

From: David Larson [mailto:dlarson1000@comcast.net]
Sent: Friday, September 30, 2011 11:25 AM
To: #Servicing Compensation
Subject: Comments regarding reduction of servicing fees

Within the mortgage market, consolidation has served to reduce competition and focus origination and MSR ownership in the hands of a very limited group of servicers. When or if one of those servicers experience serious capital constraints, it can place the entire flow of mortgage origination and servicing under considerable pressure. Added to this phenomena has been the looming effects of the new BASEL III accords, which limit the capital that banks are permitted to allocate to MSRs and similar assets. Combining the effects of industry consolidation and capital allocation restriction creates potentially devastating problems which call for innovative solutions. These solutions should recognize that the existing capital in the market are being constrained by factors which not servicing related, but if not addressed can have troublesome effects on the entire industry and ultimately squeeze entire sectors of originators from the market. If banks are forced, for any reason ranging from capital constraints caused by other business units within the bank, to BASEL III limitations (and even to legal problems) to constrict the capital allocated by the bank to servicing, their response is inevitable---they will turn to existing retail customers as their primary focus and abandon other channels. We need only look at recent correspondent lending announcements at Bank of America as our most recent example. FHFA is encouraged to remember that capital problems at banks are strongly affected by factors external to the mortgage space, and that any solution offered by FHFA authority cannot solve the banks' global problems, nor ultimately the problems of FHFA. The only long term solution lies in attracting significant new capital to servicing as a way to expand the availability of mortgages.

Therefore, any solution adopted by the FHFA must have at its core an incentive to attract new capital to the servicing industry. That capital, it should be recognized, will never have the leverage power available to banks, even with the most generous assumptions. IRR calculations will be governed by many factors, but two are worthy of mention here. Cost of servicing loans has been a point of advantage for most large banks---new capital entrants will not have this leverage point and will need to accept lower returns on capital than banks. There is likely little that FHFA can do to effectively deal with this limitation. However, ultimately it is the difference between servicing fees and costs which generate the spread used to calculate margins. Any effort which has the effect of reducing servicing fees and therefore reducing these margins runs counter to the need to attract new capital, and provides additional advantage to existing large players, who already enjoy benefits of scale, higher leverage and low servicing costs. Most importantly, while the reduction of servicing fees appears on the surface to assist larger banks by reducing the capital required to support servicing, in the long run these lower fees can only exacerbate the problem, further accelerate consolidation, further crowd out new entrants and most importantly expose the FHFA and nation to future higher risk of additional dislocations in the industry.

Therefore, I am hopeful that any solution adopted by the FHFA look to maintaining or raising the servicing fee revenue---not constricting revenues by lowering fees. That is not to say that solutions cannot match revenues and expenses. However, this issue should be separate and distinct from the question of total servicing revenues.

I hope that this perspective is helpful.

David Larson
978-317-7258 (Cell)
561-848-1624 (Home)