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February 3, 2009

Ms. Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-6628

**Re: Petition for Rulemaking**

Dear Ms. Murphy:

On behalf of Federated Investors, Inc. (“Federated” or “Petitioner”),<sup>1</sup> we hereby petition the Securities and Exchange Commission (“Commission”), pursuant to Commission Rule of Practice 192(a), to amend Rule 15c3-3 under the Securities Exchange Act of 1934 (“Exchange Act”), to treat U.S. government money market mutual fund shares, where the underlying portfolio assets of the fund consist of securities issued or guaranteed by the U.S. government or its agencies or instrumentalities, as “qualified securities” to meet a broker-dealer’s deposit requirements under the Special Reserve Bank Account for the Exclusive Benefit of Customers (“Special Reserve Account”).<sup>2</sup>

This proposed amendment, we believe, will improve broker-dealers’ operational flexibility in meeting their obligation under Rule 15c3-3 and will allow broker-dealers to obtain more competitive yields on such assets while, at the same time, not compromise the Rule 15c3-3’s Congressional purpose of safeguarding customers’ deposits or credit balances. Further, this proposed amendment would inure to the benefit of qualifying money market funds and provide the Commission with an opportunity to clearly express its confidence in money market mutual funds. We appreciate that Rule 15c3-3 is central to the system of protecting customers’ funds held by broker-dealers. We would not

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<sup>1</sup> Federated is a mutual fund sponsor with total assets under management of approximately \$420 billion, of which \$350 billion constitute money market funds.

<sup>2</sup> On March 19, 2007, the Commission proposed certain amendments to the financial responsibility rules for broker-dealers. In that release, the Commission proposed to expand the definition of “qualified securities” to include certain money market funds that invest in securities meeting the definition of “qualified securities.” The Commission has not yet acted on this rule proposal. Federated believes that the March 2007 proposal expanding the definition of “qualified securities” is unnecessarily limiting. This petition for rule making does not recommend the adoption of the March 2007 amendment as proposed. Federated requests that this petition receive separate and independent review pursuant to Commission Rule of Practice 192(a).

petition for this rule making if we did not believe that the modest change we urge was inconsistent with investor protection.

Specifically, we propose amending Rule 15c3-3(a)(6) to define “qualified securities” as “a security issued by the United States, a security in respect to which the principal and interest are guaranteed by the United States, *or a redeemable security of an investment company registered under the Investment Company Act of 1940 and described in 17 C.F.R. § 270.2a-7, unaffiliated with the broker dealer and which limits its investments to securities issued or guaranteed by the United States Government or its agencies or instrumentalities (including repurchase transactions).*” (proposed amendment in italics and referred to herein as “**U.S. government money market fund**”).

## I. Overview.

The Commission adopted Rule 15c3-3 in 1972 in response to a Congressional directive to strengthen the financial responsibility requirements for broker-dealers that carry customer assets.<sup>3</sup> With respect to customer funds, Rule 15c3-3 requires broker-dealers to account for all customer funds held by the broker-dealer. The intent of the rule is to require a broker-dealer to hold customer assets in a manner that enables their prompt return in the event of insolvency. The required amount of customer funds to be segregated is calculated pursuant to a formula set forth in Exhibit A to Rule 15c3-3. If, under the formula, customer credit items exceed customer debit items, the broker-dealer must maintain cash or “qualified securities” in that net amount in a “Special Reserve Bank Account for the Exclusive Benefit of Customers.”

Rule 15c3-3 is the result of compromise between customer protection and broker-dealer flexibility. Rule 15c3-3 limits a broker-dealer’s ability to put customer cash and securities at risk by using them to finance its own activities, such as proprietary trading. However, the rule allows brokers to, among other things, deploy customer funds into margin loans to other customers, which does not confer the same level of safety for those funds as would occur were all the customer funds required to be “locked up” in the reserve account in the form of U.S. Treasury securities or cash. Those who crafted Rule 15c3-3 to protect customer funds were not seeking absolute safety of customer funds, but rather sought a degree of protection that recognized the needs of both the broker-dealer and its customers without significantly impairing the safety of customers’ funds.

In funding the reserve account, Rule 15c3-3(e) provides that a broker-dealer may deposit only “cash and/or qualified securities in an amount not less than the amount computed in accordance with the formula set forth in §240.15c3-3a.” Rule 15c3-3(a)(6) defines the term *qualified security* as meaning “a security issued by the United States or a security in respect of which the principal and interest are guaranteed by the United States.”

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<sup>3</sup> In 1971, Congress amended Section 15(c)(3) of the Exchange Act to clothe the Commission with the authority to adopt rules providing for safeguards respecting the financial responsibility of brokers concerning the use of customers’ deposits or credit balances. See Release No. 9388 (Nov. 8, 1971).

The strict limitations on the types of assets that can be used to fund a broker-dealer's customer reserve account are designed to further the purpose of Rule 15c3-3, namely, that customer assets be segregated and held in a manner that makes them readily available to be returned to the customers.

Petitioner submits that the inclusion of "U.S. government money market fund" shares, a security that was not available at the time the Commission drafted and adopted Rule 15c3-3, as a "qualified security" would provide greater operational flexibility to broker-dealers in meeting their Rule 15c3-3 customer protection requirements without compromising customer protection.

**II. U.S. government money market funds would provide greater operational flexibility and efficiency to broker-dealers in meeting their Rule 15c3-3 customer protection requirements.**

Under current law, a broker-dealer may only meet its deposit requirement by depositing cash or a qualified security into the special reserve account. Accordingly, a broker-dealer must assemble a portfolio of U.S. Treasury securities or deposit cash into the account or a combination thereof.

In order to deposit U.S. Treasury securities into its special reserve account, a broker-dealer must assemble a portfolio of U.S. Treasury securities by constantly buying and selling them to ensure that it has sufficient funds in the reserve account. Such active management of a U.S. Treasury portfolio can become complex and may cause a broker-dealer to incur a loss, as most transactions in government securities take place only in large denominations. For example, a representative of a major broker dealer has provided that the broker-dealer was required to undertake to engage in sixty-two separate transactions in order to assemble a portfolio of Treasury bills to meet its deposit requirements under Rule 15c3-3. Further, such active management requires significant broker-dealer resources.

By using a U.S. government money market fund, the broker-dealer avoids the operational risk of purchasing and selling U.S. Treasury securities and can reduce the confusion, complexity and opportunity for error that can result. Broker-dealers would have much greater efficiency in their ability to maintain the appropriate level of deposit in the reserve account, and would be able to purchase and sell U.S. government money market funds in precise dollar amounts. Further, broker-dealers will also be able to reduce the human and other costs associated with managing a reserve account with U.S. Treasuries. In sum, the use of U.S. government money market funds will facilitate a broker-dealer's ability to meet its cash management and liquidity in a highly cost-efficient manner.

