American Bankers Association

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Conference of State Bank Supervisors
1129 20thStreet, NW
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PS.PublicComment@csbs.org.

Re: Proposed Regulatory Prudential Standards for Nonbank Mortgage Servicers

Dear Sir or Madam:

The American Bankers Association ("ABA")[1] appreciates the opportunity to comment on the recent solicitation issued by the Conference of State Bank Supervisors ("CSBS") regarding proposed regulatory prudential standards for nonbank mortgage servicers.[2] CSBS is requesting public comment on "Proposed Regulatory Prudential Standards for Nonbank Mortgage Servicers" and seeks feedback to help inform state regulators in their ongoing development of a consistent national regulatory structure for nonbank mortgage servicers.

ABA members are critical participants in the national mortgage markets as originators and investors (both in portfolio loans serviced by others and in mortgage-backed securities and similar secondary market investments). On behalf of our customers and shareholders, our members have a vital interest in the effective functioning of primary and secondary mortgage markets, as well as in the stability of our financial system. For all these reasons, ABA strongly supports the efforts of CSBS to develop comprehensive and consistent safety and soundness standards for nonbank mortgage servicers and investors in mortgage servicing. These planned "Baseline Prudential Standards" would promote stronger protections for mortgage borrowers and investors, while also enhancing the stability of our nation's mortgage finance system.

[1] The American Bankers Association is the voice of the nation's $21.2 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $17 trillion in deposits and extend more than $11 trillion in loans. Learn more at www.aba.com.

[2] PROPOSED REGULATORY PRUDENTIAL STANDARDS FOR NONBANK MORTGAGE SERVICERS 2020, September 2020 (https://www.csbs.org/system/files/2020-09/FinalProposedPrudentialStandardsForComment-2020_1.pdf#page=2)

Importance of Prudential Standards

ABA concurs with the observations and concerns cited by the CSBS in the request for comments regarding expansions of nonbank mortgage servicing and the need for these entities to have greater oversight and be held to higher risk management standards. Over the past decade, following a period of punitive actions such as False Claims Act allegations, DOJ actions and Consent Orders against bank-owned mortgage originator/servicers, nonbank entities that specialize in loan servicing have grown exponentially in size, complexity and importance, with business models continuing to evolve. This rapid expansion of nonbank servicers affirms that the non-depository segment has become a critical (and increasingly dominant) component of the mortgage markets. The expansion of safety and soundness measures must therefore be addressed in order to support the long term stability of the housing market.

While many nonbank mortgage servicers may have started as specialty/default servicers, they now operate with similar business models as large bank-owned mortgage originator/servicers—but without the strict regulatory regime that governs depositories. The importance of these firms was highlighted during the initial stages of the pandemic, as was the potential fragility of their businesses. Were it not for the swift action of the Federal Reserve and other arms of the government that helped stabilize financial markets earlier this year, potential failures in the ranks of nonbanks may have led to more severe damage to the U.S. economy. The augmented systemic risk posed by these institutions is clear and well delineated in the solicitation for comments.

Recent experience under the COVID-19 pandemic confirms the need for the expanded oversight and regulation proposed by the CSBS. In the months of March-June 2020, the onset of pandemic conditions across most states resulted in millions of Americans experiencing material reductions and/or elimination of income, which led to considerable numbers of households becoming unable to make scheduled mortgage payments. This exceptional situation prompted an unprecedented need for borrower forbearance, which strained nonbank servicers' liquidity reserves. This financial stress was most pronounced for nonbank mortgage servicers, as their business models focus almost exclusively on mortgage servicing operations with fewer funding options, and limited liquidity risk management expectations compared to depositories. The structural vulnerability, therefore, became concentrated in the nonbank servicing sector, which lacked the liquidity they needed to cope with the widespread forbearance demands during by the pandemic and still meet obligations to investors, which are critical to the functioning of the mortgage market. Although the economic conditions resulting from COVID-19 may be improving, and the potential disaster related to margin calls was narrowly averted, this sector will continue to be vulnerable to widespread increases in delinquency or payment forbearance needs brought on by unforeseen contingencies, including economic shocks.

Given the large and growing systemic importance of these firms, ABA believes that, going forward, it is imperative to ensure that all mortgage servicing operations understand and manage their liquidity and other risks to ensure they are able to remain financially and operationally robust during periods of stress.

Even Playing Field & Consistent Standards

In its solicitations for comment, CSBS asserts that the proposed Baseline Standards would apply basic safety and soundness principles to all nonbank servicers, while the Enhanced Prudential Standards would take into account servicers' diverse business models and risk profiles. ABA strongly supports CSBS' efforts to develop comprehensive and consistent safety and soundness standards that are tailored to the risks of a servicer's business operations. As a general matter, firms that provide financial services should receive equivalent regulation and oversight as do banks. This mitigates both, regulatory arbitrage and systemic risk, helping to ensure that activities important to market functioning will continue through periods of stress.

