

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of \*  SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4 File No.\* SR -  - \*  Amendment No. (req. for Amendments \*)

Filing by Fixed Income Clearing Corporation  
 Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

<b>Initial *</b> <input checked="" type="checkbox"/>	<b>Amendment *</b> <input type="checkbox"/>	<b>Withdrawal</b> <input type="checkbox"/>	<b>Section 19(b)(2) *</b> <input checked="" type="checkbox"/>	<b>Section 19(b)(3)(A) *</b> <input type="checkbox"/>	<b>Section 19(b)(3)(B) *</b> <input type="checkbox"/>
			Rule		
<b>Pilot</b> <input type="checkbox"/>	<b>Extension of Time Period for Commission Action *</b> <input type="checkbox"/>	<b>Date Expires *</b> <input type="text"/>	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

<b>Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010</b>	<b>Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934</b>
<b>Section 806(e)(1) *</b> <input type="checkbox"/>	<b>Section 806(e)(2) *</b> <input type="checkbox"/>
<b>Section 3C(b)(2) *</b> <input type="checkbox"/>	

**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 the MBSD Rules regarding FICC time of novation, treatment of itself as the settlement counterparty for certain Transaction types, and proposal to implement new processes to promote operational efficiencies for Clearing Members.

**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 \*  Last Name \*

Title \*

E-mail \*

Telephone \*  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.

(Title \*)

Date  Executive Director and Associate General Counsel

By

(Name \*)

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.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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

**Form 19b-4 Information \***

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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 \***

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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 \***

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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**

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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**

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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**

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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**

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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**

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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 the Proposed Rule Change

(a) The proposed rule change is annexed hereto as Exhibit 5 and consists of modifications to the Mortgage-Backed Securities Division (“MBSD”) Clearing Rules (“MBSD Rules”) of Fixed Income Clearing Corporation (“FICC” or the “Corporation”).<sup>1</sup> In connection with this proposed rule change, FICC is proposing to (1) move the time that FICC treats itself as the settlement counterparty for SBO-Destined Trades<sup>2</sup> to the time of trade comparison, which is earlier in the lifecycle of the trade,<sup>3</sup> (2) move the time that FICC novates and treats itself as the settlement counterparty for Trade-for-Trade Transactions<sup>4</sup> to the time of trade comparison, which is earlier in the lifecycle of the trade, (3) novate and establish itself as the settlement counterparty at the time of trade comparison for Specified Pool Trades,<sup>5</sup> and (4) guarantee and novate trades with stipulations (“Stipulated Trades”), a proposed new trade type, at the time of trade comparison and treat FICC as the settlement counterparty at such time.<sup>6</sup>

In connection with these changes, FICC is also proposing new processes that would promote operational efficiencies for MBSD Clearing Members.<sup>7</sup> These processes include the

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<sup>1</sup> Capitalized terms used and not otherwise defined shall have the meaning assigned to such terms in the MBSD Rules or the FICC MBSD EPN Rules, as applicable, available at <http://www.dtcc.com/en/legal/rules-and-procedures>.

<sup>2</sup> Pursuant to the MBSD Rules, the term “SBO-Destined Trade” means a TBA transaction in the Clearing System intended for TBA Netting in accordance with the provisions of the MBSD Rules. See MBSD Rule 1, supra note 1.

<sup>3</sup> FICC currently novates SBO-Destined Trades at trade comparison. No changes are being proposed to the time that novation occurs.

<sup>4</sup> Pursuant to the MBSD Rules, the term “Trade-for-Trade Transaction” means a TBA Transaction submitted to the Corporation not intended for TBA Netting in accordance with the provisions of the MBSD Rules. See MBSD Rule 1, supra note 1.

<sup>5</sup> Pursuant to the MBSD Rules, the term “Specified Pool Trade” means a trade in which all required pool data, including the pool number to be delivered on the Contractual Settlement Date, are agreed upon by Members at the time of execution. See MBSD Rule 1, supra note 1.

<sup>6</sup> For the avoidance of doubt, no changes are being proposed to FICC’s trade guarantee (other than with respect to adding Stipulated Trades, the proposed new trade type, to the trade types guaranteed by FICC). FICC will continue to guarantee SBO-Destined Trades, Specified Pool Trades and Trade-for-Trade Transactions at trade comparison.

<sup>7</sup> Pursuant to the MBSD Rules, the term “Clearing Member” means any entity admitted into membership pursuant to Rule 2A. See MBSD Rule 1, supra note 1.

following: (1) eliminating the Notification of Settlement<sup>8</sup> process, (2) establishing a process (referred to as the “Do Not Allocate” (“DNA”) process) that would permit offset among SBON Trades<sup>9</sup> and Trade-for-Trade Transactions, (3) establishing a secondary process for pool netting (referred to as the “Expanded Pool Netting” process), (4) eliminating the “give-up” process for Brokered Transactions,<sup>10</sup> and (5) amending the components of the Cash Settlement<sup>11</sup> calculation.

In addition, FICC would modify its Real-Time Trade Matching (“RTTM”) system to permit the submission of SBO-Destined Trades in all trade size amounts. This change would occur systemically in the RTTM system. MBSD’s trade size submission requirements are not reflected in the MBSD Rules. As a result, this change would not require changes to the MBSD Rules.

(b) Not applicable.

(c) Not applicable.

## **2. Procedures of the Self-Regulatory Organization**

The proposed rule change was approved by the Businesses, Technology, and Operation’s Committee of FICC’s Board of Directors on April 13, 2017.

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<sup>8</sup> Pursuant to the MBSD Rules, the term "Notification of Settlement" means an instruction submitted to the Corporation by a purchasing or selling Clearing Member pursuant to the MBSD Rules reflecting settlement of an SBO Trade, Trade-for-Trade Transaction or Specified Pool Trade. See MBSD Rule 1, supra note 1.

<sup>9</sup> Pursuant to this proposed rule change, FICC is proposing to amend the term “SBON Trade” to refer to a trade that Clearing Members settle directly with FICC. This proposed term is further described in section 3.(a)II.H.1. of this proposed rule change.

<sup>10</sup> Pursuant to the MBSD Rules, the term “Brokered Transaction” means any “give-up” transaction calling for the delivery of an Eligible Security the data on which has been submitted to the Corporation by Members, to which transaction a Broker is a party. See MBSD Rule 1, supra note 1.

<sup>11</sup> Pursuant to the MBSD Rules, the term “Cash Settlement” refers to the payment each Business Day by the Corporation to a Member or by a Member to the Corporation pursuant to Rule 11. See MBSD Rule 1, supra note 1.

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

(a) Purpose

FICC currently processes SBO-Destined Trades, Specified Pool Trades and Trade-for-Trade Transactions.<sup>12</sup> For each of these trade types, FICC guarantees the settlement of such transactions at the time of trade comparison regardless of whether such transactions are (1) novated and settled versus FICC or (2) settled bilaterally between Clearing Members.<sup>13</sup> In connection with this guarantee, the buying Clearing Member and the selling Clearing Member counterparties are contractually bound, with FICC acting as a third-party guarantor in the event that either Clearing Member fails to meet its settlement obligations.

In addition to its guarantee, FICC also currently novates certain transactions – meaning that, the legal obligations that exist between Clearing Member counterparties are terminated and such obligations are replaced with new obligations to deliver securities to and receive securities from FICC. While FICC guarantees all SBO-Destined Trades, Specified Pool Trades and Trade-for-Trade Transactions at trade comparison,<sup>14</sup> currently, FICC novates and treats itself as the settlement counterparty for SBO-Destined Trades and Trade-for-Trade Transactions at different points during the lifecycle of each trade type.

More specifically, under the current MBSR Rules, FICC novates SBO-Destined Trades at the time of trade comparison, however, FICC does not treat itself as the settlement counterparty for purposes of processing and settlement until after the Pool Netting<sup>15</sup> process is complete and FICC has established Pool Receive Obligations<sup>16</sup> or Pool Deliver Obligations,<sup>17</sup> as

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<sup>12</sup> FICC also processes Option Contracts, however, these transactions are not the subject of this filing and no changes are being proposed in connection with this trade type.

<sup>13</sup> See MBSR Rule 5, supra note 1.

<sup>14</sup> Id.

<sup>15</sup> Pursuant to the MBSR Rules, the term “Pool Netting” means the service provided to Clearing Members, as applicable, and the operations carried out by the Corporation in the course of providing such service in accordance with Rule 8. See MBSR Rule 1, supra note 1.

<sup>16</sup> Pursuant to the MBSR Rules, the term “Pool Receive Obligation” means a Clearing Member's obligation to receive Eligible Securities from the Corporation at the appropriate Settlement Value either in satisfaction of all or part of a Pool Net Long Position. See MBSR Rule 1, supra note 1.

<sup>17</sup> Pursuant to the MBSR Rules, the term “Pool Deliver Obligation” means a Clearing Member's obligation to deliver Eligible Securities to the Corporation at the appropriate Settlement Value either in satisfaction of all or part of a Pool Net Short Position. See MBSR Rule 1, supra note 1.

applicable, for each Clearing Member that has entered into an SBO-Destined Trade.<sup>18</sup> With respect to Trade-for-Trade Transactions, FICC does not novate such transactions or treat itself as the settlement counterparty for purposes of netting, processing, and settlement until the Pool Netting process is complete<sup>19</sup> and each Clearing Member that has entered into a Trade-for-Trade Transaction receives its Pool Receive Obligations or Pool Deliver Obligations, as applicable. For Specified Pool Transactions, FICC does not novate Specified Pool Trades or treat itself as the settlement counterparty during any point of the trade lifecycle.

In connection with this proposed rule change, FICC's overarching goal is to novate and treat itself as the settlement counterparty to all Transactions<sup>20</sup> (other than Option Contracts<sup>21</sup>) at the time of trade comparison. Specifically, FICC is proposing to (1) move the time that FICC treats itself as the settlement counterparty for SBO-Destined Trades to the time of trade comparison, which is earlier in the lifecycle of the trade, (2) move the time that FICC novates and treats itself as the settlement counterparty for Trade-for-Trade Transactions to the time of trade comparison, which is earlier in the lifecycle of the trade, (3) novate and establish itself as the settlement counterparty at the time of trade comparison for Specified Pool Trades, and (4) guarantee and novate Stipulated Trades at the time of trade comparison and treat FICC as the settlement counterparty at such time. These changes would not create any new material risk for FICC because FICC guarantees the settlement of all Transactions at trade comparison<sup>22</sup> and no changes (other than the proposed inclusion of Stipulated Trades) are being proposed in connection with the timing or substance of FICC's guarantee.

