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MSR Task Force
Conference of State Bank Supervisors
1129 20th St, NW, 9th Floor
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Re: Proposed Regulatory Prudential Standards for Non-Bank Mortgage Servicers

The American Bankers Association ("ABA")[1] appreciates the opportunity to comment on the Proposed Regulatory Prudential Standards for Non-Bank Mortgage Servicers drafted by the Conference of State Bank Supervisors ("CSBS") and the American Association of Residential Mortgage Regulators ("AARMR").[2] The proposed Baseline Standards would apply basic safety and soundness principles to all non-bank servicers, while the Enhanced Prudential Standards would take into account servicers' diverse business models and risk profiles. [3]

ABA strongly supports the efforts of CSBS and AARMR to develop comprehensive and consistent safety and soundness standards that are based on the risk of a servicer's business operations. Similar risk models should receive equivalent regulatory treatment, regardless of whether the entities involved are banks or non-banks. In sum, the proposed standards will help protect mortgage borrowers and investors and enhance the stability of the nation's mortgage finance system.

Background

Non-bank specialty servicers have become an important part of the mortgage market, servicing a large and growing proportion of outstanding mortgage debt. In recent years, non-bank servicers have taken on a more pronounced role in servicing residential mortgage loans. For example, of the 30 largest mortgage servicers, those that were not banks held a 17% share of the mortgage servicing market at the end of 2013, up from 9% at the end of 2012, and 6% at the end of 2011. The growth of the non-bank sector is widely expected to continue to increase in 2015.

[1] The American Bankers Association is the voice of the nation's $15 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits and extend more than $8 trillion in loans. Learn more at aba.com.

[2] http://www.csbs.org/regulatory/Documents/MSR-ProposedRegulatoryPrudentialStandardsforNon-BankMortgageServicers.pdf

[3] The proposed Baseline Standards would apply to all non-bank mortgage servicers. The Baseline Standards would include capital, liquidity, risk management, data standards, data protection (including cyber risk), corporate governance, servicing transfer requirements, and change in control requirements. The proposed Enhanced Prudential Standards would apply to firms based on their other lines of business, size, and overall complexity. The Enhanced Prudential Standards would address capital, liquidity, stress testing, and living wills and recovery and resolution plans.

At the same time, mortgage servicing rights at U.S. commercial banks and thrifts have declined by more than half since their peak in mid-2008, or from $84 billion to $40 billion.[4] Basel III's high capital requirement for MSAs is a key factor in banks' decisions to exit or reduce their servicing holdings. The Basel III capital requirements have resulted in a major market shift as large and small banks that specialize in mortgage banking transfer large quantities of servicing rights to non-depository institutions that are not subject to regulatory capital requirements. We recognize the importance of correctly valuing assets for capital purposes; however, performance, capacity, and service should be the primary drivers of who obtains market share in mortgage servicing -- not differentially high capital standards imposed on one segment of the industry.

Need for Prudential Standards

The recent, rapid growth of non-bank entities underscores the need for more rigorous and consistent monitoring of the financial condition, stability, and management of these firms. Non-bank servicers face many of the same risks as bank servicers, but are not subject to comparable safety and soundness, data protection, or corporate governance standards.[5] The absence of a consistent regulatory framework for these entities jeopardizes the stability of the mortgage finance system and creates risk for consumers and taxpayers. These concerns have been widely discussed by state and federal regulators, lawmakers, and other policy-making bodies. For example:

- Questionable Capital Reserves. Non-bank servicers have purchased mortgage servicing rights from banks, but do not operate under a prescribed capital standard. If market conditions were to deteriorate, non-bank servicers may not have adequate reserves to meet economic challenges and to continue servicing mortgage loans without interruption.[6]

- Inadequate Liquidity. Liquidity problems could also lead to operational issues for non-bank servicers. Servicers are responsible for advancing principal and interest payments to the mortgage investor/creditor if a borrower is delinquent or defaults on his/her mortgage loan. In some cases, non-banks have borrowed funds in order to meet these obligations. While servicers will be repaid for the advances when the loan is foreclosed, modified, or otherwise paid off, they are not compensated for the cost of borrowing and may be responsible for

[4] Report of Federal Housing Finance Agency Office of Inspector General, *FHFA Actions to Manage Enterprise Risks from Nonbank Servicers Specializing in Troubled Mortgages* (July 1, 2014). The report also notes that nine of Fannie Mae's top 20 servicers are not banks, and they account for 28% of the overall group's loan volume, or 3.6 million mortgage loans with approximately $600 billion in unpaid principal balances. Similarly, non-bank servicers represent 7 of Freddie Mac's top 20 servicers and account for 15% of the group's loan volume, or 1.3 million loans with approximately $230 billion in unpaid principal balances.

