

Cooper & Kirk

Lawyers

A Professional Limited Liability Company

1523 New Hampshire Avenue, N.W.
Washington, D.C. 20036

David H. Thompson
dthompson@cooperkirk.com

(202) 220-9600
Fax (202) 220-9601

February 3, 2021

Via Electronic Mail

Vanessa Countryman, Esq., Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Petition for Review of Order Granting Approval of a 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, Release No. 34-94013; File No. SR-FINRA-2021-010.

Dear Ms. Countryman:

As Counsel for the Bond Dealers of America (“BDA”) and Brean Capital, LLC, (“Brean”) (collectively, “Petitioners”), we are transmitting the Petitioner’s Petition for Review of the Order Granting Approval of a 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 (Securities Exchange Act Release No. 34-94013; File No. SR-FINRA-2021-010). The action approving the proposed rule change was made by the Division of Trading and Markets pursuant to delegated authority (17 CFR 200.30-3(a)(12)) on January 20, 2022 (see <https://www.sec.gov/rules/sro/finra/2022/34-94013.pdf>). The Petitioners filed their Notice of Intention to Petition for Review on January 27, 2022.

Respectfully submitted,



David H. Thompson
Harold S. Reeves
Peter A. Patterson

Thomas J. Fleming, Olshan Frome Wolosky, LLP
Adrienne M. Ward, Olshan Frome Wolosky, LLP

**Before the
SECURITIES AND EXCHANGE COMMISSION**

In the Matter 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)

File No. SR-FINRA-2021-010

PETITION FOR REVIEW

ADRIENNE M. WARD
THOMAS J. FLEMING
OLSHAN FROME WOLOSKY LLP
1325 Avenue of the Americas
New York, NY 10019
(212) 451-2300

DAVID H. THOMPSON
PETER A. PATTERSON
HAROLD S. REEVES
COOPER & KIRK, PLLC
1523 New Hampshire Ave., N.W.
Washington, D.C. 20036
(202) 220-9600

Counsel for Petitioners

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PETITION FOR REVIEW

The Bond Dealers of America (“BDA”) and Brean Capital, LLC (“Brean”) hereby petition the Commission for review pursuant to Rule 430 of the Securities and Exchange Commission’s (the “Commission” or “SEC”) Rules of Practice, 17 CFR 201.430, of the January 20, 2022, Order (“the Approval Order”)¹ in File No. SR-FINRA-2021-010 issued by the Division of Trading and Markets (“Division” or “Staff”) pursuant to delegated authority Granting Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Amend the Requirements for Covered Agency Transactions under FINRA Rule 4210 as Approved Pursuant to SR-FINRA-2015-036 (“the Proposed Rule Change”).

Summary Of The Argument

Since 2014, when FINRA first contemplated taking the unprecedented decision to subject forward-settling transactions in federal government mortgage backed securities (“MBS” and, when government backed, “Agency MBS”) to margin requirements, Petitioners have alerted FINRA and the Division that FINRA lacks the statutory authority to enact this proposed rule, and catalogued the harms that imposing margin requirements on such Covered Agency Transactions (“CATs”) will have on broker operations, market liquidity, competition, the securities markets, the housing market, and the American consumer. Due to our continuing serious concerns and the many questions that remain unanswered in this rulemaking, Petitioners request that the Commission grant their petition for review, deny the Proposed Rule Change, and reject FINRA’s proposal to establish an effective date on which its margin regime would take effect.

The most serious problem with FINRA’s nearly-decade-long drive to impose margin requirements on CATs is that it lacks the statutory authority to do so. The Exchange Act vests

¹ The “Approval Order” can be found at <https://bit.ly/3GtJvEy>.

authority to set margin for securities trades in the Board of Governors of the Federal Reserve System (the “Board”). *See* 15 U.S.C. § 78g(a). And it *exempts* CATs from this regulatory regime. *See id.* Congress therefore has authorized the Board alone to set margin requirements for securities transactions but even it cannot do so for CATs. FINRA’s efforts to set margin requirements for CATs therefore are doubly *ultra vires*.

Even if FINRA were authorized to impose this type of rule, its proposal would still fail. From the inception of the Agency MBS market to the present, broker-dealers have managed their risk when executing CATs through net capital requirements and sound underwriting practices. FINRA has never made any showing nor offered any analysis to support its conclusion that these requirements and practices do not adequately protect against the market risks that FINRA purports to address. Indeed, after six years, the administrative record remains devoid of any evidence suggesting that the problem that SR-FINRA-2015-036 (the “2015 Rule”) and Proposed Rule Change (the 2015 Rule and Proposed Rule Change are, together, “CAT Rule”) seek to resolve in fact exists.

Rather than solving problems, this Rule will create them. The imposition of mandatory margin requirements in the Agency MBS market will have a negative effect on market liquidity, particularly the liquidity that FINRA-registered regional broker-dealers now provide to the key market participants including regional dealers, banks, mortgage originators, and other institutional investors. Should the Commission grant the Proposed Rule Change and authorize FINRA to establish an effective date on which the CAT Rule would take effect, it would only create risk in the market and unnecessarily burden competition. Indeed, since 2017, the threat that the 2015 Rule would be permitted to take effect has impacted competition, providing primary dealers with

disproportionate power to dictate terms and shifting business to non-FINRA bank dealers that are not subject to any margin regime.

If allowed to take effect, FINRA's margin regime would further diminish the role of regional broker-dealers and severely limit the business that they can do by rapidly depleting the capital they need to operate. The 2015 Rule, as amended by the Proposed Rule Change, would thus erect an impediment to a free and open market and to the efficient functioning of that market. And, because the CAT Rule would have the perverse result of shifting trading to less regulated markets, it will harm both investors and the public interest.

For years, FINRA has acknowledged the disruption to the market that its 2015 Rule would have caused had it ever been allowed to take effect. When, in 2019, it delayed the effective date for a third time, FINRA acknowledged that it was considering amendments to the 2015 Rule "in the interest of avoiding unnecessary disruption to the Covered Agency Transaction market."² The Proposed Rule Change and Amendment No. 1, however, do not mitigate the harms that they purport to address, but would instead aggravate them for a substantial portion of the market. This is because profound structural flaws make the architecture of the FINRA's proposed margin regime unworkable.

In the equity markets, margin applies when credit is extended to customers who purchase existing securities that they then hold in their accounts as collateral. The value of the securities may fluctuate based on post-settlement price changes. If a customer fails to meet a margin call by depositing funds or securities into their account, then the security held as collateral is liquidated.

² Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Extend the Implementation Date of Certain Amendments to FINRA Rule 4210 Approved Pursuant to SR-FINRA-2015-036, Exchange Act Release 34-87441 (Nov. 1, 2019), 84 Fed. Reg. 60132 (Nov. 7, 2019).

By contrast, FINRA’s CAT Rule will apply to Agency MBS that generally do not exist as of the trade date or will not be available until the settlement date and thus cannot be held in a customer’s account as collateral. The CAT Rule applies to price changes that occur between the trade date and the monthly settlement date. If a customer fails to meet such a pre-settlement margin call, there is thus no “security” to liquidate. These market features make MBS (including CATs), unlike equities and other debt securities, unsuitable for standard margin requirements.

Congress acknowledged this unsuitability when it enacted the Secondary Mortgage Market Enhancement Act of 1984 (the “SMMEA”) and prohibited requiring margin on private-label MBS:

Unlike issues of corporate debt securities, which customarily are issued for one-week settlement, the operation of the secondary mortgage market is essentially a forward trading delivery market that requires a settlement period of as much as four-to-six months. The extended period is required because the mortgages to be included in the pool backing the securities are originated only after commitments for the purchase of the securities have been obtained. Because most of the rules regarding settlement periods, extensions of credit, and broker-dealer relationships with their customers and with each other, have been promulgated with a view toward the corporate debt securities market, adjustments to the applicable laws and regulations are necessary to accommodate the needs of private issuers of mortgage-backed securities.³

The SMMEA prohibits margin on private-label MBS precisely because those securities may not exist on the transaction date and take an extended time to settle. The same is true for CATs. In addition, during the time between the security’s first trade date and its settlement date, long strings of offsetting buy and sell transactions involving that security often develop. This raises the further concern that FINRA’s scheme may initiate a chain of fails whenever even a single customer in the chain is unwilling or unable to post margin, or the broker is unable to collect margin, because there

³ S. Rep. 98-293, “Secondary Mortgage Market Enhancement Act of 1984,” (Nov. 2, 1983), 98th Cong., 1st Sess. 1983, 1984, *reprinted in* U.S.C.C.A.N. 2809, 2816.

is no security to “liquidate.” FINRA’s response in Amendment No. 1 sidesteps these questions and ignores others regarding how this rule would work in practice.

Nor has FINRA meaningfully addressed the capital drain that would be caused by its purported “solution” to an acknowledged problem faced by small and medium-size members who are unable to collect margin from their customers. To provide relief, FINRA proposed permitting its members to take a charge against their tentative net capital,⁴ but also set “the lesser of \$30 million or 25% of the member’s tentative net capital” as the threshold beyond which members are prohibited from entering into new CATs for non-margin parties.⁵ Petitioners demonstrated in their comment letters how, in the event of market movement, regional broker-dealers will be required to post cash margin and/or take these specified net capital deductions at a multiple of the regulatory net capital currently required to support the trade.⁶ These charges could mount rapidly after only a handful of trades, forcing a broker-dealer to liquidate its customers’ positions or effectively suspend its market operations. In the event of a market dislocation, this would likely cause many broker-dealers to suspend purchases and sell positions, with inevitable disastrous consequences for the market. It is important to remember that these charges are imposed, even where the broker-dealer has hedged the position or sold it to a creditworthy party.

⁴ See Amendment No. 1 at 26 (Ex. 4, proposed Rule 4210(e)(H)(i)(i)), *available at* <https://bit.ly/3uiRgee> (“Amendment No. 1”).

⁵ *Id.* at 30. The threshold is referred to as the “25% TNC / \$30MM Threshold” in Amendment No. 1.

