FEDERAL HOUSING FINANCE AGENCY

ADVISORY BULLETIN

AB 2014-06

MORTGAGE SERVICING TRANSFERS

Purpose

The Federal Housing Finance Agency (FHFA) is issuing this advisory bulletin to communicate supervisory expectations for risk management practices in conjunction with the sale and transfer of mortgage servicing rights (MSRs) or the transfer of the operational responsibilities of servicing mortgage loans owned or guaranteed by Fannie Mae and Freddie Mac (collectively, the Enterprises).

Background

The sale and transfer of MSRs or the transfer of mortgage servicing has recently increased for a number of reasons. Some servicing transfers are initiated by the Enterprises. An Enterprise may seek to facilitate or require the transfer of mortgage servicing to a different servicer in an effort to improve mortgage servicing performance. A transfer may also be necessitated by a mortgage servicer's failure to meet contractual requirements. Servicing transfer requests may also be initiated by the owner of the MSRs or the servicer of the mortgage portfolio. For example, changes in capital regulations or servicing profitability may prompt commercial banks and financial services companies to seek to reduce MSR holdings. Some non-bank mortgage servicing companies have recently increased acquisitions of MSRs and the servicing of mortgage loans.

There are different variations for structuring transfers to the acquiring entities. Historically, both the ownership of the MSRs and the servicing of the mortgage loans were transferred to the same entity. However, the MSRs owner and the mortgage servicer may be separate entities, which would necessitate one or more sub-servicer arrangements. For example, the MSRs owner may be established as a limited liability company with the primary purpose of sub-contracting servicing to one or more servicers. In some situations, more than one entity is responsible for the representations and warranties related to the origination, selling, or servicing of a transferred mortgage servicing portfolio. Different types of entities involved in MSR holding structures can impact the financial, operational, and legal risks associated with any given transfer.

Any sale and transfer of MSRs or transfer of the operational aspect of servicing mortgage loans owned or guaranteed by Fannie Mae or Freddie Mac requires the approval of the applicable Enterprise in accordance with its seller/servicer guide.

Guidance

An Enterprise should only approve those transactions that are consistent with sound business practice, aligned with the Enterprise's board-approved risk appetite, and in compliance with regulatory and Conservator requirements. Certain bulk servicing transfers also require the approval of FHFA as Conservator for the Enterprises.

Each Enterprise should have in place policies and procedures within its risk management program for evaluating risks of proposed sales or transfers of MSRs and transfers of the servicing of mortgage loans, considering the particular circumstances of the transfers (*e.g.*, volume and profile of the loans transferred, structure and complexity of the transaction, counterparty exposure, servicing concentrations, and/or borrower experience). The Enterprise's policies and procedures should identify, assess, and appropriately mitigate risk. The policies and procedures should provide for risk-based periodic reporting to the board of the transfers' risk effect on the mortgage servicing portfolio. The Enterprise should maintain documentation of supporting analysis of transfer approval decisions that is sufficient to enable subsequent supervisory review.

This advisory bulletin sets forth guidance for how each Enterprise should develop policies and procedures for reviewing and approving the sale and transfer of MSRs or the transfer of the servicing of mortgage loans. The policies and procedures should enable the Enterprise to understand its potential counterparty risk exposure resulting from servicing transfers.

Analysis of Mortgage Servicing Transfers

The Enterprise should analyze and document the terms and conditions of all proposed transactions. The Enterprise should evaluate the risks and potential benefits of proposed transfers, taking into account relevant factors regarding the transferee, the transferor, and the borrower, as well as, the Enterprise's overall risk management strategy for servicers. The analysis should incorporate and reflect the views of both risk management and business line management.

The analysis should reflect a risk-based approach and consideration of all relevant risks, including (but not limited to) the following factors:

Financial Risk Factors

- Financial strength of the transferee servicer or the MSRs owner based upon a current analysis;
- Existing and anticipated sources of capital and liquidity for the transferee servicer or the MSRs owner;
- Confirmation of the responsible party(ies) for origination and servicing representation and warranty obligations;
- Ability of all relevant participants to meet contractual obligations, including representations and warranties and other contractual obligations, including during adverse scenarios in which the counterparty may have trouble accessing liquidity and capital;
- Terms of any financial support arrangements (e.g., letters of credit, net worth or other guarantees, or other investment structures that securitize the servicing income or the advance receivables); and
- Complexity of the counterparty financial structure, including financial arrangements with other parties.

