INTEREST RATES

Hedging with Mortgage Rate (OB30C) Futures

Mortgage Rate futures represent a novel risk management tool for mortgage lenders, offering a highly correlated and efficient alternative to traditional instruments like To-Be-Announced (TBA) Mortgage-Backed Securities (MBS) and U.S. Treasury futures. They are cash-settled to the Optimal Blue 30-Year Fixed Rate Conforming Index (Bloomberg ticker: OB30C Index), which is derived directly from mortgage rate locks. These futures reduce basis risk by providing exposure to the primary-secondary spread.

CONTRACT SPECS	
UNDERLYING INDEX	Optimal Blue 30-Year Fixed Rate Conforming Index
CONTRACT SIZE	$5,000 x contract index ($50 in DV01)
PRICING	Contract index = 100 – underlying index
TICK SIZE	0.005 index points (½ basis point per annum) = $25
LISTINGS	Six consecutive monthly contracts
DAILY SETTLEMENT	Calculated using futures market activity; 2:00 p.m. CT
FINAL SETTLEMENT	Cash settled to arithmetic average of Index over past five days
LAST TRADE DATE	SIFMA Class A 30-Yr UMBS Monthly Settlement Day
BLOCKS	100 contract minimum; 15-minute reporting time

Key mechanism: basis risk reduction

Mortgage Rate futures track the primary mortgage rate, the same rate that drives the value of a lender's pipeline and Mortgage Servicing Rights (MSRs) and also serves as a proxy for the rate borrowers are presented. Unlike TBAs, which possess negative convexity (meaning the hedge effectiveness changes unpredictably with large rate swings) and are priced in the secondary market, Mortgage Rate futures offer a linear fixed DV01 exposure to primary mortgage rates, ensuring a more consistent and predictable hedge effectiveness, which can outperform TBA hedging strategies.

Three critical hedging use cases

1. LONGER-DATED LOCK PIPELINE HEDGING

Challenge: Rate lock commitments that extend beyond 60 or 90 days expose the lender to greater duration risk and significant pull-through uncertainty. Hedging these exposures with TBAs can be difficult since there is little liquidity more than two months out, meaning that positions need to be rolled at least every two months, increasing hedge costs.

Futures solution: Mortgage Rate futures are listed for six months, allowing lenders to effectively hedge longer-dated locks.

2. MORTGAGE SERVICING RIGHTS (MSR) HEDGING

Challenge: MSRs are complex assets that gain value when interest rates rise (because fewer borrowers refinance, extending cash flows) and lose value rapidly when rates fall (due to increased prepayments). Historically, MSRs have been hedged using long duration instruments like U.S. Treasury futures or SOFR Interest Rate swaps.

Futures solution: Mortgage Rate futures are directly linked to the daily change in primary mortgage rates—the principal driver of prepayment risk and, consequently, MSR valuation. This significantly reduces the basis risk inherent in hedging MSRs with Treasury, SOFR or TBA hedges, which do not always move in lockstep with mortgage rates due to volatility in the primary-secondary spread.

3. NON-QM PIPELINE HEDGING

Challenge: Non-Qualified Mortgages (Non-QM) are not eligible for securitization by Government-Sponsored Enterprises (GSEs), meaning there is no liquid TBA market to hedge them directly. Lenders must rely on cross-hedging—using an instrument highly correlated to the interest rate movement of the Non-QM loan, even if the underlying assets are different.

Futures solution: Since the primary mortgage rate still generally governs Non-QM interest rate risk, using Mortgage Rate futures offers a superior cross-hedge compared to less-correlated instruments like Treasury futures and TBAs.

View more information and access related resources here.

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