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September 8, 2008

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Jennifer J. Johnson
Secretary
Board of Governors of the
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20th Street and Constitution Avenue, N.W.
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Re: Status of Bank Repurchase and Reverse Repurchase Agreement Activities Involving Non-Exempt Securities under the Securities Exchange Act of 1934, SEC Release Nos. 34-56501 and 34-56502; Regulation R; Docket No. R-1274

Ladies and Gentlemen:

The ABA Securities Association ("ABASA")[1] appreciates the opportunity to submit this letter in response to the request by the Securities and Exchange Commission ("SEC") and the Board of Governors of the Federal Reserve System (the "Board") (hereinafter referred collectively to as the "Agencies") for information on the nature and extent of bank repurchase and reverse repurchase ("repo") agreement activities involving non-exempt securities. The Agencies' request for information was made in the context of their joint adoption of Regulation R, which implements the so-called "push-out" provisions under Section 3(a)(4) of the Securities Exchange Act of 1934 (the "Exchange Act"), as amended by the Gramm-Leach-Bliley Act ("GLBA").[2] We have provided responses to the Agencies' specific requests for information in the attached annex. ABASA urges the Agencies to clarify

[1] 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.

[2] Exchange Act Release No. 34-56501, 72 Fed. Reg. 56514, at 56544-45 (Oct. 3, 2007) (the "Reg R Release"). The SEC separately asked for information concerning bank repo activities in the companion release addressing the dealer provisions under Section 3(a)(5) of the Exchange Act. See Exchange Act Release No. 34-56502, 72 Fed. Reg. 56562, at 56566 (Oct. 3, 2007).

promptly that banks may enter into repos and reverse repos with non-exempt securities without being subject to broker-dealer registration. [3]

We are not asking the Agencies to reach any generic conclusions on whether repo and reverse repurchase activities undertaken by entities would constitute broker-dealer activity requiring registration under Section 15 of the Securities and Exchange Act. We are writing to urge the Agencies to make it clear that banks would not have to register as broker-dealers to engage in these activities. ABASA strongly believes that such a requirement would be unduly burdensome for banks and would not provide any meaningful investor protections to the public because repo and reverse repurchase activities are substantially equivalent to the types of activities that banks enter into on a daily basis and for which they are specifically regulated. Indeed, banking regulators have a history of overseeing and issuing guidance on repo and similar activities for banks.

Repos are created by a contract outlining the rights and obligations of the parties and have characteristics of both purchases and sales and financing transactions.[4] Historically, repos have been short-term instruments used by various market participants, including banks and broker-dealers, to provide financing to customers or to finance their own positions. The ability to re-hypothecate or sell the purchased securities or collateral received in a repo has been one of the hallmarks of the transaction, thus permitting the credit provider to also fund itself. As discussed in detail below, repos are economically equivalent to secured financings and squarely fall within the traditional banking activity of providing and obtaining secured financing. We therefore believe that viewing purchases and sales in the context of repo transactions as constituting broker-dealer activity when engaged in by banks would elevate form over substance without any compelling public policy reason for requiring banks to register as broker-dealers. In addition, repos provide banks with a number of advantages over other types of financing activities, including a well-established legal framework, widely accepted and

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[3] Clearly, banks may engage in these activities on an agency basis excepted from broker-dealer registration under the trust and fiduciary or custody exceptions of the GLBA and Regulation R. This submission is limited to those activities that do not qualify for these exceptions.

[4] In the U.S., the form of Master Repurchase Agreement ("MRA") governed by New York law is typically used, whereas, internationally, the form of Global Master Repurchase Agreement ("GMRA") governed by English law is typically used. As discussed further in this letter, repo and reverse repo transactions are economically equivalent to financings, but structured legally as purchases and sales. The MRA and GMRA contain statements that identify the transaction as a purchase and sale, with transfer of title to the securities, and the agreements require the parties to deliver the necessary documents and take necessary steps to ensure the transfer of title to the securities. This legal distinction does not materially change the overall function, purpose and economics of the transaction.

standardized documentation, and extensive internal systems and controls and related compliance mechanisms.