⁶ Letter from Michael Decker, Senior Vice President, Public Policy, Bond Dealers of America, to Vanessa Countryman, Secretary, Commission (June 15, 2021) (“BDA Letter”) (<https://bit.ly/3rery8z>); Letter from Thomas J. Fleming & Adrienne M. Ward, Olshan, on behalf of Brean Capital, LLC, to Vanessa Countryman, Secretary, Commission (June 15, 2021) (“Brean Letter”) (<https://bit.ly/3Hd7usS>); Letter from Thomas J. Fleming & Adrienne M. Ward, Olshan, on behalf of Petitioners, to Vanessa Countryman, Secretary, Commission (Sept. 10, 2021) (“Petitioners’ Letter”) (<https://bit.ly/3L2r2Ti>).

While the Proposed Rule Change therefore partially addresses the issue of customers that are unwilling or unable to post margin, it does so by creating a mechanism by which a regional broker-dealer's capital will be rapidly depleted. The Proposed Rule Change will thus sharply reduce the liquidity that regional broker-dealers provide to the Agency MBS markets, make counterparties reluctant to do business with them, and likely cause them to exit or to curtail their activities in that market. These exits would harm regional banks, mortgage originators, and the regional broker-dealers' other customers that tend not to have ready access to primary dealers.

The Division has not held FINRA accountable for its deficient rulemaking. Again and again, FINRA offered summary conclusions and affirmations of belief that are unsupported by any evidence, by data, or by reasoning. The Division accepted FINRA's assurances that it had spoken with industry participants, even though FINRA never disclosed the contents of those communications. All too often, in rendering its decision, the Division simply parroted FINRA. As a result, the Approval Order shares the flaws of FINRA's proposal. The Exchange Act and the Administrative Procedure Act require more than a rubber stamp.

The Division failed to perform its duty to ensure that the Proposed Rule Change complies with the requirements of the Exchange Act. The numerous and significant problems that the 2015 Rule would create have not been remedied by the Proposed Rule Change. For this reason, the Commission should grant the Petition for Review, and reject the Proposed Rule Change, including its proposal to set an effective date for the CAT Rule.

Background

I. The Agency MBS Market

A. Participants

Most residential mortgages in the United States are securitized, with the underlying loans pooled into a separate legal trust, which issues the MBS and passes on mortgage payments to

investors after deducting mortgage servicing fees and other expenses. In the agency market, each MBS carries a credit guarantee from Fannie Mae, Freddie Mac, or Ginnie Mae. The MBS market serves the critical functions of allowing mortgage lenders to hedge the risk that interest rates will fluctuate and permits them to fund their origination pipelines. The market creates efficiencies and cost savings for lenders that are passed on to borrowers in the form of lower rates and fees. The Agency MBS market and the liquidity it provides are essential to the stability of the U.S. housing market.⁷

Data compiled by SIFMA indicates that in 2020, \$3.7 trillion in Agency MBS were issued; in 2021 (through July), \$2.5 trillion, and average daily trading volumes (as reported on TRACE) in 2020 were \$262.3 billion for Agency TBAs, \$25.7 billion for specified pools, and \$1.8 billion for CMOs.⁸ The market includes more than 100 broker-dealers of varying sizes, who buy and sell on a riskless basis or effectuate offsetting trades within hours. There are approximately 20 primary dealers that operate in market-making and principal roles. Most primary dealers are major financial institutions and have bank affiliates. Studies by economists at the Federal Reserve have established that the top 10 primary dealers intermediate more than 85% of CAT transactions.

Most broker-dealers in the market are introducing brokers, trading through clearing firms. Many of these introducing firms are regional or smaller broker-dealers, and include minority, woman, and veteran-owned firms. They play an important role in the secondary market, typically providing liquidity by matching buyers and sellers of secondary, less liquid non-netting Specified

⁷ See James Vickery & Joshua Wright, TBA TRADING AND LIQUIDITY IN THE AGENCY MBS MARKET, Federal Reserve Board of New York, Policy Review at 2–3 (May 2013), (<https://nyfed.org/3oAz647>); see also James Collin Harkrader & Michael Puglia, FIXED INCOME MARKET STRUCTURE: TREASURIES VS. AGENCY MBS, FEDS Notes (Aug. 25, 2020), (<https://bit.ly/3Hh5OhT>).

⁸ SIFMA Research tracks current data for U.S. mortgage-backed securities; those data can be found at <https://bit.ly/3ubK2IZ>.

Pools and new issue CMOs. They manage their risks carefully, and have for decades operated without incident, even during the 2008 crisis, with only limited balance sheets. The clearing firms hold substantial collateral of introducing brokers and a single clearing firm, Pershing, clears for the majority of the introducing brokers. Some of the regional broker-dealers have bank affiliates, a relationship which permits them to avoid the Proposed Rule Change. Critical to the issues presented by the 2015 Rule and Proposed Rule Change, introducing brokers cannot collect margin directly from customers. While clearing firms can, there is currently no mechanism that would permit margin paid to a clearing firm by an introducing broker's customer to be credited to that introducing broker's counterparty to satisfy the Rule's requirements.

Agency MBS investors include a wide range of institutions, including state and local pension plans, investment companies and funds, insurance companies, and regional banks and mortgage originators. Some of these institutions, including pension funds and state agencies, may be prohibited by their charters from pledging assets and are, therefore, unable to post margin. Similarly, registered investment companies cannot re-pledge collateral. Many of these institutions trade primarily through introducing brokers, in large part because smaller- and medium-sized regional firms are best-suited to satisfy their specific needs. These introducing brokers know their clients and their clients' risk and credit profiles well, and vice-versa. The Federal Reserve is also a significant participant in the market.

B. Types Of CATs

FINRA's 2015 Rule defines CATs as To-Be-Announced ("TBA") transactions, Specified Pool Transactions ("Specified Pools"), and Transactions in Collateralized Mortgage Obligations ("CMOs").⁹

⁹ Amendment No. 1 at 21–22.

The TBA market, which was established in the 1970s, is approximately 90% of the CAT market. TBAs facilitate the forward trading of MBS issued by Fannie Mae and Freddie Mac, as well as Small Business Administration (SBA) backed Asset-Backed Securities (ABS). With TBAs, the parties agree that the seller will deliver to the buyer a pool or pools of a specified face amount and meeting certain other criteria but the specific pool or pools to be delivered at settlement is not specified at the time of execution.

The TBA market generally adheres to “Good-Delivery Guidelines,” which are set forth in SIFMA’s Uniform Practices Manual and utilizes standardized trade documents developed by SIFMA.¹⁰ The Good-Delivery Guidelines functionally standardize the market. TBAs have one good delivery and one settlement date per month (the “Good Day,” depending on pool type), with specific pool information provided two days before settlement date.

Most TBA trades clear through FICC and are nettable, i.e., the loss incurred on one trade can be offset by a corresponding gain on another trade. Nettable trades will not result in a margin charge or increased net capital charge to regional broker-dealers. It is trading in non-netting Specified Pool and new issue CMOs that will be most adversely affected by the Proposed Rule Change, because such trades, even in riskless transactions that have no balance sheet impact, will not net for purposes of calculating margin.¹¹ In a typical trade, the broker buys the security, with a sell order in hand for a small markup. The trade is, for this reason, “riskless.” For balance sheet

¹⁰ See TBA MARKET FACT SHEET, SIFMA (2015) (<https://bit.ly/3L26biE>).

¹¹ In Amendment No. 1, FINRA took issue with Brean’s discussion of “netting” in its June 15, 2021 comment letter. Amendment No. 1 at 7–8, n.18. It is understood that for purposes of the Proposed Rule Change, positions will net when they settle with the same counterparty. For this reason, TBAs settling through FICC may “net” because FICC is the counterparty. A purchase and sale of CATs that do not clear through FICC, or a hedging transaction in which only one side settles through FICC, are non-netting under the rule. By contrast, for purposes of the net capital rules, netting is considered on a balance sheet, or economic, basis.

purposes, the broker has a gain or loss based on the price difference. As Petitioners demonstrated in their comment letter of June 10, 2021,¹² while today, such trades may result in a 10% charge to net capital based on the mark-to-market loss, under the Proposed Rule Change, the same trades may result in both a net capital charge at 100% of the mark-to-market loss *and* a requirement to collect the same amount of margin. Amendment No. 1 did not change these requirements.

Specified Pools are Agency MBS or SBA ABS requiring the delivery at settlement of a pool or pools that are identified by a unique pool identification number at the time of execution. The actual identities of bonds to be bought and sold are known at the time of the trade. Certain Specified Pools are deliverable into a TBA short and will net for the purposes of the Proposed Rule Change. But many Specified Pools will not net under the Proposed Rule Change because they generally do not meet the “Good-Delivery Guidelines” for a TBA, in that the pools could be backed by high-balance mortgages, 40-year mortgages, and adjustable-rate and interest-only mortgages. Non-netting Specified Pools may be higher value than TBAs, in that they have the most advantageous prepayment characteristics, but lack the liquidity of the TBA market because they are not fungible.¹³

New issue CMOs subject to the Proposed Rule Change (i.e., not those CMOs that trade in secondary markets) are a securitized product backed by Agency pass-through MBS, mortgage loans, other types of MBS or assets derivative of MBS, that are structured in multiple classes of tranches with each class or tranche entitled to receive distributions of principal or interest according to the requirements adopted for the specific class or tranche.

¹² Petitioners Comment Letter (Sept. 10, 2021) at 27–30.

¹³ See James Vickery & Joshua Wright, TBA TRADING AND LIQUIDITY IN THE AGENCY MBS MARKET, Federal Reserve Board of New York, Staff Report No. 468 at 6–7 (Aug. 2010) (<https://nyfed.org/3oAz647>).

Each non-netting Specified Pool and new issue CMO is unique, and, therefore, substitute securities may be impossible to locate. Like TBAs, non-netting Specified Pools generally settle on a scheduled “good day,” which is the same scheduled date as TBAs. New issue CMO transactions generally settle on the last business day of the month.

