March 31, 2020

Via Email: ServicerEligibility@fhfa.gov
Federal Housing Finance Agency
400 7th Street SW
Washington, D.C. 20024

Re: *Updated Eligibility Requirements for Enterprise Single-Family Seller/Servicers*

Dear Sir or Madam:

The Conference of State Bank Supervisors ("CSBS")[1] appreciates the opportunity to comment on the proposed updated minimum financial eligibility requirements for Fannie Mae and Freddie Mac Seller/Servicers issued by the Federal Housing Finance Agency (the "FHFA"). The proposed updates would further strengthen the financial requirements and establish a more consistent capital and liquidity framework for nonbank mortgage servicers with different business models.[2] As explained below, CSBS supports the proposed updates to the minimum eligibility requirements for Enterprise Seller/Servicers. Given the larger, more prominent role assumed by nonbank mortgage companies in mortgage servicing over the past decade, more robust financial standards are warranted to ensure the strength and resiliency of these companies accounts for their broader footprint in the market.

As the Financial Stability Oversight Council noted in its 2019 Annual Report (the "Report"), the increased involvement of nonbanks in mortgage origination and servicing may pose a potential emerging threat to financial stability in the event of the failure of a large nonbank servicer or simultaneous failure of several midsize nonbank servicers. Either of these scenarios presents complications for transferring large servicing volumes in a timely manner. Furthermore, as of year-end 2019, nonbanks accounted for 90% of mortgaged loan originations in Ginnie Mae mortgage backed securities ("Ginnie Mae loans") and serviced 69 percent of Ginnie Mae mortgages.[3] This growth in market share leaves nonbank mortgage servicers with significantly greater risk exposure given the higher delinquency and default rates and extended servicing advance requirements of Ginnie Mae.

The Report also notes that nonbanks maintain liquidity levels that are significantly below those held by banks and are heavily reliant on short-term funding. This liquidity risk combined with low operating capital may leave nonbank mortgage servicers unable to absorb adverse economic shocks. According to the Report, if delinquency rates rise and nonbanks experience solvency or liquidity strains, the resulting operational and financial challenges could lead to consumer harm and disruption to the servicing market. If this stress were to spread to other market participants, then dislocation in the housing and mortgage markets could result.

In light of these fragilities, the FHFA proposal would strengthen the financial requirements for Enterprise Seller/Servicers by increasing the capital charge for Ginnie Mae loans, raising the base and supplemental

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[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] The FHFA requirements apply to both originators and servicers. CSBS currently sees greater consumer risk in the servicing side of the market and therefore our comments are appropriately focused on those industry participants.
[3] Housing Finance Policy Center, *Housing Finance at a Glance: A Monthly Chartbook* (January 2020), distributed by Urban Institute, https://www.urban.org/sites/default/files/publication/101611/january_chartbook_2020.pdf.

liquidity requirement for Ginnie Mae and Enterprise servicing, and enhancing the quality of allowable assets for purposes of these liquidity requirements. CSBS believes that the proposed updates take a measured approach to strengthening the resiliency of Seller/Servicer counterparties.

The greater emphasis placed on liquidity relative to the current requirements is a particularly important aspect of the proposed updates given the heavy reliance of nonbank mortgage companies on short-term funding for both originations and servicing advances. As discussed below, liquidity risk is an increasing area of focus for state regulators in their oversight of nonbank mortgage servicers. CSBS also supports lowering the non-performing loan (NPL) threshold for triggering the escalated liquidity requirement from six percent to four percent. This revision should help to reduce the pro-cyclicality of the NPL escalator and ensure that Seller/Servicers maintain increased liquidity heading into a rising delinquency environment, however the pro-cyclical effect remains and further consideration should be given to alternative means of addressing liquidity needs ahead of adverse conditions.

The proposal notes that the new financial requirements are not a "regulatory standard" and that financial regulatory requirements are the responsibility of "applicable regulators". State regulators are among the applicable regulators responsible for overseeing nonbank mortgage originators and servicers that are Enterprise Seller/Servicers. State nonbank mortgage regulators have increasingly focused on safety and soundness in addition to compliance as a fundamental element of consumer protection.[4] In light of the potential for consumer harm, in 2015, CSBS proposed nonbank mortgage servicer prudential standards covering capital, liquidity, risk management, data standards, cybersecurity, corporate governance, servicing transfer requirements, and change of control. In addition to these baseline standards, CSBS also proposed an enhanced prudential standards framework for more complex nonbanks focusing on capital, liquidity, stress testing, living wills, and recovery and resolution plans. The baseline prudential standards proposed by CSBS for capital and liquidity were largely consistent with the FHFA's financial eligibility requirements for Enterprise Seller/Servicers.

While the 2015 standards were not finalized, since that time, several states have incorporated the FHFA's current minimum financial eligibility requirements into their mortgage servicer licensing laws.[5] Despite not being incorporated by every state, these prudential requirements are applied on a nationwide basis to the same extent as the FHFA eligibility requirements. Moreover, CSBS and state regulators have committed to re-proposing prudential standards in the near future because the growing presence of nonbanks in the mortgage servicing market has elevated the importance of servicers maintaining adequate capital and liquidity and operating in a safe and sound manner. In this effort, CSBS will strive to maintain an appropriate level of consistency between state-imposed prudential requirements and the FHFA's updated financial eligibility requirements to ensure that the two sets of requirements operate harmoniously to strengthen the resiliency of nonbank mortgage servicers.

Robust collaboration and coordination between FHFA and CSBS are critical to ensure consistency and harmonization. CSBS has benefited from our ongoing collaboration with FHFA on this topic and we believe that this collaborative relationship can be enhanced further to ensure greater consistency. In particular, CSBS believes that establishing a formal information sharing arrangement directly with FHFA would enable more robust collaboration and ultimately enable both CSBS and FHFA to more efficiently and effectively fulfill our respective oversight roles. Accordingly, we encourage FHFA to continue coordinating with CSBS on the issue of nonbank mortgage supervision and to explore avenues for enhancing collaboration with CSBS and state regulators.

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[4] The distinction between consumer protection and prudential regulation breaks down in practice when, for instance, the unsound financial condition of a nonbank would result in a sudden failure that directly causes consumer harm.
[5] *See e.g.*, Wash. Rev. Code Ann. § 31.04.300; Wash. Admin. Code § 208-620-321.

CSBS notes that we are submitting this letter in the midst of a national emergency caused by the spread of Coronavirus 2019 (COVID-19). This emergency has resulted in significant disruptions in economic activity which has had widespread implications for the mortgage markets and even necessitated the establishment of nationwide forbearance programs. Obviously, in the coming weeks and months, the nonbank mortgage industry will face incredible challenges which will test their financial capacity to an unanticipated extent. The ability of regulators to coordinate effectively will likewise be put to the test. CSBS believes this emergency only underscores the need for state and federal regulators to formalize coordination and communication channels to ensure that we can work together to meet the coming challenges and ensure the continued orderly functioning of the mortgage market.

In conclusion, CSBS believes the proposed updates to the financial eligibility requirements for Enterprise Seller/Servicers would provide necessary improvements to the current standards. CSBS and its members play a central role in ensuring these entities conduct safe and sound servicing operations. State regulators are responsible for providing comprehensive oversight that balances consumer protection obligations, efficient supervision, and market viability. The continued growth and complexity of the mortgage servicing sector underscores the importance of enhancing coordination and collaboration between FHFA and state regulators in their respective oversight capacities.

Sincerely,

John Ryan
President & CEO