October 7, 2015

BY EMAIL

Federal Housing Finance Agency
Office of Strategic Initiatives
400 7th Street SW, Ninth Floor
Washington, DC 20026

Re: FHFA Update on Single Security – Further Feedback

Dear Sir or Madam:

The Structured Finance Industry Group[1] ("SFIG") is responding to the Federal Housing Finance Agency's ("FHFA") invitation to provide further feedback regarding the Single Security initiative, pursuant to the FHFA's "Update on the Structure of the Single Security" (the "Update") dated May 15, 2015. On October 13, 2014, SFIG responded to the FHFA's earlier request for input (the "RFI") on the Single Security initiative ("Prior SFIG Letter").[2]

SFIG's comments and observations are based on the views of the members of SFIG's GSE Reform Task Force ("Task Force"). The Task Force is comprised of constituencies from all areas of the residential mortgage securities market, including investors, issuers, servicers, due diligence firms, law firms, trustees, accounting firms, rating agencies and other market participants.

SFIG's primary focus is on the re-invigoration of the private label securities ("PLS") market for residential mortgage-backed securities ("RMBS"). Notwithstanding this emphasis on PLS, our membership has a heavy stake in the development of the Single Security and of the Common Securitization Platform ("CSP"), as well as in the reform of the GSEs and of the housing finance system generally. Our membership's interest is driven principally by two factors; first, the current size of the "GSE footprint" in the nation's mortgage markets and the uncertainty around GSE reform efforts makes it difficult for the PLS market to gain traction, and second, regardless

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[1] SFIG is a member-based, trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market, with over 300 members including at present 62 investors. SFIG provides an inclusive network for securitization professionals to collaborate and, as industry leaders, drive necessary changes, be advocates for the securitization community, share best practices and innovative ideas, and educate industry members through conferences and other programs. Members of SFIG represent all sectors of the securitization market including issuers, investors, financial intermediaries, law firms, accounting firms, technology firms, rating agencies, servicers, and trustees. Further information can be found at www.sfindustry.org.

[2] Available at http://www.sfindustry.org/images/uploads/pdfs/Single_Security_Letter.pdf.

of the role of the PLS market, it will almost certainly be the "agency MBS" side of the market that will continue to provide the benchmark pricing, both at the consumer-facing mortgage level as well as at the capital markets-facing securities level. In light of these factors, SFIG remains supportive of efforts to reform the GSEs, provided that any transition to a future state includes a gradual transition process to preserve the To Be Announced ("TBA") market and does not create a bifurcated market between newly issued and legacy securities.

We present below our comments regarding the Update; highlighting areas of agreement and areas of continuing concern.

Areas of Agreement Between FHFA and SFIG

Single Security Objective. SFIG agrees with the FHFA that the broad objectives in developing a Single Security are to establish a single, liquid market for the mortgage-backed securities issued by each GSE that are backed by fixed-rate loans and to maintain the liquidity of this market at all times. Achievement of those objectives would enhance the liquidity of the TBA market and further FHFA's statutory obligation to ensure the liquidity of the nation's housing finance markets.

TBA Market Eligibility. SFIG agrees with the FHFA's position that first-level Single Securities should finance fixed-rate mortgages now eligible for financing in the TBA market.

Multiple-Lender Pools. SFIG agrees with the FHFA that lenders should continue to be able to contribute mortgage loans to multiple-lender pools that back first-level Single Securities.

Payment Delay. SFIG is comfortable with FHFA's decision to adopt the 55-day payment delay convention currently used by Fannie Mae with respect to the Single Security.

Disclosure Requirements. SFIG is comfortable with FHFA's decision to adopt Freddie Mac's disclosure conventions.

Stakeholder Involvement. SFIG agrees with the decision to empanel the Single Security and Common Securitization Platform Industry Advisory Group ("Advisory Group") announced on July 8, 2015 by the GSEs and Common Securitization Solutions, LLC ("CSS"). We are honored to participate, and we look forward to robust conversations that will drive industry support and successful implementation of the Single Security and CSP. We believe that the other Advisory Group participants are consistent with our recommendations as to the type of organizations that should be included in such an advisory group, as set forth in the Prior SFIG Letter, and the specific organizations selected represent excellent choices.

We do note, however, that it would be helpful to expand investor participation in the Advisory Group to ensure any issues that arise for this critical part of the industry (*e.g.* adjustments to prepayment models, analysis of accounting treatment, modifications to investment guidelines, and alterations to technology interfaces) are discussed and addressed appropriately. We would further suggest that the Advisory Group convene more frequently as critical decisions are made during the implementation process.

