

subject line if email 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 Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change 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 Web site 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 such filing also will be available for inspection and copying at the principal office of the Exchange. 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-NYSEArca-2017-57, and should be submitted on or before June 23, 2017.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>24</sup>

**Eduardo A. Aleman,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-80812; File No. SR-FICC-2017-002]

### Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Instituting Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change To Implement the Capped Contingency Liquidity Facility in the Government Securities Division Rulebook

May 30, 2017.

#### I. Introduction

On March 1, 2017, Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-FICC-2017-002

("Proposed Rule Change") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> to implement a Capped Contingency Liquidity Facility in FICC's Government Securities Division Rulebook.<sup>3</sup> The Proposed Rule Change was published for comment in the **Federal Register** on March 20, 2017.<sup>4</sup> To date, the Commission has received three comment letters to the Proposed Rule Change.<sup>5</sup> On April 25, 2017, the Commission designated a longer period within which to approve the Proposed Rule Change, disapprove the Proposed Rule Change, or institute proceedings to determine whether to approve or disapprove the Proposed Rule Change.<sup>6</sup> This order institutes proceedings under Section 19(b)(2)(B) of the Act<sup>7</sup> to determine whether to approve or disapprove the Proposed Rule Change.

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> FICC also filed the Proposed Rule Change as advance notice SR-FICC-2017-802 ("Advance Notice") pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010, 12 U.S.C. 5465(e)(1), and Rule 19b-4(n)(1)(i) under the Act, 17 CFR 240.19b-4(n)(1)(i). Notice of filing of the Advance Notice was published for comment in the **Federal Register** on March 15, 2017. Securities Exchange Act Release No. 80191 (March 9, 2017), 82 FR 13876 (March 15, 2017) (SR-FICC-2017-802). The Commission extended the deadline for its review period of the Advance Notice from April 30, 2017 to June 29, 2017. Securities Exchange Act Release No. 80520 (April 25, 2017), 82 FR 20404 (May 1, 2017) (SR-FICC-2017-802). The proposal in the Proposed Rule Change and the Advance Notice shall not take effect until all regulatory actions required with respect to the proposal are completed.

<sup>4</sup> Securities Exchange Act Release No. 80234 (March 14, 2017), 82 FR 14401 (March 20, 2017) (SR-FICC-2017-002).

<sup>5</sup> See letter from Robert E. Pooler, Chief Financial Officer, Ronin Capital LLC, dated April 10, 2017, to Robert W. Errett, Deputy Secretary, Commission; letter from Alan B. Levy, Managing Director, Industrial and Commercial Bank of China Financial Services LLC ("ICBC"), Philip Vandermause, Director, Aardvark Securities LLC, David Rutter, Chief Executive Officer, LiquidityEdge LLC, Robert Pooler, Chief Financial Officer, Ronin Capital LLC, Jason Manumaleuna, Chief Financial Officer and EVP, Rosenthal Collins Group LLC, and Scott Skyrn, Managing Director, Wedbush Securities Inc. ("ICBC Letter"); and letter from Timothy J. Cuddihy, Managing Director, FICC, dated March 8, 2017, to Robert W. Errett, Deputy Secretary, Commission ("FICC Letter"), available at <https://www.sec.gov/comments/sr-ficc-2017-002/ficc2017002.htm>. Since the proposal contained in the Proposed Rule Change was also filed as an Advance Notice, Release No. 80191, *supra* note 3, the Commission is considering all public comments received on the proposal regardless of whether the comments are submitted to the Proposed Rule Change or the Advance Notice.

<sup>6</sup> See Securities Exchange Act Release No. 80524 (April 25, 2017), 82 FR 20685 (May 3, 2017).

<sup>7</sup> 15 U.S.C. 78s(b)(2)(B).

#### II. Description of the Proposed Rule Change

FICC's current liquidity resources for its Government Securities Division ("GSD")<sup>8</sup> consist of (i) cash in GSD's clearing fund; (ii) cash that can be obtained by entering into uncommitted repo transactions using securities in the clearing fund; (iii) cash that can be obtained by entering into uncommitted repo transactions using the securities that were destined for delivery to the defaulting GSD member; and (iv) uncommitted bank loans.<sup>9</sup>

With this Proposed Rule Change, FICC proposes to amend its GSD Rulebook ("GSD Rules")<sup>10</sup> to establish a rules-based, committed liquidity resource (*i.e.*, the Capped Contingency Liquidity Facility<sup>®</sup> ("CCLF")) as an additional liquidity resource designed to provide FICC with a committed liquidity resource to meet its cash settlement obligations in the event of a default of the GSD Netting Member or family of affiliated Netting Members ("Affiliated Family") to which FICC has the largest exposure in extreme but plausible market conditions.<sup>11</sup>

##### A. Overview of the Proposal

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

##### 1. Declaration of a CCLF Event

Following a default, FICC would first obtain liquidity through its other available non-CCLF liquidity resources.

