May 2, 2016

By Electronic Mail (rule-comments@sec.gov)

Robert W. Errett
Deputy Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Notice of Filing of Amendment No. 2 and Designation of a Longer Period for Commission Action on Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change To Amend FINRA Rule 4210 (Margin Requirements) To Establish Margin Requirements for the TBA Market, as Modified by Amendment Nos. 1 and 2

Dear Mr. Errett:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] submits this letter to the Securities and Exchange Commission ("**SEC**") in response to the request for comment on SR-FINRA-2015-036, a proposal by FINRA to amend FINRA Rule 4210 to establish margin requirements for transactions in the "to-be-announced" ("**TBA**") market (the "**Proposal**").[2] This letter is written on behalf of both SIFMA's buy- and sell-side members.

SIFMA and SIFMA's Asset Managers Group have submitted six comment letters on other versions of the Proposal.[3] In total, the SEC web site indicates that the SEC has received 54 comment letters on the filing, and FINRA indicated that it had received 29 comment letters on an earlier version of the Proposal. It is clear at this time that FINRA has read a great number of letters as to the Proposal. SIFMA acknowledges that FINRA has responded in various ways,

---

[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly one million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $20 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit http://www.sifma.org.

[2] Notice of Filing of Amendment No. 2 and Designation of a Longer Period for Commission Action on Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change To Amend FINRA Rule 4210 (Margin Requirements) To Establish Margin Requirements for the TBA Market, as Modified by Amendment Nos. 1 and 2, Exchange Act Release No. 77579, 81 Fed. Reg. 22347 (Apr. 15, 2016). *See also* Order Instituting Proceedings to Determine Whether to Approve or Disapprove Proposed Rule Change to Amend FINRA Rule 4210 (Margin Requirements) to Establish Margin Requirements for the TBA Market, as Modified by Partial Amendment No. 1, Exchange Act Release No. 76908 (Jan. 14, 2016), 81 Fed. Reg. 3532 (Jan. 21, 2016); and Notice of Filing of a Proposed Rule Change To Amend FINRA Rule 4210 (Mar. 14, 2015), 80 Fed. Reg. 63603 (Oct. 20, 2015).

[3] Letter from SIFMA to SEC dated Feb. 11, 2016; Letter from SIFMA AMG to SEC dated Feb. 11, 2016; Letter from SIFMA to SEC dated Nov. 10, 2016; Letter from SIFMA AMG to SEC dated Nov. 10, 2016; Letter from SIFMA to FINRA dated Mar. 28, 2014; Letter from SIFMA AMG to SEC dated Mar. 28, 2014.

including providing some limited guidance in its previous response to commenters. Yet, the Proposal remains largely unchanged, notwithstanding the very specific and, we believe, very reasonable, suggestions that have been made.

We write again today not to restate the suggestions made in previous letters, though SIFMA continues to stand by the reasoning of those letters and the arguments made therein. Instead, we are writing to express our disappointment and concern with the fact that FINRA generally has not made meaningful adjustments to the rule proposal in response to reasonable comments from broker-dealer and investor market participants that would preserve the fundamental purposes of the rule while being less costly and less likely to cause participants to exit the market. FINRA's justification for rejecting SIFMA's suggestions seems to be that firms could implement the necessary technology, rather than an argument that the Proposal is an economically efficient and non-disruptive means to achieve the desired end. FINRA is obligated by its own written policies to consider the costs of its rulemaking; we do not believe FINRA's analysis has appropriately captured these costs.[4] Further, under the Exchange Act, the SEC is required to determine whether any rules imposed by FINRA are "necessary or appropriate."

I. General Approach

SIFMA supports FINRA's goal of addressing the counterparty credit risk and systemic risk posed to broker-dealers by TBA Transactions.[5] What SIFMA disagrees with is the requirements FINRA has proposed to impose in order to achieve this goal. The Proposal would require TBA Transactions to be margined in a manner that is dissimilar from, and more difficult to implement than, the margining of other comparable financial transactions. We note that the Proposal fundamentally differs from (i) margining of TBA Transactions under the Treasury Market Practices Group's recommendations; (ii) margining of other fixed income transactions under existing FINRA Rule 4210; and (iii) margining of other OTC transactions under forthcoming swaps margin requirements. This is most notable as to the timing of the margin requirements and, as a practical matter, most burdensome as to the discrepancies between the Proposal and the existing FINRA requirements as to debt securities.

In particular, FINRA seeks to replace the current standard for fixed income transactions of (a) a capital charge within five business days of an unsatisfied margin call[6] with (x) a requirement that firms collect margin or take capital charges within one business day following the arising of the deficiency and (b) a margin collection requirement of "as promptly as possible" (with a cap of 15 business days) with (y) a requirement to liquidate deficient accounts within five business days.[7]

---

4 FINRA, Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking (the "**Cost-Benefit Framework**") (Sept. 2013).

5 We use the term "**TBA Transactions**" in this letter as shorthand for the types of transactions that would be subject to the requirements of the Proposal.