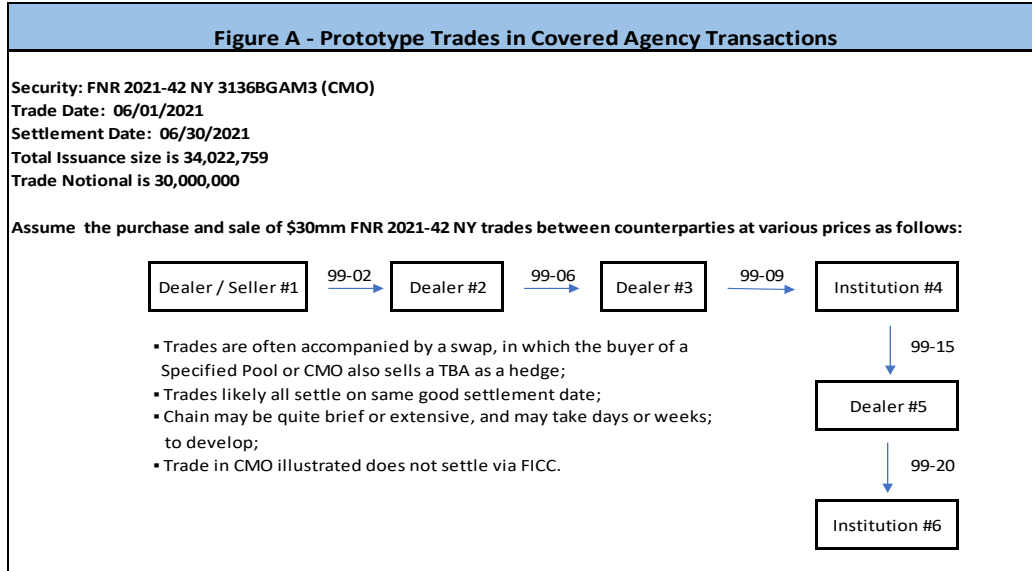
Ample price data is available to market participants and regulators. Since May 2011, FINRA members have been required to report Agency MBS trades to FINRA’s TRACE system. After the close of each trading day, FINRA publicly reports summary statistics of daily trading volumes and prices, such as the weighted average transaction price for different coupons, issuers, and settlement months, as well as the number and volume of trades. The trading itself occurs electronically on an over-the-counter basis, primarily through two platforms, DealerWeb (for inter-dealer trades) and TradeWeb (for customer trades).¹⁴

The premise of FINRA’s margin regime is that broker-dealers are subject to credit risk as the value of Agency MBS fluctuate between trade and settlement date.¹⁵ In reality, their exposure is limited by hedging and offsetting trades that effectively lock in modest profits or losses. Indeed, it is a feature of the CATs market that broker-dealers, as well as originators, will typically buy (or sell) a TBA as a hedge against their trading of a non-netting Specified Pool or new issue CMO. This often results in a “chain” of trades arising, as illustrated by Figure A.

¹⁴ Both platforms offer investors real-time estimates of the prices at which trades can be executed. Federal Reserve analysis shows that the quotes generally track prices of completed transactions closely. Vickery & Wright, *supra* note 7, at 9.

¹⁵ Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; 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 34-76148 (Oct. 14, 2015), 80 Fed. Reg. 63603, 63609 (Oct. 20, 2015) (the “2015 Notice”).

Figure A



Each intermediary party in the chain reduces its exposure by making corresponding buys and sells in the case of each security. These chains, which facilitate risk management and aid in accurately pricing these securities, develop over time, with downstream buyers purchasing closer to the settlement date.

C. FINRA’s Protracted And Flawed Effort To Extend Rule 4210 To CATs

Even in the most volatile months of 2008, the market for Agency MBS operated properly. While trading in non-agency MBS became illiquid, economists at the N.Y. Federal Reserve observed that “issuance and trading in the agency MBS market remained relatively robust throughout the crisis period.”¹⁶ The role of clearing brokers, the use of hedging, sound underwriting, and the collateral maintained by broker-dealers assured that parties remained able to honor their commitments on settlement date.¹⁷

¹⁶ Vickery & Wright, *supra* note 7, at 4.

¹⁷ *Id.*

In January 2014, FINRA initiated its effort to expand Rule 4210 to cover CATs.¹⁸ As the rationale for the proposal, FINRA quoted the Treasury Market Practices Group (“TMPG”) of the N.Y. Federal Reserve:

To the extent that they remain unmarginated, uncleared agency MBS transactions can pose significant counterparty risk to individual market participants. Moreover, the market’s sheer size . . . raises systemic concerns. If one or more market participants were to default on forward-settling agency MBS trades, the agency MBS market could transmit losses and risks to a broad array of other participants.¹⁹

FINRA also indicated a need for rulemaking because the best practices that had been adopted by the TPMG were “recommendations – . . . not requirements.”²⁰ Beyond quoting the TMPG, FINRA cited no data supporting the existence of the stated market risk.²¹ Numerous market participants commented, including Petitioners.²²

On October 6, 2015, FINRA filed a notice to amend Rule 4210 and soliciting comments.²³ FINRA relied upon its delegated authority under Section 15A(b)(6) of the Exchange Act to promulgate the rule change, claiming that it “will help to reduce the risk of loss . . . in one of the largest fixed income markets and thereby help to protect investors and the public interest by ensuring orderly and stable markets.”²⁴ The proposal continued the structure set forth in FINRA’s January 2014 notice, while making two adjustments for smaller firms (and customers); a proposed

¹⁸ Margin Requirements: FINRA Requests Comment on Proposed Amendments to FINRA Rule 4210 for Transactions in the TBA Market, Regulatory Notice 14-02 (FINRA Jan. 2014). The TPMG, a group of approximately 20 market participants (banks, primary dealers, large institutional investors), has historically *not* included regional broker-dealers.

¹⁹ *Id.* at 2 (quoting Report of the TMPG, Margining in Agency MBS Trading (Nov. 2012).)

²⁰ *Id.*

²¹ *Id.*

²² The comment letters in SR-FINRA-2015-036 are available at <https://bit.ly/3ue0NmN>.

²³ 2015 Notice, 80 Fed. Reg. 63603 (Oct. 20, 2015).

²⁴ *Id.* at 63609.

\$250,000 *de minimis* transfer amount and an exception where margin requirements would not apply if gross open Agency MBS positions with a FINRA member were \$2.5 million or less.²⁵

A significant theme of the 2015 Notice was to conclude, based on an analysis of historical TRACE data concerning TBA trades (data that did not include trades of Specified Pools or CMOs), that 85.7% of trades would fall within the \$250,000 amount, and about half of all FINRA broker-dealers would not have to post margin under this exception.²⁶ FINRA then provided examples of ranges of margin that would be posted based upon the analyzed data set.²⁷ While these amounts might have appeared manageable, they were disconnected from actual market functioning, in which a party must calculate in advance of a CAT counter-party risk and available cash to pay such margin. Again, numerous market participants commented, including Petitioners.²⁸

On June 15, 2016, after FINRA had filed three amendments to the proposal, the Commission issued an Order approving the rule change, finding that it was consistent with Section 15A(b)(6) of the Exchange Act.²⁹ The third amendment raised the *de minimis* exception from \$2.5 million to \$10 million, based on additional data that showed that the exception would otherwise apply to a small number of accounts.³⁰ In approving the 2015 Rule, the Commission credited comments regarding the considerable operational and systems work necessary to implement it,

²⁵ *Id.* at 63613.

²⁶ *Id.* at 63612–13.

²⁷ *Id.* at 62613.

²⁸ The comment letters in SR-FINRA-2015-036 are available at <https://bit.ly/3ue0NmN>.

²⁹ Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval to a Proposed Rule Change To Amend FINRA Rule 4210 (Margin Requirements) To Establish Margin Requirements for the TBA Market, as Modified by Amendment Nos. 1, 2, and 3, Exchange Act Release 34-78081 (Jun. 15, 2016), 81 Fed. Reg. 40364, 40374 (Jun. 21, 2016) (“2016 Approval Order”).

³⁰ *Id.* at 40369.

stating that six months were required for the risk limit determination requirements and eighteen months for implementing the remainder of the rule.³¹

Regional broker-dealers continued to voice concerns regarding the rule’s workability due to the anticipated drain on capital, as well as the many unanswered questions about how margin requirements would apply to chain trades and other CATs.³² In response, FINRA repeatedly delayed the 2015 Rule’s effective date. Finally, in November 2019, in delaying implementation for the third time, FINRA acknowledged that it would consider amendments to address these concerns about the 2015 Rule’s impact on smaller- and medium-sized firms.³³

With the onset of COVID-19, the Agency MBS market again faced a severe disruption. The issue, however, was unrelated to the “risk” that FINRA purported to address with its 2015 Rule and the Proposed Rule Change. Trades did not fail to settle. Chain trades did not collapse. Instead, as economists at the N.Y. Federal Reserve who studied the data observed, the disruption was that the primary dealers reduced their activity (in part to protect their balance sheets), leading to a sharp reduction in market liquidity.³⁴ The Federal Reserve stepped in and provided liquidity to the primary dealers through purchases and hedging activity.³⁵ By contrast, it was the experience of BDA members that FINRA-member regional broker-dealers provided robust liquidity in terms of balance sheet and sales efforts. This is the same liquidity that the Proposed Rule Change would

³¹ *Id.* at 40376. Petitioners do not challenge the risk limit determination requirements, the only part of the 2015 Rule to have taken effect.

³² The comment letters in SR-FINRA-2015-036 are available at <https://bit.ly/3ue0NmN>.

³³ 84 Fed. Reg. at 60133.

³⁴ *See* Jiakai Chen *et al.*, DEALERS AND THE DEALER OF LAST RESORT: EVIDENCE FROM MBS MARKETS IN THE COVID-19 CRISIS, Federal Reserve Board of New York, Staff Report No. 933 at 6 (Jul. 2020, rev. Oct. 2021) (“Chen”).

³⁵ *Id.*

threaten. In short, March 2020 showed that FINRA's 2015 Rule, if implemented, (a) would not have addressed that market contraction, and (b) would have exacerbated liquidity shortfall by reducing critical participation of regional broker-dealers.

