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October 6, 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 20549-1090

Re: File Number SR-FICC-2017-002 – Notice of Filing of Proposed Rule Change – Capped Contingency Liquidity Facility (“CCLF”) and Order Instituting Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change

Dear Mr. Errett:

Fixed Income Clearing Corporation (“FICC”)¹ appreciates the opportunity to respond to the U.S. Securities and Exchange Commission’s (the “Commission”) request to provide additional observations regarding the above-referenced matter.

I. Procedural Background

On March 1, 2017, FICC filed proposed rule change SR-FICC-2017-002 (the “Proposed Rule Change”) with the Commission.² The purpose of the Proposed Rule Change is to amend the

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 Counsel pursuant to Section 805 of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”) 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 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 See Securities Exchange Act Release No. 80234 (March 14, 2017), 82 FR 14401 (March 20, 2017) (SR-FICC-2017-002). FICC also filed the Proposed Rule Change as advance notice SR-FICC-2017-802 pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010, 12 U.S.C. 5465(e)(1), and Rule 19b-4(n)(1)(i) under the Exchange Act, 17 CFR 240.19b-4(n)(1)(i). The Commission issued a notice of no objection to the advance notice on June 29, 2017. See Securities Exchange Act Release No. 81054 (June 29, 2017), 82 FR 31356 (July 6, 2017).

GSD Rulebook (the “GSD Rules”)³ to include CCLF, which would be a rules-based committed liquidity facility designed to help ensure that FICC maintains sufficient liquid financial resources to meet GSD’s cash settlement obligations in the event of a default of the Affiliated Family to which FICC has the largest exposure in extreme but plausible market conditions (the “CCLF Proposal”), as required by Rule 17Ad-22(b)(3)⁴ of the Exchange Act. The CCLF Proposal is also designed to comply with Rule 17Ad-22(e)(7)⁵ of the Exchange Act, which requires FICC to have policies and procedures reasonably designed to effectively monitor, measure, and manage liquidity risk.

On April 25, 2017, the Commission issued a notice of designation of longer period for its action on the Proposed Rule Change.⁶ On May 30, 2017, the Commission issued an order instituting proceedings to determine whether to approve or disapprove the Proposed Rule Change,⁷ and on September 15, 2017, the Commission issued a notice of designation of longer period for its action on proceedings to determine whether to approve or disapprove the Proposed Rule Change.⁸ The Commission has invited interested persons to provide views, data, and arguments concerning the Proposed Rule Change, including whether the Proposed Rule Change is consistent with the Exchange Act and the applicable rules or regulations thereunder. FICC has provided evidence of such consistency in the Proposed Rule Change and has previously supplemented the record with correspondence to the Commission (the “DTCC Letter”).⁹ FICC is further supplementing the record with the additional information set forth below.

II. Additional Information on CCLF Proposal

A. Manner in which Netting Member could comply with the Proposed Rule Change.

Pursuant to the Proposed Rule Change, each Netting Member would be obligated to provide an amount up to its CCLF requirement (referred to in the Proposed Rule Change as the “Individual Total Amount”) during a CCLF Event. In addition, each Netting Member would be required to attest that it has incorporated its CCLF requirement into its liquidity planning. In an effort to provide Netting Members with an appropriate level of flexibility, FICC does not impose any specific rules regarding the manner in which such Netting Members must meet their liquidity

³ 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 the Proposed Rule Change, available at <http://www.dtcc.com/legal/sec-rule-filings>, as applicable.

⁴ 17 CFR 240.17Ad-22(b)(3).

⁵ 17 CFR 240.17Ad-22(e)(7).

⁶ See Exchange Act Release No. 80524 (April 25, 2017), 82 FR 20685 (May 3, 2017).

⁷ See Exchange Act Release No. 80812 (May 30, 2017), 82 FR 25642 (June 2, 2017).

⁸ See Exchange Act Release No. 81638 (September 15, 2017), 82 FR 44234 (September 21, 2017).

⁹ Letter from Timothy J. Cuddihy, Managing Director, DTCC to Robert W. Errett, Deputy Secretary, U.S. Securities and Exchange Commission (April 25, 2017).

obligation. This approach allows Netting Members to consider options that best suit their specific business, operating model, balance sheet, liquidity plans, and ownership structure. As previously discussed with several Netting Members, FICC believes that there are various ways that a Netting Member could fulfill its CCLF requirement.

