

The Bond Market Association's
Revised Buy-In Procedures for
Mortgage Backed Securities

Treasury Regulations

Sell Order Fails:

If a broker-dealer has executed a customer's MBS* sell order (not identified by the customer as a short sale) and has not obtained possession of the securities from the customer within 60 calendar days after the settlement date, the broker-dealer must close the transaction by purchasing, or otherwise obtaining, securities of like kind and quantity.

17 C.F.R. § 403.4(m).

Fully-Paid Fails:

Broker-dealers must take prompt steps to obtain possession or control, through a buy-in procedure or otherwise, of MBS that are subject to transactions recorded as failed to receive for more than 60 calendar days and in which the broker-dealer has a possession or control deficit.

17 C.F.R. § 403.4(h).

* For these purposes, "MBS" are mortgage-backed securities that are also "government securities" under the Exchange Act. Other mortgage-backed securities are subject to the SEC's buy-in requirements (Rule 15c3-3(d)(2) and (m)).

MBS Buy-In Procedures

- TBMA's MBS Buy-In Procedures were originally published in 1994, shortly after the adoption of the Treasury regulations, as recommended guidelines* to assist broker-dealers in effecting buy-ins in order to comply with the Treasury regulations.
- Experience with the Procedures, particularly in connection with the high volume of fails in 2003, indicated a need for clearer guidance regarding the process for buy-ins under the unique circumstances of the MBS market.
- The Procedures have been revised over the past two years. The revised MBS Buy-In Procedures are expected to be published on or about June 30, 2006, with immediate effectiveness.

** The MBS Buy-In Procedures are recommended guidelines that TBMA believes represent common industry practice. Although MBS broker-dealers and other market participants generally follow these practices, compliance with these guidelines is strictly voluntary.*

Options for Closing Fails

- **Delivery.**
 - In TBAs, seller may deliver any MBS acceptable for delivery under industry custom & practice.
 - Seller and buyer can also agree to the delivery of substitute MBS.
- **Sell-back / buy-back.**
 - In Sell Order Fails, the buyer can sell the MBS back to the failing customer.
 - In Fully-Paid Fails, the buyer can buy the MBS back from the fully-paid or excess margin customer.
- **Buy-in.**
 - The Procedures address this option in detail.
- **Assignment.**
 - When a Sell Order Fail is caused by the seller's failure to receive MBS from another party, the buyer may accept assignment of the seller's fail to receive transaction, with a cash settlement of any price difference.

Buy-In Terminology

Parties:

- Originating Purchaser: A broker-dealer having an obligation to close out a Fully-Paid Fail or a Sell Order Fail.
- Seller: A party from whom MBS are due to complete a transaction.

Transactions:

- Specified Transaction: A sale of specified MBS pools.
- TBA Transaction: A sale of MBS pools “to be announced” in accordance with industry custom and practice.
 - Allocated TBA: A TBA Transaction for which the MBS pools have been specified by the Seller.
 - Unallocated TBA: A TBA Transaction for which the MBS pools have not been specified by the Seller.

Buy-In Process

1. Send buy-in notice.
 - a. Buy-in notices may be retransmitted by the Seller receiving the buy-in notice to parties failing to deliver the relevant MBS to it.
 - b. Proposed buy-in execution date may be extended.
2. Execute the buy-in.
3. Send notice of buy-in execution.
4. Settle any payments in respect of the buy-in.

Send Buy-In Notice

- The Buy-In Notice may not be sent until 60 calendar days have passed after the original settlement date.
- The Buy-In Notice must be sent no later than noon on the 10th business day prior to the execution date proposed in the notice.
- The Buy-In Notice shall include specified information identifying the transaction and the parties.
- A model Notice of Buy-In is Exhibit A to the Procedures.