On May 19, 2021, the Commission published the Notice regarding the Proposed Rule Change announcing that FINRA was seeking to address concerns raised by member firms regarding the impact of the 2015 Rule on smaller firms and the ability of certain firms to shift business to non-FINRA member bank dealers, which would place member firms without such affiliates at a competitive disadvantage.³⁶ FINRA proposed three revisions to the 2015 Rule: (1) to eliminate a 2% maintenance margin requirement; (2) to permit members under certain conditions to take a capital charge instead of collecting margin for net mark-to-market losses on CATs; and (3) to clarify the language regarding the \$250,000 *de minimis* transfer exception and the \$10 million gross open position exception.³⁷ With respect to the alternative of permitting the capital charge, FINRA wrote:

These conditions and limitations are designed to help protect the financial stability of members that opt to take capital charges while restricting the ability of the larger members to use their capital in lieu of collecting margin to compete unfairly with smaller members.³⁸

On June 15, 2021, Petitioners submitted comments on the Proposed Rule Change.³⁹ Among other things, their comment letters demonstrated, using concrete examples involving common

³⁶ Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc., Notice of Filing of a Proposed Rule Change to Amend the Requirements for Covered Agency Transactions under FINRA Rule 4210 (Margin Requirements) as Approved Pursuant to SR-FINRA-2015-036, 86 Fed. Reg. 281161, 28162 (May 19, 2021).

³⁷ *Id.* at 28163.

³⁸ *Id.*

³⁹ *See, supra* note 6.

trades (something missing from FINRA’s notices), that the proposed alternative of a net capital charge would rapidly deplete regional broker-dealers’ capital. This would create untenable risks for counterparties to do business with such firms and could effectively put them out of business. Such a result in the name of assisting smaller- and medium-sized firms could not be justified, particularly when such firms have for years participated in the Agency MBS market without any evidence of firm failure due to CATs or of their presenting systemic risk. The letters also explained that the 2015 Rule would remain unworkable despite the Proposed Rule Change, and FINRA’s proposal to “consider revisiting [the rule’s] requirements as may be necessary to mitigate the rule’s impact” was simply not tenable.⁴⁰ By the time FINRA “revisits” requirements, regional broker-dealers would likely have exited or been shut out of the business. Indeed, this is why the Exchange Act requires the Commission to determine that a rule will not negatively impact the market before approving its adoption.

Amendment No. 1 did not address these concerns. The sole substantive change made was to remove the member firm’s obligation to liquidate the counterparty’s position.⁴¹ As discussed below, this proposal did not alleviate the solvency concerns raised in Petitioners’ June 15, 2021, comments, because regional broker-dealers would still face untenable net capital demands. FINRA, moreover, again failed to address critical specific questions regarding how particular aspects of the rule will work in practice.

On January 20, 2022, the Division, acting pursuant to delegated authority, approved the Proposed Rule Change, including FINRA’s proposal to set an effective date for the CAT Rule between 9–10 months following approval the (“Effective Date Proposal”). The Division largely

⁴⁰ 86 Fed. Reg. at 28162.

⁴¹ Amendment No. 1 at 9–10.

accepted FINRA's unsupported assertions and unreasoned analysis on faith, frequently incorporating FINRA's assertions verbatim in its final approval order.

Petitioners now seek review by the Commission and ask that it disapprove the Proposed Rule Change, including the Effective Date Proposal. The liquidity provided by broker-dealers is critical to the Agency MBS market, which in turn provides the liquidity that is crucial to the proper function of the American housing market.⁴² This lesson did not appear to be absorbed by FINRA when it issued the Proposed Rule Change or Amendment No. 1. The Proposed Rule Change, as shown below, severely restricts the liquidity of introducing brokers whose role is key to the smooth operation of the Agency MBS market.

**Petitioners Have Satisfied
The Procedural Requirements Of Rules 430 And 431**

Rules 430 and 431 of the Rules of Practice authorize a person aggrieved by an action taken by the Staff pursuant to delegated authority to petition for review by the Commission.⁴³ Rule 431 requires the Commission to consider the standards set forth in Rule 411(b)(2) when deciding whether to grant the petition. The Commission is thus to consider whether the Petition makes a reasonable showing that (i) a prejudicial error was committed in the conduct of the proceeding; or (ii) the decision embodies: (A) a finding or conclusion of material fact that is clearly erroneous; (B) a conclusion of law that is erroneous; or (C) an exercise of discretion or decision of law or policy that is important and that the Commission should review.

Petitioners have satisfied the requirements of Rule 430. Brean and dozens of members of the BDA are FINRA members who are subject to FINRA 4210; they will bear the costs of complying with the Proposed Rule Change, will bear the anticompetitive burdens it imposes, and

⁴² Chen at 4, 6.

⁴³ See 17 CFR §§ 201.430, 201.431.

will suffer concrete financial injuries because of the Rule. Petitioners also submitted comments before the Division.⁴⁴ They are thus aggrieved for purposes of petitioning for review. In compliance with Rule 430(b)(1), Petitioners filed their notice of intention to petition for review on Thursday, January 27, 2022.

The Commission should grant the Petition for Review because, as set forth fully below, the Division's decision embodies findings of material fact that are clearly erroneous, conclusions of law that are erroneous, and constitutes an exercise of discretion or decision of law or policy that is important and that the Commission should review. The Proposed Rule Change will substantially reduce liquidity in the Agency MBS markets and harm competition with no concrete benefit. The Proposed Rule Change creates a substantial risk to the functioning of this critical multi-trillion-dollar market during periods of interest rate volatility. For these reasons, the Petition for Review satisfies the standard set forth in Rule 431.

⁴⁴ *See, supra* note 6.

Argument

I. FINRA And The Commission Lack The Statutory Authority To Impose Margin Requirements On CATs.

Federal law vests the authority to establish and regulate margin for securities transactions with the Federal Reserve Board, while exempting Agency MBS from margin requirements. FINRA and the Division nevertheless interpret Section 15A(b)(6), a general grant of rulemaking authority, as overriding the specific vesting of the power to regulate margin in the Board and the specific prohibition on setting margin for exempted securities, as defined in the Exchange Act. This interpretation violates the plain text of the Exchange Act and cannot be reconciled with basic canons of statutory construction.

A. Congress Vested The Authority To Set Margin Requirements In The Board.

“It is axiomatic that an administrative agency’s power . . . is limited to the authority delegated by Congress.” *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988). Congress has not conferred any authority to regulate margin on securities transactions on either the Commission or FINRA. Instead, the Exchange Act vests that authority in the Board. FINRA seeks to usurp this authority by setting margin requirements for CATs. The Commission cannot approve the unlawful and *ultra vires* margin regime that the 2015 Rule and the Proposed Rule Change purport to enact. The Commission, therefore, must disapprove these rules as contrary to law and in exceedance of statutory authority, and deny the Effective Date Proposal.⁴⁵

⁴⁵ In deciding this petition, the Commission should recognize that its members may be removed from office by the President for any reason and are therefore obliged to carry out the President’s policy agenda. *Collins v. Yellen*, 141 S. Ct. 1761, 1783 (2021) (agencies are not independent in the absence of “plain language” to that effect). No statute expressly gives members of the Commission for-cause removal protection, so they do not have such protection. What is more, to the extent members of the Commission have for-cause removal protection, the Commission’s structure violates the separation of powers. To the extent that the Commission refuses to take up this petition or decides it adversely to Petitioners’ interests without recognizing

Under Section 7 of the Exchange Act, the Board is the federal agency authorized to set and to regulate margin requirements for any security:

For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Board of Governors of the Federal Reserve System shall, prior to October 1, 1934, and from time to time thereafter, prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security (other than an exempted security or a security futures product).

15 U.S.C. § 78g(a). To the extent that the Exchange Act confers the authority to prescribe rules and regulations with respect to margin on any security, therefore, it confers that authority on the Board.

Section 7(b) further clarifies that this authority is exclusive with the Board. That provision authorizes the Board to raise and lower margin requirements for “all or specified securities or transactions, or classes of securities, or classes of transactions”:

Notwithstanding the provisions of subsection (a) of this section, the Board of Governors of the Federal Reserve System, may, from time to time, *with respect to all or specified securities or transactions, or classes of securities, or classes of transactions*, by such rules and regulations (1) prescribe such lower margin requirements for the initial extension or maintenance of credit as it deems necessary or appropriate for the accommodation of commerce and industry, having due regard to the general credit situation of the country, and (2) prescribe such higher margin requirements for the initial extension or maintenance of credit as it may deem necessary or appropriate to prevent the excessive use of credit to finance transactions in securities.

15 U.S.C. § 78g(b) (emphasis added). The Board is thus granted authority to prescribe lower and high margin requirements for “all” securities and all “classes of transactions.” *Id.* For the

the President’s lawful authority to supervise the Commission’s work, Petitioners preserve the right to sue for any appropriate remedies, including a declaratory judgment that members of the Commission do not have for-cause removal protection.

Commission to permit FINRA to set margin for securities would thus create a conflict with Congress' decision to confer that authority on the Board and risks creating competing and conflicting margin regimes.

The legislative history of Section 7 confirms what the statute's plain text makes clear. As the House Report explained, the "underlying theory of the [Exchange Act] with respect to control of credit" was that "to effect such better balance [in the use of the nation's credit resources], *all* speculative credit should be subject to the central control of the Federal Reserve Board as the most experienced and best equipped credit agency of the Government," and that "[t]o achieve that control the Federal Reserve Board should be vested with the most effectual and direct power over speculative credit, i.e., the power to control margins on the actual ultimate speculative loans themselves."⁴⁶

Congress reaffirmed its intention to confer the authority to regulate margin on the Board when, in 2000, it decided to authorize the imposition of margin requirements on security futures products. Security futures products are not subject to the margin requirements established under Section 7(a). 15 U.S.C. 78g(a). Congress authorized the creation of a separate regime of margin requirements for these specific securities when it enacted the Commodity Futures Modernization Act of 2000 ("CFMA").⁴⁷ The CFMA added subsection (2) to section 7(c) of the Exchange Act, directing the Board to prescribe rules establishing initial and maintenance margin requirements for security futures products. The CFMA also added section 7(c)(2)(B), which authorizes the Board to delegate this rulemaking authority, jointly, to the SEC and Commodity Futures Trading Commission ("CFTC"). On March 6, 2001, the Board delegated this authority to the SEC and

⁴⁶ H.R. Rep. No. 73-1383, at 7, 73d Cong., 2d Sess. (April 27, 1934) (emphasis added).

