## II. Contents of Filing

To accompany its Notice, the Postal Service filed the following materials:

- Attachment 1—an application for non-public treatment of materials filed under seal;
- Attachment 2—a redacted copy of Governors' Decision No. 14–04;
- Attachment 3—a redacted copy of UPU International Bureau (IB) Circular 49, which contains the new rates;
- Attachment 4—a copy of the certification required under 39 CFR 3015.5(c)(2); and
- Attachment 5—documentation in support of inflation-linked adjustment for inward land rates.

*Id.*, Attachments 1–5.

The Postal Service also filed supporting financial workpapers, an unredacted copy of Governors' Decision 14–04, an unredacted copy of the new rates, and related financial information under seal. *Id.*

In accordance with Order Nos. 2102 [2] and 2310,[3] the Postal Service has: (1) Provided documentation supporting the inflation-linked adjustment as Attachment 5; (2) updated its advisory delivery information in a timely manner in the UPU's online compendium to justify bonus payments; (3) provided the date that the UPU advised the United States of the Inward Land Rate, and provided the calculation of the rate for the pertinent year, in the UPU IB Circular 49 as Attachment 3; (4) provided the special drawing rights (SDR) conversion rate of 1 SDR to $1.41474 U.S. dollars used for the cost coverage analysis; and (5) provided the estimated cost coverage for Inbound Parcel Post (at UPU rates) for the pertinent year. Notice at 3–4.

## III. Commission Action

The Commission establishes Docket No. CP2016–207 for consideration of matters raised by the Notice.

The Commission invites comments on whether the Postal Service's filing is consistent with 39 U.S.C. 3632, 3633, and 39 CFR part 3015. Comments are due no later than June 23, 2016. The public portions of the filing can be accessed via the Commission's Web site (*http://www.prc.gov*).

The Commission appoints Katalin K. Clendenin to serve as Public Representative in this docket.

Applicability for Inbound Parcel Post (at UPU Rates) and Application for Non-Public Treatment, June 14, 2016, at 1–2 (Notice).

[2] Docket No. CP2014–52, Order Accepting Price Changes for Inbound Air Parcel Post (at UPU Rates), June 26, 2014, at 6 (Order No. 2102).

[3] Docket No. CP2015–24, Order Accepting Changes in Rates for Inbound Parcel Post (at UPU Rates), December 29, 2014, at 4 (Order No. 2310).

## IV. Ordering Paragraphs

*It is ordered:*

1. The Commission establishes Docket No. CP2016–207 for consideration of the matters raised by the Postal Service's Notice.

2. Pursuant to 39 U.S.C. 505, Katalin K. Clendenin is appointed to serve as an officer of the Commission to represent the interests of the general public in this proceeding (Public Representative).

3. Comments are due no later than June 23, 2016.

4. The Secretary shall arrange for publication of this order in the **Federal Register**.

By the Commission.

**Stacy L. Ruble,**

*Secretary.*

[FR Doc. 2016–14564 Filed 6–20–16; 8:45 am]

**BILLING CODE 7710–FW–P**

## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–78081; File No. SR–FINRA–2015–036]**

## Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; 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

June 15, 2016.

## I. Introduction

On October 6, 2015, Financial Industry Regulatory Authority, Inc. (''FINRA'') filed with the Securities and Exchange Commission (''Commission''), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act'') [1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend FINRA Rule 4210 (Margin Requirements) to establish margin requirements for covered agency transactions, also referred to, for purposes of this proposed rule change as the To Be Announced (''TBA'') market.

The proposed rule change was published for comment in the **Federal Register** on October 20, 2015.[3] On November 10, 2015, FINRA extended the time period in which the Commission must approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change to January 15, 2016.[4] The Commission received 109 comment letters, including 50 Type A comment letters and four Type B comment letters, in response to the proposal.[5] On January 13, 2016, FINRA responded to the comments and filed Amendment No. 1 to the proposal.[6] On January 14, 2016, the Commission issued an order instituting proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act [7] to determine whether to approve or disapprove the proposed rule change, as modified by Amendment No. 1.[8] The Order Instituting Proceedings was published in the **Federal Register** on January 21, 2016.[9] The Commission received 23 comment letters in response to the Order Instituting Proceedings.[10] On March 21, 2016, FINRA responded to the comments and filed Amendment No. 2.[11] On April 11, 2016, the Commission noticed Amendment No. 2 to the proposed rule change to solicit comments from interested persons and designated a longer period for

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Exchange Act Release No. 76148 (Oct. 14, 2015), 80 FR 63603 (Oct. 20, 2015) (File No. SR–FINRA–2015–036) (''Notice'').

[4] *See* Extension No. 1, dated Nov. 10, 2015. FINRA's extension of time for Commission action, *available at http://www.finra.org/sites/default/files/rule_filing_file/SR-FINRA-2015-036-extension-1.pdf.*

[5] The public comment file for the proposed rule change is on the Commission's Web site available at *https://www.sec.gov/comments/sr-finra-2015-036/finra2015036.shtml*. The Type A and B form letters generally contain language opposing the inclusion of multifamily housing and project loan securities within the scope of the proposed rule change, as originally proposed in the Notice. *See* Notice, *supra* note 3. The Commission staff also participated in numerous meetings and conference calls with certain commenters and other market participants.

[6] *See* Amendment No. 1 to the proposed rule change, dated Jan. 13, 2016 (''Amendment No. 1''), *available at http://www.finra.org/sites/default/files/rule_filing_file/SR-FINRA-2015-036-amendment-1.pdf*. FINRA's responses to comments received on the Notice and proposed amendments in response to those comments are included in Amendment No. 1.

[7] 15 U.S.C. 78s(b)(2)(B).

[8] *See* Exchange Act Release No. 76908 (Jan. 14, 2016), 81 FR 3532 (Jan. 21, 2016) (Order Instituting Proceedings To Determine Whether To Approve or Disapprove Proposed Rule Change to Amend FINRA Rule 4210 (Margin Requirements) to Establish Margin Requirements for the TBA Market, as Modified by Partial Amendment No. 1) (''Order Instituting Proceedings'').

[9] *Id.*

[10] *See* comment file, *supra* note 5.

[11] *See* Amendment No. 2 to proposed rule change, dated Mar. 21, 2016 (''Amendment No. 2''), *available at http://www.finra.org/sites/default/files/rule_filing_file/SR-FINRA-2015-036-ammendment2.pdf*. FINRA's responses to comments received on the Order Instituting Proceedings and proposed amendments in response to those comments are included in Amendment No. 2.

Commission action on the proposal, until June 16, 2016.[12] The Commission received nine additional comment letters in response to the Amendment No. 2 Notice.[13] On May 26, 2016, FINRA responded to the comments and filed Amendment No. 3.[14] The Commission is publishing this notice and order to solicit comment on Amendment No. 3 and to approve the proposed rule change, as modified by Amendment Nos. 1, 2, and 3 on an accelerated basis.[15]

## II. Description of the Proposed Rule Change [16]

FINRA proposed amendments to FINRA Rule 4210 (Margin Requirements) to establish requirements for: (1) TBA transactions,[17] inclusive of adjustable rate mortgage (''ARM'') transactions; (2) Specified Pool Transactions; [18] and (3) transactions in collateralized mortgage obligations (''CMOs''),[19] issued in conformity with a program of an agency or Government-Sponsored Enterprise (''GSE''), with forward settlement dates, (collectively, ''Covered Agency Transactions,'' also referred to, for purposes of this order, as the ''TBA market'').

FINRA stated that most trading of agency and GSE Mortgage-Backed Security (''MBS'') takes place in the TBA market, which is characterized by transactions with forward settlements as long as several months past the trade date.[20] FINRA stated that historically, the TBA market is one of the few markets where a significant portion of activity is unmargined, thereby creating a potential risk arising from counterparty exposure. With a view to this gap between the TBA market versus other markets, FINRA took note of the TPMG recommended standards (the ''TMPG best practices'') regarding the margining of forward-settling agency MBS transactions.[21] FINRA stated that the TMPG best practices are recommendations and, as such, currently are not rule requirements. FINRA's existing margin requirements do not address the TBA market generally.

Accordingly, to establish margin requirements for Covered Agency Transactions, FINRA proposed to redesignate current paragraph (e)(2)(H) of FINRA Rule 4210 as new paragraph (e)(2)(I), to add new paragraph (e)(2)(H), to make conforming revisions to paragraphs (a)(13)(B)(i), (e)(2)(F), (e)(2)(G), (e)(2)(I), as redesignated by the rule change, and (f)(6), and to add to the rule new Supplementary Materials .02 through .05. The proposed rule change, as modified by Amendments Nos. 1 and 2, is described in further detail in sections A.-C. below. The changes proposed in Amendment No. 3 are described in section D. below.

### *A. Proposed FINRA Rule 4210(e)(2)(H) (Covered Agency Transactions)*

The key requirements of the proposed rule change are set forth in new paragraph (e)(2)(H) of FINRA Rule 4210.

#### 1. Definition of Covered Agency Transactions (Proposed FINRA Rule 4210(e)(2)(H)(i)c)

Proposed paragraph (e)(2)(H)(i)c. of the rule would define Covered Agency Transactions to mean:

- TBA transactions, as defined in FINRA Rule 6710(u), inclusive of ARM transactions, for which the difference between the trade date and contractual settlement date is greater than one business day;
- Specified Pool Transactions, as defined in FINRA Rule 6710(x), for which the difference between the trade date and contractual settlement date is greater than one business day; and
- CMOs, as defined in FINRA Rule 6710(dd), issued in conformity with a program of an agency, as defined in FINRA Rule 6710(k), or a GSE, as defined in FINRA Rule 6710(n), for which the difference between the trade date and contractual settlement date is greater than three business days.

#### 2. Other Key Definitions Established by the Proposed Rule Change (Proposed FINRA Rule 4210(e)(2)(H)(i))

In addition to Covered Agency Transactions, the proposed rule change would define the following key terms for purposes of new paragraph (e)(2)(H) of Rule 4210:

- The term ''bilateral transaction'' means a Covered Agency Transaction that is not cleared through a registered clearing agency as defined in paragraph (f)(2)(A)(xxviii) of Rule 4210;
- The term ''counterparty'' means any person that enters into a Covered Agency Transaction with a member and

[12] *See* Exchange Act Release No. 77579 (Apr. 11, 2016), 81 FR 22347 (Apr. 15, 2016) (Notice of Filing of Amendment No. 2 and Designation of a Longer Period for Commission Action on Proceedings to Determine Whether to Approve or Disapprove Proposed Rule Change to Amend FINRA Rule 4210 (Margin Requirements) to Establish Margin Requirements for the TBA Market, as Modified by Amendment Nos. 1 and 2) (''Amendment No. 2 Notice'').

