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MORTGAGE BANKERS ASSOCIATION

January 21, 2020

The Honorable Mark Calabria  
Director  
Federal Housing Finance Agency  
400 7<sup>th</sup> Street, SW  
Washington, DC 20219

**RE: Request for Input: Enterprise UMBS Pooling Practices<sup>1</sup>**

Dear Director Calabria:

The Mortgage Bankers Association (MBA)<sup>2</sup> respectfully submits our comments to the Federal Housing Finance Agency (FHFA) in response to a Request for Input (RFI) on pooling practices by Fannie Mae and Freddie Mac (the Enterprises) in the Uniform Mortgage-Backed Security (UMBS) market.

MBA has consistently supported the development of the UMBS and recognizes the many short- and long-term benefits that come from transitioning to the new system, including enabling a more efficient, resilient, and liquid secondary mortgage market. The implementation of the UMBS also provides a strong foundation for the future integration of competitors to the Enterprises and has curbed the trading disparities that previously characterized the market for conventional securities.

The RFI proposes a new waterfall approach for allocating loans to standardized multi-lender pools, specified pools, and special-purpose/single-lender pools. If implemented, this proposal would significantly alter the structure of the UMBS market, with major implications for borrowers, lenders, and investors. After careful consideration, MBA believes the proposed changes are likely to have a negative effect on market liquidity and could thereby raise borrowing costs and reduce access to credit. Further, it is not

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<sup>1</sup> FHFA, "Request for Input: Enterprise UMBS Pooling Practices," November 4, 2019. Available at: [https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/Pooling\\_RFI.pdf](https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/Pooling_RFI.pdf).

<sup>2</sup> 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 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, credit unions, 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](http://www.mba.org).

clear that there are problems or inefficiencies in the current market that provide justification for the scale of the proposed changes. MBA therefore strongly urges FHFA not to implement the proposal as envisioned in the RFI.

### **The Transition to the UMBS Market**

After years of preparation by FHFA, the Enterprises, and numerous market participants, the transition to the UMBS market in 2019 occurred without major operational problems or disruptions in trading. This outcome was no small feat and should be recognized as a significant accomplishment. In the RFI, FHFA points to a series of indicators that reveal a relatively well-functioning market following the transition, such as strong trading volume, robust exchanges of legacy Freddie Mac securities, and active commingling of UMBS issued by the two Enterprises.

These positive initial developments do not obviate the need for continued monitoring of liquidity metrics, prepayment rates, and general market activity by FHFA and the Enterprises. Substantial alignment of prepayment rates – and thereby cash flows – will ultimately determine the long-term acceptance of UMBS by investors and other market participants.

The final rule implementing the UMBS, which was issued by FHFA in early 2019, provides strong authorities by which the Agency can both monitor alignment of cash flows and require changes in Enterprise policies or practices to address any notable misalignment.<sup>3</sup> As will be discussed further, these authorities should form the basis of any future FHFA actions to foster UMBS liquidity – not major changes to pooling practices.

### **Unclear Impetus for New Pooling Practices**

The proposal contained within the RFI calls for an increase in the share of loan production that is delivered into multi-lender pools by virtue of incentives provided to, or requirements levied on, originators. Specified pools would continue to be permitted, but there would be tighter limits on these pools which would be set by FHFA and/or the Enterprises. Single-lender pools that are not eligible for the To Be Announced (TBA) market would be used to address anomalies in prepayment speeds exhibited by certain originators.

The smooth initiation of the UMBS market presents an unlikely basis for the pooling changes proposed in the RFI. Indeed, it is not immediately clear why a relatively well-functioning market warrants such substantial changes. FHFA only notes that the

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<sup>3</sup> 84 FR 7793, “Uniform Mortgage-Backed Security.” March 5, 2019. See: <https://www.federalregister.gov/documents/2019/03/05/2019-03934/uniform-mortgage-backed-security>.

Enterprises may undertake different pooling practices for their single-lender and multi-lender pools, which could lead to divergences in prepayment rates. This observation does not constitute sufficient justification for a major restructuring of a large market that is critically important to the health of broader financial markets and the global economy. Before FHFA moves forward on any elements of this proposal, MBA believes the Agency must provide a more thorough explanation of the problem it is seeking to address and a more robust justification for the merits of this particular solution.

### **Comparisons to the Ginnie Mae Market**

In the RFI, FHFA observes that “this proposal would result in pooling practices similar to those under the Ginnie Mae II program.”<sup>4</sup> It is unclear, however, why FHFA would seek to replicate the Ginnie Mae model for the pooling practices of the Enterprises. Both historical experience and current market conditions reveal that the conventional market has exhibited deeper liquidity over a sustained period, relative to the Ginnie Mae market. Differences in liquidity and market depth are partially attributable to factors other than pooling practices, but there is little evidence to suggest that the Ginnie Mae model would prove to be preferable to the conventional model.

The proposal seems to rely on the assumption that pooling loans with more attractive features (for many investors) in larger pools alongside loans with less attractive features will improve overall demand for multi-lender pools. While it is possible that such an outcome could occur, MBA is concerned that this assumption ignores likely responses to the proposal by both originators and investors that could dampen aggregate demand in the conventional market, largely due to limited optionality for both sets of market participants.

### **Problems with Limiting Pooling Options**

At its core, the proposal would limit the options available to originators with respect to pooling. Most production would be delivered into multi-lender pools, and there likely would be strict (though unclear, based on the RFI) restrictions on the use of specified pools.

