June 22, 2022

Sandra L. Thompson
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, D.C. 20219

Dear Director Thompson,

SIFMA[1] writes this letter on behalf of its buy- and sell-side members to express our strong and unified objection to Fannie Mae and Freddie Mac's ("Enterprises") recent announcements that, beginning July 1, a 50-basis point charge would be imposed by an Enterprise on all Supers and CMOs that include collateral guaranteed by the non-issuing Enterprise.[2] Our members were very surprised to see these announcements that the Enterprises released with no forewarning. We believe that if this charge is allowed to go in to effect there will be severely negative near-term impacts across the various UMBS markets, which will ultimately be borne by the borrowers that rely on these markets to finance their mortgages. Most importantly, market participants have questioned the longer-term future of UMBS and the continuation of the successes that it has achieved since its implementation.

In less than two weeks, Super and CMO markets will be bifurcated with negative, yet unknown in scale consequences for UMBS TBA liquidity. We urgently request that FHFA direct the Enterprises to rescind this action as soon as possible so that the fee is not imposed.[3] The Enterprises and FHFA should then discuss with MBS market participants a less disruptive path forward. We suggest reverting the risk weight for cross-GSE exposures to zero, as it was before the enterprise capital framework was revised in December 2020 under your predecessor.[4] We stand ready to provide any needed assistance to FHFA.

UMBS History, Core Principles, and Benefits

As you know, the development and implementation of the UMBS and single TBA delivery was a carefully planned, years-long project that involved extensive dialog with originators, investors, housing

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[1] *SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development.*
SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).
[2] See, e.g., June 14, 2022 notice from Fannie Mae, available here: https://capitalmarkets.fanniemae.com/mortgage-backed-securities/new-fee-structure-certain-structured-transactions
[3] We have been informed by members that both Enterprises have already begun imposing this fee as of the time of this writing, ahead of the July 1 start date in the announcements.
[4] 85 FR 82150. This provision is §1240.32(c)(2) of the final rule. We note that in the preamble to the final rule, the FHFA did not substantively address any of the concerns expressed by numerous commenters that the cross-guarantee capital charge could harm UMBS. See, e.g., page 82184.

advocates, and market makers.[5] FHFA, the Treasury Department, the Enterprises, and market participants collectively spent thousands of hours discussing trading, operational, and a multitude of other issues before they arrived at the final form of UMBS and related market structures, with a central goal of ensuring the fungibility of the MBS guaranteed by the Enterprises so that liquidity to finance mortgages would be maximized. Additionally, market makers and investors spent significant time and resources educating their clients about the changes UMBS would bring, so that MBS market participants would view UMBS as a positive step and agree that TBA delivery should be shifted to a single contract. This was not an easy task, as UMBS represented a major change to the Enterprises' MBS markets which had functioned effectively for 30 years. Through much hard work the market grew more comfortable, TBA delivery guidelines were amended, and the UMBS was implemented. Now, market participants must be able to trust that what was promised to them will be maintained.

The fungibility of UMBS is the central idea that allows market participants to engage in UMBS markets; it has always been the key underpinning of the TBA markets. For a single TBA contract to work, investors must accept that the two issuers' MBS are effectively interchangeable. Within this concept of fungibility for UMBS there are two important elements we highlight. First, the MBS created by the GSEs have to perform in a similar manner. FHFA has implemented prepayment monitoring and related rules to achieve relative parity here. Second, and relevant to this new charge the GSEs plan to impose, UMBS need to be able to be commingled between the GSEs in as frictionless a manner as possible. This ability to commingle provides a number of benefits that were, and remain, critical to the acceptance of UMBS:

- It prevents pricing disparities between the Enterprises that were previously based on liquidity, among other things. The elimination of the pricing discrepancies that have historically existed between the GSEs was a primary rationale for UMBS. Under UMBS, natural market mechanisms keep pricing aligned between the Enterprises, and one Enterprise does not need to create financial incentives for originators to execute through them.
- It creates a greater pool of liquidity for market participants to access. For example, if an investor desires to create a CMO with a particular characteristics, it is far more efficient to source collateral from both Enterprises at the same time than be limited to what is available issued by one or the other. This aggregation activity has grown in importance since the launch of the single security, as the refinancing wave in 2020-2021 and higher conforming loan limits have expanded the number of categories of loan characteristics that create "story pools" desired by investors. These pools, of course, are granular and the market greatly benefits from being able to aggregate them across the Enterprises.
- It allows investors to have exposure to the issuer they want to or need to face due to investment guidelines or regulations; and
- It provides operational benefits to MBS holders through their ability to combine less liquid smaller pieces of MBS into larger securities that are more liquid and easier to manage.

