FSOC

Report on Nonbank Mortgage Servicing 2024

1. Introduction

- Nonbank mortgage companies (NMCs) have become a dominant force in the U.S. mortgage market, significantly increasing their market share since the 2008 financial crisis.
- As of 2022 data, NMCs originated approximately two-thirds of U.S. mortgages and owned the servicing rights on 54% of mortgage balances (from 39% in 2008), implying their vital operational capacity in both loan origination and servicing.
- NMCs are the key mortgage originators and servicers for groups considered historically underserved by traditional financial institutions.
- Though NMCs have specialized in technologies and operations to streamline mortgage processes, their concentrated focus on mortgage-related products exposes them to significant risks.
- NMCs profitability is highly sensitive to fluctuations in mortgage demand and defaults, and they face substantial liquidity risks due to high leverage and reliance on volatile debt markets.
- Recent years have seen the Federal government’s increased exposure to NMCs, with a significant portion of mortgage servicing available through insurance and direct guarantees of loans financed through Ginnie Mae securitizations and through the financial support for Fannie Mae and Freddie Mac in conservatorship.
- The Federal government’s increased reliance presents challenges in regulatory enforcement and potential disruptions in mortgage servicing during times of financial stress.
- This report explores the critical role NMCs play, their key strengths and vulnerabilities, the mortgage market shift towards NMC, and the implications for the federal government's exposure to these firms.

Regulatory Framework for Nonbank Mortgage Companies

State Financial Regulators

State financial regulators have broad licensing, examination, and enforcement authority over NMCs operating within their states.

Consumer Financial Protection Bureau (CFPB)

The CFPB has supervisory authority over NMCs to assess their compliance with federal consumer financial law and enforcement authority to take action against violations of federal consumer financial laws. It has a consumer protection focus, but is not a comprehensive prudential regulator for NMCs.

Ginnie Mae and FHFA

Ginnie Mae and the Federal Housing Finance Agency have limited regulatory authority over NMCs, primarily through contractual relationships.

The Enterprises

Fannie Mae and Freddie Mac, as private companies, assess and manage risks from their contractual relationships with NMCs.

2. Mortgage Servicers

2.1. Servicer Responsibilities

- Mortgage servicers are responsible for a wide range of loan administration tasks, including collecting, recording, and distributing payments, handling delinquent borrowers, determining loss mitigation strategies, implementing loss mitigation plans, foreclosing, evicting, and property maintenance after eviction.
- These duties are critical for borrowers, guarantors, insurers, and investors.

2.2. Servicer Business Models

- Servicer business models vary, with some performing duties in-house and others using third-party subservicers. The share of mortgages serviced by NMCs that utilize subservicers has grown significantly, from 25% in 2015 to around 50% today.
- The top 20 Agency servicers, mostly NMCs, hold the servicing rights on nearly $6.3 trillion in mortgages, about 70% of the total Agency market.

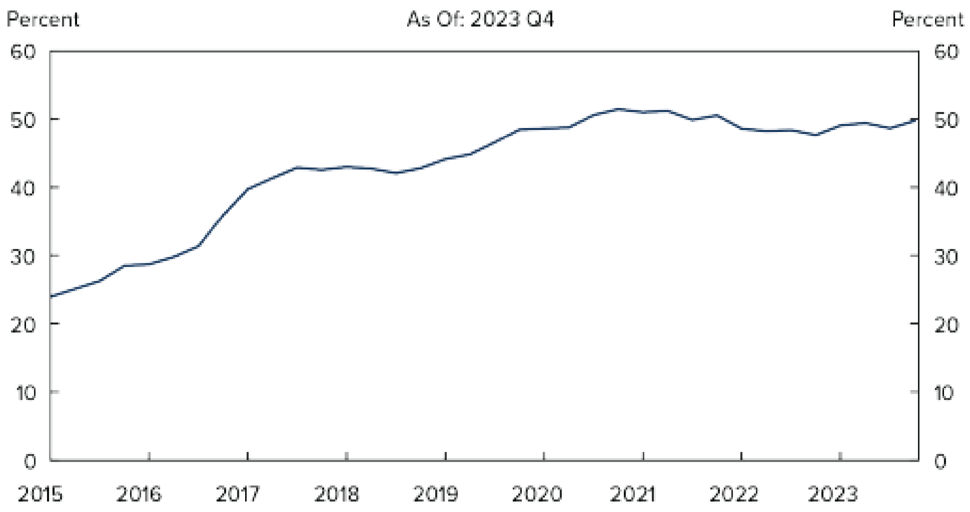
continued

2.2. Servicer Business Models

Primary Activity of Servicers and Subservicers

Servicer	Subservicer
Hold servicing rights	Do not hold servicing rights
Record servicing assets on balance sheet	Do not record servicing assets on balance sheet
Retain some (or most) mortgage loan administration functions	Provide loan administration functions that are not performed by the servicer
Responsible for cash outlays required under servicing contract	Not responsible for cash outlays required under servicing contract

Figure 1: Share of NMC Servicing Subserviced by Another Firm



- Fig 1 shows the growth of NMCs using Subservicers
- The share of mortgages serviced by NMCs that use subservicers has increased significantly, rising from 25% in 2015 to around 50% today.

continued

2.2. Servicer Business Models

Table below illustrates data from ***Inside Mortgage Finance*** for the **20 largest Agency servicers** (both bank and nonbank)

Table 1: Top Agency MBS Servicers, Q4 2023

Firm	Type	Rank	Servicing UPB Balance (in $ Billions)	Market Share (Percent)	Utilizes Subservicer	Provides Subservicing
Lakeview/Bayview Loan Servicing	Nonbank	1	644.5	7.3	Yes	No
Chase Home Finance	Bank	2	597.0	6.7	No	No
PennyMac Corp	Nonbank	3	588.5	6.7	No	No
Wells Fargo	Bank	4	539.9	6.1	No	No
Mr. Cooper Group	Nonbank	5	531.7	6.0	No	Yes
New Rez/Caliber Home Loans (Rithm)	Nonbank	6	474.1	5.4	No	Yes
Rocket Mortgage	Nonbank	7	463.6	5.2	No	Yes
Freedom Mortgage Corp	Nonbank	8	456.7	5.2	No	Yes
United Wholesale Mortgage, LLC	Nonbank	9	274.4	3.1	Yes	No
U.S. Bank NA	Bank	10	220.0	2.5	No	No
Matrix Financial Services/Two Harbors	Nonbank	11	213.2	2.4	Yes	No
Truist	Bank	12	210.6	2.4	No	No
PNC Bank NA	Bank	13	202.5	2.3	No	No
Ocwen Financial/PHH Mortgage	Nonbank	14	163.0	1.8	No	Yes
Onslow Bay Financial	Nonbank	15	150.3	1.7	Yes	No
LoanDepot.com LLC	Nonbank	16	134.0	1.5	No	No
Carrington Mortgage Services, LLC	Nonbank	17	126.6	1.4	No	Yes
Fifth Third Bank	Bank	18	97.6	1.1	No	No
Citizens Bank NA RI	Bank	19	96.3	1.1	No	No
CMG Mortgage Inc	Nonbank	20	92.6	1.0	Yes	No
Top 10 Agency MBS Servicers Total			4,790.4	54.1		
Top 20 Agency MBS Servicers Total			6,277.1	70.9		
Total Nonbank Agency MBS Servicers in Top 20			4,313.2	48.7		
All Agency MBS Servicers Total			8,847.8			

- Top 20 Agency servicers hold the servicing rights on nearly $6.3 trillion in unpaid balances on mortgages in Agency pools .
- Nonbank mortgage servicers in the top 20 hold the servicing rights on $4.3 trillion, or almost half, of the total Agency market.
- NMCs are seven of the 10 largest Agency servicers and 13 of the largest 20 Agency servicers.

continued

2.2. Servicer Business Models

Table 1a: NonBank Agency Servicers

Type	Firm	UPB Balance (in $ Billlions)	Market Share	Utilizes Subservicer	Provides Subservicing
Nonbank	**Lakeview/Bayview Loan Servicing**	644.5	7.3	Yes	No
	PennyMac Corp	588.5	6.7	No	No
	Mr. Cooper Group	531.7	6.0	No	Yes
	New Rez/Caliber Home Loans (Rithm)	474.1	5.4	No	Yes
	Rocket Mortgage	463.6	5.2	No	Yes
	Freedom Mortgage Corp	456.7	5.2	No	Yes
	United Wholesale Mortgage, LLC	274.4	3.1	Yes	No
	Matrix Financial Services/Two Harbors	213.2	2.4	Yes	No
	Ocwen Financial/PHH Mortgage	163.0	1.8	No	Yes
	Onslow Bay Financial	150.3	1.7	Yes	No
	LoanDepot.com LLC	134.0	1.5	No	No
	Carrington Mortgage Services, LLC	126.6	1.4	No	Yes
	CMG Mortgage Inc	92.6	1.0	Yes	No
Total		**4313.20**			

