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April 13, 2018

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

Robert W. Errett
Deputy Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: **File No. SR-FICC-2018-001 (the "Rule Filing") – Exchange Act Release No. 82876 (March 14, 2018) – Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to the Required Fund Deposit Calculation in the Government Securities Division Rulebook, and**

File No. SR-FICC-2018-801 (the "Advance Notice") – Exchange Act Release No. 82820 (March 7, 2018) – Notice of Extension of Review Period of Advance Notice to Implement Changes to the Method of Calculating Netting Members' Margin in the Government Securities Division Rulebook

Dear Mr. Errett:

Fixed Income Clearing Corporation ("FICC")[1] appreciates the opportunity to respond to the comment letters submitted by the Independent Dealer and Trader Association ("IDTA"),[2] Amherst Pierpont Securities LLC ("Amherst"),[3] and KGS-Alpha Capital Markets, L.P. ("KGS")[4]

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 in recognition of FICC's 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 DTCC's other registered clearing agencies provide critical infrastructure for the clearance and settlement of securities transactions in the U.S.

2 Letter from James Tabacchi, Chairman, Independent Dealer and Trader Association to Eduardo A. Aleman, Assistant Secretary, Securities and Exchange Commission (March 29, 2018) (the "IDTA Letter").

3 Letter from Michael J. Santangelo, Chief Financial Officer, Amherst Pierpont Securities LLC to Brent J. Fields, Secretary, Securities and Exchange Commission (April 4, 2018) (the "Amherst Letter").

4 Letter from Levent Kahraman, Chief Executive Officer, KGS-Alpha Capital Markets, L.P. to Brent J. Fields, Secretary, Securities and Exchange Commission (April 4, 2018) (the "KGS Letter").

to the Securities and Exchange Commission (the "Commission") with respect to the Rule Filing[5] and the Advance Notice[6] (collectively, the "Filings").

I. Background

On January 12, 2018, FICC filed the Filings with the Commission to amend the GSD Rulebook (the "GSD Rules").[7] The Filings propose changes to GSD's method of calculating Netting Members' margin (referred to in the GSD Rules as the Required Fund Deposit). As described in the Filings, FICC is proposing to (1) amend the method of calculating the VaR Charge component; (2) add a new component referred to as the "Blackout Period Exposure Adjustment"; (3) eliminate the Blackout Period Exposure Charge and the Coverage Charge components; (4) amend the Backtesting Charge component; and (5) amend the calculation for determining the Excess Capital Premium. In addition, FICC is proposing to provide transparency with respect to GSD's existing authority to calculate and assess Intraday Supplemental Fund Deposit amounts. Collectively, the proposed changes help to ensure that the Required Fund Deposit ("RFD") amounts maintain backtesting coverage at a 99% confidence level for all Netting Members on an ongoing basis.

As explained 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) each promulgated under the Exchange Act.[8] Rule 17Ad-22(e)(4) requires 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.[9] Rule 17Ad-22(e)(6) requires, in part, 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.[10]

5 See Exchange Act Release No. 82588 (January 26, 2018), 83 FR 4687 (February 1, 2018) (SR-FICC-2018-001).

6 See Exchange Act Release No. 82779 (February 26, 2018), 83 FR 9055 (March 2, 2018) (SR-FICC-2018-801).

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, available at http://www.dtcc.com/legal/sec-rule-filings.

8 17 CFR 240.17Ad-22(e)(4) and (e)(6); see supra note 5, at 4691.

9 17 CFR 240.17Ad-22(e)(4).

10 17 CFR 240.17Ad-22(e)(6).

II. FICC Filing Rationale and Impact

As discussed in the Filings and FICC's previous comment letter,[11] FICC has observed that GSD's current VaR model has underperformed during periods of increased volatility. In April 2017, FICC amended the GSD Rules to implement the Margin Proxy in an effort to avoid backtesting deficiencies such as those that FICC observed during the fourth quarter of 2016.[12] While the Margin Proxy has historically provided a more accurate VaR Charge calculation than the full valuation approach, the current VaR Charge as supplemented by the Margin Proxy calculation reflects relatively low market price volatility that has notably persisted in the mortgage-backed securities ("MBS") market since the beginning of 2017. FICC believes that its current approach contains an insufficient amount of look-back data to ensure that the backtesting will remain above 99% if volatility returns to levels seen beyond the 1-year look-back period that is currently used to calibrate the Margin Proxy for MBS. The proposed approach, which among other things includes an extended look-back period, would help to ensure that the RFD amount maintains backtesting coverage at a 99% confidence level.

