding regarding its separate identity; and
- To maintain adequate capital in light of its contemplated business operations.

SPE Corporations

In addition to the general SPE criteria set forth above, an SPE corporation should conform to the following additional criteria:

- The corporation should have at least one independent director.
- The unanimous consent of the directors, including that of the independent director(s), should be required to: (i) file, consent to the filing of, or join in any filing of, a bankruptcy or insolvency petition or otherwise institute insolvency proceedings; (ii) dissolve, liquidate, consolidate, merge, or sell all or substantially all of the assets of the corporation; (iii) engage in any other business activity; and (iv) amend the articles of incorporation of the corporation.
- The directors should be required to consider the interests of the corporation's creditors when making decisions.

Standard & Poor's generally requests nonconsolidation opinion(s).

SPE Limited Partnerships

In addition to the general SPE criteria set forth above, an SPE limited partnership should conform to the following additional criteria:

- At least one general partner of a limited partnership should be a bankruptcy-remote entity, usually an SPE corporation.
- The consent of the bankruptcy-remote general partner should be required to (i) file, consent to the filing of, or join in any filing of, a bankruptcy or insolvency petition, or otherwise institute insolvency proceedings; (ii) dissolve, liquidate, consolidate, merge, or sell all or substantially all of the assets of the partnership;

(iii) engage in any other business activity; and (iv) amend the limited partnership agreement.

- If there is more than one general partner, the limited partnership agreement should provide that the partnership will continue (and not dissolve) as long as another solvent general partner exists.
 - The general partner(s) should be required to consider the interests of the partnership's creditors when making decisions.
- Standard & Poor's generally requests nonconsolidation opinion(s).

SPE General Partners

An SPE general partner should meet all criteria set forth for SPE corporations, SPE limited partnerships or SPE LLCs, depending on whether the general partner is a corporation, a limited partnership, or an LLC.

SPE LLCs

In addition to the general SPE criteria set forth above, an SPE LLC should conform to the following additional criteria:

- At least one member of an LLC should be a bankruptcy-remote entity, usually an SPE. Generally, only the bankruptcy-remote member should be designated as the manager by the law under which the LLC is organized, and the LLC's articles of organization should provide that it will dissolve only on the bankruptcy of a managing member.
- The unanimous consent of the members, including the vote of the independent director of the bankruptcy-remote member, should be required to (i) file, consent to the filing of, or join in any filing of, a bankruptcy or insolvency petition or otherwise institute insolvency proceedings; (ii) dissolve, liquidate, consolidate, merge, or sell all or substantially all of the assets of the LLC; (iii) engage in any other business activity; and (iv) amend the LLC's organizational documents.
- The member(s) should be required to consider the interests of the entity's creditors when making decisions.
- To the extent permitted by tax law, the articles of organization should provide that, upon the insolvency of a member, the vote of a majority-in-interest of the remaining members is sufficient to continue the life of the LLC. If the required consent of the remaining members to continue the LLC is not obtained, its articles of organization must provide that the LLC not liquidate collateral (except as provided under the transaction documents) without the consent of the holders of rated securities. Such holders may continue to exercise all of their rights under the existing security agreements or mortgages and must be able to retain the assets until the rated securities have been paid in full or otherwise completely discharged. Standard & Poor's generally requests nonconsolidation opinions.

Standard & Poor's generally requests a tax opinion to the effect that the LLC will be taxed as a partnership and not as a corporation.

In connection with single-member LLCs, the criteria, at the time of publication, are still in the developing stage. Therefore, transferors intending to use a single-member LLC in a structured transaction are encouraged to check with Standard & Poor's regarding its single-member LLC criteria, including its opinion requirements.

SPE Trusts

Based on an analysis of Sections 101 and 109 of the Bankruptcy Code, only a trust that is determined to be a "business trust" under the Bankruptcy Code is eligible to become a debtor under the Bankruptcy Code. Thus, if the entity holding assets in a structured transaction is not a business trust for Bankruptcy Code purposes, there generally will be no concern about the entity's ability to make payments on the rated securities as a consequence of the entity's insolvency. In such a case, SPE criteria for bankruptcy remoteness would be inapplicable.

The term business trust, however, is not defined in the Bankruptcy Code. Rather, whether a particular trust will be determined to be a business trust for bankruptcy law purposes depends upon a very fact-specific analysis of the trust, focusing on factors such as the purposes, organization, and activities of the trust and whether the trust is a business trust under applicable state law or under the IRC.

In the absence of settled legal standards, the legal review assumes, as a general matter, that any trust, whether the trust is a state common law trust, a statutory business trust, or an owner trust, is eligible to become a debtor under the Bankruptcy Code. Therefore, to conclude that a trust is bankruptcy remote, the trust should meet the SPE criteria, including in the appropriate cases, nonconsolidation opinions.

In addition, in the case of state common law trusts, the trust agreement should provide that the bankruptcy of one or more of the beneficiaries of the trust will not result in the dissolution of the trust.

In some cases, comfort that a trust will not be subject to early termination may be warranted. In this regard, analysts may request a "trust opinion" to the effect that, under the law of the relevant state, the trust is irrevocable and that, under such state's law, no creditor of a beneficiary would have the right to terminate the trust and reach the assets and that no receiver, liquidator, or bankruptcy trustee would have any rights to the trust's assets greater than the rights of the beneficiaries of the trust.

Collateral-Specific Criteria

This section discusses the legal criteria that arise in part because of the specific nature of the collateral being securitized, i.e., reverse mortgage loans.

As stated above, as a general matter all necessary steps should be taken to perfect any sale of, or grant of a security interest in, the assets being securitized.

In structured reverse mortgage loan transactions, the assets backing the rated securities are made up of the original mortgage notes, the mortgages, all “mortgage-related documents,” (generally consisting of all mortgage assignments, modification and consolidation agreements, and the original title insurance policy), and related property, such as insurance policies. The mortgage notes evidence the debt and the mortgages evidence liens on the underlying mortgaged properties, including both the real property and any property permanently affixed as “fixtures.”

Under the laws of most states delivery of the original mortgage notes to the issuing SPE or indenture trustee/custodian, as applicable, is required to perfect the security interest in the notes and, as the mortgages evidence liens on the underlying mortgaged properties, recordation of mortgage assignments with the appropriate recording offices is required to perfect assignments of the mortgage liens on the underlying mortgaged properties. Recordation generally entitles the secured party to foreclose upon and sell the underlying mortgaged properties upon a payment default.

Based on the above, in structured reverse mortgage loan transactions, delivery of the original mortgage notes (endorsed in blank or in the name of the appropriate transferee) to the issuing SPE or indenture trustee/custodian, as applicable and recordation of all mortgage assignments are necessary. In addition, the original or certified copies of all mortgages and mortgage assignments, showing evidence of recordation, and all other mortgage-related documents should be delivered to the issuing SPE or indenture trustee/custodian, as applicable.

In connection with its requirement for delivery of the mortgage notes, Standard & Poor’s recognizes that *sales* of instruments, as opposed to pledges, are not governed by the UCC, but they are governed by the law of the state in which the property is located. As a general matter, if the transferor delivers the mortgage notes to the trustee, as set forth above, specific state sale opinions regarding the notes will not be necessary. This criterion is based on the belief that delivery of the mortgage notes would, at a minimum, be sufficient to perfect a sale under the laws of the relevant states (that is, potentially any state in which property is located).

Related to the above, in reverse mortgage loan transactions, true sale, either/or, security interest, and debt security interest opinions need opine only as to the mortgage notes and the proceeds thereof. Regarding the mortgages (which are governed by the real property laws of each of the states in which the mortgaged properties are located), comfort is derived from the fact that the issuing SPE or indenture trustee/custodian,

as applicable, has a first priority perfected lien on the underlying mortgaged properties because the mortgage assignments are recorded in the name of the issuing SPE or indenture trustee/custodian, as applicable. An opinion to this effect is generally not necessary.

In some states, delivery of a mortgage note alone, without recordation, is sufficient to transfer rights to the related mortgage, including foreclosure rights. As a general matter, in those “nonrecordation states,” recordation of the mortgage assignments is not necessary; provided, however, that for mortgages secured by mortgaged properties located within nonrecordation states, a state “nonrecordation opinion” (or memorandum of law) is typically requested stating that recordation is not required for transfer to the intermediate SPE or issuing SPE, as applicable, of a first priority perfected lien on the underlying mortgaged properties. However, all original mortgage notes (endorsed in blank or in the name of the appropriate transferee), mortgages, mortgage assignments (endorsed in blank or in the name of the appropriate transferee), and mortgage-related documents be delivered to the issuing SPE or indenture trustee/custodian, as applicable will still be required. For a limited percentage of mortgaged properties located within nonrecordation states (generally not more than 10% of the total pool of mortgages being securitized) and depending upon concentrations, the request for a nonrecordation opinion may be waived.

As an exception to the standard criteria, if a structured reverse mortgage transaction is insured by a financial guarantee insurance company *and* the transferor of the assets into the structured transaction is investment grade, recordation of the mortgage assignments (on the assumption that, if recordation in the name of the issuing SPE or indenture trustee/custodian becomes necessary, the “insurer” will cover the recordation expenses and also that the precipitous insolvency of an investment-grade issuer is unlikely) will not be necessary. In such circumstances, however, all original mortgage notes (endorsed in blank or in the name of the appropriate transferee), mortgages, mortgage assignments (endorsed in blank or in the name of the appropriate transferee), and mortgage-related documents for all mortgaged properties constituting part of the assets should be delivered to the issuing SPE or indenture trustee/custodian, as applicable. The transaction documents will provide that, if, at any time, the transferor’s rating falls below investment grade, all mortgage assignments should be recorded (except for mortgaged properties located within nonrecordation states, in which case, depending upon the concentration, a nonrecordation opinion may be requested). Any true sale, security interest, either/or, and debt security interest opinion delivered in a structured insured residential mortgage loan transaction involving an investment-grade transferor should state that, upon delivery of the mortgage notes, the transferee will have either all of the transferor’s right, title, and interest in the

mortgage notes (in the case of a sale) or a first priority perfected security interest in the notes (in the case of a pledge), and upon recordation of the mortgage assignments, the transferee would have a first priority perfected lien on the underlying mortgaged properties.

If a transferor in a structured reverse mortgage loan transaction seeks a weak-link-dependent issue credit rating, that is, one that is no higher than the issuer credit rating of any of the transaction participants, analysts will request *neither* recordation of the mortgage assignments *nor* delivery of the original mortgage notes, mortgages, mortgage assignments, or mortgage-related documents and, consequently, no delivery of a security interest, either/or, or debt security interest opinion.

If, however, the transferor's issuer credit rating falls below the issue credit rating of the rated securities, analysts generally will request:

- That all mortgage assignments be recorded (except for mortgaged properties located within nonrecordation states, in which case, depending upon the concentration, a nonrecordation opinion may be required);
- Delivery of all original mortgage notes (endorsed in blank or in the name of the appropriate transferee), mortgages, mortgage assignments (showing evidence of recordation), and mortgage-related documents to the issuing SPE or indenture trustee/custodian, as applicable; and
- Delivery of a security interest, either/or, or debt security interest opinion, as applicable, to the effect that the issuing SPE or indenture trustee/custodian, as applicable, has either all of the transferor's right, title, and interest in the mortgage notes (in the case of a sale) or a first priority perfected security interest in the mortgage notes (in the case of a pledge).

