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Mr. John Ryan
Conference of State Bank Supervisors
1129 20th Street, NW, 9th Floor
Washington, DC 20036

**PROPOSED REGULATORY PRUDENTIAL STANDARDS
FOR NONBANK MORTGAGE SERVICERS 2020**

Dear Mr. Ryan:

The Community Home Lenders Association (CHLA) is pleased to submit these comments in response to the proposal by the Conference of State Bank Supervisors (CSBS) for model regulatory prudential standards for non-bank mortgage servicers. CHLA submits these comments as the only national association exclusively representing independent mortgage bankers (IMBs) - non-banks that originate and service mortgage loans.

CHLA supports CSBS' objective of having prudential servicing standards that cover all sectors of the servicing industry, including non-banks, in order to protect consumers and foster confidence that servicers meet financial standards to ensure continuity in loan servicing. CHLA supports CSBS proposed enhanced state requirements for larger Complex Servicers. Baseline requirements are also appropriate to close the current regulatory gap - which is servicing of non-agency loans, including riskier non-QM loans.

However, Fannie Mae, Freddie Mac, and Ginnie Mae already impose robust capital, liquidity, and corporate management servicing requirements and conduct ongoing supervision of approved seller-servicers/issuers.

CSBS is not proposing a uniform model law where all states adopt identical requirements. Instead, CSBS is encouraging each of the 50 states to impose financial and management requirements that could differ from state to state, and would be duplicative of but slightly different from Fannie/Freddie servicing requirements. Therefore, imposing such requirements on smaller Fannie/Freddie (or Ginnie Mae) servicers that service *de minimi*s levels of non-federal agency loans would provide little or no discernible regulatory benefit – while adding significant and costly reporting, compliance, and exam burdens on such small businesses.

Without changes to the CSBS proposal, the impact would likely be to drive smaller community-based servicers out of the servicing business and to transfer their existing servicing to nationwide mega-servicers. In turn, this would likely: (1) increase (not decrease) financial risk, (2) increase systemic risk in servicing, & (3) harm consumers both through reduced competition and higher servicing costs and by replacing localized, personalized servicing with impersonal, automated, inaccessible servicing done by national servicers.

<u>CHLA Recommendations</u>: To address smaller servicer concerns and target regulation where most needed:

1. **Smaller servicers that service *de minimis* numbers of non-Federal agency mortgage loans should be deemed to be in compliance with the final CSBS servicing requirements if they are a Fannie Mae or Freddie Mac approved seller-servicer (or Ginnie Mae issuer) in good standing.**

2. **Individual states should exempt servicers with statistically insignificant numbers of total loans serviced in their state from the new requirements that CSBS establishes in their final proposal.**

3. **To minimize regulatory burdens, new servicing requirements should be maximally aligned with Fannie/Freddie requirements, and multi-state exams should be used whenever possible.**

4. **The proposed Enhanced Regulatory Standards for Complex Servicers are appropriate, since such servicers constitute the great majority of consumer, financial, and systemic servicing risk.**

<u>Identifying the Mortgage Servicing Regulatory Gap</u>

CSBS states that *"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 . . . there are no comprehensive enterprise-wide liquidity requirements."* CSBS also states that *"The current regulatory framework does not have clear enterprise-wide expectations for internal controls, compliance and risk management systems."*

The CSBS proposal concludes that *"State regulators believe that the Baseline Standards are appropriate for any covered servicer regardless of size or complexity."* On the basis of these conclusions, CSBS is proposing servicing requirements that it is encouraging <u>**all**</u> 50 states to adopt for <u>**all**</u> non-bank servicers.

CHLA believes this is appropriate for servicers that service non-*de minimis* levels of non-agency loans, in order to impose financial and management requirements that apply to such loans, particularly if the servicer is not currently subject to comparable Fannie Mae, Freddie Mac, or Finnie Mae requirements.

Non-agency lending and servicing was a significant portion of the market in the period leading up to (and significantly contributing to) the 2008 housing crisis. Types of non-agency loans include:

(1) Private label securities (PLS), including REIT-sponsored loans.

(2) Jumbo loans (not eligible for conventional or FHA financing) that are held in portfolio.

(3) Non-QM loans that are held in portfolio.

(4) QM non-agency loans that are held in portfolio (which are likely to expand once the CFPB completes its elimination of DTI calculations as part of its pending proposed QM changes.

However, the CSBS conclusions cited above about financial and management deficiencies that formed the basis of their proposal and recommendation that each state adopt their own requirements do <u>not</u> apply to Fannie Mae or Freddie Mac approved servicers of Fannie/Freddie loans. Similarly, they do <u>not</u> apply to issuer/servicers of Ginnie Mae securities, which securitize underlying Federal Housing Administration (FHA), Rural Housing Service (RHS), and Veterans Administration (VA) loans.

