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June 12, 2012

Submitted via email to: !planninggroup@fhfa.gov

Toni Harris
Manager, Strategic Planning and Performance Management
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20024

RE: Comments on Draft Strategic Plan

Dear Ms. Harris,

SIFMA is pleased to respond to the Federal Housing Finance Agency's ("FHFA") request for comments on its draft *Strategic Plan: Fiscal Years 2013-2017*. At the broadest level, SIFMA supports the goal of the strategic plan to modernize the infrastructure of Fannie Mae and Freddie Mac ("Enterprises") and prepare them for the future, which is yet to be determined. We also agree strongly that consideration must turn to the future, to definition of the goals of U.S. housing policy, and how the Enterprises and securitization more broadly do or do not fit in to that picture. SIFMA strongly believes that active securitization markets must play a role in this future. We believe that the restoration of these markets will occur along a spectrum of credit risk, starting with the least risky markets and methodically moving outward along the credit curve. Therefore, it is appropriate and indeed necessary that the primary, near term focus must be on the markets served by the Enterprises, to ensure that they can efficiently and prudently serve their customers and consumers.

SIFMA recommends that the Enterprises give priority to the alignment of their operations. Doing so will set the stage for the longer-term future of the Enterprises and mortgage finance in this county more broadly, including non-agency securitization.

There is a crucial gap in the actual and perceived performance and therefore liquidity of the mortgage-backed securities (MBS) issued by the GSEs. This liquidity differential impacts the overall cost and efficiency of the GSE securitization process, and their ability to fund mortgage lending optimally. We believe the Enterprises have the ability to rectify many of the causes of this gap. We note that opportunities are available now to begin to address the performance differential between the Enterprises, through focus on improving the existing "cheapest-to-deliver" securities in each market.

Addressing these (and other) issues will at times require FHFA to view the Enterprises together, as opposed to separate operational silos. We believe this is appropriate, prudent, and necessary to serve the interests of the taxpayers who have provided support for, and now own the majority of both of the Enterprises.

Involvement of industry in every stage of the planning and development process will be critical to success. The industry cannot be presented a plan to which it did not help create, and no plan will be successful if it is not accepted by the market. SIFMA will provide further feedback on these issues, and stands ready to assist the Enterprises and the FHFA from the outset.

In the attached Appendix, we have provided further, more detailed considerations on these issues. Please do not hesitate to contact us for more information or with any questions, and we look forward to discussing them in greater depth with FHFA.

Sincerely,

Richard A. Dorfman
Managing Director
Head of Securitization

Chris Killian
Managing Director

CC: Wanda DeLeo, Ph. D.
Deputy Director, Office of Strategic Initiatives

Appendix - Considerations for Preparing for the Next Stage of Housing Finance

The Near-Term Goal of should be to Align the Operations of Fannie Mae and Freddie Mac

- FHFA should follow a phased approach for the strategic plan where the initial stage prioritizes the alignment of the operations of the GSEs. Aligning the operations of the GSEs will set the stage for the second phase of the strategic plan and the longer-term future of the GSEs and mortgage finance more broadly.
- Market performance indicates a crucial gap in the actual and perceived performance and liquidity of the MBS issued by the GSEs. This liquidity differential impacts the overall cost and efficiency of the GSE securitization process, and their ability to fund mortgage lending optimally. In a worst case scenario, the liquidity gap would continue to widen, leading to excessive inefficiency and cost. Alignment will lay the groundwork for efforts to mitigate this performance gap. We believe the Enterprises have the ability to rectify many of the causes of this gap.
- Addressing this will at times require FHFA to view the GSEs together, as opposed to separate operational silos. This is necessary and appropriate to serve the interests of the taxpayers who own the majority of each Enterprise.
- Involvement of industry in every stage of the planning and development process will be critical to success. The industry cannot be presented a plan to which it did not help create and no plan will be successful if it is not accepted by the market.
- Notwithstanding the above, opportunities are available now to begin to address the performance differential between the Enterprises. Focus should be on improving the existing “cheapest-to-deliver” securities in each market. This can be done independently of the strategic plan, and should begin immediately, as returns will accrue immediately.

