November 10, 2015

Submitted via Email to rule-comments@sec.gov
Robert W. Errett
Deputy Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Proposed Rule Change to Amend FINRA Rule 4210 (Margin Requirements) to Establish Margin Requirements for the TBA Market; Release No. 34-76148; File No. SR-FINRA-2015-036

Dear Mr. Errett:

The Asset Management Group ("AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the Securities and Exchange Commission (the "Commission") with comments on SR-FINRA-2015-036, a proposal by FINRA to amend FINRA Rule 4210 to establish margin requirements for Covered Agency Transactions (the "Proposal").[2]

AMG supports mitigating counterparty credit risk for Covered Agency Transactions and reducing systemic risk. However, we believe that in some areas the Proposal unnecessarily shifts risks and burdens to the counterparty facing the FINRA member participants ("Members"), and in other areas, should be amended to make the rule more workable or clear.[3] Specifically, as

[1] AMG's members represent U.S. asset management firms whose combined assets under management exceed $30 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds, undertakings for collective investments in transferable securities ("UCITS") and private funds such as hedge funds and private equity funds.

[2] Notice of Filing of a Proposed Rule Change To Amend FINRA Rule 4210 (Margin Requirements) To Establish Margin Requirements for the TBA Market, Exchange Act Release No. 76148 (Oct. 14, 2015), 80 Fed. Reg. 63603 (Oct. 20, 2015) ("Release 76148").

"Covered Agency Transactions" include (1) To Be Announced ("TBA") transactions, inclusive of adjustable rate mortgage ("ARM") transactions, (2) Specified Pool Transactions, and (3) transactions in Collateralized Mortgage Obligations. *See* Release 76148 at 63603.

[3] As noted in the comments that follow, we believe that the Proposal does not sufficiently address some of the concerns raised by market participants during the prior comment period in respect of the revisions to Rule 4210 originally proposed by FINRA in January 27, 2014, including comments submitted by AMG.

discussed further below: (i) imposition of maintenance margin on non-Members will unfairly affect a very narrow segment of market participants and have only a limited impact, if any, on systemic risk; (ii) variation margin should be mandatorily exchanged bilaterally in order to more effectively mitigate risk and to establish a consistent market practice; (iii) mandatory liquidation for uncured margin deficiencies should not be required or, alternatively, a longer period should be allowed in order to avoid disadvantaging non-Members in resolving disputes and to allow legitimate disputes to be addressed; (iv) same-day margining requirements should be replaced with a three-day transfer period to avoid operational problems and provide a workable time frame for market participants; (v) the small account and cash account exceptions use terms that require further specificity and clarification; (vi) the Proposal should provide for an exception from margin requirements for sovereign wealth funds, recognize foreign equivalent entities to "exempt accounts" as exempt, and clarify the treatment of collective investment trusts; (vii) Members should be allowed to negotiate commercial terms such as thresholds and minimum transfer amounts with certain large and creditworthy corporate counterparties; (viii) the Commission should work with international regulators to ensure harmonization of rules in the market for Covered Agency Transactions; and (ix) the compliance date should be 18-24 months following the amended rule's effective date to allow market participants time to adequately prepare for the new requirements.

I. Imposition of Maintenance Margin on Non-Members Will Unfairly Affect a Very Narrow Segment of Market Participants and Have Only a Limited Impact on Systemic Risk.

The Proposal provides that for bilateral transactions with non-exempt accounts, Members must collect maintenance margin equal to two percent (2%) of the market value of the securities subject to the transaction.[4] In addition to the definition of "exempt accounts" under the existing rule (with respect to maintenance margin), the Proposal contains two exceptions from the margin requirements: (1) an exception (the "Cash Account Exception") from maintenance margin for transactions with non-exempt accounts if the original contractual settlement for such transactions is in the month of the trade date or in the month succeeding the trade date provided that (x) the customer regularly settles its Covered Agency Transactions on a DVP basis or for cash and (y) the non-exempt account does not engage in dollar rolls, round robin trades or other type of financing techniques; and (2) a separate exception (the "Small Account Exception") from both maintenance and variation margin for counterparties with gross open positions of $2.5 million or less in the aggregate, if the original contractual settlement for all transactions with the non-exempt account is in the month of the trade date or in the month succeeding the trade date for such transactions and (x) the customer regularly settles its Covered Agency Transactions on a DVP basis or for cash and (y) the non-exempt account does not engage in dollar rolls, round robin trades or other type of financing techniques.

[4] Additionally, as discussed further below, if the deficiency in margin is not satisfied within five business days, the Member must take liquidating action, unless FINRA grants the Member an extension.

AMG opposed the imposition of maintenance margin in its 2014 comment letter to FINRA[5] and now reiterates its objection. FINRA's approach seems to be based on a view that maintenance margin will be a *de minimis* issue because, through the combined effect of the Small Account Exception, the Cash Account Exception and the exception from maintenance margin for "exempt accounts," maintenance margin will be limited to a very narrow segment of market participants.[6]

AMG's members strongly believe that the better, simpler approach is to eliminate maintenance margin altogether. The narrow reach of the maintenance margin requirement is troubling because it will disproportionately affect resource-constrained small to mid-sized market participants. It is not at all clear why this particular segment of the market should bear additional costs and credit risks of maintenance margin while larger and smaller accounts do not. FINRA's response to this point centers on the anticipated future benefits of the margin requirements, which, according to FINRA, "should accrue over time and help maintain a properly functioning retail mortgage market even in stressed market conditions" and eventually "benefit all market participants."[7] AMG believes, instead, that by singling out this one market segment, these market participants will be driven out of the market or will migrate to non-Member dealers. In addition, SIFMA AMG believes that maintenance margin is not necessary in the market for Covered Agency Transactions because of the large aggregate size, fungibility and liquidity of this market.[8]

