April 10, 2017

Robert W. Errett
Deputy Secretary
Securities and Exchange Commission,
100 F Street, NE
Washington, DC 20549

RE: FILE NUMBER SR-FICC-2017-002

Dear Mr. Errett:

Ronin Capital, LLC ("Ronin") appreciates the opportunity to comment on a proposed rule change by the Fixed Income Clearing Corporation ("FICC") to modify the Government Securities Division ("GSD") Rulebook to implement the Capped Contingency Liquidity Facility ("CCLF").[1]

As more fully described below, Ronin requests that the Securities and Exchange Commission (the "Commission") reject FICC's proposed rule change because such rule change places an unfair burden on smaller GSD Netting Members and is anticompetitive.

Implementation of the CCLF is meant to ensure that the FICC has sufficient financial resources "to meet its cash settlement obligations in the event of a default of the largest family of affiliated Netting Members."[2] If such a default exceeded liquid resources available to the FICC, additional financial resources would be provided by its non-defaulting Netting Members. The CCLF provides a rules-based mechanism through which the FICC acquires these additional financial resources from its GSD membership.

The CCLF was architected to comply with Rule 17Ad-22(b)(3), as amended, of the Securities Exchange Act of 1934 (the "Exchange Act"), which requires the FICC to:

> Maintain sufficient financial resources to withstand, at a minimum, a default by the participant family to which it has the largest exposure in extreme but plausible market conditions[3]

While it is clear that the FICC must "maintain sufficient financial resources" to withstand a default by its largest participant family ("Cover 1"), the manner by which this is accomplished is not prescribed. Thus, the FICC (and other CCPs) have a large amount of flexibility with respect to developing a plan that complies with this rule. Given this inherent flexibility, Ronin is disappointed that the FICC has chosen to demonstrate compliance with this rule by developing a liquidity plan that we believe places an anticompetitive burden on some of its members. We believe the CCLF, as currently designed, unnecessarily impacts the business models of smaller GSD Netting Members, particularly those members that are not bank holding companies. In our opinion, the CCLF unfairly penalizes smaller Netting Members in order to protect the FICC from default risks posed only by its largest Netting Members. Unfortunately, we also believe the CCLF does nothing to prevent the growth of settlement risk and its corresponding Cover 1 requirement. These facts should concern regulators.

[1] SEC Release No. 34-80234; File No. SR-FICC-2017-002
[2] SEC Release No. 34-80234 p. 2
[3] See 17 CFR 240.17Ad7-22(b)(3)

The purpose of this comment letter is to demonstrate the unfair and unnecessary competitive burden the CCLF imposes on smaller GSD Netting Members, while doing nothing to limit the growth of the Cover 1 requirement. Ronin will expound on the following:

1) The default of a smaller Netting Member does not present settlement risk to the FICC.
2) Only the largest Netting Members present potential settlement risk to the FICC.
3) The CCLF forces smaller Netting Members to subsidize the outsized liquidity risks posed by the largest Netting Members. This is anticompetitive.
4) The largest Netting Members have clear advantages in satisfying the requirements demanded by the CCLF.
5) The CCLF does nothing to discourage an increase in the Cover 1 requirement. Other proposed GSD rule changes may increase settlement risk and the subsequent growth of the Cover 1 requirement.[4]
6) Negative economic impact and/or an inability to meet the CCLF requirement might force smaller Netting Members to leave the GSD. This fact, as well as the creation of a potent barrier to entry for prospective new Netting Members, only serves to promote concentration risk.
7) Consolidation and concentration increase asymmetric risk to the FICC. Diversity of membership diminishes this risk. A broad and diverse GSD membership will be better able to withstand the next financial crisis. Concentration and lack of diversification among the GSD membership only promote systemic risk.

Because of these concerns, Ronin respectfully asks the Commission to reject approval of the change to the GSD Rulebook that would implement the CCLF. The FICC has sufficient flexibility under Rule 17Ad-22(b)(3) of the Exchange Act to devise a liquidity plan that does not unfairly burden its smaller Netting Members. <u>If settlement risk associated with clearing U.S. Treasuries is concerning to regulators, a liquidity plan should likely present requirements which discourage the growth and concentration of this risk. Instead, the CCLF merely forces all Netting Members to subsidize this liquidity risk.</u> Ultimately, we hope that the Commission will direct the FICC to devise a more benign and effective plan for complying with Rule 17Ad-22(b)(3).

