Servicing Retained/Released Resource Guide

In the current market environment, many lenders are considering expanding their business by retaining servicing, rather than selling loans on a servicing-released basis, or possibly developing a business strategy that combines the two options. Fannie Mae offers servicing-retained options to our approved seller-servicers for both whole loan and MBS executions to help lenders meet their strategic goals.

This **Resource Guide** outlines various factors related to business strategy, execution, economic and financial impact, and operations that may be important to lenders in deciding on their preferred servicing strategy. This Resource Guide is being provided for informational purposes only, should not be construed as legal, accounting, or tax advice, and may not highlight all of the relevant risks or benefits associated with adopting a particular servicing strategy. Lenders should consult with their own strategic, legal, and other advisors who are best able to advise on a lender's specific business circumstances.

Please contact your Fannie Mae Account Manager with any questions.

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Business Considerations

- Potential capitalization requirements associated with a servicing portfolio
- Differences in accounting treatment for various servicing strategies (if any)
- Ability to manage the risks associated with Mortgage Servicing Rights (MSR) volatility
- Cash flow differences (e.g., the tradeoff, if any, between receiving cash from the immediate sale of servicing (servicing-released) and the economic value from holding servicing over time (servicing-retained)
- Potential origination volumes that may be needed to meet profitability or other thresholds
- Need to develop strategies around holding or selling various products
- Need to establish a comprehensive risk management function, including:
    - Developing a risk tolerance policy and framework;
    - Developing an interest rate risk management strategy (outsourced or managed in-house);
    - Assessing the availability of data from your loan origination system; and
    - Creating a structure for risk management and analytic functions, including best execution analysis, pipeline tracking, mark-to-market, and position reports.
- Developing a flexible strategy – how will your decision to retain or sell servicing change based on different business or market considerations

Execution Considerations

Lenders should understand differences in whole loan vs. MBS execution.

- Excess Servicing
  - Fannie Mae whole loan execution eliminates the need for excess servicing as the lender sells the net pass-through rate (PTR = note rate – servicing fee).
    - A lender may retain anywhere from 25– 50bps in servicing.
  - For MBS execution, the buy-up/buy-down program can be utilized to fit a loan into a particular MBS coupon by buying up or buying down the guaranty fee (Coupon = note rate – servicing fee – guaranty fee). A lender can also retain excess servicing in lieu of using the buy up/buy down program.
- Remittance
  - Both the Actual/Actual and Scheduled/Scheduled remittance options are available for Fannie Mae whole loan sales through Pricing & Execution – Whole Loan® (PE – Whole Loan®).
    - Actual/Actual remittance is generally made as borrower payments are made. This remittance structure may at times have a higher price through PE – Whole Loan than Scheduled/Scheduled.
    - Only Scheduled/Scheduled remittance is available for the MBS execution.
      - Scheduled/Scheduled remittance requires interest and principal advances to be made on a schedule regardless of whether borrower payment has been received by the servicer.

Contact the Fannie Mae Capital Markets Pricing & Sales Desk at: 800-752-0257 with questions regarding these execution considerations.

Economic/Financial Considerations

- There are various strategies and techniques for valuing and hedging servicing assets:
  - Valuation of MSRs is generally based on the net present value of the future income stream, net of servicing costs. The value and pricing of MSRs can be highly dependent on future assumptions.
  - Modeling various hypothetical future interest rate risk scenarios can help highlight the potential volatility of servicing values.
- Ability to assess impacts of mark-to-market, interest rate risk, and impairment risk on the lender's balance sheet in various scenarios.
- Ability to manage an MSR portfolio, including accounting implications under various scenarios.
- Understanding potential sources of both revenue and expense:
  - Revenue – servicing fee income, prepayment speed assumptions, float on P&I and T&I, late fees, ancillary fees, cross-sell opportunities, customer retention value, etc.

- Expenses – salaries and benefits for staff members who support servicing or subservicing, overhead, hedging costs, amortization of the cost of acquiring MSRs, other direct costs, etc.

Operational Considerations

- Understanding the costs and benefits of building an internal valuation model, purchasing an “off-the-shelf” analytics/valuation model, or outsourcing development of a customized model to a third-party valuation/analytics vendor.

- Understanding the costs and benefits of keeping other servicing operations in-house or outsourcing to a third-party provider, subservicing, hedging, pipeline management, servicing platform, valuation models, daily operations, risk management, etc. Lenders may elect to use a subservicer to fulfill some or all of their mortgage loan servicing obligations.

Deciding whether to retain servicing, sell servicing-released, or combine them

There are many factors to consider when selling a loan servicing-retained or servicing-released to Fannie Mae, including:

Servicing Retained	
Advantages	**Disadvantages**
Retain relationship with borrower.	Cash investments and capital reserve requirements to hold servicing assets.
Receive servicing cash flow stream.	Must develop detailed business policies and procedures to support servicing.
Create a stream of potential earnings that can be countercyclical over certain interest rate scenarios.	P&I advance expenses associated with loans with Scheduled/Scheduled remittance cycles.
Possible to scale servicing costs by using a subservicer.	Costs for subservicing and other third-party service providers.
Create franchise value in firm.	Costs of technology investments or outsourcing technology.
Increased profitability when aggregators offer less competitive SRP bids	Potential changes in profitability based on aggressiveness of SRP bids.

