FinancialAnalysis
PARTNERS LLC

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Submission to: Servicing_Comp_Public_Comments@FHFA.gov

This letter is to provide our comments to the Federal Housing Finance Agency (FHFA) regarding its "Alternative Mortgage Servicing Discussion Paper," released on September 27, 2011. As background, the undersigned has been involved in the mortgage banking industry for over 33 years, including as a CPA auditing mortgage servicers, as a mortgage company CFO and as an entrepreneur that has successfully provided capital to the mortgage servicing and warehouse lending components of the industry. We have spent much of 2011 raising capital to provide mezzanine financing to privately held mortgage bankers principally to fund their investment in mortgage servicing rights, including loans serviced for FNMA, FHLMC and GNMA.

While we appreciate the interest of FHFA and other regulators to ensure quality service to borrowers, reduce financial risk to servicers, and ensure flexibility for guarantors to better manage non-performing loans, we believe that any change to the current servicing compensation model is unnecessary to accomplish these goals. Indeed, we believe the so called "fee for service" alternative that seems to be favored by FHFA *is dangerously flawed and misguided.* Furthermore, you should know that *adoption of this alternative would cause us to abandon our project to provide capital to the mortgage servicing industry.*

Financial Analysis Partners believes that FHFA's premise that servicer compensation incentives are misaligned with borrowers' and guarantors' interests is totally flawed and baseless. Under the current compensation arrangement servicers receive servicing fees only as the borrower pays. The servicing fee is collected out of the borrowers' remittances. If a loan goes delinquent there is no remittance from which to collect the servicing fee. In most cases the servicer is required to advance principal and interest to investors and protect the property if it's abandoned, maintain insurance and taxes, etc. If the servicer can successfully modify the loan, then the delinquent servicing fees can be collected. If the loan forecloses, the unpaid fees are never collected. These economics create a powerful incentive to keep mortgages current and work with borrowers when loans go delinquent.

In the existing servicing compensation model, servicers retain an economic interest in the performance of the loans they are servicing. Since non-performing loans are more costly to service than current loans, the servicer is incentivized to reduce the level of delinquencies in order to maximize profits. Any proposal that compensates a servicer with additional fees for non-performing loans simply doesn't make sense, since it encourages servicers to allow performance to deteriorate. Furthermore, a flat fee-for-service model would represent a dramatic net decrease in overall servicer compensation and would cause mortgage servicing to become a very low margin business requiring massive economies of scale. The obvious result is that the industry would undergo further consolidation, forcing smaller and medium-sized servicers to exit the business completely. Such an outcome would be virtually guaranteed and cannot possibly be in the best interest of the American people.

The adoption of the FHFA fee for service alternative may be beneficial for a very few mega-servicers to help them comply with capital requirements under Basel III, but it will have a negative effect for all other small and medium-size servicers, and would effectively reduce the role of all servicers to that of a subservicer for Fannie Mae and Freddie Mac. Modifying the servicing fee structure under the FHFA fee for service proposal will cause further consolidation of mortgage servicing rights among the largest servicers, without any meaningful benefit for the industry as a whole. Bluntly, we believe it would actually lead to poorer service to borrowers rather than an improvement – taking all the profit out of an activity and reducing competition is a sure fire way to guarantee poor performance!

While we do not endorse a change to the current servicing compensation model, we do recognize that regulators may feel that there is a need for change. If FHFA feels strongly that making fundamental changes to the servicing fee structure is necessary, of the options presented in the September 27th discussion paper, we urge FHFA to adopt the cash reserve model. Of the two proposals presented, it is the only one which truly meets FHFA's stated objective while ensuring minimal disruptions to the market.

We would be pleased to provide additional comments or answer any questions you may have about the opinions expressed in this letter. You may reach me at 281-980-0757 or at dfleig@financialanalysispartners.com. Again, we urge you to refrain from adopting a radical change to mortgage servicer compensation. To repeat, adoption of the so called fee for service alternative would dramatically curtail the investment of new capital in residential mortgage servicing, including our abandonment of a private equity fund capital raise which is close to a successful conclusion after a great deal of effort over the past 9 months.

Sincerely,

David C. Fleig
President

Copy to: U.S. Congressman Pete Olson
U.S. Senator John Cornyn
U.S. Senator Kay Bailey Hutchison