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April 25, 2017

By Electronic Mail (rule-comments@sec.gov)

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

Re: **FILE NUMBER SR-FICC-2017-002 – Notice of Filing of Proposed Rule Change – Capped Contingency Liquidity Facility® ("CCLF")**

Dear Mr. Errett:

Fixed Income Clearing Corporation ("FICC")[1] appreciates the opportunity to respond to the comment letter submitted by Ronin Capital, LLC ("Ronin")[2] to the U.S. Securities and Exchange Commission (the "Commission") regarding a proposed rule change (the "Rule Filing")[3] filed by FICC pursuant to Section 19(b)(2) of the Exchange Act.[4]

1 FICC is a clearing agency registered with the Commission pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act"). FICC is comprised of two Divisions—the Government Securities Division ("GSD") and the Mortgage-Backed Securities Division ("MBSD"). GSD provides central counterparty services to its customers with respect to the U.S. government securities market, and MBSD provides such services to the U.S. mortgage-backed securities market. FICC has been designated as a systemically important financial market utility ("SIFMU") by the Financial Stability Oversight Council pursuant to Section 805 of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (the "Clearing Supervision Act"), 12 U.S.C. 5464, in recognition of its critical role in the national financial infrastructure. FICC is a subsidiary of The Depository Trust & Clearing Corporation ("DTCC"), which is a user-owned, user-governed holding company for FICC, two other registered clearing agencies and SIFMUs regulated by the Commission, and a number of other companies that provide a variety of post-trade processing and information services. FICC and the other registered clearing agencies in the DTCC group provide the critical infrastructure for the clearance and settlement of securities transactions in the U.S.

2 Letter from Robert E. Pooler, Jr., Chief Financial Officer, Ronin Capital, LLC to Robert W. Erret, Deputy Secretary, U.S. Securities and Exchange Commission (April 10, 2017) ("Ronin Letter").

3 See Securities Exchange Act Release No. 80234 (March 14, 2017), 82 FR 14401 (March 20, 2017) (SR-FICC-2017-002).

4 15 U.S.C. 78s(b)(2).

I. Background

On March 1, 2017, FICC filed the Rule Filing[5] with the Commission to amend the GSD Rulebook ("GSD Rules")[6] to include CCLF, a GSD Rules-based committed liquidity facility designed to help ensure that FICC maintains "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," as required by Rule 17Ad-22(b)(3)[7] of the Exchange Act. In addition to meeting the requirements of Rule 17Ad-22(b)(3), the CCLF proposal has been designed to assure the safeguarding of securities and funds in FICC's custody or control, consistent with Section 17A(b)(3)(F) of the Exchange Act.[8] Specifically, FICC believes that the CCLF proposal would enable FICC to access additional liquidity in the event that its other liquidity resources are insufficient upon the default of a Netting Member, which would ensure that FICC has sufficient funds to meet its cash settlement obligations to its non-defaulting Netting Members. Moreover, the CCLF proposal has also been designed to comply with newly adopted Rule 17Ad-22(e)(7) under the Exchange Act.[9] As of April 11, 2017, Rule 17Ad-22(e)(7) requires FICC to "establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [e]ffectively measure, monitor, and manage the liquidity risk that arises in or is borne by the covered clearing agency . . . ."[10]

In its comment letter, Ronin requests that the Commission reject the CCLF proposal that is the subject of the Rule Filing mainly on the following grounds:

- The CCLF proposal would force smaller Netting Members to subsidize the outsized liquidity risks posed by the largest Netting Members.[11]
    - The CCLF proposal does nothing to limit the growth of the Cover 1 requirement.[12]
    - The default of a smaller Netting Member does not present settlement risk to FICC.[13]

5 On March 1, 2017, FICC filed this proposed rule change as an advance notice (SR-FICC-2017-802) ("Advance Notice") with the Commission pursuant to Section 806(e)(1) of the Clearing Supervision Act, 12 U.S.C. 5465(e)(1), and Commission Rule 19b-4(n)(1)(i) under the Exchange Act, 17 CFR 240.19b-4(n)(1)(i). See Securities Exchange Act Release No. 80191 (March 9, 2017), 82 FR 13876 (March 15, 2017) (SR-FICC-2017-802).

