

The Evolving Market for **Servicing Rights**

BY JEFFREY M. LEVINE

**A review of the many factors shaping the value
and demand for mortgage servicing rights.**

Twenty-five years ago, when I started out in the mortgage banking industry, the consensus was that mortgage servicing rights (MSRs) were always worth a point (that is, 100 basis points). In other words, a portfolio of \$1 billion of Fannie Mae, Freddie Mac or Ginnie Mae servicing was worth \$10 million. Ironically, while peaking at values as high as 175 basis points in the mid-2000s, MSRs are now trading back to the 1985 levels I referred to above. (Figure 1 shows historical values of MSRs over time.) ▲ Before I delve into the reasons for this, I think a primer would be helpful. What are MSRs? Are they an asset or a liability? ▲ Simply put, MSRs represent the net present value (NPV) of the cash flows associated with a servicer's obligation (the liability) to service mortgage loans for the underlying investor. These include the right to earn service fees, ancillary fees and float income on custodial funds and borrower escrows (the asset). Add to this the nuance that repurchase exposure to government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac travels with ownership of the MSRs, as well as obligations to fund servicing advances on delinquent loans—a major issue today—and the distinction between whether or not MSRs are an asset or a liability, or both, becomes very murky. ▲ Servicing rights are quoted in the market as both a percentage of the unpaid principal balance (UPB) of the underlying mortgage loans and as a multiple to the weighted-average service fee (net of guaranty fees) to which the servicer is entitled to earn on the pool. In Figure 2, assuming a 25 basis point net servicing fee, a pool of MSRs worth 100 basis points would be valued at a 4.0x multiple.

The multiple is a net present value calculation, taking into account scheduled amortization on the underlying mortgages, as well as unscheduled prepayments (typically from refinances), discounted at a required rate of return or yield. Unlevered yields for prime GSE MSR values have typically ranged from high single-digits to low double-digits, or 8 percent to 12 percent, with the higher yields associated with Ginnie Mae or other less liquid, smaller blocks of MSRs, and haven't changed much over time.

Banks have been the most optimal owners of prime MSRs. This is due to their ability to leverage the investment with deposits and other liabilities, as well as maximize the value of MSRs associated with hedging the asset, holding the custodial funds and cross-selling other financial products to the underlying borrowers.

Consolidation in the MSR sector has been significant as economies of scale—not to mention liquidity and capital to fund the asset—have allowed banks to be the dominant owners of this asset.

In fact, the top five servicers (80 percent bank-owned)

now control more than 65 percent of the MSR market (see Figure 3), servicing collectively \$6.43 trillion in mortgage debt as of March 31, 2010. This is up significantly from 1995, when the top five servicers only controlled 15 percent of the market.

Different types of MSRs

MSRs are typically differentiated between prime and non-prime, primary versus special, and residential versus commercial. The proliferation of the securitization market in the late 1990s and 2000s expanded the world of non-GSE MSRs and created a new sector of servicers for non-prime, subprime and commercial loans, often embedded into residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS).

The securitization structure also created the roles of primary, special and master servicer and, thus, separate assets for the respective MSRs. Primary servicing is what we typically think of as MSRs, special servicing refers to the loss mitigation and heavy-duty default component of servicing, and master servicing represents the bookkeeping and oversight function akin to a bond trustee.

A recent trend in the current “high default” environment fostered by the Great Recession is the attention to special servicing. The GSEs have created the concept of component servicing, whereby they encourage (or force) the transfer of high-risk or highly delinquent servicing rights from primary servicers to special servicers.

The industry has seen a tremendous amount of servicing sold or transferred to component servicers over the past 12 months, easily in excess of \$100 billion of UPB and all of it “below the radar screen,” as most servicers do not like to publicize the fact that their investors were not confident in their default servicing capabilities.

