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April 17, 2017

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

Robert W. Errett
Deputy Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. SR-FICC-2017-003

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”) with respect to a proposed rule change (the “Rule Filing”)³ filed by FICC pursuant to Section 19(b) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).⁴

I. Background

On March 1, 2017, FICC filed with the Commission a proposed rule change, and on March 13, 2017, FICC filed Amendment No. 1 to such proposed rule change, which amended and replaced the original filing in its entirety. The Rule Filing consists of amendments to the GSD Rulebook (“Rules”)⁵ that would expand the types of entities that are eligible to participate in FICC as Sponsored Members under Rule 3A (Sponsoring Members and Sponsored Members).

¹ FICC is a clearing agency registered with the Commission pursuant to the Securities Exchange Act of 1934, as amended. 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 (“Dodd-Frank”) 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. Errett, Deputy Secretary, U.S. Securities and Exchange Commission (April 7, 2017) (“Ronin Letter”).

³ SR-FICC-2017-003.

⁴ 15 U.S.C. 78s(b)(1).

⁵ Capitalized terms not defined herein are defined in the Rules, available at <http://www.dtcc.com/legal/rules-and-procedures>.

FICC believes that the Rule Filing is consistent with Section 17A(b)(3)(F) of the Exchange Act, which requires, in part, that the Rules be designed to (i) “promote the prompt and accurate clearance and settlement of securities transactions,”⁶ and (ii) “remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and, in general, to protect investors and the public interest.”⁷

As stated in the Rule Filing, by expanding the types of entities that may participate in FICC as Sponsored Members, FICC believes that the proposed rule change would help to safeguard the U.S. financial market by lowering the risk of liquidity drain (through FICC’s guaranty of completion of settlement for a greater number of eligible transactions), protecting against fire sale risk (through FICC’s ability to centralize and control the liquidation of a greater portion of a failed counterparty’s portfolio) and decreasing settlement and operational risk (by making a greater number of transactions eligible to be netted and subject to guaranteed settlement, novation and independent risk management through FICC). By lowering the risk of liquidity drain in the U.S. financial market and protecting against fire sale risk, FICC believes the proposed rule change would “protect investors and the public interest” consistent with the requirements of the Exchange Act, cited above. By decreasing settlement and operational risk, FICC believes the proposed rule change would also “promote the prompt and accurate clearance and settlement of securities transactions” and “remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions” consistent with the requirements of the Exchange Act cited above.

II. Risk Management of the Sponsoring Member-Sponsored Member Program

The Rule Filing includes modifications to Rule 3A that would expand the entity types eligible to participate in FICC as Sponsored Members beyond registered Investment Companies under the Investment Company Act of 1940 to all “Qualified Institutional Buyers” (“QIBs”) under Rule 144A of the Securities Act of 1933, as well as other institutional firms not expressly denoted within Rule 144A, but which otherwise meet the financial requirements specified in paragraph (a)(1)(i) therein.⁸

Ronin claims this proposed expansion of Sponsored Member eligibility, which could include a hedge fund (to the extent it is a QIB under Rule 144A or otherwise meets the financial requirements specified in paragraph (a)(1)(i) therein, satisfies the other requirements set forth under Rule 3A and has at least one Sponsoring Member bank willing to sponsor it into GSD membership), would increase the risk of loss mutualization to GSD Netting Members. FICC disagrees with this claim for the following reasons:

- A. As described in the Rule Filing, none of the risk management practices applicable to Sponsoring Members would change in connection with FICC’s proposed expansion of Sponsored Member eligibility. These risk management practices include (i) the requirement that a Sponsoring Member be a well-capitalized GSD Bank Netting Member with at least \$5 billion in equity capital⁹; (ii) the requirement that a Sponsoring Member provide FICC with a guaranty of the payment and performance of each of its Sponsored Member’s obligations to FICC, referred to in the Rules as a “Sponsoring Member Guaranty”¹⁰ and (iii) the requirement that a Sponsoring Member post all of the Clearing Fund associated with the activity of its Sponsoring Member Omnibus Account, which is

⁶ 15 U.S.C. 78q-1(b)(3)(F).

