November 10, 2015

Robert W. Errett
Deputy Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Comments on Proposed Rule Change to Amend FINRA Rule 4210 (Margin Requirements) to Establish Margin Requirements for the TBA Market; File No. SR-FINRA-2015-036

Dear Mr. Errett:

The Mortgage Bankers Association[1] (MBA) appreciates the opportunity to respond to the Securities and Exchange Commission's request for comment on the proposed rule change by the Financial Industry Regulatory Authority (FINRA) to amend FINRA Rule 4210 to establish margin requirements for the TBA market.[2] The Proposal would require market participants who trade agency mortgage-backed securities (MBS) on a forward-settling basis with a FINRA-member broker-dealer to post margin. Included among these market participants are mortgage bankers who utilize the TBAs and other forward-settling MBS transactions to hedge their interest rate exposures.

Our comments provide the perspectives of the commercial/multifamily and residential real estate finance sectors regarding the Proposal's impact on borrowers in these respective markets. In providing these comments, MBA incorporates by reference its comments dated March 28, 2014 in response to the initial FINRA proposal.[3]

At the outset, MBA appreciates the inclusion by FINRA of a mortgage banker exemption from the maintenance margin requirement. Such an exemption alleviates what would have been a

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.

[2] 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, 80 FR 63603 (Oct. 20, 2015) (Proposal or Proposed Rule).

[3] Our comments also are consistent with comments previously made to the Treasury Market Practices Group in response to TMPG recommendations relating to margin requirements for agency MBS trading, dated September 9, 2014.

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significant burden for mortgage bankers.[4] However, as discussed more fully in our attached comments, there are substantial changes that need to be made to the Proposal to avoid disrupting the manner in which the multifamily and residential housing finance markets operate. As discussed in greater detail in our submission, we recommend:

- For the Multifamily Rental Housing aspects of the Proposal
    - Multifamily agency securities should be expressly exempt from the Proposal.
    - Existing safeguards in multifamily agency finance, including the use of a good faith deposit, should be deemed as satisfying any potential margin requirement.

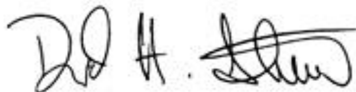
- For the Single-Family Residential aspects of the Proposal
    - The mortgage banker exemption should be expanded to apply to variation margin; or
    - The margin threshold should be significantly raised to minimize the number of instances mortgage bankers would incur margin calls.

We also believe that FINRA has not adequately considered the economic impact of the Proposal on the real estate finance markets. Notably, the Proposal does not appear to address the economic impact on multifamily housing finance. We therefore recommend that, prior to adoption of the Proposal, further economic analysis be performed to ensure that these markets are not inappropriately impacted.

Finally, we have been concerned about the brevity of the comment period on the Proposal, particularly given the complexity of the issues involved and the potential impact on the mortgage finance market. MBA will continue to perform its analysis of the Proposal and will supplement our letter, as necessary, with further comments.

Attached are MBA's comments reflecting the perspectives of the commercial/multifamily finance members, followed by the perspectives of the residential housing finance members. Any questions should be directed to Thomas Kim, MBA Senior Vice President, at (202) 557-2745 (tkim@mba.org) or Dan McPheeters, MBA Associate Director, at (202) 557-2780 (dmcpheeters@mba.org).

Sincerely,



David H. Stevens
President and Chief Executive Officer
Mortgage Bankers Association

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[4] The Proposal defines mortgage banker to capture real estate lenders. Specifically, the Proposal reads: "The term 'mortgage banker' means an entity, however organized, that engages in the business of providing real estate financing collateralized by liens on such real estate."

cc: The Honorable Mary Jo White, Chair
The Honorable Luis A. Aguilar, Commissioner
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner

Stephen Luparello, Director, Division of Trading and Markets
Gary Goldsholle, Deputy Director, Division of Trading and Markets
Gary Barnett, Deputy Director, Division of Trading and Markets
Michael A. Macchiaroli, Associate Director, Division of Trading and Markets
Thomas McGowan, Associate Director, Division of Trading and Markets
Randall Roy, Deputy Associate Director, Division of Trading and Markets

Attachments

MBA COMMENTS ON THE MULTIFAMILY HOUSING FINANCE IMPLICATIONS OF THE PROPOSED RULE ON MARGIN REQUIREMENTS FOR THE TBA MARKET (FILE NO. SR-FINRA-2015-036)

November 10, 2015

The Mortgage Bankers Association appreciates the opportunity to comment on the Proposed Rule Change to Amend FINRA Rule 4210 to establish margin requirements for the TBA market (Proposed Rule).[1] MBA recognizes the objectives of the Proposed Rule and shares the goals of maintaining integrity and efficiency in the agency mortgage-backed securities market. For the reasons discussed below, however, the multifamily housing and residential healthcare agency markets[2] should not be subject to the proposed margin requirement during the multifamily agency financing and securitization process.[3]

EXECUTIVE SUMMARY

The Proposed Rule would have significant and unintended consequences on the financing of multifamily apartments, the vast majority of which is affordable to families earning below median income. Although the focus of the Proposed Rule is to impose margin requirements in the single-family "to-be-announced" (TBA) market, the Proposed Rule appears to include in its scope the multifamily housing finance programs of Fannie Mae, Freddie Mac, and the Ginnie Mae/Federal Housing Administration without adequate consideration and without an economic analysis on the impact to multifamily rental housing.

The agency multifamily market has operated efficiently, competitively and subject to strong safeguards (*including the posting of good faith deposits for the benefit of broker-dealers/investors*) under both vibrant and stressed market conditions. Significantly, the forward-settling multifamily agency securitization market is much smaller than the single-family TBA market and, in turn, does not present the systemic risk considerations that appear to be a reason behind the Proposed Rule. With the forward-settling portion of the multifamily market lending about $40 to 50 billion annually in a strong year (compared to annual lending on single-family homes which exceeds $1 trillion), this market does not present systemic risk concerns.

Moreover, the amount of outstanding forward commitments at a given point in time would be only a *fraction* of the total annual lending volume. For example, for the Fannie Mae multifamily program in 2014, the average weekly exposure of outstanding forward commitments was

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[1] 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, 80 Fed. Reg. 63603 (Oct. 20, 2015).

[2] Multifamily housing generally refers to rental housing properties with five or more dwelling units. This includes rental apartments, affordable rental housing, seniors housing and residential healthcare properties (assisted living, skilled nursing, senior living communities, and other facilities), as well as manufactured housing communities and student housing.

[3] Our comments are focused on new issue multifamily agency securitizations, rather than trades of such securities following settlement in the secondary market.

estimated to be only *$3.56 billion*. The average daily transaction volume in the single-family mortgage market is in the range of $100 billion.[4] Thus, the multifamily forward-settling market, while vital to the financing of rental housing, is not large enough to present systemic risk concerns.