Criteria Relating to Various Forms of Credit Enhancement

Credit enhancement can take many forms in structured finance, most of which trigger the application of specific criteria.

Cash collateral accounts (CCA), collateral investment amounts (CIA), and reserve accounts are frequent choices for enhancement in structured transactions. A CCA or a CIA is typically provided for in a loan agreement among the provider, the issuing SPE, the intermediate SPE, and the original transferor into the securitization structure. Analysts look for nonpetition language in the loan agreement, whereby the provider agrees not to file any intermediate SPE and the issuing SPE into bankruptcy and not to join in any bankruptcy filing, and for clear language as to the subordinated position of the provider. An "enforceability opinion" that the loan agreement is the legal, valid, and binding obligation of the provider, enforceable in accordance with its terms may be requested. To the extent the provider is a U.S. branch or division of a non-U.S. institution, analysts will generally request a "home country enforceability

opinion” under the law of the country where the non-U.S. institution’s head office is located, addressing the enforceability of the obligation against the non-U.S. institution, among other matters.

To the extent that a transaction relies on funds invested under an investment agreement with a rated entity, the opinions described above in connection with the use of a CCA or CIA may be requested. The investment agreement should not contain any provisions that would relieve the institution from its obligation to pay. In both cases, the issuer credit rating of the provider must be consistent with the issue credit rating of the transaction.

If credit enhancement takes the form of a reserve fund or account, the transfers of funds deposited in the account will be subject to review. To the extent that monies other than proceeds of the rated securities are used to fund the account, it may be necessary to provide a preference opinion to the effect that the funds transferred and the related payments to the holders of the rated securities would not be recoverable as a preference under Section 547(b) of the Bankruptcy Code. It also may be necessary to deliver a fraudulent conveyance opinion to the effect that the funds transferred and related payments would not be deemed a fraudulent conveyance under state and federal laws. In addition, if the reserve account is kept in the name of a party other than the issuing SPE or indenture trustee/custodian, as applicable, the owner of the reserve account must grant a first priority perfected security interest in the account to the issuing SPE and deliver a security interest, either/or, and debt security interest opinion, as applicable.

Moreover, all credit enhancement funds must be held in accordance with the criteria for eligible deposit accounts (*see Criteria Related to the Trustee, the Servicer, and the Custodian; Criteria Related to Eligible Deposit Accounts; Criteria Related to Eligible Investments*).

Criteria Related to Retention of Subordinated Interests by Transferor in a True Sale

In certain circumstances, it is not possible to rely on the characterization of a transaction as a true sale even though the parties to the transaction are comfortable that they have achieved a true sale and counsel is willing to deliver a true sale opinion as defined by the criteria. For example, analysts will generally not rely on true sale opinions if the transferor takes back a subordinated interest in assets that, in Standard & Poor’s opinion, do not have an adequate capacity to pay principal and interest on the subordinated interest. This subordinated interest may be in the form of a deferred purchase price, subordinated note, or subordinated certificates. Similarly, analysts generally will not rely on true sale opinions if the transferor guarantees payments significantly higher than reflected by the level of historical losses on the assets

being sold. Although these transactions may actually be true sales, they have a higher likelihood of being recharacterized as secured loan transactions.

In structured transactions in which the securities issued are rated 'AAA', the assets should be able to withstand severe economic stress scenarios. Thus, the value of the assets purchased will be in excess of the amount of rated securities issued. On the other hand, to avoid fraudulent conveyance concerns, the purchase price should reflect the fair market value of the assets. The balance required to pay the purchase price may be contributed as capital to the SPE. Alternatively, the SPE, regardless of whether it is a subsidiary of the transferor, may use a subordinated promissory note to cover the balance of the purchase price of the assets. The subordinated note permits the deferral of the payment of a portion of the purchase price until the SPE has funds available for the payment. Payment is usually made in accordance with a schedule based upon anticipated cash flow on the assets.

In other instances, a transferor may retain a subordinated interest in a senior/subordinated transaction characterized by the subordination of certain certificates to serve as credit support for the senior certificates. (More complex transactions involve multiple levels of subordination and also may be structured to contain reserve funds and/or insurance policies to provide credit support for certain enhanced classes of subordinated certificates.) In these instances, the SPE usually sells the senior certificates and the enhanced subordinated certificates either to the public through an underwriter or through a private placement offering and transfers the unenhanced subordinated certificates to the transferor as partial consideration for the sale of the assets.

When a transferor takes back either a subordinated note or subordinated certificates (either in partial payment for the assets that are sold or otherwise) or guarantees payment on the sold assets, the sale from the transferor to the intermediate SPE (or directly to the issuing SPE) can be undermined. The transferor could arguably be said not to have fully divested itself of all rights to the assets (one of the legal tests of ownership) by holding the subordinated note or subordinated certificates or by guaranteeing payment on the assets. A court could view and recharacterize the transfer of assets and the holding of the subordinated note or subordinated certificates or the making of the guarantee as a financing by the transferor (secured by a pledge of or lien on the assets), rather than a true sale of such assets. The use of a subordinated note or retention by the transferor of subordinated certificates (or the provision of a guarantee) may be viewed as recourse retained by the transferor, that is, that the transferor has not transferred all of the risks and benefits of owning the assets because, to be repaid, the transferor is dependent on the performance of the assets.

Accordingly, analysts will evaluate the likelihood of repayment of the subordinated note or payment of the retained subordinated certificates (or the likelihood of the need for the guarantee) in adequately stressed economic conditions to get comfort that no recourse was retained by the transferor. The subordinated note or retained

subordinated certificates should be shadow rated on a pool default analysis, that is, without regard to possible dilutions in the pool, at an investment-grade level. In the case of a retained subordinated note, analysts typically focus on, among other things, the amount of equity that is contributed to the SPE and is available for payment of the subordinated note. This approach provides additional comfort that the risks and benefits analysis (because of the likely repayment of the subordinated note or payment of the retained subordinated certificates) would result in the transaction being deemed a sale.

In many cases, the transaction can be structured in an acceptable manner or the transaction can be analyzed under a blended rating approach (relying in part on the issuer credit rating of the parent). In some situations, the transferor may hold the subordinated note or subordinated certificates if they represent only a small portion of the assets or if the retained subordinated certificates constitute a strip or non-economic residual. Alternatively, the transferor may retain subordinated certificates if it represents that it intends to resell the retained subordinated certificates. If the transferor retains all of the securities issued in a structured transaction, the true sale opinion should state that when the securities are sold to a third party, the transfer of assets by the transferor will be deemed a true sale, except for any portion remaining with the transferor.

In other cases, an affiliate (either a wholly owned subsidiary or a sister company of the transferor) may hold the subordinated certificates or subordinated note. The affiliate may or may not be an SPE. If the affiliate is newly created solely for the purpose of holding the subordinated certificates or subordinated note, there is an increased concern that the affiliate is really the transferor. In such circumstances, in addition to the opinions otherwise required by the transaction structure, analysts will request a nonconsolidation opinion to the effect that the affiliated entity holding the subordinated certificates or subordinated note would not be consolidated with the transferor in the event of the latter's bankruptcy.

Swap Opinion Criteria

Structured finance transactions frequently include swap agreements that transform the cash flow characteristics of an issuing SPE's assets into payment terms desired by investors in the rated securities. For example, interest payments on a specified principal amount of the issuing SPE's assets may be calculated based on a fixed rate and denominated in a non-U.S. currency. Investors in the rated securities may be willing to accept the credit risk of the asset but desire payments calculated based on a margin above a specified index and denominated in U.S. currency. In this event, the issuing SPE would enter into an agreement with a swap counterparty providing that the fixed rate, non-U.S. currency payments that the issuing SPE receives on the assets

will be paid to the swap counterparty in return for the swap counterparty's floating-rate payments to the issuing SPE in U.S. currency. The issuing SPE will make its payments on the rated securities from the payments received from the swap counterparty.

In this example, the issue credit rating would depend on the issuer credit rating of the swap counterparty and on the issue credit rating of the issuing SPE's assets. If the swap counterparty does not have an issuer credit rating or has an issuer credit rating that is lower than the issue credit rating sought for the transaction, its obligations must be guaranteed by an affiliate or another entity of sufficient credit quality to attain the desired rating.

In transactions where the issue credit rating is dependent on a swap agreement and guarantee, if any, the following legal opinions are requested for the swap counterparty and guarantor, as applicable, under the law of the jurisdiction of organization of the relevant entity and under the governing law of the swap agreement and guarantee, as applicable:

- An enforceability opinion in connection with the swap agreement and guarantee against the swap counterparty and the guarantor, as applicable, according to their respective terms;
- A “pari passu opinion” stating that payments due under the swap agreement and the guarantee, as applicable, rank at least pari passu with the unsecured and unsubordinated obligations of the swap counterparty and the guarantor, as the case may be;
- A “choice of law opinion” stating that local courts in the jurisdictions of the swap counterparty and the guarantor, as applicable, would recognize the choice of law in the swap agreement and the guarantee, as the case may be, and the choice of law is prima facie valid and binding under such local law;
- A “recognition of claim opinion” stating that local courts in the jurisdictions of the swap counterparty and the guarantor, as applicable, would recognize and enforce as a valid judgment any final and conclusive civil judgment of a court of competent jurisdiction for monetary claims made under the swap agreement and the guarantee, as the case may be;
- If payments to the holders of the rated securities may be affected by the subsequent imposition of taxes on payments made by the swap counterparty or the guarantor under the swap agreement or guarantee, as the case may be, a “swap counterparty/guarantor tax opinion” stating that, under current law, no such tax applies and that there is no pending legislation to create such a tax; and
- If payments to the holders of the rated securities may be affected by the subsequent imposition of taxes on payments made by the issuing SPE under the swap agreement, an “issuing SPE swap tax opinion” confirming that under current law no such tax applies and that there is no pending legislation to create such a tax.

The enforceability opinion described above may be waived for swap counterparties and guarantors if similar opinions have been received under the same governing law in similar transactions.

Interim Criteria for the Tenth Circuit Court of Appeals Eliminated

Based upon the decision of the Tenth Circuit Court of Appeals in *Octagon Gas System Inc. v. Rimmer*, 1993 U.S. App. Lexis 12423 (Tenth Cir. May 27, 1993) in June 1993, certain criteria were adopted for transactions involving the sales of receivables by originators that have a principal place of business in the Tenth Circuit. The Octagon decision, contrary to existing authority, suggests that in a bankruptcy of a seller of accounts or chattel paper, the sold accounts or chattel paper would be considered part of the seller's property. The interim criteria imposed an 'AA' ceiling on transactions originated by Tenth Circuit Code transferors and required an amortization trigger if the entity's issuer credit rating fell below "investment grade."

Two developments have reduced significantly the likelihood that a Tenth Circuit Court would follow the Octagon decision. These developments are the rejection of the Octagon court's interpretation of Article 9 of the UCC by the Permanent Editorial Board for the UCC in PEB Commentary No. 14 (June 1994) and the amendment of the Oklahoma UCC (April 1996) to provide that Article 9 does not prevent the transfer of ownership of accounts or chattel paper and that the determination of whether a particular transfer of accounts or chattel paper constitutes a sale or a transfer for security purposes is not governed by Article 9.