Operational Risk Factors

- The Enterprise's, the transferee's, and the transferor's business objective for the proposed transfer;
- Transferee servicer's status as an "approved" servicer by the Enterprise;
- Transferee servicer's and any sub-servicer's delegations and authority to conduct business on behalf of the Enterprise in relation to the servicing portfolio being transferred;
- Organizational structure, location, management team, and operations of the transferee servicer and any sub-servicers;
- Transferee servicer's and any sub-servicer's expertise and performance record, including the results of recently conducted Enterprise on-site reviews;
- Servicing fee distribution between the MSRs owner and the transferee servicer to ensure proper alignment of incentives and coverage of costs;
- Servicer capacity, taking into account staffing, facilities, information technology systems, and any sub-servicing arrangements;
- Outstanding obligations and past performance regarding repurchase recoveries and compensatory fee recoveries;
- Operational complexity of the transaction;
- Third party service providers or vendors contractually obligated to the servicer, but not to the Enterprise;
- Adequacy of the transferee servicer's business continuity plan, inclusive of any applicable sub-servicers or material vendors;
- Current and potential effects of the transfer on borrowers, including those associated with in-process workouts, bankruptcies, and litigation; and

- Overall effect of the transfer on the servicer relationship and any resulting counterparty concentrations for an Enterprise.

Legal and Compliance Risk Factors

- Potential compliance risk associated with the characteristics of the mortgage loans being serviced;
- Based upon publicly available information, the transferor servicer's, transferee servicer's, and any sub-servicer's record of compliance with consumer protection laws, including provisions of the Consumer Financial Protection Bureau's Regulation X, which implements the *Real Estate Settlement Procedures Act*;
- Extent to which the transferor servicer, transferee servicer, and any sub-servicer is subject to federal or state regulatory oversight; and
- Any public regulatory or other enforcement actions relating to safety and soundness, legal, or compliance issues (*e.g.*, consumer compliance, fraud, financial reporting) of the servicers or sub-servicers.

Policies and procedures should be consistent with prudent counterparty risk management practices and with FHFA guidance, including risk-based contingency planning in accordance with FHFA Advisory Bulletin AB-2013-01, *Contingency Planning for High-Risk or High-Volume Counterparties*, as appropriate.

Transfer Execution Monitoring

The Enterprise's policies and procedures should clearly outline its expectations to facilitate the transfer of data and records. Further, the Enterprise should have a risk-based process to monitor the execution of the transfers so that all servicing transfers occur in a timely manner and in accordance with approved terms, servicing guide requirements, and applicable mortgage servicing transfer-related laws and regulations. The Enterprise should also have a process to update and maintain its systems to accurately identify all parties involved in the servicing of a particular loan portfolio.

Monitoring should cover the transfer of loan records, information regarding loans with loss mitigation in process (including loan modifications), compliance with laws and regulations relating to mortgage servicing transfers, compliance with approved terms including loan product types and status of loans to be transferred, and quality control review results. For loans that are subject to existing loss mitigation agreements or have loan modification agreements in process, the transfer terms should require the transferee servicer to honor and abide by such agreements or propose options that are no less beneficial to the borrower, and provide for the transferee servicer to obtain all information needed to complete the modification. Transfer execution monitoring should encompass consideration of all relevant participants, including the MSRs owners, servicers, sub-servicers, and third party service providers and vendors, as appropriate.

Policies and procedures for Enterprise approval determinations should incorporate assessments of the effectiveness of any prior transfers. Transfer execution monitoring should continue for a sufficient period of time post-transfer to enable the Enterprise to evaluate the effectiveness of the transfer and incorporate that evaluation in future approval decisions.

Related Guidance

Contingency Planning for High-Risk or High-Volume Counterparties, Federal Housing Finance Agency Advisory Bulletin 2013-01, April 1, 2013, establishes guidelines for contingency plans for high-risk or high-volume counterparties and describes the criteria the regulated entities should use to develop plans for managing counterparty credit risk exposures.

Advisory bulletins communicate guidance to FHFA supervision staff and the regulated entities on specific supervisory matters pertaining to the Federal Home Loan Banks, Fannie Mae, and Freddie Mac. Contact Kari Walter, Senior Associate Director, Office of Supervision Policy at (202) 649-3405 or Kari.Walter@fhfa.gov, or Kathy Beach, Principal Examiner (Policy), Examination Standards Branch, at (202) 649-3521 or Kathy.Beach@fhfa.gov, with comments or questions pertaining to this bulletin.