2.2. Servicer Business Models

Table 1b: Bank Agency Servicers

Type	Firm	UPB Balance (in $ Billlions)	Market Share	Utilizes Subservicer	Provides Subservicing
Bank	Chase Home Finance	597.0	6.7	No	No
	Wells Fargo	539.9	6.1	No	No
	U.S. Bank NA	220.0	2.5	No	No
	Truist	210.6	2.4	No	No
	PNC Bank NA	202.5	2.3	No	No
	Fifth Third Bank	97.6	1.1	No	No
	Citizens Bank NA RI	96.3	1.1	No	No
Total		**1963.90**			

Table 1c: Total UPB Balance for NonBank/Bank Agency Servicers

Type	UPB Balance (in $ Billions)
Nonbank	4313.20
Bank	1963.90

continued

2.2. Servicer Business Models

Table 2: Top Residential Mortgage Subservicers,04 2023

Firm	Type	Rank	Subservicer Balance (in $ Billions)	Market Share	Subservicer Only
Cenlar	Bank	1	875.0	21.9	**Yes**
Dovenmuehle	Nonbank	2	515.0	12.9	**Yes**
Mr. Cooper	Nonbank	3	403.8	10.1	**No**
Loan Care	Nonbank	4	320.0	8.0	**Yes**
Flagstar	Bank	5	294.9	7.4	**No**
Service Mac	Nonbank	6	245.2	6.1	**Yes**
Ocwen Financial/PHH Mortgage	Nonbank	7	139.9	3.5	**No**
Select Portfolio Servicing	Nonbank	8	133.0	3.3	**Yes**
M&T Bank	Bank	9	115.1	2.9	**No**
New Rez/Caliber/Shellpoint	Nonbank	10	102.5	2.6	**No**
Estimated Subservicing Market Total			**3144.40**		

continued

2.2. Servicer Business Models

Table 2a: Nonbank Residential Mortgage Subservicers,04 2023

Firm	Type	Rank	Subservicer Balance (in $ Billions)	Market Share	Subservicer Only
Dovenmuehle	Nonbank	2	515.0	12.9	**Yes**
Mr. Cooper	Nonbank	3	403.8	10.1	**No**
Loan Care	Nonbank	4	320.0	8.0	**Yes**
Service Mac	Nonbank	6	245.2	6.1	**Yes**
Ocwen Financial/PHH Mortgage	Nonbank	7	139.9	3.5	**No**
Select Portfolio Servicing	Nonbank	8	133.0	3.3	**Yes**
New Rez/Caliber/Shellpoint	Nonbank	10	102.5	2.6	**No**
Estimated Subservicing Market Total			**1859.40**		

continued

2.2. Servicer Business Models

Table 2b: Bank Residential Mortgage Subservicers,04 2023

Firm	Type	Subservicer Balance (in $ Billions)	Market Share	Subservicer Only
Cenlar	Bank	875.0	21.9	**Yes**
Flagstar	Bank	294.9	7.4	**No**
M&T Bank	Bank	115.1	2.9	**No**
Estimated Subservicing Market Total		**1285.00**		

Table 2c: Nonbank/Bank Subservicer Balance

Type	Subservicer Balance (in $ Billions)
Nonbank	**1859.40**
Bank	**1285.00**

continued

2.2. Servicer Business Models

Relationship, Risk, and Challenges of Servicer Business Model

- **Tables 1** and **2** indicate that servicing and subservicing relationships create significant connections across firms and between the bank and Non-Mortgage Company (NMC) sectors.
- Five of the 20 largest Agency servicers rely on subservicers for administrative servicing duties and six of the 20 largest Agency servicers provide subservicing for other entities.
- NMCs often use multiple subservicers, which they may share with other NMCs and banks.
- Servicers are responsible for cash outlays as required by the servicing contract, while both servicers and subservicers handle critical loan administration functions.
- Vulnerabilities at subservicers can lead to widespread stress in the system due to their multiple clients.
- The similarity in NMC business models could lead to simultaneous financial distress among multiple servicers.
- Agencies may be required to manage several failures at once and complicate the process of finding new firms to take over failing NMC portfolios.

continued

3. Growth in Agency Securitization and Nonbank Mortgage Companies

3.1. Increased Government and Enterprise Backing

1 **Credit Guarantee**

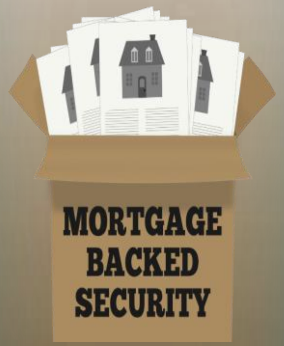
The share of outstanding mortgages with a government or Enterprise guarantee has increased since the 2007-09 financial crisis, providing protection against credit losses on the underlying mortgages.

2 **Timely Payment Guarantee**

The guarantee ensures timely payment of principal and interest on the securitizations that fund the mortgages, providing stability to the market.

3 **Enterprise Conservatorship**

The U.S. Department of the Treasury has provided financial support to Fannie Mae and Freddie Mac through the Senior Preferred Stock Purchase Agreements, maintaining market stability and mortgage availability.



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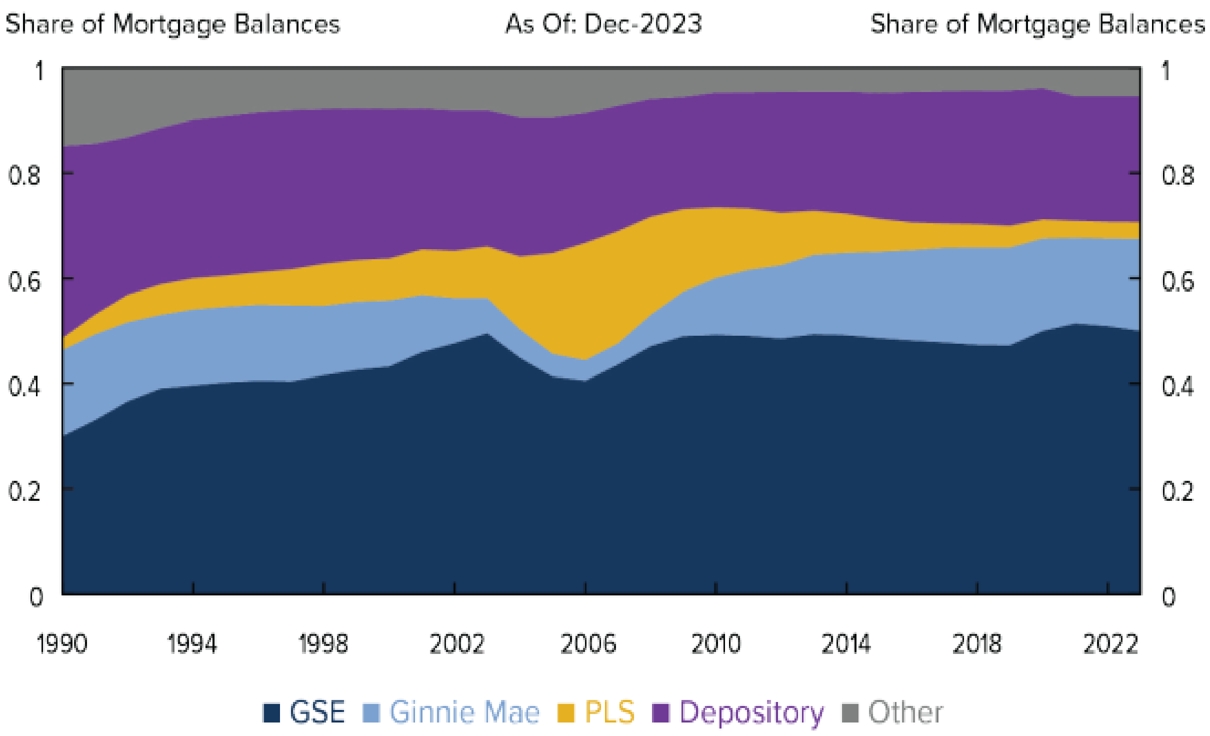
3. Growth in Agency Securitization and Nonbank Mortgage Companies

3.1. Increased Government and Enterprise Backing

Figure 2: Outstanding Mortgage Balances by Sector



- The Fig. shows the share of outstanding mortgages funded by Agency securitization (Enterprise & Ginnie Mae) rose from 46% in 1990 to 68% in 2023 .

