BAML | Barclays | Citi | CS | Deutsche | JPM | MS | Nomura | Wells | BNP Paribas

**Takeaways:**

1. **Wells on GSEs vs. GNMA: are checks and balances different?** Wells looked into the growth of cash window program, the associated challenge of faster speeds of non-bank lenders and a significant increase in responsibilities and complexity of GSEs' business. Wells believes that although the cash window speeds are faster than non-cash window pools, the differential in speed is modest and GSEs tend to monitor extremely high speeds and have enforcement tools at their disposal. In contrast, the GNMA program lacks any meaningful checks and balances to prevent the aggressive behavior of lenders.
2. **MS - Common securitization platform and single security (SS): where we stand:** MS took a view on most pressing industry concerns that need further clarification – what the mortgage benchmark will look like and how the securities will be priced. MS thinks the benchmark will likely be constructed on a balance-weighted basis as before, with an additional security type. From a general pricing perspective, the size of the float will grow, worsening the TBA deliverable and weakening rolls, cheapening up mortgages. This may make specified pools better bid.
3. **JPM - Fannie starts securitizing reperforming loans:** The first sizable securitizations occurred in July, with the creation of $336mm of R3 pools (reinstated or "non-modified reperforming" 30yr loans). Currently, Freddie's M/H/R pools have only appeared in the market as CMO collateral, but Fannie has expressed goals to support and develop a pools market.

**JP Morgan:**

1. **Basis:** JPM is modestly negative on the basis, mainly owning to valuations, but recognize that carry is powerful driver in the current environment, attracting sponsorship.
2. **Money market reform and CMO floaters:** As we approach October 14th, the date money market reform goes into effect, JPM expects LIBOR to drift higher, and this could at the margin benefit floating rate assets, including CMO floaters.
   a. LIBOR has surged over the past month – 6-month and 12-month LIBOR have risen by 20-25bp over the past month, causing LIBOR curve to steepen. Several factors have contributed to the increase.
      i. First, money market reform has caused money market funds to shorten the maturity of their assets and significantly increase their liquidity.
      ii. Second, uncertainty in the future of LIBOR (or its replacement) has risen recently, and is most impactful on longer maturities.
      iii. Finally, LCR has pushed banks to term out their liabilities, bringing more supply to longer maturities just as demand is shifting shorter.
   b. Investors who are looking for short duration assets may, at the margin, opt for floaters rather than short fixed rate CMOs, owning to the upward pressure on LIBOR going forward.

3. **Money market reform and agency repo:** Regulations have pushed money market investors into government funds, and thus far, agency repo has benefited on a relative basis. JPM doesn't see a huge impact of the money market reform on the mortgage market, specifically in terms of repo.

4. **FNCI 3.5s: tainted TBA float:** Short WAM 10-yr pools have tainted premium coupon 15-yr TBA deliverable. Given the poor deliverable, investors would be well served by avoiding taking delivery and instead rolling their positions. Alternatively, investors can stipulate no 10-yr delivery for a couple of ticks, or look for low pay-up pools.

    a. This year, in terms of price, the 15-yr coupon stack has become extremely inverted in higher coupons. (inverted = price of FNCI 4s and 4.5s is lower than FNCI 3.5s)

        i. Compared to early 2015 when rates were at similar levels, 15-yr super premium coupons are about three points lower in price, while FNCI 2.5s and 3s are more or less in line.

    b. The deliverable in high coupon 15-yr has been "polluted" by short WAM pools. As 10yr pools are deliverable into the 15yr TBA, 10yr pools with more than five years of seasoning frequently come through the box.

        i. Over the past six months, short WAM 10-yr fluctuated from 20-30% of the deliverable to over 70% in some months.

    c. The only avenue to clean up the float would be for a non-rolling account (such as the Fed) to start buying the 3.5 coupon.

        i. Unfortunately, the Fed's purchases generally focus on production coupons. Mortgage rates may have to rise substantially before the Fed can get involved.

