December 21, 2011

*VIA E-MAIL: **Servicing_Comp_Public_Comments@fhfa.gov***

Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20552

Re: Alternative Mortgage Servicing Compensation Discussion Paper

Ladies and Gentlemen:

The American Securitization Forum ("ASF")[1] appreciates the opportunity to submit this letter to express our views relating to the servicing compensation proposals set forth in the Alternative Mortgage Servicing Compensation Discussion Paper, dated September 27, 2011 (the "Discussion Paper"). ASF commends the Federal Housing Finance Agency ("FHFA") for seeking industry input regarding the development of alternative mortgage servicing compensation structures. ASF has become the preeminent forum for securitization market participants to express their views and ideas. ASF was founded as a means to provide industry consensus on market and regulatory issues, and we have established an extensive track record of providing meaningful comment to government agencies on issues affecting our market. The views expressed in this letter are based on feedback received from our broad membership.

The Discussion Paper was introduced to address concerns relating to the current servicing fee model ("Current Model"), which provides for a servicer to be paid a fee equal to 25 basis points of the principal balance of the related mortgage loans (the "Minimum Servicing Fee"). Under the Current Model, a portion of the Minimum Servicing Fee will be capitalized (a "Capitalized MSR"), which may be difficult for many institutions to retain[2] and may not provide adequate

1 The American Securitization Forum is a broad-based professional forum through which participants in the U.S. securitization market advocate their common interests on important legal, regulatory and market practice issues. ASF members include over 330 firms, including issuers, investors, servicers, financial intermediaries, rating agencies, financial guarantors, legal and accounting firms, and other professional organizations involved in securitization transactions. ASF also provides information, education and training on a range of securitization market issues and topics through industry conferences, seminars and similar initiatives. For more information about ASF, its members and activities, please go to www.americansecuritization.com.

2 Under the Current Model, the Minimum Servicing Fee is required to be retained by the servicer. As a result, a portion of the Minimum Servicing Fee must be recognized as a capital asset by the servicer, requiring many servicers to hold capital against such asset and perform periodic valuations of such asset (which is difficult due to

incentives or sufficient funds for a servicer to effectively service defaulted or non-performing loans. The Discussion Paper proposes two alternative mortgage servicing compensation models. The first model would modify the Current Model by (i) reducing the existing Minimum Servicing Fee from 25 basis points to between 12.5 and 20 basis points and (ii) authorizing the establishment of a reserve account to cover servicing expenses once a loan becomes non-performing (the "Reserve Fund Model"). The second model would replace the Current Model with a fee for services arrangement whereby the applicable guarantor, either Fannie Mae or Freddie Mac (the "Enterprises"), would be responsible for monitoring the servicing and paying the servicer a set fee each month for performing loan servicing. The related guarantor would also be responsible for compensating the servicer for any actions taken to service non-performing loans. Under this model, a portion of the Minimum Servicing Fee would still be payable to the related servicer; however, such excess servicing fee would be a tradable asset, not required to be retained by the related servicer (the "Fee For Services Model").

The ASF membership, which represents a large and diverse group of industry participants, including servicers, originators, issuers and investors, as well as legal, tax and accounting professionals, expressed a wide variety of opinions on the proposals. While there was no consensus view on the relative merits of either model, our membership weighed the specific features of both proposals and offered comments that we believe should be considered in either case. In addition, the lack of specificity of the proposals and the uncertainty surrounding the plans for the future operations of the Enterprises make it difficult to address many of the questions with any level of certainty. We set forth below, however, our responses to certain of the questions raised by the Discussion Paper as well as our views on the proposed models with respect to non-Enterprise securitization structures.

I. Responses to Certain Questions in the Discussion Paper

What are the impacts of these proposals on the competitive landscape in origination and servicing markets, service to borrowers, and efficiency in secondary market?

It is not clear whether either proposal would have any significant impact on the level of competition in the servicing or origination markets. For example, while the Fee For Services Model could lower barriers to entry for smaller servicers, it would also be of greatest benefit to those servicers that can best take advantage of the economies of scale inherent in servicing operations. In contrast, the Reserve Fund Model retains certain of the attributes of the Current Model (e.g., capitalization of the Minimum Servicing Fee) that may, as outlined in the Discussion Paper, reduce competition due to the impact of the capitalization of the Minimum Servicing Fee; however, it is also possible that proposed increased capital requirements associated with the retained Minimum Servicing Fee will actually increase competition, as such increased capital requirements may necessitate the reduction of a large servicer's servicing rights portfolio. Similarly, any impact on the origination markets is impossible to predict, as the

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the lack of an efficient market for such asset). The asset may also be subject to significant volatility, making it difficult and expensive to hedge.

elimination of the "natural hedge" provided by the Minimum Service Fee may introduce unacceptable volatility into overall mortgage operations.

> *What are the benefits and/or the impediments to your business model of having a capitalized MSR asset?*

Given our broad membership, the individual nature of this question makes it impossible to provide a response that cuts across our membership's diverse interests. Ultimately, such a determination would depend on a vast array of individual circumstances, including the regulatory capital obligations of the firm, the size of their balance sheet, their niche in the market and their current business plan.

