February 11, 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: 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; Release No. 34-76908; File No. SR-FINRA-2015-36

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 (as amended by partial amendment no. 1) to amend FINRA Rule 4210 to establish margin requirements for transactions in the "to-be-announced" ("**TBA**") market (the "**Proposal**").[2]

This letter provides further detail as to a number of objections raised by SIFMA to FINRA in response to the original version of the Proposal. While certain of our comments were addressed in FINRA's response to commenters on the original proposal, many of SIFMA's comments, including the most serious concerns as to operational and practicability issues, remain unresolved. If these issues are not addressed, it is likely that there will be a material reduction of

---

[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 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 (GFMA). For more information, visit http://www.sifma.org.

[2] 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). *See also* Notice of Filing of a Proposed Rule Change To Amend FINRA Rule 4210 (Mar. 14, 2015), 80 Fed. Reg. 63603 (Oct. 20, 2015).

participants, both buy- and sell-side, in the TBA market.[3] It is not apparent that the withdrawal of participants from the market will result in any material improvement in financial safety, either as to individual firms or on a systemic basis. This loss to the TBA market would indirectly be reflected in the cost of mortgages to individuals as support is withdrawn from a crucial leg of the financing chain.

We would like to make one further general point before addressing more detailed concerns. Some SIFMA members have already observed customers shifting TBA business to regional banks that are not subject to FINRA requirements or the Treasury Market Practices Group ("**TMPG**") margining recommendations.[4] A non-FINRA member is not subject to Rule 4210 and would thus have a significant competitive advantage over a FINRA-regulated broker-dealer if the Proposal were to be adopted. These customer shifts may be particularly damaging to broker-dealers who are neither associated with banks nor non-U.S. affiliates that can engage in TBA transactions; *i.e.*, these broker-dealers do not have any alternative booking arrangements through which they could compete with entities that can book transactions to a non-broker-dealer. This flight from broker-dealers could reasonably be expected to continue and potentially be exacerbated if the concerns raised as to the burdens of the Proposal on broker-dealers and their customers are not addressed, and smaller broker-dealers could be particularly impacted by this flight. To the extent that this shift happened on a broad scale, broker-dealers could find themselves generally unable to compete in the TBA market.

We do not believe that it is FINRA or the SEC's intent in this rulemaking to push business away from broker-dealers. Accordingly, we believe that care should be taken with respect to the burden placed upon broker-dealers and their customers so as to not further exacerbate this situation.

I. Introduction

FINRA's goal in issuing the Proposal, that of managing the counterparty credit risks of broker-dealers, is one that SIFMA supports. At the same time, a trade-off must be acknowledged between the benefits that may be provided by any particular set of requirements relating to credit protection and the expense of those requirements. These expenses may be divided into two broad types: (i) expenses to the market generally (as reflected by a reduction of the number of investors willing to invest in a particular asset class); and (ii) expenses to broker-dealers that are subject to the additional requirements. These two types of expenses are not independent. To the extent that any particular set of requirements raises costs to broker-dealers, it forces firms to pass along those costs, or at least a portion thereof, to their customers. At some point, those costs

---

[3] We make reference to TBA transactions in this letter generically; however, the intent is to address all products within the scope of the Proposal (*i.e.*, "Covered Agency Transactions").

[4] Certain of the entities that could service these customers may be banks and other entities that are complying with the margining recommendations of the Treasury Market Practices Group. However, many more "sell-side" market participants are not subject to the TMPG recommendations or the FINRA rules (*e.g.*, small- and medium-sized banks, and foreign institutions).

may not be sustainable or recoverable (including by passing them along to customers), which may force some investors and dealers to exit the market.

The SEC has asked a substantial number of questions as to the effect of the Proposal, and the costs imposed by the Proposal, on the mortgage securities market generally.[5] These are important issues for the SEC and FINRA, perhaps in company with other federal regulators, to address. While SIFMA cannot easily address the effect of the Proposal on the mortgage market as a whole, we can speak to the cost of these requirements as to individual firms.[6] These costs are substantial, for the straightforward reasons we discuss below, particularly in Section II.

In this letter, SIFMA also proposes a number of ways in which the Proposal might be amended to bring its requirements in line with existing credit and regulatory requirements. Conforming the Proposal to comparable requirements under existing law would materially reduce the costs of the Proposal without substantially reducing the benefits FINRA seeks to obtain.

II. The "TBA Account" to be Established by the Proposal

There are currently, as a practical and operational matter, five types of accounts that broker-dealers hold for customers: (i) the custodial cash account, (ii) the delivery-versus-payment ("**DVP**") cash account, (iii) the Regulation T margin account, (iv) the good faith account, and (v) the FINRA Rule 4210 portfolio margin account. Each of these accounts is distinguished by certain types of rules: *e.g.*, the types of transactions that may be recorded in the account, whether credit can be extended in the account, the amount of credit that may be extended, the period of time that customers have to make deliveries of cash or securities, and the time period that customers are allowed before they are subject to a mandatory close-out. In addition to those major requirements, each of the accounts is subject to numerous "lesser" requirements and procedures: *e.g.*, mandatory freeze procedures, disclosure requirements, suitability and credit procedures, and so on.

The Proposal would effectively mandate that broker-dealers servicing customers in the TBA market build a sixth account type that is unique to TBAs. This account might be called a Regulation T margin account, good faith account or a FINRA portfolio margin account – but it is none of these.[7] The requirements that FINRA would impose on this new account – which we will refer to as the "**TBA Account**" – are distinct in important ways from the requirements that are imposed on other types of accounts. For example: (i) the types of permitted transactions are different, (ii) the periods which customers have to pay are different, (iii) the period before a customer is required to be liquidated is different, (iv) the manner in which customers are divided

---

[5] Proposal at 3544-45.

[6] To that end, SIFMA is ready and willing to work with the SEC and FINRA (and any other relevant regulatory authorities) to supply you with such market or economic information within the access of our members.

[7] FINRA indicated that the new rules would apply "regardless of the type of account to which [the transactions] are booked." Proposal at 3534.

into categories is different, and so on.[8] In fact, the requirements applicable to the TBA Account are more akin to the requirements that will apply to security-based swaps and other types of derivatives than they are to current securities account requirements. This is likely to be very costly and would substantially complicate the building of such systems for firms that do not have experience in building or maintaining such systems (in addition to the costs for firms revising existing systems) and revising the systems to accommodate TBA Account requirements for those firms that have systems in place.

Building and maintaining systems that comply with any of the five existing sets of customer account requirements is enormously complicated, expensive and time consuming. Building a sixth type of margin account system would not be any easier. In fact, adding more account systems may increase complexity exponentially rather than in an additive or even multiplicative fashion. This is because account systems do not operate as wholly separate silos. Any individual customer may have different types of accounts, and may even trade the same security in different types of accounts. In some cases, it will be necessary to move a position from one type of account to another: *e.g.*, from the TBA Account to the Regulation T margin or the FINRA portfolio margin account once the TBA has been settled; or from the margin account to the cash account if the customer elects to pay off debt (or from the cash account to the margin account if the customer elects to borrow).

What makes this new TBA Account type even more difficult to construct is that many of the market participants who might be required to use the account do not currently use either the Regulation T margin account or the FINRA portfolio margin account. Rather, many of these market participants are currently institutional DVP cash account customers, many of whom may be subject to either legal prohibitions or other restrictions on establishing margin accounts or other accounts that require them to hold collateral with a custodian rather than a broker-dealer. Further, as explained below, the Proposal is inconsistent with the operation of a DVP account. This raises the likelihood that these customers who stay in the TBA market after the adoption of the new requirements will do so by moving their activities away from broker-dealers.

Further, the costs associated with establishing a new type of margin account should not be viewed in isolation. Many of the firms that would be subject to the operational requirements under the Proposal will also be required to build new accounts in a similar time period to comply with, among other things, (i) three different margin requirements for uncleared swaps in the United States and many more overseas and (ii) SEC requirements for cleared swaps. These requirements will burden substantially similar resources at firms. At some point, the operational complexity of these requirements simply becomes overwhelming. Even if it were, in some abstract sense, worthwhile for firms to build an additional account type to effect TBA transactions, is it worthwhile to do so in light of the other impending regulatory requirements?

---

[8] Margin calculations currently required by FINRA Rule 4210 are generally based on positions held in the account as of the close of business the prior day (or, in the case of day trading, transactions that occurred the prior day). The Proposal would require firms to calculate maintenance margin on a transaction-by-transaction basis and segregate TBA transactions from other securities in the account. For example, if an account has an open TBA transaction, a corporate bond and a debit balance, the amount of the debit and the dates the debits occur must be separated to ensure that margin is calculated correctly and margin deficits aged appropriately.

Firms must consider not only the expense of the new systems, but the availability of personnel, the period of time required to build and test the systems, and the operational complexity.

Finally, we note that the securities industry generally is in the process of moving to regular-way settlement in two days rather than three (the "**T+2 Project**").[9] This change raises further questions as to the Proposal. First, current schedules anticipate the T+2 Project to be finalized in the third quarter of 2017. The T+2 Project will require significant operational resources from broker-dealers at roughly the same time as similar resources would be needed to comply with the Proposal.[10] Second, since all regular-way settlement periods are soon expected to move from three days to two, how can it be cost-justified to adopt a set of rules that accelerates the margin delivery timelines as to one set of transactions when the market is changing more generally?

III. Specific Suggestions

While SIFMA recognizes the shared desire to reduce credit exposures in the financial system, we are not convinced that the Proposal will do so to a degree that is sufficient to offset (i) the overall reduction of the amount of credit that will be available with regard to housing-related projects, (ii) the departure of broker-dealers from providing services that would be subject to the very complicated scheme of regulation, or (iii) the loss of liquidity resulting from a reduction in the number of investors using these products as a result of the rules. The suggestions made below are intended to materially reduce the burden that the Proposal would create without significantly diminishing any benefits that the Proposal might provide.[11]

The first set of suggestions is to somewhat expand the exemptions provided in the Proposal so that they will not apply in situations where the benefit of their application is slight at best. The second set of suggestions is to conform the Proposal to existing regulatory requirements; *i.e.*, to conform the TBA account requirements to existing account procedures, rather than creating a wholly new account type.

---

[9] *See, e.g.*, Letter dated Sept. 16, 2015 from Mary Jo White, Chair of the SEC to Kenneth E. Bentsen, Jr., President & CEO, SIFMA and Paul Schott Stevens, President & CEO, Investment Company Institute, *available at* https://www.sec.gov/divisions/marketreg/chair-white-letter-to-sifma-ici-t2.pdf.

[10] Further, and as noted further below, margin requirements for uncleared derivatives – which place a very similar burden on financial institutions in terms of the legal, documentation, and operational processes needed to transition to the new regulations, will be implemented in these coming months as well, with compliance scheduled to be rolled out on a phased basis beginning in late 2016.

[11] The suggestions in this letter are not meant to be exhaustive but to build on and focus the points made in SIFMA's previous letters on this Proposal. *See* Letter from SIFMA to Robert W. Errett, Secretary of the SEC dated Nov. 10, 2015 ("**SIFMA TBA Letter I**"), *available at*: https://www.sec.gov/comments/sr-finra-2015-036/finra2015036-52.pdf. *See also* the letters submitted in response to FINRA Regulatory Notice 14-02, cited at note 20, *infra*.

A. Scope of Requirements

1. “Cash” Account Exception

The Proposal would provide an exemption from maintenance margin for transactions subject to a number of conditions including that the counterparty “regularly” settles its TBA transactions “on a DVP basis or for ‘cash.’”

SIFMA has previously expressed its concern as to the ambiguity of the term “regularly.” In response, FINRA stated that the term evidences FINRA’s “intent to provide scope for flexibility on members’ part as to how they implement the exceptions.”[12] Given this response, SIFMA understands the term “regularly” in its plain-English sense to mean: a substantial portion of the time. We do not understand it to mean “virtually always, with rare exceptions.” If that understanding is not correct, or if FINRA intends to impose some more objective definition of the term, we ask that FINRA provide further guidance to members.