While maintenance margin would provide limited, if any, benefits to the market for Covered Agency Transactions, it would also levy significant costs. The posting of maintenance margin imposes additional credit risk upon counterparties who transact with Members and will increase costs for those counterparties caused by the posting of cash or securities. Moreover, the risks associated with increased credit exposures to non-Members are exacerbated, because, unlike other markets (for example, the Federal banking agencies' margin requirements for non-cleared swaps) where the counterparty's initial margin must be segregated and held at a non-affiliated custodian, the Proposal does not have this requirement.[9]

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[5] Letter from AMG to FINRA re: Proposed Amendments to FINRA Rule 4210 for TBA Transactions, *available at* http://www.finra.org/sites/default/files/NoticeComment/p477653.pdf (the "AMG 2014 FINRA Comment Letter," incorporated herein by reference and attached as an appendix).

[6] *See* Release 76148, *supra*, at 63610 (FINRA stating that, "[b]ased on discussions with industry participants, FINRA expects that very few accounts would be treated as non-exempt accounts under the rule, and hence most would not be subject to the maintenance margin requirement").

[7] *Id.* at 63616.

[8] The liquidity in the TBA market is well-established and trades on a "cheapest to deliver" basis, making settlement easier. *See* SIFMA, TBA Market Fact Sheet: The TBA Market, 2013, *available at* http://www.sifma.org/.

[9] FINRA stated that it is considering the use of tri-party custodial arrangements, but does not propose to address it as part of the Proposal.

Finally, the maintenance margin requirement is inconsistent with the Treasury Markets Practice Group's ("TMPG") best practice recommendations for margining of forward-settling treasury, agency debt and agency mortgage-backed securities transactions. The TMPG, which is sponsored by the Federal Reserve Bank of New York and whose recommendations are followed by a variety of institutions — including securities dealers, banks, buy-side firms, market utilities and others — did not include a requirement to collect maintenance margin. Creating a mismatch between FINRA margin standards and the TMPG best practice recommendations will lead to conflicting requirements, unnecessary compliance and build-out costs, confusion in the marketplace as well as material economic differences between trading with a Member and a non-Member.

II. Bilateral Exchange of Variation Margin Should be Required to More Effectively Mitigate Systemic Risk and to Maintain a Consistent Market Practice.

In the Proposal, FINRA states that it "supports the use of two-way margining as a means of managing risk but does not propose to address such a requirement as part of the rule change."[10]

AMG believes that the Proposal should require Members to adopt bilateral variation margining. As discussed in our prior comment letter, two-way variation margining is a means to mitigate the credit risk that non-Member market participants will have with respect to their Member counterparties.[11] The goal of the Proposal should be to reduce systemic risk with respect to Covered Agency Transactions. To do this effectively, all market participants must be required to post and receive margin. This approach is consistent with the TMPG best practice recommendations, which recognized (and endorsed) two-way margining, stating that in order to help both parties mitigate counterparty risk, "two-way variation margin should be exchanged on a regular basis."[12]

AMG believes that requiring two-way variation margin will establish a consistent market practice that will help protect investors and avoid negative impacts in the market. In the absence of a regulatory mandate, two-way variation margin will be left to the contractual negotiation between the parties, unfairly impacting smaller market participants with limited negotiating power and potentially leading to a fragmentation of the market as Member firms may adopt varying internal policies regarding its use. In light of other burdens disproportionately affecting smaller market participants under the Proposal (see Section I above), the absence of a mandatory two-way variation margin requirement could drive such participants entirely out of the market.

AMG is also concerned that a one-way margin regime for TBA transactions would disincentivize market participants from entering into significant amounts of Covered Agency

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[10] Release 76148, *supra*, at 63620.

[11] AMG 2014 FINRA Comment Letter at 6-7.

[12] TMPG, Best Practices for Treasury, Agency Debt, and Agency Mortgage-Backed Securities Markets, 2013, *available at* http://www.newyorkfed.org/tmpg/bestpractices_052313.pdf.

Transactions due to a lowering of their risk-adjusted expected returns. Although a bilateral margining regime may also result in some reduction in investment and trading in Covered Agency Transactions, this reduction would likely to be less significant because of the reduced risk to buy side market participants due to the margin they would collect.

III. Mandatory Liquidation for Uncured Deficiencies Should Not be Required or, Alternatively, a Longer Period Should be Allowed to Avoid Disadvantaging Non-Members in Resolving Disputes and to Allow Legitimate Disputes to Be Addressed.

The Proposal provides that, unless FINRA has specifically granted the Member additional time, the Member would be required to liquidate positions if, with respect to exempt accounts, a mark-to-market loss is not satisfied within five business days, or, with respect to non-exempt accounts, a deficiency is not satisfied within such period.[13]

AMG believes that by requiring Members to liquidate positions after 5 business days, FINRA is employing too heavy-handed an approach to risk mitigation. Instead, the Proposal should be aligned with the TMPG approach, which considered and rejected requiring such liquidating action after a failure to post margin.

