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June 24, 2024

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

Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Response to Comment Letters Filed with the Commission Regarding File No. SR-FICC-2024-003 – Exchange Act Release No. 99710 – as modified by Amendment No. 1 (the "Filing") by Fixed Income Clearing Corporation

Dear Ms. Countryman:

Fixed Income Clearing Corporation ("FICC")[1] appreciates the opportunity to respond to the comment letters submitted by the Independent Dealer and Trader Association ("IDTA") and SIFMA[2] (each, a "Commenter;" collectively, the "Commenters") to the Securities and Exchange Commission ("Commission")[3] relating to a proposal (the "Proposal") by FICC to amend the FICC GSD Rulebook ("GSD Rules")[4] set forth in the Filing to enhance the GSD VaR Floor by incorporating a Minimum Margin Amount ("MMA") and expand the application of the enhanced VaR Floor to the existing Margin Proxy.[5] FICC's comments to issues raised by the Commenters

[1] FICC is a clearing agency registered with the U.S. Securities and Exchange Commission ("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 ("Dodd-Frank") 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 Robert Toomey, Head of Capital Markets, Managing Director/Associate General Counsel, SIFMA, dated May 22, 2024 ("SIFMA Letter"). The SIFMA Letter includes comments relating to other FICC proposals; however, this letter will only address comments specifically relating to the Proposal.

[3] Comment letters are available at https://www.sec.gov/comments/sr-ficc-2024-003/srficc2024003.htm.

[4] Capitalized terms not defined herein are defined in the GSD Rules, available at https://www.dtcc.com/-/media/Files/Downloads/legal/rules/ficc_gov_rules.pdf.

[5] File No. SR-FICC-2024-003.

with respect to the Proposal are set forth below.[6] Where Commenters raised similar issues, they are addressed collectively. FICC also received comments specific to separate rule proposals SR-FICC-2024-005 and SR-FICC-2004-007 to which FICC will reply in the normal course.

I. BACKGROUND

As part of its market risk management strategy, FICC manages its credit exposure to Members by determining the appropriate Required Fund Deposit to the Clearing Fund and monitoring its sufficiency, as provided for in the GSD Rules. The aggregate amount of all Members' Required Fund Deposit constitutes the Clearing Fund. The Clearing Fund is designed to maintain an appropriate amount of financial resources from each Member to support FICC in the event that it needs to step in and complete settlement on their behalf. FICC requires that the Clearing Fund is sized to cover observed market price changes with a 99% confidence level.

The VaR Charge generally comprises the largest portion of a Member's Required Fund Deposit amount. The VaR Charge is calculated using a risk-based methodology that is intended to capture the market price risk associated with the securities in a Member's portfolio. The VaR methodology uses historical market moves to project the potential gains or losses that could occur in connection with the liquidation of a defaulting Member's portfolio.

FICC's VaR model is designed to provide a margin calculation that covers the market risk in a Member's portfolio. The VaR model calculates the risk profile of each Member's portfolio by applying certain representative risk factors to measure the degree of responsiveness of the portfolio's value to the changes of these risk factors over a historical lookback period of at least 10 years that may be supplemented with an additional stressed period.

FICC regularly assesses market and liquidity risks as such risks relate to its margin methodologies to evaluate whether margin levels are commensurate with the particular risk attributes of each relevant product, portfolio, and market. For example, FICC employs daily backtesting to determine the adequacy of each Member's Clearing Fund deposit. FICC compares the Required Fund Deposit[7] for each Member with the simulated liquidation gains/losses, using the actual positions in the Member's portfolio(s) and the actual historical security returns. A backtesting deficiency occurs when a Member's Required Fund Deposit would not have been adequate to cover the projected liquidation losses and highlights exposure that could subject FICC to potential losses in the event that a Member defaults. Similarly, FICC backtests its sensitivity

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[6] FICC also reviewed the letter from Robert Toomey, Head of Capital Markets, Managing Director/Associate General Counsel, SIFMA, and William C. Thum, Managing Director and Assistant General Counsel, SIFMA, dated April 1, 2024. FICC does not believe that such letter raises any new substantive issues specific to this Proposal which require a further response other than as included in this letter.

[7] Members may be required to post additional collateral to the Clearing Fund in addition to their Required Fund Deposit amount. See e.g., Section 7 of GSD Rule 3 (Ongoing Membership Requirements), supra note 1 (providing that adequate assurances of financial responsibility of a member may be required, such as increased Clearing Fund deposits). For backtesting comparisons, FICC uses the Required Fund Deposit amount, without regard to the actual, total collateral posted by the member to the GSD Clearing Fund.

