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June 10, 2013

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: **File No. SR-NSCC-2013-02 (the "Rule Filing") and SR-NSCC-2013-802 (the "Advance Notice"); Securities and Exchange Commission ("SEC" or the "Commission") Releases No. 34-69313 (April 4, 2013) and 34-69451 (April 25, 2013), respectively**

Dear Ms. Murphy:

National Securities Clearing Corporation ("NSCC") appreciates the opportunity to respond to the comment letters submitted by National Financial Services LLC ("NFS")[1], Citadel LLC ("Citadel")[2], Charles Schwab & Co., Inc. ("Schwab")[3], SIFMA[4], Knight Capital Group, Inc. ("Knight")[5], Bracewell & Giuliani on behalf of ITG Inc. ("ITG")[6], Fidelity Investments ("Fidelity")[7], Deutsche Bank Securities Inc. ("DB")[8], and ConvergEx Group (ConvergEx)[9] with respect to the above captioned Rule Filing and Advance Notice (collectively, the "Filings"), relating to NSCC's proposal to provide for supplemental liquidity deposits to NSCC's Clearing Fund designed to ensure that NSCC has adequate liquidity resources to meet its liquidity needs (the "SLD Proposal").

Since the commenters raise a number of similar concerns about the SLD Proposal, NSCC responds to their comments collectively as set forth below.

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[1] Letter from Michael J. Kearney to Mr. Raymond J. Esposito, dated March 19, 2013.
[2] Letter from John C. Nagel to Ms. Elizabeth Murphy, dated April 18, 2013.
[3] Letters from Peter Morgan to Ms. Elizabeth Murphy dated April 22 and May 1, 2013, respectively.
[4] Letter from Thomas Price to Ms. Elizabeth Murphy, dated April 23, 2013.
[5] Letter from Leonard J. Amoruso & Matthew S. Levine to Ms. Elizabeth Murphy, dated April 25, 2013.
[6] Letter from Julian Rainero to Ms. Elizabeth Murphy, dated April 25, 2013.
[7] Letter from Scott C. Goebel to Ms. Elizabeth Murphy, dated April 25, 2013.
[8] Letter from Giovanni Favretti to Ms. Elizabeth Murphy, dated April 25, 2013.
[9] Letters from Christopher M. Springer to Ms. Elizabeth Murphy, dated May 2, 2013 and May 22, 2013, respectively.

[redacted]

I. SLD Proposal Summary and Proposed Enhancements

A. The Current Proposal

The Filings would modify NSCC's Rules & Procedures (the "Rules") to add a new Rule 4A, which provides for a supplemental liquidity funding obligation designed to cover the liquidity exposure attributable to those Members and families of affiliated Members ("Affiliated Families") that regularly incur the largest gross settlement debits over a settlement cycle both during times of normal trading activity ("Regular Activity Periods"), as well as during times of increased trading and settlement activity that arise around quarterly triple options expiration dates ("Options Expiration Activity Periods").

The obligation of a Member or the Members of an Affiliated Family to make a Regular Activity Supplemental Deposit (a "Regular Activity Liquidity Obligation") or a special deposit in relation to Options Expiration Activity (a "Special Activity Liquidity Obligation") would be imposed on the thirty (30) unaffiliated Members and/or Affiliated Families who generate the largest aggregate liquidity needs over a settlement cycle that would apply in the event of a close out (that is, over a period from date of default through the following three (3) settlement days), based upon an historical look-back period. The calculations for both the Regular Activity Liquidity Obligation and the Special Activity Liquidity Obligation are designed so that NSCC has adequate liquidity resources to enable it to settle transactions, notwithstanding the default of one of these thirty (30) largest unaffiliated Members and/or Affiliated Families during Regular Activity Periods, as well as during Options Expiration Activity Periods. The Liquidity Obligations imposed on Members of Affiliated Families would be apportioned among the Family Members in proportion to the liquidity risk (or peak exposure) they present to NSCC.

The SLD Proposal is designed to supplement NSCC's liquidity resources and work in tandem with NSCC's committed credit facility (the "Credit Facility") which it maintains as a liquidity resource (in addition to the Clearing Fund) should a Member default. The Regular Activity Liquidity Obligations would be calculated and imposed semi-annually, the first of which will be made to coincide with the annual renewal of the Credit Facility, and the second such calculation being made 6 months thereafter. The proposal seeks to strike a balance between reliance on the Credit Facility to reduce the burden on Members for cash outlay, while at the same time obligating those Members who expose the CCP to the largest liquidity risks to fund their fair share of the liquidity "differential". As deliberately structured, the SLD Proposal contains both obligations and incentives. So, for example, the obligation of a Member or the Members of an Affiliated Family to make a Regular Activity Supplemental Deposit will be reduced by any liquidity such Members or their affiliates may provide as commitments under the Credit Facility. To the extent that NSCC is successful in raising significant amounts of its needed liquidity through the Credit Facility, whether due to Members or their affiliates making commitments thereunder or due to non-affiliated commercial lenders, a diversified lender facility serves to mitigate the liquidity risk of NSCC and its membership as a whole, while likewise reducing the cash outlay obligations of the top 30 Members and Affiliated Families.

The Special Activity Liquidity Obligations are structured to address any additional liquidity shortfalls (over and above NCSS's available Regular Activity liquidity resources) that arise during the heightened activity period around quarterly options expiration. As such, these additional deposits are required to be maintained on deposit with NSCC only through the completion of the related settlement cycle and for a few days thereafter.

B. Proposed Enhancements

Recognizing some valid concerns of Members, NSCC is proposing to amend the SLD Proposal with several enhancements collectively designed to mitigate potential cash outlay burdens, as well as respond to transparency concerns by clarifying the implementation timeframe and the reporting that will be provided to Members.

