

Streamlining MSR Transfer: Blockchain Shows the Way

Abstract

Frequent sale and purchase of mortgage loans as well as their servicing rights in the US is critical to market liquidity and for generating revenues. However, the mortgage servicing rights (MSR) transfer process is intricate to say the least, given the manual checks and cumbersome handoffs that make it error-prone and can potentially jeopardize borrower interest. Therefore, it has attracted strict regulatory scrutiny and the industry is under tremendous pressure to execute smooth transfer ensuring service continuity and regulatory compliance. Any slipups can result in financial, legal, or reputational risk for servicers. This paper analyzes the complexities of MSR transfers and explores blockchain as a possible solution to alleviate the associated process challenges and risks.

Current Mortgage Landscape: Evaluating the Challenges in MSR Transfer

For decades, the sale and transfer of mortgage servicing rights (MSR) have been a critical part of the mortgage value chain. The use of traditional business models have led to increased risk and limited trust across the mortgage value chain. Huge amounts of loan data and documents (both electronic and physical) move from one entity's systems (transferor servicer) to another's (transferee servicer). It demands close collaboration between the parties involved to ensure continuity in mortgage servicing obligations. Data is exchanged through data tapes or spreadsheets making it difficult to review and reconcile causing additional delays and bottlenecks in handoffs and funding leading to consumer complaints. Consequently, regulators have warned servicers to refrain from sloppy account transfers during MSR sale. Government sponsored enterprises (GSEs) like Fannie Mae and Freddie Mac are considering extending services and technology to lenders to enable smooth, secure, and effective data management during the transfers to avoid regulatory pitfalls.

MSR transfer execution is fraught with challenges for both the buyer and the seller as there are moving parts to it. Despite the fact that the loan portfolios are changing hands, the MSR buyer and seller organizations have no control over the loan servicing events such as mortgage payments, loan defaults, and bankruptcy proceedings and so on affecting the underlying loan attributes in the mortgage portfolio. However, service continuity cannot take a back seat. A typical transfer process takes 60-90 days and requires the retiring servicer to keep the new servicer up-to-date on the loan servicing activities. Multiple data and document exchange requirements during the transition phase expose the entities to the risk of documents getting lost or misplaced in transit.

Delay in loss mitigation activities, initiation of dual-track foreclosure, unnecessary force-placed insurance in the absence of real-time updates, and error-prone manual processes add to the complexity. Distrust between the parties due to lack of transparency and the need to ensure safe and secure MSR transfer without compromising borrowers' personal data further complicate the situation. To address these challenges, the mortgage industry needs a technology that can bring key stakeholders together during the transfer process and give them full visibility into a transaction, while ensuring security and auditability of data.

Why Blockchain for Mortgage Industry?

The mortgage industry perceives blockchain as a game changer for their business given its ability to facilitate speedy, transparent and secure data movement. Interestingly, the Mortgage Industry Standards Maintenance Organization (MISMO) has created the Blockchain Community of Practice¹ to evaluate potential use cases of blockchain and its feasibility for the mortgage industry which is a significant and welcome move. Another significant event has been the formation of the Office of Innovation by the Bureau of Consumer Financial Protection (CFPB)² to promote competition and innovation. In addition, CFPB has also proposed a product sandbox to enable companies to test new financial offerings under their safe harbor provision.³

MSR transfers demand a coordinated effort between the transaction partners and blockchain could be the much-needed innovation, for it is capable of creating a conducive ecosystem by bringing these parties together on a single platform. Blockchain's capability of providing key participants real-time access to data, while simultaneously maintaining an electronic ledger of the entire transaction ensures transparency and provides proof of compliance. It can enable servicers to view transactions in real time, instilling confidence in the integrity of a transaction. Also, the immutability of data stored in blockchain ledgers creates auditable trails and helps build trust between stakeholders.

Putting it all Together

Adopting blockchain for MSR transfers will require lenders to set up a private blockchain with permissioned access for all the stakeholders. Once a mortgage loan is originated on the blockchain platform, the parties to the transaction would share relevant loan information required to assess a loan application. Based on set criteria for approval, blockchain would enable automatic generation of mortgage contract, loan account setup, and title registration. An immutable record of the entire transaction would be maintained on the blockchain ledger, which is extended with read and write control to the transferee servicers and other parties when the loan is sold or servicing rights transferred. Alternatively, a new blockchain database could be built and integrated into the loan origination, servicing, or other systems of the transferor servicer—this could serve as the single source of truth. This sophisticated shared blockchain database can have additional nodes (partners) with limited access to the data records. The nodes must include transferor servicer, transferee servicer, GSEs,

transferor and transferee custodians and additional parties if necessary (see Figure 1).