We describe the workings of repurchase transactions (both in the text and, more fully, in the annex), outline the regulatory treatment of repurchase transactions and conclude that all repos are the functional and economic equivalent of traditional banking activities. Because there is no substantive difference between repo activities on exempt securities versus repo activities on non-exempt securities, banks should not be required to register as broker-dealers to conduct those activities, regardless of whether the bank engages in a repo transaction, a reverse repo transaction or both transactions on the same exempt or non-exempt security.

In light of the continued issues of liquidity in the marketplace, we believe confirming the ability of banks to provide another method of financing to the marketplace to be imperative.

<u>Overview of Repo Transactions</u>

As the Agencies are well aware, a repo is a transaction widely used by various market participants to acquire immediately available funds by selling securities and simultaneously agreeing to repurchase the same or similar securities at a specified price on a later date.

For exempt and non-exempt securities alike, various features of repo transactions work together to achieve the same economic substance as a secured financing – an activity that banks engage in everyday and for which they are carefully scrutinized by banking regulators. More specifically, a standard repo consists of a two-part transaction. The first part consists of the sale of securities by one party, the Seller, to another party, the Buyer, in exchange for cash. The second part consists of the contemporaneous agreement by the Seller to repurchase the securities at the original price, plus an agreed upon "price differential" (essentially the interest component) on a specified future date or on demand. A reverse repurchase agreement ("reverse repo") is the identical transaction viewed from the perspective of the second party, who purchases securities with an agreement to resell.

A repo has two pricing components: First, the amount of cash transferred to the Seller is typically less than the prevailing market value of the securities transferred to the Buyer. This differential is sometimes referred to as the "haircut" and it functions exactly like an over-collateralization feature in a loan, where the repo Seller is the borrower of cash and the repo Buyer is the lender. Second, the repurchase price paid at the maturity date by the Seller is equal to the original purchase price plus the price differential calculated, like interest based on time, at a predetermined rate from the original trade date to the maturity date of the repo transaction.

The party purchasing the securities in a repo transaction is not making an investment decision related to those securities. Rather, "purchased securities" in a repo transaction share many characteristics of collateral pledged in a secured financing. First, the repo transaction often includes provisions (subject to consent of the repo buyer/lender) for substitution of the purchased securities during the tenure of the transaction, thus replicating collateral substitution provisions of secured financings. Second, the repo Seller is entitled to receive from the Buyer an amount equal to all income paid on the securities to the full extent as if such securities were not sold, thus again replicating collateral arrangements of secured financings. Third, with a repo, purchased securities are marked-to-market daily and the seller is obligated to provide margin (or has the right to return of margin) upon the decrease (increase) in value of the securities. These mechanisms demonstrate that the amount of collateral to which the repo Buyer is entitled is directly correlated to the Seller's obligation to repurchase the securities or, put another way, to repay its loan. Indeed, the Seller's obligation to repurchase the securities for the original purchase price plus the agreed price differential (in contrast to a then-current market price) means that the seller retains full exposure to market risk on the securities as it would with any collateral pledged in a secured loan. From an accounting standpoint, the transaction is not viewed as a "sale" of the securities and, instead, remains on the seller's books. Lastly, just as with a secured loan, in the event the Seller defaults on its obligations or otherwise becomes insolvent, the Buyer is entitled to take possession of, and sell the securities, applying the proceeds toward the Seller's obligation to repurchase the securities.

Additional detail regarding repo transactions is included in the Annex to this letter.