For example, upon implementation of the Proposed Rule Change, Netting Members could access the repurchase (“repo”) agreement market to borrow funds through a 1-month term repo arrangement. In the event that the associated funds are not required during a CCLF Event, an overnight reverse repo arrangement could be initiated with the surplus liquidity. The cost (or spread) of this repo arrangement would be the difference between the 1-month term repo obligation versus the overnight reverse repo, which (on average) is 4 basis points annualized (or \$40,000 per \$100 million of repo notional trade amount).¹⁰ While FICC believes that all Netting Members could leverage this type of repo arrangement,¹¹ this financing option may be most appealing to smaller-sized Netting Members with limited funding alternatives.

As described in the Proposed Rule Change, Netting Members with lower liquidity needs would only be allocated an Aggregate Regular Amount, and as of January 1, 2017, there are 58 Netting Members that fall into this category. These Netting Members would have an aggregate CCLF requirement of \$4.96 billion (compared to the Aggregate Total Amount of \$73.84 billion for all Netting Members).¹² If a 4 basis point spread is applied to \$4.96 billion, this would result in an aggregate cost of \$1.98 million for *all* 58 Netting Members. FICC recognizes that future costs could be different from the historical averages used in this example, however, this estimate provides an indication of the potential annualized cost of the Proposed Rule Change based on prevailing repo market conditions over the past 5 years.

In addition to accessing the repo agreement market, FICC believes that Netting Members could also secure their CCLF requirements by (1) obtaining other external liquidity arrangements, (2) securing intercompany liquidity agreements, and (3) increasing their capital allocation for the contingent exposure. The associated cost of these options are dependent on each Netting Member’s financial and organizational structure thus it is difficult to provide a generalized approach that would be suitable for all Netting Members.

Each of the options referenced above would give each Netting Member the ability to comply with the Proposed Rule Change, including the obligation to attest that the CCLF requirement has been incorporated into such Netting Member’s liquidity planning.

¹⁰ Bloomberg L.P. (2017) USD Overnight GC Govt Repo (Ticker USRG1T CMPN Curncy) and USD Repo Govt GC 1M Repo (Ticker USRGCGA ICUS Curncy) 10/1/2012 to 9/29/2017. Retrieved September 29, 2017 from Bloomberg database.

¹¹ Netting Members could use different repo term lengths other than 1-month to stagger the maturity of the funds borrowed, and shorter term repo interest rates are typically lower than 1-month term repo rates.

¹² See Proposed Rule Change, 82 FR at 14405.

B. The value of GSD’s daily liquidity reporting and the manner in which such information could help Netting Members adjust their trading behavior and manage their liquidity risk to FICC.

On a daily basis, FICC makes various risk reports available to its Netting Members so that each Netting Member understands its trading activity and the risks that such activity presents to GSD. Consistent with this approach, upon implementation of the Proposed Rule Change, FICC would make a liquidity funding report available to each Netting Member. This report would allow Netting Members to monitor their liquidity exposure and FICC’s regulatory liquidity requirements. FICC would expect each Netting Member to monitor its settlement activity and how it impacts the peak liquidity risk that it presents to FICC. The CCLF reporting would also enhance transparency and alleviate the need for Netting Members to develop their own separate reporting.

As previously discussed with Netting Members and as noted in the DTCC Letter,¹³ Netting Members could reduce their peak liquidity exposures by modifying their overnight settlement activity. Such modifications would reduce such Netting Member’s CCLF requirement.

For example, based on the information in the liquidity funding report, a Netting Member could stagger the maturities of its repo trades by entering into term repos in order to reduce its peak overnight exposure. In connection with this change, it would cost a Netting Member an average of 4 basis points annualized (or \$40,000 per \$100 million of repo notional trade amount). FICC understands that Netting Members would not term finance their entire repo book and that the actual amount of their repo book that could be term financed would require analysis by each Netting Member, however, FICC anticipates that Netting Members could modify their settlement activity via term repos or forward starting repos, as applicable, for those peak exposure days that significantly exceed their average liquidity exposure. As illustrated below, FICC notes that Netting Members’ peak liquidity exposures typically exceed their average liquidity exposures by approximately 2 times.

