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MORTGAGE SERVICING RIGHTS – THE GOOD, THE BAD, AND THE UGLY

As origination profits wane, many lenders are winning the fight with positive revenue due to the increased valuation of their servicing book. The strategy of creating a counter cyclical business model has been a successful plan to smooth the ups and downs of the mortgage market, with the last decade seeing a broad expansion of lenders playing in this space.

Those with a history in the servicing space know that the ease of navigating a servicing book primarily focused on posting on-time payments and handling basic requests can shift quickly as loans season and delinquencies increase. A web of complex regulatory requirements, escalating complaints, and increased costs of higher-skilled team members to evaluate loss mitigation options can quickly transition to rough waters. And while Mortgage Servicing Rights (MSR) markups are putting many P&Ls in the black today, hedging MSRs can be imprecise and volatile, creating risk of future write-downs and reduced profits.

How do you get in front of these challenges to avoid the battles that may breakout through the industry?

Although not easy, there is a way. Gaining a full understanding of the risks, putting in proper oversight and controls, and ensuring a robust staffing plan is in place to recruit and train a skilled team is vital to keeping both the consumers and regulators satisfied.

INCREASED VALUATION – THE GOOD

The increasing value of MSRs has been a valuable asset during the first quarter as profits from originations were diving. Many lenders with a large servicing book stayed “in the black” as they reported a significant increase in MSR valuations or increased revenue by selling these hot commodities into the market.

Holding servicing to provide for this hedge may redeem the bottom line of lenders and help to weather the storm. While holding MSRs may provide a hefty positive accounting adjustment, it can’t pay the bills unless they are turned to cash through a sale or over the long term via servicing revenue. Whether the MSRs are retained with an increased book value, sold to infuse cash into the business to cover origination losses or allow for other investments, lenders need to be cautious to not only focus on winning short-term battles but building a strategy to win the war. A clear vision regarding the balance between origination volume and servicing can be a key strategy to stabilize the bottom line.

AVOIDING REGULATORY ATTENTION – THE BAD

For those that choose to hold servicing, the Consumer Financial Protection Bureau (CFPB) Supervisory Highlight states that in light of the increased number of borrowers who need loss mitigation assistance, the Bureau is prioritizing its supervision of mortgage servicers. Bureau examiners identified numerous legal violations committed by servicers, including violations of Unfair, Deceptive or Abusive Acts or Practices (UDAAP), Regulation Z under the Truth in Lending Act, Regulation X under the Real Estate Settlement Procedures Act. The CFPB continued their focus and issued a new report in May 2022 and made the following comments:

"While many mortgage servicers are successfully assisting borrowers to avoid foreclosure, today's report highlights that some servicers are lagging their peers and are less well-equipped to assist borrowers who have exited pandemic housing protections," said Consumer Financial Protection Bureau Director Rohit Chopra*. "We will be closely monitoring mortgage servicer performance to ensure that they are meeting their obligations under the law.*

As we have seen in the past, heightened consumer complaints will increase the chances of a CFPB examination. With the wide array of infractions that have been recognized by the CFPB, it will be a difficult task for any servicer to avoid being cited for a violation as they try to navigate compliance with fluid and varied requirements by investors and regulators.

Being in front of process gaps or delays that cause complaints is a crucial defense to minimize risk. Businesses that wait until they see the rise in complaints, may be too late to identify and implement timely solutions. The time is now to evaluate processes, identify gaps, and implement solutions that deliver efficient and accurate service to consumers.

Companies leveraging a sub-servicer are not protected from reputational or regulatory risk if violations are found. While the sub-servicer performs the servicing, the company who owns the MSR is ultimately responsible for their performance. A defined oversight plan that has a focused team actively engaged with the sub-servicer is a must. Never be afraid to challenge a process or demand additional data to evaluate performance. The experienced and talented sub-servicers in today’s market understand and will support the need to have proper controls and oversight in place!

FALSE CLAIMS ACT (FCA) OF 1863 - THE UGLY

You are probably thinking, *is that a typo in the title*? Actually, it is not, although there have been changes to the statute over the years, the basis for the significant claims against lenders is a 150+ year old law intended to prevent defense contractor fraud during the American Civil War.

We saw the risk of these claims rise against FHA lenders and servicers during the last housing crisis. The broad definition of fraud and significance of trebled damages across large populations caused some of the largest lenders to shy away from originating FHA loans. In late 2019, an agreement was signed between the DOJ and HUD to give the industry greater confidence that FCA would not be used for minor infractions.

