

Federal Housing Finance Agency
Office of Inspector General



Compliance Review of FHFA's Review Process for Transfers of Enterprise Mortgage Servicing Rights



COM-2018-001

February 6, 2018

Executive Summary

Fannie Mae and Freddie Mac (the Enterprises) contract with banks, non-banks, and other financial institutions (servicers) to service the mortgages they own or guarantee. Each servicer owns the mortgage servicing rights (MSR) for the mortgages that it services. One servicer may transfer MSR to another, provided that the Enterprise that owns or guarantees the underlying mortgages reviews the proposed transaction and verifies that the acquiring servicer has the capacity to service the loans and to manage the associated risks.

The Federal Housing Finance Agency (FHFA or Agency) has largely delegated to the Enterprises responsibility for reviewing and approving MSR transfers. In 2012 and 2013, we identified weaknesses in the Agency's delegated approach. Accordingly, in 2013 we recommended that FHFA establish a formal review process for significant MSR transfers, and it agreed to do so.

The Agency established a formal review process for reviewing large transfers, or "Significant Transfers," of MSR. The objective of FHFA's review process is to ensure that each Enterprise's Significant Transfer proposals provide assurance that the acquiring servicer has the financial and operational capacity to service the transferred loans and to manage the associated risks. The process, contained in the Agency's 2014 Guidelines for Reviewing Significant MSR Transfers (MSR Guidelines), sets out nine factors to guide substantive consideration of the proposed transfer and assigned particular responsibilities within the Agency.

We performed this compliance review to determine whether FHFA followed its formal review process from June 2016 through June 2017 (our review period). We determined that the Agency's review documentation shows that it complied with the process and shows rigor in the reviews themselves. For example, the records show that the Agency considered the nine factors set out in the MSR Guidelines, probed Enterprise supporting material by seeking additional information, and imposed risk-mitigating conditions on its approvals in five of the six Significant Transfers during our review period.

This report was prepared by Alisa Davis, Senior Policy Advisor, with assistance from David P. Bloch, Senior Investigative Counsel, Bruce McWilliams, Senior Investigative Evaluator, and Wesley M. Phillips, Senior Policy Advisor. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report.



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This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, www.fhfaig.gov.

Richard Parker

Deputy Inspector General for Compliance & Special Projects

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ABBREVIATIONS

DHMG	Division of Housing Mission and Goals
DOC	Division of Conservatorship
Enterprises	Fannie Mae and Freddie Mac
Fannie Mae	Federal National Mortgage Association
FHFA or Agency	Federal Housing Finance Agency
Freddie Mac	Federal Home Loan Mortgage Corporation
LOI	Letters of Instruction
MSR	Mortgage Servicing Rights
MSR Guidelines	Guidelines for Reviewing Significant MSR Transfers
OHRP	Office of Housing and Regulatory Policy
OIG	Office of Inspector General
Servicers	Banks, non-banks, and other financial institutions

BACKGROUND

OIG's 2012 and 2013 Evaluation Reports Identified Weaknesses in FHFA's Delegated Approach to MSR Transfers

In November 2008, FHFA, as conservator of the Enterprises, issued Letters of Instruction (LOI) in which it delegated to the Enterprises the authority to independently conduct certain business activities and withheld that authority for others. FHFA's delegation included the authority to review and approve MSR transfers.

In a 2012 evaluation report,¹ we identified weaknesses in FHFA's delegated approach to MSR transfers. We noted that in November 2009, Fannie Mae had established a program under which it would purchase MSR from servicers that did not adequately service delinquent loans and transfer those MSR to servicers² that specialized in servicing such loans.³ We concluded that because Fannie Mae's MSR transfer program was new, large, and complex, it should have been carefully monitored by FHFA from its inception in 2009. We recommended that FHFA consider revising its LOI to withhold authority to approve unusual, high-cost initiatives such as Fannie Mae's MSR transfer program. However, when FHFA revised its LOI on November 15, 2012, it did not change its delegation of authority to review and approve MSR transfers.

