

MEMO# 29430

October 21, 2015

ICI Draft Comment Letter on FINRA Proposal to Require Margin for TBA Transactions - Your Comments Requested by October 28

[29430]

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TO: DERIVATIVES MARKETS ADVISORY COMMITTEE No. 75-15
FIXED-INCOME ADVISORY COMMITTEE No. 32-15 RE: ICI DRAFT COMMENT LETTER ON FINRA PROPOSAL TO REQUIRE MARGIN FOR TBA TRANSACTIONS - YOUR COMMENTS REQUESTED BY OCTOBER 28

ICI has drafted a comment letter to the Securities and Exchange Commission ("SEC" or "Commission") on a proposal by the Financial Industry Regulatory Authority ("FINRA") to amend FINRA Rule 4210, which applies to transactions in the To Be Announced ("TBA") market ("TBA Margin Proposal"). [1] The TBA Margin Proposal follows a 2014 proposal by FINRA to amend Rule 4210 ("2014 FINRA Proposal"), and reflects comments received by FINRA on the 2014 FINRA Proposal, although the TBA Margin Proposal is largely unchanged from the 2014 FINRA Proposal. ICI's draft letter is attached, and is summarized briefly below. Please provide any comments in writing by Wednesday, October 28, to Jennifer Choi at jennifer.choi@ici.org.

The TBA Margin Proposal would require FINRA members carrying forward transactions with customers in "Covered Agency Transactions" [2] to collect, subject to a minimum \$250,000 minimum transfer amount: (i) variation margin [3] from exempt accounts; and (ii) both maintenance margin [4] and variation margin from non-exempt accounts. [5] The definition of "exempt account" includes a number of institutional accounts, including registered investment companies. The TBA Margin Proposal establishes a one-day time frame for posting of variation margin and a close-out requirement after five business days unless a customer posts variation margin. The draft comment letter explains that these and other proposed requirements of the TBA Margin Proposal are substantially similar to those included in the 2014 FINRA Proposal.

ICI's draft comment letter makes the following recommendations regarding the TBA Margin Proposal:

- **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 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 Transactions.”** Transactions settling within three business days should not be treated as Covered Agency Transactions because they do not pose material risk beyond the ordinary settlement cycle.
- **Eliminate the Close-Out Obligation.** The TBA Margin Proposal should not result in the close-out of a Covered Agency 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.
- **Minimum Transfer Amount Should be Increased.** The TBA Margin Proposal should be amended to raise the minimum transfer amount to at least \$500,000 to make it consistent with international standards.
- **Appropriate Transition Period.** The letter recommends that customers and FINRA members be given at least one year to comply with the TBA Margin Proposal, once adopted.

Sarah A. Bessin
Associate General Counsel

[Attachment](#)

endnotes

[1] For a description of the TBA Margin Proposal, please see ICI Memorandum No. 29386 (Sept. 30, 2015), available at https://www.ici.org/my_ici/memorandum/memo29386. Comments on the TBA Margin Proposal are due to the SEC by November 10, 2015. FINRA Rule 6710(u) defines “TBA” to mean, among other things, a transaction in an Agency Pass-Through Mortgage-Backed Security or a Small Business Administration-Backed Asset-Backed Security 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 are not specified at the time of execution.

[2] Covered Agency Transactions would be defined to include, similar to the 2014 FINRA Proposal, TBA transactions and Specified Pool Transactions, both as defined under FINRA rules, for which the difference between the trade date and contractual settlement date is greater than one business day, as well as certain Collateralized Mortgage Obligations (“CMOs”), defined under FINRA rules, for which the difference between the trade date and contractual settlement date is greater than three business days. The 2014 FINRA Proposal used the term “Covered Agency Securities.”

[3] Under the TBA Margin Proposal, variation margin is called “mark to market loss” and defined as “the counterparty’s loss resulting from marking a Covered Agency Transaction to the market.”

[4] Maintenance margin would be defined as “margin equal to 2 percent of the contract value of the net ‘long’ or net ‘short’ position, by CUSIP, with the counterparty.”

[5] A “non-exempt account” is any account that is not an “exempt account.”

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