Mortgage Subservicer Oversight: Understanding Your Selection and Oversight Responsibilities

When it comes to subservicer oversight, many lenders feel they don't have the resources, experience or expertise in mortgage servicing practices – that's often why they chose to utilize a subservicer in the first place. While this is likely true for many organizations, if you are an agency seller/servicer, or GNMA issuer, this does not absolve you from your responsibility of monitoring and overseeing your subservicer's performance. So how then do you fulfill your oversight responsibilities and meet the expectations of regulators?

If after reviewing the CFPB and OCC bulletins and the various agency servicing guides, you are still unclear about what you should be doing, you are not alone. While the guidance available provides insight into various areas that should be considered, you will not find a "checklist" that can be followed to ensure that consumers' interests are being protected and consumer harm is not occurring. Guidance for third-party or subservicer oversight can be found in the following:

- *CFPB Bulletin 2012-03, Third Party Oversight*
- *OCC Bulletin 2013-29, Third Party Relationships-Ongoing Monitoring*
- *FNMA Servicing Guide, A2-1-06-Subservicing*
- *GNMA Mortgage-Backed Securities Guide, Chapter 4-Issuers and Subservicers-Responsibilities*
- *FHLMC Seller Servicer Guide, 8102.1-Managing Servicing Agents*

To be an approved seller/servicer with Fannie Mae or Freddie Mac, or an approved issuer with Ginnie Mae, a master servicer must show it has written procedures that demonstrate how it oversees its subservicer. In addition, it is expected that oversight functions are reviewed by a qualified mortgage servicing manager with substantial background and understanding of mortgage servicing practices. For smaller servicers, at least a single point of contact or small team is expected to perform oversight of their subservicers.

The following information provides guidance regarding selecting a subservicer and developing an oversight program to properly monitor their compliance with servicing standards and other applicable regulations.

Initial Due Diligence and Selecting a Subservicer

Choosing a servicing partner is paramount to growing your MSR portfolio, improving retention, maximizing ROI, and maintaining existing banking customer relationships. Other key benefits for carefully vetting and approving the right subservicer include remaining compliant with the ever-changing and complex regulatory environment, ensuring proper licensing for servicing and collecting mortgage payments, and being able to rely on the industry-specific knowledge and expertise that the subservicer possesses.

Before selecting and entering into a contractual arrangement (Master Servicing Agreement) with a subservicer, at minimum the following areas should be reviewed and/or considered:

- A review of written policies and procedures to demonstrate the manner in which the subservicer conducts its business and its knowledge of serving requirements.
- A review of the subservicer's audited financial statements to verify financial stability or solvency.
- A review of the Errors and Omissions insurance and fidelity bond policies for agency compliance.
- Ensure the minimum net worth requirements of the agencies is maintained.
- Verify which agencies the servicer is approved with. This may be relevant if you currently, or plan to, service Fannie Mae, Freddie Mac, and GNMA loans.
- Recent adverse audit findings or suspensions by agencies and/or PMI companies.
- Annual servicer ratings as published by rating agencies S&P, Fitch, and Moody's.

- Whether the subservicer allows on-site audits by its customers.
- A review of the subservicer's technology platform and ability to review loan-level activity remotely.
- Customer Complaint/Dispute Resolution policies and procedures.
- Servicing fees and the manner of payment to the servicer, including ancillary income and float revenue.
- Allowance for termination of the servicing agreement for cause and outline of the transfer policy if services are terminated.
- Review of the SSAE16 (SOC1) Report, Regulation AB, and USAP reports.
- Ability to provide private-label servicing, if this is a requirement of the organization.

Monitoring of Subservicers

Once a subservicer is selected and begins servicing on behalf of the master servicer, the importance of conducting oversight and being able to document oversight efforts to those who may inquire is critical. This oversight requirement is clearly outlined in the various guidance that has been published to date and can be either conducted internally or outsourced to a third-party. Although the extent and timing of oversight may vary based on the size and complexity of one's portfolio, most oversight activities fall into either an annual, quarterly, or monthly oversight program, or on an ongoing or as-needed schedule.

