sifma
Invested in America

March 7, 2018
Robert W. Cook, President & CEO
Robert L.D. Colby, Chief Legal Officer
Financial Industry Regulatory Authority
1735 K Street, NW
Washington, DC 20006-1506

Re: Delay in Amendments to FINRA Rule 4210 Regarding Covered Agency Transactions

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] is writing regarding the amendments to the margin requirements that apply to "covered agency transactions" (the "**Amendments**") that are currently scheduled to become effective on June 25, 2018 (the "**Scheduled Effective Date**"). In light of reports that FINRA is now reconsidering major aspects of the Amendments, SIFMA urges FINRA to act immediately and publicly to announce a delay in their effectiveness. News of this reconsideration of the Amendments has created material uncertainty and complicated the negotiation of agreements and the "onboarding" process necessary to implement the Amendments by the Scheduled Effective Date. A delay is now necessary to give FINRA time to determine, in consultation with market participants and other interested parties, whether changes to the Amendments are appropriate, and, if so, what those changes should be.[2] It is also necessary to avoid disruption to the market for covered agency transactions.

Material Changes to the Amendments. Through communications that SIFMA staff and various FINRA members have had with the FINRA Board and with FINRA staff, SIFMA members and FINRA member firms have learned that FINRA is considering fundamental changes to the Amendments.[3] Similarly, buy-side participants that enter into covered agency transactions are also aware that FINRA is considering revising the not-yet-effective Amendments. Our members and many buy-side market participants are now under the impression that material rule changes to the Amendments will be proposed, even if the specific details have not been fully determined or revealed. These rule changes could significantly alter significant legal and compliance obligations imposed on FINRA members, and, indirectly, their customers.

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[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] As discussed further below, SIFMA does not take a view in this letter as to the merits of any changes to the Amendments. We appreciate FINRA's willingness to consider and reconsider its rules and would welcome further discussion and consultation with FINRA as to any possible changes.

[3] The market remains uninformed as to the full extent of what is being considered, but the general understanding is that FINRA is contemplating changes that could, among other things, eliminate or limit the requirement to post margin for some or all customers of broker-dealers.

An already challenging implementation process has now been further complicated by the prospect that the end point will be significantly different than expected. Given the difficult operational and technological requirements of the Amendments and, even more significantly, the need for FINRA member firms to negotiate or renegotiate collectively hundreds of thousands of agreements with their customers, many FINRA member firms were going to need to stretch resources in order to accomplish the significant tasks necessary to be in compliance by the Scheduled Effective Date and to materially complete the onboarding process. However, the prospect of revisions to the Amendments has created significant uncertainty in the market as to how to proceed. Customers may simply avoid negotiating the agreements necessary to comply with the Amendments if they expect that FINRA may modify the requirements of the Amendments, particularly if FINRA does so in a manner that could obviate the need for the agreements at all, or reduces the obligation to post margin, temporarily or permanently. A customer may also take the view that if it must have an agreement in place just in case the Amendments do go into effect on the Scheduled Effective Date, it will enter into the required agreement with one or two firms and may stop doing business with other FINRA member firms.[4]

To summarize, given the current state of market uncertainty, FINRA members are concerned that it will be impossible for them to achieve levels of onboarding and negotiated agreements necessary to adequately sustain the business in covered agency transactions and avoid market disruption. This need for an announcement of delay by FINRA is urgent, given that transactions entered into during the last week of this month and not settled for ninety days could be impacted by the Amendments, if they were to become effective on the Scheduled Effective Date. This uncertainty over what requirements will apply to covered agency transactions could result in reductions in liquidity as some firms withdraw from the market while waiting to see what rules will apply.[5]

If FINRA is determined to make changes to the Amendments, in the most optimistic scenario, any rule changes adopted before the Scheduled Effective Date would become effective too late to be implemented by that date. In a more realistic scenario, rule changes would become effective *after* the Scheduled Effective Date. Under both scenarios, there may be significant market disruption. Neither FINRA members nor buy-side participants are capable of modifying the necessary technology or amending the hundreds of thousands of relevant agreements under either such scenario in the time frames that FINRA seems to contemplate. That is, when FINRA first adopted the Amendments, FINRA gave firms nine months after the publication of interpretations to those Amendments to come into compliance. Even with that lead time, the necessary technology changes and the sheer scale of the contract negotiations and/or re-negotiations raised difficult challenges.

Inefficient Use of Resources. Many FINRA members and their customers have employed significant internal and external resources and incurred significant cost to build or adapt the quite complicated systems required to obtain compliance with the Amendments. That work is ongoing, as firms race to meet the Scheduled Effective Date. Any rule change shortly before effectiveness would require additional work that would have to be performed in haste and make moot work that

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[4] In addition, customers that have already negotiated agreements could seek to amend those agreements in light of (potential) changes to the Amendments.

[5] In fact, some SIFMA members have already started to develop processes for reducing transactions with customers that have not been onboarded by the end of this month.

firms have already done. This would particularly be the case if the Amendments go into effect, and are then changed shortly thereafter. Changes to legal requirements that require significant changes to customer-facing legal agreements and operations involve significant efforts and it is simply not possible for firms to adjust to further changes in short periods of time given the massive personnel and technology resources required. Further, customers will have the same difficulties of negotiating their agreements and adopting new technology.

Disruption to Financial Markets. Failing to delay the Scheduled Effective Date, in light of the uncertainty of the relevant rule requirements, threatens a disruption to the markets for covered agency transactions and, and that disruption would have a carryover effect on other markets and market participants, such as mortgage providers who use covered agency transactions as hedges in their business. In fact, one of the most important functions that FINRA members serve through covered agency transactions is allowing mortgage lenders to hedge their risk of making housing loans. The size of those transactions is enormous. As FINRA is aware, more than $200 billion of covered agency transactions are entered into each day. Introducing a high degree of regulatory uncertainty into a market of this size may affect pricing and liquidity not only as to those transactions but also in related markets.

This letter does <u>not</u> take a view on any changes to the Amendments under consideration. SIFMA wishes to make clear that this letter is not intended to express a view as to either the substance of the Amendments as adopted, or as to any proposed changes to the Amendments. SIFMA members have a diversity of business models, and their views on the specifics of the Amendments and of any changes to them vary. SIFMA members are open to discussion with FINRA as to possible amendments. Notwithstanding the diversity of members' views on the final form of the Amendments, SIFMA members are in agreement that FINRA should immediately announce a delay of the effectiveness of the Amendments until their absolute "final" form is agreed. Not doing so will risk disruption to the market for covered agency transactions and impose material additional costs on its membership. The final form of the Amendments should follow discussion with market participants (beyond a minimum rule filing notice-and-comment process), in order to ensure that the revisions are workable for FINRA members and their customers and will not have a negative effect on the U.S. financial markets, including the mortgage market. Following that final resolution (whether or not that ultimately involves changes to the Amendments as they now stand), FINRA member firms and their customers should be given adequate time to achieve compliance.

Members of SIFMA are available to meet with FINRA on an emergency basis to discuss this issue. Please contact me at [redacted] if you have questions concerning our letter or to arrange a meeting.

Regards,

Chris Killian
Managing Director, SIFMA

cc:
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