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Invested in America

August 7, 2013

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

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

Re: **SR-NSCC-2013-02** and **SR-NSCC-2013-802** – Notice of Filing of Proposed Rule Change and Notice of Filing of Advance Notice, Each as Modified by Amendment Nos. 1 and 2, to Institute Supplemental Liquidity Deposits to National Securities Clearing Corporation's Clearing Fund Designed to Increase Liquidity Resources to Meet Its Liquidity Needs, and Order Instituting Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] appreciates the opportunity to comment on the above-referenced notices of filings made with the Securities and Exchange Commission (the "**Commission**") by the National Securities Clearing Corporation (the "**NSCC**") concerning the NSCC's proposed rule change to institute supplemental liquidity deposits designed to increase liquidity resources to meet its liquidity needs (the "**SLD Proposal**"), as well as the Commission's order instituting proceedings to determine whether to approve or disapprove the proposed rule change filed by the NSCC.[2] In particular, we address in this letter

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers, including firms that are members of and clear securities transactions through the National Securities Clearing Corporation. SIFMA's mission is to develop policies and practices that strengthen financial markets and encourage capital availability, job creation and economic growth while building trust and confidence in the financial industry. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association.

[2] *See Notice of Filing of Proposed Rule Change to Institute Supplemental Liquidity Deposits to Its Clearing Fund Designed to Increase Liquidity Resources to Meet Its Liquidity Needs*, Exchange Act Release No. 69313 (April 4, 2013), 78 FR 21487 (April 10, 2013); *Notice of Filing Amendment No. 1 and Designation of a Longer Period for Commission Action on Proposed Rule Change, as Modified by Amendment No. 1, to Institute Supplemental Liquidity Deposits to Its Clearing Fund Designed to Increase Liquidity Resources to Meet Its Liquidity Needs*, Exchange Act Release No. 69620 (May 22, 2013), 78 FR 32292 (May 29, 2013); *Notice of Filing Amendment No. 2 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change, as Previously Modified by Amendment No. 1, to Institute Supplemental Liquidity Deposits to Its Clearing Fund Designed to Increase Liquidity Resources to Meet Its Liquidity Needs*, Exchange Act Release No. 69951 (July 9, 2013), 78 FR 42140 (July 15, 2013); *Notice of Filing of Advance Notice, as Modified by Amendment No. 1, to Institute Supplemental Liquidity Deposits to Its Clearing Fund Designed to Increase Liquidity Resources to Meet Its Liquidity Needs*, Exchange Act Release No. 69451 (April 25, 2013), 78 FR 25496 (May 1, 2013); *Notice of Extension of Review Period of Advance Notice, as Modified by Amendment No. 1, to Institute Supplemental Liquidity Deposits to Its Clearing Fund Designed to Increase Liquidity Resources to Meet Its Liquidity Needs*, Exchange Act Release No. 69605 (May 20, 2013), 78 FR 31616 (May 24,

our concerns regarding the NSCC's Amendment No. 2 to the SLD Proposal and the discriminatory impact that the proposal would have on NSCC members that are not affiliated with banks, relative to those that are affiliated with banks.

As discussed in our June 24, 2013 comment letter, SIFMA appreciates the NSCC's efforts to respond to the industry's comments on the original SLD Proposal and believes Amendment No. 2 to the proposal includes some welcome improvements. However, the proposal remains complex, and we continue to believe that it could, if implemented, have significant negative effects on the NSCC's members, on systemic risk and the stability of the broader financial market, and on the investing public. Because the proposed rule change is inconsistent with applicable regulatory requirements, including, among other things, as a result of its unfair discriminatory impact on certain NSCC member firms, we believe the SLD Proposal should be disapproved. Instead, we would like to work with the NSCC to develop longer-term approaches to addressing the NSCC's liquidity and capital needs. In particular, we believe it would be helpful for the NSCC to convene an industry-wide committee to consider all reasonable alternatives and make suggestions for a way forward.

Discriminatory Impact on Non-Bank-Affiliated NSCC Members

The Commission, in its July 9, 2013 order instituting proceedings to determine whether to approve or disapprove the SLD Proposal, solicited comments on "whether Amendment No. 2 adequately addresses the concern raised by some commenters that the Proposed Rule Change could have a discriminatory impact on NSCC's non-bank affiliated Members who would be subject to the SLD Proposal but who do not currently participate in the Credit Facility."[3] SIFMA believes that Amendment No. 2 does not adequately address this concern, and thus unfairly discriminates among NSCC participants.

Specifically, as described below, the amended proposal still advantages bank-affiliated NSCC members with respect to the credit facility process, and imposes discriminatory disadvantages on non-bank-affiliated members. The unequal treatment of bank-affiliated members and non-bank-affiliated members under the proposal could also distort market conditions for the syndication of the credit facility, and could be especially disruptive during situations of market stress.

Unfair discrimination between bank-affiliated and non-bank-affiliated NSCC members

Bank-affiliated NSCC members are paid a facility fee based on the amounts they commit to the NSCC's credit facility, are able to hold on to their cash without the obligation to have cash on deposit with the NSCC, and are treated as secured creditors of the NSCC if they lend funds under the facility.

