An Industry in Crisis: Nonbank Mortgage Servicers and the CARES Act Mortgage Forbearance

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I. INTRODUCTION

The COVID-19 pandemic levied an unprecedented hardship on millions of Americans. However, certain industries have been legislatively coaxed into bearing a much larger share of the hardship than they had expected. In March 2020, Congress passed the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) in response to the overwhelming economic burden imposed by the COVID-19 pandemic. While the CARES Act was necessary to help homeowners weather the COVID-19 pandemic, it accomplishes this by placing mortgage servicers in a challenging position.

The CARES Act contains a provision that allows mortgagors to request forbearance on their mortgage payments for up to one year. This provision is helpful to mortgagors who could not pay their bills during the pandemic by deferring their mortgage payments for the period

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4. See Kaul & Goodman, supra note 1 (explaining the economic impact of the COVID-19 pandemic on homeowners).
5. See Platt, supra note 2 (discussing the position mortgage servicers have been placed in by the “CARES” Act mortgage forbearance).
of the forbearance. In practice, the provision requires mortgage servicers to continue advancing payments on mortgage-backed securities, which they are contractually obligated to make although they no longer receive payments on the underlying loans. As a result, the CARES Act’s mortgage forbearance provision created a liquidity crisis for mortgage servicers.

Many stakeholders have highlighted the desperate need for federal aid in the mortgage servicing industry because they recognize the necessity of the mortgage servicing industry to the broader housing market. The impact of the CARES Act will be more severe for nonbank

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9. Mortgage servicing involves the collection of payments due from the borrower under a mortgage loan and the disbursement of those funds to principal and interest balances and to the owners or investors in the loan. Other important responsibilities of mortgage servicers include customer service, billing, and management of delinquencies, losses, and foreclosed properties. See CONFERENCE OF STATE BANK SUPERVISORS, REENGINEERING NONBANK SUPERVISION, CHAPTER THREE: OVERVIEW OF NONBANK MORTGAGE 27 (2019), https://www.csbs.org/system/files/2020-08/chapter_three_-_overview_of_nonbank_mortgage_1.pdf [https://perma.cc/KNK2-GMJF] (explaining the general duties that mortgage servicers provide).

10. See Fast Answers: Mortgage Backed Securities, U.S. SEC. AND EXCH. COMM’N, https://www.sec.gov/fast-answers/answersmortgagesecuritieshtm.html [https://perma.cc/N856-TEZ5] (last visited Jan. 5, 2021) (“Mortgage-backed securities are debt obligations that represent claims to the cash flows from pools of mortgage loans, most commonly on residential property. Mortgage loans are purchased from banks, mortgage companies, and other originators and then assembled into pools . . . represent[ing] claims on the principal and interest payments made by borrowers on loans in the pool . . . .”).

11. See Platt, supra note 2 (highlighting the difficulties caused by the mortgage forbearance of the CARES Act).

12. § 4022, 134 Stat., at 490–91; see also Platt, supra note 2 (stating that the COVID-19 environment, under the CARES Act mortgage forbearance, creates a liquidity risk).

mortgage servicers\textsuperscript{14} than for bank-owned mortgage servicers\textsuperscript{15} because nonbank mortgage servicers lack access to the federal lending facilities that are available to bank servicers.\textsuperscript{16}

This Note proceeds in five parts and endeavors to suggest a solution for nonbank mortgage servicers facing this liquidity crisis that is both compliant with the CARES Act mortgage regulations and realistic.

Part II provides background on the mortgage servicing industry.\textsuperscript{17} Part III analyzes why the COVID-19 crisis is more damaging to nonbank mortgage servicers than to their bank counterparts.\textsuperscript{18} Part IV provides suggestions for solving the problem and addresses some immediate concerns surrounding the solution\textsuperscript{19} before briefly summarizing and concluding in Part V.\textsuperscript{20}

II. BACKGROUND OF THE MORTGAGE SERVICING INDUSTRY

A. The Role of Mortgage Servicers

Mortgage servicers are responsible for collecting and subsequently recording payments from mortgagors to apply to their principal and interest balances.\textsuperscript{21} They also distribute the funds received to the owner of the loan and toward the payment of taxes and insurance.\textsuperscript{22} Mortgage servicers effectively support the market for mortgage-backed securities by servicing loans that are pooled and backing the payment of these securities.\textsuperscript{23} Nonbank mortgage servicers play a major role in the


\textsuperscript{15} Bank-owned mortgage servicers are federal and state-chartered banks that, in their role as a depository institution, perform mortgage servicing, often for loans they originate. Id.

\textsuperscript{16} See Platt, supra note 2 (acknowledging that no servicing advance facilities exist under the Federal Reserve or Treasury for nonbank mortgage servicers).

\textsuperscript{17} See infra Part II.

\textsuperscript{18} See infra Part III.

\textsuperscript{19} See infra Part IV.

\textsuperscript{20} See infra Part V.

\textsuperscript{21} See Conference of State Bank Supervisors, supra note 9 (explaining the role mortgage servicers play in the payment of mortgage loans).

\textsuperscript{22} See id. (explaining the responsibilities of mortgage servicers).

\textsuperscript{23} See id. (stating “remittance of payment to the applicable investors” as an integral part of mortgage servicing).
market for mortgage servicing rights\textsuperscript{24} ("MSRs").\textsuperscript{25} Mortgage servicers earn a profit by charging a servicing fee in exchange for performing all of the previously outlined activities.\textsuperscript{26}

Either the government or a mortgage lender may require a mortgage servicer to extend a loan to a homeowner to cover principal and interest payments that the homeowners have missed, which is paid to the investors until the borrower can make the payments or the property is foreclosed upon.\textsuperscript{27} This arrangement between the mortgage servicer and the investors is referred to as a servicing advance and the payments are referred to as advances.\textsuperscript{28} If a borrower defaults, then a mortgage servicer will be paid through the guarantor—assuming that the loan is guaranteed—or through foreclosure and sale of the property, which servicers often manage.\textsuperscript{29}

Nonbank mortgage servicers are companies that are not a part of and have no affiliations with any depository institutions, but nonetheless engage in the business of mortgage servicing.\textsuperscript{30} Despite their integral role in the mortgage market, nonbank mortgage servicers have not always played a major role in mortgage servicing.\textsuperscript{31}

Historically, banks and thrifts have dominated the mortgage servicing industry.\textsuperscript{32} However, widespread thrift insolvency during the

\textsuperscript{24} "[A] Mortgage Servicing Right (MSR) is the contractual right to service a mortgage loan; according to accounting standards, entities owning MSRs must perform a valuation analysis and appropriately recognize the value of the MSR portfolio on the company balance sheet." Id. at 28.


