Frequently Asked Questions Regarding Exchange Act Rules 15c3-1 and 15c3-3 in Connection with Covered Agency Transactions under FINRA Rule 4210

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The following guidance addresses questions raised by market participants about Exchange Act Rules 15c3-1 and 15c3-3 in connection with the amendments to FINRA Rule 4210 with respect to Covered Agency Transactions.

Question 1) Under Rule 15c3-3, is a broker-dealer required, in connection with a Covered Agency Transaction, to include cash collateral received from a counterparty to cover a variation margin requirement (referred to in FINRA Rule 4210(e)(2)(H)(i)g. as "mark to market loss") as a credit balance in its reserve formula and to maintain physical possession or control of securities collateral received from a counterparty to meet a variation margin requirement?

Answer 1) No. When a broker-dealer holds cash or securities as collateral to meet a counterparty's variation margin requirement for a Covered Agency Transaction, the collateral is not subject to the reserve formula or possession or control requirements of Rule 15c3-3, provided the value of the collateral (less permitted haircuts with respect to securities collateral) does not exceed the amount of the variation margin requirement.

Any margin collateral held by a broker-dealer in excess of the amount of the variation margin requirement (less permitted haircuts with respect to securities collateral) would be excess variation margin and would be subject to the reserve formula or possession or control requirements of Rule 15c3-3, as applicable. For example, if a broker-dealer holds $120 in securities collateral (with a permitted haircut of $15) to meet a variation margin requirement of $100, the amount of the excess variation margin would be $5 ($120 of securities collateral - $15 permitted haircut - $100 variation margin requirement = $5 excess variation margin). The broker-dealer would be required to maintain possession or control over $5 of the securities collateral comprising the excess variation margin.

Note: For the purposes of these Q&As, a "permitted haircut" is a deduction to the market value of a security held as margin collateral for a Covered Agency Transaction that does not exceed the haircut specified for the security pursuant to paragraph (c)(2)(vi) of Rule 15c3-1.

Question 2) Under Rule 15c3-3, is a broker-dealer required to include cash collateral received from a counterparty to cover an initial margin requirement (referred to in FINRA Rule 4210(e)(2)(H)(i)f. as "maintenance margin") as a credit balance in its reserve formula or maintain physical possession or control of securities collateral received from a counterparty to meet an initial margin requirement?

Answer 2) Yes. Under Rule 15c3-3, the broker-dealer must include the initial margin cash collateral as a credit balance in its reserve formula, and maintain physical possession or control of initial margin securities collateral.

Question 3) Is a broker-dealer required to treat excess variation margin and initial margin collateral received from a broker-dealer counterparty for a Covered Agency Transaction pursuant to the PAB requirements of Rule 15c3-3?

Answer 3) Yes. See Q&A 7, 8, and 9 for the treatment of excess variation margin and initial margin collateral posted to a counterparty (including a broker-dealer counterparty).

Note: A broker-dealer counterparty is an "exempt account" under FINRA Rule 4210. FINRA Rule 4210(e)(2)(H)(ii)d. requires a broker-dealer to collect variation margin but not initial margin with respect to a Covered Agency Transaction in an exempt account.

Question 4) When a counterparty has a mark-to-market gain on a Covered Agency Transaction that is in excess of the initial margin required and previously posted by such counterparty ("excess mark-to-market gain") and the counterparty requests collateral from the broker-dealer to cover the excess mark-to-market gain, may the broker-dealer first return collateral that was previously posted by the counterparty as initial margin to cover such excess mark-to-market gain before delivering proprietary assets of the broker-dealer?

Answer 4) Yes, provided the equity in the counterparty's account meets the margin requirements for the Covered Agency Transaction after the return of the collateral to the counterparty.

Question 5) If a counterparty has a mark-to-market gain on a Covered Agency Transaction and the broker-dealer posts cash or securities collateral to the counterparty to cover the gain, may the broker-dealer include a debit item in its customer reserve formula equal to the amount posted?

Answer 5) No.

Question 6) If a counterparty has a mark-to-market gain on a Covered Agency Transaction and does not request margin collateral from the broker-dealer to cover the gain, must the broker-dealer put a credit in the reserve formula equal to the value of the mark-to-market gain pursuant to Rule 15c3-3?

Answer 6) No.

Question 7) If a counterparty has a mark-to-market gain on a Covered Agency Transaction and the broker-dealer posts cash or securities collateral to the counterparty, is the broker-dealer required to deduct from net worth when computing net capital under Rule 15c3-1 an amount equal to the value of the collateral delivered to the counterparty?

Answer 7) No. Under Rule 15c3-1, the broker-dealer need not deduct from net worth when computing net capital an amount equal to the value of the collateral delivered to the counterparty to cover a mark-to-market gain in the Covered Agency Transaction, provided the value of the collateral (less any permitted haircuts with respect to securities collateral) does not exceed the amount of the gain. If the amount of the collateral posted to the counterparty (including a broker-dealer counterparty), less permitted haircuts, exceeds the market-to-market gain, such excess must be deducted from net worth when computing net capital when the collateral is posted. For example, if the counterparty has a mark-to-market gain of $100 and the broker-dealer posts $110 of securities collateral that has a permitted haircut of $5, then the broker-dealer would need to deduct $5 ($110 of securities collateral - $100 MTM gain - $5 permitted haircut = $5 deduction from net worth).

Question 8) Must the broker-dealer immediately take a deduction from net worth under Rule 15c3-1 if variation margin collateral held by a counterparty becomes excess variation margin collateral because either the counterparty has a subsequent mark-to-market loss on the Covered Agency Transaction or the securities collateral previously posted to the counterparty increases in value (or a combination of both events occurs)?

Answer 8) No. Under Rule 15c3-1, the broker-dealer need not immediately deduct from net worth excess variation margin collateral held by a counterparty resulting from a counterparty's subsequent mark-to-market loss on a Covered Agency Transaction or a market-to-market gain on securities collateral previously posted, provided: (A) the broker-dealer calls for the return of the excess variation margin collateral; and (B) the broker-dealer receives the excess variation margin collateral from the counterparty by the close of business on the business day following the day such excess arises. If the broker-dealer does not receive the excess variation margin collateral from the counterparty (including a broker-dealer counterparty) by close of business on the next business day, it must deduct the amount of the excess variation margin collateral from net worth when computing net capital under Rule 15c3-1.

Note: The treatment under Rule 15c3-1 of excess variation margin collateral held by a counterparty that arises from a subsequent mark-to-market loss on the Covered Agency Transaction or mark-to-market gain on securities collateral previously posted by the broker-dealer (i.e., allowing one business day to retrieve the collateral before taking the deduction) is different than the treatment of excess variation margin collateral that is in excess when initially posted by the broker-dealer to the counterparty (i.e., in that case, the deduction must be taken when the collateral is posted). See Q&A 7.

Question 9) Must a broker-dealer deduct from net worth when computing net capital under Rule 15c3-1 cash or securities collateral posted to a counterparty (including a broker-dealer counterparty) as initial margin for a Covered Agency Transaction?

Answer 9) Yes.