

# Mortgage Servicing: Foundation for a Sound Housing Market

(Part IV of IV)

By Stuart I. Quinn and Faith A. Schwartz



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# Executive Summary

Mortgage loan servicing was among the many critical processes that broke down during the 2008 housing crisis. That breakdown turned a quiet back-office operation into a focal point of legislative, regulatory, and consumer action, resulting in laws and regulations that have the potential to drive up operational costs for the mortgage servicing industry. Today, as banks shed their servicing assets to comply with various capital requirements (BASEL III) and deter further headline risk, the role mortgage loan servicing plays in the post-crisis housing finance system is becoming more apparent. Federal and state regulators must now develop policies that balance industry safety and soundness with consumer protection-related oversight. In this paper, we examine some past issues and provide a high-level look at the challenges and opportunities facing the sector today.

## Background

Mortgage loan servicing handles the post-closing, day-to-day loan processes: sending bills, collecting payments, and managing liens and escrow accounts. Though it began as a relatively simple in-house process that provided lenders with a way to retain customer relationships and cross-sell other goods and services, the high-volume, low-touch nature made servicing an attractive outsourcing target for organizations that could charge a set fee for each loan managed. Delinquent mortgage rates were low during this evolution, less than 1.5 percent at the start of 2005, and troubled loans were easily managed by small loss mitigation groups specially trained in the more complex processes required.

When residential loan delinquencies and defaults began rising dramatically in 2007, mortgage servicers were wholly unprepared. Similar to a quiet country road suddenly asked to carry a major city's rush-hour traffic, the industry broke down as serious delinquencies rose to more than 11 percent by 2010. The servicing segment's inability to scale to the outsized demands will continue to reverberate throughout the housing world as the industry resets.

There's more to the story; however, because as the mortgage market grew significantly from the 1980s through early 2000s, mortgage servicing rights (MSRs) became important to the market, which had been developing along a parallel path. For secondary market transactions, MSRs were both a lucrative asset and a risk factor requiring sophisticated hedging to manage. In a nutshell, institutions holding MSRs risked losses should loans be paid off earlier than anticipated because mortgage accounting forecasts loan cash flow over a set duration, eventually covering origination costs.

In times of economic growth, when most loans are performing, the servicing business can be lucrative. The price of servicing is less than the cost of managing the book of business. Servicers can even sell some of the excess servicing-fee income to monetize cash flows. So, servicing rights can be a valuable asset to capitalize in retention and an earnings vehicle to monetize, as needed, in the origination space.

On the other side of the equation, servicing nonperforming loans can be very costly in times of stress. From the crisis start to today, the cost of servicing nonperforming mortgages has been difficult to assess. The difficulty has been due in part to continuing regulation changes and remaining uncertainty about how to accurately quantify pricing for managing nonperforming loan portfolios.

As the industry restoration goes forward, it's important to keep in mind that the ability to aggregate and service mortgage loans, or subservice others' mortgage loans, is a key component of efficient and effective primary and secondary mortgage markets. In addition, the ability to grow the market and offer loan servicing on both performing loans and nonperforming loans will continue to be a driver of housing finance pricing and execution.

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In the 21st century, the average consumer has limited visibility into the intricacies of small- and large-scale money transfers. Most payment systems today run on aesthetically appealing user interfaces that require one or two taps on a mobile device or laptop and result in a transaction, seemingly in the blink of an eye. The recent Great Recession illuminated a previously little-known, but vital, link in how the mortgage market system functions: mortgage servicers. Mortgage servicers act as the cash flow managers of the mortgage market system, providing a number of services necessary to ensuring a continuous and functioning housing finance market.<sup>1</sup> There are a variety of servicing types with processes that may vary further, depending on the contractual agreement established between the servicer and its counter parties. Since the downturn, many efforts have been made to establish a more operationally efficient process by increasing transparency, regulatory oversight and homogeneity across the sector. Already, attempts to realign industry incentives and regulatory oversight have brought about significant transformations through the Dodd-Frank Wall Street Consumer Protection Act (DFA or Dodd-Frank), Helping Families Save Their Home Act of 2009, Attorney General Settlement (AG Settlement) between five major servicers and a coalition of 49 state attorneys general, and Office of the Comptroller of the Currency (OCC) Independent Foreclosure Review (IFR).

## Who Owns My Mortgage and Why Does It Matter?

In the most simplistic mortgage servicing model, first-party servicing, a depository institution funds a borrower's loan and determines it will achieve the best economic outcome by retaining the loan and servicing rights on its own balance sheet. Borrowers receive statements from and make payments to the institution with which they signed their closing documents. The lending institution collects payments and, in the event of delinquency or default, determines how best to optimize that loan's value. Depending on the borrower's circumstances, lenders servicing their own loans might restructure the troubled loan or file a notice of default and initiate foreclosure to liquidate the loan and sell the property to a third party.<sup>2</sup>

First-party servicing became increasingly infrequent as mortgage industry specialization evolved and using securitization to introduce leverage became common practice. The industry shift also introduced direct and indirect costs that impact cash flows, limiting the likelihood that first-party servicing will operate as outlined.

