GSE Activity Report

Monday, February 28, 2022

Servicer 2.0 Strikes

Summary

Responding to continuing FSOC complaints about nonbank servicers, FHFA has proposed new seller-servicer eligibility standards that crack down hard on any nonbank servicer whose size evokes systemic qualms. Although all nonbanks and perhaps a few small bank seller-servicers will come under tougher net-worth requirements that hive off Ginnie servicing, FHFA targets its wrath at large nonbanks. These must not only comply with new capital and liquidity planning standards along with stringent liquidity standards, but are apparently viewed so dubiously by the agency that nonbanks also must get a third party to vouch for their viability under standards that get tougher as the servicer gets bigger.

Impact

This proposal comes after tries in 2015 and 2020 at new capital and liquidity criteria, with FHFA clearly determined in 2020 to recraft the standards, even though it decided to give servicers some forbearance due to COVID's chaotic market impact. As before, this proposal does not have the force of rule, reflecting instead the standards FHFA believes the GSEs must at a minimum use to assess seller-servicer risk and resulting eligibility. Each GSE can make its requirements tougher as well as grant exceptions (although how and for what is not made clear).

Reflecting the lessons FHFA says the GSEs have learned about servicers under stress, the standards first adjust net-worth criteria for all seller servicers by, for example, deleting DTAs from tangible net worth and adding a scaler requirement that differentiates between GSE and Ginnie servicing, tacking on a higher incremental capital requirement on Ginnie UPBs to reflect Ginnie's own requirements. The 2.0 standards also raise the current six percent leverage ratio on non-depository firms to nine percent (i.e., the community-bank leverage ratio). FHFA believes this requirement will not "unduly burden" small nonbank seller-servicers; what it does to big ones is left unsaid.

Taking stock of servicer illiquidity under stress, the new standards would also recraft the current construct in hopes of making it less procyclical. The new approach eliminates the sharp uptick in liquidity standards as loans go unpaid to varying standards based on remittance type to favor actual-to-actual repayment schedules. Like the capital rules, liquidity standards would also differentiate between loan type, now adding different standards for other loans to those set for GSE and Ginnie obligations. Eligible high-quality liquid assets remain unchanged.

The standards would also include a liquidity add-on for nonbank services using the TBA market (i.e., larger ones) due to potential TBA price spikes triggering margin calls, akin to those when the pandemic struck. This is a two percent liquidity requirement related to outstanding TBA-hedging positions. And atop this add-on is a liquidity buffer for large servicers that could only be drawn down with GSE approval under FHFA oversight; under certain conditions, FHFA could also direct the GSEs to allow the sector as a whole to tap their buffers.

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Finally, large seller-servicers (i.e., those with master accounts of more than $50 billion in UPB or as designated by a GSE) must file annual capital and liquidity plans with the GSEs along with notice of any material changes to a prior plan. Most notably, the plans must include liquidity stress tests under GSE-prescribed scenarios and contingent capital and funding strategies that are tested and reaffirmed each year. And in what is clearly a significant expression of distrust, large nonbank seller-servicers must also obtain an annual third-party assessment of the firm's performance and creditworthiness. This report is to substantiate assertions about the company's resilience as measured by express and additional ratings and related quality assurances that get tougher as the servicer gets bigger. Also reflecting the agency's worries, the GSEs are to assess each large nonbank servicer each quarter for compliance with its plans and look annually at whether the plans still make sense.

Outlook

FHFA provides no projected impact assessment of how these standards will affect nonbank firms, but the answer is "a lot." Market conditions appear to favor nonbank capital raises, although their cost may prove considerably more than insignificant, as rates rise and risk-off decisions predominate. As with banks under their liquidity standards, nonbank seller-servicers will need to allocate capital not only for profitable assets, but also for the low-yielding assets required under the liquidity rules and, for large firms, the new buffer.

Some nonbanks may thus seek to emphasize Ginnie servicing for as long as those rules remain more accommodating or renew consideration of becoming banks or being bought by a bank. To the extent acquisition is determined to be desirable, the largest nonbanks may find that the Administration's new competition policy creates major obstacles to deals with any big bank that is already a significant seller-servicer.

FHFA sets these standards with a short fuse, making them effective at year end despite a one-year transition for capital and liquidity increases. FHFA will receive input for 60 days and the GSEs will then set the standards at FHFA's minimums or above these thresholds should they choose to do so for any current or future specific seller-servicer or sector thereof.

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