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## Servicer Evaluation: HSBC Mortgage Corp. (USA)

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[Table of Contents](#)

### Opinion

Standard & Poor's Ratings Services has ABOVE AVERAGE rankings on HSBC Mortgage Corp. USA (MC) as a residential mortgage loan servicer, subordinate-lien mortgage loan servicer, and residential subprime mortgage loan servicer. The outlook is stable in each category.

The overall rankings reflect our view of MC's experienced and tenured management team, automation, policies and procedures, training regimen, internal controls, and default management abilities. MC assigns some traditional mortgage servicing processes to the company's Group Service Centers (GSCs) in India and the Philippines. According to MC, it closely monitors and controls the tasks it assigns, which include service-level agreements and weekly reporting.

The rankings also reflect our opinion that the company's practice of running on two servicing platforms may be inefficient and may impede effective customer service and default management. While customer service's average speed to answer (ASA) has risen over prior periods, it is within the comparable range of other servicers we monitor. Collection statistics ASA and abandonment rates have risen above the median level of other servicers we monitor. We recognize that the company's decision to exit subprime lending generated by MC's sister company, HSBC Finance, may have contributed to the halt of the scheduled conversion/migration to one servicing platform. MC is a wholly owned subsidiary of HSBC Bank USA N.A. and part of U.K.-based HSBC Holdings plc. In addition, it is our understanding that the company has not fully implemented and retested the audit department's recommendations, which are based on reviews of the servicer.

MC has informed us that it is continuing with the strategic consolidation plan it formed in late-2008 to centralize servicing management across the U.S. and expects to complete this effort this year. The company has completed its alignment and centralization of its management activities according to function.

MC provides metrics through Standard & Poor's Servicer Evaluation Analytical Methodology (SEAM) questionnaire, and the company's statistics generally align with those of other similarly ranked mortgage servicers and other servicers we monitor.

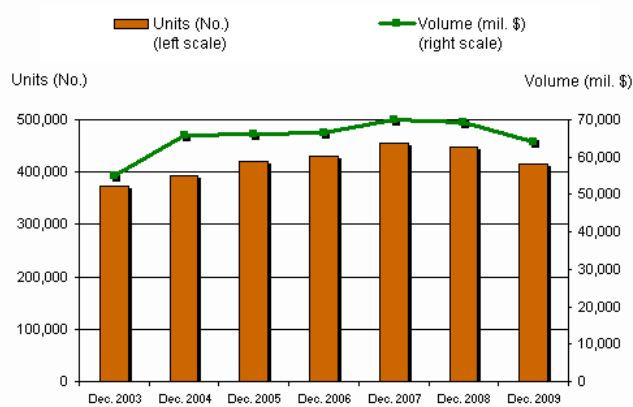
The levels of delinquencies in MC's prime loan servicing portfolio align with those reported in The Mortgage Bankers Association's fourth-quarter 2009 National Delinquency Survey, while its subprime delinquencies were marginally above them. Delinquencies for the subordinate-lien portfolio were also slightly above those in the fourth-quarter 2009 American Bankers Association Consumer Credit Delinquency report.

### Outlook

The outlook is stable for each servicing asset type. Although the prime and subordinate-lien portfolio volumes have declined over the past two years, we believe stabilization in the financial markets may open up opportunities for the bank to offset this runoff with newly originated mortgage loans. We view the falling number of subprime loans as a negative ranking consideration, however, and we would consider revising our outlook to negative or lowering our ranking if the decline continues.

Chart 1

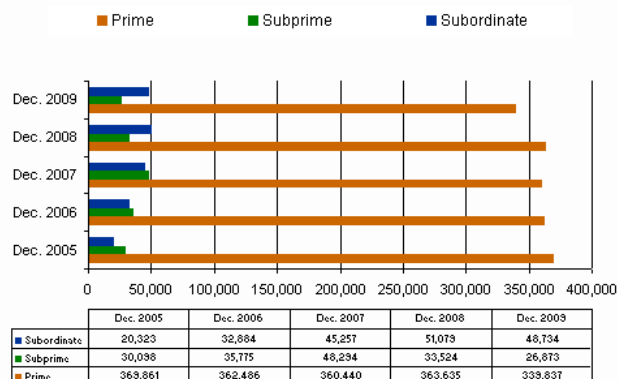
Portfolio UPB And Units—Prime, Subprime, And Subordinate



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Chart 2

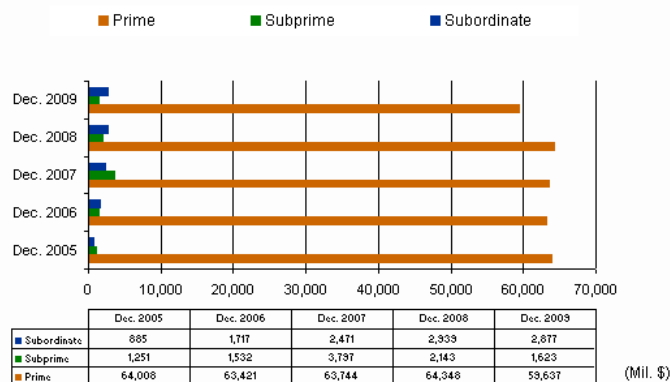
## Units



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Chart 3

## Volume

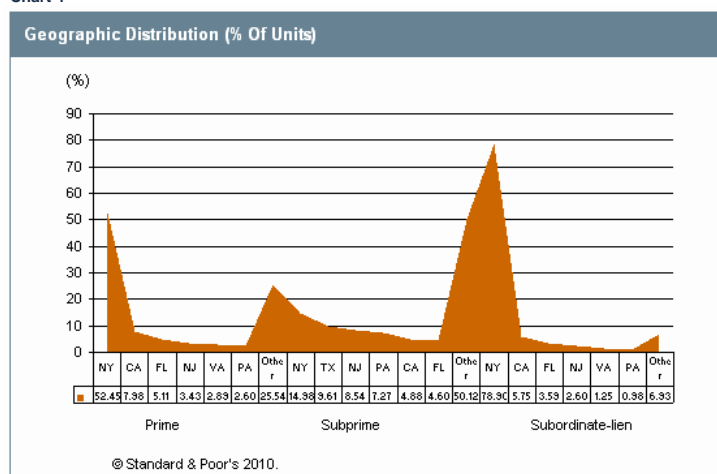


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Table 1

**Delinquency Statistics?Second-Half 2009**

	30 days	60 days	90+ days	Total % of units	Foreclosure (%)	Bankruptcy (%)	REO (No.)
Prime	2.75	1.27	2.32	6.34	1.68	0.70	3,322
Subprime	9.49	4.83	17.61	31.93	3.72	3.41	301
Subordinate	1.12	0.57	2.64	4.33	0.45	0.59	14

**Chart 4****Profile**

HSBC Holdings plc generally ranks among the largest and most diversified financial services groups in the world. It employs nearly 300,000 full- and part-time staff and serves more than 100 million customers across 88 countries and territories. It is managed through a matrix structure aligned with customer groups, global businesses, and regions.

In our opinion, MC is an experienced residential mortgage loan servicer. Its headquarters are in Depew, N.Y. (a suburb of Buffalo). MC was incorporated as a separate mortgage banking subsidiary in 1985, and the company formed a separate mortgage servicing unit with the 1997 acquisition of First Federal Savings and Loan of Rochester, N.Y. HSBC acquired Republic Bank of New York in 1999 and Household Finance in 2003. According to MC, the Household acquisition, combined with MC's mortgage servicing operations, provided the opportunity for the mortgage lending units to leverage each other's best practices and enhance vendor relationships. MC is the 18th-largest servicer by number of loans serviced according to the fourth-quarter 2009 National Mortgage News Quarterly Data Report and is an approved servicer for Freddie Mac, Fannie Mae, Ginnie Mae, FHA, VA, and SONYMA loans.