The alternative, third-party servicing, occurs one of two ways, when:

- (1) A residential mortgage-backed security (RMBS) is structured and securitized through one of the distribution channels: government-sponsored entities (GSEs) Fannie Mae and Freddie Mac, government-owned Ginnie Mae; or private-label securities (PLS)
- (2) A whole-loan or balance-sheet lender uses a subservicer or a default/specialty servicer<sup>3,4</sup>

<sup>1</sup> Laurie Goodman (Amherst Securities), "Testimony on National Mortgage Servicing Standards and Conflict of Interest before the Senate subcommittee on Housing, Transportation and Community Development," May 11, 2011.

<sup>2</sup> States foreclosure process varies between judicial and nonjudicial.

<sup>3</sup> Levitin, Adam J. and Tara Twomey, "Mortgage Servicing," Yale Journal on Regulation, Vol. 28, No. 1 (2011) at 7.

<sup>4</sup> Commercial mortgage backed securities (CMBS) also utilize servicers, the scope of this paper is subjugated to single family residential forward mortgage servicing as the operations, economics and assumptions vary across these products.

Third-party servicer obligations and duties are outlined in federal regulation, state, and local law. They vary depending on what type of security the loan backs:

- ▶ GSE securities must follow Fannie Mae’s *Servicing Guide* and Freddie Mac *Single-Family Seller/Servicer Guide*
- ▶ Ginnie Mae securities must follow the respective guarantors’ (FHA, VA, USDA/RD, or PIH)<sup>5</sup> servicing guidelines
- ▶ Private label securities must follow the terms negotiated in the pooling and servicing agreements (PSAs) between the investor, trustee and the servicer.

There are a number of variances between the guidelines, so servicers generally specialize in specific loan product type or investor type.

Servicers must adhere to a number of contractual and regulatory rules, but overarching duties remain consistent. Servicing roles are segmented into performing loans and nonperforming loans (NPL or default servicing). This bifurcation is necessary to demonstrate the changes in activities, cash flows and, in some instances, servicer performance per loan.

Performing loan servicing is primarily a customer service and payment processing industry. Efficient payment processing requires servicers to have strong operational acuity, compliance frameworks, and technical architecture. Direct costs associated with servicing performing loans include personnel and equipment needed to onboard loans, dispatch transfer notifications to borrower, send billing statements, and process payments. Through automation and other technological efficiencies, performing-loan servicers benefit from economies of scale. Servicing nonperforming loans (in which a borrower has missed a monthly payment) cannot rely on automated processes, so is far more labor intensive and costly.

Performing Loans — Key Functions
Collection of monthly payments
Remittance of Principal and Interest (P+I) <ul style="list-style-type: none"> <li>▶ Guarantor (if present)</li> <li>▶ Escrow payments for tax and insurance (T+I)</li> </ul>
Maintain loan file records
Detailing balance, payment changes
Reporting to investors/guarantors/trustees
Processing lien release
Responding to payoff requests
Non-Performing Loans — Key Functions
Advances of principal and/or interest, T+I
Initiate contact to determine reason for payment gap
Identify loss mitigation options and collect paperwork
Refer to foreclosure, short sale, deed-in lieu
Maintain property to code

“Efficient payment processing requires servicers to have strong operational acuity, compliance frameworks, and technical architecture.”

### The Abbreviated Business Model

Mortgage servicers have a number of income streams, but their primary cash flows come from servicing fees, which are a fixed-fee percentage<sup>6</sup> of the outstanding loan balance, with adjustments based on the investor and/or the loan quality. The riskier the loan is, the higher the fee will be. General industry servicing fees are:

- ▶ Prime, fixed-rate mortgage (FRMs): 25 bps
- ▶ Adjustable rate mortgages (ARMs): 37.5 bps
- ▶ FHA and VA loans: 44 bps.<sup>7</sup>

For instance, the servicing income of a prime FRM for Fannie Mae or Freddie Mac on a mortgage loan of \$213,071 with two years’ duration would be

“...primary cash flows come from servicing fees, which are a fixed-fee percentage<sup>1</sup> of the outstanding loan balance...”

<sup>5</sup> Federal Housing Authority, Veteran’s Administration, U.S. Department of Agriculture Rural Development, Public and Indian Housing

<sup>6</sup> Fee percentages are noted in basis points (bps), with 100 bps equal to 1 percent, 50 bps equal to .5 percent, etc.

<sup>7</sup> Mortgage Bankers Association (MBA), “Residential Mortgage Servicing in the 21st Century,” May 2011, p. 29

approximately \$1,065 (0.0025\*213,071\*2).<sup>8</sup> Since the servicer receives the payment directly from the consumer, servicers receive their payments before investors. This time lag often results in supplemental income for servicers. For example, borrowers make payments on the first of the month, but servicers are not required to remit the payment (less the fixed servicing fee) to investors until later in the month, allowing servicers to earn two to three weeks' interest over each payment period (float income). Mortgage servicers also capture late fees and ancillary income from a number of different business functions, including additional copies of tax and escrow statements, detailed payment history, property inspections, etc.

