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January 9, 2018

Via FedEx
Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

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OFFICE OF THE SECRETARY

Re: Amendments to Financial Industry Regulatory Authority ("FINRA") Rule 4210

Mr. Secretary,

We represent Brean Capital, LLC ("Brean"), an independent investment bank and broker dealer with extensive experience trading in the MBS market. We write to follow up on our meeting with the SEC and FINRA on December 19, 2017, and specifically to memorialize our remarks at that meeting by revising our earlier letter dated November 7, 2017 concerning proposed changes to FINRA Rule 4210 (the "Rule") that the U.S. Securities and Exchange Commission ("Commission") issued on June 15, 2016.

I. EXECUTIVE SUMMARY

While proposed Amended Rule 4210 purports to reduce risks relating to defaults on MBS with long settlement dates, the Rule has the opposite effect. It enhances systemic risk by compelling defaults, even where there is no serious risk that settlement will fail; a default by one party would then trigger other defaults by downstream parties in the chain of distribution. The Rule, moreover, will not provide the benefits that the SEC and FINRA anticipate. The Rule does not apply to banks, and so is easily evaded. Recent events have confirmed that many Broker-Dealers with bank affiliates stand ready to take advantage of this loophole. The Rule also imposes anti-competitive burdens on Broker-Dealers, which will reduce liquidity, and in the end, harm mortgage borrowers. Last, the Rule overlooks extensive protections currently in place to assure continued functioning of the MBS market, regardless of volatility. Indeed, the market for Covered Agency Transactions (TBAs, Specified Pools, and CMOs) has operated well for over 30 years, even in the most volatile situations.

The core problems created by the Rule involve Specified Pool and CMO securities, which are unique and difficult to value. For this reason, we have proposed that Amended Rule 4210, at the very least, be modified to exclude these types of securities prior to settlement date.

II. THE MARKETPLACE FOR SPECIFIED POOL AND CMO SECURITIES

The Covered Agency Transactions most adversely affected by the Rule are those involving Specified Pool and CMO securities. A review of the current market for these securities is necessary to understand the adverse impact of the Rule.

Both Specified Pool and CMO securities settle one day a month, referred to as the "good settlement" date. For "when issued" securities, this settlement process allows the originator time to identify and assemble the mortgages that conform to parameters of the Specified Pool. The originator offers prospective homebuyers a guaranteed rate on a home mortgage for a limited period of time, typically 60 days. The originator sells these mortgages through the MBS market in advance of closing, thereby hedging against interim market changes. Five days before settlement date, the precise composition and quantity of the Specified Pool is fixed and a CUSIP assigned, so that the purchaser knows the amount due at closing. The long settlement date is thus an essential component to the transaction.

A secondary market exists for previously issued Specified Pool and CMO securities. The monthly "good settlement" date for these securities allows timely quantification of the monthly factor, so that the purchaser understands the face amount of the mortgages remaining in the Specified Pool.

The MBS marketplace has operated with long settlement dates for more than three decades. During these years, a large liquid market has evolved with approximately $14 billion in average daily trading volume in 2017 for Specified Pool transactions and $1 billion for CMOs. The comparable daily market in 2017 for TBA securities is approximately $196 billion.

The market is characterized by more than 100 Broker-Dealers of varying sizes, who often buy and sell on a riskless basis or effectuate an offsetting trade within hours. Some of these Broker-Dealers have bank affiliates, which provide them with ready ability to avoid the Rule. In addition to Broker-Dealers, there are approximately 20 Primary Dealers that operate in market-making and principal roles. The Primary Dealers include major financial institutions, such as Credit Suisse AG, Deutsche Bank Securities Inc., Goldman Sachs & Co. LLC, J.P. Morgan Securities LLC, and Morgan Stanley & Co. LLC. These, too, often have bank affiliates. The market for Specified Pool and CMO, as well as TBA, securities includes a large number of firms that originate these securities and many institutional investors who acquire them for their portfolios, such as state and local pension plans, investment companies, investment funds, insurance companies, and banks.

