February 23, 2021

Vanessa Countryman
Secretary
Securities and Exchange Commission 100 F Street NE
Washington, DC 20549-1090

Re: Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Instituting Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change To Modify the Calculation of the MBSD VaR Floor To Incorporate a Minimum Margin Amount ("Order")

Dear Mrs. Countryman,

SIFMA[1] appreciates this additional opportunity to provide feedback on this important proposal[2] from the FICC that is the subject of the Order.[3]

The Order requests that *"that interested persons provide written submissions of their views, data, and arguments with respect to the issues identified [therein]".* The Order refers to the FICC's 2020 proposal to create a minimum margin amount, and for that our comments remain the same. We have included them as an annex to this letter. To summarize our view: we believe that the FICC's proposed approach could be disruptive to market participants and is not the appropriate way to fix issues that have arisen with the VaR model.

The Order requests comment on how the proposal conforms to various requirements of Section 17A of the Securities and Exchange Act of 1934. We have comments on three of the provisions referenced in the order:

> *"**Section 17A(b)(3)(I) of the Act**, which requires that the rules of a clearing agency do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act;"*

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[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).
[2] FICC's proposed rule is available here: https://www.federalregister.gov/documents/2020/12/10/2020-27087/self-regulatory-organizations-fixed-income-clearing-corporation-notice-of-filing-of-proposed-rule
[3] The Order is available here: https://www.sec.gov/rules/sro/ficc/2021/34-91092.pdf

We believe, for the reasons discussed in our letter found in the Appendix, that the proposed rule would indeed place a burden on competition not necessary or appropriate in furtherance of the purposes of the Act. This is because the proposal would result in unpredictable and long-lasting spikes in margin requirements, which we believe could be avoided were FICC to focus on remediating the problems that arose in the VaR model.

> *"**Rule 17Ad-22(e)(6)(i) and (v)** under the Act, which require a covered clearing agency 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 (1) considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market, and (2) uses an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products; and"*

As discussed in our letter in the Appendix, we believe the appropriate method for measuring credit exposure is through an amended VaR model, and not through the implementation of the proposed minimum margin amount charge.

> *"**Rule 17Ad-22(e)(23)(ii) under the Act**, which requires a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to provide sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the covered clearing agency."*

As discussed in our letter in the Appendix, we believe the proposed approach could result in sudden and persistent spikes in margin requirements. Furthermore, given the "greater of" construction between VaR and the MMA, participants would always need to be prepared to fund the MMA, even if it were not required on a particular day. We believe this would make it more difficult for participants to identify and evaluate material costs.

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Please do not hesitate to contact me if you have additional questions or comments.

Regards,

Christopher Killian
Managing Director
Securitization, Corporate Credit, and Libor

APPENDIX
SIFMA's January 29, 2020 Comment Letter

January 29, 2020

Vanessa Countryman
Secretary
Securities and Exchange Commission 100 F Street NE
Washington, DC 20549-1090

Re: File No. SR-FICC-2020-017; Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change to Modify the Calculation of the MBSD VaR Floor to Incorporate a Minimum Margin Amount

Dear Ms. Countryman,

SIFMA[4] appreciates the opportunity to respond to this rule proposal from the Fixed Income Clearing Corporation (FICC).[5] FICC plays a critical role in facilitating a liquid and robust agency mortgage-backed securities market, including the TBA market, which is a key component of the U.S. housing finance system, and a key driver of the economy. Importantly, the housing market has been one of the few bright spots over the last year, as many other components of the economy have suffered.

We also thank the SEC for extending the comment period to allow for a more in-depth discussion of this important proposal.

Central counterparties such as FICC need to collect appropriate margin from their members to ensure the robustness of the CCP as well as to protect their members from the risk and cost of the failure of another member. In the MBS market, we saw the value of this form of organization when Lehman Brothers failed. However, it is important that the levels of margin be calibrated appropriately – enough margin to protect the CCP and its members, but not too much so as to create a drag on the market it serves, and in this case the mortgage markets more broadly.

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[4] *SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA).*

[5] FICC's proposed rule is available here: https://www.federalregister.gov/documents/2020/12/10/2020-27087/self-regulatory-organizations-fixed-income-clearing-corporation-notice-of-filing-of-proposed-rule

The FICC is proposing to supplement its current VaR-based margin model with another component that would establish a minimum margin amount (MMA), and the margin due from a member would be the greater of those two calculations. FICC states that this is being done because *"FICC's VaR model did not respond effectively to the recent levels of market volatility and economic uncertainty, and the VaR Charge amounts that were calculated using the profit and loss scenarios generated by FICC's VaR model did not achieve a 99% confidence level for the period beginning in March 2020 through the beginning of April 2020."*[6]

Accordingly, FICC is proposing to increase margin requirements, at times, to ensure the CCP is appropriately protected. We do not object to increases in margin designed to protect the CCP and its members, but we do object to increases that are not calibrated appropriately.

