

VOLUME 2:

The Servicing Decision

**Why the Retained Versus Released Decision
Demands More Than a Reflex**

**A practical guide to how mortgage lenders can
make smarter decisions about releasing or retaining
servicing, and what to keep in-house if retaining.**

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Setting the Stage

WHY THE RETAINED VERSUS RELEASED DECISION DEMANDS MORE THAN A REFLEX

[Volume 1 of The Servicing Decision](#) examined a question that many mortgage lenders have long grappled with: for originators that choose to retain servicing, should the loan administration function be handled in-house or outsourced to a subservicer? That volume highlighted (and the industry's experience has consistently confirmed) that the answer is a strategic choice with long-term consequences for profitability, borrower experience, and operational resilience. It is not a question of costs alone, or portfolio size, or what the lender has always done.

This volume tackles a different question: whether to retain servicing, and if servicing is retained, what should be retained. For many lenders, the retained versus released question is executed through a process that may not adequately account for all the long-term implications; it is often more focused on the immediate day-one cash and income statement impact than on the long-term impact on cash, customers, equity, and taxes.

Done well, the decision to retain servicing can stabilize earnings, foster long-term borrower relationships, and build a consistent source of fee income. Done poorly, or with the wrong loans retained, it can create operational, regulatory, and financial risk that compounds quietly until it becomes a severe problem.

What follows is a rigorous, balanced examination of both paths. Releasing servicing is not a failure of strategy or ambition; for many originators, it is the right choice. Retaining servicing is not automatically the more sophisticated option; it demands infrastructure, discipline, and organizational commitment that should not be underestimated. Whether a lender has retained servicing for years, sold released for years, or is contemplating retention for the first time, this guide is designed to provide a conceptual framework, some guardrails, and a set of best practices. It is not a how-to manual. It is a framework for making a consequential decision with the clarity it deserves.

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One prerequisite demands early emphasis: a mortgage lender cannot retain servicing without the proper approval. For Fannie Mae and Freddie Mac (also referred to as “GSE”), a lender may hold selling authority without holding servicing authority, which requires a separate level of approval. A lender can be an approved seller to Fannie Mae or Freddie Mac, or it can be an approved seller and servicer; those are different designations. Many lenders initially obtain their seller and/or servicer authority from one agency and then pursue the other once established. Both Fannie Mae and Freddie Mac have experienced and dedicated teams to assist lenders through the approval process.

Ginnie Mae is a separate approval entirely, with operational and financial requirements detailed in [Chapters 2 and 3 of the Ginnie Mae guide](#). Lenders that route all production through aggregators and have not pursued agency (Fannie Mae, Freddie Mac, or Ginnie Mae) approvals simply do not have the option to retain agency servicing, regardless of whether the economics might favor it. That approval, and what it enables, is the starting point. It is important to note that once a servicing approval is received, the lender understands the financial, capital, operational, performance, and servicing minimums required to maintain good standing. State servicing licensing requirements must also be obtained and maintained, and if the decision is made to retain servicing, it is best to consult with a law firm that understands the licensing requirements.

CHAPTER 1:

Understanding the Decision

What “Retained” and “Released” Actually Mean, and Why the Distinction Matters

For mortgage originators that create secondary-market-eligible loans and hold the necessary agency approval and state licenses to service, every closed loan presents a choice. The decision of what to retain and/or release, and how, is among the most consequential a mortgage lender makes. It impacts the cash flow, capital/equity position, balance sheet composition, income statement, competitive positioning, and the long-term ability to manage the borrower relationship for future products or services, and taxes. It warrants a well-documented, consistent, and integrated approach aligned with the lender’s long-term strategy.

DEFINING THE DECISION

When a mortgage originator creates a secondary-market-eligible loan, as discussed earlier, two separable assets are created: the right to receive the majority of the loan’s principal and interest, and the right to administer the loan by collecting payments, managing escrow, communicating with the borrower, handling delinquencies, and receiving a servicing fee in return. These two assets can be sold together or separately. Whether they travel together or apart is what the retained versus released decision determines.

THE FIVE EXECUTION PATHWAYS

In practice, the retained versus released decision branches into five distinct execution models, each with varying levels of financial, operational, regulatory, and compliance risk.

1 Servicing released to an aggregator. The lender sells the loan servicing released to an aggregator, a financial institution that purchases loans for delivery to an agency, securitization, or portfolio investment. Selling a loan servicing released often generates maximum day-one cash, as the combined value of the loan and the servicing right is monetized. The lender receives immediate cash for both the loan and the servicing value. The lender does not service the loans nor maintain an on-going relationship with the borrower beyond the origination process. Selling a loan servicing released includes a number of representations and warranties, and potentially some prepayment or default language in the sale contract. This is the most common path for lenders without agency approvals or those who have chosen to not retain servicing as part of their strategy. It is important to note that certain mortgage products may be sold servicing released by mortgage originators who choose not to retain certain mortgage products.

2 Direct agency delivery with immediate MSR transfer. The lender sells the loan directly to a GSE, or creates a Uniform Mortgage-Backed Security (UMBS) or a Ginnie Mae security, but immediately transfers the servicing to an MSR investor upon delivery. The lender maintains a direct-to-agency delivery relationship but immediately monetizes the Mortgage Servicing Right (MSR) value via a co-issue or Pools Issued for Immediate Transfer (PIIT) sale to an MSR buyer.

