



AN UPDATE

ON IMPLEMENTATION OF THE SINGLE SECURITY AND THE COMMON
SECURITIZATION PLATFORM

March 2017



Division of Conservatorship

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Background

The Federal Housing Finance Agency's (FHFA) *2014 Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac* includes the strategic goal of developing a new securitization infrastructure for Fannie Mae and Freddie Mac (the Enterprises) for mortgage loans backed by 1- to 4-unit (single-family) properties. To achieve that strategic goal, the Enterprises, under FHFA's direction and guidance, have formed a joint venture, Common Securitization Solutions (CSS). CSS's mandate is to develop and operate a Common Securitization Platform (CSP or platform) that will support the Enterprises' single-family mortgage securitization activities, including the issuance by both Enterprises of a common single mortgage-backed security (to be called the Uniform Mortgage-Backed Security or UMBS). These securities will finance the same types of fixed-rate mortgages that currently back Enterprise-guaranteed securities eligible for delivery into the "To-Be-Announced" (TBA) market. CSS is also mandated to develop the platform in a way that will allow for the integration of additional market participants in the future.

The development of and transition to the new UMBS constitute the Single Security Initiative. FHFA has two principal objectives in undertaking this initiative. The first objective is to establish a single, liquid market for the mortgage-backed securities issued by both Enterprises that are backed by fixed-rate loans. The second objective is to maintain the liquidity of this market over time. Achievement of these objectives would further FHFA's statutory obligation and the Enterprises' charter obligations to ensure the liquidity of the nation's housing finance markets. The Single Security Initiative should also reduce the cost to Freddie Mac and taxpayers that has resulted from the historical difference in the liquidity of Fannie Mae's Mortgage-Backed Securities (MBS) and Freddie Mac's Participation Certificates (PCs).¹

FHFA, the Enterprises, and CSS are committed to developing the Single Security Initiative and the CSP in a transparent manner. This commitment includes the regular release by FHFA of public updates to provide information to, and solicit feedback from, policymakers, market participants, and the public. In one of those updates, *An Update on the Common Securitization Platform* (September 2015), FHFA announced a two-part release process for the CSP and Single Security Initiative. Release 1 implements the CSP for Freddie Mac's existing single-class securities. Release 2 will implement the CSP with respect to the issuance of UMBS by both

¹ MBS may also refer to mortgage-backed securities more generally, including PCs, Giants, and UMBS issued by Freddie Mac and MBS, Megas, and UMBS issued by Fannie Mae.



Enterprises. This *Update* reiterates our commitment to transparency by addressing topics that stakeholders have indicated are important to the industry and policymakers:

- The implementation of Release 1 of the CSP;
- The planned implementation timeframe for Release 2 of the CSP, which will coincide with trading in and issuance of UMBS and related resecuritizations;²
- Milestones that the Enterprises and CSS have achieved since the July 2016 *Update on Implementation of the Single Security and the Common Securitization Platform* (July 2016 Update) and that are integral to implementation of Releases 1 and 2 of the CSP and the implementation of the Single Security Initiative;
- The steps FHFA will take to review potential changes to Enterprise programs, policies, and practices, and to monitor and address any corresponding effects on the prepayment speeds and relative pricing of the Enterprises' mortgage-backed securities; and
- The costs of building and running the CSP.

Progress in the Development of the Single Security and CSP

I. Release 1 Has Been Implemented

In July 2016, FHFA released an *Update on Implementation of the Single Security and the Common Securitization Platform* (July 2016 Update) and *Timeline*, which reiterated FHFA's commitment to implement Release 1 in 2016. As previously announced, CSS and Freddie Mac successfully implemented Release 1 on November 21, 2016.³ The implementation involved moving certain back-office operations of Freddie Mac to CSS and the CSP. With the implementation of Release 1, Freddie Mac is now using the CSS modules for Data Acceptance, Issuance Support, and Bond Administration activities related to Freddie Mac's current single-class, fixed-rate securities — PCs and Giants — and for certain activities related to the underlying mortgage loans such as tracking unpaid principal balances. The implementation of Release 1 marks the start of CSS's transition from its role as a software development joint venture to one also focused on supporting the mortgage securitization processes of the Enterprises.