⁷ Id.

⁸ SR-FICC-2017-003.

⁹ See Rule 3A, Section 2(a).

¹⁰ See Rule 1, “Sponsoring Member Guaranty” definition and Rule 3A, Section 2(c).

calculated twice daily on a gross basis (*i.e.*, for Clearing Fund calculation purposes, each Sponsored Member's trading activity is Value at Risk ("VaR") margined separately and the sum of those total VaR margin calculations are collected from the Sponsoring Member) and FICC's right to apply all such Clearing Fund deposits plus all other Clearing Fund deposits of the Sponsoring Member for its Netting System accounts against any obligations owing to FICC by the Sponsoring Member, including (but not limited to) in a Sponsoring Member default situation.¹¹

- B. As banks, Sponsoring Members are subject to extensive prudential supervision and regulation pursuant to which guaranties of performance, such as the Sponsoring Member Guaranty, must be accounted for as part of their regulatory capital planning and sufficient capital must be reserved by the banks to cover their liabilities under such guaranties. FICC believes that such reservation of capital by the banks substantially mitigates the risk of a Sponsoring Member being unable to perform under its Sponsoring Member Guaranty in a Sponsored Member default situation, which in turn, mitigates the risk of any potential loss mutualization to other Netting Members stemming from a Sponsoring Member's Sponsored Member activity.
- C. Even in the unlikely event that the aforementioned capital requirements imposed on Sponsoring Members as banks were to fail in preventing a Sponsoring Member from defaulting on its obligations to FICC under the Sponsoring Member Guaranty, as described above, FICC would be able to apply all of the gross VaR margin collected from the Sponsoring Member for its Sponsoring Member Omnibus Account plus all other Clearing Fund deposits of the Sponsoring Member for its Netting System accounts against any obligations owing to FICC by the Sponsoring Member before any of the other resources in the GSD default loss waterfall would be tapped, including, in the final tranche of such waterfall, potential loss mutualization to other GSD Netting Members.
- D. Neither the protections of a Sponsoring Member bank's guaranty of performance nor its Clearing Fund deposits (including the gross VaR margin that the Sponsoring Member is required to post to FICC for its Sponsoring Member Omnibus Account) would be available to FICC to cover potential default losses to the extent hedge funds were permitted to become Netting Members as Ronin appears to advocate.¹²
- E. Ronin also claims that the potential for balance sheet netting and capital efficiencies will increase Sponsoring Members' lending capacity and thereby lead to more leverage when compared to activity that previously was done outside of a central counterparty ("CCP").¹³ While it is possible that the balance sheet and capital efficiencies of trading through FICC may increase Sponsoring Members' lending capacity, the same can be said for any other Netting Member whose ability to transact outside of a CCP is subject to balance sheet and capital constraints. In contrast, however, those Netting Members are margined on a net basis by FICC, as opposed to Sponsoring Members whose Sponsored Member activity is margined by FICC on a gross basis as described above.
- F. Additionally, Ronin argues that benefits such as balance sheet offsets or reduced capital charges that result from expanding eligibility of Sponsored Members would be limited to

¹¹ See Rule 3A, Section 10.

¹² Ronin Letter on pg. 6.

¹³ Ronin Letter on pg. 4.

certain Members.¹⁴ This assertion overlooks that all Members will benefit from additional balance sheet and capital efficiencies to the extent that they are counterparties to Sponsoring Members in new Sponsored Member activity that is cleared through FICC.

- G. Ronin also asserts that new Sponsored Members would become more leveraged as a result of their participation in FICC.¹⁵ This is unlikely, however, because a Sponsored Member's activity must be done via a single counterparty, the Sponsoring Member. Therefore, the Sponsoring Member is incented to monitor and manage the Sponsored Member's counterparty risk to ensure that the Sponsored Member does not present inappropriate risk to the Sponsoring Member. In this regard, as described above, FICC has appropriate risk controls in place and the Sponsoring Members are subject to extensive prudential regulation. If consistent with its prudential requirements, a Sponsoring Member can provide additional liquidity to a Sponsored Member. This is consistent with the Exchange Act and is not a basis to disapprove the proposed rule change.

