PROPOSED REGULATORY PRUDENTIAL STANDARDS FOR NONBANK MORTGAGE SERVICERS 2020

Non-Depository Supervisory Committee

September 2020
Executive Summary

Nonbank mortgage servicers are an important segment of the financial services community. These institutions currently service over half of the agency mortgage market\(^1\) and roughly 40% of the total $11 trillion single-family residential mortgage market.\(^2\) As the institutions responsible for transmitting monthly borrower payments to investors or loan holders, mortgage servicers are an integral part of the mortgage market ecosystem.

A servicer is the company responsible for the administration of the loan beginning immediately after closing and continuing until the loan is paid off and the lender’s security interest in the property is released or cancelled. A servicer is responsible for collecting borrower payments including principal, interest, taxes and insurance, then remitting or forwarding those payments to investors. If a borrower is delinquent on payments, the responsibility falls to the servicer to do everything it can to collect the payment and any late fees or penalties authorized under the original loan contract. Servicers are responsible for managing loss mitigation and borrower forbearance of payments and initiating foreclosure proceedings when a borrower reaches a certain stage of delinquency. Servicers also manage a variety of administrative responsibilities including accounting, record keeping, investor reporting and advancing unpaid amounts to investors, taxing authorities and insurance providers.

Without servicing, the mortgage market in the United States as currently structured would cease to function. Servicers occupy the space between the consumer and the loan holder or investor. This creates an obligation to both parties of the transaction, making servicers simultaneously responsible for efficiently servicing the market and protecting consumers.

The role of a servicer is controlled by borrower protections established by law on the side of the consumer and by contract and investor protections on the side of the beneficial owner of the mortgage-backed security. Between these two legal anchors, management is responsible for operating the institution in a safe and sound manner.

State regulators believe that a sound financial condition and safe management practices are essential to compliance and consumer protection. These prudential standards seek to establish state regulator requirements and expectations not only for legal compliance, but safe and sound operations as well.

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1. The “agency” mortgage market includes mortgage loans purchased or securitized by Fannie Mae or Freddie Mac (also known as Government Sponsored Enterprises or GSEs) and loans made, insured, or guaranteed by the Department of Housing and Urban Development, Department of Veterans Affairs, or Department of Agriculture (also known as Ginnie Mae guaranty mortgage loans).
2. All loans, agency plus privately made mortgage loans.
State regulators, through the Conference of State Bank Supervisors (CSBS), have been monitoring nonbank mortgage servicers for the last few years. This monitoring has resulted in observations and concerns about rapid market share growth, nonbank institution size and their financial stability and governance. To address these concerns, we are issuing our Proposed Regulatory Prudential Standards for Nonbank Mortgage Servicers for public comment.

In 2015, the states, working through the Mortgage Servicing Rights Task Force, a group of state regulators from California, Illinois, Massachusetts, Minnesota, Pennsylvania, New York, South Dakota, Texas and Washington, developed baseline prudential standards and enhanced prudential standards for nonbank mortgage servicers. This updated proposal has been developed with oversight from the CSBS Non-Depository Supervisory Committee (NDSC) and relies heavily on the original 2015 proposal.

Since 2015, CSBS has undertaken significant supervisory activity in the nonbank mortgage servicing space through the Multistate Mortgage Committee (MMC) and the NDSC. Work in this area includes:

- Development of enhanced examination review standards for mortgage servicers
- Increased examination reviews and enforcement actions for mortgage servicers
- Additional training for examiners including financial condition review
- Significant analysis and monitoring of large servicer financial condition and viability
- Collaboration with federal agencies responsible for mortgage oversight
- Consumer relief information, industry guidance and the development of examination processes related to forbearance rights and responsibilities and foreclosure under the CARES Act.

This proposal is updated to reflect a changed nonbank mortgage market, continued significant growth and complexity and an evolved understanding of state regulators concerning the need for supervisory standards. Given their credentialing, licensing and examination authority over nonbank mortgage servicers, state regulators play a central role in ensuring that these entities conduct servicing operations in a safe and sound manner and have strong consumer protections in place.

State regulators are well-positioned, as the primary prudential regulatory authorities of these institutions and as regulators with experience and responsibility for a diverse range of bank and nonbank financial services providers, to design and implement a comprehensive prudential

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3 A guide for managing and resolving enforcement actions with troubled servicers. Not publicly available.
4 https://www.csbs.org/mortgage-examination-supplements
6 https://www.csbs.org/cares-act-forbearance-foreclosure
regulatory framework for nonbank mortgage servicers. This framework will help achieve the following goals:

- 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;
- Enhance effective regulatory oversight and market discipline over these entities; and
- Improve transparency, accountability, risk management and corporate governance standards.

Therefore, state regulators propose and seek public comment on a set of baseline and enhanced prudential standards that are to be applied to nonbank mortgage servicers and investors in mortgage servicing licensed by and operating in the states, with certain exceptions and qualifications:

- These standards are not intended to apply to servicers solely owning and conducting reverse mortgage servicing.
- These standards have limited application, as covered below, to entities that only perform subservicing for others.

The Baseline Prudential Standards (hereinafter, Baseline Standards) cover eight areas, including capital, liquidity, risk management, data standards and integrity, data protection (including cyber risk), corporate governance, servicing transfer requirements and change of control requirements. To the extent possible, the Baseline Standards will leverage existing standards or generally accepted business practices. Once adopted by state regulators, these standards will represent regulatory requirements for state-licensed nonbank mortgage servicing firms. Additional detail can be found in the section titled “Baseline Prudential Standards.”

The nonbank mortgage servicing industry is diverse, ranging from small firms with straightforward operations to large, complex firms and asset managers with multiple business lines. By utilizing existing standards or generally accepted business practices, the Baseline Standards seek to minimize regulatory burden for small, less complex servicing firms.

Additionally, the Baseline Standards will also serve as a starting point for Enhanced Prudential Standards and Heightened Supervisory Expectations (hereinafter, Enhanced Standards) for entities that require increased regulatory oversight.

The Enhanced Standards will be applied to the following four areas: capital, liquidity, stress testing and living will/recovery and resolution planning. At a minimum, mortgage servicing entities subject to the Enhanced Standards (known as Complex Servicers) will be those servicers owning whole loans plus mortgage servicing rights (MSRs) totaling the lesser of $100 billion or
representing at least a 2.5% total market share based on Mortgage Call Report (MCR)\(^8\) quarterly data of licensed nonbank owned whole loans and MSRs.

