Single Security and CSP Industry Advisory Group (IAG)

December 8, 2017

Meeting Location: Washington D.C.

Attendees: Approximately 35 attendees in the room and about 30 others on the phone. Representatives from Citi, FTSE Russell/London Stock Exchange, Broadridge, and Blackrock Solutions participated in a Market Readiness panel to discuss how their respective organizations are preparing for the Single Security Initiative.

Overview of FHFA Update – Recap of latest FHFA update – Progress of CSP, Alignment, Market Readiness

The meeting was opened by Fannie Mae with a brief welcome and review of the agenda. FHFA was asked to review the latest FHFA Update from December 4, 2017. The review began by summarizing the success of Release 1. CSS has now been in production for over a year and is currently processing monthly bond payments for newly-issued Freddie Mac PCs off the platform. The target completion of CSP Release 2 System-to-System testing is scheduled for Q1 2018, a bit later than originally planned. However, FHFA, Fannie Mae and Freddie Mac remain confident in the Q2 2019 target date of the Common Securitization Platform to be fully operational, including the first issuance of the new Uniform Mortgage-Backed Securities (UMBS). FHFA also highlighted the ramping up of outreach activities by Fannie Mae and Freddie Mac. The Enterprises will continue to meet with various market participant groups, including seller/servicers, investors, dealers and market utilities such as the NY Fed, Bloomberg, FICC and TradeWeb, and help these sectors to prepare for the Single Security Initiative. The FHFA December Update also focused on GSE general alignment on cash flows. It was noted that the two GSEs will not be identical; however, general alignment of cash flows related to prepayment speeds and buyout policies would be monitored. Existing cash flow processes will be reviewed (within the Enterprises and FHFA) and new processes will be considered to ensure alignment going forward. FHFA also provided an update on the status of conversations with IRS, SEC and other regulatory entities regarding the Single Security Initiative. FHFA asked the audience to help ensure the vendors that they work with are prepared for the upcoming changes in the TBA market.

There was a conversation regarding how the FHFA December Update was perceived by the IAG audience. Although participants seemed to view the update favorably, the investor community is still looking for more information on alignment. Additionally, comments were made that market participants would like to be more involved in monitoring compliance. A suggestion was made to involve market participants in regular (e.g. monthly or quarterly) reviews of prepayments with FHFA, Fannie Mae, and Freddie Mac. It was also recommended to involve IAG members in the review of tangible changes as they are released to increase transparency in the market. During this discussion FHFA was also asked about differing Enterprise approaches to prepayment monitoring and management, and if there will be further conversations for the Enterprises to share best practices.

A question was also asked about whether the SIFMA working group would agree with the 2 CPR difference and if a 1 CPR difference is possible for alignment. As the goal was to try to get to one prepayment model, the model may be examined further in the future but at this time a 1 CPR difference between the Enterprises is not feasible.

A representative from SIFMA shared that they have heard positive feedback regarding the FHFA December Update and the new information that has been provided. However, feedback was also received that the Update was still lacking information that investors want to hear. The market would like to see a more robust, durable mechanism to monitor and manage prepayments. SIFMA has members who want alignment managed even more closely on the front -end of the business, with greater rigidity and formality. Currently, if divergence in alignment occurs, it is already too late because bonds are already in the market. It was noted that FHFA Director Watt's term will end in January 2019 and FHFA staffing would change, which could lead to changes in the alignment process.

The audience applauded the inclusion of thresholds for prepayment speeds, but more information is desired on how a breach of thresholds will be enforced. Although there has been more focus on actual prepayment speeds, there may not be enough focus on policy and practices. A suggestion was made to include the review process and which policies and practices can be leveraged to prevent discrepancies in speeds. The market is looking for more engagement in enforcement of prepayment speeds and asked that the Enterprises continue to work on alignment and to compete on service but not necessarily on price.

ICBA asked FHFA to evaluate how additional resources could be used to manage the alignment process, and to think about what criteria for alignment would look like and how this criteria would work after GSE reform. One view is that true alignment clarity only occurs if there is just one company.