\textsuperscript{26} See CONFEREnCE OF STrATE BAnK SUPERVISORS, supra note 9, at 28–29 (explaining how mortgage servicers are compensated).


\textsuperscript{28} See id. (defining servicing advances and the arrangement between mortgage servicers and the owners of the loans they service).

\textsuperscript{29} See Platt, supra note 2 (discussing the methods of recourse for a mortgage servicer in the event of a default); see also CONFEREnCE OF STrATE BAnK SUPERVISORS, supra note 9 (explaining briefly mortgage servicers role in foreclosure proceedings).

\textsuperscript{30} See Shoemaker, supra note 25, at 52 (defining nonbank mortgage servicers).

\textsuperscript{31} See id. at 51–53 (explaining the historical shift in the market from bank mortgage servicers to the prevalence of nonbank mortgage servicers).

\textsuperscript{32} See CONFEREnCE OF STrATE BAnK SUPERVISORS, supra note 9, at 29 (explaining the historical dominance of banks and thrifts in mortgage servicing).
savings and loan crisis (“S & L Crisis”) of the 1980s led to a sharp decline in bank and thrift market share in lending, which left a void in mortgage lending that was eventually filled by a growing number of nonbanks.\textsuperscript{33} Additionally, interest rates rose significantly in the early 1980s.\textsuperscript{34} This had a profound negative impact on savings and loan associations because of their practice of borrowing short term and lending long term, which made them unable to adjust their mortgage interest rates to the rising interest rates and competition for deposits.\textsuperscript{35} A combination of these factors and deregulation of the savings and loan industry led to widespread insolvency in the market.\textsuperscript{36}

The S & L Crisis, combined with the rise of securitization and mortgage-backed securities, provided nonbank mortgage servicers with an opportunity to enter the market.\textsuperscript{37} Between the 1990s and into the early 2000s, financial technology, such as automatic credit scoring tools and automated loan servicing management tools, led to more efficient mortgage servicing methods.\textsuperscript{38} These tools aided the growth and expansion of the mortgage servicing industry for banks and nonbanks alike.\textsuperscript{39}

From the mid-1990s to the early 2000s, the total market for servicing subprime loans\textsuperscript{40} doubled from $280 billion to $585 billion.\textsuperscript{41}

\begin{quote}
33. See Shoemaker, supra note 25, at 51 (discussing the decline of banks and thrifts in mortgage lending historically).
35. See id. (discussing savings and loan lending practices at the time of the crisis).
36. See id. at 7–9 (explaining how losses combined with deregulation accelerated the crisis).
37. See Conference of State Bank Supervisors, supra note 9, at 29–30 (analyzing the factors leading to nonbank mortgage servicers entering the mortgage servicing market).
39. See Conference of State Bank Supervisors, supra note 9, at 29 (explaining the role of technology in the propagation of the mortgage servicing industry).
40. Subprime lending is the practice of offering loans at a rate, higher than the prime rate, to borrowers with limited or poor credit history. Subprime Lending, Off. of the Comptroller of the Currency (last visited Oct. 12, 2020), https://www.occ.gov/topics/supervision-and-examination/credit/retail-credit/subprimelending.html [https://perma.cc/6XNP-3XUH].
41. See Conference of State Bank Supervisors, supra note 9, at 30 (discussing the market value of subprime loans historically).
\end{quote}
In 2006, nonbank mortgage servicers were responsible for approximately 33% of all mortgage servicing. By 2007, the market reached $1.05 trillion before the beginning of the 2008 Financial Crisis. At this time, nonbank servicers held approximately 60% of the subprime loan servicing market. But the apparent success of nonbank mortgage servicers was short-lived.

B. The 2008 Financial Crisis and the Impact on the Mortgage Servicing Industry

The 2008 Financial Crisis devastated the nonbank mortgage servicing industry. Many lenders and servicers faced insolvency and bankruptcy as a result of a massive wave of borrowers being unable to make their mortgage payments. Many servicers and lenders either exited the market, involuntarily through insolvency and bankruptcy, or merged with others to survive. Nonbank mortgage servicers dropped from approximately 33% of all mortgage servicing in 2006 to a meager 6% in 2010, effectively destroying nonbank mortgage servicers’ market share that boomed over the prior decade.

This massive wave of defaults on high-risk subprime mortgages was a catalyst for the 2008 Financial Crisis. The impact of these defaults was felt by banks that had large portfolios of subprime mortgages. Later investigation by the Financial Crisis Inquiry

42. See id. (discussing historical nonbank mortgage servicing trends).
43. Id.
44. Id.
45. See id. at 30–31 (explaining the effects of the subprime loan crisis and the impact of the 2008 Financial Crisis on nonbank mortgage servicers).
46. See Shoemaker, supra note 25, at 54 (discussing widespread insolvency and economic troubles due to the financial crisis).
47. See id. (highlighting the insolvency many nonbank mortgage servicers faced during the financial crisis).
48. See id. (explaining the historical effect of the 2008 Financial Crisis on the mortgage industry).
49. See CONFERENCE OF STATE BANK SUPERVISORS, supra note 9, at 30 (announcing statistics regarding market share of nonbank mortgage servicers after the 2008 Financial Crisis).
51. See id. at 256–57 (describing the impact of subprime loan losses on large banks in the financial sector).
Commission\textsuperscript{52} concluded that this crisis could have been avoided, but the warning signs were ignored.\textsuperscript{53} Although the 2008 Financial Crisis and the subprime mortgage crisis were painful blows, the country had to learn from the experience and soldier on.\textsuperscript{54}

