June 19, 2017

U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549
Attn: Mr. Robert W. Errett, *Deputy Secretary*

RE: FILE NUMBER SR-FICC-2017-002

Dear Mr. Errett:

Ronin Capital, LLC ("Ronin") appreciates the opportunity to further comment on a proposed rule change by the Fixed Income Clearing Corporation ("FICC") to modify the Government Securities Division ("GSD") Rulebook to implement the Capped Contingency Liquidity Facility ("CCLF").[1] This additional commentary intends to supplement an earlier comment letter submitted by Ronin (the "Ronin Letter").[2]

The FICC has a lot of flexibility in the manner by which it can comply with Rule 17Ad-22(b)(3) of the Securities Exchange Act of 1934 (the "Exchange Act"). In the Ronin letter, we claim that the proposed form of the CCLF unnecessarily places an unfair burden on smaller GSD Netting Members and is anticompetitive. While the current CCLF proposal may be judged as strictly complying with the demands of the Exchange Act, the same could be largely said of any liquidity plan the FICC might propose. Given more time, we have confidence that the FICC could develop a better liquidity plan – a plan that doesn't threaten GSD Netting Member diversity or further promote concentration of risk. Furthermore, we believe the proposed form of the CCLF will harm liquidity in the U.S. Treasury market and thus harm the U.S. taxpayer. Due to these flaws and the inherent flexibility the FICC has in designing a liquidity plan that complies with the Exchange Act, we urge the Securities and Exchange Commission (the "Commission") to reject FICC's proposed rule change in favor of developing a new and better liquidity plan.

Need for a Liquidity Plan

In response to the Ronin Letter, the FICC submitted a rebuttal letter to the Commission (the "FICC Rebuttal").[3] Despite further clarification, we still don't believe the FICC adequately addresses the concerns of smaller GSD Netting Members. We specifically want to highlight several items from this rebuttal letter.

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[1] SEC Release No. 34-80234; File No. SR-FICC-2017-002
[2] Letter from Robert E. Pooler, Jr., Chief Financial Officer, Ronin Capital, LLC to Robert W. Errett, Deputy Secretary, U.S. Securities and Exchange Commission (April 10, 2017)
[3] Letter from Timothy J. Cuddihy, Managing Director, Fixed Income Clearing Corporation to Robert W. Errett, Deputy Secretary, U.S. Securities and Exchange Commission (April 25, 2017)

To begin, the FICC states that all Netting Members benefit from the proposed liquidity plan:

- the CCLF proposal actually benefits all Netting Members and is specifically designed to comply with Commission Rule 17Ad-22(e)(7)(i), which requires FICC to maintain sufficient liquid resources…[4]; and

- All Netting Members, therefore, regardless of size would benefit from the risk mitigation that the CCLF proposal would provide.[5]

It is true that all Netting Members benefit from a liquidity plan. However, the benefits cited are generic ones – true of any liquidity plan. The generic benefits credited to the CCLF have nothing to do with the differential impact the CCLF design imposes on smaller GSD Netting Members. The FICC admits that the CCLF might burden competition:

- FICC recognizes that the proposed rule change could have an impact on competition…[6]

We contend that the FICC has the flexibility to comply with the Exchange Act without burdening competition.

Asymmetrical Risk

The FICC makes the following claim:

- each Netting Member's CCLF requirement would be a function of the liquidity risk that each Netting Member's activity presents to GSD;[7]

This is false. It is demonstrably true that more than half of the GSD Netting Members pose no liquidity risk to the FICC. As confirmed by the FICC:

- GSD's Clearing Fund cash for the period between March 31, 2016 and March 31, 2017 was $5.4 billion. There are approximately 50 out of 103 Netting Members that present peak liquidity needs beyond this value[8]

Simply stated, the peak liquidity needs of 53 of the 103 Netting Members do not even surpass the value of cash held in the Clearing Fund. This doesn't even account for other substantial uncommitted liquid resources the FICC has at its disposal. The need to exclusively rely on cash in the Clearing Fund also

[4] FICC Letter p. 6
[5] FICC Letter p. 8
[6] FICC Letter p. 6
[7] FICC Letter p. 3
[8] FICC Letter p. 6

assumes the FICC has no ability to act on its own behalf due to the extreme (and inconsistent) assumption that the repo market is impaired.[9]

As shown, smaller GSD Netting Members don't present any risk to the FICC. We also know this claim is historically true, because the FICC has efficiently handled the defaults of several large Netting Members in the past. Systemic risk is nonlinear. It bears repeating that:

- FICC handled both the Lehman Brothers and the MF Global insolvencies seamlessly.[10]

Thus, it is clear from historical evidence that liquidity risk to the FICC is only presented by the largest Netting Members. At a minimum, it can be conservatively stated that half of the GSD membership presents no liquidity risk at all. If the design of the CCLF assigns liquidity obligations as a "function of the liquidity risk that each Netting Member's activity presents to GSD," half of the GSD membership should be excluded from the CCLF.

It is also important to account for recent changes the FICC has implemented with respect to its margining process. Following the recent approval of a rule modification instituting the Margin Proxy[11] in April of 2017, assets in the Clearing Fund will increase substantially going forward. All Netting Members are already contributing to this increase in cash held in the Clearing Fund. Taking all these factors into consideration, liquidity risk to the FICC is clearly only caused by the largest Netting Members. Small and medium sized Netting Members are already contributing more to the Clearing Fund than before due to the Margin Proxy. Due to these many significant reasons, we believe it is only fair and reasonable to exclude smaller Netting Members from the need to contribute to the CCLF.