Liquidation of customer positions as a remedy for failure to transfer margin is a business decision that Members should be permitted to negotiate with their customers.[14] AMG strongly believes that parties should be free to negotiate their own provisions relating to the exercise of remedies with respect to a default and that the mandatory liquidation provision should be eliminated. In addition, market participants already have a commercial means of addressing this issue. Under Section 7 of the industry standard MSFTA agreement, failure to transfer margin on a timely basis constitutes an Event of Default, which gives the non-defaulting party the right to liquidate the positions of the defaulting party. The decision whether to exercise this right is a commercial one that is informed by the nature of, and circumstances surrounding, the default. For example, a failure to post margin for a single day may be due to an administrative error that is easily remedied, and it would be unlikely that a Member would exercise its liquidation rights. Where the non-transfer of margin extends beyond a single day, it is often the case that the failure to post the full amount is due to a legitimate dispute between the parties with the respect to the value of the position or the collateral and, therefore, the amount of margin that needs to be posted. In such cases, the non-defaulting party may determine that the failure to transfer margin does not reflect a credit concern and refrain from exercising its liquidation rights in order to engage in a dispute resolution process. A mandatory five-business day countdown clock to liquidation is likely too short to allow sufficient time for resolution of true disputes and will create an artificial imbalance in the parties' negotiating positions by setting as the "default position" that the Member is required to liquidate at its own valuations.

While we believe that there should not be any mandatory liquidation imposed by regulation, if FINRA must provide for mandatory liquidation, we believe that 15 days is a more

[13] Release 76148, *supra*, at 63607.

[14] AMG raised this concern in its prior comment, but it was not addressed in the Proposal. *Id.* at 63619.

workable period and would not materially increase risk to Members. At a minimum, the Proposal should be modified to clarify that mandatory liquidation does not apply in the event of a legitimate commercial dispute.

IV. Same Day Margining Should be Replaced with a Three-Day Transfer Period to Avoid Operational Problems and Provide a Workable Time Frame for Market Participants.

Under the Proposal, when a counterparty does not pay the required maintenance margin or the Member's mark-to-market loss, the Member must deduct from its net capital any uncollected margin at the end of the day following the business day of the creation of the deficiency. Because Members calculate the value of positions and the amount of required margin at the end of the trading day, this is the day the deficiency can be said to be created. Margin calls are typically issued on the next business day – i.e., on the business day following the day the deficiency was created. Thus, under the Proposal, margin must be posted by the end of the day on which the margin call is received, i.e., "same day" margining. This is especially challenging in situations where a Member delivers a collateral call later in the day.

AMG believes that counterparties should be free to negotiate their own settlement timelines, subject to a three-day maximum period, to accommodate the specific circumstances of individual transactions. Many market participants are just not operationally equipped to comply with same day margining, even for standard domestic transactions. The processing of margin calls for the buy side involves a number of sequential steps, including: validation of the amount of a margin call, agreement as to the value of collateral (if using non-cash collateral), approval by internal managers and coordination with third party custodians to effect the movement of collateral. Requiring same day margin is likely to result in an increase in processing errors, more disputes between parties, and a greater likelihood of defaults by counterparties, without a commensurate corresponding benefit.

Same day margining is even more problematic for transactions with non-U.S. accounts that have non-U.S. dollars as their operating currency. For example, when transacting with counterparties using non-U.S. dollar currencies, a party must have sufficient time to exchange the foreign currency for use as collateral in domestic currency (Members have been largely unwilling and/or unable to accept non-U.S. dollars as eligible collateral for Covered Agency Transactions). This currency conversion is usually done on the spot foreign exchange markets that have a two-day settlement cycle. Also, non-U.S. clients often employ non-U.S. custodians that operate in different time zones and have different holiday schedules than the asset manager or Member. Asset managers rely on their clients' custodians to deliver the cash or securities necessary to meet a margin call by a Member. An instruction to deliver margin from an asset manager to a non-U.S. custodian may arrive outside of the custodian's ordinary business hours and, as such, may not be acted upon until the following business day. In these situations, it may be impossible for a counterparty employing a non-U.S. custodian to meet a same day margin call.

Moving to same day margining would change longstanding practices for certain asset managers across portions of their client base, requiring costly and burdensome systems and

operational changes for those asset managers. It may also unnecessarily force non-U.S. counterparties out of the market. Therefore, AMG proposes that margin settlement be extended to three days following the call for margin with an allowance for parties to negotiate shorter margin settlement periods for individual transactions.

V. The Small Account and the Cash Account Exceptions Use Terms that Require Further Specificity or Clarification.

In response to commenters' concerns that the margin requirements would be particularly burdensome to smaller accounts and concerns about the implications of maintenance margin for non-exempt accounts, FINRA has proposed the Small Account Exception and the Cash Account Exception (each as defined above), respectively.

These exceptions contain ambiguities which should be clarified. Specifically, it is unclear (a) what it means for an account to "regularly" settle transactions on a DVP basis or for cash, (b) what constitutes "other financing techniques" and (c) whether engaging in a single dollar roll or round robin trade will make the exception unavailable. With respect to the Small Account Exception, it is also unclear how to treat accounts that hover around the $2.5 million level of gross open positions. Moreover, we believe that the Small Account Exception level is set too low. We are happy to discuss and otherwise assist the Commission in considering a more appropriate level.

VI. The Proposal Should Provide for an Exception From Margin Requirements For Sovereign Wealth Funds, Recognize Foreign Equivalent Entities to "Exempt Accounts" as Exempt, and Clarify the Treatment of Collective Investment Trusts.

