

**AUDIT OF THE SUPPLEMENTAL SPECIAL SERVING FEES  
BILLED FOR SECURITIZATIONS 1992-M3, 1992-C5, 1994-C1,  
1992-C2, AND 1992-M2**

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Audit Report No. 99-002  
January 8, 1999

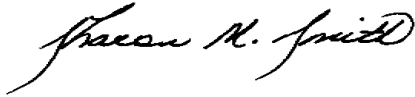


**OFFICE OF AUDITS**

**OFFICE OF INSPECTOR GENERAL**

**DATE:** January 8, 1999

**TO:** John F. Bovenzi, Director  
Division of Resolutions and Receiverships



**FROM:** Sharon M. Smith  
Director, Field Audit Operations

**SUBJECT:** Supplemental Special Servicing Fees Billed for Securitizations 1992-M3, 1992-C5, 1994-C2, 1992-C1, and 1992-M2 (Audit Report No. 99-002)

This report presents the results of an Office of Inspector General (OIG) audit of AMRESKO Management Incorporated's (AMRESKO) supplemental special servicer fees for securitizations 1992-M3, 1992-C5, 1994-C2, 1992-C1, and 1992-M2.<sup>1</sup> We identified AMRESKO billing overcharges for supplemental special servicer fees totaling \$24,223 for AMRESKO's loan servicing on two of the five securitizations, specifically 1992-C1 and 1992-M2.

## BACKGROUND

On October 2, 1998, the OIG issued a report entitled *Securitization Credit Enhancement Reserve Fund 1992-CHF* (Audit Report No. 98-083). In this report, we found that AMRESKO overbilled securitization 1992-CHF \$385,727 in supplemental special servicer fees. Specifically, AMRESKO billed supplemental special servicer fees on certain loans 1 month early and/or before it received loan files. As a result of our prior audit, on July 29, 1998, the FDIC issued a letter to AMRESKO requesting that it reimburse the securitization's reserve fund for the \$385,727 the OIG questioned.

Because of its overbillings on securitization 1992-CHF, the OIG looked at other securitizations for which AMRESKO was the special servicer. We identified five other commercial securitizations where AMRESKO received supplemental special servicer fees for servicing problem loans. The five securitizations were 1992-M3, 1992-C5, 1994-C2, 1992-C1, and 1992-M2. Table 1 provides general information regarding each of the five securitizations.

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<sup>11</sup> Securitization was the process whereby loans from Resolution trust Corporation (RTC) and Federal Deposit Insurance Corporation (FDIC) institutions were used as collateral to back securities sold to investors in the capital market.

**Table 1: General Information on Securitizations Reviewed**

<b>Securitization No.</b>	<b>Date AMRESKO Began Servicing Nonperforming Loans</b>	<b>No. of Loans Reviewed by OIG</b>	<b>Principal Balance of Loans Reviewed as of December 31, 1997</b>
1992-M3	October 27, 1995	65	\$18,114,328
1992-C5	October 27, 1995	44	28,769,445
1994-C2	November 1, 1995	40	116,362,230
1992-C1	October 27, 1995	115	89,525,472
1992-M2	October 27, 1995	94	\$76,531,366

Source: OIG analysis of relevant PSAs, loan trial balances, and fee billing invoice information provided by AMRESKO.

Each of the five securitizations has a pooling and servicing agreement (PSA) that describes the special servicer obligations. As the special servicer for these five securitizations, AMRESKO was responsible for servicing loans that met PSA default criteria and required special servicing. Special serviced loans included loans with a past due balloon payment, loans over 60 days delinquent, delinquent loans not expected to be cured by the borrower within 60 days, and loans included in court action against the borrower. Per the PSA, the monthly fee for the two securitizations identified as having billing overcharges was computed as 1/12<sup>th</sup> of 0.5 percent of the outstanding principal balance of each specially serviced loan and was to be paid to the special servicer for its special loan servicing activities.

## **OBJECTIVE, SCOPE, AND METHODOLOGY**

The objective of our audit was to determine whether AMRESKO properly calculated its supplemental special servicer fees. Our audit scope included AMRESKO billings for special servicer fees for securitizations 1992-M3, 1992-C5, 1994-C2, 1991-C1, and 1992-M2.

To accomplish the audit objective, the OIG interviewed AMRESKO personnel assigned to perform the various functions related to the servicing and billing of the specially serviced loans. The auditors reviewed the PSAs for each securitization in the audit scope to become familiar with the agreements. To determine if the supplemental special servicer fees were properly charged within the PSA terms and conditions, we tested the special servicer billing transactions.