“The majority of direct costs associated with servicing performing loans are complex, but manageable.”

As a counterbalance to that income, however, servicers must contend with costs and risks associated with servicing fees. Several factors can escalate the likelihood and severity of these risks, including:

- ▶ The front-loaded costs associated with servicing, as well as the asset's interest rate sensitivity, create a prepayment risk prior to servicers recovering onboarding costs through monthly installments.
- ▶ Lower interest rates reduce the float income recognized for principal and interest (P+I) and tax and interest (T+I) held in escrow prior to remittance.

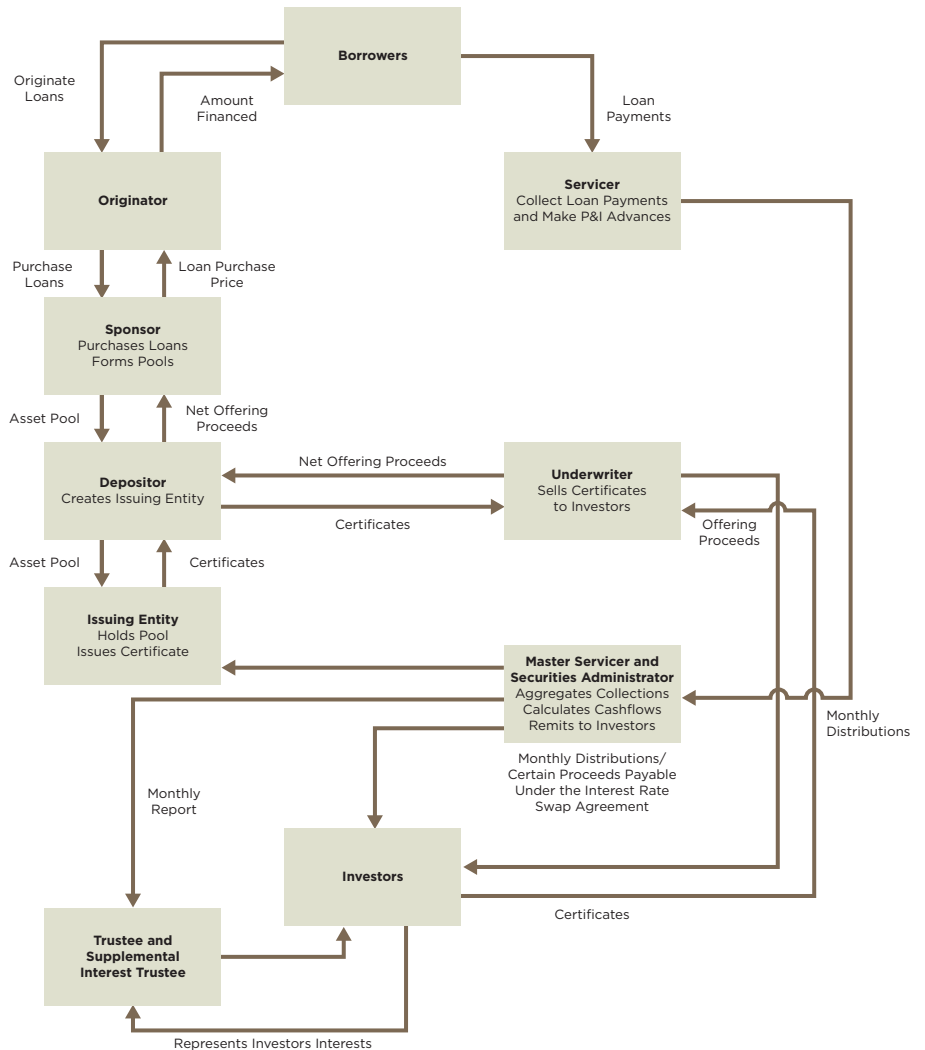
The majority of direct costs associated with servicing performing loans are complex, but manageable. Historically, fewer defaults and foreclosures occur during times of home price appreciation, reducing risk even further.

### Troubled Loans and Associated Risk

Default risk is perhaps the most formidable financial risk servicers face. When a borrower defaults and servicer no longer receives the servicing fee, most investors require the servicer to continue advancing the principal and interest (or just interest) of missed payments. Property tax and insurance payments also remain the servicer's responsibility. The servicer also bears the carrying costs incurred in default, foreclosure, and property preservation.<sup>9</sup> In addition, the

#### TRANSACTION STRUCTURE

ACE Sec. Corp. Home Equity Loan Trust, Series 2006-NC3, Prospectus Supplement (Form 424B5)



<sup>8</sup> This paper does not discuss excess servicing, buy-up/buy-down and in-depth economics of servicing. For Agency MBS execution calculation see [here](#).

