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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No.* SR - 2017 - * 801
Amendment No. (req. for Amendments *)

Filing by Fixed Income Clearing Corporation

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial *	Amendment *	Withdrawal	Section 19(b)(2) *	Section 19(b)(3)(A) *	Section 19(b)(3)(B) *
☑	☐	☐	☐	☐	☐

Pilot ☐

Extension of Time Period for Commission Action * ☐

Date Expires *

Rule
☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☐ 19b-4(f)(6)

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010

Section 806(e)(1) * ☑
Section 806(e)(2) * ☐

Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934

Section 3C(b)(2) * ☐

Exhibit 2 Sent As Paper Document ☐
Exhibit 3 Sent As Paper Document ☐

Description

Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Proposed change to amend the GSD margin methodology.

Contact Information

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name * Donaldine Last Name * Temple
Title * Executive Director and Associate General Counsel
E-mail * dtemple@dtcc.com
Telephone * (212) 855-3277 Fax

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

Date 02/01/2017

By Donaldine Temple

(Name *)

(Title *)

Executive Director and Associate General Counsel

Persona Not Validated - 1465918991530,

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information * Add Remove View	The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.
Exhibit 1 - Notice of Proposed Rule Change * Add Remove View	The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO] -xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)
Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies * Add Remove View	The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO] -xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)
Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications Add Remove View Exhibit Sent As Paper Document ☐	Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.
Exhibit 3 - Form, Report, or Questionnaire Add Remove View Exhibit Sent As Paper Document ☐	Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.
Exhibit 4 - Marked Copies Add Remove View	The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.
Exhibit 5 - Proposed Rule Text Add Remove View	The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.
Partial Amendment Add Remove View	If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of Advance Notice

(a) This advance notice of Fixed Income Clearing Corporation ("FICC") would amend the Government Securities Division ("GSD") Rulebook ("GSD Rules")[1] to include a minimum volatility calculation called the "Margin Proxy." Under the proposed rule change, FICC would apply the greater of the amount calculated by the current model-based volatility calculation ("Current Volatility Calculation") and the Margin Proxy when determining a GSD Netting Member's ("Netting Member's") daily VaR Charge,[2] as further described below. In addition, FICC would modify the calculation of the Coverage Charge[3] in circumstances where the Margin Proxy applies as further described below.

In order to effectuate the proposed rule changes described above, FICC proposes to (1) add a new defined term for Margin Proxy in Rule 1 (Definitions); (2) amend the definition of VaR Charge in Rule 1 to reference the Margin Proxy; and (3) amend Section 1b of Rule 4 (Clearing Fund and Loss Allocation) to modify the calculation of the Coverage Charge when the Margin Proxy is applied.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed change was approved by the Risk Committee of FICC's Board of Directors on January 10, 2017.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Not applicable.

4. Self-Regulatory Organization's Statement on Burden on Competition

Not applicable.

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[1] Capitalized terms used herein and not defined shall have the meaning assigned to such terms in the GSD Rules available at www.dtcc.com/legal/rules-and-procedures.aspx.

[2] The Margin Proxy would be calculated as part of the determination of the VaR Charge that occurs twice daily, based on start-of-day positions and noon positions.

[3] See description of Coverage Charge in GSD Rule 1, Definitions, supra note 1.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

In connection with this proposed rule change, FICC received a written letter from Ronin Capital LLC ("Ronin Capital").[4] A copy of this letter is attached as Exhibit 2. The aspects of this letter that relate to the proposed rule change are described below.

Abbreviated Rule Approval Process

A. The new backup model is being rushed into production.

Ronin Capital has questioned whether the risk to FICC from the current full evaluation approach is so dire that a new backup model is required to be rushed into production.

FICC believes that the Current Volatility Calculation did not respond effectively to volatile market conditions and that it must implement the proposed Margin Proxy as described in this proposed rule change as soon as possible to effectively mitigate the market price risk of each Netting Member's Margin Portfolio. As described in Item 10 below, FICC believes that the proposed changes associated with the Margin Proxy and the Coverage Charge would help to ensure that each Netting Member's Required Fund Deposit achieves a 99 percent confidence level and the proposed changes would mitigate potential losses to FICC and non-defaulting Netting Members associated with the liquidation of a defaulted Netting Member's portfolio. As described in Item 10 below, the proposed changes would support FICC's compliance with Rule 17Ad-22(e)(4) because the Margin Proxy is designed to effectively identify, measure, monitor, and manage FICC's credit exposures to participants and those exposures arising from its payment, clearing, and settlement processes.[5]

B. An abbreviated rule approval process may not be appropriate when there are known flaws with the Margin Proxy.

Ronin Capital has questioned whether an abbreviated rule approval process is appropriate when there are known flaws with the Margin Proxy. Ronin Capital notes that an example of a flaw is the inability of the Margin Proxy to reflect risk offsets among portfolio positions.

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4 See Letter from Ronin Capital LLC to Messrs. Murray Pozmanter and Timothy Cuddihy dated January 20, 2017. This letter expressed a wide range of concerns, which FICC has and will continue to consider. The aspects of this letter which do not relate to the proposed rule change will be addressed by FICC outside of the context of this filing.

5 The Commission adopted amendments to Rule 17Ad-22, including the addition of new section 17Ad-22(e), on September 28, 2016. The amendments to Rule 17Ad-22 became effective on December 12, 2016. FICC is a "covered clearing agency" as defined in Rule 17Ad-22(a)(5) and must comply with new section (e) of Rule 17Ad-22 by April 11, 2017. See Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7-03-14).

As described in Item 10 below, FICC has identified a deficiency in the Current Volatility Calculation and FICC believes that it has a responsibility to rectify this deficiency as soon as possible. With this in mind, FICC is requesting that the U.S. Securities and Commission (the "Commission") notify FICC that it has no objection to the proposed changes as expeditiously as possible in order to address the impact that market volatility has had on the GSD VaR Charge. FICC believes that this request is appropriate because the proposed changes associated with the Margin Proxy and the Coverage Charge would help to protect FICC and its Netting Members by ensuring that FICC collects sufficient Required Fund Deposits in the event that the Current Volatility Calculation does not perform as expected during volatile market conditions.

Ronin Capital's assertion that the Margin Proxy does not provide for risk offsets is incorrect. As described in Item 10 below, the proposed Margin Proxy accounts for risk offsets by including a correlation adjustment to provide risk diversification across tenor buckets that have been historically observed across the U.S. Treasury benchmarks. The VaR Charge would preserve the same diversification between U.S. Treasury and MBS asset classes that is provided by the Current Volatility Calculation. FICC is not aware of any flaws with the proposed Margin Proxy and thus FICC believes that it is prudent to request that the Commission accelerate the effectiveness of the proposed change associated with the Margin Proxy and Coverage Charge.

C. The deployment of the Margin Proxy for an extended time may further burden competition.

Ronin Capital has expressed concern that GSD's expedited need for a new VaR model may result in the deployment of the backup Margin Proxy methodology for an extended amount of time which may burden competition.

FICC acknowledges that the proposed rule change associated with the Margin Proxy and Coverage Charge may burden competition, however, FICC believes that this burden would be necessary and appropriate in furtherance of the Securities Exchange Act of 1934, as amended (the "Act").[6]

The proposed rule change associated with the Margin Proxy and the Coverage Charge could burden competition because the proposed change would result in larger Required Fund Deposit amounts for Netting Members when the Margin Proxy calculates a VaR Charge that is greater than the amount calculated pursuant to the Current Volatility Calculation When application of the Margin Proxy increases Required Fund Deposits for Netting Members that have lower operating margins or higher costs of capital compared to other Netting Members, the proposed rule change could burden competition. However, FICC does not believe that the proposed rule change associated with the Margin Proxy and Coverage Charge would impose a significant burden on competition because the increase in the Required Fund Deposit would be in direct relation to the market risk presented by each Netting Member's Margin Portfolio. Moreover, the Required Fund Deposit would be calculated with the same parameters and at the

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6 See 15 U.S.C. 78s(b)(2).

confidence level for all Netting Members. Therefore, Netting Members that present similar Margin Portfolios would have similar impacts on their Required Fund Deposit amounts.

FICC believes that the burden on competition would be necessary and appropriate in furtherance of the Act because the proposed changes associated with the Margin Proxy and the Coverage Charge would support FICC's compliance with Rule 17Ad-22(b)(1) under the Act. Specifically, the proposed changes would be reasonably designed to (x) measure FICC's credit exposures to its participants at least once a day and (y) limit FICC's exposures to potential losses from defaults by its participants under normal market conditions.[7] The proposed changes would also support FICC's compliance with Rule 17Ad-22(b)(2) under the Act because the proposed changes would reflect FICC's use of risk-based models and parameters to set margin requirements which would be reviewed monthly.[8] The proposed Margin Proxy would also support FICC's compliance with Rule 17Ad-22(e)(4) and (e)(6) under the Act because the Margin Proxy would be subject to a performance review by FICC and the Margin Proxy is a risk based margin system that would be monitored, regularly reviewed, tested and verified on an ongoing basis.[9]

For these reasons, FICC believes that any burden on competition as a result of the proposed changes associated with the Margin Proxy and Coverage Charge would be necessary and appropriate in furtherance in further of the Act as cited above.

