

**MEMO# 27989**

March 27, 2014

# ICI Comment Letter on FINRA's Proposed Margin Requirements for TBA Transactions

[27989]

March 27, 2014

TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 9-14  
DERIVATIVES MARKETS ADVISORY COMMITTEE No. 21-14  
FIXED-INCOME ADVISORY COMMITTEE No. 4-14  
SEC RULES MEMBERS No. 10-14  
SECURITIES OPERATIONS ADVISORY GROUP RE: ICI COMMENT LETTER ON FINRA'S  
PROPOSED MARGIN REQUIREMENTS FOR TBA TRANSACTIONS

On March 27, ICI submitted a comment letter to the Financial Industry Regulatory Authority ("FINRA") regarding its proposed amendments to FINRA Rule 4210 for transactions in the To Be Announced ("TBA") market. [\[1\]](#) The TBA Margin Proposal would require FINRA members carrying forward transactions with customers in "Covered Agency Securities" [\[2\]](#) to: (i) collect from non-exempt accounts both maintenance margin and variation margin and (ii) collect from exempt accounts [\[3\]](#) variation margin, subject to a minimum transfer amount of \$250,000. [\[4\]](#) A copy of the comment letter is attached.

The letter seeks modifications to the TBA Margin Proposal to mitigate the systemic risks identified by FINRA as the basis for the proposed rule change. The letter makes the following recommendations:

- **Require Two-Way Margining and Authorize Use of Tri-Party Custody Arrangements.** The new rule should require broker-dealers to post variation margin to customers when Covered Agency Securities transactions are in-the-money to the customer and the customer, thus, is subject to payment and delivery risk of the FINRA member. In addition, the rule should allow investment companies registered under the Investment Company Act of 1940 ("ICA") to use tri-party custody arrangements both to hold posted margin in compliance with requirements of the ICA and to hold margin posted to the registered investment company by the broker-dealer for operational convenience.
- **Revise the Definition of "Covered Agency Securities".** Transactions settling within three business days should not be treated as Covered Agency Securities transactions because they do not pose material risk beyond the ordinary settlement cycle.

- Minimum Transfer Amount Should be Increased. The TBA Margin Proposal should be amended to raise the minimum transfer amount to \$500,000 and eliminate any requirement that the FINRA member take a capital charge if it elects to rely on such minimum provided it has adopted appropriate risk limits, policies, and procedures.
- Eliminate the Close-Out Obligation. The TBA Margin Proposal should not result in the close-out of a Covered Agency Securities transaction for which the customer/counterparty has not posted margin within five business days of the call provided that the member firm takes a capital charge in lieu of collecting variation margin from an exempt account.
- Appropriate Transition Period. Customers and FINRA members should be given at least one year to comply with the TBA Margin Proposal, once adopted.

Jennifer S. Choi  
Senior Associate Counsel Securities Regulation

## [Attachment](#)

### **endnotes**

[1] Margin Requirements, Regulatory Notice 14-02 (January 2014), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p439087.pdf> (“TBA Margin Proposal”).

[2] The definition of “Covered Agency Security” would include TBA transactions, as defined in FINRA Rule 6710(u), for which the difference between trade date and settlement date is greater than one business day, certain mortgage pool transactions, as defined in FINRA Rule 6710(x), for which the difference between trade date and settlement date is greater than one business day and transactions in collateralized mortgage obligations, as defined in FINRA Rule 6710(dd), for which the difference between trade date and settlement date is greater than three business days.

[3] The term “exempt account” is defined in FINRA Rule 4210(a)(13) to include a number of institutional accounts, including registered investment companies. FINRA has expanded this definition with respect to certain types of transactions in Covered Agency Securities to include institutional investors that are independently audited entities with more than \$1.5 million of net current assets and more than \$1.5 million of net worth. See FINRA Rule 4210(e)(2)(F) /08, n. 2.

[4] FINRA proposes that the amount of any uncollected mark-to-market loss be deducted in computing the member’s net capital at the close of business following the business day the mark-to-market loss was created.