5. **Who gets the best rates?** TBA prices are the prime determinant of primary mortgage rates. Still, the variation in the primary/secondary spread give originators a bit of discretion over what rates they want to offer. JPM breaks out primary mortgage rates by product, purpose, loan size, and originator type.

    a. At a high level, primary rate pricing is, of course, tied to the execution available in the secondary market. Originators need to sell into forward contract, so TBA prices are the prime determinant of primary mortgage rates.

        i. GN/FN swaps modulate the differences in rates offered to conventional vs. Ginnie borrowers (and recently that's meant lower FHA and VA rates).

    b. Still, the variation in the primary/secondary spread give originators a bit of discretion over what rates they want to offer.

    c. The primary mortgage rate varies by product types (conv./FHA/VA), loan purpose (purchase/refi), originator types (Tier 1 banks, regionals, non-banks) and loan size (jumbo/large but not jumbo, etc.).

    d. **Product types:** Conventional loans tend to have higher rates than FHA loans, which in turn have higher rates than VA loans. The better pricing on Ginnies contributes to this behavior.

e. **Loan purpose:** Within conventional loans, purchase loans tend to have lower rates than refis, but the inverse has been true for much of the past year for FHA and VA loans.

f. **Originator type:** In general, it appears that Tier 1 banks offer the best purchase rate, regionals are close to average, and non-banks offer somewhat higher levels. In refis. Regionals offer the lowest average rates, while Tier 1 and non-bank rate oscillate in the average to slightly above average range.

g. **Loan size:** The best rates are given to borrowers with loans that are large but not jumbo (300-417k range); 100-200k loans face rate around an eighth higher and sub-100k loans pay almost a quarter point more in rate.

6. **Fannie starts securitizing reperforming loans:** The first sizable securitizations occurred in July, with the creation of $336mm of R3 pools (reinstated or "non-modified reperforming" 30yr loans). Currently, Freddie's M/H/R pools have only appeared in the market as CMO collateral, but Fannie has expressed goals to support and develop a pools market.

    a. Fannie also securitized a negligible amount of "I" series (fixed rate mods) and "U series" (step-up rate mods).

    b. All the R3 pools are heavily seasoned, with most originally coming from the '05 and '06 vintages, and have dented FICOs due to their prior defaults. In addition, a few of the new pools are based on loan balance collateral.

    c. One way to predict performance on these new Fannie R3 securitizations is to look at the Freddie R0 pools, issued starting in 2011.

        i. Additionally, Fannie Mae has released historical performance data on a portion of their loans that have been modified due to delinquency, and this information release should provide another avenue to explore reperformer performance and to calibrate models.

**BAML:**

1. **Basis:** stay overweight. MBS continue to appear attractive when compared to other risk assets from corporates to DUS MBS, and have even lagged the upswing in the bank stock index.

2. **A fresh look at what drives the primary rate:** BAML took a deeper dive into primary/secondary spread dynamics, comparing the sensitivity in low versus high rate environments. BAML made the case that the duration, is higher in low rates and vice versa. This makes the mortgage rate stickier when rates are low like today.

    a. It insulates 3s from coming into the money barring a massive rally and likely to keep 3.5s in the refi window even in a moderate selloff.

    b. A threshold low in primary/secondary spread, of 95bps, is determined by ample capacity, competition for borrowers, and a soft floor set by the origination costs and g-fee.

c. As rates rally and new borrowers enter the refi window, capacity constrains rise, margin widen, and spreads become ever more sensitive to rates with originators attempting to modulate volumes by dynamically adjusting margins.

3. **Evidence of any lasting TRID impact on primary/secondary spreads is lacking:** The typical argument is intuitive: TRID compliance should raise costs for originators, and therefore borrowers. Hence, there is some expectation of permanently wider primary/secondary spreads. Despite this, and some anecdotal evidence of higher costs, no impact has been observed to-date.

    a. Closing times increased briefly while originators struggled with the initial implementation of TRID, but have retraced lower since.

    b. The lack of observable TRID impact could be due to a couple of factors.

        i. First, it could simply be that the bulk of TRID compliance costs was realized upfront by originators.

        ii. Second, it could be that TRID costs are being offset by more efficient processes elsewhere.

        iii. Finally, it could be that the impact is simply small – on the order of a couple of basis points.

    c. From a modeling perspective increasing primary/secondary spreads due to TRID is premature.

