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June 22, 2015

Conference of State Bank Supervisors
Via http://www.csbs.org/regulatory/Pages/MSR.aspx

RE: Proposed Regulatory Prudential Standards for Non-Bank Mortgage Servicers

Dear CSBS,

Introduction to the California Mortgage Association

A. The authors of this letter, Elizabeth Knight and Michelle Rodriguez, are directors of the California Mortgage Association ("CMA"). CMA is the leading trade association for private mortgage lenders in California. Michelle Rodriguez is general counsel and chief compliance officer for a small non-bank mortgage servicing company that is affiliated with a private mortgage banker. Elizabeth Knight is the owner of PLM Lender Services, Inc., a small non-bank servicer for private mortgage lenders and brokers. Established in 1999 through a predecessor organization, CMA has over 250 members, consisting primarily of small business owners who make or arrange loans secured by California real estate. All of our members are state licensed mortgage brokers, who negotiate and arrange loans to borrowers made by private investors. Other members are state-licensed lenders who lend their own money directly, and then sell the loans to non-institutional investors. Many of our members also service these loans for their investors. Our members sometimes obtain servicing of mortgage loans from brokers who are retiring or quitting the business, or from investors who are dissatisfied with their current servicer and choose to transfer servicing to another broker. In addition,

some of our members are small independent mortgage servicers who service mortgages for brokers and investors. These shall all be referred to in this letter collectively as "CMA Servicer-members". Our members fall into the "Non-Bank Mortgage Servicers" category of these standards.

B. CMA Servicer-members serve borrowers who do not qualify for conventional financing, including underserved communities and small businesses. Our members provide loans to borrowers who do not qualify for conventional financing through banks or other institutional lenders; provide capital for small businesses that would otherwise go unserved; and provide a chance for homeowners to recover from difficult financial situations without losing their homes. In addition to providing much needed capital to these underserved communities, as small businesses our members provide jobs within those communities and for the many service providers they retain to assist in completing the loan and servicing transactions, such as title companies, appraisers, mortgage brokers, trustees and escrow companies. In addition to providing jobs directly, by supplying this type of financing, more jobs are created by the construction of homes, property rehabilitation, the forming of new businesses and a myriad of other employment created from funds used by Borrowers' real estate holdings not to mention additional tax revenue by way of increased value of home and transfer tax at time of sale.

C. Since our members are small companies that service relatively small volumes of loans, they often develop a close relationship with their borrowers and the lenders. They typically service less than 5,000 loans, many service 50-100 loans. They have not "grown dramatically in size, complexity" nor have they acquired massive portfolios of mortgage service rights. Additionally, they do not acquire GSEs or Ginnie Mae type loans. They typically service individual loans for private investors, or private investor funds including self-directed IRAs and mortgage pools. We agree they do not only play an important role in the post-crisis mortgage market, they have played an important role since the late 1970s. Many of them have additional business lines such as loan originations. The percentage of loans which have moved from "banker servicers" to "non-bank mortgage servicers" is not representative of our members. Bank servicers have not typically moved their portfolios to our members who are overseen by the California Bureau of Real Estate ("CalBRE") and/or the California Department of Business Oversight ("CalDBO"). Bank servicers have moved their files to large servicers

capable of servicing billions of dollars of loans, not to the smaller servicers in our organization.

Small Non-Bank Servicers Should Be Exempt from the Baseline Standards

D. Due to the nature of our members' type of loan servicing, non-bank servicing companies who service less than 5,000 loans or portfolios totaling less than $750 million ("Small non-bank servicers") should be exempt from all of the Baseline Standards and the enhanced prudential standards. We believe this would be in conjunction with the statement made in the proposal where it states "the standards should be scaled to minimize the burden on less complex firms". The burden currently on Small non-bank servicers from working with the analysis of all of the new servicing regulations, the compliance with all of the new servicing regulations, the type of clientele-both the lenders and borrowers who utilize these types of non-bank servicers is heavy. Adding an additional burden of the Baseline Standards would put many Small non-bank servicers out of business. This would further consolidate loan servicing into large servicers; the very same large servicers which were, and in some cases still are, the source of many of the problems in loan servicing. Decreasing the number of servicers would further constrict credit because of the Small non-bank servicers are often also lenders. Decreasing the number of servicers would also raise the cost of loans, decrease income tax on servicer income and servicer's employee's income, and decrease licensing fees for government agencies. If Small non-bank servicers go out of business, the state economy will also suffer from increased unemployment and lack of available credit.