VaR model daily to assess its model performance and the sufficiency of the VaR Charge for each Member.

As described in the Proposal, the VaR model has been shown to perform well in low to moderate volatility markets. From January 2013 to March 2020, the VaR model has generally performed above the 99% performance target, with deterioration in backtesting coverage only during the two stressful market periods, i.e., the COVID period during March of 2020 and the rising interest rate period that began in March of 2022. Specifically, the market events during these two stressful periods, including monetary policy changes, inflation and recession fears, have resulted in significant market volatility in the fixed income market that led to market price changes that exceeded the VaR model's projections, which yielded insufficient VaR Charges. As a result, FICC's VaR backtesting metrics fell below the performance target due to unprecedented levels of extreme market volatility. The continued uncertainty around economic data and fiscal policy outlook has highlighted the need for FICC to enhance its VaR model so that it can better respond to changes in market volatility.

FICC's GSD VaR margin calculation methodology did not respond effectively to the recent levels of market volatility and economic uncertainty, and FICC's VaR model did not backtest above the target 99% confidence level for the period beginning in July 2022 through August 2023. Pursuant to the Filing, FICC proposes to incorporate the MMA into the VaR Floor to enhance the GSD VaR model performance and improve the backtesting coverage during periods of heightened market volatility. FICC believes that the Proposal will increase the margin back-testing performance during periods of heightened market volatility by maintaining a VaR Charge that is appropriately calibrated to the observable market price volatility.

II. Concerns Stated by Commenters and FICC Response

Burden on Competition and Disproportionate Effect on Certain Members

One Commenter expressed concerns that the Proposal imposes an unnecessary burden on competition and may have a disproportionate effect on smaller FICC members.[8]

In the Filing, FICC addressed the concerns that Proposal would impose an unnecessary or inappropriate burden on competition. As noted in Item 4 of the Filing (Clearing Agency's Statement on the Burden on Competition), based on the impact studies conducted by FICC, Members on average would have had an increase in their start-of-day (SOD) VaR Charge and noon VaR Charge of approximately $22.43 million, or 17.56%, and $23.25 million, or 17.43%, respectively, if the Proposal had been in place during the impact study period and that the Proposal could impose a burden on competition.[9] In addition, the Filing makes it clear that Members may

[8] IDTA Letter p. 2 and p. 6.

[9] As stated in the Filing, the largest average percentage increase in SOD VaR Charge for any Member would have been approximately 66.88%, or $97,051, and the largest average percentage increase in noon VaR Charge for any Member would have been approximately 64.79%, or $61,613. The largest average dollar increase in SOD VaR Charge for any Member would have been approximately $268.51 million, or 19.06%,

be affected disproportionately by the Proposal because Members with lower operating margins or higher costs of capital than other Members are more likely to be impacted. As discussed in the Filing, FICC believes that any burden on competition is necessary and appropriate in compliance with Section 17A(b)(3)(I) of the Exchange Act.[10]

The methodology for computing the MMA under the Proposal does not take into consideration the Member's size or overall mix of business relative to other Members, and, therefore, does not discriminate against Members or affect them differently on either of those bases. Any effect the Proposal would have on a particular Member's margin requirement is solely a function of the market price risk posed to FICC by the Member's activity at FICC – firm size or business model is not pertinent to the assessment of that risk.

While the Required Fund Deposit is designed to determine the appropriate amount of financial resources from each Member, FICC membership standards are designed to limit the credit risks a Member may present to FICC and the other Members by ensuring, among other things, that Members have the financial and operational capabilities to meet the obligations of membership on an ongoing basis. GSD Rules 2A and 3 provide FICC with the ability to monitor Members' adherence to continued suitability for membership.

FICC is required to manage clearance and settlement risk presented by each Member with respect to the particular securities products it transacts through the system by, among other things, collecting margin sufficient to cover the market price risk with respect to those unsettled positions with a high degree of confidence. Separately, FICC is required to effectively identify, measure, monitor and manage its credit exposures through ongoing surveillance of its Members' financial strength and default risks. FICC's membership standards recognize the differences between members, including relative size, entity type or registration status.

