

proposed transactions do not raise the concerns underlying sections 17(a)(1), 17(a)(3), 17(d) and 21(b) of the Act as the Funds would not engage in lending transactions that unfairly benefit insiders or are detrimental to the Funds. Applicants state that the facility will offer both reduced borrowing costs and enhanced returns on loaned funds to all participating Funds and each Fund would have an equal opportunity to borrow and lend on equal terms based on an interest rate formula that is objective and verifiable. With respect to the relief from section 17(a)(2) of the Act, applicants note that any collateral pledged to secure an interfund loan would be subject to the same conditions imposed by any other lender to a Fund that imposes conditions on the quality of or access to collateral for a borrowing (if the lender is another Fund) or the same or better conditions (in any other circumstance).<sup>6</sup>

5. Applicants also believe that the limited relief from section 18(f)(1) of the Act that is necessary to implement the facility (because the lending Funds are not banks) is appropriate in light of the conditions and safeguards described in the application and because the open-end Funds would remain subject to the requirement of section 18(f)(1) that all borrowings of the open-end Fund, including combined interfund loans and bank borrowings, have at least 300% asset coverage.

6. Section 6(c) of the Act permits the Commission to exempt any persons or transactions from any provision of the Act if such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act. Section 12(d)(1)(J) of the Act provides that the Commission may exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision of section 12(d)(1) if the exemption is consistent with the public interest and the protection of investors. Section 17(b) of the Act authorizes the Commission to grant an order permitting a transaction otherwise prohibited by section 17(a) if it finds that (a) the terms of the proposed transaction are fair and reasonable and do not involve overreaching on the part of any person concerned; (b) the proposed transaction is consistent with the policies of each registered investment company involved; and (c)

the proposed transaction is consistent with the general purposes of the Act. Rule 17d-1(b) under the Act provides that in passing upon an application filed under the rule, the Commission will consider whether the participation of the registered investment company in a joint enterprise, joint arrangement or profit sharing plan on the basis proposed is consistent with the provisions, policies and purposes of the Act and the extent to which such participation is on a basis different from or less advantageous than that of the other participants.

For the Commission, by the Division of Investment Management, under delegated authority.

**J. Matthew DeLesDernier,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-91937; File No. SR-FINRA-2021-010]

### Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change To Amend the Requirements for Covered Agency Transactions Under FINRA Rule 4210 (Margin Requirements) as Approved Pursuant to SR-FINRA-2015-036

May 19, 2021.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 7, 2021, the Financial Industry Regulatory Authority, Inc. (“FINRA”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

FINRA is proposing to amend the requirements for Covered Agency Transactions under FINRA Rule 4210 (Margin Requirements) as approved by the SEC pursuant to SR-FINRA-2015-036. The proposed rule change would amend, under FINRA Rule 4210, paragraphs (e)(2)(H), (e)(2)(I), (f)(6), and Supplementary Material .02 through .05,

each as amended or established pursuant to SR-FINRA-2015-036.

The text of the proposed rule change is available on FINRA’s website at <http://www.finra.org>, at the principal office of FINRA and at the Commission’s Public Reference Room.

#### II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

On October 6, 2015, FINRA filed with the Commission proposed rule change SR-FINRA-2015-036, which proposed to amend FINRA Rule 4210 to establish margin requirements for: (1) To Be Announced (“TBA”) transactions,<sup>3</sup> inclusive of adjustable rate mortgage (“ARM”) transactions; (2) Specified Pool Transactions;<sup>4</sup> and (3) transactions in Collateralized Mortgage Obligations (“CMOs”),<sup>5</sup> issued in conformity with a

<sup>3</sup> FINRA Rule 6710(u) defines “TBA” to mean a transaction in an Agency Pass-Through Mortgage-Backed Security (“MBS”) or a Small Business Administration (“SBA”)-Backed Asset-Backed Security (“ABS”) where the parties agree that the seller will deliver to the buyer a pool or pools of a specified face amount and meeting certain other criteria but the specific pool or pools to be delivered at settlement is not specified at the Time of Execution, and includes TBA transactions for good delivery and TBA transactions not for good delivery. Agency Pass-Through MBS and SBA-Backed ABS are defined under FINRA Rule 6710(v) and FINRA Rule 6710(bb), respectively. The term “Time of Execution” is defined under FINRA Rule 6710(d).

<sup>4</sup> FINRA Rule 6710(x) defines Specified Pool Transaction to mean a transaction in an Agency Pass-Through MBS or an SBA-Backed ABS requiring the delivery at settlement of a pool or pools that is identified by a unique pool identification number at the time of execution.

<sup>5</sup> FINRA Rule 6710(dd) defines CMO to mean a type of Securitized Product backed by Agency Pass-Through MBS, mortgage loans, certificates backed by project loans or construction loans, other types of MBS or assets derivative of MBS, structured in multiple classes or tranches with each class or tranche entitled to receive distributions of principal or interest according to the requirements adopted for the specific class or tranche, and includes a real estate mortgage investment conduit (“REMIC”). The

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<sup>6</sup> Applicants state that any pledge of securities to secure an interfund loan could constitute a purchase of securities for purposes of section 17(a)(2) of the Act.

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

program of an agency<sup>6</sup> or Government-Sponsored Enterprise (“GSE”),<sup>7</sup> with forward settlement dates, as further defined under FINRA Rule 4210(e)(2)(H)(i)c. pursuant to the rule change (collectively, defined under the rule change as “Covered Agency Transactions”).<sup>8</sup>

In proposing the margin requirements, FINRA pointed out that the rulemaking was necessary to address the potential risk arising from unsecured credit exposures that exist in the Covered Agency Transaction market.<sup>9</sup> FINRA noted that unsecured credit exposures in the Covered Agency Transaction market could lead to financial losses by dealers. Further, FINRA noted that permitting counterparties to participate in the Covered Agency Transaction market without posting margin can facilitate increased leverage by customers, thereby potentially posing a risk to the dealer extending credit and to the marketplace as a whole.<sup>10</sup>

term “Securitized Product” is defined under FINRA Rule 6710(m).

<sup>6</sup> FINRA Rule 6710(k) defines “agency” to mean a United States executive agency as defined in 5 U.S.C. 105 that is authorized to issue debt directly or through a related entity, such as a government corporation, or to guarantee the repayment of principal or interest of a debt security issued by another entity. The term excludes the U.S. Department of the Treasury in the exercise of its authority to issue U.S. Treasury Securities as defined under FINRA Rule 6710(p). Under 5 U.S.C. 105, the term “executive agency” is defined to mean an “Executive department, a Government corporation, and an independent establishment.”

<sup>7</sup> FINRA Rule 6710(n) defines GSE to have the meaning set forth in 2 U.S.C. 622(8). Under 2 U.S.C. 622(8), a GSE is defined, in part, to mean a corporate entity created by a law of the United States that has a Federal charter authorized by law, is privately owned, is under the direction of a board of directors, a majority of which is elected by private owners, and, among other things, is a financial institution with power to make loans or loan guarantees for limited purposes such as to provide credit for specific borrowers or one sector and raise funds by borrowing (which does not carry the full faith and credit of the Federal Government) or to guarantee the debt of others in unlimited amounts.