- Trend interrupted in the 2000s with the emergence of subprime and near-prime mortgage products led to surge in the private-label securitization (PLS) market.

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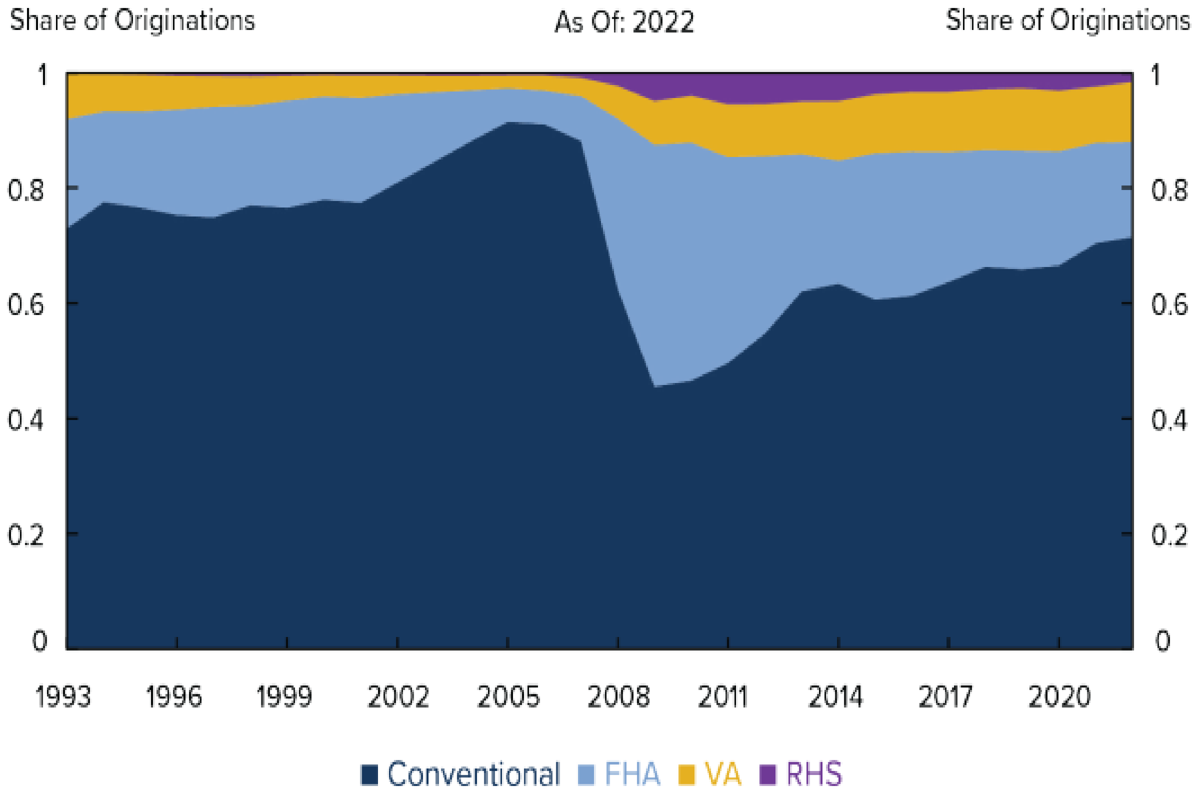
3. Growth in Agency Securitization and Nonbank Mortgage Companies

3.1. Increased Government and Enterprise Backing

Figure 3: Loan Origination by Credit Guarantor



- The Fig. shows that the share of mortgage originations using conventional guarantor grew to over 80% before the 2007 – 2009 financial crisis, then fell sharply to 40%, but recovered again to 70% during 2022.

- Agency share expanded during financial crisis led by Ginnie Mae (Fig 2), as FHA, VA, and RHS programs absorbed some of the origination activity that was funded earlier through PLS.

continued

3. Growth in Agency Securitization and Nonbank Mortgage Companies

3.2. Increased NMC Presence in Mortgage Market

Vulnerabilities Addressed

- While many NMCs failed during the 2007-2009 financial crisis, due to a sharp rise in delinquencies, unemployment, house prices decline, etc. regulations have since improved standards and restricted risky product features.

Regulatory Changes

- State and federal regulators, improved underwriting standards after the financial crisis.
- The revised capital rule issued by banking agencies in 2013 made mortgage servicing a less attractive business line for some banks, leading to an increased NMC market share.

Technological Advancements

- NMCs have been quicker to embrace new technologies that made the mortgage origination process faster making them more appealing to some borrowers., thus helping fuel growth of some NMCs

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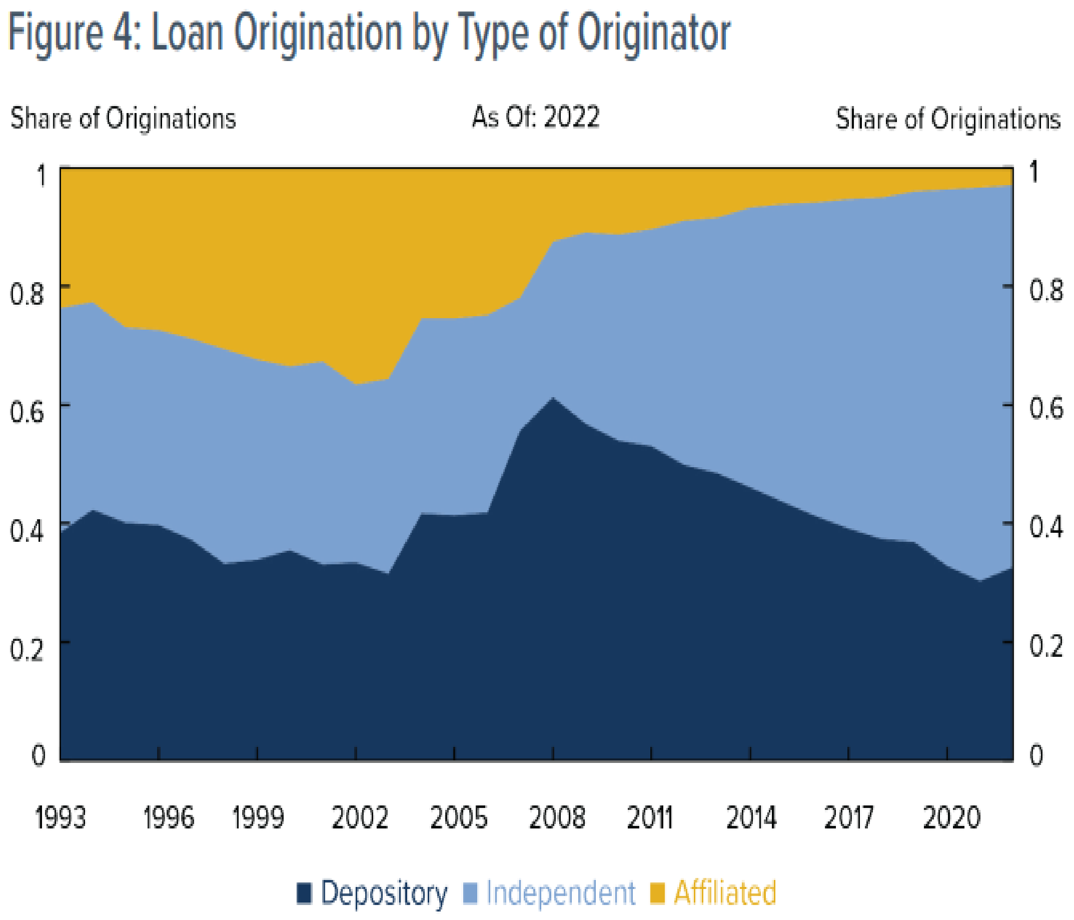
3. Growth in Agency Securitization and Nonbank Mortgage Companies

3.2.1 Increased NMC Share of Mortgage Originations



- Fig 4. implies that from 1993 to 2006, the mortgage origination market was split evenly among banks, affiliated bank NMCs, and independent NMCs.
- During the 2007-2009 financial crisis, banks took over the share from NMCs.
- Bank-affiliated NMCs closed operations after the crisis, leading to the expansion of independent NMCs, with a share of 64% of purchase mortgages by 2022.

continued

3. Growth in Agency Securitization and Nonbank Mortgage Companies

3.2.2 Increased NMC Share as Agency Counterparties

1. Enterprise Seller / Servicers

NMCs that sell loans to or service loans for an Enterprise are responsible for underwriting and servicing the loans according to Agency guidelines.