Even with the additional FINRA guidance, we are skeptical that firms will find it worthwhile to build systems that can comply with the Proposal, particularly given that the counterparties at issue are relatively small and do not use financing, and given the risk of regulatory sanction if a firm does not interpret the term “regularly” in a consistent manner with the interpretation of a FINRA examiner. The likely result is that many firms will not make this exemption available; this would be to the detriment of both small counterparties and the mortgage markets. Accordingly, SIFMA believes that, as a practical matter, the benefits of this cash account exemption will be relevant to the market only if it is made straightforward to implement. Accordingly, SIFMA urges that FINRA make the exemption available to counterparties with respect to all TBA trades settling in the next calendar month so long as the relevant counterparty’s positions are below a specified amount: *e.g.*, $10 million.[13]

2. “Exempt Account” Definition

SIFMA reiterates its suggestion that the term “exempt account” be expanded in conjunction with any adoption of the Proposal so as to limit the number of clients that will be chased from FINRA member broker-dealers.

First, FINRA should recognize financial institutions regulated under non-U.S. law as “designated accounts” and as “exempt accounts.” Such a change would exempt these institutions from the maintenance margin requirement and in some cases could substantially ease the

---

[12] Proposal at 3540.

[13] As a practical matter, such a change would provide flexibility rather than categorically excluding such accounts from margining. That is, a broker-dealer would remain required to perform a credit analysis in respect of a counterparty and would be able to determine on a case-by-case basis whether maintenance margin is appropriate. SIFMA notes that even today, when broker-dealers are under no express requirement to collect maintenance margin on TBA transactions, some market participants do, in accordance with the firm’s credit analysis for particular counterparties.

diligence burdens on member firms. It would be consistent with the treatment of such entities under other areas of financial regulation that look to similar criteria to allow persons to engage in types of financial transactions.[14] In the absence of this change, regulated foreign institutions that elect to stay in the TBA market will likely take their business away from broker-dealers. In particular, many of these institutions have a preference to (or must) settle through custodians on a DVP basis and could be forced to maintain minimum equity in their accounts as maintenance margin, even though under DVP settlement they have no assets or equity in their accounts at the broker-dealer. If the Proposal were adopted, it would effectively push these firms away from broker-dealers to other entities.

Second, and as discussed in our previous letter, trust vehicles that are owned entirely by entities that qualify as designated accounts should likewise qualify as designated accounts.[15]

FINRA did not substantively respond to SIFMA's comments on this issue as it said that it did wish to take up the definition of "exempt account."[16] While SIFMA understands that there are a variety of definitional questions that might be be addressed at another time, we believe that it would be prudent of FINRA to make these straightforward and relatively minor definitional changes now. First, the scope of the minor changes presents very little risk that, as a policy matter, the exception would somehow be used in a way that would allow extensions of credit to unsophisticated customers or customers with weak credit. Second, the change would allow broker-dealers to partially alleviate the diligence and documentation burdens associated with implementing the Proposal's requirements.

3. <u>"Small" Account Exception</u>

The Proposal would exclude from both the maintenance <u>and</u> mark-to-market margin requirements those entities that qualify for the "cash" account exception <u>and</u> whose "gross open positions" in TBA transactions with the member are $2.5 million or less in the aggregate.[17] SIFMA appreciates FINRA establishing this exception as it believes that it should help reduce the burden on smaller counterparties that "do not give risk to the [member]." With that said, and in addition to the concerns raised above as to the details of the use of the exception, it is not clear how FINRA reached the $2.5 million figure and how much of the market may actually rely upon

---

[14] *See*, *e.g.*, Exchange Act Section 3(a)(65) (definition of "eligible contract participant"); Exchange Act Rule 13d-1(b)(ii)(J) (beneficial ownership reporting requirements).

[15] More generally, any time an investment vehicle is entirely owned by entities that themselves qualify as "designated" or "exempt" accounts, such accounts should be afforded the same treatment. *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").

[16] Proposal at 3544.

[17] Proposed Rule 4210(e)(2)(H)(ii)(c)(2).

this exclusion. If this number were raised to $10 million, it would substantially expand the benefit of the exemption without allowing for undue credit risk.[18]

We note that given the $250,000 minimum transfer amount (which is, of course, subject to firms' individual assessments as to a counterparty's creditworthiness), firms rarely would be required to collect margin from accounts of such size in any event. Thus, in the absence of increasing this number to a more operationally feasible amount, firms would be put to the burden of monitoring a regulatory requirement even though the results of such monitoring would not result in the firm being required to take any action.

B. Maintenance Margin; Capital versus Margin

Under the Proposal, "Covered Agency Transactions" would be subject to a 2% initial "maintenance" margin requirement for transactions with non-exempt accounts that otherwise do not qualify for one of the exclusions discussed above.[19] SIFMA continues to oppose the maintenance margin requirement as unnecessary to assure the soundness of FINRA members, provided that members continue to take capital charges as are required under current rules.[20] This maintenance margin requirement is inconsistent with DVP settlement to a customer's custodian. Maintenance margin requires the customer to maintain assets at the broker-dealer, while DVP settlement is designed to keep the customer assets away from the broker-dealer.

As we have previously observed, and FINRA itself has long recognized for many types of debt securities transactions,[21] the requirement to collect margin <u>or</u> the requirement to take a capital charge serve identical purposes. They both assure that a broker-dealer has sufficient capital to withstand a counterparty default: in the first case, by allowing the broker-dealer to seize the counterparty's assets and, in the second case, by assuring that the broker-dealer has sufficient internal resources to absorb any potential loss. For many firms, it would make much more sense to set aside capital as to these trades rather than to build the required systems, which would be a substantial operational burden even in ordinary times, let alone in the current circumstances when so many new requirements are being imposed.

The regulatory response to proposals to allow firms to take capital charges in place of margin has commonly been that such choice favors larger firms, who have the requisite capital to take the charges, over small firms, who do not.[22] SIFMA is skeptical that this argument is

---

[18] $10 million is a somewhat conservative number in context given the low volatility in the TBA market. In fact, based on informal analysis, it appears that there is a roughly 1% likelihood of reaching the $250,000 margin call level with a notional of around $25 million.

[19] Proposed Rule 4210(e)(2)(H)(ii)(d).

[20] *See* SIFMA letters in response to FINRA RN 14-02, *available at* http://www.finra.org/industry/notices/14-02. We do not substantially repeat the arguments regarding maintenance margin made in the letters in response to FINRA RN 14-02 but continue to believe in the reasoning expressed therein.

[21] *See, e.g.*, Rule 4210(e)(2)(F) and (G).

[22] In addition, for the reasons noted herein, SIFMA continues to disagree with FINRA's view that "only requiring capital charges would render the rule without effect." Proposal at 3541.

relevant to the Proposal because we are doubtful that small firms will have the resources to build the accounting systems that the Proposal would require. (Given FINRA's obligation to perform a cost-benefit analysis, as further discussed below, it should be incumbent upon FINRA to determine that small- or medium-sized firms would be capable of incurring the costs required by the Proposal.) We also note that FINRA currently permits firms to take capital charges in a variety of analogous circumstances, such as where credit is extended on government securities and other creditworthy fixed income instruments.[23]

The maintenance margin requirement is also inconsistent with the TMPG margining recommendation and will put FINRA members at a material competitive disadvantage. FINRA members will be required to collect maintenance margin where their competitors (such as banks and foreign institutions) are not subject to such a requirement. As previously noted, this impact could be more significantly felt by small- and medium-sized broker-dealers, whose business involves serving a greater proportion of smaller investors, than for larger firms that may be able to withstand the loss of business or could refer the business to an affiliated bank or foreign institution.[24] The inconsistency with the TMPG recommendations also could require broker-dealers that originally expended significant resources to comply with TMPG recommendations to be forced to expend even more resources to comply with this new requirement.[25]

C. Inconsistencies

While we do not wish to diminish our other objections to the Proposal, we also do not wish to understate the technological difficulties that the Proposal would create because of the fact that its requirements are inconsistent with existing FINRA Rules.

The Proposal generally would require a FINRA member to (i) take a net capital charge for any margin deficiency that is not satisfied by the close of business on the next business day after the date that the deficiency arose, and (ii) liquidate positions to satisfy a deficiency if the deficiency is not satisfied within five business days from the date that the deficiency arose.

These are among the instances where the Proposal would require firms to deviate from ordinary operational practices, generally by imposing shorter timetables. SIFMA continues to emphasize that these time frames (i) are too short, even if the requirements of the Proposal were viewed in isolation from the other business conducted by member firms, and (ii) since they would require firms to make material changes to their operations in respect of a single product type, will either not be feasible to implement or will impose such large expenses that firms may choose to exit the market rather than bear them. That is, it is not easily workable for firms to create new systems that can distinguish between credit trades that are required to be settled in two days and those that are required to be settled in three days, nor can these difficulties be justified from a policy perspective. There is no reason related to credit risk why TBA

---

[23] *See* note 21, *supra*.

[24] *See* SIFMA TBA Letter I at Section II.

[25] For example, firms that signed MSFTAs with their counterparties for TBA transactions could be forced to re-negotiate those documents to include terms for maintenance margin.

transactions should settle more quickly than would other trades. Such transactions are generally less volatile than trades in many other types of securities, including most debt and many equity securities.

1. Margin Transfer Timing

The "T+1" capital charge requirement would change the existing requirements that apply to identical (but often more risky) securities credit activities of broker-dealers. Under Exchange Act Rule 15c3-1, a capital charge is not required for uncollected margin until five business days after a call for margin is made.[26] In contrast, the Proposal would require a capital charge, in many cases, on the same day as the call for margin.[27] Current Rule 4210 generally does not impose margin collection timing requirements (although it does contain liquidation timing requirements).

It is simply impractical for FINRA to make a change that is specific to this group of trades. Member firms and their counterparties have extensive operational and legal arrangements that are set up to work with the margin and capital requirements for securities transactions as a whole. Modifying these requirements so that they operate on a product-specific basis would be a tremendous task.[28] Firms would need to set up operational capacity to analyze a counterparty account as to its TBA transactions and separately as to all other securities transactions.

Further, as addressed in the SIFMA letters responding to FINRA Regulatory Notice 14-02, a one-day turnaround raises operational issues for member firms and their counterparties, including those relating to differing time zones and holidays,[29] the need for advisers to make post-trade allocations, the need to convert currencies, and the need for managers to instruct custodian transfers. In particular, consideration should be given to easing the mark-to-market margin requirements for non-U.S. customers or allowing members to take a net capital charge instead. The deadlines proposed by FINRA are operationally impossible for customers in time

---

[26] *See* Exchange Act Rule 15c3-1(c)(2)(xii).

[27] The Proposal would require margin collection or capital charges on the business day after the business day on which the "mark to market loss arises." Many firms typically compute margin deficiencies after the close of business and issue calls for margin overnight or early the following morning. Further, many contracts (including the SIFMA-published MSFTA) allow a party to post margin on the following business day if a call for margin is made after a specified time (*e.g.*, 10:00 a.m. for the MSFTA).

[28] Many firms recently undertook to comply with TMPG margining recommendations and entered into a large number of MSFTAs. Many of these agreements may allow counterparties to post margin on a T+2 basis or provide for cure periods where margin is not transferred by T+1. The Proposal's timing change would require firms to revisit these arrangements very soon after undertaking great costs to get them in place. In certain cases, this could result in counterparties being forced out of the market where they are unable to comply with the new timing requirements.

[29] In a similar context – the recent final rules to implement margin requirements for uncleared swaps – regulators provided guidance to firms as to how to interpret, *inter alia*, how differences in time zones and foreign holidays impact a one business day collection requirement. *See, e.g.*, Final Rule to Establish Margin and Capital Requirements for Covered Swap Entities, 80 Fed. Reg. 74840 (Nov. 30, 2015) at 74684-65 ("**Swaps Margin Final Rule**").

zones (*e.g.*, those in Asia), where a margin call is only received on a business day after it is made in the United States and would need to be satisfied on the following day.

FINRA responded to these concerns by citing the portfolio margin rules and the presence of the Regulatory Extension System.[30] While it is true that these rules are used by many members, SIFMA disagrees with FINRA that this fact alone should merit a change for TBA transactions. In fact, portfolio margin is a significantly different type of business than TBA transactions since it (i) allows counterparties to take on more leverage than is otherwise allowed; (ii) is limited to counterparties who meet a specified set of requirements; and (iii) is part of a regulatory scheme that imposes a greater amount of diligence and compliance requirements on broker-dealers than exists for ordinary securities credit transactions. Further, the Regulatory Extension System is one intended to grant waivers from ordinarily applicable requirements arising from unusual circumstances. It is not the purpose of this system to provide ongoing waivers from requirements that are impractical from the get-go, and firms should not be put into the position of building a process that can only be made workable if the regulators grant waivers on a routine basis. Would the system be able to accommodate permanent waivers for certain firms and customers? Would there be any limit to the number of waivers a firm could obtain either generally or for a particular customer?

