MORTGAGE BANKERS ASSOCIATION

March 25, 2015

The Honorable Melvin L. Watt
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, D.C. 20024

Reference: Proposed Minimum Financial Requirements for Enterprise Seller/Servicers (ServicerEligibility@FHFA.gov)

Dear Director Watt:

The Mortgage Bankers Association[1] (MBA) appreciates the opportunity to comment on the *Proposed Minimum Financial Requirements for Enterprise Seller/Servicers* (Proposed Requirements). MBA recognizes that adequate capital and liquidity are keys to effective counterparty risk management between the GSEs and their servicers, and we appreciate the need to periodically update these requirements. MBA believes that the GSEs have benefited significantly from the diversification of counterparty risks that has occurred in the past few years, and has cautioned repeatedly that new counterparty standards should not be a catalyst for a new trend toward further concentration of the servicing industry. We are grateful for the efforts of the FHFA and the GSEs to mitigate the impact of the Proposed Requirements on smaller independent mortgage bankers and servicers. However, MBA has several important concerns and some specific recommendations on the proposed capital and liquidity requirements that should be addressed.

Background

In its 2015 Scorecard, FHFA lists a goal to "Enhance servicer eligibility standards for Enterprise counterparties." In discussing the project with the FHFA, the factors driving

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mba.org.

the proposed standards include the growth of non-performing loans during the recent financial crisis and the growth of non-depository servicers (a/k/a, non-bank servicers). To address these concerns, the FHFA has proposed to harmonize the GSEs counterparty standards for seller/servicer eligibility, as follows:

- On the capital side, the leverage ratio would not change, and the required capital would be a base of $2.5 million plus 25 basis points (bps) of the unpaid balance (UPB) of all loans serviced. Currently, the 25 bps is applied to the UPB of loans serviced for the specific GSE, not all loans serviced.

- The proposed standards also include a 6 percent minimum capital ratio (new for Freddie only).

- The Proposed Requirements also specify minimum liquidity of 3.5 bps times total principal serviced for Fannie Mae, Freddie Mac, and Ginnie Mae (Agencies) plus an incremental 200 bps of the total of nonperforming Agency servicing in excess of 6 percent of total Agency servicing.

Finally, we note that some aspects of the proposal define terms in a manner inconsistent with the current servicing guides. In light of this, we respectfully request that FHFA circulate a second draft for a brief exposure and comment period before finalizing these standards.

General Comments and Questions

Need to Distinguish Actual vs. Scheduled Remittance Servicing

Small independent mortgage bankers have faced more challenges raising capital and liquidity. As a result they generally service for Fannie Mae and Freddie Mac on an “actual” vs. “scheduled” principal and interest basis. This means that they are only required to forward payments actually received rather than pay advances in the event that they do not receive a payment from the mortgagor.

The leading reason for the new liquidity requirements is to ensure servicers are able to advance principal and interest (P&I) and taxes and insurance (T & I) on loans in default. The largest of these advance obligations is for P & I advances. Since P&I advances are not required on “actual” servicing, MBA urges the FHFA, Fannie Mae, and Freddie Mac to reduce the required liquidity for “actual” servicing to 1 bps from the proposed 3.5 bps. This level reflects the fact that T&I represents about one-quarter to one-third of the typical full PITI payment.

Servicers that choose to service only on an actual basis should not face the same liquidity requirement as those that service exclusively on a scheduled basis. Servicers that service both on an actual and a scheduled basis should have a liquidity requirement that proportionally reflects that mix.

We strongly urge the FHFA to adopt a lower liquidity requirement that reflects the different demands of each type of servicing.

Additional Liquidity Requirement for Seriously Delinquent Loans

MBA notes that the 200 bps of additional liquidity required once a servicer hits the 6 percent non-performing loans trigger is unnecessary. First, the trigger hits after loans become 90 days delinquent. But, under the seller/servicer guides, loans are treated on an "actual" remittance basis once they become 120 days delinquent – thus eliminating the ongoing requirement to advance principal and interest. MBA acknowledges that servicers must still advance foreclosure expenses and taxes and insurance even when the loan is serviced on an "actual" remittance basis. Since servicers advance these over a period of time and these are not significant relative to principal and interest advances, the 6 percent trigger and the additional 200 bps of liquidity may be excessive in the circumstances.

MBA is also concerned that the 200 bps of additional liquidity may be a heavy burden for special servicers or for servicers who concentrate on servicing for Ginnie Mae. MBA reminds FHFA that the agencies relied heavily on special servicers during the most recent crisis, and the liquidity requirements may discourage new servicers from this segment or drive existing special servicers out of this specialty. MBA also reminds FHFA that Ginnie Mae acted as a countercyclical force during the most recent crisis. Since Ginnie Mae has its own recently updated liquidity requirement, FHFA should limit this requirement to GSE servicing only.