<sup>8</sup> The proposed rule change would redesignate the current definition of Covered Agency Transactions, as set forth in paragraph (e)(2)(H)(i)c., as paragraph (e)(2)(H)(i)b., without any change. See Exhibit 5. For purposes of this filing, all references to provisions under Rule 4210 are to provisions as amended or established pursuant to SR-FINRA-2015-036 (for convenience, also referred to in this filing as the “current rule”), except where otherwise indicated.

<sup>9</sup> See Securities Exchange Act Release No. 76148 (October 14, 2015), 80 FR 63603 (October 20, 2015) (Notice of Filing of Proposed Rule Change; File No. SR-FINRA-2015-036) (FINRA’s filing proposing SR-FINRA-2015-036, referred to as the “Original Proposal”).

<sup>10</sup> See Original Proposal, 80 FR at 63604. FINRA further pointed out that the rulemaking was necessary given that FINRA’s existing requirements, prior to the rulemaking, did not address the Covered Agency Transaction market generally, and given that existing industry best practices guidelines, such as set forth by the Treasury Market

The Commission approved SR-FINRA-2015-036 on June 15, 2016 (the “Approval Date”).<sup>11</sup> Pursuant to Partial Amendment No. 3 to SR-FINRA-2015-036, FINRA announced in *Regulatory Notice* 16-31 that the rule change would become effective on December 15, 2017, 18 months from the Approval Date, except that the risk limit determination requirements as set forth in paragraphs (e)(2)(F), (e)(2)(G) and (e)(2)(H) of Rule 4210 and in new Supplementary Material .05, each as respectively amended or established by SR-FINRA-2015-036 (collectively, the “risk limit determination requirements”), would become effective on December 15, 2016, six months from the Approval Date.<sup>12</sup>

Industry participants requested that FINRA reconsider the potential impact of certain requirements pursuant to SR-FINRA-2015-036 on smaller and medium-sized firms, and that FINRA extend the implementation date of the requirements pending such reconsideration to reduce potential uncertainty in the Covered Agency Transaction market. In Partial Amendment No. 3 to SR-FINRA-2015-036, FINRA stated that it would monitor the impact of the requirements pursuant to that rulemaking and, if the requirements prove overly onerous or otherwise are shown to negatively impact the market, FINRA would consider revisiting such requirements as may be necessary to mitigate the rule’s impact.<sup>13</sup> In response to the concerns of industry participants, FINRA has engaged in extensive dialogue, both with industry participants and other regulators, including staff of the SEC and the Federal Reserve System, for the purpose of reconsidering the requirements. Further, pending this period of dialogue and reconsideration, FINRA has extended the implementation date of the requirements pursuant to SR-FINRA-2015-036 (other than the risk limit determination requirements that became effective on December 15, 2016) on several occasions, most recently to October 26, 2021 (the “October 26,

Practices Group (“TMPG”), are recommendations and not rule requirements. *Id.*

<sup>11</sup> See Securities Exchange Act Release No. 78081 (June 15, 2016), 81 FR 40364 (June 21, 2016) (Notice of Filing of Amendment No. 3 and Order Granting Accelerated Approval to a Proposed Rule Change to Amend FINRA Rule 4210 (Margin Requirements) to Establish Margin Requirements for the TBA Market, as Modified by Amendment Nos. 1, 2, and 3; File No. SR-FINRA-2015-036) (approving SR-FINRA-2015-036, referred to as the “Approval Order”).

<sup>12</sup> See Partial Amendment No. 3 to SR-FINRA-2015-036 and *Regulatory Notice* 16-31 (August 2016), both available at: <[www.finra.org](http://www.finra.org)>.

<sup>13</sup> See note 12 *supra*.

2021, implementation date”),<sup>14</sup> and has published various guidance to assist members.<sup>15</sup>

FINRA notes that, in the period since the Approval Date, there has been opportunity to discern with greater clarity the potential impact, on both firms and their customers, of the requirements pursuant to SR-FINRA-2015-036. Members have told FINRA that the requirements, as currently approved, favor larger firms over smaller firms because larger firms would have more market power to negotiate margin agreements<sup>16</sup> with their customers. Members have pointed out that non-FINRA member bank dealers and other entities are able to participate in the Covered Agency Transaction market without being subject to FINRA Rule 4210, which thereby places FINRA member broker-dealers at a competitive disadvantage. Some smaller members told FINRA that, among other things, having the option to take a capital charge in lieu of collecting margin for their customers’ mark to market losses would help alleviate this competitive disadvantage, though it would not fully resolve the disparity that results from being subject to Rule 4210 when non-FINRA member bank dealers are not.

#### A. Summary of Proposed Amendments

Taking into account FINRA’s dialogue with members,<sup>17</sup> and the overall

<sup>14</sup> See Securities Exchange Act Release No. 90852 (January 5, 2021), 86 FR 2021 (January 11, 2021) (Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Extend the Implementation Date of Certain Amendments to FINRA Rule 4210 Approved Pursuant to SR-FINRA-2015-036; File No. SR-FINRA-2020-046). As discussed further below, FINRA plans to file a separate proposed rule change that would further adjust the October 26, 2021, implementation date to align with the effective date of the amendments to SR-FINRA-2015-036 as set forth in this proposed rule change.

<sup>15</sup> For example, FINRA made available a set of Frequently Asked Questions & Guidance to clarify certain of the requirements, available at: <[www.finra.org](http://www.finra.org)>. Further, staff of the SEC’s Division of Trading and Markets made available a set of Frequently Asked Questions regarding SEA Rule 15c3-1 and Rule 15c3-3 in connection with Covered Agency Transactions under FINRA Rule 4210, also available at: <[www.finra.org](http://www.finra.org)>.

<sup>16</sup> For example, larger firms would have more market power to negotiate Master Securities Forward Transaction Agreements (“MSFTAs”) or customer account agreements.

<sup>17</sup> As discussed further below, this included outreach to several members active in the Covered Agency Transaction market regarding the volatility experienced in that market following the outbreak of the COVID-19 pandemic in early 2020. The SEC staff has issued a report addressing the market stress during and following the COVID-19 shock. See SEC Division of Economic and Risk Analysis, U.S. Credit Markets: Interconnectedness and the Effects of the COVID-19 Economic Shock (October 2020), available at: <[https://www.sec.gov/files/US-Credit-Markets\\_COVID-19\\_Report.pdf](https://www.sec.gov/files/US-Credit-Markets_COVID-19_Report.pdf)> (the “DERA Report”).

purpose of the margin amendments, FINRA is proposing revisions to the Covered Agency Transaction requirements as approved pursuant to SR-FINRA-2015-036. Broadly, FINRA proposes:

- To eliminate the two percent maintenance margin requirement that applies to non-exempt<sup>18</sup> accounts pursuant to paragraph (e)(2)(H)(ii)e. under Rule 4210. This would eliminate the need for members to distinguish exempt account customers from other customers (“non-exempt accounts”) for purposes of Covered Agency Transaction margin. As such, without regard to a counterparty’s exempt or non-exempt account status, members would collect margin for each counterparty’s excess mark to market loss, as discussed in further detail below, unless otherwise provided by the rule;

- subject to specified conditions and limitations, to permit members to take a capital charge in lieu of collecting margin for excess net mark to market losses on Covered Agency Transactions. These conditions and limitations are designed to help protect the financial stability of members that opt to take capital charges while restricting the ability of the larger members to use their capital in lieu of collecting margin to compete unfairly with smaller members; and