**Management And Organization**

Standard & Poor's subranking on MC for management and organization is ABOVE AVERAGE.

It is generally our opinion that servicing mortgage loans on two servicing platforms, despite core employees' experience on selected platforms, is not efficient. We believe this practice could delay the company's responses to its borrowers, lead to higher turnover (especially with employees of HSBC Finance servicing its subprime loans that are running off), possibly add additional pressure on existing employees, and may cause delays in providing reporting data. In our view, this offsetting factor is balanced by our generally positive assessment of the elements we discuss in this section.

**Management and staff recruitment, development, and training**

In our opinion, MC has a seasoned management team with turnover rates that are consistent with the subranking. According to the company, the management team maintains the following attributes:

- Senior managers average approximately 22 years of industry experience, including 18 years' company tenure;
- Middle managers average approximately 15 years of industry experience and 13 years of tenure;
- Reported annualized management and staff turnover rates for the second half of 2009 were 4.35% and 23.04%, respectively; and
- MC's cross-training of employees to perform other functions helps provide backup and also contributes to career-path opportunities, skill development, and promotion, in our view.

Management reports that it plans for capacity by forecasting six to 12 months ahead for essential metrics and activity volume, and three to six months ahead for staffing capacity.

In our opinion, MC's training environment is well-structured and effective. Dedicated trainers?the E.D.G.E. (educate, develop, guide, excel) training team?administer the training programs both domestically and to applicable GSC employees. The programs are comprehensive, in our view, and include curriculums designed for both new hires and existing staff, with course

offerings available on the company intranet site. Employees may register for various courses online, and the company tracks attendance and course completion in a central database. Some characteristics of the training program, as reported by MC, include:

- The employee orientation program includes a corporate overview, basic technical training, and a mortgage banking overview;
- Employees receive technical training for both existing and any newly installed and/or upgraded LPS applications, as well as for other ancillary software programs based on job-specific requirements;
- Employees participate in training workshops that cover skill practices, mortgage banking processes and terminology, call observation, and, in some instances, the successful completion of a final examination;
- All new customer service and collection employees enroll in up to 120 hours of classroom education and 200 hours of on-the-job training. Classroom instruction covers skill practices, mortgage banking processes and terminology, relevant regulations and acts, and call observation;
- Management training helps employees develop leadership skills, including coaching and counseling, defining goals, and refining interviewing skills;
- Training for new collectors features an extensive focus on the Fair Debt Collection Practices Act (FDCPA); and
- The company established "train-the-trainer" programs for GSC trainers who receive training in the U.S.

According to MC, selected GSC employees become subject matter experts (SMEs) by completing extensive training at MC for at least 10 weeks, and MC employees identified as SMEs travel to GSC sites for a minimum of eight weeks. In conjunction with training initiatives, the company provides dedicated coaching and process monitoring until the activity is declared "business as usual."

MC may also use outside vendors and industry organizations for additional training. We believe MC's combination of structured classroom instruction, on-the-job training and mentoring, and external seminars provides an excellent and varied methodology that contributes to MC's efforts to ensure all new and current MC staff are well-versed in company policies and procedures. In addition, MC represents that some employees have participated in FHLMC's Loss Mitigation and Investor Reporting program and received certification.

#### Internal controls

Since our last review, MC has informed us that the company's operational risk management (ORM) and communication group is responsible for the development and communication of policies and procedures (P&Ps). Some reported characteristics and methodologies of MC's P&P activities include:

- The company's general counsel and government relations teams identify regulatory changes and communicate them to the compliance group, which in turn partners with ORM to identify implementation requirements;
- There are various levels of oversight and approval processes that require signoff before any changes are made to P&Ps;
- ORM manages and maintains a central database of P&Ps; and
- The company uses electronic communication as well as department meetings to inform employees of P&P changes.

In our opinion, HSBC North America Holdings Inc., MC's parent, has a sound and in-depth multitiered audit and risk assessment methodology designed to identify and mitigate risk of loss to investors.

The internal audit department reports to the senior executive vice president of the audit department, who functionally reports to the directors of the audit committee, in an effort to provide for complete independence. The internal audit divides the mortgage servicing audit into separate "inherent risks" and "control risks," which combine to gauge the overall risk. The overall risk determines the frequency of the audit cycle, and servicing audits are performed annually. Reviews by the audit and independent compliance unit are designed to satisfy traditional risk-based methodologies and performance methodologies and include the following:

- The unit develops a flexible annual audit plan employing an appropriate risk-based methodology, covering any risks or control concerns management identifies, and submits that plan to the audit committee for review and approval;
- The department follows the Standards for the Professional Practice of Internal Auditing of The Institute of Internal Auditors;
- The overall risk assessment determines the frequency of the audit cycle, which ranges from nine to 48 months. Mortgage servicing audits are now conducted annually regardless of the risk level;
- All audit reports incorporate written feedback for management, as well as a methodology for management's response; and
- A database monitors the annual audit schedule and response dates.

An independent compliance unit provides support in identifying and managing compliance risk. Activities include the following:

- The unit partners with business units to understand new or revised regulatory requirements to develop and implement

compliance procedures;

- The unit performs monthly and quarterly audits of various loan servicing areas that are designed to comply with Department of Housing & Urban Development (HUD) requirements;
- Results of the compliance audits are distributed to senior management;
- Compliance training is mandatory and available to all employees; and
- An online compliance manual is available for all employees that includes both state and federal regulations.

MC reports that it maintains a quality control (QC) group that reports to the Credit Policy/Risk Management department. The group performs the required FHA and VA servicing reviews as well as reviews surrounding early payment defaults, investor repurchase requests, and mortgage fraud. MC senior management receives all QC reports, along with responses from the applicable area.

MC's audit reports are structured to ensure adherence with prudent loan servicing practices and to verify compliance with regulatory and investor guidelines. Standard & Poor's reviewed provided 2009 mortgage servicing internal audit reports and found the reports to be comprehensive and succinct. The reports did not reveal major findings for the functional areas reviewed; however, there were findings that were either addressed or are targeted for completion through August 2010. In order to address findings and remediate future occurrences, management has represented that it has assembled a team of risk managers within servicing operations, led by a senior vice president with over 20 years of mortgage industry experience. The team is responsible for timely resolutions and working with the audit department upon remediation of a finding. There were no 2009 USAP or Regulation A/B exceptions.

In addition, as a subsidiary of a national bank, MC is regulated by the Office of the Comptroller of the Currency (OCC), which frequently monitors the servicing operations. MC submits quarterly updates, including financial statements, delinquency information, and other key metrics, to the OCC. The OCC communicates to senior management during the review process, with an exit meeting that finalizes any findings or recommendations. Also, GSEs review MC to ensure that servicing is performed in accordance with agency guidelines.

Management has represented that pending legal matters are not likely to be material. For additional information, please refer to HSBC USA Inc.'s most recent Securities and Exchange Commission filing.

#### Vendor management

MC's administration of its vendors is centralized within HSBC North America (HNAH). HNAH's vendor management responsibilities include vendor due diligence; bids, contract terms, and service-level agreements (SLAs) (provided by servicing operations); ensuring vendor compliance with Regulation AB and USAP standards; assessing vendor safeguards to ensure data privacy; and vendor database management, including a vendor review process. The group uses scorecards to monitor vendors' performance to help ensure their adherence with SLAs, and provides MC with periodic updates.

