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August 20, 2013

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

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") - Exchange Act Release No. 34-69951 (July 9, 2013) –Notice of Filing of Amendment No. 2 and Order Instituting Proceedings to Determine Whether to Approve or Disapprove Proposed Rule Change (the "Notice and Order")**

Dear Ms. Murphy:

National Securities Clearing Corporation ("NSCC")[1] appreciates the opportunity to respond to the comment letters submitted by Citadel LLC ("Citadel")[2], Charles Schwab & Co., Inc. ("Schwab")[3], SIFMA[4], Seward & Kissel LLP ("Seward") on behalf of Schwab[5], Fidelity Investments ("Fidelity")[6], and ITG Inc. ("ITG")[7] with respect to the Notice and Order.

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[1] NSCC is a clearing agency, registered with the Commission pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act"), that provides clearing, settlement, risk-management and central counterparty services for virtually all broker-to-broker trades in the United States involving equities, corporate and municipal debt, ADRs, ETFs and UITs. NSCC has been designated as a systemically important financial market utility ("SIFMU") by the Financial Stability Oversight Counsel pursuant to Section 804 of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") in recognition of its critical role in the national financial infrastructure. NSCC is a subsidiary of The Depository Trust & Clearing Corporation ("DTCC"), which is a user-owned, user-governed holding company for NSCC, two other registered clearing agencies and SIFMUs regulated by the Commission, a derivatives clearing organization (in a joint venture) regulated by the Commodity Futures Trading Commission, 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.

[2] Letters from John C. Nagel to Ms. Elizabeth Murphy, dated June 13 ("Citadel I") and August 5 ("Citadel II"), 2013, respectively.

[3] Letter from Peter Morgan to Ms. Elizabeth Murphy dated August 5, 2013.

[4] Letters from Thomas Price to Ms. Elizabeth Murphy, dated June 24 ("SIFMA I") and August 7 ("SIFMA II"), 2013, respectively.

[5] Letter from Paul T. Clark and Anthony C.J. Nuland to Ms. Elizabeth Murphy, dated August 5, 2013.

[6] Letter from Scott C. Goebel to Ms. Elizabeth Murphy, dated June 26, 2013.

[7] Letter from Mark Solomon and James Selway III to Ms. Elizabeth Murphy, dated August 5, 2013.

This letter supplements our response submitted on June 10, 2013 (the "June Letter") to earlier comment letters submitted with respect to the Rule Filing and the Advance Notice (together, as amended to date, the "Filings"). Since the commenters raise a number of similar concerns about the SLD Proposal, NSCC responds to their comments collectively as set forth below.

I. Procedural Background

On March 21, 2013, NSCC filed with the Securities and Exchange Commission ("SEC" or the "Commission") a proposed rule change relating to an amendment of its rules and procedures to establish a supplemental liquidity funding obligation to ensure that NSCC has adequate liquidity resources to meet its liquidity needs (the "Original SLD Proposal").[8] On April 19, 2013, NSCC filed with the Commission Amendment No. 1 to the Original SLD Proposal to include as Exhibit 2 a written comment on the Original SLD Proposal received by NSCC from National Financial Services, LLC.[9] Ten comment letters were submitted to the Commission in respect of the Original SLD Proposal. NSCC responded to these comment letters in our June Letter.

On June 11, 2013, NSCC filed with the Commission Amendment No. 2 to the Original SLD Proposal to enhance the Original SLD Proposal in a number of respects (the "Amended SLD Proposal").[10] Most significantly, the Amended SLD Proposal would (i) allow a Member to designate any bank, not just a bank affiliated with the Member, as its Designated Lender under the Credit Facility, (ii) allocate the excess Commitments of Regular Activity Liquidity Providers or their Designated Lenders to other Regular Activity Liquidity Providers on a *pro rata* basis (thereby reducing the amounts of the Supplemental Deposits of Regular Activity Liquidity Providers that did not have excess Commitments), (iii) include all monthly option expiration periods, not just quarterly triple-witching options expiration periods, in the Options Expiration Activity Periods used to calculate Special Activity Liquidity Obligations (thereby excluding these periods of heightened activity from the calculation of Regular Activity Liquidity Obligations and reducing the amounts of such Regular Activity Liquidity Obligations), (iv) give NSCC some discretion in determining whether to include Prefund Deposits in the calculation of Special Activity Peak Liquidity Exposures, (v) provide for Members to receive specified information on at least a monthly (and ultimately a daily) basis to permit them to monitor their Regular Activity Peak Liquidity Exposures (and thereby plan to meet any Regular Activity Liquidity Obligations they incur), (vi) clarify that no Members would be required to fund any Regular Activity Liquidity Obligations or Special Activity Liquidity Obligations earlier than the third quarter of 2013 (which time period will now have to be extended) and (vii) make certain other technical changes designed to align notice, payment and cash return time frames.

[8] *See* Exchange Act Release No. 69313 (April 4, 2013), 78 FR 21487 (April 10, 2013). On March 21, 2013, NSCC also filed with the Commission the Advance Notice. *See* Exchange Act Release No. 69451 (April 25, 2013), 78 FR 25496 (May 1, 2013).

[9] *See* Exchange Act Release No. 69620 (May 22, 2013), 78 FR 32292 (May 29, 2013). On April 19, 2013, NSCC also filed with the Commission Amendment No. 1 to the Advance Notice. *See* Exchange Act Release No. 69451 (April 25, 2013), 78 FR 25496 (May 1, 2013). The Commission thereafter extended the review period for the Advance Notice. *See* Exchange Act Release No. 69605 (May 20, 2013), 78 FR 31616 (May 24, 2013).

[10] *See* Notice and Order, 78 FR 42140 (July 15, 2013). Capitalized terms used, but not defined, in this letter have the meanings given to those terms in the Amended SLD Proposal. On June 11, 2013, NSCC also filed with the Commission Amendment No. 2 to the Advance Notice. *See* Exchange Act Release No. 69954 (July 9, 2013), 78 FR 42127 (July 15, 2013).

