SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–81054; File No. SR–FICC–2017–802]

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of No Objection to Advance Notice Filing To Implement the Capped Contingency Liquidity Facility in the Government Securities Division Rulebook

June 29, 2017.

Fixed Income Clearing Corporation (''FICC'') filed with the U.S. Securities and Exchange Commission (''Commission'') on March 1, 2017 the advance notice SR–FICC–2017–802 (''Advance Notice'') pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (''Clearing Supervision Act'') [1] and Rule 19b–4(n)(1)(i) under the Securities Exchange Act of 1934 (''Exchange Act'').[2] The Advance Notice was published for comment in the **Federal Register** on March 15, 2017.[3] The Commission received no comments to the Advance Notice, and it received four comment letters to the related Proposed Rule Change.[4] To the extent that comments to the Proposed Rule Change are relevant to the Advance Notice, they are discussed below.[5] This publication serves as notice of no objection to the Advance Notice.

I. Description of the Advance Notice

FICC's current liquidity resources for its Government Securities Division (''GSD'') [6] consist of (i) cash in GSD's clearing fund; (ii) cash that can be obtained by entering into uncommitted repo transactions using securities in the clearing fund; (iii) cash that can be obtained by entering into uncommitted repo transactions using the securities that were destined for delivery to the defaulting Netting Member; and (iv) uncommitted bank loans.[7] With this Advance Notice, FICC proposes to amend its GSD Rulebook (''GSD Rules'') [8] to establish a rules-based, committed liquidity resource (*i.e.,* the Capped Contingency Liquidity Facility® (''CCLF'')) as an additional liquidity resource designed to provide FICC with a committed liquidity resource to meet its cash settlement obligations in the event of a default of the GSD Netting Member or family of affiliated Netting Members (''Affiliated Family'') to which FICC has the largest exposure in extreme but plausible market conditions.[9]

A. Overview of the Proposal

CCLF would be invoked only if FICC declared a ''CCLF Event,'' which would occur only if FICC ceased to act for a Netting Member in accordance to GSD Rule 22A (referred to as a ''default'') and, subsequent to such default, FICC determined that its other, above-described liquidity resources could not generate sufficient cash to satisfy FICC's payment obligations to the non-defaulting Netting Members. Once FICC declares a CCLF Event, each Netting Member could be called upon to enter into repurchase transactions with FICC (''CCLF Transactions'') up to a pre-determined capped dollar amount, as described below.

1. Declaration of a CCLF Event

Following a default, FICC would first obtain liquidity through its other available non-CCLF liquidity resources. If FICC determined that these sources of liquidity would be insufficient to meet FICC's payment obligations to its non-defaulting Netting Members, FICC would declare a CCLF Event. FICC would notify all Netting Members of FICC's need to make such a declaration and enter into CCLF Transactions, as necessary, by issuing an Important Notice.

2. CCLF Transactions

Upon declaring a CCLF Event, FICC would meet its liquidity need by initiating CCLF Transactions with non-defaulting Netting Members. The original transaction that created FICC's initial obligation to pay cash to the now Direct Affected Member, and the Direct Affected Member's initial obligation to deliver securities to FICC, would be deemed satisfied by entry into the CCLF Transaction, and such settlement would be final.

Each CCLF Transaction would be governed by the terms of the September 1996 Securities Industry and Financial Markets Association Master Repurchase Agreement,[10] which would be

[1] 12 U.S.C. 5465(e)(1). The Financial Stability Oversight Council designated FICC a systemically important financial market utility on July 18, 2012. *See* Financial Stability Oversight Council 2012 Annual Report, Appendix A, *http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf.* Therefore, FICC is required to comply with the Payment, Clearing and Settlement Supervision Act and file advance notices with the Commission. *See* 12 U.S.C. 5465(e).

[2] 17 CFR 240.19b–4(n)(1)(i).

[3] Securities Exchange Act Release No. 80191 (March 9, 2017), 82 FR 13876 (March 15, 2017) (SR–FICC–2017–802) (''Notice''). FICC also filed a related proposed rule change (SR–FICC–2017–002) (''Proposed Rule Change'') with the Commission pursuant to Section 19(b)(1) of the Exchange Act and Rule 19b–4 thereunder, seeking approval of changes to its rules necessary to implement the Advance Notice. 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b–4, respectively. The Proposed Rule Change was published in the **Federal Register** on March 20, 2017. Securities Exchange Act Release No. 80234 (March 14, 2017), 82 FR 14401 (March 20, 2017) (SR–FICC–2017–002). On April 25, 2017, the Commission designated a longer period within which to approve the Proposed Rule Change, disapprove the Proposed Rule Change, or institute proceedings to determine whether to approve or disapprove the Proposed Rule Change. *See* Securities Exchange Act Release No. 80524 (April 25, 2017), 82 FR 20685 (May 3, 2017). On May 30, 2017, the Commission issued an order instituting proceedings to determine whether to approve or disapprove the Proposed Rule Change. *See* Securities Exchange Act Release No. 34–80812 (May 30, 2017), 82 FR 25642 (June 2, 2017) (SR–FICC–2017–002). The order instituting proceedings extended the Commission's period to review the Proposed Rule Change and re-opened the comment period until June 23, 2017.

[4] *See* letter from Robert E. Pooler Jr. Chief Financial Officer, Ronin Capital LLC (''Ronin''), dated April 10, 2017, to Robert W. Errett, Deputy Secretary, Commission (''Ronin Letter I''); letter from Alan B. Levy, Managing Director, Industrial and Commercial Bank of China Financial Services LLC (''ICBC''), Philip Vandermause, Director, Aardvark Securities LLC, David Rutter, Chief Executive Officer, LiquidityEdge LLC, Robert Pooler, Chief Financial Officer, Ronin Capital LLC, Jason Manumaleuna, Chief Financial Officer and EVP, Rosenthal Collins Group LLC, and Scott Skyrm, Managing Director, Wedbush Securities Inc. (''ICBC Letter''); letter from Timothy J. Cuddihy, Managing Director, FICC, dated March 8, 2017, to Robert W. Errett, Deputy Secretary, Commission (''FICC Letter''); and letter from Robert E. Pooler Jr., Chief Financial Officer, Ronin, dated June 19, 2017, to Robert W. Errett, Deputy Secretary, Commission (''Ronin Letter II''), *available at https://www.sec.gov/comments/sr-ficc-2017-002/ficc2017002.htm.*

[5] Because the proposal contained in the Advance Notice was also filed as the Proposed Rule Change, *see supra* note 3, the Commission is considering any comment received on the Proposed Rule Change also to be a comment on the Advance Notice.

[6] FICC operates two divisions—GSD and the Mortgage-Backed Securities Division (''MBSD''). GSD provides trade comparison, netting, risk management, settlement and central counterparty services for the U.S. government securities market, while MBSD provides the same services for the U.S. mortgage-backed securities market. Because GSD and MBSD are separate divisions of FICC, each division maintains its own rules, members, margin from their respective members, Clearing Fund, and liquid resources.

[7] *See* Notice, 82 at 13878.