- to make revisions designed to streamline, consolidate and clarify the Covered Agency Transaction rule language. These revisions will preserve and clarify key exceptions to the requirements, including for example the \$250,000 de minimis transfer exception<sup>19</sup> and the \$10 million gross

<sup>18</sup> The term “exempt account” is defined under FINRA Rule 4210(a)(13). Broadly, an exempt account means a FINRA member, non-FINRA member registered broker-dealer, account that is a “designated account” under FINRA Rule 4210(a)(4) (specifically, a bank as defined under Exchange Act Section 3(a)(6), a savings association as defined under Section 3(b) of the Federal Deposit Insurance Act, the deposits of which are insured by the Federal Deposit Insurance Corporation, an insurance company as defined under Section 2(a)(17) of the Investment Company Act, an investment company registered with the Commission under the Investment Company Act, a state or political subdivision thereof, or a pension plan or profit sharing plan subject to the Employee Retirement Income Security Act or of an agency of the United States or of a state or political subdivision thereof), and any person that has a net worth of at least \$45 million and financial assets of at least \$40 million for purposes of paragraphs (e)(2)(F), (e)(2)(G) and (e)(2)(H) of the rule, as set forth under paragraph (a)(13)(B)(i) of Rule 4210, and meets specified conditions as set forth under paragraph (a)(13)(B)(ii).

<sup>19</sup> Subject to specified conditions, the current rule provides for an aggregate \$250,000 de minimis transfer amount with a single counterparty, so that if the aggregate required but uncollected

open position exception<sup>20</sup> established pursuant to SR-FINRA-2015-036.

The proposed amendments are discussed in detail below.

## B. Detailed Discussion of Proposed Amendments

### 1. Elimination of Maintenance Margin Requirement; Application of Mark to Market Loss to Both Exempt and Non-Exempt Accounts

Paragraph (e)(2)(H)(ii)e. of the rule addresses Covered Agency Transactions with counterparties that are non-exempt accounts and broadly provides that maintenance margin, defined under the current rule to mean margin equal to two percent of the contract value of the net long or net short position, by CUSIP, with the counterparty, plus any net mark to market loss on such transactions, shall be required margin, subject to specified exceptions under the rule.<sup>21</sup> By contrast, paragraph (e)(2)(H)(ii)d. of the rule broadly provides that on transactions with counterparties that are exempt accounts no maintenance margin shall be required. Such transactions must be marked to the market daily and the member must collect any net mark to market loss, subject to specified exceptions under the rule.<sup>22</sup>

maintenance margin or mark to market loss does not exceed that amount, the margin need not be collected or charged to net capital. *See* Approval Order, 81 FR at 40367; *see also* paragraph (e)(2)(H)(ii)f. of the current rule in Exhibit 5.

<sup>20</sup> The current rule provides that the margin requirements for Covered Agency Transactions do not apply to a counterparty that has gross open positions in Covered Agency Transactions with the member amounting to \$10 million or less if the counterparty regularly settles its Covered Agency Transactions on a Delivery Versus Payment (“DVP”) basis or for cash and meets other specified conditions. *See* paragraph (e)(2)(H)(ii)c. of the current rule in Exhibit 5.

<sup>21</sup> *See* Approval Order, 81 FR at 40367; *see also* paragraph (e)(2)(H)(ii)e. of the current rule in Exhibit 5. The rule further sets forth specified requirements for net capital deductions and the liquidation of positions in the event the uncollected maintenance margin and mark to market loss (defined together under paragraph (e)(2)(H)(i)d. of the current rule as the “deficiency”) is not satisfied. In short, the rule provides that if the deficiency is not satisfied by the close of business on the next business day after the business day on which the deficiency arises, the member shall be required to deduct the amount of the deficiency from net capital as provided in SEA Rule 15c3-1 until such time the deficiency is satisfied; under the rule, if such deficiency is not satisfied within five business days from the date the deficiency was created, the member must promptly liquidate positions to satisfy the deficiency, unless FINRA has specifically granted the member additional time. As discussed in further detail below, the proposed rule change would eliminate current paragraph (e)(2)(H)(ii)e. in its entirety.

<sup>22</sup> *See* Approval Order, 81 FR at 40367; *see also* paragraph (e)(2)(H)(ii)d. of the current rule in Exhibit 5. Similar to paragraph (e)(2)(H)(ii)e., the current rule provides that if the mark to market loss

Members expressed concern that the two-track treatment of exempt versus non-exempt accounts is burdensome because members are obliged under the current rule to obtain and assess the financial information needed to determine which counterparties must be treated as non-exempt accounts.<sup>23</sup> Further, based on feedback from members since the Approval Date and additional observation of market conditions, FINRA believes that the potential risk that the maintenance margin requirement was intended to address when originally proposed<sup>24</sup> is not significant enough to warrant the burdens and competitive disadvantage that the requirement imposes. Members pointed out that, in practice, the maintenance margin requirement would apply to relatively few accounts that participate in the Covered Agency Transaction market. Yet, monitoring and collecting maintenance margin for such accounts is operationally burdensome and out of proportion with the number and size of the affected accounts. Further, bank dealers are not subject to the requirement to collect maintenance margin from their customers, which significantly would disadvantage FINRA members in competition with bank dealers. To address these concerns, FINRA is proposing to eliminate paragraph (e)(2)(H)(ii)d. and paragraph (e)(2)(H)(ii)e. of Rule 4210 as established pursuant to the Approval Order, and to adopt in lieu new paragraph (e)(2)(H)(ii)c., which provides that members shall collect margin for each counterparty’s<sup>25</sup> excess net mark to

is not satisfied by the close of business on the next business day after the business day on which the mark to market loss arises, the member is required to deduct the amount of the mark to market loss from net capital as provided in SEA Rule 15c3-1 until such time the mark to market loss is satisfied; if such mark to market loss is not satisfied within five business days from the date the loss was created, the member must promptly liquidate positions to satisfy the mark to market loss, unless FINRA has specifically granted the member additional time. Again, as discussed in further detail below, the proposed rule change would eliminate current paragraph (e)(2)(H)(ii)d. in its entirety.

<sup>23</sup> Further, members expressed concern that some asset manager counterparties face constraints with regard to custody of assets at broker-dealers and that, because of these constraints, some members need to enter into separate custodial agreements with third party banks to hold the maintenance margin that they collect from these asset managers. Members expressed concern that this imposes operational burdens both on themselves and their client counterparties, who may, as a consequence, choose to limit their dealings with smaller broker-dealers.

<sup>24</sup> *See* Original Proposal, 80 FR at 63608.

<sup>25</sup> Current paragraph (e)(2)(H)(i)b. defines the term “counterparty” to mean any person that enters into a Covered Agency Transaction with a member and includes a “customer” as defined in paragraph

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market loss,<sup>26</sup> unless otherwise provided under proposed new paragraph (e)(2)(H)(ii)d. of the rule, as discussed further below. As such, both exempt and non-exempt accounts would receive the same margin treatment for purposes of Covered Agency Transactions under paragraph (e)(2)(H).<sup>27</sup>

(a)(3) under Rule 4210. The proposed rule change would redesignate the definition of counterparty as paragraph (e)(2)(H)(i)a. under the rule and revise the definition to provide that the term “counterparty” means any person, including any “customer” as defined in paragraph (a)(3) of the rule, that is a party to a Covered Agency Transaction with, or guaranteed by, a member. FINRA believes that including transactions guaranteed by a member is a useful clarifying change in the context of Covered Agency Transactions. In connection with this change, FINRA proposes to add new Supplemental Material .02, which would provide that, for purposes of paragraph (e)(2)(H), a member is deemed to have “guaranteed” a transaction if the member has become liable for the performance of either party’s obligations under the transaction. *See* proposed new Supplemental Material .02 in Exhibit 5. Accordingly, if a clearing broker were to guarantee to an introduced customer an introducing broker’s obligations under a Covered Agency Transaction between that introducing firm and customer, the introducing broker would be considered a “counterparty” of the clearing broker for purposes of paragraph (e)(2)(H).

