



Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
Constitution Center (OGC Eighth Floor),
400 7th St. SW, Washington, DC 20219

November 16, 2018

Atte: Comments/RIN 2590-AA94

Dear Mr. Pollard,

The Structured Finance Industry Group¹ (“SFIG”) appreciates the opportunity to respond to the Federal Housing Finance Agency’s (“FHFA”) proposed rule on the Uniform Mortgage Backed Security (“UMBS”). SFIG’s comments are based on the views of the members of SFIG’s Government Sponsored Enterprise (“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.

As stated previously in comment letters and Congressional testimony, SFIG maintains that in any large scale undertaking—such as the implementation and adoption of the UMBS—it is critical that policymakers, regulators, and industry stakeholders work together to maintain stability and avoid market disruptions². Thus, while SFIG supports policies that would lead to a return to the historical funding mix of mortgage credit—including non-agency private label mortgage-backed securities (“PLS”), GSE, and bank balance sheet lending-- it is imperative that any transition be carefully and thoughtfully undertaken in order to maintain the existing liquidity and efficiency of the To Be Announced (“TBA”) and broader GSE securities market.

With that goal in mind, SFIG now takes the opportunity to comment on the proposed rule, including input on the policy and regulatory updates that have taken place over time since the last formal comment period for the Common Securitization Platform (“CSP”) and UMBS. We start by reiterating that there are a number of areas where we agree with the FHFA’s goals and the policies and procedures in place to meet those goals. These areas of agreement include the FHFA’s overarching objectives of increasing liquidity of the TBA market and the overall liquidity of the nation’s housing finance markets, as well as policies in

¹ SFIG is a member-based, trade industry advocacy group focused on improving and strengthening the broader structured finance and securitization market, with over 260 members including at present 47 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 See: <https://financialservices.house.gov/uploadedfiles/hhrg-115-ba04-wstate-dgoodwin-20171102.pdf>

place related to multiple lender pools, aligning of payment dates, and adopting a single set of disclosure requirements³. Additionally, we appreciate and applaud the important work that the FHFA and the GSEs have done in the Single Security Industry Advisory Group, as well as through industry outreach initiatives. These important efforts to engage with industry stakeholders and market participants have been—and will continue to be—crucial to the success of the UMBS.

With that said, we would also like to note some areas of concern that merit careful and deliberate consideration from the FHFA. While these concerns may appear by themselves to be relatively minor, if left unaddressed, they may cumulatively undermine the overall success of the UMBS initiative.

Definitions of Misalignment, Material Misalignment, and Remedial Actions

SFIG appreciates recent publications—such as the Single Security Initiative Market Adoption Playbook and the Prepayment Monitoring Report—in which the FHFA has provided recent status updates. These are good first steps, but we would request additional clarification around the remediation actions available to the FHFA under Proposed Section 1248.7. For instance, according to the proposed rule, the FHFA will “investigate differences” in instances of apparent misalignment (i.e., differentials in one-month CPR is greater than two percentage points). However, in the instances of material misalignment (i.e., one-month CPR is greater than three percentage points) the FHFA would require the Enterprises to report the likely cause of the divergence to the FHFA.

While the FHFA could presumably investigate CPR differentials of greater than three percentage points, it is not clear that they would do so, or if the required GSE reports addressed to the FHFA in such instances would stand in lieu of an FHFA investigation. Moreover, it is not clear what such an investigation would look like, or how it would fit into the FHFA’s scheduled ongoing supervision at both GSEs. Moreover, while SFIG understands the rationale behind not publicly reporting the findings of these investigations on apparent misalignment or GSE-issued reports on material misalignment, we strongly urge the FHFA to engage in outreach with the industry—especially the investment community—to explain what remediation steps will be taken, and how such steps will actually resolve any misalignment or material misalignment. Such steps will be necessary to instill confidence when the liquidity and stability of the TBA market may be at risk.

Additionally, the proposed rule notes that the triggers for what constitutes misalignment and material misalignment (currently, greater than two percent one-month CPR differential for an FHFA investigation and greater than three percent one-month CPR differential for a GSE report) could change. While some guidance as to how that change would be calculated is given under Section 1248.5(c), a proposed rule change that takes what had been a temporary change in the CPR triggers and makes it permanent after six months could also be used to clarify how the factors listed in (?) Section 1248.5(c)(1)(i-iii) actually impacted such an adjustment, or perhaps even modify those factors, as necessary.