On July 9, 2013, the Commission issued an order instituting proceedings to determine whether to approve or disapprove the Amended SLD Proposal.[11]

II. Substantive Basis for the Amended SLD Proposal

Some commenters argue that NSCC has not established a need for the Amended SLD Proposal to be adopted at the current time.[12] They take the view that the proposal is not mandated as a means to comply with SEC rules currently applicable to NSCC.[13] In a similar vein, others question how the proposal will increase "the protection of investors and persons facilitating transactions by and acting on behalf of investors."[14] Commenters challenge the methodology used for determining the need, questioning why using peak activity is appropriate or necessary, and arguing the calculated need is too conservative.[15]

In making these arguments, commenters are relying primarily on statements made with respect to the adoption of Rule 17Ad-22(b)(3),[16] the "Financial Resources Rule",[17] where the Commission expressed the belief that adoption of the SEC rule would not require major changes to the practices that have been developed to measure the sufficiency of financial resources at SEC-registered CCPs. In expressing this view, the Commission cited the 2010 International Monetary Fund Financial Sector Assessment of NSCC,[18] which itself relies on NSCC's back-test results from the period January through April 2009 showing that during this period there was sufficient liquidity to cover the needs of the failure of the largest affiliated family the majority (but not all) of the time. Since this period NSCC has seen continued increases in potential liquidity needs, driven by consolidation in the industry, developments in trading techniques (including a rise in high frequency trading), and a reduction in volatility from the post-crisis highs which result in reduced Clearing Fund requirements. This has driven the need to increase the size of NSCC's Credit Facility over this period: The size of the Credit Facility in 2008-2009 was $4.15 billion; its current size is $12.721 billion, a threefold increase. However, it is important to bear in mind that the Credit Facility is a generally static amount for the period of its term. We have seen fluctuating peak activity historically exceed the facility size and our liquidity resources. That is one of the key reasons why the Amended SLD Proposal provides for bifurcated obligations: separating those obligations relating to "Regular Activity", from those additional needs caused by heightened activity occurring during monthly Options Expiration Activity Periods and creating separate obligations for those Members causing such increased needs over and above NSCC's "Regular Activity" liquidity resources.

It is also important to note that NSCC's ability to increase the Credit Facility size by over 70% in 2013 was, in large part, due to Members anticipating the need to comply with the proposed rule change. NSCC estimates approximately 60% of the $5.291 billion increase over the prior

[11] *Id.*
[12] SIFMA I at 3; Citadel II at 4.
[13] Citadel II at 5.
[14] Seward at 3.
[15] ITG at 8; Citadel I at 9.
[16] 17 C.F.R.§240.17Ad-22(b)(3).
[17] *See* SEC Clearing Agency Standards Adopting Release (Rel. No 34-68080) (Oct. 22, 2012), 77 FR 66220 (Nov. 2, 2012), at 66236 (referred to as the "Standards Release"). The Clearing Agency Standards became effective on January 2, 2013.
[18] *Id.*, at note 183.

year can be attributed to the Proposal, allowing NSCC to raise a Credit Facility in line with the projected size of the proposed Regular Activity Peak Liquidity Need. Thus, while not actually yet in effect, the Amended SLD Proposal has already demonstrated it has a significant part to play in NSCC's continued compliance with the Financial Resources Rule.

In the Standards Release, the Commission itself recognized that clearing agency rules and procedures must continue to evolve in parallel with the risks faced:

> "so that the clearing agency can adequately respond to changes in technology, legal requirements, trading volume, trading practices, linkages between financial markets and the financial instruments traded in the markets that the clearing agency serves. Accordingly, registered clearing agencies must evaluate continually and make appropriate updates and improvements to their operations and risk management practices to facilitate the prompt and accurate clearance and settlement of securities transactions and to safeguard securities and funds in their custody or control."[19]

Since 2012, NSCC has been designated a SIFMU, and thus is now subject to heightened prudential supervision. It should be clear that given this designation and today's market environment, risk tolerance and appetites have changed. More important, however, is the clear requirement imposed by the SEC's own rule: the Financial Resources Rule currently imposes a "cover 1" requirement that NSCC must meet *on an ongoing basis*.[20] That is, NSCC must maintain, implement and enforce written policies and procedures reasonably designed to assure that it maintains sufficient financial resources to withstand, at a minimum, a default by the participant family to which it has the largest exposure in extreme but plausible market conditions. NSCC believes that the Amended SLD Proposal is necessary to assure that NSCC can continue to maintain sufficient liquidity resources as market conditions develop. While NSCC has raised, and will continue to endeavor to raise, appropriate levels of resources from the market, it is far from clear that this will always be achievable given the level of resources required. NSCC is not in a position to obligate the market to provide liquidity, and so satisfaction of the requirement can only, by its nature, be achieved by placing the ultimate burden of liquidity provisioning on Members.

While all of the commenters agreed with the principle that NSCC should have the necessary liquidity resources, their arguments fail to acknowledge the systemic role that NSCC plays in the US cash equities market, and how the maintenance of adequate liquidity, as provided by the Amended SLD Proposal, will protect against the transmission of systemic risk among NSCC's Members in the event of the failure of a major Member firm. NSCC's designation as a SIFMU means that the failure of or disruption of its functioning could create, or increase, the risk of significant liquidity or credit problems spreading among financial institutions or markets, thereby threatening financial stability.[21] Among the factors considered in determining whether an FMU should be designated systemically important are the aggregate liquidity exposure of the FMU to

[19] Standards Release at 66229.

[20] In this regard we do not believe it is correct or appropriate to wait to seek approval to implement the Amended SLD Proposal until exigent circumstances arise. By that time, by definition, the requirements of the Financial Resources Rule will have been breached.

