

Sarah A. Miller  
General Counsel

Friday, October 31, 2008

Ms. Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551

Re: Regulation W; Docket No. R-1330; *Transactions Between Member Banks and Their Affiliates: Exemption for Certain Securities Financing Transactions Between a Member Bank and an Affiliate*; 73 Federal Register 54307; September 19, 2008.

Dear Ms. Johnson:

The ABA Securities Association (“ABASA”),<sup>1</sup> an affiliate of the American Bankers Association, appreciates the opportunity to comment on the Federal Reserve Board’s (the Board) adoption, on an interim final basis, of a regulatory exemption for member banks from certain provisions of Section 23A of the Federal Reserve Act and the Board’s Regulation W to permit securities financing transactions with affiliates. The exemption facilitates the ability of an affiliate of a member bank to obtain financing, if needed, for securities or assets that the affiliate ordinarily would have financed through the U.S. tri-party repurchase agreement market.<sup>2</sup>

ABASA appreciates the need to mitigate the potential impact of dislocations in the financial markets on the proper functioning of the U.S. tri-party repurchase agreement market. We have the following comments on the proposal:

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<sup>1</sup> ABA Securities Association (“ABASA”) is a separately chartered affiliate of the American Bankers Association (“ABA”) representing those holding company members of the ABA actively engaged in capital markets, investment banking, and broker-dealer activities.

<sup>2</sup> A repurchase agreement is an agreement between a seller and a buyer, whereby the seller agrees to repurchase the assets at an agreed upon price and at a stated time. The distinguishing feature of a tri-party repurchase agreement is the use of a custodian bank, which acts as an intermediary between the two parties to the repurchase agreement.

- The January 30, 2009, deadline should be extended to December 31, 2009, to coincide with the termination of the full Federal Deposit Insurance Corporation (FDIC) insurance coverage for non-interest bearing deposit accounts component of the recently announced Temporary Liquidity Guarantee Program (“TLGP”).
- The definition of eligible assets under the proposal should be broadened to include any type of asset that was accepted as collateral by an eligible U.S. tri-party repurchase agreement custodian during the week of September 8-12, 2008.

## **Background**

In response to the continuing unusual behavior of the financial markets and the potential interference with the U.S. tri-party repurchase agreement market, the Board adopted, as an interim final rule, a regulatory exemption for member banks from certain provisions of Section 23A of the Federal Reserve Act and the Board’s Regulation W. Generally, Section 23A and Regulation W limit the aggregate amount of “covered transactions” between a bank and a single affiliate to 10 percent of bank’s capital stock and surplus and limit the aggregate amount of covered transactions between a bank and all its affiliates to 20 percent of the bank’s capital stock and surplus.<sup>3</sup> These rules also require a bank to secure extensions of credit and guarantee transactions with affiliates.<sup>4</sup>

The proposed exemption aims to increase the capacity of member banks to enter into securities financing transactions with affiliates. In order to assure the safety and soundness of the participating financial institutions and preserve the spirit of Regulation W, participation in the program is subject to certain conditions:

1. Under the exception, member banks may finance only those asset types that the affiliate currently finances through the U.S. tri-party repurchase agreement market.
2. Transactions must be marked-to-market daily and subject to daily margin maintenance requirements, and the member bank must be at least as over-collateralized in its securities financing transactions with the affiliate as the affiliate’s clearing bank was in its U.S. tri-party repurchase agreement transactions with the affiliate on September 12, 2008.
3. To ensure that the exemption is used to provide liquidity and that the new positions do not increase the overall risk of the affiliate’s portfolio, the aggregate risk profile of the exempt securities financing transactions must be no greater than the aggregate risk profile of the affiliate’s U.S. tri-party repurchase agreement transactions on September 12, 2008.
4. The member bank’s top-tier holding company must guarantee the obligations of the affiliate under the securities financing transactions or provide other security such as a pledge of a sufficient amount of additional liquid, high quality collateral subject to the Board’s approval.

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<sup>3</sup> 12 U.S.C. §371c(a)(1) and 12 CFR 223.11 and 223.12. “Covered transactions” include the purchase of assets by a bank from an affiliate, the extension of credit by a bank to an affiliate, the issuance of a guarantee by a bank on behalf of an affiliate, and certain other transactions. 12 U.S.C. §371c(b)(7) and 12 CFR 223.3(h).

<sup>4</sup> 12 U.S.C. §371c(c) and 12 CFR 223.14.

5. Use of the exemption is limited to those banks that have not been specifically informed by the Board, after consultation with the bank's regulator, that they may not use the exemption.