4. **LTV effect on seasoned bonds is flipped, high LTV convexity is worse than low LTV loans:** High LTV loans experienced muted refi speeds in early 2015. However, a robust pace of HPA and recent reductions in mortgage insurance rates has resulted in high LTV loans exhibiting worse prepay and convexity profiles than low LTV loans.

    a. New issue pool pricing is consistent with this, assigning little value above generic new issue levels for high-LTV paper.

5. **Fannie Mae announced expansion of the HomeReady program,** raising income limits to 100% of median regional income, and responding to lender inputs and requests. (pg.11)

**Citi:**

1. **Basis.** Moved to neutral from underweight as supportive technicals justify rich valuations. Overseas investors and money managers are likely to add MBS in the second half as they look attractively priced to alternative investments. Carry on MBS also remains very attractive.

2. **Technicals balanced in spite of rich valuations:** Citi presented a summary of how agency MBS holdings of various investors changed in the first half of the year along with updated supply/demand projections for 2016.

**Figure 8. Agency MBS holdings of various investors**

| | Historical Change | | | | | | | | Current Holdings (Jun-2016) | Projected Change | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 20161H | | Remainder of 2016 | Full Year 2016 |
| Gross supply | 1696 | 1349 | 1142 | 1661 | 1546 | 925 | 1250 | 719 | 5810 | 731 | 1450 |
| Chg in Outstanding Balance | 496 | (122) | 6 | 65 | 147 | 84 | 162 | 88 | | 137 | 225 |
| GSEs | (56) | (121) | (91) | (85) | (83) | (46) | (42) | (22) | 214 | 0 | (22) |
| FHLB | 8 | 4 | (1) | 0 | (19) | (2) | (6) | 0 | 79 | (5) | (5) |
| Federal Reserve | 910 | 92 | (154) | 93 | 556 | 241 | 15 | (1) | 1752 | 16 | 15 |
| Treasury | 131 | (47) | (118) | (26) | 0 | | | | | | 0 |
| Banks | 109 | 105 | 161 | 94 | (46) | 39 | 151 | 23 | 1581 | 52 | 75 |
| Foreign* | (20) | (39) | 1 | 6 | (53) | 44 | 30 | 55 | 796 | 45 | 100 |
| REITs | 16 | 38 | 105 | 109 | (88) | 9 | (50) | (5) | 222 | 0 | (5) |
| Others (M-mgrs, HFs, Insurance Companies, Dealers) | (601) | (154) | 103 | (126) | (120) | (200) | 64 | 39 | 1166 | 28 | 67 |

Source: Citi Research, Federal Reserve, Fannie Mae, Freddie Mac, FHLB, REITs filings, Fund filings, SNL, Yieldbook, 1010Data

3. **ARM refinancings contributing to fast G2 3.0 VA speeds:** VA speeds in 2015 G2 3.0s have outpaced conventionals by a wide margin recently and Citi believes that the fixed-to-ARM refinancings may be driving fast VA speeds for marginally in-the-money VA borrowers.
    a. G2 3s VA speeds reached 16 CPR in June, outpacing conventionals by a full 5 CPR. Sun West and Freedom VA loans paid close to 30 CPR in June.
        i. While investors may have grown used to high-flying VA speeds, a 30 VCPR print in GN 3.0s does beg the question – what are these borrowers refinancing into?
        ii. While other factors might be at play, there is some evidence suggesting that some of these borrowers could be refinancing into GN ARMs.
    b. Unlike conventional ARMs where 5/1s and 7/1s are the main products, GN ARMs are dominated by 3/1 and 5/1 hybrid loans that can provide even lower rates.
        i. In fact, close to 70% GN ARM loans are now issued in 3/1s – a product that provides the lowest possible initial rate in agency MBS.
        ii. A few originators dominate the issuance in 3/1 ARMs – 360 Mortgage, Sun West and Freedom.
        iii. The WAC on GN 3/1 ARM VA loans is less than 2.2%, 80bp lower than 5/1 ARMs. For a typical G2 3.0s borrower, a 2.2% mortgage rate can provide them more than 100bp incentive to refinance.
        iv. The large incentive provided by 3/1 ARMs may attract some cash-strapped or less risk-averse borrowers.

