

March 28, 2014

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:

Thank you for the opportunity to comment on the proposed amendment to FINRA rule 4210 for transactions in the TBA market, including CMO's, ARM's, Specified Pool's and TBAs (noted as "Covered Agency Securities").

Although we understand the rationale for addressing "systemic risk" within the market, we believe the new amendments could prove to be more problematic than the current system. The Treasury Market Practices Group (TMPG) of the Federal Reserve Bank of New York has adopted a set of best practices, and we believe the group does not have a solid appreciation of the drastic implications the amendments could create for small to middle size firms, such as Duncan-Williams, Inc. The TMPG is made up of mostly Primary Dealers or "Too Big to Fail" financial institutions (see attachment 1). TMPG's rules were not designed with middle market dealers in mind. Accordingly, TMPG's rules are an imperfect starting point for FINRA to use as the basis for considering and drafting Rule 4210. As currently drafted, the proposed rule will vastly impair the middle-market dealers in more ways than it will help prevent "systemic risk". We ask that FINRA please review our comments and questions regarding the TRACE FACT book, a summary of the rule, and the implications the rule may have on market participants.

I. Trace FACT Book

It is our understanding that the new requirements have been recommended to prevent "systemic risk". In order to evaluate how the new requirements could reduce "systemic risk" we should first review FINRA's 2013 TRACE FACT book highlighting TBA activity. Please observe Table S17 (attachment 2) of the FINRA FACT book regarding TBAs noting MBS activity of which TBAs accounted for 94% of the total activity. An average of 74 firms report TBA trades on a daily basis. The most active 50 firms reporting TBA trades account for 98.8% of the TBA activity and 99.7% of the total par value. We are convinced that the majority of these 50 firms are the 22 Primary Dealers and other large broker/dealers who specialize in these securities. The "systemic risk" that had the biggest effect on the financial systems can be traced directly to leveraged proprietary trading by the primary dealers and not to the failure to margin TBA trades.

II. Summary of Rule

After reviewing the rule, we have questions and comments regarding its contents and suggested actions.

Variation Margin

The proposed rule change provides that all members would be required to collect variation margin (mark-to-market) for trades in Covered Agency Securities when the exposure exceeds \$250,000. We agree with the imposition of variation margin, provided the margin remains in increments of \$250,000; therefore, margin calls would exist at \$250,000; \$500,000; \$750,000; etc. We have several questions and comments regarding the collection of collateral, as set forth below:

- If three days prior to settlement date and an open TBA trade increases the variation margin greater than \$250,000, does a firm have to call for margin? We feel that the initial variation margin calls should have a grace period of 10 days prior to settlement date.
- If a firm makes a margin call on day one and before the fifth day the market changes, negating the margin balance, is a firm still required to demand or pursue the first call?
- New issue CMO's should be exempt, as they settle once a month and pricing is not available until they settle.
- We also question why maintenance margin would be required on trades less than \$10,000,000 of which the bulk of these trades are executed by smaller regional dealers.
- Is a firm's margin collateral that it puts up with a non-exempt account considered to be good capital? Are non-exempt accounts considered control locations?

Credit Risk Committee

The amendment also would require members that trade in Covered Agency Transactions to establish a credit risk committee to set risk limits to be applied to each counterparty (non-FINRA member). Duncan-Williams, Inc. has established such a committee, but this requires quite an extensive review that will take valuable time out of each member's day.

Exempt Counterparties

With regard to transactions with Exempt Counterparties, maintenance margin is not required, but variation margin would be required for trades not settled through a registered clearing agency. If the variation margin is not received within 5 business days from the date of the margin call, the member is required to take liquidating action, unless FINRA grants an extension. How does FINRA plan to grant extensions and what will be the number of employee work hours and costs for a firm to ask for an extension? Currently members are permitted to only take a charge to net capital in lieu of collecting margin from exempt accounts. We question why a firm needs to liquidate a position if it is already haircutting its capital.

Non-exempt Counterparties

Transactions with non-exempt accounts that exceed the hedge necessary to cover the mortgage pipeline will require maintenance margin equal to 2% of the market value, in addition to variation margin. How are we to determine if the mortgage banker has hedged more than his pipeline? If we ask for annual reports, we will only receive these once a year and a banker's position could change the following day. This creates many obstacles that our risk committee will have to spend more time on to overcome. If margin is not received within 5 business days for a trade with a non-exempt counterparty, the member must liquidate the trade and is not able to request for an extension. By establishing a risk limit to each non-exempt counterparty and requiring only variation margin, we would relieve liquidity constraints for the mortgage banker and also balance the competitive scales between members and non-members, thus we are against requiring maintenance margin.