The multifamily securitization process, underwriting reviews and the character of multifamily real estate fundamentally differ considerably from the single-family market. The multifamily agency security is backed by a particular loan collateralized by an identified, unique and extensively underwritten multifamily housing property (rather than a pool of yet to be identified single-family mortgages). The asset purchased by the investor is more akin to a whole loan; its form as a security simply provides greater liquidity and the agency guarantee to the investor. Failed trades in multifamily securities are exceedingly rare because of these safeguards, as well as the rigorous oversight provided by Fannie Mae and FHA/Ginnie Mae as bearers of risk in these transactions, and the legal and financial commitment entered into by the borrower/owner to obtain a loan on the identified multifamily property.

With strong market-specific safeguards and oversight by the agencies (Fannie Mae, HUD/FHA, Ginnie Mae[5]), the market has operated for decades throughout different market cycles, including the recent major recession. Long-standing risk management standards, ongoing monitoring, and existing remedies provide strong safeguards that manage counterparty and systemic risk in this market. As a result, the number of failed deliveries is miniscule relative to the total volume of deals completed in this market — strong indicia that existing safeguards have supported lenders and broker-dealers, as counterparties, to continue their operations and fulfill their obligations.

Should lenders be required to post margin (beyond the Good Faith Deposit) for multifamily agency securities, significant burdens would be imposed on market participants, particularly small lenders who finance affordable rental properties. This would be highly disruptive, produce unintended consequences without a commensurate benefit, and potentially impact capital availability in the rental housing market that serves low- and moderate-income households.

Fundamentally, margining is *one tool* used to mitigate certain market risks. *As a means to an end*, margining should not be imposed in a reflexive manner where other safeguards exist and effective risk management tools are utilized, as in the case of the multifamily agency market. In lieu of the one-size-fits-all approach in the Proposed Rule, the Commission and FINRA should consider the existing risk management tools and safeguards in multifamily agency finance, including the Good Faith Deposit, extension fees and oversight by the agencies and regulators that have been tailored to the multifamily finance market and have been effective over many market cycles as fully addressing the objectives of the proposed margining requirement.

As discussed in detail below, we <u>recommend</u> the following for multifamily agency transactions:

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[4] *Margining in Agency MBS Trading*, TMPG, November 2012 ("Because the majority of transactions settle just once a month and trading is conducted using forward settlement, gross unsettled and unmargined bilateral agency MBS transactions could be in the range of $750 billion to $1.5 trillion at any point in time.")

[5] Both the Federal Housing Administration (FHA) and Ginnie Mae are part of the U.S. Department of Housing and Urban Development (HUD). Ginnie Mae largely operates as an independent agency within HUD.

- The rule should exempt multifamily transactions from coverage under the margin requirements. The multifamily finance market was not the reason why policymakers considered margin requirements on agency securities, nor does this market present the systemic and counterparty risks that appear to have motivated the development of the rule.

- The Commission and FINRA should expressly treat the *Good Faith Deposit (held by/for the benefit of the broker-dealer/investor)* as fully satisfying (and serving as a cap) for any margin requirement, including "variation" margin.

- Any requirement to mark-to-market on a daily or frequent basis (as contemplated by the Proposed Rule) should be eliminated, given the difficulties associated with applying the mark-to-market regime to unique multifamily properties.

- Given the depth of the issues presented, an economic impact analysis on the multifamily rental housing industry should be fully performed prior to the rule being finalized. And given the potential shock to the multifamily market (for which these rules were not designed), any implementation period must be multi-year.

I. OVERVIEW OF FORWARD-SETTLING MULTIFAMILY AGENCY SECURITIZATION

Multifamily housing refers to rental housing properties with five or more dwelling units and includes rental apartments, affordable rental housing, seniors housing, student housing, and residential healthcare properties. Residential healthcare properties include a range of property types, including assisted living, skilled nursing and other facilities, which are eligible to be financed through the agencies.

The multifamily agency securitization process differs considerably from that of the single-family TBA market. For the forward-settling portion of the multifamily agency market, a security is backed by a particular loan collateralized by an identified, unique and extensively underwritten multifamily housing property — rather than a pool of yet-to-be identified single-family mortgages. In substance, the asset purchased by the investor is much more akin to a whole loan; its form as a security simply provides greater liquidity and the agency guarantee to the investor. The average loan balance originated for multifamily and healthcare mortgages in 2014 was $9.65 million for FHA and approximately $12.3 million for Fannie Mae.[6] The borrowers/owners of the properties tend to be institutional entities, although there can be family-owned properties in the smaller multifamily housing market.

The lender and broker-dealer in the multifamily agency market are intermediaries that ultimately connect the borrower/owner to the investor of the security. The lender underwrites the multifamily property subject to agency guidelines and oversight (Fannie Mae, Ginnie Mae, and HUD/FHA) that govern the origination of the loan and the lender itself.

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[6] The proposed rule covers forward-settling agency securities. Therefore, agency models that do not utilize a forward trade would not be directly impacted by the rule. As discussed below, margining requirements could reduce competition among the agencies and other capital sources, which would not be beneficial to the market.

Multifamily Underwriting and Due Diligence

The underwriting and due diligence processes are extensive. The lender engages in a detailed examination of the multifamily property, an income-producing asset, including a property inspection, appraisal, engineering, environmental and structural assessments, a careful review of the financial details of the property, and a review of the geographic market in which the property is located. The lender also carefully evaluates the borrower entity, its key principals, financial capabilities, and historical performance in owning and operating income-producing real estate. The process, typically taking months, is comprehensive, and both the borrower and lender are fully engaged.

Rate Lock and Good Faith Deposit Held By/For the Benefit of the Broker-Dealer/Investor

If all underwriting requirements, contractual terms and agency-provided guidelines are met, a rate lock agreement is executed between the borrower and the lender on an identified, underwritten multifamily property. The borrower has a strong incentive to lock the interest rate as soon as possible to solidify loan terms. The rate lock is a legally binding commitment, which, among other things, requires a Good Faith Deposit to be provided to the lender. *The Good Faith Deposit is paid to or held for the benefit of the broker-dealer or the investor of the security.* This incentivizes the borrower to complete the transaction; the borrower may also be liable to the lender for all damages, obligations and liabilities relating to a failed closing of the loan in an amount equal to the lender's liability to its counterparty on the trade, the investor. The borrower accepts this performance risk to eliminate its interest-rate risk (market risk) that occurs during the time of the rate lock and until the time the loan is closed and funded.

Forward Settlement, Trade Confirmation and Risk Management

At the time the lender locks the rate on the loan with the borrower, the lender is, in effect, selling the loan (at the terms and rate identified with the borrower) on a forward-settling basis to a broker-dealer or institutional buyer, who is a sophisticated party able to hedge its exposure to market risk. The trade is documented in a Trade Confirmation Letter that is signed by both parties upon execution of the trade. The Trade Confirmation Letter specifies the terms of the specific underlying loan and identifies the security. This documentation includes terms for the purchase price, amount of the Good Faith Deposit held for the benefit of the broker-dealer/investor, delivery, extensions, settlement, and other representations and warranties.