Servicers of these federal agency loans are already subject to robust capital, liquidity, and corporate management requirements, with ongoing, vigorous supervision. CSBS itself acknowledges that it has developed its proposed requirements as much as possible by mirroring FHFA requirements: Capital Requirements are identical, Liquidity Requirements are similar, and Baseline 3 to 8 Standards are functionally equivalent. This letter explains in detail why these requirements are largely duplicative.

The common business model of the majority of smaller non-bank independent mortgage bankers that service loans is to originate and service federal agency loans – servicing at most *de minimis* levels of non-agency mortgage loans, typically for anomalies such as the temporary repurchase of Fannie/Freddie loans.

Therefore, applying these new CSBS proposed requirements to smaller community-based nonbank servicers with *de minimis* levels of non-agency loans is in effect a solution in search of a problem.

CHLA is <u>not</u> asking for an exemption from the CSBS proposed requirements for such servicers.

Our recommendation to close regulatory gaps, while protecting smaller IMBs that don't service non-agency loans is simple: **Smaller servicers that service *de minimis* numbers of non-Federal agency mortgage loans should be deemed to be in compliance with the proposed CSBS servicing requirements if they are a Fannie Mae or Freddie Mac approved seller-servicer (or Ginnie Mae issuer) in good standing.**

We suggest as a reasonable threshold for this treatment less than 750 non-agency serviced loans.

New Requirements on Smaller Servicers Would Compound Compliance Burdens

Nonbank mortgage lender/servicers – and particularly smaller community-based IMBS - already face a disproportionate compliance burden compared to their bank competitors. Nonbanks incur substantial costs in licensing their mortgage loan originators, all of whom must pass the SAFE Act test, undergo an independent background check, complete 20 hours of SAFE Act pre-licensing courses, and complete 8 hours of continuing education each year. Additionally, the SAFE Act imposes detailed branch office requirements on all nonbank (IMB) mortgage loan originators. In contrast, all banks and all the loan originators that work at banks are exempt from all these requirements.

Additionally, nonbank independent mortgage bankers are subject to supervision by every state they do business in – as well as by the Consumer Financial Protection Bureau (CFPB). In contrast, 99% of banks are exempt from consumer supervision by the CFPB.

Creating a a new set of capital, liquidity, and corporate governance requirements largely duplicative of Fannie/Freddie requirements in every state that a nonbank services loans would exacerbate this comparative regulatory burden for smaller community-based servicers with *de minimis* levels of non-agency loans.

It is critical to understand the economies of scale related to compliance with these types of new regulatory requirements in every state in the country. Smaller community-based nonbank lender-servicers are small businesses. Statistically, the relatively new fixed costs of reporting, compliance, and exams with respect to CSBS' proposed new requirements would result in significant new costs on a per loan basis for smaller community lenders – compared to a largely statistically insignificant cost per loan for large servicers that can spread these costs over a much larger loan base.

Extrapolated to all smaller non-banks nationwide, the likely impact is obvious: **the diversified, broad based servicing that now takes place would become more concentrated as servicing of these loans would gravitate away from smaller community servicers towards the large mega-servicers.**

It is widely understood that larger servicers constitute a greater financial risk and a greater systemic risk. Therefore, our proposal to deem smaller servicers with *de minimis* levels of non-agency loans in compliance if they meet Fannie/Freddie or Ginnie requirements would avoid the unintended consequence of increasing financial and systemic risk by driving smaller servicers out of the servicing business.

Moreover, without adoption of CHLA's proposal or some alternative that avoids imposition of this duplicative new set of requirements on smaller servicers, the result would likely be increased servicer concentration. In turn, this would result in increased costs to consumers. Additionally, consumers that previously enjoyed the benefits of more personalized, localized servicing smaller community servicers provide would find their loans being serviced by nationwide impersonal mega-servicers – the very same servicers that were the subject of massive complaints in the aftermath of the 2008 housing crisis.

Proposed Capital and Liquidity Requirements Duplicate Fannie/Freddie Requirements

The CSBS proposed Capital requirements (Baseline 1) are:

(5) **Minimum net worth:** $2.5 million, plus 25 basis points of unpaid balance (UPB) of all 1-4 unit single-family residential mortgage serviced (Agency plus non-Agency loans).

(6) **Capital:** Tangible net worth must equal at least 6 percent of total assets.