Alternatively, a broker-dealer may deposit cash into the account, putting the funds at risk of the balance sheet of the bank where the cash deposit exceeds the FDIC level of

insurability. Banks are not required to hold the cash separately from the banks' other assets. Therefore, funds in the reserve account become subject to the same risks as any other bank deposit. This is particularly true in the instance of large cash deposits being made in reserve accounts that are held at a limited number of major banks. With aggregate reserve deposits being made by broker-dealers under Rule 15c3-3 reaching an estimated \$150- \$180 billion, a substantial portion of reserve deposits are backed by the balance sheets of these banks rather than FDIC insured. Of additional concern, is the concentration of reserve deposits in a few large banks. The failure of such a bank could effectively eliminate most customer funds properly on deposit under Rule 15c3-3.

This petition to amend Rule 15c3-3 proposes an alternative measure for meeting regulatory obligations which offers comparative protections with additional benefits. This petition asks that the Commission recognize that investments in U.S. government money market funds, with all the protections of the 1940 Act for registered investment companies; the strict requirements of Rule 2a-7 under the 1940 Act; and the stability of portfolio assets limited to investments in securities issued or guaranteed by the United States government or its agencies or instrumentalities (including repurchase transactions), would allow broker-dealers greater flexibility in meeting their Rule 15c3-3 reserve account requirements without denigrating customer protection.

**III. The use of U.S. government money market funds would be consistent with Rule 15c3-3's purpose of protecting customers' funds in a manner that makes them readily available to be returned to the customers.**

**A. U.S. government money market funds would be limited to funds that satisfy the relevant requirements of Rule 2a-7 of the Investment Company Act of 1940.**

The Commission's regulatory program for money market funds under Rule 2a-7 of the Investment Company Act of 1940, as amended, has been an unqualified success.<sup>4</sup> The Commission adopted Rule 2a-7 in 1983 and has revised and strengthened the rule periodically.<sup>5</sup> An investment company may not call itself a "money market mutual fund" unless it satisfies the relevant requirements of Rule 2a-7. This rule has a number of requirements designed to ensure that the money market fund has high quality assets and can redeem shares with a net asset value of \$1.00 per share. The basic requirements for a money market mutual fund include:

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<sup>4</sup> Release No. IC-13380 (July 11, 1983), 48 Fed. Reg. 32555 (July 18, 1983) ("Rule 2a-7 Adopting Release). As noted above, money market funds (including those that limit their investments to securities issued or guaranteed by the United States Government or its agencies or instrumentalities) were not available at the time the Commission drafted and adopted Rule 15c3-3.

<sup>5</sup> Release No. IC-21837 (Mar. 21, 1996), 61 Fed. Reg. 13956 (Mar. 28, 1996).

- **Portfolio Maturity** – In general, Rule 2a-7 requires that money market mutual funds hold portfolio securities with relatively short maturities. Rule 2a-7(c)(2) provides that a money market fund must not acquire any instrument with a remaining maturity of greater than 397 calendar days and may not maintain a dollar-weighted average portfolio maturity of more than 90 days.
- **Portfolio Quality** – Rule 2a-7 requires money market mutual funds to invest in high quality portfolio securities. Rule 2a-7(c)(3) generally requires that a money market fund must have at least 95% of its portfolio investments qualifying for the top rating (“first tier”) and the remainder may be in the second highest rating category (“second tier”).
- **Portfolio Diversification** – Rule 2a-7(c)(4) provides that a money market fund “shall not have invested more than five percent of its total assets in securities issued” by the same entity, except for Government Securities.<sup>6</sup>
- **Portfolio Liquidity** – A money market mutual fund must limit its investment in illiquid assets to not more than 10% of its net assets.<sup>7</sup>

These requirements have provided a strong investor protection foundation for money market funds.<sup>8</sup>

**B. U.S. government money market funds would be limited to investments in United States Government and United States Government Agency Securities.**

We have sought to further increase the level of safety with our proposed formulation of the “U.S. government money market fund” to limit the funds’ *investments*

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<sup>6</sup> Rule 2a-7(a)(14) defines “government security” as defined in Section 2(a)(16) of the 1940 Act. That provision states that “government security” means any security issued or guaranteed as to principal or interest by the United States, or by a person controlled or supervised by and acting as an instrumentality of the Government of the United States pursuant to authority granted by the Congress of the United States; or any certificate of deposit for any of the foregoing.”

<sup>7</sup> The “board of directors of a money market fund ... may have a fiduciary obligation to limit further the acquisition of illiquid portfolio securities.” Rule 2a-7 Adopting Release, at 32561. An illiquid asset is any asset which may not be sold or disposed of in the ordinary course of business within seven days at approximately the value at which the mutual fund has valued the investment. See Investment Company Act, Release No. 14983 (Mar. 12, 1986).

<sup>8</sup> In addition, we note that federal agencies have taken action to ensure that liquidity and safety of money market funds. The Department of Treasury and the Federal Reserve actions include, among others, the Temporary Guarantee Program for Money Market Funds; the Money Market Investor Funding Facility; the Asset Backed Commercial Paper Money Market Mutual Fund Liquidity Facility; and the Commercial Paper Funding Facility.

*to securities issued or guaranteed by the United States Government or its agencies or instrumentalities (including repurchase transactions).*

A security issued or guaranteed by the United States Government, as well as a security issued by a United States Government agency or instrumentality, is exceptionally safe. There is no credit that is safer than a security issued or guaranteed by the United States Government. In addition, the markets have always assumed that a security issued by a United States Government agency or instrumentality<sup>9</sup> would have an implicit U.S. Government guarantee. Although that assumption has not been tested, based on recent events, we now know that the U.S. Government will back Fannie and Freddie securities.

On July 15, 2008, President Bush stated in a press conference,

In this case, there is a feeling that the government will stand behind mortgages through these two entities. And therefore, we felt a special need to step up and say that we are going to provide, if needed, temporary assistance through either debt or capital. ... [In response to a question:] You know, there is an implicit guarantee.<sup>10</sup>

On July 13, 2008, the Board of Governors of the Federal Reserve System announced:

The Board of Governors of the Federal Reserve System announced Sunday that it has granted the Federal Reserve Bank of New York the authority to lend to Fannie Mae and Freddie Mac should such lending provide necessary. Any lending would be at the primary credit rate and collateralized by U.S. government and federal agency securities. This authorization is intended to supplement the Treasury's existing lending authority and to help ensure the ability of Fannie Mae and Freddie Mac to promote the availability of home mortgage credit during a period of stress in financial markets.<sup>11</sup>

Freddie Mac was able to sell \$3 billion in securities after the Federal Reserves' announcements.<sup>12</sup>

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<sup>9</sup> Agencies and instrumentalities include, among others, Government Sponsored Enterprises ("GSEs") such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac").