In order to achieve the above-referenced changes, FICC is also proposing to make certain operational changes that would create efficiencies for Clearing Members. These changes include: (1) eliminating the Notification of Settlement process, (2) establishing the DNA process,

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<sup>18</sup> See MBS Rule 1, supra note 1.

<sup>19</sup> Id. FICC does not novate and does not become the settlement counterparty to Trade-for-Trade Transactions that do not enter the Pool Netting system. Instead, these transactions are required to settle among the Clearing Member counterparties outside of FICC.

<sup>20</sup> Pursuant to the MBS Rules, the term "Transaction" means a trade that is eligible for processing by the Corporation in accordance with the MBS Rules. See MBS Rule 1, supra note 1.

<sup>21</sup> Pursuant to the MBS Rules, the term "Option Contract" means an option to sell or buy a specified amount of Eligible Securities by or on a specified date to or from the other party to the contract against payment of the Strike Price. Upon exercise, a "Call Option Contract" entitles the purchaser to buy, and obligates the seller (writer) to sell, Eligible Securities for the Strike Price, whereas a "Put Option Contract" entitles the purchaser to sell, and obligates the seller (writer) to buy, Eligible Securities for the Strike Price. See MBS Rule 1, supra note 1.

<sup>22</sup> See MBS Rule 5, supra note 1.

(3) establishing the Expanded Pool Netting process, (4) eliminating the “give-up” process for Brokered Transactions, and (5) amending the components of the Cash Settlement calculation. In addition, FICC would modify its RTTM system to permit the submission of SBO-Destined Trades in all trade size amounts. These changes would not create any new material risk for FICC because these changes would be designed to enhance operational efficiencies while not materially affecting risk management processes.

## I. MBSD Processing – Overview

### MBSD’s Current Trade Comparison and Netting Processes

MBSD processes (1) to-be-announced (“TBA”) transactions (“TBA Transactions”), which are trades for which the actual identities of and/or the number of pools underlying each trade are unknown at the time of trade execution and (2) Specified Pool Trades, which are trades for which all pool data is agreed upon by the Clearing Members at the time of execution. TBA Transactions are comprised of (i) SBO-Destined Trades, (ii) Trade-for-Trade Transactions and (iii) Option Contracts.

MBSD’s Trade Comparison<sup>23</sup> system and TBA Netting<sup>24</sup> system form the basis of all of its other services. All Compared Trades<sup>25</sup> are risk managed by MBSD, but the remainder of their respective lifecycles differ according to their trade type.

The first step of MBSD’s clearance and settlement process is trade comparison, which consists of the reporting, validating and matching by FICC of both sides of a Transaction to ensure that the details of the trades are in agreement between the parties.<sup>26</sup> Trade data is entered into the RTTM system by all parties and once the trade is deemed compared, FICC guarantees the settlement of the trade, provided that the trade meets the requirements of the MBSD Rules and was entered into in good faith.<sup>27</sup> With respect to SBO-Destined Trades, upon trade comparison such

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<sup>23</sup> Pursuant to the MBSD Rules, the term “Trade Comparison” means the service provided to Clearing Members and the operations carried out by the Corporation in the course of providing such service, in accordance with MBSD Rule 5. See MBSD Rule 1, supra note 1.

<sup>24</sup> Pursuant to the MBSD Rules, the term “TBA Netting” means the service provided to Clearing Members, as applicable, and the operations carried out by the Corporation in the course of providing such service in accordance with MBSD Rule 6. See MBSD Rule 1, supra note 1.

<sup>25</sup> Pursuant to the MBSD Rules, the term “Compared Trade” means a trade the data on which has been compared or deemed compared pursuant to Rule 5 or Rule 7, as applicable. See MBSD Rule 1, supra note 1.

<sup>26</sup> See MBSD Rule 5, supra note 1.

<sup>27</sup> See MBSD Rule 5 Section 8, supra note 1.

trades are also novated to FICC.<sup>28</sup> This novation consists of the termination of the deliver, receive and related payment obligations between Clearing Members and their replacement with identical obligations to and from FICC.<sup>29</sup> With respect to Trade-for-Trade Transactions, novation does not occur at the time of trade comparison; FICC only guarantees the settlement of such Transactions upon trade comparison.<sup>30</sup> Although FICC guarantees the obligations of Specified Pool Trade counterparties to deliver, receive and make payment for securities that satisfy the same generic criteria as the securities underlying Specified Pool Trades upon trade comparison, FICC does not novate such trades.<sup>31</sup>

Next, MBSD employs two netting processes to reduce settlement obligations as well as the number of securities and the amount of cash that must be exchanged to settle certain Transactions. The netting processes occur through the TBA Netting system and the Pool Netting system.<sup>32</sup>

The TBA Netting system is used to net SBO-Destined Trades that have compared and are eligible for the TBA Netting system.<sup>33</sup> Three days before the established contractual settlement day (referred to as “72-Hour Day”),<sup>34</sup> TBA Netting for the applicable class occurs. On this date, all compared SBO-Destined Trades within the class that have been designated for the TBA Netting process are netted within and across counterparties. Even though FICC has become the legal counterparty for each SBO-Destined Trade upon trade comparison, TBA Netting occurs as though

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<sup>28</sup> See MBSD Rule 5 Section 13, supra note 1.

<sup>29</sup> Id.

<sup>30</sup> Id.

<sup>31</sup> See MBSD Rule 5 Section 12, supra note 1.

<sup>32</sup> See MBSD Rules 6, 7 and 8, supra note 1.

<sup>33</sup> Trade-for-Trade Transactions are not netted through the TBA Netting system, however, like the SBO positions, do constitute TBA settlement obligations against which Pool Instructs may be submitted. Specified Pool Trades are also not netted through the TBA Netting system, nor do such trades enter the Pool Netting system. See MBSD Rules 6 and 8, supra note 1.

<sup>34</sup> MBSD performs the TBA Netting process four times per month, corresponding to each of the four primary settlement classes and dates established by the Securities Industry Financial Markets Association (“SIFMA”). SIFMA publishes a calendar that specifies one settlement date per month for four different product classes (known as Classes A, B, C and D) that are used to categorize the various types of TBA securities. These product classes and the associated settlement dates are recognized by the industry, and they provide the foundation for MBSD’s TBA Netting process.



each SBO-Destined Trade is with the Original Contra-Side Member.<sup>35</sup> The net positions created by the TBA Netting process are referred to as the settlement balance order positions (“SBO positions”), which constitute settlement obligations against which Clearing Members will submit pool information (“Pool Instructs”) for the Pool Netting process.<sup>36</sup>

Two business days prior to the established settlement date of the TBA settlement obligations (known as “48-Hour Day”), Clearing Members that have an obligation to deliver pools (“Pool Sellers”) must notify their counterparties (“Pool Buyers”) through MBSD’s EPN Service<sup>37</sup> of the pools that such Pool Sellers intend to allocate in satisfaction of their SBO positions and/or Trade-for-Trade Transactions.<sup>38</sup> With respect to Trade-for-Trade Transactions, the relevant counterparty is the Original Contra-Side Member. With respect to SBO-Destined Trades, although MBSD is the legal counterparty, Clearing Members are directed to treat a designated SBO Contra-Side Member<sup>39</sup> as their counterparty. In addition, Clearing Members are also required to submit Pool Instructs on

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<sup>35</sup> Pursuant to the MBSD Rules, the term “Original Contra-Side Member” means a Member with whom a Member has entered into a contract for the purchase or sale of an Eligible Security or an Option Contract. See MBSD Rule 1, supra note 1.

<sup>36</sup> See MBSD Rule 6, supra note 1.

<sup>37</sup> MBSD’s electronic pool notification service (the “EPN Service”) provides Clearing Members with the ability to electronically communicate pool information to MBSD, as described in the proposed rule changes. See MBSD Rule 1, supra note 1. FICC recognizes that the term “EPN” as used in connection with the “EPN Service” also reflects the acronym of “Expanded Pool Netting.” With this in mind, FICC wishes to clarify that the EPN Service and the Expanded Pool Netting process are not associated with one another. As described above, the EPN Service is MBSD’s electronic pool notification service, which is used by Clearing Members to electronically communicate pool information to MBSD as described in this proposed rule change. Expanded Pool Netting would be a secondary pool netting process that FICC is proposing to establish as described in this proposed rule change.

<sup>38</sup> Pool allocations occur for all TBA Obligations, whether established on 72-Hour Day through the TBA Netting process or established upon comparison when the Trade-for-Trade Transaction was submitted. Pool allocations are not performed for Specified Pool Trades because the pool that is to be delivered in connection with such trade is specified upon submission.

<sup>39</sup> Pursuant to the MBSD Rules, the term “SBO Contra-Side Member” means the Member with whom a Member is directed by the Corporation to settle an SBO Trade. An “SBON Contra-Side Member” is an SBO Contra-Side Member that is not an Original Contra-Side Member with respect to such SBO Trade. An “SBOO Contra-Side Member” is an SBO Contra-Side Member that is also an Original Contra-Side Member with respect to such SBO Trade. See MBSD Rule, supra note 1

the 48-Hour Day to MBSD through its RTTM system for Pool Comparison<sup>40</sup> (which is a prerequisite to Pool Netting).<sup>41</sup> The pools must be bilaterally matched by each counterparty to the trade. Any pool allocations deemed compared at this stage (provided that neither Clearing Member has cancelled the submitted allocation) are processed through the Pool Netting system.<sup>42</sup> On the business day before the contractual settlement date (“24-Hour Day”), pool netting takes place. The Pool Netting system reduces the number of pool settlements by netting Pool Instructs stemming from SBO Trades<sup>43</sup> and Trade-for-Trade Transactions to arrive at a single net position per counterparty in a particular pool number for next-day delivery date.<sup>44</sup>

On each business day, MBSD makes available to each Clearing Member a Report<sup>45</sup> to enable such Clearing Member to settle its Pool Net Settlement Positions<sup>46</sup> on that business day.

