



THE CONFERENCE OF STATE BANK SUPERVISORS

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FINAL MODEL STATE REGULATORY PRUDENTIAL STANDARDS FOR NONBANK MORTGAGE SERVICERS 2021

Non-Depository Supervisory Committee

July 2021



Codification of Requirements for State Adoption – Model Law or Rule

The following codified language of the requirements contained in the Final Model State Regulatory Prudential Standards for Nonbank Mortgage Servicers is provided as a basis for uniform adoption by states. CSBS and the NDSC believe that uniformity and standardization across the state system are important for achieving consistent consumer protection, achieving effective and efficient regulation and supervision of a national market, and to mitigate the regulatory burden that can result from duplicative or conflicting supervisory approaches.

Sec. 100 – Definitions

Unless specified otherwise in this [Act//Rule] the following definitions shall apply:

- a) *Agency* means Fannie Mae, Freddie Mac and Ginnie Mae.
- b) *Allowable assets for liquidity* means those assets that may be used to satisfy the liquidity requirements herein, including unrestricted cash and cash equivalents and unencumbered investment grade assets held for sale or trade (Agency MBS, obligations of GSEs, U.S. Treasury obligations).
- c) *Board of directors* means the formal body established by a covered institution that is responsible for corporate governance and compliance with this [Act/Rule].
- d) *Covered Institution* means a nonbank mortgage servicer with servicing portfolios of 2,000 or more 1 – 4-unit residential mortgage loans serviced or subserviced for others, excluding whole loans owned, and loans being “interim” serviced prior to sale as of the most recent calendar year end, reported in the NMLS Mortgage Call Report, and that operates in two or more states, districts or territories of the United States either currently or as of the prior calendar year end.
- e) *Corporate governance* means the structure of the institution and how it is managed including the corporate rules, policies, processes, and practices used to oversee and manage the institution.
- f) *External audit* means the formal report prepared by an independent certified public accountant expressing an opinion on whether the financial statements are presented fairly, in all material aspects, in accordance with the applicable financial reporting framework, and is inclusive of an evaluation of the adequacy of a company’s internal control structure.
- g) *FHFA* means the Federal Housing Finance Agency.
- h) *GSE* means government-sponsored enterprises, or Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac).
- i) *Ginnie Mae* means Government National Mortgage Association.
- j) *Internal audit* means the internal activity of performing independent, objective assurance and consulting to evaluate and improve the effectiveness of company operations, risk management, internal controls and governance processes.

- k) *Interim serviced prior to sale* means the activity of collecting a limited number of contractual mortgage payments immediately after origination on loans held for sale but prior to the loans being sold into the secondary market.
- l) *Mortgage Call Report* means the quarterly or annual report of residential real estate loan origination, servicing and financial information completed by companies licensed in NMLS.
- m) *MSR Investor* means entities that invest in and own mortgage servicing rights and rely on subservicers to administer the loans on their behalf. MSR Investors are often referred to as master servicers.
- n) *Mortgage-backed security or MBS* means financial instruments, often debt securities, collateralized by residential mortgages.
- o) *Mortgage servicing rights or MSRs* refers to the contractual right to service residential mortgage loans on behalf of the owner of the associated mortgage in exchange for specified compensation in accordance with the servicing contract.
- p) *Nationwide Multistate Licensing System or NMLS* means the state system of record for non-depository, financial services licensing or registration.
- q) *Operating liquidity* means the funds necessary to perform normal business operations, such as payment of rent, salaries, interest expense and other typical expenses associated with operating the entity.
- r) *Residential mortgage loans serviced* means the specific portfolio or portfolios of residential mortgage loans for which a licensee is contractually responsible to the owner or owners of the mortgage loans for the defined servicing activities.
- s) *Reverse mortgage* means a loan collateralized by real estate, typically made to borrowers over 55 years of age, that does not require contractual monthly payments and is typically repaid upon the death of the borrower through the sale of the home or refinance by the heirs.
- t) *Risk management program* means the policies and procedures designed to identify, measure, monitor and mitigate risk sufficient for the level of sophistication of the servicer.
- u) *Risk management assessment* means the functional evaluations performed under the Risk Management Program and reports provided to the board of directors under the relevant governance protocol.
- v) *Servicer* means the entity performing the routine administration of residential mortgage loans on behalf of the owner or owners of the related mortgages under the terms of a servicing contract.
- w) *Servicing liquidity or liquidity* means the financial resources necessary to manage liquidity risk arising from servicing functions required in acquiring and financing MSRs, hedging costs (including margin calls) associated with the MSR asset and financing facilities, and advances or costs of advance financing for principal, interest, taxes, insurance and any other servicing related advances.
- x) *Subservicer* means the entity performing the routine administration of residential mortgage loans as agent of a servicer or MSR investor under the terms of a subservicing contract.