[8] GSD Rules, *available at www.dtcc.com/legal/rules-and-procedures.aspx.*

[9] As defined in the GSD Rules, the term ''Netting Member'' means a GSD member that is a member of the GSD Comparison System and the Netting System. *Id.*

[10] The September 1996 Securities Industry and Financial Markets Association Master Repurchase Agreement (''SIFMA MRA'') is *available at http://www.sifma.org/services/standard-forms-and-documentation/mra,-gmra,-msla-and-msftas/.* The SIFMA MRA would be incorporated by reference into the GSD Rules without referenced annexes, other than Annex VII (Transactions Involving Registered Investment Companies) which would be applicable to any Netting Member that is a registered investment company. FICC represents that, at the time of filing the Advance Notice, there

incorporated by reference into the GSD Rules as a master repurchase agreement between FICC as seller and each Netting Member as buyer, with certain modifications as outlined in the GSD Rules (''CCLF MRA'').

To initiate CCLF Transactions with non-defaulting Netting Members, FICC would identify the non-defaulting Netting Members that are obligated to deliver securities destined for the defaulting Netting Member (''Direct Affected Members'') and FICC's cash payment obligation to such Direct Affected Members that FICC would need to finance through CCLF to cover the defaulting Netting Member's failure to deliver the cash payment (the ''Financing Amount''). FICC would notify each Direct Affected Member of the Direct Affected Member's Financing Amount and whether such Direct Affected Member should deliver to FICC or suppress any securities that were destined for the defaulting Netting Member. FICC would then initiate CCLF Transactions with each Direct Affected Member for the Direct Affected Member's purchase of the securities (''Financed Securities'') that were destined for the defaulting Netting Member.[11] The aggregate purchase price of the CCLF Transactions with the Direct Affected Member could equal but never exceed the Direct Affected Member's maximum funding obligation (''Individual Total Amount'').[12]

If any Direct Affected Member's Financing Amount exceeds its Individual Total Amount (''Remaining Financing Amount''), FICC would advise the following categories of Netting Members (collectively, ''Affected members'') that FICC intends to initiate CCLF Transactions with them for the Remaining Financing Amount: (i) All other Direct Affected Members with a Financing Amount less than its Individual Total Amount; and (ii) each Netting Member that has not otherwise entered into CCLF Transactions with FICC (''Indirect Affected Members'').

FICC states that the order in which FICC would enter into CCLF Transactions for the Remaining Financing Amount would be based upon the Affected Members that have the most funding available within their Individual Total Amounts.[13] No Affected Member would be obligated to enter into CCLF Transactions greater than its Individual Total Amount.

After receiving approval from FICC's Board of Directors to do so, FICC would engage its investment advisor during a CCLF Event to minimize liquidation losses on the Financed Securities through hedging, strategic dispositions, or other investment transactions as determined by FICC under relevant market conditions. Once FICC liquidates the underlying securities by selling them to a new buyer (''Liquidating Trade''), FICC would instruct the Affected Member to close the CCLF Transaction by delivering the Financed Securities to FICC in order to complete settlement of the Liquidating Trade. FICC would attempt to unwind the CCLF Transactions in the order it entered into the Liquidating Trades. Each CCLF Transaction would remain open until the earlier of (i) such time that FICC liquidates the Affected Member's Financed Securities; (ii) such time that FICC obtains liquidity through its available liquid resources; or (iii) 30 or 60 calendar days after entry into the CCLF Transaction for U.S. government bonds and mortgage-backed securities, respectively.

B. CCLF Sizing and Allocation

According to FICC, its overall liquidity need during a CCLF Event would be determined by the cash settlement obligations presented by the default of a Netting Member and its Affiliated Family, as described below. An additional amount (''Liquidity Buffer'') would be added to account for both changes in Netting Members' cash settlement obligations that may not be observed during the six-month look-back period during which CCLF would be sized, and the possibility that the defaulting Netting Member is the largest CCLF contributor. FICC believes that its proposal would allocate FICC's observed liquidity need during a CCLF Event among all Netting Members based on their historical settlement activity, but states that Netting Members that present the highest cash settlement obligations would be required to maintain higher CCLF funding obligations.[14]

The steps that FICC would take to size its overall liquidity need during a CCLF event and then size and allocate each Netting Member's CCLF contribution requirement are described below.

Step 1: CCLF Sizing

(A) Historical Cover 1 Liquidity Requirement

FICC's historical liquidity need for the six-month look-back period would be equal to the largest liquidity need generated by an Affiliated Family during the preceding six-month period. The amount would be determined by calculating the largest sum of an Affiliated Family's obligation to receive GSD eligible securities plus the net dollar amount of its Funds-Only Settlement Amount[15] (collectively, the ''Historical Cover 1 Liquidity Requirement''). FICC believes that it is appropriate to calculate the Historical Cover 1 Liquidity Requirement in this manner because the default of such an Affiliated Family would generate the largest liquidity need for FICC.[16]

(B) Liquidity Buffer

According to FICC, it is cognizant that the Historical Cover 1 Liquidity Requirement would not account for changes in a Netting Member's current trading behavior, which could result in a liquidity need greater than the Historical Cover 1 Liquidity Requirement. To account for this potential shortfall, FICC proposes to add a Liquidity Buffer as an additional amount to the Historical Cover 1 Liquidity Requirement, which would help to better anticipate GSD's total liquidity need during a CCLF Event.

FICC states that the Liquidity Buffer would initially be 20 percent of the Historical Cover 1 Liquidity Requirement (and between 20 to 30 percent thereafter), subject to a minimum amount of $15 billion.[17] FICC believes that 20 to 30 percent of the Historical Cover 1 Liquidity Requirement is appropriate based on its analysis and statistical measurement of the variance of its daily liquidity need

were no registered investment companies that are also GSD Netting Members.

[11] FICC states that it would have the authority to initiate CCLF Transactions with respect to any securities that are in the Direct Affected Member's portfolio which are bound to the defaulting Netting Member.

[12] The sizing of each Direct Affected Member's Individual Total Amount is described below in Section I.B.

[13] *See* Notice, 82 at 13878.

[14] *Id.* at 13878–79.

[15] According to FICC, the Funds-Only Settlement Amount reflects the amount that FICC collects and passes to the contra-side once FICC marks the securities in a Netting Member's portfolio to the current market value. FICC states that this amount is the difference between the contract value and the current market value of a Netting Member's GSD portfolio. FICC states that it would consider this amount when calculating the Historical Cover 1 Liquidity Requirement because in the event that an Affiliated Family defaults, the Funds-Only Settlement Amount would also reflect the cash obligation to non-defaulting Netting Members. *See* Notice, 82 at 13879.

[16] *Id.*

[17] *See* Notice, 82 at 13879. For example, if the Historical Cover 1 Liquidity Requirement was $100 billion, the Liquidity Buffer initially would be $20 billion ($100 billion × 0.20), for a total of $120 billion in potential liquidity resources.

throughout 2015 and 2016.[18] FICC also believes that the $15 billion minimum dollar amount is necessary to cover changes in a Netting Member's trading activity that could exceed the amount that is implied by such statistical measurement.[19]

FICC would have the discretion to adjust the Liquidity Buffer, within the range of 20 to 30 percent of the Historical Cover 1 Liquidity Requirement, based on its analysis of the stability of the Historical Cover 1 Liquidity Requirement over various time horizons. According to FICC, this would help ensure that its liquidity resources are sufficient under a wide range of potential market scenarios that may lead to a change in a Netting Member's trading behavior. FICC also states that it would analyze the trading behavior of Netting Members that present larger liquidity needs than the majority of the Netting Members, as described below.[20]

(C) Aggregate Total Amount

FICC's anticipated total liquidity need during a CCLF Event (*i.e.,* the sum of the Historical Cover 1 Liquidity Requirement plus the Liquidity Buffer) would be referred to as the ''Aggregate Total Amount.'' The Aggregate Total Amount initially would be set to the Historical Cover 1 Liquidity Requirement plus the greater of 20 percent of the Historical Cover 1 Liquidity Requirement or $15 billion.

