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March 8, 2017

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

Eduardo A. Aleman
Assistant Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. SR-FICC-2017-001 – Exchange Act Release No. 34-79958 (February 3, 2017) – Notice of Filing of Proposed Rule Change

Dear Mr. Aleman:

Fixed Income Clearing Corporation ("FICC")[1] appreciates the opportunity to respond to the comment letters submitted by Industrial and Commercial Bank of China Financial Services LLC ("ICBCFS")[2] and Ronin Capital, LLC ("Ronin")[3] to the U.S. Securities and Exchange Commission (the "Commission") with respect to a proposed rule change (the "Rule Filing")[4] filed by FICC pursuant to Section 19(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act").[5]

I. Procedural Background

On February 2, 2017, FICC filed the Rule Filing[6] with the Commission to amend the GSD Rulebook (the "GSD Rules")[7] to establish, among other things, a minimum volatility calculation (referred

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1 FICC is a clearing agency registered with the Commission pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act"). FICC is comprised of two Divisions — the Government Securities Division ("GSD") and the Mortgage-Backed Securities Division ("MBSD"). GSD provides central counterparty services to its customers with respect to the U.S. government securities market, and MBSD provides such services to the U.S. mortgage-backed securities market. FICC has been designated as a systemically important financial market utility ("SIFMU") by the Financial Stability Oversight Counsel pursuant to Section 805 of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") in recognition of its critical role in the national financial infrastructure. FICC is a subsidiary of The Depository Trust & Clearing Corporation ("DTCC"), which is a user-owned, user-governed holding company for FICC, two other registered clearing agencies and SIFMUs regulated by the Commission, and a number of other companies that provide a variety of post-trade processing and information services. FICC and the other registered clearing agencies in the DTCC group provide the critical infrastructure for the clearance and settlement of securities transactions in the U.S.

2 Letter from Alan Levy, Managing Director, Industrial and Commercial Bank of China Financial Services LLC to the U.S. Securities and Exchange Commission (February 24, 2017).

3 Letter from Robert E. Pooler, Jr., Chief Financial Officer, Ronin Capital, LLC to Eduardo A. Aleman, Assistant Commission, U.S. Securities and Exchange Commission (February 24, 2017).

4 SR-FICC-2017-001.

5 15 U.S.C. 78s(b)(2).

6 On February 2, 2017, FICC also filed the Rule Filing as an advance notice (SR-FICC-2017-801) (the "Advance Notice") with the Commission pursuant to Section 806(e)(1) of the Dodd-Frank Act and

to as the "Margin Proxy") as the VaR Charge. As described in the Rule Filing, FICC would apply the greater of the amount calculated by the current model-based volatility calculation and the Margin Proxy when determining the daily VaR Charge for a Netting Member of GSD (a "Member"). The Rule Filing addresses FICC's concern that the current model-based volatility calculation did not achieve backtesting coverage at a 99 percent confidence level, particularly during the fourth quarter of 2016.

Based on its analysis of the fourth quarter backtesting performance, FICC observed that the current model-based volatility calculation incorporates a 1-year look-back period that was dominated by low market price volatility and did not include stressed market price moves that have been observed historically and thus did not perform well during the period of increased volatility in the fourth quarter. In order to promptly improve the backtesting coverage, FICC requested that the Commission accelerate the effectiveness of the Rule Filing pursuant to Section 19(b)(2) of the Exchange Act.[8] As noted in the Rule Filing, FICC believes that the proposed changes are consistent with the Exchange Act, including but not limited to Rules 17Ad-22(e)(4) and (e)(6) of the Exchange Act, which were recently adopted by the Commission.[9] Rule 17Ad-22(e)(4) will require FICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to its participants and those exposures arising from its payment, clearing, and settlement processes.[10] Rule 17Ad-22(e)(6) will require FICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that is monitored by management on an ongoing basis and regularly reviewed, tested, and verified.[11] FICC believes that the Rule Filing is consistent with Rules 17Ad-22(e)(4) and (6) for the reasons explained in the Rule Filing.

II. Transparency

Both commenters argue that FICC has not provided Members with enough information to evaluate the impact of the Margin Proxy.

