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December 23, 2011

Via Electronic Mail to Servicing_Comp_Public_Comments@fhfa.gov and Regular First Class Mail

The Honorable Edward DeMarco, Acting Director
Federal Housing Finance Agency
1625 I Street, NW
Washington, DC 20006-4001

Re: Mortgage Servicing Compensation Alternatives – FHFA Request for Comments and Information

Dear Director DeMarco:

On behalf of Ally Financial, Inc. ("Ally"; formerly GMAC Inc.) and GMAC Mortgage, LLC ("GMACM"), please accept my appreciation for the opportunity to provide the Federal Housing Finance Agency (FHFA) feedback regarding the alternative mortgage servicing compensation structures proposed in your agency Working Group's September 27, 2011 "Alternative Mortgage Servicing Compensation Discussion Paper ("the Paper"). Unless otherwise indicated, all terms with an initial capital letter used herein have the meanings given them in the Paper.

The recent crises in financial and housing markets have highlighted inherent limits of the current servicing compensation structure in times of elevated default and foreclosure rates. Consideration of the current system's specific shortcomings and possible alternative structures is thus timely and appropriate, and we commend the FHFA's initiative in this regard. We also agree that the extent to which any changes will have a positive impact can be measured by their contribution to the Working Group's stated goals:

- Improved borrower service
- Reduction of financial risk to servicers
- Flexibility for the Enterprises to better manage non-performing loans; and
- Promotion of liquidity in the TBA mortgage securities market.

As requested, we are providing below general observations and questions regarding the Paper's proposals, as well as responses to its specific questions.

About GMACM

GMAC Mortgage LLC ("GMACM") is a subsidiary of Residential Capital, LLC (ResCap), specializing in residential mortgage finance. GMACM originates and services residential mortgage loans under the GMAC Mortgage brand name. To the extent permitted by applicable state and federal law, GMACM brokers or sells most of its first lien mortgage loan

production to its affiliate Ally Bank, a Utah state-chartered commercial bank. Ally Bank in turn sells these loans, usually with servicing rights
retained, to secondary mortgage market investors. GMACM is approved as a seller and servicer by both of the Enterprises[1].

GMACM is the principal subservicer of loans originated or purchased by Ally Bank. It is also a provider of fee-based subservicing for unaffiliated third parties. From time to time, the company also purchases MSRs without acquiring the underlying loan asset.

GMACM is one of the largest residential mortgage loan servicers in the country. As of 9/30/2011, GMACM serviced or subserviced approximately 2.5 million loan accounts with an aggregate unpaid principal balance of approximately $389 billion.

General Observations and Questions Regarding Servicing Compensation

For the reasons detailed below and in our responses to the Paper's specific questions, we believe that of the paper's several alternative structures, a "Fee for Services" ("FFS") relationship combined with "Option B" (a contractual separation of Excess IO from MSRs), is the alternative that is most likely to achieve the Working Group's objectives[2].

However, we believe our ability to draw a firm conclusion in this regard is limited by factors and questions not explicitly mentioned in the Paper.

Key among these is the unknown extent to which current and future studies of servicing compensation may result in refinements in the compensation for specific NPL-related servicing activities. A byproduct of the past few years' rise in NPL servicing levels and the concomitant increase in foreclosure avoidance efforts (e.g., modifications, short sales, deeds in lieu of foreclosure and repayment plans) has been the ability of servicers to more accurately calculate and monitor the costs associated with those activities. We are hopeful that this information will form the basis of a more accurate alignment between these costs and the allowable reimbursement by the Enterprises.

In particular, we are hopeful that the FHFA's current Servicing Alignment Initiative (SAI) will include detailed consideration of individual compensatory fees explicitly related to specific loss mitigation activities. We also support the SAI's consideration of the role of monetary incentives in improving servicers' NPL servicing performance.

We believe this refinement process is a necessary adjunct to the "standard" servicing fee contemplated by the FFS model if that model is to achieve the objective of reducing servicers' financial risk. We are hopeful that the FHFA, the Enterprises and servicers will take the SAI into account in evaluating the Paper's alternative structures.