C. Post-Financial Crisis and the Modern Role of Mortgage Servicers

Mortgage servicers were beginning to recover from the Financial Crisis when a number of regulatory changes shifted the economic landscape and allowed for increased nonbank participation in the mortgage servicing market.\textsuperscript{55} In 2013, the Basel III\textsuperscript{56} capital requirements for depository institutions limited the amount of mortgage servicing rights that banks could hold.\textsuperscript{57} Mortgage servicing rights are a type of mortgage servicing asset ("MSA"), which is considered an asset if the net present value of the cash flows exceeds the cost to service the asset, and a liability if the cash flows do not exceed the cost to service the asset.\textsuperscript{58} These MSAs are risk-weighted at 100\%, until they exceed a specified statutory threshold, at which point the risk-weight is increased to 250\%, effectively requiring banks to have far more capital to comply with regulations for MSAs beyond this capital threshold.\textsuperscript{59}

The capital requirements imposed by Basel III limited the amount of mortgage servicing rights to a percentage of a bank’s capital, which

\textsuperscript{52} See id. at xi (“The Financial Crisis Inquiry Commission was created to ‘examine the causes of the current financial and economic crisis in the United States.’”)

\textsuperscript{53} See id. at xvi (concluding that the 2008 Financial Crisis was avoidable).

\textsuperscript{54} See Conference of State Bank Supervisors, supra note 9, at 32–33 (discussing the end of the crisis and mortgage servicers recovering from the crisis).

\textsuperscript{55} See id. (highlighting the conditions which allowed for nonbank participation in the mortgage markets).

\textsuperscript{56} Basel III is a group of proposals, proposed by the Basel Committee, that were adopted in a final rule by U.S. bank regulators in July 2013, containing \textit{inter alia} capital requirements for banks. See generally Lisa L. Broome & Jerry W. Markham, Regulation of Bank Financial Service Activities 617–19 (5th ed. 2018) (providing background on the Basel III capital ratios).

\textsuperscript{57} 12 C.F.R. § 217 (2020) (implementing Basel III capital adequacy standards to state member banks); see also Conference of State Bank Supervisors, supra note 9, at 32–33 (discussing the effects of Basel III regulations on the mortgage servicing market).

\textsuperscript{58} See Conference of State Bank Supervisors, supra note 9, at 28 (explaining how MSAs are kept on a balance sheet).

meant banks were limited on how many of these assets they were able to hold while staying within their required regulatory limits. 60 These capital requirements did not apply to nonbank mortgage servicers. 61 As a result, nonbank mortgage servicers were able to gain market share with limited competition. 62 The share of nonbank mortgages issued also increased in the wake of the 2008 Financial Crisis because of their low credit requirements, especially as compared to those of banks. 63

Following the 2008 Financial Crisis, many nonbank mortgage servicers and originators grew in market share. 64 During the first quarter of 2020, the nonbank share of agency servicers 65 had grown to 53% of the agency servicing market, up from just 24% in 2014. 66 This growing market share is attributed to the ability of nonbanks to specialize and reduce the costs associated with servicing loans. 67 One form of specialization which aided in the proliferation of nonbank mortgage servicers was the introduction of enhanced technology to the mortgage servicing industry. 68 For example, the implementation of online services—which automatically collect information pertaining to a borrower’s financial status and history—allows a lender to more quickly and efficiently make an approval decision based on these online applications 69.

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60. See id. (explaining the impact of minimum capital standards adopted from the Basel III on bank mortgage servicers).
61. See CONFERENCE OF STATE BANK SUPERVISORS, supra note 9, at 33 (explaining the emergence of nonbank mortgage servicers in the mortgage servicing market post-crisis).
62. See id. (explaining the emergence of nonbank mortgage servicers into the mortgage servicing market post-crisis).
64. See Shoemaker, supra note 25, at 54 (discussing market share for nonbank mortgage originators and servicers).
65. Agency servicers are those who service loans guaranteed by government sponsored entities or the Government National Mortgage Loan Association. CONFERENCE OF STATE BANK SUPERVISORS, supra note 9, at 55.
66. See id. (announcing statistics of nonbank mortgage servicers share of agency servicing in the market).
67. See Shoemaker, supra note 25, at 55 (analyzing factors for increased market share for nonbank mortgage servicers post-crisis).
68. See id. (stating that technological innovation played a role in the growth of the nonbank mortgage market post-crisis).
III. LIQUIDITY SHORTAGE FOR NONBANK MORTGAGE SERVICERS

A. The CARES Act Mortgage Forbearance Ramifications for Mortgage Servicers

The CARES Act provided a $2.2 trillion economic stimulus package, passed with the express purpose of addressing the economic crisis caused by the COVID-19 pandemic. The Act contains a provision that is particularly disadvantageous to mortgage servicers, stating that, “[d]uring the covered period, a borrower with a [f]ederally backed mortgage loan experiencing a financial hardship due, directly or indirectly, to the COVID-19 emergency may request forbearance on the [f]ederally backed mortgage loan, regardless of delinquency status.” For a borrower to obtain forbearance, the borrower is only required to request forbearance from the mortgage servicer, and confirm that the “financial hardship” is a result of the COVID-19 crisis. The provision states that, “[u]pon receiving a request for forbearance from a borrower . . . the servicer shall with no additional documentation required other than the borrower’s attestation to a financial hardship caused by the COVID-19 emergency . . . provide the forbearance.” This period of forbearance is to last an initial 180-days and at the borrower’s request may be extended up to an additional 180-days, subject to the borrower’s right to shorten this period at the borrower’s election. There are additional provisions relevant to mortgage servicers under the CARES Act which grant a limited forbearance to multifamily borrowers with federally backed loans. Another relevant provision mandates a 120-day period from the enactment of the act that prevents any eviction proceedings against any tenants with, among other things, a federally backed mortgage loan.