Any increase in the Required Fund Deposit as a result of the Proposal for a particular Member would be in direct relation to the specific market risk presented by such Member's portfolio, and each Member's Required Fund Deposit would continue to be calculated with the same parameters and at the same confidence level. Therefore, Members with portfolios that present similar risks, regardless of the type of Member or business model, would have similar impacts on their Required Fund Deposit amounts.

As stated in the Filing, the Proposal is designed to more effectively measure and address risk characteristics in situations where the risk factors used in the VaR model do not adequately predict market price movements and associated credit risk exposure. The Proposal is intended to ensure that each Member has an appropriate VaR Charge in the event that the VaR model yields too low a VaR Charge for such portfolios. By identifying and providing for appropriate VaR Charges, adding the MMA to the VaR Floor would help to ensure that margin levels are commensurate with the risk exposure of each portfolio during periods of heightened market

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and the largest dollar increase in noon VaR Charge for any Member would have been approximately $289.00 million, or 13.67%.

[10] 15.U.S.C. 78q-1(b)(3)(I).

volatility and economic uncertainty. This is consistent with Rule 17ad-22(e)(6)(i) under the Exchange Act[11] which requires 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, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market.

Impact on the Market Liquidity and Procyclicality

Commenter expressed concerns that the Proposal may impact market liquidity and procyclicality.[12]

The Proposal is not intended to advantage or disadvantage capital formation in any particular market segment. The Proposal focuses entirely on managing the clearance and settlement risk associated with open positions in Members' portfolios as required by Section 17A of the Exchange Act. Members with portfolios that present similar risks would be similarly impacted, regardless of other characteristics of the Member.

FICC maintains the Required Fund Deposit to account for risk of open positions in Members' portfolios, but FICC only applies the cash or securities that make up the Required Fund Deposit if there is a default by a Member. Thus while FICC understands that the increased Required Fund Deposit that may result from the Proposal can lessen liquidity for a Member by requiring that certain additional amount of cash and securities be available to FICC in the form of the Required Fund Deposit, the additional amount of the cash and securities are sized to be necessary and appropriate to mitigate the risk exposure faced by FICC in the event of member default. Additionally, FICC requires that only a portion of the minimum Required Fund Deposit be made in cash.[13] The remaining portion of the Required Fund Deposit can be made by depositing Eligible Clearing Fund Securities.

One commenter expressed concerns that in the new MMA model, margin offsets across maturity buckets would be eliminated, thus resulting in gross margining across maturity buckets and decreasing liquidity.[14] This understanding of the Proposal is inaccurate. Under the Proposal, there would still be margin offsets across maturity buckets. Specifically, under the Proposal FICC would use a filtered historical simulation ("FHS") approach where the market risk in a long position in one bucket would be offset by the market risk in a short position in another bucket, same as FICC's existing VaR model.

Lastly, FICC had considered and evaluated a number of anti-procyclical measures during the Proposal development phase; however, based on the outlook for interest rate volatility, FICC

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[11] 17 CFR 240.17ad-22(e)(6)(i).

[12] IDTA Letter p. 5-6 and SIFMA Letter p. 6-7.

[13] The GSD Rules require that each Member maintain the lesser of $5,000,000 or 10% of the Required Fund Deposit, with a minimum of $1,000,000, must be maintained in cash. GSD Rule 4, Section 3.

[14] IDTA Letter p. 5.

determined to rely upon model parameters (e.g., decay factors) in lieu of specific anti-procyclical measures. Specifically, FICC would use the decay factor to control the responsiveness of the proposed MMA to market volatility.

Clarity, Adequacy and Accuracy of Impact Data

The Commenters argue that FICC has not provided Members with enough information to evaluate the impact of MMA. IDTA suggested that because of the "misleading period of time" and "misleading and inaccurate study," the effects from the increase in margin as a result of the Proposal are not fully understood.[15] SIFMA stated that more data/analysis of the Proposal is needed to better understand the cumulative effect of the Proposal, along with the other recent GSD margin changes, on liquidity risk.[16]

FICC has been actively engaging with our Members regarding the Proposal, both prior as well as subsequent to the submission of the Filing. FICC has conducted outreach to each Member in order to provide them with notice of the Proposal and the anticipated impact for the Members. Specifically, FICC conducted two member outreaches regarding the Proposal. The first member outreach was conducted from January to February 2024 whereby all Members were advised of the Proposal and highly impacted Members were advised of their specific individualized impact. The second member outreach was conducted in April 2024, whereby all Members were provided with individual impact data updated with enhanced data as well as an extended impact study period.[17] In April, FICC amended the proposal to provide revised impact study data after identifying a discrepancy with data used to calculate the charge for an asset type that makes up a very small proportion of clearing activity. The updated impact study numbers required minor numerical adjustments to the Proposal. The revised data was incorporate into the April outreach to Members.

