Article Title: ARCHIVE | Legal Criteria: Anti-Predatory Lending Alert: Standard & Poor's Revises Criteria Related to Anti-Predatory Lending Laws Data: (EDITOR'S NOTE: —This article is no longer current. It has been superseded by "Standard & Poor's Criteria For Analyzing Loans Governed By Anti-Predatory Lending Laws," published Nov. 5, 2008.) Standard & Poor's Ratings Services is announcing that effective today for all first version loan pools received on or after today for analysis, it will require an addition to credit enhancement for certain loans included in its rated transactions that are governed by anti-predatory lending laws. As discussed in this release, this addition to credit enhancement may be waived if a seller of the loans into a securitization (Seller) meets certain financial capacity requirements. Since publishing its initial criteria relating to anti-predatory lending laws on Jan. 16, 2003, Standard & Poor's has continued to review such lending laws as they have been enacted. If, in Standard & Poor's opinion, an anti-predatory lending law imposes liability on purchasers or assignees (assignee liability), Standard & Poor's has generally published criteria prior to the law's effective date. Standard & Poor's has recently completed a review of predatory and abusive lending laws enacted to date. These criteria are the end result of in-depth reviews and analyses of over 40 federal, state, and municipal anti-predatory lending laws and ordinances. Standard & Poor's believes that when the risk associated with violating an anti-predatory lending law is quantifiable, then Standard & Poor's will allow loans governed by that law in its rated transactions if the risk is supported by the appropriate credit enhancement. To date, Standard & Poor's has relied on seller representations and warranties to cover the exposure of rated pools to the penalties associated with violating the various anti-predatory lending laws. Because of the proliferation of these laws, Standard & Poor's anticipates that an increased number of loans governed by these laws are likely to be included in rated transactions. For some of these loans, the potential assignee liability may exceed the original principal balance of the loan. This prompted Standard & Poor's to conduct a study of the maximum damages that may be imposed on assignees under the anti-predatory lending laws presently in effect. As a result of this study, Standard & Poor's has determined that it is necessary to take additional measures to protect against the cumulative effect of the potential damages associated with these loans. This risk increases for laws that have subjective standards, such as net tangible benefit or vague repayment ability tests, to determine whether a loan is "predatory." Consequently, Standard & Poor's is implementing the credit enhancement concepts discussed in its general criteria publication on predatory lending (see "Evaluating Predatory Lending Laws: Standard & Poor's Explains Its Approach," published April 15, 2003, on RatingsDirect, Standard & Poor's Web-based credit analysis system at www.ratingsdirect.com, and also on Standard & Poor's Web site at www.standardandpoors.com). Standard & Poor's Criteria Standard & Poor's is issuing this Alert to describe its expanded credit enhancement criteria, as well as its revised representation and warranty requirements, with respect to all of the anti-predatory lending laws that Standard & Poor's has reviewed and has concluded impose assignee liability (Assignee Liability Laws). Standard & Poor's will apply the following criteria for including in or excluding from its rated structured finance transactions loans governed by the Assignee Liability Laws. First, Standard & Poor's will continue to require a representation and warranty from the Seller of the loans into the transaction (the Seller) as of the cutoff date stating, "All loans were originated in compliance with all applicable laws, including, but not limited to, all applicable anti-predatory lending laws" (Compliance Representation). Second, Standard & Poor's will now require a representation and warranty from the Seller, as of the cutoff date stating, "No loan is a High Cost Loan or Covered Loan, as applicable (as such terms are defined in the then-current version of Standard & Poor's LEVELS® Glossary, which is now Version 5.6 Revised, Appendix E) and no mortgage loan originated on or after Oct. 1, 2002 through March 6, 2003 is governed by the Georgia Fair Lending Act" (Exclusion Representation). The Glossary is available on the Standard & Poor's Web site and on RatingsDirect. If an issuer chooses to include any loans governed by an Assignee Liability Law in a rated transaction, exceptions to the Exclusion Representation should be identified. In addition, it should be noted that Standard & Poor's is continuing to exclude the following loans from its rated pools: (i) High-Cost Home Loans, as defined in the New Jersey predatory and abusive lending law (NJ High-Cost Home Loans) and (ii) loans governed by the Georgia Fair Lending Act prior to its amendment on March 7, 2003 (GA Pre-Amendment Loans). (If and when the Los Angeles, CA and Oakland, CA predatory and abusive lending laws become effective, Standard & Poor's will also require the exclusion from its rated transactions of loans governed by either of these ordinances). If any loan included in a rated pool is in breach of the Compliance Representation or the Exclusion