2. Ginnie Mae Issuers

NMCs that issue securitizations guaranteed by Ginnie Mae receive the guaranty on the MBS and retain the servicing unless they transfer issuer responsibilities through the Pools Issued for Immediate Transfer program.

3. Market Share Growth

The share of mortgages originated by independent NMCs for Enterprise (66%) and Ginnie Mae (84%) securitizations has grown significantly since the 2007-09 crisis.

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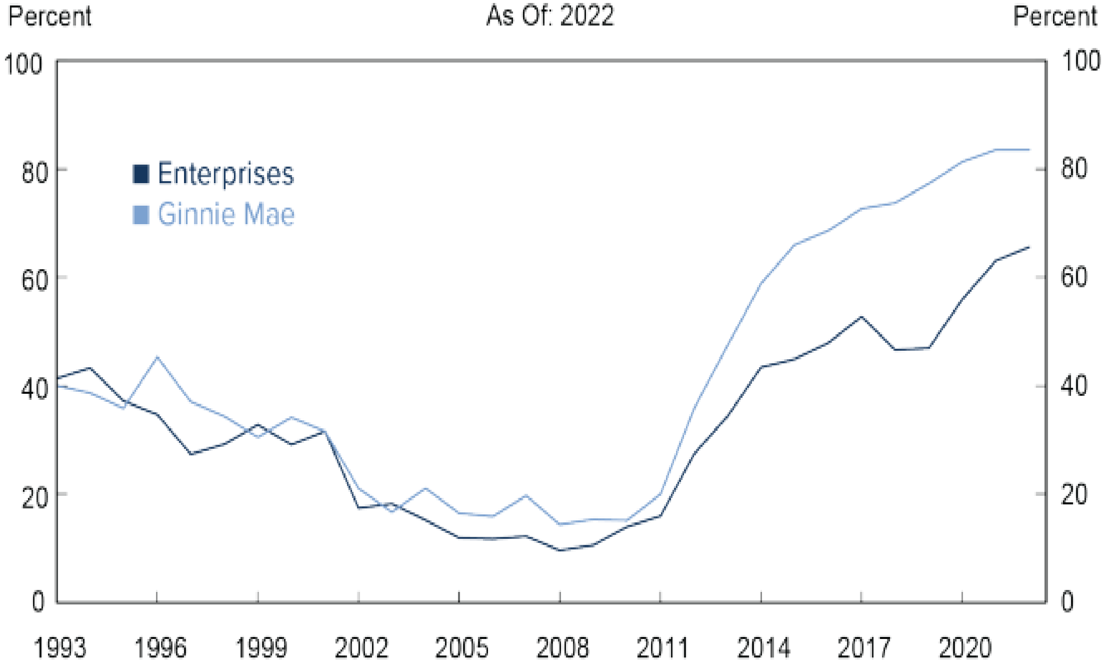
3. Growth in Agency Securitization and Nonbank Mortgage Companies

3.2.2 Increased NMC Share as Agency Counterparties

Figure 5: Share of Originations in Agency Pools Contributed by Independent NMCs



- Fig. 5 shows the market share for independent NMCs that sold originations to the Enterprises or issued a securitization guaranteed by Ginnie Mae.
- For both Ginnie Mae and Enterprise the nonbank share was 1/3rd till 2008, which grew over to 60% for Enterprise and 80% for Ginnie Mae as of 2022.

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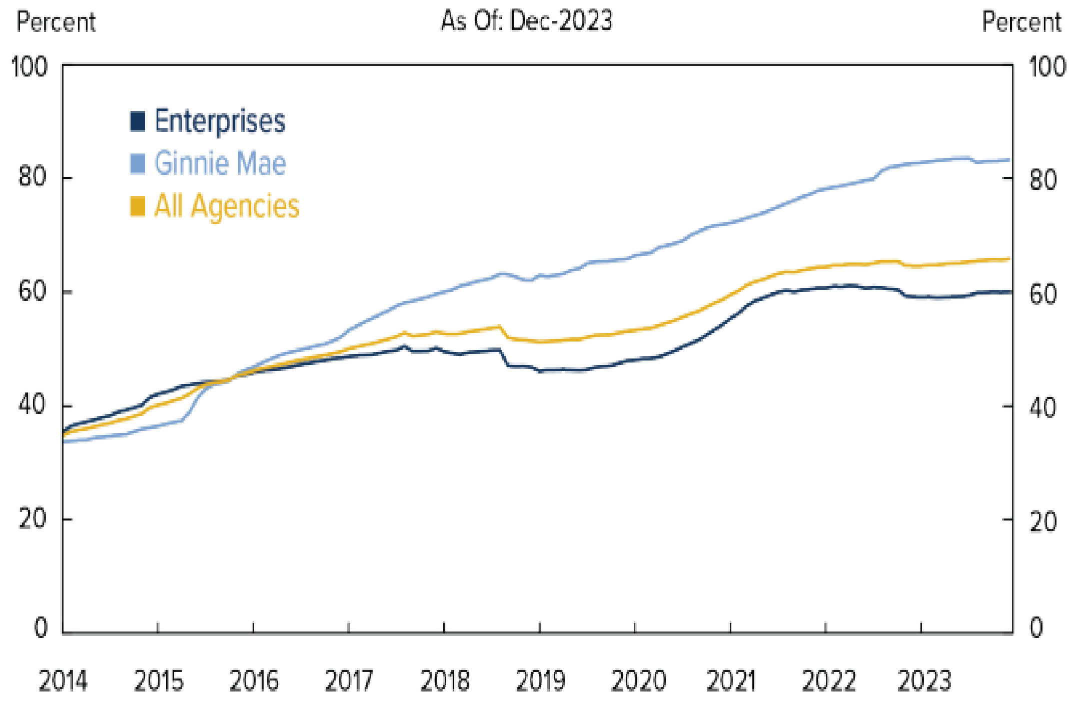
3. Growth in Agency Securitization and Nonbank Mortgage Companies

3.2.2 Increased NMC Share as Agency Counterparties

Figure 6: NMC Share of Agency Servicing



- Fig. 6 shows the share of NMCs servicing in Ginnie Mae, Enterprise, and other Agencies over time.
- The share of loans serviced by nonbank mortgage servicers for the Enterprises rose from 35% in 2014 to 60% in 2023, while the share for Ginnie Mae rose from 34% to 83% during the same period.
- The nonbank share across All Agencies grew from 40% in 1993 to over 60% in 2023.

continued

3. Growth in Agency Securitization and Nonbank Mortgage Companies

3.3. increased Aggregate Mortgage Market Exposure to Agency Securitization and NMCs

Dramatic Growth

The share of all mortgages outstanding that were serviced by NMCs and had an Agency guarantee grew from 26% in 2014 to 44% in 2023.

Aggregate Exposure

The Agency nonbank mortgage servicer exposure was approximately $6 trillion at the end of 2023, reflecting the government's increased reliance on NMCs.

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Implications

The government's growing exposure to the fragilities of NMCs means that the stability of the mortgage market is now more closely tied to the health and resilience of the nonbank sector.

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4. Strengths of Nonbank Mortgage Companies

1. Entrepreneurial Mindset

NMCs appear to have been more entrepreneurial in their marketing and market expansion than banks. They have been quicker to partner with fintech companies and leverage new technologies, especially for mortgage origination.

2. Servicing Expertise

Some NMCs developed greater experience in handling the servicing of delinquent and foreclosed mortgages after the 2007-09 crisis.

3. Origination Capacity

NMCs originated a significant share of mortgages extended to historically underserved borrowers in 2022.

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4. Strengths of Nonbank Mortgage Companies

Figure 7: NMC Share of Originations by Race or Ethnicity

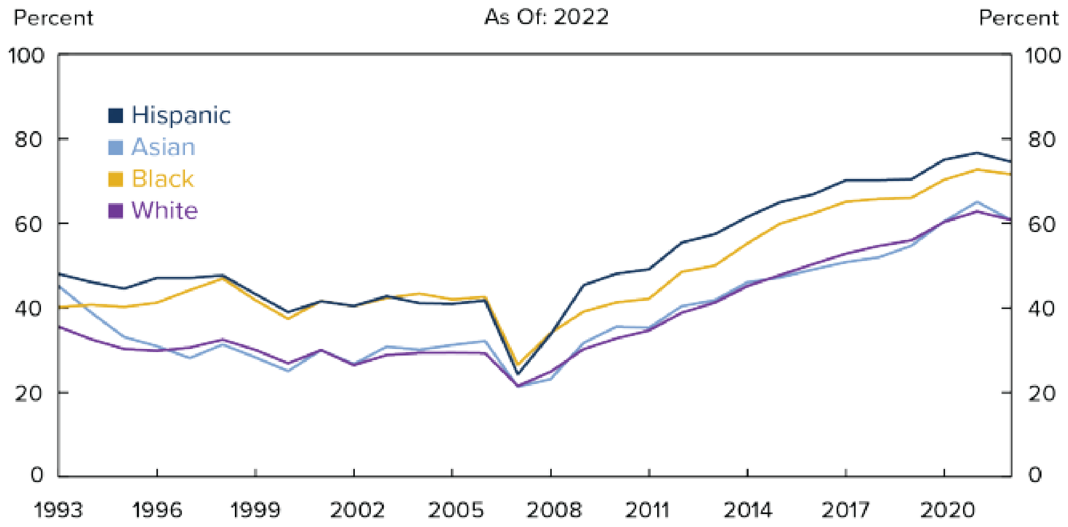

Fig. 7 shows NMCs originated 72% and 75%, respectively, of mortgages extended to Black and Hispanic borrowers in 2022, and 61% of those to Asian and White borrowers; the higher NMC share for Black and Hispanic borrowers has persisted for at least 30 years.