D. The Margin Proxy should be tested before filing a rule change and Netting Members should have the opportunity to prepare for the temporary model.

Ronin Capital expressed concern about whether FICC conducted a study of the Margin Proxy's impact prior to filing a rule change. Ronin Capital also noted that Netting Members have experience with the idiosyncrasies of the current model and that it does not make sense to rush to a new temporary model without giving Netting Members any length of time to prepare.

FICC believes that it conducted sufficient analysis prior to the submission of this proposed rule change to the Commission. FICC evaluated the sufficiency of the proposed changes for a period that exceeded 2 months. FICC's study included historical analysis of the backtesting sufficiency of the Margin Proxy. In addition, FICC reviewed the impact that the Margin Proxy would have on each Netting Member's Required Fund Deposit. In an effort to help Netting Members prepare for this proposed rule change, FICC outlined the rationale for the Margin Proxy and provided each Netting Member with reports that reflect the impact that the proposed change would have on such Netting Member's Required Fund Deposit. Thus, FICC believes that it has provided Netting Members with sufficient information and advance notice regarding the proposed changes. FICC recognizes that Netting Members may have experience

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7 See 17 CFR 240.17Ad-22(b)(1).

8 See 17 CFR 240.17Ad-22(b)(2).

9 Supra note 5.

with the idiosyncrasies of the Current Volatility Calculation. Nonetheless, FICC believes that the proposed rule change must be employed to help ensure that FICC collects sufficient Required Fund Deposit amounts at all times, particularly during volatile market conditions.

Lack of Transparency

A. Netting Members should have access to prospective rule changes before rules are filed.

Ronin Capital acknowledged that it appreciates FICC's communication with Netting Members about sensitive topics before submitting rules for commentary; however, Ronin Capital also noted that it is important for Netting Members to have access to prospective rules changes before such rules are filed with regulatory authorities.

FICC notes that it has and continues to engage in ongoing discussion with Netting Members about how proposals would impact them. With respect to this proposed change, FICC's outreach to Netting Members included discussions regarding GSD's Clearing Fund calculation as well as the VaR Charge methodology. As described above, in an effort to help Netting Members prepare for this proposed rule change, FICC outlined the rationale for the Margin Proxy and provided each Netting Member with reports that reflect the impact that the proposed change would have on such Netting Member's Required Fund Deposit. FICC staff has always made itself available to answer all questions or concerns raised by Netting Members. FICC believes that it has provided Netting Members with an appropriate level of disclosure regarding this proposed rule change and such disclosure gives Netting Members the ability to manage their obligations under the proposed rule change.

B. FICC should provide Netting Members with the ability to conduct scenario analysis and FICC's inability to do so could be anticompetitive.

Ronin Capital noted that FICC should give Netting Members the ability to conduct margin based scenario analysis. Ronan Capital also noted that given the differing costs of capital across the membership, FICC's inability to provide Netting Members with the ability to conduct such analysis could be anticompetitive.

FICC does not have technology that would allow Netting Members to conduct margin based scenario analysis. While FICC recognizes that that there may be additional benefits that Netting Members could derive from the provision of such technology by FICC, FICC does not believe that the lack of availability of such technology is anticompetitive. FICC has provided sufficient disclosure regarding the proposed change to its Netting Members and each Netting Member has been provided with the same level of disclosure. In addition, FICC staff has made itself available to answer all questions regarding the proposed change. Thus, FICC believes that all Netting Members have the ability to manage their obligations based on the information that FICC has provided in connection with this proposed change. FICC recognizes there may be additional benefits that Netting Members could derive from margin based scenario analysis thus FICC will endeavor to explore the development of this technology in the future.

6. Extension of Time Period for Commission Action

Not applicable.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notice Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Nature of the Proposed Change

FICC is proposing to introduce the Margin Proxy, which would constitute a Netting Member's daily VaR Charge in circumstances where the Margin Proxy would be greater than the Current Volatility Calculation. In circumstances where the Margin Proxy is applied by FICC, FICC also proposes to reduce the Coverage Charge by the amount that the Margin Proxy exceeds the sum of the Current Volatility Calculation and Coverage Charge, but not by an amount greater than the total Coverage Charge, as further described below.

A. Overview of The Required Fund Deposit and Clearing Fund Calculation

A key tool that FICC uses to manage market risk is the daily calculation and collection of Required Fund Deposits from Netting Members. The objective of a Netting Member's Required Fund Deposit is to mitigate potential losses to FICC associated with liquidation of such Netting Member's Margin Portfolio in the event that FICC ceases to act for such Netting Member (hereinafter referred to as a "default").[10]

A Netting Member's Required Fund Deposit consists of several components, including the VaR Charge and Coverage Charge. The VaR Charge comprises the largest portion of a Netting Member's Required Fund Deposit amount. The VaR Charge is calculated using a risk-based margin methodology that is intended to cover the market price risk associated with the securities in a Netting Member's Margin Portfolio. The methodology uses historical market

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10 GSD Rule 22A.

moves to project the potential gains or losses that could occur in connection with the liquidation of a defaulting Netting Member's Margin Portfolio.

The Coverage Charge is calculated based on the Netting Member's daily backtesting results. FICC employs daily backtesting to determine the adequacy of each Netting Member's Required Fund Deposit. The backtesting compares the Required Fund Deposit for each Netting Member with actual price changes in the Netting Member's Margin Portfolio. The Margin Portfolio values are calculated using the actual positions in such Netting Member's Margin Portfolio on a given day and the observed security price changes over the following three days. These backtesting results are reviewed as part of FICC's VaR model performance monitoring and assessment of the adequacy of each Netting Member's Required Fund Deposit.

The Coverage Charge is incorporated in the Required Fund Deposit for each Netting Member to increase the Required Fund Deposit so that the Netting Member's backtesting coverage may achieve the 99 percent confidence level (i.e., two or fewer backtesting deficiency days in a rolling twelve-month period).

B. *Proposed Change to the Existing VaR Charge Calculation*

During the fourth quarter of 2016, FICC's Current Volatility Calculation did not respond effectively to the level of market volatility at that time, and the VaR Charge amounts that were calculated using the profit and loss scenarios generated by the Current Volatility Calculation did not achieve backtesting coverage at a 99 percent confidence level. As a result, the Required Fund Deposit yielded backtesting deficiencies beyond FICC's risk tolerance. Therefore, FICC proposes to use the Margin Proxy as the VaR Charge when the Margin Proxy calculation would exceed the Current Volatility Calculation.

The Margin Proxy would cover circumstances where the Current Volatility Calculation is lower than market price volatility from corresponding U.S. Treasury and to-be-announced ("TBA")[11] securities benchmarks.

More specifically, the Margin Proxy would reflect separate calculations for U.S. Treasury securities and agency pass-through mortgage backed securities ("MBS"). The purpose of the separate calculations would be to cover the historical market prices of each of those asset classes to a 99 percent confidence level, on a standalone basis, because the historical price changes of the two asset classes are different due to market factors, such as credit spreads and prepayment risk. This separate calculation would also allow FICC to monitor the performance of each of those asset classes individually.

The Margin Proxy would be calculated per Netting Member. Each security in a Netting Member's Margin Portfolio would be mapped to a respective benchmark based on the security's

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[11] Specified pool trades are mapped to the corresponding positions in TBA securities for determining the VaR Charge.

asset class and maturity.[12] All securities within each benchmark would be aggregated into a net exposure.[13] Next, FICC would apply an applicable haircut[14] to the net exposure per benchmark to determine the net price risk for each benchmark ("Net Price Risk"). Finally, FICC would determine the asset class price risk ("Asset Class Price Risk") for U.S. Treasury and MBS benchmarks separately by aggregating the respective Net Price Risk, and for the U.S. Treasury benchmarks, the calculation includes a correlation adjustment, to provide risk diversification across tenor buckets, that has been historically observed across the U.S. Treasury benchmarks. The Margin Proxy would represent the sum of the U.S. Treasury and MBS Asset Class Price Risk. FICC would compare the Margin Proxy to the Current Volatility Calculation. FICC would apply the greater of the Margin Proxy or the Current Volatility Calculation for each asset class as the VaR Charge for each Netting Member's Margin Portfolio.

FICC believes that this proposal would provide the adequate Required Fund Deposit per Netting Member because the backtesting coverage including the Margin Proxy has been above the 99 percent confidence level for the past four years. Additionally, the Margin Proxy would be transparent to Netting Members because it would use industry standard benchmarks that can be observed by Netting Members.

The Margin Proxy methodology would be subject to performance reviews by FICC. Specifically, FICC would monitor each Netting Member's Required Fund Deposit and the aggregate Clearing Fund requirements versus the requirements calculated by the Margin Proxy. Consistent with the current GSD Rules,[15] FICC would review the robustness of the Margin Proxy by comparing the results versus the three-day profit and loss of each Netting Member's Margin Portfolio based on actual market price moves. If the Margin Proxy's backtesting results do not meet FICC's 99 percent confidence level, FICC would consider adjustments to the Margin Proxy, including increasing the look-back period and/or applying a historical stressed period to the Margin Proxy calibration, as appropriate.