(a) Sovereign Wealth Funds

The Proposal permits Members to elect not to apply the margin requirements for Covered Agency Transactions to transactions with certain governmental or quasi-governmental counterparties, including: the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation, central banks, multinational central banks, foreign sovereigns, multilateral development banks and the BIS. However, the Proposal does not to extend the exception to sovereign wealth funds because they "engage in market activity as *commercial* participants."[15] FINRA states that extending the exception to an entity without a showing that it "is expressly backed by the full faith and credit of a sovereign power or powers and is expressly limited by its organizing charter as to any speculative activity in which it may engage"[16] would "cut against the overall purpose of the rule amendments."[17]

[15] Release 76148, *supra*, at 63619.

[16] *Id.*

[17] *Id.*

In our prior comment letter, AMG requested that sovereign wealth funds be explicitly excluded from the purview of Rule 4210.[18] Sovereigns often make their investments through these specialized investment vehicles which they guarantee. Thus, they present credit profiles that are substantially similar to those of the sovereign itself.

AMG sees no reason for sovereign wealth funds to be treated differently from other government or quasi-government counterparties. As stated in the Proposal, FINRA's motivation in establishing rule requirements for the TBA market arises from "the growth in volume in the TBA market, the number of participants and the credit concerns that have been raised in recent years."[19] In footnote 38 of the Proposal, FINRA makes explicit that the exception for central banks and other similar instrumentalities of sovereign governments was styled as an election in order to provide Members with flexibility to manage the risk -- i.e., credit risk -- vis-a-vis such entities that participate in the market. Whether an entity is a "commercial participant" and whether its charter limits speculative activity is simply not relevant to the question of credit risk. So long as a sovereign wealth fund (which is essentially the instrumentality through which a sovereign invests) is supported by the credit of the sovereign, it should be treated in the same manner as the sovereign.

(b) Foreign-Regulated Entities

The Proposal should be revised to harmonize the treatment of foreign-regulated entities with their domestic counterparts. Currently, the definition of an "exempt account" excludes foreign institutions.[20] AMG believes that this interpretation unfairly prejudices non-U.S. entities that would otherwise qualify as exempt. More specifically, requiring these non-U.S. entities to post maintenance margin where their United States equivalents would be exempted would not meaningfully reduce systemic risk, and would further discourage these entities from participating in Covered Agency Transactions. Accordingly, AMG believes that these firms should be recognized as "exempt accounts."

(c) Collective Investment Trusts

The Proposal does not provide guidance on the status of collective investment trusts as "exempt accounts," which vehicles AMG believes should be included within the definition. Collective investment trusts are bank-maintained pooled investment vehicles in which qualified employee benefit plans (which themselves qualify as "exempt accounts") may invest. Collective investment trusts rely on an exclusion from the definition of "investment company" under the Investment Company Act of 1940[21]; however, collective investment trusts

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[18] AMG 2014 FINRA Comment Letter at 6.

[19] Release 76148, *supra* note 2, at 63604.

[20] *See* Interp. /01 to FINRA Rule 4210(a)(4), explaining that a "foreign institution" (*i.e.*, a financial firm that is regulated under non-U.S. law) does not qualify as a "designated account."

[21] Exclusions from the definition of investment company depend on the type of fund and include, without limitation, Sections 3(c)(1), 3(c)(3), 3(c)(7), and 3(c)(11) under the Investment Company Act.

are regulated in other ways. The bank or trust company maintaining such collective investment trust is subject to regulation and examination by the Office of the Comptroller of the Currency if it is nationally chartered, or by a state banking regulatory agency if it is state chartered. In addition, to the extent employee benefit plans that are subject to the Employee Retirement Income and Security Act of 1974 ("ERISA") participate in the fund, the bank is subject to the fiduciary provisions of ERISA and Department of Labor regulations. Moreover, applicable banking laws generally impose a fiduciary duty on the bank with respect to each client participating in the fund. Because collective investment trusts are comprised of investments by "exempt accounts" and are otherwise regulated, AMG believes collective investment trusts should themselves be considered "exempt accounts."[22]

VII. Members Should be Allowed to Negotiate Commercial Terms Such as Thresholds and Minimum Transfer Amounts with Certain Large and Creditworthy Corporate Counterparties.

AMG believes that Members should have the ability to negotiate commercial terms such as minimum transfer amounts and thresholds with certain large, creditworthy corporate counterparties with respect to Covered Agency Transactions. A portion of the market for Covered Agency Transactions consists of highly creditworthy, publicly traded, non-financial corporations. Such counterparties often do not maintain the cash reserves necessary for, nor do they have the operational systems in place to comply with, daily margining. Accordingly, we would propose that a Member be able to decide to negotiate thresholds, and also to set a minimum transfer amount with respect to such counterparties that is higher than the proposed $250,000 level.

VIII. The Commission Should Work With International Regulators to Ensure Harmonization of Rules in the Market For Covered Agency Transactions.

While outside of the scope of the Proposal, AMG also encourages the Commission to work with international regulators to ensure harmonization of rules in the market for Covered Agency Transactions. For example, if TBAs are determined to be derivatives under European regulations, absent harmonization amongst regulatory regimes, European counterparties may be confronted with competing requirements relating to documenting, reporting and margining their Covered Agency Transactions. Absent relief, these unintended consequences would further discourage non-U.S. counterparties from entering into Covered Agency Transactions with Members.