[21] FSOC Notice of Proposed Rulemaking on Authority to Designate Financial Market Utilities as Systemically Important, 76 FR 17047 (March 28, 2011).

its counterparties (as well as credit exposures), and its relationships and interdependencies with other FMUs.[22] As noted in our June Letter, 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 in turn satisfy their settlement deliveries and receive the funds that their business relies upon, notwithstanding the failure of another Member. The maintenance of adequate liquidity resources also reduces the potential for forced asset sales, either by NSCC in its liquidation of the defaulting Member's portfolio, or the surviving Members in the event that NSCC was unable to complete settlement.[23] In this way NSCC's maintenance of liquidity serves to limit the contagion that could flow from a defaulting Member through NSCC to its other Members and participants—and onward to their respective customers. Similarly, strengthening NSCC's liquidity resources also serves to mitigate the potential spread of financial risks through interrelationships it has with other FMUs.[24] We believe that the Amended SLD Proposal, which provides for ex-ante rules for liquidity provisioning, may reasonably serve to reduce the likelihood and severity of such knock-on effects. For these reasons we believe that the Commission may reasonably find that the Amended SLD Proposal is consistent with the objective under Section 17A(b)(3)(A) of the Exchange Act of promoting the prompt and accurate clearance and settlement of securities transactions.[25] And, by enabling the settlement of transactions to occur on their designated settlement dates notwithstanding the default of a major NSCC Member, the Amended SLD Proposal is designed to reduce systemic risk and is thereby consistent with the protection of customers and the public interest.

Given that the requirements for "cover 1" include the largest exposure that NSCC may face under extreme but plausible market conditions, NSCC believes it is required to take peak liquidity exposures into account when calculating its need. In order to reflect the use of the peak to determine the size of the liquidity facility required, NSCC also believes it is appropriate to take a consistent approach for allocating the SLD facility among the top 30 Members. This approach allows the obligations to be more accurately allocated among those Members that cause the peak shortfalls. This approach also incentivizes Members to reduce peak levels of liquidity risk passed on to NSCC. This reduces the 'worst case' exposure Members present to NSCC, reducing NSCC's potential exposure and ultimate requirement for liquidity resources.

These factors collectively provide a more than sufficient substantive basis for adoption of the Amended SLD Proposal at the current time.

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[22] FSOC Notice of Final Rule on Authority to Designate Financial Market Utilities as Systemically Important, 76 FR 44763 (July 27, 2011).

[23] *See* Financial Stability Oversight Council 2013 Annual Report at 3-4, 133 *et seq*.

[24] One commenter has questioned whether the Amended SLD Proposal will be replicated by other FMUs. Schwab at 17. While we have no knowledge of any such proposals, we believe it is important to note the difference in liquidity risk between cash market CCPs, such as NSCC, and derivatives CCPs. In the former, the potential liquidity needs are orders of magnitude greater than the market risk their margin collections are designed to cover; in the latter, liquidity obligations are generally more closely aligned with the market risk of their portfolios. NSCC thus believes this concern is overstated.

[25] 15 U.S.C. §78q-1(b)(3)(A).

III. Competition and Discrimination

A number of commenters argue that the Amended SLD Proposal does not meet the requirements for approval under the Exchange Act[26] and that, in particular, the Amended SLD Proposal (i) imposes a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act[27] and/or (ii) discriminates among Members in their use of the clearing agency.[28] NSCC believes that the Amended SLD Proposal does meet the requirements for approval under the Exchange Act, and that the Commission would be acting within the scope of its regulatory authority and discretion to approve the Amended SLD Proposal on the current record.

One commenter opines that the record "does not provide an adequate basis" for the Commission to approve the Amended SLD Proposal, that any such approval of the Amended SLD Proposal would be "open to challenge" and that Section 25(a) of the Exchange Act [29]"allows a person aggrieved by a Commission order approving an SRO rule change to seek review of the order" in court.[30] NSCC believes that this view is incorrect, and that there is sufficient information in the record for the Commission to make a determination on the merits of the Amended SLD Proposal.

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 organization."[31] Section 19(b)(2)(C)(ii) of the Exchange Act provides, conversely, that "[t]he Commission shall disapprove a proposed rule change of a self-regulatory organization if it does not make [such a finding]".[32]

Competition. With respect to competition, Section 17A(a)(2)(A) of the Exchange Act directs the Commission to facilitate the establishment of the national system for clearance and settlement, having due regard for *inter alia* the "maintenance of fair competition among brokers and dealers, clearing agencies, and transfer agents."[33] Section 17A(b)(3)(I) of the Exchange Act 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]."[34] Rule 19b-4(b)(1) promulgated by the Commission under Section 19(b) of the Exchange Act[35]provides that a proposed rule change by a self-regulatory organization (which includes a registered clearing agency) shall be filed on Form 19b-4.[36] The General Instructions to Form 19b-4 prescribe the information to be included in the completed form. With respect to competition, the self-regulatory organization is required to "state whether the proposed rule change will impose any

[26] Citadel I at 1; Citadel II at 2; Schwab at 9-11; Seward at 2-4; ITG at 3.
[27] Citadel I at 2, 7-8; SIFMA I at 2, 8-9; Schwab at 2-3, 13-15; Seward at 2-4; ITG at 3-8.
[28] Citadel I at 2, 7-8; SIFMA I at 2, 5, 8; SIFMA II at 1-3; Schwab at 16.
[29] 15 U.S.C. § 78y(a).
[30] Seward at 1, 3 and 5.
[31] 15 U.S.C. §78s(b)(2)(C)(i).
[32] *Id*. at §78s(b)(2)(C)(ii).
[33] *Id*. at §78q-1(a)(2)(A).
[34] *Id*. at §78q-1(b)(3)(I).
[35] *Id*. at §78s(b).
[36] 17 C.F.R. § 240.19b-4(b)(1).

burden on competition or whether it will relieve any burden on, or otherwise promote, competition and 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."[37] The self-regulatory organization is further required to explain why any impact on competition is not believed to be a significant burden on competition or why any burden on competition is necessary or appropriate in furtherance of the purposes of the Exchange Act.

