

SOMA TSLF Options Program: Frequently Asked Questions

The following is intended to address operational questions about the System Open Market Account (SOMA) Term Securities Lending Facility Options Program (TSLF Options Program or TOP).

Effective July 30, 2008

GENERAL

What is TOP?

TOP offers options on a short-term fixed rate Term Securities Lending Facility (TSLF) bond-for-bond loan of general Treasury collateral against a pledge of eligible collateral. The term of the loan typically spans a short period of traditional collateral market dislocation, such as a quarter-end dates. While the price of the loan is fixed, the price of the option is determined by competitive bidding.

What is the purpose of TOP?

TOP is intended to enhance the effectiveness of TSLF by offering added liquidity over periods of heightened collateral market pressures, such as quarter-end dates.

How is TOP related to TSLF auctions?

TOP offers options on short-term TSLF loans at a future date. Option holders have the opportunity to exercise the option and borrow up to the amount awarded in the TOP auction at a fixed rate or allow the option to expire without a claim. Loans made through TOP are shorter in term than the 28-day TSLF loans. In most cases, the term and settlement of the loan will not coincide with regularly-scheduled TSLF auctions.

What is the typical length of a TOP-related loan?

TOP-related loans are shorter than TSLF loans, with terms of two weeks or less. They are targeted to span potentially stressed financing dates.

How are options allocated among dealers?

Option awards are determined by a competitive bidding process in a single-price auction format. Primary dealers that have elected to participate in the program may submit up to two bids via FedTrade after the auction period has opened, at approximately 2:00 p.m. ET on the day following the TOP auction announcement.

How are options exercised?

Dealers who have received option awards may exercise the option by participating in a related TSLF operation held at 2:00 pm ET on the day the option expires. Dealers can exercise up to the amount of options held at a predefined fixed rate.

Can a dealer exercise an option early?

No, TOP options are only exercisable on expiration day.

How often will the New York Fed sell these options?

The New York Fed may auction options on multiple dates for a single loan, and may offer options well in advance of a loan period.

How much can dealers bid at each auction?

Dealers can bid for no more than 20 percent of the par value offered at each auction. In the event there is more than one TOP auction for a given loan, cumulative dealer auction awards may not exceed 20 percent of the total offering amount. In addition, the New York Fed reserves the right to reject bids at its discretion.

Can a dealer transfer TOP options?

No.

When will the New York Fed announce TOP offerings?

The New York Fed will announce the par value of the offering amount and the term of the underlying loan prior to each TOP auction. The announcement will specify the general collateral Treasuries offered in the underlying TSLF loan, the fixed fee for the underlying TSLF loan, the duration of the underlying TSLF loan, auction start and close times, option exercise date and time, and loan settlement and maturity dates. Announcements will be posted to the New York Fed website.

Are the auction results released to the public?

Yes. Aggregate TOP auction results including the stop-out award rate, total propositions submitted

and accepted and the bid-to-cover ratio will be posted on the New York Fed's website. On expiration date, the total amount of options exercised will be released on the New York Fed website.

Are primary dealers required to bid? Can other market participants bid in the operation?

Like other Desk operations, only primary dealers are eligible counterparties for TOP. Dealer participation is voluntary. The New York Fed does not evaluate dealer performance based on participation in the TOP. No other market participants are eligible.

BIDDING

How do dealers bid?

Dealers that have elected to participate in the program may submit bids via FedTrade or, if necessary, over the phone. The bid rate represents the fee or premium that a participant is willing to pay for the right to borrow a basket of Treasury general collateral at a fixed rate over a short term that extends over a key financing date.

What is the minimum bid rate for TOP auctions?

The minimum bid rate for the options is one (1) basis point.

In what sequence are bids considered?

Bids will be tiered from highest bid level to lowest. The highest bid will be awarded ahead of the bid with the next highest rate, and so on, until the announced auction size is filled. If a dealer's aggregate bid amount exceeds 20 percent of the offering amount, the higher accepted bid rate will be awarded first and the lower accepted bid would be curtailed to the maximum loan amount.

How many bids can a dealer submit in TOP auctions?

Dealers can submit up to two propositions per auction.

What is the minimum and maximum par amount for which a dealer can bid?

Like TSLF auctions, each dealer bid can be for no more than 20 percent of the offering amount and each dealer will be awarded no more than 20 percent of the offering amount. The minimum bid for the TOP auction is \$10 million.

What dollar increments should be used when bidding?

Bids must be submitted in increments of \$10 million in TOP auctions. Bids submitted in increments less than \$10 million will not be accepted. However, partial awards can be rounded to the nearest \$1 million. As such, options can be exercised in increments of \$1 million.

How many decimal places should be used when bidding?

TOP auction bids can be submitted in percent form out to four decimal places.

How are dealers notified of awards?

Dealers are notified of awards via FedTrade or by phone in a timely manner after the auction is complete.

Where do dealers call if they experience difficulties?

Dealers may call the New York Fed's Primary Dealer Support at 877-376-9837 if they are having system-related problems.

FEES AND SETTLEMENT

How is the option fee calculated?

The option fee will be calculated by multiplying the amount of the loan by the total quoted price of the borrowed securities as of the close of business on the day before option expiration, by the stop-out fee rate, and by the term of the underlying loan, in days, divided by 360.

The full option fee is owed regardless of whether or not the option is exercised. If the option is exercised, a separate loan fee will be assessed based on the criteria set forth in the TSLF terms and conditions.