<sup>8</sup> FICC operates two divisions—GSD and the Mortgage-Backed Securities Division ("MBSD"). GSD provides trade comparison, netting, risk management, settlement and central counterparty services for the U.S. government securities market, while MBSD provides the same services for the U.S. mortgage-backed securities market. Because GSD and MBSD are separate divisions of FICC, each division maintains its own rules, members, margin from their respective members, clearing fund, and liquid resources.

<sup>9</sup> See Notice, 82 at 14402.

<sup>10</sup> GSD Rules, available at [www.dtcc.com/legal/rules-and-procedures.aspx](http://www.dtcc.com/legal/rules-and-procedures.aspx).

<sup>11</sup> As defined in the GSD Rules, the term "Netting Member" means a GSD member that is a member of the GSD Comparison System and the Netting System. *Id.*

<sup>24</sup> 17 CFR 200.30-3(a)(12).

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

## 2. CCLF Transactions

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

Each CCLF Transaction would be governed by the terms of the September 1996 Securities Industry and Financial Markets Association Master Repurchase Agreement,<sup>12</sup> which would be incorporated by reference into the GSD Rules as a master repurchase agreement between FICC as seller and each Netting Member as buyer, with certain modifications as outlined in the GSD Rules ("CCLF MRA").

To initiate CCLF Transactions with non-defaulting Netting Members, FICC would identify the non-defaulting Netting Members that are obligated to deliver securities destined for the defaulting Netting Member ("Direct Affected Members") and, in return, would be obligated to receive a cash payment. FICC would need to finance those transactions through CCLF, in order to cover the defaulting Netting Member's failure to deliver the cash payment ("Financing Amount"). FICC would notify each Direct Affected Member of the Direct Affected Member's Financing Amount and whether such Direct Affected Member should deliver to FICC or suppress any securities that were destined for the defaulting Netting Member. FICC would then initiate CCLF

Transactions with each Direct Affected Member for the Direct Affected Member's purchase of the securities ("Financed Securities") that were destined for the defaulting Netting Member.<sup>13</sup> The aggregate purchase price of the CCLF Transactions with the Direct Affected Member could equal but never exceed the Direct Affected Member's maximum funding obligation ("Individual Total Amount").<sup>14</sup>

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

FICC states that the order in which FICC would enter into CCLF Transactions for the Remaining Financing Amount would be based upon the Affected Members that have the most funding available within their Individual Total Amounts.<sup>15</sup> No Affected Member would be obligated to enter into CCLF Transactions greater than its Individual Total Amount.

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

its available liquid resources; or (iii) 30 or 60 calendar days after entry into the CCLF Transaction for U.S. government bonds and mortgage-backed securities, respectively.

## B. CCLF Sizing and Allocation

According to FICC, its overall liquidity need during a CCLF Event would be determined by the cash settlement obligations presented by the default of a Netting Member and its Affiliated Family, as described below. An additional amount ("Liquidity Buffer") would be added to account for both changes in Netting Members' cash settlement obligations that may not be observed during the six-month look-back period during which CCLF would be sized, and the possibility that the defaulting Netting Member is the largest CCLF contributor.

FICC believes that its proposal would allocate FICC's observed liquidity need during a CCLF Event among all Netting Members based on their historical settlement activity, but states that Netting Members that present the highest cash settlement obligations would be required to maintain higher CCLF funding obligations.<sup>16</sup>

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

### Step 1: CCLF Sizing

#### (A) Historical Cover 1 Liquidity Requirement

FICC's historical liquidity need for the six-month look-back period would be equal to the largest liquidity need generated by an Affiliated Family during the preceding six-month period. The amount which would be determined by calculating the largest sum of an Affiliated Family's obligation to receive GSD eligible securities, plus the net dollar amount of its Funds-Only Settlement Amount<sup>17</sup> (collectively, the "Historical Cover 1 Liquidity Requirement"). FICC believes that it is appropriate to calculate the Historical Cover 1 Liquidity Requirement in this manner because the default of such an

<sup>16</sup> *Id.*

<sup>17</sup> According to FICC, the Funds-Only Settlement Amount reflects the amount that FICC collects and passes to the contra-side once FICC marks the securities in a Netting Member's portfolio to the current market value. FICC states that this amount is the difference between the contract value and the current market value of a Netting Member's GSD portfolio. FICC states that it would consider this amount when calculating the Historical Cover 1 Liquidity Requirement because in the event that an Affiliated Family defaults, the Funds-Only Settlement Amount would also reflect the cash obligation to non-defaulting Netting Members. *Id.*

<sup>12</sup> The September 1996 Securities Industry and Financial Markets Association Master Repurchase Agreement ("SIFMA MRA") is available at <http://www.sifma.org/services/standard-forms-and-documentation/mra,-gmra,-msla-and-msftas/>. The SIFMA MRA would be incorporated by reference into the GSD Rules without referenced annexes, other than Annex VII (Transactions Involving Registered Investment Companies), which would be applicable to any Netting Member that is a registered investment company. FICC represents that, at the time of filing the Proposed Rule Change, there were no registered investment companies that are also GSD Netting Members. See Notice, 82 at 14402.

