FHFA Promotes Loan Servicing Uniformity and Penalties for Non-Compliance

By: Jann Swanson | Wed, Feb 23 2011, 2:16 PM

Despite the current political focus on reforming the housing finance market, the Acting Director of the Federal Housing Finance Agency (FHFA) **told an audience** that his agency remains committed to meeting the existing goals of the government sponsored enterprises (GSEs) Freddie Mac and Fannie Mae for which FHFA is the conservator. Edward J. DeMarco, speaking to members of the Mortgage Bankers Association at its National Mortgage Servicing Conference and Expo said that FHFA seeks to retain value in the GSE's business operations and maintain their support for the housing market.

The GSEs have been instructed to undertake several joint initiatives to strengthen their business operations, DeMarco said. The first, the **Loan Quality Initiative (LQI)** requires the GSEs to develop standards to improve the quality and uniformity of data collected at the front end of the mortgage process. If potential defects in the process can be detected at the beginning of the process then it is possible to improve the quality of mortgages the Enterprises purchase which will, in turn, reduce originators' repurchase risk. LQI is expected to be phased in over the remainder of this year and next.

Second, the **Joint Servicing Compensation Initiative** will involve the GSEs working with FHFA and the Department of Housing and Urban Development (HUD)) to consider alternative compensation for servicers of single-family mortgages. The goals of this initiative are to improve service for borrowers, reduce financial risk to servicers, provide flexibility for guarantors to manage non-performing loans, and provide continued liquidity to the "**To Be Announced**" mortgage securities market.

DeMarco said that meeting these goals will require taking into account several factors:

- **Maintaining liquidity and consumer choice in the mortgage market**. This means allowing originators to offer borrowers the best rates. The extent to which the current servicer compensation structure provides protection against excessive refinancing solicitation and helps to make prepayment speeds more predictable and the impact of alternatives will be an issue the joint initiative will look at closely.
- **Ensuring that the servicing business model for both performing and non-performing loans is profitable and available for all sizes of servicers**. The industry is becoming highly concentrated with 10 companies responsible for 70 percent of the servicing market. The extent to which the compensation structure impacts the economic choice to maintain a servicing platform must be evaluated.
- **Ensuring that mortgage originators have flexible execution options**. At present origination and servicing are closely linked as the value of mortgage servicing often offsets origination costs. However, retaining the servicing may be problematic for some institutions. The initiative will consider ways to provide flexibility to originators to retain or release servicing through other structures that do not mandate the holding of a servicing right asset.
- **Increasing flexibility for guarantors to manage non-performing loans**. The current system was not set up to handle large volumes of non-performing loans or compensate servicers for managing them. DeMarco said this contributes to "less than optimal servicer performance in foreclosure prevention efforts and hinders the Enterprises' loss mitigation efforts." The joint initiative is charged with seeking a structure that better aligns the cost of servicing to the compensation received.

DeMarco said the initiative may consider a fee for servicing compensation structure for non-performing loans as well as the possibility of reducing or eliminating the minimum mortgage servicing fee for performing loans. FHFA expects to coordinate efforts of the joint initiative over the next few months to gather feedback from the industry, consumer groups and regulators. Any implementation of a new structure would not be expected to occur before the summer of 2012.

With respect to more near-term issues, DeMarco said that FHFA and the **GSEs have established a working group to align the GSEs' current servicing standards and establish appropriate incentives to encourage contact with borrowers early in any delinquency**, Each of the Enterprises has its own servicing guide and procedures, a greater consistency will build on the best practices of each and ease the burden on servicers. The working group will develop consistent timelines and requirements for contacts with borrowers so there is no confusion about what is expected by the Enterprises from servicers. **This includes consideration of appropriate penalties to encourage efficient resolution and liquidation of properties in cases where foreclosure is necessary**. The Enterprises will be moving forward with servicer penalties for last year in the coming weeks, but will announce a new set of requirements, timelines, incentives, and penalties by the end of the first quarter of this year.

DeMarco said that FHFA is closely involved with other regulators in developing national servicing standards. This heightened coordination between primary and secondary market supervisors should help market participants operate with more uniform regulatory standards and expectations.

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