May 13, 2021

FINRA
1735 K Street, NW
Washington. D.C. 20006-1506

VIA ELECTRONIC MAIL

RE: Request for Comment on Proposed Amendments to FINRA Rule 4210 regarding When Issued and Other Extended Settlement Transactions (Regulatory Notice 21-11)

Vining Sparks appreciates the opportunity to submit this letter in response to FINRA's solicitation of comments in connection with Regulatory Notice 21-11 (the "Notice"). This letter covers six points:

- A suggestion to simplify When Issued / Extended Settle capital charges.
- FINRA's estimation of the additional risk that will be mitigated by the proposal.
- The need to add an exception to this proposal for New Issue US Government Agency securities.
- Placing certain customer types in a disadvantaged situation by generally discouraging extended settlements.
- The interaction between this proposal and the margin requirements for Covered Agency Securities that are effective in October of 2021.
- Consider adding granularity to the FOCUS report to accommodate upcoming rule changes.

Suggestion to simplify the proposal and save member firms time and money

Our firm reviews extended settle trades and currently takes a capital charge for the mark to market exposure on such trades and includes this capital charge in our monthly FOCUS filing. Apart from new issues, our extended settle trades are infrequent and the size of the mark to market haircuts are negligible (always well below $75,000 and usually under $10,000). However, building yet another margin computing tool (or altering the one in place for Covered Agency Securities) that would systematically identify all trades that meet the ultimate definitions proposed in the Notice and purchasing even more market prices from pricing vendors in order to comply with this proposal is expensive in both initial design and programming time and in ongoing pricing fees. As an option in lieu of computing margin/taking capital charges for extended settle trades as proposed, we suggest that

FINRA consider providing firms the option to take a fixed “extended settlement trade charge” against net capital of perhaps $100,000 (possibly more), thus preventing firms from sustaining these actual hard dollar costs both initially and on an ongoing basis. This approach would achieve the goal of penalizing a firm’s Net Capital if they chose to execute extended settle trades but relieves them of the time and expense of building and maintaining a system and purchasing prices for another compliance only tool.

FINRA’s estimation of the additional risk that will be mitigated by the proposal.

In the Notice on page 8, statistics were cited about how many member firms submitted extended settle US Treasury trades, Non-UST Government Agency trades and Corporate trades in an average month during 2020. No statistics were quoted for Municipal trades. Questions about this:

- What were the resulting mark to market exposures to the firms with these extended settle trades? Total daily average extended settlement mark to market exposure by firm would be a meaningful statistic to share to demonstrate the significance of this exposure. Disclosure of such data would allow member firms to better understand how much market risk FINRA is trying to eliminate with the proposal. FINRA should have ample access to daily CUSIP level market prices which could be used to compute and track such exposures.
- Are there any known occurrences of non-settlement of such extended settle trades? If so, were customers negatively impacted? Were dealers?
- Has any data been collected about the account type with which extended settle trades are typically transacted? Much is written in the proposal about security type and dealer accounts, DVP accounts and cash accounts, but nothing in the proposal speaks to the type of DVP account.

Add an Exception for New Issue US Government Agency Securities

We request that FINRA add an exception for New Issue Government Agencies like what has been proposed for US Treasuries and Municipals. Federal Home Loan Bank, Farmer Mac and other agency new issues typically have a first settlement that extends 3-30 days following the initial issue. The Notice does not explicitly include Agencies with the 14-day exception provided for US Treasuries, but we were told by the Bond Dealers Association margin working group that FINRA intended to include Agencies with Treasuries – we hope that the BDA’s understanding is correct. We request FINRA to explicitly confirm that Agencies are included with US Treasuries and that FINRA would consider extending the exception for New Issue Agencies to at least 30 days. Our firm currently has trades pending in 52 New Issue Agency cusips - 17 cusips settle inside of 14 days, 14 cusips settle between 15 & 20 days and 21 cusips settle between 21 & 29 days. We would be happy to share this trade level data with FINRA if requested. These extended settlement ranges are typical in this product group and a 30-day exception would be necessary to prevent undue and arbitrary margin requests or capital charges for such ordinary trades in this product group. If no exception for such new issues is granted, requiring a capital charge for such transactions would further disadvantage FINRA member firms that sell such securities as compared to non-FINRA member bank dealers.