<sup>13</sup> FICC states that it would have the authority to initiate CCLF Transactions with respect to any securities that are in the Direct Affected Member's portfolio which are bound to the defaulting Netting Member.

<sup>14</sup> The sizing of each Direct Affected Member's Individual Total Amount is described below in Section II.B.

<sup>15</sup> See Notice, 82 at 14403.

Affiliated Family would generate the largest liquidity need for FICC.<sup>18</sup>

#### (B) Liquidity Buffer

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

FICC states that the Liquidity Buffer would initially be 20 percent of the Historical Cover 1 Liquidity Requirement (and between 20 to 30 percent thereafter), subject to a minimum amount of \$15 billion.<sup>19</sup> FICC believes that 20 to 30 percent of the Historical Cover 1 Liquidity Requirement is appropriate based on its analysis and statistical measurement of the variance of its daily liquidity need throughout 2015 and 2016.<sup>20</sup> FICC also believes that the \$15 billion minimum dollar amount is necessary to cover changes in a Netting Member's trading activity that could exceed the amount that is implied by such statistical measurement.<sup>21</sup>

FICC would have the discretion to adjust the Liquidity Buffer, within the range of 20 to 30 percent of the Historical Cover 1 Liquidity Requirement, based on its analysis of the stability of the Historical Cover 1 Liquidity Requirement over various time horizons. According to FICC, this would help ensure that its liquidity resources are sufficient under a wide

range of potential market scenarios that may lead to a change in a Netting Member's trading behavior. FICC also states that it would analyze the trading behavior of Netting Members that present larger liquidity needs than the majority of the Netting Members, as described below.<sup>22</sup>

#### (C) Aggregate Total Amount

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

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

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

The Aggregate Total Amount would be allocated among Netting Members in order to arrive at each Netting Member's Individual Total Amount. FICC would take a tiered approach in its allocation of the Aggregate Total Amount. First, FICC would determine the portion of the Aggregate Total Amount that should be allocated among all Netting Members ("Aggregate Regular Amount"), which FICC states initially would be set at \$15 billion.<sup>23</sup> FICC believes that this amount is appropriate because the average Netting Member's liquidity need from 2015 to 2016 was approximately \$7 billion, with a majority of Netting Members having liquidity needs less than \$15 billion.<sup>24</sup> Based on that analysis, FICC believes that the \$15 billion Aggregate Regular Amount should capture the liquidity needs of a majority of the Netting Members.<sup>25</sup>

Second, as discussed in more detail below, after allocating the \$15 billion Aggregate Regular Amount, FICC would allocate the remainder of the Aggregate Total Amount ("Aggregate Supplemental Amount") among Netting Members that incurred liquidity needs above the Aggregate Regular Amount within the six-month look-back period. For example, a Netting Member with a \$7 billion peak daily liquidity need

would only contribute to the \$15 billion Aggregate Regular Amount, based on the calculation described below. Meanwhile a Netting Member with a \$45 billion Aggregate Regular Amount would contribute towards the \$15 billion Aggregate Regular Amount and the Aggregate Supplemental Amount, as described below.

FICC believes that this tiered approach reflects a reasonable, fair, and transparent balance between FICC's need for sufficient liquidity resources and the burdens of the funding obligations on each Netting Member's management of its own liquidity.<sup>26</sup>

Under the proposal, the Aggregate Regular Amount would be allocated among all Netting Members, but Netting Members with larger Receive Obligations<sup>27</sup> would be required to contribute a larger amount. FICC believes that this approach is appropriate because a defaulting Netting Member's Receive Obligations are the primary cash settlement obligations that FICC would have to satisfy as a result of the default of an Affiliated Family.<sup>28</sup> However, FICC also believes that, because FICC guarantees both sides of a GSD Transaction and all Netting Members benefit from FICC's risk mitigation practices, some portion of the Aggregate Regular Amount should be allocated based on Netting Members' aggregate Deliver Obligations<sup>29</sup> as well.<sup>30</sup> As a result, FICC proposes to allocate the Aggregate Regular Amount based on a scaling factor. Given that the Aggregate Regular Amount would be initially sized at \$15 billion and would cover approximately 80 percent of Netting Members' observed liquidity needs, FICC proposes to set the scaling factor in the range of 65 to 85 percent to the value of Netting Members' Receive Obligations, and in the range of 15 to 35 percent to the value of Netting Members' Deliver Obligations.<sup>31</sup>

