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Press Releases - 2011
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EXCERPTS FROM SUPERINTENDENT LAWSKY'S REMARKS ON NON-BANK MORTGAGE SERVICING IN NEW YORK CITY

Benjamin M. Lawsky, Superintendent of Financial Services for the State of New York, is delivering remarks today at the Mortgage Bankers Association 2014 National Secondary Market Conference in New York City.

The following are excerpts from Superintendent Lawsky's remarks on non-bank mortgage servicing as prepared for delivery.

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Excerpts from Superintendent Lawsky's Remarks at the Mortgage Bankers Association 2014 National Secondary Market Conference
New York, NY
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As Prepared for Delivery

Let's start with the issue of non-bank mortgage servicers. Specifically, the parallel growth of non-bank servicers – as well as their affiliates, which provide ancillary services.

First, some context on how a loan and the servicing of that loan become separate assets. This background will be familiar to many of you, but it's not well known among the wider public.

In a typical scenario, mortgage loans are originated or purchased by a bank or other large financial institution, which then pools them together into a security. A pooling and servicing agreement (PSA) governs the rights and obligations of the parties, including the rights of certain investors to collect mortgage payments, and the compensation to be paid to a servicer to collect borrower payments and transmit them to investors.

A trustee is appointed as a fiduciary to represent the collective rights of mortgage investors, but as a functional matter the trustee does very little. And the bank often retained for itself the right to service the mortgages and to collect the servicer compensation designated by the PSA.

Recently, however, there has been an evolution in the mortgage servicing industry. Regulators are – appropriately, in the wake of the financial crisis – putting in place stronger capital requirements for big banks. In particular, they are giving those banks less credit for the – often distressed – mortgage-servicing rights (MSRs) on their balance sheets.

Rather than building up stronger capital buffers in response, many large banks are instead offloading those MSRs to non-bank mortgage servicers – which are often more lightly regulated.

There are, of course, likely other factors at play beyond capital requirements. But the recent trend toward explosive growth in non-bank mortgage servicing itself is undeniable – regardless of its cause.

Now, one of the things we're concerned about as a regulator is whether these MSR sales trigger a race to the bottom that puts homeowners at risk. Remember, in most cases, the compensation to be paid for servicing is fixed by the PSA; it cannot be diminished. So the cheaper a servicer can service those mortgages, the more profit it expects to earn from the fixed servicing fees, and the more it can offer the banks to buy these MSRs.

The result is high prices paid for MSRs, together with incentives for cut-rate servicing by non-banks. Indeed, one large non-bank servicer touted that it can service distressed loans at a more than 70 percent discount – in part due to expanded use of information technology.

Regulators have a responsibility to ask whether the purported "efficiencies" at non-bank mortgage servicers are too

good to be true.

The servicers advertise themselves as having scalable and efficient technology to deal with this influx of loans, and I'm as big a proponent of technology as anyone. But technology alone does not keep a family in its home.

People lead complicated lives, and helping them work through their issues often requires creative solutions. It is human capital – people – that help families keep their homes. Human beings are not as readily scalable as the technology that supposedly supports them.

And the explosive growth of non-bank servicers only compounds these problems as the companies try (often unsuccessfully) to keep up with a rapidly increasing portfolio of loans.

So, what are the consequences of this potential race to the bottom? Well, it should be no surprise that borrowers tend to be the losers here. When we at DFS take a closer look at some of these non-bank servicers, we find corners being cut, to the disadvantage of homeowners.

Mortgage investors also lose out. After all, they are the ones paying rack rates for bargain basement services.

Borrowers and investors both suffer when a servicer does not know how to pull together its loan files strewn around the globe. Or when a servicer is unable to extract information from its many incompatible computer systems at the right time and for the right purpose. Or when a borrower cannot get a straight answer from a servicer on a loan modification that could both save a family's home and reduce an investor's losses.

Moreover, while some defend the non-bank mortgage servicing industry as providing better service than the large banks – that's cold comfort for most borrowers and investors given the bank's track record in this area (even if it were true). It also wouldn't justify regulators turning a blind eye to a rapidly growing non-bank sector in which the homes of millions of families are at stake.

As Comptroller of the Currency Thomas Curry recently noted, it's vital that state regulators stay vigilant about risks moving outside the traditional banking system and into the shadows at non-banks.

Furthermore, it's also important to remember who would benefit from light-touch regulation in this space. It's not the borrowers or the mortgage investors. It's the banks that are receiving top dollar for their MSRs, and the non-bank servicers that are paying these sums because they often believe they can still profit through cut-rate service.

What's more, our review of non-bank servicers has also turned up another enormous profit center associated with these MSRs that could put homeowners and mortgage investors at risk: the provision of what we call ancillary services.

Under a business model employed by several large non-bank mortgage servicers, the servicer or an affiliate provides fee-based services for every single step in the real estate process.

Need to inspect a property to determine whether it's vacant? We have an affiliate that can do it.

Need to market your short-sale property to a wider audience? We have an online auction site that can do it.

Need to sell a property in a foreclosure sale? We can handle it.

Need to sell your real-estate-owned property following foreclosure? We have an affiliated real estate brokerage.

Need to collect on a debt that's no longer secured by the property? Use our affiliated debt collector.

Need to get a non-performing loan off your books? We even have an affiliate that will buy loans from investors, pursue foreclosure, and turn those idle properties into profitable rentals.

The list of services available goes on and on and on.

Now, in most circumstances, there's nothing inherently wrong with companies and their affiliates providing a range of ancillary services.

However, these are not ordinary circumstances where a customer has the opportunity to choose from a range of options and selects the option that meets the customer's requirements at the lowest price.

Rather, this is the extraordinary circumstance where there effectively is no customer to select its vendor for ancillary services. Non-bank servicers have a captive (and often confused) consumer in the homeowner.

Yes, the borrower interacts most with the servicer, but has little or no power in this relationship and is typically at the mercy of the servicer. Yes, the mortgage investors pay the servicers' bills, but those investors constitute a large and diverse group that does not speak with a single voice. Yes, the trustee nominally represents the investors, but it lacks the authority to select the servicer and lacks either the capacity or will to demand that the servicer do a good

job.

So who makes the decision about where to procure these ancillary services, and how much of the investor's or the borrower's money to pay for them? It's usually the servicer, seemingly with no oversight whatsoever. The very same servicer that benefits – either directly or indirectly – from the profitability of the affiliated companies that provide these services.

The potential for conflicts of interest and self-dealing here are perfectly clear. Servicers have every incentive to use these affiliated companies exclusively for their ancillary services, and they often do. The affiliated companies have every incentive to provide low-quality services for high fees, and they appear in some cases to be doing so.

Indeed, so long as the volume of MSRs remains high, servicers and their affiliates make a profit. A performing loan keeps churning servicing fees. A delinquent loan merits monitoring of the property, for a fee. An underwater mortgage is solicited for a short sale, for auction fees, technology fees, broker fees, referral fees, and servicing fees. A foreclosed property involves a foreclosure sale, for a fee. A property that doesn't sell in foreclosure becomes real estate owned and then sold, for many more fees.

In the context of the non-bank mortgage servicing market, homeowners and investors are at risk of becoming fee factories.

It's the regulator's role to monitor these fees in the mortgage industry imposed through potentially conflicted arrangements. And when these ancillary services are being provided either at a sub-standard quality or at inflated prices – or both – that deserves strong scrutiny.

We've publicly highlighted our concerns about ancillary services with one particular non-bank servicer, but they are not the only industry player doing this. So you should expect us to expand our investigation into ancillary services in the coming weeks and months.

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