



Carl B. Wilkerson
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Brent Fields, Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

February 11, 2016

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, as Modified by Partial Amendment No. 1.¹

Dear Mr. Fields:

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”).²

ACLI supports the SEC’s action to institute proceedings pursuant to Securities Exchange Act Section 19(b)(2)(B)(6) to determine whether to approve or disapprove the proposed rule change, as modified by Partial Amendment No. 1. We share the SEC’s observation that FINRA’s proposal “raises concerns that the potential operational difficulties and costs of implementing the proposed rule may cause some firms to either withdraw from the TBA market or cease dealing with certain types of counterparties.”³ We concur with the SEC’s statement that the initiative “raises questions with regard to the potential effects of the proposal on the mortgage market, as a whole.”⁴

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

¹ Release No. 34-76908; File No. SR-FINRA-2015-036, Order Instituting Proceedings To Determine Whether To Approve or Disapprove Proposed Rule Change To Amend FINRA Rule 4210 (Margin Requirements) To Establish Margin Requirements for the TBA Market, as Modified by Partial Amendment No. 1; 81 Fed Reg. 3532 (Jan. 21, 2016) [<https://www.gpo.gov/fdsys/pkg/FR-2016-01-21/pdf/2016-01058.pdf>] (the “Proposal”).

² *Id.*

³ *Id.* at 3544

⁴ *Id.*

Reform and Consumer Protection Act (the “Dodd Frank Act”). ACLI supports the efforts of FINRA and the SEC to mitigate the creation of systematic risk in the financial markets. As noted in our November 10, 2015 letter of comment, however, certain aspects of Rule 4210 are overly broad in relation to the type of risk it seeks to contain and have the potential to significantly raise the costs of managing investment portfolios for Financial End-Users such as Life Insurers, Pension Plans, and other Asset Managers. FINRA’s Partial Amendment No. 1 does not address or rectify these concerns.

The margin requirements as set forth in Rule 4210 under FINRA Partial Amendment No. 1 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.

I. Summary of Position on FINRA’s Partial Amendment No. 1

- The comment period is inadequate on FINRA’s Partial Amendment No. 1;
- FINRA failed to properly gauge the economic and competitive impact of the proposal as required under the Securities Exchange Act of 1934;
- ACLI’s comments were dismissed with uninformative, conclusory responses; and,
- ACLI opposes the SEC’s approval of the amended FINRA proposal and requests the opportunity for an oral hearing on the record.

II. Overview of ACLI’s Comments on the Proposal

As indicated in our previous comment letter to the Commission dated November 10, 2015, ACLI believes that Rule 4210; (i) is overbroad in requiring collateral for short dated TBA and Specified Pool transactions, (ii) usurps the autonomy of counterparties by dictating minimum collateral transfer amounts and transaction close-out and margin delivery periods, and (iii) disadvantages non-FINRA members in not mandating bi-lateral margining. ACLI further believes that 180 days is an insufficient time frame for institutions to effect compliance with the requirements of Rule 4210. A copy of our prior submission on Rule 4210 appears in an appendix to this letter for your convenience.

• FINRA Should Amend the Definition of Covered Agency Transactions

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. In its analysis of TBA Market volatility, FINRA concedes that such volatility would not be expected to significantly increase in a more volatile interest rate environment.⁵ ACLI believes that the costs to collateralize short dated TBA Market settlements exceed the risks inherent in the settlement period established under Rule 4210. The collateralization requirement of Rule 4210 adds an unnecessary layer of regulation that creates competing demands among those investments that require the posting of eligible collateral. Because the inventory of eligible collateral within an institution is not infinite, the opportunity cost of posting such collateral to an ever-expanding range of financial products will force institutions to forgo investing in these products and / or pass the additional costs

⁵ 80 Fed. Reg. 63614, footnote 100.

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of collateralization onto consumers. In the case of the TBA Market, collateralization of short dated settlements will result in decreased demand and liquidity in this market and substantially higher financing costs for Americans purchasing homes.

Although ACLI recognizes that default risk increases incrementally as settlement periods are extended, we believe that such risks 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 Transactions⁶ under Rule 4210 to cover only forward-settling TBA Market transactions whose settlement dates extend beyond the first Standard Settlement Date⁷ following the trade date for such transaction.