71. § 4022, 134 Stat. at 490–91.
72. Id.
73. Id.
74. Id.
75. See § 4023, 134 Stat. at 491–492 (allowing multifamily mortgage servicers to request forbearance due to a COVID-19 related financial hardship and sets forth the relevant restrictions to the provision).
76. See § 4024, 134 Stat. at 492–494 (providing a federal moratorium on eviction filings).
On December 27, 2020, Congress enacted the Consolidated Appropriations Act of 2021 ("Relief Act")\(^{77}\), which provides for an extension of the eviction moratorium\(^{78}\) and emergency rental assistance payments.\(^{79}\) While incredibly helpful to renters, it does little to address the real issue that this pandemic has levied against mortgage servicers for the prior nine months of forbearance.\(^{80}\)

The statutory right of forbearance provided to the nation’s homeowners, landlords, and tenants has disrupted the stream of payments to mortgage servicers.\(^{81}\) This disruption places servicers between the borrowers and the owners of the loans, where they cannot collect payments on the mortgages they service.\(^{82}\) Furthermore, the CARES Act does nothing to address the fact that mortgage servicers are still contractually obligated to continue making payments to the owners of the mortgage-backed securities on the loans they service.\(^{83}\)

In the case of mortgage-backed securities guaranteed by the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), or the Federal National Mortgage Association ("Fannie Mae") is a government sponsored enterprise that purchases and guarantees single family mortgage loans, issues debt securities to investors, and converts multifamily mortgage loans into MBS, which provides liquidity to the market. [What We Do, Fannie Mae](https://www.fanniemae.com/about-us/what-we-do) (last visited Oct. 12, 2020) (explaining Fannie Mae’s function and business activities).

4. The Federal Home Loan Mortgage Corporation ("Freddie Mac") is a government sponsored enterprise that buys mortgage loans on the secondary market and sells them as MBS to provide liquidity to the market. [See Our Business, Freddie Mac](http://www.freddiemac.com/about/business/) (last visited Oct. 12, 2020) (explaining Freddie Mac’s function and business activities).
Government National Mortgage Association ("Ginnie Mae"), mortgage servicers are required to make scheduled payments to the holders of those securities. However, the mortgage servicers are no longer receiving payments from mortgagors who invoked forbearance, creating a liquidity challenge for mortgage servicers. Under the CARES Act mortgage forbearance, mortgage servicers are only temporarily denied funds they are due as the servicers of their loans. Therefore, the concern is the immediate impact of the forbearance. Mortgage servicers could not have predicted that they would be unable to collect those payments due to a legislative action designed to protect the interests of mortgagors. Mortgage servicers now bear the economic risk of borrowers’ forbearance, which was not considered when they entered into servicing agreements.

In April 2020, the Federal Housing Finance Agency ("FHFA") announced that Fannie Mae and Freddie Mac would limit the servicer obligation to advance mortgage-backed securities payments to four months for loans in forbearance. While the FHFA’s actions are helpful to mortgage servicers, a liquidity facility is still needed to handle the large number of loans in forbearance and resolve the four months for which mortgage servicers will still be required to cover payments on mortgage-backed securities.

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87. See Platt, supra note 2 (discussing the payments due under MBS guaranteed by government-sponsored entities ("GSEs") like Fannie Mae, which requires principal and interest, and Freddie Mac, which requires only interest be advanced).

88. See id. (discussing that mortgage servicers are not receiving payments under the forbearance provision of the CARES Act).

89. See id. (discussing the short-term liquidity risks for mortgage servicers created by the CARES Act mortgage forbearance).

90. See id. (discussing the short-term impact of the mortgage forbearance on mortgage servicers).

91. See id. (discussing the inability of mortgage servicers to account for the risk of a pandemic).

92. See id. ("[Mortgage servicers] did not realistically contemplate the impacts of required forbearance for the significant number of loans impacted by the global pandemic in allocating the risks in the servicing agreements.").

backed securities. The fact that there is a limit to the amount that mortgage servicers will be required to advance does not negate the four months of payment that servicers are burdened with in the meantime. Furthermore, if mortgage servicers are expected to advance payments for four months of the potentially one year forbearance period, short-term liquidity issues are almost a certainty.

B. The Disproportionate Impact of the Mortgage Forbearance on Nonbank Mortgage Servicers

The CARES Act mortgage forbearance impacts nonbank mortgage servicers more severely than bank mortgage servicers because they do not benefit from the federal safety nets and lending facilities that safeguard the stability of banks. Banks have deposit insurance provided by the Federal Deposit Insurance Corporation (“FDIC”) and have access to the Federal Reserve as the “lender of last resort” which provides banks with liquidity through discount window lending for both short-term and more severe liquidity needs. No such comparable lending facilities currently exist for nonbank mortgage servicers.

Nonbank mortgage servicers also tend to have fewer “unencumbered assets” than banks do in the event of a liquidity

94. See Kaul & Tozer, supra note 8 (discussing why the four-month cap by Fannie Mae and Freddie Mac is not necessarily going to completely solve the crisis).

95. See Platt, supra note 2 (discussing the short-term financial burden that mortgage servicers are being forced to bear under the CARES Act mortgage forbearance).

96. See Press Release, Fed. Hous. Fin. Agency, supra note 93 (announcing a four-month cap to mortgage servicer payment advancing obligations); see also Platt, supra note 2 (discussing the liquidity issues likely to arise for mortgage servicers under the forbearance).


98. A lender of last resort is an institution that provides liquidity insurance to the system it supports. See Paul Tucker, Re-Thinking the Lender of Last Resort 12–13 (Bank for Int’l Settlemets, BIS Papers No. 79, 2014), https://www.bis.org/publ/bppdf/bispap79.pdf [https://perma.cc/UUM8-Z6LX] (describing the role of a “lender of last resort”).

