



June 23, 2015

MSR Task Force
Conference of State Bank Supervisors
1129 20th St, NW, 9th Floor
Washington, DC 20036

re: CSBS Proposed Framework for Prudential Regulation of Non-bank Servicers

The Mortgage Bankers Association (MBA)¹ appreciates the opportunity to comment on the Conference of State Bank Supervisors' (CSBS) proposed framework for prudential regulation of independent mortgage (or "non-bank") servicers (the Proposal). Determining appropriate regulatory standards for non-bank servicers has been a topic that has attracted interest in recent years and we are grateful that CSBS has provided opportunities for feedback and taken the lead in the discussion.

CSBS is an excellent forum to propose these ideas as it is a collective organization of state regulators. While we call for more explanation of the need for and scope of the Proposal's standards in our comments below, it is clear the worst outcome for the industry, and ultimately the consumers it serves, is a patchwork regime of different standards or inconsistent regulations that makes it difficult for a servicer licensed in multiple states to understand its responsibilities and make future financial plans.

We also question the need for the prudential regulatory regime as proposed. Independent mortgage servicers are unlikely to create systemic risk either as financial intermediaries or moral hazard through insured deposits and access to the Federal Reserve's discount window or the payment system. Therefore, the Proposal does not appear to be protecting a direct taxpayer or systemic financial stability interest. There are also existing regimes that non-bank mortgage servicers must adhere to through engagement with their key counterparties, including government or government regulated entities. In order to do business with these counterparties, they must meet their financial and operational eligibility requirements. Continued eligibility is contingent on ongoing monitoring of the entity's financial condition and their adherence to operational requirements. As a last resort, the bankruptcy process has proven to be effective for an orderly resolution of a failing servicer.

Even if one believes that certain baseline standards are appropriate, it does not follow that CSBS should seek to impose the proposed "enhanced standards." It is true that an especially large servicer may cause more disruption if it were to fail. However, these large and/or complex

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.

servicers are also more likely to be fully integrated into the extensive system of counterparty regulation by the Fannie Mae and Freddie Mac (the GSEs), the Government National Mortgage Association (GNMA) and their warehouse banks. Additionally, the capital and liquidity requirements are designed as a stable ratio, so growing larger should not, by itself, cause concern.

Our comments on the Proposal are laid out as follows:

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I. The Proposed Prudential Regulatory Standards

The Proposal contains two sets of standards. The first are baseline standards that will apply to all state licensed non-bank mortgage servicers and the second are enhanced standards that will apply to certain complex or large non-bank mortgage servicers.

Baseline Standards: The proposed baseline standards will cover all non-bank mortgage servicers licensed by and operating in a state. The standards cover eight areas:

1. *Capital:* The proposed capital standard mirrors the Federal Housing Finance Agency's (FHFA) proposed standard² and will require a base net worth of \$2.5 million dollars in addition to 25 bps of the unpaid principal balance of the entire portfolio (all serviced loans).
2. *Liquidity:* The proposed liquidity standard is 3.5 bps of all serviced loans. This proposal declined to adopt the FHFA's increased liquidity requirement of 200 bps if the agency servicing portfolio contains more than 6 percent delinquent loans. The baseline liquidity standard contains a provision requiring "management to have a methodology for liquidity needs for other activities." This methodology would be subject to challenge and additional liquidity requirements by state regulators.

² Available here: <http://www.fhfa.gov/PolicyProgramsResearch/Policy/Pages/Proposed-Minimum-Financial-Requirements-for-Enterprise-Seller-Servicers.aspx>. FHFA recently finalized these proposed standards on May 20th. The final standards are substantially similar to the proposed standards and are available here: <http://www.fhfa.gov/Media/PublicAffairs/Pages/New-Eligibility-Requirements-for-SellerServicers.aspx>

3. *Risk Management*: Non-bank servicers will be required to have a risk management program scaled to the organization's complexity and risk profile under the Proposal. This program will be required to assess and mitigate the firm's exposure to risk on an on-going basis. An independent risk management assessment must be conducted on an annual basis.
4. *Data Standards*: The Proposal requires all servicers, even those who service less than 5,000 loans, to meet the data standards embodied in the Consumer Financial Protection Bureau (CFPB)'s Mortgage Servicing Rules.³ The Proposal expects that all firms will also have documented processes and internal audits for data on-boarding and maintenance.
5. *Data Protection*: The proposed standards break data protection down into three categories with enumerated requirements. The Proposal outlines expectations around (1) governance over information technology (IT); (2) a security risk assessment strategy for IT; and (3) routine information technology (IT) monitoring and testing.
6. *Corporate Governance*: Ginnie Mae reporting standards⁴ will be used as the baseline standard for corporate governance and will include audited financial statements as well as audit reports conducted by independent public accountants. The audit reports include both assessments of internal controls as well as compliance testing and validation of financial condition.
7. *Servicing Transfers*: The baseline standard will align with the relevant CFPB⁵ and FHFA⁶ bulletins on the subject. The Proposal specifically notes certain general standards outlined in both bulletins with a focus on validating data, addressing errors before contacting the borrower and stressing communication with transferor servicers.
8. *Change of control requirements*: State regulators will require prior notification of (i) a change in 10% or more in ownership of a company or (ii) the ability of person or group acting in concert to elect a majority of corporate directors or (iii) the ability of a group to effect a change in policy of the corporation (regardless of ownership interest). The regulators propose to evaluate financial capacity and management expertise of the new owners or controllers.

