January 1, 2020

Federal Housing Finance Agency
Division of Conservatorship
400 7th Street SW, 8th Floor
Washington, D.C., 20219

Re: Enterprise UMBS Pooling Practices Request For Input

Introduction.
Cardinal Financial Company, Limited Partnership ("Cardinal") appreciates the opportunity to respond to the Federal Housing Finance Agency's ("FHFA") November Enterprise UMBS Pooling Practices Request For Input ("RFI"). Cardinal understands and is supportive of the FHFA's obligation to ensure the liquidity of the United States housing finance markets. Cardinal is encouraged by the FHFA's willingness to seek feedback on the proposal to alter UMBS pooling practices from market participants.

Background.
Driven by the FHFA's charter obligations, in an effort to increase liquidity in the secondary mortgage market, the FHFA eliminated the Fannie/Freddie ("Enterprise") swap with the introduction of a Uniform Mortgage Backed Security ("UMBS"). To support investor confidence in UMBS, the FHFA also issued the UMBS Final Rule, which aligns the Enterprises to maintain consistent cash UMBS flows. To that end, one of the more significant changes from the Final Rule was that it lowered the maximum mortgage note rate eligible, and the maximum servicing fee for each loan included in a given UMBS security. In March 2019 UMBS started trading in the forward market with security settlements in June 2019.

Summary Of The Issue And FHFA Proposal.
The ultimate success of UMBS depends on market participants' view that UMBS are fungible with respect to the issuing Enterprise. While the UMBS market has been functioning well, diverging pool speeds between the Enterprises could put UMBS fungibility at risk. In an attempt to solve this issue, the FHFA is proposing (the "Proposal") to align pooling practices for all issuing participants by:

1. Forcing 70-80% of production into multi-lender pools;
2. Allowing specified pool creation only under prescribed circumstances; and

3. Directing certain seller/servicers to deliver all or a percentage of production into single issuer pool.

Proposal Breakdown.
Cardinal observed the aggregate prepayment speeds between Enterprises to be aligned but the Fannie Mae Major and Freddie Mac multi prepayments speeds have diverged. Instead of addressing this specifically, the Proposal applies to all issuing market participants.

There are likely a few reasons for the speed divergence between Enterprises. Specifically, each respective Enterprise's Automated Underwriting System (AUS) may drive collateral characteristics which are more or less likely to refinance, unequal exposure weightings between Enterprises to any large more efficient seller/servicer could drive up prepayment speeds, and differences between Enterprise pooling strategy could create differences in Major/Multi s-curves.

Further, either Enterprise can exclude the fastest paying collateral from its respective multi-lender pool, ultimately driving up payups on even seasoned multi-lender pools, while driving faster, smaller pools to make up a greater proportion of the To Be Announced ("TBA") deliverable. In turn, pricing in the new deliverable would, in effect, increase mortgage rates.

However, as the Proposal suggests, forcing a percentage of TBA eligible collateral into multi-lender pools would not only result in decreased lender execution but also raise borrowing costs. Plus, more efficient servicers in the multi-lender pool would unfairly benefit from the increased execution afforded to all participating lenders. This would come at the expense of servicers with slower prepays.

The Proposal goes on to suggest driving certain seller/servicers to single issuer pools exclusively. This is a recent practice in the GNMA market but has yielded limited results in terms of slowing overall prepayments, and is an Cardinal believes is an option available to both Enterprises today.

Further, the parallels the Proposal draws to the GNMA II program are misplaced. UMBS enjoy superior liquidity versus the GNMA II program. Further, the economics of GNMA securitization differ from UMBS. Custom pools in the GNMA II market are non deliverable into TBA, which causes them to trade at a deep discount, and GNMA I market is hindered by 50 bps gross to net WAC pooling requirement.

Thus, the high share of the GNMA II multi-lender pool is a result of reduced economics driven by the structure of the program, not end investors. The pooling requirement in the GNMA I market has, also for the wrong reasons, driven production to the GNMA II multi-lender pool.

While a large share of the GNMA market trades with no pay-up, a large share of the UMBS market trades with pay-ups. However, this is not indicative of poor liquidity in the UMBS market. A market deep enough to price all the Specified stories relative to TBA is emblematic of superior liquidity. Thus, GNMA should look to the Conventional bond market for ideas to improve liquidity.

Lastly, the Proposal punishes efficiency because it is focused on prepayment speeds, not abusive practices that may drive a share of those prepayments. More efficient seller/servicers have always existed. Their efficiency leads to lower borrower costs and produces better borrower experiences.

Building Toward A Solution.
Cardinal understands the prepayment speed fungibility issue resulting from the advent of UMBS. However, Cardinal respectfully disagrees with the proposed suggestions to solve it.

The Proposal conflicts with free market principles that have helped make the Conventional MBS market the most liquid bond market in the United States. It punishes more efficient seller/servicers in inefficient ways, imprudently borrows from structurally different markets, limits Specified pool story innovation, reduces lender execution, and ultimately leads to higher rates for borrowers.

Cardinal prefers to operate in an environment that accepts different business models, embraces nimble business platforms, fosters innovation, and rewards investment in technology because such an environment ultimately leads to improved borrower experiences and lower borrower costs.

Cardinal favors a solution that meets the following criteria:

1) Adheres to free market principles;
2) Punishes abusive practices while minimizing structural changes to the market;
3) Allows Specified pool stories to thrive in an ever changing marketplace;
4) Does not increase borrower costs; and
5) Does not stifle innovation and investment in technology.

With that criteria in mind, the Enterprises can limit the pooling of faster paying loans from multi-lender pools while permitting all loans that would receive pay-ups to be pooled Specified. Some level of standardization would need to be formalized to determine exclusion criteria, but origination in the Specified market would not be impacted.

In addition, using tools already available to the Enterprises, abusive seller/servicers can receive reduced pricing in the form of higher g-fees or degraded buy-up buy-down grids. Also, allow for the possibility of lender fines. This would impact the lender directly without redefining the structure of the marketplace.

Thank you for giving Cardinal the opportunity to provide feedback on the Uniform Pooling Practices proposal.

Sincerely,

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Cardinal Financial Company, Limited Partnership

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