<u>**Nomura**</u>:

1. **Basis:** Nomura continues to suggest a neutral stance on the MBS basis at current spread levels.

2. **Freddie Mac's monthly volume summary:** Earlier this week, Freddie Mac released its monthly volume summary, which showed that their agency MBS holdings declined by only $6bn in 1H'16, although their total retained portfolio size declined by about $26bn.

    a. It appears that Freddie is relying more on declines in non-agency MBS and mortgage loan holdings than declines in its agency MBS holdings for meeting portfolio cap requirements.

3. **American Capital (AGNC) and Specified pools:** On Wednesday, AGNC reported that its holdings of agency MBS declined by $1bn to $57.7bn during 2016 Q2. One interesting change in the portfolio composition was an increase in the share of specified pools.

    a. The share of specified pools increased from 55% to 60% of the portfolio during 2016 Q2 (an increase of about $2-3bn).

    b. Weakness in the dollar roll market in 2016 and payup appreciation as rates rallied have resulted in increased investor demand for specified pools.

4. **Overseas investor demand and China:** From the overseas investor demand side, most of the positive net demand for MBS has been coming from Japan while China's holdings have been remaining nearly flat. Historically, the net annual overseas investor demand exceeded $40-50bn only when China was a significant net buyer.

5. Nomura took **a deep dive into the 15-yr MBS** and forecasted prepays under a rally scenario assuming 15-yr primary rate declines to 2.5%.

    a. Share of smaller lenders: Consistent with the trends observed in the broader Agency MBS market, the share of the nonbank lenders such as Quicken has increased. Among the larger lender, only Wells seems to have retained its share over the past 2.5 years.

**Fig. 7: Originator Distribution for Fannie 15-year Loans by Vintage**

| 2012 | | 2013 | | 2014 | | 2015 | | 2016 1H | |
|---|---|---|---|---|---|---|---|---|---|
| Servicer | Mkt Share (%) | Servicer | Mkt Share (%) | Servicer | Mkt Share (%) | Servicer | Mkt Share (%) | Servicer | Mkt Share (%) |
| Wells Fargo | 21.5% | Wells Fargo | 18.9% | Wells Fargo | 11.3% | Wells Fargo | 12.0% | Wells Fargo | 11.9% |
| Chase | 10.2% | Chase | 5.5% | Quicken | 8.8% | Quicken | 9.7% | Quicken | 9.0% |
| Flagstar | 4.1% | Quicken | 5.2% | Chase | 7.4% | Chase | 4.0% | Provident | 3.3% |
| Citi | 3.6% | Bank of America | 3.8% | Greentree | 5.1% | Suntrust | 3.8% | Chase | 3.3% |
| Quicken | 3.5% | Citi | 3.8% | Nationstar | 4.3% | Greentree | 3.1% | Suntrust | 3.3% |
| PHH | 3.1% | Suntrust | 2.5% | Flagstar | 2.8% | Nationstar | 2.7% | Greentree | 2.9% |
| Suntrust | 2.2% | Provident | 2.4% | Bank of America | 2.7% | Flagstar | 2.6% | Flagstar | 2.6% |
| Ally | 2.0% | Flagstar | 2.4% | Citi | 2.5% | Impac | 2.4% | United Shore | 2.1% |
| Bank of America | 2.0% | PHH | 2.2% | Suntrust | 2.4% | Citi | 2.2% | Nationstar | 1.8% |
| Chicago Mortgage | 1.9% | Greentree | 2.2% | Freedom | 1.6% | Freedom | 2.0% | Franklin American | 1.6% |
| Other | 45.9% | Other | 51.1% | Other | 51.0% | Other | 55.5% | Other | 58.2% |