FICC states that it would initially assign a 20 percent weighting

<sup>18</sup> *Id.*

<sup>19</sup> See Notice, 82 at 14404. For example, if the Historical Cover 1 Liquidity Requirement was \$100 billion, the Liquidity Buffer initially would be \$20 billion (\$100 billion × 0.20), for a total of \$120 billion in potential liquidity resources.

<sup>20</sup> According to FICC, it uses a statistical measurement called the "coefficient of variation," which is calculated as the standard deviation divided by the mean, to quantify the variance of Affiliated Families' daily liquidity needs. See Notice, 82 at 14403. FICC states that this is a typical approach used to compare variability across different data sets. *Id.* FICC states that it will use the coefficient of variation to set the Liquidity Buffer by quantifying the variance of each Affiliated Family's daily liquidity need. *Id.* FICC believes that a Liquidity Buffer of 20 to 30 percent, subject to a minimum of \$15 billion, would be an appropriate Liquidity Buffer because FICC found that, throughout 2015 and 2016, the coefficient of variation ranged from an average of 15 to 19 percent for Affiliated Families with liquidity needs above \$50 billion, and an average of 18 to 21 percent for Affiliated Families with liquidity needs above \$35 billion. *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> From 2015 to 2016, 59 percent of all Netting Members presented average liquidity needs between \$0 to \$5 billion, 78 percent of all Netting Members presented average liquidity needs between \$0 and \$10 billion, and 85 percent of all Netting Members presented average liquidity needs between \$0 and \$15 billion. *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> "Receive Obligation" means a Netting Member's obligation to receive eligible netting securities from FICC at the appropriate settlement value, either in satisfaction of all or a part of a Net Long Position, or to implement a collateral substitution in connection with a Repo Transaction with a right of substitution. GSD Rules, *supra* note 10.

<sup>28</sup> See Notice, 82 at 14404.

<sup>29</sup> "Deliver Obligation" means a Netting Member's obligation to deliver eligible netting securities to FICC at the appropriate settlement value either in satisfaction of all or a part of a Net Short Position or to implement a collateral substitution in connection with a Repo Transaction with a right of substitution. GSD Rules, *supra* note 10.

<sup>30</sup> See Notice, 82 at 14404.

<sup>31</sup> See Notice, 82 at 14404.

percentage to a Netting Member's aggregate peak Deliver Obligations ("Deliver Scaling Factor") and the remaining percentage difference, 80 percent in this case, to a Netting Member's aggregate peak Receive Obligations ("Receive Scaling Factor").<sup>32</sup> FICC would have the discretion to adjust these scaling factors based on a quarterly analysis that would, in part, assess Netting Members' observed liquidity needs that are at or below \$15 billion. FICC believes that this assessment would help ensure that the Aggregate Regular Amount would be appropriately allocated across all Netting Members.<sup>33</sup>

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

The remainder of the Aggregate Total Amount (*i.e.*, the Aggregate Supplemental Amount) would be allocated among Netting Members that present liquidity needs greater than \$15 billion using Liquidity Tiers. As described in greater detail in the Notice, the specific allocation of the Aggregate Supplemental Amount to each Liquidity Tier would be based on the frequency that Netting Members generated liquidity needs within each Liquidity Tier, relative to the other Liquidity Tiers.<sup>34</sup> More specifically, once the Aggregate Supplemental Amount is divided among the Liquidity Tiers, the amount within each Liquidity Tier would be allocated among the applicable Netting Members, based on the relative frequency that a Netting Member generated liquidity needs within each Liquidity Tier.<sup>35</sup> FICC explains that this allocation would result in a larger proportion of the Aggregate Supplemental Amount being

borne by those Netting Members who present the highest liquidity needs.<sup>36</sup>

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

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

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

- The largest peak daily liquidity need of an Affiliated Family;
- the Liquidity Buffer;
- the Aggregate Regular Amount;
- the Aggregate Supplemental Amount;
- the Deliver Scaling Factor and the Receive Scaling Factor used to allocate the Aggregate Regular Amount;
- the increments for the Liquidity Tiers; and
- the length of the look-back period and the reset period for the Aggregate Total Amount.<sup>37</sup>

FICC represents that, in the event that any changes to the above-referenced parameters result in an increase in a Netting Member's Individual Total Amount, such increase would be effective as of the next bi-annual reset.<sup>38</sup>

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

Any increase in the Aggregate Total Amount resulting from FICC's quarterly assessments or FICC's daily monitoring would be subject to approval from FICC management, as described in the Notice.<sup>39</sup> Increases to a Netting

Member's Individual Total Amount as a result of its daily monitoring would not be effective until ten business days after FICC issues an Important Notice regarding the increase. Reductions to the Aggregate Total Amount would be reflected at the conclusion of the reset period.

