

Following is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

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4000. FINANCIAL AND OPERATIONAL RULES

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4210. Margin Requirements

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(e) Exceptions to Rule

The foregoing requirements of this Rule are subject to the following exceptions:

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(2) Exempted Securities, Non-equity Securities and Baskets

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(F) Transactions with Exempt Accounts Involving Certain

“Good Faith” Securities

Other than Covered Agency Securities as defined in paragraph (e)(2)(H) of this Rule, [O]n any “long” or “short” position resulting from a transaction involving exempted securities, mortgage related securities, or major foreign sovereign debt securities made for or with an “exempt account,” no margin need be required and any marked to the market loss on such position need not be collected. However, the amount of any uncollected marked to the market loss shall be deducted in computing the member’s net capital as provided in SEA Rule 15c3-1 [and, if applicable, Rule 4110(a),] subject to the limits provided in paragraph (e)(2)([H]) [below] of this Rule.

(G) Transactions With Exempt Accounts Involving Highly Rated Foreign Sovereign Debt Securities and Investment Grade Debt Securities

On any “long” or “short” position resulting from a transaction made for or with an “exempt account” (other than a position subject to paragraph (e)(2)(F or H) of this Rule), the margin to be maintained on highly rated foreign sovereign debt and investment grade debt securities shall be, in lieu of any greater requirements imposed under this Rule, (i) 0.5 percent of current market value in the case of highly rated foreign sovereign debt securities, and (ii) 3 percent of current market value in the case of all other investment grade debt securities. The member need not collect any such margin, provided the amount equal to the margin required shall be deducted in computing the member’s net capital as provided in SEA Rule 15c3-1 and[, if applicable, Rule 4110(a),] subject to the limits provided in paragraph (e)(2)([H]I) [below] of this Rule.

(H) Covered Agency Securities

(i) Definitions

a. For purposes of this Rule, Covered Agency

Securities include:

1. To Be Announced (“TBA”) transactions, as defined in Rule 6710(u), for which the difference between the trade date and contractual settlement

date is greater than one business day, inclusive of adjustable rate mortgage (ARM) transactions;

2. Specified Pool Transactions, as defined in Rule 6710(x), for which the difference between the trade date and contractual settlement date is greater than one business day;

3. transactions in Collateralized Mortgage Obligations (“CMOs”), as defined in Rule 6710(dd),¹ issued in conformity with a program of an Agency, as defined in Rule 6710(k), or a Government Sponsored Enterprise, as defined in Rule 6710(n), for which the difference between the trade date and contractual settlement date is greater than three business days.

b. A “mortgage banker” is an entity, however organized, that engages in the business of providing real estate financing collateralized by liens on such real estate.

c. A “counterparty” is any person that enters into a Covered Agency Security transaction with a member and

¹ FINRA has filed paragraph (dd) of Rule 6710 for approval by the SEC. See Securities Exchange Act Release No. 70906 (November 20, 2013), 78 FR 70602 (November 26, 2013) (Notice of Filing of Proposed Rule Change; File No. SR-FINRA-2013-046).

includes a “customer” as defined in paragraph (a)(3) of this Rule.

d. “Bilateral transaction” shall mean a transaction that is not cleared through a registered clearing agency.

e. “Standby” means contracts that are put options that trade over-the-counter, with initial and final confirmation procedures similar to those on forward transactions.

(ii) Transactions in Covered Agency Securities

a. All cash and margin transactions in Covered Agency Securities with any counterparty, other than a central bank, are subject to the provisions of paragraph (e)(2)(H) of this Rule.

b. Members that engage in Covered Agency Security transactions with any counterparty shall make a determination in writing of a risk limit to be applied to each such counterparty. The risk limit determination shall be made by a credit risk officer or credit risk committee in accordance with the member’s written risk policies and procedures.

c. Transactions cleared through a registered clearing agency, as defined in paragraph (f)(2)(A)(xxviii) of this Rule, and subject to the margin requirements of that

clearing agency shall not be subject to the margin requirements specified in paragraph (e)(2)(H) of this Rule.

