May 14, 2021

VIA ELECTRONIC SUBMISSION

Jennifer Piorko Mitchell
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: SIFMA Response to FINRA Regulatory Notice 21-11; Proposed Amendments to the Margin Rule Regarding When Issued and Other Extended Settlement Transactions

Dear Ms. Mitchell,

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on proposed amendments to the margin rule regarding when issued and other extended settlement transactions, as set forth by the Financial Industry Regulatory Authority, Inc. ("FINRA") in FINRA Regulatory Notice 21-11 dated March 15, 2021 ("FRN 21-11"). Although we appreciate FINRA releasing this proposal for comment, we set forth the concerns of our members below.

Executive Summary:

Part I of this letter addresses our comments regarding FINRA's margin proposals with respect to when issued securities offerings (new issues).

By excepting initial public offerings ("IPOs") of equity securities from the requirement to collect margin or incur net capital charges, FINRA has recognized that there are circumstances where the collection of margin or the incurrence of net capital charges is not necessary to protect a FINRA member against credit exposure. These circumstances are not limited to IPOs, however, and we note that FINRA has not articulated a rationale for recognizing this exception for such IPOs, but not for other types of offerings. Given that "extended settlement" in offerings of new issues is generally driven by the financing terms/needs of the issuers or the logistical requirements of documenting the offering, we do not believe that a distinction between IPOs and other types of offerings is warranted in the scheme of the margin

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).

regulations applicable to broker-dealers as contemplated by Congress and the Federal Reserve Board. Therefore, we strongly urge FINRA to reconsider its proposal to exclude other offerings, other than IPOs of equity securities, from the scope of the exception. We believe that the collection of margin and the imposition of net capital charges for settlements of new issues that occur beyond T+2[2] – for all offering/security types (equity, debt, asset-backed securities, municipal and U.S. government securities) - would be operationally complex, and would require a substantial (in terms of cost and time) design and implementation effort for new operational processes and controls to (i) attempt to collect margin from customers who do not maintain margin accounts at the member and who likely will not be accustomed, or set up, to satisfy margin calls in a timely/required manner and (ii) monitor and calculate net capital charges in lieu of collecting margin under (i). Again, we strongly urge FINRA to reconsider its position on this topic.

While members with a larger capital base will more readily be able to absorb these net capital charges, smaller firms may be disadvantaged and may not be able to participate in certain new issue offerings. Even for larger firms, incurring these substantial and costly net capital charges could result in underwriters encouraging issuers to shorter settlement periods which could raise borrowing/financing costs for issuers. In this regard, we believe that FINRA's when issued proposals may in some instances adversely impact the ability of issuers to take advantage of favorable market opportunities to manage their balance sheets/financial needs, and may result in the imposition of substantial, and costly, net capital charges on member firms whose customers will balk at the provision of margin because the issuer has chosen to settle the offering on a longer than T+2 basis, and not because the customer is unable to pay for the securities.

Because the closing/settlement dates of new issues of non-equity/debt securities (or any when issued offering) are generally driven by the issuer based on a myriad of considerations, and not due to the ability or willingness of investors to pay, we believe that a FINRA member is not extending credit in the sense contemplated by the margin rules. Rather, it is more akin to being an arranger of credit arising from a delay in setting the closing timeframe by the issuer. In any event, the typical investors in new issuances of debt and other new issues of securities (other than common stock and municipal securities) that are marketed by FINRA members are largely sophisticated and financially secure institutional investors who do not subject members to significant credit risk/exposure.

We emphasize the universal fact that it is the *atypical* debt securities (including for municipal securities and asset-backed securities) offering that will, or can, close by T+2. Requiring a T+2 settlement requirement, or otherwise requiring the collection of margin or, in certain cases, imposing a net capital charge in lieu of collecting such margin, could result in unnecessary additional costs to issuers as well as FINRA members. As noted, FINRA members would likely be subject to substantial additional (and costly) net capital charges as firms would choose to incur these charges in lieu of collecting margin from customers who would not be expecting or willing to provide margin in when issued transactions where the securities are not available for delivery to the customer for some period of time as determined by the issuer, and not by the customers/investors. We set forth herein the various key considerations that dictate the issuer's need for a delayed, or extended, settlement, in particular, for high yield and investment grade debt offerings.

We also note special circumstances relating to new issuances of asset-backed securities;discuss why FINRA's margin proposals should not apply to new issuances of municipal securities because of FINRA Rule 0150(b) and (c), why FINRA Rule 4210 should not apply to "transactions" in municipal securities; and why the exception for new issues of U.S. Treasury securities is too narrowly written, which

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[2] Where "T" refers to the trade date and "2" refers to the number of business days after the trade date. As used herein, "x" in "T+x" refers to the number of business days following the trade date, T.

we believeshould be expanded to encompass new issues by U.S. agencies. We further discuss other proposed exceptions to the general margin requirement for extended settlement situations.

We discuss a suggested harmonization of language used to address a FINRA member's election to take a net capital charge in lieu of collecting margin, as may be available to members, and note that the proposed "cap" on taking net capital charges in lieu of collecting margin is too restrictive and would limit the ability of some members to market new issues because, as noted above, their large institutional customers will likely be unwilling to provide margin for a transaction where the securities are not available for immediate delivery to such investors because of the *issuer's* imposed closing timetable.

Part II of this letter addresses our comments to the proposed definition of "extended settlement", and in particular, our concerns about the inconsistency between the more permissive requirements of Regulation T (for example, generally allowing customers to pay for their purchases by T+4 for U.S. securities, and one day after the required settlement in the applicable market for foreign securities, and allowing customers to deliver sold shares promptly) and the much stricter requirements reflected in the FINRA proposals (for example, generally requiring member firms to collect margin for trades with T+3 and T+4 settlement cycles irrespective of whether the customer is a purchaser or seller, or whether the security trades in a foreign securities market).

We also highlight how the proposed definition would, we believe, adversely impact the market for variable rate demand obligations, which are debt securities that are generally issued by municipal issuers. These debt securities, and other similar securities, are designed by the issuer so that the interest rate thereon resets periodically which, then, dictates the settlement date of the trade (which is typically beyond the second business day after the trade date). We strongly believe that it should not be necessary to collect margin, or incur a net capital charge in lieu thereof, for a security that trades at par given the short term nature of these securities. Because there will usually be no mark-to-market loss on these securities, such a margining requirement is an unnecessary burden on the industry. We also feel that it is a similarly unnecessary burden to impose this requirement on securities that traditionally have a T+5 settlement date to coincide with interest rate resets. To that end we strongly urge FINRA to consider an exception for variable rate demand obligations, and other similar securities, that trade at par or for which regular way settlement is longer than T+2.

We also express comments regarding what should constitute a broker-dealer's "good faith" belief that a customer will make full payment for a purchase of securities in a cash account in the time allotted therefor under Regulation T (a payment period) and suggest a specific exception be added for foreign securities with settlement under foreign settlement cycles that exceed the standard settlement cycle in the U.S. – comparable to an exemption/exception in Regulation T. We further suggest a proposed exception relating to employee stock option/stock purchase plans, and suggest a proposed clarification regarding the impact of the proposals with respect to trades involving sales of securities by customers.

Part III of this letter addresses our comments on the applicability of the proposals to secondary transactions (not when issued offerings) where we state our belief that because bona fide DVP customers are largely institutional investors of substantial financial size, the associated credit risk arising from an extended settlement is low and the proposals for collecting margin or incurring net capital charges in lieu thereof should not apply. We also propose separate exceptions for (i) transactions with exempt accounts and (ii) special situations/distressed trading/post-reorganization of equities with DVP customers for similar reasons.

Part IV of this letter addresses our comments on the proposed changes to the definition of "customer," in particular, regarding the extension of the term "customer" to broker-dealers, including exempted borrowers, and our concern that the proposals are too broad and would have unintended consequences for normal broker-to-broker trading. We suggest that the definition of customer with respect to another broker-dealer be limited to where the other broker-dealer has a carried proprietary account with a FINRA member.

Part V of this letter addresses our comments on whether the proposals should extend to non-security products, such as bank-issued certificates of deposit, because these products should be evaluated on a product-by-product basis which we believe are better addressed through the SEC's net capital rule.

Finally, Part VI of this letter addresses our comments on the potential impact of the proposals on the SEC's customer reserve formula arising from the characterization of when issued transactions as triggering a margin requirement. We note that the characterization of extended settlements in when issued securities offerings as triggering margin requirements could result in the establishment of one-sided debit balances in the customer reserve formula (item 10), reducing the need for reserve/lockup of customers' cash, which could also result in increasing the ability of a FINRA member to rehypothecate customers' securities.

In sum, we believe that FINRA's proposals are so extensive – operationally for member firms, and from a customer and issuer perspective - that FINRA should consider removing these proposals at this time and, instead, commence a dialogue with member firms to better understand and assess the potential impact to their businesses, capital and customers, and to the financing needs of issuers.

I. When Issued Securities Offerings:

We address, upfront, one of our major concerns with FRN 21-11 which is the proposed treatment of "when issued" securities offerings that settle beyond T+2 (an "extended settlement" as defined in the proposals) under FINRA Rule 4210(f)(3).

As discussed herein, FINRA's proposed amendments, and related interpretations, would permit an exception from the requirement to collect margin or otherwise incur net capital charges for extended settlements of IPOs of equity securities, but would not extend such exception to new issues of non-equity/debt securities offerings (including asset-backed securities offerings) or to follow-on or secondary equity offerings. Although we agree with the inclusion in the proposed exception for IPOs of equity securities, we do not believe that there is a meaningful justification to treat, and FINRA has not articulated a rationale to treat differently these other types of offerings. As such, we believe that FINRA's proposal is not warranted and is likely to require FINRA member firms (individually, a "Member") to maintain a significant amount of excess net capital. We think that this would be the case because (i) it is unlikely that Members would elect to collect margin from customers/investors and, instead, would incur net capital charges, where permitted, and (ii) of the need to change the existing, accepted, structure of the when issued market which is characterized by the widespread prevalence of offerings in the corporate debt and asset-backed securities markets with extended settlements (see data set forth below). In addition, FINRA's proposals could complicate the ability of issuers to refinance their capital structure and to quickly access and take advantage of favorable funding conditions. With respect to item (i) above, these proposals would likely restrict the availability of new issues for marketing to "retail" customers (that is, customers who do not qualify as exempt accounts or who are not bona fide DVP customers) because, as proposed, Members could not elect to incur a net capital charge in lieu of collecting margin from such retail investors. We believe that such retail investors (as well as investors who qualify as exempt accounts or bona fide DVP customers, but where the Member may not be eligible to incur a net capital charge in lieu of collecting margin due to FINRA's proposed "caps" on such charges under FINRA Rule 4210(e)(2)(I) as discussed herein), would not be expecting or willing to provide margin as the offered securities are not made available for delivery to them on a T+2 basis due to the timing of such delivery as determined by the issuer, and not due to any willingness or ability of such investors to fully pay for the purchases.

(i) FINRA Rule 4210(f)(3) and as Proposed:

When issued securities offerings refer to new issues of securities – equity or debt – of an issuer (U.S. government, municipal or non-government (including non-profit) issuers) that settle beyond the standard T+2 settlement cycle in the United States as set forth in Rule 15c6-1 under the U.S. Securities Exchange Act of 1934 (the "Exchange Act"), as promulgated by the U.S. Securities and Exchange Commission (the "SEC").[3]

Pursuant to FRN 21-11, FINRA Rule 4210(f)(3) would be amended to state that with respect to any "extended settlement" or net position resulting from transactions in a when issued security in a customer's cash account, "equity must be maintained equal to the margin required were such securities transaction or position in a margin account", unless a specified exception was available.[4]

Thus, the FINRA proposals would treat when issued securities as being "issued" and subject to margin requirements (even in a cash account) in the case of an extended settlement, unless the transaction fits within certain narrow exceptions, as discussed herein. Other than with respect to certain exceptions for IPOs as well as new issues of U.S. Treasury securities and municipal securities (and offerings otherwise excepted by FINRA, as discussed below), even if a Member could avail itself of a proposed exception from having to collect margin from its customers/purchasers, the Member would, still, be subject to incurring a costly net capital charge (that would, potentially, be "capped" for any particular Member).[5] This is in contrast to the treatment of when issued (and when distributed) securities offerings pursuant to Section 220.8(b)(1)(i)(B) and (C) of Regulation T, as promulgated by the Federal Reserve Board (the "FRB") pursuant to Section 7(c) of the Exchange Act, which allows when issued (and certain when distributed) securities to be effected in a cash account without the imposition of any margin requirement (or the imposition of net capital charges) as long as the customer agrees to fully pay for the security within a "payment period" after the security is *made available by the issuer for delivery to purchasers*.[6] The approach under Regulation T is a more rational/logical approach as the Regulation T payment period arises only after the issuer makes the securities available for delivery. This is the only period when the purchaser is actually/technically *able to settle the purchase of* the securities; that is, it is closer to establishing the timeframe for a true extension of credit to customers rather than the period, as contemplated under the FINRA proposals, where the Member, and the customer, are simply waiting for the offering to settle.

(ii) FINRA's Proposed Interpretation of an Exception for Certain Public Offerings:

FINRA Rule 4210(f)(3)(B), currently, provides an exception from the margin requirement in a cash account with respect to a new issues/when issued offering of a security that is the "subject of a primary

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[3] SEC Rule 15c6-1(a) sets the "standard" settlement cycle in the U.S. as the second business after the date of contract, or trade date; however, SEC Rule 15c6-1(a), by its terms, does not apply to securities issued by the U.S. government or municipal securities, among certain other types of securities. Pursuant to SEC Rule 15c6-1(d), the parties are deemed to have agreed to an alternative date for settlement in connection with a firm commitment offering for cash if the issuer and the managing underwriter have agreed to such alternative date and, as such, the parties could agree to a longer settlement period than T+2.