3 Servicing retained with in-house loan administration. The lender sells the loan directly to Fannie Mae or Freddie Mac, creates a UMBS security, or creates a Ginnie Mae security, retaining the right to service in all cases. The lender creates the MSR as an asset on the balance sheet and begins a stream of income and servicing expenses that unfold for the life of the loan. The loan administration function is performed internally.

This pathway demands the most infrastructure: a servicing platform, compliance staff, vendor relationships, and the discipline to manage the servicing business alongside origination.

4 Servicing retained with a subservicer. This execution model is nearly identical to the in-house model, except the loan administration function is performed by a third party. The MSR owner retains ownership of the asset and the master servicer designation while relying on the subservicer for day-to-day borrower interactions. This pathway preserves most of the financial benefits of retention while substantially reducing the operational burden. The advantages and considerations of this arrangement are addressed in depth in Volume 1.

5 Portfolio retained. The lender holds the loan on its own balance sheet rather than selling it into the secondary market. This pathway falls outside the primary purpose of this guide, which focuses on loans originated for secondary market sale.

WHAT HAS CHANGED, AND WHY THIS DECISION DEMANDS MORE RIGOR NOW

According to the Financial Stability Oversight Council's 2024 Report on Nonbank Mortgage Servicing, nonbank servicers now hold approximately 66 percent of all agency mortgage servicing rights, up from 35 percent in 2014. The shift was driven in large part by the capital treatment of MSRs under Basel III, which assigns a 250 percent risk weighting to the asset, making the MSR very capital-intensive for regulated depositories. Banks were also subject to penalties under the False Claims Act, which further disincentivized retaining FHA servicing, and many still bear the scars of the delinquencies and repurchase demands of the post-2008 period. The structural reordering continues to evolve as the strategic value of servicing data, along with the desire to retain a customer for life, intensifies competition for borrower relationships. Historically, servicing data was viewed as a routine task, but it is now recognized as a critical component to understand the borrower and create a long-term financial relationship.

Note: the current 250 percent risk weighting is being challenged by the Mortgage Bankers Association and other industry trade groups, which have advocated for reducing the risk weighting to 100 percent under the latest Basel III proposal. The comment period closed in mid-June 2026. Contact our team for the latest developments on MSR risk weighting.

At the same time, the MSR secondary market has matured significantly, with a deepening pool of loan buyers that includes banks, insurance companies, real estate investment trusts, and private equity-backed specialty servicers. The analytical sophistication with which those buyers value servicing assets has also increased, and industry consolidation has raised the strategic stakes further. Large-scale mergers are creating mega mortgage platforms that combine origination scale with substantial servicing portfolios. These platforms operate as self-reinforcing flywheels where the servicing relationship feeds future origination, which grows the portfolio, then creates even more origination. The originator that releases its servicing feeds that flywheel for its competitors. Increasingly, retail-focused mortgage lenders are exploring retained servicing to retain borrowers as lifelong clients.

CHAPTER 2:

Why Retain? Why Release?

The Core Case for Each Path

Every retained versus released decision is, at its core, based on a set of assumptions. The total price of a servicing released execution is known; however, the breakout between the loan and the actual Servicing Release Premium (SRP) is opaque. The internal MSR value used in the best execution analysis is an estimate based on a diverse set of assumptions. The total gap between a retained and released execution is observable, but the true value of the servicing is difficult to compare, and the day-one math may not capture the entire financial picture.

THE CASE FOR RELEASING

Releasing servicing has acquired an unfair reputation in parts of the industry, often portrayed as short-term thinking or a choice made by lenders who could not hold the asset. That framing is too simple and increasingly wrong. If the decision is made to release, it is important to understand that the mortgage customer may be lost for future originations or cross-selling other products. In addition, loan officer recruitment and retention may prove more difficult. Yet for many lenders and in many market conditions, releasing is strategically the correct decision and the best option.

The Cash Case

The most straightforward case for releasing is also the most powerful: cash! The need to monetize the value of servicing for immediate cash may be the lender's most important and pressing need. Cash (other than paying taxes) comes with no conditions attached. It does not prepay ahead of schedule. It does not go delinquent. It does not generate a compliance violation or require a team of specialists to manage in the event of a natural disaster.

For independent mortgage banks and other non-depository institutions whose business

models depend on gain-on-sale income to fund overall mortgage operations, cash matters enormously. When origination margins compress or volume declines, retaining servicing may not be the best strategic choice, either short- or long-term. It becomes a cash flow problem. For newer or smaller servicers, the servicing portfolio may take months or years to reach the scale at which it generates a positive net cash flow. Servicing cash flow is one key element, but it is important to look at servicing on a pre- and post-tax cash basis (refer to chapter 4 for more detail), in addition to the impact on the income statement, balance sheet, and equity.

The question for non-depositories is not whether retaining servicing is desirable in theory. It is whether the institution understands the pros and cons of retaining servicing and is retaining servicing consistent with its strategy.