2013); *Notice of Filing Amendment No. 2 to an Advance Notice, as Previously Modified by Amendment No. 1, to Institute Supplemental Liquidity Deposits to Its Clearing Fund Designed to Increase Liquidity Resources to Meet Its Liquidity Needs*, Exchange Act Release No. 69954 (July 9, 2013), 78 FR 42127 (July 15, 2013).

[3] *See supra note 2*, Exchange Act Release No. 69951, 78 FR 42140, 42146.

In contrast, non-bank-affiliated members of the NSCC are required to find "designated lenders" to participate in the credit facility on their behalf, which is not a standard request of lenders, and would likely need to pay a fee to their designated lenders in addition to the facility fee that would be paid to lenders by the NSCC under the credit facility. If a non-bank-affiliated member subject to the supplemental liquidity deposit requirement were unable to find a designated lender and were forced to make a cash deposit to the NSCC, that member would suffer the capital impacts of making the deposit, would not receive any fees from the NSCC on its deposit (unlike the bank-affiliated members participating in the credit facility, which would be paid a facility fee for their commitments under the facility), and would be treated as an unsecured creditor of the NSCC with respect to the amount of the cash deposit. Non-bank-affiliated firms subject to the NSCC's supplemental liquidity deposit obligation would be faced every year with the need to induce the participation of a designated lender in the NSCC's credit facility or to deposit potentially significant amounts of cash with the NSCC.

An additional important distinction in the treatment of bank-affiliated and non-bank-affiliated NSCC members is that there are significant differences in terms of cost, balance sheet impact, and liquidity impact between a contingent liability, or commitment to fund under the credit facility, on the one hand and a funded cash deposit on the other hand. Unlike banks, which would reserve only a small portion of capital against their credit facility commitments, non-bank-affiliated members of the NSCC would be forced to leverage relationships and raise significantly more capital to induce banks to participate on their behalf (let alone to make cash deposits to the NSCC). For the NSCC's non-bank-affiliated members, the SLD Proposal would significantly increase risk and operational costs whether those members were able to obtain the participation of designated lenders in the NSCC's credit facility or were required to make cash deposits to the NSCC.

Impacts on the credit facility syndication process

The NSCC's amended proposal, if implemented, could discourage banks that are not affiliated with NSCC members from taking part in the initial credit facility subscription process, as these banks would know that they could potentially earn a higher return by waiting for non-bank-affiliated NSCC members to seek them out as designated lenders and pay them to make a commitment to the facility on their behalf that would be additional to the fee paid to lenders under the facility by the NSCC.

Additionally, the proposed rules, if implemented, could create the opportunity for bank-affiliated NSCC members to put liquidity pressure on non-bank-affiliated competitors. For example, banks with NSCC member affiliates could commit to the facility only to the extent of their affiliates' supplemental liquidity deposit obligations and wait to be asked to serve as designated lenders for the non-bank-affiliated members, thereby earning fees from the non-bank-affiliated NSCC members in addition to the credit facility fee. The proposed rules could also allow these banks to cap their commitments to the credit facility at the amount of their affiliates' supplemental liquidity deposit obligations, which would result in maximizing the amount that non-bank-affiliated members would be responsible for depositing in cash or finding designated lenders to cover. Moreover, given that the non-bank-affiliated members of the NSCC are not involved in negotiating the credit facility renewal each year and have no visibility into how the size of the facility or other terms and conditions are established, there is the potential for distrust among NSCC members in connection with the credit facility renewal process.

The proposed structure would also create moral hazard for the NSCC as it determines the terms for the credit facility. For example, the NSCC could offer below-market terms for the facility, knowing that it could require supplemental liquidity deposits from its member firms for the amount of any shortfall. This scenario would have a limited impact on bank-affiliated members, which would be able to satisfy their supplemental liquidity deposit obligations by participating in the credit facility. However, it would have a significant negative impact on non-bank-affiliated members of the NSCC, which would have to either make cash deposits to the NSCC or incent unwilling banks to make commitments to the facility on their behalf. This scenario would effectively require the non-bank-affiliated members of the NSCC to make up the difference between the NSCC's below-market terms and market pricing with fees and likely with supplemental guarantees to their designated lenders. This incremental cost would be borne solely by the non-bank-affiliated members.

Sensitivity during stress situations

Scenarios where the annual renewal of the credit facility occurs during a stress situation highlight the significant negative impact of the SLD Proposal on non-bank-affiliated members, as compared with their bank-affiliated competitors. For example, the timing of the annual renewal of the NSCC's credit facility could coincide with adverse market conditions when funding is scarce and banks are unwilling to commit to the credit facility. In such a situation, NSCC members that have bank affiliates could commit at the minimum levels required to meet their supplemental liquidity deposit obligations, while banks that are not affiliated with NSCC members would either not participate in the facility or participate at a very low level.

