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Commissioner Van Zeck
U.S. Department of the Treasury
Bureau of the Public Debt
799 9th Street, NW
Washington, DC 20239

Dear Commissioner Zeck:

The purpose of this letter is to respectfully request reaffirmation of the exemptions from certain capital and customer protection rules granted in 1989 by the Department of the Treasury's Bureau of the Public Debt (the "Bureau") on behalf of government securities broker and dealer participants of the predecessor of the Fixed Income Clearing Corporation ("FICC").¹ We are also requesting (in a separate letter) affirmation by the staff of the Securities and Exchange Commission (the "SEC") that the exemptions also apply with respect to the equivalent capital and customer protection rules that are under the SEC's jurisdiction. This request is being put forth by FICC because one of the facts on which the original granting of the relevant exemptions was based will change, as further described below.

By way of background, FICC operates, through its Government Securities Division, a system for the netting of compared trades of certain eligible Treasury and Agency securities (the "Netting System"). Participants of FICC that participate in the Netting System are called "Netting Members." Each business day, FICC calculates and reports to Netting Members each net settlement position, including fails, that Netting Members have in an eligible netting security. When FICC releases its report detailing net settlement positions, all deliver and receive obligations (together with related payment obligations) that were created by the Netting Members' trades submitted for netting are terminated and replaced by deliver, receive and payment obligations to or from FICC.

For each net position, the Netting Member is either obligated to deliver securities to FICC or to receive securities from FICC; the Netting Member could also have a flat position. Every delivery and receipt by a Netting Member to and from FICC is done

¹ FICC is a registered clearing agency under Section 17A of the Securities Exchange Act of 1934, as amended. FICC's extension of temporary registration may be found at the following citation: Commission Exchange Act Release No 51911 (June 21, 2005), 70 FR 37878. The Government Securities Clearing Corporation ("GSCC") is FICC's predecessor.

against simultaneous payment, through Fedwire, at a uniform system price established by FICC each business day for each eligible netting security. The uniform system price represents the market value of a security for a day's trades. Currently, fails are not netted with other fails or with new trades. Instead, they are generally maintained on an independent basis until settled.²

On each business day, FICC conducts a funds-only settlement process for marking-to-market purposes, which is a separate process from the securities settlement process described above. Specifically, Netting Members pay to, or collect from, FICC a single funds-only settlement amount. Included in the funds-only settlement are: (i) an adjustment consisting of the difference between the contract value and the uniform system price for settling trades, and (ii) a mark-to-market adjustment for every fail net settlement position, including accrued interest.

In a letter dated November 22, 1989 (the "Bureau Letter")³, the Bureau granted exemption to government securities brokers and dealers that are Netting Members from the following capital and customer protection requirements regarding aged fails: (i) as incorporated in 17 CFR 402.2(d), paragraphs 17 CFR 240.15c3-1(c)(2)(iv)(E) and (c)(2)(ix); (ii) as incorporated in 17 C.F.R. 403.4, paragraph 240.15c3-3(d)(2) and Exhibit A (Note D of Item 4 and Item 12); and (iii) 17 C.F.R. 403.5(c)(1)(iii) (hereinafter referred to in this letter collectively as the "Regulatory Exemptions").

The Bureau found (and stated in the Bureau Letter) that: (i) GSCC's mark-to-market procedure provided financial safeguards to Netting Members for credit and market risk that paralleled the capitalization required of such Members under the Regulatory Exemptions requiring capitalization, and (ii) the protection provided to customers through the mark-to-market mechanism was comparable to that provided under the Exemption Regulations requiring customer protection because GSCC's mark-to-market procedure provided brokers and dealers with sufficient funds to satisfy contractual obligations to customers.⁴

In addition to the marking-to-market mechanism, the conclusions of the Bureau Letter were also based upon a specific set of facts as to the operation of the Netting System generally that was represented by GSCC at the time of submission of its request for relief in this regard. In the near future, one of the ways in which the Netting System operated at the time of the issuance of the Bureau Letter, namely, that fails were not netted with other fails or new trades, will change. Specifically, FICC has received SEC approval to

² The only exception is if there is a pair-off opportunity or when FICC has conducted its special individual fail netting processes, both of which are described in more detail in this letter.

³ See Letter from Richard L. Gregg, Commissioner, Bureau of the Public Debt, to Jeffrey F. Ingber, Associate General Counsel, Government Securities Clearing Corporation (November 22, 1989) [available at <http://www.publicdebt.treas.gov/gsr/gsr029i.htm>].