<sup>26</sup> FINRA proposes to delete the current definition of “mark to market loss” under paragraph (e)(2)(H)(i)g. as adopted pursuant to the Approval Order and to replace it with a definition of “net mark to market loss” under proposed new paragraph (e)(2)(H)(i)d. Under the new definition, a counterparty’s “net mark to market loss” means (1) the sum of such counterparty’s losses, if any, resulting from marking to market the counterparty’s Covered Agency Transactions with the member, or guaranteed to a third party by the member, reduced to the extent of the member’s legally enforceable right of offset or security by (2) the sum of such counterparty’s gains, if any, resulting from: (a) Marking to market the counterparty’s Covered Agency Transactions with the member, guaranteed to the counterparty by the member, cleared by the member through a registered clearing agency, or in which the member has a first-priority perfected security interest; and (b) any “in the money,” as defined in paragraph (f)(2)(E)(iii) of Rule 4210, amounts of the counterparty’s long standby transactions written by the member, guaranteed to the counterparty by the member, cleared by the member through a registered clearing agency, or in which the member has a first-priority perfected security interest. Under proposed new paragraph (e)(2)(H)(i)c., a counterparty’s “excess” net mark to market loss is defined to mean such counterparty’s net mark to market loss to the extent it exceeds \$250,000. As such, by specifying excess net mark to market loss, FINRA notes that the proposed rule preserves the \$250,000 de minimis transfer exception set forth under paragraph (e)(2)(H)(ii)f. as adopted pursuant to the Approval Order. Further, FINRA notes that, in the interest of clarity, proposed new paragraph (e)(2)(H)(ii)c. expressly provides that members would not be required to collect margin, or take capital charges, for counterparties’ mark to market losses on Covered Agency Transactions other than excess net mark to market losses. Last, as discussed further below, the proposed rule change would delete paragraph (e)(2)(H)(ii)f. in the interest of consolidating the rule language.

<sup>27</sup> Current paragraph (e)(2)(H)(ii)d. of the rule contains provisions designed to permit members to

2. Option for Capital Charge in Lieu of Mark to Market Margin

Proposed new paragraph (e)(2)(H)(ii)d. of the rule is designed, subject to specified conditions and limitations, to permit members the option to take a capital charge in lieu of collecting margin for a counterparty’s excess net mark to market loss (that is, as discussed above, the net mark to market loss to the extent it exceeds \$250,000). Informed by FINRA’s engagement with members, FINRA believes this approach is appropriate because it would help alleviate the competitive disadvantage of smaller firms vis-à-vis larger firms. Smaller firms expressed concern that larger firms can leverage their greater size and scale in obtaining margining agreements with their counterparties, and that counterparties would prefer to transact with larger firms with which margining agreements can more readily be obtained, or with banks that are not subject to margin requirements under Rule 4210. Smaller firms told FINRA that having the option to take a capital charge, in lieu of collecting margin, would help alleviate the competitive disadvantage of needing to obtain margining agreements with such counterparties because there would be an alternative to collecting margin. To this end, as noted above, the proposed rule includes conditions and limitations that are designed to help protect the financial stability of members that opt to take capital charges while restricting the ability of the larger members to use their capital to compete unfairly with smaller members. Specifically, the proposed new paragraph provides that a member need not collect margin for a counterparty’s excess net mark to market loss under paragraph (e)(2)(H)(ii)c. of the rule, provided that:

- The member must deduct the amount of the counterparty’s unmargin excess net mark to market loss from the member’s net capital computed as provided in SEA Rule 15c3–1, if the counterparty is a non-margin counterparty<sup>28</sup> or if the excess

net mortgage bankers, as defined pursuant to current paragraph (e)(2)(H)(i)h. of the rule, as exempt accounts under specified conditions. Because the proposed rule change eliminates the distinction between exempt and non-exempt accounts for purposes of Covered Agency Transactions, this language is no longer needed and will be deleted.

<sup>28</sup> Proposed new paragraph (e)(2)(H)(i)e. defines a counterparty as a “non-margin counterparty” if the member: (1) Does not have a right under a written agreement or otherwise to collect margin for such counterparty’s excess net mark to market loss and to liquidate such counterparty’s Covered Agency Transactions if any such excess net mark to market loss is not margined or eliminated within five

net mark to market loss has not been margined or eliminated by the close of business on the next business day after the business day on which such excess net mark to market loss arises;<sup>29</sup>

- if the member has any non-margin counterparties, the member must establish and enforce risk management procedures reasonably designed to ensure that the member would not exceed either of the limits specified in paragraph (e)(2)(I)(i) of the rule, as proposed to be revised pursuant to this rule change,<sup>30</sup> and that the member’s net capital deductions under proposed paragraph (e)(2)(H)(ii)d.1. of the rule for all accounts combined will not exceed \$25 million;<sup>31</sup>

- if the member’s net capital deductions under paragraph (e)(2)(H)(ii)d.1. of the rule for all accounts combined exceed \$25 million for five consecutive business days, the member must give prompt written notice to FINRA. If the member’s net capital deductions under paragraph (e)(2)(H)(ii)d.1. of the rule for all accounts combined exceed the lesser of \$30 million or 25% of the member’s tentative net capital, as such term is defined in SEA Rule 15c3–1, for five consecutive business days, the member may not enter into any new Covered Agency Transactions with any non-margin counterparty other than risk-reducing transactions, and must also, to the extent of its rights, promptly collect margin for each counterparty’s excess net mark to market loss and promptly liquidate the Covered Agency transactions of any counterparty whose excess net mark to market loss is not margined or eliminated within five business days from the date it arises, unless FINRA has specifically granted the member additional time;<sup>32</sup> and

- the member must submit to FINRA such information regarding its unmargin excess net mark to market losses, non-margin counterparties and related capital charges, in such form and manner, as FINRA shall prescribe by Regulatory Notice or similar communication.<sup>33</sup>

business days from the date it arises; or (2) does not regularly collect margin for such counterparty’s excess net mark to market loss.

<sup>29</sup> *See* proposed paragraph (e)(2)(H)(ii)d.1. in Exhibit 5.

<sup>30</sup> Current paragraph (e)(2)(I) sets forth specified concentration thresholds. As discussed further below, the rule change would make conforming revisions to the rule.

<sup>31</sup> *See* proposed paragraph (e)(2)(H)(ii)d.2. in Exhibit 5.

<sup>32</sup> *See* proposed paragraph (e)(2)(H)(ii)d.3. in Exhibit 5.

<sup>33</sup> *See* proposed paragraph (e)(2)(H)(ii)d.4. in Exhibit 5.

