



January 22, 2019

SUBMITTED VIA E-MAIL

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

Re: File No. SR-FICC-2018-013; Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change to Expand Sponsoring Member Eligibility in the Government Securities Division Rulebook and Make Other Changes

File No. SR-FICC-2018-802; Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Advance Notice to Expand Sponsoring Member Eligibility in the Government Securities Division Rulebook and Make Other Changes

Dear Mr. Fields:

The Independent Dealer and Trader Association (“IDTA” or “Association”)¹ submits this letter in response to your request for comment on the Fixed Income Clearing Corporation’s (“FICC”) filing with the Securities and Exchange Commission (“SEC”) of the proposed rule change SR-FICC-2018-013 (the “Proposed Rule Change”) to amend the FICC Government Securities Division (“GSD”) Rulebook (the “GSD Rules”) in order to expand the group of Netting Members that may participate as Sponsoring Members, and to increase the types of transactions that can be included in a Sponsoring Member’s Omnibus Account.²

¹ The IDTA was formed to create a forum for independent dealers and traders to discuss and consider the impact of market operational issues on their industry sector and to advocate for constructive solutions that promote the liquidity and efficiency of capital markets. The objective of the IDTA is to form an interactive line of communication with regulators and other relevant policy makers, with particular emphasis on the SEC, the Treasury Department, and the Federal Reserve Bank of New York. The IDTA is composed of nine organizations registered as broker-dealers or futures commission merchants (or affiliates of such organizations) that are not affiliated with a bank holding company. A list of current IDTA membership is attached as Appendix I.

² Securities Exchange Act Release No. 34-84951 (Dec. 21, 2018), 83 Fed. Reg. 67801 (Dec. 31, 2018) (“Proposed Rule Change”), available at <https://www.govinfo.gov/content/pkg/FR-2018-12-31/pdf/2018-28376.pdf>. FICC also filed a nearly identical advance notice SR-FICC-2018-802 (“Advance Notice”) on December 13, 2018. See *Regulatory Rule Filings*, DTCC, <http://www.dtcc.com/legal/sec-rule-filings> (last visited Jan. 22, 2019). Though the advance notice has not yet been officially noticed by the SEC in the *Federal Register*, this letter responds to both the Proposed Rule Change and the Advance Notice.

The IDTA shares FICC’s stated goals to decrease settlement and operational risk; however, there are several elements of the proposal that should be further explained *before* the SEC approves the Proposed Rule Change. First, FICC should clarify how Category 2 Sponsoring Members will be evaluated and what additional financial requirements FICC could impose on them. Second, FICC should explain how increasing the types of transactions that can be included in a Sponsoring Member’s Omnibus Account will work operationally. Third, FICC should provide details on its conclusory statements that the Proposed Rule Change will benefit the market. It also should commit to provide transparency on these supposed benefits going forward.

To summarize, the Proposed Rule Change would create two categories of Netting Members that would be eligible to become Sponsoring Members.³ The first category – “Category 1 Sponsoring Members” – would include currently eligible Bank Netting Members that are “well-capitalized” and have at least \$5 billion in equity capital. The second category – “Category 2 Sponsoring Members” – would include Netting Members that are Tier One Netting members (except for Inter-Dealer Broker Netting Members and Non-IDB Repo Brokers). In addition to mandating assurance requirements on both Category 1 and Category 2 Sponsoring Members, the Proposed Rule Change would impose *further* financial requirements and activity limits on Category 2 Sponsoring Members.⁴ The Proposed Rule Change also would expand the “Sponsored Member Trade” definition to allow a Sponsoring Member to establish a Sponsoring Member Omnibus Account that may contain transactions between a Sponsored Member and a Netting Member other than the Sponsoring Member.⁵

While the IDTA generally supports FICC’s proposal to open up the Sponsored Member program to more Netting Members, it questions elements of the Proposed Rule Change that should be clarified. These issues are further discussed below.

I. FICC Should Clarify How Category 2 Sponsoring Members Will Be Evaluated And What Additional Financial Requirements And Assurances FICC Could Impose On Them.

