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7-1-2009

## Guidance on the Net Capital and Reserve Formula Treatment of Senior Unsecured Debt Securities Issued Under the Debt Guarantee Program

Financial Industry Regulatory Authority, Inc. (FINRA): National Association of Securities Dealers, Inc. (NASD)

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## FDIC Guaranteed Debt

### Guidance on the Net Capital and Reserve Formula Treatment of Senior Unsecured Debt Securities Issued Under the Debt Guarantee Program Component of the FDIC's Temporary Liquidity Guarantee Program

Effective Date: July 15, 2009

#### Executive Summary

FINRA is issuing this *Notice* to advise firms of the Net Capital and Reserve Formula treatment of senior unsecured debt securities issued under the Debt Guarantee Program component of the Federal Deposit Insurance Corporation's (FDIC) Temporary Liquidity Guarantee Program. Terms of the guidance are detailed in a July 15, 2009, letter to the Securities and Exchange Commission (SEC), included as Attachment A to this *Notice*.

Questions concerning this *Notice* should be directed to:

- ▶ Yui Chan, Managing Director, Risk Oversight and Operational Regulation (ROOR), at (646) 315-8426;
- ▶ Joanne Li, Director, ROOR, at (646) 315-8403; or
- ▶ Kathryn Mahoney, Director, ROOR, at (646) 315-8428.

#### Background & Discussion

In November 2008, the Board of Directors of the FDIC adopted a final rule regarding the Temporary Liquidity Guarantee Program (TLGP). The TLGP was announced by the FDIC as an initiative to counter the system-wide credit crisis in the nation's financial sector.

To assist firms in proper treatment of senior unsecured debt securities issued pursuant to the Debt Guarantee Program component of the FDIC's TLGP (the Program) under Rules 15c3-1 (Net Capital) and 15c3-3 (Reserve Formula) of the Securities Exchange Act of 1934, the SEC's Division of Trading and Markets staff has provided guidance to FINRA. The guidance is detailed in Attachment A of this *Notice*.

July 2009

#### Notice Type

- ▶ Guidance

#### Suggested Routing

- ▶ Compliance
- ▶ Finance
- ▶ Legal
- ▶ Operations
- ▶ Regulatory Reporting
- ▶ Senior Management

#### Key Topic(s)

- ▶ Customer Protection
- ▶ FDIC Guaranteed Debt
- ▶ Net Capital

#### Referenced Rules & Notices

- ▶ SEA Rule 15c3-1
- ▶ SEA Rule 15c3-3

As prescribed in the FDIC's final rule regarding the Program, the FDIC will fully and unconditionally guarantee senior unsecured debt securities issued by participating entities pursuant to the Program between October 14, 2008, and June 30, 2009, through the earlier of

- the maturity of such debt;
- the mandatory conversion date of any mandatory convertible debt; or
- June 30, 2012.

In addition, as prescribed in the FDIC's subsequent rule amendment regarding the Program, the FDIC will fully and unconditionally guarantee senior unsecured debt securities issued by participating entities pursuant to the Program between April 1, 2009, and October 31, 2009, through the earlier of

- the maturity of such debt;
- the mandatory conversion date of any mandatory convertible debt; or
- December 31, 2012.

The debt securities issued pursuant to the Program, which include commercial paper, non-convertible debt securities and mandatory convertible debt securities, may be:

1. **full-term guaranteed by the FDIC:** any debt securities issued pursuant to the Program that have a maturity date that ends, or a mandatory conversion date that is effective, on or before the aforementioned Program end-dates, such that the debt securities are guaranteed by the FDIC for the entire term from the date they are issued until their maturity date or mandatory conversion date;
2. **partial-term guaranteed by the FDIC:** any debt securities, except mandatory convertible debt securities, issued pursuant to the Program that have a maturity date that ends after the aforementioned Program end-dates, such that the debt securities are guaranteed by the FDIC for the entire period from the date they are issued until the Program's end-date, but are not guaranteed by the FDIC for any remaining period beyond the Program's end-date through their maturity date; or
3. **non-guaranteed by the FDIC:** any debt securities issued pursuant to the Program that are not guaranteed by the FDIC for any period from the date they are issued until their maturity date.