<u>Legal Framework Applicable to Repos</u>

Repo transactions are typically documented under standard industry forms which are used for exempt and non-exempt securities alike. These forms are very flexible, well understood by the marketplace, and benefit from industry enforceability and netting opinions. As a result, it is much more efficient to enter into a repo than other, more heavily negotiated forms of secured financings, particularly for short-term transactions.[5] Moreover, the 2005 amendments to the U.S. Bankruptcy Code (the "Code") expanded the definitions of "repurchase agreement" and "reverse repurchase agreement," and afforded greater legal certainty and protection from the automatic stay and

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[5] The MRA and the GMRA are legally enforceable contracts, including with regard to their close-out or netting provisions. Many U.S. banks, broker-dealers, and institutional investors are accustomed to using the MRA and GMRA across a variety of asset categories, including non-exempt securities.

avoidance provisions in the Code.[6] Among the reasons cited most often by market participants for the popularity of using repos are established standardized documentation and market practices, as well as the legal advantages under the Code.

Historically, banks have been active in the repo market for U.S. government securities, which is estimated to be one of the largest and most liquid financial markets in the world. Gradually, bank repo activities have evolved over time to include non-exempt securities, such as mortgage-backed securities and other corporate securities.[7] Today, in terms of bank customers, many institutional investors and broker-dealers active in the mortgage market, as well as other markets, rely on the repo market to meet their financing needs.

The steady increase in bank repo activities involving non-exempt securities reflects the critical role that banks play as a source of funding to market participants in need of short-term liquidity to finance their holdings of such securities. Indeed, Board actions to permit major money center banks to extend credit to mortgage market participants via reverse repos on mortgage-backed and related securities in a conduit arrangement with their affiliates attest to the fact that repos provide a convenient operational platform and legal framework for such financing activities.[8]

Regulatory Treatment of Bank Repo Transactions

Bank repo activities are regulated by banking regulators and there would be little benefit to the marketplace and bank counterparties in having banks regulated as broker-dealers before banks can engage in the full panoply of repo activities. Consistent with the overarching business purposes served by bank repo activities, the bank regulatory agencies generally and historically have treated repos like extensions of credit. For example, the Handbook on

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[6] See Section 101(47) of the Code (definition of repurchase agreement). Banking law provides repo transactions with similar legal certainty, and similar exemptions from avoidance and repudiation statutes, in a situation where the Federal Deposit Insurance Corporation is appointed conservator or receiver for an insured depository institution. See 12 U.S.C. Section 1821(e)(8), and particularly, 12 U.S.C. Section 1821(e)(8)(D)(ii) and (v) (definitions of "securities contract" and "repurchase agreement"). The expected turnover of the purchased securities among financial participants and the related potential systemic implications are two of the reasons that repurchase agreements are exempt from the automatic stay of the Code and the avoidance and repudiation provisions of the Federal Deposit Insurance Act.

[7] Primary dealer repo activities have similarly expanded beyond US government and agency securities to include mortgage-backed and corporate securities. See, e.g., http://www.newyorkfed.org/markets/statistics/deal.pdf.

[8] See letters from Robert deV. Frierson, Secretary of the Board, to Patrick S. Antrim, Bank of America Corporation, Carl Howard, Citigroup Inc., and Kathleen A. Juhase, JPMorgan Chase & Co., all dated Aug. 20, 2007.

Dealer Activities from the Office of the Comptroller of the Currency ("OCC") reminds examiners "that 'reverse repo' agreements are merely another form of secured lending."[9] Similarly, the policy statement issued by the Federal Financial Institutions Examination Council ("FFIEC") on examining bank repo activities provides various guidelines that banks should adopt in their credit policies and controls for the underlying collateral.[10] In short, the bank regulatory agencies have long supervised bank repo activities as part of the bank's credit extension business, requiring it to have sound credit risk management practices – e.g., by focusing on counterparty creditworthiness, obtaining control of the collateral and implementing concentration limits.[11] The bank regulatory agencies also have recognized that a bank may engage in repo activities in order to meet its own funding requirements.[12] In this regard, we note that the Federal Reserve has recently expanded the list of securities that it will accept under various lending and repurchase programs that are designed to provide liquidity to the market. The Federal Reserve has not thought of itself as participating in the trading of securities, but as providing much needed funding and liquidity to the current market. Banks view repo activity in the same way.