2. Position Liquidation Requirement

As with the margin transfer timing requirement, SIFMA believes that the T+5 liquidation requirement is an unnecessary change to existing practices, where firms (i) have 15 days following a margin call to take liquidating action under the FINRA rules[31] and (ii) are not subject to a liquidation requirement under the TMPG margining recommendations.

D. Minimum Transfer Amounts

The Proposal would allow firms to include a minimum transfer amount ("**MTA**") of up to $250,000 in their margining arrangements such that no margin or capital charges would be required to be collected until the required transfer exceeded the specified threshold.

SIFMA appreciates the inclusion of an MTA, as it is consistent with market practices. While $250,000 is a frequently used number, SIFMA believes that it is too low to be established as a universal ceiling and does not provide enough discretion for FINRA members to make an appropriate credit assessment. Because member firms are otherwise required by the Proposal to take various steps to assess the risk of their counterparties, SIFMA feels that member firms can and should be able to make a decision on a case-by-case basis as to how high or low the minimum transfer amount should be on a counterparty-by-counterparty basis. For instance, an MTA of $250,000 may be appropriate for a smaller investor but inappropriate when trading with, *e.g.*, a large bank, GSE, or other user of TBA transactions with very strong credit. At a

---

[30] Proposal at 3541.

[31] FINRA Rule 4210(f)(6).

minimum, we encourage FINRA to look to the $500,000 minimum transfer amount that U.S. regulators adopted for margin requirements for uncleared swaps (which is roughly consistent with the international accord on the same point).[32]

E. Compliance Dates

FINRA indicated that it would announce the effective date of the Proposal, once approved, within 60 days following approval and that such effective date would be no later than 180 days following that announcement. This time frame was entirely too short. SIFMA believed that an implementation period of at least 18 months would be appropriate for the Proposal, and that two years would be more practical. FINRA did agree to the extension to 18 months (other than for risk determinations), for which we are appreciative, but we continue to believe that two years (for all aspects of the rule)[33] would be more practical.

F. Segregation Issues Under SEC Rule 15c3-3

In the Proposal, FINRA did not address the issue of the treatment of customer margin under Exchange Act Rule 15c3-3 (the "**Custody Rule**"). This is somewhat understandable given that the SEC, not FINRA, is responsible for the interpretation and amendment of the Custody Rule. However, given the interaction between the Proposal and the Custody Rule, SIFMA believes it would be prudent for the SEC to consider a corresponding interpretation of the Custody Rule were it to approve the Proposal. At a minimum, the SEC should issue an interpretation that no segregation requirement under the Custody Rule applies to any "variation" or "mark-to-market" margin posted by a customer in TBA transactions. If there were a segregation requirement, broker-dealers would be essentially required to fund customer losses because (i) customer variation margin would be required to be segregated by broker-dealers and (ii) at the same time, broker-dealers could be required to post an amount equal to such variation margin on the other side of the transaction. This would skyrocket cash demands on broker-dealers, which would force many firms from the markets, and materially raise costs to customers who would ultimately have to bear the expense of the funding costs relating to their transactions.

We will also make again a point that we made above. Many of the customers that would be required to post initial margin under the Proposal are DVP account customers who may not have legal or corporate authority to post collateral with a broker-dealer, and thus will be motivated to either move their transactions to non-broker-dealers or exit the TBA market entirely.

G. Cost-Benefit Analysis

---

[32] *See* Swaps Margin Final Rule.

[33] While the written risk limit determination applies generally under the rules as they stand today, modifying these determinations solely for TBAs would effectively require broker-dealers to complete all of the customer diligence requirements implicated by the Proposal within six months even when such customers will not be within the scope of the rules for at least another year thereafter.

Given the substantial technological burdens that would result from the Proposal, we also wish to highlight FINRA's obligation to consider the comprehensive costs and burdens associated with its proposed rules. Recently and in line with the SEC initiative, FINRA's Office of the Chief Economist issued a "Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking."[34]

In the Framework, FINRA stated that it has an obligation to take into account the costs and benefits of its rulemaking and is further committed to enhancing its economic impact assessments of rules going forward.[35] According to the Framework, the economic impact assessment ideally should permit the comparison of the costs and benefits of the different regulatory options under consideration with a similar degree of specificity. In this regard, we think that it is essential that FINRA assess the costs of the Proposal vis-à-vis the costs of the alternatives that we propose that (i) slightly expand certain the exemptions and eliminate the maintenance margin requirement and (ii) more notably, conform the collection and liquidation timing requirements to those that currently apply.

IV. Conclusion

In summary, SIFMA believes that the operational difficulties in implementing the Proposal will cause some firms to either withdraw from the TBA market or at least to stop dealing with certain types of counterparties where the operational requirements of the Proposal are inconsistent with existing settlement or credit procedures and would require substantial infrastructure modification or investment. Expanding the exemptions in the Proposal, and conforming the requirements of the Proposal to existing account procedures, would substantially reduce its costs without materially reducing any benefits.

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

---

34 *See Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking* (Sept. 2013) ("**Framework**"), available at: https://www.finra.org/EconomicImpactAssessment.

35 *See* Framework at 3.

Appendix I

SIFMA TBA Letter I
(November 10, 2015)

SIFMA & SIFMA/AMG letters submitted in response to FINRA Regulatory Notice 14-02
(both March 28, 2014)

November 10, 2015

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: SR-FINRA-2015-036: Notice of Filing of a Proposed Rule Change To Amend FINRA Rule 4210 (Margin Requirements) To Establish Margin Requirements for the TBA Market

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] SIFMA supports FINRA's goal of managing counterparty credit risk and welcomes the opportunity to comment on the Proposal. Nonetheless, we are concerned as to the potential material negative impact of the Proposal on the mortgage market (particularly as to whether the burdens of certain aspects of the Proposal will cause either member firms or their counterparties to withdraw from parts of the market), as well as issues of clarity and operational feasibility.

Without wanting to give diminished weight to our other concerns, we particularly wish to emphasize that certain of the Proposal's requirements are not operationally practicable, at least at any reasonable expense. As further discussed below, SIFMA believes that the operational

[1] SIFMA brings together the shared interest of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. 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 www.sifma.org.

[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. 636303 (Oct. 20, 2015).

difficulties in implementing the Proposal will cause some firms to either withdraw from the TBA market or at least to stop dealing with certain types of counterparties where the operational requirements of the Proposal are inconsistent with existing settlement or credit procedures and would require substantial infrastructure modification or investment.

We also hope the SEC and FINRA will consider whether the benefits of the Proposal, as currently constructed, are worth the costs of implementation (including, but not limited to, the likely withdrawal of participants from the mortgage markets). The Proposal does not require the collection of maintenance margin from small counterparties (to the extent that exceptions can be implemented)[3] or large counterparties[4] but only from medium-sized counterparties. These medium-sized counterparties do not pose systemic risk. The difficulty of constructing a maintenance margin process solely for these counterparties will discourage many firms from serving them at all. This is likely to drive counterparties from the mortgage markets, which is a negative from a policy perspective, or limit the number of firms available to serve the middle-market. Accordingly, should the decision be made to proceed with a variant of the Proposal, we urge the SEC and FINRA to consider rules that would be simpler to implement and would not unduly burden medium-sized counterparties. This might be achieved by (i) eliminating the requirement to collect maintenance margin from any counterparty (rather than singling out medium-sized counterparties to make such transfers) and (ii) raising the minimum transfer amount. We emphasize, however, that even these changes will not make the Proposal workable unless the operational and other mechanics as applied to TBAs are conformed to those that apply to all other securities products.

I. Scope of Requirements

A. Product Scope

SIFMA appreciates that FINRA has worked to align the scope of transactions covered by the Proposal ("**Covered Agency Transactions**") with the scope of products subject to the recommendations of the Treasury Market Practice Group regarding best practices for forward-settling agency mortgage-backed securities transactions ("**TMPG Best Practices**").[5] While SIFMA has raised concerns as to this scope and the potential issues that it may cause,[6] SIFMA also appreciates the benefits of regulatory consistency. As such, SIFMA encourages FINRA to

---

[3] *See infra* Section I.B.5.

[4] Due to the "exempt account" and other exceptions. *See infra* Section I.B.3.

[5] Proposal at 63605 & n. 27.

[6] *See* Letter from SIFMA to FINRA re. FINRA RN 14-02, *available at* http://www.finra.org/sites/default/files/NoticeComment/p477648.pdf (the "**SIFMA 14-02 Letter**") at pp. 1-3. The SIFMA 14-02 Letter is included as Appendix I hereto. *See also* Letter from SIFMA Asset Management Group to FINRA re. FINRA RN 14-02, *available at* Letter dated Mar. 28, 2014, from the SIFMA Asset Management Group to FINRA, *available at* http://www.finra.org/sites/default/files/NoticeComment/p477653.pdf ("**AMG 14-02 Letter**").

continue to work with the TMPG to ensure that relevant guidance as to product scope continues to remain consistent.[7]

B. Entity Scope

Under the Proposal, FINRA would establish a number of different categories of counterparties as to which different margin requirements apply. Depending on the identity of the counterparty, a member could be required to collect maintenance margin and/or mark-to-market margin, or it could be excused from the margin requirements entirely, provided that it takes appropriate capital charges.

As a general matter, FINRA should clarify the Proposal to address (i) when the various counterparty status determinations must be made (and how frequently updated, if relevant); and (ii) what level of diligence is required to determine status.[8] Each of these broad goals serves the purposes of providing firms and their counterparties with clarity as to their status under the rules and easing the operational burden. A requirement that FINRA members continuously monitor their counterparties' status would make many of the exceptions and exclusions impracticable as an administrative matter. SIFMA would welcome the opportunity to work with FINRA to craft appropriate and workable standards for the timing and extent of the relevant diligence.

1. "Cash" Account Exception

The Proposal would provide an exemption from maintenance margin for transactions subject to the following conditions: (i) the scheduled settlement for the transaction is not later than the month following the trade date; (ii) the counterparty "regularly" settles its Covered Agency Transactions "on a DVP basis or for 'cash'"; and (iii) the counterparty, in its transactions with the member does not (a) engage in "dollar roll" transactions, as defined in FINRA Rule 6710(z); (b) engage in "round robin" trades; or (c) use "other financing techniques" for its Covered Agency Transactions.[9]

While SIFMA appreciates FINRA's decision to provide an exemption from maintenance margin for accounts that trade with an expectation of actually taking physical delivery or ownership of positions, we have concerns that the conditions in the exemption would not be practical to implement.

---

7 *Id.* (noting examples of products that are in scope for both proposals). With that said, SIFMA recognizes that certain firms may not currently settle certain transactions within the "T+1" period that would be required under the Proposal for TBAs and Specified Pools. As with other issues in the Proposal, this is a point where many firms would benefit from having sufficient time to build operational and other systems so as to comply with an amended Rule 4210.

8 In particular, and as noted in *infra* Section I.B.4 with respect to mortgage bankers, FINRA should indicate that it would be reasonable for firms to rely on counterparty representations (though reliance on representations would not be the only way for a member to comply). *Cf.* Exchange Act Rule 3a71-3(a)(3)(ii) (providing for reliance on counterparty representations for certain status determinations for purposes of security-based swap transactions).

9 Proposed Rule 4210(e)(2)(H)(ii)(e).

As a starting matter, to the extent that FINRA's concern is to differentiate between transactions that settle and those that are closed out with a cash payment, SIFMA believes that the language regarding "dollar rolls" and "round robins" would be difficult to implement and, in any event, captures transactions that go far beyond the risks that the language is intended to prevent. Market participants either settle a particular trade physically or they do so by cash payment. "Dollar rolls" and "round robins" are simply alternative ways to settle. There is no reason to single out such trades; and the language is further problematic because it is not always possible to identify whether a particular trade or group of trades is intended to constitute a dollar roll because, for example, the trades may not occur at the same time or even on the same day.

