Collateralized Mortgage Obligation (CMO) Haircuts

The average life maturity may be used to determine the required haircut percentage for CMOs.

The required haircut percentage, pursuant to SEC Rule 15c3-1(c)(2)(vi), for CMOs can vary depending upon certain characteristics of the specific instrument. For example, if the CMO has been issued under the Secondary Mortgage Market Enhancement Act (SMMEA) and is rated in one of the four highest rating categories by at least two NRSROs, the security may be haircut as a nonconvertible debt security pursuant to SEC Rule 15c3-1(c)(2)(vi)(F). If, however, the security is not rated in one of the four highest rating categories by at least two NRSROs, the security should be haircut pursuant to SEC Rule 15c3-1(c)(2)(vi)(J), Other Securities.

A CMO may not be haircut as a government security pursuant to SEC Rule 15c3-1(c)(2)(vi)(A). While a CMO may be secured by mortgage-backed securities that are backed by the full faith and credit of the United States government, such as a GNMA, the actual CMO is a separate security neither issued nor guaranteed by the United States. For this reason, the CMO should not be haircut as a government security.

However, if the CMO itself is issued or guaranteed by the U. S. Government, the haircut would be calculated pursuant to 15c3-1(c)(2)(vi)(A).

SEC Staff of DMR to NASD, December 1994