submitted on or before February 11, 2016.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[20]

Robert W. Errett,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–76908; File No. SR–FINRA–2015–036]

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

January 14, 2016.

I. Introduction

On October 6, 2015, Financial Industry Regulatory Authority, Inc. (''FINRA'') filed with the Securities and Exchange Commission (''SEC'' or ''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. The Commission received 109 comment letters,[4] which include 50 Type A comment letters and four Type B comment letters in response to the proposed rule change. On January 13, 2016, FINRA responded to the comments and filed Partial Amendment No. 1 to the proposal.[5] The Commission is publishing this order to solicit comments on Partial Amendment No. 1 from interested persons and to institute proceedings pursuant to Exchange Act Section 19(b)(2)(B)[6] to determine whether to approve or disapprove the proposed rule change, as modified by Partial Amendment No. 1.

Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to the proposed rule change, not does it mean that the Commission will ultimately disapprove the proposed rule change. Rather, as discussed below, the Commission seeks additional input on the proposed rule change, as modified by Partial Amendment No. 1, and on the issues presented by the proposal.

II. Description of the Proposed Rule Change[7]

In its filing, FINRA proposed amendments to FINRA Rule 4210 (Margin Requirements) to establish requirements for: (1) TBA transactions,[8]

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[20] 17 CFR 200.30–3(a)(12).

[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* Letters from Margaret Allen, AGM Financial, dated November 10, 2015 (''AGM Letter''); Paul J. Barrese, Sandler O'Neill & Partners, L.P., dated November 10, 2015 (''Sandler O'Neill Letter''); Doug Bibby and Doug Culkin, National Multifamily Housing Council and National Apartment Association, dated November 10, 2015 (''NMHC/NAA Letter''); David W. Blass, Investment Company Institute, dated November 9, 2015 (''ICI Letter''); Robert Cahn, Prudential Mortgage Capital Company, LLC, dated November 10, 2015 (''Prudential Letter''); James M. Cain, Sutherland Asbill & Brennan LLP (on behalf of the Federal Home Loan Banks), dated November 10, 2015 (''Sutherland Letter''); Timothy W. Cameron, Esq. and Laura Martin, Securities Industry and Financial Markets Association, Asset Management Group, dated November 10, 2015 (''SIFMA AMG Letter''); Jonathan S. Camps, Love Funding, dated November 9, 2015 (''Love Funding Letter''); Richard A. Carlson, Davis-Penn Mortgage Co., dated November 9, 2015 (''Davis-Penn 1 Letter''); Michael S. Cordes, Columbia National Real Estate Finance, LLC, dated November 9, 2015 (''Columbia Letter''); Carl E. Corrado, Great Lakes Financial Group, LP, dated January 4, 2016 (''Great Lakes Letter''); Daniel R. Crain, Crain Mortgage Group, LLC, dated November 6, 2015 (''Crain Letter''); James F. Croft, Red Mortgage Capital, LLC, dated November 10, 2015 (''Red Mortgage Letter''); Dan Darilek, Davis-Penn Mortgage Co., dated November 9, 2015 (''Davis-Penn 2 Letter''); Jayson F. Donaldson, NorthMarq Capital Finance, L.L.C, dated November 10, 2015 (''NorthMarq Letter''); Robert B. Engel, CoBank, ACB (on behalf of the Farm Credit Banks), dated November 10, 2015 (''CoBank Letter''); Robert M. Fine, Brean Capital, LLC, dated November 10, 2015 (''Brean Capital 1 Letter''); Tari Flannery, M&T Realty Capital Corporation, dated November 9, 2015 (''M&T Realty Letter''); Bernard P. Gawley, The Ziegler Financing Corporation, dated November 10, 2015 (''Ziegler Letter''); John R. Gidman, Association of Institutional INVESTORS, dated November 10, 2015 (''AII Letter''); Keith J. Gloeckl, Churchill Mortgage Investment, LLC, dated November 6, 2015 (''Churchill Letter''); Eileen Grey, Mortgage Bankers Association & Others, dated October 29, 2015 (''MBA & Others 1 Letter''); Mortgage Bankers Association & Others (including American Seniors Housing Association), dated November 10, 2015 (''MBA & Others 2 Letter''); Tyler Griffin, Dwight Capital, dated November 10, 2015 (''Dwight Letter''); Pete Hodo, III, Highland Commercial Mortgage, dated November 5, 2015 (''Highland 1 Letter''); Robert H. Huntington, Credit Suisse Securities (USA) LLC, dated November 10, 2015 (''Credit Suisse Letter''); Matthew Kane, Centennial Mortgage, Inc., dated November 9, 2015 (''Centennial Letter''); Christopher B. Killian, Securities Industry and Financial Markets Association, dated November 10, 2015 (''SIFMA Letter''); Robert T. Kirkwood, Lancaster Pollard Holdings, LLC, dated November 10, 2015 (''Lancaster Letter''); Tony Love, Forest City Capital Corporation, dated November 5, 2015 (''Forest City 1 Letter''); Tony Love, Forest City Capital Corporation, dated November 10, 2015 (''Forest City 2 Letter''); Anthony Luzzi, Sims Mortgage Funding, Inc., dated November 9, 2015 (''Sims Mortgage Letter''); Diane N. Marshall, Prairie Mortgage Company, dated November 10, 2015 (''Prairie Mortgage Letter''); Matrix Applications, LLC, dated November 10, 2015 (''Matrix Letter''); Douglas I. McCree, CMB, First Housing, dated November 10, 2015 (''First Housing Letter''); Michael McRoberts, DUS Peer Group, dated November 2, 2015 (''DUS Letter''); Chris Melton, Coastal Securities, dated November 9, 2015 (''Coastal Letter''); John O. Moore Jr., Highland Commercial Mortgage, dated November 6, 2015 (''Highland 2 Letter''); Dennis G. Morton, AJM First Capital, LLC, dated November 10, 2015 (''AJM Letter''); Michael Nicholas, Bond Dealers of America, dated November 10, 2015 (''BDA Letter''); Lee Oller, Draper and Kramer, Incorporated, dated November 10, 2015 (''Draper Letter''); Roderick D. Owens, Committee on Healthcare Financing, dated November 6, 2015 (''CHF Letter''); Jose A. Perez, Perez, dated November 9, 2015 (''Perez Letter''); David F. Perry, Century Health Capital, Inc., dated November 9, 2015 (''Century Letter''); Deborah Rogan, Bellwether Enterprise Real Estate Capital, LLC, dated November 10, 2015 (''Bellwether Letter''); Bruce Sandweiss, Gershman Mortgage, dated November 18, 2015 (''Gershman 1 Letter''); Craig Singer and James Hussey, RICHMAC Funding LLC, dated November 9, 2015 (''Richmac Letter''); David H. Stevens, Mortgage Bankers Association, dated November 10, 2015 (''MBA Letter''); Stephen P. Theobald, Walker & Dunlop, LLC, dated November 10, 2015 (''W&D Letter''); Robert Tirschwell, Brean Capital, LLC, dated November 10, 2015 (''Brean Capital 2 Letter''); Mark C. Unangst, Gershman Mortgage, dated November 23, 2015 (''Gershman 2 Letter''); Charles M. Weber, Robert W. Baird & Co. Incorporated, dated November 10, 2015 (''Robert Baird Letter''); Steve Wendel, CBRE, Inc., dated November 10, 2015 (''CBRE Letter''); Carl B. Wilkerson, American Council of Life Insurers, dated November 10, 2015 (''ACLI Letter''); David H. Stevens, Mortgage Bankers Association, dated January 11, 2016 (''MBA Supplemental Letter''). 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. The Commission staff also participated in numerous meetings and conference calls with some commenters and other market participants.

[5] *See* Partial Amendment No. 1, dated January 13, 2016 (''Partial Amendment No. 1''). FINRA's responses to comments received and proposed amendments are included in Partial Amendment No. 1. The text of Partial Amendment No. 1 is available on FINRA's Web site at *http://www.finra.org,* at the principal office of FINRA, and at the Commission's Public Reference Room.

[6] 15 U.S.C. 78s(b)(2)(B).

[7] The proposed rule change, as described in this Item II, is excerpted, in part, from the Notice, which was substantially prepared by FINRA. *See supra* note 3.