### 3. Streamlining and Consolidation of Rule Language; Conforming Revisions

In support of the amendments discussed above, FINRA is proposing several amendments to the current rule designed to streamline and consolidate the rule language and otherwise make conforming revisions:

- The rule change consolidates language related to the \$250,000 de minimis transfer exception and the \$10 million gross open position exception while, as discussed above, preserving these exceptions in substance. The \$250,000 de minimis transfer exception is preserved because paragraph (e)(2)(H)(ii)c. under the revised rule specifies that the members shall collect margin for each counterparty's excess net mark to market loss, unless otherwise provided under paragraph (e)(2)(H)(ii)d. of the rule (that is, as discussed above, the provisions under the proposed rule that permit a member to take a capital charge in lieu of collecting margin, subject to specified conditions). The rule change deletes paragraph (e)(2)(H)(ii)f., which currently addresses the de minimis exception and would be rendered redundant. With respect to the current \$10 million gross open position exception, FINRA proposes to revise paragraph (e)(2)(H)(ii)a. of the rule, which specifies counterparties that are excepted from the rule's margin requirements, to include a "small cash counterparty" among the enumerated entities included in the exception. Proposed new paragraph (e)(2)(H)(i)h. would provide that a counterparty is a "small cash counterparty" if:

- The absolute dollar value of all of such counterparty's open Covered Agency Transactions with, or guaranteed by, the member is \$10 million or less in the aggregate, when computed net of any settled position of the counterparty held at the member that is deliverable under such open Covered Agency Transactions and which the counterparty intends to deliver;<sup>34</sup>

- the original contractual settlement date for all such open Covered Agency Transactions is in the month of the trade date for such transactions or in the month succeeding the trade date for such transactions;<sup>35</sup>

- the counterparty regularly settles its Covered Agency Transactions on a DVP basis or for cash;<sup>36</sup> and

- the counterparty does not, in connection with its Covered Agency Transactions with, or guaranteed by, the member, engage in dollar rolls, as defined in Rule 6710(z), or round robin trades,<sup>37</sup> or use other financing techniques.<sup>38</sup>

The above elements are substantially similar to the elements that are currently associated with the exception as set forth under current paragraph (e)(2)(H)(ii)c.2., which would be deleted, along with the definition of "gross open position" under paragraph (e)(2)(H)(i)e., which would be rendered redundant. The new proposed language reflects that the scope of transactions addressed by the rule include Covered Agency Transactions with a counterparty that are guaranteed by the member.

- FINRA proposes to delete the definition of "bilateral transaction" set forth in current paragraph (e)(2)(H)(i)a. The definition is in connection with the provisions under the current rule relating to margin treatment for exempt accounts under paragraph (e)(2)(H)(ii)d. and for non-exempt accounts under paragraph (e)(2)(H)(ii)e., both of which paragraphs, as discussed above, FINRA proposes to delete pursuant to the rule change. Further, FINRA notes that the term "bilateral transaction" is unduly narrow given that the proposed revised definition of "counterparty," as discussed above, would have the effect of clarifying that the rule's scope includes transactions guaranteed by the member.

- FINRA proposes to delete the definition of the term "deficiency" set forth in current paragraph (e)(2)(H)(i)d. Under the current rule, the term is designed in part to reference required but uncollected maintenance margin for Covered Agency Transactions. Because the rule change proposes to eliminate such maintenance margin, the term is not needed.

- Current paragraph (e)(2)(H)(ii)a. addresses the scope of paragraph (e)(2)(H) and certain types of counterparties that are excepted from the rule, provided the member makes and enforces written risk limits pursuant to paragraph (e)(2)(H)(ii)b. Current paragraph (e)(2)(H)(ii)b. contains the core language under the rule relating to risk limits. FINRA is proposing to revise both paragraphs so as to conform with the rule change and to consolidate the language relating to

written risk limits in these paragraphs within paragraph (e)(2)(H)(ii)b. Paragraph (e)(2)(H)(ii)a.1. would be revised to read: "1. a member is not required to collect margin, or to take capital charges in lieu of collecting such margin, for a counterparty's excess net mark to market loss if such counterparty is a small cash counterparty, registered clearing agency, Federal banking agency, as defined in 12 U.S.C. 1813(z), central bank, multinational central bank, foreign sovereign, multilateral development bank, or the Bank for International Settlements; and . . ." <sup>39</sup> Paragraph (e)(2)(H)(ii)a.2. would be revised to read: "2. a member is not required to include a counterparty's Covered Agency Transactions in multifamily housing securities or project loan program securities in the computation of such counterparty's net mark to market loss, provided . . ." <sup>40</sup> Paragraph (e)(2)(H)(ii)a.2.A. would not be changed, other than to be redesignated as part of part of (e)(2)(H)(ii)a.2. Paragraph (e)(2)(H)(ii)a.2.B. would be eliminated as redundant <sup>41</sup> because, correspondingly, paragraph (e)(2)(H)(ii)b. would be revised to read: "A member that engages in Covered Agency Transactions with any counterparty shall make a determination in writing of a risk limit for each such counterparty, including any counterparty specified in paragraph (e)(2)(H)(ii)a.1. of this Rule, that the member shall enforce. The risk limit for

<sup>39</sup>The proposed new term "small cash counterparty" is discussed above. The proposed language in the paragraph reflects FINRA's proposed establishment of the option to take a net capital charge in lieu of collecting margin. Further, FINRA notes that, for clarity, the proposed rule change adds registered clearing agencies to the types of counterparties that are within the exception pursuant to paragraph (e)(2)(H)(ii)a. as revised. This preserves the treatment of registered clearing agencies under the rule in light of the proposed deletion of current paragraph (e)(2)(H)(ii)c. In this regard, also in the interest of clarity, FINRA proposes to add new paragraph (e)(2)(H)(i)f. by way of defining the term "registered clearing agency."

<sup>40</sup>Under current paragraph (e)(2)(H)(ii)a.2., a member is not required to apply the margin requirements of paragraph (e)(2)(H) to Covered Agency Transactions with a counterparty in multifamily housing securities or project loan program securities, provided the securities meet the specified conditions under the rule and the member makes and enforces the written risk limit determinations as specified under the rule. FINRA notes that the proposed rule change does not change the treatment of multifamily housing securities or project loan program securities under the current rule other than to clarify, in express terms, that a member is not required to include a counterparty's Covered Agency Transactions in multifamily housing securities or project loan program securities in the computation of such counterparty's net mark to market loss.

<sup>41</sup>See proposed paragraph (e)(2)(H)(ii)a. in Exhibit 5.

<sup>34</sup> See proposed paragraph (e)(2)(H)(i)h.1. in Exhibit 5.

<sup>35</sup> See proposed paragraph (e)(2)(H)(i)h.2. in Exhibit 5.

<sup>36</sup> See proposed paragraph (e)(2)(H)(i)h.3. in Exhibit 5.

<sup>37</sup>The term "round robin" is defined under current paragraph (e)(2)(H)(i)i. of the rule and, pursuant to the rule change, would be redesignated as paragraph (e)(2)(H)(i)g., without any change.

