



Nonbank Servicer Regulation

New Capital and Liquidity Requirements Don't Offer Enough Loss Protection

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The role of nonbanks in servicing single-family mortgages has increased tremendously over the past five years, mostly at the expense of large depository institutions. This increase can be attributed to three factors. One, many nonbank servicers specialize in servicing troubled loans and are often able to cure delinquencies more effectively than banks can. Two, significantly higher bank capital requirements make it very expensive for depositories to own servicing assets. Three, elevated representation and warranty litigation and reputational risks on pre-crisis originations forced many lenders with legacy exposure to curtail lending significantly.

In response to both the growing presence of nonbanks in the mortgage market and the relatively thin regulation under which they operate, the government-sponsored enterprises (Fannie Mae and Freddie Mac) and Ginnie Mae have issued new capital, liquidity, and net worth requirements for servicers of their mortgages. These requirements aim to reduce counterparty risk exposure from servicers in order to ensure the continued safety and soundness of Fannie, Freddie, and Ginnie. This brief explores whether these new financial requirements offer adequate loss protection given the risks.

Our key findings are that nonbank servicers have substantial exposure to interest rate and default risk that can put enormous strain on income, cash flow, and liquidity during periods of unsettled interest rates or rising defaults; and that the newly issued capital and liquidity requirements are somewhat unsophisticated and unlikely to offer adequate protection when these risks rise. We conclude that the recent steps taken to ramp up nonbank regulation are a good starting point, but that more needs to be done to ensure the government agencies and taxpayers are adequately protected against these risks under all economic environments.

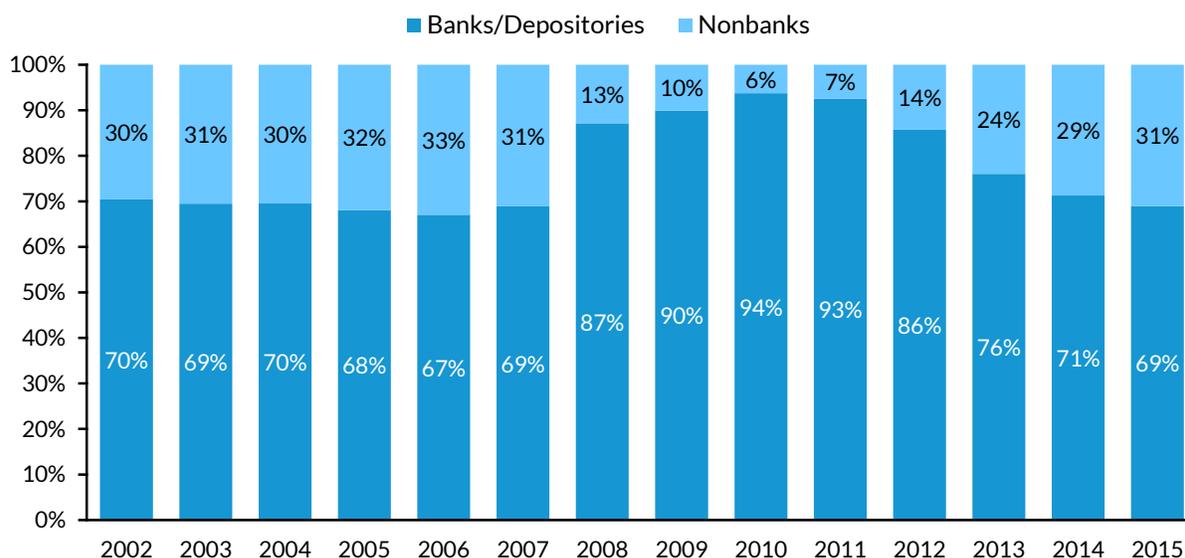
Recent Trends in Mortgage Servicing

Large banks have traditionally been the dominant player in almost all segments of the mortgage business, from origination to secondary market activities to servicing and loss mitigation. The servicing business in particular has remained a major stronghold of large, vertically integrated depository financial institutions. Vertical integration brought multiple opportunities for profit, from origination fees paid by borrowers, to gain-on-sale when selling into the secondary market, to servicing fees paid over the life of loan. Keeping servicing in house also allowed banks to retain customer relationships after loan origination, often resulting in cross-sell opportunities down the road.

