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Submitted Electronically to: [Servicing\\_Comp\\_Public\\_Comments@FHFA.gov](mailto:Servicing_Comp_Public_Comments@FHFA.gov)

██████████ Bank appreciates the opportunity to comment on FHFA's *Alternative Mortgage Servicing Compensation Discussion Paper* (Discussion Paper). Below please find our general comments on the Discussion Paper:

**Background**

In February 2011, FHFA issued a document that illustrated four proposed servicing fee structures that are being explored by the GSE's. On September 27, 2011 FHFA issued a Discussion Paper that requests comments on two proposed models: 1) a cash reserve structure (the "Alternative Minimum Servicing Fee" or "AMSF") and 2) a structure that calls for payment for servicing performing loans of \$10 per loan per month and existing incentive payments for non-performing loans (NPLs). In the AMSF, servicers would retain a reduced Minimum Servicing Fee strip (ranging from 12.5 to 20 basis points) relative to today's 25 basis points standard, with an additional reserve account (ranging from three to five basis points) to cover non-performing loan servicing costs. The FHFA currently favors the fee for service model.

FHFA has stated its goals for this Discussion Paper are: (i) improve service for borrowers; (ii) reduce financial risk to servicers; and (iii) provide flexibility for guarantors to better manage non-performing loans, while promoting continued liquidity in the TBA mortgage securities market.

**General Observations**

- The existing fee structure has been in place and served well for decades. The proposed change is a radical departure from what is known to work.
- Discussions are premature in that Freddie and Fannie do not yet fully agree on a servicing standard. Therefore, we cannot negotiate compensation prior to knowing what will be required.
- Since a large servicer can generally service loans at a cost lower than a small servicer, a reduction to servicing compensation would likely create a barrier for smaller servicers to compete and new servicers to enter the market.
- Under the current compensation structure, ██████████ Bank has been able to maintain low delinquency rates by successfully growing our infrastructure to manage the current economic conditions and borrower's financial hardships.
- The FDIC in their Supervisory Insights dated May 2011 state that the delinquency rates and servicing problems at community banks such as ██████████ Bank have been far lower than those of the top 14 servicers. As such, the problems with the larger intuitions should be addressed with those that have fallen short in those areas.
- Many servicers use servicing as a countercyclical component to hedge production revenue. For example, an increase in rates causes a reduction in MSR decay, and amortization expense, which offsets, in part,

the decrease in production revenues related to the higher rate environment. With less MSR's recorded on the balance sheet, this natural "macro hedge" would be lost.

- Under the proposed fee for service structure, the GSEs may unilaterally change the fees paid to servicers.

### **The Proposed Fee for Service Structure Does not Comport with FHFA's Stated Objectives**

- I) **It Does Not Improve Service for Borrowers:** The proposal as stated in the Discussion Paper would be to compensate servicers at \$10 per loan per month over the life of the loan for performing loans and no compensation for NPLs other than existing incentive compensation. This represents a net decrease in overall servicer compensation. Such low levels of compensation are insufficient for small servicers such as [REDACTED]
- II) Bank to continue to invest long term in facilities, systems and infrastructure to serve the borrower better. Further, existing incentive compensation programs do not necessarily focus on the most important areas like 30- and 60-day delinquent loan servicing.

In addition, the proposed fee for service structure coupled with expected increases in G-fees will ultimately increase prices borrowers pay to finance their homes.

- I) **It Does Not Reduce Servicer's Financial Risk:** The proposed fee for service structure results in the servicer being locked in a flat monthly fee per loan for up to 30 years giving rise to inflation risk. Changes to that fee structure could be made unilaterally by the GSEs further exposing the servicer to financial risk. Likewise, the fee structure does not call for cash reserves or additional payments for servicer costs related to catastrophic economic, delinquency and foreclosure events. In addition, the fee for service structure exposes the servicer to a potentially significant new risk. Presently, servicers are paid out of the principal and interest payments from the borrowers. Under the proposed structure, the servicer's compensation would be paid by the GSEs. Given the fact that the GSEs are now in conservatorship and their future fate is not known, this gives rise to a significant counterparty risk to the servicer.
- II) **It Does Not Provide Flexibility for Guarantors to Better Manage Non-Performing Loans:** Again, the low levels of compensation proposed will not allow for the Servicer to adequately invest in the infrastructure necessary to manage NPLs.

### **Impact on the Competitive Landscape**

- I) **Uncertainty Around Inflation Increases:** Although inflation has been reasonably low in recent years, the government's deficit spending could eventually result in inflation. Although the proposed structure calls for the GSEs to review the fee annually, this would be a unilateral decision whereby the servicer has no role in the process and the decision would be prospectively applied. This uncertainty is an additional barrier to entry and may be an additional risk that causes existing servicers to exit the market.
- II) **Bifurcation of Seller and Servicer Reps and Warranties:** Under the GSEs' existing seller/servicer guidelines, the servicer is responsible not only for servicing reps and warranties but also for seller or originator reps and warranties. The GSEs have been aggressively enforcing seller reps and warranties in recent years, and this has caused the secondary market for GSE MSR's to grind to a halt. The GSEs propose to allow the servicer to pay a fee to bifurcate the seller reps and warranties from servicer reps and warranties in the future under the fee for service structure.
- III) **Concerns about Collectability of Incentive Payments:** In the Discussion Paper, the only compensation for servicing NPLs is existing incentive programs. Such fees can be unilaterally withheld by the GSEs or the GSEs could otherwise curtail servicer advance recoveries if certain deadlines in the Seller/Servicer

Guidance are missed by servicers as a result of the servicer's diligent and conscientious efforts to assist borrowers in loan modification or other loss mitigation programs.

### **Difficulties in analyzing the Proposed AMSF (Reserve Account) Structure**

While the AMSF proposal has received backing of the MBA and The Clearing House, each has a different idea of how it should play out. The feasibility of this proposal as it relates to capital requirements, accounting and tax treatment, trust considerations, origination economics, and other impacts are not yet determined and warrant further analysis before an objective business analysis can be made.

Most of the proposed features in the AMSF concept could include the following changes detrimental to successful servicers such as ██████ Bank.

- If the MSF is reduced below the current 25bps, the funds necessary for ongoing development and infrastructure are also reduced.
- The reserve account would “kick-in” after pre-determined, thresholds are met. Above-average servicer performance that helps negate the need for the reserve account could lead to a partial or full refund of the reserve account to the servicer, based on pre-determined triggers and performance targets. These triggers are not currently defined, but a clearly defined plan could benefit a servicer like ██████
- The servicer bears the risk that the MSF and the reserve account are insufficient to cover the servicer's costs. The guarantor/investor/trustee *may* directly compensate servicers to cover any resulting shortfall; however the plan does not indicate they would be required to do so or if compensation would change based on the Servicer Alignment Initiative. Current and proposed plans do not focus on important early delinquency areas such as 30-60 day delinquent loans.

In summary, the reserve account proposal attempts to incorporate concepts discussed in the industry, as a mechanism to move forward with any changes as proposed by FHFA. It is the position of ██████ that any changes to the existing model would be premature and the proposed fee for service model would be detrimental and bar smaller servicers and community banks ability to enter and compete in the market.

██████ Bank appreciates the opportunity to share its observations with you. Any questions about our comments should be directed to ██████ Vice President Loan Servicing, at ██████ or ██████  
Regards,