



September 16, 2021

Ms. Vanessa Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-1090

Via email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

RE: File No. SR-FINRA-2021-010 (Proposed Rule Change to Amend the Requirements for Covered Agency Transactions under FINRA Rule 4210 (Margin Requirements) as Approved Pursuant to SR-FINRA-2015-036)

Dear Ms. Countryman:

This letter is submitted by the Financial Industry Regulatory Authority (“FINRA”) in further response to comments received by the Securities and Exchange Commission (“SEC” or “Commission”) on the above-referenced proposed rule change (the “Proposal”),<sup>1</sup> as modified by Partial Amendment No. 1,<sup>2</sup> which proposed to amend the requirements for Covered Agency Transactions<sup>3</sup> under FINRA Rule 4210 as approved by

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<sup>1</sup> See Securities Exchange Act Release No. 91937 (May 19, 2021), 86 FR 28161 (May 25, 2021) (Notice of Filing of Proposed Rule Change to Amend the Requirements for Covered Agency Transactions under FINRA Rule 4210 (Margin Requirements) as Approved Pursuant to SR-FINRA-2015-036; File No. SR-FINRA-2021-010).

<sup>2</sup> See Partial Amendment No. 1 to SR-FINRA-2021-010, available at: [www.finra.org](http://www.finra.org). For purposes of this letter, all references to “Partial Amendment No. 1” are to Partial Amendment No. 1 to SR-FINRA-2021-010.

<sup>3</sup> Covered Agency Transactions are defined under current FINRA Rule 4210(e)(2)(H)(i)c. to include: (1) To Be Announced (“TBA”) transactions, inclusive of adjustable rate mortgage (“ARM”) transactions; (2) Specified Pool Transactions; and (3) transactions in Collateralized Mortgage Obligations (“CMOs”), issued in conformity with a program of an agency or Government-Sponsored Enterprise (“GSE”), with forward settlement dates, as further defined more fully under paragraph (e)(2)(H)(i)c. The Proposal, as modified by Partial Amendment No. 1, would redesignate paragraph (e)(2)(H)(i)c. as paragraph (e)(2)(H)(i)b., without any change. TBAs, Specified Pool Transactions and CMOs are defined under FINRA Rules 6710(u), 6710(x) and 6710(dd), respectively. For purposes of this letter, all references to provisions under Rule 4210 are to

the SEC pursuant to SR-FINRA-2015-036. As set forth in further detail in the Proposal, as modified by Partial Amendment No. 1, the proposed rule change would amend, under FINRA Rule 4210, paragraphs (e)(2)(H), (e)(2)(I), (f)(6), and Supplementary Material .02 through .05, each as amended or established pursuant to SR-FINRA-2015-036.<sup>4</sup>

The Commission published the Proposal for public comment in the Federal Register on May 25, 2021.<sup>5</sup> The Commission received five comment letters in response to the Proposal. On August 9, 2021, FINRA filed Partial Amendment No. 1 to respond to the comments the Commission received on the Federal Register publication and, in response to the comments, to clarify certain provisions under the proposed rule language.<sup>6</sup>

On August 26, 2021, the Commission published in the Federal Register a notice and order to solicit comment from interested persons and to institute proceedings (the “Order Instituting Proceedings”) pursuant to Section 19(b)(2)(B) of the Securities Exchange Act of 1934 (“SEA”) to determine whether to approve or disapprove the Proposal, as modified by Partial Amendment No. 1.<sup>7</sup> The Commission received two comments in response to the Order Instituting Proceedings.<sup>8</sup>

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provisions as amended or established pursuant to SR-FINRA-2015-036 (for convenience, also referred as the “current rule”), except where otherwise indicated.

<sup>4</sup> For convenience, for purposes of this letter, SR-FINRA-2015-036 is referred to as the “original rulemaking.” The Commission approved the original rulemaking on June 15, 2016. See Securities Exchange Act Release No. 78081 (June 15, 2016), 81 FR 40364 (June 21, 2016) (Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval to a Proposed Rule Change to Amend FINRA Rule 4210 (Margin Requirements) to Establish Margin Requirements for the TBA Market, as Modified by Amendment Nos. 1, 2, and 3; File No. SR-FINRA- 2015-036) (the “Approval Order”).

<sup>5</sup> See supra note 1.

<sup>6</sup> See supra note 2.

<sup>7</sup> Securities Exchange Act Release No. 92713 (August 20, 2021), 86 FR 47665 (August 26, 2021) (Notice of Filing of Amendment No. 1 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change, as Modified by Amendment No. 1, to Amend the Requirements for Covered Agency Transactions under FINRA Rule 4210 (Margin Requirements) as Approved Pursuant to SR-FINRA-2015-036; File No. SR-FINRA-2021-010).