[4] As more fully discussed herein, the term "extended settlement" would be defined in FINRA Rule 4210 to mean "any contract for the purchase or sale of a security (including an exempted security) that does not provide for the payment of funds by the customer (in the case of a customer purchase) or delivery of securities by the customer (in the case of a customer sale) by the second business day after the date of the contract."

[5] Our working assumption for the proposals is that if there is no margin to collect, there should not be a separate net capital charge requirement. We request that FINRA confirm this belief.

[6] Pursuant to Section 220.2 of Regulation T, a "payment period" means the number of business days in the standard settlement cycle in the U.S., as defined in SEC Rule 15c6-1(a) (currently, two business days) plus two business days, or a total of four business days.

distribution in connection with a bona fide offering by the issuer to the general public of 'cash'" (the "Public Offering Exception").

Pursuant to FRN 21-11, FINRA provides its interpretation that the Public Offering Exception "was intended" to exclude from the margin requirement of such rule only "initial public offerings (IPOs) of equity securities on a when issued basis" and, thus, is not available for (i) new issues of non-equity/debt securities[7] - whether registered under the U.S. Securities Act of 1933 (the "Securities Act") or offered pursuant to SEC Rule 144A thereunder or some other exemption from registration thereunder (for example, Section 3(a)(4) of the Securities Act) - as well as (ii) follow-on or secondary public offerings of equity securities by the issuer or a selling securityholder.

We fail to see why new issuances of non-equity/debt securities and other new issues offerings should not be equally entitled to the Public Offering Exception as long as the offering is made to the investor for full cash payment, and we do not believe that FINRA has articulated a rationale to support a distinction from IPOs of equity securities. In particular, debt represents less risk than equity in the issuer's capital structure as debt ranks higher in the capital structure and, in certain, cases will be secured by collateral. Moreover, our view is that the value of debt is, as a general matter, much less volatile than the value of most equity securities as price of debt generally moves based on movements in interest rates, which tend not to be as volatile as price movements in equity securities, including we believe with respect to the volatility of structured notes linked to equity measures (single stocks or equity indices) which are generally more muted than any of the underlying equity measures themselves. Furthermore, the purchasers of convertible, high yield or investment grade debt securities, and other types of new issues as described above, are typically large sophisticated institutional investors who are typically more creditworthy than "retail" investors (defined as those investors' accounts that are neither exempt accounts nor accounts of bona fide DVP customers, as those terms are used herein) who may be purchasing in IPOs of equity securities.

An extension of the Public Offering Exception to new issuances of non-equity/debt securities, and other new issues offerings as described above, should encompass both registered offerings under the Securities Act that are freely transferable as well as offerings conducted pursuant SEC Rule 144A, Regulation S, and other available exemptions from registration under the Securities Act, which are "restricted securities" but which qualify as having a "ready market" per guidance promulgated by the SEC under SEC Rule 15c3-1, the SEC's net capital rule.[8] In this regard, we note that the FRB also incorporates "ready market" criteria into Regulation T with respect to the determination of marginability of "foreign margin stock" in Section 220.2 of Regulation T.[9]

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[7] Because convertible debt securities are "equity securities" within the meaning of Section 3(a)(11) of the Exchange Act and Rule 3a11-1 thereunder, then new issues of convertible debt securities should be covered under the Public Offering Exception as construed by FINRA. We seek confirmation from FINRA on this point.

[8] Pursuant to SEC guidance that is generally set forth in the FINRA Guide to Financial and Operational Rules (the "FINRA Guide") relating to SEC Rule 15c3-1(c)(2)(vii), new issues of non-equity/debt securities sold to institutional investors (qualified institutional buyers) by Members pursuant to SEC Rule 144A are generally deemed to be tradeable in a "ready market." As such, an offering of non-equity/debt securities conducted pursuant to SEC Rule 144A is, as a practical matter, broadly distributed in the institutional marketplace, so that such offerings are generally equivalent to a registered offering of such types of securities that are, typically, distributed to similar institutional investors.

[9] A "foreign margin stock" has loan value under Regulation T if the stock (equity security) in question is "deemed to have a "ready market" under SEC Rule 15c3-1…or a "no-action" position issued thereunder." See guidance that the SEC has issued in this regard via FINRA Regulatory Notice 16-13.

Accordingly, we do not see the need to distinguish IPOs of equity securities and new issues of non-equity/debt securities and other offerings, as described above, for the purposes of the Public Offering Exception.[10]

(iii) FINRA's Authority to Impose Margin Requirements on Members:

Although Section 220.1(b)(2) of Regulation T provides that Regulation T does not preclude any exchange, national securities association (FINRA), or creditor (an Exchange Act-registered broker-dealer) from imposing additional requirements or taking action for "for its own protection," Regulation T specifically allocates responsibility to set margin standards to self-regulatory organizations (an "SRO"), like FINRA, in certain specified circumstances that would otherwise contemplate the imposition of margin, but which are not governed, or not specifically governed, by Regulation T: portfolio margining per Section 220.1(b)(3)(i); intraday margining arising from day trading; margining relating to put and call options per Section 220.12(f)(1) and (2); imposition of maintenance margin requirements; and margining relating to good faith accounts and, relatedly, to broker-dealer credit accounts providing for good faith margin, such as pursuant to Section 220.7(c) (joint back office), Section 220.7(e) (emergency and subordinated credit), Section 220.7(f) (special omnibus credit to registered broker-dealers) and Section 220.7(g) (special purpose credit to other broker-dealers). Thus, we think that Section 220.1(b)(2) of Regulation T does not preclude an SRO, like FINRA, from stepping in and imposing margin requirements where the FRB has declined to do so.

However, where Regulation T does specifically regulate a particular type of securities arrangement or transaction, as in a cash account, but the FRB has specifically declined to impose a margin requirement with respect to certain/specific transactions occurring in a cash account under enumerated, and comprehensive, conditions - such as with respect to when issued (and when distributed) transactions/contracts that meet the requirements for being effected in a cash account in accordance with Section 220.8(d)(1)(i) - we think that the imposition of margin requirements on such transactions is inconsistent with the margining regime contemplated by Congress as set forth in Section 7(c) of the Exchange Act and as implemented through Regulation T.[11]

Thus, we think that it is inconsistent with the requirements of Section 7(c) of the Exchange Act and Regulation T promulgated thereunder for FINRA to impose margin requirements, or net capital charges, on cash accounts where such accounts are specifically, and comprehensively, regulated under Regulation T, and no margin requirements (or net capital charges) are required, or contemplated, thereunder (per Section 220.8 of Regulation T). Further, FINRA's proposals would, in certain cases, permit a Member to incur a net capital charge in lieu of collecting margin, but if margin is not required

[10] We also believe that FINRA has not set forth a rationale that would distinguish among IPOs of equity securities and follow-on offerings of newly-issued equity securities by an issuer.

[11] See SEC Release No. 34-46292 relating to customer margin rules regarding security futures: "Section 7(c)(2) provides that the customer margin requirements for security futures must satisfy four requirements. First, they must preserve the financial integrity of markets trading security futures products. Second, they must prevent systemic risk. Third, they must (a) be consistent with the margin requirements for comparable option contracts traded on any exchange registered pursuant to Section 6(a) of the Exchange Act; and (b) provide for initial and maintenance margin levels that are not lower than the lowest level of margin, exclusive of premium, required for comparable exchange-traded options. *Fourth, they must be and remain consistent with the margin requirements established by the Federal Reserve Board under Regulation T*. (emphasis supplied). See also FRRS 5-650.12: "It is important to note that Congress authorized the Board to establish both *initial* and *maintenance* margins but that the Board has established only initial margins. Further, the Board's imposition of initial margin is only a minimum requirement. Section 220.1(b)(2) of Regulation T permits any securities exchange, national securities association, or broker-dealer to impose additional requirements. *Thus, an exchange or broker-dealer rule could require higher levels than Regulation T does or impose a specific margin when Regulation T requires a good faith margin*." (emphasis supplied).

under Regulation T, there should not be a need to, separately, impose a margin-like requirement through the imposition of a net capital charge.

(iv) When Issued Transactions Where Settlement Is Set by the Issuer Are More Akin to an Arranging of Credit and Not an Extension of Credit by the Member as Contemplated by the Margin Rules:

With respect to a when issued securities offering by an issuer, the determination of the closing date for the offering is determined by the issuer based on various timing considerations applicable to it, and not based on the willingness or ability of a customer/purchaser of a Member (acting as underwriter/initial purchaser) to pay for the securities. As explained more fully below, offerings of new issues of debt securities typically close between three to ten business days after the pricing date (that is, T+3 to T+10), with closing from T+11 to T+14 occasionally occurring, particularly in the market for high yield debt securities. For example, the issuer may wish to align (or more closely align) the closing of a securities offering with the use of proceeds of such offerings, such as repaying outstanding debt or funding an acquisition. Or, the issuer may not have an immediate use of proceeds, but desires to access a favorable pricing market and delay closing to reduce the period of additional interest expense for unused funds. In addition, the issuer may seek a longer than T+2 settlement to finalize the definitive documentation, particularly in a complex transaction, such as a secured note offering or any offering that is made in the context of a larger overall transaction, such as a leveraged buy-out or a recapitalization. These are just the more common considerations driving the timing of closing, but in any event, the timing is driven by the issuer, and not the investors as purchasers of the offered securities.

As such, the Member's role from a margin perspective is more akin to arranging an extension of credit where the issuer primarily dictates the (credit) terms of closing – those terms are just passed onto the customer/investor as set by the issuer. Although the Member will, in a firm commitment offering, have agreed to purchase the securities from the issuer, as principal, on T in order to resell such securities to the investors on T, the typical closing periods for non-equity/debt securities offerings, as described above (and other offerings as described herein), are not overly extended, and involve securities for which there will be a "ready market" as also described above, and so should not present undue credit exposure to Members.[12]

In addition, a Member's role in these offerings also seems more akin to an issuer-directed share arrangement, as contemplated under FINRA Rules 5130 and 5131 (relating to the allocation of "new issues" – generally initial public offerings of equity securities), which allows a Member to allocate new issue securities to purchasers pursuant to the direction of the issuer even though the purchaser may be a "restricted person" or "covered person" under such rules and to whom a Member would, otherwise, not be permitted to sell new issues. The rationale for such an exception, which seems analogous to the proposed application of margin requirements to when issued securities transactions, is that the Member does not direct the allocation decision to the purchaser – that is done by the issuer.[13] Extending the logic of this rationale, a Member is merely passing on, or arranging, the closing terms to/for its customers as determined by the issuer, and on a relatively short-term timeframe. As such, we believe that there should not be a requirement to collect margin on these transactions, or incur a net capital charge in lieu of

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[12] As noted herein, these closing periods would be well within the T+15 requirement for a Member to collect any margin or mark-to-market amount required under current FINRA Rule 4210(f)(6) and, thus, to collect the full payment amount from investors.

[13] See Notice to Members 03-79 of the former National Association of Securities, Inc. under "Issuer-Directed Securities."

collecting any such margin, as any credit extension is in effect determined by the issuer, not the Member.[14]

And, as we have noted, Members believe that customers/investors would not be expecting or willing to provide margin for securities that are not available for delivery to such customers/investors by the issuer until some future date, again where such closing date is determined by the issuer, and not due to the willingness or ability of customers/investors to fully pay for their securities purchase.

Although a Member acting as an underwriter/initial purchaser for new issue offerings may, on occasion, be subject to a "sticky" offering (that is, an offering that is not fully sold to purchasers by trade date), the Member would be subject to a net capital charge on the unsold portion, and the inability of the Member to fully sell the offering would not be due to any inability or unwillingness of customers/investors, to whom the Member has sold securities, to pay for those securities. Thus, we do not think that a sticky new issue/offering involving an extended settlement would increase the credit risk to the Member from those investors who have agreed to purchase the securities. And this risk is mitigated by the numerous contractual safeguards (such as, a material adverse change or "MAC" clause) that are built into underwriting/purchase agreements with issuers.

(v) Potential Adverse Impact to Capital Raising Efforts by Issuers of Non-Equity/Debt New Issuances:

We believe that the imposition of a margin requirement, or net capital charges in lieu of collecting margin, in new issue offerings with extended settlements will result in Members incurring substantial and costly net capital charges. While Members with a larger capital base will more readily be able to absorb these net capital charges, smaller firms may be disadvantaged and not be able to participate in new issues offerings. Even for larger firms, incurring these substantial and costly net capital charges could result in underwriters encouraging issuers to shorter settlement periods which could raise borrowing/financing costs for issuers. This may in some instances adversely impact the ability of issuers to take advantage of favorable market opportunities. And, Members would be potentially capped on the

[14] We acknowledge that under Regulation T, when issued transactions are treated differently if effected in a margin account (and, thus, subject to margining) versus a cash account (and, thus, not subject to margining if the customer makes full payment within a payment period (four business days) after the issuer has made the securities available for delivery to purchasers). But the difference in treatment among these accounts is instructive to the determination of whether there is a "true" credit extension by the Member. For a when issued transaction in a margin account, under Section 220.4(b)(3) of Regulation T, the required margin on a net long or net short commitment is the margin that would be required if the securities were an issued margin security, plus any unrealized loss on the commitment or less any unrealized gain. Presumably, however, an investor would only elect to effect a when issued transaction in a margin account, and become subject to margining when it would otherwise not be so subject if the transaction would be effected in a cash account, when there is a "true" extension of credit by the Member; that is, where the Member will finance the investor's purchase of the securities in question with a debit balance, and in accordance with the margin requirement of Section 220.12 of Regulation T, as opposed to a mere delay in payment of the full purchase price because of a delay in the delivery of the securities to the purchaser as dictated/determined by the issuer. Although Section 11(d)(1) of the Exchange Act prohibits a Member from, directly or indirectly, extending, maintaining or arranging for the extension or maintenance of credit to or for a customer on any security (other than an exempted security as defined in Section 3(a)(12) of the Exchange Act – generally, U.S. government securities and municipal securities), such prohibition only applies where the Member participated in the new issue distribution as a member of a selling syndicate or group within 30 calendar days prior to such transaction. If the Member did not participate in such distribution, it would be permitted to extend credit to the customer/investor in compliance with Section 11(d)(1), but would be required to effect such transaction in a margin account subject to the margin requirement of Section 220.4(b)(3). In this case, however, the Member is, in a true economic sense, extending credit (margin financing) to the customer/investor. But if the customer/investor is not seeking financing of its purchase, then an extended settlement period as dictated/determined by the issuer, should not constitute an extension of credit for either Section 11(d)(1) or under Section 220.8 of Regulation T for cash account transactions.

amount of net capital charges they may incur for these purposes. None of these impacts would arise because the customer/investor is unable or unwilling to pay for the securities.