FICC notes that it has provided each GSD Member (including Ronin and IBCBFS) with a two-month impact study that reflects the impact of the Margin Proxy on the VaR Charge and Coverage Charge from October 31, 2016 through December 30, 2016 (i.e., before and after the November 2016 U.S. presidential election). FICC has also made itself available to answer questions and concerns relating to the impact study and the Rule Filing. In addition, at the request of several Members (including Ronin and IBCBFS), FICC participated in meetings. During these meetings, FICC discussed the historical short-term and long-term impact of the Margin Proxy on individual and aggregate margin requirements. In an effort to provide further transparency, FICC has responded to individual Member requests for additional data and information. Nevertheless, FICC recognizes that some Members still have concerns

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Commission Rule 19b-4(n)(1)(i), 17 CFR 240.19b-4(n)(1)(i). A copy of the advance notice is available at http://www.dtcc.com/legal/sec-rule-filings.aspx.

7 Capitalized terms used herein and not defined shall have the meaning assigned to such terms in the GSD Rules available at www.dtcc.com/legal/rules-and-procedures.aspx or the Rule Filing, which is available at http://www.dtcc.com/legal/sec-rule-filings?subsidiary=FICC+-+GOV&pgs=z.

8 15 U.S.C. 78s(b)(2).

9 The Commission adopted amendments to Rule 17Ad-22, including the addition of new section 17Ad-22(e), on September 28, 2016. The amendments to Rule 17Ad-22 became effective on December 12, 2016. FICC is a "covered clearing agency" as defined in Rule 17Ad-22(a)(5) and must comply with new section (e) of Rule 17Ad-22 by April 11, 2017. See Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7-03-14).

10 Id.

11 Id.

about the Margin Proxy, as evidenced by the two comment letters. FICC understands these concerns and does not take them lightly.

In its comment letter, Ronin expressed concern that the two-month impact study does not adequately reflect the impact of the Margin Proxy on Members. FICC believes that the two-month impact study was appropriate because it covered a period that reflected a material increase in GSD's margin requirements. Specifically, the current model-based volatility calculation resulted in an increased aggregate VaR Charge across the GSD membership of $8.3 billion on October 31, 2016 to $11.3 billion on November 30, 2016. FICC's analysis indicates that this increase was primarily driven by the volatility caused by the 2016 U.S. presidential election, which resulted in the 10-year U.S. Treasury rate increasing by 37 basis points - reflecting the largest weekly move in 3 years.[12] With respect to the Coverage Charge, the amount collected increased from $0.8 billion to $2.2 billion across the GSD membership over the same period.[13]

Given this market move and the material change in both the VaR Charge and Coverage Charge, FICC believes that it was prudent to provide Members with impact analyses that covered this two-month period. The impact analyses give Members the ability to effectively measure the Margin Proxy's impact because the current market shocks and position changes can be assessed relatively easily. Moreover, a short-term impact analysis, particularly over a stressed period, gives Members the ability to assess the impact of a stress event on the VaR Charge. Similarly, Members can also observe the changes to the Coverage Charge that occurred during a period of heightened volatility. Nevertheless, FICC recognizes that some Members may desire a longer term impact study for a more comprehensive overview of the model's performance. As a result, FICC has engaged in discussions with Members about the impact of the Margin Proxy on Members over a long-term historical period. FICC has responded to Ronin's and ICBCFS' request for a longer-term impact study, and FICC will make similar impact studies available to all Members.

Ronin also expressed concern that FICC did not sufficiently study the impact of the Margin Proxy on Members. In response, FICC notes that it performed an analysis of the impact of the Margin Proxy's on Members for the period of 2013 through 2016. The analysis revealed that the GSD margin requirements would have increased from $9.7 billion to $11.3 billion (i.e., 16%), on average, across the GSD membership. This result does not account for the reductions in an estimated $0.7 billion that would have been applied, on average, during this period as a result of the Coverage Charge. FICC believes that its internal analysis of four years of data has yielded sufficient information on the expected impact of the Margin Proxy on Members.

