

FEDERAL RESERVE BANK *of* NEW YORK *Serving the Second District and the Nation*

FAQs: Agency MBS Purchases

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The following frequently asked questions (FAQs) provide further information about the Federal Reserve's additional asset purchases of agency mortgage-backed securities (MBS) and the reinvestment of principal payments from agency securities.

Effective August 5, 2014

GENERAL

Why is the Desk purchasing agency MBS?

The Federal Open Market Committee (FOMC) directed the Open Market Trading Desk (the Desk) at the Federal Reserve Bank of New York to purchase additional MBS and longer-term Treasury securities (see <http://www.federalreserve.gov/monetarypolicy/fomccalendars.htm> for the most recent FOMC statement). The FOMC also directed the Desk to maintain its existing policies of reinvesting principal payments from the Federal Reserve's holdings of agency debt and agency MBS in agency MBS and of rolling over maturing Treasury securities at auction. The FOMC noted that these actions should put downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative.

For more information on Treasury purchases, please see Frequently Asked Questions for purchases of Longer-term Treasury Securities.

What types of agency MBS will the Desk purchase?

Agency MBS purchases will likely be concentrated in newly-issued agency MBS in the To-Be-Announced (TBA) market because these securities have greater liquidity and are closely tied to primary mortgage rates. The Desk may purchase other agency MBS if market conditions warrant. Only fixed-rate agency MBS securities guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae are eligible assets for purchase. These eligible assets include, but are not limited to, 30-year and 15-year securities of these issuers. Ineligible assets include CMOs, REMICs, Trust IOs/Trust POs and other mortgage derivatives or cash equivalents.

What explains changes in the total current face value of agency MBS held in the SOMA?

The total current face value of agency MBS held in the System Open Market Account (SOMA) will increase as a result of additional asset purchases. The pace of the increase in holdings will fluctuate somewhat due to differences between trade and settlement dates for transactions of agency MBS, and due to the timing of principal payment dates for agency debt and agency MBS.

How much will the Desk purchase each month in agency MBS associated with the additional asset purchases and how will this be communicated?

Additional agency MBS will be purchased at a monthly pace as directed by the FOMC in its most recent statement (see <http://www.federalreserve.gov/monetarypolicy/fomccalendars.htm>). The amount of additional agency MBS to be purchased each month will be announced on or around the last business day of the prior month. The amount published is subject to change should the FOMC alter its directive to the Desk during the month or if market conditions warrant.

How much will the Desk purchase each month in agency MBS associated with the reinvestment program and how will this be communicated?

Reinvestments in agency MBS will be made as directed by the FOMC in its most recent statement (see <http://www.federalreserve.gov/monetarypolicy/fomccalendars.htm>). On or around the eighth business day of each month, the Desk will publish a tentative amount of

reinvestment-related purchases expected to take place between the middle of the current month and the middle of the following month. This amount will be approximately equal to the amount of principal payments from agency debt and agency MBS expected to be received over that period, adjusted for any variations from prior periods. The amount published is subject to change should the FOMC alter its directive to the Desk during the month or if market conditions warrant. Adjustments for any deviation between anticipated and actual agency MBS purchases over a given monthly period will be made by modifying the following month's agency MBS purchases. For example, if actual agency MBS purchases were \$1 billion smaller (larger) than previously announced, the Desk would increase (decrease) the following month's anticipated agency MBS purchases by \$1 billion.

How would a change in the FOMC directive be reflected in the published purchase amounts?

The amounts of additional agency MBS and reinvestments in agency MBS published by the Desk are based on already announced FOMC decisions, and make no assumptions about future policy actions. Accordingly, if the FOMC announced a modification to its policy stance with a new policy directive, the Desk would release an updated statement regarding MBS purchases.

Will the Federal Reserve conduct agency MBS dollar rolls or coupon swaps?