It is atypical for a new offering of non-equity/debt securities to close by T+2. New issuances of non-equity/debt securities typically close between three to ten business days after the pricing date (that is T+3 to T+10), with closings from T+11 to T+14 occasionally occurring, particularly in the market for high yield debt securities. For new offerings of high yield debt, closings from T+6 to T+10 are more common than closings from T+3 to T+5, and each of these closing ranges/groups is far more common than closings by T+2.[15] Moreover, for new issues of debt securities coupled with a tender offer for, or redemption of, outstanding debt securities of the same issuer, closings typically occur on T+5 to T+10 to allow the issuer to close both the new issue and the tender offering or redemption, concurrently,

[15] The tables below set forth the number offerings of high yield debt securities between January 1, 2021 and April 13, 2021 at each settlement period, and includes the same data both by ascending settlement period (left chart) and by most frequent settlement periods (right chart). The top six most frequent settlement periods are all longer than T+2, and seven of the top eight settlement periods are longer than T+2, with T+10 being the most common settlement period by far:

T+	# of deals	% of total
T+1	3	1.22%
T+2	13	5.31%
T+3	39	15.92%
T+4	15	6.12%
T+5	39	15.92%
T+6	19	7.76%
T+7	20	8.16%
T+8	11	4.49%
T+9	1	0.41%
T+10	72	29.39%
T+11	6	2.45%
T+12	4	1.63%
T+13	2	0.82%
T+14	1	0.41%

T+	# of deals	% of total
T+10	72	29.39%
T+3	39	15.92%
T+5	39	15.92%
T+7	20	8.16%
T+6	19	7.76%
T+4	15	6.12%
T+2	13	5.31%
T+8	11	4.49%
T+11	6	2.45%
T+12	4	1.63%
T+1	3	1.22%
T+13	2	0.82%
T+9	1	0.41%
T+14	1	0.41%

in order to avoid the double carry of interest costs (that is, avoiding having interest accrue on the new issue and the securities to be retired at the same time). In addition, securities sold to finance an acquisition also tend to close on a T+10 or longer basis (out to T+14) in order either to align the closing of the acquisition with the closing of the financing, or so that the issuer can avoid incurring interest expense for as long as possible if the proceeds of the offering are being deposited into escrow. As noted above and below, this lengthened settlement is driven by the financing needs/terms of the issuer, and not the ability or willingness of customers/investors to pay.

(a) New Issue of Debt Securities in Conjunction with a Tender Offer for or Redemption of Outstanding Debt Securities:

Many times, the issuer is in the market for a new issuance in order to raise proceeds to take advantage of lower interest rates that the issuer will use to fund a tender offer for, or redemption of, other outstanding debt securities. The issuer wants to be able to delay the settlement of the new issue to coincide with the closing of the tender offer or the redemption date to avoid the "double interest" by closing on the new issuance on or about the date of settlement of the tender offer. Typically, tender offers, which are subject to SEC tender offer rules, close between 11 to 12 business days after launch (and closing that quickly requires use of an "early settlement structure"). Frequently, investors whose debt securities are being purchased in the tender offer are purchasers of the debt securities being issued in the new offering to finance the tender offer or redemption (but not in all cases).

Requiring a T+2 closing timeframe for a new issuance of debt securities in order to avoid either collecting margin from investors/customers or incurring net capital charges in lieu of collecting such margin could result in several problems as follows:

- as noted above, increased cost of financing for the issuer (double interest for several days to several weeks, an unnecessary "tax" or cost on the issuer);

- creating an adverse time-lag in roll for investors: the investors would need to fund the new issue on a T+2 basis, but would not receive their funds from the tender offer until a significant time later; and

- potential deal covenant issues, mostly for sub-investment grade issuers: (i) the old and new securities may not be permitted to be outstanding at the same time because of limiting debt incurrence covenants under their existing indentures and/or credit agreement and (ii) accordingly, these issuers could be limited in the management of their balance sheet as some cost-reducing refinancings would not be permitted.

And, not requiring a T+2 closing timeframe for a new issuance of debt securities, and thus being subject to either having to collect margin or incur net capital charges, could result in the following problems:

- having to adopt additional compliance infrastructure to qualify a subset of investors as exempt accounts and the increased complexity of tracking net capital charges in lieu of collecting margin therefrom; and

- potential decreased access to new issues by investors/customers who do not qualify as exempt accounts or bona fide DVP customers and, thus, who would be required to provide margin.

Over the past several years, redemption provisions have been modified to facilitate, and limit the effect, of the aforementioned impacts with the addition of conditional redemption features and shortened redemption notice periods. In 2015, after substantial discussion with various parties, the SEC allowed a tender offer period as short as 5 business days in limited circumstances, and even that relief effectively prohibits the closing of an eligible tender earlier than 7 or 8 business days after launch (5 business days for the offer plus time for settlement/guaranteed delivery). A regulatory regime which encourages closing of the new issue to T+2 could reduce the benefits of these carefully considered, and negotiated, market modifications.

Although FINRA is proposing an exception from the when issued margin requirement for certain "refunding" of securities of the same issuer,[16] this exception would be limited to situations where the purchaser of the new issuance is also the holder of the old security, which is unlikely to be the case for all purchasers in a marketed securities offering (and, even if it were the case, the issuer and Members would not know that as a certainty at the time of marketing or pricing). As a result, Members would be required to collect margin against some purchasers of the securities in an offering or incur a net capital charge with respect thereto, but not others. This could be very operationally difficult for Members. Finally, the proposed FINRA exception, like the counterpart exception in Regulation T, is limited to the maturity or redemption of an old security of the same issuer, and would not appear to encompass the situation, which is not uncommon, where the issuer is seeking to replace an outstanding bank loan that does not constitute a security or a security of a subsidiary or other affiliate.[17]

(b) New Issuances of High Yield Notes/Bonds ("HY Notes" or, individually, a "HY Note"):

With respect to a new issuance of HY Notes, such offerings are often difficult to close/settle by T+2 because of many logistical issues arising from these offerings, such as finalizing the applicable trust indenture and other closing documents and, if applicable, coordinating the delivery of collateral (and the documentation relating thereto), all of which would be very difficult to coordinate by a T+2 close. Rather, closings of HY Note offerings typically occur on T+3 to T+10, with some offerings occasionally closing between T+11 and T+14, as noted above.

Indentures governing HY Notes are heavily negotiated and bespoke, and it would create a substantial burden to try to finalize these indentures as well as all of the other definitive transaction/deal documents within two business days after pricing. Also, many HY Note transactions are secured and it would not be feasible to finish the collateral documentation and perfection on a T+2 timeframe. With large numbers/volume of HY Note offerings by Members, trying to achieve T+2 settlement increases operational risk from trying to "rush" closing/settlements.

As noted above, in order to accommodate even a condensed closing cycle of T+3 or T+4, issuers would need to delay their offering (to provide the transaction professionals with the requisite time to prepare closing documents in advance of pricing), which is likely to cause issuers to miss attractive

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[16] FINRA is proposing an exception, similar to the exception in Section 220.8(b)(1)(i)(D) of Regulation T with respect to the purchase of a new refunding security, provided that such purchase is made no more than 35 calendar days prior to the date of the maturity or redemption of an old security of the same issuer, which old security is held in the customer's cash account at the Member, and is for an amount that does not exceed 103% of the proceeds of such old security. The difference between the proposed FINRA exception and the exception in Regulation T is a proposed requirement by FINRA that the old security be held in the customer's cash account at the Member.

[17] Although Section 220.8(b)(1)(i)(D) of Regulation T provides for a comparable refunding exemption with respect to the issuance of a new security and the repurchase of an outstanding or "old" securities "of the same issuer", some of our members believe that this exemption should apply to new issuances of a non-equity/debt securities that are the same product type, although not of the same issuer, of the outstanding security being tendered or redeemed. For example, Issuer A is seeking to repurchase outstanding debt securities and the customer would like to use the proceeds to purchase a new issue of debt securities of comparable maturity, terms and rating being issued by Issuer B.

marketing windows and increase their interest expense, as well as increase the amount of expenses incurred prior to terminating a "busted deal."

Again, the timing of the closing is not driven by the willingness or ability of the purchaser to pay, but is arising from the concurrent requirements and operational mechanics of these offerings as driven by the financing and timing needs of the issuers.

We believe these considerations would apply equally to new issues of investment grade debt securities and other new issue offerings.

(c) New Issuances of Structured Notes ("SNs" or, individually, a "SN"):

There are new offerings of SNs that are done with delayed settlements (beyond T+2) where the goal is to price a number of tranches of the same SN and then settle all the sales at once, in particular with respect to SNs that are interest rate-based. These offerings are structured as an at-the-market offering which commences to allow for current sales but with the settlement for all sales specified as a date in the future (e.g., T+10). This format allows for the investors to lock in the price as interest rates may move and is efficient for the issuers since they do not have to have a closing for every tranche. Given the low volatility of interest rates, the prices on these products do not move much during the offering period, but the prices do vary. This particular offering technique allows an issuer to avoid having to otherwise have multiple closings versus aggregating into one closing.

(d) Suggested Solution:

Under the scenarios described above, the settlement timeframe is driven by the issuer or the logistical aspects of documenting complex transactions, and not by the willingness or ability of purchasers to pay, and purchasers will not be expecting or want to provide margin when the securities in question have not yet been issued and, thus, have not been delivered to purchasers. Members would end up taking costly and substantial net capital charges[18] in lieu of collecting margin. These net capital charges would be unnecessary to protect the creditworthiness of Members and would potentially concentrate new issuances to larger more capitalized Members at the expense of smaller, less well-capitalized firms. Given that the timing of the closing is driven by the issuer, and not the willingness or ability of the purchaser to pay, we think that these costs substantially outweigh any benefit of the proposed interpretation, and we do not believe that FINRA has articulated, or established, a cost/benefit analysis or other rationale for why these proposals are needed.

Accordingly, we believe that allowing/permitting the closing of these new issue offerings – without the need to collect margin or take a net capital charge - by T+14 would not expose Members to material risk and costs. Moreover, in each of these cases, closing would be within the T+15 requirement for a Member to collect any margin or mark-to-market amount required under current FINRA Rule 4210(f)(6).[19]

(vi) New Issuances of Asset-Backed Securities ("ABS"):

New issuances of ABS are issued by special purpose vehicles (an "SPV") and are typically conducted pursuant to SEC Rule 144A. Closing cannot occur within T+2, and generally would not occur for a time period well beyond T+2, because the closing is delayed by the "ramp" period during which the

[18] SIFMA believes that these charges could, for a given Member, be in the hundreds of millions of dollars, and could exceed $1 billion depending upon the number and size of offerings at any given time with longer than T+2 settlement.

[19] The FINRA proposals would permit settlements in new issues of municipal securities, which we further discuss below, on a longer timeframe than T+15 without the need to collect margin or incur a net capital charge, and we are not suggesting to impose a shorter T+15 timeframe therefor.

asset manager for the SPV is in the market acquiring the collateral/underlying securities or other assets that are deposited into the SPV as a condition for the issuance of ABS securities, a process which takes time and cannot/should not be rushed. This delay is wholly driven by the collateral manager's attempt to acquire collateral/underlying assets in accordance with the terms of the offering requirements and in an efficient matter, as well as timing to finalize deal ratings from rating agencies, and has nothing to do with the willingness or ability of purchasers to pay.

Until the collateral manager acquires the underlying collateral/assets, pricing of the transactions cannot be finalized, and there is no reason to collect margin by the Member or have the Member incur a capital charge. In this regard, the FRB recognized these types of pricing/deal constraints in an interpretive letter issued in 1988[20] that acknowledged similar constraints involving secondary trades in outstanding pass-through securities as being consistent with the delivery-versus-payment ("DVP") exception and, thus, allows such a delayed settlement transaction to occur in a cash account per Section 220.8(b)(2) of Regulation T (provided the delay in payment by the purchaser does not exceed 35 calendar days as a result of the "mechanics of the transaction").

Such FRB guidance, however, predates the broader development of the ABS market, including ABS involving collateralized loan obligations, and new issuances of ABS generally do not settle/close for up to 40 calendar days after trade date for non-CLO ABS[21] (and up to 42 calendar days for CLO ABS) due to the timing to consummate the ramp period in an efficient matter, finalize deal documentation, and obtain credit ratings from third party rating agencies.

Accordingly, we believe that FINRA should permit new issuances of ABS to occur in a cash account without having to collect margin or incur a net capital charge as long as the closing occurs within 42 calendar days after the trade date.