In a 2013 evaluation report,⁴ we again identified weaknesses in FHFA's delegated approach to MSR transfers. The report focused primarily on FHFA's oversight and approval of an \$11.6 billion settlement agreement between Fannie Mae and Bank of America reached in December 2012.⁵ However, we noted that in a contemporaneous transaction, Fannie Mae

¹ *OIG, Evaluation of FHFA's Oversight of Fannie Mae's Transfer of Mortgage Servicing Rights from Bank of America to High Touch Servicers* (Sept. 18, 2012) (EVL-2012-008) (online at www.fhfa.gov/Content/Files/EVL-2012-008.pdf).

² Under their contracts with servicers, the Enterprises may purchase MSR directly from servicers that are deemed to be performing poorly.

³ Under their contracts with the Enterprises, servicers perform a variety of functions including: collecting payments; working with delinquent borrowers to restructure their obligations to reduce the likelihood of foreclosure; and processing foreclosures, if necessary. According to Fannie Mae, loan "workouts" generally expose the Enterprise to lower credit losses than foreclosures.

⁴ *OIG, FHFA's Oversight of Fannie Mae's 2013 Settlement with Bank of America* (Aug. 22, 2013) (EVL-2013-009) (online at www.fhfa.gov/Content/Files/EVL-2013-009.pdf).

⁵ The settlement between Fannie Mae and Bank of America resolved Fannie Mae's long-standing claim that Bank of America sold it defective mortgages and mishandled mortgage servicing on behalf of the Enterprise. Many of the mortgages at issue were originated by Countrywide Home Loans, which Bank of America had acquired.

approved Bank of America’s transfer of the MSR for 1.1 million Fannie Mae loans.⁶ Pursuant to a request from the Agency’s former Office of Conservatorship Operations, FHFA’s Office of Housing and Regulatory Policy (OHRP) reviewed the proposed transfer and recommended that the Agency approve it. We found that OHRP’s review of this MSR transfer was an isolated event and was not conducted according to a formal process. We recommended that the Agency adopt a formal review process for all significant MSR transfers. The Agency agreed to do so by January 31, 2014.

FHFA Established a Formal Review and Approval Process for Significant MSR Transfers

On October 2, 2013, FHFA issued instructions to the Enterprises requiring them to submit “Significant Transfers” of MSR for Agency review and approval. The instructions set out the supporting information the Enterprises were to include with each submission. These initial instructions defined Significant Transfers as transfers of MSR for 25,000 or more loans. The Agency subsequently determined that its review process was not risk-based and issued amended instructions on May 11, 2016, changing the definition of Significant Transfers.^{7 8} Under the revised definition, Significant Transfers are those in which:

- MSR on 100,000 or more loans would be transferred to a non-bank servicer; or
- MSR on 25,000 or more loans would be transferred to any acquiring servicer if the transfer would:
 - Increase the acquiring servicer’s portfolio of seriously delinquent Enterprise-owned loans by at least 25%; and
 - At least 500 of the 25,000 or more loans to be transferred are in a seriously delinquent status, i.e., 90 or more days past due.

⁶ Although Fannie Mae’s approval of Bank of America’s MSR sale was not part of the broader settlement agreement, FHFA determined that the substantive and temporal links between the transactions required it to review both.

⁷ The amended instructions also require the Enterprises to complete reports on certain large MSR transfers not subject to the review process and to submit monthly reports on all Enterprise MSR activity. We observed that the Enterprises did not always comply with these requirements, and we informed Agency staff. The Agency issued revised MSR Guidelines in August 2017 during our fieldwork, which incorporated references to post-transfer reporting the Enterprises must complete and OHRP’s review of monthly MSR activity reports the Enterprises are required to provide to FHFA.

