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

FAQs: MBS Purchase Program

The following frequently asked questions (FAQs) provide further information about the program to purchase agency mortgage-backed securities (agency MBS) that was announced by the Federal Reserve on November 25, 2008. This agency MBS program will be managed at the direction of the Federal Open Market Committee (FOMC) by the Federal Reserve Bank of New York (New York Fed). The New York Fed has selected four investment managers to help implement the agency MBS program.

Effective December 30, 2008

General

What is the policy objective of the Federal Reserve's program to purchase agency mortgage-backed securities?
The goal of the program is to provide support to mortgage and housing markets and to foster improved conditions in financial markets more generally.

Why is it necessary for the Federal Reserve to transact in the agency MBS market via external investment managers?
The operational and financial characteristics of MBS purchases are significantly more complicated than those associated with the assets that have traditionally been purchased by the Federal Reserve. The Federal Reserve has chosen external investment managers as a means of implementing the MBS program quickly and efficiently while at the same time minimizing operational and financial risks.

Because of the size and complexity of the agency MBS program, a competitive request for proposal (RFP) process was employed to select four investment managers and a custodian. The investment managers are BlackRock Inc., Goldman Sachs Asset Management, PIMCO and Wellington Management Company, LLP. The selection criteria were based on the institution's operational capacity, size, overall experience in the MBS market and a competitive fee structure. The contract for a custodian is not yet final.

What securities are eligible for purchase under the program?
Only fixed-rate agency MBS securities guaranteed by Fannie Mae, Freddie Mac and Ginnie Mae are eligible assets for the program. The program includes, but is not limited to, 30-year, 20-year and 15-year securities of these issuers. The program does not include CMOs, REMICs, Trust IOs/Trust POs and other mortgage derivatives or cash equivalents. Eligible assets may be purchased or sold in specified pools, in "to be announced" (TBA) transactions, and in the dollar roll market.

What is the investment strategy that will be employed?
Investment managers will employ a passive buy and hold investment strategy in accordance with investment guidelines prescribed by the Federal Reserve. Purchases will be guided by commonly referenced market indices. The agency MBS program will involve the outright purchase of up to $500 billion in agency MBS by the investment managers on behalf of the Federal Reserve by the end of the second quarter of 2009. The New York Fed will adjust the pace of its purchases based on input from the investment managers about market conditions and the impact of the program. The investment managers will be required to purchase securities frequently and to disclose the Federal Reserve as principal.

The investment strategy may involve the use of dollar rolls as a supplemental tool to smooth market supply and demand. A dollar roll is a transaction involving the sale of agency MBS for delivery in the current month and the simultaneous agreement to repurchase substantially similar (although not the same) securities on a specified future date.

Does the agency MBS program expose the Federal Reserve to increased risk of losses?
Assets purchased under this program are fully guaranteed as to principal and interest by Fannie Mae, Freddie Mac, and Ginnie Mae, so the Federal Reserve's exposure to the credit risk of the underlying mortgages is minimal. The market valuation of agency MBS can fluctuate over time based on the interest rate environment; however, the Federal Reserve's exposure to interest rate risk is mitigated by the conservative, buy and hold investment strategy of the agency MBS purchase program.

When will the purchases begin?
Purchases are expected to begin in early January, 2009.

Who will the investment managers trade with and who is eligible to sell agency MBS to the Federal Reserve under the program?

offers for themselves and for their customers.

Will the agency MBS held by the Federal Reserve through this program be eligible for lending through the Term Securities Lending Facility (TSLF) or the daily System Open Market Account (SOMA) securities lending operations conducted by the New York Fed?
There are no plans for the agency MBS held by the SOMA to be available for borrowing through the TSLF or the daily securities lending program.

How will purchases under the agency MBS program be financed?
Purchases will be financed through the creation of additional bank reserves.

What is the legal basis for the agency MBS purchase program?
Purchases of agency MBS in the open market, under the direction of the FOMC, are permitted under section 14(b) of the Federal Reserve Act.

How is the Federal Reserve's agency MBS purchase program related to the U.S. Treasury's efforts to purchase agency MBS?
The Federal Reserve's agency MBS program is separate and distinct from the U.S. Treasury's program but both programs are aimed at fostering improved conditions in mortgage markets.

How will holdings under the agency MBS program be reported?
Balance sheet items related to the agency MBS purchase program will be 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." There will be an explanatory cover note on the release when the new items appear for the first time. However, these data may be published well after trade execution due to agency MBS settlement conventions. In addition, the New York Fed will publish the SOMA agency MBS activity in more detail on its external website on a weekly basis.

What measures will the Federal Reserve take to ensure that an investment manager implementing the MBS program will not have an unfair advantage relative to other market participants due to the information it receives about the MBS program?
Each investment manager will be required to implement ethical walls that appropriately segregate the investment management team that implements the Federal Reserve's agency MBS program from other advisory and proprietary trading activities of the firm. The New York Fed will monitor each investment manager's compliance with this requirement.

Where should questions regarding the MBS purchase program be directed?
Questions regarding the MBS program should be directed to the New York Fed's Public Affairs department: 212-720-6130.