A single Specified Pool might have multiple buyers who then sell the securities in a chain of transactions, all closing on the "good settlement" date. In addition, Broker-Dealers, as well as originators, typically buy (or sell) a TBA security as a hedge against their trading of a Specified Pool or CMO. The premise of the Rule is that Broker-Dealers are subject to credit risk as the value of the MBS security fluctuates between trade date and settlement date. In reality, their exposure is limited by hedging and offsetting trades, designed to lock in a modest profit (or loss) depending on the market's movement. The diagram annexed as Exhibit A shows a typical chain of sales for these securities, offset with TBAs. The intermediary parties in the chain have reduced their exposure with corresponding buys and sells. A chain of sales could well exceed the length in this example. These chains develop over time, so that downstream buyers are purchasing closer to the settlement date.

Consistent with the market's desire to limit risk, the vast majority of Broker-Dealers are introducing brokers, trading through clearing firms. The largest such firm, Pershing, has approximately 80% of the market. Brean utilizes Pershing, which is contractually obligated to clear its trades. To assure its ability to close on settlement date, Pershing holds substantial collateral from Brean, 2% of the principal amount of all "when issued" Covered Agency Transactions. As of November 30, 2017, Brean had $44 million posted with Pershing as collateral for its government securities and CMO positions, even though it had net open trade exposure of less than $1 million. Brean had approximately $800 million in open trades, split equally between long and short positions. Brean also maintains regulatory capital far in excess of regulatory minimums. As of November 30, 2017, Brean had regulatory capital in excess of $75 million.

Even in the most volatile months of 2008, the market for these MBS securities operated properly. The role of clearing brokers, the use of hedging, and the collateral maintained by Broker-Dealers, all assured the ability of parties to honor their commitments on settlement date.

III. AMENDED RULE 4210 WILL ENHANCE MARKET RISK WITHOUT ANY CORRESPONDING BENEFIT

A. <u>Enhanced Systemic Risk</u>

The proposed Rule interjects a host of uncertainties that exacerbate risk. The Rule does not identify the party responsible for marking-to-market the MBS or the methodology for doing so. As a result, the parties are left to negotiate over these items. But parties setting prices have conflicting interests as buyer and seller and will likely have different views on value in setting margin. For Specified Pool and CMO securities, there is no definitive price established by a reliable market, as these securities may be unique or hard to locate. For this very reason, many of these securities do not clear on FICC, Fixed Income Clearing Corporation. As a result of their unique nature, there is a significant risk of marks on Specified Pool and CMO securities that vary from actual value, imposing collateral obligations where none should exist. This risk is multiplied, as margin departments often set value, independent of a trading desk. To do so, they rely on models to price unique securities, which may produce incorrect results. Brean has purchased a security at 108, for example, and that same day been told by the selling party's margin department that the security should be valued at 103.

A key feature in Amended Rule 4210 is the requirement that a position be terminated, *i.e.* sold out, if a party fails to post collateral within five days. But Covered Agency Transactions are generally traded through a chain of buyers and sellers, with modest markups. As a result, the vast majority of brokers are hedged, with minimal exposure. In fact, many brokers may have even executed "riskless trades," i.e., placing the "buy" order only when a "sale" order was in hand.

On a forced liquidation, however, downstream parties will not be able to locate a substitute security for Specified Pool and CMO transactions. A non-delivery by one party places all other parties in default, leaving them to sort out who owes what to whom on a difficult-to-price security that has not been delivered through no fault of any downstream party. The costs and risks associated with this process will only deter trading—or lead to higher prices, harming the consumer. In effect, the proposed Rule adds a new element to each parties' risk analysis.

Before the Rule, one could look to the counterparty's financial strength; now, one must consider each trading party with whom the counterparty does business, since a failure to meet margin at any point in the chain can lead to a failed settlement further down in the chain. In fact, Brean has been asked by one counterparty to disclose all of its offsetting positions, so that counterparty could assess the possible consequences of a default by someone else dealing with Brean.