III. Impact on Market Participants

Margin Department

Most smaller fixed income broker/dealers are less likely to have a margin department, as the majority of their accounts are DVP or cash. Margin, operations, and compliance can very well cost more than the total margin exposure. Just the control and movement of collateral can increase costs by \$100,000+ per year.

Operations

In addition to operations support, firms will be required to hire additional personnel and purchase a reporting system to mark positions on a daily basis and track market activity. Currently, we know of five systems that are available, and the ones that are completely outsourced cost a minimum of \$50,000 a year. Any system that is cheaper requires significant employee work hours from our firm in addition to the costs of the system. Firms will also be responsible for the costs of moving collateral. We believe that between hiring additional employees, training the employees, and implementing

Liquidity Constraints

Liquidity constraints will exist as a result of posting variation margin to a counterparty without the ability to collect when the other side of the trade clears through a registered clearing agency. Non-exempt customers will also face liquidity constraints in posting margin, and not being able to post margin could limit their participation in the TBA market.

Non-FINRA Members

Non-FINRA members (non-FINRA regulated dealer banks) will gain an unfair competitive advantage as they remain exempt from any margin regulations and can trade with counterparties, exempt and non-exempt, without the burden of variation or maintenance margin. This unfair competitive advantage will obviously result in transactions processed away from FINRA member firms.

Mortgage Bankers

It is reasonable to believe that the mortgage bankers' processing costs will increase: cost of margin, movement of collateral, money wires, daily market prices for validation of marks, etc. Due to the increase in the processing costs, it is safe to say that the additional costs will be passed on to the consumer and have a negative impact on housing markets.

Collateral

FINRA states "all margin eligible securities, with the appropriate margin requirement, should be permitted as collateral to satisfy required margin". Given FINRA's apparent concern about market risk, it would be counter-intuitive to permit equity securities to be used as collateral, even at 75%, in these highly volatile markets. Most, if not all, Master Securities Forward Transaction Agreements (MSFTAs) only accept exempt securities or cash as good collateral. The standard MSFTA also states that a party can use collateral to re-hypothecate, pledge, and even enter into REPO transactions. Is FINRA going to allow firms to treat collateral received from a margin call the same way?

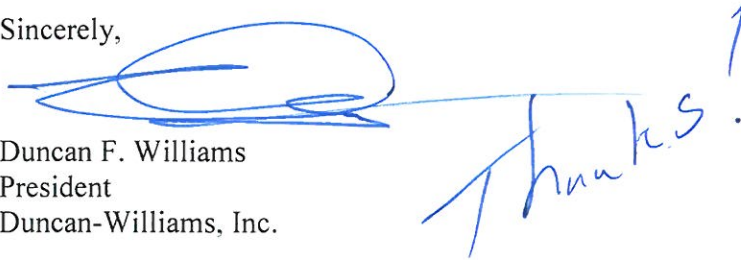
IV. Conclusion

Institutional investors will always have a large brokerage firm and Primary Dealers that will provide them with access to the MBS market. The smaller institutional investors and retail accounts do not have access to these dealers, as their volume of business may be minimal, but they rely on the small to mid-sized regional broker/dealers. Smaller brokerage firms that will be the most greatly affected by the proposed margin requirements are the firms that are motivated to provide smaller investors and the retail customers with access to information and expertise. With fewer small to mid-sized broker dealers, smaller institutional investors will have less access to motivated market professionals that are willing and able to service them. The proposed rule amendments will ultimately eliminate the ability of small to mid-sized broker/dealers to participate in the MBS market in any meaningful manner.

In conclusion, we are concerned that FINRA has proposed an amendment that will vastly impair the middle-market dealers in more ways than it will help prevent "systemic risk" at this point. We ask FINRA to reconsider many aspects of the proposal and work with the middle-market firms to gain a better understanding of how we can mitigate risks without forcing many firms out of the TBA market. As suggested by FINRA, a six to twelve month period for implementation is warranted. We look forward to working with you, and thank you again for the opportunity to submit these comments and questions.

Sincerely,

Duncan F. Williams
President
Duncan-Williams, Inc.



Thanks!