SIFMA asked if there is anything the market can do to speed up the IRS response to the Single Security tax issues. Freddie Mac noted that with all the competing priorities that the IRS is working on – including the pending tax legislation -- there may not be much that the market can do to influence the speed of IRS focusing on pending Single Security Initiative questions.

Market Readiness Update

In an effort to increase outreach efforts in 2018, Fannie Mae and Freddie Mac have engaged Ernst & Young (EY) to help with broader outreach activities, such as 1-on-1 interviews and digital communications (e.g. newsletters). EY will also assist in building out the stakeholder list for market participants, facilitating communication and risk management plans, and helping to align readiness activities.

One of the major unknowns in the Market Readiness efforts is the vendor community. To help mitigate the possible risks associated with not fully understanding the scope of impact to the vendor community, investors and dealers are encouraged to reach out now to their vendors to determine where the vendors are in their preparations.

The Enterprises are working on the assumption that Market Readiness will take market participants at least 12 months (until the end of 2018). It was noted that members of the SIFMA Operations Committee said forward trades of UMBS could start as early as 5-6 months ahead of the go-live date. SIFMA plans to update their TBA market good delivery guidelines to incorporate UMBS, but the timing for a member vote on updated guidelines has not been established. In the meantime, SIFMA is looking for more transparency on alignment – they don't want to see a lot of deliverability optionality between the Enterprises' securities.

Market Readiness Perspectives Panel

The Market Readiness perspective panel was kicked off with each of the four guests introducing themselves and explaining what readiness activities their companies have started.

Citi began the panel discussion; Citi is in the process of looking into internal and competing interests that relate to the timing of the Single Security Initiative. They already have a list of 25 projects planned for 2018, including FINRA 4210 and MFID2. Citi began their Market Readiness engagement by talking with their clients about the UMBS, but more recently Citi has begun to look internally at readiness. Citi has internally raised concerns on whether investors have everything they need in place to be ready in time for UMBS go-live, but Citi is still planning on getting their internal processes ready. Citi IT folks are evaluating internal systems to determine the changes that are needed and to gauge the level of effort to implement changes resulting from the Single Security Initiative. Citi's broker-dealer arm alone has at least 15 systems that will be impacted by UMBS. Citi is still in the internal assessment phase for all their impacted systems. They were asked whether they think 12 months will be sufficient time to prepare. Citi said they believe they can get to the projected dates, but they are still in the midst of assessing impacts and feel that it is too early in the project to commit to the 12-month timeframe.

Representatives from FTSE Russell followed with how FTSE Russell is looking at the Single Security Initiative from an index perspective. FTSE Russell's governance framework is central to considering how its benchmarks absorb market structure changes, such as the Single Security Initiative. FTSE has a formal governance process in place which must be used to consider market structure changes such as this and whether they warrant any modifications to the way in which FTSE tracks a particular market with its benchmarks. The governance process also includes mechanisms to notify all clients of the results of a governance review at the same time and with ample lead time in the event that any changes are announced.

Broadridge then began their part of the panel, explaining their focus is on post trade, middle office, and back office activities for the TBA market. Broadridge has restarted the client steering committee they developed 15 months ago. They are working with their committee, meeting monthly to evaluate the impact of the Single Security Initiative. Broadridge also has a project team in place for middle and back office activities, and is looking at how processes that have been used in the past for another multiyear loan project can be leveraged for the Single Security Initiative. Additionally, Broadridge asked for more details around the exchange. Broadridge is also working with eMBS on the Disclosure aspects of any changes. They are also in communication with FICC so they understand when the Gold PC becomes no longer clearing-eligible.

Through the outreach Broadridge is engaging in – including to other companies their customers work with -- they also see the need to focus on outliers and firms that are not as engaged with the Single Security Initiative, or are using a legacy version of a system.

There was a question asked regarding whether Broadridge will provide testing with their clients once they have built the Single Security changes in their systems; during a previous project (Novation) Broadridge tested with clients for 8 months, but they believe the testing cycle for UMBS will not be as long.

The final panelist was from BlackRock Solutions. He stated that the necessary internal resources for the Single Security Initiative changes have been identified. A working group that includes portfolio management, data, legal and operations meets on a monthly basis. They have created several workstreams with three primary focus points: 1) technology and Aladdin; 2) compliance; and 3) analytics enhancement. Weekly meetings are held to track the progress of these workstreams. The biggest hurdle that has come up is the expected impact to market indices on which BlackRock is dependent.