<sup>38</sup> See proposed paragraph (e)(2)(H)(i)h.4. in Exhibit 5.

a counterparty shall cover all of the counterparty's Covered Agency Transactions with the member or guaranteed to a third party by the member, including Covered Agency Transactions specified in paragraph (e)(2)(H)(ii)a.2. of this Rule. The risk limit determination shall be made by a designated credit risk officer or credit risk committee in accordance with the member's written risk policies and procedures."<sup>42</sup>

- Paragraph (e)(2)(I) under Rule 4210 addresses concentration thresholds. FINRA is proposing to make revisions to align the paragraph with the proposed new language as to paragraph (e)(2)(H), in particular the elimination of the maintenance margin requirement and the introduction of the proposed new term "small cash counterparty." Specifically, FINRA proposes to revise the opening sentence of the paragraph to read: "In the event that (i) the net capital deductions taken by a member as a result of marked to the market losses incurred under paragraphs (e)(2)(F), (e)(2)(G) (exclusive of the percentage requirements established thereunder), or (e)(2)(H)(ii)d.1. of this Rule, plus any unmarginated net mark to market losses below \$250,000 or of small cash counterparties exceed . . ." <sup>43</sup> Current paragraph (e)(2)(I)(i)c. would be redesignated as (e)(2)(I)(ii) and would read: "(ii) such excess as calculated in paragraph (e)(2)(I)(i) of this Rule continues to exist on the fifth business day after it was incurred . . ." The final clause of the paragraph would be revised to read: ". . . the member shall give prompt written notice to FINRA and shall not enter into any new transaction(s) subject to the provisions of paragraphs (e)(2)(F), (e)(2)(G) or (e)(2)(H) of this Rule that would result in an increase in the amount of such excess."

- Paragraph (f)(6) under Rule 4210 addresses the time within which margin or "mark to market" must be obtained. FINRA proposes to delete the phrase "other than that required under paragraph (e)(2)(H) of this Rule," so the rule, as revised, would read: "The amount of margin or 'mark to market' required by any provision of this Rule shall be obtained as promptly as possible and in any event within 15 business days from the date such deficiency occurred, unless FINRA has specifically granted the member additional time." FINRA believes this is appropriate given the proposed elimination of current paragraph

(e)(2)(H)(ii)d. and paragraph (e)(2)(H)(ii)e. of the rule, both of which set forth, among other things, specified time frames for collection of mark to market losses or deficiencies, as appropriate, and liquidation of positions that are specific to Covered Agency Transactions.

- Current Supplemental Material .02 addresses the requirement for monitoring procedures with respect to mortgage bankers, for purposes of treating them as exempt accounts pursuant to current paragraph (e)(2)(H)(ii)d. Current Supplemental Material .03 addresses how the cure of mark to market loss or deficiency, as defined under the current rule, may cure the need to liquidate positions. Current Supplemental Material .04 addresses determining whether an account qualifies as an exempt account. The proposed rule change would render each of these provisions unnecessary, given that the rule change eliminates the need to distinguish exempt versus non-exempt accounts, including, as discussed above, the language targeted toward mortgage bankers, and eliminates the liquidation provisions under current paragraph (e)(2)(H)(ii)d. and paragraph (e)(2)(H)(ii)e. of the rule. FINRA proposes to redesignate current Supplemental Material .05 as Supplemental Material .03.<sup>44</sup>

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a *Regulatory Notice* to be published no later than 60 days following Commission approval. The effective date will be no later than 120 days following publication of the *Regulatory Notice* announcing Commission approval.<sup>45</sup> Further, FINRA plans to file a separate proposed rule change that would adjust the October 26, 2021, implementation date for the requirements pursuant to SR-FINRA-2015-036 (other than the risk limit determination requirements that became effective on December 15, 2016) to align with the effective date of the amendments to SR-FINRA-2015-036 as set forth in this proposed rule change. FINRA believes this alignment is appropriate in the interest of regulatory clarity.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions

<sup>44</sup> See the Supplemental Material provisions in Exhibit 5.

<sup>45</sup> FINRA notes that the proposed rule change would not impact members that are funding portals or that have elected to be treated as capital acquisition brokers ("CABs"), given that such members are not subject to Rule 4210.

of Section 15A(b)(6) of the Act,<sup>46</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. Based on extensive engagement with industry participants, FINRA believes that the proposed rule change is consistent with the Act because, by eliminating the maintenance margin requirement for Covered Agency Transactions and by permitting members, under specified conditions, to take a capital charge in lieu of collecting margin, the proposed amendments will alleviate the negative competitive impact that the requirements pursuant to SR-FINRA-2015-036 could have for smaller firms. Smaller firms told FINRA that the requirements pursuant to SR-FINRA-2015-036, absent the proposed revisions by FINRA, would have the effect of favoring larger firms that could leverage their greater size and scale and non-member banks that are not subject to the requirements of FINRA rules. The proposed rule change, by alleviating this disadvantage, would help promote competition by leveling the playing field among participants in the Covered Agency Transaction market, thereby reducing disruption in the Covered Agency Transaction market without the loss of investor protection.

## B. Self-Regulatory Organization's Statement on Burden on Competition

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

## Economic Impact Assessment

FINRA has undertaken an economic impact assessment, as set forth below, to further analyze the regulatory need for the proposed rule change, its potential economic impacts, including anticipated costs, benefits, and distributional and competitive effects, relative to the current baseline, and the alternatives FINRA considered in assessing how best to meet its regulatory objective.

### A. Regulatory Need

In Partial Amendment No. 3 to SR-FINRA-2015-036, FINRA stated that it would monitor the impact of the requirements specified in the rule change, inclusive of any potential intended or unintended regulatory, economic or competitive consequences.

<sup>46</sup> 15 U.S.C. 78o-3(b)(6).

<sup>42</sup> See proposed paragraph (e)(2)(H)(ii)b. in Exhibit 5.

<sup>43</sup> See proposed paragraph (e)(2)(I) in Exhibit 5.

In response to concerns raised by industry participants regarding the impacts of the requirements, FINRA has engaged in extensive dialogue with industry participants, staff of the SEC and the Federal Reserve System, to reconsider the specified requirements, and to propose any necessary amendments to the requirements adopted pursuant to SR-FINRA-2015-036.

#### B. Economic Baseline

The economic baseline for the proposed rule change is based on (1) the existing state of the market and firm practices, (2) Rule 4210 prior to the amendments pursuant to SR-FINRA-2015-036 (for convenience, “pre-revision Rule 4210”), and (3) the amendments pursuant to SR-FINRA-2015-036 that, other than the risk limit determination requirements that became effective on December 15, 2016, would be implemented on the October 26, 2021, implementation date.

Through several discussions and consultations with member firms and other relevant stakeholders since the SEC approved SR-FINRA-2015-036, FINRA has learned about some of the unintended consequences identified as part of the rulemaking. A particular aspect that has been identified is with respect to competition among FINRA members firms, and between member and non-member firms. The outbreak of the COVID-19 pandemic in early 2020 affected the financial system, increasing volatility in different markets, including the Covered Agency Transaction market.<sup>47</sup> This exogenous shock to the market took place while FINRA was well into the process of evaluating feedback and concerns raised regarding the margin requirements for trading in this market. FINRA sought feedback, and discussed with several firms, the impact on the Covered Agency Transaction market of the increased volatility, including the impact of the margin requirements pursuant to SR-FINRA-2015-036 and the requirements as they would be amended pursuant to this rule filing. Overall, firms that participated in the outreach were supportive of the proposed rule amendments as set forth in this filing.