E. Overview of the Non-Bank Mortgage Servicing Industry The proposal discusses the Non-Bank Mortgage Servicers' strengths. These strengths are nowhere more apparent than our type of members. CMA Servicer-members are able to handle loans which require intensive and demanding oversight. They do not concentrate on these types of loans, as the overall portfolio is expected to perform, but when there is a problem with a loan, it gets the additional attention it requires. Many times, the attention is given to the file by the owner of the company due to his/her relationship with the borrower and the lender(s). As to the perceived "lower servicing costs" of being a non-bank servicer, it does cost a Small non-bank servicer as much if not more per loan to service due to overall cost of business and the small number of loans being serviced.

F. Additionally, this document, discusses the Non-Bank Mortgage Servicers' weaknesses. The susceptibility of Non-Bank Mortgage Services in economic downturn because they do not operate under a prescribed capital standard and, therefore, "may retain less capital," is an issue which does not come into play with these types of Small servicers. There are many reasons why a prescribed capital standard would be unnecessary: 1.) typically these are not "guaranteed" loans, they are privately owned loans – lenders who are private investors or funds. Under California Real Estate law, it is not legal to "guarantee" a loan; 2) servicers are entitled to be paid by the lenders even on a non-performing loan according to most servicing contracts, therefore, even if the payments are not coming in from the borrowers, the servicers have the ability to bill the lenders (typically monthly), thereby not substantially affecting their cashflow; 3) Most servicers do not hold an interest in the loan, therefore, their cashflow is not affected should a loan become non-performing; 4) should advances be made for taxes, insurance, senior liens or other issues, the lender will make the advance – the servicer typically is not responsible for the advance except on particular consumer loans under the CFPB regulations 5) Small non-bank servicers are able to make decisions quickly and can reduce the size of staff, space, overhead and outsource to a similar type servicer should the need arise in a very short period of time thus keeping them liquid..

G. It is true that State Regulators in California together with the Consumer Financial Protection Bureau ("CFPB") have already established a variety of standards that apply to non-bank mortgage servicers. There are stringent rules in California regarding licensing and bonding depending on the type of license held by the servicer. Most CMA servicer-members service loans under a license granted by the CalBRE, which has a Consumer Recovery Fund, from which victims of licensee fraud or theft can recover some or all of their losses. Additionally, the non-bank servicers are required to follow all CFPB servicing standards related to consumer protection depending upon whether they fall under the "large" or "small" servicer definition under CFPB.

<u>Questions for Public Comment.</u>

1. Along with the Proposed Regulatory Prudential Standards for Non-Bank Mortgage Servicers, the CSBS specifically posed eleven questions for commenters to address. Below, we address each of these questions in turn.*Should all non-bank*

mortgage servicers be required to have a full financial statement audit conducted by an independent certified public accountant?

Currently, the CalBRE rules require a review of certain licensees' trust accounts by independent accountants. These reviews are submitted to the CalBRE. Since law already exists requiring independent review of licensee financials, it is unnecessary to impose additional auditing requirements. Alternately, if additional auditing requirement are deemed necessary, an exemption for Small non-bank servicers is necessary so that Small non-bank servicers, who do not have as many loans among which to spread the auditing costs, are not driven out of business, further consolidating mortgage servicing into a few large companies, reducing competition, quality, choice, and increasing prices for loan servicing which is passed on to consumers.

2. *Should there be a 6 percent net worth requirement in addition to the minimum capital requirement plus add-on?*

First, some CMA Servicer-members are licensed with the CalDBO, which already has net worth requirements. One set of net worth requirements should be sufficient. The Servicer-members licensed by the CalBRE do not have net worth requirement because their clients are covered under the Consumer Recovery Fund. Therefore, a net worth requirement is not needed for CalBRE licensees.