⁴⁷ H.R. 5660, Commodity Futures Modernization Act of 2000, incorporated in Consolidated Appropriations Act of 2001, Pub. Law 106-554 (Dec. 21, 2000).

CFTC.⁴⁸ The Commissions subsequently adopted the initial customer margin requirements for security futures in 2002.⁴⁹ Thus, Congress has shown that, when it intends to authorize the Board to delegate its authority to set margins, it knows how to do so, and does so unambiguously and explicitly.

Congress has never delegated authority, nor authorized the Federal Reserve to subdelegate any such authority to FINRA to set margin on CATs. FINRA has simply conferred that power on itself. The duty falls to the Commission under Section 19(b), therefore, to enforce the provisions of the Exchange Act and void this unlawful and *ultra vires* Proposed Rule Change.

B. The General Grant Of Authority To FINRA In Section 15A(b)(6) Must Yield To The Specific And Limited Grant Of Authority To The Board In Section 7.

FINRA maintains that it has authority to regulate margin because Congress required FINRA to adopt rules to, among other things, “protect investors and the public interest.” 15 U.S.C. § 78o-3(b)(6). Section 7, FINRA argues, speaks only to the authority of the Board; it does not limit FINRA’s power to establish its own margin regime pursuant to the general grant of rulemaking power granted by Section 15A(b)(6).⁵⁰

This argument, which the Division accepted without further analysis,⁵¹ cannot be squared with the clear expression of Congress’ intention that margin “should be subject to the central

⁴⁸ Letter from Jennifer J. Johnson, Secretary of the Board, Federal Reserve Board, to James E. Newsome, Acting Chairman, CFTC, and Laura S. Unger, Acting Chairman, SEC (Mar. 6, 2001), reprinted as Appendix B to Customer Margin Rules Relating to Security Futures, 66 Fed.Reg. 50720, 50741 (Oct. 4, 2001).

⁴⁹ Securities & Exchange Commission and Commodity Futures Trading Commission, *Customer Margin Rules Relating to Security Futures*, 67 Fed. Reg. 53146 (Aug. 14, 2002).

⁵⁰ FINRA Letter of Sept. 16, 2021 at 7 (“FINRA has noted that SEA Section 7 sets forth the parameters of the margin setting authority of the Federal Reserve Board and does not bar action by FINRA.”).

⁵¹ Approval Order at 34–35, posted at <https://bit.ly/34cMIj>.

control of the Federal Reserve Board as the most experienced and best equipped credit agency of the Government.”⁵² If Section 15A(b)(6) confers the authority that FINRA claims, then margin would no longer be subject to the central control of the Board, but the dual responsibility of FINRA and the Board.

FINRA’s argument also contravenes the “commonplace of statutory construction that the specific governs the general.” *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992). This canon has full application where, as here, a grant of general authority and a more limited grant of authority on a specific subject coexist in the same statutory scheme. *See RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645 (2012) (quoting *D. Ginsberg & Sons, Inc. v. Popkin*, 285 U.S. 204, 208 (1932)). *See also HCSC–Laundry v. United States*, 450 U.S. 1, 6 (1981) (per curiam) (specific provision governs the general provision “particularly when the two [statutory provisions] are interrelated and closely positioned...”). And it “is particularly true where, as [here], ‘Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions.’ ” *RadLAX Gateway*, 566 U.S. at 645 (quoting *Varity Corp. v. Howe*, 516 U.S. 489, 519 (1996) (Thomas, J., dissenting)). To the specific question of how margin should be set, Congress provided the answer in Section 7; Section 15A simply does not convert that answer into an optional suggestion.

To read Section 15A(b)(6) as a sweeping grant of comprehensive and unlimited authority would render the specific guidance and limitations announced in Section 7—and, for that matter, any of the limitations imposed by any section of the Exchange Act—superfluous. It would thus run afoul of “the basic interpretive canon that a ‘statute should be construed [to give effect] to all its provisions, so that no part will be inoperative or superfluous, void or insignificant.’ ” *Genus*

⁵² *Supra* note 46, at *7.

Med. Techs. LLC v. FDA, 994 F.3d 631, 638 (D.C. Cir. 2021) (quoting *Corley v. United States*, 556 U.S. 303, 314 (2009) (quoting *Hibbs v. Winn*, 542 U.S. 88, 101 (2004)) (alteration in original).

C. Congress Has Not Authorized The Imposition Of Margin On Exempted Securities.

While the foregoing suffices to demonstrate that FINRA lacks statutory authority for its rule, the case against that authority is even stronger. That is because Congress not only vested exclusive authority to regulate margin in the Board but also *exempted* CATs from Board regulation, making clear that *any* imposition of margin on them is ultra vires. Section 7 authorizes the Board to promulgate “rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security (*other than an exempted security or a security futures product*).” 15 U.S.C. § 78g(a) (emphasis added). Section 3(a)(12) of the Exchange Act defines “exempted securities” to include “government securities,” which are, in turned, defined in Section 3(a)(42)(c) to include the CATs here at issue.⁵³ Congress has thus not granted the Board, much less the Commission or FINRA, any authority to regulate margin for CATs.

It has long been recognized that Agency MBS (and therefore CATs) are exempt from margin requirements. In 1984, for example, Congress adopted the SMMEA, to improve the marketability of private label mortgage-backed securities. Among other things, the SMMEA prohibits the regulation of credit extensions for private label MBS, provided a bona fide agreement for delivery of the security against full payment within 180 days of the purchase date is in force. When deciding to prohibit the imposition of margin on forward-settling private MBS, Congress acknowledged what FINRA and the Division have failed to grasp: namely, that forward-settling

⁵³ See, e.g., 12 U.S.C. § 1723c (Fannie Mae and Ginnie Mae securities exempt); 12 U.S.C. § 1455g (Freddie Mac securities exempt).

government-backed MBS are exempt from the margin rules authorized by the Exchange Act: “It should be noted that Government-Backed Mortgage-Backed Securities are exempt from these rules now.”⁵⁴ Congress has confirmed, therefore, what the plain text of the Exchange Act makes clear: CATs are exempt from margin.

Since it first proposed including CATs in Rule 4210, FINRA has never offered a legal rationale to support departing from the decades-old regulatory regime wherein Agency MBS have not been subject to Section 7’s margin requirements, and the Division made no attempt to do so in its approval order. Even a perceived need for “more comprehensive regulation” does not entitle the Commission to re-write the Exchange Act.

II. The Proposed Rule Change Imposes Burdens On Competition That Are Neither Necessary Nor Appropriate.

Had FINRA’s original 2015 Rule ever been allowed to take effect, it would have imposed burdens on competition that were neither necessary nor appropriate. To its credit, since 2019, FINRA has acknowledged the burdens that its proposed rule change would unnecessarily place on competition. It originally sought to alleviate those burdens by, among other things, exempting counterparties whose gross open positions in CATs are less than \$2.5 million (a threshold it subsequently raised to \$10 million⁵⁵) from the new margin requirements and by establishing a \$250,000 *de minimis* threshold up to which amount members would not need to collect margin. The Proposed Rule Change would now eliminate the two percent maintenance margin requirement altogether and, subject to specified conditions and limits, allow FINRA members to take a capital charge instead of collecting margin for mark-to-market losses on positions pending settlement.⁵⁶

⁵⁴ *Supra* note 3.

⁵⁵ *See* 2016 Approval Order, 81 Fed. Reg. at 40368. *See also* Amendment No. 1 at 5–6.

⁵⁶ *See* Amendment No. 1 at 6–7.

Despite FINRA's efforts to mitigate the harms that its 2015 Rule would cause smaller market participants and lessen the burdens that it will impose on competition, the fact remains that these burdens, while reduced, remain significant, unnecessary and inappropriate. An unlawful burden remains unlawful, even when made lighter. No evidence or analysis has ever been offered to justify FINRA's belief that Agency MBS need to be subjected to a pre-settlement date margin regime. Indeed, that the market remained liquid and continued to function throughout the 2008 financial crisis and in March 2020 confirms that FINRA has proposed a solution to a non-existent problem.

It is FINRA's rule, not pre-existing practices, that threatens the system. Were the CAT Rule ever allowed to take effect, it will confer a decisive competitive advantage on larger players and non-FINRA banks, driving smaller broker-dealers out of the Agency MBS market. There are at least three ways in which the Rule would work this harm to competition.

First, even after the Proposed Rule Change, FINRA's margin regime would continue to confer a competitive advantage on those brokers with bank affiliates that are not subject to FINRA's Rule 4210. Because banks are outside the scope of Rule 4210, they are not required to have margin agreements with customers, to collect margin from their counterparties, or to subject their forward-settling Agency-MBS transactions to these proposed mark-to-market margining requirements. An economically rational actor, given the choice between having to post margin to a FINRA member and avoiding this obligation and its associated costs by doing business with a non-member, will inevitably choose the latter. This is simple economic common sense.⁵⁷ The

⁵⁷ For the perverse incentives created by the Proposed Rule, *see, e.g.*, Letter from Chris Killian, SIFMA, to Secretary, Securities and Exchange Commission (June 15, 2021) (<https://bit.ly/3onTtRM>), 2–3; BDA Letter at 2–5; Brean Letter at 10–21. *See also* Letter from Kirk R. Malmberg, President and CEO, Federal Home Loan Bank of Atlanta, to Vanessa Countryman,

FINRA member will also be burdened with unquantifiable credit risk by the CAT Rule, while the non-member will continue to conduct business as it currently does. We should expect each firm's charges to its customers to reflect their respective costs. FINRA's proposed margin regime thus provides the regional banks and their affiliates to whom they can source inventory a marked competitive advantage over regional broker-dealers who are FINRA members. And because banks have a lower cost of capital to begin with, the CAT Rule would only further tilt an already unlevel playing field.

FINRA's margin regime thus creates incentives for market participants to take their business to non-FINRA members, removing an ever-greater share of the transactions in these securities from FINRA's oversight (including TRACE reporting), standards, and regulations. This shift is harmful to competition and perverse from a regulatory perspective.

