RJO FIG

Fixed Income Group A Division of RJ O'Brien

ICE/Ellie Mae Primary Mortgage Rate Lock Futures Markets are Up and Streaming—Open to Trade

- Ellie Mae gathers >40% of daily rate lock data for Conventional 30 year (FN/FHR) and Jumbo 30 year. The rate reported is generated as an Annual Percentage Rate. The loan-balance-weighted average APR is reported next-business-day. The last five-ish years of data for both the conventional and jumbo silos can be found on Bloomberg via:
    - Conventional: LRC30APR<Index>
    - Jumbo: LRJ30APR<Index>
- The acronyms on Bloomberg for the TRADE-ABLE Futures are:
    - Conventional: VAIA <Comdty> CT <Enter>
    - Jumbo: VJIA<Comdty>CT<Enter>
- The symbology on Refinitiv is:
    - Conventional: <0#C30C:>
    - Jumbo: <0#SJO:>

Looking at the Conventional Future on Bloomberg, we see:

VAIN2 Comdty | Export | Settings

ICE US 30Y MTG FUT

Source | Session | Display Quoted V

Exchange Symbol 30C | Currency USD

Aggr Vol 0 | Aggr Open Int 0

Futures

Show Weekly Monthly Quarterly Seasonal Yearly

Description	Open Int	Settle Px ↑	Bid	Ask	Bid Size	Ask Size
1) Spot						
2) Jul22		93.850	93.805	93.820	30	30
3) Aug22		93.850	93.790	93.815	10	10
4) Sep22		93.835	93.780	93.805	10	10
5) Oct22		93.835	93.780	93.800	10	10
6) Nov22		93.835	93.765	93.810	10	10
7) Dec22		93.840	93.755	93.825	10	10

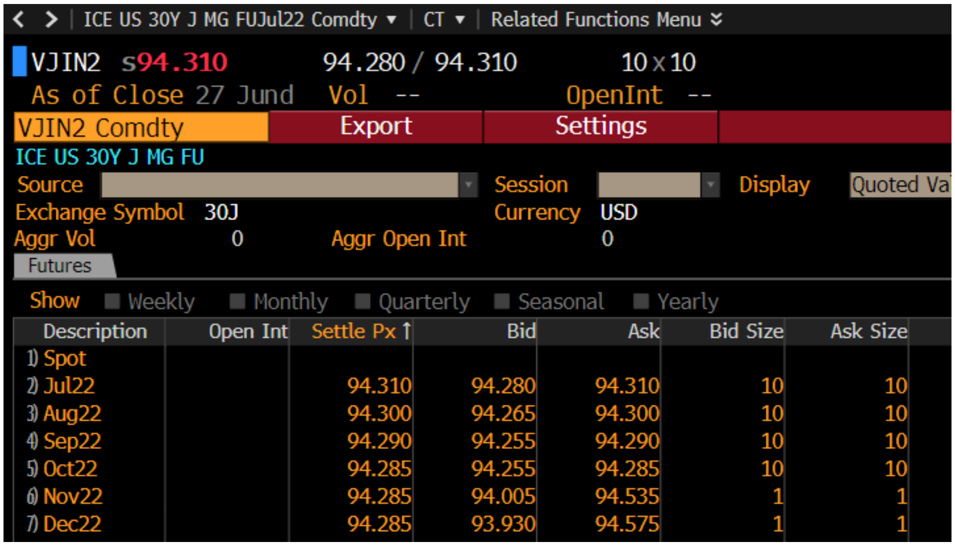
Both Conventional and Jumbo trade at a price: 100 – Futures Price = Implied Primary Rate. The July'22 future shows 93.805 X 93.82. In rate terms, 6.195% @ 6.180%. The futures settle on SIFMA settle dates (July 14, 2022 here), so the 'proposition' is: "Where will the all-inclusive PRIMARY conventional rate be on July 14?" The 'all-inclusive' means pass-through rate + servicing + G-Fee + xxx; the actual all-in borrower APR. All contracts that are not rolled, CASH settle (nothing to deliver) to the Ellie Mae posted value for settle date.

Each RL futures contract has a tick value (bp value) of a FIXED $50/basis point. Unlike TBA and other mortgage product, this future is non-convex. Since the sole determinant of settlement value is the Ellie Mae APR, there is no fixed coupon, no cheapest-to-deliver, no WAM—this is a straight PRIMARY RATE product. A change in futures price from 93.80 to 93.81 results in $50 P&L (gain for the long, loss for the short). Someone in Secondary/Pipeline risk management will likely be SHORT these futures to hedge 'rates up'. A trader on the MSR side will likely be LONG these contracts to hedge 'rates down'.

Because there is NO 'fixed coupon' nor a physical loan delivery, the drop more closely emulates the financing curve (amortizing SOFR) than anything like TBA. Month-to-month is much flatter.

For SECONDARY/Conventional, this is a huge opportunity. If your deliveries into UMBS (like most) are <10%, these futures offer an alternative to substantially cut the drop cost via cross hedging. Of course, the product is non-convex/linear, so the risk profile is different. While each pipeline risk management team will have their own view, I suspect over time that the Conventional Rate Lock futures become a meaningful percentage of total hedge. When drops are steep, the RL product is highly enticing. When drops flatten, percentage of RL hedge likely declines.

For SECONDARY/JUMBO—there is finally a functional hedge vehicle with visibility out the curve for primary jumbo rates. Current forward Jumbo looks like this:



Description	Open Int	Settle Px	Bid	Ask	Bid Size	Ask Size
1) Spot						
2) Jul22		94.310	94.280	94.310	10	10
3) Aug22		94.300	94.265	94.300	10	10
4) Sep22		94.290	94.255	94.290	10	10
5) Oct22		94.285	94.255	94.285	10	10
6) Nov22		94.285	94.005	94.535	1	1
7) Dec22		94.285	93.930	94.575	1	1

For SECONDARY/Extended Rate Locks/Builder Forwards/Lock'n'shop—there is now a product that will get you out the curve further than the TBA stack. Ask FIG about combining options with this product.

For MSR hedgers—Finally, a PRIMARY RATE hedge vehicle! Straight up DV'01 match—no key rate buckets. No convexity mis-match. Way cheaper than CMM.

For those with flexibility to use a new product, it's time to get involved. When there is sufficient liquidity and open interest in these futures, OPTIONS will be listed. Monthly cash-settle means no 'getting trapped' in a new product. As always, everyone should determine the appropriateness of any risk transfer vehicle for their institution. If you use a 3rd Party Risk Management system, please contact your vendor and tell them to get this product into their software.

While the notional value of the future is shown at $500,000, this value is a function of the fixed $50/bp contract construction. Crudely, each 1 RL Future is closer to $100k of new production UPB. If your risk management system calculates the DV'01 (rate sensitivity) of a loan at $450/$1million, your hedge ratio is: $450/$50 = 9 RL Futures per $1million loans. If you need $50,000 in DV'01 coverage on MSR risk, you calculate $50,000/$50 = 1,000 RL futures. Often, Jumbo will be analyzed at faster prepay speeds and shorter durations/lower dv'01s. So, a new production Jumbo may have $350 per $1million face in dv'01-- thus, $350/$50 = 7 Jumbo RL futures.

Call the RJO Fixed Income Group desk **(800-367-3349)** or email us at FIG@rjobrien.com to set up a call or to ask any questions.

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