Source: Fannie Mae, Nomura Securities International

6. **Update on Jumbo conforming pools:** Nomura reviewed recent issuance and prepay trends and compared current valuations in a historical context.

    a. About 70-75% of all jumbo pools are locked up in CMOs, generally structured as PACs. Banks have been the largest buyer of such securities given their higher yields.

    b. Issuance of conventional loans has decreased sharply from 2010-13 levels most likely due to banks retaining higher-quality jumbo loans.

c. Across conventional jumbo loans, the share of Big 4 banks has decreased to 25% in 2016 YTD from 49% in 2012; Wells' share went from 37% in 2012 to 10% 2016 YTD.

**Fig. 19: Top Originators, Fannie and Freddie Jumbo Loans**

| 2012 | | 2013 | | 2014 | | 2015 | | 2016 YTD | |
|---|---|---|---|---|---|---|---|---|---|
| Big4 | 49% | Big4 | 44% | Big4 | 22% | Big4 | 30% | Big4 | 25% |
| Bofa | 0% | Bofa | 1% | Bofa | 8% | Bofa | 7% | Bofa | 0% |
| Chase | 9% | Chase | 13% | Chase | 2% | Chase | 5% | Chase | 5% |
| Citi | 2% | Citi | 4% | Citi | 6% | Citi | 11% | Citi | 10% |
| Wells | 37% | Wells | 27% | Wells | 6% | Wells | 7% | Wells | 10% |
| Provident | 7% | Quicken | 8% | Quicken | 9% | USBank | 9% | Quicken | 6% |
| USBank | 6% | USBank | 7% | USBank | 8% | Nationstar | 6% | PlazaHome | 5% |
| Flagstar | 5% | Nationstar | 5% | Nationstar | 6% | LoanDepot | 5% | Pingora | 4% |
| Quicken | 5% | PennyMac | 4% | Caliber | 5% | Quicken | 4% | Flagstar | 4% |
| PennyMac | 3% | Prospect | 2% | Prospect | 5% | Flagstar | 4% | USBank | 4% |
| PNC | 1% | Provident | 2% | PlazaHome | 4% | Prospect | 3% | UnitedShore | 3% |
| Prospect | 1% | BBT | 2% | Flagstar | 4% | Caliber | 3% | BBT | 3% |
| FifthThird | 1% | FifthThird | 2% | Freedom | 4% | Stonegate | 3% | Stonegate | 2% |
| BBT | 1% | Stearns | 2% | Stearns | 3% | Pingora | 3% | Everbank | 2% |
| Others | 19% | Others | 22% | Others | 29% | Others | 30% | Others | 41% |

Source: Fannie Mae, Freddie Mac, Nomura Securities International

d. At current levels, CK 3.0 and 3.5s pay-ups look fair.

7. **Prepayment speed projections:** Nomura expects July aggregate conventional prepays to almost unchanged month over month, with the increase in refi activity offsetting a sharp drop in day count and a slight decline in turnover.

   a. Nomura expects the majority of prepay impact associated with the recent rally to show in August, with August prepays increasing 26% month-over-month.

**<u>Morgan Stanley:</u>**

1. **2016 supply-demand update:** MS update supply/demand forecast for 2016, increasing gross issuance by 10% to $1.43tn; net issuance forecast unchanged at $185bn.

2. **American Capital (AGNC) added mortgages in Q2:** AGNC added size in 2Q, increasing their position by $5.8bn 30-yr pools and $1.2bn 15-yr TBAs. This could be an indication that aggregate REIT demand could be net positive for the quarter.

3. **Common securitization platform and single security (SS): where we stand:** MS took a view on most pressing industry concerns that need further clarification – what the mortgage benchmark will look like and how the securities will be priced. MS thinks the benchmark will likely be constructed on a balance-weighted basis as before, with an additional security type. From a general pricing perspective, the size of the float will grow, worsening the TBA deliverable and weakening rolls, cheapening up mortgages. This may make specified pools better bid.

