February 11, 2016

Submitted Electronically

Robert W. Errett
Deputy Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-025

RE: Notice of Filing of a Proposed Rule Change To Amend FINRA Rule 4210 to Establish Margin Requirements for the TBA Market (SR-FINRA-2015-036)

Dear Mr. Errett:

On behalf of the Bond Dealers of America (“BDA”), I am pleased to submit this letter in response to the Financial Industry Regulatory Authority (FINRA) Rule 4210 amendments to establish margin requirements for certain ‘exempt’ securities, including To-Be-Announced (TBA) securities (SR-FINRA-2015-036). BDA is the only DC-based group representing the interests of middle-market securities dealers and banks focused on the U.S. fixed income markets.

BDA does not believe the proposed rule is consistent with Section 15A(b)(6) of the Exchange Act.

Section 15A(b)(6) of the Exchange Act, requires FINRA to adopt rules that promote just and equitable principles of trade.’ As the Commission noted in its order to institute proceedings, smaller firms have raised legitimate concerns with how this proposed rule would impact competition in the market for ‘covered agency securities’. BDA believes the rule will significantly disadvantage the smaller liquidity providers active in this market and further concentrate trading and counterparty risk amongst the very small number of large dealers that already dominate this market—potentially increasing systemic risk and reducing retail-investor access to ‘covered agency securities’.

FINRA is interpreting its statutory authority as a national securities association under Securities Exchange Act Section 15A(b)(6) as a nearly all encompassing statutory
authority to attempt to adopt a new, ‘exempt’ security margin regime for broker-dealers. By virtue of the way the rule is drafted it applies to all dealers transacting in the market for exempt ‘covered agency securities’ regardless of the size of the dealer or the potential for that dealer to create systemic risk.

The proposed rule will require dealers of all sizes, regardless of how active a firm is in the market or how many open trades a dealer has in exempt ‘covered agency securities,’ to build the compliance systems and hire the new personnel that will be required to comply with the rule. Of course, these new compliance and technology costs are contingent on smaller dealers believing it will be profitable to continue to provide liquidity in this market. Hiring three new employees to staff a new margin department that will perform the daily analysis of counterparty exposures, manage any movement of margin capital, and manage margin agreements and risk determinations will conservatively cost an estimated $150,000 per employee per year, inclusive of salary and benefits.

However, adding new internal staff represents only a fraction of the expected additional cost burden to dealers. Adding expensive third-party vendor technology solutions will also be required to track and calculate counterparty exposures in ‘covered agency securities’ and to produce internal reports for the new margin staff to analyze and use to manage margin transfers. One common vendor solution has an upfront cost of $625,000 in licensing fees alone in year one. Additionally, a competing vendor solution would cost as much as $870,000 over just the first two years of use alone. These ongoing costs do not include personnel costs and would require staff training and a lengthy implementation time.

The need for these additional resources is reasonably to be expected for smaller dealers that do not currently participate in the uncleared derivatives or other markets that would have previously required them to build out designated margin departments. From a technology perspective, for many smaller firms the proposed rule will require a wholesale build of a new margin tracking program, rather than the reprogramming of an existing margin calculator. For smaller firms that do not execute a lot of transactions in the market for ‘covered agency securities’ these costs are an extreme burden and will likely cause many small firms to decide that supplying liquidity to this market is impossible based purely on the increased regulatory, technology, and compliance costs.

It is very important to highlight the fact that these new cost burdens would be required to track exposures that would very rarely exceed the minimum transfer amount of $250,000 or the gross open position limit of $2.5 million. Many dealers, especially smaller dealers, would never have an exposure exceeding the proposed thresholds. The new cost burdens included in the rule and the potential damage to competition needs to
be justified against this economic and market reality. The BDA has advocated for an increased minimum transfer amount of $1 million and an increased gross open position limit of $10 million to further reduce the compliance burden of the rule. This change would not, however, amend the practical requirements of adding new technology and personnel costs to comply with the proposed rule.

The tables displayed below highlight the reality in the TBA and CMO markets. According to the 2014 FINRA TRACE Fact Book, trading in these markets is highly concentrated. Measured by TBA Par volume, the 10 most active firms represented over 80% of the liquidity in 2014 (the last full year data is currently available) and the trend already seems to be towards greater consolidation in the market. This rule is anticompetitive with respect to smaller firms and will exacerbate the trend of liquidity consolidation as smaller firms exit.