The motivation for repo transactions is to obtain or provide funding, not to buy or sell securities. In fact, securities regulators and securities self-regulatory organizations also treat repos similar to traditional credit activities of banks.[13] For example, FINRA has taken the position that, for purposes of

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[9] See OCC Handbook on Bank Dealer Activities, p. 8 (March, 1990), available at http://www.occ.treas.gov/handbook/BankDealer1.pdf.

[10] See FFIEC, "Repurchase Agreements Between Depository Institutions with Securities Dealers and Others; Notice of Modification of Policy Statement," 63 Fed. Reg. 6,935, at 6,938 (Feb. 11, 1998).

[11] Bank regulators treat repos as a form of financing or loan under a variety of other regulations. See Regulation K, 12 CFR 211.4(a)(7) (permitting commodities and securities repos for non-US branches of US banks that are "the functional equivalents of extensions of credit"); 12 CFR 32.2(k)(1)(iii) and (iv) (OCC rules specifically defining reverse repos on non-exempt securities as loans or extensions of credit for legal lending limit purposes); regulatory capital rules treat a reverse repo as a secured loan under the credit risk rules and the risk weighting is based on the risk category of the counterparty and the collateral. See Capital Adequacy Guidelines: Risk Based Measure (Appendix A), Section III.A.

[12] See Board Trading and Capital Markets Activities Manual § 4015.1 (Apr. 2001) (recognizing that the repo market "gives a bank the means to use its securities portfolio to obtain additional liquidity – that is, funding – without liquidating its investments or recognizing a gain or loss on the transaction"). Moreover, with respect to repos on securities other than U.S. government and agency securities, the Board has stated that they are also generally treated as deposits of the selling bank, subject to reserve requirements under Regulation D. Id; See also 12 C.F.R. § 204.2(a)(1)(vii). Similar to the OCC's lending limit provision cited in footnote 11, Regulation D considers repos on securities other than U.S. government and agencies to be the functional equivalent of the bank extending credit and having a liability to counterparty.

[13] For example, banks are exempt from registration as government securities dealers under the Exchange Act to the extent they engage only in repos on government securities. 17 CFR 401.4, See 52 Fed. Reg. 19642, at 19647 (May 26, 1987) (noting that "loans by a bank that are secured by government securities, a normal banking activity, are the financial equivalent

trade reporting requirements, repos are financing transactions and exempt from those requirements.[14]

Given the objective of functional regulation underlying GLBA, we believe that the Congress intended that banks be able to continue to engage in their traditional activity of financing and funding through the repo structure, without having it "pushed out" to a registered broker-dealer. In this regard, it must be emphasized that bank repo transactions involving non-exempt securities (as well as exempt securities) are entered into for reasons that are fundamentally different from outright purchases or sales of such securities.

Banks Use of Repos

Requiring banks to "push out" repos on non-exempt securities would significantly and adversely impact their ability to provide liquidity and financing to participants in the securities and credit markets, without any corresponding investor protection benefits. As noted above, repos play an integral role in providing liquidity to the capital markets. Confirming the ability of banks to repo non-exempt securities is likely to bring additional liquidity to the non-exempt securities markets. Requiring such activity to be "pushed out" would not only unnecessarily reduce liquidity in these markets, but would also increase operational risk by creating duplicative operational, settlement and recordkeeping arrangements by virtue of allowing financing activity involving exempt securities to be conducted by one entity (the bank) but requiring financing activity involving non-exempt securities to be pushed-out into a separate entity (an affiliated broker-dealer). Allowing all repo activity to be conducted through the bank also serves to reduce risk by facilitating netting arrangements between the bank and counterparty.