Systemic risk is exacerbated by the standard form Master Securities Forward Transaction Agreement ("MSFTA") Since FINRA announced consideration of the Rule, Brean has been asked by many counterparties to execute an MSFTA. Brean had not previously executed these agreements. The terms of these documents, and their burdens are discussed below. In 2017, SIFMA issued a proposed Form of MSFTA to assist its members. The proposed form provides that a broker must close out *all* positions based on a default in *one* position.[1] Any such across-the-board liquidation would not only cause multiple breakdowns in otherwise financially sound chains of distribution, but also threaten the broker with insolvency. This points to another systemic risk factor. If a party becomes insolvent, those who have posted collateral with the insolvent party stand to lose their collateral. Thus, one firm's failure is now more likely to bring down other firms.

Amended Rule 4210 overlooks the ample protections already in place to guard against defaults. For example, Brean's clearing broker, which is obligated by contract to clear its trades, had approximately $44 million in collateral as of November 30, 2017, while Brean's net exposure was less than $1 million. The vast majority of Broker-Dealers, moreover, clear through Pershing, which is contractually obligated to clear their trades and which retains collateral to

[1] 2017 SIFMA Form of Amendment to Conform with FINRA 4210 ¶8.

assure its ability to do so. In addition to the collateral posted at Pershing, Brean had net regulatory capital in excess of $75 million. These amounts are typical for Brean. Disclosure through monthly focus reports, and other financial data, enable Broker-Dealers to select counterparties that are fiscally solvent. A Broker-Dealer has a strong self-interest in doing so. In light of its hedged positions, net capital, and collateral with Pershing, Brean is already well positioned in the event of any market disruption. Brean believes that its position is typical for Broker-Dealers who trade in Specified Pool and CMO transactions.

B. Ease of Avoidance

The proposed Rule is also easily evaded, since it applies only to Broker-Dealers, and not to Banks. Some Broker-Dealers, and most Primary Dealers, have bank affiliates. These firms are now in the process of moving their trading in Covered Agency Transactions so that Amended Rule 4210 will not apply to their activities.

Brean learned recently from a Primary Dealer based in New York that all trades in Covered Agency Transactions and Treasuries will now be handled by a New York branch office of an affiliated bank domiciled outside the U.S. The effect of this change is to avoid compliance with Amended Rule 4210. Brean believes that the change is a direct response to the Rule. Brean does business with a State Pension Fund, whose Charter does not permit pledging of pension assets, so it cannot post margin. The Pension Fund has advised that it will avoid Rule 4120 by trading with bank affiliates. Brean also has been told by several customers that other brokers have touted the ability of their bank affiliates to handle these transactions, free from any margin requirements. This reduced-cost alternative is a significant selling point that puts Brean and other Broker-Dealers at a severe disadvantage. It is inevitable that trading in these MBS securities will simply migrate to a less regulated marketplace.

In the past, the SEC and/or FINRA have suggested that guidance from the Federal Reserve Bank offers under TMPG will prevail in the banking market. But this guidance is a "best practice" guideline only, not a rule. Based on its experience, Brean does not believe that TMPG guidelines are being followed. Brean has searched for quantitative data to determine the degree of compliance and found none.

The shift in trading to banks leads to another problem. Trades by banks are not reported on TRACE, reducing transparency and further reducing pricing reliability.

C. Anti-Competitive Impact

The Amended Rule's margin requirements are by their nature anticompetitive, in violation of Exchange Act §§ 15A(b)(6) and (b)(9), which require FINRA to promote fair trade principles while protecting investors and the public, and not impose any unnecessary burden on competition.[2] All three branches of government require objective cost-benefit analysis in federal rulemaking. Accordingly, Congress requires the Commission, when engaged in rulemaking under the Exchange Act, to consider "the protection of investors, [and] whether the action will promote efficiency, competition and capital formation." The Commission must "balance, against other regulatory criteria and considerations, the competitive implications of self-regulatory [actions]."[3] The executive branch warns that an agency "must ...propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs."[4] The D.C. Circuit likewise holds that a party suffers "'constitutional injury in fact when agencies ... allow increased competition' against them,"[5] and will overturn a rule where the Commission fails to conduct an

