Nasdaq

Theodore Bragg
Vice President - Strategic Planning
165 Broadway
New York, NY 10006
P: [redacted]
E: [redacted]

November 1, 2017

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

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: **File Number SR-FICC-2017-002 – Notice of Filing of Proposed Rule Change – Capped Contingency Liquidity Facility ("CCLF") and Order Instituting Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change**

Dear Mr. Fields:

Nasdaq, Inc. respectfully submits this comment letter on behalf of the Nasdaq Fixed Income ("NFI") trading platform, which operates an electronic central limit order book and matching engine for "On-the-Run" U.S. Treasury Securities ("USTs"). NFI clears trades executed on its platform via the clearing brokerage services of Cantor Fitzgerald, a Clearing Member of the Fixed Income Clearing Corporation ("FICC"). In addition to operating three Nordic clearinghouses, Nasdaq also operates six options and three equities exchanges in the U.S., trades more U.S. equity options than any U.S. exchange operator, is a large shareholder of the Options Clearing Corporation ("OCC"), and nominates two directors to the OCC Board of Directors.

In Nasdaq's considerable experience, clearing in the UST market lags behind clearing of U.S. equities and options in scope of coverage, transparency, and cost. In its April 22, 2016, response to the Treasury Department's *Request for Information on the Evolution of the U.S. Treasury Market Structure*,[1] Nasdaq observed that:

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1 *See* 81 F.R. 3928 (Jan. 22, 2016), available at: https://www.treasurydirect.gov/instit/statreg/gsareg/RFITreasuryMarketStructure.pdf.

> The clearing market structure, in our view, has fallen behind the realities of automated trading. The uneconomical cost of clearing large volumes of trades with very small net positioning has resulted in the majority of trading that occurs in the UST market being done without utilizing a centralized clearing counterparty ("CCP"). This development poses material counterparty risk to the market. The market instead relies on the solvency of the trading venues and an ever diminishing number of Clearing Brokers.[2]

Nasdaq recommended a universal central counterparty or interoperable clearing model to increase transparency and minimize systemic risk. Nasdaq also observed that clearing costs:

> represent a frictional market force, which leads to either a virtuous or a vicious cycle. Lower costs lead to more liquidity and less market risk, while higher costs lead to less liquidity and more market risk. The virtuous cycle would be aided, for example, by a model including intra-day netting because allowing immediate offsetting of positions would reduce both systemic risk and member margin requirements. The relationship between risk and cost closes the cycle. Lower risk leads to lower clearing costs and vice-versa. Thus, it is imperative that the CCP be cost efficient and well governed, having representation from a cross-section of all market participants.[3]

The Treasury Department recently agreed with each of Nasdaq's recommendations and observations. In its *Report to the President: A Financial System That Creates Economic Opportunities – Capital Markets*,[4] the Treasury Department observed that changes in clearing practices related to the growth of Proprietary Trading Firms and Interdealer Broker platforms (such as NFI), has had multiple effects:

> First, there is less netting down of settlements than there would be if all interdealer market participants were FICC members. Second, if a large PTF with unsettled trading volumes were to fail, the failure could introduce risk to the market and market participants.

Treasury also noted "any effort to include PTFs in FICC's membership is complicated by the current fee structure and capital requirements imposed by FICC on its members, which could pose an economic barrier to entry for these firms." As a result,

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2 Available at: https://www.treasurydirect.gov/instit/statreg/gsareg/NasdaqRFIResponse.pdf.

3 *Id.*

4 Available at: https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf.

Treasury recommended further study of potential clearing enhancements due to "the fees and other standards that FICC imposes on its members, and how those fees compare to fees for similar services in other markets.[5]"

In his short tenure, Chairman Clayton has already spoken multiple times of the need to reform the structure of the USTs market. For example, in his July 12, 2017 Remarks Before the Economic Club of New York, the Chairman announced his plans to form a Fixed Income Market Structure Advisory Committee ("FIMSAC") comprised of a broad range of industry experts to study and address pressing issues of Treasury market structure.[6]

Nasdaq respectfully submits that there are few issues more pressing, presenting greater systemic risk, or more widely agreed to be in need of study than the lagging system of clearing of USTs. The above-captioned FICC proposal will impact, perhaps dramatically, the ecosystem that the Treasury Department has already singled out as needing further study and reform. In fact, the proposal reaches the heart of the manner that most concerned Treasury, namely the allocation of costs and fees on FICC members as well as the resulting incentives and conduct of non-FICC members.

Accordingly, Nasdaq recommends that the Commission consider deferring any ruling on the Capped Contingency Liquidity Fund in order to refer it for further study by the soon-to-be-formed FIMSAC.

Respectfully submitted,

Theodore Bragg
Vice President - Strategic Planning

cc: Commissioner Kara Stein
Commissioner Michael Piwowar
Division of Trading and Markets
Division of Economic and Risk Analysis

5 *Id.*

6 Available at: https://www.sec.gov/news/speech/remarks-economic-club-new-york.