PHH Mortgage appreciates the opportunity to provide feedback on the Request for Input: Proposed Single Security Structure. Our perspective may be somewhat unique, as we are a top ten, non-bank mortgage originator.

We agree with the objective of the Single Security: achieve maximum market liquidity while mitigating any risk of market disruption. If investors don’t have a preference between Fannie Mae (FNMA) and Freddie Mac (FHLMC) securities, the Single Security will achieve its objective of reducing the price spread between the Agencies’ bonds. However, due to investor appetite for specified collateral and potentially one Agency over the other, a pricing differential could emerge. Additionally, the overall price of the Single Security may decline due to worsened characteristics of the cheapest to deliver collateral.

The following are some additional high level comments behind the proposal:

* The liquidity driven price spread between FNMA and FHLMC TBA should decrease to zero as both are deliverable into the Single Security.
* However, specified pools may still be formed. If current markets are an indication of the future state, the majority of new production will trade as specified pools at a premium to the Single Security. The existence of specified pools will permit investors to isolate either FNMA or FHLMC securities within the Single Security, potentially enabling the FNMA / FHLMC price spread to persist.
* Loans with the most desirable characteristics will be sold in specified pools. The Single Security will be formed from the residual loans with less desirable characteristics. The result will result in a slight decrease in the Single Security TBA price, when compared to the entire deliverable universe.
* The Single Security construct increases the quantity of bonds eligible for TBA delivery. This will reduce the occurrence of front month bond scarcity, which in turn improves roll levels. The outcome is lower originator hedge costs, improving borrower facing rates.
* The FHLMC Guarantor Fee subsidization should be eliminated, as FHLMC would no longer need to compensate for the FNMA/FHLMC spread.

PHH believes the initiative is a move in the right direction. However, there are several structural issues which should be addressed to avoid future price differentiation between FNMA and FHLMC underlying bonds in the Single Security. Investors may desire FNMA only or FHLMC only securities under the Single Security proposal. Reasons for this include, but are not limited to, credit exposure limits to a specific Agency, underlying loan characteristics of the Agency’s security, prepayment speeds and perceived differentiated credit risk between FNMA and FHLMC.

If price differentiation occurs, the result would be lower overall TBA prices, as loans with more favorable attributes are pooled separately and the remainder delivered into TBA. Since most originators use TBA pricing to establish their rate sheets, the lower prices would drive higher borrower facing rates.

A potential solution is to eliminate single lender securities (specified pools). If only multi-lender pools exist, co-mingling FNMA and FHLMC securities, then investors can only acquire bonds which are representative of the broad universe of originations. Better performing loans from both Agencies would be included in the multi-lender pool, improving the loan characteristics of the TBA security. This would result in higher TBA pricing and lower borrower facing rates.

This solution resembles how the Ginnie Mae II (GN II) market exists today. Minimal GN II production is securitized into specified pools since they are not deliverable into the TBA. Investors in GN II multi-lender securities benefit from knowing their acquisitions are representative of the broad market, containing all types of loan characteristics. This permits TBA GN II pricing to be as high as possible, which benefits borrowers by driving lower rates.

The elimination of the specified pool market may not be a welcome development by the dealer or investor community. Dealers use specified pools as opportunities to generate additional revenue as investors have different risk appetites and duration needs. An analysis should be done that weighs the benefits and drawbacks of improved TBA pricing at the expense of reduced investment options for investors and dealers.

**Request for Input**

The following statements address the questions FHFA identified in the Single Security proposal:

1. What key factors regarding TBA eligibility status should be considered in the design of and transition to a Single Security?

PHH recommends that FHFA maintain current SIFMA guidelines when considering TBA eligibility. Current SIFMA guidelines include 10% tolerance on Jumbo Conforming, $1mm minimum pooling requirement for single lender pools, 0.01% delivery variance, among other requirements. This would ensure the least amount of market disruption while still achieving the intended goal of increased liquidity.

1. What issues should be considered in seeking to ensure broad market liquidity for the legacy securities?

The exchangeability provision accomplishes this objective. Exchangeability prevents bond orphaning, supporting the liquidity and establishing a floor for legacy bonds if the investor desires to exchange them.

1. What operational, system, policy, or other effects on the industry should be considered?

There are a few policy topics which FHFA should consider as it designs the rules surrounding the Single Security. The following highlights a few items which we believe worthy of consideration:

* FNMA/FHLMC Price Spreads

From a credit and prepayment standpoint, new production FNMA and FHLMC securities currently perform similarly. However, this has the potential to change in the future. Additionally, investors may target a certain level of exposure to either entity as mandated by their board or charter, or based on their preference to one Agency’s credit, collateral characteristics, prepayment speeds or bond liquidity. This would drive relative demand and therefore prices at which FNMA or FHLMC securities trade relative to the Single Security. The result would be the re-emergence of the FNMA/FHLMC spread, causing the market to trade similarly as today.

One solution to this issue is to eliminate single lender securities, only permit multi-lender pools to be formed. In this construct, FNMA and FHLMC bonds are blended together in the same securities, eliminating potential investor differentiation between the Agencies.

* Agency Counterparty Risk

While the Agencies are in conservatorship, there is very little counterparty risk differentiation between the Agencies. However, in a post conservatorship world, investors may perceive differences in the guarantor’s insurance. If this occurs, significant price differences between FNMA and FHLMC issuance might be observed.

* Seller / Servicer Responsibilities and Options

It is important Servicer responsibilities are not altered. There should be no impact to Servicers on existing MSRs in respect to remittance cycles or other cash flow components, including interest rate shortfall obligations. The current practice of Agency buyouts of loans which are four months delinquent should be mandated for both FNMA & FHLMC, which causes the remittance cycle to move from Scheduled / Scheduled to Actual / Actual. This permits Servicers to minimize their advances on delinquent principal and interest, which is a difficult to finance asset type for non-bank servicers. It is also worth considering forcing the Agencies to conform their Servicer remittance cycles and interest rate shortfall decisions to be comparable to each other.

* 2nd Level Securitizations

The cost to build 2nd level securities should be the same for all participants and clearly communicated to the market.

* MSR Sales

Both FNMA and FHLMC currently permit loan level MSR sales. The creation of the Single Security should not necessitate a change to pool level MSR sales. The same flexibility to sell MSR’s as it exists now should be allowed.

* Buy-up/Buy-down

Both FNMA and FHLMC currently permit Sellers to perform loan level buy up/buy downs within a pool. This should remain unchanged.

* Time to Implementation

The release of the Single Security can occur prior to the development of the common securitization platform (CSP). The market can realize the benefits inherent in the Single Security much more quickly if it is decoupled from the CSP initiative.

1. What can be done to ensure a smooth implementation of a Single Security with minimal risk of market disruption?

No comment.

**Conclusion**

PHH supports FHFA’s Single Security Proposal. We believe the Single Security Structure will provide the desired impact FHFA intends. However, there is risk to improved Single Security pricing unless the ability to create single lender securities is eliminated. For various reasons, investors may request FNMA or FHLMC only pools. These specified pools would trade at a spread to the Single Security TBA. While the investor may be benefit from more investment options, the borrower would be worse off due to the lower TBA pricing. PHH believes both the borrower’s and investor’s interests should be taken into account as this critical policy is developed.