First, NSCC will allow any Member to designate a commercial lender, whether or not affiliated with the Member, to commit to the line as a designee of the Member, subject to satisfaction of reasonable lender criteria.[10] This will reduce the Member's Regular Activity Liquidity Obligation cash requirement by the amount of any such commitment. Thus with this amendment, all Members, whether or not they have affiliated commercial banks, are equally incentivized to seek out lenders to maximize the size of the Credit Facility.

Second, any "excess" Credit Facility commitments made by such Members or their designated lenders (that is, the amount of any commitment by the designated lender that exceeds the designating Member's calculated Regular Activity Liquidity Obligation) would be allocated ratably among *all* Regular Activity Liquidity Providers to reduce their cash deposit requirements, in the same way that commitments of non-affiliated lenders are currently applied under the SLD Proposal.

Third, the seasonal/peak facility methodology that currently is provided for Options Expiration Activity Periods will be extended to cover monthly options expiry periods, so that it will be calculated and collected 12 times a year. The effect of this change will be to *reduce* the size of the Regular Activity Liquidity Obligations and, by treating all monthly options expiry periods (where there is greater activity fluctuation than during other periods) as special activity, provide greater stability and predictability to the size of the Regular Activity Liquidity Obligations. Preliminary analyses based upon current numbers estimate that adapting this methodology to all monthly expiry periods could reduce the size of the aggregate Regular Activity Liquidity Obligations by up to 20%. While recalibrating the Special Activity Liquidity Obligations on a monthly basis reduces the amount of the Regular Activity Liquidity Obligations for the Members covered under the proposal, it also results in allocating the liquidity burdens among those Members more equitably, since only those Members whose monthly options-related activity generate liquidity needs in excess of NSCC's then available liquidity resources will be obligated to fund such additional amounts.[11]

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[10] Designed to cover issues such as credit risk, concentration risk and lender diversity so as to ensure the continued robust viability of the line.

[11] That is, since the allocation formula ratably applies the excess amount needed due to Special Activity based upon the affected Member's Special Activity Peak Liquidity Exposure, then to the extent that a Member's Special Activity Peak Liquidity Exposure (as defined) is less than or equal to NCSS's available Regular Activity resources, that Member's share of the Special Activity Liquidity shortfall will be zero.

As regards Members' voluntarily prefunding Regular and Special Activity liquidity amounts, NSCC will monitor Members' prefunding activity to understand the impact such prefunded amounts have on the amount of its committed liquidity resources. The amendment will provide NSCC with some discretion when including prefunded deposits within its calculated liquidity resources, so as to provide some flexibility in the event it becomes too reliant upon voluntary prefunding to meet its minimum liquidity needs. This will address any concern that should prefunding not be available when actually needed, NSCC will nevertheless have sufficient liquid resources to effect settlement.

Reporting. The amendment will make clear that all Members—not just those in the current top 30—will be provided with reports at least monthly that are designed to show Members the liquidity exposure they present to NSCC and enable them to monitor their Regular Activity Peak Liquidity Exposure, based upon their current activity.[12] Members will also receive information on the Member's Special Activity Peak Liquidity Exposure and the calculation and amount (if any) of their Special Activity Peak Supplemental Deposits. In this regard, and as more fully discussed below, NSCC Risk staff will continue to work with Members to help them understand and develop tools to forecast the liquidity exposure they present to NSCC.

Implementation Timeframe and Funding Notice. The amendment will also clarify that while the Rule, once approved, will then be effective, the Members' first obligation to fund their Regular Activity Liquidity Obligations, as well as Special Activity Supplemental Deposits, will not be until the third quarter options expiry period in September, 2013. Moreover, Members will be provided with not less than 30 days prior notice of their initial Regular Activity Liquidity Obligations for deposit at that time. NSCC Risk staff will also, at that time, provide to affected Members their Special Activity Peak Liquidity Exposure within the look-back period.

Technical clarifications and changes. The amendment will include certain technical changes and clarifications designed to align notice, payment and cash return timeframes, and clarify the operation of the calculation formulas to ensure they operate as intended. In particular, in order to take into account any future additional or alternative qualifying liquidity resources NSCC may obtain, the definitions and calculation formulae will be modified to enable NSCC to take such resources into account when determining the additional cash amounts (if any) that Members would be required to provide as SLD deposits.

These enhancements and clarifications (collectively, the "Amended Proposal") will be reflected in amendments to the Filings.

C. Basis for approval

NSCC believes that the SLD Proposal, particularly as amended with the enhancements described above for the Amended Proposal, is fair, represents an appropriate and reasonable apportionment of the liquidity risk burden among NSCC's membership as a whole, and complies with the requirements of Section17A of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as ensuring adequate liquidity resources will protect Members and enable them to complete their settlement, notwithstanding the default of a major Member of NSCC, thereby

[12] The preparation of such reports will, by year-end, be automated and provided to Members on a more frequent basis.

promoting the prompt and accurate settlement of securities transactions and the protection of investors. At the same time, we believe the Commission may find, for the reasons discussed in more detail below, that the Amended Proposal evidences due regard for competition among brokers and dealers, and does not impose an undue burden on competition. Any impact on competition must be viewed against the requirements of the Exchange Act as an entirety, including the rules and regulations adopted thereunder.[13] This includes the Clearing Agency Standards rule[14] which recognizes that the imposition of certain requirements on a clearing agency's participants are necessary and appropriate for the safe operation of the clearing agency's clearance and settlement operations and for the protection of investors. For these reasons, NSCC believes the Filings, once amended to reflect the Amended Proposal, should be approved.