The Desk may use dollar roll and coupon swap transactions if needed to facilitate settlement associated with its unsettled agency MBS purchases. A dollar roll is a transaction that generally involves the purchase or sale of agency MBS for delivery in the current month, with the simultaneous agreement to sell or purchase substantially similar (although not necessarily the same) securities on a specified future date. A coupon swap is a transaction that involves the sale of one agency MBS and the simultaneous purchase of another agency MBS, each with different coupons.

Would agency MBS dollar roll or coupon swap transactions reduce the amount of total outright agency MBS purchases?

No. Dollar roll and coupon swap transactions are the simultaneous sale and purchase of the same face amount of agency MBS. Thus, they only affect the timing or composition of the settlement of the Federal Reserve's agency MBS purchases.

Does the Federal Reserve assess the TMPG agency MBS fails charge?

Yes. Beginning February 1, 2012, the failure of the Federal Reserve's counterparties to deliver agency MBS for the contractual settlement date of the Desk's trades has resulted in the Federal Reserve assessing the applicable agency MBS fails charge recommended by the Treasury Market Practices Group (TMPG). Additional information can be found at <http://newyorkfed.org/tmpg/>.

Will principal payments from other Federal Reserve holdings, such as those held in the Maiden Lane portfolios, be reinvested in agency MBS?

No. The FOMC directed the Desk to reinvest principal payments from agency securities held in the SOMA portfolio. Principal payments from other Federal Reserve holdings, including the Maiden Lane portfolio and SOMA assets denominated in foreign currencies, are unrelated to this directive.

How will transactions of agency MBS affect the New York Fed's aggregation of agency MBS CUSIPs in the SOMA portfolio announced in January 2011?

The Desk will aggregate the SOMA's agency MBS holdings as needed. Additional information on the New York Fed's aggregation of the SOMA's agency MBS CUSIPs can be found at http://www.newyorkfed.org/markets/Agency_MBS_CUSIP_Aggregation_faqs.html. The New York Fed will continue to publish information about its aggregated CUSIPs on its public website.

OPERATIONS

Who is eligible to transact in agency MBS with the Federal Reserve?

The New York Fed's primary dealers are eligible to transact in agency MBS directly with the Federal Reserve. Primary dealers are expected to submit bids or offers for themselves and for their customers.

How will agency MBS transactions be conducted?

The Desk will conduct purchases of agency MBS via FedTrade, the Desk's proprietary trading system. The Desk will conduct all dollar roll transactions via Tradeweb, a commercial trading platform.

FedTrade operations will be conducted using multiple-price competitive auctions, with each primary dealer able to submit up to ten offers on each security in an operation. Offers in FedTrade operations will be evaluated based on their proximity to prevailing market prices at the auction close. Transactions conducted over Tradeweb will be executed through a competitive bidding process and in line with standard market practices.

What is a "multiple-price" auction?

A "multiple-price" auction is an auction in which the same security can be awarded at different prices, with awards given to participants at their individual price levels. This is unlike a "single-price" or uniform price auction, where each awarded participant pays the same price.

How often will purchases take place?

Purchases will be conducted on a frequent basis over the course of each month, and will be guided by general MBS market conditions, including, but not limited to, supply and demand conditions, market liquidity, and market volatility.

How will the tentative schedule of FedTrade operations be communicated?

The Desk will publish a tentative schedule of FedTrade operations each Friday around 12 p.m. for agency MBS purchases for the weekly period beginning on the following Monday. On occasions where Friday is a holiday, the schedule will be published on the previous business day. The tentative schedule will include information on the upcoming operation dates, times, security types (agency and coupon) and maximum purchase amount per security. The FedTrade operations schedule published by the Desk is based on already-announced FOMC decisions, and makes no assumptions about future policy actions. The schedule is subject to change should the FOMC alter its directive to the Desk during the month or if market conditions warrant.

What is the minimum offer amount per security that a dealer may submit over FedTrade?

The minimum offer size is \$1 million, with a minimum increment of \$1 million.

How many offers per security can a dealer submit during a purchase operation over FedTrade?

