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Housing Finance & Regulatory Affairs

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Federal Housing Finance Agency
Office of Strategic Initiatives
400 7th Street, SW
Washington, DC 20024

Re: Request for Input: Proposed Single Security Structure

Submitted via Electronic Delivery to: *fhfa.gov*

Dear Sir or Madam:

On behalf of the National Association of Home Builders (NAHB), I appreciate the opportunity to submit comments on the Federal Housing Finance Agency's (FHFA) proposal to develop a single security structure for mortgage-backed securities (MBS) issued and guaranteed by Fannie Mae and Freddie Mac (the Enterprises). A single agency security could have a significant, positive impact on the liquidity of the MBS market and offer other benefits to the housing finance system. However, the design and implementation must be carefully considered in order to preserve critical characteristics of a vital, viable secondary market, such as to-be-announced (TBA) eligibility.

NAHB is a Washington-based trade association representing more than 140,000 members involved in all aspects of single-family and multifamily residential construction. The ability of the home building industry to meet the demand for housing, including addressing affordable housing needs, and contribute significantly to the nation's economic growth is dependent on an efficiently operating housing finance system that offers home buyers access to mortgage financing at reasonable interest rates through all business conditions.

Background

In February 2012, FHFA issued the first *Strategic Plan for Enterprise Conservatorships: The Next Chapter in a Story that Needs an Ending* (Strategic Plan). This plan set forth a framework for how the Enterprises themselves would begin to reshape their role within the housing finance system even while industry stakeholders, Congress and the Obama Administration grappled with a legislative solution for broad housing finance reform and a transition from the Enterprises. It was in this document FHFA first proposed to begin building a new infrastructure for the secondary mortgage market that "would allow for a single mortgage-backed security". Soon thereafter, FHFA released a 2012 Conservatorship Scorecard that provided the implementation roadmap for the Strategic Plan. In the Scorecard, FHFA tasked the Enterprises to work together and with FHFA to develop and finalize a plan for the design and construction of a single securitization platform that could serve both Enterprises and a post-conservatorship mortgage market with multiple future issuers.

Subsequent documents issued by FHFA have reinforced the agency's commitment to ensure the Enterprises build a new infrastructure for the secondary mortgage market of the future that includes a common securitization platform to replace the Enterprises' proprietary systems and new standardized pooling and servicing agreements. However, it was not until FHFA issued the 2014 Conservatorship Scorecard in May and the Strategic Plan for Fiscal Years 2015-2019 in August that the Enterprises were assigned the specific goals of designing the operational and system capabilities necessary for issuing a single or common security for the Enterprises within the Common Securitization Platform (CSP) with the goal of improving the liquidity of the Enterprises' securities.

Today, a pricing advantage on Fannie Mae-issued securities over Freddie Mac-issued securities has created a less efficient and less competitive MBS marketplace than would exist if the pricing differential between these agency securities were eliminated. The pricing disparity is due primarily to lack of liquidity in Freddie Mac securities which can be attributed to the following:

1) Freddie Mac securities traditionally have prepaid faster, providing a disincentive to investors and causing them to be priced at a discount. Though prepayment speeds have converged in recent years, the effect has lingered and Fannie Mae securities are significantly favored by investors.

2) The less attractive Freddie Mac security has a smaller market share and trades with less frequency. This has resulted in less liquidity for Freddie Mac securities.

Even though investors in Freddie Mac securities receive principal and interest payments 10 days earlier than investors in Fannie Mae securities, this seeming advantage has never been as valuable as the liquidity premium that accrues to Fannie Mae securities. Rather, to compensate for the price differential, Freddie Mac often reduces the guarantee fees (g-fees) it charges its sellers, effectively subsidizing lenders at an estimated annual cost of hundreds of millions of dollars to Freddie Mac. Under Freddie Mac's conservatorship status, this loss of revenue to Freddie Mac amounts to a significant government subsidy borne by taxpayers.

As proposed, FHFA is hopeful a single, fungible security would eliminate the long-time price differential between Fannie Mae and Freddie Mac securities by creating a more liquid agency MBS market. Further, with the elimination of the price differential, a substantial subsidy cost to taxpayers would be reduced or eliminated and competition between Fannie Mae and Freddie Mac should increase. Both results would lead to lower interest rates for home buyers.

FHFA's Proposed Single Security Structure

FHFA has issued a specific proposal for how the Single Security it envisions would be structured. The proposal includes details of the key common features, security issuer and guarantee structure, eligible loan/security products, use of re-securitizations and multiple-lender pools, disclosure framework and selling and servicing guides. The proposal also addresses the timing and implementation of the Single Security and how to ensure legacy Enterprise securities are fungible with the new Single Security. Broadly described, FHFA proposes to combine features of each Enterprise's security into the Single Security. The proposed structure of the Single Security, (i.e. payment date to investors, pooling prefixes, minimum pool submission amounts) aligns primarily with Fannie Mae's MBS structure; the proposed disclosure framework aligns with Freddie Mac's loan-level and security-level disclosures.

There would be no difference in the way loans are purchased and guaranteed by each Enterprise. Both Fannie Mae and Freddie Mac would continue to issue and guarantee their own securities collateralized only by the mortgage loans they each have purchased. There would be no commingling of Fannie Mae-purchased loans and Freddie Mac-purchased loans in the Single Security. Investors would purchase a Single Security through the TBA market and receive a security of all Fannie Mae or all Freddie Mac loans. The Single Security could be used to form Fannie Mae Majors and Freddie Mac Multi-lender pools.

