COMMUNITY
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March 17, 2020

FHFA Proposed Increases in Financial Requirements for Seller/Servicers

Hon. Mark Calabria
Director, Federal Housing Finance Agency
400 7th Street SW
Washington, DC 20024

Dear Director Calabria:

We write to urge the Federal Housing Finance Agency (FHFA) to suspend implementation of its proposed increased financial requirements on GSE seller-servicers - since they are likely to aggravate concerns about credit availability for both mortgage lenders and mortgage borrowers during the current period of severe economic uncertainty caused by COVID-19 (the coronavirus).

Further, if and when FHFA decides to implement these requirements, CHLA urges FHFA **NOT** to apply these new requirements to smaller IMBs (e.g. those under $10 billion in servicing), pending analysis of differences between large and small seller/servicers. It is our understanding that the modeling used to develop the uniform requirements did not distinguish between the significantly different advance responsibilities and operational performance of large and small servicers.

CHLA is the only national association that exclusively represents independent mortgage bankers (IMBs), the very type of non-bank entities that are targeted for significantly increased net worth and liquidity requirements in this proposal. CHLA members are small and small to mid-sized non-bank GSE seller/servicers – which have led the way in access to mortgage credit in recent years.

6 MONTH SUSPENSION - IMPACT OF CORONAVIRUS

All indications are that the coronavirus is likely to have a severe negative impact on the economy. Congress and the Administration are contemplating a number of actions to address economic dislocations, potential restrictions in credit availability, and reduced personal income. Moreover, the pending Congressional coronavirus legislation imposes significant new sick pay requirements on smaller businesses, raising concerns about the financial impact on such entities.

Independent mortgage bankers (IMBs) play a critical role in the origination and servicing of mortgage loans – accounting for over 50% of all new mortgage loans. In this environment, it would be destabilizing to establish significantly more stringent net worth and liquidity requirements on IMB seller/servicers at this time. The result could be a contraction in the availability of mortgage credit – including for mortgage refinancing, which is an important source of financial liquidity for consumers at a time when personal finances are under severe strain.

Thus, we call on FHFA to suspend implementation of the proposed servicing requirements.

NEW REQUIREMENTS SHOULD NOT APPLY TO SMALL IMBs

If and when FHFA implements these new requirements, it is CHLA's conclusion that a "one-size-fits-all approach" - applying significantly higher liquidity requirements equally to both small and large seller/servicers - is not justified by a counterparty risk analysis, and could in some ways increase risk – for the following reasons:

(1) Applying these requirements to small seller/servicers ignores the significant financial and systemic risk differences between large and small servicers, failing to consider: (a) the low advance risk of actual/actual servicers, (2) the lower costs of transferring distressed portfolios of small servicers, and (3) small servicers' better servicing performance record.

(2) Applying these new liquidity requirements to small servicers would increase systemic risk, by driving servicing from smaller to more concentrated, riskier large servicers.

(3) Applying the requirements to small seller/servicers increases their risk - reducing MSR values, increasing regulatory and warehouse lending risk, and causing Ginnie Mae defaults.

(4) Applying these requirements to small seller/servicers does not appear to give due consideration to the impact on small businesses (along the lines of SBREFA).

Therefore, CHLA calls on FHFA <u>not</u> to apply these new requirements to smaller seller/servicers (e.g., <$10 billion in servicing), <u>unless and until</u> these issues are fully addressed.

<u>Small Seller/Servicer Financial Increases Not Justified by Counterparty Risk</u>

CHLA acknowledges that Fannie Mae and Freddie Mac have a legitimate interest in establishing financial requirements with the objective of having viable individual seller-servicers – fully able to meet counterparty risk obligations, advance responsibilities, and servicing and loss mitigation functions that go with servicing GSE loans.

CHLA did not object when Fannie and Freddie increased the minimum net worth to $2.5 million in 2015, a tenfold increase. However, CHLA believes these proposed requirements - particularly with respect to liquidity - are not justified with respect to smaller servicers, based on an analysis of counterparty risk (including ways in which the proposals increase risk), on the advance responsibilities of smaller servicers, and on a cost-benefit impact analysis of access to credit.

