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October 13, 2014

Federal Housing Finance Agency
Office of Strategic Initiatives
400 7th Street, S.W.
Washington, D.C. 2004

Re: Single Security Structure

Dear Sir or Madam:

The Housing Policy Council (HPC)[1] of the Financial Services Roundtable appreciates the opportunity to comment on the proposal by the Federal Housing Finance Agency (FHFA) to create a single security to be issued and guaranteed by Fannie Mae and Freddie Mac.

HPC has been a consistent advocate for the creation of a single security. We endorsed the concept in a December 3, 2012 letter to FHFA on the proposed Securitization Infrastructure and in a white paper on GSE Transitional Issues, which we submitted to FHFA on February 10, 2014. A copy of the section of that white paper related to a single security is attached to this letter. In addition to the matters addressed in our white paper, HPC offers the following comments on the transitional issues associated with FHFA's current proposal.

Benefits of a Single Security

A single security would benefit the housing finance market, consumers, investors and taxpayers. A single security would expand the liquidity for the agency MBS market and thereby should lower rates for borrowers. A single security would minimize, if not eliminate, some of the pricing inefficiencies in the market and save taxpayers hundreds of millions of dollars per year, which Freddie Mac currently pays to originators in order to maintain market share. A single security also would remove a potential impediment to new market entrants when the GSEs emerge from conservatorship or Congress enacts GSE reform legislation.

Timing

FHFA has indicated that the establishment of a single security is a multi-year process. This time frame reflects the agency's intention to link the adoption of the single security with the launch of the common securitization platform ("CSP"). HPC believes that it is important to take the time necessary to ensure that the transition to a single security is conducted properly and does not disrupt the market for agency MBS which we endorse. However, we do not believe that the adoption of the single security as proposed is contingent upon the successful launch of the CSP. We believe that the two GSEs are

[1] The Housing Policy Council of the Financial Services Roundtable consists of thirty companies that originate, service, and insure mortgages. HPC's member companies originate approximately seventy-five percent and service approximately two-thirds of all mortgages in the United States. HPC's missions is to promote the mortgage and housing marketplace interests of its member companies in legislative, regulatory, and judicial forums.

functionally and operationally aligned enough today for this proposal to move forward in a manner that is not linked to the competition of the CSP. As we noted above, a single security carries many benefits, not the least of which is the elimination of a significant cost to taxpayers. "De-linking" the establishment of a single security and the completion of the CSP would permit these benefits to accrue sooner rather than later and would not detract from the progress made on the CSP. While these two efforts can be "de-linked," HPC would emphasize that we also support completion of the CSP in the near term.

Maintaining Competition

In aligning the features of the single security to be issued by Fannie Mae and Freddie Mac, we urge FHFA to be attentive to competition between the two GSEs. Today, competition between the GSEs is stifled because Freddie Mac's PCs lack sufficient market liquidity. As the proposal moves forward, FHFA should seek to encourage competition between the GSEs in various ways, including the quality of service and the implementation of innovations. However, while promoting competition is important, FHFA should take appropriate steps to ensure that there is sufficient alignment of the features of the single security issued by the two GSEs in order to promote fungibility between the two securities. For example, we do believe credit characteristics of underlying loans need to be sufficiently aligned to ensure all MBS issued by Fannie Mae and Freddie Mac maintain similar, if not identical, prepayment speeds.

Active Oversight

In order for the securities issued by Fannie Mae and Freddie Mac to be fungible on an on-going basis, it is important that essential parameters of the securities (e.g. prepay-speeds) become largely aligned. For example, the fungibility of the securities could be impaired if the prepayment speeds on the mortgages underlying the securities issued by one GSE start to materially differ from the prepayment speeds underlying the securities issued by the other GSE. To avoid this and any other potential deviations from the standards applicable to the single security, we recommend that FHFA establish an ongoing process (e.g., an actively managed MBS Policy Group comprised of FHFA and the guarantors) and an enforcement mechanism to oversee compliance with the standards.