As a result, FICC believes that the sensitivity approach would provide better coverage on volatile days, such as those observed in 2016 and other earlier periods, where FICC's VaR Charge was not adequate to maintain a 99% confidence level for each Netting Member. The proposed sensitivity approach is based on a risk factor approach for securities in a Netting Member's portfolio to calculate such Netting Member's VaR Charge. If Netting Members have similar portfolios, the impact of the proposed VaR Charge calculation, together with the other proposed changes to the RFD calculation, would be similar. In response to IDTA's suggestion that FICC should disclose the impact of the proposal to the Commission,[13] FICC notes that this information was included in the Filings that were submitted to the Commission on January 12, 2018.

FICC believes that the proposed VaR Charge calculation and RFD calculation are reasonable and consistent with publicly available repo margin requirements. Table 1, referenced below, provides a comparison of the haircuts under the current VaR Charge methodology (calculated on April 2, 2018), haircuts under the proposed sensitivity VaR Charge methodology (calculated on April 4, 2018), and haircuts for the tri-party data collected by the Federal Reserve Bank of New York (as of March 9, 2018). This information is illustrated for securities with similar durations.

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[11] Letter from Timothy J. Cuddihy, Managing Director, The Depository Trust & Clearing Corporation to Robert W. Errett, Deputy Secretary, Securities and Exchange Commission (March 19, 2018) ("(the "FICC Letter").

[12] Exchange Act Release No. 34-79958 (February 3, 2017), 82 FR 10117 (February 9, 2017) (SR-FICC-2017-001).

[13] IDTA Letter at page 3.

Table 1

Equivalent Haircuts Comparison

VaR Charge (as supplemented by the Margin Proxy) and the Proposed Sensitivity VaR Charge

	VaR Charge/Margin Proxy	Proposed Sensitivity VaR Charge
Conventional 30-year MBS	0.75%	1.45%
Conventional 15-year MBS	1.10%	1.47%
GNMA 30-year MBS	1.18%	0.99%
GNMA 15-year MBS	1.27%	1.43%
1-3 year U.S. Treasuries	0.34%	0.43%
5-7 year U.S. Treasuries	1.41%	1.44%
10-15 year U.S. Treasuries	2.48%	2.51%

The Federal Reserve Bank of New York – Tri-Party Haircuts[14]

	Median	10^{th} – 90^{th} Percentile
Agency MBS[15]	2.0%	2.0 – 3.0%
U.S. Treasuries (excluding Strips)	2.0%	2.0 – 2.01%

Pursuant to the Filings, the RFD amount may include a Blackout Period Exposure Adjustment ("BPEA") during the Blackout Period. The BPEA could increase the RFD amount for some Netting Members by 0.92% for conventional MBS and 1.20% for Ginnie Mae ("GNMA") securities (calculated on April 1, 2018). The addition of the BPEA and MBS equivalent haircut under the proposed sensitivity VaR calculation would result in total equivalent haircuts that would not exceed the 90^{th} percentile haircut for tri-party Agency MBS (which applies during and outside of the Blackout Period).

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14 Federal Reserve Bank of New York, www.newyorkfed.org/data-and-statistics/data-visualization/tri-party-repo/index.html#interactive/margins, Retrieved April 5, 2018

15 Published tri-party haircuts do not exist for MBS pools that are eligible under FICC's GCF Repo Service. MBS pools would be subjected to a basis risk factor charge under the proposed VaR Charge calculation.

In response to Amherst's statement that the Margin Proxy provides the appropriate VaR Charge coverage,[16] FICC believes that, based on the equivalent haircut comparison, it is possible that the Margin Proxy approach may prove to be inadequate to anticipate the risk of volatility returning to levels seen beyond the 1-year look-back period given that it contains an insufficient amount of look-back data for MBS.