#### Technology

In our view, MC operates in an efficient automated environment as a remote client of LPS (formerly Fidelity Information Services). Characteristics of the systems architecture for business operations and recovery are as follows:

- The present systems architecture is sufficient to support portfolio growth, in our view;
- MC uses a variety of LPS' ancillary applications and technology services, including Electronic Loan Interface (ELI), Passport, Director, and Customer CareNet;
- Imaging technology provides for easy access to certain documents and facilitates customer inquiries;
- The company uses various First American mortgage-related products;
- The company uses REKON software for processing mortgage reconveyance documents;
- An automated call management system allocates incoming calls, and a voice response unit (VRU) provides electronic responses to customer inquiries;
- A workforce management tool is used for telephone staffing;
- The company uses a call recording application to record 100% of customer service and collection calls;
- MC uses an autodialer to build, load, and track calling campaigns on delinquent loans;
- Freddie Mac's Early Indicator, along with internal behavior scores, help the company identify high-risk mortgage loans;
- NewTrak electronically refers and tracks bankruptcy and foreclosure cases sent to outside counsel; and
- Lexis Nexis Banko provides electronic access to foreclosure and bankruptcy filings, discharges, dismissals, and case conversions nationwide.

MC's disaster recovery and business continuity (DR/BC) plan consists of:

- A fully developed plan with a hierarchy of critical business functions and a calling tree;
- Redundancy of critical business functions between other company locations;
- Encrypted off-site storage of nightly backups and a daily mirror backup of production recorded at an off-site location; and
- Annual testing, which includes contingency plan reviews to ensure connectivity to servicing sites, and updated

document controls.

In addition to DR/BC connectivity, disaster simulation, validation, and remediation performed annually within the company, MC now tests connectivity and restoration of the host system (LPS/Fidelity) with one of the host's disaster facilities at least annually as part of the company's overall DR/BC plan. We believe validating connectivity at LPS/Fidelity's first, second, and third disaster recovery facilities over alternating testing periods may reduce corporate risk.

## Residential Servicing? Loan Administration

Standard & Poor's subranking on MC is ABOVE AVERAGE for (prime) residential mortgage loan servicing administration.

### Overview

MC's servicing operations leverage the company's infrastructure to service not only prime assets but also subprime and subordinate-lien assets. Although many of the servicing activities follow similar methodologies, the immediate mortgage loan servicing administrative section represents prime servicing. Please refer to the applicable asset sections for relevant information and selected charts and graphs.

Ms. Kathryn Madison, EVP and Chief Servicing Officer for HSBC's consumer and mortgage lending organization, is responsible for MC's servicing administration. The company reported as of Dec. 31, 2009, that it was servicing an aggregate portfolio of more than 416,000 loans with a total unpaid principal balance (UPB) exceeding \$64 billion. The prime and subordinate-lien portfolios are heavily concentrated in New York, which accounts for more than 52% and 78% of the number of loans, respectively, and nearly 44% and 72% of the corresponding total UPB, respectively.

Standard & Poor's reviewed all areas of loan servicing, including loan boarding, payment processing, investor accounting and reporting, customer relations, and default administration (including foreclosure and bankruptcy processing). In our opinion, the established controls are sound.

Chart 5

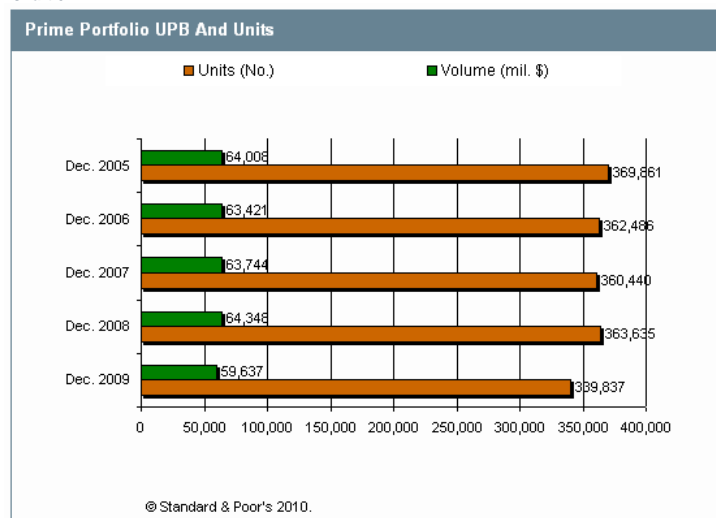
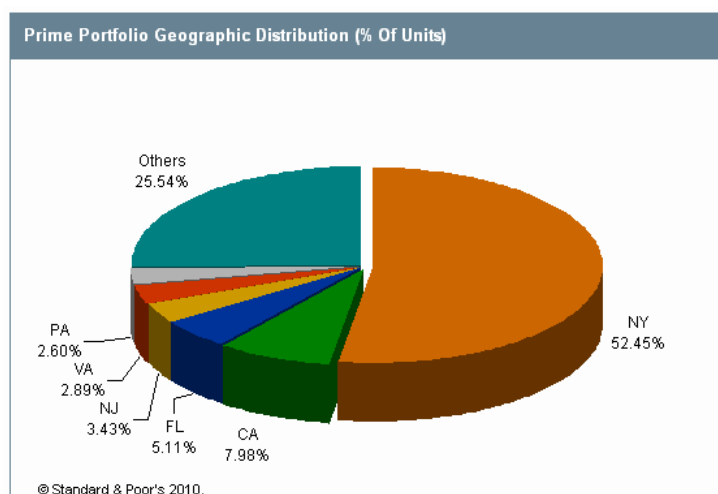


Chart 6



#### Loan boarding

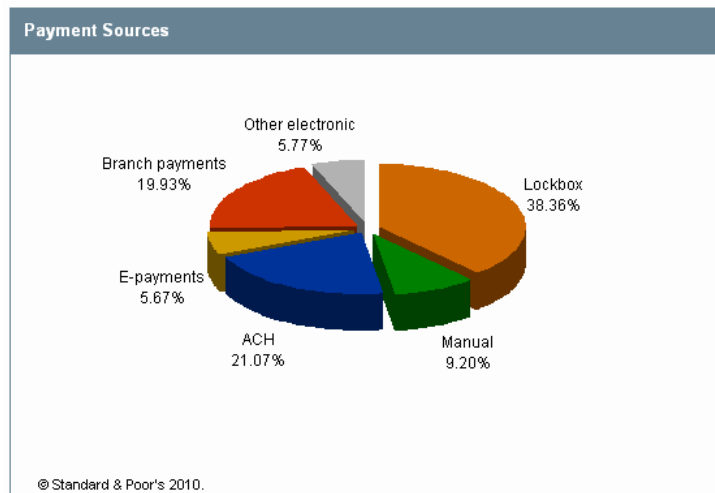
According to the company, new loan setup and loan boarding is a two-day process beginning with an interface from the origination system on the day of funding. Critical data integrity reports from the origination system validate the information prior to the interface. LPS generates edit reports on more than 100 checkpoints that provide guidance and identification of possible data boarding errors. Servicing acquisitions, which are fully automated, use either Electronic Loan Interface (ELI) or LPS' Acquisition Services consultants. Using loan document images, MC divides its verification activities between its servicing centers in Buffalo and India. In addition, the company conducts welcome call campaigns through the Manila call center. These calls confirm key borrower information and offer Automated Clearing House (ACH) and Internet banking alternatives.