Through this trade, the lender hedges its interest-rate risk during the time of the rate lock until the time the loan is securitized and delivered to the dealer or investor. *As a result, under the terms of the "mortgage banker" exemption in the Proposed Rule, we believe that multifamily mortgage bankers would be exempt from the maintenance margin requirement*.[7] The lender also manages its counterparty risk by performing due diligence on the borrower, the income-producing multifamily rental property, and the broker-dealer, including but not limited to the review of financial statements, credit ratings, and establishing counterparty exposure limits. It is worth noting that due to the length of time, certain affordable multifamily projects may not be

[7] 80 Fed. Reg. 63607.

economically viable if the borrower had to assume interest rate risk until the security is delivered to an investor.

The property/loan-specific origination and securitization process for multifamily loans differs significantly from the single-family TBA market where lenders enter into forward TBA contracts while originating single-family loans for delivery. In the single-family mortgage market, lenders seek to fill a pipeline and inventory with mortgages prior to settlement (when pools must be delivered). Single-family originators assume the risk that they will be able to deliver the agreed-upon quantity of loans with similar generic terms by a certain date.

This differs greatly from the multifamily agency securitization market, where the underlying loan has been identified and underwritten, and is already committed to by both the borrower and the lender. Meaningful penalties exist for the borrower if the borrower were to fail to close the loan.

End-User Exemption Analogue

Multifamily agency lenders present a vastly different counterparty profile than secondary market trading firms. An appropriate analogue is the "end user" exemption that is utilized in other securities regulatory contexts. For example, the CFTC's final swap rules exempt from the clearing requirement swaps entered into for the hedging or mitigation of risk. The policy purpose is to allow firms that are not actively "taking a position" in the market to hedge risks that arise as an incidental part of conducting business, without incurring prohibitive regulatory burdens. The forward-settling nature of new issue multifamily MBS exists to allow borrowers to rate lock their loans. The forward commitments entered into help facilitate that process and mitigate risks that arise incident to that activity. Margining, therefore, should not be required in this context.

II. THE MULTIFAMILY FORWARD-SETTLING AGENCY MARKET DOES NOT POSE SYSTEMIC RISK

Systemic risk concerns appear to be a central reason for requiring margin in the multifamily forward-settling market. The Proposed Rule highlights the rationale in a report by Treasury Market Practices Group (TMPG) by stating that "to the extent uncleared transactions in the TBA market remain unmargined, these transactions 'can pose significant counterparty risk to individual market participants' and that 'the market's sheer size . . . raises systemic concern.'"[8]

The TMPG's release that accompanied its report summarized the purposes for which margining is recommended: "A sizeable portion of the non-centrally cleared agency MBS market currently remains unmargined, posing both counterparty and systemic risks to overall market functioning if one or more market participants were to default."[9] While the concerns raised in the TMPG's paper may be applicable to certain securities markets, the new issue multifamily agency market contains safeguards that make the potential for a systemic event highly remote.

Given both the smaller size of this market and the structural characteristics of multifamily asset-based lending, we do not believe that this market presents systemic risk.

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[8] 80 Fed. Reg. 63604, citing to *Margining in Agency MBS Trading*, TMPG, November 2012.

[9] *TMPG Recommends Margining of Agency MBS Transactions to Reduce Counterparty and Systemic Risks*, TMPG, November 14, 2012.

Size of Forward-Settling Multifamily Agency Securitization Market

While the multifamily agency market is a critically important source of financing for rental housing in the U.S., the volumes are not large enough to pose systemic risk concerns. In 2014, forward-settling multifamily executions originated approximately $43 billion in multifamily lending,[10] compared to the over $1 trillion in single-family mortgage originations.

Moreover, it is important to recognize that only a *fraction* of the annual origination volume is outstanding during a forward commitment period at a given point in time. For example, while the total originations under Fannie Mae DUS program for 2014 was $28.9 billion, the weekly average amount of outstanding forward commitments in the Fannie Mae DUS program is estimated to be at about *$3.56 billion*.

Asset-Specific Lending as Risk Mitigant

The asset-specific lending character of this market largely confines the risk to the identified asset and isolates it from "contagion risk." Since multifamily properties are heterogeneous, each agency multifamily security is property-specific with the terms of the mortgage loan and security known at the time of forward trade. Unlike in the single-family mortgage market, multifamily agency lenders do not enter into forward TBA contracts and seek to fill a pipeline and inventory with mortgages prior to settlement (when pools must be delivered). Single-family originators assume the risk that they will be able to deliver the agreed upon quantity of loans with similar generic terms by a certain date. This differs greatly from the multifamily agency securitization market, where the underlying loan is already committed to by both the borrower and the lender, with meaningful penalties to the borrower for failing to close the loan.

The multifamily execution risk is backed by the Good Faith Deposit held for the benefit of the broker-dealer or investor and managed by the terms of the rate lock agreement with the borrower. In the event of a delivery failure, financial relief for losses comes from remedies provided in the transaction documents — there is not a market mechanism to replace the security with another similar security, given that the trade is for a specific security backed by an identified multifamily loan. In other words, the trades and securities are *not fungible*, as the multifamily transaction stipulates a specific asset — a loan on an identified, unique multifamily property.

Because the entire securitization transaction is driven by the identified, income-producing multifamily property that is under lender due diligence for months, risks are largely isolated to the particular transaction. The borrower cannot simply and easily switch lenders or capital sources based on market fluctuations. Breakage fees are substantial, and costly third-party reviews have been performed that cannot be readily transferred to another lending source. In addition, the months required to switch capital sources would prevent borrowers from capitalizing on short-term interest rate movements, as the lengthy underwriting process for the borrower would have to begin again upon switching lenders. Consequently, the concerns about systemic risk are clearly not applicable to the multifamily agency MBS market.

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[10] The reference to $43 billion in 2014 multifamily forward settling agency transactions is the combined volume of the 2014 Fannie Mae and FHA/Ginnie Mae multifamily programs.

De Minimis Number of Delivery Fails as Reflection of Existing Safeguards

There have been very few settlement fails in the history of the forward-settling multifamily agency market. Many lenders have reported that they have experienced no delivery fails or one or a few fails *during their entire history as agency lenders*.[11]

The de minimis number of delivery fails is strong *indicia* that the safeguards and counterparty risk protections in the market have been effective, even during periods of severe market disruption. In other words, the extremely small number of delivery fails demonstrates that lenders, as counterparties, continued to operate as ongoing concerns and fulfilled their obligation as loan sellers and/or issuers. We understand the same to be true for broker-dealers as counterparties in the multifamily agency market.

III. EXISTING SAFEGUARDS AND RISK MANAGEMENT IN THE MULTIFAMILY FORWARD-SETTLING AGENCY MARKET

Strong safeguards already exist to provide counterparty risk protections in the multifamily agency MBS market that obviate the need for the proposed margining requirements.

Good Faith Deposit Held By/For the Benefit of the Broker-Dealer

Upon rate lock, multifamily MBS trades are backed by a legally binding contract with the borrower. As part of this contract, the lender requires the borrower, among other things, to place a Good Faith Deposit for the benefit of the broker-dealer or, if applicable, the ultimate investor in the security. The borrower may also be liable for all damages, obligations and liabilities relating to a failed origination of the loan in an amount equal to the lender's liability to the counterparty on the trade (investor) under the rate lock.