As a result, the interim criteria adopted in June 1993 for transactions originated in the Tenth Circuit has been eliminated. These transactions are rated under the usual criteria.

As a matter of law, the Octagon decision has not been overruled in the rest of the Tenth Circuit and, therefore, opinions of counsel that include a discussion of Octagon will be accepted as long as counsel also opines that Octagon was wrongly decided.

Criteria: Trustee, Servicer, Custodian, Eligible Deposit Accounts, and Eligible Investments

Criteria Related to the Trustee and Affiliated Trustee

The indenture trustee/custodian in a structured transaction is primarily responsible for receiving payments from servicers, guarantors, and other third parties and remitting these receipts to investors in the rated securities in accordance with the terms of the indenture, in addition to its monitoring, custodial, and administrative functions. To ensure that the indenture trustee/custodian performs these functions and preserves investor rights, the following criteria should be met:

- The indenture trustee/custodian should hold dedicated assets in funds and accounts designated for a particular transaction;
- The funds and accounts should be held, in trust, for the benefit of investors in the rated securities. Such funds should be held in the indenture trustee/custodian bank's trust department unless such bank has the required rating;
- The funds should not be commingled with other funds of the indenture trustee/custodian;
- The indenture trustee/custodian cannot resign without the appointment of a qualified successor;
- If the servicer resigns or is removed, the indenture trustee/custodian should be willing and able to assume the responsibility for interim servicing; and
- The presence of trust funds and accounts protects the transaction against the indenture trustee/custodian's insolvency. Funds held in trust for the benefit of investors in the rated securities cannot be enjoined with an insolvent indenture trustee/custodian's estate.

Affiliated Trustees

In a structured transaction, comfort is generally derived from the independence of the trustee from any transferor of assets into the securitization structure. In this regard, several concerns exist. First, if an affiliate of any transferor serves as trustee, the true sale of assets from the transferor might be negated. Second, according to the commentary to Section 9-305 of the UCC, for certain types of collateral, possession of the collateral by an agent of the secured party is sufficient to perfect a security interest in the collateral. The section states, however, that "the debtor or a person controlled by [the debtor] cannot qualify as such an agent for the secured party." Thus, if an affiliate of a transferor serves as trustee, the trustee might be deemed to be controlled by the transferor and the trustee's security interest in the assets might not be perfected. Consequently, an affiliate of a transferor will be permitted to serve as trustee, only if the certain conditions are met. First, the affiliated trustee is an

entity that is in the business of functioning in the trustee capacity for other parties. Second, if the transfer of assets to the issuing SPE is a true sale, the true sale opinion delivered in connection with the transfer should cite the affiliated relationship between the transferor and the trustee and give an opinion to the effect that the trustee is holding the assets on behalf of the holders of the rated securities and that, by delivering the assets to the trustee, there has been a valid true sale of the assets by the transferor to the issuing SPE. Third, the security interest opinion delivered in connection with the trustee's first priority perfected security interest in the assets on behalf of the holders of the rated securities includes the opinion that the trustee would not be deemed to be controlled by the affiliated transferor in accordance with Section 9-305 of the UCC.

In some circumstances, it may be necessary that the trustee be replaced by an unaffiliated trustee based on a downgrading of the trustee or its affiliated parent/transferor.

Criteria Related to the Servicer

In a structured transaction, the servicer agrees to service and administer assets in accordance with its customary practices and guidelines and has full power and authority to make payments to and withdrawals from deposit accounts that are governed by the documents.

The servicer's fee should cover its servicing and collection expenses and be in line with industry norms for securities of similar quality. If the fee is considered below industry averages, an increase may be built into the transaction. The increase might be needed to entice a substitute servicer to step in and service the portfolio. If the servicing fee is calculated based on a certain dollar amount per contract, the fee will increase as a percentage of assets due to amortization of the pool. This is an important consideration when assessing available excess spread to cover losses and fund any reserve account.

Independent accounting reports should be provided at least annually. The reports should state whether the servicer is in compliance with the transaction documents and whether its policies and procedures were sufficient to prevent errors. Exceptions, if any, should be listed.

To ensure continuity, the transaction documents should provide that a servicer is not allowed to resign unless it is no longer able to service under law or finds a successor. No resignation should become effective until a successor or the trustee, as successor, has assumed the servicer's responsibilities. The trustee generally has the power to replace the servicer if the servicer is not performing its servicing functions adequately.

Commingling

The filing of a bankruptcy petition would place a stay on all funds held in a servicer's own accounts. As a result, receipt of these funds to make payments on the rated securities would be delayed. In addition, funds commingled with those of the servicer would be unavailable to the structured transaction. This commingling risk is addressed by looking both to the rating of the servicer and the amount of funds likely to be held in a servicer account at any given time.

Criteria Related to the Custodian and Affiliated Custodians

As a general matter, in a structured transaction, analysts derive comfort from the independence of a custodian from any transferor of assets into the securitization structure. This, however, raises several concerns. First, if an affiliate of any transferor serves as custodian, the true sale of assets from the transferor might be negated. Second, according to the commentary to Section 9-305 of the UCC, for certain types of collateral, possession of the collateral by an agent of the secured party is sufficient to perfect a security interest in such collateral.

The section states, however, that "the debtor or a person controlled by [the debtor] cannot qualify as such an agent for the secured party." Thus, if an affiliate of a transferor serves as custodian, the custodian might be deemed to be controlled by the transferor and the custodian's security interest in the assets might not be perfected. Consequently, an affiliate of a transferor will be permitted to serve as custodian only if the following conditions are met:

- The affiliated custodian is an entity that is in the business of functioning in the custodial capacity for other parties;
- If the transfer of assets to the issuing SPE is a true sale, the true sale opinion delivered in connection with the transfer should cite the affiliated relationship between the transferor and the custodian and give an opinion to the effect that the custodian is functioning as an agent of the trustee (that is, the agency relationship may not be assumed) and that, by delivering the assets to the custodian, there has been a valid true sale of the assets by the transferor to the issuing SPE; and
- The security interest opinion delivered in connection with the custodian's first priority perfected security interest in the assets on behalf of the trustee includes the opinion that the custodian would not be deemed to be controlled by the affiliated transferor pursuant to Section 9-305 of the UCC.

In some circumstances, analysts may require that the custody arrangements terminate and the assets be returned to the trustee for safekeeping, based on a downgrading of the custodian or its affiliated parent/transferor.

Criteria Related to Eligible Deposit Accounts

A structured financing provides for different accounts to be established at closing to serve as collection accounts in which revenues generated by the securitized assets are deposited and to establish reserves funds. Often the accounts in which the reserves are held contain significant sums held over a substantial period of time. Criteria regarding these accounts has been developed. The criteria are intended to immunize and isolate a transaction's payments, cash proceeds, and distributions from the insolvency of each entity that is a party to the transaction. An insolvency of the servicer (sub or master), trustee, or other party to the transaction should not cause a delay or loss to the investor's scheduled payments on the rated securities. As a general matter, analysts rely on credit, structural, and legal criteria to ensure that a structured transaction's cash flows are protected at every link in the cash flow chain.

When analyzing a structured financing, the criteria adjust to the specific circumstances presented by a transaction. The criteria for the collection of funds will depend on who will hold the funds and how the funds will be held. The subservicer and the institution where the collection account is established can be different entities. When two entities are involved with the collection of funds (the servicer and the institution holding the account), investors should be protected from the insolvency of either party. The following criteria address many of the potential combinations typically found in a structured finance transaction.

Collection Accounts

Unless collections on assets are concentrated at certain times of the month, for a period of up to two business days after receipt, any servicer, whether or not rated, may keep collections on the assets in any account of the servicer's choice, commingled with other money of the servicer or of any other entity. Before the end of the two business day period, the collections on the assets should be deposited into an "eligible deposit account," as described below. As a general matter, all servicers, including unrated servicers, may keep/commingle collections for up to two business days, based on Standard & Poor's credit assumption, made in connection with all structured transactions, that two days' worth of collections on assets will be lost.

If, however, collections on the assets are concentrated at certain times within a month (for example, the first, 15th, or 30th of a month), a servicer rated below 'A-1' should not be able to keep/commingle collections on the assets even for the two business day period, as described above. Rather, to prevent a potentially significant loss on assets, it is generally necessary that, in transactions involving concentrated collections in which the servicer is rated below 'A-1', either additional credit support be provided to cover commingling risk or obligors be instructed to make payments to lockbox accounts, which, in turn, are swept daily to an eligible deposit account.

The servicer, unless rated the same as the rating sought on the structured transaction, should be prevented from accessing either the lockbox or sweep accounts.

In addition, if a transferor does not wish that two days' worth of losses on collections be factored into the credit analysis, it may structure the transaction (whether or not collections are concentrated at certain times of a month) to have a lockbox account, whose deposits are swept daily to an eligible deposit account.

Beyond the two business day period discussed above, a servicer rated at least 'A-1' may keep/commingle collections on assets or deposit collections in an account of its choice, at any institution, provided the servicer obligates itself unconditionally to remit all collections to an eligible deposit account once a month. In addition, the transaction documents should provide that, if the servicer's rating falls below 'A-1,' the servicer will establish an eligible deposit account within not more than 10 calendar days and transfer collections to this account within two business days of receipt.

If a servicer is rated below 'A-1' or is unrated, or if an 'A-1' rated servicer's obligation to remit collections is not unconditional, the servicer should deposit all collections into an eligible deposit account within two business days of receipt.

Other Accounts. All other accounts maintained by the master servicer, special servicer, or trustee in a structured transaction (for example, reserve accounts) should qualify as eligible deposit accounts.

Eligible Deposit Accounts

An eligible deposit account is one that is either an account or accounts maintained with a federal or state-chartered depository institution or trust company that complies with the definition of "eligible institution," as described below; or a segregated trust account or accounts maintained with the corporate trust department of a federal depository institution or state-chartered depository institution subject to regulations regarding fiduciary funds on deposit similar to Title 12 of the Code of Federal Regulation Section 9.10(b), which, in either case, has corporate trust powers, acting in its fiduciary capacity.

In transactions rated 'AAA', eligible institutions means institutions whose commercial paper, short-term debt obligations, or other short-term deposits are rated at least 'A-1+' if the deposits are to be held in the account for less than 30 days; or long-term unsecured debt obligations are rated at least 'AA-' if the deposits are to be held in the account more than 30 days. Following a downgrade, withdrawal, or suspension of such institution's rating, each account should promptly (and in any case within not more than 10 calendar days) be moved to a qualifying institution or to one or more segregated trust accounts in the trust department of such institution, if permitted.

Each eligible account should be a separate and identifiable account, segregated from all other funds held by the holding institution. The account should be established and maintained in the name of the trustee on behalf of the issuing SPE, bearing a

designation clearly indicating that the funds deposited therein are held for the benefit of the holders of the rated securities. An eligible account should not be evidenced by a CD, passbook, or other instrument. The trustee should possess all right, title, and interest in all funds on deposit from time to time in the account and in all proceeds thereof. The account should be under the sole dominion and control of the trustee for the benefit of the holders of the rated securities and should contain only funds held for their benefit.

