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Servicer Evaluation: Scotiabank Inverlat S.A.

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Opinion

Standard & Poor's Rating Services' ranking on Scotiabank Inverlat S.A. (SBI) is STRONG as a residential mortgage servicer for the Mexican market. The outlook is stable.

The overall ranking reflects our opinion of the servicer's STRONG management and organization and loan administration subrankings, which are supported by the following strengths:

- A knowledgeable and experienced management team in all of the areas that support servicing operations;
- A solid organizational structure with dedicated personnel for all critical servicing functions;
- A robust systems environment as well as sound business contingency and continuity plans;
- Stringent internal controls and audit programs that ensure a high-quality operation;
- Effective collections, loan modification and asset recovery procedures;
- Low delinquency levels of its residential portfolio indicate efficient and consistent servicing over the past five years.

Outlook

The outlook is stable. In our opinion, SBI will continue enhancing its collection mechanisms and technological platform over the next 12-18 months to further improve efficiencies within its servicing operations while maintain low delinquency levels within its residential portfolio.

Profile And Portfolio

SBI is the banking division of Grupo Financiero Scotiabank Inverlat S.A. de C.V. (GFSBI), which in turn is a subsidiary of the Bank of Nova Scotia (Scotiabank) from Canada. GFSBI, as a financial group, is one of Mexico's prominent financial institutions.

SBI has conservative underwriting criteria, as it has granted most of the residential loans it has originated to "formal economy" employees, or those individuals who are on a company's payroll and have their taxes deducted. In addition, it offers residential loans with interest rates that can be reduced over time if obligors maintain current, which in our opinion, are factors that exert a positive influence on the performance of the loans in the residential portfolio.

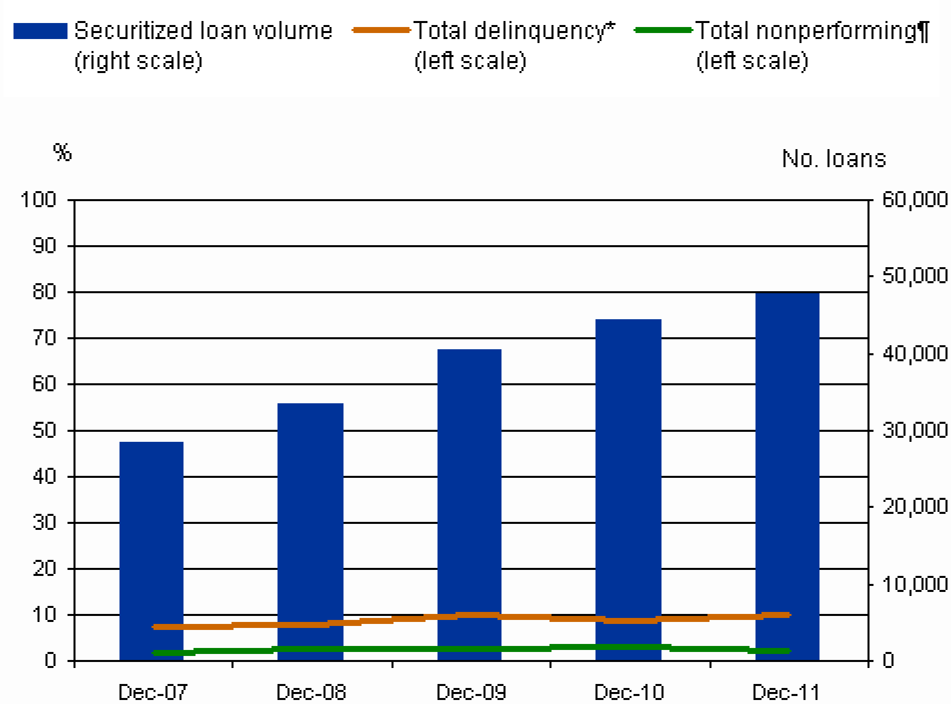
The bank has remained a leader in offering higher-balance residential loans (averaging $1.2 MXN per loan) over the past two years. This has led SBI's portfolio to include loans for properties that are concentrated in the most developed states of the country, which is where high-end properties are located.