Many new entrants to the servicing sector have focused on this role, most notably Armonk, New York-based IBM's acquisition of the core operating assets of Beaverton, Oregon-based Wilshire Credit Corporation's servicing business (owned by Charlotte, North

Figure 1 Historical Mortgage Servicing Rights (MSR) Values



Figure 2 MSR Cash Flow Summary

Year	Beginning Principal	Service Fees	Ancillary Fees and Float	Total Income	Expense	Pre-Tax Net Income	Present Value
1	\$1,000,000,000	\$2,384,216	\$382,379	\$2,766,595	\$420,266	\$2,346,329	\$2,224,822
2	\$901,982,063	\$2,079,455	\$368,383	\$2,447,838	\$366,996	\$2,080,842	\$1,787,724
3	\$773,761,846	\$1,778,846	\$321,383	\$2,100,229	\$325,191	\$1,775,038	\$1,380,488
4	\$661,445,358	\$1,519,635	\$279,597	\$1,799,232	\$287,645	\$1,511,587	\$1,064,171
5	\$564,740,580	\$1,297,380	\$243,377	\$1,540,757	\$251,298	\$1,289,459	\$821,722
6-30	\$0	\$7,094,703	\$1,647,490	\$8,742,193	\$1,855,037	\$6,887,156	\$2,732,976
Total		\$16,154,235	\$3,242,609	\$19,396,844	\$3,506,434	\$15,890,411	\$10,011,904
	Original UPB	\$1,000,000,000		Key Assumptions			
	NPV Cash Flows	\$10,011,904		Annual Service Fee		0.25%	
	NPV (% UPB)	1.00%		Prepayment Speed (PSA)		200	
	NPV Multiple*	4.0		Cost to Service		\$75	
				Pre-Tax Discount Rate		10.00%	

*Multiple of annual service fee
SOURCE: MILESTONE ADVISORS

Carolina-based Bank of America), completed in March 2010.

Figure 4 highlights recent mergers and acquisitions (M&A) activity in the servicing sector, whereby new entrants have acquired servicing platforms or existing operations (and related portfolios) have been sold and consolidated.

A relatively new, but growing, segment of the MSR market involves reverse-mortgage servicing. Reverse MSRs are highly valuable given their very predictable cash flows and prepayments—loans do not typically refinance as elderly borrowers, the target of reverse loans, do not usually sell their homes and these loans are more costly and cumbersome to refinance. Additionally, they can also be modeled in correlation with life insurance actuarial tables, further reducing the volatility of prepayment and increasing the value of the related MSR asset.

Financing the MSR asset

Newly originated MSRs have positive net asset value and, as such, require cash and capital to fund their acquisition. MSRs are a by-product of the loan origination and secondary marketing process, and are often the net profit on a newly originated loan. Lenders are currently capitalizing new originations at between 125 and 150 basis points (these values are higher than what might be seen in the bulk MSR trading market, for reasons I discuss later in this article), and the entire profit on a newly originated

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loan is typically less than half of that (60 to 75 basis points).

If the lender retains the MSR on a newly originated loan, the net profit, and then some, is a “book” profit for accounting purposes, requiring financing and capital—either internal or external—to fund the asset. If the lender sells the MSR on a servicing-released basis, the asset is sold for cash, but the acquiring servicer has the same financing and capital need.

Banks are best situated to internally finance their MSRs. However, independent lenders have also been able to retain MSRs through a combination of secured and unsecured financing facilities. These non-banks also rely on external funding for servicing advances on delinquent loans.

Figure 5 lists independent (non-bank) servicers that each service between \$1.7 billion and roughly \$410 billion of MSRs and, collectively, account for only 10.3 percent of the total market.

