U.S. RMBS Servicer Roundtable Takeaways

U.S. Mortgage Servicing Outlook for 2017

Special Report

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U.S. RMBS Servicer Handbook (October 2016)

U.S. RMBS Deal Agent Cost Analysis (July 2016)

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Key Roundtable Takeaways

Fitch Ratings' RMBS group held a servicer roundtable (Roundtable) event on Nov. 10, 2016 to discuss current trends in U.S. mortgage servicing and the industry's outlook for 2017.

In attendance were 31 senior executives from many of the leading bank and nonbank mortgage servicers, as well as representatives from prospective deal agents (DAs).

Discussion topics included:

- Servicing in Transition (including nonbank servicer growth and regulation).
- Servicers and Deal Agents Working Together in New RMBS.
- Challenges and Opportunities in Servicing Technology.

This report provides a summary of the Roundtable's key takeaways, presentation slides and survey results *(found in Appendix)*.

Nonbank Servicing Trend to Continue: Nonbank servicing share is expected to continue to grow, although the growth will come increasingly from mortgage origination activity rather than large servicing transfers.

Increased Regulation Has Benefits: Servicers recognize that increased regulation has improved servicing quality, although it is unclear whether these benefits have outweighed the costs.

Deal Agent Challenges Remain: Most servicers believe that significant work is still needed to meet data and reporting requirements if DAs become involved in new RMBS.

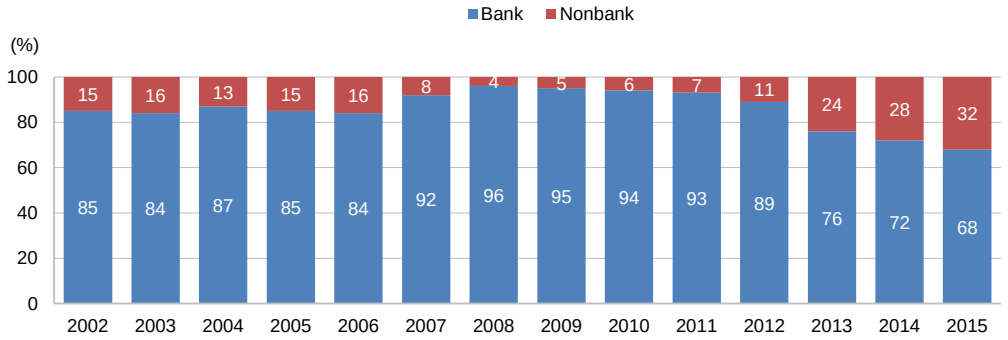
Technology Improvements Needed in 2017: Enhancements will continue to be needed in order to satisfy regulatory and investor requirements and to fill gaps in core servicing systems.

Technology Costs to Grow: Although most servicers remain dissatisfied with current technology offerings, regulatory compliance needs will drive more technology spending for servicers.

Servicing in Transition

Approximately 89% of Roundtable participants expect that nonbank servicers will continue to take market share from banks in 2017. Although this trend has previously been driven by mortgage servicing right (MSR) sales and subservicing, this flow has declined. MSR sale activity levels may increase again, but earlier subservicing activity was largely due to regulatory settlements that required large banks to move loans to subservicers, which is currently not expected to continue to be a significant source of nonbank growth. Future activity is more likely to be driven by servicing sales from banks who want to reduce Basel III impact on capital and from new loan origination activity by nonbanks who also service loans.

Market Share

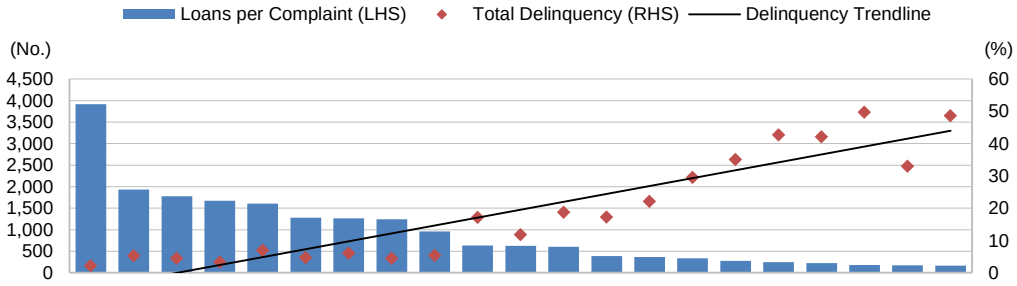


Source: Federal Reserve.

High-touch servicers continue to be in demand by investors who value their transparency or are seeking an operational partner for residential mortgage investments. This trend is expected to continue as more capital continues to be directed toward higher credit risk loans in the nonprime, nonperforming and re-performing sectors.

While many Roundtable participants are not actively pursuing Ginnie Mae opportunities, a small number of servicers have continued to selectively purchase pools of Ginnie Mae servicing. Some servicers have less interest in Ginnie Mae servicing due to the cost of servicing this product and the perceived inadequacy of the servicing fee income.

Loans per Complaint and Total Delinquency 2015–2016



Note: Each bar and marker corresponds to one servicer.
Source: CFPB, Fitch-rated servicers.