   MS looked at the most important CSP/SS issues below:

   a. **What will mortgage benchmark look like:** In the event that the CSP is rolled out in *parallel* at first, then the benchmark will likely just be constructed on a balance-weighted basis as before, with an additional security type.

i. If there is a more *instantaneous* switchover to a single TBA market, there will likely be a period where unconverted pools will receive their weighting in the index. This raises one or two practical problems:

1. It may be difficult to manage this benchmark without there being an FH TBA market, as benchmarked investors may have difficulty sourcing the 45-day Golds.

2. Another issue is one of diversity. There are certain investors that are required to have broad diversification across their portfolios. With SS, a dedicated mortgage benchmark might have over 70% of its holdings in the new SS, which may not pass guidelines and could prevent investors from actively trading GNMAs vs SS.

b. **What will happen to legacy securities?** Investors who exercise the conversion option on Freddie PC will be compensated for the difference in payment delay, and the exchange program will commence simultaneously to or before trading of the SS and will stay open indefinitely.

i. Legacy 45-day Gold securities will still be permitted to be created by Freddie in Gold Giant PCs and REMICs backed by 45-day Gold Giants and PCs.

c. **Will the policies and practices of each GSE be aligned?** Feedback from industry commenters suggested that policies affecting prepayments should be identical and competitiveness should rather be along the lines of customer service and product innovation. The FHFA agreed on aligning policies impacting prepayment speeds.

i. **Policies which will be aligned** – mortgage removal practices (repurchases and buy-backs).

ii. **Policies which will not be aligned:** Loan eligibility requirements (already consistent), servicer remittance (effect on prepayment speeds is minimal) and seller mix profiles (this would run counter to competitiveness between the agencies.

d. **What will the SS look like?** SS will have payment delays and pooling requirements modeled after Fannie securities (55-day payment delay). Disclosures will be taken from Freddie.

e. **How will re-securitization be treated?** The CSP will facilitate issuance of first- (single pool of mortgages) and second-level (analogous to Fannie Megas and Freddie Giants) SS.

i. Third-level securities such as REMICs/CMOs, which are multi-class, will be created as they currently are, with only difference being that will now include first- and second-level SS as collateral too.

ii. Further, the CSP will enable investors to commingle first- and second-level SS issued by both GSEs into second-level SS guaranteed by either GSE.

f. **How will the GSEs' single-family guarantee business be impacted, and what of counterparty risk?** The scope of the CSP was narrowed to only concern securitization activities -

Underwriting, servicing standards, loan sourcing, guaranteeing and execution of loan aggregation will all continue to be the responsibilities of each GSE individually.

i. The FHFA also recently decide not to adopt any cross-guarantee mechanism as this can be achieved by re-securitizing a first-level security from one GSE with the other.

ii. The counterparty risk investors are exposed to would be that of whichever enterprise issued the security.

g. **Will the rolling out of the CSP be immediate or sequential?** The FHFA prefers that the trading of the SS and issuance through the CSP being sooner rather than later, and altogether rather than in stages. Several responders to the initial proposal believe the risk of market disruption is too great.

**Wells Fargo:**

1. **Basis:** Overweight. Overseas MBS demand is a key reason for MBS overweight recommendation.

2. **GSEs vs. GNMA: are checks and balances different?** Wells looked into the growth of cash window program, the associated challenge of faster speeds of non-bank lenders and a significant increase in responsibilities and complexity of GSEs' business. Wells believes that although the cash window speeds are faster than non-cash window pools, the differential in speed is modest and GSEs tend to monitor extremely high speeds and have enforcement tools at their disposal. In contrast, the GNMA program lacks any meaningful checks and balances to prevent the aggressive behavior of lenders.

   a. **Changing landscape of the mortgage market:** Pre-crisis small originators primarily relied on U.S. banks as large aggregators to securitize their loans via the GSEs or GNMA.

      i. Under the new Basel 3 rules, banks are required to hold much higher capital against their servicing books. Banks started reducing the size of their MSR books and reduced their footprints in the correspondent lending and mortgage lending.

      ii. GSEs' cash window (CW) program became the program of choice for these lenders and is now responsible for close to 40% of all conventional fixed rate securitizations.