Federal Guarantee

Currently, many investors are willing to purchase agency MBS only because of the financial support provided to Fannie Mae and Freddie Mac by the Treasury Department under the terms of the Preferred Stock Purchase Agreement. Any process that is perceived to weaken rather than maintain or strengthen that support will concern investors, particularly larger ones like foreign holders of MBS. Therefore, it is imperative that the single security issued by the GSEs has to have a similar support. Ideally, that support would take the form of a federal guarantee. We realize, however, that only Congress can authorize such a guarantee. As an alternative, we recommend that FHFA explore the establishment of some form of cross-guarantee mechanism between the two GSEs, similar to the joint and several liability structure used by the Federal Home Loan Banks. At the very least, FHFA should clearly specify the "waterfall" of credit counter-parties to be faced in re-wrapped securities including access to the underlying collateral in event of a guarantor bankruptcy.

Minimize the Risk of a Second Transition

We urge FHFA to minimize the risk of a “second” transition. Several GSE reform bills are pending in Congress. At some point, and hopefully sooner rather than later, one of these bills will be enacted and that bill will affect the current structure and operations of the agency MBS market. While FHFA cannot be expected to anticipate precisely how this legislation will evolve, we urge FHFA to be attentive to the various proposals and to take steps in the transition that reduce the potential for any material changes in the design of the single security that may result from the legislation. One way to do this could be to phase in proposed harmonization of GSE operational features (e.g. 90-120 day buy-out policies, reporting, etc.) in such a way as to let the market digest each one at a time, starting with the set of changes that would succeed under any potential change to the GSEs caused by future legislation.

Regular and On-going Engagement

The comments we have provided in this submission address some overarching issues. We recognize, however, that there are many other much more granular issues associated with the transition from the current agency MBS structure to a single security. Therefore, we encourage FHFA to establish a regular and on-going process for interacting with originators, investors and other stakeholders to ensure that transition to a single security moves forward in an appropriate manner.

Thank you for your consideration of these comments. For follow up, please contact Paul Leonard, Senior Vice President of Government Affairs, at 202-589-1921.

Sincerely,

John H. Dalton
President, Housing Policy Council
Financial Services Roundtable

APPENDIX – A

SINGLE SECURITY

The GSE mortgage security "To Be Announced" (TBA) market for Fannie Mae MBS and Freddie Mac PCs are two separate and distinct markets. This is in part because each GSE has different operational and underwriting requirements for the underlying mortgage loans, different payment dates for securities and observably different servicing policies and practices. Despite their similarities and FHFA's current conservatorship and resulting government support of both entities, secondary mortgage investors value Freddie Mac and Fannie Mae securities differently. Between the two, Freddie Mac PCs enjoy far less liquidity as compared to similar Fannie Mae MBS, and the historical pricing spread between the two has only widened sharply during their conservatorship. The current dual market has resulted in sub-optimal liquidity, diminished competition and reduced taxpayer revenue.

The dual markets happen to be supported by dual securitization infrastructures that by all accounts need major updating to avoid market failure. Recognizing the potential expense to taxpayers from having both Fannie and Freddie update their securitization infrastructures separately, the Federal Housing Finance Agency (FHFA) in 2012 determined to combine the upgrading process into one larger effort. Toward that end, in May 2012 FHFA released its "Strategic Plan: Fiscal Years 2013-2017" (the "Strategic Plan"), which, among other things, proposed to build a new common infrastructure for Fannie Mae and Freddie Mac (the GSEs). In October, FHFA followed up with a white paper issued for comment entitled, "Building a New Infrastructure for the Secondary Mortgage Market". Then in March 2013 FHFA released its "Conservatorship Strategic Plan: Performance Goals for 2013" which lists first the build out of a "Common Securitization Platform". In between issuing plans and white papers, both FHFA and staffs at both GSEs began taking steps to outline the development of a single securitization platform that would "allow for a single mortgage-backed security."