⁸ FHFA determined that its reviews should focus on large transfers involving non-banks, since they are subject to less federal regulatory oversight than insured banks, and on large transactions that materially increase an acquiring servicer’s portfolio of delinquent loans, since servicing responsibilities and risks are higher for delinquent loans than for non-delinquent loans.

In March 2014, FHFA issued the MSR Guidelines, which set forth the Agency’s review process and remain unchanged. The MSR Guidelines require OHRP to review the facts of each proposed transfer to determine whether it is “reasonable,” based on the application of nine factors addressing potential risks associated with the proposed transfer. The factors are:

- Transferee financial strength and commitment
- Transferee institutional structure
- Representations and warranties, including any bifurcation of the selling and servicing representations and warranties
- Operational risks associated with the transferor and the transferee
- Capacity of the transferee to absorb the transaction
- Outstanding transferee compensatory fees⁹
- Any advance financing facilities
- Offshoring prohibitions imposed by the transferee or the Enterprise
- Risk mitigation summary, synthesizing analyses of the preceding factors.

The MSR Guidelines also assign particular responsibilities to offices and officers within FHFA, as follows:

- OHRP (an office within the Division of Housing Mission and Goals (DHMG)):
 - Reviews the details of each proposed Significant Transfer, including the financial and operational capacities of the servicers involved.
 - Provides the DHMG Deputy Director with a memorandum and supporting documents recommending that she approve, approve conditionally, or disapprove each proposed Significant Transfer.
- DHMG Deputy Director:
 - Concurs or non-concurs with OHRP’s recommendation and forwards the matter to the FHFA Director.

⁹ Compensatory fees are punitive fees that an Enterprise assesses against a servicer that does not process foreclosures according to the Enterprise’s standards.

- FHFA Director or Designee:
 - Approves, approves with conditions, or disapproves the Significant Transfer.
- Division of Conservatorship (DOC):
 - Communicates each decision to the affected Enterprise.

From June 2016 to June 2017, FHFA reviewed and approved six Significant Transfers proposed by the Enterprises. We discuss FHFA’s review of these six proposed transfers in the next section of this report.

COMPLIANCE REVIEW RESULTS

We conducted this review to examine FHFA’s compliance with its formal processes for reviewing Significant Transfers from June 2016 through June 2017 (our review period). We examined records for the Agency’s review and approval of six Significant Transfers during that period. We found that FHFA followed the review process set forth in the MSR Guidelines. We also observed that the Agency’s records reflect attention and deliberation during the review process.

FHFA’s Reviews Complied with the Process Set Forth in the MSR Guidelines

The Agency’s records show that it followed the formal review process set out in its MSR Guidelines. Specifically, the records show: all MSR transfers subject to the formal review process that were submitted to FHFA were reviewed by the Agency; Enterprise submissions included supporting material;¹⁰ OHRP prepared memoranda addressing the nine factors and recommending approval;¹¹ appropriate superior reviewing officials entered approvals; and DOC made email transmissions of the approvals to the Enterprises.

FHFA’s Review Documentation Reflects Rigor in the Form of Attention and Deliberation

We observed that FHFA’s review documentation was not pro forma, but rather reflected substantive attention and deliberation. For example, five of the six Significant Transfers were to a new non-bank servicer, and the review records for those reflect a higher level of Agency attention. OHRP sought additional information, more than what was included in Enterprise supporting material and sent one of its own analysts to the non-bank servicer’s plant to assess operational capacity. OHRP ultimately recommended approval, but only with specific remedial measures designed to reduce risk to the Enterprise. OHRP attached other conditions to its recommendations, including conditions enhancing the financial condition of the new non-bank servicer and requiring additional status reporting by the Enterprise.

¹⁰ We found that the Enterprises’ supporting documents sometimes omitted items of information specified in the instructions. The Agency told us that it did not need those particular items for those particular reviews.

¹¹ In two of the six transfers, OHRP did not document its assessment of one factor—outstanding transferee compensatory fees. OHRP told us that there was little compensatory fee activity to consider in these two proposed transfers, so an analysis of compensatory fees was not necessary in these two reviews.

