

FEDERAL HOUSING FINANCE AGENCY'S SINGLE SECURITY INITIATIVE

MARCH 2016

Introduction

The US housing market has largely recovered from the historic lows of the financial crisis.¹ While most housing market indicators are encouraging, the US housing market continues to rely on extraordinary levels of government support, ranging from monetary policy to the dominant roles of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), referred to collectively as the Enterprises. The Enterprises remain in conservatorship and are majority owned by the US Treasury. Over 95% of residential mortgage backed securities (MBS) issuance is government guaranteed as of January 2016.² Of the \$8.75 trillion US mortgage-related securities outstanding (including both residential MBS and commercial MBS), 81.7% is Agency-issued.³

Despite the magnitude and importance of this market and over 8 years of conservatorship, comprehensive housing reform legislation has not been enacted and is not likely to be enacted in this national election year. Notwithstanding the absence of legislation, significant initiatives are underway at the Enterprises at the direction of the Federal Housing Finance Agency (FHFA), the regulator and conservator of Fannie Mae and Freddie Mac. In this *ViewPoint*, we explore one such initiative: the Single Security proposal. We consider the benefits and challenges of this proposal and recommend steps to protect investors and facilitate market acceptance.

KEY OBSERVATIONS AND RECOMMENDATIONS FOR A SINGLE SECURITY

1. We support the implementation of FHFA's Single Security initiative. This would result in a more liquid mortgage market and increased taxpayer and homeowner savings; however, there are challenges and considerations in combining Fannie Mae and Freddie Mac MBS that must be addressed.
2. It is imperative to align the key policies and practices of Fannie Mae and Freddie Mac in order to avoid the risk of misalignment that could occur as the two Enterprises continue to act as competing for-profit companies. This misalignment could result in losses to investors.
3. There must be a clear, explicit, and independent monitoring framework that is embedded into the administration of the Single Security program.
4. In order to avoid opportunistic behaviors that could harm market participants, FHFA should align performance goals at Fannie Mae and Freddie Mac with the success of the Single Security initiative.
5. FHFA should provide leadership and coordinate across regulators to ensure that a number of existing legal, regulatory, tax, and accounting issues are considered to account for a Single Security market structure.
6. Once the new framework for a Single Security is in place, a swift transition period would be the best approach to avoid the negative consequences that would result from three active to-be-announced (TBA) contracts in the market simultaneously.

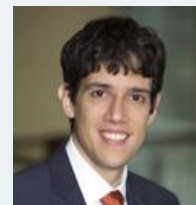
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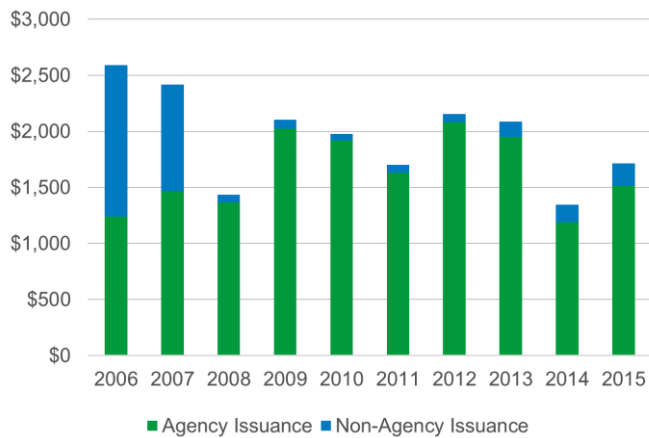


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In this *ViewPoint*

▶ The Single Security Objectives and Proposal	2
▶ Liquidity	3
▶ Considerations and Recommendations	3
▶ Other Considerations: Documentation, Legal, and Regulatory	6
▶ Transition	7
▶ Conclusion	8

Exhibit 1: MORTGAGE-RELATED SECURITIES ISSUANCE



Source: SIFMA. As of Dec. 31, 2015.