We also note that full or even substantial replacement of the Advisory Group members on an annual basis could lead to a deficiency in both institutional knowledge and decision-making for the Single Security implementation process. We would recommend that the Advisory Group maintain some continuity during the multi-year project through a staggered approach to rotating Advisory Group participants.

Finally, it is SFIG's understanding that implementation of the Single Security will be managed by CSS and the GSEs, while policy decisions should be directed to the FHFA. However, the line between policy and procedure can be unclear. As an example, it is uncertain to the industry as to how any variation in prepayment speeds will be addressed.

The opportunity to respond to policy outcomes through RFI's and one-off meetings with the FHFA is standard practice for rulemakings and is appreciated. However, such avenues may not be sufficient to ensure such a critical project is implemented in a manner that secures support from industry and meets the stated goals of the FHFA, including increasing TBA market liquidity and fungibility of GSE securities. Consequently, we recommend that the FHFA hold more formal and frequent industry discussions, including roundtables on critical issues, to ensure the Single Security achieves the stated goals and has the confidence of industry participants. We further recommend that the FHFA take a more active role in the Advisory Group on issues where the line between policy and procedure are intertwined.

Areas In Which SFIG Has Continuing Concerns

SFIG's membership remains concerned about certain aspects of the Update, including the level of harmonization of the Single Security, the timing of the implementation process, and the nature of any guarantee associated with the new security. We trust that the FHFA will continue to adopt an open-minded approach to these concerns. As we noted in the closing of the Prior SFIG Letter, achieving a broad consensus regarding the implementation of the Single Security initiative is a necessary condition to avoiding possibly severe negative consequences to the nation's housing finance markets.

Level of Harmonization. In its Update, the FHFA states two primary goals for the Single Security. The first is achievement of its statutory obligation to ensure the liquidity of the nation's housing finance system. The second is to reduce or eliminate the cost to taxpayers of subsidizing Freddie Mac's securitization of single-family mortgage loans. At the same time, the Update states that it "does not believe it would be necessary or appropriate to require complete alignment of the [GSEs'] programs, policies and practices as a condition precedent to the implementation of the Single Security initiative." This conclusion applies to policies and procedures relating to the removal of loans from the securitizations; future changes in programs that may affect prepayment speeds; servicer remittance policies; legal documentation; and mortgage loan eligibility requirements. In a number of these functional areas, the FHFA's conclusions regarding the lack of a need for complete alignment is tempered by its expressed intent to "carefully assess" specific policies and procedures as they evolve in the future.

SFIG believes that greater up-front harmonization of the GSEs' policies and procedures is not only necessary, but fundamental to the success of the Single Security initiative, and must be addressed prior to its launch. In fact, one of the main reasons for the pricing differential in the present system is because the GSEs issue securities under two distinct origination and selling and servicing guides.

If the goal of the Single Security initiative is fungibility of GSE securities (while still allowing each GSE to "compete" against the other along other dimensions, such as customer service), then it would seem to follow that beyond alignment of disclosures and payment timing, all policies and procedures that affect security performance should be identical. If not, the Single Security initiative is likely to produce "harmonized" or "synchronized" securities rather than a "single" security, and would likely fail to meet the FHFA's stated goals.

Timing of Implementation. With respect to a strategy for implementing the Single Security, the FHFA states in the Update that "[b]reaking the Single Security initiative into a sequence of steps with lengthy pauses between them would delay the initiation of issuance and trading probably for several years, without providing any clear benefits."

The FHFA's preferred approach to implementation is at odds with not only SFIG's recommendation for a sequential approach, but it is also at odds with best practices for major technology rollouts.

In both the Prior SFIG Letter as well as in SFIG's September 2013 Senate Banking Committee testimony,[3] SFIG stressed its view that the FHFA would be well served by adopting a sequential approach to Single Security implementation, in which required changes are implemented only in small increments announced in advance. The market reaction to those changes would then be assessed both individually and cumulatively before taking the next step.

In the Prior SFIG Letter, SFIG observed that the current TBA and broader GSE securities market is one of the most liquid and efficient capital markets in the world. SFIG also believes that the Single Security and CSP initiative will be beneficial to the industry and overall liquidity. However, both projects also present risk to the TBA market if implemented incorrectly. The better the level of industry understanding and time for preparation prior to rollout, the more industry members can anticipate and act to mitigate risks.

If it is indeed the case that the principal benefit of implementing the Single Security initiative is the elimination of inefficiencies resulting from maintaining Freddie Mac PCs as separate securities, then, narrowly, that (rather than broader notions of improving overall market liquidity) should be the benefit against which the costs of implementing the initiative are properly weighed.