Step 2: Allocation of the Aggregate Total Amount Among Netting Members

(A) Allocation of the Aggregate Regular Amount Among Netting Members

The Aggregate Total Amount would be allocated among Netting Members in order to arrive at each Netting Member's Individual Total Amount. FICC would take a tiered approach in its allocation of the Aggregate Total Amount. First, FICC would determine the portion of the Aggregate Total Amount that should be allocated among all Netting Members (''Aggregate Regular Amount''), which FICC states initially would be set at $15 billion.[21] FICC believes that this amount is appropriate because the average Netting Member's liquidity need from 2015 to 2016 was approximately $7 billion, with a majority of Netting Members having liquidity needs less than $15 billion.[22] Based on that analysis, FICC believes that the $15 billion Aggregate Regular Amount should capture the liquidity needs of a majority of the Netting Members.[23]

Second, as discussed in more detail below, after allocating the $15 billion Aggregate Regular Amount, FICC would allocate the remainder of the Aggregate Total Amount (''Aggregate Supplemental Amount'') among Netting Members that incurred liquidity needs above the Aggregate Regular Amount within the six-month look-back period. For example, a Netting Member with a $7 billion peak daily liquidity need would only contribute to the $15 billion Aggregate Regular Amount, based on the calculation described below. Meanwhile, a Netting Member with a $45 billion Aggregate Regular Amount would contribute towards the $15 billion Aggregate Regular Amount *and* the Aggregate Supplemental Amount, as described below. FICC believes that this tiered approach reflects a reasonable, fair, and transparent balance between FICC's need for sufficient liquidity resources and the burdens of the funding obligations on each Netting Member's management of its own liquidity.[24]

Under the proposal, the Aggregate Regular Amount would be allocated among all Netting Members, but Netting Members with larger Receive Obligations[25] would be required to contribute a larger amount. FICC believes that this approach is appropriate because a defaulting Netting Member's Receive Obligations are the primary cash settlement obligations that FICC would have to satisfy as a result of the default of an Affiliated Family. However, FICC also believes that, because FICC guarantees both sides of a GSD Transaction and all Netting Members benefit from FICC's risk mitigation practices, some portion of the Aggregate Regular Amount should be allocated based on Netting Members' aggregate Deliver Obligations[26] as well.[27] As a result, FICC proposes to allocate the Aggregate Regular Amount based on a scaling factor. Given that the Aggregate Regular Amount would be initially sized at $15 billion and would cover approximately 80 percent of Netting Members' observed liquidity needs, FICC proposes to set the scaling factor in the range of 65 to 85 percent to the value of Netting Members' Receive Obligations, and in the range of 15 to 35 percent to the value of Netting Members' Deliver Obligations.[28]

FICC states that it would initially assign a 20 percent weighting percentage to a Netting Member's aggregate peak Deliver Obligations (''Deliver Scaling Factor'') and the remaining percentage difference, 80 percent in this case, to a Netting Member's aggregate peak Receive Obligations (''Receive Scaling Factor'').[29] FICC would have the discretion to adjust these scaling factors based on a quarterly analysis that would, in part, assess Netting Members' observed liquidity needs that are at or below $15 billion. FICC believes that this assessment would help ensure that the Aggregate Regular Amount would be appropriately allocated across all Netting Members.[30]

(B) FICC's Allocation of the Aggregate Supplemental Amount Among Netting Members

The remainder of the Aggregate Total Amount (*i.e.,* the Aggregate Supplemental Amount) would be allocated among Netting Members that

[18] According to FICC, it uses a statistical measurement called the ''coefficient of variation,'' which is calculated as the standard deviation divided by the mean, to quantify the variance of Affiliated Families' daily liquidity needs. *Id.* FICC states that this is a typical approach used to compare variability across different data sets. FICC states that it will use the coefficient of variation to set the Liquidity Buffer by quantifying the variance of each Affiliated Family's daily liquidity need. *Id.* FICC believes that a Liquidity Buffer of 20 to 30 percent, subject to a minimum of $15 billion, would be an appropriate Liquidity Buffer because FICC found that, throughout 2015 and 2016, the coefficient of variation ranged from an average of 15 to 19 percent for Affiliated Families with liquidity needs above $50 billion, and an average of 18 to 21 percent for Affiliated Families with liquidity needs above $35 billion. *Id.*

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] According to FICC, from 2015 to 2016, 59 percent of all Netting Members presented average liquidity needs between $0 to $5 billion, 78 percent of all Netting Members presented average liquidity needs between $0 and $10 billion, and 85 percent of all Netting Members presented average liquidity needs between $0 and $15 billion. *Id.*

[23] *Id.*

[24] *Id.*

[25] ''Receive Obligation'' means a Netting Member's obligation to receive eligible netting securities from FICC at the appropriate settlement value, either in satisfaction of all or a part of a Net Long Position, or to implement a collateral substitution in connection with a Repo Transaction with a right of substitution. GSD Rules, *supra* note 8.

[26] ''Deliver Obligation'' means a Netting Member's obligation to deliver eligible netting securities to FICC at the appropriate settlement value either in satisfaction of all or a part of a Net Short Position or to implement a collateral substitution in connection with a Repo Transaction with a right of substitution. GSD Rules, *supra* note 8.

[27] *See* Notice, 82 at 13880.

[28] *Id.*

[29] For example, assume that a Netting Member's peak Receive and Deliver Obligations represent 5 and 3 percent, respectively, of the sum of all Netting Members' peak Receive and Deliver Obligations. The Netting Member's portion of the Aggregate Regular Amount (''Individual Regular Amount'') would be $600 million ($15 billion * 0.80 Receive Scaling Factor * 0.05 Peak Receive Obligation Percentage), plus $90 million ($15 billion * 0.20 Deliver Scaling Factor * 0.03 Peak Deliver Obligation Percentage), for a total of $690 million.

[30] *See* Notice, 82 at 13882.

present liquidity needs greater than $15 billion using Liquidity Tiers. As described in greater detail in the Notice, the specific allocation of the Aggregate Supplemental Amount to each Liquidity Tier would be based on the frequency that Netting Members generated liquidity needs within each Liquidity Tier, relative to the other Liquidity Tiers.[31] More specifically, once the Aggregate Supplemental Amount is divided among the Liquidity Tiers, the amount within each Liquidity Tier would be allocated among the applicable Netting Members, based on the relative frequency that a Netting Member generated liquidity needs within each Liquidity Tier.[32] FICC explains that this allocation would result in a larger proportion of the Aggregate Supplemental Amount being borne by those Netting Members who present the highest liquidity needs.[33]

The sum of a Netting Member's allocation across all Liquidity Tiers would be such Netting Member's Individual Supplemental Amount. FICC would add each Netting Member's Individual Supplemental Amount (if any) to its Individual Regular Amount to arrive at such Netting Member's Individual Total Amount.