- **FINRA Should Require Bilateral Margining**

While Rule 4210 requires FINRA members to collect margin from counterparties, it does not require the bilateral exchange of such margin to cover such counterparty's exposure to a FINRA member. This 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 Treasury Market Practice Group's ("TMPG") Statement of Best Practices for Treasury, Agency Debt and Agency Mortgage-Backed Securities Markets⁸. Bilateral margining protects both sides of a transaction against the risk, of default, promotes economic stability in the financial markets and prevents the accumulation of systemic risk at financial institutions engaged in transactions of significant size. 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 derivatives⁹.

⁶ ACLI additionally notes that multifamily MBS are substantially different from those issued within the single-family TBA market. It is our understanding that many multifamily lenders—a number of which are business units of U.S. insurers—and broker-dealers do not currently margin forward MBS; to do so would add significant costs for the lenders and borrowers that could make some mortgage products unfeasible in the future with no tangible benefits.

Under the current proposal, broker-dealers would be given the discretion to elect not to require lenders to hold margins on certain multifamily forward MBS, subject to internal risk limit determinations, but multifamily MBS are otherwise subject to the margin requirement. However, multifamily mortgage products that are originated in conformity with certain government sponsored entities' and the Federal Housing Administration's programs, which are specifically subject to this rule, achieve the same goals of reducing systemic risk in the market as FINRA's proposed margin requirements. These multifamily MBS are subject to a number of risk mitigation tools including a good faith deposit that is transferred to the MBS purchaser if the sale falls through, strict underwriting requirements, and regulatory oversight from Federal government agencies.

Accordingly, ACLI recommends that multifamily MBS issued in conformity with Fannie Mae, Freddie Mac, and FHA guidelines should be completely excluded from any margining under the rule.

⁷ 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.

⁸ Available at http://www.newyorkfed.org/tmpg/best_practices.html.

⁹ 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").

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.

- **FINRA Should Modify the Minimum Transfer Amount and Allow for Flexible Margin Thresholds**

Rule 4210 requires FINRA members to establish “risk limits” for the level of credit they are willing to extend to their counterparties when executing TBA Market transactions, with such limits being determined at the discretion of the FINRA member. However, the minimum collateral transfer amount under Rule 4210 is capped at \$250,000 and provides no flexibility for upward adjustments. ACLI believes that the responsibility to establish appropriate risk limits for a particular counterparty encompasses 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 the province of each individual counterparty and is consistent with the TMPG Statement of Best Practices for Treasury, Agency Debt and Agency Mortgage-Backed Securities Markets¹⁰.

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.

- **FINRA Should Modify Transaction Close Out and Margin Delivery Periods**

Rule 4210 requires the collateralization of any margin deficiency to occur within one business day its creation, and further dictates that any such deficiency not collateralized within five business days is subject to an immediate “liquidating action.” A single day margin delivery period is inconsistent with generally established market conventions that allow two to three business days for collateral deliveries. Further, the mandatory five day close out period for failed margin deliveries usurps the independent business judgment of each counterparty to the transaction. ACLI believes that the declaration of an Event of Default should remain the province of each counterparty based upon terms negotiated in the governing master agreement, 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. Each of these components 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, ACLI suggests 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 governing master agreement. 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.

¹⁰ Available at http://www.newyorkfed.org/tmpg/best_practices.html .

- **FINRA Should Extend the Compliance Implementation Period**

ACLI believes that 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 guidelines¹¹, TBA Market participants will need to amend or renegotiate existing Master Securities Forward Transaction Agreement's ("MSFTA") 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 suggests 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

III. The Comment Period is Inadequate

Industry groups like our trade association circulate regulatory proposals, elicit membership input, develop a consensus, and circulate draft letters of comment before submission. This worthwhile, but time intensive, process is difficult to execute in a 21 day comment period, particularly given the proposals' significance and complexity. The comment period should be extended to allow all interested parties a functional opportunity to address the FINRA amendments. The 21 calendar days (15 business days) allocated for the comment period is inadequate. FINRA has been dealing with the revised proposal since November 10, 2015, about 72 days. Interested parties should have at least an equivalent period.

The special time burdens confronting regulated industries and large organizations in digesting regulatory proposals were explicitly recognized by the Administrative Conference of the United States in its publication entitled *A Guide to Federal Agency Rulemaking*¹³ ("Guide"), which notes that:

Interested persons often are large organizations, which may need time to coordinate an organizational response, or to authorize expenditure of funds to do the research needed to produce informed comments.¹⁴

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").