Exhibit A

The Bond Market Association
Model Notice of Buy-In for Mortgage-Backed Securities

To: Customer XYZ, 321 Main St, Chicago, IL 60000 321 Walls Street 212-765-4321
(Seller Name) (Address / Fax)

From: Dealer ABC Buy-In Department, 123 Wall Street, New York, NY 10000
(Originating Purchaser Firm Name) (Address)

Joe Dealer 212-123-4567 212-765-4320
(Originating Purchaser Contact Name) (Phone) (Fax)

Date: 1/16/06

Re: Buy in on 1/30/06 of \$17,000,000 Par Value
(Buy-In Execution Date) (Par / Face Value)

of FN30 6.0% Trade Reference # 500 which are due from you to us on
(Description of Securities)

a contract made on 10/10/05 at 100-25
(Trade Date) (Contract Price)

for settlement on 11/14/05.
(Settlement Date)

We hereby notify you in accordance with The Bond Market Association Buy-In Procedures for Mortgage-Backed Securities that, unless the securities described above have been delivered to us by 3:00 p.m. on the Buy-In Execution Date specified above, the securities will be bought in for your account in fulfillment of our obligation under Part 403 of the regulations implementing the Government Securities Act of 1986.

Please acknowledge receipt of this notice by signing in the space provided below and returning to us a copy of this notice.

Note: If some or all of the foregoing securities are due to you from another party, you may be permitted to retransmit this notice to that party within one business day of your receipt of this notice.

Acknowledged:

By: _____

Phone: _____ Fax: _____

Retransmission

- Sellers may retransmit buy-in notices within one business day of receipt.
- Buy-in notices may only be retransmitted to Sellers that have failed to deliver the relevant MBS for at least 60 calendar days after the settlement date.
- The Retransmitted Buy-In Notice shall include specified information identifying the transaction, the parties and other retransmitting parties.
 - Dealers may indicate “customer” in passing on retransmitted buy-in notices received from their customers.
- A model Notice of Retransmitted Buy-In is Exhibit B to the Procedures.

Exhibit B

The Bond Market Association
Model Notice of Retransmitted Buy-In for Mortgage-Backed Securities

To: Dealer DEF. Buy-In Department, 456 Park Avenue, New York, NY 10000
(Seller Name) (Address / Fax)

From: Customer XYZ, 321 Main St, Chicago, IL 60000 321 Walls Street 212-765-4321
(Retransmitting Party Firm Name) (Address)

Steven R. E. Transmittor 215-333-3333 215-333-3339
(Retransmitting Party Contact Name) (Phone) (Fax)

Date: 1/17/06

Re: Buy in on 1/30/06 of \$17,000,000 Par Value
(Buy-In Execution Date) (Par / Face Value)

of FN30 6.0% Trade Reference # 234 which are due from you to us on
(Description of Securities)

a contract made on 10/3/05 at 100-27
(Trade Date) (Contract Price)

for settlement on 11/14/05.
(Settlement Date)

Originating Purchaser: Dealer ABC. Buy-In Department, 123 Wall Street, New York, NY 10000, 212-123-4567

Previous Retransmitting Parties: 1. _____ 2. _____
 3. _____ 4. _____ 5. _____
 6. _____ 7. _____ 8. _____

This buy-in notice was originated by the above-referenced Originating Purchaser in accordance with The Bond Market Association Buy-In Procedures for Mortgage-Backed Securities (the “Procedures”) in order to fulfill its obligations under Part 403 of the regulations implementing the Government Securities Act of 1986.

We hereby notify you in accordance the Procedures that, unless the securities described above have been delivered to us by 3:00 p.m. on the Buy-In Execution Date specified above, the securities will be bought in for your account.

Please acknowledge receipt of this notice by signing in the space provided below and returning to us a copy of this notice.

Note: If some or all of the foregoing securities are due to you from another party, you may be permitted to retransmit this notice to that party within one business day of your receipt of this notice.