As noted in the IDTA Letter, Netting Members with portfolios that are mostly comprised of conventional MBS have seen recent increases in the impact study that compares the current RFD with the proposed RFD.[17] Using data as of March 28, 2018 to provide a comparison to the IDTA figure,[18] the chart below reflects FICC's calculation of the impact of the proposed RFD based on the size of the Netting Member and whether such Netting Member had MBS concentration.[19]

Table 2

Netting Members Excess Net Capital[20] / Net Capital	RFD comparison for Netting Members with MBS concentration	RFD comparison for all other Netting Members	RFD comparison for all Netting Members
Less than or equal to $100 million	+71.9%	-38.5%	+28.2%
Greater than $100 million and less than or equal to $250 million	+93.5 %	-19.1%	+57.3%
Greater than $250 million and less than or equal to $500 million	+64.9%	+8.4%	+60.0%
Greater than $500 million	+36.2%	+10.1%	+15.8%
All Netting Members	+52.0%	+8.7%	+21.5%

Table 2 shows that the impact of the proposal would not be determined by the size of the Netting Member but rather the composition of such Netting Member's portfolio. The largest impact of the proposal is for those Netting Members with MBS concentrations. While FICC acknowledges that smaller Netting Members with MBS concentrations would be impacted more, FICC notes that many of these Netting Members have less diversified portfolios thus the effect of

16 Amherst Letter at page 2.

17 IDTA Letter at page 3.

18 FICC selected the business date to show results just prior to the IDTA Letter.

19 FICC assumed that if a Netting Member had more than a 20% change in its RFD during the Blackout Period then the Netting Member had a concentration in MBS. The information in Table 2 was measured monthly from May 1, 2017 to November 30, 2017.

20 FICC included the Excess Net Capital for Broker-Dealers pursuant to the current GSD Rules.

the RFD calculation on conventional MBS would be more pronounced. FICC also notes that smaller Netting Members without MBS concentrations would typically experience a decrease in their RFD while large Netting Members would experience an increase on average.

Table 3 reflects the impact of the proposed changes based on Netting Member type:

Table 3

Netting Member Type	RFD Increase
Bank	7.9%
Dealers with a bank affiliate	15.3%
Dealers without a bank affiliate	46.5%
Other	94.6%

As reflected in Table 3, the largest impact is to the other Netting Member type (i.e., not a Bank or Dealer), which typically has portfolios with MBS concentrations. This impact is commensurate with the increase in equivalent haircuts for the proposed sensitivity VaR Charge calculation versus the current VaR Charge calculation (as supplemented by the Margin Proxy) as illustrated in Table 1. The analysis reflected in Table 3 supports FICC's position that the impact of the proposal would be determined by a Netting Member's portfolio composition rather than a Netting Member "type," as a result, Netting Members with lower MBS concentrations would experience smaller impacts from the proposal.

In sum, the impact of the proposed changes would not be a function of a Netting Member's size or type but rather the underlying portfolio diversification. As a result, Netting Members with portfolios that are heavily concentrated with MBS would experience larger impacts under the proposal. Therefore, FICC disagrees with the IDTA's assertion that the proposal targets certain types of Netting Members.[21] FICC believes that the proposal does not create a burden on any particular size/type of Netting Member that does not result from the necessary and appropriate risk mitigation of the underlying securities in each Netting Member's portfolio.

In connection with the impact study that FICC submitted with the Filings,[22] FICC observed that the impact on the RFD for the period May 1, 2017 to November 30, 2017 reflected a 7% increase on average across all Netting Members, and specifically for this period, there was an average 11% increase for Netting Members with MBS concentrations and an average 5% increase for other Netting Members. Using illustrative dates to supplement the impact study filed with the Commission, Table 4 demonstrates that the proposed RFD remains consistent with the impact study while the current RFD has declined, as the volatility in the fourth quarter of 2016 was no

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21 IDTA Letter at page 1.

22 See supra notes 5 and 6.

longer included in the RFD calculation for MBS. This divergence is the primary driver of the recent increases when comparing proposed RFD to current RFD denoted in Table 2 and Table 3.