- y) *Subservicing for others means* the contractual activities performed by subservicers on behalf of a servicer or MSR investor.
- z) *Tangible net worth* means total equity less receivables due from related entities less goodwill and other intangibles less pledged assets.
- aa) *Whole loans* mean those loans where a mortgage and the underlying credit risk is owned and held on balance sheet of the entity with all ownership rights.

Sec. 200 – Applicability – Exclusions

- a) This [Act/Rule] shall be applicable to covered institutions as defined. For entities within a holding company or affiliated group of companies' applicability shall be at the covered institution level.
- b) *Exclusions.* The following exclusions apply:
 - i. This [Act/Rule] does not apply to not-for-profit mortgage servicers or housing finance agencies.
 - ii. Sec. 300, Financial Condition, shall not apply to Servicers solely owning and/or conducting reverse mortgage servicing, or the reverse mortgage portfolio administered by covered institutions or the whole loan portion of portfolios.

Sec. 300 – Financial Condition

- a) A covered institution must maintain capital and liquidity in compliance with this section.
- b) Generally Accepted Accounting Principles (GAAP) required. For the purposes of complying with the capital and liquidity requirements of this section, all financial data must be determined in accordance with GAAP.
- c) A covered institution that meets the FHFA Eligibility Requirements for Enterprise Single-Family Seller/Servicers for capital, net worth ratio, and liquidity, regardless of whether the servicer is approved for GSE servicing, meets the requirements of subsections a) and b) of this section.
 - i. Covered institutions shall maintain written policies and procedures implementing the capital and servicing liquidity requirements of this section. Such policies and procedures must include a sustainable written methodology for satisfying the requirements of subsection c. of this section and be available to [the commissioner] upon request.
- d) *Operating Liquidity.* Covered institutions shall maintain sufficient allowable assets for liquidity in addition to the amounts required for servicing liquidity, to cover normal business operations.
 - i. Covered institutions shall have in place sound cash management and business operating plans that match the size and sophistication of the institution to ensure normal business operations. Management must develop, establish and implement plans, policies and procedures for maintaining operating liquidity

sufficient for the ongoing needs of the institution. Such plans, policies and procedures must contain sustainable, written methodologies for maintaining sufficient operating liquidity and be available to [the commissioner] upon request.