Acknowledged:

By: _____

Extensions

- Extensions of the proposed buy-in execution date are available under certain circumstances to:
 - Sellers receiving retransmitted buy-in notices less than 2 business days prior to the proposed buy-in execution date.
 - Extension to 2nd business day after receipt of the retransmitted notice.
 - Sellers providing notice prior to the execution of the buy-in of new or changed pool information on TBA transactions.
 - Extension to 2nd business day after effectiveness of the new or changed information.
 - Sellers providing notice prior to the execution of the buy-in that the MBS are in transfer, in transit or being shipped that day.
 - Extension to the 3rd business day after such notice (or 5th for physical certificates).
- The procedures include detailed guidance regarding the process of obtaining and giving notice of extensions.

Buy-In Execution

- If the MBS have not been delivered by 3pm on the proposed buy-in execution date (as extended), the Originating Purchaser shall use commercially reasonable efforts to execute the buy-in.
 - The Originating Purchaser shall buy-in at current market value all or any part of the same or Comparable Securities necessary to complete the failing transaction.
 - The buy-in shall be for the account and liability of the Seller.
 - The buy-in may be for settlement on the next regularly scheduled settlement date for the relevant MBS.
- If the buy-in is not executed by the end of the 2nd business day after the proposed buy-in execution date (as extended), the buy-in notice shall expire and a new buy-in notice must be sent.

Buying-In TBA Transactions

- In a TBA transaction, the Seller has the right to select, and change, the particular MBS that it will deliver.
 - This right exists even when the Seller has failed to make delivery (although a compensation “claim” may be payable in some cases).
- For aged fails, the Seller’s selection of the pools to deliver also determines the outstanding principal amount to be delivered.
- Providing guidance regarding the selection and amount of MBS to be purchased in a buy-in was a principal purpose of the revision to the Procedures.
 - In all cases, buy-in the same or Comparable Securities.
 - For Unallocated TBAs, buy in MBS with an outstanding principal amount equal to the original TBA principal amount, and make an economic adjustment for the absence of amortization.
 - For Allocated TBAs or Specified Transactions, buy-in MBS an outstanding principal amount equal to the amortized principal amount of the identified pools.

Buying In Specified Transactions or Allocated TBAs

- Buy-in the amortized principal amount of the specific MBS pools subject to the transaction.
- Net monies due in connection with the buy-in are calculated based on:
 1. The difference between the buy-in settlement amount and the original settlement amount.
 2. Accrued coupon interest paid on the relevant pool between the original settlement date and the buy-in settlement date.
 3. Principal payments paid on the relevant pool between the original settlement date and the buy-in settlement date.
- A model for notice of the execution of a Specified Transaction or Unallocated TBA buy-in (including detailed worksheets for calculating the net monies due) is attached as Exhibit C to the Procedures.

Buying In Unallocated TBAs

- Buy-in the unamortized principal amount.
- Net monies due in connection with the buy-in are calculated based on:
 1. The difference between the buy-in settlement amount and the original settlement amount.
 2. Accrued coupon interest paid derived from generic amortization factors for the relevant TBA cohort (available on Bloomberg).
 3. An economic adjustment based on the generic amortization factors to eliminate benefit or harm to the purchaser from receiving the unamortized principal amount.
- A model notice of the execution of an Unallocated TBA buy-in (including detailed worksheets for calculating the net monies due) is attached as Exhibit D to the Procedures.

Generic TBA Factors

FNCL 6 N 11/05 Mtge PDI

N270 Mtge **PDI**

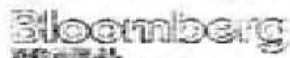
TBA FACTORS
FNCL 6.000 11/5
 CUSIP: 01F0606B6

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Bloomberg, in conjunction with the Bond Market Association (BMA), maintains factor histories for new generic cohorts for the purpose of reconciling TBA trades that extend beyond good settlement. Please refer to the BMA standard guidelines for the appropriate application of these factors.

