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Servicer Evaluation: Scotiabank Inverlat S.A.

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*(**Editor's Note:** In the version of this report published earlier today, the short-term credit rating on Scotiabank Inverlat S.A. was misstated in the Financial Position section. A corrected version follows.)*

Opinion

Standard & Poor's Ratings Services' ranking on Scotiabank Inverlat S.A. (SBI) is STRONG for individual mortgage loan servicing in the Mexican market.

The ranking reflects the company's history and accomplishments with handling residential mortgage loans, and acknowledges the following strengths:

- A solid organizational structure with dedicated personnel for all critical servicing functions;
- A highly skilled and specialized staff with an average 11.4 years of experience in the industry;
- Comprehensive, well-documented, and frequently updated policies and procedures, as well as business contingency and continuity plans;
- Highly integrated, automated, flexible, and standardized servicing systems;
- Tight, robust internal controls that ensure that the company meets its operative standards and that risk exposure remains under strict control;
- Effective collections and asset recovery procedures;
- Comprehensive and flexible investor reporting;
- Proper cash management standards;
- Superior customer service features;
- Recent experience with securitized portfolio servicing;
- A highly effective loan modification program; and
- Portfolio figures that indicate efficient and consistent servicing over the past five years.

Outlook

The outlook is stable. SBI has proven to be committed to constantly improving its operative standards, heavily investing in technological and analytical support, effectively implementing new products, and operating under corporate governance standards. We expect these characteristics to continue to be key among the company's distinctive traits. Standard & Poor's believes the company will continue to benefit from its high level of integration with its Canadian-based parent.

Profile

Scotiabank Inverlat is the banking division of Grupo Financiero Scotiabank Inverlat (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 been able to capitalize on new business opportunities thanks to the group's knowledgeable client base, expanding network coverage, and prominent position in the high-end residential loan segment.

In 1987, Casa de Cambio Inverlat was incorporated in the Mexican market. In 1993, the Inverlat Financial Group (GFI) was formed through the consolidation of the foreign exchange, banking, and securities brokerage businesses. Scotiabank acquired 10% of GFI in 1996 and had 55% participation by 2000. Grupo Financiero Scotiabank Inverlat S.A. de C.V. became the official name in 2001, and the bank was renamed Scotiabank Inverlat S.A.

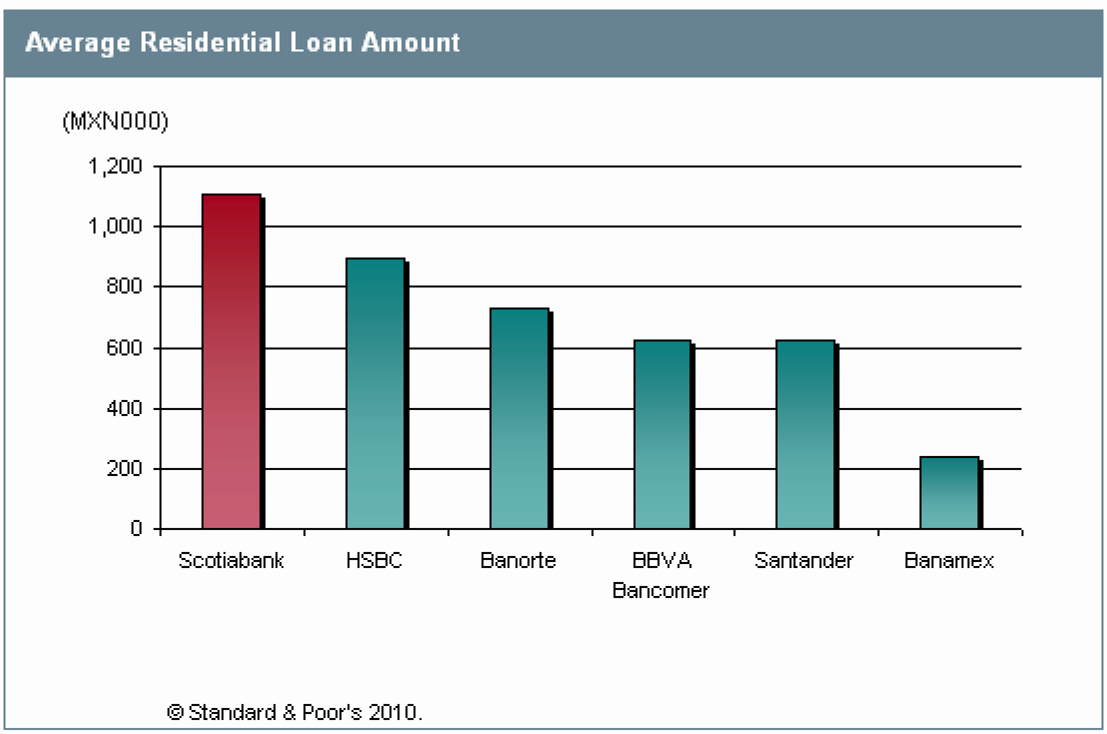
The bank has more than 500 branches and over 1,100 ATMs. It has shown positive results, including greater efficiency in its operations and increasing earnings returns. It is a market leader in auto and mortgage loans in its target high-income market. Recent strategies include growing the number of branches and taking advantage of operational efficiencies to gain market share and consolidate business operations.