The impact study period of July 1, 2021 to June 30, 2023 was specifically selected by FICC to demonstrate the effectiveness of the Proposal in both low and high volatile markets. As stated in the Filing, the overall backtesting coverage at FICC was 98.87% during the impact study period from July 2021 to June 2023. As the impact study period covers both low and high volatile markets, backtesting coverages are blended to represent such. In fact, GSD's rolling 12-month backtesting coverage fell below the 99% target in June 2022 and remained below 99% until June 2023, with the lowest being 98.33% in November 2022. However, as stated in the Filing, if the Proposal had been in place during the impact study period, the overall margin backtesting coverage would have been improved to 99.33% from 98.87% for the entirety of the impact study period. Thus, the Proposal is not designed to just increase the overall margin backtesting coverage by .13%, as claimed by one Commenter.[18] Rather, as a part of the overall risk management enhancement program that FICC undertook in response to challenges presented by the COVID

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[15] IDTA Letter p. 3 and p. 6.

[16] SIFMA Letter p. 5-6.

[17] FICC extended the impact study period end date from June 30, 2023 to December 31, 2023 when it generated the individualized client impact data in April 2024.

[18] IDTA Letter p. 2.

and the rising interest rate periods, the Proposal is specifically designed to enhance the GSD VaR model performance and improve the backtesting coverage during periods of extreme market volatility.

As part of the Filing, daily Member-level impact data was filed with the SEC confidentially to show the holistic impact[19] of the Proposal through different market volatility regimes. Individualized impact data was also distributed to the Members. FICC also conducted member outreach to explain the effects of the MMA. In addition, FICC provided tools and resources to assist Members to determine their Clearing Fund requirements and the impact of the Proposal. When creating individual impact study for the Members, FICC notes not only the average impact for the entire impact study period, but also the average impact on those days that the proposed MMA would have been applied for that specific Member. In the individualized impact study that FICC shared with each Member during member outreach, FICC also indicated maximum margin increases and the corresponding dates for the Member; however, due to confidentiality concerns, only the averages and maximum dollar and percentage changes were included in the Filing.

In addition to the Filing and member outreach, FICC provides other tools and resources to enable Members to determine their margin requirements and the impact of proposals. FICC maintains the Real Time Matching Report Center (RTTM), Clearing Fund Management (CFM)System, and FICC Customer Reporting (FIR) service which are client accessible websites for accessing risk reports and other risk disclosures. These websites enable a Member to view and download Clearing Fund requirement information and margin component details. The reporting enables a Member to view, for example, a portfolio breakdown by CUSIP, including the amounts attributable to the sensitivity based VaR model. In addition, Members are able to view and download spreadsheets that contain market amounts for current clearing positions, and the associated VaR Charge. These tools and resources would be updated to incorporate MMA upon the implementation thereof, subject to regulatory approval.

FICC also maintains the FICC Risk Client Portal which is a Member accessible website portal that provides Members the ability, for information purposes, to view and analyze certain risks relating to their portfolio, including daily customer reports and calculators to assess the risk and Clearing Fund impact of certain activities. FICC maintains the FICC Client Calculator available on the FICC Risk Client Portal that provides functionality to Members to enter 'what-if' position data and recalculate their VaR Charges to determine margin impact pre-trade execution. The FICC Client Calculator allows Members to see the impact to the VaR Charge if specific transactions are executed, or to anticipate the impact of an increase or decrease to a current clearing position. Enhancement to the FICC Client Calculator is underway to incorporate MMA and is currently expected to be available to Members in the test region prior to the implementation of MMA. Furthermore, FICC is currently developing a tool that would enable non-Member firms to assess potential VaR Charge (and proposed MMA upon the implementation thereof, subject to regulatory approval).

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[19] As stated in the Filing, the impact study data was generated based on the assumption that the $1 million minimum Required Fund Deposit and the Portfolio Differential Charge were both in effect for the entirety of the impact study period.