Related Criteria

U.S. RMBS Master Rating Criteria (June 2016)

Rating Criteria for U.S. Residential and Small Balance Commercial Mortgage Servicers (April 2015)

While increased regulation has become a significant operational burden across the industry and has driven servicing costs higher, approximately 89% of the attendees believe that regulation has led to improved servicing quality and has provided benefits to consumers. Regulation has made servicing transfers cleaner due to better data quality on in-flight loan modifications and loss mitigation efforts already undertaken by the prior servicer.

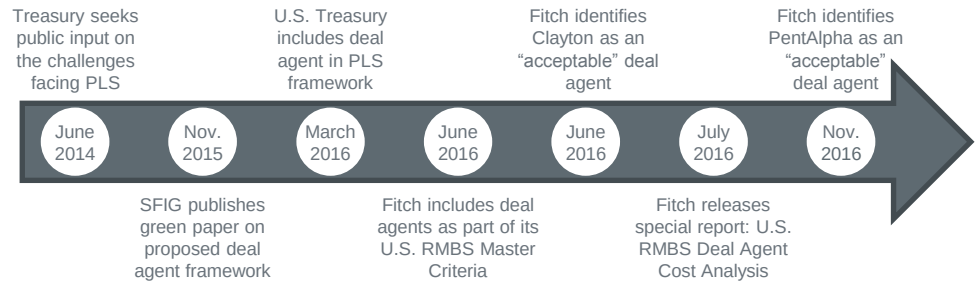
Servicers agreed with Fitch's perspective that the level of borrower complaints is often directly related to the amount of delinquent loans they service. Servicers also perceive that regulators use complaint-level data to select servicers to review. One major nonbank servicer stated that addressing and preventing complaints has been a major initiative of theirs over the past 18 months and, as a result, complaints against it have dropped by 60%.

Servicers speculated that some change in regulatory focus is possible due to the change in the administration, but this is still uncertain, and servicer emphasis on compliance will not be altered or reduced in 2017. The overall sentiment expressed was that high regulatory scrutiny for the servicing industry is the new norm. The majority of growing servicers recognize a need to increase their focus on performing loans next year, particularly special servicers who may view becoming an effective performing loan servicer as an enhancement to their business. Some high-touch servicers see the need to make further investments as they expand into the performing loan space in 2017. A key issue is finding the right fit for employees throughout this transition. Also, several servicers noted that a move into performing loan servicing requires investments in enhancing/upgrading their websites and interactive voice response systems.

Servicers and DAs Working Together in New RMBS

The industry has worked to establish a framework for DAs in potential new transactions in order to address critical weaknesses often seen in legacy RMBS such as ineffective enforcement mechanisms, weak oversight of transaction parties, poor communication with investors and a general lack of transparency. Many investors believe that DAs can improve servicer performance, but servicers and DAs see that further work is needed prior to implementation of the DA in RMBS transactions. In fact, 86% of Roundtable participants believe that there are reporting challenges for servicers under the proposed Structured Finance Industry Group's (SFIG) DA construct.

Deal Agents — Timeline



Source: SFIG, Fitch.

Servicers believe that DAs can perform an important function by communicating directly with investors. However, among Roundtable participants, uncertainty remains with regard to the incremental value of DAs performing servicer oversight. Additional third-party oversight for a small portion of a servicer's portfolio (only deals where the DA was named) may pose operational challenges. The potential for duplicative work and overlapping responsibilities between DAs and master servicers may exist under the proposed framework, which participants felt may be costly and counterproductive. DAs noted that, in addition to servicer oversight, they can add value in new RMBS through cash flow reconciliation and custodian and trustee oversight.

Deal Agents — Key Roles as Identified by SFIG

	Deal Agent	Master Servicer	Servicer
Custody of Documents	x		
Collection of Payments from Borrowers			x
Monitor and Oversee Collections of Payments	x	x	
Maintain Loan Level Records			x
Receives Servicer Reporting	x	x	
Servicer Advances			x
Monitor and Review of Reps and Warrants	x	x	
Review Collateral, on an Ongoing and Periodic Basis, in Accordance with Deal Documents	x		x
Prepare Findings of Servicing Related Breach Review	x	x	
Enforce Communication Protocol	x		
Conduct Monthly Servicer Calls	x	x	
Direction and Oversight of Default Management Deaccessioning	x	x	
Verify MI Claims Submissions	x	x	
Initiate FC Process			x
Report Material Breach of any Material Rep, Warranty or Covenant	x	x	x

Source: SFIG.