> *Should a lender's excess IO remain contractually attached to the MSR, or would seller/servicers prefer to have the excess IO be a separate stand alone asset (unencumbered by the Enterprises)?*

The flexibility of separating the excess IO strip was generally viewed favorably for either proposal; however, it is impossible to predict that any sizeable market would develop for such interests. In addition, without guidance from the IRS, it is unclear whether a detached IO that is freely transferrable by the servicer would fall under the existing tax safe harbor, and accordingly, it is difficult to forecast the potential impact of any adverse tax consequences from retaining such IO interest.

> *Would these proposals encourage greater investment in non-performing loan operations or abilities in a benign market cycle?*

We believe that, without a more specific proposal, including the resolution of proposed servicing fees for non-performing loans and the potential development of national servicing standards, it is impossible to provide appropriate insight to this question. We believe that the FHFA's next iteration of this Discussion Paper must include the relevant proposed terms and fees associated with the servicing of performing and non-performing loans so that the industry can appropriately respond to this question.

> *Should any of the provisions that were proposed in the fee for service proposal be considered independent of any other changes to servicing compensation structure?*

There is a general consensus among servicers that to the extent the proposals provide greater flexibility and/or reductions of costs, such provisions would be a benefit for the Current Model or either of the proposals. For example, bifurcating the seller and servicing representations, and limiting the principal and interest advancing requirements to four months would help reduce the overall servicing costs for servicers.

II. Views with Respect to Non-Enterprise Securitization Structures

Generally, it is difficult to envision that the Fee for Services Model could be implemented without the active, continuing involvement of the Enterprises (both in the oversight and financial backstop roles). As proposed, the Fee for Services Model requires the guarantor, Fannie Mae or Freddie Mac, to (i) pay the servicing fee for performing and non-performing loans (including amounts in excess of any master servicing fee collected) and (ii) provide active oversight of the servicing (including determination of special and non-performing loan servicing standards and fees, enforcing seller and servicer representations and, if necessary, transferring servicing and appointing successor servicers). It does not appear that the Fee for Services Model could be applied in a typical private label securitization structure without the appointment of an independent third party to act in the enhanced master servicing role described above, including the obligation to make the servicing payments for performing and non-performing loans.[3] Obviously, if the compensation for such enhanced master servicing role is to come out of a strip similar to the strip provided for in the Current Model for the compensation of servicers, such structure would not alleviate any of the valuation, capital or volatility concerns, in that it would merely transfer the issues for the servicers in the Current Model to the master servicer in the Fee for Services Model.[4] However, if the Fee for Services Model is implemented by paying any servicing or special servicing fees out of securitization cash flow instead of obligating the master servicer to fund such amounts, the potential impact on such cash flows would be difficult to accurately model and would be expected to adversely impact the efficiency of the related securitization.[5] Additionally, private label securitization structures incorporate subordination through the issuance of securities that are subordinated to the senior securities with respect to both payments and the allocation of losses. Due to the differing interests of the various tranches, investors may not agree on whether loss mitigation was appropriate in many cases.

In contrast, the Reserve Fund Model appears to present fewer conceptual issues in the application outside of the Enterprise securitization transactions. We do note, however, that the tax and accounting treatment of the reserve account is uncertain, including uncertainty about the proper treatment of the reserve account under the REMIC regulations, the applicability of the tax safe harbor and the treatment of such reserve account for capital purposes. A more detailed outline of the expected operations of the reserve fund, including the potential costs that the reserve is meant to capture and whether such costs are reimbursable by the borrower or other parties may help minimize some of the inherent uncertainties surrounding this proposal.

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3 Indeed, such concerns are applicable to the Fee for Services Model if adopted by the Enterprises to the extent that the operations of the Enterprises are expected to be reduced or diminished in the future, such as described in the Administration's report entitled "Reforming America's Housing Finance Market."

4 In addition, the treatment of the excess master servicing strip for tax purposes is uncertain and may actually increase total tax liability to the extent that the servicing safe harbor is not applicable to such strip.

5 Because the servicing fee payments under the Fee for Services Model are unknown at this stage, it is hard to gauge the impact on REMIC structure/treatment.

Given the uncertainty surrounding both proposals, the potential for significant unintended consequences and the concerns as to the application of such models to the securitization structures other than Enterprise securitizations, in each case without the clear expectation of significant benefits to servicers, borrowers or investors, we cannot recommend the implementation of either proposal. We believe, however, that the implementation of fundamental changes of the type discussed in the Fee for Services Model would greatly increase the chance of unintended consequences and thus create more risk in both the servicing and origination markets. Accordingly, we believe that the incremental changes proposed as part of the Reserve Fund Model are less intrusive, would be easier to implement across more types of transactions and would create less risk of severe unintended consequences. In any event, as stated above, the specific details of both proposed models will need to be more fully described before the industry can provide detailed feedback on either model.

ASF very much appreciates the opportunity to provide the foregoing views in connection with the proposals set forth in the Discussion Paper. Should you have any questions or desire any clarification concerning the matters addressed in this letter, please do not hesitate to contact me at 212.412.7107 or at tdeutsch@americansecuritization.com, or ASF's outside counsel on this matter, Edward Douma of Hunton & Williams LLP at 804.788.8320 or at edouma@hunton.com.

Sincerely,

Tom Deutsch

Tom Deutsch
Executive Director
American Securitization Forum