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

The CCLF proposal would become operative 12 months after the later date of the Commission's approval of the Proposed Rule Change and the Commission's no objection to the related Advance Notice. FICC represents that, during this 12-month period, it would periodically provide each Netting Member with estimated Individual Total Amounts. FICC states that the delayed implementation and the estimated Individual Total Amounts are designed to give Netting Members the opportunity to assess the impact that the CCLF proposal would have on their business profile.<sup>40</sup>

FICC states that, as of the implementation date and annually thereafter, FICC would require that each Netting Member attest that it incorporated its Individual Total Amount into its liquidity plans.<sup>41</sup> This required attestation, which would be from an authorized officer of the Netting Member or otherwise in form and substance satisfactory to FICC, would certify that (i) such officer has read and understands the GSD Rules, including the CCLF rules; (ii) the Netting Member's Individual Total Amount has been incorporated into the Netting Member's liquidity planning;<sup>42</sup> (iii) the Netting Member acknowledges and agrees that its Individual Total Amount may be changed at the conclusion of any reset period or otherwise upon ten business days' Notice; (iv) the Netting Member will incorporate any changes to its Individual Total Amount into its liquidity planning; and (v) the Netting Member will continually reassess its liquidity plans and related operational plans, including in the event of any changes to such Netting Member's Individual Total Amount, to ensure such Netting Member's ability to meet its Individual Total Amount. FICC states that it may require any Netting Member

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> According to FICC, the attestation would not refer to the actual dollar amount that has been allocated as the Individual Total Amount. FICC explains that each Netting Member's Individual Total Amount would be made available to such Member via GSD's access controlled portal Web site. *Id.*

<sup>32</sup> For example, assume that a Netting Member's peak Receive and Deliver Obligations represent 5 and 3 percent, respectively, of the sum of all Netting Members' peak Receive and Deliver Obligations. The Netting Member's portion of the Aggregate Regular Amount ("Individual Regular Amount") would be \$600 million (\$15 billion \* 0.80 Receive Scaling Factor \* 0.05 Peak Receive Obligation Percentage), plus \$90 million (\$15 billion \* 0.20 Deliver Scaling Factor \* 0.03 Peak Deliver Obligation Percentage), for a total of \$690 million.

<sup>33</sup> See Notice, 82 at 14404.

<sup>34</sup> See Notice, 82 at 14404–05.

<sup>35</sup> For example, if the Aggregate Supplemental Amount is \$50 billion and Tier 1 has a relative frequency weighting of 33 percent, all Netting Members that have generated liquidity needs that fall within Tier 1 would collectively fund \$16.5 billion (\$50 billion \* 0.33) of the Supplemental Amount. Each Netting Member in that tier would be responsible for contributing toward the \$16.5 billion, based on the relative frequency that the member generated liquidity needs within that tier.

<sup>36</sup> See Notice, 82 at 14404–05.

<sup>37</sup> See Notice, 82 at 14406.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

to provide FICC with a new certification in the foregoing form at any time, including upon a change to a Netting Member's Individual Total Amount or in the event that a Netting Member undergoes a change in its corporate structure.<sup>43</sup>

On a quarterly basis, FICC would conduct due diligence to assess each Netting Member's ability to meet its Individual Total Amount. This due diligence would include a review of all information that the Netting Member has provided FICC in connection with its ongoing reporting obligations pursuant to the GSD Rules and a review of other publicly available information. FICC also would test its operational procedures for invoking a CCLF Event, and Netting Members would be required to participate in such tests. If a Netting Member failed to participate in such testing when required by FICC, FICC would be permitted to take disciplinary measures as set forth in GSD Rule 3, Section 7.<sup>44</sup>

#### E. Liquidity Funding Reports Provided to Netting Members

On each business day, FICC would make a liquidity funding report available to each Netting Member that would include (i) the Netting Member's Individual Total Amount, Individual Regular Amount and, if applicable, its Individual Supplemental Amount; (ii) FICC's Aggregate Total Amount, Aggregate Regular Amount, and Aggregate Supplemental Amount; and (iii) FICC's regulatory liquidity requirements as of the prior business day. The liquidity funding report would be provided for informational purposes only.