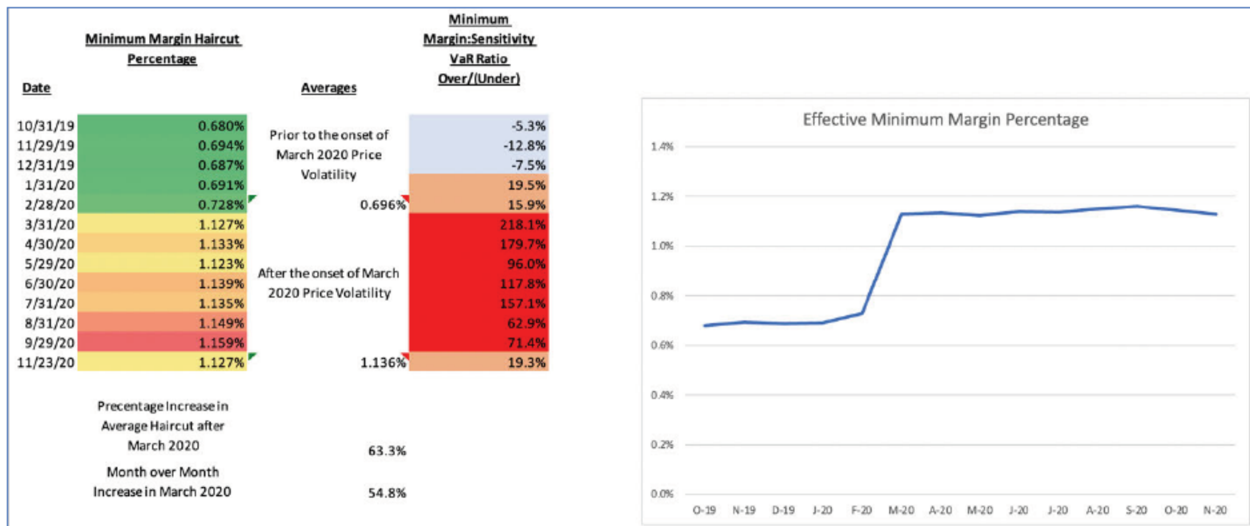
The VaR Model Should Be Fixed

We have a fundamental concern with this proposal: if FICC's sensitivity VaR model is not calculating margin requirements appropriately, we believe that FICC should seek to remedy specific components of that model so that it does. The alternative presented to the market here is to add on a blunter instrument to ensure margin remains at the appropriate confidence levels. We note that despite not achieving the 99% confidence and the market disruption that occurred, there were no failures or other events that created systemic issues. However, sudden, unpredictable spikes in margin requirements could create failures and lead to more systemic problems.

Based on some of our members' analysis of the impact studies provided by FICC (see Figure 1), the VaR calculation rarely yielded more conservative measures than the minimum margin method did. Furthermore, since the proposed VaR Floor is the greater of the two measures, the sensitivity VaR calculation may no longer be the driver of each member's VaR requirement.

[6] See Proposed Rule: https://www.federalregister.gov/d/2020-27087/p-24

Figure 1 *(source: SIFMA member firm)*



Date	Minimum Margin Haircut Percentage	Averages	Minimum Margin:Sensitivity VaR Ratio Over/(Under)
10/31/19	0.680%	Prior to the onset of March 2020 Price Volatility	-5.3%
11/29/19	0.694%		-12.8%
12/31/19	0.687%		-7.5%
1/31/20	0.691%		19.5%
2/28/20	0.728%	0.696%	15.9%
3/31/20	1.127%	After the onset of March 2020 Price Volatility	218.1%
4/30/20	1.133%		179.7%
5/29/20	1.123%		96.0%
6/30/20	1.139%		117.8%
7/31/20	1.135%		157.1%
8/31/20	1.149%		62.9%
9/29/20	1.159%		71.4%
11/23/20	1.127%	1.136%	19.3%
	Precentage Increase in Average Haircut after March 2020	63.3%	
	Month over Month Increase in March 2020	54.8%	

FICC has clarified that the entire sensitivity VaR amount will still be levied as part of each member's Required Funds Deposit and that the difference between the VaR Floor and the sensitivity VaR would be listed as the minimum margin charge when it is greater than zero. However, in practice, this means that the results from the sensitivity VaR model will rarely determine the total margin requirement of each member since the minimum margin calculation typically yields larger results. Minimum margin charges grew rapidly during a period of price volatility that began in March 2020 and dominated the sensitivity VaR for a long period of time thereafter.

