REQUEST FOR INPUT: PROPOSED SINGLE SECURITY STRUCTURE

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Division of Conservatorship

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EXECUTIVE SUMMARY

This Request for Input outlines the proposed structure of a Single Security to be issued and guaranteed by Fannie Mae or Freddie Mac (the Enterprises). The Federal Housing Finance Agency's (FHFA's) 2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac (2014 Strategic Plan) includes the goal of developing a single Enterprise mortgage-backed security as part of the efforts to build a Common Securitization Platform (CSP). In order to advance the early stages of this multi-year initiative, FHFA seeks public input on the proposed Single Security structure that is outlined below.

Maintaining a highly liquid secondary mortgage market is a fundamental requirement for the success of the Single Security. In order to achieve maximum market liquidity, the proposed Single Security would leverage the Enterprises' existing security structures. The proposal would encompass many of the pooling features of the current Fannie Mae Mortgage Backed Security (MBS) and most of the disclosure framework of the current Freddie Mac Participation Certificate (PC). The following sections provide details on the features of the proposed Single Security.

FHFA's goal for the proposed Single Security structure is for legacy Fannie Mae MBS and legacy Freddie Mac PCs (legacy securities) to be fungible with the Single Security for purposes of fulfilling "to-be-announced" (TBA) contracts. Because the proposed Single Security design would include most of the features of the current Fannie Mae MBS, an exchange option for legacy Fannie Mae MBS to Single Securities may not be necessary. To achieve the goal of maintaining maximum market liquidity, it is important to ensure that the legacy Freddie Mac PC is fully fungible with the Single Security as well. Therefore, if necessary, investors would be offered an option to exchange a legacy PC for a comparable Single Security.

The development of the Single Security will be a multi-year effort. FHFA and the Enterprises will continue to seek input and to work with stakeholders throughout the process to achieve the goal of improving overall secondary mortgage market liquidity while mitigating any risk of market disruption.

BACKGROUND

As outlined in the 2014 Strategic Plan, FHFA is prioritizing ways to improve the overall liquidity of the Enterprises' mortgage-backed securities. This includes the development of a Single Security that will reduce trading value disparities between Fannie Mae MBS and Freddie Mac PCs. The different mortgage securities currently issued by the Enterprises are not fungible with one another, and Freddie Mac PCs have historically traded less favorably than Fannie Mae MBS.

Fannie Mae MBS and Freddie Mac PCs trade in the TBA market, which is a type of forward market in mortgage-backed securities. The actual security to be delivered to fulfill a TBA trade is not designated at the time the trade is made. Rather, on the trade date, six criteria are agreed on: the issuer, the maturity, the coupon rate, the face value, the price, and the settlement date. The specific securities delivered to complete the trade are "to be announced" 48 hours prior to the settlement date. These features create a very efficient system for forward trading in mortgage-backed securities.

The TBA market is an important contributor to a strong, vibrant and highly liquid secondary mortgage market, which creates many benefits for taxpayers, lenders, investors and borrowers. This serves to make more capital available for lending, enables broad lender participation, and reduces costs throughout the housing finance system. In fact, TBA market liquidity can also translate to important borrower benefits in the form of lower mortgage rates, more efficient lending processes, lower transaction costs, and the ability to "lock in" the interest rate on a mortgage prior to closing on the loan.[1] As a result, preservation of the TBA market for Enterprise mortgage-backed securities is an important consideration in the development of the Single Security.

The 2014 FHFA Scorecard for Fannie Mae and Freddie Mac (2014 Scorecard) requires the Enterprises to identify the key components, features, and standards needed for a Single Security. The Scorecard also requires work underway on the CSP to include the development of the operational and system capabilities necessary for the Enterprises to issue a Single Security through the CSP.

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[1] J. Vickery and J. Wright, "TBA Trading and Liquidity in the Agency MBS Market," Federal Reserve Bank of New York *Economic Policy Review*, May 2013, 1-18.

KEY FEATURES OF THE PROPOSED SINGLE SECURITY STRUCTURE

FHFA's proposed Single Security structure includes details about the following features: security issuer and guarantee structure, common features, loan/security products in scope, multiple-lender pools, re-securitizations, disclosures, and Selling and Servicing guides.

The design of the Single Security is intended to leverage existing features of the Fannie Mae MBS and the Freddie Mac PC. The Single Security would align with many of the key features of the current Fannie Mae MBS, such as the timing of payments to investors at 55 days.[2] The Single Security would also utilize a common disclosure framework that aligns with current Freddie Mac PC disclosures.

Security Issuer and Guarantee Structure. The Single Security would be issued and guaranteed by either Fannie Mae or Freddie Mac. The Single Security would be a first-level securitization that would contain underlying mortgage loans acquired either 100 percent by Fannie Mae or 100 percent by Freddie Mac. There would be no commingling of loans purchased by Freddie Mac and Fannie Mae at this first-level of Single Security formation. This is the same purchase and guarantee framework for a Fannie Mae MBS or a Freddie Mac PC that exists today.

