

How States are Transforming Mortgage Supervision

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By Chuck Cross, CSBS Senior Vice President of Nonbank Supervision and Enforcement

State oversight of financial institutions is transforming through a new strategic approach that we are calling Networked Supervision. It is about leveraging our collective intelligence across the states and with federal regulators. It is about building trust and making our industries into allies who know that the state system would rather reduce than increase regulatory burden. And it is about relying heavily on data, technology and each other to get the job done.

Networked supervision is the driving force behind a recent state initiative on mortgage supervision that I discussed at the Mortgage Bankers Association's Regulatory Compliance Conference 2020 on November 9. We released our [Regulatory Prudential Standards for Nonbank Mortgage Servicers Proposal](#) for public comment on October 1.

What do we mean by prudential standards?

Prudential standards should be considered a combination of financial condition requirements and governance controls, for example, board oversight, risk management, audit practices, adherence to regulatory requirements and data security controls.

Nonbank mortgage servicers play an integral role in the market - a market that simply would not operate as it does today without them. However, from a supervisory perspective, we have concerns with the growth of nonbank mortgage servicers and their corporate governance practices.

In 2011, nonbanks represented 6% of the agency market; today they represent well over 50%, with the largest companies growing even larger. With size comes complexity, and with complexity comes risk, and with risk comes a greater need for consumer protection, which is at the heart of what we do. The core of this proposal is financial condition, but we are also focused on how individual companies are managed.

Why states are addressing prudential standards?

First, state regulators are both the primary regulatory (meaning licensing authority) and the prudential examining authority for all nonbank institutions.

Second, the federal requirements may be sufficient for the loans they cover, but neither FHFA nor Ginnie Mae cover the entire market. Only state regulators have jurisdiction over all portfolios.

Third, the idea that prudential standards are only necessary to protect institutions relying on a government backstop ignores the potential for significant consumer harm from mortgage payment interruption, misapplication of consumer funds, accounting errors or a host of other harms state regulators have seen with compromised institutions. In our experience, prudent operations and consumer protection go hand in hand.

Further, existing federal requirements do not provide adequate coverage for our purposes. Let me explain what I mean by adequate coverage: we like most of what we see in the federal space and to the greatest extent practical have aligned with the federal approach. However, these requirements do not cover everything for which state supervisors are responsible.

The existing requirements cover either the Fannie/Freddie portfolio or the Federal Housing Administration/Veterans Affairs portfolio. But the FHFA eligibility requirements are not intended for the Ginnie Mae space specifically, and vice versa. Remember that state regulators are responsible for more than the agency portfolio. Private label and whole loan servicing are under state jurisdiction. FHFA and Ginnie Mae requirements do

not cover these loans. When existing requirements do fit, they likely are not enforceable by states. FHFA or Consumer Financial Protection Bureau regulatory standards may or may not be enforceable by a state, and Ginnie Mae standards are clearly not enforceable by any state.

So, what is in our proposal?

Our proposal is bifurcated into two sections: baseline standards that are intended to apply to all nonbank servicers and enhanced standards that apply to only the most complex servicers. Both sections focus on capital and liquidity as the core of the requirements.

Throughout, we have tried to align with existing federal standards to the greatest extent practical. For example, the calculations we use for capital and liquidity are the same calculations required by FHFA in their seller/servicer eligibility requirements but applied to the entire portfolio under state supervision.

We have aligned with federal agencies elsewhere as well, such as CFPB and FHFA on servicing transfers and Ginnie Mae standards for audit reports. We are considering Ginnie Mae's approach to individualized stress testing for how we address enhanced standards for complex servicers.

We have leaned away from allowing unused portions of credit lines to count as liquidity, the same as we saw in FHFA's 2.0 proposal. The states and FHFA have simultaneously come to the understanding that credit lines, even committed lines, are certain right until the point when they are no longer certain. The argument that a larger financial institution will stand behind these commitments no matter what is legally untested and unrealistic. We think that a servicer should thoughtfully and prudently self-manage its liquidity needs and position across the organization, subject to regulator scrutiny.

Simply put, management should be aware of how much cash it takes to run the company and factor in some cushion for unexpected events. We don't say how much cushion in

our proposal, but examiners will review this area and discuss the appropriate position with management.

Note that we don't try to cover everything in this proposal, like what is the minimum threshold for inclusion in the baseline standards. We are looking for industry and others to help guide us to the right decision on these and other points as we finalize the standards.

And that is where I make the pitch for comments.

If you are a stakeholder in this matter, our comment period is open until December 31. We need to hear from you. Some companies and organizations have been scheduling face to face discussions. Others will write to us. We will take your thoughts any way we can get them.

This initiative and dozens more comprise Networked Supervision: a new way of regulatory thinking and supervisory approach built upon a collective intelligence of ideas that foster transparency, trust and innovation by leveraging resources and coordination across regulators, engaging industry in the supervisory process, and using technology and data to do more than we could before.