sifma

Invested in America

June 24, 2013

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

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

Re: **SR-NSCC-2013-02** and **SR-NSCC-2013-802** – Notice of Filing of Proposed Rule Change and Notice of Filing of Advance Notice, Each as Modified by Amendment Nos. 1 and 2, to Institute Supplemental Liquidity Deposits to National Securities Clearing Corporation's Clearing Fund Designed to Increase Liquidity Resources to Meet Its Liquidity Needs

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("**SIFMA**")[1] appreciates the opportunity to comment on the above-referenced notices of filings made with the Securities and Exchange Commission (the "**Commission**") by the National Securities Clearing Corporation (the "**NSCC**") concerning the NSCC's proposed rule change to institute supplemental liquidity deposits designed to increase liquidity resources to meet its liquidity needs (the "**SLD Proposal**").[2]

SIFMA believes that a clearing agency performing central counterparty services is essential to the proper functioning of the capital markets, and that ensuring the clearing agency is well capitalized and financially sound serves to benefit both the clearing agency's members and the capital markets

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers, including firms that are members of and clear securities transactions through the National Securities Clearing Corporation. SIFMA's mission is to develop policies and practices that strengthen financial markets and encourage capital availability, job creation and economic growth while building trust and confidence in the financial industry. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association.

[2] *See Notice of Filing of Proposed Rule Change to Institute Supplemental Liquidity Deposits to Its Clearing Fund Designed to Increase Liquidity Resources to Meet Its Liquidity Needs*, Exchange Act Release No. 69313 (April 4, 2013), 78 FR 21487 (April 10, 2013); *Notice of Filing Amendment No. 1 and Designation of a Longer Period for Commission Action on Proposed Rule Change, as Modified by Amendment No. 1, to Institute Supplemental Liquidity Deposits to Its Clearing Fund Designed to Increase Liquidity Resources to Meet Its Liquidity Needs*, Exchange Act Release No. 69620 (May 22, 2013), 78 FR 32292 (May 29, 2013); *Notice of Filing of Advance Notice, as Modified by Amendment No. 1, to Institute Supplemental Liquidity Deposits to Its Clearing Fund Designed to Increase Liquidity Resources to Meet Its Liquidity Needs*, Exchange Act Release No. 69451 (April 25, 2013), 78 FR 25496 (May 1, 2013); *Notice of Extension of Review Period of Advance Notice, as Modified by Amendment No. 1, to Institute Supplemental Liquidity Deposits to Its Clearing Fund Designed to Increase Liquidity Resources to Meet Its Liquidity Needs*, Exchange Act Release No. 69605 (May 20, 2013), 78 FR 31616 (May 24, 2013); Form 19b-4 filing constituting Amendment No. 2 to Rule Filing SR-NSCC-2013-02 (June 11, 2013), available at http://www.dtcc.com/downloads/legal/rule_filings/2013/nscc/SR-NSCC_2013-02_Amendment_2.pdf (not yet noticed by the Commission) ("**Proposed Rule Change Amendment No. 2**"); Form 19b-4 filing constituting Amendment No. 2 to Rule Filing SR-NSCC-2013-802 (June 11, 2013), available at http://www.dtcc.com/downloads/legal/rule_filings/2013/nscc/SR-NSCC_2013-02-802_Amendment_2.pdf (not yet noticed by the Commission).

as a whole. SIFMA thus appreciates the need for the NSCC, both as a central counterparty and as a financial market utility that has been designated by the Financial Stability Oversight Council as systemically important, to maintain sufficient financial resources to withstand a default by the NSCC member or family of affiliated members to which the NSCC has the largest exposure. SIFMA also understands the NSCC's desire to broaden the base of support for its liquidity needs beyond the small group of firms that has historically supported these needs through participation in the NSCC's revolving credit facility, and believes it is important to enable all of the NSCC's members to help the NSCC maintain sufficient financial resources.