Discrimination. With respect to discrimination, Section 17A(b)(3)(F) of the Exchange Act provides that a clearing agency shall not be registered unless the Commission determines *inter alia* that the rules of the clearing agency "are not designed to permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency".[38] Although not directly relevant to the type of discrimination alleged by the commenters here, Rule 17Ad-22(d)(2) promulgated by the Commission under Section 17A of the Exchange Act [39]and Sections 763 of Title VII[40] and 805 of Title VIII[41] of the Dodd-Frank Act provides that "[e]ach registered clearing agency shall establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . have participation requirements that are objective and publicly disclosed, and permit fair and open access."[42]

Record. The General Instructions to Form 19-b-4 prescribe the information to be included in the completed Form. With respect to the amount of information to be included, the self-regulatory organization is enjoined to "provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the [Exchange] Act and the applicable rules and regulations under the [Exchange] Act."[43] Pursuant to Rule 700(b)(3) of the Rules of Practice, if proceedings are instituted with respect to a proposed rule change, "[t]he burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder that are applicable to the self-regulatory organization is on the self-regulatory organization that proposed the rule change."[44] Rule 700(b)(3) goes on to elaborate on the information that the self-regulatory organization is required to provide pursuant to the General Instructions to Form 19-b-4, including all "information necessary for the public to provide meaningful comment on the proposed rule change and for the Commission to determine whether the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to the self-regulatory organization."[45] With respect to what constitutes the record on which the Commission shall determine a matter, Rule 700(d)(3) of the Rules of Practice provides that "[t]he record shall consist of the proposed rule change filed on Form 19b-4 by the self-regulatory organization, including all attachments and exhibits thereto, and all written materials received from any interested parties on the proposed rule change, including the self-regulatory organization that

[37] Form 19b-4.
[38] 15 U.S.C. §78q-1(b)(3)(F).
[39] *Id*. at §78q-1.
[40] Pub. L. No.111-203, § 763.
[41] 12 U.S.C. § 5464.
[42] 17 C.F.R. § 240.17Ad-22(d)(2).
[43] Form 19b-4.
[44] 17 C.F.R. § 201.700(b)(3).
[45] *Id.*

filed the proposed rule change . . . as well as any written materials that reflect communications between the Commission and any interested parties."[46]

Supplemental Liquidity Providers and Others

A number of commenters argue that it is anticompetitive or discriminatory for NSCC to impose a Regular Activity Liquidity Obligation on only the 30 Unaffiliated Members or Affiliated Families with the largest Regular Activity Peak Liquidity Exposures.[47] We believe we have fully addressed this argument in our June Letter.[48] From a fairness perspective, NSCC believes the Amended SLD Proposal appropriately places the burden of providing liquidity squarely on those Members who present the largest liquidity risk. The commenters do not dispute this on a factual basis; they merely disagree with the proposal's allocation of responsibility, arguing that this aspect of the Amended SLD Proposal is self-evidently discriminatory, without providing any supporting statutory authority.

In point of fact, the effect of the Amended SLD Proposal would be to create the following categories of liquidity providers to NSCC:

a. a category of all Members of NSCC – obligated to make Required Deposits to the Clearing Fund in accordance with the provisions of existing Rule 4 and permitted to make excess deposits if they wish to do so. All Members ultimately pay for liquidity resources raised by NSCC;

b. a category of 30 Regular Activity Liquidity Providers – obligated to make Supplemental Deposits to the Clearing Fund to the extent that their Regular Activity Liquidity Obligations to the Clearing Fund are not offset by (i) the Commitments of their Designated Lenders to the Credit Facility, (ii) their *pro rata* share of the Commitments of other lenders under the Credit Facility and (iii) their *pro rata* share of the Commitments of other Regular Activity Liquidity Providers or their Designated Lenders in excess of the Regular Activity Liquidity Obligations of such Regular Activity Liquidity Providers;

c. a category of the few Unaffiliated Members or Affiliated Families expected to be Special Activity Liquidity Providers – obligated to make Supplemental Deposits to the Clearing Fund in the amounts of their Special Activity Liquidity Obligations;

d. a category of Designated Lenders – providing Commitments under the Credit Facility on behalf of Regular Activity Liquidity Providers (and perhaps in part on their own behalf as well); and

e. a category of other lenders – providing Commitments under the Credit Facility that are not made on behalf of Regular Activity Liquidity Providers (but which nevertheless

[46] *Id*. at §201.700 (d)(3).
[47] Citadel I at 7-8; SIFMA I at 8; Schwab at 3, 13-14. We note that these commenters, who would be Regular Activity Liquidity Providers but likely not Special Activity Liquidity Providers, do not complain that the Amended SLD Proposal would impose Special Activity Liquidity Obligations on Special Activity Liquidity Providers that would not be shared by Regular Activity Liquidity Providers like themselves. We also note that these commenters, who are substantial users of the services of NSCC, have not (because they are not banks) been called upon in the past to assist NSCC with its liquidity needs by participating in the Credit Facility.
[48] June Letter at 11.

> reduce *pro rata* the amounts of any Supplemental Deposits that Regular Activity Liquidity Providers would be required to make in respect of their Regular Activity Liquidity Obligations).

NSCC believes that this diversified approach to addressing its liquidity needs as a SIFMU should not be characterized as arbitrary, anticompetitive or discriminatory. There is a difference between making distinctions among Members based on the risk they present to NSCC[49] and discriminating among Members in contravention of Section 17A(b)(3)(F), *i.e.*, adopting a rule that is "designed to permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency."[50] Likewise, there is a difference between a neutral rule of general application to all Members that could have a disparate effect on Members with diverse business models and strategies[51] and a rule that (i) imposes "any burden on competition not necessary or appropriate in furtherance of the purposes of [the Exchange Act]" in contravention of Section 17A(b)(3)(I) of the Exchange Act [52]or (ii) otherwise conflicts with the mandate given to the Commission by Congress to maintain "fair competition among brokers and dealers, clearing agencies, and transfer agents" as set forth in Section 17A(a)(2)(A) of the Exchange Act.[53]

This aspect of the Amended SLD Proposal – limiting Regular Activity Liquidity Providers to the 30 Unaffiliated Members or Affiliated Families that present the greatest risk to NSCC and, by extension, to the national system for the clearance and settlement of securities transactions -- is neither arbitrary, anticompetitive, nor discriminatory. On the contrary, it is a considered and measured solution to a difficult problem that NSCC as a SIFMU is required to solve.