For banks and credit unions, the cash argument carries little weight. Banks and credit unions have a diverse set of cash sources. Depositories have diverse funding sources and can easily absorb the deferral of immediate cash, and if servicing fits within

their strategy, it is retained. The retain/release math for these institutions is different, a point addressed more fully in Chapter 3.

The Risk Perspective

Outside of cash, the next most common reason for releasing servicing is the potential risks associated with retaining it. The decision to retain servicing exposes the MSR holder to a number of risks, and risks can change quickly. The most obvious risk is the potential valuation risk associated with the MSR asset. The MSR asset value is volatile and can change quickly due to a number of factors, including interest rate risk, prepayment risk, default risk, cash advance obligations, and regulatory and compliance risk, which shift over time in ways that are difficult to predict.

A lender that retains servicing without the expertise and infrastructure to manage risks often wish they had released it. The risks associated with retaining servicing are not hypothetical; they are structural features of servicing and vary greatly with market conditions. Some of these risks can be mitigated based on what servicing is retained, but servicing is not a risk-free asset.

The Customer Considerations

When a lender sells a loan servicing released, it surrenders the borrower relationship to whoever acquires the loan. The loan officer and mortgage lender who spent time building trust with that borrower have now handed that relationship to a stranger shortly after the loan closes. If the customer doesn't fit the lender's strategic profile and is unlikely to generate future business opportunities, the relationship transfer might make the most business sense. Servicing a customer introduces other risks, such as compliance and regulatory oversight, which can be avoided

when servicing is released. For a deeper look into these customer considerations, refer to Volume 1.

THE CASE FOR RETAINING

The case for retaining servicing is compelling if the risks are well understood and managed, and servicing fits within the overall strategy. Retaining the riskier servicing can create an illiquid or poorly performing servicing portfolio in terms of returns relative to a well-crafted portfolio retention strategy.

The Annuity Factor

A lender that retains a well-constructed servicing portfolio will, over time, generate positive cash flows that can help offset the volatility of the origination business. Rather than the cash being infused at the time of selling the loan, the servicing cash (less expenses) is received over time. Typically, the modeled servicing cash flows extend when rates increase and origination declines. Gain-on-sale income is volatile and cyclical. Servicing fee income is steadier and does not disappear when origination volumes fall or origination margins compress. The lenders that retained a material amount of servicing weathered the origination challenges that began in the second half of 2022 and remain present today in many cases, more effectively than the mortgage lenders that did not retain servicing.

Servicing fee income can offset the volatile nature of the mortgage origination business. Without it, the mortgage business has no ballast—only the volatility of the origination market, with no offset from servicing when conditions deteriorate in the mortgage origination business.

A lender that retains servicing also retains the relationship with the borrower. Servicing puts the lender in monthly communication with the borrower, and if servicing is done well, the servicer is the institution the borrower may engage with when they want to refinance, obtain a second mortgage/home equity line, or buy a new home. When mortgage rates change and refinancing makes sense, the servicer is hopefully the first and only consideration the borrower makes. Recent ICE Mortgage Technology data indicates that servicers have retained approximately 30 percent of their borrowers in refinance transactions over the past decade.

Each refinance captured from an existing servicing book generates a new origination gain (hopefully), a new MSR, and extends the relationship. Each refinance that goes to a competitor terminates the servicing cash flows. Beyond recapture, retained servicing generates a continuous stream of behavioral data that enables a servicer to identify refinance and cross-sell opportunities earlier than a competitor who has never had a relationship with that borrower.

The ‘Trigger Leads Bill’ that took effect March 5, 2026, dramatically restricts who can market to borrowers based on credit trigger data, effectively closing off one of the primary channels through which non-servicing lenders could engage with potential borrowers. For lenders that release servicing and rely on trigger leads as a source of mortgage leads, this is a meaningful change in the competitive landscape. For lenders with retained servicing, the legislation reinforces an existing advantage: they already own the relationship and do not need to purchase access to it.

Increasingly, retail-focused mortgage originators view retraining servicing as critical to loan officer recruitment and retention.

The Customer Data Dimension

Historically, servicing data was an afterthought; the common objective was to retain and update only the minimal data required to service the loan and comply with investor and guarantor standards. However, as technology and data storage costs changed and servicers became more engaged with their customers, servicers learned that servicing data was valuable and no longer simply a necessary by-product.

Several material mergers and acquisitions, and the consolidation of larger servicers, have created larger platforms with significant data analysis and recapture programs. As a result, some lenders are concerned about losing their customers to a competitor who can better leverage the servicing data and engage with them to identify refinance opportunities and capture other potential revenue. The ultimate success of these mega-servicers and their ability to mine and monetize the data as a strategy remains to be seen in the coming years. While the industry awaits results on the value and actionability of the servicing data, as discussed previously, retail-focused lenders are increasingly interested in exploring whether they should retain a portion of their mortgage production to protect the customer relationship and support long-term recapture opportunities.

The Enterprise and Equity Value

An IMB with no servicing has a thin balance sheet, lacks stored value created from servicing (the MSR asset), and often struggles to create equity. A company that retains servicing has a more diverse balance sheet, but the inclusion of the MSR asset creates stored value and grows the entity's equity. In M&A transactions, which have dramatically reshaped the competitive landscape in recent years, the servicing portfolio has become the primary basis for immediate transaction value in many deals, aside from potential earn-outs from future production. Companies that have consistently released servicing have maximized short-term cash at the expense of building the MSR asset and potentially the company's equity.