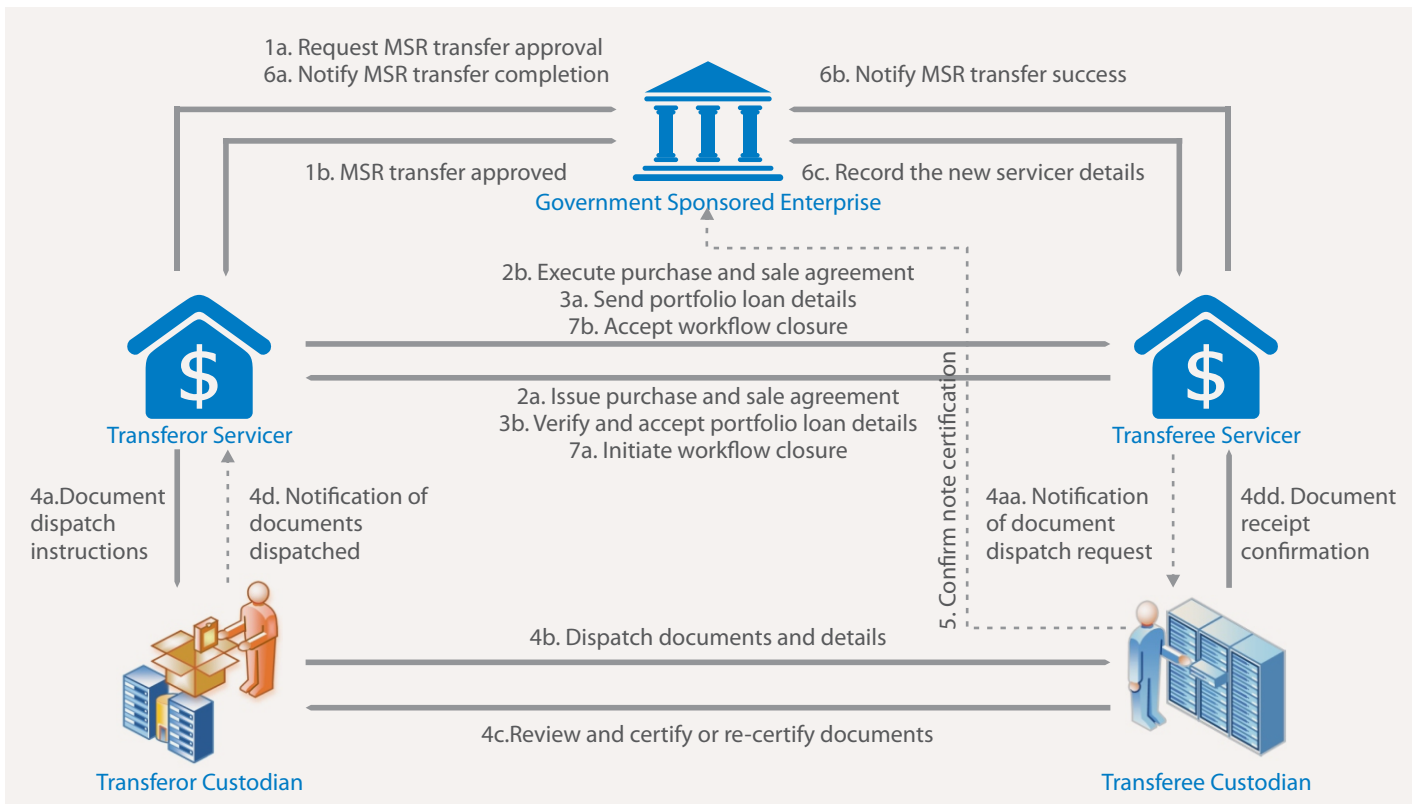


Figure 1: Blockchain-based MSR Transfer

Digital identities can be used to authenticate each network user or entity on the blockchain. Once into the system, the acquiring servicers (transferee), who are given limited access, can perform a quality check of the portfolio before executing an MSR purchase and sale agreement. Once the contract is signed, transferee servicers can have full access to the mortgage loan records and documents for review and onboarding. For loans originated on the blockchain ledger, the technology allows original documents to be stored on the blockchain with a provision for shared access. For loans that are not originated on the blockchain ledger, documents can be added on the blockchain with a digital identity to prevent duplication and record version change.

Documents and data shared in real time from a single shared source are vetted through compliance checks with proof built directly into the system. Once the loan data is validated, reconciled and on-boarded to the transferee servicer’s system, the MSR transfer workflow can be completed triggering the transfer of funds to the transferor servicer. Once funds are transferred, transferee servicer’s access to the blockchain is revoked.