[5] State regulators have credentialing and licensing authority over non-bank servicers, and the Consumer Financial Protection Bureau examines them for compliance with consumer protection laws and regulations. However, non-bank servicers have not been subject to consistent and robust safety and soundness oversight.

[6] We note that on May 20, 2015, Fannie Mae and Freddie Mac adopted minimum net worth and liquidity requirements for their seller/servicers. However, these standards are not regulatory requirements.

continuing such advances for an extended period of time. A liquidity-challenged non-bank servicer may not be able to fully fund its operations, which could result in lower quality servicing for consumers.

- Financing MSR Transactions. The Federal Housing Finance Agency ("FHFA"), Ginnie Mae, Fannie Mae, Freddie Mac, and the Financial Stability Oversight Council have expressed concern regarding non-bank servicers' use of short-term financing to acquire large volumes of mortgage servicing rights. Short-term financing could strain the operations and finances of these servicers. ABA understands that recent financing arrangements for MSR transactions have 3-5 year terms and that, in some cases, investors expect a 15%-18% yield. Some regulators are concerned that investors will flee if they do not receive their anticipated return. This could detrimentally impact the liquidity and valuation of mortgage servicing rights for all servicers, which could have a ripple effect on the broader mortgage market.

- Taxpayer Risk. Because Freddie Mac, Fannie Mae, and Ginnie Mae guarantee payments on mortgage-backed securities, the inability of non-bank servicers to fulfill their obligations puts taxpayers at risk and jeopardizes the stability of the mortgage finance system. Fannie Mae and Freddie Mac oversee their servicing arrangements with both bank and non-bank servicers. However, as servicing migrates from the bank to the non-bank sector, the extent of the Federal regulatory regimen on which the Enterprises can place a certain level of reliance in structuring their oversight is significantly diminished. Similarly, Ginnie Mae officials have noted the oversight gap as non-banks comprise an increasing percentage of Ginnie Mae issuers and servicers. Increased oversight at the state level would help to ensure that servicers have the financial wherewithal to make principal and interest payments to bondholders and should help to identify, and hopefully address, concerns with non-bank servicers before they become too severe.

- Bankruptcy of a Non-Bank Servicer. Increased safety and soundness oversight could help to manage financial difficulties faced by a non-bank servicer and to proactively make arrangements for the transfer of mortgage servicing rights if a servicer is in a financially troubled condition. If a non-bank servicer were to fail, significant questions could arise regarding the capacity of the market to financially absorb and operationalize the transfer of an unprecedented number of servicing rights. We are also concerned about the potential gaps in borrower service and borrower confusion that could occur in this situation.

- Data Security. The security of borrowers' financial account data and other personally identifiable information is a significant public policy and national security concern. We are pleased that the proposed prudential standards for non-bank servicers would address governance over information technology, information technology security risk assessment, and routine information technology testing and monitoring.

Between January 2005 and May 6, 2015, over 5,000 data breaches exposed more than 800 million records nationwide.[7] Data security will require enhanced attention, resources, and diligence on the part of all participants in the financial system – banks and non-banks alike. In particular, we note hackers involved in recent data breaches have exploited vulnerabilities in the systems and internal controls of third-party vendors in order to gain entry to the systems and data maintained by their ultimate targets. For this reason, we strongly urge CSBS and AARMR to adopt third-party vendor oversight standards, in addition to general data security and information technology management requirements.

Summary

Consistent oversight of the financial health, governance, and data security of non-bank firms will help to shore up the stability of our nation's mortgage finance system. While non-banks are already subject to certain consumer protection laws and regulations, the adoption of prudential regulatory standards will also help to ensure that consumers do not experience service interruptions or a deterioration in the quality of the servicing of their mortgage loans.

Thank you for the opportunity to comment on the proposal and for your consideration of ABA's views. If you have any questions, please contact me at kshonk@aba.com.

Sincerely,

Krista J. Shonk

[7] Source: Identity Theft Resource Center.