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Robert W. Errett
Deputy Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

November 10, 2015

Re: Notice of Filing of a Proposed Rule Change to Amend FINRA Rule 4210 (Margin Requirements) to Establish Margin Requirements for the TBA Market; File Number SR-FINRA-2015-036.

Dear Mr. Errett:

The American Council of Life Insurers ("ACLI") is a national trade association with 300 members that represent more than 90 percent of the assets and premiums of the life insurance and annuity industry in the United States. Many of our members also provide life insurance, annuity and employee benefit programs on a global basis. We greatly appreciate the opportunity to offer the Securities and Exchange Commission ("SEC" or the "Commission") our commentary on the proposed amendments to Financial Industry Regulatory Authority Inc. ("FINRA") Rule 4210 (Margin Requirements) ("Rule 4210") for forward settling To Be Announced ("TBA") transactions, Specified Pool Transactions and transactions in Collateralized Mortgage Obligations ("CMO") (collectively the "TBA Market").[1]

Life Insurers have actively participated in the dialogue surrounding the regulation of domestic and international financial markets, and have provided constructive input on a myriad of proposed rulemaking, including the implementation of Title VII and Section 619 of the Dodd Frank Wall Street Reform and Consumer Protection Act (the "Dodd Frank Act"). The ACLI supports the efforts of FINRA and the SEC to mitigate the creation of systematic risk in the financial markets. Certain aspects of Rule 4210, however, are overly broad in relation to the type of risk it seeks to contain and has the potential to significantly raise the

[1] Notice of Filing of a Proposed Rule Change To Amend FINRA Rule 4210 (Margin Requirements) To Establish Margin Requirements for the TBA Market, Exchange Act Release No. 76148 (Oct. 14, 2015), 80 Fed. Reg. 63603 (Oct. 20, 2015).

costs of managing investment portfolios for Financial End-Users such as Life Insurers, Pension Plans, and other Asset Managers.

The margin requirements as set forth in Rule 4210 will impede the operational efficiency of the TBA Market thereby negatively impacting market liquidity for these transactions, increasing the costs to invest in the TBA Market, and ultimately having a chilling effect on the consumer mortgage market. We greatly appreciate the opportunity to share our views on this significant initiative.

I. FINRA Should Amend the Definition of Covered Agency Transactions

Following the lead of the Treasury Markets Practice Group ("TMPG"), FINRA has proposed that collateral be pledged for: (i) TBA and specified pool transactions with settlement dates that extend beyond one business day, and (ii) collateralized mortgage obligation ("CMO") transactions with settlement dates of greater than three business days. The posting of collateral for these transactions, which essentially carry the risk of "spot trades," create operational inefficiencies and increased costs for institutional investors that far outweigh the risks associated with the short dated settlement of these transactions.

- *Costs to Collateralize Short Dated Settlements Exceed the Risks Inherent in the Settlement Period.*

FINRA has indicated that approximately 28.5% of the transactions that would be subject to Rule 4210 are "Dollar Roll" transactions, in which a simultaneous sale and forward purchase of an Agency Pass-Through Mortgage Backed Security creates a funding mechanism similar to Repurchase Transactions. However, Dollar Roll transactions must be distinguished from the standard cash or physical settlements that comprise the majority of TBA Market activity. Institutional investors, like insurance companies, purchase securities in the TBA Market as investments with the intent of settling such transactions (either on a cash or physical basis) on the next occurring Standard Settlement Date[2]. Standard settlements of TBA Market transactions do not create leverage or the potential market risks engendered by financing transactions, such as Dollar Rolls, and should not be subject to the same margining requirements.

[2] Standard Settlement Date means; (i) with respect to TBA and specified pool transactions the monthly settlement dates established by the Securities Industry and Financial Markets Association ("SIFMA") and published on their website and (ii) with respect to CMO transactions, the standard month end market convention settlement date.