Figure 8: NMC Share of Originations to Low and Moderate Income (LMI) Borrowers

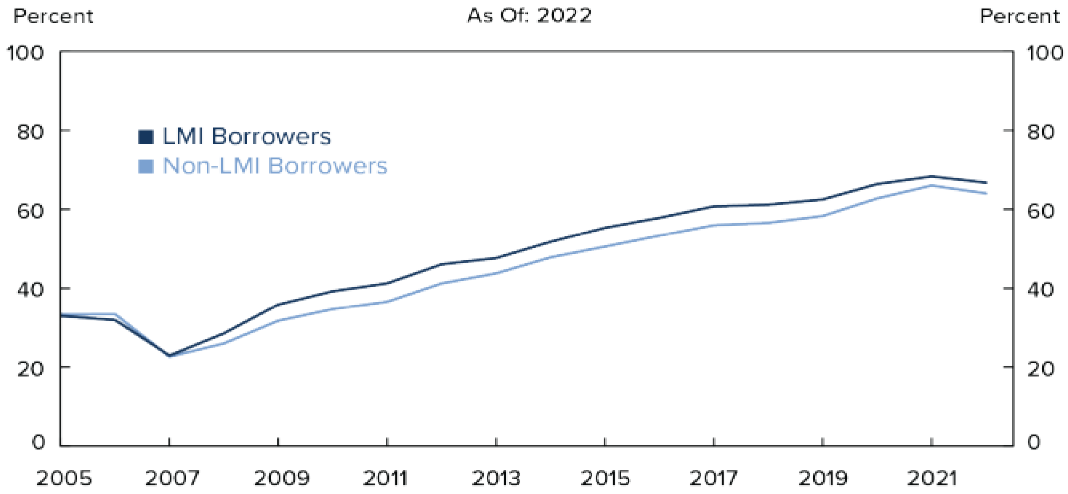

Fig. 8 shows that In 2022, NMCs originated 67% of mortgages extended to low-to-moderate income borrowers and 64% of mortgages extended to borrowers with higher incomes.

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4. Strengths of Nonbank Mortgage Companies

Figure 9: NMC Share of Agency Originations by FICO Score

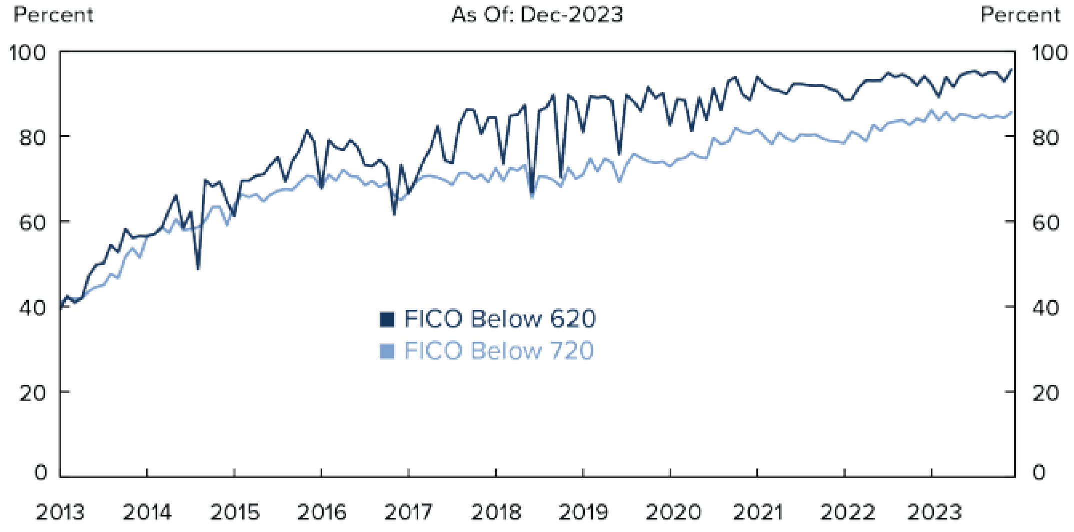

Fig. 9 shows NMCs originated 96 percent of mortgages in Agency pools with borrowers having a credit score less than 620 and 86 percent of mortgages with borrowers having a credit score below 720

- NMCs attract new sources of capital, such as private equity funding, which increases market liquidity but also introduces new risks.
- These new sources of capital may be less likely to make long-term investments in infrastructure and more likely to respond to downturns in mortgage-market conditions by exiting their mortgage-related investments and redeploying their capital elsewhere.

continued

5. Vulnerabilities of Nonbank Mortgage Companies

- Non-bank mortgage companies (NMCs) face significant risks due to the concentrated nature of their balance sheets.
- NMCs typically hold a high proportion of mortgage-related assets, including mortgages held for sale, mortgage servicing rights (MSRs), and other illiquid items.
- This concentration leaves them vulnerable to mortgage-related shocks and volatility, particularly in the valuations of their MSRs.
- NMCs also face liquidity risks from their funding sources, such as warehouse lines of credit and MSR-backed credit facilities, as well as from their servicing obligations and potential loan repurchase requests.

continued

5. Vulnerabilities of Nonbank Mortgage Companies

Fluctuating Profitability

NMCs' profitability is highly sensitive to changes in mortgage demand and defaults, as they only offer mortgage-related products and services.

Liquidity and Leverage Risks

NMCs' reliance on debt that can be repriced, reduced, or canceled during stress, combined with high leverage, can lead to significant liquidity risks.

Speculative-Grade Ratings

As a result of their vulnerabilities, rating agencies typically assign speculative-grade credit ratings to NMCs' debt obligations.

Contagion Risks

Commonalities in NMC vulnerabilities and shared funding providers and subservicers could lead to contagion across the sector.

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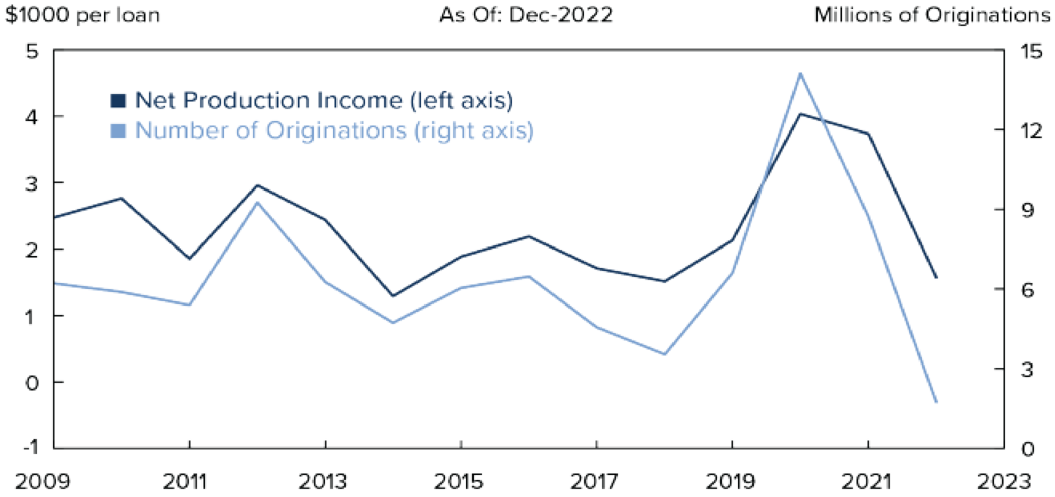
5. Vulnerabilities of Nonbank Mortgage Companies