II. Background

NSCC's liquidity resources currently consist of its Clearing Fund, which comprises the aggregate Clearing Fund amounts posted by its Members, and the Credit Facility. NSCC has maintained a committed credit facility for nearly 20 years, as a liquidity supplement to the Clearing Fund in the event of a Member failure. These resources are collectively designed to enable NSCC to complete settlement with all of its Members over a complete settlement cycle in the event of a Member failure. In a three day (T+3) settlement cycle, that effectively means that NSCC must maintain sufficient liquidity resources to enable it to complete settlement on the date of a Member's insolvency, and over the next three settlement days. Maintenance of adequate liquidity resources is a key element in reducing systemic risk, as it ensures that orderly settlement can be completed among non-defaulting Members so that they can complete their settlement deliveries and receive the funds that their business relies upon, notwithstanding the failure of another Member. In this way a central counterparty's ("CCP's") maintenance of liquidity serves to limit the contagion that could flow from a defaulting member through the CCP to its other participants.

Over the past several years, following the collapse of Lehman, and more recently MF Global, regulators of financial market infrastructures worldwide have focused increasingly on risk management standards. As activity becomes increasingly centralized in central counterparties, it is all the more critical that they have appropriate rules, procedures and tools to enable them to adequately manage the risks that their members present them. In the United States this is reflected in the new Clearing Agency Standards adopted by the SEC pursuant to sections 763 and 805 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "DFA"). In its adopting Release[15] the SEC noted:

> "Section 805(a) of the Clearing Supervision Act [Title VIII of the DFA] directs the Commission to take into consideration relevant international standards and existing prudential requirements for clearing agencies that are designated as FMUs. The current international standards most relevant to risk management of

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[13] See Exchange Act Sec. 19(b)(2)(C)(i).

[14] Exchange Act Rule 17Ad-22.

[15] SEC Rel. No. 34-68080; File No.S7-08-11, 17 CFR Part 240 [77 Fed. Register 66220 (Nov. 2, 2012), at p. 66222]. The Clearing Agency Standards became effective on January 2, 2013.

> clearing agencies are the standards developed by the International Organization of Securities Commissions ("IOSCO") and the Committee on Payment and Settlement Systems ("CPSS") that are contained in the report entitled Principles for Financial Market Infrastructures ("FMI Report"). These international standards were formulated by securities regulators and central banks to promote sound risk-management practices and encourage the safe design and operation of entities that provide clearance and settlement services. The FMI Report harmonizes and, where appropriate, strengthens the previous international standards. . . ."

The FMI Report provides 24 principles applicable to financial market infrastructures (the "PFMI"); each Principle is accompanied by the key considerations that should be considered when evaluating compliance with a stated Principle, as well as explanatory notes. The Principle most relevant to NSCC's SLD Proposal is Principle 7: Liquidity Risk. It provides that:

> An FMI should effectively measure, monitor, and manage its liquidity risk. An FMI should maintain sufficient liquid resources in all relevant currencies to effect same-day and, where appropriate, intraday and multiday settlement of payment obligations with a high degree of confidence under a wide range of potential stress scenarios that should include, but not be limited to, the default of the participant and its affiliates that would generate the largest aggregate liquidity obligation for the FMI in extreme but plausible market conditions.[16]

Key consideration 5 provides:

> For the purpose of meeting its minimum liquid resource requirement, an FMI's qualifying liquid resources in each currency include cash at the central bank of issue and at creditworthy commercial banks, committed lines of credit, committed foreign exchange swaps, and committed repos, as well as highly marketable collateral held in custody and investments that are readily available and convertible into cash with prearranged and highly reliable funding arrangements, even in extreme but plausible market conditions.[17]

The commenters are all, we believe, well aware of these standards and what they imply: Before the PFMI were finalized, they were the subject of extensive discussion and comment within the industry. In response to CPSS/IOSCO's consultation and request for comments—in particular to the request for comments on whether central counterparties should be subject to credit and liquidity requirements under a "cover 1" versus "cover 2" standard—industry groups

[16] This is referred to as a "cover 1" standard. Key consideration 4 to this Principle notes that a CCP involved in activities with a more complex risk profile or that is systemically important in multiple jurisdictions should consider maintaining additional liquidity resources sufficient to cover stress scenarios that would include the default of the *two* participants and their affiliates that would generate the largest aggregate payment obligation to the CCP in extreme but plausible market conditions (referred to as a "cover 2" standard).

[17] The guidance goes on to note that if an FMI has routine access to credit at the central bank of issue, it may count such access as part of its minimum requirement to the extent is has collateral eligible for pledging to the central bank. NSCC does not have such routine access, and so must rely on either external sources or its Members to satisfy the minimum requirements.

representing the members affected by the SLD Proposal, as well as DTCC and other FMIs, weighed in on the proposed liquidity requirements.[18] DTCC argued that a cover 2 standard was not necessary, and noting the significant cash outlay that would be required for cash market CCPs, argued it would not be reasonably achievable in regard to liquidity risk for CCPs or other FMIs processing high volumes of transactions with large aggregate values in the cash markets.

These arguments were taken into account and are reflected in the final PFMI, and we believe the final Principle and its key considerations inform the interpretation and application of the SEC's Financial Resources Rule (Rule 17Ad-22(b)(3)).

Development of the SLD Proposal. NSCC has been working on both increasing its liquidity resources, as well as reducing its liquidity needs, over a number of years-- most critically following the events of 2008 and the closeout of Lehman Brothers, Inc. Towards this end, over the past four years NSCC has had numerous discussions with its financial advisors, consultants, and financial institutions (including not only banks, but insurance companies and others) as well as with its board members and its supervisors, on ways to (i) increase participation and diversity in the committed credit facility, and (ii) access other viable alternative sources of liquidity.