Enhanced Prudential Standards: The Proposal outlines the perceived need for enhanced standards for certain firms based on "other lines of business, size, and overall complexity." The Proposal does not define a certain size threshold or measure of complexity. These firms are required to have enhanced planning, modeling, metrics and audit capabilities in the four areas outlined below that quantify the appropriate level of risk tolerance as well as on- and off-balance sheet activity and exposure. These firms would be expected to develop their own methodologies

³ Available here: <http://www.consumerfinance.gov/regulations/2013-real-estate-settlement-procedures-act-regulation-x-and-truth-in-lending-act-regulation-z-mortgage-servicing-final-rules/>

⁴ Available here: http://www.ginniemae.gov/doing_business_with_ginniemae/issuer_resources/MBSGuideLib/Chapter_03.pdf

⁵ "Bulletin 2014-01. Compliance Bulletin and Policy Guidance: Mortgage Servicing Transfers." Consumer Financial Protection Bureau, August 2014. Available here:

http://files.consumerfinance.gov/f/201408_cfpb_bulletin_mortgage-servicing-transfer.pdf

⁶ "Advisory Bulletin 2014-06. Mortgage Servicing Transfers." Federal Housing Finance Agency, June 2014. Available here:

<http://www.fhfa.gov/SupervisionRegulation/AdvisoryBulletins/AdvisoryBulletinDocuments/2014%20AB-06%20Mortgage%20Servicing%20Transfers%20Advisory%20Bulletin.pdf>

and monitoring capabilities in these areas, subject to independent third party assessment. The four specific areas are:

1. *Capital*: The supervisory expectation is that these firms develop a capital standard that is appropriate given the overall risk profile of the entity. Such a standard would evaluate the risks proposed by particular class/type of servicing or the particular loan types.
2. *Liquidity*: The expectation is that firms will determine the on-balance sheet liquidity level necessary to maintain normal operations during a moderate stress environment and that the on-balance sheet liquidity would comprise of high quality liquid assets as defined by the Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC) and Federal Reserve.⁷ The methodology would also quantify, subject to testing and regulatory review, any sources of off-balance sheet liquidity, such as unfunded lines of credit or other sources.
3. *Stress Testing*: Firms subject to the enhanced standards will need to perform stress testing that incorporates third party confirmation of the appropriateness of the model and validity of the outcomes and assumptions. This testing should inform the company's capital and liquidity planning.
4. *Living Will and Recovery Resolution Plans*: The Proposal contemplates that the servicers subject to the enhanced standards will maintain a "living will" that clearly outlines the ownership, operational structure, and recovery paths from significant hardship events. As part of this process, they also would develop a plan subject to regulatory review that would enable management or regulators to effectuate an orderly resolution if required.

The Proposal notes that typical resolution plans include:

- Consolidated financial information;
- Description of the corporate entity;
- Description of principal business lines;
- Description of foreign operations;
- Identity of vendors key to the firm's operations;
- Identity of principal officers;
- Description of material management information systems; and
- Outline of a recommended plan, with descriptions of potential purchasers of either servicing rights, bulk transfers, or the company outright."

II. General Comments

a. Unclear Rationale for These Standards

At the outset, we question the need for such prescriptive prudential regulatory standards for independent mortgage servicers, particularly with regard to the "enhanced standards." The CFPB has already promulgated and implemented extensive mortgage servicing rules that govern nearly every facet of the servicing relationship and cover all servicers, bank and non-bank, large

⁷ This definition is available here: <http://www.gpo.gov/fdsys/pkg/FR-2014-10-10/pdf/2014-22520.pdf>

and small.⁸ Additional regulatory powers to govern consumer-facing conduct were granted by the *Dodd-Frank and Wall Street Reform and Consumer Protection Act* (Dodd-Frank) to the CFPB and the states through their power to penalize acts and practices that they believe to be unfair, deceptive or abusive (UDAAP).

The Proposal does not include consumer facing standards or regulate the conduct of a servicer toward their customers. We applaud CSBS for recognizing that these rules provide comprehensive national standards for all servicers and that additional prescriptive standards in this space would be duplicative and burdensome. Indeed, the costly demands of regulatory implementation and other factors have significantly increased the costs of servicing for both performing and non-performing loans and further increase the cost of new origination.⁹

The CSBS standards in the Proposal are intended to address the operational and certain key enterprise risks presented by the growth of independent mortgage servicers to command a greater share of the mortgage servicing market. Such growth is not a unique phenomenon but rather a swing of the pendulum between business models that has shifted back and forth throughout the years.¹⁰ As the pendulum makes its most recent swing, there have been calls for “prudential regulation” of non-bank or independent mortgage servicers due to undefined “risks” they may pose.¹¹ The market changes and the rationale for these standards are outlined in the preamble of the Proposal.

Before discussing the proposed regulations in depth, it is worth examining the concept of “prudential” regulation of non-bank servicers. Prudential regulation is generally understood to be the regulation of the banking sector by federal or state regulatory authorities to ensure that the banks are sufficiently capitalized and have sufficient liquidity. This supervision and regulation is justified by the fact that the regulated institutions receive insured deposits, have direct access to the payment systems, and are able to turn to the government as a lender of last resort. The increased regulation is meant to counter the moral hazard of potentially higher risk-taking by the banks due to both the insured deposits and lender of last resort benefits.