<sup>10</sup> Press Conference of the Honorable George W. Bush, July 15, 2008.

<sup>11</sup> <http://www.federalreserve.gov/newsevents/press/other/20080713a.html>.

<sup>12</sup> On July 15, 2008, THE WALL STREET JOURNAL reported:

Further, Congress passed legislation that President Bush signed, that statutorily authorizes the U.S. Treasury to purchase any obligations and other securities issued by the GSEs.<sup>13</sup> In addition, on September 7, 2008, the Secretary of the Treasury and the Director of the Federal Housing Finance Agency (“FHFA”) announced that they were taking additional steps to bolster the financial integrity of the GSEs.<sup>14</sup>

Based on the above, it is not conceivable that the U.S. Government would let these GSEs fail, with enormous ripple effects on both the housing markets and on the institutions holding their debt. Whatever question lingered about whether the federal government would back the GSEs has been answered by President Bush, Chairman Bernanke, Secretary Paulson, and Congress.<sup>15</sup>

Finally, there are in excess of fifty U.S. government money market funds, none of which have ever broken the buck.<sup>16</sup> Accordingly, we believe that there should be no question that such investments are safe.

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Freddie Mac passed a crucial test of investor confidence Monday when there was strong demand for short-term debt it was selling, .... A closely watched auction of \$3 billion in Freddie’s short-term debt drew more bids than usual. The company was able to sell its three- and six-month notes at lower-than-expected yields, which in turn helped keep its borrowing costs low.

“Freddie Mac Auction Eases Concerns,” July 15, 2008, page A15, available at [http://online.wsj.com/article/SB121603898437750725.html?mod=googlenews\\_wsj](http://online.wsj.com/article/SB121603898437750725.html?mod=googlenews_wsj)

<sup>13</sup> H.R. 3221, P.L. No. 110-289, Sections 1117-1118.

<sup>14</sup> See Treasury and Federal Housing Finance Agency Action to Protect Financial Markets and Taxpayers, available at <http://www.treasury.gov/press/releases/hp1129.htm>, and authorities cited therein. See also “Government Support Underlying Obligations held by Federated Government Obligations Funds” (Dec. 17, 2008), attached hereto as **Exhibit A** which further describes the nature of the United States Government’s support underlying certain debt obligations issued or guaranteed by agencies or instrumentalities of the United States Government.

<sup>15</sup> We also petition that the Commission permit such portfolios to include repurchase transactions with respect to such securities. We do not believe that the addition of repurchase transactions would be a significant departure from current practice. Under current law, broker-dealers may use borrowed Treasury securities for deposit into their special reserve accounts. See SEC Staff to NASD, Nov. 1993 (available at <http://www.finra.org/web/groups/industry/@ip/@reg/@rules/documents/industry/p037772.pdf>)

<sup>16</sup> By comparison, between 1994 and 2008, the FDIC reports that 80 institutions failed, incurring losses of over \$2 trillion, and that dollar amount does not include recent failures such as IndyMac, First National Bank of Nevada, and First Heritage Bank NA. See FDIC website calculation of closings and assistance transactions between 1994 and 2008, available at <http://www2.fdic.gov/hsob/SelectRpt.asp?EntryTyp=30>.

**IV. U.S. government money market funds may be used by FCMs to meet CFTC segregation requirements analogous to Rule 15c3-3.**

This petition request would also modernize Rule 15c3-3(a)(6) and place it on an equal footing with other regulatory changes.

Other regulators allow the use of money market funds for similar purposes. For example, the Commodity Futures Trading Commission allows futures commission merchants (“FCMs”) to use Rule 2a-7 funds to satisfy its segregation requirements.<sup>17</sup> Section 4(d)(2) of the Commodity Exchange Act (“CEA”) established the hallmark principle of segregation of customer funds and the trust-like nature of the broker’s duties in respect of such funds. Because of the absence of an analogue to the Securities Investor Protection Corporation (“SIPC”), the CFTC segregation requirements are of critical importance under the CEA’s regulatory scheme, and are arguably more important than segregation requirements under securities laws. Accordingly, we believe it is all the more telling that the CFTC has permitted the use of Rule 2a-7 funds for this purpose and has had good experience with this rule.<sup>18</sup>

There does not appear to be any customer protection justification that allows FCMs to use money market funds for segregation purposes, but denies broker-dealers the authority to use money market funds in an analogous function, especially when the SEC itself regulates money market funds.

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<sup>17</sup> See Investment of customer funds, CFTC Rule 1.25 (17 CFR§ 1.25)

(a) Permitted investments.

(1) Subject to the terms and conditions set forth in this section, a futures commission merchant (“FCM”) of a derivatives clearing organization may invest customer money in the following instruments:

...

(viii) Interests in money market mutual funds.

(2)

(i) In addition, a future commission merchant or derivatives clearing organization may buy and sell the permitted investments lists in paragraphs (a)(1)(i) through (viii) of this section pursuant to agreements for resale or repurchase of the instruments....

<sup>18</sup> In 2000 the CFTC allowed FCMs to invest customer funds in money market funds based upon, in part, its conclusion that “an expanded list of permitted investments could enhance the yield available to FCMs, clearing organizations and their customers without compromising the safety of customer funds.” 65 Fed. Reg. 39008, 39014 (June 22, 2000) (rule proposal); 65 Fed. Reg. 77993 (Dec. 13, 2000) (rule adoption). The rule initially limited FCMs to using money market funds that received the highest rating from a nationally recognized statistical rating agency, if rated at all. After several years of favorable experience, the CFTC amended its rule and allowed FCMs to use any money market fund. See 68 Fed. Reg. 38654 (June 30, 2003); 70 Fed. Reg. 28190, 28194-95 (May 17, 2005)(noting that SEC Rule 2a-7 establishes important risk-limiting standards governing the portfolio quality, diversification, and maturity of money market funds.) To our knowledge, the CFTC has not publicly identified any problems that have resulted as a consequence of this further change.



**V. U.S. government money market funds have broad support in the broker-dealer community.**

We petition for this change in Rule 15c3-3 in response to broad support for the broker-dealer community.<sup>19</sup> Federated simply is trying to respond to the needs of its customer base. Indeed, the petition for change would not solely benefit Federated. This petition for rule making proposes an approach that other funds could meet and Federated fully expects that other fund complexes will compete with Federated for broker-dealers' assets.

**VI. Approving U.S. government money market funds for the Rule 15c3-3 deposit requirements would constitute a strong signal of support and confidence by the Commission in the mutual fund industry.**

We note that the proposed change would also support the ongoing efforts of the Department of Treasury and the Federal Reserve in their respective programs to instill and maintain confidence in the financial community, particularly the mutual fund industry. The Department of Treasury has noted that money market funds play an important role as an investment vehicle for many Americans and that maintaining confidence in the money market fund industry is critical to protecting the integrity and stability of the global financial system. The limited modification we seek, if implemented by the Commission, would likewise send a strong signal of public confidence in this segment of the financial community and would be consistent as well as supportive of the efforts of the Department of Treasury and the Federal Reserve.

