December 22, 2011

Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20552

VIA E-MAIL: Servicing_Comp_Public_Comments@fhfa.gov

RE: Alternative Mortgage Servicing Compensation Discussion Paper

Ladies and Gentlemen:

As an investor in residential mortgage backed securities ("RMBS") for our clients, BlackRock understands the importance of residential mortgage servicing and of the key relationships, responsibilities and interplay of interests among the borrower, the servicer, the guarantor and the investor. The performance of the mortgage servicer can greatly impact the performance of RMBS. BlackRock welcomes and applauds the focus of the Federal Housing Finance Agency (the “FHFA”), together with Fannie Mae, Freddie Mac, and the Department of Housing and Urban Development (“HUD”), on the issue of mortgage servicing through the Joint Initiative. We appreciate that the discussion of two ideas for new residential mortgage servicing compensation structures in the U.S. (the “Alternative Compensation Structures”) in the Alternative Mortgage Servicing Compensation Discussion Paper (the “Discussion Paper”) followed substantial consultation with a range of stakeholders. Given the potential impact of mortgage servicing on the residential mortgage capital markets, BlackRock welcomes the opportunity to provide comments on the Discussion Paper and the Alternative Compensation Structures.

By way of background, BlackRock is one of the world’s leading asset management firms, managing approximately $3.3 trillion on behalf of institutional and individual clients globally through a variety of products, including fixed income, equity, cash management, alternative investment, real estate and other advisory services. We manage assets on behalf of clients including corporate, public and multi-employer pension plans; sponsored mutual funds; endowments; foundations; charities; corporations; official institutions; and insurance companies and other financial institutions. We have a strong interest, on behalf of our clients, in the orderly functioning of the mortgage-backed securities market. BlackRock believes that promoting the orderly functioning of the RMBS market is vital to assure an adequate flow of credit to the mortgage market, which in turn is critical in order to sustain economic recovery. There are several issues raised by the Discussion Paper that could impact the performance of the RMBS market, and BlackRock welcomes the opportunity to highlight these issues.

BlackRock has consistently indicated its support for the establishment of national servicing standards regulations for residential mortgage loans, which would apply to all mortgages and lenders. We believe that the proposed Alternative Compensation Structures, and potentially other structures, are best addressed as part of a discussion regarding comprehensive national servicing standards, rather than on a stand-alone basis. We believe servicer compensation arrangements should satisfy principles and standards established in national servicing standards, and that the arrangements should be fully and
transparently disclosed. As the Discussion Paper recognizes (in the section regarding private-label mortgage-backed securities), servicing responsibilities and compensation are interrelated.

Furthermore, we believe that the facts and circumstances of any particular situation (e.g., the character and quality of a particular pool of underlying mortgages) are likely to be relevant to the optimal servicer compensation structure for that situation. Given the potentially disparate characteristics of individual pools, it may be shortsighted to mandate any one compensation structure for all situations.

I. Background

Up until the last few years, mortgage servicers focused on building efficiencies within the servicing process to lower costs and increase profitability. Since the vast majority of borrowers made timely mortgage payments, little investment was needed to support the technologies and infrastructure necessary to service non-performing loans. Instead, investments were made in more efficient servicing of performing loans through increased automation. From 2004 to 2009, the large residential mortgage servicers grew significantly, with the largest mortgage servicers controlling the majority of the mortgage servicing in the United States.

With the onset of the financial crisis, delinquencies increased, exposing deficiencies within the mortgage servicing process. Many servicers were ill-prepared to effectively process and service the high number of delinquent borrowers. Mortgage servicing call centers were overwhelmed as servicing representatives struggled to keep up with the growing load of delinquent borrowers. Loss mitigation programs were not thoroughly developed and many were ineffective, leaving delinquent borrowers with few options.

Some have observed that a contributor to poor mortgage-servicing performance was the mortgage compensation structure. The traditional structure of mortgage servicing fees pays servicers a flat basis point fee per loan on the outstanding principal balance. As delinquencies increased, servicers required more resources for non-performing loans. Non-performing loan servicing requires more manual processes, as additional staffing is needed to establish and maintain contact with delinquent borrowers. The traditional structure for mortgage servicing fees does not provide for fee increases as the cost of servicing an increasing number of delinquent loans rises. As a result, conflicts can emerge among the servicer, borrower, guarantor and investors. Simply stated, servicers look to minimize additional expenses as their cost of servicing increases, while delinquent borrowers, guarantors and investors desire additional servicing resources to address the rising delinquencies.

II. National Residential Mortgage Servicing Standards

We appreciate that the Joint Initiative has appropriately recognized these conflicts, and has proposed Alternative Compensation Structures designed to change the mortgage servicing fee structure to accommodate the increased costs associated with servicing non-performing loans. However, BlackRock believes the Joint Initiative’s effort to propose Alternative Compensation Structures should be more clearly addressed as part of a broader comprehensive effort to improve residential mortgage servicing, including through the development of national servicing standards. Such standards would


attempt to properly align potentially conflicting interests. Exploring Alternative Compensation Structures in greater detail on a stand-alone basis, rather than as part of an exploration of national servicing standards including contractual duties and matters other than compensation, would likely lead to suboptimal recommendations.

We believe any set of servicing standards should include principles regarding servicer compensation. Addressing the concerns and conflicts identified in the Discussion Paper through mandated principles as opposed to mandated solutions would permit compensation structures to be tailored to the particular facts at hand. It would also more easily accommodate future innovations.