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[22] *Cf*. Securities Act Rule 144A(a)(v) (including in the definition of "qualified institutional buyer" entities where all of the equity owners are "qualified institutional buyers").

IX. The Compliance Date Should Be 18-24 Months Following the Effective Date to Allow Market Participants Time to Adequately Prepare for the New Requirements.

In its rule filing, FINRA indicated that it "supports in general the suggestion of an implementation period that permits members adequate time to prepare for the rule change and welcomes further comment on this issue."[23] We believe that the Proposal should have a compliance date that is at least 18-24 months following the effective date. This time period would allow Members and non-Members to change necessary systems and amend existing documentation, as well as educate clients, so as to be able to comply with Rule 4210. Compliance with requirements of the Proposal is expected to be particularly demanding at a time where market participants' resources are already stretched to their limits due to ongoing efforts to comply with the significant regulatory changes that were instituted pursuant to the Dodd-Frank Act EMIR and other regulatory initiatives across the globe (Australia, Canada, Hong Kong, Singapore, etc.).

In particular, compliance with the new regulatory regime contemplated by the Proposal would require Members and non-Members to renegotiate their existing MSFTAs. The amendment process can be expected to impose significant costs on market participants and delays in implementation. The market's experience with the TMPG best practice recommendations is instructive. Due to the very broad participation in the market for Covered Agency Transactions, despite diligent efforts, market participants were unable to negotiate and execute MSFTA agreements with significant numbers of counterparties within the nearly 14 month period established by the TMPG to achieve substantial compliance. An equally long (if not longer) period of time should be provided to implement the Proposal.

In addition, the new regime established by the Proposal will require new policies and procedures to ensure compliance, as well as implementation of software updates to properly track delivery and receipt of margins, account for margin movements for new transaction types, enable pre-trade and post-trade compliance checking, permit reconciliation between portfolio accounting and custody. Asset managers will need to re-evaluate their entire client populations to identify which clients are exempt from margining altogether, which clients may be subject to maintenance margin (if this concept remains in the Proposal) and which clients may require ongoing monitoring to ensure they are appropriately categorized under the rule (i.e. with respect to net worth). Some of the software systems currently utilized, particularly by buy-side market participants, are vendor systems, and it is not certain that such vendors will provide the requisite enhancements to their products on time (or at all). After the vendors deliver the enhancements (or new systems are sourced), market participants will have to perform testing of the functionalities and workflows and integrate across multiple systems end-to-end. Members would also require time to educate personnel about the rule, train them to use the new functionalities in the systems and alter their operating models.

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[23] Release 76148, *supra* note 2, at 63620.

For the reasons stated above, the AMG requests that: (i) the requirement of maintenance margin be eliminated; (ii) variation margin be made mandatorily bilateral; (iii) mandatory liquidations for uncured margin deficiencies not be required or a longer liquidation period be imposed; (iv) same-day margining requirements be replaced with a three-day transfer period; (v) certain terms in the small account and cash account exceptions, as described above, be clarified and made more specific; (vi) the Proposal provides an exception from margin requirements for sovereign wealth funds, recognizes foreign equivalent entities to "exempt accounts" as exempt, and clarifies the treatment of collective investment trusts; (vii) Members be allowed to negotiate thresholds and minimum transfer amounts with creditworthy corporate counterparties; (viii) the Commission consider international regulatory harmonization efforts; and (ix) the compliance date be set at 18-24 months following the amended rule's effective date.

The AMG thanks the Commission for the opportunity to comment on the Proposal to Amend FINRA Rule 4210. Should you have any question, please do not hesitate to contact Tim Cameron at 202-962-7447 or tcameron@sifma.org; Laura Martin at 212-313-1176 or lmartin@sifma.org; or Daniel Budofsky of Morgan, Lewis & Bockius LLP at 212-309-6160 or budofsky@morganlewis.com.

Respectfully submitted,

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[APPENDIX TO FOLLOW]

| asset management group

March 28, 2014

Securities Industry and Financial Markets Association
Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Proposed Amendments to FINRA Rule 4210 for TBA Transactions

Dear Ms. Asquith:

The Asset Management Group ("**AMG**")[24] of the Securities Industry and Financial Markets Association ("**SIFMA**") is pleased to submit this letter to the Financial Industry Regulatory Authority ("**FINRA**") in response to FINRA's request for comment on its proposed amendments to FINRA Rule 4210 which would establish margin requirements for transactions in "Covered Agency Securities," which include transactions in the "To-Be-Announced" ("**TBA**") market[25] (the "**Proposed Amendments**").

AMG generally supports the aim of the Proposed Amendments to mitigate the counterparty credit risk borne by participants in the TBA market and reduce the potential for systemic risk. However, we have the following comments on the Proposed Amendments, each as discussed further below: (i) the maintenance margin requirement should be eliminated; (ii) "liquidating action" should not be mandated by the Proposed Amendments; (iii) "commonly controlled accounts" should not include accounts by virtue of being managed by the same asset manager; (iv) the parties to Covered Agency Securities should be free to negotiate the settlement period for posting margin up to a three-day period after a margin call; (v) certain technical changes should be made to the Proposed Amendments; and (vi) the compliance date for the Proposed Amendments should be 18 months following effectiveness.

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[24] AMG's members represent U.S. asset management firms whose combined assets under management exceed $20 trillion. The clients of AMG member firms include, among others, registered investment companies, ERISA plans and state and local government pension funds, many of whom invest in commodity futures, options, and swaps as part of their respective investment strategies.