We also note that the proposal seems to be based on a conclusion that the VaR model did not perform to its 99% parametrization. It has been argued that the COVID-related volatility and repricing was a 'once-a-generation' type of event. The unexpected, quick, and pervasive nature of the economic shock from global lockdowns, and the previously never-before-seen aggressiveness of central bank response implies that the realized volatility likely would be some of the largest historically. In layman terms, some argue that March moves were beyond a 99th percentile level of severity, and a VaR model calibrated to a 99th percentile should not have been expected to anticipate these moves, just as a levee built to contain a 100-year storm may fail during a 500-year storm.

While it may not have been the intention, the introduction of minimum margin renders the results of the sensitivity model irrelevant considering that members will not be able to anticipate when the minimum margin will again spike in response to market fluctuations. We do not believe this is the right approach, and in fact creates new risks for the members it seeks to protect.

MMA May Cause Sudden and Persistent Spikes in Margin Requirements

As shown in the graphic above, at certain times the minimum margin amount would have far exceeded the levels required by the VaR model, such as periods following significant price volatility. These increased levels appear to persist into time periods when volatility has subsided. This has created a concern that the CCP may be proposing to collect an excessive amount of margin, when looked at on the whole and over a longer time period. The initial lookback period FICC proposes to implement is two years, but according to their statement the period used to determine a deficit in the desired 99% coverage ratio is only one month.

In conversations since the rule was proposed, FICC indicated that the gap between the MMA and the VaR calculations became more aligned through the summer and fall of 2020. However, it is not the case that these conditions will remain the same going forward. For example, a change in Federal Reserve operations in the MBS market could cause price volatility which would lead to the MMA becoming binding at a significantly higher margin level. We also note that at the time of this writing our members have not received updated impact studies showing this closer alignment.

Importantly, under the new MMA approach there is a risk that isolated events of price volatility can quickly cause very significant increases in margin requirements. Our members are concerned that once the MMA exceeds the VaR calculation, because of the way the measure is constructed, margin requirements could suddenly jump 50% or more from the previous margin requirements. According to FICC's impact studies the average increase in the overall minimum margin in the wake of a relatively short bout of price volatility could be as high as 63%. Based on our members' review of available data, these spikes persist for at least 9 months and seem likely to last throughout the entire remaining lookback period, creating a situation where FICC may be over-margining. This means that FICC members would have to reserve funding capacity to deal with these spikes. This could cause inefficient capital allocation and at worst impair other lines of business at FICC member firms.

MMA May Challenge Economics of MBS Trading Businesses

As mentioned, given the opaque nature of the FICC clearing fund calculations, this spike will be unpredictable. This will make it difficult for FICC member firms to plan for the funding and liquidity of their businesses. The opacity is also present in the VaR model, but given the potential severity of the spikes here, it is more concerning. On the other hand, if the FICC were to better tune the existing VaR model to account for recent episodes of volatility, FICC members would likely be better able to understand what might cause increases in margin requirements, and how long they would last, given the history FICC member firms have with the VaR models. Furthermore, given the more sensitive nature of the VaR model, the margin requirements would likely be more closely tied to actual risk levels. This seems like the correct long-term solution to this problem.

Market Impacts Need to be Explored

We also believe that a more complete examination of the market impacts of this proposal should be undertaken. The rule filing does not discuss anticipated impacts on cost to do business for CCP members, which would be reflected in measures like bid/ask spreads. The rule filing also does not discuss how impacts of this rule proposal would potentially differ for larger firms vs. smaller firms. We note that many of our smaller to midsize broker dealer members have expressed concerns about this proposal. Furthermore, one of the main counterparties of these dealers are mortgage originators hedging their MBS pipelines who tend to have a more one-sided risk profile from the perspective of FICC (short), who would also share in any enhancement to the cost of doing business. Ultimately, the mortgage borrowers on the loans that collateralize the MBS delivered in a TBA trade bear the cost of these protective measures, so it is important to ensure they are calibrated appropriately.

Another issue our members have raised is the FICC's CCLF charges which are an additional funding requirement for FICC participants. While the margin charges and CCLF are not directly related, our members have inquired whether FICC intends to review and/or adjust CCLF charges in light of these changes.

The Rule Should Not Be Approved at this Time

Given all of this, we believe that more time should be taken to analyze this rule, and FICC should present (1) rationale for why the VaR model cannot be appropriately recalibrated, as this seems like a superior approach to what is proposed in this release, and (2) some analysis of the potential market impact of these rule changes. We do not believe the rule should be approved until this is completed.

Please contact me with any questions or for more information at [redacted] or [redacted].

Regards,

Christopher Killian
Managing Director
Securitization, Corporate Credit, and Libor