The directive to develop and implement the Single Security is part of FHFA’s Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac (the Strategic Plan) and is intertwined with another Strategic Plan initiative – the development of a Common Securitization Platform (CSP).⁴ A primary reason for building the CSP is to facilitate the implementation of the Single Security. In fact, FHFA Director Mel Watt highlighted that FHFA is leveraging the creation of a CSP to establish a Single Security, and both endeavors continue to be a high priority as FHFA furthers its efforts to facilitate liquidity in the nation’s housing finance market.⁵

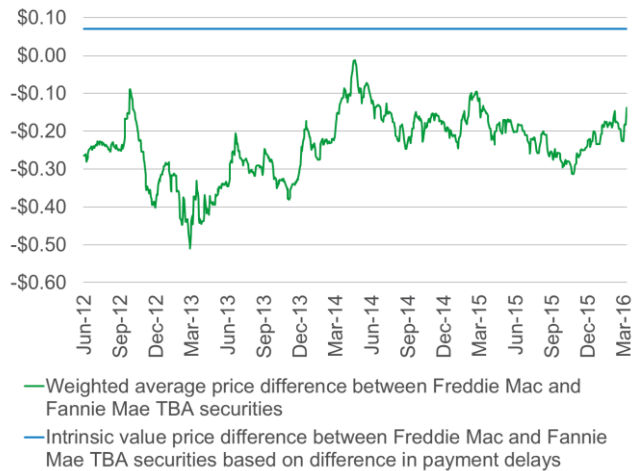
We are generally supportive of the Single Security initiative and its policy objectives. Specifically, we support the goal of establishing a single, liquid market for the MBS issued by the Enterprises that reduces the cost to taxpayers and homeowners. However, there are a host of critical issues in the design and execution of such a program that must be addressed in order for the program to be readily accepted by investors and ultimately achieve its objectives.

The Single Security Objectives and Proposal

In recent years, annual issuance of Fannie Mae MBS has exceeded issuance of Freddie Mac Participation Certificates (PCs) by about 70%, and the trading volume of Fannie Mae MBS has been about nine times the trading volume of Freddie Mac PCs.⁶ The greater liquidity in Fannie Mae MBS has led to higher trading prices than comparable Freddie Mac PCs, which pay the same coupon rate and are backed by similar collateral. Exhibit 2 illustrates the weighted average difference in price between Freddie Mac and Fannie Mae TBA securities, weighted by the percentage of each coupon

issued during each month. Between June 2012 and March 2016, Freddie Mac TBA securities have traded anywhere from \$0.01 to \$0.51 lower than Fannie Mae TBA securities. The blue line in this chart represents the approximate intrinsic value difference of Freddie Mac and Fannie Mae TBA securities, based on the difference in payment delay between the two securities. Given that Freddie Mac TBA securities have a shorter payment delay than Fannie Mae TBA securities by 10 days (because Freddie Mac securities make payments on the 15th of the month in comparison to Fannie Mae payments on the 25th of the month), the current intrinsic value difference is approximately a positive value of \$0.07, as the ability to earn interest on Freddie Mac payments for 10 extra days a month results in a positive value.

Exhibit 2: PRICE DIFFERENCE BETWEEN FREDDIE MAC AND FANNIE MAE TBA SECURITIES



Source: Barclays; BlackRock. As of March 14, 2016.

As a result of this price differential, in order to entice mortgage originators to securitize their mortgage loans into the lower-priced Freddie Mac PCs, Freddie Mac has subsidized its guarantee fees (G-fees) to compensate for the pricing differential. FHFA’s Single Security initiative proposes to make the securities issued respectively by Fannie Mae and Freddie Mac fungible, and thereby consolidate the liquid forward market in agency mortgages. It should be noted that Fannie Mae and Freddie Mac will remain distinct issuers. FHFA’s proposal seeks to increase and maintain market liquidity and obviate the use of taxpayer funds by Freddie Mac to subsidize the pricing differential between Freddie Mac and Fannie Mae securities. We agree that this is a laudable objective.

