Bond Dealers of America

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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 Securities and Exchange Commission's ("Commission") notice to solicit comments on proposed amendments ("Proposal") to Financial Industry Regulatory Authority (FINRA) Rule 4210 to establish margin requirements on Covered Agency Securities, including To-Be-Announced (TBA) securities. BDA is the only DC-based group representing the interests of middle-market securities dealers and banks focused on the United States fixed-income markets and we welcome this opportunity to present our comments on the Proposal.

In comparison to FINRA Regulatory Proposal 14-02, the Proposal is an improvement in some respects. BDA appreciates the work FINRA has done to reduce the number of counterparties and circumstances where the proposed amendments to Rule 4210 would apply. However, the Proposal, as written, would significantly burden small-to-medium sized dealers, especially when transacting with mid-sized or larger counterparties. BDA does not believe the Proposal represents the optimal or most cost-effective method for addressing the risks associated with unsettled securities transactions in Covered Agency Securities.

BDA members believe that Covered Agency Trades that settle 'regular way,' in the spot month or one month forward on the dates published in the Uniform Practice for Clearance and Settlement of Mortgage Backed Securities, should be exempt from the Proposal. As much as BDA appreciates FINRA's attempt to reduce the amount of trades and counterparties that the rule applies to by creating exceptions based on the gross open position limit and the minimum transfer amount, BDA members do not believe that basing a margin rule on settlement conventions that are not common practice in the market is good policy. In many instances, market participants have to wait until factors are published to settle a trade and that may not occur for weeks after the trade date. In that instance, settling a TBA trade on a T+1 basis, for example, is not even possible.

Despite FINRA's best efforts, BDA believes that the burden of the rule will fall upon small-to-medium sized dealers and exposures that could not present systemic risk concerns. Furthermore, BDA believes that the Proposal will further concentrate transactions in the market for Covered Agency Securities amongst the largest dealers and amongst financial institutions that do not have to comply with FINRA rules to the detriment of the marketplace as a whole.

BDA appreciates the work FINRA has done to improve the Proposal in response to the concerns raised by market participants, including BDA member firms. BDA offers some additional substantive recommendations to improve the Proposal and to further minimize the operational and compliance burden on small-to-medium sized dealers. BDA's comments and recommendations are outlined below.

The gross open position level and the minimum transfer amount are set too low and will primarily harm small-to-medium sized dealers transacting with medium-sized counterparties.

The $2.5 million 'gross open position' limit and the $250,000 minimum transfer limit in the Proposal are established at levels that are too low. Small and medium sized dealers transacting with medium-to-large-sized counterparties will feel the burden of setting these limits too low most acutely. BDA recommends increasing the 'gross open position' limit to $10 million and increasing the minimum transfer amount to $1,000,000. BDA believes these levels would allow for small-to-medium sized dealers to transact in reasonable size and avoid the negative impact of counterparties minimizing their use of small-to-medium sized dealers in order to avoid the costs and complexity of complying with all the operational and legal requirements of the $250,000 minimum transfer amount in particular.

BDA believes that higher limits are reasonable because each firm will be required by the Proposal to have a process by which risk limits and determinations are set for each counter party. However, transactions between small-to-medium sized dealers and larger and more sophisticated counterparties should not be subject to the operational burdens that will be associated with an insufficient minimum transfer amount. A higher, $1,000,000 minimum transfer amount, is more appropriate for transactions with larger, more sophisticated, and creditworthy counterparties. BDA believes, given the Proposal's requirement to have risk limits established for each account, the Commission should strongly consider a higher risk limit and a higher minimum threshold amount in order to prevent small-to-medium sized dealers from losing customers to larger dealers who will be better able to internalize the operational and administrative costs associated with the Proposal.

With respect to transactions between a dealer and a small non-exempt, retail counterparty, the $250,000 minimum transfer amount will rarely, if ever, be breached because the trade sizes are far too small. With respect to accounts that routinely trade in small quantities, BDA believes performing credit determinations is an unnecessary burden that will hurt dealers, especially smaller dealers, transacting with retail customers. For a dealer to engage in a credit limit determination with all of its retail counterparties when the trade is settling on the first good settlement date and the trade will be small in size will be a tremendous operational and compliance burden that will produce no real benefits for the marketplace. This burden will be hardest on smaller dealers with fewer resources to handle these analyses from an operational and compliance perspective and could be a factor that causes dealers to exit the market for Covered Agency Securities.

BDA believes the proposed five percent limit on net capital deductions applicable to any one account or group of commonly controlled accounts should be raised to avoid potential harm to dealers, clients, and the marketplace.

BDA strongly recommends that the limit on net capital deductions applicable to any one account or group of commonly controlled accounts be raised to at least ten percent. The five percent of net capital deduction limit is another aspect of the proposal that would harm small-to-medium sized dealers transacting with medium-to-large counterparties.