C. *Proposed Modification to the Coverage Charge when the Margin Proxy is Applied*

FICC also proposes to modify the calculation of the Coverage Charge when the Margin Proxy is applied as the VaR Charge. Specifically, FICC would reduce the Coverage Charge by

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12 U.S. Treasury and agency securities would be mapped to a U.S. Treasury benchmark security/index. Mortgage-backed securities would be mapped to a TBA security/index.

13 Net exposure is the aggregate market value of securities to be purchased by the Netting Member minus the aggregate market value of securities to be sold by the Netting Member.

14 The haircut is calculated using historical market price changes of the respective benchmark to cover the expected market price volatility at 99 percent confidence level.

15 See definition of VaR Charge in GSD Rule 1, Definitions, supra note 1.

the amount that the Margin Proxy exceeds the sum of the Current Volatility Calculation and Coverage Charge, but not by an amount greater than the total Coverage. FICC's backtesting analysis demonstrates that the proposed Margin Proxy would provide sufficient margin coverage without the addition of the Coverage Charge because FICC backtest results inclusive of the Margin Proxy achieve the 99 percent confidence level without the inclusion of the Coverage Charge.

FICC would not modify the Coverage Charge if the Margin Proxy is not applied as the VaR Charge.

Anticipated Effect on and Management of Risks

FICC believes that the proposed changes to establish the Margin Proxy and to adjust the Coverage Charge when the Margin Proxy is applied would enable FICC to better limit its exposure to Netting Members arising out of the activity in their Margin Portfolios.

The proposal to establish the Margin Proxy would affect FICC's management of risk because it would help to address deficiencies observed in the Current Volatility Calculation by establishing the Margin Proxy as a minimum volatility calculation for each Netting Member's Margin Portfolio based on historical price changes of a set of reference securities. The proposed methodology would enhance FICC's risk management capabilities by establishing a volatility floor based on the composition of each Netting Member's Margin Portfolio, enabling FICC to establish a VaR Charge that provides better backtesting coverage than the Current Volatility Calculation.

FICC's proposal to modify the calculation of the Coverage Charge would affect FICC's management of risk by removing unnecessary components from the Required Fund Deposit calculation. As described above, the Coverage Charge is based on historical portfolio activity, which may not be indicative of a Netting Member's current risk profile. As part of FICC's development of the Margin Proxy, FICC performed backtesting to validate model performance, and conducted analyses to determine the impact of the proposed changes to the Netting Members. Results of FICC's backtesting performance when the Margin Proxy is applied indicate that the backtesting coverage is higher when the VaR Charge includes the Margin Proxy and the Coverage Charge has been adjusted, as compared to the VaR Charge including the Current Volatility Calculation and the unadjusted Coverage Charge. Given an improvement in model coverage that achieves coverage above the 99 percent confidence level, FICC believes that it is appropriate to reduce the Coverage Charge by the amount that the Margin Proxy exceeds the sum of the Current Volatility Calculation and Coverage Charge, but not by an amount greater than the total Coverage Charge, as further described below.

FICC has also managed the effect of the overall proposal by conducting outreach with Netting Members regarding the proposed changes and informing such Members as to the reasons for these proposed changes. FICC has provided each Netting Member with an individual impact study. In addition, FICC's Market Risk Management team and Relationship Management team have been available to answer all questions.

Consistency with the Clearing Supervision Act

FICC believes the proposed changes, described above, are consistent with Section 805(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act")[16] because these changes would promote robust risk management by giving GSD the ability to better cover its exposure to Netting Members arising out of the activity of such Members' Margin Portfolios.

In addition, FICC believes that the proposed changes associated with the Margin Proxy and Coverage Charge are consistent with the requirements of Rules 17Ad-22(b)(1) and (b)(2) under the Act.[17] Rule 17Ad-22(b)(1) requires a registered clearing agency that performs central counterparty services to establish, implement, maintain and enforce written policies and procedures reasonably designed to measure its credit exposures to its participants at least once a day and limit its exposures to potential losses from defaults by its participants under normal market conditions so that the operations of the clearing agency would not be disrupted and non-defaulting participants would not be exposed to losses that they cannot anticipate or control.[18] The proposed changes associated with the Margin Proxy and Coverage Charge would continue FICC's practice of measuring its credit exposures at least once a day and would enhance GSD's risk-based margining framework, the objective of which is to calculate each Netting Member's Required Fund Deposit such that, in the event of a Netting Member's default, the defaulting Netting Member's own Required Fund Deposit would mitigate potential losses to FICC and non-defaulting Netting Members associated with the liquidation of such defaulted Netting Member's portfolio. Therefore, FICC believes that these proposed changes are consistent with Rule 17Ad2-22(b)(1) under the Act.

Rule 17Ad-22(b)(2) under the Act requires a registered clearing agency that performs central counterparty services to establish, implement, maintain and enforce written policies and procedures reasonably designed to use margin requirements to limit its credit exposures to participants under normal market conditions and use risk-based models and parameters to set margin requirements and review such margin requirements and the related risk-based models and parameters at least monthly.[19] The proposed changes associated with the Margin Proxy and Coverage Charge would enhance the risk-based model and parameters that establish margin requirements for Netting Members. This enhancement to the risk-based model and parameters would use margin requirements to limit FICC's credit exposure to its Netting Members. Since the proposed changes are designed to calculate each Netting Member's Required Fund Deposit at a 99 percent confidence level, FICC believes each Netting Member's Required Fund Deposit could mitigate its own losses in the event that such Netting Member defaults under normal

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16 See 12 U.S.C. 5464(b).

17 See 17 CFR 240.17Ad-22(b)(1) and (b)(2).

18 See 17 CFR 240.17Ad-22(b)(1).

19 See 17 CFR 240.17Ad-22(b)(2).

market conditions. Therefore, FICC believes that these proposed changes are consistent with Rule 17Ad2-22(b)(2) under the Act.

FICC also believes that the proposed changes are consistent with Rules 17Ad-22(e)(4) and (e)(6) of the Act, which were recently adopted by the Commission.[20] Rule 17Ad-22(e)(4) will require FICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those exposures arising from its payment, clearing, and settlement processes.[21] The Margin Proxy methodology would be subject to performance reviews by FICC. If the Margin Proxy's backtesting results do not meet FICC's 99 percent confidence level, FICC would consider adjustments to the Margin Proxy, including increasing the look-back period and/or applying a historical stressed period to the Margin Proxy calibration, as appropriate. Therefore, the proposed changes associated with the Margin Proxy and Coverage Charge would enhance FICC's ability to identify, measure, monitor and manage its credit exposures to Netting Members and those exposures arising from its payment, clearing, and settlement processes by maintaining financial resources to cover a wide range of foreseeable price moves under both normal and stressed market conditions. Therefore, FICC believes the proposed changes are consistent with the requirements of Rule 17Ad-22(e)(4), promulgated under the Act.

Rule 17Ad-22(e)(6) will require FICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that is monitored by management on an ongoing basis and regularly reviewed, tested, and verified.[22] The proposed changes associated with the Margin Proxy enhance GSD's risk-based margin system that would continue to be monitored by FICC management on an ongoing basis and regularly reviewed, tested, and verified. Therefore, FICC believes that the proposed changes are consistent with the requirements of Rule 17Ad-22(e)(6), promulgated under the Act.

Accelerated Commission Action Requested

Pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,[23] FICC requests that the Commission notify FICC that it has no objection to the proposed changes as expeditiously as possible. FICC requests accelerated Commission action in order to address the impact of recent volatility in the financial markets on the GSD VaR Charge. GSD's VaR Charge did not achieve backtesting coverage at a 99 percent confidence level, as described herein. The proposed changes would enhance the risk-based model and parameters that establish margin requirements for Netting Members. These enhancements to the risk-based model and parameters are designed

[20] Supra note 5.

[21] Id.

[22] Id.

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

to calculate each Netting Member's Required Fund Deposit at a 99 percent confidence level and would mitigate potential losses to FICC and non-defaulting Netting Members associated with the liquidation of a defaulted Netting Member's portfolio.

11. Exhibits

Exhibit 1 – Not applicable.

Exhibit 1A – Notice of advance notice for publication in the Federal Register.

Exhibit 2 – Comment letter received from Ronin Capital LLC in connection with the proposed rule change.

Exhibit 3 – Not applicable.

Exhibit 4 – Not applicable.

Exhibit 5 – Proposed changes to the GSD Rules.

EXHIBIT 1A

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-[_________]; File No. SR-FICC-2017-801)

[DATE]

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Advance Notice to (1) Implement the Margin Proxy and (2) Modify the Calculation of the Coverage Charge in Circumstances Where the Margin Proxy Applies

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, as amended ("Act"),[2] notice is hereby given that on February 2, 2017, Fixed Income Clearing Corporation ("FICC") filed with the U.S. Securities and Exchange Commission ("Commission") the advance notice SR-FICC-2017-801 ("Advance Notice") as described in Items I, II and III below, which Items have been prepared by the clearing agency.[3] The Commission is publishing this notice to solicit comments on the Advance Notice from interested persons.

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1 See 12 U.S.C. 5465(e)(1).