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<sup>40</sup> Pursuant to the MBSD Rules, the term “Pool Comparison” means the service provided to Clearing Members, as applicable, and the operations carried out by the Corporation in the course of providing such service, in accordance with Rule 7. See MBSD Rule 1, supra note 1.

<sup>41</sup> As with the EPN Service allocation process described above, Clearing Members submit Pool Instructs against all of their TBA Obligations regardless of whether the TBA Obligation stems from the TBA Netting process or the TBA Obligation is established upon comparison when the Trade-for-Trade Transaction was submitted.

<sup>42</sup> See MBSD Rule 8, supra note 1.

<sup>43</sup> Pursuant to the MBSD Rules, the term “SBO Trade” means a settlement balance order that offsets an SBO Net Open Position pursuant to the MBSD Rules. A Member which has one or more “Long SBO Trades” in a particular CUSIP number is a net purchaser with respect to that CUSIP number, as the case may be; a Member which has one or more “Short SBO Trades” is a net seller. An SBO Trade may be either an SBON Trade or an SBOO Trade. See MBSD Rule 1, supra note 1.

<sup>44</sup> A Clearing Member’s “counterparty” for purposes of notifications, netting and processing as described in this paragraph is the SBO Contra-Side Member or the Original Contra-Side Member for SBO-Destined Trades and Trade-for-Trade Transactions, respectively. See MBSD Rule 6, supra note 1.

<sup>45</sup> Pursuant to the MBSD Rules, the term “Report” means any document, record, or other output prepared by the Corporation and made available to a Member in any format (including, but not limited to, machine-readable and print-image formats) or medium (including, but not limited to, print copy, magnetic tape, video display terminal, and interactive message formats) that provides information to such Member with regard to the services provided by, or the operations of, the Corporation. See MBSD Rule 1, supra note 1.

At the time that the Report is made available, all deliver, receive and related payment obligations between Clearing Members that were created by compared pools that comprise a Pool Net Settlement Position or Positions are terminated and replaced by the Pool Deliver Obligations, Pool Receive Obligations, and related payment obligations to and from FICC.<sup>47</sup> Each Clearing Member then provides appropriate instructions to its clearing bank to deliver to MBSD, and/or to receive from MBSD, Eligible Securities against payment or receipt at the appropriate settlement value.

Certain obligations among Clearing Members settle outside of FICC – meaning that, Clearing Members are required to settle such obligations directly with their applicable settlement counterparties.<sup>48</sup> These obligations include (1) Pool Instructs that are not included in Pool Netting (either because they are ineligible or because they do not meet selection criteria for inclusion) and (2) Specified Pool Trades, which are not eligible for Pool Netting. Clearing Members must report that an obligation has settled bilaterally with their applicable settlement counterparties to FICC by submitting a Notification of Settlement to MBSD for pool settlements relating to all trade types, with the exception of Option Contracts.<sup>49</sup> This is required because MBSD will not know which pools actually have settled directly between Clearing Members unless it receives a separate notification. Once the mandatory details on the Notification of Settlement instructions submitted by both Clearing Members are compared, the associated obligation is deemed to have settled and will therefore no longer be subject to MBSD’s risk management.

## **II. MBSD Processing – Proposed Changes**

### **A. FICC’s proposed change to novate all Transactions (other than Option Contracts) and treat itself as the settlement counterparty for all such Transactions at trade comparison**

MBSD is proposing to novate all Transactions (except Option Contracts) at the time of trade comparison. This means that, upon trade comparison, the deliver, receive and related payment obligations between the Clearing Members with respect to SBO-Destined Trades and Trade-for-Trade Transactions would terminate and be replaced by identical obligations to and from FICC (i.e., FICC would become the buyer to every seller and the seller to every buyer). A similar process would occur for Specified Pool Trades and Stipulated Trades, except that, for those trades, the existing deliver, receive and related payment obligations would be terminated and replaced with obligations to deliver, receive and make payment for securities that satisfy the

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<sup>46</sup> Pursuant to the MBSD Rules, the term “Pool Net Settlement Position” means either a Pool Net Short Position or a Pool Net Long Position, as the context requires. See MBSD Rule 1, supra note 1.

<sup>47</sup> Id.

<sup>48</sup> See MBSD Rule 5 Section 12 and MBSD Rule 8 Section 2, supra note 1.

<sup>49</sup> See MBSD Rule 10, supra note 1.

same generic criteria (such as coupon rate, maturity, agency, and product) as the securities underlying the Specified Pool Trades or Stipulated Trades. FICC would not novate or guarantee the obligations to deliver the particular securities underlying Specified Pool Trades or securities that contain the particular stipulations set forth in Stipulated Trades. In addition, FICC is proposing to treat itself as the settlement counterparty throughout the lifecycle of the trade for netting, processing and settlement purposes.<sup>50</sup> These changes are described in detail below.

### **1. SBO-Destined Trades**

Currently, MBSB novates SBO-Destined Trades at the time of trade comparison, however, FICC does not treat itself as the settlement counterparty for netting and processing purposes until after the Pool Netting process is complete and FICC has established Pool Receive Obligations or Pool Deliver Obligations, as applicable, for each Clearing Member that has entered into an SBO-Destined Trade. As a result, Clearing Members are directed to (1) allocate pools through the EPN Service to designated SBO Contra-Side Members and (2) submit Pool Instructs through the RTTM system.<sup>51</sup>

MBSB is proposing to treat itself as settlement counterparty for netting and processing purposes, at the time of trade comparison. SBO-Destined Trades would proceed to the TBA Netting process as they do today; however, the SBO positions that result from the TBA Netting process would reflect FICC as the settlement counterparty. Thus, Clearing Members would no longer be directed to settle with a designated SBO Contra-Side Member,<sup>52</sup> but with FICC. On 48-Hour Day, Clearing Members that are Pool Sellers would notify MBSB (rather than their designated SBO Contra-Side Member) through the EPN Service of the allocated pools. FICC would then submit corresponding notifications to Clearing Members that are Pool Buyers. Pool Instructs (as defined above) would continue to be submitted to MBSB on 48-Hour Day through FICC's RTTM system. In an effort to create operational efficiencies, FICC is proposing to amend its MBSB Rules to provide that, if a Clearing Member does not submit its Pool Instructs by the established deadline, FICC would determine and apply the Pool Instructs for that Clearing Member. Such determination would be based on the allocated pools that the Clearing Member has submitted through the EPN Service. As a result of this proposed change, all pools would be compared and FICC would no longer require Clearing Members to settle uncomparing pools directly with their applicable settlement counterparties (i.e., outside of FICC).

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<sup>50</sup> Upon trade comparison, Clearing Members would receive a notification through the RTTM system establishing FICC as each party's novated and settlement counterparty.

<sup>51</sup> See MBSB Rule 7, supra note 1.

<sup>52</sup> FICC would eliminate its calculation for determining the Settlement Value of SBON Trades and SBOO Trades. The MBSB Rules refer to the calculation as "CUSIP Average Price" or "CAP" for SBON Trades and "Firm CUSIP Average Price" or "FCAP" for SBOO Trades. See MBSB Rule 6, supra note 1.

In addition to the above, FICC is also proposing to eliminate the trade size restriction for SBO-Destined Trades. Currently, SBO-Destined Trades are only eligible for the TBA Netting process if such trades details are submitted through the RTTM system in multiple amounts of one million with the minimum set at one million. FICC is proposing to remove this restriction from the RTTM system. As a result, Clearing Members would be permitted to submit SBO-Destined Trades in any trade size. MBSB's trade size restrictions are not reflected in the MBSB Rules, thus the proposed change would not necessitate any changes to the MBSB Rules.

For the avoidance of doubt, FICC is not proposing to change the trade size restrictions for Trade-for-Trade Transactions and Specified Pool Trades.

## **2. Trade-for-Trade Transactions**

Currently, FICC does not novate Trade-for-Trade Transactions or treat itself as settlement counterparty for purposes of netting, processing, and settlement until, in each case, the Pool Netting process is complete and each Clearing Member receives their Pool Receive Obligation or Pool Deliver Obligations, as applicable, from FICC.<sup>53</sup> As a result, Clearing Members are required to allocate pools to their original counterparty through the EPN Service and submit Pool Instructs through the RTTM system. Once Pool Netting is complete, the deliver, receive and related payment obligations between Clearing Members that were created by compared pools that comprise a Pool Net Settlement Position are terminated and replaced by Pool Deliver Obligations, Pool Receive Obligations, and related payment obligations to and from FICC.<sup>54</sup>

FICC is proposing to novate Trade-for-Trade Transactions at trade comparison and treat itself as settlement counterparty, at that time, for purposes of processing and settlement. Similar to the process with SBO-Destined Trades, Clearing Members with an obligation to deliver pools would notify MBSB (rather than their original counterparty) through the EPN Service and FICC would submit corresponding notifications to Clearing Members that are Pool Buyers. Clearing Members would continue to be required to submit Pool Instructs. In the event that Pool Instructs are not submitted by the established deadline, FICC would determine Pool Instructs for that Clearing Member.

## **3. Specified Pool Trades**

Currently, FICC does not novate Specified Pool Trades during any point of the trade lifecycle (though, upon Trade Comparison of Specified Pool Trades, FICC guarantees the obligation to deliver, receive and pay for securities that satisfy the same generic criteria as the securities underlying the Specified Pool Trades).<sup>55</sup> Specified Pool Trades are eligible for neither the TBA Netting process nor the Pool Netting process. In addition, Specified Pool Trades are directly settled between the original counterparties.

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<sup>53</sup> See MBSB Rule 8 Section 4, supra note 1.

<sup>54</sup> See MBSB Rule 8 Section 6, supra note 1.

<sup>55</sup> See MBSB Rule 5, supra note 1.