SIFMA appreciates the NSCC's efforts to respond to the industry's comments on the original SLD Proposal and believes Amendment No. 2 to the proposal, which the NSCC filed with the Commission on June 11, 2013, includes some welcome improvements. Nevertheless, as described below, SIFMA remains concerned about certain aspects of the proposal, which is complex and could have far-reaching impacts on both the business and capital models of a broad range of market participants as well as the broader financial system. As a threshold matter, SIFMA believes that the NSCC has failed to articulate a substantive basis for the SLD Proposal, and that the proposal is fundamentally flawed because it lacks an adequate risk-based justification and would result in the supplemental liquidity deposit obligations of NSCC's member firms being dependent from year to year on the NSCC's success in obtaining commitments under its revolving credit facility. In addition, the proposed rule change fails to meet the standard for Commission approval because it lacks transparency, would unfairly discriminate and impose unnecessary and inappropriate burdens on competition among NSCC members, and could negatively impact market liquidity and systemic risk.

The NSCC has indicated in discussions with SIFMA and its member firms that, due to the size of the NSCC's revolving credit facility that was renewed in May 2013,[3] there will be no supplemental liquidity deposit requirements before the next renewal of the credit facility in May 2014. Given this and the NSCC's stated intention to review and evaluate the financing options available to it prior to the May 2014 renewal of the credit facility,[4] SIFMA believes that the SLD Proposal is premature. SIFMA believes the NSCC and the industry, and indeed the broader financial system, would be better served if the NSCC were first to explore other financing options and options to reduce its liquidity needs over the longer term and then to develop a proposal to enable it to satisfy its liquidity requirements pending implementation of longer-term measures.

As a result, SIFMA respectfully urges the Commission to take measures under applicable law to ensure the SLD Proposal does not become effective,[5] pending the NSCC's review of financing options and longer-term measures to reduce liquidity requirements. SIFMA would welcome the opportunity to work with the NSCC and Commission staff to better understand the NSCC's liquidity needs and develop alternatives to the SLD Proposal that might better achieve the NSCC's goals while also minimizing the potential negative effects of the changes.

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[3] *See Notice of Filing and No Objection to Advance Notice to Renew Its Existing Credit Facility*, Exchange Act Release No. 69557 (May 10, 2013), 78 FR 28936 (May 16, 2013) ("**Credit Facility Advance Notice**").

[4] Letter from Larry Thompson, Managing Director and DTCC General Counsel, to Elizabeth Murphy, Secretary, Securities and Exchange Commission (June 10, 2013).

[5] *See* 15 U.S.C. 78s(b)(2), 12 U.S.C. 5465(e)(1)(E).

I. The NSCC has failed to articulate a substantive basis for the SLD Proposal.

The NSCC cites Rule 17Ad-22(b)(3) under the Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), as the statutory basis for the SLD Proposal.[6] Among other things, Rule 17Ad-22(b)(3) requires a registered clearing agency that performs central counterparty services, such as the NSCC, to have in place written policies and procedures reasonably designed to maintain sufficient financial resources to withstand a default by the member or family of affiliated members to which the clearing agency has the largest exposure in extreme but plausible market conditions.[7]

The Commission adopted Rule 17Ad-22, which became effective on January 2, 2013, in order to establish risk management standards for registered clearing agencies in accordance with Section 805 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**")[8] relating to the standards for systemically important financial market utilities and payment, clearing and settlement activities.[9] However, in adopting Rule 17Ad-22, the Commission stated its understanding that all of the central counterparties registered with it, which would include the NSCC, already maintained sufficient financial resources to meet the liquidity standard established pursuant to the new rule.[10] Indeed, the Commission cited a report noting that the NSCC had been evaluating itself against this standard since 2009.[11]

In addition, the NSCC recently filed with the Commission an advance notice of renewal of its 364-day revolving credit facility.[12] In that filing, the NSCC explained that the new credit facility and its substantially similar predecessor credit facilities have been in place since the introduction of same-day settlement at the NSCC because the NSCC requires same-day liquidity resources to cover the failure to settle of the NSCC's largest member or affiliated family of members. The filing described the credit facility and the NSCC's Clearing Fund as integral parts of the NSCC's risk management structure, and noted that they "together help NSCC to have sufficient liquidity to complete end-of-day money settlement."[13] As noted above, the NSCC has not, since its inception,

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[6] 78 FR 21487, 21488; 78 FR 25496, 25497.

[7] 17 C.F.R. 17Ad-22(b)(3).

[8] 12 U.S.C. 5464.

[9] *Clearing Agency Standards*, Exchange Act Release No. 68080 (Oct. 22, 2012), 77 FR 66220 (Nov. 2, 2012) (the "**Clearing Agency Standards Release**").