The MSR portfolio is not just about the annuity-like cash flows. It is a strategic source of stored value on the balance sheet.

The Natural Hedge

Traditionally, there is a natural offset between the mortgage origination business and the servicing business. When rates rise and origination volumes fall, prepayment speeds slow, servicing income extends, and the MSR values increase. When rates fall and origination volumes surge, prepayment speeds accelerate and MSR values decline. The same market condition that compresses origination margins often expands servicing value, and vice versa. Lenders that have both substantial origination businesses and material retained portfolios have, over time, demonstrated materially lower earnings volatility than peers relying solely on

origination income. The natural hedge may not work as well in practice because several factors beyond the absolute level of mortgage interest rates affect the origination function. In addition, the volume of originations made during the COVID-era has impacted the origination function as a large volume of historically low note rate servicing was created.

HOW THE DECISION IS MADE, AND HOW IT SHOULD BE

For mortgage lenders that do not retain the vast majority of servicing, the retained versus released decision is often made by comparing the aggregator released execution to the internal MSR value plus the direct agency loan execution. That framework is not without logic, but it requires a well-developed process to determine the MSR value assigned to the decision-making process. If the MSR value process is not performed with the same level of precision as sophisticated aggregators, a poor best execution decision can be made due to the difference between the internal MSR value and the value assigned by the aggregators.

As discussed earlier, the released execution always provides the most immediate cash. The capitalized MSR value is the fair value assigned by the mortgage lender and includes a number of significant assumptions creating the present value of future cash flows. Key assumptions to determine the MSR value include prepayment speeds, servicing costs, discount rates, and recapture income. A lender that treats its internal MSR valuation as authoritative without pressure-testing its assumptions may be running a poor quality or unreliable best execution model.

The retained MSR value is not a fact about the actual cash flows or a guarantee. It is a model's best estimate, constrained by the quality of the assumptions made and the detail with which they are applied.

A sound retained versus released decision process should begin with a strategic question, not a mathematical one: Which loans does this institution actually want in its servicing portfolio? Not which loans have the best day-one MSR value, but which loans fit the institution's long-term strategy, customer relationship standards, geographic footprint, recapture capability, cross-sell infrastructure, and operational capacity. Once that definition

exists, production can be sorted deliberately: retain from the population of the loans that fit the strategic profile, release the rest as efficiently as possible. The goal is not to maximize the day-one cash extracted from every loan; it is to retain the loans that fit the strategic profile and objectives and release the rest.

A lender that retains the wrong loans is not building a long-term investment. It is building a set of potential risks that may result in negative cash flows or an illiquid portfolio.

CHAPTER 3:

The Decision by Institution Type

The Core Case for Each Path

The retained versus released decision is not the same for every lender. The cash dynamics, risk tolerances, and customer relationship implications differ, and the organizational identity that shapes how each institution thinks about the mortgage business differs most of all.

INDEPENDENT MORTGAGE BANKERS

No institution type carries more retained versus released variations than the independent mortgage banker. At one end of the spectrum sits the small retail mortgage originators for whom retaining servicing is a cash management challenge first and an investment thesis second. At the other end sits the large-scale servicing platform generating significant cash with a large, dedicated capital markets operation, direct agency relationships, and the analytical infrastructure to model MSR value, including the recapture economics across various economic and market conditions.

For smaller IMBs, releasing servicing is often straightforward because day-one cash is the constraint, the origination engine runs on monetizing the servicing, and the infrastructure required to manage a retained portfolio does not yet exist. Smaller IMBs with the necessary agency approvals to retain servicing often only retain a material amount of servicing when the gain on sale margin from originations is elevated. During periods of lower origination volumes or gain on sale margin compression, minimal servicing is often retained. The minimal servicing retained should be the servicing that fits their strategy

and has the best chance of providing positive cash flows. It is imperative not to select and retain servicing with elevated risks that will generate suboptimal cash flows.

For mid-size to large IMBs, the retained versus released is split into two groups. Some mid-to-large IMBs are remarkably similar to the smaller IMBs in terms of being very selective and retaining minimal servicing except for when market conditions dictate that servicing can be retained. For mid-size to large-scale IMBs that have a material servicing portfolio, they are more likely to continue to retain a majority of their servicing and often only sell servicing released when the released execution is materially higher than the internal valuation. Mid-size and large IMBs with material servicing portfolios view their servicing portfolio as a competitive advantage. Large servicing portfolios generate significant cash that allows the IMB to retain servicing and address the cash shortfall created from the retained decision. The IMBs that have built sustainable, through-cycle businesses have almost without exception built them on the foundation of a retained servicing portfolio.

One nuance is more specific to IMBs using a subservicer; the subservicing arrangement removes one of the traditional pressures toward retention. A bank or credit union with an in-house operation must retain sufficient volume to justify its fixed infrastructure. An IMB that uses a subservicer faces the challenge of maintaining enough servicing to cover the subservicing minimums, but does not have the same staffing constraints of servicing in-house. The retained versus released decision can be made purely on an economic and strategic basis, as well as internal staffing needs.

