Freddie Mac

Mortgage Servicing Rights (MSR) Financing Pilot Program

Freddie Mac has provided briefings on our MSR Financing pilot program to industry groups, media and Congressional staff. This factsheet captures and expands on the information Freddie Mac has shared to date.

Summary of MSR Financing pilot program

Freddie Mac's MSR Financing pilot program provides financing to servicers, with several specific limitations, secured by the servicers' mortgage servicing rights. This financing enhances the liquidity of the mortgage servicing market and enables Freddie Mac to better manage counterparty risk.

Limitations: The pilot is intended to supplement, rather than displace, current sources of market liquidity. Accordingly, there are four key conditions on the pilot:

- **Servicers:** The pilot program is limited to non-bank servicers only.
- **Collateral ownership:** It also is limited to servicing rights on single-family loans owned only by Freddie Mac. No other loans are permitted.
- **Collateral amount percentage:** Dedicated collateral for the funding amount may not exceed servicing rights related to 50% of UPB on the borrowing servicer's total portfolio of Agency loans serviced (excluding subservicing). "Agency" refers to loans guaranteed by Freddie Mac, Fannie Mae and Ginnie Mae.
- **Lending volume:** FHFA has imposed a cap on the pilot program's total funding amount.

To ensure safety and soundness, participants must meet standard counterparty credit risk requirements and remain in good standing as Freddie Mac servicers.

Freddie Mac completed phase one of the pilot program, which covered developing legal agreements and operating procedures with a small number of sophisticated servicers. This effort provided the basis for developing standards to be used more broadly should FHFA approve moving beyond a pilot.

The pilot program was developed in consultation with and approved by FHFA, as conservator.

Policy background

Non-banks are servicing larger percentages of Freddie Mac's single-family book of business and that of the industry overall. However, they face challenges in obtaining funding. Unlike banks, they lack access to deposits, a particularly stable form of funding, and instead rely on other more uncertain sources of funds to meet their liquidity needs.

Borrowing against their MSR assets is a common funding tool for some non-banks. However, their access to such financing is constrained by (1) the rights of the owner of the servicing (in this case, Freddie Mac), which makes it more difficult for lenders to obtain full first-lien security on the MSR as collateral and (2) the complexity and historically volatile value of MSR assets.

For these reasons, among others, FHFA has identified the stability of non-bank servicers as a policy concern. As an initial step in addressing this concern, FHFA worked with both Enterprises to develop and issue updated and aligned servicer eligibility standards, which were published in 2015.

More recently, FHFA's annual Conservatorship Scorecards directed Freddie Mac to assess the current mortgage servicing business model.

- The 2017 Scorecard required Freddie Mac to initiate a multiyear assessment of both the challenges facing the market and also potential solutions, with the objective of ensuring ongoing liquidity and counterparty strength.

- The 2018 Scorecard requires Freddie Mac to continue assessing challenges and potential solutions for improving the mortgage borrower's experience, expanding liquidity, and increasing efficiency.

<u>Pilot Program Is Charter Compliant</u>

Freddie Mac's purpose, as set out in its Congressional charter, includes increasing liquidity, stability and affordability in the secondary mortgage market. Increasing sources of funding and reducing the costs of such funding to non-bank servicers is clearly included within that charter purpose.

Moreover, servicing mortgages is a necessary and appropriate power associated with the Freddie Mac's authority to purchase and own mortgages and is therefore within Freddie Mac's charter authority. In the exercise of that authority, Freddie Mac contracts with third-party servicers and enters contractual relationships with them in order to facilitate mortgage servicing.

Additionally, through MSR financing, Freddie Mac deals solely with servicers; it does not participate in the origination of mortgages.

Objectives and expected benefits

The MSR Financing pilot program was developed after Freddie Mac assessed impediments that non-bank servicers face in obtaining financing, which can in turn impact the liquidity of the mortgage market. The pilot's objective is to assess whether offering MSR financing improves the availability and terms of financing for non-bank servicers, and thus increases the efficiency of the mortgage market and the resilience of non-bank servicers.

Freddie Mac will assess whether the pilot program generates these benefits:

- Improving the efficiency of financing MSRs may help improve the stability of Freddie Mac's non-bank servicer counterparties. Consumers should benefit from a more stable, liquid servicing market.

- Improving the stability of non-bank servicers ensures their strength as counterparties to Freddie Mac, which helps protect Freddie Mac and, by extension, taxpayers.

We hope this information is helpful to those seeking to understand the MSR Financing pilot.