From time to time, a bank may enter into repos and reverse repos with respect to the same securities at the same time. In those instances, banks primarily seek to act as suppliers of credit by financing market participants and then to address their own funding needs by re-hypothecating or selling the

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of reverse repurchase agreement transactions"). For purposes of the margin and credit provisions of the Exchange Act (e.g., Section 7), repos are generally treated as extensions of credit subject to applicable margin requirements. See also MSRB Interpretation 2004-19, Reporting of Transactions Arising from Repurchase Agreements ("Repos, however, are not the type of transactions that were intended for reporting under Rule G-14. This is because the paired transactions of a repo function as a financing agreement and the underlying transactions, while technically purchase-sale agreements, are not necessarily effected at market prices.")

[14] See FINRA website: http://www.FINRA.org/RegulatorySystems/TRACE/FrequentlyAskedQuestions/RulesCompliance/
index.htm#answer6 ("For purposes of TRACE reporting, bona fide properly documented repo transactions are not viewed as transactions in the secondary market for the purchase and sale of corporate bonds, but, rather, as financing transactions for members.")

purchased securities. The two transactions may be indistinguishable from "matched book" activities, as that term is commonly understood.[15] Nevertheless, the motivation is the delivery of financing between two market participants and not the acquisition and disposition of the actual security between two customers. There is no reason why the matching of two financing transactions should require a bank (as opposed to other market participants) to register as a broker-dealer. The activities are part of traditional bank activities. Thus, at most, a bank is receiving financing that results in a repayment obligation of the bank and supplying credit that results in an expected receipt of repayment by the bank. This activity is a bank's most fundamental intermediation activity, no different from the receipt of deposits that eventually are returned to a depositor, following their use by the bank in supplying credit to other customers. The creditworthiness of the counterparties to the transaction is the key consideration in the analysis of the repayment obligation, and not an investment decision related to the securities (although the value of the securities is relevant because they serve as collateral).

Some banks perform the repo and reverse repo functions with different personnel in different divisions or off of different desks. The repo function, where the bank seeks its own financing, may be delegated to a treasury function of the bank, whereas the reverse repo function may be assigned to customer facing loan and financing desks. The treasury function often has a portfolio of securities that are different from, and/or in addition to, those received in reverse repos, such as securities held in the bank's proprietary book, securities received as collateral in derivatives transactions and other securities where pledge or re-hypothecation is possible in order for the bank to obtain funding.

In other words, banks engage in repo activities involving non-exempt securities for the purposes of providing financing or raising funds. Simply put, bank repo activities are substantially similar to other activities undertaken by banks which are already subject to comprehensive regulation administered by the bank regulatory agencies and, as such, do not raise the type of policy concern that calls for SEC oversight through registration as a broker-dealer.

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[15] This practice refers to entering into a reverse repo with one counterparty to acquire a security with a view to disposing of a security of the same issue in a repo to another counterparty, or vice versa, with the intention of profiting on the spread in borrowing and lending rates on the two transactions. Such a book is "matched" when the reverse repo and the repo are for identical time periods. See, e.g., Continental Grain Company, SEC No-Action Letter (public. avail. Nov. 6, 1987).

In conclusion, ABASA appreciates the ongoing efforts of the Agencies and their staff to address repo transactions in non-exempt securities. In our view, the ability of banks to enter into repo transactions involving non-exempt securities under the Exchange Act is an important area of economic policy that can benefit from further legal clarity. We are especially concerned that any risk of uncertainty (perceived or real) may adversely affect the competitive position of U.S. banks, given the fact that foreign banks face no such legal obstacle in conducting repo activities outside the United States. Indeed, prompt attention to this matter would ensure that U.S. banks continue to provide liquidity without incurring the extensive operational costs associated with any potential "push-out" requirements.[16] We respectfully request the Agencies' concurrence with our view that a bank engaged in repos and reverse repos on non-exempt securities as part of its traditional banking business is not required to register as a broker or dealer under Section 15 of the Exchange Act.