A number of the commenters have asserted or assumed, without any factual basis, that NSCC did not look at alternative approaches to the SLD.[19] Members in outreach discussions (as well as some commenters) have also somewhat simplistically suggested a series of alternative "options" to the SLD Proposal as if they are all viable (and less burdensome) alternatives.[20] In fact, the SLD Proposal was developed as an outgrowth of the ongoing search for alternative liquidity sources. Among the alternatives NSCC has considered, but determined are not reasonably viable currently, are the following:

- as regards managing the size of liquidity needs, adopting a confidence level approach whereby NSCC would dimension the size of its liquidity needs by using a statistical distribution. For example, under this approach NSCC would calibrate its liquidity need based in a 95th percentile confidence level using a suitable look-back period. However, given that Member liquidity needs do not readily conform to a normal distribution and that such an approach would not address the periodic peak fluctuations due to, for example, option expiry periods, this

[18] Among the more than 100 comment letters submitted to CPSS/IOSCO on the proposed PFMI were letters submitted by the Global Financial Markets Association (an international association of three financial trade associations, one of whom is SIFMA), ISDA, the Institute of International Finance (the global association of financial institutions); the Payments Risk Committee, J.P. Morgan, and Citigroup. The PFMI comment letters, including DTCC's response, are available at www.bis.org.

[19] See, e.g., Schwab May 1st letter at 4.

[20] Such comments have ranged all over the lot. So, while some Members have expressed concern that NSCC is over-reliant on the credit markets and its committed facility, others have argued that we could solve the entire liquidity problem with a larger line by merely paying line lenders higher fees (See, e.g., ConvergEx May 22nd letter at 7.) As to that point NSCC, in consultation with its syndication agent and lead banks, surveyed the pricing and lending capacity in the marketplace, and based on that information it was determined that the Credit Facility's fee structure was appropriate for maximizing the facility amount. On the other hand, some comments posit alternatives they clearly know are not currently viable, due to the long industry and regulatory lead time required: For example, Schwab assumes that "NSCC did not consider working with the Commission to reduce NSCC's liquidity needs by shortening the settlement cycle under NSCC's Continuous Net Settlement system." Id. at 4.

approach was not deemed appropriate. Moreover, given the heightened risk management standards applicable to NSCC as a designated Systemically Important Financial Market Infrastructure under the DFA and the regulatory standards discussed above, this approach was not deemed acceptable from a risk tolerance perspective, as it might not provide full liquidity coverage in the event of the default the Member and its affiliates to whom NSCC would have the largest exposure.

• adopting a capped contingent liquidity facility among NSCC Members to cover a portion of the liquidity needs using NSCC settlement securities as a stock loan, in a manner similar to the facility incorporated into the Fixed Income Clearing Corporation's Mortgage-Backed Securities Division Clearing Rules (the "MBSD CCLF"). However, the key differences in the MBSD CCLF are that that facility only uses highly liquid Federal Reserve discount window-eligible collateral. NSCC's settlement securities are not currently discount window-eligible, and thus not readily adaptable to such an approach.

• obtain an insurance policy that could be drawn upon for liquidity purposes. This option also was determined not to generate significant liquidity on a timely basis (and is no longer readily available); it also would not likely qualify as the type of liquid resource required by the SEC rule.

• obtain multiple bilateral lines of credit. This was determined to present difficult inter-creditor issues, particularly as liquidity financing in this context generally relies on the settlement securities due to the defaulting member as collateral. Moreover, it would be more expensive than the current syndicated facility while not likely to yield significant additional liquidity, and potentially introduce unacceptable funding delays through dealing with multiple points of contact and draw-down procedures.

• establish a commercial paper program. This type of funding carries roll-over risk. Moreover it is not generally deemed appropriate for use as liquidity in the event of a Member default, as noted in PFMI Principle 7 key consideration 5 (quoted above), and would still require NSCC to maintain a back-up line.

• establish equity repurchase agreement (repo) relationships. However, to be deemed qualifying liquidity under the standards discussed above, such arrangements would need to be maintained on a committed evergreen basis, and would likely present similar timely drawdown and inter-creditor issues as would the use of multiple bilateral credit lines.

As for suggestions that we solve the liquidity problem by shortening the settlement cycle, in the long term we agree that this is an approach that should be pursued. In fact DTCC is actively working with the industry and SEC staff to evaluate the steps necessary to accomplish, as well as the costs and benefits that would accrue from, shortening the settlement cycle in the equity cash markets from the current T+3 cycle. Based on industry outreach and the work done by Boston Consulting Group,[21] DTCC's preliminary view is that the cycle could be shortened to T+2 in 2016, and to T+1 in 2020, but this remains the subject of industry discussion and

[21] In the spring of 2012, DTCC commissioned Boston Consulting Group to conduct a business case analysis of the costs and benefits of moving to a shortened settlement cycle. See "Cost benefit analysis of shortening the settlement cycle" (October, 2012) at www.dtcc.com.

agreement, and in any event would be a multi-year industry wide-initiative. However, NSCC must maintain adequate liquidity resources now—it cannot wait until three to seven years to comply with SEC mandated requirements, nor expose its membership to such liquidity risks in the interim. Moreover, the maintenance of adequate liquidity is key to the implementation of other product enhancements sought by NSCC Members—such as moving the trade guaranty from its current time at midnight of T+1 to the point of trade validation and comparison.

For these reasons the SLD Proposal was developed as a means to supplement NSCC's liquidity resources and ensure that NSCC is able to maintain adequate liquidity, while leveraging the committed credit facility (and providing incentives designed to maximize and diversify the line). Nevertheless, we are cognizant of Member concerns about the refinancing risk presented by the annual renewal of the credit facility, and will continue to explore ways to mitigate that risk by diversifying our liquidity resources, as more fully discussed under section IV below.

Member Outreach. As NSCC was investigating various alternatives for obtaining liquidity, beginning in early 2011, as part of the annual credit facility renewal, NSCC staff began reaching out to its top members to educate them about the liquidity needs their activity presented to the clearing corporation, and seeking their support in providing liquidity resources. NSCC staff conducted similar outreach to the top 30 firms in early 2012, in particular seeking support for the committed facility during the renewal process. Based upon those outreach efforts and discussions, as well as the work done reviewing alternative sources, the SLD Proposal took shape.

