April 4, 2018

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

Re: Proposed Rule Change and Advance Notice Filing by the Government Securities Division of Fixed Income Clearing Corporation Regarding Its Required Fund Deposit Calculation; Release Nos. 34-82588 and 82779; File Nos. SR-FICC-2018-001 and SR-FICC-2018-801

Amherst Pierpont Securities LLC ("**APSL**" or "**the Company**") is writing in response to the recent changes proposed by the Fixed Income Clearing Corporation (the "**FICC**") with regard to the Government Securities Division ("**GSD**") calculation of Netting Members' margin, known as the Required Fund Deposit amount (hereinafter, the "**proposal**" or "**RFDC Proposal**").[1] Our comments focus on the challenges posed by three components of the RFDC Proposal and the corresponding implementation process, namely: the VaR charge component, the excess capital premium calculation, and the blackout period exposure adjustment. Our view is that a rush toward immediate implementation, without sufficient time for full transparency, testing and consideration of the concerns highlighted in the following comments may result in increased risk to industry stakeholders and the markets they support, as well as impose an unnecessary competitive burden on FICC GSD's non-bank Netting Members.

As described below, APSL believes that the proposed changes present novel and complex issues under Section 17A of the Securities Exchange Act of 1934 ("Exchange Act") and the Payment, Clearing and Settlement Supervision Act of 2010 with respect to FICC GSD's risk management practices and its obligations under Section 17(b)(3)(I) of the Exchange Act and Commission Rules 17Ad-22(e)(6)(i) and (v), (21)(i) and (ii) and (23)(ii). APSL believes that if the RFDC Proposal is not allowed a fully-considered implementation process, the proposal could cause FICC to run afoul of these requirements.

I. Introduction

APSL is a registered broker-dealer under the Exchange Act and is a member of the Financial Industry Regulatory Authority, Inc. ("**FINRA**").[2] APSL, headquartered in New York, provides institutional and middle market clients with access to a broad range of fixed income products including investment grade corporate credit, Rates, securities finance, Agency and non-Agency MBS, and related investment banking & advisory services. APSL self-clears the majority of its business on a delivery

[1] FICC submitted the proposed changes with the SEC as a proposed rule change and an advance notice. *See* Exchange Act Release Nos. 34-82588 (January 26, 2018) (SR-FICC-2018-001); 82779 (March 2, 2018) (SR-FICC-2018-801).

[2] The Company is also registered as an introducing broker with the Commodity Futures Trading Commission and is a member of the National Futures Association.

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versus payment ("**DVP**") and receive versus payment ("**RVP**") basis; it has been an FICC participant since 2010 in both the GSD and Mortgage-Backed Securities Division ("**MBSD**").

II. Proposed Changes to the VaR Charge Calculation

A. Calculation Transparency.

The RFDC Proposal, as drafted, would amend the calculation of GSD's VaR Charge by replacing the "full revaluation" approach with a "sensitivity" approach. APSL understands this change is driven in part as a result of the weaknesses of the "full revaluation" approach exposed during the fourth quarter of 2016. The Company does not dispute that the "full revaluation" approach has certain deficiencies which warrant attention, deficiencies which the "sensitivity" approach is intended to address. In addition, the Company acknowledges the FICC has already taken some steps to engage the GSD membership regarding these proposed changes, including providing parallel reporting since December 2017. However, given the potential impact of the proposed changes, certain volatility exhibited through the parallel testing results, and the need for APSL to complete appropriate back-testing and obtain further insight into FICC's back-testing results, the Company is requesting additional time and tools be given to the members in order to continue to assess the full impacts and appropriateness of these proposed changes.

FICC has been providing members with the proposed "sensitivity" approach GSD VaR calculation only since late December 2017. During this time the FICC has been providing the "sensitivity" calculation while keeping the "full revaluation" approach in production. This parallel output has been valuable for industry members, as it has enabled them to begin to assess the changes. However, only three to four months of parallel testing is too short a timeframe to cover several aspects of the potential impacts on the margin requirements. The Company notes that more time is required to assess the impact of these proposed changes and notes that at least a six to nine month parallel test period would be more appropriate in order to ensure several market cycles are covered as part of this testing period. In addition, in order for Netting Members to proactively manage their business and assess potential margin requirements related to the new proposed sensitivity approach, tools, in addition to the sensitivity approach calculations, are required to run scenario and other analyses so they can replicate, validate and back-test the proposed "sensitivity" approach calculations. Without this deeper level of transparency in the calculations for the Required Fund Deposit amount, member firms are limited in their ability to identify and anticipate changes in the "sensitivity" GSD VaR charge.