Prior to and throughout the 2008 financial crisis, the TBA Market remained stable and liquid without the support of collateral securing the ordinary course settlement of these transactions. Moreover, in its analysis of TBA Market volatility, FINRA itself concedes that volatility in the TBA Market would not be expected to significantly increase in a more volatile interest rate environment[3]. Finally, FINRA acknowledges that over 50% of the TBA Market transactions included in its economic baseline analysis consist of "interdealer trades, which are already subject to mark to market margin between members of the Mortgage-Backed Securities Division ("MBSD") of the Fixed Income Clearing Corporation ("FICC," a subsidiary of the Depository Trust & Clearing Corporation ("DTCC)), which acts as a central counterparty."[4] Consequently, of the 2.06 million TBA Market transactions analyzed by FINRA,[5] 1.10 Million were interdealer transactions, already subject to mark to market margin requirements and 29% of the 960,000 dealer to customer transactions consisted of Dollar Rolls; leaving roughly 34% (681,600 transactions) of the total analyzed transactions as standard dealer to customer TBA Market settlements.

The costs associated with operating and maintaining a collateral management infrastructure to accommodate the short dated settlement periods required under Rule 4210 are significant and will create operational burdens for investors that far outweigh the potential market risks posed by this relatively small and low volatility component of the TBA Market.

- *The Opportunity Cost of Allocating Eligible Collateral to Short Dated Settlements Will Decrease TBA Market Liquidity.*

The requirements of other regulations adopted to implement the Dodd-Frank Act have compelled institutional investors to closely monitor and efficiently allocate investment portfolio securities that constitute eligible collateral for derivatives transactions. Rule 4210 adds an additional layer of regulation that creates competing demands among those investments that require the posting of eligible collateral. Financial institutions will now be required to re-evaluate the allocation of such eligible collateral in order to continue investing in the TBA Market.

The pool of eligible collateral within an institution is not infinite. The opportunity cost of posting collateral to an ever-expanding range of financial products will force institutions to forgo investing in these products and / or pass the additional costs of collateralization onto consumers. In the case of the TBA Market, collateralization of short dated settlements will

[3] 80 Fed. Reg. 63614, footnote 100.
[4] 80 Fed. Reg. 63610.
[5] *Id.*

likely result in decreased demand and liquidity in this market and substantially higher borrowing costs for Americans purchasing homes. In the case of insurance companies, the increased costs associated with purchasing mortgage-backed securities ("MBS") to match insurance and annuity obligations will increase the costs of these insurance products as well.

ACLI recognizes that default risk increases incrementally as settlement periods are extended. These risks, however, must be balanced against the associated costs of posting eligible collateral for short dated TBA Market settlements and the negative impact on the markets that are affected.

Accordingly, ACLI suggests that, with respect to standard TBA Market settlements, the Commission amend the definition of Covered Agency Transactions under Rule 4210 to cover only forward-settling TBA Market transactions whose settlement dates extend beyond the first Standard Settlement Date following the trade date for such transaction.

For example, if a party executes a TBA transaction with a trade date of November 1, 2015, and the next Standard Settlement Date for the securities underlying such transaction is November 15, 2015, then no margin would be required in respect of such transaction. Any transactions executed on November 1, 2015 with a scheduled settlement date that falls beyond November 15, 2015 would, however, be subject to the margin requirements of Rule 4210.

II. FINRA Should Require Bilateral Margining

Rule 4210 requires FINRA members to collect margin from counterparties but does *not* require the bilateral exchange of such margin to cover such counterparty's exposure to a FINRA member. The practice of unilateral margin posting by counterparties to FINRA members is inconsistent with the established market convention of bilateral margining applied in the derivatives, repo and securities lending markets, as well as the TMPG's Statement of Best Practices for Treasury, Agency Debt and Agency Mortgage-Backed Securities Markets.[6] Accordingly, ACLI suggests that Rule 4210 be amended to require bilateral margining arrangements when the same are requested by a FINRA member counterparty.

[6] Available at http://www.newyorkfed.org/tmpg/best_practices.html .