Table 4

	Current RFD	Proposed RFD
12/28/2017	$10.9 billion	$12.1 billion
1/28/2018	$11.2 billion	$11.9 billion
2/28/2018	$10.3 billion	$12.2 billion
3/28/2018	$9.6 billion	$11.6 billion
Average RFD for the period 5/1/2017 – 11/30/2017	$11.7 billion	$12.2 billion

FICC believes that the difference in the current RFD calculation versus the proposed RFD calculation indicates that the current RFD calculation may not calculate an amount that is sufficient for all Netting Members if volatility returns to levels seen beyond the 1-year look-back period. In addition, the comparison of the VaR Charge (as supplemented by the Margin Proxy) to the tri-party equivalent haircuts for conventional MBS (see Table 1 above) indicates that the current VaR Charge (as supplemented by the Margin Proxy) would provide materially lower coverage than the tri-party repo margins.

FICC believes that the proposed changes to the VaR Charge calculation would be necessary to maintain a sufficient and robust RFD amount that covers FICC's current and future exposure to each Netting Member at a 99% confidence as required by Rule 17Ad-22(e)(4) under the Exchange Act.[23] The proposed changes would provide FICC with a more effective measure of the risks that these calculations were designed to assess. As a result, the proposed changes would give FICC the ability to effectively identify, measure, monitor and manage its exposures to market price risk. In addition, the proposed changes would provide FICC with the ability to limit its exposure to potential losses from Netting Member default. FICC also believes that the proposed changes would help to ensure FICC's compliance with Rule 17Ad-22(e)(6) under the Exchange Act[24] because the proposed changes would help FICC calculate and collect adequate RFD amounts that are commensurate with the risks and particular attributes of each relevant product, portfolio, and market.

Given that the proposed RFD remains consistent with the impact study provided to the Commission as part of the Filings, the recent RFD impacts are primarily influenced by MBS concentrations (rather than a Netting Member's type or size), and the comparison of equivalent VaR Charge haircuts to tri-party haircuts indicate that the proposed VaR Charge is appropriate, FICC respectfully urges the Commission to approve the Rule Filing and issue a notice of no

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23 17 CFR 240.17Ad-22(e)(4).

24 17 CFR 240.17Ad-22(e)(6).

objection to the Advance Notice so that FICC would continue to remain in compliance with its requirements under the Exchange Act.

III. FICC Netting Member Outreach and Feedback Process

FICC respectfully disagrees with IDTA's assertion that Netting Members have had less than one month to review the proposed changes.[25] FICC also disagrees with Amherst's assertion that the proposal is inconsistent with Rule 17Ad-22(e)(23) under the Exchange Act.[26] As part of the proposal, FICC developed a communication and outreach plan that was designed to provide transparency of FICC's margining approach, educate Netting Members on the proposed changes and provide insight on the manner in which the proposal would impact the membership. As noted in the FICC Letter,[27] this plan included the following:

1. The membership was invited to participate in FICC customer forums on August 16, 2017 and August 23, 2017. The membership was provided with an overview of the proposal and given the opportunity to ask questions. Netting Members were invited to contact FICC if they had specific questions about the overall proposal and the impact to their specific portfolio.

2. The first impact study was provided to Netting Members from September 20, 2017 through September 26, 2017. Each Netting Member received individual historical impact reports for the study period of July 1, 2015 through June 30, 2017. In addition, Netting Members were provided with a list of answers to frequently asked questions ("FAQ") related to the proposal.

3. From August 2017 through December 2017, to the extent requested, FICC attended meetings and conference calls with Netting Members on an individual basis and responded to various requests for additional information.

   FICC notes that on September 28, 2017, FICC participated in a meeting to discuss the proposed changes to the Clearing Fund methodology with the predecessor group to the IDTA. This meeting included ED&F Man Capital Markets Inc., Ronin Capital, LLC, Rosenthal Collins Group, LLC and South Street Securities LLC.

4. On November 30, 2017, FICC issued an Important Notice to announce that the parallel period would begin on December 18, 2017. The Important Notice invited Netting Members to contact FICC's Product Risk group with any questions about the Clearing Fund methodology and the related impact study.

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25 IDTA Letter at page 5.

26 17 CFR 240.17Ad-22(e)(23), see also Amherst Letter at page 5.