In addition, it is not uncommon for new issuances of ABS to have the contractual settlement date phrased as "on or about [specific date]" to provide the issuer with flexibility to move the settlement date forward by one business day in the event of an administrative delay in the performance of a necessary closing step by a third party, such as The Depository Trust Company ("DTC"). To address this, we request that FINRA acknowledge that the customary "on or about" language particular to ABS would not, in and of itself, disqualify a new issuance of ABS for qualifying for the exception from margining and net capital charges, if the specified number of days falls within T+42.

(vii) New Issuances of Municipal Securities:

FINRA's proposals would establish an exception from the margin requirement of FINRA Rule 4210(f)(3)(B) with respect to a new issue transaction in a cash account involving the issuance of any municipal security with a scheduled issuance date no later than the 42nd calendar day after the date of the contract without the need to collect margin or incur a net capital charge for market-to-market loss.

We note, however, that pursuant to FINRA Rule 0150(b), FINRA's rules are "not intended to be, and shall not be construed as, rules concerning transactions in municipal securities." Moreover, pursuant to FINRA Rule 0150(c), FINRA Rule 4210, among other FINRA rules, is applicable to "transactions in,

[20] See FRRS 5-615.956.

[21] For new issues of residential mortgage-backed securities ("RMBS"), we do note that settlement delay beyond T+2 is generally not due to the ramping up of the transaction, but more about finalizing transaction documents, interfacing with credit rating agencies, waiting for payment dates on the loans, calculating the fund flows and agreeing to, and streamlining servicing transfers. T+2 settlement would be a very difficult requirement in the RMBS space and these offerings typically settle around T+7, but could be longer.

and business activities relating to exempted securities, except municipal securities, conducted by members and associated persons."

Although by reason of FINRA Rule 0150(b) and (c), FINRA Rule 4210 would not appear, by its terms, to apply transactions in municipal securities (whether with respect to initial or maintenance margin requirements), we understand that with respect to FINRA Rule 0150(b), FINRA takes the position – not memorialized - that FINRA Rule 4210 (margin) regulates "business conduct" of Members and securities "positions" thereof (in contrast to securities "transactions" by Members), and is not a "transactional rule." In addition, we understand that with respect to FINRA Rule 0150(c), the phrase "except municipal securities" is intended to exclude municipal securities from the definition of "exempt securities" (as such term is defined in Section 3(a)(12) of the Exchange Act, which includes both "government securities", as defined in Section 3(a)(42) of the Exchange Act, and "municipal securities", as defined in Section 3(a)(29) of the Exchange Act). As such, we understand that FINRA takes the position that certain enumerated FINRA rules apply to government securities by reason of FINRA Rule 0150(c) and all FINRA rules, and thus including FINRA Rule 4210, apply to municipal securities "positions" by reason of FINRA Rule 0150(b), as noted above.

However, as proposed in FRN 21-11, the when issued margin requirement would apply to extended settlement *transactions* in a when issued security in a cash account in an amount equal to the margin required "were such *transaction* or position in a margin account." (emphasis supplied). The proposed amendments use "transaction" and "position" for these purposes interchangeably and the proposed title for FINRA Rule 4210(f)(3) would be "Transactions and Other Extended Settlement Transactions." In this regard, FINRA Rule 4210(f)(3) clearly contemplates securities offerings – transactions – involving the issuance of new securities – whether registered under the Securities Act or exempt therefrom.

As such, pursuant to FINRA Rule 0150(b), and as construed by FINRA, the when issued margin requirement of FINRA Rule 4210(f)(3) should not apply to when issued transactions, or offerings, involving municipal securities.[22] [23]

(viii) New Issuances of Government Securities:

FRN 21-11 sets forth a proposed exception from the when issued requirement of FINRA Rule 4210(f)(3)(A) – without the need to collect margin or incur a capital charge – with respect to new issuances of U.S. Treasury securities, provide the new issue transactions close/settle within T+14 calendar days. We believe that this proposal should encompass any security considered to be a

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[22] Notwithstanding the foregoing, we think that direct purchases of municipal securities from the municipal issuer by a Member for its own account, where issuance of the securities, and thus delivery of the securities being sold, is delayed beyond T+42 calendar days should not be deemed to be a when issued transaction that is subject to a margin requirement or net capital charge.

[23] Additionally, following the Tax Cuts and Jobs Act of 2017's elimination of tax-exempt advance refundings, many municipal issuers have started issuing when issued municipal securities with settlement past T+42 in order to derive debt service savings previously available for their municipalities' outstanding bonds (aka "forward issue"). Notwithstanding the foregoing, we think the application of the T+42 calendar day standard for municipal securities would effectively stifle municipalities from issuing forward issue municipal securities. This, in turn, would prevent municipalities from realizing any portion of the savings previously available through tax-exempt advance savings.

"government security" under SEC Rule 15c3-1(c)(2)(vi)(A), which would include U.S. agency securities and agency mortgage-backed securities, not just U.S. Treasury securities.[24]

(ix) When Issued Transactions with bona fide DVP Customers:

FINRA is proposing to provide an "exception" from the proposed general requirement to impose margin for an extended settlement with respect to when issued transactions in a cash account involving bona fide DVP customers.[25] The proposed DVP exception would allow a Member to elect to not collect margin from a bona fide DVP customer provided that (i) the settlement of the transaction occurs "promptly" after the securities are made available for delivery, and no later than the 35th calendar day after the trade date and (ii) the Member deducts the amount of any margin, that would otherwise be required if the securities were actually issued, from such Member's net capital computed in accordance with SEC Rule 15c3-1 and, if applicable FINRA Rule 4110(a), subject to the limits set forth in FINRA Rule 4210(e)(2)(I).

This exception is comparable to the DVP exception/exemption set forth in Section 220.8(b)(2) of Regulation T for cash account transactions, except that the proposed FINRA exception does not contain the requirement, set forth in Section 220.8(b)(2), that the delay in payment by the customer must be due to the "mechanics of the transaction and is not related to the customer's willingness or ability to pay."

In the context of a when issued transaction, it is not clear what constitutes "prompt" settlement. Under the when issued exception/exemption in Section 220.8(b)(1)(i)(B) and (C), in order for the transaction to occur in a cash account without being subject to margin, the customer would be required to make full payment within one payment period of the date that the security "was made available by the issuer for delivery to purchasers." This would suggest that the customer must "promptly" pay/settle - within four business days - after the date that the securities are made available for delivery by the issuer to the purchasers. However, FRN 21-11 could be read as interpreting "promptly" to mean that the customer must pay/settle "within the standard settlement cycle" in the U.S. as set forth in SEC Rule 15c1-6(a), that is, within two business days after the issuer has made the securities available for delivery to the purchasers.[26] As set forth in our comments above, we do not believe that Congress or the FRB intended to allow an SRO, such as FINRA, to impose a more shortened payment cycle as specifically contemplated by the FRB and, thus, the term "promptly" should be construed in conformity with Section 220.8(b)(1)(i) to mean that the customer must pay/settle within four (that is, a payment period), not two, business days after the issuer has made the securities available for delivery to the purchasers.

[24] See the FINRA Guide at SEC Rule 15c3-1(c)(2)(vi)(A)/01. For SEC net capital purposes, securities issued by U.S. agencies and agency mortgage-backed securities are deemed to have comparable market/credit risk as securities issued by the U.S. government.

[25] FINRA proposes to define a "bona fide DVP customer" to mean a "customer with whom the member has a payment on delivery (POD)/collect delivery (COD) arrangement that satisfies the requirements of FINRA Rule 11860 and, to the extent applicable, provides for prompt affirmation of any non-depository eligible transactions." FINRA Rule 11860 requires, among other things, that for POD/COD transactions, the customer (i) must provide the Member with the name and address of the customer's agent and applicable account number prior to, or at the time, of accepting an order from the customer, (ii) the Member notes on the order the fact that it is a POD or COD transaction, as applicable, and (iii) the Member shall have received an agreement from the customer that the customer will furnish the customer's agent with applicable instructions with respect to the receipt or delivery of the securities involved in the transaction promptly.

[26] See FRN 21-11 under "Background and Discussion" under Part A "Extended Settlement Transactions; Definition and General Rule."

With respect to the requirement that a Member take/incur a net capital charge equal to the amount of any margin that it does not collect, see our comments with respect to when issued transactions in exempt accounts below. In addition, because bona fide DVP customers are largely institutional investors of substantial financial wherewithal, the associated credit risk is low and there should not be a need to impose margin or otherwise require a net capital charge therefor. And, the calculation and monitoring of net capital charges will be time consuming and burdensome, and we believe provides little value in the context of a transaction where the settlement date/closing is determined by the issuer, and is not dictated by the desire/objective of the Member to extend credit to its customers or the willingness or ability of customers to pay.

(x) When Issued Transactions with Exempt Accounts:

(a) Margin Collection/Net Capital Charges:

Pursuant to FRN 21-11, FINRA also proposes to provide an exception from the when issued margin requirement with respect to any transaction with an "exempt account", as defined in FINRA Rule 4210(a)(13)[27], or with a non-member broker-dealer.[28]

However, FRN 21-11 proposes two different regimes for (i) when issued transactions with exempt accounts and (ii) when issued transactions, or "mechanics of the transaction", with bona fide DVP customers. As such, if the purchaser qualifies as an exempt account, the Member may take/incur a net capital charge equal to the amount of any *marked-to-market* loss on the position in lieu of collecting maintenance margin from the exempt account. But, if the purchaser is a bona fide DVP customer (or if the transaction is otherwise delayed due to the mechanics of the transaction, and not because of the bona fide DVP customer's willingness/ability to pay), then the net capital charge that the Member may take in lieu of collecting maintenance margin is equal to the amount of margin *that would otherwise be required if the securities were actually issued.* With respect to the net capital charges described under each of (i) and (ii) above, the net capital charge is computed in accordance with SEC Rule 15c3-1 and, if applicable, FINRA Rule 4110(a), and is subject to the overall limit on taking net capital charges in lieu of collecting margin set forth in FINRA Rule 4210(e)(2)(I).[29] The former (marked-to-market) approach is akin to a variation margin requirement with margin or net capital charges only required to the extent of a

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[27] An "exempt account" means certain regulated institutions, such as non-member broker-dealer which is registered as a broker or dealer under the Exchange Act, as well, in general, any person that has a net worth of at least $45 million and financial assets of at least $40 million, and who meets certain information requirements.

[28] Because the term "exempt account" includes a non-member broker-dealer which is registered as such under the Exchange Act, the separate reference to a "non-member broker-dealer", presumably, refers to a foreign broker-dealer which is not required to be registered as a broker or dealer under the Exchange Act, such as a foreign broker-dealer operating pursuant to the exemption from such registration set forth in SEC Rule 15a-6(a)(4)(i). We seek confirmation of this point.

[29] Presumably, a such net capital charge would be an "undermargined" charge under SEC Rule 15c3-1(c)(2)(xii); that is, a net capital charge where the customer's (or non-customer's) equity in the account does not meet the maintenance margin requirements of the broker-dealer's designated examining authority under the Exchange Act (here, FINRA). See the further discussion herein.

market loss whereas the latter (margin that would otherwise be required) approach is akin to an initial margin requirement with maintenance margin required upfront notwithstanding any market loss.[30]

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[30] The "marked-to-market" approach is the net capital charge approach employed under current FINRA Rule 4210(e)(2)(F) with respect to margining of transactions in exempted securities, mortgage-related securities and major foreign sovereign debt securities (as each of those terms is defined in FINRA Rule 4210(a)), in each case, with exempt accounts, and is also the net capital approach to be employed for margining of transactions in covered agency transactions, in lieu of collecting margin, with exempt accounts under FINRA Rule 4210(e)(2)(H). The "margin that would be required" approach is the net capital approach employed under current FINRA Rule 4210(e)(2)(G) with respect to margining of transactions in highly rated sovereign debt securities and investment grade debt securities (as each of those terms is defined in FINRA Rule 4210(a)), in each case, with exempt accounts.

Both (e)(2)(F) and (e)(2)(G) (and (e)(2)(H)) relate to securities that are subject to good faith margin under Regulation T and, thus, there is no specified initial margin requirement thereunder. And, Regulation T does not impose a maintenance margin requirement (see Section 220.3(c) of Regulation T: credit initially extended may be maintained regardless of, among other things, "reductions in the customer's equity resulting from changes in market prices). Rather, the initial (and maintenance) margin requirements for these two provisions are specified (that is, other than via a good faith standard) solely under FINRA Rule 4210. Because the initial and maintenance margin requirements are the same for these types of good faith positions under FINRA Rule 4210, a reduction in the "current market value" of the security (as such term is defined in FINRA Rule 4210(a)) below the initial margin amount would cause the equity in the customer's account in respect of such position to decline below the "maintenance" margin requirement and, thus, would trigger a maintenance margin deficiency in the customer's (purchaser's) account in respect of the position. In lieu of having to collect the additional margin from the customer to maintain the maintenance margin requirement, the Member would be required to take a net capital charge for such marked-to-market amount (loss) (presumably, as an undermargined net capital charge under SEC Rule 15c3-1(c)(2)(xii), as described above) (but would not be required to take a net capital charge on uncollected initial margin amount under (e)(2)(F) or (e)(2)(H), but see below). The "margin that would be required approach", on the other hand, suggests that the Member would need to take a net capital charge for the initial margin amount in lieu of collecting such margin (under (e)(2)(G)), but would not be required to take a net capital charge for marked-to-market loss in respect of the customer's position for maintenance margin purposes (in case the current value of the security declines).

