

September 14, 2016

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Via Email to rule-comments@sec.gov

Re: File No. SR-FINRA-2016-023 – Response to Comments

Dear Mr. Fields:

This letter responds to comments submitted to the Securities and Exchange Commission (“SEC” or “Commission”) regarding the above-referenced filing, a proposed rule change to increase transparency for transactions in collateralized mortgage obligations (“CMOs”).

The Proposal was published for comment in the Federal Register on July 6, 2016.¹ The Commission received three comment letters directed to the rule filing.² While all three commenters supported the Proposal in part, they also raised questions about certain elements of the Proposal. The following are FINRA’s responses, by topic, to the commenters’ material concerns.

Transaction Size Threshold for Dissemination

Under the Proposal, FINRA established a transaction size threshold to disseminate CMO transactions either immediately upon receipt or in periodic aggregate reports. Specifically, CMO transactions of \$1 million or more (calculated based upon original principal balance) will be subject to aggregate, periodic dissemination on a weekly and monthly basis, provided there have been at least five transactions of \$1 million or more

¹ See Securities Exchange Act Release No. 78196 (June 29, 2016), 81 FR 44065 (July 6, 2016) (“Proposal”).

² See Letters from Mike Nicholas, Chief Executive Officer, Bond Dealers of America, dated July 27, 2016 (“BDA Letter”); Lynn Martin, President and Chief Operating Officer, ICE Data Services, dated July 27, 2016 (“ICE Data Services Letter”); and Chris Killian, Managing Director, Securitization, the Securities Industry and Financial Markets Association, dated July 27, 2016 (“SIFMA Letter”).

that occurred in the same security in the reporting period reported by at least two different market participant identifiers (“MPIDs”). For smaller-size transactions—those valued under \$1 million (calculated based upon original principal balance)—FINRA will disseminate trade-by-trade information immediately upon receipt by FINRA’s Trade Reporting and Compliance Engine (“TRACE”).

The three commenters questioned the \$1 million transaction size threshold, although each suggested different, competing alternatives: SIFMA argued for a lower threshold, ICE Data Services argued for a higher threshold, and BDA argued for no threshold. According to SIFMA, a lower threshold would better reflect “true retail activity” and would pose less risk to liquidity.³ ICE Data Services and BDA argued the opposite, that a higher threshold, or no threshold at all, would promote greater transparency and raise less of a concern about a bifurcated market.⁴

FINRA received substantially similar comments when it previously solicited feedback on its proposed approach to CMO dissemination, including the \$1 million threshold, in a Regulatory Notice.⁵ As FINRA explained in the Proposal, commenters at the Regulatory Notice stage argued both for a higher and lower transaction size threshold, for many of the same reasons expressed again in the comments that the Commission received on the filing.⁶ FINRA took these comments into account as it further analyzed and modified the Proposal in part based on input received during the Regulatory Notice process. For the reasons explained in the Proposal, and based on the detailed economic analysis FINRA included in the Proposal, FINRA continues to believe that the \$1 million threshold is an appropriate balance between transparency and the risk of decreased liquidity provision.⁷ FINRA notes that it will continue to monitor the market and assess the need for additional transparency.

Minimum Activity Level Threshold for Dissemination of New-Issue CMO Transactions

As noted above, CMO transactions above the \$1 million threshold will be disseminated in periodic, aggregate reports, provided they also meet the minimum activity level threshold, which the Proposal established as at least five transactions of \$1 million or more in the same security in the reporting period reported by at least two different MPIDs.

³ See SIFMA Letter at 1-2.

⁴ See BDA Letter at 1-2; ICE Data Services Letter at 2-3. ICE Data Services also recommended that the transaction size, for purposes of applying the \$1 million threshold, should be calculated based on current principal balance instead of original principal balance.

⁵ See FINRA Regulatory Notice 15-04 (February 2015).

⁶ See Proposal, supra note 1, 81 FR at 44071 (discussing comments received on FINRA Regulatory Notice 15-04).

⁷ See id. at 44067-44071.

SIFMA’s comment on the Proposal recommended a higher minimum activity level threshold for CMO transactions executed prior to the first settlement date. According to SIFMA, raising the threshold from five to 10 trades for these new issue transactions (while keeping the threshold at five trades for secondary market transactions) would better protect trades associated with the “initial distribution” of a CMO from dissemination. SIFMA argued that, without the higher threshold, most if not all new issue CMO transactions would be subject to the periodic aggregate reports.⁸ SIFMA raised a similar point when FINRA solicited comment on the proposal through the Regulatory Notice. As FINRA noted in the Proposal, SIFMA argued in response to the Regulatory Notice that only secondary trades in CMOs should be disseminated.⁹ The Proposal explained, however, that FINRA did not believe the current framework for identifying primary transactions under the “List of Fixed Price Transaction” definition applied to CMOs, and additionally that to apply the framework to CMOs would result in a significantly less effective proposal.¹⁰ Moreover, because the transactions in question would be subject to periodic, aggregate reports (and not trade-by-trade dissemination), FINRA continues to believe that the proposed activity threshold of five trades sufficiently addresses SIFMA’s concern in this respect. For these reasons, FINRA continues to believe this approach is appropriate.