For the purpose of this analysis, we assessed SBI's on-balance-sheet and securitized mortgage portfolios. As of December 2011, these portfolios comprised 47,755 loans with a balance of approximately MXN45.4 billion. The portfolio had a nonperforming ratio of 2.2% (percentage of loans more than 90 days delinquent), which we believe is an indicator of excellent collections levels when compared with the collection metrics of other commercial banks that act as residential servicers.

As of December 2011, SBI had the fifth-largest mortgage portfolio of the banks in the Mexican market and it had a residential market share of approximately 15%. Despite the recent financial crisis (2008-2010), SBI's mortgage portfolio grew at a compound rate of 10% over the past five years (see chart 1).

In our opinion, SBI can maintain or increase its market share in the residential market because its residential mortgage area has well-established business strategies for the short, medium, and long term that seek to develop more competitive products and more efficient procedures.

Residential Loan Performance
2007-2011



*One-90 days delinquent. ¶More than 90 days delinquent).

Management And Organization

The subranking for management and organization is STRONG.

In our opinion, SBI maintains management and organizational attributes that foster an efficient loan administration environment and correspond with a STRONG subranking.

Staff

SBI's management and staff are knowledgeable and experienced--both within the industry and with respect to company tenure.

As of December 2011, the mortgage area's senior and middle managers averaged approximately 20 years of industry experience and approximately 16 years of tenure with SBI. Collection managers averaged 11 years of industry experience and almost 11 years of tenure with the bank.

Structure and employee turnover ratios

SBI's servicing operations are strongly supported by the bank's sound organizational structure and in particular by three main business units: collections, residential mortgage, and risk.

In our opinion, the collections, residential mortgage, and risk areas have worked jointly to maintain performance metrics within its portfolio that indicate efficient and consistent servicing over the past five years.

The collections area is responsible for collection management for one-90 day delinquencies through call center and field collectors management; the risk area is in charge of the definition of the creditor´s risk profiles and collection strategies; and the residential business area continuously analyses the residential portfolio performance and helps define the bank's relief programs and underwriting guidelines.

The residential mortgage area comprises 106 employees, and as of December 2011, the turnover ratio in the area was around 12.5%, which we believe is in line with other residential servicers we rank. The area is divided in three subareas: sales, products, and portfolio management.

The collection area is further divided in two different subareas: a front end that is responsible for the collection management of the obligors with one to three delinquent payments, and a back end area responsible for the borrowers that are delinquent by more than three payments.

As of December 2011, the front-end collections area comprised 63 employees and the turnover ratio in this area was around 11.9%. As of the same date, the back-end collections area comprised 32 employees and the turnover ratio in this area was less than 1%. In general, we believe lower employee turnover ratios contribute to a stable loan-servicing environment.

SBI's servicing operations are supported by the accounting, finance, IT, and operations areas. Other areas that support the collection management and other business units of the bank are human resources, audit, and internal controls.

Training

SBI offers a comprehensive training program for its staff and has well-established coaching practices that enable it to continuously reinforce the technical and business skills of its team members.

Each business area offers new hire orientation sessions and specific trainings programs for tenured employees. The training programs comprise mandatory and optional courses that employees must fulfill before assuming any new responsibility.

Training for collection staff is tailored to strength each collector's negotiation and customer service skills. In addition, collection managers give several coaching and evaluations sessions to their respective team in orders to highlight staff's strengths and weaknesses and achieve an overall better performance of the collection's team and the portfolio. Collection management has seen that its commitment to reinforcing staff skills has resulted in low employee turnover ratios and has provided employees with an incentive to pursue a career path within the bank.

Technology

SBI's technology applications are robust, effectively integrated and designed to address the residential servicer's data management and reporting needs.

The collection IT platform comprises both in-house and vendor-provided systems that can support the servicing operation as business growths. The collection and risk areas share several IT applications that enable SBI to classify clients according to risk profile and thereby define the respective collections strategies based on risk profiles.

Disaster recovery plan and business continuity plan

In our opinion, SBI has sound disaster recovery and business continuity procedures (DRP and BCP) that enable the bank to resume critical operations following an adverse event.