Some IMBs will finance or leverage their MSR (the value) to help reduce the stress on cash deferment. MSR financing terms and structures can vary greatly based on the size of the IMB. While MSR lines reduce the cash drain from retaining servicing, they introduce another potential risk of a margin call if the MSR value falls below the desired loan-to-value on the MSRs. The larger IMBs may also issue corporate debt to help finance the retention of servicing and, in some cases, have created complex financial structures to help bridge the cash shortfall created by retaining and having to fund servicing advances.

BANKS: LARGE, COMMUNITY, AND REGIONAL

For large banks, the binding constraint is not cash, it is capital. The MSR is a 250 percent risk-weighted asset under the current Basel III. Since most banks are in the retail origination channel and maybe the correspondent channel, the question bank leadership is actually asking is not “what is the best execution?” but “how much risk-weighted capital do we want allocated to MSRs,” and “if we retain servicing, what other products can we offer to the servicing portfolio?” The released execution is often not part of the playbook; the focus is to originate mortgage loans for current or future potential bank customers with multiple products and relationships.

In practice, large banks tend to retain the vast majority of what they originate, not because they have conducted a rigorous loan-level best execution analysis, but because they view mortgages as a customer relationship business and servicing as inseparable from

that relationship. When large banks release servicing, it is typically driven by the release of a specific product type or by a capital reallocation decision.

Community and regional banks occupy a more nuanced position. Depending on the size of the bank (in terms of total assets), they may face the same capital treatment as the large banks. Many have found a workable equilibrium that includes retaining servicing on loans originated to customers with whom the bank has broader relationships, such as deposits, commercial lending, and investment services. They release the remainder, where the long-term cross-sell opportunity is limited, and the capital cost is not justified.

It is important to note that bank capital rules do change, and the current BASEL III risk-based capital rules are under review, and the proposed rules eliminate the 25 percent cap of MSRs to Tier 1 Common Equity. A reduction in the risk weighting to banks likely means that banks, over time, will retain more servicing that fits their definition of the optimal customer to retain.

CREDIT UNIONS

Credit unions occupy a category of their own. The member-first focus that defines credit union governance reshapes the retained versus released question at its foundation. For a credit union, the argument for retaining servicing is often a relationship argument: retaining the servicing relationship means retaining the touchpoint through which the credit union demonstrates its ongoing commitment to the member's financial well-being.

The cash constraints for IMBs or capital constraints for banks are not present. More often, a credit union or Credit Union Service Organization (CUSO) either retains servicing or sells released as part of their strategy. A handful of credit unions with material volumes and diverse lending business will execute the retained/released decision similar to IMBs and will perform a version of the best execution. Similar to other mortgage lenders, a credit union elects to retain servicing where other relationships exist within the credit union and release servicing when there is no other product relationship.

CHAPTER 4:

The Four Cs of Retained Servicing

Cash, Customer, Capital, and Capacity

If the prior chapters have established anything, it is that the retained versus released decision is more complex than the day-one cash and immediate income statement impact. For institutions genuinely evaluating whether retention makes sense, or that have already been committed to it, there are four dimensions that must be considered, planned for, and managed with discipline. We call them the Four Cs: Cash, Customer, Capital, and Capacity.

CASH

Cash is the dimension some lenders focus on, and also the one most frequently misunderstood. By choosing to retain, the lender forgoes the immediate cash value of the servicing and begins to accumulate a fee income stream over the life of the loan. The question is whether the lender can sustain itself through the period of servicing build-up before the portfolio reaches scale to provide material cash flows.

Even with a subservicer managing loan administration, there are fixed oversight costs, compliance infrastructure requirements, and potential operational minimums.

Tax treatment varies materially based on the corporate structure. Consult with a qualified tax advisor or a Richey May mortgage banking tax expert before incorporating tax considerations into your MSR retention analysis.

There is also a tax dimension worth noting. When a loan is sold servicing released, the SRP is taxable in the period the cash is received. When servicing is retained, the initial MSR capitalization is generally not a taxable event if it is done at safe-harbor levels; the tax liability accrues over time on cash servicing revenues net of cash expenses. For non-

cash-constrained lenders, this tax deferral has real economic value, and depending on the corporate structure and length of time servicing is retained, a subsequent MSR bulk sale creates an opportunity to receive capital gains tax treatment on a portion of the MSR gain on sale. Taxes related to servicing are generally aligned with the receipt of cash.

It is imperative and often overlooked that the actual cash flow from servicing is monitored and tracked. Tracking cash includes not only the various cash revenue and expense items, but also the timing of servicing advances and their subsequent recovery. If the riskier servicing is retained, the MSR value may be positive, but servicing from a cash flow perspective is negative.

CUSTOMER

The customer dimension of retained servicing may ultimately be its most important consideration going forward, and the one most challenging to include in best execution analyses. Retaining servicing means retaining the relationship with the borrower for future business or products. A customer who has had a positive origination experience and a positive servicing experience is more likely to pursue additional transactions.

However, building the recapture capability is not automatic and should not be viewed as easy. It requires organizational alignment and commitment to execute. Effective recapture programs have the data, communication, and monitoring to ensure the recapture program is effective. Most lenders that retain servicing understand the need for an effective recapture program and may underestimate the time and effort required to be effective at recapture.