#### Cash management and investor accounting

In our opinion, MC has an efficient cash management operation that incorporates good internal controls to minimize risk of loss from human error or fraud. The company uses multiple internal lockboxes as well as rules-based payment processing technology to process monthly mortgage payments. Approximately 91% of the payments are electronic. Mail sent directly to MC servicing centers or payments coded to reject during lockbox processing represent approximately 9% of payments. Based on our observations, along with MC's statements, we believe MC displays solid controls in the payment processing function, including:

- The payment posting area's level of security includes employee card key access;
- Check batches are subject to multiple levels of review and are system-reconciled;
- Unprocessed items require a 24-hour resolution, and management performs desk inspections periodically to ensure that all items have been processed within the specified period;
- Rejected checks and payment checks received through the mail are imaged and assigned to a functional workflow for identification and posting. Any check held overnight is stored in a fireproof cabinet;
- Payment stops are updated daily to mitigate additional delays and expenses associated with accounts in the process of foreclosure;
- A dedicated individual disassociated from the payment posting function reconciles the payment clearing account daily to ensure proper segregation of duties; and
- MC uses HSBC Bank's check-image archive system to expedite research of financial transactions and root-cause analysis of applications.

Chart 7



A separate and distinct department performs investor remitting, reporting, and account reconciliation activities. The company, in our view, has appropriate segregation of duties among staff handling these functions. Management has represented that there are no items aged more than 60 days and that the investor accounting department has the following risk management methodologies in place:

- Investors align workflow assignments to help the staff develop and maintain their expertise;
- The servicing system performs a daily reconciliation of the clearing account and generates exception reports, which investor accounting personnel review;
- An auto sweep of clearing account funds into the respective custodial accounts is in place;
- A dedicated staff disassociated from reporting and remitting functions reconciles custodial accounts monthly. Outstanding items are identified within 30 days and cleared within 45 days;
- Managers review investor reports and bank account reconciliations;
- The data gathering process for investors is fully automated with no manual data manipulation, thus preserving integrity of data reported to investors;
- The department performs investor reporting both electronically and in print; and
- As an added control, the accounting department is responsible for all wire transmissions.

Chart 8

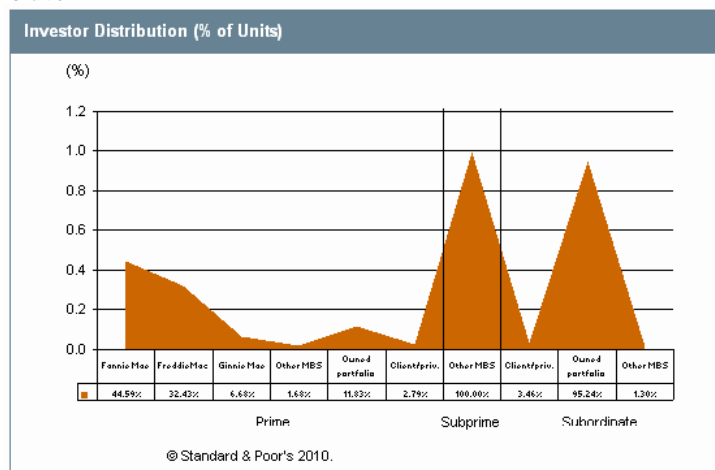
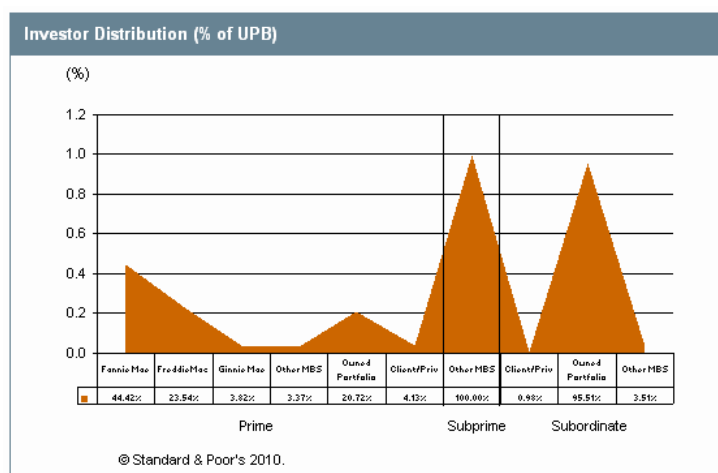


Chart 9





### Customer relations

MC reports that it uses its global call centers in Depew, N.Y.; Bangalore, India; and Manila, Philippines, to respond to borrower telephone inquiries. Nearly 75% of incoming call volume is managed outside of MC's Depew call center. Service-level agreements (SLAs) are in place in an effort to closely align the off-shore operations with MC customer service matrixes, as referenced below. A VRU provides account-level data to customers, and an automated call distribution system (ACD) routes calls to the appropriate customer service representatives, including those who speak other languages, including Spanish, Mandarin, and Cantonese.

In addition to primary customer service representatives, a team of skilled "guest representatives" educated to assist with borrower inquiries supplements the telephony network during high-volume periods. A dedicated correspondence unit provides written responses to borrower inquiries when required and within regulatory guidelines. A Web site is also available for borrowers to obtain static loan information, make payments, and correspond with the company. Other reported factors of MC's customer relations are as follows:

- The company-reported VRU capture and Web usage rates of 56% and 62%, respectively, are better than the reported averages of other servicers we follow. However, the reported first-call resolution rate, at 76%, is lower than the average of other servicers we follow;
- Call centers operate from 7 a.m. to 11 p.m. EST Monday through Friday and from 8 a.m. to 5 p.m. Saturday and Sunday. In addition, customers may visit over 400 HSBC branch offices to obtain responses to their inquiries;
- Staff turnover rates at the Depew and off-shore call centers are 25% and 26%, respectively;
- The company's call monitoring of customer service staff falls within the median range of other mortgage servicers we monitor;
- Although the ASA and abandonment rates at both the Depew and off-shore centers are above the median range of mortgage servicers we monitor, we believe they are acceptable;
- Customer service handles borrowers who are less than 25 days delinquent, who can use various electronic payment vehicles to expedite a borrower-initiated payment;
- All calls are recorded and logged with a reason code and description, which enables management to identify trends and support communication matters;
- The company uses automatic number identification (ANI) technology to capture incoming numbers for future contact reference;
- Customer issues are tracked at the mortgage corporation and bank levels in a browser-based "Electronic Complaint Tracking System." The database is employed to detail and categorize borrower issues as well as ensure regulatory compliance;
- A dedicated research and correspondence team tracks and monitors written correspondence to ensure RESPA compliance. The team is also responsible for root-cause analysis and tracking to drive process improvements throughout the company;
- All calls are recorded, and 10% of the calls are video-captured; and
- The company has represented that a third-party vendor conducts weekly random customer satisfaction surveys based on the prior week's customer call.

The Manila team conducts welcome call campaigns to greet new customers, confirm key information, answer questions, and offer EFT and Internet banking. The company indicates that relationship customers are a key focus as well. Customer requests for product enhancements and other banking products are referred to the appropriate department for execution. In addition, the Manila group supplements collections activity by placing reminder calls and supporting outbound collection campaigns. Calling campaigns are structured using a risk-based approach to prioritize calling queues.

MC uses REKON and the image and workflow (IAW) system for processing mortgage reconveyance documents and managing timelines to ensure timely processing. The applications have built-in compliance calculators to track the expected completion date for each release in the processing pipeline. IAW monitors documents it receives and assigns a priority number to each loan paid based on the time remaining to maintain compliance with state timeline requirements. According to MC, the processing centers in Depew and Bangalore prepare lien releases. An aging report provides rates of compliance with reconveyance timelines, which MC reported as 99.17% for December 2009.