Implementation Period for Shorter Reporting Timeframe for CMO Transactions

As part of the Proposal, FINRA will reduce the time period for reporting CMO transactions to TRACE from end-of-day to within 60 minutes of execution. The purpose of this change is to facilitate timely dissemination of CMO transactions under the Proposal. FINRA stated in its filing that if the Proposal were approved, FINRA would announce the operative date of the Proposal in a Regulatory Notice within 90 days of approval, and that the operative date would be within one year from publication of the Regulatory Notice.

SIFMA commented to the Commission that one year is a reasonable amount of time for firms to prepare for implementation of the Proposal. However, SIFMA suggested a phased-in approach to 60-minute reporting once the Proposal becomes operative, starting with a six-month term of 120-minute reporting before transitioning to 60-minute reporting. SIFMA cites as an example the phased implementation period that FINRA used when it shortened the reporting timeframe for asset-backed securities (ABS).¹¹ Yet as SIFMA acknowledges, FINRA’s phased approach to shorter ABS reporting timeframes was different in that started with 45-minute reporting before settling on 15-minute reporting. FINRA initially contemplated in its Regulatory Notice a 15-minute reporting requirement for CMO transactions, with a phased-implementation

⁸ See SIFMA Letter at 2.

⁹ See Proposal, supra note 1, 81 FR at 44071.

¹⁰ See id. at 44072.

¹¹ See SIFMA Letter at 3.

period that would first require 45-minute reporting. Based on the economic analysis set forth in the filing, FINRA modified the Proposal to 60-minute reporting to lessen the potential costs of the Proposal while still providing sufficiently timely transparency to the market. In addition, based on FINRA's 2016 year-to-date analysis of reported CMO trades, 84% of CMO transactions are already reported to TRACE within 60 minutes and 70% are reported within five minutes. Thus, absent data or evidence that would change the analysis, FINRA continues to believe its proposed implementation of the 60-minute reporting requirement is appropriate and will not be unduly burdensome for member firms.

Inclusion of Last Trade Price in Periodic Aggregate Reports

The ICE Data Services Letter stated that FINRA should include most recent trade prices in the periodic, aggregate reports it disseminates under the Proposal.¹² As FINRA explained in its filing, it considered doing so but modified its approach in light of the responses to its Regulatory Notice. As part of that Regulatory Notice, FINRA included a sample of a periodic, aggregate report that it would use for transactions above the \$1 million threshold. Based on comments FINRA received on the Regulatory Notice, FINRA modified the Proposal to address concerns about reverse engineering by removing certain data fields from the periodic report, including last sale price.¹³

Definition of CMO

The Proposal will apply to transactions in CMOs, and the term CMO is defined in FINRA Rule 6710(dd) to mean a type of Securitized Product backed by Agency Pass-Through Mortgage-Backed Securities (as defined in paragraph (v) of Rule 6710), mortgage loans, certificates backed by project loans or construction loans, other types of mortgage-backed securities or assets derivative of mortgage-backed securities, structured in multiple classes or tranches with each class or tranche entitled to receive distributions of principal and/or interest according to the requirements adopted for the specific class or tranche, including real estate mortgage investment conduits ("REMICs").¹⁴ SIFMA's comment to the Commission questioned whether FINRA intended to include agency commercial mortgage-backed securities ("CMBS") like Ginnie Mae Project Loans within the Proposal.¹⁵ Given that agency CMBS fall clearly within the definition of CMO, they are within the intended scope of the Proposal. Other CMBSs not specifically included within the definition of CMO would not be subject to dissemination under the Proposal.

¹² See ICE Data Services Letter at 5.

¹³ See Proposal, supra note 1, 81 FR at 44072.

¹⁴ See id. at 44065 n.3.

¹⁵ See SIFMA Letter at 2.

FINRA believes that the foregoing responds to the issues raised by comments on the Proposal. If you have any questions, please contact me at [REDACTED] or [REDACTED]

Sincerely,

/s/ Alexander Ellenberg

Alexander Ellenberg
Associate General Counsel
Regulatory Policy and Oversight