Cross-sell sits alongside recapture as a meaningful retention benefit, varying considerably by institution type. For banks and credit unions, the servicing relationship is a natural channel for the full spectrum of consumer banking products. For non-depositories, the opportunity is narrower, including second mortgages, home equity lines, and investment property loans, but still real. Cross-selling is not only meaningful as a source of incremental revenue but also fosters customer loyalty.

CAPITAL

Agency seller-servicer approval is the first capacity threshold and requires minimum capital requirements of \$2.5 million plus 25 basis points of the outstanding servicing portfolio. Additional capital and liquidity metrics vary across GSEs and Ginnie Mae, with different standards. Mortgage lenders that retain servicing should not only confirm the current capital and liquidity thresholds directly with the agencies but also establish and retain a servicing quality control program, demonstrating the required capital and operational infrastructure. These are real requirements, but they are not insurmountable barriers for institutions that are genuinely committed to the investment required to service.

Capital is the dimension that looks most different across institution types. For banks, it is the primary constraint: the 250 percent risk weighting under Basel III makes retaining MSR capital-intensive by design, and for banks approaching capital constraints, that weighting can make MSR retention prohibitively expensive regardless of the economic case. If the final BASEL III rules do not address the 250 percent risk weighting for MSRs, it is unlikely mid-size and large banks will increase their MSR concentration. As stated earlier, the proposed BASEL III rules eliminate the 25 percent cap on MSRs to Tier 1 Common Equity; this is more relevant for small to mid-size banks that have a higher concentration of MSRs.

It is important to note that Ginnie Mae has implemented risk-based capital rules similar to BASEL III that limit the amount of MSRs non-banks can hold. Ginnie Mae, much like the BASEL III rules, assigns MSRs a 250 percent risk weighting and requires non-bank Ginnie Mae issuers to maintain a 6 percent Risk Based Capital Ratio (Adjusted Net Worth/Total Risk Based Assets).

For IMBs, capital constraints manifest primarily as access to MSR financing. MSR financing lines, which typically allow a lender to borrow against 60 to 70 percent of the portfolio's market value, are a legitimate and widely used tool for managing the cash deferral that retention creates. But they introduce margin call exposure: when MSR values decline (as they do when rates fall and prepayments accelerate), the collateral supporting the financing line diminishes. Margin calls arrive precisely when the origination business is under the most stress. Understanding the full risk profile of MSR financing before deployment is a prerequisite for using it responsibly.

For all institution types, capital position also determines the institution's capacity to absorb advance obligations when borrowers become delinquent. Servicers may be required to advance principal, interest, taxes, and insurance payments out of their own cash. For IMBs without the balance sheet depth of a bank, these obligations can become material and tie up a significant amount of cash.

CAPACITY

Capacity is the dimension most frequently overlooked by lenders who are new to retaining servicing, and the one most likely to produce the gap between the strategy and the actual financial results.

Retaining servicing is not a set-it-and-forget-it decision. The retained portfolio requires active oversight: regular MSR valuations that engage with the underlying assumptions, ongoing monitoring of actual cash flows against modeled projections, surveillance of escrow advance trends, measurement of actual recapture rates against what the retention

strategy assumed, and periodic stress-testing of portfolio value under adverse rate scenarios.

For lenders that retain servicing and lack significant or deep expertise in it, servicing can serve as a distraction. It is important that adequate servicing knowledge and expertise exist with key functions including capital markets, accounting, finance, and senior management.

Retaining servicing changes the timing of post-closing quality control. While feedback is received immediately from aggregators, it is often delayed when loans are sold to the agencies. A mortgage lender needs to ensure adequate capacity exists to support a retained servicing strategy in terms of post-closing, loan delivery, compliance, and other areas impacted by the change in operations.

Retaining servicing without the analytical infrastructure, management discipline, and recapture strategy to support it is not a long-term plan for success.

CHAPTER 5:

Risks

What the MSR Exposes You To, and Why It Matters

Retaining servicing is not a risk-free decision. Risks can change quickly due to a variety of economic, environmental, or regulatory changes.

VOLATILITY OF SERVICING CASH FLOWS

The income a retained portfolio generates is not fixed, and even without prepayments, it declines over time. Prepayment speeds are typically driven by the spread between the current mortgage rate available in the market and the mortgage rate on the servicing

portfolio. When rates fall and refinances surge, cash flows that were expected over years compress or disappear as borrowers pay off their loans. When rates rise and prepayments slow, cash flows extend. Managing this volatility may require a financial hedging program. At

a minimum, a risk tolerance that explicitly acknowledges and accepts cash flow volatility needs to be modeled and communicated.

Advance obligations compound this volatility of cash. When borrowers become delinquent, servicers may have to advance principal and interest payments to investors, and they must always advance tax and insurance payments from their own cash. As stated earlier, a portfolio can have a positive modeled MSR value and generate negative actual cash flows. The 2020 COVID-19 period remains the most instructive recent illustration: mass forbearance requests forced servicers to confront advance obligations at a scale no model had anticipated, in a market environment where the secondary bid for servicing rights collapsed entirely.

The risks embedded in retaining servicing are not hypothetical. They are structural features of the asset class that activate the market conditions that are often the most difficult for a lender to absorb.