III. Burden on Competition

Ronin makes several claims regarding the anticompetitive impact of the Rule Filing on non-bank GSD Netting Members, each of which FICC rebuts below:

- A. Ronin claims that the Rule Filing is anticompetitive because Sponsored Members are not responsible to FICC for default loss mutualization or required to contribute to GSD's proposed Capped Contingency Liquidity Facility ("CCLF").

While Ronin is correct that FICC does not assign responsibility for default loss mutualization or CCLF to Sponsored Members, it fails to point out that those responsibilities are borne by the Sponsored Members' Sponsoring Member,¹⁶ the costs of which FICC understands are factored into the fees the Sponsoring Member charges to Sponsored Members for facilitating Sponsored Member activity.

- B. Ronin also argues that the proposed rule change would be anticompetitive because it would result in GSD Bank Netting Members incurring more settlement risk by acting as Sponsoring Members.¹⁷ To the contrary, the potential increase in participation in FICC as a result of the proposed rule change would reduce settlement risk because (1) Sponsoring Members will be able to take advantage of additional netting that results from increased participation in FICC and (2) FICC will collect additional gross margin that would otherwise remain outside of the CCP.

- C. Ronin also claims that the Sponsoring Member-Sponsored Member program, in its proposed expanded form, will increase the "Cover 1" requirement on which the size of the proposed GSD CCLF is based. FICC believes that it is unlikely that Sponsored Member activity will drive the "Cover 1" requirement for the proposed GSD CCLF given that, historically, the Sponsoring Member-Sponsored Member program has been used to facilitate short-term cash investments by their Sponsored Members and we expect that this will continue. However, the CCLF is designed so that requirements are in proportion to the liquidity exposure that each Netting Member presents to GSD. Moreover, the two

¹⁴ Ronin Letter on pg. 4

¹⁵ Ronin Letter on pg. 3.

¹⁶ See Rule 3A, Section 12(b) and proposed rule changes to implement the GSD CCLF in Securities Exchange Act Release No. 80234 (March 14, 2017), 82 Fed. Reg. 14401 (March 20, 2017) (SR-FICC-2017-002).

¹⁷ Ronin Letter on pg. 2.

tiered CCLF proposal means that Individual Supplemental Amounts¹⁸ would only be applied to approximately 20% of the GSD Netting Members that place the largest liquidity needs on GSD and not to the majority of the GSD Netting Members. Therefore, if there was an increase in the GSD “Cover 1” liquidity need arising from Sponsored Member activity, the relevant Sponsoring Members would commensurately be subject to larger CCLF requirements as well as Individual Supplemental Amounts.

IV. 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. Since the Securities Acts Amendments of 1975 and reaffirmed by Congress in Dodd-Frank, Congress has encouraged greater use of centralized clearing. Indeed, even Ronin, while raising risk and competition issues, notes it is “fully supportive of the expansion of centralized clearing.”¹⁹ Moreover, State Street “strongly supports” the proposal because, among other things, it provides “important benefits to a broader range of institutional investors. This includes insurance companies, public and private pension funds, common and collective trust funds and charitable foundations and endowments”²⁰

The proposed Sponsored Membership program, consistent with the Exchange Act, expands access to those benefits while building on existing risk safeguards both at FICC and the Sponsoring Member. While there may be different marketplace consequences of this expansion, those consequences do not constitute an unfair burden on competition or otherwise warrant disapproval under the Exchange Act. Accordingly, we urge the Commission to promptly approve the proposed rule change so the system as a whole and institutional investors in particular can obtain access to the universally acknowledged benefits of centralized clearing.

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

Very truly yours,



Murray Pozmanter
Managing Director
Head of Clearing Agency Services

¹⁸ The term “Individual Supplemental Amount” means the portion of the Aggregate Supplemental Amount that is allocated to each Netting Member by FICC in accordance with Section 2a(b)(iv) of Rule 22A. SR-FICC-2017-002.

¹⁹ Ronin Letter on pg. 1.

²⁰ Letter from Stefan M. Gavell, Executive Vice President and Head of Regulatory, Industry and Government Affairs, State Street Corporation, to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission (April 7, 2017).