Chart 1: Comparison of Average Liquidity Exposure to Peak Liquidity Exposure¹⁴

	Average Liquidity Exposure	Average Peak Liquidity Exposure	Unweighted Ratio of Avg. to Peak Liquidity Expo.	Weighted Ratio of Avg. to Peak Liquidity Expo.
Netting Members allocated only an Aggregate Regular Amount	1,294,225,442	3,184,024,719	2.46	2.96
Netting Members allocated an Aggregate Supplemental Amount	16,681,423,255	27,753,136,263	1.66	1.76
All Netting Members	4,582,088,222	8,433,834,878	1.84	2.11

Correspondence from Industrial and Commercial Bank of China Financial Services LLC (the “ICBCFS Letter”) suggests that if implemented, the CCLF Proposal will cause “a material negative effect on the government securities markets in ordinary conditions.”¹⁵ The ICBCFS

¹³ DTCC Letter, *supra* note 9, at 9.

¹⁴ This chart reflects GSD data for the look-back July 1, 2006 through December 31, 2016 which is also used in connection with the Proposed Rule Change.

¹⁵ Letter from Alan B. Levy, Chief Financial Officer, Industrial and Commercial Bank of China Financial Services LLC (“ICBCFS”) to U.S. Securities and Exchange Commission (May 24, 2017) on behalf of itself,

Letter also states that there is a “limited amount of liquidity available in the market”¹⁶ and “CCLF will reduce available funding in ordinary times.”¹⁷ FICC disagrees with these statements as FICC believes that the term repo costs and potential actions to reduce peak liquidity exposure to average levels will not materially impact the functioning of the repo market or create knock-on impacts to the broader government securities market. Additionally, the CCLF Proposal protects against the transmission of systemic risk among Netting Members in the event of the failure of a large Netting Member. Specifically, FICC believes that its ability to maintain adequate liquidity resources is a key element in reducing systemic risk because it helps to ensure that orderly settlement can be completed among non-defaulting Netting Members and that Netting Members can complete their own settlement deliveries and receive the funds that their businesses rely upon, notwithstanding the failure of another Netting Member.

C. The CCLF Proposal addresses a risk that spans beyond extreme but plausible.

Consistent with feedback that FICC has previously received, and subsequently addressed in the Proposed Rule Change and the DTCC Letter,¹⁸ the ICBCFS Letter states that the market conditions that would trigger a CCLF Event are not plausible. The ICBCFS Letter explains that there was a demand for U.S. Treasuries in the market after the default of Lehman Brothers Inc. thus it is likely that FICC will be in the position to finance U.S. Treasuries through repurchase agreements should a default of a large Netting Member occur in the future.

FICC believes that the repo market plays a key role in facilitating the financial system, and a well-functioning repo market would support GSD liquidity needs. FICC also notes that as the financial crisis unfolded in 2007 and 2008, the Federal Reserve took several extraordinary actions that supported the overall financial market and increased demand for U.S. Treasuries. These steps included establishing the Term Auction Facility, the Primary Dealer Credit Facility, the Term Securities Lending Facility, and bilateral currency swap agreements with several foreign central banks. In addition, the Federal Reserve provided liquidity directly to borrowers and investors in key credit markets, expanded its open market operations to support the functioning of credit markets, lowered longer-term interest rates, and reduced market stress through the purchase of longer-term securities for the Federal Reserve's portfolio.

Since that time, the Dodd-Frank Act¹⁹ has scaled back the Federal Reserve's ability to lend in unusual and exigent circumstances, removed discretionary lending programs, and has taken steps with resolution/wind-down planning to reduce the expectations of government intervention. While FICC recognizes that the Federal Reserve still has broad authority to promote financial

Aardvark Securities LLC, LiquidityEdge LLC, Rosenthal Collins Group, L.L.C., and Wedbush Securities Inc., at 2.

¹⁶ ICBCFS Letter, supra note 15, at 5.

¹⁷ Id.

¹⁸ See Proposed Rule Change, 82 FR at 14408; DTCC Letter, supra note 9.

¹⁹ Dodd-Frank Act, Pub. L. No. 111-203, § 929-Z, 124 Stat. 1376, 1871 (2010).

stability, FICC cannot assume that such actions may occur in future market conditions nor can it assume that the timing of any such actions will always coincide and support FICC's need to meet GSD's liquidity obligations.