## II. Summary of Comments Received

The Commission received three comment letters in response to the Proposed Rule Change.<sup>45</sup> Two comment letters, the Ronin Letter and ICBC Letter, objected to the Proposed Rule Change. One comment letter from FICC responded to the objections raised by Ronin.

### A. Objecting Comments

Ronin argues that the Proposed Rule Change would (1) place an unfair and anticompetitive burden on smaller Netting Members because such members do not present any settlement risk to FICC; (2) cause concentration and systemic risk by potentially forcing smaller Netting Members to leave GSD (as well as creating a barrier to entry for

prospective new Netting Members) or clear their trades through larger Netting Members; and (3) cause FICC's liquidity needs to grow by potentially increasing the size of FICC's largest Netting Members.<sup>46</sup> As an alternative to the Proposed Rule Change, Ronin suggests that FICC should instead impose CCLF requirements only on larger Bank Netting Members that present FICC with settlement risk.<sup>47</sup>

Similarly, ICBC argues that the Proposed Rule Change would result in harmful consequences to smaller Netting Members and other industry participants.<sup>48</sup> Specifically, ICBC argues that the Proposed Rule Change could force smaller Netting Members to exit the clearing business or terminate their membership with FICC due to the cost of CCLF funding obligations, thereby (1) increasing market concentration; (2) decreasing market competition; (3) increasing FICC's credit exposure to its largest participant families; and (4) driving smaller Netting Members to clear transactions bilaterally instead of through a central counterparty.<sup>49</sup>

Although ICBC acknowledges that FICC, as a registered clearing agency, is required to maintain sufficient financial resources to withstand a default by the largest participant family to which FICC has exposure in "extreme but plausible conditions,"<sup>50</sup> ICBC argues that the scenario that CCLF is designed to address is not "plausible" because U.S. government securities are riskless assets that would not suffer a from liquidity shortage, even amidst a financial crisis similar to that in 2008.<sup>51</sup> Moreover, ICBC argues that CCLF is unnecessary because FICC's current risk models have proven to be effective.<sup>52</sup>

ICBC also argues that CCLF could (i) result in FICC's refusal to clear certain trades, thereby increasing the burden on the Bank of New York, the only private bank that clears a large portion of U.S. government securities;<sup>53</sup> (ii) cause FICC members to reduce their balance sheets devoted to the U.S. government securities markets, which would have broad negative effects on markets and taxpayers;<sup>54</sup> (iii) negatively impact traders with hedge positions, resulting in negative downstream effects on the smooth functioning of the U.S. government securities market;<sup>55</sup> and

(iv) effectively drain liquidity from other markets by requiring more liquidity to be available to FICC than is necessary.<sup>56</sup>

### B. Supporting Comment

The FICC Letter written in support of the proposal primarily responds to Ronin's assertions. In response to Ronin's concerns regarding the potential economic impacts on smaller non-bank Netting Members, FICC states that CCLF was designed to minimize the burden on smaller Netting Members and achieve a fair and appropriate allocation of liquidity burdens.<sup>57</sup> Specifically, FICC notes that it sought to structure CCLF so that (1) each Netting Member's CCLF requirement would be a function of the liquidity risk that each Netting Member's activity presents to GSD; (2) the allocation of the CCLF requirement to each Netting Member would be a "fraction" of the Netting Member's peak liquidity exposure that it presents to GSD;<sup>58</sup> and (3) the proposal would fairly allocate higher CCLF requirements to Netting Members that generate higher liquidity needs.<sup>59</sup> FICC further notes that, since CCLF contributions would be a function of the peak liquidity exposure that each Netting Member presents to FICC, FICC asserts that each Netting Member would be able to reduce its CCLF contribution by altering its trading activity.<sup>60</sup>

In response to Ronin's assertion that CCLF could promote concentration and systemic risk, FICC argues that the proposal would actually reduce systemic risk. Specifically, FICC asserts that, by providing FICC with committed liquidity to meet its cash settlement obligations to non-defaulting members during extreme market stress, CCLF would promote settlement finality and the safety and soundness of the securities settlement system, thereby reducing systemic risk, as discussed further below.<sup>61</sup>

Finally, in response to Ronin's concern that CCLF could cause FICC's liquidity needs to grow, FICC notes that

<sup>56</sup> ICBC Letter at 5.

<sup>57</sup> FICC Letter at 3–4.

<sup>58</sup> *Id.* at 3. FICC represents that the ratio of CCLF requirement to Netting Member's peak liquidity need is significantly larger, on average, for the top 10 Netting Members compared to all other members. *Id.* at 4.