[8] *See* FINRA Rule 6710(u) defines TBA to mean a transaction in an Agency Pass-Through Mortgage-

inclusive of adjustable rate mortgage (''ARM'') transactions; (2) Specified Pool Transactions;[9] and (3) transactions in Collateralized Mortgage Obligations (''CMOs''),[10] issued in conformity with a program of an agency[11] or Government-Sponsored Enterprise (''GSE''),[12] with forward settlement dates, (collectively, ''Covered Agency Transactions,'' also referred to, for purposes of this filing, 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.[13] The agency and GSE MBS market is one of the largest fixed income markets, with approximately $5 trillion of securities outstanding and approximately $750 billion to $1.5 trillion in gross unsettled and unmargined transactions between dealers and customers.[14]

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 noted the TMPG recommended standards (the ''TMPG best practices'') regarding the margining of forward-settling agency MBS transactions.[15] FINRA stated that the TMPG best practices are recommendations and as such currently are not rule requirements. FINRA believes unsecured credit exposures that exist in the TBA market today can lead to financial losses by dealers. Permitting counterparties to participate in the TBA market without posting margin can facilitate increased leverage by customers, thereby potentially posing a risk to the dealer extending credit and to the marketplace as a whole. Further, FINRA's present requirements do not address the TBA market generally.[16]

Accordingly, to establish margin requirements for Covered Agency Transactions, FINRA proposed to redesignate current paragraph (e)(2)(H) of Rule 4210 as new paragraph (e)(2)(I), to add new paragraph (e)(2)(H) to Rule 4210, 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 is informed by the TMPG best practices and is described in further detail below.[17]

A. Proposed FINRA Rule 4210(e)(2)(H) (Covered Agency Transactions)[18]

FINRA intends the proposed rule change to reach its members engaging in Covered Agency Transactions with specified counterparties. The core 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)[19]

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.

FINRA intended the proposed definition of Covered Agency Transactions to be congruent with the scope of products addressed by the TMPG best practices and related updates.[20]

2. Other Key Definitions Established by the Proposed Rule Change (Proposed FINRA Rule 4210(e)(2)(H)(i))[21]

In addition to Covered Agency Transactions, the proposed rule change would establish the following key definitions 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 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

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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.

[9] *See* 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.

[10] *See* FINRA Rule 6710(dd).

[11] *See* FINRA Rule 6710(k).

[12] *See* FINRA Rule 6710(n) and 2 U.S.C. 622(8).

[13] *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* SEC's Staff Report, Enhancing Disclosure in the Mortgage-Backed Securities Markets, January 2003, available at: <*https://www.sec.gov/news/studies/mortgagebacked.htm*>.

[14] *See* Treasury Market Practices Group (''TMPG''), Margining in Agency MBS Trading, November 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.

[15] *See* TMPG, Best Practices for Treasury, Agency, Debt, and Agency Mortgage-Backed Securities Markets, revised June 10, 2015, available at: <*https://www.newyorkfed.org/medialibrary/microsites/tmpg/files/TMPG_June%202015_Best%20Practices*>.

[16] *See* Interpretations/01 through/08 of FINRA Rule 4210(e)(2)(F), available at: <*http://www.finra.org/web/groups/industry/@ip/@reg/@rules/documents/industry/p122203.pdf*>. Such guidance references TBAs largely in the context of Government National Mortgage Association (''GNMA'') securities. The modern TBA market is much broader than GNMA securities.

[17] *See supra* note 15; *see also,* TMPG, Frequently Asked Questions: Margining Agency MBS Transactions, June 13, 2014, available at: <*https://www.newyorkfed.org/medialibrary/microsites/tmpg/files/marginingfaq06132014.pdf*>; TMPG Releases Updates to Agency MBS Margining Recommendation, March 27, 2013, available at: <*https://www.newyorkfed.org/medialibrary/microsites/tmpg/files/Agency%20MBS%20margining%20public%20announcement%2003-27-2013.pdf*>.

[18] This section describes the proposed rule change prior to the proposed amendments in Partial Amendment No. 1, which are described below.

[19] *See supra* note 3; *see also,* Exhibit 5, text of proposed rule change, as originally filed.

[20] *See* description of Partial Amendment No. 1 in section II.D.1. below, proposing to allow member firms to elect not to apply the proposed margin requirements to multifamily housing and project loan securities.

[21] *See supra* note 3; *see also,* Exhibit 5, text of proposed rule change, as originally filed.

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)) [22]

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,[23] 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.

- Risk Limits

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.

- *Exceptions from the Proposed Margin Requirements: (1) Registered Clearing Agencies; (2) Gross Open Positions of $2.5 Million or Less in Aggregate*

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),[24] 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

[22] *Id.*

[23] 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 SEA Section 3(a)(6), 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).'' *See supra* note 3.

[24] *See* FINRA Rule 6710(z).

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.[25]

- *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.[26] 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.

FINRA believes that the maintenance margin requirement is appropriate because it aligns with the potential risk as to non-exempt accounts engaging in Covered Agency Transactions and the specified two percent amount is consistent with other measures in this area. 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 the required maintenance margin 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''). The proposed rule provides that the full amount of the sum of the required maintenance margin and any mark to market loss must be collected when such sum exceeds the de minimis transfer amount.

- *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. With respect to standbys, only profits (in-the-money amounts), if any, on long standbys shall be recognized.

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) [27]

The proposed rule change makes a number of revisions to paragraphs (e)(2)(F) and (e)(2)(G) of FINRA Rule 4210: [28]

- 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 . . . '' FINRA believes that this clarification will help demarcate the treatment of products subject to paragraph (e)(2)(F) versus new paragraph (e)(2)(H). 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 assessing the amount of credit extended

[25] The proposed rule change adds to Rule 4210 new Supplementary Material .02, which provides that for purposes of paragraph (e)(2)(H)(ii)d. of the rule, members must adopt written procedures to monitor the mortgage banker's pipeline of mortgage loan commitments to assess whether the Covered Agency Transactions are being used for hedging purposes. The proposed requirement is appropriate to ensure that, if a mortgage banker is permitted exempt account treatment, the member has conducted sufficient due diligence to determine that the mortgage banker is hedging its pipeline of mortgage production. In this regard, FINRA notes that the current Interpretations under Rule 4210 already contemplate that members evaluate the loan servicing portfolios of counterparties that are being treated as exempt accounts. *See* Interpretation/02 of FINRA Rule 4210(e)(2)(F).

[26] The proposed rule change adds to FINRA Rule 4210 new Supplementary Material .03, which provides that, for purposes of paragraph (e)(2)(H) of the rule, to the extent a mark to market loss or deficiency is cured by subsequent market movements prior to the time the margin call must be met, the margin call need not be met and the position need not be liquidated; provided, however, if the mark to market loss or deficiency 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 shall be required to deduct the amount of the mark to market loss or deficiency from net capital as provided in Exchange Act Rule 15c3–1 until such time the mark to market loss or deficiency is satisfied. FINRA believes that the proposed requirement should help provide clarity in situations where subsequent market movements cure the mark to market loss or deficiency.

[27] This section describes the proposed rule change prior to the proposed amendments in Partial Amendment No. 1, which are described below.

[28] *See supra* note 3; *see also,* Exhibit 5, text of proposed rule change, as originally filed.

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.'' FINRA believes this amendment makes the risk limit determination language in paragraphs (e)(2)(F) and (e)(2)(G) more congruent with the corresponding language proposed for new paragraph (e)(2)(H) of the rule.

- 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) [29]

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: [30]

- 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.

If the Commission approves the proposed rule change, FINRA proposed to announce the effective date of the proposed rule change in a *Regulatory Notice* to be published no later than 60 days following Commission approval. The effective date would be no later than 180 days following publication of the *Regulatory Notice* announcing Commission approval.[31]

D. Partial Amendment No. 1

In Partial Amendment No. 1, FINRA responds to comments received on the Notice [32] and adds to the proposed rule language, in response to comments, proposed paragraph (e)(2)(H)(ii)a.2 to FINRA Rule 4210, which provides that a member may elect not to apply the margin requirements of paragraph (e)(2)(H) to multifamily and project loan securities, subject to specified conditions. Further, FINRA proposes in Partial Amendment No. 1 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. FINRA proposes that the remainder of the proposed rule change become effective 18 months from the date the proposed rule change is approved by the Commission.