Sincerely yours,

Sarah A. Miller

cc: Julie Williams, Senior Deputy Comptroller and Chief Counsel of the Office of the Comptroller of the Currency

Ellen Broadman, Director, Securities and Corporate Practices, in the Office of Chief Counsel of the Office of the Comptroller of the Currency

[16] For example, a bank may no longer be able to take advantage of certain netting and set-off arrangements available if bank repo activities involving non-exempt securities are "pushed out" to a broker-dealer affiliate.

Annex A

1. ***The nature, structure (including term and type of security involved), and purpose of repurchase and reverse repurchase agreements currently conducted with respect to non-exempt securities:***

As a general matter, ABASA is not aware of any meaningful difference in the manner in which a repo on non-exempt securities is structured from those involving exempt securities. Client objectives in entering into these transactions involving both exempt and non-exempt securities are the same: to seek financing and to obtain liquidity of securities positions. In addition, the reversing party seeks to satisfy its customers' financing needs, as well as to utilize its otherwise idle cash (sometimes in just an overnight repo) and make incremental income on this cash.

Both types of repo transactions involve a financing arrangement in which one party (the "Seller") acquires funds by selling securities to another party (the "Buyer"), subject to an obligation to repurchase the securities on a future date. Just as with repos on exempt securities, the market for repos on non-exempt securities offers both overnight and term repos and covers a wide range of non-exempt securities, including mortgage- backed securities, corporate debt and equity securities.

Key features of a repo, whether involving exempt or non-exempt securities, are as follows:

- <u>Initial Sale Price of Securities Discounted to Provide Credit Protection</u>**.** The initial price at which the Seller sells securities to the Buyer usually reflects a discount to their current market price to provide credit protection to the Buyer – <u>e.g.</u>, if the securities are worth $100x, the initial sale price might be $95x.

- <u>Mark-to-Market of Securities</u>**.** During the term of a repo, the securities delivered to the Buyer are "marked-to-market" and the Seller or Buyer can call for the return or delivery of securities or cash to maintain the agreed ratio (<u>e.g.</u>, $95x/$100x) between the purchase price and the value of the securities.

- <u>Substitution of Securities</u>**.** The parties frequently agree that during the term of the repo the Seller may substitute the securities initially sold to the Buyer with other securities of equal or superior quality.

- Implicit "Interest Rate." The price at which the Seller repurchases securities upon termination of the repo equals the initial sale price *plus* a "price differential" based on an interest rate agreed by the parties – the economic equivalent of "interest" payable in respect of the credit extended to the Seller. This "price differential" is in fact the main "pricing" component negotiated in connection with a repo. For example, the trading screens for repos typically quote "rates" for financings of various types of securities (along with principal amount, maturity, and security type).

- Seller Retains the Market Exposure to the Securities. The Seller in a repo does not transfer economic risk of the securities. During the term of the repo, the Seller is entitled to receive from the Buyer an amount equal to all income paid on the securities. This, coupled with the Seller's obligation to repurchase the securities at the price they were initially sold to the Buyer (plus interest, as described above), results in the Seller retaining full exposure to market risk on the securities. As a result, when the Buyer executes a repo, it is not making an investment decision with respect to the underlying security.

Just as with repos on exempt securities, repos on non-exempt securities are used primarily as a means of financing. Banks and other market participants prefer to structure their financing transactions as repos for a number of reasons, including the following:

- Enhanced Legal Certainty. Repos are generally understood to provide each party with more favorable legal protections, both in the United States and other jurisdictions, in the event of a default or insolvency of the other party. For example, the Code historically has provided greater protections for repo participants from certain Code provisions that otherwise impair the rights of secured lenders.[1] Although amendments to the Code in 2005 provided similar protections to "margin loans," market participants generally continue to favor the repo form, based on the view that it continues to provide greater legal certainty and protection. In addition, in a secured loan a "pledgee" is restricted by the Uniform Commercial Code in its ability to dispose of collateral in ways that would not apply to a Buyer in a repo.