[13] *See* Letters from Robert Fine, Brean Capital, LLC, dated April 27, 2016 (''Brean Capital 4 Letter''); Mortgage Bankers Association, dated May 2, 2016 (''MBA 3 Letter''); Securities Industry and Financial Markets Association, dated May 2, 2016 (''SIFMA 3 Letter''); James M. Cain, Sutherland Asbill & Brennan LLP (on behalf of the banks of the Farm Credit System), dated May 2, 2016 (''Sutherland 3 Letter''); James M. Cain, Sutherland Asbill & Brennan LLP (on behalf of the Federal Home Loan Banks, dated May 02, 2016, (''Sutherland 4 Letter''); Chris Melton, Coastal Securities, dated May 2, 2016 (''Coastal 3 Letter''); Michael Nicholas, Bond Dealers of America, dated May 2, 2016 (''BDA 3 Letter''); Manisha Kimmel, Thomson Reuters, dated May 2, 2016 (''Thompson Reuters Letter''); and Bond Dealers of America, dated May 26, 2016 (''BDA 4 Letter''). *See also supra* note 5.

[14] *See* Amendment No. 3 to proposed rule change, dated May 26, 2016 (''Amendment No. 3''), *available at http://www.finra.org/sites/default/files/rule_filing_file/SR-FINRA-2015-036-amendment-3.pdf.* FINRA's responses to comments received on the Amendment No. 2 Notice and proposed amendments in response to comments to Amendment No. 2 are included in Amendment No. 3.

[15] The text of the proposed rule change, as modified by Amendment Nos. 1, 2, and 3 (the ''Amendments'') is available at the principal office of FINRA, on FINRA's Web site at *http://www.finra.org,* and at the Commission's Public Reference Room.

[16] The proposed rule change, as modified by Amendment Nos. 1 and 2, as described in this Item II.A.–C., is excerpted, in part, from the Notice and Amendment Nos. 1 and 2, which were substantially prepared by FINRA, and the Order Instituting Proceedings and Amendment No. 2 Notice. *See supra* notes 3, 8, and 12. *See also supra* notes 6 and 11. Amendment No. 3 is described in section II.D. below.

[17] *See* FINRA Rule 6710(u) (defining TBA to mean a transaction in an Agency Pass-Through Mortgage-Backed Security (''MBS'') or a Small Business Administration (''SBA'')-Backed Asset-Backed Security (''ABS'') where the parties agree that the seller will deliver to the buyer a pool or pools of a specified face amount and meeting certain other criteria but the specific pool or pools to be delivered at settlement is not specified at the Time of Execution, and includes TBA transactions for good delivery and TBA transactions not for good delivery).

[18] FINRA Rule 6710(x) defines Specified Pool Transaction to mean a transaction in an Agency Pass-Through MBS or an SBA-Backed ABS requiring the delivery at settlement of a pool or pools that is identified by a unique pool identification number at the time of execution.

[19] FINRA Rule 6710(dd) defines CMO to mean a type of Securitized Product backed by Agency Pass-Through MBS, mortgage loans, certificates backed by project loans or construction loans, other types of MBS or assets derivative of MBS, structured in multiple classes or tranches with each class or tranche entitled to receive distributions of principal or interest according to the requirements adopted for the specific class or tranche, and includes a real estate mortgage investment conduit (''REMIC'').

[20] *See, e.g.,* 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* Commission's Staff Report, Enhancing Disclosure in the Mortgage-Backed Securities Markets, Jan. 2003, *available at https://www.sec.gov/news/studies/mortgagebacked.htm; see also* Treasury Market Practices Group (''TMPG''), Margining in Agency MBS Trading, Nov. 2012, *available at https://www.newyorkfed.org/medialibrary/microsites/tmpg/files/margining_tmpg_11142012.pdf* (the ''TMPG Report''). The TMPG is a group of market professionals that participate in the TBA market and is sponsored by the FRBNY.

[21] *See* TMPG, Best Practices for Treasury, Agency, Debt, and Agency Mortgage-Backed Securities Markets, revised Feb. 2016, *available at https://www.newyorkfed.org/medialibrary/microsites/tmpg/files/TMPG_BestPractices_2_19_16.pdf.*

includes a ''customer'' as defined in paragraph (a)(3) of Rule 4210;

- The term ''deficiency'' means the amount of any required but uncollected maintenance margin and any required but uncollected mark to market loss;
- The term ''gross open position'' means, with respect to Covered Agency Transactions, the amount of the absolute dollar value of all contracts entered into by a counterparty, in all CUSIPs; provided, however, that such amount shall be computed net of any settled position of the counterparty held at the member and deliverable under one or more of the counterparty's contracts with the member and which the counterparty intends to deliver;
- The term ''maintenance margin'' means margin equal to two percent of the contract value of the net long or net short position, by CUSIP, with the counterparty;
- The term ''mark to market loss'' means the counterparty's loss resulting from marking a Covered Agency Transaction to the market;
- The term ''mortgage banker'' means an entity, however organized, that engages in the business of providing real estate financing collateralized by liens on such real estate;
- The term ''round robin'' trade means any transaction or transactions resulting in equal and offsetting positions by one customer with two separate dealers for the purpose of eliminating a turnaround delivery obligation by the customer; and
- The term ''standby'' means contracts that are put options that trade over-the-counter (''OTC''), as defined in paragraph (f)(2)(A)(xxvii) of Rule 4210, with initial and final confirmation procedures similar to those on forward transactions.

3. Requirements for Covered Agency Transactions (Proposed FINRA Rule 4210(e)(2)(H)(ii))

The specific requirements that would apply to Covered Agency Transactions are set forth in proposed paragraph (e)(2)(H)(ii). These requirements would address the types of counterparties that are subject to the proposed rule, risk limit determinations, specified exceptions from the proposed margin requirements, transactions with exempt accounts,[22] transactions with non-exempt accounts, the handling of de minimis transfer amounts, and the treatment of standbys.

Counterparties Subject to the Rule

Paragraph (e)(2)(H)(ii)a. of the proposed rule provides that all Covered Agency Transactions with any counterparty, regardless of the type of account to which booked, are subject to the provisions of paragraph (e)(2)(H) of the rule. However, paragraph (e)(2)(H)(ii)a.1. of the proposed rule provides that with respect to Covered Agency Transactions with any counterparty that is a Federal banking agency, as defined in 12 U.S.C. 1813(z) under the Federal Deposit Insurance Act, central bank, multinational central bank, foreign sovereign, multilateral development bank, or the Bank for International Settlements, a member may elect not to apply the margin requirements specified in paragraph (e)(2)(H) provided the member makes a written risk limit determination for each such counterparty that the member shall enforce pursuant to paragraph (e)(2)(H)(ii)b., as discussed below.

Paragraph (e)(2)(H)(ii)a.2. of the proposed rule provides that a member is not required to apply the margin requirements of paragraph (e)(2)(H) of the rule with respect to Covered Agency Transactions with a counterparty in multifamily housing securities or project loan program securities, provided that: (1) Such securities are issued in conformity with a program of an Agency, as defined in FINRA Rule 6710(k), or a GSE, as defined in FINRA Rule 6710(n), and are documented as Freddie Mac K Certificates, Fannie Mae Delegated Underwriting and Servicing bonds, or Ginnie Mae Construction Loan or Project Loan Certificates, as commonly known to the trade, or are such other multifamily housing securities or project loan program securities with substantially similar characteristics, issued in conformity with a program of an Agency or a Government-Sponsored Enterprise, as FINRA may designate by Regulatory Notice or similar communication; and (2) the member makes a written risk limit determination for each such counterparty that the member shall enforce pursuant to paragraph (e)(2)(H)(ii)b. of Rule 4210.[23]

Risk Limits [24]

Paragraph (e)(2)(H)(ii)b. of the rule provides that members that engage in Covered Agency Transactions with any counterparty shall make a determination in writing of a risk limit for each such counterparty that the member shall enforce. The rule provides that the risk limit determination shall be made by a designated credit risk officer or credit risk committee in accordance with the member's written risk policies and procedures. Further, in connection with risk limit determinations, the proposed rule establishes new Supplementary Material .05. The new Supplementary Material provides that, for purposes of any risk limit determination pursuant to paragraphs (e)(2)(F), (e)(2)(G) or (e)(2)(H) of the rule:

- ○ If a member engages in transactions with advisory clients of a registered investment adviser, the member may elect to make the risk limit determination at the investment adviser level, except with respect to any account or group of commonly controlled accounts whose assets managed by that investment adviser constitute more than 10 percent of the investment adviser's regulatory assets under management as reported on the investment adviser's most recent Form ADV;
- ○ 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;
- ○ The member may base the risk limit determination on consideration of all products involved in the member's business with the counterparty, provided the member makes a daily record of the counterparty's risk limit usage; and
- ○ A member shall consider whether the margin required pursuant to the rule is adequate with respect to a particular counterparty account or all its counterparty accounts and, where appropriate, increase such requirements.

[22] The term ''exempt account'' is defined under FINRA Rule 4210(a)(13). Broadly, an exempt account means a FINRA member, non-FINRA member registered broker-dealer, account that is a ''designated account'' under FINRA Rule 4210(a)(4) (specifically, a bank as defined under Section 3(a)(6) of the Exchange Act, a savings association as defined under Section 3(b) of the Federal Deposit Insurance Act, the deposits of which are insured by the Federal Deposit Insurance Corporation, an insurance company as defined under Section 2(a)(17) of the Investment Company Act, an investment company registered with the Commission under the Investment Company Act, a state or political subdivision thereof, or a pension plan or profit sharing plan subject to the Employee Retirement Income Security Act or of an agency of the United States or of a state or political subdivision thereof), and any person that has a net worth of at least $45 million and financial assets of at least $40 million for purposes of paragraphs (e)(2)(F) and (e)(2)(G) of the rule, as set forth under paragraph (a)(13)(B)(i) of Rule 4210, and meets specified conditions as set forth under paragraph (a)(13)(B)(ii). FINRA is proposing a conforming revision to paragraph (a)(13)(B)(i) so that the phrase ''for purposes of paragraphs (e)(2)(F) and (e)(2)(G)'' would read ''for purposes of paragraphs (e)(2)(F), (e)(2)(G) and (e)(2)(H).''

[23] *See* Exhibit 4 and Exhibit 5 in Amendment No. 2. *See also supra* note 11.

[24] This section describes the proposed rule change prior to the proposed amendments to new Supplementary Material .05 in Amendment No. 3, which are described in section II.D. below.

Exceptions From the Proposed Margin Requirements: (1) Registered Clearing Agencies; (2) Gross Open Positions of $2.5 Million or Less in Aggregate [25]

Paragraph (e)(2)(H)(ii)c. provides that the margin requirements specified in paragraph (e)(2)(H) of the rule shall not apply to:

- Covered Agency Transactions that are cleared through a registered clearing agency, as defined in FINRA Rule 4210(f)(2)(A)(xxviii), and are subject to the margin requirements of that clearing agency; and
- any counterparty that has gross open positions in Covered Agency Transactions with the member amounting to $2.5 million or less in aggregate, if the original contractual settlement for all such transactions is in the month of the trade date for such transactions or in the month succeeding the trade date for such transactions and the counterparty regularly settles its Covered Agency Transactions on a Delivery Versus Payment (''DVP'') basis or for cash; provided, however, that such exception from the margin requirements shall not apply to a counterparty that, in its transactions with the member, engages in dollar rolls, as defined in FINRA Rule 6710(z), or round robin trades, or that uses other financing techniques for its Covered Agency Transactions.