According to Inside Mortgage Finance data for the largest servicers, the percentage of single-family unpaid principal balance (UPB) serviced by banks remained stable at roughly 70 percent between early 2000s and 2007, with nonbanks accounting for the remaining 30 percent (figure 1). However, as the crisis unfolded, many nonbanks either went out of business or were acquired by larger banks, resulting in a sharp uptick in bank share to 94 percent by 2010.

FIGURE 1

Bank/Nonbank Split Based on Unpaid Principal Balance Serviced, 2002–15



Source: Urban Institute calculations based on Inside Mortgage Finance data.

Note: Shares for 2002 to 2004 are based on the top 30 servicers, shares for 2005 to 2007 are based on the top 40 servicers, and shares for 2008 onward are based on the top 50 servicers.

This increasing concentration of servicing in banks after the crisis has reversed significantly during the past few years. In 2015, the market-share split between banks and nonbanks was one again at the pre-crisis level of 70/30 percent. There are several reasons for this shift. First, large banks were heavily exposed to loans made during the run-up to the housing bubble. As defaults increased after the housing

crisis, many of these loans were subjected to buybacks under the government-sponsored enterprises' (GSEs') and the FHA's rep and warrant indemnification policies. Faulty loans also generated a flood of litigation that many lenders ultimately settled, paying tens of billions of dollars in fines. Worried about further negative fallout from financial, litigation, and reputational risk, these lenders significantly curtailed their lending and servicing activities. In comparison, smaller nonbanks had very limited legacy loan exposure and faced lower litigation and reputational risks, putting them in a stronger position to pick up the slack.

Second, as the volume of delinquencies skyrocketed after the bubble, so did the need for servicers to allocate substantial resources to either bring loans out of delinquency or see them through expensive and time-consuming foreclosures. Servicing nonperforming loans tends to be high-touch, labor-intensive, and very expensive (Goodman 2014). To minimize losses for both borrowers and investors, servicers need to reach out and invest the time to understand each borrower's financial situation, evaluate multiple loss-mitigation strategies, and find the best approach to cure the delinquency. Banks, having encountered very low delinquencies historically, didn't have much experience servicing large volumes of delinquent loans and were therefore ill-prepared for this task. Nonbanks—often smaller and less complex, with lower regulatory capital and compliance costs, very limited legacy exposure, and pre-crisis experience in the origination and servicing of lower-quality loans—were better situated to respond to the changing landscape.

Third, the already steep cost of servicing nonperforming loans has increased even more under the Basel III capital regime, which treats mortgage servicing rights (MSRs) highly unfavorably and doesn't apply to nonbanks. Under Basel III, which went into effect January 1, 2015, MSRs are subject to at least a 250 percent risk weight up to a certain threshold and a substantially higher risk weight thereafter. This, too, has encouraged banks to pull back from the servicing business, opening the door for nonbanks to fulfill this market need.

Current Regulation of Nonbank Financial Institutions

Though both banks and nonbanks were underregulated and undercapitalized before the crisis, the financial reforms put in place afterward have largely addressed those issues on the bank side. Nonbank regulation is one piece of unfinished business from the crisis. Traditionally, nonbanks have not been subject to the same level of supervisory financial regulation and capital requirements as depositories. Nonbanks don't hold consumer deposits and don't have a retail presence, thus limiting the potential for customer disruption in the event of insolvency. Further, disruption of servicing upon failure of a nonbank servicer is typically avoided by transferring servicing rights to a financially sound servicer,¹ thus ensuring continued collection of mortgage payments from borrowers and uninterrupted remittance of principal and interest (P&I) to mortgage-backed securities (MBS) investors.