The Good Faith Deposit collected from the borrower is typically 2 percent for Fannie Mae DUS loans and *0.5 to 1 percent for loans securitized through Ginnie Mae. The Good Faith Deposit, as collateral that is posted, is a form of margin.* Given that Ginnie Mae and Fannie Mae somewhat appeal to different market segments, *the difference in the amount of Good Faith Deposit reflects each agency's evaluation of market dynamics and execution risk*. Extension fees are also required where there is an inability to meet the original closing timeframe under the rate lock agreement.

Agency/Regulatory Oversight and Counterparty Risk Measures

The agencies (Fannie Mae, Ginnie Mae and HUD/FHA) exercise extensive oversight and monitoring of lenders that originate multifamily loans and securitize through forward-settling platforms. Fannie Mae, for example, performs regular monitoring of transactions and oversight of all (currently 25) of the DUS lenders' operations and performance. This includes periodic on-site lender assessments, on-going transaction reviews, and a review of financial and business eligibility. Lenders submit quarterly financial information and attest to compliance with required capital levels, including restricted liquidity, operational liquidity and net worth requirements.

[11] Among the small number of delivery fails that have occurred, a common cause was a property-level event (rather than a counterparty risk-driven cause), such as property damage caused by a natural disaster.

Restricted liquidity must be held at a U.S. bank and is monitored on a monthly basis. If the monitoring reveals negative trends, Fannie Mae may increase the frequency of reporting and communication with the lender's senior management; require submission of an action plan to address risk and liquidity issues; and require posting of additional restricted liquidity and maintenance of additional operational liquidity. These safeguards place stringent requirements on the financial condition of DUS lenders.

For FHA lenders who securitize through Ginnie Mae, HUD requires lenders to submit evidence that they have complied with HUD approved Quality Control Plans at least twice annually. If there is a certain level of nonperforming loans, HUD will meet with senior executives to discuss workout approaches. FHA also requires lenders to submit audited financial statements annually, and requires lenders to meet net worth and liquidity requirements. Ginnie Mae also has higher net worth and liquidity requirements for Ginnie Mae issuers than those for FHA lenders that do not issue Ginnie Mae securities. Compliance with these standards are subject to annual audits.[12] Ginnie Mae independently sends outside auditors to lenders/issuers[13] for an audit at least every three years and more frequently if any material deficiencies are identified.

Beyond the above *direct* oversight/regulation of individual lender/issuers, the lender manages its counterparty risk by performing due diligence on the borrower, the income-producing multifamily rental property, and the broker-dealer, including but not limited to the review of financial statements, credit ratings, and establishing counterparty exposure limits. Likewise, broker-dealers manage their counterparty risk by performing due diligence on the lenders, including but not limited to the review of financial statements, compliance with agency (FHA, Ginnie Mae, and Fannie Mae) requirements, and establishing counterparty limits.

<u>Safeguards that Govern *Prior* to Rate Lock</u>

It is important to note that even prior to the rate lock and posting of the Good Faith Deposit, numerous steps have occurred to align the interests of the parties to complete the transaction and avoid a delivery failure.

A rate lock is virtually always issued after the multifamily loan and property has been fully underwritten, including the performance of an appraisal, and engineering and environmental analyses. For loans to be purchased by Fannie Mae in the DUS program, the lender not only must meet underwriting guidelines, the lender may share in the risk of loss with Fannie Mae, either in a first loss position or on a pari passu basis. For loans to be insured by HUD and securitized through Ginnie Mae, the *lender must submit the loan application to HUD*, and HUD must issue a firm commitment. After draft loan documents have been prepared and submitted to HUD for approval, the lender/issuer and HUD must both agree that the transaction can proceed forward and set a target date for closing. This is, again, in stark contrast to the "TBA" character of single-family homogeneous mortgage pools where the underlying loans have not been identified at the time of the trade.

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[12] *See* Ginnie Mae Handbook 5500.3, Rev-1 Paragraph 3-8.

[13] The Ginnie Mae website in November 2015 lists 57 approved multifamily and healthcare finance issuers.

Completion of the underwriting and due diligence that takes place prior to rate lock provides strong alignment of objectives between the borrower and lender to consummate the transaction. Borrowers also pay a commitment fee for processing of the loan, another incentive for the borrower to close the transaction. These steps, in effect, significantly help manage counterparty and execution risk during the forward-commitment period.

Agency Remedies and Ability to Assign Loan to Another Lender

In the very unlikely situation that a lender files for bankruptcy or experiences severe financial hardship during the forward-settling period, HUD/Ginnie Mae could direct the loan to be assigned to another issuer to complete the delivery. Ginnie Mae requires assignment documents to be executed at closing and submitted to the agency for issuance of the security.[14] For Fannie Mae DUS transactions, Fannie Mae is the purchaser of the loan and issuer of the MBS (with the lender receiving either cash or more typically an MBS). Fannie Mae has substantial latitude and authority to address anomalous situations involving lender default. In addition, where lenders utilize a warehouse line made available by Fannie Mae, additional remedies would exist to address a lender-collapse situation.[15] Thus, in extraordinary situations, where necessary, agency remedies exist that would limit counterparty risk to the broker-dealer/investor.

IV. MARGIN REQUIREMENTS ON MULTIFAMILY WOULD BE DISRUPTIVE AND LEAD TO UNINTENDED CONSEQUENCES WITHOUT A COMMENSURATE BENEFIT

Disruptive Impact on Multifamily and Affordable Rental Housing

The forward-settling multifamily agency market enables the borrower to rate lock and the lender to mitigate interest-rate risk, thereby allowing the lender to finance additional multifamily projects and provide liquidity to the market. A margining requirement would effectively impose additional liquidity requirements creating a barrier to entry for smaller lenders and placing liquidity pressures on multifamily agency lenders broadly. Particularly given the safeguards and protections that already exist in the market (*e.g.*, the Good Faith Deposit, agency oversight and regulation, and counterparty risk management measures), we believe the negative consequences outweigh any incremental benefit.

Requiring lenders to post margin for multifamily agency securities would pose significant burdens on market participants, disrupt mechanisms that are currently in place, and result in unintended consequences. The liquidity and operational burden would be particularly detrimental to smaller lenders. Small, non-bank-owned lenders, who tend to finance more affordable rental properties with Ginnie Mae or Fannie Mae, will face difficulty in implementing margining mechanisms; the personnel, infrastructure and resources needed for these firms could be cost prohibitive.

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[14] Ginnie Mae MBS Guide, Appendix V-1, Chapter 6(C).

[15] After funding a loan, lenders have the ability to assign the loan to Fannie Mae that will be placed on the warehouse line and delivered back to the lender prior to settlement through a simultaneous redelivery confirmation (back to the lender) and the warehouse line sale (to the dealer). If a lender were to become insolvent while loans were on the warehouse line, Fannie Mae would work with the dealer to deliver the bonds.