Under that rationale, it is not clear that non-bank mortgage servicers require the sort of prudential regulatory regime in the Proposal. Any regulation would not appear to be protecting a direct taxpayer or systemic financial stability interest as they do not create systemic moral hazard risk through insured deposits and access to the Federal Reserve’s discount window or any government backstop.

Non-bank mortgage servicers are also subject to financial monitoring through engagement with their key counterparties — The Department of Housing and Urban Development (HUD)/GNMA; Fannie Mae and Freddie Mac and other mortgage backed securities investors. In order to do business with these counterparties, they must meet their eligibility requirements. Continued eligibility is contingent on ongoing monitoring of the entity’s financial condition and their

⁸ See 78 FR 10695.

⁹ This dynamic is explored in depth in a forthcoming whitepaper produced by MBA and PricewaterhouseCoopers, *The Changing Dynamics of the Mortgage Servicing Landscape*. MBA will provide a copy to CSBS and it will be available on the MBA website.

¹⁰ For more information on this, see *The Changing Dynamics of the Mortgage Servicing Landscape*.

¹¹ While non-bank servicers have grown significantly in recent years for reasons outlined in *The Changing Dynamics of the Mortgage Servicing Landscape*, it is worth remembering that they still only make up less than ¼ of the market.

adherence to operational requirements. The Proposal recognizes this relationship by incorporating many of these requirements into the baseline standards.

Calls for prudential regulation thus seem to be motivated by a fear of the disruption that would occur should a large non-bank servicer become insolvent. Like all businesses, some mortgage servicers have and will fail. There is undoubtedly consumer disruption or confusion when this occurs. However, the current national regulatory regime has stringent requirements on servicing transfers that forbid transferee servicers from taking actions that would negatively impact consumers and would likely remain in place even if the transferor servicer were in financial distress. It is also likely that CFPB and other regulators would look unfavorably upon any practices that resulted in serious harms to consumers due to a servicing failure and subsequent distressed transfer of servicing and could use their UDAAP authority to impose sanctions for such conduct.

For investors that receive remittances from servicers, a servicing failure would be disruptive but would not likely be catastrophic. Absent fraud—which, by its nature, would be designed to circumvent the regulatory structure—all servicer operations would not immediately cease. Currently, larger investors and the GSEs monitor the financial and operational condition of their servicers and could move servicing, if a failure appeared imminent, to mitigate any negative effects. Investors, term lenders and advance lenders are involved in monitoring and will step in should any signs of trouble develop. As a last resort, the bankruptcy process can be utilized for an orderly resolution. In some instances during the bankruptcy process, secured creditors can be required to advance operational funds in order to allow for an orderly resolution.

Servicing is also a cash-flow positive business and servicers would continue to receive payments from consumers and/or their servicing fee and would be able to sell owned mortgage servicing rights (MSRs) to shrink and retrench. Finally, the robust subservicing capacity that exists could be leveraged to provide a stop-gap solution that would keep most payments flowing.

For these reasons, we believe CSBS should further explain the motivating rationale for the Proposal. In particular, it would be helpful to understand more clearly the issues these standards are intended to address and why the current system of government counterparty and investor requirements — in addition to existing state bonding and other financial requirements — is insufficient to address the growth of non-bank servicers.

Any regulation should also be mindful of the fact that the private-label market remains largely dormant following the recent financial crisis. Should it re-emerge, it would be helpful if CSBS outlines (i) why it believes that these servicers will not also service agency product and thus be subject to these rules and not require a separate framework; (ii) why these servicers would be so large as to pose a risk that justifies such regulation; and (iii) why future private-label securities (PLS) investors would not be able to ascertain and require sufficient counterparty risk standards to protect their interests.

b. Serious Issues Raised by Implementation of Standards

Though we question the need for such broad standards, MBA supports the general approach taken by the baseline standards to leverage existing regulatory requirements and generally accepted business practices. Utilizing existing standards will make it easier for servicers to implement these requirements or report relevant metrics to their examiners. This will

particularly benefit small servicers who may not have the resources or expertise required to navigate complex or overlapping regulatory requirements.

The benefits of this approach will be lost, however, if there is a piecemeal implementation process or if these standards are changed when adopted by the states via rule or legislation. Adoption of multiple and possibly contradictory standards/interpretations of acceptable levels of capital and liquidity or operational metrics will be extraordinarily expensive and confusing. This burden will be especially acute on those covered by the enhanced standards, as their company-specific plans are subject to the interpretation, questioning and possible revision of every state regulator in which they operate.

MBA understands and appreciates the sovereignty of CSBS's member states. However, we believe that the topics covered by both the baseline and enhanced standards touch on common standards and principles that are not likely to change or have significant need for variation by state or region. Capital, liquidity, risk management and data standards support the entire organization and cannot be effectively modified or apportioned among the states.

In light of this, we urge CSBS to seriously consider how they might best achieve a uniform solution amongst their members to implement all aspects of the Proposal that they finalize. Failure to do so will undermine much of the good work that has gone into crafting the baseline standards and the desired objectives of the enhanced standards.

c. Centralize The State Prudential Requirements Into One Regulatory Body

One way that CSBS could address the implementation issues raised above would be to explore creating a "self-regulatory organization" (SRO) or other general oversight body in service to the state regulators collectively.