Unsurprisingly, the strong pace of growth and increased role of nonbanks since the crisis have prompted calls for greater supervision (FHFA 2014a; FSOC 2014). The growth in MSRs owned by nonbanks has been so rapid that the necessary investments in operations, such as systems and

processes,² have not kept up. The flood of MSR transfers from banks eager to offload servicing portfolios occurred before nonbanks were able to upgrade their systems, processes, or staff training; nonbanks often relied on a patchwork of measures that eventually led to major operational mistakes and errors. Such errors often caused significant financial harm to borrowers in unnecessary foreclosures or the inability to receive a timely loan modification. To mitigate their risk of increased exposure to nonbanks and minimize consumer harm, the GSEs and Ginnie Mae, as well as the Consumer Financial Protection Bureau, have issued new regulatory and capital requirements for mortgage servicers.³ While the GSEs' and Ginnie Mae's requirements are mostly financial—covering minimum capital, liquidity, and net worth requirements—the Consumer Financial Protection Bureau's requirements focus more on consumer protection.

Because the requirements set forth by each of these agencies mostly address the specific risks they are exposed to or responsible for regulating, comprehensive firmwide standards are lacking. In light of this, the Conference of State Bank Supervisors (CSBS)—a coalition of state regulators—has proposed state-level baseline financial and operational standards for nonbank servicers (CSBS n.d.). Collectively these capital and liquidity standards will help establish a minimum financial floor for nonbank entities considering servicing residential mortgages. Yet, CSBS's operational standards in risk management, servicing transfers, corporate governance, and data protection will, if finalized, promote better customer service and protection.

Table 1 summarizes the key financial requirements adopted by the GSEs and Ginnie Mae and those proposed by the CSBS. For comparison, this table also shows MSR treatment under Basel III. The GSEs and Ginnie Mae finalized these financial standards without releasing robust supporting analysis to justify them, leaving it unclear if the standards are adequate considering the risks involved. To determine whether they are, we must first assess how risky nonbank servicing really is.

TABLE 1

Nonbank Servicer Capital and Liquidity Requirements

| | Fannie/Freddie seller servicers | Ginnie Mae issuers | CSBS baseline | CSBS enhanced (complex firms) | Basel III MSRs (doesn't apply to nonbanks) |
|------------------------------|--|---|---|--|---|
| Minimum net worth | \$2.5 million plus 25 bps of servicing UPB | \$2.5 million plus 35 bps of issuer UPB | \$2.5 million plus 25 bps of servicing UPB | Management and board of directors to develop methodology subject to third-party verification and regulatory approval; methodology should incorporate portfolio size, advance requirements, loan type, etc. | 250% risk weight for MSRs under 10% of Tier 1 capital; dollar-for-dollar charge for MSRs over 10% of Tier 1 capital |
| Minimum capital ratio | Net worth/total assets of ≥6% | Net worth/total assets of ≥ 6% | None | | |
| Minimum liquidity | 3.5 bps of agency servicing UPB plus incremental 200 bps of NPL servicing over 6% agency UPB | Greater of \$1 million or 10 bps of MBS outstanding | 3.5 bps of all servicing UPB; no incremental charge | | |
| Effective date | Dec. 31, 2015 | Jan. 1, 2015 (new issuers); Dec. 31, 2015 (prior issuers) | Proposed | Proposed | Jan. 1, 2015 |

Note: bps = basis points; CSBS = Conference of State Bank Supervisors; MBS = mortgage-backed securities; MSR = mortgage servicing rights; NPL = nonperforming loans; UPB = unpaid principal balance.

Risks Faced by Nonbank Servicers

The value of MSR— which form a considerable portion of a nonbank balance sheet— depends on both interest rate risk and default risk. MSRs grant the owner the right to receive and retain servicing fees from borrower monthly payments.⁴ The value of MSRs is essentially the present value of the servicing income that a servicer expects to receive over the life of a loan, net of servicing expense. In other words, MSR values depend on two factors: annual servicing fee minus the cost of servicing the loan, and the life of the loan (years). Because the servicing fee is largely fixed at origination and the cost of servicing performing loans fairly modest, the single most important driver of MSR values for nondistressed loans tends to be the life of the loan.⁵ The longer a mortgage remains in active payment status— that is, the borrower neither prepays (refinances) nor defaults— the more servicing income a servicer can expect to earn, and the more valuable the MSR becomes. Thus, MSR prices depend on the default and prepayment rate each pool experiences.