Even for large lenders with diversified operations, changes to the current procedures and arrangements between dealers and lenders would require significant effort and lead time (in addition to dealing with the inherent difficulties of marking-to-market heterogeneous assets, as discussed below). And even if "two-way" margin were to be imposed, the requirement to do so would remove the ability of the lender to determine whether the cost of mitigating a remote risk is worth the benefit of reducing such risk.

Inherent Difficulties of Marking-to-Market

Mark-to-market valuation for multifamily loans will be difficult and, in some cases, nearly impossible to do in an accurate or consistent manner. Multifamily agency MBS, like the underlying collateral, is heterogeneous and different dealers will often provide differing bids on a bond. This would compound the difficulty of determining how much margin would need to be posted.

Price discovery will be challenging at best and likely cause disputes among lenders and dealers, exacerbating the time and resources expended to comply with the requirement. *There are no widely used indexes, exchanges, or virtual marketplaces to trade agency multifamily MBS at this time*. Each bond is sold via direct placement or auction to set a rate for a specific property with specific characteristics, *e.g.*, asset/product type, loan term, prepayment protection, amortization, interest only period, and lien position. An adjustment to one of the variables above may increase/decrease the rate by 15-20 basis points. Additionally, the same loan may have a bid range of up to 20-40 basis points from different dealers depending on the desirability of the specific real estate property to be financed. A highly structured loan with a few special disclosures may never be offered again, making on-going mark-to-market valuation purely subjective.

Differences in perceived value will result in disputes, which will require time and effort to resolve. The mark-to-market issue could be even more problematic for construction loans that back Ginnie Mae Construction Loan Certificates (CLCs).[16] Notably, the availability of FHA new construction/substantial rehabilitation loans that are securitized by Ginnie Mae during construction/rehabilitation state is a hallmark of the FHA program and is a primary construction-to-permanent loan structure that supports affordable and workforce multifamily housing and residential healthcare facilities.

Unintended Consequences

Imposing margining also would raise the cost of capital of forward-settling executions, shifting capital away from certain agency executions and toward others. Borrowers will be incentivized to approach other sources, thereby reducing the level of market competition, and putting forward-settling capital sources at a strong disadvantage. This would reduce the positive diversification

[16] The Ginnie Mae program is unique in that the new construction or substantial rehabilitation of a multifamily or residential healthcare property is financed through one long term loan with two securities – one for the construction loan phase (CLCs – a series of CLCs are issued and settled as draws occur during the construction period) and the other for the project's permanent loan (PLC – issued in exchange for the outstanding CLCs when the loan is converted to a permanent loan). Counterparty exposure is reduced incrementally over the construction term. Borrowers draw funds according to their construction schedule throughout the term and the individual construction draws are delivered to the investor (dealer) on a pro-rata basis, thus reducing the counterparty exposure.

of capital sources that currently exists in the multifamily finance market and reduce market liquidity that supports multifamily rental housing. An incentive would also be created to trade multifamily MBS away from broker-dealers who are required to impose margining.

The affordable rental housing market, in particular, could be disproportionately harmed. Capital sources, whether equity or debt, are often limited for "targeted affordable properties," such as those supported by the federal low-income housing tax credit, historic tax credits, or city or local government grants. The capital that would be necessary to provide margining may not be available from any of the market participants that are constructing, rehabilitating or refinancing an affordable rental property. Notwithstanding the limited availability of capital for these property types, the same safeguards and protections noted above exist, including the Good Faith Deposit and stringent oversight and monitoring by the agencies.

Likewise, many borrowers (who may ultimately bear the cost of margining) are not in a position to post significant margin beyond the Good Faith Deposit. A significant number of borrowers who own, operate and renovate affordable rental housing are smaller institutions or nonprofit organizations. Unable to post margin (beyond the Good Faith Deposit), such borrowers would be unable to lock-in a long-term fixed rate during the underwriting and closing process, which would significantly increase their execution risk. The effect could be that modest multifamily rental properties, seniors housing properties, or affordable apartment buildings may not get constructed, renovated or rehabilitated.

In sum, given the protections and oversight that currently exist, margining as proposed is neither necessary nor beneficial. Conversely, imposing margining will cause harm by creating disruption, placing at risk certain lenders and/or borrowers without the infrastructure or resources to implement margining. This, in turn, would impede capital flow to a market that largely serves low- to moderate-income families who rent their homes.

V. THE PROPOSED RULE'S ECONOMIC AND OTHER IMPACTS ON THE MULTIFAMILY MARKET WERE NOT CONSIDERED

FINRA does not appear to have considered the Proposed Rule's economic impact on the multifamily rental housing market. The Proposed Rule scopes in multifamily agency securities in a footnote by referencing the views of the Treasury Market Practices Group, a best practices group.[17] We are deeply concerned by the abbreviated manner with which the Proposed Rule sweeps in multifamily rental housing sector with little or no justification.

FINRA's policy on economic impact assessments contains three key principles: FINRA will a) consult with key stakeholders in the development of rules; b) provide clarity about the objectives and potential impact of rule proposals and alternatives considered; and c) obtain supporting evidence where possible.[18] MBA greatly appreciates the ongoing dialogue with FINRA. We are

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[17] 80 Fed. Reg. 63605, note 27.

[18] FINRA, *Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking* (Sept 2013)

(available at: www.finra.org/sites/default/files/Economic%20Impact%20Assessment_0_0.pdf). Similarly, the Commission has established a very high burden for evaluating the economic impact of rulemakings. *See Current Guidance on Economic Analysis in SEC Rulemakings*, March 16, 2012. (https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf)

very concerned, however, that the Proposed Rule does not address the multifamily rental housing market with regard to the latter two principles. Consequently, we believe that the multifamily finance market should be exempted from the rule.

Finally, given the significant impact that the Proposed Rule could have on the multifamily finance market if adopted as proposed, we believe it is imperative that a sufficient implementation period be provided for any new or amended requirements in this area. At a minimum, we recommend that such an implementation period be at least two years.

CONCLUSION

The size and limited exposure of the multifamily forward-settling agency market, the safeguards that already exist to address counterparty risk, and the agency oversight and monitoring of multifamily agency lenders strongly indicate that margining, as proposed, is not necessary in the multifamily agency market. In lieu of a one-size-fits all approach that would impose harmful consequences, we urge the Commission and FINRA to exempt new issue multifamily agency securitizations from the proposed margining requirements. Any potential rule should also treat the Good Faith Deposit as satisfying any margin requirement, including variation margin, in light of existing safeguards in the multifamily agency securitization market.

