January 21, 2020

Dr. Mark Calabria PHD
Director
Federal Housing Finance Agency
400 7th St SW
Washington, DC 20219

Re: Enterprise UMBS Pooling Practices- Request for Input

Dear Director Calabria,

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to provide comments on the Federal Housing Finance Agency's (FHFA) "Enterprise UMBS Pooling Practices" Request for Input (RFI). The FHFA is seeking input regarding possible improvements in Uniform Mortgage Backed Security (UMBS) liquidity by requiring the Enterprises (Fannie Mae and Freddie Mac, or the GSEs) to channel more of their loan purchases into large multi-lender pools thereby diminishing the impact any one lender/issuer's loan production could have on the prepayment performance of the pool, which would, theoretically, improve liquidity and pricing for all GSE sellers. The FHFA is also requesting input on any other policies or practices that could improve UMBS liquidity.

The GSEs successfully launched the UMBS in June of 2019. This launch was the culmination of more than five years of work by both GSEs to create a new conventional mortgage backed security (MBS) backed by mortgages acquired by both Fannie Mae and Freddie Mac. The goal was to increase liquidity in the GSE MBS market by permitting the UMBS to be good delivery for To-Be-Announced (TBA) trades while allowing loans from either GSE to be co-mingled in any

[1] The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. With more than 50,000 locations nationwide, community banks constitute 99 percent of all banks, employ nearly 750,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding more than $5 trillion in assets, nearly $4 trillion in deposits, and more than $3.4 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at www.icba.org.

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UMBS. The GSEs would no longer issue their own respective MBS for fixed-rate mortgages. Further, to help boost liquidity, Freddie Mac, who legacy MBS had a different pass through schedule than Fannie Mae MBS, would run an exchange program where it would exchange legacy MBS for identical UMBS through the Common Securitization Platform (CSP) which was jointly developed and is jointly managed by the GSEs. Since its launch in June, the UMBS appears to have performed well and mortgage pricing has not been negatively affected during the transition.

However, for the UMBS to be successful over the long term the two GSEs must make sure prepayment speeds are closely aligned. Any material variance of speeds from either GSE will cause investors to demand a higher premium for prepayment risk or they will seek to purchase UMBS backed solely by one GSE's production rather than UMBS pools with co-mingled loan production. Both actions would hurt UMBS liquidity and have a negative impact on mortgage pricing.

While both GSEs and FHFA have put extensive monitoring processes in place, the mere fact that the GSEs are two separate entities with different views on credit and risk will always result in performance differences in the loans that back the UMBS. This need for alignment between two private companies is the one major disadvantage of the UMBS. The ability and desire to maintain this alignment will continue to be a challenge for both companies and the FHFA as regulator. While in conservatorship, the FHFA can exert considerable control over both GSEs. Once they exit conservatorship and return to the marketplace as two private companies, it will be more challenging to maintain alignment as both companies will want to innovate and compete. ICBA has expressed similar concerns with the UMBS previously and we continue to have concerns that this need to maintain alignment will stifle innovation and competition between the two GSEs.

The RFI suggests that the impact on UMBS prepayment speeds by any one issuer or group of loans can be diluted by requiring the GSEs to issue larger UMBS pools, resulting in more diversity in terms of sellers/issuers, loan types, LTVs, geography, and borrower credit profiles. Clearly, increasing the size of the UMBS pool would mute the impact any one seller/issuer would have. However, larger pools would require the GSEs to warehouse the loans they acquire for longer periods of time and would increase their hedging costs.

Moreover, creating larger pools doesn't necessarily resolve the issue of alignment which is really the problem that the RFI is attempting to address. As stated earlier, the need to maintain alignment is an unfortunate flaw with the UMBS construct that will always be present as long as there are two GSEs. The RFI fails to provide any real analysis on the costs/ benefits of creating larger pools versus the current pooling model, nor does it discuss the additional warehousing/carry costs and other risks posed by creating these pools. While some investors may prefer larger pools, they remove flexibility from seller/servicers that prefer to securitize and sell their loans as a single issuer. These entities could see a deterioration in their overall execution as they would no longer enjoy pricing benefits of unique pooling factors such as small loan balances, or geography, if forced to sell through multi-lender pools. There could also be other unintended consequences of forcing the creation of the larger pools. FHFA suggests that these larger pools will be similar to GNMA II multi-lender pools that are comparatively similar in liquidity. However, GSE MBS issuance far exceeds GNMA issuance and enjoys more liquidity.

FHFA is seeking input at a time when the market has only had about six months experience with the UMBS. The market has not had the opportunity to observe UMBS performance in rapidly changing rate scenarios or in deteriorating credit markets. Having divergent credit performance in a recession is more likely to occur as the GSEs have different tolerances for credit risk. It is not clear at this point how those will manifest themselves in the next downturn with regard to UMBS performance.

Given the lack of data and analysis relating to UMBS performance during its brief tenure, it will be extremely challenging to anticipate and mitigate any unintended consequences moving forward. ICBA therefore believes it may be premature at this juncture to change the GSE pooling practices. We suggest the FHFA and the GSEs continue to monitor performance for several more years, allowing for the collection and publication of UMBS performance data that would better support changing the current pooling practices, or help identify other modifications that may be needed to improve liquidity.

Other UMBS Pooling Suggestions

Recently, larger lenders have entered risk-sharing arrangements with the GSEs as a means to improve their price execution in exchange for retaining some part or all of the credit risk on a large pool of loans. While some of these structures result in non-TBA eligible UMBS, some loans with significant risk sharing could ultimately end up in standard TBA pools. Further, it is likely that these large lenders do not place all their loan production into these risk-sharing structures, which creates the opportunity for them to adversely select the GSEs in terms of both credit and prepayment performance. We strongly believe that lenders that choose to create risk-sharing structures on large pools of loans should be restricted to only single issuer non-TBA UMBS. Loan pools that have extensive risk-sharing structures will have different performance outcomes, and the issuing lender should not be permitted to include them in standard TBA pools. Also, given the adverse selection risk from these lenders, the GSEs should closely monitor the performance of these lenders' non-risk-shared loan production and take steps to minimize any negative impact on UMBS performance. It is likely those entities that have the scale to aggregate and create these types of risk-sharing structures also possess

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trading operations with market-making capabilities to easily market those non-TBA UMBS, which should not negatively impact the market in general.

In summary, ICBA appreciates the opportunity to provide input on this RFI. However, we urge FHFA to delay any such changes at this point and allow the market to have more time to observe UMBS performance. Detailed UMBS performance statistics from both GSEs and FHFA over time should indicate what, if any, changes need to be made to improve security performance and UMBS liquidity along with a better analysis of the impact on GSE sellers/issuers and the resulting benefit in liquidity and pricing. We do strongly encourage FHFA and the GSEs to monitor the impacts of large lender risk-sharing structures on UMBS performance and take appropriate actions to minimize the price execution advantage these transactions have over the broader GSE market.

ICBA looks forward to working with FHFA staff and the GSEs on this issue as it moves forward. Please contact me at ron.haynie@icba.org if you have any questions regarding this letter.

Sincerely,
/s/
Ron Haynie
Senior Vice President, Mortgage Finance Policy
Independent Community Bankers of America