Criteria Related to Eligible Investments

The recent proliferation of market risk in securities being issued in the debt markets has resulted in the restriction of eligible investments for structured financings. The following will not be accepted as an eligible investment without prior review:

- Any security with the ‘r’ symbol attached to the rating;
- Any security that contains a noncredit risk that the ‘r’ was intended to highlight, whether or not the issue is rated; and
- All mortgage-backed securities.

These requirements are part of an ongoing effort to address the increase of noncredit risk in the fixed-income markets. In July 1994, the ‘r’ symbol was introduced to alert investors that certain debt instruments may experience high volatility or dramatic fluctuations in their expected returns because of market risk. Standard & Poor’s first started to address market risk with the introduction of market risk ratings on bond funds in January 1994.

Government Securities Not Immune

The obligations of the U.S. and certain other issuers whose securities would be classified as government securities are of very strong credit quality. However, a credit opinion does not take into consideration noncredit factors, such as market risk or timing of payments, which are a part of the overall investment decision. The government securities market is not immune from market risk.

An eligible investment list contains both government and nongovernment securities. While this list is widely used, it is sometimes used inappropriately. When used in rating a structured financing, the list provides the low-risk, short-term investments eligible to house, temporarily, the cash flows of the transaction (usually 30 days or less). Eligible investments generally mature before the next scheduled distribution date. Longer-term reserve funds also are invested in eligible investments. Because the funds may be needed to make the next scheduled distribution, at least a portion of the funds should be invested in short-term investments. The following eligible investments should not have maturities in excess of one year. Any use other than those listed above may not be appropriate.

Eligible Investments

The following investments are eligible for 'AAA' rated transactions:

1. Certain obligations of, or obligations guaranteed as to principal and interest by, the U.S. government or any agency or instrumentality of the U.S. government, when such obligations are backed by the full faith and credit of the U.S. are eligible. As all such obligations are not explicitly rated, the obligation must be limited to those instruments that have a predetermined fixed-dollar amount of principal due at maturity that cannot vary or change. If the obligation is rated, it should not have an 'r' highlighter affixed to its rating. Interest may be either fixed or variable. If the investments may be liquidated before their maturity or are being relied on to meet a certain yield, additional restrictions are necessary. Interest should be tied to a single interest rate index plus a single fixed spread, if any, and move proportionately with that index. These investments include, but are not limited to:
 - Treasury obligations—all direct or fully guaranteed obligations;
 - Farmers Home Administration—certificates of beneficial ownership;
 - General Services Administration—participation certificates;
 - Maritime Administration—guaranteed Title XI financing;
 - Small Business Administration—guaranteed participation certificates and guaranteed pool certificates;
 - Department of Housing and Urban Development—local authority bonds; and
 - Washington Metropolitan Area Transit Authority—guaranteed transit bonds.
2. FHA debentures.
3. Certain obligations of government-sponsored agencies that are not backed by the full faith and credit of the U.S. are eligible. As such obligations are not explicitly rated, the obligation must be limited to those instruments that have a predetermined fixed-dollar amount of principal due at maturity that cannot vary or change. If the obligation is rated, it should not have an 'r' highlighter affixed to its rating. Interest may be either fixed or variable. If the investments may be liquidated before their maturity or are being relied on to meet a certain yield, additional restrictions are necessary. Interest should be tied to a single interest rate index plus a single fixed spread, if any, and move proportionately with that index. These investments are limited to:
 - Federal Home Loan Mortgage Corp.—debt obligations;
 - Farm Credit System (formerly Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives)—consolidated systemwide bonds and notes;
 - Federal home loan banks—consolidated debt obligations;
 - Federal National Mortgage Association—debt obligations;
 - Student Loan Marketing Association—debt obligations;
 - Financing Corp.—debt obligations; and
 - Resolution Funding Corp. (Refcorp)—debt obligations.

4. Certain federal funds, unsecured CDs, time deposits, banker's acceptances, and repurchase agreements having maturities of up to 365 days, of any bank whose short-term debt obligations are rated 'A-1+' are eligible. In addition, the instrument should not have an 'r' highlighter affixed to its rating, and its terms should have a predetermined fixed-dollar amount of principal due at maturity that cannot vary or change. Interest may be either fixed or variable. If the investments may be liquidated before their maturity or are being relied on to meet a certain yield, additional restrictions are necessary. Interest should be tied to a single interest rate index plus a single fixed spread, if any, and move proportionately with that index.
5. Certain deposits that are fully insured by the FDIC are eligible. The deposit's repayment terms should have a predetermined fixed-dollar amount of principal due at maturity that cannot vary or change. If the deposit is rated, it should not have an 'r' highlighter affixed to its rating. Interest may be either fixed or variable. If the investments may be liquidated before their maturity or are being relied on to meet a certain yield, additional restrictions are necessary. Interest should be tied to a single interest rate index plus a single fixed spread, if any, and move proportionately with that index.
6. Certain debt obligations maturing in 365 days or less that are rated 'AA-' or higher are eligible. The debt should not have an 'r' highlighter affixed to its rating, and its terms should have a predetermined fixed-dollar amount of principal due at maturity that cannot vary or change. Interest can be either fixed or variable. If the investments may be liquidated before their maturity or are being relied on to meet a certain yield, additional restrictions are necessary. Interest should be tied to a single interest rate index plus a single fixed spread, if any, and move proportionately with that index.
7. Certain commercial paper rated 'A-1+' and maturing in 365 days or less are eligible. The commercial paper should not have an 'r' highlighter affixed to its rating, and its terms should have a predetermined fixed-dollar amount of principal due at maturity that cannot vary or change. Interest may be either fixed or variable. If the investments may be liquidated before their maturity or are being relied on to meet a certain yield, additional restrictions are necessary. Interest should be tied to a single interest rate index plus a single fixed spread, if any, and move proportionately with that index.
8. Investments in certain short-term debt of issuers rated 'A-1' with certain restrictions are eligible. In this case, short-term debt is defined as: commercial paper, federal funds, repurchase agreements, unsecured CDs, time deposits, and banker's acceptances. The total amount of debt from 'A-1' issuers must be limited to the investment of monthly principal and interest payments (assuming fully amortizing

collateral). The total amount of ‘A-1’ investments should not represent more than 20% of the rated issue’s outstanding principal amount, and each investment should not mature beyond 30 days. Investments in ‘A-1’ rated securities are not eligible for reserve accounts, cash collateral accounts, or other forms of credit enhancement in ‘AAA’ rated issues. In addition, none of the investments may have an ‘r’ high-lighter affixed to its rating. The terms of the debt should have a predetermined fixed-dollar amount of principal due at maturity that cannot vary or change. Interest may be either fixed or variable. If the investments may be liquidated before their maturity or are being relied on to meet a certain yield, additional restrictions are necessary. Interest should be tied to a single interest rate index plus a single fixed spread, if any, and move proportionately with that index.

9. Investment in money-market funds rated ‘AAAm’ or ‘AAAm-G’ are eligible.
10. Certain stripped securities where the principal-only and interest-only strips of noncallable obligations are issued by the U.S. Treasury and of Refcorp securities stripped by the Federal Reserve Bank of New York are eligible.

Any security not included in this list may be approved after a review of the specific terms of the security and its appropriateness for the issue.

Select Specific Opinion Criteria/Language

General

- True sale, nonconsolidation, security interest, either/or, and debt security interest opinions should be delivered by outside counsel to any participant in a structured transaction.
- In connection with security interest opinions, either/or opinions, debt security interest opinions, characterization opinions, and certificate of title opinions (all opinions based on state law), an opinion of counsel not admitted to the bar of the relevant state, *provided* such counsel states that it bases its opinions on a review of the laws of such state, including both the state’s relevant statutes and case law is acceptable.
- An opinion based on the Legal Opinion Accord of the American Bar Association Section of Business Law (1991) is not acceptable unless such opinion specifically identifies (by number) those sections of the Accord on which the opinion is relying. An opinion stating that it should be interpreted in accordance with the *Special Report by the TriBar Opinion Committee, Opinions in the Bankruptcy Context; Rating Agency, Structured Financing and Chapter 10 Transactions*, 46 BUS. LAW 717 (1991) will be accepted.
- As a general matter, “would” opinions are necessary, except for nonconsolidation opinions and common law security over deposit accounts. In these two cases,

“should” opinions are accepted based on the fact dependent nature of nonconsolidation opinions and the scarcity of deposit account jurisprudence, respectively.

- Language to the effect that the “issue is not free from doubt” or that the conclusion is “more probable than not” is not acceptable.
- The proviso “although a court may find otherwise” is not preferred but is acceptable.
- A statement that the “opinion is not a guarantee of outcome or result” is acceptable.

Bring-Down Opinion. Counsel delivering a bring-down opinion in the context of a subsequent transfer should state that it has reviewed the facts of the subsequent transfer and that such facts do not differ from those recited in the previously delivered opinion, and the assumptions set forth in the previously delivered opinion, which assumptions are the only assumptions being made in the bring-down opinion. Bring-down opinions accepted only from the same counsel that delivered the opinions being brought down.

Corporate Opinion. In U.S. transactions, comfort is received as to the due organization, valid existence, and good standing of transaction participants from the representations and warranties of the transaction participants. Depending upon the circumstances, however, analysts may request a corporate opinion to the following effect:

- That each party to the transaction is duly organized, validly existing under the laws of the jurisdiction of its formation, and is in good standing under the laws of such jurisdiction and any other jurisdictions in which it is required to qualify to do business;
- That each party to the transaction has the full power and authority to carry on its business and to enter into the transactions documents to which it is a party and the transactions thereby contemplated;
- That the execution, delivery, and performance of the transaction documents by the relevant party will not violate any law, regulation, order, or decree of any governmental authority or constitute a default under or conflict with the organizational documents or other agreements governing or to which the relevant party is a party;
- That no approval, consent, order, or authorization is required in connection with the execution, delivery, and performance of the transaction documents other than those approvals, consents, orders, and authorizations that have been obtained in connection with the closing of the transaction; and
- That the payments set forth in there transaction documents do not violate applicable usury laws.

Corporate opinions are generally requested in international transactions and in connection with a transaction participant that is a non-U.S. entity.

Enforceability Opinion. As a general matter, in U.S. transactions, comfort as to the legality, validity, and enforceability of the transaction documents comes from the representations and warranties of the transaction participants. Depending upon the

circumstances, however, an enforceability opinion may be requested to the effect that the transaction documents, or any particular transaction document, constitutes the legal, valid, binding, and enforceable obligations of the signatories. Enforceability opinions in international transactions and in connection with a transaction document to which a non-U.S. entity is a signatory are generally requested.

Representations and Warranties

The following are representations and warranties that are generally requested on rated transactions.

Representations and Warranties of the Originator, the Seller, and the Servicer

Organization and Good Standing

The seller/originator is a national banking association or corporation duly organized and validly existing in good standing under the laws of the U.S. and has full corporate power, authority, and legal right to own its properties and conduct its business as such properties are presently owned and such business is presently conducted, and to execute, deliver, and perform its obligations under this agreement and to execute and deliver to the trustee the certificates pursuant hereto.

