



**Focus on Hot/Warm/Cold Backup Servicing Tradeoffs**

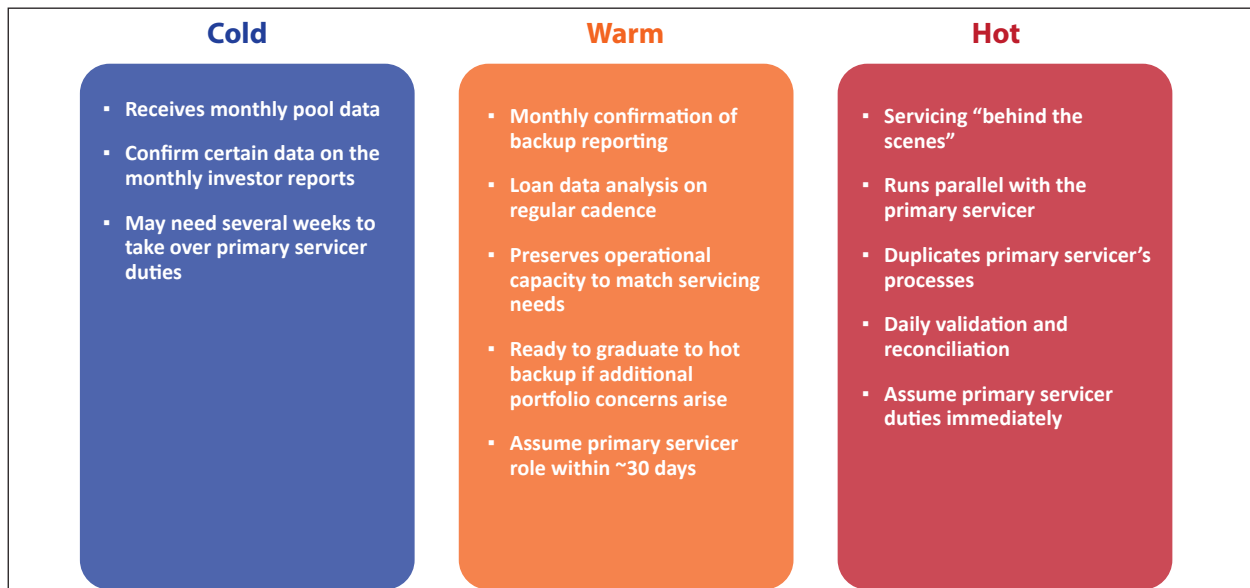
We expect greater market focus on the value vs. cost tradeoff of various types of backup servicers, following the Tricolor developments. So-called “hot” or “warm” backup servicers may be able to more quickly or smoothly take over servicing duties from a deal’s primary servicer. Cold backup servicing, or when a backup servicer’s “temperature” is not clearly defined in deal documents, can face greater delays in servicing transfers. But backup servicing fees would naturally be larger the higher the servicing temperature is. Issuers and investors will closely look at the backup servicing cost/benefit analysis, that may have been an afterthought so far.

The backup servicer of Tricolor’s subprime auto ABS deals is reportedly mightily struggling to take over servicing duties, after the surprise bankruptcy filing of the auto lender. Press stories about the backup servicer’s team getting locked out of Tricolor’s HQ in Dallas, TX, underscore some of the unique aspects of the situation. Tricolor’s TAST deals do not appear to feature a hot backup servicer, based on deal documents. A hot backup servicer essentially services the portfolio behind the scenes (Figure 1). It runs parallel with the primary servicer. Hot backup servicing arguably can succeed primary servicing at any moment. Hot backup servicers note they do everything a primary servicer does, except actually contact the loan borrowers.

Stav Gaon  
 +1 (646) 768-9173  
 sgaon@academysecurities.com

Headquarters Address:  
 Academy Securities, Inc.  
 622 Third Avenue, 12th Fl  
 New York, NY 10017

Figure 1. Backup Servicer Types



Source: Industry publications, Ratings agencies and Academy Securities

## Backup Servicing: Tricolor Spotlights Backup Servicers Temperature

### Hot Backup Servicing Not Common

**Hot backup servicing does not appear prevalent in ABS deals, based on anecdotal evidence and sample data queries we ran.** To be sure, systematically identifying the type of backup servicing across deals is not straightforward. Cashflow systems and some ABS deal datasets do not readily indicate backup servicers, let alone their type.

