

J.P.Morgan

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Federal Housing Finance Agency
Division of Conservatorship
400 7th St. SW, 8th Floor
Washington, DC 20219

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Re: REQUEST FOR INPUT - ENTERPRISE UNIFORM MORTGAGE-BACKED SECURITIES (“UMBS”) POOLING PRACTICES

JPMorgan Chase & Co. (“JPMC,” “we” or “our”) appreciates this opportunity to comment on the Federal Housing Finance Agency (“FHFA”) Request for Input entitled “Enterprise UMBS Pooling Practices” (the “RFI”). Our comments draw on our broad base of perspectives in the To-Be-Announced (“TBA”) market. JPMC and its affiliates are, collectively, among the largest users, investors and market makers in UMBS and the TBA market. Additionally, JPMC’s mortgage bank is one of the largest originators and servicers of residential mortgages in the United States. Each year we transfer hundreds of thousands of mortgage loans to Fannie Mae and Freddie Mac (together, the “Enterprises”) and our servicing portfolio includes a significant percentage of loans guaranteed by the Enterprises.

We applaud FHFA’s willingness to seek input from market participants to better understand how UMBS is impacting the TBA market. We believe that, before taking actions that may potentially curtail the depth and liquidity of the second largest and most liquid market in the world, FHFA should consider the strong market concerns articulated in this letter along with comment letters filed by SIFMA, HPC, MBA and the ABA.

The TBA market should be considered one of the crown jewels of the modern financial system.¹ Its depth, liquidity and resiliency are critical to the smooth functioning of the U.S. mortgage market and other financial markets around the world. An efficient TBA market directly benefits U.S. home buyers by reducing overall mortgage interest rates and by enabling buyers to lock in lower mortgage rates as they shop for a home or finalize a purchase. Limitations on loan pooling flexibility would lead to a disproportionate increase in mortgage rates for low- and moderate-income borrowers and ultimately limit the Enterprises’ ability to serve such families.

The Pooling Concepts Proposed in the RFI Would Weaken the TBA Market

We acknowledge the validity of the performance concerns about the TBA market that motivated FHFA to issue the RFI. However, we believe that the multi-lender pooling proposal would be harmful to the TBA market and should be fundamentally reconsidered. A requirement to pool loans with varying prepayment speeds impairs the proper functioning of the market and unfairly disallows a premium for originations that are attractive to investors. In fact, as observed in the Ginnie Mae market, multi-lender pools are likely to provide a strong incentive for unscrupulous originators to deliver undesirable collateral.

¹ TBA Trading and Liquidity in the Agency MBS Market, James Vickery and Joshua Wright *Federal Reserve Bank of New York Staff Reports*, no. 468, August 2010. https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr468.pdf

By limiting the issuance of specified pools in favor of multi-lender pools, the pooling concepts in the RFI would reduce market depth and liquidity because a bias or mandate in favor of multi-lender pools will limit the ability of originators to pool mortgages in response to market preferences. This in turn would adversely impact investor demand, market depth and liquidity, rather than improve overall TBA market performance. Moreover, the proposal would dilute many of the specified pools (e.g., low balance, high LTV, low credit score) and therefore disproportionately harm underserved segments of the mortgage market such as affordable housing and first time home buyers. Higher levels of investor demand for specified pools directly translates to lower mortgage rates for such borrowers.

The end result of such reductions in investor demand and improper functioning of market forces would be a deterioration of UMBS performance. This deterioration would lead to increased rates and will raise the cost of homeownership for millions of American families. This impediment to borrowing runs counter to the mission of the FHFA and should be reconsidered.

Fewer Investor Options Frustrate the Goals of UMBS and Weaken the TBA Market

A key reason for promoting alignment of Enterprise mortgage pooling policies and practices is to facilitate the ability to combine level 1 UMBS pools into level 2 (CMO)² securities to accommodate investor preferences for custom cash flows. Preserving the ability to meet investor demand maintains and increases market depth. The proposed changes would significantly weaken demand for CMOs by reducing options for investors to create custom cash flows and frustrate the purpose of seeking Enterprise policy alignment itself.

Investor participation and activity in the UMBS market is a function of the numerous investment options it provides. Unlike other markets where bonds have pre-set terms, UMBS market participants can fit their investment horizon needs based on the predicted cash flows of the variety of mortgage pools available. Any move towards generic cash flows, as would be the case if there is a bias for multi-lender pools, minimizes investors' ability to meet their specific, distinct needs and risks a reduction of investor demand in UMBS.