SIFMA reiterates that it is not opposed generally to limitations as to the use of the "cash" account exception that address the primary goals of the Proposal. It is understood that the Proposal is intended address counterparty exposure.[10] However, SIFMA is concerned that the limitations in the proposed rule text are overbroad and actually may include risk-reducing transactions. For example, round robin trades often are worked out *after* the settlement date as a means of mitigating fails. It would be inappropriate to remove a counterparty because it uses such transactions, particularly given that their use may provide important systemic benefits, such as the reduction of open fails.[11]

SIFMA is also concerned as to the ambiguity of the term "regularly." While we are satisfied that the term does not mean "always," there is a wide range of meanings that may be given the term. To the extent that this condition applies, we think that FINRA should provide guidance indicating that a firm would be in compliance if it understood the term to mean that, *e.g.*, "the firm has a reasonable expectation, whether based on the counterparty's prior history, in light of discussions with the counterparty, or otherwise,[12] that the counterparty will physically settle more often than not."

Even if FINRA were to adopt the clarifying suggestions that we have proposed above, SIFMA is concerned that members who have counterparties that could benefit from this exception will be required to make significant changes to systems in order to rely on the exception. That is, implementing the procedures to comply with this exception would require firms to track and monitor counterparty activity and to continually re-assess whether a counterparty "regularly" settles trades. In practice, we are skeptical that firms will find it worthwhile to build systems that can comply with the FINRA proposal, particularly given that the counterparties at issue are relatively small and do not use financing, and given the risk of regulatory sanction if a firm does not interpret the term "regularly" in a consistent manner with the interpretation of an examiner. The likely result is that many firms will not make this

---

[10] *See* Proposal at 63617.

[11] While the "regularly" phrase does not clearly apply to the dollar roll / round robin / other financing aspect of the exception, FINRA should clarify what amount of such transactions would render the exception not usable by a counterparty. As drafted, the Proposal seems to suggest that a single dollar roll, round robin, or "other financing" trade could result in the counterparty being subject to maintenance margin.

[12] Generally, the firm would form a well-founded belief and not disregard "red flags."

exemption available; this would be to the detriment of both small counterparties and the mortgage markets. Accordingly, SIFMA believes that, as a practical matter, the benefits of this exemption will be relevant to the market only if it is made straightforward to implement. For example, FINRA might make the exemption available to counterparties with respect to trades settling in the next calendar month so long as the relevant counterparty's positions were below a specified amount (set by the member's credit department) and where the firm reasonably believes that the counterparty may physically settle the trade.[13]

2. Sovereign Entities

The Proposal contains an exclusion from the margin collection requirements for Covered Agency Transactions entered into with the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve, the Federal Deposit Insurance Corporation,[14] central banks, multinational central banks, foreign sovereigns, multilateral development banks, or the Bank for International Settlements. As noted in the SIFMA 14-02 Letter, SIFMA believes that this definition should be expanded to include sovereign wealth funds that are guaranteed by sovereigns, as these entities present a similar credit profile to trades directly with a sovereign entity.

In the Proposal, FINRA said that it declined to add these entities to the sovereign exclusion because they act as "commercial participants" and that (i) the potential for "regulatory arbitrage" and (ii) the purposes of the Proposal would be frustrated unless it could be shown that an entity 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."[15]

While SIFMA accepts that concerns of competitive treatment are relevant to the treatment of sovereign wealth funds in certain instances, SIFMA believes that none of the factors listed is relevant insofar as the Proposal is concerned. The Proposal is fundamentally about credit. Whether a sovereign fund's activity is described as "commercial" or "governmental" does not fundamentally change the credit analysis. For credit purposes, the fund is simply a vehicle for the sovereign. Second, FINRA's suggestion of a "full faith and credit" requirement is an essentially technical differential; if a sovereign stands willing to guarantee the obligations of the fund, then the broker-dealer may look to that sovereign to be made whole in the event the fund fails.

In addition to sovereign wealth funds, SIFMA also recommends that FINRA expand the "sovereign" exception to include U.S. government-sponsored entities ("**GSEs**") and the U.S.

---

[13] Such reasonable belief could be formed, *e.g.*, by the receipt of a representation from the customer regarding its activities.

[14] The Proposal's limiting reference to these three banking agencies referenced in 12 U.S.C. 1813(z) seems unnecessarily restrictive. All U.S. governmental entities should be able to rely upon this exclusion. As the discussion further below indicates, there is no credit reason to make such a distinction.

[15] Proposal at 63619.

federal home loan banks. Many of such entities' obligations are guaranteed by the U.S. government, explicitly or implicitly.[16] Furthermore, these entities are integral to the mortgage market in the United States. Subjecting them to margin requirements could potentially impose additional costs on their ability to hedge their portfolios. This could have a disruptive and/or costly effect on persons financing home purchases. As such, SIFMA recommends that FINRA include these entities within the scope of the "sovereign" exception in the Proposal.

3. Exempt Account Definition

The Proposal uses the term "exempt account" generally as it is used under current FINRA Rule 4210. SIFMA understands that FINRA intends to review this definition as part of a "future, separate rulemaking effort." SIFMA believes that the definition of "exempt account" contains a number of points worth reconsidering. While it is understood that FINRA would prefer to address that as part of a separate rulemaking effort, SIFMA notes that the current Proposal could impose requirements under Rule 4210 to new groups of counterparties. To this end, SIFMA wishes to highlight two groups of counterparties that could be addressed by straightforward amendments to the definition of "exempt account," even as more general concerns with the definition are saved for later consideration.

a. Foreign-Regulated Entities

Under Interp. /01 to FINRA Rule 4210(a)(4), a "foreign institution" (*i.e.*, a financial firm that is regulated under non-U.S. law) does not qualify as a "designated account." As noted in the SIFMA 14-02 Letter, SIFMA believes that this interpretation should be withdrawn and that FINRA should recognize firms regulated under non-U.S. law as "designated accounts," and "exempt accounts." Such a change would substantially ease the diligence burdens on member firms and would be consistent with the treatment of such entities under other areas of financial regulation that look to similar criteria to allow persons to engage in specified financial transactions.[17]

b. Common Trust Funds, Collective Trust Funds

It is common for pension plans and other similar entities to use trust vehicles such as "common trust funds" and "collective trust funds" to make investments. Where these trusts are beneficially owned entirely by entities that otherwise qualify as a "designated account," such entities should also be afforded treatment as a "designated account."[18]

---

[16] For instance, the Government National Mortgage Association (Ginnie Mae) is a government-owned corporation, and the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) are subject to a conservatorship of the Federal Housing Finance Agency.

[17] *See*, *e.g.*, Securities Exchange Act of 1934, as amended ("**Exchange Act**"); Section 3(a)(65) (definition of "eligible contract participant"); Exchange Act Rule 13d-1(b)(ii)(J) (beneficial ownership reporting requirements).

[18] More generally, any time an investment vehicle is entirely owned by entities that themselves qualify as "designated" or "exempt" accounts, such accounts should be afforded the same treatment. *Cf.* Securities Act

4. Mortgage Bankers Exception

Under the Proposal, FINRA members may accord "mortgage bankers" the same treatment as "exempt accounts" if the mortgage bankers use Covered Agency Transactions to "hedge their pipeline of mortgage commitments."[19] FINRA members would be required to adopt written procedures to monitor the mortgage banker's pipeline of mortgage loan commitments in order to assess whether the Covered Agency Transactions are being used for hedging purposes.

SIFMA understands FINRA's desire to limit the scope of the mortgage banker exception to entities engaged in *bona fide* hedging activities. However, the diligence requirement creates an impossible burden for members to meet in terms of meaningfully monitoring the activities of their counterparties beyond transactions with the member.[20] As requested in the SIFMA 14-02 Letter, SIFMA believes it would be appropriate for FINRA to confirm that members could comply with the "hedging" aspect of the exception by obtaining representations or certifications from the mortgage bankers as to their use of Covered Agency Transactions.[21] It is not practical to expect members to monitor mortgage bankers' transactions with third parties or to determine whether each transaction is "hedging" an existing mortgage loan commitment. Even if a review of the type suggested by the Proposal were possible, a mortgage banker that wished to evade the limitations could trade in an amount equal to its mortgage pipeline with numerous banks. In sum, regardless of the procedures that may be put into place, firms do not have any better means to implement this exemption than to rely on a counterparty's representation.

5. "Small" Account Exception

In addition to the "Cash" account exception discussed above, the Proposal would exclude from both the maintenance <u>and</u> mark-to-market margin requirements those entities that qualify for the "cash" account exception <u>and</u> whose "gross open positions" in Covered Agency Transactions with the member amount to $2.5 million or less in the aggregate.[22] SIFMA appreciates FINRA establishing this exception as it believes that it should help reduce the burden on smaller counterparties that "do not give risk to the [member]." With that said, and in addition to the concerns raised above as to the details of the use of the exception, it is not clear how

---

Rule 144A(a)(v) (including in the definition of "qualified institutional buyer" entities where all of the equity owners are "qualified institutional buyers").

[19] Proposed Rule 4201(e)(2)(H)(ii)(d).

[20] In responding to this comment, FINRA in the Proposal cited current interpretation /02 to Rule 4210(e)(2)(F), noting that the rule already contemplates evaluating the loan servicing portfolios. SIFMA notes that the monitoring or servicing portfolios requirement under the current rule applies only to mortgage bankers who do not otherwise meet the $1.5 million "net current assets" test.

[21] *Cf.* SEC Proposed Rule, *End-User Exception to Mandatory Clearing of Security-Based Swaps*, 75 Fed. Reg. 79992 (Dec. 21, 2010) and CFTC Regulations 23.505 and 50.50 (setting forth standards for diligence as to use of the end-user exception from mandatory clearing for (security-based) swaps, which also contain "hedging" requirements).

[22] Proposed Rule 4210(e)(2)(H)(ii)(c)(2).

FINRA reached the $2.5 million figure and how much of the market may actually rely upon this exclusion.

We note that given the $250,000 minimum transfer amount (which is, of course, subject to firms' individual assessments as to a counterparty's creditworthiness), firms rarely would be required to collect margin from accounts of such size in any event. Thus, firms would be put to the burden of monitoring a regulatory requirement even though the results of such monitoring would not result in the firm being required to take any action.

In order not to do damage to the mortgage market through a loss of liquidity and added administrative burdens for dealers, we would propose that this exemption be turned into a genuine "small account exception." This could be achieved by eliminating the requirement that trades settle in the cash account and by allowing for a larger open position amount, such as $10 million. This would allow small institutions to continue to participate in the mortgage markets and for members to continue to serve such counterparties.

II. Maintenance Margin

Under the Proposal, "Covered Agency Transactions" would be subject to a 2% "maintenance" margin requirement for transactions with non-exempt accounts that otherwise do not qualify for one of the exclusions discussed above.[23]

SIFMA continues to oppose the maintenance margin requirement as unnecessary to assure the soundness of FINRA members, provided that members continue to take capital charges as are required under current rules.[24] As a starting matter, SIFMA observes that the requirement to collect margin or the requirement to take a capital charge serve identical purposes. They both assure that a broker-dealer has sufficient capital to withstand a counterparty default, in the first case, by allowing the broker-dealer to seize the counterparty's assets and, in the second case, by assuring that the broker-dealer has sufficient internal resources to absorb the loss.

The Proposal also provides exemptions as to the collection of margin from both small firms and large firms; the maintenance margin requirement would primarily impact medium-sized counterparties. Even as to these counterparties, a $250,000 margin buffer is allowed. Ultimately, firms will be required to build a substantial operational system in order to collect a limited amount of margin from a limited number of counterparties. For many firms, it would make much more sense to set aside capital as to these trades rather than to build the required systems, which would be a substantial operational burden even in ordinary times, let alone in the current circumstances when so many new requirements are being imposed.

---

[23] Proposed Rule 4210(e)(2)(H)(ii)(d).

[24] *See* SIFMA 14-02 Letter; *see also* AMG 14-02 Letter. We do not substantially repeat the arguments regarding maintenance margin made in the letters in response to FINRA RN 14-02 but continue to believe in the reasoning expressed therein.

In addition, the Proposal creates substantial complexity for firms in calculating margin requirements where an account may trade in numerous products including but not limited to Covered Agency Transactions. Margin calculations currently required by FINRA Rule 4210 are generally based on positions held in the account as of close of business the prior day (or, in the case of day trading, transactions that occurred the prior day). The Proposal would require firms to calculate maintenance margin on a transaction-by-transaction basis and segregate Covered Agency Transactions from other securities in the account. For example, if an account has an open TBA transaction, a corporate bond and a debit balance, the amount of the debit and the dates the debits occur must be separated to ensure that margin is calculated correctly and margin deficits aged appropriately.