In terms of regulation and oversight, and risk identification and mitigation, the discrepancies between bank and nonbank entities are large. Current laws do not impose comprehensive enterprise-wide expectations for nonbanks in terms of internal controls, compliance and risk management systems. Nor are nonbank servicers subject to comparable safety and soundness, data protection, or corporate risk governance standards. The lack of standards placed on nonbank mortgage servicers provides these firms with a competitive advantage relative to banks, which may appear to provide benefits to consumers and the economy. However, by allowing the systemic risks to go unmitigated, the absence of standards creates additional vulnerability and instability.

In this sense, ABA would urge that state regulators align prudential standards for nonbank mortgage servicers with those of the federal banking agencies. We agree with CSBS that, to the extent possible, Baseline Standards should leverage "existing standards or generally accepted business practices" (Page 4) and the so-called "twelve factors."[3] CSBS should acknowledge the need to tailor detailed requirements to the size and complexity of an entity's servicing and other business activities that could affect its financial condition and operational resiliency. To that end, ABA has the following comments on specific aspects of the Regulatory Proposal:

- The Operating Liquidity requirements currently do not include any formulae, examination of Sources and Uses of Liquidity, or stress scenario analysis – all of these should be considered in the Baseline Standards. Nonbanks should be required to perform stress testing to identify potential gaps in capital and liquidity through times of economic stress
- Ginnie Mae MSR should be separately classified or accounted for in the capital formulae and liquidity requirements since the demands are higher and a future downturn would amplify the demand for liquidity – as seen when so many nonbanks faced margin calls at the onset of the pandemic
- When assessing capital risk due to servicing portfolio composition, regulations should not only consider Ginnie Mae separately, but should also recognize that FHA and VA carry

[3] The CSBS is considering designing comprehensive prudential standards appropriate for nonbank mortgage servicers, as follow--1. Capital Requirements, 2. Liquidity Requirements, 3. Risk Management Standards, 4. Data Standards, 5. Data Protection, including Cyber Risk, 6. Corporate Governance, 7. Servicing Transfers Requirements, 8. Change of Control, 9. Stress Testing, 10. Living Wills and Recovery and Resolution Plans, 11. Reserves and Valuation Methodology, and 12 Transactions with affiliates.

different risks and expose servicers to varying levels of credit losses and/or out-of-pocket costs

- When assessing minimum operating liquidity, servicer advance obligations (and delinquency) for different types of servicing should be considered – specifically, Ginnie Mae requires servicers to advance payments for a longer period than the GSEs.

Phase-In Periods

ABA recommends that any final regulatory prudential standard for nonbank mortgage servicers should direct state authorities to advance with reasonable phase-in periods that allow covered institutions ample time to come to compliance with enhanced capital and liquidity reserves. As described in the RFI, nonbank servicers do not currently operate under prescribed capital standards and, as a general rule, retain less capital than depository institutions. Although FHFA and Ginnie Mae impose multiple net worth, capital and liquidity requirements, such standards may not cover servicers' full range of business, and are often significantly lower than those held by depository institutions. In addition, MSR value is often one of the largest components of nonbank net worth, which can result in a "double-leverage" situation since the MSR (and thus the net worth) would be greatly diminished in a downturn.

As mentioned, we believe it is proper that these standards be strengthened, but the policy objective is, and should remain, to enhance systemic safety and soundness, not to inadvertently force firms to exit the market for inability to comply. ABA recommends that these uniform standards adopt a 3-5 year phase-in period so that institutions can properly build up reserves, reform operations and construct the systems necessary to remain in servicing operations.

Going Forward

ABA applauds CSBS on this important initiative, and we recommend that, in light of the system vulnerabilities revealed in the recent COVID-19 forbearance urgency, the Conference must advance the proposal without delay to assure confidence in the proper functioning of our mortgage markets. As noted in the RFI, this proposal will not, in itself, result in any immediate requirement; final regulatory prudential standards for nonbank mortgage servicers can only become effective through state legislation, state rule or other formal undertaking. The inherent length and uncertainty of this process means that it is imperative that all stakeholders advance steadfast towards agreement and ratification of these guidelines. To assure prompt, consistent and clear standards, ABA strongly advises adoption of existing federal frameworks, as they are readily available, very complete, and will assure a solid and tested foundation for these guidelines.

Conclusion

ABA appreciates and supports CSBS objectives to achieve a solid oversight and regulatory infrastructure for nonbank mortgage companies. State prudential standards must deliver consistency across all jurisdictions, assure broad systemic health, and be as developed and robust as those applied to banks.