99. See Broome & Markham, supra note 56, at 175 (explaining the role of the discount window and deposit insurance in reducing risk to banks); see also Discount Window Lending, FED. RES. BD. (2020), https://www.federalreserve.gov/regreform/discount-window.htm [https://perma.cc/SG9R-RGKW] (explaining the purpose and function of the discount window).

100. See Platt, supra note 2 (acknowledging that no servicing advance facilities exist under the Federal Reserve or Treasury for nonbank mortgage servicers).
shortage. Unencumbered assets are not used to collateralize transactions, are available to convert into cash for funding purposes, and are not restricted from being used as a liquidity buffer. This relatively low amount of unencumbered assets leaves less of a buffer in the event of a liquidity crisis. The CARES Act mortgage forbearance therefore has a more severe effect on nonbank mortgage servicers. The liquidity risk presented will likely put strain on the resources of most nonbank mortgage servicers because they did not consider this risk when they entered into their servicing agreements.

IV. RECOMMENDATIONS

A. Establish a Liquidity Facility to Provide for the Short-Term Credit Needs of Nonbank Mortgage Servicers

The CARES Act mortgage forbearance covered 70% of all single-family mortgages with an unpaid principal balance of $7 trillion. By the end of June 2020, over 4.2 million homeowners took advantage of the forbearance provided by the Act. Nonbank mortgage servicers are a significant portion of the total mortgage servicing market. At the

101. See Kim et al., supra note 63 (stating that nonbanks have fewer unencumbered assets than banks do).


103. See Kim et al., supra note 63 (explaining that nonbank mortgage servicers have fewer unencumbered assets than bank mortgage servicers); see also Platt, supra note 2 (acknowledging that no servicing advance facilities exist under the Federal Reserve or Treasury for nonbank mortgage servicers).

104. See Kim et al., supra note 63 (explaining that nonbank mortgage servicers have fewer unencumbered assets than bank mortgage servicers); see also Platt, supra note 2 (acknowledging that no servicing advance facilities exist under the Fed or Treasury for nonbank mortgage servicers).

105. See Platt, supra note 2 (“[T]his liquidity risk likely strains the resources of most nonbank mortgage servicers, not because they lack financial strength, but because the parties did not realistically contemplate the impacts of required forbearance”).

106. See KAUL & TOZER, supra note 8 (announcing statistics regarding the potential scope of the CARES Act mortgage forbearance).

107. Id.

beginning of 2020, nonbank mortgage servicers were responsible for servicing 53% of the agency servicing market.109

The primary issue for nonbank mortgage servicers is a lack of liquidity to pay the principal and interest due on mortgage-backed securities.110 A liquidity facility to lend to these servicers would alleviate the overwhelming burden imposed by the CARES Act mortgage forbearance provision.111 This would allow nonbank mortgage servicers to continue to comply with the requirements of the CARES Act while allowing them to pay the owners of government mortgage-backed securities that they service.112

The lending facility could be established by the Federal Reserve.113 Under the authority granted by Federal Reserve Act Section 13(3) (“Section 13(3)”), the Federal Reserve Board can establish a lending facility in “unusual or exigent circumstances.”114 Pursuant to changes to Section 13(3) under the Dodd-Frank Wall Street Reform and Consumer Protection Act,115 the facility would also need to have “broad-based eligibility.”116 The facility would also need to grant liquidity to the financial system broadly, “secured sufficiently to protect taxpayers from losses,” with “the prior approval of the Secretary of the Treasury,” and to be wound up in a “timely and orderly fashion.”117 The Federal Reserve has established that “broad-based” means a facility that “at least five entities” could qualify for, and that is not designed to save failing firms.118

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109. See id. (announcing statistics of nonbank mortgage servicers share of agency servicing in the market).

110. See Kaul & Tozer, supra note 8 (discussing mortgage servicer liquidity concerns).

111. See id. at 8 (recommending a liquidity facility to fund government mortgage-backed securities advancements for mortgage servicers to address liquidity concerns).


114. Id.


117. See id. (stating other requirements for an emergency lending facility under Section 13(3)).

The Federal Reserve has already established lending facilities pursuant to its authority under Section 13(3), and there is clear statutory authority for another lending facility to be established in this fashion. The Commercial Paper Funding Facility (“CPFF”) is a credit facility established under Section 13(3) of the Federal Reserve Act. The Federal Reserve Bank of New York committed to lend to a special purpose vehicle (“SPV”) on a “recourse basis,” and the Treasury agreed to take a $10 billion equity investment in the SPV. The SPV would function by purchasing “three-month U.S. dollar-denominated commercial paper” from issuers subject to certain restrictions. The intended effect is to increase the flow of credit and to provide liquidity to businesses in the commercial paper market.

The lending facility suggested herein would work in a similar fashion to the CPFF. The Federal Reserve Bank of New York would lend to a mortgage servicer SPV, and the Treasury would agree to take an equity investment in the SPV. The amounts invested would depend on the exact liquidity needs at the time the facility is established. This SPV would then extend lines of credit directly to nonbank mortgage

[https://perma.cc/B3CR-TV6L] (defining “broad-based” within the understanding of “broad-based eligibility” within Section 13(3)).


121. A special purpose vehicle is a legal entity created by a company or organization with its own assets, liabilities, and legal status. What is a Special Purpose Vehicle (SPV)?, Corp. Fin. Inst., https://corporatefinanceinstitute.com/resources/knowledge/strategy/special-purpose-vehicle-spv/ [https://perma.cc/EUL2-NN3Q] (last visited Jan. 5, 2021).

122. Fed. Reserve Bd., supra note 120.

123. See id. (stating the business of the facility and how it will function).


125. See Kaul & Tozer, supra note 8 (suggesting liquidity facility along the lines of CPFF for government loan servicers).


