

## Blog Post

### The Line Reports from the MBA Servicing Conference: Servicer Liability Issues

Posted on **May 26, 2010** by Peter K. McKee, Jr.

*The Line* is on the road this week at the Mortgage Banker's Association Servicing and Technology Conference. "Live from New York," so to speak.

Among the first day's panels was a discussion of recurring sources of liability for servicers, and how those related risks might be better managed. It's no coincidence that, as Reg AB and various other financial reform proposals get rolled out, risk management concerns crop up all across the lending industry. In this context, though, the liability concerns are primarily from borrowers and from the parties with whom the servicers have their contracts.

In the realm of borrower-related risks, preserving the confidentiality of borrower information was emphasized. Apparently brokers have tried to get the inside track on note sales by misrepresenting themselves as auditors or borrower representatives. So verifying the identity of borrower representatives and the scope of that representative's authority is an essential threshold determination. And if the conversation involves financial information, the written delegation of authority has to include release of financial information.

Once the borrower representative has been authenticated, the next step (familiar to most) is a pre-negotiation agreement (PNA) that purports to create a safe space for workout discussions without risk of alleged waivers or oral agreements. The hardball form of PNA includes borrower acknowledgements of default, waivers of claims and the like. But servicers acknowledged that using the hardball approach was not always the most efficient, and that a simpler agreement that deals with the inadmissibility of workout discussions can be sufficient. Courts have also on occasion been reluctant to enforce the hardball PNAs.

Borrowers making a lender liability claim often look to show reliance on oral statements of a lender representative, so panelists stressed the importance of originators and servicers within the same shop being aligned in their communications with the borrower. To provide an incentive on that score, one panelist noted that borrower lawsuits frequently name as defendants not only the institution, but also the individual lender representative personally.

In the context of contractual liability to other servicing agreement parties, an interesting picture emerged that differentiated scope differences between portfolio, CMBS, and GSE servicing. There are varying delegations of authority. For life company-type portfolio servicing, the servicer's role was described as a variation of agency: the life company wants duties of loyalty and disclosure from the servicer like that of an agent, but it does not want the servicer to have binding authority. There is, nonetheless, a lender-servicer relationship that, while defined in broad strokes, has many aspects that are borne of the parties' course of dealing.

CMBS servicing, by contrast, is contractually detailed. There is no "relationship" as such, just a pooling and servicing agreement that is rather unbending in its requirements.

Fannie Mae Delegated Underwriting and Servicing (DUS) program uses a different approach: the DUS servicer has skin-in-the-game through the loss-sharing features of the DUS Program.

For servicers with more than one of these servicing platforms, the differences are such that there's a virtue in having staff dedicated to one platform.

File issues were identified as a source of potential liability to servicers: event triggers that are not identified, interest rate changes that are misunderstood or missed altogether, and billing mistakes all are examples of problems that might cost servicers.

In a CMBS context, indemnification is a key protection to servicers that are party to a pooling and servicing agreement (at least for liability for acts do not amount to gross negligence. Many sub-servicers, however, do not have comparable protections in their sub-servicing agreements. Limitations on liability are not the same as indemnification, because the

## Blog Post

former still leaves even a vindicated defendant with its costs of defense.

The point was also made that the standard insurance many primary and sub-servicers obtain provides mortgage impairment losses, but that is a far less robust coverage than an errors and omissions (E & O) policy. Servicers should review and update their insurance coverages.