C. FICC's Ongoing Assessment of the Sufficiency of CCLF

As described above, the Aggregate Total Amount and each Netting Member's Individual Total Amount (*i.e.,* each Netting Member's allocation of the Aggregate Total Amount) would initially be calculated using a six-month look-back period that FICC would reset every six months (''reset period''). FICC states that, on a quarterly basis, FICC would assess the following parameters used to calculate the Aggregate Total Amount (and could consider changes to such parameters if necessary and appropriate):

- The largest peak daily liquidity of an Affiliated Family;
- the Liquidity Buffer;
- the Aggregate Regular Amount;
- the Aggregate Supplemental Amount;
- the Deliver Scaling Factor and the Receive Scaling Factor used to allocate the Aggregate Regular Amount;
- the increments for the Liquidity Tiers; and
- the length of the look-back period and the reset period for the Aggregate Total Amount.[34]

FICC represents that, in the event that any changes to the above-referenced parameters result in an increase in a Netting Member's Individual Total Amount, such increase would be effective as of the next bi-annual reset.[35]

Additionally, on a daily basis, FICC would examine the Aggregate Total Amount to ensure that it is sufficient to satisfy FICC's liquidity needs. If FICC determines that the Aggregate Total Amount is insufficient to satisfy its liquidity needs, FICC would have the discretion to change the length of the six-month look-back period, the reset period, or otherwise increase the Aggregate Total Amount.

Any increase in the Aggregate Total Amount resulting from FICC's quarterly assessments or FICC's daily monitoring would be subject to approval from FICC management, as described in the Notice.[36] Increases to a Netting Member's Individual Total Amount as a result of its daily monitoring would not be effective until ten business days after FICC issues an Important Notice regarding the increase. Reductions to the Aggregate Total Amount would be reflected at the conclusion of the reset period.

D. Implementation of the Proposed Changes and Required Attestation From Each Netting Member

The CCLF proposal would become operative 12 months after the later date of the Commission's no objection of this Advance Notice and its approval of the related Proposed Rule Change. FICC represents that, during this 12-month period, it would periodically provide each Netting Member with estimated Individual Total Amounts. FICC states that the delayed implementation and the estimated Individual Total Amounts are designed to give Netting Members the opportunity to assess the impact that the CCLF proposal would have on their business profile.[37]

FICC states that, as of the implementation date and annually thereafter, FICC would require that each Netting Member attest that it incorporated its Individual Total Amount into its liquidity plans.[38] This required attestation, which would be from an authorized officer of the Netting Member or otherwise in form and substance satisfactory to FICC, would certify that (i) such officer has read and understands the GSD Rules, including the CCLF rules; (ii) the Netting Member's Individual Total Amount has been incorporated into the Netting Member's liquidity planning;[39] (iii) the Netting Member acknowledges and agrees that its Individual Total Amount may be changed at the conclusion of any reset period or otherwise upon ten business days' Notice; (iv) the Netting Member will incorporate any changes to its Individual Total Amount into its liquidity planning; and (v) the Netting Member will continually reassess its liquidity plans and related operational plans, including in the event of any changes to such Netting Member's Individual Total Amount, to ensure such Netting Member's ability to meet its Individual Total Amount. FICC states that it may require any Netting Member to provide FICC with a new certification in the foregoing form at any time, including upon a change to a Netting Member's Individual Total Amount or in the event that a Netting Member undergoes a change in its corporate structure.[40]

On a quarterly basis, FICC would conduct due diligence to assess each Netting Member's ability to meet its Individual Total Amount. This due diligence would include a review of all information that the Netting Member has provided FICC in connection with its ongoing reporting obligations pursuant to the GSD Rules and a review of other publicly available information. FICC also would test its operational procedures for invoking a CCLF Event, and Netting Members would be required to participate in such tests. If a Netting Member failed to participate in such testing when required by FICC, FICC would be permitted to take disciplinary measures as set forth in GSD Rule 3, Section 7.[41]

E. Liquidity Funding Reports Provided to Netting Members

On each business day, FICC would make a liquidity funding report available to each Netting Member that would include (i) the Netting Member's Individual Total Amount, Individual Regular Amount and, if applicable, its Individual Supplemental Amount; (ii)

[31] *See* Notice, 82 at 13880–81.

[32] For example, if the Aggregate Supplemental Amount is $50 billion and Tier 1 has a relative frequency weighting of 33 percent, all Netting Members that have generated liquidity needs that fall within Tier 1 would collectively fund $16.5 billion ($50 billion * 0.33) of the Supplemental Amount. Each Netting Member in that tier would be responsible for contributing toward the $16.5 billion, based on the relative frequency that the member generated liquidity needs within that tier.

[33] *See* Notice, 82 at 13882.

[34] *See* Notice, 82 at 13881.

[35] *See* Notice, 82 at 13881–82.

[36] *Id.* at 13882.

[37] *See* Notice, 82 at 13883.

[38] *See* Notice, 82 at 13882.

[39] According to FICC, the attestation would not refer to the actual dollar amount that has been allocated as the Individual Total Amount. FICC explains that each Netting Member's Individual Total Amount would be made available to such Member via GSD's access controlled portal Web site. *Id.*

[40] *Id.*

[41] GSD Rules, *supra* note 8.

FICC's Aggregate Total Amount, Aggregate Regular Amount and Aggregate Supplemental Amount; and (iii) FICC's regulatory liquidity requirements as of the prior business day. The liquidity funding report would be provided for informational purposes only.

II. Summary of Comments Received

The Commission received four comment letters in response to the proposal. Three comment letters—Ronin Letters I and II and the ICBC Letter—objected to the proposal.[42] One comment letter from FICC responded to the objections raised by Ronin.[43]

A. Objecting Comments

In both of its comment letters, Ronin argues that the cost of complying with the CCLF could impose a disproportionately negative economic impact on smaller Netting Members, which could potentially force smaller Netting Members to clear through larger Netting Members or leave GSD (as well as create a barrier to entry for prospective new Netting Members).[44] Ronin argues that a reduced Netting Member population resulting from these increased costs could, in turn, lead to larger problems, such as: (1) Increasing the size of FICC's exposure to those Netting Members that generate the largest liquidity needs for FICC (because some of the departed Netting Members could become customers of, and clear their transactions through, such remaining Netting Members); (2) increasing Netting Member concentration risk at FICC due to the reduced overall population of Netting Members following the implementation of the CCLF; and (3) increasing systemic risk because of the increased exposure and concentration risks described above.[45]

Similarly, Ronin and the ICBC Letter argue that the proposal would result in harmful consequences to smaller Netting Members and other industry participants.[46] Specifically, the ICBC Letter argues that the Proposal could force smaller Netting Members to exit the clearing business or terminate their membership with FICC due to the cost of CCLF funding obligations, thereby: (1) Increasing market concentration; (2) increasing FICC's credit exposure to its largest participant families; and (3) driving smaller Netting Members to clear transactions bilaterally instead of through a central counterparty.[47]

Although Ronin and the ICBC Letter acknowledges that FICC, as a registered clearing agency, is required to maintain sufficient financial resources to withstand a default by the largest participant family to which FICC has exposure in ''extreme but plausible conditions,'' [48] Ronin and the ICBC letter argue that the scenario that CCLF is designed to address is not ''plausible'' because U.S. government securities are riskless assets that would not suffer from a liquidity shortage, even amidst a financial crisis similar to that in 2008.[49] Moreover, the ICBC Letter argues that the CCLF is unnecessary because FICC's current risk models are ''time proven.'' [50] Finally, Ronin argues that if FICC were truly interested in mitigating liquidity risk, a hard cap could be placed on the maximum liquidity exposure allowable for each Netting Member.[51]