We also hope that in performing its work the SAI and others will not give disproportionate attention to loan *modification* activities at the expense of the many other foreclosure alternatives servicers may offer. Like modifications, these alternatives entail increased staffing and other costs. We thus encourage the SAI participants to develop a comprehensive list of fees and

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[1] Unless otherwise noted, terms with an initial capital letter have the same meaning as is assigned to them in the Paper.

[2] We will refer to this structure as "Alternative 2B".

incentives that addresses the entire "menu" of loss mitigation options. Without such a comprehensive list and the agreement by the investors to pay the servicer for its related expenses, the FFS model does not provide sufficient incentive for current or prospective servicers to participate in the servicing business.

Other pertinent considerations and questions include the following:

- How did the Working Group arrive at $10/loan as the appropriate FFS amount? Will the Working Group consider increasing this amount if servicers can demonstrate its inadequacy, or is it considered integral to the viability of the FFS model?

- Servicer advances are a significant financial burden, particularly in periods of elevated NPL rates. The Paper states that a servicer must continue to advance principal and interest payments through month four, but does not indicate whether this four month limitation will be applied equally to tax and insurance advances..

- Does the Working Group believe that so-called "bifurcation" of selling and servicing representations and warranties - elimination of a non-originating servicer's exposure to origination-related claims – could be implemented independent of any changes to the existing compensation structure?

  If so, will the Enterprises require other changes (e.g., increased minimum net worth requirements for originators) to ameliorate their presumptive increased risk of loss?

<u>Discussion of the Paper's Alternative Structures</u>

<u>Alternative 2B</u>
As noted above, of the alternative structures described in the Paper, we believe Alternative 2B is most likely to achieve the Working Group's objectives. From the industry's perspective, it would result in the following:

- Reduction in or elimination of several significant MSR-related expenses for both current and prospective servicers of GSE loans, including hedging expenses and the cost of maintaining adequate capital. The latter will become an even greater burden if minimum capital requirements increase as anticipated with the implementation of Basel III

- Separation of the current servicing contract into two components: (i) an executory contract (that does not require capitalization) for services to be rendered in the future, and (ii) a separate IO strip that can be freely traded and pledged

- Increased flexibility in managing MSR/IO exposure.

- Elimination of the uncertainty caused by the inherent variability in MSR valuation methods.

As explained more fully in our response below to Question 1, we believe the measures outlined in the Paper will be effective in addressing potential MBS investor concerns that may arise from adoption of Alternative 2B. We also believe that relative to today's MSR contract, the separate excess IO instruments that can be freely traded and pledged will be

attractive to investors and trade at marginal discounts to Trust IOs/IOs, thereby improving liquidity and price discovery.

As discussed in detail in Section III.B. of the Paper, residential mortgage loan servicing involves significant risks and expenses that have little to do with the servicer's actual competence in servicing loans. Even the most efficient and effective servicer is subject to financial risk due to the volatility of the MSR asset and exposure to loan origination representation and warranty liability to the Enterprises. A servicer must also bear the cost of maintaining adequate capital and hedging costs and must contend with the absence of uniform valuation methodologies across the industry.

The Other Alternative Structures

Unlike Alternative 2B, the Paper's other Alternatives do little to reduce a servicer's financial risks. They contemplate a model that is not fundamentally different from the current structure and are thus unlikely to help achieve the Working Group's stated objectives.

Alternative 1 (reserve account) would not eliminate MSR-related capital requirements. Additionally, it is not clear whether a reserve account would mitigate sufficiently the exposure to increased costs as a result of unanticipated increases in rates of default servicing.

As we understand it, Alternative 2A (fee for service, but with the disposition of excess IO still contractually controlled by the Enterprises), would eliminate a successor servicer's exposure to origination representation and warranty claims. We believe this may result in some marginal improvement in liquidity.

However, because Alternative 2A does nothing to broaden the universe of potential IO purchasers, price competition will remain effectively nonexistent. Servicers will continue to retain excess IO, despite the associated capital expense.

