March 28, 2014

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington. D.C. 20006

VIA ELECTRONIC MAIL

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

Dear Ms. Asquith,

Vining Sparks appreciates the opportunity to submit this letter in response to FINRA's solicitation of comments in connection with Regulatory Notice 14-02, proposed amendments to FINRA Rule 4210. This letter begins with a discussion of why we believe the proposed amendments should be tempered by limiting the types of counterparties subject to variation margin requirements on Covered Agency Securities. Following this request, additional topics that FINRA requested feedback on related to the current amendments, as proposed, are covered, including questions, comments and suggestions for FINRA to consider in an effort to help make the amendments effective, operable, fair and minimally disruptive for member firms.

Exemption Request

Vining Sparks agrees with well thought through efforts to improve the safety, soundness and reputation of member firms and the securities industry as a whole and to ensure the protection of customer assets. We understand that FINRA is attempting to synch up their rules with rules recently implemented for primary dealers by the Treasury Market Practices Group. We also generally support the proposed amendments to FINRA Rule 4210 when applied to: 1) TBA trades; 2) specified pool, arm pool and CMO trades settling beyond the next good settlement date or outside of the current settlement cycle (typically no more than 35 days beyond trade date) ;

and 3) trades with non-regulated highly leveraged counterparties. However, we believe that **the proposed amendments to FINRA Rule 4210 over-reach the stated goal of settlement risk reduction in the TBA / MBS market by requiring *regulated customers* to post margin on trades that they have no history of failing to honor**. Since our firm's inception in the early 80s, and after executing well over 200,000 Covered Agency Securities trades with regional and community banks, credit unions and savings banks, **we have never had a regulated institution fail to honor a trade in any of the securities that the proposed Rule 4210 amendments would require to be margined**. Simply stated, the expansion of variation margin requirements to regulated entities is an attempt to solve a problem that we have not heard of, witnessed, or experienced.

In the Background and Discussion Section of Regulatory Notice 14-02, FINRA makes the very general statement that "Most trading of agency mortgage-backed securities (MBS) takes place in what is generally referred to by industry participants as the TBA market which is characterized by transactions with forward settlements of as long as six months past trade date." While this may be a true statement for the market overall, this is not a fair representation of the type of business conducted by regulated entities such as regional and community banks, credit unions and savings banks. Over the last 3 years, less than 4% of the Covered Agency Security trades that our firm executed with regulated entities were TBA trades. The other 96% of the trades were specified pools, arms or CMOs, almost all of which settled within the current settlement cycle. Our firm's trading history should fairly represent, within a reasonable range, that of other institutional focused regional broker dealers that serve regulated entities.

Since most trades in the MBS market are TBA trades, TBA's generally have longer settlement terms and carry greater mark to market risk than non-TBAs, and the most risky segment of the market trading TBAs are unregulated & sometimes highly leveraged customers, we believe FINRA's rule change would be far more effective and efficient if only TBAs with non-regulated entities were included in the amendment. This would encompass the vast majority of what the TMPG has forced primary dealers to margin. We understand that FINRA is attempting to synch their regulations up with the TMPG rule applicable to primary dealers, but primary dealers typically serve a different market than regional broker dealers. Most member firms do not have the same risk profile as primary dealers and FINRA needs to fully consider this when enacting rule changes.

Once again, we understand and support the need to reduce the risks associated with non-settlement of TBA trades with highly leveraged non-regulated entities, where such an event could, theoretically, create hardships for member firms that lack adequate risk controls if such a counterparty went out of business prior to the settlement of pending trades. However, regional and community banks, credit unions and savings banks typically take delivery of such securities on the next good settlement date for the type of security traded, generally within one month of the trade date. Such entities are also regulated by what the Dodd Frank Act described as "Prudential Regulators". We believe that the proposed rule change penalizes regulated entities in order to protect the overall market from non-regulated entities that are allowed to take on elevated levels of risk. **For all of the above reasons, we ask that FINRA consider exempting entities regulated by Prudential Regulators from being required to post variation margin on any specified pool, arm pool or CMO trade with settlement terms within the current settlement cycle.**

