

MEMO# 29033

May 28, 2015

FHFA Updates Proposed "Single Security" Structure for Fannie Mae and Freddie Mac MBS, Seeks Additional Input

[29033]

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 35-15
FIXED-INCOME ADVISORY COMMITTEE No. 14-15
INVESTMENT ADVISERS COMMITTEE No. 2-15
MONEY MARKET FUNDS ADVISORY COMMITTEE No. 13-15
SMALL FUNDS COMMITTEE No. 8-15 RE: FHFA UPDATES PROPOSED "SINGLE SECURITY"
STRUCTURE FOR FANNIE MAE AND FREDDIE MAC MBS, SEEKS ADDITIONAL INPUT

On May 15, the Federal Housing Finance Agency ("FHFA") released An Update on the Structure of the Single Security (the "Update"). [\[1\]](#) This follows FHFA's August 2014 Request for Input ("RFI") on its proposed structure for a "single security" that would be issued and guaranteed by Fannie Mae or Freddie Mac (the "Single Security"). [\[2\]](#) The objective is to create a single, liquid market in Fannie Mae and Freddie Mac mortgage-backed securities ("MBS"), in part by seeking to ensure fungibility of legacy Fannie Mae and Freddie Mac MBS with the new Single Security. [\[3\]](#) The Single Security is part of FHFA's larger plan to build a Common Securitization Platform for use by Fannie Mae and Freddie Mac (the "Enterprises").

The Update invites further feedback from interested parties but does not provide a deadline. However, it notes that FHFA has directed the Enterprises to finalize the Single Security structure this year. ICI is considering whether to submit a comment letter and will host a member call on June 9 at 3 p.m. ET to solicit member input. If you are interested in participating in the call, please RSVP to Kimberly Hair at kim.hair@ici.org.

Summary of Update

The key features of the Update's Single Security proposal are not substantially different from those set forth in the RFI. Those features are briefly summarized below.

- **Security Issuer and Guarantee Structure.** Each Enterprise would issue and guarantee first-level Single Securities backed by mortgage loans that the Enterprise has

acquired; the Enterprises would not cross-guarantee each other's first-level securities.

- Common Features. The key features of the new Single Security would be the same as those of the current Fannie Mae MBS, including a payment delay of 55 days.
- Loan Products in Scope. First-level Single Securities would finance fixed-rate mortgage loans now eligible for financing through the "To-Be-Announced" ("TBA") market. [4]
- Multiple-Lender Pools. Lenders would continue to be able to contribute mortgage loans to multiple-lender pools.
- Re-Securitizations. Each Enterprise would be able to issue second-level Single Securities (i.e., re-securitizations) backed by first- or second-level securities issued by either Enterprise.
- Disclosures. The loan- and security-level disclosures for Single Securities would closely resemble those of Freddie Mac Participation Certificates ("PCs").
- Alignment of Enterprise Programs, Policies, and Practices. Current Enterprise policies and practices related to the removal of mortgage loans from securities (buyouts) would be generally similar and aligned for purposes of the Single Security. [5]
- Legacy Fannie Mae MBS and Freddie Mac PCs. Freddie Mac would offer investors the option to exchange legacy PCs for comparable Single Securities backed by the same mortgage loans and would compensate investors for the cost of the change in the payment delay. Fannie Mae will not offer an exchange option for legacy MBS because FHFA expects investors to treat them as fungible with Single Securities.

The Update discusses feedback received on the RFI. For the most part, FHFA has rejected commenters' recommendations. [6] Compared to the RFI, however, the Update provides considerably more detail about the Single Security proposal, particularly with respect to counterparty risk; loan- and security-level disclosures; the Enterprises' policies, procedures, and practices related to the removal of mortgage loans from securities; and the exchange option for holders of Freddie Mac PCs.

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endnotes

[1] Available at:
www.fhfa.gov/AboutUs/Reports/ReportDocuments/Single%20Security%20Update%20final.pdf.

[2] Available at
www.fhfa.gov/PolicyProgramsResearch/Policy/Documents/RFI-Single-Security-FINAL-8-11-2014.pdf. See Institute Memorandum [No. 28326](#), dated August 19, 2014, for a summary of the RFI.

[3] The Update notes that Freddie Mac securities have historically traded less favorably than Fannie Mae securities. The Update suggests that eliminating the differential would reduce costs to Freddie Mac and taxpayers.

[4] The TBA market is a forward market for agency MBS. In a TBA trade, the buyer and seller agree to the issuer (e.g., Fannie Mae or Freddie Mac), maturity, coupon, price, par amount, and settlement date at the trade date, but the exact MBS to be delivered by the seller are announced just prior to settlement.

[5] Some commenters are concerned that differences in the Enterprises' programs, policies, and practices could lead to divergence in prepayment speeds between their securities, which in turn could lead to divergence in prices and adversely affect market liquidity.

[6] However, the Update notes that the Enterprises have agreed to bring into greater alignment their policies and practices related to removals of mortgage loans from securities. It also specifies that investors who exchange their Freddie Mac PCs for Single Securities would be compensated for the payment delay (like the Fannie Mae MBS, the Single Security would make payments on the 55th day after the monthly interest on a mortgage begins accruing, whereas Freddie Mac PCs make payments on the 45th day).

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