2 See 17 CFR 240.19b-4(n)(1)(i).

3 On February 2, 2017, FICC filed this Advance Notice as a proposed rule change (SR-FICC-2017-001) with the Commission pursuant to Section 19(b)(1) of the Act, 15 U.S.C. 78s(b)(1), and Rule 19b-4, 17 CFR 240.19b-4. A copy of the proposed rule change is available at http://www.dtcc.com/legal/sec-rule-filings.aspx.

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

This Advance Notice consists of amendments to the FICC Government Securities Division ("GSD") Rulebook ("GSD Rules")[4] in order to include a minimum volatility calculation called the "Margin Proxy." Under the proposed rule change, FICC would apply the greater of the amount calculated by the current model-based volatility ("Current Volatility Calculation") calculation and the Margin Proxy when determining a GSD Netting Member's ("Netting Member's") daily VaR Charge,[5] as further described below. In addition, FICC would modify the calculation of the Coverage Charge[6] in circumstances where the Margin Proxy applies, as further described below.

In order to effectuate the proposed rule changes described above, FICC proposes to (1) add a new defined term for Margin Proxy in Rule 1 (Definitions); (2) amend the definition of VaR Charge in Rule 1 to reference the Margin Proxy; and (3) amend Section 1b of Rule 4 (Clearing Fund and Loss Allocation) to modify the calculation of the Coverage Charge when the Margin Proxy is applied.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, the clearing agency included statements concerning the purpose of and basis for the Advance Notice and discussed any comments it received on the Advance Notice. The text of these statements may be examined at the

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4 Capitalized terms used herein and not defined shall have the meaning assigned to such terms in the GSD Rules available at www.dtcc.com/legal/rules-and-procedures.aspx.

5 The Margin Proxy would be calculated as part of the determination of the VaR Charge that occurs twice daily, based on start-of-day positions and noon positions.

6 See description of Coverage Charge in GSD Rule 1, Definitions, supra note 4.

places specified in Item IV below. The clearing agency has prepared summaries, set forth in sections A and B below, of the most significant aspects of such statements.

(A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants, or Others

In connection with this proposed rule change, FICC received a written letter from Ronin Capital LLC ("Ronin Capital").[7] A copy of this letter is attached as Exhibit 2. The aspects of this letter that relate to the proposed rule change are described below.

Abbreviated Rule Approval Process

A. The new backup model is being rushed into production.

Ronin Capital has questioned whether the risk to FICC from the current full evaluation approach is so dire that a new backup model is required to be rushed into production.

FICC believes that the Current Volatility Calculation did not respond effectively to volatile market conditions and that it must implement the proposed Margin Proxy as described in this proposed rule change as soon as possible to effectively mitigate the market price risk of each Netting Member's Margin Portfolio. As described in Item II(B) below, FICC believes that the proposed changes associated with the Margin Proxy and the Coverage Charge would help to ensure that each Netting Member's Required Fund Deposit achieves a 99 percent confidence level and the proposed changes would mitigate potential losses to FICC and non-defaulting Netting Members associated with the liquidation of a defaulted Netting Member's portfolio. As described in Item II(B) below, the proposed changes would support FICC's compliance with Rule 17Ad-22(e)(4)

[7] See Letter from Ronin Capital LLC to Messrs. Murray Pozmanter and Timothy Cuddihy dated January 20, 2017. This letter expressed a wide range of concerns, which FICC has and will continue to consider. The aspects of this letter which do not relate to the proposed rule change will be addressed by FICC outside of the context of this filing.

because the Margin Proxy is designed to effectively identify, measure, monitor, and manage FICC's credit exposures to participants and those exposures arising from its payment, clearing, and settlement processes.[8]

B. An abbreviated rule approval process may not be appropriate when there are known flaws with the Margin Proxy.

Ronin Capital has questioned whether an abbreviated rule approval process is appropriate when there are known flaws with the Margin Proxy. Ronin Capital notes that an example of a flaw is the inability of the Margin Proxy to reflect risk offsets among portfolio positions.

As described in II(B) below above, FICC has identified a deficiency in the Current Volatility Calculation and FICC believes that it has a responsibility to rectify this deficiency as soon as possible. With this in mind, FICC is requesting that the Commission notify FICC that it has no objection to the proposed changes as expeditiously as possible in order to address the impact that market volatility has had on the GSD VaR Charge. FICC believes that this request is appropriate because the proposed changes associated with the Margin Proxy and the Coverage Charge would help to protect FICC and its Netting Members by ensuring that FICC collects sufficient Required Fund Deposits in the event that the Current Volatility Calculation does not perform as expected during volatile market conditions.

[8] The Commission adopted amendments to Rule 17Ad-22, including the addition of new section 17Ad-22(e), on September 28, 2016. The amendments to Rule 17Ad-22 became effective on December 12, 2016. FICC is a "covered clearing agency" as defined in Rule 17Ad-22(a)(5) and must comply with new section (e) of Rule 17Ad-22 by April 11, 2017. See Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7-03-14).

Ronin Capital's assertion that the Margin Proxy does not provide for risk offsets is incorrect. As described in Item II(B) below, the proposed Margin Proxy accounts for risk offsets by including a correlation adjustment to provide risk diversification across tenor buckets that have been historically observed across the U.S. Treasury benchmarks. The VaR Charge would preserve the same diversification between U.S. Treasury and MBS asset classes that is provided by the Current Volatility Calculation. FICC is not aware of any flaws with the proposed Margin Proxy and thus FICC believes that it is prudent to request that the Commission accelerate the effectiveness of the proposed change associated with the Margin Proxy and Coverage Charge.

C. The deployment of the Margin Proxy for an extended time may further burden competition.

Ronin Capital has expressed concern that GSD's expedited need for a new VaR model may result in the deployment of the backup Margin Proxy methodology for an extended amount of time which may burden competition.

FICC acknowledges that the proposed rule change associated with the Margin Proxy and Coverage Charge may burden competition, however, FICC believes that this burden would be necessary and appropriate in furtherance of the Act.

The proposed rule change associated with the Margin Proxy and the Coverage Charge could burden competition because the proposed change would result in larger Required Fund Deposit amounts for Netting Members when the Margin Proxy calculates a VaR Charge that is greater than the amount calculated pursuant to the Current Volatility Calculation When application of the Margin Proxy increases Required Fund Deposits for Netting Members that have lower operating margins or higher costs of capital compared to other Netting Members, the proposed rule change could burden competition.

However, FICC does not believe that the proposed rule change associated with the Margin Proxy and Coverage Charge would impose a significant burden on competition because the increase in the Required Fund Deposit would be in direct relation to the market risk presented by each Netting Member's Margin Portfolio. Moreover, the Required Fund Deposit would be calculated with the same parameters and at the confidence level for all Netting Members. Therefore, Netting Members that present similar Margin Portfolios would have similar impacts on their Required Fund Deposit amounts.

FICC believes that the burden on competition would be necessary and appropriate in furtherance of the Act because the proposed changes associated with the Margin Proxy and the Coverage Charge would support FICC's compliance with Rule 17Ad-22(b)(1) under the Act. Specifically, the proposed changes would be reasonably designed to (x) measure FICC's credit exposures to its participants at least once a day and (y) limit FICC's exposures to potential losses from defaults by its participants under normal market conditions.[9] The proposed changes would also support FICC's compliance with Rule 17Ad-22(b)(2) under the Act because the proposed changes would reflect FICC's use of risk-based models and parameters to set margin requirements which would be reviewed monthly.[10] The proposed Margin Proxy would also support FICC's compliance with Rule 17Ad-22(e)(4) and (e)(6) under the Act because the Margin Proxy would be subject to a performance review by FICC and the Margin Proxy is a risk based margin

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[9] See 17 CFR 240.17Ad-22(b)(1).

[10] See 17 CFR 240.17Ad-22(b)(2).

system that would be monitored, regularly reviewed, tested and verified on an ongoing basis.[11]

For these reason, FICC believes that any burden on competition as a result of the proposed changes associated with the Margin Proxy and Coverage Charge would be necessary in furtherance in further of the Act as cited above.

D. The Margin Proxy should be tested before filing a rule change and Netting Members should have the opportunity to prepare for the temporary model.

Ronin Capital expressed concern about whether FICC conducted a study of the Margin Proxy's impact prior to filing a rule change. Ronin Capital also noted that Netting Members have experience with the idiosyncrasies of the current model and that it does not make sense to rush to a new temporary model without giving Netting Members any length of time to prepare.

FICC believes that it conducted sufficient analysis prior to the submission of this proposed rule change to the Commission. FICC evaluated the sufficiency of the proposed changes for a period that exceeded 2 months. FICC's study included historical analysis of the backtesting sufficiency of the Margin Proxy. In addition, FICC reviewed the impact that the Margin Proxy would have on each Netting Member's Required Fund Deposit. In an effort to help Netting Members prepare for this proposed rule change, FICC outlined the rationale for the Margin Proxy and provided each Netting Member with reports that reflect the impact that the proposed change would have on such Netting Member's Required Fund Deposit. Thus, FICC believes that it has provided Netting Members with sufficient information and advance notice regarding the proposed changes. FICC recognizes that Netting Members may have experience with the idiosyncrasies of

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11 Supra note 8.

the Current Volatility Calculation, FICC nonetheless believes that the proposed rule change must be employed to help ensure that FICC collects sufficient Required Fund Deposit amounts at all times, particularly during volatile market conditions.