[10] *See id.*, 77 FR at 66236 and n.183 (citing an International Monetary Fund assessment of the NSCC's observance of an identical standard recommended by the Technical Committee of the International Organization of Securities Commissions ("**IOSCO**") and the Committee on Payment and Settlement Systems ("**CPSS**")). *See also* National Securities Clearing Corporation Assessment of Compliance with the CPSS/IOSCO Recommendations for Central Counterparties (Nov. 14, 2011) at pp. 6, 27 (available at http://www.dtcc.com/legal/compliance/NSCC_Self_Assessment.pdf) (stating that the NSCC broadly observes the recommended CPSS/IOSCO liquidity standard and noting that the NSCC's process for allocating losses to non-defaulting members in the "worst possible scenario," where the deposits of defaulting members to the NSCC's Clearing Fund were insufficient to cover the losses attributable to their defaults, had not been invoked from the time of NSCC's inception to the time of the assessment, despite "the 2008 well-publicized broker-dealer close outs" and, more generally, the close-out of more than 20 defaulting firms since the NSCC's inception).

[11] *Id.*, 77 FR at 66236, n.183.

[12] *See* Credit Facility Advance Notice, *supra* note 3.

[13] *Id.*, 78 FR at 28936.

had to allocate losses to non-defaulting members,[14] let alone, to SIFMA's knowledge, had to draw on one of its credit facilities. It is thus unclear why the proposed supplemental liquidity deposits are even necessary.

The NSCC has, moreover, failed to explain why the calculations it has proposed under the SLD Proposal would provide an appropriate measure of any need for supplemental liquidity it may have. Among other things, the NSCC has not explained either the basis for its assumptions that a defaulting member would be trading at peak historical levels and that participants would not curtail their activity with the defaulting member, or the reasonableness of its use of the largest calculated supplemental liquidity need over a 12-month period, in the case of trading activity during business days other than those coinciding with monthly options expiration activity periods, or over a 24-month period, in the case of trading activity during monthly options expiration activity periods, to determine the supplemental liquidity deposit obligations of its members.[15] In fact, the proposed calculations and assumptions would appear to overestimate any supplemental liquidity need the NSCC may face.

The NSCC's failure to articulate a need for the proposed supplemental liquidity deposits is particularly notable in light of the fact, as described above, that the NSCC has been evaluating itself since 2009 against the liquidity standard now set forth in Rule 17Ad-22, and given the lack of any identified changes – with respect to the NSCC's Clearing Fund and revolving credit facility or otherwise – that would indicate a need for significant revisions to the historical risk management structure that has provided sufficient liquidity to the NSCC from the time of the NSCC's inception to the present. To the extent the intent is to reduce reliance on, or broaden participation in, the credit facility, SIFMA respectfully suggests that the NSCC's intent be clearly stated and that alternative means to accomplish the intended goals be discussed and considered.

II. The SLD Proposal is fundamentally flawed.

Under the SLD Proposal, the NSCC seeks to provide a mechanism for calculating its liquidity needs and then requiring supplemental liquidity deposits sufficient to cover any liquidity shortfall from 30 of the NSCC's nearly 300 clearing members in a manner that the NSCC describes as proportionate to the liquidity risk these 30 members present to the NSCC. However, the proposed mechanism for calculating the NSCC's liquidity needs, identifying the 30 members that would be required to make supplemental deposits, and determining the supplemental deposit obligations of these members is fundamentally flawed because it lacks an adequate risk-based justification. Indeed, the calculation mechanism would be based on the transactional or clearing volume of the NSCC's members, and not on any measure of the actual risk presented. In addition, the proposal is flawed because it would result in the supplemental liquidity deposit obligations of the NSCC's member firms being dependent from year to year on the NSCC's success in obtaining commitments under its revolving credit facility.

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[14] *See supra* note 10.

[15] More fundamentally, the NSCC has not even defined, in a manner that puts the public on notice and enables meaningful comment, the "extreme but plausible market conditions" under which it would determine its liquidity needs and assess member firms' supplemental liquidity deposit obligations. See discussion in Section III.a *infra*.

