



INTEREST RATES

Hedge Mortgage Servicing Rights with Eris SOFR

By CME Group

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For years, owners of mortgage servicing rights (MSR) assets have hedged using Eris Swap futures, enjoying the cash flow performance of interest rate swaps in a transparent, easily-tradable listed futures contract requiring less than half the initial margin (IM) of cleared interest rate swaps. Interest rates surging to levels well above the majority of servicing coupons has generated significant mark-to-market gains for holders of MSRs created prior to 2022. Investors of all sizes, even those with small servicing balances, can lock in these gains by hedging with Eris SOFR, mitigating the MSR price impairment a rates rally would cause.

SOFR hedges minimize unexplained P&L versus valuation models

The uneven development of SOFR liquidity during the market's transition away from LIBOR in recent years complicated MSR valuation models and led many MSR holders to switch their hedges from LIBOR-based swaps to U.S. Treasuries. Today, SOFR markets have met or surpassed historical LIBOR markets in depth and liquidity, and the spread between SOFR and Treasury rates has moved ten basis points or more in some months. With interest rates hitting levels not seen in decades, choosing hedges that align with the SOFR-based inputs of MSR valuation models is crucially important. By integrating Eris SOFR Swap futures into their risk management models and hedging strategies, MSR investors can ensure high hedge correlation and low unexplained profit and loss.

- **Tracks SOFR, aligning with MSR risk management models**

Ensure your hedges align with the SOFR-based inputs of your valuation model, given recent volatility in SOFR/Treasury spreads.

- **Returns SOFR-based interest on variation margin (VM)**

Funding VM when rates move against your hedge costs less with Eris SOFR than other futures, as the contract design embeds receiving overnight interest at SOFR (price alignment interest).

- **Saves capital with efficient futures IM**

Post collateral up to 65% lower than equivalent cleared IRS positions, preserving the flexibility to use capital elsewhere. Example: Every \$30mm of 10-year Eris SOFR saves \$1mm in IM.

MSR Hedging Comparison

HEDGING BENEFITS	ERIS SOFR SWAP FUTURES	TREASURY FUTURES	INTEREST RATE SWAPS
TRACKS SOFR, ALIGNING WITH MSR CASH FLOW MODELS	✓		✓
RETURNS SOFR-BASED INTEREST ON VM	✓		✓
SAVES CAPITAL WITH EFFICIENT FUTURES IM	✓	✓	

Next Steps

1. Ask your risk/valuation advisor how Eris SOFR can be used to hedge MSRs and how to incorporate the CME Eris SOFR Swap curve into your mortgage rate model.
2. Ask the product experts at Eris Innovations for more information: questions@erisfutures.com
3. Visit erisfutures.com for additional resources.

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