Finally, the additional liquidity requirement will make it difficult for servicers to invest in the additional staff, training and other capacity building activities needed to address expanding borrower needs as serious delinquencies rise. This runs counter to the policy goal of ensuring that servicers build capacity to address rising delinquencies.

For these reasons, we urge FHFA to reduce or eliminate the liquidity add-on provisions.

Proposed Capital Standard May Create Disparate Outcomes

Under the current capital standards, Fannie Mae and Freddie Mac understood and accepted that the same capital was being used for each of Fannie Mae's, Freddie Mac's, and Ginnie Mae's individual capital requirements. MBA is concerned that the change to 25 bps of the principal balance for all loans serviced is an excessively large increase – especially for servicers who service for each of the Agencies and not just one of them. The increase comes only a few years after Fannie Mae and Freddie Mac raised the minimum capital ten-fold, from $250 thousand to $2.5 million. For servicers that have a balanced portfolio across all three entities, the proposal results in a tripling of the minimum capital requirement. For others, the minimum capital standard would remain unchanged. The result is a dramatically different capital impact <u>not</u> related to underlying counterparty risk exposure but rather simply to the mix of business of the servicer.

MBA back-tested using available data from MBFRF reports and found that all but a handful of seller/servicers would be in compliance with the capital proposal today. However, a company will want to have a cushion of capital in place in the event a reduction in profits or a decrease in servicing values reduce capital. In an informal survey of 76 member companies, 9 percent said they did not meet the capital or liquidity standard, and 15 percent had less than a 20 percent cushion against the standards. However, more than 45% indicated they would have to retain additional earnings or raise liquidity levels to remain compliant with the proposed standard over the next 12 months. The costs of raising additional capital and/or liquidity could discourage or retard these servicers' ability to grow, or cause them to deploy their capital for other purposes.

This highlights the fact that the major impact of the proposed standards stems less from the minimum levels and more from their impact on decisions made at the margins: Do I continue to grow my servicing, or do I deploy my capital elsewhere?

MBA notes that the GSEs have a priority lien on MSRs to cover things like seller/servicer reps and warranties. This priority lien should afford Fannie Mae and Freddie Mac additional protection beyond capital and liquidity standards. In light of these considerations, MBA requests FHFA, Fannie Mae, and Freddie Mac to perform a quantitative analysis to determine whether a 15 bps or 20 bps marginal capital requirement would accomplish the same risk management objectives with a more balanced impact on multi-agency servicers.

Proposed Capital Standard Could Adversely Impact Servicing Values

When MBA met with FHFA, Fannie Mae, and Freddie Mac on February 3, 2015, it became apparent that FHFA had not yet performed a comprehensive study of the impact of the Proposed Requirements on the value of MSRs. In the meeting MBA expressed concern that the proposal could have a negative impact on the value of MSRs. MBA subsequently surveyed servicing brokers and valuation companies. Most agreed that the Proposed Requirements will have a negative impact on servicing values over the long-term. They pointed out that coming off several profitable years, most seller/servicers are well-capitalized and believe that the short-term impact will be small. However, over the long-term, market participants will hardwire a minimum 25 percent capital requirement[2]– reflecting the estimated marginal capital requirement on adding new servicing – in determining the discount rate used to value and bid on servicing. For jumbo loan servicers the impact will be greater because jumbo servicing generally trades one multiple behind Fannie Mae and Freddie Mac servicing. Likewise, distressed servicing sells at a very low multiple of the annual servicing fee. Thus,

[2] The 25 percent comes from the 25 bps of required capital divided by an average MSR valuation of 100 basis points (the 25 bps annual servicing fee times a 4 multiple).

raising the required capital to support the asset significantly impacts the important special servicer/segment of the market.

The general consensus of the long-term impact is that servicing values will go down from 5 bps to 10 bps as a result of the new capital requirement. In surveying actual market participants (servicers), 47 percent believe that the Proposed Requirements will have a negative impact on servicing values. MBA points out that for servicers carrying MSRs at fair value, this will negatively impact capital. Likewise, this will adversely impact the value of the GSEs' priority lien on the MSR asset.

MBA requests FHFA, Fannie Mae, and Freddie Mac perform a quantitative analysis to determine whether a 15 bps or 20 bps marginal capital requirement would accomplish the same risk management objectives. This would mitigate the adverse impact of the new capital requirement on the long-term value of MSRs.