CONCLUSIONS

In 2012 and 2013 we identified weaknesses in FHFA’s delegated approach to MSR transfers, and we recommended that the Agency establish a formal review process for significant transfers. FHFA implemented a formal process in its 2014 MSR Guidelines and adjusted its instructions to the Enterprises in 2016 following its own risk-based assessment.

We determined in this compliance review that FHFA followed its formal process in reviewing the six Significant Transfers it considered from June 2016 through June 2017. Moreover, the Agency’s documentation of its reviews reflects attention and deliberation, suggesting a rigorous process.

OBJECTIVE, SCOPE, AND METHODOLOGY

The objective of this review was to assess FHFA’s compliance with its formal review process for MSR transfers as established in the MSR Guidelines and the amended instructions. We assessed six Significant Transfers,¹² from June 2016 through June 2017 (our review period).

To accomplish our objective, we reviewed FHFA’s MSR Guidelines and the Agency’s revisions in 2013 and 2016 to its servicing instructions to the Enterprises. To assess FHFA’s compliance with the MSR Guidelines, we compared OHRP’s documented analyses of the Significant Transfers against the nine financial and operational evaluative factors in the MSR Guidelines, as well as the documentation supporting its decisions on those transactions. We obtained evidence that DHMG and the Director approved the Significant Transfers. We reviewed DOC’s emails that communicated the Agency’s decisions on the Significant Transfers to the Enterprises. We also compared the content of the six Significant Transfer proposals that the Enterprises submitted to FHFA to the supporting data requirements in the amended instructions.

In addition, we analyzed data in the Enterprises’ monthly pipeline reports to independently identify transfers subject to the Agency’s formal review process. We reviewed other documents regarding additional actions of the Enterprises and FHFA regarding the MSR transfers. Finally, we interviewed Agency personnel and reviewed other public documents regarding MSR transfers.

We conducted our compliance review during the period July 2017 to January 2018 under the authority of the Inspector General Act of 1978, as amended, and in accordance with the *Quality Standards for Inspection and Evaluation* (January 2012), which were promulgated by the Council of the Inspectors General on Integrity and Efficiency.

We provided a draft of this report to FHFA for its review and comment. On February 5, 2018, the Agency provided its management response, which is reprinted in the appendix.

¹² FHFA explained that it processed all six of the MSR transfers submitted for its approval by the Enterprises during our review period as Significant Transfers, although one of the six did not meet the definition of a Significant Transfer. Accordingly, we evaluated FHFA’s oversight of these six transactions under its Significant Transfer guidelines.

APPENDIX: FHFA MANAGEMENT RESPONSE.....



Federal Housing Finance Agency

MEMORANDUM

TO: Richard Parker, Deputy Inspector General for Compliance

FROM: Sandra Thompson, Deputy Director, Division of Housing Mission and Goals 

SUBJECT: Management Response to OIG Report: *Compliance Review of FHFA's Review Process for Transfers of Enterprise Mortgage Servicing Rights*

DATE: February 5, 2018

Thank you for the opportunity to respond to the Federal Housing Finance Agency Office of Inspector General's (FHFA OIG) draft report, *Compliance Review of FHFA's Review Process for Transfers of Enterprise Mortgage Servicing Rights* (Report). The Report presents the results of FHFA OIG's evaluation of the Federal Housing Finance Agency's (FHFA) compliance with its formal review process for Mortgage Servicing Rights (MSR) transfers, as established in the MSR Guidelines and the Amended Instructions.

I am pleased that FHFA OIG concluded that FHFA followed its formal process set forth in the MSR Guidelines and that FHFA records reflect substantive attention and deliberation during the review process.

Please feel free to contact me with any questions.

Cc: Larry Stauffer, Acting Chief Operating Officer
John Major, Internal Controls and Audit Follow-up Manager

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