VOLATILITY OF MSR VALUES

The retained MSR is one of the most interest-rate-sensitive assets a mortgage company can hold. That sensitivity is structural: as rates fall and prepayment speeds accelerate, MSR values decline at an accelerating rate. As rates rise, values increase, but at a decelerating rate. This asymmetry means the downside of a

falling-rate environment is consistently larger than the simple arithmetic suggests for the fee stream. Over the past fifteen years, banks' MSR portfolios have gained or lost more than 25 percent of their value in one quarter (note that this is a change in MSR value before the impact of any financial hedges).

Volatility in the MSR value is not just limited to changes in value attributable to interest rates; regulatory changes can occur at the state or national level. In addition, the servicing standard of the investor or guarantor can change and have a direct impact on servicing cash flows. It is important to stay current and up to date on laws and regulations as some may have an impact on the small subset of the overall servicing population. A few recent examples include the increased use of forbearance and the recent changes to the FHA waterfall for loan modifications. Changes in servicing operational requirements, prepayments, defaults, foreclosure timelines, and servicing advances can all create volatility in the MSR value.

This volatility is not a reason to avoid retaining servicing. Though it is a reason to manage it deliberately through hedging, disciplined portfolio construction, regular stress testing, and a recapture capability that converts rate-driven prepayment risk into a refinance opportunity rather than a loss.

CHAPTER 6:

Pitfalls and Other Considerations

Strategy Fit, Common Mistakes, and What to Watch

DOES RETAINED SERVICING FIT YOUR STRATEGY?

Before committing to retain servicing, every institution should answer a question that sounds obvious but is more frequently skipped than asked: does retaining servicing fit within the broader strategy of this organization?

Retaining servicing is correct for institutions that have or are prepared to fund the potential cash shortfall on day one, possess the recapture capability to capture the customer value embedded in the MSR, have the capital position to absorb advance obligations and MSR financing margin risk, and maintain the management infrastructure to oversee the portfolio as a business function. For institutions that genuinely have the cash, customer focus, capital, and capacity, the case for retention is compelling. For those that do not, retaining servicing can result in a cash drain and complete distraction for management.

The most common version of the misaligned strategy is the institution that retains servicing because the day-one best execution math said to do so, without a strategic pre-sort, recapture program, or monitoring discipline to know when the portfolio is performing above or below assumptions. Over time, the result is substandard from a cash flow perspective.

The self-selection trap is a related failure mode. Aggregators in the secondary market price precisely: borrowers with strong credit, desirable balances, and favorable prepayment or default profiles command higher SRP premiums. Borrowers with lower

credit quality, less desirable balances, or delinquency risk command lower premiums. A lender that follows the best execution day-one math without a strategic pre-sort ends up, functionally, retaining whatever the secondary market does not want to pay for, packaged as a servicing portfolio that shows a positive modeled value but performs poorly in practice and could be illiquid if the servicing portfolio was offered in the bulk MSR market.

TAX CONSIDERATIONS

At the core, taxes associated with servicing generally follow cash. When a loan is sold servicing released and the SRP is received, that premium is taxable during the period of receipt of the cash. When servicing is retained, the initial MSR capitalization at safe-harbor levels is generally not a taxable event; tax liability accrues over time. For tax adverse lenders, this deferral has real economic value.

Entity structure adds a second layer. C corporations pay ordinary income tax on all servicing-related income regardless of the holding period. For S corporations and other pass-through entities common among privately held IMBs, individual owners may qualify for long-term capital gains treatment on proceeds from an MSR sale after a twelve-month holding period, which can represent a material economic advantage.

Tax treatment varies materially by entity corporate structure. These are illustrative principles, not tax advice. Consult a qualified tax advisor or a Richey May mortgage banking tax expert before incorporating tax considerations into your retention decision.

ACCOUNTING: FAIR VALUE VS. LOCOM

Before retaining its first MSR, a lender must make a consequential and largely irreversible accounting election: whether to carry the MSR under Lower of Cost or Market (LOCOM) or fair value accounting.

Under LOCOM, the asset is carried at whichever is lower: its amortized cost or its current market value. MSR appreciation above the amortized basis does not flow through the income statement, but impairment does. For lenders new to retaining servicing, or those without active hedging programs, LOCOM is often a more prudent accounting election.

Under fair value, the MSR is marked to market each period, and both increases and decreases flow immediately through the income statement. This method more accurately represents the market reality of the asset and is most commonly used by institutions with active hedging programs.

For a full discussion of how the accounting election interacts with hedging strategy, MSR financing, and financial reporting governance, consult a Richey May mortgage banking expert.

The prospective fair value election is irrevocable. A lender that elects fair value cannot revert to LOCOM. The reverse transition is possible at the beginning of a new fiscal year. This decision should be driven by the institution's hedging posture, appetite for

income statement volatility, and long-term plans for the portfolio.

Regardless of whether LOCOM or Fair Value accounting is adopted, the initial recording of the MSR asset is at fair value.

HEDGING

The decision to use financial instruments to hedge the MSR asset is a complex topic and may be addressed more deeply in a future paper, however, a mention here is needed. Entities that hold a material MSR portfolio to their balance sheet, income statement revenue, or net worth, may elect to use financial hedges to limit their financial exposure to the MSR value changes. There is no perfect MSR hedge; however, understanding the modelable key assumptions and their impact on value change is best practice, regardless of whether financial hedges are used. In addition, MSR hedging requires cash, and depending on the financial instruments used, it can require significant cash.