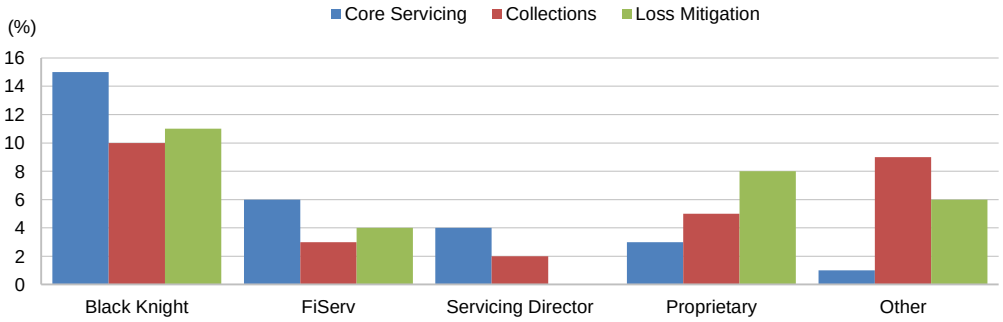
The industry-proposed DA construct calls for an expansion in servicer-reported data, but standardization of the data may be a challenge given differing servicing platforms and reporting capabilities. One servicer expressed that industry-expanded reporting requirements such as MISMO and agency standards already address much of what investors are looking for and that the improved report detail effectively addresses transparency concerns.

The potential for increased costs remains a consideration for servicers thinking about involving themselves in RMBS transactions with a DA. Larger servicers also expressed concerns with system access capabilities and incorporating a DA into their already heavily regulated risk framework.

Challenges and Opportunities in Servicing Technology

Less than one-half of the Roundtable participants expressed satisfaction with their core servicing systems. Limitations of core servicing systems currently in place force servicers to use technology wrap-arounds and this will likely continue in 2017, with 82% expecting that wrap-around systems will not be reduced next year. A significant part of this effort is due to regulatory compliance needs and initiatives.

U.S. RMBS Servicing Technology — Vendor Market Share

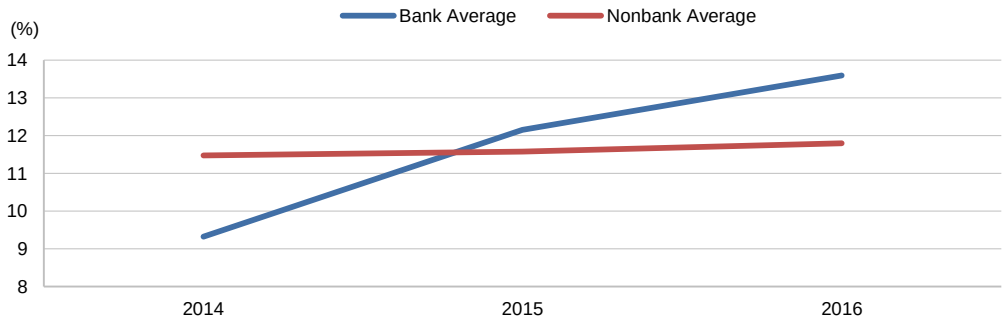


Source: Fitch-rated servicers.

New servicing technology development has not kept pace with the evolving needs of the industry. Despite significant need and elevated costs caused by increased usage of wrap-around systems, technology providers have not sufficiently introduced new solutions to solve

current problems. Servicers stated that usage of wrap-around technology is needed to help them ensure regulatory compliance and to help them to grow their business. However, large bank servicers that have seen improvements in their portfolio delinquencies may be more focused on the simplification and modernization of their systems.

Technology as % of Budget — Bank versus Nonbank Averages



Source: Fitch-rated servicers.

With 82% of Roundtable participants noting that technology has not kept up with the pace of changes in state, federal and investor requirements, technology spending continues to be a need. Approximately 86% of the participants expect that technology expenditures as a percentage of budgets will be increased next year, and regulatory compliance remains at the forefront of technology spending for 2017.

Importantly, servicers believe that new technology can lead to improved performance. For example, one bank's recording technology that captures key words, inflection and emotions, which is stored and used to coach employees, has been seen to drive improvements; regulators might begin to expect such technology to be commonplace among servicers.

Appendix

Survey Results

	Yes %
Servicing in Transition	
Is your company a bank?	29
Do you expect the bank to nonbank servicing trend to continue in 2017?	89
Has increased regulation improved the quality of servicing?	89
Is the future of high touch servicers dependent upon their growth into performing loan servicing?	54
Is your firm likely to increase its emphasis on the acquisition of servicing of performing loans in 2017?	64
Will the interest rate environment in 2017 be more favorable for mortgage servicers?	64
Servicers and Deal Agents Working Together in New RMBS	
Would the DA's role as laid out in the SFIG green paper resolve the concerns that investors have about RMBS servicing?	32
Do you think that Deal Agent oversight can improve servicing performance?	36
Do you think that on-site servicer reviews by Deal Agents would add value?	32
Does your institution anticipate becoming involved in transactions with a Deal Agent in 2017?	43
Are there reporting challenges for servicers under the proposed Deal Agent construct?	86
Challenges and Opportunities in Servicing Technology	
Are you satisfied with your core servicing system?	43
Wrap-around systems remain prevalent; do you see a reduced need for these in 2017?	18
Is the existing technology able to keep up with the pace of changes in state, federal, and investor requirements?	18
Is technology as a percentage of your budget likely to be increased in 2017?	86
Do you foresee a need in 2017 for increased technology expenditure as a result of new RMBS activity?	43

Source: Survey responses from U.S. RMBS Servicer Roundtable.