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MORTGAGE BANKERS ASSOCIATION

MBA COMMENTS ON THE SINGLE-FAMILY RESIDENTIAL REAL ESTATE FINANCE ASPECTS OF THE PROPOSAL CONCERNING MANDATORY MARGIN FOR TBA TRANSACTIONS (FILE NO. SR-FINRA-2015-036)

November 10, 2015

The residential single-family real estate side of MBA appreciates the opportunity to comment on the Proposal and its impact on borrowers and the residential mortgage market. This Proposal is the culmination of a multi-year effort by FINRA to implement a change made by the Treasury Market Practices Group (TMPG) in late 2012 to its Best Practices Recommendations (Best Practices) for market participants who trade agency TBAs. The Best Practices are binding on primary dealers but serve as recommendations for other market participants. Notably, around this time the Securities Industry and Financial Markets Association (SIFMA) released updates to its Master Securities Forward Trading Agreement (MSFTA) that placed greater emphasis on margining provisions. While specific terms are subject to voluntary agreement between each set of counterparties, the MSFTA is the standard master trading document in the industry. The Proposal resulted from efforts by TMPG to encourage adoption of its Best Practices by market participants other than primary dealers.

The Proposal generally mandates that broker-dealers collect maintenance and variation margin from counterparties who trade TBAs. While the Proposal exempts mortgage bankers who are hedging their origination risks from initial margin requirements, it would require broker-dealers to collect variation margin from mortgage bankers for the entire amount of any adverse price movement once the mark-to-market exposure exceeds $250,000. [1]

For example, a mortgage banker may originate $100,000,000 per month over the course of a year,[2] and would typically sell forward roughly the same amount in TBAs to hedge the resulting interest rate exposure. Assuming no other mitigating factors, the Proposal would require this mortgage banker to incur a margin call equal to the entire price movement once the adverse price movement exceeded 25bps, a common movement even during calm market periods.[3] The broker-dealer would be required to collect the margin amount on the next day and liquidate the position if the exposure continues for more than five days.

MBA strongly recommends that the Commission disapprove the Proposal. MBA urges FINRA to exempt mortgage bankers' TBA hedge transactions from the Proposal's variation margin requirement, thus allowing broker-dealers and mortgage bankers themselves to manage this critical risk management tool. To highlight a recent example, the "taper tantrum" during the summer of 2013 saw substantial interest rate volatility, with rates rising then abruptly falling,

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[1] Subject to a netting provision that is largely inapplicable to mortgage bankers.

[2] A mortgage banker with this volume is considered Small under MBA's Peer Group Survey.

[3] For example, according to data provided by a regional bank MBA member, the two year trading period from 10/25/13 through 10/26/15 saw the prices on the FNMA 30year 3.0% TBA security range 8.53 points, and prices on the FNMA 30year 3.5% TBA security ranged more than 6.4 points. The standard deviations of the day-to-day price changes were 32.5bps and 26.4bps, respectively.

before rising again for much of the remainder of the year. Despite this significant volatility, mortgage bankers remained sound counterparties, and the market continued to function unimpeded. This is a testament to risk management practices that are prevalent among broker-dealers who offer trading lines to mortgage bankers.

I. BACKGROUND

Mortgage bankers provide mortgage applicants with the ability to lock-in an interest rate on their mortgage loan while the mortgage bank underwrites and processes the loan application. This process allows consumers to secure a rate that will be used to underwrite their mortgage application, ensuring that if market rates increase the lender will still be able to close the loan at the rate for which the borrower was initially qualified. If this "rate lock" is not hedged, originators would be at risk of closing a loan that is "underwater" from a market standpoint if rates rise. Therefore, mortgage bankers enter into TBA trades to both mitigate this interest-rate risk and to provide the benefit of certainty to the consumer.

Mortgage bankers generally enter into forward TBA contracts whereby the originator agrees to deliver the loans expected to close into a future Ginnie Mae, Fannie Mae or Freddie Mac MBS at a specified price, to be settled generally within 30-90 days from the date the TBA is entered into. This process creates a hedge for the mortgage banker which puts the originator into a "risk neutral" position that preserves the revenue margin needed to cover the bank's loan origination and operating expenses, plus the target return on capital. In other words, the value of the newly originated mortgages and loans held for sale will offset the change in value of the forward-commitment.

Once the loan is closed, the originator continues using those same forward TBA contracts to hedge the loans held for sale until the agency MBS pool is created and the TBA is settled. In many cases, the forward-settling trade also acts as the mechanism by which the lender delivers the loan to the secondary market.

As a matter of course, mortgage bankers provide their broker-dealers with access to the information necessary to ensure that the mortgage bankers are sufficiently capitalized and are using the forward-settling trades prudently to hedge their exposures. Through this on-going monitoring, broker-dealers and hedge advisors would be able to confirm that the mortgage banker is not speculating. This information is ordinarily exchanged both at the time a trading relationship is established and on an on-going basis to ensure there have not been material changes in the strength of the counterparty. As the trading relationship develops, the broker-dealer gains an even more intimate understanding of the flow of their counterparties' business – allowing the broker-dealer to spot behavior that is out of the ordinary.

With this due diligence in place, many broker-dealers establish margin thresholds far higher than would be mandated under the Proposal to reduce the operational and financial burden on their clients, instead compensating themselves through the spread charged to execute the trade. This practice allows mortgage bankers to allocate their liquidity to funding loans for consumers at competitive rates. Notably, the Proposal already relies on this due diligence to ensure that the existing mortgage banker exemption is being complied with appropriately.

The financial system benefits from TBA trades because the ability to reliably hedge interest rate risk allows for a diverse, competitive market of mortgage bankers to efficiently access the

secondary market and operate nationwide, including in rural and underserved areas. This competitive landscape significantly reduces the concentration of risk which threatens other areas of the financial system and improves the quality of service mortgage bankers are able to offer their clients, including in rural and underserved markets.

II. GENERAL COMMENTS

MBA strongly opposes the Proposal's mandate that broker-dealers collect variation margin from mortgage bankers. Mortgage bankers who are hedging their exposures are rightfully designated as exempt accounts for purposes of maintenance margin, and FINRA should extend this treatment to exempt mortgage bankers from variation margin as well. In addition, FINRA did not sufficiently evaluate the economic impact of the Proposal on the residential mortgage markets. Therefore, MBA requests that the Commission disapprove of the Proposal. Each of these objections will be addressed in turn.

Mortgage Bankers who are hedging their commercial exposures should be treated as exempt accounts and exempted from any variation margin requirements because: a) as hedgers of commercial risk, they are acting as "end users," and end users are ordinarily exempted from mandatory transaction requirements when the transaction is related to hedging risks; b) failing to extend the exemption to cover variation margin would distort the residential mortgage origination markets; and c) the exposures arising from mortgage banker hedging transactions do not represent a systemic risk to the financial markets.

Mortgage Bankers are Acting as End Users

As noted in the Background section, mortgage bankers trade TBAs to hedge their commercial exposures arising from originating loans to consumers and businesses. TBAs represent the most liquid, diverse sample of national borrowers, making it an effective hedge against general market exposures that may arise during or immediately after the origination of a mortgage loan. This market allows lenders to provide prospective homebuyers with interest rate lock commitments, and the additional liquidity facilited by the TBA market helps borrowers receive lower interest rates on their mortgages.[4] In this context, mortgage bankers are acting as "end users" of the financial risks that arise in the course of their commercial activities.

