MBA®

MORTGAGE BANKERS ASSOCIATION

December 28, 2020

John W. Ryan
President and Chief Executive Officer
Conference of State Bank Supervisors
1129 20th Street, NW, 9th Floor
Washington, DC 20036

RE: Proposed Regulatory Prudential Standards for Nonbank Mortgage Servicers

Dear Mr. Ryan:

The Mortgage Bankers Association (MBA)[1] appreciates the opportunity to provide observations and recommendations on the Conference of State Bank Supervisors (CSBS) proposal for prudential standards that would be applied by state regulators to independent mortgage banks (IMBs) that engage in mortgage servicing.[2, 3] MBA also appreciates the regular engagement and open dialogue that CSBS has maintained with mortgage industry participants as it has reviewed and analyzed the role of IMBs in mortgage origination and servicing.

As CSBS notes in the proposal, IMBs have gained substantial market share in agency origination and servicing over the past decade. These market share gains reflect both competitive steps taken by IMBs, such as significant technology investments, as well as factors that have discouraged participation by depository institutions, such as punitive capital treatment of mortgage servicing assets. IMBs have become the predominant providers of mortgage credit to low- to moderate-income households and other historically underserved communities.

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[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, DC, the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to 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 2,100 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, credit unions, thrifts, REITs, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

[2] Conference of State Bank Supervisors, "Proposed Regulatory Prudential Standards for Nonbank Mortgage Servicers," October 1, 2020. Available at: https://www.csbs.org/system/files/2020-09/FinalProposedPrudentialStandardsForComment-2020_1.pdf.

[3] Throughout these comments, the term "IMB" will be used to reference those nonbank mortgage servicers covered by the CSBS proposed prudential framework.

This important role puts IMBs at the center of efforts to ensure affordable housing and wealth-building opportunities for consumers throughout the country. IMBs contributed to the strong housing market recovery in the midst of the COVID-19 pandemic this year, as well, by facilitating economic stimulus in the form of record-level refinances that lower consumers' monthly payments. State-level agencies that regulate IMBs should be mindful of the vital role IMBs play in the housing finance system as they balance the need for well-developed regulation and supervision with the need to ensure the broad availability of mortgage credit. Any additional requirements or obligations placed on IMBs should not unduly diminish consumer access to credit.

Prudential standards, such as those proposed by CSBS, represent a particular type of regulation and supervision – one which seeks to guard against public support of private companies during times of stress (*i.e.*, bailouts) or the transmission of risk to other financial institutions (*i.e.*, systemic or contagion risk). A comprehensive prudential framework requires significant resources from the companies to which it is applied, both to meet minimum financial requirements and to ensure compliance.

The costs of prudential oversight borne by depository institutions are offset by certain stabilizing benefits derived from the federal government, including access to deposit insurance, the payments system, and emergency borrowing structures. Absent consistent access to these types of government support, IMBs face the risk of regulatory mandates that impose the costs of prudential oversight but do not confer any of the benefits. Consequently, MBA urges caution in the application of prudential standards to IMBs, particularly those that go above and beyond standards already in place through other agencies or guarantors. Any new standards should: 1) include a clear rationale for the imposition of such standards that specifies the taxpayer harm or contagion risk that would be expected due to the insolvency of one or more IMBs; and 2) appropriately consider the impact that heightened prudential standards would have on the cost and availability of credit for consumers.

Further, if CSBS finalizes a prudential framework for IMBs, there are additional steps that it should take to ensure appropriate implementation. IMBs are subject to oversight by a wide variety of entities beyond state regulators, including the Consumer Financial Protection Bureau (CFPB), Ginnie Mae, Fannie Mae and Freddie Mac (the government-sponsored enterprises, or GSEs), the Federal Housing Administration (FHA), the Department of Veterans Affairs (VA), the Department of Agriculture (USDA), warehouse lenders, and other counterparties. CSBS should work closely with Ginnie Mae and the GSEs, in particular, to make technical revisions to the Ginnie Mae or GSE standards that the CSBS proposal explicitly references. While alignment between federal and state standards is a positive development, CSBS also should seek out opportunities to improve these aligned standards. MBA offers recommendations for such improvements below.

Finally, the unique nature of the state-based oversight of IMBs places a premium on broad, uniform adoption of any framework by state regulators across the country. While a CSBS proposal for harmonized standards is an important step, it yields little benefit – and possible harm – if state regulators do not actually harmonize their standards in practice. CSBS should devote significant attention and resources to promoting nationwide adoption of any framework it finalizes to avoid fragmented standards or inconsistent adoption.

MBA's more detailed comments below are organized as follows:

- Part I – Broad Recommendations for the Framework
- Part II – Recommendations for the Baseline Standards
- Part III – Recommendations for the Enhanced Standards

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Part I – Broad Recommendations for the Framework

Conceptual Underpinning for Prudential Standards

A comprehensive framework for prudential supervision of IMBs will carry significant implications for servicing market dynamics, IMB compliance costs, and the cost and availability of credit for consumers. In the proposal, CSBS notes that "a sound financial condition and safe management practices are essential to compliance and consumer protection" and further that the framework is designed to "provide better protection for borrowers, investors and other stakeholders in the occurrence of a stress event, in which adverse circumstances affecting one or a series of companies, or alternatively a wider market dislocation, could result in harm."

The concept of prudential supervision in the banking sector typically addresses concerns regarding systemic risk or, for most banking organizations, the potential for moral hazard by virtue of their access to government-insured deposits or the Federal Reserve Discount Window. Safety and soundness standards are linked directly to the responsibilities that banks maintain with respect to consumers' insured deposits and the need to protect taxpayer funds.

With respect to systemic risk, the CSBS proposal discusses the growth in servicing market share of IMBs, though market share alone does not constitute systemic risk, nor does an increasing market share across the IMB sector constitute systemic risk arising from the insolvency of any particular IMB. Concerns regarding the availability of financing for certain types of lending and servicing, such as FHA-insured lending and servicing, if several IMBs became insolvent are better addressed not by prudential regulation of IMBs, but rather through steps to promote these types of activities by a wider variety of institutions, including depository institutions.[4]

The proposal references earlier recommendations by the Financial Stability Oversight Council (FSOC) regarding potential systemic risks related to IMBs, though it does not directly provide the CSBS views on any specific FSOC concerns. Given the relatively small exposure of banks to IMBs through well-collateralized warehouse lending, as well as the lack of interconnectedness between IMBs and other critical financial market participants, it is not immediately clear that systemic risk concerns are warranted. Indeed, the recent experience during the COVID-19 pandemic has demonstrated the stability of the relationships between warehouse lenders and IMBs, despite the significant exogenous shock posed by the pandemic. During this period, IMBs were able to secure expanded access to warehouse financing to meet near-

[4] For further details on steps that could be taken to encourage greater participation in FHA-insured lending and servicing by depository institutions, see: Fratantoni, Michael, "Why Have Banks Stepped Back from Mortgage Servicing?" *International Banker*, September 2, 2020. Available at: https://internationalbanker.com/finance/why-have-banks-stepped-back-from-mortgage-servicing/.

record consumer demand. To the extent regulators and guarantors believe IMB liquidity risks require additional mitigation, revised policies should focus on ways to promote IMB access to additional liquidity sources, which would diversify IMBs' liquidity strategies and reduce reliance on any particular source.