Lack of Transparency

A. Netting Members should have access to prospective rule changes before rules are filed.

Ronin Capital acknowledged that it appreciates FICC's communication with Netting Members about sensitive topics before submitting rules for commentary; however, Ronin Capital also noted that it is important for Netting Members to have access to prospective rules changes before such rules are filed with regulatory authorities.

In response to the above, FICC notes that it has and continues to engage in ongoing discussion with Netting Members about how proposals would impact them. With respect to this proposed change, FICC's outreach to Netting Members included discussions regarding GSD's Clearing Fund calculation as well as the VaR Charge methodology. As described above, in an effort to help Netting Members prepare for this proposed rule change, FICC outlined the rationale for the Margin Proxy and provided each Netting Member with reports that reflect the impact that the proposed change would have on such Netting Member's Required Fund Deposit. FICC staff has always made itself available to answer all questions or concerns raised by Netting Members. FICC believes that it has provided Netting Members with an appropriate level of disclosure regarding this proposed rule change and such disclosure gives Netting Members the ability to manage their obligations under the proposed rule change.

B. FICC should provide Netting Members with the ability to conduct scenario analysis and FICC's inability to do so could be anticompetitive.

Ronin Capital noted that FICC should give Netting Members the ability to conduct margin based scenario analysis. Ronan Capital also noted that given the differing costs of capital across the membership, FICC's inability to provide Netting Members with the ability to conduct such analysis could be anticompetitive.

FICC does not have technology that would allow Netting Members to conduct margin based scenario analysis. While FICC recognizes that that there may be additional benefits that Netting Members could derive from the provision of such technology by FICC, FICC does not believe that the lack of availability of such technology is anticompetitive. FICC has provided sufficient disclosure regarding the proposed change to its Netting Members and each Netting Member has been provided with the same level of disclosure. In addition, FICC staff has made itself available to answer all questions regarding the proposed change. Thus, FICC believes that all Netting Members have the ability to manage their obligations based on the information that FICC has provided in connection with this proposed change. FICC recognizes there may be additional benefits that Netting Members could derive from margin based scenario analysis thus FICC will endeavor to explore the development of this technology in the future.

While FICC recognizes that that there may be additional benefits that Netting Members could derive from the provision of such technology by FICC, FICC does not believe that the lack of availability of such technology is anticompetitive.

(B) Advance Notice Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Nature of the Proposed Change

FICC is proposing to introduce the Margin Proxy, which would constitute a Netting Member's daily VaR Charge in circumstances where the Margin Proxy would be greater than the Current Volatility Calculation. In circumstances where the Margin Proxy is applied by FICC, FICC also proposes to reduce the Coverage Charge by the amount that the Margin Proxy exceeds the sum of the Current Volatility Calculation and Coverage Charge, but not by an amount greater than the total Coverage Charge, as further described below.

A. *Overview of the Required Fund Deposit and Clearing Fund Calculation*

A key tool that FICC uses to manage market risk is the daily calculation and collection of Required Fund Deposits from Netting Members. The objective of a Netting Member's Required Fund Deposit is to mitigate potential losses to FICC associated with liquidation of such Netting Member's Margin Portfolio in the event that FICC ceases to act for such Netting Member (hereinafter referred to as a "default").[12]

A Netting Member's Required Fund Deposit consists of several components, including the VaR Charge and Coverage Charge. The VaR Charge comprises the largest portion of a Netting Member's Required Fund Deposit amount. The VaR Charge is calculated using a risk-based margin methodology that is intended to cover the market price risk associated with the securities in a Netting Member's Margin Portfolio.

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[12] GSD Rule 22A.

The Coverage Charge is calculated based on the Netting Member's daily backtesting results. FICC employs daily backtesting to determine the adequacy of each Netting Member's Required Fund Deposit. The backtesting compares the Required Fund Deposit for each Netting Member with actual price changes in the Netting Member's Margin Portfolio. The Margin Portfolio values are calculated using the actual positions in such Netting Member's Margin Portfolio on a given day and the observed security price changes over the following three days. These backtesting results are reviewed as part of FICC's VaR model performance monitoring and assessment of the adequacy of each Netting Member's Required Fund Deposit.

The Coverage Charge is incorporated in the Required Fund Deposit for each Netting Member to increase the Required Fund Deposit so that the Netting Member's backtesting coverage may achieve the 99 percent confidence level (i.e., greater than two backtesting deficiency days in a rolling twelve-month period).

B. *Proposed Change to the Existing VaR Charge Calculation*

During the fourth quarter of 2016, FICC's Current Volatility Calculation did not respond effectively to the level of market volatility at that time, and the VaR Charge amounts that were calculated using the profit and loss scenarios generated by the Current Volatility Calculation did not achieve backtesting coverage at a 99 percent confidence level. As a result, the Required Fund Deposit yielded backtesting deficiencies beyond FICC's risk tolerance. Therefore, FICC proposes to use the Margin Proxy as the VaR Charge when the Margin Proxy calculation would exceed the Current Volatility Calculation.

The Margin Proxy would cover circumstances where the Current Volatility Calculation is lower than market price volatility from corresponding U.S. Treasury and to-be-announced (“TBA”)[13] securities benchmarks.

More specifically, the Margin Proxy would reflect separate calculations for U.S. Treasury securities and agency pass-through mortgage backed securities (“MBS”). The purpose of the separate calculations would be to cover the historical market prices of each of those asset classes to a 99 percent confidence level, on a standalone basis, because the historical price changes of the two asset classes are different due to market factors, such as credit spreads and prepayment risk. This separate calculation would also allow FICC to monitor the performance of each of those asset classes individually.

The Margin Proxy would be calculated per Netting Member. Each security in a Netting Member’s Margin Portfolio would be mapped to a respective benchmark based on the security’s asset class and maturity.[14] All securities within each benchmark would be aggregated into a net exposure.[15] Next, FICC would apply an applicable haircut[16] to the net exposure per benchmark to determine the net price risk for each benchmark (“Net Price Risk”). Finally, FICC would determine the asset class price risk (“Asset Class

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13 Specified pool trades are mapped to the corresponding positions in TBA securities for determining the VaR Charge.

14 U.S. Treasury and agency securities would be mapped to a U.S. Treasury benchmark security/index. Mortgage-backed securities would be mapped to a TBA security/index.

15 Net exposure is the aggregate market value of securities to be purchased by the Netting Member minus the aggregate market value of securities to be sold by the Netting Member.

16 The haircut is calculated using historical market price changes of the respective benchmark to cover the expected market price volatility at 99 percent confidence level.

Price Risk") for U.S. Treasury and MBS benchmarks separately by aggregating the respective Net Price Risk, and for the U.S. Treasury benchmarks, the calculation includes a correlation adjustment, to provide risk diversification across tenor buckets, that has been historically observed across the U.S. Treasury benchmarks. The Margin Proxy would represent the sum of the U.S. Treasury and MBS Asset Class Price Risk. FICC would compare the Margin Proxy to the Current Volatility Calculation. FICC would apply the greater of the Margin Proxy or the Current Volatility Calculation for each asset class as the VaR Charge for each Netting Member's Margin Portfolio.

FICC believes that this proposal would provide the adequate Required Fund Deposit per Netting Member because the backtesting coverage including the Margin Proxy has been above the 99 percent confidence level for the past four years. Additionally, the Margin Proxy would be transparent to Netting Members because it would use industry standard benchmarks that can be observed by Netting Members.

The Margin Proxy methodology would be subject to performance reviews by FICC. Specifically, FICC would monitor each Netting Member's Required Fund Deposit and the aggregate Clearing Fund requirements versus the requirements calculated by the Margin Proxy. Consistent with the current GSD Rules,[17] FICC would review the robustness of the Margin Proxy by comparing the results versus the three-day profit and loss of each Netting Member's Margin Portfolio based on actual market price moves. If the Margin Proxy's backtesting results do not meet FICC's 99 percent confidence level, FICC would consider adjustments to the Margin Proxy, including increasing the look-

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17 See definition of VaR Charge in GSD Rule 1, Definitions, supra note 4.

back period and/or applying a historical stressed period to the Margin Proxy calibration, as appropriate.

C. *Proposed Modification to the Coverage Charge when the Margin Proxy is Applied*

FICC also proposes to modify the calculation of the Coverage Charge when the Margin Proxy is applied as the VaR Charge. Specifically, FICC would reduce the Coverage Charge by the amount that the Margin Proxy exceeds the sum of the Current Volatility Calculation and Coverage Charge, but not by an amount greater than the total Coverage. FICC's backtesting analysis demonstrates that the proposed Margin Proxy would provide sufficient margin coverage without the addition of the Coverage Charge because FICC backtest results inclusive of the Margin Proxy achieve the 99 percent confidence level without the inclusion of the Coverage Charge.

FICC would not modify the Coverage Charge if the Margin Proxy is not applied as the VaR Charge.

Anticipated Effect on and Management of Risks

FICC believes that the proposed changes to establish the Margin Proxy and to adjust the Coverage Charge when the Margin Proxy is applied would enable FICC to better limit its exposure to Netting Members arising out of the activity in their Margin Portfolios.