Such an organization would benefit both state regulators and the servicers they license and oversee. If properly structured, cooperative and on-going reporting would allow for relatively real-time supervision around a set of common defined metrics. Compliance examinations of servicers and course corrections if necessary would remain the purview of each state regulator. Regulators would benefit from centralized expertise on complicated financial issues, shared testing and reporting as well as a deeper insight into company operations. State taxpayers would also benefit from the centralization of this function as expensive competencies and similar analysis would not have to be replicated by different states. For servicers, supervision, examination and reporting burdens would be centralized and presumably lessened. Additionally, there would be regulatory clarity around expectations and consistency across the states.

MBA urges CSBS to conduct a study or otherwise consider this suggestion to determine the appropriate governance structure and the necessary metrics and inputs required to make state regulators comfortable. We also encourage CSBS and its members to evaluate the best systems or methods to centralize the reporting burden to make this complementary rather than additive for servicers.

MBA would be glad to assist in this effort and welcomes the opportunity to discuss this further.

d. Serious Definitional Issues Around Proposed Standards Coverage

The Proposal needs to be clearer on who is intended to be covered by these standards. States do not have a clear and uniform framework for licensing servicers or for what kinds of activities are

covered. The language of the Proposal suggests that this will apply to “all firms” that are licensed by a state regulator under their licensing regime. State licensing laws vary significantly and do not always apply only to those that own the MSR or are responsible for collecting and remitting or advancing payments to investors.

Many states only have general “mortgage banking statutes” and applying these standards to that population broadly could capture loan originators and others that should not be subject to this regulation. While many servicers have origination arms that are already covered by the GSE standards, applying these capital and liquidity standards to smaller mortgage lenders that do not service could have very serious consequences. Failure to specifically define the entities that are covered by this Proposal could lead to unintended outcomes, possibly including significant disruption or events of default in existing trusts, debts/warehouse arrangements, or servicing agreements and may not make sense given the actual tasks or business model of the entity that is subject to the state licensing.¹²

For instance, the Proposal’s focus on “MSRs” suggest that these standards are not intended to cover subservicers—which is the right decision, particularly with regards to the financial requirements. However, given that they perform servicing activities, subservicers are licensed in some states. In the absence of a uniform definition of “servicer,” the Proposal may need to make clear which activities it intends to subject to the outlined standards. This definition should be offered for public input ahead of the Proposal’s final publication.

In addition, there are small, specialized nonprofit servicers that could be harmed by the proposed prudential standards, such as the neighborhood affiliates of Habitat for Humanity. It is believed that fewer than 80 of the 1,400 Habitat for Humanity affiliates would have the required capital net worth of \$2.5 million or meet the standards for liquidity. Consequently, any effective framework should clearly state that the Proposal does not apply to nonprofit servicing organizations.

While we understand that different states have different views on what sort of conduct falls under their applicable licensing statutes, these standards have been pegged to certain assumptions about business models, MSR ownership and financial responsibilities. Failing to address the definitional issues will lead to the sort of implementation challenges discussed above.

¹² For example, the Illinois Residential Mortgage Lending Act (which covers servicing, origination and other mortgage lending functions) says: “‘Servicing’ shall mean the collection or remittance for or the right or obligation to collect or remit for any lender, note owner, note holder, or for a licensee’s own account, of payments, interests, principal, and trust items such as hazard insurance and taxes on a residential mortgage loan in accordance with the terms of the residential mortgage loan; and includes loan payment follow-up, delinquency loan follow-up, loan analysis and any notifications to the borrower that are necessary to enable the borrower to keep the loan current and in good standing. “Servicing” includes management of third-party entities acting on behalf of a residential mortgage licensee for the collection of delinquent payments and the use by such third-party entities of said licensee’s servicing records or information, including their use in foreclosure. 205 ILCS 635/1-4(q) (emphasis added). Thus a regulation that implemented the Proposal’s standards without careful consideration of the activities it intends to regulate would potentially be requiring outside collection companies to maintain capital and liquidity reserves.

III. Specific Comments on the Standards

The Baseline Standards

As a general matter, we support the CSBS decision to lessen the implementation burden by leveraging already existing standards or best practices in order to avoid regulatory duplication. We believe that this will benefit independent mortgage servicers and allow state regulators to leverage the significant existing body of regulations that have been promulgated and implemented in recent years.

Please see below for our specific comments on aspects of the baseline standards, broken down by area of coverage:

a. Capital and Liquidity

These comments assume that the final CSBS standards will, to the extent they build off the FHFA/GSE proposed standards, mirror the final standards that were released on May 20, 2015. The Proposal states that when a GSE changes the capital escalator, the standards would be adjusted. Given that there is currently alignment, we would suggest that any changes only occur when FHFA and both GSEs change their minimum eligibility requirements.¹³ While we are generally supportive of using these commonly adopted standards and their relevant definitions, we do have the following concerns:

- i. There are serious definitional questions that need to be addressed before these standards are implemented.

Any baseline standards — but particularly with regard to capital and liquidity — should make clear what activities are intended to be covered. The GSE’s capital and liquidity standards ensure that a servicer has sufficient ability to meet advance requirements and perform necessary foreclosure and property preservation activities. In some respects, this takes primacy over the need to ensure operational continuity as the GSEs maintain the ability to move servicing at any time.