Under the Proposed Rule Change, FICC could impose financial requirements on a Category 2 Sponsoring Member applicant that are greater than the financial requirements relevant to such applicant in its capacity as a Netting Member under Section 4(b) of Rule 2A.⁶ The Proposed Rule Change goes on to explain that FICC’s determination as to whether to impose such increased financial requirements would be based on a number of factors, including the level of the applicant’s anticipated positions and obligations; the anticipated risk associated with the applicant’s proposed volume and types of transactions; and the applicant’s overall financial condition.⁷ FICC also would be able to impose “adequate assurances” of a Sponsoring

³ Proposed Rule Change, *supra* note 2, at 67802.

⁴ *Id.* at 67803.

⁵ *Id.*

⁶ *Id.*

⁷ *Id.* The determination would be subject to approval by the FICC Board of Directors.

Member's financial responsibility and operational capacity within the meaning of Section 7 of Rule 3.⁸

The criteria upon which FICC may make its determination, and the additional financial requirements and assurances it could impose on Category 2 Sponsoring Members, provide little guidance for a Netting Member to evaluate whether to seek to become a Sponsoring Member. The cursory explanation in the Proposed Rule Change of the factors FICC will use to evaluate an applicant does not give a Netting Member a clear understanding of what FICC will ultimately require of its applicants. The lack of specificity in the proposed standards also presents risks that standards will be imposed unequally among Netting Members. Moreover, the uncertainty in what additional financial requirements and assurances may be mandated on a Category 2 Sponsoring Member could discourage applicants, particularly if a Netting Member could not forecast or plan around these additional requirements. An applicant should know what criteria it will be evaluated on, and what obligations FICC will impose on it, *before* it devotes resources to applying to the Sponsored Member program.

Although other parts of the GSD Rules provide FICC with flexibility when imposing requirements on its members,⁹ the Sponsored Member program is a discrete, FICC-sponsored program that can easily and readily define its contours. Moreover, Rule 3A sets forth an appeals process when an application is denied outright,¹⁰ but the GSD Rules do not appear to allow a Netting Member whose application is approved to appeal FICC's decision to impose additional financial requirements and assurances on it. Before the Proposed Rule Change is approved, FICC should provide additional transparency into how it plans to evaluate applicants and make available the possible, additional financial requirements and assurances it could impose on various applicants wishing to become Category 2 Sponsoring Members.

II. FICC Should Explain How Increasing The Types Of Transactions That Can Be Included In A Sponsoring Member's Omnibus Account Will Work Operationally.

The Proposed Rule Change would allow a Sponsoring Member to establish a Sponsoring Member Omnibus Account that may contain transactions between a Sponsored Member and a Netting Member other than the Sponsoring Member.¹¹ However, there appears to be inconsistencies in the description of the operation of the Sponsoring Member Omnibus Account, and it is unclear how this process will work at a practical level.

In one part, the Proposed Rule Change explains that the Required Fund Deposit in a Sponsoring Member Omnibus Account is presently calculated using the total activity of each Sponsored Member without any netting between Sponsored Members' activity within a single

⁸ *Id.*

⁹ *See, e.g.*, Rule 2A(4)(b) (providing FICC with the discretion to impose greater financial responsibility standards than the "minimum requirements" listed, without discussing the bounds of FICC's discretion).

¹⁰ Current Rule 3A(b) [Proposed Rule Change Rule 3A(b)(iii)].

¹¹ Proposed Rule Change, *supra* note 2, at 67804.

Sponsoring Member Omnibus Account.¹² In a later part, though, the Proposed Rule Change states that the calculation of the Required Fund Deposit for a Sponsoring Member Omnibus Account would be inclusive of all transactions between a Sponsored Member and a Netting Member other than the Sponsoring Member, as well as transactions between a Sponsored Member and the Sponsoring Member.¹³ FICC should reconcile these statements and clarify how the Proposed Rule Change affects the calculation of the Required Fund Deposit in a Sponsoring Member's Sponsored Member Omnibus Account.

FICC also should clarify how the Sponsoring Member Omnibus Account could potentially contain activity between Sponsored Members and Netting Members other than the Sponsoring Member. Our understanding has been that the Sponsoring Member submits to FICC transactions only between itself and its Sponsored Members for inclusion in the Omnibus Account.