The default rate on a pool of performing mortgages can be reasonably estimated using loan and borrower credit characteristics, and this estimate remains relatively stable under all but the most severe economic environments. The expected default rate therefore tends to be less of a driver of MSR values from day to day. In contrast, mortgage rates are much more difficult to predict and change daily, causing the prepayment outlook and, ultimately, MSR prices to change constantly.⁶ The interest rate risk inherent in MSRs is amplified by three additional factors:

- inherently high volatility of MSRs
- complex and imperfect hedging
- significant nonbank balance-sheet exposure to MSRs

MSRs Are Highly Volatile

Mortgage servicing rights are very similar to interest-only (IO) securities, which are backed by the interest portion of a mortgage. The price of a typical agency mortgage-backed security, such as a pass-through, is driven by the likelihood of receiving both the principal and interest payments. When a mortgage prepays, though investors lose future interest income, the principal component of the mortgage-backed security retains its value. The price of an IO (MSR), in contrast, is driven by the likelihood of receiving just the interest payment (servicing fee). Thus, when a mortgage underlying an IO (MSR) pool prepays, the expected cash flow from that mortgage vanishes. As a result, an IO (MSR) has a steeper decline in value and greater price volatility than a traditional mortgage-backed security.

Another source of heightened volatility is that MSRs are not actively traded in an open liquid market. Instead, as level 3 assets, MSR values are significantly model dependent, giving rise to increased model risk. The thinly traded nature of MSRs also means it can take longer for new information to be priced in, often resulting in more pronounced price swings.

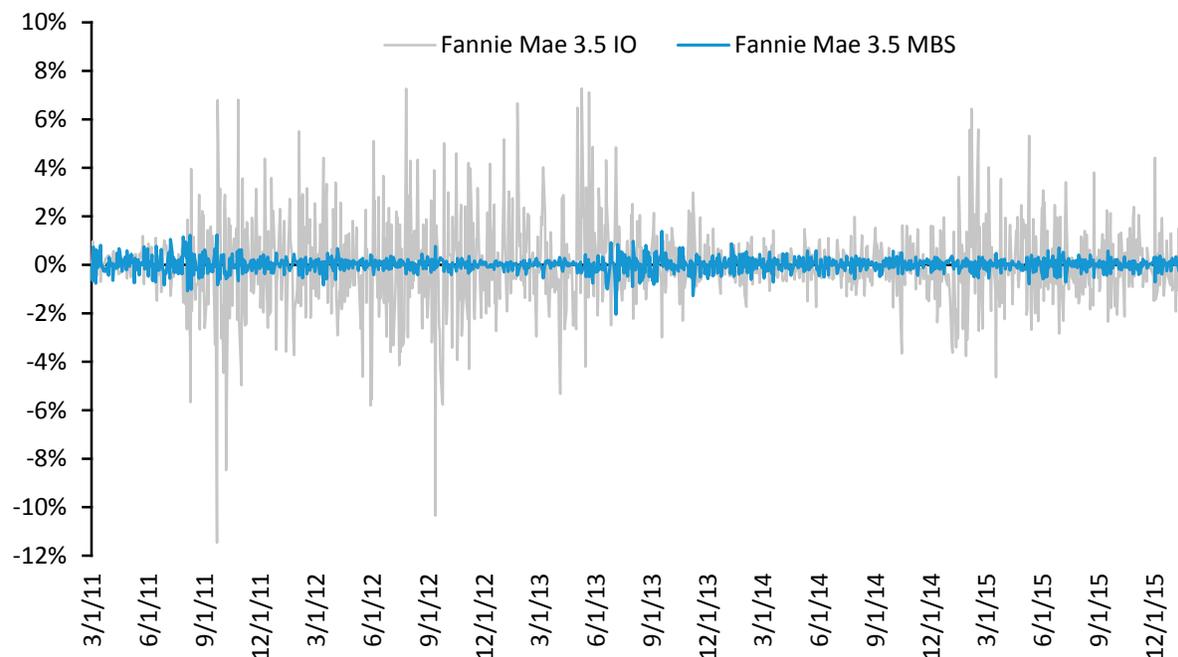
To illustrate MSR volatility, we compared the daily price change for 3.5 percent coupon Fannie Mae MBS to the same coupon Fannie IO from 2011 to 2015 (figure 2). The coefficient of variance⁷— which