Overseeing Alignment of Covered Programs, Policies, and Practices

As noted in the proposed rule and in other publications, the GSEs have undertaken a number of initiatives that have aligned their programs, policies, and practices. For purposes of the rule, those programs, policies, and practices that affect the CPR of each GSE’s securities are defined as “covered programs, policies and procedures” under Section 1248.6. While the preamble of the proposed rule states that these alignment initiatives have resulted in narrowing the CPR differential between Fannie Mae and Freddie Mac securities, SFIG notes that such alignment has taken place while both GSEs operated under

³For a more complete review of the areas where SFIG agrees with the Single Security, please see: http://www.sfindustry.org/images/uploads/pdfs/SFIG_Comment_Letter_FHFA_Update_on_Single_Security_fixed.pdf

conservatorship. The conservatorship has allowed the FHFA an extraordinary level of control into GSE operations that did not exist and/or was not exercised previously.

Promulgating this regulation would presumably grant the FHFA a necessary level of control over covered programs, policies, and procedures in a future scenario where the GSEs exit conservatorship. If, however, such control is insufficient to align the GSEs covered programs, then the FHFA will lack the ability to alleviate or solve TBA market illiquidity resulting from misaligned policies and procedures. On the other hand, too much control by the FHFA over covered programs risks a de facto continuation of the FHFA's authority as conservator. Striking the appropriate balance will be both necessary and challenging. Moreover, to the extent additional guarantors in addition to Fannie Mae and Freddie Mac are ever contemplated in a future housing finance system, the FHFA would need to ensure that their authority would extend to the covered programs, policies, and procedures of such future guarantors.

Market Adoption and Avoiding a Race to the Bottom

The FHFA must recognize that alignment is merely a means to an end, and the regulatory authority put in place by this proposed rule to achieve alignment should not override other concerns, such as maintaining credit standards at both GSEs. Currently, market pricing differentials owing to differences between Fannie Mae and Freddie Mac securities creates market-based incentives that help to ensure that the quality of securities at each GSE does not deteriorate. Under a single security, however, it is not clear to us why these incentives would not dissolve, and could create a "race-to-the-bottom" where the regulatory pressure towards alignment incentivizes the GSE with the higher-performing security to implement covered programs, policies, and procedures that align with the covered programs of the GSE with the lower-performing security. In such a scenario, any benefits owing to alignment would be outweighed by the cumulative costs of the race-to-the-bottom.

Moreover, while the Internal Revenue Service (the "IRS") has issued Revenue Ruling 2018-24⁴, which provides some guidance on the tax consequences of converting from a 45-day participation certificate ("PC") to a 55-day UMBS, a complete understanding of tax consequences of the make-whole payment for converting to the UMBS—as well as any potential inducement fees paid to investors in order to incentivize conversion—is not yet clear. In their continual monitoring of the TBA market, the FHFA should continue to work with industry stakeholders and market participants to determine whether an inducement fee would be a cost-effective means of increasing adoption (and thus improving liquidity) of the UMBS. Additionally, work must continue with the IRS to determine the tax consequences of both the float compensation as well as any potential future inducement fee.

Final Concerns and Conclusion

Two final concerns merit consideration. First, while the GSEs and the FHFA have made strides in achieving milestones while working towards a 2Q 2019 implementation date of the UMBS, the effects of previous cost overruns and missed deadlines linger, and will likely remain throughout the implementation and adoption phase. We commend the FHFA and the GSEs for their recent outreach and engagement efforts on this front, noting that such efforts have helped to alleviate these concerns, and we recommend that they continue such efforts going forward. Finally, the shifting political landscape—especially with a scheduled change in leadership at the FHFA in the coming months—creates some level of uncertainty. While we would hope and expect a new FHFA Director to demonstrate continuity and commitment, it is possible that personnel changes result in a shift in policy priorities and resources devoted to the success of the UMBS.

⁴ <https://www.irs.gov/pub/irs-drop/rr-18-24.pdf>

Notwithstanding these concerns, SFIG remains optimistic that the UMBS initiative will yield the desired results and stated objectives of the project. We once again thank the GSEs and the FHFA for their work on this project, for their efforts to consult with the industry and update the market in advance, and we appreciate the opportunity to engage in that process by commenting on this proposed rule.

Respectfully Submitted,

A handwritten signature in black ink, appearing to read 'D. Goodwin', written over a horizontal line.

Daniel Goodwin
Head of RMBS and CMBS Policy
Structured Finance Industry Group, on behalf of the Task Force