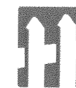

HomeStreet Bank®

December 23, 2011

Mr. Edward DeMarco
Acting Director
Federal Housing Finance Agency
1700 G Street, NW
Washington DC 20552

Dear Mr. DeMarco:

We appreciate the opportunity to comment on Federal Housing Finance Agency's Alternative Mortgage Servicing Compensation Discussion Paper (September 27, 2011).

In looking at the national servicing situation, particularly among the largest servicers, we understand why there is a view that the structure of servicing needs to change. However, we believe that factors in the origination of the loans created the problems that now beset the servicing industry, rather than the problems being intrinsic to servicing. These factors include a lack of sound underwriting standards compounded by negatively amortizing loans and wide spread speculation in housing, with Congressional and Administration policies promoting ever increasing and unrealistic homeownership rates in a market place where many lenders were not regulated. Even during this economic downturn originators and servicers with a rational credit culture and well designed loan products have had manageable levels of loan defaults.

HomeStreet Bank is an excellent example of a mortgage lender who did not originate sub prime or option ARM loans and as a result has not experienced related high levels of defaults. We service over $6 Billion in loans, with an October 2011 serious delinquency rate on loans serviced for Fannie Mae of .96%, versus 3.11% for their Non-Credit Enhanced loans.

The following are our comments on the various alternative servicing compensation models, with most of our comments addressing the Fee for Service (FFS) Model and its stated goals:

MBA's Alternative Servicing Compensation Model

MBA's alternative servicing compensation proposal doesn't drastically change the current compensation for mortgage servicing. However, prudent loan originators and servicers are penalized by having to earn back the reserve account set aside of 5 basis points, which we believe is inappropriate.

The Clearing House Servicing Compensation Model

The Clearing House proposal in addition to having a reserve account of 3 basis points reduces the base servicing to 12.5 basis points. We believe this formula reduces compensation to a level where it may be uneconomical for smaller servicers to participate.

Fee For Service (FFS) Servicing Compensation Model

Improve Service for Borrowers

While a stated objective, it is not at all clear that the FFS model with the separation of compensation between performing loans (PLs) and non-performing loans (NPLs) will

improve service for borrowers. There are many arguments that it will do the exact opposite, the first of which is if a servicer determines that NPLs are more profitable than PLs, then what incentive does a servicer have to assist borrowers in remaining current? Under current mortgage servicing rights (MSR) compensation most NPL costs are borne by the servicer which is an incentive to originate and/or purchase sound loans that will perform. The servicer's and borrower's interests are thus reasonably aligned at present and the GSEs have sufficient authority to make adjustments to servicer incentives if changes are deemed necessary. Further comments on the relative profitability and the effect on servicers can't be made since there has been no outline of proposed NPL compensation.

The proposed FFS will make it difficult for all but large companies to continue to service loans. Borrowers will see increased automation which may enhance some types of service, but access to a live person for tax, escrow and payment questions will become rarer, degrading overall service levels even further.

Reduce Financial Risk to Servicer

Under the existing servicing compensation model MSRs are a complicated investment which requires expertise to manage, but properly managed they provide an attractive return on investment The cost to manage a servicing hedge has been one of the justifications for eliminating MSR assets. In our experience and in a normal interest rate environment hedge instruments generate income which serves to offset natural decay and any cost of hedging. Similar to pipeline hedging, servicing asset hedging can be outsourced with internal oversight.

Small fixed fees for PLs create significant inflation risk for servicers. Servicers would commit to servicing PLs for up to 30 years, with the fee set at sale of the loans. Over time costs could significantly outstrip revenue. The inflation risk could make servicing a very unattractive investment.

Another risk to servicers that FFS creates is a reliance on the GSEs for the FFS payments. Rather than deducting and retaining the servicing income as part of the remittance process, the entire borrower payment would be remitted with the GSEs remitting back the FFS to the servicer. Depending on the then status of the GSEs, the counter party risk may be unacceptable.

Provide flexibility for guarantors to better manage non-performing loans;

Under FFS the proposed servicer compensation for NPLs would be paid by the GSEs out of Guaranty Fees. We don't see how this proposal would better allow them to manage NPLs. GSEs already control the amount of the Guaranty Fees and they already pay incentives to servicers for performance. However, eliminating or reducing the MSR asset reduces the leverage that the GSEs have over the servicer. Servicing can be transferred for cause, and that leverage over the MSR investment is the ultimate incentive for servicer performance.

Promoting continued liquidity in the TBA mortgage securities market;

The existing servicing compensation model aligns the interests of servicers and investors. Both have significant investments in assets that are subject to loss if prepayments occur at unexpectedly high levels. Additionally, servicer's investment in MSRs promotes origination and purchase of high quality loans, since much of the cost of NPLs is borne by the servicer.

Promoting enhanced competition in the market for origination and servicing.

The very large banks have long had an advantage in originating loans with a much greater ability to pay the highest servicing premiums due to their very low cost of funds and capital advantages. With a FFS of $10 per loan, it is only the largest servicers that would remain in the business.

The last issue we wish to address is whether provisions of the FFS that should be considered independent of other changes to servicing

Selling and servicing representations and warranties should be bifurcated. Doing so will attract servicing purchasers who currently do not want to assume the selling representations and warranties, thus improving servicing liquidity.

A net tangible benefit test keeps all parties interests aligned and should be required for streamlined refinances.

Excess Interest Only (IO) should be a separate stand alone asset, unencumbered by the GSEs. Once excess IOs begin trading, this active market will assist servicers in managing their servicing assets.

In summary, HomeStreet Bank believes that the challenges facing the servicing industry are the result of origination products and standards that no longer exist and that servicing compensation should remain unchanged. Again, we appreciate the opportunity to comment on this extremely important industry issue.

Sincerely,

Mark K. Mason
Chairman and CEO