¹³ See, *A Guide to Federal Agency Rulemaking* (1983) at 124. The American Bar Association updated and republished this *Guide* in 1998. See Lubbers, *A Guide to Federal Agency Rulemaking*, Third Edition (1998), American Bar Association, Government and Public Lawyers Division and Section of Administrative Law and Regulatory Practice. Subsequent citations to the *Guide* are to the updated and revised ABA publication.

¹⁴ See *Guide* at 196.

The *Guide* reviews the legislative history of the Administrative Procedure Act and emphasizes that the notice of proposed rulemaking “must be sufficient to fairly apprise interested parties of the issues involved, so that they may present responsive data or argument.”¹⁵ The *Guide* further explains that rules developed through notice and comment procedures must be rational, and that notice and opportunity for comment under §553 of the APA should properly “give interested persons a chance to submit available information to an agency to enhance the agency’s knowledge of the subject matter of the rulemaking.”¹⁶ The *Guide* also points out that “informal rulemaking procedures should provide interested persons an opportunity to challenge the factual assumptions on which the agency is proceeding and to show in what respect such assumptions are erroneous.”¹⁷ Our request for an extended comment period comports with these goals.

IV. Insufficient Competitive and Economic Impact Analysis

The FINRA proposal contains a deficient economic impact statement, and does not quantify the burdens on *all* broker-dealers and market participants. These are important considerations in evaluating the proposed margin rule initiative. FINRA must provide complete and responsive information on competitive and economic impact so that the SEC can properly execute unequivocal statutory duties to screen SRO initiatives for anticompetitive effect. The SEC cannot create the analysis on its own initiative. It is incumbent on the SRO to fully develop and deliver this information, as explained below.

When it amended the Exchange Act in 1975, Congress specifically charged the SEC with the responsibility to evaluate competitive burdens of SRO rules and rule changes. The Senate report on the legislation stated that:

Sections 6(b)(8), 19(b) and 19(c) of the Exchange Act would *obligate* the Commission to review existing and proposed rules of the self-regulatory organizations and to abrogate any present rule, or to disapprove any proposed rule, having the effect of a competitive restraint it finds to be neither necessary nor appropriate in furtherance of a legitimate regulatory objective.¹⁸

Section 23(a) of the Exchange Act was also added in 1975, and requires the SEC to consider the anti-competitive effects of rule changes, and to balance any impact against the regulatory benefit to be obtained.¹⁹ Similarly, Sections 15A(b)(6) and (9) of the 1934 Act require the SEC to evaluate carefully the competitive impact of proposed SRO rules and amendments.

¹⁵ Administrative Procedure Act: Legislative History, S. Doc. No. 24879-258 (1946) [hereinafter legislative history of the APA].

¹⁶ See *Guide* at 197.

¹⁷ *Id.* at 182 and 196.

¹⁸ S. Rep. 94, 94th Cong., 1st Sess. (April 14, 1975) at 12.

¹⁹ *Id.* at 12.

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The Securities Act Amendments of 1975 significantly expanded the SEC's oversight and regulatory powers concerning SRO rules, and specifically directed the SEC to carefully evaluate competitive factors in exercising its SRO oversight. Importantly, Congress did not intend to confer general antitrust immunity on SRO rulemaking that was subject to the SEC's oversight review.²⁰

The antitrust immunity created by Congress contemplates active oversight by the SEC in executing its responsibilities to ensure consistency with the securities laws, and to blunt the anticompetitive behavior inherent in self-regulatory conduct. Otherwise, a Congressional grant of substantial regulatory authority to private organizations without federal regulatory oversight would violate the constitutional prohibition against the delegation of legislative powers.

The antitrust threshold in the 1934 Act is not an optional procedure. The legislative history unequivocally highlighted that thorough review of competitive burdens is mandatory in SRO rulemaking:

This *explicit obligation* to balance, against other regulatory criteria and considerations, the competitive implications of self-regulatory [actions].... The Commission's obligation is to weigh competitive impact in reaching regulatory conclusions.... [and] disapprove any proposed rule, having the effect of a competitive restraint if finds to be neither necessary nor appropriate in furtherance of a legitimate regulatory objective.²¹

In order for SEC review to provide immunity for self-regulatory conduct, the review must be active, and must result in a ruling by the SEC that is judicially reviewable.²² Section 25 of the 1934 Act states that the SEC's actual findings are conclusive if supported by substantial *evidence*, and that its decisions should be overturned only if "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law, the excess of statutory jurisdiction, authority, or limitations, or short of statutory right, or without observance of procedures required by law." The proposal fails the statutory safeguards to competition set forth above.