<sup>9</sup> Number of payments advanced and terms differ based on investor guidelines. Some investors only require scheduled interest payments to be covered, while others require P+I. Default management costs are generally advanced and reimbursed as well.

servicer is obligated to engage the borrower to determine the underlying reason for the missed payment or payments and whether that borrower has the capacity to continue making payments. The investor or guarantor must eventually reimburse the servicer for most costs associated with advancing payments on behalf of the borrower, but the direct cost of labor, technology, and resources to provide borrowers with proper loss mitigation options are generally nonrefundable.<sup>10</sup> The risk is much greater for nondepository mortgage servicers that may not have adequate capital to advance payments and other default-related expenses over long time periods. Carrying costs are further exacerbated by the volume of nonperforming loans held by any institution, particularly with servicers not accustomed to managing large nonperforming portfolios.

“Carrying costs are further exacerbated by the volume of nonperforming loans held by any institution...”

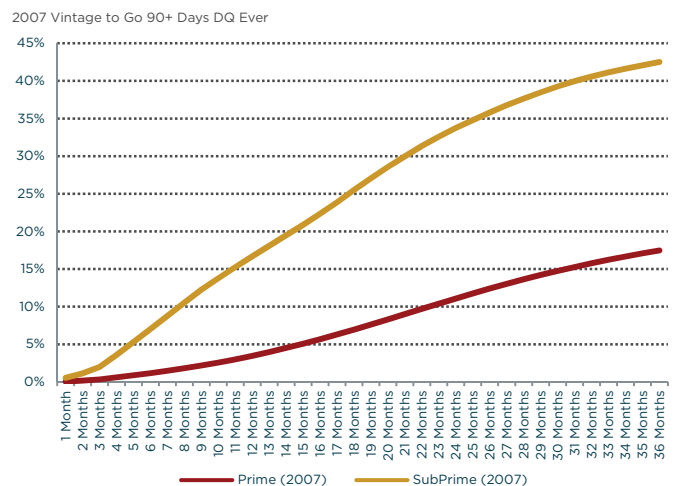
Given the cost divergence between performing and nonperforming loan, many have questioned the appropriateness of servicer compensation that seems too small when loans go delinquent and too big for performing loans.<sup>11</sup>

### Accommodating Large-Scale Defaults

As U.S. home prices peaked nationwide and subsequently began to collapse, borrowers who qualified for adjustable-rate mortgages (ARMs) or option-adjusted ARMs with the intention to refinance before interest rates adjustment found they were suddenly ineligible for refinancing. As interest rates adjusted upward, many such borrowers could no longer meet their monthly mortgage obligations. A number of these mortgages had been securitized into private label securitization vehicles, each with a unique set of pooling and servicing agreements servicers were required to uphold.<sup>12</sup> As early payment defaults (loans with three or more missed payments in the first year) began escalating in 2007, servicers unaccustomed to servicing subprime loans or large portfolios of nonperforming loans were inundated by demand for labor-intensive outreach, document collection, loss mitigation efforts, or nonstandardized loan workout programs. Inconsistencies between PSAs, servicer guidelines, federal law, government programs, and state overlays became more difficult to navigate under such exigent circumstances. Then, as the scale of the crisis pushed the entire economy to the brink of a historic recession, the mortgage industry, nonprofits, and the government made a good-faith effort to establish standards wherever possible.

With prime and subprime loan delinquency rates growing by the end of 2007, the mortgage market responded by establishing HOPE NOW, an alliance between nonprofit housing counselors, mortgage companies, investors, and other mortgage market participants. The alliance developed nonbinding mortgage servicing guidelines to serve as a framework for establishing best practices when reaching out to distressed borrowers. The guidelines also covered document collection, case management, and modification activity reporting.<sup>13</sup> The U.S. economy’s rapid downward spiraling led to Congress passing the Emergency Economic Stabilization Act (EESA) of 2008, which established the Troubled Asset Relief Program (TARP), enabling the Department of Treasury to stabilize a number of capital-deficient and illiquid institutions against further deterioration. TARP provided

FIGURE 1. EARLY PAYMENT DEFAULTS



Source: CoreLogic

<sup>10</sup> The GSEs and the Home Affordable Modification Program (HAMP) offer financial incentive compensation to servicers for effective loss mitigation. Reimbursement amounts vary by result and line item. A list of GSE servicer billable items can be found here in Form 571

<sup>11</sup> Laurie Goodman (Amherst Securities), “Testimony on National Mortgage Servicing Standards and Conflict of Interest before the Senate subcommittee on Housing, Transportation and Community Development,” May 11, 2011.

<sup>12</sup> As mentioned earlier, Fannie Mae and Freddie Mac (the GSEs) have standard servicer guides, but PLS PSAs were not standardized.

<sup>13</sup> Modifications will be used broadly to encompass all non-liquidation alternatives: repayment plans, forbearance, rate reduction, re-amortization, shared appreciation, principal reductions, etc.

