



THE CONFERENCE OF STATE BANK SUPERVISORS

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FINAL MODEL STATE REGULATORY PRUDENTIAL STANDARDS FOR NONBANK MORTGAGE SERVICERS 2021

Non-Depository Supervisory Committee

July 2021



Summary

On October 1, 2020, the Conference of State Bank Supervisors (CSBS), at the direction of the CSBS Board of Directors and under the auspices of the CSBS Non-Depository Supervisory Committee (NDSC), released a proposal for public consideration entitled *Proposed Regulatory Prudential Standards for Nonbank Mortgage Servicers* (“Proposal” or “Proposed Standards”). The Proposal was based on state regulators’ determination that a sound financial condition and safe management practices are essential to compliance and consumer protection. The Proposal sought to establish state regulator requirements and expectations not only for legal compliance but also for safe and sound operations.

Following the NDSC’s review of public comments and further consideration, including revisions to the Proposal, the CSBS Board issues these *Final Model State Regulatory Prudential Standards for Nonbank Mortgage Servicers* (“Final Model Standards”) as uniform state policy for the supervision of nonbank mortgage servicers meeting specific coverage requirements. As discussed herein, this policy is intended as a model for voluntary adoption by each state as deemed appropriate and necessary. Nothing in this policy establishes legal requirements, and the policy itself does not constitute law, regulation, official guidance, or interpretation of any state agency that has not taken affirmative action to incorporate these standards as such.

Issuance and Publication Dates – Implementation

CSBS issued its Proposal on October 1, 2020, with a public comment period running through December 31, 2020. The Final Model Standards were approved as uniform state policy on July 23, 2021.

As discussed under [CSBS Policy](#) (pg 14), the requirements contained in this policy are only effective through state implementation. State agencies may use this policy to formulate law, rule, guidance or procedure under their individual jurisdictional authority or legislative process.

Contact Information

Questions regarding CSBS policy, or the Final Model Standards may be submitted to Chuck Cross, CSBS Senior Vice President Nonbank Supervision and Enforcement at ccross@csbs.org. Additional or updated information may be found at <https://www.csbs.org/policy/research-data-tools/comments-prudential-standards-non-bank-mortgage-servicers>.

Summary of Final Rule

The Final Model Standards cover two major categories that comprise prudential standards: financial condition and corporate governance. To the extent practical, the Final Model Standards align with existing standards or leverage generally accepted business practices. These Final Model Standards represent model regulatory requirements for state-licensed nonbank

mortgage servicing firms that exceed the de minimis cutoff discussed under Coverage – Exceptions – Qualifiers (pg. 3). Details of the Final Model Standards can be found under the Section-by-Section Analysis (pg. 14). Codification of the requirements of the Final Model Standards can be found under Codification of Requirements for State Adoption – Model Law or Rule (pg. 24).

Coverage – Exceptions – Qualifiers

The nonbank mortgage servicing industry is diverse, ranging from small firms with straightforward operations to large, complex institutions and asset managers with multiple business lines. By employing a de minimis coverage trigger and existing standards or generally accepted business practices, the Final Model Standards minimize regulatory burden for small, less complex servicing firms while establishing uniformity and standardization for the industry.

In general, the Final Model Standards are intended for state licensed or supervised nonbank mortgage servicers and investors in mortgage servicing, with certain exclusions, exceptions and qualifiers identified below:

Coverage: These standards apply to nonbank mortgage servicers with portfolios of 2,000 or more 1 – 4-unit residential mortgage loans serviced or subserviced for others and operating in two or more states¹ as of the most recent calendar year end, reported in the Nationwide Multistate Licensing System (NMLS) Mortgage Call Report.² For purposes of determining coverage under these Final Model Standards, “residential mortgage loans serviced” excludes whole loans owned and loans being “interim” serviced prior to sale.

Applicability: The Final Model Standards apply to all nonbank mortgage servicers meeting the coverage requirements.

Exclusions:

- a) The financial condition requirements in these Final Model Standards do not apply to servicers solely owning and/or conducting reverse mortgage servicing or the reverse mortgage portfolio administered by forward mortgage servicers that may otherwise be covered under these standards. Although state regulators identify risk in this type of specialty servicing, the reverse servicing business model is unique, with different structures and control needs and therefore has been excluded from the financial requirements.
- b) These standards do not apply to not-for-profit mortgage servicers or housing finance

¹ Defined as Covered Institutions in the Model Law, see Codification of Requirements for State Adoption – Model Law or Rule – Sec. 100 Definitions (pg. 24).

² The NMLS Mortgage Call Report is a quarterly report of residential real estate loan origination, servicing and financial information completed by companies licensed in NMLS. For more information, visit the NMLS Resource Center, available at: <https://mortgage.nationwidelicensingsystem.org/slr/common/mcr/Pages/default.aspx>

agencies.

Exceptions:

- a) The capital and liquidity requirements of the Final Model Standards have limited application to entities that only perform subservicing for others.
- b) The capital and liquidity requirements of the Final Model Standards do not include the whole loan portion of portfolios in the calculations of those respective requirements.

Qualifiers:

- a) *Standards as Policy:* These Final Model Standards are established as CSBS policy and do not constitute law, regulation, official guidance or interpretation of any state agency that has not taken affirmative action to incorporate these Final Model Standards as such. State regulators and state legislatures are responsible for determining the applicability of these Final Model Standards under their respective jurisdictions. State regulators should consider these Final Model Standards models for statutory amendments or regulations under existing supervisory authority.
- b) *No Intent to Prohibit Coverage for Single State Servicers:* These model standards are not intended to limit or prohibit an individual state from determining that all or a portion of these standards are applicable to servicers not meeting the minimum coverage trigger. Such determinations are limited to single state jurisdiction and do not affect the uniformity of these standards as a national model.
- c) In some situations, a servicer may meet the coverage triggers while servicing negligible amounts of loans in a particular state. Determination of coverage in a low volume state can only be made by that individual state. The NDSC encourages commissioners to independently consider the impacts of added regulatory burden in situations where servicing volume is negligible. [Note: Sec. 500 of the Model Law (pg. 29) provides commissioner flexibility for unique circumstances.]
- d) *Mortgage Servicing Rights (MSR) Investors:* A MSR investor subject to licensing as a servicer in any state is considered a servicer.
- e) *Applicable to Licensed Entity:* These standards apply to the servicer or state licensed entity level within a holding company or affiliated group of companies.
- f) *Supervisory Authority Reserved:* The Final Model Standards as policy does not control or alter state authority to supervise nonbank mortgage servicers. State agencies exercise statutory authority to protect consumers and regulate industry and the local market. While this policy sets forth standards and controls intended to foster uniformity at the national level, CSBS and its state members respect and reserve each state's sovereign jurisdiction, authority, and responsibility.

Background

Nonbank mortgage servicers are an important segment of the financial services community. These institutions currently service 60% of the agency mortgage market³ and roughly 45% of the total \$11 trillion single-family residential mortgage market.⁴ As the institutions responsible for transmitting monthly borrower payments to investors or loan holders, mortgage servicers are an integral part of the mortgage market ecosystem.