Transactions With Exempt Accounts

Paragraph (e)(2)(H)(ii)d. of the proposed rule provides that, on any net long or net short position, by CUSIP, resulting from bilateral transactions with a counterparty that is an exempt account, no maintenance margin shall be required. However, the rule provides that such transactions must be marked to the market daily and the member must collect any net mark to market loss, unless otherwise provided under paragraph (e)(2)(H)(ii)f. The rule provides that if the mark to market loss is not satisfied by the close of business on the next business day after the business day on which the mark to market loss arises, the member shall be required to deduct the amount of the mark to market loss from net capital as provided in Exchange Act Rule 15c3–1 until such time the mark to market loss is satisfied. The rule requires that if such mark to market loss is not satisfied within five business days from the date the loss was created, the member must promptly liquidate positions to satisfy the mark to market loss, unless FINRA has specifically granted the member additional time. Under the rule, members may treat mortgage bankers that use Covered Agency Transactions to hedge their pipeline of mortgage commitments as exempt accounts for purposes of paragraph (e)(2)(H) of this Rule.

Transactions With Non-Exempt Accounts

Paragraph (e)(2)(H)(ii)e. of the rule provides that, on any net long or net short position, by CUSIP, resulting from bilateral transactions with a counterparty that is not an exempt account, maintenance margin, plus any net mark to market loss on such transactions, shall be required margin, and the member shall collect the deficiency, as defined in paragraph (e)(2)(H)(i)d. of the rule, unless otherwise provided under paragraph (e)(2)(H)(ii)f. of the rule. The rule provides that if the deficiency is not satisfied by the close of business on the next business day after the business day on which the deficiency arises, the member shall be required to deduct the amount of the deficiency from net capital as provided in Exchange Act Rule 15c3–1 until such time the deficiency is satisfied. Further, the rule provides that if such deficiency is not satisfied within five business days from the date the deficiency was created, the member shall promptly liquidate positions to satisfy the deficiency, unless FINRA has specifically granted the member additional time.

The rule provides that no maintenance margin is required if the original contractual settlement for the Covered Agency Transaction is in the month of the trade date for such transaction or in the month succeeding the trade date for such transaction and the customer regularly settles its Covered Agency Transactions on a DVP basis or for cash; provided, however, that such exception from maintenance margin requirement shall not apply to a non-exempt account that, in its transactions with the member, engages in dollar rolls, as defined in FINRA Rule 6710(z), or round robin trades, as defined in proposed FINRA Rule 4210(e)(2)(H)(i)i., or that uses other financing techniques for its Covered Agency Transactions.

De Minimis Transfer Amounts

Paragraph (e)(2)(H)(ii)f. of the rule provides that any deficiency, as set forth in paragraph (e)(2)(H)(ii)e. of the rule, or mark to market losses, as set forth in paragraph (e)(2)(H)(ii)d. of the rule, with a single counterparty shall not give rise to any margin requirement, and as such need not be collected or charged to net capital, if the aggregate of such amounts with such counterparty does not exceed $250,000 (''the de minimis transfer amount'').

Unrealized Profits; Standbys

Paragraph (e)(2)(H)(ii)g. of the rule provides that unrealized profits in one Covered Agency Transaction position may offset losses from other Covered Agency Transaction positions in the same counterparty's account and the amount of net unrealized profits may be used to reduce margin requirements.

*B. Conforming Amendments to FINRA Rule 4210(e)(2)(F) (Transactions With Exempt Accounts Involving Certain ''Good Faith'' Securities) and FINRA Rule 4210(e)(2)(G) (Transactions With Exempt Accounts Involving Highly Rated Foreign Sovereign Debt Securities and Investment Grade Debt Securities)*

The proposed rule change makes a number of revisions to paragraphs (e)(2)(F) and (e)(2)(G) of FINRA Rule 4210: [26]

- The proposed rule change revises the opening sentence of paragraph (e)(2)(F) to clarify that the paragraph's scope does not apply to Covered Agency Transactions as defined pursuant to new paragraph (e)(2)(H). Accordingly, as amended, paragraph (e)(2)(F) states: ''Other than for Covered Agency Transactions as defined in paragraph (e)(2)(H) of this Rule . . .'' For similar reasons, the proposed rule change revises paragraph (e)(2)(G) to clarify that the paragraph's scope does not apply to a position subject to new paragraph (e)(2)(H) in addition to paragraph (e)(2)(F) as the paragraph currently states. As amended, the parenthetical in the opening sentence of the paragraph states: ''([O]ther than a position subject to paragraph (e)(2)(F) or (e)(2)(H) of this Rule).''
- Current, pre-revision paragraph (e)(2)(H)(i) provides that members must 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 the rule which shall be made available to FINRA upon request. The proposed rule change places this language in paragraphs (e)(2)(F) and (e)(2)(G) and deletes it from its current location. Accordingly, FINRA proposes to move to paragraphs (e)(2)(F) and (e)(2)(G): ''Members shall maintain a written risk analysis methodology for

[25] This section describes the proposed rule change prior to the proposed amendment to increase the $2.5 million to $10.0 million in Amendment No. 3, which is described in section II.D. below.

[26] *See supra* notes 3, 8, and 12; *see also* Exhibit 5 in Amendment No. 2, text of proposed rule change, as modified by Amendment Nos. 1 and 2.

assessing the amount of credit extended to exempt accounts pursuant to [this paragraph], which shall be made available to FINRA upon request.'' Further, FINRA proposes to add to each: ''The risk limit determination shall be made by a designated credit risk officer or credit risk committee in accordance with the member's written risk policies and procedures.''

- The proposed rule change revises the references in paragraphs (e)(2)(F) and (e)(2)(G) to the limits on net capital deductions as set forth in current paragraph (e)(2)(H) to read ''paragraph (e)(2)(I)'' in conformity with that paragraph's redesignation pursuant to the rule change.

*C. Redesignated Paragraph (e)(2)(I) (Limits on Net Capital Deductions)* [27]

Under current paragraph (e)(2)(H) of FINRA Rule 4210, in brief, a member must provide prompt written notice to FINRA and is prohibited from entering into any new transactions that could increase the member's specified credit exposure if net capital deductions taken by the member as a result of marked to the market losses incurred under paragraphs (e)(2)(F) and (e)(2)(G), over a five day business period, exceed: (1) For a single account or group of commonly controlled accounts, five percent of the member's tentative net capital (as defined in Exchange Act Rule 15c3–1); or (2) for all accounts combined, 25 percent of the member's tentative net capital (again, as defined in Exchange Act Rule 15c3–1). As discussed above, the proposed rule change redesignates current paragraph (e)(2)(H) of the rule as paragraph (e)(2)(I), deletes current paragraph (e)(2)(H)(i), and makes conforming revisions to paragraph (e)(2)(I), as redesignated, for the purpose of clarifying that the provisions of that paragraph are meant to include Covered Agency Transactions as set forth in new paragraph (e)(2)(H). In addition, the proposed rule change clarifies that de minimis transfer amounts must be included toward the five percent and 25 percent thresholds as specified in the rule, as well as amounts pursuant to the specified exception under paragraph (e)(2)(H) for gross open positions of $2.5 million or less in aggregate.

Redesignated paragraph (e)(2)(I) of the rule provides that, in the event that the net capital deductions taken by a member as a result of deficiencies or marked to the market losses incurred under paragraphs (e)(2)(F) and (e)(2)(G) of the rule (exclusive of the percentage requirements established thereunder), plus any mark to market loss as set forth under paragraph (e)(2)(H)(ii)d. of the rule and any deficiency as set forth under paragraph (e)(2)(H)(ii)e. of the rule, and inclusive of all amounts excepted from margin requirements as set forth under paragraph (e)(2)(H)(ii)c.2. of the rule or any de minimis transfer amount as set forth under paragraph (e)(2)(H)(ii)f. of the rule, exceed: [28]

- 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 Exchange Act Rule 15c3–1), or
- for all accounts combined, 25 percent of the member's tentative net capital (as such term is defined in Exchange Act Rule 15c3–1), and,
- such excess as calculated in paragraphs (e)(2)(I)(i)a. or b. of the rule continues to exist on the fifth business day after it was incurred,

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

Implementation Date [29]

FINRA proposed that the risk limit determination requirements as set forth in paragraphs (e)(2)(F), (e)(2)(G) and (e)(2)(H) of Rule 4210 and proposed Supplementary Material .05 become effective six months from the date the proposed rule change is approved by the Commission.[30] FINRA proposed that the remainder of the proposed rule change become effective 18 months from the date the proposed rule change is approved by the Commission.[31]

*D. Amendment No. 3*

In response to comments the Commission received on the Amendment No. 2 Notice,[32] FINRA filed Amendment No. 3 to propose revisions to paragraph (e)(2)(H)(ii)c.2. and Supplementary Material .05(a)(1).[33] Specifically, in Amendment No. 3, FINRA proposes to increase the specified amount for the gross open position exception from $2.5 million or less in aggregate to $10 million and amend new Supplementary Material .05(a)(1) to revise the proposed language to delete the clause that reads ''except with respect to any account or group of commonly controlled accounts whose assets managed by that investment adviser constitute more than 10 percent of the investment adviser's regulatory assets under management as reported on the investment adviser's most recent Form ADV.'' Finally, FINRA clarified which provisions related to the risk limit determinations in the proposed rule change would become effective with regard to the six month implementation timeframe after the proposed rule change is approved by the Commission.

1. Gross Open Position Exception and the $250,000 De Minimis Transfer Amount

As proposed in the Notice and modified by Amendment Nos. 1 and 2, the proposed rule would set forth an exception from the proposed margin requirements for counterparties whose gross open positions in Covered Agency Transactions with the FINRA member total $2.5 million or less in aggregate, subject to specified conditions.[34] The proposed rule also sets forth, for a single counterparty, a $250,000 de minimis transfer amount up to which margin need not be collected or charged to net capital, subject to specified conditions.

In response to the solicitation of comments on the Amendment No. 2 Notice,[35] and similar to comments received on the Notice and the Order Instituting Proceedings,[36] commenters suggested increasing the $2.5 million gross open position amount and the $250,000 de minimis transfer amount.[37] Two commenters recommended that the $2.5 million be increased to $10

[27] This section describes the proposed rule change prior to the proposed amendments in Amendment No. 3 including increasing the $2.5 million cash account exception to $10.0 million. The proposed changes in Amendment No. 3 are described in section II.D. below.

[28] *See supra* notes 3, 8, and 12; *see also* Exhibit 5 in Amendment No. 2, text of proposed rule change, as modified by Amendment Nos. 1 and 2.

[29] *See* section II.D. below for a clarification in Amendment No. 3 regarding the specific provisions related to the risk limit determinations that become effective six months after Commission approval of the proposed rule change. *See* Amendment No. 3, *supra* note 14.

[30] *See supra* notes 8 and 12.

[31] *Id.*

[32] *See supra* note 12. With the exception of the comments received on the gross open position exception, the $250,000 de minimis transfer amount, new Supplementary Material .05, and the clarification of which provisions of the proposed rule change become effective six months after Commission approval of the proposed rule change, FINRA's responses to comments received on the Amendment No. 2 Notice are discussed in section III. below.

[33] *See* Amendment No. 3, *supra* note 14.

[34] *See supra* notes 3, 8, and 12. *See also* description of proposed rule change in section II.A.-C. above.