Annual Monitoring Recommendations

- Conduct an on-sight visit to the subservicer's facility, taking specific notice of physical environment controls (i.e. visitor badges, locked server rooms, cameras, etc.) and the protection of non-public borrower information (NPI).
- Review financial statements for net worth compliance.
- Review E&O and fidelity bond policies for agency compliance.
- Review SSAE16 (SOC1) and request management responses for any significant control weaknesses or findings.
- Review critical vendor listing and evidence that the subservicer has developed monitoring policies and procedures for each (i.e. performs oversight of them).
- Review applicable policies and procedures for the incorporation of significant regulatory or agency changes.
- Review business continuity/disaster recovery plan and review the results of IT assessments performed (i.e. call tree exercise, network security assessment, penetration testing, etc.)

Quarterly Monitoring Recommendations

- Review call center reports for key metrics or significant changes since the last review (i.e. hold times, abandonment rate, etc.)
- Compare delinquency rate to prior periods and industry averages.
- Review consumer complaint logs and evidence that timely responses were provided to borrowers, and identify trends and/or patterns that might suggest that internal controls are failing.
- Review a sample of loans in various servicing areas for the following:
- Escrow disbursements are made timely and any penalty is assessed to the correct party. Escrow analysis performed per agency guidelines.
- Ensure Notice of Transfer requirements for newly-boarded loans are met.
- Evidence that reconciliations are performed and aged items are addressed.
- Ensure that ARM resets are calculated correctly and that notifications are provided to borrowers per agency timelines.
- Verify investor remittances are made by agency-specified cut-off dates.
- Ensure that late charges assessed agree to the note and/or state limits.
- For paid-in-full loans, review for evidence that escrow overages were returned within agency timeframes and lien releases properly administered.
- Discuss with subservicer any performance issues with critical vendors, turnover of key personnel, results of QC/internal audit reviews, or self-reporting items.

Monthly Monitoring Recommendations

- Review a sample of defaulted loans for evidence that borrowers are offered loss mitigation/alternative-to-foreclosure options per agency timelines, that loans are referred to foreclosure per agency requirements, and that non-performing bankruptcy loans are properly handled.
- Review monthly management reports provided by subservicer for trends, issues, anomalies, etc.
- Ensure all Early Payment Default (EPD) and First Payment Default (FPD) loans are QC'd and reported per agency guidelines.
- Monitor consumer complaints submitted to the CFPB, BBB, or received internally to ensure responses/research conducted and provided to borrowers.
- Reconcile servicing advances to loan-level detail in servicing system.
- Ensure any payments received internally and forwarded to subservicer are accounted for and effective dated to date of receipt.
- Review that loans with lender-placed insurance (LPI) were provided proper notices and any cancelled LPI policies were refunded back to the borrower's escrow account.
- Review a sample of loans boarded within the past 60 days for evidence that no late charges were assessed and no negative credit reporting occurred for the first 60 days after boarded with subservicer.

On-going or As-Needed Recommendations

- Ensure that loans transferred to the subservicer (whether on bulk or flow basis) are reconciled to subservicer records (i.e. UPB, escrow balances, critical fields, etc.).
- Ensure that document or information requests from subservicer are provided or responded to in a timely manner.
- For new subservicer relationships, ensure regular calls are scheduled and attended for the purpose of addressing concerns, training opportunities, issues, etc.

Conclusion

Whether conducted internally or outsourced to a third-party, proper oversight of your subservicer is essential in today's highly regulated environment. Regardless of the size or maturity of your portfolio with a subservicer, you are required and expected to have a developed and documented oversight program. Not only will having one keep you out of compliance hot water, but an effective oversight program can mitigate or identify origination concerns, mitigate losses, and provide confidence that your borrowers are receiving the personal attention you expect them to receive.

About the Author

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About Richey May & Co, LLP

As a certified public accounting firm with over 25 years of experience serving lenders across the country, Richey May has developed an oversight review program that includes testing of subservicers' policies and procedures and internal controls. We do this on behalf of multiple clients at the same time, thereby sharing expenses and creating cost savings that are passed on to participating clients. More information can be found on our **website**.

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