Ronin and the ICBC Letter also raise potential systemic risk concerns by stating that the CCLF could: (1) Cause FICC members to reduce their balance sheets devoted to the U.S. government securities markets, which would have broad negative effects on markets and taxpayers; [52] (2) negatively impact traders with hedged positions, potentially resulting in inefficient pricing and an increased likelihood of disruptions in the U.S. government securities markets.[53] The ICBC Letter raises additional systemic risk concerns, stating that CCLF could: (1) Result in FICC's refusal to clear certain trades, thereby increasing the burden on the Bank of New York (''BONY''), the only private bank that clears a large portion of U.S. government securities; [54] and (2) effectively drain liquidity from other markets by requiring more liquidity to be available to FICC than is necessary.[55]

B. Supporting Comment

The FICC Letter written in support of the proposal primarily responds to Ronin's assertions. In response to Ronin's concerns regarding the potential economic impacts on smaller non-bank Netting Members, FICC states that the CCLF was designed to minimize the burden on smaller Netting Members and achieve a fair and appropriate allocation of liquidity burdens.[56] Specifically, FICC notes that it structured the CCLF so that: (1) Each Netting Member's CCLF requirement would be a function of the peak liquidity risk that each Netting Member's activity presents to GSD; (2) the allocation of the CCLF requirement to each Netting Member would be a

[42] *See* Ronin Letter I, Ronin Letter II, and ICBC Letter.

[43] *See* FICC Letter. The Ronin Letter II and the ICBC Letter (with Ronin as a co-signatory) raised the same substantive issues as the Ronin Letter I. Accordingly, the Commission considers the FICC Letter to be responsive to the Ronin Letters I and II and the ICBC Letter.

[44] Ronin Letter I at 2; Ronin Letter II at 1–5. For example, Ronin notes that it would have to pay for access to a committed line of credit each year to have sufficient resources to attest that it can meet its CCLF contribution requirement. Ronin Letter I at 5; Ronin Letter II at 3. Ronin asserts that obtaining such a line of credit is not only ''economically disadvantageous'' but also ''creates a dependency on an external entity which could prove to be an existential threat'' (*i.e.,* the inability of non-bank Netting Members to secure a committed line of credit at a reasonable rate could cause such members to exit FICC). Ronin Letter II at 3 . In contrast, Ronin suggests that larger Netting Members with access to the Federal Reserve Discount Window (and resulting ability to easily borrow funds using U.S. government debt as collateral) would not necessarily have to pay for such credit lines and could merely inform FICC that they are ''good for [the CCLF contribution requirement].'' Ronin Letter I at 5. Ronin argues that FICC has ''failed to recognize this differential impact as a threat to GSD member diversity.'' Ronin Letter II at 3.

[45] Ronin Letter I at 1–9; Ronin Letter II at 1–5. Ronin also argues that the Proposed Rule Change would place an unfair and anticompetitive burden on smaller Netting Members and such members do not present any settlement risk to FICC. Ronin Letter I at 2, 5–7; Ronin Letter II at 1–5. Regarding burden, Ronin argues that the cost of obtaining the resources necessary to meet FICC's CCLF contribution requirements could force some smaller non-bank Netting Members to leave GSD or reduce the amount of U.S. Treasury securities transactions they clear through FICC. Ronin Letter I at 2, 5–7; Ronin Letter II at 3–4. Moreover, Ronin suggests that the proposal is unfair because the default of a smaller Netting Member (whose liquidity needs are covered by the liquidity available to FICC in the GSD clearing fund) would not present settlement risk to FICC. Specifically, Ronin notes that, for the period of March 31, 2016 to March 31, 2017, the peak liquidity need of 53 of the 103 GSD Netting Members did not exceed the amount of cash in the GSD clearing fund. Ronin Letter II at 3. In addition, Ronin argues that the CCLF would impose an unfair burden by forcing smaller Netting Members to subsidize the ''outsized liquidity risks'' posed by the largest Netting Members. Ronin Letter I at 2; Ronin Letter II at 2–3.

These issues are relevant to the Commission's review and evaluation of the Proposed Rule Change, which is conducted under the Exchange Act, but not to the Commission's evaluation of the Advance Notice, which, as discussed below in Section III, is conducted under the Clearing Supervision Act and generally considers whether the proposal will mitigate systemic risk and promote financial stability. Accordingly, these concerns will be addressed in the Commission's review of the related Proposed Rule Change, as applicable, under the Exchange Act.

[46] Ronin Letter II at 4–5; ICBC Letter at 2–7.

[47] Ronin Letter II at 4–5; ICBC Letter at 2–6. Like Ronin, the ICBC Letter also argues that increased costs to Netting Members from the CCLF could inhibit competition by forcing smaller Netting Members to exit the clearing business or terminate their membership with FICC. ICBC Letter at 2–4. As discussed above, *see supra* note 19, this concern will be addressed in the Commission's review of the related Proposed Rule Change, as applicable under the Exchange Act.

[48] Ronin Letter II at 4–5; ICBC Letter at 1–2.

[49] Ronin Letter II at 4–5; ICBC Letter at 3.

[50] ICBC Letter at 3.

[51] Ronin Letter II at 4.

[52] *Id.* at 1, 4; Ronin Letter II at 3.

[53] ICBC Letter at 4.

[54] *Id.* at 2, 5.

[55] *Id.* at 5; Ronin Letter II at 4.

[56] FICC Letter at 3–4.

''fraction'' of the Netting Member's peak liquidity exposure that it presents to GSD; [57] and (3) the proposal would fairly allocate higher CCLF requirements to Netting Members that generate higher liquidity needs.[58] FICC further notes that, since CCLF contributions would be a function of the peak liquidity exposure that each Netting Member presents to FICC, each Netting Member would be able to reduce its CCLF contribution by altering its trading activity.[59]

In response to Ronin's assertion that the CCLF could promote concentration and systemic risk, FICC argues that the proposal would actually reduce systemic risk. FICC notes that it plays a critical role for the clearance and settlement of securities transactions in the U.S., and, in that role, it assumes risk by guaranteeing the settlement of the transactions it clears.[60] By providing FICC with committed liquidity to meet its cash settlement obligations to non-defaulting members during extreme market stress, FICC asserts that the CCLF would promote settlement finality to all Netting Members, regardless of size, and the safety and soundness of the securities settlement system, thereby reducing systemic risk.[61]

Finally, in response to Ronin's concern that the CCLF could cause FICC's liquidity needs to grow, FICC notes that in its outreach to Netting Members over the past two years, bilateral meetings with individual Netting Members, and testing designed to evaluate the impact that changes to a Netting Member's trading behavior could have on the Historical Cover 1 Liquidity Requirement, FICC has found opportunities for Netting Members to reduce their CCLF requirements and, as a result, decrease the Historical Cover 1 Liquidity Requirement.[62] Specifically, FICC notes that during its test period, which spanned from December 1, 2016 to January 31, 2017, 35 participating Netting Members voluntarily adjusted their settlement behavior and settlement patterns to identify opportunities to reduce their CCLF requirements.[63] According to FICC, the test resulted in an approximate $5 billion reduction in GSD's peak Historical Cover 1 Liquidity Requirement, highlighting that growth of the Historical Cover 1 Liquidity Requirement could be limited under the proposal.[64]

III. Discussion and Commission Findings

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, its stated purpose is instructive: to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities (''FMUs'') and strengthening the liquidity of systemically important FMUs.[65] Section 805(a)(2) of the Clearing Supervision Act [66] authorizes the Commission to prescribe risk management standards for the payment, clearing, and settlement activities of designated clearing entities and financial institutions engaged in designated activities for which it is the supervisory agency or the appropriate financial regulator. Section 805(b) of the Clearing Supervision Act [67] states that the objectives and principles for the risk management standards prescribed under Section 805(a) shall be to:

- promote robust risk management;
- promote safety and soundness;
- reduce systemic risks; and
- support the stability of the broader financial system.

