



MORTGAGE BANKERS ASSOCIATION

November 16, 2018

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20219

RE: Uniform Mortgage-Backed Security [RIN: 2590-AA94]

Dear Mr. Pollard:

The Mortgage Bankers Association (MBA)¹ thanks the Federal Housing Finance Agency (FHFA) for the opportunity to comment on its proposed rule to promote the successful market adoption of the Uniform Mortgage-Backed Security (UMBS).² MBA strongly supports the development of both the UMBS and the Common Securitization Platform (CSP), which together will represent a vastly improved single-family secondary mortgage market infrastructure. A formal rulemaking to codify processes and procedures for substantially aligned cash flows between issuers should bring greater certainty to market participants and stimulate increased investor demand, which should in turn generate significant benefits for borrowers and taxpayers.

The Case for the Single Security

As FHFA notes, the direct objective of the “Single Security Initiative” is to improve liquidity in the single-family mortgage-backed securities issued by Fannie Mae and Freddie Mac (the Enterprises) that trade in the To-Be-Announced (TBA) market. The markets for these two classes of securities are already highly liquid, and combining

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, DC, the association works to ensure the continued strength of the nation’s residential and commercial real estate markets; to expand homeownership; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,300 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA’s website: www.mba.org.

² 83 FR 46889, “Uniform Mortgage-Backed Security,” September 17, 2018. Available at: <https://www.federalregister.gov/documents/2018/09/17/2018-20124/uniform-mortgage-backed-security>.

them into a UMBS market should result in a large increase in the tradeable supply of securities within a single market, relative to the supplies that are currently segmented across two different markets today. MBA expects the result to be enhanced liquidity and better execution that drives down the yields demanded by investors, which would then flow through to borrowers in the form of lower average mortgage interest rates.

While the Enterprises remain in conservatorship, the development of the UMBS should also generate considerable benefits for taxpayers. Because Freddie Mac securities are far less liquid than similar securities issued by Fannie Mae, the Freddie Mac securities trade at a meaningful discount. To maintain its competitiveness, Freddie Mac is effectively forced to lower the guarantee fees it charges. These reduced guarantee fees result in lower receipts for Freddie Mac and, because the Enterprises currently pay the majority of their profits to the U.S. Treasury in the form of dividends, the reduced guarantee fees also represent subsidies provided by taxpayers. Successful implementation of the UMBS should lessen the trading disparities across securities issued by the Enterprises, eliminating the need for these taxpayer subsidies.

MBA also firmly believes in the importance of robust competition among guarantors in the secondary market. However, competition based on the liquidity of securities that are otherwise substantially aligned across collateral type, credit risk, disclosures, and other relevant features does not benefit investors, lenders, or borrowers. Instead, FHFA is correct to focus competition between the Enterprises on factors such as product offerings, technology, and customer service. These are the areas in which competition leads to innovation or better execution, which then produces more efficient markets and lower costs for borrowers. Simply put, the liquidity of their securities should not be a basis for competition between the Enterprises, and there is no compelling reason for Fannie Mae and Freddie Mac TBA-eligible securities to trade in separate markets.

The Critical Need for Substantial Alignment of Prepayment Speeds

As is noted above, TBA-eligible securities issued by the Enterprises are already structurally similar in many respects. In order for investors to accept UMBS issued by either Enterprise on an equivalent basis, however, it is vital that the cash flows investors receive—which are dictated by the prepayment rates of the loans underlying the securities—are substantially aligned. If this outcome is not ensured, many investors will likely opt for stipulated trades, which would in turn weaken TBA market liquidity and undermine the very purpose of the transition to the UMBS.

It is important to recognize, though, that perfect alignment of cash flows is not necessary for successful adoption of the UMBS. The nature of a market in which guarantors are constantly competing for business from their lender customers is such

that there will almost certainly be some differences in prepayment speeds across securities. For example, differences in the low down payment products offered by the Enterprises likely account for small differences in prepayment speeds. These differing products, however, generate benefits for lenders and borrowers in terms of greater choice. It will be incumbent upon FHFA as regulator (and conservator) to determine when competition leads to differing prepayment speeds that are unacceptable for the purposes of maintaining strong investor demand for UMBS. In doing so, FHFA should not stifle competition by insisting on perfect alignment of cash flows across securities issued by the Enterprises.

MBA supports the concept of thresholds for prepayment speed divergences that would trigger various actions and responsibilities for FHFA and the Enterprises. In particular, thresholds should be articulated publicly and well understood in their meaning and calculation methodology. To this end, MBA appreciates the publication of prepayment data in FHFA's December 2017 update on the Single Security Initiative,³ as well as the ongoing publication of its quarterly Prepayment Monitoring Reports,⁴ as important steps in this direction. Similarly, the requisite actions and responsibilities triggered by divergences beyond the prescribed thresholds should be sufficiently potent to swiftly remediate these divergences. Together, the presence of transparent triggers and strong remedial actions should provide market participants with greater confidence in the alignment of cash flows necessary for a successful UMBS.

