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December 27, 2011

Federal Housing Finance Agency (FHFA)
1700 G Street, NW
4th Floor
Washington, DC 20552

Re: Comments regarding "Alternative Mortgage Servicing Compensation Discussion Paper"

Dear Sir or Madam,

The Credit Union National Association (CUNA) appreciates the opportunity to comment on the Federal Housing Finance Agency's (FHFA) "Alternative Mortgage Servicing Compensation Discussion Paper" (Discussion Paper). This letter represents CUNA's views on the alternative servicing compensation proposals set forth in the Discussion Paper. By way of background, CUNA is the nation's largest credit union trade organization, representing approximately 90 percent of our nation's 7,300 state and federal credit unions, which serve approximately 93 million members.

The Discussion Paper outlines two possible alternative servicing compensation proposals for public consideration and comment:

1. "Reserve account": Establish a reserve account within the current servicing compensation structure, in which case the minimum servicing fee would be reduced from today's 25 basis point minimum to a minimum of between 12.5 and 20 basis points, with an additional reserve amount of between 3 and 5 basis points set aside in a reserve account. This would be used to offset unexpectedly high servicing costs associated with servicing non-performing loans; or

2. "Fee for Service": Create a new compensation structure, where the guarantor would pay a set dollar fee per loan for servicing (effectively tying the compensation to the number of loans being serviced rather than the size of the loans). This would be funded by a master servicing strip collected by the guarantor from interest payments paid by the borrowers.

CUNA understands that FHFA's objectives are to improve service for borrowers, reduce financial risk to servicers, and to provide flexibility for guarantors to better manage non-performing loans while promoting liquidity in the mortgage securities market.

However, CUNA has significant concerns with the proposals because CUNA does not believe that the Discussion Paper adequately describes the proposals in sufficient detail. In light of the vagaries of the proposals, CUNA believes that any change in the mortgage servicing compensation structure is unnecessary and inappropriate at this time, and moreover, is concerned that the proposed changes could have the effect of consolidating the servicing industry into a few large players resulting in diminishing service levels to borrowers.

Further Details on the Proposals are Necessary

Before any servicing compensation proposal can be viewed as a realistic alternative to today's model, CUNA and its members urge FHFA to release further details on each proposal. CUNA, its members, and other industry participants need to fully understand the specifics of each proposal – for example, how would each model be implemented, would current loans be grandfathered, what are the accounting effects of the proposals (e.g., the effect of each on originator/seller compensation and on the value of the securities sold to the GSEs), and what are the potential impacts on these proposals in light of Congress's proposed guarantee fee increases? CUNA also urges FHFA to release further details on any servicing standards that would be tied to these compensation proposals, prior to altering the current compensation model.

Consequently, CUNA and its members prefer no change in the servicing compensation structure, unless the proposals and their likely effects are properly laid out in detail in advance, industry participants are given a sufficient amount of time to comment on the details of the proposals, and it is clear that credit unions and their members would benefit from the changes. CUNA and its members cannot adequately evaluate the proposals as they appear in their current form.

One important example of the vague nature of the proposals outlined in the Discussion Paper is the effect that any reduction in servicing fees would have on the excess interest-only (IO) strip. For instance, if the excess IO strip is monetized at origination, it could increase the value of the security and the cash flows to the originator/seller at the time the loan is sold. But, the accounting impact of this scenario is unknown. It is uncertain whether originators/sellers would indeed be better off with potential cash up-front (through a buyup at the time of securitization), or by maintaining the 25 bps MSR annuity under the current structure. This has not been sufficiently modeled in the Discussion Paper.

CUNA agrees with FHFA's objective to bifurcate the seller's and servicer's representations and warranties (R&W), but needs more information regarding how this would work. Under the GSEs' existing guidelines, the servicer is responsible for both the seller/originator and servicer R&W. The FHFA's proposal allows the servicer to pay a fee to bifurcate the R&W so that the servicer is no longer responsible for the seller's R&W, but is only responsible for the servicer's R&W. However, the amount of the fee that the seller must pay for bifurcation is uncertain, and it is unknown whether the expense of this fee will outweigh any benefit the originator/seller might otherwise receive through monetizing the excess IO strip up-front. Moreover, bifurcation could be implemented under the current servicing compensation structure without pursuing either of the sweeping changes suggested in the Discussion Paper.

Any Change in the Mortgage Servicing Compensation Model is Premature

CUNA and its members believe that any change in the mortgage servicing compensation model at this point in time is premature. Given the uncertain future of the GSEs (both of which remain in conservatorship) as well efforts by various agencies, legislators, and Attorneys General to create national servicing standards, any change in mortgage servicing compensation would be inappropriate at this time.