The following subsections deal with specific points that FINRA has asked member firms to provide commentary on related to the proposed amendments:

Identification of counterparties that will require a MSFTA

After FINRA implements these amendments, will FINRA **require** a FINRA member to have an executed MSFTA in place **prior to** transacting **any** Covered Agency Security trade with a customer? Will FINRA require member firms to establish a MSFTA with a new customer when opening a new account? Might FINRA implement a par size cap and/or a trade frequency cap on members with specific counterparties over which MSFTA documentation must be gathered and put in place prior to executing additional or larger trades? Guidance from FINRA on these questions will allow member firms to better plan for the resulting operational changes they will face.

Mortgage Banking customers, dealers and other customers that frequently purchase Covered Agency Securities on a regular basis are easily identifiable and members should start the MSFTA documentation process early with such counterparties in order to comply with this upcoming rule change. Of immediate concern, however, are customers that infrequently purchase Covered Agency Securities and/or that purchase small lots of Covered Agency Securities. Such counterparties can number in the many hundreds or few thousands for regional member firms. The execution of a MSFTA with each such counterparty would be extremely burdensome, costly and time-consuming and in most instances, unnecessary since such counterparties may never approach a mark to market call requirement. Often, member firms will not know whether a counterparty will need a MSFTA until a trade with such counterparty uncovers a potential need for margin, and by then it is too late to initiate the MSFTA collection process and margin transfer in time to meet the five day close out requirement that FINRA currently recommends in the proposed amendment. Will FINRA allow member firms a grace period to execute a MSFTA with the counterparty in such a situation? Will FINRA monitor and enforce the margin requirements and proposed close out requirements differently depending on the type of counterparty or based on a firm's history with such counterparty?

Since FINRA is proposing a $250,000 de minimis threshold under which margin is not required to be collected on Covered Agency Security trades, we request FINRA to consider allowing member firms to use their professional judgment when deciding whether or not to attempt to begin MSFTA documentation proceedings with specific counterparties based on the counterparties recent trading patterns. In other words, if recent trading patterns suggest that a counterparty would not be likely to trade a large position or trade frequently, we would request that the acquisition of MSFTA documentation not be required by FINRA. Also, we request that FINRA allow a grace period for acquiring a MSFTA after identification of trades on which margin may ultimately be required.

Close out requirement for non-transfer of margin after 5 days

FINRA's proposed close out requirement, while perhaps workable for clients with whom the broker-dealer has an MSFTA, is unworkable for clients with whom the broker-dealer does not have an MSFTA. Unless FINRA expects broker-dealers to have MSFTA's in place as a pre-requisite for opening an account, there are a number of legitimate situations whereby a customer account may not yet have an MSFTA. Examples include either an account that the dealer did not expect to have sufficient exposure with to warrant an MSFTA or a situation where the broker-dealer is in the process of obtaining the MSFTA from the account but the account has not yet obtained the board approvals required to execute the agreement.

A potential, but unintended result of the forced close out rule is the creation of a perverse incentive for a distressed customer to elect not to deliver margin in order to initiate close out proceedings early, protracting the recovery process for the broker-dealer. In such a situation, the broker dealer would need to implement closeout proceedings and incur legal expenses to recover losses from the customer, rather than providing the customer with the opportunity to settle the trade on the intended settlement date. While the broker-dealer would likely elect not to conduct future business with that customer, the problem created by the forced close out has the potential to create, rather than reduce, exposures.

One reasonable alternative to forced trade closeout could be an increase in the net capital charge from 100% to a higher percentage on uncollected and past due margin. This provides members with additional incentive to collect the past due margin, but does not force costly and messy legal proceedings. In addition, this would allow the member firm the flexibility to manage their credit risk on a case by case basis.

Another reasonable alternative to forced trade closeout would be to allow the member to not close out trades which have a relatively short number of days until settlement date - possibly 30 days or less. Other than TBAs, most trades in Covered Agency Securities settle within 30 days. Members would be better able to assess settlement risk on trades closer to settlement date.