The Housing Policy Council[2] and its members support FHFA's strategic initiatives and believe they can be beneficial to the mortgage markets in the medium and long term. We do believe, as noted in our letter on Securitization Infrastructure, dated December 3, 2012, that FHFA should take a more incremental approach to infrastructure reform. One of those steps we noted in the letter is the creation of a unified agency security in the near term (a "Single Agency Security") that could be substituted for Fannie Mae MBS and Freddie Mac PCs.

The creation of a Single Agency Security is not meant to address broader GSE reform that may be considered and enacted by Congress over the long-term (although this transformation would not hinder

[2] The Housing Policy Council ("HPC") of the Financial Services Roundtable is a trade association that represents 29 of the leading national mortgage finance companies. HPC members originate, service, and insure mortgages. We estimate that HPC member companies originate approximately 75% of mortgages and service two-thirds of mortgages serviced in the U.S.

such reform either). A Single Agency Security would minimize, if not eliminate, some of the pricing inefficiencies that currently exist in the market. Such a plan could be implemented without amendments to the GSEs' charters, and thus can be acted upon by FHFA without any additional Congressional action. The creation of a Single Agency Security would expand liquidity for the agency MBS market, lower rates to borrowers, expand completion amongst the current GSEs and reduce the insuperable barriers to entry for new guarantor entities.

Discussion

Freddie Mac pools historically have traded at a discount to Fannie Mae pools, and Freddie Mac traditionally has made up for this discount by providing loan sellers a lower guarantee fee or other concessions. Despite the pricing concessions, large originators have shifted their sales from Freddie Mac to Fannie Mae. This shift has resulted in less volume for Freddie Mac PCs, creating a vicious circle whereby the fewer securities created, the greater the liquidity premium issuers bear when creating Freddie Mac PCs, which causes issuers to prefer Fannie Mae MBS to Freddie Mac PCs and so on an so forth. This circle has further amplified the liquidity concession already inherent in such securities. Currently Fannie Mac has greater tradable supply in each cohort of TBA.

30 Year TBA Float as of 01/11/2013, excludes REMICs, Specified and NY Fed Holdings (billions)

Coupon	3	3.5	4	4.5	5	5.5	6	6.5
Freddie	$ 28	$ 48	$ 51	$ 51	$ 26	$ 33	$ 17	$ 3
Fannie	$ 55	$ 122	$ 126	$ 84	$ 70	$ 59	$ 37	$ 7

15 Year TBA Float as of 01/11/2013, excludes REMICs, Specified and NY Fed Holdings (billions)

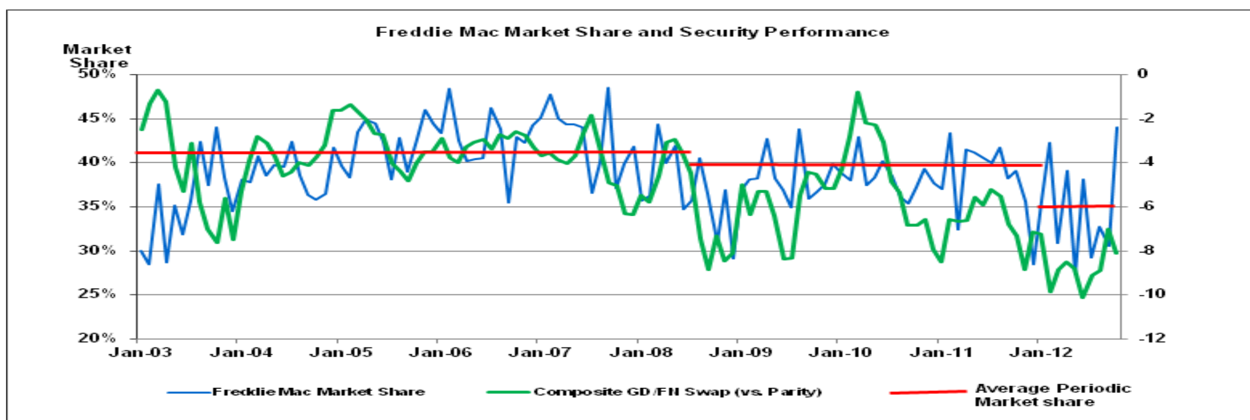
Coupon	3	3.0	4	4.0	5	5.0
Freddie	$ 26	$ 28	$ 19	$ 20	$ 14	$ 8
Fannie	$ 50	$ 54	$ 42	$ 37	$ 24	$ 17