Over the past 18 months NSCC has been in active discussions with Members likely to be affected by the SLD proposal, as well as with its supervisors and other market regulators, as to the design and operation of the proposal. This has involved significant Member outreach, including more than 100 meetings with Members to enhance Members' understanding of liquidity risks and to discuss the SLD Proposal. Outreach efforts have included engagement with a range of senior personnel in Member firms, including firm treasurers, directors of operations, chief financial officers and chief operating officers. As part of this outreach, NSCC provided documentation to the top 30 firms that (i) outlined the (then) current structure and calculation of the SLD, and (ii) included an impact study to show potential SLD requirements to the affected Member were the SLD Proposal to be adopted by NSCC.

As a key element, the SLD Proposal has been structured so that SLD deposits constitute Clearing Fund deposits. NSCC believes this brings them within the meaning of "clearing deposits" as that term is used in Securities Exchange Act Rule 15c3-1 (Net Capital Requirements). [22]

[22] Some commenters have also questioned whether the Proposal raises issues under Regulation W. (See Schwab May 1st letter at 4.) We believe these concerns have been appropriately considered and addressed in the Filings, where we note that if a bank that is an affiliate of an NSCC non-bank Member is considering making a commitment under the Credit Facility, it should make its own commercial credit decision as to whether to commit and in what amounts, as it would otherwise do in the ordinary course of business. Moreover, the enhancements described above for the Amended Proposal would allow any Member to designate an unaffiliated lender to commit to the line, which would reduce the Member's SLD cash requirement.

And, while some commenters have argued that the proposal as initially discussed with them differed materially from the final filed proposal,[23] that is because the proposal *did, in fact*, evolve as a result of Member outreach in an effort to mitigate the impact of "seasonal" peak liquidity needs such as those due to quarterly options expiration. In fact one of the key enhancements to the proposal over this 18 month period was to provide for baseline funding for Regular Activity Periods, and additional short-term funding for periods of increased activity that arise around options expiration periods (the Special Activity Liquidity Obligations). The purpose of this bifurcation is to minimize the impact of such peak liquidity-need periods on Members, and place the additional funding requirements for those needs on those Members principally responsible for such peaks. As filed, the SLD Proposal also includes incentives for Members to better manage their exposures—whether by prefunding their anticipated needs, or by moderating their trading activity to minimize their liquidity needs. Thus over time the SLD Proposal has evolved to be more sensitive (and finely calibrated) to Members' actual exposures and to minimize the amount of time funds would be required to be held by NSCC.

III. Fairness of Proposal

The commenters' key concerns relate to the fairness of the SLD Proposal. This argument devolves into three basic claims—that the proposal unfairly treats those Members that do not have bank affiliates differently from those that do; that it unfairly discriminates among Members by applying the requirement only to the top 30 Members/Member Families, as opposed to the entire Membership at large; and finally that the proposal competitively disadvantages a sector of the market (the agency brokerage sector). We address each of these claims below.

A. Calculation credit for Members with bank affiliates versus for "independent" Members

NFS,[24] ITG,[25] Schwab,[26] and ConvergEx[27] all argue that the SLD Proposal unfairly discriminates between "Independent Members" (that is, those Members that do not have a bank affiliate) and those Members that do. For example, ITG argues that NSCC did not address the competitive effect of this distinction where Members that provide commitments as Lenders under the Credit Facility receive dollar-for-dollar credit for those commitments against their required supplemental deposit. They argue that access to the Credit Facility may be limited—either by the terms of the facility (whether now or in the future) or for practical reasons—to Members that are banks or are affiliated with banking institutions.[28]

[23] Fidelity letter at 2.
[24] NFS letter.
[25] ITG letter at 4;
[26] Schwab May 1st letter at10 and 12;
[27] ConvergEx May 2nd letter at 2.
[28] Some commenters have also argued that, because the terms of the Credit Facility are maintained as confidential, there was insufficient information provided to them to evaluate the terms and provisions of the Credit Facility. See, e.g., Schwab April 22nd letter at 3. In point of fact, as discussed above, all top 30 Members and/or their affiliates were invited to participate in the 2013 line; as invitees each one would have been provided the same information as any other prospective lender (including a termsheet), so long as they agreed to the customary nondisclosure provisions included in such materials.

We understand these concerns, and in an effort to address them we believe the proposed enhancements described above for the Amended Proposal will remove any perceived discrimination in this regard. That is, the Amendment to the SLD Proposal will provide that any Member may designate a financial institution to commit to the Credit Facility, whether or not that lender is an affiliate of the Member, and that the amount of the designated lender's commitment to NSCC will reduce the "designating" Member's supplemental deposit requirement. Any designated lender committing to the Credit Facility will be relying on the terms of that commercial facility, including its security and collateralization provisions and relying on the credit of NSCC for repayment; any such lender will therefore *not* be relying on the reference Member's balance sheet for repayment. This amendment should likewise remove any concerns that Members with bank affiliates are competitively advantaged over Independent Members in this regard.[29]

B. Why top 30?

Knight, along with Fidelity, ITG and Schwab, question the fairness of the SLD requirements being imposed on the top 30 Members and/or Affiliated Member Families: "it is not clear why the NSCC has determined to impose an SLD requirement on only 30 of its members rather than the full membership (approximately 150 firms). Consequently, the burden of this significant additional liquidity requirement *unfairly* [emphasis supplied] falls on roughly 20% of the NSCC members, and will result in significantly disparate treatment of members."[30]