In addition, state regulators may determine specific servicers, including Subservicers Only, not meeting the above definition of Complex Servicer to be included as Complex Servicers and subject to the Enhanced Standards based on a unique risk profile, growth, market importance, or financial condition of the institution.

Complex Servicers may be inclusive of each of the nonbank mortgage servicing business models discussed below: Originator/Servicers, Monoline Servicers, MSR Investors and Subservicers Only. Additional detail regarding the Enhanced Standards can be found in the section titled “Enhanced Prudential Standards and Heightened Supervisory Expectations.”

State regulators request public comment on all aspects of these proposed standards.

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\(^8\) Nationwide Multistate Licensing System (NMLS) reports required under state statute or rule.
Overview of the Nonbank Mortgage Servicing Industry

The 2015 Proposal recognized that nonbank entities that specialize in loan servicing had grown dramatically in size, complexity and importance in the post-crisis mortgage market. That dynamic has been amplified in the intervening years and continues into 2020 with business models evolving significantly. Nonbank mortgage servicers and asset managers have acquired massive portfolios of mortgage servicing rights, many of which initially consisted of delinquent loans that required specialized skill in high-touch servicing. As the volume of delinquent loans sold by depositories trailed off and more loans resolved, this market niche consolidated and the trading of MSRs evolved to focus on newer production and servicing of GSE\(^9\) and government-backed loans often in agency-sponsored mortgage-backed securities (MBS).

Changes in the mortgage market and these entities’ rapid growth have highlighted the critical services these firms provide to homeowners, investors and other market participants. The goal of these standards is to ensure not just that the regulatory approach keeps pace with changes in the market but that state regulators are able to provide robust oversight that balances consumer protection, prudential regulation and market viability.

Nonbank Mortgage Servicing Administration

Mortgage loan servicing is a critical component of the broader housing finance system. Loan administration by nonbank mortgage servicing companies include the following responsibilities and servicing functions:

- Calculating, collecting, recording and remitting a mortgage loan borrower’s principal and interest payments.
- Maintaining accurate account records and customer billing statements.
- Managing mortgage escrow accounts.
- Providing accurate investor reporting.
- Collecting and managing insurance claims.
- Distributing, tracking and financing servicing advances.
- Managing delinquent and defaulted mortgage loans, as well as those in bankruptcy proceedings.
- Assessing loans for modification and other loss mitigation activities.
- Overseeing foreclosure proceedings.
- Managing real estate owned (REO) following foreclosure.
- Maintaining accurate and reliable cash management systems.
- Maintaining adequate technology, information systems and data security.
- Vendor oversight.
- Regulatory compliance, internal audit and quality control.

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\(^9\) Fannie Mae and Freddie Mac.
Nonbank mortgage servicing companies perform these functions on behalf of mortgage loan owners and guarantors, be they financial institutions, private investors, Ginnie Mae, or government sponsored enterprises (GSEs) such as Fannie Mae and Freddie Mac. Nonbank servicers earn contractually established fee income, typically based on the unpaid principal balance (UPB) of the loans serviced. Nonbank mortgage servicers may also have additional business lines, such as loan origination and warehouse lending.

Nonbank Mortgage Servicing Industry Trends

A large and increasing share of MSRs has shifted out of commercial banks and into nonbank mortgage servicing companies. The market share of the 30 largest nonbank mortgage servicers in 2011 stood at only 6% according to estimates from the Federal Housing Finance Agency (FHFA) and Inside Mortgage Finance Publications. Analysis by Inside Mortgage Finance Publications for 2014 through Q1 2020 reflects the share of agency (GSE plus Ginnie Mae) servicers to have grown from 24% to 53% while the share for banks declined to 46%, indicating the pervasive increase in servicing volume by nonbanks industry-wide. [See Figure 1]

**Figure 1. Recent Growth of Nonbank Mortgage Servicers**

![Chart showing change in agency MBS servicers by institution type from 2014 to 2020. Source: Inside Mortgage Finance]

Nonbank Mortgage Servicer Business Models
Multiple business models are evidenced in the nonbank mortgage servicing market today. Business models include Monoline Servicers, Originator-Servicers, MSR Investors and Subservicers Only. Note that some companies may have more than one characteristic of these business models.

**Monoline Servicers** are companies that own MSRs and specialize specifically in servicing, be it performing servicing, special servicing (typically for higher risk borrowers) or component servicing and without a loan origination platform. Monoline servicers reflect a business model that has declined significantly in market share in the years since the last financial crisis and notably in the years since the 2015 Proposal. The nonbank mortgage servicing market was beginning to evolve when the 2015 Proposal was released, and Monoline Servicers absorbed much of the volume shed by large banks in the aftermath of the crisis. Today, many Monoline Servicers have either been acquired, gone out of business or evolved their business model into subservicing only, or Originator-Servicer models (both discussed below).

**Originator-Servicers** originate mortgage loans and retain the associated servicing. Some companies in this model generate substantial origination volume, retain their servicing but outsource the servicing to subservicers, a fast-growing and heavily concentrated market among a notable group of banks and nonbanks. Companies that are primarily Originator-Servicers may also purchase servicing from others or even perform subservicing for others on a fee basis. This model has grown significantly in market share due to the organic growth from their origination capabilities, with a focus on agency paper (GSE and Ginnie Mae).

**MSR Investors** purchase mortgage servicing and outsource the servicing administration to subservicers. This model represents the newest and fastest growing segment of the mortgage servicing business. The emergence of MSR investors such as asset managers and real estate investment trusts (REITs) that invest in mortgage assets has pushed the market in new directions, challenging previous definitions of “mortgage servicer” and the appropriate regulatory oversight and prudential standards.

**Subservicers Only** perform the administration of servicing for others without holding MSRs or whole loans. This business model is consolidated into a small number of relatively large nonbank servicers administering the servicing for many MSR Investors or other clients.

Each of these servicing business models exhibit a different risk profile. In general, servicers face risks associated with MSR asset value (the impacts of which are dictated by MSR type held and outside economic influences), servicing liquidity needs (dictated by contractual relationship between owner and servicer, make up of servicing and market conditions) and operational risk.