27 FICC Letter at page 5.

5. From January 8, 2018 through January 19, 2018, Netting Members received individual historical impact reports for the study period of May 1, 2017 through November 30, 2017. Netting Members also received an updated FAQ document.

6. On December 18, 2017, FICC launched the GSD External Parallel Test, which provided Netting Members with the ability to review the proposed Clearing Fund methodology within FICC's test environment.

7. Since September 2017, FICC has participated in many discussions with individual Netting Members regarding the proposal and the Netting Members' impact studies.

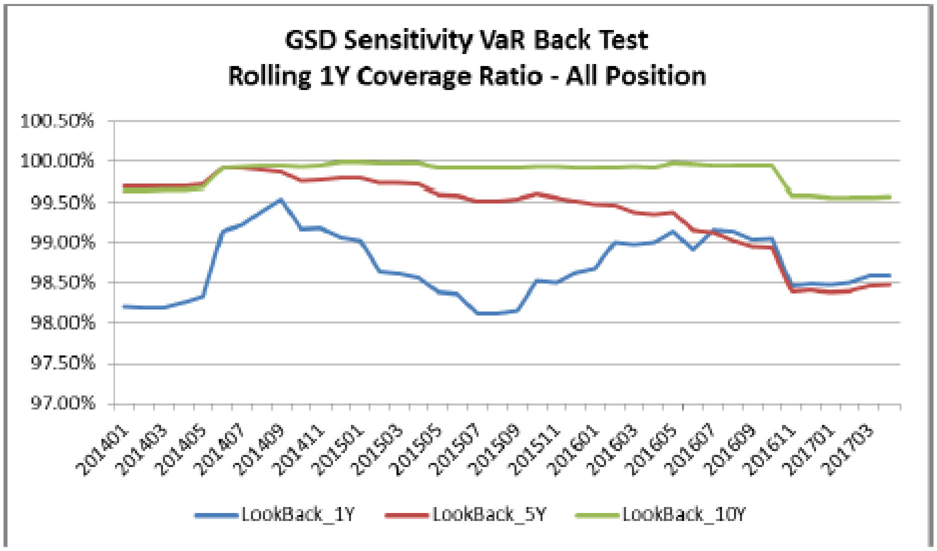
In addition to the above, at the request of several Netting Members, FICC has provided additional analyses that have included (1) reviews of VaR Charge amounts based on sample portfolios, (2) reviews of risk factor analytics that support the proposed VaR Charge calculation, and (3) CUSIP level comparisons that enable Netting Members to better understand the calculations and proposed changes. For the reasons stated above, FICC believes that the membership has been provided with sufficient time and information to assess the impact of the proposed rule changes. FICC has and will continue to make itself available to discuss the proposal and the impact that it would have on individual Netting Members.

IV. GSD's Methodology and Backtesting Calculation

FICC believes that it is fair and appropriate to use the same liquidation/hedge period for each Netting Member. FICC acknowledges that the liquidation of a small portfolio may not be a systemic risk to the financial system, however, as stated in the FICC Letter, FICC also believes that the three-day liquidation period is an accurate assumption of the length of time that it would take to liquidate or hedge a portfolio based the volume and types of securities that can be found in a Netting Member's portfolio at any given time.[28]

As part of FICC's model validation report, FICC performed a benchmark analysis of its calculation of the VaR Charge. In an effort to assess whether the ten-year look-back period would be appropriate, FICC's analysis included two alternative look-back periods – the five-year look-back period and the one-year look-back period. The following chart from FICC's model validation report compares the rolling one-year backtesting performance for the one-year, five-year and ten-year look-back periods using all Netting Member portfolios for the period of January 1, 2013 through April 28, 2017. The chart shows that the ten-year look-back period (which included a stress period) provides backtesting coverage above 99% while the five-year look-back period and the one-year look-back period do not.

[28] FICC Letter at page 3.



FICC acknowledges IDTA's comment that a ten-year look-back period is infrequently used in risk calculations for bank capital and market risk measurement in trading books as suggested by the McKinsey & Company study.[29] It should be noted that the Rule Filing is not designed to adhere to risk calculations for banks nor is it designed to adhere to the market-risk calculations that are used in trading books. Consistent with the Exchange Act, the Rule Filing is designed to adhere to FICC's requirements as a covered clearing agency and its ability to meet its performance obligations as a central counterparty with respect to GSD. With this in mind, FICC's proposed look-back period provides the appropriate RFD coverage for GSD's exposures and is consistent with the Exchange Act.