	2004		2005		2006	
	factor	coupon	factor	coupon	factor	coupon
Jan					0.958866720	6.000000000
Feb					0.943510139	6.000000000
Mar						
Apr						
May						
Jun						
Jul						
Aug						
Sep						
Oct						
Nov			1.000000000	6.000000000		
Dec			0.978568699	6.000000000		

Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 920410
 Hong Kong 852 2977 6000 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 919 2000 Copyright 2006 Bloomberg L.P.
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Notice of Buy-In Execution

- The Originating Purchaser provides immediate telephonic notice of the buy-in price to the Seller.
- Such telephonic notice shall be confirmed in writing on the buy-in execution date.
 - Model notices of buy-in execution are attached to the Procedures as Exhibits C & D.
 - The written notice should calculate the net monies due.
 - If the calculation of the net monies due cannot be made when the written notice is sent, a preliminary written notice may be sent on the buy-in execution date and followed by a revised notice promptly following the time when it becomes possible to complete the calculations.

Payment of Net Monies Due

The net monies due in connection with a buy-in shall be paid no later than 1 business day after the buy-in settlement date.

Example: Unallocated TBA

Trade information:

- Seller: Customer XYZ
- Originating Purchaser: Dealer ABC
- Trade Date: 10/10/05
- Security type: Fannie Mae 30-Year 6.0%
- TBA Fail Amount:
 - Par Value: \$17,000,000
- Price: 100-25
- Settlement Date: 11/14/05

Buy-in information:

- Buy-in Execution Date: 1/30/06
- MBS bought in: Fannie Mae 30-Year 6.0%
- Amount Bought In:
 - \$17,000,000 Outstanding Principal
- Price: 103-10
- Buy-in Settlement Date: 2/13/06
 - The next scheduled class A settlement date

Example: Unallocated TBA

- The net monies due in connection with the buy-in are equal to the sum of:
 - A. The difference between the buy-in settlement amount and the pool fail settlement amount.
 - B. Accrued coupon interest paid between the original settlement date and the buy-in settlement date.
 - C. An economic adjustment reflecting the fact that the original par amount was bought in.
- Use the worksheets from Exhibit D to calculate the components of this calculation.

Example: Unallocated TBA

A. Difference in Settlement Amounts.

- Calculate settlement amounts using the standard formulas.
- The buy-in settlement amount is calculated using:
 - the unamortized principal amount (*i.e.* a 1.0 factor),
 - the buy-in price,
 - accrual through the buy-in settlement date.

Calculation of Original Settlement Amount:

$$\frac{\$17,000,000}{\text{(Par Value of the TBA Fail)}} \times \frac{100-25}{\text{(Fail Price)}} \times (1/100) = \frac{\$17,132,812}{\text{(Cost of Principal Amount)}}$$

$$\frac{\$17,000,000}{\text{(Par Value of the TBA Fail)}} \times \frac{0.06}{\text{(Coupon)}} \times \left(\frac{13}{360} \right) = \frac{\$36,833}{\text{(Accrued interest)}}$$

$$\frac{\$17,132,812}{\text{(Cost of Principal Amount)}} + \frac{\$36,833}{\text{(Accrued interest)}} = \frac{\$17,169,645}{\text{(TBA Fail Settlement Amount)}}$$

Calculation of Buy-In Settlement Amount:

$$\frac{\$17,000,000}{\text{(Par Value of the TBA Fail)}} \times \frac{103-10}{\text{(Buy-In Price)}} \times (1/100) = \frac{\$17,563,125}{\text{(Cost of Principal Amount)}}$$

$$\frac{\$17,000,000}{\text{(Par Value of the TBA Fail)}} \times \frac{0.06}{\text{(Coupon)}} \times \left(\frac{12}{360} \right) = \frac{\$34,000}{\text{(Accrued interest)}}$$

$$\frac{\$17,563,125}{\text{(Cost of Principal Amount)}} + \frac{\$39,667}{\text{(Accrued interest)}} = \frac{\$17,597,125}{\text{(Settlement Amount)}}$$