A servicer is the company responsible for the administration of the loan beginning immediately after closing and continuing until the loan is paid off and the lender's security interest in the property is released or cancelled. A servicer is responsible for collecting borrower payments including principal, interest, taxes, and insurance, then remitting or forwarding those payments to investors, taxing authorities or insurance providers.⁵ If a borrower is delinquent on payments, the responsibility falls to the servicer to do everything it can to collect the payment and any late fees or penalties authorized under the original loan contract. Servicers are responsible for managing loss mitigation and borrower forbearance of payments and initiating foreclosure proceedings when a borrower reaches a certain stage of delinquency.⁶ Servicers also manage a variety of administrative responsibilities including accounting, record keeping, investor reporting and advancing unpaid amounts to investors, taxing authorities and insurance providers.

Without servicing, the mortgage market in the United States as currently structured would cease to function. Servicers occupy the space between the consumer and the loan holder or investor. This creates an obligation to both parties of the transaction, making servicers simultaneously responsible for efficiently servicing the market and protecting consumers.

The role of a servicer is controlled by borrower protections established by law on the side of the consumer and by contract and investor protections on the side of the beneficial owner of the mortgage-backed security (MBS). Between these two legal anchors, management is responsible for operating the institution in a safe and sound manner. The core of these standards is focused on that responsibility.

Nonbank entities that specialize in loan servicing have grown dramatically in size, complexity, and importance in the post-financial crisis mortgage market. Nonbank mortgage servicers and

³ The "Agency" mortgage market includes mortgage loans purchased or securitized by Fannie Mae or Freddie Mac (also known as Government Sponsored Enterprises, or GSEs) and loans made, insured or guaranteed by the U.S. Departments of Housing and Urban Development, Veterans Affairs or Agriculture (together known as Ginnie Mae guaranty mortgage loans).

⁴ All loans, Agency plus privately made mortgage loans.

⁵ Note that servicers hold tax and insurance payments in escrow for borrowers for months until payment is due, creating additional responsibilities for holding and accounting for other people's money.

⁶ The Covid-19 pandemic resulted in the CARES Act, federal legislation that enabled greater use of payment forbearance provisions while temporarily changing the reporting of delinquencies and placing moratoriums on foreclosures. These prudential standards, while originally proposed during the pandemic, were not developed to address the pandemic or the CARES Act provisions.

asset managers acquired massive portfolios of mortgage servicing rights after 2011, many of which initially consisted of delinquent loans that required specialized skill in high-touch servicing. As the volume of delinquent loans sold by depositories following the crisis trailed off and more loans resolved, this market niche consolidated, and the trading of MSRs evolved to focus on newer production and servicing of GSE and government-backed loans often in Agency-sponsored MBS.

Changes in the mortgage market and nonbank servicer rapid growth have highlighted the critical services these institutions provide to homeowners, investors, and other market participants. A more detailed discussion of the nonbank mortgage origination and servicing markets, including a description of servicer business model and risk can be found in the CSBS white paper series entitled *Reengineering Nonbank Supervision*, found at www.CSBS.org.

Nonbank Mortgage Servicing Administration

Mortgage loan servicing is a critical component of the broader housing finance system. Loan administration by nonbank mortgage servicing companies include the following responsibilities and servicing functions:

- Calculating, collecting, recording and remitting a mortgage loan borrower's principal, interest, taxes, insurance or other payments
- Maintaining accurate account records and customer billing statements.
- Managing mortgage escrow accounts (taxes, insurance, etc.)
- Providing accurate investor reporting
- Collecting and managing insurance claims
- Distributing, tracking, and financing servicing advances
- Managing delinquent and defaulted mortgage loans, as well as those in bankruptcy proceedings
- Assessing loans for modification and other loss mitigation activities
- Overseeing foreclosure proceedings
- Managing real estate owned (REO) following foreclosure
- Maintaining accurate and reliable cash management systems
- Maintaining adequate technology, information systems and data security
- Vendor oversight
- Regulatory compliance, internal audit and quality control

Nonbank mortgage servicing companies perform these functions on behalf of mortgage loan owners and guarantors, be they financial institutions, private investors, Ginnie Mae, Fannie Mae or Freddie Mac. Nonbank servicers earn contractually established fee income, typically based on the unpaid principal balance (UPB) of the loans serviced. Nonbank mortgage servicers

may also have additional business lines, such as loan origination and warehouse lending.⁷

Summary of Process and Review of Comments

CSBS issued the Proposal on October 1, 2020, with a public comment period running through December 31, 2020. Seventeen comments were received in writing or through a requested comment meeting directly with CSBS staff. Subsequent interviews with some commenters provided further clarification in finalizing the proposal. These comments can be found at <https://www.csbs.org/policy/research-data-tools/comments-prudential-standards-non-bank-mortgage-servicers>.

The NDSC considered all comments and made determinations to accept, reject or seek compromise, on each issue raised. A summary of the most relevant comments and the NDSC's determination can be found below.

Summary of Comments

Comment: *Insufficient risk established by CSBS; No established need; Lack of authority; Sufficient regulatory supervision at the federal level.*

Various industry commenters provided arguments that insufficient risk exists in today's market to warrant state prudential standards and that no clear need for the standards has been established. Some commenters were concerned that CSBS lacked authority to develop policy or that state regulators lacked authority to establish prudential requirements for nonbank mortgage servicers.

NDSC Determination

State regulators, through CSBS, have monitored nonbank mortgage servicers since 2011. This monitoring resulted in observations and concerns of rapid market share growth, nonbank institution size and the financial stability and adequate governance of nonbank mortgage servicers. These observations and concerns occurred at the same time state regulators began identifying new problems with nonbank mortgage servicers, some of which would only resolve through enforcement actions.

Rapid industry growth means nonbank mortgage servicers are responsible for a greater share of consumer care and protection. Sound financial condition and safe management practices are essential to performing compliance and consumer protection obligations, yet many nonbank mortgage servicers are historically thinly capitalized with insufficient nonborrowed liquid capacity. Additionally, state, and federal regulators have identified through examinations significant failings at the institutional level in corporate governance and board oversight. State

⁷ See [CSBS.org, White Paper – Reengineering Nonbank Supervision, Chapter Three – Mortgage](https://www.csbs.org/white-paper-reengineering-nonbank-supervision).

examinations include findings of documentation problems leading to wrongful foreclosures, accounting problems leading to unreconciled escrow accounts, lost or misappropriated consumer funds or incorrectly assessed fees. Further, when a servicer fails, loan transfers to a stable servicer are not a simple undertaking. In a best-case scenario, transactions may be suspended as loans are boarded and issues are sorted through. In a worst-case scenario, documents are lost, funds are misapplied or misplaced, interrupted payments cause derogatory reports on consumer's records, or other consumer harm results.