The MSR financing market has been significantly

Figure 3 Top Servicers—Third Quarter 1995 vs. First Quarter 2010 (\$ millions)

1995				2010			
Rank	Company	3Q95 Volume	Market Share	Rank	Company	1Q10 Volume	Market Share
1	Countrywide Funding Corp.	\$127,580	3.60%	1	Bank of America	\$2,151,451	21.83%
2	GE Capital Mortgage Services	\$113,900	3.30%	2	Wells Fargo & Co.	\$1,797,759	18.24%
3	Fleet Mortgage Group	\$100,900	2.90%	3	Chase	\$1,376,310	13.96%
4	Norwest Mortgage Inc.	\$100,110	2.90%	4	CitiMortgage Inc.	\$699,782	7.10%
5	Prudential Home Mortgage Co.	\$80,300	2.30%	5	Residential Capital LLC (GMAC)	\$406,902	4.13%
6	NationsBanc and affiliates	\$77,580	2.20%	6	U.S. Bank Home Mortgage	\$191,846	1.95%
7	Chase Manhattan Mtg. Holdings	\$74,220	2.10%	7	SunTrust Mortgage Inc.	\$176,108	1.79%
8	Bank of America	\$62,310	1.80%	8	PNC Mortgage/National City	\$154,099	1.56%
9	GMAC Mortgage Co.	\$58,940	1.70%	9	PHH Mortgage	\$153,060	1.55%
10	Chemical Bank and affiliates	\$52,820	1.50%	10	OneWest Financial	\$115,000	1.17%
11	Home Savings of America FSB	\$49,500	1.40%	11	MetLife Home Loans	\$109,181	1.11%
12	Mellon Mortgage Co.	\$45,700	1.30%	12	Aurora Loan Services Inc.	\$91,455	0.93%
13	Great Western Bank FSB	\$43,020	1.20%	13	American Home Mtg. Srvg. Inc.	\$90,224	0.92%
14	Citicorp Mortgage and affiliates	\$40,900	1.20%	14	Branch Banking & Trust Co.	\$89,339	0.91%
15	BancBoston Mortgage Corp.	\$39,650	1.10%	15	Cenlar FSB	\$85,000	0.86%
16	PNC Mortgage Co.	\$37,550	1.10%	16	Dovenmuehle Mortgage	\$75,500	0.77%
17	First Union Mortgage Co.	\$37,270	1.10%	17	HSBC Mortgage Corp. USA	\$66,547	0.68%
18	Barnett Mortgage Co.	\$32,970	0.90%	18	Annaly Capital Investment	\$61,984	0.63%
19	Source One Mtg. Services Corp.	\$28,560	0.80%	19	Fifth Third Mortgage	\$60,048	0.61%
20	Wells Fargo Bank, National City	\$24,530	0.70%	20	EverBank Mortgage	\$53,398	0.54%
Total		\$1,228,310	35.10%	Total		\$8,004,993	81.21%

SOURCES: NATIONAL MORTGAGE NEWS, INSIDE MORTGAGE FINANCE

Figure 4 Mergers and Acquisitions (M&A) Activity in the Servicing Sector

Buyer Name	Target Name	Announced Date	Price/LTM Earn. (x)	Price/Book (%)
Ocwen	HomeEq	5/28/10	N/A	N/A
Fidelity National Financial	LoanCare	5/14/09	N/A	N/A
IBM Corp.	Wilshire Credit Corp.	10/5/09	N/A	N/A
Centerbridge Partners/Green Tree	Irwin Home Equity	3/31/09	N/A	N/A
Vantium Capital	Acqura Loan Services	9/23/08	N/A	N/A
Lexia (Shinsei Bank)	Specialized Loan Servicing	9/8/08	N/A	N/A
Impac Mortgage	UBS Servicing	7/14/08	N/A	N/A
WL Ross & Co.	American Home Mortgage	9/25/07	N/A	N/A
Carrington Capital Management	New Century	4/2/07	N/A	N/A
Residential Credit Solutions	Aames Servicing	1/17/07	N/A	N/A
New Century Mortgage	Irwin Mortgage	1/3/07	N/A	100.0
Morgan Stanley	Saxon Capital Inc.	8/9/06	8.6	118.6
Barclays	HomeEq Servicing Group	6/22/06	17.4	100.0
CSFB	SPS Holdings Group	1/19/05	NA	168.0
Merrill Lynch	Wilshire	1/16/04	14.3	174.5