With respect to moral hazard, any analogy to the banking system is tenuous at best. IMBs do not accept government-insured deposits, nor can they access the Federal Reserve Discount Window (or Federal Home Loan Bank advances, for that matter).[5] If an IMB were to experience financial stress, any government or government-adjacent exposures (*e.g.*, via Ginnie Mae or the GSEs) already are addressed by capital, liquidity, and other standards currently in place. It therefore is difficult to see the ways in which taxpayers would incur harm if an IMB were to become insolvent. More broadly, it is critical to recognize that, as was noted recently by a Federal Reserve governor, "the optimal regulatory framework for mortgage companies [IMBs] should differ from that of banks."[6]

The CSBS proposal also discusses consumer and investor protections related to the safe and sound operations of IMBs. Consumer protections are critically important in the mortgage servicing market, and IMBs currently are subject to thorough servicing rules administered by the CFPB, in addition to relevant state consumer protection statutes. The existing CFPB framework includes stringent requirements related to servicing transfers, supervision to ensure servicers are compliant with these requirements even during periods of financial stress, and enforcement authority to punish institutions that fail to comply.

Investor protections also are important, given servicers' roles in advancing payments (including, in some cases, even when the borrower has failed to make his or her required payment). Absent fraud, which by its nature is designed to circumvent regulatory and supervisory measures in place, IMBs' servicing portfolios would continue to generate positive cash flows even in a period of financial stress through ongoing borrower payments (including servicing fees), as well as through the sale of mortgage servicing rights (MSRs) if necessary. Investors and public or private guarantors can take steps to transfer servicing before the outright insolvency of an IMB, but even upon insolvency, the bankruptcy process has been and should continue to be used to support an orderly resolution.

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[5] MBA has recommended a detailed framework by which the Federal Housing Finance Agency could establish a clear path for Federal Home Loan Bank eligibility for captive insurance companies that are affiliated with housing-focused institutions, such as IMBs. For details, please see: MBA, "RE: Federal Home Loan Bank Membership – Request for Input," June 23, 2020. Available at: https://www.mba.org/Documents/MBA_FHFA_RFI_FHLB_Membership_June2020.pdf.

[6] Bowman, Michelle W., "The Changing Structure of Mortgage Markets and Financial Stability," November 19, 2020. Available at: https://www.federalreserve.gov/newsevents/speech/bowman20201119a.htm.

MBA therefore recommends that CSBS more clearly articulate its rationale for the imposition of a comprehensive framework of prudential supervision of IMBs. Absent a more detailed explanation, it will be difficult to judge whether any benefits associated with this prudential supervision outweigh its costs.

Alignment Between Federal and State Standards

CSBS correctly notes in the proposal that, in addition to state regulators, several other entities maintain various types of financial, operational, and consumer protection standards that IMBs must meet. These standards include those put in place by the Federal Housing Finance Agency (FHFA) through the GSEs, Ginnie Mae, the CFPB, FHA, VA, USDA, and warehouse lenders and other creditors that provide financing to IMBs.

MBA commends CSBS for seeking to align its recommended state-level standards with existing federal standards in many elements of the proposal. Such alignment is consistent with one of the underlying purposes of the framework – namely, to ensure uniform standards across companies and jurisdictions. The result of this alignment would be improved, coordinated oversight for regulators and guarantors, as well as reduced compliance costs for IMBs.

Alignment with existing FHFA/GSE capital and liquidity standards, Ginnie Mae internal audit standards, and CFPB and FHFA servicing transfer standards, as is proposed by CSBS, would provide such benefits. CSBS should issue similar recommendations for other parts of the framework for which there are appropriate, existing federal standards. Examples include CFPB data standards, Ginnie Mae change of control standards, and Ginnie Mae stress testing standards (within the Enhanced Standards).

MBA support for alignment with federal standards should not, however, be construed as an endorsement of all existing federal standards in their current forms. As will be noted in greater detail throughout these comments, there are important reforms to many of these standards that should be implemented – regardless of whether state-level requirements are indexed to them. The reliance on these standards by state regulators only increases the importance of federal regulators or guarantors making the necessary adjustments to ensure adequate market functioning. Just as CSBS advocates for appropriate federal standards for state-chartered community banks, CSBS should play an active role in working with the industry, as well as federal regulators or guarantors – either on a bilateral basis or through the FSOC – to advocate for necessary policy improvements relevant to IMBs. If the existing federal standards are deemed to be in need of revisions or updates, regulators and market participants will be better served by coordinating such revisions or updates so that they are applied consistently across various federal and state regulators, as well as federal guarantors.

Uniform Adoption by State Regulators

The development of a prudential framework for IMBs by CSBS does not, on its own, produce changes to any individual state-level requirements. The implementation of this framework by a wide majority of state regulators across the country, therefore, will have just as much impact on the utility of the framework as the actual content of the framework. Said differently, the recommendations put forth by CSBS only will be successful if adopted in a broad, uniform manner by state regulators.

In light of this fact, as well as CSBS' convening power and thought leadership among state regulators, it is critical that CSBS invest significant resources to encourage broad, uniform adoption if it moves forward with finalization of a prudential framework. In particular, CSBS should consider mechanisms to better ensure the framework does not lead to a patchwork regime of different standards – the worst-case outcome of this process.

CSBS should consider, for example, an effort to obtain written agreements from state regulators that they will adopt the CSBS framework.[7] CSBS could determine and announce that it will recommend adoption of the framework only if written agreements have been obtained with a certain threshold of states (or perhaps written agreements covering a certain threshold share of the residential servicing market). Under this approach, the framework would take hold in most, if not all, of the country simultaneously. CSBS could recommend a uniform effective date for state regulators to further support a coordinated approach, as well.

Streamlining of the Examination Process

One of the most challenging aspects of the state-based system of IMB oversight is the often duplicative or overlapping nature of examinations conducted by state regulators with respect to IMBs operating in multiple states. It is common for IMBs to be engaged in several concurrent examinations that are not coordinated in ways that would streamline processes, yield consistent interpretations of rules and guidelines, and reduce burdens on both examiners and the IMB.

MBA has long advocated for a unitary examination for multi-state IMBs, and thus the recent CSBS announcement of the "One Company, One Exam" initiative was

[7] In some cases, approval from state legislative bodies may be necessary to adopt all or portions of the CSBS framework. CSBS should work with state regulators in those jurisdictions to ensure that these regulators take proactive steps to secure this legislative approval.

particularly welcome.[8] While more details on the parameters, scope, and implementation of the initiative will determine its ultimate success, the concept is encouraging – as is the successful development of a similar initiative conducted with respect to money services businesses.

One of the core factors determining the success of the initiative will be the adherence of state regulators to its terms. Based on early descriptions of the initiative, state regulators will have the choice to: 1) participate in a multi-state examination; 2) not participate in this examination but receive the relevant results; or 3) neither participate in nor receive the results of the examination, and abide by an "examination moratorium" for a period of time. Much as with the adoption of the broader IMB prudential framework, CSBS should take proactive steps to encourage state regulators to adhere to the "One Company, One Exam" parameters.