These requirements are identical to existing Fannie Mae/Freddie Mac requirements or non-bank Fannie/Freddie servicers – and are in fact lower than capital requirements set by Ginnie Mae.

The proposed CSBS "Liquidity Requirements" (Baseline No. 2) are:

(7) **Liquidity:** 3.5 basis point of Agency plus non-agency UPB ---- plus an incremental non-performing loan (NPL) charge of 200 basis points on the portion of non-performing Agency plus non-agency UPB above 6 percent of total Agency plus non-agency UPB.

These requirements use the same calculation as existing Fannie/Freddie requirements – except that the metrics also apply to non-agency loans, while Fannie/Freddie requirements do not.

We would also note that FHFA recently proposed increasing Fannie/Freddie Liquidity Requirements, but suspended their imposition in light of the COVID-19 crisis.

We also note that these financial requirements are directly imposed by Fannie Mae and Freddie Mac – but are developed under the supervision of FHFA, a robust financial regulator of Fannie and Freddie.

A number of conclusions follow from this comparison. First, since CSBS-proposed Capital Requirements are identical to both existing Fannie/Freddie and Ginnie Mae requirements, there is absolutely no point in establishing identical requirements for Fannie/Freddie servicers that already meet these requirements. The only impact will be to impose a wholly redundant reporting and exam burden with no regulatory benefit.

Second, for a servicer with de minimis levels of non-agency loans, the different liquidity calculation is statistically meaningless. For example, for a non-bank servicing 10,000 agency loans and 200 non-agency loans (with an average loan size of $250,000), the liquidity requirement would be 2% higher – $892,500 vs. $875,000.

Third, CSBS justifies its proposed Liquidity Requirements on the basis of the need *"to ensure sufficient reserves to continue servicing the MSRs in their portfolios in the event of material financial stress."* However, Fannie/Freddie and Ginnie Mae liquidity requirements are already established out of an abundance of caution, with the goal of ensuring that servicers advance funds for all missed payments on agency loans.

Assuming that Fannie/Freddie and Ginnie Mae are competent to establish appropriate liquidity requirements for agency loans, the only real purpose of states to establish their own requirements would be to address risks from servicing non-agency loans. Therefore, there is no reason to establish separate but duplicative liquidity requirements for smaller servicers with a de minimis level of non-agency loans.

Fourth, there is no contention in the CSBS proposal that Fannie/Freddie or Ginnie Mae financial or management servicing requirements are inadequate to the task at hand.

Finally, we note that any time the CSBS proposed Capital Requirements or Liquidity Requirements exceed the Fannie/Freddie requirements - however slightly - the higher CSBS requirements would apply. This increases the likelihood that non-bank servicers with *de minimis* levels of non-agency loans will face two sets of requirements with little difference – exacerbating regulatory compliance burdens.

Proposed Corporate Management Requirements Duplicate Fannie/Freddie Requirements

CSBS proposed Baseline Standards 3 through 8 are not identical to Fannie/Freddie requirements or to Ginnie Mae requirements. However, per the analysis below, Baseline Standards 3 through 8 are functionally equivalent to comparable servicing requirements imposed by Fannie Mae and Freddie Mac.

Therefore, because the requirements differ, the reporting, compliance and exam burdens of these six requirements are costly and substantial – but do not provide a discernible regulatory benefit from applying them to smaller community servicers with *de minimis* levels of non-agency loans.

3. Risk management: This CSBS proposed Baseline Standard for risk management requires servicers to create a risk management program under board oversight that measures, monitors, and mitigate risks to the firms. While there is no exact such requirement for agency servicers, Fannie/Freddie and Ginnie expect their servicers to be able to manage the risks of their business and to their firms, and they conduct various forms of oversight to ensure this. This includes requiring submission of detailed quarterly financial reports on a standard form used by Fannie, Freddie and Ginnie for submission of audited financial statements, documented internal audit and management control procedures, quality control requirements for mortgage origination and servicing, requiring the creation and maintenance of information security programs and business continuity and disaster recovery plans, and overall organizational reviews.

Fannie Mae, for example, conducts detailed audits of selected seller/servicers that examine both compliance with Fannie's requirements and operational capabilities. The operational reviews include enterprise risk management, change management, people management and technology and business continuity. It should be noted also that FHA also has many of these requirements for its approved lenders, especially audited financial information and extensive quality control requirements.

4. Data standards: This CSBS proposed Baseline Standard for data standards would apply data and documentation standards for servicers with more than 5,000 loans through the mortgage servicing rules of both RESPA and TILA to all nonbank servicers and all serviced loans. This includes being able to provide specific information to a borrower within five days of a request. Fannie/Freddie and Ginnie require seller/servicers to comply with all applicable laws and regulations, and Fannie/Freddie require representations and warranties of compliance. Therefore, this requirement is duplicative for servicers of more than 5,000 loans that are Fannie/Freddie approved seller-servicers.