The maintenance margin requirement is also inconsistent with the TMPG Best Practices and will put FINRA members at a material competitive disadvantage. FINRA members will be required to collect maintenance margin where their competitors (such as banks and foreign institutions) are not subject to such a requirement. As previously noted, this impact could be more significantly felt by smaller broker-dealers, whose business involves serving a greater proportion of smaller investors, than for larger firms that may be able to withstand the loss of business or could refer the business to an affiliated bank or foreign institution. The inconsistency with the TMPG Best Practices also could require broker-dealers that expended significant resources to comply with TMPG Best Practices to be forced to expend even more resources to comply with this new requirement.[25]

Additionally, the requirement likely would lead to investors being forced to leave the market for Covered Agency Transactions. For some investors, the requirement to set aside maintenance margin will make entering into Covered Agency Transactions uneconomical. This would have a negative impact on the mortgage market through a loss of liquidity and could lead to greater costs for mortgage originators and other market participants that, in turn, could result in greater costs to mortgage borrowers.

III. Margin Transfer and Position Liquidation Timing

The Proposal generally would require a FINRA member to (i) take a net capital charge for any margin deficiency that is not satisfied by the close of business on the next business day after the date that the deficiency arose, and (ii) liquidate positions to satisfy a deficiency if the deficiency is not satisfied within five business days from the date that the deficiency arose.

These are among the instances where the FINRA Proposal would require firms to deviate from ordinary operational practices, generally by imposing shorter timetables. SIFMA continues to emphasize that these time frames are (i) too short, even if the requirements of the Proposal were viewed in isolation from the other business conducted by member firms, and (ii) given that they would require firms to make material changes to their operations in respect of a single product type, are not feasible to implement. That is, it is not workable for firms to create new

---

[25] For example, firms that signed MSFTAs with their counterparties for Covered Agency Transactions could be forced to re-negotiate those documents to include terms for maintenance margin.

systems that can distinguish between credit trades that are required to be settled in two days and those that are required to be settled in three days, nor can these difficulties be justified from a policy perspective. There is no reason related to credit risk why Covered Agency Transactions trades should settle more quickly than would other trades, given that such transactions are generally less volatile than trades in many other types of securities, including both most debt and many equity securities.

A. Margin Transfer Timing

The "T+1" capital charge requirement would change the existing requirements that apply to identical (but often more risky) securities credit activities of broker-dealers.[26] Under Exchange Act Rule 15c3-1, a capital charge is not required for uncollected margin until five business days after a call for margin is made.[27] In contrast, the Proposal would require a capital charge, in many cases, on the same day as the call for margin.[28] Current Rule 4210 generally does not impose margin collection timing requirements (although it does contain liquidation timing requirements).

It is simply impractical for FINRA to make a change that is specific to this group of trades. Member firms and their counterparties have extensive operational and legal arrangements that are set up to work with the margin and capital requirements for securities transactions as a whole. Modifying these requirements so that they operate on a product-specific basis would be a tremendous task.[29] Firms would need to set up operational capacity to analyze a counterparty account as to its Covered Agency Transactions and separately as to all other securities transactions.

Further, as both the SIFMA 14-02 Letter and the AMG 14-02 Letter made clear, a one-day turnaround raises operational issues for member firms and their counterparties, including

---

[26] SIFMA concedes that the FINRA portfolio margin rules require a net capital deduction in the same manner as the Proposal and liquidating action within three business days. *See* Rule 4210(g)(10). However, portfolio margin is a significantly different type of business than Covered Agency Transactions given that it (i) allows counterparties to take on more leverage than is otherwise allowed; (ii) is limited to counterparties who meet a specified set of requirements; and (iii) is part of a regulatory scheme that imposes a greater amount of diligence and compliance requirements on broker-dealers than exists for ordinary securities credit transactions.

[27] *See* Exchange Act Rule 15c3-1(c)(2)(xii).

[28] The Proposal would require margin collection or capital charges on the business day after the business day on which the "mark to market loss arises." Many firms typically compute margin deficiencies after the close of business and issue calls for margin overnight or early the following morning. Further, many contracts (including the SIFMA-published MSFTA) allow a party to post margin on the following business day if a call for margin is made after a specified time (*e.g.*, 10:00 a.m. for the MSFTA).

[29] Many firms recently undertook to comply with TMPG Best Practices and entered into a large number of MSFTAs. Many of these agreements may allow counterparties to post margin on a T+2 basis or provide for cure periods where margin is not transferred by T+1. The Proposal's timing change would require firms to revisit these arrangements very soon after undertaking great costs to get them in place. In certain cases, this could result in counterparties being forced out of the market where they are unable to comply with the new timing requirements.

those relating to differing time zones and holidays,[30] the need for advisers to make post-trade allocations, the need to convert currencies, and the need for managers to instruct custodian transfers.

B. Position Liquidation Requirement

As with the margin transfer timing requirement, SIFMA believes that the T+5 liquidation requirement is an unnecessary change to existing practices, where firms (i) under the FINRA rules, have fifteen days following a margin call to take liquidating action;[31] and (ii) are not subject to a liquidation requirement under the TMPG Best Practices.

The decision to liquidate counterparty transactions is a very serious business decision. For instance, under the Master Securities Forward Transaction Agreement ("**MSFTA**"),[32] a firm would need to declare a "default." Many market participants include "cross-default" provisions in their MSFTAs and other trading documentation that could lead to a chain reaction of defaults for the counterparty. Market participants generally do not take such a step lightly; mandating it in a shorter time period than historically has been required could adversely affect market participants and markets. As we have previously noted,[33] firms may choose not to liquidate a counterparty despite a missed margin call for numerous reasons. For one, a *bona fide* dispute may be ongoing and the firms may be working to resolve such a dispute. Even if FINRA were to go ahead with the liquidation requirement, SIFMA strongly urges it to create exceptions that recognize that disputes happen and allow member firms to take capital charges on such deficiencies pending resolution of the dispute. As previously noted, SIFMA is more than willing to work with FINRA to set appropriate measures to limit the size of such disputes or the amount of time a dispute could continue before liquidating action is required.[34]

IV. Minimum Transfer Amounts

The Proposal would allow firms to include a minimum transfer amount ("**MTA**") of up to $250,000 in their margining arrangements such that no margin or capital charges would be required to be collected until the required transfer exceeded the specified threshold.

SIFMA appreciates the inclusion of an MTA, as it is consistent with market practices. However, while $250,000 is a frequently used number, SIFMA believes that it is too low to be

[30] In a similar context – the recent final rules to implement margin requirements for uncleared swaps – regulators provided guidance to firms as to how to interpret, *inter alia*, differences in time zones and foreign holidays impact a one business day collection requirement. *See* Final Rule to Establish Margin and Capital Requirements for Covered Swap Entities (Oct. 22, 2015) (unofficial text) at 93-96, *available at* https://fdic.gov/news/news/press/2015/pr15081.html ("**Swaps Final Rule**").

[31] FINRA Rule 4210(f)(6).

[32] The SIFMA-published form is available at http://www.sifma.org/services/standard-forms-and-documentation/mra,-gmra,-msla-and-msftas/.

[33] *See* SIFMA 14-02 Letter and AMG 14-02 Letter.

[34] *See* SIFMA 14-02 Letter at 7-8 and SIFMA AMG Letter at 4.

established as a universal norm and does not provide enough discretion for FINRA members to make an appropriate credit assessment. Given that member firms are otherwise required by the Proposal to take various steps to assess the risk of their counterparties, SIFMA feels that member firms can and should be able to make a decision on a case-by-case basis as to how high or low the minimum transfer amount should be on a counterparty-by-counterparty basis. For instance, an MTA of $250,000 may be appropriate for a smaller investor but inappropriate when trading with, *e.g.*, a large bank, GSE, or other user of Covered Agency Transactions with very strong credit.[35]

In addition, a minimum transfer amount of $250,000 would require firms to amend contracts that have higher MTAs or threshold amounts. Particularly given that many of these contracts were executed in response to the requirements of the TMPG, SIFMA believes that FINRA should allow such existing contracts to be "grandfathered" – *i.e.*, any new MTA adopted by FINRA should not apply to existing contractual relationships for a specified period of time. However, it would be preferable simply to raise the minimum transfer amount to $500,000, subject to a firm's credit risk procedures.

V. Risk Determinations

The Proposal generally would take the "written risk analysis" requirement that exists in current Rule 4210 and apply it to Covered Agency Transactions. Below, SIFMA suggests a number of modifications to this requirement as it is drafted in the Proposal.

A. Investment Advisory Accounts

Proposed Interpretation 4210.05(a)(1) provides that members may make risk limit determinations at the investment adviser level unless any account or group of commonly controlled accounts whose assets are managed by the adviser constitute more than 10% of the adviser's regulatory assets under management. FINRA indicated in the Proposal that it believes that accounts above this threshold "pose a higher magnitude of risk."[36]

SIFMA does not understand why accounts above the 10% threshold should present a higher magnitude of risk and believes that the limitation creates an unnecessary additional hurdle and diligence requirement. Even where a risk determination is made based on who the adviser for an account is, a member firm is still required to make status determinations and collect margin at the level of the account's beneficial owner. If a member, in making its risk analysis, chooses to undertake such an analysis, taking account of the adviser (and with knowledge of that

---

[35] At a minimum, we encourage FINRA to look to the $500,000 minimum transfer amount that U.S. regulators adopted for margin requirements for uncleared swaps (which is roughly consistent with the international accord on the same point). *See* Swaps Final Rule.

[36] Proposal at 63618.

adviser, how it trades and its investment mandate for the account), then it should not matter whether the adviser trades predominantly for one account or another.[37]

B. Drafting Changes to Risk Determinations

In proposing changes to the existing Rule 4210 risk determination requirement, FINRA essentially has, and perhaps unintentionally, recreated the requirement three times: (i) in FINRA 4210(e)(2)(F) ("Transactions with Exempt Accounts Involving Certain "Good Faith" Securities"); (ii) in FINRA 4210(e)(2)(G) ("Transactions With Exempt Accounts Involving Highly Rated Foreign Sovereign Debt Securities and Investment Grade Debt Securities"); and (iii) in the Covered Agency provisions of Proposed 4210(e)(2)(H). This suggests three separate risk determinations for any accounts engaged in the three types of transactions. However, proposed Interpretation 4210.05(a)(3) says that a member may base the risk determination on "consideration of all products involved in the member's business with the counterparty, provided the member makes a daily record of the counterparty's risk limit usage . . .").

SIFMA requests that FINRA (i) clarify that a single risk determination may be made under (e)(2)(F)-(H) for a particular counterparty; (ii) clarify that Interpretation 4210.05(a)(3) does not extend beyond the products covered by (e)(2)(F)-(H);[38] and (iii) eliminate the additional "daily record" requirement under the .05(a)(3) determination. In particular, as to point (iii), SIFMA does not believe there is a need for this additional limitation, particularly given that current Rule 4210 imposes no such requirement and allows firms to make such determinations for credit extended under (e)(2)(F) and (e)(2)(G), collectively.

VI. Concentration Limits on Capital Deductions

The Proposal would modify the existing concentration limits on net capital deductions under Current Rule 4210 in order to capture the expanded scope of the rule under the Proposal. SIFMA accepts the policy behind this technical change but continues to believe that FINRA should make conforming changes to raise the concentration limits to reflect the added margin requirements under the Proposal, given that the existing risk limits were created prior to the issuance of, and without consideration of the effect of, the Proposal. Consistent with the previous suggestion in the SIFMA 14-02 Letter, SIFMA believes that it would be appropriate to increase, to 10 percent, the limit for any one account or commonly controlled accounts.[39]

---

[37] To the extent that the 10% requirement remains in the final rules, FINRA should clarify that the analysis compares the amount of the commonly controlled accounts at the member firm to the adviser's overall AUM.

[38] For example, such a risk determination does not necessarily need to cover portfolio margin transactions, non-securities products, and other transactions. However, SIFMA does believe that a member should have the flexibility to make such a cross-product risk determination, if it so chooses, and still satisfy the risk determination requirement of Rule 4210.

[39] SIFMA 14-02 Letter at 11-12.

VII. Two-Way Margining

While the TMPG Best Practices encourages firms to engage in two-way margining as a means for reducing risk, the FINRA Proposal would not impose such a posting requirement on member firms. FINRA indicated in the Proposal 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."[40] SIFMA encourages FINRA to continue to express support for firms that choose to implement two-way margining, particularly given that this is consistent with the TMPG Best Practices and large portions of the market already have made contractual and operational arrangements to engage in two-way margining.