Take the Next Step

Clearly, blockchain has immense potential to streamline data distribution procedures and facilitate secure and seamless MSR transfer and deliver myriad benefits to all the stakeholders (see table 1).

Player	Existing challenges	Benefits
<ul style="list-style-type: none"> MSR transferor – releasing servicing rights 	<ul style="list-style-type: none"> Manual process for GSE approval, purchase and sale agreement execution and payment transfers Manual efforts to link documents and data for portfolio transfer Multiple data transfers during interim servicing Manual sharing of document hard copies with transferee servicer and custodian Default and buyback risk due to missing information 	<ul style="list-style-type: none"> Smart contracts to trigger quick document execution, payment transfers and workflow closure Automatic integration of accurate loan data and documents with servicing platform Real time data transfer – eliminates multiple transfers Real-time document access to transferee and custodian Reduced buybacks due to accurate loan data and documents
<ul style="list-style-type: none"> MSR transferee – acquiring servicing rights 	<ul style="list-style-type: none"> Time consuming due -diligence process leading to delayed on-boarding Discrepancy resolution over emails Incorrect or missing data or documents Default risk and wrong customer communication due to lack of timely servicing updates Delays in reporting to GSEs, investors 	<ul style="list-style-type: none"> Quick due-diligence review with real -time access to transferor’s data enabling faster on-boarding Real time data updates with audit trails enable quick error tracking and reconciliation Accurate data and documents Accurate customer communication with real -time access to customer servicing status (active or default) Timely reporting with audit trails
<ul style="list-style-type: none"> GSEs, investor 	<ul style="list-style-type: none"> Lack of transparency in portfolio management. Inefficient portfolio management Higher default risk due to inefficient securities monitoring 	<ul style="list-style-type: none"> Increased visibility of the servicing portfolio Real time data analytics resulting in improved asset performance and portfolio management Fewer defaults due to improved monitoring creating a stable and liquid market for MSRs
<ul style="list-style-type: none"> End customers or borrowers 	<ul style="list-style-type: none"> Lack of transparency Hurdles in customer service Missing payments or data 	<ul style="list-style-type: none"> Increased transparency in servicing management Smooth, un-interrupted servicing despite servicer change Timely and accurate payments and loan balance data

Table 1: Benefits of Blockchain Technology

To ensure hassle-free migration to blockchain, banks must initiate some preliminary steps before embarking on an implementation program:

- Standardize data assets and ensure data interoperability between blockchain systems and the existing lending systems for seamless data movement.
- Choose between executing a smart contract with the MSR and loan agreements integrated into the blockchain ledger or signing agreements externally and subsequently integrating the digital documents. Individual banks will need to weigh the cost and effort of implementing a smart contract against the benefits depending on their specific needs.
- Adopt measures to ensure compliance with data privacy regulations as customer sensitive data is shared through the blockchain.
- Collaborate with fintechs to develop pilots and run tests in a sandbox environment to assess the viability of the solution based on organization-specific requirements.



Looking Ahead

Given the encouraging signs of support from regulators for fintech innovations, the time is ripe for mortgage industry players to innovate and reap the benefits of blockchain technology. The evolving digital ecosystem also compels mortgage servicers to rethink their business models and transform operations by adopting new age technologies or risk losing market share. The way forward for mortgage servicers lies in collaborating with key stakeholders to adopt blockchain-powered automation. However, the ownership, funding and governance of blockchain platforms as well as the modalities for a new blockchain-specific regulatory framework will need to be worked out to ensure a seamless, friction-free transition.

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About The Authors

Lakshmi Priya Das

Lakshmi Priya Das is a Functional Consultant with TCS' Banking, Financial Services and Insurance (BFSI) business unit. A subject matter expert in mortgage operations, she worked with a leading mortgage servicing organization before joining TCS. Over the last 14 years, Lakshmi has built significant expertise in the US retail mortgage market and has worked on strategic consulting assignments for TCS' leading clients. Lakshmi holds a Bachelor's degree in Computer Science from Seshadripuram College, Bangalore, India, and a Master's degree in Finance from Symbiosis Centre For Distance Learning, Pune, India.

Kalpana Palaniappan

Kalpana Palaniappan is a Domain Consultant with TCS' Banking, Financial Services and Insurance (BFSI) business unit. She worked with a leading mortgage servicing organization prior to joining TCS. She has 16 years of mortgage experience providing consulting and domain support for business transformation initiatives. Kalpana is a IIBA-certified business analyst and US mortgage underwriter. She holds a Bachelor's degree in Commerce from Christ University, Bangalore, India, and a Master's degree in Finance from the Mount Carmel Institute of Management, Bangalore, India.

Contact

Visit the [Banking & Financial Services](#) page on www.tcs.com

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