Although the SLD Proposal appears intended to enhance the NSCC's ability to reduce the risks faced by its members and to contribute to global financial stability, the proposal is not designed to accomplish these goals because it lacks an adequate risk-based justification. For example, calculation of the NSCC's liquidity needs and of its members' supplemental liquidity deposit obligations under the SLD Proposal would be based on the purchase obligations of the NSCC's member firms. However, a calculation that does not take into account offsetting sales by the members, and the related payments due to them, does not provide a true measure of risk. Similarly, a calculation that does not take into account the relative risks presented by different business models and activities would result in inaccurate assessments of risk and the liquidity that would be needed upon a member's default. For example, an NSCC member that settles on a same-day basis or that trades on an agency-only basis would present fewer liquidity risks to the broader financial system than a member that settles over the four-day settlement cycle or trades on a principal basis. While we understand that the NSCC, as the central counterparty, would be obligated to complete a clearing member's transactions if the member were to fail, we believe that looking at only the NSCC's side of the activity would result in the imposition of disproportionately large supplemental liquidity deposit obligations on certain business models and activities when the risks presented by those business models and activities are viewed in the context of the broader financial system. We would thus urge the NSCC and the Commission, in considering longer-term mechanisms to address risk in the securities clearance and settlement system, to investigate means by which the NSCC could take advantage of its member firms' offsetting sales and to develop a mechanism to address settlement risk in institutional delivery ("**ID**") transactions.

Nor is it clear from the SLD Proposal why the supplemental liquidity deposits should be borne by only 30 of the NSCC's members or how this would serve to reduce member risks or contribute to financial stability. The NSCC stated in its recent letter to the Commission that it has determined that its top 30 members most appropriately captured the liquidity exposure over and above its available Clearing Fund liquidity, and that as of the end of February 2013 the top 30 members represented approximately 85% of the total membership by peak liquidity needs over the preceding six-month period.[16] Yet the NSCC does not explain the appropriateness of seeking to capture 85% of the total membership by peak liquidity needs, rather than a greater or lesser percentage, or provide a risk-based justification for the selected threshold. Nor does the NSCC explain what would happen if, for example, two firms in the top 30 were to merge and two others were to exit clearing, with all of the activity being distributed to other firms in the top 30 (now 27). Would three new firms from within the remaining 15% of the membership by peak liquidity needs be called on to make supplemental liquidity deposits? Why would this be justified if the NSCC believes that 85% is the appropriate measure?

Because of these deficiencies, the calculations described in the SLD Proposal appear likely to result in a measure of the NSCC's liquidity needs and an apportionment of liquidity requirements to members that bear little or no relation to the actual systemic risks that the activities of the NSCC's members present or to the actual members that present the greatest risk. The net effect would be to impose on certain NSCC members supplemental deposit obligations that are not proportionate to the risks these members present, with the significant negative firm-level, competitive and systemic effects described below, while at the same time failing to accomplish the risk management objectives of the SLD Proposal, Rule 17Ad-22 and the Dodd-Frank Act.

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[16] *See supra* note 4.

In addition to its failure to take into account the actual risks of its members' business models and trading activities, the SLD Proposal is fundamentally flawed because it would tie the supplemental liquidity deposits that NSCC members would be required to make to the amount of the NSCC's revolving credit facility. The credit facility is renewed annually, and its size is dependent, among other things, on market conditions during the relatively short period of time the facility is open for commitments and on participation by parties in many cases unaffiliated with NSCC members. So while the NSCC's members could be required to make supplemental deposits that could total many times more than the amounts they currently are required to deposit in the NSCC's Clearing Fund, they would be unable to influence or predict these obligations, let alone adequately plan for them on a long-term basis. SIFMA appreciates the value of the credit facility in providing support for the NSCC's liquidity needs from lenders beyond the NSCC's membership, and thus in reducing the burden on members. However, tying NSCC members' supplemental liquidity deposit obligations to the amounts committed under a credit facility that is remarketed annually during a limited period of time would create significant uncertainty, increase the risks faced by the NSCC's members, and contribute to significant instability among the affected firms and in the capital markets.

III. The SLD Proposal is not consistent with the requirements of the Exchange Act and the rules and regulations thereunder.[17]

a. The SLD Proposal lacks transparency.

Rule 17Ad-22 requires each registered clearing agency, such as the NSCC, to establish, implement, maintain and enforce written policies and procedures reasonably designed to "[p]rovide for a well-founded, transparent, and enforceable legal framework for each aspect of its activities" and to "[p]rovide market participants with sufficient information for them to identify and evaluate the risks and costs associated with using its services."[18] The SLD Proposal is not consistent with either of these requirements.