The intention of the proposed rule is to assure that affiliates of a member bank, such as an SEC-registered broker-dealer, can continue to locate financing for securities and other assets that in the ordinary course of business would have been financed through the U.S. tri-party repurchase agreement market. The exemption expires on January 30, 2009.<sup>5</sup>

### **Concerns Arising From the Proposed Interim Final Rule**

#### *Extension of the Deadline*

The January 30, 2009, expiration date should be extended to December 31, 2009, to coincide with the termination of the non-interest bearing deposit account insurance component of the recently announced Temporary Liquidity Guarantee Program ("TLGP"). The proposed rule, like the TLGP program, was developed as part of a larger government effort to strengthen confidence and encourage liquidity in the nation's banking system.<sup>6</sup> Inasmuch as the FDIC and the Board found it prudent to extend the TLGP deadline beyond January 30, 2009, to assure its availability during this time of continuing market dislocation, the extraordinary relief offered by the TLGP and the temporary exemption from certain provisions of Section 23A of the Federal Reserve Act and the Board's Regulation W should be coterminous to ensure that the purposes of the exemption can be fully realized. Waiting until January to extend the deadline could send unintended adverse signals to the market about the Board's expectations with respect to the duration of the current credit crisis that would have negative consequences that far outweigh any downside risk of leaving the facility open for a longer period of time.

#### *Expanded Asset Eligibility*

The rule, as proposed, limits the use of the exemption only to those asset types that the *affiliate* currently finances in the US tri-party repurchase agreement market. A more equitable and rational restriction would be to limit transactions to the financing of any asset type that was accepted as collateral by an eligible US tri-party repurchase agreement custodian during the week of September 8-12, 2008. While we recognize and honor the Board's interest in creating an exemption that will facilitate necessary financing without undermining the purposes of Section 23A of the Federal Reserve Act and the Board's Regulation W, we are concerned that this condition is an arbitrary limitation that will limit the utility of the proposed exemption. Furthermore, we respectfully suggest that this condition is not necessary to ensure safe and sound banking practices. The proposed rule only exempts "covered transactions" from the quantitative limits, collateral requirements, and low-quality asset prohibitions of Section 23A of the Federal Reserve Act and Regulation W. It does not exempt them from the safe and sound banking practices requirement. Moreover, the Board's legitimate safety and soundness concerns

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<sup>5</sup> All transactions under the exemption still are subject to the market terms restrictions of Section 23B of the Federal Reserve Act (12 U.S.C. 371c-1), requiring terms and conditions that are substantially the same, or at least as favorable to the bank, as those that would have applied to comparable transactions or with a non-affiliate.

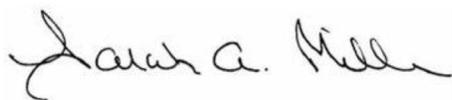
<sup>6</sup> See FDIC Issues Interim Rule to Implement the Temporary Liquidity Guarantee Program, Federal Deposit Insurance Corporation, <[www.fdic.gov/news/news/press/2008/pr08105.html](http://www.fdic.gov/news/news/press/2008/pr08105.html)> (10/23/08).

are effectively dealt with through other conditions to the exemption, specifically the conditions that the new positions do not increase the overall risk of the affiliate's portfolio; that the member bank must be at least as over-collateralized in its securities financing transactions with the affiliate as the affiliate's member bank was in its U.S. tri-party repurchase agreement transactions; and, that the member bank's top tier holding company must guarantee the obligations of the affiliate under the securities financing transactions.

Rather than addressing safety and soundness concerns, the asset limitation at issue may unwittingly serve to provide advantageous circumstances to specific member banks simply because they happened to have financed a particular asset type during the week of September 8-12, 2008. Furthermore, this limitation appears arbitrary because there is no justification provided in support of the limitation. Nor is there any finding that the types of assets financed by member bank affiliates in the U.S. tri-party repurchase market during the week of September 8-12, 2008, are representative of the types of assets generally financed by member bank affiliates. Because the stated purpose of the exemption is to increase the capacity of member banks to finance affiliate transactions, subject to certain safety and soundness conditions, this arbitrary limitation on the types of assets that can be financed should be expanded to more effectively serve the increased liquidity and confidence building purposes of the temporary exemption.

Thank you for the opportunity to comment on this proposed interim rule. Should you have any questions, please contact the Carolyn Walsh at 202-663-5253 or [cwalsh@aba.com](mailto:cwalsh@aba.com), or contact Denyette DePierro at 202-663-5333 or [ddepier@aba.com](mailto:ddepier@aba.com).

Sincerely,

A handwritten signature in cursive script that reads "Sarah A. Miller". The signature is written in black ink and is positioned above the typed name.

Sarah A. Miller