FICC is proposing to novate Specified Pool Trades upon Trade Comparison. Such novation would be limited to the obligations to deliver, receive and make payment for securities satisfying the same generic criteria as the securities underlying the Specified Pool Trades. As a result, upon Trade Comparison, the existing deliver, receive and related payment obligations between Clearing Members under Specified Pool Trades would be terminated and replaced with obligations to or from FICC to deliver, receive and make payment for securities satisfying the same generic criteria as the securities underlying the Specified Pool Trades. FICC would not novate the obligation to deliver the securities for the particular specified pool.

Additionally, FICC is proposing to settle Specified Pool Trades directly with the Clearing Member party thereto (rather than require that counterparties to such trades settle directly with one another). No other changes are being proposed with respect to the processing of Specified Pool Trades. Such trades would continue to be ineligible for the TBA Netting and Pool Netting systems.

#### **4. Stipulated Trades**

FICC is proposing to introduce Stipulated Trades as a new trade type that would be eligible for processing by MBSD. A Stipulated Trade is a trade in which pools allocated and delivered against the trade must satisfy certain conditions (i.e., stipulations) that are agreed upon by the parties at the time that the trade was executed.<sup>56</sup> FICC would guarantee and novate Stipulated Trades at Trade Comparison provided that such trade meets the requirements of the MBSD Rules and was entered into in good faith. Such guarantee and novation would be limited to the obligations to deliver, receive and make payment for securities satisfying the same generic criteria as the securities underlying the Stipulated Trade, but not the obligation to deliver securities that contain the particular stipulations contained in the Stipulated Trades. At Trade Comparison, the deliver, receive and related payment obligations between Clearing Members would be terminated and replaced with obligations to deliver, receive and make payment for securities satisfying the same generic criteria as the securities underlying the Stipulated Trades.

Because of the narrow nature of FICC's guarantee and novation, in the event of a Clearing Member's default, FICC would only be required to deliver, receive or make payment for securities that have the same generic terms, such as coupon rate, maturity, agency, and product, as the securities that underlay the Stipulated Transaction.

Clearing Members would be required to allocate Stipulated Trades to FICC through the EPN Service. Such allocation would result in the creation of pool obligations, which would settle with FICC based on the settlement date agreed to as part of the terms of the trade. Similar to Specified Pool Trades, Stipulated Trades would be eligible for neither the TBA Netting process nor the Pool Netting process.

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<sup>56</sup> Trades carrying stipulations may reflect terms that include but are not limited to the following: issuance year, issuance month, weighted average coupon, weighted average maturity and/or weighted average loan age, etc.

**B. Proposed change to eliminate the Notification of Settlement process**

As described above, the Notification of Settlement process requires Clearing Members to notify FICC of obligations that have settled directly between Clearing Members and their applicable settlement counterparties.<sup>57</sup> Once both parties to a Transaction submit a Notification of Settlement to MBSB through the RTTM system, the obligations are no longer subject to MBSB's margin calculation process.<sup>58</sup> Because FICC is proposing to novate and directly settle all SBO-Destined Transactions, Trade-for-Trade Transactions and Specified Pool Trades, the Notification of Settlement process would be eliminated from the MBSB Rules.

**C. Proposed change to establish the DNA process**

FICC is proposing to establish a process that would give Clearing Members the ability to offset Trade-for-Trade Transactions<sup>59</sup> and/or SBON Trades.<sup>60</sup> This process would be referred to as the "DNA" process. The purpose of this process is to exclude SBON Trades and Trade-for-Trade Transactions from the pool allocation process<sup>61</sup> and securities settlement.

The Do Not Allocate process would be available to Clearing Members at the start of business day on 48-Hour Day through 4:30 p.m. on 24-Hour Day. During this time, Clearing Members with two or more open TBA Obligations<sup>62</sup> with the same Par Amount,<sup>63</sup> CUSIP

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<sup>57</sup> See MBSB Rule 10, supra note 1.

<sup>58</sup> See MBSB Rule 4, supra note 1.

<sup>59</sup> Specified Pool Trades and Stipulated Trades would not be eligible for the proposed Do Not Allocate process because such trades are not eligible for the Pool Netting process. See MBSB Rule 8, supra note 1.

<sup>60</sup> The proposed MBSB Rules would use the term "SBON Trades" to signify obligations that result from the TBA Netting process. Such obligations would reflect FICC as the settlement counterparty.

<sup>61</sup> As noted above, the pool allocation process requires Clearing Members to allocate pools on 48-Hour Day through the EPN Service. Pursuant to this proposed change, Clearing Members would not be required to allocate pools for obligations that have been offset through the Do Not Allocate process.

<sup>62</sup> Pursuant to the MBSB Rules, the term "TBA Obligations" means SBO-Destined obligations and, with respect to Trade-for-Trade Transactions, settlement obligations generated by the Trade Comparison system. See MBSB Rule 1, supra note 1.

<sup>63</sup> Pursuant to the MBSB Rules, the term "Par Amount" means for Trade-for-Trade and SBO Transactions, Option Contracts and Pool Deliver and Pool Receive Obligations, the current face value of a Security to be delivered on the Contractual Settlement Date. With respect to Specified Pool Trades, "Par Amount" shall mean the original face value of a

Number<sup>64</sup> and SIFMA designated settlement date would be permitted to offset (i.e., “pair-off”) such obligations. In order to initiate the offset, Clearing Members would be required to submit a request (“DNA Request”) to MBSD through the RTTM system. Upon FICC’s validation of this request, the obligations would be reduced and the Clearing Member would not be required to allocate pools against such obligations. As a result, a Clearing Member’s overall number of open obligations would be reduced.

The proposed Do Not Allocate process would generate Cash Settlement credits and debits from the price differential of the resulting offsetting obligations. The proposed Cash Settlement obligations are described below in section F.

1. *Cancellations*

Clearing Members would be permitted to cancel a DNA Request, however, such cancellation must be submitted through the RTTM system prior to the time that the designated offsetting TBA Obligations have settled. Upon FICC’s timely receipt of a cancellation request, the trades that were previously marked for the Do Not Allocate process would reopen and the Clearing Member would be expected to notify MBSD through the EPN Service of the pools that such Clearing Member intends to allocate to the open obligations.

2. *Example of the Do Not Allocate process*

*Assume that the TBA Netting process results in the following:*

Dealer A as seller has a TBA Obligation to FICC in a Fannie Mae (“FNMA”) 30-year 3% coupon for a July 2017 settlement (CUSIP Number 01F030678) with a Par Amount of 100mm.

*Assume that the following Trade-for-Trade Transaction has been novated to FICC:*

Dealer A as buyer has a TBA Obligation to FICC in FNMA 30-year 3% coupon for a July 2017 settlement (CUSIP Number 01F030678) with a Par Amount of 100mm.

In connection with the above, Dealer A would have the option of submitting a DNA Request at anytime between the start of business day on 48-Hour Day through 4:30 p.m. on 24-Hour Day. Upon FICC’s receipt and validation of the DNA Request, FICC would

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Security to be delivered on the Contractual Settlement Date. See MBSD Rule 1, supra note 1. Pursuant to this proposed rule change, FICC is proposing to amend this defined term as described in section H. 1.

<sup>64</sup> Pursuant to the MBSD Rules, the term “CUSIP Number” means the Committee on Uniform Securities Identification Procedures identifying number for an Eligible Security. See MBSD Rule 1, supra note 1.



reduce each of Dealer A's TBA Obligations in accordance with the DNA Request and reduce the overall number of Dealer A's open TBA Obligations.

In addition, FICC would calculate a Cash Settlement obligation for Dealer A (the "Do Not Allocate Transaction Adjustment Payment") difference between the Settlement Price of the buy and sell TBA Obligation transactions multiplied by the contractual quantity.

In the event that Dealer A cancels its DNA Request, the marked TBA Obligations would reopen and Dealer A would be required to allocate pools for such obligations.

**D. Proposed change to establish a secondary Pool Netting process – Expanded Pool Netting**

As described above, the Pool Netting system reduces the number of pool settlements by netting Pool Instructs stemming from SBON Trades and Trade-for-Trade Transactions to arrive at a single net position per counterparty in a particular pool number for next-day delivery date.<sup>65</sup> Prior to the Pool Netting process, Pool Sellers must notify their Pool Buyers through MBSB's EPN Service of the pools that will be allocated in satisfaction of a TBA Obligation. In accordance with the SIFMA Guidelines,<sup>66</sup> such notifications must occur before 3:00 p.m.<sup>67</sup> on 48-Hour Day. Notifications that take place after this time are considered late and the delivery of such pools to the related Pool Buyers will be delayed for one additional business day.

In order to capture notifications submitted after 3:00 p.m. on 48-Hour Day through 4:30 p.m. on 24-Hour Day, FICC is proposing to establish an additional netting cycle (referred to as Expanded Pool Netting). Similar to the initial Pool Netting process, Expanded Pool Netting would result in a reduction in the number of Pool Delivery Obligations. As with the existing Pool Netting process, the proposed Expanded Pool Netting process would (1) calculate Pool Net Settlement Positions in a manner that is consistent with Section 3 of MBSB Rule 8 and (2) allocate Pool Deliver Obligations and Pool Receive Obligations in a manner that is consistent with Section 4 of MBSB Rule 8. The Expanded Pool Netting process would occur four times per month in accordance with the SIFMA designated settlement date. Pool Net Settlement Positions and the resultant Pool Deliver Obligations and Pool Receive Obligations would only be provided to Clearing Members during such times.

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<sup>65</sup> A Clearing Member's "counterparty" for purposes of notifications, netting and processing as described in this paragraph is the SBO Contra-Side Member or the Original Contra-Side Member for SBO-Destined Trades and Trade-for-Trade Transactions, respectively. See MBSB Rule 6, *supra* note 1.

<sup>66</sup> Pursuant to the MBSB Rules, the term "SIFMA Guidelines" means the guidelines for good delivery of Mortgage-Backed Securities as promulgated from time to time by SIFMA. See MBSB Rule 1, *supra* note 1.

<sup>67</sup> All times referenced herein are Eastern Time.

The proposed Expanded Pool Netting process would generate Cash Settlement credits and debits. The proposed Cash Settlement obligations are described below in section F.