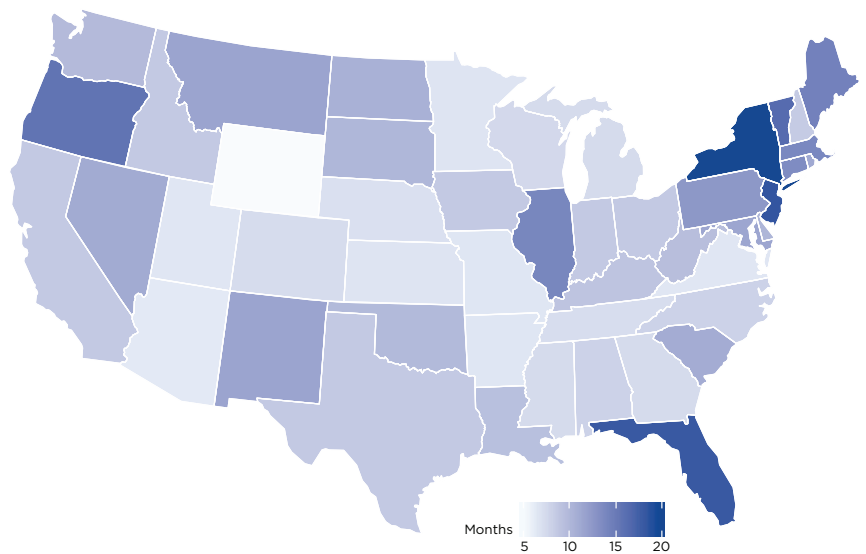
the funding mechanism and authorization for the Obama administration’s Home Affordable Modification Program (MHA-HAMP), which allotted \$75 billion to help prevent foreclosures across the U.S.<sup>14</sup> EESA was amended by the American Reinvestment and Recovery Act of 2009 and, in February of that year, the administration announced its Making Home Affordable (MHA) program under the U.S. Department of Treasury, which provided a more prescriptive modification waterfall for mortgage servicers attempting to restructure delinquent homeowners’ mortgages.<sup>15</sup>

## The Road to Mortgage Servicing Reform

Under MHA-HAMP, more than 100 servicers<sup>16</sup> agreed to facilitate mortgage modifications for qualified borrowers under the program, while adhering to restrictions outlined in private investor PSAs.<sup>17</sup> Efforts to ensure long-term reform continued with the passage of the Dodd-Frank Act in July 2010. Dodd-Frank led to creation of the Consumer Financial Protection Bureau (CFPB), which has become the supervisory agency of mortgage servicers. Dodd-Frank also transferred rule-making authority to CFPB for the Real Estate Settlement Procedures Act (RESPA, Regulation X) and the Truth in Lending Act (TILA, Regulation Z), two federal laws that apply to mortgage servicing operations. Amending RESPA and TILA to enhance consumer protections required the CFPB to coordinate with overseers of the consent orders of the 49-state, \$25-billion National Mortgage Settlement and the Office of the Comptroller of the Currency’s (OCC), and the Federal Reserve’s independent foreclosure review (IFR) settlement. The OCC and Federal Reserve IFR agreements, signed over 2011 and 2012, covered 16 of the largest mortgage servicers or foreclosure service providers. Beyond paying enormous monetary penalties, the consent agreements required the mortgage servicers to review their organizational structures, including how they oversee third-party service providers; conduct internal quality control and audits; develop policies and procedures for default management processes from delinquency to foreclosure auction; and manage their documentation practices. Both agreements established timelines to ensure servicers responded quickly to payment postings and consumer requests. Servicers also had to define loss mitigation procedures, allow time for appeals, designate single-point-of-contact (SPOC) customer service, and provide monitoring and disclosure of all foreclosure process fees.<sup>18</sup> The

“Under MHA-HAMP, more than 100 servicers<sup>16</sup> agreed to facilitate mortgage modifications for qualified borrowers under the program...”

FIGURE 2. FORECLOSURE TO REO TIMELINE MAP  
Weighted Average by State



Source: May 2014

<sup>14</sup> EESA was amended by the American Reinvestment and Recovery Act of 2009, the dollars for the Making Home Affordable (MHA, “HAMP Programs”) were 50 billion from TARP and 25 billion from Fannie Mae and Freddie Mac.

<sup>15</sup> The MHA program has been enhanced a number of times and extended twice, the program includes a number of tools beyond modification: repayment plans, short sale assistance (HAFA), principal reduction alternatives (PRA), etc.

<sup>16</sup> This number has declined due to voluntary and involuntary consolidation within the mortgage servicing market place, those servicing on behalf of the GSEs are required to participate even if they are non-participants in Treasury’s MHA program.

<sup>17</sup> Limited participation at the outset due to the lack of a safe harbor provision for participants, a safe harbor was provided by the Helping Families Save Their Homes Act of May 2009.