Representation, Standard & Poor's will continue to require the Seller to repurchase any such loan(s) at a purchase price that would make the securitization trust whole, including any costs and damages incurred by the issuer in connection with such loan. Third, Standard & Poor's will continue to require sellers into a securitization structure to demonstrate that their existing compliance procedures are effective to identify which loans fall into the various loan categories set forth in the applicable Assignee Liability Law and, if a Seller chooses to include in any rated pool loans governed by any of the Assignee Liability Laws, to determine that all such loans do not violate the applicable law. Fourth, effective July 1, 2004, Standard & Poor's will require Sellers to identify on the loan level file submitted to Standard & Poor's for review in connection with a securitization transaction whether each loan to be included in a rated pool is a Home Loan, in addition to the already required disclosure of any Covered Loan and High Cost Loan, as applicable (as such terms are defined in the Glossary). This timeframe has been adopted considering the system changes required for issuers and originators to be capable of capturing and reporting the required information to Standard & Poor's. Fifth, Standard & Poor's requires that a Seller into a securitization structure of loans governed by any Assignee Liability Law satisfy Standard & Poor's credit enhancement criteria, as more fully described below. This requirement may be waived if a Seller has an outstanding long-term debt rating from Standard & Poor's equal to or higher than the highest rated security to be issued in the applicable transaction or the payment of principal of and interest on the rated securities is guaranteed (pursuant to a guaranty agreement, LOC, or similar agreement) by an entity with such a rating. Credit Enhancement Criteria and Methodology Standard & Poor's will continue to rely on representations and warranties that a loan complies with an applicable anti-predatory lending law, if Standard & Poor's concludes that the law has clear and objective standards. If, on the other hand, in Standard & Poor's opinion, an anti-predatory lending law does not contain clear and objective standards(1), there is an increased risk that originators or sellers may inadvertently breach a compliance representation or warranty made in good faith. For the loans covered by these subjective laws, Standard & Poor's will require additional credit enhancement as described below. Credit enhancement requirements (CER) will be calculated on both the loans governed by anti-predatory lending (APL) governed loans and on those that are not (non-APL loans). For the APL governed loans, CER will be calculated for each jurisdiction that is included in the pool. CER will be provided for each transaction with the inclusion and exclusion of the APL governed loans. Credit Enhancement Methodology The calculation of CER for non-APL loans will be accomplished through Standard & Poor's existing loan level analysis, ratings methodologies, and criteria for determining a foreclosure frequency (FF) and loss severity (LS) for each loan. Calculation of APL loan CER will encompass: Defensive Claims Calculation Standard & Poor's will use the FF as calculated utilizing the LEVELS® model to determine the frequency or probability of a defensive claim. Standard & Poor's assumes all defaulted loans will be subject to defensive APL loan claims; The LS for the APL loans will be calculated outside of the model based upon the specific jurisdiction's damages as described further in the Standard & Poor's Assumptions Appendix to the Anti-Predatory Lending Law Update table; The greater of the APL LS and Standard & Poor's LEVELS® model LS will be used; and Multiplying the FF by the greater of the APL loss severity or the LEVELS® model LS will yield the CER for the defensive claims. The loan level CER formula for the defensive claims is: FF x (the greater of APL LS or LEVELS LS). Affirmative Claims Calculation To determine the affirmative APL claims Standard & Poor's assumes 25% of the nondefaulted loans (Litigation Frequency, or LF) will be subject to affirmative APL claims. The formula for determining this is (100- ('AAA' FF)*25%; The LS for the APL loans will be calculated outside of the model based upon the specific jurisdiction's damages as described further in the Standard & Poor's Assumptions Appendix to the Anti-Predatory Lending Law Update table; and Multiplying the LF times the APL loss severity will yield the CER for the affirmative claims. The loan level CER formula for the affirmative claims is: LF x APL LS. Aggregate CER Calculation To determine the aggregate loan level CER for APL loans: FF x (the greater of APL LS or LEVELS LS) + LF x (APL LS). The CER will be reported separately for APL governed and non-APL loans. The two (or more) sets of CER will be weighted together to produce the pool level CER. Credit Enhancement Criteria Standard & Poor's will base its credit enhancement requirements for a loan governed by a given anti-predatory lending law on its assessment of potential loss calculated for each such loan included in a rated pool (see table), as adjusted for the incidence of estimated affirmative and defensive claims. Anti-Predatory Lending Law Loss Severities by Jurisdiction (%) Arkansas (High-Cost Home Loans) 119 Cleveland Heights, Ohio (Covered Loans) 37 