“By dollar volume, annual issuance of [Fannie Mae] MBS has exceeded issuance of PCs by about 70 percent in recent years, and the trading volume of [Fannie Mae] MBS has been about nine times that of PCs.”

— FHFA, *An Update on the Structure of the Single Security*

Liquidity

Under the proposal, Fannie Mae and Freddie Mac would issue and guarantee first-level Single Securities backed by mortgage loans they have acquired. First-level Single Securities are single-class securities backed by mortgage loans purchased by either Freddie Mac or Fannie Mae. These first-level Single Securities would be known as “Uniform MBS” and be deliverable into the TBA market. The key features of the Uniform MBS will be the same as those of the current Fannie Mae MBS, which includes a payment delay of 55 days.

Freddie Mac would offer investors the option to exchange legacy PCs for comparable Uniform MBS backed by the same mortgage loans and would attempt to compensate investors for the cost of the change in the payment delay. It is not expected that Fannie Mae would offer an exchange option for legacy Fannie Mae MBS because it is expected that the market will treat them as fungible with the Uniform MBS.

As proposed, the loan-level and security-level disclosures for Single Securities would closely resemble those of Freddie Mac PCs. Further, the proposal contemplates that current policies and practices, including those related to the removal of mortgage loans from securities – buyouts – are generally aligned today and would be similar and aligned, though *not identically* aligned, for the new Single Security. As discussed more fully below, strict alignment of these policies and practices is critical to the ready adoption of the Single Security by the market.

Considerations and Recommendations

We are supportive of the Single Security program, yet critical design and implementation considerations remain.

A move towards a Single Security for both Fannie Mae and Freddie Mac would benefit the mortgage market. While the current market for Fannie Mae securities is large and deep, the market for Freddie Mac securities is less liquid because of its smaller footprint. Accordingly, Freddie Mac securities are often quoted as a spread to the benchmark Fannie Mae securities. Creating a single set of benchmark securities would increase depth and size of these securities collectively and thereby increase market liquidity. In an environment in which market participants are increasingly concerned about liquidity, this would be a welcome development.

A Single Security would also normalize the pricing spread between Fannie Mae and Freddie Mac issued MBS. This, in turn, would end the need for Freddie Mac to incent originators via a subsidy to package loans eligible for both agencies into

Exhibit 3: DIFFERENT SECURITY STRUCTURE HIGHLIGHTS

	Fannie Mae MBS	Freddie Mac PCs	Uniform MBS
Payment Delay	55 days	45 days	55 days
Data Disclosure	Distinct (yet overlapping) set of disclosures by each Enterprise		Aligned disclosures, similar to current Freddie Mac disclosures
Issuer	Fannie Mae	Freddie Mac	Fannie Mae or Freddie Mac
Ability to cross-guarantee other Enterprise's pools?	No	No	Yes
Conversion of legacy pools to Uniform MBS?	Not necessary – they are fungible	Yes	N/A
Deliverable into TBA	Legacy Fannie Mae securities	Legacy Freddie Mac securities	<ul style="list-style-type: none"> Legacy Fannie Mae securities Fannie Mae-issued Uniform securities Freddie Mac-issued Uniform securities Legacy Freddie Mac securities exchanged for 24-delay “mirror” securities

Freddie Mac PCs rather than Fannie Mae MBS, which are priced at a premium. While Freddie Mac remains in conservatorship, this subsidy is effectively a taxpayer expense. Ending this subsidy would save taxpayer money with little or no negative consequence to the Enterprises' stated policy objectives.

While implementation of the Single Security initiative could result in a more liquid mortgage market and taxpayer savings, there are challenges in combining Fannie Mae and Freddie Mac securities. Some of these challenges, if not properly addressed, could result in a degradation of the quality of Agency mortgage securities and a resultant loss of value and liquidity that could overwhelm the benefits of the Single Security initiative. The resulting lower mortgage prices would lead to higher borrowing costs for homeowners unnecessarily, a situation we think FHFA should be determined to avoid.

