June 27, 2017

Via Electronic Submission
(www.regulations.gov)
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Attn: Robert W Errett, Deputy Secretary

Re: Notice Seeking Public Comment on SR-FICC-2017-002

Dear Mr. Errett:

The signatories listed below appreciate the opportunity to respond to the U.S. Securities and Exchange Commission ("SEC") and submit comments regarding rules change to Implement the Capped Contingency Liquidity Facility in the Government Securities Division Rulebook.

Background:

Registered clearing agencies that perform central counterparty services are required to maintain sufficient financial resources to withstand a default by the largest participant family to which the clearing agency has exposure in "extreme but plausible conditions." See SEA Rule 17Ad-22(b)(3). In light of this requirement, the Government Securities Division ("GSD") of the Fixed Income Clearing Corporation[1] ("FICC") has proposed a rule change to establish the creation of a Capped Contingent Liquidity Facility (CCLF) that would require solvent members of the GSD to fund the portfolio of a failed participant family during the liquidation

[1] The Fixed Income Clearing Corporation (FICC), a subsidiary of The Depository Trust & Clearing Corporation (DTCC), is composed of the Government Securities Division (GSD) and the Mortgage-Backed Securities Division (MBSD). The GSD is responsible for the clearing of U.S. Treasury and agency securities.

process of that participant family.[2] We had previously submitted a letter to the SEC on these issues (the "Prior Letter"). This letter is intended to provide some further operational details.

As a brief overview CCLF is put in place due to Dodd Frank requiring all Financial Market Utility (FMU) CCP to have in place a plan in case of a large member default (SIFI) and that the FMU should have the ability to fund itself during the liquidation of the defaulting member's collateral.

We believe this makes sense for all asset classes except for US Treasuries. US Treasuries are different as it is a flight to quality asset and during a credit crisis institutions sell all other asset classes and buy US Treasuries. Throughout SEC rules US Treasuries and agencies are provided special treatment and exemptions. I think we all can agree that the SIFI default will not be due to its US Treasury activity but other activities such as leveraged loans, etc. As FICC has stated this is not a risk issue, but a funding issue during the liquidation process. FICC collects enough margin based on the members risk to FICC FICC is the last FMU that needs to fulfill its Dodd Frank requirement and due to the size they could not get its own facility so instead of looking to get an exemption they are looking to get this allocated to members based on a formula.

FICC made it clear to us that as long as the repo markets are functioning nothing will be allocated to any members as they will be able to fund this collateral directly during the liquidation process. If the repo markets for FICC members are not functioning, then the US Treasury market is not a functioning market and one of the FRB mission/mandate is to ensure a functioning US Treasury market. CCLF will not solve this problem but will add potentially additional systemic risk to the markets.

A brief discussion on the repo markets:

The repo market in US Treasuries and agencies is a large market. It is both a bilateral market and FICC CCP market as members have access to a closed market on the broker screens where all trades are executed on an anonymous basis and FICC becomes the central counterparty on all transactions. Based on recent Federal Reserve data there is $400 billion of repo activity executed and netted at FICC through that marketplace. This is a highly liquid market and during the credit crisis functioned exceedingly well. Since the credit crisis we have had structural changes that have affected the markets. One important change which started in September 2013, and was supposed to be temporary,

---

[2] The establish of the CCLF is not intended to address market risk in ordinary market conditions, as the current margining models that GSD are sufficient in this regard.

https://www.newyorkfed.org/markets/opolicy/operating_policy_130920.html), was the FRB Reverse Repo program and most recently allowing FMU CCP to deposit customer cash directly with the FRB. Currently the reverse repo program has approximately $150-200 billion and has been approved to go to $2 trillion. We have no data on how much FMU CCP has on deposit with the FRB, but we would think it is substantial as they are getting the reserve rate which is approximately 25 basis points greater than what they can earn executing tri-party repo with banks and broker dealers. This is important because with these two programs in place and if there is a SIFI default, all institutions that have access will deposit its cash with the FRB. Any bank or broker dealer that has tri-party repo with these institutions will be moved to the FRB. In the case of a SIFI default and CCLF is allocated to FICC members, all members will be looking to finance that collateral on the repo screens, but a large portion of the institutional cash will go directly FRB. Even if the bank and broker dealers are offering better rates than the FRB during a crisis institutions are not looking at increasing revenues, but are adverse to risk. This can help cause the repo markets from not properly functioning causing systemic risk to the system.

Is CCLF operationally feasible in times of stress?

The Bank of New York is the only remaining clearing bank as JP Morgan has exited this marketplace. CCLF just moves the risk from FICC to BONY without the margin that FICC maintains of the defaulting member. Does FRB want additional risk to BONY? We have asked FICC since late 2015 if they discussed with BONY how they will react when FICC allocates the CCLF to its members. The question was recently asked and the only response was that they did have this conversation and operationally they can deliver this collateral to BONY, but no discussions if BONY would accept this risk. FICC said that each member needs to discuss this directly with BONY. Current real world environment on how BONY accepts instructions from its clients: BONY has what they call a net free equity (NFE) limit that will allow its customer to accept a delivery in without a corresponding on-going delivery out. This is based on a credit limit or margin posted with BONY. Now the real world discussion: let's assume that the repo markets are not functioning, which is highly unlikely, and FICC looks to allocate CCLF. When they start allocating collateral BONY may only accept enough collateral into its customer box that is based on that customers NFE limit. Once the limit is met and BONY does not want to take on additional risk to that customer all incoming receives that the customer executed with their counterparties may be DK'ed back to the counterparty. As we are in a credit crisis the street will perceive that customer that is DK'ing trades is having financial problems which can quickly spiral into being cut off from the market place. If many firms are in the same position this can cause systemic risk to the marketplace. If BONY was to accept the allocation of CCLF without a corresponding delivery all we have done is move the risk from FICC to BONY. Even if firms were to get committed facilities, in a real world situation the bank that provides that facility will not fund that CCLF event until it has a listing of the collateral and can verify market values, etc… It is not practical to think that this can be accomplished quickly and if FICC could not get committed facilities how would members get these facilities.

We have discussed in our last comment letter if CCLF goes through the implications for reduced liquidity in the repo markets, spreads widening, balance sheet reduction, costs to members, and ultimately is a cost to the taxpayer. Since the crisis, based on recent data from the NY Fed, the repo market has decreased by $5 trillion and is 50% smaller than it was pre-crisis. CCLF will only add to reducing liquidity in the repo markets.

What is the need?

We need to do an in-depth study on this issue as the current proposal does not address the real world implication or the possible systemic risk that this may cause to the markets. In The Prior Letter, we had provided a list of issues that should be considered in connection with such a study.

Legal Issues:

Finally, we believe the proposal is legally deficient for the reasons set out in this letter and The Prior Letter: (i) the situation posed by the FICC is not plausible; (ii) the proposal does not take account of the differences between U.S. government securities and other securities; and (iii) the proposal does not account for the interests of all stockholders, including the U.S. government as issuer of securities. *See generally SEA Rule 17Ad-22 (standards for clearing agencies.)*

Very truly yours,

Alan Levy
Managing Director

Other signatories to this comment letter

Aardvark Securities LLC	Philip Vandermause, Director
Ronin Capital, LLC	Robert Pooler, Chief Financial Officer
Wedbush Securities Inc.	Scott Skyrm, Managing Director