However, because, as noted above, the initial and maintenance margin requirements under FINRA Rule 4210 for these types of (Regulation T) good faith positions are the same (the initial margin requirement is equal to the maintenance margin requirement), FINRA may be using "marked-to-market" interchangeably with "margin that would be required" so that a "marked-to-market" margin requirement is, in effect, the "margin that would be required." As an example, suppose there is a long commitment by the customer for a when issued position in a debt security. Let us assume that this would be subject to a 20% (maintenance) margin requirement under FINRA Rule 4210(e)(2)(C)(ii). Suppose that the customer purchases $100 principal amount of a debt security (when issued – extended settlement). Under Regulation T, the position is subject to good faith margin (and, in fact, no margin if in a cash account). Under FINRA Rule 4210, the maintenance margin (which is the same as the initial margin) is $20 (20%), which presumes a "debit" balance of $80 (80%). So the Member would take a $20 net capital charge in lieu of collecting margin from the customer. Suppose further that the next day, the market value of the position declines to $95 (a $5 marked-to-market loss). The "equity" in the account (again, presuming an $80 debit) falls to $15 (15.8% = ($95 - $80)/$95). Because this equity is less than the maintenance margin that the customer is "required" to have of $20, the BD is required to take an additional charge of $5 to maintain, or get back to, the "required margin" of $20. So, in this case, the "required margin" is the same as the maintenance margin, and equals the initial FINRA requirement, which now requires an additional charge for the market-to-market loss because the "equity" has fallen below the required margin amount, and the Member is required to take a charge on the "required margin."

On the other hand, per the FINRA guide to margin interpretations at FINRA Rule 4210(e)(2)(F) – Exhibit 1 (relating to GNMA transactions), a "marked-to-market" loss charge appears to be separate from a "capital charge." For example, under FINRA Rule 4210(e)(2)(H)(i)(g) (relating to the new covered agency transaction margin requirements that are not yet in operation), "mark to market loss" means "the counterparty's loss resulting from marking a Covered Agency Transaction to the market" and would be different from a "maintenance margin" requirement of 2% of the contract value with the counterparty (and which we understand is proposed to be eliminated by FINRA). We seek clarification from FINRA on this point.

Although, as discussed above, we do not believe, in the first instance, that the collection of margin or the imposition of net capital charges is warranted, we think that these margin regimes should be harmonized so that a Member is only required to collect margin, or alternatively take/incur a net capital charge, to the extent of a marked-to-market loss with respect to both (a) transactions with bona fide DVP customers, whether in when issued securities or other extended settlements due to the mechanics of the trade and (b) when issued transactions with exempt accounts (or as we propose herein, transactions with exempt accounts in other extended settlements). As we also note herein, we believe that such harmonization should also be extended to taking/incurring net capital charges in lieu of collecting margin with respect to FINRA Rule 4210(e)(2)(F), (G) and (H).

The exempt account requirement to collect or otherwise take a net capital charge equal to a marked-to-market loss is presumably due to the lower credit risk posed by exempt accounts. As noted in our discussion above regarding when issued transactions with bona fide DVP customers, these customers are largely institutional investors with substantial financial wherewithal and, similar to exempt accounts, pose lower credit risk. We believe that credit risk would be sufficiently managed through the collection of any market loss, or alternatively, through net capital charges equal to any such market loss.

(1) Timing of Capital Charges in Lieu of Collecting Margin:

Notwithstanding our comments above regarding the applicability of the proposed when issued margin requirements to municipal securities new issues/offerings in the first instance, then even assuming that the proposal would apply, suppose that Customer A purchases a new issue municipal security with a 41-calendar day settlement and Customer B purchases a new issue municipal security with a 43-calendar day settlement. As such, Customer A's purchase is within the proposed 42-calendar exception for municipal securities, but Customer B's purchase is outside that exception.

Accordingly, under the proposal in FRN 21-11, the Member would not be subject to a net capital charge for Customer A's purchase, but a net capital charge would be required for Customer B's purchase. Because, in this example, Customer B's transaction is one day over the specified 42-calendar day cutoff, it would seem overly burdensome/costly to require the Member to incur a net capital charge for 43 calendar days. Rather, we think that it would be more reasonable to require the Member to incur a net capital charge commencing on the 43rd calendar day given that the risk in both transactions is largely the same/equal.

The marked-to-market approach, on the other hand, is required for when issued commitments arising under Section 220.4(b)(3) of Regulation T for margin accounts. Pursuant thereto, the required margin on a net long commitment in a when issued security in a margin account – in contrast to a when issued security in a cash account where no margin is required if the position fits within Section 220.8(b)(1)(i)(B), as described above - is the margin that would be required if the security were an issued margin security, "plus any unrealized loss on the commitment or less any unrealized gain." If the when issued security is a margin equity security, the required margin would be 50% under Section 220.12(a), and the long commitment would be subject to an additional marked-to-market amount based on any unrealized loss. As such, in the Regulation T context, because there is a separate "required margin", or initial margin, requirement of 50%, but no separate maintenance margin requirement, a "marked-to-market" charge together with "the margin that would be required" makes sense (but maybe makes less sense in the case of good faith positions where there is no specified initial margin requirement under Regulation T, but only a maintenance margin requirement under FINRA Rule 4210 that is equal to the "initial" margin requirement thereunder).

We also note that under FINRA's proposed exceptions set forth in FRN 21-11 for when issued transactions in either U.S. Treasury securities or municipal securities, a Member would not be required to collect margin or incur a net capital charge therefor or incur a net capital charge for any marked-to-market loss on the customer's position.

(b) FINRA Rule 4210(e)(2)(I):

Pursuant to FRN 21-11, FINRA Rule 4210(e)(2)(I)(ii) would be revised to take into account net capital deductions by a Member "as a result of uncollected margin incurred under paragraph (f)(3)" together with "marked to the market losses incurred under paragraphs (e)(2)(F) and (e)(2)(G)."

The proposed change, however and subject to the discussion above, does not appear to incorporate marked-to-market losses incurred under proposed changes to (f)(3) with respect to when issued transactions with exempt accounts, as discussed above, and we seek clarification on this point. Moreover, as discussed above, only (e)(2)(F) imposes a net capital charge for uncollected marked-to-market losses, not (e)(2)(G), and we seek further clarification on this point as well.

Finally, and importantly, aggregating net capital deductions across when issued securities, (e)(2)(F) and (G), and in the near future, (e)(2)(H) for covered agency transactions ("CAT"), as appears to be the case, will likely limit the availability of Members to incur net capital charges in lieu of collecting margin that their customers are not expecting to provide. This may have a disproportionate impact on smaller less capitalized firms and, thus, could reduce competition for issuers and customers with respect to affected transactions.[31]

(c) Definition of Exempt Account:

The definition of exempt account in 4210(a)(13)(B) is defined in terms of a "person" that meets certain requirements. The term "person" is defined in FINRA Rule 4210(a)(8) to have the meaning set forth in Section 3(a)(9) of the Exchange Act. Section 3(a)(9), in turn, defines a "person" to include a "natural person."

We think that this make clear that a natural person could qualify as an exempt account. However, it would appear that such a natural person would need to comply with the information requirement set forth in FINRA Rule 4210(a)(13)(B)(i) and (ii)(e). The latter financial information

[31] We note that pursuant to FINRA's recent rule filing relating to proposed changes to its margin requirements relating to CAT under FINRA Rule 4210(e)(2)(H) (see SR-FINRA-2021-010), the cap in FINRA Rule 4210(e)(2)(I) with respect to net capital charges in lieu of collecting margin would be calculated based on the marked to market ("MTM") losses under (e)(2)(F), (e)(2)(G) (exclusive of the .5%/3% requirements therein) ***or*** (e)(2)(H) (per proposed FINRA Rule 4210(e)(2)(H)(ii)d.1), **plus** MTM losses below $250K or of new small cash counterparties under (H)(ii)d. The small cash counterparty term replaces the provision relating to $10 million of open gross positions under the current rule. As drafted, it appears that a Member would look, separately, at its capital charges it has incurred in lieu of collecting margin under each of (e)(2)(F), (e)(2)(G) and (e)(2)(H), and would add any MTM losses below $250K or of small cash counterparties under (e)(2)(H)(ii)d, and the largest sum would be subject to the cap on net capital charges under (e)(2)(I). This non-aggregation approach across product types would be far preferable to Members as it imposes a much less severe/restrictive constraint on a Member's valuable capital resources. In this regard, FINRA's rule proposal with respect to CAT seems to indicate that the only substantive changes to (e)(2)(I) were to align (e)(2)(I) to conform to the proposed changes to (e)(2)(H), in particular, the elimination of the 2% maintenance margin requirement and the introduction of the new term of "small cash counterparty", but not with respect to the combination of capital charges with (e)(2)(F) and (e)(2)(G). The proposed revision to (e)(2)(I) for the CAT filing, however, does not conform to the proposed changes to (e)(2)(I) set forth in FRN 21-11, such as the inclusion of proposed changes to (f)(3) (when issued), and the fact that capital charges in lieu of collecting margin under (e)(2)(F), (G) and (f)(3) would appear to be aggregated for the purposes of the (e)(2)(I) cap. As noted above, we believe that a non-aggregation approach, per the CAT proposal, is clearly preferable from a net capital resource perspective for Members. We seek confirmation from FINRA as to how it proposes to impose the net capital cap under FINRA Rule 4210(e)(2)(I) and, again, note our concern if the net capital cap applies on an aggregate basis.

requirement speaks, for example, in terms of a statement of change in "stockholders' equity" which is not relevant to a natural person and does speak about information regarding the person's "business" and "operations." But, the provision also states that the requirement to provide financial information is subject to the "reasonable belief" of the Member as to what the Member needs.

In an SEC release relating to former NASD Rule 2520 (now, FINRA Rule 4210) relating to the exempt account definition,[32] FINRA/NASD stated that:

"The proposal also permits the extension of good faith margin to certain non-equity securities held in exempt accounts. The Commission notes that the definition of exempt account is limited to certain regulated entities ***as well as to persons with net worth*** of at least $40 million and financial assets of at least $45 million about whom ***certain information is publicly available or who make available to the broker-dealer certain current financial information***." (italics/bolding supplied).

As such, it appears that FINRA would contemplate that an exempt account could be an unregulated "entity" or natural person, but we seek confirmation thereof from FINRA.

We believe that the information requirement would be satisfied, for example, if the Member's books and records show the assets under management in the customer's account or through the provision of brokerage or bank account statements from other financial institutions.

II. Definition of Extended Settlement:

As noted in Part I above, FINRA's proposed definition of "extended settlement" is any contract for the purchase or sale of a security, including an "exempted security" (U.S. government securities, like a U.S. Treasury security or a municipal security), that does not provide for the payment of funds by the customer (for a purchase) or delivery of securities (for a sale) by the second business day after the date of the contract (that is, by T+2).

Thus, an extended settlement would arise even if the customer promises to pay (or deliver) within a "payment period" under Regulation T; that is, within T+4. The payment period just applies to the timing of a customer's payment for purchases per Section 220.8(b)(1) of Regulation T, and not the customer's delivery of securities in connection with a sale.

However, FRN 21-11 states that an extended settlement would not include an "ordinary" DVP transaction where (i) the seller agrees to deliver on T+2 (or within the T+2 settlement cycle – that is, "promptly"), (ii) the buyer agrees to make payment against delivery, and (iii) settlement is delayed because of "unforeseen" (unplanned) mechanics of the transaction – not due to the ability or willingness of the customer to pay. However, a DVP transaction where the parties "agree or expect" that delivery or payment will be delayed beyond the ordinary settlement cycle (T+2), even though as a result of the mechanics of the transaction and not the willingness or ability of the customer to pay, would constitute an extended settlement.

As set forth in FRN 21-11, FINRA believes that its proposed definition of "extended settlement" is based on, and follows, the cash account provisions of Regulation T: Section 220.8(a)(1) and (2) require for the firm (Member) to accept in good faith the customer's representation to "promptly" deposit funds (for a purchase) or deliver securities (for a sale). Based on FRB guidance, and for ordinary secondary market transactions, "promptly" has been construed to mean by regular-way settlement date, currently, T+2 in the United States per SEC Rule 15c6-1(a) with the additional two business days in a payment period to be at the option of the Member to allow, and not the right of the customer to delay payment.

[32] See SEC Release No. 34-48407 (2003).

(i) FINRA's proposed definition of "extended settlement" is too broad:

(a) General:

FINRA's proposed definition of "extended settlement" requires that with respect to the purchase of securities, the customer agrees to pay by T+2 and that any delay that might arise is due to the "unforeseen" mechanics of the transaction; that is, circumstances that are not planned or anticipated by the parties.

As described further below, we believe that to the extent that securities which trade at par, and/or which either by their structure or current market practice provide for settlement beyond T+2, should be excepted from the margin/net capital requirements arising from an extended settlement.

An example where this approach is problematic and would disrupt an important segment of the market relates to the secondary market (including tenders) for variable rate demand obligations, or "VRDOs", which are issued mostly by municipal issuers but may, also, be issued by non-municipal or "corporate" issuers.

VRDOs typically have interest resets at 1 and 7 calendar days, but may have resets at 14, 21 and 28 calendar days, and permit investors to tender their VRDOs after issuance to the issuer at par plus accrued interest, generally, on a similar basis. VRDO tenders are supported by a liquidity or credit facility, typically from a financial institution/bank. An issuer will hire a remarketing agent to reset rates and facilitate the resale of tendered VRDOs to another purchaser.

If an investor owning VRDOs tenders its VRDOs, the remarketing agent will attempt to resell the VRDOs to another investor. For example, a weekly VRDO would be required to be tendered for purchase by the issuer on a T+5 basis. The remarketing agent is notified by the tender agent and begins the process of remarketing. If the VRDOs are remarketed, they typically will settle through the tender agent and remarketing agent to the new purchaser. If they are not remarketed, the VRDOs will either be purchased by the liquidity provider through the tender agent, with the proceeds going to the tendering holder/seller, or purchased by the remarketing agent as part of its market making business whereby the remarketing agent will subsequently resell the VRDOs. In either case, the settlement will occur on a T+5 basis.