Market participants indicated that the order and timing of official sector activities, including the Federal Reserve Board’s federal funds rate cut and its

quantitative easing measures, including purchases of U.S. Treasury securities (“UST”) and mortgage-based securities (“MBS”), and the mortgage loan forbearance relief provided under the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”),<sup>48</sup> as amended, were coincident with short-term significant increases in volatility in UST and MBS pricing, resulting in increased margin calls, lower counterparty liquidity, and an adverse effect on related hedges. Most of the firms that participated in FINRA’s outreach efforts had signed with their counterparties margining agreements (MSFTAs or customer account agreements), giving the firms the ability to collect margin when necessary. These firms reported that in most cases, clients met their margin calls, with uncollected margin amounts being charged against the firm’s capital, in accordance with pre-revision Rule 4210 and, in some cases, the requirements pursuant to SR-FINRA-2015-036 and the SEC staff’s related guidance regarding SEA Rule 15c3-1 and Rule 15c3-3.<sup>49</sup> Thus, FINRA learned that firms have in principle already adjusted to the requirements of SR-FINRA-2015-036, which as such is an appropriate baseline for the proposed rule change.

The economic baseline considers the impact of the proposed rule change against the obligations, costs, and benefits associated with the requirements of SR-FINRA-2015-036. FINRA recognizes that some firms might continue to operate under the requirements of pre-revision Rule 4210, versus the requirements of SR-FINRA-2015-036. In establishing the rule change pursuant to SR-FINRA-2015-036, FINRA provided an analysis of the economic baseline that existed pre-2015 (the year that FINRA filed SR-FINRA-2015-036 with the SEC), and the potential economic impacts of the proposed changes pursuant to SR-FINRA-2015-036.<sup>50</sup> FINRA understands that the individual impacts experienced as a result of the proposed rule change as set forth in this filing will depend upon the extent to which member firms wholly adopted, partially adopted or are waiting to implement the requirements of SR-FINRA-2015-036.

#### C. Economic Impacts

FINRA has analyzed the potential costs and benefits of the proposed rule change, and the different parties that are

expected to be affected. FINRA has identified member firms that engage in Covered Agency Transactions and their customers as the parties to be mainly affected by the proposed rule change. The proposed rule change is expected to provide relief to member firms, while promoting competition without diminishing investor protections.

#### Anticipated Benefits

FINRA believes that the proposed rule change would provide several direct benefits to member firms. First, the removal of the two percent maintenance margin requirement on non-exempt accounts would benefit member firms by reducing costs arising from two main channels. First, firms would no longer incur costs associated with distinguishing between exempt and non-exempt accounts. Second, the proposed rule change would provide operational relief with respect to obtaining custody and related agreements in connection with the need to collect maintenance margin. FINRA understands that the requirement to collect maintenance margin has led firms to enter into separate custodial agreements with third party banks to hold the maintenance margin where counterparties are constrained from custodying assets direct with broker-dealers. This resulted in an operational burden to both the member firms and their counterparties. Anecdotally, mid-size and smaller member firms have claimed an additional indirect cost to the current rule, specifically, that this operational burden has resulted in counterparties reducing the number of member firms with which they transact.

Second, the proposed rule change would permit member firms the option to take a capital charge in lieu of collecting margin for a counterparty’s excess net mark to market loss. The proposal would allow member firms to do so subject to specified conditions and limitations as discussed above, and would preserve the substance of the exceptions permitted under the current rule.<sup>51</sup> These conditions and limitations are designed to help protect the financial stability of members that opt to take capital charges. The proposed limit on the capital charges taken by the firm in lieu of collecting margin provides guardrails to ensure that large member firms do not use this provision to corner the market in these securities.

FINRA has learned that allowing firms to take a capital charge in lieu of collecting margin would further benefit them by decreasing operational burdens. These burdens arise from the costs

<sup>47</sup> See the DERA Report, note 17 *supra*. See also Federal Reserve Bank of New York Staff Reports, *It’s What You Say and What You Buy: A Holistic Evaluation of the Corporate Credit Facilities* (July 2020), available at: <[https://www.newyorkfed.org/medialibrary/media/research/staff\\_reports/sr935.pdf](https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr935.pdf)>.

<sup>48</sup> Public Law 116–136, 134 Stat. 281 (2020).

<sup>49</sup> See the SEC staff Frequently Asked Question set as referenced in note 15 *supra*.

<sup>50</sup> See the Original Proposal as referenced in note 9 *supra*.

<sup>51</sup> See, for example, note 19 and note 20 *supra*.

associated with obtaining the required margin agreements from counterparties, and from the competitive advantage large dealers have, stemming from their ability to enter into MSFTAs with trading counterparties. Finally, FINRA believes that this provision would result in a transfer of the risk from the customer to the member firm. This would benefit the firm's customers and trading counterparties by reducing their costs and decreasing their risk exposure. As such, this could serve as an additional incentive to establishing trading relationships.

FINRA believes that, in addition to the main benefits discussed above, member firms would benefit from the streamlining of the rule text and clarifications provided throughout, including the provisions and exceptions as discussed above and set forth by the rule. One such example is the proposed change to the definition of counterparty in the rule. The proposed definition is expected to reduce costs associated with determining liability and responsibilities when establishing the contractual relationship between the member firm and its counterparty. A second example is the proposed amendment that defines the required margin by reference to the proposed new defined term "excess net mark to market loss." The proposed language streamlines and clarifies the language pursuant to SR-FINRA-2015-036 with regard to the \$250,000 de minimis transfer amount, thereby making it easier to determine the applicable margin.<sup>52</sup> This is expected to reduce the costs associated with determining the margin requirements when establishing trading relationships.

#### Anticipated Costs

FINRA notes that while the choice by member firms to commit capital in lieu of margin has anticipated benefits, as discussed above, such choice can also potentially result in some costs. The magnitude of these costs depends on the firm's trading activity, its access to capital, and the capital reserves necessary to fulfill the firm's margin obligations. As firms are not required to commit capital in lieu of margin, FINRA expects that firms will only do so when they believe it appropriately balances benefits and risks.

Moreover, the member firm's decision to take a capital charge in lieu of capital has additional associated costs. Taking a capital charge reduces the amount of excess net capital a firm has available for other uses and exposes the firm to financial and business risk if its

counterparties fails to deliver. Additional related costs could stem from the necessary compliance systems needed to make sure the permitted limits on taking such capital charges are met, and the costs related to when the firm needs to keep to these limits for an extended period, as set forth in the proposed rule text.

#### Anticipated Competitive Effects

Collectively, the proposed rule change is expected to potentially level the playing field both between regional and primary broker-dealer members and between member firms and non-FINRA member regional banks. While FINRA has no direct measure of trading activity by non-member firms, it is expected that the main provisions of the proposed rule change would reduce incentives to limit trading relationships with FINRA member firms on account of the regulatory-imposed costs. Decreasing the costs associated with the collection of maintenance margin, and the ability to take a capital charge in lieu of collecting margin, would lower the overall costs associated with engaging in Covered Agency Transactions. FINRA believes that this would ultimately lower the barriers to entry into the Covered Agency Transaction market and increase competition. The magnitude of the competitive impact depends on the extent to which the requirements pursuant to SR-FINRA-2015-036 have already impacted market participant behavior. Finally, the collective impacts described above are expected to benefit the investor community, by providing investors more options for trading in this market.