Former SEC Commissioners, including a Chairman, reemphasized the critical importance of identifying and addressing the costs and benefits of rulemaking.²³ The former SEC Chairman directed the SEC's "General Counsel's Office to carry out a 'top-to-bottom' review of our process for assessing the economic ramifications of our rulemakings."²⁴ FINRA should strive for nothing less.

²⁰ See, Smythe, *Government Supervised Self-Regulation in the Securities Industry and the Antitrust Laws: Suggestions for an Accommodation*, 62 N.C. L. Rev. 475 (1984) at 504 [the SEC has an obligation in reviewing SRO conduct to "weigh the competitive impact in reaching regulatory conclusions"]. See also Linden, *A Reconciliation of Antitrust Law with Securities Regulation: the Judicial Approach*, 45 GEO. Wash. L. Rev (1977); Johnson, *Application of Antitrust Laws to the Securities Industry*, 20 SW. L.J. (1966); Note, *The Application of Antitrust Laws to the Securities Industry*, 10 WM. & Mary L. Rev. (1968).

²¹ S. Rep. 94, 94th Cong., 1st Sess. (April 14, 1975) at 13 [emphasis added]. Congress noted that SROs are "quasi-public organizations, not private clubs." *Id* at 29. *Accord*, 121 Cong. Rec. 10728, 10756 (Apr. 17, 1975)

²² See Guide at 197.

²³ See, speeches by SEC Chairman Cox and Commissioners Atkins, Casey, and Nazareth at the PLI SEC Speaks Conference (Feb. 9, 2007) that can be found, respectively at: <http://www.sec.gov/news/speech/2007/spch020907cc.htm>, <http://www.sec.gov/news/speech/2007/spch020907psa.htm>, <http://www.sec.gov/news/speech/2007/spch020907klc.htm>, and <http://www.sec.gov/news/speech/2007/spch020907aln.htm> .

²⁴ See comments of Commissioner Atkins at <http://www.sec.gov/news/speech/2007/spch020907psa.htm> .

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In a different context, former SEC Chairman Levitt emphasized the importance of reviewing the impact of rulemaking on competition when he stated:

In response to the National Securities Markets Improvement Act of 1996 (NSMIA), the Commission has rededicated itself to considering how rules affect competition, efficiency, and capital formation as part of its public interest determination. Accordingly, the Commission intends to focus increased attention on these issues when it considers rulemaking initiatives. In addition, the Commission measures the benefits of proposed rules against possible anti-competitive effects, as *required* by the Exchange Act.²⁵

Congress, courts, and the executive branch of government have issued unequivocal guidance mandating thorough, objective cost-benefit analysis in federal agency rulemaking.²⁶ Collectively,

²⁵ See testimony of Arthur Levitt, SEC Chairman, concerning appropriations for fiscal year 1998 before the Subcommittee on Commerce, Justice, and State, the Judiciary, and Related Agencies of the House Committee on Appropriations (Mar 14, 1997), which appears at <http://www.sec.gov/news/testimony/testarchive/1997/tsty0497.txt>

²⁶ Executive branch mandates for cost-benefit analysis began in 1981 with Executive Order 12,291 that created a new procedure for the Office of Management and Budget (OMB) to review proposed agency regulations, and ensured the president would have greater control over agencies and improve the quality and consistency of agency rulemaking. Cost-benefit analysis formed the core of the review process. The order unambiguously stated that “regulatory action shall not be undertaken unless the potential benefits to society for the regulation outweigh the potential costs to society.” 46 Fed. Reg. 13193, 13193 (Feb. 17, 1981). Regulatory agencies, therefore, must balance the benefits of proposed rules against their costs.

In 1993 Executive Order 12,866 superseded the 1981 order, but retained cost-benefit analysis as a fundamental requirement in rulemaking. Executive Order 12,866 instructs that “in deciding whether and how to regulate, agencies should assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating.” Exec. Order No. 12,866, 3 C.F.R. 638 (1993). In a manner parallel to the 1981 order, Executive Order 12,866 advises that agencies must perform their analysis and choose the regulatory approach that maximizes net benefits. The 1981 and the 1993 executive orders emphasize different approaches to the same cost–benefit end. The 1981 order required that the benefits “outweigh” the costs, while the 1993 order required only that the benefits “justify” the costs. See generally Peter M. Shane, *Political Accountability in a System of Checks and Balances: The Case of Presidential Review of Rulemaking*, 48 ARK. L. REV. 161, 176-78 (1994) (comparison of 1981 and 1993 executive orders with additional detail and observing that the 1993 “order focuses on a similar mandate, but describes it with greater nuance”).