1. Proposed Exemption for Multifamily and Project Loan Securities

In its original filing, FINRA noted that the scope of Covered Agency Transactions [33] is intended to be congruent with the scope of products addressed by the TMPG best practices and related TMPG updates, and that the term would include within its scope multifamily housing and project loan program securities such as Freddie Mac K Certificates, Fannie Mae Delegated Underwriting and Servicing bonds, and Ginnie Mae Construction Loan or Project Loan Certificates (collectively, ''multifamily and project loan securities'').[34]

Commenters expressed concerns that FINRA should not include multifamily and project loan securities within the scope of the proposed margin requirements.[35] These commenters said that the proposed rule change would impose undue burdens on participants in the multifamily and project loan securities market, that the multifamily and project loan securities market is of small size relative to the overall 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. These commenters also stated that there are safeguards in the market, including the provision of good

[29] This section describes the proposed rule change prior to the proposed amendments in Partial Amendment No. 1, which are described below.

[30] *See supra* note 3; *see also,* Exhibit 5, text of proposed rule change, as originally filed.

[31] *See* description of Partial Amendment No. 1, in section II.D.2. below, which revises the proposed implementation dates.

[32] *See supra* note 3. With the exception of comments received related to multifamily housing and project loan securities and the proposed implementation dates, FINRA's responses to comments received are discussed in section III below.

[33] *See* section II.A.1. above, for a description of the definition of Covered Agency Transactions in the original filing. *See supra* note 3.

[34] *See supra* note 3.

[35] *See* Letter Type A, Letter Type B, AGM Letter, AJM Letter, BDA Letter, Bellwether Letter, CBRE Letter, Centennial Letter, Century Letter, CHF Letter, Churchill Letter, Columbia Letter, Crain Letter, Davis-Penn 1 Letter, Davis-Penn 2 Letter, Draper Letter, DUS Letter, Dwight Letter, First Housing Letter, Forest City 1 Letter, Forest City 2 Letter, Gershman 1 Letter, Gershman 2 Letter, Great Lakes Letter, Highland 1 Letter, Highland 2 Letter, Lancaster Letter, Love Funding Letter, M&T Realty Letter, MBA Letter, MBA & Others 1 Letter, MBA & Others 2 Letter, MBA Supplemental Letter, NMHC/NAA Letter, NorthMarq Letter, Perez Letter, Prairie Mortgage Letter, Prudential Letter, Red Mortgage Letter, Richmac Letter, Sims Mortgage Letter, W&D Letter, and Ziegler Letter.

faith deposits by the borrower to the lender, and requirements imposed by the issuing agencies and GSEs, and, related to that point, that the manner in which multifamily and project loan securities are originated and traded does not give rise to the type of credit exposure that may exist in the TBA market overall. Commenters said that about $40 to $50 billion per year in multifamily and project loan securities are issued versus about $1 trillion for the TBA market overall,[36] that a typical multifamily or project loan security is based on a single loan for a single project the identity of which is known at the time the lender and borrower agree to the terms of the loan and the security is underwritten, thereby helping to reduce settlement risk, and that, by contrast, securities in the overall TBA market are based on pools of loans that often have not been originated at the time the Covered Agency Transaction takes place.[37] Commenters said that multifamily and project loan securities are not widely traded and often cannot be marked to the market for purposes of complying with the proposed margin requirements.[38]

In response, FINRA has reconsidered and does not propose at this time to require that members apply the proposed margin requirements,[39] to multifamily and project loan securities, subject to specified conditions. Specifically, FINRA proposes in Partial 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, 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; 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.[40] FINRA believes that the proposed exception for multifamily and project loan securities is appropriate at this time.

Based on FINRA's analysis of transactional data, multifamily and project loan securities constitute a small portion of the Covered Agency Transactions market overall,[41] which suggests multifamily and project loan securities are less likely to pose issues of systemic risk. However, in this regard, FINRA notes that systemic risk is only one facet of FINRA's concern. As a matter of investor protection and market integrity, FINRA believes that it is appropriate to require that members make and enforce written risk limit determinations for their counterparties in multifamily and housing securities. FINRA believes that imposing the requirement on members to make and enforce risk limits as to counterparties in multifamily and project loan securities is appropriately tailored, as discussed in the original filing with respect to the risk limit requirement generally,[42] to help ensure that the member is properly monitoring its risk. The requirement would serve to help prevent over-concentration in these products. In light of ongoing analysis in this area, FINRA may consider additional rulemaking if necessary.[43]

FINRA is aware that the proposed exception for multifamily and project loan securities may potentially impact the estimates of expected mark to market margin requirements presented in the Statement on Burden on Competition section of the original filing. Specifically, the original analysis was based on the net exposure to any single counterparty in any TBA market transaction, and therefore may have included situations where the exposure on an open position in a single family TBA market transaction could be offset by an opposite exposure on an open position in a multifamily TBA market transaction with the same counterparty.

As such, the proposed exception for multifamily and project loan securities may alter the net margin calculation for members. Members that transact strictly in multifamily TBA market securities would find that their margin obligations would be lower under this formulation, and thus have lower burdens imposed, if the member elects not to apply the margin requirements specified in paragraph (e)(20(H) of the rule as permitted by proposed paragraph (e)(2)(H)(ii)a.2. But members who transact in both single and multifamily TBA market securities with a given counterparty might find that their margin obligations could be higher or lower in the presence of the exception. In addition, these members would likely incur additional costs to monitor single and multifamily TBA market transactions separately.

While the amendment proposed in Partial Amendment No. 1 may impact the margin requirements for some members, FINRA has reason to expect that these impacts would be small based on a review of TBA market transactions. First, the size of the multifamily and project loan securities market is estimated to be relatively small compared to the single family segment of the market. According to the Financial Accounts of the United States published by the Federal Reserve Board, as of the third quarter of 2015, there were approximately $189.9 billion of multifamily residential agency and GSE-backed mortgage pools outstanding, compared to approximately $1.5 trillion for single family mortgage pools.[44] Second, FINRA staff also analyzed the TBA transactions in 2014 from TRACE and found that less than 1% of TBA transactions occurred in Delegated Underwriting and Servicing (''DUS'') pools securities sponsored by Fannie Mae.

To estimate the impact of the exception on broker-dealers and mortgage banks, FINRA staff also analyzed transactional data provided by a major clearing broker-dealer. This

[36] *See* CBRE Letter, CHF Letter, Forest City 1 Letter, Forest City 2 Letter, Letter Type A, MBA Letter, and NMHC/NAA Letter.

[37] *See* Century Letter, MBA Letter, MBA Supplemental Letter, and NorthMarq Letter.

[38] *See* Century Letter, MBA Letter, NorthMarq Letter, and W&D Letter.

[39] In the interest of clarity, FINRA notes that the ''proposed margin requirements'' refers to the margin requirements as to Covered Agency Transactions as set forth in the original filing, as amended by Partial Amendment No. 1. Products or transactions that are outside the scope of Covered Agency Transactions are otherwise subject to the requirements of FINRA Rule 4210, as applicable.

[40] *See* Exhibit 4 and Exhibit 5 in Partial Amendment No. 1. Proposed Rule 4210(e)(2)(H)(ii)b. sets forth the proposed rule's requirements as to written risk limits.

[41] In a sample of open transactions provided by a major clearing broker-dealer, transactions in multifamily securities sum up to approximately $5 billion and constitute approximately 8% of the total open transactions in TBA market securities across 1,142 accounts.

[42] *See supra* note 3.

[43] For example, the federal banking agencies (the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency) recently stated that with respect to commercial real estate lending they have observed certain risk management practices at some financial institutions that cause them concern. *See* Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency Joint Release, ''Statement on Prudent Risk Management for Commercial Real Estate Lending'' (Dec. 18, 2015), available at: <*https://www.fdic.gov/news/news/press/2015/pr15100.html*>.

[44] *See* Table L.125 in Board of Governors of the Federal Reserve System Statistical Release (December 10, 2015), available at: <*http://www.federalreserve.gov/releases/z1/current/z1.pdf*>.

dataset contains 27,350 open transactions as of January 7, 2016 in 1,142 accounts at 49 brokers. 261 of these accounts, at four brokers, had exposure to multifamily and project loan securities. The size of the open transactions in the single family securities ranged between $7,000 and approximately $14 billion per account in the whole sample, with an average (median) of approximately $64 million ($6.9 million). For comparison purposes, the size of open transactions in the multifamily securities ranged between $25,000 and approximately $2 billion per account, with an average (median) of approximately $20 million ($640,000).[45]

Of the 261 accounts that had exposure to multifamily and project loan securities, only nine also had open transactions in single family securities. While the size of the open transactions for multifamily securities in these nine accounts is larger than that for single family securities in these same nine accounts that had exposure to both types of securities, the difference is not statistically significant due to the small sample size and high variance.