We judgmentally selected our sample of loans for initial testing based on error rates and loan size. We also selected loans throughout the audit period from monthly billing periods beginning at the time AMRESKO became special servicer for each securitization (see Table 1) either through December 31, 1997 or the termination of the securitization.

We reviewed each loan selected for testing to determine the correct billing start date for calculating the supplemental special servicer fee. We then calculated the correct supplemental special servicer fee as stipulated in the relevant PSA. Our initial testing of three of the five securitizations (1992-M3, 1992-C5, and 1994-C2) indicated no exceptions that required

additional work. However, for the other two securitizations, 1992-C1 and 1992-M2, we identified material billing exceptions resulting in supplemental special servicer fee overcharges. Based on these exceptions, we expanded our review of securitizations 1992-C1 and 1992-M2 to include all billings where AMRESCO was the special servicer.

Our audit work related to securitization 1992-C1 included 115 specially serviced mortgage loans with a gross principal balance of \$89,525,472, covering 26 monthly billing cycles. Our audit work related to securitization 1992-M2 included 94 specially serviced mortgage loans with a gross principal balance of \$76,531,366, covering 21 monthly billing cycles. There were only 21 billing cycles for 1992-M2 because the securitization was terminated on July 2, 1997.

To determine the correct special servicer fees for securitizations 1992-C1 and 1992-M2, we established the correct billing date, per the applicable PSA, and then multiplied the monthly loan principal balance by the contract rate of  $1/12^{\text{th}}$  of 0.5 percent for each month the loan was specially serviced.

The OIG did not perform a review of the special servicer's internal controls. Instead, we relied on substantive testing to meet our audit objective. The OIG performed work primarily at AMRESCO's office in Dallas, Texas. The audit was conducted from February 1998 through August 1998 in accordance with generally accepted government auditing standards.

## **RESULTS OF AUDIT**

The audit disclosed that AMRESCO overbilled a total of \$24,223 for supplemental special servicing fees on two of the five securitizations reviewed. The two securitizations AMRESCO overbilled were 1992-C1 and 1992-M2. The audit did not disclose any overbillings for the other three securitizations, 1992-M3, 1992-C5, and 1994-C2 initially included in our audit scope.

### **SPECIAL SERVICER OVERCHARGED \$24,223 FOR SERVICING FEES**

AMRESCO overcharged two securitizations a total of \$24,223 because it incorrectly billed for supplemental special servicer fees regarding securitizations 1992-C1 and 1992-M2. These special servicer fees overbillings occurred because the special servicer incorrectly billed the supplemental special servicer fee (1) 1 month early, (2) before receiving the loan files, or (3) after sending loans back to the master servicer.

#### **Special Servicer Fees Billed 1 Month Early**

The special servicer overcharged \$19,249 for securitizations 1992-C1 and 1992-M2 because it started billing servicing fees 1 month earlier than the PSA allowed. OIG auditors identified a total of 63 specially serviced mortgage loans in the two securitizations where the special servicer billed a supplemental special servicer fee starting 1 month early.

We believe the PSAs are clear regarding when a mortgage loan becomes a specially serviced mortgage loan and when the supplemental special servicer fee would be payable. The PSAs provide that a mortgage loan becomes a specially serviced mortgage loan when a servicing transfer event has occurred and is continuing, and that a supplemental special servicer fee is payable on the specially serviced mortgage loan's related due date (date the loan's monthly payment is due). Both PSAs defined a specially serviced mortgage loan as a loan where ". . . a Servicing Transfer Event has occurred and is continuing . . ." The master servicer designated the servicing transfer event once a loan met certain defined defaults in the payment of the mortgage. Once a loan was defined as a special serviced mortgage loan, both PSAs establish in Section 1.01 ". . . with respect to any Due Period, the Supplemental Special Servicer Fee payment is allowed . . . on the related Due Date." The PSAs state in section 1.01 that the due period, with respect to any distribution date, begins the second day of the preceding calendar month to and including the first day of the current calendar month. That is, in order for a supplemental special servicer fee to be payable on a particular loan, the loan must have been identified as a special serviced loan in the month prior to the beginning of a new due period.

The following example illustrates the billing problem we identified that was common to both securitizations. For securitization 1992-C1, the servicing transfer event date for one loan was December 12, 1995. Per the PSA, the special servicer was not entitled to charge a supplemental special servicer fee for this loan until January 2, 1996, the beginning of the upcoming due period. However, the special servicer began charging the servicing fee at the beginning of the month the servicing transfer event took place, which was December 2, 1995. The incorrect fee billing resulted in a 1-month overpayment of \$1,524.86. The overbillings for both securitizations for supplemental special servicer fees billed 1 month early totaled \$19,249.