One other concern about the lack of a new issue agency exception, or one that is for only 14 days – One side of a new issue agency transaction is often a purchase from the issuing agency. If the market moves away from the seller and advantages the purchaser, is FINRA recommending that member firms call margin from the issuing agency or take a capital charge for the negative mark to market? The agencies are unlikely to pay this margin, and they might be legally prevented from doing so. This point needs to be considered as this rule enhancement moves forward.

Disadvantaging Customer Types that often purchase trades that settle on an extended basis.

Large Public Funds Accounts often schedule the settlement of their security purchases to coincide with known funding receipts from taxes, assessments, or maturing portfolio securities. They use this information to make extended settlement purchases when they spot suitable securities at favorable prices. These transactions do not create undue or excess credit risk since these customers know exactly when funds are available. The proposal would either margin these transactions or penalize a dealer with a capital charge.

- Does FINRA want to discourage this type of trade and potentially prevent these types of customers from making effective and timely portfolio decisions?
- Does FINRA believe that these transactions are inappropriate or that they impart significant risk to the dealer or customer?
- FINRA should consider an exception from margining and or capital charges for extended transactions with institutional customer account types, especially Public Funds Accounts.

Interaction between proposed amendments in the Notice and the Covered Agency transaction margining regulations effective in October of 2021

The following section does not incorporate the proposed substantive and technical language changes to Covered Agency Transaction margining that was released in the 87-page document 6 days ago by FINRA. However, after reading the new release briefly we believe that the following questions and comments are still applicable even if the technical terms may have changed.

Covered Agency transactions have their own specific set of margin rules as referenced in the Notice. There is no discussion of how a member firm with a DVP customer that has both pending Covered Agency transactions and marginable extended settle transactions should be treated. Questions for this situation:

- Is FINRA recommending that such an account would potentially be margined twice by two different measures?
- Would the margin requirement computed for each type of trade be potentially combined or netted if exposures are in the opposite direction?
- Currently in 4210, there is a $10,000,000 total open gross trade threshold (small cash buyer threshold) under which an exception for margining Covered Agency transactions is granted.

    - Will there be a similar exception put in place for other extended settle trades in such account?
    - Will the balance of extended settle trades be added to Covered Agency transactions to compute this exception?
    - If they are added together are there plans to increase the current $10,000,000 open gross trade threshold?

- For Covered Agency Transactions, currently there is a $250,000 de-minimus threshold of exposure by account before either margin would be required or a net capital charge would be taken.

    - Will there be a de-minimus threshold established for extended settle trades?
    - Would the de-minimus level apply to the combined/netted amount of Covered Agency and Extended Settle trade types?
    - Might the de-minimus level be increased if exposure from the two types of trades are combined?

A final point about the inconsistency between the proposals for Covered Agency Transactions and other Extended Settle transactions would be that as the Notice is currently written, extended settle transactions would be margined or capital charged immediately at the first dollar of exposure, while Covered Agency Transactions have a $250,000 buffer. This means that a non-new issue Agency security settling T+5 with a $10,000 MTM on days 1-5 would have a $10,000 burden, but that an MBS TBA settling T+55 would have zero burden until the MTM exceeded $250,000. This is inconsistent and seems unreasonable.

Suggestion to promote clarity in FOCUS reporting of net capital charges in lieu of margin for both Covered Agency Transactions and those proposed in the Notice

Currently, any Net Capital Charges in lieu of margin for Covered Agency Transactions or for the extended settle transactions as proposed in the Notice would be included in line 3610 of the FOCUS Report - "Other Deductions & Charges". This line is above the Tentative Net Capital Line. A 25% total TNC limitation for such charges in total for a firm is part of the current rule effective October 26, 2021 and added to in this proposal. Rather than using line 3610 to report these charges above TNC, which is circular since a deduction pre-TNC is being limited by a % of TNC, wouldn't it make sense to add a deduction post TNC for capital charges in lieu of margin? This would make it clear for member firms, FINRA, the SEC and other interested users of the data.

Please let me know if you would like any additional explanation or clarification of these issues or comments.

Thank you for allowing us the opportunity to share our questions and concerns.

Allen Riggs
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