FICC notes that the RFD and backtesting results at the Netting Member level as well at the aggregate level were filed with the Commission. Based on the results, FICC believes that its proposed RFD methodology would appropriately address the risks presented by each Netting Member's clearing portfolio. Specifically, FICC believes that the 3-day assumption for the backtesting calculation and proposed look-back period would be consistent with Rules 17Ad-22(e)(4) and (e)(6) under the Exchange Act[30] because the 3-day assumption and the proposed look-back period would effectively measure and mitigate FICC's potential future exposure from its Netting Members from the last margin collection and the expected period to liquidate/hedge positions following a Netting Member default as required by Rules 17Ad-22(e)(4) and (e)(6).

V. Excess Capital Premium Concerns

FICC obtained the Commission's approval to impose the Excess Capital Premium to more effectively manage the risk posed by a Netting Member whose activity causes it to have a Clearing

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[29] IDTA Letter at page 7.

[30] 17 CFR 240.17Ad-22(e)(4) and (e)(6).

Fund requirement that is greater than its excess regulatory capital.[31] The approval order provides FICC's rationale and the Commission's finding that the rule change is consistent with the requirements of the Exchange Act.[32]

In connection with the proposed changes, FICC recognizes that for a majority of Netting Members, the proposed VaR Charge calculation would be higher than the current VaR Charge calculation excluding the Margin Proxy and that the higher VaR Charge could result in a higher Excess Capital Premium for some Netting Members. However, FICC believes that this increase is appropriate for the exposure that the Excess Capital Premium is designed to mitigate.

FICC notes that even with the potential increase in the proposed VaR Charge, the majority of Netting Members would not incur the Excess Capital Premium. Additionally, FICC believes that the proposed change to Net Capital for the Excess Capital Premium would reduce the impact to Netting Members. For example, during the GSD External Parallel Test period, which covered December 18, 2017 to April 2, 2018, five Netting Members would have been subject to an Excess Capital Premium based on the proposed VaR Charge and the existing practice of using the Excess Net Capital, and during this period in total would have incurred 188 instances of an Excess Capital Premium in the RFD at end of day. However, the proposed change to utilize Net Capital would reduce the Excess Capital Premium from 188 to 159 instances during this period. As a result of the proposed change to utilize Net Capital (instead of the existing practice of using the Excess Net Capital) in the Excess Capital Premium calculation, the Netting Member with the largest number of instances would have had a 27% reduction in the number of instances of Excess Capital Premium and, on average, an 82% decrease in the dollar value of the charge on the days such Excess Capital Premium occurred.

FICC believes that the proposed change to the Excess Capital Premium would benefit a small set of Netting Members and potentially lower the Excess Capital Premium for Netting Members that exhibit fluctuations in their Excess Net Capital because the proposed change would be based on Net Capital that may be more predictable. FICC notes that GSD Rule 3, Section 14 gives FICC the discretion to apply, as it deems appropriate, potential discounting of haircuts as suggested by Amherst.[33]

As noted in the IDTA Letter, the narrative in the Rule Filing mistakenly describes Excess Capital Premium as the amount that a Netting Member's RFD exceeds its Excess Capital,[34] however, the correct description is stated earlier in the Rule Filing.[35]

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[31] See Exchange Act Release No. 54457 (September 15, 2006), 71 FR 55239 (September 21, 2006) (SR-FICC-2006-03)

[32] Id. at page 12

[33] Amherst Letter at page 4.

[34] IDTA Letter at page 8.

[35] See supra note 5, at 4689 ("GSD's Required Fund Deposit Calculation—Other Components").