Risks to the UMBS Markets, and the Mortgage Market, from this Fee

The imposition of a 50-basis point fee on Super transactions will effectively eliminate the ability of market participants to create commingled Supers, as it will be non-economic in nearly any conceivable scenario. This means UMBS are no longer completely fungible, and breaks a core underpinning of the

[5] For one example of this coordination, see this announcement regarding the formation of the Industry Advisory Group: https://www.fanniemae.com/newsroom/fannie-mae-news/fannie-mae-freddie-mac-and-common-securitization-solutions-create-single-security

market's acceptance of UMBS. Certain segments of the Enterprises' MBS markets will immediately, once again, become a two-issuer market. Accordingly, the benefits we describe above will be undone.

In particular, our members have expressed significant concern that pricing disparities between the Enterprises may begin to occur again, particularly in the specified pool market where issuer-based payups may reappear. TBA trades may be increasingly stipulated to ensure that a particular issuer's securities are delivered. CMOs will become harder to create and will become bifurcated between the Enterprises. Additionally, market participants will not be able to aggregate less liquid positions in to larger, more liquid, and easier to manage positions. Each of these effects would diminish liquidity, including in TBA markets.

While the total amount of commingled Supers (around $350BN) is not large relative to the total outstanding amount of Enterprise MBS, we believe this is not the correct point of comparison. First, simply having the ability to commingle securities is the key feature. It is an option that is being taken away with this fee, and harm from this cannot be quantified. Second, the correct comparison is not to the total outstanding Enterprise MBS, rather it is to the amount of MBS private market participants have absorbed since 2019. While some Supers weren't commingled and some included bonds issued prior to June 2019, the size of the mortgage market has grown by roughly $2 trillion since 2019, and almost $1.5 trillion of that was absorbed by the Fed. Viewed this way, the creation of commingled Supers is far more significant and reflects the importance of them to the UMBS project.

If this fee is imposed, CMOs will need to be created as Fannie Mae-only or Freddie Mac-only, making it more difficult to assemble collateral with specific characteristics desired by CMO investors. As you know, CMOs are a very important part of the UMBS market, and their benefits accrue in particular to smaller lenders and provide support for specific segments of the mortgage market. While acknowledging there are other potentially confounding factors, it is perhaps one of the clearest ways to see the influence of commingling on mortgage trading. For the first five months of 2019, Enterprise CMO issuance averaged $4.9 billion a month. In June 2019, when commingling began, the number jumped to $11 billion for that month, and averaged $9.5bln from June to December 2019. That 94% increase in monthly UMBS CMO issuance was not replicated in the Ginnie Mae market, which only saw issuance increase by 40% over the same period.

While TBA, specified pool, and CMO markets are distinct, they are intimately connected. Harm to one creates harm to the other markets. The end result is likely to be a corrosion of liquidity in all of these markets, which will harm all market participants and all of the borrowers whose mortgages they finance.

Breaking Fungibility Creates Questions about the Future of UMBS

More importantly, market participants now have cause to question the longer-term future of UMBS if this fee is allowed to go forward. As we mentioned above, the ability to commingle is central to the fungibility of UMBS, and without fungibility, UMBS does not work as effectively. Market participants may lose confidence that UMBS is the correct market structure and the longer-term risk is that the market devolves back into a two-issuer market where one issuer is the benchmark and the other trades at a discount to them, pricing disparities re-emerge between the GSEs, and efficiency and liquidity gains stemming from UMBS are erased.[6] Said differently, the risk is that the market reverts back to what UMBS was designed to fix. This would be a very costly reversion to all concerned.

There is absolutely no reason to put the mortgage finance system at risk for this to occur. Given all of these harms and the lack of any countervailing benefits, we believe the appropriate course of action is to protect the UMBS market and the mortgage finance system by not allowing these ill-advised charges to be implemented. As we discuss below, we believe the optimal path would be to suspend the cross-guarantee capital charges and through a rulemaking, revert the 20% capital charge for cross-enterprise exposures back to 0% as it was in the 2018 formulation of the framework.

The new charge for Super creation arose because the Enterprise Capital Framework ("ECF") finalized in 2020 imposes a 20% risk weight against exposures to the non-issuing Enterprise. SIFMA objected to this 20% risk weight when the revised framework was proposed in early 2020, noting that the capital charge "strikes at the core of what [is] critically important in UMBS", which is the ability to commingle UMBS.[7] Both Enterprises themselves also objected to the 20% risk weight in their comments on the proposal.[8] In those comments, Freddie Mac stated that "[a]ssigning a risk weight for commingled collateral would result in disparate pricing between the Enterprises…This impact on pricing would undermine the single security initiative's core premise of fungibility without achieving a measurable risk objective…The imposition of a charge would likely reverse the early incentives to treat Freddie Mac and Fannie Mae UMBS as fully fungible."[9] Numerous other commenters also objected to this capital charge for cross-Enterprise exposures because it could be harmful to UMBS, including SFA[10], the Mortgage Bankers Association,[11] the Housing Policy Council,[12] the National Association of Home Builders,[13] the

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[6] We also believe that a fee like this would foreclose on the ability of any new entrant to successfully compete with the Enterprises in the future.