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10 Where a servicer handles just one piece of the loan lifecycle, i.e., default servicing, loss mitigation evaluation, property management/preservation, etc.

11 We contrast “subservicing” with Subservicing Only to draw a delineation between servicers that own MSRs and also perform servicing administration for others and those subservices that do not own MSRs and only perform servicing administration functions for others (Subservicers Only).
(managed at the company level, but impacted by market conditions and revenue sources). Due to underlying contracts and the makeup of servicing portfolios, no two servicer risk profiles are the same. However, certain potential risk characteristics can be combined to create a generic risk profile by business model type. [See Figure 2]

**Figure 2 – Servicing Risk Matrix**

![Servicing Risk Matrix by Business Model](image)

For example, an Originator-Servicer may retain a significant amount of servicer asset valuation risk, but that risk is offset by revenue streams from origination activity that funds not only servicing liquidity needs, but operational needs as well. In contrast, a Subservicer Only has neither asset valuation risk nor servicing liquidity needs but must manage its operational risk from a finite revenue stream. Still different is an MSR Investor that bears significant asset valuation risk, but little operational risk associated with the administration of servicing.

Further complicating an understanding of servicer risk are the nuances of the contracts underpinning the servicer relationship. For example, when a servicer is required to remit payments of principal and interest as scheduled regardless of the borrower’s timely payment, a significant servicing liquidity need exists. However, when servicer payments are due only upon borrower payment, the need for servicing advance liquidity is mitigated because the funds are not contractually due until received from the borrower. The uniqueness of each servicing...
model, including the servicer contractual relationship and managerial controls and the servicing portfolio’s responses to market changes, requires regulators to have an intimate understanding of each individual company. These unique situations complicate development of industry standards.

The chart below highlights the changing dynamic of the industry based on market share of three business models just in the past five years:

![Figure 3](chart.png)

As noted, sub-servicers are critical to the current mortgage servicing business. Nonbank volume of loans and MSRs subserviced by others has more than tripled since the 2015 Proposal was released based on MCR data, with entities now in the top ten of such volume that were not even reporting UPB volumes in the first quarter of 2015. Similarly, many of the largest mortgage servicers at that time have evolved to become large Subservicers Only, a line of business that, among nonbank participants, is highly concentrated with roughly 80% market share held by the top eight companies in this business model.

There are several factors that have driven the large migration of MSRs out of banks and into nonbank servicers and investors. First, the Basel III capital rules, which apply to banks but not nonbank mortgage servicers, have made MSRs more expensive to retain for banks. While banks were previously allowed to apply the value of their MSRs to help meet Tier 1 capital requirements, the new capital rules limit the amount of MSRs that can apply to Common Equity Tier 1 (CET1) capital to 10%, though recently this has been increased to 25% for small- to midsize banks. MSRs that fall within this 10% or 25% threshold will be subject to a risk weight of 250% as of 2018, while those that exceed the respective threshold carry a dollar-for-dollar
capital charge.

The large spike in delinquent and defaulted loans following the housing downturn and financial crisis also contributed heavily to the transfer of MSRs to nonbank servicers. Indeed, a large share of the early post-crisis MSR transfers from banks to nonbank servicers (primarily monoline servicers) consisted of portfolios of troubled loans. Servicing such loans is a high-touch and labor-intensive process with significant litigation, regulatory and headline risk. Given these factors, it is likely commercial banks viewed troubled loans as too challenging and costly to continue to service.

Nonbank Mortgage Servicers’ Strengths

Nonbank mortgage servicing companies have several strengths relative to bank servicers and their business model provides several unique benefits to the market. Since servicing troubled loans is such an intensive and demanding business, companies that specialize in and concentrate their operations around servicing these types of loans are often more efficient at the process. With more advanced servicing technology systems, nonbank servicers may also be better able to offer loss mitigation alternatives to troubled borrowers. They also benefit from lower servicing costs compared to their bank-servicer peers who may face more stringent regulatory and financial requirements. As the servicing market has evolved to compensate specialty servicers on a fee-for-service basis, select nonbank servicers almost exclusively have continued to attract the business of troubled loan servicing while bank servicers have little to no appetite for the various risk exposures that come with servicing such loans.

Nonbanks now own servicing rights on almost seven out of ten loans in Ginnie Mae MBS, which is limited to government-insured FHA or V.A.- and USDA-guaranteed loans. These loans target first-time homebuyers with limited funds for down payment, veterans and their families and homebuyers in rural areas. These are critical market segments that many banks do not serve and as of November 2019 nonbanks owned servicing rights for 71.6% of UPB guaranteed by Ginnie Mae, more than double the UPB percentage in the first quarter of 2014 (source: Ginnie Mae Global Market Report.)

Nonbank Mortgage Servicers’ Weaknesses

Nonbank mortgage servicers and the regulatory framework under which they operate also have


key weaknesses. Nonbank servicers may be more susceptible to economic downturns as they do not operate under a prescribed capital standard and therefore may retain less capital. And there are no comprehensive enterprise-wide liquidity requirements or standards to ensure sufficient reserves to continue servicing the MSRs in their portfolios in the event of material financial stress.\(^\text{14}\)

The current regulatory framework does not have clear enterprise-wide expectations for internal controls, compliance and risk management systems. Nonbank servicers may not have mature policies and procedures in place to accommodate the rapid and aggressive growth of their MSR portfolios and the increased complexity of the organization.

Regulators and the industry have also recognized widespread data quality and data integrity issues, especially in the context of transferring servicing rights. Some nonbank mortgage servicers have struggled to integrate acquired loan portfolios and to locate legal and collateral documents associated with transferred loans. All these issues are exacerbated if a servicer’s operational capacity has not kept pace with its growth. After publication of the Consumer Financial Protection Bureau’s (CFPB) servicing rules implemented in January 2014 and detailed transfer requirements published by Fannie Mae, Freddie Mac and Ginnie Mae, operational controls and compliance have shown marked improvement. However, with hundreds of billions of dollars of UPB, this is an area still fraught with exposure to operational, data and documentation issues that leave borrowers, investors and counterparties exposed to potential risk.