The primary challenges of the Single Security initiative are twofold. The first challenge is the inherent tension that exists between creating a single set of benchmark securities for Fannie Mae and Freddie Mac while still encouraging competition between the two Enterprises. The second challenge is the potential for negative consequences of misalignment of certain policies and procedures between the Enterprises, which could cause significant losses for investors.

The first challenge – the tension of two competing entities distributing their products through a single channel – is quite problematic. The Single Security, by its very nature, suggests fungibility between the securities of the two Enterprises. This premise is logical given that both entities are in conservatorship and are majority-owned by the US government. However, Fannie Mae and Freddie Mac continue to behave as independent companies with independent and competing strategies. This tension, if not managed effectively, could ultimately result in a decline in the prices of mortgage-backed securities and a drop in the liquidity of the benchmark single securities.

In the current framework, each Enterprise is incentivized to closely monitor the prepayment risk of its own securities (which is ultimately passed onto investors) since higher prepayment risk would lead investors to price that Enterprise's securities at a lower price than the other Enterprise's securities. The Single Security initiative in essence creates a cooperative structure whereby the price of the benchmark securities is determined by the value of the mortgage securities issued by both Enterprises. As with other cooperative structures, this can lead to the potential for opportunistic behaviors by each of the members of the cooperative (in this case the Enterprises). The Enterprises

would continue to compete on the credit quality of the loans – which would lower insurance costs – and on market share, but they would have less incentive to monitor the prepayment risk of these loans. In this cooperative structure, a deterioration in the price of the TBA will damage each Enterprise equally, since there is a Single Security. Alternatively, if one Enterprise continues to ensure that there is no increase in the prepayment risks of their loans, the other Enterprise will benefit from that as well. This is ultimately because investors have less flexibility to discriminate between the securities in a single TBA contract. Therefore, the consequences to an individual Enterprise of higher prepayment risk for the loans that it guarantees are lower, and the incentives to monitor and manage prepayment risks are reduced as well. Such a structure risks a "race to the bottom," in which each Enterprise focuses on improving the return on their respective loans and establishing better relationships with originators while **potentially sacrificing increased prepayment risk**, which is directly passed on to investors. This situation would lead to a degradation in the pricing and ultimately liquidity of the agency mortgage market.

The second challenge – misalignment between the Enterprises' policies and procedures – can lead to unnecessary investor losses. There are a host of readily apparent examples of misalignment in which Enterprise actions can affect cash flows to investors. For example:

- (i) A change to either security characteristics or to policies and procedures that affect securities in the secondary market, but which do not affect borrowers.
- (ii) Either a change to or introduction of programs affecting the primary mortgage market that are mandated by regulation or law.
- (iii) Either a change to or introduction of programs affecting the primary mortgage market that are conceived within an Enterprise.

When the Enterprises implement changes that affect the cash flows to investors, but do so in a different manner and over different time periods, it can lead to disruption in the market. For example, when Freddie Mac and Fannie Mae announced that they would be repurchasing all loans that were over 120 days delinquent from their pools in early 2010 – an instance of the first example of misalignment referenced above – they each announced a different schedule for repurchase. As a result, each Enterprise's securities experienced a very large increase in prepayments, but not at the same time. A situation like this within the framework of a Single Security may result in investors suffering significant losses merely because of misalignment of the Enterprises' policies. In this case, the deliverable to the Single Security would be Fannie Mae securities in one month and Freddie Mac securities in the other. Another example of misalignment of policies is the

different implementation of the Home Affordable Refinance Program (HARP) at each Enterprise in 2009 – an instance of the second example of misalignment set forth above – which resulted in different prepayment characteristics for similar specified pools of each Enterprise. These examples highlight the types of situations that must be avoided to ensure that investors are not penalized and to prevent undermining confidence in the Single Security.