- Standardized Documentation. Over many years, the standardized forms of documentation for repos (e.g., MRA and GMRA) have been tested and refined and have become widely used and well

[1] For example, the Code provisions generally allow qualifying repo participants to terminate, liquidate, accelerate and set off debts and claims under repos free from the automatic stay, and protect pre-petition margin and settlement payments in connection with repos from avoidance as preferential transfers or constructive fraudulent conveyances.

understood. Legal opinions on the enforceability and netting provisions of these standardized forms under the laws of various jurisdictions are broadly available. These features generally permit repo documentation to be executed quickly and at relatively low cost and may allow a bank to qualify more readily for lower regulatory capital requirements. In contrast, there is no standardized documentation for secured loans, and parties to loan transactions must conduct more extensive negotiations and incur corresponding costs. Indeed, standardized repo documentation developed for the securities markets has become so widely accepted and preferred that it is frequently used for financing transactions involving non-securities (such as whole loans).

- <u>Counterparty Demand and Internal Operations and Controls</u>. As a matter of market practice, counterparties frequently expect or demand that financing transactions be effected in the form of a repo. Certain investors are permitted by their constituent documents or applicable law to enter into repos but not other forms of financings. Many other investors simply use repo documentation because it is so widely accepted and has the other perceived advantages described above. In addition, both banks and other parties engaged in securities financing activities have developed extensive internal systems and controls and related compliance mechanisms for their repo business. In many cases, it is difficult to effect other forms of securities financing using these same systems without significant modifications. Accordingly, banks will face significant operational hurdles and other inefficiencies if they are forced to provide financing in the form of a secured loan rather than a repo.

2. ***The types of customers and financial institutions currently involved in repurchase and reverse repurchase agreements with respect to non-exempt securities:***

There are many market participants that engage in repo and reverse repo transactions on both exempt and non-exempt securities, including corporations, hedge funds, money managers, foreign central banks, broker-dealers, banks, and insurance companies. Certain pension funds governed by ERISA and other similar market participants may prefer to engage in securities lending, as opposed to repo and reverse repo transactions, for the over-collateralization by cash feature of securities lending transactions and the regulatory limitations on acceptable collateral.[2] It is not unusual, however, for those entities to reinvest the cash collateral received in a securities lending transaction in repos, e.g., an ERISA fund will use the cash to purchase securities with an agreement to resell those securities and earn a return on the cash.[3]

3. ***The extent to and manner in which banks currently engage, as agent or principal, in repurchase and reverse repurchase agreements with respect to non-exempt securities:***

Outside of the US, all banks engage in repo and reverse repo transactions in all types of securities. For example, Regulation K permits non-US branches of US banks to engage in repos on securities and commodities.

Within the US, bank repo and reverse repo transaction activity is robust. According to FFIEC's aggregate data on bank-wide call reports, from 1998 to 2006, the total amount of federal funds sold and securities purchased under repos by all U.S. depository institutions almost doubled, from $362 billion to $711 billion.[4] In their principal capacity, banks use the repo structure to provide financing to third parties as well as to meet their own funding requirements. As agent, banks provide securities lending services, where they lend securities as agent on behalf of principal lenders. In the US, cash collateral received in exchange for these loaned securities is often lent out in reverse repo transactions in order to collect "interest" on a short-term basis; one common transaction is to place the cash in a tri-party repo where it may be collateralized by both exempt and non-exempt securities. Our sense is that bank repo and reverse repo transaction activity outside the US involving non-exempt securities is more developed; banks outside the US often conduct repos/reverses as principal utilizing non-exempt collateral, both in connection with securities lending transactions (as described above), and on a "stand-alone" basis (i.e., apart from securities lending activity).