6 Exchange Act Rule 15c3-1(c)(2)(xii).

7 FINRA instead continues to look to the model of portfolio margining as a basis for the new requirements. SIFMA continues to find this model to be the wrong comparison. As we previously have noted, portfolio

These shortened time periods are very difficult to implement from both a technological and an operational standpoint. They require firms to build systems that can differentiate transaction types on a CUSIP-specific basis. They require customers to margin a mortgage security and TBA traded on the same day on different time schedules. These shortened time periods could perhaps be justified if TBA Transactions were riskier or more volatile than trades in other debt securities. They are not.[8]

Rather than setting margin requirements on TBAs in a manner that is compatible with existing systems and operational procedures, FINRA instead is choosing to subject TBA Transactions to a wholly unique set of requirements. SIFMA understands that new and different requirements are necessary from time to time in order to impose regulatory goals. We do not believe this material divergence from current market practice is warranted in this situation.[9] An effective, very detailed and robust margining regime is already in place–both through FINRA's rules for other fixed-income products and TMPG's margining regime for TBA Transactions.

In its previous comment letter to FINRA on the Proposal, SIFMA pointed out that, in light of the new requirements, FINRA effectively has created a new account type that is to be used only for TBA Transactions. FINRA responded to SIFMA's comments by stating that the rule does not explicitly *mandate* a new account type while denying the practical reality that it will operationally require firms to treat TBAs distinctly from other fixed-income products.[10] While FINRA did not require a new "TBA account," it created particular requirements for TBA Transactions that forces firms to distinguish those transactions in novel ways from all other fixed income transactions. It is these novel requirements that define the new account type, not whether the account is given a unique name.

---

margin is part of a particular regulatory scheme that applies to products that present much greater risk than TBA Transactions, is available <u>only</u> to customers who meet certain financial and other requirements, and was created with the intent of *liberalizing* margin requirements for customers who could accommodate that level of risk. FINRA essentially is taking the rules that apply to a particular subset of institutional customers who are willing to take additional risk and seeking to apply them to (nearly) all customers regardless of the size of their accounts or the risk presented by their transactions.

In addition, we note that many smaller firms may not offer portfolio margining and, thus, these requirements would be wholly new for them.

[8] For example, over the period from January 2008 to February 2014, 30-year agency TBA transactions had a maximum 25-day price fluctuation of approximately 4.3%. In other words, the largest price movement over a 25-business-day period was approximately 4.3% for an index of all agency TBAs (with a 30-year maturity).

[9] *Cf*. Exchange Act § 15A(b)(9) (requiring the SEC to determine whether rules "impose [any] burden on competition not necessary or appropriate in furtherance of the purposes of [the Exchange Act]"). *See also* Steps to Increase Competition and Better Inform Consumers and Workers to Support Continued Growth of the American Economy, Executive Order 13725 (Apr. 15, 2016), 81 Fed. Reg. 23417 (Apr. 20, 2016) ("[A]gencies with authorities that could be used to enhance competition . . . shall, where consistent with other laws, use those authorities to promote competition, arm consumers, and eliminate regulations that restrict competition without corresponding benefits to the American public.").

[10] 81 Fed Reg. at 22355.

FINRA continued that it is "well within the operational and technological ability of firms to appropriately handle margining of TBA market transactions."[11] SIFMA is not arguing that it is not possible for many firms to address the Proposal.[12] What SIFMA is arguing is that the Proposal is not reasonably tailored to achieve the goal of reduced counterparty risk without imposing undue burden on broker-dealers and their investor clients and undue disruption to MBS markets. The Proposal would impose new requirements on TBA Transactions that are different from those which apply to every other fixed income transaction.[13] Imposing these new requirements for TBA Transactions would create unnecessary costs, likely including the significant reduction of activity in or complete exit of firms from the business of trading TBAs, which would be detrimental not only to those firms but also to mortgage borrowers who rely on the effective functioning of the TBA market to provide affordable and predictable mortgage rates.[14] We do not believe that TBA Transactions present a greater risk profile than other fixed income transactions or that TBA Transactions are peculiar in ways that would merit a different approach, nor does it appear that FINRA is making this argument. Indeed, SIFMA observes the TBA market remained liquid throughout the financial crisis while many other markets were significantly impaired or stopped trading entirely. Yet TBA transactions are treated in a more burdensome manner than these other less liquid products.