In 2008, SBI issued its first and only residential mortgage-backed securities (RMBS) transaction for MXN2,500 million (SCOTICB 08).

Portfolio composition and growth strategy

SBI has focused on the higher-end segment of residential loans averaging MXN1,105,000 per loan, which is significantly higher than other banks and Sofoles. Scotiabank has been the leader in the higher-end residential segment for more than seven years.

Chart 1



SBI's portfolio has a high concentration in the Mexico City metro area due to its focus on high-end properties. It is noteworthy that all the loans SBI has originated are granted to "formal economy" employees (individuals on payroll with taxes deducted).

Chart 2

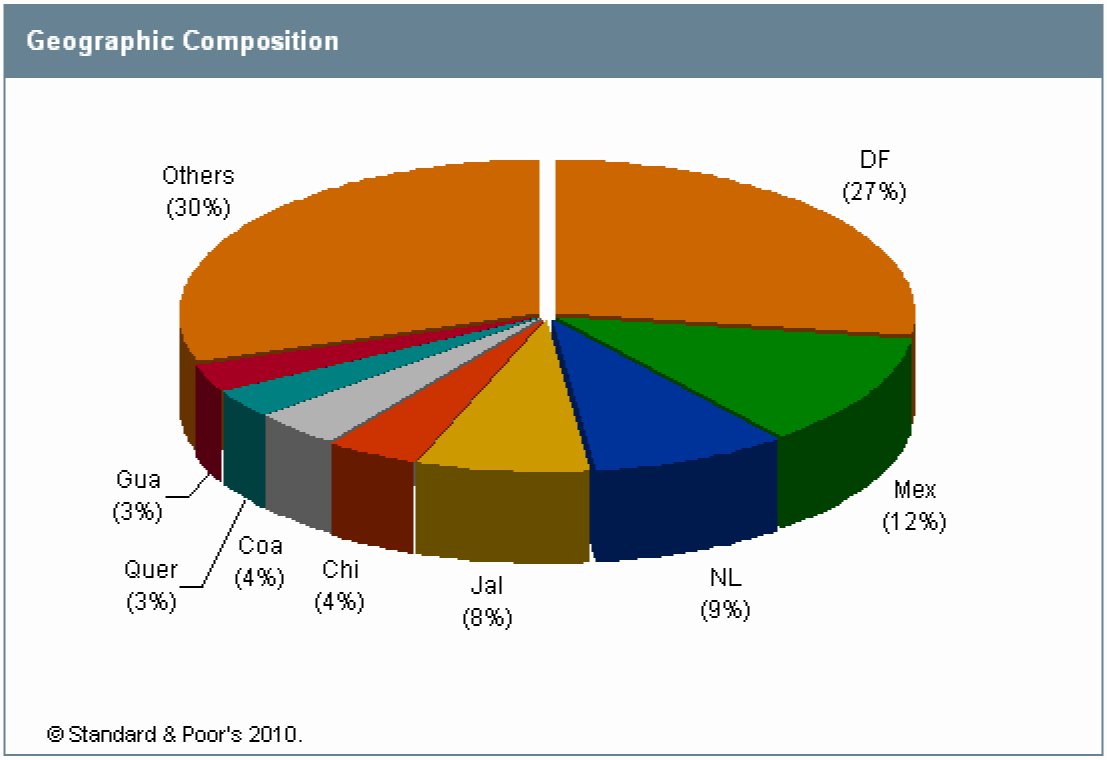
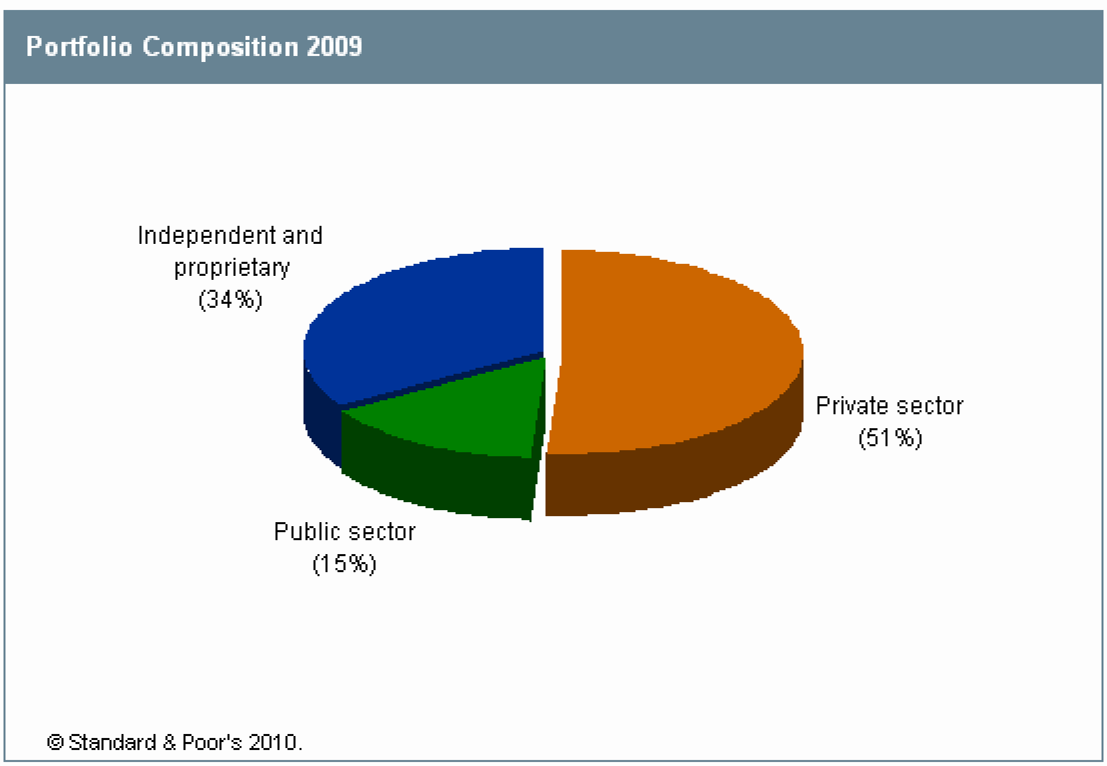