#### Special loans

A dedicated special loan team manages adjustable-rate mortgages (ARMs), home equity lines of credit (HELOCs), balloon mortgages, interest-only loans, and other loan products requiring special handling. Characteristics of the special loan team, according to MC, include the following:

- Administrative tasks and tracking are performed electronically;
- The area maintains daily ARM loan indices, with security controls requiring a processor and approver;
- Established risk-based borrower programs are designed to proactively address potential payment issues;
- MC reviews and approves a sample of customer billing statements daily to ensure that loans are accurately transmitted to the billing statement vendor;
- The company also reviews a sample of monthly HELOC statements to ensure the accuracy of transaction data;
- The team counsels HELOC borrowers on loan rate product options; and
- The team provides special loan workout alternatives that include assignments, CEMAs (consolidation, extension, and modification agreements), principal curtailment, HUD 235, and balloon payments. MC also administers private mortgage insurance (PMI) terminations in accordance with the Homeowner's Protection Act and state and investor guidelines.

#### Escrow administration

MC has advised us that approximately 73% of its prime and less than 10% of its subprime servicing portfolios maintain escrow accounts for tax, hazard, or flood insurance. MC uses the services of tax and insurance vendors to monitor tax and insurance payments. It is our understanding that MC uses the vendors' various applications to monitor payments. MC has informed us that recognition of failure to pay taxes (for a non-escrow loan) will initiate a series of letters to the borrower and may, after analysis, prompt MC to make the tax payment and establish an escrow account. In addition, non-escrow insurance cancellations may result in the initiation of a forced-placed insurance policy. As with delinquent tax payments, the company will initiate a series of letters and calls to borrowers, as well as calls to known insurance carriers. Borrower inquiries about tax and insurance are administered by customer service and, if necessary, the applicable tax and insurance group. We believe MC operates a well-controlled escrow administration area that benefits from its oversight of its third-party vendor relationships. Other attributes of escrow administration include the following:

- Electronic interfaces between MC and vendors are in place;
- Nonreimbursable tax penalties related to servicing were negligible during the past 12 months;
- MC communicates expired or cancelled policies for escrowed and non-escrowed accounts to the hazard and flood insurance vendors via an electronic data interchange (EDI);
- MC has access to the tax vendor's Web site, which contains lender-specific reports, agency disbursement calendars, links to online manuals, and taxing authority Web sites;
- The insurance vendor has EDI billing and remittance in place with all major insurance carriers;
- Management control reports and quarterly vendor visits help to ensure compliance with established service levels;
- MC tracks primary mortgage insurance (PMI) via escrow lines on the LPS servicing system; and
- Forced-placed insurance rates are low, in our opinion. Policies are placed at 60 days after expiration for hazard insurance and 45 days after expiration for flood insurance if there is no evidence of coverage.

**Table 2**

#### Insurance

	Placed	Cancelled	Renewed
Hazard (%)	1.06	14.40	5.25
Flood (%)	0.13	13.09	2.48

#### Default management

According to MC's management, the company aligns its default servicing (secured loans) across four "centers of excellence"? phone collections, lost mitigation, late-stage defaults, and recovery management. We describe these centers in more detail below.

The default management department handles collections, loss mitigation, foreclosures, bankruptcies, and REOs.

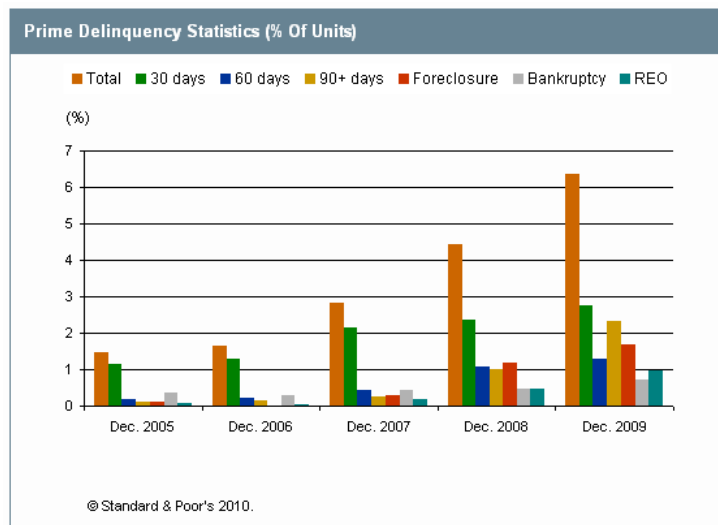
**Table 3**

#### Prime Loan Statistics

Dec. 2009   Dec. 2008   Dec. 2007   Dec. 2006   Dec. 2005

Units (No.)	339,837	363,635	360,440	362,486	369,861
Volume (mil. \$)	59,637	64,348	63,744	63,421	64,008
Total delinquency (% of loans)	6.34	4.44	2.81	1.65	1.45
30 days	2.75	2.36	2.13	1.29	1.15
60 days	1.27	1.07	0.42	0.22	0.19
90+ days	2.32	1.01	0.26	0.14	0.11
Foreclosure (%)	1.68	1.19	0.27	0.11	0.10
Bankruptcy (%)	0.70	0.45	0.42	0.27	0.37
REO Inventory (No.)	3,322	1,714	617	156	256

Chart 10



Phone collections are aligned into five distinct areas. Early-stage collections (from one to 59 days past due (DPD)); Mid-range collections (60 to 119 DPD); late-stage collections (120 DPD and greater); post-foreclosure review; and specialty calling (modification follow-up and performance management).

Early-stage collectors, including representatives from Bangalore, who complement the evening shift, use a predictive autodialer to administer calling campaigns. Early-stage inbound calls from borrowers less than 25 DPD may be channeled through customer service (less than 25% of such calls) or collections based on loan risk characteristics and past payment performance. MC reported the following aspects of its collection structure and controls:

- Collection employee turnover at the company's U.S. and non-U.S. centers were 25% and 18%, respectively, for the second half of 2009;
- MC bases its collection timelines on investor requirements and prudent loan servicing practices;
- The company uses data and voice recording technology for collector coaching;
- Global mail-tracking technology for payments helps to effectively manage calling campaigns;
- The predictive dialer aligns each connected call with an employee's skill set, according to the calling campaign;
- Early-stage collectors use the predictive dialer for outbound calls approximately 80%-90% of the time. Manual calling queues established by LPS' MSP are used for no-contact, no-number, and skip-tracing work;
- The U.S. call center statistics?ASA and abandonment rates?are high compared with those of other servicers we monitor. The non-U.S. statistics are consistent with the ranking level;
- Customer service employees are trained to respond to incoming calls from delinquent borrowers. Delinquent borrowers are automatically routed to a collection representative from the VRU at 25 days past due;
- A flip-chart desk guide assists collectors in responding to borrowers' questions;
- Collection representatives use Freddie Mac's Early Indicator and an internal behavior score to assess the portfolio and develop calling campaigns based on default risk;
- Extended evening and weekend hours are in place to canvass the portfolio; and
- The company uses data and voice recording for collector coaching.

According to company guidelines, early-stage collectors have discretionary authority to enter borrowers into short-term repayment plans (usually less than three months) according to an established tiered methodology and further authorization, as applicable. Repayment plans are tracked in the system, and accounts automatically revert to the collection queue if they break the plan. In addition, management represents that all servicing units are educated to identify borrowers who are likely to default and forward this information to specialized personnel in the default department.

Mid-range collectors (for accounts 60 to 119 DPD) and late-stage collectors (for accounts 120 DPD and greater) are responsible for inbound and outbound calls to and from borrowers. The company indicates that these teams attempt to secure payments from defaulted borrowers as well as provide limited loss mitigation options. The teams also perform skip tracing, review broken promises to pay, and manage calling campaigns and foreclosure referrals in accordance with investor and regulatory guidelines. Other characteristics of these teams include the following:

- They support early-stage collections as necessary;
- They review loss mitigation activities on loans in foreclosure at established contract parameters;
- Systematic calling campaigns are in place to allocate and queue loans; and
- The length of a repayment plan is dictated by the borrower's financial position and investor guidelines, with logic, rates, and options built and maintained in the applicable application system.