<sup>18</sup> The OCC IFR was for loans foreclosed upon between Jan. 1, 2009 to Dec. 31, 2012 and the National Mortgage Settlement foreclosed borrower



National Mortgage Settlement alone carried 304 mortgage servicing standards and 29 performance metrics for testing servicers.<sup>19</sup>

The National Mortgage Settlement binding consent orders and settlement terms were filed in D.C. Circuit court on April 5, 2012. Four months later, the CFPB issued its proposed mortgage servicing rules amending TILA – RESPA and included nine overarching subject areas, including discretionary rulemaking beyond the explicit authority outlined in RESPA.<sup>20</sup> These nine topics became finalized and effective on January 10, 2014 and include: (1) periodic billing statements; (2) interest rate adjustment notices; (3) prompt crediting and payoff statements; (4) force-placed insurance costs; (5) error resolution and information request; (6) servicing policies, procedures and requirements; (7) early intervention; (8) continuity of contact; and (9) loss mitigation procedures. The CFPB clarifies that these are the minimum standards and do not preempt higher servicing standards required by mortgage loan owners or states where additional prohibitions and protections exist. In the rulemaking, the CFPB aimed to coordinate with existing standards and previous settlements, as well as to reemphasize the need for high-touch servicing.

## Monitoring Performance & Standards

The significant downturn in the housing market leading to the Great Recession required quick and adept policy responses. Despite the number of competing policy priorities, there was significant consensus in Congress and among regulators around the need to establish mortgage servicing standards. Servicer performance is now measured and monitored in a number of ways, including:

- ▶ Fannie Mae Servicer Total Achievement and Reward (STAR),
- ▶ Freddie Mac Servicer Success Scorecard,
- ▶ HUD's Tier-Ranking System (TRS),
- ▶ CFPB's Consumer Complaint Database Report,
- ▶ Making Home Affordable HAMP Servicer Scorecard,
- ▶ National Mortgage Settlement monitor report,
- ▶ Nationally recognized statistical rating agencies, such as Moody's, S&P, and Fitch Ratings

The credit guarantors and rating agencies largely apply similar metrics broadly categorized into four buckets: roll-rate analysis, modification sustainability (or recidivism), liquidation timeframes and adherence to guidelines, and outreach oversight and procedures. The MHA and National Mortgage Settlement scorecards specify metrics within the participation agreements that test for violations of the program and trial modification conversions. While the CFPB consumer complaint database report does not account for a number of these factors, it enables the bureau to analyze trends in servicer performance, geography and service category.

“...significant consensus in Congress and among regulators around the need to establish mortgage servicing standards...”

Today, mortgage servicers must meet the demands of several audiences. They must deliver best-in-class customer service to borrowers, maximize investor returns, and remain in compliance with a myriad of laws and agreements, including investor agreements, state and local consumer protection laws, federal laws, and all local and federal consent orders.

payment program covered those borrowers from Jan. 1, 2008 to Dec. 31, 2011. Oklahoma was the only non-party state to the agreement.

<sup>19</sup> Smith, Joseph A., “National Mortgage Settlement: Compliance in Progress Report,” May 14, 2014.

<sup>20</sup> Consumer Financial Protection Bureau, “Mortgage Servicing Rules under the Real Estate and Settlement Procedures,” January 17, 2013. p. 4

While state law will continue to preempt national mortgage standards in tightening consumer protections, creating compliance overlays and increased operational complexities, more can be done to enhance coordination at the federal level. Each federal agency charged with regulating the financial services industry may operate under defined missions and priorities, but working together to establish mortgage servicing standards and performance measurements would move us closer to national uniform standards.<sup>21</sup>

## The Remaining Questions:

### Have second liens been adequately addressed?

Throughout the crisis, subordinate liens slowed or stymied distressed borrowers' loan modification options. Because subordinate-lien holders have the power to prevent loan modification deals from going through and homes carrying second mortgages were twice as likely to go underwater, many borrowers were unable to take advantage of relief options available.<sup>22</sup>

Subordinate-lien holders can include other banking institutions, nonperforming loan investors, tax-lien holders, homeowners associations, and other debt holders. When those lien holders choose to slow or stop the loan modification process, resolution timelines increase, thus creating larger losses for investors and requiring servicers to continue advancing funds to cover missed payments.<sup>23</sup> The current government standards within the HAMP Second-Lien Modification Program (HAMP 2MP) treat liens equally, but the incentives do not necessarily align to allow the same modification for each borrower with multiple liens.<sup>24</sup> As home prices continue to rise, the 54 percent of first-lien mortgage holders who have already refinanced into rates below 4.5 percent may decide against making step-up home purchases at higher interest rates, choosing instead to tap into home equity to renovate existing properties. It is unclear if the treatment of liens, priority, and modifications of terms in second-lien servicing has been adequately delineated to offer comprehensive investor protection in future downturns.