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act [68] and Section 17A of the Exchange Act (''Rule 17Ad–22'').[69] Rule 17Ad–22 requires registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.[70] Therefore, it is appropriate for the Commission to review changes proposed in advance notices against both the objectives and principles of these risk management standards, as described in Section 805(b) of the Clearing Supervision Act and Rule 17Ad–22.[71]

A. Consistency With Section 805(b) of the Clearing Supervision Act

The Commission believes that the changes proposed in the Advance Notice are consistent with the objectives and principles described in Section 805(b) of the Clearing Supervision Act.[72] Specifically, the Commission believes that the proposal is designed to promote robust risk management by reducing the risk that FICC could not meet its cash settlement obligations to non-defaulting Netting Members during a default. As described above, the CCLF would be designed to provide sufficient liquidity to cover the peak cash settlement obligations of the family of affiliated Netting Members that would generate the highest liquidity need for FICC. It also would include an additional Liquidity Buffer to account for unexpected trading behavior that could increase GSD's Historical Cover 1 Liquidity Requirement or a situation in which a Netting Member with a large CCLF contribution defaults and cannot meet its CCLF requirement.

The Commission also believes that the proposal is designed to reduce systemic risk and support the stability of the broader financial system. As FICC noted, the CCLF is expected to promote settlement finality, as well as safety and soundness of the securities settlement system, by providing FICC with needed liquidity in the event that it experiences severe liquidity pressure from a Netting Member default and by mitigating the risk that reverse repo participants do not receive their cash back in the event of a default of a Netting Member (who, during the normal course of business, would be obligated to supply such cash).[73] Given FICC's importance to the financial system,[74] the Commission believes that FICC's ability to settle GSD transactions during such an event could contribute to reducing systemic risks and supporting the stability of the broader financial system. The Commission also believes that the CCLF could support the stability of the broader financial system by providing Netting Members with a pre-determined and capped potential CCLF contribution, which could allow Netting Members to better measure, manage, and control their exposures to FICC.

As noted above, both Ronin and the ICBC Letter express a concern that the increased costs associated with the

[57] *Id.* at 3. FICC notes that, on average, a Netting Member's CCLF requirement would be less than 2.5 percent of their respective peak liquidity need, with the smallest Netting Members having a CCLF contribution requirement of approximately 1.5 percent of their peak liquidity need. *Id.* at 4–5.

[58] *Id.* at 3–4. FICC notes that the Aggregate Regular Amount (proposed to be sized at $15 billion) would be applied to all Netting Members on a pro-rata basis, while the Aggregate Supplemental Amount, which would make up approximately 80 percent of the Aggregate Total Amount, would only apply to the Netting Members generating the largest liquidity needs (*i.e.,* in excess of $15 billion). *Id.* at 4.

[59] *Id.* at 3, 7.

[60] *Id.* at 7–8.

[61] *Id.*

[62] *Id.* at 8–9.

[63] *Id.* at 9–10.

[64] *Id.*

[65] *See* 12 U.S.C. 5461(b).

[66] 12 U.S.C. 5464(a)(2).

[67] 12 U.S.C. 5464(b).

[68] 12 U.S.C. 5464(a)(2).

[69] *See* 17 CFR 240.17Ad–22.

[70] *Id.*

[71] 12 U.S.C. 5464(b).

[72] *Id.*

[73] *See* FICC Letter at 7–8.

[74] *See* 12 U.S.C. 5463.

CCLF could potentially force some Netting Members to leave FICC. These commenters argue that a reduced Netting Member population resulting from these increased costs could, in turn, lead to larger problems, such as: (1) Increasing the size of FICC's exposure to those Netting Members that generate the largest liquidity needs for FICC (because some of the departed Netting Members could become customers of, and clear their transactions through, such remaining Netting Members); (2) increasing Netting Member concentration risk at FICC due to the reduced overall population of Netting Members following the implementation of the CCLF; and (3) increasing systemic risk because of the increased exposure and concentration risks described above.

In addition, Ronin and the ICBC Letter state their view that the expected costs of the CCLF could discourage market participants from centrally clearing their repo transactions through FICC, encouraging them to execute and manage their repo activity in the bilateral market instead of through a central counterparty. The ICBC Letter similarly argues that increased costs, due to the CCLF, for traders with hedged positions could cause such traders to reduce market activity, which could lead to reduced liquidity, inefficient pricing, and an increased likelihood of disruptions in the U.S. government securities markets.

The Commission notes that the concerns expressed above by Ronin and the ICBC Letter are based upon a number of implicit but also specific assumptions. As discussed immediately below, the Commission does not believe that the basis for these assumptions is clear and, therefore, the Commission is not persuaded that the proposal is inconsistent with Section 805(b) of the Clearing Supervision Act.

First, the magnitude of the stated concerns regarding potential reductions in GSD's Netting Member population, with resultant increases in liquidity demands for FICC, concentration risk, and systemic risk are based upon certain assumptions regarding how existing Netting Members may participate in the cleared repo market following implementation of the CCLF. For example, the concern that the most significant liquidity demands generated by particular Netting Members could increase because of the CCLF is based upon an assumption that departing Netting Members would choose to become customers of, and clear their repo transactions through, the remaining Netting Members that present the largest liquidity demands for FICC. However, neither Ronin nor the ICBC Letter explain why this outcome is more likely than alternative outcomes, such as departing Netting Members distributing their activity across the breadth of remaining Netting Members that present both large and small liquidity demands for FICC. For FICC's Cover 1 Liquidity Requirement to have increased under such a scenario, not only would a departed Netting Member need to have cleared through the remaining Netting Member that generated FICC's Cover 1 Liquidity Requirement, but it also would need to have contributed to that Netting Member having generated FICC's Cover 1 Liquidity Requirement.

The Commission notes that even granting the underlying assumptions implied by Ronin and the ICBC Letter, the extent to which increases in the largest liquidity demands for FICC would implicate systemic risk concerns could be mitigated by features of the CCLF. As the Commission understands from the proposal and the FICC Letter, the amount of committed resources available under CCLF would, by design, support FICC's ability to meet liquidity obligations in the event of a default of the participant family that would generate the largest aggregate payment obligation.[75] In other words, the amount of liquidity resources available to FICC under the CCLF would be scaled to FICC's largest liquidity demand, so that even if there were increased concentration and higher liquidity demands, the CCLF would continue to mitigate liquidity risks associated with the default of the participant or participant family that presented the largest liquidity need.