measures how dispersed or volatile a dataset is—was under 3 percent for mortgage-backed securities but as high as 18 percent for IO over this period. In dollar terms, MBS prices varied from \$92 to \$108, a 17 percent move, while IO prices swung from \$11 to \$26, or over 136 percent.

FIGURE 2

Daily Price Change of 3.5 Percent Coupon Fannie Mae Mortgage-Backed Security (MBS) and 3.5 Percent Interest-Only (IO)

Change from previous day



Source: Credit-Suisse LOCUS Analytics platform.

MSR Hedging Is Highly Complex and Imperfect

Of course, servicers are well aware of this volatility and try to mitigate it by hedging. But hedging is not without challenges. First, MSR hedging requires complex trading strategies that rely on complicated derivative financial instruments. This method of offsetting MSR volatility also comes at the expense of heightened exposure to market risk. Typically, this doesn't present a major problem as long as markets function normally. However, when markets freeze or liquidity becomes scarce—as happens from time to time—hedging can become very difficult or prohibitively expensive. Additionally, hedges already in place might not function as expected, leading to unexpected losses.

Second, MSR hedging is designed to protect against interest-rate movements within certain bounds. If rates diverge beyond those bounds, the effectiveness of hedging erodes quickly. While servicers can put in place more comprehensive hedges that offer greater protection, the costs often become so excessive as to be uneconomical. As mortgage rates rise and prepayment speeds fall, MSR

become more valuable and hedges lose value. Because prepayment speeds cannot fall forever, at some point MSR values rise at a declining rate and eventually stabilize, even as the hedges continue to lose value. Interest-rate increases beyond this point would cause hedges to lose value without being offset by rising MSR values, eventually producing losses. Finally, hedging does not protect against non-interest rate drivers of prepayment speeds, such as a cut in FHA premiums or other actions that increase borrower incentives for refinancing.

MSRs Constitute a Much Higher Share of Nonbank Balance Sheets

Though banks and nonbanks both own MSRs and are both exposed to MSR volatility, the risk is more pronounced for nonbanks because MSRs constitute a much larger share of their balance sheets. Table 2 shows the balance-sheet-carrying value of MSRs and MSRs as a share of total assets for the five largest publicly listed banks and nonbanks as of the third quarter of 2015.

TABLE 2

Mortgage Servicing Rights (MSRs) Held by the Largest Public Banks and Nonbanks, Q3 2015

| | MSRs owned (\$ millions) | MSRs (% of total assets) | Shareholders' equity (% of total assets) |
|-------------------------|-----------------------------|-----------------------------|---|
| Largest banks | | | |
| Wells Fargo | 13,055 | 0.7 | 11.0 |
| JP Morgan | 6,716 | 0.3 | 10.2 |
| Citi | 1,766 | 0.1 | 12.2 |
| Bank of America | 3,043 | 0.1 | 11.9 |
| US Bank | 2,397 | 0.6 | 11.0 |
| Largest nonbanks | | | |
| Nationstar | 3,242 | 19.0 | 10.0 |
| Walter | 1,753 | 9.3 | 5.0 |
| Ocwen | 1,153 | 14.4 | 13.5 |
| Penny Mac | 1,307 | 34.3 | 25.9 |
| PHH Corporation | 927 | 24.0 | 38.3 |

Sources: Company SEC filings for Q3 2015.

There are three important takeaways.