FICC recognizes that Members need to anticipate margin requirements particularly when settlement activity may deviate from historical levels. While FICC recognizes that Members have different approaches to assessing their margin requirements, FICC will continue to discuss certain daily fluctuations in Members' VaR Charges and provide additional transparency by isolating the risk drivers of such fluctuations. FICC has engaged, and will continue to engage in ongoing dialogue with Members in order to help Members gauge the individual impact of the proposed margin methodology changes. In response to recent dialogue with Members, FICC will provide each Member with (1) supplemental data regarding historical Margin Proxy amounts, and (2) Margin Proxy estimates so that Members can

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12 Eddie van Der Walt, E. and Mariana Duarte Arago, *Selloff in Bonds, Emerging-Market Assets Deepen as Dollar Gains,* Bloomberg L.P. (November 14, 2016).

13 A Member's Coverage Charge is determined based on an intraday backtest of its VaR Charge, and the increase in the Coverage Charge over November 2016 reflected observed backtesting exceptions.

understand their margin requirements on a daily basis prior to the conclusion of the regulatory process and formal implementation of the Margin Proxy.

III. Margin Proxy Design

Both commenters expressed concern about the design of the Margin Proxy. ICBCFS notes: (1) that offsetting positions that are close in duration may fall into different maturity buckets; (2) that the inclusion of 2007 through 2009 in the stressed period may not be appropriate; and (3) "when-issued rolls" may have dramatic impact on the VaR Charge.[14] Ronin asks: (1) whether the VaR Charge needs to address idiosyncratic risk such as the U.S. presidential election,[15] and (2) whether the volatility around the U.S. presidential election was extreme.[16]

With respect to the Margin Proxy's design, the primary goal of the Margin Proxy is to achieve the 99 percentile confidence level backtesting coverage ratio for all Members. Recent data from the fourth quarter of 2016 indicates that the VaR Charge, on its own, is not always sufficient to ensure that the 99 percent coverage ratio is met. FICC's review of backtesting coverage results has demonstrated that the backtesting coverage including the Margin Proxy would have been above the 99 percent confidence level for the past four years.

In addition, FICC believes that it is appropriate to use the benchmark indices to set a minimum volatility calculation as the VaR Charge. FICC notes that the market price changes of U.S. Treasuries are dominated by systematic risk factors that are segmented primarily by the tenor of the security and that these are captured most effectively by common aggregate indices containing most of the tradable bonds in the fixed income market.

With respect to IBCFS' concern around offsetting positions, FICC notes that the current model-based volatility calculation incorporates historical correlation of risk factors that vary with overall market conditions to estimate offset of market price risk within a portfolio and the Margin Proxy incorporates a similar approach. Since the Margin Proxy is designed as a minimum volatility calculation, the approach is less complex and uses a longer time window to measure market price offset than the current model-based volatility calculation. The Margin Proxy incorporates position offsets within tenor buckets and offset across tenor buckets that have been historically observed across the U.S. Treasury benchmarks.

With respect to IBCFS' concern regarding the inclusion of 2007 – 2009 in the look-back period, FICC believes that its proposed look-back period is appropriate because it would cover a range of historical market price volatility necessary to achieve a 99 percent confidence level. Because VaR models typically rely on historical data to estimate the probability distribution of potential market prices, FICC believes that a longer look-back period will typically produce more stable VaR estimates that adequately reflect extreme market moves. This would help ensure that the VaR Charge does not decrease as quickly during intervals of low volatility, nor increase as sharply in crisis periods – as it would using a shorter look-back period.

In connection with ICBCFS' concern about "when issue rolls," FICC notes that the Margin Proxy maps when-issued Treasury securities to the same maturity bucket as the new issue. As a result, the VaR Charge will not be impacted due to the movement of securities between maturity buckets during the when-issued period.

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[14] ICBCFS on pg. 2.

[15] Ronin on pg. 1.

[16] Ronin on pg. 6.

In response to Ronin's questions about whether FICC should consider idiosyncratic risk such as the market price moves post 2016 U.S. presidential election in determining the VaR Charge and whether the volatility around the 2016 U.S presidential election was extreme, FICC notes that within the last several years the marketplace has witnessed extreme price changes based on events such as Standard & Poor's credit rating downgrade of the U.S. Government (2011), the taper-tantrum (2013), the U.S. Treasury flash crash (2014), Brexit (2016) and the recent U.S. presidential election (2016). This demonstrates to FICC that the market remains vulnerable to pockets of price instability despite regulatory advances and changes in market structure. For example, the 2013 taper-tantrum and the 2016 U.S. presidential election resulted in price changes of at least 4.5 standard deviations for the majority of the U.S. Treasury yield curve.[17] The recent backtesting deficiencies in the fourth quarter of 2016 were indicative to FICC that the one-year look back period in the current model-based volatility calculation may not sufficiently account for these periods of extreme volatility and thus may expose FICC to the risk of insufficient margin coverage. With this in mind, FICC believes that incorporating a longer stress period in the Margin Proxy calibration is appropriate and would be consistent with Rule 17Ad-22(e)(6) of the Exchange Act.[18]