D. The CCLF Proposal may impact the behavior of smaller Netting Members.

Consistent with feedback that FICC has previously received, and subsequently addressed in the Proposed Rule Change and the DTCC Letter,²⁰ the ICBCFS Letter and correspondence from Ronin Capital, Inc. (the "Ronin Letter") note that the Proposed Rule Change could force some Netting Members to withdraw from GSD and clear through other Netting Members, thereby decreasing competition and increasing concentration in the clearing business.²¹ These letters offer no substantive support for these concerns. The letters merely assert that this *may* or *could* happen. As explained in the Proposed Rule Change and the DTCC Letter, the CCLF Proposal is designed to mutualize GSD's liquidity risk in the same manner that FICC mitigates all of its counterparty risk exposures and FICC believes that Netting Members should support the potential liquidity risk created by their trading activity. The Proposed Rule Change is not designed to be discriminatory or limit Netting Member participation at GSD rather, it is designed to appropriately limit GSD's exposure, further align interests of GSD and its Netting Members, and reduce systemic risk.

III. Consistency of the Proposed Rule Change with the Exchange Act

A. Section 17A(b)(3)(F) of the Exchange Act requires, in part, that the GSD Rules be designed to promote the prompt and accurate clearance and settlement of securities transactions.

The Proposed Rule Change describes its consistency with Section 17A(b)(3)(F) of the Exchange Act.²² FICC believes that it is also important to note that its designation as a SIFMU means that the failure of or disruption of its functioning could create (or increase) the risk of significant liquidity or credit problems spreading among financial institutions or markets, thereby threatening financial stability.²³ Among many factors that are considered in determining whether a SIFMU should be designated systemically important, consideration is given to the aggregate liquidity exposure of the SIFMU to its counterparties (as well as credit exposures), and its relationships and interdependencies with other SIFMUs.²⁴ While all commenters agree, in principle, that FICC should have the necessary liquidity resources, their arguments fail to acknowledge FICC's systemic role in the marketplace. However, it is in consideration of this role

²⁰ Proposed Rule Change, 82 FR at 14409; DTCC Letter, supra note 9.

²¹ ICBCFS Letter, supra note 15, at 2 and Letter from Robert E. Pooler, Jr., Chief Financial Officer, Ronin Capital, LLC to Robert W. Errett, Deputy Secretary, U.S. Securities and Exchange Commission (April 10, 2017), at 2.

²² See Proposed Rule Change, 82 FR 14409.

²³ FSOC Notice of Proposed Rulemaking, 12 CFR Part 1320, 76 FR at 17047 (2011).

²⁴ FSOC Notice of Final Rule on Authority to Designate Financial Market Utilities as Systemically Important, 12 CFR Part 1320, 76 FR at 44763 (2011).

that FICC would like to implement the CCLF Proposal. FICC believes that the CCLF Proposal would help to protect against the transmission of systemic risk among non-defaulting Netting Members in the event that a larger Netting Member defaults under stressed market conditions.

B. Section 17A(b)(3)(I) of the Exchange Act requires that the GSD Rules do not impose a burden on competition not necessary or appropriate in furtherance of the Exchange Act.

The Proposed Rule Change notes that the burden on competition that is created by the Proposed Rule Change is necessary and appropriate to comply with the requirements of the Exchange Act and the rules thereunder.²⁵ FICC notes that the cost that Netting Members would incur should they decide to leverage the repo market could impose a burden on competition, however, FICC believes that such burden would be necessary and appropriate in furtherance of the Exchange Act. FICC believes that such burden is necessary because the proposed change would support FICC's compliance with Section 17A(b)(3)(I) of the Exchange Act and Commission Rules 17Ad-22(b)(3) and (e)(7). FICC also believes that the burden is appropriate because a Netting Member's potential costs of meeting its CCLF requirement would be driven by the liquidity need that such Netting Member presents to GSD. Further, FICC does not believe that the impact of the potential costs on Netting Members are sufficiently large such that it would create broader economic impacts to the financing markets or Treasury trading activities. FICC notes that by comparison, the International Monetary Fund estimated that Liquidity Coverage Ratio ("LCR") requirement under Basel Committee on Banking Supervision 2010 recommendations (e.g. Basel III) would raise liquidity costs by approximately 11 basis points in the U.S.²⁶ However, the impact of LCR and other Basel III reforms have shown that the financial markets can "adapt to regulatory changes without radical actions that would harm the wider economy."²⁷

C. Commission Rule 17Ad-22(b)(3) requires FICC to establish, implement, maintain and enforce policies and procedures reasonably designed 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

The Proposed Rule Change describes the CCLF Proposal's consistency with Commission Rule 17Ad-22(b)(3)²⁸ and FICC believes that the record is inadequate with respect to its proposed compliance with this Rule.