The late-stage collection team is responsible for loss mitigation options that include repayment plans, payment plans set for modifications, stipulation agreements, and partial claim reviews, according to MC. Management reports that the team is cross-trained on all product and investor guidelines

According to company guidelines, loss mitigation efforts may begin at any time during the collection process or when a borrower contacts MC, but no later than 45 days past due. The company reports that it continues to be involved with various outreach efforts, such as Hope Now, National Community Reinvestment Coalition, Neighbor Works America, Consumer Credit Counseling Services, local organizations, and its own homeownership initiatives, in an effort to provide borrowers who want to stay in their homes workable solutions to avoid foreclosure. In addition, the company represents that it actively participates in the State Foreclosure Prevention Working Group, which consists of state attorneys general, state banking regulators, and many of the 20 largest subprime mortgage servicing and lending organizations.

The loss mitigation department, which functions separately from the collection department, follows company and investor guidelines in its approach to loss mitigation and soliciting delinquent borrowers. Loans are referred to the department through the LPS MSP task referral process. Within 48 hours of a referral, a representative will attempt to contact the borrower to discuss workout options. The company reported the following other aspects of its loss mitigation area:

- The company added experienced internal underwriters from originations, as well as late-stage default processors;
- The system generates a formal loss mitigation solicitation letter when the foreclosure process commences, in accordance with investor guidelines or by the 45th day of delinquency;
- MC uses multiple loss mitigation templates (e.g., Fannie Mae short sale, Freddie Mac modifications, and SONYMA deed-in-lieu) to ensure compliance with investor guidelines and company processes;
- Borrowers working through "trial modification" periods receive a telephone reminder call three days prior to the payment due date;
- Web submission of financial packages is permitted, which enables employees to expedite an effective workout strategy;
- The department has delegated authority from GSEs and clients to approve workout plans in accordance with established guidelines;
- A tiered approval process is in place for repayment plans according to the length of the plan; and
- Loss mitigation activities continue throughout the foreclosure process, and follow a dual path that consists of pursuing loan workout activities designed to minimize risk of loss to investors while adhering to timelines critical to the foreclosure process.

Chart 11

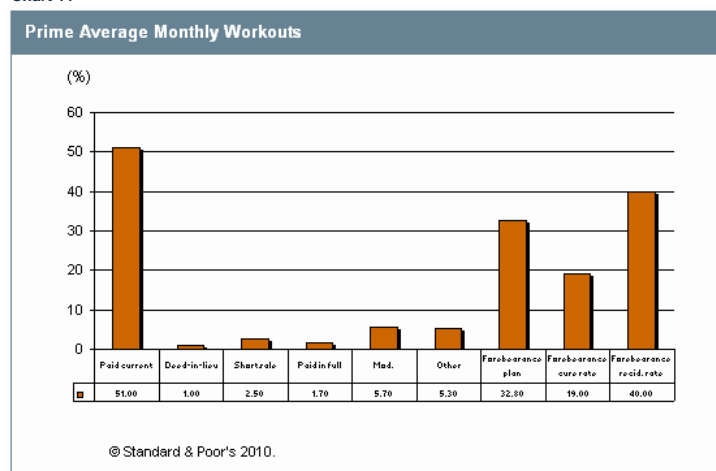
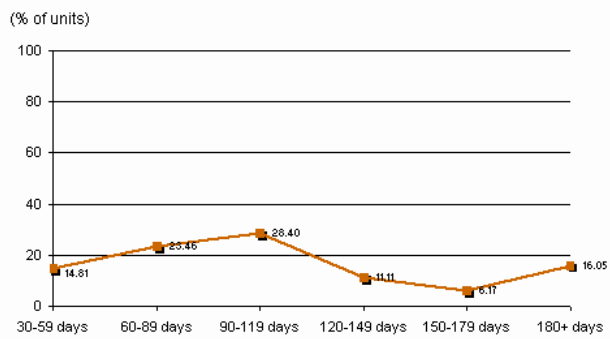
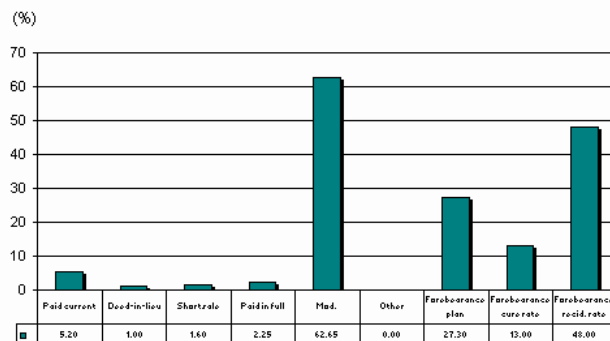


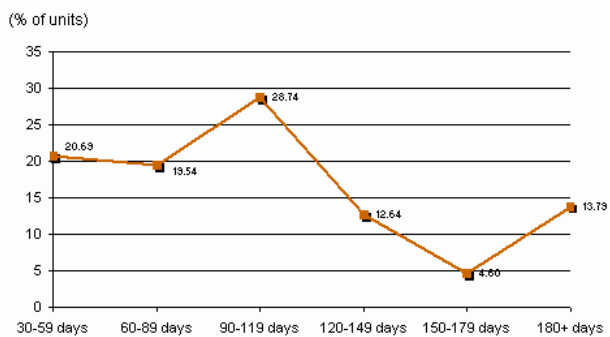
Chart 12

**Prime Forbearance Break Rate**

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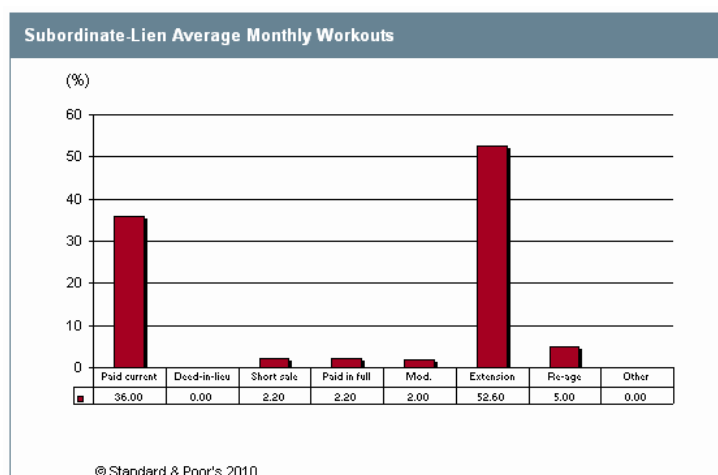
**Chart 13****Subprime Average Monthly Workouts**

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**Chart 14****Subprime Forbearance Break Rate**

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**Chart 15**



The company characterizes foreclosures, bankruptcies, REOs, and other specialized activities as "Late-Stage Default Servicing." According to management, an internal independent foreclosure approval team reviews each loan being considered for foreclosure. The team is tasked with ensuring that all appropriate attempts at loss mitigation have occurred prior to approving a loan for foreclosure and referring it to a foreclosure attorney. Management represents that the review process includes:

- A complete analysis of the loan at origination;
- A review of collection history and loss mitigation efforts;
- A review of adherence to company policies and procedures and investor guidelines; and
- Approval or disapproval of a loan referral to foreclosure.

MC continues to use the services of third-party vendors to administer to various default servicing activities, including foreclosure processing, property preservation, and senior-lien monitoring. The company uses LPS MSP, Desktop workstation, and Newinvoice to manage its foreclosure processes for legal and event tracking, bidirectional image transmissions, and an LPS reporting Web site.