The special servicer disagreed with the OIG's finding regarding when the billings for supplemental special servicer fees should have started. According to the special servicer's senior portfolio manager, the special servicer began billing the fees when loans were identified as requiring special servicing, which she believed was consistent with the PSA language. We disagree with the special servicer's position. The PSA clearly allows the special servicer to begin billing special servicer fees only on the second day of the month following the servicing transfer event. However, for the billings we question, the special servicer billed in the same month that the transfer event took place, or 1 month early.

### **Special Servicer Fees Billed Before Loan Files Were Received**

In addition to billing fees 1 month early, the special servicer overcharged \$3,597 for securitizations 1992-C1 and 1992-M2 by billing servicing fees on 12 loans before the special servicer received the loan files necessary to commence loan servicing. For these 12 loans, supplemental special servicer fees were charged for periods ranging from 1 to 5 months before the special servicer actually received the loan files and related documentation.

The OIG believes that the special servicer could not commence identifiable loan servicing work without the loan files, and the special servicer did not provide us any evidence to the contrary. Our position is supported by language in the PSA, which states in section 3.21:

Upon determining that a Servicing Transfer Event has occurred with respect to any Mortgage Loan, the Master Servicer shall immediately give notice thereof, together with a copy of the related Mortgage File, to the Special servicer and shall use its best efforts to provide Special servicer with all information documents . . . and records . . . relating to the Mortgage Loan and reasonably requested by the Special servicer to enable it to assume its functions hereunder.

The PSA further states that the Master Servicer shall use its best efforts to provide the mortgage file within five business days of the occurrence of each related servicing transfer event and in any event shall continue to act as master servicer and administrator of such mortgage loan until the special servicer has commenced the servicing of such mortgage loan.

An example of the special servicer billing supplemental special servicing fees before receipt of loan files and documentation is a loan in securitization 1992-M2. In this case, the special servicer began charging for supplemental servicing in December 1995. However, the special servicer did not receive the loan file until May 3, 1996. Therefore, AMRESKO should not have billed the special servicer fee for this loan until June 2, 1996. Accordingly, we questioned servicing fees of \$370.54, for the period December 1995 through May 1996.

The OIG found that the special servicer did not commence servicing any loans until it had received the pertinent loan documents and records. For the special servicer to charge and receive a fee before the loan file had been received and the actual work of loan servicing had begun is not reasonable and contrary to the intent of the PSA and reasonable business acumen. We believe that the fees billed prior to receipt of the loan files were unnecessary and unreasonable because FDIC received no identifiable servicing benefits for the fees paid.

The special servicer disagrees with the OIG's finding on when the billings for supplemental special servicer fees can start when loan files are received late. According to the special servicer's vice president of special servicing, the PSA allows the servicer to start billing the special servicer fee after the servicing transfer event occurs. Further, the vice president stated that the receipt of loan documentation is the responsibility of the master servicer and is, therefore, not within the special servicer's control.

The OIG recognizes that the PSA is silent regarding when compensation can begin for special serviced loans where a delay occurs in the special servicer receiving the loan documentation. However, we substantiated that the special servicer provided no loan servicing while waiting for loan files; therefore, it is not reasonable for the special servicer to be paid for work it did not actually perform. Such payments appear to constitute unjust enrichment.

## **Special Servicer Fees Billed After Loans Were Sent Back to Master Servicer**

The special servicer continued to bill supplemental special servicer fees on four loans contained in securitization 1992-M2 after it sent the loans back to the master servicer. This error resulted in an overcharge of \$1,377 to the FDIC. For example, a loan was designated a specially serviced loan and sent to the special servicer on October 31, 1995. AMRESKO serviced the loan until it returned the loan to the master servicer on January 8, 1996. However, AMRESKO continued to charge a special servicer fee on this loan for an additional 9 months. Therefore, for this loan, we questioned the additional 9 months of servicing fees totaling \$691.

PSA, section 3.21, provides that upon determining that a specially serviced mortgage loan has become current and has remained so for three consecutive monthly payments, the special servicer shall immediately give notice of that fact to the master servicer. Upon giving such notice, the special servicer's obligation to service that loan then terminates. For the three loans identified in securitization 1992-M2, the loans had been returned to the master servicer and, as such, were not eligible for a special servicing fee.

The special servicer agrees with the OIG's finding of not billing for supplemental special servicer fees after the loans are sent back to the master servicer. The special servicer's vice president of special servicing stated that such billings are the result of human error and occur very seldom.