[35] *See* Amendment No. 2 Notice, *supra* note 12.

[36] *See* discussion of comments received and FINRA's responses in the Order Instituting Proceedings and the Amendment No. 2 Notice, *supra* notes 8 and 12.

[37] *See* Brean Capital 4 Letter and Thomson Letter.

million.[38] One commenter suggested that increasing the gross open position amount to $10 million would have ''a material impact in reducing the level of automation and operations staff required to support TBA margining.'' [39] Another commenter stated that the $2.5 million threshold ''will likely serve as a barrier to entry for a large number of participants that might otherwise enter the market and add to the market's liquidity, system stability and competition,'' and suggested an increase to $10 million.[40] With respect to the $250,000 de minimis transfer amount, one commenter suggested increasing it to $500,000.[41]

In response to these comments, with respect to the amount of the proposed gross open position exception, FINRA stated it has reconsidered and proposed to increase the specified amount from $2.5 million or less to $10 million or less.[42] FINRA stated that it has ''taken note of the ongoing concerns expressed in comments and believes that increasing the amount to $10 million is consistent with the goal, as noted in the original filing, of ameliorating the rule's impact on business activity and addressing the concerns of smaller firms and customers.'' [43]

To estimate the likely impact of the proposed increase for the gross open position amount to $10 million, FINRA staff analyzed the dataset that was provided to FINRA by a major clearing broker and contained 5,201 open positions as of May 30, 2014, in 375 customer accounts from ten introducing broker-dealers.[44] FINRA stated that, in this dataset, only 66 accounts had gross open positions less than the originally proposed threshold of $2.5 million. FINRA stated, according to its analysis, increasing the gross open position exception to $10 million would include within the proposed exception an additional 150 accounts that had exposures greater than $2.5 million but less than or equal to $10 million. FINRA concluded that a greater number of smaller firms and customers would be subject to the gross open position exception for the proposed margin obligations, and, therefore, not subject to the margin requirements under the rule.[45]

Based on the sample of data available, FINRA stated that it estimated that neither the number of the accounts that would be required to post margin under the proposed rule, nor the estimated margin that would have to be posted for those accounts, would change due to the proposed increase in the gross open position amount.[46] FINRA stated this result is mainly due to the proposed $250,000 de minimis transfer amount, which already provides significant relief to customers with smaller aggregate positions. Therefore, to the extent the sample examined is representative of the activity in Covered Agency Transactions more generally, FINRA stated that it believes that the proposed change is not likely to have significant impact on the expected margin obligations of firms and customers with large gross open positions.[47] However, FINRA stated the proposed increase for the gross open position amount is expected to benefit smaller firms and customers, as the higher aggregate amount limits the costs to increasing business activity in Covered Agency Transactions without having to post margin under the proposed rule requirements for smaller firms.[48]

With respect to the $250,000 de minimis transfer amount, as FINRA noted in Amendment Nos. 1 and 2, FINRA stated that it believes that the proposed threshold is appropriate for the rule's purposes and does not propose to amend the requirement at this time.[49] However, FINRA stated that it will reconsider the requirement as appropriate when the Commission completes its rulemaking as to margin requirements for security-based swaps.[50]

2. Risk Limit Determinations

As proposed in the Notice, proposed Supplementary Material .05(a)(1) requires that, for purposes of any risk limit determination pursuant to paragraphs (e)(2)(F), (e)(2)(G), or (e)(2)(H) of Rule 4210, if a member engages in transactions with advisory clients of a registered investment adviser, the member may elect to make the risk limit determination at the investment adviser level, except with respect to any account or group of commonly controlled accounts whose assets managed by that investment adviser constitute more than 10 percent of the investment adviser's regulatory assets under management as reported on the investment adviser's most recent Form ADV.[51]

In response to the solicitation of comments on the Amendment No. 2 Notice,[52] and similar to comments received on the Order Instituting Proceedings,[53] one commenter expressed concern that FINRA members may have difficulty determining which accounts constitute more than 10 percent of an investment adviser's regulatory assets, because this ''information is frequently maintained confidentially by an investment adviser due to privacy practices and regulations.'' [54] This commenter proffered rule language to address this issue.[55]

In response to comments received, FINRA stated that it has reconsidered the proposed requirements set forth in Supplementary Material .05(a)(1) and is revising the proposed language to delete the clause that reads ''except with respect to any account or group of commonly controlled accounts whose assets managed by that investment adviser constitute more than 10 percent of the investment adviser's regulatory assets under management as reported on the investment adviser's most recent Form ADV.'' [56] As such, for purposes of any risk limit determination pursuant to paragraphs (e)(2)(F), (e)(2)(G) or (e)(2)(H) of Rule 4210, the proposed requirement under Supplementary Material .05(a)(1) as revised would read: ''If a member engages in transactions with advisory clients of a registered investment adviser, the member may elect to make the risk limit determination at the investment adviser level; . . .'' [57] FINRA stated that it is mindful of the concerns its members have expressed as to potential burdens under the rule, and believes the revision is appropriate. However, FINRA noted that it expects

[38] *Id.*

[39] *See* Thomson Letter.

[40] *See* Brean Capital 4 Letter.

[41] *See* Thomson Letter.

[42] *See* proposed paragraph (e)(2)(H)(ii)c.2. in Exhibit 4 in Amendment No. 3.

[43] *See* Amendment No. 3, *supra* note 14. *See also* Notice, *supra* note 3.

[44] *See* Amendment No. 3, *supra* note 14. FINRA made use of this dataset in the original filing. *See* Notice, *supra* note 3. The dataset provides account-level information.

[45] *See* Amendment No. 3, *supra* note 14.

[46] *Id.*

[47] *Id.*

[48] *See* Amendment No. 3, *supra* note 14. In other words, the increase of the gross open position amount from $2.5 million to $10.0 million may reduce costs for smaller counterparties, as well as potentially reduce compliance costs for smaller firms, without significantly impacting the overall amount of margin expected to be posted under the proposed rule by counterparties with large gross open positions.

[49] *See supra* notes 8 and 12. *See also* Notice, *supra* note 3.

[50] *See Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers; Proposed Rule,* Exchange Act Release No. 68071 (Oct. 18, 2012), 77 FR 70214 (Nov. 23, 2012).

[51] *See* Notice, *supra* note 3. *See also* description of proposed rule change in section II.A.–C. above.

[52] *See* Amendment No. 2 Notice, *supra* note 12.

[53] *See* Order Instituting Proceedings, *supra* note 8.

[54] *See* Brean Capital 4 Letter.

[55] *Id.*

[56] *See* Amendment No. 3, *supra* note 14.

[57] *See* Exhibit 4 in Amendment No. 3.

members to be mindful of their obligations as to making and enforcing risk limits under the rule. In making risk limit determinations as to advisory accounts, FINRA stated that it expects members to exercise appropriate diligence in understanding the extent of their risk and to craft their risk limit determinations accordingly.[58]

FINRA stated that it does not have data to assess the number of accounts, investment advisers or firms that might be impacted by this amendment. FINRA also stated that it anticipates that this change to the proposed rule will reduce the regulatory burden since it reduces the regulatory compliance costs associated with making the required risk limit determinations. FINRA further stated that the change does create the potential for firms to accept higher risk limits than they otherwise would, given that FINRA proposes to delete the 10 percent threshold. However, FINRA believes this additional risk is mitigated by the firms' obligations to make and enforce appropriate risk limits as described in section II.A.3. above.[59]

3. Implementation Period

In response to solicitation of comments on the Amendment No. 2 Notice,[60] and similar to comments received on the Notice and the Order Instituting Proceedings,[61] one commenter stated that a 24-month implementation period for the proposed rule should be permitted so as to permit ''adequate interpretative guidance that is likely to impact system requirements.''[62] This commenter also believed a 24-month period would be needed to implement the rule because of other significant regulatory initiatives, such as the T+2 migration and the new conflict of interest rule promulgated by the Department of Labor.[63]

In response to this comment, FINRA stated that it is mindful of the implementation challenges posed by various regulatory initiatives.[64] However, FINRA stated that it continues to believe that the rule change should become effective 18 months from the date the proposed rule change is approved by the Commission, except that the risk limit determination requirements as set forth in paragraphs (e)(2)(F), (e)(2)(G) and (e)(2)(H) of Rule 4210 and proposed Supplementary Material .05 would become effective six months from the date the proposed rule change is approved by the Commission.[65] FINRA also noted the rule change has been under consideration in the public domain for a period of more than two years. FINRA stated that it does not believe it would serve the public interest to extend the rule's implementation beyond 18 months once approved by the Commission.[66]

## III. Summary of Comments Received on the Amendment No. 2 Notice and FINRA's Responses

As noted above, the Commission received 109 comment letters, including 50 Type A letters and four Type B letters, on the Notice; 23 comment letters on the Order Instituting Proceedings; and an additional nine comment letters on the Amendment No. 2 Notice.[67] The comments received on the Notice and FINRA's response to those comments are described in detail in the Order Instituting Proceedings.[68] The comments received on the Order Instituting Proceedings and FINRA's response to those comments are described in detail in the Amendment No. 2 Notice.[69] The nine comment letters received in response to the Amendment No. 2 Notice and FINRA's response to comments are summarized below.[70]

*A. Scope of the Proposal*

1. Multifamily and Project Loan Securities [71]

In the Notice, FINRA included multifamily and project loan securities within the scope of Covered Agency Transactions noting it intended that the scope of products to be consistent with the scope of products addressed by the TMPG best practices.[72] In response to the publication of the Notice, many commenters expressed concerns with FINRA including multifamily and project loan securities within the scope of the proposed margin requirements.[73] These commenters generally stated that the proposed rule change would impose undue burdens on participants in the multifamily housing securities market, that the multifamily housing securities market is small relative to the overall

[58] *See* Amendment No. 3, *supra* note 14.

[59] *Id.*

[60] *See* Amendment No. 2 Notice, *supra* note 12.

[61] *See* Notice, and Order Instituting Proceedings, *supra* notes 3 and 8.

[62] *See* Thomson Letter.

[63] *See* Thomson Letter.

[64] *See* Amendment No. 3, *supra* note 14.

[65] In the interest of clarity, FINRA noted that the following provisions would become effective six months after the proposed rule change is approved by the Commission: (1) under paragraph (e)(2)(F) and paragraph (e)(2)(G), each as revised by the proposed rule change, the sentences that begin ''Members shall maintain a written risk analysis methodology . . .'' and ''The risk limit determination shall be made . . .''; (2) under proposed paragraph (e)(2)(H), as set forth in the proposed rule change, proposed paragraph (e)(2)(H)(ii)b.; and (3) proposed Supplementary Material .05, as revised by Amendment No. 3. To help effectuate the application of these provisions, the proposed definitions of ''counterparty,'' as set forth in proposed paragraph (e)(2)(H)(i)b., and ''Covered Agency Transactions,'' as set forth in proposed paragraph (e)(2)(H)(i)c., would also become effective six months after the proposed rule change is approved by the Commission. To ensure clarity of cross-references within the rule, under paragraph (e)(2)(F) and paragraph (e)(2)(G), each as revised by the proposed rule change, the proposed phrase ''subject to the limits provided in paragraph (e)(2)(I) of this Rule'' in the final sentence of the first paragraph of paragraph (e)(2)(F) and paragraph (e)(2)(G) would become effective six months after the proposed rule change is approved by the Commission, as would: (1) The proposed header for new paragraph (e)(2)(H), which, as set forth in the rule change, would read ''Covered Agency Transactions''; (2) under new paragraph (e)(2)(H), as set forth in the proposed rule change, the proposed designation ''(i) Definitions'' and the proposed designation ''(ii) Margin Requirements for Covered Agency Transactions''; (3) the phrase ''For purposes of paragraph (e)(2)(H) of this Rule:'' Under proposed new paragraph (e)(2)(H)(i); and (4) the proposed redesignation of current paragraph (e)(2)(H) as new paragraph (e)(2)(I), except that the proposed revision to the header of paragraph (e)(2)(I) would become effective 18 months from the date the proposed rule change is approved by the Commission. *See* Exhibit 5 in Amendment No. 3.