The average number of days until settlement is also larger, being approximately 79 days for the open transactions in multifamily securities versus 50 days for the transactions in single-family securities.[46]

The evidence presented here suggests that some brokers may have sizable positions in multifamily securities. However, as evidenced by the data, these positions are likely to be maintained by a small number of brokers and the size of the multifamily TBA market is currently a small portion of the overall TBA market that does not potentially represent any systemic risk. Further, in the sample examined, only nine brokers with transactions in multifamily TBA market securities also had open transactions in single family TBA market securities, suggesting there is limited correlation in counterparty risk across the two segments of the market.

2. Proposed Implementation Period

Commenters said that considerable operational and systems work will be needed to comply with the proposed rule change, including changes to or renegotiation of Master Securities Forward Transaction Agreement (''MSFTA'') documentation and other agreements.[47] These commenters suggested that firms should be permitted 18 months to two years to prepare for implementation of the proposed rule change.

In response, FINRA believes that a phased implementation should be appropriate. FINRA proposes 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 of the rule become effective six months from the date the proposed rule change is approved by the Commission. FINRA proposes that the remainder of the proposed rule change become effective 18 months from the date the proposed rule change is approved by the Commission.

The text of the proposed rule change, as amended by Partial Amendment No. 1, 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. In addition, you may find a more detailed description of the original proposed rule change in the Notice.[48]

III. Summary of Comments and FINRA's Responses [49]

As noted above, the Commission received 109 comment letters on the proposed rule change, including 54 Type A and B letters.[50] These comments and FINRA's responses to the comments are summarized below. [51]

A. Impact and Scope of the Proposal (Other Than With Respect to Multifamily and Project Loan Securities)

Some commenters supported the proposed rule change's goal of addressing counterparty risk in the TBA market and reducing systemic risk.[52] Some commenters acknowledged the need for overall consistency between the proposal and the best practices recommendations of the TMPG.[53] However, commenters expressed concerns that the proposal's scope is overly broad and its requirements too complex to be operationally feasible, and that the proposal would increase costs on various participants in the mortgage market, including small, medium or regional participants, with the effect of driving some participants from the market.[54] One commenter said that all but the largest firms would be driven out of the market.[55] Another commenter questioned the need for the rulemaking on grounds that the TBA market remained stable prior to and throughout the 2008 financial crisis.[56] That commenter also expressed concern that the pool of eligible collateral available for margin purposes is limited and that the opportunity cost of posting collateral would force institutions to forgo participating in the market or would force them to pass costs on to consumers.[57] One commenter suggested the rule should only reach TBA transactions and Specified Pool Transactions.[58] Another commenter suggested the proposal should not reach Specified Pool Transactions.[59] Another commenter suggested that both Specified Pool Transactions and CMOs should be taken out of the proposal's scope and questioned FINRA's authority to impose the requirements.[60] Several commenters suggested that the proposed settlement cycles set forth in the definition of Covered Agency Transactions—that is, greater than one business day between the trade date and the contractual settlement date for TBA transactions and Specified Pool Transactions, and greater than three business days for CMOs—are too short.[61] These commenters proffered alternatives such as a specified settlement cycle for TBA transactions of three days or greater, on grounds that transactions settling within three days present minimal risk,[62] or a specified cycle based on Securities Industry and Financial Markets Association (''SIFMA'') monthly settlement dates,[63] or, for Specified Pool Transactions, a specified cycle of three or more business days.[64]

In response, other than with respect to multifamily and project loan securities, as discussed above, FINRA does not propose to modify the proposed rule's application to Covered Agency

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[45] The difference between the average size of open transactions for single family and multifamily securities is statistically significant at the 5% level.

[46] The difference between the average settlement days for single family and multifamily securities is statistically significant at the 5% level.

[47] *See* ACLI Letter, AII Letter, ICI Letter, Sandler O'Neill Letter, SIFMA Letter, and SIFMA AMG Letter.

[48] *See supra* note 3.

[49] *See supra* note 3, for full FINRA discussion of the original filing. Comments received and FINRA's responses to the comments related to the multifamily housing and project loan securities, as well as the proposed implementation dates are addressed in section II.D. above.

[50] *See supra* note 4.

[51] *See supra* note 5.

[52] *See* ACLI Letter, AII Letter, Brean Capital 1 Letter, SIFMA Letter, and SIFMA AMG Letter.

[53] As set forth more fully in the original filing, FINRA noted that the proposal is informed by the TMPG best practices. *See supra* note 3.

[54] *See* ACLI Letter, BDA Letter, Brean Capital 1 Letter, Coastal Letter, and SIFMA Letter.

[55] *See* Brean Capital 1 Letter.

[56] *See* ACLI Letter.

[57] *Id.*

[58] *See* ICI Letter.

[59] *See* Robert Baird Letter.

[60] *See* Coastal Letter.

[61] *See* ACLI Letter, BDA Letter, ICI Letter, Matrix Letter, Robert Baird Letter, and SIFMA Letter.

[62] *See* ICI Letter.

[63] *See* ACLI Letter.

[64] *See* Robert Baird Letter.

Transactions as set forth in the original filing. Further, FINRA does not propose to modify the specified settlement periods as set forth in the Covered Agency Transactions definition. With respect to FINRA's authority, in the original filing FINRA noted that it believed that the rule change is consistent with the provisions of Section 15A(b)(6) of the Exchange Act.[65] FINRA noted, as set forth more fully in the original filing,[66] that the proposed margin requirements will likely impose direct and indirect costs, including direct costs of compliance with the requirements and indirect costs resulting from changed market behavior of some participants, which may impact liquidity in the market. Though FINRA shares commenters' concerns regarding such potential effects, FINRA believes the proposed requirements are needed because the unsecured credit exposures that exist in the TBA market today can lead to financial losses by members. In this regard, FINRA noted that the TBA market has the potential for a significant amount of volatility,[67] and that permitting counterparties to participate in the TBA market, in the absence of the proposed requirements, can facilitate increased leverage by customers, thereby posing risk to the member extending credit and to the marketplace and potentially imposing, in economic terms, negative externalities on the financial system in the event of failure. Consequently, FINRA believes as to the assertion that there has been no or limited degradation in the TBA market does not of itself demonstrate that there is no credit risk in this market.[68]

In the original filing, FINRA discussed how it had considered, among other things, various options for narrowing the scope of Covered Agency Transactions or extending the specified settlement cycles.[69] As FINRA noted, the FRBNY staff advised FINRA that such modifications to the proposal would result in a mismatch between FINRA standards and the TMPG best practices, thereby resulting in perverse incentives in favor of non-margined products and leading to distortions of trading behavior, including clustering of trades around the specified settlement cycles in an effort to avoid margin expenses. Further, in response to comments on the proposal as it had been published for comment in *Regulatory Notice* 14–02,[70] FINRA engaged in extensive discussions with industry participants and other regulators, including staff of the SEC and the FRBNY, and engaged in analysis of the potential economic impact of the proposal. Following its publication in the *Regulatory Notice,* FINRA made revisions to the proposal to ameliorate its impact on business activity and to address the concerns of smaller customers that do not pose material risk to the market as a whole, in particular those engaging in non-margined, cash account business. These revisions included, among other things, the establishment of the exception from the proposed margin requirements for any counterparty with gross open positions amounting to $2.5 million or less, subject to specified conditions, as well as specified exceptions to the maintenance margin requirement and modifications to the proposal's de minimis transfer provisions.[71] As such, FINRA reiterates its view that narrowing the scope of Covered Agency Transactions or modifying the proposed settlement cycles in the fashion suggested by commenters would undermine the rule's fundamental purpose of improving counterparty risk management and, further, that the revisions made to the proposal, as described in the original filing, will ameliorate its impact.