d. Transactions with Exempt Counterparties: On any long or short position resulting from a bilateral transaction in a Covered Agency Security with a counterparty that is an “exempt account” as defined under paragraph (a)(13) of this Rule, no maintenance margin shall be required. However, such transactions shall be marked to the market daily and the member shall collect any loss resulting from such marking to market (mark to market loss). The amount of any uncollected mark to market loss shall be deducted in computing the member’s net capital as provided in SEA Rule 15c3-1. This deduction shall be applied at the close of business following the business day the mark to market loss was created. If such mark to market loss is not satisfied within five business days from the date the loss was created, the member shall promptly take liquidating action, unless FINRA grants the member an extension of time. (See Supplementary Material .03 of this Rule.) Members may treat mortgage bankers that use Covered Agency Securities to hedge their pipeline of mortgage commitments as exempt accounts for purposes of

paragraph (e)(2)(H) of this Rule. (See Supplementary Material .02 of this Rule.)

e. Transactions with Non-Exempt Accounts: On any long or short position resulting from a bilateral transaction in a Covered Agency Security with a counterparty that is not an “exempt account” as defined under paragraph (a)(13) of this Rule, maintenance margin equal to 2% of the market value of the securities subject to the transaction shall be required. In addition, the member shall collect any mark to market loss to the counterparty on such position. The deficiency, which is represented by the sum of the amount of any uncollected maintenance margin and uncollected mark to market loss, shall be deducted in computing the member’s net capital as provided in SEA Rule 15c3-1 until such time as the deficiency is satisfied. This deduction shall be applied at the close of business following the business day the deficiency was created. If such deficiency is not satisfied within five business days from the date the deficiency was created, the member shall promptly take liquidating action, unless FINRA grants the member an extension of time.

f. Any aforementioned deficiency or mark to market losses with a single counterparty need not be

collected if the aggregate amount of such deficiency or mark to market loss does not exceed \$250,000 (“the de minimis transfer amount”), provided the member deducts such amount in computing net capital as provided in SEA Rule 15c3-1. The deduction shall be applied at the close of business following the business day the deficiency or mark to market loss was created. The de minimis transfer amount applies to any required maintenance margin and mark to market losses. The full amount of the sum of the required maintenance margin and any mark to market loss must be collected when such sum exceeds the de minimis transfer amount.

g. 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. Only profits (in-the-money amounts), if any, on “long” standbys are recognized.

(H) Limits on Net Capital Deductions for Exempt Accounts

(i) Members shall maintain a written risk analysis methodology for assessing the amount of credit extended to

exempt accounts pursuant to paragraphs (e)(2)(F) and (e)(2)(G) of this Rule which shall be made available to FINRA upon request.

(ii) In the event that the net capital deductions taken by a member as a result of deficiencies or marked to market losses incurred under paragraphs (e)(2)(F) and (e)(2)(G) of this Rule (exclusive of the percentage requirements established thereunder) exceed:

a. [on] for any one account or group of commonly controlled accounts, 5 percent of the member's tentative net capital (as such term is defined in SEA Rule 15c3-1), or

b. [on] for all accounts combined, 25 percent of the member's tentative net capital (as such term is defined in SEA Rule 15c3-1), and,

c. such excess over the member's tentative net capital as calculated in paragraphs (e)(2)(I)(ii)a or b of this Rule continues to exist[s] on the fifth business day after it was incurred,

the member shall give prompt written notice to FINRA and shall not enter into any new transaction(s) subject to the provisions of paragraphs (e)(2)(F), [or] (e)(2)(G) or (e)(2)(H) of this Rule that would result in an increase in the amount of such excess under, as applicable, [subparagraph (ii)] paragraph (e)(2)(I)(ii) of this Rule.

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••• Supplementary Material: -----

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.02 Monitoring Procedures. For purposes of paragraph (e)(2)(H)(ii)d of this Rule, members shall 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.

.03 Deficiency. For purposes of paragraph (e)(2)(H) of this Rule, 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 position need not be liquidated; provided, however, the deduction from net capital shall be applied on the date following the creation of the deficit.

.04 Determination of Exempt Account. For purposes of paragraph (e)(2)(H) of this Rule, the determination of whether an account qualifies as an exempt account shall be made based upon the beneficial ownership of the account. Sub-accounts managed by an investment adviser, whereby the beneficial owner is other than the investment adviser, shall be margined individually.

.05 Risk Limit Determination. For purposes of paragraph (e)(2)(H)(ii)b of this Rule, members of limited size and resources that do not have a credit risk officer or credit risk committee may designate an appropriately registered principal to make the risk limit determinations.

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