FINRA also stated in its response that "regulation, like industry, continually evolves with new and ongoing initiatives" and that it would not be feasible for FINRA to wait for other rulemaking initiatives to be completed.[15] This response does not address the concern we raised. It is true that SIFMA has requested certain amendments to existing rules and that FINRA has declined to make such amendments. However, SIFMA has not asked FINRA to forego imposing new requirements; rather, as noted above, SIFMA has been consistently supportive of FINRA's aim of reducing counterparty credit risk. What SIFMA urged, given that firms are already are required to build massive new systems in response to competing–and similar–regulatory requirements for derivatives and other products, is that FINRA recognize how those competing demands are important considerations vis-à-vis the costs and timing of implementing the Proposal. FINRA's initiative adds a further cost burden in excess of what is required to achieve FINRA's goals. The amount of that cost is what SIFMA is questioning. There are reasonable alternatives that would not jeopardize the fundamental aim of risk reduction sought by the Proposal.

---

[11] *Id*.

[12] We do note that it is possible that some firms may not be able to reasonably address the burdens of the Proposal in a cost-efficient manner and instead will choose to exit the market.

[13] Among other things, we note in particular the new time period for collecting margin and liquidating transactions.

[14] The Proposal also may have a disproportionate impact in this regard on small and mid-sized broker-dealers whose systems are built to address ordinary fixed income transactions and may be unable to amortize the costs of implementing a new account type. While FINRA notes that the exemption for small cash accounts may reduce this burden, it covers only a small portion of the market and would limit the flow of business to such smaller firms.

[15] 81 Fed Reg. at 22355.

II. Economic Impact

It is clear from FINRA's latest response that there continues to be a basic disagreement between FINRA and the industry as to the cost and difficulties of the Proposal.[16] FINRA states in its proposal that firms with existing technology for collateral management in repo, swap and OTC derivatives transactions "would only have to build into their current systems the exceptions provided for under the proposed rule."[17] We believe that FINRA is underestimating the complexity of how these systems work, and also misses the fact that not all firms that trade TBAs engage in repo, swap, and OTC derivatives transactions. As previously noted, FINRA's Proposal requires more than "exceptions" to existing systems, and adapting current operations to suit the new Proposal would involve a significant amount of time and cost for firms.

FINRA notes that it understands that estimates vary depending on the size and business model of a firm and follows that by providing an analysis of the costs that relies entirely on anecdotal numbers provided from "sources at one firm," "one service provider," and "one firm."[18] The estimates provided by these firms are clearly below the very low end based on conversations we have had with our members, and based on some of our members' experiences with the implementation of the TMPG's margin recommendation (which, we note, is less complex than FINRA's proposal under Rule 4210). FINRA later acknowledges that actual implementation costs may be higher for some firms, but seems to suggest that those firms either should decrease their activity in TBA Transactions (which would seem undesirable from a policy standpoint and does not actually reduce the cost of building systems) or "may" choose to build more rigorous systems to avoid non-compliance.[19] As alluded to in our previous letters, we also have received indications from a number of smaller member firms that if FINRA were to finalize 4210 as proposed, their first order of business would be to decide whether they could remain in the TBA and agency MBS markets, with a strong inclination to leave the business as the costs of implementation and compliance would be uneconomical. This would result in a loss of investor choice and reduced liquidity in the mortgage market. For the reasons we discussed above and in previous letters, this is a bad result from an economic and public policy perspective. FINRA could implement the Proposal in a less costly manner and firms would not be forced to consider whether the compliance burden make the financing of housing-related securities uneconomical.

---

[16] FINRA states that it believes that commenters' estimates "fall toward the higher end of the cost range" for implementing the Proposal. *Id*. at 22354. This is a comment FINRA also made when responding to the initial comments on the Proposal. *See* 80 Fed. Reg. 63603, 63613 (Oct. 20, 2015).

[17] In addition, we note that some smaller firms may not have any of these systems in place and, thus, may need to start from scratch in building systems to margin TBA Transactions.

[18] In particular, we note that the reliance on a single service provider for a cost estimate is misleading. Such a service provider has a clear business incentive for FINRA to adopt the Proposal. Furthermore, the particular service provider's estimates are quite misleading, as they suggest that, for only $1,000 (where firms "could spend higher amounts . . . for more robust levels of service") and a one-week installation, firms would be completely set up. 81 Fed Reg. at 22354. To state the obvious, if this were a $1,000 and one-week expenditure, SIFMA would not expend this level of time and energy in seeking improvements to the Proposal.

[19] *Id* at 22355.

In its Cost-Benefit Framework, FINRA undertakes a number of specific obligations, most significantly the obligation to ask "what are the reasonable alternatives?"[20] At a minimum, even if the basic requirements of the Proposal are maintained, a clearly reasonable alternative would be for FINRA to conform the Proposal's margin transfer and liquidation timing requirements to the timing requirements that generally apply to margin transactions in fixed income instruments under current Rule 4210. This would be both a reasonable and far less costly alternative to the Proposal as it is currently drafted.

* * *

SIFMA appreciates the opportunity to comment on the Proposal. Should you have any questions regarding our comments, please do not hesitate to contact the undersigned at the numbers below.

* * *

Sincerely,

Christopher B. Killian
Managing Director, Securitization
(212) 313-1126

---

20 Cost-Benefit Framework at 6.