**E. Proposed change to eliminate the “give-up” process for Brokered Transactions**

Currently, FICC operates its brokered business on a “give-up” basis. This means that MBSD discloses (or “gives-up”) the identity of each Dealer<sup>68</sup> (to a Brokered Transaction) after a period of time.<sup>69</sup> Under the proposed rule change, FICC would eliminate the need to disclose Dealers’ identities because FICC would novate all Brokered Transactions and treat itself as the settlement counterparty once such transactions have been Fully Compared.<sup>70</sup> Thus, the Report that FICC issues once a Brokered Transaction has been Fully Compared would refer to FICC as settlement counterparty.

**F. Proposed change to the Cash Settlement process**

Cash Settlement is a daily process of generating a single net credit or debit cash amount at the Aggregated Account<sup>71</sup> level and settling those cash amounts between Clearing Members and MBSD.<sup>72</sup> FICC’s proposal to become the settlement counterparty upon trade comparison and the proposed Do Not Allocate process would necessitate the following changes to the Cash Settlement calculation.

1. FICC is proposing to eliminate the *SBO Market Differential*<sup>73</sup> because this amount calculates the price difference for SBO

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<sup>68</sup> Pursuant to the MBSD Rules, the term “Dealer” means a Member that is in the business of buying and selling Securities as principal, either directly or through a Broker. See MBSD Rule 1, supra note 1.

<sup>69</sup> See MBSD Rule 5 Section 7, supra note 1.

<sup>70</sup> Pursuant to the MBSD Rules, the term “Fully Compared” means that trade input submitted by a Broker matches trade input submitted by each Dealer on whose behalf the Broker is acting in accordance with the Net Position Match Mode. See MBSD Rule 1, supra note 1.

<sup>71</sup> Pursuant to the MBSD Rules, the term “Aggregated Account” means either a single Account linked to an aggregate ID or a set of Accounts linked to an aggregate ID for the processing of Transactions in the Clearing System. Pursuant to the MBSD Rules, Members’ Cash Settlement obligations and Mark-to-Market requirements are calculated on a net basis at the aggregate ID level. See MBSD Rule 1, supra note 1.

<sup>72</sup> See MBSD Rule 11, supra note 1.

<sup>73</sup> Pursuant to the MBSD Rules, the term “SBO Market Differential” means the amount computed pursuant to the MBSD Rules, reflecting the difference between Firm CUSIP Average Prices (in the case of an SBO Netted or SBO Net-Out Position) or between the

positions settled among Clearing Members. This amount would no longer be required because Clearing Members would settle all SBO-Destined Trades directly with FICC.

2. FICC is proposing to add the following components to the Cash Settlement calculation:

a. The proposed *TBA Transaction Adjustment Payment* would reflect the cash differential that would result when calculating the net proceeds of the contractual quantity of an SBO-Destined Trade when comparing such trade's Settlement Price and the System Price.<sup>74</sup>

The proposed TBA Transaction Adjustment Payment would be an amount equal to the difference between the SBO-Destined Trade's Settlement Price and the System Price, multiplied by the contractual quantity of such trade, and then divided by 100. To differentiate between the buyer and seller of the transaction, an indicator of -1 for the buy trade and +1 for the sell trade is multiplied by the contractual quantity of such trade.

For example, the TBA Transaction Adjustment Payment for an SBO-Destined Trade having a contractual quantity of 5,000,000 would be calculated as follows:

Contractual quantity (sell): 5,000,000  
SBO-Destined Trade - Settlement Price: 100.25  
System Price: 100  
Calculation:  $1 \times 5,000,000 (100.25 - 100)/100$   
TBA Transaction Adjustment Payment: \$12,500 (credit)

b. The proposed *Expanded Pool Net Transaction Adjustment Payment* would be included in the event that a Clearing Member misses the deadline established by FICC for the Pool Netting process. Unlike the Pool Netting process, which runs daily, the Expanded Pool Netting process would only run four times per month in accordance with the SIFMA designated settlement date. As a result, an Expanded Pool Net Transaction Adjustment Payment would only occur four times per month. The calculation for the Expanded Pool Net Transaction Adjustment Payment is the same as the Pool Net Transaction Adjustment Payment.

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CUSIP Average Price and the Firm CUSIP Average Price (in the case of an SBON Trade). See MBSD Rule 1, supra note 1.

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Pursuant to the MBSD Rules, the term "System Price" means the price for any trade or any Pool Deliver Obligations or Pool Receive Obligation not including accrued interest, established by the Corporation on each Business Day, based on current market information, for each Eligible Security. See MBSD Rule 1, supra note 1.

The Expanded Pool Net Transaction Adjustment Payment would reflect an amount equal to the difference between the System Price and the SBON Trade's Settlement Price or Trade-for-Trade Transaction's Settlement Price, as applicable, multiplied by the total current face value of the pools used to satisfy such obligation, then divided by 100. To differentiate between a buy and sell transaction, an indicator of +1 for a buy trade and -1 for a sell trade would be multiplied by the total current face value of the pools used to satisfy the obligation.

c. The proposed *Do Not Allocate Transaction Adjustment Payment* would reflect the cash differential among TBA Obligations that have been offset through the Do Not Allocate process.

The proposed Do Not Allocate Transaction Adjustment Payment would be an amount equal to the difference between the Settlement Price of the buy and sell TBA Obligation transactions multiplied by the contractual quantity. To differentiate between a buy and sell transaction, an indicator of -1 for a buy trade and +1 for a sell trade is multiplied by the contractual quantity of such trade.

For example, the Do Not Allocate Transaction Adjustment Payment for a 2,000,000 DNA Request would be calculated as follows:

Contractual quantity: 2,000,000  
Trade price of buy transaction: 99  
Trade price of sell transaction: 100  
Buy calculation:  $-1 \times 2,000,000 \times 99 = -\$1,980,000$   
Sell calculation:  $1 \times 2,000,000 \times 100 = \$2,000,000$   
Do Not Allocate Transaction Adjustment Payment: \$20,000 (credit)

d. The proposed *TBA Reprice Transaction Adjustment Payment* would reflect the cash differential between the price of a TBA Obligation that was not allocated by a Clearing Member by the deadline established by FICC and the price of the replacement TBA Obligation that was calculated at the System Price.

The TBA Reprice Transaction Adjustment Payment would be an amount equal to the difference between the TBA Obligation's Settlement Price and the System Price, multiplied by the unallocated contractual quantity, then divided by 100. To differentiate between a buy and sell transaction, an indicator of -1 for a sell trade and +1 for a buy trade is multiplied by the unallocated pool's contractual quantity.

For example, the TBA Reprice Transaction Adjustment Payment for a TBA Obligation with a contractual quantity of 5,000,000 that was not allocated by a Clearing Member by the deadline established by FICC would be calculated as follows:

Contractual quantity (buy): 5,000,000

SBON Trade - Settlement Price: 100

System Price: 101

Calculation:  $1 \times 5,000,000 (101 - 100)/100$

TBA Reprice Transaction Adjustment Payment: \$50,000 (credit)

e. The proposed *Variance Transaction Adjustment Payment* would capture the variance (i.e., difference)<sup>75</sup> between a TBA Obligation and the current face value of the pools allocated in satisfaction of such obligation. Specifically, this payment would reflect the cash differential calculated between the SBON Trade's Settlement Price or the Trade-for-Trade Transaction's Settlement Price, as applicable, and the System Price using the variance of the Pool Netting process or the Expanded Pool Netting process, as applicable, based on the current face value of the pools used in satisfaction of the trade.

The Variance Transaction Adjustment Payment would be an amount equal to the difference between the SBON Trade's Settlement Price or the Trade-for-Trade Transaction's Settlement Price, as applicable, and the System Price, multiplied by the difference between the TBA Obligation and the allocated pools used in satisfaction of such trade and then divided by 100. To differentiate between a buy and sell transaction, an indicator of -1 for a buy trade and +1 for a sell trade would be multiplied by the total variance amount.

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Pursuant to the SIFMA Guidelines, TBA trades are allowed to have a variance equal to plus or minus 0.01% of the dollar amount of the transaction agreed to by the parties. As a result of this guideline, FICC would capture the variance of TBA Obligations and the current face value of the pools allocated in satisfaction of such obligations.

For example, the Variance Transaction Adjustment Payment for a sell transaction that has one million under allocated and one million over allocated<sup>76</sup> would be calculated as follows:

Sell trade price: 100.125  
 Good delivery million #1 allocation: 999,895.77  
 Good delivery million #2 allocation: 1,000,007.13  
 System Price: 99  
 Calculation:  $1 \times (104.23 - 7.13) \times (99 - 100.125)/100$   
 $= 1 \times (97.10) \times (-1.125)/100$   
 Variance Transaction Adjustment Payment: \$1.09 (debit)

f. The proposed *Factor Update Adjustment Payment* would be calculated in the event that updated pool factor information is released after the clearing bank’s settlement of a pool. This update would create a cash differential that would require a debit to the seller and a credit to the buyer.

Example:

Seller A sells Pool 1 FNMA 30yr 3% coupon to Buyer B with a contractual settlement date of April 3, 2017, at a price of 100. Because the April 2017 factor is unavailable on the contractual settlement date, the pool would settle at the clearing bank with a settlement amount based on the factor that was released in March 2017.

Principle - current face value x price  
 Interest - current face value x coupon/360 x settlement date -1

<u>Original Face</u>	<u>Current Face Value</u>	<u>Principal</u>	<u>Interest</u>	<u>Net Money</u>	<u>Factor</u>
1,000,000	1,000,000.00	1,000,000.00	166.67	1,000,166.67	1.00 (March)
1,000,000	990,000.00	990,000.00	165.00	990,165.00	0.99 (April)
				10,001.65	

Factor Update Adjustment amount: \$10,001.65 (i.e., the difference between the March 2017 and April 2017 settlement amounts)

Since Seller A was overpaid for the original settlement, they will be debited to reflect the lower factor and Buyer B will be credited.

<sup>76</sup>

Id.

## **G. Delayed implementation of the proposed rule change**

The proposed changes would become effective within 45 Business Days after the date of the Securities and Exchange Commission's (the "Commission") approval of this proposed rule change. Prior to the effective date, FICC would add a legend to the MBSD Rules to state that the specified changes to the MBSD Rules are approved but not yet operative and to provide the date such approved changes would become operative. The legend would also include the file number of the approved proposed rule change and would state that once operative, the legend would automatically be removed from the MBSD Rules.