<sup>8</sup> See Letter from Thomas J. Fleming & Adrienne M. Ward, Olshan, and David H. Thompson & Harold Reeves, Cooper & Kirk, PLLC, on behalf of Bond Dealers of America, Inc. (“BDA”) and Brean Capital, LLC (“Brean Capital”), to Vanessa

FINRA is submitting this letter to respond to the comments the Commission received on the Order Instituting Proceedings. SIFMA and SIFMA AMG acknowledged FINRA's response in Partial Amendment No. 1 to their comments and requests for clarification. SIFMA and SIFMA AMG reiterated their request for an implementation period of 18 months for the proposed requirements or, in the alternative, at least one year. FINRA addresses this issue in Section D below.

BDA and Brean Capital objected that the proposed application of regulatory requirements to Covered Agency Transactions is unnecessary, arbitrary or capricious and will harm the market, impose burdens or drive out market participants, that FINRA has not responded to their concerns or has not mitigated the impact of the requirements, and that FINRA does not have authority to adopt the requirements. BDA and Brean Capital have expressed these contentions repeatedly, and FINRA has repeatedly addressed them. Many of their repeated criticisms are criticisms of the requirements that were approved pursuant to SR-FINRA-2015-036 and do not speak to the changes put forward in the Proposal, as modified by Partial Amendment No. 1. In Partial Amendment No. 1, FINRA noted that it has engaged industry participants extensively on their concerns since the process of soliciting comment on requirements for Covered Agency Transactions began in January 2014 with the publication of Regulatory Notice 14-02 and in 2015 with FINRA's original rulemaking for Covered Agency Transactions.<sup>9</sup>

As discussed in Sections A through C below, FINRA believes that BDA and Brean

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Countryman, Secretary, SEC, dated September 10, 2021 (together, "BDA and Brean Capital"); and letter from Chris Killian, Managing Director, Securitization, Corporate Credit, Libor, Securities Industry and Financial Markets Association ("SIFMA") and Asset Management Group of Securities Industry and Financial Markets Association ("SIFMA AMG"), to Secretary, SEC, dated September 10, 2021 (together, "SIFMA and SIFMA AMG"). Unless noted otherwise, all references to commenters in this letter are to commenters as listed in this note.

<sup>9</sup> See Securities Exchange Act Release No. 76148 (October 14, 2015), 80 FR 63603 (October 20, 2015) (Notice of Filing of a Proposed Rule Change to Amend FINRA Rule 4210 (Margin Requirements) to Establish Margin Requirements for the TBA Market; File No. SR-FINRA-2015-036); see also Regulatory Notice 14-02 (January 2014). Even before the publication of these materials, as discussed in SR-FINRA-2015-036, FINRA had engaged in extensive outreach and consultation with market participants and staff of the Federal Reserve Bank of New York ("FRBNY") and the SEC. See 80 FR 63603, 63604-05. In Partial Amendment No. 3 to SR-FINRA-2015-036, FINRA noted that up to that point there had been four opportunities for public comment on the original rulemaking, beginning with Regulatory Notice 14-02.

Capital have raised no material issue that has not already been addressed. Requirements for Covered Agency Transactions have been under discussion for a considerable time and have long been anticipated by market participants. As such, with this letter FINRA urges the Commission to expeditiously approve the Proposal, as modified by Partial Amendment No. 1.

A. The Rulemaking is Necessary

In Partial Amendment No. 1, as in the original rulemaking, FINRA pointed out that establishing requirements is necessary because of the risks posed by unsecured credit exposures in the Covered Agency Transaction market.<sup>10</sup> Economists pointed to the multi-trillion dollar size of the Covered Agency Transaction market and its particular importance to the US mortgage industry.<sup>11</sup> Market professionals, such as the Treasury Market Practices Group (“TMPG”), voiced concerns to the effect that exposures in a market of this sheer size could pose risks to dealers, customers and the financial marketplace.<sup>12</sup> In identifying the Covered Agency Transaction market as an area in need of regulatory attention, FINRA noted that the requirements adopted pursuant to SR-FINRA-2015-036 were informed by best practices recommendations of the TMPG, as well as by discussions with industry participants and other regulators.<sup>13</sup>

FINRA’s rulemaking has occurred within a larger context in which regulators over the years since the financial crises of 2007 and 2008 have applied margin and capital requirements to a wide variety of financial institutions and products for the purpose of protecting the stability of the financial markets. Internationally, the Basel Committee on Banking Supervision (the “Basel Committee”) has established the Basel Framework, a full

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<sup>10</sup> See, e.g., 80 FR 63603, 63615-16.