The state system is charged through individual statute with establishing effective corporate controls and consumer-focused responsibilities for nonbank mortgage servicers. Such controls and responsibilities are only effective when enforceable by the primary regulators. A national set of standards, covering both agency and non-agency servicing, is the most effective format for entities operating in multiple jurisdictions and present less regulatory burden than unique state requirements.

Fannie Mae and Freddie Mac are publicly traded corporations under the conservatorship of their regulator, the Federal Housing Finance Agency (FHFA). FHFA has regulatory authority over Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System, but it does not have direct regulatory authority over nonbank mortgage lenders and servicers. FHFA is responsible for ensuring that Fannie Mae and Freddie Mac operate in a safe and sound manner through prudential supervision and regulation. Bank and nonbank institutions desiring to make and/or service Fannie Mae or Freddie Mac loans must comply with the program standards implemented by the GSEs under FHFA regulations or requirements and associated bulletins or guidelines. However, the requirements or guidelines established as a condition of participation in their seller/servicer programs are not regulations per se.⁸

Ginnie Mae is a government-owned corporation within the U.S. Department of Housing and Urban Development that guarantees mortgage-backed securities backed by federally insured or guaranteed loans. Like the GSEs, Ginnie Mae does not directly regulate nonbank mortgage servicers, and the requirements established by Ginnie Mae for mortgage servicers are a condition of participation in Ginnie Mae servicing programs, not regulations per se.

The Consumer Financial Protection Bureau (CFPB) is a regulator of nonbank mortgage servicers. However, the CFPB enforces consumer compliance and protection but has not established regulatory requirements or standards pertaining to the financial condition of nonbank mortgage servicers.

State financial regulators are the only comprehensive regulators for nonbank mortgage servicers, meaning they are the only regulators with authority to license, as well as examine, investigate, and enforce compliance with consumer protection regulations, as well as financial condition and corporate governance requirements. As such, state regulators are the "primary"

⁸ "No existing regulations expressly govern counterparty contracting or third-party relationship risk management ..."
https://www.fhfaog.gov/sites/default/files/AUD%202012-001_0.pdf

and “prudential” regulator of nonbank mortgage servicers.

Comment: *Alignment with federal agencies is paramount*

Commenters stressed that alignment with existing federal requirements will present the least amount of regulatory burden. In certain areas, however, commenters requested that the Final Model Standards not align with existing federal requirements; for example, the federal prohibition on using credit lines to satisfy liquidity and the use of a non-performing loan incremental add on to bolster liquidity.

NDSC Determination

As discussed below in the Section-by-Section Analysis (pg. 14), state regulators have aligned supervisory approaches with existing standards and requirements wherever practical. However, perfect alignment with the federal program requirements is not possible due to inconsistencies in authorities, jurisdiction and implementation of program requirements across the agencies. FHFA has established eligibility requirements for enterprise single-family seller/servicers that are applicable to nonbank servicers participating in the servicing of loans sold to Fannie Mae or Freddie Mac, but even here, Fannie Mae and Freddie Mac implement these requirements differently. Ginnie Mae has established requirements for the servicing of loans in Ginnie Mae-guaranteed MBS (FHA, VA, USDA and public and Indian housing loans); however, these requirements are not applicable to Fannie Mae and Freddie Mac loans and vice versa, even though the various requirements apply to the same servicers administering responsibilities under all three program areas.

Further, each of the government agencies subjectively interprets the requirements with individual servicers.⁹ Even if aligned perfectly with one of the federal standards (e.g., FHFA through Fannie Mae), these standards would be misaligned with the other standards (i.e., Ginnie Mae or FHFA through Freddie Mac). This subjective environment is compounded by the routine practice of each agency providing requirement waivers to individual servicers.

State regulators acknowledge that although alignment is imperfect, establishing an entirely new set of standards would increase industry burden without an equivalent gain in consumer protection. To lessen regulatory burden and foster consistency across government agencies, the financial condition requirements in these standards align with the capital and liquidity requirements under the FHFA eligibility requirements, except for state requirements for operating liquidity. As such, all servicers must at a minimum adhere to the capital and liquidity requirements established by FHFA for the servicer’s entire servicing portfolio of owned MSRs, unless otherwise exempted. Model Law Sec. 300 – Financial Condition (pg. 26) deems

⁹ For example, in determining net worth for the calculation of required capital, Freddie Mac adjusts capital by subtracting “affiliated receivables” and “pledged assets net of associated liabilities,” whereas Fannie Mae only does so “If elected by Fannie Mae based on our assessment of associated risk.”

compliance with the FHFA eligibility requirements, when applied to the servicer's entire portfolio, to comply with the financial condition requirements. Therefore, a modification of FHFA's requirements for capital and liquidity automatically amends the financial condition requirements of these standards. In general, Ginnie Mae's financial condition requirements are more restrictive than FHFA's, making the FHFA eligibility requirements a floor for these standards.

The NDSC has further determined that where federal requirements already exist in the form of regulations that are applicable to nonbank mortgage servicers and enforceable by state regulators, it is duplicative to include these requirements in the Final Model Standards. Therefore, the following sections originally included in the proposal have been eliminated from the Final Model Standards:

- Data Standards – covered under Regulation X §1024.38
- Data Protection, including cyber risk – covered under the FTC Safeguards Rule
- Servicing Transfer Requirements – covered under Regulation X and CFPB Bulletins

Comment: *Institution coverage should have a de minimis cutoff*

Some commenters felt that applying the standards to very small institutions was not warranted due to lower levels of market risk. Other commenters felt that applying subjective enhanced requirements to institutions with servicing portfolios of \$100 billion or more unfairly burdened these very large servicers.

NDSC Determination

As discussed under Coverage – Exclusions – Qualifiers (pg. 3), the Final Model Standards contain a de minimis cutoff or coverage trigger that applies to servicers with portfolios of 2,000 or more 1 – 4-unit residential mortgage loans serviced or subserviced for others, excluding whole loans owned and loans being “interim” serviced prior to sale, and operating in two or more states, as of the most recent calendar year end, reported in the NMLS Mortgage Call Report.

In some situations, a servicer may meet the coverage triggers while having negligible amounts of loans serviced in a particular state. For example, a servicer operates in two states with servicing volume of 10,000 loans in one state but only 20 loans in the other state. While the servicer meets both triggers for coverage under these standards, the volume in the second state may be insufficient to warrant the application of national level standards and accompanying examination requirements in that state. Determination of coverage in the low volume state can only be made by that individual state. While the burden of licensing and examination is applicable in the higher volume state, it may be inapplicable and overly burdensome for both the company and regulator in the low volume state. The NDSC encourages commissioners to independently consider the impacts of added regulatory burden

in situations where servicing volume is negligible for their state. [Note: Sec. 500 of the Model Law (pg. 29) provides commissioner flexibility for unique circumstances.]

Additionally, the Final Model Standards eliminate the complex servicer determination and replace the enhanced prudential standards and heightened supervisory expectations section with Sec. 500 – Authority (pg. 29). While still subjective in nature based on identified risk, the subjectivity tracks well with existing legal authority in most states.