**VII. Conclusion.**

Petitioner seeks this change to Rule 15c3-3 because it wishes to respond to the needs of its customers. Broker-dealers have a strong desire to avoid the operational risks of managing portfolios of U.S. Treasury securities and to limit the balance sheet risk of bank deposits. Money market funds, specifically money market funds that are limited to investments in securities issued or guaranteed by the United States Government or its agencies or instrumentalities (including repurchase transactions), are safe. FCMs enjoy the same conveniences for purposes analogous to the Rule 15c3-3 special reserve account requirement. We believe that it is long overdue for the SEC to allow broker-dealers and investors to enjoy this same advantage.

We thank you for your consideration of this request for rule making.

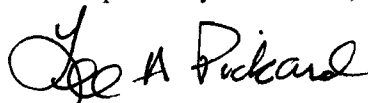
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<sup>19</sup> Many of the comment letters or memoranda of meetings in the public file concerning the March 2007 proposal broadly support this change to Rule 15c3-3.

Ms. Elizabeth M. Murphy  
February 3, 2009  
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Please do not hesitate to contact Lee A. Pickard or Peter E. McLeod of Pickard and Djinis, LLP at (202) 223-4418 with any questions or requests for further information with respect to the matters set forth in this letter. We look forward to your response.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Lee A. Pickard". The signature is stylized with a large initial "L" and "P".

Lee A. Pickard

cc: The Honorable Mary L. Shapiro  
The Honorable Kathleen L. Casey  
The Honorable Elisse B. Walter  
The Honorable Luis A. Aguilar  
The Honorable Troy A. Paredes  
Mr. Erik R. Sirri, Director, Division of Trading and Markets  
Mr. Daniel M. Gallagher, Deputy Director, Division of Trading and Markets  
Mr. Michael A. Macchiaroli, Associate Director, Division of Trading and Markets  
Mr. Thomas K. McGowan, Assistant Director, Division of Trading and Markets

GOVERNMENT SUPPORT  
UNDERLYING OBLIGATIONS  
held by  
**FEDERATED GOVERNMENT  
OBLIGATIONS FUND**

**Federated**

WORLD-CLASS INVESTMENT MANAGER<sup>®</sup>

**EXHIBIT**

A

tabbles<sup>®</sup>

December 17, 2008

To: Eugene F. Maloney

From: Melanie L. Fein

GOVERNMENT SUPPORT  
UNDERLYING OBLIGATIONS  
held by  
**FEDERATED GOVERNMENT  
OBLIGATIONS FUND**

You asked me to describe the nature of the government support underlying certain debt obligations issued or guaranteed by agencies of the U.S. government and which are held in the portfolio of the Government Obligations Fund for which an affiliate of Federated Investors, Inc. is the investment adviser (hereinafter "GOF").

Specifically, you asked me to address the government support underlying debt obligations issued or guaranteed by the following government agencies:

- > Federal National Mortgage Association ("Fannie Mae")
- > Federal Home Loan Mortgage Corporation ("Freddie Mac")
- > Federal Home Loan Bank System
- > Farm Credit System
- > Department of Housing and Urban Development

In general, the debt obligations issued or guaranteed by each of these agencies are supported by a comprehensive system of federal supervision and regulation that supports the safety and soundness of the agencies and their ability to repay their obligations. In addition, specific statutory provisions explicitly or implicitly guarantee or otherwise enhance the creditworthiness of their obligations, as follows:

- > **Fannie Mae and Freddie Mac** debt obligations are supported by a binding contractual commitment by the U.S. Treasury to fund obligations of the agencies up to \$100 billion each and temporary statutory authority for the Treasury to purchase an unlimited amount of their securities until December 31, 2009.
- > **Federal Home Loan Bank** debt obligations are supported by similar statutory authority for the Treasury to purchase up to \$4 billion of their obligations and additional temporary authority for the Treasury to purchase an unlimited amount of their obligations until December 31, 2009.
- > **Farm Credit System** debt obligations are supported by a system of mutual liability and an insurance fund dedicated to ensuring the timely payment of interest and principal on insured obligations issued by the Farm Credit Banks.
- > Debt obligations guaranteed by the **Department of Housing and Urban Development** pursuant to the Housing and Community Development Act of 1974 are explicitly backed by the full faith and credit of the United States.

These provisions are discussed in greater detail below.

You also asked me to address the bankruptcy risk characteristics of repurchase agreements that GOF enters into with banks and broker-dealers using securities issued or guaranteed by the U.S. Treasury or government agencies as collateral. As discussed below and in the attached memorandum, the Bankruptcy Code includes several provisions that protect parties to repurchase agreements in the event of a counterparty's bankruptcy.

# GOVERNMENT AGENCY DEBT SECURITIES

## A. Fannie Mae and Freddie Mac Notes

The Federal National Mortgage Association (“FNMA”), commonly known as “Fannie Mae,” and the Federal Home Loan Mortgage Corporation (“FHLMC”), commonly known as “Freddie Mac,” (collectively, the “GSEs”) are government-sponsored entities created by the federal government to provide financial support for the housing markets in the United States.<sup>2</sup>

Prior to enactment of the Housing and Economic Recovery Act of 2008 (“Recovery Act”),<sup>3</sup> the debt obligations of the GSEs generally were thought to be backed by an implicit guarantee of the U.S. government inherent in their status as government-sponsored entities. After the GSEs appeared likely to default on their debt obligations in the summer of 2008, Congress enacted the Recovery Act in order to, among other things, make the implicit government guarantee of the GSEs more explicit.

The Act authorized the Treasury to purchase unlimited amounts of GSE debt obligations and other securities and placed the GSEs under the oversight of a new independent agency—the Federal Housing Finance Agency (“FHFA”).<sup>4</sup> The FHFA was authorized, under certain circumstances, to take the GSEs into conservatorship.<sup>5</sup>

### GSE Rescue Plan

On September 7, 2008, the Treasury Department, FHFA and the GSEs implemented a rescue plan pursuant to which the Treasury now is effectively guaranteeing the GSEs’ obligations up to at least \$100 billion each, through a binding contractual arrangement.

Under the rescue plan, FHFA appointed itself conservator of the GSEs, with the consent of each.<sup>6</sup> Pursuant to this conservatorship, FHFA has assumed all legal authority of the shareholders, directors, and officers of the GSEs.<sup>7</sup> The conservatorships have no fixed termination date.

