Servicing Retained or Released?; The CFPB and Credit Reports; CFPB's Guidance on Policies and Procedures Manual

By: Rob Chrisman | Mon, Dec 17 2012, 9:22 AM

A successful mortgage CEO once told me, "Your ego isn't always your amigo. It's amazing what you can accomplish when you don't care who receives the credit." Speaking of credit, although a slightly different kind, ever wonder how the **credit reporting agencies** "manage" yours? The CFPB is here to explain it. **[READ: Everything You Wanted to Know About Credit Bureaus, Reports, Files and Scores]**

And occasionally someone asks about **a Policies and Procedure Manual, especially in preparation for a CFPB examination**. First, you should have one anyway, with or without the threat of an exam. But a word to the wise: I had lunch Friday with some high level, CFPB-aware, attorneys, and I asked them about "canned" policies and procedures manuals. They replied that buying one off the shelf (like "Policies and Procedures for Dummies") is ineffective, and can actually be worse. **The CFPB wants to see YOUR policy and procedures, that pertain to YOUR company, and that you FOLLOW them**. But there are seven modules on the CFPB website that you can construct a manual around. Go to http://www.consumerfinance.gov/, Law & Regulation, Examination Manual, Download the manual in PDF. Watch for "Mortgage Origination" in the table of contents - the seven modules are there. "C" is the Statutory and Regulation Based Procedures also, and pay attention to the Compliance Management System.

"Rob, my boss tells me that **my company might start servicing loans**. But all I've heard about is the $25 billion lawsuit from a while back. Is servicing going to **help us or push us under?**" What you're basically asking is what are the issues regarding your company retaining servicing, and keeping it on their books, versus selling servicing rights in the secondary market. It is a very complex situation, but there are some basics to keep in mind.

First a refresher. Earlier this year Kate Berry with American Banker had a story regarding the $25 billion national mortgage settlement, and that "attorney Robert Maddox is still fulminating against it. Maddox, who represents Ally Financial, says he told each of the 49 state attorneys general and officials from the Justice Department and the Department of Housing and Urban Development, those allegations of improper foreclosure practices was nothing more than a ruse by regulators to extract money for defaulted borrowers and impose more requirements on the five largest mortgage servicers."

Kate's write up goes on. "I've said it to every attorney general, DOJ and HUD official that it was a Trojan horse for the government to fix perceived problems in mortgage servicing," says Maddox, a partner at Bradley Arrant Bolt Cummings LLP, a 400-lawyer firm in Birmingham, Ala. The settlement essentially boiled down to two demands from regulators, he says. "State attorneys general wanted to fix mortgage servicing practices that constituents were complaining about and the Obama administration wanted to get principal reductions on a large scale," Maddox says of the national settlement that was reached in February and signed in April. For the next three years, the top five mortgage servicers, Ally, BofA, Wells Fargo, Chase, and Citigroup, will be working directly with the settlement's monitor, Joseph A. Smith Jr., the former North Carolina banking commissioner, to ensure compliance with the agreement.

Regulators identified significant weaknesses in banks' foreclosure processing. The five banks charged improper fees, misapplied mortgage payments, wrongfully denied modifications to borrowers, abused the bankruptcy process, improperly foreclosed on members of the military and tried to rip off the Federal Housing Administration, according to the Treasury department's inspector general.

Yet Maddox still maintains that **few, if any, borrowers were wrongly foreclosed upon**. "The most frustrating part of all of it was that there was no acknowledgment of borrower responsibility," he says. "Were there inaccuracies? Yes. But those inaccuracies didn't do damage to the borrower who was already in default. The penalty has to meet the harm." Maddox argues that regulatory uncertainty caused servicers to halt foreclosures, hindering a housing recovery. State laws that extended the timelines on foreclosures led to millions of seriously delinquently loans being stuck in limbo. "It takes five years now to foreclose on someone in New York, and two to three years in Florida," says Maddox. "The process shouldn't be lengthened and continue to grow and grow if there is a scenario where the borrower can't be helped. All they're doing is cratering the real estate market."

With that as the context for your question, you should know that first, **most companies that sell their loans on a servicing released basis have seen a drastic dip in cash servicing values (SRP) over the past year** (just ask your secondary guy or gal to see your mandatory adjusters or SRP grids). Wider primary/secondary spreads have obviously been a major topic of conversation, especially among loan officers who (always) feel like lock desks are holding back on rate sheets ("Hey, the MBS market says you can sell these loans for 105, but they're only 102 on our rate sheet - are you keeping all of that for your bonus?")

Remember that some companies have left the arena (MetLife, BofA for wholesale and correspondent, Wells for wholesale quickly come to mind) and so **large banks don't have to be quite as competitive in paying up for loans - and that includes paying up for the servicing.** Sellers have seen a decline to MSR (mortgage servicing rights) pricing and elongated turnaround times on higher quality production. This had led many originators to grow increasingly concerned on the value of their secondary executions, including co-issue, best efforts, mandatory, and assignment of trades (AOT). As a result, many lenders, both depository and non-depository, are either considering holding the asset and retaining servicing rights where they never have before. ("Geez, if the big guys aren't going to pay me what its worth, we'll just keep it.")