Comment: *Financial condition concerns, primarily liquidity requirements and the prohibited use of lines of credit for funding servicing administration requirements*

Several commenters felt that the standards should not align with FHFA’s non-performing loan incremental add on to liquidity or FHFA’s (through Fannie Mae¹⁰ and Freddie Mac¹¹) and Ginnie Mae’s prohibition on funding liquidity needs through credit lines. Commenters argued that the incremental add on created an unreasonable pro-cyclical situation for institutions and that credit lines are a durable, stable source of liquidity, as reflected throughout 2020.

Some commenters felt that a modification of FHFA’s eligibility requirements for financial condition, whether moving towards greater or lesser restrictions, should automatically be followed by these standards.

NDSC Determination

In determining where best to align these standards, state regulators focused closely on liquidity requirements, an area of balance and controversy for regulators/agencies and the industry. This focus included:

- The industry practice of providing or supplementing servicing liquidity through lines of credit.
- The structure of contractual advancing obligations unique to each servicer that has a significant impact on liquidity.
- The pro-cyclical nature of FHFA’s liquidity requirement in the form of an incremental non-performing loan charge.

With each of the above issues, these Final Model Standards reflect a specific supervisory position, qualified as follows:

- *Servicing liquidity provided through committed lines of credit:* The Final Model Standards align with federal Agency requirements, which disallow this source of servicing liquidity. State regulators take the position that such lines, even if committed, are neither stable

¹⁰ <https://singlefamily.fanniemae.com/media/24621/display>

¹¹ <https://singlefamily.fanniemae.com/media/24621/display>

nor durable sources of funds when needed the most, either during an adverse economic event or with an individual servicer's seriously deteriorated financial position. The industry argued that the Covid-19 pandemic disproves this concern, as lines were stable throughout the crisis period. However, offsetting the crisis destabilization was the anomaly of one of the most prosperous periods in history for nonbank mortgage institutions creating stability for the industry amidst the pandemic, and the NDSC remained unconvinced in the stable and durable arguments.

- *Contractual advancing obligations controlling the amount and duration of servicer payment obligations to investors (e.g., actual/actual versus scheduled/actual or schedule/schedule obligations)*¹²: Although state regulators understand the significant pro and con effect these arrangements have on individual servicer liquidity, the Final Model Standards align with the federal agency requirements by not including this potential timing impact as a mitigating factor in the liquidity requirements. This decision is made largely due to the difficulty in identifying and monitoring each individual servicer's advancing obligation structure across their portfolio. However, state regulators may consider these contractual structures when examining servicer financial condition, especially when considering the overall impact on safety and soundness and risk management.
- *Pro-cyclical nature of FHFA's non-performing loan charge*: The non-performing loan charge effectively requires servicers to hold more liquidity as the rate of delinquency in their portfolio increases. Many argue that the result is pro-cyclical or has the effect of requiring more liquidity when the servicer is least able to do so (i.e., at times when revenues may be falling, and servicing costs are rising). State regulators agree with this conclusion; however, the Final Model Standards are intentionally aligned with FHFA's eligibility requirements for consistency across government agencies, versus taking a counter-cyclical approach of requiring servicers to build liquidity reserves when performance is on a more positive path with increasing revenues and profitability. Model Law Sec. 500 – Authority (pg. 29) is intended to provide commissioners with flexibility and authority where economic, environmental, or societal events are of such severity to warrant a temporary suspension of all or certain sections of these standards.

With each of these liquidity scenarios, state regulators are aligned with their federal counterparts and intend to stay in close communication with the Agencies and remain receptive to amendment when and if a change in requirements is deemed appropriate. Through alignment, where possible, state regulators are committed to the greatest consumer protection at the lowest regulatory burden.

¹² These contractual designations refer to the point in time at which payments either received or scheduled must be remitted to the investor.

Comment: Corporate Governance and Risk Management Concerns

Some commenters expressed concern with the proposal addressing certain corporate governance requirements and risk management controls. For example, commenters expressed a desire that servicers not be required to establish a formal board of directors, that an independent external audit requirement presented too much burden for servicers, and that change of control requirements should align with NMLS requirements to avoid potentially conflicting standards.

NDSC Determination

Corporate governance refers to the structure of the institution and how it is managed. It includes the corporate rules, and the practices and processes used to oversee and manage the institution. Corporate governance dictates how its board of directors and management balance responsibilities to shareholders, the public, regulators, and its own employees. Corporate governance includes risk management controls determined to be essential to servicer operations. However, the NDSC agreed with commenters in certain areas of corporate governance.

Specifically, the Final Model Standards have been amended from the Proposal to allow alternatives to the required board of directors and to eliminate the change of control requirements, as this latter area will be controlled by NMLS requirements for all licensed entities.

All amendments to corporate governance can be found under the [Section-by-Section Analysis](#) (pg. 14).

Comment: Implementation concerns related to uniformity and timing

Some commenters expressed concern that standards should only be implemented in a uniform manner at a time when all states are willing and able to adopt new legislation. Other commenters expressed concern that standards be implemented over at least 12 months or more.

NDSC Determination

Implementation is effective through individual state action. The Final Model Standards should not and cannot control the ability or timing for state adoption. The NDSC intends to work through CSBS membership to encourage uniform adoption of the Final Model Standards wherever possible; however, effective adoption may come in multiple forms including legislation, regulation, guidance, interpretation, examination standards or individual enforcement action with specific servicers.

CSBS Policy

The Final Model Standards are established as CSBS policy and do not constitute law, regulation, official guidance or interpretation of any state agency that has not taken affirmative action to incorporate the standards as such. State regulators and state legislatures are responsible for determining the applicability of the Final Model Standards under their respective jurisdictions. CSBS encourages state regulators to consider the Final Model Standards as a model for statutory amendments where possible, as regulations where statutory authority already exists, or other adoption in situations where an agency possesses sufficient supervisory flexibility to address issues of elevated risk or potential consumer harm (e.g., guidance, interpretation, examination procedure).

Section-by-Section Analysis

General

The 2020 Proposed Standards were published in two main sections:

- 1) Baseline prudential standards applicable to all nonbank mortgage services.
- 2) Enhanced prudential standards and heightened supervisory expectations applicable to those servicers identified as complex servicers.

The Final Model Standards convert the baseline prudential standards applicable to all nonbank mortgage servicers to model standards applicable to any nonbank mortgage servicer meeting the coverage requirements in [Sec. 200 – Applicability – Exclusions](#) (pg. 26).

Amendments and Eliminations from the Proposed Standards

The NDSC has made substantive amendments and eliminations from the Proposal to the Final Model Standards as discussed below.

