# Compliance with New TBA Transaction Regulation

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# Managing Rule 4210

NRI White Paper
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NRI

# Summary

- New 4210 Regulations have been made, modifying current margin requirements
- Originating in December of 2016, risk limit determination requirements are in effect, while other requirements have been pushed back
- Written risk determinations must be made and enforced
- There are several exceptions or allowances when looking at New Regulations
- Unless provided with an exception, members are required to collect mark to market margin and maintenance margin
- Compliance with new regulation is essential to efficient business processes
- Firms need a Margin Calculation solution that will integrate with existing back office systems

# Background

## Introduction

Since 2007, mortgage securitisation by private financial institutions has continued to decrease. During this period of decline, the issuing of agency mortgage-backed-securities has endured and remains forceful. Over 90% of Mortgage-Backed Securities (MBS) transactions take place in the forward, to-be-announced (TBA), market[1].

The TBA market acts as one of the biggest fixed income markets, holding approximately $5 trillion of securities outstanding and between $750 billion and $1.5 trillion in gross un-settled and un-margined dealer to customer transactions[2].

In 2016 the SEC approved FINRA'S rule change, bringing new amendments to Rule 4210. The goal was to establish requirements for Covered Agency Transactions. Included within CAT's are forward-settling agency MBS – or TBA transactions[3].

The regulation will impact the following:

1) TBA transactions – including adjustable rate mortgage (ARM) transactions
2) Specified Pool Transaction
3) Collateralised Mortgage Obligations (CMOs) issued in conformity with a program of an agency of Government- Sponsored Enterprise, with forward settlement dates

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| **Open position exception** | $10 million or less per agreement |
| **Maintenance margin** | 2% of market value of underlying securities in Master Securities Forward Transaction Agreements (MSFTA) |
| **Mark-to-market margin or "loss"** | Counterparty's loss resulting from marking a Covered Agency Transaction to market |
| **Minimum transfer amount** | $250,000 per legal agreement (MSFTA) |
| **Posting party designation** | Unilateral in favor of sell side |
| **Position liquidation** | 5 days if mark-to-market loss or deficiency is not satisfied |
| **Exemptions** | *Full exemption* — Federal banking agencies, central banks, multinational central banks, multilateral development banks, foreign sovereigns, and the Bank for International Settlements.<br>*Maintenance margin exemption* — FINRA members and non-member registered broker/dealers, mortgage bankers that hedge their loans, banks, savings associations, insurance companies, investment firms, and state and local governments. [2] |

1 New York Feed, *TBA Trading and Liquidity in the Agency MBS Market,* https://www.newyorkfed.org/medialibrary/media/research/epr/2013/1212vick.pdf

2 Bloomberg Professional Services, *Comply with new FINRA 4210 rules for TBA transactions*, https://data.bloomberglp.com/professional/sites/10/FINRA-4210-Rules-Fact-Sheet.pdf

3 Finra, *Frequently Asked Questions & Guidance Covered Agency Transactions Under FINRA Rule 4210,* https://www.finra.org/sites/default/files/faq_coveredtransactions_rule4210.pdf

## Key Preparatory Steps?

On January 29th, FINRA released the following statement:

*"Financial Industry Regulatory Authority, Inc. ("FINRA") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to extend, to March 25, 2020, the implementation date of the amendments to FINRA Rule 4210 (Margin Requirements) pursuant to SR-FINRA-2015-036, other than the amendments pursuant to SR-FINRA-2015-036 that were implemented on December 15, 2016"* [4].

Implementation of FINRA Rule 4210 has had several false starts. The final rules are still fluid with the extension to March 25th 2020.

Preparation for the implementation of new regulation is key in order to avoid unnecessary disruption. The following areas should be evaluated in terms of current capabilities and efficiencies.

Key areas include:

- Capturing and utilising key terms from the MSFTA
- Identifying counterparty exemptions, to determine full or partial exemption
- Identifying transaction types, when referencing TBA transactions, Specified Pool Transactions, and CMO's
- Calculating initial and maintenance margin, when dealing with non-exempt accounts
- Making and enforcing Risk Limits at the appropriate level when dealing with counterparties engaging in Covered Agency Transactions
- Margin requirements for exempt and non-exempt accounts, to ensure appropriate mark to market and maintenance margin collection
- Tracking maintenance and mark to market margin calls, while complying with aging rules

## The GX-Margin Solution

Through development of the GX-Margin product, NRI has delivered a functionally rich platform that supports the margin and collateral management requirements across the OTC, secured financing, prime brokerage and MBS asset classes. This comprehensive platform facilitates consolidation of all collateral management requirements into a single solution, enabling all activities to be managed in one place. Current users of the product have leveraged these consolidation benefits to enhance their operating model by bringing together different collateral management users into a centralised function, where process standardisation and economies of scale delivers a robust, scalable solution.

The GX Margin solution supports a range of different margin calculations including support for TBA's and upcoming 4210 regulation. As organisations assess the capabilities and efficiencies of their processes, the GX-Margin solution is well-positioned to face these new challenges. Some key functionality within the platform includes:

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[4] Finra, *Rule Filing,* http://www.finra.org/sites/default/files/rule_filing_file/SR-FINRA-2019-005.pdf

- Automated margin calculation and call generation per agreement type
- Interfaces with industry utilities – Acadiasoft, Tri-resolve – to drive automation and efficiency
- Automated email capture and call creation, eliminating mutual effort and providing enhanced control to the call management process
- Workflow based dispute tracking and resolution
- Support for both triparty and bilateral custody models
- Collateral booking and management
- Consolidated inventory management view, providing real time transparency on location and status of collateral
- MI and reporting capability to support regulatory and risk management objectives

4210 specific activities include but not limited to:

- Capture exempt / non-exempt flags
- Based on Maintenance Margin Exempt Flag, Maintenance Margin appends to the account displayed at counterparty level
- Based on Maintenance Margin Non-Exempt Flag, 2% of Net Principal will be applied while calculating the requirement
- System will track the aging of the 'PARTIALLY AGREED' and 'DISPUTED' calls.

Developed upon modern, componentised architecture the GX-Margin solution is simple to integrate into existing infrastructure, making deployment practical and straightforward. This integration ease avoids large scale disruption through providing a modular add-on to existing infrastructure.

Contact us at gx-info@nri.co.jp to see how the GX-Margins solution can support your automation and compliance goals.

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## About NRI

NRI is a global top 10 Fintech company with annual sales exceeding $5 billion. Leveraging our consulting expertise, NRI provides state-of-the-art managed service and financial system solutions to transform financial institutions into digital companies equipped to thrive in the new digital era. With a 50-year track record of success and a team of 13,000 skilled professionals in more than 50 offices globally, NRI caters to a wide range of post-trade operational needs by mitigating cost and risk, and improving efficiency.
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