6 Capitalized terms used herein and not defined shall have the meaning assigned to such terms in the GSD Rules available at www.dtcc.com/legal/rules-and-procedures.aspx, or in the Rule Filing, supra note 3.

7 17 CFR 240.17Ad-22(b)(3).

8 15 U.S.C. 78q-1(b)(3)(F).

9 17 CFR 240.17Ad-22(e)(7).

10 Id.

11 Ronin Letter, page 2.

12 Id.

13 Id.

- The CCLF proposal is designed to protect one systemically important institution (FICC) from other systemically important institutions (the "G-SIBs").[14]

- Other tools, such as NSCC's Supplemental Liquidity Deposits ("SLD"), target those members that generate the largest aggregate liquidity needs.[15]

- The CCLF proposal would place an unfair burden on smaller Netting Members and is anticompetitive.[16]

  - The largest Netting Members have clear advantages in satisfying the requirements demanded by the CCLF proposal.[17]

- The CCLF proposal promotes concentration and lack of diversification among the GSD membership and only promotes systemic risk.[18]

II. CCLF Structure and Design

Ronin claims that the design of the CCLF proposal "forces smaller Netting Members to subsidize the outsized liquidity risks posed by the largest Netting Members," and the CCLF proposal as structured "does nothing to discourage an increase in the Cover 1 requirement."[19] Ronin further argues that the "default of a smaller Netting Member does not present settlement risk to the FICC" and that the CCLF proposal is designed "to protect one systemically important institution (the FICC) from other systemically important institutions (the G-SIBs)."[20]

FICC is required 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 ("Cover 1 Requirement").[21] FICC's liquidity requirements are calculated daily and represent the notional settlement value of the securities due to settle on a designated Business Day for a given Netting Member. Throughout the development of the CCLF proposal, FICC has sought to structure the proposal so that (1) each Netting Member's CCLF requirement would be a function of the liquidity risk that each Netting Member's activity presents to GSD; (2) the allocation of the CCLF requirement to each Netting Member would be a fraction of the Netting Member's peak liquidity exposure that it presents to GSD; and (3) the proposal would fairly allocate higher CCLF requirements to Netting Members that generate higher liquidity

14 Ronin Letter, page 3.

15 Ronin Letter, page 7.

16 Ronin Letter, page 1.

17 Ronin Letter, page 2.

18 Id.

19 Id.

20 Ronin Letter, page 3.

21 The term "Cover 1 Requirement" shall refer herein to FICC's applicable regulatory requirement as well as the CCLF requirement pursuant to the Rule Filing.

needs. CCLF is specifically designed to minimize the burden on smaller Netting Members and achieve a fair and appropriate allocation of liquidity burdens.

CCLF has two key provisions to achieve this balance: (1) an Aggregate Regular Amount (currently sized at $15 billion) applied to all Netting Members on a pro-rata basis, and (2) an Aggregate Supplemental Amount applied *only* among those Netting Members that incur liquidity needs above the Aggregate Regular Amount within the six-month look-back period. FICC specifically designed this two-tiered approach to fairly and equitably allocate the liquidity requirements among Netting Members. The Aggregate Supplemental Amount *by design* represents the amount of liquidity required beyond the Aggregate Regular Amount of $15 billion[22] to support FICC's Cover 1 Requirement. As of January 2017, the Aggregate Supplemental Amount is equal to approximately 80% of the Aggregate Total Amount, or $58.84 billion. Clearly, this illustrates that the Aggregate Supplemental Amount is borne by those Netting Members who present the highest liquidity needs. Under the proposal, the Aggregate Supplemental Amount would not be allocated across all Netting Members but rather would be allocated only to those Netting Members that present more liquidity risk. Netting Members that would be required to fund an Aggregate Supplemental Amount would support approximately 93% of the total CCLF requirement. Additionally, those Netting Members whom individually present liquidity exposure beyond $50 billion in the aggregate represent approximately 53% of the Aggregate Total Amount. As illustrated in Table 1, the CCLF requirements would be borne by those Netting Members with the highest liquidity needs rather than being subsidized by the Netting Members with the smallest liquidity needs.