Based on an analysis of all Members, it was determined that the top 30 Members/Affiliated Member Families most appropriately captured the liquidity exposure over and above NSCC's available Clearing Fund liquidity. In fact, NSCC liquidity analyses show that the liquidity requirements attributable to the top 30 Members and Affiliated Member Families account for the vast majority of NSCC's liquidity needs. As of the end of February 2013, the top 30 Members and Affiliated Member Families *represented approximately 85%* of the total membership by peak liquidity needs over the prior six month period. The analysis also shows that the remaining membership's peak liquidity demands are covered by the required deposits to the Clearing Fund. So, from a fairness perspective, we disagree with the commenters; rather, NSCC believes the SLD Proposal appropriately places the burden of providing liquidity squarely on those Members who present the largest liquidity risk. It is not appropriate that the entire membership bear the burden of the liquidity needs generated by NSCC's largest trading firms. (In this regard it is worth noting, however, that the full membership currently bears the cost of the Credit Facility as an operating expense that factors into NSCC's overall fee structure, as well as their share of the Clearing Fund. Thus taken together, we believe this collective liquidity funding approach represents a fair apportionment of NSCC's aggregate liquidity needs amongst its membership.)

C. Proposal competitively disadvantages a sector of the market.

ITG, Knight and ConvergEx speculate that the amount of liquidity required under the SLD Proposal will likely result in increased concentration by "pushing smaller self-clearing Members either out of business or into correspondent clearing relationships with a very small number of

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[29] See Schwab April 22nd letter at 4.
[30] Knight letter at 2; see also Schwab May 1st letter at 9.

large financial institutions." [31] This is a comment that is made virtually every time that the clearing agency has a risk mitigant proposal that requires firms to provide funding, whether it be increased capital requirements, revisions to the Clearing Fund formula, or otherwise.

To the extent the commenters are referring to brokers whose business is largely agency-based transactions, ConvergEx argues that the SLD proposal overstates the risk posed by such brokers because they "settle transactions on a delivery-versus-payment basis."[32] This is not truly accurate: An agency broker who executes a market transaction that clears at NSCC is obligated, as principal, to settle that transaction at NSCC irrespective whether his institutional customer completes the institutional delivery "dvp" side of the transaction (which occurs outside of NSCC). And NSCC, as the central counterparty, remains obligated to complete the other side of the market transaction if the agency broker fails. Institutional customers of the agency brokers are not NSCC Members and have no contractual obligation with NSCC to complete those trades if the agency broker fails. So, the risk presented to NSCC and its other Members should an agency broker fail is that the institutional customer will take its own market action, and NSCC will incur the liquidity obligation of completing the market settlement. Agency brokers cannot argue that they are immune from the risk of failure, as recent events have shown that they, like other firms, remain subject to market events, technology risks, etc.

If the argument is that smaller less well capitalized firms have less access to funding than do larger well capitalized firms, then our view is that *no* Member has the right to impose on NSCC (and the rest of the membership) the burden of bearing the risks of the Member's business model. Moreover, as noted previously, the SLD Proposal does provide incentives for Members to manage the liquidity risks of their business; by doing so they can reduce the share of their SLD obligation.

Implicit in all these arguments is the concern that Members are being asked share the burden of funding the liquidity needs that are dependent on the actions, including trading levels, of other Members, and thus the amounts are not within the contributing Member's control. However, from a fairness perspective, that proportionate share of the affected Member's liquidity burden (whether it be an agency broker or otherwise) will *always be less than the Member's own peak liquidity needs*, and the Member is in the best position to monitor and manage the liquidity risks presented by its own activity. Moreover, there is precedent for allocating the liquidity or funding needs based upon peak activity: that is how The Depository Trust Company allocates amounts Participants must deposit into the DTC Participants Fund.[33]

IV. Transparency and Refinancing Risk

The other set of key concerns raised by Members relates to transparency. Members are concerned that they do not have sufficient information to evaluate the proposal's impact on their ability to forecast their near and longer term liquidity, funding and capital requirements.[34]

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[31] ITG letter at 3; Knight letter at 3.
[32] ConvergEx May 22nd letter at 5.
[33] The allocation formula is described in the DTC Settlement Service Guide, available at www.dtcc.com.
[34] Knight letter at 1.

They argue that that the Filings did not provide sufficient information to enable them to evaluate whether they will be included within the top 30 liquidity providers, and want to understand what steps they might take to manage or reduce the amount they could be required to provide.[35] Implicit in these comments is a concern about refinancing risk—that is, while the current line of credit is in effect they understand the amount of liquidity resources available to offset SLD cash deposit needs, but commenters are concerned that their obligations might substantially increase should the next, or a subsequent, refinancing of the facility yield commitment amounts materially lower than the Corporation's liquidity need.

NSCC understands, and absolutely agrees, that Members have to be able to evaluate risks of their membership and be able to plan for their liquidity obligations. At the same time, we also believe it is critical that Members understand the risks that their own activity presents to NSCC, and be prepared to monitor their own activity and alter their behavior if they want to minimize their liquidity risk. While robust reporting has always been a key element of the proposal, as indicated above the Amended Proposal will make this clear. Information reporting will be provided to all Members – not just those in the top 30 – at least monthly. These reports will show Members the liquidity exposure they present to NSCC to enable them to monitor their activity and the "Regular Activity Peak Liquidity Exposure" (as defined in the Rule text) that results from their activity. Information provided in these reports will include:

a. the Regular Activity Peak Liquidity Exposure of the Member on each Business Day of the preceding month;

b. NSCC's largest Regular Activity Peak Liquidity Need for the preceding month;

c. in the case of an Unaffiliated Member, for each Business Day of the preceding month, the percentage that the Regular Activity Peak Liquidity Exposure of the Member bears to the aggregate Regular Activity Peak Liquidity Exposures of all Regular Activity Liquidity Providers (the percentage for a Member that is not a Regular Activity Liquidity Provider for that month will be zero); and

d. in the case of an Affiliated Family, for each Business Day of the preceding month, the percentage that the aggregate Regular Activity Peak Liquidity Exposures of all Members of that Affiliated Family bears to the aggregate Regular Activity Peak Liquidity Exposures of all Regular Activity Liquidity Providers (Affiliated Families that are not Regular Activity Liquidity Providers for that month will show zero percentage).

