

The Depository Trust Company
IMPORTANT
REVISED

B#: 3449-08
DATE: May 08, 2008
TO: All Participants
CATEGORY: Settlement/Underwriting
FROM: Enterprise Risk Management
ATTENTION: Settlement Manager/Managing Director/Cashier
SUBJECT: Adjustments to DTC's Collateral Monitor Haircuts - Revision

Please be advised that DTC, in order to uphold that its minimum collateral monitor haircuts remain in sync with its line-of-credit banks, is modifying its collateral haircut schedule effective Friday, May 16, 2008.

Participants may refer to the attached schedule below for new general collateral haircut rates.

Please note a revision to B+/B/B- (Moody's: B1/B2/B3) rated municipal bonds from the May 2nd Important Notice in the attached haircut schedule. Rating classes were also clarified in the Asset-Backed Securities section.

As an added reference, please refer to the below excerpt on the following page from the *Settlement Services Guide* with a summary of DTC collateral monitor.

Questions regarding this notice should be directed to your Relationship Manager.

Collateralization

Collateralization ensures that your account has sufficient collateral for DTC to liquidate if you fail to pay your settlement obligation and become insolvent. DTC's collateralization procedures prevent the completion of transactions that would cause your net debit to exceed the total available collateral in your account.

DTC operates on a fully collateralized basis. You are required to have sufficient collateral in your account to support net settlement debits you incur. Transactions that would cause your net debit to exceed the total value of collateral in your account are held in a recycle (pend) queue until sufficient collateral is available.

Your primary sources of collateral are:

- Cash deposited to the Participants Fund
- Proprietary or firm positions (such as dealer, investment, or margin positions) that you designate as collateral
- Securities received (and not paid for) versus payment
- Securities added to your account and not received versus payment (such as deposits, free deliveries, free pledge releases, release of segregated securities) that you designate as collateral.

Collateral Valuation of Securities

The value of securities designated as collateral is based on the prior business day's closing market price, less a haircut. Haircuts are used to protect DTC and its participants from price fluctuations if DTC is required to liquidate collateral of an insolvent participant. Furthermore, because DTC may have to finance a participant's failure overnight, DTC's haircut structure takes into consideration haircuts imposed by our line-of-credit banks. The full market value of securities is not normally obtainable from a bank that accepts securities as collateral to support a loan; banks generally consider the relative price volatility of the collateral and impose a haircut on the market value of securities. Securities that are not acceptable to DTC's line-of-credit banks do not receive collateral value in our system; therefore, a 100 percent haircut is applied to these securities.

DTC employs haircuts ranging from 2 to 100 percent. Because the collateral value of securities is based on their prior day's closing market prices, these haircuts may not be sufficient in cases where prices fall dramatically intraday. DTC can reprice and modify haircuts of selected issues intraday and can systemically revalue the collateral of participants holding these securities.

Using the Collateral Monitor to Measure Available Collateral

DTC tracks collateral in your account by a control position called the Collateral Monitor (CM). At the opening of each business day, your CM is credited with your Participants Fund deposit. At all times, the CM reflects the amount by which the collateral in your account exceeds the net debit in your settlement account. In other words, the CM equals the sum of the value of your collateral and net settlement obligation.

For example, if you have collateral securities with a market value of \$10,000 and a 10 percent haircut, the value of your collateral is \$9,000. If you also incurred a debit of \$8,000, your CM is \$1,000 $\{(10,000 - [0.1 \times 10,000]) + (-\$8,000)\}$.

Conceptually, every transaction translates into a collateral flow and a cash flow, one a credit and the other a debit. The net value of these two flows is used to update the CM. Since the value of securities as collateral is subject to a haircut on the market value, the cash component (for settlement value) of each transaction is generally greater in value than its securities component. Thus, the completion of a delivery versus payment generally results in an increase in the deliverer's CM and a decrease in the receiver's CM, based on the difference between the collateral value of the securities and the settlement value of the transaction. Transactions that do not have a cash component, such as deposits and "free" deliveries, are considered to have a zero cash component.

When processing a transaction, DTC verifies that the deliverer's and receiver's CMs will not become negative when the transaction completes. If the transaction would cause either party to have a negative CM and thereby be undercollateralized, the transaction will recycle until the deficient account has sufficient collateral to complete (see Recycle Processing) .

Controlling Collateral

Securities received versus payment are automatically designated as net additions (NA) because the receiver has not yet paid for these securities. Your CM is credited the collateral value (market value minus the applicable haircut) of all positions designated NA. Conversely, your CM is not affected by positions designated as minimum amount (MA). You can manage your collateral in the following ways:

- **Opening (start-of-day) securities positions as collateral:** You can give DTC standing instructions to designate as collateral all securities in your account at the opening of each day. All start-of-day positions are then designated NA, and your CM is credited the collateral value of the start-of-day positions. Contact your Relationship Manager to change your standing instructions.
- **Unvalued additional securities:** You can give DTC standing instructions to designate all unvalued additions of securities to your account (such as deposits and free DOs received) as either NA or MA. Contact your Relationship Manager to change your standing instructions.

Warning! Consider the implications of classifying your securities as collateral. Collateral can be used to support your debt and therefore can be liquidated by DTC if you are unable to pay your settlement obligation.

- **Intraday reclassification of securities:** You can submit instructions to DTC using the PTS function DYMA to reclassify as collateral a specific quantity of an issue previously classified as non-collateral. This results in a CM credit equal to the collateral value of the reclassified securities. Conversely, you can use the PTS function DYNA to reclassify collateral securities as non-collateral.

Note- A DYNA instruction will not execute if the removal of the collateral from your account would cause your CM or simulated CM to become negative.