The Proposed Standards included requirements for:

- Capital
- Liquidity
- Risk Management Standards
- Data Standards
- Data Protection, including Cyber Risk
- Corporate Governance
- Servicing Transfer Requirements

- Change of Ownership and Control Requirements
- Stress Testing
- Living Wills and Recovery and Resolution Plans

The Final Model Standards include general modifications to the Proposed Standards as follows:

- The Final Model Standards are now grouped into two major categories: financial condition and corporate governance.
- Corporate governance includes separate categories for:
 - Board of directors (now allows for a “similar body” where appropriate)
 - Internal audit
 - External audit
 - Risk management
- Eliminated from the Final Model Standards are:
 - Corporate governance (eliminated as a sub supervisory section; amended to a major category of the Final Model Standards)
 - Data standards
 - Data protection, including cyber risk
 - Servicing transfer requirements
 - Change of ownership and control requirements (removal allows for NMLS consistency)
 - Enhanced prudential standards and heightened supervisory expectations, including the following supervisory areas related to the Enhanced Prudential Standards:
 - Complex Servicer
 - Capital
 - Liquidity
 - Stress testing
 - Living Wills and Recovery and Resolution Plans

The Final Model Standards include two major categories of supervision: financial condition and corporate governance. Essentially, corporate governance is comprised of all aspects of directing and managing a company, including the financial requirements, however, due to the importance of financial condition to safe and sound servicer operations, it is reflected as a standalone category. Together, financial condition and corporate governance constitute the Final Model State Regulatory Prudential Standards for Nonbank Mortgage Servicers.

There are six sub supervisory areas covered under the two major categories:

Financial Condition

Capital
Liquidity

Corporate Governance

Board of Directors
Internal Audit
External Audit

Risk Management

Requirements

The Final Model Standards contain “requirements” or standards for compliance. Each requirement is codified into model language for uniform adoption by individual states. See Codification of Requirements for State Adoption – Model Law or Rule (pg. 24). As stated above, the requirements in this model set of standards constitute policy and do not impose any immediate requirement on nonbank mortgage servicers.

Applicability – Exclusions

The Final Model Law or Rule applies to any servicer defined as a covered institution. Coverage or applicability is intended to apply at the servicer or licensed entity level rather than to other corporate entities of or within a family of companies (e.g., a holding company or affiliate of the servicer).

Specific exclusions from coverage include not-for-profit mortgage servicers or government housing finance agencies. The financial condition requirements do not apply to servicers solely owning and/or conducting reverse mortgage servicing, or the reverse mortgage portfolio administered by forward mortgage servicers otherwise covered.

Financial condition requirements for subservicers are limited under the FHFA eligibility requirements due to the lack of owned servicing. For example, net worth add-on and liquidity requirements apply only to UPB of servicing owned, thereby limiting the financial requirements for subservicers, and servicers who own MSRs and also subservice for others. However, the base capital and operating liquidity requirements as well as the corporate governance requirements apply to subservicers.

Financial Condition

Under financial condition, the supervisory areas of capital and liquidity, align with FHFA’s eligibility requirements. However, the capital and liquidity requirements of the Final Model Standards apply FHFA’s requirements to a broader set of servicing by including non-agency servicing (in other words, applicable to all servicing unless otherwise specified).

Generally Accepted Accounting Principles (GAAP): All financial data necessary for compliance with the financial condition requirements must be determined in accordance with GAAP.

Capital and Servicing Liquidity

The Final Model Standards for capital are based on FHFA eligibility requirements for enterprise single family seller/servicers¹³ and currently require the following:

Tangible net worth: Total equity less receivables due from related entities less goodwill and other intangibles¹⁴ less pledged assets.

Minimum capital:

- Minimum net worth of \$2.5 million.
- Tangible net worth divided by total assets \geq 6%.

For nonbank owners of MSR, there is an additional net worth requirement of 25 basis points of UPB for total loans serviced, excluding reverse mortgage servicing, subservicing for others, and “interim”¹⁵ servicing.

Special note: In practice, the minimum capital ratio is calculated based on a GAAP as well as a non-GAAP basis, the latter reflecting allowable, documented GSE removals for assets and liabilities associated with items such as reverse mortgages, subservicing contracts, rights to MSR, seriously delinquent loans in Ginnie Mae MBS and optional early buyout balances and securitized loan balances where only a residual interest is owned.

Liquidity

The following important terms are applicable to the liquidity standards:

- *Servicing liquidity*¹⁶ or *liquidity:* The financial resources necessary to manage liquidity risk arising from servicing functions required in acquiring and financing MSR, hedging costs (including margin calls) associated with the MSR asset and applicable financing facilities, and advances or costs of advance financing for principal, interest, taxes, insurance, and any other servicing related advances.
- *Operating liquidity:* The funds necessary to perform normal business operations, such as payment of rent, salaries, interest expense and other typical expenses associated with operating the entity. Consideration for operating liquidity must include an

¹³ <https://www.fhfa.gov/PolicyProgramsResearch/Policy/Documents/2015-FAQs.pdf>

¹⁴ For purposes of this calculation, other intangibles exclude the value of MSR whether pledged to secure financing or not.

¹⁵ “Interim” means the period of time in which an originator is responsible for servicing the loan prior to sale of the loan and the associated MSR.

¹⁶ State regulators refer to servicing liquidity to differentiate this type of liquidity from operating liquidity. FHFA draws no distinction between servicing liquidity and operating liquidity. Therefore, the terms servicing liquidity and liquidity have the same meaning. At times, these standards use the term servicing liquidity to draw a clear distinction from operating liquidity.

understanding of increases in operating needs due to changing economic climate or other stresses impacting servicer operations.

- *Allowable assets for liquidity:* Assets that may be used to satisfy the liquidity requirements include unrestricted cash and cash equivalents and unencumbered investment grade assets held for sale or trade (agency MBS, obligations of GSEs, U.S. Treasury obligations).

Consistent with FHFA, state regulators limit the allowable financial resources that may be used to satisfy liquidity requirements to high quality liquid assets. State regulators also recognize that servicer advancing obligations differ by investor, which could have a significant impact on required resources to meet those advancing obligations. While not a formal component of the liquidity calculations, differences in advancing obligations at individual servicers may be evaluated and taken into consideration by state regulators as part of the overall financial condition review.

Special note: Consistent with Fannie Mae, Freddie Mac and Ginnie Mae, allowable sources of liquidity shall not include unused/available portions of committed servicing advance lines of credit or other unused/available portions of credit lines such as normal operating business lines.¹⁷

Minimum Servicing Liquidity Requirements

State regulators base the minimum servicing liquidity requirement on the current eligibility requirements established by FHFA¹⁸ but apply these calculations to the total owned servicing portfolio. Currently, the base servicing liquidity requirement is set at 3.5 basis point of total servicing UPB, excluding subservicing for others and reverse mortgage servicing.

Servicing loans in forbearance, delinquency or foreclosure imposes additional costs on servicers and thus requires additional financial resources to cover these costs. Accordingly, the Final Model Standards align with FHFA's current eligibility requirements for enterprise single family seller/servicers, which includes an incremental non-performing loan (NPL)¹⁹ charge to enhance the sensitivity of liquidity requirements to portfolio performance. Due to the incremental nature of the charge, as the volume of NPLs increase, so too do the servicer's liquidity requirements.