<sup>1</sup> GOF is an open-end investment company registered with the Securities and Exchange Commission (the “SEC”) under the Investment Company Act of 1940 that holds itself out as a money market mutual fund in compliance with the requirements of that Act and regulations issued by the SEC thereunder. According to Federated’s web site, GOF has been assigned the highest possible ratings from Standard & Poor’s, Moody’s and Fitch.

<sup>2</sup> 12 U.S.C. §§ 1454, 1716(a).

<sup>3</sup> Pub. L. 110–289, 12 Stat. 2654 (enacted July 30, 2008).

<sup>4</sup> Recovery Act, § 1117(a) (adding 12 U.S.C. § 1719(g)) & (b) (adding 12 U.S.C. § 1455(f)), and § 1101.

<sup>5</sup> *Id.*, § 1145.

<sup>6</sup> Federal Housing Finance Agency, “Statement of FHFA Director James B. Lockhart” (September 7, 2008), at 6, available at [http://treasury.gov/press/releases/reports/ihfa\\_statement\\_090708hp1128.pdf](http://treasury.gov/press/releases/reports/ihfa_statement_090708hp1128.pdf).

<sup>7</sup> Recovery Act, § 1145(a) (amending 12 U.S.C. § 4617(b)(2)).

Concurrently with the conservatorships, the GSEs entered into identical Senior Preferred Stock Purchase Agreements (“Agreements”) with the Treasury Department to provide capital and liquidity support, pursuant to Treasury’s authority under the Recovery Act.<sup>8</sup> Under the Agreements, the Treasury received certain senior preferred stock with an initial liquidation preference of \$1 billion in each GSE, as well as warrants to purchase 79.9 percent of the common stock of each GSE on a fully-diluted basis at a nominal price.<sup>9</sup>

### Treasury Backing for GSE Obligations

In exchange for the equity received through the Agreements, the Treasury became contractually bound to make available to each GSE up to \$100 billion. The funds must be provided at the request of the FHFA, on a quarterly basis (or sooner if the GSE would otherwise be forced into receivership), in an amount sufficient to cover the difference between the GSE’s assets and liabilities.<sup>10</sup>

Treasury’s obligation to provide this funding to each GSE continues until the earlier of (i) liquidation of the GSE (with any difference between assets and liabilities paid off),<sup>11</sup> (ii) full payment of all of the GSE’s liabilities, or (iii) when the \$100 billion limit has been reached.<sup>12</sup> Treasury’s obligation is expressly not contingent upon the GSEs’ financial condition or receivership.<sup>13</sup> For each infusion of funds, the liquidation preference of Treasury’s senior preferred stock increases by the same amount.<sup>14</sup> Amendments to the Agreements are prohibited to the extent that they would decrease the amount of Treasury’s commitment or add conditions if a GSE reasonably believes that such an amendment would have an adverse material effect on debtholders.<sup>15</sup>

Thus, although the Agreements specifically state that they do not give rise to a “guarantee” of any obligation,<sup>16</sup> the Treasury in effect has assumed responsibility for each GSE’s obligations up to \$100 billion.

### Authority for the Agreements

The Recovery Act expressly authorized the Treasury to purchase GSE securities “on such terms and conditions as the Secretary may determine and in such amounts as the Secretary may determine” as necessary to stabilize the financial and mortgage-finance markets and protect taxpayers.<sup>17</sup> Because the Agreements involve the purchase of GSE securities subject to terms and conditions agreed to by the Treasury, they appear to fall within the

<sup>8</sup> Amended and Restated Senior Preferred Stock Purchase Agreement (September 26, 2008), available at <http://www.ustreas.gov/press/releases/reports/seniorpreferredstockpurchaseagreementtrea.pdf> (Freddie Mac) and <http://www.ustreas.gov/press/releases/reports/seniorpreferredstockpurchaseagreementfnm1.pdf> (Fannie Mae).

<sup>9</sup> Agreement, ¶ 3.1 The Agreements imposed additional duties upon the parties, as well. For example, the GSEs were each prohibited from increasing their aggregate indebtedness by more than ten percent, ¶ 5.5, and from entering any merger, acquisition, or reorganization without Treasury’s advance permission, ¶ 5.4, and were required to limit their mortgage asset holdings to \$850 billion by December 31, 2009, and to decrease such holdings by ten percent each year thereafter, down to a floor of \$250 billion, ¶ 5.7. The GSEs also assumed certain reporting requirements under ¶ 5.9. This memorandum focuses on the Treasury’s obligation to fund the GSEs and is not intended to give an exhaustive description of the Agreements.

<sup>10</sup> Agreement, ¶¶ 2.1, 2.2, 2.3.

<sup>11</sup> FHFA stated at the inception of the Agreements that FHFA has no present intention of liquidating the GSEs. FHA Fact Sheet, “Questions and Answers on Conservatorship” (September 7, 2008), at 3, available at [http://treasury.gov/press/releases/reports/fhfa\\_conserv\\_faq\\_090708hp1128.pdf](http://treasury.gov/press/releases/reports/fhfa_conserv_faq_090708hp1128.pdf).

<sup>12</sup> Agreement, ¶ 2.5.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*, ¶¶ 2.1 & 3.3.

<sup>15</sup> *Id.*, ¶ 6.3.

<sup>16</sup> *Id.*, ¶ 6.6.

<sup>17</sup> Recovery Act, § 1117(a), adding 12 U.S.C. § 1719(g)(1) & 1117(b), adding 12 U.S.C. § 1455(f)(1).

Treasury's statutory authority.<sup>18</sup> Moreover, the Treasury itself has acknowledged that each of the Agreements "is a binding legal obligation between two parties."<sup>19</sup> Furthermore, an executive department is generally considered to have authority to contract in the course of carrying out an authorized program.<sup>20</sup>

The authority of the GSEs to enter the Agreements is clear. The Recovery Act allows the FHFA Director to assume conservatorship over the GSEs in the event, among others, that the GSEs consent.<sup>21</sup> Once conservatorship has been assumed, the FHFA may exercise all rights of the GSE,<sup>22</sup> which includes the right to enter contracts.<sup>23</sup>

## B. Federal Home Loan Bank System Notes

Notes issued by the Federal Home Loan Bank System are supported by the Treasury Department's authority to purchase securities of the Federal Home Loan Banks and by the federal regulatory system governing the Federal Home Loan Banks, as described below.