Second, the stated concerns regarding incentives for market participants to choose not to centrally clear their repo transactions through FICC and, instead, execute and manage their repo activity in the bilateral market are based upon certain assumptions regarding how market participants would consider the relative costs and benefits of engaging in cleared repo transactions at FICC versus bilateral repo transactions. For example, the ICBC Letter argues that moving to bilateral repo transactions would be somewhat less efficient than continuing to clear repo transactions at FICC, but that it would be materially less expensive.[76] However, this conclusion assumes that market participants would be willing to forgo certain benefits of FICC's central clearing process (*e.g.,* centralized netting, reduction of exposures, and the elimination of the need to maintain multiple risk management and operational relationships with a multitude of counterparties), when moving to bilateral repo transactions, to avoid incurring the cost of committing to provide liquidity to FICC under the CCLF. The ICBC Letter provides no data or evidence to suggest that bilateral clearing would ultimately prove more attractive to firms than central clearing at FICC, after accounting for the benefits of central clearing, even if the CCLF is implemented. Accordingly, the Commission is not persuaded that the proposal is inconsistent with Section 805(b) of the Clearing Supervision Act.

Separately, the Commission also notes, as it understands from the proposal and the FICC Letter, that the CCLF would require each Netting Member to contribute to the CCLF only a ''fraction'' of the peak liquidity exposure that they present to GSD.[77] Moreover, FICC has taken steps to enable all Netting Members to manage their commitments under the CCLF. For example, by establishing Netting Members' Individual Total Amounts through a tiered and proportionate approach, most Netting Members[78] would likely only be required to contribute their respective pro-rata amounts towards the first $15 billion of the Aggregate Total Amount. Also, the proposal would not require Netting Members to hold or provide to FICC their CCLF contribution (*i.e.,* their Individual Total Amount) prior to a CCLF Event.[79] Rather, the proposal would require Netting Members to attest to their ability to meet their CCLF requirement should FICC declare a CCLF event. Although Netting Members may incur some costs in securing their CCLF resources, the Commission believes, in light of the benefits that would arise from implementing the CCLF, that those additional costs do not cause the proposal to be inconsistent with Section 805(b) of the Clearing Supervision Act.

The ICBC Letter also raises the concern that the CCLF could transfer risk from FICC to BONY, the only private bank that acts as a tri-party custodian to a large portion of U.S. government securities, if FICC chooses to limit its risk by refusing to clear trades following a default. The Commission notes, however, that, as

[75] FICC Letter at 4.

[76] ICBC Letter at 3.

[77] FICC Letter at 3.

[78] As noted above, from 2015 to 2016, FICC observed that 85 percent of Netting Members had liquidity needs of $15 billion or less.

[79] As Ronin notes, a Netting Member could pay for access to a committed line of credit to have sufficient resources to attest that it can meet its CCLF contribution requirement. Ronin Letter at 5.

proposed, the CCLF does not contemplate the refusal to clear trades following the default of a Netting Member, nor does FICC impose trading limits on Netting Members.[80] Instead, the CCLF is designed to provide additional liquidity resources as FICC's liquidity needs increase, so that FICC can meet its settlement obligations and continue its clearance and settlement operations. In addition, the Commission notes that the ICBC Letter's concern regarding transferred risk to BONY is based upon the assumption that the proposal could encourage market participants to move their repo transactions away from central clearing through FICC to the bilateral repo market. As already discussed above, the Commission does not believe the basis for this assumption is clear.

For these reasons, the Commission believes that the proposal is consistent with Section 805(b) of the Clearing Supervision Act.

B. Consistency With Exchange Act Rule 17Ad–22

The Commission believes that the proposed changes associated with the CCLF are consistent with the requirements of Rule 17Ad–22(e)(7) under the Exchange Act, which requires FICC to establish, implement, maintain, and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage liquidity risk that arises in or is borne by FICC, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity.[81]

Specifically, Rule 17Ad–22(e)(7)(i) requires policies and procedures for maintaining sufficient liquid resources to effect same-day settlement of payment obligations in the event of a default of the participant family that would generate the largest aggregate payment obligation for the covered clearing agency in extreme but plausible market conditions.[82] As described above, the CCLF would be a rules-based, committed repo facility, designed to provide FICC with a liquidity resource in the event that FICC's other liquidity resources prove insufficient during a Netting Member default. Moreover, the CCLF would be sized to meet GSD's peak liquidity need during the prior six months, plus an additional Liquidity Buffer.

The ICBC Letter argues, as summarized above, that FICC's current risk models are ''time proven'' and the scenario the CCLF is intended to address (*i.e.,* an inability to access liquidity via the U.S. government securities repo market) is implausible. To support this position, the ICBC Letter cites to the 2008 financial crisis, in which the repo market continued to function. Ronin also notes that, for the period of March 31, 2016 to March 31, 2017, the peak liquidity need of 53 of the 103 GSD Netting Members did not exceed the amount of cash in the GSD clearing fund. In response, the Commission first notes that the 2008 financial crisis did not entail a default by a Netting Member that generated the largest liquidity demand on FICC and, therefore, the comparison that the ICBC Letter seeks to draw with the proposal is not clearly applicable. In addition, the Commission believes that extreme but plausible scenarios are not necessarily limited to only those events that have actually happened in the past, but could also include events that could potentially occur in the future. Moreover, the Commission notes that the ''time proven'' FICC risk models highlighted in the ICBC Letter are risk models that relate to market risk, whereas the CCLF is designed to address liquidity risk—a separate category of risk. Similarly, in response to Ronin's claim regarding the sufficiency of the cash component to the GSD clearing fund to cover the peak liquidity need of 53 of 103 GSD Netting Members over the given period, the Commission notes that the GSD clearing fund is calculated and collected to address market risk, not liquidity risk. The Commission also notes that the composition of the clearing fund, including the cash component, varies over time. Thus, the Commission believes that the proposal is reasonably designed to help FICC effectively measure, monitor, and manage liquidity risk by helping FICC maintain sufficient qualifying liquid resources to settle the cash obligations of the GSD participant family that would generate the largest liquidity need in extreme but plausible market conditions, consistent with Rule 17Ad–22(e)(7)(i).

Rule 17Ad–22(e)(7)(ii) under the Exchange Act requires policies and procedures for holding qualifying liquid resources sufficient to satisfy payment obligations owed to clearing members.[83] Rule 17Ad–22(a)(14) of the Exchange Act defines ''qualifying liquid resources'' to include, among other things, committed repo agreements without material adverse change provisions, that are readily available and convertible into cash.[84] As described above, the proposed CCLF is designed to provide FICC with a committed repo facility to help ensure that FICC has sufficient, readily-available liquid resources to meet the cash settlement obligations of the family of affiliated Netting Members generating the largest liquidity need. Therefore, the Commission believes that the proposal is consistent with Rule 17Ad–22(e)(7)(ii).

Rule 17Ad–22(e)(7)(iv) under the Exchange Act requires policies and procedures for undertaking due diligence to confirm that FICC has a reasonable basis to believe each of its liquidity providers, whether or not such liquidity provider is a clearing member, has: (a) Sufficient information to understand and manage the liquidity provider's liquidity risks; and (b) the capacity to perform as required under its commitments to provide liquidity.[85] As described above in Section II.D.3, FICC would require GSD Netting Members to attest that they have accounted for their potential Individual Total Amount, and FICC has had discussions with Netting Members regarding ways Netting Members, regardless of size or access to bank affiliates, can meet this requirement.[86] Moreover, FICC proposes to conduct due diligence on a quarterly basis to assess each Netting Member's ability to meet its Individual Total Amount. According to FICC, this due diligence would include a review of all information that the Netting Member provided FICC in connection with its ongoing reporting requirements, as well as a review of other publicly available information.