The Current Regulatory Environment

State regulators, the CFPB, Ginnie Mae (formerly the Government National Mortgage Association) and the Federal Housing Finance Agency (FHFA) through Fannie Mae and Freddie Mac\(^\text{15}\) have all established a variety of standards that apply to nonbank mortgage servicers. For example, state regulators have established bonding, licensing and records requirements, the CFPB has issued servicing standards related to consumer protections and the FHFA and Ginnie Mae have imposed various net worth, capital and liquidity requirements. Still, these standards and requirements are not currently consistent and do not cover all servicers’ entire books of business. For example, FHFA requirements apply to Fannie/Freddie Seller/Servicers but not to Ginnie Mae Issuers and neither FHFA nor Ginnie Mae standards apply to private label servicing. Additionally, nonbank mortgage servicing companies and investors are not subject to consistently comprehensive safety and soundness standards in single-state examinations as

\(^{14}\) Note that while FHFA has proposed new Servicer Eligibility requirements with enhanced liquidity standards for servicing advances on GSE and Ginnie Mae holdings, these standards do not directly consider private label servicing portfolios or liquidity for normal or stressed business operation overhead.

\(^{15}\) Formerly known as the Federal National Mortgage Association and the Federal Home Loan Mortgage Corp. these government sponsored enterprises (GSEs) are also known as Fannie and Freddie.
they are in multistate examinations.\textsuperscript{16}

In its 2014 Annual Report, the Financial Stability Oversight Council (FSOC)\textsuperscript{17} identified the rapid growth in nonbank mortgage servicers as a market development that warranted heightened risk management and supervisory attention. FSOC recommended that state regulators work together to develop prudential and corporate governance standards for nonbank mortgage servicing companies, in collaboration with the CFPB and FHFA.\textsuperscript{18}

FSOC revisited nonbank mortgage servicing in its 2019 Annual Report\textsuperscript{19}, in which it recognized that state regulators had taken steps to mitigate nonbank servicer risks and recommended “that federal and state regulators continue to coordinate closely to collect data, identify risks and strengthen oversight of nonbank companies involved in the origination and servicing of residential mortgages.”

Alignment with FHFA Minimum Eligibility Requirements

As discussed below in the Baseline Standards, state regulators intend to align supervisory approaches wherever possible. FHFA has established Eligibility Requirements for Enterprise Single-Family Seller/Servicers that are applicable to most servicers under state jurisdiction. To lessen regulatory burden and foster consistency across regulators, these proposed state regulator standards are intended to align with the calculations for capital and liquidity under the FHFA eligibility requirements. However, state regulators intend to apply these calculations to all servicing portfolios under state jurisdiction, rather than limit coverage to agency servicing only.

\textsuperscript{16} Improvements have been made in the quality of single-state reviews since 2015, led by the multistate standards implemented by the MMC, found at CSBS.org.

\textsuperscript{17} The Financial Stability Oversight Council consists of the following members: Secretary of the Treasury, Chairman of the Board of Governors of the Federal Reserve System, Comptroller of the Currency, Director of the Consumer Financial Protection Bureau, Chairman of the Securities and Exchange Commission, Chairperson of the Federal Deposit Insurance Corporation, Chairperson of the Commodity Futures Trading Commission, Director of the Federal Housing Finance Agency, Chairman of the National Credit Union Administration, a presidentially-appointed independent member with insurance expertise, Director of the Office of Financial Research (non-voting), Director of the Federal Insurance Office (non-voting), a state insurance commissioner (non-voting), a state banking supervisor (non-voting) and a state securities commissioner (non-voting).


Scope of Proposal

This proposal is intended to cover mortgage servicers under state jurisdiction. Included in this category are MSR Investors, Originator-Servicers, Monoline Servicers, Subservicers Only and owners of whole loans. State regulators intend to seek comment on whether this scope of coverage is appropriate and whether other types of servicers (e.g., reverse mortgage servicers) should be covered. Further, this proposal differentiates between “owned” servicing and servicing for others under both the capital and liquidity requirements due to the risk of double counting MSRs.

Factors to Consider in Developing Prudential Standards for Nonbank Mortgage Servicers

In alignment with FSOC’s recommendation, state regulators have considered a variety of prudential and corporate governance standards for nonbank mortgage servicing companies. When appropriate and available, state regulators have sought to leverage existing requirements or generally accepted business practices. In the 2015 proposal, state regulators closely evaluated the following 12 factors in designing comprehensive prudential standards appropriate for nonbank mortgage servicers:

1. Capital Requirements  7. Servicing Transfers Requirements
2. Liquidity Requirements  8. Change of Control
4. Data Standards  10. Living Wills and Recovery and Resolution Plans
5. Data Protection, including Cyber Risk  11. Reserves and Valuation Methodology
6. Corporate Governance  12. Transactions with Affiliates

These 12 factors identified in 2015 are valid today and are incorporated into this 2020 proposal. This proposal outlines state regulators’ baseline prudential regulatory framework for nonbank mortgage servicers and provides additional information and analysis regarding each of the prudential standards proposed. The proposed Enhanced Standards are designed to build upon the Baseline Standards.

State regulators welcome public comment on all aspects of the proposed standards and specifically request comments on the questions that conclude this report.

A Scaled Approach

In 2015 the states expressed strongly that the standards should be scaled to minimize the
burden on less complex firms. State regulators believe that the Baseline Standards are appropriate for any covered servicer regardless of size or complexity. Additionally, this proposal applies enhanced requirements to Complex Servicers, generally considered to have a higher risk profile. Baseline Standards and Enhanced Standards are each covered in their own section below.

**No Immediate Requirement Imposed**

This proposal does not impose any immediate requirement on nonbank mortgage servicers. The standards covered in this proposal are presented for public comment. Final Regulatory Prudential Standards for Nonbank Mortgage Servicers would only become effective through state law, rule or other formal undertaking.

**BASELINE PRUDENTIAL STANDARDS**

The Baseline Standards focus on eight of the 12 factors described above:

1. Capital  
2. Liquidity  
3. Risk Management  
4. Data Standards  
5. Data Protection, including Cyber Risk  
6. Corporate Governance  
7. Servicing Transfers Requirements  
8. Change of Control

For each of these areas, state regulators propose to leverage existing standards or generally accepted business practices. This approach is intended to make the transition as easy as possible as the industry should be familiar and compliant with existing standards. In areas lacking standards directly applicable to nonbank mortgage servicers, state regulators rely on generally accepted business practices to leverage widely available resources for implementation.