Chart 3



Despite the economic crisis in 2009, which caused a decrease in the total amount of the loans SBI originated (to 47,109 million in 2009 from 51,068 million in 2008), the company was able to increase the amount of loans by 2.96% (in pesos) and the number of loans by 2.8% last year compared with 2008 figures, including on- and off-balance-sheet loans. Scotiabank's market share grew to roughly 21.5% in 2009 from 18% in 2008. For 2010, SBI's goal is to increase the number of loans originated to 9,500 from 9,250.

Chart 4

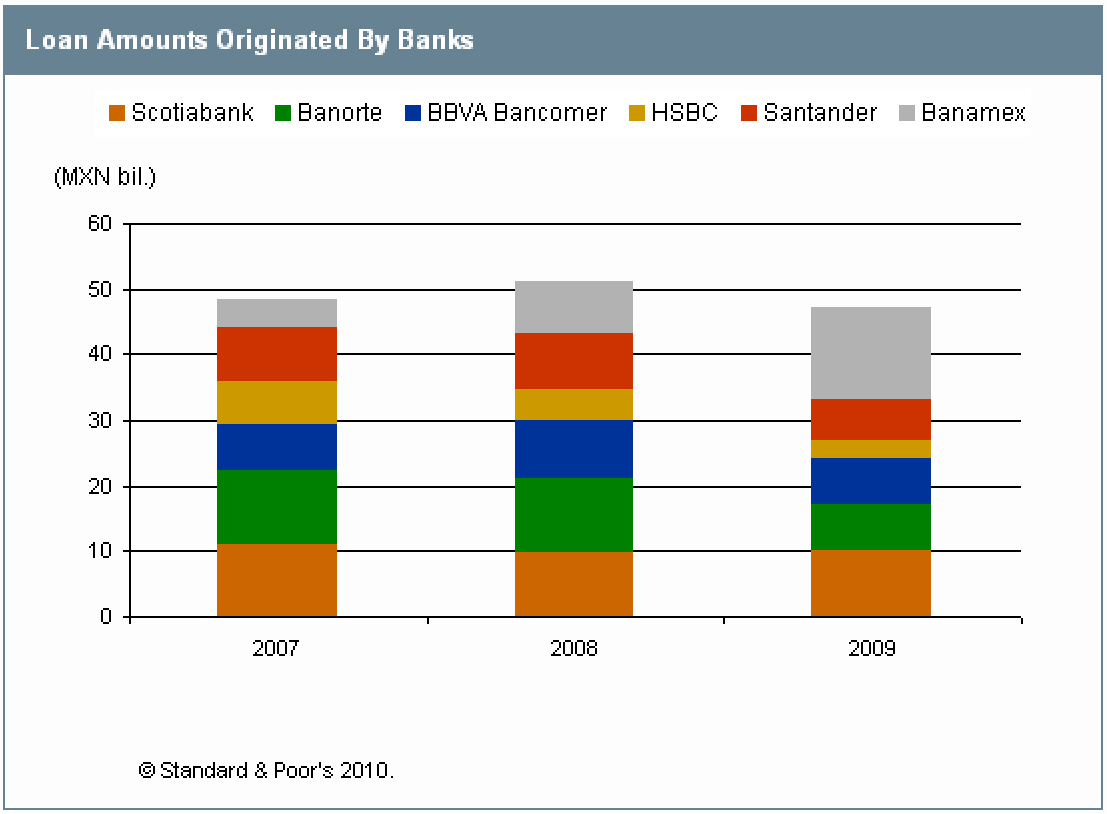
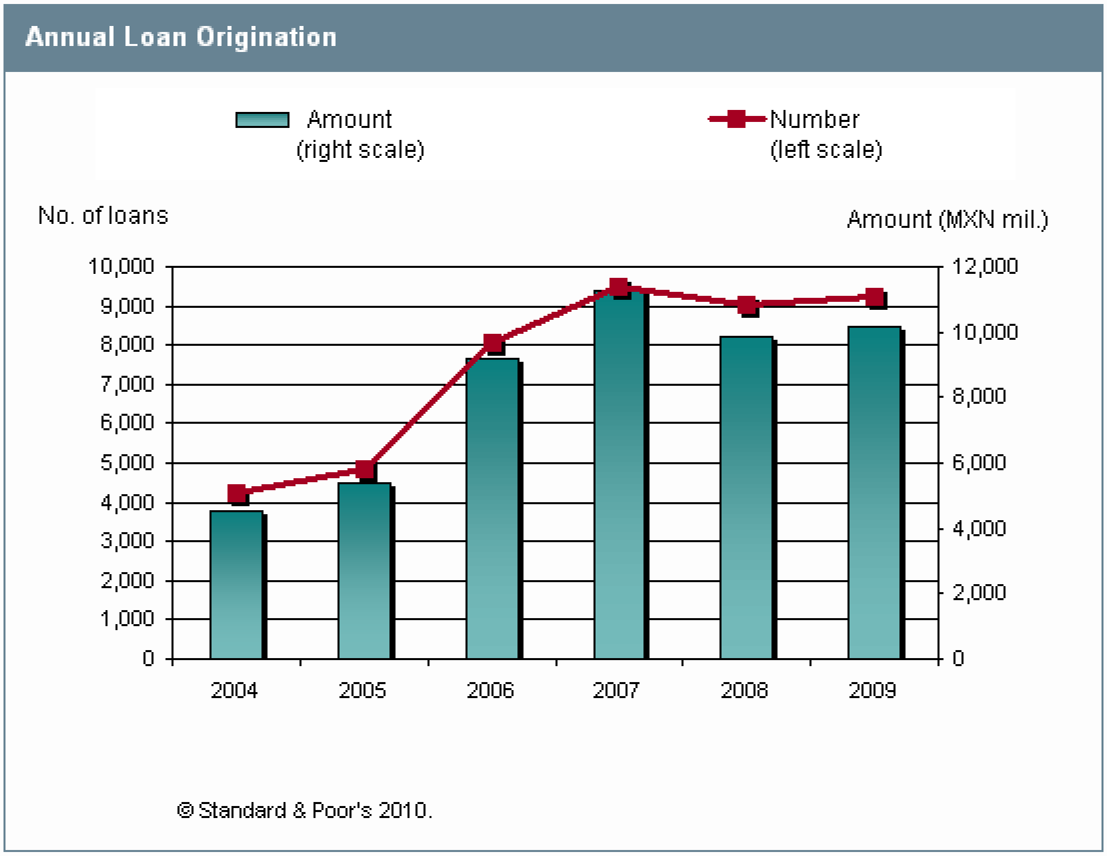


Chart 5



Scotiabank offers three main products:

- "Pagos Reducidos" (Reduced Payments): the customer receives a low interest rate for an initial period of the loan's life, after which the rate increases slightly (1%-2%).
- "Pagos Oportunos" (On-Time Payments): the interest rate of the loan decreases if the client makes 12 consecutive payments on time.
- "Valora" (Value): the interest rate is set according to the customer's risk level; after three years, the interest rate increases or decreases 25 basis points per year based on the borrower's payment behavior, with an 11% floor and a 13.5% cap.

