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May 10, 2022

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street NE
Washington DC 20549

Dear Ms. Countryman,

We eight minority- and women-owned broker-dealers are pleased to provide comments on SEC Release No. 94724, "Order Granting Petition for Review and Scheduling Filing of Statements; In the Matter of Financial Industry Regulatory Authority, Inc. Regarding an Order Granting the Approval of Proposed Rule Change, as Modified by Amendment No. 1, To Amend the Requirements for Covered Agency Transactions Under FINRA Rule 4210 (Margin Requirements) as Approved Pursuant to SR–FINRA–2015–036" (the "Release").

All the firms on this letter are active in or planning to enter the business of underwriting new-issue agency mortgage-backed securities ("MBS"), "Covered Agency Transactions" in the language of the FINRA amendment that is the subject of the Release. We work with mortgage originators to fund and purchase new mortgage loans which go into pools which support MBS. We also place securities with long-term investors. Firms like ours are central to the mortgage finance system in the US. If FINRA's Covered Agency Transaction amendment is fully implemented, it is very likely that the activities of minority- and women-owned dealers who underwrite new-issue agency MBS would be severely constrained as a result of the capital charges the proposal would impose on firms, even to the point of driving some of us out of the MBS business entirely.

On January 20, 2022 the SEC's Division of Trading and Markets approved under delegated authority a FINRA rule change to amend the requirements for FINRA Rule 4210 (the "CAT Amendment"). We eight firms oppose this change to Rule 4210 because it brings the very real possibility that routine, low-risk transactions could consume all of a firm's regulatory capital under the wrong market conditions. The CAT Amendment disadvantages mid-size, non bank-affiliated broker-dealers relative to others and is therefore anticompetitive. We urge the Commission to reject the CAT Amendment and direct FINRA to revise the Rule in line with long established market practices governing the clearance and settlement of agency mortgage-backed securities (MBS) transactions.

The CAT Amendment would require broker-dealers who underwrite most new-issue agency MBS transactions to collect and hold variation margin from customers purchasing securities. Because FINRA has recognized that many mid-size broker-dealers do not have and cannot obtain margin agreements or Master Securities Forward Transactions Agreements (MSFTAs) with their MBS customers, the CAT Amendment includes an option for a dealer to take a capital charge in lieu of collecting margin on a dollar-for-dollar basis.

The most fundamental flaw with the CAT Amendment is that is does not comport with long-established market practices around the clearance and settlement of agency MBS. Sales of new MBS do not settle on a T+2 basis like much of the rest of the capital markets. Rather, new-issue agency MBS settle on a monthly schedule established and published by SIFMA. The reason for this schedule is that assembling a pool of mortgages to back a new MBS takes time. Mortgage originators need time to approve new loans and warehouse loans until the pool is fully assembled. At the same time, they need firm funding commitments that the MBS backed by the pools will be underwritten and sold on the settlement day published by SIFMA. That means dealers must obtain purchase commitments from investor customers well in advance of the scheduled settlement date. That time between when the customer commits to a purchase and when the securities are delivered would trigger the margin requirements under the CAT Amendment because it almost always exceeds two days.

Procedures for clearing and settling MBS trades involving monthly closing dates have existed since 1981. The processes and systems that support agency MBS issuance are established and proven. The system of monthly settlements functioned robustly during the financial crisis. FINRA has not demonstrated why it is necessary to impose a T+2 clearing standard on a market that simply does not support it. The CAT Amendment would disrupt well-tested MBS market practices. For this reason, we urge the Commission to direct FINRA to rewrite the CAT Amendment in a manner consistent with market practices for clearing MBS trades. Trades should be marginable only if they settle outside the SIFMA settlement schedule.

In addition, the CAT Amendment is anticompetitive because it would have the effect of disadvantaging certain broker-dealers relative to others. Broker-dealers who are affiliated with banks and run their marginable business from within a bank are exempt from Rule 4210 generally. They are subject to a separate Federal Reserve margin regime that does not require margining new-issue agency MBS sales. Large broker-dealers not affiliated with banks generally are able to negotiate margin agreements of MSFTAs with their investor customers and have a means to collect and hold margin funds when necessary.

Many mid-size broker-dealers active in the agency MBS market, on the other hand, including the minority- and women-owned firms on this letter, generally do not have margin agreements or MSFTAs with their investor customers. Investors do not execute and maintain these agreements with dealers with whom they may trade only occasionally. That means most mid-size broker-dealers have no means to collect and hold margin funds from customers. Moreover, many mid-size MBS dealers are correspondent or introducing dealers whose trades clear through a clearing firm. That means even if the correspondent firm with the customer relationship was able to obtain a margin agreement or MSFTA from a customer, only the clearing dealer can accept or hold customer margin funds. All this leads to the fact that if the CAT Amendment becomes fully implemented, firms like ours would be unable to collect and hold margin funds and would in almost all cases need to take capital charges in lieu of margin.

With the only means of compliance available to most mid-size firms being capital charges, these underwriters could see substantial impairment of regulatory capital in just the kind of market conditions we are witnessing today. Customer orders of new-issue agency MBS result in long customer positions. In a rising rate environment like today, capital charges in lieu of variation margin could quickly consume all the capital a firm can allocate to this activity. The CAT Amendments would result in situations where some BDs' activities are essentially frozen until the monthly MBS settlement date. This would severely handicap firms like ours who compete with dealers not subject to Rule 4210 or who are able to collect and hold customer margin funds. And it would be applied to transactions which are fully hedged or offset from our firms' perspective and present very little risk.

There are other serious problems with the CAT Amendment. For example, for correspondent firms who clear through clearing dealers, including all the firms on this letter, the CAT Amendments could result in requirements for dealers to post variation margin to their clearing firms in addition to taking capital charges in lieu of customer margin, doubling the financial hit those firms face under the Rule. Combined, these effects would create an extremely anticompetitive market environment where some firms are able to skirt Rule 4210 by operating their marginable business through a bank while subjecting non-bank dealers to onerous, even crippling regulation. The CAT Amendment also fosters regulatory arbitrage by incentivizing firms to avoid Rule 4210 altogether and simply operate this business through an affiliated bank.

Reverting to the version of the Rule adopted by the Commission in 2016 would be even worse. That version of the Rule requires collecting both maintenance and variation margin on CAT trades and does not allow for a dealer capital charge in lieu of collecting margin. The 2016 Rule would squeeze minority- and women-owned dealers like ours out of the MBS business immediately and completely.

All these issues could be addressed simply by changing the definition of marginable trade in the CAT Amendment to be consistent with well established industry and market practices around monthly settlement schedules. New-issue agency MBS underwriting is not a T+2 market. It never has been. FINRA Rules should respect that. We urge the Commission to reject the CAT Amendment and direct FINRA to revise the proposal in keeping with industry standards by requiring margin only on transactions that clear outside the scheduled settlement window.

Thank you for your consideration. If we can answer any questions or respond to comments, please contact us through Michael Decker, Senior Vice President, Bond Dealers of America,