Agreement with the terms of the initiative, for example, could be enforced through access to the State Examination System (SES). Under this approach, the information-sharing benefits of SES would be linked to the adoption of "One Company, One Exam." Similarly, CSBS could seek written agreements with state regulators to confirm their participation in the initiative and their plans to adhere to any instance in which an "examination moratorium" applies.

The success of the initiative also will be dependent on whether it reduces conflicting requests, interpretations, or conclusions from different state regulators participating in a multi-state examination. While current multi-state examinations are complicated by the presence of differing state-level statutes that may require differentiation in examination practices, a uniform prudential framework should be interpreted in a uniform manner across participating regulators.

Another potential benefit of the "One Company, One Exam" initiative is the ability of various state-level examiners to coordinate on post-examination follow-up requests. Under the existing multi-state examination process, IMBs often are subject to overlapping requests from multiple examiners, with these examiners in some cases seeking substantially similar information in ways that nonetheless require duplication of work to fulfill. As it implements the "One Company, One Exam" initiative, CSBS should be mindful of this concern and ensure coordinated efforts not only during the examination, but also during any follow-up work. Improved functionality offered through the SES should facilitate this type of information sharing across state regulators.

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[8] Conference of State Bank Supervisors, "One Company, One Exam for Mortgage Companies – The Future of Mortgage Supervision," November 9, 2020. Available at: https://www.csbs.org/ocoemortgagepodcast.

Finally, CSBS should take steps to ensure that proprietary or confidential information obtained through examinations – including information related to any of the prudential standards proposed in the framework – be safeguarded and not subject to public disclosure. While information sharing across state regulators is an important and necessary component of an effective multi-state examination process, state regulators should be permitted to share proprietary or confidential information only with those entities (including other state regulators) that have adopted appropriate protections for this information.

<u>Implementation Timeline</u>

The proposal also seeks comment on an appropriate implementation timeline for state regulators to provide to IMBs. Because of the comprehensive nature of the framework and the changes that may be needed with respect to systems and processes, MBA recommends that CSBS include an implementation timeline of 12-18 months in any final framework that it produces. CSBS also should promote a uniform implementation timeline across its state regulator members to the greatest extent possible, such that the framework is not put in place in some jurisdictions earlier than others, which would diminish the value of a unified framework.

As will be discussed in further detail below, CSBS should recommend a separate implementation timeline applicable to situations in which an IMB that had been subject only to the Baseline Standards becomes subject to the Enhanced Standards. In these situations, MBA recommends that state regulators provide 12 months after the point at which an IMB is determined to warrant Enhanced Standards (and is notified of this determination) before those standards become effective.

Part II – Recommendations for the Baseline Standards

<u>Applicability</u>

The CSBS framework seeks to apply the prudential standards contained within the proposal to “nonbank mortgage servicers and investors in mortgage servicing licensed by and operating in the states,” with an exclusion for servicers solely owning and conducting reverse mortgage servicing and a partial exclusion for subservicers. Because states do not have uniform licensing laws for servicers, existing standards do not necessarily apply to all institutions envisioned as covered servicers by CSBS – particularly with respect to owners of MSRs.

CSBS should clarify that the prudential standards would not apply to loan originators that do not service loans but that are covered by state-level mortgage banking statutes. Similarly, CSBS should clarify that nonprofit servicing organizations – such as Habitat for Humanity affiliates – are excluded from the proposal, as well. Finally, CSBS should provide further details regarding its expectations for the manner in which the framework would be applied to certain types of MSR investors, such as real estate investment trusts (REITs), that are not engaged in consumer-facing servicing activities.

While the implementation of the framework could carry significant costs for all IMBs, the Baseline Standards are likely to impose costs that may be particularly difficult for smaller IMBs to manage given their more limited resources. While the framework creates separate Enhanced Standards that would apply to a handful of IMBs, there is no distinction within the Baseline Standards among the thousands of IMBs to which they would apply. An IMB with a $50 million servicing portfolio would be subject to substantially the same standards as an IMB with a $50 billion servicing portfolio.

CSBS should address this outcome by recognizing portions of the Baseline Standards in which it can more clearly distinguish between IMBs of different types and sizes. Elements of the Baseline Standards that rely on quantitative thresholds in place at the GSEs or Ginnie Mae are areas in which IMBs already are subject to uniform standards (*i.e.*, they already meet the minimum GSE or Ginnie Mae requirements), and therefore there is less of a need to distinguish between different types of IMBs.

Other more qualitative elements of the Baseline Standards, such as risk management, data protection, and corporate governance, however, represent opportunities to establish de minimis thresholds for applicability or further gradations of requirements. For smaller or less complex IMBs, reasonable risk management processes, for example, are going to be less extensive than those needed for larger or more complex IMBs. Said differently, the risk management processes of the IMB with the $50 million servicing portfolio need not be as complex as those of the IMB with the $50 billion servicing portfolio. Any state-level prudential standards should recognize this difference.

In these more qualitative portions of the Baseline Standards, state regulators should limit their focus to those IMBs that conduct a certain share of the aggregate servicing within the state. CSBS should recommend in the framework, for example, that IMBs be examined for these portions of the Baseline Standards only by their home state regulator or by regulators in states for which the IMB is responsible for more than a particular threshold of servicing (*e.g.*, X percent of aggregate servicing in the state).[9] This approach will limit the burdens associated with frequent examinations of these qualitative standards – and the potentially inconsistent interpretations of different

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[9] MBA looks forward to collaborating with CSBS and state regulators to perform the data analysis necessary to determine an appropriate threshold. Such a threshold should be set at a level to ensure smaller servicers are not subject to undue burden and should leverage existing federal standards, such as those put in place by the CFPB, wherever possible.

state regulators – for institutions that do not conduct significant business in a given state.

Similarly, as is noted below, CSBS should align with areas in which existing federal standards already entail de minimis thresholds. The CFPB data and documentation standards, which apply only to institutions that service more than 5,000 loans, provide an important example. The CSBS framework should not apply these standards to IMBs that are not already subject to them. If CSBS is committed to alignment with federal standards wherever feasible, such alignment should include de minimis thresholds for applicability.

Finally, CSBS should provide greater detail as to how the framework would apply to IMBs that originate but sell all servicing, as these institutions do serve as "interim servicers" in the early stages of the loan (immediately following closing until the servicing rights are sold). These IMBs do not present many of the servicing-related risks described in the proposal, and CSBS should identify elements of the Baseline Standards that need not be applied to these institutions (*e.g.*, most of the standards outside of those related to data protection and servicing transfers).

Capital and Liquidity

IMBs' capital and liquidity positions represent their financial strength and ability to weather market downturns. As such, these capital and liquidity positions are monitored regularly not only by company management, but by the GSEs, Ginnie Mae, warehouse lenders, and other counterparties with direct financial exposure to IMBs. The framework largely recommends alignment with the GSE capital and liquidity standards applicable to IMB seller/servicers, which is an appropriate step to promote consistency across the industry. There is no compelling reason state-level evaluations of IMBs' financial resources should differ from similar evaluations by federal guarantors (aside from the application to loans outside the purview of those federal guarantors, as is discussed in the proposal).