Table 1: CCLF Comparison ($ millions)

	Average Peak Liquidity Need	Average CCLF Requirement	Ratio of Avg. Peak Liq. Need to Avg. CCLF Req.
Top 10 Firms	$40,603	$6,092	15.0%
Firms 11-25	$18,956	$ 534	2.8%
Firms 26-50	$ 8,471	$ 128	1.5%
Firms 51+	$ 1,487	$ 22	1.5%

The allocation of CCLF requirements to each Netting Member would be a fraction of each Netting Member's peak liquidity exposure. On average, a Netting Member's CCLF requirement is less than 2.5% of their respective liquidity need, with the CCLF requirement of

22 The total size of the CCLF referred to as the Aggregate Total Amount reflects the Cover 1 Requirement plus a buffer, which is floored at $15 billion. As of January 2017, the Aggregate Total Amount of CCLF is $73.84 billion, the Aggregate Regular Amount mutualized to all Netting Members is $15 billion, and the Aggregate Supplemental Amount is set at $58.84 billion.

the smallest Netting Members at around 1.5%. FICC has designed the CCLF proposal to meet its Cover 1 Requirement, while minimizing the impact to all Netting Members.

Ronin also contends that the CCLF proposal does nothing to limit the growth of the Cover 1 Requirement. On the contrary, FICC has explicitly constructed the Aggregate Supplemental Amount to distinguish between Netting Members that present higher liquidity needs on a more frequent basis, and would allocate more of the Aggregate Supplemental Amount to such Netting Members. Therefore, if G-SIB (X) presented FICC with a liquidity need on a particular day of $50 billion, their CCLF requirement would be a function of the pro-rata portion of the $50 billion Tier *plus all preceding Tiers, plus* their respective allocation under the Aggregate Regular Amount. Clearly, the risk premium that results from presenting a larger liquidity need would act as a lever to curb or slow down the growth of the Cover 1 Requirement.

In addition, based on FICC's client outreach on the CCLF proposal, FICC expects that all Netting Members will have balance sheet and capital implications from the proposal. In particular, bank capital requirements force banks and their subsidiaries to maintain a minimum ratio of capital to assets based on the underlying risk exposure of those assets. Those firms with higher CCLF requirements will be required to hold capital for their contingent exposure and not simply declare that they "are good for it" as Ronin asserts.[23] As capital is a constrained resource, all Netting Members will be incented to continuously manage risk and limit their liquidity exposure and capital impact from the CCLF proposal

Ronin also draws comparisons to NSCC's SLD[24] requirements, stating that the SLD "provides a precedent that supports the exclusion of smaller Netting Members from the need to participate in the CCLF."[25] However, what Ronin fails to appreciate is that SLD operates in a manner whereby NSCC calls on mandated (e.g., "Ex-Ante") cash deposits from members during the normal course of business to preserve NSCC's liquidity sufficiency for both historical and future liquidity exposure. Given the nature of the securities financing transactions cleared at FICC, the CCLF proposal would allow FICC to access Netting Member financing on a *contingent* (as opposed to an ongoing) basis and would offer a solution that would (1) obviate the need for Netting Members to pre-fund their FICC liquidity requirements and (2) provide Netting Members the opportunity to deploy their balance sheet usage in other ways that they see fit. The SLD is designed to cover the liquidity exposure attributable to those members that regularly incur the largest liquidity exposures. FICC believes that the CCLF proposal is designed in a consistent way. All Netting Members would benefit from FICC's liquidity resources, and in the event that those resources are not adequate, those Netting Members with the largest liquidity exposures would have the largest CCLF requirements.

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[23] Ronin Letter, page 5.

[24] See NSCC Rule 4(A). The NSCC Rules & Procedures are available at www.dtcc.com/legal/rules-and-procedures.aspx.