III. FICC Should Provide Details On Its Conclusory Statements That The Proposed Rule Change Will Benefit The Market. It Also Should Provide Transparency of These Supposed Benefits Going Forward.

The Proposed Rule Change claims that it will enhance liquidity, diminish the risk being mutualized among Netting Members, and provide broader benefits to the market. It states that the proposed changes to the GSD Rules will help “safeguard the U.S. financial market by lowering the risk of liquidity drain, protecting against fire sale risk, and decreasing settlement and operational risk.”¹⁴

However, these are conclusory statements that are unproven and unsupported by data. FICC notes that expanding the types of Netting Members that are eligible to participate in FICC as Sponsoring Members could “increase the number of Sponsoring Members and, in turn, the number of Sponsored Member Trades that would be cleared and settled by FICC.”¹⁵ While true, this ignores the role that the Sponsored Member program could have in increasing concentration risk to FICC. If the program succeeds in reducing the balance sheets for Netting Members that participate in the Sponsored Member program, while such Netting Members maintain their existing degrees of leverage, it could be said that the risk to the other Netting Members has in fact increased. Moreover, if a Sponsored Member fails on its obligation to receive securities, the

¹² *Id.* at 67802 (“Specifically, for purposes of calculating the Unadjusted GSD Margin Portfolio Amount for a Sponsoring Member Omnibus Account, each Sponsored Member's activity is assigned a separate VaR Charge, and, as such, the Unadjusted GSD Margin Portfolio Amount for the Sponsoring Member Omnibus Account is not reduced by any netting of positions as between different Sponsored Members within that Sponsoring Member Omnibus Account.”).

¹³ *Id.* at 67804 n.40 (“To the extent a Sponsoring Member elects to establish a Sponsoring Member Omnibus Account that may contain transactions between a Sponsored Member and a Netting Member other than the Sponsoring Member, the Required Fund Deposit for such Sponsoring Member Omnibus Account would be calculated to be inclusive of all transactions submitted into such account, including any transactions between a Sponsored Member and a Netting Member other than the Sponsoring Member as well as any transactions between a Sponsored Member and the Sponsoring Member.”).

¹⁴ *Id.* at 67804.

¹⁵ *Id.*

Sponsoring Member assumes responsibility for the trades in the Sponsoring Member Omnibus Account. From this perspective, the risk a Sponsoring Member poses to FICC may be greater than if such activity was transacted through another Netting Member that is not a Sponsoring Member.

Additionally, the Proposed Rule Change's statements with respect to particular Netting Members – e.g., “the opportunity for Sponsoring Members to intermediate their Sponsored Members’ securities transactions in a more capital efficient manner through FICC may allow such Sponsoring Members to engage in a greater number of securities transactions, thereby potentially increasing their Sponsored Members’ opportunity to lend and, in turn, *their income*”¹⁶ – does not address the program’s benefits to FICC or Netting Members, generally.

Because the actual effects of the Proposed Rule Change are unknown, FICC should provide transparency to all Netting Members of the impact of the Sponsored Member program. The IDTA proposes that FICC:

1. Increase the availability of anonymized data that shows the benefits of the Sponsored Member program;
2. Distribute periodic reports on the concentration of trade volumes among Sponsoring Members; and
3. Adopt a rubric for the ongoing monitoring of Sponsoring Members’ trade activity, including the frequency of reporting and the types of metrics used to evaluate risk.

Finally, if FICC finds that the program increases risk, it should have a process to restrict participation in the program until the risks can be properly addressed.

* * *

The IDTA thanks the SEC for considering the Association’s comments. Should you have any questions, please contact me at [REDACTED] or [REDACTED].

Sincerely,



James Tabacchi
Chairman
Independent Dealer and Trader Association

CC: Michael Bodson, President and CEO, DTCC

¹⁶ *Id.* at 67804 (emphasis added).

Appendix I: IDTA Membership

As of January 1, 2019

Aardvark Securities, LLC

Bethesda Securities, LLC

Buckler Securities, LLC

Curvature Securities LLC

ED&F Man Capital Markets Inc.

J.V.B. Financial Group, LLC

Mirae Asset Securities (USA), Inc.

Ronin Capital, LLC

South Street Securities LLC