[2] *See, e.g.*, FINRA Regulatory Notice 14-02: Margin Requirements, at 3 (Jan. 27, 2014).
[3] *See* S. Rep. 94, 94th Cong., 1st Sess. (April 14, 1975) at 12-13
[4] *See also* Executive Order 13,563. § 1(b), 76 Fed. Reg. 3821 (Jan. 18, 2011)
[5] *Fin. Planning Ass'n v. S.E.C.*, 482 F.3d 481, 486 (D.C. Cir. 2007) (association had standing to challenge SEC rule exempting certain broker dealers from IAA; Congress sought to protect ability of bona fide investment advisers to

adequate cost-benefit analysis.[6] Accordingly, past Commissioners have emphasized the critical importance of addressing a rule's costs and benefits.[7]

Notwithstanding this federal guidance, the Rule disproportionately burdens smaller and medium-sized broker dealers and favors broker dealers with regional bank affiliates that can purchase the same securities, but are not subject to FINRA's rules. Under the Rule, FINRA members must collect margin from counterparties. But, as regional banks are outside the scope of the Rule, they need not collect margin from their counterparties or subject their counterparties to mark-to-market margining. Where a counterparty is given the choice between posting margin to a FINRA member, or avoiding this obligation and associated costs by trading with a non-FINRA member, the less capital-intensive and expensive choice is obvious. The Rule provides regional banks and their broker-dealer affiliates to whom they can source inventory, a vast competitive edge over other FINRA members. And, unsurprisingly, customers have already taken steps to move their business accordingly.

The Rule also disproportionately burdens small-to-medium sized brokers by imposing a variety of costs that, as compared to larger players, are outsized relative to these brokers' revenues. Such costs include both the cost of capital (especially on introducing brokers who now face a double margin requirement) and new operational costs. For example, for dealers that engage in only a moderate amount of Covered Agency Transactions, the costs of evaluating new

compete on a level regulatory playing field); *Taxation with Representation of Wash. v. Regan*, 676 F.2d 715, 723 (D.C. Cir. 1982) (organization had standing to challenge IRS rule by demonstrating injury from the unequal application of the statute), *rev'd on other grounds*, 461 U.S. 540 (1997); *Haitian Refugee Ctr. v. Gracey*, 809 F.2d 794, 799 (D.C. Cir. 1987) ("drain on [an] organization's resources" is "concrete and demonstrable" injury).

[6] *See Chamber of Commerce of U.S. v. SEC*, 412 F.3d 133 (D.C. Cir. 2005); *Am. Equity Inv. Life Ins. Co. v. SEC.*, 613 F.3d 166 (D.C. Cir. 2010); *Bus. Roundtable v. SEC.*, 647 F.3d 1144 (D.C. Cir. 2011).

[7] *See* Feb. 9, 2007 speeches of Chairman Cox and Commissioners Atkins, Casey, and Nazareth at PLI SEC Speaks Conference; SEC Chairman Levitt's testimony on March 14, 1997 ("the Commission measures the benefits of proposed rules against possible anti-competitive effects, as required by the Exchange Act.")

technology providers, building compliance systems, hiring new personnel, and implementing the margining system, are an extreme burden. Smaller broker dealers must decide whether they can survive in the TBA market under the Rule, or whether these implementation and compliance costs will prove uneconomical.[8] Larger dealers are better-equipped to internalize such operational costs. If the vast number of small and midsized brokers were to determine that it no longer makes economic sense to stay in the market under the Rule's new operational and capital costs, the market would be left in the hands of a small number of extremely large investment banks. FINRA has declined to explain how consolidation of the marketplace, with its inevitable reduction in liquidity, fulfills its duty to adopt rules that justly and equitably impact market participants.

