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SERVICING

PMSI's CEO on why servicers can't ignore low exception rates

By **Bonnie Sinnock** May 20, 2025 3:00 PM



Dan Thompson, chief executive of mortgage servicing management firm PMSI, numbers among industry veterans who managed mortgages during and prior to the Great Financial Crisis, so he's seen worst-case scenarios and worked to help the industry avoid them since.

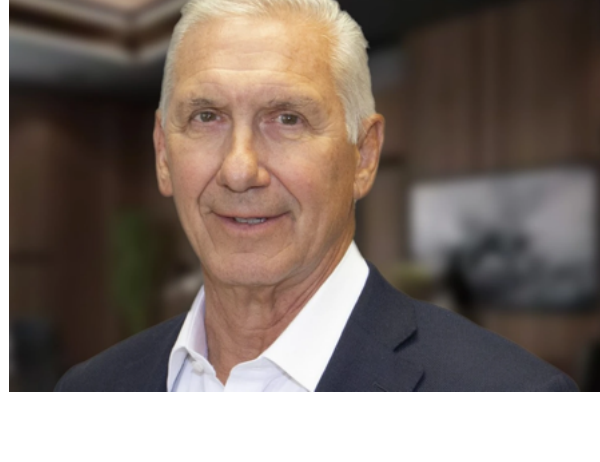
The instances where exceptions from common servicing procedures were used averaged around 1% in 2024, which is many multiples lower than during the days when he was creating a platform to handle special servicing at Credit Suisse. But the seemingly small number is more important than it may suggest at first glance.

That's because the impact of exceptions is magnified in [the secondary mortgage market](#), where influential government-sponsored enterprises that currently buy a significant number of loans in the U.S. weigh them heavily in servicer scorecards.

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"What Dan has done over the course of 25 years at PMSI is work to ensure that data is accurate, so that you are not facing a surprise from Fannie Mae or Freddie Mac," said Rhonda Gallion, senior vice president at the company, which was previously known as Preferred Mortgage Services.

Such a "surprise" can cost a mortgage servicer hundreds of thousands or even millions of dollars even when exception rates are as low as they have been recently, Gallion said.



In the excerpts of a conversation with Thompson that follows, he more fully explains why the importance of identifying exceptions, researching their root causes and correcting them has an outsized importance relative to the rate at which they occur currently.

What makes small exception rates so costly

Thompson: The crux of our world in investor reporting and accounting isn't when everything goes right. It's when things don't. There's one saying I think is a truism after being around mortgages for three decades which is that [in servicing](#) there is always something to fix, it's just a matter of what degree, because there are so many moving parts. Everyone's always learning to do new things and when human beings get involved with systems, they make errors. It only happens maybe 1% to 2% of the time on a portfolio, so that seems pretty innocuous. But **whenever you're managing a lot of loans, data discrepancies actually become cash discrepancies. That's the risk.**

Servicers expect their systems to do a great job of handling exceptions, but investors don't necessarily take that at face value. The GSEs go through this process where you're transmitting data to them, and they're transmitting your errors back to you. So you're constantly researching and managing these errors. **Around 40% of the GSE scorecard is focused on investor reporting and accounting but the servicer only spends about 2 to 3% of their direct costs on it. That seems to be a bit of a mismatch.**

To put it in perspective, our platform managed about \$8.5 billion a month in remittance to Fannie Mae, Freddie Mac and Ginnie. We also transmitted about \$300 million to MSR owners for their servicing fees, and another \$100 million to the GSEs for guarantee fees. So **when you start doing the math for 1% to 2% of that amount of cash, you'll see there are a lot of zeros in front of it.**



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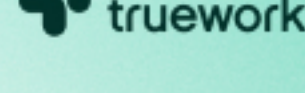
How exceptions get categorized

Thompson: There are three types of exceptions that we track. There are reporting exceptions between the servicer and the investor, portfolio reconciliation exceptions and test of cash.

Portfolio reconciliation involves what's called a trial balance of your entire portfolio. There's a loan, count, an unpaid principal balance, principal and interest, a note rate and a pass through rate that you're supposed to send to the investor. This is a new requirement from Freddie Mac and Fannie Mae has historically done this. You take your servicer trial balance, and you take the investor trial balance and you compare. Any difference you have to mark in a schedule and research.