Difference between Settlement Amounts:

$$\frac{\$17,602,792}{\text{(Buy-in Settlement Amount)}} - \frac{\$17,169,645}{\text{(TBA Fail Settlement Amount)}} = \frac{\$427,480}{\text{(difference)}}$$

Example: Unallocated TBA

B. Accrued coupon interest.

- Monthly interest payments are calculated for each record date between the original settlement date and the buy-in settlement date.
 - In this case, November 2005, December 2005 and January 2006.
- Interest payments are calculated using:
 - The par value of the TBA fail.
 - Generic monthly factors (from Bloomberg).

Calculation for November 2005:

$$\frac{\$17,000,000}{\text{(Par Value of the TBA Fail)}} \times \frac{1.0000000}{\text{(Nov05 Generic Factor)}} \times \frac{0.06}{\text{(Coupon)}} \times (30/360) = \frac{\$85,000}{\text{(Accrued interest)}}$$

Calculation for December 2005:

$$\frac{\$17,000,000}{\text{(Par Value of the TBA Fail)}} \times \frac{.978568699}{\text{(Dec05 Generic Factor)}} \times \frac{0.06}{\text{(Coupon)}} \times (30/360) = \frac{\$83,178}{\text{(Accrued interest)}}$$

Calculation for January 2006:

$$\frac{\$17,000,000}{\text{(Par Value of the TBA Fail)}} \times \frac{.958866720}{\text{(Jan06 Generic Factor)}} \times \frac{0.06}{\text{(Coupon)}} \times (30/360) = \frac{\$81,504}{\text{(Accrued interest)}}$$

Accrued coupon interest from prior months: \$249,682

Example: Unallocated TBA

C. Economic adjustment.

- Since the entire par value of the TBA fail is bought in, the Originating Purchaser receives more MBS than if delivery had been made.
- When the MBS are trading at a premium, this benefits the Originating Purchaser; when they are trading at a discount, this harms the Originating Purchaser.
- The economic adjustment uses the generic principal amortization and the buy-in price to eliminate this benefit or harm.

Calculate generic principal amortization:

$$\frac{\$17,000,000}{\text{(Par Value of the TBA Fail)}} \times \left(1.0 - \frac{.943510139}{\text{(Feb06 Generic Factor)}}\right) = \frac{\$960,328}{\text{(Generic Principal Amortization)}}$$

Calculate the economic adjustment:

$$\left(\frac{\$960,328}{\text{(Generic Principal Amortization)}} \times \frac{1}{100}\right) \times \left(100 - \frac{103-10}{\text{(Buy-In Price)}}\right) -$$

$$\left(\frac{\$960,328}{\text{(Generic Principal Amortization)}} \times 0.06 \times \frac{1}{360} \times \frac{12}{\text{(Interest Accrual Days Used for Buy-in Settlement Amount)}}\right) = \frac{\$33,732}{\text{(Economic Adjustment)}}$$

Example: Unallocated TBA

Calculation of net monies due:

A. Difference in Settlement Amounts	\$ 427,480
B. Accrued coupon interest	249,682
C. Economic adjustment	(33,732)

Net monies due: \$ 643,430



Further information:

- The Bond Market Association has created a web page (<http://www.bondmarkets.com/story.asp?id=2436>) for information regarding the revised Procedures, including:
 - A final prepublication draft of the Procedures.
 - A list of educational events (conference sessions, seminars, etc.).
 - Educational materials, including the materials from the educational events (as they become available).
- The Bond Market Association's staff is available to address any questions or concerns about the Procedures. Contact:
 - Chris Killian (646.637.9226 or ckillian@bondmarkets.com),
 - Robbin Conner (646.637.9228 or rconner@bondmarkets.com), or
 - Lynnette Hotchkiss (646.637.9218 or lhotchkiss@bondmarkets.com)