In the areas of capital and servicing liquidity, this proposal aligns with FHFA’s eligibility requirements calculations and the standards will automatically change as FHFA’s requirements are modified. However, this proposal applies FHFA’s requirements to a broader set of servicing by including non-agency servicing as well. Where the Baseline Standards exceed existing standards the state regulators will consider whether an appropriate phase in period is necessary.

**Requirement:** Any servicer required by a GSE to maintain capital or liquidity in excess of FHFA’s minimum eligibility requirements must report this event to state regulators.\(^{20}\)

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\(^{20}\) Drafting note: State regulators are considering inclusion of any similar requirements by Ginnie Mae.
CAPITAL

The Baseline Standards for capital require the following:

Net Worth: Total Equity Capital as determined by Generally Accepted Accounting Principles (GAAP), MINUS goodwill and other intangible assets (excluding mortgage servicing rights); and MINUS receivables from related parties and pledged assets net of associated liabilities.

Minimum Net Worth
- The higher of $2.5 million net worth plus 25 basis points of owned UPB for total 1 – 4-unit residential mortgage loans serviced\(^{21}\), OR
- FHFA Eligibility Requirements for Enterprise Single- Family Seller/Servicers\(^{22}\) (as modified from time to time).
- Clarification: For Subservicers Only that are not originators and do not own MSRs or whole loans: Minimum net worth requirement is $2.5 million net worth with no additional add on for UPB.

Minimum Capital Ratio
- The higher of Net Worth / Total Assets $\geq 6\%$, OR
- FHFA Eligibility Requirements for Enterprise Single- Family Seller/Servicers (as modified from time to time).

LIQUIDITY

- Servicing Liquidity: The financial resources necessary to manage liquidity risk for MSRs and loans owned by the servicer arising from servicing functions required in acquiring and financing MSRs, margin calls associated with financing facilities, and advances or costs of advance financing for principal, interest, taxes, insurance and any other servicing related advances.
- Operating Liquidity: The funds necessary to perform normal business operations, such as payment of rent, salaries, interest expense and other typical expenses associated with operating the entity. Consideration of such liquidity includes an understanding of increases in operating needs due to changing economic climate or other stresses impacting servicer operations.

\(^{21}\) State regulators intend to seek comments on whether this term should include whole loans.

State regulators limit the assets that may be used to satisfy liquidity requirements to high quality asset classes.

- Allowable Assets for Liquidity: Assets that may be used to satisfy these liquidity requirements include unrestricted cash and cash equivalents and unencumbered investment grade assets held for sale or trade (agency MBS, obligations of GSEs, US Treasury obligations). Allowable assets do not include unused/available portions of committed servicing advance lines of credit or other unused/available portions of credit lines such as normal operating business lines.

**Minimum Servicing Liquidity**

State regulators intend to rely on the eligibility requirement calculations established by FHFA but apply these calculations to the entire owned servicing portfolio, including whole loans.

**Requirement:**
- Base Servicing Liquidity:
  - The higher of 3.5 basis points of agency servicing\(^\text{23}\) UPB plus non-agency servicing UPB, or
  - FHFA Eligibility Requirements for Enterprise Single- Family Seller/Servicers applied to both agency and non-agency servicing (as modified from time to time).

Servicing loans in forbearance, delinquency or foreclosure imposes additional costs on servicers and thus requires additional financial resources to cover these costs. Accordingly, the Baseline Standards include an incremental non-performing loan (NPL) charge to enhance the sensitivity of liquidity requirements to portfolio performance. Due to the incremental nature of the charge, as the volume of NPLs increase, so too do the servicer’s liquidity requirements.

**Requirement:**
- Incremental Non-Performing Loan (NPL) Charge
  - The higher of an incremental 200 basis points charge on NPLs for the portion of agency and non-agency NPLs greater than 6.0% of total servicing, or
  - FHFA Eligibility Requirements for Enterprise Single- Family Seller/Servicers applied to both agency and non-agency NPLs (as modified from time to time).

Note: This proposal does not require minimum Servicing Liquidity for the subserviced portion of a portfolio.

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\(^{23}\) Agency servicing includes mortgage loans purchased or securitized by Fannie Mae or Freddie Mac and loans made, insured, or guaranteed by the Department of Housing and Urban Development, Department of Veterans Affairs, or Department of Agriculture.
Requirements for Maintaining Appropriate Levels of Operating Liquidity

While the above standard addresses the funds needed for servicing functions, Operating Liquidity is not directly addressed. The Operating Liquidity requirement for state-licensed mortgage servicers (below) takes into consideration this gap in existing standards.

**Requirement:** All servicers must maintain sufficient Allowable Assets for Liquidity in addition to the amounts required for minimum Servicing Liquidity to cover normal or non-servicing related operating expenses and general business risk (as described under Operating Liquidity above). In general, all servicers, regardless of size and complexity must have in place sound cash management and business operating plans that match the size and sophistication of the institution. Management is expected to develop, establish and implement plans, policies and procedures for maintaining Operating Liquidity sufficient for the ongoing needs of the institution.

State regulators acknowledge that some servicers may maintain Allowable Assets for Liquidity in excess of the financial resources needed to cover the costs of servicing. State regulators believe this excess should be considered available for Operating Liquidity needs. In other words, if a servicer maintains the required 3.5 basis points of liquidity for its entire portfolio, but on average, its cost coverage for servicing is less than this amount, then the excess funds should be considered available to cover Operating Liquidity.

**Requirement:** In addition to policies and procedures implementing the minimum Servicing Liquidity requirements above, management is required to have a sustainable written methodology for determining and maintaining, at all times, sufficient Operating Liquidity to ensure normal business operations, as well as recovery or orderly wind-down of critical operations and services. This methodology should account for the following factors:
- Servicer business model
- Composition of portfolio
- Allowable assets for liquidity
- Average monthly operating expense need
- Excess funds after coverage of monthly servicing expenses available to cover operating expenses

**RISK MANAGEMENT**

Nonbank mortgage servicers face multiple risks which need to be appropriately managed through a variety of market and economic cycles. The ability of nonbank mortgage servicers to internally measure, monitor and mitigate risks inherent to servicing will help increase the
financial strength of nonbank servicers and is a prudent business practice.