Asymmetrical Burden

We believe the FICC, and all CCPs, benefit from Netting Member diversity. The design of the CCLF threatens this diversity. The differential impact that the CCLF will have on each Netting Member is not just a function of each firm's assigned liquidity obligation. The ease with which each Netting Member can fulfill this obligation is also critical in assessing impact. We believe the FICC has failed to recognize this differential impact as a threat to GSD member diversity. The fact that the larger Netting Members seem quite comfortable with the extremely large contingent requirements imposed by the CCLF is perhaps an indicator that impact is asymmetrical.

Non-bank GSD Netting Members do not have banking deposits. Capital is precious for these non-bank firms. To prove compliance with the contingent requirements of the CCLF, non-bank Netting Members are required to contract with a bank to establish a committed line of credit. Not only is this economically disadvantageous, this requirement also creates a dependency on an external entity which could prove to be an existential threat. An inability to secure a committed line of credit at a reasonable rate would force non-bank Netting Members to withdraw from the GSD. We believe it is reckless not to exclude smaller

[9] It is normal business practice for CCPs to utilize the repo market to earn a return on client cash held in the form of margin. The assumption that cash invested in this manner by the CCP is guaranteed to be returned is inconsistent with the precondition that the repo market is impaired.
[10] http://www.dtcc.com/news/2015/may/05/systemic-importance
[11] SEC Release No. 34-80349; File No. SR-FICC-2017-001

firms from this existential threat. After all, these smaller firms don't present any liquidity risk to the GSD. The GSD is clearly not strengthened through the elimination or reduced involvement of its smaller Netting Members.

If the FICC was truly interested in mitigating liquidity risk, a hard cap could be placed on the maximum liquidity exposure allowable for each Netting Member. This simple mandate would directly mitigate FICC's liquidity risk and preclude any need for a liquidity plan. Assuming a hard cap is unpalatable, we believe other more equitable solutions should be considered. As pointed out in the Ronin Letter, the NSCC's SLD Proposal provides such a solution. As explained by the FICC in its rebuttal:

- The SLD is designed to cover the liquidity exposure attributable to those members that regularly incur the largest liquidity exposures.[12]

We fail to understand why a similar approach isn't appropriate for the GSD. Clearly, a liquidity plan which excludes smaller market participants could also comply with the demands of the Exchange Act. We believe such a design is necessary for the GSD to avoid harming membership diversity. The CCLF requirement may be contingent – but it still exerts a potent economic hardship on some Netting Members – a hardship that might even prove to be an existential threat to GSD membership.

Negative Impact

Ronin believes implementation of the CCLF will have significant, negative impacts on the U.S. Treasury market during normal times as well as during a crisis. Any negative change to liquidity in the U.S. Treasury market is certain to harm the U.S. taxpayer. We believe this negative impact outweighs any perceived benefits associated with implementing the CCLF. Ronin claims the following:

- The set of conditions that would lead to the declaration of a CCLF Event[13] are so extreme that we believe such conditions are implausible.
- The declaration of a CCLF Event, during a crisis, would seriously harm liquidity by draining cash from the global financial system in order to support a riskless asset class (U.S. Treasuries). This action is bound to have detrimental effects on other asset classes.
- The design of the CCLF (6-month lookback) assigns Netting Members a future unknown liability. This uncertainty may hinder solvent Netting Members from increasing participation in the Treasury market during a crisis.
- Approval of the CCLF will have unintended consequences including the promotion of concentration risk within the FICC as well as harming Treasury market liquidity - both during normal and crisis market conditions.

[12] FICC Letter p. 5
[13] SEC Release No. 34-80812 p. 3

Conclusion

Liquidity risk to the FICC is entirely dependent on the trading activities of its largest Netting Members. The size of the GSD's current $74 billion[14] liquidity need is not reduced through the elimination or diminished involvement of its smaller Netting Members. The current form of the CCLF will only further encourage concentration risk. <u>We don't believe the U.S. Treasury market is best served by creating a greater dependency on a select few to serve as gatekeepers for centralized clearing</u>. We believe this is the sign of a flawed design.

<u>If regulation continues to burden small and medium sized firms to subsidize risks that only the largest firms present, the number of market participants will continue to decline.</u> Regulation meant to mitigate "too big to fail" risk should not result in impactful negative consequences for smaller firms that don't pose any risk to the U.S. financial system. Systemic risk caused by U.S. Treasuries, if even plausible, is certainly only a problem caused by the largest firms. Systemic risk is an asymmetrical risk, not a linear risk. Consequently, we believe care needs to be taken that new regulation meant to mitigate liquidity risk does not diminish Treasury market liquidity or harm diverse participation in centralized clearing. Centralized clearing proved to be a pillar of strength during the past financial crisis. Weakening diversity of membership in an attempt to strengthen centralized clearing is likely to prove self-defeating.

In conclusion, we request that the Commission reject FICC's proposed rule change in favor of developing a new and better liquidity plan. We thank the Commission for considering our comments. If you should have any questions, please contact me by email at [REDACTED] or by telephone at [REDACTED].

Sincerely,

Robert E Pooler Jr.,
Chief Financial Officer
Ronin Capital, LLC

[14] https://www.wsj.com/articles/cost-of-repo-safety-net-hits-74-billion-1490014800