

January 21, 2020

Federal Housing Finance Agency
Division of Conservatorship
400 7th Street SW, 8th floor
Washington, DC 20219

Re: FHFA Request for Input on Enterprise UMBS Pooling Practices

Bayview welcomes the opportunity to provide comment on Enterprise UMBS Pooling Practices. We are supportive of FHFA's goal in maintaining fungible, deep, liquid markets in UMBS. However, we do believe that this can be achieved under a framework that includes the following;

- **No hard limit on the percentage of production that can be specified**
- **Originators need to be able to determine what constitutes a specified pool based on MBS investor requirements and demand**
- **Any new system will still allow single issuer specified pools**
- **Specified pools will continue to be TBA deliverable**

Please see more detail to several FHFA questions in the RFI below;

Question 2. Which approaches to pooling (i.e., the Enterprises' current approaches, FHFA's proposed approach, or other approaches) are preferable and why?

As mentioned in the RFI, the Enterprises currently have many tools to achieve the goal of prepayment alignment. In particular, the GSE's can adjust their pricing structure by lender to incentivize better prepayment performance (buyup/buydown, upfront LLPA, minimum servicing retention). Any changes to policy that provides more flexibility in how the GSE are able to price and pool would probably make alignment easier, and reduce barriers for new entrants. Restricting pooling options by market participants or the GSEs to "hide" poor prepayment behaviors by specific lenders ultimately punishes the entire marketplace for a limited number of poor performing participants.

To help alignment and promote the creation of Supers, FHFA can allow the GSEs to use the speed on Supers instead of the speed on the underlying pools for purposes of alignment testing. Combined with a policy of allowing free Supers, this can help comingle existing pools based on a number of dimensions including Enterprise, loan age, and servicer. This type of tool would allow the GSEs to fix alignment issues on existing pools when problems arise, instead of trying to counter potential alignment issues before they even occur.

Question 3: What benefits, costs, and other considerations should FHFA weigh as it reviews options?

Care must be taken when making changes to the specified pool market. The majority of storied bonds are comprised of low-to-middle income borrowers (low loan balance, high LTV, or low FICO). Investors pay very large premiums for these bonds, and these proceeds are often used to reduce the cost of these mortgages for these traditionally underserved borrowers.

In whatever pooling option the FHFA chooses, originators should retain the ability to keep their high-quality specified pools as single issuer. This best serves the borrower by allowing the originator to get the full value of the borrower's favorable characteristics by preventing other originators from watering down the quality of the pool.

In addition, all single issuer specified pools (with the expectation of non-deliverable alignment pools) should retain their TBA eligibility. While it doesn't suggest the opposite, the RFI mentions GNMA Multi-Issuer pools as a preferred model. In GNMA, specified pools are not TBA eligible. As a result, specified pools in GNMA can trade at larger discounts and often go through periods of worse liquidity. This can disadvantage both borrowers and investors.

Recent developments in the GNMA multi-issuer program also highlight the potential challenges of creating only one all-encompassing pool. As production has shifted from GNMA's single issuer program into their multi-issuer program, the market has gradually lost the ability to police prepayment behavior. This burden has been transferred from market forces to program administrators (FHA, VA, and GNMA). Administrators have enacted a dozen program changes over the past few years, many of which require increasing levels of regulation and monitoring. However, a solution that appeases all market participants (and improves the performance of GNMA securities) has been elusive.

GNMA currently has a strict multi-pool program that strongly discourages the potential separation of underlying loans by their varying levels of performance. A drawback to this approach is that the overall execution of this multi-pool is always at the mercy of its fastest prepaying sub-cohort. These worst performing loans drag down overall execution, while the best performing loans subsidize the worst ones. Since market forces are keen at exploiting subsidies, over time the program becomes heavily weighted towards the worst performing loans, placing even more burden on the rest of the program. This is a vicious cycle that is difficult to manage through regulation. It is much easier to allow market forces to start pricing cohorts differently when their performance begins to deviate significantly. This is the fundamental advantage of the single issuer system. Loans don't always have to be grouped into buckets by performance, but having that option will allow the market to correct itself once imbalances inevitably develop.

To see an example of this, we can look at today's conventional market. The recent creation of more specified pools is not the disease, but the symptom of the market attempting to cure itself of some prepayment behaviors that may have gotten too fast for current valuations.

Question 6: Should FHFA prescribe limits to the issuance of specified pools through or by the Enterprises?

Setting limits on the quantity and composition of specified pools is a complicated task, one that is better left up to market forces. As seen in the GNMA example above, regulations create subsidies, and subsidies are often exploited by a small set of participants to the detriment of the entire market.

In addition to preserving the current system of checks and balances, a market based pooling system will allow for continued innovation. The market is constantly evolving, and creating a hard rule around what could be defined as specified could stifle that. One example is the Housing Finance Authority (HFA) market. While these loans have been around for a while, they only recently began to be pooled

separately from generic high LTV loans. HFA loans provide extremely strong levels of call protection for an investor, and their payups have grown to be several points above generic high LTV loans. The additional premium that investors now pay for these pools are crucial to the economics of the loans. As the specified market for these pools has grown, issuance of the loans has grown with it.

By leaving pooling decisions up to originators, a thriving market for HFA pools has blossomed. A similar situation occurred a few years earlier when some originators tested pooling MHA loans into separate pools. Over time these pools began to command large payups, and the increased economics turned a struggling program into a giant success. In both cases, the ultimate winners of this innovation were borrowers. And in both cases, the programs may not have flourished if originators were not given the flexibility to try new pooling options, or if they were limited in pooling by fixed quotas.

Finally, in addition to curbing affordability options, creating hard limits on specified issuance could limit the breadth of mortgage options available to borrowers. Shorter term mortgages (25yr and 20yr) are just one example of this. As a refinance product, the issuance of these specified pools are highly variable over time.