**Requirement:** All organizations must establish a risk management program under the oversight of the board of directors. The risk management program must have appropriate processes and models in place to measure, monitor and mitigate financial risks and changes to the risk profile of the firm and assets being serviced. The risk management program must be scaled to the complexity of the organization, but be sufficiently robust to manage risks in several areas, including, but not limited to:

- Credit risk
- Liquidity risk
- Operational risk
- Market risk
- Compliance risk
- Reputation risk

A risk management assessment must be conducted on an annual basis concluding with a formal report to the board of directors. Evidence of risk management activities throughout the year must be maintained, including findings of issues and the response to address those findings.

**DATA STANDARDS**

Federal regulation requires data and documentation standards for all entities that service more than 5,000 loans through the Mortgage Servicing Rules under the Real Estate Settlement Act (Regulation X)\(^{24}\) and Mortgage Servicing rules under the Truth in Lending Act (Regulation Z)\(^{25}\), collectively referred to as the “Mortgage Servicing Rules.” The Mortgage Servicing Rules require that within five days of a request by the borrower the servicer must be able to retrieve the following documents and data on each mortgage loan serviced:

- Transactions credited or debited to the loan account, including escrow and suspense.
- Security instrument.
- Notes created by servicing personnel.
- Data fields created by the servicer’s systems; and
- Copies of information provided by the borrowers to the servicer.


**Requirement:** Baseline Standards will require the Mortgage Servicing Rules standards to apply to all nonbank mortgage servicers and all serviced loans. As part of effective risk management, all firms will be required to have a documented process for onboarding, maintenance and internal audit of serviced loans.

**DATA PROTECTION**

For the nonbank mortgage servicing industry, significant operations are data dependent. Information security is a critical component in protecting customer information and privacy. In addition, strong controls over the protection of customer data mitigate the likelihood of a cyber-threat, security breach, or identify theft.

Data protection in the Baseline Standard is covered in three sections: governance over the information technology (IT), information technology security risk assessment strategy and routine information technology testing and monitoring.

**Requirement:**

**Governance over IT** must include:

- An effective management structure that encompasses proper responsibilities and authorities.
- Documented accountability that provides clear reporting lines, clear expectations and the use of authority to achieve compliance with policies and standards.
- Strong oversight by the board of directors.
- Documented board approval of written IT policies.
- Senior Management having appropriate responsibility to ensure integration of controls; and
- Security Officers having appropriate authority to respond to security events that occur.

**IT Security Risk Assessment** encompasses:

- Identifying the data that needs protecting.
- Identifying the entity’s outsourcing strategy.
- Classifying and ranking sensitive data.
- Assessing threats and vulnerabilities.
- Evaluating control effectiveness.
- Prioritizing risks.
- Assessing the probability of an event occurring and the impact the event will have; and
- Identifying gaps in internal controls.
IT Security Testing and Monitoring include:

- Monitoring threats.
- Evaluating emerging threats.
- Monitoring for external vulnerabilities and developing mitigation strategies.
- Performing periodic self-assessments.
- Adopting timely corrective action of significant deficiencies.
- Consideration of business continuity and disaster recovery.
- Assessing the scope impact and urgency of new threat vulnerabilities; and
- Reassessing the security environment and enhancing, as necessary.

CORPORATE GOVERNANCE

Requirement:

The board of directors of a nonbank mortgage servicer must establish a sound corporate governance framework to protect the financial, reputational, cultural and strategic interests of the firm and the firm’s stakeholders and set minimum standards of acceptable behavior for employees. The board of directors must also establish an appropriate set of internal controls, as well as a method for independently validating the accuracy and reliability of the financial and servicing information of the firm. Accurate and reliable information is necessary to monitor compliance with prudential standards, evaluate emerging risks and file an accurate Mortgage Call Report.26

Internal audit requirements must be appropriate for the size and complexity and risk profile of the firm. Ginnie Mae reporting standards will be used as the Baseline Standard.27 The requirements include audited financial statements and audit reports conducted by an independent public accountant (IPA) including:

- Assessment of the internal control structure.
- Computation of adjusted net worth.

26 The Mortgage Call Report (MCR) is a quarterly report of residential real estate loan origination, servicing and financial information completed by companies licensed in NMLS. For more information, visit the NMLS Resource Center, available at: https://mortgage.nationwidelicensingsystem.org/slr/common/mcr/Pages/default.aspx
- Validation of valuation reserve methodology.
- Verification of adequate fidelity and errors and omissions (E&O) insurance.
- Compliance testing over servicing, pooling and reporting activities; and
- Testing of controls around risk management activities, including stress testing and compliance.

SERVICE TRANSFER REQUIREMENTS

The Baseline Standards for servicing transfers will align with the CFPB's Compliance Bulletin and Policy Guidance: Mortgage Servicing Transfers.\textsuperscript{28} The bulletin sets forth guidance addressing not only the data mapping problems so often experienced during a large transfer of loans, but also the compatibility of the data. Additionally, FHFA Advisory Bulletin 2014-06: Mortgage Servicing Transfers provides guidance required for participation in their programs.\textsuperscript{29}

Requirement:

The Baseline Standards incorporate both sets of guidance, including these general principles:

- Maintain policies and procedures that are reasonably designed to achieve the objective of facilitating the transfer of information during mortgage servicing transfers.
- Implement a post-transfer process for validating data to ensure it is transferred correctly and is functional, as well as develop procedures for identifying and addressing data errors for inbound loans.
- Organize and label incoming information, as well as ensure that the transferee servicer uses any transferred information before seeking information from borrowers; and
- Conduct regularly scheduled calls with transferor servicers to identify any loan level issues and to research and resolve those issues within a few days of them being raised.


CHANGE OF OWNERSHIP AND CONTROL REQUIREMENTS

Requirement:

All nonbank mortgage servicers must provide 30 business days prior notification of a change in ownership of 10% or more of a mortgage servicer.

Such notice is intended to permit regulators to initially evaluate the proposed change in ownership and determine whether additional information about the new owners is needed to permit regulators to thoroughly evaluate the new owner’s financial capacity and management expertise to effectively operate the nonbank mortgage servicer. If such a determination is made, regulators will notify the applicant and seek additional information about the owners’ financial capacity and management experience.