Of course, retaining (keeping) servicing isn't a walk in the park. For starters, you don't move ol' Edna over to run servicing since she's loyal and a good underwriter. **You need someone with a better background doing it**, and those folks are commanding some good comp levels. Servicing laws vary with each state, and potential liabilities lurk. And how much are you going to be servicing? Rather than do it themselves, at least to begin with many companies weigh hiring a **subservicer**. When considering servicing in-house versus sub-servicing relates to cost as in "economies of scale" when farming out servicing.

The tone to current mortgage originations, given the lower interest rate environment we've had all year, is that we are locked into low WAC (weighted average coupon) and high duration MSRs (it could be on your books for a very long time) attached to the underlying mortgage written. **And this type of possible cash flow (the borrower paying .25% per year for a long time on Fannie & Freddie product, for example) is what makes it favorable to retain servicing rights for lenders who can afford it**.

Other factors usually considered when evaluating MSRs are prepayment speeds, eerily lowered when set against historically lower interest rates and mortgages, as well as capital constraints of committing to an in-house servicing arrangement. In-house service analyzers aid the process when holding servicing rights. One method to aid distribution is getting GSE or FHA originator/servicer approval which could open up greater liquidity for selling loans and ease of automated processing via FNMA DU (Desktop Underwriter). However, the approval time from the agencies is anywhere from six months plus for both FNMA and GNMA. Additionally, **GNMA looks for adequate size, experience, and up to date reporting functionality of the issuer-servicer before any such approval would be forthcoming** - so no small and inexperienced players need apply there.

When analyzing what loans to hold and which to sell, revenue and expenses associated with each loan are itemized: fees, float, late fees comprise revenue while servicing costs (base and delinquencies), as well as, foreclosure advances are weighed. When looking at the foreclosure advances (servicers advance), it was deemed wise to build a "delinquency curve" as states prepay differently accounting for different escrow account needs and different taxes subtracted from cash flows. As an example, Texas ("Hook 'em!) has no income tax but a rather large escrow fee as compensation, so any loans from that state have to be treated differently when considering servicing (sell or hold).

Lastly, and to sum up, the future of servicing will be determined by capital, a competent staff, the constraints of Basel III and its balance sheet revelations, all of which may lead to less servicers still from larger banks as subs. However, the recent influx of more in-house servicing may refreshingly offer a counter balance to generally declining competition if outsourcing serving-a sort of counter balance is net in effect.

Turning to some **recent investor and agency updates**, a quick reminder that for full details one should read the actual bulletin, but that these will give you a flavor of current trends.

First, a clarification on a point with California's Pinnacle Capital from yesterday. I noted, "California's **Pinnacle** has removed the two-year seasoning requirement and has added credit score overlays to the existing requirements for deed-in-lieu, pre-foreclosure, and short sale seasoning requirements. Fall Line Distance guidance has been added for all FHA loans and USDA borrowers with only one credit score are now ineligible. Additional guidance now applies to Enhanced DU Refi Plus products." The paragraph leaves the reader to believe that Pinnacle has removed the 2 year "penalty" phase from short sale/pre-foreclosure proceedings completely, but the reality is they have actually increased the 2 years to 4 years. I apologize for any confusion.

The **FHA** has updated the maximum allowable loan amount for National Housing Act, 203(b) (basic 1-4 family), 203(h) (disaster victim mortgages), and 203(k) (rehabilitation mortgage insurance) loans. For forward mortgages, the limits apply to all case numbers assigned within the designated "Effective Period." The updates don't affect Home Equity Conversion mortgages, for which the maximum loan amount remains $625,500. The individual high-cost county loan limits have been revised as well; the maximum has been increased for several counties in the Houston-Sugar Land-Baytown MSA in Texas and the Anchorage and Kodiak MSAs and various other non-metro areas in Alaska. For a full matrix of the updated limits, see http://bitly.com/FHAFAQ.

After having amended its original prohibition of property flipping on FHA single-family properties back in 2006 by allowing additional exceptions to the time restrictions on sales, **HUD** has extended the waiver through the end of 2014. Sellers are reminded that the waiver isn't limited to foreclosed properties but that it doesn't apply to HECM transactions.

Fannie Mae has updated its allowable maximum for foreclosure attorney and trustee fees for mortgage, participation pool, and MBS mortgage loans that are serviced under special servicing options. See the Fannie website for full details of the new fees.

Freddie Mac and Fannie have announced plans to implement the **Uniform Mortgage Servicing Dataset** in 2013 to complement the recently-integrated Uniform Mortgage Data Program. In preparation, the GSEs are asking for feedback on servicing-related data points from insurers, regulators, private investors, vendors, and technology providers in addition to servicers. More information about the project is available here.

Our hearts and prayers go out to the families of the 26 dead, including 20 kids, in the Newtown, Conn., elementary school shooting. It is impossible to fathom the depth and breadth of the emotions of what that town is going through and what it will continue to go through during the holiday season.

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