² For brevity hereafter and unless otherwise noted, UMBS will be used to refer to the Uniform Mortgage-Backed Securities themselves and to both single- and multi-class resecuritizations thereof.

³ See *FHFA Announces Successful Implementation of Release 1 of the Common Securitization Platform*.



Release 1 does not affect Fannie Mae or the nature of the mortgage-backed securities issued by either Enterprise, nor is it directly associated with issuance of UMBS, which will happen with Release 2. The implementation of Release 1 has achieved a seamless transition of operational responsibilities for the monthly issuance and settlement of mortgage-backed securities backed by 10-, 15-, 20-, and 30-year fixed-rate loans and for the computation of the monthly pool and bond factors⁴ for Freddie Mac's PCs and Giants.

The implementation of Release 1 demonstrates that the system, operations, and controls of CSS and the CSP are functional. This should provide greater assurance to market participants and policymakers that Release 2 will be successfully implemented. Just as Release 1 was a large and complex undertaking, Release 2 will be as well. In fact, Release 2 will entail additional complexity and challenges in that it will require close coordination with many market participants and vendors, as well as close attention to software development and back-office operations.

II. Announcement of the Timeframe for Release 2 Implementation

FHFA plans implementation of Release 2 and the introduction of the Single Security during the second quarter of 2019. FHFA's *2016 Scorecard for Fannie Mae, Freddie Mac and Common Securitization Solutions* called for the Enterprises and CSS to publish a timeframe for implementing the Single Security Initiative on the CSP in 2016 and anticipated that implementation would occur in 2018. After the successful implementation of Release 1, CSS and the Enterprises undertook an extensive review of lessons learned and progress on Release 2. As a result of that review, the anticipated implementation timeframe for Release 2 has been delayed from 2018 to the second quarter of 2019. The drivers of this anticipated implementation date include the demonstrated need for additional time for the development, testing, validation of controls, and governance processes necessary to have the highest level of confidence that the implementation will be both smooth and successful.

Release 2 will allow both Enterprises to use the Data Acceptance, Issuance Support, Disclosure, and Bond Administration modules of the CSP. The Enterprises will use those modules to perform activities related to their outstanding fixed-rate, single- and multi-class mortgage-backed securities, including the new UMBS and single- and multi-class resecuritizations of UMBS.

⁴ Release of pool and bond factors to the market enables investors to calculate the principal and interest payments they expect to receive on mortgage securities they own. The pool factor for an MBS or PC is a fraction equal to the remaining security-level principal balance at the end of the previous reporting period divided by the original security-level principal balance. The bond factor for a resecuritization is comparable to the pool factor for an MBS or PC except that the remaining security-level principal balance used to calculate a bond factor reflects the cumulative distribution of the underlying securities, not the underlying mortgage loans.



Single-class resecuritizations of UMBS (to be known as Supers) will be analogous to Fannie Mae Megas and Freddie Mac Giants, which are respectively single-class resecuritizations of Fannie Mae MBS and Freddie Mac PCs. Multi-class resecuritizations will include tranching securities such as collateralized mortgage obligations (CMOs) and real estate mortgage investment conduits (REMICs). Such resecuritizations may commingle UMBS or Supers originally issued by both Fannie Mae and Freddie Mac. The CSP modules will also be used to perform activities related to the loans underlying those securities. Additionally, Release 2 will allow the Enterprises to use CSS and the CSP to issue and administer certain non-TBA securities, including securities backed by adjustable-rate mortgages.