Management And Organization

Standard & Poor's subranking on SBI is STRONG for management and organization.

The subranking primarily reflects the following:

- A highly experienced management team and staff with expertise in the residential lending sector;
- A comprehensive organizational structure;
- Well-documented processes and procedures that must comply with the financial group's global standards;
- More than 15 years of tenure with the bank and additional experience in the banking or mortgage sectors for

upper management;
- Strong and successful strategies to contain delinquencies, especially within the "Valora" product;
- Successful implementation of the loan modification programs;
- Comprehensive disaster recovery and business continuity plans, which the company tests annually with satisfactory results;
- The training programs for SBI's staff; and
- The company's technological strategies.

Organizational structure

Standard & Poor's believes Scotiabank has an organizational structure and reporting lines that are adequate to support an effective operation with efficient workflow that avoids conflicts of interest. SBI restructured its organization to increase its focus on containing defaults and delinquencies, including the creation of a new loan modification department ("Restructuras"). The department focuses on taking proactive and reactive measures to contain defaulted and delinquent loans, as well as current loans from high-risk borrowers. SBI also created a securitization department ("Bursatilización") to oversee off-balance-sheet loans. An overview of the changes is as follows:

- Comercial Crédito Hipotecario: originates mortgage loans through the Specialized Sales Force, external brokers, and branches. Originates construction bridge loans.
- Producto Hipotecario: creates new products and maintains operative control of the product.
- Reestructuras: develops and implements loan modification programs.
- Bursatilización: administers the securitized pool.
- Créditos No-Residentes: handles mortgage loans in U.S. dollars for Canadian and U.S. citizens.

Another important change for Scotiabank was the incorporation of the Specialized Sales Force, which is divided into three regional centers: the Alternative Origination Channels, which include mortgage brokers and origination through branches; and construction bridge loans to the Commercial Department of Mortgage Loans.

Staffing and human resources

SBI's staff is adequate for the portfolio it services and provides for an efficient operation. The company has a very solid management team with in-depth knowledge of the industry, as well as efficient procedures and a highly automated environment for its loan servicing operation, which enable the company to appropriately address its servicing activities in a well-defined organizational structure. SBI employs dedicated personnel for all critical servicing functions, and it shares resources with the bank only when no conflict of interest exists. Managers within the organization average 10 to 15 years of industry experience, while members of the servicing staff, on average, have 10 years of experience. Additionally, members of the management team have an average 10 years of tenure in the company.

Training

SBI's training efforts are well above the industry's standards, and it has programs in place to ensure that every employee receives ongoing training. In addition to internal training, SBI offers formal training courses that are designed in a business-oriented path to address business necessities. The process to define training contemplates analysis, planning, design and development, implementation, and evaluation. Training topics include business behavior, adaptability to change, leadership, coaching, and mentoring. The company offers introductory courses for new employees and employers.

SBI is implementing a new program called Mortgage Loan Certification ("Certificación Crédito Hipotecario") in which the executive employees of the branches receive specialized training in the mortgage loan products and then must pass a test at the end of the course to achieve certification.

Turnover

SBI's total employee turnover rate in 2009 was 8%, which mainly reflects turnover in high-rotation tasks, namely the Special Sales Force. The turnover rate is well below industry standards, specifically for the call center, which had roughly 11% turnover in 2009, likely due to the benefits the bank offers. Standard & Poor's found SBI to have a motivated and professional workforce in its mortgage unit.

Systems and technological platform

SBI conducts its mortgage servicing business through a highly automated work environment with an excellent array of computer systems that characterize a global bank. All systems are properly integrated to ensure that common data elements are entered only one time. The company's systems cover all processes involved with underwriting and servicing loan portfolios--from marketing to foreclosure to asset liquidation--under a highly automated environment.

SBI's origination and loan administration software has remained the same for the past couple of years, with only minor operational improvements. The software system, called SEA (short for Automatic Evaluation System), provides the real-time status of any credit application, as well as historical borrower performance, including all collection actions taken. All of the loans are processed through this system and the mortgage software.

The central mortgage system has six modules: parametrization; new-loan registration; delinquent loans; payments or liquidations; reports and account statements; and interface.