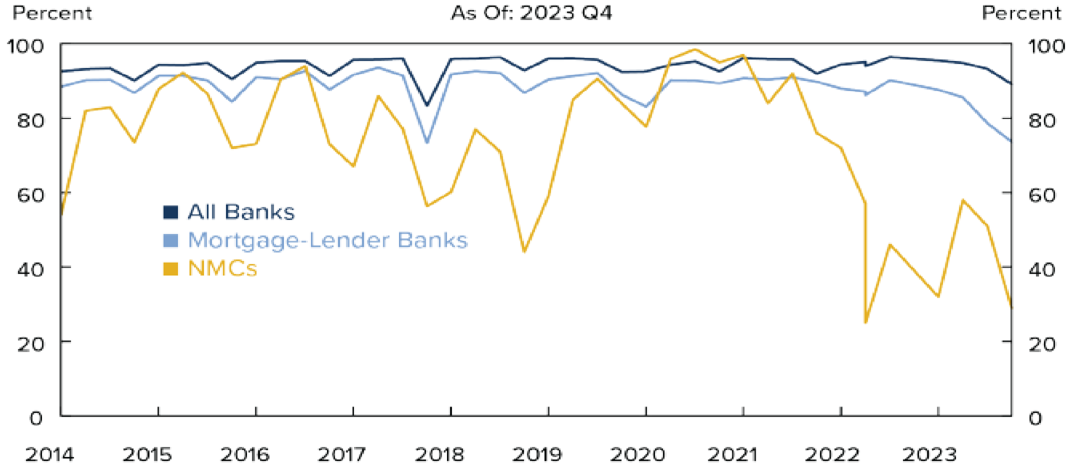
5.1 Vulnerability to Macroeconomic Shocks

Figure 10: Net Production Income and Mortgage Originations



- Fig. 10 shows net production income and no. of originations of NMCs from 2009 to 2023.
- Both net production income and originations spiked in 2020, and fell steeply since with net production income turning negative at the end of 2022.
- NMCs earned $1,558 in net production income on each loan origination, in 2022.

Figure 11: Share of Firms that are Profitable



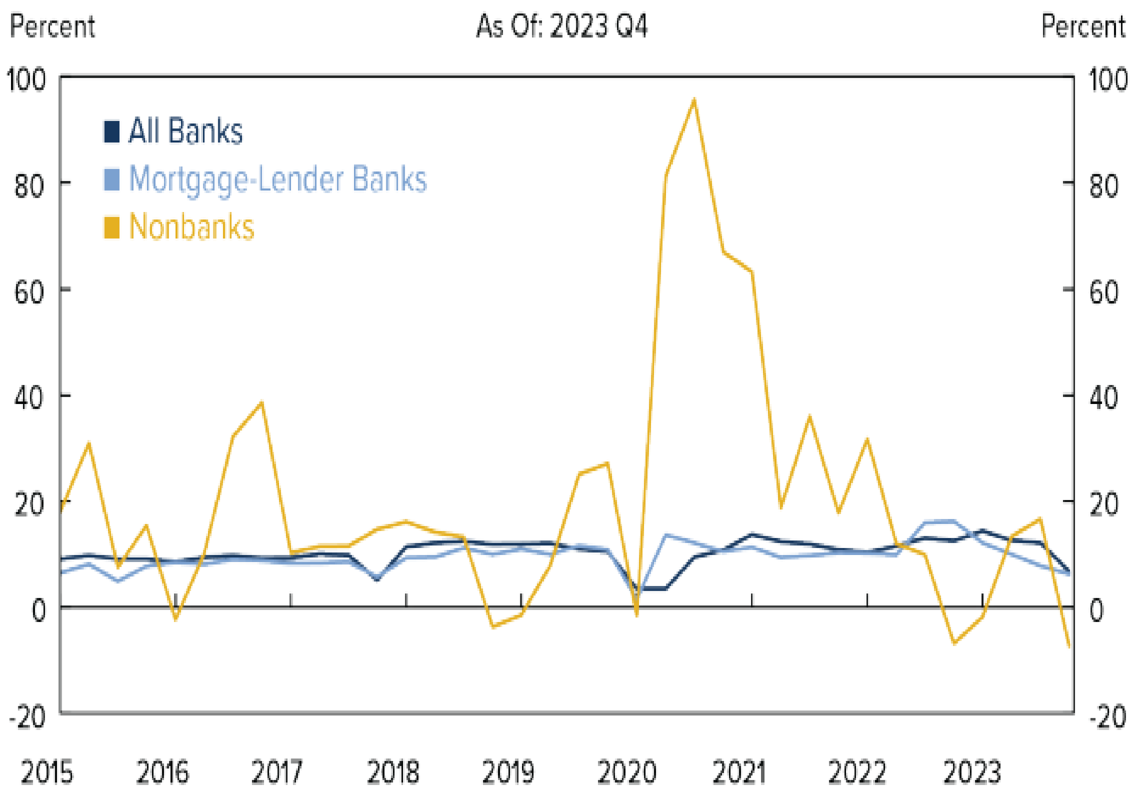
- Fig. 11 shows the share of profitable banks, NMCs and banks focusing on mortgages from 2014 to 2023.
- The average share of banks being profitable was 94%, 88% for mortgage-lender banks, and 73% for NMCs.

continued

5. Vulnerabilities of Nonbank Mortgage Companies

5.1 Vulnerability to Macroeconomic Shocks

Figure 12: Annualized Return on Equity



- Fig. 12 shows shows the volatility of NMC profitability by plotting the annualized return on equity (ROE) for NMCs, banks, and mortgage-focused banks
- From 2015 to 2023, ROE for NMCs ranged from a high of 96% in the third quarter of 2020 to a low of –7.3% in the fourth quarter of 2023, which is in line with the swings in profitability.
- For banks overall, ROE ranged from a high of 14.4% in the first quarter of 2023 to a low of 3.5% in the second quarter of 2020.
- For mortgage-lender banks, the range was 16.2 % in the fourth quarter of 2022 to 1.5% in the first quarter of 2020.

continued

5. Vulnerabilities of Nonbank Mortgage Companies

5.2 Risks Associated with NMC Assets

1

Value Uncertainty

MSR valuations are highly subjective and uncertain, as they depend on complex models that make assumptions about loan prepayment and default behavior.

2

Interest Rate Sensitivity

MSR valuations can swing dramatically with changes in interest rates, as lower rates increase the likelihood of borrower refinancing and reduce the value of the servicing rights.

3

Delinquency Impacts

Rising delinquencies can also lead to a drop in MSR valuations, as there may be no buyers for servicing rights on non-performing loans.

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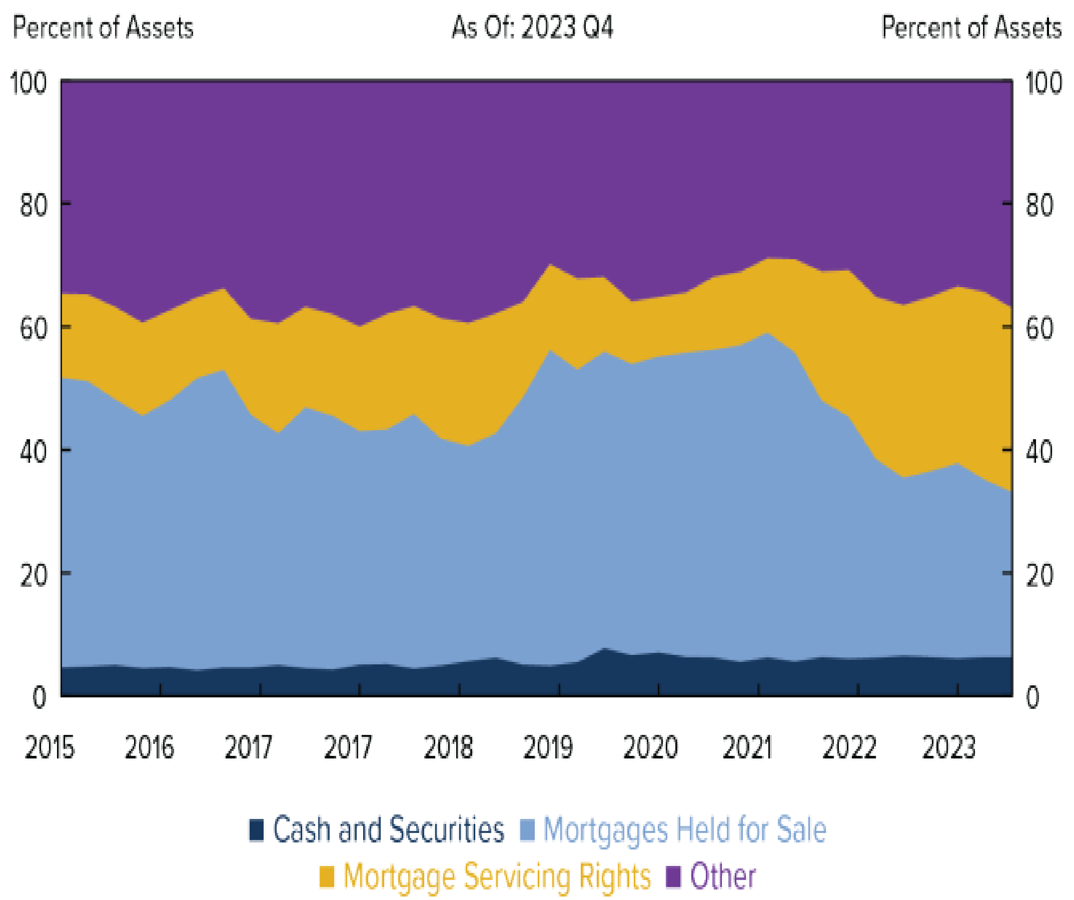
5. Vulnerabilities of Nonbank Mortgage Companies