FHFA and the Enterprises recognize that successful implementation of Release 2 and the transition of the TBA market to trading UMBS and Supers requires planning, investment, and work on the part of many market participants. The announcement in this *Update* of the planned timeframe for implementation of Release 2 provides market participants with more than 24 months' advance notice and is intended to facilitate further engagement on the part of market participants in the transition to UMBS. Implementation of the Single Security Initiative involves a range of readiness activities for lenders, investors, dealers, system and software vendors, data providers, and key infrastructure providers. As with the Enterprises, all of these market participants will have to develop project plans, manage and test operational changes, implement new technologies or changes to existing technology, update legal agreements, and establish appropriate controls. In addition, some firms may need to consider accounting, tax, legal and other implications of the changed market. As requested in feedback received from many industry participants, this announcement provides much more advance notice than the 12 months' notice FHFA committed to in our original plan for the industry to undertake required readiness activities.

FHFA and the Enterprises will continue to work closely with market participants to ensure that implementation of Release 2 and the transition to UMBS proceed smoothly. The timing of some of the interim milestones may change given the multi-year nature of this initiative, the complexity of Release 2, and the need for coordination among the Enterprises, CSS, third-party suppliers, and other market participants; however, we have high confidence in the second quarter implementation timeframe for Release 2.

III. Other Important Milestones Have Been Successfully Reached

In conjunction with the publication of the *July 2016 Update*, FHFA published a *Timeline* of achieved and expected CSP and Single Security Initiative milestones. Since the *Timeline* was published, several additional milestones have been reached.



- ✓ In July 2016, Fannie Mae and Freddie Mac published final features and disclosures for Release 2.⁵ The features announced in May 2015 by FHFA⁶ were adopted as final without change by the Enterprises. UMBS will have the same features as the current Fannie Mae MBS, with Freddie Mac adopting the same prefixes for TBA securities and the same 55-day payment delay. The Enterprises also agreed upon an enhanced set of disclosures that incorporates market standards and promotes liquidity in the TBA market. The final disclosures related to UMBS were modified from those published in May 2015 by FHFA⁷ to minimize the likelihood of the disclosed data being used to identify individual borrowers.
- ✓ In July 2016, Freddie Mac and CSS also successfully completed end-to-end testing for Release 1. End-to-end testing ensures that the business processes and applications are performing as designed from start to finish and that information flows between system components as intended. CSS and Freddie Mac completed testing of all business scenarios that are currently used as part of Release 1. This testing proved the ability of CSS and Freddie Mac to perform simultaneously the business processes necessary for Freddie Mac to use the platform for its fixed-rate, single-class securities and included the related systems and processes of CSS's bank agent (J.P. Morgan Chase) and the Federal Reserve Bank of New York.
- ✓ In October 2016, Freddie Mac published an update to the market on its legacy securities exchange program, including information on the process to exchange existing Freddie Mac securities for the new UMBS and the approach planned to compensate current securities holders for 10 days of lost interest income ("float").⁸
- ✓ In November 2016, Freddie Mac and CSS successfully completed operational and production readiness activities needed for Release 1. CSS finalized its internal business processes needed to run the CSP's Data Acceptance, Issuance Support, and Bond Administration modules and support the fixed-rate, single-class securitization activities of Freddie Mac under Release 1. CSS also established workflows, policies, procedures, controls, and service level agreements supporting those business processes.
- ✓ In November 2016, Freddie Mac and CSS successfully completed parallel testing for Release 1. Parallel processing tests whether the same inputs in two different systems produce the same output. CSS and Freddie Mac ran the CSP and Freddie Mac's existing production systems in parallel to ensure that each system produced the same results for

⁵ The final features and disclosures may be found on Fannie Mae's website [here](#) and on Freddie Mac's website [here](#).

⁶ See *An Update on the Structure of the Single Security*, May 15, 2015, Appendix A.

⁷ See *An Update on the Structure of the Single Security*, May 15, 2015, Appendix C.

⁸ The update may be found on Freddie Mac's website [here](#).



Freddie Mac's current fixed-rate, single-class securities. This testing also included the related systems and processes of CSS's bank agent and the Federal Reserve Bank of New York.