The current incremental NPL Charge required by FHFA is 200 basis points charged on NPLs greater than 6.0% of total servicing UPB, excluding Subservicing for others and reverse

¹⁷ As announced by Fannie Mae and Freddie Mac at the direction of FHFA. The respective announcements can be found at the following links:

<https://singlefamily.fanniemae.com/news-events/announcement-svc-2020-08-servicing-guide-update> and <https://guide.freddiemac.com/app/guide/bulletin/2020-48>

¹⁸ <https://www.fhfa.gov/PolicyProgramsResearch/Policy/Documents/2015-FAQs.pdf>.

¹⁹ Loans 90+ days delinquent and in foreclosure.

mortgage servicing.

As discussed under Summary of Process and Review of Comments (pg. 7), the NPL charge effectively requires servicers to hold more liquidity as the rate of delinquency in their portfolio increases. Many argue that the result is pro-cyclical or has the effect of requiring more liquidity when the servicer is least able to do so (i.e., at times when revenues may be falling, and servicing costs are rising). The NDSC agrees with this observation; however, the Final Model Standards are intentionally aligned with FHFA's current requirements for consistency across government agencies, versus taking a counter-cyclical approach of requiring servicers to build liquidity reserves when performance is on a more positive path with increasing revenues and profitability. Again, the NDSC has determined that alignment with the federal agencies is the most appropriate course of action at this time, however, the NDSC intends to continue close engagement with the federal agencies and remains receptive to amendment when and if a change in requirements is deemed appropriate.

The Final Model Standards require that management maintain written policies and procedures implementing the minimum servicing liquidity requirements. Such policies and procedures must include a sustainable written methodology for satisfying the servicing liquidity requirements. Written policies and procedures memorialize management's attention to this crucial responsibility and provide reference points for state examiners in reviewing servicer compliance.

Requirements for Maintaining Appropriate Levels of Operating Liquidity

Operating liquidity are the funds necessary to perform normal business operations beyond the servicing liquidity requirements. All servicers must maintain sufficient Allowable Assets for Operating Liquidity in addition to the amounts required for minimum servicing liquidity to cover normal or non-servicing related operating expenses and general business risk (as described above). All servicers must have in place sound cash management and business operating plans that match the size and sophistication of the institution to ensure normal business operations. Management must develop, establish, and implement plans, policies, and procedures for maintaining operating liquidity sufficient for the ongoing needs of the institution. Such plans, policies and procedures must contain sustainable, written methodologies for maintaining sufficient operating liquidity.

Written methodologies should at a minimum include the following factors:

- Servicer business model
- Composition of portfolio
- Allowable Assets for Liquidity
- Average monthly operating expense need

- Excess funds after coverage of monthly servicing expenses available to cover operating expenses

Corporate Governance

Corporate governance refers to the structure of the institution and how it is managed. It includes the corporate rules, and the practices and processes used to oversee and manage the institution. Corporate governance dictates how its board of directors and management balance responsibilities to shareholders, the public, regulators, and its own employees.

Board of Directors

The board of directors is responsible for establishing a sound corporate governance framework to protect the financial, reputational, cultural and strategic interests of the institution and the institution's stakeholders and set minimum standards of acceptable behavior for employees. The board of directors must also establish an appropriate set of internal controls, as well as a method for independently validating the accuracy and reliability of the financial and servicing information of the institution. Accurate and reliable information is necessary to monitor compliance with prudential standards, evaluate emerging risks and file an accurate Mortgage Call Report.

Special Note: Filing an accurate and timely Mortgage Call Report is an existing requirement of state law that is fundamental to state regulators' ability to determine compliance with these standards.

Institutions must establish a formal board of directors responsible for ensuring the responsibilities in the Final Model Standards. For institutions that are not approved to service loans by Fannie Mae, Freddie Mac or Ginnie Mae or where these federal agencies have granted approval for a board alternative, an institution may establish a similar body (referred to in these standards as the board of directors) constituted to exercise oversight and fulfill the responsibilities below. The board of directors is responsible for:

- Establishing a written corporate governance framework, including appropriate internal controls designed to monitor corporate governance and assess compliance with the framework.
- Monitoring and ensuring institution compliance with the corporate governance framework and the Final Model Standards.
- Accurate and timely regulatory reporting, including the Mortgage Call Report.

Internal Audit

Internal audit is an independent assessment and evaluation of the institution's internal controls, including financial condition controls and requirements and management responsibilities in performing sound risk management and corporate governance. The internal audit should ensure institution compliance, accurate financial controls, and reporting, and assist in maintaining effective and efficient institution operations. The internal audit identifies problems and recommends corrective action to senior management and the board of directors.

The board must establish internal audit requirements that are appropriate for the size and complexity and risk profile of the servicer, with appropriate independence to provide a reliable evaluation of the servicer's internal control structure, risk management and governance.

External Audit

Audited financial statements by an independent public accountant provide a transparent third-party evaluation of the reliability and accuracy of management's presentation of a company's financial position and results of operations and highlight potential areas of risk. This not only provides reliable data for calculation of the financial requirements in the Final Model Standards but also provides independent evidence of the financial adequacy of the servicer.

For external audit and financial reporting, certain Ginnie Mae reporting requirements will be used to meet the external audit standards.²⁰ The requirements include audited financial statements and audit reports conducted by an independent public accountant including:

- Annual financial statements that must include a balance sheet, statement of operations [income statement] and cash flows, including notes and supplemental schedules and be prepared in accordance with GAAP.
- Assessment of the internal control structure.
- Computation of tangible net worth.
- Validation of MSR valuation and reserve methodology, if applicable.
- Verification of adequate fidelity and errors and omissions insurance.
- Testing of controls related to risk management activities, including compliance and stress testing, where applicable.

²⁰ "MBS Guide. Chapter 3: Eligibility Requirements – Maintaining Ginnie Mae Issuer Status." Ginnie Mae, October 2014. Available at: http://www.ginniemae.gov/doing_business_with_ginniemae/issuer_resources/MBSGuideLib/Chapter_03.pdf.

Risk Management

Nonbank mortgage servicers face multiple risks which need to be appropriately managed through a variety of market and economic cycles. The ability of the servicer to internally measure, monitor and mitigate risks inherent to servicing is a prudent business practice and will help increase the servicer's financial strength.

Risk Management Program

All servicers must establish a risk management program under the oversight of the board of directors that identifies, measures, monitors, and controls risk sufficient for the level of sophistication of the servicer. The risk management program must have appropriate processes and models in place to measure, monitor and mitigate financial risks and changes to the risk profile of the servicer and assets being serviced. The risk management program must be scaled to the complexity of the organization, but be sufficiently robust to manage risks in several areas,²¹ including, but not limited to:

- *Credit risk*: The potential that a borrower or counterparty will fail to perform on an obligation.
- *Liquidity risk (including servicing and operating liquidity)*: The potential that the servicer will be unable to meet its obligations as they come due because of an inability to liquidate assets or obtain adequate funding or that it cannot easily unwind or offset specific exposures.
- *Operational risk*: The risk resulting from inadequate or failed internal processes, people and systems or from external events.
- *Market risk*: The risk to the servicer's condition resulting from adverse movements in market rates or prices.
- *Compliance risk*: The risk of regulatory sanctions, fines, penalties or losses resulting from failure to comply with laws, rules, regulations or other supervisory requirements applicable to the servicer.
- *Legal risk*: The potential that actions against the institution that result in unenforceable contracts, lawsuits, legal sanctions or adverse judgments can disrupt or otherwise negatively affect the operations or condition of the servicer.
- *Reputation risk*: The risk to earnings and capital arising from negative publicity regarding the servicer's business practices.