Servicing Released	
Advantages	**Disadvantages**
Leverage funds received upfront for the servicing asset to support other business areas.	Hedging interest rate risk of the MSR and accounting responsibilities.
Avoid servicing asset risk.	Potential loss of borrower relationship and/or refinance opportunity.
Not required to hold additional capital.	Volatility of Servicing Released Premiums (SRPs).
Avoid hedging interest rate risk of the MSR.	Potential loss of a long-term regular revenue stream.
Do not need a servicing operation.	Potential for pricing changes during lock period.
Depending on market environment, may be better overall execution.	Subject to pricing overlays and underwriting/origination policies of aggregators.
In some cases, enable Fannie Mae sales with access to secondary marketing advantages such as ASAP, ASAP Plus, and specified pools through an aggregator.	Early payoff - SRP recapture risk.

Servicing Released	
Advantages	**Disadvantages**
	Possible separate wires for loan asset and SRP fundings.
	Possible minimum monthly volume requirements imposed by servicing buyers.

Servicing Marketplace

Most Fannie Mae-approved sellers may begin using Servicing Marketplace, available in Pricing & Execution – Whole Loan.

> **NOTE:** *New lenders who are Provisionally Approved are able only to sell loans with servicing-released during this period. Seller/Servicer applicants who are approved may retain servicing when they reach Full Approval.*

	Servicing Marketplace
Fannie Mae seller eligibility requirements	Fannie Mae-approved sellers with a minimum net worth of $2.5 million plus the greater of 25bps of UPB servicing or 25bps of bifurcated sales for the past 3 years
Fannie Mae onboarding process	Most Fannie Mae-approved sellers have access to Servicing Marketplace. Sellers must establish relationship(s) with at least one servicing partners before selling loans servicing-released using the Servicing Marketplace.
Seller access to servicers	Seller and servicer negotiate terms of the relationship, including SRP pricing, servicing Purchase and Sales Agreement (PSA), and data and document delivery requirements.
Available through PE – Whole Loan	Yes.
SRP pricing method	Seller has access to servicer SRP pricing and performs own best-ex analysis, then chooses the servicing partner when committing.
Bifurcation option	All sales bifurcated.
Execution options	Whole Loan – Mandatory
Commitment type	Single or multiple loans
Minimum transaction volume	Servicers may impose delivery volume min/max depending on the individual seller.
SRP locked in at time of commitment	Yes. Seller locks-in the SRP pricing schedule that will apply to all loans delivered under the associated commitment.
All-in funding for sale of loan and servicing within 48 hours	Yes.
Servicing buyers	View this chart for the current Servicing Marketplace servicing buyers

Definitions

Business Component	Definition
Best Efforts Whole Loan Execution	Ability to sell directly to Fannie Mae without taking on the interest rate risk associated with a borrower rate lock. The asset price will be lower than a mandatory execution.
Mandatory Whole Execution	Ability to sell directly to Fannie Mae while taking on the interest rate risk associated with a borrower rate lock.
Pipeline Best Execution	Ability to compare all-in delivery pricing for sellers to deliver loans at their highest value.
Pipeline Hedging	Ability to derive daily and intraday risk and hedging reports based on best execution and expected closing percentages.
Outsourced Hedging	Pipeline Hedging where the vendor monitors seller's risk position and executes trades daily on behalf of the client (usually through POA). The relationship suits new hedgers well, as they leverage the trade desk, expertise, and trade volume of the vendor.
Pipeline Consulting	Consulting across a variety of pipeline topics such as finding warehouse banks, internal controls, lock-in and hedge policies, investor relationships and selecting pipeline hedging vendor. This relationship may cross over to consulting on servicing topics.
Pipeline Analytics Licensing	Vendor offers a commercial, turn-key product that sellers can license and use to affect hedging a mortgage pipeline and performing best execution. Licensing is typically employed by sellers with risk management expertise.
Retain/Release Analytics	Vendors that provide daily analytics on whether selling individual loans on a retained or released basis is more advantageous to the seller.
Subservicing	Vendor that provides outsourced servicing for servicers.
Servicing Consulting	Consulting across a variety of servicing topics including starting a servicing operation, determining whether to service or subservice, loss mitigation and compliance, and variety of other topics.
Servicing Valuation Services	Vendors that provide third-party market values for servicing portfolios. Some of these vendors also broker servicing rights when servicers are looking to sell servicing.
Servicing Valuation Software	Vendor offers a commercial, turn-key product that can be licensed and used by servicers and vendors providing servicing valuation services to price and account for servicing assets. Licensing is typically employed by servicers with some MSR valuation expertise and a reasonable-sized portfolio.
Servicing Risk Management Services	Vendor offers risk management measurement, hedge strategies, and recommendations for hedging a servicer's MSR portfolio. Vendor may or may not provide outsourced hedge execution. Vendor employs valuation and hedge analytics in making its recommendations.
Servicing Risk Management Software	Vendor offers a commercial turn-key product that servicing hedgers can license and use to hedge and account for servicing assets and hedges. Licensing is typically employed by servicers with MSR hedge expertise.