**MBS Third Party Transactions**

From time to time in connection with mortgage securities forward transactions, a dealer may agree to accept performance obligations that have been delegated by its counterparty to a third party with whom the dealer does not have an original contractual relationship.

A typical example of such a third-party transaction would be as follows: Dealer A sells mortgage securities to a customer on a forward basis. The customer separately sells to Dealer B on a forward basis the same type of securities purchased from Dealer A, potentially at a different market price. Rather than settling its separate transactions with Dealer A and Dealer B, the customer would request Dealer A to make delivery to Dealer B on behalf of the customer, with any money differences subsequently being settled among the parties. In effect, third-party transactions result in the netting of two distinct trades.

The above-mentioned type of transaction is often incorrectly referred to as a trade assignment. However, third-party transactions and trade assignments differ considerably, particularly as they relate to the performance obligations of a dealer acting in the capacity of seller or buyer (Dealer A or B, respectively, in the above example). In a trade assignment, all of the seller's performance obligations to a buyer that arise out of a single transaction are transferred from the seller to the assignee. Transfer of the seller's performance obligations in this situation are commonly facilitated by the execution of a standard trade assignment agreement published by The Bond Market Association. Pursuant to this agreement, the assignee assumes the seller's obligations to make delivery to a buyer, on the terms and conditions originally agreed to between the seller and the buyer. Upon making this assignment, the seller's performance obligations to the buyer for that transaction are extinguished. Also, the buyer may look only to the assignee for performance. Unlike trade assignments, third-party transactions involve two separate and distinct contractual transactions. The parties to these transactions retain their performance obligations to each other, even though these obligations may be satisfied by making delivery to, or accepting delivery from, a non-original counterparty. In this respect, third party transactions resemble the manual netting of two distinct trades.

Third-party transactions may be attractive to market participants who lack the internal facilities to clear and settle mortgage transactions, or who generally wish not to assume these responsibilities. However, these benefits may generate additional costs and risks for other market participants. First, dealers participating in third-party transactions effectively subsidize the clearance and settlement costs of the party whose trades have been netted. Dealers are also exposed to additional credit risk, since the customer (most of whom are not MBSCC participants) is not obligated to post margin, as in the case of MBSCC participants. Second, lack of standardized documentation for third-party transactions may produce undesirable legal and transactional risks, such as the enforcement of performance obligations in the event that one party fails to make payment or delivery. Third, parties to such transactions may need to consider the implications these transactions may have on their books and records, suitability, know-your-customer and similar regulatory and self-regulatory requirements.

The Association recommends that its members consider taking steps to educate the marketplace, and individual market participants, about the mechanics, costs, risks and other attributes of third-party transactions.