Greater liquidity translates into superior security pricing. Superior security pricing enables Fannie Mae to dominate the current GSE issuance market. While Freddie Mac is able to compensate via pricing concessions, there is a real concern over whether an entity outside conservatorship could continue as a going concern with such concessions and whether such a business model is sustainable. These concerns will be amplified once we leave this historically low rate environment and the Federal Reserve ends its MBS purchase programs.

To be fair, current high issuance levels are creating enough absolute new issue MBS volume that Freddie Mac PCs are liquid enough to provide for a workable TBA market for such securities. Additionally, the high absolute prices for agency MBS has created a high demand for prepayment advantaged specified pools, Because these specified pools do not trade in the TBA market and the investor is able to choose the collateral backing the MBS, Freddie Mac *specified* pools do not trade at a discount to Fannie Mae specified pools. Once rates begin to rise, issuance levels drop and the Federal

Reserve's appetite for agency MBS is reduced, investor pay-ups for specified pools will drop and Freddie Mac will be forced to compete directly with Fannie Mae's superior TBA pricing advantage.

Further, as stated in the most prominent white papers on GSE reform (across the political spectrum), there is a desire for additional enterprises participating in the future agency MBS market. Any new entrant into this space would suffer similar, and likely worse, pricing concessions due to liquidity concerns. This would make the barriers to entry for a new participant a near– economic impossibility.



Combined liquidity would level the playing field for both existing and new entrants, so while no plan for the resolution of the GSEs and their market is certain, the creation of a single security would lay the ground work for a new entrant. That said, these actions do not require the entry of new participants or any other requisite future steps to pay dividends. The increase in liquidity of Freddie Mac securities should eliminate the need for "market adjustment payment" pricing, thereby increasing tax payer revenue. The increase in overall market liquidity should also create more valuable securities in the aggregate, which will result in lower mortgage rates being passed through to consumers.

A key driver of liquidity in the agency market is fungibility of each GSE's securities. In order for a Single Agency Security proposal to be effective, fungibility must extend across the Single Agency Securities, regardless whether they were issued by Fannie Mae or Freddie Mac. For this to occur, both perceptions about and features of Fannie Mae MBS and Freddie Mac PCs that contribute to the current pricing differential must be eliminated. This goal would require a standardization of: (i) loan delivery and pooling requirements; (ii) remittance requirements; (iii) underwriting guidelines and refinance programs; (iv) the credit quality of the guaranty provided to each of the new security; (iv) servicing standards and loan repurchase policies; and (v) disclosure policies. Each of these elements could be achieved in the near-term, by leveraging guidelines and standards that already exist or are currently being developed as part of previously announced FHFA initiatives.

Differences between GSE pooling and delivery requirements create both intrinsic differences in bond valuations (e.g. delay-days) and operational differences that may tend to foster disproportionate

allocation of collateral by issuers (e.g. delivery restrictions and variances). Both of these differences must be eliminated to the greatest extent possible. While shorter payment delay periods create more valuable securities, the least administratively burdensome and most feasible alignment of the 45-day Freddie TBA and the 55-day Fannie TBA is to move all of the payment dates to the 25th of the month, matching Fannie Mae's current payment date structure. A securities administrator can easily hold remittances another 10 days. Further, this would avoid servicer confusion and error during the conversion period, which will be heightened if partial conversions are allowed and because CMOs will not be converted.

