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Invested in America

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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")[1] 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

[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.

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 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.[2]

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

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[2] 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).

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.

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,[3] 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 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.[4]

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

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[3] 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.

[4] 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.

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.[5] 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 the non-failing party; it does not permit the failing party to collect margin on the failed transaction.[6]

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."

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[5] 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.

[6] 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.

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 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.[7] 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).[8] 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 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.[9]

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

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

[9] 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

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.

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:

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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.

- 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.[10] 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

[10] 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.

marked to market losses below the threshold amount. (Or, if they are required to take a capital charge, the charge be only a portion of the uncollected amount, as is the case under the current rule.[11]) 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.[12] 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

[11] 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).

[12] 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.

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.

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.[13]

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

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13 As mentioned in footnote 10 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.

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.

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.[14] 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

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

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).

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.

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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,

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