A similar principle was recently ratified by both the Commission and the Commodity Futures Trading Commission (CFTC), which recognized in their joint swaps rules that end users can be unduly burdened by mandatory transaction rules.[5] Further, while the risk to mortgage bankers is financial in nature, it is clearly a commercial risk contemplated by the respective Commissions as worthy of protection against unforeseen consequences and disruptions.[6] MBA strongly recommends that FINRA adopt a similar approach for mortgage bankers, whose financial

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[4] *See* Vickery, James and Joshua Wright, *TBA Trading and Liquidity in the Agency MBS Market*; (available at: http://www.newyorkfed.org/research/epr/2013/1212vick.pdf)

[5] For example, the final swap and securities-based swap clearing rules included end-user exemptions that included under the "small financial institution" entities that would meet FINRA's mortgage banker definition.

[6] *See* 77 Fed. Reg. 139, at 42571 (recognizing that "an entity that may elect the end-user exception can be subject to financial risks related to its commercial activities and that these risks can constitute commercial risks").

exposure is a byproduct of their commercial business of originating real estate-secured loans for borrowers, including prospective homebuyers.

Failing to Exempt Mortgage Bankers From Variation Margin Would Distort the Mortgage Finance Markets

Imposing mandatory, daily variation margin with a minimum transfer amount of only $250,000 would also significantly distort both the single-family and commercial/multifamily lending markets. For single-family lenders, hedging interest rate exposure during the origination and warehousing processes allows lenders to offset the commercial risks of originating loans for mandatory commitment sales into the secondary market, particularly those derived from interest rates.

Mandatory sales, because they result in a commitment to provide an agreed-upon loan delivery balance, often result in better pricing for lenders in return for providing volume certainty to their investors. This allows even small but well-run mortgage bankers to grow and compete for customers against larger or more entrenched market participants. Requiring margin to be exchanged frequently, as would be the case under the Proposal, would impose significant operational costs, driving many mortgage bankers away from mandatory commitments – making them less competitive in offering mortgage products to consumers and further concentrating the TBA market. Alternatively, it would cause lenders to be less willing to provide rate locks to consumers so as not to incur the interest rate-related risks.

Mortgage Bankers that Utilize TBAs for Hedging Purposes do not Represent a Systemic Risk

The Proposal also suffers from being a solution in search of a problem. As FINRA notes in the Proposal, 70% of transactions and 85% of notional TBA trading volume is currently subject to margin obligations, and the majority of this volume is interdealer trading among primary dealers who are required to follow TMPG's Best Practices. It is this high concentration and mutual exposure that TMPG sought to address in changing their Best Practices – indeed, the systemic implications of "daisy chain" trade fails caused by a credit event at a single counterparty was a primary justification put forth by TMPG.[7]

In contrast, mortgage bankers represent a fraction of the overall TBA trading volume. Moreover, mortgage banker activity is distributed across hundreds of lenders, rendering the systemic impact of the failure of a single mortgage banker to be essentially negligible. For example, the TBA market demonstrated its resilience during the financial crisis, weathering the failures of major lenders such as Countrywide, Washington Mutual, Wachovia and others without faltering. Mortgage origination activity, and thus TBA hedging volume, is far less concentrated today, meaning any future failure would be even less impactful.

The Proposal also already includes a mechanism for ensuring that the mortgage banker is hedging rather than speculating as a component of broker-dealer compliance, and this oversight process is readily transferable to monitor the mortgage bankers' activities during the life of the forward-commitment. As long as the position remains a hedge, it should be exempt from mandatory variation margining.

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[7] TMPG, *Margining in Agency MBS Trading*, November 2012.

FINRA did not Adequately Evaluate the Proposal's Economic Impact

FINRA did not adequately consider the Proposal's economic impact. Specifically, FINRA's analysis consisted of a cursory examination of the TBA market over a short period of time, and did not appear to evaluate the financial and other costs the Proposal would impose on mortgage bankers and borrowers. FINRA's analysis led to it concluding that a majority of mortgage bankers would not be impacted by the $250,000 minimum transfer amount.

FINRA's policy on economic impact assessments contains three key principles: FINRA will a) consult with key stakeholders in the development of rules; b) provide clarity about the objectives and potential impact of rule proposals and alternatives considered; and c) obtain supporting evidence where possible. [8] While FINRA engaged in significant, substantive outreach with MBA regarding the Proposal's impact on mortgage bankers, many of the issues raised during these meetings were left unaddressed in the Proposal. FINRA appears to have relied solely on an evaluation of 35 days of trading data from a single broker-dealer, falling short of its internal principle to "obtain supporting evidence where possible."

For instance, FINRA's analysis consisted of a review of data from one broker-dealer across 35 days leading up to and including May 30, 2014. This time-period, which FINRA describes as including positions held as of May 30, 2014, encompassed a modest-volatility period for the year.[9] Additionally, the Federal Reserve was, and continues to remain, a significant presence in the agency MBS market. FINRA's analysis did not control the results of its study against typical market volatility, against the expected withdrawal of the Federal Reserve as an active buyer of TBA-eligible MBS or even to follow its sample data through other periods throughout 2014, rendering its broad conclusion that mortgage bankers are unlikely to be impacted unreliable.

In an effort to evaluate FINRA's review, MBA reached out to members to obtain market data. One such response consisted of the daily pricing information cited above. MBA also received anectdotal information from a member broker-dealer that is also a FINRA member. This information indicates that throughout the entire year of 2014, more than 10% of its mortgage banker clients would have incurred margin calls at least once. This information also determined that these entities would have incurred margin calls on average five times per month.

This review, combined with the daily trading data noted above, leads to the strong inference that many mortgage bankers would face margin calls at least once per month, incurring financial and

[8] FINRA, *Framework Regarding FINRA's Approach to Economic Impact Assessment for Proposed Rulemaking* (Sept 2013) (available at:

www.finra.org/sites/default/files/Economic%20Impact%20Assessment_0_0.pdf). Similarly, the Commission has established a very high burden for evaluating the economic impact of rulemakings. *See Current Guidance on Economic Analysis in SEC Rulemakings*, March 16, 2012.. (https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf) (noting that "….The D.C. Circuit has viewed these provisions, together with the requirement under the Administrative Procedure Act that Commission rulemaking be conducted "in accordance with law," as imposing on the Commission a "statutory obligation to determine as best it can the economic implications of the rule. Similarly, the court has found certain Commission rules arbitrary and capricious based on its conclusion that the Commission failed adequately to evaluate a rule's economic impact.") (at 3).

[9] MBA surveyed active TBA-trading mortgage bank members to gain insight into the daily TBA pricing behavior throughout 2014. *See also* fn3, *supra*.

operational disruption. Unlike trading firms, mortgage bankers are in the business of originating mortgage loans – their commercial activities result in mortgage bankers being "long" mortgages, and this origination activity requires liquidity in order to fund loans and hold them for sale, as well as imparting a clear imperative to hedge the resulting exposures. Requiring mortgage bankers to divert their liquidity from origination to guard against potentially frequent margin calls imposes an acute liquidity risk on mortgage bankers and will limit the availability of credit to borrowers and hamper the competitiveness of many mortgage bankers. Warehouse lenders are unlikely to finance these liquidity needs, and unsecured, standby commitments are likely to be expensive. None of these economic or operational impacts were evaluated by FINRA, nor does it appear that FINRA collected data to conduct such an evaluation.

