



5445 DTC Parkway
Suite 1160
Greenwood Village,
Colorado 80111
Tel: 303-268-8400
Fax: 303-268-8401

UCM, INC.'S RESPONSE TO FHFA'S ALTERNATIVE MORTGAGE SERVICING COMPENSATION DISCUSSION PAPER DATED SEPTEMBER 27, 2011

This is a preliminary response to FHFA's Discussion Paper released September 27, 2011. UCM will prepare a more in-depth response shortly, but we wanted to address some of the most important issues to assist others in considering the Discussion Paper.

Discussion of Reserve Method Servicing Compensation –

- UCM fully supports the MBA's proposal to establish a MSF of 20 basis points with a separate reserve for NPLs established at the rate of 5 basis points per year. Under current accounting rules, servicers cannot record reserves for expected losses until some delinquency event occurs, despite knowing that almost any portfolio will ultimately have some level of delinquencies and related NPL costs. The MBA's proposal:
 - Brings accounting and actual cash flows into better alignment.
 - Maintains a fair compensation level to all competent servicers, large and small.
 - Increases the collateral value of the MSR and the related NPL reserve to the GSEs and any potential successor servicers
 - Unused reserves will provide a small offset for the loss of servicing value when borrowers elect to prepay their mortgages.
 - If a maximum per-loan reserve size of say 20 basis points is established (UCM suggests that it be capped at 20 to 30 basis points), then the servicer is further incented to keep borrowers current to maximize the return after the reserve reaches its terminal maximum level after a few years.
 - Further aligns borrower/servicer and investor interests and increases "skin in the game"
- The Clearing House proposal is essentially the same as the MBA's, but the compensation is cut roughly in half. The biggest problem with this is proposal is that it will guaranty further concentration of servicing with the large money-center banks. If the amount of MSR capitalized per loan is cut roughly in half, then the number of loans that banks can control, either under Basel III or more rational limits that the OCC might elect to establish, will double. This will further concentrate systemic risk with too-big-to-fail institutions, contrary to the *Joint Initiative's* objectives.

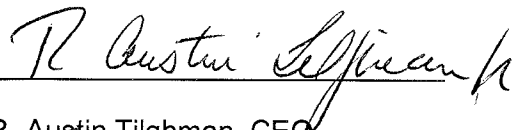
Discussion of Fee-For-Service Servicing Compensation –

- FHFA spent five-months (May through September, 2011) drafting its radical \$10, per loan, per month proposal and still provided no details. The mortgage industry heard about the \$10 proposal in May and yet there's still no definition of an NPL, no NPL compensation schedule and even the \$10 is subject to review and modification in the future at the Enterprise's whim.
 - Potential servicers cannot model the prospective business cash flows or returns without a definition of what the critical terms will be.
 - Saying that the \$10 per loan per month is adequate and might be modified in the future creates uncertainty that stymies those being asked to commit capital to run a servicing business. Servicing is not simply an IO investment but cash flows that support investment in a business. Additionally, MSRs provide collateral for the Agencies. Investors need certainty, not an indefinite framework.
 - The "*Fee For Service Term Sheet*" assumes that a master servicing fee of 8 basis points will be sufficient to cover the \$10 per month servicing fee. In large portions of the country the average initial loan size ranges between \$90,000 and \$120,000 such that 8 basis points is only \$6 to \$8 per month. That's based on the initial loan balances, but the situation is further aggravated when the borrowers make their monthly payments for several years and reduce the loan balances even further. To address this issue:
 - Will there be geographic cross subsidies?
 - Will the per loan fee for service vary by geographic area?
 - Are bond investors put at greater risk if their individual mortgage pools are not self-supportive?
- The Discussion Paper is seriously flawed throughout by the presumption that any servicer could easily elect to retain a 20-basis point IO to offset the lost minimum servicing fee because:
 - The analysis presumes that the IO would command the same multiple in the market as the current minimum servicing fee, when it will be seriously penalized in price because it's an "Orphan IO" (an IO with no related PO);
 - The analysis assumes that there will be no origination volume penalty when, in fact, in many market conditions, loading another 20-basis points into yield or price will penalize volume 60% to 80% versus the competition. It ignores the likelihood that the value of any IO, retained or sold, will be taxed up front at a Federal tax rate of 35%, rather than paid over time and reduced by the cost to service. If the IO is "retained" then the tax liability would be payable well before related receipts are received.
- The Discussion Paper says under Highlights "set fee per loan for performing loans" that "Compensation set at 'market' for the defined services providing servicers with market based compensation and likely eliminating the need to capitalize the servicing asset and its associated valuation and hedging complexities of a capitalized MSR asset." This critical presumption is misguided.