The close-out decision should be a business decision concluded upon by members who are able to take into account all extenuating and relational circumstances and not driven solely by market movements and regulatory directive. Closing out trades should be the final option that members pursue against customers to remedy settlement failures. By accelerating the closeout to a point in time prior to settlement date, customers are not allowed the opportunity to deliver on the terms of the original agreement.

Covered Agency Securities Transactions by Non-FINRA members – Negative competitive consequences for FINRA member firms

Regional broker dealers that are organized as bank dealers and regulated by banking regulators will not be required to follow FINRA's margin rules as ultimately approved and implemented unless banking regulators subsequently enact similar margin collection requirements for Covered Agency Securities trades. Such bank dealers also do not submit trade data to TRACE[1].

Institutional customers prefer not to post initial or mark to market margin on Covered Agency Securities for obvious reasons. If a customer can purchase the same or similar security from either a member firm or non-member firm at a similar price, the customer will be inclined to purchase from the dealer that will not require them to execute an MSFTA or post margin. The implementation of this rule will clearly give bank dealers an advantage in selling Covered Agency Securities to institutional customers. Bank dealers should also be able to charge slightly higher prices for the added convenience of not requiring customers to post margin. These higher prices will also not be disclosed via TRACE, further limiting market transparency.

Another potential impact on FINRA members is that bank dealers, which would have the implicit advantage of allowing customers to not post margin, would be able to selectively increase trading exposures to the most credit worthy institutional customers to the detriment of their less credit worthy customers. This would move more credit-worthy customers from FINRA firms to non-FINRA firms. A gradual decline in FINRA members' market share and the credit quality of the customers which they serve would result. The unintended consequences of increasing bank dealers' customer credit quality, a decline in FINRA firm market share and a decline in FINRA firm customer credit quality should be of concern to FINRA.

One more disruptive impact to FINRA members is the business done with Non-Exempt counterparties. Why would any Non-Exempt Counterparty that is accustomed to settling transactions DVP ever trade with a FINRA member again if all FINRA members are required to collect maintenance margin and Non-FINRA dealers would not collect margin? Wouldn't all Non-Exempt Counterparties that are paying attention try move their business to bank dealers?

It would be in the best interest of FINRA member firms as a whole, and especially firms recognized as regional broker dealers, if FINRA would seriously engage bank regulators in discussions on the

[1] Omission from TRACE reporting is clearly an advantage that bank dealers have over FINRA members because price transparency on such trades is hidden from customers and the rest of the marketplace. However, since FINRA members do post their trades to TRACE, some measure of market transparency exists and bank dealers' advantages due to non-reporting is somewhat mitigated by the pricing disclosed on trades in similar bonds. Said another way, TRACE reporting helps to keep pricing by non-FINRA broker dealers near market even though their prices are not disseminated via TRACE. This self-limiting feature of TRACE has helped prevent a noticeable portion of bond business from shifting away from FINRA members to non-FINRA members as TRACE has been implemented over the past several years. No self-limiting feature will exist if bank dealers are not required to collect margin from customers.

topics of trade transparency and margin collection requirements and work in the interests of member firms to level the playing field. To believe that a more unequal playing field will not be exploited by those favored by the eventual changes to Rule 4210 is short-sighted and ultimately damaging to member firms.

Maintenance Margin / Non Exempt Accounts

The amendment to further require maintenance margin for Covered Agency Securities trades with any Non-Exempt Account, as currently proposed, over-reaches the requirement that the TMPG has enacted for primary dealers by asking customers for margin when there is potentially no material market risk and little-to-no negative equity in the trade. For member firms that do not transact any retail business, do not have any margin account customers and where the delivery and receipt of securities is almost exclusively DVP/RVP, this amendment creates a tremendous operational, record keeping and transactional burden and also adds transactional costs. For DVP member firms, the collection, tracking and processing of maintenance margin provides almost no settlement risk mitigation and will be unduly burdensome both operationally and from a relationship standpoint. Many more problems will be created than solved by implementing this part of the amendment on DVP / RVP accounts. We respectfully ask FINRA to leave the maintenance margin requirement in Rule 4210 unchanged, since the ultimate variation margin rule implemented will adequately cover exposure risks in Covered Agency Securities.