Rather than increase investor demand by reducing variation in prepayment rates, as is posited in the RFI, MBA is concerned that the proposal could weaken investor demand due to this restricted range of pool types. The significant diversity of investors in the conventional MBS market is the driver of the deep liquidity in this market. A diverse range of investors features a diverse range of preferences, and regulatory limits on

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<sup>4</sup> FHFA, “Request for Input: Enterprise UMBS Pooling Practices,” November 4, 2019. Available at: [https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/Pooling\\_RFI.pdf](https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/Pooling_RFI.pdf).

pooling parameters could prevent the creation of pools that are demanded by certain investors.

For example, real estate investment trusts (REITs) largely invest in whole pools due to their unique regulatory requirements. If a greater portion of production is delivered into large, generic multi-lender pools, the investment options available to REITs would be reduced. While FHFA notes in the RFI that the Enterprises would continue to meet the needs of such investors, it is not clear how they would do so.

From the originator perspective, further limits on pooling options also present concerns. In the current market, many originators receive pay-ups by delivering loans with particular characteristics – often those that are associated with lower prepayment rates – into specified pools. If originators had fewer options to create specified pools, it would lower the profitability of these types of lending, which in turn could deter lenders from offering certain products. Borrowers would then have more limited product choice or could potentially experience reduced access to credit due to higher prices for these products.

### **Addressing Anomalies in Prepayment Rates**

In the RFI, FHFA requested feedback regarding the treatment of lenders that exhibit “extraordinarily high prepayment rate performance.”<sup>5</sup> It is important for FHFA and the Enterprises to monitor prepayment rates, as investors rely on a certain level of consistency and predictability in cash flows. Further, abnormal prepayment rates among individual institutions could be an indicator of inappropriate activity such as loan churning.

MBA supports the practice of establishing reasonable thresholds to determine when prepayment rates are outside of ranges found to be acceptable by FHFA and the Enterprises. If lenders breach these thresholds, FHFA and/or the Enterprises should conduct further examination and due diligence to attempt to ascertain the cause of the abnormal prepayment rates. If these higher prepayment rates are not attributable to actions that provide a benefit to borrowers, FHFA and/or the Enterprises should prescribe remedial actions. Exclusion from multi-lender pools should only occur if a lender fails to remediate issues within an appropriate timeframe. The various components of this process should be clearly communicated, such that any eventual pooling restrictions on individual lenders do not come as a “surprise.” In order to promote UMBS fungibility, it is appropriate for these parameters and processes to be substantively aligned across the Enterprises.

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<sup>5</sup> Id.

To deter excessive prepayment rates, FHFA and the Enterprises should also utilize measures referenced in the RFI that can be taken through existing authorities, including corrective actions with respect to individual loan officers, required repayment of premiums paid for loans, and limits on premium pricing. In instances in which originators are deemed to be churning loans to the detriment of borrowers, the Enterprises could also utilize pricing mechanisms, such as adjustments to guarantee fees. UMBS liquidity would be better protected through this type of targeted approach to addressing high prepayment rates rather than through wholesale changes to the market structure.

### **Operational Challenges**

The proposal featured in the RFI contains very few details regarding its implementation by FHFA, the Enterprises, and market participants, as well as numerous elements that require further elaboration or explanation. For example, the proposal contemplates incentivizing *or* requiring lenders to deliver the vast majority of their production into generic multi-lender pools. In this case, the practical differences between incentives and requirements could be substantial.

It is also unclear how the Enterprises would incentivize or require this outcome. If the Enterprises were to incentivize the use of multi-lender pools, they could do so by lowering guarantee fees or broadening underwriting standards for loans that are delivered into multi-lender pools or, alternatively, by raising guarantee fees or tightening underwriting standards for loans delivered into single-lender pools. The differences between these two options would have major implications for borrowers, originators, and investors. It is also unclear whether each Enterprise would use unique methods to incentivize delivery into multi-lender pools. Such differences could alter delivery patterns across the two Enterprises and lead to divergences in prepayment rates.

If the Enterprises were to require the use of multi-lender pools for the majority of production, it is unclear what exceptions would be granted for specified pools. In the RFI, FHFA identifies certain categories of loans that are typically more attractive to investors in the current market, such as loans with lower balances, higher loan-to-value ratios, or lower credit scores. The proposal would allow these loans to be delivered into specified pools, but no details are provided as to the composition of these pools and the share that must feature loans with certain characteristics. FHFA also notes that these loan criteria are subject to change over time, but more detail would be needed to understand the conditions by which they would change, as well as how frequently they likely would change.

The Enterprises could target a particular share of issuance – the RFI suggests 70-80 percent of each month's TBA-eligible MBS issuance – but variation in ongoing issuance and delivery patterns would make it difficult to consistently achieve this result. It is

unclear whether FHFA would intervene if one Enterprise regularly fell below this target, and if so, what that intervention would entail.

FHFA and the Enterprises should provide further clarity on these implementation issues before considering any advancement of this proposal. Additionally, any changes that FHFA does undertake should only occur after a lengthy implementation period that allows all market participants to adequately prepare.

## **Conclusion**

The development of the UMBS and its subsequent implementation have laid the groundwork for sustained improvements in the secondary mortgage market. While MBA understands and supports FHFA's need to proactively respond to any future misalignment in prepayment rates across securities issued by the Enterprises, this proposal envisions large-scale changes to market structure when narrower remedies would likely achieve better results. MBA encourages FHFA to reconsider any changes to existing pooling practices and instead take a more targeted approach to aligning prepayment rates that will not have a potentially negative effect on pooling options, market diversity, and product availability to borrowers.

We appreciate the opportunity to comment on this proposal and look forward to continued engagement with FHFA as the UMBS market develops. Thank you in advance for your consideration of these comments. Should you have questions or wish to discuss further, please contact Sasha Hewlett, Director of Secondary and Capital Markets, at (202) 557-2805 and [shewlett@mba.org](mailto:shewlett@mba.org).

Sincerely,



Pete Mills  
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Mortgage Bankers Association