The solution to mitigate these risks and to instill confidence in this Single Security initiative is a combination of alignment of appropriate policies and procedures and ongoing monitoring of the Enterprises. The Single Security requires fungibility between the securities of each Enterprise; this in turn requires fungibility between the primary drivers of valuation of the securities. It is crucial that alignment be made transparent and comprehensible to all market participants. There is no value to a misalignment of Enterprise policies and procedures that affect securities in the secondary markets or affect borrower programs that are mandated by regulation or law. We understand that FHFA believes that there is value in having the Enterprises continue to function as independent entities to foster innovation. However, there must be sufficient alignment so that investors do not suffer losses as a result of accepting a Single Security, as this would weaken the price of the security, which would translate into higher costs for borrowers. A robust monitoring framework would give investors confidence that sufficient oversight exists to prevent a “race to the bottom” as described above.

In fact, the recommendation to align policies and practices between the two Enterprises has been echoed by many. In the Update on the Structure of the Single Security, FHFA acknowledged that “Respondents generally recommended that FHFA address this issue by aligning the Enterprises’ programs as well as key Enterprise policies and practices that affect prepayments.” Regarding changes in Enterprise programs, policies, and practices, FHFA wrote that “FHFA expects that the processes followed by the Enterprises and FHFA will involve careful assessment of the potential effects on prepayment speeds of any such potential changes developed or considered in the future.”⁷ We commend FHFA for acknowledging the importance of maintaining the close similarity of prepayment speeds of the Enterprises. Yet, FHFA has also indicated that it is not necessary or appropriate to require complete alignment of the Enterprises’ programs, policies and practices.⁸ We do not believe that this response is sufficient. **An explicit alignment of key Enterprise’s programs, practices, and policies is imperative. Moreover, there must be a clear, explicit, and independent monitoring framework that is embedded into the administration of the Single Security program.**

There are several forms of alignment that would not excessively limit the ability of the Enterprises to function as

independent entities. Fully aligning the programs, policies, and procedures of the Enterprises that either (1) affect the cash flows of their securities, or (2) are programs that are mandated by regulation or law would address the first two examples of misalignment described above. In the case of changes to the security cash flows, anything that affects either the removal or adjustment of loans in the security (such as repurchases) or the security features (such as payment delay) needs to be implemented identically at both Enterprises to prevent harm to the valuation of the Single Security that would not otherwise occur if the securities remained separate. In the case of programs mandated from outside the Enterprises by law or regulation, there is no reason to implement such programs (e.g., HARP) differently; in fact, they should be implemented identically. The lack of consistent implementation is currently not a significant issue in the mortgage market since each Enterprise has its own TBA contract. However, in a Single Security framework, the cost of different implementation may lead to significant investor losses with no commensurate benefit to any other stakeholder.

Alignment of new programs conceived within an individual Enterprise, if those programs materially affect the prepayment behavior of the loans underlying the securities, would address concerns about the third type of misalignment described above. FHFA, along with industry participants, should determine a “materiality test” for such programs. If a program is likely to affect the prepayment behavior of a significant portion of borrowers, it should be announced publicly and the other Enterprise should be able to implement it identically.

A third form of alignment is to align performance goals at the Enterprises with the success of the Single Security initiative. This will create another mechanism to avoid opportunistic behaviors at each respective Enterprise. FHFA should create a goal in its Strategic Plan to ensure that each Enterprise will incorporate the recommendations made above and will not behave in a way that will compromise the valuation of the Single Security. The exact metrics of success for the Enterprises should be designed by FHFA using stakeholder input. This goal should be evaluated as part of FHFA’s annual Scorecard for Fannie Mae, Freddie Mac, and Common Securitization Solutions.

A robust monitoring framework will ensure that the objectives of alignment are met. FHFA should monitor differences in prepayment speeds of similar mortgage loans for each Enterprise. While prepayment speeds cannot be identical since the Enterprises do not control them, they should be substantially similar for large groups of loans with similar characteristics. Currently, there are few significant prepayment differences between the securities of the Enterprises. However, large differences have occurred in the past, most notably during the high refinancing periods in 2003 and 2004. The current similarity in prepayment behavior does

not guarantee that this will remain the case in the future; indeed, future disparities will again emerge in the absence of an effective monitoring framework. A monitoring framework similar to Ginnie Mae's "compare ratios," in which servicers are measured on the delinquency rates of their loans relative to other servicers, could be used to monitor the prepayment speeds of loans guaranteed by each Enterprise. A persistent discrepancy should be investigated by FHFA and the findings reported to the public in a timely manner, along with a detailed plan to bring these prepayment speeds back in line.