Sec. 400 – Corporate Governance

- a) *Board of directors required.* Covered Institutions shall establish and maintain a board of directors responsible for oversight of the covered institution.
- b) *Alternative to board of directors.* For covered institutions that are not approved to service loans by a GSE or Ginnie Mae, or where these federal agencies have granted approval for a board alternative, an institution may establish a similar body constituted to exercise oversight and fulfill the board of directors' responsibilities in Sec. 400 c. below.
- c) *Board of directors' responsibilities.* The board of directors shall be responsible for:
 - i. Establishing a written corporate governance framework, including appropriate internal controls designed to monitor corporate governance and assess compliance with the corporate governance framework, available to [the commissioner] upon request.
 - ii. Monitoring and ensuring institution compliance with the corporate governance framework and this [Act/Rule].
Accurate and timely regulatory reporting, including the requirements for filing the Mortgage Call Report.
- d) *Internal Audit.* The board of directors shall establish internal audit requirements that are appropriate for the size, complexity and risk profile of the servicer, with appropriate independence to provide a reliable evaluation of the servicer's internal control structure, risk management and governance. Board established internal audit requirements and the results of internal audits shall be made available to [the commissioner] upon request.
- e) *External Audit.* Covered Institutions shall receive an external audit, including audited financial statements and audit reports conducted by an independent public accountant annually. The external audit shall be available to [the commissioner] upon request and include at a minimum:
 - i. Annual financial statements including a balance sheet, statement of operations [income statement] and cash flows, including notes and supplemental schedules prepared in accordance with GAAP.
 - ii. Assessment of the internal control structure.
 - iii. Computation of tangible net worth.
 - iv. Validation of MSR valuation and reserve methodology, if applicable.
 - v. Verification of adequate fidelity and errors and omissions (E&O) insurance.
 - vi. Testing of controls related to risk management activities, including compliance and stress testing, where applicable.

- f) *Risk Management.* Covered institutions shall establish a risk management program under the oversight of the board of directors and available to [the commissioner] upon request that identifies, measures, monitors, and controls risk sufficient for the level of sophistication of the servicer. The risk management program must have appropriate processes and models in place to measure, monitor and mitigate financial risks and changes to the risk profile of the servicer and assets being serviced.

The Risk Management Program must be scaled to the complexity of the organization, but be sufficiently robust to manage risks in several areas, including, but not limited to:

- i. *Credit risk:* The potential that a borrower or counterparty will fail to perform on an obligation.
 - ii. *Liquidity risk:* The potential that the servicer will be unable to meet its obligations as they come due because of an inability to liquidate assets or obtain adequate funding or that it cannot easily unwind or offset specific exposures.
 - iii. *Operational risk:* The risk resulting from inadequate or failed internal processes, people, and systems or from external events.
 - iv. *Market risk:* The risk to the servicer's condition resulting from adverse movements in market rates or prices.
 - v. *Compliance risk:* The risk of regulatory sanctions, fines, penalties or losses resulting from failure to comply with laws, rules, regulations or other supervisory requirements applicable to the servicer.
 - vi. *Legal risk:* The potential that actions against the institution that result in unenforceable contracts, lawsuits, legal sanctions or adverse judgments can disrupt or otherwise negatively affect the operations or condition of the servicer.
 - vii. *Reputation risk:* The risk to earnings and capital arising from negative publicity regarding the servicer's business practices.
- g) *Risk Management Assessment.* Covered institutions shall conduct a risk management assessment on an annual basis concluding with a formal report to the board of directors available to [the commissioner] upon request. Evidence of risk management activities throughout the year must be maintained and made part of the report, including findings of issues and the response to address those findings.

Sec. 500 – Authority

- a) *Rules*. The [commissioner] may adopt rules necessary to implement this [Act].
[Drafter’s note: Subsection 500a. is not necessary where these standards are adopted as rule.]
- b) *Examination, Investigation, Enforcement*. [The specific language of this section shall be determined by state law.]
- c) *Authority to Address Risk as Necessary*. The [commissioner] may:
 - i. Where risk is determined by a formal review of a specific covered institution to be extremely high, order or direct the institution to satisfy additional conditions necessary to ensure that the institution will continue to operate in a safe and sound manner and be able to continue to service loans in compliance with state and federal law and/or regulation.
 - ii. Where risk is determined by a formal review of a particular covered institution or institutions to be extremely low, provide notice that all or part of this [Act/Rule] is not applicable to those covered institutions.
 - iii. Where economic, environmental, or societal events are determined to be of such severity to warrant a temporary suspension of all or certain sections of this [Act/Rule], provide public notice of such temporary suspension.