The proposal to establish the Margin Proxy would affect FICC's management of risk because it would help to address deficiencies observed in the Current Volatility Calculation by establishing the Margin Proxy as a minimum volatility calculation for each Netting Member's Margin Portfolio based on historical price changes of a set of reference securities. The proposed methodology would enhance FICC's risk management capabilities by establishing a volatility floor based on the composition of each Netting Member's Margin Portfolio, enabling FICC to establish a VaR Charge that provides better backtesting coverage than the Current Volatility Calculation.

FICC's proposal to modify the calculation of the Coverage Charge would affect FICC's management of risk by removing unnecessary components from the Required Fund Deposit calculation. As described above, the Coverage Charge is based on historical portfolio activity, which may not be indicative of a Netting Member's current risk profile. As part of FICC's development of the Margin Proxy, FICC performed backtesting to validate model performance, and conducted analyses to determine the impact of the proposed changes to the Netting Members. Results of FICC's backtesting performance when the Margin Proxy is applied indicate that the backtesting coverage is higher when the VaR Charge includes the Margin Proxy and the Coverage Charge has been adjusted, as compared to the VaR Charge including the Current Volatility Calculation and the unadjusted Coverage Charge. Given an improvement in model coverage that achieves coverage above the 99 percent confidence level, FICC believes that it is appropriate to reduce the Coverage Charge by the amount that the Margin Proxy exceeds the sum of the Current Volatility Calculation and Coverage Charge, but not by an amount greater than the total Coverage Charge, as further described below.

FICC has also managed the effect of the overall proposal by conducting outreach with Netting Members regarding the proposed changes and informing such Members as to the reasons for these proposed changes. FICC has provided each Netting Member with an individual impact study. In addition, FICC's Market Risk Management team and Relationship Management team have been available to answer all questions.

<u>Consistency with the Clearing Supervision Act</u>

FICC believes the proposed changes, described above, are consistent with Section 805(b) of the Clearing Supervision Act[18] because these changes would promote robust risk management by giving GSD the ability to better cover its exposure to Netting Members arising out of the activity of such Members' Margin Portfolios.

In addition, FICC believes that the proposed changes associated with the Margin Proxy and Coverage Charge are consistent with the requirements of Rules 17Ad-22(b)(1) and (b)(2) under the Act.[19] Rule 17Ad-22(b)(1) requires a registered clearing agency that performs central counterparty services to establish, implement, maintain and enforce written policies and procedures reasonably designed to measure its credit exposures to its participants at least once a day and limit its exposures to potential losses from defaults by its participants under normal market conditions so that the operations of the clearing agency would not be disrupted and non-defaulting participants would not be exposed to losses that they cannot anticipate or control.[20] The proposed changes associated with the Margin Proxy and Coverage Charge would continue FICC's practice of measuring its credit exposures at least once a day and would enhance GSD's risk-based margining framework, the objective of which is to calculate each Netting Member's Required Fund Deposit such that, in the event of a Netting Member's default, the defaulting Netting Member's own Required Fund Deposit would mitigate potential losses to FICC and non-defaulting Netting Members associated with the liquidation of such defaulted Netting

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18 <u>See</u> 12 U.S.C. 5464(b).

19 <u>See</u> 17 CFR 240.17Ad-22(b)(1) and (b)(2).

20 <u>See</u> 17 CFR 240.17Ad-22(b)(1).

Member's portfolio. Therefore, FICC believes that these proposed changes are consistent with Rule 17Ad-22(b)(1) under the Act.

Rule 17Ad-22(b)(2) under the Act requires a registered clearing agency that performs central counterparty services to establish, implement, maintain and enforce written policies and procedures reasonably designed to use margin requirements to limit its credit exposures to participants under normal market conditions and use risk-based models and parameters to set margin requirements and review such margin requirements and the related risk-based models and parameters at least monthly.[21] The proposed changes associated with the Margin Proxy and Coverage Charge would enhance the risk-based model and parameters that establish margin requirements for Netting Members. This enhancement to the risk-based model and parameters would use margin requirements to limit FICC's credit exposure to its Netting Members. Since the proposed changes are designed to calculate each Netting Member's Required Fund Deposit at a 99 percent confidence level, FICC believes each Netting Member's Required Fund Deposit could mitigate its own losses in the event that such Netting Member defaults under normal market conditions. Therefore, FICC believes that these proposed changes are consistent with Rule 17Ad-22(b)(2) under the Act.

FICC also believes that the proposed changes are consistent with Rules 17Ad-22(e)(4) and (e)(6) of the Act, which were recently adopted by the Commission.[22] Rule 17Ad-22(e)(4) will require FICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor,

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21 See 17 CFR 240.17Ad-22(b)(2).

22 Supra note 8.

and manage its credit exposures to participants and those exposures arising from its payment, clearing, and settlement processes.[23] The Margin Proxy methodology would be subject to performance reviews by FICC. If the Margin Proxy's backtesting results do not meet FICC's 99 percent confidence level, FICC would consider adjustments to the Margin Proxy, including increasing the look-back period and/or applying a historical stressed period to the Margin Proxy calibration, as appropriate. Therefore, the proposed changes associated with the Margin Proxy and Coverage Charge would enhance FICC's ability to identify, measure, monitor and manage its credit exposures to Netting Members and those exposures arising from its payment, clearing, and settlement processes by maintaining financial resources to cover a wide range of foreseeable price moves under both normal and stressed market conditions. Therefore, FICC believes the proposed changes are consistent with the requirements of Rule 17Ad-22(e)(4), promulgated under the Act.

Rule 17Ad-22(e)(6) will require FICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that is monitored by management on an ongoing basis and regularly reviewed, tested, and verified.[24] The proposed changes associated with the Margin Proxy enhance GSD's risk-based margin system that would continue to be monitored by FICC management on an ongoing basis and regularly reviewed, tested, and verified. Therefore, FICC believes that the proposed

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23 Id.

24 Id.

changes are consistent with the requirements of Rule 17Ad-22(e)(6), promulgated under the Act.

Accelerated Commission Action Requested

Pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,[25] FICC requests that the Commission notify FICC that it has no objection to the proposed changes as expeditiously as possible. FICC requests accelerated Commission action in order to address the impact of recent volatility in the financial markets on the GSD VaR Charge. GSD's VaR Charge did not achieve backtesting coverage at a 99 percent confidence level, as described herein. The proposed changes would enhance the risk-based model and parameters that establish margin requirements for Netting Members. These enhancements to the risk-based model and parameters are designed to calculate each Netting Member's Required Fund Deposit at a 99 percent confidence level and would mitigate potential losses to FICC and non-defaulting Netting Members associated with the liquidation of a defaulted Netting Member's portfolio.

III. Date of Effectiveness of the Advance Notice, and Timing for Commission Action

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date that the proposed change was filed with the Commission or (ii) the date that any additional information requested by the Commission is received. The clearing agency shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing the

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25 See 12 U.S.C. 5465(e)(1)(I).

clearing agency with prompt written notice of the extension. A proposed change may be implemented in less than 60 days from the date the advance notice is filed, or the date further information requested by the Commission is received, if the Commission notifies the clearing agency in writing that it does not object to the proposed change and authorizes the clearing agency to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

The clearing agency shall post notice on its website of proposed changes that are implemented.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the Advance Notice is consistent with the Clearing Supervision Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FICC-2017-801 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number SR-FICC-2017-801. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the Advance Notice that are filed with the Commission, and all written communications relating to the Advance Notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of FICC and on DTCC's website (http://dtcc.com/legal/sec-rule-filings.aspx). All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FICC-2017-801 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Secretary

Exhibit 2

ronin CAPITAL LLC

January 20, 2017

Messrs. Murray Pozmanter and Timothy Cuddihy
Depository Trust and Clearing Corporation
5701 Washington Boulevard (Floor 10) Jersey
City, NJ 07310

Messrs. Pozmanter and Cuddihy:

Over the past several years, Ronin Capital has met with representatives of the Fixed Income Clearing Corporation (FICC) to discuss a number of topics that we believe negatively impact members of the Government Securities Division (GSD). These topics include, but are not limited to:

- inefficiencies of the Cross-Margining Agreement with the Chicago Mercantile Exchange (CME),
- the ineffectiveness of TMPG fails charges in clearing up settlement issues,
- asymmetric risks presented to the FICC by High-Frequency Trading (HFT), and
- anticompetitive aspects of the Capped Contingency Liquidity Facility (CCLF).