The twelve Federal Home Loan Banks were created by Congress in 1932 to improve the supply of funds to local lenders that in turn finance loans for home mortgages. The Federal Loan Bank Act authorizes the Banks to issue notes and other debt obligations to finance their activities.<sup>24</sup> Obligations of the Banks are lawful investments and may be accepted as security, for all fiduciary, trust, and public funds invested or deposited under the authority or control of the United States or any officer or officers thereof.<sup>25</sup>

In addition to notes issued by the individual Banks, the FHFA may issue consolidated Federal Home Loan Bank debentures on which the Banks are jointly liable.<sup>26</sup> Any such debentures outstanding may not exceed five times the total paid-in capital of all the Federal Home Loan Banks at the time of issuance and may not exceed the notes or obligations of member institutions held and secured by all the Federal Home Loan Banks. If no debentures are outstanding, or in order to refund all outstanding consolidated debentures issued, the FHFA may issue consolidated Federal Home Loan Bank bonds which shall be the joint and several obligations of all the Banks.<sup>27</sup>

All obligations of Federal Home Loan Banks are required by statute to state that "such obligations are not obligations of the United States and are not guaranteed by the United States."<sup>28</sup> Nevertheless, such obligations are thought to carry an implicit guarantee of the government similar to that of the GSEs.

<sup>18</sup> Although that authority expires on December 31, 2009, Recovery Act, § 1117(a) (adding 12 U.S.C. § 1719(g)(4)) & (b), adding 12 U.S.C. § 1455(l)(4), the purchase has already been completed, and no further purchases are required to complete Treasury's commitment of funds. The Recovery Act places no temporal limitation on the duration of such purchase agreements, only on Treasury's authority to enter them. The Recovery Act explicitly excludes from any temporal limitation the Treasury's authority to exercise any rights received in connection with such purchases. *Id.*, § 1117(a), adding 12 U.S.C. § 1719(g)(2)(A) and (b), adding 12 U.S.C. § 1455(l)(2)(A). The Treasury Department has stated that all GSE securities, regardless of when issued, are protected by the Agreements. Department of the Treasury, "Frequently Asked Questions: Treasury Senior Preferred Stock Purchase Agreement," HP-1131 (September 11, 2008) (hereinafter "HP-1131 FAQ"), available at <http://www.ustreas.gov/press/releases/hp1131.htm>.

<sup>19</sup> HP-1131 FAQ.

<sup>20</sup> *United States v. Winstar*, 518 U.S. 839, 890 n.36 (1996).

<sup>21</sup> Recovery Act, § 1145(a), amending 12 U.S.C. § 4617(a)(3)(l).

<sup>22</sup> *Id.*, amending 12 U.S.C. § 4617(b)(2).

<sup>23</sup> 12 U.S.C. §§ 1452(c)(4), 1723a(a).

<sup>24</sup> 12 U.S.C. § 1431(a).

<sup>25</sup> 12 U.S.C. § 1435.

<sup>26</sup> 12 U.S.C. § 1431(b).

<sup>27</sup> 12 U.S.C. § 1431(c).

<sup>28</sup> *Id.*



Specifically, the Secretary of the Treasury is authorized to purchase any obligations issued by the Federal Home Loan Banks provided that the aggregate principal amount of such obligations held by the Treasury does not exceed \$4 billion.<sup>29</sup> The Housing and Economic Recovery Act of 2008 temporarily increased this amount to “such amounts as the Secretary may determine” in his discretion until December 31, 2009.<sup>30</sup> As with the GSEs, in exercising this temporary authority, the Treasury Secretary must determine that such action is necessary to provide stability to the financial markets, prevent disruptions in the availability of mortgage finance, and protect the taxpayer.

The Recovery Act placed the Federal Home Loan Banks, along with the GSEs, under the supervision and regulation of the FHFA,<sup>31</sup> which is endowed with the same conservatorship powers as with the GSEs. Thus, the FHFA and Treasury could implement an arrangement with the Banks similar to the one implemented as to the GSEs. As of this date, they have not exercised such authority, but could elect to do so upon a determination by the Secretary that it was necessary to provide stability to the financial markets, prevent disruptions in the availability of mortgage finance, and protect the taxpayer.<sup>32</sup>

The Federal Home Loan Banks also are subject to the extensive prudential supervision and regulation by the FHFA similar to that accorded to the GSEs, which provides a further measure of government support for the Federal Home Loan Bank System and its obligations.

### C. Farm Credit System Notes

Notes issued by the Farm Credit Banks are supported by the federal regulatory framework applicable to the Farm Credit System and by the Farm Credit Insurance Fund which Congress established to insure the timely payment of interest and principal on insured obligations issued by the Farm Credit Banks.

The Farm Credit System was created by Congress in 1916 to provide financing to the agriculture sector. The System currently operates pursuant to the Farm Credit Act of 1971, as amended<sup>33</sup> and consists of the Farm Credit Banks, federal land bank associations, production credit associations, banks for cooperatives, and “such other institutions as may be made a part of the System,” all of which are subject to regulation by the Farm Credit Administration (the “FCA”).<sup>34</sup>

<sup>29</sup> 12 U.S.C. § 1431(j). As a condition to such purchases, the Treasury Secretary must certify to Congress that “alternative means cannot be effectively employed to permit members of the Federal Home Loan Bank System to continue to supply reasonable amounts of funds to the mortgage market, and the ability to supply such funds is substantially impaired because of monetary stringency and a high level of interest rates.”

<sup>30</sup> Recovery Act, § 1117(c), adding 12 U.S.C. § 1431(l). Although not authorized to make new purchases above \$4 billion after December 31, 2009, the Secretary may continue to hold and sell amounts above that threshold beyond that date.

<sup>31</sup> Previously, the Banks were regulated by the Federal Housing Finance Board—also an independent agency—pursuant to the Federal Home Loan Bank Act. 12 U.S.C. § 1421 *et seq.*

<sup>32</sup> Recovery Act, § 1117(c), adding 12 U.S.C. § 1431 (h)(1).

<sup>33</sup> 12 U.S.C. § 2001 *et seq.*

<sup>34</sup> 12 U.S.C. § 2002. The FCA is governed by a three-person board whose members are appointed by the President with the advice and consent of the Senate. The FCA’s board members also serve as the board of directors of the Farm Credit System Insurance Corporation.

The FCA is an independent agency of the U.S. government created by Congress to charter the Farm Credit Banks. The statute specifically designates the Banks as “Federally chartered instrumentalities of the United States.”<sup>35</sup> The FCA has broad powers to supervise and regulate the Farm Credit Banks, similar to the powers of the federal banking regulators with respect to commercial banks and the FHFA with respect to the GSEs and Federal Home Loan Banks.