SOURCE: SNL FINANCIAL

Figure 5 Top Non-Bank Servicers, First Quarter 2010 (\$ millions)

1Q 2010			
Rank	Company	1Q10 Volume	Market Share
5	Residential Capital LLC (GMAC)	\$406,902	4.13%
9	PHH Mortgage	\$153,060	1.55%
13	American Home Mtg. Servicing Inc.	\$90,224	0.92%
15	Cenlar FSB	\$85,000	0.86%
16	Dovenmuehle Mortgage	\$75,500	0.77%
18	Annaly Capital Investment	\$61,984	0.63%
21	Provident Funding Associates	\$44,216	0.45%
23	Nationstar Mortgage	\$33,275	0.34%
40	Saxon Mortgage Services	\$8,756	0.09%
43	Midwest Loan Services	\$8,340	0.08%
44	NATIXIS Real Estate Capital	\$7,695	0.08%
45	Nationwide Advantage Mortgage	\$7,600	0.08%
46	Capstead Inc.	\$7,585	0.08%
49	Celink	\$6,638	0.07%
50	Anworth Mortgage	\$6,531	0.07%
51	Impac Funding Corp.	\$6,480	0.07%
61	VNB Mortgage Services	\$2,447	0.02%
65	Guardian Mortgage Co.	\$2,050	0.02%
66	Franklin American Mortgage	\$1,877	0.02%
68	Graystone Solutions	\$1,682	0.02%
Total		\$1,017,843	10.33%

SOURCE: NATIONAL MORTGAGE NEWS

constrained since 2007, with the retrenchment of the warehouse lending market—warehouse lenders have historically been the most active providers of MSR financing—and with the notorious collapse of the highly levered servicer, Taylor Bean & Whitaker Mortgage Corporation (TBW). The TBW collapse and resulting bankruptcy triggered a seizure of its more than \$80 billion of MSRs by Ginnie Mae and Freddie Mac (according to a U.S. Bankruptcy Court filing, Aug. 24, 2009), and the syndicate of banks that lent against this asset are likely to realize significant losses on their loans.

In addition to financing the cost or purchase price of the MSR asset, non-bank servicers also need liquidity to fund servicing advances. Servicers are required to advance tax and insurance payments and foreclosure expenses on all delinquent loans—often for more than a year due to extended foreclosure timelines—plus principal and interest on delinquent loans in both agency and non-agency securities.

In the case of highly delinquent subprime loans, the servicing advance balance could easily be many times in excess of the value of the MSRs. In recent subprime MSR trades, the sellers have had to provide a significant amount of financing for these advances to enable the buyer to close the purchase.

Some independents—particularly larger, well-capitalized lenders—have been able to access the high-yield debt market to finance their MSRs. Also, Troubled Asset Relief Program (TARP) funding (through the government guarantee program) was made available last year to help finance servicing advances on delinquent loans for a handful of large, rated servicers. However, the overall availability of MSR financing for non-bank servicers remains very limited and very expensive by historical comparisons.

Types of MSR sale transactions

Servicing is sold in a number of different fashions, including bulk sale, co-issue, assignment of trade (AOT) and flow. Even a whole-loan sale, best efforts, is a form of servicing sale as the underlying MSR travels with the loan and is a meaningful component of the value of the loan to the end investor.

AOT, flow and co-issue sales are the most prevalent forms of MSR transactions in terms of volume sold, as these, combined with the whole-loan sales mentioned, are a routine form of secondary execution for independent and smaller bank lenders that choose not to retain their servicing, with billions sold every month. AOT transactions also offer tax advantages to the MSR buyers, as well as enhanced execution on the underlying mortgage-backed securities (MBS) trade when the loans are combined with the buyer's own production. AOT buyers also enjoy reduced guarantee fee and volume pricing they receive from MBS investors.