B. Maintenance Margin

As set forth more fully in the original filing, non-exempt accounts[72] would be required to post two percent maintenance margin plus any net mark to market loss on their Covered Agency Transactions.[73] Commenters opposed the maintenance margin requirement and expressed concerns about the proposed requirement's impact and efficacy.[74] One commenter said that the requirement would disproportionately affect small to medium-sized participants and would exacerbate risks by not requiring that the margin be segregated and held at a non-affiliated custodian.[75] A commenter similarly expressed concern that the requirement would disadvantage small dealers.[76] One commenter said that the requirement would have the effect of requiring maintenance margin from medium-sized firms, rather than small or large firms, and that the requirement would create complexity for members by requiring that maintenance margin be calculated on a transaction by transaction basis.[77] Another commenter also expressed the concern that the requirement would impact medium-sized firms and suggested that FINRA should consider a tiered maintenance margin requirement for trades under a defined gross dollar amount.[78] One commenter said that the requirement should be eliminated.[79] Another commenter suggested that the TMPG best practices do not have a maintenance margin requirement, which would create opportunity for regulatory arbitrage.[80] The same commenter said that the accounts that would be subject to the requirement are too small to create systemic risk.[81]

In response, FINRA does not propose to modify the maintenance margin requirement. Maintenance margin is a mainstay of margin regimes in the securities industry, and as such the need to appropriately track transactions should be well understood to market participants. FINRA is sensitive to commenters' concerns as to the potential impact of the requirement on members and their non-exempt customer accounts. For this reason, as set forth more fully in the original filing and as discussed further below, FINRA revised the proposal to include an exception tailored to customers engaging in non-margined, cash account business. FINRA noted that the requirement is designed to be aligned to the potential risk in this area and that the two percent amount approximates rates charged for corresponding products in other contexts.[82]

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[65] *See supra* note 3. Section 15A(b)(6) 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.

[66] *See supra* note 3.

[67] *See supra* note 3. ACLI suggested that FINRA had conceded in the original filing that the TBA market seems to respond only slightly to the volatility in the U.S. interest rate environment. In response, this only partially states the tenor of FINRA's analysis, which, again, noted that price movements in the TBA market over the past five years suggest the market has *potential* for significant volatility.

[68] *See supra* note 3.

[69] *Id.*

[70] *Regulatory Notice* 14–02 (January 2014) (Margin Requirements: FINRA Requests Comment on Proposed Amendments to FINRA Rule 4210 for Transactions in the TBA Market).

[71] *See supra* note 3. Commenters expressed concerns regarding these exceptions as set forth in the original filing. Commenters' concerns, and FINRA's response, are addressed more fully below.

[72] *See supra* note 23.

[73] *See supra* note 3.

[74] *See* AII Letter, Robert Baird Letter, BDA Letter, Matrix Letter, SIFMA Letter, and SIFMA AMG Letter. Some commenters expressed concern as to the operational feasibility of the rule's proposed exception to the maintenance margin requirement. These comments, and FINRA's response, are addressed more fully below.

[75] *See* SIFMA AMG Letter.

[76] *See* BDA Letter.

[77] *See* SIFMA Letter.

[78] *See* Matrix Letter.

[79] *See* Baird Letter.

[80] *See* AII Letter.

[81] *Id.*

[82] *See supra* note 3.

C. ''Cash Account'' Exceptions

As set forth more fully in the original filing,[83] the proposed margin requirements would not apply to any counterparty that has gross open positions [84] 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 DVP basis or for cash. Similarly, a non-exempt account would be excepted from the rule's proposed two percent maintenance margin requirement 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 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), or ''round robin'' trades, or that uses other financing techniques for its Covered Agency Transactions. FINRA noted that these exceptions are intended to address the concerns of smaller customers engaging in non-margined, cash account business.[85]

Commenters expressed concern that the cash account exceptions are difficult to implement operationally and are in need of further guidance.[86] These commenters suggested that the term ''regularly settles'' is ambiguous and vague, that members may find it too difficult to comply with the requirement and may therefore choose not to make the cash account exceptions available to their customers, that the references to dollar rolls, round robin trades and other financing techniques should be removed to make the cash account exceptions more accessible, or that the rule should permit members to rely on representations counterparties make where activity away from the member firm is involved. A commenter sought guidance as to whether it would suffice if the member has a reasonable expectation of the customer's behavior based on the customer's prior history of physical settlement.[87] Another commenter sought guidance as to the scope of the term ''other financing techniques'' and whether, for instance, a customer's engaging in a single dollar roll or round robin trade would make the cash account exceptions unavailable.[88]

In response, FINRA does not propose to modify the cash account exceptions as proposed in the original filing.[89] Given that the purpose of the exceptions is to help ameliorate the proposal's impact on smaller customers, it is not FINRA's expectation that the exceptions should be onerous to implement. FINRA believes that, as worded, the term ''regularly settles'' is sufficient to convey that the rule's intent is to provide scope for flexibility on members' part as to how they implement the exceptions. FINRA expects that members are in a position to make reasonable judgments as to the observed pattern and course of dealing in their customers' behavior by virtue of their interactions with their customers. In this regard, FINRA believes the import of the term ''other financing techniques'' should be clear as a matter of plain language, that is, transactions other than on a DVP basis or for cash suggest the use of financing. FINRA does not expect that a customer that engages in a single dollar roll or round robin trade would be denied access to the exceptions provided the member can reasonably demonstrate a regular pattern by that customer of settling its Covered Agency Transactions on a DVP basis or for cash. In so doing, a member may use the customer's history of transactions with the member, as well as any other relevant information of which the member is aware. Further, FINRA believes that members should be able to rely on the reasonable representations of their customers where necessary for purposes of this requirement. FINRA welcomes further discussion with industry participants on this issue, and will consider issuing further guidance as needed.

D. Two-Way (Bilateral) Margin

Several commenters suggested that the proposed rule should require the posting of two-way or bilateral margin in Covered Agency Transactions, so that members and their counterparties in such transactions would both post and receive margin.[90] These commenters suggested that two-way margin is necessary to effectively reduce risk given the exposure of the parties and that two-way margin is standard in other contexts. A commenter suggested that the TMPG encourages firms to engage in two-way margining and that FINRA should express support for firms that do so.[91]

In response, FINRA noted in the original filing that it supported the use of two-way margining as a means of managing risk.[92] However, FINRA does not propose to address such a requirement at this time as part of the proposed rule change. FINRA welcomes further dialogue with industry participants on this issue.

E. $2.5 Million Gross Open Position Amount and the $250,000 de Minimis Transfer Amount

As discussed above, the proposed rule sets forth an 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, as specified by the rule. As set forth more fully in the original filing, 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, as specified by the rule.[93] One commenter suggested that the $2.5 million amount is too low and that FINRA should provide guidance as to treatment of accounts that fluctuate in the approximate range of that amount.[94] A couple of commenters suggested a $10 million exception for gross open positions.[95] As to the $250,000 de minimis transfer amount, a few commenters suggested increasing the amount to $500,000.[96] One commenter expressed concern that members would end up needing to monitor the $250,000 amount even though it would benefit few if any customers.[97] This commenter further suggested that the rule should grandfather existing agreements that already provide for $500,000 de minimis transfer amounts.[98] A commenter suggested $500,000 is appropriate because that amount is used

[83] *Id.*

[84] *See* Exhibit 5 in Partial Amendment No. 1.

[85] *See supra* note 3. For convenience, the $2.5 million and maintenance margin exceptions are referred to as the ''cash account'' exceptions for purposes of Partial Amendment No. 1.

[86] *See* Robert Baird Letter, BDA Letter, Credit Suisse Letter, Matrix Letter, SIFMA Letter, and SIFMA AMG Letter.

[87] *See* SIFMA Letter.

[88] *See* SIFMA AMG Letter.

[89] *See supra* note 3.

[90] *See* ACLI Letter, AII Letter, Crain Letter, ICI Letter, SIFMA AMG Letter, and Sutherland Letter.

[91] *See* SIFMA Letter.

[92] *See supra* note 3.

[93] *See supra* note 3.

[94] *See* SIFMA AMG Letter.

[95] *See* SIFMA Letter and BDA Letter.

[96] *See* ACLI Letter, ICI Letter, and SIFMA Letter.

[97] *See* SIFMA Letter.