- **Settlement Progress Payments (SPPs):** You can increase your CM by wiring Settlement Progress Payments (SPPs) to DTC's account at the Federal Reserve Bank of New York (FRBNY). Your CM and your settlement account will be credited for the amount of the SPP; thus, SPPs also reduce your actual net debit. See Wire Instructions for more information.)

To view your CM balance, use the PTS function RMCI.

Security Type	Rating	Collateral Haircut¹	Previous Collateral Haircut¹
<u>US Treasury & Agency Securities, including Government Zero Coupon Bonds</u> Interest bearing with remaining terms to maturity of up to 10 years. Interest bearing with remaining terms to maturity in excess of ten years. Zero coupon with remaining terms to maturity of up to five years. Zero coupon with remaining terms to maturity in excess of five years.	--	2%	2%
	--	5% ²	5%
	--	2%	2%
	--	5%	5%
<u>Money Market Instruments</u> Corporate and Municipal Commercial Paper Discount Notes Institutional Certificates of Deposit (original maturity 270 days or less) Short-Term Bank Notes Preferred Stock in CP-Like Mode (PFD/CP) Banker's Acceptances ³	A-2/P2 or above	5%	2%
	A-3/P3	20%	5%
	Below A-3/P3 or unrated	100%	100%
Corporate and Municipal Variable-Rate Demand Obligations in CP Mode (VRDO/CP)	A-1/VMIG1 ⁴ or above	2%	2%
	A-2/VMIG2	10%	2%
	A-3/VMIG3/VMIG4	20% (35% VMIG4)	5%
	Below A-3/VMIG4 or unrated	100%	100%
Municipal Bonds Medium-Term Notes Corporate Bonds Institutional Certificates of Deposit (original maturity greater than 270 days)	A-/A3 or above	10%	5%
	BBB+/Baa1 through BBB-/Baa3	20%	5%
	BB+/Ba1 through BB-/Ba3	30%	25%
	B+/B1 through B-/B3 (non-Muni)	40% (100% Muni)	25%
	CCC+/Caa1 through C or unrated	100%	25%
ARPS and TRPS	AA-/Aa3 and above	10%	5%
Municipal Notes (including Tax-Exempt) and other Short-Term Municipal Debt	A-1(SP1+/SP1)/MIG1/P1	2%	5%
	A-2(SP2)/MIG2/P2	10%	5%
	A-3/P3/MIG3/MIG4	20% (35% MIG4)	5%
	Below A-3/P3/VMIG4 or unrated	100%	25%
Corporate & Municipal VRDOs (non-CP mode)	SP-1/VMIG1 or above	5%	5%
	SP-2/VMIG2	10%	5%
	VMIG3	20%	25%
	VMIG4	35%	25%
	Below SP-2 /VMIG4 or unrated	100%	25%

Security Type	Rating	Collateral Haircut¹	Previous Collateral Haircut¹
Equity Securities (Common, Preferred, Warrants, Rights, Units, UITs) listed on a U.S. national securities exchange, NASDAQ or a Canadian securities exchange with a market price of \$5.00 or more per share or per other unit	\$10/Share or above ⁵	20%	10%
	----- \$7.50/Share to \$9.99/Share ⁵	30%	25%
	----- \$5/Share to \$7.49/Share	50%	50%
	----- Below \$5/Share	100%	100%
Equity Securities (Common, Preferred, Warrants, Rights, Units, UITs and ADRs) not listed on a nationally recognized US or Canadian stock exchange or NASDAQ	\$5/Share or above	40%	25%
	----- Below \$5/Share	100%	100%
144 A/Reg S Equity Securities	\$5/Share or above	100%	100%
	----- Below \$5/Share	100%	100%
144 A/Reg S Debt Securities	A-/A3 or above	100%	100%
	----- BBB+/Baa1 through BBB-/Baa3	100%	100%
	----- BB+/Ba1 through B-/B3	100%	100%
	----- Below B-/B3	100%	100%
Collateralized Mortgage Obligations (CMOs) Priced by two or more vendors: largest percentage price decrease resulting from a +50/-100 basis point rate shift.	AAA	30%	10%
	----- AA+/Aa1 through AA/Aa2	40%	10%
	----- Below AA	100%	100%
	----- Priced by less than two vendors	100%	100%
Asset Backed Securities (ABS) Priced by two or more vendors	AA/Aa2 and above	25%	10%
	----- Below AA/Aa2	100%	100%
	----- Priced by less than two vendors	100%	100%
	All ratings	100%	100%

¹ Securities are assigned a 100% haircut if the issue has matured, the issuer is in bankruptcy or the security is not priced by an approved DTC pricing model or by a third-party vendor for a period of 10 business days or more.

- 2 Certain GNMA Pass Through securities are assigned higher haircuts (i.e., 10% on project loans and notes, 12% on construction loans, or 20% on manufactured housing loans) to address liquidity concerns.
- 3 The ratings to be applied to Bankers Acceptances shall be the short-term deposit rating of the accepting bank or, if the accepting bank does not have a short-term deposit rating, the rating of the short-term debt of the holding company of the accepting bank. All Bankers Acceptances currently receive a 100% haircut.
- 4 Variable Municipal Investment Grade
- 5 DTC further reduces its risk by assigning higher haircuts, where applicable, to equity securities designated as "highly or extremely volatile", based on their 90-day price volatility. A security is considered "highly volatile" when its price volatility reaches 100 during a 90-day period. Securities identified as "highly volatile" are assigned a haircut of 25%, unless a higher price-based or restricted securities haircut applies. When price volatility reaching 200 in a 90-day period is identified, a security is designated "extremely volatile" and assigned a haircut of 50%, unless a higher haircut applies.