The Division concluded that eliminating the two percent margin requirement and permitting FINRA members to take a charge against capital in lieu of margin "should help to alleviate this disparity."⁵⁸ That FINRA members will be put at some competitive disadvantage to the banks is thus not in dispute. But FINRA and the Division have seriously downplayed the significant incentive that a customer will have to prefer doing business with a bank that is not subject to regulation by FINRA instead of with a smaller FINRA member who will have to assess and collect margin on mark-to-market losses that result from pre-settlement market price fluctuations on forward-settling Agency MBS. Contrary to the Division's conclusion, it is no solution to this problem that the FINRA member can take charges against its own capital rather

Secretary, Commission at 1–2 (Jan. 18, 2022), (<https://bit.ly/3sbRYHm>); Letter from Senator John Boozman, Senator Thom Tillis, and Senator Cynthia M. Lummis, to Gary Gensler, Chairman, Commission (Jan. 10, 2022) ("Boozman et al Letter") at 1–2, (<https://bit.ly/3gmpogR>).

⁵⁸ *Supra* note 51, at 26.

than assess margin.⁵⁹ When selecting a broker, a sophisticated customer—and, as the Commission is no doubt aware, the participants in the Agency MBS market are sophisticated—will take account of the fact that a margin requirement that bears no relation to that customer’s actual risk might unexpectedly force its broker-dealer into technical insolvency, render that broker unable to conduct transactions on its behalf, and possibly even result in the liquidation of its position. When some customers are required by their broker to put up margin, and others are not, those customers are naturally going to suspect that they are being disadvantaged vis-à-vis those other customers and are going to take their business elsewhere.

Second, the Proposed Rule Change will place small-to-medium sized member brokers at a competitive disadvantage with larger member brokers and banks. It does so by imposing costs that smaller players are less well-positioned to bear. Smaller broker-dealers act as intermediaries between primary brokers and institutional buyers of Agency MBS. They operate in what is, from a balance sheet perspective, an effectively riskless environment.⁶⁰ Because they bear little or no risk, they generate less revenue and have lower capital requirements. Larger brokers operate in higher-risk environments, often holding uncovered long positions on their books for considerable periods of time. Because they are willing to bear higher risks, they can generate higher revenues and must maintain higher operating capital levels.

FINRA asserted, and the Division accepted, that the competitive disadvantage at which the 2015 Rule placed smaller members would be adequately remedied by the Proposed Rule Change’s imposition of the 25% TNC / \$30MM Threshold. What is now being proposed, in other words, is that every member broker—small, medium, and large alike—may substitute capital charges for

⁵⁹ *Supra* note 51, at 28.

⁶⁰ *See* Petitioners’ Letter at 27–28 (Illustration 2).

margin only up to the lesser of \$30 million or 25% of its net capital. Once a firm reaches either “Threshold,” it is prohibited from trading, except to liquidate positions and reduce tentative net capital until the issue is resolved. Even a larger broker, with net capital of a billion or even \$10 billion, can absorb only \$30 million of their customers’ mark-to-market losses if it does not collect margin from them.

This proposed “solution” gives rise to two problems. First, to whatever extent the ability to substitute a capital charge for a margin requirement might have redressed the competitive imbalance between member firms and non-member banks, that relief is now limited by the 25% TNC / \$30MM Threshold. FINRA is taking away with one hand what it claims to give with the other, aggravating the competitive imbalance between member brokers and non-member banks to redress the imbalance between large and small members.

Second, the 25% TNC / \$30MM Threshold would drastically limit the ability of FINRA members to introduce liquidity into the market during periods of unusual volatility. Even those member firms that could readily and safely inject liquidity far in excess of \$30 million in times of market turbulence would be unable to do so if the CAT Rule comes into force. They would be unable to perform their traditional role of adding liquidity and stability to the market. Instead, these larger firms would have to stand on the sidelines or, at worst, be forced by the CAT Rule to liquidate their customers’ positions and add volatility to the market.

FINRA offered the 2020 collapse of Archegos Capital as an example of the type of risk that the CAT Rule is supposed to manage. This is a curious choice. Archegos did not involve CATs. Its credit exposure derived from total return swaps where banks took large positions in equity securities, and Archegos had incurred substantial speculative risks and suffered massive market losses in concentrated positions that triggered margin calls and forced liquidations.

Perversely, FINRA's margin regime introduces precisely these risks by requiring the liquidation of what are otherwise economically riskless positions in forward settling Agency MBS. The CAT Rule could create the same spiral of liquidations that were triggered by Archegos' conduct, in other words, even in the absence of speculative trading or any risk.

Finally, by creating an incentive for small-to-medium sized FINRA members to exit the market, the Proposed Rule Change would further diminish competition and decrease liquidity. Under FINRA's margin regime, it will no longer make economic sense for these smaller participants to build the compliance systems, hire the new personnel, and implement the margining systems required by the CAT Rule. They will either exit the Agency MBS market voluntarily or be driven out by the economic and competitive realities. As a result, market power will soon be even more concentrated in the hands of a small number of very large primary dealers. FINRA remains unable to explain how a proposed rule that will result in such consolidation, and that will reduce market resilience and liquidity, comports with the requirements of Section 15A(b)(6) and Section 15A(b)(9). The Division, for its part, simply did not address this concern.

III. FINRA's Margin Regime Will Increase Systemic Risk And Reduce Market Liquidity And Is Unworkable.

A. The CAT Rule Will Deplete Regional Broker-Dealers' Capital Frequently And Unnecessarily.

A key feature of Petitioners' comment on the Proposed Rule Change was an analysis of how the option to take a net capital charge (effectively a requirement, since an introducing broker has no way to collect cash collateral on most CATs) can force regional broker-dealers to suspend trading altogether after only a handful of typical trades.⁶¹ This consequence follows from the 25% TNC / \$30MM Threshold. Customers in the Agency MBS market are almost exclusively

⁶¹ *Id.* at 27–30.

institutional investors. Aggregate daily trading volumes run in the \$200 to \$300 billion range. Individual trades often involve positions in the hundreds of millions of dollars. Downstream in a chain, a regional broker-dealer may also split an Agency MBS with a face value exceeding \$100 million, for example, among multiple smaller institutions. For that reason, even a broker-dealer that services smaller institutional investors will, as Petitioners' analysis demonstrates, frequently risk crossing the threshold.

Petitioners offered three examples of typical trades booked for good day settlement to illustrate the adverse effects that the Proposed Rule Change will have on market participants. The examples illustrate how the capital charges associated with just four or five typical trades could easily put a member over the capital charge threshold. The sample trades examined by Petitioners are neither atypical nor rare. A firm like Brean makes trades just like them each day. Brean can make these trades confidently—and has done so since 1973 without any fails—even though it maintains only \$90 million in capital both because the CATs are structured to be risk-neutral to its balance sheet and because Brean assesses the credit risk of its counterparties, just as those counterparties assess the credit risk presented by Brean. Brean's credit is further underwritten by its clearing firm, Pershing.

There are draconian consequences to reaching the Threshold. After five business days, the member is prohibited from entering any new CATs with non-margin counterparties. If the member has the right to collect margin from the counterparty for whose transaction it booked the mark-to-market loss (which an introducing broker does not), then it must promptly collect margin from that party. After five business days, it must promptly liquidate the CATs of any counterparty whose excess net mark-to-market loss has not been margined or eliminated.

For pension funds and other institutional investors that are prohibited from providing margin, the Rule means that, should they choose to trade through a FINRA-member regional broker-dealer, their positions may be liquidated in times of even moderate market volatility, and there will be nothing they can do to avoid those liquidations. The Rule does not require member firms to reasonably manage their risks, therefore, but transforms those firms into risks that institutional customers must avoid. Institutional investors that are prohibited from providing margin will move their business to non-member banks.

The CAT Rule will be a mechanism for transforming moderate market volatility into a liquidity crisis. As firms that reach their threshold are forced to suspend market operations, liquidity begins to dry up and prices fall. Five days later, forced liquidations drive down prices still further, triggering other firms to book mark-to-market losses and driving them across their capital thresholds, which perpetuates the cycle of suspensions and liquidations. FINRA's margin regime thus has the potential to transform interest rate fluctuations into market routes.

FINRA has never questioned Petitioners' analysis of how its margin regime would function under the three trade scenarios presented by Petitioners. Instead, FINRA first objected to the characterization of these CATs as "riskless," observing that, while riskless from a balance sheet perspective, they are not riskless from a credit risk perspective because "a firm is exposed to the credit risk of both the buyer and seller, and the offsetting transactions provide no protection against those risks." Regardless of whether these CATs are considered riskless, the point that Petitioners are making stands: even a handful of typical transactions can put a member firm over the 25% TNC / \$30 million Threshold. While FINRA assumes that the customers are unknown, Brean in fact analyzes the creditworthiness of its counterparties, as it is already required to do and Brean's overall creditworthiness is in turn monitored by its clearing firm, Pershing.

FINRA further responded that “when the firm’s risk management procedures function as they are required to be designed, the member will rarely cross the 25% TNC / \$30 million threshold, much less exceed it for five consecutive business days.”⁶² FINRA here responds to a concrete demonstration that something is going to happen frequently with nothing more than an assertion of faith that it should happen rarely. If FINRA is suggesting that the threshold will rarely be crossed because FINRA members will simply liquidate their customers’ positions whenever the market begins to move, it is assuming that something bad will rarely happen under the CAT Rule because the rule will force something truly terrifying to happen first. That is not a reason for approving FINRA’s Proposed Rule Change.

Finally, Petitioners’ illustrations revealed another feature of these markets that FINRA had overlooked; namely, that these transactions are already often subject to contractual margin requirements that are imposed by the clearing firms. Under Illustration 2, for example, Brean’s current margin requirements with Pershing would require a \$300,000 charge to net capital to cover a \$3,000,000 mark-to-market loss on a non-specified pool of Ginnie Mae securities that Brean had purchased and sold to a customer.⁶³ FINRA’s proposed margin regime would now require Brean to post margin of \$3,000,000 to cover that same mark-to-market loss, even when that customer has also posted \$3,000,000 in margin with the clearing broker, as it is contractually required to do by its clearing firm. A margin regime that in practice will result in margin calls of \$2 to cover every \$1 of mark-to-market losses is an irrational recipe for market illiquidity.

Neither FINRA nor the Division analyzed how FINRA’s margin regime would interact with the contractual requirements that are imposed by clearing firms. The Division accepted

⁶² Amendment No. 1 at 10 n. 21.