As is noted above, support for alignment with federal standards does not, however, imply that existing federal standards are designed and implemented appropriately. MBA has provided extensive comments to FHFA on proposed updates to the GSE capital and liquidity requirements for IMB seller/servicers originally released in

January 2020.[10, 11] This proposal has since been withdrawn, and FHFA is expected to issue a new proposal in the coming weeks.[12]

Several features of the existing or proposed GSE capital and liquidity standards are in need of significant revisions to better reflect the IMB business model and the appropriate measurement of capital and liquidity. These revisions already were critically important to ensure smooth market functioning, and the potential for state regulator alignment with the GSE standards only makes these revisions even more necessary. As such, CSBS should work closely with FHFA and the GSEs to improve the standards that will be relied upon, rather than simply accept these standards as developed by FHFA and the GSEs.

Allowable Assets for Liquidity

In developing an appropriate set of liquidity requirements, regulators not only should promote safety and soundness, but also encourage regulated institutions to engage in strong risk management practices. CSBS should recognize that incentive structures within capital and liquidity standards are critically important, and improper incentives can lead to perverse outcomes.

One prominent example with respect to IMBs is the use of committed servicing advance lines of credit. These lines of credit feature committed funding from a reliable counterparty that typically can be withdrawn only in response to one or more specific covenant violations – in contrast to uncommitted lines of credit that can be withdrawn at any point. IMBs use these lines of credit to address liquidity needs that arise from advancing obligations with regard to delinquent loans in their servicing portfolios. For most IMBs, the advancing obligations associated with loans guaranteed or insured by FHA, VA, or USDA generate the most significant liquidity needs. Under the terms of these lines of credit, IMBs borrow against servicing advance receivables – a high-quality asset given the government-insured or government-guaranteed nature of the majority of the underlying mortgage loans.

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[10] FHFA, "FHFA Proposes Updated Minimum Financial Eligibility Requirements for Fannie Mae and Freddie Mac Seller/Servicers," January 31, 2020. Available at: https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Proposes-Minimum-Financial-Eligibility-Requirements-for-Fannie-Mae-and-Freddie-Mac-SellerServicers.aspx.

[11] MBA, "Industry Views on Updated Eligibility Requirements for Enterprise Single-Family Seller/Servicers," April 30, 2020. Available at: https://www.mba.org/Documents/MBA_FHFA_IMB_Financial_Requirements_April2020.pdf.

[12] FHFA, "FHFA to Re-Propose Updated Minimum Financial Eligibility Requirements for Fannie Mae and Freddie Mac Seller/Servicers," June 15, 2020. Available at: https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-to-Re-Propose-Updated-Minimum-Financial-Eligibility-Requirements-for-Fannie-Mae-and-Freddie-Mac-Seller-Servicers.aspx.

As with the previously proposed updates to the GSE capital and liquidity standards, the CSBS framework excludes the unused or available portions of committed servicing advance lines of credit. In doing so, it removes an important incentive for IMBs to obtain and pay for these committed lines of credit. Many IMBs may determine that, absent the ability to help satisfy liquidity requirements, the costs of obtaining committed lines of credit (rather than uncommitted lines of credit) are too great and forgo them altogether. This outcome would diminish, not strengthen, aggregate IMB liquidity.

If the framework does not provide recognition for committed lines of credit, IMBs will have a perverse incentive to draw these lines down at the end of each reporting period to strengthen their liquidity positions, only to reverse these actions shortly thereafter. This unintended consequence of the framework would do nothing to improve the actual resiliency of IMBs, but rather would lead to a substitution of available liquidity sources for reporting purposes.

In the proposal, CSBS simply states that it will not count committed lines of credit towards liquid assets, but it does not provide any rationale for doing so. Given the committed nature of this funding and the distinctions between committed and uncommitted lines of credit, it is incumbent upon CSBS to provide further explanation as to its concerns. CSBS should consider this exclusion in light of the industry's recent experience during the COVID-19-induced market downturn. Despite widespread concerns regarding liquidity and potential advancing obligations in March 2020, committed lines of credit to IMBs remained in place and were available without interruption. If these lines of credit were durable enough to withstand a global recession and a severe macroeconomic shock, it is not clear what type of scenario would lead to their widespread withdrawal.

In December 2020, FHFA directed the GSEs to remove the unused or available portions of committed lines of credit from consideration for purposes of minimum liquidity requirements for IMBs.[13] MBA believes this policy change is inappropriate for the reasons cited above, and it is not clear how this revised liquidity definition will fit into broader changes to the liquidity requirements for IMBs that are expected but have yet to be announced. Regardless of the treatment of committed lines of credit by the GSEs at any given point in time, it is not clear why the CSBS framework, which seeks to align state-level requirements with those put in place by FHFA, would use a definition of liquid assets that does not simply reference the FHFA/GSE definition of liquid assets. In its proposal, CSBS "hard-wires" a definition that would not change even if FHFA updates the GSE standards at a later date. This structure would lead to misalignment between federal and state standards if FHFA decides, for

[13] Fannie Mae, "*Selling Guide* Announcement (SEL-2020-07)," December 16, 2020. Available at: https://singlefamily.fanniemae.com/media/24631/display. Freddie Mac, "Bulletin 2020-48," December 16, 2020. Available at: https://guide.freddiemac.com/app/guide/bulletin/2020-48.

example, to provide partial credit for committed lines of credit through some type of haircut.

Finally, CSBS should work with FHFA to not only recognize committed servicing advance lines of credit, but also to recognize other sources of committed liquidity. These sources include MSR financing facilities and lines of credit from affiliates, among others.

The Incremental Non-Performing Loan (NPL) Charge

The use of an incremental liquidity charge when NPLs rise above a given threshold is a procyclical feature of the framework that stands proper liquidity management on its head. This feature requires IMBs to strengthen their liquidity positions when delinquencies already are at heightened levels. These heightened delinquency levels often are indicative of broader market stress, making it the most difficult time at which to increase liquid assets and also the time when liquid assets must be drawn down to meet advancing obligations.

A well-structured liquidity framework would require IMBs to build up their liquid assets when markets are strong and delinquencies are low and then use these liquid assets to meet advancing obligations and other demands during downturns when delinquencies rise. In other words, absent the incremental NPL charge, well-managed IMBs would approach their liquidity positions in a manner exactly opposite of that which is required by the incremental NPL charge. FHFA itself acknowledged this core concept of sound liquidity risk management in its recent proposed rule to establish liquidity requirements for the GSEs, noting that “an appropriate framework would incent the [GSEs] to build their liquidity portfolios in good times, so that it is available to be deployed as necessary in times of stress.”[14]

This procyclicality has been acknowledged by CSBS in recent comments to FHFA. In response to the proposed updates to the GSE capital and liquidity standards, CSBS noted that reducing the existing NPL threshold would “help to reduce the pro-cyclicality of the NPL escalator,” but that “the pro-cyclical effect remains and further consideration should be given to alternative means of addressing liquidity needs ahead of adverse conditions.”[15]

[14] FHFA, “Enterprise Liquidity Requirements,” December 17, 2020. Available at: https://www.fhfa.gov/SupervisionRegulation/Rules/RuleDocuments/Liquidity_NPR%20to%20Fed%20Reg_Web%20version.pdf

[15] CSBS, “Re: Updated Eligibility Requirements for Enterprise Single-Family Seller/Servicers,” March 31, 2020. Available at: https://www.csbs.org/sites/default/files/2020-03/CSBS%20Letter--FHFA%20Updated%20Minimum%20Eligibility%20Requirements.pdf.