NSCC Risk staff will continue to work with Members to help them understand and develop tools to forecast the liquidity exposure they present to NSCC; they will also use the reports to discuss with Members the types of actions that could mitigate their peak liquidity exposure. In addition, among the tools included in the Proposal for Members to manage their exposure is the ability to prefund deposits over a period where they project their own activity will increase their liquidity exposure. So, for example, if a Member that would be a Special Activity Liquidity Provider anticipates that its Special Activity Peak Liquidity Exposure at any time during a particular

[35] Schwab April 22nd letter at 3.

Options Expiration Activity Period will be greater than the amount calculated by NSCC, then it can make an additional cash deposit to the Clearing Fund (in excess of its Required Deposit) that it designates as a "Prefund Deposit."[36]

As regards providing sufficient lead time for planning around annual credit line renewals, (particularly so that affected Members may line up designated liquidity providers for the facility), NSCC Risk staff will provide Members with an impact analysis of their projected SLD obligations beginning on November 31st of each year, well in advance of the renewal date. That information will show the potential impact on affected Members based upon different facility funding levels.

With respect to the more general concern about refinancing risk and NSCC's reliance on the committed credit facility, NSCC will continue to explore additional financing sources. In an effort to "future proof" the SLD Rule, the Amended Proposal will include a new definition — "Other Qualifying Liquid Resources"— designed so that NSCC may take any such resources into account when calculating SLD amounts and use them to reduce the amount of cash that Members would be obligated to deposit as SLD amounts. NSCC will review and evaluate the financing options available to it and the related costs of those options. It will present the findings of that review to the DTCC Board of Directors prior to the next renewal of the Credit Facility in May 2014, so as to enable the Board to take those factors into account when sizing and agreeing to the fee and costs structure of the renewal Credit Facility, and the consequent impact on Members' cash SLD deposit obligations. Among the items to be included in this review are:

- analysis of the availability, size, cost, and credit risk necessary to obtain the additional commitments under the renewal facility likely to reduce SLD cash deposit requirements to zero;

- analysis of the availability, size, cost and credit risk to obtain a multi-year committed facility;

- an understanding of the aggregate costs (if any) for Members to designate commercial lenders to commit to the line as their designees;

- analysis of the availability, size, cost and potential depth of a capital markets funding among Members and/or third parties as an additional liquidity resource, including the viability of offering the funding to Members or mandating their participation in such funding; and

- a summary of the steps that Members have taken to reduce their NSCC liquidity profile, and whether this should be factored into the historical analysis used to determine NSCC's Regular Activity liquidity needs and Members' share of that need.

NSCC will update the membership on the results of this review and the Board's determination. As for future liquidity initiatives designed to increase NSCC's liquidity resources and potentially reduce SLD deposit requirements, NSCC will update the membership with information about

[36] Some comments have questioned the process for interim adjustments and the lack specificity for that. (SIFMA letter at 2, and DB letter at 2.) The discretion provided in that process is deliberate so as to permit NSCC the flexibility not to require interim adjustments unless it deems the risk and amount of any interim shortfall to be material.

these initiatives and their rationale, how the initiative fits within NSCC's liquidity risk tolerance and the likely impact of the initiative.

We believe that these actions, collectively, should enable Members to evaluate the liquidity risks of the Amended Proposal and be better positioned to plan for the liquidity and funding needs required thereunder. NSCC remains committed to assisting Members in this regard and believes that the information reporting, together with the substantive enhancements included in the Amended Proposal and discussed under item I. B above, should mitigate refinancing risk concerns.

V. Impact on Competition

A. Regulatory Requirements for Proposed Rule Changes

Section 19(b)(2)(C)(i) of the Exchange Act provides that "[t]he Commission shall approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of [the Exchange Act] and the rules and regulations issued under [the Exchange Act] that are applicable to such organizations." The requirements of the Exchange Act that are specifically applicable to clearing agencies are set forth in Section 17A relating to a national system for the clearance and settlement of securities transactions. Section 17A(a)(2)(A) directs the Commission to facilitate the establishment of the national system, having due regard for inter alia the "maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents". Section 17A(a)(3)(I) provides that a clearing agency shall not be registered unless the Commission determines inter alia that "[t]he rules of the clearing agency do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of [the Exchange Act]."

Rule 19b-4(a)(i) promulgated by the Commission under Section 19(b) of the Exchange Act provides that a proposed rule change by a self-regulatory organization (which includes a registered clearing agency) shall be filed on Form 19b-4. The General Instructions for Form 19-b prescribe the information to be included in the completed form. With respect to competition, the self-regulatory organization is required to "[s]tate whether the proposed rule change will have an impact on competition and, if so, (i) state whether the proposed rule changed will impose any burden on competition or whether it will relieve any burden on, or otherwise promote, competition and (ii) specify the particular categories of persons and kinds of businesses on which any burden will be imposed and the ways in which the proposed rule change will affect them". The self-regulatory organization is further required to explain (i) why any impact on competition is not believed to be a significant burden on competition or (ii) why any burden on competition is necessary or appropriate in furtherance of the Exchange Act.

B. Position of NSCC as Utility for Securities Industry

NSCC is an operating subsidiary of The Depository Trust & Clearing Corporation ("DTCC"), which is a user-owned, user-governed holding company for NSCC, two other registered clearing agencies, a derivatives clearing organization under a joint venture, and a number of other companies that provide a variety of post-trade processing and information services. NSCC and the other registered clearing agencies in the DTCC group provide the critical infrastructure for the clearance and settlement of securities transactions in the United States. They operate as utilities for their users, allowing such users to compete against each other (for the benefit of their retail and institutional customers) on the basis of performance and price and not on the basis of any relative advantage with respect to clearing and settlement services.