<sup>59</sup> *Id.* at 3–4. FICC notes that the Aggregate Regular Amount (proposed to be sized at \$15 billion) would be applied to all Netting Members on a pro-rata basis, while the Aggregate Supplemental Amount, which would make up approximately 80 percent of the Aggregate Total Amount, would only apply to the Netting Members generating the largest liquidity needs (*i.e.*, in excess of \$15 billion). *Id.* at 4.

<sup>60</sup> *Id.* at 3, 7.

<sup>61</sup> *Id.* at 7–8.

<sup>43</sup> *Id.*

<sup>44</sup> GSD Rules, *supra* note 10.

<sup>45</sup> See *supra*, note 4.

<sup>46</sup> Ronin Letter at 1–9.

<sup>47</sup> Ronin Letter at 7–9.

<sup>48</sup> ICBC Letter at 2–7.

<sup>49</sup> ICBC Letter at 2–6.

<sup>50</sup> ICBC Letter at 1–2.

<sup>51</sup> ICBC Letter at 3.

<sup>52</sup> *Id.*

<sup>53</sup> ICBC Letter at 2, 5.

<sup>54</sup> ICBC Letter at 3.

<sup>55</sup> ICBC Letter at 4.

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

#### IV. Proceedings To Determine Whether To Approve or Disapprove the Proposed Rule Change and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act<sup>65</sup> to determine whether the Proposed Rule Change should be approved or disapproved. Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the Proposed Rule Change. As noted above, institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, the Commission seeks and encourages interested persons to comment on the Proposed Rule Change, and provide arguments to support the Commission's analysis as to whether to approve or disapprove the Proposed Rule Change.

Pursuant to Section 19(b)(2)(B) of the Act,<sup>66</sup> the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of the Proposed Rule Change's consistency with the Act and the rules thereunder. Specifically, the Commission believes that the Proposed Rule Change raises questions as to whether it is consistent with (i) Section 17A(b)(3)(F) of the Act,<sup>67</sup> which

requires, in part, that clearing agency rules be designed to assure the safeguarding of securities in the custody or control of the clearing agency and, in general, protect investors and the public interest; (ii) Section 17A(b)(3)(I) of the Act,<sup>68</sup> which provides that clearing agency rules cannot impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act; and (ii) Rule 17Ad-22(e)(7) under the Act,<sup>69</sup> which requires FICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage liquidity risk that arises in or is borne by FICC, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity.<sup>70</sup>

Specifically, Rule 17Ad-22(e)(7) requires policies and procedures for (i) maintaining sufficient liquid resources to effect same-day settlement of payment obligations in the event of a default of the participant family that would generate the largest aggregate payment obligation for the covered clearing agency in extreme but plausible market conditions;<sup>71</sup> (ii) holding qualifying liquid resources sufficient to satisfy payment obligations owed to clearing members;<sup>72</sup> (iii) undertaking due diligence to confirm that FICC has a reasonable basis to believe each of its liquidity providers, whether or not such liquidity provider is a clearing member, has (a) sufficient information to understand and manage the liquidity provider's liquidity risks and (b) the capacity to perform as required under its commitments to provide liquidity;<sup>73</sup> and (iv) maintaining and testing with each liquidity provider, to the extent practicable, FICC's procedures and operational capacity for accessing its relevant liquid resources.<sup>74</sup>

#### V. Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to issues raised by the Proposed Rule Change. In particular, the Commission invites the written views of interested persons concerning whether the Proposed Rule Change is consistent with Sections 17A(b)(3)(F) and 17A(b)(3)(I) of the Act,

Rule 17Ad-22(e)(7) under the Act, cited above, or any other provision of the Act, or the rules and regulations thereunder. Interested persons are invited to submit written data, views, and arguments on or before June 19, 2017. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal on or before June 23, 2017. 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 email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FICC-2017-002 on the subject line.

##### Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-FICC-2017-002. This file number should be included on the subject line if email 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 Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the Proposed Rule Change that are filed with the Commission, and all written communications relating to the Proposed Rule Change 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 Web site 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 such filings also will be available for inspection and copying at the principal office of FICC and on DTCC's Web site (<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-2017-002 and should be submitted on or before June 19, 2017. If comments are received, any rebuttal comments should be submitted on or before June 23, 2017.

<sup>62</sup> *Id.* at 8-9.

<sup>63</sup> *Id.* at 9-10.

<sup>64</sup> *Id.*

<sup>65</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>66</sup> *Id.*

<sup>67</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>68</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>69</sup> 17 CFR 240.17Ad-22(e)(7).

<sup>70</sup> *Id.*

<sup>71</sup> 17 CFR 240.17Ad-22(e)(7)(i).

<sup>72</sup> 17 CFR 240.17Ad-22(e)(7)(ii).

<sup>73</sup> 17 CFR 240.17Ad-22(e)(7)(iv).