VIII. Introducing / Clearing Issues

The adoption of the Proposal, or an amended version of the Proposal, would raise a number of issues with respect to introducing / clearing arrangements that should be clarified before the Proposal is finalized.

First, it should be the responsibility of the introducing broker to determine whether a counterparty qualifies as an "exempt account" (or other status determinations under the Proposal)[41] and that a clearing broker should be able to rely on [a written representation] provided by the introducing broker as to the counterparty's status.

Second, and consistent with the view that the introducing broker is best suited to make status determinations, the introducing broker also should be responsible for the written risk determinations required under the Proposal. As the person with direct interaction with the counterparty and who will perform the direct credit diligence, the introducing broker is best suited to perform this analysis.

Third, in many instances, it will be appropriate for the introducing broker, rather than the clearing broker, to take any required capital charges. Many of the introducing brokers involved in the TBA market are fully capitalized firms, with authority to engage in proprietary trading, even though they do not self-clear. As to such firms ("**Capitalized IBs**"), we believe it should be permissible (though not necessarily required)[42] for the Capitalized IB to take any capital charges in respect of the relevant transactions where either (i) the Capitalized IB and the relevant counterparty have agreed in writing that the clearing broker is not responsible for the settlement of the relevant trade but is acting only as a custodian and settlement agent, or (ii) the Capitalized IB has provided a guarantee of the counterparty's liability to the clearing broker and the amount of collateral posted by the Capitalized IB to the clearing broker (and on which the clearing broker may readily foreclose) would be sufficient to satisfy any margin of the counterparty if the

---

[40] Proposal at 63620.

[41] *E.g.*, "mortgage bankers," sovereigns, and the "cash" account criteria.

[42] That is, the Capitalized IB and the clearing broker would retain the flexibility to agree as to the allocation of capital charges. As is currently the case, a clearing broker could continue to take capital charges, and it would be required to do so as in the case of, for example, a so-called "$5,000 introducing broker."

counterparty itself had posted the relevant collateral with the clearing broker. Such an arrangement would allow the introducing broker to agree with a counterparty that the counterparty is not required to post certain margin amounts and that the introducing broker would take any relevant capital charges (rather than the clearing broker being responsible). We likewise would expect that the introducing broker would be responsible for making any risk determinations in respect of the counterparty.

IX. Compliance Dates

FINRA indicated that it would announce the effective date of the Proposal, once approved, within 60 days following approval and that such effective date would be no later than 180 days following that announcement. This time frame is entirely too short.

As we have discussed throughout this letter, the Proposal raises a large number of operational and technological issues for FINRA members and their counterparties. In particular, many firms would be required to make operational builds to, *inter alia*, (i) comply with a change in settlement timing for certain products; (ii) recognize new account types to handle the new categories of counterparties; (iii) monitor counterparty transactions to ensure that the counterparty can continue to rely on exclusions; (iv) collect maintenance margin; (v) impose strict deadlines for collecting margin and liquidating counterparties that are different from the deadlines for the vast majority of other securities credit transactions; and (vi) impose margin requirements on Covered Agency Transactions separate from margin on the rest of a counterparty's positions. Expecting firms to build these systems in a short time frame is not practicable (and, we again emphasize, that certain of the requirements are inherently impractical, from an operations perspective).

In addition, the Proposal would require firms to spend a great deal of time negotiating legal terms to document the new margin requirement. It would effectively require every market participant to sign up to an MSFTA (or similar agreement governing forward transactions and containing margin terms). These agreements take time and resources to negotiate and operationalize. As SIFMA members who implemented the TMPG Best Practices found, entering into these agreements involves engaging with a large number of counterparties, many of whom are also limited in their legal resources. Furthermore, even where firms already have MSFTAs or other similar agreements in place, material amendments could be necessary depending on what final rules are adopted by FINRA.

Finally, we note that even if, in a vacuum, firms were able to implement the Proposal in "no more than 180 days," that is simply not the regulatory environment in which financial firms exist. The last few years have seen extensive regulatory overhaul that has stretched to the limit the resources of both FINRA members and their counterparties. In this regard, we note that the bank regulators have just adopted margin requirements for swap transactions.[43] These requirements will tax both FINRA members and their counterparties; the identical resources that

---

[43] *See supra* note 35. Similar requirements are expected to be adopted in the near future by the CFTC, the SEC, and regulators across the globe.

will be necessary to implement any requirements imposed by the Proposal will also be required to be devoted to the swap margin requirements. This is, of course, to say nothing of the other regulations that have been recently adopted or that seem to be in the regulatory pipeline.

Accordingly, we believe that an implementation period of at least 18 months is appropriate for the Proposal, and that two years would be more practical.[44]

* * *

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

44 SIFMA remains willing to engage in further discussions with FINRA as to the time period for compliance, including discussions as to any potential phasing-in of the requirements.

Appendix I – SIFMA Letter 14-02

Appendix I – SIFMA Letter 14-02

March 28, 2014

Submitted Via Email to pubcom@finra.org

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Comment on Proposed Amendments to FINRA Rule 4210 for Transactions in the TBA Market

Dear Ms. Asquith:

The Securities Industry and Financial Markets Association ("SIFMA")[45] submits 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 to establish margin requirements for transactions in the "to-be-announced" ("TBA") market (the "Proposed Amendments"). SIFMA supports FINRA's stated aim to reduce counterparty credit risk and welcomes the opportunity to comment on the Proposed Amendments. In this comment letter, we will focus on the major impact of the Proposed Amendments, with a focus on the impact on FINRA members, while also addressing issues of clarity, operational feasibility and unintended consequences.

I. Scope of Proposed Amendments

The Proposed Amendments apply to cash and margin transactions in "Covered Agency Securities" with any counterparty, other than a central bank. FINRA has proposed to include as "Covered Agency Securities" (a) TBA transactions, as defined in FINRA Rule 6710(u), for which the difference between the trade date and the contractual settlement date is greater than one business day (including adjustable rate mortgage ("ARM") transactions), (b) "Specified Pool Transactions," as defined in FINRA Rule 6710(x), for which the difference between the trade date and the contractual settlement date is greater than one business day (such transactions, together with TBAs, "Agency MBS" transactions), and (c) transactions in "Collateralized Mortgage Obligations" ("CMOs"), as defined in FINRA Rule 6710(dd), issued in conformity with a program of an "Agency," as defined in FINRA Rule 6710(k), or a "Government

[45] SIFMA brings together the shared interest of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. 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 www.sifma.org.

Sponsored Enterprise," as defined in FINRA Rule 6710(n), for which the difference between the trade date and contractual settlement date is greater than three business days.[46]

A. Sovereign Counterparties

Under the Proposed Amendments, transactions in Covered Agency Securities with a counterparty that is a "central bank" would not be subject to margin requirements under Rule 4210. Although the Proposed Amendments do not include a definition of "central bank," footnote 23 of Regulatory Notice 14-02 (the "RN 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." SIFMA recommends that FINRA incorporate this interpretation into Rule 4210 (or into its interpretation handbook). SIFMA further requests that FINRA also exempt (or include in the definition or interpretation of "central bank" for purposes of the Proposed Amendments) "sovereign wealth funds" guaranteed by sovereigns, where "sovereign wealth fund" is defined as "a specialized investment fund created or owned by a government to hold foreign assets for long-term purposes." SIFMA believes that sovereign wealth funds guaranteed by sovereigns present similar credit profiles to sovereign themselves and should, therefore, be similarly excluded from the scope of the Proposed Amendments.

B. Bona Fide Cash Transactions by Smaller Firms

FINRA members that are not members of the Fixed Income Clearing Corporation's Mortgage-Backed Securities Division (the "MBSD") should not be required to margin Specified Pool Transactions booked into their customer's cash accounts for T+3 (or sooner) settlement. These transactions, which are executed by smaller dealers with their customers and frequently do not even settle on the standard monthly settlement dates, are true cash account transactions and there is no more reason to margin them than any other cash account transactions. This narrow exclusion to the definition of "Covered Agency Securities" would be a significant benefit to small dealers and their customers (who would be able to continue to engage in bona fide cash transactions without major operational and documentary changes) and would also be consistent with the intent behind the definition of "Covered Agency Securities." We understand that FINRA defined "Covered Agency Securities" to correspond to the Treasury Market Practice Group's ("TMPG's") Best Practices for Treasury, Agency Debt and Agency Mortgage-Backed Securities Markets (the "TMPG Best Practices"), which recommended the exchange of two-way variation margin for Agency MBS transactions with a settlement date greater than T+1 and CMO transactions with a settlement date greater than T+3. We understand that one reason why the TMPG's recommendation had this scope is that the TMPG wanted their recommendation to cover the significant volume of T+2 and T+3 Agency MBS transactions executed at and around the time the TBA sellers notify the buyers of the pools to be delivered. The exclusion requested in this paragraph would not prevent Rule 4210 from covering the vast majority of this volume.

---

[46] We understand that the Proposed Amendments to Rule 4210 cover only forward settling purchase or sale transactions on agency MBS or CMOs and are not intended to affect the margin requirements for ordinary credit transactions (such as margin loans or repo transactions).

C. Securities Outside the Scope of the TMPG Recommendation

As presently constituted, the Proposed Amendments appear to cover TBA and specified pool transactions on certain securities (*e.g.*, pools of agency multifamily loans) that are outside the scope of the TMPG's recommendations. Scope differences between Rule 4210 and the TMPG Best Practices would be contrary to FINRA's stated design for the scope of the Proposed Amendments "to be congruent with the products covered by the TMPG best practices." They would also introduce competitive disparities between FINRA members and other agency MBS dealers, as well as increase the documentary and administrative burden on FINRA members. We therefore recommend that FINRA clarify that only pools of single-family residential mortgages (and CMOs backed by such pools) are covered by the proposed new provisions of Rule 4210.

II. Margin Requirements

A. Maintenance Margin Requirement

Under the Proposed Amendments, bilateral transactions in Covered Agency Securities would be marked to the market daily and the member firm required to collect from its counterparties any mark to market loss on such transactions. In addition, if the counterparty is not an exempt account, the member firm would be required to collect maintenance margin equal to 2% of the market value of the securities subject to the transaction.

SIFMA opposes the requirement that 2% maintenance margin be collected from non-exempt accounts. The TMPG Best Practices only recommend the exchange of variation margin; they do not recommend the collection of maintenance margin. This deviation from the Best Practices can place FINRA members at a competitive disadvantage or have an adverse impact on the market for Covered Agency Securities. Customers who are unable to meet the requirements to qualify as exempt accounts, or who are unwilling to provide the necessary information to be considered by the member firm to be exempt accounts,[47] will have a choice of posting maintenance margin to a FINRA member (with the concomitant expense and credit exposure to the FINRA member), taking their business to a bank acting as a government securities dealer, or exiting the market altogether. We believe that a significant number of investors could opt to take their business to banks (with adverse effects on their former broker-dealers) or exit the market (with adverse effects on the Agency MBS market and indirect adverse effects on the mortgage, and therefore real estate, markets). These effects may be particularly devastating to small firms, which depend to a greater extent on non-exempt account investors, and the CMO market, which has a large proportion of retail investors. Even if no investors left the market or moved to banks, the cost of maintenance margin can be expected to reduce demand for Covered Agency Securities, therefore increasing the hedging costs for mortgage originators (or reducing the value of their production), who can be expected to pass these costs on to mortgage borrowers, thereby

---

[47] High net worth individuals are often reluctant to provide their broker-dealers with detailed financial information and, even if eligible for "exempt account" status, may choose not to provide this information. This issue is likely to be particularly acute for smaller broker-dealers who depend on this client base.

increasing the expense of mortgages used by American families to buy their homes. Further, in order to collect the required maintenance margin from non-exempt accounts, FINRA members will face the operational burden and costs of having to implement new documentation with customers or renegotiate existing documentation.[48]

B. Calculation of Maintenance Margin on Net Position

To the extent that FINRA does decide to impose a 2% maintenance margin requirement on bilateral transactions in Covered Agency Securities by non-exempt account customers, SIFMA seeks clarification of the position on which such margin should be charged. SIFMA believes that the 2% margin should not be charged on a counterparty's gross positions, but instead on the net of all of the counterparty's positions. A counterparty's gross positions are not the best representative of the risk posed by those positions. For example, a "paired" TBA position, where the counterparty has locked in a gain or loss by buying and selling the same CUSIP, has no risk to the broker-dealer (beyond any locked-in loss) rather than twice as much risk as either of the separate legs of the paired TBA. Similarly, a broker-dealer has less risk exposure to a counterparty that sells one TBA and buys another (*e.g.*, in a "dollar roll" trade) than the broker-dealer would have to a counterparty that had just one side of the transaction. For this reason, we believe that the 2% maintenance margin requirement should be calculated only on the counterparty's net position, calculated as the difference between the aggregate market value of all of the counterparty's buy positions in Covered Agency Securities and the aggregate market value of all of counterparty's sell positions in Covered Agency Securities. Further, SIFMA recommends that FINRA clarify how a firm should determine the value of the counterparty's positions in TBA transactions, given that the underlying securities do not have a concrete value outside of the TBA market (*i.e.*, should the current TBA contract price be used?).