In the current environment, only lenders that are looking to strategically reduce or exit their MSR asset are accessing the bulk sale market as pricing remains depressed due to a supply/demand imbalance, prepayment concerns and seller-counterparty risk. Figure 6 is representative of selected large MSR transactions executed over the past few years or pending in the market.

Historically, the bulk sale market was a very robust market providing excellent value and liquidity to sellers. This market will likely return as mortgage interest rates ultimately rise—dropping the volume of originations and reducing prepayment concerns, as well as reducing the concern of repurchase risk as loan quality improves. However, due to capital constraints discussed later in this article, values will likely not return to previous peak levels.

Prepayment risk

Prepayment speeds have the largest impact on value to MSRs. Referred to in terms of either conditional prepayment rate (CPR) or PSA (a bond-industry convention ini-

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tially developed by the Public Securities Association [PSA] for publishing equivalent rates), prepayment speeds are quoted as a percentage of total loans prepaid on an annualized basis.

A typical current-coupon mortgage loan might be modeled at a 6 percent to 9 percent CPR (100 percent to 150 percent PSA once fully ramped), which means that a \$1 billion pool of such loans would be expected to see \$60 million to \$90 million of its loans prepay each year. A meaningful increase in expected CPRs, even if short-

term, causes MSR values to fall significantly.

Most servicers hedge their MSR value, either with financial derivatives, mortgage-backed securities and/or a “natural hedge” in the form of their origination franchises. The natural hedge refers to the fact that when rates fall and MSRs lose value, lenders' profits from their origination franchises (i.e., funding profitable refinances) will increase proportionately.

Repurchase and counterparty risk

When purchasing GSE MSRs, the selling and servicing representations and warranties made by the prior lender/servicer travel to the new owner of the MSRs. Fannie Mae and Freddie Mac have been particularly active in demanding repurchases for prior originations—even loans that are seasoned.

A May 11, 2010, *American Banker* article reported that servicers were forced to repurchase more than \$3.1 billion of loans during the first quarter of 2010, an increase of approximately 65 percent from a year earlier. While servicers actively try to rebut these repurchase claims

Figure 6 Recent MSR Trades (\$ millions)

Date	Buyer/Target	Product Type	UPB	Notes
Oct-2007	WL Ross/ AHM Servicing	FNMA, GNMA, Private	\$50,000	Includes purchase of advances at a discount, plus a platform premium
Mar-2008	AHM Servicing/ Option One Mortgage	Subprime	\$53,000	Distressed MSR sale following shutdown of origination business
Feb-2010	BOK Financial/ Charter Bank	FNMA, FHLMC, GNMA	\$4,000	Sold in conjunction with a failed bank
Feb-2010	Select Portfolio Services/ Thornburg Mortgage	Hybrid ARM, Jumbo	\$11,000	Portfolio bought out of bankruptcy court
Sep-2010	Ocwen/ Barclays (HomEq)	Subprime	\$22,400	Strategic exit by seller; substantial seller financing
TBD	TBD/ AmTrust/FDIC	FNMA, FHLMC	\$21,000	High-quality servicing; failed bank
TBD	TBD/ Taylor Bean & Whitaker	GNMA, FHLMC, Private	\$80,000	Seller in bankruptcy

SOURCES: MILESTONE ADVISORS, U.S. BANKRUPTCY FILINGS

and are successful in many cases, the sheer scope and size of this exposure has put a significant damper on the MSR sale market.

In some cases, the GSEs are requiring seller/servicers to post collateral to secure their repurchase exposure and buyers are reluctant to purchase MSRs from sellers they perceive as being unable to indemnify or buy back such GSE repurchases from the new servicer/buyer. The amount of such repurchase exposure can be a meaningful portion of the positive MSR value of the overall portfolio.