Because the GSD is the leading provider of trade comparison, netting and settlement for Government securities,[1] including U.S. Treasuries, it is critical for liquidity in the U.S. Treasury market that the GSD remains economically viable for its members. Any negative effect to liquidity in U.S. Treasuries has the potential to degrade the liquidity premium of U.S. Treasuries - a premium estimated as high as 15%.[2] **Since the U.S. Treasury market is the primary means of financing the U.S. federal government, this liquidity premium greatly benefits the U.S. taxpayer.**

The U.S. Treasury market has always been a deep and liquid market. We believe the GSD greatly contributes to both liquidity and transparency. And yet, we believe the value proposition of the GSD is in decline. The GSD has already suffered a decrease in volumes which has resulted in fee increases.[3] Another proposed change, the CCLF, has the potential to add significant

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[1] http://www.dtcc.com/clearing-services/ficc-gov
[2] https://www.newyorkfed.org/research/staff_reports/sr590.html pg. 25
[3] SEC Release No. 34-78529; File No. SR-FICC-2016-004 p. 3

asymmetric costs to some members, which could ultimately harm membership diversity. **Increased fees and higher margin requirements for GSD members may lead to further declines in volume - a vicious cycle**. In conjunction with these existing challenges, a new potential threat to liquidity and membership diversity is now being proposed - a change to the methodology used in the GSD VaR (Value-at-Risk) model. This specific change is the focus of this note.

On January 10, 2017, Ronin Capital met with representatives of the FICC as part of a small working group to discuss possible changes in the GSD VaR model. Unexpected volatility encountered during the presidential election was referenced by FICC representatives as causing an underperformance in the current GSD VaR model. As a result of this underperformance, it was stated that several GSD member-firms had presented unacceptable risks to the FICC. In order to mitigate these risks, it was communicated that urgent changes to the GSD VaR model were needed. In coordination with the Securities and Exchange Commission (SEC), a number of VaR model changes would be proposed and implemented over an abbreviated timeline.

Ronin Capital is concerned that this hasty reaction is unwarranted and could possibly cause more harm than good. It is self-evident that risk models are not static constructs. As circumstances change or as new information becomes available, risk models often need to evolve or be replaced. We have no problem with such changes as long as there is a proven benefit associated with any new costs. It is possible the new GSD VaR model will provide a measurable benefit to both the FICC and its membership. However, we have some general concerns related to:

- the appropriateness of utilizing a mortgage VaR model for U.S. Treasuries,
- the need for an abbreviated rule approval process, and
- general lack of transparency.

The remainder of this note is intended to expound on these general concerns in more detail.

Model Appropriateness

The main purpose of the meeting with the FICC was to discuss the need for a new GSD VaR model. However, additional items were also discussed. One item of note was the stated desire of the FICC to collapse the separate rulebooks of the Mortgage-Backed Securities Division (MBSD) and the GSD into a single cohesive rulebook. Naturally, an important prerequisite of this effort involves synchronizing disparate risk margin models.

Presently, the FICC has a rule filed with the SEC to replace the VaR model for the MBSD.[4] The need for replacement stems from the failure of an internal prepayment model, which "had failed

[4] SEC Release No. 34-79491; File No. SR-FICC-2016-007

to perform as expected due to shifting market dynamics that were not accurately captured by the model."[5] While this failure may justify replacing the MBSD VaR model, it is certain that flaws in the prepayment model have no bearing on the construction of a VaR model for U.S. Treasuries. Is there a completely different rationale driving the desire to replace the GSD VaR model?

High-level details regarding the new GSD VaR model were described verbally during the meeting with the FICC. The methodology for calculating margin for GSD members was described in terms that nearly match the new MBSD methodology that was recently filed with the SEC. **Given significant credit-based differences between mortgages and U.S. Treasuries, we question whether it is appropriate to utilize the MBSD VaR model as a basis for margining U.S. Treasuries**. If analysis conducted in the aftermath of the Financial Crisis is used as a guide, fire-sale risk associated with mortgages is very different from that of U.S. Treasuries.[6] During any future crisis, we believe it is reasonable to assume that U.S. Treasuries will be in great demand, given their status as high-quality liquid assets (HQLA). Can the same be said of mortgages? Given the different profiles of these two asset classes, particularly during a crisis, we believe any risk model which is unable to differentiate U.S. Treasuries as a "special" asset class is flawed. Is it possible the desire to harmonize the rulebooks of the MBSD and the GSD results in a more generalized VaR model that may not properly acknowledge the "specialness" of U.S. Treasuries?

Abbreviated Rule Approval Process

FICC representatives characterized the need for updating the GSD VaR model as so pressing that an abbreviated rule approval process was being considered. The eventual plan is to employ a new sensitivity model approach to GSD VaR as a replacement for the current full evaluation approach. It is claimed that the sensitivity model approach outperforms the full evaluation approach by incorporating "both historical data and current risk factor sensitivities" as opposed to being "calibrated only with historical data."[7] Ignoring whether this new sensitivity model is appropriate for U.S. Treasuries, it seems rational that a "more comprehensive" model would improve on a model that was merely based on historical data. However, the FICC is not actually ready to implement the sensitivity VaR model for the GSD. Instead, urgency is driving the need to deploy an alternative volatility calculation (the "Margin Proxy") in the interim - this model is described in the MBSD rule filing as a "back-up to the sensitivity approach."[8]

[5] SEC Release No. 34-79491; File No. SR-FICC-2016-007 pp. 6-7
[6] https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr616.pdf
[7] SEC Release No. 34-79491; File No. SR-FICC-2016-007 p. 11
[8] SEC Release No. 34-79491; File No. SR-FICC-2016-007 p. 21

Ronin Capital questions whether the risk to the FICC from the current "full evaluation" approach is so dire that a new "backup" model is required to be rushed into production. Is an abbreviated rule approval process appropriate when there are known flaws in the Margin Proxy model? For example:

> Invocation of the Margin Proxy would likely produce slightly higher VaR Charges for Clearing Members compared to the VaR model if reliable data were available because it would reduce certain risk offsets among portfolio positions. The Margin Proxy is expected to be invoked rarely.[9]

This reduction in risk offsets can be overlooked in the MBSD rule filing because the Margin Proxy methodology is only going to be used:

> ...in the event that the requisite data used to employ the sensitivity approach is unavailable for an extended period of time.[10]

However, this is not true for the GSD. **The expedited need for a new VaR model may result in the deployment of the "backup" Margin Proxy methodology for an extended amount of time**. This state of affairs may burden competition. As stated in the MBSD rule filing:

> FICC believes that any burden on competition from the availability of the Margin Proxy as an alternative that FICC may invoke under limited circumstances is appropriate in furtherance of the Act because it ensures that FICC will continue to have a methodology that it could use to calculate the VaR Charge in the event that a vendor data disruption reduces the reliability of the VaR model, thereby better limiting FICC's credit exposures to participants under such circumstances.[11]

No claim is made that the Margin Proxy alternative does not burden competition. It is only stated that the burden on competition is minimal because the Margin Proxy will only be utilized in limited circumstances.

Finally, the FICC conducted an extensive study for the MBSD before filing for a rule change:

> FICC conducted a study of the impact of implementing the proposed sensitivity approach on each Clearing Member's portfolio. The study, which covered two and a half years, revealed that the sensitivity approach is more responsive to changing market conditions.[12]

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[9] SEC Release No. 34-79491; File No. SR-FICC-2016-007 p. 29
[10] SEC Release No. 34-79491; File No. SR-FICC-2016-007 p. 7
[11] SEC Release No. 34-79491; File No. SR-FICC-2016-007 p. 29
[12] SEC Release No. 34-79491; File No. SR-FICC-2016-007 p. 28

Is such a study unnecessary for the GSD? Was market volatility following the election so extreme that an "untested" alternative volatility approach (the "Margin Proxy") is preferable to the full evaluation approach? The full evaluation approach may have known flaws, but the GSD membership has experience with the idiosyncrasies of the current model. Given the lack of transparency associated with FICC VaR models in general, does it make sense to rush a new "temporary" model into production without giving GSD members any length of time to prepare for its introduction?

Lack of Transparency

Ronin Capital certainly appreciates that FICC is communicating with members about sensitive topics before submitting rules for public commentary. We believe it is important for all members to have access to prospective rule changes *before* such rules are filed with the regulatory authorities. We also recognize that the FICC needs to weigh the needs of its membership in aggregate, which may result in rule changes that asymmetrically burden individual member firms. Given the potential burden on competition associated with any rule change, it is critical that the FICC is transparent to its membership.

We believe that the FICC benefits from member diversity. Consequently, it is also important for the FICC to ensure that its rules do not burden competition. There are major structural differences among current GSD members. In particular, there are vast structural differences between members that are bank-holding companies (BHCs) and those that are not (non-BHCs). These differences can result in a higher cost of capital for some types of firms when compared with others. As a result, detailed capital planning is more important for some GSD member firms than others.

The proprietary nature of the various FICC VaR models is stated as a need for keeping model details confidential. The following statement was made as part of the recent SEC rule filing made on behalf of the MBSD:

> The proposed sensitivity approach and Margin Proxy methodologies would be reflected in the Methodology and Model Operations Document - MBSD Quantitative Risk Model (the "QRM Methodology"). FICC is requesting confidential treatment of this document and has filed it separately with the Secretary of the Commission.[13]

In other words, there is documentation associated with the new MBSD model. However, this document is confidential. FICC members are only privy to verbal high-level details, and are thus responsible for attempting to simulate the model through trial and error on their own volition.

[13] SEC Release No. 34-79491; File No. SR-FICC-2016-007 p. 2

Ronin Capital believes this state of affairs is irresponsible. It is amazing in the year 2017 that GSD members cannot submit sample portfolios to the FICC on a pseudo real-time basis and receive calculated margin numbers. **Given differing costs of capital across the membership, the inability to conduct any type of scenario analysis with respect to VaR margin might be anticompetitive**. Any risk margin model should be rules-based and repeatable. Otherwise, there is likely an unfair burden on firms that have a higher cost of capital, when compared to competitors that do not.

