sifma
Invested in America

asset management group

June 15, 2021

Submitted via rule-comments@sec.gov

Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Dear Madam or Sir,

The Asset Management Group of SIFMA[1] ("SIFMA AMG") respectfully submits its responses to the Commission's consultation on amendments to FINRA's rules governing margin requirements for covered agency transactions.[2] SIFMA AMG members include many of the largest and most active participants in the mortgage-backed securities markets covered by this rule and share a keen interest in the continued liquidity of these markets, which provide the funding for the majority of mortgage lending in the United States. Managing counterparty credit risk is also a concern for asset managers, not just dealers, and AMG members generally support and frequently employ margining arrangements to address this risk. SIFMA AMG has submitted a number of comment letters on this proposal over the years.[3]

In this letter we provide comments on certain aspects of the current proposal that are important to our members.

1. **<u>SIFMA AMG Supports the Elimination of Maintenance Margin Requirements</u>**

SIFMA AMG previously requested that FINRA eliminate the maintenance margin provisions of the rules.[4] FINRA has proposed to eliminate these provisions, and we support that change.

2. **<u>SIFMA AMG Believes More Time is Needed for Implementation</u>**

FINRA has proposed that it *"will announce the effective date of the proposed rule change in a Regulatory Notice to be published no later than 60 days following Commission approval. The effective date will be*

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[1] SIFMA AMG brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed $45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. For more information, visit http://www.sifma.org/amg.
[2] Available here: https://www.federalregister.gov/documents/2021/05/25/2021-10959/self-regulatory-organizations-financial-industry-regulatory-authority-inc-notice-of-filing-of-a
[3] SIFMA AMG letters on 4210 covered agency transactions proposals:
2014: https://www.finra.org/sites/default/files/NoticeComment/p477653.pdf
2015: https://www.sifma.org/wp-content/uploads/2017/05/agency-mbs-1.pdf
2017: https://www.sec.gov/comments/sr-finra-2015-036/finra2015036-79.pdf
[4] See, e.g. SIFMA AMG letter from March 2014: https://www.finra.org/sites/default/files/NoticeComment/p477653.pdf

no later than 120 days following publication of the Regulatory Notice announcing Commission approval."[5] This lays out an implementation window of no longer than 180 days (6 months), which creates a possible scenario where the implementation period is less than six months.

SIFMA AMG members are extremely concerned about this constrained time period for implementation and how it could present market access risks for SIFMA AMG members and disrupt the liquidity in the covered agency markets which are so important to the U.S. housing finance system.

In previous comment letters, SIFMA AMG requested 18 months after publication of final rule text to implement the final rules.[6] SIFMA AMG members continue to believe that this is an appropriate period of time for implementation and respectfully request that FINRA accommodate our request.

It is important to keep in mind that once these rules are effective, an asset manager who does not have a margining agreement with a dealer counterparty will likely not be able to trade covered agency products with that counterparty. Indeed, this cutoff may occur well in advance of the effective date, given that these are products traded on a forward basis. In the case of TBAs, dealers may choose to cease trading with undocumented counterparties a number of months before the effective date so that they do not end up with uncollateralized exposures crossing over the effective date. In other words, a dealer facing a six-month implementation window may limit trading as soon as three or four months after the finalization of the rules.

Even if an asset manager is able to negotiate agreements with some of their existing counterparties, it is important to note that asset managers need trading relationships with multiple dealers to ensure best execution for their clients.

While we have covered these concerns in previous communications, we summarize them again here:

- Implementing these proposed amendments is a cross-firm legal, IT, operational, and client management effort. Margin and other agreements must be negotiated. Internal systems must be updated, purchased from vendors and integrated, or created from scratch.
- Clients must be educated as to why this is happening. Asset managers will need to discuss these rules with clients across the globe, obtain authority to enter into agreements, discuss operational arrangements for margin exchange, and determine documentation provisions for each client.
- New or amended industry standard margin documentation will have to be discussed and agreed among market participants. This cannot happen until the industry has final rules in place upon which to base these discussions.
- Margin agreement negotiations will not, and realistically cannot, resume until rules are final and industry standard forms and amendments are agreed. As we have seen in the past, this can be a lengthy process especially for clients without margin documentation. Negotiating documentation usually involves the client's legal counsel as well as a certain level of education, all of which takes both time and resources.
- Where asset managers and FINRA members have elected with respect to certain trading accounts not to document and collateralize for various reasons, new agreements and full

[5] Proposal at 28166.