The Farm Credit Banks mutually support each other’s obligations. Each Farm Credit Bank is fully liable for any notes, bonds, debentures, or other obligations that it issues and for interest payments on long-term notes, bonds, debentures, or other obligations issued by other Farm Credit Banks.<sup>36</sup> Each Bank also is primarily liable for the portion of any issue of consolidated or system-wide obligations made on its behalf and is jointly and severally liable for additional sums as required by the Farm Credit Administration in order to make payments of interest or principal which any primarily liable Bank cannot make.<sup>37</sup>

The Farm Credit Act specifically provides, with respect to debt obligations of the Farm Credit Banks, that “the United States shall not be liable or assume any liability directly or indirectly thereon.”<sup>38</sup>

Nevertheless, Congress created a federal agency and insurance fund whose primary purpose is to insure the notes and other obligations of the Farm Credit Banks.<sup>39</sup> The Farm Credit System Insurance Corporation is required to expend amounts in the Farm Credit System Insurance Fund (“Fund”) to the extent necessary to insure the timely payment of interest and principal on insured obligations.<sup>40</sup>

The FCA may not call on any Farm Credit institution to satisfy the liability of the institution on any joint, consolidated, or system-wide obligation participated in by the institution or with respect to which the institution is primarily, or jointly and severally, liable, before the Insurance Fund is exhausted.<sup>41</sup> In the event the assets of the Fund were to be exhausted, joint and several liability of all Banks would be triggered, in which case the financial resources of the other Banks would be used to repay the defaulting Bank’s portion of the debt issuance.

The Farm Credit System Insurance Fund is funded by annual insurance premiums paid by the Farm Credit Banks. Premium rates are calculated using a statutorily defined formula based on System loan volume with different rates for accrual loans, nonaccrual loans, and loans guaranteed by Federal or State governments. Congress has directed the Farm Credit System Insurance Corporation to build the Fund to a “secure base amount.”<sup>42</sup>

<sup>35</sup> 12 U.S.C. § 2011.

<sup>36</sup> 12 U.S.C. § 2155(a).

<sup>37</sup> *Id.*

<sup>38</sup> 12 U.S.C. § 2155(c).

<sup>39</sup> 12 U.S.C. 2277a-1.

<sup>40</sup> 12 U.S.C. § 2277a-9(c)(1).

<sup>41</sup> 12 U.S.C. § 2155(d).

<sup>42</sup> The secure base amount is defined as two percent of the aggregate of outstanding insured obligations of all insured Banks, adjusted downward by a certain percentage of the System’s government guaranteed loans. The Farm Credit System Reform Act of 1996 provided the Corporation’s board the authority, in its sole discretion, to reduce insurance premiums from the statutory rates before the Fund reaches the secure base amount.

The Farm Credit Act specifically provides that debt obligations of the Farm Credit Banks are permissible fiduciary investments for trustees:

- > The bonds, debentures, and other similar obligations issued under the authority of this Act shall be lawful investments for all fiduciary and trust funds and may be accepted as security for all public deposits.<sup>43</sup>

## D. Housing and Urban Development Guaranteed Notes

The Government Obligations Fund also holds notes (or obligations that are backed by a trust or pool composed of such notes) that are issued by various “eligible public entities” and which are guaranteed by the U.S. Department of Housing and Urban Development pursuant to section 108 of the Housing and Community Development Act of 1974.<sup>44</sup>

Section 108 of the Act authorizes the Secretary of Housing and Urban Development to guarantee notes or other obligations issued by eligible public entities (or their public-agency designees), for the purposes of financing specified housing rehabilitation and economic development projects.<sup>45</sup> An “eligible public entity” generally is defined as “any unit of general local government.”<sup>46</sup>

To receive the guarantee, an issuer must, among other things: enter into a contract for repayment of the guaranteed notes or other obligations; pledge any grant for which the issuer may become eligible under the Act; and furnish such other security as the Secretary may deem appropriate in making the guarantees (including increments in local tax receipts generated by the activities assisted or dispositions proceeds from the sale of land or rehabilitated property).<sup>47</sup>

The Act specifically provides that “the full faith and credit of the United States is pledged to the payment of all guarantees made under this section [108]” and that “any such guarantee made by the Secretary shall be conclusive evidence of the eligibility of the obligations for such guarantee with respect to principal and interest, and the validity of any such guarantee so made shall be incontestable in the hands of a holder of the guaranteed obligations.”<sup>48</sup>

Section 108 also authorizes the Secretary to guarantee the timely payment of principal and interest on trust certificates or other obligations that may be offered by the Secretary (or by another offeror approved by the Secretary) that are based on and backed by a trust or pool composed of notes or other obligations guaranteed or eligible for guarantee by the Secretary under section 108.<sup>49</sup> The guarantee of such trust certificates or other obligations is backed by the full faith and credit of the United States to the same extent as the guarantee of the underlying notes.<sup>50</sup>

<sup>43</sup> 12 U.S.C. § 2157. I am not aware as to whether this particular provision has been interpreted by the courts in any given circumstances and have not researched the extent to which this provision would preempt any state trust law to the contrary. The provision most likely pertains only to fiduciaries and trustees holding government funds.

<sup>44</sup> 42 U.S.C. § 5308(a).

<sup>45</sup> A guarantee under this authority may be used to assist a grantee in obtaining financing “only if the grantee has made efforts to obtain such financing without the use of such guarantee and cannot complete such financing consistent with the timely execution of the program plans without such guarantee.”

<sup>46</sup> 42 U.S.C. § 5308(o).

<sup>47</sup> 42 U.S.C. § 5308(d).

<sup>48</sup> 42 U.S.C. § 5308(f).

<sup>49</sup> 42 U.S.C. § 5308(r).

<sup>50</sup> *Id.*

## BANKRUPTCY RISK AND REPURCHASE AGREEMENTS

GOF enters into U.S. government securities repurchase agreements with a number of different banks and broker-dealers. These counterparties generally are large and reputable institutions. Nevertheless, you have asked me to address the risks that may arise in the event that a counterparty declares bankruptcy.

The Bankruptcy Code includes provisions that protect counterparties in repurchase transactions in the event of bankruptcy and generally allow a party to liquidate, terminate, accelerate, exercise security rights, and offset obligations under a repurchase agreement notwithstanding a bankruptcy. In particular, the Bankruptcy Code provides an exception from the automatic stay provisions for parties to repurchase agreements.

Attached hereto is a memorandum prepared by Bryan Cave LLP discussing the Bankruptcy Code provisions in greater detail. The memorandum concludes that, in a typical Treasury repurchase transaction involving a bankrupt counterparty, a creditor generally should be able to liquidate the collateral and to apply it to the debtor's obligations.<sup>51</sup>

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*In preparing this memorandum, I have relied solely on your representations as to the types of obligations in the GOF portfolio. I have not reviewed the terms or conditions of any specific notes or obligations.*

*This memorandum has addressed certain bankruptcy risk characteristics of repurchase agreements on U.S. Treasury securities, but is not intended to provide a comprehensive analysis of the risks of repurchase agreements.*

*This memorandum should not be interpreted as providing investment advice regarding the Federated Government Obligations Fund, any government agency debt securities or other obligations, or any repurchase agreement transactions.*

<sup>51</sup> I would note that I am not expert in the Bankruptcy Code and defer to the memorandum prepared by Bryan Cave LLP.