Systemic Risk

Rule 17Ad-22(b)(3) of the Exchange Act requires the FICC to maintain the financial resources to ensure it can withstand the default, in plausible market conditions, of the participant family to which it has the largest exposure. The FICC quantifies the size of this liquidity need in the CCLF rule proposal as follows:

> FICC's historical liquidity need for the six-month look-back period would be an amount equal to the dollar amount of the largest sum of an Affiliated Family's obligation to receive GSD eligible securities plus the net dollar amount of its Funds-Only Settlement Amount (collectively, the "Historical Cover 1 Liquidity Requirement").[5]

Simply stated, the size of FICC's liquidity need (i.e. the size of the CCLF) is completely determined by the largest participant family. The identity of this largest participant family might change every six months - the identity of FICC's largest Netting Member ("MegaBank XYZ") is kept anonymous. However, despite this anonymity, it is almost certain that MegaBank XYZ is a global systemically important bank ("G-SIB").[6] Again, the size of the CCLF is "based on the largest Affiliated Family's activity during a six-month look-

[4] SEC Release No. 34-70688 has the potential to massively increase the risk the CCLF is attempting to mitigate
[5] SEC Release No. 34-80234 p. 8
[6] http://www.fsb.org/wp-content/uploads/2016-list-of-global-systemically-important-banks-G-SIBs.pdf

back period."[7] This is a very large number. At present, the activity of anonymous MegaBank XYZ has resulted in a CCLF requirement of nearly $74 billion.[8] Meanwhile, the trading activities of smaller Netting Members have no bearing on whether the size of the CCLF increases or decreases over a given six-month period. MegaBank XYZ alone anonymously drives the size of FICC's liquidity need.

Now, the FICC has been designated a systemically important financial market utility ("SIFMU") by the Financial Stability Oversight Council.[9] Concisely stated, the need for creating a liquidity plan like the CCLF is to protect one systemically important institution (the FICC) from other systemically important institutions (the G-SIBs). This raises the question, is it fair to force other GSD Netting Members to subsidize this risk? If the size of this liquidity risk is so large as to systemically threaten the U.S. Financial System, isn't it more prudent to come up with a plan that reduces the size of this risk?

CCLF Event

Ronin understands that the goal of Rule 17Ad-22(b)(3) of the Exchange Act, as applied to the FICC, is to ensure that a participant default would not disrupt the operations of the FICC or that of its non-defaulting Netting Members. In other words, the objective of the CCLF is to shield the FICC, a SIFMU, from systemic risk caused by the default of a Netting Member. Given the critical nature of this undertaking, Ronin believes it is important to qualify which types of Netting Members might present systemic risk to the FICC.

Following a Netting Member default, the FICC only declares a CCLF Event if liquidity from other available resources is "not able to generate sufficient cash to pay the non-defaulting Netting Members."[10] The FICC explicitly states that a CCLF Event would be declared when:

> FICC determines that it does not have the ability to obtain sufficient liquidity from GSD's Clearing Fund, by entering into repurchase transactions using securities in the Clearing Fund or securities that were destined to the defaulting Netting Member, or through uncommitted bank loans with its Clearing Agent Banks.[11]

This statement makes it clear that the FICC has sizable liquid resources available to mitigate the default of a Netting Member. Certainly, it is intuitive that any Netting Member, whose "maximum liquidity need" falls short of liquidity held in the Clearing Fund, couldn't possibly trigger a CCLF Event. This isn't just a theoretical assertion - the FICC has already proven its ability to handle several large Netting Member defaults using existing financial resources. As clearly stated by the FICC:

> FICC handled both the Lehman Brothers and the MF Global insolvencies seamlessly.[12]

Given the fact that the defaults of Lehman Brothers and MF Global were "seamlessly" handled, what type of firm is large enough to systemically threaten the FICC? Is the CCLF only needed to protect the FICC from the default of the largest global banks - i.e. the default of one of the G-SIBs?