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<th>TBA Trading Data Based on 2014 TRACE FACT Book</th>
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<tr>
<td>% of TBA Par Activity Captured by</td>
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<tr>
<td>5 most active firms</td>
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<td>10 most active firms</td>
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<td>25 most active firms</td>
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<td>50 most active firms</td>
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<th>Agency CMO Trading Data Based on 2014 TRACE FACT Book</th>
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<td>% of Agency CMO Par Activity Captured by</td>
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An additional factor incentivizing consolidation under the proposed amendment is that implementation of the rule as proposed would impose an incremental burden on investment managers for each additional dealer counterparty. Such investment managers will not post margin without sufficient contractual protections. It is not probable that investment managers will bother to negotiate and execute margin agreements with an unlimited number of counterparties, which means that smaller dealers who trade in smaller volumes are likely to be cut out from this limited number of TBA market counterparties selected by each investment manager.
The liquidity concentration statistics highlighted above foreshadow the decision that investment managers will make if the Commission approves this rule. Funds will chose to enter into margin agreements with only their largest dealer counterparties. It would be highly burdensome for investment managers to enter into margin agreements with every dealer active in this market. Investment funds have already communicated to the Commission that they are dissatisfied with the lack of two-way margining in the proposed rule. It is a very likely outcome that investment funds will limit their counterparty exposures, from both a trading and margin perspective as a result of this rule. Additionally, it is extremely important to note that concentration in trading amongst larger bank-affiliated dealers will likely mean that fewer trades are reported to TRACE and transactions will occur outside the broker-dealer space. Therefore, dealers that are not bank affiliated will be the only parties subject to the full scope of the margin rule. The path of least resistance for bank-affiliated dealers will be to follow the TMPG best practices recommendation, which is not an enforceable rule.

In addition to the harm that this amendment will cause to the competitive landscape in the U.S. mortgage market by placing an unjust and inequitable burden on small-to-medium size broker-dealers who pose no systemic threat to the U.S. financial system, we believe that FINRA is reading its statutory authority as entailing a far more expansive authority than it actually provides. Section 15A(b)(6) grants FINRA authority to adopt rules that create a level and fair playing field for all dealers in a way that is protective of investors and the public. To date, Rule 4210 has supplemented the Federal Reserve Board’s Regulation T as to actual financing transactions and thus addresses a clear risk by providing a mechanism requiring dealers to operate within appropriate norms. But with these amendments, FINRA has proposed an anti-competitive rule that has a scope beyond the commensurate risk in that it is not addressing actual financing transactions. Accordingly, we disagree with FINRA’s expansive reading of its statutory authority. If FINRA believes that there are essentially no limits to its statutory authority, we are highly concerned about what this means for future rulemaking and the authority of Congress to set policy.

*Furthermore, BDA believes this rulemaking violates the Congressional intent of Section 7 of the Exchange Act.*

The generality of the authority granted to FINRA under Section 15A(b)(6) cannot supersede the very specific statutory directives contained in Section 7 of the Exchange Act, in which Congress clearly uses its authority to amend, enact, or draft federal law in this policy area, which is precisely what FINRA is attempting to do.

Section 7 grants the authority to adopt margin rules to the Federal Reserve. Accordingly, the Federal Reserve adopted Regulation T, which defines margin standards
applicable to broker-dealers. Importantly with respect to the proposed rule, the authority of the Federal Reserve to draft margin amendments does not extend to exempt securities, including the group of exempted securities defined as ‘covered agency securities’ by FINRA in the proposed rule. This was not an oversight.

As evidence of this fact, when Congress debated and enacted the Secondary Mortgage Market Enhancement Act of 1984 (SMMEA) transactions in private, non-governmental mortgage securities (‘non-exempt securities’) were explicitly exempted from margin requirements if a bona fide agreement for delivery of a mortgage related security against full payment within 180 days of the purchase date was in force. The Senate Banking Committee’s report on SMMEA articulated the legal and policy rationale for doing so by explicitly stating, “government-backed securities are exempt from these rules now.”

BDA believes that FINRA has fundamentally misread Section 7 of the Exchange Act, overreached on its own authority and ignored the intent of Congress to set policy in this exact policy area—establishing margin requirements for exempt securities.

**BDA believes the logic FINRA applied with respect to project loan and multifamily securities supports the exclusion of specified pools, ARMs, and CMOs from the proposed rule.**

BDA believes the changes FINRA made in Amendment No. 1 are based on sound logic that dictates the scope of the rule be appropriate to accomplish FINRA's goal of reducing risk within the 'covered agency securities' market. FINRA acknowledged that project loan and multifamily securities constitute a small percentage of the overall market for ‘covered agency securities’ and contain features that are risk-reducing. Therefore, it is appropriate to expect that they would not contribute to the creation of systemic risk and that they be exempted from the rule.

BDA thinks that this more reasonable approach should be applied to the proposed rule generally. BDA believes that the proposed rule would be greatly improved by focusing on actual to-be-announced securities and not on the group of ‘covered agency securities’ defined in the proposed rule. As BDA stated in its March 2014 comment letter to FINRA the actual TBA market is more than seven times the size of the specified pool, ARM, and CMO markets combined. BDA encourages the Commission to re-focus the proposed rule on the TBA market, which is the larger market, carries much greater risk and in many cases represents actual financing transactions.

**BDA urges the Commission to disapprove the proposed rule unless significant changes are made and FINRA’s legal authority to adopt rules in this area are clarified.**
In conclusion, BDA believes the Commission has a responsibility to address both the legal and policy concerns raised in response to the Commission’s request for comment. This rule has the very real potential to have an anti-competitive impact on broker-dealers. BDA urges the Commission to work with FINRA to produce a rule that can address systemic risk without unreasonably damaging the ability of small-to-medium sized dealers to compete.

Sincerely,

[Signature]

Mike Nicholas
Chief Executive Officer