TMPG | Treasury Market Practices Group

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TMPG Recommends Margining of Agency MBS Transactions to Reduce Counterparty and Systemic Risks

The Treasury Market Practices Group (TMPG) today strengthened the existing "Best Practices for Treasury, Agency Debt, and Agency Mortgage-Backed Securities Markets" to include a recommendation that forward-settling agency MBS transactions be margined in order to prudently manage counterparty exposures. In order to allow market participants to develop the necessary legal and operational infrastructure for margining agency MBS transactions, the TMPG recommends that firms implement the margining practice on a rolling basis beginning immediately, and complete the process by early June 2013.

The forward-settling nature of most agency MBS transactions exposes trading parties to counterparty credit risk between trade and settlement. A sizable portion of the non-centrally cleared agency MBS market currently remains unmargined, posing both counterparty and systemic risks to overall market functioning if one or more market participants were to default. Counterparties can help mitigate this risk by exchanging margin as the market value of the deliverable securities fluctuates. Widespread use of margining for unsettled agency MBS transactions would enhance financial system stability and support market function during periods of market stress. The TMPG also released today a white paper describing the risks posed by unmargined agency MBS trading and how margining can help mitigate such exposures.

The TMPG recommends that market participants exchange two-way variation margin on a regular basis to mitigate counterparty credit risk. Written master agreements should describe the parties' agreement on all aspects of the margining regime, including collateral eligibility, timing and frequency of margin calls and exchanges, thresholds, valuation of exposures and collateral, and liquidation.

In support of the recommended best practice, the Securities Industry and Financial Markets Association (SIFMA) released an updated version of its Master Securities Forward Transaction Agreement, providing a legal framework for agency MBS forward trading and the margining of such transactions.

"The TMPG strongly believes that wider adoption of margining will improve risk management in the agency MBS market, which should improve liquidity and level the playing field for all market participants" said Tom Wipf, Chair of the TMPG. "The TMPG commends SIFMA for supporting this effort with the development of a new master agreement."

Members of the public may submit questions or comments to tmpg@ny.frb.org.

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About the Treasury Market Practices Group (TMPG):
The Treasury Market Practices Group (TMPG) is a group of market professionals committed to supporting the integrity and efficiency of the Treasury, agency debt and agency mortgage-backed

securities (MBS) markets. The TMPG is composed of senior business managers and legal and compliance professionals from a variety of institutions – including securities dealers, banks, buy-side firms, market utilities and others – and is sponsored by the Federal Reserve Bank of New York. More information is available at: www.newyorkfed.org/tmpg

For more information on:

"Best Practices for Treasury, Agency Debt, and Agency Mortgage-Backed Securities Markets," see www.newyorkfed.org/tmpg/bestpractices_11142012.pdf

"Margining in Agency MBS Trading" (TMPG White Paper), see http://www.newyorkfed.org/tmpg/margining_tmpg_11142012.pdf.

Contact for Mr. Wipf (TMPG Chair):
Ms. Mary Claire Delaney
Morgan Stanley, Corporate Communications
(212) 761-2427 or maryclaire.delaney@morganstanley.com