- Current accounting rules require recording either an asset or liability at the initial booking of an MSR (when the mortgage is securitized). Changing the compensation from an amount expressed basis points to a dollar amount per loan will not change the valuation and recording process at all.
- If the value were ever zero, that'd be a surprising coincidence and would constitute a breakeven operation.
- If FHFA were able to arrive at a zero value for the MSR asset, then the return to investors would also be zero. Why would any investor do that?
- Perhaps the FHFA is confusing servicing with subservicing, where the subservicer usually receives a fixed fee per month for servicing mortgages; however, the subservicer has no direct contractual right to mortgage cash flow except for a portion of the fee over a contract period that's typically one to five years. All the obligations to advance, buy-out fraudulent loans, receive benefits from escrows, etc. remain with the primary servicer for the life of the loans. Hence, subservicers record no asset or liability when they receive a new subservicing portfolio.
- Mortgage banking is an extremely cyclical business, with year-to-year production historically swinging dramatically as mortgage interest rates rise and fall. Owning both a production operation and a servicing operation is widely viewed as the way to maintain a balanced enterprise because the two businesses are countercyclical and tend to offset each others' ups and downs. Reducing the minimum servicing fee substantially reduces the offset from the servicing business when interest rates rise and production volumes are likely to fall. Mandating industry instability by radically changing the compensation structure cannot be in the country's best interest.
- Since this discussion began, Fannie Mae recently purchased a significant servicing portfolio from Bank of American and, perhaps as rumored, from others. The potential conflicts of interest are not even hinted at in the Discussion Paper even though Fannie Mae is now a taxpayer funded competitor with its servicing customers. This raises questions such as:
 - With fee-for-service compensation, who will hold the money and, if it's Fannie Mae, will they pay themselves first?
 - Should Fannie Mae now recuse itself from this discussion because of their conflict of interest?
 - With Fannie Mae using taxpayer money to buy MSRs, how can private capital compete?
 - What administrative structure will be necessary to fairly monitor and adjust a national fee for service system? One can envision Medicare and Social Security.
 - What Congressional oversight needs to take place to approve these changes?
- Many mortgage bankers believe that differential Guarantee-fees ("G-fees") that are volume-based rather than risk-based have contributed significantly to the concentration of MSRs in the largest, too-big-to-fail institutions. Differential G-fees have existed for many years and persist to this day, according to recent studies. If an objective of FHFA's exercise is to reduce systemic risk, then why isn't a risk-based G-fee being established?

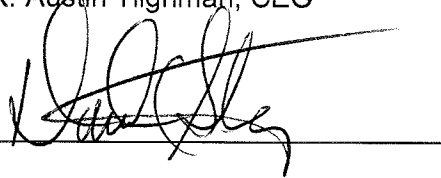
- It is rumored that the GSEs plan to substantially increase their G-fees to fund losses related to prior-years' originations. Mortgage interest rates, servicing compensation and G-fees are all intertwined and all have an impact on mortgage rate with fees and costs charged to consumers. Without knowing the probable range of G-fees, mortgage bankers cannot model the likely mortgage rates, fees and charges or the likely profitability.
- The Discussion Paper states that "This model (fee for service) was ... designed to meet the following key objectives of the *Joint Initiative*:
"Improve service for borrowers; Reduce financial risk to servicers; ... promote continued liquidity in the TBA mortgage securities market; and Promote enhanced competition in the market for origination and servicing."
 - The stated objectives are admirable, but none of those goals are achieved.
 - Reducing compensation to servicers does not improve service for borrowers. That's better done by attracting new capital, establishing new servicing standards and assuring that they're followed.
 - Financial risk to servicers increases when you reduce compensation because it increases the chance that servicers won't have sufficient funds to advance for delinquent borrowers. It also reduces or eliminates the margin on performing loans, which is the majority of most portfolios. The remaining asset is more negatively convex and harder and more costly to hedge than the current asset or MBA's proposed fee with reserve.
 - The fee-for-service incents mortgage bankers to focus on origination profits, which will reduce liquidity (raising prices) not increase TBA market liquidity.
 - Nothing in the Discussion Draft supports the assertion that competition in the market for origination and servicing will be enhanced. If anything, the proposal will lead to further concentration of MSR's in the too-big-to-fail money center banks. Fannie Mae's entry into the purchased MSR market further clouds this issue.
- The Discussion Paper fails to address the handling of Master Servicing Fees and G-fees by the Enterprises managing those. These fees need to be handled with insurance discipline and placed in separate reserves to handle the Enterprises' obligations for performing loans and NPLs. Separate reserves should be established by origination vintage and carefully monitored versus actual experience. If G-fees are increased to partially cover prior production loss exposures (taxpayers have already paid a portion of this) then separate reserves should be established to track those losses versus the collected G-fees and the fees reduced as the losses finally subside.
- UCM supports the bifurcation of the seller and servicer Representations and Warranties. Buyback requests are most often related to a failure in the origination process, ranging from miscalculation of ratios (perhaps leaving out new debt added by the borrower between application and closing) to out and out fraud. This should not be the responsibility of the servicer, unless the seller and servicer are the same.

We would be happy to discuss this topic with any interested party.



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R. Austin Tilghman, CEO



A handwritten signature in cursive script, appearing to read "David C. Stephens", written over a horizontal line.

David C. Stephens, COO & CFO