Finally, the proposed sensitivity model approach relies on data provided by an external vendor. An advantage of this approach is that FICC would leverage "external vendor expertise, which FICC does not need to develop in-house."[14] This is also claimed as an advantage for transparency:

> The second benefit of the proposed sensitivity approach is that it would provide more transparency to Clearing Members. Since Clearing Members typically use risk factor analysis for their own risk and financial reporting such Members would have comparable data and analysis to assess the variation in their VaR Charge based on changes in the market value of their portfolios.[15]

We are not sure this "transparency" will come without a significant cost. If the FICC does not provide a mechanism for analyzing the margin requirements of sample portfolios, are members required to build their own sensitivity models in the hope of replicating FICC's model? Will GSD members be forced to contract with an external vendor for risk factor data?

Finally, in order to margin U.S. Treasuries effectively, is it truly necessary to "leverage external vendor expertise"[16] when SEC net capital rules (15c3-1) for U.S. Treasuries have proven effective for many, many years?[17]

Unintended Consequences?

Newly filed MBSD rules contain a new risk mitigation method which is called a "VaR Floor." This VaR Floor "would be employed as an alternative to the amount calculated by the proposed model for portfolios where the VaR Floor would be greater than the model-based charge amount."[18]

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[14] SEC Release No. 34-79491; File No. SR-FICC-2016-007 p. 11
[15] SEC Release No. 34-79491; File No. SR-FICC-2016-007 pp. 11,12

[16] SEC Release No. 34-79491; File No. SR-FICC-2016-007 p. 8
[17] The SEC Net Capital Rule (Rule 15c3-1)
[18] SEC Release No. 34-79491; File No. SR-FICC-2016-007 p. 14

Because it is applied to "gross unsettled positions,"[19] the VaR floor seems to be intended to mitigate risks presented by members that are engaged in rapidly turning over their portfolios. While not commenting on the need or appropriateness of such a change with respect to the MBSD, Ronin Capital believes a similar change to GSD rules would certainly ensure that no high-frequency trading (HFT) firms would ever join the FICC. Aside from a regulatory mandate forcing all U.S. Treasury transactions to be centrally cleared, this rule change would seem to guarantee that the significant trading volumes conducted by principal trading firms (PTF)[20] will continue to clear outside of the FICC. Is this a desired result?

Conclusion

Ronin Capital believes that the GSD is critical for liquidity in the U.S. Treasury market. Unfortunately, declining volumes have led to increases in fees. This reduces the value proposition of centralized clearing, despite the many tangible benefits. Higher margin requirements might have an even worse effect on membership. Cost of capital differences among member firms may lead to asymmetrical impact. This could harm GSD member diversity.

We believe the desire for harmonizing rules for mortgages and U.S. Treasuries may result in VaR model calculations that don't recognize the "specialness" of U.S. Treasuries. Are the risks to the FICC so great that an alternative volatility calculation (the "Margin Proxy") needs to be approved and deployed in an abbreviated timeframe? We believe this hasty response might do more harm than good, given a lack of transparency. This is particularly true if the potential effects on the membership are asymmetrical.

Given the potential for asymmetrical impact to the GSD membership as well as a general lack of transparency, we believe any new rule filing should be delayed until:

- proper impact studies are conducted with respect to the effects of the VaR model change on GSD members,
- technology is put in place to enable GSD members to submit sample portfolios in order to conduct margin-based scenario analysis.

We believe the FICC must ensure that any rule change does not present a competitive burden on a particular type of member firm. We also believe that membership diversity benefits liquidity in U.S. Treasuries. This ultimately benefits the U.S. taxpayer.

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[19] SEC Release No. 34-79491; File No. SR-FICC-2016-007 pp. 7,14
[20] Joint Staff Report: The U.S. Treasury Market on October 15, 2014

EXHIBIT 5

<u>Bolded, underlined text</u> indicates added language
~~Bolded, strikethrough text~~ indicates deleted language

FIXED INCOME CLEARING CORPORATION

GOVERNMENT SECURITIES DIVISION RULEBOOK

RULE 1 - DEFINITIONS

Unless the context requires otherwise, the terms defined in this Rule shall, for all purposes of these Rules, have the meanings herein specified.

*** * * ***

Margin Proxy

> **The term "Margin Proxy" means, with respect to each Margin Portfolio, a minimum volatility calculation for specified Net Unsettled Positions of a Netting Member, calculated using historical market price changes of such U.S. Treasury and agency pass-through mortgage-backed securities indices determined by the Corporation. The Margin Proxy would be applied by the Corporation as an adjustment to the model-based volatility calculation of the VaR Charge for each Netting Member's Margin Portfolio. The Margin Proxy shall cover such range of historical market price moves and parameters as the Corporation from time to time deems appropriate.**

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VaR Charge

> The term "VaR Charge" means, with respect to each Margin Portfolio, a calculation of the volatility of specified ~~**net unsettled positions**~~**Net Unsettled Positions** of a **Netting** Member as of the time of such calculation. Such volatility calculations shall be made in accordance with any generally accepted portfolio volatility model, including, but not limited to, any margining formula employed by any other clearing agency registered under Section 17A of the Securities Exchange Act of 1934. Such calculation shall be made utilizing such assumptions (including confidence levels) and based on such observable market data as the Corporation deems reasonable, and shall cover such range and assessment of volatility as the Corporation from time to time deems appropriate. **If, with respect to the Margin Portfolio of a Netting Member, the model-based volatility calculation pursuant to this definition results in a lower amount than the Margin Proxy calculated for that Margin Portfolio, then the Margin Proxy will be applied as the VaR Charge.**

* * * *

RULE 4–CLEARING FUND AND LOSS ALLOCATION

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Section 1b – Unadjusted GSD Margin Portfolio Amount

(a) Each Business Day, the Corporation shall determine, with respect to each Margin Portfolio, an Unadjusted GSD Margin Portfolio Amount as the sum of the following~~;~~**:**

(i) the VaR Charge**,**

plus

(ii) the Coverage Charge,

minus

(iii) in the case of a Margin Portfolio of a Cross Margining Participant that is subject to one or more Cross-Margining Arrangements, in the discretion of the Corporation, an amount not to exceed the sum of any applicable Cross-Margining Reductions, calculated on the current Business Day for such Cross-Margining Participant in accordance with the applicable Cross-Margining Agreements~~.~~,

plus

(iv) ~~I~~in the case of a Margin Portfolio of a GCF Counterparty, the GCF Premium Charge and/or GCF Repo Event Premium and/or the Early Unwind Intraday Charge, if applicable,

plus

(v) in the case of a Margin Portfolio of a GCF Counterparty with backtesting deficiencies, the Blackout Period Exposure Charge, if applicable, during the monthly Blackout Period and until the applicable GCF Clearing Agent Bank updates the Pool Factors used for collateral valuation~~.~~,

plus

(vi) in the case of a Netting Member with backtesting deficiencies, the Backtesting Charge, if applicable~~.~~,

plus

(vii) the Holiday Charge, if applicable, on the Business Day prior to a Holiday.

The Corporation shall determine a separate Unadjusted GSD Margin Portfolio Amount for a Netting Member’s Market Professional Cross-Margining Account.

The Corporation shall have the discretion to not apply the VaR calculation(s) to net unsettled positions in classes of securities whose volatility is less amenable to statistical analysis, or to Term Repo Transactions and Forward-Starting Repo Transactions (including term and forward-starting GCF Repo Transactions) whose term repo rate volatility is less amenable to statistical analysis. In lieu of such calculation, the component required with respect to such transactions shall instead be determined based on a historic index volatility model.

The Corporation shall take into account the VaR confidence level applicable to the Member in calculating the VaR Charge and Coverage Charge. In the case of a Margin Portfolio containing accounts of Permitted Margin Affiliates, the Corporation shall apply the highest VaR confidence level applicable to the Member or its Permitted Margin Affiliates.

When the Margin Proxy is applied as the VaR Charge, the Corporation shall reduce the Coverage Charge up to the amount that the Margin Proxy exceeds the sum of the model-based volatility calculation and the Coverage Charge, but not by an amount greater than the total Coverage Charge.

The Corporation shall have the discretion to calculate an additional amount ("special charge") applicable to a Margin Portfolio as determined by the Corporation from time to time in view of market conditions and other financial and operational capabilities of the Member. The Corporation shall make any such determination based on such factors as the Corporation determines to be appropriate from time to time.

The Corporation shall calculate the Unadjusted GSD Margin Portfolio Amount applicable to a Sponsoring Member Omnibus Account, and the Sponsoring Member Omnibus Account Required Fund Deposit, subject to the provisions set forth in Section 10 of Rule 3A.

The minimum Clearing Fund requirement applicable to an Inter-Dealer Broker Netting Member or a Netting Member that maintains one or more Broker Accounts shall at all times be no less than $5 million.

Once applicable minimum Clearing Fund amounts have been applied, the Corporation shall apply any applicable additional payments, charges and premiums set forth in these Rules.

* * * *