Secondly, a base net worth of $2.5 million with an escalator of .25 percent of unpaid principal balance of the serviced portfolio may be obtainable when the servicer has over two billion dollars in servicing, but is unattainable when a servicer has $500 million or less in private investor or fund servicing. A portfolio in the amount of $100 million is still large for CMA Servicer-members, that net worth requirement would close the doors of the true Small non-bank servicers. Again, this type of net worth requirement is not necessary for the non-bank servicers who service non-GSE loans. To have the same standard as a Fannie Mae or Freddie Mac servicer would be preposterous. If by "6% net worth requirement", you mean 6% of the loan portfolio on top of the $2.5 million base with escalator would drive most small servicers out of business, further consolidating mortgage servicing into a few large companies, reducing competition, quality, choice, and increasing prices for loan servicing which is passed on to consumers.

3. *Is the Fannie Mae and Freddie Mac proposal to require more liquidity when delinquencies rates rise reflective of increased risk? What operational challenges does this standard create?*

Since CMA Servicer-members do not service Fannie/Freddie loans, Fannie/Freddie requirements would not affect them. If you propose extending the

Fannie/Freddie proposal to non-Fannie/Freddie servicers, then it would put many Small non-bank servicers out of business. Small non-bank servicers do not have a large number of loans over which to spread the cost of retaining capital for liquidity. Small non-bank servicers would have to raise their servicing fees, and be unable to compete with large servicers who have more loans over which to spread the extra cost.
Also, CMA Servicer-members generally obtain the extra costs for defaulted loans (i.e. advances for unpaid property taxes, and insurance) directly from the lenders, so they do not need reserves for these amounts.

4. *How should state regulators approach formulating a prudential standard for liquidity, considering a firm's potential cash outlays for both private label and GSE backed paper?*

A liquidity standard of 3.5 basis points for CMA Servicer-members is also unnecessary for the same reason as base net worth. Also, the assets (the mortgages being serviced) are owned by investors who make the decisions on their loans, are hands on in making the loans, and do not expect the non-bank servicer to pay for any losses unless said loss occurred due to error on the part of the servicer. Even with this, almost all non-bank servicers carry some form of E & O insurance. To require a Small non-bank servicer to adopt the GSE's standard would be unnecessary and overly burdensome

5. *What is a reasonable ownership percentage threshold to trigger a change in control event?*

Most CMA Servicer-members are small businesses with one or two main owners. When there is a change in control, the new party must go through the same rigorous coursework, character scrutiny, and testing as the former owners did – perhaps even more rigorous since the standards for obtaining a license have only gotten more stringent in time. So, further government oversight over the change in control is unnecessary.

Also, Change of Control Requirements that require a change in ownership of a mortgage servicer be reported in order to evaluate whether the new owners have the financial capacity and management expertise to effectively operate the non-bank servicer would have the appearance of favoring monopolies and appear to be a "restraint of trade." Owners of these companies, as other types of companies, build up the businesses many times with the thought of selling at retirement or at the peak of the market for that business. If government had to approve this transfer, it would be burdensome and not allow for freedom of trade.

In reality, all CMA Servicer-members would already notify their clients if there was a change in control of the company, so an additional government burden

to require a notice is redundant. If the notice must be sent, a 51% change in ownership is a fair number to precipitate the notice.

6. *Which criteria should be used to determine the firms that are subject to enhanced prudential standards?*

Although the Financial Stability Oversight Council has identified non-bank mortgage servicers as a portion of the business that warranted heightened risk management and supervisory attention, the oversight of the California servicing is strictly regulated and enforced. CalBRE and the CalDBO have copious rules, regulation and enforcement of said rules.

The proposal, states State Regulators believe "enhanced prudential standards may be appropriate for large, complex non-bank mortgage servicing companies". The proposed enhanced prudential standards build upon the Baseline Standards and additional standards would be applied to firms according to factors such as the number or dollar amount of loans serviced, the composition of the servicing portfolio, and the entity's primary business. We question whether enhanced standards are necessary, because the Baseline Standards seem comprehensive and stringent. However, if enhanced standards are deemed necessary, then we believe that the enhanced standards should apply only to the largest servicers, as determined by dollar-amount of loans serviced, and number of loans. The largest servicers are responsible for most of the problems in the industry, and their failures would have the most systemic impact, so they should be subject to enhanced standards if such enhanced standards are deemed necessary.