[25] Ronin Letter, page 7.

III. Burden on Competition

Ronin claims that the CCLF proposal "places an unfair burden on smaller GSD Members and is anticompetitive."[26] Ronin states that requiring all Netting Members to fund a liquidity plan to ensure that FICC has sufficient financial resources to handle the default of its largest participant family "is anticompetitive for those Netting Members that clearly don't present systemic risk to the FICC."[27]

The CCLF proposal is not designed to address fire-sale risk. FICC believes that all Netting Members present liquidity risk to FICC and to that end, we believe *a mutualized* liquidity program is prudent and consistent with how FICC manages market price risk. GSD's Clearing Fund requirement is necessary to mitigate the market price risk that FICC has from each Netting Member. Each Netting Member's Clearing Fund requirement is calibrated to a 99th percentile confidence level, and therefore, it does not cover all potential market price changes. In the event that a Netting Member defaults and their Clearing Fund was not adequate, the residual loss would be mutualized across all surviving Netting Members in proportion to the size of their Clearing Fund contributions. All Netting Members present liquidity risk to FICC, and in the event that FICC's liquidity resources are insufficient, the surviving Netting Members would provide a mutualized liquidity pool – relative to the liquidity risk they presented to FICC.

Additionally, Ronin suggests that the Clearing Fund would mitigate the liquidity risk presented by smaller Netting Members. Consider that GSD's Clearing Fund cash for the period between March 31, 2016 and March 31, 2017 was $5.4 billion. There are approximately 50 out of 103 Netting Members that present peak liquidity needs beyond this value, indicating that if any one of these Netting Members failed, their individual failure could require FICC to access liquidity tools beyond the cash component of GSD's Clearing Fund. FICC believes that Ronin's assertion that the CCLF proposal is designed to "protect one systemically important institution (the FICC) from other systemically important institutions (the G-SIBs)"[28] is not a basis to disapprove a proposed rule change, because the CCLF proposal actually benefits all Netting Members and is specifically designed to comply with Commission Rule 17Ad-22(e)(7)(i), which requires FICC to maintain sufficient liquid resources "under a wide range of foreseeable stress scenarios."[29] Any Netting Member can succumb to a wide variety of market, trading, and operational risk scenarios that could result in such Member presenting higher liquidity needs than historically observed.

FICC recognizes that the proposed rule change could have an impact on competition because each Netting Member's Individual Total Amount would place a committed funding requirement on Netting Members, and this requirement would increase the cost of participating in GSD. However, the committed funding requirement has been designed to be allocated in accordance with the two-tiered structure to apply most significantly to the Netting Members that

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26 Ronin Letter, page 1.

27 Ronin Letter, page 4.

28 Ronin Letter, page 3.

29 17 CFR 240.17Ad-22(e)(7)(i).

present the largest liquidity requirements. As such, the CCLF proposal has been designed to address and mitigate the concerns of smaller Netting Members. FICC believes that the burden on competition that is created by the proposed rule change is necessary to comply with the requirements of the Exchange Act and rules thereunder. As has been explained herein and in the Rule Filing, the CCLF proposal would provide FICC with a committed liquidity arrangement that would be sized to provide FICC with 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. Further, FICC believes that the CCLF proposal would assure that FICC safeguards securities and funds in its custody and control by providing FICC with committed liquidity to meet its cash settlement obligations in furtherance of the Exchange Act.

As stated in the Rule Filing, FICC also believes that the burden on competition created by the CCLF proposal would be appropriate in furtherance of the Exchange Act. The CCLF required contributions would be calculated in proportion to the liquidity needs that each Netting Member presents to FICC over a given six-month look-back period. The CCLF proposal would ensure that all Netting Members fairly and equitably contribute to FICC's liquidity requirements.

IV. Systemic Risk

Ronin states that the CCLF proposal promotes concentration risk and lack of diversification among GSD's membership and thereby promotes systemic risk.[30]

As FICC stated in the Rule Filing, FICC believes that each Netting Member is in the best position to monitor and manage the liquidity risk presented by its own activity. FICC believes that all Netting Members should maintain suitable capital to meet FICC enhanced requirements so that such Members do not need to clear through larger institutions or exit the business. FICC 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.

