

Pursuant to this authority, the Federal Reserve Board promulgated Regulation T,<sup>9</sup> which sets minimum initial margin requirements. Regulation T provides that transactions in non-equity securities are subject to either “good faith” margin requirements<sup>10</sup> or the level set by the rules of a self-regulatory organization (“SRO”), whichever is higher.<sup>11</sup> Accordingly, the maintenance margin requirements established by the NYSE or another SRO set the minimum margin levels for non-equity securities.<sup>12</sup>

As described more fully below, the proposal amends NYSE rule 431 to: (1) Lower the customer maintenance margin requirements for certain non-equity securities; and (2) permit good faith margin treatment for certain non-equity securities held in “exempt accounts,” as defined in the proposal.

#### *B. Reduced Customer Maintenance Margin for Non-Equity Securities Not Held in Exempt Accounts*

With respect to non-equity securities that are not held in exempt accounts, the proposal: (1) Reduces the customer maintenance margin requirement for highly rated foreign sovereign debt<sup>13</sup> from 20% of current market value to 1% to 6% of current market value, depending on the time to maturity; (2) reduces the customer maintenance margin requirement for exempted securities other than U.S. government obligations from 15% of current market value to 7% of current market value; (3) reduces the customer maintenance margin requirement for investment grade non-equity securities<sup>14</sup> from 20% of current market value to 10% of current market value; and (4) establishes a customer maintenance margin requirement of 20% of current market value for all other marginable non-equity securities.<sup>15</sup>

#### *C. Good Faith Margin Treatment for Certain Non-Equity Securities Held in Exempt Accounts*

##### *1. Good Faith Margin Treatment*

The proposal will permit broker-dealers to effect transactions in “exempt accounts” without being required to collect either margin or marked to the market losses<sup>16</sup> on exempted securities, mortgage-related securities,<sup>17</sup> or major foreign sovereign debt securities.<sup>18</sup> However, a broker-dealer must take a capital charge for any uncollected marked to the market losses on exempt account positions in these securities.<sup>19</sup>

For transactions in exempt accounts involving highly rated foreign sovereign debt<sup>20</sup> and investment grade debt,<sup>21</sup> the proposal establishes margin requirements of 0.5% and 3%, respectively.<sup>22</sup> Although a broker-dealer is not required to collect this margin, it must take a capital charge for any uncollected margin and for any uncollected marked to the market losses.<sup>23</sup>

##### *2. Limitation on Capital Charges*

The proposal limits the amount of capital charges a broker-dealer may take in lieu of collecting marked to the market losses.<sup>24</sup> Specifically, a broker-dealer may not enter into transactions with exempt accounts that would increase the broker-dealer’s capital charges if the broker-dealer’s capital charges exceed: (1) 5% of the broker-dealer’s tentative net capital<sup>25</sup> on any one account or group of commonly controlled accounts; or (2) 25% of the broker-dealer’s tentative net capital on all accounts combined, unless the excess no longer exists on the fifth business day after it was incurred. The broker-dealer also must notify the NYSE

that it has reached the 5% or 25% threshold.

##### *3. Definition of Exempt Account*

The proposal defines “exempt account” to include the accounts of certain regulated entities, including banks, savings and loans, insurance companies, and registered investment companies. In addition, the proposal defines an “exempt account” to include any person that has a net worth of at least \$40 million and financial assets of at least \$45 million and who: (1) Is an issuer of registered securities; (2) is an issuer of securities that provides the Commission with the information required under rule 12g3-2(b) under the Exchange Act;<sup>26</sup> (3) is a person with respect to which there is publicly available certain information required in rule 15c2-11 under the Exchange Act;<sup>27</sup> or (4) makes available to the broker-dealer such current information regarding the person’s ownership, business, and financial condition (including a current audited statement of financial condition, statement of income, or comparable financial reports) that the broker-dealer reasonably believes to be accurate, sufficient for the purposes of performing a risk analysis in respect of the person.<sup>28</sup>

##### *4. Written Risk Analysis Methodology*

Under the proposal, a broker-dealer must maintain a written risk analysis methodology for managing the credit risk associated with extending good faith margin on securities transactions in exempt accounts.<sup>29</sup> The NYSE has prepared an Information Memo providing guidelines for the risk analysis methodology that it will distribute to members following approval of the proposal. The Information Memo states that a member’s written risk analysis methodology should include the following:

- Procedures for obtaining and reviewing the appropriate customer account documentation and the customer financial information necessary to determine exempt account status for the extension of credit under the rule;
- Procedures and guidelines for the determination, review and approval of credit limits to customers and across all customers who qualify as exempt accounts under the rule;
- Procedures and guidelines for monitoring credit risk exposure to the

agency that meet certain requirements. See NYSE rule 431(a)(16).

<sup>16</sup> Marked to the market losses are unrealized losses on a position in securities resulting from a decline in the position’s market value.

<sup>17</sup> The proposal defines “mortgage related securities” to mean securities that fall within the definition in section 3(a)(41) of the Exchange Act. See NYSE rule 431(a)(12).

<sup>18</sup> The proposal defines “major foreign sovereign debt securities” as debt securities issued or guaranteed by the government of a foreign country or supranational entity that are assigned a rating in the top rating category by at least one nationally recognized statistical rating organization. See NYSE rule 431(a)(11).

<sup>19</sup> See NYSE rule 431(e)(2)(F).

<sup>20</sup> See *supra* note 13.

<sup>21</sup> See *supra* note 14.

<sup>22</sup> See NYSE rule 431(e)(2)(G).

<sup>23</sup> See NYSE rule 431(e)(2)(G).

<sup>24</sup> See NYSE rule 431(e)(2)(H).

<sup>25</sup> Generally, tentative net capital is a broker-dealer’s net worth after deducting most illiquid assets but before making haircut deductions.

<sup>9</sup> 12 CFR 220 *et seq.*

<sup>10</sup> Regulation T defines “good faith” margin as the amount of margin that a broker-dealer would require in exercising sound credit judgment.

<sup>11</sup> 12 CFR 220.12(b).

<sup>12</sup> See NYSE rule 431(c).

<sup>13</sup> The proposal defines “highly rated foreign sovereign debt securities” as debt securities issued or guaranteed by the government of a foreign country, its provinces, states or cities, or a supranational entity that are assigned a rating in one of the two top rating categories by at least one nationally recognized statistical rating organization. See NYSE rule 431(a)(9).

<sup>14</sup> The proposal defines “investment grade debt” as any debt securities assigned a rating in one of the top four rating categories by at least one nationally recognized statistical rating organization. See NYSE rule 431(a)(10).

<sup>15</sup> The proposal defines “other marginable non-equity securities” to include debt securities not traded on a national securities exchange that meet certain requirements and private pass-through securities not guaranteed by a U.S. government

<sup>26</sup> 17 CFR 240.12g3-2(b).

<sup>27</sup> 17 CFR 240.15c2-11.

<sup>28</sup> See NYSE rule 431(a)(13).

<sup>29</sup> See NYSE rule 431(e)(2)(H).