### The cost of servicing, too much or too little?

In 2011, the U.S. Department of Housing and Urban Development (HUD) and Federal Housing Finance Agency (FHFA) created a joint-agency working group to discuss alternatives to the existing servicing compensation model. Under FHFA guidance, both Fannie Mae and Freddie Mac had already established the Servicer Alignment Initiative (SAI) to deliver incentive performance payments (or penalties) for default management outcomes that supplemented or reduced servicer income. The joint agency working group proposed three alternative options:

- ▶ MBA Reserve Account Proposal
- ▶ Clearing House Reserve Account Proposal
- ▶ FHFA Fee-for-Service Proposal

All three proposals were aimed at counterbalancing the effective cost differential between servicing performing and nonperforming loans. The first two proposals suggested that servicers would retain a decremented minimum servicing fee strip from 12.5 to 20 basis points, along with a reserve account funded by reallocating a few more basis points. The reserve account could be triggered by a default threshold. The additional funds could be tapped in instances of high defaults on particular vintages or loan types, serving as a capital protection against the escalated costs of default servicing. The FHFA third alternative proposal went further by proposing a fixed-dollar value for performing loans serviced, rather than a minimum servicing fee as a percentage of the principal. Under the proposal, and the GSEs would supplement nonperforming servicer income through incentive-based compensation (i.e., SAI incentives). The proposal provides additional details and rationales, including the option to tie an excess interest-only (IO) strip to the mortgage servicing right or contractually separate the excess IO and bifurcate the representation and warranties.

<sup>21</sup> FHA, VA, USDA, programmatic changes would require Congressional action to amend statutory language.

<sup>22</sup> Whelan, Robbie, "Second-Mortgage Misery: Nearly 40% Who Borrowed Against Home Are Underwater," *The Wall Street Journal*, June 7, 2011.

<sup>23</sup> Cordell, Larry, et al., "The Incentives of Mortgage Servicers: Myths and Realities," Federal Reserve Board, Washington D.C., Oct. 2008, p. 27-28.

<sup>24</sup> Laurie Goodman (Amherst Securities), "Testimony on National Mortgage Servicing Standards and Conflict of Interest before the Senate subcommittee on Housing, Transportation and Community Development," May 11, 2011. p. 3-4

The initial proposals raised a number of concerns through the commenting period, particularly the fragility of the housing market and servicing, in the light of SAI changes, modifications to the HAMP, implementation of state and county mediation, and ongoing business disputes and litigation.

Issues surrounding compensatory fees, servicing representations and warranties, and default management cost reimbursement continue to persist. The FHFA indicated in its most recent scorecard that it intends to revisit some of these concerns in the future.

*“The servicing marketplace has consolidated due to mortgage servicers exiting the business...”*

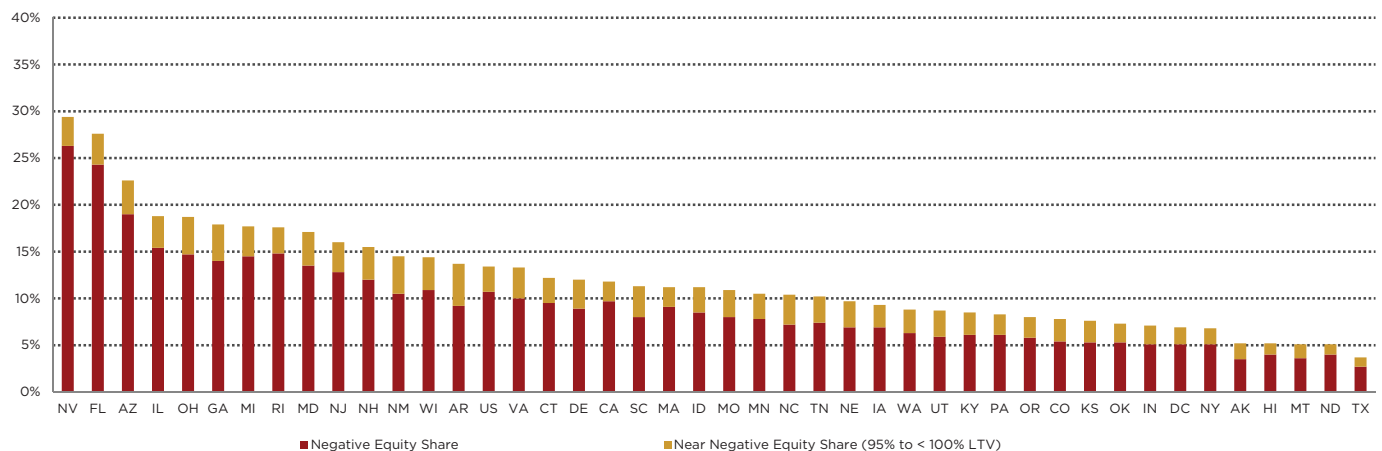
### The servicing market actors

The servicing marketplace has consolidated due to mortgage servicers exiting the business over the increased pressures of headline risk, the need to attain economies of scale, and capital requirements under Basel III.<sup>25</sup> As a result, nonbank mortgage servicers have been acquiring large amounts of mortgage servicing rights through bulk trades and company acquisitions. Among the top 30 servicers, nonbank servicers grew from 6 percent in 2011 to 17 percent by the end of 2013 and made up 9 and 7 of the top 20 Fannie Mae and Freddie Mac servicers, respectively.