Dealers can submit up to ten offers per security, with each offer reflecting a price and par amount. This should facilitate both dealer and dealer client participation.

Does the Federal Reserve require the posting of margin for unsettled agency MBS trades?

Yes. The Federal Reserve requires counterparties to post margin to the New York Fed. Margin is calculated on a daily basis and serves to protect the New York Fed from counterparty credit risk exposure arising from the unsettled agency MBS TBA trades.

Whom should dealers call if they experience difficulties during a FedTrade operation?

Primary dealers may call the New York Fed's Trading Desk with submission and verification questions. For FedTrade system-related problems, dealers may call the New York Fed's Primary Dealer Support line.

Under what circumstances may the Federal Reserve conduct agency MBS dollar rolls?

Based on the directive from the FOMC, the Desk may conduct dollar rolls in order to facilitate settlement associated with its unsettled agency MBS purchases. Selling dollar rolls effectively postpones the settlement of outstanding forward purchase commitments, while buying dollar rolls effectively brings settlement forward. Dollar rolls would typically be conducted only if implied financing rates on agency MBS are notably below or above the general level of short-term interest rates, as such conditions may signal a shortage or abundance of supply, respectively, available for settlement. The Desk may conduct dollar rolls throughout the month ahead of TBA settlement dates and will seek to complete most such transactions at least four business days prior to settlement. During the month, the Desk will increase the amount of dollar rolls conducted as the degree of shortage or abundance of supply indicated by implied financing rates increases. All dollar roll transactions will be conducted over Tradeweb.

Under what circumstances may the Federal Reserve conduct agency MBS coupon swaps?

Based on the directive from the FOMC, the Desk may conduct coupon swaps in order to facilitate settlement associated with its unsettled agency MBS purchases. However, the Desk does not anticipate conducting such transactions unless market conditions suggest the settlement of purchases is unlikely over a significant period of time, as suggested by persistent and notably negative dollar-roll implied financing rates, prolonged fails, or other market functioning indicators.

Will the Federal Reserve use investment managers, or other vendors, to conduct agency MBS transactions?

The New York Fed will use internal staff to execute agency MBS transactions. Wellington Management Company will continue to provide investment management services and JPMorgan Chase will continue to provide custodial services.

REPORTING

How will the Desk communicate the FedTrade operation results?

Operation results from FedTrade will be posted on the New York Fed's website following each operation. The information posted will include the total amount of propositions received per auction, the total amount of propositions accepted per auction, the total amount accepted per security, and the settlement month. In addition, participating dealers will receive the operation results, including their accepted propositions, via FedTrade, immediately following the close of the auction.

How will the Desk communicate all agency MBS transaction details?

The New York Fed publishes SOMA agency MBS transaction activity on its website on a weekly basis. Activity data includes the total amount of weekly purchases and dollar roll transactions by agency, coupon, maturity and settlement month. This information will include transactions conducted over FedTrade and the commercial trading platform used by the Desk.

How are the Federal Reserve's holdings of agency MBS reported?

Agency MBS transactions are reported after settlement occurs on the H.4.1. statistical release titled "Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks." This report also includes information on total outstanding commitments to buy and sell MBS in a supplemental table entitled "Supplemental Information on Mortgage-Backed Securities." Trade settlements may occur well after trade execution due to agency MBS settlement conventions. The New York Fed also publishes on a weekly basis detailed data on all settled SOMA agency MBS holdings. Any change in the composition of these reported holdings over time is a function of principal payments, outright purchases, dollar roll, and coupon swap activity.

Will the Desk release operation pricing results?

Yes. In order to ensure the transparency of its agency MBS transactions, the Desk, at mid-month for the prior monthly period, will continue to publish historical operation results. This information will include the transaction prices in individual operations. Operation results will include agency MBS transactions associated with both the additional asset purchases and the reinvestment program. In addition to the pricing information released each month, Section 1103 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 requires that detailed operational results, including counterparty names, be released two years after each quarterly transaction period.

FAQ: April 1, 2014»
