Community Bank Views – Single Security Initiative, UMBS March 29, 2019

What is the Single Security, Uniform MBS (UMBS), initiative?

Under the direction of the Federal Housing Finance Agency's Single Security Initiative, Fannie Mae and Freddie Mac will begin issuing a joint security known as the Uniform MBS (UMBS) beginning June 3rd, 2019. This Single Security initiative is expected to strengthen the U.S. mortgage market by supporting liquidity in the To Be Announced (TBA) market, thereby maintaining or possibly lowering the cost of housing finance and benefiting borrowers, taxpayers, and investors.[1]

With this brings many changes to the Mortgage Pass Through market. Including, but not limited to, the TBA market and the market for outstanding pools. Effective June 2019, there will no longer be issuance in new Freddie Mac GOLD, 45 day delay, Pass Through pools. At that time, a new UMBS with a 55 day delay will be the only form of Pool issuance and TBA Trading.

Impact on TBA Market

There are currently separate TBA contracts for Fannie Mae and Freddie Mac MBS. The two are currently quite identical with the major differences being 1) the Guarantor and 2) the payment delay [55 day for Fannies & 45 days for Freddies]. On March 12th, 2019, TBA trading in the new UMBS TBA contracts began. Starting with the June 2019 settlements, new UMBS TBA contracts will accept delivery of securities with a 55-day delay guaranteed by either Fannie Mae or Freddie Mac. Once the June settlement date arrives (June 13th for 30yr pools) the existing Freddie Mac GOLD TBA contracts (45 day delay) will cease to exist since no new Freddie Mac GOLD pools will be issued. The June 2019 UMBS TBA contracts can be satisfied with outstanding FNMA 55 day delay pools or old 45 day delay Freddie GOLD pools that have been converted to a new 55 day delay "mirror" UMBS security.

The Exchange Option: Converting Legacy Freddie GOLD Pools to Mirror UMBS Pools

Beginning in May 2019, all holders of legacy Freddie Mac (45 day delay) pools will have the option to voluntarily convert or exchange their securities for a new mirror UMBS (55 day delay) pool. In addition to receiving the new UMBS mirror pool, the bond holder will also receive compensation from Freddie Mac for the 10 day delay difference. This exchange is optional and can be facilitated in one of two ways. Either by "dealer facilitated" or "direct to Freddie Mac" methods.

- *Dealer Facilitated* – an investor transfers a bond to a dealer, who then converts the security with Freddie before returning the mirror security to the investor. This path "will stay open for the foreseeable future," according to Freddie.
- *Direct to Freddie Mac* – direct exchanges with Freddie Mac will go through Tradeweb and are "expected to be open for 3-5 years."

The IRS has published its "Revenue Ruling 2018-24" regarding the tax treatment of the legacy Freddie pool exchange. Per the ruling, the exchange of mortgage backed securities pursuant to the Single Security Initiative does not constitute a taxable exchange. However, the IRS did not rule on the taxability of the compensation payment made for the 10 day delay difference and is not expected to provide additional guidance on the topic. Please refer to your tax professional for guidance (CMG does not provide tax advice).

In the event of an exchange, each mirror pool will have the same collateral history as the legacy (45 day delay) pool. Conversion does not change the characteristics of the underlying loans. However, investors who convert, or exchange, will have a new CUSIP, pool number, ticker prefix, issue date, servicer name, and pool type. Bloomberg will have a reference to the original, legacy Freddie Mac pool and the new mirror pool. The screenshot on the following page shows a Bloomberg DES page on a representative legacy pool (FG Q17649) with link to the new UMBS pool number (FN ZL5674).

You can see the legacy pool number on the top left of the image and the new mirror pool number is also available on the DES page. If you were to view the mirror pool on Bloomberg (FN ZL5674) it would also reference the original legacy pool (FG Q17649). In both cases, all loan and pool details are identical; WAM, WAC, factor, prepayment speeds, etc…

FG Q17649 Mtge | Export | Page 1/2 Security Description

FGLMC 4 S 4.311(269)71 CUSIP 3132J85K2 | Pool Level | 95) Buy | 96) Sell

1) Summary | 2) Comments

Pool	FG Q17649	Seasoning	FGLMC 4 S	As Of	03/2019
Type	(Q1) Conventional Conv 30 years	Vintage	FGLMC 4 2013	Issue Date	04/01/2013
Traits	30/360	UMBS	FN ZL5674	Maturity Date	04/01/2043

Seller Wells Fargo Bank, N.A. Issuer FHLMC

12) Pool Information

Coupon	4.000	WAC	4.311	Orig WAC	4.319
		WARM	269	Orig WAM	350
		WALA	71		

13) Collateral Information

WAOLTV	68	AOLS	60,497	Orig TPO	2.91
WAOLTV-HPI*	52	WAOLS	63,061	Curr TPO	2.05
WAOCLTV	71	MAXLS	85,000		
WAOCS	745	WAOLT	350		

Loans 296 Delay 44 (14)

TRACE Eligible

Balance	
Factor	0.55994613
Orig Amt	27,122,747
Curr Amt	15,187,277

Prepay	CPR	PSA
1 Month	9.5	158
3 Month	8.4	139
6 Month	7.1	118
1 Year	10.4	173
Life	7.4	154

18) States	%UPB
Florida	10.4
Texas	8.9
Minnesota	6.9

15) Paydown Information

*Value calculated by Bloomberg

Prepay History	Mar19	Feb	Jan	Dec	Nov	Oct	Sep	Aug	Jul	Jun	May	Apr18
1 Month CPR	9.5	1.7	13.4	3.4	2.6	11.3	6.1	13.2	18.9	7.9	25.0	8.6
3 Month CPR	8.4	6.3	6.6	5.8	6.7	10.3	12.9	13.5	17.6	14.2	14.3	7.1
6 Month CPR	7.1	6.5	8.5	9.4	10.2	14.0	13.6	13.9	12.5	10.8	11.0	9.1
12 Month CPR	10.4	10.3	10.5	10.1	10.6	11.6	11.1	10.9	10.6	10.3	10.8	8.9

We believe there is no immediate need or requirement for the typical bank bond portfolio to exchange legacy pools for new 55 day delay pools. The primary reasons being the full tax implication (the 10 day delay compensation) is not 100% known and the exchange process will remain open for a reasonable period of time. We will continue to reassess our view as more information becomes available. *Be sure to evaluate your own institution's unique situation prior to making a decision.*

CONCLUDING POINTS:

- All new UMBS pools with have the 'FN' prefix and will have a 55 day payment delay.
- All "deliverable" collateral types are eligible for exchange (10yr, 15yr, 20yr, 30yr conforming pools).
  ARMs and other non-deliverable asset types are not eligible (Jumbo, Hi LTV, Modified, Interest Only).
- The conversion, or exchange, is optional. You may choose to hold your legacy Freddie Mac (45 day delay) security. Investors will still receive principal and interest on these securities and still carry the same guarantee. A potential drawback could be liquidity down the road as there will no longer be a Freddie Mac TBA Contract after June 2019.
- There are many variables not addressed in this piece. Please contact your sales representative with questions or concerns. The Capital Markets Group of Commerce Bank can help you navigate these changes.

Sources:

1. Single Security Initiative Market Adoption Playbook. Freddie Mac and Fannie Mae. September 2018 pg 5.

Mark Mower
Senior Vice President – Mortgage Backed Securities Trading
Commerce Bank – Capital Markets Group
mark.mower@commercebank.com