Colorado (Covered Loans) 119 District of Columbia (Section 7(A) Covered Loans) 137 District of Columbia (Section 7(B) Covered Loans) 137 Florida (High-Cost Home Loans) 119 Georgia (amended law) (High-Cost Home Loans) 110 Home Ownership Equity Protection Act (Section 32 Loans) 119 Illinois (High-Risk Home Loans) 110 Maine (High-Rate, High-Fee Loans) 119 Massachusetts (High Cost Home Loans) 116 New Jersey (Covered Home Loans- Refinancings Only) 110 New Mexico (High-Cost Home Loans) 110 New York State (High-Cost Home Loans) 163 Ohio (Covered Loans) 37 Oklahoma (Subsection 10 Mortgage Loans) 119 Toledo, Ohio (Home Loans) 95 In the interest of market transparency, Standard & Poor's is publishing its findings regarding the maximum damages that may be imposed on assignees for violations of the anti-predatory lending laws listed on the table, "Anti-Predatory Lending Law Update," published on both RatingsDirect and on Standard & Poor's Web site. Standard & Poor's is publishing its findings to increase investor awareness of potential damages for a given loan, as well as market awareness of the issue of assignee liability overall. Market participants should note that the additional credit enhancement requirement will be applied primarily to high cost loans that have historically not been a large component of Standard & Poor's rated transactions. As performance and loss information for the loans subject to additional credit enhancement develops, Standard & Poor's will adjust its criteria as appropriate. Criteria Implementation Since Standard & Poor's currently requires that all High Cost and Covered loans be reported on the loan level file, the criteria described above requiring adequate credit enhancement to cover the potential liability of Assignee Liability Law loans is effective immediately. Going forward, the published ratings analysis for transactions rated by Standard & Poor's will include a breakout of the incidence of loans by state jurisdiction that would fall into the categories on the attached chart and the sizing of the additional enhancement required for those loans to be included in Standard & Poor's rated transactions. Please note that effective July 1, 2004, Standard & Poor's will require Sellers to identify on the loan level file submitted to Standard & Poor's for review in connection with a securitization transaction whether each loan to be included in a rated pool is a Covered Loan, High Cost Loan, or Home Loan, as applicable (as such terms are defined in the Glossary). Laws Without Assignee Liability The following lists the anti-predatory lending laws that Standard & Poor's has reviewed to date and has concluded impose no assignee liability. In accordance with its general policy, Standard & Poor's does not impose special criteria for including in its rated transactions any loans that are governed by these laws. Therefore, with the exception of the anti-predatory lending law of Cleveland, Ohio, regarding which Standard & Poor's received numerous inquiries, Standard & Poor's has not published criteria for including within its rated transactions any loans governed by these laws. California Chicago, Ill. Cleveland, Ohio Cook County, Ill. Idaho Maryland Michigan Minnesota Mississippi Nebraska New York (Part 41) Pennsylvania Texas Utah Vermont Virginia Washington Wisconsin Standard & Poor's regularly reviews its criteria to keep current with changes in the law in the area of predatory lending. These criteria are not stagnant but evolve over time. Standard & Poor's will continue to publish its criteria to keep market participants informed of any new approaches in this area. (For a further explanation of Standard & Poor's criteria for and approach to evaluating anti-predatory lending laws, see "Standard & Poor's Implements Credit Enhancement Criteria and Revises Representation and Warranty Criteria for Including Anti-Predatory Lending Law Loans in U.S. Rated Structured Finance Transactions," published May 13, 2004, on RatingsDirect, Standard & Poor's Web-based credit analysis system at www.ratingsdirect.com, and on Standard & Poor's Web site, wwww.standardandpoors.com.) Credit Analysts Frank Raiter, (212) 438-2579, frank_raiter@sandp.com; Susan Barnes, (212) 438-2394, susan_barnes@sandp.com, Scott Mason, (212) 438-2539, scott_mason@sandp.com. Notes (1) In evaluating the clarity of an anti-predatory lending law, Standard & Poor's will look to see how clearly a law sets forth what constitutes prohibited actions and/or omissions for a given loan category. Standard & Poor's looks for clear language that would enable an originator or seller to comply with the law. Notwithstanding a law's lack of clarity, however, Standard & Poor's will consider mitigating factors in deciding whether to require additional credit enhancement. These mitigating factors include the following: (i) whether damages are imposed under the law only if there is a "pattern or practice" of violating the law; (ii) if the law requires the borrower to prove that a violation was committed "knowingly and intentionally"; (iii) if a law provides objective standards for satisfying a repayment ability test or a net tangible benefits test; (iv) the litigation history of the law; (v) procedural factors contained in a law, such as statutes of limitation, cure periods, rebuttable presumptions, restrictions on affirmative and defensive claims against assignees; and (v) and other factor that Standard & Poor's deems relevant.