Blackrock does not believe that FINRA 4210 will be a problem or a competing priority for the Single Security Initiative. As of yet, not many clients have reached out to Blackrock about the Single Security Initiative. For BlackRock's own planning and development, they are looking for more clarity around the mortgage indices' and their potential changes, involvement of the custodial banks in the exchange process, and the final IRS ruling on exchanges. They were asked whether they have thought about testing with their clients Internal testing will begin in Q2 or Q3 2018, and clients may be asked to get involved. Blackrock has sent an update to all clients that will be impacted, and plans to increase the frequency of their updates as the go-live approaches.

Freddie Update: PC Exchange; Impact of Single Security Initiative on Freddie Seller/Servicers; SEC/IRS Update; Use of Early Adopters

Freddie Mac discussed the PC Exchange, the impact to servicers/sellers, and an update on Asian investors. During the Exchange discussion, the finalized transaction capacity of 50,000 trades/exchange business day was discussed. Participants in the exchange will also be able to reserve a date and time for exchange; Freddie Mac will continue to think about how to regulate this process. There is no fee to exchange. Freddie Mac will compensate investors for the 10 days' payment difference (exchange of a 45-day Participation Certificate to a 55-day UMBS). Freddie Mac plans to announce the schedule for mirror issuance in Q1 2018, and will then issue the eligible mirror securities later in the year. Freddie Mac is still awaiting IRS and SEC rulings on Single Security-related items, including the exchange.

Servicers and sellers will need to make minor changes when dealing with Freddie Mac to incorporate the new 10-year product, as well as new labeling/prefix changes. Freddie Mac will engage with these groups to ensure they understand the plan for the changes internally and with upstream software and data providers. Freddie Mac is also encouraging data vendors to get ready in advance of Q2 2019 and to help their customers get ready. Fannie Mae will not have any changes for seller and servicers.

Freddie Mac recently completed a number of investor visits in Asia. These investors raised some questions about exchanges, and asked for coordinated outreach to their (US-based) custodians. A suggestion was made to provide documentation beyond English to better equip foreign investors. Since investors are geographically dispersed additional coordination assistance is needed.

There are still a few pending questions that will need to be resolved around exchange, including the previously mentioned IRS tax treatment guidance. FHFA and the Enterprises are also looking for IRS guidance on 817(H), the diversification requirements for insurance companies.
Freddie Mac mentioned that the Enterprises expect to receive a reply from the SEC soon on accounting treatment for the exchange.

Open Discussion – Feedback on CSP/SS Update, Industry Testing, General Comments and Questions

During the open discussion, several additional points were brought up by the IAG members. The first topic was on the decision to have Fannie Mae 'go-live' on the Common Securitization Platform at the same time as the UMBS "go-live." FHFA and the Enterprises reminded the members that there will be a long period of parallel testing before the go-live, and since Fannie Mae MBS are essentially the new UMBS market on Day 1, there is really no difference in the implementations.

Additional concerns were raised on the amount of time needed for the market to review and potentially revise credit and concentration limits. The point was raised that internal concentration limits may be more of a concern for the industry, rather than what is included in industry guidelines and regulations. Companies will need to look at internal documents and determine if there are any necessary changes needed for internal guidance.

SIFMA has conducted a call to probe how companies are doing in their outreach efforts. Additionally, SIFMA is working to get to a standardized approach for how changes will be made and rolled out. Through SIFMA's outreach, they have gauged that the market is aware but not really moving on assessments. This is one of the reasons why the Enterprises have brought in EY to assist with Market Readiness and adoption.

Next Steps, Next Meeting and Adjourn

Fannie Mae closed the meeting, reminding members to provide feedback to Fannie Mae, Freddie Mac and FHFA on stakeholders that should be included in Market Readiness and any further questions the audience may have regarding CSP or the Single Security Initiative. Additionally, Fannie Mae suggested that the IAG meeting structure may be reformatted going into 2018. The objective of a changed format for the meeting would be to have more targeted discussions with each sector separately.