127. See id. (explaining the mechanics of the CPFF); see also Kaul & Tozer, supra note 8, at 8 (suggesting liquidity facility along the lines of CPFF for government loan servicers and proposing that the Treasury take an equity position to absorb credit losses).
servicers of federally backed mortgage loans that qualify for forbearance under the CARES Act, subject to certain conditions.\textsuperscript{128} This facility would only be available for nonbank mortgage servicers, although bank mortgage servicers are also struggling.\textsuperscript{129} This facility should be enacted to prevent the collapse on the nonbank mortgage servicing industry because this industry lacks the liquidity safety nets available to bank mortgage servicers.\textsuperscript{130} This facility should be enacted to minimize the required resources and effectively triage the servicers most in need of liquidity.\textsuperscript{131} A liquidity facility must exist for nonbank mortgage servicers during economic crises to avoid straining the liquidity of the housing market, and this facility can be a template for solving this problem in the future.\textsuperscript{132} This facility will not run afoul of the Federal Reserve’s rule regarding “broad-based eligibility” as long as the facility is used for the purpose of preventing the collapse of the industry as a whole.\textsuperscript{133}

The CARES Act provides for funding for such a liquidity facility by creating a Treasury fund of $454 billion to be invested in Federal Reserve emergency facilities.\textsuperscript{134} The CARES Act provides that the funds, “shall be available to make loans and loan guarantees to . . . facilities established by the Board of Governors of the Federal Reserve System.”\textsuperscript{135} The purpose of these funds is to, “provide liquidity to the financial system that supports lending to eligible businesses, States, or municipalities.”\textsuperscript{136}

\textsuperscript{128} See Fed. Reserve Bd., supra note 120 (explaining function of special purpose vehicle in the CPFF); see also Kaul & Tozer, supra note 8, at 8 (suggesting banks extend lines of credit to be purchased by Ginnie Mae issuers).

\textsuperscript{129} See Platt, supra note 2 (discussing the suffering of all mortgage servicers under the forbearance).

\textsuperscript{130} See Light, supra note 97 (discussing nonbank mortgage lenders lack of federal assistance compared to banks and potential crisis looming).

\textsuperscript{131} See id. (discussing the difficulties of nonbank mortgage servicers in the current crisis); see also Platt, supra note 2 (discussing the suffering of mortgage servicers under the forbearance generally).

\textsuperscript{132} See Kaul & Tozer, supra note 8 (stating that a liquidity crisis is coming and can be addressed by establishing a liquidity facility).

\textsuperscript{133} See Press Release, Fed. Reserve Bd., supra note 118 (defining “broad-based” within the understanding of “broad-based eligibility” within Section 13(3)).


\textsuperscript{136} Id.
The Treasury is given further authority under the CARES Act to appropriate funds in the Exchange Stabilization Fund\textsuperscript{137} for the purposes of funding any emergency facilities established under the Act.\textsuperscript{138} As of July 2020, the Treasury reported that there was $482 billion left in the Exchange Stabilization Fund, and in September 2020, the Treasury pledged $195 billion to support emergency facilities established by the Federal Reserve.\textsuperscript{139}

However, when the Relief Act was signed into law, it permanently rescinded the “unobligated balances made available under Section 4027 of the CARES Act.”\textsuperscript{140} Additionally, the Relief Act amended the CARES Act, and starting after December 31, 2020, it prevents the Federal Reserve from funding any Section 13(3) facilities pursuant to Section 4003(b)(4) of the CARES Act.\textsuperscript{141} As a result, the contemplated facility will likely require additional legislation to be allocated funding; however, that is almost certainly a worthwhile goal.\textsuperscript{142} Because of the severe impact the failure of nonbank mortgage servicers would have on the broader economy, providing liquidity to these businesses is essential, and the CARES Act, at one point, provided funding for exactly this purpose.\textsuperscript{143}

In March 2020, the Mortgage Bankers Association (“MBA”) estimated that, if one-quarter of eligible borrowers chose to invoke the forbearance for six months, mortgage servicers would be required to

\textsuperscript{137} The Exchange Stabilization Fund is established under 31 U.S.C. § 5302(a)(1) for the purposes of “. . . investing in obligations of the United States Government . . .,” amounts in the fund that are not required to carry out the acts therein at the time they are passed, with the approval of the President. 31 U.S.C. § 5302(a)(1) (2018).

\textsuperscript{138} § 4027, 134 Stat. at 496–97.

\textsuperscript{139} See MARC LABONTE ET AL., HOW MUCH MONEY REMAINS UNDER TITLE IV OF THE CARES ACT? 1 (2020), https://crsreports.congress.gov/product/pdf/IN/IN11512#:~:text=As%20shown%20in%20Figure%201,to%20%241%2C950%20billion%20to%20recipients. [https://perma.cc/JRJ8-4JEH] (announcing funds remaining in the ESF and the Treasury’s plans going forward).

\textsuperscript{140} See Consolidated Appropriations Act of 2021, Pub. L. 116-260, § 1003(a)(1) (2020) (“[T]he unobligated balances made available under section 4027 of the CARES Act (15 U.S.C. 9061), $429,000,000,000 shall be permanently rescinded on the date of enactment of this Act.”).

\textsuperscript{141} See Consolidated Appropriations Act § 1005(c)(1) (“After December 31, 2020, the Board of Governors of the Federal Reserve System and the Federal Reserve banks shall not make any loan, purchase any obligation, asset, security, or other interest, or make any extension of credit through any program or facility established under section 13(3) of the Federal Reserve Act . . . in which the Secretary made a loan, loan guarantee, or other investment pursuant to section 4003(b)(4) . . .”).

\textsuperscript{142} See, e.g., Light, supra note 97 (discussing generally the potential risk posed to the financial system by nonbank mortgage servicers failures).