## **H. Detailed description of the proposed changes to the MBSD Rules**

### **1. *Proposed Changes to MBSD Rule 1 (Definitions)***

FICC is proposing to delete the terms "Broker Give-Up Date" and "Broker Give-Up Trade" because FICC would no longer disclose a Dealer's identity on the Report that FICC issues in connection with Brokered Transactions.

FICC is proposing to amend the term "Brokered Transaction" to delete the reference to "give-up" because FICC would no longer disclose a Dealer's identity on the Report that FICC issues in connection with Brokered Transactions.

FICC is proposing to amend the term "Contractual Settlement Date" to add a reference to "Stipulated Trade," which would be a new eligible trade type. FICC is also proposing to replace the term "SBO Trade" with "SBON Trade." The distinction between these two trade types would no longer be required because all obligations that result from the TBA Netting process would settle with FICC.

FICC is proposing to delete the term "CUSIP Average Price" and "CAP" because this calculation would be replaced by the System Price for SBON Trades.

FICC is proposing to add the new defined term "Do Not Allocate" to define the process that would allow Clearing Members to offset Trade-for-Trade Transactions and/or SBON Trades with the same Par Amount, CUSIP Number and established date in the settlement cycle.

FICC is proposing to add the new defined term "Do Not Allocate Adjustment Payment" to define the cash differential that would result when Trade-for-Trade Transactions and/or SBON Trades are offset through the Do Not Allocate process.

FICC is proposing to amend the term "EPN Service" to clarify that this service would be used by Clearing Members to electronically communicate pool information to FICC in accordance with the MBSD Rules.

FICC is proposing to add the new defined term "Expanded Pool Net Transaction Adjustment Payment" to define the cash differential that would result from SBON Trades and Trade-for-Trade Transactions, as applicable, that would be included in the Expanded Pool Netting process.

FICC is proposing to add the new defined term “Expanded Pool Netting” to define the netting process that would occur for SBON Trades and Trade-for-Trade Transactions that have missed the cut-off time for the Pool Netting process.

FICC is proposing to add the new defined term “Factor Update Adjustment Payment” to define the cash differential that would result when an updated factor is released after Pool Deliver Obligations and Pool Receive Obligations have settled.

FICC is proposing to delete the term “Firm CUSIP Average Price” and “FCAP” because this calculation would be replaced by the System Price for SBON Trades.

FICC is proposing to add the new defined term “Guaranteed/Novated Obligations” to define FICC’s obligation to deliver or receive a Security satisfying TBA criteria and the payment related thereto.

FICC is proposing to delete the term “Notification of Settlement” because all SBO-Destined Trades, Trade-for-Trade Transactions and Specified Pool Trades would settle with FICC, thus the Notification of Settlement process would no longer be required.

FICC is proposing to amend the term “Novation” to mean the termination of deliver, receive and related payment obligations between Clearing Members and the replacement of such with obligations to deliver or receive a Security satisfying certain TBA criteria as determined by FICC and the payment obligations related thereto.

FICC is proposing to amend the term “Par Amount” to include a reference to “Stipulated Trades,” which would be a new trade type, and replace the term “SBO Transaction” with the term “SBON Trade.”

FICC is proposing to add the new defined term “Pool Settlement Position” to define either a Pool Receive Obligation or a Pool Deliver Obligation.

FICC is proposing to add the new defined term “SBO” to define the settlement balance orders that constitute the net positions of a Clearing Member as a result of the TBA Netting process. The resulting transactions from this TBA Netting process are identified as SBON Trades.

FICC is proposing to delete the term “SBO Contra-Side Member” because FICC would no longer direct Clearing Members to settle trades with other Clearing Members.

FICC is proposing to delete the term “SBO Market Differential” because this term defines the price for SBO-Destined Trades that are settled between other Clearing Members. As described above, FICC would no longer direct a Clearing Member to settle its SBO obligation with another Clearing Member. As a result, the calculation for determining the price would no longer be required.

FICC is proposing to delete the term “SBO Net-Out Position” because FICC would no longer offset a Clearing Member’s purchase and sale transactions with another Clearing Member.



FICC is proposing to delete the term “SBO Netted Position” because FICC would no longer offset a Clearing Member’s purchase and sale transactions with another Clearing Member.

FICC is proposing to amend the term “SBO Trade” to refer to SBON Trade. This would be defined as a trade that is settled directly with FICC.

FICC is proposing to delete the existing definition of “SBON Trade” because FICC would no longer direct a Clearing Member to settle with another Clearing Member. FICC has redefined this definition as referenced above.

FICC is proposing to delete the term “SBOO Trade” because this term refers to a trade that FICC directs a Clearing Member to settle with another Clearing Member.

FICC is proposing to amend the term “Settlement Price” to (1) include a reference to “Stipulated Trade,” which would be a new trade type, (2) define the System Price as the Settlement Price for SBON Trades and (3) remove the reference to SBOO Trades and the related calculation for such trades.

FICC is proposing to amend the term “Settlement Value” to include a reference to “Stipulated Trade,” which would be a new trade type. FICC is also proposing to amend this definition to eliminate the reference to SBOO Trade, which is a term that FICC is also proposing to delete from the MBSD Rules.

FICC is proposing to add the new defined term “Stipulated Trade” because it would be a new trade type that Clearing Members would be permitted to submit to MBSD.

FICC is proposing to add the new defined term “TBA” or “To-Be-Announced” to define a contract for the purchase or sale of a mortgage-backed security to be delivered at an agreed-upon future date because as of the transaction date, the seller has not yet identified certain terms of the contract, such as the pool number and number of pools, to the buyer.

FICC is proposing to add the new defined term “TBA Reprice Transaction Adjustment Payment.” This term would provide FICC’s cash settlement calculation for the repricing of TBA Obligations that have not been allocated by the time established by FICC.

FICC is proposing to add the new defined term “TBA Transaction Adjustment Payment.” This term would provide FICC’s cash settlement calculation for SBO-Destined Trades.

FICC is proposing to amend the term “Trade-for-Trade Transaction” to state that this transaction type would be eligible for the Pool Netting system and the Expanded Pool Netting system.

FICC is proposing to add the new defined term “Variance Transaction Adjustment Payment.” This term would provide FICC’s cash settlement calculation for SIFMA’s permitted variances with respect to TBA Obligations.

**2. *Proposed Changes to MBSD Rule 2 (Members)***

FICC is proposing to amend MBSD Rule 2 to delete the reference to “Broker Give-Up Trades” and replace it with “Brokered Transactions” because a Dealer’s identity would no longer be disclosed in the Reports that FICC makes available in connection with Brokered Transactions.

**3. *Proposed Changes to MBSD Rule 4 (Clearing Fund and Loss Allocation) Section 1 (General )***

FICC is proposing to amend this section to reflect that the term “Transactions” as used in MBSD Rule 4 would apply to Stipulated Trades.

**4. *Proposed Changes to MBSD Rule 5 (Trade Comparison)***

*Proposed Changes to MBSD Rule 5, Section 1 (General)*

FICC is proposing to amend this section to specify the obligations that would be guaranteed and novated at Trade Comparison.

*Proposed Changes to MBSD Rule 5, Section 2 (General Responsibilities of Members in the Trade Comparison System)*

FICC is proposing to delete a paragraph that requires Clearing Members to settle certain Transactions directly with their applicable settlement counterparties.

*Proposed Changes to MBSD Rule 5, Section 7 (Broker Give-Up Trades)*

FICC is proposing to delete this section in its entirety because the identities of Dealers to a Brokered Transaction would no longer be disclosed in the Reports issued by FICC.

*Proposed Changes to MBSD Rule 5, Section 8 (Binding Nature of Comparisons)*

FICC is proposing to include a reference to the “Open Commitment Report,” which is currently a report provided to Clearing Members.

*Proposed Changes to MBSD Rule 5, Section 9 (Cancellation and Modification of Trade Data by Members)*

FICC is proposing to amend this section to state that trade data would be submitted to FICC.

*Proposed Changes to MBSD Rule 5, Section 12 (Obligations)*

FICC is proposing to amend this section to state that settlement obligations between each buyer and seller, respectively, would be established with FICC in connection with SBO-Destined Trades, Trade-for-Trade Transactions, Specified Pool Trades and Stipulated Trades.

*Proposed Changes to MBSD Rule 5, Section 13 (Novation)*

FICC is proposing to amend this section to state the following: (1) FICC will guarantee and novate Specified Pool Trades, Stipulated Trades and Trade-for-Trade Transactions that meet the requirements of the MBSD Rules and have been entered into in good faith; (2) FICC will not novate Specified Pool Trades, Stipulated Trades or Trade-for-Trade Transactions that are partially compared; (3) To the extent a partially compared Specified Pool Trade, Stipulated Trade or Trade-for-Trade Transaction becomes Fully Compared, FICC will novate such trade; (4) At the time that a Specified Pool Trade, Stipulated Trade or Trade-for-Trade Transaction is novated to FICC, such trade shall cease to be bound by any bilateral agreement between the parties to the trade with respect to the deliver, receive and related payment obligations; however, if the trade becomes uncomparing or is cancelled, such trade shall be governed by the bilateral agreement that governs such trade prior to the novation.

**5. *Proposed Changes to MBSD Rule 6 (TBA Netting)  
Section 1 (Netting)***

FICC is proposing to amend this section to delete the provisions that state that FICC would direct Clearing Members to settle SBO Trades with their original counterparties or other Clearing Members. FICC is also deleting its calculation of the Settlement Price of such trades. FICC is proposing amend this section to state that (1) TBA Netting would result in SBON Trades, (2) FICC would assign one or more SBON Trades to offset SBO Net Open Positions<sup>77</sup> and (3) the Settlement Price for SBON Trades would be the System Price.