Thus, while we appreciate the use of FHFA/GSE standards due to their already broad coverage over many companies that are traditionally thought of as “mortgage servicers,” it is important to ensure that these standards are not universally applied to “all firms” licensed by the states. Nor do they necessarily take into account activities that might fall into state servicing licensing requirements but would not make a company a GSE Seller/Servicer.

As mentioned above, subservicers do not have the advance requirements that would necessitate this form of counterparty risk management. The final CSBS standards should recognize this and clearly state that the capital and liquidity standards only apply to the state licensed entity that owns the MSR or has subsequent advancing responsibilities when calculating the unpaid principal balance (UPB) servicing balance for the financial requirements.

Example of servicers that should be excluded from the capital and liquidity standards are distressed asset servicers that own and service and small developers that develop properties

¹³ FHFA involvement is necessary because a tie to “a GSE” could have unexpected consequences given the uncertain future and possible post-conservatorship state of the GSEs.

and then service and hold the loans in portfolio.¹⁴ These servicers are state licensed and hold risk on their own books. Their liquidity needs should not be regulated as they do not have significant advancing responsibilities.

- ii. We support the CSBS decision not to implement the FHFA proposal's additional liquidity requirements above a certain delinquency threshold.

For more, please see our response to specific questions for comment #3 on page 15.

b. *Risk Management*

Not all independent mortgage servicers have a Board of Directors. This part of the Proposal should be revised to reflect either company management or a board of directors.

It is unclear what is intended in the Proposal when it states that a risk management assessment should be "independently conducted on an annual basis." If the intention is to require an outside firm to conduct the risk management review, this will be costly and burdensome for servicers, particularly smaller servicers, and overstates the level of risk posed by the entities.¹⁵ Rather, the baseline standard's "independent assessment" should be carried out by company personnel that are empowered to do so by company management and have internal independence from the personnel that prepared the risk management plan or conduct the servicing. Evidence of internal independent reviews would be maintained and available for review by the licensing regulator.

We also note that CFPB requires independent company audits of compliance management systems (CMS) to ensure compliance with their rules and as such this requirement may be duplicative and unnecessary—particularly with regard to compliance risk, vendor/affiliate risk, and operational risk. Such reports could be made available to state examiners.

c. *Data Standards*

MBA opposes stripping the "small servicer" exemption here. CFPB presumably conducted a cost-benefit analysis in applying their exemptions and determined that the burden on small servicers (less than 5,000 loans) outweighed any consumer benefits and thus they should not be subject to these requirements. To the extent that this is intended as a supervisory requirement, examiners can work with their regulated entities to come up with a reasonable schedule for the production of information that takes into account the immediacy of the need for the information and capacity of the servicer.

d. *Data Protection*

MBA notes that a centralized reporting agency or mechanism mentioned above would have the ability to rapidly disseminate threat or data breach information to its members in an efficient fashion.

e. *Corporate Governance*

¹⁴ Given the proposals focus on MSR, it is important to note that under generally accepted accounting principles (GAAP) no MSR is created when a loan is originated and serviced in portfolio. The normal servicing fee remains part of the interest income and is not a separate revenue stream.

¹⁵ If this independent third party review is intended, the SRO discussed above could both distribute the costs among more servicers and lessen duplication by allowing both an independent and regulatory review.

We appreciate that the internal audit requirements will be evaluated based on the size and complexity of the firm.

f. Servicing Transfer Requirements

Servicing transfers are an area of intense regulatory attention and the Proposal leverages this by including both a CFPB and FHFA bulletin as the source of its proposed requirements. While these are widely applied standards, including this topic in the Proposal may be redundant. Consumer facing issues are already covered for all servicers by the CFPB bulletin that is in force. The myriad of other standards proposed here would serve to ensure that a transferee servicer is able to absorb the transferred servicing (capital/liquidity; data standards) and that a transferor servicer is transmitting accurate data (data standards).

Additionally, the vast majority of the market transfers are already subject to review and approval. Both Fannie Mae and Freddie Mac, under the conservatorship FHFA, and Ginnie Mae have reporting requirements around servicing transfers in addition to the ability to block transfers. While these entities are not regulators, as federally-related guarantors they bear the greatest risks if a servicer failure occurs and are highly incentivized to pay close attention to servicing transfers.

g. Change of Control Requirements

We support the decision to require prior notification, rather than approval, as the baseline standard. Requiring prior approval would be extremely confusing and burdensome, particularly given the relatively low change of control threshold.

We believe that the standard should be set at 20 percent. Different states have different requirements regarding the applicable ownership percentages with variation between 10 percent - 50 percent. Ginnie Mae's standard is 20 percent.¹⁶ In light of the desire to leverage commonly accepted and widely followed standards, Ginnie Mae's 20 percent standard should be incorporated as the baseline standard. Additionally, the Proposal uses Ginnie Mae standards as the source of its corporate governance regulations, so this is an appropriate source to determine change of control percentage.

We do have concerns that the phrase "effect a change in policy of the corporation" is vague and suggests that even minor leadership or executive changes would require notifying a state regulator. This would be burdensome for all servicers and overly broad and unhelpful for regulators.

