



CONFLICTS OF INTEREST GUIDANCE FOR PRIMARY DEALERS PARTICIPATING IN THE TERM ASSET-BACKED SECURITIES LOAN FACILITY

I. Introduction

The purpose of this guidance pertaining to conflicts of interest for primary dealers participating in the Term Asset-backed Securities Loan Facility (“TALF program” or “Program”) is to highlight certain requirements and expectations of such primary dealers in order to safeguard public confidence in the TALF program, the Federal Reserve and the participating primary dealers.

Under the terms of the TALF program, a participating primary dealer will perform a variety of critical roles. Because potential borrowers under the TALF program must interface with primary dealers in order to obtain a TALF loan, the primary dealers will act as agents on behalf of potential borrowers to submit loan subscription requests to the Federal Reserve Bank of New York (“FRBNY”). In addition, a primary dealer may be an underwriter of securities that may be pledged as collateral to the TALF program or a TALF borrower. Primary dealers are also expected to: (i) assess the eligibility of prospective borrowers and collateral, (ii) receive that portion of the interest and principal distributions on the collateral that is for the account of the borrowers, (iii) disburse such interest and principal to the borrowers, and (iv) perform certain due diligence and recordkeeping functions. In certain circumstances, a primary dealer may also be affiliated to a sponsor or issuer of TALF eligible collateral.

This document is intended to ensure the integrity of the TALF program by (i) providing primary dealers with guidance in navigating the multiple roles that they may perform and (ii) establishing a protocol for the primary dealers to escalate, report and manage potential or actual conflicts of interest that may arise during the performance of their TALF duties.

II. Scope

Each participating primary dealer is required to identify and remediate any potential conflicts of interest that arise or may arise in connection with activities undertaken under the TALF program, and in certain circumstances, communicate a conflict of interest identification and remediation plan to the FRBNY. Pursuant to Section 11.3 of the MLSA, each participating primary dealer has committed to abide by the following:

- 1) prior to submitting a TALF loan request on behalf of any person, a primary dealer must establish, implement and maintain policies and procedures designed to identify the existence of any actual or potential conflict of interest that may exist or arise as a result of

its intended activities under the TALF and take appropriate remedial action to address any conflict of interest identified; and

- 2) prior to accepting a loan on behalf of itself or a Related Person, a primary dealer must submit a conflict of interest identification and remediation plan (a “Remediation Plan”) designed to address actual or potential conflicts of interest that exist or may arise if (i) a primary dealer or a Related Person intends to borrow funds from the TALF, (ii) such primary dealer or a Related Person acted or intends to act as underwriter for the securities proposed or to be proposed as collateral for a TALF loan, and (iii) such primary dealer or a Related Person has submitted or intends to submit the TALF loan request to the FRBNY on behalf of itself or a Related Person.¹

Moreover, the FRBNY has determined that additional safeguards are required under certain circumstances. These additional safeguards are outlined in Section V.

III. Conflict of Interest Identification and Remediation

A. General Requirement

Participating primary dealers are required to establish conflict of interest policies and procedures associated with their TALF activities. Such policies and procedures must include conflict of interest identification and remediation measures designed to address actual and potential conflicts that may arise out of the primary dealer’s multiple roles in any TALF transaction, including the risk that the primary dealer or a Related Person may gain, or stand to gain, an unfair competitive advantage in arranging a loan under the TALF. Moreover, measures taken must ensure that all eligible borrowers who seek a loan from the TALF through a primary dealer are treated fairly and that the integrity of the primary dealer’s participation in the TALF is not undermined.

B. Specified Remediation Plan for Submission to FRBNY

As noted, a primary dealer must submit a Remediation Plan to the FRBNY if such primary dealer or any Related Person intends to arrange a TALF loan, act as an underwriter for the collateral that will be purchased with such loan, and borrow through the TALF. In such circumstances, the Remediation Plan developed by the primary dealer should at a minimum meet the requirements of this Subsection.

i. Identification

A Remediation Plan must identify any actual or potential conflicts of interest that may arise pursuant to the primary dealer’s duties under the TALF program and must include all information necessary for FRBNY to assess such actual or potential conflict. If a primary dealer identifies a conflict, its Remediation Plan must include, at a minimum, the following identification information:

¹ “Related Person” means any affiliate of a primary dealer, or any other person that has been formed or sponsored by, or is controlled or managed by or otherwise affiliated with, such primary dealer or any of its affiliates.