While aligning the characteristics of the loans guaranteed by each Enterprise (e.g., ensuring that there is a similar mix of originators and servicers for each Enterprise) is not necessary and may not be practical, it is prudent to monitor this mix to understand potential differences in the strategies of the Enterprises. Of particular concern is the possibility for explicit deals between one Enterprise and an originator to receive better collateral characteristics for loans that may negatively affect the prepayment response of those loans. FHFA should publish a periodic detailed issuance report in which the Enterprises should explain deviations in the collateral characteristics of newly guaranteed loans. If the deviation also increases the refinancing risk of the loans of one Enterprise relative to the other, an explanation of the deviation should be given.

The above recommendations focusing on alignment between the Enterprises and transparency to investors would materially increase the probability of success of the Single Security initiative. These recommendations would increase fungibility of the underlying securities of the Enterprises in a manner consistent with their objectives. This in turn should help to increase the liquidity of the Single Security, thereby increasing the price for market participants and lowering the cost of mortgage financing for the end borrower.

Other Considerations: Documentation, Legal, and Regulatory

The ability to issue MBS that conform to the Single Security initiative's requirements is predicated upon the launch and success of the CSP that has been mandated by FHFA and the Enterprises.⁹ However, the Single Security initiative will require significant effort by market participants beyond the CSP, FHFA, and the Enterprises.

The current structure of the agency mortgage market is embedded in the architecture and operations of the broader capital markets. The investment guidelines of many entities, including corporations, pension plans, endowments, and foreign central banks, have specific guidelines for MBS issued by Fannie Mae and Freddie Mac, including their respective TBA contracts. These guidelines would have to be reviewed and, in some cases, revised to account for the Single Security.

“The Single Security initiative will require significant effort by market participants beyond the CSP, FHFA, and the Enterprises.”

Margining agreements between counterparties for TBAs are designed for the current market framework of a TBA contract for each Enterprise. These agreements would similarly need to be updated and revised to reflect the Single Security framework. Moreover, diversification requirements, such as those for Bank-Owned Life Insurance (BOLI) vehicles, would need to be clarified to account for a TBA contract in which the issuer of the underlying securities is uncertain.

Accounting and potentially tax treatment for both conversions of "legacy" Freddie Mac PCs to "new" Freddie Mac securities that are eligible for the single TBA, and accumulations of one Enterprise's first-level securities into a second-level security guaranteed by the other Enterprise, need to be confirmed. In addition, trading, settlement, accounting, and risk systems across the financial markets would need to be modified to account for a single TBA.

Though Fannie Mae and Freddie Mac will remain the distinct respective issuers of the Single Security, the legal, regulatory, accounting, and tax issues surrounding the implementation of the Single Security are potentially significant. **FHFA needs to provide leadership and coordinate at a minimum with the Fed, OCC, FDIC, SEC, CFTC, IRS, State Insurance Regulators, NAIC, SIFMA, FINRA, FASB, and other relevant bodies to ensure clear interpretive policy guidance is issued and safe harbors are provided as necessary.**

All of these issues require significant investments by asset managers and other market participants to ensure a smooth transition to the Single Security. FHFA has been transparent in its announcements and cautious thus far in the timeline, recognizing the work necessary in the industry to successfully implement a Single Security. An industry working group has been formed, though it convenes relatively infrequently and its scope may require expansion. FHFA and the Enterprises should ensure that market participants and relevant constituents participate in decisions that impact the framework of the Single Security, and such decisions should incorporate stakeholder input. Involving relevant industry stakeholders throughout the process will help avoid decisions that could lead to sub-optimal consequences in downstream processes of market participants. We recommend that the industry working group include smaller and more active sub-groups to review and determine optimal decisions that affect the concerns outlined in this *ViewPoint*. We also recommend that the timeline for implementation remain flexible and allow for all of the important issues – many of them not directly involving the Enterprises – to be resolved prior to implementation of the Single Security. Failure to do so may result in a disruption to the mortgage (and housing) markets.