The Enhanced Standards

The obvious threshold question is to which servicers do these enhanced standards apply? Please see our thoughts on this in our response to question #6 on page 17.

We outlined our thoughts on the appropriateness of prudential standards above, but note that even if one applies the baseline standards, it does not follow that CSBS should seek to impose enhanced standards. It is true that an especially large servicer may cause more disruption if they were to fail and that a very large or "complex" servicer may be more difficult for a state to

¹⁶ "Change in ownership or control" means, for purposes of this Section 3-13(B), a change in ownership of 20 percent or more of the stock or other ownership interest in the Issuer." Available here: http://www.ginniemae.gov/doing_business_with_ginniemae/issuer_resources/MBSGuideLib/Chapter_03.pdf

examine. However, these large and/or complex servicers are also more likely to be fully integrated into the extensive system of counterparty regulation by the GSEs, GNMA and their warehouse banks. These entities have recently raised their capital and liquidity standards and this — along with uniformly applied reasonable baselines standards — goes a long way toward addressing the Financial Oversight Stability Council’s (FSOC) concerns.¹⁷ Additionally, the capital and liquidity requirements are designed as a stable ratio, so growing larger should not, by itself, cause concern.

Also, the factors that mitigate the possible disruption of a servicer failure apply even at a large scale. Independent mortgage servicers generally have a lower risk profile due to simple, liquid, short duration balance sheets. Servicing is also a cash-flow positive business and a distressed servicer would continue to generate cash flow through payments from consumers and/or servicing fees and would be able to sell owned MSRs in a competitive market to raise capital to retrench.

MBA appreciates that the enhanced standards will rely on company-derived plans that are appropriate to a particular enterprise’s profile. We have serious concerns, however, about requiring individual regulatory approval of each particular standard. Rather than developing a unitary “prudential” framework for large or complex non-bank servicers, these enhanced standards could result in a servicer being subject to multiple regulators with different interpretations of business judgments. The calculation of appropriate capital and liquidity levels by state regulators would not be a completely objective process and different regulatory views on reasonable outcomes could create chaos for a company seeking to abide by the standards in good faith. The SRO or centralized reporting mechanisms discussed above would be particularly useful to mitigate this risk by allowing for a unified review overseen by a body accountable to the states.

a. *Capital and Liquidity*

Any CSBS enhanced standards should apply to the state-licensed entity and not a corporate parent company. These are the entities that are already subject to the capital and liquidity requirements of their counterparties, including Ginnie Mae and the GSEs, who have evaluated the acceptable risk tolerance and determined the appropriate levels of financial reserves.¹⁸ They are also the entities that the state regulators have legal authority and jurisdiction to examine and require information from as a result of licensing laws and inspection requirements. Attempting to examine or impose financial requirements on corporate parent companies that are not licensed under state law raises legal questions in light of the counterparty requirements and monitoring required at the licensed servicer entity level.

These enhanced capital and liquidity standards — based on regulatory approval of business judgments across broad criteria — are an unnecessary replication of a unified bank supervisory process instituted to protect depositors and the government as a lender of last resort. The baseline capital and liquidity standards provide a bright-line standard that has been vetted and proposed by the federal agency responsible for managing the counterparty risk for the vast

¹⁷ See FSOC 2104 Annual Report, pg. 10.

¹⁸ The GSEs do have specialized capital requirements for certain servicers. Rather than requiring multi-state review and approval, the enhanced standards could hold servicers to the higher of its GSE or GNMA capital and liquidity eligibility requirements.

majority of the current market. These also apply to many of the large or complex servicers that would be covered under this Proposal.

Finally, increased reporting of financials and proactive information sharing between the GSEs, investors and state regulators could address many of the issues that this Proposal appears to be confronting. Sources of such information already exist through the Mortgage Call Report (MCR) and Mortgage Bankers Financial Reporting Form (MBFRF). These and other reporting sources could be supplemented, if necessary, with other metrics to provide ongoing insight into operations. It will likely be more productive and efficient to centralize the reporting and analysis of this information into a central body controlled by and accountable to state regulators.

b. *Stress Testing*

As written, this section could be interpreted to require large or complex servicers to develop capital and liquidity plans based on internal company modeling and their own specific assumptions about their future economic or financial environment. In other words, what they need to run their business. If this is the intended result, MBA could be supportive.¹⁹ A prudent capital and liquidity risk management strategy should consider possible future contingencies and funding needs. However, as mentioned above, it would be extremely burdensome to require that the assumptions and subjective factors underlying any stress test be subject to questioning and approval by multiple state regulators with different economic and modeling assumptions. Again, a single, unified SRO would seem to offer a place to discuss these assumptions and possibly offer some third party insight on the company tests.