ENHANCED PRUDENTIAL STANDARDS AND HEIGHTENED SUPERVISORY EXPECTATIONS

Beyond the Baseline Standards proposed for all servicers, certain servicers (referred to as Complex Servicers) will be subject to Enhanced Prudential Standards as well as heightened supervisory expectations based on their other lines of business, size, risk or overall complexity, as discussed more fully below. State regulators see a need for Complex Servicers to have in place advanced risk management and management information systems to mitigate risk. Specifically, these Complex Servicers must deploy enhanced planning, modeling, metrics and audit in the following four areas:

1. Capital
2. Liquidity
3. Stress Testing

The Complex Servicer’s management and board of directors is expected to develop and utilize methodologies to determine and monitor appropriate measures for the firm in each of the above areas. The methodologies must quantify the appropriate level of support and risk tolerance of the Complex Servicer. The approaches must account for balance sheet and off-balance sheet activity and exposures. Capital and liquidity must ensure ongoing operations and accommodate a moderate stress environment.

Independent third-party assessment will be considered an important part of the Enhanced Standards. The third-party vendor must have expertise in developing and validating risk
management modeling assumptions and should provide confirmation to the regulators that the model is appropriate, the assumptions are valid and the outcomes realistic.

**Complex Servicer Identification**

Determining a threshold for companies identified as Complex Servicers includes a consideration of factors such as the number or dollar amount of loans serviced, the composition of the servicing portfolio, the entity’s primary business (e.g., subservicing, master servicer, etc.) and business model, endogenous factors unique to the institution and exogenous factors likely to have significant effect on the institution due to portfolio or business model risk.

The table below [Figure 4] of the number of nonbank servicers within categories of UPB of servicing owned plus whole loans held for sale or investment reflects potential thresholds for consideration of Complex Servicer based on the size of the servicer.

<table>
<thead>
<tr>
<th>Unpaid Principal Balance of Owned Servicing and Whole Loans</th>
<th># of nonbank Servicers at 3/31/2020</th>
<th>Cumulative Market Share of Covered Nonbank Licensees</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100 billion</td>
<td>8</td>
<td>58.12%</td>
</tr>
<tr>
<td>$80 billion</td>
<td>9</td>
<td>60.70%</td>
</tr>
<tr>
<td>$75 billion</td>
<td>11</td>
<td>65.21%</td>
</tr>
<tr>
<td>$50 billion</td>
<td>20</td>
<td>80.45%</td>
</tr>
</tbody>
</table>

Source: NMLS Call Report Data

While UPB can be argued as the single greatest factor in determining the complexity of servicers, other factors such as the level of delinquencies in the portfolio, the risk profile of the loans in the portfolio and company financial structure are also factors evidencing complexity of the servicer.

Complex servicers are those servicers owning whole loans plus mortgage servicing rights (MSRs) totaling the lesser of $100 billion or representing at least a 2.5% total market share based on Mortgage Call Report (MCR)\(^{30}\) quarterly data of licensed nonbank owned whole loans and MSRs. In addition, state regulators may determine specific servicers, including subservicers, not meeting the above definition of Complex Servicer to be included and subject to the Enhanced Standards and supervisory expectations based on a unique risk profile, growth, market importance, or financial condition of the institution.

\(^{30}\) Nationwide Multistate Licensing System (NMLS) reports required under state statute or rule.
CAPITAL

Capital standards applicable to Complex Servicers should be commensurate with the risk within the entire firm.

Requirement:

The firm’s management and board of directors is expected to develop a methodology to determine and monitor the entire firm’s capital needs. This methodology must incorporate the risk characteristics, described below, that influence the overall risk profile of the entity.

Risks from a Particular Servicing Class

The composition of a servicing portfolio can vary and include differing levels of risk to the servicer based on:

- Size of each portfolio segment owned (proprietary, private label, Ginnie Mae, GSE);
- Size of portfolio serviced for others; and
- Advancing requirements across each portfolio segment.

Risks from Particular Loan Types

Different loan types present different levels of financial and operational risk to servicers. Each of the following loan types have significantly different risk characteristics dictating varying levels of capital need based upon the inherent risk:

- Prime
- Non-prime
- Jumbo
- Agency (GSE and Ginnie Mae)
- Non-QM

The Complex Servicer’s management and board of directors is responsible for developing a methodology for supporting the capital adequacy of the firm and the capital planning process. The methodology must appropriately incorporate unique risks from these loan types, as well as other idiosyncratic risks and must be validated by an independent third party.

LIQUIDITY

Liquidity management is integral to a comprehensive prudential regime. Adequate liquidity
levels held by Complex Servicers will minimize the likelihood that financial downturns have an adverse effect on these entities and provide regulators more options if severe problems require regulatory remedies.

**Requirement:**

Liquidity risk management must include a framework that encompasses cash flow projection analysis, a diversified funding strategy, stress testing and sound contingency funding plans.

The Complex Servicer’s management and board of directors is expected to develop and routinely utilize a methodology to measure and monitor the liquidity needs of the enterprise. The methodology must quantify the amount of necessary on-balance sheet liquidity to ensure normal operations during a moderate stress environment. Complex servicers must maintain on-balance sheet liquidity consisting of Allowable Assets for Liquidity described under the Baseline Standards. The methodology must quantify the use of any off-balance sheet liquidity such as use of special purpose entities, parent company or affiliate support, unfunded or uncommitted lines of credit or other sources. Any forms of off-balance sheet liquidity must be tested and will be subject to regulatory review and approval.

**Minimum Operating Liquidity**

In addition to the Baseline Standards for Operating Liquidity for all servicers, for Complex Servicers, minimum Operating Liquidity amounts will be determined on an individual company basis. Management is expected to develop, establish and implement plans, policies and procedures for complying with liquidity requirements imposed by state regulators.

State regulators will evaluate the Complex Servicer’s liquidity methodology and implementation of the methodology and require additional operating liquidity where deemed necessary. In conducting servicer reviews, examiners will consider institution and market risks including:

1. Asset concentration in MSRs.
2. Examination ratings for operational compliance.
4. Servicer advancing obligation for each counterparty and availability of custodial funds to support advancing obligations.
5. Cost and availability of financing for servicing operations and advancing obligations.
6. Hedging strategy.
7. Corporate credit ratings.
8. Corporate family considerations, including affiliate or parent company support or exposure.
9. Stability and oversight of third-party sub-servicer, if applicable.
10. Planned or recent growth of portfolio or business.

Complex servicers that do not hedge their MSR portfolio may be directed by state regulators to carry additional liquidity or document why they do not hedge and the evaluation process they utilized in deciding this strategy.