- ✓ In November 2016, Freddie Mac and Fannie Mae jointly published updated disclosure specifications for the Single Security Initiative, which included for the first time multi-class specifications and sample files for all disclosures.⁹

The Appendix A summarizes upcoming milestones for Release 2.

Alignment Actions

Some industry stakeholders have expressed concerns about the possibility that prepayment rates of the Enterprises' securities might diverge and undermine the fungibility of Fannie Mae and Freddie Mac UMBS and Supers. This fungibility is central to the success of the Single Security Initiative at broadening and enhancing the liquidity of the secondary mortgage market on an ongoing basis. Such a divergence could occur if Enterprise policies, programs, and practices that significantly affect prepayments are not aligned.

Our *July 2016 Update* described specific steps FHFA planned to take and steps it would require the Enterprises to take to ensure the continued consistency of prepayment speeds across the Enterprises' mortgage-backed securities. The *July 2016 Update* indicated that each Enterprise would be required to submit for FHFA review any proposed changes that the Enterprise believed could have a measureable effect on the prepayment rates and performance of TBA-eligible securities, including its analysis of any effects on prepayment speeds and/or removals of delinquent mortgage loans from securities under a range of scenarios. In addition, FHFA committed to monitor Enterprise programs, policies, and practices that are initially determined to have no significant effect on prepayment rates or security performance and work with the Enterprises to address any unexpected effects as they arise.

To support the implementation of these changes, FHFA has established an internal Single Security Governance Committee (SSGC) composed of FHFA executives with legal, policy, and conservatorship responsibilities. The SSGC will monitor issuance and prepayment performance of Fannie Mae's and Freddie Mac's mortgage-backed securities and take appropriate steps to address price differences, if they arise, between the two Enterprises' mortgage-backed securities.

⁹ The multiclass disclosure specifications may be found on Fannie Mae's website [here](#) and on Freddie Mac's website [here](#).



More specifically, the SSGC will monitor factors that affect the cash flows of each Enterprise's mortgage-backed securities, such as the attributes of underlying loans, and programs, policies, and practices with respect to loan origination or the creation and management of mortgage-backed securities. The SSGC will also monitor the prepayment experience of similar bond cohorts for divergence in prepayment speeds. If a significant divergence arises, the SSGC will research the causes by reviewing differences in the underlying loan attributes, programs, policies, and practices, or other potential drivers and will review and assess any likely or actual effect of changes in Enterprise policies. Finally, the SSGC will review and monitor the liquidity of each Enterprise's mortgage-backed securities and of the TBA market to identify any unusual or anomalous patterns. FHFA will work with the Enterprises to appropriately address any significant items that arise.

Costs Related to the CSP

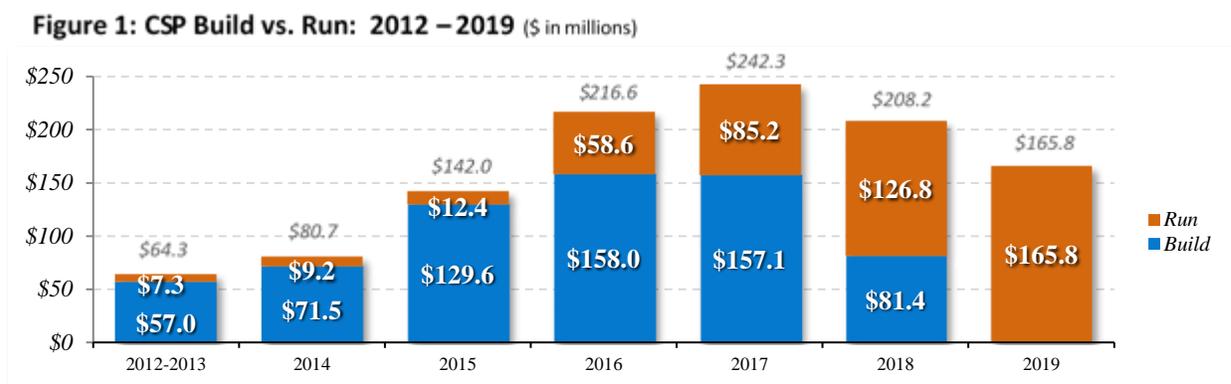
As we have consistently indicated, development of the CSP, which will make possible the issuance of a common single-class mortgage-backed security by the Enterprises, is a multi-year project that requires significant resources. Between February 21, 2012, when the CSP project was first announced by FHFA, and the end of 2016, the Enterprises invested \$454 million to develop the CSP and organize and initiate CSS operations.¹⁰ To initiate its operations, CSS needed to establish its corporate functions, including corporate finance, enterprise risk management, information security, human resource management, and internal audit. In addition, CSS had to establish an out-of-region operations center and develop and test its business continuity and disaster recovery plans. Each Enterprise has disclosed its half of investments in CSS as part of its administrative expenses in its annual (10-K) and quarterly (10-Q) reports filed with the SEC. These investments enabled CSS expenditures to finance the creation of detailed functional requirements for the CSP, the architectural design of the application, development and testing of the software, the creation of an independent information technology environment