Regular Activity Liquidity Providers with Bank Affiliates and Others

A number of commenters argue that the Designated Lender aspect of the Amended SLD Proposal is anticompetitive or discriminatory because it favors Regular Activity Liquidity Providers that have bank affiliates over Regular Activity Liquidity Providers that do not have bank affiliates.[54] These commenters appear to assume (i) that a Regular Activity Liquidity Provider with a bank affiliate will always use its affiliate as its Designated Lender, (ii) that such Regular Activity Liquidity Provider will receive better terms from its bank affiliate than it would receive from a bank that was not an affiliate, and (iii) that such bank affiliate will give such Regular Activity Liquidity Provider better terms than it would give a Regular Activity Liquidity Provider that was not an affiliate. These commenters also appear to assume that a Regular Activity Liquidity Provider without a bank affiliate (x) will not be able to find a bank to act as its Designated Lender, or (y) will not be able to find a bank to act as its Designated Lender on commercially reasonable terms, or (z) will not be able to find a bank to act as its Designated Lender on terms as favorable as those available to a Regular Activity Liquidity Provider with a bank affiliate. These commenters offer no support for any of these assumptions, which form the basis for their claims that this aspect of the Amended SLD Proposal is anticompetitive and/or

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[49] See the discussion above and our June Letter at 10-11.
[50] 15 U.S.C. §78q-1(b)(3)(F).
[51] See the discussion above and our June Letter at 15-16.
[52] 15 U.S.C. §78q-1(b)(3)(I).
[53] *Id.*at §78q-1(a)(2)(A).
[54] Citadel I at 2, 8; SIFMA II at 2-3; Schwab at 14-15; ITG at 2, 11.

discriminatory within the meanings of the relevant Sections of the Exchange Act and the rules thereunder (cited above). They simply assert these assumptions as facts.[55] To the extent their issue is focused on costs—that is whether NSCC is sufficiently pricing the Credit Facility to maximize interest in participation, this issue is addressed in Section V below.

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 Agreement. In response to comments submitted to the Commission on the Original SLD Proposal, and dialogue with a number of Members who did not submit comments but otherwise provided their input to NSCC, the Original SLD Proposal was amended so that the Amended 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 Agreement. A Designated Lender is any financial institution that (i) is designated by an Unaffiliated Member or Affiliated Family to be a lender under the Credit Facility and (ii) agrees to be so designated by such Unaffiliated Member or Affiliated Family to be a lender under the Credit Facility and (iii) satisfies the reasonable criteria to be a lender under the Credit Facility established by NSCC. Nothing in the Amended SLD Proposal requires that a Designated Lender be an affiliate of the relevant Regular Activity Liquidity Provider and nothing in the Amended SLD Proposal prohibits it. The Amended SLD Proposal is silent and neutral on this subject.

This aspect of the Amended SLD Proposal – permitting any bank and not just an affiliate of a Regular Activity Liquidity Provider to participate in the Credit Facility on behalf of such Regular Activity Liquidity provider – is neither anticompetitive nor discriminatory. On the contrary, it is an accommodation to Members intended to recognize their balance sheets, liquidity profiles, and business relationships, and provide them with options to reduce their cash outlays in the form of Supplemental Deposits to the Clearing Fund. The alternative would be to de-link the Regular Activity Liquidity Obligation of a Regular Activity Liquidity Provider from its Commitment or the Commitment of its designee under the Credit Facility, and thereby increase its cash obligation to make Supplemental Deposits to the Clearing Fund.

Nature of Purported Anticompetitive Effect

A number of commenters have argued that implementation of the Amended SLD Proposal could force some Members to withdraw from NSCC and clear through other Members, thereby decreasing competition and increasing concentration in the clearing business.[56] These commenters offer no support for these claims. They simply assert that this may or could happen.

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[55] In light of the fact that banks have statutory and regulatory obligations (and internal policies and procedures) requiring that they deal with affiliates on an arms' length basis, it is likely that all of these assumptions are false, and that the commenters would find (i) that Regular Activity Liquidity Providers with bank affiliates may in some cases choose to use unaffiliated banks as their Designated Lenders and (ii) that Regular Activity Liquidity Providers without bank affiliates may be able to enlist as Designated Lenders both banks that are affiliates of other Members as well as banks that are not affiliates of any Members. There is simply not a shred of evidence in the record that Regular Activity Liquidity Providers without bank affiliates could not find Designated Lenders to act for them on commercially reasonable terms.

[56] SIFMA I at 9 (". . . for some NSCC members, the SLD Proposal could result in a decision to exit self-clearing and, for the firms that provide clearing services for other, smaller broker-dealers, to also exit those business lines");

It is important to note that the anticompetitive effect of the Amended SLD Proposal alleged by the commenters is that it would establish a Regular Activity Liquidity Obligation on the 30 Unaffiliated Members or Affiliated Families with the largest Regular Activity Peak Liquidity exposures, which (i) would be applied on a neutral basis to all Unaffiliated Members and Affiliated Families that present the same liquidity risk-profile to NSCC, (ii) would be measured by the metric (gross debits) that creates the risk-exposure for NSCC, (iii) could be satisfied by the making of a Commitment under the Credit Facility or the payment of a Supplemental Deposit to the Clearing Fund, in either case at the option of the Regular Activity Liquidity Provider and in any combination, and (iv) could be subject to reduction without cost or expense to the Regular Activity Liquidity Provider to the extent that lenders who are not Designated Lenders make Commitments under the Credit Facility or that any regular Activity Liquidity Providers make Commitments under the Credit Facility (directly or through Designated Lenders) in excess of their Regular Activity Liquidity Obligations.