C. Margining of Fails

SIFMA also seeks clarification that the Proposed Amendments would not require FINRA members to margin Covered Agency Securities transactions for which the selling party has failed to deliver the security by the contractual settlement date ("fails"). SIFMA notes that the margining of fails would be operationally challenging for many member firms. In fact, TMPG considered adopting a recommendation to margin fails in its Best Practices but ultimately did not recommend such margining due to the operational difficulties.[49] In recognition of the operational difficulties of margining fails, and the asymmetry between the party failing and the party being failed to, SIFMA's Master Securities Forward Transaction Agreement (the "MSFTA"), which is the agreement most commonly used to document margin requirements on Covered Agency Securities transactions, permits but does not require the collection of margin by

[48] FINRA members' investment manager customers will, in turn, have to go back to their clients to get permission to post margin to the FINRA member, creating further costs and delays.

[49] While TMPG does not currently recommend the margining of fails in its Best Practices, TMPG has indicated that it might re-visit the margining of fails at a future time.

the non-failing party; it does not permit the failing party to collect margin on the failed transaction.[50]

III. Exempt Accounts

A. Mortgage Bankers

Under the Proposed Amendments, member firms may treat "mortgage bankers" that use Covered Agency Securities to hedge their pipelines as exempt accounts, but the member firms must "adopt procedures to monitor the mortgage banker's pipeline of mortgage loan commitments to assess whether the Covered Agency Securities are being used for hedging purposes."

SIFMA believes that while firms should (and currently do) understand their mortgage banker clients' business and set limits accordingly, firms are certainly not in a position, nor do they have the access or tools required, to meaningfully monitor the trading activities of a mortgage banker with its multiple trading counterparties or whether any one transaction or a particular set of transactions are executed by a mortgage banker for hedging, commercial, speculative or any other purpose.

SIFMA would like to confirm that FINRA members may comply with this requirement by adopting reasonable procedures such as obtaining representations or a certification from mortgage bankers about the nature of their business and use of Covered Agency Securities transactions for hedging purposes, and that FINRA members have flexibility in designing such procedures. Again, a requirement that member firms monitor their mortgage banker clients is not feasible and would largely eliminate the ability of mortgage bankers to qualify as exempt counterparties. This outcome would hamper the market through which mortgage bankers hedge their origination pipelines. As mentioned earlier, increased costs in hedging the origination pipeline resulting would likely be passed on to mortgage borrowers, making it ultimately more expensive to finance home purchases.

B. Non-U.S. Entities

The definition of "exempt account" in FINRA Rule 4210(a)(13) includes accounts of brokers or dealers registered under the Exchange Act, banks, savings associations the deposits of which are insured by the Federal Deposit Insurance Corporation, insurance companies, investment companies registered with the SEC under the Investment Company Act, a state or political subdivision thereof, and pension or profit sharing plans subject to ERISA or of an

---

[50] Although due to the complexity of the Agency MBS market, fails are still more common in that market than other markets, they have been significantly reduced by the TMPG's recommendation that, by February 2012, market participants begin imposing fails charges on the failing party. Primary Dealer Statistics from the FRBNY show an average weekly AMBS failure-to-deliver (across all coupons) for 2010 and 2011 of $447.935 billion as compared to an average of $122.066 billion in the period from February 2012 to March 27, 2013. Data available at http://www.newyorkfed.org/markets/gsds/search.html.

agency of the United States or a state or a political subdivision thereof. For transactions in Covered Agency Securities, SIFMA recommends expanding this definition to include non-U.S. equivalents of these types of exempt accounts.

IV. Margin Collection and Transaction Liquidation

Pursuant to the Proposed Amendments, to the extent that a counterparty does not pay any required maintenance margin or marked to market loss, a member firm 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. Further, if such deficiency is not satisfied within five business days from the date the deficiency was created, the FINRA member must promptly take liquidating action, unless FINRA grants the firm an extension of time. SIFMA believes these timeframes are too short.

A. Conforming Timeframes

Under the SEC's Net Capital Rule, broker-dealers are not required to take a capital charge for uncollected margin until five business days after the margin call.[51] Member firms are not required to take liquidating action for uncollected margin until fifteen days after the margin call (or longer if FINRA provides an extension).[52] As noted above, SIFMA does not believe that Covered Agency Securities transactions represent a greater risk than transactions in other, generally more volatile, securities, like equities and high yield bonds. We therefore believe that Covered Agency Securities transactions should be subject to the same timeframes for capital charges and liquidating action as transactions in other securities, unless it can be demonstrated that there are special circumstances that render Covered Agency Securities transactions more risky. Inconsistent time periods for these purposes may be especially operationally difficult. In fact, the normal process of looking at a client's entire account to determine whether the client has adequate equity to satisfy Rule 4210's requirements would mean that it is impossible to attribute a margin deficit to Covered Agency Securities transactions rather than to other positions in the client's account.

B. The Proposed Timeframes Are Too Short

In addition to the operational issues for member firms arising from inconsistent timeframes, substantial operational changes would need to be made at member firms to accelerate the collection of margin in all cases to the day after the margin deficiency is created. Even with substantial operational changes, it may be very difficult to make margin calls early on T+1 when, for example, investment managers do not allocate transactions in Covered Agency Securities until T+1. Things are even worse on the client side. Many clients, even large and sophisticated investment managers, are unable to meet margin calls on the same day they are

---

[51] Exchange Act Rule 15c3-1(c)(2)(xii).

[52] FINRA Rule 4210(f)(6).

made. Some clients are located in different time zones, and closed for the day by the time the member firm delivers the margin call. In some cases, the margin may be posted in non-US currencies, requiring transfers in markets that have closed by the time the margin call is made. In some cases, stringent controls over the movement of funds and securities make it impossible to meet margin calls on the day that they are made. In other cases, there may be disputes about the proper size of the margin call that take some time to resolve. Thus, a one business day period for the collection of margin is simply unrealistic in many cases.[53]

A short liquidation period is equally problematic. Where a member firm and its client differ on the amount of margin that is owed, it may take more than five business days to reconcile the requirements and resolve the dispute. Further, triggering liquidating action might have unintended consequences for the counterparty and the market generally by leading to cross defaults and further liquidating action. Rather than requiring a five-day liquidation period, SIFMA would support proposing that, if a client has not paid any required maintenance margin or marked to market loss within five business days from the date the margin collection deficiency was created, the client's ability to trade with the FINRA member in Covered Agency Securities should be limited to transactions that do not increase the risk of the client's position until the margin is posted or liquidating action is required. During this period, the FINRA member would take a capital charge for the deficiency, protecting the FINRA member from the exposure to the client.

SIFMA would support proposing the current fifteen-day timeframe from FINRA Rule 4210(f)(6) for bilateral transactions in Covered Agency Securities, especially since taking liquidating action with respect to such transactions, particularly new issue CMOs and Specified Pool Transactions, might take longer and be more complex than FINRA expects. SIFMA believes that a five-day liquidation period might be insufficient for firms to resolve disputes and to perform reconciliations. Further, triggering liquidating action might have unintended consequences for the counterparty and the market generally by leading to cross defaults and further liquidating action. A fifteen-day period would allow member firms to maintain consistent operations across positions and to avoid unnecessary liquidating action.

---

[53] SIFMA recognizes that Rule 4210(g)(10)(B) requires that a FINRA member deduct the amount of a portfolio margin deficiency from its net capital on the next business day after the business day on which such deficiency arises. That example should not be regarded as a guide for the appropriate timeframes for the current proposal. While a FINRA member can elect to apply the portfolio margin requirements set forth in Rule 4210(g) as opposed to the strategy-based margin requirements to a particular account, a FINRA member would not be able to opt out of the Proposed Amendments for any or all accounts. Further, the client base subject to the Proposed Amendments is much broader and qualitatively different from the client base subject to the portfolio margin rule. For example, unlike many non-U.S. clients that engage in Covered Agency Securities transactions, clients approved for portfolio margining are generally U.S. entities or at least have a manager operating during U.S. business hours. The issues flagged in the paragraph above are particularly relevant for the client base subject to the Proposed Amendments and generally do not apply for clients approved for portfolio margining.

C. Extensions of Time in Certain Circumstances

If FINRA does not take our recommendation that the time periods for the collection of margin on Covered Agency Securities transactions be conformed to the generally applicable time periods under Exchange Act Rule 15c3-1(c)(2)(xii) and FINRA Rule 4210(f)(6), then we recommend that FINRA create electronic codes for requesting extensions on certain grounds and create automatic extensions for requests on those grounds. Grounds for automatic extensions should include:

- The existence of a bona fide dispute over the amount of margin required; and
- The occurrence of a holiday in the counterparty locale.

D. Tolerance of Relatively Small Margin Disputes

In the absence of definitive sources of objective pricing for Covered Agency Securities, disputes between FINRA members and counterparties over the proper amount of margin calls are inevitable. In the case of relatively small bona fide disputes over the amounts reflected in margin calls, SIFMA recommends that FINRA members be permitted to refrain from taking liquidating action even when the margin deficit (based on the member's calculation) remains uncollected beyond the liquidation cut-off date. In particular, SIFMA suggests that FINRA allow members to continue to take a capital charge on such margin deficits during the pendency of a bona fide dispute based on the member's valuation instead of requiring that the member take liquidating action. SIFMA would be happy to work with FINRA to set the appropriate measure of the relative size of the dispute (*e.g.*, the difference between the member and its counterparty's mark-to-market as a proportion of security value, the difference in margin call as a proportion of current exposure, potential future exposure or the credit limit set for the counterparty) and an appropriate limit to assure that the difference which would not trigger required liquidating action is relatively small.

E. Clarifications

SIFMA would like to confirm that "business day" for purposes of counting time until a capital charge is incurred or liquidating action is required based on required margin not being posted means the member firm's clearing day.

We would also like to confirm that, even if Rule 4210 is amended as proposed, members would be permitted to agree to negotiated time periods for the satisfaction of margin calls; provided that those time periods did not exceed the time before liquidating action would be required and any required capital charges are taken. For instance, a member firm and its counterparty could agree that if a margin call is made by 10:00 a.m., the counterparty would deliver margin by the close of business on the next business day and if the margin call is not made by such time on a business day, the counterparty could deliver margin by the close of business on the second following business day. In that case, if a call is made by 10:00 a.m. based on the prior day's closing price, and the counterparty does not deliver margin until it's due on the next business day, the member firm would have a capital charge for the uncollected margin on the day the call is made. If the call is not made until 10:15 and the counterparty does

not deliver margin until the second following business day, the member firm would have a capital charge for the uncollected margin on the day the call is made and on the following day. Any member firm making such an agreement should, of course, analyze the effect on its capital and liquidity. This approach would be consistent with many existing client agreements and, therefore, would reduce the burden of member firms having to renegotiate existing client agreements.

V. De Minimis Transfer Amount

Under the Proposed Amendments, any margin that a member firm is required to collect with respect to bilateral transactions in Covered Agency Securities with a single counterparty need not be collected if the aggregate uncollected amount does not exceed $250,000 (the "de minimis transfer amount"), provided the member firm deducts such amount in computing net capital as provided in Exchange Act Rule 15c3-1. When the uncollected margin exceeds the de minimis transfer amount, the full amount must be collected by the member firm.