[25]The TBA market includes transactions in adjustable rate mortgages ("**ARMs**"), Specified Pool Transactions and Collateralized Mortgage Obligations ("**CMOs**") with forward settlement dates.

I. The Maintenance Margin Requirement Should Be Eliminated

AMG feels strongly that the requirement for maintenance margin should be eliminated from the Proposed Amendments.[26] The issue is not a new one. In developing its Best Practices for Treasury, Agency Debt and Agency Mortgage-Backed Securities Markets (the "**TMPG Best Practices**"),[27] the Treasury Market Practices Group (the "**TMPG**") carefully considered – then rejected – the idea of imposing initial (or "maintenance") margin in the TBA Market. The TMPG Best Practices currently contains no such requirement. AMG generally supports the TMPG Best Practices and believes that FINRA rules should generally be consistent with them. For FINRA to require Members to collect maintenance margin from non-exempt customers would force those customers to transact with non-Member banks and severely fragment the market.[28]

AMG believes that there is no compelling reason to impose a maintenance margin requirement in the TBA market. The purpose of maintenance margin is to protect a party from potential future exposure to changes in the marked-to-market value of securities during the "liquidation period" in which the position is being closed out or replaced, following a default by its counterparty. The amount of maintenance margin reflects an estimate of this potential future exposure and depends in large part on the expected duration of the liquidation period. The greater the liquidity of an instrument, the shorter the liquidation period is likely to be. The TBA market is extremely liquid. First, the aggregate size of the market is extremely large.[29] Second, the TBA market is limited to securities sponsored by government-sponsored agencies ("**agency MBS**") which benefit from agency guarantees of payment of principal and interest on the underlying mortgages. Third, agency MBS are subject to either an explicit or implicit government credit guarantee. Fourth, transactions in the TBA market are highly homogenous. Since the identity of the mortgages in the agency MBS to be delivered at settlement is not specified on the trade date, TBAs trade solely on the basis of six general parameters of the securities to be delivered (issuer, maturity, coupon, price, par amount, and settlement date). Finally, TBAs trade on a "cheapest to deliver" basis, making settlement easier and increasing

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[26] The Proposed Amendments provide that for bilateral transactions with non-exempt accounts, FINRA members ("**Members**") must collect, in addition to variation margin, maintenance margin equal to two percent (2%) of the market value of the securities subject to the transaction. If sufficient margin is not collected, the Member will be required to deduct the uncollected amount from the Member's net capital at the close of business following the business day on which the deficiency was created. Additionally, if the deficiency in margin is not satisfied within five business days, the Member must take liquidating action, unless FINRA grants the Member an extension.

[27] Treasury Markets Practice Group, Best Practices for Treasury, Agency Debt, and Agency Mortgage-Backed Securities Markets, Revised May 2013 (*available at* www.newyorkfed.org/tmpg).

[28] As discussed further in Section II herein, the Proposed Amendments require a net capital deduction and the obligation to take liquidating action for both exempt and non-exempt accounts.

[29] "The TBA market is the most liquid, and consequently the most important secondary market for mortgage loans. . . . [A]n average of $246 billion of agency MBS was traded each day in March 2013 . . . ." SIFMA, TBA Market Fact Sheet: The TBA Market, 2013 (av*ailable at* http://www.sifma.org/).

liquidity. With such vast liquidity, TBA market participants should be able to liquidate and replace defaulted positions easily and quickly, with minimal risk of exposure to changes in the marked-to-market value of the securities that are the subject of the transaction. As a result, there is no need for maintenance margin in the TBA market.

The proposed maintenance margin requirements will adversely affect the market. Because the requirements are only applicable to non-exempt accounts, the costs would be borne by smaller market participants. In addition, asset managers may only be able to deliver information relating to assets under their management, not the full financials for a separately managed account client. In such a scenario, clients who would otherwise be exempt accounts might nonetheless be required to post maintenance margin because asset managers will be unable to provide dealers with sufficient financial information to take them out of the scope of the proposed requirements. As a result, such smaller clients and separately managed account clients are likely to be driven out of this investment space or pushed to transact with non-Member banks, causing consolidation and reduced liquidity. Such reduced liquidity will increase hedging costs for mortgage originators and the cost of mortgages for homeowners.[30]

Maintenance margin will also introduce new credit exposures and market risks. By posting maintenance margin to protect a Member against its counterparty's default, the counterparty risks losing this amount if the Member defaults. The maintenance margin requirement also decreases liquidity by freezing large amounts of high quality collateral, which could increase systemic risk. In addition, counterparties may have to borrow to meet maintenance margin requirements, which would shift risk into the funding markets.

Finally, the one-size-fits-all requirement of two percent mandatory maintenance margin on all non-exempt accounts is too blunt an instrument; instead the parties closest to the transaction are best positioned to determine the need for, and amount of, maintenance margin in each transaction. The Proposed Amendments already require Members to assign a risk limit determination to "any counterparty" with which it will engage in relevant transactions. AMG believes that this risk assessment could be more properly used as a tool to determine the counterparties from whom a Member would require maintenance margin.