Currently, SBI is using an outsourced contract hardware provider under a scalable contract. This allows the company to grow when necessary without using resources from its core banking business. The capability of the company's technological platform is quite robust, and the system allows for horizontal and vertical scalability.

For backup activities, management software tools enable daily (15-version), weekly (five-version), and monthly (12-version) backup tapes for critical information, including all information from the six modules above.

For collection purposes, SBI implemented new Debt Manager software in August 2009. This system has a friendlier interface that permits multiproduct management, account management by legal status, and online generation of collection reports, among other activities.

Business continuity and disaster recovery

Standard & Poor's believes SBI has demonstrated a serious commitment to implementing and properly documenting its business continuity plan (BCP) and disaster recovery plan (DRP). SBI bases its contingency plans on the financial group's corporate policies. The corporation designs the plans, which the group's business units then adapt to fit their needs.

The BCP and DRP are well documented. The company tests the DRP annually, and the company's internal audit department has reviewed the results and found them to be satisfactory. The last test was on Sept. 5, 2009, and the next test is scheduled for October 2010. The company currently outsources the primary and secondary DRPs to IBM, which maintains high operational and security standards. The DRP permitted the recovery of SBI's critical systems in its two alternative sites: IBM Interlomas in Mexico City and IBM Apodaca in Monterrey. Notably, the CNBV (Comisión Nacional Bancaria y de Valores) had no observations or questions about the last DRP.

The BCP is a common practice in all Scotia's financial groups, especially in Canada, and the company produces an updated report on the results of the BCP test every six months. SBI has a specialized department, LIMIT, that supervises the effectiveness of the BCP. The alternative site for SBI's operations is approximately 15 km from the headquarters. All key employees have remote access in case it is impossible for them to access the headquarters or the alternative site. In the event that employees don't have access to SBI's facilities at night, on the weekend, or on holidays, the LIMIT team will coordinate the staff to start the BCP.

Internal controls and auditing

In Standard & Poor's opinion, the company maintains effective quality control and internal audit practices and demonstrates a proactive approach toward implementing and maintaining proper internal controls.

Internal controls verify operational effectiveness and efficiencies, the accuracy of financial information, and compliance with rules, policies, and norms. All departments have to promote a control environment through risk identification, activity control (policies), effective communication and information delivery, and operational surveillance.

Internal controls for the company include formal internal auditing through the financial institution's audit department, which abides to the institution's global standards.

This year's audit will take place in the third quarter and will evaluate all processes and controls in the mortgage loan department: product creation, origination, analysis and evaluation, dispositions, risk administration, process systems, issuance and distribution of mortgage insurance, and policies and records.

Standard & Poor's criteria for servicers with a STRONG ranking call for an annual audit.

Legal

SBI works with roughly 70 external, highly regarded and experienced law firms for asset repossessions, foreclosures, and judicial procedures. In August of 2010, SBI will implement a new law firm selection process through an invitation to tender.

The company faces no litigation with the potential for material damage at this time.

Loan Administration

Standard & Poor's subranking on SBI is STRONG for loan administration.

The subranking reflects the company's reliable loan servicing function, which is characterized by a strict origination sales force and adequate risk management for its loan profiles and business initiatives. Overall efficiency is reflected in SBI's portfolio figures and sound internal controls. The company has contained the amount of delinquent and defaulted loans despite the harsh economic environment through its loan modification programs and extensive product offerings.

New loan setup

Overall, SBI has a well-managed new loan setup process, with fast response times and sound controls. The company uses a series of electronic signatures for loan boarding and data validation with different layers of control. A new loan must be set up in the system before any funds are disbursed, and this process is completely automated.

In order to grant the loan, SBI must follow strict risk management controls. The company segregates clients using a matrix that incorporates an internal index risk assessment and the general score from the credit bureau. The clients are classified based on the probability of various risks using both scores.

Considering an average loan of MXN1.1 million, the annual ratio of servicing cost per loan is roughly 1.62%. SBI has a ratio of 105 loans per collection employee (including front- and back-end collections).

Document tracking

SBI's document-tracking procedures have incorporated imaging of all documents to minimize physical handling of such documents. The system allows remote access for internal consultation purposes. All external inquiries continue to be handled on a case-by-case basis, with adequate document and information safety procedures, including sufficient tracking mechanisms. RECALL has been SBI's file storage services provider for two years.

For the off-balance-sheet pool, only specialized securitization executives can access the loan documentation.

Payment processing

SBI has well-automated and efficient payment processing functions. For about 80% of collections, the system automatically generates payments and applies them against the customer's checking account. The other 20% of payments are made via branch deposits and transfers.