The concept of bilateral margin posting is of particular significance to the life insurance industry. It is customary best practice for life insurers to require two-way posting of variation margin in the OTC derivatives, Repo and Securities Lending market. The ACLI has been a vocal proponent of bilateral margining and, in its commentary to each of the Prudential Regulators, the CFTC and the SEC addressing the margining of OTC derivatives under the Dodd Frank Act, has strongly advocated requiring two-way posting of variation margin/collateral. We continue to support this position as applied to margining requirements in the TBA Market.

Bilateral margin standards promote economic stability in the financial markets and prevent the accumulation of systemic risk at financial institutions engaged in transactions of significant size. Quite simply, bilateral margining protects both sides of a transaction against future credit risk, the default by either counterparty. Additionally, a regulatory mandate for bilateral margining under Rule 4210 serves to create parity among TBA Market participants, a principal consistent with international standards established for two way margining of OTC uncleared derivatives.[7]

ACLI, therefore, strongly recommends that, to the extent requested by a counterparty, FINRA members should be required to post margin to their counterparties in the same manner as required for counterparties to post margin to FINRA members.

III. FINRA Should Modify the Minimum Transfer Amount and Allow for Flexible Margin Thresholds

- *Increase Minimum Transfer Amount Limit to $500,000.*

Rule 4210 currently sets a minimum transfer amount of $250,000 associated with collateral deliveries upon the creation of counterparty exposure; while also requiring FINRA members to establish "risk limits" for the level of credit they are willing to extend to their counterparties when executing TBA Market transactions. Although the level of such credit risk under Rule 4210 is determined at the discretion of the FINRA member, the minimum transfer amount is capped at $250,000 and allows no flexibility for upward adjustments. TBA Market participants should have the flexibility to determine minimum transfer amounts

[7] *See* Basel Committee on Banking and Supervision and Board of the International Organization of Securities Commissions, margin Requirements for Non-Centrally-Cleared Derivatives, September 2013, *available at* http://www.iosco.org/library/puddocs/pdf/IOSCOPD423.pdf ("BCBS/Iosco Final Policy Framework")

up to a limit of $500,000, which such amount is consistent with both US and international standards established for minimum transfer amounts for uncleared OTC derivatives.[8]

- *Allow Flexibility for Prudent Collateral Thresholds.*

Additionally, the ability to establish appropriate risk limits for a particular counterparty should also encompass each party's right to determine initial collateral thresholds. The ability of each party to independently establish and negotiate prudent and reasonable collateral thresholds is also consistent with the TMPG Statement of Best Practices for Treasury, Agency Debt and Agency Mortgage-Backed Securities Markets.[9]

ACLI, therefore, suggests that the SEC increase the minimum transfer amount limit proposed in Rule 4210 to $500,000 and further allow FINRA members and their counterparties the flexibility to determine prudent and reasonable collateral threshold levels on a case-by-case basis depending on the nature of the trade, product type, and their own independent evaluations of the creditworthiness of a counterparty.

IV. FINRA Should Modify Transaction Close Out and Margin Delivery Periods

- *Event of Default Close-Out Determinations Should Remain the Province of the Parties to the Affected Transaction.*

Under Rule 4210 any exposure deficiencies not collateralized within five business days would require an immediate "liquidating action." ACLI objects to the mandatory five day close out period for the failure to deliver margin set forth in Rule 4210. TBA transactions will generally be governed by the SIFMA Master Securities Forward Transaction Agreement ("MSFTA") in compliance with the TMPG's Statement of Best Practices for Treasury, Agency Debt and Agency Mortgage-Backed Securities Markets.[10] The MSFTA sets forth certain events of default ("Events of Default"), which include the failure of a party to deliver collateral when required; and further allows for the parties to agree on a cure period to remedy any such failure.