¹⁰ The \$454 million invested by the Enterprises through December 31, 2016 includes amounts invested by the Enterprises prior to the execution of a cost sharing agreement in November 2014 and capital contributions since execution of the cost sharing agreement. Figure 1 shows total costs incurred by CSS through 2016 and projected by CSS from 2017 through 2019. Through 2016, those costs total \$503.6 million. The difference between the total investment reported by the Enterprises and the total costs arises from (1) timing differences between when costs are incurred by CSS and when those costs are expensed by the Enterprises and (2) amounts invested by the Enterprises prior to the execution of the cost sharing agreement. In addition, these costs do not include costs associated with adapting the Enterprises' existing information technology platforms and operations to integrate with the CSP and with the Enterprises' issuance of UMBS. Those costs are separately disclosed as part of the administrative expenses in the Enterprises' 10-Ks and 10-Qs.



within CSS to support software development and testing, development of CSS's business and operational capabilities, and the operations of CSS. CSS and the Enterprises project additional CSP build and run costs of \$616.3 million between 2017 and the end of 2019. While FHFA considers these costs projections to be reasonably reliable, the scope and complexity of building the CSP make it difficult to project costs precisely. The Enterprises will continue to publicly disclose those costs in their SEC filings as they are incurred.

Figure 1 provides further information on costs incurred by CSS through 2016 and projected by CSS from 2017 through 2019. CSS splits its activities between "build" and "run." Build relates to the development and testing activities undertaken by CSS to enable the Enterprises to use the CSP and the related infrastructure and operational processes. Run relates to the activities undertaken by CSS to run the CSP and related processes for the Enterprises and to operate CSS as a stand-alone business, including the ongoing support for the platform software and hardware in production, operation of securitization business processes, regular business continuity and disaster recovery testing, and ongoing implementation of CSS corporate functions. The run costs for 2019 include costs related to the completion of Release 2 operational and control testing and parallel processing and do not represent CSS's ongoing run costs.



The following considerations help put the above cost and budget information in perspective:

- Upon the implementation of Release 2, CSS will be responsible for bond administration of approximately 900,000 securities, which are backed by almost 26 million home loans having a principal balance of over \$4 trillion. CSS's responsibilities related to security issuance, security settlement, bond administration and disclosures were described in the September 2015 *Update on the Common Securitization Platform*. The Enterprises and investors, along with home owners and taxpayers, will rely on the operational integrity and resiliency of the CSP to ensure the smooth functioning of the U.S. housing mortgage market.
- Many of these expenses would have been incurred regardless of whether development of

the CSP had been undertaken because of the need for the Enterprises to update their respective single-family securitization infrastructures.