In such a situation, the NSCC members without bank affiliates would likely face extreme difficulty in obtaining commitments to the NSCC's credit facility from designated lenders and may only be able to obtain such commitments at great expense, if at all. If commitments from designated lenders were not available, non-bank-affiliated members of the NSCC (i) would be forced to make significant cash deposits that would need to be raised within a short timeframe, (ii) would introduce significant risk to market clearing activity if funds could not be raised, possibly increasing defaults, and (iii) would be at a significant disadvantage relative to NSCC members with bank affiliates since cash deposits would not be a requirement for the activity of these members. Non-bank-affiliated members of the NSCC would thus face increased funding requirements in more volatile market conditions, precisely when liquidity would become most scarce. They would need to raise longer-term capital to meet these requirements, putting pressure on margins and potentially placing these members at a competitive disadvantage relative to NSCC members with bank affiliates. In addition, liquidity planning and daily funding would become more problematic, raising the risk profile of many non-bank-affiliated NSCC members during periods of volatility.

Lack of Transparency

The issues addressed above related to the SLD Proposal's unfair discriminatory impact on non-bank-affiliated members of the NSCC would be exacerbated by the proposal's fundamental lack of transparency.

As described in our June 24, 2013 letter, the SLD Proposal lacks transparency in a number of respects, including the lack of detail regarding the assumptions that would underlie the NSCC's calculations; the unknowable impact that the activities of other member firms could have on an entity's supplemental liquidity deposit obligations; the inability of NSCC members to anticipate the activities of other member firms that could give rise to interim liquidity deposits or liquidity calls; and the year-to-year variability of the supplemental liquidity deposit requirement depending on the NSCC's success in renewing its credit facility. The composition of the NSCC's top 30 firms in terms of trading volume could change at different points in time in the ordinary course of business, and the NSCC's arbitrary 30-firm cut-off for imposition of the supplemental liquidity deposit requirement could result in firms trying to position themselves outside of the top 30, all contributing to increased uncertainty relating to the supplemental liquidity deposit requirement.

Further, the SLD Proposal lacks transparency regarding the requirements that would apply to banks seeking to become designated lenders for non-bank-affiliated NSCC members and the mechanism pursuant to which an NSCC member could obtain an offset against its supplemental liquidity deposit obligation for the commitment of its designated lender. In sum, NSCC members could be subject to onerous deposit requirements that they would be unable to control or influence, let alone predict or plan for. This lack of transparency would have a significant negative effect on the NSCC's members, and particularly on those members without bank affiliates that could be required to incentivize reluctant lenders to participate in the NSCC's credit facility or obtain and deposit with the NSCC significant amounts of cash.

Formation of an Industry Committee to Consider Alternatives

SIFMA acknowledges the importance of addressing systemic risk in our capital markets, including during periods of reasonably foreseeable market volatility, and appreciates the need for the NSCC to maintain sufficient financial resources. Unfortunately, however, the SLD Proposal fails to address these issues effectively. The SLD Proposal would not provide an equitable or effective approach to mitigating systemic risk; would base liquidity requirements on metrics and factors that are opaque and beyond the control of the NSCC's members; would be indifferent to the intrinsic risks of individual members; could lead to a concentration of risk; fails to acknowledge many additional risks that firms face, including liquidity and refinance risks, that could be aggravated by elements of the proposal; and is unclear as to its capital treatment.

Given the complexity of the issues involved and the diversity of firm types among the NSCC's membership, SIFMA believes the most effective way to develop viable long-term solutions is to form a committee of NSCC member firms to explore the issues in dialogue with the NSCC.

As identified in our June 24, 2013 letter and in the letters of other commenters, there are a number of alternatives that should be considered. Among others, the NSCC should consider making substantial and fundamental changes in its capital structure and liquidity planning to improve its financial strength and provide a more secure and resilient organization for all member firms. The current SLD Proposal merely defers for one year the refinance risk related to the NSCC's annual renewal of its credit facility, putting the NSCC and its membership at risk rather than making substantive improvements in the NSCC's liquidity. Lengthening the term of the credit facility to three or five years would reduce the NSCC's refinance risk and strengthen its liquidity. While we understand that a three- or five-year credit facility may need to be priced at a premium to obtain participation, we believe incurring additional costs would be more appropriate than imposing the proposed supplemental liquidity deposit requirement, as a longer-term facility would avoid the discriminatory and other negative effects of the SLD Proposal. A more structured and effective approach would also benefit all NSCC member firms and should avoid the capital burden being placed on a few firms. In addition, the NSCC should consider increasing deposits on a risk-adjusted basis across its membership in order to reduce the need for additional liquidity deposits from a small group of members. More fundamentally, as noted in our prior letter, the NSCC should consider those changes that could reduce, and enable the NSCC to more accurately identify, its liquidity requirements.

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SIFMA greatly appreciates the Commission's consideration of the matters raised above in connection with the NSCC's SLD Proposal. If you have any questions or would like to discuss any of the foregoing, please feel free to contact me at 212-313-1260.

Sincerely,

Thomas Price
Managing Director, Operations, Technology & BCP