The Company would also like to highlight that FICC has less risky alternatives than pursuing an expedited implementation process. We refer to supplemental actions FICC took after the fourth quarter of 2016, when the "full revaluation" approach did not respond effectively to the market volatility. Specifically, FICC implemented a Margin Proxy calculation (which it continues to use) to ensure that each Netting Member's VaR Charge achieved a minimum 99% confidence level. In the proposed rule filings, we do not believe the FICC has presented the SEC with the full impact analysis of the supplemental Margin Proxy calculation. We believe the full analysis would reveal that the current margining process, inclusive of the Margin Proxy, has already significantly and materially increased Netting Members' Required Fund Deposit amounts. APSL believes this increase in the required GSD margin during the fourth quarter 2016 period highlights a practical interim solution for FICC to ensure it collects adequate levels of margin to protect itself and Netting Members during times of stress.

Therefore, as noted in an earlier comment to the SEC on February 22nd, 2018, the Company cautions the SEC against any approval or notice of no objection regarding the proposed changes until appropriate time and additional tools and information are provided to FICC members to complete a comparison of the Required Fund Deposits between the current methodology and the proposed new sensitivity model

approach. Specifically, APSL urges FICC to provide the appropriate tools to replicate the new sensitivity model approach or to grant access to the previously proposed FICC GSD calculator in order to more effectively manage the liquidity risk to members which may be introduced through these proposed changes. Based on the significant increases in the Required Fund Deposits during the fourth quarter 2016 under the current margin methodology, the Company believes there is limited risk in allowing sufficient time for these concerns to be addressed. Without appropriate time, tools and information to be able to manage liquidity risk that may be introduced by the proposed changes, the Company believes the proposal would be inconsistent with the requirements in SEC Rule 17Ad-22(e)(23)(ii)[3] *that require FICC to provide sufficient information to enable participants to identify and evaluate the risks, fees and other material costs they incur by participating in FICC.*

B. Common Platform Cross Margining.

As part of APSL's overall business strategy, the Company runs a hedged Agency MBS portfolio typically maintaining long pass-through positions at GSD and short To Be Announced ("**TBA**") positions at MBSD. Throughout the implementation of changes to the MBSD margin charge methodology in 2016, the Company discussed the benefits of consolidating both the MBSD and GSD methodologies with the FICC, with the goal of a common platform which would allow for the implementation of cross-margining between the GSD and MBSD. The Company believes that a failure to implement this cross-margining benefit in connection with the proposed changes would be inconsistent with the requirements under Commission Rule 17Ad-22(e)(6) that 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, at a minimum, considers, and produces margin levels commensurate with the risk and particular attributes of each relevant product, portfolio, and market[4] and that uses an appropriate method for measuring credit exposures that accounts for relevant product risk factors and portfolio effects across products.[5] Specifically, without the benefit of cross-margining, firms similar to APSL will pay a costly premium any time the firm's MBSD MTM calculation results in excess margin (i.e., the amount over the MBSD VaR charge), because the excess is not returned to the Company – instead it is retained at MBSD.[6] With cross-margining on a common MBSD/GSD platform, the excess margin at MBSD would not need to be returned to the Company. It could be credited directly against any deficit at FICC, resulting in a more accurate risk measure. The Company believes there is broad agreement between FICC Netting Members and FICC that the implementation of cross-margining is a more accurate and proper approach to capture the true risk measurement for Netting Members.

The incomplete implementation resulting from the lack of cross-margining capability is a deficiency in the overall FICC proposal which will inflate the margin requirements and this inflation, in turn, could distort the liquidity profile of the Company and other Netting Members that have a similar business profile to APSL. This distortion could be avoided by adopting a more comprehensive reform. In addition, FICC's proposal to establish a VaR Floor without assessing the implications of cross-margining is a deficiency that could lead to further distortions of risk calculations. The Company notes that at the time of a market stress event, the impact of cross-margining could be significant and material to many Netting Members. The Company believes further appreciation of this impact is required.