#### D. Alternatives Considered

FINRA considered various alternatives to the proposed rule amendments. For example, with regard to the provisions under proposed paragraph (e)(2)(H)(ii)d.3. that specify the \$30 million or 25% of tentative net capital thresholds,<sup>53</sup> FINRA considered imposing the specified consequences as set forth under the proposal as soon as a member exceeds a limit of \$25 million in capital charges in lieu of collecting margin. Industry participants expressed concern that the abrupt imposition of such consequences in cases of market stress, without allowing time for the member to collect margin, would be burdensome to firms. FINRA believes this concern is valid and as such is proposing that incurring capital charges in excess of \$25 million for five consecutive business days will require

notice to FINRA, while incurring capital charges in excess of \$30 million or 25% of a firm's tentative net capital for five consecutive business days will also require firms to take the specified steps to manage their risk.

FINRA believes that the proposal strikes an appropriate balance between regulatory burdens and the ability of member firms to compete in these markets, as well as member firms' financial responsibility and operational risk considerations and compliance.

#### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments were neither solicited nor received.

#### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) By order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments

- Use the Commission's internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2021-010 on the subject line.

##### Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2021-010. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will

<sup>52</sup> See note 26 *supra*.

<sup>53</sup> See proposed Rule 4210(e)(2)(H)(ii)d.3. in Exhibit 5.

post all comments on the Commission's internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2021-010 and should be submitted on or before June 15, 2021.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>54</sup>

**J. Matthew DeLesDernier,**  
Assistant Secretary.

[FR Doc. 2021-10959 Filed 5-24-21; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-91947; File No. SR-NASDAQ-2020-057]

### Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Order Approving a Proposed Rule Change, as Modified by Amendment No. 2, To Allow Companies To List in Connection With a Direct Listing With a Primary Offering in Which the Company Will Sell Shares Itself in the Opening Auction on the First Day of Trading on Nasdaq and To Explain How the Opening Transaction for Such a Listing Will Be Effected

May 19, 2021.

#### I. Introduction

On September 4, 2020, The Nasdaq Stock Market LLC ("Nasdaq" or the "Exchange") filed with the Securities and Exchange Commission

("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to allow companies to list in connection with a primary offering in which the company will sell shares itself in the opening auction on the first day of trading on the Exchange and to explain how the opening transaction for such a listing will be effected. The proposed rule change was published for comment in the **Federal Register** on September 21, 2020.<sup>3</sup> On November 4, 2020, pursuant to Section 19(b)(2) of the Exchange Act,<sup>4</sup> the Commission designated a longer period within which to either approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.<sup>5</sup> On December 17, 2020, the Commission instituted proceedings under Section 19(b)(2)(B) of the Exchange Act<sup>6</sup> to determine whether to approve or disapprove the proposed rule change.<sup>7</sup> On February 22, 2021, the Exchange filed Amendment No. 1 to the proposed rule change, which superseded the proposed rule change as originally filed.<sup>8</sup> The

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 89878 (September 15, 2020), 85 FR 59349 (September 21, 2020). Comments received on the proposal are available on the Commission's website at: <https://www.sec.gov/comments/sr-nasdaq-2020-057/srnasdaq2020057.htm>.

<sup>4</sup> 15 U.S.C. 78s(b)(2).

<sup>5</sup> See Securities Exchange Act Release No. 90331 (November 4, 2020), 85 FR 71708 (November 10, 2020).

<sup>6</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>7</sup> See Securities Exchange Act Release No. 90717 (December 17, 2020), 85 FR 84025 (December 23, 2020) ("Order Instituting Proceedings" or "OIP").

<sup>8</sup> Amendment No. 1 to the proposed rule change revised the proposal to (1) add to the requirements that must be satisfied before a security can be released for trading in the cross that the actual price calculated by the cross must be at or above the lowest price and at or below the highest price of the price range established by the issuer in its effective registration statement; (2) revise the fourth tie-breaker used in calculating the Current Reference Price (as defined below) to provide that this tie-breaker will be the price that is closest to the lowest price of the price range disclosed by the issuer in its effective registration statement; (3) revise the price to be used by Nasdaq for purposes of qualifying a security for listing to provide that Nasdaq will use a price per share equal to the lowest price in the price range disclosed by the issuer in its effective registration statement to determine whether the company has met the applicable Market Value of Unrestricted Publicly Held Shares (as defined below), bid price, and market capitalization requirements; (4) add that, notwithstanding the provisions of Rule 4120(c)(8)(A), Nasdaq, in consultation with the financial advisor to the issuer, will make the determination of whether the security is ready to trade as described in Rule 4120(c)(8)(A), and Nasdaq will make the determination of whether to postpone or reschedule the offering, but will do so

proposed rule change, as modified by Amendment No. 1, was published for comment in the **Federal Register** on March 2, 2021.<sup>9</sup> On March 17, 2021, the Commission extended the time period for approving or disapproving the proposal to May 19, 2021.<sup>10</sup> On April 30, 2021, the Exchange filed Amendment No. 2 to the proposed rule change, which superseded the proposed rule change, as modified by Amendment No. 1.<sup>11</sup> The Commission is approving the proposed rule change, as modified by Amendment No. 2.

#### II. Description of the Proposal, as Modified by Amendment No. 2

Listing Rule IM-5315-1 provides additional listing requirements for listing a company that has not previously had its common equity securities registered under the Exchange Act on the Nasdaq Global Select Market at the time of effectiveness of a registration statement<sup>12</sup> filed solely for the purpose of allowing existing shareholders to sell their shares (a "Selling Shareholder Direct Listing"). To allow a company to also sell shares on its own behalf in connection with its initial listing upon effectiveness of a registration statement, without a traditional underwritten public offering, the Exchange has proposed to adopt Listing Rule IM-5315-2. This proposed

only if there is insufficient buy interest to satisfy the CDL Order and all other market orders, or if the actual price calculated by the cross is outside the price range established by the issuer in its effective registration statement; and (5) make minor technical changes to improve the clarity of the proposal. Amendment No. 1 to the proposed rule change is available on the Commission's website at <https://www.sec.gov/comments/sr-nasdaq-2020-057/srnasdaq2020057-8400450-229459.pdf>.

<sup>9</sup> See Securities Exchange Act Release No. 91205 (February 24, 2021), 86 FR 12245 (March 2, 2021) ("Notice").

<sup>10</sup> See Securities Exchange Act Release No. 91345 (March 17, 2021), 86 FR 15530 (March 23, 2021).

<sup>11</sup> Amendment No. 2 to the proposed rule change revised the proposal to (1) clarify Nasdaq's intent in Amendment No. 1 that in a Direct Listing with a Capital Raise, Nasdaq alone would make a determination of whether to postpone and reschedule the offering, and would not postpone and reschedule if (i) all market orders will be executed in the cross, and (ii) the actual price calculated by the cross is at or above the lowest price and at or below the highest price of the price range established by the issuer in its effective registration statement; and (2) make minor technical and conforming changes to improve the clarity of the proposal. Because the changes in Amendment No. 2 to the proposed rule change do not materially alter the substance of the proposed rule change or make conforming or technical amendments, Amendment No. 2 is not subject to notice and comment. Amendment No. 2 to the proposed rule change is available on the Commission's website at <https://www.sec.gov/comments/sr-nasdaq-2020-057/srnasdaq2020057-8746216-237241.pdf>.

<sup>12</sup> The reference to a registration statement refers to a registration statement effective under the Securities Act of 1933 ("Securities Act").

<sup>54</sup> 17 CFR 200.30-3(a)(12).