⁶³ Petitioners’ Letter at 27 (Illustration 2).

FINRA's assurances on faith, based on FINRA's vague representation that it had conducted "extensive dialogue with introducing and clearing firms" about those requirements and assured the commission that it would address these problems in the future.⁶⁴

An after-the-fact promise to fix a problem with the CAT Rule is not an argument for approving that Proposed Rule Change, but an admission that the Rule should not be allowed to go into effect as-is and a reason for sending FINRA back to the drawing board.

B. FINRA's Margin Regime Will Disrupt The Chain Trades That Are Characteristic Of The Agency MBS Market.

FINRA and the Division have also not adequately addressed the threat that FINRA's margin regime presents to the "chain" transactions. Agency MBS are generally traded through a chain of buyers and sellers, with modest price changes at each link in the chain. These chains allow for the operation of the price mechanism in the case of securities that would otherwise be difficult to value and ensure that the market remains liquid. Almost all the transactions in such a chain will be hedged. Indeed, many brokers, including Brean, generally execute only "riskless trades" (again in the sense of balance sheet impact) by placing a "buy" order only when a corresponding "sale" order is already in hand. These transactions therefore present minimal balance sheet exposure.

Breaking one link would cause all subsequent links in the chain to fail. Whenever FINRA's margin regime causes a forced liquidation of a position that is part of a chain, the downstream parties will be rendered unable to locate substitute securities for non-netting Specified Pools and new issue CMOs that they would need to replace the securities that they would have received from the liquidated party and, by extension, to meet their obligations to the next party in the chain. A non-delivery by one party thus places all other parties in default, leaving them to sort out who

⁶⁴ Amendment No. 1 at 20.

owes what to whom on a security that has not been delivered through no fault of any downstream party. This adds a new, unmanageable, and frankly unnecessary risk that each party must factor into its risk analysis. These procedural costs and risks will deter trading and result in higher prices by adding a liquidity premium to each transaction. The Proposed Rule Change thus harms investors and, through the harms that will flow through the mortgage market, the American public at large.

FINRA's first response to these objections was to note that FINRA's 2015 Rule imposed its own liquidation requirements that would also threaten to disrupt the chain transactions that are characteristic of the TBA market.⁶⁵ The Division accepted this observation nearly verbatim in its Approval Order.⁶⁶ This is tantamount to suggesting that it would be lawful to blow up a building because one had been planning to burn it down. The fact that, had it ever been allowed to take effect, the 2015 Rule would also have threatened the efficient functioning of the TBA market is no defense of FINRA's 2021 Proposed Rule Change.

FINRA further responded that by identifying four categories of situations in which a counterparty might fail to margin its excess net mark-to-market loss by the fifth business day after it arises, while arguing that only one of these situations has any prospect of triggering a liquidation.⁶⁷ This response fails to address the substance of the objection that the Proposed Rule Change creates a risk of chain failures that adds a new and untenable counterparty risk, i.e., the risk that a transaction will fail because of a failure of another transaction elsewhere in a chain of transactions.⁶⁸

⁶⁵ Amendment No. 1 at 9.

⁶⁶ *Supra* n. 51, at 36.

⁶⁷ Amendment No.1 at 10–13.

⁶⁸ *See* Petitioners' Letter at 33–34.

To date, a party can assess its risks by acquiring an understanding of its immediate counterparty's financial strength; going forward, under FINRA's margin regime, one must consider each trading party with whom each counterparty does business at the time of the trade, i.e., unknown parties with whom the firm has no direct dealings, since a failure to meet margin at any point in the chain can lead to a failed settlement further down in the chain. The costs and risks associated with this process will only foster uncertainty and deter trading—or lead to higher prices by adding a liquidity premium, harming the consumers in the housing markets. FINRA failed to take account of these risks, costs, and harms to the market, to market participants, and to consumers.

FINRA also failed to balance the reduction in risk the Proposed Rule Change would purportedly create against the harm to market liquidity it would cause. These harms are magnified because of the prominence of chain trades discussed above. As illustrated in Figure A, under FINRA's margin regime, multiple counterparties, all but one of which has already liquidated its position, will have to post margin to cover pre-settlement mark-to-market losses for the same underlying security. Such redundant and duplicative margining magnifies the drain on liquidity that will result under the CAT Rule.

One feature of the Proposed Rule Change that purportedly was devised to diminish the risk that the forced liquidations the 2015 Rule would have required will have a particularly pernicious effect. Specifically, FINRA has proposed eliminating the liquidation requirement that otherwise would apply when a member firm crosses the 25% TNC / \$30 million threshold when that member firm does not have the right to liquidate.⁶⁹ But because an introducing broker that has crossed the threshold cannot collect margin or liquidate the securities in this situation, it will have no means

⁶⁹ Amendment No. 1 at 9–10

to get out of the penalty box until after the settlement date, which could be weeks away. In the interim, the firm would be prohibited from entering any CATs with a “non-margin counterparty,” a constituency that includes important participants in this market. In other words, unlike most margin arrangements, where the concern is the relationship between a broker and a particular customer, FINRA will block new transactions with all counterparties. This is an untenable prospect for most institutional investors, who will simply take their business elsewhere.

There are other problems with FINRA’s analysis of the impact of its Proposed Rule Change on chain trades. FINRA opines, for example, that five days, with the possibility of a 14-day extension, should provide sufficient time to resolve most issues. The setting of these time periods do not appear to have been informed by any data or analysis, and FINRA has not provided any examples of what might be reasonable circumstances under which extensions will be granted or what factors it might weigh when deciding to grant an extension. Parties would be reluctant to engage in this business uncertain that FINRA will grant such extensions and of the standards that will apply. As we enter the seventh year of this rulemaking, it is remarkable that the Division accepted on faith FINRA’s estimate of how long it should take to resolve complicated financial issues.

FINRA also assures the Commission that parties should be able to resolve disputes about how properly to mark their positions to market within five days, and that such disputes about valuation should not trigger the liquidation requirement under the Proposed Rule Change.⁷⁰ The suggestion that disputes about the present market price of a thinly-traded, non-nettable, good-day settling pool of Agency MBS should usually be resolved in five days or less is wishful thinking masquerading as reasoned decision-making. As Petitioners argued to the Division, FINRA should

⁷⁰ Amendment No. 1 at 11–12.

have identified, but did not identify, which party should be responsible for marking these securities to market and should have established the methodology that is to be used to do so. As a result of FINRA's failure to act, the parties must debate and negotiate the market price of assets for which precise market prices are not easily established. These are transactions that often involve hundreds of millions, if not billions, of dollars of securities. Buyers and sellers have conflicting interests when it comes to assessing their current price and have powerful incentives to disagree, and to disagree tenaciously, when it comes to setting margin. As the Commission is no doubt aware, certain market participants also have disproportionate market power. As a result, there is significant risk that the marks on non-netting Specified Pools and new issue CMOs will often vary from their actual value, imposing collateral obligations where none should exist. This risk is multiplied, as margin departments often set value independent of a trading desk. They rely on models to price unique securities, which may produce results quite different from the market itself. This is a significant question, to which FINRA has offered no answer.

Nor did Amendment No. 1 address the role of the clearing broker or reflect that FINRA considered the actual way in which introducing brokers clear trades. As noted above, Pershing, the dominant clearing firm, imposes its own margin requirements by contract. Amendment No. 1 did not reference any data that would support that the collateral currently collected by Pershing is insufficient to protect against the risk the Proposed Rule Change seeks to address. Nor did it address the inability of many regional broker-dealers to collect margin even if a customer posts it with a clearing firm. On this point, the Proposed Rule Change does not provide a mechanism by which an introducing broker will receive a credit for collecting margin if the customer deposits the requisite funds with the clearing firm.

Lastly, regional broker-dealers are particularly vulnerable under the standard terms of the Master Securities Forward Transaction Agreement (“MSFTA”) developed by SIFMA. Since FINRA announced inclusion of CATs in Rule 4210, many counterparties have required use of the standard form MSFTA, which regional broker-dealers had not previously executed. MSFTAs are not, however, a substitute for a margin agreement and do not require the posting of collateral. In 2018, SIFMA issued a proposed Form of MSFTA that includes CATs in anticipation of the 2015 Rule taking effect. The proposed MSFTA form provides that a broker may close out all positions based on a default in one position. Any such across-the-board liquidation would not only cause multiple breakdowns in otherwise financially sound chains of distribution, but also threaten the regional broker-dealer with insolvency. The Proposed Rule Change is blind to this reality, and this points to a marked increase in another systemic risk factor, insolvency risk. If a party becomes insolvent, those who have posted collateral with the insolvent party stand to lose their collateral. Thus, one firm’s failure is now more likely to impact other firms.

C. By Reducing The Number Of Market Participants, The CAT Rule (Inclusive Of The Proposed Rule Change) Will Enhance Systemic Risk

The Proposed Rule Change enhances systemic risk in at least five ways: 1) it removes liquidity from the Agency MBS markets; 2) it introduces substantial uncertainty due to the difference between trade prices and the calculation of mark-to-market loss for margin purposes; 3) it does not offer an adequate solution to the “chain” fail problem; 4) it increases the bargaining power of primary dealers to the detriment of introducing brokers; 5) it encourages those broker-dealers with bank affiliates to shift the business to banks, which will not be subject to Proposed Rule Change and—in the absence of this onerous regulation—will have a far lower cost of capital.

The operation of the Proposed Rule Change would have a heavy and disproportionate financial and regulatory impact on FINRA-member regional broker-dealers, increasing the costs

of riskless transactions at least ten-fold. This use of capital will drastically reduce the liquidity that they bring to the market. These costs would fall heavily on the regional banks and mortgage originators that rely on these FINRA member firms to hedge their risks. BDA members have found that primary dealers are ill-fitted to provide these types of institutions with the service they need because of the customers' size or to understand those customers' business and credit needs.

D. The Proposed Rule Change Will Harm Women And Minority Owned Businesses And Will Have A Disparate Impact On Underserved Communities.