²¹ Definitions for the risks identified are derived from the Commercial Bank Examination Manual of the Federal Reserve System. <https://www.federalreserve.gov/publications/files/cbem.pdf>

Risk Management Assessment

A risk management assessment must be conducted on an annual basis concluding with a formal report to the board of directors. Evidence of risk management activities throughout the year must be maintained, including findings of issues and the response to address those findings.

Authority

Model Law Sec. 500 – Authority (pg. 29) establishes commissioner authority to adopt rules and conduct examinations, investigations and enforcement. Specific language for these parts should be drafted by states to conform with the legislature’s grant of authority. In situations where these standards are adopted as rule rather than law, this subsection of Sec. 500 may be unnecessary.

The Final Model Standards are applicable to all servicers meeting the de minimis cut off, regardless of size, complexity, business model or institutional risks. In certain situations, a commissioner or other agency head may determine independently or through a multistate review that exceptions to the standards are necessary for effective or efficient supervision of individual servicers or the industry. Such necessity may include situations where specific servicers exhibit extremely high or low levels of risk or where the economy, environment or society have experienced extraordinary events. These situations may warrant controls or supervisory attention for servicers above or below the specific requirements of these standards, or a temporary suspension of the standards or part of the standards pending the resolution of an event.

Where standards are increased for a particular servicer, state supervisors should provide notice to the servicer through a formal administrative undertaking that explains the nature of the risk identified, the authority for any modification of the requirements and the ability for the servicer to contest the modification.

In situations where servicers exhibit extremely low levels of risk (e.g., insufficient servicing volume to justify the burden associated with the standards) the state supervisor, following review and determination, may exempt such servicers from some or all the requirements of the standards.

Additionally, severe economic, environmental, or societal events (such as the Covid-19 pandemic) may warrant a temporary suspension of part of these standards. In such situations, commissioners or agency heads need the flexibility and authority to act appropriately and in the best interests of consumers, the industry and the public.

Sec. 500 c. of the Model Law or Rule, Authority to Address Risk as Necessary (pg. 29), is intended to provide commissioners or agency heads with the flexibility and authority to respond appropriately to individual servicer or industry needs.

Codification of Requirements for State Adoption – Model Law or Rule

The following codified language of the requirements contained in the Final Model State Regulatory Prudential Standards for Nonbank Mortgage Servicers is provided as a basis for uniform adoption by states. CSBS and the NDSC believe that uniformity and standardization across the state system are important for achieving consistent consumer protection, achieving effective and efficient regulation and supervision of a national market, and to mitigate the regulatory burden that can result from duplicative or conflicting supervisory approaches.

Sec. 100 – Definitions

Unless specified otherwise in this [Act//Rule] the following definitions shall apply:

- a) *Agency* means Fannie Mae, Freddie Mac and Ginnie Mae.
- b) *Allowable assets for liquidity* means those assets that may be used to satisfy the liquidity requirements herein, including unrestricted cash and cash equivalents and unencumbered investment grade assets held for sale or trade (Agency MBS, obligations of GSEs, U.S. Treasury obligations).
- c) *Board of directors* means the formal body established by a covered institution that is responsible for corporate governance and compliance with this [Act/Rule].
- d) *Covered Institution* means a nonbank mortgage servicer with servicing portfolios of 2,000 or more 1 – 4-unit residential mortgage loans serviced or subserviced for others, excluding whole loans owned, and loans being “interim” serviced prior to sale as of the most recent calendar year end, reported in the NMLS Mortgage Call Report, and that operates in two or more states, districts or territories of the United States either currently or as of the prior calendar year end.
- e) *Corporate governance* means the structure of the institution and how it is managed including the corporate rules, policies, processes, and practices used to oversee and manage the institution.
- f) *External audit* means the formal report prepared by an independent certified public accountant expressing an opinion on whether the financial statements are presented fairly, in all material aspects, in accordance with the applicable financial reporting framework, and is inclusive of an evaluation of the adequacy of a company’s internal control structure.
- g) *FHFA* means the Federal Housing Finance Agency.
- h) *GSE* means government-sponsored enterprises, or Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac).
- i) *Ginnie Mae* means Government National Mortgage Association.
- j) *Internal audit* means the internal activity of performing independent, objective assurance and consulting to evaluate and improve the effectiveness of company operations, risk management, internal controls and governance processes.

- k) *Interim serviced prior to sale* means the activity of collecting a limited number of contractual mortgage payments immediately after origination on loans held for sale but prior to the loans being sold into the secondary market.
- l) *Mortgage Call Report* means the quarterly or annual report of residential real estate loan origination, servicing and financial information completed by companies licensed in NMLS.
- m) *MSR Investor* means entities that invest in and own mortgage servicing rights and rely on subservicers to administer the loans on their behalf. MSR Investors are often referred to as master servicers.
- n) *Mortgage-backed security or MBS* means financial instruments, often debt securities, collateralized by residential mortgages.
- o) *Mortgage servicing rights or MSRs* refers to the contractual right to service residential mortgage loans on behalf of the owner of the associated mortgage in exchange for specified compensation in accordance with the servicing contract.
- p) *Nationwide Multistate Licensing System or NMLS* means the state system of record for non-depository, financial services licensing or registration.
- q) *Operating liquidity* means the funds necessary to perform normal business operations, such as payment of rent, salaries, interest expense and other typical expenses associated with operating the entity.
- r) *Residential mortgage loans serviced* means the specific portfolio or portfolios of residential mortgage loans for which a licensee is contractually responsible to the owner or owners of the mortgage loans for the defined servicing activities.
- s) *Reverse mortgage* means a loan collateralized by real estate, typically made to borrowers over 55 years of age, that does not require contractual monthly payments and is typically repaid upon the death of the borrower through the sale of the home or refinance by the heirs.
- t) *Risk management program* means the policies and procedures designed to identify, measure, monitor and mitigate risk sufficient for the level of sophistication of the servicer.
- u) *Risk management assessment* means the functional evaluations performed under the Risk Management Program and reports provided to the board of directors under the relevant governance protocol.
- v) *Servicer* means the entity performing the routine administration of residential mortgage loans on behalf of the owner or owners of the related mortgages under the terms of a servicing contract.
- w) *Servicing liquidity or liquidity* means the financial resources necessary to manage liquidity risk arising from servicing functions required in acquiring and financing MSRs, hedging costs (including margin calls) associated with the MSR asset and financing facilities, and advances or costs of advance financing for principal, interest, taxes, insurance and any other servicing related advances.
- x) *Subservicer* means the entity performing the routine administration of residential mortgage loans as agent of a servicer or MSR investor under the terms of a subservicing contract.