**6. *Proposed Changes to MBSD Rule 7 (Pool Comparison)***

*Proposed Changes to MBSD Rule 7, Section 1 (Pool Comparison)*

FICC is proposing to amend this section to state that Clearing Members with Stipulated Trades would be required to allocate and submit Pool Instructs for Pool Comparison. FICC is also proposing to amend this section to state that Clearing Members would be required to notify FICC of their pool allocations to satisfy open TBA Obligations and Stipulated Trade obligations, and that FICC would submit pool details on behalf of Clearing Members that do not submit such pool details by the time established by FICC. Because FICC would submit such details on behalf of Clearing Members, FICC is proposing to eliminate the provision that provides that pool details not submitted by Clearing Members would be identified as uncomparing. FICC is also proposing to clarify that the data submitted by each contra-party would be submitted to the Corporation.

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<sup>77</sup> Pursuant to the MBSD Rules, the term “SBO Net Open Position” means any SBO-Destined Trade that cannot be offset pursuant to the MBSD Rules. See MBSD Rule 1, supra note 1.

*Proposed Changes to MBSD Rule 7, Section 2 (Cancellation and Modification of Data by Clearing Members)*

In connection with a Clearing Member's request to cancel data, FICC is proposing to amend this section to state that data that has been submitted by a Clearing Member and affirmed by FICC would be deemed compared.

*Proposed Changes to MBSD Rule 7, Section 3 (Do Not Allocate Process for TBA Obligations)*

FICC is proposing to include this new section to describe the Do Not Allocate process. This process would allow Clearing Members that have two or more Trade-for-Trade Transactions and/or SBON Trades with the same Par Amount, CUSIP Number and established date in the settlement cycle to offset such obligations against one another. This section would provide the process for initiating a Do Not Allocate request and the process for cancelling such request.

*Proposed Changes to MBSD Rule 7, Section 4 (Pool Settlement Positions for Stipulated Trades)*

FICC is proposing to include this new section to describe Pool Settlement Positions, allocation of Pool Deliver Obligations and Pool Receive Obligations, and the process for substitutions regarding Stipulated Trades

*Proposed Changes to MBSD Rule 7, Section 5 (Pool Deliver Obligations and Pool Receive Obligations for Specified Pool Trades)*

FICC is proposing to include this new section to describe the Pool Deliver Obligations and Pool Receive Obligations for Specified Pool Trades.

**7. *Proposed Changes to MBSD Rule 8 (Pool Netting System)***

*Proposed Changes to MBSD Rule 8, Section 2 (Eligibility for Pool Netting)*

FICC is proposing to refer to this section as "Section 2A" rather than "Section 2." In addition, FICC is proposing to delete the provision that requires pools that are ineligible for the Pool Netting process to be settled bilaterally with their settlement counterparties.

*Proposed Changes to MBSD Rule 8, Section 2B (Eligibility for Expanded Pool Netting)*

FICC is proposing to amend Rule 8 to include new "Section 2B." This section would establish a secondary pool netting process formally referred to as the Expanded Pool Netting process.

*Proposed Changes to MBSD Rule 8, Section 3 (Calculation of Pool Net Settlement Positions)*

FICC is proposing to amend this section to apply the calculation of Pool Net Settlement Positions to Eligible Securities processed by the Expanded Pool Netting process.

*Proposed Changes to MBSD Rule 8, Section 4 (Allocation of Pool Deliver and Pool Receive Obligations)*

FICC is proposing to amend this section to establish that Pool Deliver Obligations and Pool Receive Obligations would apply to Eligible Securities processed by the Expanded Pool Netting process.

*Proposed Changes to MBSD Rule 8, Section 6 (Novation of Obligations)*

FICC is proposing to amend this paragraph to state that novation would occur with respect to the Pool Deliver Obligations and Pool Receive Obligations.

*Proposed Changes to MBSD Rule 8, Section 7 (Obligation to Submit SBOO and SBON Trades to Pool Netting)*

FICC is proposing to delete the reference to “SBOO.” This term refers to SBO-Destined Trades that are settled between Clearing Members that are not original counterparties to such trades. This term would no longer be required because FICC is proposing to treat itself as the settlement counterparty to all SBO-Destined Trades. FICC is also proposing to amend this section to reflect that Trade-for-Trade Transactions would have to be submitted into the Pool Netting system.

**8. *Proposed Changes to MBSD Rule 10 (Notification of Settlement)***

FICC is proposing to delete this rule because all SBO-Destined Trades, Trade-for-Trade Transactions and Specified Pool Trades would settle with FICC. As a result, the Notification of Settlement process would no longer be required.

**9. *Proposed Changes to MBSD Rule 11 (Cash Settlement)***

FICC is proposing to delete the “SBO Market Differential” component and replace it with the term “TBA Transaction Adjustment Payment.” The term “SBO-Market Differential” calculates the price for SBO Trades originally among different counterparties as well as SBO Trades originally among the same counterparties. This calculation would be no longer required because all SBO Trades (referred to in proposed rules as “SBON Trades”) would settle with FICC as the settlement counterparty. As a result, FICC is proposing to replace the “SBO Market Differential” component and replace it with the term “Transaction Adjustment Payment.” This component would calculate an SBO-Destined Trade in an amount equal to the difference between such trade’s Settlement Price and System Price.

FICC is also proposing to add the following new components to the Cash Settlement calculation: (a) TBA Transaction Adjustment Payment, (b) Expanded Pool Net Transaction Adjustment Payment, (c) Do Not Allocate Transaction Adjustment Payment, (d) TBA Reprice

Transaction Adjustment Payment, (e) Variance Transaction Adjustment Payment, and (f) Factor Update Adjustment Payment.

**10. *Proposed Changes to MBSD Rule 12 (Fails Charge)***

FICC is proposing to amend this section to state that Clearing Members would be responsible for a fails charge if FICC receives an allocation of TBA Obligations prior to the established deadline and is unable to transmit the notification until after such time.

**11. *Proposed Changes to MBSD Rule 17 (Procedures for When the Corporation Ceases to Act) Section 2 (Action by the Corporation – Close-Out Procedure)***

FICC is proposing to delete a provision that relates to the Notification of Settlement process. FICC is also proposing to amend certain provisions that are no longer necessary because FICC has specified the obligations that it novates in the proposed definition for the term “Guaranteed/Novated Obligations.”

**12. *Proposed Changes to MBSD Rule 17A (Corporation Default)***

FICC is proposing to delete the provision that establishes Novation for all Compared Trades. This provision is no longer necessary because SBO-Destined Trades, Specified Pool Trades, Stipulated Trades and Trade-for-Trade Transactions would occur at trade comparison.

(b) Statutory Basis

Section 17A(b)(3)(F) of the Securities Exchange Act of 1934, as amended (“Exchange Act”) requires, in part, that the rules of the clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions.<sup>78</sup>

FICC believes that the proposed change to novate Specified Pool Trades, Stipulated Trades, and Trade-for-Trade Transactions at trade comparison would promote the prompt and accurate clearance and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act, because this change would provide Clearing Members with legal certainty early in the trading cycle that FICC would become the legal counterparty to each Clearing Member (i.e., FICC would become the buyer to every seller and the seller to every buyer) as set forth in the proposed rule change. The legal certainty would enable Clearing Members that submit such transactions to FICC to know early in the trade processing cycle that they have only one party (that is, FICC) with which to interact following trade comparison. FICC believes that this would, in turn, simplify processing for Clearing Members and thereby promote the prompt

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

and accurate clearance and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act.<sup>79</sup>

FICC also believes that the proposed change to establish itself as the settlement counterparty to SBO-Destined Trades, Specified Pool Trades, Stipulated Trades, and Trade-for-Trade Transactions at trade comparison would promote the prompt and accurate clearance and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act because all such trades would settle directly with FICC. As such, the settlement of all such trades would be governed by the MBSD Rules (as opposed to potentially being subject to settlement mechanisms outside of FICC). FICC believes that this would streamline settlement processing because the MBSD Rules would govern all such processing and thereby promote the prompt and accurate clearance and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act.<sup>80</sup>

FICC believes that the proposed rule changes associated with providing the operational efficiencies to Clearing Members noted in this filing would also promote the prompt and accurate clearance and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act. These proposed rule changes are as follows: (a) the submission of Pool Instructs by Clearing Members would become optional because FICC would be permitted to submit on behalf Clearing Members, (b) Clearing Members would no longer to be required to fulfill Notification of Settlement obligations because all of the above-referenced transactions would settle with FICC, (c) Clearing Members would have the ability to exclude TBA Obligations from the pool allocation process, netting and securities settlement through the DNA process, (d) Clearing Members would have the ability to have their pools netted by the Expanded Pool Netting process in the event that such Clearing Members miss the established deadline for the initial Pool Netting process, (e) Dealer Netting Members would remain anonymous with the elimination of the “give-up” process for Brokered Transactions, (f) Clearing Members would be allowed to submit SBO-Destined Trades in all trade sizes, and (g) Clearing Members would be allowed to submit Stipulated Trades as a new trade type. All of these proposed changes would either eliminate operational steps on the part of Clearing Members (such as, for example, the elimination of the Notification of Settlement process where Clearing Members currently have required processing obligations) or would enable Clearing Members to take advantage of MBSD’s processing efficiencies (such as enabling Clearing Members to submit SBO-Destined Trades in all trade sizes). FICC believes that the elimination of operational steps on the part of Clearing Members and the provision of further opportunities for Clearing Members to take advantage of MBSD’s processing would streamline MBSD processing as a whole for Clearing Members and further extend the benefits of MBSD’s clearance and settlement services to Clearing Members, and would thereby promote the prompt and accurate clearance and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act.<sup>81</sup>

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<sup>79</sup> Id.

<sup>80</sup> Id.

<sup>81</sup> Id.