Due Qualification

Each of the seller, the originator and the servicer is duly qualified to do business and is in good standing (or is exempt from such requirement) in any state required in order to conduct business and has obtained all necessary licenses and approvals with respect to the seller required under federal and the applicable state law; provided however, that no representation or warranty is made with respect to any qualifications, licenses, or approvals that the trustee would have to obtain to do business in any state in which the trustee seeks to enforce any receivable.

Due Authorization

The execution and delivery of this agreement and the execution and delivery to the trustee of the certificates by the seller or the originator and the consummation of the transactions provided for in this agreement have been duly authorized by each of the seller, the originator and the servicer by all necessary corporate action on its part and this agreement will remain, from the time of its execution, an official record of the seller, the originator and the servicer.

Binding Obligation/Enforceability

Each of the agreements constitutes a legal, valid, and binding obligation each of the seller, the originator and the servicer enforceable against the seller, the originator

and the servicer except when limited by bankruptcy, reorganization, insolvency, moratorium, or other similar laws affecting creditors' rights. The agreements are in full force and effect, and are not subject to any specific dispute, offset, counterclaim, or defense.

No Conflict

The execution and delivery of this agreement and the certificates, the performance of the transaction contemplated by this agreement, and the fulfillment of the terms hereof will not conflict with, result in any breach of any of the material terms and provisions of, or constitute (with or without notice or lapse of time or both) a material default under any indenture, contract, agreement, mortgage, deed of trust, or other instrument to which the seller, the originator and the servicer is a party or by which it or any of its propriety are bound.

No Violation

The execution and delivery of this agreement, any supplement and the certificates by the seller, the originator and the servicer, the performance by the seller, the originator and the servicer of the transaction contemplated by this agreement and any supplement, and the fulfillment by the seller, the originator and the servicer of the terms hereof and thereof will not conflict with, violate, or result in any breach of any of the material terms and provisions of, or constitute (with or without notice or lapse of time or both) a default under any requirement of law applicable to the seller, the originator and the servicer or any material indenture, contract, agreement, mortgage, deed of trust, or other instrument to which the seller, the originator and the servicer is a party or by which it or any of its properties are bound.

No Proceedings

There are no proceedings or investigations, pending or, to the best knowledge of each of the seller, the originator and the servicer threatened against the seller, the originator and the servicer before any court, regulatory body, administrative agency, or there tribunal or governmental instrumentality (i) asserting the invalidity of this agreement or the certificates (ii); seeking to prevent the issuance of the certificates or the consummation by the seller of any of the transactions contemplated by this agreement or the certificates; (iii) seeking any determination or ruling that, in the reasonable judgment of the seller, the originator and the servicer would materially and adversely affect the performance by each of the seller, the originator and the servicer of its obligation under this agreement; (iv) seeking any determination or ruling that would materially and adversely affect the validity or enforceability of this agreement or certificates of any series; or (v) seeking to affect adversely the income tax

attributes of the trust or the certificates under the U.S. federal or applicable state income tax systems.

All Consents Obtained

All approvals, authorizations, consents, orders, or other actions of any persons or of any governmental body or official required in connection with the execution and delivery by each of the seller, the originator and the servicer, as applicable, of this agreement and the certificates, the performance by each of the seller, the originator and the servicer of the transactions contemplated by this agreement, and the fulfillment by each of the seller, the originator and the servicer, as applicable of the terms hereof and thereof, have been obtained, except such as may be required by state securities or “blue sky” laws in connection with the distribution of any certificates.

Not an Investment Company

The seller/originator is not an “investment company” within the meaning of the Investment Company Act, nor is it exempt from all provisions of such act.

Misstatement of Fact

No statement of fact made in the pooling and servicing agreement contains any untrue statement of a material fact or omits to state any material fact necessary to make statements contained herein or therein not misleading. (If the deal is public, this statement is implied. While Standard & Poor’s appreciates seeing it in the documents, it is more critical on a private placement or in the overseas markets.)

Additional Representations and Warranties of the Servicer

- The collection practices used by the servicer with respect to the mortgage loans have been, in all material respects, legal, proper, prudent and customary in the reverse mortgage servicing business;
- The servicer shall cause the related obligor to maintain for each mortgage loan, and if the obligor does not so maintain, shall itself maintain (A) fire and hazard insurance with extended coverage on the related mortgaged property in an amount which is at least equal to the lesser of (i) 100% of the then “full replacement cost” of the improvements and equipment, without deduction for physical depreciation, and (ii) the outstanding principal balance of the related mortgage loan, and (B) such other insurance as provided in the related mortgage loan;
- The servicer will keep in force during the term of this agreement a policy or policies of insurance covering errors and omissions for failure in the performance of the servicer’s obligations under this agreement, which policy or policies shall be in such form that would meet the requirements of FNMA if it were the purchaser of the mortgage loans or industry standard;

- The servicer shall also maintain a fidelity bond in the form and amount that would meet the requirements of FNMA or industry standard;
- The servicer shall also cause any sub-servicer to maintain a policy of insurance covering errors and omissions and a fidelity bond would meet such requirements;
- If the mortgaged property is located in a federally designated special flood hazard area, the servicer will cause the related obligor to maintain or will itself obtain flood insurance in respect thereof. Such flood insurance shall be in an amount equal to the lesser of the unpaid principal balance of the related mortgage loan and the maximum amount of such insurance required by the terms of the related mortgage and as is available for the related property under the national flood insurance program (assuming that the area in which such property is located is participating in such program);
- The servicer will examine any subservicing agreement. Any designated subservicer and the terms of each subservicing agreement will be required to comply with the representations and warranties. The terms of any subservicing agreement will not be inconsistent with any of the provisions of this agreement; and
- The transactions contemplated by this agreement are in the ordinary course of business of the servicer.

Representations and Warranties Relating to the Mortgage Loans

- The seller/originator has good title to the assets and is sole owner of the assets, free and clear of any mortgage, pledge, lien, security interest, charge or other encumbrance and has full authority to sell the assets.
- The mortgage loans comply with all applicable state and federal lending laws and regulations, including without limitation, usury, equal credit opportunity disclosure and recording laws.
- No default or waiver exists under the mortgage documents, and no modifications to the mortgage documents have been made that have not been disclosed.
- Each mortgage loan is and will be a mortgage loan arising out of the originator's practice in accordance with the seller/originator's underwriting guidelines. The seller has no knowledge of any fact that should have led it to expect at the time of the initial creation of an interest in the mortgage loan that such mortgage loan would not be paid in full when due.
- No selection procedures believed by such seller/originator to be adverse to the interests of the investor certificateholders have been used in selecting the mortgage loans.
- As of issuance, each mortgage is a valid and enforceable lien subject only to (a) the lien of current real property taxes, (b) covenants, conditions and restrictions, right of way, easements.

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- As of closing, there is no mechanics' lien or claim for work, labor or material affecting the premise except those which are insured against by the title insurance policy.
 - As of closing, there is no delinquent tax or assessment lien against the property.
 - As of closing, there is no valid offset, defense or counterclaim to any note or mortgage.
 - As of closing, the physical property subject to any mortgage is free of material damage and is in good repair.
 - Each loan at the time it was made complied in all material respects with applicable state and federal laws.
 - At time of origination, no improvement located on or being part of mortgage property was in violation of any applicable zoning and subdivision laws or ordinances.
 - None of the loans is a temporary construction loan; any new construction shall not be material or interfere with the habitability or legal occupancy and shall be completed within 120 days after weather conditions permit.
 - Each original mortgage has been recorded or is in the process of being recorded in the appropriate jurisdictions wherein such recordation is required to perfect the lien thereof for the benefit of the Trust.
 - The related mortgage file contains each of the documents and instruments specified.
 - Loans originated are being serviced according to the seller/servicer guidelines.
 - In terms of the mortgage note and the mortgage have not been impaired, altered or modified in any material respect, except by a written instrument which has been recorded or is in the process of being recorded.
 - A lender's title policy or binder, or other assurance of title insurance customary in a form acceptable to FNMA was issued at origination and each policy or binder is valid and remains in full force and effect.
 - Appraisal Form 1004 or Form 2055 with an interior inspection for first lien mortgage loans has been obtained.
 - If an alternative collateral valuation method acceptable to Standard & Poor's is used to determine the value of a property, the percentage of loans and method should be stated.
 - If the property is in a FEMA designated flood area, the flood insurance policy is in effect.
 - As of closing, a hazard insurance policy is in effect for each loan.
 - No loans are secured by a leasehold interest.

Pool Characteristics Representation and Warranties

The reverse mortgage pool characteristics should contain the following:

- As of closing, no loans have a contractual breach;

- The range of LTV's;
- The range of mortgage interest rates;
- The highest percent in one zip code;
- The percentage of primary residences;
- The percentage of single family detached residences;
- The percentage of condominiums and two- to four-family residential properties;
- The range of loans' principal balances;
- The range of mortgagor's ages; and
- The percentage of males, females, and couples.

Surveillance

Debt ratings on structured financings remain in effect as long as current information is furnished on a regular basis. The purpose of surveillance is to ensure that the rating continues to reflect the performance and structure of the transaction. The goal of surveillance is to identify emerging risks in rated transactions. To that end, transaction activity will be monitored and evaluated periodically.

The surveillance of structured financings emphasizes individual elements crucial to the credit quality of these stand alone issues. The surveillance of structured financings involves monitoring the pivotal events that condition the assumptions upon which ratings are based. Those pivotal events include the repayment rate, which affects bond value, and the weighted average current loan-to-value of the portfolio, which affects the collateral value.

The repayment rate not only affects the speed at which principal is being paid off, but also the amount of interest accruing on such period. The repayment rate is tracked by following the number of repayments on a monthly basis and comparing that number to the assumptions made by the residential mortgage ratings group at transaction closing. Issuers are required to provide the number of people who repay each month and the reason for the repayment. Because the reverse mortgage is a new product, the residential group is asking that details of the repayment rate also be supplied. The details include repayment due to mortality or a move. To further stratify moves, analysts will track the age and marital status of people as they move from their homes.

As people move or die, the weighted average original loan-to-value ratio will change. By tracking that change along with the accrued interest, it is possible to monitor whether or not the collateral is sufficient to fully pay off the principal along with all accrued interest.

In order to effectively analyze trust performance, servicers should send pertinent information no later than the monthly distribution date. Before a transaction's closing date, the data that will be itemized in the servicing report is reviewed to ensure that all necessary information is included. Attached are examples of monthly reports that

are required on a monthly basis. The first is a remittance report, second, an activity report encompassing portfolio characteristics, third a move out experience report.

The performance of every rated reverse mortgage issue is monitored on an ongoing basis. Ratings on these issues may change to reflect the rating of the liquidity or credit provider. For example, an 'AAA'-rated pass-through, whose rating relies on an 'AAA' liquidity provider, would be downgraded to reflect a downgrade in the liquidity provider's financial strength rating.

In addition to rating changes due to a credit provider downgrade, actual repayment rates are considered. The rating may change to reflect the bond size and repayment rate experienced as compared to cash flow assumptions made at time of origination. Repayment rates are carefully monitored due to the potential risk that actual repayment rates could be slower than the stressed repayment rates used. Should actual repayment rates slow considerably, then accrued interest plus principal may exceed the projected equity in the underlying properties of the securitization. In this situation, it would be necessary to adjust the rating downward to reflect the loss of equity in the pool.