[66] *See* Amendment No. 3, *supra* note 14.

[67] *See* discussion in section I. above. *See also* comment file, *supra* note 5.

[68] The topics covered by commenters in response to the Notice and in FINRA's response to those comments included: Multi-family and project loan securities; implementation time period; impact and scope of the proposal; maintenance margin; cash account exceptions; bilateral margining; $2.5 million gross open position amount and the $250,000 de minimis transfer amount; timing of margin collection and position liquidation; concentration limits; mortgage bankers; risk limit determinations; advisory clients of registered investment advisors; Federal Home Loan Banks and Farm Credit Banks and other comments. *See* Order Instituting Proceedings, *supra* note 8. *See also* Amendment No. 1, *supra* note 6.

[69] The topics covered by commenters in response to the Order Instituting Proceedings and in FINRA's response to those comments included: Multifamily and project loan securities; impact and costs of the proposal; scope of the proposal; creation of account types; maintenance margin; cash account exceptions; de minimis transfer amount; timing of margin collection and position liquidation; bilateral margining; third party custodians; exempt account treatment; third party providers; netting services; scope of FINRA's authority; and the implementation period. *See* Amendment No. 2 Notice, *supra* note 12. *See also* Amendment No. 2, *supra* note 11.

[70] *See* Amendment No. 3, *supra* note 14. Comments related to the increase in the gross open position exception to $10 million; the clarification of the treatment of the risk limit determinations for investment advisers in new Supplementary Material .05; and the clarification of specific rule language that takes effect six months after the date of Commission approval with regard to the risk limit determinations are addressed in section II.D. above.

[71] *See* Order Instituting Proceedings, *supra* note 8 and Amendment No. 2 Notice, *supra* note 12 (for a full discussion of the comments related to the proposed inclusion of multifamily housing securities within the scope of the rule, FINRA's responses to these comments, and FINRA's analysis of the impact of excluding multifamily housing securities from the scope of the rule).

[72] *See* Notice, *supra* note 3.

[73] *See* Order Instituting Proceedings, *supra* note 8.

TBA market, and that the regulatory benefits gained from any reduction of systemic risk and counterparty exposure would be outweighed by the harms caused to the market.[74] Commenters also stated that multifamily housing and project loan securities are not widely traded and often difficult to mark to the market.[75] In response to comments on the Notice, FINRA amended the proposed rule, in Amendment No. 1, to provide that the margin requirements would not apply to multifamily family housing and project loan securities, subject to the conditions described above.[76]

In response to the Order Instituting Proceedings, commenters expressed support for the proposed exception for multifamily and project loan securities as set forth in proposed paragraph (e)(2)(H)(ii)a.2. in Amendment No. 1.[77] Some commenters suggested FINRA clarify the intent of the proposed exception by changing ''a member may elect not to apply the margin requirements'' to ''a member is not required to apply the margin requirements.'' [78] Other commenters expressed concern that, because of changes in nomenclature or other future action by the agencies or GSEs, some securities that have the characteristics of multifamily and project loan securities may not be documented as Freddie Mac K Certificates, Fannie Mae Delegated Underwriting and Servicing bonds, or Ginnie Mae Construction Loan or Project Loan Certificates, and may thereby inadvertently not be included within the proposed exception.[79] In response to these comments, FINRA amended the proposed rule, as modified by Amendment No. 1, in Amendment No. 2, to revise the phrase ''a member may elect not to apply the margin requirements . . .'' in paragraph (e)(2)(H)(ii)a.2. to read ''a member is not required to apply the margin requirements . . .'' [80] In Amendment No. 2, FINRA also proposed to revise proposed paragraph (e)(2)(H)(ii)a.2.A. to add the phrase ''or are such other multifamily housing securities or project loan program securities with substantially similar characteristics, issued in conformity with a program of an Agency or a Government-Sponsored Enterprise, as FINRA may designate by Regulatory Notice or similar communication.'' [81]

The Commission received one comment on this topic in response to the solicitation of comments on the Amendment No. 2 Notice.[82] This commenter stated that it strongly supports the modifications in the Amendments as to multifamily housing securities and project loan program securities and that it appreciates FINRA's response to this issue.[83]

2. Covered Agency Transactions

Similar to comments received on the Notice and the Order Instituting Proceedings,[84] in response to the solicitation of comments on the Amendment No. 2 Notice, one commenter stated the proposal should not include Specified Pool Transactions because these products do not share the same risk as other Covered Agency Transactions.[85] This commenter stated that ''FINRA has not provided any evidence that transactions in specified pools that do not settle in one business day represent the same class of risk as TBA transactions.'' [86] Another commenter stated that the proposed definition of Covered Agency Transactions should be revised to focus on long-dated settlements and that Specified Pool Transactions should not be included within the rule's scope.[87] This commenter proffered a definition of Covered Agency Transactions.[88]

As discussed in more detail in Amendment Nos. 1 and 2, in response to these comments, FINRA stated it does not believe there is a compelling reason to revise the proposed definition and settlement scope of Covered Agency Transactions, nor except Specified Pool Transactions from the definition of Covered Agency Transactions.[89] FINRA stated that it is mindful of the concerns of commenters, and is proposing in Amendment No. 3 to increase the $2.5 million gross open position exception to $10 million, which FINRA believes should benefit smaller firms and customers.[90]

*B. General Comments on the Proposal and Its Impact*

Similar to comments received on the Notice and the Order Instituting Proceedings,[91] in response to the solicitation of comments on the Amendment No. 2 Notice, FINRA stated that commenters expressed continued opposition to the proposal on account of its potential impact.[92] One commenter stated that it believes there is a basic disagreement between FINRA and the industry as the cost and difficulties of the proposal.[93] Another commenter stated that FINRA ''has failed to address recommendations to simplify the implementation of the TBA Margining proposal in a manner consistent with its intent to address systemic concerns in the TBA market.'' [94] In a similar vein, one commenter stated that FINRA has not made any meaningful adjustments to the proposal and that it is not tailored to reduce counterparty risk without undue burdens on members and their clients.[95] In addition, this commenter stated that the proposal fundamentally differs from the TMPG best practices, requirements that apply to other fixed income products under current Rule 4210, and requirements that apply to swaps under other regulatory regimes.[96] This commenter also stated that the risk profile of Covered Agency Transactions is not greater than that of other fixed income transactions, but that Covered Agency Transactions are being treated under the proposal in a manner that is more burdensome than these other products.[97] This commenter further stated that, based on conversations with its members, FINRA's estimates of the cost of implementing the proposal are at the low end and that smaller firms will need to decide whether they can remain in business involving Covered Agency Transactions.[98] In a similar vein, another commenter stated that the proposal is anti-competitive and costly,[99] and a different commenter said that the proposal would negatively

[74] *Id.*

[75] *See* Order Instituting Proceedings, *supra* note 8.

[76] FINRA proposed in Amendment No. 1 to add to FINRA Rule 4210 new paragraph (e)(2)(H)(ii)a.2. to provide that a member may elect not to apply the margin requirements of paragraph (e)(2)(H) of the rule with respect to Covered Agency Transactions with a counterparty in multifamily housing securities or project loan program securities; *see* Exhibit 4 and Exhibit 5 in Amendment No. 1. Proposed Rule 4210(e)(2)(H)(ii)b. sets forth the proposed rule's requirements as to written risk limits. *See also* Order Instituting Proceedings, *supra* note 8.

[77] *See* Order Instituting Proceedings, and Amendment No. 2 Notice, *supra* notes 8 and 12.

[78] *Id. See also* comment file, *supra* note 5.

[79] *Id.*

[80] *See* Amendment No. 2 Notice, *supra* note 12; *see also,* Exhibit 4 and Exhibit 5 in Amendment No. 2.

[81] *Id.*

[82] *See* MBA 3 Letter.

[83] *Id.*

[84] *See supra* notes 3, 8, and 12.

[85] *See* Coastal 3 Letter.

[86] *Id.*

[87] *See* BDA 3 Letter.

[88] *Id.*

[89] *See* Amendment No. 3, *supra* note 14. *See also supra* notes 8 and 12.

[90] *See* Amendment No. 3, *supra* note 14. *See also* section II.D. above.

[91] *See supra* notes 3, 8, and 12.

[92] *See* SIFMA 3 Letter, Thomson Letter, Coastal 3 Letter, BDA 3 Letter, and Brean Capital 4 Letter.

[93] *See* SIFMA 3 Letter.

[94] *See* Thomson Letter.

[95] *See* SIFMA 3 Letter.

[96] *Id.*

[97] *Id.*

[98] *Id.*

[99] *See* Coastal 3 Letter.

impact small-to medium-sized firms.[100] This commenter stated that FINRA's estimates of the costs of implementing the rule are unfair and biased.[101] One commenter stated the proposal would drive business away from introducing firms and toward larger firms.[102] This commenter also stated that it has observed instances where larger firms are using margin to gain competitive advantage.[103]

In response to these comments, FINRA stated that it has actively sought input from the industry and other members of the public throughout the rulemaking process. In total, FINRA noted that there have been four opportunities to comment on the proposal, beginning with the comment on the proposal as originally published in *Regulatory Notice* 14–02.[104] FINRA stated that it engaged in discussions with industry participants and analyzed the potential economic impact of the proposal, including the potential costs of implementation.[105] In response to the input received from commenters, FINRA stated that it made several changes to the proposal, including the establishment of an exception for gross open positions for cash accounts, up to an aggregate specified amount, as specified by the rule,[106] and an exception, again for cash accounts as specified by the rule, from the rule's maintenance margin requirements.[107]