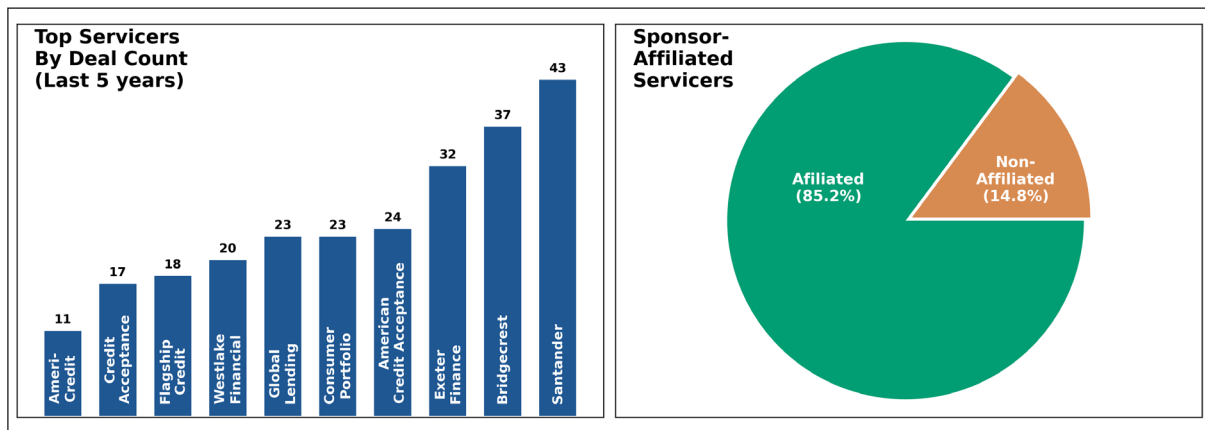
**Deal documents language around the precise duties of backup servicing, or their type, can be ambiguous.** At times, deal documents will explicitly note the backup servicing type – for example, Carvana Auto Receivables Trust (CRVNA) 2021-N1 has a “warm” backup servicer. In turn, in TAST 2025-2 and in several other subprime auto ABS transactions, we see that deal documents simply note that the backup servicer will receive monthly pool data, and confirm “certain data” on the monthly investor reports. Such language around the backup servicer role is largely consistent with cold backup servicing duties, with a very limited level of servicing.

### Spotting Situations that Warrant Higher Backup Servicing Temperature

Rating agencies and legal memoranda suggest situations where transaction parties should be particularly inclined to include hot or warm backup servicing. These include:

- **The primary servicer is an affiliate of the originator.** Originator and servicer affiliation makes an intuitive rationale for elevated level of backup servicing. The originator failure, bankruptcy filing, or a similar event of default, could naturally impact the affiliated servicer as well, as Tricolor dramatically showed. Still, in the subprime auto ABS sector at least, such recommendation may be too broad. Most primary servicers are affiliated with deal sponsors, based on deal data (Figure 2). As such, if the market adopted the sponsor/servicer affiliation principle to determine the backup servicing level, nearly all deals would need to feature hot backup servicing going forward. Alternatively, the market practice of deals having a primary servicer that is affiliated with the sponsor may change.

Figure 2. Subprime Auto ABS Primary Servicers and Affiliation with Originators



Source: Bloomberg and Academy Securities

## Backup Servicing: Tricolor Spotlights Backup Servicers Temperature

- **Elevated risk of servicing transfer need at a future date.** Higher risk for servicing transfer also makes intuitive reason for hot backup servicing, similar to sponsor/servicer affiliation. Of course, the challenge is identifying, at deal origination, those situations of higher prospects for servicing transfers. One concrete possibility is servicers with below average rating. Rating agencies maintain servicer ratings that can identify weaker servicers. Deal documents regularly refer to the expertise and strength of the transaction servicers. All told, we'd expect to see close correlation of the primary servicer rating and the backup servicer type.

### Backup Servicing Fees Vary Across Deals and Sectors

**Servicer fees could limit the prevalence of hot backup servicing.** It may not make sense for every deal to feature hot backup servicing, and its attendant cost. We see a variety of fee schedules for backup servicers. For example, in Tricolor's TAST 2025-2 deal, the backup servicer receives a monthly fee of \$3,000, based on deal documents. In other subprime auto ABS deals we reviewed we saw other backup servicing fee schedules, such as those based on a percentage (say 0.015%) of the pool balance. The fact deals do not readily identify hot/warm/cold backup servicers makes it difficult to consistently compare backup servicing fees by type.

**Backup servicing is not limited to subprime auto ABS deals.** We see references to backup servicers in other ABS/RMBS sectors. We will not be surprised to see differences in backup servicing fees across different sectors. The fee may be a function of the complexity in maintaining hot/warm backup servicing across different sectors. Interestingly, CMBS deals do not feature full-fledged backup servicing. But deals do include an entity that should stand ready to assume advancing if the master servicer fails to advance when required. As such, these "backup advancing parties" can take over some servicing responsibilities. But in CMBS, those backup servicers do not appear to maintain shadow reporting, loan analysis and other actions ABS/RMBS backup servicers may do.

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