In addition to the illogical nature of the incremental NPL charge, the negative impact on IMBs extends beyond broad-based concerns regarding proper liquidity management. The incremental NPL charge will disproportionately harm IMBs that tend to exhibit higher NPL rates due to their business models or geographic footprints – for example, IMBs that primarily service FHA-insured loans, loans in states with judicial foreclosure processes or greater exposure to natural disasters, or distressed loans.

A natural response to this feature of the framework will be for IMBs to institute credit overlays on loans with a higher likelihood of delinquencies. Because these overlays largely would fall on FHA-insured loans, and because FHA-insured loans primarily serve low- to moderate-income borrowers and first-time homebuyers, the impact on access to credit could be severe. Further, these dynamics likely would lead to reduced liquidity in the Ginnie Mae MSR market, as potential buyers lower their demand for pools with higher delinquencies, making it more difficult to transfer servicing in times of stress – precisely when an IMB may be trying to raise capital or lower its advancing burden.

Given these highly problematic structural flaws with the incremental NPL charge, CSBS should advocate forcefully that FHFA remove it from the GSE standards when they are re-proposed.

Lack of Distinction between Actual and Scheduled Servicing Remittances

Another potential improvement to the GSE capital and liquidity standards, and any state-level standards that align with the GSE standards, is the recognition that different servicing remittance structures present widely different risks. Actual remittances of principal and interest only require servicers to advance payments received from borrowers. As such, this remittance structure entails lower liquidity risks for servicers relative to scheduled remittances, in which servicers potentially could be required to advance significant missed payments in periods of high borrower delinquencies.

Neither the GSE capital and liquidity standards nor the CSBS framework recognizes this important difference, thereby missing an opportunity to incent IMBs to engage in practices that minimize their most notable liquidity risk. Incentive structures matter, and to encourage the use of actual servicing remittances when feasible, these requirements should provide credit for the portion of IMBs' servicing portfolios under this remittance structure. This approach, for example, could take the form of a lower base servicing liquidity requirement for this portion of the portfolio.

FHFA previously has noted its intention to "continue to evaluate the requirement on an ongoing basis to determine whether a differentiation should be made."[16] As with the other structural flaws in the GSE capital and liquidity standards noted above, CSBS should work collaboratively – and proactively – with FHFA to improve the GSE standards. These improvements should occur prior to the implementation of any new requirements rather than at an unspecified later date.

The "Higher of" Construct

It is not clear why quantitative thresholds proposed by CSBS feature a "higher of" construct that includes both existing (or in some cases, proposed) GSE standards as well as linkages to the GSEs standards as modified. This construct essentially sets the existing (or proposed) GSE standards as floors for capital and liquidity standards, such that the recommended requirements for IMBs can increase if the GSE standards are made more stringent, but cannot decrease if the GSE standards are made more accommodative.

CSBS does not provide any rationale for this approach in the proposal. Given the endorsement of aligned federal and state standards, the framework should feature alignment at all times. If future GSE standards are made more accommodative, however, that alignment would be lost.

The proposal does not explain why it is appropriate for state regulators to follow changes in the GSE standards when they are made more stringent, but not when they are made more accommodative. If FHFA and the GSEs decrease minimum capital or liquidity requirements for IMBs, presumably they are doing so based on program changes and data-driven analyses informed by the close counterparty relationships the GSEs maintain with their IMB seller/servicers. There is no clear reason state regulators would not continue their alignment with the GSE standards in this scenario. Said differently, the requirements set by state regulators should not be calibrated at higher levels than the comparable requirements set by federal regulators or guarantors.

As such, CSBS should remove the "higher of" construct in the recommended capital and liquidity standards and simply align with the GSE standards.

Alignment in Use of Waivers or Deviations from Requirements

The need for alignment between federal and state requirements extends not just to the requirements as written, but also as applied by the various regulators and

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[16] FHFA, "Frequently Asked Questions: Updated Eligibility Requirements for Enterprise Single-Family Seller/Servicers," January 31, 2020. Available at: https://www.fhfa.gov/Media/PublicAffairs/Documents/Servicer-Eligibility-FAQs-1302020.pdf.

guarantors that oversee IMBs. This distinction is critical in situations in which the GSEs grant waivers or allow deviations from the stated requirements – a common practice across their IMB seller/servicers. In situations in which one or both GSEs have determined that a deviation from the stated requirements is appropriate, it is not clear that the CSBS framework provides a mechanism for state-level requirements to follow suit in a uniform manner.

In order to preserve alignment, the framework should ensure that the state-level requirements related to net worth, capital, and liquidity use the same calculations as those used by the GSEs – including exclusions or adjustments made at the discretion of the GSEs. More simply, an IMBs' net worth, capital ratio, and liquid assets should be calculated as the same figures for purposes of federal and state-level requirements. If a GSE makes an adjustment to one of these calculations, that adjustment should automatically carry over to any calculations undertaken for purposes of state-level requirements.

This mechanism is particularly important with respect to the proposed definition of "net worth" in the framework, which mirrors the definition used by the GSEs. This definition excludes "pledged assets net of associated liabilities." Taken in its most literal form, this definition could be interpreted as excluding the value of pledged MSRs from an IMB's net worth. MSRs represent a major component of most IMBs' total assets, and MSRs frequently are pledged as collateral to financing facilities (as is required, for example, under the terms of the Ginnie Mae acknowledgement agreement). If pledged MSRs were excluded from the relevant calculations, many IMBs would experience a significant reduction in net worth. The GSEs and Ginnie Mae, however, do not exclude pledged MSRs in such a broad manner, and instead recognize MSRs when pledged as collateral for lines of credit. Absent alignment with the GSE and Ginnie Mae interpretations of the net worth calculations, state regulators could find that many IMBs fall short of their net worth requirements – despite these IMBs remaining in good standing with the GSEs and Ginnie Mae.

Other examples of the potential for misalignment relate to the minimum capital ratio and the accounting treatment of various types of assets. In many cases, Generally Accepted Accounting Principles (GAAP) require that assets be "grossed up" onto an IMB's balance sheet, though the GSEs and Ginnie Mae provide waivers or exceptions for the purposes of calculating the ratio of net worth to total assets. Issuers of Home Equity Conversion Mortgages (HECMs), for example, maintain repurchase obligations that prevent securitized HECMs from receiving true sale accounting. As such, HECMs would enlarge some IMBs' balance sheets, making them more likely to fall below a 6 percent capital ratio. The GSEs and Ginnie Mae typically have provided waivers in these situations, and Ginnie Mae codified this exemption in a recent All Participant Memorandum.[17] Similar issues related to GAAP treatment and true sale accounting impact residual interests in private-label mortgage-backed securities, contingent Ginnie Mae loan repurchases when issuers have the option to buy delinquent loans out of pools, and MSRs related to subservicing contracts for which advancing responsibilities have been sold to a third party. In each case, the stated requirements of the existing capital standards would imply that IMB balance sheets be considered much larger than they should be from an economic perspective. Waivers and adjustments from federal regulators and guarantors have been necessary and applied appropriately in these situations.

