RESPONSE TO FHFA JOINT SERVICING COMPENSATION INITIATIVE
PREPARED BY UCM, INC.
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INTRODUCTION –

UCM, Inc. has been deeply involved in the discussion of changing servicing compensation, including organizing and attending meetings with FHFA and the GSEs in Washington, continuous discussions with mortgage bankers, mortgage industry advisors, trade groups and direct discussion with the individual GSEs, Federal Reserve Board and Bank staff, industry lobbyists and other interested parties. Having just returned from some intense sessions at the MBA's Secondary Market Conference and Expo in New York City, we thought that it would be a good time to update our understanding of the discussion.

The good news is that the discussion seems to have taken an introspective turn with more and more participants on both sides of the issue, from GSEs to mortgage servicers, now saying that we need to have a more thoughtful debate, including leaving the MSF ("Minimum Service Fee") where it is.

FEE FOR SERVICE –

Although FFS was mentioned in the FHFA's original paper, no specifics were offered for people to consider. There is now interest from the GSEs to explore FFS as another possible alternative. They're not saying that it's "the answer", but, instead, they're saying that if we're going to consider alternatives, let's not leave this one out.

UCM agrees that we can't have a full discussion of the options and leave FFS out of the debate. We see significant problems with this approach, including establishing fair fees for servicers nationwide and providing a means to maintain compensation flexibility as rules, costs and loans change in the future. Funding presents huge challenges, requiring holding and reallocating funds from states with high average balance loans to states with lower balances.

Despite the difficulties, we agree that someone should attempt to craft a FFS schedule as an alternative to evaluate and consider. Once an actual FFS plan is proposed, it can be modeled to determine the value of the resulting cash flow, the capitalization required up front and the likely impact on securitization, income and incentives.

"ADEQUATE COMPENSATION" –

Fannie Mae is still advocating a "sweet spot" where no MSR asset or liability is booked. They seem totally alone on this front. We can't find another person that views this as a viable plan. We would say that there's nothing "sweet" about an obligation to service for up to 360-months where the servicing compensation simply covered your servicing costs, and the discounted cash flows net to zero.

If you did achieve this dream of zero MSR for a moment in time, then what would be the GSE's collateral requirement needed to protect their positions as guarantors? One can imagine the FDIC negotiating the servicing of a failed bank. The question will change from "What will you pay us for it?" to "What will we have to pay you to take it?"

Discussing this option with servicers of all sizes and others involved in the debate, other than Fannie Mae, always leads to chuckles and questions like, "How could I go to my board and request capital when my models show the return is zero?"

What is lost in the current discussion of reducing compensation to servicers is the concept of "Skin in the Game" which is the focus of the national mortgage legislation and debate. Reducing skin in the game is counter to the interest of the borrowers, investors, guarantors and servicers.

REFRAME THE DISCUSSION –

This has been most encouraging to us. We're now hearing it from every side, that radically changing the compensation is not the immediate problem and more important issues need the focus of the Regulators, GSE's and Congress. The open debate on MSRs fostered full recognition that there are many challenges and interlinking aspects to servicing and servicing compensation. For instance, we can't possibly come up with changes to compensation or an acceptable FFS matrix until we've established final standards for NPL ("Non Performing Loan") processing and revised National Servicing Standards.

Here's a framework that UCM would suggest that's consistent with what we're hearing from others:

1. The GSEs should finalize NPL servicing requirements, including contractual penalties and/or incentives, codifying required procedures for handling NPLs.
2. The GSEs must establish new risk-based Guarantee Fees. We continue to hear that the GSEs will soon increase G-Fees, but we're told that the issue cannot be discussed in our forums due to anti-trust considerations. Since we can't prospectively price loans under the various proposals without knowing the G-fees, then the GSEs simply need to do whatever they do and either affirm the current G-fee scenarios, or establish new risk-based G-fees.
3. Agree on and issue National Servicing Standards that will cover loans subject to GSE contractual rules. Hopefully there'll be consistency between the National Standards and GSE rules
4. Complete the definition of QRM and QM so that we understand the new costs and limits of origination. Capital charges for retained mortgage risk could have a huge impact on capital available for servicing operations.
5. Calculate costs to comply with the new regulations imposed by the Bureau of *Consumer Financial Protection* (CFPB)

6. Define the GSEs' roles in housing finance for the future. Some of the servicing compensation proposals now considered require the GSEs to be fee-bankers for the next 30-years. It seems logical to understand the intent of Congress for their futures before we put them in additional long-term roles.
7. Finally, if there any disconnect between servicer incentives and borrower and guarantor interests, we can readdress servicing compensation. The outcome might increase servicer compensation.

CONCLUSION –

UCM is pleased to report that this discussion seems to be maturing. We hear that the GSEs will be asked to put together more detailed proposals after Labor Day and that it's, perhaps, realistic to expect to see those by mid-July. That should lead to another round of reactions and meetings and discussions.

There's also a strong chance that the discussion will be reframed, with the various related problems addressed in an appropriate order before we start changing things that might not need changing.

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