If, after considering the negative implications of the currently proposed maintenance margin rule amendment discussed above, FINRA still intends to implement maintenance margin, we ask FINRA to please consider two changes that would improve the current proposal. The first change to consider is to **only collect margin on sales to non-exempt accounts, exempting purchases from margin collection**. Forced margin collection on purchases from non-exempt accounts will alienate customers and not afford them any protection – asking a customer to pay us margin up front when they are selling us the security will not ever make sense to customers. The second change to consider is to **exempt smaller trades from maintenance margin**. Under the current proposal, a $2,000 margin call would result from a $100,000 trade - clearly collection of margin at such a small level would be a nuisance for all involved, provide immaterial risk coverage, and further add to compliance costs as discussed later. **We ask that trades under $1.5 million be exempted from the rule to materially reduce the number of such small and immaterial margin transfers**. Such a change would effectively make the minimum maintenance margin transfer amount $30,000 – still a very small relative amount.

Issues & Disruptions caused by Covered Agency Securities settlement terms migrating to T+1

In order to avoid potential margin posting requirements on Covered Agency Securities trades, most industry participants believe that settlement terms on specified pool trades will migrate from the next "good settlement date" for the specific product to T+1. The following are some issues to consider that may result from this general change in settlement terms:

Funding

Currently, dealers use the next "good settlement day" each month to settle MBS pool trades in each specific security type. Traders will buy for the next good settlement date and then during the days leading up to this good settlement date, will sell to customers for the same settlement date. The concept of good settlement date significantly lessens member firms' funding requirements, which have been negatively impacted by recent regulatory pressures. If settlement terms move to T+1, firms will need to hold more settled inventory positions to meet the needs of customer purchases and sales that require next day delivery. The increase in funding requirements will impact small to medium sized firms disproportionately as such firms typically trade small blocks of specified pools with their bank, credit union and S&L customers while larger firms are more focused on large block trades and the "true" TBA markets. Small blocks of specified pools are generally either funded by Tri-Party Repo, settlement bank loans or clearing broker loans due to the small size of each individual lot. DVP repo funding is generally limited to large block sizes. Most mid-sized dealers do not have access to the Tri-Party Repo funding market and will either increase funding with their settlement bank or be forced to reduce their participation in the MBS market or, worst case, exit the market altogether. In addition, a trend toward T+1 settlement will push dealers that utilize some sort of repo funding to shorter term or overnight repos whereas the current "good day" settlement practice permits longer term and in theory safer repos.

Liquidity and Pricing

Regional broker dealers are the primary providers of liquidity for fixed income security transactions for the 6,000 plus small to medium sized banks and savings banks and the 6,800 plus credit unions in the United States. Primary dealers typically do not move down market to serve this customer base and do not invest in a sales force with the relationships necessary to flourish in this customer footprint. If regional broker dealers are forced to limit their involvement in the MBS market due to the funding constraints as discussed above, liquidity for customers will be negatively impacted and the reduced availability of inventory will cause competitive pricing to suffer as well.

TBA Market Liquidity

If enacted, the proposal to require margin on specified pool trades beyond T+1 settlement would damage the liquidity in the mortgage TBA market as well. The proposal would certainly shift many trades in specified pools to T+1 and away from the current monthly "good settlement date" on which the majority of specified pool and TBAs settle. Doing so will materially reduce the volume of collateral available for delivery into TBA commitments that settle on the "good settlement date". The end result would be a less liquid TBA market, wider price swings, wider bid-ask spreads, and more fails. The only alternative to counteract the damage to the TBA market would be for dealers to increase their inventory of specified pools. This is not likely to happen given the deleveraging trend over the past few years and the risks and costs of carrying, hedging and funding such inventory to be held for the primary purpose of satisfying TBA commitments.