These examples highlight the importance of ensuring that calculations, waivers, and adjustments made by federal regulators or guarantors should be made in an identical fashion by state regulators.

The Need for Clarity Regarding "Operating Liquidity"

In addition to the requirements associated with "servicing liquidity," or the liquidity needed to manage servicing activities, the framework includes an additional concept of "operating liquidity." As described in the proposal, operating liquidity references the liquidity needed to manage basic business expenses, including rent and payroll.

The distinction between these functions in terms of liquidity planning is not unreasonable, particularly in light of the detailed liquidity risk management that IMBs (and other types of servicers) undertake. It is not clear in the proposal, however, why there are separate liquidity requirements for these functions or how these separate requirements interact with each other. The proposal, for example, first states that IMBs must maintain liquid assets "in addition" to the servicing liquidity requirements, but later implies that "excess funds" from IMBs' servicing liquidity due to a lower "cost coverage for servicing" can be used to meet the operating liquidity requirements.

Based on this description, it is not apparent whether the aggregate liquidity requirement for IMBs (assuming NPLs below the threshold for the incremental charge) is 3.5 basis points of the servicing portfolio, 3.5 basis points of the servicing portfolio plus an additional operating liquidity requirement, or some other figure based on whether "excess funds" from servicing liquidity are available.

CSBS should more clearly specify how these requirements would be calculated and applied with respect to both servicers and subservicers.

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[17] Ginnie Mae, "APM 19-06: Counterparty Risk Management Policy Series – Volume 3: New Rating Requirements, New Risk Factors, Revised Financial Requirements, and Other Revised Participation Requirements," August 22, 2019. Available at: https://www.ginniemae.gov/issuers/program_guidelines/Pages/mbsguideapmslibdisppage.aspx?ParamID=100.

Risk Management

The framework references oversight by, and reporting to, the board of directors of the IMB with respect to risk management. CSBS should note that not all IMBs maintain a board of directors, and the framework should provide sufficient flexibility by referencing the board of directors, senior management, senior officers, or individuals holding similar titles and responsibilities.

Data Standards

The framework references another set of existing federal standards in its consideration of data and documentation standards. As CSBS notes, the CFPB under Regulation X and Regulation Z requires servicers to be able to produce several pieces of pertinent information about a given loan following a request by the consumer. This CFPB requirement applies to all institutions that service more than 5,000 loans. The 5,000-loan threshold exists to balance the consumer benefits of this requirement with the costs that would be borne by small servicers.

CSBS proposes to apply this requirement to all IMBs and all serviced loans, though no explanation is provided as to why the 5,000-loan threshold is not warranted. If CSBS believes these data and documentation standards must be applied to all IMBs, it should articulate clearly why the CFPB threshold is not appropriate and how its determination of costs and benefits differs from that of the CFPB. Absent this explanation, MBA recommends that CSBS maintain alignment with the CFPB standards, including the use of the 5,000-loan threshold for applicability.

Data Protection

CSBS is correct to note the importance of data protection in an environment of cyber risks that are growing in scale and complexity. While the data protection elements outlined in the framework are appropriate considerations for IMBs, the standards proposed are vague and it would be difficult for any particular IMB to feel confident that it is in compliance with these numerous standards. Because these proposed standards leave ample space for interpretation, they also are likely to develop into fragmented requirements across various state regulators.

To promote industry compliance and lower costs, CSBS instead should focus on providing “best practices” or other resources that IMBs can use to improve their internal monitoring, testing, and controls. These best practices should draw on vendor management standards or information technology protocols developed by financial regulators or guarantors at the federal and state levels (while tailoring these standards or protocols to reflect IMB business models). Only after conducting this work should CSBS consider incorporating data protection standards into any recommended prudential framework.

Additionally, CSBS should collaborate with federal regulators and Congress in the ongoing development of common, national standards for data protection. This work represents the best opportunity to avoid a fragmented system of data protection requirements that vary by jurisdiction – an outcome that would not benefit consumers, market participants, or regulators.

Corporate Governance

Within the standards addressing corporate governance, CSBS appropriately aligns its framework with the reporting and internal audit requirements in place through Ginnie Mae. As with other areas of the framework, alignment between federal and state standards will facilitate compliance and reduce industry burden.

Based on the phrasing in the proposal, it is unclear if a “sound corporate governance framework,” a “set of internal controls,” and a “method for independently validating the accuracy and reliability of the financial and servicing information of the firm” represent differing requirements that fall under the umbrella of “corporate governance,” or if together these components are captured if IMBs are in compliance with the existing Ginnie Mae requirements. CSBS should clarify these terms and specify that it is not recommending requirements beyond those in place through Ginnie Mae.

Finally, the framework specifies that an IMB’s board of directors is responsible for the company’s corporate governance policies. As noted above, not all IMBs maintain boards of directors, so the framework should provide sufficient flexibility by referencing the board of directors, senior management, senior officers, or individuals holding similar titles and responsibilities.

Servicing Transfers

Some of the most important reforms following the Great Recession addressed weaknesses associated with servicing transfers. The CFPB and FHFA bulletins with which CSBS proposes alignment include many of these reforms, targeting information flow, data integrity, and resolution of problems that are identified. Again, explicit alignment with federal standards already in place will promote consistency in practice and in oversight, which is particularly crucial with respect to servicing transfers. CSBS also should seek opportunities to collaborate with the CFPB and other industry stakeholders to increase consumer education with respect to servicing transfers. Finally, it is important to recognize that the CFPB’s servicing rules already protect borrowers from many of the issues that might arise during a servicing transfer.

Further work to facilitate consistency in servicing transfers is taking place under the auspices of the Mortgage Industry Standards Maintenance Organization (MISMO) – the mortgage industry's standard-setting body. MISMO's Servicing Transfers Development Work Group is identifying and prioritizing challenges associated with servicing transfers, with the goal of creating standards and best practices that allow for a more seamless and consistent experience for servicers and borrowers.[18] These efforts will be complementary to existing requirements put forth by the CFPB, FHFA, state regulators, and others.

Change of Control

The proposed requirements related to a change of control of an IMB effectively mirror the existing Ginnie Mae requirements with respect to the notification timeline and the threshold for determining "control."[19] The use of a notification requirement rather than an approval requirement is appropriate, as the process and timeline for approval from the relevant state regulator could, in many cases, significantly delay the transaction. The notification system as described in the framework would allow state regulators to obtain additional information regarding a new owner if needed without creating the unnecessary burden or complication associated with an approval requirement.

To better align the framework with existing standards, CSBS should recommend that state regulators utilize the Nationwide Multistate Licensing System & Registry (NMLS) process and align fully with NMLS requirements. By leveraging NMLS for all required notices, including those related to change of control, change in name, or other changes in pertinent company information, CSBS can promote more consistent and higher-quality information sharing between IMBs and state regulators.