The President of the Government National Mortgage Association recently wrote to the Commission, explaining that she had been contacted by Ginnie Mae's stakeholders regarding the harms that would result from FINRA's proposed margin requirements. These stakeholders demonstrated that the proposed requirements would "have a detrimental impact on smaller broker-dealers who are most focused on community institutions and would have to absorb margin demands that render this segment of the business uneconomic."⁷¹ Like Petitioners, President McCargo was troubled by the absence of any evidence or analysis in the administrative record addressing these consequences of the proposed rule change:

[W]e have not seen materials or analysis that specifically consider the consequences and impact the proposal would have on the housing finance sector and access to the liquidity for underserved communities, which are the focus of our government mortgage securitization program. As you know, equity in access to homeownership wealth is a prominent goal of the Biden Administration.⁷²

Agency MBS are disproportionately originated and distributed by smaller firms. Those firms will disproportionately bear the burdens imposed by the margin requirements of FINRA 4210.

⁷¹ Letter from Alanna McCargo, President, Government National Mortgage Association to Vanessa Countryman, Secretary, Securities and Exchange Commission, at 1 (Jan. 20, 2022).

⁷² *Id.* at 2.

The burdens of FINRA’s margin regime also fall disproportionately on firms that are owned and operated by women and minorities. As the eleven Federal Home Loan Banks recently informed the Commission, the proposed margining requirements would impose significant operational and compliance costs on broker-dealers that will be particularly difficult for the generally smaller minority- and women-owned firms to meet.⁷³ FINRA’s effort to alleviate these harms was, unfortunately, “insufficient.”⁷⁴ Once again, FINRA does not seem to have fully grasped the intricacies of the markets it is seeking to regulate:

Removing the maintenance margin requirement affords limited relief, because in many instances, under the margining requirements adopted in 2015, the maintenance margin requirement would not have applied to many counterparties by virtue of there being an exemption from maintenance margin for “exempt accounts” (as defined in the above-referenced rulemaking, i.e., certain regulated entities and entities with large amounts invested).⁷⁵

Nor did FINRA take adequate account of the disparate impact its proposal will have on women and minority owned businesses:

In addition, allowing a broker-dealer to incur a capital charge in lieu of collecting margin still has a negative economic impact on a broker-dealer and will also require new legal and operational processes to ensure compliance. As a result, even with the proposed amendments, many minority and women owned broker-dealers may still elect to curtail, or withdraw entirely from, engaging in Covered Agency Transactions, which at the margin may reduce the market liquidity for such instruments and by extension increase the cost of housing finance.⁷⁶

⁷³ Letter from Kirk R. Malmberg, President and CEO, Federal Home Loan Bank of Atlanta to Vanessa Countryman, Secretary, Securities and Exchange Commission, at 1 (January 18, 2022) (“The margining requirements imposed by FINRA Rule 4210 will not only have a direct economic effect on broker-dealers and their counterparties by requiring the exchange of margin with counterparties. They will also require broker-dealers to incur significant legal and operational costs.”).

⁷⁴ *Id.* at 2.

⁷⁵ *Id.*

⁷⁶ *Id.*

Had FINRA consulted with industry participants, it would have discovered the pernicious effects that its margining requirements would have on the industry. And had the Division required FINRA to provide it with the evidentiary basis for its conclusions, it would have been able to discern that FINRA had failed adequately to evaluate those effects.

The duty now falls to the Commission, therefore, to remedy these defects and ensure that a deficient rulemaking does not reverse the strides that women and minorities have made in the securities industry, nor deny underserved communities of access to affordable home mortgages.

E. The Division Failed To Engage In Reasoned Decision-making.

The administrative record in this rulemaking consists of little more than a long series of statements by the Division that it has been assured by FINRA that FINRA spoke with industry participants and that the Division is taking FINRA's word that it has addressed these concerns.⁷⁷ The parties to this engagement are never identified. The specific concerns they voiced are never described. What FINRA did to address those concerns, or how FINRA believes it will address them, is never revealed. There is no evidence to support the specific provisions of the Proposed Rule Change, no evidence supporting the overall need for these changes or, for that matter, the need for FINRA to establish a margin regime for these securities *at all*.

Where commenters have identified problems, or identified issues that remain unresolved, FINRA responds only by assuring the Division that it will address them through future engagement

⁷⁷ See, e.g., *supra* note 51, at 22 (“FINRA stated that it has engaged with industry participants extensively on these concerns, and has addressed them on multiple occasions”); 22 n. 66 (“FINRA highlighted that it had engaged in extensive outreach and consultation with market participants”); 24 (“FINRA engaged in extensive dialogue, both with industry participants and other regulators ...”); 24 (“FINRA stated that it developed the proposed rule change in direct response to the concerns of industry participants”); 56 (“FINRA has engaged in extensive dialogue with introducing and clearing firms”).

and more facilitated dialogue.⁷⁸ The closest thing to evidence to be found in the administrative record are expressions of belief by FINRA that its Rule is sound and should be approved.⁷⁹ But that does not suffice. Indeed, there is “little” supporting value in the “self-serving views of the regulated entit[y].”⁸⁰ And “unquestioning reliance on [FINRA’s] defense of its own actions is not enough to justify approving [a] Plan”; “[i]nstead, the SEC [must] critically review[] FINRA’s analysis or perform[] its own.”⁸¹

FINRA’s assurances that the patent problems and inadequacies that plague the Proposed Rule Change will be addressed by future engagement and facilitated dialogues ring particularly hollow. Industry has heard this before, when FINRA promised that it would engage with industry and remedy the defects in the 2015 Rule. FINRA has not done so.

⁷⁸ See, e.g., *supra* note 51, at 55. See also *id.* at 55 (“FINRA expects to engage with member firms and industry participants in developing tailored reporting requirements.”); 56 (“FINRA stated that it intends to continue to discuss the proposed rule change and its implementation with clearing and introducing firms, and to facilitate dialogue among them as the Covered Agency Transaction margin requirements are implemented”); 56 (“FINRA has indicated it will continue to facilitate dialogue ...”).

⁷⁹ See, e.g., *supra* note 51, at 25 (“FINRA believes the revisions to the original rulemaking as set forth more fully in the proposed rule change, with the additional clarifications provided to commenters, afford industry participants appropriate relief and clarity, and that the rulemaking should proceed.”); 32 (“FINRA stated that it believes that this suggestion would significantly undercut the objective of the rule.”). In one case, the unexplained belief is rooted in unspecified engagement. See, e.g., *supra* note 51, at 9 (“Informed by FINRA’s engagement with members, FINRA believes this approach is appropriate because it would help alleviate the competitive disadvantage of smaller firms vis-à-vis larger firms.”).

⁸⁰ *NetCoalition v. SEC*, 615 F.3d 525, 541 (D.C. Cir. 2010) (“The self-serving views of the regulated entities, however, provide little support to establish that significant competitive forces affect their pricing decisions.”). *Accord Susquehanna Int’l Grp., LLP v. SEC*, 866 F.3d 442, 446 (D.C. Cir. 2017).

⁸¹ *Id.* at 446. See also *Bradford Nat’l Clearing Corp. v. SEC*, 590 F.2d 1085, 1113–14 (D.C. Cir. 1978) (finding the SEC’s reasoning inadequate when it approved registration of a clearing agency by deferring to the clearing agency’s “business judgment” on an issue governed by the Act).

In sum, neither FINRA nor the Division have ever offered any of the data upon which FINRA relied, revealed the substance of any of the conversations with industry upon which FINRA claims to have relied, or revealed any of the evidence upon which it relied when drafting and redrafting its margin rules. “It is a small matter to abide by the injunction of the arithmetic teacher: Show your work!” *City of Holyoke Gas & Elec. Dept. v. FERC*, 954 F.2d 740, 743 (D.C. Cir. 1992). Neither FINRA nor the Division have done so here. All FINRA has done is state that it considered problems and found that they were adequately addressed. “But ‘stating that a factor was considered’—or found—‘is not a substitute for considering’ or finding it.”⁸²

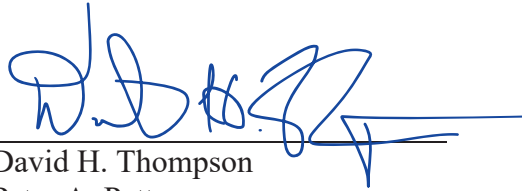
Conclusion

The core problems created by the Proposed Rule Change were not addressed by Amendment No. 1 and do not resolve the fundamental issues presented by the 2015 Rule. The Proposed Rule Change cannot be approved, and the CAT Rule, excepting those portions that pertain to the risk limit determination requirements, must be repealed.

⁸² See *Susquehanna International*, 866 F.3d at 446 (quoting *Gerber v. Norton*, 294 F.3d 173, 185 (D.C. Cir. 2002) (quoting *Getty v. Fed. Savings & Loan Ins. Corp.*, 805 F.2d 1050, 1055 (D.C. Cir. 1986)).

DATED: February 3, 2022

Respectfully Submitted,

A handwritten signature in blue ink, appearing to read 'D.H. Thompson', with a long horizontal line extending to the right.

Adrienne M. Ward
Thomas J. Fleming
OLSHAN FROME WOLOSKY LLP
1325 Avenue of the Americas
New York, NY 10019
(212) 451-2300

David H. Thompson
Peter A. Patterson
Harold S. Reeves
COOPER & KIRK, PLLC
1523 New Hampshire Ave., N.W.
Washington, D.C. 20036
(202) 220-9600

Counsel for Petitioners

CERTIFICATE OF COMPLIANCE

Pursuant to Rule 450(d) of the Commission's Rules of Practice, I certify that this brief complies with the requirements of Rule 450(c) and contains 13,982 words.

/s/ David H. Thompson
David H. Thompson

CERTIFICATE OF SERVICE

I, David H. Thompson, counsel for the Bond Dealers of America and Brean Capital, LLC, hereby certify that on February 3, 2022, I served a copy of the attached Petition for Review of the Order Granting Approval of a 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 (Securities Exchange Act Release No. 34-94013; File No. SR-FINRA-2021-010) on Vanessa Countryman, Vanessa Countryman, Esq., Secretary, Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549-1090, by electronic mail at Secretarys-Office@sec.gov in compliance with SEC Rule of Procedure 150(c), and on FINRA, by electronic mail to their counsel of record at adam.arkel@finra.org.

Dated: February 3, 2022

/s/ David H. Thompson
David H. Thompson