III. **Considerations in Evaluating Alternative Compensation Structures**

In assessing the potential Alternative Compensation Structures and/or the principles that might govern compensation structures as part of a broader framework, the following points from an investor’s perspective should be taken into consideration.

A. **Servicing compensation and the impact on bondholders**

The reserve account structure explored in the Discussion Paper would provide for a reduced Minimum Servicing Fee ("MSF") plus an additional reserve account to cover non-performing loan servicing costs (the "Reserve Account Structure"). The reserve account could be accessed after predetermined thresholds are met, with the additional servicing fees to offset higher servicing costs associated with non-performing servicing. In a high-delinquency environment, the reserve account could be depleted. The Discussion Paper indicates that the guarantor/investor/trustee might directly compensate servicers to cover any shortfall in the reserve account, consistent with current practice. The prospect of funds being taken out of the cash flows generated by the transaction to pay the servicer additional compensation will create uncertainty for investors.

The fee for service compensation structure described in the Discussion Paper (the “Fee for Service Structure”) would provide for more predictable compensation for the servicer, but could create uncertainty if this fee is deducted from the cash flow of the transaction. The Fee for Service Structure would create inconsistency in the fee structure based upon the size of the loan. Additionally, the notes to Exhibit 3 of the Discussion Paper indicate that the servicing compensation under this structure would be reassessed at least annually for material changes to the servicing requirements, inflation or costs. The issue of how a decision is made to change servicing compensation and by whom needs to be carefully thought through so as to mitigate potential conflicts. Any post-issuance changes to the servicing fees would impact predictability of the cash flow to the investor if the higher fee structure is deducted from the cash flow of the transaction, potentially impacting credit enhancement levels and other features of a securitization.

One of the hallmarks of the GSE and private label RMBS markets has been the relative predictability of the cash flows. From the principal and interest received by the servicer, only very specific fees, which are fully disclosed, are removed from the distribution to the bondholders. This certainty attracts private capital to the mortgage sector. BlackRock is concerned that either of the
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Alternative Compensation Structures might introduce a fee structure that would be less transparent and less predictable, and thus provides a disincentive for private capital.

B. Replacement Servicer

Under the current servicing compensation model, investors generally gain comfort knowing that the servicing fee is sufficient to attract successor servicers should the current servicer default or need to be replaced. The current market provides sufficient liquidity and market depth to provide for the servicing transfer, should one need to occur.

The Alternative Compensation Structures described in the Discussion Paper call for a reduced MSF and additional compensation for non-performing loans via the reserve account or direct compensation from the guarantor. BlackRock is concerned that the servicing fees may be insufficient to attract replacement servicers that may be needed. The concern is particularly heightened for poorly performing pools, where the MSF and any remaining funds in the reserve account (under the Reserve Account Structure) may provide insufficient compensation to attract replacement servicers.

One solution may be to designate a backup or replacement servicer at the time of issuance of the transaction. This will provide investors with greater certainty that servicing on the transaction will be uninterrupted.

In addition, servicing must remain an economically viable business for servicers to assure capacity as well as liquidity in the mortgage servicing rights market in order to ensure that successor servicers are available in the event of primary servicer failures. Servicing compensation structures should remain profitable. The structure of any reserve accounts will impact liquidity of the specific pool, as poorly performing pools may see their reserve accounts quickly depleted as more funds are used to pay the higher servicing fees for delinquent loans.

C. Alignment of Interests

One of the primary concerns for any investor in a security is to ensure that the incentives of the stakeholders are properly aligned. In the RMBS market, this alignment of interests with the mortgage servicer is critical to attracting and retaining investor interest.

The Reserve Account Structure provides that if the mortgage loan performance is better than anticipated, any funds remaining in the reserve account would go to the servicer as additional compensation. This release mechanism appears to align the interest of the investor with that of the servicer, in that they both want strong performance of the mortgage portfolio.

However, BlackRock cautions that it would be critical that the trigger events that would control the compensation to the servicer be objectively defined and transparent in order to avoid opportunities for the servicers to inappropriately increase their compensation.
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IV. Conclusion

BlackRock appreciates the opportunity to comment on the proposed Alternative Compensation Structures. We believe the Joint Initiative’s efforts to analyze servicer compensation issues will improve the effectiveness of mortgage servicing for investors, servicers, borrower, and guarantors. We believe these efforts can result in improved transparency and stability in the RMBS market.

As the Joint Initiative continues to consider servicer compensation structures going forward, it will be important to:
- focus further on enhancing transparency and preserving the predictability of the cash flow for investors,
- assure that compensation structures maintain liquidity in the mortgage servicing market to attract replacement servicers, and
- design any new compensation structure to align the interests of the servicer with the investor.

A targeted focus on compensation structures alone will not yield the benefits that a comprehensive, holistic approach to addressing national servicing standards would. A key component of any such servicing standards would be a set of principles regarding appropriate servicer compensation structures. Examples of such principles would include a requirement to ensure there is an alignment of interests, as well as a requirement for full and transparent disclosure of the servicer compensation arrangements.

We believe it would be best to approach this issue by mandating principles as opposed to mandating particular compensation structures. This would permit flexibility and allow compensation structures to adapt to particular situations and evolve over time.

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We thank the Joint Initiative for the opportunity to comment on the proposed Compensation Structures. We look forward to working with the Joint Initiative on this comment process. If you have any questions or would like further information, please do not hesitate to contact me.

Sincerely,

Barbara G. Novick
Vice Chairman