CSBS should consider providing more details regarding its recommended change of control notifications in the proposal. IMBs would benefit from greater clarity regarding the notification process, including confirmation that separate notifications are not

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[18] MISMO, "Servicing Transfers Development Work Group." Available at: https://www.mismo.org/get-started/participate-in-a-mismo-workgroup/servicing-transfers-dwg.

[19] The Ginnie Mae standards for "control" and "principal owner" reference the definitions set forth by the Financial Accounting Standards Board in "Statement of Financial Accounting Standards No. 57." Available at:
https://www.ginniemae.gov/doing_business_with_ginniemae/issuer_resources/MBSGuideLib/Chapter_03.pdf and
https://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1218220130781&acceptedDisclaimer=true.

required for state regulators in all states where the IMB services loans. Reliance on NMLS systems would reduce the need for such duplicative notifications.

CSBS also should clarify that the change in control notification requirements will differ for public companies relative to privately-held companies. For public companies, it will not be feasible to provide such advance notice of a change in control, and any required notifications to state regulators should reflect this fact.

Finally, CSBS should recommend an expedited process or a waiver of the standard notification period for circumstances in which an IMB is seeking to raise common equity, particularly to address short-term capital needs. Such a process could be structured for the IMB to request a waiver from its home regulator, and the regulator would be required to grant or deny the waiver within a relatively short period, such as three days. This process would allow state regulators to maintain authority over the change of control notifications, but would prevent unnecessary delays in more urgent situations.

Part III – Recommendations for the Enhanced Standards

<u>Applicability</u>

The CSBS framework includes additional requirements related to capital, liquidity, stress testing, and living will and recovery/resolution plans for those IMBs of a particular size or degree of complexity. The proposal notes that state regulators "see a need" for certain servicers "to have in place advanced risk management and management information systems to mitigate risk."

As was noted with respect to the use of prudential standards for all IMBs, it is imperative that CSBS articulate the specific risks that it views as necessitating the Enhanced Standards contained in the proposal. These more stringent prudential standards for certain IMBs should be designed to address heightened concerns regarding greater taxpayer risk upon an IMB's insolvency, greater systemic risk upon an IMB's financial stress, or both. MBA remains broadly skeptical of arguments for taxpayer risk or systemic risk emanating from any particular IMB. To determine whether the Enhanced Standards provide public policy benefits that outweigh the costs to the covered IMBs and to consumers, CSBS should more clearly provide its rationale for proposing them.

Given the additional costs associated with the Enhanced Standards, it is critical that IMBs have a clear understanding of the thresholds delineating the Enhanced Standards from the Baseline Standards. CSBS proposes that IMBs automatically become subject to the Enhanced Standards if their MSR and whole loan portfolios exceed $100 billion or 2.5 percent of the IMB market share. These thresholds present areas in need of further clarification:

- Does CSBS plan to index the $100 billion threshold to some measure of inflation or market growth? If it does not, the $100 billion threshold will grow less relevant over time and the 2.5 percent threshold may become binding more frequently.
- What is the relevant time period for the calculation of the 2.5 percent threshold? If an IMB exceeds the 2.5 percent threshold in a given quarter, does it trigger the Enhanced Standards? Does CSBS plan to use market share data from prior quarters, or an average over several quarters?
- Is there a rationale for the market share threshold to cover only the IMB portion of the market rather than the entire market? If, for example, the total IMB servicing market share fell to 20 percent, then a 2.5 percent share of the IMB market would equate to only a 0.5 percent total market share, which does not seem to warrant the Enhanced Standards.
- How does the proposal address an IMB that wavers above and below a threshold from quarter to quarter? It seems that an IMB should exceed a threshold consistently (four consecutive quarters, for example) in order to trigger the Enhanced Standards.
- What is the process for state regulators to determine that an IMB should be subject to the Enhanced Standards due to its complexity, even if it does not cross either threshold? Can a determination by a single state regulator trigger the Enhanced Standards? Will CSBS play a role in this determination? Are there ways for IMBs to engage in this process?
- If there is a mechanism by which state regulators can subject an IMB to Enhanced Standards despite it not meeting either threshold, why is there not a corresponding mechanism by which state regulators can determine that an IMB does not warrant the Enhanced Standards even if it crosses one or both thresholds?

In addition to the issues raised above, MBA recommends that CSBS provide clarity on the implementation timeline associated with the Enhanced Standards. It is not feasible for an IMB that was compliant with the Baseline Standards to immediately come into compliance with the Enhanced Standards, particularly given some of the requirements related to new methodologies for capital and liquidity adequacy, third-party assessments of stress tests, and development of a resolution plan. CSBS should include in the framework a 12-month period after the point at which an IMB is determined to warrant Enhanced Standards (and is notified of this determination) before the Enhanced Standards take effect.

Capital and Liquidity

The capital and liquidity standards proposed under the Enhanced Standards appropriately acknowledge that different IMBs with vastly different business models should not be subject to a "one size fits all" threshold or metric. The risk profiles of the largest IMBs, in particular, vary based on the composition of their servicing portfolios, their sources of funding, and several other factors that are unique to each company. The directive that the IMB's management develop processes to measure and monitor capital and liquidity needs, based on that company's unique risk profile, is reasonable, as any IMB that triggers the threshold for the Enhanced Standards already has such processes in place.

It is not clear, however, if CSBS intends to require a different type of capital and liquidity adequacy analysis when it twice references the capital needs of "the entire firm" and later references the liquidity needs "of the enterprise" in the proposal. As with the Baseline Standards, any Enhanced Standards should apply to the state-licensed entity rather than a corporate parent company. The state-licensed entity is the subject of the Baseline Standards, as well as any Ginnie Mae or GSE requirements. Further, it is the state-licensed entity over which state regulators maintain legal authority to impose reporting and financial requirements and conduct examinations. Extensions of the capital and liquidity standards to corporate parent companies that may not be state-licensed raise questions regarding state regulators' jurisdiction and legal authority. As such, CSBS should clarify that any capital and liquidity standards under the Enhanced Standards apply to the same state-licensed entity as the Baseline Standards.

The proposal also references the need for capital and liquidity to "ensure ongoing operations and accommodate a moderate stress environment." While this is a reasonable objective of an IMB's capital and liquidity planning, it is unclear whether CSBS intends to explicitly link the capital and liquidity standards to the use of stress testing under the Enhanced Standards. Such an approach would be misguided, as it would entail too much reliance on stress test results that are subject to significant uncertainty and modeling assumptions. While it may be appropriate for IMBs to consider the results of any stress tests – whether conducted by Ginnie Mae or conducted internally – in their capital and liquidity planning, state regulators should not require that capital and liquidity needs be dictated by these stress tests.

Stress Testing

Despite the limitations noted above, stress testing is one of several tools that companies and regulators can use as a means of understanding and estimating resiliency against adverse market conditions. Many large IMBs run internal analyses akin to stress tests, in which the anticipated impact of various economic and financial scenarios is modeled. These analyses help inform decisions regarding capital and liquidity planning, as well as other elements of IMBs' business strategies.