First, as described above, the NSCC has failed to articulate a need for the proposed supplemental liquidity deposits.

Second, the NSCC has not defined the "extreme but plausible market conditions" under which it would determine its liquidity needs.[19] The SLD Proposal identifies certain "stressed market conditions," but specifically indicates that the assumptions underlying the NSCC's calculations would not be limited to the identified conditions. The NSCC provides neither any justification for

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[17] Section 19(b)(2)(C)(i) of the Exchange Act provides that the Commission "shall approve a proposed rule change … if it finds that such proposed rule change is consistent with the requirements of [the Exchange Act] and the rules and regulations issued [thereunder]." 15 U.S.C. 78s(b)(2)(C)(i). Section 19(b)(2)(C)(ii) requires the Commission to "disapprove a proposed rule change … if it does not make" such a finding. 15 U.S.C. 78s(b)(2)(C)(ii).

[18] 17 C.F.R. 240.17Ad-22(d)(1) and (9).

[19] *See* Clearing Agency Standards Release, 77 FR at 66236 (noting the Commission's expectation that it would review and publish for public comment rule proposals from clearing agencies to adopt definitions for the "extreme but plausible market conditions" requirement under Rule 17Ad-22 that are appropriate for the markets they serve).

the assumptions it has identified nor any explanation of what additional assumptions may be made or the circumstances under which it would be reasonable to make additional assumptions.

Third, the SLD Proposal would permit the NSCC to seek interim liquidity deposits from its top 30 members if the aggregate amount of the supplemental deposits available to the NSCC were to decrease by an amount that exceeded an unspecified threshold determined by the NSCC – whether as a result of the retirement of a member, a cease to act or otherwise – and would permit the NSCC to make interim liquidity calls if it were to observe an increase in its liquidity needs that exceeded an unspecified threshold determined by the NSCC. The SLD Proposal contains no restrictions on the amount, timing or frequency of either interim liquidity deposits or liquidity calls and provides no information regarding the thresholds that may trigger them or how the NSCC would determine those thresholds. It would be very difficult, if not impossible, for the NSCC's members to forecast their possible obligations under these provisions, particularly given the lack of transparency with respect to the triggering thresholds and the inability to anticipate the activity of other member firms that might impact these requirements. It could also be difficult for the NSCC's members to post the required cash in the requested timeframes (within five business days for interim liquidity deposits and within two business days for liquidity calls). Further, the proposal provides that deposits resulting from liquidity calls would be held by the NSCC until the next applicable reset period, while a member's "prefund" deposits made voluntarily to avoid liquidity calls would be refunded after the period of activity for which the deposits were made. Such a rule would be unnecessarily burdensome to the NSCC's members, particularly given the lack of transparency with respect to the NSCC's proposed calculations and the consequent difficulty for members in determining when they might receive a liquidity call. In addition, the NSCC has stated that the difference in the periods over which the deposits would be held is intended to incentivize members to make prefund deposits and avoid interim liquidity calls.[20] It is unclear why it would be appropriate for a clearing agency to impose such a punitive requirement that is not relevant to the stated goal of enhancing its ability to meet its liquidity needs.

Fourth, as described above, the supplemental liquidity deposit obligations of NSCC's member firms would depend from year to year on a credit facility renewal process that members would be unable to influence or predict, let alone plan for on a long-term basis.

Fifth, although we appreciate the NSCC's most recent proposal to allow members that do not have bank affiliates to designate unaffiliated commercial lenders to participate on their behalf in the NSCC's credit facility, it remains unclear how or to what extent NSCC members without bank affiliates would be able to do so. Among other things, any lender designated by an NSCC member would be subject to satisfaction of the NSCC's "reasonable lender criteria." While the NSCC has indicated that these would be designed to cover issues such as credit risk, concentration risk, and lender diversity, the NSCC has not specified any of these criteria, and it is unclear to what extent the criteria may limit the ability of an NSCC member that is not affiliated with a bank to designate a lender to commit to the credit facility. In addition, the mechanism pursuant to which an NSCC member would obtain an offset against its supplemental liquidity deposit requirement for the commitment of its designated lender is unclear.