         1. The CW program effectively fulfills the role of the aggregator, and lenders benefit from fast turnaround in terms of receiving cash for the loans they sell.

         2. The CW program takes care of pipeline hedging for lenders who may lack the infrastructure.

         3. The program reduces the size of the warehouse line of credit that lenders need to run their business.

         4. Since GSEs are not allowed to retain servicing, to support lenders who do not have a capacity to retain servicing, GSEs also have flow agreements with some firms who are looking to acquire servicing.

iii. GNMA doesn’t offer anything similar to a cash window program and instead supports them via the G2 program. Also, non-bank aggregators play a bigger role in the GNMA market.

b. **Fragmentation in mortgage lending and increased GSE responsibilities:** The cash window program is highly fragmented and top 10 sellers account for only 23% of the volumes.

   i. Now that GNMA and GSEs deal with a lot more originators and servicers, the complexity of their business has increased significantly.

   ii. In case of GNMA, the primary focus is on ensuring the safety and soundness of the security issuer. GSEs on the other hand have a lot more responsibilities:

      1. GSEs have to price the Gfee based on the lender.

      2. They have to offer the pricing sheets for cash window lenders.

      3. They have to price the buy-up and buy-down metrics.

      4. They have to oversee the servicing practices of various servicers and ensure that servicers are following all the rules for loss mitigation.

c. **Are non-bank servicers more aggressive?** MBS investors constantly worry about the aggressiveness of smaller lenders in driving prepayment speeds.

   i. Lenders that sell loans on servicing released basis have very little skin in the game, and they can make additional origination fees if they decide to refi these loans.

   ii. Similar concerns have been voiced by investors in the context of pools that contained loans acquired via the cash window channel.

   iii. Comparison of cash window speeds relative to non-cash window speeds shows that the cash window speeds are indeed faster, although the differential in speed is rather modest at this juncture.

   iv. However, such assertion cannot be made in the context of the GNMA program where speeds for loans originated via the VA program and some specific servicers in the case of FHA are exhibiting much faster speeds.

d. **Are GSEs doing something different?** GSEs are constantly at a risk in that a lender could adversely select one of their securitization channels. As a result, the GSEs have the tendency to constantly monitor the speeds of various servicers.

   i. If the GSEs believe the speeds of specific lender will be much faster, they can alter the Gfee pricing and the buy-up and buy-down multiples for those lenders, which may take away lenders’ ability to offer competitive rates.

   ii. Besides repricing the risk, GSEs can also fall back on the three contractual levers at their disposal to penalize the lenders:

      1. Premium recapture

2. Buyup payment recapture, and

3. Volume limitations.

iii. In contrast to the GSEs, the Ginnie Mae program lacks any meaningful contractual checks and balances to prevent the aggressive behavior of lenders to refi borrowers for very small incentives.

3. **Increasing incidence of short WAM paper in 15-yr:** The net issuance of 15yr products has been generally negative over the past few years, leading WAMs to increase. This has led to an increasing risk of delivery of short WAM paper into 15yr TBA, negatively impacting the TBA prices.

   a. With highly seasoned collateral where the maturity of the mortgage is quite short, the pull-to-par effect starts dominating and its value starts decreasing.

   b. Generally 70ish WALA is considered short WAM paper in the 15yr space.

**Credit Suisse:**

1. **Lessons for the FN 3 dollar roll from FN 3.5s:** The continued strength in FN 3 roll has been both a source of support and a topic of debate in the market. It appears that a roughly 0.75 to 1pt higher in price (~25bp lower in CC) on FN 3s is need for the FN 3 roll to cheapen near term.

   a. If the rates remain roughly at current levels, the build-up of the 2016 float and its seasoning could start pushing some pressure on the roll in the Sep/Oct cycle, but its full impact is only likely to be felt in the Nov/Dec cycle or later.