⁴ The Bureau Letter noted that similar conclusions were reached by the SEC staff in two no-action letters (dated June 11, 1987 and December 22, 1987) addressed to the National Securities Clearing Corporation ("NSCC") (FICC's affiliate) regarding NSCC's Reconfirmation and Price Service and as evidenced by NSCC's treatment of fails in its Continuous Net Settlement system as unaged under the SEC net capital rule.

amend its rules to implement a daily fail netting process whereby outstanding participant fail obligations will be netted with current settlement activity on a daily basis.⁵ FICC will not implement this new process until it receives the relief sought herein.

It is important to understand what led to FICC's submission of the filing to implement a daily fail netting process. As noted above, in today's Netting System, failed obligations are not netted with trading activity. At the end of each business day, obligations which failed to settle at the clearing bank on that day are closed and marked-to-market. New obligations, which link back to the original fails, are created at the marked price for settlement the next business day. Separate from fail processing, FICC nets activity scheduled to settle for the first time the following business day, creating additional obligations from the results of the net.

Under the current process, Netting Members can end up having positions with FICC on both sides of the market. To address this, the obligations created from new activity can be paired off with equal and opposite obligations created from fails. However, for a pair-off to occur, the obligations must be equal in par. The current pair-off process, therefore, does not maximize the opportunities to reduce obligations with FICC.

Prior to submission of the daily fail netting rule filing, FICC had the authority in its rules to net fails with other settlement activity in its discretion. In recent years, FICC has been integrally involved in assisting the industry in addressing significant fail situations. When the market experienced significant fails in the May 2013 10-Year Treasury Note, FICC's Netting Members urged it to take an active role in assisting the industry in alleviating the pressures caused by the significant fails in this security. In response, FICC conducted a special netting of fails with participants' current settlement activity on several occasions. These actions on the part of FICC were well received by the industry, as they alleviated the number of open fails and associated settlement issues and risks of the open positions.

However, the individual occasions of fail netting were only an intermediate step in resolving the need for the more regular fail processing. Also, as stated above, the pair off process does not maximize the opportunities to reduce obligations with FICC. The industry's continued experience with fails has caused a heightened demand on the part of Netting Members for FICC to institute an on-going solution. The daily fail netting rule filing was submitted in response to the industry. Prior to submitting the filing, FICC solicited feedback on its daily fail netting proposal via an Important Notice to Members. All comments received on the proposal were positive. Moreover, no adverse comment letters were received by the SEC or FICC on the rule filing itself.⁶

⁵ See Commission Exchange Act Release Nos. 51865 (June 17, 2005) [File No. SR-FICC-2005-11], 70 FR 36679; and 52157 (July 28, 2005) [File No. SR-FICC-2005-11], 70 FR 44959.

⁶ We wish to note also that FICC's fail netting proposal does not represent a business opportunity for FICC; this service is not expected to generate additional revenue for FICC, but rather is expected to reduce revenue as a result of a decrease in clearance obligations as well as a decrease in fees collected for par value coming out of the Netting System.

FICC believes that the implementation of the daily fail netting process will reduce risk, create operational efficiencies, and generally be of tremendous value to the industry. The process will allow for offsetting positions to completely cancel out. Netting Members will be able to remove outstanding failed obligations from their books. The service will also minimize and consolidate outstanding positions, and thus provide a clearer position of the securities movements that truly need to be made among FICC participants; the additional netting will lead to less securities movements.

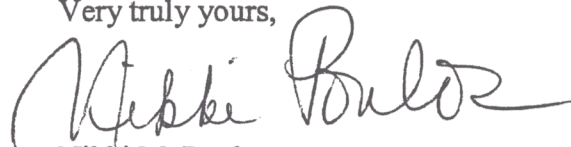
Under the proposed daily fail netting process, the risk management of fails, as it was considered by the Bureau in issuing the Bureau Letter, will be maintained. Fails will still be marked-to-market; the rule filing on daily fail netting made no change regarding the risk management of the fails. In fact, the methodology that is used for marking fails to market under the current system (and that will be continue to be used for fails under the proposed daily fail netting process) employs the identical calculation (including price and value) that is used to compute the mark-to-market amount of the non-failed positions (i.e., the net settlement positions). Moreover, FICC will maintain the ability to track the age of fails under the new process.

Given that the daily fail netting proposal will provide significant benefits to Netting Members and that FICC's risk management of fails will remain as it is currently, FICC respectfully requests a written affirmation from the Bureau that the Regulatory Exemptions will continue to apply once the daily fail netting process is implemented.

* * *

Please contact Susan Tysk, Managing Director, at (212) 855-7612, or the undersigned, at (212) 855-7633, if you have any questions or need any additional information regarding the above request.

Very truly yours,



Nikki M. Poulos
Vice President and
General Counsel

cc: Lori Santamarena, Executive Director, Government Securities Regulations Staff, U.S. Department of the Treasury, Bureau of the Public Debt ✓

Jerry Carpenter, Assistant Director, Division of Market Regulation, Securities and Exchange Commission