<sup>74</sup> 17 CFR 240.17Ad-22(e)(7)(v).

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>75</sup>

**Eduardo A. Aleman,**

*Assistant Secretary.*

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BILLING CODE 8011-01-P

## SECURITIES AND EXCHANGE COMMISSION

### Proposed Collection; Comment Request

*Upon Written Request Copies Available From:* Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE., Washington, DC 20549-2736

#### Extension:

Rule 17g-1 and Form NRSRO, SEC File No. 270-563, OMB Control No. 3235-0625

Notice is hereby given that pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), the Securities and Exchange Commission (“Commission”) is soliciting comments on the existing collection of information provided for in Rule 17g-1, Form NRSRO and Instructions to Form NRSRO under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).<sup>1</sup> The Commission plans to submit this existing collection of information to the Office of Management and Budget for extension and approval.

Rule 17g-1, Form NRSRO and the Instructions to Form NRSRO contain certain recordkeeping and disclosure requirements for nationally recognized statistical rating organizations (“NRSROs”). Currently, there are 10 credit rating agencies registered as NRSROs with the Commission. Based on staff experience, NRSROs are estimated to spend annually a total industry-wide burden of 2,527 hours and external cost of \$4,000 to comply with the requirements.

Written comments are invited on: (a) Whether the proposed collection of information is necessary for the proper performance of the functions of the Commission, including whether the information shall have practical utility; (b) the accuracy of the Commission’s estimates of the burden of the proposed collection of information; (c) ways to enhance the quality, utility, and clarity of the information on respondents; and (d) ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology.

Consideration will be given to comments and suggestions submitted in writing within 60 days of this publication.

The Commission may not conduct or sponsor a collection of information unless it displays a currently valid control number. No person shall be subject to any penalty for failing to comply with a collection of information subject to the PRA that does not display a valid Office of Management and Budget (OMB) control number.

Please direct your written comments to: Pamela Dyson, Director/Chief Information Officer, Securities and Exchange Commission, c/o Remi Pavlik-Simon, 100 F St. NE., Washington, DC 20549 or send an email to: [PRA\\_Mailbox@sec.gov](mailto:PRA_Mailbox@sec.gov).

Dated: May 30, 2017.

**Eduardo A. Aleman,**

*Assistant Secretary.*

[FR Doc. 2017-11466 Filed 6-1-17; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-80802; File No. SR-NASDAQ-2017-038]

### Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Proposed Rule Change Relating to the First Trust Municipal High Income ETF

May 26, 2017.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 16, 2017, The NASDAQ Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

Exchange’s proposed rule change relating to the First Trust Municipal High Income ETF (the “Fund”) of First Trust Exchange-Traded Fund III (the “Trust”), the shares of which have been approved by the Commission for listing and trading under Nasdaq Rule 5735 (“Managed Fund Shares”). The shares of

the Fund are collectively referred to herein as the “Shares.”

The text of the proposed rule change is available on the Exchange’s Web site at <http://nasdaq.cchwallstreet.com>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

#### II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

The Commission has approved the listing and trading of Shares under Nasdaq Rule 5735, which governs the listing and trading of Managed Fund Shares on the Exchange.<sup>3</sup> However, no Shares are currently listed and traded on the Exchange. The Exchange believes the proposed rule change reflects no significant issues not previously addressed in the Prior Release.

The Fund is an actively-managed exchange-traded fund (“ETF”). The Shares will be offered by the Trust, which was established as a Massachusetts business trust on January 9, 2008. The Trust, which is registered with the Commission as an investment company under the Investment Company Act of 1940 (the “1940 Act”), has filed a registration statement on Form N-1A (“Registration Statement”) relating to the Fund with the Commission.<sup>4</sup> The Fund is a series of the Trust.

<sup>3</sup> The Commission approved Nasdaq Rule 5735 in Securities Exchange Act Release No. 57962 (June 13, 2008), 73 FR 35175 (June 20, 2008) (SR-NASDAQ-2008-039). The Commission previously approved the listing and trading of the Shares of the Fund. See Securities Exchange Act Release No. 78913 (September 23, 2016), 81 FR 69109 (October 5, 2016) (SR-NASDAQ-2016-002) (“Prior Release”).

<sup>4</sup> See Post-Effective Amendment No. 27 to Registration Statement on Form N-1A for the Trust, dated August 31, 2015 (File Nos. 333-176976 and 811-22245). The descriptions of the Fund and the Shares contained herein are based, in part, on information in the Registration Statement. Before

<sup>75</sup> 17 CFR 200.30-3(a)(57).

<sup>1</sup> See 17 CFR 240.17g-1 and 17 CFR 249b.300.

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.