Finally, FINRA did not evaluate the impact to consumers and other borrowers resulting from an increase in mortgage rates and reduction in competition that would arise due to the Proposal. These effects would be driven by the inability of many mortgage bankers to appropriately hedge their exposures or incur greater costs in doing so – costs that would be passed along to borrowers. FINRA also neglected to analyze the impact of mortgage bankers being forced to switch from mandatory to best efforts delivery commitments, in the process forsaking significant amounts of their gain on sale or limiting their competitiveness in various products.

These objections, each of which was raised in MBA's earlier comment letter, will be addressed more fully below:

Borrowers Will Have Less Access to Credit

The Proposal will harm borrowers by limiting their access to credit. Mortgage bankers who hedge their locked loan pipeline and loans held for sale sell their loans predominantly on a mandatory execution basis. Mandatory execution means that the mortgage banker takes the risk that they will be able to deliver the agreed upon quantity of loans by a certain date. The alternative is best efforts execution, whereby the investor or aggregator assumes the risk of a mortgage banker's failure to deliver the agreed upon volume of loans. Not surprisingly, mortgage bankers who are able to utilize mandatory execution are compensated for this risk through better pricing for their loans, which translates into more competitive rates for borrowers.[10] MBA members have indicated that this premium ranges from 18 to 50 basis points relative to the size of the loan in the current market, imposing a significant opportunity cost on best efforts execution.

Additionally, best efforts execution relies more heavily on aggregators as the investors in the loan, who often require loans to exceed the minimum credit requirements imposed by the Fannie Mae or Freddie Mac (the GSEs). These additional requirements, called credit overlays, effectively make it harder for a consumer to qualify for a loan. For example, many aggregators will not purchase a loan with a credit score below 640 or will impose additional cash reserve requirements on borrowers for loans approaching or exceeding this limit, regardless of compensating factors. Some aggregators also refuse to purchase mortgages made to finance the purchase of a condo. Each of these overlays impose a limit on some borrowers' ability to obtain competitively priced loans.

[10] As a rule of thumb, the pricing needs to be about a quarter of a point better per loan in order for mandatory execution to be worthwhile. Each point in price is worth about 25 basis points in interest rate paid by a borrower.

Mortgage Capital Will Become More Expensive if the Proposal is Not Amended

Moreover, implementing margin monitoring and posting systems represents a significant cost for many mortgage bankers. This cost includes not only the cash to support any margin calls, but also wire transfer, processing, and operational costs. Under the Proposal, these additional costs would need to be recouped through higher interest rates charged to consumers – either to pay for the additional overhead or to compensate for the lower return on best efforts execution. While FINRA did address these costs to some extent, the cursory study contained in the Proposal was insufficient to appropriately gauge the impact of mandatory margining on mortgage bankers.

The expense of establishing the controls and procedures to comply with the Proposal may, in many cases, exceed the value of the counterparty risk against which the margin is intended to protect. These costs will be a dead-weight loss for the duration of the trade and would likely contribute to further consolidation in the mortgage banking industry as companies find themselves too small to comply. Some originators may even be driven to the less profitable best efforts execution, resulting in a significant competitive disadvantage. In fact, these costs could become large enough to drive the mortgage banking industry to consolidate further. Originators may withdraw from certain markets or merge with other companies, limiting consumer choice. This issue is particularly acute for rural and underserved areas where access to credit is already limited.

The Proposal's Terms Will Harm Competition

Since it was released, primary dealers have implemented TMPG's Best Practices recommendation that market participants exchange variation margin while waiting for their TBA transactions to settle.[11] While FINRA's Proposal operationalizes much of TMPG's recommendation, it discards a core theme underlying the recommendation. The TMPG relied on standard market practices to guide the final terms of each trading relationship, allowing market participants the flexibility necessary (within reason) to meet their own capital needs as well as those of their counterparties.

The Proposal, however, allows no such flexibility. Parties trading TBAs with a broker-dealer as part of a prudent hedging strategy in response to commercial risk would be required to post margin once the exposure exceeds the Proposal's minimum transfer amount of $250,000 – regardless of the expected value of the mortgage bankers' pipeline of locked loans and loans held for sale.

It is important to note that most, if not all, MSFTAs to which mortgage bankers are a party require margin to be posted under certain circumstances. The parties themselves negotiate the terms of these agreements, and take into account counterparty credit strength, the experience of the management team of the mortgage banker, and the length and experience of the relationship between the mortgage banker and the broker-dealer. In many cases, the broker-dealer will require audited financial statements, pipeline reports and, in some cases, the use of a third-party hedge advisory firm to ensure that the trading line is being used prudently. A minimum transfer amount of $250,000, with no threshold to act as a buffer, is inconsistent with the standard industry practices for mortgage banker hedge transactions.

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[11] *See* TMPG, *Best Practices for Treasury, Agency Debt, and Agency Mortgage-Backed Securities Markets*, *revised* May 2013 (available at: www.newyorkfed.org/tmpg) (emphasis added).

One of the Proposal's unintended consequences will be the further expansion of Fannie Mae's footprint in the secondary mortgage market. Fannie Mae's cash window provides competitive funding terms that are in many cases superior to other best efforts execution channels in either price, funding speed, or both.[12] Moreover, Fannie Mae's capital markets desk is not subject to FINRA regulation. While Fannie Mae has indicated that it will follow TMPG's recommendation, it has set its margin threshold at $3,000,000, with a $50,000 minimum transfer amount.[13] These terms dwarf what the Proposal would allow a FINRA-regulated broker-dealer to offer even its safest counterparty. At a time when comprehensive reform of Fannie Mae and Freddie Mac is a top priority of both Congress and the Administration, FINRA should not promulgate rules which hamper the private market's ability to compete in the secondary mortgage market.

Given the cursory nature of the residential analysis and the lack of any consideration of the above factors, FINRA lacks sufficient basis to assert that it "does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act."[14] Further, FINRA's assertion that mortgage bankers are unlikely to incur margin calls under the current Proposal lacks sufficient empirical support.

For these reasons, MBA strongly urges the Commission to disapprove the Proposal in its current form. MBA urges FINRA to amend the Proposal to extend the mortgage banker exemption to cover variation margin in addition to maintenance margin. Alternatively, FINRA should significantly increase the threshold for TBAs in order to alleviate the burdens described above and allow mortgage bankers and their broker-dealer counterparties the ability to calibrate their risk management protocols within this outer boundary.

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[12] Fannie Mae's cash window promises to fund the loan as soon as two business days after delivery. *See* Selling Whole Loans to Fannie Mae at 43

(available at: https://www.fanniemae.com/content/job_aid/selling-whole-loans.pdf)

[13] Fannie Mae, *Selling Guide* Announcement SEL-2013-10 (December 19, 2013).

[14] 80 Fed. Reg. 63609 (October 30, 2015)