[6] See March 2014 SIFMA AMG letter at 6: https://www.finra.org/sites/default/files/NoticeComment/p477653.pdf , and SIFMA AMG's 2015 letter at 10: https://www.sifma.org/wp-content/uploads/2017/05/agency-mbs-1.pdf

operational setups will now be needed. These accounts will be competing for dealers' attention and smaller accounts may be disadvantaged, and likely unable to complete setup with all current trading relationships within the six months.

- Before a margin agreement can be put in place, '40 Act funds will require control agreements to be put in place with each margin agreement negotiated with a dealer. This not just an additional document to negotiate, it also involves negotiation with a third-party – the custodian. There are a limited number of custodians who serve many clients, and therefore it is likely that their legal resources will be constrained. Negotiating these control agreements is a notoriously lengthy and resource intensive endeavor.
- Multiple rulemakings compete for the same and limited set of SIFMA AMG member legal and documentation resources. We highlight the Uncleared Margin Rule ("UMR"), the SEC's use of derivatives rules, and LIBOR transition in this regard as initiatives that place similar demands on limited member resources. In many cases, particularly for buyside firms, the same documentation teams at broker-dealers, custodians, and asset managers are working on these initiatives in addition to 4210. We suggest that FINRA keep these other initiatives in mind when choosing a new effective date and try to avoid implementing 4210 amendments in an overlapping manner – in particular, overlapping the September 2022 UMR date where a greater number of clients are expected to be in scope.
- Given the history of this rulemaking with its multiple delays and amendments, AMG members have started and stopped implementations once or more than once. AMG members will need to convince both internal stakeholders (e.g., trading desks, operational, client service, and IT resources) along with external clients that yes, this is real and yes, this needs to get done this time.

Implementation without full market readiness could cause real commercial effects in the TBA market. The effect immediately following the implementation date, when a significant number of trading relationships could disappear overnight due to lack of readiness, could be to introduce volatility and reduce liquidity. These effects would harm FINRA member broker dealers, asset managers, mortgage originators and servicers, and mortgage borrowers. FINRA's goal should be materially complete market readiness so as not to be the cause of such disruptions.

Given all of this, we reiterate our request for an 18-month implementation timeframe. We believe this is reasonable request that balances the costs of implementation and the risk that firms may lose access to the covered agency transaction markets (and that the markets may experience a decline in liquidity) against the benefits of collateralization of these trading relationships.

3. FINRA Should Confirm Market Practice for Liquidation Requirements Satisfies Amended Rules

SIFMA AMG had previously objected to the five-day liquidation requirement in the previous version of the rules.[7] Accordingly, we were pleased to see that the proposed rule change would eliminate current paragraph (e)(2)(H)(ii)d, which included the liquidation requirement. The revised rules have a new section (f)6 which lay out a fifteen-day liquidation requirement.

However, the new concept of a "non-margin counterparty" has created confusion among SIFMA AMG members. A counterparty is a non-margin counterparty if the FINRA member *"(1) Does not have a right under a written agreement or otherwise to collect margin for such counterparty's excess net mark to*

[7] See, e.g. 2014 letter at 3.

market loss and to liquidate such counterparty's Covered Agency Transactions if any such excess net mark to market loss is not margined or eliminated within five business days from the date it arises; or (2) does not regularly collect margin for such counterparty's excess net mark to market loss."[8]

SIFMA AMG believes that a written agreement such as an MSFTA with a "cure period" (or similar provision after the expiration of which liquidating action may be taken) of less than or equal to five business days would satisfy this requirement underlined above. An explanatory note to this effect in the final rule would be useful to help avoid disagreements among market participants as to the liquidation requirements in the rule.

4. "Excess Net Mark to Market" Definition

We understand from conversations with FINRA staff that FINRA intended the construct of "excess net mark to market" to function as a threshold, whereby no margin need be collected up to $250,000, however margin must be collected (or capital charges taken) for all amounts above this level. The proposal appears to allow firms to alternately treat this $250,000 level as an MTA and collect the entire amount. We note that industry standard documentation, such as SIFMA's MSFTA, includes an MTA provision, and we understand from our members that a $0 threshold and a $250,000 MTA is a common market practice. We believe that many market participants may elect to continue to treat the $250,000 level as an MTA because that would ensure that uncollateralized exposures are minimized, would minimize the risk and cost of handling small-dollar wire transfers, and would be consistent with current documentation arrangements.

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We appreciate the Commission's attention to these comments. For more information or to discuss any issues further, please do not hesitate to contact me at [redacted] or [redacted].

Sincerely,

Chris Killian
Managing Director
Securitization, Corporate Credit, Libor

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[8] Proposal, footnote 28.