IV. Timeline

Both commenters expressed concerns about the request for accelerated approval of the proposal.[19] FICC has addressed the commenters' concerns regarding the timeline for approval in the Rule Filing and believes that it has provided the requisite justification therein. In particular, FICC notes that if it fails to remedy the deficiencies in the model-based volatility calculation, FICC and its Members will be exposed to the risk that a defaulting Member will not be sufficiently covered by margin. Therefore, FICC believes that it is important to rectify this deficiency as quickly as possible.

V. Burden on Competition

In the Rule Filing, FICC has already addressed Ronin's concern that the Margin Proxy is anticompetitive.[20] As noted in Item II(B) (Clearing Agency's Statement on the Burden on Competition) and Item II(C) (Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others) of the Rule Filing, FICC does not believe that the Margin Proxy and Coverage Charge would impose a significant burden on competition because, among other things, the increase in the Required Fund Deposit would be in direct relation to the portfolio market risk and calculated with the same parameters and confidence level for all Members and is necessary to assure the safeguarding of the securities and funds that are in FICC's possession and cover FICC's risk exposure to its Members.

VI. Other Observations

In response to the concerns raised by Ronin regarding FICC's backtesting process,[21] FICC notes that it conducts backtesting on an ongoing basis to monitor and assess the performance of FICC's volatility-based models. The backtesting methodology gives FICC the ability to gauge whether the calculated coverage ratio meets FICC's targeted 99 percentile confidence level at an individual Member-level. In addition to FICC's internal backtesting analysis, FICC also engages a third-party validation firm to annually review and evaluate FICC's overall backtesting framework, methodology and assumptions for

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17 See Bank for International Settlements, *A Paradigm Shift in Markets?* (December 11, 2016).

18 Supra note 9.

19 ICBCFS on pg. 2 and Ronin on pg. 3.

20 Ronin on pg. 11.

21 Ronin on pg. 7.

reasonability and consistency. While certain opportunities for improvement have been identified, none are critical to FICC's backtesting framework and calculation.

The concerns raised by ICBCFS and Ronin regarding fails and Ronin's recommendation regarding the cross-margining arrangement with the CME are not related to this Rule Filing. However, FICC notes that it is engaged in ongoing initiatives related to these concerns and FICC will update Members in the future.

VII. Adequacy of Record

The General Instructions to Form 19b-4 (the "Form") 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."[21] FICC believes that the documents submitted in connection with this Rule Filing are sufficiently clear and comprehensible for the Commission to order the approval of the Rule Filing. The documents submitted include the Rule Filing itself, the Advance Notice, the narratives included with the Rule Filing and the Advance Notice, this letter and the letters submitted by the commenters. This letter addresses a number of the concerns raised by commenters; however, to the degree commenters' concerns are not addressed above, FICC believes that the record contains adequate responses with regards to such concerns.[22]

In addition, FICC believes that the Rule Filing is consistent with Section 17A(b)(3)(F)[23] of the Act and the rules and regulations promulgated thereunder including 17Ad-22(b)(1), (b)(2), (e)(4) and (e)(6) as described in the Rule Filing.[24] While some of the commenters may disagree with the Margin Proxy, FICC believes that the Rule Filing provides a basis for the Commission to make a determination on the merits. To the extent that the Commission requires any further information, FICC would be happy to supplement the record accordingly.

Should you have any questions, please do not hesitate to call me at

Very truly yours,

Timothy J. Cuddihy
Managing Director
Financial Risk Management

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21 Form 19b-4.

22 For example, some of the concerns raised by commenters regarding the anticompetitive burdens of the Margin Proxy, the appropriateness of an abbreviated rule approval process and a perceived lack of transparency and background testing by FICC have been addressed in the Rule Filing.

23 See 15 U.S.C. 78q-1(b)(3)(F).

24 Supra note 8.