First, MSRs make up less than 1 percent of total assets for each of the five banks. For the largest nonbanks however, the number ranges from 9 percent to 34 percent. Higher exposure to a volatile asset class only increases earnings and cash-flow volatility. Second, nonbank exposure to MSRs is not consistently offset by higher equity capital. That is, nonbanks with greater MSR exposure are not necessarily holding more capital. Third, and perhaps most important, the wild dispersion of equity—ranging from 5 percent to 38 percent—raises questions about nonbank financial discipline and balance sheet rigor, especially compared with more uniform bank equity levels.

Risk of Rising Delinquencies

Mortgage default activity can be driven by various macroeconomic factors, such as rising unemployment, falling housing prices, and interest rate shocks. When a mortgage defaults, the servicer not only loses servicing income but must also keep advancing monthly P&I payments to the investor using its own funds, as well as incur the notoriously high cost of servicing a now-delinquent mortgage. For mortgages backed by the FHA and the GSEs, servicers eventually get reimbursed for P&I advances and certain other costs. But until such time, servicers must have the financial strength to keep advancing—an obligation that can cause a severe liquidity crunch if defaults rise rapidly and unexpectedly. In addition, Ginnie Mae requires servicers to keep pool-level delinquencies below certain thresholds that, if breached, could trigger enforcement action and further accentuate liquidity pressures.⁸ These concerns are especially bigger for nonbanks that specialize in servicing delinquent or lower-quality mortgages. Having a higher concentration of lower-quality mortgages exposes specialty servicers to higher risks relative to servicers with more balanced portfolios. Regardless, when a nonbank servicer shows signs of trouble or violates its credit covenants, warehouse lenders and other providers of credit can quickly decide to pull back or restrict lines of credit. Additionally, because nonbanks tend to have less stable sources of funding and non-investment-grade credit ratings,⁹ any last-ditch efforts to borrow from other sources are unlikely to succeed.

In the midst of such a panic, the only viable option is to quickly find a buyer for the servicing portfolio, often resulting in a fire sale. Once again, this is a bigger worry for servicers of predominantly lower quality loans because buyers may be unwilling to take on servicing or might want a steeper discount. The nightmare scenario is an across-the-board rise in defaults that threatens multiple servicers, curtailing the number of potential buyers and complicating regulatory efforts to contain the panic. The GSEs are able to take possession of loans from an insolvent servicer and hold the loans in their investment portfolios as a last resort, but Ginnie Mae has no such ability. Ginnie Mae *must* find a new buyer for the servicing portfolio, putting it in a tighter spot. Nevertheless, difficulties associated with troubled servicing at either Ginnie Mae or the GSEs could put taxpayers, who are ultimately guaranteeing the mortgages, at risk.

Does Current Regulation Address These Risks?

High MSR volatility and significant nonbank exposure to MSRs suggests that the interest rate risks faced by nonbanks can cause significant stress during periods of rate volatility. These risks are further compounded by the obligation to advance payments to investors when borrowers default. Such risks seem low today because of the very low expected default rates of today's ultra-safe loans and a relatively stable interest rate environment. But they will not stay low forever. The capital requirements for all financial institutions—including nonbanks—should be high enough to offer protection *through the economic cycle*. Though the new capital and liquidity requirements issued by the GSEs and Ginnie Mae may seem adequate in today's environment, in our opinion they won't offer adequate protection when things turn south. There are two reasons for our concern.

First, setting aside the discussion of whether existing capital requirements are adequate, a more fundamental issue is that they are not risk based.¹⁰ Under the GSEs' and Ginnie Mae's capital regimes, nonbanks must hold the same minimum net worth of 6 percent of total assets regardless of how much MSR exposure they have, how effective their hedges are, or how creditworthy their loans are. Nonbank firms are highly heterogeneous and differ substantially in size and riskiness of their servicing portfolio, financing structures, and business diversification. At one end of the spectrum are specialized firms skilled at servicing distressed and delinquent mortgages; at the other end are firms that service higher-quality mortgages originated after the crisis. Likewise, some nonbanks have sizable origination businesses that provide a natural hedge against MSR risk, while others rely heavily on servicing income.