Servicers also have custodial accounts managed on investors' behalf. Every month, the servicers' requirement with the GSEs is to perform a test of the amount of cash that should be in them. So, based upon the loans in the portfolio and their statuses (prepaid or delinquent or liquidated) the numbers need to add up. If there's a shortage in the account, it's up to the servicer to fund that. If there's a surplus in the account, it can stay there.

Most of the work we do is really understanding the nuances of the cash in those custodial accounts. The math is the most complex there. We need to make certain that the proper people in the supply chain get the right amount, whether that's the mortgage servicing rights owner, the servicer or the investor. There can be a cost or a potential impairment for the MSR owner.



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The kinds of servicing mistakes that get made

Thompson: It could be cashing in applying a curtailment before the payment. It creates an interest shortfall. Guess who has to fund that interest shortfall? Mortgage servicing rights holders. It comes out of their funds. They should apply the payment first, then the curtailment. When they get it wrong, it's just a small amount dollar-wise, a matter of interest on a curtailment. That's not going to break the bank, but it's also things like **when you've modified the loan with the GSE system but you didn't modify it in the servicing system.** The GSEs will still expect the money associated with that modification in that case. Then you could have ten \$20,000 differences in your custodial account based on one modification alone.

We've worked on a portfolio transfer where we identified upwards of \$5 million in cash discrepancies between two systems because a servicer hadn't updated the second liens. There are probably about 30 different servicing functions. Functions are upstream processes from investor reporting that lead to these types of exceptions.



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The type of activity that typically drives exceptions up

Thompson: There's a correlation between the exogenous factors of both [origination activity](#) and default activity. When origination activity and default activity are low, your exceptions are going to be lower. When they are high, exceptions bump up.

Spikes, generally speaking, can be associated with a vendor's system change that hasn't been well vetted or a large portfolio transfer. If you know what happened, you can bring those spikes down immediately. Our systems have a layer of artificial intelligence and can scale quickly. When you have a portfolio of 3 million loans and the exception rate of about 1.5% percent (as in 2024), you're looking at about 45,000 exceptions a month that we have to research. That is a lot of research.

Custodial accounts managed for Fannie, Freddie and Ginnie are where most people don't have great transparency. Their reconciliations and all their research often are not managed in databases, and once that information leaves the system of record, it is susceptible to human error. That will carry over and create more variances. The more it happens, the more it spirals out of control.



How the risk can be managed

Thompson: We found that folks that are natural-born problem solvers take to our way of doing things. We have an organization full of mathematicians and statisticians who have researched almost three quarters of a billion dollars in cashflow variances over the past year and whittled that down into about \$24 million.

There also are nonmonetary differences where the system of record wasn't managed properly. Those could be creating false positives.

We've spent about \$15 million of our own capital on our systems and we've overlaid other technology and artificial intelligence on top of that. As a result, we see a lot that the rest of the industry doesn't.

The massive servicing data chain is so critical, and yet it's quite frankly, overlooked. It deserves the attention and expertise because of its complexity and the risk it introduces to you, Mr. Servicer, across a number of areas that you may or may not even be aware of.

What we have found ourselves doing quite a bit, is educating industry partners to say, here's why you should care, and here's what you should be doing from a technology perspective.

You have a couple choices: make a massive investment or don't. You're probably not going to make that investment all at once right now but there are ways in which you can elevate your operation very quickly.

What's always fascinating to me is when we pull a portfolio and run it through our system for the first time for people who were going along thinking everything was fine. I call it "the iceberg."

On his roots in servicing during the Great Financial Crisis

Thompson: In all my experiences prior to this led to the creation of this business. I've always been an entrepreneur in large corporations, building platforms and businesses. I've always worn risk management and P&L hats as well. I have been an innovator.

What I found was very interesting about this segment is it's so complicated and involved. You have to have a lot of passion and a lot of tenacity to be able to take something that has been ignored for three decades by the industry and build something cohesive.