Ronin's assertion that certain Netting Members could merely submit an attestation declaring that they ''are good

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[80] The Commission also notes that Ronin, in the Ronin Letter II, recommended that, as an alternative approach to the CCLF, FICC could impose a hard cap on the maximum liquidity exposure allowable for each Netting Member. As an initial matter, the Commission notes that this comment suggests an approach not provided for in the proposal submitted to the Commission. In addition, the Commission notes that the commenter has not explained or demonstrated how the absence of a hard cap would cause the proposal to be inconsistent with the Clearing Supervision Act.

[81] 17 CFR 240.17Ad–22(e)(7). Although the commenters discuss the proposal in the context of Rule 17Ad–22(b)(3), the Commission has analyzed the proposal under Rule 17Ad–22(e)(7). As noted in the Commission's adoption of Rule 17Ad–22(e), while Rule 17Ad–22(e) may overlap with some requirements in Rule 17Ad–22(b), it is not inconsistent with Rule 17Ad–22(b) and, as a general matter, includes requirements intended to supplement the more general requirements in Rule 17Ad–22(b). *See* Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016).

[82] 17 CFR 240.17Ad–22(e)(7)(i).

[83] 17 CFR 240.17Ad–22(e)(7)(ii).

[84] 17 CFR 240.17Ad–22(a)(14).

[85] 17 CFR 240.17Ad–22(e)(7)(iv).

[86] *See* FICC Letter at 9.

for'' their CCLF contribution [87] fails to account for the fact that the proposal also requires FICC to conduct its own due diligence. Specifically, FICC would confirm that Netting Members have sufficient information to understand and manage their liquidity risks and to meet its commitments to provide liquidity. Therefore, the Commission believes that the proposal is consistent with Rule 17Ad–22(e)(7)(iv).

Finally, Rule 17Ad–22(e)(7)(v) under the Exchange Act requires policies and procedures for maintaining and testing with each liquidity provider, to the extent practicable, FICC's procedures and operational capacity for accessing its relevant liquid resources. As described above, under the proposal, FICC would test its operational procedures for invoking a CCLF Event and require Netting Members to participate in such tests. Therefore, the Commission believes that the proposal is consistent with Rule 17Ad–22(e)(7)(v).

IV. Conclusion

It is therefore noticed, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,[88] that the Commission DOES NOT OBJECT to advance notice SR–FICC–2017–802 and that FICC hereby is AUTHORIZED to implement the change as of the date of this notice or the date of an order by the Commission approving proposed rule change SR–FICC–2017–002 that reflects the changes that are consistent with this Advance Notice, whichever is later.

By the Commission.

Jill M. Peterson,

Assistant Secretary.

[FR Doc. 2017–14145 Filed 7–5–17; 8:45 am]

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[87] Ronin Letter at 2.

[88] 12 U.S.C. 5465(e)(1)(I).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–81056; File No. SR–LCH SA–2017–005]

Self-Regulatory Organizations; LCH SA; Order Approving Proposed Rule Change, as Amended by Amendment No. 1 Thereto, To Add Rules Related to the Clearing of CDX.NA.HY CDS

June 30, 2017.

I. Introduction

On April 28, 2017, Banque Centrale de Compensation, which conducts business under the name LCH SA (''LCH SA''), filed with the Securities and Exchange Commission (''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b-4 thereunder,[2] a proposed rule change (SR–LCH SA–2017–005) to amend LCH SA's CDS Margin Framework and CDSClear Default Fund Methodology in order to permit LCH SA to clear CDS contracts on the CDX.NA.HY index. On May 5, 2017, LCH SA filed Amendment No. 1.[3] The proposed rule change was published in the **Federal Register** on May 17, 2017.[4] The Commission received no comment letters regarding the proposed change. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description of the Proposed Rule Change

LCH SA has proposed various changes to its CDS Margin Framework and CDSClear Default Fund Methodology for the purpose of permitting LCH SA to clear CDS contracts on the CDX.NA.HY index.

A. Changes to CDS Margin Framework

With respect to the CDS Margin Framework, LCH SA proposed to amend the short charge component of its margin methodology to provide a description of the purpose of the short charge, noting that it is intended to account for the probability of a credit event occurring during the period from the default of a Clearing Member to liquidation of the defaulting Clearing Member's portfolio, as well as to adjust the method for calculating the short charge to account for CDX.NA.HY index contracts. Under its current CDS Margin Framework, LCH SA calculates the short charge component by taking the larger of (1) a ''Global Short Charge,'' derived from the Clearing Member's top net short exposure with respect to any CDS contract and its top net short exposure among the three ''riskiest'' reference entities (of any type), *i.e.* those that are most likely to default, in the Clearing Member's portfolio, and (2) the top two net short exposures with respect to CDS contracts on senior financial entities.[5] LCH SA believes that high yield entities are risker than senior financial entities, and as a result it proposed to introduce a ''High Yield Short Charge'' that would replace the top two net short exposures to CDS on senior financial entities in its approach to calculating the short charge.[6] Consequently, the short charge under the proposed rule change would be the greater of (1) the ''Global Short Charge,'' as described above, and (2) a ''High Yield Short Charge,'' calculated from a member's top net short exposure (with respect to high yield CDS) and its top two net short exposures among the three ''riskiest'' reference entities in the high yield category in the Clearing Member's portfolio.[7]

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] LCH SA filed Amendment No. 1 to replace the initial filing in its entirety in order to clarify certain changes to the CDSClear Margin Framework.

[4] Securities Exchange Act Release No. 34–80666 (May 11, 2017), 82 FR 22699 (May 17, 2017) (SR–LCH SA–2017–005) (''Notice'').

[5] Notice, 82 FR at 22700.

LCH SA also proposed to make certain conforming changes throughout Section 4.1.1 of the CDS Margin Framework, which describes the ''net short exposure'' calculation, to refer to CDX.NA.HY contracts, as well as to clarify that in order to calculate margin in Euros, all US dollar denominated variables are converted to Euros utilizing the current USD/Euro foreign exchange rate and calibrated haircut based upon historical data. Furthermore, LCH SA proposed conforming changes to Section 4.1.2 of the CDS Margin Framework, which describes the ''top exposure'' component of the short charge and Section 4.1.3 of the CDS Margin Framework, which describes the process by which LCH SA identifies the ''riskiest'' entities (of any type) in determining the short charge, to incorporate terms for CDX.NA.HY index contracts and to clarify the calculation as it applies to high yield indices. LCH SA also proposed clarifying changes to Section 4.1.4 of the CDS Margin Framework to summarize the calculation for the short charge amount.[8]

LCH SA proposed to amend the CDS Margin Framework by deleting Section 4.3 in its entirety because the substance of that section would be contained in other sections of the CDS Margin Framework as a result of the proposed changes described above.[9]

In addition, LCH SA also proposed to amend Section 5.1 of the CDS Margin Framework, which sets forth the wrong way risk (''WWR'') component of LCH SA's margin methodology. According to LCH SA, the current approach leverages the short charge framework by calculating the top two net short exposures of financial entities in a Clearing Member's portfolio following the calculation described above for the short charge margin. LCH SA then compares these top two net short exposures of financial entities to the Global Short Charge and imposes the

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.*