GMACM's Responses to the Agency's Questions

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

Impacts on Competitive Landscape

- To service GSE loans under the current structure, servicers must be prepared to both manage their MSR investment and competently perform servicing activities. It is our view that the number of companies able and willing to do both is considerably smaller than the universe of those interested in servicing alone. Consequently, we believe that the fee for service model, and Alternative 2B in particular, lay the groundwork to increase competition.

- By substituting a future income stream for a capitalized asset, adoption of Alternative 2B will reduce the cost of entering the servicing business. As with elimination of successor liability for origination warranty claims, this is likely to encourage new competitors to enter the market as well as lead to increased competition among existing servicers.

- Because Alternatives 1 and 2A do not change fundamentally today's servicing compensation structure, neither is likely to result in any meaningful increase in competition.

Impact on Borrowers

- It is probable that servicers' MSR-related capital expenses will increase in years to come. This is especially likely if the Basel III proposal is implemented as currently proposed. The increased costs are likely to result in increased servicing fees. Although an originating lender must consider many factors when establishing the mortgage loan interest rate paid by the consumer, the fee it will pay for servicing is a significant consideration. By eliminating MSR-related capital requirements, adoption of Alternative 2B will remove one source of upward pressure on loan interest rates. Alternatives 1 and 2A will not have a similar salutary effect.

Financial Impact On Servicing and Origination Markets

- On its face, the Reserve Account proposed in Alternative 1 appears to be a logical way to insure that sufficient funds are available to offset unexpected increases in NPLS costs. However, we believe its effectiveness would be limited. If a servicer funds the reserve account out of current income, it simply continues to assume the risk of higher than expected delinquency rates. If instead the originator increases interest rates to offset the Reserve Account fee, it will be protected against increased NPLS costs, but will be at a competitive disadvantage to those who do not elect to price in such additional fees and consequently can offer a lower rate to the borrowers. Moreover, with this alternative which will likely result in higher loan rates, the servicers will effectively absorb all the risk of higher delinquency rates without any compensating reward if such rates are *lower* than anticipated.

Impact on Efficiency in Secondary Markets

- We appreciate the concern by MBS investors that reducing the minimum service fee (MSF) could remove current disincentives to so-called "churning" of servicing portfolios. However, our experience is that the likely effect of an MSF reduction on prepayment speeds is negligible. First, servicers' influence is limited by current GSE restrictions on borrower solicitation. Moreover, borrowers consider

many factors in deciding whether and when to refinance, and will do so when they consider it to be financially advantageous, irrespective of servicer influence.

- To the extent streamlined refinance programs may increase the risk of prepayment rates disproportionate to the decline in interest rates, this risk should be addressed adequately by the net tangible benefit test outlined in the Paper.

- Liquidity in the Trust IO market has waned in recent years as can be witnessed by the few number of new Trust IOs in the market. In the absence of this market, a synthetic IO market was developed in March of 2010 to provide investors with alternatives to meet their needs. The demand for these synthetic securities was so overwhelming that subsequent synthetic IO securities were created to keep up with that demand. Additionally, in 2011 there were several excess IO transactions that occurred which were well received by the market. These deals were traded at a marginal discount to Trust IOs but note that in a historical context, these deals traded at a smaller discount to Trust IOs as compared to deals that occurred in the early and mid 2000's. Given the high demand for IO product, liquidity for IO created at the time of origination should be quite deep.

- Typically, bonds that have less than $10m of current face amount are subject to a liquidity charge, and this could impede smaller originators. However, one alternative to avoid this issue would be to allow purchasers of bifurcated IOs to combine securities from various originators, which would create larger, multi-servicer deals. These securities may then trade at a premium to similar excess IO, all else equal, because of the diversification of servicer risk. Consequently, smaller originators would still have the option of retaining the IO on balance sheet or selling to the agencies. The creation of a market for bifurcated IO puts them in no worse a position than if the bifurcated IO market did not exist. If a bifurcated market were to be introduced, it would provide additional color and insight to all market participants as to the value of the IO, which would help any originator make better decisions around selling or retaining excess IO.

- Structuring these deals should be similar to structuring an excess servicing transaction where servicing has been accumulated over a longer period of time. Accordingly, the same internal secondary market groups or external dealer services would be used to structure newly created excess IO.