Therefore, as the current FICC proposal does not contemplate the simultaneous implementation of cross-margining with the GSD sensitivity approach (and it fails to identify a plan on when this cross-margining may be introduced in the future), the Company proposes the implementation of the sensitivity

[3] 17 CFR 240.17Ad-22(e)(23)(ii).
[4] 17 CFR 240.17Ad-22(e)(6)(i).
[5] 17 CFR 240.17Ad-22(e)(6)(v).
[6] For example, if the MBSD VaR is 100 and the MTM is (20), the Company's margin requirement would be 80. However, if the MBSD VaR is 100 and the MTM is 200 (a surplus of 100), FICC does not return the excess margin of 100 to the Company.

model approach be delayed until cross-margining across a common platform between the GSD and MBSD can also be implemented. APSL believes the FICC does not need to implement the proposed changes prior to fully evaluating the potential offsetting opportunities that may be available to Netting Members. The implementation of this cross-margining would be consistent with FICC GSD's obligations to design of a risk-based margining system under Commission Rules 17Ad-22(e)(6)(i) and (v),[7] *as described above, and under Rules 17Ad-22(e)(21)(i) and (ii)*[8] *to be efficient and effective in meeting the requirements of its participants and the markets it serves and have its management regularly review the efficiency and effectiveness of its clearing and settlement arrangements and operating structure, including risk management policies, procedures, and systems.*

III. Proposed Change to the Excess Capital Premium Calculation

Currently, FICC calculates the Excess Capital Premium using an "Excess Net Capital" measure in its formula (i.e., the premium is calculated using a Netting Member's Excess Net Capital as the denominator and its VaR as the numerator). The proposed change would use a "Net Capital" measure rather than the "Excess Net Capital" measure, thereby resulting in a lower denominator. For firms such as APSL, which primarily self-clear on a DVP versus RVP basis, this change will have a minimal impact.

Where broker-dealer Netting Member firms will see a material impact is in the adoption of the sensitivity approach in calculating VaR; this change will significantly increase the numerator in the formula and thereby materially increase the likelihood of triggering the Excess Capital Premium charge. The Company would like to bring this to the attention of the Commission and requests that FICC consider whether additional changes to the calculation may be warranted. The mere existence of this Excess Capital Premium Calculation which references a broker-dealer's "Net Capital" imposes an additional competitive burden on broker-dealer Netting Members that APSL believes may not be consistent with Section 17A(b)(3)(I) of the Exchange Act.[9] For example, non broker-dealer Netting Member's Excess Capital used in the measurement of any Excess Capital Premium charge may not be based on net worth after reductions for haircuts or other non-allowable asset deductions similar to broker-dealer Netting Member requirements. Given that the new sensitivity approach will result in a higher VaR (and more importantly, a corresponding higher Required Fund Deposit amount) consideration should be given to further enhancements (e.g., increasing the ratio from 1 to a higher threshold level) in order to minimize the competitive disadvantage placed on broker-dealer Netting Members. In addition, part of the impact of the Excess Capital Premium Calculation may be alleviated if the change were implemented in conjunction with cross-margining, but without this cross-margining, the results may have distortive effects, notwithstanding the laudable merits behind the individual changes. The lack of tools to replicate the potential Required Fund Deposit and the lack of cross-margining benefit as noted in the paragraphs above would only serve to exacerbate any potential impact on liquidity introduced through this new proposed Excess Capital Premium calculation.

Therefore, the Company is proposing the FICC and the SEC review the impacts of the Excess Premium Multiplier on individual broker-dealer members and any undue competitive burdens this calculation may place on them. In addition, any change in the Required Fund Deposit figure utilized in the Excess Premium calculation be adopted only after sufficient time is allotted members to build the proper tools to replicate the new sensitivity model (or have access to the previously proposed FICC GSD calculator). Furthermore, implementation should be closely coordinated with cross-margining on a common platform.

[7] 17 CFR 240.17Ad-22(e)(6)(i) and (v).
[8] 17 CFR 240.17Ad-22(e)(21)(i), (ii).
[9] 15 U.S.C. 78q-1(b)(3)(I).