The market currently does not meaningfully distinguish the credit quality of a Fannie or Freddie guaranty where both are under a receivership system that effectively provides the federal government's full-faith-and-credit coverage. However, if and when the entities exit receivership, or to the extent that one or both exhaust their government backstop, the market will begin to price in the relative strength of each issuer. These concerns will be heightened due to Freddie's current pricing disadvantages and reduced profitability due to their necessary pricing concessions. The most effective solution to this concern is to create a separate full-faith-and-credit guaranty on top of the GSE wraps but this strategy would require congressional action.

We would instead advocate for a system of cross-indemnity where each GSE enter into a contract to guaranty the other's obligations on their MBS (comparable to the Federal Home Loan Banks' joint and several liability). The dual guaranteed bonds would then be delivered as a Single Agency Security. It is our understanding that the GSEs and FHFA have explored co-issuance alternatives for the GSEs but did not come to any conclusions. Our suggestion above is from an outsider's perspective and therefore, while we have provided one potential alternative, we defer to the GSEs and FHFA and would advocate for whichever solution presents the fewest legal and procedural challenges.

A key issue to address is the differing GSE guidelines that effectively create a universe of "Fannie only" and "Freddie only" loans. While these differentials tend to be on the margin, they foster a system that does not create fungible underwriting standards. We would support the FHFA creating, along with the GSEs' and the industry's input, a universal set of underwriting guidelines for agency (and later successors') deliverability. Lastly, we would support a system in which each issuer is allowed to establish its own identity and pursue the pooling strategies that it believes provide the most effective pricing to its customers. In pursuit of this last goal we believe it is important to maintain the option of single-issuer and specified pool deliveries in addition to the ability to form multi-issuer and mega/giant pools. Each of these alternatives would always be delivered under a Single Agency Security ticker that would not be identified with either GSE. .

In this system, by mitigating the performance differences between Fannie Mae and Freddie Mac, investors would be indifferent to whether Fannie Mae or Freddie Mac is primarily responsible for the guarantee of timely payment of principal and interest on the securities. Any interest in the details of a security's performance would be based upon the loan-level information made available. It should be

noted that this step only works in conjunction with a system that eliminates the inherent differences between bonds issued by the GSEs, such as the system described above. Under this proposal an originator / aggregator would continue to deliver to either Fannie or Freddie under the terms negotiated with each enterprise. However, having eliminated substantially all of the performance differences between the two securities from an investor standpoint, there should be little or no cost ascribed to the delivery of either security.

In order to not alienate current investors and to cause as little disruption to the TBA market as possible, legacy agency securities cannot be orphaned and a conversion mechanism must be provided. While there are no insurmountable hurdles to conversion, the mechanism would have to address taxation issues (conversions must be like kind exchanges for tax purposes), compensate current holders for day delay conversions, and allow for optional conversion over time to allow investors to clear their own operational hurdles. We would support a system whereby SIFMA provides for the creation of a new "Single Agency Security TBA" deliverable while simultaneously ending the practice of supporting Fannie and Freddie TBA deliveries. They could further provide that delivery of the newly created "Single Agency Security MBS" would satisfy the delivery requirement for both Fannie and Freddie forward commitments to prevent widespread fails.

Conclusion

The Housing Policy Council supports FHFA's previously announced strategic initiatives around the creation of a common securitization platform. However, we also believe that FHFA could take a more incremental approach to infrastructure reform, one of those steps being the creation of a Single Agency Security. The creation of a Single Agency Security is not meant to address broader GSE reform that may be considered and enacted by Congress over the long-term (although this transformation would not hinder such reform either). However, it could be implemented without amendments to the GSEs' charters, and thus can be acted upon by FHFA without any additional Congressional action.

Implemented correctly, a Single Agency Security could benefit all participants in the mortgage market, including borrowers, originators, investors, taxpayers and the U.S. government. It would minimize, if not eliminate, some of the pricing inefficiencies that currently exist in the market. Finally, creation of a Single Agency Security would expand liquidity for the agency MBS market, lower rates to borrowers, expand completion amongst the current GSEs and reduce the insuperable barriers to entry for new guarantor entities.