Any attempt to mitigate FCA risk is welcome, but the agreement still has a fairly low hurdle to allow FCA actions (1). Any activity that involves certifying compliance with HUD requirements which include underwriting, insuring, and filing claims (loss mitigation or conveyance) should not be taken lightly. It is a best practice to review these processes annually to identify and close any gaps, especially after an extremely high-volume time where controls can be weakened.

KEEPING MSRs GOOD

We are coming out of a very long period of forbearance relief and foreclosure moratorium that presented minimal risk of consumers losing their home. As these programs end, a rise in consumers complaints to states and federal regulators has begun. We expect regulators will put the spotlight on the servicer and look for areas of weakness. The servicing process is complex with an array of disciplines that require a specific expertise-collections, bankruptcy, loss mitigation, property preservation, etc. As consumers pass through the home retention process, these hand-offs create the biggest gaps that can go unrecognized, even when each vertical team is focused on their key performance indicators. Even if all processes are followed to the letter, disparate outcomes can create regulatory and reputation risks.

Maintaining the “Good” and combating the “Bad” and the “Ugly”, is critical to perform a full review of processes, controls, metrics, and effectiveness of escalation procedures. In today’s environment, these are the types of reviews that may take a backburner as lenders focus on putting out fires in other areas of their business. To quote Clint Eastwood from another one of his epic movies “Now you've got to ask yourself one question. Do I feel lucky?”

Luck is not a strategy and servicers who have a identified their gaps, adjusted, and implemented the proper metrics and oversight into their process will be in the best position to combat any future actions from regulators. With pressure on the front-end of the business, lenders will feel pressure to cut cost across the board when in fact this is the time to ensure servicing operations are operating at their best.

MEET OUR HOUSING FINANCE TEAM

VICKI BOTT

Director, Reference Point Housing Finance Lead

Vicki has extensive leadership experience across the financial services industry. During her 35-year mortgage-banking tenure, she held the following positions:

- EVP, Regulatory Compliance and Operational Risk at Guaranteed Rate (Stearns Lending)
- Credit Strategy SVP of Wells Fargo home Lending
- National Sales Support and Strategy Wholesale SVP at Wells Fargo Home Lending
- Deputy Assistant Secretary/Single Family of Housing and Urban Development (HUD)

JON BAYMILLER

Engagement MD and Mortgage Operations Expert

Jon has 35+ years of experience in the residential mortgage industry. Previous positions include:

- President & CEO of New York Community Bank Mortgage Banking
- Advisory Board Member of Union Home Mortgage, Inc.
- Executive Vice President at AmTrust Bank
- Executive Vice President at CitiMortgage
- Executive Vice President and COO of Principal Residential Mortgage

BILL BECKMANN

Senior Advisor to Reference Point – Housing Finance

Bill has 40 years of experience in financial services focused primarily on mortgage banking operations and technology. Previous roles include:

- Senior Advisor at Housing and Urban Development
- Director and Committee Chair of non-profit, for-profit, and loan fund boards at Enterprise Community Partners
- CEO of Merscorp Holdings, Inc.
- CEO of CitiMortgage, Inc.
- CEO of The Student Loan Corp

MIKE MCPARTLAND

Engagement MD and Private Banking Mortgage Expert

Mike has 30+ years of experience in financial services with extensive experience leading teams in mergers and transformation initiatives across organizations. Previous roles include:

- Managing Director at Citigroup
  - Global Head of Residential Real Estate Lending
  - North America Head, PB Lending
  - US PB Fair Lending Officer
- Managing Director at JPMorgan Chase
  - US Residential Mortgage Product Head, PB and WM

DAVE STADLER

Engagement MD and Mortgage Technology Expert

Dave has over 40 years of experience in Financial Services with a broad background in operations and technology across financial services. Previous positions include:

- Mortgage CIO experience at Freddie Mac and GMAC/ResCap/Ally
- ~20 years at Accenture as a partner focused primarily on mortgage banking and technology

DAVE STEVENS

Senior Advisor to Reference Point – Housing Finance

Dave is a 38-year veteran of Mortgage Banking. He has led a variety of teams both in the industry and in Washington. Previous positions include:

- President and CEO of MBA
- US Asst. Secretary of Housing, Fed Housing Commissioner at HUD
- President and COO of Long & Foster Real Companies, Inc.
- Head of Single Family at Freddie Mac
- Head of Wholesale Lending Wells Fargo

(1) the most serious violations (so-called “Tier 1” violations under HUD regulations) exist either: in at least 15 loans or in loans with an unpaid principal balance of at least $2 million; AND there are aggravating factors such as evidence that the violations are systemic or widespread.