To this end, it is important to recognize that multi-lender pools are themselves useful at creating options for market participants. Multi-lender pools, however, should not be preferred to specified pools, but rather should be regarded as a tool to optimize best execution options for originators. In some cases, multi-lender pools offer investors the option to diversify the originators and servicers that comprise their pools. Additionally, under certain market conditions, originators can utilize multi-lender pools to take smaller pools of collateral and yet still receive the pricing benefits afforded to larger pool sizes. In a well-functioning market, the mix of multi-lender and specified pools will achieve equilibrium and reflect a market evaluation regarding single-issuer risk. Therefore, a bias or mandate favoring multi-lender pools would materially diminish critical market feedback and impair execution mechanisms.

Less Disruptive Alternatives to Pooling RFI Objectives

Recent experience with TBA market liquidity is directly attributable to undesirable counterparty behaviors that can be more efficiently addressed through stricter Fannie Mae and Freddie Mac counterparty surveillance and management, rather than through the UMBS pooling practices outlined in the RFI.

² The Collateralized Mortgage Obligation (CMO) market serves as a useful illustration of how greater options increase, rather than decrease, market demand and functionality. Over \$1 trillion CMOs are currently outstanding, representing almost 20% of the overall Agency MBS market. CMOs are created by tailoring already existent Enterprise Pass-Throughs into further levels of individualization and distinctiveness to meet specific investor demand. Less investor demand for CMOs will lead to lower value to originators at initial pooling and, ultimately higher rates for American borrowers.

Accordingly, a less disruptive method to address the TBA market concerns identified in the RFI would be to more clearly align and strengthen the Enterprises' counterparty management practices and pricing.³

Counterparty Management Techniques Already Available to the Enterprises

The Enterprises today have significant influence on what loans are being delivered into multi-lender pools:

- Loan eligibility –seasoning requirement, coupon
- Seller eligibility – Enterprises can restrict access to multi-issuer
- Buy up / down pricing – influences coupon selection
- Cash window pricing – can take the pooling decision away from originator

Additional Counterparty Management Recommendations to Improve Market Dynamics

- Standardize, improve disclosures and track eligibility for multi-lender pools for compliance. This could include behavioral performance as well as provide a mix of delivery targets.
- Improve cash window transparency to provide real time feedback regarding the effect of cash window activities on TBA deliverables as discussed in the RFI.
- The Enterprises compete only with each other in pricing how much originators can buy up or buy down the guarantee fee. Accordingly, the Enterprises are a source of competitive pricing levers that can be used to create disparities in securities composition. Our interaction with investors generally suggests that this narrow competition for pricing and multi-pool participation disparities are underlying factors causing misalignment in the TBA market.
- Rescind the current limitation of IO to 50bps, which has led to sub-optimal pricing for consumers, more risk to originators (multiples repriced monthly though locks are typically for >30 days) and undesirable outcomes for market participants (e.g., less skin in the game for originators with faster prepayments). Removing the 50bps limitation would attract private capital (balance sheet, excess IO securitization, coupon swaps) into competition with the Enterprises and improve market pricing across the entire spectrum of note rates offered.
- Any changes affecting pooling practices should be communicated at least 120 days in advance to allow originators certainty that they can clear existing borrower commitments. Additional time may be beneficial to allow the market to price in and adapt to expected impacts of any changes.

Conclusion

The availability and cost of mortgage credit for millions of American families depends on a deep and liquid TBA market. Protecting the operation of the TBA market to ensure its enduring depth and liquidity should be paramount to FHFA's mission. Any policy that distorts market forces expressed through investor preferences or that limits originator pooling flexibility will fundamentally and adversely restrict mortgage credit availability and increase mortgage rates and should not be implemented.

Sincerely,



Liam O. Sargent
Head, Global Securitized Products

³ Accordingly, the proposals outlined in the Pooling RFI should be distinguished from the recommendations contained in the Chase comment letter, dated November 16, 2018, urging FHFA to promote alignment between Fannie Mae and Freddie Mac's mortgage servicing policies and practices (the Alignment Comment Letter³). The concerns expressed in the Alignment Comment Letter are materially different from those impacting TBA Market liquidity since the launch of the UMBS on June 3, 2019.