We believe that further statistical analysis of the Freddie Mac pricing issue is warranted. As we have stated above, SFIG is supportive of the Single Security initiative, but we consider it essential that a consensus be reached regarding the potential costs as well as the potential benefits of various implementation strategies. The FHFA, the GSEs and all stakeholders must have a clear consensus of what exactly we are all trying to accomplish.

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[3] Available at http://www.sfindustry.org/images/uploads/pdfs/SFIG_Testimony_Housing_Finance_Reform.pdf.

SFIG continues to believe that, given the efficiency of the market right now, there is almost certainly more to lose than there is to gain if the implementation process of this initiative proceeds poorly. Consequently, we re-iterate our view that a staged, incremental implementation process would be best; the potential costs and benefits are by no means symmetric.

However, if the FHFA persists in rolling out the technology simultaneously, SFIG would recommend that the prior system remains operational, so the housing market can function if the new system faces any issues. We would also recommend that the FHFA issue a detailed project plan that includes a timeline, benchmark goals and a general target date for roll-out and implementation of the Single Security and CSP. The Advisory Group would likely be required to meet more frequently as benchmark dates and goals arise, however; industry input at critical times in the process will help bolster the success of the project. This may cause some benchmark dates to change, however; multi-year projects typically have revisions as industry participants work to resolve issues to move a project forward. Additionally, should FHFA pursue a rollout all at once, SFIG requests access to end-stage testing in order to bolster member confidence leading up the rollout.

Markets thrive on certainty, and one as important to the U.S. housing finance system as the TBA market would benefit from as much disclosure on this project as possible.

Nature of Guarantee. The Update anticipates a re-securitization format by which one GSE can in effect guarantee a first-level Single Security issued by the other GSE. We note that several commenters suggested as an alternative a cross-guaranty approach, which the FHFA rejected.

As SFIG has stated in its testimony before the Senate Committee on Banking, Housing, and Urban Development, as well as during the debates on Senator Johnson and Senator Crapo's housing finance reform bill, a federally guaranteed security should be a fundamental element of long-term housing finance reform.

Many of the subsidiary issues raised by SFIG regarding the implementation of the Single Security initiative would either be eliminated entirely, or substantially reduced, were a Government guarantee to attach to the Single Security. Among the subsidiary issues likely resolved in whole or in substantial part as a result of the adoption of a Government guarantee are:

- issues surrounding position limits;
- issues relating to how the guarantee fee ("g-fee") for the second-level (re-securitized) Single Security would be priced, and how g-fees between the first and second levels would be allocated;
- questions about what would happen were one or both of the GSEs to exit conservatorship in the absence of comprehensive GSE reform;
- legal risks relating to challenges to the Preferred Stock Purchase Agreements currently in place at each GSE – we note in this context that a number of market commenters are expressing an elevated sense of this risk as a result of the recent AIG ruling;

- issues and risks raised by the potential for a "double transition" scenario, in which the Single Security is implemented in a manner that proves to be inconsistent with subsequent legislative action regarding broader GSE reform;

- concerns related to a potential increase in stipulated trades naming one or the other GSE as the issuer, with a corresponding decrease in TBA market liquidity.

We acknowledge that providing an express Government guarantee to GSE securities post-conservatorship would require legislative action, and therefore would be difficult, if not impossible, to consider in the current plan to implement the Single Security. SFIG also recognizes that both the FHFA's efforts to implement the Single Security and Congressional action on housing finance reform are both intertwined and yet mutually exclusive at the same time. In this light, SFIG is committed to working with both Congress and the FHFA to ensure both short-term and long-term plans to implement the Single Security and housing finance reform are successful and beneficial to the liquidity of the TBA market and its participants.

CONCLUSION

The GSEs and the FHFA have successfully accomplished many of the goals set forth in the FHFA's Strategic Plan and Scorecard (*e.g.*, the risk transfer transactions and NPL sales).

However, perhaps unlike some of the other elements of the Strategic Plan and the Scorecard, the Single Security is by no means "low-hanging fruit" in terms of guaranteed benefits to the nation's system of housing finance. Indeed, a reading of all of the RFI responses that have been submitted by no means indicates a consensus as to how, or even as to whether, to proceed with this initiative. SFIG urges FHFA to utilize the Advisory Group and additional industry conversations in order to build consensus prior to rollout.

SFIG continues to believe that the initiative is worthwhile and is supportive of the Single Security, but also continues to believe that tampering with one of the world's most efficient markets should only be undertaken in a manner that will not alarm investors – in particular foreign investors – and that has an almost certain likelihood of success.

We greatly appreciate the opportunity to provide further feedback on the Single Security initiative, and we look forward to working with FHFA and the GSEs in the Advisory Group. Please contact the undersigned at Richard.Johns@sfindustry.org or 202.524.6301 with any questions or comments.

Sincerely,

Richard Johns
Executive Director