The repurchase exposure takes into account such factors as vintage (2005–2008 are more risky due to relaxed underwriting and rapidly increasing home values), loan-to-value (LTV) ratio, percentage of full-documentation versus limited-documentation mortgages, FICO® score and current delinquency/default status.

My firm has been extremely active in advising both buyers and sellers on sizing the repurchase risk associated with MSR portfolios, and has developed extensive analytics that we have tested on negotiations involving more than \$50 billion of MSRs.

The same repurchase exposure does not affect the buyers of non-GSE MSRs (i.e., non-agency jumbo, alternative-A, subprime RMBS) or Ginnie Mae MSRs, as “the sins of the originator” of these loans do not travel to the buyer. There is still exposure, however, to the current servicer on Ginnie Mae loans for errors made in filing Federal Housing Administration (FHA) insurance claims or not following FHA or Department of Veterans Affairs (VA) loss-mitigation timelines.

The CMBS servicing market embraced the concept of special servicing long before the trend intensified in the residential MSR sector.

FHA insures servicers against all default losses subject to certain exclusions (i.e., first two months of interest on defaulted loans, non-reimbursable foreclosure costs, and the difference between the Ginnie Mae pass-through rate and the FHA debenture rate in effect at the time the loan was originated). The VA does not insure loans but instead guarantees against default and, as such, may choose to “no bid” the real estate-owned (REO) in the case of severely depreciated real estate values or fraud by the original lender, in which case the servicer will likely take the additional loss.

Commercial MSRs

Similar to the residential MSR market, banks represent more than 77 percent of the market share of the top CMBS primary servicers, as shown in Figure 7.

The CMBS servicing market embraced the concept of special servicing long before the trend intensified in the residential MSR sector, as the typical defaulting/defaulted commercial loan is significantly larger (multi-millions of dollars versus hundreds of thousands of dollars), with

Figure 7 Midyear Survey of Commercial/Multifamily Mortgage Servicing Volumes (as of June 30, 2010)*

Rank	Company	Volume (\$ millions)	Market Share
1	Wells Fargo (including Wachovia)	\$381,560	41.91%
2	PNC Real Estate/Midland Loan Services Inc.	\$129,954	14.27%
3	Berkadia Commercial Mortgage LLC	\$120,370	13.22%
4	Bank of America Merrill Lynch	\$95,329	10.47%
5	KeyBank Real Estate Capital	\$87,344	9.59%
6	GEMSA Loan Services LP	\$13,578	1.49%
7	Principal Global Investors	\$13,530	1.49%
8	Prudential Asset Resources	\$12,678	1.39%
9	Holliday Fenoglio Fowler LP	\$7,724	0.85%
10	NorthMarq Capital	\$7,168	0.79%
11	Deutsche Bank	\$5,469	0.60%
12	Grandbridge Real Estate Capital LLC	\$4,536	0.50%
13	BNY Mellon	\$4,185	0.46%
14	CWCapital LLC and CWCapital Asset Management	\$4,154	0.46%
15	Situs Asset Management	\$3,021	0.33%
16	Nationwide Life Insurance Co.	\$2,910	0.32%
17	Pacific Life Insurance Co.	\$2,112	0.23%
18	C-III Asset Management LLC	\$1,918	0.21%
19	Waterstone Asset Management	\$1,587	0.17%
20	Q10 Capital LLC	\$1,256	0.14%
Total		\$900,383	98.90%

*Total primary and master servicing CMBS, CDO or other ABS

SOURCE: MORTGAGE BANKERS ASSOCIATION (MBA)

complex ownership and collateral performance issues.

There has been recent M&A activity associated with both primary and special CMBS servicers and MSRs, specifically two large transactions announced in the past 12 months: The sale of Horsham, Pennsylvania-based Capmark Financial Group Inc.'s North American loan origination and servicing businesses to Horsham-based Berkadia Commercial Mortgage LLC (a partnership owned by Berkshire Hathaway Inc. and Leucadia National Corporation); and the sale of Needham, Massachusetts-based CW Financial Services LLC to New York-based Fortress Investment Group LLC.