The five percent limit and the proposed requirement to not enter into any subsequent transactions with a counterparty that has exceeded the capital deduction limit puts small-to-medium sized dealers at a competitive disadvantage relative to larger dealers, in addition to other non-dealer financial institutions that do no have to comply with FINRA rules. A higher, ten percent limit, would allow smaller dealers to continue to transact in the marketplace for Covered Agency Securities with larger counterparties without the potential for having to cease trading with a larger counterparty, which is a business risk that larger dealer counterparties will have to consider prior to entering into a Covered Agency Transaction with a smaller dealer.

BDA members believe that the five percent net capital deduction limit is another factor that would create an undue burden for smaller dealers by making it less likely that medium-to-large sized counterparties will be willing to transact with smaller dealers. The limit should be raised to ten percent to ensure a fair and competitive marketplace.

BDA is concerned with the vagueness of the phrase "regularly settles" in the exception language.

The requirements of section (e)(2)(H) of the Proposal do not apply if the transaction and the counterparty meet certain conditions. However, the language included in the exception is unclear. BDA requests clarification of the phrase "**<u>regularly settles</u>** its Covered Agency Transactions on a Delivery Versus Payment ("DVP") basis or for cash…"

It is not clear from the Proposal how frequently a counterparty's transactions would need to settle on a DVP or cash basis in order to be considered eligible for the exception. It would make sense to have an account that is set up as a DVP account to be automatically eligible for the exception. However, BDA requests greater clarity and guidance on this point, which is essential for understanding and accessing the exception. As a practical matter the ambiguity of "regularly" leads to a variety of questions regarding how to comply, including what percentage or frequency of trades settle for cash or DVP would be required to be deemed regular, and what processes, procedures, and technology, if any, would firms need to set up to track and analyze customer settlements to ensure that the settlements of a given counterparty continued to settle DVP or for cash on what an examiner would consider a regular basis.

BDA believes that "dollar rolls" should be included in the exception language of H(ii)(c)(2) if they meet the other settlement and risk exposure criteria.

BDA believes that the language related to "dollar rolls" should be amended and those trades—if they meet the Proposal's quantitative risk limits and settlement criteria—should be allowed to access the Proposal's exception. It is not clear what additional risks a dollar roll trade poses. Secondarily, the language of this section also assumes the dealer always knows that both legs of the dollar roll will be executed at the same time and that a dealer knows the intent and existing Covered Agency Security holdings of its counterparty.

The Proposal will dramatically increase costs for smaller dealers that are active in dollar rolls and round robins, especially related to the requirement to collect 2 percent maintenance margin and the lack of a 'gross open position' exception. This will have the practical effect of concentrating trading in dollar rolls and round robins (no matter how large or small the trade) amongst the larger dealers that already dominate the marketplace for Covered Agency Securities—with all the attendant risks caused by concentration of risk, trading, and liquidity amongst fewer and fewer dealers in any securities market.

BDA believes that the margin and liquidation rules applicable to Covered Agency Securities should be harmonized with the current FINRA margin and liquidation rules that apply to other securities.

FINRA has designed a unique set of rules specifically for Covered Agency Securities. The Proposal would require different rules for margin-transfer timing and liquidation than the rules that currently apply to transactions in securities that are more volatile than Covered Agency Securities, such as corporate equities and bonds.

Exchange Act Rule 15c3-1 requires a capital charge to be taken five days after the initial call for margin. In the Proposal, FINRA is proposing to require a capital charge on a next-business-day basis, but has not outlined a market-based rationale for why imposing a completely new and more stringent method for this specific subset of securities is appropriate. This adds an unnecessary layer of operational burden and cost on dealers, especially smaller dealers who will have to design entirely new processes and procedures and systems to comply with the Proposal's unique requirements.

Additionally, under current requirements, FINRA Rule 4210(f)(6) has established a 15-day period for the collection of margin related to a mark-to-market deficiency before a firm has to liquidate a position. BDA does not believe that the risks associated with the market for Covered Agency Securities presents such a starkly different level of risk that it would require a completely new regulatory approach with significantly shorter time limits for requiring capital charges, margin collection, or a liquidation process. For small-to-medium sized dealers, this type of approach simply adds to regulatory and compliance complexity without providing commensurate benefits to market stability or functioning. In addition, five days does not provide enough time for a process to rectify disputes between dealers and customers about what the required mark-to-market margin requirement is. Therefore, BDA suggests that

FINRA harmonize the margin and liquidation rules in order to ease regulatory burdens on dealers, especially smaller dealers.

BDA appreciates the Proposal's approach as it relates to exempting certain transactions with non-exempt accounts from maintenance margin but still has concerns with the Proposal's language and potential impact related to maintenance margin for non-exempt accounts.