\textsuperscript{143} § 4003(b)(4), 134 Stat. at 470; see generally Sorohan, supra note 13.
advance upwards of $75 to $100 billion to investors. The number of mortgages in forbearance peaked on June 15, 2020, with 8.55% of mortgage loans in forbearance or approximately 4.3 million homeowners. This number has subsequently declined, reaching 5.38% or roughly 2.7 million homeowners by February 1, 2021. This falls short of the estimated one-quarter of homeowners used in projections by the MBA, and well within the financial scope of the Treasury’s funds allocated by the CARES Act for this purpose. However, simply because the COVID-19 crisis has not been as devastating as the initially projected figures, there is no reason to believe it will not be in the future. This should be seen as a near miss with tragedy, and a better reason to create some framework to support nonbank mortgage servicers in times of crisis.

B. Strengthen Existing Federal Oversight and Increase Regulatory Measures

The authority to oversee nonbank mortgage servicers currently lies with the Consumer Financial Protection Bureau (“CFPB”). The CFPB is responsible for supervising depository institutions with over $10 billion in assets and any affiliated companies, in addition to nonbank

144. Sorohan, supra note 13.
148. See Sorohan, supra note 13 (discussing the predicted figures of one-quarter of eligible borrowers invoking forbearance).
149. See id. (discussing the lack of structure to help nonbank mortgage servicers).
150. See Omnibus Appropriations Act of 2009 § 626(a), 12 U.S.C. § 5538(a) (2018) (“The Bureau of Consumer Financial Protection shall have the authority to prescribe rules with respect to mortgage loans . . . [and] enforce [those] rules . . . in the same manner, by the same means, and with the same jurisdiction, powers, and duties, as though all applicable terms and provisions of the Consumer Financial Protection Act of 2010 were incorporated into and made part of this subsection.”).
mortgage originators and servicers.\textsuperscript{151} CFPB oversight is supervisory in nature, and aimed at protecting consumers from “unfair or deceptive act or practices regarding mortgage loans.”\textsuperscript{152} The Government Accountability Office (“GAO”) stated that the CFPB lacked any means to create a list of nonbank mortgage servicers, and therefore, the CFPB does not have a full record of the companies under the scope of its regulation.\textsuperscript{153} The inability to identify the regulated nonbank mortgage servicers indicates a need for more comprehensive oversight of nonbank mortgage servicers under the CFPB.\textsuperscript{154} Moreover, the Conference of State Bank Supervisors (“CSBS”) proposed regulatory standards for nonbank mortgage servicers.\textsuperscript{155} These standards covered a broad range of topics, including capital and liquidity requirements.\textsuperscript{156} For larger nonbank mortgage servicers, CSBS has proposed a risk-weighted capital requirement.\textsuperscript{157} This new requirement, combined with proposed liquidity requirements, would help to limit the amount of risk that nonbank mortgage servicers can be subjected to and would insulate nonbank mortgage servicers from challenging economic situations.\textsuperscript{158} The crisis to mortgage servicers was not caused directly by the COVID-19 crisis.\textsuperscript{159} Rather, this crisis was caused when the CARES Act...
required mortgage servicers to shoulder the burden of ensuring the safety
and security of mortgagors, whose forbearance was unforeseeable,160
through legislation.161 Unlike the 2008 Financial Crisis, the current crisis
was not caused by large scale defaults in the mortgage market, but rather
a disruption of expected payments.162 The mortgage servicing industry
would not be in its current position but for the passage of the CARES
Act’s mortgage forbearance provision.163

The COVID-19 crisis was also a far greater threat than what was
contemplated in the increased stress testing scenarios, proposed by
Ginnie Mae, to be imposed on nonbank mortgage lenders.164 This
suggests that regulation alone would not have prevented this mortgage
servicer liquidity crisis if no lending facility exists to support the industry
in times of crisis.165 However, even if increased regulation could have
conceivably avoided the liquidity crisis that nonbank mortgage servicers
are facing, regulators did not take the necessary steps to implement
regulations in the lead up to the COVID-19 crisis.166

Therefore, as a condition of access to the liquidity facility, there
should be a mandatory assent to increased regulatory oversight of the
nonbank mortgage servicers that choose to take advantage of the
facility.167 However, the oversight must be greater than what the CFPB
currently provides because these institutions need regulations that will
promote soundness and limit the risk that they can pose to the
economy.168 Additionally, there should be an assent to increased capital
and liquidity standards, as contemplated by the CSBS, in order to ensure
that risk mitigation is a part of the regulatory solution.169 This will help

160. See id. (discussing how mortgage servicers are getting an unfair deal as a result of the
CARES Act legislation and mortgage forbearance).
the mortgage forbearance was the result of legislation in response to a crisis).
162. See Platt, supra note 2 (discussing how the mortgage forbearance disrupted payments
to mortgage servicers); see also Shoemaker, supra note 25, at 54 (stating that the financial
crisis was caused by large scale defaults on subprime loans).
163. § 4022, 134 Stat. at 490–91; see generally Platt, supra note 2.
164. See Light, supra note 97 (discussing generally Ginnie Mae’s proposed stress tests being less
severe than the COVID-19 crisis).
165. See id. (discussing Ginnie Mae’s proposed stress tests being less severe than the
COVID-19 crisis, and implicitly arguing that proposed regulations would not have prevented
the crisis).
166. See id. (highlighting regulatory inaction regarding nonbank mortgage servicers lack
of credit and liquidity in preparation for crisis).
167. See generally U.S. GOV’T ACCOUNTABILITY OFF., supra note 153.
168. See Light, supra note 97 (discussing the risk posed by nonbank mortgage servicers).
169. See generally CSBS 2015, supra note 156.
ensure that dangerous economic situations such as the COVID-19 pandemic and the 2008 Financial Crisis do not bring nonbank mortgage servicers to the brink of collapse every time they occur.\textsuperscript{170}