In order to assist Netting Members to prepare for their maximum funding obligations under the CCLF and alter their trading behaviors should they desire to minimize the liquidity risk that they present to FICC, FICC would provide a liquidity funding report to each Netting Member on a daily basis. FICC has also stated in the Rule Filing that it would implement the proposed rule change 12 months after the later of the date of the Commission's approval of the Rule Filing or its no objection of the Advance Notice filing. During this 12-month period, FICC would periodically provide Netting Members with information that will allow them to assess the impact of their CCLF requirements and make any changes they deem necessary to lower their required amounts.

Contrary to what Ronin asserts, FICC believes that the CCLF proposal would, in fact, reduce systemic risk in the event of a default of a Netting Member that causes FICC to invoke the CCLF. FICC provides a critical role for the clearance and settlement of securities transactions in the U.S. and as part of that role assumes the transfer of risk by novating and guaranteeing transactions. FICC guarantees that non-defaulting Netting Members will receive

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30 Ronin Letter, page 2.

their cash back in the case of a buy/sell of a security cleared through FICC and their repo collateral back at the close of the repo transaction, while reverse participants will receive the start amount paid at the repo's inception, plus interest. CCLF would effectively allow reverse repo participants to receive their cash back in the event of a default of a Netting Member (who during the normal course of business would be obligated to supply cash). All Netting Members, therefore, regardless of size would benefit from the risk mitigation that the CCLF proposal would provide. By facilitating the payment of cash versus the delivery of a security (DVP) during extreme market stress, CCLF achieves settlement finality and would be a cornerstone to promoting the safety and soundness of the settlement system and therefore would reduce systemic risk.

V. Industry Consultation

As Ronin is aware, DTCC has established a standing member-based advisory group, the Clearing Agency Liquidity Council ("CALC"), as a forum for the discussion of liquidity and liquidity-related financing needs and trends.[31] The CALC is made up of both large and small Netting Members and has focused on liquidity initiatives being considered by FICC and NSCC to address liquidity planning for member defaults during periods of normal and stressed markets. Any new initiatives, such as the CCLF proposal, are shared with the CALC throughout the design/development process.

In consultation with the CALC and prior to the formalization of the CCLF proposal, GSD considered the U.S. Treasury market structure dynamics, existing liquidity tools available in the market to satisfy FICC's liquidity requirements, the feasibility of leveraging the existing liquidity tools employed in the DTCC complex, including the MBSD CCLF program,[32] the NSCC committed credit facility, the NSCC SLD rule,[33] and the NSCC Prefunded Liquidity Program (consisting of commercial paper notes and extendible notes).[34] We also discussed other liquidity tools available in the financial markets that had not been implemented by DTCC. Each option was evaluated based on a number of factors, including market capacity, impact to FICC and its members, cost, and reliability in adverse market conditions. FICC's goal was to design a program to incent Netting Members to manage and monitor their own liquidity exposure while ensuring that FICC has adequate liquidity resources to meet its Cover 1 Requirement. Additionally, GSD maintains uncommitted repo agreements and can finance via the repo market the securities in the Clearing Fund and those purchased on behalf of the defaulting Netting Member to raise funds. FICC believes that the repo market will be available for financing in all but the most adverse market conditions. The CALC preferred the CCLF – a contingent, Member-supported solution for a most extreme market scenario.

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31 See Important Notices dated September 18, 2013: NSCC, A# 7706, P&S# 7276; DTC, B# 1658-13; GSD, GOV# 066.13 and MBSD, MBS# 164.13. All Important Notices are available at http://www.dtcc.com/en/legal/important-notices.