It may be challenging to find firms that could serve as the third party validation of stress testing. Even private firms that may be equipped to create models would be incurring possible legal exposure opining on the management calculations. It is worth noting that Dodd-Frank stress tests required by the Federal Reserve do not include third party validation.²⁰

c. *Living Will and Recovery Resolution Plans*

As an initial matter, the bankruptcy process is a time-tested method for resolving the affairs of private firms, the disposition of their assets and the interests of their creditors. Non-bank servicers are not holding public deposits so the bankruptcy process—which has been used for servicers in the past—should continue to serve this function.²¹ It is not clear that the involvement of multiple actors in the process would add meaningful protections to guarantors,

¹⁹ We would not support a Proposal that suggested state licensed servicers develop Comprehensive Capital Analysis and Review (or CCAR)-like and Liquidity Coverage Ratio (LCR) or similar stress testing for non-bank servicers. These intensive reviews, conducted under the auspices of the Federal Reserve, are for entities that hold public deposits and are intended to assess an ability to absorb unexpected losses and continue to serve as financial intermediaries in a distressed economic environment. While non-bank servicers are clearly susceptible, like all firms, to be adversely effected by an economic downturn, they do not play such an outsized role in the financial system as to require CCAR/LCR-like stress testing reviews.

²⁰ “The company-run stress tests are hypothetical results and are not intended to be forecasts or expected outcomes, and the agencies will not make any public statements about the results.” Board of Governors of the Federal Reserve. Agencies Release Statement on Dodd-Frank Act Company Stress Tests at Medium-Sized Financial Companies. June 2, 2015. Available here: <http://www.federalreserve.gov/newsevents/press/bcreg/20150602a.htm>

²¹ Indeed, one motivating factor behind the bank receivership process is that insurance proceeds should have priority on a failing bank’s assets. It is not clear that state regulators have analogous interest in either the financial resolution or distributions from a failing independent mortgage servicer.

insurers or investors and could result in confusion that complicates efforts for an orderly resolution. Indeed, moving from the known and supervised process through bankruptcy into an unknown and fragmented resolution regime may result in warehouse lenders being less willing to provide funding to non-bank servicers. A chaotic process could also introduce unintended consumer harm if it interferes with the transfer process.

It is also worth questioning the appropriateness of this living will and recovery resolution requirement given that these large or complex servicers are not designated “systemically important financial institutions.” The living will and resolution recovery plans in Dodd-Frank were intended for bank holding companies with more than \$50 billion in assets and for FSOC-designated systemically important non-bank financial institutions.²² No independent mortgage servicer has received this designation by FSOC, despite their authority to designate certain non-bank institutions as systemically important.

On a more practical level, much of the information requested would already be available through corporate governance requirements, state license filings and other publically available documents or reporting channels. Also, the GSEs, GNMA and investors have the ability to move servicing under different circumstances before or during a period of crisis. In light of this and the existence of the bankruptcy process, few substantive protections are gained by requiring the development of a recovery resolution plan.

Additionally, any plan should not require a description of “potential purchasers of either servicing rights, bulk transfers, or the company outright.” MSR trade on an open market, as do the stocks of servicers that are publicly traded. The capacity and appetite to absorb a bulk transfer fluctuates by company based on market conditions and the size of the transfer. Providing such information in a recovery resolution plan would thus either be so broad as to be useless or, if specific, may actually prove damaging to unrelated firms if it were to become public.²³

²² See 12 CFR 1310.

²³ A publicly traded servicer could, for instance, be negatively impacted if they are not listed as a potential purchaser of MSRs from another large servicer because of the possible implications of the failure to include them.

IV. Responses to Specific Questions for Comment

CSBS requested that comments offer feedback on the following specific questions. The MBA response is below each question.

1. Should all non-bank mortgage servicers be required to have a full financial statement audit conducted by an independent certified public accountant?

Fannie Mae, Freddie Mac and Ginnie Mae already require seller/servicers to provide annual audited financial statements. Thus, MBA suggests that this standard not apply to small servicers who do not service for Fannie Mae, Freddie Mac, or Ginnie Mae.

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

Any net worth requirement should be mindful of the current accounting treatment of Home Equity Conversion Mortgages (HECMs). HECM assets under the FHA/GNMA program remain on the books of the seller/servicer as a result of Financial Accounting Standards Board (FASB) Opinions 166 and 167. These programs are sponsored by the government to assist senior citizens in their retirement and states should not impose standards that would discourage or penalize participation.

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 the standard create?

We support the decision not to include FHFA's proposed 200 bps extra liquidity requirement when a servicer's delinquency rate exceeds 6 percent. The 200 bps of additional liquidity required once a servicer hits the 6 percent non-performing loans trigger is unnecessary and is not reflective of increased risk.

First, as applied to the large percentage of the market that is GSE loans, this trigger does not make sense. 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 additional 200 bps of liquidity may be excessive.

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. The agencies and investors relied heavily on special servicers during the most recent financial crisis. Liquidity requirements may discourage new servicers from this segment or drive existing special servicers out of this specialty.

Anything that increases the cost of servicing delinquent loans will necessarily lead to tighter credit, as the current market and regulatory environment limits the ability of originators to charge

for these higher costs upfront. More generally, increases in servicing costs result in higher costs to borrowers.

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 the Home Affordable Modification Program (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.

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?

The GSEs and GNMA have known that their servicers have varying levels of exposure to both their loans and private label securities. Thus, it is likely that these entities have baked that into the standards that they have recently released for their counterparties. This is reinforced by the fact that the GSEs’ recent final capital standard now covers the entire servicing portfolio. They did not, however, do so for liquidity.

Despite this, the liquidity demands for private-label servicing are not likely to be significantly more onerous than for GSE servicing into the future. Servicing advance reimbursements are at the top of the cash waterfall in most PLS agreements. Also under most agreements, servicers do not have to make advances that they deem not recoverable. Finally, PLS advances are also able to be financed relatively easily.