If a committee vote results in a rating change, the issuer and trustee will be notified. For public ratings, a press release is normally disseminated.

Appendix A

Reverse Mortgage Glossary

Accrued Interest—Interest that has been earned but not paid.

Accumulated Fees—Current and prior unpaid fees.

Annual Payment Cap—Maximum percentage per year by which an adjustable rate mortgage borrower’s monthly principal and interest payment can increase.

Appraisal Date—The date the appraised value is determined.

Appraisal Types—The various methods used to estimate the value of a property, including the following:

- **Drive-by Form 704:** More commonly known as the “drive-by” report. This “Second Mortgage Appraisal Report” used to derive a value from an exterior-only inspection and may or may not include photos. There is no neighborhood or interior analysis.
- **Form 2055:** This form is a property inspection report where an interior and exterior inspection is performed. It requires a quantitative sales comparison analysis in which the appraiser assigns a dollar value to reflect the market’s reaction to any features of the comparable sale that differ from those of the subject property.
- **Form 2065:** This form offers an exterior-only property inspection option and the use of a qualitative sales comparison analysis (instead of the traditional dollar adjusted quantitative analysis). The qualitative sales comparison analysis looks at market data in terms of value relationships between the comparable properties and the subject property, without assigning an estimated dollar value to those relationships.
- **Form 2075:** This form is a property inspection report that requires an exterior-only inspection of the subject from the street by a state licensed or certified appraiser. Note: Form 2075 is not an appraisal, USPAP does not apply.
- **URAR Form 1004:** More commonly known as the “full appraisal”. The actual name of the report is the Uniform Residential Appraisal Report (URAR). This report encompasses a detailed interior and exterior inspection (including neighborhood analysis) and has several addendum’s including plot graphs, photos, appraiser reps and warranties and environmental information. The Uniform Residential

Appraisal Report (1004) is a unique blend of quantitative and qualitative information about a subject property.

Appraised Value—An opinion of the value of a property at a given time, based on facts regarding the location, improvements, etc., of the property and surroundings.

ARM (adjustable rate mortgage)—A mortgage loan whose interest rate adjusts at a specified interval based on a specific index.

Automated Appraisal System—An automated system that is used to derive a property value without the opinion of an appraiser. These systems are typically hedonic models or repeat sales indices.

Approved Automated Appraisal System—A Standard & Poor's accepted automated system used to derive a property value. The process for validating such systems includes:

- Reviewing the system's quality control;
- Reviewing the system's data sources;
- Analyzing the results of a test portfolio for such variables as variance, geographic coverage, and hit rate; and
- Reviewing user aspects of the system such as comparable sales and time frame averaging.

Closing Date—The effective date of the loan contractual agreement. Interest starts accruing from this date.

Compound Interest—Interest paid on the outstanding principal and also on the unpaid interest that has accumulated.

Current Interest Rate—The interest rate in effect on the mortgage loan.

Current Loan Balance—The mortgage loan's outstanding principal balance at the time of evaluation.

Cut-off Date—The date as of the end of the reporting period.

End Payment Date—The last date on which a periodic payment is made to a borrower.

Fee (loan level)—A specified dollar amount or percentage of a specified amount applied periodically to a reverse mortgage loan.

Fixed Rate Mortgage Loan—Fixed rate, level payment, fully amortizing mortgage loan that repays the debt in constant monthly installments.

Gender—Male or female status of the borrower(s).

House Value Fee—Lenders typically receive additional amounts charged as a percentage of the house value and due upon loan repayment.

Interest Rate—The percentage of a sum of money charged for its use.

Interest Rate Adjustment Frequency—The time between coupon adjustments of a floating rate mortgage loan.

Lifetime Maximum Rate—Maximum rate of interest which can be applied to an adjustable rate loan over the course of the loan's life.

Lifetime Minimum Rate—Minimum rate of interest which can be applied to an adjustable rate loan over the course of the loan's life.

Loan Identifier—A unique character string (alpha-numeric) which identifies each reverse mortgage loan.

Loan Purpose—The ends to which the loan proceeds will be applied. These include:

- Debt Consolidation: proceeds of the reverse mortgage are used to satisfy outstanding debt.
- Estate Planning: proceeds of the reverse mortgage are used to maximize tax planning, charitable gift giving, and provide money to heirs.
- Home Care: proceeds of the reverse mortgage are used to modify a home and/or provide for assisted living.
- Income Supplement: proceeds of the reverse mortgage are used to provide the borrower with a cash or a life annuity.
- Life Style: proceeds of the reverse mortgage are used to make major purchases, complete home renovations, or take significant vacations.

Loan Status—The current status of the loan is categorized as follows:

- Active (A): borrower is occupying the property as his/her principal residence.
- Move Out (M): borrower has moved out of the property and is no longer occupying it as his/her principal residence. Loan sale proceeds have not been received.
- Death (D): borrower has died. Loan sale proceeds have not been received.

Loan Type—The type of loan generally falls under one of the following types:

- Annuity or Term Mortgage Loan: a mortgage loan that has a predetermined loan payment schedule for a definitive time frame. The loan is due only when the borrower either dies, permanently moves out of the property, or sells the house.
- Hybrid Mortgage Loan: a mortgage loan that combines features of Annuity, Tenure and Line of Credit loan types.
- Line of Credit (LOC) Mortgage Loan: a mortgage loan that avails the borrower to a revolving line of credit which they can draw upon at any time during the life of the loan. The interest rate is variable and accrues on the outstanding balance only, while the undrawn principal limit grows at an annual rate.
- Tenure Mortgage Loan: a mortgage loan that has no predetermined maturity date. It matures only when the borrower either dies, permanently moves out of the property, or sells the house.

Margin—The amount expressed as a percentage, the sum of which when added to an index results in the coupon of a adjustable rate mortgage loan.

Master Servicer of the Loan—The entity who oversees the activities of the primary servicer(s). These oversight functions include the following: (1) tracking the collection of funds from servicers custodial account to the certificate account; (2) ensure orderly receipt of the servicers monthly remittance and servicing reports; (3) monitoring the loan level default actions of the servicer; (4) aggregate reporting and distributing to trustees/investors; and (5) have the authority to remove and replace a servicer if necessary.

Maximum Line-of-Credit Amount—The maximum dollar amount of a line-of-credit mortgage loan, determined at loan origination, from which a borrower may draw upon.

Next Adjustment Date—The date of the next coupon adjustment for a floating rate mortgage loan.

Original Interest Rate—The annual percentage rate calculated as specified on the mortgage note at the time of the loan's origination.

Original Loan Balance—The dollar amount of mortgage loan at origination.

Original Loan-to-Value Ratio (Reverse Mortgage to Home Value)—The amount of the outstanding mortgage lien on a property divided by the lesser of the appraised value or the sales price.

Originator of the Loan—A person who solicits builders, brokers and others to obtain applications for mortgage loans. Origination is the process by which a mortgage banker or direct lender brings into being a mortgage secured by real property.

Periodic Rate Cap on Adjustment Date—Maximum rate of interest which an adjustable rate loan can increase or decrease by, on the loan's rate is eligible to adjust.

Primary Servicer of the Loan—The entity responsible for the following: (1) collection of monthly payments; (2) remittance of funds from the custodial account to the certificate account; (3) monitor and escrow property insurance and real estate tax payments; (4) follow up on all delinquent borrowers including loss mitigation efforts; (5) initiate foreclosure proceedings when necessary; and (6) report monthly activity.

Principal Residence—The residential property physically occupied by the owner for the majority of the year. It is the address of record for the borrower for such activities as federal income tax reporting, voter registration, and occupational licensing.

Property Address—The street address on which the property with the lien is located.

Property Type—The types of property are generally categorized as follows:

- **Cooperative:** also called a stock cooperative or a co-op. A structure of two or more units in which the right to occupy a unit is obtained by the purchase of stock in the corporation which owns the building.
- **Deminimus (detached) PUD:** a planned unit development containing detached units.
- **Duplex:** an apartment containing two floors or levels.
- **Hi-rise Condominium:** a system of ownership of individual units in a multiunit structure, combined with joint ownership of commonly used property (sidewalks, hallways, stairs, etc.). Standard & Poor's considers a hi-rise condominium to contain more than four stories.
- **Low-rise condominium:** a system of ownership of individual units in a multiunit structure, combined with joint ownership of commonly used property (sidewalks, hallways, stairs, etc.). Standard & Poor's considers a low-rise condominium to contain four or fewer stories.
- **Planned Unit Development (PUD):** a zoning classification that allows flexibility in the design of a subdivision. Planned Unit Development generally set an overall density limit for the entire subdivision, allowing the dwelling units to be clustered to provide common open space.
- **Single Family Attached:** any building containing exactly two dwelling units. Adjacent units may share walls and other structural components but generally have separate access to the outside and do not share plumbing and heating equipment.
- **Single Family Detached:** a type of residential structure designed to include one dwelling.
- **Three/Four Family:** a property that consists of a structure that provides living space (dwelling units) for three to four families, although ownership of the structure is enhanced by a single deed.
- **Town House:** a dwelling unit, generally having 2 or more floors and attached to other similar units via party walls. Town houses are often used in planned unit developments and condominium developments, which provide for clustered or attached housing and common open space.
- **Two Family:** a property that consists of a structure that provides living space (dwelling units) for two families, although ownership of the structure is enhanced by a single deed.

Relocation Date—The date on which the borrower(s) no longer occupies the property as a principal residence.

Repayment Amount—Any payments by a borrower prior to the time the loan is due and payable. Such funds are used to pay principal, interest, and/or fees due on the reverse mortgage loan.

Reverse Mortgage Loan—A non-recourse mortgage loan on a home that requires no repayment for as long as the borrower uses it as their principal residence.

Scheduled Loan Payment Amount—A predetermined scheduled amount to be lent to a borrower over a specified time frame.

Shared Equity Premium—The lender receives a premium, (i.e. a fixed percentage) on the home value (usually 2% to 10%) either up front, or at maturity.

Shared Appreciation Premium—The lender receives a participation (usually 50% to 100%) in any appreciation in the home value between loan origination and maturity.

Start Payment Date—The first date on which a periodic payment is made to the borrower.

Unscheduled Loan Payment—An additional principal amount lent to a borrower not predetermined under the contractual mortgage terms.

Zip Code—The US postal zip code in which the property with the lien is located.

Appendix B

Information Required for On-Site Review of Company

This information should be faxed to Standard & Poor's Attn: _____

Fax # (212) 438-2661. Please call before faxing: _____

Company Name: _____

Contact Person for follow up questions: _____

Phone number of contact person: _____

On-site servicing review scheduled for: _____

Products to be reviewed for securitization: _____

(NOTE: Please provide information for total portfolio and for product (i.e., Reverse) being reviewed. Questions can be answered on a form provided by Standard & Poor's (please print) OR typed up separately).

Table 1 Key Portfolio/Product Statistics [†]					
	20__*	20__**	19__*	19__**	19__**
Loan production					
Total loan count					
Volume (\$MM)					
Average cost to originate					
Weighted average LTV					
Weighted average age of borrowers					
Loan administration					
Total loan count					
Volume (\$MM)					
Average cost to service					
Number of loans serviced per employee					
Weighted average LTV					
Weighted average age of borrowers					
Foreclosure (%)					
Losses as a percentage of UPB					

[†]Please provide statistical information in the following format: Portfolio statistic/Product statistic (ie: Total Loan Count:1,234/565 — total loan count for the portfolio is 1,234 and the total loan count for the product is 565.)