Requiring all nonbanks to hold same capital regardless of risk is not only unsound but also a notable departure from the bank capital regime, which requires assets to be risk weighted.¹¹ This issue is currently muted because the lessons from the housing crisis are still very fresh, default rates on new production are extremely low, interest rates are stable, and—most important—a broad-based aversion to risk is still in fashion. But as the scars from the crisis heal further and normalcy returns, risk aversion will slowly give way to risk seeking. And in the absence of risk-based capital requirements, there will be no formal regulatory deterrent against excessive risk taking. The GSEs and Ginnie Mae could address this gap by requiring the use of risk-weighted assets in place of total assets in capital calculation.

Second, though the GSEs' 200 basis-point liquidity requirement for nonperforming loans is well intentioned, it will likely end up being counterproductive because it requires nonbanks to shore up liquidity buffers at precisely the wrong time—namely, after defaults have risen and raising new capital is much more difficult and expensive. A better alternative would be to substantially increase the basic liquidity requirement of 3.5 basis points while decreasing or eliminating the incremental nonperforming loan charge. Adequate liquidity at all times will ensure nonbanks are better prepared going into a crisis. Reducing firm risk will no doubt increase the cost of doing business and reduce returns, partly because of a flawed servicing compensation structure that pays too much for servicing performing mortgages and too little for servicing nonperforming ones. However, as much as we would like to see a better servicing compensation framework, in reality that framework is nowhere in sight. And in our opinion it isn't prudent to hold up nonbank safety and soundness waiting for servicing compensation reforms.

Ginnie Mae requires its issuers to hold a much higher minimum liquidity: 10 basis points, three times the GSEs' basic liquidity requirement. On the flipside, Ginnie does not impose the incremental 200 basis points charge on nonperforming loans, opting instead to rely on extensive ongoing monitoring to help identify potential trouble early on. While there is nothing wrong with monitoring, we think it should be the second line of defense, after the requirement to hold adequate capital, for two reasons.

- First, capital and liquidity are linked. As losses rise and the capital cushion shrinks, nonbanks may have trouble accessing warehouse lines of credit, causing liquidity issues. Though Ginnie Mae is hoping monitoring will facilitate early detection, financial distress can often set in quickly and unpredictably, leaving little or no time for remedial action. For example, in the third quarter of 2015, several nonbanks had to significantly write down the value of their MSRs because of unanticipated interest-rate movement, causing many to take a quarterly loss.

Though the threat of insolvency was low, interest rate movements will surely be more pronounced and more sudden sometime in the future, limiting the effectiveness of monitoring.

- Second, because monitoring relies heavily on the timely submission of accurate financial statements, there is the added risk of reporting fraud, errors, and delays, especially for nonpublic firms or those without audited financial statements.

A stronger capital regime would seem to be a better form of defense in both these situations.

Of course, no “one size fits all” in servicing, especially given how much nonbanks differ from each other. Requiring community-based servicers with tiny portfolios to hold the same level of capital as larger firms could effectively throw them out of business, ultimately harming borrowers in those communities. Similarly, requiring specialty servicers—many of whom have a good track record of curing delinquencies—to hold much more capital could raise their costs significantly, forcing them to cut corners. To strike the appropriate balance and minimize any possible unintended disruption, the agencies could consider tying capital requirements to such variables as firm size, complexity, MSR exposure, or reliability of financing sources.

Why Do We Need a Stronger Nonbank Industry?

When faced with an insolvent servicer situation, Ginnie Mae and the GSEs generally respond by facilitating the transfer of the portfolio to a financially sound servicer. The goal is to ensure continued collection of borrower monthly payments and uninterrupted P&I payments to investors. However, servicing transfers have two major downsides .

First, ensuring proper continuity of servicing *quality* for borrowers, especially delinquent borrowers, often ends up deprioritized during transfers despite best intentions. Finding a new buyer quickly and maximizing sale proceeds are almost always likely to be more important. The skill set required for default servicing can vary significantly depending on the cause of delinquency and other factors. Servicing a portfolio of underwater defaulted mortgages requires a very different approach than servicing low loan-to-value mortgages that defaulted because of a job loss or divorce. Servicers that specialize in the latter often find it challenging to work on the former because they don’t have the right processes, systems, or people. This mismatch only increases the likelihood of additional borrower stress through lost data and documentation, delays in receiving a workout option, and so on.