32 See MBSD Rule 17. The MBSD Clearing Rules are available at www.dtcc.com/legal/rules-and-procedures.aspx.

33 See NSCC Rule 4(A), supra note 24.

34 See Securities Exchange Act Release No. 75730 (August 19, 2015), 80 FR 51638 (August 25, 2015) (SR-NSCC-2015-802).

In its comment letter, Ronin also states that the largest Netting Members have clear advantages in satisfying the requirements demanded by the CCLF. FICC has also discussed with the CALC ways that Netting Members (regardless of size or access to bank affiliates) can meet their CCLF requirements. As stated above, this dialogue has made it clear that all Netting Members would have balance sheet and capital implications from the CCLF proposal.

Moreover, over the course of the past two years, FICC has made structural revisions to the CCLF proposal to address input from key stakeholders (such as FICC's Supervisors) and the CALC and believes the current structure of the CCLF proposal represents the best proposal for FICC to protect itself and its Netting Members should repo market capacity materially contract in the future. FICC has also conducted extensive bilateral Netting Member outreach over the course of the past two years, which has included distribution of impact studies on a 6-month basis, a specific test-period designed to evaluate the impact that behavioral changes can have on the Cover 1 Requirement as well as individual Netting Member CCLF requirements, and bilateral meetings to discuss drivers of liquidity requirements and peak dates driving such requirements. FICC notes that during this test period, which spanned from December 1, 2016 to January 31, 2017,[35] participating Netting Members voluntarily adjusted their settlement behavior and settlement patterns to identify opportunities to reduce their CCLF requirements. The test resulted in an approximate $5 billion reduction in FICC's peak Cover 1 Requirement, highlighting that there is an opportunity under the CCLF design for Netting Members to take steps to limit the growth of the Cover 1 Requirement, or, if they choose not to, be subject to higher CCLF requirements via the Aggregate Supplemental Amount.

VI. Other Observations

FICC believes it is critical that Netting Members understand the risks that their own activity presents to FICC, and be prepared to monitor their activity and alter their behavior if they wish to minimize the liquidity risk they present. Accordingly, effective in 2018, FICC will make available via an automated report to each Member a daily report showing the amount of liquidity FICC would need in the event of the default of such Member.

The concerns raised by Ronin regarding the expansion of the Sponsored Member program, which is the subject of FICC Rule Filing Number SR-FICC-2017-003, have been addressed by FICC in a separate letter responding to Ronin's concerns regarding that filing.[36]

VII. Basis for Approval

For the reasons described above, there is a sound basis for the Commission to approve the proposed rule change as consistent with the purposes of the Exchange Act. In its Release on the Standards for Covered Clearance Agencies, the Commission stated that, in 2012, the Commission adopted Rule 17Ad-22 under the Exchange Act to strengthen the substantive regulation of registered clearing agencies and promote the safe and reliable operation of

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[35] See Important Notice dated November 21, 2016, GSD, GOV# 191-16, supra note 31.

[36] Letter from Murray Pozmanter, Managing Director, Head of Clearing Agency Services, DTCC, to Robert W. Errett, Deputy Secretary, U.S. Securities and Exchange Commission (April 17, 2017).

registered clearing agencies, among other things. The Commission noted that through Rule 17Ad-22(b) in particular, the Commission established certain requirements for clearing agencies that provide central counterparty services. More recently, in proposing amendments to Rule 17Ad-22, the Commission sought to establish an enhanced regulatory framework for registered clearing agencies that meet the definition of a "covered clearing agency," such as FICC. The CCLF proposal has been designed to meet the requirements established by the liquidity risk management provisions contained in these Commission Rules. Moreover, by meeting the requirements of these provisions, the CCLF proposal by definition will reduce systemic risk by allowing FICC to obtain necessary liquidity to meet its settlement obligations in the event of an extreme but plausible market condition where FICC's existing liquidity tools are not sufficient. Finally, FICC has designed the CCLF proposal to be fair and equitable to all Netting Members and believes that any burden on competition is necessary and appropriate in furtherance of the Exchange Act, as described herein and in the Rule Filing.

Should you have any questions, please do not hesitate to call me at [redacted].

Very truly yours,

Timothy J. Cuddihy
Managing Director
Financial Risk Management