National Association of Home Builders

Housing Finance and Regulatory Affairs
David L. Ledford
Executive Vice President
dledford@nahb.org

November 16, 2018

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
8th Floor
400 7th Street, SW
Washington, DC 20219

RE: Uniform Mortgage-Backed Security (RIN 2590-AA94)

Submitted by Electronic Delivery to http://www.regulations.gov and RegComments@fhfa.gov

Dear Mr. Pollard:

On behalf of National Association of Home Builders (NAHB), I appreciate the opportunity to provide comments in response to the Federal Housing Finance Agency's (FHFA) Proposed Rule to require Fannie Mae and Freddie Mac (the Enterprises) to align programs, policies and practices to support the successful adoption of the Uniform Mortgage-Backed Security (UMBS). This is an important step toward ensuring that the UMBS ultimately will enhance the liquidity, efficiency and competition in the To-Be-Announced (TBA)-eligible mortgage-backed securities (MBS) market.

NAHB represents over 140,000 members who are involved in building single family and multifamily housing, remodeling, and other aspects of residential and light commercial construction. NAHB's members construct approximately 80 percent of all new housing in America each year. Our members rely on an efficient housing finance system to help provide decent, safe, and affordable single family and multifamily housing across the country.

Background

The FHFA first announced its goal of a single agency security in its 2012 *A Strategic Plan for Enterprise Conservatorships: The Next Chapter in a Story that Needs an Ending*. In the section that proposes a common securitization platform (CSP) to take the place of each Enterprise's individual, proprietary securitization platform, FHFA wrote, "In the intermediate term, a single platform would allow for a single mortgage-backed security. Accomplishing this objective will take time." FHFA noted that enhancing liquidity for MBS was to be a central objective of the CSP and a single MBS.

The single security was proposed as a strategy to eliminate pricing disparities between Fannie Mae MBS and Freddie Mac Participation Certificates (PCs) and increase the overall liquidity in the TBA MBS market. Freddie Mac securities traditionally have traded at a price disadvantage to Fannie Mae securities primarily due to faster prepayment speeds, which made PCs less attractive to investors. The subsequent reduced trading volume and frequency resulted in less liquidity for Freddie Mac securities and contributed to the pricing difference. FHFA determined that if Fannie Mae MBS were fungible with Freddie Mac PCs, the combined volume of a single, common security would achieve the dual goals of enhanced market liquidity and pricing parity between the Enterprises' MBS. This conclusion led to the agency's mandate in May 2014, spelled out *in The 2014 Strategic*

Plan for the Conservatorships of Fannie Mae and Freddie Mac, that the Enterprises would develop a single, common security.

The TBA market was established in the 1970s and its success is due to the fundamental assumption that certain MBS will meet homogenous parameters that make them interchangeable or fungible. Maintaining the integrity of the TBA market is critical to the success of the UMBS. To make Fannie Mae and Freddie Mac securities fungible with each other, the Enterprises will have to align programs, policies and processes to eliminate differences that could impact prepayment speeds or other parameters that could affect the cash flow to investors. Alignment, and the Enterprises' commitment to a transparent process to maintain this alignment, will be important to investors seeking confidence in the fungibility of the two MBS.

Throughout the lengthy process of developing the CSP, and implementing a single, common security, now the UMBS, FHFA and the Enterprises continually sought feedback from the industry stakeholders to ensure the transition to these new industry systems would not be disruptive to the TBA MBS market.

Proposed Rule

In general, the proposed rule codifies the requirements for the UMBS that FHFA has put in place throughout the process of proposing, requesting input, and implementing the UMBS since 2012. However, FHFA is asking questions and looking for comments related to how it plans to ensure the alignment of Fannie Mae and Freddie Mac programs, policies and practices to prevent a material, negative effect on cash flows to TBA-eligible MBS investors. A misaligned program, policy or practice is defined by FHFA as one that causes a divergence of at least three percentage points in the one-month conditional prepayment rate (CPR) or the CPR as temporarily adjusted by FHFA to account for market conditions. Also, the proposed rule provides for the Enterprises to establish a regime for maintaining alignment through consultation, reporting and FHFA oversight.

