

To whom it May Concern:

The proposed changes to MSR Compensation put forth by FHFA should not be enacted. The stated reasons for the changes are not going to be solved by changing compensation structure or economics in this way. Most likely these changes would lead to further consolidation of mortgage servicing and thus further dysfunction due to both lack of competition and concentration risk during crises.

The World Economy vis-a-vis the United States housing market has not yet found a bottom. Continual changes in the economic structure of servicing as well as further regulation and changes of the financial markets will undoubtedly create a longer recovery. This in turn will effect employment which will also slow the recovery of the United States economy.

This author strongly urges the FHFA to tread lightly with this important part of the World & United States economy. Servicing values directly affect MBS pricing. MBS markets effect housing in the United States. The housing market is \$10 Trillion or approximately 1/6 of the world GDP. In a time where there is vast uncertainty it is prudent to think things through with great dilligence before acting. This proposal is not well timed nor is it completely vetted- as all aspects of the ideas have not been properly documented, communicated or studied.

If enacted these changes would lead to fewer servicers in the United States. The United States housing market would be served far better by several hundred or thousand smaller servicers taking the majority of the market share of servicing.

This is not to say that the larger institutions should not have a larger portion of servicing than average servicer- they should. However, there should be an emphasis on diversification of the system for servicing.

The proposed changes would stifle diversity by making it improbably that smaller or medium sized originators would take on additional risk of servicing for little return. Ultimately the consumer would be hurt by the lack of competition in this part of the industry by fewer innovative ideas and higher fees and charges. The current model favors a disproportionately few servicers and this proposal ensures the status quo.

Servicing disaggregation (meaning the spreading out of MSR to be performed by many different entities instead of just 10) would both connect the originators of mortgages to the quality of the mortgages as well as the performance of the servicing asset which in turn would impact the performance of the MBS market in a positive way.

Disaggregation would also allow the larger banks to lessen the burden they have to carry the market through volatile times. Often times they are so significant that they must provide services for certain segments of the population even if this does not

bode well for their share holders because they are the only ones who can provide large scale services. With their balance sheets reduced they would be free to earn higher yielding servicing values for more esoteric servicing that would reach deeper of their own volition into the market. The medium and the smaller servicers would be able to handle the bulk of the GSE market were it phased in over time.

More originators, coming into servicing and building their servicing rights on their balance sheets, would stabilize the real estate mortgage finance industry because many of the originators and servicers would have cash flows that they currently lack due to an imbalance of MSR ( 70% of all servicing is on the balance sheets of less than 10 entities. ). The current proposal would further consolidate this into even fewer entities thus exacerbating the current perceived “problem” with mortgage servicing.

Furthermore, should there be a need for the servicer to perform default servicing administration, it stands to reason that a more locally owned and operated institution would be able to handle their customers with greater care and cultural understanding. This would also allow for the system to take larger shocks without a systemically important institution damaging the entire system. Also, the regional banking institutions would be more amenable to the particular circumstances of that region.

The following will hopefully support the above premise. For this comment paper the supporting documentation origins have not been cited but are available upon request.

### **Fee for Service:**

The basic premise of this proposed model states that a fixed flat fee per month would be paid to the servicer. In short, the fee is less than most servicers’ cost to service loans. Due to this economic fact many of the current servicers would not be able to continue to aggregate servicing. Fewer participants is worse for any industry.

The Fee For Service Model also states that the fee would not be guaranteed and is subject at any time to changes up or down. The instability of this asset would create uncertainty about the assets future value. Marking this asset would become very volatile. This would be a costly problem.

### **Pay for Performance:**

This idea will create an incentive to write poorly performing loans and put poorly performing assets onto the books of banks and mortgage servicers. It does not make sense to pay someone more if they have a loan that has gone bad but this is what is proposed. In fact, one would argue that the more money a business loses due to poorly performing loans then it would learn to be more diligent in the process of

writing mortgages. This in turn would lead to further innovation and tightening of policies and procedures. This then would lead to fewer losses and greater profits. This then would lead to higher quality of customer service and more innovation, etc...

### **Cash Flow:**

It is proposed that the cash flow of the servicing compensation would first belong to the GSEs then be passed along to the servicers. Having the servicing income follow this cash flow path, while also considering that both GSEs are under capitalized, has the potential to make this asset less valuable and more susceptible to risk due to solvency risk of the GSEs. Basically, this creates a higher 3<sup>rd</sup> party risk assessment.

### **Excess MSR & IO Strip:**

The current buy-up & buy-down grids would need to be adjusted to allow for the fee for service model and also the “.125% servicing model”. There is no current paperwork describing this issue but the consequences of this excess MSR and where it goes and how it is valued is a variable that will create instability in the MSR and MBS markets due to lack of precedent. Orphan IO servicing has some merits when it comes to bifurcation of reps and warrants and lien position for the purposes of obtaining financing. However, the negatives are many and the questions are even more.

### **Taxes:**

Currently the IRS safe harbor that allows for the postponement of taxes until actual cash flow is an important part of growth for smaller servicers. It allows them to build their balance sheet while deferring taxes. This then allows for more leverage and strong cash flow- two things that are very important in mortgage market cyclicity.

Under the changes there is no mention of the tax consequences. IO is treated differently when taxed and it is not as favorable in tax treatment. There has been no paper that discusses this to date by FHFA or the IRS. Because there has been no discussion one has to deduce that this was not at all discussed and is “unknown”. This then becomes a large problem for the smaller servicers and originators trying to aggregate servicing. They must solve this problem with no precedent in unstable times. It creates a slower build up time for originators and servicers. This then attracts fewer investors interested in backing smaller originators and servicers. Thus further creating hurdles for the mortgage market to become more diversified- which is very important to both the purpose of the FHFA’s stated goal with these proposals as well as the stability of our financial system as a whole. Fewer is worse than many.

### **Proposed .125% MSR:**

In short this will help large banks effected by Basel 3 restrictions. It is these very same banks that are currently holding 70% of all mortgage servicing rights. They are the status quo. If the proposed changes seek to fix the status quo then this will not achieve this. In fact, it will result in further aggregation of MSR by larger servicers because they will no longer need to be concerned about the restrictions of Basel 3 and they will have a large advantage over smaller servicers due to cost of funds, etc... It is unclear how this will actually help servicing in any way.

Also unknown is how the buy-up and buy-down grids would function, what the excess IO would be and how the tax treatment thereof would be handled. It is also dubious as to what economic value this asset would have for mortgage originators.

### **Summary:**

These changes would take a highly liquid asset like MBS and create uncertainty of value with unseen consequences to the markets and the economy as a whole. It is unclear what- if anything -will happen when and if this change occurs. It is unclear why any changes are being proposed as it does not seem to address the issue of servicing in any real way at all. If any change must be made for some reason then a more conservative change would be less dramatic and far less disruptive.

No changes should be enacted now; However, if a change had to be made it is prudent to use a model that would call for a 5 basis point reserve plus a 20 basis point notional pass through to servicers. This reserve would be held in escrow in a bankrupt remote way for a period of time ( 2 years) and then released to the servicer. If the loan were to pre pay sooner this would be adjusted accordingly.

Sincerely,

Matt Ostrander  
CEO  
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