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[8] *See* Basel Committee on Banking and Supervision and Board of the International Organization of Securities Commissions, margin Requirements for Non-Centrally-Cleared Derivatives, September 2013, *available at* http://www.iosco.org/library/puddocs/pdf/IOSCOPD423.pdf ("BCBS/Iosco Final Policy Framework")
See also margin and Capital Requirements for Covered Swap Entities (Oct. 22, 2015), available at https://www.fdic.gov/news/board/2015/2015-10-22_notice_dis_a_fr_final-rule.pdf . ("Prudential Regulators Margin Adopting Release").
[9] Available at http://www.newyorkfed.org/tmpg/best_practices.html
[10] *Id.*

The declaration of an Event of Default should remain the province of the parties based upon terms negotiated in the MSFTA, the non-defaulting party's assessment of prevailing circumstances surrounding such Event of Default, the credit worthiness of the counterparty to the transaction, and current market conditions. This is especially relevant when a common cause of a failure to deliver collateral is the existence of a good faith dispute between the parties. Any failure to deliver collateral in the context of a dispute between the parties, when the parties are following agreed upon procedures to resolve the dispute, should not be grounds for a mandatory liquidating action.

- *Margin Delivery Periods Do Not Reflect Standard Market Convention.*

Rule 4210 further provides that margin deficiencies must be collateralized within one business day of the creation of such exposure. ACLI objects to this abbreviated margin delivery period as it is inconsistent with generally established collateral delivery periods of two to three business days that exist in the derivatives and other similar markets. Requiring such an abbreviated margin delivery period will require investors to modify existing collateral delivery systems and procedures. Modifications to these systems and procedures will be a time consuming and costly process.

The mandatory close out and margin delivery components of Rule 4210 will have the unintended consequences of increasing the costs associated with executing TBA Market transactions and will ultimately reduce the liquidity in the MBS market.

Accordingly, we suggest that the Commission omit the mandatory five day liquidation period set forth in Rule 4210, and continue to allow the parties to maintain the flexibility to determine appropriate close out and cure periods as provided for in the MSFTA. We further suggest that the Commission modify Rule 4210 to allow the parties to negotiate margin delivery periods that are consistent with standard market conventions.

V. FINRA Should Extend the Compliance Implementation Period

180 days is an insufficient time frame for institutions to effect compliance with the requirements of Rule 4210. The abbreviated margin delivery period under Rule 4210 will require investors to modify existing collateral delivery systems and procedures. Modifications to these systems and procedures will be a time consuming and costly process, not likely to be achieved within the 180 day compliance period. Additionally, in

order to reconcile the various differences between Rule 4210 and the TMPG guidelines,[11] TBA Market participants will need to amend or renegotiate existing MFSTA's with those counterparties that have existing margining agreements in place and negotiate new MFSTA's with those counterparties that have not yet executed such agreements.

ACLI, therefore, recommends that a compliance period of at least 18 months represents a more reasonable timeframe in light of the considerable system modifications and document negotiation efforts that will be required for parties to comport with Rule 4210.[12]

VI. Conclusion

ACLI would like to reiterate our appreciation for the efforts that the Commission and FINRA have expended in attempting to create a more resilient TBA Market. We are pleased to be able to continue to participate through the comment process, and respectfully submit that certain aspects of Rule 4210 discussed above have the potential to unintentionally reduce market liquidity, increase costs in the MBS markets and unnecessarily increase the costs of purchasing both insurance products and homes for Americans. Please let me know if you have any questions.

Sincerely,

/S/

Carl B. Wilkerson

[11] Differences between the MFSTA and Rule 4210 currently include: (i) the ability of the parties to negotiate a flexible Minimum Transfer Amounts, (ii) the ability of the parties to negotiate cure periods and close-out timing in connection with the failure to deliver collateral, (iii) the ability to affect bilateral margining between the parties, (iv) the ability of the counterparties to negotiate the level of maintenance margin required if applicable and (vi) modification of collateral delivery periods.

[12] We note that compliance periods of similar duration have been adopted for the margin requirements associated with uncleared OTC Derivatives Transactions. *See* margin and Capital Requirements for Covered Swap Entities (Oct. 22, 2015), *available at* https://www.fdic.gov/news/board/2015/2015-10-22_notice_dis_a_fr_final-rule.pdf . ("Prudential Regulators Margin Adopting Release").