C. Responses to Criticisms and Potential Concerns

The primary criticism against establishing a liquidity facility for nonbank mortgage servicers contemplates the likelihood that nonbank mortgage servicers will evade the natural consequences of their own actions.\textsuperscript{171} No one anticipated the scope and scale of the COVID-19 crisis, but regulators were aware of the potential for a nonbank liquidity crisis.\textsuperscript{172} Nonbank mortgage servicers even lobbied against stricter regulations and “stress testing” requirements being placed on them, arguing that their rising participation in the mortgage market did not pose a risk to the broader financial system.\textsuperscript{173}

The housing industry is heavily reliant on nonbank mortgage servicers.\textsuperscript{174} The Secretary of the Treasury has announced the creation of a “task force” within the Financial Stability Oversight Council (“FSOC”) to monitor nonbank mortgage servicers as a potential systemic risk to the broader economy, however, there has not yet been a public report on their findings.\textsuperscript{175} Federally backed mortgages constitute approximately 70\% of all single family loans, a total of over 33 million loans.\textsuperscript{176} As of 2020,

\textsuperscript{170} See generally U.S. GOV’T ACCOUNTABILITY OFF., \textit{ supra} note 153.
\textsuperscript{171} See Light, \textit{ supra} note 97 (discussing the foreseeability and general criticism of “bailing out” nonbank mortgage servicers).
\textsuperscript{172} See id. (highlighting regulators’ awareness of the risk posed by nonbank mortgage servicers).
\textsuperscript{173} Stress tests are scenarios designed to analyze the impact of a given event on the financial health and liquidity of the tested entity or company. See Ginnie Mae, Request for Input: Stress Testing Framework 2, 5, 7–8, 27 (2019), \url{https://www.ginniemae.gov/newsroom/publications/Documents/ginniemae_rfi_stress_testing.pdf} (The Version 1 stress testing framework forecasts an issuer’s financial performance over the next eight quarters under a base and an adverse scenario . . . ).
\textsuperscript{174} See Light, \textit{ supra} note 97 (discussing how nonbank mortgage servicers lobbied against increased regulations for capital and liquidity requirements).
\textsuperscript{175} See KAUL & TOZER, \textit{ supra} note 8 (analyzing statistics regarding the scope of the mortgage forbearance provision); see also Shoemaker, \textit{ supra} note 25, at 54 (analyzing the prevalence of nonbank mortgage servicers post-financial crisis).
\textsuperscript{176} Jesse Westbrook, Mnuchin Forms Task Force to Confront Mortgage Firms’ Liquidity, BLOOMBERG (Mar. 26, 2020, 4:37 PM), \url{https://www.bloomberg.com/news/articles/2020-03-26/mnuchin-forms-task-force-to-confront-mortgage-firms-liquidity} (“The Version 1 stress testing framework forecasts an issuer’s financial performance over the next eight quarters under a base and an adverse scenario . . . ”).
\textsuperscript{177} KAUL & TOZER, \textit{ supra} note 8.
nonbank mortgage servicers held 53% of the agency servicing market, which is comprised of federally backed loans.\textsuperscript{178} Regardless of the culpability of nonbank mortgage servicers for the current crisis, with this large of a portion of the market share of mortgage servicing activities they cannot be allowed to fail in their current state or they could risk the instability of the entire housing market.\textsuperscript{179}

\textbf{V. Conclusion}

Ultimately, nonbank mortgage servicers are a substantial portion of the modern mortgage servicing market.\textsuperscript{180} The COVID-19 pandemic has had a profound and substantial negative impact on this industry.\textsuperscript{181} However, the mortgage servicing industry was unfairly burdened with the responsibility of shouldering the mortgage forbearance provision of the CARES Act, which they could not have reasonably anticipated.\textsuperscript{182} As a result of intentional legislation, nonbank mortgage servicers are facing a liquidity crisis that they are not equipped to deal with.\textsuperscript{183} Furthermore, their failure could potentially cause the entire market to collapse because of the substantial role nonbank mortgage servicers play in the housing market.\textsuperscript{184}

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\textsuperscript{178} See CSBS 2020, supra note 108 (discussing the statistics of nonbank mortgage servicers share of agency servicing in the market and the how the agency servicing market ties in with federally backed mortgage loans).
\textsuperscript{180} See CONFERENCE OF STATE BANK SUPERVISORS, supra note 9, at 34 (announcing statistics regarding substantial market share of nonbank mortgage servicers in the MSR & agency servicing market).
\textsuperscript{181} See Kaul & Goodman, supra note 1 (analyzing the allocation of the funds provided to offset the impact of the COVID-19 crisis on the economy); see also KAUL & TOZER, supra note 8.
\textsuperscript{183} See Platt, supra note 2 (discussing the legislative burden placed on mortgage servicers by the CARES Act).
\textsuperscript{184} See CONFERENCE OF STATE BANK SUPERVISORS, supra note 9, at 34 (highlighting the substantial market share of nonbank mortgage servicers); see also WADE, AM. ACTION FORUM, supra note 179, at 2–3 (highlighting concerns of a collapse of the housing market).
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Therefore, a mortgage servicing facility should be established because it would provide liquidity to nonbank mortgage servicers to help them survive the COVID-19 crisis. Nonbank mortgage servicers are in a worse position than bank mortgage servicers, who have safety nets to help them withstand this liquidity crisis. Although the contemplated facility will not directly benefit bank mortgage servicers, it is in the best interest of everyone involved to help nonbank mortgage servicers manage this liquidity shortage and avoid the fallout of allowing them to fail.

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185. See Platt, supra note 2 (discussing the unfair negative impact of the “CARES” Act mortgage forbearance provision on mortgage servicers).
186. See Light, supra note 97 (emphasizing nonbank mortgage lenders lack of federal “safety nets” compared to banks and potential crisis looming).
187. See Conference of State Bank Supervisors, supra note 9, at 34 (announcing statistics regarding substantial market share of nonbank mortgage servicers); see also Wade, Am. Action Forum, supra note 179, at 2–3 (arguing for relief for mortgage servicers to prevent systemic threat to the economy).

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