Fails

If settlement terms on specified pools generally move toward T+1, the industry should expect an increase in fails, especially in Investment Advisor accounts. Investment Advisors typically execute a trade and then follow up with the settlement account allocation details for such trade. Investment Advisors are not always able to provide settlement account allocation details on trade date and often new settlement accounts must be established by dealers to accommodate the settlement instructions provided by Investment Advisors. Specific settlement accounts protect end customers via DVP/RVP settlement. Any delays beyond trade date in communicating and processing such information will cause fails to occur that would not have occurred in a regular "good settlement date" scenario. Investment Advisors are also more likely than other accounts to move to T+1 since the proposed amendment looks through the IA to the beneficial owner of the account for payment of margin.

Post settlement factor updates

More trades settling T+1 will cause more trades to settle on "bad factors", which will increase post trade settlement money transfers in order to re-factor trades. Currently such operational and money transfer nuisances and risks are avoided by settling trades on the proper factors, generally on "good settlement date". Customer exposure to dealers will increase as factor adjustments result in payments being owed to customers. Currently, factor update payments owed to customers are treated as free credits when computing the required 15c3-3 deposit – an increase in these payables will further constrain member firm liquidity.

Custodial / Safekeeping Delays

Many types of customers pledge securities in their portfolio as collateral for various types of borrowing. When a customer sells a security which is pledged as collateral, the pledgee must notify the safekeeping or custodial agent before the pledged security can be released and ultimately delivered to the purchaser. Typically, this process will take more than one day to turn around and if all trades move to T+1, this type of operational slowdown at the Custodian will likely cause un-needed increases in fails as well. Currently it is not uncommon for a bank customer to ask for T+4 or T+5 settlement to allow time for pledge releases to occur at the safekeeping agent prior to delivery.

Proposed Margin Requirements and Rule 15c3-3

The proposed amendments to Rule 4210 will require member firms to collect both maintenance and variation margin from customers in situations where no previous requirement existed. In a future regulatory notice or other communication to FINRA members, FINRA should specifically address how they intend to treat customer funds or securities collected as maintenance and variation margin under the amended Rule 4210 for purposes of complying with Rule 15c3-3. We ask that FINRA carefully consider their interpretation to adequately protect customers, but not impair member firm liquidity.

Written Credit Approval Requirement for Counterparties trading Covered Agency Securities

What degree of documentation does FINRA expect member firms to collect and maintain when setting and monitoring counterparty credit risk limits for counterparties trading in Covered Agency Securities? Can the type of counterparty (regulated versus non-regulated) and the type of Covered Agency Security traded (long settle TBA versus regular way specified security) impact the depth and frequency of documentation required? We suggest that member firms be allowed to establish a reasonable, risk based approach to setting and monitoring their written counterparty risk limits.

Costs of complying with proposed Rule 4210 Amendments

Firms engaged in trading Covered Agency Securities will need to buy, build or lease a technology solution to compute and manage maintenance and variation margin requirements. For a regional broker, the cost of building or purchasing a system could easily reach the $150,000 to $350,000 range, possibly higher. Renting a reasonably priced 3rd party system can exceed $8,500 per month and become a permanent monthly expense. Also, one of the largest clearing banks, a TMPG member, is offering an all-in margin computation, collection and management solution for the price of $500 per month per MSFTA serviced. Regional dealers would typically need hundreds of MSFTAs serviced which, at such a price, would render such a service provider prohibitively expensive.

In addition, at least one full time employee will need to be retained to operate the system, communicate with sales reps and counterparties, monitor margin requirements, issue margin calls and, collect, pay or return margin. Another full time employee will need to be added to deal with the increased counterparty credit documentation requirements. Firms will also experience a period of outsized legal expenses during the MSFTA review and implementation phase as each Annex may be slightly different and require legal review. Additionally, firms will suffer from a lack of productivity during the MSFTA collection, review and execution process - educating customers on why this is necessary and explaining the process.

Closing

On behalf of Vining Sparks, I appreciate the opportunity to share our concerns, comments and questions on the proposed amendments to Rule 4210. We sincerely hope that FINRA will thoughtfully consider our requests and concerns as well as the concerns of other industry participants on this proposed amendment prior to finalizing it as this amendment will ultimately have significant and far-reaching impact on member firms and customers alike.

Sincerely,

Allen Riggs
Chief Financial Officer
Vining Sparks IBG, LP