7. *Do any of the Baseline Standards threaten the viability of a servicer?*

The requirements proposed in the eight categories listed in the Baseline Prudential Standards are completely out of line with capabilities of a typical Small non-bank servicer. Below, we enumerate the problems with the Baseline Standards.

a.) Capital Requirements – We addressed the Small non-bank servicers' problems with the proposed capital requirements above at #2 above.

b.) Liquidity Requirements - We addressed the Small non-bank servicers' problems with the proposed liquidity requirements above at #3 & #4 above.

c) Risk Management. The writing of a "Risk Management" program would be burdensome for the Small non-bank servicer. Unlike banks which employ staff that can write risk management programs, a Small servicer would likely have to

hire an outside attorney to assist in writing of the risk management program. The Small non-bank servicer does not have a large number of loans over which to spread the cost of creating the risk management program.

d.) Data Standards. The data standards under the CFPB's Mortgage Servicing Rules are already being followed by most CMA Servicer-members because they do not qualify as a "small servicer" under the current definition. So imposing an additional rule regarding the standards would impose an unnecessary layer of liability and government oversight.

e) Data Protection. Data Protection is always a critical component of any loan servicing operation. As we know, the best systems can be hacked, as was just seen with the 1,000,000 accounts with the IRS which were hacked. No system is foolproof. There are already laws in California regarding notification of customers of businesses whose data security has been breached. Another layer of regulation is unnecessary and burdensome.

f.) Corporate Governance. Many of the ownership interests of the Small non-bank servicers are held by single owners and not "stakeholders." While we agree that there should be minimum standards of acceptable behavior for employees in the business and appropriate internal controls, the CalBRE and CalDBO already regulate the broker's or owner's supervision of employees.

Regarding the requirement of other reports detailing the servicer's operations and financials, such reports are already collected via the Nationwide Mortgage Licensing System("NMLS") for CMA Servicer-members with NMLS endorsements, and also collected separately by the CalBRE & CalDBO. To require another set of similar, but slightly different reports would be unduly burden and unnecessary. Our concerns regarding audits of servicer financial are detailed in #1 above.

g) Servicing Transfer Requirements. Smooth and transparent servicing transfers are important to our Small non-bank servicers, but the transfer of loans can typically be from one loan to 250 loans. It would be highly unusual for our servicers to transfer in more than this. The CFPB already has requirement in place regarding servicing transfers. Another set of rules would be unduly burdensome and unnecessary.

h.) Change of Control requirements. Our concerns regarding the notice of change in ownership are stated above at #5.

8. *What is a reasonable transition period to implement the Baseline Standards? Are there specific standards that would require additional time to implement?*

   A reasonable time-frame to implement the Baseline Standards would be 18 months after the rules are finalized by the state agency. It will take servicers that long to write and test the necessary policies and procedures, and to make changes to accumulate the necessary capital and provide for the required liquidity. Meeting the capital and liquidity requirement will undoubtedly be the most troublesome and time-consuming for Small non-bank servicers, and will likely put many out of business, as stated above. Additionally, once see they were unable to reach the capital and liquidity requirement, the value of the companies would drop and a fair value could not be received for the servicing rights.

   Additionally, tens of thousands of loans would be required to be moved to servicers that CSBS feels are qualified or back to the private sector, which would be an issue due to the work involved with this transition.

9. *What timeframes would be appropriate to implement each of the enhanced standards?*

   A reasonable time-frame to implement the enhanced standards would be 24 months after the rules are finalized by the state agency or after the servicer exceeds the eligibility criteria for enhanced standards. This would give the servicer time to complete the stress testing and amass the extra capital and liquidity requirements.

10. *What effect will the enhanced standards have on the warehouse and advance facility borrowing contract/capacity of large servicers?*

    The enhanced standards should not have a negative impact on the large servicer's ability to obtain and maintain a warehouse facility. As CMA Servicer-members are Small servicers and many obtain any necessary advances directly from the lenders, so they do not have advance facilities.