Areas of Focus for Alignment of the Operations of the GSEs

Below we briefly set forth a number of areas where the Enterprises should focus their initial efforts. The steps should include the following to ensure that the performance of collateral generated by either GSE is considered equivalent. It is important to keep in mind the nature of the TBA market as a cheapest-to-deliver market. In other words, investors in TBA MBS transactions must expect, and price their trading based on, the worst collateral that they could receive. This implies that alignment of the perception of each Enterprise’s MBS product involves alignment of the cheapest-to-deliver issued by each, or setting a common baseline for security performance across the Enterprises.

We also note that steps can be taken now to improve the cheapest-to-deliver of a given Enterprise's existing MBS; this need not await further development of the strategic plan. There are a variety of ways this can be done involving aggregations of securities in order to create larger pools with more homogeneous characteristics or otherwise. SIFMA can provide more specific recommendations here, but we note that any efforts will require the freedom for the Enterprises to work collaboratively and creatively with the investors and liquidity providers of their MBS products. We believe efforts by the Enterprises to improve their cheapest to deliver should be fully and strongly supported.

A key benefit of this recommended alignment will be to reduce competition for market share that leads to lowering of standards and lower performance of securities issued by the enterprises. Such competition for market share is perceived, especially by the Enterprises' MBS investors, to create incentives to relax requirements and invite differences in collateral performance, reducing homogeneity and therefore liquidity. As a more level playing field is created between the Enterprises, competition would be more truly focused on customer service and responsiveness.

The end result of these activities will be to render the Enterprises and their associated MBS more homogeneous. This should benefit both Enterprises in the near term. It will also set the stage for the future of this market and will put the Enterprises in a position where they will be able to best serve their customers, investors, and consumers.

SIFMA suggests initial focus on the alignment of the following areas:

- **Align and Modernize the Infrastructure --** Current Enterprise systems are aged, and can be difficult for market participants to use. Systems must be upgraded and modernized. Market confidence in operational integrity through reliable and accessible systems is no less important to market participants than security structures and the Enterprises' financial stability. The Enterprises should complete modernization with similar, preferably identical, interfaces to the lender and investor communities.

- **Align the Operations of the GSEs from Underwriting to Servicing –** The Enterprises should align their operations from delivery through pooling and disclosure. This includes underwriting systems (i.e. DU/LP), disclosure, pooling practices, servicing practices, pricing practices, third-party origination policies, loan level and security data disclosures, guarantee fee structures, etc. Certain initiatives are already underway and are to be commended, such as the servicing alignment initiative and improvements to loan level disclosure. We believe they should be continued and further enhanced – for example, greater uniform historical loan level disclosure for both Enterprises.

- **Align the Implementation of New Initiatives and New Programs**. The Enterprises should follow common deadlines, work plans, and final implementation for new programs and initiatives. The market has previously borne the uncertainty of differing implementations of various new programs and initiatives, with negative consequences for MBS investors and therefore the consumers served by the Enterprises. The two most recent examples are the implementations of HARP and the large-scale buyouts of delinquent loans in 2010. Going forward, the Enterprises should implement new programs and initiatives in an identical fashion, so as to render their MBS more homogeneous.

- **Align the Payment Dates --** The current Fannie Mae and Freddie Mac securities have one major difference – when security holders are paid. Freddie's PC's pay on the 15th of the month following the collection of payments from borrowers, while Fannie Mae's MBS pay on the 25th. This timing difference has implications for the valuation of the securities. To improve homogeneity, these structures should be aligned.

- **Address the Credit Quality of the Enterprises** -- The agreements with the Department of the Treasury will reset to limited amounts at the end of 2012. This, at some point, could lead to MBS investors to view the creditworthiness of each GSE differently. This would reduce homogeneity and overall liquidity. This could be resolved with cross collateralization or other means of sharing the guarantees and PSPA support. While we do not have a concrete recommendation at this time we believe it is an area that merits careful consideration and exploration by FHFA, starting now.

- **Address the Existing Float of TBA Eligible Securities in the Transition to any New State --** Utmost care must be taken that changes to the operations of the GSEs and/or the structure of their securities do not interrupt their ability to provide funding.

  To the extent that the structure of the securities of the GSEs changes, consideration must be given to how to bridge the deliverability of the existing securities into the TBA market for the new securities. For example a change in payment delay will have either positive or negative implications on the value of a security depending on the direction of the change. For a TBA market in a given issuer's securities to function, the payment delay for all securities traded in that market should be the same as recommended above. What follows is that changes to the delay would require that an exchange program for existing securities be implemented so that existing securities would be fungible with the new securities. We discuss here a specific instance of change to one security feature, payment delay, but to the extent that other significant changes are made the principle is more broadly applicable. FHFA should begin to consider how securities exchange programs could be optimally structured.