The most significant issue that will impact the success of the UMBS will be its acceptance by investors whose primary concern will be that the Fannie Mae and Freddie Mac UMBS are fungible and will maintain the integrity of the TBA market. Fungibility is critically dependent on cash flows being sufficiently similar so as not to incent UMBS investors to make trades in which the investor stipulates it only will accept delivery of a UMBS backed by loans guaranteed by one or the other Enterprise. This stipulation, on any scale, would essentially defeat the purpose of the UMBS. Similar cash flows are dependent on aligned prepayment speeds and aligned policies concerning the removal of delinquent mortgage from MBS in exchange for payment of the remaining principal amount to the investor, i.e. repurchases or buy-outs.

The chief benefit of the current TBA market has been homogenization of the securities being traded - that one Fannie Mae, Freddie Mac or Ginnie Mae pool is interchangeable for another guaranteed by the same entity. An investor understands what is being purchased when buying an MBS issued by one of these agencies. If that same assurance cannot be maintained in the upcoming UMBS market, the TBA concept is no longer effective and the UMBS will not trade as hoped.

Though there are issues to be resolved by other industry participants that will impact how the UMBS will be accepted and supported by the market, FHFA's role is to focus on being as transparent as possible about how the aspects of the process it controls will be handled so the other players can respond accordingly.

<u>NAHB Comments</u>

The comments expressed in this letter primarily are intended to convey NAHB's approval for the lengthy and thorough process undertaken by FHFA and the Enterprises to get to this point, including the partnerships with the industry, and in particular, with SIFMA. We believe working closely with SIFMA to address the association's priority issues will prove critical to mitigating disruption of the market as the final implementation of the UMBS takes place.

NAHB believes the UMBS has significant potential to be positive for the MBS market and homebuyers. Moving the combined volume of Fannie Mae and Freddie Mac MBS into the UMBS should increase liquidity, especially in coupons that are thinly traded, and benefit pricing to homebuyers. Also, a liquid and efficient UMBS market should eliminate pricing differences between Fannie Mae and Freddie Mac mortgage purchases, forcing them to compete for mortgage loans based on service which could lead to greater efficiency at each Enterprise and also benefit homebuyers.

NAHB agrees with the widely-accepted sentiment that it will be key to the success of the UMBS for the market to trust there is a transparent process in place to ensure new products or changes to existing products will be aligned within the Enterprises. There should be a process in place to notify market participants if a program is expected to impact prepayment speeds. Market participants must have confidence that if issues arise that appear to cause prepayment speed differences they will be addressed quickly.

NAHB recommends that FHFA establish new product implementation guidelines that emphasize transparency and include an opportunity for feedback by market participants when a product or program has the potential to impact prepayment speeds. Preferably, FHFA and the Enterprises would discuss potential new programs and products with market participants prior to final development to help them consider potential consequences to the TBA market.

In light of the importance of prepayment speeds, NAHB also recommends that FHFA implement a formal process to review ongoing prepayment behavior of the UMBS collateralized by Fannie Mae and Freddie Mac loans to preempt possible disruptions to the market due to noticeable aberration in prepayment performance. This might take the form of a committee that meets quarterly or semi-annually. NAHB further recommends that such a committee include executives from FHFA, Fannie Mae, Freddie Mac and select industry participants.

Finally, the ultimate success of the UMBS will be dependent on its full acceptance by investors. Therefore, NAHB believes FHFA and the Enterprises should enhance steps to increase investor awareness and understanding of the upcoming transition to a single security. Any reluctance of domestic and international investors to accept the changes may cause a disruption in the TBA market and reduce liquidity. Even a short disruption will have long term effects on the liquidity of the market and confidence of market participants. FHFA and the Enterprises should continually survey investors to gauge their understanding and comfort level with the transition.

<u>Conclusion</u>

The importance of alignment and standardization of the Enterprises' programs, policies and practices to the success of the UMBS cannot be underestimated. NAHB believes FHFA is cognizant of this and is taking appropriate steps, including issuing this proposed rule, to proactively address potential problems.

Thank you for your consideration of NAHB's comments. For more information, please contact Rebecca Froass, Director of Financial Institutions and Capital Markets at rfroass@nahb.org.

Sincerely,

David L. Ledford

David L. Ledford
Executive Vice President
Housing Finance and Regulatory Affairs