5.2 Risks Associated with NMC Assets

Figure 13: Composition of NMC Assets



- Fig. 13 shows the composition of NMC Assets, which are highly concentrated in mortgage-related assets.
- NMCs typically have only about 5% of their assets in unrestricted cash and securities .
- Mortgages held for sale total around 30% to 50% of aggregate assets, depending on the year .
- Mortgage servicing rights are 10% to 30% of NMC assets.
- Other NMC assets which includes certain securitized mortgages that NMCs are required to recognize under accounting regulations largely cannot be monetized.

continued

5. Vulnerabilities of Nonbank Mortgage Companies

5.3.1 Liquidity Risk from Financing Sources

Warehouse Line of Credit

- NMCs rely on short-term warehouse lines of credit to finance their mortgage originations, until the mortgages can be securitized.
- This poses risks such as margin calls, run dynamics, and potential repricing or cancellation of the lines.

Hedges

- NMCs also face liquidity risks from margin calls on the hedges they use to protect against interest rate movements while mortgages are funded on warehouse lines.
- A sharp decline in interest rates, leads to large margin calls, and such margin calls were a substantial source of instability in March 2020.

MSR-Backed Credit Lines

- NMCs use credit lines collateralized by their MSRs, but these lines are subject to margin calls and volatility in the MSR valuations.
- MSR lines are smaller in aggregate than warehouse lines: about 35 lenders extended MSR lines with aggregate credit limits of approximately $30 billion in fourth quarter of 2023

continued

5. Vulnerabilities of Nonbank Mortgage Companies

5.3.2 Liquidity Risk from Servicing Obligations and Repurchase Requests

Serving Advances

- NMCs must advance funds for principal, interest, taxes, and other expenses on behalf of the Agencies or securitization trusts, which can strain their liquidity, especially for Ginnie Mae servicing.
- Enterprise servicers are only required to advance principal or interest for up to 120 consecutive days.
- Ginnie Mae servicers advance the scheduled interest and principal payments, as well as taxes, insurance premiums, and foreclosure expenses, until the delinquency is resolved.

Loan Repurchases

- NMCs may be required to repurchase mortgages from Agency and Ginnie Mae pools, which can also impact their liquidity if they do not have the necessary funds.

continued

5. Vulnerabilities of Nonbank Mortgage Companies

5.4. Leverage

High Leverage Ratios

- **Many NMCs have high ratios of secured debt to gross tangible assets, of less than 30% for that factor of its long-term debt rating to be consistent with an investment grade.**

- **Out of 550 NMCs that file the MBFRF, only 37% had secured debt less than 30% of gross tangible assets as of the third quarter of 2023.**

- **Thirty-five percent had ratios in excess of 60 percent, which Moody's considers to be speculative of poor standing and subject to very high credit risk.**

Speculative-Grade Debt

Table 3: Count of NMCs by Corporate Family Credit Rating

Substantial Credit Risk			High Credit Risk			Very High Credit Risk		
Ba1	Ba2	Ba3	B1	B2	B3	Caa1	Caa2	Caa3
X	X	X X	X X X	X X		X X		

- **1 of these companies had the highest rating (Ba1) within the speculative-grade category.**

- **2 NMCs had a rating (Caa1) that in the judgment of Moody's rendered their debt in "poor standing**

continued

5. Vulnerabilities of Nonbank Mortgage Companies

5.5 Operational Risk

1. Operations Continuity

NMCs must invest in technology and controls to ensure continuity of operations, especially during times of high delinquencies when servicing becomes more complex and labor-intensive.

2. Cyber Threats

NMCs face growing cyber risks that must be addressed through robust risk management frameworks and security measures.
security measures.

3. Third-Party Risk

NMCs must effectively manage the risks posed by their extensive network of third-party vendors and service providers
providers

4. Quality Control

Maintaining strong quality control processes is crucial for NMCs to avoid loan repurchase requests and other operational issues.

continued

5. Vulnerabilities of Nonbank Mortgage Companies

5.6. interconnections

1. Lender Interconnections

NMCs are interconnected through their common lenders, such as warehouse providers, which can lead to contagion if one lender experiences distress.

2. Servicing Relationships

Servicing and subservicing relationships also create interconnections, where distress at one NMC or subservicer can impact the ability of other servicers to fulfill their obligations.

3. Systemic Implications

The interconnected nature of the NMC industry and its linkages to the broader financial system mean that risks at individual at individual NMCs can have systemic implications.

continued

6. Transmission Channels

1. Exposures

The ability of NMCs to execute their functions affects stakeholders beyond just borrowers, including investors, credit guarantors, municipalities, and the Agencies. Disruptions can lead to significant losses and costs for these stakeholders.

2. Asset Liquidation

Forced liquidation of NMC assets, such as MSRs, can further depress valuations and have a material impact on NMC solvency and access to credit, potentially leading to broader market disruption.
.

3. Critical Functions

Disruptions to NMCs' ability to perform critical functions like servicing can directly harm borrowers, such as by causing confusion, disrupting payments, and interrupting loss mitigation assistance

4. Contagion

The interconnectedness and similarities in NMC business models create the potential for contagion, where the failure of one NMC can spread to others and threaten the stability of the entire mortgage market.

continued

6. Transmission Channels

6.1 Critical Functions and Services

1. Servicer Financial Stress

- Originators have a legal responsibility to ensure borrowers are informed about mortgage options and take out appropriate loans. Servicers must ensure borrowers have clear titles, payments are accurately reported, and taxes/insurance are paid. When borrowers face difficulties, servicers must analyze loss-mitigation options to help them keep their homes.

2. Servicing Transfers

- Transferring a distressed servicer's entire portfolio is a time-consuming and resource-intensive process. Operational challenges can lead to substantial borrower harm and market disruption if the transfer is not executed accurately and efficiently. Borrowers in loss mitigation may have to restart the process with the new servicer.

- In recent years, the Mortgage Industry Standards Maintenance Organization (MISMO) Servicing Transfer Development Workgroup has been collaborating to identify and address issues associated with servicing transfer data and develop a standardized servicing transfer dataset and process

3. NMC Disruptions

- If an NMC servicer enters bankruptcy, it may struggle to obtain the debtor-in-possession financing required to continue operations. Without this financing, the servicer would likely cease operations, causing mass confusion for borrowers and disrupting the accurate and timely payment of funds to stakeholders.

- While regulators can appear in bankruptcy court, they do not have unlimited power to protect borrowers. Bankruptcy law contains various prohibitions that must be carefully navigated, and the Enterprises' and Ginnie Mae's primary responsibility is to protect their own assets, even if that imposes costs on other stakeholders.

continued

6. Transmission Channels

Mortgage Origination Disruptions

1. Temporary Credit Restrictions

Widespread disruption in the NMC sector could temporarily restrict mortgage credit, particularly for higher-risk or historically underserved borrowers. It may take time for new originators to enter the market and replace lost capacity, leading to more expensive and difficult-to-obtain credit.

2. Borrower Harm

Disruptions to mortgage origination can directly harm borrowers by limiting their access to credit and making homeownership less attainable, especially for vulnerable populations.

continued

6. Transmission Channels

6.2 Exposures

Stakeholder Impacts

- Disruptions to NMC functions affect stakeholders beyond just borrowers. Investors and credit guarantors depend on originators and servicers to minimize credit losses.
- Municipalities' finances depend on timely property tax payments. Agencies can incur significant losses when transferring servicing from a failed servicer.