<sup>11</sup> See James Vickery & Joshua Wright, TBA Trading and Liquidity in the Agency MBS Market, Federal Reserve Bank of New York (“FRBNY”) Economic Policy Review, May 2013, available at: <<https://www.newyorkfed.org/medialibrary/media/research/epr/2013/1212vick.pdf>>; see also 80 FR 63604.

<sup>12</sup> See TMPG, Margining in Agency MBS Trading, November 2012, available at: <[https://www.newyorkfed.org/medialibrary/microsites/tmpg/files/margining\\_tmpg\\_11142012.pdf](https://www.newyorkfed.org/medialibrary/microsites/tmpg/files/margining_tmpg_11142012.pdf)>; see also 80 FR 63604. The TMPG is a group of market professionals that participate in the Covered Agency Transactions market and is sponsored by the FRBNY.

<sup>13</sup> See TMPG, Best Practices for Treasury, Agency, Debt, and Agency Mortgage-Backed Securities Markets, revised July 2019, available at: <[https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/TMPG\\_BestPractices\\_071119.pdf](https://www.newyorkfed.org/medialibrary/Microsites/tmpg/files/TMPG_BestPractices_071119.pdf)>; see also 80 FR 63605.

set of standards for member country regulators to apply to the prudential regulation of specified banks and banking activities.<sup>14</sup> In 2010, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”),<sup>15</sup> Title VII of which established among other things a framework for regulators to adopt comprehensive rules to regulate margin and capital for entities engaging in swap and security-based swap activity. US regulators have adopted rules that carry out these Dodd-Frank Act margin and capital mandates.<sup>16</sup>

FINRA notes that events in connection with market volatility and other stress stemming from the COVID-19 pandemic<sup>17</sup> have once again illustrated the importance of risk and exposure limits. The recent default of Archegos Capital Management, and related multi-billion dollar losses incurred by Credit Suisse, is yet another case in point.<sup>18</sup> These events reinforce that FINRA’s attention to unsecured exposures in the Covered Agency Transaction market, in view of its significance to the US mortgage market and financial system generally, is rationally founded. The Covered Agency Transaction market today is substantial. As of the second quarter of 2021, total average daily dollar trading volume for these types of products as reflected in FINRA Trade Reporting and Compliance Engine

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<sup>14</sup> See, e.g., background to and explanation of the Basel Framework standards as published by the Basel Committee, available at: <<https://www.bis.org/baselframework/background.htm>>.

<sup>15</sup> Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>16</sup> See, e.g., Department of the Treasury, Office of the Comptroller of the Currency, 85 FR 39754 (July 1, 2020) (Final Rule: Margin and Capital Requirements for Covered Swap Entities); Commodity Futures Trading Commission, 85 FR 57462 (September 15, 2020) (Final Rule: Capital Requirements of Swap Dealers and Major Swap Participants); and Securities Exchange Act Release No. 86175 (June 21, 2019), 84 FR 43872 (August 22, 2019) (Final Rule: Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital and Segregation Requirements for Broker-Dealers).

<sup>17</sup> See, e.g., S.P. Kothari et al., U.S. Credit Markets: Interconnectedness and the Effects of the COVID-19 Economic Shock (October 2020) (report of the SEC Division of Economic and Risk Analysis regarding market stress during the COVID-19 shock of March 2020), available at: <[https://www.sec.gov/files/US-Credit-Markets\\_COVID-19\\_Report.pdf](https://www.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf)>.

<sup>18</sup> See Credit Suisse Group Special Committee of the Board of Directors, Report on Archegos Capital Management (July 29, 2021), available at: <<https://www.credit-suisse.com/about-us-news/en/articles/media-releases/archegos-202107.html>>.

(“TRACE”) data was approximately \$300 billion.<sup>19</sup> The regulatory need for attention to this area is no less than when FINRA initiated the original rulemaking.