Second, servicing transfers can also become uneconomical for Ginnie Mae and the GSEs. Because ultimately these entities are backing the loans, any shortfall between the P&I advances that must be made by the new servicer and the value of the servicing transferred would have to be borne by these agencies. That is, Ginnie Mae and GSEs might have to pay the new servicer to pick up the loans, putting taxpayers at risk.

For these reasons, we believe transfer of servicing must be used only as a last resort. The first line of defense should be better safety and soundness measures through adequate capitalization to reduce the

risk of insolvency. Currently, the risks, costs, and disruptions associated with transfer of servicing under distress are borne largely by borrowers, the agencies, and ultimately taxpayers. Bolstering nonbank capital requirements would effectively pass on some of this cost to the industry and reduce the risk posed to other entities.

Conclusion

The growth of nonbank servicers over the past five years has filled a critical market need. If nonbanks had not filled the void left by depository institutions, many mortgages that were successfully cured, often through specialized and creative loan modification techniques, would have ended in foreclosure.

But with greater power comes greater responsibility. Though the current capital and liquidity standards promulgated by the GSEs and Ginnie Mae are a welcome step, these requirements appear inadequate once the risks and complexities of nonbank servicing are taken into account. We urge the GSEs and Ginnie Mae to revisit this topic in order to strike a healthier balance between capital requirements and ensuring a well-functioning industry that works for borrowers, investors, and taxpayers, in both good times and bad.

Notes

1. Such transfers are generally initiated by the entity owning the loans (Fannie Mae, Freddie Mac, or Ginnie Mae).
2. See FHFA (2014a), pages 7–8, and FHFA (2014b), page 26.
3. See “Fannie Mae and Freddie Mac Issue New Eligibility Requirements for Sellers/Servicers,” Federal Housing Finance Agency, news release, May 20, 2015, <http://www.fhfa.gov/Media/PublicAffairs/Pages/New-Eligibility-Requirements-for-SellerServicers.aspx>; “Ginnie Mae Announces Changes in Issuer Requirements at 2014 MBA Annual Convention,” news release, October 20, 2014, http://www.ginniemae.gov/media_center/Pages/PressReleaseDispPage.aspx?ParamID=94; and “2013 Real Estate Settlement Procedures Act (Regulation X) and Truth in Lending Act (Regulation Z) Mortgage Servicing Final Rules,” Consumer Financial Protection Bureau, January 10, 2015, <http://www.consumerfinance.gov/regulations/2013-real-estate-settlement-procedures-act-regulation-x-and-truth-in-lending-act-regulation-z-mortgage-servicing-final-rules>.
4. This fee is typically 25 basis points for GSE-backed and 44 basis points for FHA-insured mortgages.
5. The value of nonperforming MSR depends predominantly on the cost of servicing because both prepayment and default risks are inapplicable.
6. Prepayment behavior is also very sensitive to non-interest rate drivers, such as the introduction of borrower-friendly refinance programs (streamlined refinance and HARP, for example) and reduction in mortgage insurance premiums, among others.
7. The ratio of standard deviation to the mean. Higher value indicates more volatility.
8. See chapter 18 of Ginnie Mae’s Mortgage-Backed Securities Guide at http://www.ginniemae.gov/doing_business_with_ginniemae/issuer_resources/MBSGuideLib/Chapter_18.pdf.
9. Moody’s credit rating for five largest nonbanks’ senior debt ranges from Ba3 to B3.
10. The one exception is the GSEs’ 200 basis points incremental charge on defaulted mortgages—a charge that doesn’t address interest rate risk and addresses credit risk after the fact.
11. Banks are also subject to absolute capital requirements that are not risk based. Also known as leverage ratio, these requirements are designed to cap financial institution debt and leverage regardless of how low-risk their assets are.

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