- A key goal of the Single Security Initiative, made possible by the Enterprises investing in the CSP and CSS, is to reduce the costs to Freddie Mac and taxpayers that result from the persistent difference in the liquidity of Fannie Mae MBS and Freddie Mac PCs. This persistent difference in liquidity has imposed significant annual costs on Freddie Mac, and ultimately on taxpayers, because it lowers the amounts available for dividend payments by Freddie Mac to the U.S. Department of the Treasury under the Senior Preferred Stock Purchase Agreement.¹¹ Eliminating this difference by issuance of the new UMBS by both Enterprises should over time recoup most, if not all, of the cost to the Enterprises of building the CSP and CSS.¹²

Conclusion

FHFA and the Enterprises believe that the activities and processes described above will help achieve the key goals and objectives of the Single Security Initiative, including maintaining a broader, more liquid secondary mortgage market over time. FHFA welcomes public input on this Update from interested parties. Feedback can be [submitted electronically](#) via FHFA.gov, or to the Federal Housing Finance Agency, Office of Strategic Initiatives, 400 7th Street, S.W., Washington, DC 20219. All pertinent submissions received will be made public and posted without redaction to FHFA's website.

¹¹ See the FHFA webpage on [Senior Preferred Stock Purchase Agreements](#).

¹² Publicly available estimates of these savings have ranged from \$400 million to \$600 million per year.



Appendix A—Release 2 Upcoming Milestones

Application Development for Release 2 (Expected to be completed in 2017).

CSS will complete the development and internal testing of the platform functionality of Release 2 not included in Release 1. Further development and internal testing of the platform will occur as Enterprise and tri-party testing for Release 2 occurs.

System-to-System Testing for Release 2 (Expected to be completed in 2017).

CSS and the Enterprises will complete joint system-to-system testing of the functionality of the CSP's Data Acceptance, Issuance Support, Disclosure, and Bond Administration modules that will support the Enterprises' current fixed-rate securities, both single- and multi-class; the issuance of UMBS, including commingled resecuritizations and activities related to the underlying loans. CSS and the Enterprises will also complete joint system-to-system testing of the functionality of the Issuance Support and Bond Administration modules that support non-TBA mortgage securities, including those backed by adjustable-rate loans. The testing will encompass transactions that have complexity that is comparable to, and transaction volumes that exceed those of, each Enterprise's current book of business.

Pre-Parallel Testing for Release 2 (Expected to be completed in 2018). CSS and the Enterprises will test the functional performance of the CSP to ensure that computations are accurate and consistent, convert large amounts of loan and security data to the CSP, and test performance to ensure that the CSP has the capacity to meet peak or unexpected processing demands within acceptable timeframes. CSS will also test both business continuity and disaster recovery capabilities and controls associated with the CSP.

Operational and Production Readiness for Release 2 (Expected to be completed in 2Q 2019). CSS will complete the building and testing of the internal business processes it needs to support both Enterprises' securitization activities under Release 2. These include the processes needed to run the CSP's Data Acceptance, Issuance Support, Disclosure, and Bond Administration modules as well as the processes needed to support the Enterprises' current fixed-rate securities, both single- and multi-class, and certain non-TBA mortgage securities; their issuance of UMBS, including commingled resecuritizations; and certain of their activities related to the underlying loans. These business processes will include workflows, policies, procedures, controls, and service level agreements.

Parallel Testing for Release 2 (Expected to be completed in 2Q 2019). CSS and the Enterprises will run the CSP and the Enterprises' existing production systems in parallel to ensure that each system produces the expected results for securitization activities supported by Release 2.