BDA appreciates that FINRA endeavored to minimize the regulatory burden of requiring maintenance margin for non-exempt accounts. As FINRA notes, the current exceptions are meant to reduce regulatory burden and allow smaller dealers to continue to compete in this marketplace. However, proposed section (e)(2)(H)(ii)(f) does seem to require the collection of maintenance margin in the event that a non-exempt account's mark-to-market loss is greater than the $250,000 minimum transfer amount. The section states:

"*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.*"

This section would have the practical effect of requiring maintenance margin only in the event that the non-exempt account had a mark-to-market loss. However, in the event that solely the market-to-market exposure was collected, the exposure to the dealer would be identical to the risk exposure of the original trade, which did not require maintenance margin. It is not clear why a maintenance margin requirement should apply in these circumstances and BDA members believe that smaller dealers will be significantly disadvantaged by this provision, which weakens the overall exception for transactions with non-exempt accounts.

BDA believes the Proposal would benefit from clarification on several matters regarding introducing brokers and clearing brokers.

Additionally, with respect to the computation of a margin or capital charge, introducing firms that clear through a clearing firm and ultimately a central clearing counterparty, the introducing firm's VaR-computed margin deposit with it's clearing firm should be counted towards any margin or capital charge it is required to accept against the trade, so introducing firms do not have to take the same or similar charges twice.

Furthermore, for introducing firms that clear their trades through clearing brokers, who may only be acting as custodian or settlement agent, BDA thinks it is appropriate for the introducing broker to make the determinations regarding the classification of an account as exempt or non-exempt and with respect to risk limits. Additionally, BDA members would appreciate clarification of the Proposal's requirements related to which entity, clearing broker or introducing broker, is responsible for taking capital charges so that introducing brokers and clearing brokers understand their responsibilities related to compliance with the rule.

The Proposal's dealer due diligence requirements related to the business activities of 'mortgage bankers' need to be amended.

BDA member firms do not have the ability to assess whether a specific transaction with a mortgage banker is designed to hedge the mortgage banker's pipeline. BDA member firms assume that mortgage bankers approach the market for the purposes of hedging and not speculation. But, from a practical standpoint, BDA member firms do not know to what extent a mortgage banker's pipeline of mortgages is hedged. BDA members could only conceivable rely upon the representation of the mortgage banker that they are, in fact, engaging in a transaction in order to hedge. BDA is opposed to the mortgage banker's exception outlined in the Proposal. Furthermore, BDA believes this is an additional layer of regulatory burden that will drive smaller dealers, with less operational, legal, and compliance resources from the market for Covered Agency Securities.

BDA believes that an exemption should be designed for Fannie Mae Designated Underwriting and Servicing (DUS) securities.

BDA notes that the approved list of Fannie Mae DUS multi-family lenders are exempt from FINRA rules, including the proposed rule.[1] DUS transactions require a good faith deposit, which is a sufficient deterrent for cancelled trades. Additionally, approved Fannie Mae DUS lenders do not speculate on forward trades and the good faith deposit that is collected before any trade has created a strong historical track record that shows borrowers in DUS transactions do not walk away from a rate lock or transaction that the borrower has authorized by contract.

This new margining rule would unnecessarily harm the ability of broker-dealers who provide liquidity to DUS securities to compete on the same level playing field with investors and financial institutions that will not be required to comply with this rule. This rule is not needed for Fannie Mae DUS MBS trades, which contribute minimally to the overall risk of this market, and would create an unfair advantage for the non-dealer financial institutions that do not have to comply with the margining requirements. BDA urges FINRA to provide an exemption for the DUS transactions that would not disincentive an approved, non-dealer DUS lender from transacting with a broker-dealer.

BDA believes the Proposal's 180-day effective date is completely inadequate.

BDA member firms believe that a two-year implementation schedule is more appropriate given the Proposal's high level of operational and legal complexity. From a legal perspective, BDA firms will need to introduce and finalize agreements with many counterparties, some of which may take significant time and involve considerable explanation and negotiation. As currently proposed, BDA member firms, especially smaller firms will need greater amounts of time to contemplate the new systems and procedures for this security-specific regulatory proposal.

In conclusion, BDA urges FINRA and the Commission to work to significantly amend the proposed rule. As currently written BDA believes the rule will harm small-to-medium sized

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[1] List of Approved Fannie Mae Delegated Underwriting and Servicing (DUS) Lenders https://www.fanniemae.com/multifamily/dus-lenders.

dealers. Smaller dealers will either chose to leave the marketplace for Covered Agency Securities or compete on un-level playing field against larger dealers in addition to the non-dealer financial institutions that will not be required to comply with the Proposal. BDA appreciates the opportunity to present comments on the Proposal and looks forward to continuing to work proactively with regulators on this rulemaking.

Sincerely,

Michael Nicholas
Chief Executive Officer