Transition

Once the structure of the Single Security is finalized and agreed upon by the relevant constituents, and the logistical changes required for the adoption of the Single Security are settled, it will be important to transition the Single Security into the market in a manner that will be the least disruptive and most effective.

It is important to avoid a situation in which three separate TBA securities – a Fannie Mae TBA, a Freddie Mac TBA, and a new Single Security TBA – trade simultaneously. This scenario would create confusion and uncertainty of the deliverable since a security would be deliverable into two different contracts at the same time. The value of each individual TBA contract would be more volatile during this period, and the liquidity of all contracts would likely be

temporarily hampered, which is undesirable during a sensitive transition phase.

One strategy to avoid this situation is to retire the separate Enterprise TBA contracts on the same month that the new Single Security TBA is introduced. In this approach, the separate Enterprise TBA contracts would trade as usual until the end of a specific monthly cycle. During this cycle, the “back month” (or following month’s) TBA contract would be the new Single Security TBA. There would be no new separate Enterprise TBA contracts for the following month. The TBA roll – the calendar spread between the TBA contracts of subsequent months – would be quoted as the difference between each separate Enterprise TBA contract in the “front month” and the Single Security TBA in the “back month.” At the end of this cycle, the separate TBA contracts

Exhibit 3: PROPOSED TRANSITION TO A SINGLE SECURITY

	SETTLEMENT MONTH			
	MONTH 1	MONTH 2	MONTH 3	MONTH 4
Available TBA Contracts	Month 1 Fannie Mae TBA Month 1 Freddie Mac TBA	Month 2 Fannie Mae TBA Month 2 Freddie Mac TBA	Single Security TBA	Single Security TBA
Deliverable Securities	Fannie Mae TBA: <ul style="list-style-type: none"> Legacy Fannie Mae securities Fannie Mae-issued “Single Security” Freddie Mac TBA: <ul style="list-style-type: none"> Legacy Freddie Mac Securities 	Fannie Mae TBA: <ul style="list-style-type: none"> Legacy Fannie Mae securities Fannie Mae-issued “Single Security” Freddie Mac TBA: <ul style="list-style-type: none"> Legacy Freddie Mac Securities 	Single Security TBA: <ul style="list-style-type: none"> Legacy Fannie Mae securities Fannie Mae-issued “Single Security” Freddie Mac-issued “Single Security” Legacy Freddie Mac securities exchanged for 24-delay “mirror” securities 	Single Security TBA: <ul style="list-style-type: none"> Legacy Fannie Mae securities Fannie Mae-issued “Single Security” Freddie Mac-issued “Single Security” Legacy Freddie Mac securities exchanged for 24-delay “mirror” securities
TBA Rolls Available	Month 1 Fannie Mae – Month 2 Fannie Mae Month 1 Freddie Mac – Month 2 Freddie Mac	Month 2 Fannie Mae – Month 3 Fannie Mae Month 2 Freddie Mac – Month 3 Freddie Mac	Month 3 Single Security – Month 4 Single Security	Month 4 Single Security – Month 5 Single Security

would settle regularly. The Single Security TBA that is settling in the following month would be the only TBA that remains. **This transition is best done during a period with less operational and regulatory concerns in the market; quarter-ends and year-ends should be avoided.** Legacy Freddie Mac PCs would continue to trade as specified pools (i.e., individual securities) and could be exchanged at any time for the "new" Freddie Mac PCs that would be deliverable into the Single Security TBA.

This approach would require a rigorous testing period prior to the transition, during which notification and settlement procedures for the Single Security TBA are tested to ensure that they function flawlessly. We imagine that this testing could be done over a period of a few months since these procedures are very similar to the current ones employed for the Enterprise's TBA contracts.