- 1) the primary dealer's relationship to the TALF borrower;
- 2) a description of the activities that give rise to the conflict, including relevant processes;
- 3) any actual or potential Organizational Conflicts of Interest; and²
- 4) any material Personal Conflicts of Interest that have not been fully mitigated by the firm's internal insider trading or information barrier policies.³

ii. Remediation

Mitigation measures may depend on a variety of factors, including the type of conflict, the structure of the offering, and the organizational structure of the primary dealer and the Related Person. Measures designed to address the conflict may include:

- 1) adoption, implementation, and enforcement of a code of conduct or other ethics policy that may address conflicts of interest;
- 2) adoption, implementation, and enforcement of appropriate information barriers to prevent unauthorized individuals from obtaining nonpublic information relating to the offering;
- 3) protocols that separate the conflicting activities of a primary dealer or a Related Person;
- 4) execution of processes or procedures to ensure that the sale or placement of the TALF eligible securities would be conducted fairly; and
- 5) any other steps appropriate under the circumstances.

iii. Waivers

The Chief Compliance Officer of the FRBNY may grant requests for waivers submitted under a Remediation Plan when it is clear, from the totality of the circumstances, that a waiver is appropriate consistent with the just administration of the TALF program.

iv. Submission

Each primary dealer must submit its Remediation Plan to the TALF Compliance Director prior to accepting a TALF loan on behalf of itself or a Related Person. Notwithstanding, the FRBNY strongly recommends that each primary dealer submit its Remediation Plan as soon as possible. Additionally, primary dealers must communicate to the TALF Compliance Director any material changes or updates to their Remediation Plans, and must submit a subsequent Remediation Plan upon request. Remediation Plans should be transmitted via email to talf.compliance@ny.frb.org.

² "Organizational Conflict of Interest" means a situation in which the primary dealer has an interest or relationship that could cause a reasonable person with knowledge of the relevant facts to question the primary dealer's objectivity or judgment to perform TALF activities or its ability to adequately represent parties with adverse interests.

³ "Personal Conflict of Interest" means a personal, business, or financial interest of an individual, his or her spouse, minor child, or other family member with whom the individual has a close personal relationship that could adversely affect (i) the individual's ability to perform his or her duties, or (ii) his or her objectivity or judgment in performance of such duties.

IV. Exemptions

Under Section 36 of the Securities Exchange Act of 1934 (“Exchange Act”), the United States Securities and Exchange Commission issued a no-action letter granting limited relief from the prohibition on arranging certain credit contained in Section 11(d)(1) of the Exchange Act. Specifically, such relief was requested to permit brokers and dealers that act as primary dealers to participate in the TALF by facilitating extensions of nonrecourse credit on behalf of the FRBNY to purchasers of certain new issues of asset-backed securities in the distribution of which such primary dealers may have participated as member of a selling syndicate or group within the meaning of Section 11(d)(1). For more information, please refer to the SEC no-action letter at the following address:

<http://www.sec.gov/divisions/marketreg/mr-noaction/2009/frbny021709.pdf>

V. Additional Safeguards for the TALF program

A basic tenet that underlies the TALF program is that eligible collateral will be most prudently selected if an independent investor’s economic capital is put to risk. Accordingly, the Federal Reserve has imposed the following requirements to limit possible conflicts between the TALF’s goals and the interest of other participants.

A. Restriction on Moral Recourse and Related Certification

On December 31st of each year of the TALF program, each primary dealer is required to submit a certification to the FRBNY stating that neither the primary dealer nor any affiliate will enter into any agreement pursuant to which the primary dealer or its affiliates will, directly or indirectly, acquire from any borrower any collateral the issuance of which was underwritten or sold by any primary dealer (“Subject Collateral”) at a price designed to reduce or eliminate any loss that such borrower would realize on the sale of such Subject Collateral in a fair market value transaction, or enter into any other agreement or consummate any other transaction intended to have the same effect. For additional information see Appendix 1 of the MLSA.

B. Limitation on Hedging Transactions

With respect to Subject Collateral, the limitation described in Subsection A. of this Section also prohibits a primary dealer or an affiliate from entering into any transaction that is designed to hedge against losses specific to securities purchased with TALF financing. This prohibition extends to both direct hedges, such as credit default swaps, and correlative hedges, such as short-selling the ABX index. However, the prohibition does not extend to hedges on a borrower’s broader portfolio, which may include securities purchased with TALF loans.

C. Restriction on Purchasing Self-Originations

Primary dealers and their affiliates are prohibited from purchasing with a TALF loan securities that contain underlying credit exposures that were originated by such primary dealer or any Related Person.

VI. Questions and Comments

Questions and comments made with respect to this guidance are encouraged by the FRBNY and may be submitted to the TALF Compliance Director via telephone at 1-212-720-2363 or via email at talf.compliance@ny.frb.org. This guidance is subject to change at any time.