In addition to tenders permitted under the VRDO structure, VRDOs also trade in the traditional secondary market (that is, not in connection with tenders). It is typical in that market for such trades to settle on a T+5 basis based on custom in the VRDO secondary market. These VRDO trades generally occur at par plus accrued interest given both the frequent interest rate resets and that VRDOs have tender rights attached to them as described above.

As such, in both scenarios, given that it is likely that the remarketing agent, the liquidity provider or a new purchaser will purchase tendered VRDOs on a longer than T+2 settlement basis, we believe that the definition of "extended settlement" should provide an exception for these secondary transactions. The liquidity-supported structure of VRDOs, the short tender timing and remarketing periods, the frequent market-based interest rate resets and, most importantly, because VRDOs primarily trade at par (most VRDOs are weeklies), all support such an exception and, as such, VRDOs should be excepted from the requirement to collect margin or incur a net capital charge as contemplated under FINRA Rule 4210(f)(3) because they are low risk investments. We would also note that, given the above VRDO structure and discussion, it is also the case that there should rarely be (i) a mark-to-the-market loss on a VRDO, (ii) a need to collect margin therefor, or (iii) a need for a Member to incur a net capital charge in lieu of the collection of such margin and, therefore, the proposed margin and net capital requirements contemplated by the FINRA proposal would not serve any credit protection purpose.

The foregoing rationale should apply equally to non-municipal VRDOs and similar structured municipal and non-municipal securities.[33]

Additionally, we note that the reset terms of VRDOs are set/established by the issuer – not based on the customer's ability or willingness to pay. Thus, and as discussed in Part I above with respect to when issued securities offerings, the Member is more of a facilitator in arranging for the extension of credit to the purchaser pursuant to (credit) terms established by the issuer. The same is the case for interest reset securities issued by non-municipal VRDO issuers.

As such, transactions where the terms of the security require a delayed settlement - a mechanical function of the security that is not due to the willingness or ability of the customer to pay - should be permissible in a cash account, without the need for margin or a net capital charge, even if the settlement occurs more than two business days after the trade date and is agreed to, or contemplated, by the purchaser. Such an embedded term of the security applies to all purchasers, not any particular purchaser, and continuously occurs per the design of the particular security by the issuer. We think that Section 220.8(a)(1)(ii) of Regulation T – which requires that the Member accept in good faith the customer's agreement that the customer/purchaser will promptly make full cash payment for the security before selling and it (and does not contemplate selling the security prior to making such payment) - is not intended to encompass a security transaction where a term of the security - applicable to all customers and established by the issuer without discretion on the part of the Member - requires or embeds a delayed settlement by the issuer, as in the case of an interest reset, and FINRA's proposals should be consistent. Otherwise, the proposed definition of "extended settlement" could have the effect of limiting financing flexibility/options for municipal and other issuers and, thus, could raise borrowing costs for such issuers.

We acknowledge that there should be an outside period of time in which full payment should be made (that is, an outer time period for the interest rate of a security to reset), which we think should be (i) 42 calendar days in the case of a municipal security and (ii) 35 calendar days for non-municipal securities. The reasons therefor *are as follows*:

Although resets arising under VRDOs do not constitute the issuance of a new security by the issuer, the reset event, and the ability to tender VRDOs, is similar to a when issued security as the issuer does, in fact, reset the interest rate periodically that functions as a maturity shortening for investors in the case of a tender of the VRDOs – similar to issuing a new security. With respect to new issues of municipal securities, including VRDOs, FINRA is proposing an exception from the margin requirement of FINRA Rule 4210(f)(3), including the need to collect margin or take a capital charge, provided that the municipal security would "settle" within T+42 calendar days after the trade date. Because the issuer is responsible for the reset of the terms (interest rate) of its outstanding security – like issuing a new security – where resets occur on a frequent, and regular, basis as well as the fact that the VRDOs trade at par and have liquidity support, then we think that FINRA's stated justification for the exception for when issued municipal security transactions from margin and net capital charge charges - that these transactions "present low risks relative to other non-equity offerings" - should, similarly, provide an exception for resets of VRDOs in tenders/remarketed transactions, and secondary market transactions, as long as the transaction settles within T+42 calendar days.

For non-municipal VRDOs, we would suggest an outer payment period of 35 calendar days after trade date – akin to the DVP exception in Section 220.8(b)(2) of Regulation T and as set forth as a proposed DVP exception for secondary transactions in FRN 21-11. Even if not a municipal security, it should follow the same rationale as for municipal VRDOs, described above, and in addition the interest reset set by the issuer is akin to the blackout pricing guidance described above for secondary

[33] Including, for example, TOB Floaters, Variable Rate Demand Preferred (VRDP) Shares, VROs and Windows-based securities.

transactions involving certain ABS which allows reliance on the DVP exception in Section 220.8(b)(2). Until the interest rate is set, the price to close/settle is not precisely known. And, because of the low risk of these securities, as described above, the collection of margin, or the incurrence of a net capital charge in lieu of the collection of such margin, seems equally unnecessary.

(1) Unforeseen Circumstances:

Further, we think that FINRA should provide clarification as to what constitutes “unforeseen” issues or circumstances. For example, many retail customers elect to pay for purchases of securities by check. As such, receipt of the check by the Member could be delayed through the delivery process past settlement date (until T+4) and, if further delayed, could require the Member to seek an extension of time from FINRA to receive payment pursuant to Section 220.8(d) of Regulation T. We think that FINRA should clarify that any such delay in the receipt of customer’s check in payment for a purchase of securities is an allowable “unforeseen” circumstance. In addition, even if the check is received by the Member by the settlement date, it could take several more days to collect upon the check – beyond the settlement date or even T+4 (that is, outside a payment period). Because the receipt of the customer’s check by the Member would constitute the receipt of customer “funds” for the purposes of the customer reserve formula under SEC Rule 15c3-3a, even if the check is not yet deposited by the Member, the receipt of a check should constitute receipt of payment by the customer or should at least qualify as an “unforeseen” circumstance for these purposes.[34]

A further example of what should be an “unforeseen” circumstance would, we think, be a situation where a security that is being transferred on a sale is subject to a restrictive legend that requires removal by the issuer’s transfer agent (“de-legending”) and that takes longer than T+2 to achieve, through no fault of the customer or the Member, and where the Member did not agree to an extended settlement (beyond T+2) with the customer. For example, we believe that de-legending of restricted securities should not be subject to T+2 settlement where the transfer involves restricted securities pursuant to Rule 144 under the Securities Act that may not be capable of being delivered on T+2 settlement date due to processing to remove a restricted legend even if such processing is contemplated/foreseen by the parties, provided that delivery is made as soon as all restrictions on delivery have been removed, and in any event within 35 calendar days after the trade date.[35]

(b) Extended Settlement Should Not be Deemed to Occur if Full Payment is Received by T+4 and the Member has a Good Faith Belief on Trade Date that Customer Will Make Payment:

In FRN 21-11, FINRA expressed the rationale that its proposed definition of “extended settlement” – requiring the customer/purchaser to agree to make full payment by T+2 - is consistent with the requirement in Section 220.8(a)(1)(ii) that the customer/purchaser "promptly" pay for the customer’s purchase. In this regard, FINRA is relying on guidance from the FRB that “promptly” contemplates that the customer/purchaser must agree to make full payment - by T+2, the “ordinary” settlement date. As such, FINRA’s position is that the requirement set forth in Section 220.8(b)(1)(i) that a customer must agree to make full payment for a purchase in a cash account within a payment period (that is, by T+4) does not necessarily mean that the *customer* has the right/option to delay payment for the additional 2 business days. However, because the prompt payment requirement of Section 220.8(a)(1)(i) must be

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[34] See the FINRA Guide at SEC Rule 15c3-3, Exhibit A – Item 1/18: customer checks received by the Member for the account of the customer must be included in the Member’s computation of reserve requirements on the day they are received by the Member; customer checks, though not yet deposited, are customer funds.

[35] See: https://www.sec.gov/divisions/marketreg/mrfaqregsho1204.htm.

read in conjunction with the requirement to make full payment within a payment period per Section 220.8(b)(1)(i), it should follow that (b)(1)(i) must necessarily mean the receipt of full payment within a payment period is done "promptly." As such, the key determination should be whether or not the Member can accept the customer's/purchaser's agreement in "good faith" to make the payment within T+4. Assuming that the Member is reasonably assured – in good faith – that the customer will make full payment by T+4, the Member should be able to exercise its "option" or discretion to permit payment by T+4, as contemplated by the FRB. Thus, a good faith belief that payment will occur within T+4, but not necessarily by T+2, should not be an extended settlement, even if contemplated or agreed to by the parties as long as the Member accepts in good faith the purchaser's agreement to fully pay by T+4. The establishment of such good faith belief by the Member should be the focus, not the agreement to purchase by T+2.

We think that a Member could establish this good faith belief in a number of ways. However, a presumption of good faith belief for timely payment should arise if the customer (i) is an "exempt account" or "bona fide DVP customer" as those terms are (or would be) defined in FINRA Rule 4210 (and, thus, the customer has the financial wherewithal to make the payment), (ii) has securities held by the Member in a cash or margin account that the customer agrees to sell in time to settle on T+4, (iii) has cash that will be settling in the customer's account at the Member from a foreign sale by T+4, or (iv) agrees to transfer cash from a trade settlement from another account at another Member or broker-dealer, or will transfer securities from an account at another Member or broker-dealer that the customer will sell via the Member for settlement, in each case, by T+4.

Moreover, pursuant to Section 220.8(b)(4) of Regulation T, a Member is not required to liquidate or cancel a customer's purchase in a cash account for nonpayment unless full payment has not been made "within the required time", that is, within a payment period (T+4), subject to a de minimis exception with respect to sums due that do not exceed $1,000. Thus, because Section 220.8(b)(1) mandates that a customer must make full payment within a payment period, and Section 220.8(b)(4) does not require that the Member cancel or liquidate a position for nonpayment until the completion of the payment period, it should follow that the customer has until the completion of a payment period – by T+4 – to make full payment, or delivery of securities that are being sold and, thus, which should be deemed to be "prompt" payment or delivery for the purposes of Section 220.8(a)(1) and (a)(2), respectively, even if the customer and the Member agree to allow the customer to make full payment or to make delivery by T+4. Further, pursuant to the when issued provision of Section 220.8(b)(1)(i)(B), the customer need only make full payment within a payment period (that is, 4 business days) after the issuer makes the securities available for delivery. So, allowing for full payment within T+4 would be consistent with the cash account provisions of Section 220.8 of Regulation T.

In light of the short-term duration before payment or delivery is made – payment/delivery by T+4 – which is consistent with a payment period under Regulation T for a cash account - should mean that there is minimal credit risk/exposure to the Member which is the stated concern of FINRA for its extended settlement proposals. Accordingly, it should not be necessary to require the Member to collect margin or incur a net capital charge in lieu thereof, and it should not be necessary to have limit such transactions to exempt accounts and/or bona fide DVP customers.

Finally, we note that FINRA is proposing in FRN 21-11 for certain collateralized mortgage obligations ("CMOs"). Although FINRA's justification for T+3 settlement for CMOs is to harmonize the requirement for CMOs that are subject to FINRA Rule 4210(e)(2)(H) (where (e)(2)(H) applies if the settlement *exceeds* T+3), presumably, FINRA believes that settlement by T+3 does not appreciably increase credit risk to the Member. Following the same logic, extending the time for payment to T+4 in accordance with specific mandate of Regulation T should, similarly, not appreciably result in an increase of credit risk to the Member.

(c) Foreign Securities that Settle under Foreign Settlement Cycles that Exceed T+2:

FINRA should recognize the exception, as set forth in Section 220.8(b)(1)(ii) of Regulation T, with respect to foreign securities: full payment by the customer/purchaser should be allowed in a cash account, without the need for the Member to collect margin or take a capital charge, provided such payment is made within a payment period of the trade date or within one day after the date on which settlement is required to occur by the rules of the applicable foreign securities market – but not to exceed 35 calendar days after the trade date.

The exception, as adopted by the FRB in Regulation T, recognized the increasing internationalization of securities markets and the need to address operational and competitive challenges for U.S. broker-dealers who facilitate trades in those international markets. Because Regulation T was originally designed to address the practices in the U.S. securities markets, the FRB determined that the application of the requirements to foreign/international markets proved to be inconsistent with the counterpart requirements and practices in such foreign markets (where foreign markets often provide regular-way settlement cycles that exceed those in the U.S. (that is, which exceed T+2)). As such, U.S. broker-dealers faced both operational and competitive disadvantages with respect to the execution of foreign securities transactions for both U.S. and foreign clients.[36]

To the extent that such transactions would not otherwise qualify for the DVP exception for delays due to the "mechanics of the transaction" (for example, transactions in foreign securities that are booked to the customers' cash accounts that are carried by the broker-dealer), these transactions should not require the imposition of margin or the need to incur a net capital charge in lieu thereof. We think that this should be the case whether or not the transactions qualify as when issued securities offerings.

(d) Suggested Modification to the Definition:

As previously noted, the proposed definition of extended settlement would require that the customer provide funds for a purchase or deliver the securities for a sale "by the second business day after the date of the contract."

To be consistent with Section 220.8 of Regulation T and the definition of payment period thereunder, which ties the settlement date to the standard settlement in the U.S. pursuant to SEC Rule 15c6-1(a), and in particular, if the standard settlement is changed in the future, we suggest that the definition of extended settlement should specify a timeline that explicitly references the phrase "the standard settlement cycle in the U.S. pursuant to Rule 15c6-1(a) under the U.S. Securities Exchange Act of 1934" rather than relying of a formulation that specifies a fixed number of days from "the date of the contract." We believe that this approach would ease operational burdens on Members in the event of further changes (shortening) of the standard settlement cycle in the U.S.