VI. GSD Offsets – MBSD and the Chicago Mercantile Exchange

FICC notes that it operates under two Divisions – GSD and MBSD.[36] Each Division has its own rules and members. GSD provides trade comparison, netting, risk management, settlement and central counterparty services for the U.S. Government securities market, and MBSD provides the same services for the U.S. mortgage-backed securities market. As a registered clearing agency, FICC is subject to the requirements that are contained in the Exchange Act and in the Commission's regulations and rules thereunder. These requirements include Exchange Act Rule 17Ad-22 (the "Clearing Agency Standards"),[37] which was adopted by the Commission in 2012 in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, that became effective on January 1, 2013 and has recently been amended to provide enhanced standards for entities that meet the definition of covered clearing agency. In this regard, FICC must ensure that the GSD Rules and the MBSD Rules, individually, are consistent with the Exchange Act. Because FICC must comply with the Exchange Act for GSD and MBSD separately, FICC disagrees with Amherst's statement that FICC's failure to implement a cross-margining arrangement would be inconsistent with the requirements under Rule 17Ad-22(e)(6).[38]

FICC agrees that data sharing and cross-margining arrangements would be beneficial to its membership. As noted in the FICC Letter, FICC has and will continue to explore data sharing and cross-margining opportunities. FICC is in the process of completing a proposal that would enable a margin reduction for Netting Members with MBS positions that offset between GSD and MBSD. Upon the Commission's approval of the Rule Filing, FICC will begin to discuss the proposal with the Commission and FICC's membership. FICC will also continue to develop a framework with the Chicago Mercantile Exchange ("CME") that will enhance FICC's existing cross-margining arrangement with the CME. As the framework develops, FICC will engage the Commission and the Commodity and Futures Trade Commission.

As noted in the FICC Letter, the proposed changes to the GSD Clearing Fund methodology are necessary because they provide appropriate risk mitigation that must be in place *before* FICC can fully evaluate potential offsetting opportunities that may be available to Netting Members.[39]

VII. MBS Blackout Period Exposure Adjustment

FICC believes that the proposed BPEA is appropriate at the intraday collection cycle on the last business day of the month to mitigate exposure that begins on the first business day of the following month because it is consistent with the Exchange Act, which requires FICC "to establish, implement, maintain and enforce written policies and procedures reasonably designed to result in a margin system that, at a minimum, considers and produces margin levels commensurate with the

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[36] GSD was previously known as the Government Securities Clearing Corporation ("GSCC"), which was established in 1986. MBSD was previously known as the MBS Clearing Corporation ("MBSCC"), which was established in 1979. FICC resulted from a merger of GSCC and MBSCC on January 1, 2003.

[37] 17 CFR 240.17Ad-22.

[38] Amherst Letter at page 4.

[39] FICC Letter at page 4.

risks and particular attributes of each relevant product, portfolio, and market."[40] FICC believes that BPEA collections that occur after the MBS collateral pledge would not mitigate the risk that a Netting Member defaults after the collateral is pledged but before such Netting Member satisfies the next day's RFD. As a result, IDTA's proposed change to the timing of the BPEA would be inconsistent with FICC's requirements under the Exchange Act.[41]

FICC considered different approaches for determining the calculation of the BPEA. FICC's key considerations included the effectiveness of the RFD calculation – ensuring that FICC has sufficient backtesting coverage, and giving Netting Members transparency and the ability to plan for the BPEA requirements. MBS pay-down rates are influenced by several factors that can be projected at the loan level,[42] however, such projections would be dependent on several assumptions that may not be predictable and transparent to Netting Members. Thus, the proposed BPEA applies weighted averages of pay-down rates for all active mortgage pools of the related program during the three most recent preceding months, and FICC believes that this approach would allow Netting Members to effectively plan for the BPEA. FICC's analysis reveals that the actual portfolio pay-down is generally consistent with the BPEA's estimated portfolio pay-down.[43]

FICC respectfully disagrees with IDTA's suggestion that a probability of default approach would be more appropriate.[44] IDTA's suggestion would provide lower RFD coverage than the current approach as well as under the proposed changes, and such amounts as proposed by IDTA would not be sufficient to maintain the RFD coverage at a 99% confidence level. As a result, IDTA's proposal would be inconsistent with FICC's requirements under the Exchange Act.