The Commission should have rejected the Rule, as well, because the Rule's harm to smaller broker dealers outweighs its benefits. Introducing brokers generally operate on a riskless or extremely low-risk basis, matching long exposure with short exposure. Nonetheless, regulatory capital requirements and introducing brokers' margin arrangements with their clearing firms already impose substantial capitalization requirements in Covered Agency Transactions. Now, the Rule threatens to pile an additional, unnecessary capital burden—and the cost of that capital—onto these introducing brokers, disregarding the "riskless" nature of their trading position. Moreover, the Rule creates special problems for brokers trading with registered investment companies, where the collateral cannot be repledged. Typically, the collateral posted by one party could be used by the counterparty to reduce or eliminate the counterparty's exposure. Because of unique requirements applicable to registered investment companies,

[8] *See* Nov. 20, 2016 Letter from Charles M. Weber, Robert W. Baird & Co. Inc., to Robert W. Errett, Deputy Secretary, SEC, re: SR-FINRA-2015-036: Comments on the Proposed Amendment to FINRA Rule 4210, https://www.sec.gov/comments/sr-finra-2015-036/finra2015036-39.pdf.

however, margin posted by any such entity could not be re-posted by the broker to satisfy the Rule's requirements on MTM losses on the other side of the riskless trade. Consequently, to satisfy the Rule, the broker would need to acquire additional capital, despite a neutral trading position. The Rule thus adds another layer of unnecessary cost, and further harms smaller firms.

In addition, brokers acting on a riskless basis will be damaged by the Rule's demand for position liquidation when a counterparty fails to post margin. In this situation, the counterparty would not deliver the security to the broker, even if the broker, operating on a riskless basis, owes delivery of that security to a third party. This can significantly damage the innocent broker in Specified Pool and CMO securities. The Rule thus adds a new element of instability.

Before the Rule was announced, the market operated without written agreements, such as MSFTA's. In the past year, such agreements have become necessary to establish a trading relationship, as the uncertainties in the Rule have forced brokers to negotiate MSFTA contracts as a condition to trading. The Rule worsens competitive dynamics by forcing smaller and medium-sized broker dealers to enter into MSFTAs for bilateral margining with market-dominant Broker-Dealers and Primary Dealers. Trading with these major Broker-Dealers is essential to market participation, and these major players can and do use their dominance to impose onerous terms on the smaller and medium-sized broker in such bilateral agreements.

Besides adding costs, and reducing liquidity when an agreement cannot be reached, the MSFTA offers the larger firms this opportunity to exercise market power in other ways. The larger firms insist that each has the exclusive right to value securities and demand collateral under the Rule. Dominant market players may also require more collateral, independent of margin. For example, a major asset manager will not sign an MSFTA with Brean unless it receives 2% of principal as collateral and a unilateral right to price for margin purposes. If Brean buys from a Primary Dealer and sells to the above asset manager on a riskless basis, Brean could be quadruple margined on a riskless trade. The chart annexed as Exhibit B outlines such a situation, where Brean would have $6 million in collateral and trade valued in a conflicting fashion by two separate firms. The fact that the Rule invites these burdens, rather than preventing them, is compelling proof of its fatal flaws.

IV. The Commission Lacked Authority to Approve Amended FINRA Rule 4210

A. Overview of Rule Margin Requirements

The Rule is an unauthorized and unreasonable exercise of the Commission's power to regulate margin on agency MBS. Because the Securities Exchange Act of 1934 defines agency MBS as "exempted securities," they have never been subject to margin regulation under § 7 of the Exchange Act.[9] Congress used § 7 to empower the FRB, and no other government entity, with authority to regulate margin, which is defined as the amount of credit that can be extended and maintained on any security other than an exempted security ("the Board of Governors of the Federal Reserve System shall, prior to the effective date of this section and from time to time thereafter, prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security (other than an exempted security or a security futures product)").[10] FINRA Rule 4210(a) (6) defines exempted securities as does the Exchange Act—to encompass agency MBS.[11] But rather than exclude "exempted securities," the Rule now encompasses them. Accordingly, the Covered Agency Transactions

[9] Congress defines agency MBS as "exempted securities." *See* 15 U.S.C. §§ 78c(a)(12) ("exempted securities" include "government securities"); 78c(a)(42).
[10] *See* 15 U.S.C. § 78g (emphasis added).
[11] *See* Sec. Exch. Act Release No. 78081, at 3-4 (June 15, 2016) ("Release No. 78081").

are comprised almost entirely of MBS that have never been subject to margin regulation under Section 7—until now.