Most importantly however, advance responsibilities are impacted by delinquencies and there is not much of a PLS market at the moment. Should one be revived, the basic underwriting requirements embodied in the CFPB’s Ability to Repay/ Qualified Mortgage (ATR/QM) rule suggest that these GSE or PLS loans will be relatively sustainable.²⁴ CSBS should keep this mind when making a recommendation as excessive liquidity requirements would make it even more unlikely that the PLS market will return, limiting the growth of the housing market and its ability to service homeowners in all states.

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

²⁴ For instance, even a loan that is not a qualified mortgage must be fully documented and underwritten using factors that have been historically sound.

As discussed above in our specific comments, MBA suggests using the Ginnie Mae 20 percent standard. As the Proposal uses Ginnie Mae standards as the source of its corporate governance regulations, this is an appropriate source to determine change of control percentage.

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

As discussed above, we do not believe that there is a demonstrated necessity for these enhanced standards. However, given the intended focus on systemic risk we would suggest that any line drawn captures only the largest servicers. We note that FSOC has the authority to designate certain non-bank financial companies as systemically important financial institutions. This designation may make the most sense for determining when to apply enhanced standards, with the baseline standards providing the floor to address the generalized diffuse risk mentioned in the FSOC report.

However the line is drawn, CSBS needs to ensure that the standards allow for a company that crosses the threshold to have time to prepare, plan for and implement any enhanced requirements. We would recommend a 12-month period following the end of the quarter in which the company crosses the line.

Complexity is a different issue, as the Proposal does not define complexity or outline what is intended to be captured. Presumably the large servicers discussed above would also fall into the category of “complex” due to their size and scope of operations. We would recommend limiting the enhanced standards—if CSBS determines they are necessary—to the largest servicers whose failure could arguably have the most impact on the system.

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

The definitional issues highlighted in our above comments on capital and liquidity could cause serious issues for non-traditional servicers or those firms that may be captured by a broad state licensing regime. For this reason, we reiterate the need to make clear the activities that are intended to be covered by all baseline standards.

For more conventional servicers, MBA back-tested the FHFA’s proposed capital and liquidity standards using available data from MBFRF reports and found that all but a handful of seller/servicers would be in compliance with the FHFA capital proposal and thus the current CSBS Proposal. 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 reduces their capital. In surveying MBA members we found that 15 percent had less than a 20 percent cushion, and 21 percent believe that they will have to raise more capital over time to create better cushion. For small, independent mortgage bankers, the costs of raising capital and other opportunity costs would encourage some to exit the servicing space and deploy their capital for other purposes.

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

It is difficult to fully answer these questions without knowing in what manner or fashion the Proposal would be finalized. On one hand, by leveraging existing standards or generally accepted business practices, the implementation process should be easier than it would be otherwise for most of the standards. This obviously assumes a uniform implementation of these standards across the states, as designing state-specific solutions would be very cumbersome and costly.

A reasonable implementation period would likely be one year following any rule or statute going into effect. This should be appropriate as the largest servicers are likely familiar with these requirements given the fact that these standards leverage federal or counterparty requirements. Smaller servicers could use this period of time to build any processes or financial strength required. Obviously this assumes that the baseline standards would remain as either existing regulatory regimes or generally accepted business practices and would not be additive.

It is also important that any implementation period provide a regulatory process or temporary exemption for companies making progress toward the minimum standard when implemented, as well as a remediation plan for those that drop below. Such a process would be aligned with the GSE/FHFA finalized standards on capital and liquidity.

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

As mentioned in our general comments, we do not believe that there is a necessity for these enhanced standards. Rather, the baseline standards and the on-going government and counterparty monitoring should be sufficient.

We would suggest CSBS study the proposed SRO concept as one way to address the proposed enhanced standards. Following study of this idea and consideration of these and other comments, we would have a better sense of the intended outcome and appropriate implementation timeframe.

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

We do not believe there would be a significant impact as proposed since the warehouse banks already review financial forecasts as part of their lending and monitoring process. However, uncertainty generated by a 50 state approval process could create significant problems.

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?

Risk weighting of assets to determine minimum capital standards for banks is appropriate because the standards are intended to protect the FDIC and U.S. taxpayers with respect to government insured deposits. Non-banks have no liabilities that are guaranteed or insured by the U.S. government. Independent mortgage servicers generally have a lower risk profile due to

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simple, liquid, short duration balance sheets. Finally, their borrowings are generally from warehouse lenders. These lenders protect themselves through various debt covenants including maximum leverage ratios.

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June 23, 2015

V. Conclusion

MBA would like to reiterate our deep appreciation for CSBS willingness to engage on this issue and consider stakeholder opinions. Going forward, we would welcome further conversations around the need for a prudential regulatory regime and the best ways to implement any standards. Continued thoughtful discussion, especially regarding the SRO, should minimize burden and reporting costs for non-bank servicers and allow them to continue to serve consumers in your respective member states. Please feel free to contact myself or Justin Wiseman, Director of Loan Administration Policy, at (202) 557-2854 or jwiseman@mba.org with any questions you may have.

Sincerely,

A handwritten signature in black ink, appearing to read "Pete Mills", with a stylized flourish at the end.

Pete Mills,
Senior Vice President
Residential Policy and Member Services
Mortgage Bankers Association