[7] SEC Release No. 34-80234 p. 9
[8] https://www.wsj.com/articles/cost-of-repo-safety-net-hits-74-billion-1490014800
[9] https://www.federalreserve.gov/paymentsystems/designated_fmu_about.htm
[10] SEC Release No. 34-80234 p. 4
[11] SEC Release No. 34-80234 p. 4
[12] http://www.dtcc.com/news/2015/may/05/systemic-importance

Subsidizing Versus Reducing

Ronin believes the CCLF would not be needed if the G-SIBs reduced their liquidity needs. Proof of this statement seems to be verified by history - the FICC handled the defaults of Lehman Brothers and MF Global without issue. Therefore, it seems clear that only the default of one of the largest global banks, a G-SIB, would result in a liquidity need that the FICC could not handle with currently available liquid resources. Given the need to mitigate risks stemming from the default of a G-SIB, we believe the FICC has three distinct courses of action:

1) Require those Netting Members that present systemic risk to reduce their liquidity needs such that the FICC can handle the default of its largest participant family using existing financial resources.
2) Require those Netting Members that present systemic risk to fund a liquidity plan to ensure that the FICC has sufficient financial resources to handle the default of its largest participant family.
3) Require all Netting Members to fund a liquidity plan to ensure that the FICC has sufficient financial resources to handle the default of its largest participant family.

FICC has chosen the third option. Unfortunately, unlike the other two options, Ronin believes the third option is anticompetitive for those Netting Members that clearly don't present systemic risk to the FICC. Forcing all Netting Members to subsidize the asymmetrical risks presented by the G-SIBs would seem to clearly present a competitive burden as well as a possible moral hazard. To put this competitive burden in context, we believe it is important to note that Ronin already posts significant capital to FICC's Clearing Fund. The FICC provides the following background information about the Clearing Fund:

> FICC requires each Netting Member to deposit margin (referred to in the GSD Rules as "Required Fund Deposits") into the Clearing Fund, which constitutes the financial resources that FICC could use to cover potential losses resulting from a Netting Member default.[13]

So, if Ronin were to default, the margin we have posted to the Clearing Fund would cover any potential losses that might arise from such a default. <u>Deposits that Ronin makes to the Clearing Fund are meant to protect the FICC from the potential risk of loss associated with our trading activities. In contrast, our CCLF requirement is meant to protect the FICC from liquidity risk associated with the trading activities of MegaBank XYZ.</u> Is it fair that our CCLF requirement is larger than our Clearing Fund obligation? More specifically, <u>is it fair that our share of MegaBank XYZ's current $74BB liquidity need is larger than the average deposit margin we post for our own trading?</u>

To be fair, margin is intended to mitigate risk of loss. In contrast, the CCLF is intended to mitigate fire sale risk. Despite these differences, it is important to restate that Ronin does not pose any fire sale risk. Only the largest Netting Members, the G-SIBs, present the possibility of fire sale risk. Again, the FICC seamlessly managed the default of Lehman Brothers and MF Global. Why should smaller Netting Members be forced to subsidize a liquidity plan meant to protect the U.S. Financial System from fire sale risk when only the default of a G-SIB could cause a fire sale? This is clearly an unfair competitive burden for smaller Netting Members. We believe the claim of a competitive burden is particularly clear when one considers the various ways in which Netting Members attest that their CCLF requirements have been incorporated into their liquidity plans.[14] This is the subject of the next section.

[13] SEC Release No. 34-80234 p. 3
[14] SEC Release No. 34-80234 p. 19

Liquidity Plans

Each Netting Member must attest that it has the ability to meet the requirements presented by the CCLF. This requirement is stated as follows:

> As of the implementation date and annually thereafter, FICC would require that each Netting Member attest that its Individual Total Amount has been incorporated into its liquidity plans.[15]

Simply stated, each Netting Member must attest that it has the liquid resources available to commit to the FICC if a CCLF Event were to be declared. What does this mean exactly?

Capital is precious for non-bank Netting Members. Because Ronin is not a bank holding company, it must contract with a bank to establish a committed line of credit in order to attest that it can meet its CCLF requirement. Obviously, this committed line of credit is not free. To protect the FICC from the liquidity risks presented by the anonymous MegaBank XYZ, Ronin is required to pay fees to a bank on a yearly basis.