Based on these factors, the SLD Proposal appears neither well-founded nor transparent. More significantly, these factors mean that NSCC members do not know or cannot control or influence

[20] 78 FR 21487, 21490; 78 FR 25496, 25498.

the considerations that may be relevant to the NSCC's determination of whether they should be required to provide supplemental liquidity deposits and, if so, when and in what amounts those deposits will be required.[21] This makes it impossible for NSCC members to evaluate the SLD Proposal's risks and costs to their businesses, or to manage their liquidity exposure, over the long term.

b. The SLD Proposal would unfairly discriminate among NSCC members.

Section 17A(b)(3)(F) of the Exchange Act requires that the rules of a clearing agency not unfairly discriminate among members in the use of the clearing agency,[22] and Rule 17Ad-22(d)(2) requires each registered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to have participation requirements that permit fair and open access.[23] The SLD Proposal is inconsistent with these requirements.

As noted above, under the SLD Proposal, the NSCC would select only 30 of its member firms to cover any liquidity shortfall. The imposition of supplemental liquidity obligations on only approximately 10% of the NSCC's membership is not equitable and would unfairly disadvantage the selected members, relative to members that are not required to make supplemental deposits. Among other things, the selected members could be required to make substantial cash deposits and thus see a major capital impact, and would most likely also incur additional costs associated with securing adequate funding, satisfying potential interim deposit requirements and liquidity calls, and developing and maintaining the human resources and system infrastructure needed to monitor any anticipated requirements. The SLD Proposal would thus unfairly discriminate among NSCC members with respect to their use of and access to the NSCC's system.

c. The SLD Proposal would impose unnecessary and inappropriate burdens on competition.

Section 17A(b)(3)(I) of the Exchange Act requires that the rules of a clearing agency not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.[24] The SLD Proposal imposes significant burdens on competition that are neither necessary nor appropriate.

As described above, the decision to impose supplemental liquidity deposit obligations on only approximately 10% of the NSCC's membership could have a significant negative impact on the liquidity, working capital and risk management of the affected members relative to unaffected

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[21] We appreciate the NSCC's amendments to the SLD Proposal to include reporting to its members designed to show them the liquidity exposure they present to the NSCC, and we believe the reports will be helpful to a certain extent. However, even automated and more frequent reports cannot address the fundamental problems related to the lack of transparency regarding the NSCC's calculation assumptions and thresholds, other member firms' activities on any given firm's supplemental liquidity deposit obligations, and the year-to-year uncertainty of the credit facility renewal process.

[22] 15 U.S.C. 78q-1(b)(3)(F).

[23] 17 CFR 240.17Ad-22(d)(2).

[24] 15 U.S.C. 78q-1(b)(3)(I). Further, the Commission is required in connection with its regulation of clearing agencies to have due regard for "maintenance of fair competition among brokers and dealers[.]" 15 U.S.C. 78q-1(a)(2)(A).

members. Yet the SLD Proposal fails to address why such impacts on the 30 affected members may be necessary or appropriate. In addition, the proposal apparently fails to consider whether NSCC members will manage their activities in an attempt to avoid being counted among the 30 members required to make supplemental deposits, and what market-distorting effects such conduct could have.

The SLD Proposal states that "any perceived burden on competition caused by the SLD Proposal is necessary and appropriate to prevent systemic risk."[25] However, as described above, the calculations to be made under the SLD Proposal would not reflect the actual systemic risk posed by an affected NSCC member. It is thus unclear how the burdens on competition of a proposal that does not adequately address systemic risk could be necessary or appropriate to preventing that risk.

Furthermore, for some NSCC members, the SLD Proposal could result in a decision to exit self-clearing and, for the firms that provide clearing services for other, smaller broker-dealers, to also exit those business lines. This result would reduce competition in the market for clearing services, thus providing fewer options for introducing brokers and potentially impacting investors in the form of higher commissions and fees. These significant competitive effects are neither justified nor even substantively addressed in the SLD Proposal.