We expect M&A activity in the CMBS sector—both servicing businesses and MSRs—to grow as delinquencies in the commercial real estate sector increase, and servicing efficiencies and capabilities become more important than ever.

Future trends

We see the following future trends affecting MSRs, as the asset and the market continue to evolve:

- eNote servicing;
- MERS® evolution;
- changes to the GSEs; and
- impact of Basel III.

While file imaging and electronic conversion and transfer of servicing files have been commonplace for the past five-plus years, eNote origination and servicing is just starting to gain acceptance and popularity. eNotes should not be confused with electronic files, which usually involve images or scans of the original paper files and collateral instruments. In an eMortgage, the collateral documents (note and mortgage) are signed electronically—either via an eSignature pad akin to that used at retail stores for credit-card purchases, or using an “I accept” click box via a secure online closing. There is no hard-copy document with a physical signature, but instead, an online set of data that can be viewed as a printed document containing a genuine facsimile signature.

eNotes have been fully accepted by Fannie Mae and Freddie Mac in virtually all legal jurisdictions. eNotes are stored in electronic—versus traditional physical—vaults, and are tracked in Reston, Virginia-based Mortgage Electronic Registration Systems Inc.'s (MERS') eRegistry system as opposed to endorsed and shipped in traditional paper format.

Early adopters of eNotes/eMortgages were AmTrust Savings (now a division of Westbury, New York-based New York Community Bank) and Troy, Michigan-based Flagstar Bank. In fact, of the approximately \$22 billion in MSRs that AmTrust owned prior to its failure in December 2009, and which my firm recently marketed for the Federal Deposit Insurance Corporation (FDIC), approximately 70 percent consisted of eNotes.

Many lenders and servicers are just now becoming eNote-capable, and we expect this trend to continue.

MERS is a non-profit company formed more than 15 years ago to promote servicing efficiencies by eliminating the costly preparation and recording of paper assignments and replacing them with a system that updates the MERS

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database with subsequent investor/servicer changes. MERS continues to lead the industry in new electronic developments, including electronic registry of loans in warehouse—which reduces both costs and fraud—and a universal unique mortgage identifier number that would also help reduce fraud and improve visibility for originators, servicers, investors and regulators.

As this article is being written, the U.S. government is organizing meetings and planning sessions regarding the future of the GSEs. While the exact ownership and

form of a new GSE structure or a new government-sponsored MBS market is unknown, we believe a meaningful by-product of such changes will be the nature and structure of MSRs.

Additionally, new international banking regulatory standards recently finalized (and which U.S. regulators have adopted), known as Basel III, will significantly alter the capital treatment by banks of MSRs. Non-U.S. regulators consider MSRs an intangible asset and initially gave it zero value toward bank regulatory capital. However, U.S. regulators negotiated a compromise position whereby MSRs (together with deferred tax assets and investments in other financial institutions) would be limited to no more than 15 percent of capital.

Although full implementation of the Basel III accords will be years away, the impact of this change will be significant given the fact that, as pointed out earlier in this article, banks are currently the dominant owners of MSRs. This change to capital treatment will likely reduce values (and potentially increase costs to the borrower) as banks will be required to hold more capital against the asset.

As I suggested at the beginning of this article, it has been “back to the future” for MSRs. While current economic conditions have reduced the value of this asset back close to 1985 levels and some of the same consolidation trends we have seen before continue to occur, the future will bring new structures, risks and rewards to this important sector of the mortgage banking industry.

Whether viewed as an asset or a liability, MSRs remain the end product of every mortgage loan that lenders originate and, often, the only ongoing source of contact they have with their mortgage customers. Thus, significant time, attention, capital and investment dollars will continue to be dedicated to developing and managing this important asset. **MB**

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