



SINCE 1902

CONFERENCE OF STATE BANK SUPERVISORS

March 25th, 2020

The Honorable Steven T. Mnuchin
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Jerome H. Powell
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Dear Secretary Mnuchin and Chair Powell,

On behalf of the Conference of State Bank Supervisors (CSBS),¹ I write to you to highlight the urgent need for action by the U.S. Department of the Treasury (Treasury) and the Board of Governors of the Federal Reserve System (Federal Reserve) to ensure the orderly functioning of the housing finance market. The spread of coronavirus disease 2019 (COVID-19) is a national emergency that has resulted in significant disruptions in economic activity and unprecedented volatility in the financial markets. Federal agencies with authority over housing finance have responded quickly and decisively to allow borrowers to stay in their homes during the crisis by instituting moratoriums on foreclosure and encouraging institutions to extend forbearance to distressed borrowers.²

CSBS fully supports accommodating borrowers in this manner. Additionally, we believe that corresponding actions must be taken to support the mortgage servicing sector through this period of mortgage forbearance. In particular, CSBS urges the Federal Reserve, in consultation with Treasury, to establish a liquidity facility under Section 13(3) of the Federal Reserve Act to support the mortgage servicing sector in anticipation of widespread borrower payment forbearance. We are concerned that, absent such a facility, mortgage servicers will experience a severe liquidity shortage that may threaten their continued viability and, by extension, the health of the nation's housing finance market.

The state regulatory agencies that are CSBS's members are responsible for regulating a wide range of bank and nonbank financial companies, including mortgage originators and servicers. As a result, CSBS has a significant interest not only in ensuring that these institutions treat their customers fairly but also in ensuring the adequacy of their financial condition to ensure that they may continue to perform responsibilities fundamental to maintaining a sound mortgage market. State regulators have been actively

¹ CSBS is the nationwide organization of state banking and financial regulators from all 50 states, American Samoa, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands. CSBS supports the state banking agencies by serving as a forum for policy and supervisory process development, by facilitating regulatory coordination on a state-to-state and state-to-federal basis, and by facilitating state implementation of policy through training, educational programs, and exam resource development.

² Government-sponsored enterprises Fannie Mae and Freddie Mac are also offering, among other homeowner assistance, streamlined forbearance plans for up to 12 months.

monitoring the financial condition of nonbank mortgage servicers in particular. The concerns we express herein regarding the impact of borrower forbearance on liquidity and solvency in the mortgage servicing sector are informed by this monitoring activity.

High rates of borrower forbearance on a national scale will create a significant liquidity strain for mortgage servicers due to the requirements imposed on servicing mortgages that back Fannie Mae, Freddie Mac (collectively, the Government-Sponsored Enterprises (GSEs)) or Ginnie Mae mortgage-backed securities (MBS). Specifically, mortgage servicers are contractually bound to continue to advance monthly payments to investors, insurers, and taxing authorities, regardless of whether the borrower actually makes those payments. This servicing advance obligation can extend for months for mortgages backing MBS guaranteed by the GSEs to potentially over a year for mortgages backing MBS guaranteed by Ginnie Mae. We anticipate a large number of borrowers will seek such forbearance for near term payment dates, so this liquidity strain will materialize in the near term when servicers must begin remitting payments to secondary market investors.

We are particularly concerned with the ability of servicers of mortgages underlying Ginnie Mae MBS as borrowers of mortgages backed by the Federal Housing Administration (FHA) and the U.S. Department of Veterans Affairs (VA) are more vulnerable, credit strained and prone to suffer loss of employment. Servicers responsible for this segment of the market may experience greater liquidity stress due to higher rates of delinquency and the near term need for forbearance assistance. Nonbank servicers play a disproportionately large role in this key market segment as they are responsible for 69 percent of FHA/VA loan servicing yet, unlike banks, do not have access to low cost funding in the form of deposits. This combination of less liquidity and greater responsibility for potentially compromised portfolios makes this market segment particularly vulnerable during this period.

If a significant proportion of borrowers cease making payments for the duration of the COVID-19 pandemic, mortgage servicers will face servicing advance obligations that far exceed those ever experienced or anticipated. Although mortgage servicers maintain liquid assets to ensure that they can sustain high levels of servicing advance obligations, it is unlikely that these assets would be sufficient to cover servicing advances when, as is estimated, between one-quarter and one-half of borrowers enter forbearance and suspend payments. A liquidity strain of this magnitude could threaten the ability of a mortgage servicer, particularly nonbank servicers, to remain a going concern. The failure of a large nonbank servicer or multiple midsize nonbank servicers could result in dislocation in the mortgage market and further exacerbate stress therein.

Given the prospect of imminent, widespread borrower forbearance and the resultant liquidity strains for mortgage servicers, CSBS believes it is absolutely imperative for the Federal Reserve to use its authority under Section 13(3) to establish a liquidity facility for mortgage servicers. Such a program would clearly be within the Fed's authority to lend to solvent institutions in response to unusual and exigent circumstances through a broad-based emergency credit facility. While the Federal Reserve has established multiple emergency facilities in the past weeks, CSBS believes that establishing a facility specifically for mortgage servicers is critical to maintaining confidence in the mortgage servicing sector and ensuring adequate funding is available for servicing advances.

Importantly, state regulators stress that establishing an emergency liquidity facility to enable mortgage servicers to cope with widespread forbearance does not obviate the need for state regulators, along with our federal counterparts, to adopt prudential standards that will enhance the safety and soundness of the nonbank mortgage industry. To the contrary, such a facility only reinforces the need for robust capital and liquidity regulation. While it is unlikely that even the most stringent prudential standards would enable a

monoline nonbank servicer to weather the widespread forbearance that will be faced in the near term, strong capital and liquidity standards are nevertheless needed to enable servicers to better weather even more moderate rates of delinquency. For this reason, state regulators have recently recommitted to enhancing and establishing prudential standards for nonbank mortgage servicers and the present need for an emergency facility only strengthens our resolve to enhance the resiliency of this sector.

State regulators are responsible for protecting consumers and promoting stable financial markets in their states. CSBS fully supports the borrower forbearance policies adopted in response to COVID-19 pandemic. Mortgage payment forbearance will not only ensure that borrowers remain in their homes in furtherance of social distancing guidelines, but also will enable borrowers to emerge from this crisis while avoiding detrimental impacts to their credit or ability to sustain homeownership. At the same time, we believe that it is equally important to ensure that mortgage servicers are financially and operationally capable of effectuating these accommodations while serving their crucial role as connections between homeowners and the capital markets. Therefore, for the benefit of borrowers, servicers and our nation's housing finance system as a whole, CSBS urges the Federal Reserve to, without delay, establish a liquidity facility to support mortgage servicers.

Sincerely,

A handwritten signature in black ink, appearing to read "John W. Ryan".

John Ryan
President & CEO

cc: Hon. Mitch McConnell, Majority Leader, U.S. Senate
Hon. Chuck Schumer, Minority Leader, U.S. Senate
Hon. Nancy Pelosi, Speaker, U.S. House of Representatives
Hon. Kevin McCarthy, Minority Leader, U.S. House of Representatives