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VIA ELECTRONIC MAIL
Marcia E. Asquith
Office of the Corporate Secretary
Financial Industry Regulatory Authority
1735 K. Street, NW
Washington, DC 20006-1506

RE: FINRA Regulatory Notice 14-02: FINRA Requests Comment on Proposed Amendments to FINRA Rule 4210 for Transactions in the TBA Market

Dear Ms. Asquith:

On behalf of the FirstSouthwest Company ("FSC"), I am pleased to submit this letter in response to the Financial Industry Regulatory Authority's ("FINRA") solicitation of comments in connection with Regulatory Notice 14-02 (Notice), proposed amendments to FINRA Rule 4210 for transactions in the TBA Market (Proposed Amendments). FirstSouthwest is a middle market investment bank who for over 68 years. FirstSouthwest has dedicated expertise and experience in all areas of the capital markets including sales, trading, underwriting throughout the United States Additionally, FSC has a Correspondent Clearing Services group which provides omnibus and fully disclosed clearing services to FINRA member firms for trade execution, clearing and back office services. Services are provided to approximately 80 correspondent firms.

FSC believes that the proposed rule could significantly impact market participants, in particular, middle market dealers and that the requirement to collect maintenance margin may not be appropriate or workable in all instances as proposed by FINRA; and the multitudes of non-exempt accounts under investment advisors (IAs) bear special consideration. FSC believes FINRA is incorrect in their assumption that few retail customers participate in this market. While it may be true that many customers may not participate in the TBA market, most all specified pools, once allocated, will always end up in retail accounts. Many of our customers are community banks who will buy these for their portfolio and will buy these in advance of the pool being allocated.

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 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. In our opinion if FINRA were to consider eliminating from the requirements of the proposed rule all MBS specified pool, ARM, and CMO transactions, FINRA would still capture margining of almost 90% of daily exposure in MBS securities, without unintended disruption to the MBS specified pool, ARM, and CMO markets, including retail clients and the subaccounts of investment advisors.

Maintenance Margin Requirements:

Under the existing proposal, FINRA would require a member firm to collect maintenance margin equal to 2% of the market value of the securities subject to the transaction. First Southwest is opposed to the requirement to collect the 2% maintenance margin from non-exempt accounts. Not only is the requirement outside of Treasury Market Practice Group’s (“TMPG’s”) best practice recommendation, but it lacks regulatory precedent. In other markets, maintenance margin is required because leverage is used for speculating and trading larger quantities than would be possible if purchases had to be paid for in full upon delivery. In the TBA market as defined to include TBAs, specified pools, ARMs and CMOs, investors pay in full on settlement date when the securities are delivered. At FSC many of the MBS purchases are relatively small, often from community banks, with assets of $25 million or less. It is common that we may sell an entire class or TBA coupon of MBS and have allocations to as many as 30 banks, if all of these banks are required to put up a margin of 2%, the amount would be $100,000.00 on a $5 million trade. While the amount of margin falls below the minimum amount, the aggregate would result in a $3 million capital charge to FSC. ($100,000 x 30 banks).

In the TBA MBS markets, 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, 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. FINRA members’ who have business with investment managers will need to have their sub-account customers, permission to post margin to the FINRA member, creating further costs, reducing liquidity for these account and cause delays in trade approvals.

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. Rule 15c3-1(c)(2)(xii). Member firms are not required to take liquidation action for uncollected margin until fifteen days after the margin call (or longer if FINRA provides an extension). Rule 4210(f)(6). FSC 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 transaction liquidation as transactions in other securities unless it can be demonstrated that there are special circumstances that render Covered Agency Securities transactions more risky. 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. Thus we believe one business day period for the collection of margin is simply unrealistic in many cases. FSC would support proposing the current fifteen-day timeframe from FINRA Rule 4210(f)(6) for bilateral transactions in Covered Agency

Securities, especially since liquidation of such transactions, particularly new issue CMOs and Specified Pool Transactions, might take longer and be more complex than FINRA expects.

Concentrated Exposures:

In 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.

FSC believes the concentration limits proposed by FINRA should be reconsidered and raised. We believe that these thresholds are unattainable by most customers of member firms and will cause even further operational challenges and potentially, an unnecessary stoppage of trades, particularly for smaller firms. Supplemental Material .04 says that 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. FSC would like to confirm that this principle applies only where the investment adviser manages multiple subaccounts, and that, 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 can be made based on the status of the entire account and no information about the underlying beneficial owners needs to be obtained by the member firm

Implementation Period:

FSC believes that an implementation period of at last eighteen months after approval would be appropriate as the Proposed Amendments would require member firms and their clients to make numerous operational and costly changes. 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.

FSC would like to stress that many of the points made in the Proposed Amendments are of serious concern to smaller and middle market member firms. Middle market member firms are not "primary dealers" and have not been subject to the TMPG's Best Practices for Treasury, Agency Debt and Agency Mortgage-Backed Securities Markets (the "TMPG Best Practices"). The comprehensive change proposed will likely impair liquidity and disproportionately impact middle-market dealers in all areas of the Agency Mortgage-Backed Securities Markets. Attempting negotiations with clients concerning margin collection with respect to Covered Agency Transactions will be new to many such firms and the operational costs and time required to implement the Proposed Amendments will be proportionally higher and will potentially result in competitive disadvantages to non-TMPG member firm's business in the Agency Mortgage-Backed Securities Markets.

FSC would also like to note on behalf of the member firms we provide clearing services to that theses, 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 investment management firms. FSC respectfully requests that FINRA consider the acute effects of the Proposed Amendments on the smaller member firms.

We look forward to working with you and are available to answer any follow-up questions you may have. Thank you again for the opportunity to submit these comments.

Sincerely,

Michael J. Marz

Michael Marz
Vice Chairman