It is unclear from the proposal whether CSBS expects IMBs to be subject to an external stress test as a condition of meeting the Enhanced Standards. To the extent such external stress tests are considered, CSBS should focus on aligning its requirements with the ongoing work being undertaken by Ginnie Mae. This would represent a far more appropriate outcome than the development of unique stress tests by one or more state regulators. The use of a single, common stress test would provide consistency in results and eliminate significant burdens on state regulators (in developing new stress tests) and on IMBs (in complying with multiple stress tests). The logic behind this alignment is consistent with the logic underpinning other areas of the proposal in which CSBS recommends linkages to existing federal standards.

As is noted above, support for alignment with an existing federal approach does not imply full endorsement of that approach in its current form. Ginnie Mae has worked to develop and refine its stress testing framework in recent years, and this work is ongoing.[20] MBA has provided recommendations on ways that Ginnie Mae could improve the structure of its stress testing framework, as well as the manner in which the results are used.[21] These recommendations focused on:

- Use of the stress test results as one of many factors in Ginnie Mae's oversight of issuers rather than as a standalone basis for any actions that Ginnie Mae takes;
- Use of the stress test results as a basis for beginning more in-depth analysis of an issuer's financial condition rather than as a dispositive conclusion regarding its resiliency to stress;
- Identification of outliers rather than "rating" all issuers, particularly given that parsing minor differences in resiliency across issuers that are well inside an acceptable range of results is a poor use of resources;
- Concern that a rating system with discrete categories places too great an emphasis on arbitrary thresholds between categories;
- The need for appropriate levels of transparency regarding the data inputs, models, and assumptions underlying the stress tests; and

[20] Ginnie Mae, "Request for Input: Stress Testing Framework and Recommendations," July 23, 2019. Available at: https://www.ginniemae.gov/newsroom/publications/Documents/ginniemae_rfi_stress_testing.pdf.

[21] MBA, "RE: Request for Input: Stress Testing Framework and Recommendations," September 16, 2019. Available at: https://www.mba.org/Documents/MBA_Ginnie_Mae_Stress_Test_RFI_September2019(0).pdf.

- The need for strict confidentiality of the stress test results.

As with other elements of the framework, CSBS should work collaboratively with the appropriate federal entity – in this case, Ginnie Mae – to improve the federal standards if they are to be used as the basis for state regulator requirements. CSBS also should make explicit that stress testing is a tool to assist in capital and liquidity planning rather than a conclusive measure of IMBs' capital and liquidity needs.

Business Continuity

The framework as proposed includes a requirement for what it references as "living wills and recovery resolution plans." The living will requirements set forth in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) apply to bank holding companies with assets greater than $50 billion and non-bank financial companies designated for Federal Reserve supervision by FSOC.[22] These requirements reflect a view that systemic risk can be mitigated if regulators have, in advance of any material financial distress or insolvency, detailed strategies for a rapid resolution of these companies.

As noted above, the absence of any FSOC designation of IMBs is consistent with the understanding that the insolvency of any particular IMB is unlikely to trigger contagion in the financial system. The lack of systemic concern also was reflected in Ginnie Mae's summary of its recent "liquidity meetings" with the largest IMBs.[23] Much of the value associated with living wills in the context of large banks relates to counterparty transactions and relationships involving complex derivatives or other products that may complicate a rapid and orderly resolution. There is not an equivalent concern with respect to IMBs, as even the largest IMBs engage in far less complex financing and hedging transactions. As such, without further explanation regarding the risks that CSBS fears would not be well-managed through the bankruptcy process, it is difficult to determine the value that living wills would provide with respect to IMBs.

In the case of banks or credit unions that hold insured deposits, the receivership process better ensures prioritization of claims to minimize losses to the government insurance funds – a concern that is not relevant in the case of an insolvent IMB. The time-tested bankruptcy process provides a well-understood, orderly system for the disposition of an insolvent IMB's assets and obligations, and indeed has worked well in the case of the recent bankruptcy of a large IMB. Further, the ability of guarantors like the GSEs to unilaterally transfer servicing allows for a more manageable

[22] Public Law 111-203, Section 165(d).

[23] Ginnie Mae, "Report on Issuer Liquidity Meeting Series: February – April 2019," May 17, 2019. Available at: https://www.ginniemae.gov/newsroom/publications/Documents/issuer_liquidity_meeting_series_report.pdf.

approach to satisfying consumer-facing concerns before an IMB reaches the point of insolvency.

The bankruptcy process has served the interests of IMB customers, creditors, counterparties, and other stakeholders well, and the introduction of additional or competing plans to handle an IMB's insolvency could result in confusion and greater uncertainty about the process.

It is more appropriate for CSBS to consider the potential insolvency of an IMB through the lens of "business continuity" rather than "living wills." Business continuity ensures that appropriate systems and protocols allow IMBs to respond to market or company-specific shocks, servicing transfer protocols are in place to protect consumers when such transfers are necessary, and there are no impediments to regulators or guarantors taking any necessary actions to promote market stability. One area that may be ripe for further consideration is the concept of designated "back-up servicers" to facilitate urgent transfers.

Further, many of the individual pieces of information listed in the CSBS framework are readily available through corporate filings, corporate governance requirements, and state licensing filings, among other sources. It is particularly important that the framework avoid any recommendation that IMBs identify potential purchasers of MSRs, bulk transfers, or the company outright. Given that the buying and selling of MSRs generally occurs as bids on specific portfolios or specified flow arrangments, as well as the presence of a public market for stocks of publicly-traded IMBs, identification of specific buyers is unlikely to be practical or such buyers will change far more frequently than these reports would be updated.

Rather than rely on living wills, the CSBS framework instead should focus on appropriate levels of information sharing across state regulators, Ginnie Mae, and the GSEs so that these parties are aware of potential stress at large IMBs and can prepare accordingly for any necessary actions (such as servicing transfers).

* * *

MBA appreciates the opportunity to provide observations and recommendations on the CSBS proposed regulatory prudential standards for IMB servicers, as well as the ongoing communication and collaboration with state regulators through CSBS.

As noted above, IMBs play an important role in the origination and servicing of residential mortgages throughout the country, with a particular focus on mortgages that serve low- to moderate-income households and other historically underserved communities. Any prudential standards that are applied to IMBs above and beyond those already in place should: 1) include a clear rationale for the imposition of such standards that specifies the taxpayer harm or contagion risk that would be expected due to the insolvency of an IMB; and 2) appropriately consider the impact that heightened prudential standards would have on the cost and availability of credit for consumers.

If CSBS moves forward to finalize the proposal, it should undertake additional steps to ensure a transparent framework that is aligned with the existing requirements of federal regulators and guarantors. CSBS should work proactively with the appropriate federal regulators or guarantors to make technical improvements to the various federal standards on which the framework relies. CSBS also should focus on developing ways to ensure broad, uniform adoption by state regulators. Without coordinated adoption at the state level, the benefits of the CSBS proposal will be lost and IMBs will face the unnecessary burdens and costs associated with a patchwork system of varying state requirements. It therefore is incumbent upon CSBS to place just as much emphasis on facilitating adoption of the framework by state regulators as it did on developing the framework in the first place.

Thank you in advance for your consideration of these comments. Should you have questions or wish to discuss further, please contact Pete Mills, Senior Vice President of Residential Policy and Member Engagement, at (202) 557-2878 or pmills@mba.org.

Sincerely,

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