[98] *Id.*

in other regulatory contexts.[99] One commenter suggested raising the de minimis transfer amount to $1 million.[100] Some commenters suggested that the rule should permit parties to negotiate higher thresholds.[101] Another commenter suggested the $250,000 de minimis transfer amount would not be sufficient for participants in the multifamily market.[102]

In response, FINRA does not propose to alter the $2.5 million amount for gross open positions and does not propose to alter the $250,000 de minimis transfer amount. As discussed in the original filing, FINRA believes that these amounts are appropriately tailored to smaller accounts that are less likely to pose systemic risk.[103] FINRA believes that increasing the thresholds would undermine the rule's purpose. In that regard, permitting parties to negotiate higher thresholds by separate agreement, whether entered into before the rule takes effect or afterwards, would only serve to cut against the rule's objectives. FINRA does not propose to alter the de minimis transfer amount on account of multifamily securities transactions given that, as discussed above, FINRA is amending the rule so that members may elect not to apply the proposed margin requirements to multifamily and project loan securities, subject to specified conditions.[104]

F. Timing of Margin Collection and Position Liquidation

As set forth more fully in the original filing, 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, 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.[105] Further, unless FINRA has specifically granted the member additional time, 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.[106] Commenters expressed concerns that the proposed rule's time frame for collection of the mark to market loss or deficiency (that is, margin collection) and the time frame for liquidation are too onerous, that longer periods should be permitted as the five-day liquidation period is not sufficient to resolve various issues that may arise, that parties should be permitted to set the applicable time frames in a MSFTA or other agreement, and that the time frames do not align with the 15 days permitted under FINRA Rule 4210(f)(6) or other market conventions.[107] Two commenters suggested that the ''T+1'' margin call would raise operational issues.[108] Another commenter suggested that the capital charge should apply five days after the initial margin call.[109] Another commenter suggested FINRA should allow firms to take a capital charge in lieu of collecting margin.[110] Another commenter suggested that allowing dealers to take a capital charge is a suitable practice to address margin delivery fails and that the forced liquidation requirement should be eliminated.[111]

In response, FINRA does not propose to modify the timing for margin collection and position liquidation as set forth in the proposed rule change. With respect to position liquidation, while it is true that longstanding language under FINRA Rule 4210(f)(6) sets forth a 15-day period, more recent requirements adopted under the portfolio margin rules, which have been in widespread use among members, set forth a three-day time frame.[112] FINRA believes that, with respect to Covered Agency Transactions, the five-day period should provide sufficient time for members to resolve issues. Further, as FINRA noted in the original filing, FINRA believes the five-day period is appropriate in view of the potential counterparty risk in the TBA market.[113] Consistent with longstanding practice under FINRA Rule 4210(f)(6), the proposed rule allows FINRA to specifically grant the member additional time. FINRA maintains, and regularly updates, the Regulatory Extension System for this purpose. FINRA welcomes further discussion with industry participants on this issue. With respect to the timing of margin collection, FINRA notes that the proposed language ''by the close of business on the next business day after the business day'' on which the market to market loss or deficiency arises is consistent, again, with language under the portfolio margin rules, which are well understood by members.[114] FINRA does not believe it is appropriate to revise the proposed rule to permit members to take a capital charge in lieu of collecting margin. FINRA notes that taking a capital charge, of itself, does not suffice to address counterparty risk, which is a key purpose of the proposed rule change. Further, FINRA believes that only requiring capital charges would render the rule without effect. FINRA does not believe it is appropriate to eliminate the liquidation requirement given that the requirement is intended to mitigate risk.

G. Concentration Limits

As set forth more fully in the original filing, under current (pre-revision) paragraph (e)(2)(H) of the rule, a member must provide written notification to FINRA and is prohibited from entering into any new transactions that could increase credit exposure if net capital deductions, over a five day period, exceed: (1) For a single account or group of commonly controlled accounts, five percent of the member's tentative net capital; or (2) for all accounts combined, 25 percent of the member's tentative net capital.[115] Commenters suggested that the five percent threshold should be raised to 10 percent so as to take account of the impact of the proposal.[116] In response, FINRA does not propose to revise the five percent threshold. FINRA noted in the original filing that both the five percent and the 25 percent thresholds are currently in use and are designed to address aggregate risk in this area.[117] FINRA noted that if the thresholds are easily reached in volatile markets, then that would suggest the thresholds serve an important purpose in monitoring risk.

H. Mortgage Bankers

As set forth more fully in the original filing, the proposed rule provides that members may treat mortgage bankers that use Covered Agency Transactions to hedge their pipeline of commitments as exempt accounts for purposes of paragraph (e)(2)(H) of the rule.[118]

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[99] *See* ICI Letter.

[100] *See* BDA Letter.

[101] *See* CoBank Letter, SIFMA AMG Letter, Sutherland Letter.

[102] *See* Crain Letter.

[103] *See supra* note 3.

[104] *See* section II.D.1. above.

[105] *See supra* note 3.

[106] *Id.*

[107] *See* ACLI Letter, AII Letter, BDA Letter, SIFMA Letter, and SIFMA AMG Letter.

[108] *See* SIFMA Letter and SIFMA AMG Letter.

[109] *See* BDA Letter.

[110] *See* ICI Letter.

[111] *See* AII Letter.

[112] *See* FINRA Rule 4210(g)(9) and FINRA Rule 4210(g)(10).

[113] *See supra* note 3.

[114] *See* FINRA Rule 4210(g)(10)(B).

[115] *See supra* note 3. Under the proposed rule change, current paragraph (e)(2)(H) would be redesignated as paragraph (e)(2)(I).

[116] *See* BDA Letter and SIFMA Letter.

[117] *See supra* note 3.

[118] *Id.*

Proposed Supplementary Material .02 of the rule provides that members must adopt written procedures to monitor the mortgage banker's pipeline of mortgage loan commitments to assess whether the Covered Agency Transactions are being used for hedging purposes.[119] The Mortgage Bankers Association (''MBA'') suggested that, in addition to excepting mortgage bankers from treatment as non-exempt accounts if they hedge their pipeline of commitments, and thereby excepting them from the maintenance margin requirements that would otherwise apply, FINRA should also except mortgage bankers from the mark to market (also referred to as variation) margin requirements that would apply to exempt accounts.[120] MBA suggested that mortgage bankers function as ''end users'' that should not be unduly burdened by mandatory transaction rules, that requiring variation margin would distort the mortgage finance markets, and that hedging transactions by mortgage brokers do not represent a systemic risk. MBA said that FINRA had not done sufficient economic analysis as to the rule's impact on mortgage bankers.[121] Several other commenters said that FINRA should clarify what level of diligence members need to apply to determine whether a mortgage banker is hedging its pipeline of commitments and thereby eligible to be treated as an exempt account.[122] Commenters sought guidance as to whether for example members may comply by obtaining representations or certifications from the mortgage bankers.

In response, as FINRA noted in the original filing, the type of monitoring set forth in the proposed rule is not a wholly new requirement.[123] The current Interpretations under Rule 4210 already contemplate that members evaluate the loan servicing portfolios of specified counterparties that are being treated as exempt accounts.[124] FINRA believes it is sound practice that members have written procedures to monitor the portfolios of mortgage bankers that are being treated as exempt accounts. As discussed earlier with respect to the cash account exceptions, FINRA believes that members should be able to rely on the reasonable representations of their mortgage banker customers where necessary for purposes of this requirement. FINRA welcomes further discussion with industry participants on this issue, and will consider issuing further guidance as needed. FINRA does not propose to modify the proposal to except mortgage bankers from the mark to market requirements, such as by creating an ''end user'' or other similar type of exception, as doing so would undermine the rule's purpose by excepting a major category of participant in the market. FINRA believes that such an exception would create incentives that would distort trading behavior, which could increase the risk of member firms and their customers. As discussed in section III.A. above, and as further discussed below, FINRA has noted that the proposed rule change will likely impose direct and indirect costs, which may lead to decreased liquidity in the market.[125] However, FINRA has noted the need for the rule change given the potential for risk in this market.[126]

In response to MBA's suggestion that FINRA did not do sufficient economic analysis as to the rule's impact on mortgage bankers, FINRA notes the following. First, MBA stated that FINRA's analysis consisted of a cursory examination of the TBA market over a short period of time using data from one broker-dealer across 35 days leading up to and including May 30, 2014.[127] In response, FINRA notes that this interpretation of the data used in the analysis is not accurate; the sample period is not 35 days and the data do not contain the open positions of a single broker-dealer. To estimate the potential burden on mortgage bankers, FINRA analyzed data provided by a major clearing broker. This dataset contained 5,201 open transactions as of May 30, 2014 in 375 customer (including mortgage banker) accounts at 10 broker-dealers. These open transactions were created between October 18, 2013 and May 30, 2014, with approximately 60% created in May 2014. Based on FINRA's discussions with the clearing broker, FINRA believes that the sample is a good representation of typical exposures. These open positions would require posting margin on 35 days throughout the sample, corresponding to less than 0.01% of the 14,001 account-day combinations.