- y) *Subservicing for others means* the contractual activities performed by subservicers on behalf of a servicer or MSR investor.
- z) *Tangible net worth* means total equity less receivables due from related entities less goodwill and other intangibles less pledged assets.
- aa) *Whole loans* mean those loans where a mortgage and the underlying credit risk is owned and held on balance sheet of the entity with all ownership rights.

Sec. 200 – Applicability – Exclusions

- a) This [Act/Rule] shall be applicable to covered institutions as defined. For entities within a holding company or affiliated group of companies' applicability shall be at the covered institution level.
- b) *Exclusions.* The following exclusions apply:
 - i. This [Act/Rule] does not apply to not-for-profit mortgage servicers or housing finance agencies.
 - ii. Sec. 300, Financial Condition, shall not apply to Servicers solely owning and/or conducting reverse mortgage servicing, or the reverse mortgage portfolio administered by covered institutions.

Sec. 300 – Financial Condition

- a) A covered institution must maintain capital and liquidity in compliance with this section.
- b) Generally Accepted Accounting Principles (GAAP) required. For the purposes of complying with the capital and liquidity requirements of this section, all financial data must be determined in accordance with GAAP.
- c) A covered institution that meets the FHFA Eligibility Requirements for Enterprise Single-Family Seller/Servicers for capital, net worth ratio, and liquidity, regardless of whether the servicer is approved for GSE servicing, meets the requirements of subsections a) and b) of this section.
 - i. Covered institutions shall maintain written policies and procedures implementing the capital and servicing liquidity requirements of this section. Such policies and procedures must include a sustainable written methodology for satisfying the requirements of subsection c. of this section and be available to [the commissioner] upon request.
- d) *Operating Liquidity.* Covered institutions shall maintain sufficient allowable assets for liquidity in addition to the amounts required for servicing liquidity, to cover normal business operations.
 - i. Covered institutions shall have in place sound cash management and business operating plans that match the size and sophistication of the institution to ensure normal business operations. Management must develop, establish and implement plans, policies and procedures for maintaining operating liquidity

sufficient for the ongoing needs of the institution. Such plans, policies and procedures must contain sustainable, written methodologies for maintaining sufficient operating liquidity and be available to [the commissioner] upon request.

Sec. 400 – Corporate Governance

- a) *Board of directors required.* Covered Institutions shall establish and maintain a board of directors responsible for oversight of the covered institution.
- b) *Alternative to board of directors.* For covered institutions that are not approved to service loans by a GSE or Ginnie Mae, or where these federal agencies have granted approval for a board alternative, an institution may establish a similar body constituted to exercise oversight and fulfill the board of directors' responsibilities in Sec. 400 c. below.
- c) *Board of directors' responsibilities.* The board of directors shall be responsible for:
 - i. Establishing a written corporate governance framework, including appropriate internal controls designed to monitor corporate governance and assess compliance with the corporate governance framework, available to [the commissioner] upon request.
 - ii. Monitoring and ensuring institution compliance with the corporate governance framework and this [Act/Rule].
Accurate and timely regulatory reporting, including the requirements for filing the Mortgage Call Report.
- d) *Internal Audit.* The board of directors shall establish internal audit requirements that are appropriate for the size, complexity and risk profile of the servicer, with appropriate independence to provide a reliable evaluation of the servicer's internal control structure, risk management and governance. Board established internal audit requirements and the results of internal audits shall be made available to [the commissioner] upon request.
- e) *External Audit.* Covered Institutions shall receive an external audit, including audited financial statements and audit reports conducted by an independent public accountant annually. The external audit shall be available to [the commissioner] upon request and include at a minimum:
 - i. Annual financial statements including a balance sheet, statement of operations [income statement] and cash flows, including notes and supplemental schedules prepared in accordance with GAAP.
 - ii. Assessment of the internal control structure.
 - iii. Computation of tangible net worth.
 - iv. Validation of MSR valuation and reserve methodology, if applicable.
 - v. Verification of adequate fidelity and errors and omissions (E&O) insurance.
 - vi. Testing of controls related to risk management activities, including compliance and stress testing, where applicable.

- f) *Risk Management*. Covered institutions shall establish a risk management program under the oversight of the board of directors and available to [the commissioner] upon request that identifies, measures, monitors, and controls risk sufficient for the level of sophistication of the servicer. The risk management program must have appropriate processes and models in place to measure, monitor and mitigate financial risks and changes to the risk profile of the servicer and assets being serviced.

The Risk Management Program must be scaled to the complexity of the organization, but be sufficiently robust to manage risks in several areas, including, but not limited to:

- i. *Credit risk*: The potential that a borrower or counterparty will fail to perform on an obligation.
 - ii. *Liquidity risk*: The potential that the servicer will be unable to meet its obligations as they come due because of an inability to liquidate assets or obtain adequate funding or that it cannot easily unwind or offset specific exposures.
 - iii. *Operational risk*: The risk resulting from inadequate or failed internal processes, people, and systems or from external events.
 - iv. *Market risk*: The risk to the servicer's condition resulting from adverse movements in market rates or prices.
 - v. *Compliance risk*: The risk of regulatory sanctions, fines, penalties or losses resulting from failure to comply with laws, rules, regulations or other supervisory requirements applicable to the servicer.
 - vi. *Legal risk*: The potential that actions against the institution that result in unenforceable contracts, lawsuits, legal sanctions or adverse judgments can disrupt or otherwise negatively affect the operations or condition of the servicer.
 - vii. *Reputation risk*: The risk to earnings and capital arising from negative publicity regarding the servicer's business practices.
- g) *Risk Management Assessment*. Covered institutions shall conduct a risk management assessment on an annual basis concluding with a formal report to the board of directors available to [the commissioner] upon request. Evidence of risk management activities throughout the year must be maintained and made part of the report, including findings of issues and the response to address those findings.

Sec. 500 – Authority

- a) *Rules*. The [commissioner] may adopt rules necessary to implement this [Act].
[Drafter’s note: Subsection 500a. is not necessary where these standards are adopted as rule.]
- b) *Examination, Investigation, Enforcement*. [The specific language of this section shall be determined by state law.]
- c) *Authority to Address Risk as Necessary*. The [commissioner] may:
 - i. Where risk is determined by a formal review of a specific covered institution to be extremely high, order or direct the institution to satisfy additional conditions necessary to ensure that the institution will continue to operate in a safe and sound manner and be able to continue to service loans in compliance with state and federal law and/or regulation.
 - ii. Where risk is determined by a formal review of a particular covered institution or institutions to be extremely low, provide notice that all or part of this [Act/Rule] is not applicable to those covered institutions.
 - iii. Where economic, environmental, or societal events are determined to be of such severity to warrant a temporary suspension of all or certain sections of this [Act/Rule], provide public notice of such temporary suspension.