

NEW SERVICE BULLETIN

Fixed Income Clearing Corporation



**The Depository Trust &
Clearing Corporation**

Restoration of the Interbank GCF Repo®* Service

July 11, 2007

FICC has developed a plan, in conjunction with its clearing banks, The Bank of New York (“BNY”) and JP Morgan Chase (“Chase”), and with the full support of the Funding Division of the Securities Industry and Financial Markets Association, to return the GCF Repo Service to inter-clearing bank status upon receipt of regulatory approval.

In an Important Notice issued on March 11, 2003 (GOV026.03 –“Shift of the GCF Repo Service to Intra-Bank”), FICC informed its members that it was moving its GCF Repo Service to intra-clearing bank status in order to allow for sufficient time 1) to study certain payment system risk issues that arose from the inter-clearing bank funds settlements related to the service and, 2) to identify a satisfactory solution.

Background

The GCF Repo service allows Government Securities Division (the “GSD”) dealer members to trade general collateral repurchase agreements (“repos”) throughout the day without requiring intra-day, trade-for-trade settlement on a delivery-versus-payment basis. The service allows the dealers to trade such general collateral repos, based on rate and term, throughout the day with inter-dealer broker netting members (“brokers”) on a blind basis. Standardized, generic CUSIP numbers have been established exclusively for GCF Repo processing and are used to specify the acceptable type of underlying Fedwire book-entry eligible collateral, which includes Treasuries, Agencies and certain mortgage-backed securities. The GCF Repo service has its own net at the end of the day.

The GCF Repo service was developed as part of a collaborative effort among GSCC (FICC’s predecessor), its two clearing banks – BNY and Chase – and industry representatives.¹ GSCC introduced the GCF Repo service on an *intra*-clearing bank basis in 1998. Under the intrabank

*“GCF Repo” is a registered trademark of the Fixed Income Clearing Corporation.

¹ BNY and Chase remain the two clearing banks approved by FICC to provide GCF Repo settlement services. In the future, other banks that FICC, in its sole discretion, determines to have met its operational requirements may be approved to provide GCF Repo settlement services.

service, dealers can only engage in GCF Repo transactions with other dealers that clear at the same clearing bank.

In 1999, GSCC expanded the GCF Repo service to permit dealer participants to engage in GCF Repo trading on an *inter*-clearing bank basis, meaning that dealers using different clearing banks could enter into GCF Repo transactions (on a blind brokered basis). Because dealer members that participate in the GCF Repo service do not all clear at the same clearing bank, introducing the service as an interbank service necessitated the establishment of a mechanism to permit after-hours movements of securities between the two clearing banks to deal with the fact that GSCC would likely have unbalanced net GCF securities and cash positions within each clearing bank. In other words, it is likely that at the end of GCF Repo processing each business day, the dealers in one clearing bank will be net funds borrowers, while the dealers at the other clearing bank will be net funds lenders. (Movements of cash do not present the same need because the cash Fedwire remains open later than the securities Fedwire.) To address this issue, GSCC and its clearing banks established, and the Securities and Exchange Commission approved, a legal mechanism by which securities would “move” across the clearing banks without the use of the securities Fedwire.² Therefore, at the end of the day, after the GCF net results are produced, securities are pledged via a tri-party-like mechanism and the inter-bank cash component is moved via Fedwire. In the morning, the pledges are unwound; that is, funds are returned to the net funds lenders and securities are returned to the net funds borrowers.

In 2003, FICC shifted the GCF Repo service back to intrabank status. By that time, the service had grown significantly in participation and volume. However, with the increase in use of the service, certain payments systems risk issues arose from the inter-bank funds settlements related to the service. FICC shifted the service back to intrabank status to enable management to study the issues presented and identify a satisfactory solution for returning the service to interbank status.

Proposal

FICC has now developed a proposal to address the issues raised by the interbank morning funds movement and to allow for returning the GCF Repo Service to interbank status. The proposal addresses these issues by using a hold against a dealer’s “net free equity” (“NFE”) to collateralize its GCF Repo cash obligation to FICC on an intraday basis.³ The proposal will introduce changes to the service only with respect to the morning “unwind” period. No changes will occur with respect to the after-hours movement of securities occurring the previous day.