- Operationally, pledging these securities should be as easy pledging any other type of security. The market will have to determine the appropriate haircut to apply and the size of that haircut will likely dictate how these securities are pledged.

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

    a) ***Does a capitalized MSR impede competition in the servicing and origination market?***

***Ally Response*: YES**

- The current servicing compensation structure compels servicers to invest in MSRs in order to service GSE loans. As a result, servicers must be prepared to manage the MSR investment as well as provide operational servicing activities.

- Relatively few companies, most relatively large and sophisticated, have both the ability and the desire to effectively and efficiently service mortgage loans as well as manage the financial risks of MSR assets.

- Consequently, we believe it is foreseeable that that a fee for service model may increase competition for servicing by separating the MSR investing from the servicing operational activities and improving the liquidity and transferability of the servicing contract.

- The costs associated with MSRs (primarily hedging and capital costs) are a significant component of origination economics and thereby a key element in setting the borrower note rate.

- Originators that could provide new competition in the servicing business but who are unwilling or unable to manage MSRs are compelled to sell loans servicing released.

- By perpetuating the capitalized servicing asset concept, Alternatives 1 and 2A do little to improve competition in the residential servicing and origination markets.

b) Does the impact vary across various business and interest rate cycles?

***Ally Response*: YES**

- The performance of MSR assets and related hedges are highly sensitive to many complex and often interrelated factors, including changes in the level of interest rates (mortgage, swap, UST), the shape of the interest rate curves, level of mortgage spreads and borrower prepayment behavior.

- As noted, the financial risks associated with MSRs can be managed effectively only by a relatively sophisticated enterprise. Originators with a relatively small servicing portfolio are often unable or unwilling to make the investment in resources needed to hedge this risk. These competitors may be forced to exit the market when conditions become unfavorable to continued MSR ownership. Worse, the adverse financial impact on a small originator-servicer may be so severe that it will be forced to cease business altogether.

- By enabling smaller originators to participate in the servicing market as a servicer, excess IO investor or both without the large expense and risk associated with MSR ownership, Alternative 2B would lessen the impact on these competitors of adverse market conditions.

c) Does the impact vary across size of servicers and originators?

Ally Response: ***YES***

- As discussed above, capitalized MSRs are 1) capital intensive, 2) difficult to manage/hedge, 3) highly volatile. This requires sophisticated risk management and hedging capabilities generally found only among larger servicers.

d) Would greater transparency in MSR valuation improve the competitive landscape?

Ally Response: *NO, for the following reasons:*

- MSR valuation models and methodologies vary greatly. Under Alternative 1 as well as Alternative 2A, retained excess IO will continue to be recorded within the capitalized MSR balance while doing nothing to address these variations.

- We believe that in Alternative 2B the separate IO security likely will be marked by proxy to the trust IO market, producing a more uniform value on excess IO retained. In addition, the base MSR contract would not require an accounting valuation because it would not be capitalized.

- We would expect that Alternative 2B would reduce disparities in fair values of base MSR and excess IO components used in determining the mortgage note rate and subsequent accounting valuations.

e) What is the impact of a potential reduction in tax Safe Harbor?

- Although GMACM does not currently utilize the Safe Harbor provision, we believe most of its peers do so.

- It is not clear how the IRS would react to any change in the compensation structure. The reaction could range from maintaining the substance of the current ruling to eliminating the safe harbor all together.

- From a broader industry perspective, the tax safe harbor does provide economic benefit to originators. We have estimated that the benefit to

loan interest rates is approximately As a result, some increase in note rates may result from a reduction in the Safe Harbor.

- However, by providing the originator with the flexibility to monetize the excess IO under Alternative 2B, the increase in tax liability may be partially or even completely offset.

f) ***Should the servicer be required to hold a capitalized MSR asset (effectively be an IO investor) as a condition of performing servicing activities?***

- ***Ally Response: NO****, for the reasons stated in our response to Question 2 (a) above.*

3) ***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)***

a) ***Does the impact from market-based pricing of the excess IO vary across size of servicers and originators?***
b) ***Does contractually separating the excess IO from the MSR create more liquidity and price transparency?***

- Please see our response to Question 2 (d) above.

c) ***Is the flexibility to separate the operational activities (servicing) from the financial management activities (investing in and managing MSR/IO exposure), as outlined in the Fee for Service proposal, beneficial or harmful to the industry?***

- Please see our response to Questions 2 (a) through 2(d) above.