*YTD 20 **Ending December

Standard & Poor's On-Site Review

Management & Organization

How long has the company been in operation? _____

How long has the company been originating/servicing the product being securitized?

Management's tenure with company: _____

Management's industry experience: _____

Management turnover rate: _____

Total number of employees: _____

Does the company have a formal training function? _____

Are procedure manuals present for all operational areas? If no, explain. _____

Are all licenses and insurance coverages in place and conform to FNMA/HUD standards? If no, explain. _____

List all material lawsuits outstanding against the company and circumstances: _____

Is there a written strategic plan for the achievement of short and long-term goals?

Who is servicing this product? _____

Who is the master servicer (if applicable)? _____

Table 2					
Financial Position (Consolidated) [†]					
	1999*	1998**	1997**	1996**	1995**
Revenue (\$ mil.)					
Net income (\$ mil.)					
Net worth (\$ mil.)					
*YTD 20__. **Ending December. †Specify organization for which financial information is reported.					

Loan Production

List production channels and corresponding % of volume received through each:

Front end system(s) utilized: _____

List the top 5 states and their corresponding percentages of volume: _____

Number of Branches: _____ Number of Acct Reps: _____

Number of Approved Brokers: _____ No. of Approved Correspondents: _____

Does any one seller provide over 10% of total volume to the company? _____

If yes, explain situation: _____

Do you have a formal broker/correspondent approval process? _____

Are brokers/correspondents monitored for delinquency performance, annual licensing renewals, and documentation exceptions through QC audits? If no, explain. _____

Is processing centralized? If no, explain the process. _____

Is funding centralized? If no, explain the process. _____

Are closing/escrow agents monitored? _____

Are state-specific documents generated through the system? _____

Are FNMA/HUD forms utilized? If not, explain: _____

Who can clear u/w conditions and what types? _____

How are branch managers compensated? _____

Do you conduct a pre- or post-closing audit? If yes, explain. _____

Underwriting

Average experience for u/w's: _____ U/w's tenure with company: _____

Do the u/w's have experience with the specific product type being reviewed? _____

If yes, number of years: _____

Is u/w centralized? If no, explain: _____

Average pre-approval turnaround time: _____

% Approved: _____ % Suspended: _____ % Denied: _____

Average final turnaround time: _____

% Approved: _____ % Suspended: _____ % Denied: _____

Is there a second look decline process in place? _____

Percentage of loans approved on an exception basis: _____

Most common exception type: _____

Is there an exception approval process in place? If no, explain. _____

Are lending authority limits in place: _____

How are u/w guidelines documented (what format; manual, on-line)? _____

How are u/w's compensated? _____

Is there an appraiser approval process: _____

Is an approved appraiser list maintained: _____

Are appraisals performed by in-house and/or independent appraisers? _____

No. of in-house appraisers: _____

Average experience of in-house appraisers: _____

Are in-house appraisers monitored for the quality of their work? If yes, explain: _____

Are appraisers monitored at least annually for licensing? _____

What types of appraisals or collateral assessment types are utilized: _____

Are forms FNMA? _____

Are all active appraisers monitored by QC at least annually? _____

Complete the following, if an automated collateral system(s) are utilized:

Name of automated collateral system: _____

How long has this system been used? _____

For what product(s) is the automated collateral system used? _____

Quality Control

Percent of sample having minor exceptions requiring no corrections: _____

Percent of sample having minor exceptions where corrections were required: _____

Percent of sample having serious exceptions: _____

Percent of exceptions by severity in most recent audit: _____

Are responses required to exceptions and followed up on by QC? _____

Number of repurchases made in the past 12 months for which the company
did not have recourse to a third party: _____

Number of field appraisals obtained on sample size: _____

Variance tolerance allowed between original appraised value and QC field review: _____

Are all sellers included in the QC sample at least annually? _____

Secondary Marketing

Who sets prices? _____ How often are they set? _____

How are they disseminated to the branches and third party originators? _____

Describe the process for tracking rate-lock commitments outstanding: _____

Describe the process for tracking loans in the pipeline: _____

What is the average monthly closure rate? _____

Who has the authority to execute trades? _____

Are trading authority limits in place? _____

How is trading activity monitored? _____

Does the company hedge its pipeline? _____

Its servicing portfolio? _____

What types of hedging vehicles are utilized? _____

Percentage of hedge position: _____

How often are securitizations issued? _____

How long has the company been issuing securitizations? _____

Who funds the related warehouse and for what amounts? _____

How are loans pooled or designated to a securitization? _____

What investor commitments are typically used (forward sales contract, options delivery)? _____

Are mark-to-market forward valuations performed? _____

How frequently are mark-to-market valuations performed? _____

Who prepares mark-to-market valuations? _____

Does the company outsource its hedging function? If so, to whom? _____

What source of funds are utilized to fund the reverse mortgages? _____

Are warehouse lines utilized? If yes, what percentage of your funding needs are covered by warehouse lines? _____

How many warehouse lines do you have? _____

What are the terms of the warehouse lines? _____

What is the typical advance rate on the warehouse lines? _____

Do all of the reverse mortgages have a take out commitment? _____

If yes, with whom are the take out commitments with? _____

What are the terms of the take out commitments? _____

What is the typical price of a take out commitment? _____

Management Information Systems (MIS)

Describe the disaster recovery plan in place: _____

Does it encompass systems and sites? _____

Is the system “back up” nightly? _____

Are back-up tapes stored off-site? _____

Is their a hot-site? _____

Are there any system capacity issues? _____

Are there system security features? _____

Loan Administration

Management’s average industry experience: _____ Average tenure: _____

Top five states and correspondence % of portfolio: _____

Weighted Average LTV: _____ Weighted Average Maturity: _____

Servicing System(s) utilized: _____

Linked to front-end systems: _____

Is there a servicing QC program? If yes, describe: _____

Are any loans serviced off the system? _____

Loan Set-Up

Are loans boarded manually, via tape, modem, etc. and corresponding %: _____

What type of data integrity check is performed? _____

Payment Disbursement

Are all disbursements made to borrowers only? _____

Is there a segregation between personnel disbursing funds and those who reconcile the accounts? _____

Customer Service

Average experience of customer service reps in industry: _____

Average experience of customer service reps with company: _____

Average hold time: _____

Is abandon rate and nature of the inquiry tracked? _____

Is the system backed up nightly? _____

Are inquiries handled by customer service or are they forwarded to the various departments for resolution? _____

Are customer service reps required to answer a certain number of calls per day?

If yes, how many? _____

Percentage of calls answered through VRU: _____

Does the customer service dept have shifts to cover the geographic areas of the portfolio?

How are written inquiries handled? _____

Average response time: _____

How are customer service reps monitored? _____

Taxes and Insurance

Tax service utilized: _____

Insurance carrier _____

Forceplaced carrier _____

What amount of coverage are loans forceplaced? _____

Are any taxes or insurance paid in house? If yes, explain. _____

Have any tax penalties been assessed in the past 12 months? If yes, for what? _____

Have any insurance coverages lapsed in the past 12 months due to non-payment? _____

Are tax payments advanced if a loan is delinquent? If no, explain _____

Arms

Describe the loan set up controls and QC checks that are in place: _____

Is the ARM information compared to the loan file? _____

Has an ARM portfolio audit been performed? _____

Are controls in place for index input? If none, explain: _____

Describe the frequency of ARM audits: _____

Release of Liens

Are state requirements (time frames) on the system for release? _____

If no, how are they prioritized? _____

Have all loans been released within the required time frames for the past 12 months?

If no, explain: _____

Have any penalties been incurred due to late releases for the past 12 months? _____

Are state specific release forms on the system? _____

How are documents retrieved from custodians, trustees? _____

Investor Reporting/Accounting

Average experience of staff? _____ Tenure with company _____

Type of reports prepared? _____

Number of reports prepared monthly: _____

Have any penalties been incurred in the past 12 months due to late or incurred reporting or remitting? If yes, explain. _____

Who has the authority to release funds? _____

Are system controls in place for fund transfers (destinations)? _____

Is there a separation between inventory reporters and the people preparing reconciliations? If no, explain: _____

Are all reconciliations required to be completed within 30 days? If no, explain: _____

Are all reconciliations completed within 30 days? If no, explain: _____

How are reconciling items aged and tracked? _____

What is the oldest reconciling item? _____

Who monitors the titling and eligibility of custodial accounts and how often? _____

Foreclosure

Are foreclosures handled by in-house or an attorney network? _____

Is there a foreclosure committee? _____

Average number of days delinquent at foreclosure initiation: _____

How is attorney performance monitored? _____

Are state specific procedures and timeframe on the system? _____

Who has the authority to change the timeframes? _____

What are the average foreclosure times for the top five states? _____

Average experience of foreclosure staff: _____

Are property inspections ordered monthly? If no, explain: _____

Real Estate Owned

Average experience of the REO staff? _____ Tenure with the company: _____

Are REO's marketed in house? If no, explain: _____

What percentage of property's acquired are occupied? _____

What is the average eviction time? _____

What type of property valuations are performed and timeframes? _____

Who has the authority to enter into listing agreements? _____

How is the listing price derived? _____

Who has the authority to sign a contract? _____

What is the company's policy toward repairs? _____

What is the average sales price to appraised value? _____

What is the average marketing time (not including eviction)? _____

How often is a marketing strategy reviewed? _____

Master Servicing

How long has the company been performing this function? _____

List the top five states and corresponding percentage of portfolio: _____

Management's average experience: _____ With company: _____

Number of investors: _____

System(s) utilized: _____

Is information maintained at the loan level? _____

Are servicer's financial officer's certs, insurance coverages monitored? at least annually? _____

Are delinquent loan actions monitored at least annually? _____

Are fcl/REO comments maintained in the data base? _____

Has the company received any penalties due to late or incorrect reporting or remitting the past 12 months? _____

Is there a formal servicer monitoring area which performs on-site operational reviews? _____

Are all custodial accounts reconciled monthly and within 30 days? _____

Are all clearing accounts reconciled daily? _____

Must all reconciling items be identified and cleared within 30 days? _____

How many investor reports are prepared manually? _____

Is management signoff required on reconciliations? _____

Are any loans maintained off of the system? _____

Document Requirements

Please forward to Standard & Poor's the following items as early as possible preferably prior to the on-site visit:

- Copies of your underwriting guidelines, procedures, and product matrix.
- Company background and organization chart.
- Management profile (senior management and department heads).
- Copies of your audited financial statements for the past five years.
- Copies of your two most recent quality control reports.
- Copies of articles of incorporation (if applicable).
- Lost information reported on a static pool basis for the past ten years.
- Copies of the most recent audits including FNMA, HUD, and Uniform Single Audit Program (USAP).
- Copies of restrictive covenants within existing debt agreement and most recent compliance certification.

