

MEMO# 27950

March 12, 2014

Draft ICI Comment Letter on FINRA's Proposed Margin Requirements for TBA Transactions; Member Feedback Requested by Thursday, March 20

March 12, 2014

TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 8-14

DERIVATIVES MARKETS ADVISORY COMMITTEE No. 15-14

FIXED-INCOME ADVISORY COMMITTEE No. 3-14

SEC RULES COMMITTEE No. 9-14

SECURITIES OPERATIONS ADVISORY GROUP RE: DRAFT ICI COMMENT LETTER ON FINRA'S PROPOSED MARGIN REQUIREMENTS FOR TBA TRANSACTIONS; MEMBER FEEDBACK REQUESTED BY THURSDAY, MARCH 20

Recently, the Financial Industry Regulatory Authority ("FINRA") issued a request for comment on 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.

We have prepared a draft comment letter in response to the proposed amendments, which is attached. If you have comments on the draft letter, please provide them to Jennifer Choi at jennifer.choi@ici.org by Thursday, March 20.

In the draft letter, we seek 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-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 Security 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 to hold margin in compliance with requirements of the ICA. Tri-party custody arrangements also should

be permitted for holding 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 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. We request that customers and FINRA members 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] These transactions 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 CMOs, 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 type of Covered Transactions 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.