B. FINRA Addressed the Concerns of Industry Participants

In Partial Amendment No. 1, FINRA noted that, in finalizing the original rulemaking, it made key revisions expressly to mitigate any potential impact on smaller and mid-sized firms and on activity in the Covered Agency Transaction market.<sup>20</sup> As summarized more fully in the Proposal and Partial Amendment No. 1,<sup>21</sup> when the Commission approved the original rulemaking, FINRA stated<sup>22</sup> that it would monitor the impact of the new requirements and, if the requirements prove overly onerous or otherwise are shown to negatively impact the market, would consider revisiting such requirements as may be necessary to mitigate the rule’s impact. FINRA engaged in extensive dialogue with industry participants, as well as staff of the SEC and the Federal Reserve System, to reconsider the impact of the Covered Agency Transaction requirements, with particular attention to smaller and mid-sized firms. At the request of industry participants, FINRA has extended several times the implementation date of the requirements pursuant to the original rulemaking pending such reconsideration.<sup>23</sup>

As discussed more fully in the Proposal, members expressed concern that they faced a competitive disadvantage vis-à-vis non-FINRA member bank dealers and other

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<sup>19</sup> Trade data tables are available in the FINRA TRACE Fact Book, available at: <<https://www.finra.org/filing-reporting/trace/trace-fact-book>>.

<sup>20</sup> As summarized more fully in Partial Amendment No. 1, FINRA increased the exception for gross open positions in Covered Agency Transactions from \$2.5 million to \$10 million, created a specified exception from the maintenance margin requirement for cash investors, excepted multifamily housing securities and project loan program securities from the margin requirements, and established a \$250,000 de minimis transfer exception.

<sup>21</sup> See Proposal, *supra* note 1, at 86 FR 28161, 28162.

<sup>22</sup> See Partial Amendment No. 3 to SR-FINRA-2015-036, available at: <[www.finra.org](http://www.finra.org)>.

<sup>23</sup> FINRA has recently extended the implementation date of the margin requirements pursuant to SR-FINRA-2015-036 to January 26, 2022. See Securities Exchange Act Release No. 92897 (September 8, 2021), 86 FR 51207 (September 14, 2021) (Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Extend the Implementation Date of Certain Amendments to FINRA Rule 4210 Approved Pursuant to SR-FINRA-2015-036; File No. SR-FINRA-2021-022).

entities that are not subject to the requirements of Rule 4210.<sup>24</sup> In response, again as discussed more fully in the Proposal, FINRA's key revisions to the requirements included permitting members, subject to specified conditions, to take a capital charge in lieu of collecting margin for each counterparty's excess mark to market loss.<sup>25</sup> BDA and Brean Capital contended that permitting members to take the capital charge in lieu of collecting margin is untenable, that having requirements for Covered Agency Transactions would have the effect of causing a "chain" of fails, that firms will be driven from the market and that FINRA has not addressed critical questions as to how the requirements will work. In response, FINRA notes that these arguments are not novel and that FINRA exhaustively addressed them with industry participants throughout the course of the original rulemaking and the development of the Proposal. FINRA provided extensive further explanations in Partial Amendment No. 1.

#### C. FINRA's Authority

BDA and Brean Capital have repeatedly contended that the margin requirements for Covered Agency Transactions, as set forth pursuant to the original rulemaking and as proposed to be amended by the Proposal, are not consistent with the intent of SEA Section 7. FINRA has repeatedly addressed this contention, noting in the original rulemaking, and again in Partial Amendment No. 1, that the requirements are consistent with the provisions of SEA Section 15A(b)(6).<sup>26</sup> FINRA has noted that SEA Section 7 sets forth the parameters of the margin setting authority of the Federal Reserve Board and does not bar action by FINRA.

#### D. Implementation

SIFMA and SIFMA AMG suggested an implementation period of 18 months for the proposed requirements or, in the alternative, at least one year. As discussed in Partial Amendment No. 1, FINRA believes that an extended implementation time frame of 18 months would undermine the objectives of the Covered Agency Transaction requirements. In Partial Amendment No. 1, FINRA responded to commenters' concerns by setting an effective date for the rule change of nine to ten months from Commission approval, which is longer than the time frame FINRA had set forth in the Proposal. FINRA noted that Covered Agency Transactions have been under discussion for a considerable time, both prior to and since the Commission approved the original rulemaking, and that this subject matter is well understood by members and industry participants. The public interest would not be served by continuing delay. FINRA believes that, if the Commission approves the

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<sup>24</sup> See Proposal, supra note 1, at 86 FR 28161, 28162.

<sup>25</sup> See Proposal, supra note 1, at 86 FR 28161, 28162-63.

<sup>26</sup> See Approval Order, supra note 4, at 81 FR 40364, 40373; see also Partial Amendment No. 1.

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Proposal, as modified by Partial Amendment No. 1, the specified time frame, as set forth in Partial Amendment No. 1, is appropriate.

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FINRA believes that the foregoing responds to the material concerns raised by the commenters. If you have any questions, please contact me at 202-728- 6961, email: adam.arkel@finra.org.

Sincerely,

/s/ Adam Arkel

Adam Arkel  
Associate General Counsel  
Office of General Counsel