I. Background

Since the onset of the financial crisis, the to-be-announced mortgage-backed securities (TBA-MBS) market has faced an unusual set of challenges. Led by an absence of supply, investors faced a difficult trading environment amid low levels of mortgage origination while the Federal Reserve MBS Purchase Program began reducing the available inventory of TBA-MBS in the secondary market.

The Fed eventually completed the first round of TBA buying in March 2010 as the industry witnessed an estimated $1.25 trillion in supply removed from the system. And though the program successfully lowered 30-year mortgage rates for U.S. homeowners, these conditions began to result in significant failed deliveries of mortgage pools for many institutional market participants who now had limited access to liquidity.

This trading environment became even more taxing for investors on February 1, 2012 when the Treasury Market Practices Group within the Fed implemented a new fail charge for firms that failed to deliver pools to satisfy these trades. After the expiration of an initial grace period, dealers are now fined zero to two percent of the notional volume of a failed TBA-MBS trade.

Through conversations with major asset managers, Tradeweb leveraged its dealer-to-customer marketplace to create a proprietary electronic solution to help reduce the likelihood of systemic “daisy chain” or “round robin” fails. The new solution allows customers to “step out” of offsetting trades in the same instrument where the pool delivery obligations are the same, decreasing the number of counterparties and overall risk in the TBA-MBS market.
II. The Issue

The fundamental problem with failed deliveries in the TBA-MBS market is the potential domino-effect of failed trades that can result from them. Often referred to as a “daisy chain” or “round robin,” cyclical fails can result from counterparties’ inability to supply securities on delivery day. One of the reasons this threat exists is because many market participants use a strategy to “turn” trades, selling TBA mortgage-backed securities they expect to receive from a purchase made earlier.

When there is less supply in the marketplace, the possibility of a failed trade increases. For example:

1. Dealer A sells 1 million Fannie Mae 4.0 bonds (1M FN4) to Asset Manager 1;
2. Asset Manager 1 sold those same bonds to Dealer B in turn;
3. Dealer B, who expects to purchase 1M FN4s from Asset Manager 1, sold 1M FN4s to Dealer C, and so on.

If Dealer A fails to deliver the bonds to Asset Manager 1 on delivery day, the Asset Manager is unable to sell bonds to Dealer B, resulting in a daisy chain of fails due to a lack of liquidity. In some scenarios, Dealer C may have sold the bonds to Dealer A, whereupon the daisy chain becomes a round robin.

To resolve failed TBA-MBS trades, clients could “assign” trades from one dealer to another. However, assignment is most often a time-intensive and generally expensive process.
III. Round Robin: The Tradeweb Solution

A Tradeweb Round Robin Trade Ticket enables customers with equal, offsetting positions between two dealers to simultaneously step out of the trade with each dealer. The functionality allows an asset manager to remove itself from the security delivery process.

Since the end result of the Round Robin is position-neutral for all parties, Tradeweb applies the mid-market level to the trade. The process includes the following steps:

1. The Asset Manager bought 1M FN4 bonds from Dealer A on February 1st (S/D of February 13th)
2. The Asset Manager sold 1M FN4 bonds to Dealer B on February 2nd (S/D of February 13th)
3. The Asset Manager brings up a Round Robin ticket on Tradeweb, reversing the current position and therefore creating neutral (or flat) positions with both dealers
   - SELL 1M FN4’s to Dealer A
   - BUY 1M FN4’s to Dealer B

4. Dealer A and Dealer B face off against one another.
   - Dealer A BUYS from Dealer B
   - Dealer B SELLS to Dealer A

5. No change in the exchange of money
Round Robin Process

DEALER A

BOUGHT 1M FN4 FEB 1 @ 105-20

SELL 1M FN4 FEB DEALER A @ 105-19
BUY 1M FN4 FEB DEALER B @ 105-19

DEALER A SELLS 1M FN4 FEB @ 105-19 TO DEALER B

DEALER B BUYS 1M FN4 FEB @ 105-19 FROM DEALER A

DEALER B

SOLD 1M FN4 FEB 2 @ 105-21
IV. Market Growth

Adoption of the Tradeweb Round Robin technology took off quickly after launching in November of 2010. By April 2011, monthly Round Robin trading volume exceeded $45 billion. The aggressive growth of Round Robin trading was an early demonstration of the tool’s effectiveness at pairing off TBA (to-be-announced) mortgage pool transactions with dealers, and helping to reduce the likelihood of failed MBS trades.

As of March 2012, more than $1 trillion of risk has been offset in the TBA-MBS market through the use of this pioneering trading technology. There have been more than 23,000 transactions by over 40 different buy-side institutions since the launch of the functionality, and a record $120 billion of Round Robin trades were executed in February 2012, and $159 billion in March.

Tradeweb remains the industry’s largest execution venue for TBA mortgage trading, which represents the majority of all institutional residential mortgage trading. Launched in February 2001, there has been over $140 trillion in transactions executed by asset managers and other institutional clients on Tradeweb since inception. Monthly trading volumes now exceed $2 trillion on the electronic multi-dealer-to-customer platform.
V. Frequently Asked Questions

What does the Round Robin look like from the dealer’s perspective?
Trading desks at each dealer receive a pop-up notice when a client initiates a Round Robin trade. Dealers only have the option to accept or pass, and the trade is contingent on both dealers accepting the trade.

What if the original trade was not executed on Tradeweb?
The original trade(s) do not need to have been executed on Tradeweb; there are no restrictions as to where the trade(s) originated. Tradeweb does not confirm the original positions.

Are Round Robin trades TRACE reportable?
No, Round Robin trades are not considered new trades and are therefore not TRACE reportable.

What is the cutoff for Round Robin trades?
The cutoff time is noon (12:00 p.m. ET) three days before the settlement date of the respective issuer, or noon the day before 48 hour day.

Does someone on the trading desk have to initiate a Round Robin?
Round Robin tickets can be generated by a person on the trading desk or a middle/back-office user as long as they are authorized to do so.
For more information:

**Americas**
+1 800 541 2268
help@tradeweb.com

**Europe**
+44 (0) 20 7776 3200
europe.clientservices@tradeweb.com

**Asia**
Tokyo
+81 (0)3 6441 1020
contact.asia@tradeweb.com

Hong Kong
+852 3762 3430
contact.asia@tradeweb.com

Singapore
+65 6417 4532
contact.asia@tradeweb.com