FICC believes that the GSD Rules, together with the member outreaches conducted by FICC, the Filing and the tools and resources available to Members provide sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in GSD in accordance with Rule 17ad-22(e)(23)(ii) under the Exchange Act.[20]

Special Charge and Other Margin Enhancements

The Commenters expressed concerns about the combined effect on Members' Required Fund Deposits from the Proposal and from the special charge and/or other recent changes to GSD margin requirements.[21]

As stated above, the impact results provided in the Filing includes the impact through different market volatility regimes and also was generated based on the assumption that the $1 million minimum Required Fund Deposit and the Portfolio Differential Charge were both in effect for the entirety of the impact study period to provide a holistic assessment of the Proposal.

The Proposal is designed to address the market risk inherent in each Member's portfolio and mitigate potential losses to FICC associated with liquidation of a Member's portfolio in the event of a Member default. Introducing the MMA would adjust the VaR Floor to help ensure that FICC collects adequate Required Fund Deposits from its Members to cover the market price risk of each Member's unsettled portfolio.

The special charge that is currently being assessed by FICC[22] is designed to supplement the Clearing Fund requirement for the two days prior to and on the day of five scheduled economic indicator release dates (i.e., Unemployment Rate, Consumer Price Index, Personal Consumption Expenditure Price Index, Announcement of Fed Funds Target, and Minutes of the FOMC) if one of the forward looking indicators (i.e., MOVE, Fed Funds Futures, and implied vs. realized volatility) were to signal potential heightened market volatility. While the method used to calculate price risk is different, this special charge was designed to complement the Proposal. Specifically, the current special charge is designed to cover the periods leading up to the market events that can impact the market, while the Proposal is specifically designed to respond to observed market volatility and supplement the VaR model following the observation of extreme market volatility. By applying the current special charge under certain circumstances in advance of and on the day of a specific event, FICC expects that the VaR model, in conjunction with the proposed MMA, would be able to respond to observed market volatility, obfuscating the need for additional special charges.

FICC has also recently implemented a number of margin enhancements at GSD, each of them is also designed to address a specific risk exposure. For example, in July 2023, GSD revised

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20 17 CFR 240.17ad-22(e)(23)(ii).

21 IDTA Letter p. 4-5 and SIFMA Letter p. 5-6.

22 See "Collection of Special Charge at Volatile Market Events" memo issued by FICC to GSD Members on April 12, 2024.

the stressed period used to calculate the VaR Charge in order to provide a better risk coverage on the short-end of the curve. In October 2023, GSD adopted a Portfolio Differential Charge ("PD Charge") in order to mitigate the risk presented to FICC by period-over-period fluctuations in a Member's portfolio. Each of these margin enhancements, along with the Proposal, is specifically designed to mitigate a different risk and limit FICC's exposures, both currently and in light of the anticipated volume increase in Treasury activities clearing through FICC.

In summary, FICC believes that the Proposal would increase the margin back-testing performance during periods of heightened market volatility by maintaining a VaR Charge that is appropriately calibrated to the observable market price volatility.

The General Instructions to 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."[23] FICC believes that the documents submitted in connection with the Filing are sufficiently clear and comprehensible for the Commission to order the approval of the Filing. The documents submitted include the Filing itself, the related advance notice, the narratives included with the Filing and the advance notice, this letter and the letters submitted by the commenters. This letter addresses a number of concerns raised by the commenters; however, to the degree commenters' concerns are not addressed above, FICC believes that the record contains adequate responses with regards to such concerns.

In addition, FICC believes that the Proposal is consistent with Section 17A(b)(3)(F) of the Exchange Act,[24] Rule 17ad-22(e)(4)(i) under the Exchange Act[25] and Rule 17ad-22(e)(6)(i) under the Exchange Act[26] as described in the Filing and as further described herein. FICC also believes that the Proposal is consistent with Rule 17ad-22(e)(23)(ii) under the Exchange Act[27] as described herein. While some of the commenters may disagree with the Proposal, FICC believes that the Filing is consistent with the Exchange Act and provides a basis for the Commission to make a determination on the merits.

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23 Form 19b-4.

24 15 U.S.C. 78q-1(b)(3)(F).

25 17 CFR 240.17ad-22(e)(4)(i).

26 17 CFR 240.17ad-22(e)(6)(i).

27 17 CFR 240.17ad-22(e)(23)(ii).

FICC appreciates the opportunity to respond to the comment letters.

Sincerely,

Timothy B. Hulse

Managing Director
Financial Risk, Governance & Credit Risk