FICC's proposal to both (1) collect BPEA from Netting Members that pledge MBS repo collateral and (2) credit the VaR Charge (in the form of a BPEA credit) to Netting Members secured by the MBS repo collateral, recognizes the change in the MBS collateral value during the Blackout Period. The BPEA is designed to cover the pay-down exposure that reduces the value of the MBS collateral pledged by Netting Members and would accrue to the benefit of Netting Members that accepted the MBS collateral during the Blackout Period. If FICC ceases-to-act for a Netting Member that pledged MBS collateral, the BPEA increase (to the RFD) would cover the MBS pay-down. Conversely, if FICC ceases to act for a Netting Member that accepted the MBS collateral, the BPEA credit would recognize that the MBS pay-down would increase the liquidation proceeds. Therefore, FICC believes that the proposed approach to collect and credit the BPEA would be consistent with the Exchange Act because the BPEA would cover FICC's

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40 17 CFR 240.17Ad-22(e)(6).

41 IDTA Letter at page 13.

42 These factors include the diversification of the underlying MBS pools, price appreciation, refinancing opportunities, loan size, loan age, etc.

43 FICC's model validation included a review of the proposed BPEA and actual pay-down results from 2013-2016. The results denote that the coefficient of determination (which measures the historical relationship between BPEA and observed MBS pay-downs and is statistically referred to as R^2) is 95%, which indicates that the BPEA is highly correlated with the actual MBS pay-downs.

44 IDTA Letter at page 13.

exposure to all Netting Members during the Blackout Period. Furthermore, the existence of potential RFD credits may encourage additional MBS repo lending.

FICC believes the proposed BPEA is necessary because it would help to ensure that FICC maintains a sufficient and robust RFD that covers FICC's current and future exposure to changes in MBS collateral from pay-down exposure from its Netting Members, at a 99% confidence level, which is consistent with Rule 17Ad-22(e)(4) under the Exchange Act.[45] FICC also believes that the proposed changes would help FICC calculate RFD amounts for each Netting Member that are commensurate with the risks and particular attributes of each relevant product, portfolio, and market as required by Rule 17Ad-22(e)(6) under the Exchange Act.[46] On the other hand, the current VaR Charge calculation and Blackout Period Exposure Charge may not be sufficient on a long term basis to cover potential market price and actual collateral value changes during the Blackout Period as required by Rules 17Ad-22(e)(4) and (e)(6) as cited above.

While FICC believes that the proposed VaR Charge calculation and BPEA are necessary and appropriate in furtherance of the Exchange Act, FICC would be willing to amend the implementation date of its proposal to (1) stagger the implementation of the BPEA through the end of 2018, and (2) eliminate the Blackout Period Exposure Charge at the end of 2018. FICC would be comfortable with this change because the proposed VaR Charge and the existing Blackout Period Exposure Charge would appropriately mitigate the potential MBS pay-down on a short term basis given FICC's assessment of MBS pay-down projections for this calendar year. During the staggered implementation period, FICC would further develop the GSD offset proposal with MBSD to facilitate margin reductions.

VIII. Adequacy of Record

The General Instructions for 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."[47] 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, an impact study that shows the portfolio level VaR Charge under the proposed methodology for the period January 3, 2013 through December 30, 2016, an impact study that shows the aggregate RFD amount by Netting Member for the period May 1, 2017 through November 30, 2017, the GSD Initial Margin Model, the FICC Letter, this letter and the letters submitted by the commenters.

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45 17 CFR 240.17Ad-22(e)(4).

46 17 CFR 240.17Ad-22(e)(6).

47 Form, available at https://www.sec.gov/files/form19b-4.pdf.

In addition, FICC believes that the Rule Filing is consistent with Section 17A(b)(3)(F)[48] of the Exchange Act and the rules and regulations promulgated thereunder, including Rules 17Ad-22(e)(4) and (e)(6),[49] as described in the Rule Filing. FICC believes that the Rule Filing provides a basis for the Commission to make a determination on the merits. FICC respectfully requests that the Commission approve the Rule Filing without delay because such approval would help to ensure that FICC is sufficiently covered by the RFD in the event of a Netting Member's default. 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 [redacted].

Very truly yours,

Timothy J. Cuddihy
Managing Director
Financial Risk Management

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48 15 U.S.C. 78q-1(b)(3)(F).

49 17 CFR 240.17Ad-22(e)(4) and (e)(6).