Conclusion

The proposed Single Security initiative is potentially beneficial for borrowers, investors, taxpayers, and the Enterprises – if implemented correctly. The larger set of pools in a consolidated TBA contract would improve the liquidity of agency mortgage securities, thereby benefiting market participants. As a result of a potentially lower liquidity premium, this would also translate into lower mortgage rates for homeowners. It would eliminate the need for Freddie Mac

to provide subsidies to originators to securitize with them rather than with Fannie Mae – a savings that will benefit taxpayers. The Single Security initiative is also an opportunity to better align the Enterprises and provide greater transparency to the market. The full alignment of policies, procedures, and implementation of new programs is a prerequisite for the Single Security in order to ensure that investors do not bear losses as a result of behavior that arises because of the tension created by two for-profit companies operating in a cooperative-like structure.

The challenges of such a large transition are formidable. The Enterprises have been embedded in the ecosystem of the fixed income markets for decades and updates to policies, procedures, and systems will be significant but essential. A cautious and deliberate approach to the implementation of this Single Security initiative is necessary to limit errors and increase the probability of success. The transition of a multi-trillion dollar market will require attention to many details given the importance of mortgage-backed securities to the housing market. We believe that once the new framework is in place, a swift transition is the best approach to avoid the pitfalls of three active TBA contracts in the market simultaneously.

Notes

1. Housing starts and home sales continued to increase through year-end 2015 while delinquencies and foreclosures continue to decline. Home prices are still very affordable by historical standards. See Urban Institute, "Housing Finance at a Glance: A Monthly Chartbook." (Jan. 2016), available at <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/2000588-Housing-Finance-at-a-Glance-A-Monthly-Chartbook-January-2016.pdf>.
2. Id.
3. SIFMA, US Mortgage-Related Issuance and Outstanding (Feb. 3, 2016), available at <http://www.sifma.org/research/statistics.aspx>.
4. FHFA's Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac (the Strategic Plan) seeks to maintain foreclosure prevention activities and credit availability for new and refinanced mortgages, reduce taxpayer risk through increasing the role of private capital in the mortgage market, and build a new single-family securitization infrastructure for use by the Enterprises. See FHFA, 2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac (May 13, 2014), available at <http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2014StrategicPlan05132014Final.pdf>.
5. FHFA, Remarks by Director Melvin Watt at the Mortgage Bankers Association Annual Convention (Oct. 20, 2015), available at <http://www.fhfa.gov/Media/PublicAffairs/Pages/Prepared-Remarks-of-Melvin-L-Watt,-Director,-Federal-Housing-Finance-Agency-at-the-MBA-Annual-Convention.aspx>.
6. FHFA, An Update on the Structure of the Single Security (May 15, 2015), available at <http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/Single%20Security%20Update%20final.pdf> (FHFA May 2015 Update on the Structure of the Single Security).
7. FHFA May 2015 Update on the Structure of the Single Security.
8. FHFA, 2015 Scorecard Progress Report (Mar. 2016) at 27, available at <http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/Progress-Report-2015-Scorecard.pdf>.
9. The Single Security and CSP initiative continues to progress. On Sep. 15, 2015, FHFA announced that the initial use of the CSP would be by Freddie Mac, followed by a subsequent release that would enable both Freddie Mac and Fannie Mae to use the CSP to issue Single Securities. On Dec. 17, 2015, FHFA announced that they plan to implement the CSP for Freddie Mac's existing single-class securities in 2016 and plan to implement the Single Security on the CSP for both Fannie Mae and Freddie Mac in 2018. See FHFA, An Update on the Common Securitization Platform (Sep. 15, 2015), available at <http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/CSP-Update-Final-9-15-2015.pdf>; FHFA, 2016 Scorecard for Fannie Mae, Freddie Mac, and Common Securitization Solutions (Dec. 17, 2015), available at <http://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2016-Scorecard.pdf>.

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