

FEDERAL RESERVE BANK of NEW YORK *Serving the Second District and the Nation***FAQs: Reinvestment of Principal Payments on Agency Debt and Agency Mortgage-Backed Securities in Treasuries**

Effective October 5, 2010

General

What is the objective of the Federal Reserve's reinvestment of principal payments from agency debt and agency mortgage-backed securities (agency MBS) in longer-term Treasury securities?

The goal of reinvestments is to keep constant the face value of domestic securities held in the Federal Reserve's System Open Market Account (SOMA). SOMA holdings of domestic securities totaled about \$2.054 trillion as of August 4, 2010, and this policy will ensure that these holdings remain near this level.

How much will the face value of domestic securities held in the SOMA vary from the August 4 level of \$2.054 trillion?

Total SOMA assets will likely vary around \$2.054 trillion to some degree due to differences in settlement dates for purchases of Treasury securities and principal payments on agency debt and agency MBS. As purchases and principal payments settle, the actual face value of domestic securities held in the SOMA may be above or below \$2.054 trillion by several billion dollars on any given week.

Will principal payments from other Federal Reserve holdings, such as those held in the Maiden Lane portfolios, be reinvested in longer-term Treasury securities?

No, repayments from other Federal Reserve holdings, including the Maiden Lane portfolios, SOMA assets denominated in foreign currencies, and any other Federal Reserve asset holdings, will not be reinvested into longer-term Treasury securities.

What Treasury securities will the Desk purchase?

The Desk will concentrate purchases in the 2- to 10-year sectors of the nominal Treasury curve, although purchases will occur across the nominal Treasury and TIPS yield curves. The Desk will refrain from purchasing securities:

- trading with heightened scarcity value in the repo market for specific collateral,
- maturing within five weeks,
- that are cheapest to deliver into the front-month Treasury futures contracts, and
- that the SOMA already holds in an amount that is, or is very near, 35 percent of the outstanding supply.

Specific issues that will be excluded from consideration will be announced at the start of each operation. Currently, the Desk does not plan to purchase Treasury bills, STRIPS, or securities trading in the when-issued market.

Has the Federal Reserve changed its 35 percent per issue limit in light of this announcement?

No, the System Open Market Account's current per issue limit for Treasury holdings remains at 35 percent. The Desk will reevaluate this decision as needed.

How much will the Desk purchase each month in Treasury securities and how will this be communicated?

On or around the eighth business day of each month, the Desk will publish an anticipated amount of 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 MBS expected to be received over that period and agency debt maturing between the seventh business day of the month and the sixth business day of the following month, in addition to any variations from prior periods.

This announcement will also include a schedule of anticipated Treasury purchases, including operation dates, settlement dates, security types to be purchased (nominal coupons or TIPS), and a maturity range of eligible issues for each operation.

Will purchases be adjusted for the effect of inflation on the original face value of TIPS securities held in the SOMA?

Inflation compensation for the SOMA's holdings of TIPS securities results in an increase in outright holdings of domestic securities. Accordingly, the total amount of purchases of longer-term Treasury securities will be reduced over time by the amount of inflation accrual.

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The August 4 level of \$2.054 trillion in securities holdings does not account for about \$2.5 billion in unsettled purchases from the \$1.25 trillion agency MBS purchase program. The settlements of these MBS purchases will result in an increase in the face value of our securities holdings that will reduce the necessary amount of total purchases of longer-term Treasury securities by an equal amount.

How will the Desk adjust for any unexpected deviations between anticipated and actual longer-term Treasury purchases over a given monthly period?

An adjustment for any deviation will be made by modifying the following month's Treasury purchases. For example, if MBS principal payments were \$1 billion larger (smaller) than expected, or if actual Treasury purchases were \$1 billion smaller (larger) than previously announced, the Desk would increase (decrease) the following month's anticipated Treasury purchases by \$1 billion.

Does the reinvestment of agency MBS and agency debt principal payments impact the existing policy for reinvesting the proceeds from maturity Treasury securities held in the SOMA?

No, the Desk's existing Treasury reinvestment policy of reinvesting the proceeds from maturing Treasury securities in Treasury auctions will not be altered.

Who is eligible to sell Treasury securities to the Federal Reserve under this program?

Primary dealers are eligible to transact directly with the Federal Reserve. Dealers are encouraged to submit offers both for themselves and their customers.

Will the Federal Reserve lend the Treasury securities it purchases through this program?

Yes, Treasury securities purchased through this program will be available to borrow through SOMA's securities lending facility.

OPERATION

How will the purchases be conducted?

Consistent with its prior outright purchases of Treasury securities, the Desk will arrange these purchases with the Federal Reserve Bank of New York's primary dealers through a series of multiple-price competitive auctions using the Desk's FedTrade system.

How often will the Desk conduct operations to purchase longer-dated Treasuries?

In general, the Desk will aim to conduct 2 to 3 operations per week.

How many offers can a dealer submit during an operation?

Dealers are limited to five offers per issue.

What is the minimum amount for which a dealer may submit offers?

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

How will the Desk communicate the operation results?

Operation results will be posted on the New York Fed website following each operation. The information posted will include the total amount of offers received, total amount of offers accepted, and the amount purchased per issue. In addition, participating dealers will receive the operation results, including their accepted propositions, via FedTrade.

Whom do dealers call if they experience difficulties during the operation?

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

Settlement

When and how does Treasury security settlement take place?

Treasury security settlement will occur on a T+1 basis, i.e. one business day after the day of the operation, via the Fedwire Securities System.