## **RECOMMENDATIONS**

We recommend that the Director, Division of Resolutions and Receiverships, take the following actions:

- (1) Disallow \$19,249 in supplemental special servicer fees resulting from the special servicer billing 1 month early (questioned cost).
- (2) Disallow \$3,597 in supplemental special servicer fees resulting from the special servicer billing before it had performed any loan servicing work (questioned cost).
- (3) Disallow \$1,377 in supplemental special servicer fees resulting from the special servicer billing three loans that were no longer designated as specially serviced (questioned cost).

## **CORPORATION COMMENTS AND OIG EVALUATION**

On December 8, 1998, the Deputy Director, Franchise and Asset Marketing, DRR, provided a written response to a draft of this report. The response is presented as appendix I of this report.

The Deputy Director, Franchise and Asset Marketing, DRR, stated that he agreed with our three recommendations and would disallow \$24,223 in questioned costs. In addition, the Deputy

Director has pursued settlement of these findings by issuing a letter requesting that AMRESKO reimburse the securitization reserve fund for the total amount we questioned.

The Corporation's response to the draft report provided the elements necessary for management decisions on the report's recommendations. Therefore, no further response to this report is necessary. Appendix II presents management's proposed action on our recommendations and shows that there is a management decision for each recommendation in this report.

Based on the audit work, the OIG will report questioned costs of \$24,223 in its *Semiannual Report to the Congress*.



**FDIC**


**Federal Deposit Insurance Corporation**  
**550 Seventeenth Street, NW**  
**Washington, D.C. 20429**

**CORPORATION COMMENTS**

**Division of Resolutions and Receiverships**  
**Franchise and Asset Marketing Branch**

Date: December 8, 1998

Memorandum to: Sharon M. Smith  
 Director, Field Audit Operations  
 Office of Inspector General

From:  James R. Wigand  
 Deputy Director

Subject: Response to Draft Report Entitled Supplemental Special Servicing Fees Billed for Securitizations 1992-M3, 1992-C5, 1994-C2, 1992-C1, and 1992-M2.

The referenced audit expanded the scope of work on two findings detailed in the October 2, 1998 report entitled Securitization Credit Enhancement Reserve Fund 1992-CHF (Audit Report No.98-083). Specifically, the overcharging by Amresco Management Incorporated of supplemental special servicer fees. Additional transactions where Amresco is Special Servicer for five securitizations were reviewed, and a reported overcharging of \$24,223 was found.

We concur with the recommendations in the report and have requested that Amresco refund to the Reserve Fund the amount overcharged. A copy of our letter to Amresco is attached.

If you have any questions about this response, please do not hesitate to contact me.

Attachment

Cc: John F. Bovenzi, Director, DRR  
 Robert M. Cittadino, Acting Director, OICM

**MANAGEMENT RESPONSES TO RECOMMENDATIONS**

The Inspector General Act of 1978, as amended, requires the OIG to report the status of management decisions on its recommendations in its semiannual reports to the Congress. To consider FDIC’s responses as management decisions in accordance with the act and related guidance, several conditions are necessary. First, the response must describe for each recommendation

- the specific corrective actions already taken, if applicable;
- corrective actions to be taken together with the expected completion dates for their implementation; and
- documentation that will confirm completion of corrective actions.

If any recommendation identifies specific monetary benefits, FDIC management must state the amount agreed or disagreed with and the reasons for any disagreement. In the case of questioned costs, the amount FDIC plans to disallow must be included in management’s response.

If management does not agree that a recommendation should be implemented, it must describe why the recommendation is not considered valid. Second, the OIG must determine that management’s descriptions of (1) the course of action already taken or proposed and (2) the documentation confirming completion of corrective actions are responsive to its recommendations.

This table presents the management responses that have been made on recommendations in our report and the status of management decisions. The information for management decisions is based on management’s written response to our report.

<b>Rec. Number</b>	<b>Corrective Action: Taken or Planned/Status</b>	<b>Expected Completion Date</b>	<b>Documentation That Will Confirm Final Action</b>	<b>Monetary Benefits</b>	<b>Management Decision: Yes or No</b>
1	DRR agreed to disallow \$19,249 in supplemental special servicer fees resulting form the special servicer billing one month early.	Completed	Reimbursement Check	\$19,249 Disallowed costs	Yes
2	DRR agreed to disallow \$3,597 in supplemental special servicer fees resulting form the special servicer billing before it had performed any loan servicing work.	Completed	Reimbursement Check	\$3,597 Disallowed costs	Yes
3	DRR agreed to disallow \$1,377 in supplemental special servicer fees resulting form the special servicer billing three loans not designated as special serviced.	Completed	Reimbursement Check	\$1,377 Disallowed costs	Yes