5. Data protection: This CSBS proposed Baseline Standard requires servicers to establish governance over information technology, IT security risk assessments, and IT security testing and monitoring. As noted, Fannie/Freddie require information security programs that are consistent with this baseline standard. They also require business continuity and disaster recovery plans that include addressing IT-related events.

6. Corporate governance: This CSBS proposed Baseline Standard requires creation of a sound corporate governance framework, including appropriate internal controls and an internal audit function. As noted above, Fannie/Freddie and Ginnie, as well as FHA, require both from their seller/servicers.

7. Servicing transfers: This CSBS proposed Baseline Standard would align with CFPB and FHFA policy guidance on ensuring smooth and accurate transfer of information during mortgage servicing transfers. Fannie/Freddie follow FHFA's policy guidance and provide extensive guidance in their Guides, and Ginnie likewise has guidance of its own.

8. Change of ownership and control requirements: This would require 30 business days prior notice of a change in ownership of 10 percent or more of a mortgage servicer. Fannie/Freddie and Ginnie have detailed requirements that cover changes in not only ownership but also organization and status.

Individual States Should Establish a De Minimis Threshold for Baseline Requirements

CSBS asks in its request for comment whether there should be a *de minimis* threshold for application of the Baseline Requirements.

CHLA does believe that there should be an exemption from the new baseline requirements based on some kind of de minimis numerical threshold of a firm's number of serviced loans. CSBS could develop an appropriate national threshold exemption based on metrics such as the total number of serviced loans nationwide or on the overall percentage of nationally serviced loans that a servicer has in its servicing portfolio.

However, CHLA believes that a *de minimis* threshold for applicability of these new requirements is best applied on a state by state basis.

Therefore, CHLA recommends that CSBS modify its proposal to encourage each state to establish an exemption for servicers with a statistically insignificant number of total loans serviced in their state.

And, after CSBS finalizes its proposal, each individual state should establish such an exemption.

A state exemption threshold should be meaningful, excluding servicers whose loan volume in a state does not justify the added reporting and exam burdens of complying with these detailed new requirements.

Since states vary by size, we suggest a threshold exemption level in which the total number of loans serviced in that state is both less than 1% of the total loans serviced in that state **and** is less than 5,000 total loans serviced in that state.

Why are individual state exemptions important for servicers with small numbers of loans in that state? CHLA members are typical of smaller community-based lender/servicers. Our members commonly originate and service loans primarily in one or a only few states, but also originate and service smaller levels of loans in a number of states in close proximity to their main state of operations.

Our members have concluded that imposition of new servicing requirements in every state in which they service small levels of loans is likely to cause their exit from servicing in such states, unless there is an exemption or streamlined treatment that avoids costly new reporting, compliance and exam burdens.

Additionally, servicers could become reticent to bid on MSR pools if it means taking on new regulation by a number of states where the firm only has small levels of loans in each state.

Put simply, the small economic benefits of servicing a few loans in a state does not justify the regulatory costs of new state financial and management requirements that are duplicative, but slightly different from requirements that are imposed by Fannie Mae, Freddie Mac and Ginnie Mae.

Servicing Requirements Should be Streamlined with Those of Federal Agency Loans

We recommend that the CSBS-proposed Baseline Requirements be streamlined and aligned as much as possible with Fannie Mae, Freddie Mac, and Ginne Mae requirements, in order to reduce regulatory burden.

Further, we recommend that the determination of compliance by servicers with CSBS servicing requirements be carried out through multistate exams, to avoid redundant and unnecessary cost burdens. In areas of conflict, the requirements should clearly state which authority is governing.

Enhanced Prudential Standards are Appropriate for More Complex Servicers

CHLA concurs in CSBS's proposal to establish Enhanced Prudential Standards and Heightened Supervisory Expectations – which include enhanced Capital, Liquidity, Stress Testing, and Living Will and Recovery and Resolution Plans – for Complex Servicers.

These Complex Servicers have been the major source in the significant growth in non-bank mortgage servicing since the 2008 housing crisis. Moreover, these Complex Servicers constitute the great majority of consumer, financial, and systemic servicing risk.

As always, we appreciate the open dialog we have enjoyed with the CSBS, we appreciate your consideration of our comments, and we stand ready to discuss them with you in more detail.

Sincerely,

COMMUNITY HOME LENDERS ASSOCIATION