(ii) Employee Stock Options/Stock Purchase Plans:

We would like to confirm that an extended settlement would not arise if a Member facilitates the exercise of an employee stock option sell order, in accordance with Section 220.3(e)(4)[37] of Regulation T, in connection with a cashless exercise of an employee stock option (where the employee will pay for the

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[36] See Section 4:7 of Securities Credit Regulation, Second Edition, by Charles F. Rechlin et. al.

[37] Section 220.3(e)(4) permits a Member to temporarily finance a customer's receipt of securities pursuant to an employee benefit plan registered on SEC Form S-8 or the withholding of taxes for an employee stock award plan whereby the Member may accept, in lieu of the securities, a properly executed exercise notice, where applicable, and instructions to the issuer to deliver the stock to the Member.

exercise price to the issuer from the sale proceeds of the sale of the shares acquired on the exercise of the stock option) whereby the Member has to borrow the shares to make delivery because the employer has not yet delivered the shares. As we noted in Part I above, we do not believe that FRN 21-11 intends the proposed definition of extended settlement to override permissible transactions under Regulation T for which a customer is not required to provide margin to the Member. In this case, requiring the provision of margin would undermine the utility of a cashless exercise as permitted under Regulation T.

In addition, we think that FINRA should recognize an exception from extended settlement treatment (margin or net capital charge, as applicable) with respect to all facilitation of transactions involving employee stock ownership plans (for example, a stock plan award, where a participant is awarded stock, and does not have to make any payment therefor, and the Member is delayed in receiving the shares under the plan if/when the participant sells them).

(iii) Customer Sales of Securities:

The definition of extended settlement applies to both (a) where a customer does not fully pay for securities in the case of a purchase of such securities by the customer by the second business day after the date of the contract and (b) where a customer does not deliver the securities in the case of a sale of such securities by the customer within such time frame, such to unforeseen circumstances, as described above.[38]

We believe that it is inconsistent with Regulation T to apply the proposed definition of extended settlement to customer sale trades. Unlike the requirement under Regulation T that customers with a cash account pay for their purchases within a payment period, Regulation T contains no specific number of days for the customer to deliver the securities being sold. Instead, pursuant to Section 220.8(a)(2)(i) and (ii) of Regulation T, if a Member "buy[s] from or sell[s] for any customer any security", then either (i) the security must be held in the customer's cash account or (ii) the Member must accept in good faith the customer's statement that the security is owned by the customer or the customer's principal, and that it will be promptly deposited into the customer's cash account.

Further, the introduction in the proposal of a specific time period for customers to deliver their sold securities could also be inconsistent with the timing contemplated in SEC Rule 15c3-3. Specifically, in the case of a sale of securities by the customer where the customer does not deliver the securities to the Member by the second business day after the date of the contract for the sale thereof (and absent unforeseen circumstances), and other than a sale where the customer/seller does not own the securities being sold, the Member is subject to the close-out requirement of SEC Rule 15c3-3(m). More specifically, such rule states that if a Member executes a sell order of a customer (other than an order to execute a sale of securities which the seller does not own, which is deemed to include a security sold short against the box) and if for any reason whatever, the Member has not obtained possession or control of the securities from the customer within 10 business days after the settlement date (subject to extension of time by FINRA under SEC Rule 15c3-3(n)), the Member shall immediately thereafter close the transaction with the customer by purchasing securities of like kind and quantity, subject to certain exceptions set forth in the FINRA Guide at SEC Rule 15c3-3(m).

We think that in light of the specific close-out time frame set forth in SEC Rule 15c3-3(m) (and (n)), and that (m) does not apply to short sales by customers, Members should not be subject to margin or net capital charge requirements if the Member closes-out the transaction within the time frame permitted

[38] Pursuant to Section 220.8(a)(2)(i) and (ii) of Regulation T, if a Member "buy[s] from or sell[s] for any customer any security", then either (i) the security must be held in the customer's cash account or (ii) the Member must accept in good faith the customer's statement the security is owned by the customer or the customer's principal, and that it will be promptly deposited into the customer's cash account.

thereunder on the grounds that the time frame specified in SEC Rule 15c3-3(m) adequately defines a Member's good faith belief under Section 220.8(a)(2)(ii) of Regulation T.

III. Secondary Transactions:

(i) Extended Settlement Transactions with a Bona Fide DVP Customer:

Pursuant to FRN 21-11, FINRA proposes an exception from having to collect margin in respect of an extended settlement regarding a transaction with a bona fide DVP customer which meets the requirements of Section 220.8(b)(2) of Regulation T, as described above, provided that the Member takes a net capital charge for the amount of margin that would otherwise be required to be deducted from such Member's net capital as provided in SEC Rule 15c3-1 and, if applicable, FINRA Rule 4110(a), subject to the limits provided in FINRA Rule 4210(e)(2)(I).

See our comment above regarding taking a consistent position with respect to net capital deductions in lieu of collecting margin for when issued transactions and extended settlement transactions, including the fact that because bona fide DVP customers are largely institutional investors of substantial financial wherewithal, the associated credit risk is low and there should not be a need to impose margin or otherwise require a net capital charge.

In any event, as we have described above, we think that a delay in the payment for the transaction that is due to the mechanics of the transaction, and not the willingness or ability of the customer to pay should not warrant/require either the collection of margin or a net capital charge because the delay is really not an extension of credit arising by the Member.

(ii) Proposed Exception for Transactions with Exempt Accounts:

We would also propose an exception from having to collect margin for secondary transactions involving extended settlements with exempt accounts that is akin to the proposed exception for when issued transactions, as described above. We think that this is reasonable because the credit risk of a Member should be minimalized when facing an exempt account with substantial financial wherewithal.

(iii) Special Situations/Distress Trading/Post-Reorganization Equities with DVP Customers:

Equity securities issued in a post-reorganization as well as unregistered, non-DTC eligible and illiquid equity securities routinely settle on a delayed basis due to the mechanics of the transactions: the transactions are bespoke arrangements that require negotiation of agreements following the agreement to memorialize the economic terms of a trade, and there may be needs to remove restrictive legends on transferability (or "de-legending"), and such transactions can, due to the mechanics thereof, take up to 35 calendar days from trade date to consummate and close.

These types of transactions are typically limited to bona fide DVP customers who are sophisticated institutional counterparties with substantial financial means. As such, because the settlement of these transactions are delayed because of mechanics involving bespoke/negotiated arrangements, and not because of the ability or willingness of the customer to pay, and also involve institutional counterparties with substantial financial means, we think that these transactions should be excepted from the extended settlement proposals, without the need to either collect margin or incur a net capital charge in lieu of collecting such margin (or, at the very most, should be subject only to a net capital charge for marked-to-market loss).

IV. Definition of "Customer":

The current definition of "customer" in FINRA Rule 4210(a)(3) excludes another broker-dealer where (i) a Member either purchases a security from, or sells a security to, such other broker-dealer for the account of the Member or its customers or (ii) a broker-dealer that qualifies as an "exempted borrower", as defined in Section 220.2 of Regulation T, except where the Member carries a proprietary account of such exempted borrower pursuant to FINRA Rule 4210(e)(6).[39] Pursuant to Section 220.1(b)(3)(ii), credit extended by a Member based on the good faith determination that the borrower is an exempted borrower is not subject to margin requirements of Regulation T.[40]

(i) The Proposed Revisions to Include Broker-Dealers Would Expand the Application of FINRA Rule 4210 to Normal Brokerage Activities that are Unintended:

Pursuant to FRN 21-11, FINRA proposes to amend the definition of "customer" in FINRA Rule 4210(a)(3) to "include" as a customer "another broker or dealer (other than an exempted borrower) whenever the member extends, arranges or maintains any credit on behalf of the other broker or dealer, including by entering or maintaining an extended settlement transaction, reverse repurchase transaction, or non-purpose securities borrow transaction with the other broker-dealer." (the "Broker-Dealer Inclusion").

In addition, FINRA proposes to amend the margin requirement in FINRA Rule 4210(e)(6)(A) to apply not only where a Member carries the proprietary account of another broker-dealer, which is registered with the SEC, as the rule currently requires, but also as follows: "or *otherwise* extend credit to such a broker-dealer…." (emphasis supplied). As noted above, the definition of "customer" in FINRA Rule 4210(a)(3) does not include an exempted borrower, except for the proprietary account of a broker-dealer carried by a Member pursuant to FINRA Rule 4210(e)(6). These proposed revisions suggest that the margin requirements of FINRA Rule 4210(e)(6)(A) would apply even if neither broker-dealer to a transaction/trade is a carried (proprietary) account of the other.

We believe that these proposed changes would extend the reach of FINRA Rule 4210 too broadly and would encompass activities that are not intended to be covered by the margin rules, as described below. In addition, although we agree with the proposed exclusion of an exempted borrower from the definition of "customer" as per the Broker-Dealer Inclusion (that is, where a Member would not be deemed to be extending, arranging or maintaining credit to, or on behalf of, an exempted borrower for the purposes of FINRA Rule 4210), we find that provision to be inconsistent with the separate provision in the definition of "customer" which states that an exempted borrower, with an account carried by a Member pursuant to FINRA Rule 4210(e)(6), *is* a "customer" of the Member.

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[39] Pursuant to FINRA Rule 4210(e)(6)(A), a Member may carry the proprietary account of another broker-dealer, which is registered with the SEC, upon a margin basis which is satisfactory to both parties, provided that (i) the requirements of Regulation T are adhered to as well as certain requirements for the margining of security futures, and certain requirements of the Commodity Exchange Act, and the account is not carried in a deficit equity condition and (ii) in the case where there is a deficiency between the equity maintained in the account and the haircut requirements under SEC Rule 15c3-1 and, if applicable, FINRA Rule 4110(a), such deficiency must be charged against the Member's net capital, subject to certain modifications with respect to securities covered by FINRA Rules 4210(e)(2)(F) and (e)(2)(G).

Pursuant to FINRA Rule 4210(e)(6)(B), a Member that is a carrying and clearing broker-dealer may carry the account of a participating broker-dealer on a good faith basis in accordance with the joint back office provision of Section 220.7(c) of Regulation T, subject to certain further requirements.

[40] See also Section 220.7(g)(4) of Regulation T. There is a similar exception from the margin requirements of Regulation U with respect to credit extended to an exempted borrower. See Section 221.1(b)(3) of Regulation U.

(ii) FINRA should not extend the definition of "customer" in Rule 4210 to include broker-dealers, except where a Member is carrying the proprietary account of another broker dealer to whom it has extended a margin loan:

(a) In general, as discussed in subpart (a) above, we believe that the extension of the definition of "customer" to other broker-dealers is unnecessary to manage risk for FINRA Members for the following reasons:

(1) The risks of many of the types of transactions the proposals would affect are adequately captured by the SEC's net capital rule, SEC Rule 15c3-1, where Members are required, for instance, to take haircut-based capital charges for equity non-purpose lending, as well as deficit based charges in connection with stock loan/borrow and repurchase/reverse repurchase agreements.

(2) Broker-dealers already exchange daily mark-to-market ("MTM"), or variation margin ("VM") on secured financing transactions. Where such margin fails to be exchanged or margin posted is inadequate, Members would be required to take deficit based capital charges under SEC Rule 15c3-1. See, for example, SEC Rule 15c3-1(c)(2)(iv)(B).

(3) Requiring two broker-dealers to exchange maintenance margin under FINRA Rule 4210 would essentially take the liquidity resources of one Member and shift it onto another, draining the resources of one Member at the expense of the other without providing additional risk mitigation benefits.

(b) Normal Brokerage Activities:

The broadening of the coverage of the definition of "customer" to "any" extension of credit to or with another broker-dealer, and subjecting the Member to net capital charges under proposed changes to FINRA Rule 4210(e)(6)(A), even without a carrying relationship between the Member and other broker-dealer, might suggest that normal broker-to-broker transactions in which a fail arises could result in the treatment of the other broker-dealer to be a customer of the other depending on whether there is a fail to deliver or a fail to receive (that extends beyond T+2, and thus which would be an extended settlement under FINRA Rule 4210). Although the definition of "customer" would be revised to exclude another broker-dealer from whom a security has been purchased or to whom a security has been sold "on a regular way basis", it is not clear what "regular way" contemplates in light of the proposed definition of extended settlement, and the addition of the Broker-Dealer Inclusion would add uncertainty as to how to treat counterparties which are broker-dealers.

(c) Other Regular Arrangements with Broker-Dealers:

Section 220.7(f) of Regulation T permits a Member, without being subject to the margin requirements of Regulation T, to extend credit to another SEC-registered broker-dealer under an account carried for the other broker-dealer on an omnibus (not a fully disclosed) basis in order to finance the securities transactions of the customers of the carried broker-dealer. In an omnibus arrangement, the introducing broker-dealer is responsible for margining trades with, or for, its underlying customers in accordance with Regulation T and FINRA Rule 4210. And, pursuant to SEC Rule 15c3-1(c)(2)(iv)(B), a carrying Member is already required to incur/take a net capital charge on deficits in omnibus accounts maintained under Section 220.7(f) of Regulation T. Under the proposed revisions to FINRA Rule 4210, as described above, the introducing broker-dealer would appear to be a customer of the Member and the Member would need to be subject to the net capital requirements of FINRA Rule 4210(e)(6)(A) even though the account is not a proprietary account of the other broker-dealer and the introducing broker-dealer, in turn, would be responsible for the margining of its underlying customers, including any related net capital charges (such as, an undermargined net capital charge under SEC Rule 15c3-1(c)(2)(xii)(A)).