**STRESS TESTING**

Stress testing is an analysis or simulation used on asset and liability portfolios to determine the impact caused by different financial and economic hypothetical situations or scenarios. Complex servicers will be required to maintain a robust, forward-looking capital and liquidity planning process that considers the servicer’s unique markets and risks. The process should inform the firm’s ability to maintain sufficient capital and liquidity throughout times of economic and financial stress.

Independent third-party assessment and validation is considered an important part of the stress testing regime. A third-party vendor with expertise in developing and validating risk modeling assumptions provides state regulators with confirmation that the model is appropriate, the assumptions are valid and the outcomes realistic.

**LIVING WILL AND RECOVERY RESOLUTION PLANS**

Although FSOC has not designated any nonbank mortgage servicers as systemically important financial institutions, these firms play a critical role in the housing market. During periods of material financial stress, living wills provide a critical roadmap that clearly illustrates the ownership and operational structure of the organization and outlines a possible path to recovery should certain events pose significant hardship for a Complex Servicer.

The roadmap also outlines the necessary steps for management or the regulators to execute an efficient and orderly resolution should failure become inevitable. Typical resolution plans include:
- Consolidated financial information.
- Description of the corporate entity and corporate family.
- Description of principal business lines.
- Description of foreign operations.
- Identity of vendors key to the firm’s operations.
- Identity of principal officers.
- Identity of key creditors and credit terms.
- Description of material management information systems; and
Outline of a recommended plan, with descriptions of potential purchasers of either servicing rights, bulk transfers, or the company outright.

**Requirement:**

Complex Servicers are expected to develop and maintain a living will and recovery resolution plan, subject to state regulator review and approval.
REQUEST FOR PUBLIC COMMENT

State financial regulators supervise the nonbank mortgage industry, including mortgage servicers. Over the years, state regulators have used established standards and common practices to perform supervision of this industry. More recently, though, state regulators believe that formalizing and adding to these standards and practices by adopting prudential standards are appropriate steps given the market growth of nonbank mortgage servicers.

To this end, CSBS is requesting public comment on “Proposed Regulatory Prudential Standards for Nonbank Mortgage Servicers” and seeks feedback on specific questions that will help inform state regulators as we continue to develop a consistent regulatory structure for nonbank mortgage servicers. All public comments will be made available at www.csbs.org.

CSBS appreciates any feedback and response to the proposed standards. Although we solicit your response to specific areas through the questions below, we are interested in any other observations you can provide on the standards.

Where the standards are vague or imprecise, we seek your guidance in striking the appropriate balance between consumer protection, safety and soundness and regulatory burden. For each of your comments, please reference the section in the standards you are referring to and provide as much specificity and detail as will help us understand your observation, concern, or suggestion. With all comments, please provide your name, organization, email and phone contact.

We appreciate your responses. All comments are due by December 31, 2020.

Please submit comments to: PS.Publiccomment@csbs.org

Specific areas in which we are interested in feedback are listed below:

General

1. Is the need for state prudential standards sufficiently established?
2. Do any of the standards threaten the viability of a servicer or a specific subsector within the industry?
3. What is a reasonable transition period to implement the standards?
4. Are there specific standards that would require additional time to implement?
5. What effect will the enhanced standards have on the warehouse and advance facility borrowing contracts/capacity of large servicers?

Coverage

6. Do you agree with a scaled approach for coverage where all servicers are subject to Baseline Standards and Complex Servicers only are subject to Enhanced Standards?
7. Nonbank servicer coverage in this proposal is intentionally unspecific. We seek comment to assist in the appropriate coverage triggers. In this proposal, we have not established a de...
minimis threshold for baseline coverage. Further, we have limited coverage of Subservicers Only and have excluded companies that only perform servicing for reverse mortgages. Finally, we have proposed a triggering level for Complex Servicers that would be subject to the Enhanced Standards. We request comment on the following:

a. Should there be a de minimis threshold (a minimum volume or size threshold that triggers coverage)? Please identify any threshold and explain your reasoning.

b. What risk factors besides size of servicing portfolio are appropriate to consider for those servicers that have no agency servicing volume and therefore are not covered by either FHFA or Ginnie Mae requirements?

c. Have we struck the correct balance for Subservicer Only coverage as well as exclusion of portfolios serviced for others? Please explain any disagreement with our inclusion/exclusion of subservicing activity.

d. Do you agree or disagree on whether servicers performing only servicing for reverse mortgages should be excluded from this proposal? If you disagree, please explain your reasoning.

e. What size or volume of servicing do you believe is the appropriate threshold for a Complex Servicer? Please explain.

f. Are there specific risk factors that should be considered in the evaluation for inclusion or exclusion as a Complex Servicer? Please provide detail.

Capital and Liquidity

8. The capital and liquidity components of this proposal align with existing and future FHFA Seller/Servicer requirements where possible. Do you support such alignment?

9. Do you agree with the components included in the calculation of net worth? Is there an alternative calculation that would be more effective?

10. State supervisors hold jurisdiction over a nonbank servicer’s entire portfolio. Do you feel that applying the FHFA calculations to all owned servicing is an appropriate approach for these standards?

11. These standards define two types of liquidity need: Servicing Liquidity for the direct performance of servicing and Operating Liquidity for general operations of the organization. Do you agree with these definitions? What alternative definitions would you propose?

12. Allowable Assets for Liquidity is intended to align with FHFA’s 2019 Servicer Eligibility 2.0 Proposal. Do you agree with this alignment?

Corporate Controls

13. Do the Risk Management standards appropriately capture the risks faced by nonbank mortgage servicers?

14. Is it a reasonable expectation that all covered servicers establish a risk management program under a board of directors scaled to the complexity of the organization?
15. Is it appropriate for the Data Standards to incorporate the CFPB’s Mortgage Servicing Rules standards? What alternative standards should we consider?

16. Are the Data Protection standards appropriate for the data risks inherent in nonbank mortgage servicers?

17. Is it appropriate to rely on the Ginnie Mae audit standards for Corporate Governance?

18. Should all covered nonbank mortgage servicers be required to have a full financial statement audit conducted by an independent certified public accountant?

19. Is it appropriate for the Servicing Transfer Requirements to rely on existing CFPB and FHFA transfer requirements?

20. For Change of Ownership and Control, do you believe we have chosen the correct number of days for notification and the appropriate ownership percent trigger?