SBI's BCP mirrors the financial group's BCP methodology, which has been proven worldwide. The bank has a specific area to identify critical operations, and thus the procedures that should be implemented, as well as the key personnel that will be responsible for the ongoing business if a contingency occurs. This area carries out preventive activities and BCP testing on a yearly basis.

The bank considers its servicing operations as critical for its overall operation; therefore, the BCP contemplates that, in case of contingency, the collection area can operate from two different alternative locations owned by the bank, ensuring the facilities' full availability.

SBI's DRP complements the BCP by ensuring that the systems the bank has ranked as critical, such as the servicing IT platform, can be reestablished following an adverse event. In our opinion, SBI's DRP includes complete back-up guidelines that mitigate operative risk to any contingency. The bank successfully tested the collection area's BCP and DRP in April 2011.

Internal controls

SBI has a comprehensive and stringent internal audit methodology that it established for the whole Scotiabank financial group and ensures high quality within the servicing operation.

The internal audit area has an independent role within the bank and comprises eight employees that coordinate random audits for the whole organization including support areas, business areas, and branches. This team is mainly responsible for identifying and evaluating risk. In addition to highlighting the principal risks within the areas, the internal audit supports the areas in establishing corresponding risk mitigation strategies. It also helps develop campaigns to inform and communicate the implemented internal controls.

We reviewed the latest internal audit reports for the front- and back-end areas of the residential mortgage and collection departments. The reports highlighted several observations regarding quality controls and operative procedures, particularly for the residential business area. However, as of December 2011, all observations were solved.

Policies and procedures

Policies and procedures (P&Ps) for SBI's residential servicing operations are comprehensive, well documented, clearly written, and accessible to staff thorough the banks intranet. The P&Ps for the securitized portfolio establish the particular management for the off-balance-sheet portfolio. SBI updates all P&Ps every year, or before if necessary.

Loan Administration

The subranking for residential loan administration is STRONG.

As a residential loan servicer, we believe SBI has proficient loan administration capabilities and highly effective loan modifications programs that, together, help SBI maintain efficient figures within its portfolio. As a servicer, SBI has high quality standards for loan boarding, document tracking, payment processing, and investor reporting.

Loan boarding and document tracking

In our opinion, SBI's residential loan boarding process is centralized and highly automated. The portfolio currently comprises loans originated only by the bank; therefore, there is no operative risk involved with boarding loans that were modified by other servicers.

All the original loan documents are guarded by a proficient external supplier and imaged in a document manager application to minimize its physical handling. The access to the documents is limited and it is given to employees according to its position within the organization in order to ensure documents safety.

Payment processing

SBI has well-automated and efficient payment processing functions.

Borrowers make payments for their loans directly to SBI; therefore, servicing personnel do not receive any live checks or cash on site, which mitigates cash control risk. Because the centralized mortgage accounting department has online access to bank account activity and the branch deposit system, it can perform daily cash balancing, which facilitates the formal month-end reconciliation process.

The payments for the loans in the securitized portfolio are also made directly to SBI; the servicer identifies these payments and transfers them to the corresponding trust account in the early hours of the next day.

Insurance policies

SBI has adequate insurance protection for its residential portfolios, including property damage, life, unemployment, and mortgage insurance. Insurance premiums are factored into borrowers' monthly payments to the bank.

If a borrower becomes delinquent on payments, SBI maintains insurance protection by continuing to advance the premium payments to its affiliate. This process ensures that gaps in insurance protection never occur.

Investor reporting

Standard & Poor's believes the bank has proficient reporting capabilities that enable to provide information about the portfolio performance to investors and others interested parties.

SBI's reporting software allows the easy and real-time use of all information and can produce a range of reports that provide loan-level details on items such as curtailments, delinquencies, and collector performance.

Customer services

As a servicer, SBI is committed to providing creditors proficient assistance throughout the loan's payment processes. SBI's collections call center is highly automated and provides efficient customer service as agents follow an escalation process to handle customer complaints.

We believe SBI's call center operations are well automated and utilize a variety of technologies, such as an automated call distribution (ACD) system and a voice response unit (VRU), to provide highly competent customer service to borrowers.