The Single Security would be used to form second level securitizations or re-securitizations that could be formed by commingling Fannie Mae and Freddie Mac Single Securities. Known as Fannie Mae Megas, Freddie Mac Giants, or Fannie Mae and Freddie Mac multi-class securities (Stripped MBS and Real Estate Mortgage Conduits (REMICs)), re-securitizations issued and backed by collateral purchased by either Enterprise could contain:

- Single Securities issued by both Enterprises or just one of them;
- Legacy securities issued by both Enterprises or just one of them; or
- A combination of Single Securities and legacy securities, which could be issued by both Enterprises or just one of them.

FHFA also emphasizes the importance of developing a Single Security that is fungible with legacy securities and plans to take steps to make sure current holders of Fannie Mae and Freddie Mac securities have comparable securities when the new Single Security is in place. Ensuring fungibility between new Single Securities and legacy securities is critical to the strategy to increase market liquidity and reduce pricing disparities between Freddie Mac and Fannie Mae securities. As the marketplace gains access to a significantly larger pool of securities that can be interchangeable to create re-securitizations, FHFA posits this will bring in more private investors, improve liquidity and drive down interest rates to mortgage borrowers.

Since many of the proposed features of the Single Security would match Fannie Mae's current security structure, it is likely the new Single Security collateralized with Fannie Mae loans will be fungible with legacy Fannie Mae securities. It is not as clear how to create fungible securities between the Single Security collateralized by Freddie Mac loans and legacy Freddie Mac securities since the payment date to investors would be different. FHFA has proposed it would offer the option for current holders of a Freddie Mac security to exchange the security for a comparable Single Security backed by the same mortgage loans.

NAHB Comments

NAHB is supportive of the effort to develop a Single Security. We believe the proposal should move forward provided that stakeholders and participants in the securities market provide extensive input to FHFA regarding the ultimate structure and implementation of the Single Security and the securities markets will accept the Single Security as good TBA delivery for Fannie Mae and Freddie Mac securities. As underwriting, servicing, and other material loan level variances that may have contributed to differences in the performance of Fannie Mae versus Freddie Mac securities have been substantially reduced, NAHB believes the proposed structure for the Single Security can be successful. However, a more unpredictable requirement for success of the Single Security and acceptance by the TBA market will be dependent on investors believing the guarantee of each Enterprise is interchangeable.

Although FHFA has stated the development and implementation of the Single Security is a multi-year project tied to the completion of the CSP, NAHB believes the Single Security can and should be implemented as soon as possible. Further, we agree with FHFA that all proposed changes, Single Security, Re-securitizations and the option to exchange legacy securities for Single Securities, should be introduced at the same time to avoid potentially disrupting the market three times. Until the completion of the CSP, the Enterprises can continue to use their individual securitization platforms, modifying each as necessary to issue the Single Security per FHFA's final specifications.

NAHB believes the transition to the Single Security should begin soon for numerous reasons. Importantly, it is not sustainable for Freddie Mac to continue to subsidize lenders through lower g-fees to entice them to issue Freddie Mac securities. An ongoing subsidy will weigh on Freddie Mac's profitability and may eventually lead Freddie Mac to require new draws from Treasury. Moreover, spreads between Fannie Mae securities and Freddie Mac securities currently are narrow. If there should be another market downturn, the illiquidity of Freddie Mac securities relative to Fannie Mae securities could widen the spreads and cause Freddie Mac to increase the subsidy to investors at the expense of taxpayers.

Also, certain current industry factors will simplify the transition to a new Single Security. Mortgage origination volumes are relatively low, interest rates continue to be low and Fannie Mae and Freddie Mac have aligned many selling and servicing guidelines to allay investor concerns about collateral differences between Fannie Mae and Freddie Mac securities. Making the transition when origination volumes are low has the benefit of impacting fewer borrowers if the market reacts negatively and mortgage interest rates move higher.

When interest rates are low, security issuance tends to be concentrated in fewer coupons. Issuing new Single Securities into fewer coupons will enhance liquidity in each coupon – an important concern for supporting a new security. This consideration is especially significant if mortgage origination volumes remain low. Transitioning while interest rates are low has the added advantage of making it easier for a Freddie Mac legacy security to be exchanged for the new Single Security as it is more likely that legacy securities being exchanged also will carry a low interest rate.

When the CSP is complete and available to issue securities, NAHB believes additional benefits will accrue to the marketplace. This securitization vehicle will offer new industry players a way to compete with Fannie Mae and Freddie Mac. The CSP has the potential to reduce the barrier to entry to the TBA market by offering a new, private market entrant access to a securitization vehicle rather than a private market participant having to create one. If the CSP issues securities that are good TBA delivery, a private market entrant can create securities and compete on the same playing field as Fannie Mae and Freddie Mac.

Conclusion

Thank you for your consideration of NAHB's comments. The Single Security is a significant step in the greater goal of comprehensive housing finance system reform. The Single Security and Common Securitization Platform have been called for in numerous housing finance system reform proposals, including NAHB's white paper, *Comprehensive Framework for Housing Finance System Reform,* and various legislative proposals by members of Congress. With the timing for housing finance reform still uncertain, NAHB is pleased that FHFA is considering this action and we look forward to offering further input as the process moves forward.

If you have questions, please contact Becky Froass, Director, Financial Institutions and Capital Markets, at 202-266-8529 or rfroass@nahb.org.

Sincerely,

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