NSCC does not believe that requiring Members to take financial responsibility for the liquidity exposure of their activity levels at NSCC — and the risk they expose NSCC and other Members to — can or should be viewed as anticompetitive under the relevant provisions of the Exchange Act and the rules thereunder. As we noted in our June Letter,[57] from a fairness perspective, the proportionate share of the affected Member's liquidity burden will always be less that the Member's own peak liquidity needs (and, in fact, only a percentage of its peak). In every case NSCC has found where the Commission has determined that a proposed rule change has an anticompetitive effect, there has been clear and overt (and purposeful) interference or restraint by the self-regulatory organization in the business of their participants.[58] That is demonstrably not the case with the Amended SLD Proposal.

Burden on Competition

As indicated above, NSCC does not believe that the Amended SLD Rule is anticompetitive in any of the ways alleged by the commenters. However, to the extent that any aspect of the Amended SLD Rule may be perceived to impose a burden on competition, any such burden on competition is necessary and appropriate in furtherance of the following purposes of the Exchange Act and the rules thereunder:

Schwab at 14 (". . . entities that do not have eligible bank affiliates will be under pressure to leave the self-clearing business, as will members and Affiliated Families that do not have a bank affiliate and become Supplemental Liquidity Providers as other entities leave the business"); ITG at 2 (as initially proposed and as amended, the proposed rule change "will likely have the unintended consequence of forcing many Independent Members, even relatively large and well-capitalized firms, out of the business of clearing transactions. . ."). It is noteworthy that the two firms that have made these comments have not said that implementation of the Amended SLD Proposal would or could force them to withdraw from NSCC – only that other unnamed firms might be forced to do so.

[57] June Letter at 12.

[58] *See*, *e.g.*, Order Disapproving NASDAQ Proposed Rule Change, Exchange Act Release No. 68629 (January 11, 2013, 78FR 3928 (January 17, 2013) (self-regulatory organization proposing to offer a novel order type designed to compete with the services offered by broker-dealers); Order Disapproving NYSE and Amex Proposed Rule Changes, Exchange Act Release No. 67437 (July 13, 2012), 77 FR 42525 (July 19, 2012) (self-regulatory organization proposing to make certain information available to designated market makers and on-floor brokers but not to off-floor brokers); Order Disapproving NASDAQ Proposed Rule Change, Exchange Act Release No. 65362 (September 20, 201), 76 FR 59466(September 26, 2011) (self-regulatory organization proposing to link market data fees to execution volume and transaction credits to market data purchases).

a. Section 17A(b)(3)(A) of the Exchange Act provides that a clearing agency shall not be registered unless the Commission determines *inter alia* that "[s]uch clearing agency is so organized and has the capacity to be able to facilitate the prompt and accurate clearance and settlement of securities transactions and derivatives agreements, contracts, and transactions for which it is responsible. . . "[59]

b. Section 17A(b)(3)(F) of the Exchange Act provides that a clearing agency shall not be registered unless the Commission determines that the rules of the clearing agency are designed *inter alia* "to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivatives agreements, contracts, and transactions" and "in general, to protect investors and the public interest . . . ."[60]

c. As discussed in Section II above, Rule 17Ad-22(b)(3) requires that a clearing agency "[m]aintain sufficient financial resources to withstand, at a minimum, a default by the participant family to which it has the largest exposure in extreme but plausible market conditions . . . ."[61]

d. As also discussed in Section II above, it is a national systemic imperative that a SIFMU like NSCC have the liquidity it needs to be able to conduct its operations in a safe and sound manner and support the stability of the broader financial system.

In light of these purposes of the Exchange Act and the rules thereunder that are furthered by the Amended SLD Proposal, and particularly in light of the critical role that NSCC plays in the national financial infrastructure as a SIFMU, to the extent that any aspect of the Amended SLD Proposal may be perceived to impose a burden on competition, the benefits of systemic risk mitigation overweigh any such burden on competition. And, any such burden on competition is necessary and appropriate in the circumstances and should not bar approval of the Amended SLD Proposal by the Commission.

IV. Clearing Members Have Control over their Risks and Costs

Some commenters argue that the Amended SLD Proposal is problematic because it will impose liquidity requirements on Members that they cannot predict or control.[62] Their issue stems largely from the fact that NSCC's peak liquidity needs are determined, via necessity under the applicable rule, based upon the liquidity exposure NSCC would face in the event of the default of the Member/Member Family that would generate the largest aggregate liquidity obligation in extreme but plausible market conditions. As noted in our June Letter, we plan to provide transparency around the calculations by providing robust reporting, not only to the top 30 Members, but to all Members. The reporting process is currently manual, and is in the process of being automated. And, while one commenter dismisses "monthly" reporting as inadequate,[63] the commenters are aware that it is NSCC's intention, once the automation process is complete, to issue such reports on a daily basis. We believe the reporting will provide Members with

[59] 15 U.S.C. §78q-1(b)(3)(A).
[60] *Id.* at §78q-1(b)(3)(F).
[61] 17 C.F.R. §240.17Ad-22(b)(3).
[62] Citadel II at 3-5; SIFMA II at 5; ITG at 9-10.
[63] Citadel II at 7.

sufficient information to enable them plan for their liquidity needs and adjust their trading activity accordingly.

Moreover, as we noted in our June Letter,[64] Members are being asked to share only a portion of that peak burden and, 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; very likely it will be only a portion of its own peak liquidity. The Member is in the best position to monitor and manage the liquidity risks presented by its own activity.[65]

As regards the argument that the Amended SLD Proposal's interaction with the Credit Facility is "arbitrary and capricious"[66] we believe that the commenter misconstrues the intent of the excess allocation process. In Appendix A attached we walk through example calculations that outline the consistent application of the formula.