MC has said it monitors its vendors, rates their quality (accuracy, responsiveness, and timeliness), and holds periodic meetings with them according to an established schedule.

MC maintains all customer contact and interaction, and according to MC, the following processes and controls are in place:

- MC proactively monitors its foreclosure and bankruptcy foreclosure timelines and cost schedules to ensure adherence with investor guidelines;
- Files are referred to foreclosure automatically according to investor timelines;
- The company maintains electronic file referral and communication with approved outside counsel;
- The foreclosure cure rates are 1% for the prime and subprime portfolios and 4% for the subordinate-lien portfolio. We believe these low cure rates are a positive reflection of MC's efforts to work with borrowers to secure workout arrangements to avoid foreclosure;
- LPS generates monthly attorney performance reports;
- Property inspections identify occupancy, condition, and whether the property is listed for sale. The company ensures that vacant properties are secured and files insurance claims if the inspection identifies property damage; and
- Global resources representatives support foreclosure functions, specifically payoff statements, reinstatement quotes, foreclosure referrals, workstation activation, and reporting.

According to company guidelines, MC manages claims and post-foreclosure liquidations through the LPS claims workstation. The workstation application incorporates processing templates that include investor and state-specific guidelines. The completion of each process automatically triggers related reporting. Claims are processed through the workstation via EDI activation to investors or the insurer Web site and/or through paper generation. MC reviews and reconciles all claim funds it receives to ensure the remittance of all funds due. If necessary, it files supplemental claims. MC has represented that no claims were denied or curtailed in the second half of 2009.

MC represents that for all loans except those guaranteed by Freddie Mac, the company adheres to Fannie Mae's bankruptcy timelines and follows the related cost schedule guidelines. MC's bankruptcy controls appear to adhere with company and regulatory policies, and include the following:

- MC receives bankruptcy notification electronically through PACER and Electronic Bankruptcy Notification and via the

U.S. mail;

- MC notifies attorneys electronically;
- The company uses the LPS MSP bankruptcy workstation to process, manage, and report applicable cases and employs processing templates and investor-specific work steps to administer each case action. The completion of steps within the template trigger default reporting, credit bureau reporting, tasks, letters, and system coding;
- Motions for relief are electronically referred to the applicable attorney in accordance with investor guidelines;
- In Chapter 7 cases, delinquency timelines are established in accordance with investor guidelines for automatic submission to the attorney of record to commence filing a motion for relief;
- In Chapter 13 cases, LPS Outsource (a third-party vendor) reviews the plan, files any objections to the plan, if applicable, and files all proofs of claims. MC monitors for post-petition delinquency through daily account reviews. In accordance with investor guidelines, a loan is referred to the attorney of record to file a motion for relief when the loan becomes delinquent (post-petition);
- Global resources representatives support bankruptcy functions; and
- Image workflows and procedures are in place to process bankruptcy documents and information electronically.

The REO department oversees the management, procurement, and review of all property valuation orders. The department monitors REO inventory and properties through the REO workstation and updates marketing plans to reflect all activity involving the property. Managerial approval is required on plans for properties that have been deemed to incur losses. MC has partnered with Habitat for Humanity and other charitable organizations as an additional sale/deeding conduit for truly challenged REO properties. The department reviews all applicable properties for possible eligibility for a charitable donation campaign. We believe the company has sound procedures in place for maximizing recoveries of REO properties, as supported by the following:

- MC requires two valuations—one appraisal and one broker price opinion (BPO)—throughout the course of REO servicing in order to accurately compare and apply necessary foreclosure sale bidding logic, future marketing strategy, and timely charge-off review and processing;
- Asset managers develop list prices based on sale agent conference calls and market analysis, which may include an actual site visit;
- An individual marketing plan that requires management approval is developed for each asset;
- The company selects brokers from an approved list and reviews brokers regularly through a scorecard rating methodology. Unacceptable performance results in removal from MC's approved broker list;
- MC requires its brokers to provide a digital photograph of the property, which it uses to activate MC's Web site listing all the company's REO serviced properties for sale;
- Hazard insurance coverage is obtained on all REO properties;
- The company offers "cash for keys" and "cash for deed" (a.k.a., relocation assistance) to borrowers for the majority of occupied properties it obtains through foreclosure to avoid costly and protracted eviction proceedings and to expedite REO marketing time;
- The company performs cost/benefit analysis when considering repairs;
- The average inventory turnaround time for prime and subprime borrower properties was approximately 260 days as of December 2009;
- The average eviction time for prime loans is 49 days, while the average for subprime loans is 90 days; and
- The gross and net sales-to-market value ratios are 97% and 89%, respectively, for originated prime loans and 94% and 84% for subprime loans.

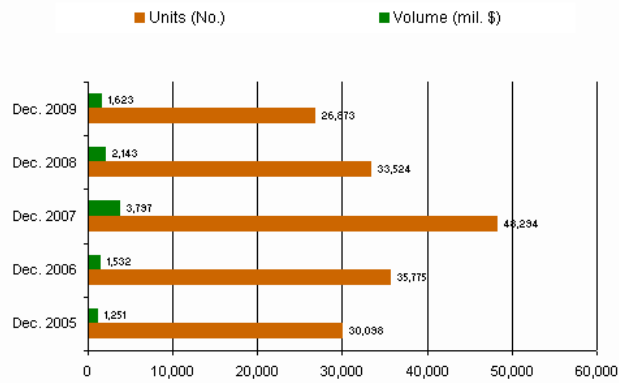
### Loan Administration?Subprime

The subranking for subprime loan administration is ABOVE AVERAGE.

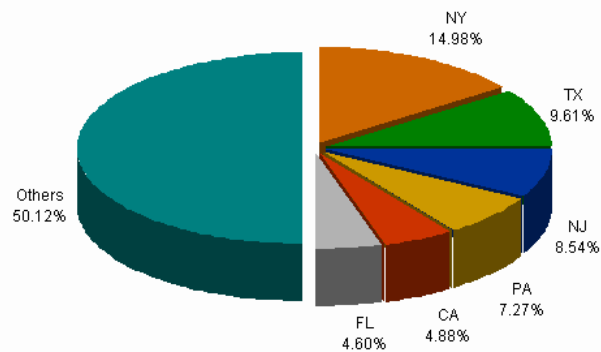
In our opinion, the rise in overall delinquencies reflects the current economic environment, as well as a 20% decline in the total number of subprime loan units and an increase in 120-plus DPD delinquencies due to foreclosure avoidance initiatives and state/county/GSE foreclosure moratoriums.

According to management, the collection group employs assertive collection practices using a risk-based scoring methodology as well as product-specific and/or investor guidelines to identify high-risk borrowers early in the collection cycle. The use of LPS collection workstation queues designed to align loans by risk, along with calling campaigns, are part of MC's efforts to focus on borrowers at high risk for default. We believe MC's loss mitigation efforts are proactive and attempt to prevent foreclosure and recidivism. Loan modifications will include escrow unless investor guidelines dictate otherwise.