FINRA stated that these measures were expressly intended to address the concerns of smaller participants in the TBA market. FINRA stated that with such concerns in mind, it included the $250,000 de minimis transfer amount.[108] In arriving at this amount, FINRA stated it gave careful consideration to the needs of small firms that could otherwise potentially be at a disadvantage, if the de minimis amount were higher, vis-à-vis larger, more highly capitalized firms, while at the same time taking into account the need to reduce the risk of material credit exposure. In addition, FINRA stated that to address the rule's potential impact on mortgage bankers, the rule permits members to treat such market participants as exempt accounts, subject to specified conditions, and thereby not subject to the maintenance margin requirement.[109] FINRA further stated that to address concerns regarding the rule's potential impact on the market for multifamily housing securities and project loan program securities, FINRA revised the proposal to expressly provide that members are not required to apply the rule's margin requirements to such securities, subject to specified conditions.[110] FINRA stated that it does not believe that the commenters, in the most recent round of comment on the proposal in response to the Amendment No. 2 Notice, have raised new issues as to the rule's impact that have not been previously addressed. However, FINRA stated it is mindful of the concerns of market participants that believe smaller firms may be adversely affected by the proposal. To that end, FINRA stated that in Amendment No. 3, it proposed to increase the threshold exception from the proposed margin requirements [111] from $2.5 million to $10 million in gross open positions in Covered Agency Transactions with the member. Further, FINRA noted that, if approved by the Commission, it will monitor the proposal's impact when the new rule takes effect and, if the requirements prove overly onerous or otherwise are shown to negatively impact the market, will consider revisiting such requirements as may be necessary to mitigate the rule's impact.[112]

*C. "Cash Account" Exceptions*

As set forth more fully in the Notice,[113] and revised in this Amendment No. 3, the proposed margin requirements would not apply to any counterparty that has gross open positions [114] in Covered Agency Transactions with the FINRA member amounting to $10 million or less in aggregate, if the original contractual settlement for all such transactions is in the month of the trade date for such transactions or in the month succeeding the trade date for such transactions and the counterparty regularly settles its Covered Agency Transactions on a DVP basis or for cash. Similarly, a non-exempt account would be excepted from the rule's proposed two percent maintenance margin requirement, for any size transaction, if the original contractual settlement for the Covered Agency Transaction is in the month of the trade date for such transaction or in the month succeeding the trade date for such transaction and the customer regularly settles its Covered Agency Transactions on a DVP basis or for cash. The proposed rule uses parallel language with respect to both of these exceptions to provide that they are not available to a counterparty that, in its transactions with the member, engages in dollar rolls, as defined in FINRA Rule 6710(z),[115] or "round robin" [116] trades, or that uses other financing techniques for its Covered Agency Transactions. FINRA noted that these exceptions are intended to address the concerns relating to smaller customers engaging in a non-margined, cash account business.[117]

Similar to comments received on the Notice and the Order Instituting Proceedings,[118] in response to the Amendment No. 2 Notice, one commenter stated that it is concerned about implementing the cash account exceptions and that the proposed rule's

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[100] *See* BDA 3 Letter.

[101] *See* BDA 3 Letter.

[102] *See* Brean Capital 4 Letter.

[103] *Id.*

[104] *See* Amendment No. 3, *supra* note 14. *See also,* Regulatory Notice 14–02 (FINRA Requests Comment on Proposed Amendments to FINRA Rule 4210 for Transactions in the TBA Market) (January 2014). In the Notice, FINRA discussed comments received in response to Regulatory Notice 14–02. *See* Notice, *supra* note 3.

[105] *See* Amendment No. 3, *supra* note 14. *See also supra* notes 3, 8, and 12.

[106] *See* proposed paragraph (e)(2)(H)(ii)c.2. in Exhibit 4 and Exhibit 5 in Amendment No. 3. As discussed more fully in Amendment No. 3, in response to ongoing concerns expressed in comments about the rule's potential impact, FINRA is amending the exception from the proposed margin requirements for counterparties whose gross open positions in Covered Agency Transactions with the member amount to $2.5 million or less in aggregate, so as to increase the $2.5 million amount to $10 million. *See also* section II.D. above discussing proposed changes in Amendment No. 3.

[107] *See* Amendment No. 3, *supra* note 14. *See also* proposed paragraph (e)(2)(H)(ii)e. in Exhibit 5 in Amendment No. 3.

[108] *See* proposed paragraph (e)(2)(H)(ii)f. in Exhibit 5 in Amendment No. 3.

[109] *See* Amendment No. 3, *supra* note 14. *See also* proposed paragraph (e)(2)(H)(ii)d. and Supplementary Material .02 in Exhibit 5 in Amendment No. 3.

[110] *See* proposed paragraph (e)(2)(H)(ii)a.2. in Exhibit 5 in Amendment No. 3.

[111] In the interest of clarity, FINRA noted that the "proposed margin requirements" refers to the margin requirements as to Covered Agency Transactions as set forth in the original filing, as modified by Amendment Nos. 1, 2 and 3. Products or transactions that are outside the scope of Covered Agency Transactions are otherwise subject to the requirements of FINRA Rule 4210, as applicable.

[112] *See* Amendment No. 3, *supra* note 14.

[113] *See* Notice, *supra* note 3.

[114] Paragraph (e)(2)(H)(i)e. of the proposed rule defines "gross open position" to mean, with respect to Covered Agency Transactions, the amount of the absolute dollar value of all contracts entered into by a counterparty, in all CUSIPs; provided, however, that such amount shall be computed net of any settled position of the counterparty held at the member and deliverable under one or more of the counterparty's contracts with the member and which the counterparty intends to deliver. *See* Exhibit 5 in Amendment No. 3, *supra* note 14.

[115] FINRA Rule 6710(z) defines "dollar roll" to mean a simultaneous sale and purchase of an Agency Pass-Through MBS for different settlement dates, where the initial seller agrees to take delivery, upon settlement of the re-purchase transaction, of the same or substantially similar securities.

[116] Paragraph (e)(2)(H)(i)i. defines "round robin" trade to mean any transaction or transactions resulting in equal and offsetting positions by one customer with two separate dealers for the purpose of eliminating a turnaround delivery obligation by the customer. *See* Exhibit 5 in this Amendment No. 3.

[117] *See* Notice, *supra* note 3.

[118] *See supra* notes 3, 8, and 12.

provisions as to dollar rolls and round robin trades are not feasible to implement.[119] In response to the comment, FINRA noted that it previously addressed this issue in Amendment Nos. 1 and 2.[120] FINRA stated that it believes that dollar roll and round robin provisions are appropriate given that these are types of financing techniques.[121] As such, FINRA stated that it does not propose to modify the proposed requirements, other than, to increase the amount for the gross open position exception from $2.5 million or less to $10 million or less, as described above.

*D. Timing of Margin Collection and Position Liquidation*

As set forth more fully in the Notice, and reiterated in the Order Instituting Proceedings and the Amendment No. 2 Notice,[122] FINRA noted that the proposed rule provides that, with respect to exempt accounts, if a mark to market loss, or, with respect to non-exempt accounts, a deficiency,[123] is not satisfied by the close of business on the next business day after the business day on which the mark to market loss or deficiency arises, the member must deduct the amount of the mark to market loss or deficiency from net capital as provided in Exchange Act Rule 15c3–1.[124] Further, FINRA stated that unless FINRA has granted a member additional time to collect the mark to market loss or deficiency, the member is required to liquidate positions if, with respect to exempt accounts, a mark to market loss is not satisfied within five business days, or, with respect to non-exempt accounts, a deficiency is not satisfied within such period.[125]

Similar to comments received on the Notice and the Order Instituting Proceedings,[126] in response to the solicitation of comment on the Amendment No. 2 Notice, one commenter stated that the proposed requirements are difficult to implement and are not compatible with existing systems and procedures for other fixed income products.[127] A different commenter stated that these differences reduce the ability to leverage the functionality of existing systems.[128] In response to these comments, FINRA stated that it does not propose to modify the proposed requirements. FINRA reiterated that the proposed language as to timing of margin collection is consistent with existing language under Rule 4210.[129] With respect to the liquidation requirement, FINRA stated that it believes that the five business day period, along with the opportunity to seek an extension of time when circumstances warrant, should provide sufficient time for members to resolve issues.[130]

*E. Two-Way (Bilateral) Margin and Third Party Custodians*

Similar to comments received on the Notice and the Order Instituting Proceedings, in the comments in response to the Amendment No. 2 Notice, some commenters stated that they oppose the proposed rule change because it does not require two-way margin.[131] These commenters stated that the TMPG best practices expressly calls for two-way margining to mitigate counterparty risk and requiring only one-way margin increases systemic risk.[132] These commenters also stated that the proposal fails to recognize the counterparty credit risk to non- FINRA members, and that the prudential regulators have adopted two-way margining in the context of requirements for swaps.[133] Finally, these commenters stated that providing for two- way margining and affording the counterparties the right to segregate, by means of third party custodian relationships, the margin they post to a FINRA member would provide heightened protection.[134]

In response to these comments, FINRA noted in the original filing, and Amendment Nos. 1 and 2, that though FINRA supports the use of two-way margining, FINRA does not propose to address such a requirement at this time as part of the proposed rule change.[135] With respect to third party custodial arrangements, FINRA stated that these are best addressed in a separate rulemaking or guidance, as appropriate. FINRA reiterated that it is mindful of the concerns that commenters have expressed, and will revisit two-way margining and related issues when the Commission completes its rulemaking as to margin requirements for security-based swaps.[136] FINRA noted that the proposed rule does not prevent parties from entering into agreements that provide for two-way margining should they wish to do so, provided those parties comply with all applicable requirements.

*F. Scope of FINRA's Authority*

Similar to comments received on the Notice and the Order Instituting Proceedings,[137] some commenters stated FINRA does not have authority to impose the proposed margin requirements, as it is not consistent with the intent of section 7 of the Exchange Act.[138] Some commenters cited the Senate Report in connection with the adoption of the Secondary Mortgage Market Enhancement Act of 1984 (''SMMEA'') in support of this view.[139] As discussed in more detail in the Order Instituting Proceedings and Amendment No. 2 Notice, FINRA stated that it believes the proposed rule change is consistent with the provisions of section 15A(b)(6) of the Exchange Act.[140] FINRA further stated that section 7 of the Exchange Act sets forth the parameters of the margin setting authority of the Federal Reserve Board and does not bar action by FINRA.[141]

*G. Cleared Covered Agency Transactions*

In response to the Amendment No. 2 Notice, one commenter expressed concern that the proposed rule would impose a double margin requirement on introducing firms that are already required to post margin pursuant to agreements with clearing firms.[142] This commenter proffered language to exempt such transactions from the rule's margin requirements.[143] Another commenter said that FINRA should coordinate with the Mortgage-Backed Securities Division (''MBSD'') of Fixed

[119] *See* Thomson Letter.

[120] *See supra* notes 8 and 12.

[121] *See* Amendment No. 3, *supra* note 14.

[122] *See supra* notes 3, 8, and 12.

[123] The term ''deficiency'' means the amount of any required but uncollected maintenance margin and any required but uncollected mark to market loss. *See* proposed FINRA Rule 4210(e)(2)(H)(i)d. in Exhibit 5 to Amendment No. 3.

[124] *See* Amendment No. 3, *supra* note 14.

[125] *See* Amendment No. 3, *supra* note 14. *See also* Notice, *supra* note 3.

[126] *See supra* notes 3, 8, and 12.

[127] *See* SIFMA 3 Letter.

[128] *See* Thomson Letter.

[129] *See* Amendment No. 3, *supra* note 14. *See also* FINRA Rule 4210(g)(10)(B).

[130] *See* Amendment No. 3, *supra* note 14.

[131] *See* Sutherland 3 Letter and Sutherland 4 Letter.

[132] *Id.*

[133] *Id.*

[134] *Id.*

[135] *See* Amendment No. 3, *supra* note 14.