  As discussed above, given the cheapest-to-deliver nature of the TBA market, the key to bridging the old with the new will be to focus on aligning the cheapest-to-deliver. Previously we discussed aligning the cheapest-to-deliver across the two Enterprises; here we consider aligning the cheapest to deliver from a single Enterprise's "old" MBS product to their "new and improved" MBS product, to the extent that there are material changes to the MBS. Speaking very broadly, if the cheapest to deliver is considered equivalent, it should be possible to bridge the markets successfully. Given that focus is on improving the operations of the GSEs, the new cheapest-to-deliver would be expected to be better than the old cheapest-to-deliver option.

This implies that the focus should be on improving the cheapest-to-deliver of the existing stock of securities.

Requirements for Success

Both the steps outlined above and the broader goals of the Strategic Plan will require careful planning, the engagement of the industry, frequent communication, and a focus on the Enterprises' core activities.

- **Planning, Execution, and Support** -- Successful execution of the strategic plan will require (1) a realistic scope, (2) a detailed public project plan, (3) vigorous execution, and (4) high-level support of the industry, the Enterprises, and the regulator.

- **Industry Must Be Involved in the Creation of the Future** -- Involvement of industry in every stage of the planning and development process will be critical to the success of the strategic plan. The industry cannot be presented a plan which it did not help create. Any significant changes will need to be analyzed and explored from a multitude of perspectives by those who buy, sell, and provide liquidity for the Enterprises. It is they who are the final arbiters of the success or failure of any securitization program. Recall that this was the type of process which created the TBA market over 30 years ago, and is the only manner in which the market will fully and efficiently adapt to change.

- **Communication** -- Fannie and Freddie must be free to communicate with the industry, and with one another. The strategic plan will not succeed if the Enterprises are locked away, unable to communicate with the market in which they operate. There will be a need for frequent, unfiltered and consistent dialog with industry participants.

- **Enterprises as the Initial Priority** -- The Enterprises themselves create significant challenge and potential risk, so they should be the priority. The fact is that the GSEs are likely to exist, and therefore should add value, for a fairly long period of time. To do so they must be able to function efficiently and economically. Today the market is concerned that this is not happening – the infrastructure is aging and liquidity differentials are being exacerbated.

  The restoration of a non-guaranteed, private label securitization market will necessarily be preceded by the successful execution of a plan involving the MBS of the GSEs as they move through conservatorship. Accordingly the Fannie Mae and Freddie-Mac specific concerns should dominate. SIFMA fully supports the notion that a single platform should be interoperable with participants outside of the Enterprises, but believes that FHFA should immediately focus on areas where it has expertise and control – the Enterprises.

Considerations for the Future

The alignment of the operations of the GSEs will set the stage for the future of both the Enterprises and for mortgage finance more broadly. SIFMA is focused on the preservation and maximization of the liquidity of the TBA markets, and the maximization of the benefit to consumers of forward sales of MBS. These include liquidity, ability to lock rates, national mortgage markets, broad availability of fixed-rate products, and the attraction of massive amounts of capital to the U.S. mortgage markets.

SIFMA is considering with its members a number of potential longer-term paths for the TBA markets for the Enterprises' MBS. There are numerous legal questions related to the authorities of the GSEs under their charters and the authority of the FHFA under its charter, which we are beginning to consider with appropriate counsel. There are also a host of market-related questions and concerns that need to be thought through and vetted in more detail. Together, explorations of these issues will create a better sense for the possibilities for the future, and the sense of market participants as to what is the best path forward.

At this stage our members believe it is premature to recommend a specific path. Rather, we believe the Enterprises should prioritize the initiative outlined above – alignment – that is a necessary first step for the future of the Enterprises and/or their resolution. We expect to provide further recommendations in coming months, as we further explore these and other issues with our membership.[1]

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<u>About SIFMA</u>

SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.SIFMA.org.

[1] We note that the future of the Enterprises' debt funding securities is not contemplated in the strategic plan. We believe it will be necessary to subject the debt funding products and procedures to the same rigorous review and planning process in the course of a holistic strategic review of the Enterprises business models and activities.