While we have little insight into how a large global bank attests that its CCLF requirement has been incorporated into its liquidity plan, we strongly suspect that such banks can merely state that they are "good for it." Such an assertion is logical. The GSD only clears U.S. government debt. Banks have access to the Federal Reserve Discount Window and can easily borrow funds using US government debt as collateral. As specified:

> The Discount Window functions as a safety valve in relieving pressures in reserve markets; extensions of credit can help relieve liquidity strains in a depository institution and in the banking system as a whole. The Window also helps ensure the basic stability of the payment system more generally by supplying liquidity during times of systemic stress.[16]

Non-defaulting Bank Netting Members can monetize U.S. government debt via the Federal Reserve Discount Window when needed. Thus, Bank Netting Members have clear advantages in simply stating that the CCLF has been incorporated into their liquidity plans.

To be fair, there isn't anything particularly virtuous about being a non-bank Netting Member. Ease in complying with the requirements of the CCLF should not be a determining factor when deciding which Netting Members should or should not contribute to the CCLF. However, Ronin strongly believes there would be no need for the CCLF if the largest global banks reduced their settlement risk. If the largest global banks willfully choose not to reduce their settlement risk to a level that doesn't systemically threaten the FICC, it should be the sole responsibility of the largest global banks to mitigate this risk. Smaller Netting Members should not be forced to subsidize liquidity risks over which they have no control.

Competitive Burden

Prior history has proven that a CCLF Event could only be caused by the default of a G-SIB. At the same time, the CCLF forces smaller Netting Members to subsidize liquidity risks posed by only the largest global banks. This is despite the fact the largest global banks can easily meet the requirements presented by the CCLF. In its present form, the CCLF certainly presents an economic cost to non-bank Netting Members.

[15] SEC Release No. 34-80234 p. 19
[16] The Federal Reserve Discount Window p. 1

As mentioned previously, these non-bank Netting Members are forced to contract with a bank for a committed line of credit. But what if a non-bank Netting Member is unable to secure a committed line of credit to fulfill the requirements mandated by the CCLF? This could lead to a clearing model where only banks can participate as Netting Members. In the CCLF rule filing, the FICC acknowledges this potential problem:

> FICC values each Netting Member and does not wish to force any Netting Member to clear through larger Netting Members or exit the business as a result of this proposed rule change. However, FICC believes that all Netting Members should endeavor to maintain suitable capital to meet FICC's enhanced participation requirements so that such Members do not have to clear through larger financial institutions or exit the business. Because each Netting Member is in the best position to monitor and manage the liquidity risks presented by its own activity, FICC believes that Netting Members should endeavor to manage their own liquidity.[17]

This acknowledgement seems reasonable aside from the fact that the CCLF has nothing to do with "managing the liquidity risks presented by our own activity." The CCLF is needed to manage the liquidity risk presented by MegaBank XYZ - the anonymous Netting Member currently presenting a nearly $74 billion liquidity need. Again, the FICC states that it "does not wish to force any Netting Member to clear through larger Netting Members or exit the business." Unfortunately, "wishes" don't prevent the CCLF, as designed, from imposing an anticompetitive burden on smaller Netting Members, particularly non-bank Netting Members. The G-SIBs alone present liquidity risk to the FICC. If a CCLF Event were declared, these very same banks could easily borrow funds against U.S. government debt at the Federal Reserve Discount Window. Given the G-SIBs could easily handle a CCLF Event, it is unclear why smaller Netting Members should be required to subsidize this risk.

Furthermore, the intended goals of the CCLF also seem to be at odds with additional rule modifications being proposed by the FICC. One such rule modification has the stated goal:

> to Expand the Types of Entities That Are Eligible to Participate in Fixed Income Clearing Corporation as Sponsored Members[18]

This new rule will enable Bank Netting Members that are well-capitalized and have at least $5 billion in equity capital to sponsor "qualified institutional buyers." This rule modification has the potential to increase the FICC's liquidity need beyond the current $74 billion. This rule modification doesn't further mutualize settlement risk - it will only serve to potentially grow the liquidity needs of its existing Bank Netting Members. Is the FICC more able to comply with Rule 17Ad-22(b)(3) of the Exchange Act by growing the liquidity needs of its largest participants, i.e. the G-SIBs?