Common Features. Single Securities issued by either Enterprise would have key common features that exist in the current market, including:

- A payment delay of 55 days;
- Pooling prefixes;[3]
- Mortgage coupon pooling requirements;
- Minimum pool submission amounts;
- General loan requirements such as first lien position, good title, and non-delinquent status;
- Seasoning requirements; and
- Loan repurchase, substitution and removal guidelines.

Details on these common characteristics can be found in Exhibit A: Proposed Single Security Structure.

Loan/Security Products in Scope. The initial focus of the initiative would be the highly liquid market for TBA-eligible fixed rate mortgages, with an emphasis on 30-year and 15-year loans. Additionally, 10-year and 20-year mortgages would be in scope.

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[2] The payment to investors is made 55 days from the mortgage payment due date. For example, a mortgage payment due on June 1 would be remitted to the investor on July 25.
[3] A pooling prefix is a two-digit code that generally denotes the terms and types of mortgage products in a security.

Multiple-Lender Pools. The Single Security would also continue to enable the formation of multiple-lender pools, currently known as Fannie Mae Majors or Freddie Mac Multi-lender pools. These programs enable the aggregation of smaller mortgage loan deliveries, usually by smaller-volume lenders, into a larger, more diversified pool. This aggregation feature is an important way for smaller-volume lenders to access the secondary market and obtain better security price execution.

Re-Securitizations. The proposal outlined in this paper also encompasses second-level securitizations (called re-securitizations) of Single Securities issued by either Enterprise. Re-securitizations would contain underlying first-level securities, which could be securities issued entirely by Fannie Mae, entirely by Freddie Mac, or commingled securities issued by both Enterprises. Since the proposed Single Security is intended to be fungible with legacy Fannie Mae MBS and Freddie Mac PCs, re-securitizations issued and guaranteed by either Enterprise could be backed by:

- Single Securities issued by both Enterprises or just one of them;
- Legacy securities issued by both Enterprises or just one of them; or
- A combination of Single Securities and legacy securities, which could be issued by both Enterprises or just one of them.

Such second-level securitizations are currently referred to as Fannie Mae Megas, Freddie Mac Giants,[4] and Fannie Mae and Freddie Mac multi-class securities, commonly referred to as Stripped MBS and Real Estate Mortgage Investment Conduits (REMICs). This additional re-securitization capability would serve to expand secondary mortgage market liquidity and may also help to reduce the costs of administering multiple securities.

Disclosures. The disclosure framework proposed for the Single Security is closely aligned with the current Freddie Mac PC loan- and security-level disclosures. The disclosures would include common data element names and definitions, calculations, and data derivations.

The Single Security would also have standard frequency and timing of loan- and security-level disclosures. At-issuance security disclosures would be made on or before the final settlement date.

Selling and Servicing Guides. The Enterprises would maintain their separate Servicing and Selling Guides and continue certain alignment activities as outlined in the 2014 Strategic Plan and the Scorecard.

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[4] Fannie Mae Megas have underlying collateral that includes groups of existing Fannie Mae-issued MBS or Megas, and/or REMICs. Freddie Mac Giants have underlying collateral that includes groups of existing Freddie Mac-issued PCs or Giants, and/or REMICs.

TIMING AND IMPLEMENTATION

As noted above, this initiative is a multi-year effort, and FHFA does not, at this time, have a date when the Single Security would be implemented. When appropriate, FHFA's intention is to implement the Single Security for single- and multi-class securities for both Enterprises at the same time. The introduction of the Single Security would include the re-securitization capabilities described above. FHFA believes it would be necessary to introduce the Single Security, the re-securitization capabilities, and any option to exchange legacy securities at the same time. Simultaneous introduction of all three changes would be important to maintain market continuity, maximize market liquidity, and minimize the risk of market disruption.

OUTSTANDING LEGACY FANNIE MAE MBS AND FREDDIE MAC PCS

FHFA and the Enterprises are in the early stages of assessing the key issues and potential effects of the proposed Single Security structure. Because of the importance of developing one broad market with maximum market liquidity, an important consideration is how best to ensure that legacy Enterprise securities and newly-issued Single Securities are fungible with one another. As of May 31, 2014, there were $2.7 trillion in Fannie Mae MBS and $1.5 trillion Freddie Mac PCs outstanding.

Many of the proposed Single Security features are similar to those of the legacy Fannie Mae MBS. Therefore, legacy Fannie Mae MBS would likely be fungible with the Single Security. FHFA is committed to achieving comparable fungibility for legacy Freddie Mac PCs. To further the goal of achieving maximum market liquidity, legacy Freddie Mac PC investors, if necessary, would be offered the option to exchange a Freddie Mac PC for a comparable Single Security backed by the same mortgage loans. [5] The option would be available for the life of the legacy PC starting from the introduction of the Single Security.

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[5] Freddie Mac PCs remit payments to investors on the 45th day, which is 10 days sooner than the Single Security period of 55 days. If this difference in payment prevents the legacy PC from being fully fungible, if necessary, an option to exchange the legacy PC for a Single Security over the life of the legacy PC security would be offered.