Chart 16

**Subprime Portfolio UPB And Units**

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**Chart 17****Subprime Portfolio Geographic Distribution**  
(% of units)

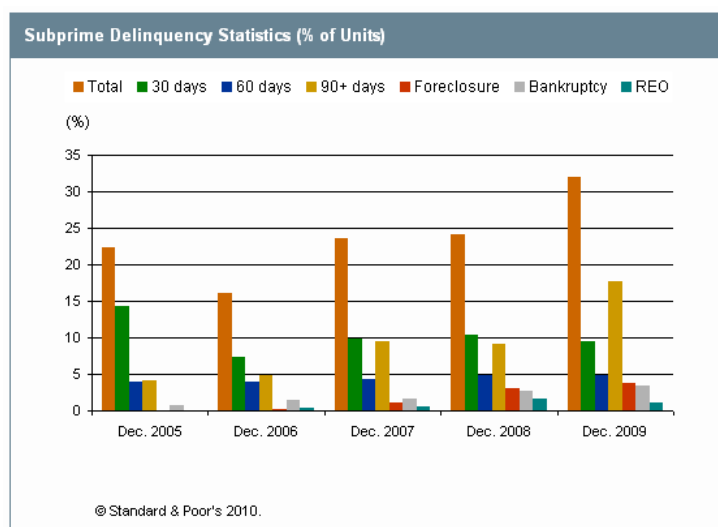
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**Table 4****Subprime Loan Statistics**

	Dec. 2009	Dec. 2008	Dec. 2007	Dec. 2006	Dec. 2005
Units (No.)	26,873	33,524	48,294	35,775	30,098
Volume (mil. \$)	1,623	2,143	3,797	1,532	1,251
Total delinquency (% of loans)	31.93	24.12	23.53	16.01	22.31
30 days	9.49	10.27	9.76	7.32	14.28
60 days	4.83	4.79	4.22	3.89	3.85
90+ days	17.61	9.06	9.55	4.80	4.18
Foreclosure (%)	3.72	3.09	1.15	0.14	0.04
Bankruptcy (%)	3.41	2.72	1.67	1.38	0.63
REO Inventory (No.)	301	512	290	135	

**Chart 18**





### Loan Administration?Subordinate-Lien

The ranking for subordinate-lien loan administration is ABOVE AVERAGE.

Management has represented that MC administers subordinate-lien loans either on LPS or on a First Data Resources (FDR) application. Loans originated before May 2005 reside on FDR, with the exception of loans in foreclosure or bankruptcy or those that are 180 days delinquent, which are transferred to LPS for control consistency. Although it is inefficient, in our view, to manage loans on two different systems, we believe MC maintains effective controls and managerial reports and has system transfer methodologies in place to minimize risk.

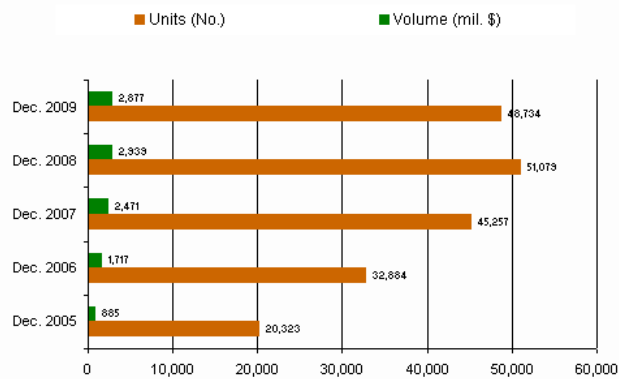
HSBC Bank's check-capturing department captures home equity line of credit (HELOC) drafts and transmits them to the appropriate application system. The check-capturing area follows MC guidelines by making some automated pay or return decisions, such as those affecting drafts that exceed the line of credit and signature review for those that exceed an established dollar amount. MC reported the following other aspects of its HELOC processes:

- The company's corporate security area monitors HELOC advances and payments electronically for suspicious activity. Address changes are reviewed for "hot" zip codes, and no HELOC drafts may be ordered for a specific period;
- The company performs scheduled credit reviews to uncover changes in the credit profile and/or declines in property value;
- MC suspends delinquent loans for six months at 30 DPD and terminates them at 60 DPD. Credit lines are reduced or suspended based on deterioration in the credit profile or declines in property value in relation to the current underwriting guidelines;
- The company accepts requests to block HELOC withdrawals from any authorized owner;
- Cancellation of a HELOC withdrawal restriction requires all joint parties to authorize the removal of the block. We view this process as a prudent control to avoid unnecessary expenses (legal and/or settlement) associated with joint borrowers' withdrawal disputes;
- Third-party wires are prohibited but HSBC will transfer funds to an HSBC account; and
- As an additional control, a service department representative reviews questionable withdrawal requests to validate the action to be administered.

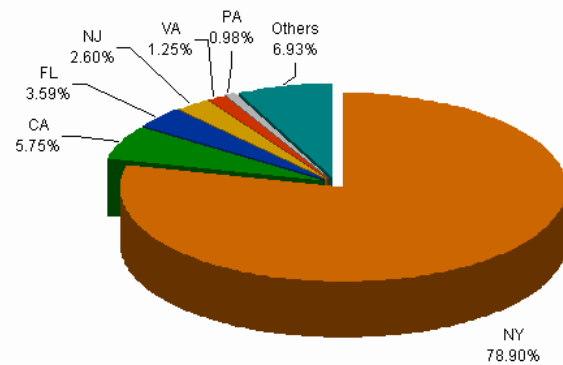
According to company guidelines, proof of real estate tax sufficiency and active insurance coverage at loan origination is a condition of loan funding. MC requests proof of payment from the borrower when it receives notification from the taxing authority of a delinquent tax payment. The company also uses the services of a contracted third-party vendor to monitor delinquent borrowers' tax payment status and report delinquent taxes, notice of senior-lien foreclosure actions, and bankruptcy filings. MC states that it will advance a tax payment and establish an escrow account if necessary.

Company guidelines require that its name is listed as the mortgagee on borrower insurance policies, and pertinent borrower insurance information is recorded into LPS for future reference, which MC's insurance department tracks. If MC receives an insurance cancellation notice, the loan enters into the company's lender-placed insurance letter cycle.

Chart 19

**Subordinate-Lien Portfolio UPB And Units**

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**Chart 20****Subordinate-Lien Portfolio Geographic Distribution**  
(% of units)

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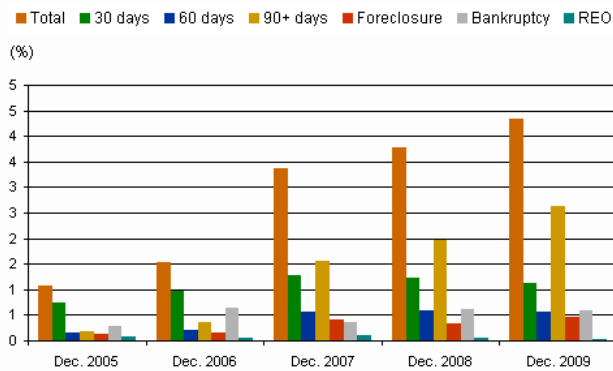
**Table 5****Subordinate-Lien Statistics**

	Dec. 2009	Dec. 2008	Dec. 2007	Dec. 2006	Dec. 2005
Units (No.)	48,734	51,079	45,257	32,884	20,323
Volume (mil. \$)	2,877	2,939	2,471	1,717	885
Total delinquency (% of loans)	4.33	3.78	3.38	1.54	1.07
30 days	1.12	1.22	1.28	0.97	0.75
60 days	0.57	0.59	0.55	0.21	0.15
90+ days	2.64	1.97	1.55	0.36	0.17
Foreclosure (%)	0.45	0.34	0.42	0.15	0.14
Bankruptcy (%)	0.59	0.60	0.36	0.64	0.29
REO inventory (No.)	14	28	39	21	15

**Chart 21**

Contact Client

### Subordinate-Lien Delinquency Statistics (% of units)



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#### Resources

Inside the S&P 500

### Financial Position

In accordance with Standard & Poor's criteria, we determined MC's financial position to be SUFFICIENT.

In our view, there is sufficient financial strength to sustain MC's servicing operations for the next 12 to 18 months. For additional information on HSBC Holdings plc, the ultimate parent of MC, please refer to RatingsDirect on the Global Credit Portal, at [www.globalcreditportal.com](http://www.globalcreditportal.com).

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