Ronin believes the expansion of the Sponsored Member program and the subsequent increase in liquidity risk is only reeasonable if the dollar value of the "Cover 1" requirement is immaterial. Increasing settlement risk through the Sponsored Member program only makes sense if the largest global banks are easily able to attest that the CCLF has been incorporated into their liquidity plans - these banks have access to the Federal Reserve Discount Window and can borrow an unlimited amount of funds against U.S. government collateral. Unfortunately for non-bank Netting Members, if the CCLF doesn't actually constrain the largest global banks, this liquidity need will continue to grow. We believe this is particularly true if Bank Netting Members are permitted to sponsor hedge funds and other financial institutions. It seems likely that the CCLF will force smaller Netting Members to subsidize an increasing liquidity requirement. Our view is

[17] SEC Release No. 34-80234 p. 29
[18] SEC Release No. 34-70688; File No. SR-FICC-2017-003

that it makes more sense to reduce settlement risk rather than implement rule modifications that are likely to increase the CCLF requirement.

Another Solution

The National Securities Clearing Corporation ("NSCC") complied with Rule 17Ad-22(b)(3) of the Exchange Act without requiring all clearing members to participate in a liquidity plan. The liquidity obligation of the NSCC's "SLD Proposal" was "imposed on the 30 Members or Affiliated Families who generate the largest aggregate liquidity needs...."[19] Given the fact the Commission approved this method of compliance with Rule 17Ad-22(b)(3) of the Exchange Act, it seems plausible that a similar plan - one that excluded smaller Netting Members - might have been architected for the GSD. Did the FICC view the size of the CCLF as being too large for the G-SIBs to handle on their own? Was this decision made even though the G-SIBs alone present liquidity needs beyond those that the FICC has seamlessly handled in the past? If a CCLF Event was declared, does the FICC believe accessing the Federal Reserve Discount Window presents a competitive burden on the largest global banks?

Ronin doesn't believe the CCLF, in its present form, will reduce the liquidity needs of the largest global banks. We believe the G-SIBs can readily attest to any liquidity plan the FICC architects to comply with Rule 17Ad-22(b)(3) of the Exchange Act. We also believe non-defaulting G-SIBs can easily handle any liquidity demands imposed by the declaration of a CCLF Event. The largest global banks can simply provide liquidity as needed by accessing the Federal Reserve Discount Window.

Ronin believes imposing the CCLF requirement solely on the largest Netting Members is fair, because only the default of one of the largest Netting Members could possibly require the FICC to declare a CCLF Event. History seems to back this assertion. We believe the NSCC's "SLD Proposal" provides a precedent that supports the exclusion of smaller Netting Members from the need to participate in the CCLF. After all, the CCLF is only needed to protect the FICC from the largest global banks. Simply excluding smaller Netting Members seems a much fairer alternative than requiring such members to subsidize a liquidity plan that has true negative economic consequences at best, and at worst, may force them to give up their GSD membership. If an increase in the CCLF requirement perversely results in a competitive advantage for the largest global banks, it is unwise to ignore the clear moral hazard and unreasonable to claim that such a structure somehow effectively reduces settlement risk.

A Desired Result?

Ronin believes it is important to clarify that the criticisms of the CCLF expressed in this comment letter in no way detracts from our belief that the FICC serves a critical role within the U.S. Financial System. We are Netting Members of the GSD. We place great value in our ability to clear U.S. Treasuries independently and we certainly understand and believe in the many benefits of centralized clearing.

Unfortunately, it appears the FICC is choosing a path that will eliminate diversity of membership and promote concentration. In our opinion, compliance with the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") should not create a dependency on the very same firms at the center of the past financial crisis. We fail to see how the FICC is strengthened by promoting concentration. Clearly, the FICC is not safer if it drives out its smaller Netting Members or makes it less economic for them to compete. This could not have been the desired result of compliance with Dodd-Frank.