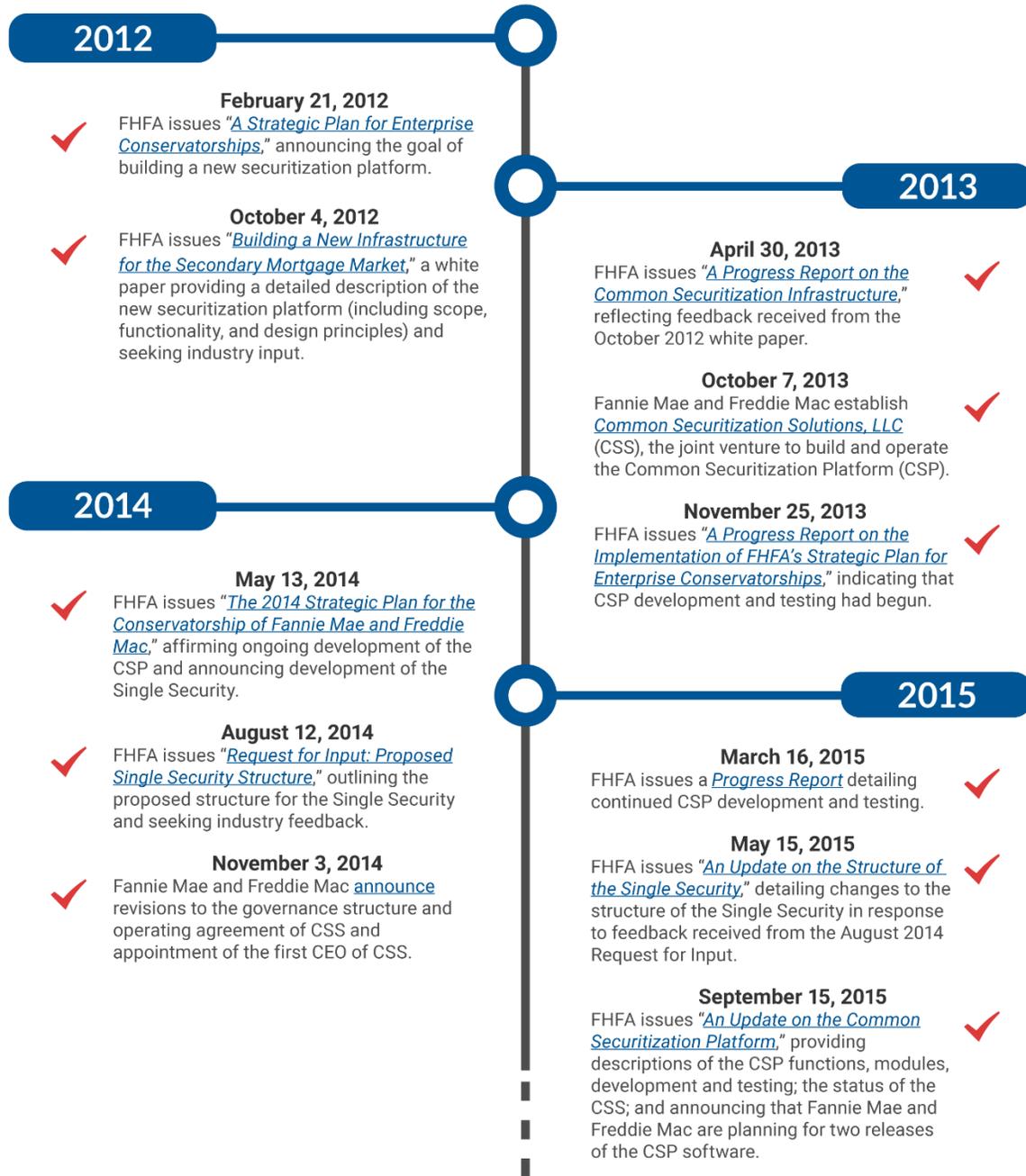


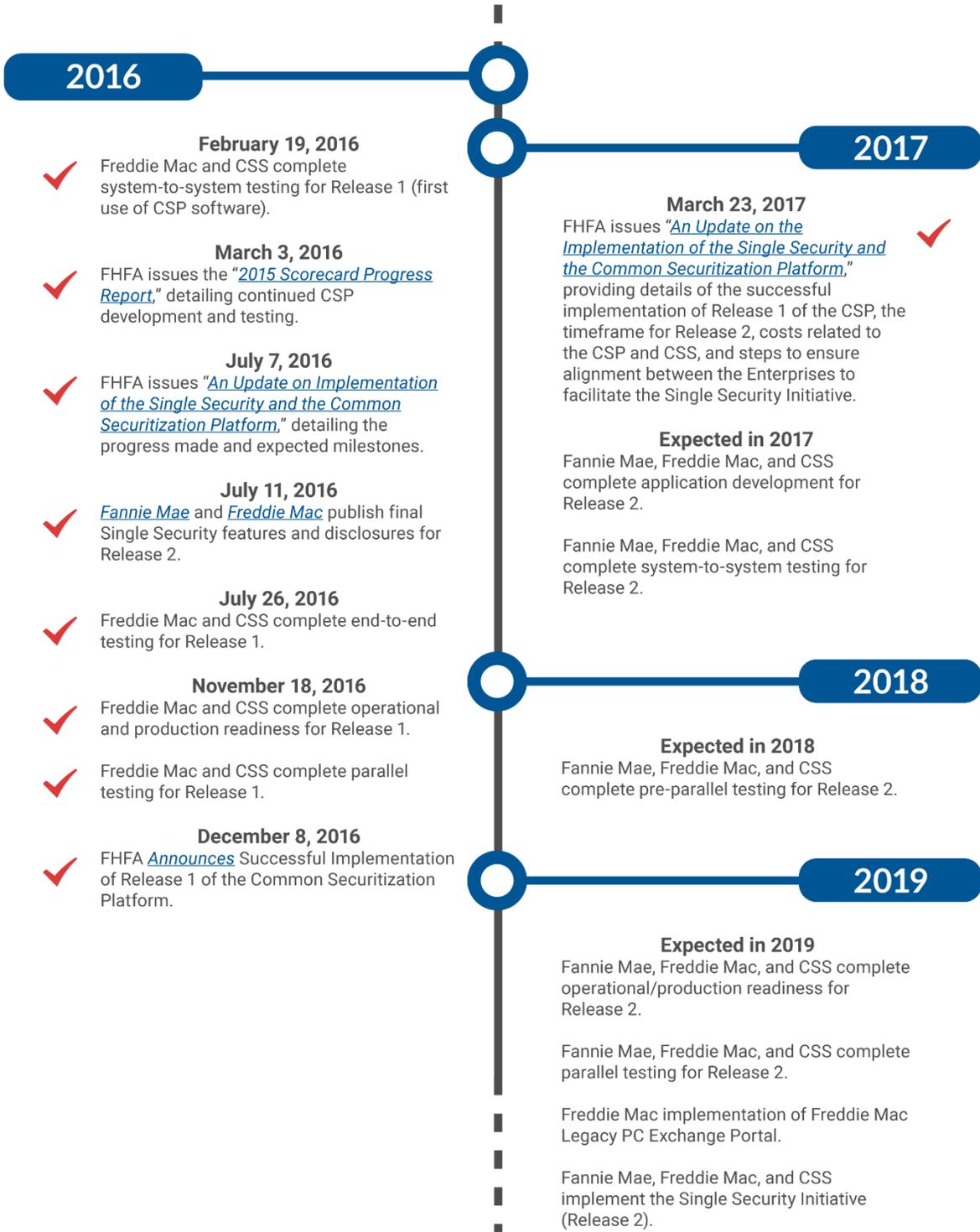
Implementation of Legacy PC Exchange Portal (Expected in 2Q 2019). Freddie Mac will implement the portal through which security dealers can exchange legacy PCs for comparable Freddie Mac-issued UMBS backed by the same pools of mortgage loans. Prior to the implementation of the Exchange Portal, Freddie Mac will announce a schedule of the fees that will be paid to owners of exchanged legacy PCs to compensate for the change in the payment delay from 45 days to 55 days.

Release 2 Implementation (Expected in 2Q 2019). Implementation of the Single Security Initiative will coincide with Release 2 implementation, which will include both Enterprises sharing the same security structure for both single and multiclass securities and both utilizing the CSP's Data Acceptance, Issuance Support, Disclosure, and Bond Administration modules.



Appendix B—CSP / Single Security Initiative Timeline





As of March 23, 2017