The FHFA has oversight and must approve transfers exceeding 25,000 loans at this time. Other state and federal regulators have also taken notice of this shift and are monitoring whether these transfers pose capacity issues that degrade consumer service quality. Regulators have also suggested that nondepository servicers pose counterparty risks due to their different risk reserving and capital requirements. On July 1, 2014, the FHFA Office of the Inspector General outlined its concerns over whether the safety and soundness supervision of nonbank mortgage servicers was robust enough.<sup>26</sup> Fannie Mae requires minimal capital standards for all servicers, and nonbank servicers have continuously shown adequate performance under their monitoring reports. However, complaints against nonbank servicers have escalated in the CFPB’s consumer complaint database, which could simply be commensurate with the increase in delinquent borrowers they are managing.<sup>27</sup>

FIGURE 3. NEGATIVE EQUITY BY STATE

As of Q2 2014



Source: CoreLogic

<sup>25</sup> Accounting/tax treatment and valuation of MSR’s play a large role in transfers and hedging functions of mortgage servicers. This treatment is beyond the scope of this paper, but an overview can be found [here](#), p. 8-12

<sup>26</sup> Federal Housing Finance Agency Office of Inspector General, *AUD-2014-014: FHFA Actions to Manage Enterprise Risks from Non-Bank Specializing in Troubled Mortgages*, July 1, 2014.

<sup>27</sup> See Fannie Mae, *Servicer Retained/Released Resource Guide*, April 2014.

As of May 2014, home prices in the U.S. had experienced 27 consecutive months of year-over-year price increases, the foreclosure inventory was down 53 percent nationally from its January 2010 peak, and as of Q2 2014 homes in negative equity were down 56 percent from the 12.1 million peak in Q4 2011. As economic recovery progresses and more markets begin appreciating, mortgage servicing will continue to operate under a microscope. One of the largest lessons learned through the crisis was that home equity has the ability to mask market imperfections and “normal” market tensions that often offset each other. The larger loan balances servicers desire are generally offset by investor appetite, underwriters, and servicing fees. Similarly, in a real estate boom, a borrower facing hardship can tap the equity of his or her home. When net proceeds from foreclosure or REO sales are high, servicers will make money on late fees and investors are made whole, resulting in less controversy and litigation among mortgage market participants. The CFPB has attempted to standardize the servicing process and provide front-end origination safeguards through the Ability to Repay and Qualified Mortgage (ATR/QM) rules outlined in our first *Foundations of a Sound Housing Market* piece.

It is clear the conversation around servicing has not fully subsided, and the next few years will likely grow the foundation established during the crisis. This particular segment of the market has been through a massive reformation and the industry remains in the early stages of fully implementing voluminous regulations that will be monitored and reviewed for effectiveness in the years to come.

**Faith A. Schwartz:**

Faith is responsible for managing the CoreLogic government business, while providing policymaker education and thought leadership. Prior to joining CoreLogic, she was an executive director at the HOPE NOW Alliance, a nonprofit coalition created in 2007 to help homeowners in distress stay in their homes by bringing together servicers, lenders, investors, Federal Reserve Banks, and government-sponsored enterprises.

Faith is a former member of the Federal Reserve Consumer Advisory Committee and currently sits on the boards of the CoreLogic Academic Research Council, the Structured Finance Industry Group (SFIG), and HOPE LoanPort, which provides a communication loan workout vehicle for borrowers, counselors, and investors. In 2013, Faith was honored by the MBA as one of the Top 20 Leading Industry Women and in 2012, was selected as one of HousingWire's Women of Influence.

**Stuart I. Quinn**

Stuart is responsible for policy research and strategy for the CoreLogic government business. Prior to joining CoreLogic, he was the data metrics manager for the HOPE NOW Alliance, responsible for developing and analyzing monthly and state foreclosure prevention data. Stuart formerly worked as a consultant for the American Chemical Society assisting as a multimedia specialist and market analyst.

## ABOUT CORELOGIC

CoreLogic (NYSE: CLGX) is a leading property information, analytics and services provider in the United States and Australia. The company's combined data from public, contributory and proprietary sources includes over 3.5 billion records spanning more than 40 years, providing detailed coverage of property, mortgages and other encumbrances, consumer credit, tenancy, location, hazard risk and related performance information. The markets CoreLogic serves include real estate and mortgage finance, insurance, capital markets, transportation and government. CoreLogic delivers value to clients through unique data, analytics, workflow technology, advisory and managed services. Clients rely on CoreLogic to help identify and manage growth opportunities, improve performance and mitigate risk. Headquartered in Irvine, Calif., CoreLogic operates in seven countries. For more information, please visit [corelogic.com](http://corelogic.com).

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