Over the last few years, Ginnie Mae has heightened its scrutiny of non-bank issuers. However, Ginnie Mae has explicitly acknowledged substantive differences in financial and systemic risk between its largest and smaller issuers, including introducing the concept of stress testing only for its largest issuers. This distinction is grounded in reality. Unwinding large, complex servicers is much more complex than unwinding smaller, community-based servicers. Additionally, the costs of resolving large servicing portfolios is much larger, both because of the portfolio size and the relative ability of other servicers to take over a portfolio.

Unfortunately, the proposal appears to ignore differences between large and small servicers.

CHLA cannot opine as to the reasonableness of the proposed net worth and liquidity increases as they would apply to large seller/servicers. However, for smaller seller/servicers – e.g. those with a servicing portfolio of less than $10 billion - these increases do not seem proportional to their counterparty risk of loss or their advance risks, for a number of reasons.

It is our understanding, based on conversations with FHFA, Fannie, and Freddie, that there are three primary categories of risk underlying these increased financial requirements: (1) rep and warrant risk, (2) risk associated with portfolio trading losses, and (3) advance risk.

We would note that smaller servicers do not generally engage in portfolio trading, and therefore are not at risk of loss for this. Counterparty risk relating to non-performance in honoring reps and warrants, due to improperly underwritten loans, is a legitimate concern. Further, while we do not have access to analysis justifying the proposed net worth increases, we acknowledge that net worth is a valid tool to ensure viability and performance on reps and warrants.

However, liquidity requirements are typically set to ensure that servicers have the liquidity needed to meet advance responsibilities. For many reasons, CHLA believes that the significantly more stringent liquidity standards being proposed are not justified for smaller servicers.

Most small servicers operate under an actual/actual model (i.e. they don't have advance responsibilities when a borrower misses a payment); thus, advance risk for small servicers is much smaller. It is our understanding that the modeling used to generate the liquidity requirements did not distinguish between actual/actual servicers and actual/scheduled servicers. This alone calls into question the application of more stringent liquidity requirements to smaller servicers.

We are also not aware of whether the decision to apply these requirements equally to large and smaller seller/servicers took into account the differences in their business models, the greater degree to which smaller IMBs have skin in the game, and the superior operational and servicing performance of smaller IMBs, as attested to by various post 2008 housing crisis reports

Higher Smaller Seller/servicer Requirements Would Increase Systemic Risk

Higher financial requirements for smaller seller/servicers would drive some of them out, increasing servicer concentration, and increasing financial and systemic risks to Fannie Mae and Freddie Mac.

Higher Small Seller/servicer Financial Requirements Would Increase Their Risk

(1) The proposal would increase regulatory risk where there is currently no market risk, causing IMB warehouse lenders for smaller IMBs to reduce credit availability due to the higher requirements (particularly the revised NPL thresholds during an economic downturn) and due to uncertainty that additional requirements might follow in the future.

(2) The proposal will create defaults with Ginnie Mae issuers where none currently exist under Ginnie Mae guidelines, since a GSE default triggers a Ginnie Mae default.

(3) Analysts such as Compass Point have concluded that proposed requirements will reduce MSR values. This will increase financial risk, particularly for small IMB seller/servicers.

(4) Elimination of lines of credit as a source of liquidity will reduce small IMBs' financial flexibility, without any clear rationale why this source of funding is excluded.

Applying Financial Requirements to Small IMBs Ignores Small Business Impact

The Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) requires certain agencies, including the CFPB, to convene panels to assess the impact of new regulations on small businesses, creating an opportunity to provide advice and recommendations on regulatory alternatives to maximize the burden on small entities. SBREFA has been used in a number of mortgage rulemakings – including TRID, RESPA, LO Comp, and HMDA.

While SBREFA is not required for FHFA, we believe it is appropriate for FHFA to conduct some analysis of the impact of the proposed increase in net worth and liquidity requirements on smaller business – taking into consideration the following issues:

(1) A more concentrated market of seller/servicers – as a result of higher barriers to entry and a reduction in the number of existing seller/servicers - would mean fewer GSE lenders originating loans, thus reducing consumer choice and increasing mortgage rates/costs.

(2) Less competition and potentially higher rates on FHA loans, as a result of liquidity ratios that are higher than Ginnie Mae ratios with respect to GSE loans, and which therefore will create incentives to reduce Ginnie Mae issuance and in turn FHA loan origination.

In closing, we appreciate your consideration of these recommendations.

Sincerely,

COMMUNITY HOME LENDERS ASSOCIATION

CC: Hugh R. Frater, CEO, Fannie Mae
David Brickman, CEO, Freddie Mac