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The Company would also like to continue further discussions with FICC regarding the Excess Capital Premium calculation, including but not limited to:

- *Which margin components are to be included in the calculation and potential volatility*
- *The possible discounting of certain haircuts applied against the Net Capital figures in the FOCUS report based on the liquidity profile of the Company*
- *Introduction of a notification period (i.e., 48 hour notification similar to many FINRA notification periods) to allow Netting Members to address any Excess Premium multiplier trigger by either reducing overall GSD Required Fund Deposit levels and/or reduce overall regulatory capital utilization.*

IV. Proposed Change to Establish the Blackout Period Exposure Adjustment as a Component to the Required Fund Deposit calculation

FICC is proposing to add a new component to the Required Fund Deposit calculation that would be applied to the VaR Charge for all GCF Counterparties with GCF Repo Transactions collateralized with mortgage-backed securities during the Blackout Period (the "**Blackout Period Exposure Adjustment**"), and proposing to eliminate the existing Blackout Period Exposure Charge. This change would result in a Blackout Period Exposure Adjustment being calculated on allocated vs. actual collateral characteristics. Specifically, the adjustment would be based on the weighted averages of pay-down rates for all active mortgage pools presented to FICC during the three most recent preceding months applied to a firm's balance, rather than the firm's individual collateral mortgage pools presented to FICC. We believe this proposed change would eliminate the prudent risk and position management Netting Members can undertake in order to reduce overall FICC exposure; in short, firms would no longer have reason to manage the prepay characteristics of mortgage-backed securities positions held either within or outside FICC.

Currently APSL reviews mortgage-backed security collateral prepay characteristics and as a result, APSL can utilize significant alternative sources of financing capacity, in order to diversify the financing of certain positions away from FICC. This allows APSL to ultimately help reduce FICC's overall pay down risk. The Company believes the proposed Blackout Period Exposure Adjustment methodology is a less accurate measurement of individual Netting Members risk profile. Furthermore, the approach would penalize those Netting Members who deliver lower risk profile assets, thereby potentially rewarding Netting Members who deliver higher risk profile assets.

Therefore, the Company proposes that FICC retain the approach which provides incentives for counterparties to more effectively manage the prepay characteristics of the mortgage-backed securities positions held within FICC. This approach would continue to give Netting Members the option to potentially reduce overall FICC risks during the pay down cycle. The Company also continues to discuss options with FICC to retain more transparency and granularity to measure the Blackout Period Exposure Adjustment and assess the implications of certain exclusions within the calculation such as non-pay down positions (i.e., DUS bonds/Project Loans). Without this important transparency and ability to understand the effects of the proposal, APSL believes, that the proposal is inconsistent with the requirements in SEC Rule 17Ad-22(e)(23)(ii) that require FICC to provide sufficient information to enable participants to identify and evaluate the risks, fees and other material costs they incur by participating in FICC[10] and also with the requirements in SEC Rule 17Ad-22(e)(6)(i) that require FICC to establish a risk-based margin system that, at a minimum, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market.[11]

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[10] 17 CFR 240.17Ad-22(e)(23)(ii).
[11] 17 CFR 240.17Ad-22(e)(6)(i).

V. Summary

In summary, the Company commends FICC for identifying the deficiencies in the current GSD VaR and other calculations, proposing the new sensitivity model approach, and for taking the time to discuss several of the concerns noted by the Company in this letter. As noted above, APSL requests that FICC voluntarily withdraw the current proposal to allow sufficient time for FICC to work with APSL and appropriate stakeholders to design important modifications that would address these concerns.

The Company does not believe that the proposal should be resubmitted until such time as:

- FICC is in a position to provide Netting Members the proper tools to run further sensitivity and projection analysis – analysis which are needed to more effectively manage overall FICC exposures.
- FICC implements a plan to introduce cross-margining between the GSD and MBSD at the same time as the implementation of the proposed GSD margin changes.
- Further discussions are completed to clarify the calculation and process of the Excess Capital Premium Calculation, inclusive of addressing potential competitive disadvantages through the current and proposed calculation, discussions related to introducing a 48 hour notification "cure" period, and further clarification on the items included within the Excess Capital Premium calculation.
- Further discussions are completed regarding the overall method of calculating the Blackout Period Exposure calculation and possible retention for incentives of Netting Members to manage the prepay characteristics of mortgage-backed securities positions held either within or outside FICC during the Blackout Periods.

If the proposal is not withdrawn by FICC and modified accordingly, APSL believes the SEC should not accept the changes as they are currently proposed since they would present concerns and inconsistencies, as described above, under Section 17A(b)(3)(I) of the Exchange Act and Commission Rules 17Ad-22(e)(6)(i) and (v), (21)(i) and (ii) and (23)(ii).

We thank the SEC for considering our comments. If you should have any questions please contact me at [redacted]

Sincerely,

Michael J. Santangelo
Chief Financial Officer
Amherst Pierpont Securities LLC