IV. The SLD Proposal could have significant negative effects on systemic risk and the stability of the financial system.

Section 806 of the Dodd-Frank Act requires a designated financial market utility to provide advance notice of a proposed rule change that could materially affect the nature or level of risks presented by the utility and to describe in that notice the nature of the change; the expected effects of the change on risks to the utility, its participants or the market; and the means by which the utility plans to manage any identified risks.[26] Although the Dodd-Frank Act does not specify a standard of review for advance notices filed pursuant to Section 806, the Commission has stated that it is appropriate for the Commission to review advance notices against the objectives and principles for risk management standards as described in Section 805(b) of the Dodd-Frank Act.[27] These objectives and principles include reducing systemic risk and supporting the stability of the broader financial system.[28]

The SLD Proposal could have significant negative effects on the liquidity of NSCC member firms, market liquidity, systemic risk and the stability of the broader financial system, while the NSCC has failed in the proposal to identify these risks or identify how it could manage them. As a result,

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[25] Proposed Rule Change Amendment No. 2, *supra* note 2.

[26] 12 U.S.C. 5465(e)(1)(A) and (C).

[27] *See* Credit Facility Advance Notice, *supra* note 3, 78 FR at 28937, stating also that it is appropriate for the Commission to review advance notices against the clearing agency standards in Rule 17Ad-22 that were promulgated under Section 805. The SLD Proposal's failure to satisfy Rule 17Ad-22 standards is discussed above.

[28] *See* 12 U.S.C. 5464(b); 12 U.S.C. 5461(b).

the SLD Proposal satisfies neither the requirements of Section 806 nor the objectives and principles described in Section 805(b) of the Dodd-Frank Act.[29]

First, the SLD Proposal would reduce firms' liquidity and working capital to the extent they are required to make supplemental deposits, including interim deposits and deposits in response to liquidity calls, to the NSCC. This effect would pull liquidity out of the financial system as well, in amounts that could be significant.

Second, the SLD Proposal, if implemented, would make it difficult for firms to plan for their own liquidity needs during stress scenarios and could result in firm failures. NSCC members would have capital tied up in deposits to the NSCC's Clearing Fund, and there could be a significant question as to their ability to satisfy supplemental and interim liquidity deposit obligations and liquidity calls (particularly given their unspecified timing, frequency and/or size, as well as the short period of time in which the cash would need to be provided once required), let alone liquidity requirements related to the operations of their businesses in stress scenarios. In addition, the lack of certainty regarding the impact of the SLD Proposal year to year would make it difficult to evaluate firms' expected future performance, and thus could significantly impede the ability of firms to obtain investors in or lenders to their businesses when needed. The proposed supplemental liquidity requirements could, moreover, cause affected firms to exceed their regulatory net capital, either forcing firms to further capitalize their businesses or introducing firms with lower excess net capital and thus introducing credit risk. This risk further impacts other credit arrangements, counterparty risk and daily operating risk. The net result of these factors could very well be firm failures, as well as a significant negative impact on market liquidity and stability.

Third, the SLD Proposal could impact the decision of firms to continue self-clearing and clearing for other, smaller broker-dealers. The lack of a transition period for firms to consider and execute plans to modify their business activities or exit self-clearing if they are unable to make any required supplemental or interim deposits or to satisfy any liquidity calls would cause instability in the market. In addition, the decision of firms to exit self-clearing and exit businesses providing clearing services to other broker-dealers would result in concentration of risk at other clearing firms. This would result in additional execution costs that could be passed on to investors in the form of higher commissions and fees. Concentrating risk would also have a negative effect on market liquidity and could increase the potential for systemic disruption in the event of future firm failures or other market events.

These effects of the SLD Proposal could have a significant negative impact on the stability of the broader financial system, and it is unclear how the NSCC could mitigate this impact. It is notable that the NSCC itself has recognized that these effects could result from a requirement for member firms to make supplemental deposits in a circumstance that would have a far less significant impact on NSCC's members and the broader financial system. Specifically, in a recent filing with

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[29] Further, Section 17A(b)(3)(F) of the Exchange Act requires the rules of a clearing agency to be designed, "in general, to protect investors and the public interest," 15 U.S.C. 78q-1(b)(3)(F), and the Commission is required in connection with its regulation of clearing agencies to have due regard for the public interest and the protection of investors, 15 U.S.C. 78q-1(a)(2)(A). The significant negative effects of the SLD Proposal on systemic risk and the stability of the financial system are contrary to the public interest and the protection of investors.

the Commission in connection with its implementation of the Foreign Account Tax Compliance Act ("**FATCA**"), the NSCC declined to increase "the amount of cash required to be deposited into the Clearing Fund" because such an increase "would reduce [the affected] member's liquidity and could have significant systemic effects. The amount of the FATCA [w]ithholding taxes [that would otherwise be the subject of increased Clearing Fund deposits] would be removed from market liquidity, which could lead to increased risk of member failure and increased financial instability."[30]

In sum, the risks presented by the SLD Proposal to firms' liquidity, market liquidity, systemic risk and the stability of the financial system are quite significant.