President Obama reaffirmed the importance of cost-benefit analysis in 2011 through Executive Order 13,563, and reinforced the core principles in Executive Order 12,866 by emphasizing that “each agency must . . . propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs.” Exec. Order 13,563, § 1(b), 76 Fed. Reg. 3821 (Jan. 18, 2011). The order further notes that “each agency is directed to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible.” Additional analysis of this order can be found in Helen G. Boutrous, *Regulatory Review in the Obama Administration: Cost-Benefit Analysis for Everyone*, 62 ADMIN. L. REV. 243, 260 (2010). Importantly, five administrations between 1981 to present have consistently made cost-benefit analysis a threshold for federal agency rulemaking.

In a trilogy of three significant cases involving SEC rulemaking beginning in 2005, the U.S. District Court for the federal circuit overturned major rules due to the SEC’s failure to conduct adequate cost-benefit analysis which the court viewed as arbitrary and capricious actions contrary to the mandates of the APA. See *Chamber of Commerce 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), and *Bus. Roundtable & U.S. Chamber of Commerce v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011). In sum, therefore, the guidance established by statutes, executive Orders, and seminal recent court cases strongly warrant a more carefully balanced and detailed cost-benefit analysis before the proposal moves forward. See generally Peter M. Shane, *Political Accountability in a System of Checks and Balances: The Case of Presidential Review of Rulemaking*, 48 ARK. L. REV. 161, 176-78 (1994).

In the Capital Markets Efficiency Act of 1996, Congress added Section 3(f) to the Exchange Act requiring that whenever the SEC is engaged in rulemaking under the Exchange Act, it shall “consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.”

these standards ensure that federal agencies “strike the right balance,” and develop “more affordable, less intrusive rules to achieve the same ends--giving careful consideration to benefits and costs.”²⁷ Nothing less should be accepted in the FINRA TBA margin proposal. Notwithstanding its regulatory and competitive impact analysis, FINRA’s Amendment No. 1 failed these standards.

V. Partial Amendment No. 1 Addresses Interested Parties’ Comments with Unresponsive, Conclusory Explanations

FINRA’s adequately captures interested person’s commentary, but addresses them in insufficient, nonresponsive and conclusory explanations. For example, FINRA briefly notes ACLI’s comments in the text accompanying footnotes 47, 52, 56, 61, 63, 67, 90, 96, & 107 of the release. Regarding these comments, FINRA simply states:

In response, other than with respect to multifamily and project loan securities, as discussed above, FINRA does not propose to modify the proposed rule’s application to Covered Agency Transactions as set forth in the original filing. Further, FINRA does not propose to modify the specified settlement periods as set forth in the Covered Agency Transactions definition.²⁸

At another point, concerning ACLI’s comments recommending two-way margining, FINRA states:
In response, FINRA noted in the original filing that it supported the use of two-way margining as a means of managing risk. However, FINRA does not propose to address such a requirement at this time as part of the proposed rule change. FINRA welcomes further dialogue with industry participants on this issue.²⁹

These unresponsive and dismissive FINRA answers to core aspects of the proposal are wholly insufficient. Without more, commentators are hard pressed to conjure FINRA’s substantiation for its inaction on these matters and denied the opportunity to refute FINRA’s analysis. The convenient demurer on two-way margining fails to address a substantive issue very germane and timely to the proposal fails the SRO rulemaking process and statutory standards for SEC review and approval.

We urge the Commission to consider Rule 4201 from a “totality of the circumstances” perspective. The financial crisis of 2008 has resulted in a number of parallel regulatory initiatives that, collectively operate to thwart financial institutions from carrying out their traditional role of financial intermediation. Regulations under the Dodd-Frank Act, such as the Net Stable Funding Ratio, Enhanced Supplementary Leverage Ratios and Rule 4210, when viewed in isolation appear to

Similarly, the legislation requires the SEC’s Chief Economist to prepare an economic analysis report on each proposed SEC regulation that would be provided to each SEC Commissioner and published in the Federal Register before the regulation became effective. Congress indicated its hope “that this report will demonstrate serious economic analysis throughout the process of developing regulations.”