V. Implementation Timing and Member Input

As outlined in our June Letter, NSCC has conducted extensive Member outreach, both in developing the SLD Proposal, and throughout the filing and comment periods. And, as noted above, a number of the enhancements included in the Amended SLD Proposal were in direct response to Member input and ideas. Nevertheless, we recognize that some Members still have concerns about the Amended SLD Proposal, as evidenced by the current comment letters. We understand these concerns and do not take them lightly. Accordingly, NSCC has determined to take the following actions:

First, given the criticality of liquidity and its systemic importance in the safe operation of NSCC, as well as the other clearing agencies designated as SIFMUs within the DTCC group, and the ongoing evolving nature of these issues, DTCC has determined to formalize its outreach approach with regard to liquidity issues: It will establish a new standing Member advisory group, the Clearing Agency Liquidity Council (the "CALC"), to facilitate two-way dialogue between DTCC's clearing agencies and their relevant member firms regarding liquidity initiatives and liquidity-related financing options.

The CALC will be composed of individuals providing a broad and balanced representation of the clearing agency subsidiaries' membership. CALC members will be selected to achieve a diverse representation in terms of industry segment and member impact. The CALC will facilitate a proactive discussion whereby DTCC can advise CALC members about liquidity and liquidity-related financing options under consideration, including initiatives that may impact member firms. CALC members will have the opportunity to comment and provide input on any such options which may assist DTCC in shaping the initiatives. Liquidity and related financing trends may also be discussed as they relate to member firms and their funding obligations. We

[64] June Letter at 12.

[65] In this regard we do not believe that the Amended SLD Proposal is at cross purposes with FINRA Regulatory Notice 10-57 (Risk Management—Funding and Liquidity Risk Management Practices), November 2010. Rather we believe the Amended SLD Proposal will serve to make Members more cognizant of the liquidity risks they present to NSCC, and provide them with the information to enable them to modify or plan for their activities accordingly.

[66] ITG at 10 *et seq*.

anticipate that the first matters to be brought to the CALC will be (i) the liquidity financing and pricing review that NSCC has undertaken to perform to address concerns about refinancing risk prior to the renewal of the current Credit Facility,[67] and (ii) evaluating potential alternative collateral approaches that could be used to fund a portion of a Member's Supplemental Liquidity cash deposit obligation.

Second, while we will seek to have the Commission approve the Amended SLD Proposal, we recognize that the proposal's existing Special Transition Rule requires extending. Given commenters' request for an extensive transition period,[68] NSCC will provide that the deposit obligation of those Members who would otherwise be subject to a Regular Activity Liquidity Obligation will be held in abeyance until (i) NSCC is more fully able to observe the operation of the Regular Activity Liquidity Obligation calculations as they now stand, and (ii) a subsequent rule filing, following consultation with the CALC, considering the application of the Regular Activity Liquidity Obligations is approved by the Commission. In all other respects, the Amended SLD Proposal would be operative. This recognizes that, given the current size of the Credit Facility, Members would unlikely be required to make Regular Activity Supplemental Deposits for a period of time, but this approach would still render the proposal operative for all calculations and provide for adequate liquidity with respect to Options Expiration Activity Periods by requiring Special Activity Supplemental Deposits from those Members that would be subject thereto.

The benefits of these actions will collectively:

● allow NSCC to complete automation of the SLD reporting, so that Members can be provided with daily reports and have a period of time to work with the reports and their liquidity planning (the "burn in" period they requested);

● enable NSCC to work through analysis with the CALC of the feasibility of additional/diversified financing resources and pricing;

● work through in a more timely fashion with the CALC alternative collateral approaches before the obligation to provide Regular Activity Supplemental Deposits becomes operative; and

● provide NSCC with the means to assure its current compliance with the SEC's Financial Resources Rule.

VI. Adequacy of Record

The record in this proceeding is substantial and detailed, and sufficiently clear and comprehensible for the Commission to order the approval of the Amended SLD Proposal. The record consists of the Amended SLD Proposal itself, the narratives included with the Original SLD Proposal and the Amended SLD Proposal, our June Letter and this letter and the letters submitted by the commenters. While some of the commenters may disagree with the Amended SLD Proposal, it cannot be said that the record does not provide a basis for the Commission to

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[67] *See* June Letter at 14-15; Amendment No. 2 at 7-8.
[68] Citadel I at 14; Citadel II at 12.

make a determination on the merits. To the extent that the Commission requires any further information from NSCC in order to reach a determination on the merits of the Amended SLD Proposal, NSCC would be happy to supplement the record accordingly.

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

Very truly yours,

Larry E. Thompson
Managing Director and DTCC General Counsel

cc: Mr. Peter Curley, Associate Director, Division of Trading and Markets
Mr. John Ramsay, Acting Director, Division of Trading and Markets
The Honorable Mary Jo White, Chairman
The Honorable Luis A. Aguilar, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
The Honorable Dr. Michael S. Piwowar, Commissioner
The Honorable Kara M. Stein, Commissioner
Peter Morgan, Senior Vice President & Deputy General Counsel, Charles Schwab & Co.
John C. Nagel, Managing Director of Citadel Securities
Scott C. Goebel, Deputy General Counsel, Fidelity Investments
Mark Solomon and James Selway III, Managing Director and Deputy General Counsel, Investment Technology Group, Inc.
Paul T. Clark and Anthony C.J. Nuland, Seward and Kissel LLP
Thomas Price, Managing Director, SIFMA

APPENDIX A

The relevant component in the allocation formula (*e.g.*, Section 5 of the proposed Rule 4A text) is (D)(iii): "an additional amount to provide each Regular Activity Liquidity Provider *with the benefit of a full allocation* [emphasis supplied] of the amount in clause (ii) above." The intention behind this component is to reflect that simply allocating the total original excess (Commitment minus Obligation) across the Regular Activity Liquidity Providers would result in excess being allocated to Members in amounts greater than any remaining required SLD deposit. To solve for D, one looks for the value such that the sum of the positive Regular Activity Supplemental Deposits equals the difference between (x) the Regular Activity Peak Liquidity Need of NSCC, and (y) the sum of the Other Qualifying Liquid Resources and the total Credit Facility Commitments to NSCC.