In addition to the new joint servicing standards that Fannie Mae and Freddie Mac released in June 2011, other agencies, legislators, and state Attorneys General are busy developing national servicing standards. For example, the Consumer Financial Protection Bureau (CFPB) is currently working to develop national servicing standards. In October 2011, the CFPB released its Mortgage Servicing Examination Strategy and Procedures manual, and on December 13, 2011, CFPB released a request for comment seeking input regarding mortgage servicing model forms. The Office of the Comptroller of the Currency (OCC) has also released bulletins setting forth its baseline expectations for the oversight and management of mortgage foreclosure activities by national banks.

Further, the state Attorneys General are in the process of negotiating a settlement with the top five mortgage servicers – Bank of America Corp., Wells Fargo & Co., Ally Financial Inc., Citigroup Inc. and JPMorgan Chase & Co. – which will include new servicing standards. Finally, several bills have been introduced in both the House of Representatives and the Senate throughout the course of 2011 dealing specifically with servicing standards. Due to this flurry of activity in developing new national servicing standards, it would be premature to implement any change in the current servicing compensation structure at this time. Although the above servicing standards proposals are aimed at specific entities and may not directly overlap, any of these could eventually be used as the baseline for best practices in the servicing industry. Without waiting for national servicing standards to fully develop, it would be difficult, perhaps impossible, for servicers (particularly smaller servicers) to know which sets of standards they must follow under either of the compensation models proposed in the Discussion Paper.

Likewise, the standards imposed by any new FHFA servicing compensation structure are likely to be short-lived pending the outcome of the GSE conservatorships. CUNA believes it is therefore premature for FHFA to introduce any change to the servicing compensation structure before (1) the future of the GSEs is determined and (2) national servicing standards are successfully developed and implemented. To do so may well have a disruptive effect on the already fragile housing market across the country. Additionally, due to the lack of substantive detail surrounding the accounting and cash flow impacts of the proposals, as discussed above, there could conceivably be many unintended consequences attached to implementing either of the proposed approaches prior to the creation of any national servicing standards for the industry.

The Proposals Could Lead to Servicing Market Consolidation

CUNA is also concerned that FHFA's servicing compensation proposals could have the effect of significantly reducing competition in the servicing market. Lowering servicing compensation below the current 25 bps level could reduce the number of players in the servicing market to a select few large servicers with significant economies of scale.

Regardless of whether credit unions sell the mortgages they originate or keep them in portfolio, many credit unions retain the mortgage servicing rights (MSRs). Retaining MSRs is vital to maintaining a strong relationship with a credit union's members, as its members are its owners. Unlike a for-profit bank or servicer, a credit union's relationship with its member-owners forms the core of its existence.

Credit unions build net worth with retained earnings, such as fee income received through servicing loans. Losing the ability to service loans profitably, or even at a break-even level, could negatively impact the ability of some credit unions to add to their net worth, resulting in unwanted and harmful effects on otherwise satisfied members and lenders, alike. But – although not modeled adequately in the proposals – in a scenario in which the originator/seller could monetize the excess IO strip up-front, the resulting up-front compensation may substitute to some extent for the lost servicing fees. This result, however, is unclear from the Discussion Paper.

Additionally, for small servicers acting only in the servicing business, reducing the servicing fee below 25 bps could threaten their existence and/or act as a barrier to entry in the servicing market. While again important details of the proposals are lacking, one thing does seem to be clear and that is it would be difficult for small servicers to break even under either of FHFA's proposed models. Only large servicers with significant economies of scale will be able to profitably service loans, which will likely lead to consolidation in the industry, thereby substantially reducing competition in the market for servicing. If fewer servicers are responsible for servicing a larger number of loans, it will likely diminish service to borrowers – precisely the opposite result from the FHFA's goal.

With delinquency rates at a fraction of those of the major banks,[1] in part because of credit unions' excellent servicing levels, credit unions have not experienced the same servicing issues that plagued the large banks and servicers during the financial crisis. Therefore, even though the compensation models set forth in the Discussion Paper are not aimed directly at credit unions or small servicers, they could have an unwarranted negative impact on their hard-earned servicing revenues.

Conclusion

CUNA and its members urge FHFA to release further details on each proposal laid out in the Discussion Paper, and to refrain from making any changes to the servicing compensation structure until the future of the GSEs are determined and national servicing standards are developed. While we understand FHFA's objectives, it is impossible to understand at this point what the effects of either proposal will be on credit unions and on the industry as a whole. We also believe any change in servicing compensation at this point is premature, in light of the myriad servicing standards proposals flowing from various initiatives by agencies, legislators, and Attorneys General. CUNA and its members are also concerned that the reduction in servicing compensation proposed under either option will lead to consolidation in the industry, driving out the small servicers and significantly reducing competition.

Thank you for the opportunity to comment on the Discussion Paper. If you have any questions concerning our letter, please feel free to contact CUNA's Senior Vice President and Deputy General Counsel Mary Dunn or me at (202) 508-6776.

Sincerely,

Kristina A. Del Vecchio
Counsel for Special Projects

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[1] See, e.g., Leighton Hunley & Peter Johnson, "Why do credit unions see superior loss experience in residential real estate loans?", MILLIMAN INSIGHT (Dec. 10, 2010).