For the securitized pool, all the payments are made directly to SBI. However, the payment is identified and transferred to the corresponding trust account in the early hours of the next day.

As a result of these payment methods, servicing personnel do not receive any live checks or cash on site, which mitigates risk with respect to cash controls. 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.

Insurance policies

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

In the event that 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 company has good reporting capabilities. SBI maintains sufficient segregation of duties, with separate staff performing activities regarding remitting, reporting, and account reconciliation. Specialized business intelligence software with drag-and-drop capabilities allows for easy, real-time use of all information.

A dedicated staff manages the investor and management reporting functions, which the bank's infrastructure facilitates. The loan servicing system can produce a range of reports that provide loan-level details on items such as curtailments and delinquencies. The servicing system can also download data electronically to spreadsheet applications for more customized reporting. All the reports can be accessed via the Internet.

Customer service features

Standard & Poor's believes SBI has an adequate customer service function that benefits from system automation, a specialized sales force, and proactive servicing procedures. The company's main servicing center is located in its Mexico City office, with a smaller one in Monterrey. Inbound call center operations are shared between the credit card insurance departments and general bank operations, and special personnel are devoted to outbound calls for mortgage loans.

The inbound customer service line is available 24/7. The company tracks the content of all incoming calls through a dedicated system that is linked to the servicing system. Call types are also noted on a system menu, and onscreen scripts assist customer service personnel for collection purposes. The system tracks any outstanding issues resulting from customers' telephone inquiries, and supervisors closely monitor response and resolution times.

For 2009, Scotiabank accomplished its goal of 95% "satisfied" or "very satisfied" customers in its call center. In 2010, the goal is to maintain the percentage of satisfied customers. Currently, SBI is applying a policy in which call center employees solve the customer's problem or address the inquiry in just one call.

Advances

SBI currently does not make servicer advances for residential mortgage loans.

Early-stage collections

SBI aligns its collection procedures to its credit risk assessments of borrowers during the underwriting stage and employs preemptive collection strategies. The company adjusts its strategies according to the borrower's performance. The company typically follows up on riskier borrowers more intensively than average and employs specialized senior collectors for these accounts.

SBI divides its collection efforts into the following categories:

- Preemptive collections
- Administrative collections
- Extrajudicial and judicial collections

Preemptive collections involve offering high-risk customers (those with a high probability of default) an early modification program for their loans. SBI employs this strategy for clients that demonstrate the capability and intention to make payments and have had zero or just one missing payment.

Administrative collections begin in the first 90 days of delinquency through phone calls and physical visits to borrowers by specialized executives to identify potential future problems, and these efforts occur parallel with the judicial process. Legal proceedings begin after 90 days, when the accounts are assigned to a third-party law firm.

The company has specialized executives who negotiate with nonperforming clients to obtain a promise of payment or, in some cases, offer the customer a loan modification program for the loan. Collection personnel are assessed according to the amount and effectiveness of the promises to pay they receive.

During 2009, SBI realized the first phase of a loan modification program focused on the "Pagos Reducidos" product, which experienced increasing delinquencies and defaults. SBI plans to keep the loan modification programs for these types of loans this year.

The servicing of delinquent loans depends on the stage of delinquency, and the company directly leads all collections strategies.

Table 1

Collections	
Front end	
1 DP	
High risk	Phone call (dialer), letters, visits, high contact, personal follow up, promise-to-pay confirmation
Medium risk	Phone calls, letters, variable schedules, promise-to-pay confirmation
2 DP	
High risk	Phone call (dialer), letters, visits, special collection schedule and high contact, personal follow-up, and promise-to-pay confirmation
Medium risk	Phone call, letters, variable collections schedule , promise-to-pay confirmation
3 DP	
All high risk	Phone calls, letters, visits, special collections schedule and high contact, personal follow-up, promise-to-pay
Back end	
4 DP	
Mortgage rescue plan	Collection and follow-up with specialized negotiation group made through phone calls, letters, and mainly physical visits. Parallel action with the judicial process
Judicial collection	Collection is made by judicial process in conjunction with rescue plan

Collectors making outbound calls are assigned to accounts that match their experience level, so that more experienced collectors handle higher-risk and more seriously delinquent accounts; specialized collectors are assigned for the off-balance-sheet pool. The primary collection goal is to obtain promises to pay, which the company closely tracks. SBI also frequently attempts direct debits during the collection period as part of this process.

Default management

SBI has a real estate owned (REO) department devoted exclusively to individual mortgage loan foreclosure and asset repossession activities. The department uses a specialized system for marketing repossessed assets to minimize losses. The aggregate historical recovery percentage of SBI's portfolio is roughly 72.7%, which includes all fees involved with the sales process for repossessed assets.