II. "Liquidating Action" Should Not Be Mandated by the Proposed Amendments

The Proposed Amendments provide that if a counterparty does not pay required maintenance margin or a marked-to-market loss, a Member must deduct from its net capital any uncollected margin at the close of business following the business day that the margin collection deficiency was created. Any margin deficiencies not satisfied within five business days from when the deficiency was created require the Member to promptly take "liquidating action," unless granted an extension of time by FINRA.[31] We believe that this requirement is too heavy-

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[30] See Vickery & Wright, TBA Trading and Liquidity in the Agency MBS Market, Federal Reserve Bank of New York Staff Report no. 468 (Aug 2010) (concluding that the TBA trading convention "significantly improves agency MBS liquidity, leading to lower borrowing costs for households.").

[31] FINRA Rule 4210(e)(2)(H)(ii)(e).

handed an approach, and we suggest that FINRA align its position with that of TMPG which considered and rejected mandating liquidating action after a failure to post margin. Accordingly, no such requirement appears in the TMPG Best Practices.

Whether to liquidate trading positions in the face of a counterparty failure to post margin is a business decision and should not be mandated by rulemaking. In standard collateral documentation, following a default and any applicable cure period, the non-defaulting party typically has the right – but not the obligation – to liquidate, close out and set off. Depending on the nature of the relationship with the counterparty, the reason for the default, the likelihood of curing the default, the market for the collateral, and the size of the positions, there may be reasons for the non-defaulting party to refrain from or delay liquidating positions. For example, the template Master Securities Forward Transaction Agreement ("**MSFTA**") published by SIFMA defines "Event of Default" to include any failure by a party to meet its margin obligations, but permits the parties to negotiate whether to include a cure period and how long that period should be. Following an Event of Default, the "non-defaulting party may, at its option, declare an Event of Default to have occurred" and only then, liquidate and close out all transactions under the MSFTA. Such contractual discretion is designed to allow the parties to tailor their arrangements to the particular circumstances and provide them with flexibility on when (or whether) to exercise any available contractual remedies.

In contrast, the Proposed Amendments would impose inflexible and overly aggressive, one-size-fits-all time frames. In the case of a legitimate dispute (for example, a dispute over calculation of exposure), the five-business day period is unlikely to allow sufficient time for resolution before the close-out period has run.[32] Nor do the required time frames for posting of margin account for cross-border transactions involving different time zones. Finally, mandating liquidating actions may drive market participants to transact with counterparties that are not subject to such restrictions, such as banks, thereby fragmenting the market and diminishing the competitiveness of FINRA Members in the marketplace. In sum, the parties should be free to negotiate their own provisions relating to the posting of margin, liquidation, and the related time frames.

III. "Commonly Controlled Accounts" Should Not Include Accounts by Virtue of Being Managed by the Same Asset Manager

Under Section (e)(2)(I)(ii)(a) of the Proposed Amendments, Members would be required to provide written notification to FINRA and would be prohibited from entering into any new transactions with exempt accounts that would result in increased credit exposure if net capital deductions resulting from deficiencies in collecting margin or marked-to-market losses over a five-business day period exceed five percent of the Member's tentative net capital for a single account or group of ***commonly controlled accounts***, or 25 percent of the Member's tentative net capital for all such accounts combined.

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[32] We request that, at a minimum, FINRA clarify this provision by providing that in the event of a legitimate dispute, the five-business day period does not apply.

The term, "commonly controlled accounts," is used in Section (e)(2)(I)(ii)(a) but undefined in Rule 4210. FINRA Rule 0160(a) provides that terms not defined in FINRA rules are to be defined as set forth in the FINRA By-Laws, if a definition is provided therein. Article 1(h) of the FINRA By-Laws defines the word "controlling" to mean "the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting stock, by contract or otherwise."[33]

It is our understanding that this definition excludes accounts that are related by virtue of being managed by the same asset manager, and we request that the Proposed Amendments clarify that this is the case. Accounts do not share the same credit profile simply because they share an asset manager and aggregating the exposure for such accounts is not indicative of greater credit risk with respect to any individual account. Further, because there is no recourse among the various accounts of a single investment manager, grouping such accounts together for the purposes of determining credit exposure will not mitigate risk.

IV. The Parties to Covered Agency Security Transactions Should Be Free to Negotiate the Settlement Period for Posting Margin Up to a Three-day Period After the Margin Call

The time allowed under the Proposed Amendments for parties to post margin is insufficient given differences in international time zones and holidays and the potential for operational delays. Under the Proposed Amendments, when a counterparty does not pay the required maintenance margin or the Member's marked-to-market loss, the Member must deduct from its net capital any uncollected margin at the end of the day following the business day of the creation of the deficiency. This timeline effectively requires margin to be posted the day after a margin call. Instead, counterparties should be free to negotiate their own settlement timelines, subject to a three-day maximum period, to accommodate the specific circumstances of individual transactions.

A margin settlement period of only a single day after the margin call fails to account for the different circumstances presented by differently situated market participants. Members may be transacting with counterparties located in different time zones, which would create inconsistencies in time frames for posting margin. Non-domestic counterparties may also have different holiday schedules, leading to complications in determining the business day on which margin must be posted and requiring the extension of the margin settlement period. Additionally, clients whose assets are held by custodians create notable operational delays. The significant lag time in dealing with customers who must operate through custodians (for example, in offshore transactions or transactions in non-domestic currencies) makes such a short margin settlement period infeasible. Moreover, when transacting with counterparties using non-domestic currencies, the counterparty must have sufficient time to exchange the foreign currency for use as collateral in domestic currency. This currency conversion will be done on spot foreign exchange markets and will generally introduce an additional two-day settlement cycle. At best, such a counterparty may execute the foreign exchange transaction – at an increased cost – on a

[33] It also contains a rebuttable presumption that ownership of 20% or more of the voting stock of an entity constitutes control, along with certain exceptions.

one-day settlement cycle, but this will still introduce an additional day into the margin settlement period. Moving to a settlement period of one day after the margin call would change longstanding practices for certain asset managers across portions of their client base, requiring costly and burdensome systems and operational changes for those asset managers. Thus, we propose that margin settlement be extended to three days following the call for margin with an allowance for parties to negotiate shorter margin settlement periods for individual transactions.