[19] SEC Release No. 34-70688 p. 4

We believe the FICC has flexibility in developing a liquidity plan that will comply with Rule 17Ad-22(b)(3) of the Exchange Act without unnecessarily harming its smaller Netting Members. The CCLF, in its present form, threatens the current diversity of membership in the GSD. The CCLF is likely to promote concentration risk and establish a potent barrier to entry for any new non-bank Netting Members. Is it desirable and prudent to create a clearing dependency on the largest global banks? Is liquidity in U.S. Treasuries best served by decreasing diversity of membership in the GSD?

Ronin hopes that the Commission agrees with our assertion that the G-SIBs alone present liquidity risk to the FICC. At the same time, we also believe the G-SIBs have a straightforward means of providing liquidity if a CCLF Event were to be declared. We don't believe it is anticompetitive for the largest global banks to be responsible for mitigating the settlement risk they alone present. This is particularly true when compared with the disadvantages smaller Netting Members face when forced to subsidize this outsized risk. The FICC could not possibly benefit from an increase in concentration risk. Forcing smaller Netting Members to exit the business or clear through larger Netting Members only weakens the GSD and the U.S. Financial System.

Ultimately, Ronin believes concentration will result in more risk to the FICC. A strong and diverse GSD membership will be better able to withstand the next financial crisis. Concentrated membership only increases asymmetric risk. Diversity of membership diminishes this risk. It is without question, that the U.S. Financial System deserves a better liquidity plan than the current form of the CCLF.

Conclusion

Ronin understands that the FICC must "maintain sufficient financial resources" to withstand a default by its largest participant family but history shows that liquidity risk to the FICC is only presented by the default of one of the largest global banks, a G-SIB. We believe a liquidity plan which forces all Netting Members to subsidize this liquidity risk is anticompetitive. This is particularly true for smaller Netting Members that must establish a committed line with a bank to prove compliance with the requirements of the CCLF.

Ronin doesn't believe the CCLF appropriately discourages the growth of settlement risk. Thus, the Cover 1 requirement is likely to continue to remain beyond the liquid resources of the FICC. We believe the G-SIBs alone drive the size of this liquidity need. The CCLF merely serves as a framework for forcing all Netting Members to subsidize this liquidity risk. Smaller Netting Members do not present settlement risk to the FICC, nor can they increase or decrease the size of this risk - currently estimated as nearly $74 billion. Other rule modifications, particularly a proposed rule to expand the types of entities that qualify as Sponsored Members, will likely increase the size of the CCLF requirement, which imposes a competitive burden on smaller Netting Members.

Ronin believes the Netting Members driving the size of the CCLF requirement, the G-SIBs, have clear advantages in complying with the demands presented by the CCLF. These large Bank Netting Members merely need to attest that they have incorporated the CCLF into their liquidity plans. In the unlikely circumstance that a CCLF Event is declared, these large global banks can easily borrow funds at the Federal Reserve Discount Window using the defaulting Netting Member's securities as collateral. Given the fact the largest global banks can easily comply with the requirements of the CCLF, we believe there isn't any competitive burden associated with requiring the largest Netting Members to mitigate a liquidity risk that they alone present.

The NSCC "SLD Proposal" provides a precedent which enables smaller clearing members to be excluded from contributing to a liquidity plan. Given the negative impact the CCLF imposes on smaller GSD Netting Members, it is only appropriate to consider modifications to the CCLF. Is concentration risk and a potent barrier to entry a desirable result of ensuring that the FICC is protected from the default of a G-SIB? Is diversity of CCP membership an outdated concept? Does liquidity in U.S. Treasuries benefit from excluding smaller Netting Members from the GSD? Does concentration improve the FICC's ability to weather the next financial crisis?

Given an unfair competitive burden on smaller Netting Members, Ronin respectfully requests that the Commission deny the FICC's request to modify the GSD Rulebook to implement the CCLF. We believe the FICC can architect a better liquidity plan that complies with Rule 17Ad-22(b)(3) of the Exchange Act without unduly harming its smaller Netting Members.

We thank the Commission for considering our comments. If you should have any questions, please contact me at [redacted] or [redacted].

Sincerely,

Robert E Pooler Jr.
Chief Financial Officer
Ronin Capital, LLC