Second, MBA suggested that FINRA's analysis did not control the results of its study against typical market volatility, against the expected withdrawal of the Federal Reserve as an active buyer of TBA-eligible MBS or even to follow its sample data through other periods throughout 2014.[128] However, as discussed in the original filing, FINRA analyzed the relation between interest rate volatility and the volatility in the TBA market by comparing the volatility of Deutsche Bank's TBA index in two different interest rate regimes based on 10-year U.S. Treasury yields and found no significant change across the two periods.[129] FINRA acknowledged that the Federal Reserve (specifically, the FRBNY) is a major market participant in the TBA market. The withdrawal of FRBNY as an active buyer would have a significant impact on the market, unless other market participants increase their activities or new participants choose to enter the market.[130] FINRA discussed this potential impact in the original filing.[131]

Third, MBA suggested that FINRA's analysis did not appear to evaluate the financial and other costs the proposed rule change would impose on mortgage bankers and borrowers and that FINRA did not evaluate the impact to consumers and other borrowers resulting from an increase in mortgage rates and reduction in competition that would arise due to the proposed rule change.[132] MBA suggested that the proposed rule change will harm borrowers by limiting their access to credit, and that requiring mortgage bankers to divert their liquidity from origination for margin calls imposes an acute liquidity risk on mortgage bankers. In response, as discussed earlier, FINRA acknowledged in the original filing the potential impact of the proposed rule change on market behavior of participants and noted that ''[s]ome parties who currently transact in the TBA market may choose to withdraw from or limit their participation in the TBA market.[133] Reduced participation may lead to decreased liquidity in the market for certain issues or settlement periods, potentially restricting access to end users and increasing costs in the mortgage market.'' [134] However, FINRA noted that the impact on access to credit would be limited if new participants

[119] *See* proposed FINRA Rule 4210.02 in Exhibit 5 of Partial Amendment No. 1.

[120] *See* MBA Letter.

[121] *Id.*

[122] *See* BDA Letter, Matrix Letter, SIFMA Letter, and Sandler O'Neill Letter.

[123] *See supra* note 3.

[124] *See* Interpretation /02 of FINRA Rule 4210(e)(2)(F); *see also, supra* note 3. The Interpretation cites, in part, such factors as loan balance, servicing fee, remaining life of the loan, probability of loan survival, delinquency rate, geographic relationships, cost of foreclosure and servicing costs.

[125] *See supra* note 3.

[126] *See supra* note 67.

[127] *See* MBA Letter.

[128] *Id.*

[129] *See supra* note 3.

[130] *Id.*

[131] *Id.*

[132] *See* MBA Letter.

[133] *See supra* note 3.

[134] *Id.*

choose to enter the market to offset the impact of participants that exit the market. Further, in light of the importance of the role of mortgage bankers in the mortgage finance market, FINRA noted in the original filing that the proposed rule change has accommodated the business of mortgage bankers by including provision for members to treat mortgage bankers as exempt accounts with respect to their hedging, subject to specified conditions.[135]

Fourth, MBA suggested that FINRA neglected to analyze the impact of mortgage bankers being forced to switch from mandatory to best efforts delivery commitments in the process forsaking significant amounts of their gain on sale or limiting their competitiveness in various products.[136] In response, FINRA has no basis to believe that the margin requirement would force mortgage bankers to switch from mandatory execution basis to best efforts execution. FINRA expects that the majority of the mortgage bankers' positions would be excepted from the proposed margin requirements, and market competition would maintain the origination of loans to the borrowers.

I. Risk Limit Determinations

One commenter sought clarification as to whether paragraphs (e)(2)(F), (e)(2)(H) and (e)(2)(G) of the rule require a member to write a separate risk limit determination for the types of products addressed by each of those paragraphs for each counterparty.[137] In response, FINRA notes that one written risk limit determination, for each counterparty, should suffice, provided it addresses the products. As set forth more fully in the original filing, FINRA notes that the proposed risk limit language in paragraphs (e)(2)(F) and (e)(2)(G) is drawn from language that appears under current, pre-revision paragraph (e)(2)(H) and which currently, by its terms, already applies to both paragraphs (e)(2)(F) and (e)(2)(G).[138]

J. Advisory Clients of Registered Investment Advisers

As set forth more fully in the original filing, proposed Supplementary Material .05 requires in part 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.[139] One commenter sought clarification as to whether the 10 percent threshold may be calculated as of the time of the credit review under the member's written risk analysis policy and procedures.[140] Another commenter suggested that the 10 percent threshold is not necessary and FINRA should clarify whether the 10 percent goes to the commonly controlled accounts at the member firm.[141] A commenter requested guidance as to whether it would be permissible for the member to collect aggregated margin in a single account, given that the investment adviser may be contractually prohibited from disclosing details about customers in the sub-accounts.[142]

In response, FINRA believes it is consistent with the rule's intent that the 10 percent threshold may be calculated as of the time of the member's credit review pursuant to its written risk policies and procedures.[143] FINRA expects that the 10 percent would be as to accounts of which the member is aware by virtue of the member's relationship with the investment adviser. As noted in the original filing, FINRA believes the 10 percent threshold is appropriate given that accounts above that threshold pose a higher magnitude of risk. FINRA believes that the rule does not prevent a member from aggregating margin, provided the member observes all applicable requirements under SEC and FINRA rules.[144]

K. Sovereign Entities

As set forth more fully in the original filing, 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),[145] 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) of the proposed rule 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.[146] A couple of commenters said that sovereign wealth funds should be included among the entities with respect to which a member may elect not to apply the proposed margin requirements.[147] One of the commenters said that FINRA should consider the credit profile of sovereign wealth funds rather than whether they are commercial participants.[148] In response, FINRA does not propose to make the suggested modification. The proposed exception is designed specifically for selected sovereign entities performing the functions of governments. As commercial participants in the market, sovereign wealth funds are subject to risk. As noted in the original filing, FINRA believes that to include sovereign wealth funds within the parameters of the proposed exception would create perverse incentives for regulatory arbitrage.[149]

L. Federal Home Loan Banks and Farm Credit Banks

Some commenters requested that FINRA amend the rule so that members would have discretion to except Federal Home Loan Banks (''FHLB'') and Farm Credit Banks (''FCB'') from the proposed margin requirements.[150] One commenter requested that, in the alternative, a member should have discretion to except FHLB from the proposed margin requirements when the Covered Agency Transactions are entered into for the purpose of hedging risk.[151] The commenters suggested

[135] *Id.*

[136] *See* MBA Letter.

[137] *See* SIFMA Letter.

[138] *See supra* note 3.

[139] *Id. See* proposed FINRA Rule 4210.05 in Exhibit 5 of Partial Amendment No. 1.

[140] *See* Credit Suisse Letter.

[141] *See* SIFMA Letter.

[142] *See* Sandler O'Neill Letter.

[143] The proposed rule is not intended to prescribe specific intervals at which a member would need to review risk limit determinations. However, FINRA notes that, with respect to risk limit determinations pursuant to the proposed rule, proposed Rule 4210.05(a)(4) provides that 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. FINRA believes members should be mindful, in the conduct of their business, of the need to revisit risk limit determinations as appropriate. *See* proposed Rule 4210.05(a)(4) in Exhibit 5 in Partial Amendment No. 1.

[144] *See supra* note 3.

[145] 12 U.S.C. 1813(z) defines federal banking agency to mean the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, or the Federal Deposit Insurance Corporation.

[146] *See supra* note 3.

[147] *See* SIFMA Letter and SIFMA AMG Letter.

[148] *See* SIFMA Letter.

[149] *See supra* note 3.

[150] *See* Sutherland Letter and CoBank Letter.

[151] *See* Sutherland Letter.

further that the rule should provide for a member's counterparty to have the right to segregate any margin posted with a FINRA member with an independent third-party custodian. In response, FINRA does not propose to make the requested modifications to the proposed rule. The requested exceptions would undermine the rule's purpose of reducing risk. With respect to third-party custodial arrangements, FINRA believes these are best addressed in separate rulemaking or guidance, as appropriate. FINRA welcomes further discussion of these issues.

M. Other Comments

Several commenters expressed concerns, as set forth below, that FINRA believes raise issues that are outside the scope of the proposed rule change. As such, in response, FINRA does not propose any revisions to the proposed rule change. However, FINRA welcomes further discussion of these issues.