V. The impact of the SLD Proposal on other regulatory requirements is unclear.

The NSCC SLD Proposal, if implemented, would implicate other regulatory requirements to which NSCC member firms are subject. Among other things, it is unclear how supplemental liquidity deposits would be treated with respect to the SEC's regulatory capital[31] and reserve[32] requirements. If the SLD Proposal is implemented, SIFMA requests that the Commission provide guidance regarding these regulatory requirements. In particular, SIFMA respectfully requests that the supplemental liquidity deposits be treated as "clearing deposits" for purposes of the SEC's net capital requirements. SIFMA also requests that the SEC permit clearing firms that have received funds from their clients specifically for purposes of any supplemental liquidity deposits due to the NSCC to offset the increased Rule 15c3-3 reserve formula requirement with a corresponding debit representing the client-funded portion of supplemental liquidity deposits on deposit with the NSCC, thus allowing Rule 15c3-3 treatment similar to that of the Options Clearing Corporation's margin requirement.

VI. Other, potentially more viable means to address liquidity needs exist.

SIFMA believes that longer-term measures to reduce liquidity requirements and provide the NSCC with the financial resources it needs would better serve the NSCC and its membership, and better address the goals of reducing systemic risk and supporting the stability of the broader financial system, than the SLD Proposal would. Among other things, the NSCC could take measures to reduce liquidity requirements, such as seeking to reduce the volume of unsettled trades in the system and working with the industry to develop a mechanism to address settlement risk in ID transactions, which we understand could significantly reduce the NSCC's liquidity needs. The NSCC should also integrate its systems with those of The Depository Trust Company so that the NSCC can assess each member firm's activities on a net basis, as opposed to a purchase-only basis. Such an assessment would more accurately reflect each firm's true risk profile and enable the NSCC to more accurately identify its liquidity requirements.

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[30] *Notice of Filing of Proposed Rule Change in Connection With the Implementation of the Foreign Account Tax Compliance Act (FATCA)*, Exchange Act Release No. 69497 (May 2, 2013), 78 FR 26838, 26840 (May 8, 2013) (approved pursuant to *Order Approving Proposed Rule Change in Connection with the Implementation of The Foreign Account Tax Compliance Act (FATCA)*, Exchange Act Release No. 69742 (June 12, 2013), 78 FR 36627 (June 18, 2013)).

[31] 17 C.F.R. 240.15c3-1.

[32] 17 C.F.R. 240.15c3-3.

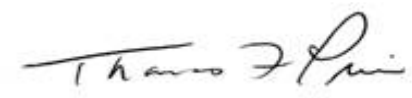
With respect to financial resources, the NSCC could consider changes to its capital structure that would provide longer-term financial resources and reduce the year-to-year variability and risk of the current proposal. In addition, the NSCC could implement alternatives or modifications to the SLD Proposal to provide any additional financial resources that may be required. These could include, among other things: increasing the size of the NSCC's revolving credit facility; seeking to obtain a multi-year credit facility or staggered credit facilities; increasing the amount of regular Clearing Fund deposits across all member firms; and/or permitting firms to deposit securities instead of or in addition to cash, to obtain letters of credit, and/or to arrange alternative credit facilities.

As noted above, SIFMA appreciates the need for the NSCC to maintain sufficient financial resources, and would welcome the opportunity to work with the NSCC to reduce liquidity requirements and develop alternatives to the SLD Proposal that might better achieve the NSCC's goals while mitigating or avoiding the significant negative effects the current proposal could have on NSCC members, on systemic risk and the stability of the broader financial market, and on the investing public.

* * *

SIFMA greatly appreciates the Commission's consideration of the matters raised above in connection with the NSCC's SLD Proposal. If you have any questions or would like to discuss any of the foregoing, please feel free to contact me at 212-313-1260.

Sincerely,



Thomas Price
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