REQUEST FOR INPUT

A highly liquid and fully functioning secondary mortgage market is important to the success of our nation's housing finance system. In order to achieve maximum secondary market liquidity, FHFA is especially interested in views on how to preserve TBA eligibility and ensure that legacy MBS and PCs are fully fungible with the Single Security. FHFA invites feedback on all aspects of the proposed Single Security structure and, in particular, requests input on the questions below:

1. What key factors regarding TBA eligibility status should be considered in the design of and transition to a Single Security?

2. What issues should be considered in seeking to ensure broad market liquidity for the legacy securities?

3. As discussed above, this is a multi-year initiative with many stakeholders. What operational, system, policy (e.g., investment guideline), or other effects on the industry should be considered?

4. What can be done to ensure a smooth implementation of a Single Security with minimal risk of market disruption?

FHFA invites interested parties to provide written input on this paper by October 13, 2014, to the Federal Housing Finance Agency, Office of Strategic Initiatives, 400 7th Street, S.W., Washington, D.C., 20024. Input can be submitted electronically via form on FHFA.gov. All input received will be made public and posted without redaction to FHFA's web site.

EXHIBIT A

Proposed Single Security Structure

Feature	Description
Structure	• First-level securitizations (currently referred to as Fannie Mae Mortgage-Backed Securities (MBS) and Freddie Mac Participation Certificates (PCs)): A Single Security would have underlying mortgage loans that were purchased either 100 percent by Fannie Mae or 100 percent by Freddie Mac. Thus, there would be no commingling of underlying collateral (or loans) at this level of Single Security formation. • Second-level re-securitizations (currently referred to as Fannie Mae Megas, Freddie Mac Giants, and multiclass Fannie Mae and multiclass Freddie Mac Stripped MBS and Real Estate Mortgage Investment Conduits (REMICs)): Re-Securitizations would have underlying legacy and/or Single Securities issued by Fannie Mae, Freddie Mac, or both Enterprises. Either Enterprise might issue and guarantee either a non-commingled or commingled second-level Single re-securitization Security.
Issuer	Fannie Mae or Freddie Mac (via the Common Securitization Platform (CSP) as agent)
Trustee	Issuing Enterprise
Bond Administration	Issuing Enterprise (via the CSP as agent)
Security Guarantee	Issuing Enterprise guarantee
Loan/Security Products in Scope	• 30-year • 20-year • 15-year • 10-year
Investor Remittance policy	Payment date would be the 25^{th} (55-day delay) for all product types.

Prefixes	**CI** – Conventional Intermediate-Term, Level-Payment Mortgages; Single-Family; maturing or due in 15 years or less. **CL** – Conventional Long-Term, Level-Payment Mortgages; Single-Family; maturing or due in 30 years or less. **CN** – Conventional Short-Term, Level-Payment Mortgages; Single-Family; maturing or due in 10 years or less. **CT** – Conventional Intermediate-Term, Level-Payment Mortgages; Single-Family; maturing or due in 20 years or less.
10-year pooling terms	10-year security Must have original terms of no less than 85 months and no more than 120 months for single-issuer pools.
15-year pooling terms	15-year security Must have original terms of no less than 85 months and no more than 180 months for single-issuer pools.
20-year pooling terms	20-year security Must have original terms of no less than 181 months and no more than 240 months for single-issuer pools.
30-year pooling terms	30-year security Must have original terms of no less than 181 months and no more than 360 months for single-issuer pools.
Minimum Pool Submission Amounts	• Fixed Rate single-issuer pool have $1 million minimum. • Multi-lender pools have $1,000 minimum. The pool will not be issued until $1 million is collected.
General Requirements of Loans Pooled into Single Security	Loans must be secured by a first lien and must represent the entire right, title, and interest in the mortgage note and related security instrument, unless expressly indicated otherwise in the pool purchase contract.
Seasoning Requirements	Lenders may pool either seasoned or current loans into single-lender security but loans that are aged more than 12 months may not be included in multi-lender security.
Servicer Requirements	All mortgages in a single-lender security pool must be serviced by the same entity.
De Minimis rules	Pursuant to current general pooling practices for Enterprise guaranteed

(SIFMA[6] Guidelines)	securities: • Co-op share loans, certain relocation mortgages, loans with significant interest rate buydowns (extended buydowns), and high balance (super-conforming) loans may be commingled in TBA-eligible prefixes as long as they do not constitute more than 10 percent of the aggregate unpaid principal balance (UPB) of the pool. If the pool has two or more of these features, with the exception of super-conforming loans, the combination cannot exceed 15 percent of the aggregate UPB of the pool. • The 15 percent combined UPB limit does not apply to super-conforming (high balance) loans.
Loan Buyouts – R&W Violations	Removal permitted in case of a breach of warranty by seller or material loan documentation defect.
Clean-up calls	No clean-up call option.
Repurchases and substitutions triggered by Investors	• Voluntary repurchases are not allowed. • Substitutions are allowed, but historically have been very infrequent.
Re-securitization Parameters – Single-class re-securitization (today's Giants and Megas)	• Fixed rate pooling generally follows the same parameters as underlying products. • No seasoning or size limitations.

[6] The Securities Industry and Financial Market Association (SIFMA) oversees the TBA guidelines.