- A few commenters said that the proposed rule change should address the responsibilities of introducing and clearing firms, including such issues as assignment of responsibility for capital charges to one party versus the other for purposes of FINRA Rule 4311 when engaging in Covered Agency Transactions. FINRA notes that the proposed rule change is not intended to address issues under Rule 4311.[152]
- A commenter said FINRA should work with international regulators to harmonize the proposed requirements with other regulatory regimes.[153] As noted above, FINRA believes this is outside the scope of the proposed rule change.
- A couple of commenters said that smaller and medium firms may find it difficult to develop in-house systems to comply with the proposed rule change.[154] One commenter requested that FINRA clarify that members may utilize third-party providers to assist with their compliance.[155] Broadly, FINRA believes third-party service providers should be permissible provided the member complies with all applicable rules and guidance, including, among other things, the member's obligations under FINRA Rule 3110 and as described in *Notice to Members* 05–48 (July 2005) (Outsourcing).
- A commenter said that FINRA should coordinate the rule change with the former Mortgage-Backed Securities Clearing Corporation, now part of the Fixed Income Clearing Corporation.[156] As noted above, FINRA believes this is outside the scope of the proposed rule change.
- Two commenters said that FINRA should provide guidance that would permit collective investment trusts, common trust funds or collective trust funds to be treated as exempt accounts.[157] One of the commenters further said that foreign institutions should be recognized as exempt accounts.[158] Another commenter suggested FINRA should confirm that an omnibus account maintained by an investment adviser may be classified as an exempt account based on the assets under management in the account and a risk analysis conducted at the investment adviser level.[159] FINRA notes that, other than for purposes of one conforming revision, as set forth in the original filing, the proposed rule change is not intended to revisit the definition of exempt accounts for the broader purposes of Rule 4210.[160]

IV. Proceedings To Determine Whether To Approve or Disapprove SR–FINRA–2015–036 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Exchange Act Section 19(b)(2)(B) to determine whether the proposed rule change should be approved or disapproved.[161] Institution of proceedings appears appropriate at this time in view of the legal and policy issues raised by the proposal. As noted above, institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, the Commission seeks and encourages interested persons to comment on the issues presented by the proposed rule change and provide the Commission with arguments to support the Commission's analysis as to whether to approve or disapprove the proposal.

Pursuant to Exchange Act Section 19(b)(2)(B),[162] the Commission is providing notice of the grounds for disapproval under consideration. In particular, Exchange Act Section 15A(b)(6) [163] 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.

FINRA, in proposing margin requirements for Covered Agency Transactions, stated that it believes unsecured credit exposures that exist in the TBA market today can lead to financial losses by dealers.[164] The Commission agrees with FINRA that permitting counterparties to participate in the TBA market without posting margin can facilitate increased leverage by customers, thereby potentially posing a risk to the dealer extending credit and to the marketplace as a whole.[165] The Commission believes, however, that the proposed rule change, as modified by Partial Amendment No. 1, to impose margin requirements on Covered Agency Transactions raises questions with regard to the potential effects of the proposal on the mortgage market, as a whole, as well as on certain market participants. In particular, the Commission believes that the proposed rule change, as modified by Amendment No. 1, raises concerns that the potential operational difficulties and costs of implementing the proposed rule may cause some firms to either withdraw from the TBA market or cease dealing with certain types of counterparties. This raises questions as to whether the proposed margin requirements are consistent with the requirements of Section 15A(b)(6) [166] of the Exchange Act, including whether the proposed rule is 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.

V. Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the issues raised by the proposed rule change, as modified by Partial Amendment No. 1. In particular, the Commission invites the written views of interested persons on whether the proposed rule change, as modified by Partial Amendment No. 1, is inconsistent with Section 15A(b)(6), or any other provision, of the Exchange

[152] *See* BDA Letter, Sandler O'Neill Letter, and SIFMA Letter.

[153] *See* SIFMA AMG Letter.

[154] *See* Matrix Letter and BDA Letter.

[155] *See* Matrix Letter.

[156] *See* Brean Capital 2 Letter.

[157] *See* SIFMA Letter and SIFMA AMG Letter.

[158] *See* SIFMA AMG Letter.

[159] *See* Credit Suisse Letter.

[160] *See supra* note 3.

[161] 15 U.S.C. 78s(b)(2). Exchange Act Section 19(b)(2)(B) provides that proceedings to determine whether to disapprove a proposed rule change must be concluded within 180 days of the date of publication of notice of the filing of the proposed rule change. The time for conclusion of the proceedings may be extended for up to an additional 60 days if the Commission finds good cause for such extension and publishes its reasons for so finding or if the self-regulatory organization consents to the extension.

[162] 15 U.S.C. 78s(b)(2)(B).

[163] 15 U.S.C. 78*o*–3(b)(6).

[164] *See supra* note 3.

[165] *Id.*

[166] 15 U.S.C. 78*o*–3(b)(6).

Act, or the rules and regulations thereunder.

Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b–4, any request for an opportunity to make an oral presentation.[167]

Interested persons are invited to submit written data, views, and arguments by February 11, 2016 concerning whether the proposed rule change should be approved or disapproved. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by March 7, 2016. In light of the concerns raised by the proposed rule change, as modified by Partial Amendment No. 1, as discussed above, the Commission invites additional comment on the proposed rule change, as modified by Partial Amendment No. 1, as the Commission continues its analysis of whether the proposed rule change, as modified by Partial Amendment No. 1, is consistent with Section 15A(b)(6), or any other provision of the Exchange Act, or the rules and regulations thereunder. The Commission is asking that commenters address the merits of FINRA's statements in support of its proposal, as modified by Partial Amendment No. 1, as well as the comments received on the proposal, in addition to any other comments they may wish to submit about the proposed rule change, as modified by Partial Amendment No. 1. Specifically, the Commission is considering and requesting comment, including empirical data in support of comments, in response to the following questions:

1. Will the proposed rule change, as modified by Partial Amendment No. 1, affect the operation and structure of the TBA markets as it exists today? If so, how?

2. What are commenters' views with respect to the benefits and costs of the proposed rule change, as modified by Partial Amendment No. 1? What implementation and ongoing costs will result, if any, from complying with the proposed rule change, as modified by Partial Amendment No. 1?

3. Will the proposed rule change, as modified by Partial Amendment No. 1, affect FINRA member firms differently based on their size (*i.e.,* small, medium or large firms)? If so, how? Will the proposed rule change, as modified by Partial Amendment No. 1, create competitive advantages or disadvantages for member firms based on their size? If so, how?

4. What are commenters' views on the impact of the proposed rule change, as modified by Partial Amendment No. 1, on other affected parties, such as non-member firms and other market participants?

5. What are commenters' views on the exception for multifamily housing and project loan securities in the proposed rule change, as modified by Partial Amendment No. 1? Does the proposed exception for multifamily and project loan securities pose any risks to FINRA members, as well as other market participants? If so, please describe these risks?

6. What are commenters' views on the implementation time required to comply with the proposed rule change, as modified by Partial Amendment No. 1?

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 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. 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 February 11, 2016. If comments are received, any rebuttal comments should be submitted by March 7, 2016.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[168]

Robert W. Errett,

Deputy Secretary.

[FR Doc. 2016–01058 Filed 1–20–16; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–76915; File No. SR–BX–2016–001]

Self-Regulatory Organizations; NASDAQ OMX BX, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Amend Exchange Rule 7018

January 14, 2016.

Pursuant to 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 January 4, 2016, NASDAQ OMX BX, Inc. (''BX'' or ''Exchange'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') the proposed rule change as described in Items I, II, and III 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 proposes to amend the fee schedule under Exchange Rule 7018(a) with respect to execution and routing of orders in securities priced at $1 or more per share.

The text of the proposed rule change is also available on the Exchange's Web site at *http://nasdaqomxbx.cchwallstreet.com*, at the principal office of the Exchange, and at the Commission's Public Reference Room.

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[167] Exchange Act Section 19(b)(2), as amended by the Securities Acts Amendments of 1975, Pub. L. 94–29, 89 Stat. 97 (1975), grants the Commission flexibility to determine what type of proceedings—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. *See* Securities Acts Amendments of 1975, Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 249, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

[168] 17 CFR 200.30–3(a)(12); 17 CFR 200.30–3(a)(57).

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

[2] 17 CFR 240.19b–4.