[7] See SIFMA/NaREIT Comment Letter, at 10, available here: https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15598

[8] See Freddie Mac comment letter, at 29, available here: https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15606; See also Fannie Mae comment letter (August 28, 2020), at 28. *"If UMBS are not seen as fungible, the market may differentiate between Fannie Mae issuances and Freddie Mac issuances, undermining the purpose of the single security initiative. The increased costs and decreased liquidity would be borne by dealers and investors (including the Federal Reserve, which is one of the largest investors in this market) and ultimately by mortgage borrowers via higher mortgage rates."* Available here: https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15605

[9] Supra note 5, at 32.

[10] See comments from SFA, at 7. *"A 20% risk weighting would be a substantial headwind for the UMBS initiative, and another step backwards to the pre- Conservatorship regime"* Available here: https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15636

[11] See comments from MBA, at 12. *"[A]ny difference between the required capital for an Enterprise's own securities relative to those issued by another Enterprise could lead to different treatment and actions that weaken the aggregate UMBS market."* Available here: https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15630

[12] See comments from HPC, at 24. *"HPC is concerned this approach would lead to bifurcated treatment of UMBS, thereby eroding the very liquidity and fungibility FHFA sought to achieve in creating UMBS in the first place… The decreased liquidity to the UMBS market would be borne by all market participants, but most importantly would also ultimately lead to higher mortgage rates for individual borrowers."* Available here: https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15620

[13] See comments from NAHB, at 9. *"Any perception of differences between the UMBS issued by Fannie Mae versus Freddie Mac will undermine the UMBS market and harm a significant, well-received reform that took years to develop and implement at FHFA's direction."* Available here: https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15578

Independent Community Bankers of America,[14] Harvard's Joint Center for Housing Studies,[15] and the Urban Institute[16]. We agree with and endorse all of these concerns.

The ECF capital charge is based on the risk weights commercial banks face for Enterprise exposures. However, the Enterprises are not commercial banks. They do not carry the same risks, and they do not serve the same purpose. Furthermore, the Enterprises exist in the context of UMBS and their conservatorships. The need for fungibility of Enterprise UMBS limits the flexibility of the Enterprises' activities and FHFA's regulation of them. UMBS trading is the fuel that powers the mortgage finance system, and ensuring its maximal liquidity and resilience should be the top priority. Accordingly, Enterprise activities, products, services, and regulation must be viewed through the lens of their impacts on this essential market.

FHFA Must Not Allow UMBS and the Mortgage Finance System to be Harmed

FHFA should (1) direct the Enterprises to rescind their announcement of these fees, (2) exercise its authority to immediately suspend this provision of the ECF, and (3) take steps to re-examine this portion of the ECF and propose changes to it in consultation with market participants. We understand that amending a rule is a long process, but the alternative of not doing so threatens the liquidity and smooth functioning of the Enterprises' MBS markets.

If FHFA is not willing to suspend this provision of the capital framework, in any case this fee cannot be allowed to go into effect. SIFMA members stand ready to discuss alternative courses of action that could address the concerns expressed here. However, any alternative approach could be suboptimal and carry with it unintended consequences, and in any case will require very careful consideration.

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We appreciate your attention to our concerns. Please do not hesitate to contact me to further discuss any of these issues. I may be reached at 212-313-1126 or ckillian@sifma.org.

Sincerely,

Christopher B. Killian
Managing Director
Securitization and Credit

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[14] See comments from ICBA, at 4. *"ICBA urges FHFA to adopt a zero-capital charge as in the 2018 proposed rule on cross-GSE guarantees."* Available here: https://www.fhfa.gov//SupervisionRegulation/Rules/Pages/Comment-Detail.aspx?CommentId=15632

[15] See Don Layton, Harvard Joint Center for Housing Studies (May 22, 2020). "*This creates a significant friction when friction-free seems to be required for the single security to work as intended…it is not good and could, in fact, sink the entire project….Replicating the simple bank regulation approach…may be inappropriate in this situation".* Available here: https://www.jchs.harvard.edu/blog/the-new-proposed-capital-rule-for-freddie-mac-fannie-mae-ten-quick-reactions

[16] See Urban Institute, "FHFA's Capital Rule Is A Step Backward", at 5. *"The cross-guarantee charge also threatens to undermine one of the other critical reforms of recent years, the single security."* Available here: https://www.urban.org/sites/default/files/publication/102595/fhfa-capital-rule-is-a-step-backward_0.pdf