Similarly, the proposed revisions would appear to encompass transactions entered into pursuant to prime brokerage arrangements between executing broker-dealers and their customers' prime brokers that are subject to the special, and carefully constructed, requirements of Section 220.6(c) of Regulation T and which are based on the SEC's 1994 no-action letter regarding prime broker arrangements.

And, there are other "special" financing arrangements in a broker-dealer credit account under Section 220.7 of Regulation T that would appear to become unnecessarily encompassed into the proposed revisions to FINRA Rule 4210, such as, the provision of emergency and subordinated credit under Section 220.7(e) of Regulation T which FINRA regulates under FINRA Rule 4110 as well as other special, and limited, provisions of Section 220.7 of Regulation where credit might arise in normal brokerage activities between broker-dealers that might constitute an extended settlement under FRN 21-11 (although we acknowledge that financing of market making activities under Section 220.7(f)(5) of Regulation T as well as joint back office arrangements under Section 220.7(c) of Regulation T have been covered by FINRA Rule 4210(e)(5) and FINRA Rule 4210(e)(2)(6)(B), respectively, for many years).

Finally, the Broker-Dealer Inclusion would include as a customer a "non-purpose securities borrow transaction with the other broker-dealer." We think that such an inclusion is unnecessary with respect to non-purpose equity securities borrowed transactions because the latter borrowing arrangements are adequately governed under the SEC's net capital rule through FINRA Guide at SEC Rule 15c3-1(c)(2)(iv)(B)/093 (relating to non-purpose equity securities borrowed transactions). Moreover, securities borrowing and lending arrangements are adequately governed by the SEC's net capital rule with respect to securities borrow deficits and securities loan deficits.[41] And, as we have discussed in Part I above, because the SEC specifically regulates the margining of securities borrowing and lending transactions by Exchange Act-registered broker-dealers, we think that it would be inconsistent with the requirements of Section 7(c) of the Exchange Act and Regulation T to impose any such additional margin requirements thereon.

Thus, we think that borrowing and lending of securities, in general, is, otherwise, adequately governed under the SEC's net capital rule as well under Section 220.10 of Regulation T which specifically regulates securities borrowing and lending activities by SEC-registered broker-dealers. We discuss the impact of the SEC's net capital rule further below.

We do not believe that the types of broker-to-broker transactions described above warrant the collection of initial or maintenance margin, or otherwise should trigger net capital charges in lieu thereof. We believe that a different conclusion would require Members to devote significant, and costly, resources to build new procedures to implement these proposed changes, but where we do not believe there would be any material credit protection benefit arising therefrom that is contemplated by the margin rules.

Accordingly, we believe that the definition of customer of FINRA Rule 4210(a)(3) and the margin/net capital requirements of FINRA Rule 4201(e)(6)(A) be limited to situations where a Member is extending credit to another broker-dealer with a proprietary account carried by the Member for such other broker-dealer, but other than with respect to an exempted borrower.

(d) FINRA should clarify that foreign broker-dealers registered with the SEC, either as broker-dealers or security-based swap dealers, or registered with the Commodity

[41] See the FINRA Guide at SEC Rule 15c3-1(c)(2)(iv)(B)/09 (securities borrowed deficits), and SEC Rule 15c3-1(c)(2)(iv)(B) and the FINRA Guide at SEC Rule 15c301d(c)(2)(iv)B)/07 and 08 (stock loan deficits).

Futures Trading Commission ("CFTC") as futures commission merchants ("FCMs") or swap dealers ("SDs"), are also exempt from the definition of customer:

(1) FINRA in its security-based swap margin rule proposal included exemptions for foreign entities along with their U.S. counterparts, including foreign broker-dealers, security-based swap dealers ("SBSDs"), and SDs. FINRA should align its margin proposals and treat foreign broker-dealers as equivalent to U.S. broker-dealers in this instance as well.

(2) Foreign broker-dealers registered with the SEC are either (a) subject to SEC Rule 15c3-1 or SEC Rule 18a-1, which provide adequate protections for secured financing transactions, or (b) the SEC has made a substituted compliance determination that their home jurisdiction capital regime is equivalent to SEC 15c3-1 or SEC 18a-1, and thus provides the same levels of protections. In such instances, the risks faced by a broker-dealer facing a domestic broker-dealer or a foreign broker-dealer are equivalent.

(3) Similarly, foreign broker-dealers registered with the CFTC as FCMs or swap dealers are (a) subject to a comparable CFTC capital regime, including one that incorporates SEC Rule 18a-1 (CFTC Rule 23.101), or (b) the CFTC has made a substituted compliance determination that their home jurisdiction capital regime is equivalent to a CFTC capital regime, thus providing the same level of protections. This would further harmonize regulatory regimes between the SEC, CFTC, and FINRA.

(4) Finally, foreign broker-dealers registered with the SEC or CFTC are subject to the security-based swap ("SBS") or swap margin rules set by either or both regulators, or the SEC and/or CFTC has made a substituted compliance determination stating that their local margin rules are comparable. Thus, FINRA should defer to this determination that foreign BDs are already adequately protected and providing adequate margin to protect their counterparties.

(iii) Should FINRA decide to amend the definition of "customer" to include broker-dealers, the margin required for inter-dealer transactions should be either "good faith margin" under FINRA Rule 4210(e)(a)(6)(A) or VM, not initial margin ("IM") or maintenance margin.

(a) As we noted above, we believe that proprietary accounts of a broker-dealer carried by a Member on which the Member has extended a margin loan should be continue to be treated as "customer", and BDs should have the option to treat these as subject to "good faith margin" under FINRA 4210(e)(a)(6)(A) or take equivalent capital charges in lieu thereof:

(1) Allowing broker-dealers to be margined under FINRA Rule 4210(e)(a)(6)(A) aligns the inter-dealer margin requirements with the net capital requirements under SEC Rule 15c3-1, recognizing the risk determinations made by the SEC in setting the capital rules.

(2) Alternative Net Capital (ANC) broker-dealers who compute market and credit charges in accordance with SEC Rule 15c3-1e should be permitted to take model-based capital charges in lieu thereof.

(3) This distinction would also render the “exempt borrower” distinction superfluous since all broker-dealers would be subject to FINRA Rule 4210 in this instance, simplifying rule language and promoting clarity.

(b) All other transactions between two broker-dealers should be subject to MTM/VM:

(1) Limiting the margin requirement to MTM/VM would better align with the exceptions for financial market intermediaries, including broker-dealers and foreign broker-dealers (plus SBSDs and SDs), in FINRA’s proposed SBS margin rule, as well as FINRA’s covered agency proposal.

(2) Similarly, the SEC’s SBS margin rule only requires VM to be exchanged between registered entities. Both the SEC and FINRA, in looking at inter-dealer transactions, have determined VM to be sufficient for risk management. The same is true for swaps margined under the CFTC’s uncleared margin rule (“UMR”).

(3) FINRA should align its various margin approaches and harmonize with the SEC to promote consistency between regulatory regimes.

(4) Inter-dealer transactions are inherently less risky because they are subject to SEC Rule 15c3-1 (or SEC 18a-1) as stated above. Thus, we believe that exchange of MTM/VM would be adequate to protect Members should FINRA decide additional risk mitigation is needed.

(5) ANC Broker-dealers should be permitted to take model-based capital charges in lieu thereof.

(c) Foreign broker-dealers registered with the SEC as broker-dealers or SBSDs, or with the CFTC as FCMs or SDs, should be subject to the same margin requirements as US BDs, due to the fact that they are already subject to SEC or CFTC capital and margin rules or their equivalents under substituted compliance, as detailed above:

(1) Further, under both the SEC’s SBS margin rule and the CFTC’s UMR, inter-dealer transactions are subject only to VM. FINRA should defer to the risk determinations made by the SEC/CFTC in order to promote consistency and regulatory harmonization. Thus, for all transactions other than a margin loan extended another BD, foreign BDs should also only be subject to VM, similar to domestic BDs, as described above.

(iv) Should FINRA decide to extend the definition of “customer” to include broker-dealers, FINRA should provide Members with adequate time to implement the margin rules, and/or the ability to take net capital charges in lieu of margin.

V. Application of the Proposals to Non-Securities:

We think that as a general matter, FINRA Rule 4210 is intended, and designed, to supplement Regulation T, and as noted above to regulate the provision of credit in areas that are specifically left to

FINRA by the FRB. Such regulations are focused chiefly on margin requirements arising from the provision of “purpose” credit per Section 7(c) of the Exchange Act.[42]

As such, we think that margin requirements in non-securities products that constitute non-purpose credit are best left to specifically tailored requirements on a product basis or through the application of the net capital rule and are otherwise adequately addressed via FINRA Rule 4210(e)(7).[43]

In particular, with respect to U.S. bank-issued certificates of deposit (“CDs”), we think that CDs issued by U.S. regulated banks are characterized by low credit risk and do not necessitate a special application of FINRA Rule 4210 other than as currently done as non-purpose credit. These “margin” requirements are adequately addressed through the SEC’s net capital rule as per FINRA Rule 4210(e)(7)/03 and the FINRA Guide at SEC Rule 15c3-1(c)(2)(iv)(B)/10.

VI. Debit Balance in the Customer Reserve Formula:

With respect to when-issued positions, there is a question as to whether FINRA’s margin proposals could trigger a “naked” or one-sided item 10 debit in the customer reserve formula under SEC Rule 15c3-3a.[44] Under FINRA’s proposals, there would be an “extension” of credit to the customer arising from, or through, the delay in payment by the customer to the Member (because the securities will not have been issued by the second business day following the trade date and, thus, the customer will not have made full payment therefor by that time). As such, a FINRA margin requirement arises (even though there is no counterpart extension of credit under Regulation T at this point if the transaction is effected by the customer in a cash account).

The foregoing suggests that there could be a debit balance arising in the customer’s cash account because of the proposed when issued FINRA margin requirement. If so, a debit on the date of the Member’s reserve computation would result, all else being the same, in a reduction in the net credit value in the customer reserve formula which could, then, result in a reduction in the amount of funds that the Member would need to reserve against or “lock up.” In addition, the establishment of a debit balance

[42]See Section 220.1(a) of Regulation setting forth the “authority and purpose” regarding the scope of Regulation T (Regulation T’s “principal purpose” is to regulated extensions of credit by “creditors”, that is, SEC-registered brokers and dealers in securities transactions). In this regard, the FRB largely excludes non-purpose credit transactions per Section 220.6(e) of Regulation T. See also FINRA Rule 4210(e)(7) relating to specific provisions relating to non-purpose credit requirements.

[43] See FINRA Rule 4210(e)(7)(C). Also, with respect to non-purpose loans collateralized by “non-margin eligible securities”, see FRN 12-44 (where the maintenance loan value for the non-margin eligible equity securities will be based on the applicable maintenance margin requirements for a margin eligible equity security).

[44] Item 10 of the customer reserve formula relates to “[d]ebit balances in customers’ cash and margin accounts excluding unsecured accounts and accounts doubtful of collection.” Although when SEC Rule 15c3-3a was adopted by the SEC, item 10 may have contemplated debit balances arising in customers’ margin accounts under Regulation T, the provision is not so limited and, arguably, could include a margin debit balance arising solely under FINRA Rule 4210. From a Regulation T perspective, a when issued transaction in a cash account would not create or establish a debit balance in a cash account until the securities are made available for delivery by the issuer at closing/settlement.

would potentially increase a customer's adjusted margin debit balance ("AMD") that could increase the amount of the customer's securities which are available for rehypothecation by the Member.[45]

But even though the debit would relate to a "long" position, it is a when-issued positon so that prior to the time that the issuer makes the securities available for delivery, there would not appear to be a need to finance the customer with cash as in a margin loan in order for the customer to make a margin long purchase (as the customer, who effects the transaction in a cash account, is expected to make full payment for the purchased securities within a payment period (four business days) after the issuer makes such securities available for delivery. From the customer's perspective, the customer is not financing the purchase, but is also not going to pay for securities that are not yet available for delivery to the customer. As such, the recognition of a debit in the customer reserve formula (item 10) seems unnecessary (and would appear to be one-sided) unless one viewed the when issued position as a fail to receive triggering an item 4 credit in the customer reserve formula that would, then, allocate to, or offset, the item 10 debit; but, there is not really a fail, here. We seek clarification from FINRA on this point.

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Thank you for considering SIFMA's comments on these proposed changes by FINRA to Rule 4210. If any questions regarding the foregoing, please contact the undersigned at (212) 313-1130 or

[45] A Member is generally able to rehypothecate a customer's "margin securities" with a market value up to 140% of the customer's AMD. A customer's margin securities with a market value in excess of 140% of the customer's AMD, and subject to possession or control, are "excess margin securities", in each case, as such terms are defined in SEC Rule 15c3-3. Margin securities include securities carried by a Member for a customer in "any" account, but do not include "fully paid securities", as defined in SEC Rule 15c3-3, that are carried in a cash account. However, securities are not deemed to be fully paid securities if the customer has not made full payment therefor and, as such, these securities would constitute margin securities, even if carried in a cash account. Thus, when issued securities for which the customer has not made full payment would appear to constitute "margin securities" for these purposes with an implied debit equal to the unpaid purchase price. See SEC Rules 15c3-3(a)(3), (a)(4) and (a)(5) as well as the FINRA Guide at SEC Rule 15c3-3(a)(5)/01. See also SEC Rule 15c3-3(b)(2)/032. Although this result would appear to also arise even under the when issued provision set forth Section 220.8 of Regulation T (for cash accounts), because the customer is not required to make full payment until such time that the issuer has made the securities available for delivery to purchasers, a debit balance would not appear to arise in the customer's cash account until that time (in contrast to an implied debit arising under FINRA's margin proposals).

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Sincerely,

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