11. *Is a prescribed risk-weighted capital adequacy measure more appropriate than a company established capital adequacy methodology for complex firms subject to enhanced prudential standards?*

    CMA Servicer-members are not complex firms, and should not be subject to the enhanced prudential standards. If for some reason they were deemed to subject to the enhanced standards, a company established adequacy methodology should be

allowed, because the company is more familiar with the risks and strengths of the company than a government agency would be.

In conclusion, the California Mortgage Association is requesting the CSBS and the state regulators exempt certain non-bank servicers from the proposed regulatory standards. We respectfully request that firms which service 5,000 or fewer loans with principal values totaling less than $750 million at any given time be exempt from these regulations. If the members of CMA were expected to conform to all of the rules including the net worth and liquidity, not only would it decimate the servicing companies and servicing entities owned by our members, but by doing this, the following would occur:

1. Originating loan companies which provide the loans of private investor loans would be unable to fund the loans as there would not be a place for the servicing.
2. Loans currently serviced by our members would have to turn over servicing to companies or private investors who are not equipped to service these types of loans.
3. The private investor lender would cease to invest in the real estate investment market. These funds could move out of the state or even out of the country.
4. The employees of the servicing company would be unemployed.
5. The employees of the investment/loan company would be unemployed.
6. Ancillary industries would be affected: title companies, escrow companies, appraisers, trustees.
7. Builders would not get the funds needed to build spec or small projects, thus leaving more unemployment for their sub-contractors and employees
8. Neighborhoods in which rehabilitation takes place would no longer have the benefit of this type of financing.
9. Consumers would be unable to obtain financing not available by bank loans
10. Costs of the servicing would rise thus hurting the lender consumer and the borrower consumer.
11. Service which is normally given to borrowers and lenders on these types of loans would go by the wayside because a "large" servicer cannot provide the special service needed to allow these loans to function properly.
12. Less revenue would go to the state licensing departments as CMA member pay Broker licensing fees, agent licensing fees and NMLS endorsement fees.
13. Less revenue to city and counties due to the inability to have funds to rehabilitate homes thus keeping the prices of the properties below their optimum.
14. Neighborhoods would no longer benefit from the "flippers" who are one of the users of the this type of money.
15. Real estate prices may drop if this type of private money was unavailable would receive less work potentially causing layoffs.

16. People who have more than the "allowance" of institutional loans would be unable to obtain real estate credit.
17. People who have less than the "acceptable" credit rating would be unable to obtain real estate credit thus not being able to rebuild their credit quickly and substantially.

To allow regulations that decimate an entire industry is obviously not the purpose of these proposed regulations, but that would be the outcome together with all of the important financial gain to the community and consumers. An important source of credit and all that goes with that would be lost. We would like to remind you that it was the private industry who primarily made use of modifications and forbearances yesars before the institutional lenders focused on them; these are now huge consumer/creditor assistance programs. The entrepreneurs who make up this industry are smart and versatile and are very important by contributing to their communities in many ways including giving employment, giving credit, allowing consumers to rebuild their credit, assisting in building lender retirement funds, donating their time and money to worthy causes and a litany of other benefits of having "Small" companies doing "Big" jobs.

We thank you for considering our comments. If you would like to speak with us directly in person or over the phone, please feel free to call us at 408-370-4030 ext. 209 for Elizabeth Knight or 818-206-2325 for Michelle Rodriguez. Additionally, should you feel the need to discuss this in person, Michelle and I would be available to meet with you personally. This is an extremely important issue for the viability of our own businesses, our employees, our lenders, our borrowers, the brokers, our trade association and our communities which we serve.

Sincerely,

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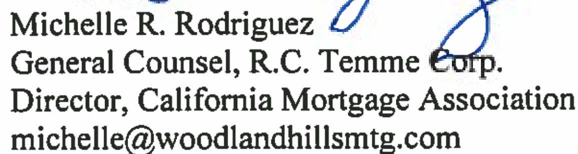

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