As of December 2011, the collections call center managed an average of 14,000 inbound calls per month and made almost 67,000 outbound calls per month; the call center's average speed of answer (ASA) is 7 seconds and its abandonment ratio is 2%, both of which are in line with other servicers ranked as STRONG.

Default management

SBI's residential servicing operations are carried out mainly through three areas: residential mortgage, collections, and risk areas. In our opinion, working as a team and addressing servicing operations through three different perspectives has allowed SBI to enrich the collection process by developing strong collection mechanisms that support the overall collections procedures and foster low delinquencies.

Early stage collections: collection management for loans that are no more than three months delinquent

Once SBI has granted a loan, the risk area analyzes the obligor's payment behavior, loan conditions, and other origination variables using business intelligence IT applications and risk models that help estimates the creditor's default probability. SBI's risk area standardizes obligor risk profiles and determines the correspondent collection strategies that the collectors should implement using estimated creditor default probabilities. Over the last two years, the servicer's acquisition of new IT applications has enhanced the accuracy of the risk area's risk assessment procedure.

SBI manages all its retail products collections through a regional collection center, also known as the front-end collection area, which resides within the organization's risk area. The collection's management considers that mortgages are the most difficult product to collect; therefore, the most skillful collectors handle residential servicing.

SBI has several stages in its collection process. In the first stage, SBI addresses preventive collection strategies through massive communication campaigns that include SMS messages (cellular phone text messaging), emails, and phone recorded messages. Subsequently, staff implements the administrative collection phase throughout call center and site visits to delinquent obligors, according to the creditor's risk profile. Preventive collection's mechanisms are also useful to reinforce the administrative collection phase.

SBI's IT platform is highly efficient and allows each collection agent to manage a portfolio of around 260 clients, which is a ratio consistent with other residential servicers with STRONG rankings. The system allows the bank assess collectors' performance through the tracking the number and the quality of completed phone calls, and the effectiveness of collection strategies through the evaluation of recovered unpaid balances and other productivity, efficiency, and quality ratios.

The risk area evaluates the effectiveness of the implemented collections strategies through a champion and challenger model, which is a testing method that allows the risk area to identify which strategy yields the best results. The residential mortgage and risk areas constantly analyze creditor payment behavior to detect key behavior facts that allows them to enhance residential underwriting criteria and develop credit products in a way that can incentivize obligors to maintain current payment behavior.

Loss mitigation: collections management for loans that are more than three months delinquent
SBI has efficient loan modification programs that have allowed the bank to mitigate losses and borrowers to keep their properties.

The back-end area of the collection department handles loss mitigation efforts. This area is further divide in four different subareas. The rescue plan area is responsible for prejudicial negotiations, which may result in relief programs for creditors. The legal area is responsible for supervising the judicial management carried out by external lawyers including giving surveillance to the foreclosure procedures. The administrative support area supports judicial procedures. The REO area regulates, promotes, and sells the foreclosed properties.

In our opinion, SBI's loss mitigation procedures are adequate and the management of the area has clearly identified where operational bottlenecks can occur. In that respect, we believe that management is working to resolve the bottlenecks and create a more efficient procedure.

Over the past year, SBI focused on residential loss mitigation by re-implementing two relief programs (Valora and the final phase of Punto Final), which it had launched in previous years to assist troubled borrowers and contain delinquencies and defaults.

In general, these relief programs include the modification of the original underwriting terms such as liquidations, restructures, and deeds in lieu. SBI's relief programs have achieved positive results. As of December 2011, 89% of the loans it modified were still current.

Financial Position

The financial position is deemed to be Sufficient and is based on Standard & Poor's 'mxAAA' and 'mxA-1' Mexican long- and short-term local scale ratings, respectively, for SBI.

Related Criteria And Research

- Scotiabank Residential Loan Servicer STRONG Ranking Affirmed, published May 16, 2012.
- Revised Criteria For Including RMBS, CMBS, And ABS Servicers On Standard & Poor's Select Servicer List, published April 16, 2009.
- Servicer Evaluation Ranking Criteria: U.S., published Sept. 21, 2004.
- Select Servicer List.