## Memorandum

Date: September 19, 2008

To: Eugene F. Maloney, Executive Vice President,  
Federated Investors Management Company, Inc.,  
Vice President and Corporate Counsel of Federated Investors, Inc.  
and member of the Executive Committee

From: Brian C. Walsh

Re: Treatment of Repurchase Agreements in Bankruptcy

### Bryan Cave LLP

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As you requested, I have summarized below four of the key provisions of the Bankruptcy Code governing repurchase agreements. In general, these provisions permit a party to a repurchase agreement to liquidate, terminate, accelerate, exercise security rights, and offset obligations under the agreement despite a bankruptcy filing by the counterparty and despite otherwise applicable bankruptcy rules that would prevent similar actions if a different type of contract were involved. They also protect most ordinary pre-bankruptcy transactions under repurchase agreements from reexamination in bankruptcy.

I understand that your customers have raised questions about repurchase agreements involving Treasury securities. The fact that Treasury securities are involved is significant for two reasons. First, the Bankruptcy Code sections discussed below concern procedural matters and do not address the economic risk that the securities involved in a repurchase agreement may decline in value and thus be insufficient to cover the related obligation. This is, of course, less of a concern with Treasury securities than with other types of securities. Second, a repurchase agreement involving United States government securities fits within the statutory definition of "repurchase agreement" in Section 101(47) of the Bankruptcy Code, provided that the term of the agreement is one year or less.

**Ipsso-facto actions.** The Bankruptcy Code generally precludes creditors from terminating or modifying contracts based on default provisions triggered by a bankruptcy filing, insolvency, or similar matters, which bankruptcy practitioners generally refer to as "ipso-facto" clauses. Section 559 of the Bankruptcy Code overrides these general principles in the case of repurchase agreements, authorizing a repo participant to liquidate, terminate, or accelerate a repurchase agreement based on an ipso-facto event if it has a "contractual right" to do so. The section also clarifies that no court or administrative agency may stay, avoid, or otherwise limit

the repo participant's right to liquidate, terminate, or accelerate unless the debtor is a stockbroker or a securities clearing agency and the order is authorized by the Securities Investor Protection Act or the federal securities laws. The term "repo participant" refers to a party with an outstanding repurchase agreement with the debtor at any time prior to the bankruptcy filing. "Contractual right" is defined broadly to include not only rights specified in the repurchase agreement itself but also rights derived from the common law and a variety of other sources.

**The automatic stay.** Section 362(b)(7) of the Bankruptcy Code provides an exception to the automatic stay for "the exercise by a repo participant ... of any contractual right (as defined in section 559) under any security agreement or arrangement or other credit enhancement forming a part of or related to any repurchase agreement, or of any contractual right ... to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more such agreements." The automatic stay ordinarily prevents creditors from pursuing collection actions against debtors, disposing of collateral, or setting off mutual debts without leave of the bankruptcy court, which can be difficult and time-consuming to obtain. As a result, the exception to the automatic stay for repurchase agreements is significant.

**Setoff.** Section 553 of the Bankruptcy Code generally preserves the right of a creditor to offset debts owed to a debtor against the creditor's claims against the debtor. However, Section 553 limits rights of setoff in some circumstances where the creditor obtains a claim against the debtor by transfer, or the creditor incurs its debt to the debtor, within 90 days prior to the bankruptcy filing. Section 553 also permits a debtor to recover amounts offset by a creditor within 90 days prior to bankruptcy if certain other facts are present. All of these restrictions expressly exclude rights of setoff and actual setoffs described in Section 362(b)(7) and 559, discussed above. Accordingly, setoffs under repurchase agreements are essentially unaffected by the Bankruptcy Code.

**Avoidance actions.** The Bankruptcy Code ordinarily permits a debtor or a trustee to attack pre-bankruptcy transactions as preferential or fraudulent transfers. Section 546(f) imposes a significant limitation on these rights: a pre-bankruptcy transfer made by, to, or for the benefit of a repo participant in connection with a repurchase agreement is avoidable only if the debtor made the transfer with actual intent to hinder, delay, or defraud creditors.

As a consequence of these provisions, in a typical Treasury repurchase transaction involving a bankrupt counterparty, the creditor should be able to liquidate the collateral and to apply it to the debtor's obligations. It is highly unlikely that the Bankruptcy Code or a bankruptcy court would prevent the creditor from taking such action. Of course, different facts might lead me to a different conclusion.

Please let me know if you have any questions about the issues discussed above.

cc: Stuart J. Kaswell

## MELANIE L. FEIN, ESQ.

*Author and Banking Law Specialist*

Melanie L. Fein provides legal services to financial institutions and other clients on a wide range of banking and securities law matters, focusing on regulatory issues at the forefront of developments in the financial services industry. She has extensive experience with matters affecting domestic and foreign banks, financial holding companies, securities firms, mutual funds, trust companies, and other financial service institutions. Much of Ms. Fein's work involves new products and services at the intersection of banking and the securities laws.

Ms. Fein has been a partner in the law firms of Goodwin Procter LLP (2003–2007) and Arnold & Porter (1986–1999). She also served as an attorney and senior counsel to the Board of Governors of the Federal Reserve System (1979–1986) and before that was on the legislative staff of Congressman John F. Seiberling of Ohio.

Ms. Fein is past chairman of the Executive Council of the Federal Bar Association's Banking Law Committee and has participated in leadership roles on committees of the American Bar Association. She has served on advisory boards for the Practising Law Institute, Consumer Bankers Association, Banking Policy Report and Stanford Journal of Law, Business & Finance, among other organizations. She is listed in the Guide to the World's Leading Banking Lawyers and An International Who's Who of Banking Lawyers, and has been awarded the highest peer rating by Martindale Hubbell.

Ms. Fein is the author of leading treatises on banking law, including *Federal Bank Holding Company Law*, *Securities Activities of Banks*, *Mutual Fund Activities of Banks* and *Law of Electronic Banking*. Her most recent work is a two-volume treatise entitled *Banking and Financial Services: A Regulatory Guide to the Convergence of Banking, Securities and Insurance in the United States*. Ms. Fein authored a major study for the Bank Administration Institute entitled *Regulating Convergence: Towards a Uniform Framework for Banking, Insurance and Investments* and has published numerous articles on banking law, including "Functional Regulation: A Concept for Glass-Steagall Reform?" in the Stanford Journal of Law, Business & Finance.

Ms. Fein has taught courses on Banking and Financial Services Law at Yale Law School where she served on the adjunct faculty from 1992–2002. Ms. Fein also has taught courses at Boston University School of Law and Catholic University's Columbus School of Law.

Ms. Fein is a member of the U.S. Supreme Court Bar and is licensed to practice in Virginia and the District of Columbia. Ms. Fein received her J.D. at Catholic University, Columbus School of Law in 1979 and her B.A. from Earlham College in 1971.