Housing Finance and Regulatory Affairs
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Federal Housing Finance Agency
Division of Conservatorship
400 7th Street, SW
8th Floor
Washington, DC 20219

Request for Input: Enterprise UMBS Pooling Practices

Submitted by Electronic Delivery: Electronic response form at FHFA.gov

Dear Director Calabria:

On behalf of the National Association of Home Builders (NAHB), I appreciate the opportunity to provide input to the Federal Housing Finance Agency (FHFA) regarding Fannie Mae's and Freddie Mac's (the Enterprises') pooling practices as they relate to the formation of "To-Be-Announced" (TBA)-eligible Uniform Mortgage-Backed Securities (UMBS). Careful planning by FHFA and the Enterprises prior to the initiation of UMBS trading in March 2019 led to a successful roll-out of the new security. If adjustments to the current UMBS pooling practices might lead to a more liquid and efficient TBA market and benefit mortgage borrowers, they should be considered thoroughly.

NAHB represents over 140,000 members who are involved in building single-family and multifamily housing, remodeling, and other aspects of residential and light commercial construction. NAHB's members construct approximately 80 percent of all new housing in America each year. Our members rely on an efficient housing finance system to help provide decent, safe, and affordable single-family and multifamily housing across the country.

Background

A common agency security, now the UMBS, was proposed as a strategy to eliminate pricing disparities between Fannie Mae mortgage-backed securities (MBS) and Freddie Mac Participation Certificates (PCs) and increase the overall liquidity in the TBA MBS market. Freddie Mac securities traditionally have traded at a price disadvantage to Fannie Mae securities primarily due to faster prepayment speeds, which made PCs less attractive to investors. The subsequent reduced trading volume and frequency resulted in less liquidity for Freddie Mac securities and contributed to the price differential. FHFA determined that if Fannie Mae MBS were fungible with Freddie Mac PCs, the combined volume of a single, common security would achieve the dual goals of enhanced market liquidity and pricing parity between the Enterprises' MBS. This conclusion led to the agency's mandate in May 2014, spelled out in the *2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac*, that the Enterprises develop a common agency security.

FHFA and the Enterprises undertook a lengthy and thorough process to move toward a common agency security. This included providing numerous opportunities for feedback and information from the housing finance industry, secondary mortgage market participants and other industry stakeholders on how to transition to a single Enterprise security. On February 28, 2019, immediately prior to March 12, 2019, the first date the UMBS could be traded in the forward TBA market, FHFA issued the Uniform Mortgage-Backed Security final rule

(Final Rule) calling for the Enterprises to maintain policies that promote aligned investor cash flows, i.e. prepayment speeds.

NAHB supports the Final Rule's call for continued alignment of certain of the Enterprises' programs, policies and practices deemed to affect cash flows to investors in TBA securities that FHFA implemented under Enterprises conservatorships. Codifying the alignment of programs, policies, and practices was intended to assure investors that the Fannie Mae- and Freddie Mac-backed mortgage securities would be accepted as fungible and the UMBS would be successful. Fungibility is critically dependent on cash flows being sufficiently similar so as not to incent investors in the TBA market to make trades for which the investor stipulates it only will accept delivery of a UMBS backed by loans guaranteed by one or the other Enterprise.

Request for Input

The UMBS has been trading since March 2019, with the first settlements taking place in June. The RFI is intended to help FHFA determine whether changes to further align the pooling practices of Fannie Mae and Freddie Mac could improve overall market stability, efficiency, or performance of the UMBS.

FHFA proposes to require three changes to the pooling process at Fannie Mae and Freddie Mac – over and above the current alignment requirements – that it believes would reduce the potential for prepayment speeds of Fannie Mae-backed mortgages and Freddie Mac-backed securities to diverge, thereby creating investor preference and harming UMBS fungibility. The proposed requirements would:

- Require or incent all sellers/servicers to deliver the vast majority of production into generic multi-lender pools.
- Reduce the production of specified pools and other pools with market pay-ups (such as certain single-lender pools that have particularly desirable characteristics).
- Limit access to TBA-eligible pools for seller/servicers with anomalies in prepayment speeds.

NAHB Comments

Investor trust in the fungibility of the UMBS created by the two Enterprises is essential to the liquidity and efficiency of the secondary mortgage market. NAHB supports efforts to maintain this broad, reliable market that is the basis for the availability of a considerable portion of all mortgage loans.

NAHB is concerned with the timing of the RFI. The UMBS has been trading only for nine months, with deliveries beginning seven months ago. As noted by FHFA, "the new, consolidated UMBS market has been functioning well, with trade volumes and spreads to Treasury securities generally within historic ranges." In light of these points, NAHB questions the practicality and necessity for such significant changes while the UMBS is very new in the marketplace and untested in various economic scenarios.