Agency Challenges

- Agencies have a vested interest in reducing servicer failure risks due to the size of their exposures (Table 1 & 2) and the limited remediation tools available.
- Assuming servicing operations from a bankrupt servicer is particularly costly, as Agencies must take on both the financial and operational responsibilities.

Statutory Limitations

- NMCs use credit lines collateralized by their MSRs, which are subject to margin calls and volatility in the MSR valuations. Ginnie Mae faces unique challenges compared to the Enterprises due to statutory limitations on its authorities.
- Enterprises can purchase and hold delinquent loans, but Ginnie Mae is not authorized to do so, which can lead to greater strain in the event of a larger servicer failure.

continued

6. Transmission Channels

6.3 Contagion and Asset Liquidation

1

- **Shared Vulnerabilities**

The interconnections between NMCs, such as shared financing and servicing providers, can lead to contagion. Changes in macroeconomic conditions or funder risk appetite can trigger a broad-based decrease in MSR valuations, forcing NMCs to rapidly liquidate their MSRs and further depress valuations.

2

- **Solvency Impacts**

As MSRs are a large share of NMC assets, the rapid liquidation and value deterioration could have a material impact on NMC solvency and access to credit, potentially leading to a broader disruption in the mortgage market.

3

- **Systemic Risk**

The similarities in NMC business models and their interconnectedness create the potential for contagion, where the failure of one NMC can spread to others and threaten the stability of the entire mortgage market and financial system.

continued

7. Existing Authorities, Recent Actions, and Council Recommendations

- State regulators and federal agencies have implemented various measures to mitigate risks associated with the rising share of mortgages serviced by NMCs. However, the combination of these state requirements and the limited federal authority to impose additional requirements does not adequately address the risks.
- Stress within the nonbank mortgage sector could lead to disorderly servicing transfers, which can disrupt the continuity and quality of mortgage servicing.
- Stressed nonbank mortgage servicers might fail to manage collections appropriately, impacting their ability to meet obligations and provide necessary services.
- The potential for inadequate loss mitigation efforts could exacerbate financial difficulties for borrowers, leading to increased defaults and foreclosures.
- Overall servicing activities might be impaired, impacting the mortgage market's functionality and stability.
- The Council’s Analytic Framework explains the range of authorities the Council may use to address any particular risk, including interagency coordination, recommendations to regulators and Congress, or the designation of certain entities.
- The Council’s recommendations for addressing risks posed by nonbank mortgage servicers is identified going forward in this report.

continued

7. Existing Authorities, Recent Actions, and Council Recommendations

7.1 Promoting Safe and Sound Operations

State Regulators

- State regulators are the primary prudential regulators of nonbank mortgage companies (NMCs).
- They have the authority to set financial and corporate governance standards and have taken steps to enhance requirements for NMCs, like adopting new CSBS standards that apply to the 50 largest NMCs and cover 98% of the nonbank mortgage market by loan count as of April 2024.

Federal Agencies

- Federal agencies like FHFA and Ginnie Mae have limited direct authority over NMCs, but have taken actions to align requirements for their NMC counterparties.
- They lack the ability to directly supervise or enforce standards on NMCs.

Coordination Challenges

- Coordination between state and federal regulators is important but hampered by legal restrictions on information sharing. This limits the effectiveness of monitoring and preparing for potential stress events.

continued

7. Existing Authorities, Recent Actions, and Council Recommendations

7.1. Recommendations

1

Enhance Prudential Requirements

The Council supports efforts by state regulators to enhance capital, liquidity, and other prudential standards for NMCs, and encourages all states to adopt the CSBS standards.

2

Require Recovery and Resolution Planning

The Council recommends that state regulators require large NMCs to develop comprehensive recovery and recovery and resolution plans to enhance financial and operational resilience.

3

Improve Monitoring and Coordination

The Council encourages continued monitoring of the NMC sector and development of joint tabletop exercises to exercises to prepare for potential servicer failures.

4

Expand Federal Authorities

The Council recommends that Congress provide FHFA and Ginnie Mae with additional authority to set and enforce and enforce safety and soundness standards for NMC counterparties.

continued

7. Existing Authorities, Recent Actions, and Council Recommendations

7.2 Addressing Liquidity Pressures in the Event of Stress

1 **Limited Liquidity Facilities**

Nonbank mortgage servicers have limited access to liquidity facilities like the Federal Home Loan Banks and Federal Reserve discount window, which are primarily available to depository institutions.

2 **Ginnie Mae's PTAP**

Ginnie Mae's Pass-Through Assistance Program (PTAP) provides a limited liquidity backstop (principal and interest advances) but does not cover all the advance obligations that can cause liquidity stress for NMCs.

3 **Federal Agency & Enterprise Support**

Federal agencies and the Enterprises have taken additional steps to relieve liquidity pressures for nonbank mortgage servicers, including limiting servicing advances, accelerating reimbursements, and encouraging private capital flows.

4 **Administrative Solutions**

To improve the durability of financing loan solutions like level pooling, exploring options to reduce risks for lenders in case a servicer fails, and enhancing the government insurance claims processes can be implemented.

continued

7. Existing Authorities, Recent Actions, and Council Recommendations

7.2 Recommendations

1	2	3
Expanding PTAP Authority	**Administrative Work**	**Federal Agency Support**
The Council recommends that Congress provide Ginnie Mae with authority to expand PTAP to cover a broader range of advance obligations and make it available during periods of severe market stress.	The Council supports HUD's ongoing administrative work to relieve liquidity pressures for Ginnie Mae issuers as well as Ginnie Mae's ongoing efforts to explore ways to facilitate financing for relieving liquidity pressures for solvent issuers.	The Council supports that Federal agencies should further explore and evaluate how existing policy tools and authorities could be further leveraged to reduce liquidity pressures from servicing advance obligations in times of stress.

continued

7. Existing Authorities, Recent Actions, and Council Recommendations

7.3 Ensuring Continuity of Servicing Operations

1 **Servicing Transfers**

The Enterprises and Ginnie Mae have tools to facilitate the transfer of servicing to new servicers, but the process can be challenging during stress events like when delinquencies may be elevated and there is limited capacity or appetite from other servicers to acquire additional servicing.

2 **Maintaining Operations**

When a servicer becomes insolvent, keeping the servicing operations running may be preferable, but regulators lack the authority to provide financing to maintain operations.

3 **Bankruptcy of NMCs**

The primary resolution mechanism for a nonbank mortgage servicer is the bankruptcy process, and the government has little ability to intervene in the bankruptcy process to protect borrowers

4 **Dodd-Frank Act**

FDIC can be appointed receiver of a failed financial company, potentially including an NMC, upon a determination that the financial company would meet specific statutory criteria under Title II of the Dodd-Frank Act.

continued

7. Existing Authorities, Recent Actions, and Council Recommendations

7.3 Recommendations

1	2	3
Liquidity to NMC	**Operational Continuity**	**Enhancing Information Sharing**
The Council encourages Congress to consider legislation to establish a fund financed by the nonbank mortgage servicing sector to provide liquidity to nonbank mortgage servicers that are in bankruptcy or have reached the point of failure.	The fund should be designed to facilitate operational continuity of servicing, including loss-mitigation activities for borrowers and advancement of monthly payments to investors, until servicing obligations can be transferred in an orderly fashion or the company has been recapitalized by investors or sold.	The Council recommends that Congress authorize greater information sharing between Ginnie Mae, federal regulators, and state regulators to enhance their ability to monitor and respond to risks in the nonbank mortgage servicing sector.

continued

8. Conclusion

- The Financial Stability Oversight Council (FSOC) recognizes the growing significance and potential vulnerabilities of nonbank mortgage companies (NMCs) in the U.S. financial system.
- With the expansion of NMCs in originating and servicing the majority of U.S. residential mortgages, their susceptibility to market shocks has also increased, posing potential risks to financial stability.
- The growing involvement of NMCs with the Agencies—Fannie Mae, Freddie Mac, and Ginnie Mae—has heightened the federal government's exposure to these vulnerabilities. This interconnectedness could lead to significant disruptions in the mortgage market and potential financial losses during periods of stress.
- Despite recent efforts by state regulators and federal agencies to address these risks, there remains a need for a more comprehensive and coordinated regulatory framework. The current patchwork of state and federal regulations does not fully mitigate the risks posed by NMCs.
- The FSOC supports continued efforts to enhance the safety and soundness of NMC operations, address liquidity pressures, and ensure continuity in servicing.
- FSOC will continue to monitor and assess these risks, taking or recommending additional measures as necessary.
- Finally, policymakers must carefully monitor the evolving mortgage landscape and ensure appropriate regulation and oversight to mitigate potential risks and maintain a stable and equitable housing finance system.

continued