V. Certain Technical Changes Should Be Made to the Proposed Amendments

A. Scope. As previously indicated, we generally support the TMPG Best Practices. Nevertheless, there are some scoping issues that we think should be addressed. For example, we agree with the Proposed Amendment's exclusion of "central banks" from the margin requirements under Rule 4210. Section (e)(2)(H)(ii)(a) of the Proposed Amendments makes clear that transactions in Covered Agency Securities with a counterparty that is a "central bank" would not be subject to margin requirements under Rule 4210. Footnote 23 of Regulatory Notice 14-02 states that that "FINRA would interpret 'central bank' to include, in addition to government central banks and central banking authorities, sovereigns, multilateral development banks and the Bank for International Settlements."[34] AMG requests that FINRA codify this interpretation directly into Rule 4210. In addition, we believe that sovereigns typically make investments through specialized investment vehicles which they guarantee. Such sovereign wealth funds present credit profiles that are substantially similar to those of the sovereign itself. Accordingly, AMG requests that sovereign wealth funds be explicitly excluded from the purview of Rule 4210.

Finally, despite our general agreement with the TMPG Best Practices, we have previously expressed our objection to including securities with T+2 or T+3 settlement cycles within the scope of their recommendations. Some of our members maintain this objection as they believe it would unnecessarily impede liquidity and do little to reduce credit exposure or mitigate systemic risk, and they believe the margin requirements should match the standard settlement cycles of the spot market for those securities (i.e., from greater than T+1 to greater than T+3). We continue to engage in discussions with the TMPG on this subject. Recognizing the need to have consistency in the regulation of the TBA market and to avoid market fragmentation, we recommend that if, and to the extent that, either the TMPG or FINRA modifies the scope of inclusion of these instruments, then the organizations work together to harmonize their provisions.

B. Bilateral Variation Margin Should Be Permissible. AMG believes that the Proposed Amendments should clarify that the counterparties may agree to adopt bilateral variation margin. Under the current version of the Proposed Amendments, a Member must collect any mark-to-market loss in excess of the *de minimis* transfer amount within one business day, or deduct the deficiency from the Member's net capital until such deficiency is satisfied. Although Regulatory

[34] Regulatory Notice 14-02, p. 11 n. 23.

Notice 14-02[35] implies that this variation margin may be bilateral,[36] the text of the Proposed Amendment indicates that, unless the transaction is between two Members, variation margin is applied only one way. Bilateral variation margining should be supported as a means to mitigate the credit risk that non-Member market participants will have with respect to their Member counterparties and may help with the reduction of systemic risk. This is consistent with the approach in the TMPG Best Practices, which states that in order to help *both* parties mitigate counterparty risk, "two-way variation margin should be exchanged on a regular basis."[37]

C. Omnibus Accounts. Supplementary Material .04 to the Proposed Amendments says that the determination of whether an account qualifies as an exempt account shall be made based on the beneficial owner of the account, and subaccounts managed by an investment adviser, where the beneficial owner is other than the investment adviser, shall be margined individually. To the extent that maintenance margin is required under the final version of the Rule, AMG would like to confirm that this principle applies only where the investment adviser manages multiple subaccounts. Conversely, where an investment adviser manages a single omnibus account and has agreed that the account may be treated as the account of a single principal, the determination of exempt account status should be made based on the status of the entire account and that no information about the underlying beneficial owners needs to be obtained by the Member.

VI. The Compliance Date for the Proposed Amendments Should Be 18 Months Following Effectiveness

The Proposed Amendments should have a compliance date that is at least 18 months following the date of their effectiveness. This time period would allow Members and non-Members to change necessary systems and documentation, as well as educate clients, so as to be able to comply with Rule 4210. The market's experience with the TMPG Best Practices is instructive. Due to the very broad participation in the market for Covered Agency Securities, despite diligent efforts, banks were unable to negotiate and execute MSFTA agreements with significant numbers of their clients within the period established by the TMPG. An equally long period of time should be expected to implement the Proposed Amendments.

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[35] FINRA Regulatory Notice 14-02, Margin Requirements: FINRA Requests Comment on Proposed Amendments to FINRA Rule 4210 for Transactions in the TBA Market, Jan. 2014.

[36] *See id.* at 4 ("However, such transactions must be marked to the market daily and the Member must collect any loss resulting from such marking to market (*i.e.*, Members must collect variation margin, which is consistent with the approach taken by the TMPG best practices and ***includes the posting of margin between all counterparties***, including broker-dealers)) (emphasis added).

[37] TMPG Best Practices, p. 3.

The AMG appreciates the opportunity to comment on the Proposed Amendments. Should you have any questions regarding our comments, please do not hesitate to call Tim Cameron at 212-313-1389, Matt Nevins at 212-313-1176 or Dan Budofsky of Bingham McCutchen LLP at 212-705-7546.

Sincerely,

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