Appendix C

Sample Reports

Table 1
Sample Remittance Report

Certificate Valuation	
<i>Class A Certificates</i>	
Amount Available (including servicing fees)	\$
Fees and Expenses due and payable	\$
Accrued Fees and Expenses	\$
Amount Available after fees and expenses	\$
<i>Interest</i>	
Class A-1 Interest	\$
Amount applied to Unpaid Class A Interest	\$
Remaining Unpaid Class A Interest	\$
<i>Principal</i>	
1. Principal Prepayments	\$
2. Liquidation Amounts	\$
3. Repurchases	\$
Senior Percentage	%
Class A Principal Distribution Amount	\$
Class A Principal Balance	\$
<i>Class B Certificates</i>	
<i>Interest</i>	
Class B-1 Interest	\$
Amount applied to Unpaid Class B Interest	\$
Remaining Unpaid Class B Interest	\$
<i>Principal</i>	
1. Principal Prepayments	\$
2. Liquidation Amounts	\$
3. Repurchases	\$
Class B Principal Distribution Amount	\$
Class B Principal Balance	\$

Table 2
Monthly Activity Report

Portfolio characteristics

Dealer Name:	As Of: Month-Year
Original Portfolio Balance	\$
Original Number of Mortgages	%
Original Weighted Average Loan-to-value	
Original Weighted Average Age of Mortgagors	
Number of Mortgages Outstanding: Opening	
Number of Repayments (due to)	
Move Out	
Mortality	
REO Sale	
Number of Mortgages Outstanding: Closing	
Cumulative Number of Repayments (due to)	
Move Out	
Mortality	
REO Sale	
Total Value of Portfolio Mortgages	\$
1. Outstanding Principal: Opening	\$
Additional Draws on LOC's	\$
Additional Scheduled Loan Payments	\$
Additional Unscheduled Loan Payments	\$
Outstanding Principal: Closing	\$
2. Accrued Interest	\$
3. Loan Level Fees	\$
Servicing Fee	\$
Other Fee 1 (Description)	\$
Other Fee 2 (Description)	\$
Other Fee 3 (Description)	\$
Weighted Average	
Age of Mortgagors	
Coupon of Mortgages	%
Loan-to-value (calculated as closing portfolio value/original weighted average home value of the portfolio)	%
Aggregate Trust Expenses	\$
Servicing Fee	\$
Partnership Fee	\$
Trustee Fee	\$
Other Fee/Expense	\$
Cumulative Portfolio Losses	\$

Table 3
Move Out Experience Report

Portfolio characteristics

Dealer Name

Age	Number of Loans—Male	Number of Loans—Female	Number of Loans—Couple
<60			
60			
61			
62			
63			
64			
65			
66			
67			
68			
69			
70			
71			
72			
73			
74			
75			
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94			
95			
96			
97			
98			
99			
100			
>100			

Appendix D

Reverse Mortgage Pool File Format

Table 1
Pool File Format

Header Name	Length	Format	Description/ Glossary Term	Valid Values
LoanID	12	x(12)	Loan Identifier	Numbers and alpha-characters 1 = Single family detached 2 = Dminiums (Detached) PUD 3 = Single family attached 4 = Two family 5 = Town House 6 = Low-rise condominium (≤4 stories) 7 = Planned Unit Development (PUD) 8 = Duplex 9 = Three/Four Family 10 = High-rise Condominium (>4 stories) 12 = Cooperative
LoanPurp	1	x(1)	Loan Purpose	D = Debt Consolidation E = Estate Planning H = Home Care I = Income Supplement L = Life Style
OrigBal	10	9(7)v99	Original Loan Balance	Must be greater than or equal to zero (no commas)
CloseDate	8	x(8)	Closing Date	MMDDYYYY (must include leading zero for month and day)
CutOffdate	8	x(8)	Cut-off Date of the loan	MMDDYYYY (must include leading zero for month and day)
SchdPmt	10	9(7)v99	Scheduled Principal Loan Payment Amount	Must be greater than or equal to zero (no commas)

Table 1 (cont'd)
Pool File Format

Header Name	Length	Format	Description/ Glossary Term	Valid Values
AccumFees	10	9(7)v99	Total Accumulated Fees as of the Cut-off Date	Must be greater than or equal to zero (no commas)
Fee1	10	9(6)v99	Fee	Percent or dollar amount, which ever is applicable; greater than or equal to zero
Fee2	10	9(6)v99	Fee	Percent or dollar amount, which ever is applicable; greater than or equal to zero
Fee3	10	9(6)v99	Fee	Percent or dollar amount, which ever is applicable; greater than or equal to zero
Fee4	10	9(6)v99	Fee	Percent or dollar amount, which ever is applicable; greater than or equal to zero
Fee5	10	9(6)v99	Fee	Percent or dollar amount, which ever is applicable; greater than or equal to zero
AccrInt	10	9(7)v99	Accrued Interest as of the Cut-off date	Must be greater than or equal to zero (no commas)
CurrBal	10	9(7)v99	Current Loan Balance	Must be greater than or equal to zero (no commas)
LoanType	2	x(2)	Loan Type	A = Annuity Loan Payments (may have initial payment) H = Hybrid L = Line Of Credit (LOC) T = Tenure (one bullet payment with no maturity)
MaxLOC	10	9(7)v99	Maximum Line of Credit Limit Amount	Must be greater than or equal to zero (no commas)
Gender1	1	x(1)	Borrower 1 Gender	M = Male; F = Female (must be populated)
Gender2	1	x(1)	Borrower 2 Gender	M = Male; F = Female (blank if no co-borrower exists)
Birth1	8	x(8)	Date of Birth (for borrower 1)	MMDDYYYY (must be populated and include leading zero for month and day)

Table 1 (cont'd)

Pool File Format

Header Name	Length	Format	Description/ Glossary Term	Valid Values
Birth2	8	x(8)	Date of Birth (for borrower 2)	MMDDYYYY (blank if no co-borrower exists; include leading zero for month and day)
RelocDate1	8	x(8)	Relocation Date (borrower 1)	MMDDYYYY (must be populated and include leading zero for month and day)
RelocDate2	8	x(8)	Relocation Date (borrower 2)	MMDDYYYY (blank if no co-borrower exists; include leading zero for month and day)
LoanStatus	1	x(1)	Loan Status as of the Cut-off date	A = Active M = Relocated Due to Move-out; pending repayment D = Relocated Due to Death; pending repayment
ApprValue	10	9(7)v99	Appraisal Value	Must be greater than zero (no commas)
ApprDate	8	x(8)	Appraisal Date	MMDDYYYY (must include leading zero for month and day)
ApprType	2	x(2)	Appraisal Type	10 = URAR Form 1040/Form 2055 (interior/exterior) 20 = Drive-by Form 704/Form 2065 30 = Automated System Property Evaluation
ApprSystem	15	x(15)	Automated Appraisal System (used in valuing the property)	MRAC, CSW, HNC, Experian, Solimar, Other (please specify)
Address	20	x(20)	Property Address No., Street, Place, Court or Avenue Name, and Apt. No.)	St. = Street; Ct. = Court, Ave. = Avenue; Pl. = Place
City	15	x(15)	City	Full Name of City
State	2	x(2)	2 Character State Abbreviation Code	NY, NJ, CT, DC., etc.
ZipCode	10	x(5)-x(4)	5 Digit Zip Code-4 Digit Postal Code	Both Zip Code and Postal Codes including leading zero and separated by a dash
StartDate	8	x(8)	Start Payment Date of the Scheduled Monthly Principal Payment Loans	MMDDYYYY (blank if no monthly installments exists for the loan; add leading zero)

Table 1 (cont'd)
Pool File Format

Header Name	Length	Format	Description/ Glossary Term	Valid Values
EndDate	8	x(8)	End Payment Date (of Scheduled Monthly Principal Payment Loans	MMDDYYYY (blank if no monthly installments exists for the loan, add leading zero)
OrigRate	7	9(3)v999	Original Interest rate	Must be greater than zero cannot be null; A rate of 5.75% will be written as 005.750
CurrRate	7	9(3)v999	Current Interest Rate	Must be greater than zero cannot be null
Index	10	x(10)	Adjustable Rate Loan Index	Blank = fixed; 1 = 1-Mo LIBOR; 6 = 6-Mo LIBOR; 1 CMT, 3 CMT, 5 CMT, PRIME, etc.
Margin	7	9(3)v999	Margin (associated with the adjustable rate loan)	Must be greater than or equal to zero; a margin of 0.50% will be written as 000.500
AdjFreq	7	9(3)v999	Interest Rate Adjustment Frequency	Must be greater than or equal to zero
PerRateCap	7	9(3)v999	Periodic Rate Cap	Must be greater than or equal to zero
LifeMaxRate	7	9(3)v999	Lifetime Maximum Rate	Must be greater than or equal to zero
LifeMinRate	7	9(3)v999	Lifetime Minimum rate	Must be greater than or equal to zero
NextAdjust	8	x(8)	Next Adjustment Date	MMDDYYYY (blank if fixed rate loan; add leading zero for month and day)
SharedEqty	7	9(3)v999	Shared Equity Premium	Must be greater than or equal to zero; a 2% appreciation share will be written as 002.000
SharedAppr	7	9(3)v999	Shared Appreciation Premium	Must be greater than or equal to zero; a 50% appreciation share will be written as 050.000
OrigLTV	7	9(3)v999	Original LTV (Reverse Mortgage Loan to Home Value Ratio); Original Balance/ Appraisal Value	Must be greater than zero; an RMHV = 55.25% will be written as 55.25

Table 1 (cont'd)
Pool File Format

Header Name	Length	Format	Description/ Glossary Term	Valid Values
CurrLTV	7	9(3)v999	Current LTV (Reverse Mortgage Loan to Home Value Ratio); Current Balance plus Accrued Interest and Fees)/ Appraisal Value	Greater than zero; includes accrued interest, loan payments and fees up to the Cut-off Date
HVFeel	7	9(3)v999	House Value Fee (in percent form); applied to the house value at repayment date prior to repayment of loan	Must be greater than or equal to zero; used for fees such as Preservation, Broker, Legal
HVFeel2	7	9(3)v999	House Value Fee (in percent form); applied to the house value at repayment date prior to repayment of loan	Must be greater than or equal to zero; a house value fee = 2.5% will be written as 2.5
HVFeel3	7	9(3)v999	House Value Fee (in percent form); applied to the house value at repayment date prior to repayment of loan	Must be greater than or equal to zero;
HVFeel5	7	9(3)v999	House Value Fee (in percent form); applied to the house value at repayment date prior to repayment of loan	Must be greater than or equal to zero;
Originator	30	x(30)	Originator of the Loan	Must be populated; cannot be null
PrimServ	30	x(30)	Primary Servicer of the Loan	Must be populated; cannot be null

Table 1 (cont'd)
Pool File Format

Header Name	Length	Format	Description/ Glossary Term	Valid Values
MastServ	30	x(30)	Master Servicer of the Loan	Must be populated; cannot be null; may be the same as Primary Servicer
SpecServ	30	x(30)	Special Servicer of the Loan	Null if no Special Servicer exists on the loan
Repayment	10	9(7)v99	Repayment Amount	Must be greater than or equal to zero; a loan may have a prepayment prior to relocation of the borrower and will be indicated here. The repayment amount may be applied to interest and/or principal and will be reflected in the appropriate fields above