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[2] See, e.g., PTE 2006-16, 71 Fed. Reg. 63786 (October 31, 2006)(Exempting certain securities lending transactions by employee benefit plans).

[3] Again, to the extent that banks engage as agent in repo activities on behalf of their trust, fiduciary or custodial clients, these activities are excepted under GLBA and are not intended to be covered by this submission.

[4] See FFIEC, Annual Reports, available at: http://www.ffiec.gov/reports.htm.

4. ***Recent developments or trends in the market for repurchase and reverse repurchase agreements with respect to non-exempt securities:***

The Board's recent grant of Section 23A waivers to several money center banks regarding financing certain stalled credit markets is instructive in this regard. In addition, repo activity for liquidity and financing has gained further importance as the Board has broadened existing, and introduced new, financing structures that rely heavily on repo and similar structures and on using both exempt and non-exempt securities as collateral (Primary Dealer Credit Facility, Term Auction Facility, Terms Securities Lending Facility, as well as discount window activities for individual banks and investment banks). Also, legislative and judicial pronouncements that repo and reverse repo transactions are exempt from the automatic stay provision, have provided further support for increased bank repo and reverse repo transaction activity.

The repo market involving non-exempt securities has grown substantially over the last few years. For example, the aggregate data for "financing" as reported by the primary U.S. government securities dealers,[5] which covers repos as well as securities lending and secured loans, indicates that the amount outstanding for mortgage-backed securities (as measured by the total securities taken in) has approximately tripled since 2001, from $219 billion to $683 billion. The comparable data for corporate securities shows that the amount of financing involving corporate securities has seen a nearly five-fold increase during the same period, from $48 billion to $214 billion. ABASA believes that much of this growth is attributable to repos involving these types of securities. In the case of the overseas market, tri-party repo arrangements involving equity securities play an important role.[6]

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[5] See The Federal Reserve Bank of New York, Primary Dealer Statistical Releases, available at http://www.newyorkfed.org/markets/primarydealers.html.

[6] A survey of 77 European institutions in June 2007 by the European Repo Council (ERC) of the International Capital Market Association (ICMA) indicated that the tri-party repo market portion of the overall EUR 6.775 billion market had grown by 11.8% and that 21% of those tri-party repo transactions were collateralized by equity securities. See ICMA European Repo Market Survey, Number 13, conducted June 2007, published September 2007. Not surprisingly, the subsequent survey indicated that repo transactions involving equity fell significantly in December 2007 due to concerns over the quality of collateral triggered by market turbulence. See ICMA European Repo Market Survey, Number 14, conducted December 2007, published March 2008. Nevertheless, this data indicates that it is not uncommon for European financial institutions to engage in repo/reverse repo transactions with non-exempt securities.

5. ***Any material similarities or differences in the use, structure, customer base, or legal, regulatory, tax or accounting treatment of repurchase and reverse repurchase agreements with respect to non-exempt securities, on the one hand, and repurchase or reverse repurchase agreements with respect to exempt securities or securities lending transactions involving exempt or nonexempt securities:***

As discussed above, repos on non-exempt securities are structured essentially in the same manner as repos on exempt securities. Both types of transactions are generally treated as extensions of credit subject to applicable margin requirements under Section 7 of the Exchange Act, and they both fall outside the scope of various securities transaction reporting regimes, such as the Trade Reporting and Compliance Engine ("TRACE") for corporate debt.[7]

As a general matter, repurchase agreements and securities lending transactions are subject to different capital and customer protection rules when entered into by a U.S. broker-dealer and different capital treatment under Basel I when entered into by U.S. banks. Foreign broker-dealers tend to have more flexibility in determining which form of transaction is appropriate for any given situation.

[7] For more information about TRACE, see http://www.finra.org/RegulatorySystems/TRACE/index.htm