Rather than setting a specific de minimis transfer amount, SIFMA recommends that each member firm be allowed to consider its own needs and its client's needs to set a reasonable threshold below which margin would not need to be collected. Unlike a de minimis transfer amount, once the uncollected margin exceeds the threshold amount, the member firm would only be required to collect that amount exceeding the threshold. Member firms generally set credit limits with respect to their aggregate exposures to each counterparty—reflecting the entire credit risk that the counterparty may pose to the firm—rather than on a product-by-product basis. Member firms currently set thresholds for margin by considering a number of factors, including the counterparty's creditworthiness (*e.g.*, a higher threshold may be allowed for a more creditworthy counterparty), operational issues (*e.g.*, a higher threshold may be set to reduce the frequency with which margin needs to be transferred) and the use and availability of the member firm's capital and liquidity.[54] SIFMA believes that the determination of appropriate thresholds should continue to be established by member firm's credit departments, based on their evaluations of, and agreements with, counterparties. Rather than setting a hard limit, SIFMA suggests the FINRA require member firms to control these limits through a credit review process and require transactions in Covered Agency Securities to be governed by the MSFTA or other agreements with margin and default provisions. Such credit review should be incorporated into the requirement that member firms make a determination in writing of a risk limit to be applied to each counterparty.

Whether or not FINRA imposes a hard limit, SIFMA believes that member firms should not be required to take capital charges on uncollected deficiencies or marked to market losses below the threshold amount. (Or, if they are required to take a capital charge, the charge be only

[54] In accordance with general industry practice, firms may also set low, but reasonable, generic limits without regard to the specific counterparty risk based on the risk of the transactions and member firm's own capital and liquidity. SIFMA recommends that such limits be expressly permitted without an individualized credit analysis.

a portion of the uncollected amount, as is the case under the current rule.[55]) In particular, the establishment of a de minimis transfer amount with a requirement to take capital charges for the full amount of deficiencies and mark to market losses below the de minimis transfer amount would have an anti-competitive effect on smaller dealers, who are unable to absorb the capital charges as easily as larger dealers. In order to encourage the appropriate credit risk limits without penalizing smaller firms, SIFMA recommends not requiring a net capital charge on margin required below the threshold amount or the de minimis transfer amount.

VI. Concentrated Exposures

The Proposed Amendments amend current FINRA Rule 4210(e)(2)(H)(ii) (re-numbered to be FINRA Rule 4210(e)(2)(I)(ii)) so that its limits on net capital deductions for exempt accounts cover the deductions relating to bilateral transactions in Covered Agency Securities.[56] In particular, the Proposed Amendments would provide that, in the event the net capital deductions taken by a member firm as a result of deficiencies or marked to market losses incurred pursuant to certain good faith securities, highly rated foreign sovereign debt securities, and investment grade debt securities or bilateral transactions in Covered Agency Securities, exceed for any one account or group of commonly controlled accounts, 5% of the member firm's tentative net capital (as defined in Exchange Act Rule 15c3-1) or for all accounts combined, 25% of the member's tentative net capital (as defined in Exchange Act Rule 15c3-1) and such excess continues to exist on the fifth business day after it was incurred, the member firm shall give prompt written notice to FINRA and shall not enter into any new transactions that would result in an increase in the amount of such excess.

Given that FINRA is adding to the types of transactions for which deficiencies would contribute to the limits on net capital deductions, SIFMA recommends that FINRA raise the limit to 10% of tentative net capital for any one account or group of commonly controlled accounts, while maintaining the limit of 25% of tentative net capital for all accounts combined. As the limits were created before the addition of net capital deductions resulting from deficiencies and marked to market losses relating to bilateral transactions in Covered Agency Securities and such net capital deductions will likely increase the amount of net capital deductions for member firms engaged in this business, SIFMA believes that the limit for any one account or group of commonly controlled accounts should be raised.

---

[55] If FINRA requires the charge to be only a portion of the uncollected deficiency or marked to market loss below the threshold amount, SIFMA suggests that such percentage be uniform across exempt and non-exempt accounts for operational ease. The percentage should take into account the remaining time to settlement (for example, a 10% charge for uncollected margin below the threshold on transactions in Covered Agency Securities maturing in 120 days, a 25% charge for uncollected margin below the threshold on those settling 121 days to 1.5 years, and a 100% charge for uncollected margin below the threshold for those settling over 1.5 years).

[56] We believe (e)(2)(H) was inadvertently omitted from proposed (e)(2)(I)(i) and (ii). We think that the addition of (e)(2)(H) after (e)(2)(G) in the last clause of proposed (e)(2)(I) would only make sense if the same addition is made in two other places as well.

VII. Further Clarifications

A. Setoff of Profits and Losses

Proposed Rule 4210(e)(2)(H)(ii)(g) provides that unrealized profits in one Covered Agency Security position may offset losses from other Covered Agency Security positions of the same counterparty account and the amount of net unrealized profits may be used to reduce margin requirements. The proposed section then says "[o]nly profits (in-the-money amounts), if any on 'long' standbys are recognized." SIFMA notes that the second sentence of proposed Rule 4210(e)(2)(H)(ii)(g) might be read to limit the entire provision to profits on long standbys, rather than clarifying that for long standbys only profits (not losses) may be factored into the setoff permitted by the first sentence. SIFMA believes the final sentence should be reworded to clarify its meaning.

B. Cured Deficiencies

Proposed Supplementary Material .03 specifies that, to the extent a deficiency is cured by subsequent market movements prior to the time the margin call must be met, the margin call need not be met and the member need not take liquidating action with respect to the position; provided, however, the deduction from net capital shall be applied on the date following the creation of the deficit. SIFMA recommends that FINRA clarify whether a member firm would be required to take a capital charge on deficiencies on the day such deficiencies are cured or whether such cure only affects the member firm on the business day following the cure.

C. Eligible Collateral

In RN 14-02, FINRA states that it believes that "all margin eligible securities, with the appropriate margin requirement, should be permitted as collateral to satisfy required margin." While SIFMA supports giving member firms the flexibility to allow any margin eligible securities as collateral for Covered Agency Securities transactions, we would like FINRA to clarify that it is making no recommendation as to what type of eligible collateral a FINRA member should accept. In particular, SIFMA believes that each member firm should make its own decision as to the types of eligible collateral that it would accept to satisfy the required margin, based on its own credit determination and operational capabilities. While certain FINRA members might accept corporate bonds and equity securities as collateral, other FINRA members might determine that limiting collateral to cash or U.S. Treasuries best serves such member's business objectives and operational capabilities.

D. Risk Limits

Proposed Rule 4210(e)(2)(H)(ii)(B) would require member firms that engage in Covered Agency Securities transactions with any counterparty to make a determination in writing of a risk limit to be applied to each such counterparty. SIFMA would like confirmation that member

firms may set limits for customers across all product lines, rather than a specific limit only for Covered Agency Securities transactions.[57]

VIII. Impact on Smaller Member Firms

SIFMA would like to stress that many of the points made in this letter are of particular concern to smaller member firms. For one thing, smaller member firms are not primary dealers and many of them have not applied the TMPG Best Practices to all their client relationships. Thus, negotiations with clients concerning margin collection with respect to Covered Agency Transactions will be new to many such firms and the costs and time required to implement the Proposed Amendments might very well be proportionally higher. Combined with the fact that smaller member firms have smaller compliance and operational staff with which to implement and comply with the Proposed Amendments, the impact of the Proposed Amendments is particularly acute with respect to such firms. Smaller firms are an important segment of the market in Covered Agency Securities, especially as regards retail investor participation in the CMO market and services to smaller banks and buy-side firms. SIFMA recommends that FINRA consider the acute effects of the Proposed Amendments on the smaller member firms.

IX. Implementation Period

In RN 14-02, FINRA seeks comment on the appropriate amount of time needed to implement the changes provided for in the Proposed Amendments. SIFMA believes that an implementation period of eighteen months after approval would be appropriate. The Proposed Amendments would require member firms and their clients to make numerous operational changes. The process to make such changes will be burdensome and costly, especially for member firms that are not primary dealers and have not applied the TMPG Best Practices to all of their client relationships. Member firms that are not already margining positions in Covered Agency Securities will face operational hurdles to beginning such margining. In addition, all member firms will have to adopt written risk policies and procedures and make written credit risk limit determinations for each counterparty pursuant to such policies and procedures. Further, member firms will have to make determinations for each counterparty about whether such counterparty is an exempt account. And even member firms that have implemented the TMPG Best Practices will have to amend a significant proportion of the MSFTAs or other agreements already in place, if the proposed amendments regarding the timing of margin collection and liquidation are adopted. In addition, many member firms will be complying with documentation and margining requirements for the first time. These burdens and costs are heightened when combined with the fact that member firms are simultaneously responding to regulatory changes in many other aspects of their business affecting their relationship and documentation with the same clients.

---

[57] As mentioned in footnote 54 above, SIFMA also recommends that FINRA confirm that member firms may continue to follow general industry practice in setting low, but reasonable, generic limits based on the risk of the transactions and member firm's own capital and liquidity, without an individualized credit analysis of the counterparty.

Moving to shortened time periods for collection of margin and liquidation would be very disruptive to current practices. Many member firms spent a significant part of the past year negotiating agreements to margin their Covered Agency Securities transactions. Part of those negotiations was negotiation of the grace periods for the provision of margin. Member firms generally took into account the standard periods in Regulation T, FINRA Rule 4210(f)(6) and Exchange Act Rule 15c3-1(c)(2)(xii), but many of those agreements would need to be renegotiated if member firms needed to collect margin on the day after the deficiency is created (which generally would mean margin must be posted on the same day as the margin call is made). The renegotiation would be very costly and time consuming.

Given the extensive and complex operational changes necessitated by the Proposed Amendments, SIFMA believes that eighteen months would be an appropriate period before implementation. SIFMA notes that the TMPG, which initially recommended six months for implementation of its Best Practices, extended that period to twelve months, and even then only for substantial completion. In fact, at the end of January 2014, primary dealers had, on average, executed margining agreements with roughly 55% of their counterparties, which covered roughly 75% of the notional amount of their Covered Agency Security transactions.[58] Given that FINRA would require complete implementation by all member firms, the number of member firms affected will be more numerous and they will vary in size and ability to make necessary operational changes, a period longer than the twelve months recommended by the TMPG is advisable.

Further, SIFMA notes that the recommendation for an eighteen month implementation period assumes that the Securities and Exchange Commission will have issued interpretations or other guidance with respect to the SEC's net capital and customer protection rules' treatment of customer (and PAB) margin collected for transactions in Covered Agency Securities. The following are just a few of the areas that would need to be clarified before firms could implement the Proposed Amendments:

- The rights of a dealer to use cash or securities received as mark-to-market or other margin on Covered Agency Securities transactions in a customer (or PAB) account (including for the delivery of margin for the dealer's related transactions with bilateral counterparties or cleared by the MBSD);
- The effects of such use on the customer (and PAB) reserve formula; and
- The manner in which a non-clearing firm exempt from Rule 15c3-3 under Rule 15c3-3(k)(2)(ii) can collect and maintain margin required by Rule 4210 (especially in circumstances where the clearing firm acts solely as settlement agent, without responsibility for the Covered Agency Securities transactions).

---

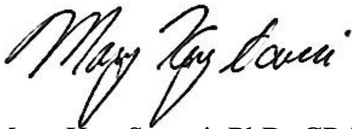
[58] Federal Reserve Bank of New York, "TMPG Meeting Minutes" (Feb. 11, 2014), *available at* http://www.newyorkfed.org/tmpg/february_minutes_2014.pdf.

To the extent that such interpretations are not issued by the time the amendments to Rule 4210 are published, SIFMA believes that a longer implementation period would be appropriate.

*   *   *

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

Sincerely,



Mary Kay Scucci, PhD, CPA
Managing Director, SIFMA
Head SIFMA Regulatory Capital and Margin
(212) 313-1331

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

March 28, 2014

Submitted via Email to pubcom@finra.org
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**") [1] 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[2] (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.

---

[1] 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.

[2] 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.[3] 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**"),[4] 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.[5]

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.[6] 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 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

---

[3] 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.

[4] 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).

[5] 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.

[6] "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/).

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.[7]

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.[8] We believe that this requirement is too heavy-handed an approach, and we suggest that FINRA align its position with that of TMPG which

---

[7] 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.").

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

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.[9] 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.

[9] 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."[10]

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 one-day settlement cycle, but this will still introduce an additional day into the margin settlement

---

[10] 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.

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."[11] 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 Notice 14-02[12] implies that this variation margin may be bilateral,[13] the text of the Proposed

---

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

[12] 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.

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."[14]

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.

*　　　　*　　　　*

---

[13] *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).

[14] 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,

Timothy W. Cameron, Esq.
Managing Director, Asset Management Group
Securities Industry and Financial Markets Association

Matthew J. Nevins, Esq.
Managing Director and Associate General Counsel, Asset Management Group
Securities Industry and Financial Markets Association