The transition to the UMBS was an enormous undertaking that was carried out with considerable thought and planning. While we hear there are concerns that market liquidity may not be at optimal levels currently, there is not consensus that the UMBS itself is the cause. NAHB believes that the market should be allowed time to adjust before imposing additional pooling requirements. Prematurely adding restrictive and prescriptive changes to the pooling practices, such as those included in the RFI, could very well disrupt the TBA market, negatively impacting the mortgage market and increasing interest rates to borrowers.

In addition, NAHB is concerned with the proposals to increase generic, multi-lender pools and reduce specified pools included in the RFI. NAHB believes these proposals would result in FHFA exerting too much control over the characteristics and availability of TBA securities rather than allowing investor interest to drive the market. NAHB believes this is not in the best interest of market participants and mortgage borrowers.

Proposal to increase issuance of generic, multi-lender pools

The proposal appears to attempt to address a divergence or prevent a significant misalignment in prepayment speeds between UMBS collateralized by Fannie Mae-guaranteed mortgage loans versus Freddie Mac-guaranteed mortgage loans. However, the proposed approach, which would require the Enterprises to deliver a large majority of their purchased mortgage loans into generic multi-lender pools formed by either Enterprise, does not eliminate misaligned prepayment speeds of the Enterprises. Rather, the proposal would mitigate the effect of misaligned prepayment speeds by forcing more mortgages into large multi-lender pools where the prepayment performance of loans or pools from individual lenders will not have as great an impact. Rather than persuade lenders and seller/servicers to address underlying origination practices causing unusual or high prepayments in their production, NAHB fears lenders that originate and pool loans with high prepayment speeds would be further encouraged by the benefits of combining their loans and pools with those from lenders and seller/servicers with lower prepayment speeds.

Requiring the creation of generic, large multi-lender pools will shrink the volume of pools with specific features, which incent investors to price the risk in a pool and pay based on pool characteristics. In effect, reducing investor choice and pool variances will reduce the incentive for investors to participate in the TBA market and decrease liquidity. This will lead to higher mortgage interest rates to borrowers.
NAHB opposes requiring increased generic multi-lend pools because the proposal that would not reduce prepayment speed differentials among lenders and UMBS and would increase mortgage interest rates to borrowers.

Proposal to reduce issuance of specified pools

Similarly, the proposal to limit specified pools and other pools with market pay-ups (such as certain single-lender pools that have particularly desirable characteristics) would limit investor choice. Again, NAHB opposes reducing specified pools because the proposal would increase mortgage interest rates to borrowers.

Specified pools allow investors to pay up for certain pools and thus drive down interest rates, ultimately reducing costs to mortgage borrowers. Reducing the number of specified pools may result in fewer loan product options for borrowers as loans become more standardized to fit into the larger, more generic multi-lender pools. The reduced liquidity in specialized loans will increase mortgage interest rates.

Proposal to exclude lenders with problematic prepayment speeds from TBA-eligible delivery

FHFA's pooling proposal suggests lenders with problematic prepayment speeds would be excluded from delivering loans or pools into TBA-eligible pools and the Enterprises should align their requirements for when this exclusion would apply to an individual lender. This proposal has merit as a way to keep prepayment speeds on each Enterprises' UMBS within the acceptable prepayment tolerance per the Final Rule. This proposal also would be less disruptive to the TBA-eligible market than dictating the allowed issuance of multi-lender and specified pools.

The Enterprises currently monitor the prepayment behavior of their seller/servicers. If this proposal to exclude lenders with a problematic prepayment speeds from TBA-eligible MBS were to be implemented, additional details would be needed to ensure an aligned standard at the Enterprises for assessing the reasons a lender has a problematic prepayment speed. NAHB cautions that the Enterprises must identify “bad actors” versus efficient, innovative lenders and not assume high prepayment speeds are the result of unacceptable or aggressive refinance practices, for example. Also, a standard for when a lender could be reinstated would be necessary. It should be assumed that having their production relegated to MBS that are not as attractive to investors would incent lenders to take action to reduce their prepayment speeds in order to have their production allowed back into TBA-eligible deliveries.

Conclusion

NAHB believes FHFA’s proposed changes to the UMBS pooling requirements for generic, multi-lender pools and specified pools are premature and would reduce liquidity in the TBA market, leading to reduced investor choice and higher interest rates for borrowers. In particular, we urge FHFA not to move forward with the proposed requirement for a high share of loans to be securitized in multi-lender pools. The transition to the UMBS was carefully orchestrated. Any further changes that could impact the market should be handled with the same due process.

Thank you for your consideration of NAHB’s comments. For more information, please contact Rebecca Froass, Director of Financial Institutions and Capital Markets at rfroass@nahb.org.

Sincerely,

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