[136] *See supra* note 50.

[137] *See supra* notes 3, 8, and 12.

[138] *See* BDA 3 Letter and Coastal 3 Letter; *see also supra* note 12.

[139] Pub. L. 98–440, 98 Stat. 1689 (1984).

[140] *See* Notice, *supra* note 3. Section 15A(b)(6) of the Exchange Act requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. *See also supra* notes 8 and 12. *See* Amendment No. 3, *supra* note 14.

[141] *See* Order Instituting Proceedings, *supra* note 8.

[142] *See* Brean Capital 3 Letter.

[143] *Id.*

Income Clearing Corporation to leverage MBSD's infrastructure.[144]

In response to these comments, FINRA stated that paragraph (e)(2)(H)(ii)c.1. of the proposed rule provides that the margin requirements of paragraph (e)(2)(H) do not apply to Covered Agency Transactions that are cleared through a registered clearing agency, as specified by the rule.[145] Furthermore, FIRNA stated it is not the rule's intent to regulate the commercial agreements of members, provided the rule's requirements are met. As such, FINRA stated that it does not propose to adopt the proffered language. FINRA noted, that the MBSD infrastructure is outside the scope of the proposed rule change, which, is not intended to apply the proposed margin requirements to Covered Agency Transactions cleared through a registered clearing agency.[146]

### *H. Trading Activity and Alternative Requirements*

One commenter expressed a number of concerns with respect to trading activity under the proposed rule.[147] This commenter proffered language to exempt from the rule's margin requirements transactions that are offset by bilateral transactions with investment companies, to amend the position liquidation requirements to apply solely to TBA transactions (as opposed to the other types of Covered Agency Transactions), to exclude from the margin requirements any mark to market losses that are offset by gains on a cleared trade, and to prescribe required procedures as to position marking that would require reference to a ''generally recognized source'' and agreement of the parties.[148] Another commenter suggested the rule should permit members to take a capital charge as an alternative to collecting maintenance margin.[149]

In response to these comments, FINRA stated that it does not believe that the proffered language is consistent with the rule's purposes. FINRA also stated that it does not believe there is a public policy purpose in writing into the rule an exemption for offsets with investment companies or cleared trades, or to confine the liquidation requirements to TBA transactions only.[150] FINRA stated that it does not propose to incorporate the proffered language as to position marking given that, for purposes of the rule, this is a matter to be addressed by the parties' commercial relations. Further, FINRA stated that it does not propose to revise the rule to permit members to take a capital charge as an alternative to the collection of maintenance margin from counterparties, as FINRA believes this would not protect members from the risk of counterparty default.[151]

Moreover, FINRA stated that a capital charge in lieu of collecting maintenance margin could have the effect of disadvantaging small firms that are not in a position to absorb capital charges to the same extent as larger, more highly capitalized firms. As such, FINRA stated that it believes the rule as proposed puts all firms on an equal footing, leveling the playing field between large and small firms, since all firms can collect maintenance margin, but not all firms can absorb the same amount of capital charges.[152]

## IV. Discussion and Commission Findings

The Commission has carefully considered the proposed rule change, as modified by Amendment Nos. 1, 2, and 3, the comments received, and FINRA's responses to the comments. Based on its review of the record, the Commission finds that the proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities association.[153] In particular, the Commission finds that the proposed rule change is consistent with section 15A(b)(6) of the Exchange Act, which requires, among other things, that FINRA rules be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.[154]

As discussed above, the proposed rule change would amend FINRA Rule 4210 to establish margin requirements for the TBA market that are designed to ''to reduce firm exposure to counterparty credit risk stemming from unsecured credit exposure that exists in the [TBA] market today.'' [155] The Commission agrees with FINRA that ''[p]ermitting counterparties to participate in the TBA market without posting margin could facilitate increased leverage by customers, thereby potentially posing a risk to the broker-dealer extending credit and to the marketplace as a whole.'' [156] The proposed rule change also is expected to ''enhance sound risk management practices'' for FINRA members and their counterparties involved in the TBA market.[157] The stated goals of the proposal are consistent with the purposes of the Exchange Act and with FINRA's authority to impose margin requirements on its members.[158] The proposed rule change will serve to promote consistent and transparent margin requirements for the TBA market for FINRA members and their counterparties. Moreover, the proposed rule change will mitigate the risk that FINRA members will compete by implementing lower margin levels for Covered Agency Transactions and will help ensure that margin levels are set at sufficiently prudent levels across FINRA members.

As outlined above, the Commission received 141 comment letters on the proposed rule change, as well as FINRA responses to these comments.[159] The Commission notes that while commenters generally supported the goals of the proposed rule change ''of addressing the counterparty credit risk and systemic risk posed to broker-dealers by TBA Transactions,'' [160] various commenters disagreed with FINRA over the proposed approach to achieve this goal and recommended changes to it.[161] Other commenters requested that the Commission disapprove the proposed rule change.[162] Finally, numerous commenters were concerned about the potential cost burden and competitive impact of the proposed rule change on FINRA members and other market participants.[163]

While the Commission appreciates the recommendations made by various commenters, and recognizes that new margin requirements for Covered Agency Transactions may result in increased costs for some FINRA

[144] *See* Thomson Letter.

[145] *See* Exhibit 5 in Amendment No. 3.

[146] *See* Amendment No. 3, *supra* note 14.

[147] *See* Brean Capital 3 Letter.

[148] *Id.*

[149] *See* Thomson Letter.

[150] *See* Amendment No. 3, *supra* note 14.

[151] *Id.*

[152] *See* Amendment No. 3, *supra* note 14.

[153] In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[154] 15 U.S.C. 78*o*–3(b)(6).

[155] *See* Notice, *supra* note 3.

[156] *Id.*

[157] *Id.*

[158] *See, e.g.,* 12 CFR 220.1(b)(2).

[159] *See* comment file *supra* note 5. The 141 comment letters include the 54 Type A and B form letters that generally contain language opposing the inclusion of multifamily housing and project loan securities within the scope of the proposed rule change, as originally published in the Notice, and prior to the exclusion of these types of securities from the rule, as modified in Amendment Nos. 1 and 2.

[160] *See, e.g.,* SIFMA 3 Letter.

[161] *See* comment file *supra* note 5.

[162] *Id.*

[163] *See supra* note 5. *See also* Notice, Order Instituting Proceedings, Amendment No. 2 Notice, and Amendment No. 3, *supra* notes 3, 8, 12, and 14.

members and their counterparties, the Commission believes that FINRA responded appropriately to their concerns. Taking into consideration the comments and FINRA's responses, the Commission believes that the proposal is consistent with the Exchange Act. In structuring the proposed rule, FINRA has reasonably balanced the goal of reducing firm exposure to counterparty credit risk stemming from unsecured credit exposures in the TBA market, with the potential costs and competitive impacts that may result from the proposed rule change. Specifically, the Commission notes that FINRA has incorporated a number of exceptions into its proposal to mitigate the impact of the proposed rule change, particularly on smaller firms and counterparties. For example, in Amendment No. 3, FINRA proposed to increase the exception from the margin requirements for any counterparty with gross open positions of $2.5 million or less in aggregate to $10 million to ameliorate the proposed rule change's impact on the TBA market and to address the concerns of how the rule would impact small firms and customers that do not take large positions in Covered Agency Transactions.[164]

In addition, FINRA has proposed an additional cash account exception available to FINRA members that would not require them to collect maintenance margin from counterparties that are non-exempt accounts, as well as a $250,000 de minimis transfer amount that would mitigate the need for counterparties to transfer small amounts of margin to a FINRA member. Moreover, under the proposed rule change, mortgage bankers may be treated as exempt accounts under specified conditions, resulting in these counterparties being subject only to the variation margin requirements under the proposal. In Amendment No. 3, FINRA also proposed to simplify new Supplementary Material .05 related to risk limit determinations at the investment adviser level to reduce regulatory burdens.[165] These provisions, in totality, should lessen the competitive impact and compliance costs of the rule on FINRA members and their counterparties, while reducing the risk of uncollateralized credit exposures arising from Covered Agency Transactions given the size of the TBA market.[166] Finally, the Commission notes that FINRA has stated that it will monitor the proposed rule's impact and, if the requirements prove overly onerous or otherwise are shown to negatively impact the TBA market, it will consider modifications to mitigate the rule's impact.[167]

The Commission acknowledges that the requirements of FINRA's proposed rule change are more prescriptive than the TMPG best practices, including, for example, the proposed maintenance margin requirement for non-exempt accounts, as well as the timing of margin collection and mandatory liquidation requirements.[168] The Commission notes FINRA's approach is generally consistent with the margining of other securities transactions under Rule 4210.[169] For example, securities transactions margined under FINRA Rule 4210 are generally subject to maintenance margin, which is a ''mainstay of regimes in the securities industry.'' [170] With respect to the maintenance margin requirement, the Commission agrees with FINRA that most accounts at broker-dealers engaging in Covered Agency Transactions likely will be exempt accounts, and therefore, only subject to the variation margin requirements under the rule.[171] In the alternative, where maintenance margin requirements apply, FINRA has proposed specific exceptions which should mitigate the impact on a counterparty, including the cash account exceptions and the $250,000 de minimis transfer amount. Finally, with respect to the proposed mandatory five-business day liquidation time period, FINRA members may request and receive extensions from FINRA under its Regulatory Extension System and FINRA has stated it ''will consider additional guidance as needed.'' [172] The Commission believes these proposed requirements are consistent with the Exchange Act and are appropriate ''in view of the potential counterparty risk in the TBA market.'' [173]

FINRA's stated purposes for proposing margin requirements on Covered Agency Transactions is consistent with other regulatory efforts that have sought to address the risk of uncollateralized credit exposure arising in different types of bilateral credit transactions following the financial crisis, in particular, after the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[174] The Commission agrees with FINRA that imposing mandatory margin requirements on FINRA members transacting business with counterparties in the TBA market addresses a gap between margining in the TBA market and margin practices and regulatory developments in other markets.[175] Margin collateral collected by a FINRA member may mitigate a broker-dealer's financial losses in the event of a counterparty default, and, in turn, serve to protect the broker-dealer's other customers. Consequently, the Commission believes that the proposed rule change would further the purposes of the Exchange Act as it is reasonably designed to protect investors and the public interest.[176]

The Commission further believes that excluding multifamily and project loan program securities from the scope of the rule, if a FINRA member makes a written risk limit determination for a counterparty trading in such securities, is appropriate. While included in the scope of the TPMG best practices, these types of securities only are a small part of the overall TBA market, and may be difficult to mark to market because they are often backed by a single project or loan.[177] Further, existing safeguards in the multi-family housing market, including the provision of good faith deposits by the borrower, may serve to mitigate the counterparty credit risk to a FINRA member with respect to a counterparty engaging trading in multifamily and project loan securities.[178]

In addition to the exclusions for multifamily housing and project loan securities, the Commission notes that numerous commenters believed other product types should be excluded from

[164] *See* Amendment No. 3, *supra* note 14.

[165] *See* Amendment No. 3, *supra* note 14, and discussion in Section II.D. above.

[166] *See* Notice, *supra* note 3.

[167] *See* Amendment No. 3, *supra* note 14, and discussion in Section II.D. above.