If the sum of the aggregate Commitments is greater than the sum of the Regular Activity Liquidity Obligations (that is, NSCC has raised sufficient resources) then the 'D' factor will be such that all Members will have zero required Regular Activity Supplemental Deposits.

For continuity, this principle and its intended application in the SLD formula are illustrated using the scenarios in the ITG letter.[69]

In the scenarios below the following notations are used:

ABC and BB: Hypothetical Regular Activity Liquidity Providers

RAPLN: Regular Activity Peak Liquidity Need

RALO: Regular Activity Liquidity Obligation

As in ITG's examples, no Other Qualifying Liquid Resources are included.

Scenario 1

RAPLN = $10BN

Credit Facility = $10BN of which non-Regular Activity Liquidity Providers provide $1BN. The remaining commitments from Regular Activity Liquidity Providers equal their Regular Activity Liquidity Obligations

ABC RALO = $100 million

The amount 'D' is calculated as solving the equation:

Sum(RALO) – Sum(Commitments) = Sum(Supplemental Deposits)

Since Sum(RALO) – Sum(Commitments) = 0 then Sum(Supplemental Deposits) = 0

Since, by the design of this example, the Regular Activity Supplemental Deposits for all Regular Activity Liquidity Providers aside from ABC are already zero (their Commitments equal their RALOs) then Member ABC's Supplemental Deposit must also be zero.

To solve for 'D': Zero = RALO – ABC Commitment – 'D' x (ABC RALO / Sum(RALO))

[69] ITG at 11 *et seq.*

Substituting in values:

Zero = 0.1BN – Zero – 'D' x (0.1BN / 10BN)

So D = $10BN

ABC Regular Activity Supplemental Deposit = **ZERO (not $90 million)**

Scenario 2

RAPLN = $10BN

Credit Facility = $10BN of which non Regular Activity Liquidity Providers provide all $10BN

ABC RALO = $100 million

The amount 'D' is calculated as solving the equation:

Sum(RALO) – Sum(Commitments) = Sum(Supplemental Deposits)

Since Sum(RALO) – Sum(Commitments) = 0 then Sum(Supplemental Deposits) = 0

If the Sum of Regular Activity Supplemental Deposits is to be zero then each Regular Activity Supplemental Deposit must be zero.

To solve for 'D': Zero = RALO – Commitment – 'D' x (RALO / Sum(RALO))

Since Commitments from Regular Activity Liquidity Providers are assumed to be zero then we have:

Zero = RALO – 'D' x (RALO / 10BN) for each Regular Activity Liquidity Provider

So D = $10BN

ABC Regular Activity Supplemental Deposit = **ZERO**

Scenario 3

RAPLN = $10BN

Credit Facility = $10BN of which non Regular Activity Liquidity Providers provide $0BN

ABC RALO = $100 million

The amount 'D' is calculated as solving the equation

Sum(RALO) – Sum(Commitments) = Sum(Supplemental Deposits)

Since Sum(RALO) – Sum(Commitments) = 0 then Sum(Supplemental Deposits) = 0

If the Sum of Regular Activity Supplemental Deposits is to be zero then each Regular Activity Supplemental Deposit must be zero.

To solve for 'D': Zero = RALO – Commitment – 'D' x (RALO / Sum(RALO))

Since the example does not specify individual Commitments from Regular Activity Liquidity Providers then 'D' cannot be specifically solved for (it could be zero if each Regular Activity Liquidity Provider's Commitment equals their RALO, or it could be $10BN if one Regular

Activity Liquidity Provider contributes nothing to the Credit Facility). However, from the formula above, the sum of the Regular Activity Supplemental Deposits are zero so each Regular Activity Liquidity Provider's Regular Activity Supplemental Deposit must be zero.

ABC Regular Activity Supplemental Deposit = **ZERO (not $100 million)**

Far from demonstrating the 'arbitrary and capricious' nature of the Amended SLD Proposal, these scenarios demonstrate a consistent and desired application of the excess to – as the proposed rule text states – 'provide each Regular Activity Liquidity Provider with the benefit of a full allocation […]'.

<u>Scenario 4</u>

RAPLN = $11BN

Credit Facility = $10BN of which non Regular Activity Liquidity Providers contribute $1BN

ABC Commitment = $0

BB Commitment = $0.9BN

ABC RALO = $0.1BN

BB RALO = $1BN

The amount 'D' is calculated as solving the equation

Sum(RALO) – Sum(Commitments) = Sum(Supplemental Deposits)

Since Sum(RALO) – Sum(Commitments) = $11BN – $10BN = $1BN

then Sum(Supplemental Deposits) = $1BN

Solve for D such that BB Regular Activity Supplemental Deposit + ABC Regular Activity Supplemental Deposit + Sum of Other Regular Activity Supplemental Deposits = $1BN

Regular Activity Supplemental Deposit = RALO – Commitment – 'D' x (RALO / Sum(RALO))

BB Regular Activity Supplemental Deposit = (1BN – 0.9BN – D x (1BN/11BN))

ABC Regular Activity Supplemental Deposit = (0.1BN – 0BN – D x (0.1BN/11BN)

Sum of Other Regular Activity Supplemental Deposits = (9.9BN – 8.1BN – D x (9.9BN/11BN)

$$(1 - 0.9 - D(1/11)) + (0.1 - 0 - D(0.1/11)) + (9.9 - 8.1 - D(9.9/11)) = 1$$

Which simplifies to 2 – D = 1 or D = 1So D = 1

Therefore ABC Deposit Amount = (0.1 – 0 – 1 x (0.1/11)) = 91 million

BB Deposit Amount = (1 – 0.9 – 1 x (1/11)) = 9 million

ITG argues that it is unfair that ABC should contribute more to the remaining deficit than BB – even though BB will be providing $909 million in aggregate compared to $91 million for ABC. In total, both members would be providing resources for 91% of their original obligation – an equal proportion. In this regard, see the discussion in Section III in this letter.