Proposed Requirements Could Be Procyclical

MBA also notes that anything that increases the cost of servicing delinquent loans will necessarily lead to tighter credit, as the current regulatory environment does not allow originators to charge for these higher costs upfront. More generally, increases in servicing costs result in higher costs to borrowers.

MBA also notes that during a credit cycle, delinquencies will rise. Once delinquencies reach the 6 percent trigger point that requires an additional 200 bps of liquidity, servicers may be reluctant to participate in programs to assist borrowers if such programs continue to require servicers to advance and report the loans as seriously delinquent. This could hurt government forbearance programs like HAMP, or those deployed in the wake of a federally declared disaster, designed to help consumers stay in their homes. Further, the escalating liquidity requirements could force many servicers to sell servicing or to purchase new, unseasoned servicing in order to manage their serious delinquency rates. This could create a supply vs. demand imbalance – impacting the market values of MSR assets. For those carrying MSR assets at fair value, this sudden decrease or increase in the value of MSRs would materially impact earnings and capital – possibly resulting in servicers being short of the required minimum capital.

Longer Phase-in and Transparency Needed

Since many servicers believe that they need to raise additional capital or liquidity to provide a safe margin with respect to the proposed minimum capital and liquidity requirements, MBA recommends that the proposed transition be a full year from date of final rule adoption, rather than the six month proposed transition period.

The minimum financial requirements should require the GSEs to establish clear and consistent guidelines for remediation rather than allowing reliance solely on Enterprise discretion. The released guidelines provide very little detail regarding the implications of temporary non-compliance with the proposed financial requirements. Simply stating "the Enterprises will have the discretion to take appropriate action, including termination of the Seller/Servicer" leaves too much unknown to market participants. The market as a whole will benefit from some clarity on remediation plans. For example, defining guidelines that establish reasonable time periods to design and execute a plan to restore capital and liquidity positions would significantly increase the transparency of and add more certainty to the new capital and liquidity requirements.

Further, if GSEs impose a capital or liquidity position that is higher than the minimum, servicers need a clear explanation of the identified concerns and a transparent path, including sufficient time, to meet the higher standards. Such clarity can have the effect of making it easier for servicers to raise capital or retain critical credit or advance lines in an adverse market scenario, thereby buffering the inherent pro-cyclical nature of the proposal. Additionally, while many of our members have indicated they plan to hold a capital cushion above and beyond the minimum proposed financial requirements, greater transparency related to remediation policies may soften any cushions, potentially improving the overall market liquidity and value of MSRs.

Need to Include Margin Posted on TBA Trades in Allowable Liquid Assets

As noted in our February 3, 2015 meeting, FINRA and the SEC will be proposing a new rule that may require mortgage bankers to post variance margin on forward TBA trades once the variance exceeds $250,000. Posting of margin on a forward TBA position means that the mortgage banker has a loss on the forward position but an offsetting gain on loans held for sale. That gain will be realized within several weeks from the reporting date. MBA requests that FHFA include cash posted as margin on forward TBA trades in its definition of "Cash and Cash Equivalents."

Definition of Liquidity

MBA thanks the FHFA for including in the definition of liquidity the unused/available portion of committed advance lines. MBA asks FHFA to also include in liquidity the unused/available portion of committed working capital lines and MSR working capital facilities.

Total Loans Serviced Should Exclude Portfolio Loans

The minimum net worth requirement would include a variable requirement of 25 bps of unpaid principal balance for "total loans serviced." MBA believes that this definition is broad enough that it may include whole loans a servicer services for its own portfolio. The GSEs have no counterparty risk associated with loans a servicer owns and services for its own portfolio. The final rule should specifically carve out these loans out from the 25 bps variable net worth requirement.

Conclusion

MBA recognizes that adequate capital and liquidity are keys to effective counterparty risk management between the GSEs and their servicers**,** and we appreciate the need to periodically update these requirements. However, MBA believes that the proposed capital standard is calibrated too high, reduced standards should be developed for "actual" vs. "scheduled" remittance servicing, and the liquidity standard may be procyclical in its impact. MBA also urges FHFA to perform a rigorous analysis of the potential impact of the capital standard on servicing values.

MBA appreciates the opportunity to share its observations with you. Please feel free to reach out with any questions about the information provided herein to Jim Gross, Vice President Financial Accounting and Public Policy and staff representative to MBA's Financial Management Committee, at (202) 557-2860 or jgross@MBA.org or Justin Wiseman, MBA's staff representative to the Loan Administration Committee at (202) 557-2854 or jwiseman@MBA.org.

Sincerely,

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President and Chief Executive Officer
Mortgage Bankers Association