4) ***Would these proposals encourage greater investment in non-performing loan operations or abilities in a benign market cycle?***
<u>Ally Response:</u> POSSIBLY, under Alternative 2B.

- It is possible that some servicers may apply the benefit of reduced capital and other MSR-related expenses costs under Alternative 2B to make system and facilities improvements.

a) ***How does this impact the alignment between guarantor and servicer interests?***

We presume this question refers to each of the Paper's three Alternatives. Because Alternatives 1 and 2A do not contemplate fundamental changes in a servicer's financial risk, we do not believe either would change fundamentally the "alignment" (i.e., the convergence, if any) between the respective interests

of the guarantor and servicer; i.e., the servicer bears most of the financial risk of high delinquency rates and the consequent increased servicing costs.

Under Alternative B, the guarantor bears more of the financial risk if the guaranty fee is not appropriately priced at the origination of the loan to cover all servicing fees owed to the servicers under the SAI. However, if the fee is accurately priced, Alternative 2B would likely have some positive impact on the guarantor-servicer alignment. However, as discussed in detail above, we are hopeful that it will not be adopted without due consideration for the specific costs associated with NPL servicing, including those related to all avenues of loss mitigation. Moreover, by establishing a more predictable set of fees and incentives in the SAI, the Enterprises should be better able to establishing guaranty fees that more accurately reflect their true financial risk.

b) Would this improve service to borrowers?

- Please see our response to Question 4. above.

5) What would be the impact of the proposals on the TBA market if there were no MSR capitalization?

a) To what degree might the net tangible benefit test and other suggested provisions help mitigate any potential negative impact on the TBA market?

The answer to this question depends upon the parameters of the net tangible benefit (NTB) test, which are not specified in the Paper. Originators (including servicer-originators) are already required by both law in a number of states and investor requirements to perform an NTB review as part of the refinance origination process. As such, unless the Enterprises' NTB test is significantly more conservative than these existing requirements, we do not believe its adoption will have a significant impact.

b) What additional steps can we take to assure continued liquidity in the TBA market?

- Please see our response to Question 1 above under the subheading *"Impacts on Efficiency in Secondary Markets"*.

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

a) Bifurcation of selling and servicing representations and warranties

- Irrespective of any other changes in the present relationship between servicers and the Enterprises, we believe this proposal has the potential to

encourage transfers of servicing. However, in the current structure the Enterprises often have recourse to at least two parties (i.e., the originator and the original servicer). Bifurcation would place all responsibility on the originator. The Enterprises reasonably can be expected to take other actions in order to reduce or offset the increased risk this poses.

b) A net tangible benefit test for streamlined refinances

- As discussed in our response to Question 1 under the subheading "*Impact on Efficiency in Secondary Markets*", we believe such a requirement would help allay secondary market concerns that fee for service alternatives would cause increased "churning" of servicing portfolios. However, we do not believe these concerns are significant under the current capitalized MSR structure. As such, if no other changes are made, a net benefit test would seem to be largely irrelevant from a servicing compensation standpoint.

c) Restriction of the amount of excess IO in a given pool

- We do not believe such a limit is necessary or appropriate.

d) Limitation of P&I advance requirements

- This represents an additional mechanism by which financial risks associated with the MSR can be limited. However, tax and insurance advances are also a significant cost to servicers, and we encourage the Working Group to extend any limit to include these payments.

e) Flexibility for excess IO execution

- Alternative 2B is the only proposed compensation model where Excess IO is bifurcated from the base servicing contract. As such, Excess IO execution flexibility appears to be significant only if Alternative 2B is adopted.

Conclusion

Thank you once again for the opportunity to share our company's views on the agency's proposals. We hope you will find them useful, and would of course be pleased to discuss any questions they may raise.

Sincerely,

Thomas A. Marano