B. <u>Congress Did Not Authorize FINRA or the Commission to Regulate Margin, Let Alone Margin on Exempted Securities</u>

The text of Exchange Act § 7 succinctly identifies the FRB, and only the FRB, as responsible for regulating margin.[12] The legislative history of § 7 likewise indicates that Congress never intended the Commission to administer margin regimes. When Congress passed the Exchange Act, it acknowledged the FRB's "unique and outstanding expertise" in regulating credit.[13] Congress's "underlying theory of [the Exchange Act] with respect to the control of credit is ... all speculative credit should be subjected to the central control of the Federal Reserve Board as the most experienced and best equipped credit agency of the Government."[14]

Significantly, Congress prohibits *both* the FRB and the Commission from regulating exempted, agency MBS, which comprise the Covered Agency Transactions.

C. <u>The Amended Rule Is an Unreasonable Construction of Exchange Act § 7</u>

The Commission has failed to adequately explain the Rule's sudden departure from the decades-old regulatory regime wherein agency MBS have not been subject to § 7's margin requirements. "A statutory interpretation ... that results from an unexplained departure from prior [agency] policy and practice is not a reasonable one."[15] FINRA's justification that "the growth of the TBA market" and "number of participants and the credit concerns that have been

[12] 15 U.S.C. § 78g(a).
[13] *Collateral Lenders Comm. v. Bd. of Governors of Fed. Reserve Sys.*, 281 F. Supp. 899, 904 (S.D.N.Y. 1968); *see also* H.R. REP. 98-994, at 47-48 (the FRB "has primary rulemaking authority" with respect to margin, while the "Commission and the securities self-regulatory organizations enforce [the FRB's] rules.").
[14] H.R. Rep. 73-1383 at 7.
[15] *See Northpoint Technology, Ltd. v. FCC*, 412 F.3d 145, 156 (D.C. Cir. 2005).

raised in recent years" is similarly insufficient.[16] The perceived need for "more comprehensive regulation" does not entitle the Commission to reinterpret the text of the Exchange Act.[17]

Also, the Commission may not interpret "exempted securities" to include agency MBS in some provisions of the Exchange Act, but not in others. The courts in this country have long adhered to the "basic canon of statutory construction that identical terms within an Act bear the same meaning," or, stated differently, a word must share the same meaning throughout all provisions of a statute.[18] The Supreme Court has rejected "forced and unconventional" attempts to imbue a phrase used more than once in the same statute, with different meanings.[19]

Here, the Rule contravenes this basic principle of statutory construction and Supreme Court precedent. The Exchange Act defines "exempted securities" to include agency MBS in § 3(a) (12) and § 7. Rule 4210(a)(6) defines "exempted securities" the same way, adopting the meaning in § 3(a)(12) of the Exchange Act. But notwithstanding the Rule's definition of "exempted securities" to include agency MBS, according to § 3(a)(12), the Rule seeks to regulate agency MBS—which, per their definition—are prohibited from regulation under § 7. It is plainly unreasonable for FINRA and the SEC to interpret "exempted securities" so that its dual definitions, in the same statute, have opposite meanings.

D. The SEC Did Not Fulfill its Statutory Responsibilities

The SEC may approve SRO rule changes, like Rule 4210, only "if it finds that such proposed rule change is consistent with" provisions of the Exchange Act. 15 U.S.C. § 78s(b)(2)(C)(i). Section 3(f) of the Exchange Act, § 15 U.S.C. 78c(f), requires the SEC to

[16] FINRA Regulatory Notice 14-02 at 1, 3 (Jan. 27, 2014).
[17] *Goldstein v. SEC*, 451 F.3d 873, 882 (D.C. Cir. 2006); *see also Util. Air Reg. Grp. v. EPA*, 134 S. Ct. 2427, 2446 (2014) ("[A]n agency may not rewrite clear statutory terms to suit its own sense of how the statute should operate.").
[18] *Estate of Cowart v. Nicklos Drilling Co.*, 505 U.S. 469, 479 (1992).
[19] *Id.* at 478-79; *Goldstein*, 451 F.3d at 882.

consider or determine whether an action, in addition to protecting investors, will promote efficiency, competition, and capital formation. When the Commission approves an SRO's proposed rule based on "unquestioning reliance" on the SRO's findings, the SEC "effectively abdicate[s]" its responsibilities under § 15 U.S.C. 78s(b)(2)(C), and the proposed rule must be set aside. *See, e.g.*, *Susquehanna Int'l Group, et al v. SEC*, No. 16-1061 (D.C. Circuit Aug. 8, 2017) (remanding challenge to Options Clearing Corp.'s capital plan back to SEC, finding that SEC failed to undertake required analysis under Exchange Act and impermissibly trusted OCC's process).