²⁷ Op-Ed, President Barak Obama, *Toward a 21st Century Regulatory System*, Wall Street Journal (Jan. 18, 2011). The President’s Op-Ed coincided with his issuance of Executive Order 13,563, which set strict standards for cost-benefit analysis in federal agency rulemaking.

²⁸ See Proposal, *supra* note 1, at 3538, 3539.

²⁹ See Proposal, *supra* note 1, at 340.

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provide the financial markets with safeguards against institutional defaults and failures. When viewed collectively, however, these regulations have a detrimental impact on overall liquidity and efficient functioning of the US financial markets. The unintended consequences of this regulatory impact could well result in a liquidity crisis that creates the same magnitude of harm that regulators seek to avert.

Conclusion

Rule 4210 is overbroad in requiring collateral for short dated TBA and Specified Pool transactions, usurps the autonomy of counterparties by dictating minimum collateral transfer amounts and transaction close-out and margin delivery periods, and disadvantages non-FINRA members in not mandating bi-lateral margining. 180 days is an insufficient time-frame for institutions to achieve compliance with the proposed requirements of Rule 4210.

The administrative process in the proposal is deficient. The rule's economic and competitive impact has not been quantified. The burdens of the rule were not balanced against its benefits. Notwithstanding FINRA's conclusory statements that the interests of *all* broker-dealers and market participants were fairly considered, the first "critical step" in "ending duplication and reducing regulatory inefficiency" has not been met.

Anticompetitive consequences were not adequately considered in the initiative. Substantive rulemaking demands careful scrutiny and compelling justification. Without meaningful analysis of competitive and economic impact, SRO rulemaking fails the explicit Congressional mandate to weigh the anticompetitive effects of rule changes, and to balance any impact against the regulatory benefit to be obtained. Insufficient balancing of burdens and benefits has been a concern of life insurers in many past FINRA rulemaking.³⁰ The lack of substantive response to our specific comments is defective and precludes analytical responses.

³⁰ An example occurs in FINRA NTM 97-2, an interpretation applying its conduct rules to a registered representative's sale of *unregistered* variable life insurance or variable annuity contracts to qualified retirement plans. This interpretation conflicted with Congressional intent in the Government Securities Act Amendments of 1993, and was not approved by the SEC when it authorized expanded FINRA sales practice authority over exempted government securities, as defined in Section 3(a)(12) of the 1934 Act. The limited expansion of authority was noticed for comment in NTM 94-62, and the SEC's approval was published in NTM 96-86. The SEC only approved authority to regulate the sale of unregistered *government* securities, not other categories of exempt securities. Nonetheless, FINRA asserted jurisdiction and applied its position in broker-dealer inspections and interpretive letters.

In 2002, FINRA subsequently sought to obtain SEC approval for its governance over these unregistered group variable life and annuity contracts in a Form 19b-4 petition for Approval of Proposed Rule Change applying FINRA Conduct Rules to the Sale of Unregistered Securities. See File No. SR-NASD-00-38, Rel. No. 34-43370. ACLI filed an extensive letter of comment with the SEC on this action outlining the initiative's burden on competition and the FINRA's lack of authority under the Government Securities Act Amendments of 1993 (GSAA). The legislative history under the GSAA specifically and exclusively referenced FINRA jurisdiction over broker-dealer sales of unregistered government securities. It did not, however, make any reference to authority over unregistered variable contracts.

The life insurance industry commented extensively on FINRA's unauthorized expansion of jurisdiction and discussed the unwarranted and inequitable competitive burdens the action imposed. FINRA offered no analysis of competitive or economic impact in its filing on the matter. The SEC approved the FINRA's request absent substantive information on competitive burdens. FINRA's jurisdiction over unregistered variable contracts generated substantial new and recurrent revenue for FINRA through enlarged FOCUS reports, and allowed broker-dealers to obtain a commission on products not required to be registered as securities.

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For the reasons stated above, the SEC should deny FINRA's request for approval of its rule amendment, as modified in Partial Amendment No. 1. ACLI requests the opportunity to provide oral testimony at a hearing, as referenced in the notice for comment on Rule 4210.

Thank you for your attention to our views. If any questions develop, please let me know.

Sincerely,

/S/

Carl B. Wilkerson



Carl B. Wilkerson
Vice President & Chief Counsel, Securities & Litigation

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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 Date². 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 environment³. 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.

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").