Based on the above, the SEC's Division of Trading and Markets staff has advised that FINRA firms may apply the Net Capital and Reserve Formula treatment on the debt securities issued pursuant to the Program as detailed in FINRA's July 15, 2009, letter to the SEC (see Attachment A of this *Notice*).

## Attachment A

July 15, 2009

Michael A. Macchiaroli, Esq.  
Associate Director  
Securities and Exchange Commission  
Division of Trading and Markets  
100 F Street, NE  
Washington, DC 20549

Dear Mr. Macchiaroli,

FINRA has requested guidance from the Division of Trading and Markets staff of the Securities and Exchange Commission as to the treatment of senior unsecured debt securities issued pursuant to the Debt Guarantee Program component of the Federal Deposit Insurance Corporation's (FDIC) Temporary Liquidity Guarantee Program (the Program), under Rules 15c3-1 (Net Capital) and 15c3-3 (Reserve Formula) of the Securities Exchange Act of 1934.

As prescribed in the FDIC's final rule regarding the Program, and confirmed through discussions with FDIC staff, the FDIC will fully and unconditionally guarantee senior unsecured debt securities issued by participating entities pursuant to the Program between October 14, 2008, and June 30, 2009, through the earlier of the maturity of such debt, the mandatory conversion date of any mandatory convertible debt or June 30, 2012. In addition, as prescribed in the FDIC's subsequent rule amendment regarding the Program, the FDIC will fully and unconditionally guarantee senior unsecured debt securities issued by participating entities pursuant to the Program between April 1, 2009, and October 31, 2009, through the earlier of the maturity of such debt, the mandatory conversion date of any mandatory convertible debt or December 31, 2012.

The debt securities issued pursuant to the Program, which include commercial paper, non-convertible debt securities and mandatory convertible debt securities, may be:

1. full-term guaranteed by the FDIC: any debt securities issued pursuant to the Program that have a maturity date that ends, or a mandatory conversion date that is effective, on or before the aforementioned Program end-dates, such that the debt securities are guaranteed by the FDIC for the entire term from the date they are issued until their maturity date or mandatory conversion date;

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2. partial-term guaranteed by the FDIC: any debt securities, except mandatory convertible debt securities, issued pursuant to the Program that have a maturity date that ends after the aforementioned Program end-dates, such that the debt securities are guaranteed by the FDIC for the entire period from the date they are issued until the Program's end-date, but are not guaranteed by the FDIC for any remaining period beyond the Program's end-date through their maturity date; or
3. non-guaranteed by the FDIC: any debt securities issued pursuant to the Program that are not guaranteed by the FDIC for any period from the date they are issued until their maturity date.

Based on the foregoing and our subsequent discussions with you, it is our understanding that the SEC's Division of Trading and Markets staff is in agreement with FINRA staff that FINRA firms may apply the following Net Capital and Reserve Formula treatment on the debt securities issued pursuant to the aforementioned Program:

SEA Rule 15c3-1 - Net Capital Treatment

Proprietary positions in full-term guaranteed commercial paper and non-convertible debt securities issued by an unaffiliated entity shall be subject to the haircut deductions under SEA Rule 15c3-1(c)(2)(vi)(A) (Government Securities).

Proprietary positions in partial-term guaranteed and non-guaranteed commercial paper issued by an unaffiliated entity shall be subject to the haircut deductions under SEA Rule 15c3-1(c)(2)(vi)(E) (Commercial Paper), if such securities meet all the required provisions thereunder. Otherwise, the applicable haircut deductions of SEA Rule 15c3-1(c)(2)(vii) and the interpretations thereunder shall be applied on such debt securities.