Specifically, the interbank funds payment will not move during the GCF morning unwind process. In lieu of making funds payments, the interbank dealers at the GCF net funds borrower bank will have a pro-rated hold placed on their NFE at the bank. This means that the dealers will grant to FICC a security interest in their NFE equal to their prorated share of the total interbank funds amount. The dealers to whom this prorated charge will be applied will have a combination of cash debit and NFE

² This is achieved via special accounts that are established on the books of the clearing banks as well as on FICC’s books.

³ NFE is a methodology that clearing banks use to determine whether an account holder (such as a dealer) has sufficient collateral to enter a specific transaction. NFE allows the clearing bank to place a limit on its customer’s activity by calculating a value on the customer’s balances at the bank. Bank customers have the ability to monitor their NFE balance throughout the day.

hold in their account that will add up to the total of the collateral pledged the prior day. Therefore, this process will have no impact on the dealer's intraday NFE profile at their Clearing Bank.

FICC will, in turn, grant to the other clearing bank (that was due to receive the funds) a security interest in the NFE to support the debit in the FICC account. The debit in the FICC account occurs because the dealers who are due to receive funds in the morning must receive those funds at that time in return for their release of collateral. The clearing banks will agree to manage the collateral value of the NFE as they do today.

The debit in the FICC account at the clearing bank referred to in the previous paragraph will get satisfied during the end-of-day GCF settlement process. Specifically, that day's new activity will yield a new interbank funds amount that will move at end of day. However, this amount will now get netted with the amount that would have been due in the morning, thus further reducing the interbank funds movement. The NFE holds will be released when the interbank funds movement is made at end of day.

In order to protect FICC and its members in the event of an intra-day default of a GCF participant, FICC will impose a collateral premium on the GCF portion of the Clearing Fund deposits of all GCF participants. FICC will require GCF participants to submit a quarterly "snapshot" of their holdings by asset type to enable Risk Management staff to determine the appropriate Clearing Fund premium.

Service Overview

What follows represents a summary of the workflows associated with the proposal.

It is important to emphasize that there are no changes to the inter-dealer broker trade entry process or the dealer affirmation process. Nor will the end-of-day collateral lock-up be affected by the new process. These changes will be operationally transparent to members. The new net payment process will be between FICC and the Clearing Banks only; dealers will still be credited cash in full when collateral is locked up.

Day 1 – Transactions and Settlement

Dealers continue to send all GCF Repo obligations to FICC against payment. FICC delivers the securities to the dealers that have net reverse positions in each security.

Eliminating trading restrictions results in an inter-bank net obligation at end of day. One clearing bank will have a net long collateral position and the other clearing bank will have a net short collateral position. FICC's inter-bank security position file for the net inter-bank repo positions is transmitted to the other bank and FICC receives cash in exchange.

Changes to the service are introduced during the morning "unwind" period on the day following net settlement of GCF repos.

Day 2 - Inter-bank Unwind

GCF settlement unwind will include the inter-bank net obligation from the previous day's net settlement.

Interbank funds payments will not move in the morning.

In lieu of funds payments, the repo dealers at the net funds borrowing bank will have a prorated hold placed on their NFE (Net Free Equity) at the bank. Dealers will grant FICC a security interest in their NFE equal to their share of the interbank funds amount

FICC will, in turn, grant the other clearing bank (that was due to receive funds) a security interest in the NFE to support the debit in the FICC account. The debit occurs because dealers who are due to receive funds in the morning will receive those funds in return for their release of collateral.

Clearing Banks will manage the collateral value of the NFE as they do today.

Day 2 - End of Day Settlement

The Clearing Bank debit gets satisfied during end-of-day GCF settlement processing on a net basis when the interbank funds payment is completed.

FICC will net the morning funds amount with the amount generated from today's activity. The net amount is paid to the net funds borrowing bank in exchange for FICC's inter-bank security position file.

Contact Information

As always, FICC is interested in comments from its GSD members and other industry participants on new services. Any comments should be directed to Murray Pozmanter at 212-855-7522 or Bart Schiavo at 212-855-7590, or send written comments via email to mpozmanter@dtcc.com or bschiavo@dtcc.com.