Here, as in *Susquehanna*, the SEC made no independent examination of the Rule, and instead provided a rubberstamp for FINRA's flawed program. For this additional reason, the Rule must be set aside.

V. Conclusion

For the foregoing reasons, the Commission should repeal the amendment to Rule 4210. We would appreciate the opportunity to further discuss these issues with the Commission or its staff, and to respond to any questions that may be posed.

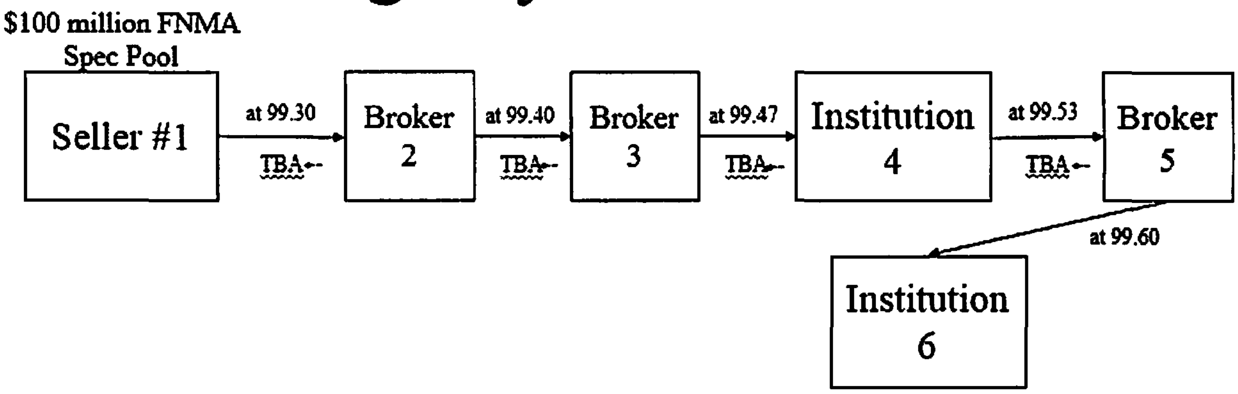
Respectfully submitted,

Thomas J. Fleming

cc: Brean Capital, LLC
Sheila Dombal Swartz
David Aman

Exhibit A

Prototype Trades in Covered Agency Transactions



- Trades are often accompanied by a swap, in which buyer of Specified Pool or CMO also sells a TBA as a hedge
- Trades likely all settle on same good settlement date
- Chain may be brief or quite extensive and may take days or weeks to develop
- Trades by Brokers and Institutions generally clear through clearing brokers

Exhibit B

Excess Margin Example

$100MM New Issue CMO Riskless Trade
Assumes Buy and Sell Are Done At Par
Buy From Primary Dealer Sell To Money Manager
Example - Both Counterparties Dictate To Brean The Mark On The Unsettled Trade
BOTH Counterparties Mark The Trade, After Trade Date At A LOSS

		Margin Requirement		
	Buy From Primary Dealer	Margin Call	2% Requirement	Total Requirement
$100MM PAR - NEW ISSUE	100,000,000		-	
Mark To Market	99,000,000	1,000,000	-	1,000,000 *
	Sell To Money Manager			
$100MM PAR - NEW ISSUE	(100,000,000)			
Mark To Market	(101,000,000)	1,000,000		1,000,000 **
2% Required By Money Manager			2,000,000.00	2,000,000
2% Required By Pershing			2,000,000.00	2,000,000
Total Margin Requirement		2,000,000	4,000,000	6,000,000

* Primary Dealer Marks the trade at $99
** Money Manager Marks the trade at $101