The Proposed Rule

At a basic level, the proposed rule directs each Enterprise to establish governance processes to consider the effects of various business practices and decisions on cash flows to investors in their TBA-eligible securities. These processes are overseen by FHFA, as is any necessary communication and consultation between the Enterprises. Should prepayment speeds diverge beyond prescribed thresholds, FHFA is authorized to require various remedial actions of the Enterprises.

These contours of the proposed rule are appropriate to achieve its purpose, and are designed in a manner that should instill confidence in UMBS investors. In particular, the use of clear, well-known thresholds defining acceptable divergences in prepayment speeds is an important component of the proposal. Similarly, the

³ FHFA, "An Update on the Single Security Initiative and the Common Securitization Platform," December 2017. Available at: https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/Update-on-the-Single-Security-Initiative-and-the-CSP_December-2017.pdf.

⁴ For example, see: FHFA, "Prepayment Monitoring Report – Second Quarter 2018," August 22, 2018. Available at: https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/Prepayment-Monitoring_2Q2018.pdf.

ongoing monitoring of Enterprise business practices by both FHFA and the Enterprises themselves should reasonably ensure that the causes of potential divergences in prepayment speeds will be identified and addressed in a timely manner.

Specifically, the proposal defines “covered programs, policies, or practices” to identify the various Enterprise management decisions or actions that may have foreseeable effects on cash flows to investors. While the list of decisions or actions in the proposed rule is extensive, MBA recommends that the definition in the final rule include other factors related to loan servicing beyond those already specified in the proposed rule, such as loss mitigation policies (not limited to those related to natural disasters), foreclosure requirements, and advancing and remittance requirements.

More broadly, rather than attempting to list every possible management decision or action that could lead to divergences in prepayment speeds, the definition of “covered programs, policies, or practices” in the final rule should feature language to the effect of “These include but are not limited to...” so as to allow FHFA greater flexibility to enforce alignment of cash flows. Similarly, the final rule could achieve this flexibility by amending the conclusion of the definition to feature language to the effect of “..., and other factors that FHFA deems appropriate.” These revisions would better ensure that FHFA is not unnecessarily limited in its oversight authority.

Given the central role of investor confidence in a successful market adoption of the UMBS, it is critical that FHFA prioritize transparency in its oversight. For example, the proposal allows FHFA the flexibility to adjust the thresholds defining acceptable divergences in prepayment speeds, and if adjusted levels are in effect for at least six months, FHFA must amend its regulations through a notice-and-comment process. This is a reasonable requirement, though MBA recommends that a final rule also require FHFA to issue public notice (though not to request comment) at the time it adjusts these thresholds.

To further the transparency of data available to investors and the general public, MBA also recommends that the final rule require FHFA to publish quarterly prepayment monitoring reports similar to those that it currently publishes on a voluntary basis. As with the existing reports, the required reports should include data on conditional prepayment rates across cohorts, as well as relevant cohort- and loan-level attributes. While the commentary in the proposal notes that “FHFA plans to continue to monitor and publish reports that include third-party data pertaining to the alignment of prepayment speeds,” this requirement should be included in the rule itself.

Future Efforts

More broadly, MBA supports the use of formal rulemaking to make more durable and transparent the reforms that have been put in place during conservatorship of the Enterprises. While comprehensive legislative reform is necessary to fully correct the structural weaknesses that contributed to the near collapse of the Enterprises, FHFA has used its conservatorship authorities to improve the functioning of the Enterprises and bolster their safety and soundness. Examples include reductions in the use of volume-based guarantee fees or underwriting concessions that disproportionately favor larger lenders, development and expansion of credit risk transfer programs that better protect taxpayers, and efforts to ensure the reliable presence of financing in the multifamily market to serve renters throughout the country. The rulemaking to promote adoption of the UMBS should serve as a model for future rulemakings to make these recent reforms more permanent in a post-conservatorship system.

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MBA appreciates the ongoing efforts of FHFA and the Enterprises in implementing the Single Security Initiative. The proposed rule to better ensure substantially aligned cash flows across securities issued by Fannie Mae and Freddie Mac is a critical component of these efforts. The processes, procedures, and parameters set forth in the proposed rule appear well-suited to achieving substantial alignment, while also allowing for appropriate competition across the Enterprises. The modest revisions suggested above would further improve transparency and regulatory oversight, contributing to successful market adoption.

Should you have questions or wish to discuss these comments, please contact Dan Fichtler, Director of Housing Finance Policy, at (202) 557-2780 or dfichtler@mba.org.

Sincerely,



Robert D. Broeksmit, CMB
President and Chief Executive Officer
Mortgage Bankers Association