As a clearinghouse for securities transactions and a central counterparty, NSCC has no reason, interest or intent to discriminate among its Members – certainly not to give any of its Members a competitive advantage or impose on any of its Members a competitive disadvantage in their operations. Although NSCC strives for complete neutrality in its interface with Members, it may be that clearing agency rules of general application to all Members could have a disparate effect on Members with diverse business models and strategies. Any such disparate effects arising out of choices made by individual Members in terms of their business models and strategies (including their relative levels of capitalization) should not be seen as due to action by the clearing agency having an impact or imposing a burden on competition.

Although NSCC is always mindful of the effect that its Rules may have on individual Members, NSCC must also be concerned with (i) the interests of its membership as a whole, (ii) its general obligations under Section 17A(b)(3) of the Exchange Act "to facilitate the prompt and accurate clearance and settlement of securities transactions and derivatives agreements, contracts, and transactions" and "to safeguard securities and funds in its custody or control", and (iii) the particular requirements of Rule 17Ad-22(b)(3) relating to the financial resources that a clearing agency which is a central counterparty (like NSCC) must maintain to cover the default of the participant family presenting the largest exposure to the clearing agency in extreme but plausible market conditions.

NSCC believes that these concerns and the interests of its Members, including their interests relating to issues of competition and the effect of the proposed rule change on competition among Members and between Members and other financial market participants, can be reconciled. But individual Members that may be affected by the proposed rule change – designed to assure that NSCC has the liquidity it needs to safely operate a clearing and settlement business and meet its obligations as a registered clearing agency and central counterparty under the Exchange Act – must also recognize that some accommodation may be required on their part.

C. Modifications to the Proposed Rule Change Address Competition Concerns

In response to comments submitted on the SLD Proposal in the form in which it was originally filed, and dialogue with a number other Members who did not submit comments but otherwise provided their input to NSCC, NSCC is revising the Proposal in a number of respects, as outlined in Section I.B above as the Amended Proposal. Several of these changes bear upon the issue of competition and whether the proposed rule change would have an impact or impose any burden on competition:

1. The Options Expiration Activity Period has been redefined to mean the days around all monthly options expiration dates (twelve per year) rather than just triple options expiration dates (four per year). As a result of this change, more periods of increased activity will be excluded by

NSCC from the calculation of its Regular Activity Peak Liquidity Need, thereby reducing the Regular Activity Liquidity Obligations of Regular Activity Liquidity Providers.

2. The original SLD Proposal provided that a Regular Activity Liquidity Provider would receive an offset against its Regular Activity Liquidity Obligation for the amount of its commitment and the commitment of any affiliate of the Regular Activity Liquidity Provider under the Credit Facility. The revised SLD Proposal provides that a Regular Activity Liquidity Provider will receive an offset against its Regular Activity Liquidity Obligation for the amount of its commitment and the commitment of any Designated Lender of the Regular Activity Liquidity Provider under the Credit Facility. In this way, any distinction between Members with bank affiliates and Members without bank affiliates, and any perceived advantage for Members with bank affiliates over Members without bank affiliates, has been eliminated.

3. The SLD Proposal has been refined to provide that a Regular Activity Liquidity Provider will receive an offset against its Regular Activity Liquidity Obligation for both (i) its pro rata share of the commitments of lenders under the Credit Facility that are not Members or their Designated lenders and (ii) its pro rata share of the commitments of Members and their Designated Lenders above the amounts of their Regular Activity Liquidity Obligations. As a result of this change, the obligations of Regular Activity Liquidity Providers to provide Regular Activity Supplemental Deposits will be ratably reduced by the amount of such "excess".

Participation in the Credit Facility is available to financial institutions that have the resources and operational capabilities to be lenders under the Facility, subject to satisfaction of reasonable lender criteria. Although the Credit Facility was renewed on May 14, 2013 for an additional term of 364 days, there are mechanisms in the facility to increase the commitments of existing lenders and admit new lenders at any time during the term. Accordingly, at the time when the proposed rule change becomes effective and before the time that any Member may have to satisfy a Regular Activity Liquidity Obligation, such Member will have an opportunity to either join the Credit Facility itself as a lender (if it has the authority to be a lender) or enter into arrangements with a bank to be its Designated Lender – in either case thereby reducing or eliminating the need for it to make a cash Regular Activity Supplemental Deposit to the Clearing Fund.

D. Impact on Competition

Finally, concerns raised from commenters on competition grounds regarding the fairness of the Proposal are fully addressed in Section III (Fairness of the Proposal) above. Accordingly, for the reasons stated above and elsewhere in the letter, NSCC believes the changes that have been made in original SLD Proposal eliminate or substantially ameliorate any impact that the Amended Proposal might have on competition, and that any perceived burden on competition caused by the Amended Proposal is necessary and appropriate to prevent systemic risk.

Conclusion

NSCC appreciates the constructive input of its Members, and believes that the foregoing discussion is appropriately responsive to their expressed concerns. For the reasons discussed above, we believe that the Commission may properly approve the Amended Proposal, as NSCC believes it meets all the requirements under the 1934 Act and applicable rules thereunder necessary for such approval.

Should you have any questions, please do not hesitate to call me at (212) 855-3240, or Noel B. Donohue, DTCC Chief Risk Officer, at (212) 855-1169.

Very truly yours,

Larry E. Thompson

Larry E. Thompson
Managing Director and DTCC General Counsel

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Mr. John Ramsey, Acting Director, Division of Trading and Markets
The Honorable Mary Jo White, Chairman
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
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