[168] *See* TPMG best practices, *supra* note 21. The proposed rule provides for specific times by which margin must be collected, or an account liquidated unless FINRA specifically grants the member additional time (for the account liquidation purposes only).

[169] *See* FINRA Rule 4210.

[170] *See* FINRA Rule 4210. *See also* Amendment No. 2 Notice, *supra* note 12.

[171] *See* Notice, *supra* note 3.

[172] *See* Amendment No. 2 Notice, *supra* note 12.

[173] *See* Order Instituting Proceedings, *supra* note 8.

[174] *See* Public Law 111–203, 124 Stat. 1376 (2010). *See also* TPMG best practices, *supra note* 21; *see also Capital, Margin, and Segregation Requirements for Security- Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers,* Exchange Act Release No. 68071 (Oct. 18, 2012), 77 FR 70213, 70258 (Nov. 23, 2012) (''The Dodd-Frank Act seeks to address the risk of uncollateralized credit exposure arising from OTC derivatives by, among other things, mandating margin requirements for non-cleared security-based swaps and swaps.'')

[175] *See* Notice, *supra* note 3.

[176] *See* 15 U.S.C. 78o-3(b)(6).

[177] *See* Order Instituting Proceedings, *supra* note 8. Commenters provided data with respect to the multifamily housing securities market in comparison to the overall TBA market, and FINRA conducted an analysis of transactional data. *Id.*

[178] *Id.*

the scope of the rule, or that FINRA should revise the definition of Covered Agency Transaction to focus on long-dated settlements.[179] The Commission agrees with FINRA that excluding additional products from the rule or modifying the settlement dates in the definition of Covered Agency Transactions potentially may ''undermine the effectiveness of the proposal'' if counterparties are permitted to maintain unsecured credit exposures on these positions.[180] Furthermore, as described above, FINRA's rationale for excluding multifamily and project loan securities is distinct from the issues raised by commenters with respect to the other suggested modifications to the definition of Covered Agency Transaction under the rule, due, in part, to the unique characteristics of multi-family housing and project loan securities.[181] The Commission believes that FINRA's proposed approach to establish a $10 million or less in aggregate per counterparty exception is appropriate in that it will continue to subject products with forward settlement dates to the rule's margin requirements, while reducing potential burdens on smaller FINRA member firms and counterparties that do not take on large positions in Covered Agency Transactions.

The Commission acknowledges the comments raised by market participants that the scope of the TPMG's best practices includes two-way variation margin, in contrast to the proposed rule change which would require FINRA members to collect margin from their counterparties (without a corresponding posting requirement). Current FINRA Rule 4210 is a collection rule and does not require broker-dealers to post margin to their customers for securities transactions margined under the rule.[182] The Commission notes that the broker-dealer margin requirements have been in place for many years.[183] In its response to comments, FINRA stated it supports two-way margining but does not propose to address two-way margining as part of the proposed rule change.[184] However, FINRA indicated it would re-examine this issue ''when the Commission completes its rulemaking as to margin requirements for security-based swaps.'' [185] The Commission believes FINRA's approach is appropriate.[186]

The Commission believes that FINRA's proposed implementation schedule is appropriate and consistent with the requirements of the Exchange Act. The Commission notes that FINRA proposed to extend the implementation timeframe in Amendment No. 1 in response to comments that considerable operational and systems work will be needed to comply with the proposed rule change.[187] The Commission believes that the proposed six-month timeframe for the risk limit determination requirements [188] and 18-month timeframe for implementation of the remainder of the rule should provide sufficient time for FINRA firms to comply with the rule's requirements.[189]

In conclusion, the Commission believes that the proposal will help protect investors and the public interest by establishing margin requirements for the TBA market to reduce the risk that unsecured credit exposures could potentially lead to losses by FINRA members, and by enhancing risk management practices at FINRA members that participate in the TBA market. The Commission also believes that FINRA gave due consideration to the proposal and met the requirements of the Exchange Act. For these reasons, the Commission finds that the proposed rule change is consistent with the Exchange Act and the rules and regulations thereunder.

### V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether Amendment No. 3, is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

*Electronic Comments*

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/sro.shtml*); or
- Send an email to *rule-comments@sec.gov.* Please include File Number SR–FINRA–2015–036 on the subject line.

*Paper Comments*

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090.

All submissions should refer to File Number SR–FINRA–2015–036. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR–FINRA–2015–036 and should be submitted on or before July 12, 2016.

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[179] *See* comment file *supra* note 5. *See also* Order Instituting Proceedings, *supra* note 8.

[180] *See* Notice, *supra* note 3.

[181] *See* Amendment No. 2 Notice, *supra* note 12.

[182] *See* FINRA Rule 4210.

[183] *See Capital, Margin, and Segregation Requirements for Security- Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers,* Exchange Act Release No. 68071 (Oct. 18, 2012), 77 FR 70213, 70259 (Nov. 23, 2012) (''In the securities markets, margin rules have been set by relevant regulatory authorities (the Federal Reserve and the SROs) since the 1930s.'')

[184] *See* Amendment No. 3, *supra* note 14.

[185] *See* Amendment No. 3, *supra* note 14. *See also Capital, Margin, and Segregation Requirements for Security- Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers,* Exchange Act Release No. 68071 (Oct. 18, 2012), 77 FR 70213 (Nov. 23, 2012)

[186] FINRA also noted ''that the proposed rule does not prevent parties from entering into agreements that provide for two-way margining should they wish to do so, provided those parties comply with all applicable requirements.'' *See* Amendment No. 3, *supra* note 14.

[187] *See* Order Instituting Proceedings, *supra* note 8.

[188] *See supra* note 65 (clarifying the specific rule provisions related to the risk limit determinations that become effective six months after Commission approval of the proposed rule change).

[189] The Commission notes that this proposal has been noticed for comment three times. *See* Notice, Order Instituting Proceedings, and Amendment No. 2 Notice, *supra* notes 3, 8, and 12. In addition, FINRA originally sought comment on proposal prior to filing it with the Commission in in 2014 through publication of a Regulatory Notice. *See* Regulatory Notice 14–02 (FINRA Requests Comment on Proposed Amendments to FINRA Rule 4210 for Transactions in the TBA Market) (Jan. 2014).

**VI. Accelerated Approval of Proposed Rule Change, as Modified by Amendment Nos. 1, 2, and 3**

The Commission finds good cause, pursuant to Section 19(b)(2) of the Exchange Act, to approve the proposed rule change, as modified by Amendment Nos. 1, 2, and 3, prior to the 30th day after the date of publication of Amendment No. 3 in the **Federal Register**. FINRA proposed the changes in Amendment No. 3 in response to issues raised by commenters.[190]

More specifically, Amendment No. 3 revised the proposal to increase the gross open position exception from $2.5 million or less to $10 million or less. Second, FINRA revised the proposed language in new Supplementary Material .05(a)(1) to delete the clause ''except with respect to any account or group of commonly controlled accounts whose assets managed by that investment adviser constitute more than 10 percent of the investment adviser's regulatory assets under management as reported on the investment adviser's most recent Form ADV.'' The Commission believes that the changes proposed in Amendment No. 3 do not raise any novel regulatory issues because they provide greater clarity with respect to the application of the proposed rule change and will reduce the regulatory burden on FINRA members, particularly smaller firms and counterparties. Therefore, the Commission finds that Amendment No. 3 is consistent with the protection of investors and the public interest.

Amendment No. 3 also clarified which paragraphs related to the required written risk limit determinations become effective six months after Commission approval of the proposed rule change. The Commission believes that these are technical clarifications and do not change the substance of the proposed implementation timeframe as proposed in the Order Instituting Proceedings and the Amendment No. 2 Notice.

Accordingly, the Commission finds good cause pursuant to Section 19(b)(2) of the Exchange Act,[191] for approving the proposed rule change, as modified by Amendment Nos. 1, 2, and 3, on an accelerated basis.

**VII. Conclusion**

IT IS THEREFORE ORDERED, pursuant to section 19(b)(2) of the Exchange Act,[192] that the proposed rule change, as modified by Amendment Nos. 1, 2, and 3 (SR–FINRA–2015–036) be, and hereby is approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[193]

**Robert W. Errett,**

*Deputy Secretary.*

[FR Doc. 2016–14561 Filed 6–20–16; 8:45 am]

**BILLING CODE 8011–01–P**

[190] *See* Amendment No. 3, *supra* note 14.

[191] 15 U.S.C. 78s(b)(2).

[192] 15 U.S.C. 78s(b)(2).

[193] 17 CFR 200.30–3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–78078; File No. SR–NASDAQ–2016–064]**

### Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Designation of a Longer Period for Commission Action on a Proposed Rule Change Relating to the Listing and Trading of the Shares of the First Trust Strategic Mortgage REIT ETF of First Trust Exchange-Traded Fund VIII

June 15, 2016.

On May 3, 2016, The NASDAQ Stock Market LLC (''Nasdaq'') filed with the Securities and Exchange Commission (''Commission''), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b–4 thereunder,[2] a proposed rule change to list and trade shares of the First Trust Strategic Mortgage REIT ETF of First Trust Exchange-Traded Fund VIII under Nasdaq Rule 5735. The proposed rule change was published for comment in the **Federal Register** on May 12, 2016.[3] The Commission received no comments on the proposed rule change.

Section 19(b)(2) of the Act [4] provides that, within 45 days of the publication of notice of the filing of a proposed rule change, or within such longer period up to 90 days as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or as to which the self-regulatory organization consents, the Commission shall either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether the proposed rule change should be disapproved. The 45th day after publication of the notice for this proposed rule change is June 26, 2016. The Commission is extending this 45-day time period.

The Commission finds that it is appropriate to designate a longer period within which to take action on the proposed rule change so that it has sufficient time to consider the proposed rule change. Accordingly, the Commission, pursuant to section 19(b)(2) of the Act,[5] designates August 10, 2016, as the date by which the Commission should either approve or disapprove or institute proceedings to determine whether to disapprove the proposed rule change (File Number SR–NASDAQ–2016–064).

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[6]

**Robert W. Errett,**

*Deputy Secretary.*

[FR Doc. 2016–14558 Filed 6–20–16; 8:45 am]

**BILLING CODE 8011–01–P**

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 77781 (May 6, 2016), 81 FR 29590 (''Notice'').

[4] 15 U.S.C. 78s(b)(2).

[5] 15 U.S.C. 78s(b)(2).

[6] 17 CFR 200.30–3(a)(31).

## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–78080; File No. SR–MIAX–2016–16]**

### Self-Regulatory Organizations; Miami International Securities Exchange LLC; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Amend Exchange Rule 510 To Extend the Penny Pilot Program Until December 31, 2016

June 15, 2016.

Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b–4 thereunder,[2] notice is hereby given that on June 13, 2016, Miami International Securities Exchange LLC (''MIAX'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'') a proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

**I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The Exchange is filing a proposal to amend Exchange Rule 510, Interpretations and Policies .01 to extend the pilot program for the quoting and trading of certain options in pennies (the ''Penny Pilot Program'').

The text of the proposed rule change is available on the Exchange's Web site at *http://www.miaxoptions.com/filter/wotitle/rule_filing,* at MIAX's principal

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.