Proprietary positions in partial-term guaranteed and non-guaranteed non-convertible debt securities issued by an unaffiliated entity shall be subject to the haircut deductions under SEA Rule 15c3-1(c)(2)(vi)(F) (Non-Convertible Debt Securities), if such securities meet all the required provisions thereunder. Otherwise, the applicable haircut deductions of SEA Rule 15c3-1(c)(2)(vii) and the interpretations thereunder shall be applied on such debt securities.

Proprietary positions in any mandatory convertible debt securities issued by an unaffiliated entity shall be subject to the haircut deductions under SEA Rule 15c3-1(c)(2)(vi)(G) (Convertible Debt Securities), pursuant to the prescribed provisions thereunder.

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Proprietary positions in any commercial paper or non-convertible debt securities issued by an affiliated entity shall be treated as a non-allowable asset, unless the broker-dealer can satisfy the requirements prescribed under interpretation /061 of SEA Rule 15c3-1(c)(2)(vi).

Proprietary positions in any mandatory convertible debt securities issued by an affiliated entity shall be treated as a non-allowable asset.

Broker-dealers that are allocated any debt securities issued by an affiliated entity pursuant to the Program, as part of a pool of collateral to a reverse repurchase transaction pursuant to the FICC General Collateral Financing Repo Program, need not apply a deduction to net capital on the reverse repurchase contract if the allocated collateral is returned the next morning. The foregoing applies irrespective of the duration of the reverse repurchase contract (*i.e.*, overnight or term). Broker-dealers must apply a charge to their net capital for the computed deficit, if any, on such reverse repurchase contracts pursuant to SEA Rule 15c3-1(c)(2)(iv)(F)(2). In addition, where the underlying collateral received from the FICC allocation includes the aforementioned debt securities issued by an affiliated entity, broker-dealers must maintain records to evidence that the reverse repurchase contracts were effected pursuant to the FICC General Collateral Financing Repo Program.

Any reverse repurchase contracts that are not transacted pursuant to the FICC General Collateral Financing Repo Program, where the underlying collateral received consists of debt securities issued by an affiliated entity pursuant to the Program, shall be treated as a non-allowable asset.

#### SEA Rule 15c3-3 Reserve Formula Treatment

Full-term guaranteed commercial paper and non-convertible debt securities issued by an unaffiliated entity pursuant to the Program, either held in inventory by a broker-dealer or obtained through a reverse repurchase contract, may be deemed a “qualified security” under SEA Rule 15c3-3(a)(6) for deposit into a Reserve Bank Account under the following conditions:

1. The total amount of all unaffiliated full-term guaranteed commercial paper and non-convertible debt securities deposited into a Reserve Bank Account may not exceed 25 percent of the broker-dealer’s aggregate SEA Rule 15c3-3 Reserve Bank Account deposit(s) (Customer and PAIB); and

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2. The total amount of all unaffiliated full-term guaranteed commercial paper and non-convertible debt securities of any single issuer deposited into a Reserve Bank Account may not exceed 10 percent of the broker-dealer's aggregate SEA Rule 15c3-3 Reserve Bank Account deposit(s) (Customer and PAIB).

The foregoing limitations have been established in view of the 20 percent risk weighting applied by federal banking agencies to debt that is guaranteed by the FDIC under the Program, which is also consistent with such agencies' capital treatment of FDIC-insured deposits.

All other commercial paper, non-convertible debt and mandatory convertible debt securities issued by either an unaffiliated or affiliated entity pursuant to the Program, may not be deemed a "qualified security" under SEA Rule 15c3-3(a)(6) for deposit into a Reserve Bank Account.

We understand that the foregoing represents a SEC staff position with respect to the Net Capital and Reserve Formula treatment of debt securities issued pursuant to the Program. Furthermore, this guidance may be withdrawn or modified if your staff determines that such action is necessary in the public interest, for the protection of investors, or otherwise in furtherance of the purpose of the securities laws.

Very truly yours,

Krisoula Dailey  
Vice President  
FINRA