SBI markets repossessed assets directly to clients via brokers, and a new tool, CARASA, promotes and sells assets on the Internet through auction-style transactions. This marketing program was very successful for repossessed automobiles.

SBI has a 2.08-year average for asset recovery. Tables 2 and 3 provide performance statistics for SBI's on- and off-balance-sheet portfolio:

Table 2

Delinquencies And Defaults By Loan Count										
Loans (on- and off-balance-sheet)										
Loans	**Dec-09**		**Dec-08**		**Dec-07**		**Dec-06**		**Dec-05**	
Total No.	**48,249**		**43,932**		**42,715**		**36,513**		**35,837**	
	Loans (No.)	**%**	**Loans (No.)**	**%**	**Loans (No.)**	**%**	**Loans (No.)**	**%**	**Loans (No.)**	**%**
Current	40,164	83.20	35,772	81.40	34,092	79.80	27,779	76.10	27,636	77.10
1-30 days	3,769	7.80	4,186	9.50	4,767	11.20	5,600	15.30	5,125	14.30

Table 2

Delinquencies And Defaults By Loan Count (cont.)

31-60 days	1,183	2.50	1,252	2.80	1,633	3.80	1,435	3.90	1,561	4.40
61-90 days	656	1.40	522	1.20	574	1.30	424	1.20	504	1.40
91-120 days	280	0.60	267	0.60	222	0.50	175	0.50	152	0.40
121-180 days	191	0.40	224	0.50	138	0.30	137	0.40	112	0.30
More than 180 days	2,006	4.20	1,709	3.90	1,289	3.00	963	2.60	747	2.10
Total	48,249	100.00	43,932	100.00	42,715	100.00	36,513	100.00	35,837	100.00
Delinquencies	8,085	16.80	8,160	18.60	8,623	20.20	8,734	23.90	8,201	22.90
Defaults	2,477	5.10	2,200	5.00	1,649	3.90	1,275	3.50	1,011	2.80

Table 3

Delinquencies And Defaults By Balance

Amounts (on- and off-balance-sheet)

Loans	**Dec-09**		**Dec-08**		**Dec-07**	
Amount ($)	40,568,476,442.89		35,001,518,076.03		31,951,208,150.13	
	Loans (bal.)	**%**	**Loans (bal.)**	**%**	**Loans (bal.)**	**%**
Current	35,205,463,433	86.8	30,133,032,966	86.1	27,534,666,730	86.2
1-30 days	2,268,283,769	5.6	2,291,421,244	6.5	2,252,636,085	7.1
31-60 days	888,978,077	2.2	812,284,174	2.3	962,182,147	3.0
61-90 days	593,680,147	1.5	346,012,853	1.0	322,258,565	1.0
91-120 days	249,825,587	0.6	205,853,839	0.6	147,163,844	0.5
121-180 days	174,857,811	0.4	188,236,818	0.5	93,361,631	0.3
More than 180 days	1,187,387,619	2.9	1,024,676,181	2.9	638,939,150	2.0
Total	40,568,476,443	100.0	35,001,518,076	100.0	31,951,208,150	100.0
Delinquencies	5,363,013,009	13.2	4,868,485,110	13.9	4,416,541,421	13.8
Defaults	1,612,071,016	4.0	1,418,766,839	4.1	879,464,625	2.8

Loans	**Dec-06**		**Dec-05**	
Amount ($)	23,262,808,866.61		16,760,220,351.20	
	Loans (bal.)	**%**	**Loans (bal.)**	**%**
Current	19,776,503,620	85.0	13,940,667,552	83.2
1-30 days	2,095,465,481	9.0	1,636,095,825	9.8
31-60 days	608,322,157	2.6	608,919,578	3.6
61-90 days	183,290,315	0.8	184,339,132	1.1
91-120 days	79,028,995	0.3	60,044,762	0.4
121-180 days	106,321,200	0.5	44,273,515	0.3
More than 180 days	413,877,098	1.8	285,879,987	1.7
Total	23,262,808,867	100.0	16,760,220,351	100.0
Delinquencies	3,486,305,247	15.0	2,819,552,799	16.8
Defaults	599,227,293	2.6	390,198,264	2.3

SBI was able to successfully contain the rise in delinquent and defaulted loans, despite the harsh economic environment in Mexico during 2009.

Financial Position

Standard & Poor's considers SBI's financial position to be SUFFICIENT based on the mxAAA/Stable/mxA-1+ (Mexican national scale) credit rating on Scotiabank Inverlat S.A.

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