REPUTATION RISK

The decision to retain servicing can create reputation risk with customers. The servicer has to follow the servicing rules established by Fannie Mae, Freddie Mac, FHA, VA or USDA. Borrowers may not understand why certain actions are allowed or not allowed, and attribute their frustration or dissatisfaction to the servicer, who is following the rules set by the investor or guarantor. See our guide, [The Servicing Decision Volume 1](#), for a further discussion.

Key Takeaways

The decision to retain versus release must be integrated into the overall business strategy. The most successful mortgage companies build a disciplined approach to their decision and periodically test and re-evaluate the decision to ensure it is consistent with their approach to cash, customers, capital, and capacity.

1

Look beyond the day-one impact. A spreadsheet or matrix can provide insight into the day-one cash but may ignore the long-term benefits of the retained/released decision. A strategy is difficult, if not impossible, to synthesize into one number. Releasing or retaining servicing has implications around the cash, the customer, the capital required (or the entity's equity), and the capacity to manage the company or invest in other initiatives.

2

The MSR fair value is an estimate. The gap between modeled and actual cash flows is driven by a number of factors including prepayment speeds, servicing costs, delinquencies, and advance obligations or recapture estimates. A servicing released or retained decision that over-relies on the MSR value as the absolute and achievable truth may result in disappointing results. Assumptions should be stress-tested, and if servicing is retained, modeled to actual results with consistent analysis.

3

Volatility is a given if servicing is retained: MSRs are a volatile asset. It is a mistake to assume that the only reason for changes in value is a change in interest rates. Cash from a servicing released decision does not prepay, default, or file complaints with the CFPB or state Attorney Generals. All retained servicing will reduce immediate cash, and even retaining servicing with the highest chances of cash flows cannot completely eliminate the valuation volatility risk associated with retaining servicing. It is critical to conduct a proper risk analysis to understand the potential sensitivity that the MSR asset introduces and how it interacts with the origination function (if applicable). The introduction of potential financial hedges to manage the MSR value risk requires constant monitoring and cash.

4

Servicing retention without a definitive recapture strategy is an incomplete strategy. The ability to defend a servicing portfolio with recapture is critical. Recapture can include other loan products, such as closed-end seconds or home equity lines. Creating a positive customer service relationship is imperative and the first step in an effective recapture strategy. The actual recapture strategy implemented must be consistent and integrated within the overall strategy.

5

The servicing released versus retained strategy requires periodic reviews. Market conditions change. Released execution fluctuates. Organizational capacity and expertise changes. Capital positions shift. Cash needs change. Building a formal and thoughtful review of the retained versus released decision is critical. Waiting for a crisis or illiquidity event to force a decision often creates a poorer financial result, whereas treating it as an ongoing strategic decision improves overall financial results.

Conclusion

THE DECISION THAT COMPOUNDS

Retaining servicing is not always the right answer, nor is selling released. If the decision is made to retain servicing, it is a strategic decision, and the analysis of what to retain needs to go well beyond the day-one cash execution differences. Selling servicing released to a counterparty that aligns with your strategy is also a perfectly defensible strategy. The decision to retain or release for many mortgage originators is also not an all-or-nothing decision.

The key considerations covered in this guide are meant to enable mortgage lenders to make a decision that is consistent with their strategy. A “one size fits all” strategy does not exist. It is critical to retain or release the servicing that aligns with the mortgage lender's strategy.

Ready to evaluate your retained versus released strategy?

Richey May's mortgage banking consultants work directly with lenders of every type and size to model the true economics of the servicing decision, identify the right execution posture, and build the oversight infrastructure that makes that posture sustainable.



Reach out at info@richeymay.com or visit richeymay.com to start the conversation.

About Richey May

For four decades, Richey May has been focused on serving the mortgage banking industry, delivering specialized expertise that helps lenders thrive in a rapidly changing marketplace. The firm offers a comprehensive suite of audit, assurance, tax, advisory, and cybersecurity services, complemented by advanced technology solutions and business intelligence offerings.

Founded with a deep care for helping mortgage lenders achieve their goals, Richey May has built an ecosystem of services designed to improve profitability, mitigate risk, and drive sustainable growth. From servicing strategy and MSR consulting to capital markets reviews, cybersecurity, and enterprise risk assessments, Richey May provides the clarity and insight needed to navigate complex economic, regulatory, and operational challenges.

OUR MORTGAGE SERVICING & COMPLIANCE LEADERS



Seth Sprague, CMB

Director, Mortgage Banking Consulting Services

With over 25 years of experience in mortgage banking and servicing, Seth Sprague, CMB, leads Richey May's Mortgage Banking Consulting Services, advising clients on profitability, servicing strategy, and MSR management. A recognized industry leader, Seth has served as Chair of the MBA's Certified Mortgage Banker (CMB) Society, sits on multiple MBA committees, and is a frequent speaker on liquidity, capital markets, and mortgage servicing trends. He is also a long-time instructor for the MBA's School of Mortgage Banking.



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