**Barclays:**

1. **Basis:** Neutral. Negative: despite the recent underperformance, mortgages still do not look cheap. Positives: given the sell-off in rates, supply and prepayment concerns have declined; as we move past the summer months, MBS net issuance is likely to decline; Overseas and real-money domestic demand remains strong, helping to provide a floor.

2. **New prod FN and G2 3.5s valuations:** Using both model valuations and empirical analysis, Barclays believe that new prod G2 3.5s are fair to rich, while new prod FN 3.5s look fair to slightly cheap.

3. **A review of 20y pools:** There has been a significant amount of interest in 20y pools this year with the decline in rates in 2016. As such, Barclays reviewed the issuance trends, collateral characteristics, prepayment profile and valuations of 20y pools.

   a. **Issuance of 20y pools:** 20y gross and net issuance tend to increase during refi episodes. However, 20y issuance today pales in comparison to what it was in 2012 and 2013. This may be a result of the flatter yield curve today, which has made short amortization products less compelling.

   b. **20y valuations:** 20y pay-ups have risen significantly this year, such that they now offer much less spread relative to their FNCL and FNCI counterparts.

      i. Barclays believes that given their strong performance this year, 20y pools now look mostly fair, despite their superior convexity profile.

**Deutsche Bank:**

1. **Short term projections: speeds dip in July before spiking in August:** DB estimates aggregate July speeds for Fannie 30yr will drop 5% and will rise 23% in August.
    a. In August, the fastest increases should predominately show in newer production, larger loan balance, non-bank collateral. After the "low hanging fruit" is refinanced in August, we then would expect the other eligible cohorts to catch up in September.

**BNP Paribas:**

1. **MBA refi index:** The refi index, which had surged by double digits (21% and 11%) in the two weeks following Brexit, fell back below the pre-Brexit level. This suggests the impact of Brexit on mortgage rates and refinancing activity has been short-lived.
    a. The refi index was down 11.2% from the previous week, driven by higher rates and smaller loan sizes.
    b. The average loan size decreased from $292k to $277k. The sharp decrease in loan size suggests that borrowers holding larger loans with pristine credit, usually considered as the lenders' low hanging fruit, may have been refinanced through the pipeline.
2. **Republican and democratic 2016 platforms on housing and mortgages:** Both parties released their platforms during their conventions for the 2016 presidential election.
    a. Overall, BNP thinks Republicans are more likely to wind down GSEs and reduce the government role in the housing market, while Democrats are more likely to preserve 30-yr mortgage and keep the housing finance system similar to its current form.
    b. In addition, the Democrats will defend the CFPB, while Republicans are more likely to clear away the controls and/or regulations that complicate and distort home buying.

**Table 1: Republican and democratic 2016 platforms on housing and mortgages**

| Policy Area | GOP Position | Dem. Policy Position |
|---|---|---|
| **Mortgage Lending** | *Provide clear and prudent underwriting standards and guidelines on predatory lending and acceptable lending practices.<br>*Compliance with regulatory standards should constitute a legal safe harbor to guard against opportunistic litigation. | No Comments |
| **GSEs and Housing Finance Reform** | *Scale back the government role in the housing market.<br>*Reconsider the utility of Fannie and Freddie as republicans clear away the jumble of subsidies and controls that complicate and distort home-buying.<br>*FHA should no longer support high income individuals. | *Substantially increase funding for the National Housing Trust Fund to expand access to affordable housing.<br>*Provide more federal resources to increase the supply of affordable housing.<br>*Support more first-time borrowers.<br>*Preserve the 30-yr fixed rate mortgage.<br>*Clarify lending rules. |
| **Consumer Finance** | * If CFPB is not abolished, the agency should be subject to Congressional appropriations.<br>*Support legislation to ensure that the problem of any financial institution can be resolved through Bankruptcy code. | *Prevent predatory lending by defending the Consumer Financial Protection Bureau (CFPB). |

*Source: BNP Paribas, Republic and Democratic Convention Website*