²⁵ See Proposed Rule Change, 82 FR at 14408.

²⁶ Stanos, A.O. and Elliot, D. International Monetary Fund Staff Discussion Note, *Estimating the Costs of Financial Regulation*, September 11, 2012, <https://www.imf.org/external/pubs/ft/sdn/2012/sdn1211.pdf>, at 16.

²⁷ See *Id.* at 22.

²⁸ See Proposed Rule Change, 82 FR at 14407.

D. Commission Rule 17Ad-22(e)(7) requires FICC to establish, implement, maintain and enforce policies and procedures reasonably designed to effectively measure, monitor, and manage liquidity risk that arises in or is borne by FICC

The Proposed Rule Change describes the CCLF Proposal's consistency with Commission Rule 17Ad-22(e)(7).²⁹ FICC believes that the record is adequate with respect to its proposed compliance with this Rule.

IV. Conclusion and Adequacy of Record

Since 1975, the Exchange Act has required clearing agencies to “promote the prompt and accurate clearance and settlement of securities transactions.”³⁰ Moreover, in furtherance of this objective (among others), the Commission requires (as of April 11, 2017) FICC to establish policies and procedures reasonably designed to effectively, measure, monitor and manage liquidity risk incurred by FICC.³¹ To that end, FICC has designed the CCLF Proposal to identify and mitigate liquidity risk to GSD by focusing on those Netting Members who present heightened liquidity risk and by requiring Netting Members to provide additional assurances that the CCLF requirement will be included in their liquidity planning. Such steps are necessary to help ensure adequate liquidity at GSD in order to comply with FICC's obligations under the Exchange Act and the rules thereunder. More importantly, however, such steps are necessary in order to help ensure that an individual Netting Member's failure does not increase systemic risk by transmitting such losses to other Netting Members.

As described above, Netting Members have a variety of methods to comply with the Proposed Rule Change at a reasonable cost; including restructuring positions. These alternatives, as well as the size of the Treasury and repo markets, help to ensure that the CCLF Proposal would not have a “material negative effect on the government securities markets in ordinary conditions.”³² In this regard, while FICC does not believe the CCLF Proposal would force some Netting Members to withdraw from GSD, to the extent such withdrawals occur, FICC does not believe the Proposed Rule Change would constitute an inappropriate burden on competition. Rather, FICC views the Proposed Rule Change as an appropriate result of reasonable steps to limit systemic risk to meet the Commission's mandated liquidity requirements.

In conclusion, FICC believes that the record in this proceeding is substantial and detailed, and sufficiently clear and comprehensible for the Commission to order the approval of the CCLF Proposal. The record consists of the Proposed Rule Change, the DTCC Letter, this letter and the

²⁹ Id.

³⁰ See 15 U.S.C. 78q-1 and S. Rep. No. 94-75, at 4 (1975) (the Senate Committee on Banking, Housing and Urban Affairs urging that “[t]he Committee believes the banking and security industries must move quickly toward the establishment of a fully integrated national system for the prompt and accurate processing and settlement of securities transactions”).

³¹ See 17 CFR 240.17Ad-22(e)(7).

³² ICBCFS Letter, supra note 15, at 2.

letters submitted by the commenters. While some of the commenters may disagree with the CCLF Proposal, FICC believes that it has provided the Commission with sufficient information such that Commission can make a determination on the merits. To the extent that the Commission requires any additional information from FICC, we would be happy to supplement the record accordingly.

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

Very truly yours,

A handwritten signature in blue ink, appearing to read "Timothy J. Cuddihy". The signature is fluid and cursive, with the first name being the most prominent.

Timothy J. Cuddihy
Managing Director
Financial Risk Management