FICC believes that the proposed changes to the cash settlement components, which are necessitated from many of the proposed operational efficiencies discussed in this filing, would also promote the prompt and accurate clearance and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act. These changes would allow FICC to continue to remain in a cash neutral position – neither owing Clearing Members funds nor having a surplus of funds on FICC’s books and records. By allowing FICC to remain flat with respect to cash settlement items, the proposed rule changes would maintain the efficiency of MBSD’s cash settlement process, which is an automated system for the settlement of funds. As such, FICC believes that adding the proposed changes to its automated system for funds settlement would promote the prompt and accurate clearance and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act.<sup>82</sup>

For these reasons, FICC believes that the proposed changes are consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to FICC, in particular Section 17A(b)(3)(F).<sup>83</sup>

#### **4. Self-Regulatory Organization’s Statement on Burden on Competition**

FICC does not believe that the proposed rule changes as described in this filing would impose any burden on competition that is not necessary or appropriate in furtherance of the Exchange Act.<sup>84</sup>

While the proposed rule changes would require Clearing Members to make technological changes and thereby incur costs in doing so and this could burden the Members competitively, the proposed rules changes have been structured to better meet the needs of Clearing Members. Specifically, the proposed rule changes would meet Clearing Members’ needs by:

- novating Specified Pool Trades, Stipulated Trades, and Trade-for-Trade Transactions at trade comparison and thereby providing Clearing Members with legal certainty early in the trading cycle that FICC would become the legal counterparty to each Clearing Member (i.e., FICC would become the buyer to every seller and the seller to every buyer) for such trades,
- eliminating operational steps on the part of Clearing Members (such as making the submission of Pool Instructs by Clearing Members optional, eliminating the “give-up” process for Brokered Transactions, and eliminating the Notification of Settlement process and Clearing Member obligations related thereto) and thereby streamlining MBSD processing as a whole for Clearing Members,

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<sup>82</sup> Id.

<sup>83</sup> Id.

<sup>84</sup> 15 U.S.C. 78q-1(b)(3)(I).



- enabling Clearing Members to take advantage of MBSB's processing efficiencies (such as, providing Clearing Members with the ability to exclude TBA Obligations from the pool allocation process, netting and securities settlement through the DNA process, allowing Clearing Members to submit SBO-Destined Trades in all trade sizes, and allowing Clearing Members to submit Stipulated Trades as a new trade type) and thereby further extending the benefits of MBSB's clearance and settlement services to Clearing Members,
- structuring the proposed changes to the cash settlement process, which are necessitated from many of the proposed operational efficiencies discussed in this filing, in a manner that would maintain the efficiency of the automated nature of the MBSB cash settlement process by calculating debits and credits to Clearing Members as applicable (and as has been described in detail in this filing) and allowing FICC to remain flat with respect to applicable cash settlement items.

Moreover, FICC believes that the proposed rule changes are appropriate in that such changes reflect Clearing Members' feedback. Consequently, FICC believes that any burden on competition derived from the proposed rule changes would be necessary and appropriate in support of the beneficial objectives of the proposed rule changes, which would be made in furtherance of the Exchange Act, as described above.

Additionally, FICC believes that any such burden on competition derived from the proposed rule changes would not be significant because Clearing Members have requested these changes and were involved in developing the business requirements.

The proposed rule changes would result in the removal of the option for Clearing Members to settle trades bilaterally amongst themselves because, as has been described in detail in this filing, FICC would treat itself as the settlement counterparty to all eligible transactions (except Option Contracts). FICC does not believe that this would impose a burden on competition. Specifically, FICC believes that trades, whether they settle with FICC or another counterparty, must settle; FICC does not believe that settling with FICC imposes greater costs on Clearing Members than settling outside of FICC. Therefore, FICC does not believe that the proposal imposes a burden on competition that is not appropriate in furtherance of the Exchange Act because all Clearing Members need to settle their trades, and FICC believes that there is an absence of any significant costs associated with its proposal that Clearing Members settle all Transactions (other than Option Contracts) with FICC.

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

FICC has not received or solicited any written comments relating to this proposal. FICC will notify the Commission of any written comments received by FICC.

#### **6. Extension of Time Period for Commission Action**

FICC does not consent to an extension of the time period specified in Section 19(b)(2) of the Exchange Act for Commission action.

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

(a) Not applicable.

(b) Not applicable.

(c) Not applicable.

(d) Pursuant to Section 19(b)(2)(C)(iii) of the Exchange Act,<sup>85</sup> FICC requests that the Commission approve this proposed rule change on an accelerated basis. FICC believes, for the reasons described below, that there is good cause to approve the proposed rule change before the 30th day following publication in the Federal Register.

First, this proposed rule change already has received ample public notice through multiple methods, and the proposed rule change will receive substantial notice through prompt publication in the Federal Register. As Congress has noted in discussing the rulemaking process under the Administrative Procedures Act, many rules may be made operative in less than 30 days because “the parties subject to [the rule] may during the usually protracted hearing and decision procedures anticipate the regulations.”<sup>86</sup> This has been the case with this proposal, where the proposal has received substantial participant input and Clearing Members have been provided frequent opportunities to provide feedback and guidance.

FICC first engaged Clearing Members in 2011 through FICC’s coordination of various working groups. Through these working groups, Clearing Members provided feedback and guidance on the design and the processes that would support the proposal. Since that time, FICC also hosted several forums, which have been designed to keep Clearing Members informed of FICC’s progress and engage Clearing Members as certain processes were being developed.<sup>87</sup>

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<sup>85</sup> 15 U.S.C. 78s(b)(2)(C)(iii).

<sup>86</sup> H. Rep. No. 1980, 79<sup>th</sup> Cong., 2d Sess. (1945) (explaining the rationale for the 30-day provision in the Administrative Procedures Act comparable to Section 19(b)(2)(C)(iii) of the Exchange Act). In discussing the rulemaking protections of Section 19 of the Exchange Act, the Senate Report states that “[i]t is the Committee’s intention in adopting this standard to hold the self-regulatory organizations to the same standards of policy justification that the Administrative Procedure Act imposes on the SEC.” S. Rep. 94-75 at 29.

<sup>87</sup> In 2015, 92 Clearing Member representatives (“Representatives”) participated in forums held in June and 157 Representatives participated in forums held in September and October.

In 2016, 139 Representatives participated in forums held in March, 241 Representatives participated in the forums held in August and 121 Representatives participated in the forums held in December.

Prior to and during each forum, Clearing Members were given the opportunity to provide additional feedback on the proposal. FICC also held a number of conference calls with individual Clearing Members in an effort to address various questions and concerns. As a result of these interactions, FICC is unaware of any adverse commentary, and understands that the industry is anxious to implement this proposal promptly.

In addition to FICC's informal dialogue with its membership, FICC filed a proposed rule change with the Commission to add a fee (the "development fee") to the MBSD Rules to cover the development cost of this proposal.<sup>88</sup> In that fee filing, FICC described the substantial aspects of the current proposal and instituted fees to cover the cost of the design, build, testing and production of the current proposal. The Commission published those fees on January 16, 2015. The Commission received no comments on the development fee proposal, and MBSD's Clearing Members have already paid roughly \$9.6 million dollars to support the development of this proposal. With such detailed knowledge of the proposal, the Clearing Members will not need the full 30 days to have adequate time to comply with the proposed rule change.

Second, the proposed changes would enhance operational integrity of the mortgage-backed securities market, thereby serving the "convenience and necessity of the people affected."<sup>89</sup> As described in detail in this filing, FICC believes that the expeditious implementation of the proposed rule change would provide its membership and the market as a whole with the benefit of having more transactions settled with FICC as central counterparty and additional operational efficiencies for FICC's securities transaction processing.

Third, approving this proposed rule change would allow for the prompt implementation of the proposed rule changes without risking the disruption of the implementation of the industry's shift to the shortened settlement cycle ("T+2"). In this regard, the Commission previously has recognized risk mitigation as an important basis for a good cause finding under Section 19(b)(2)(C)(iii) of the Exchange Act.<sup>90</sup> Delaying implementation of the proposed rule change beyond July 3, 2017 will interfere with Clearing Members' efforts to prepare for the industry's shift to T+2 in August 2017 through September 2017 due to the likely operational and

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In 2017, 200 Representatives participated in the forums held in March.

<sup>88</sup> See Exchange Act Release No. 74033 (January 12, 2015), 80 FR 2452 (January 16, 2015) (SR-FICC-2014-12).

<sup>89</sup> 92 Cong. Rec. 5650-51 (1946) (remarks of Cong. Walter) (explaining the rationale for the 30-day provision in the Administrative Procedures Act comparable to Section 19(b)(2)(C)(iii) of the Exchange Act).

<sup>90</sup> See, e.g., Exchange Act Release No. 74133 (January 26, 2015), 80 FR 5169 (January 30, 2015); Exchange Act Release No. 72762 (August 5, 2014), 79 FR 46896 (August 11, 2014); and Exchange Act Release No. 71499 (February 6, 2014), 79 FR 8527 (February 12, 2014).

resource constraints caused by simultaneously implementing both the T+2 and this current proposal. Such a disruption would increase risk in the clearance and settlement process.

In sum, widespread public notice over several years, substantial operational efficiencies, including enhanced legal certainty, and the mitigation of potential risk to the T+2 transition all support finding “good cause” to approve this proposed rule change on an accelerated basis in order to ensure prompt and accurate clearance and settlement.

**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 Exchange Act**

Not applicable.

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

Not applicable.

**11. Exhibits**

Exhibit 1 – Not applicable.

Exhibit 1A – Notice of proposed rule change for publication in the Federal Register.

Exhibit 2 – Not applicable.

Exhibit 3 – Not applicable.

Exhibit 4 – Not applicable.

Exhibit 5 – Proposed changes to the MBSD Rules.

**EXHIBIT 1A**

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-[\_\_\_\_\_]; File No. SR-FICC-2017-012)

[DATE]

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Proposed Rule Change to the Mortgage-Backed Securities Division Clearing Rules Regarding Fixed Income Clearing Corporation’s (1) Time of Novation, (2) Treatment of Itself as the Settlement Counterparty for Certain Transaction Types, and (3) Proposal to Implement New Processes to Promote Operational Efficiencies for Its Clearing Members

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May \_\_, 2017, Fixed Income Clearing Corporation (“FICC” or the “Corporation”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the clearing agency. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change consists of modifications to the Mortgage-Backed Securities Division (“MBSD”) Clearing Rules (“MBSD Rules”) of FICC.<sup>3</sup> In connection with this proposed rule change, FICC is proposing to (1) move the time that FICC treats

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

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

<sup>3</sup> Capitalized terms used and not otherwise defined shall have the meaning assigned to such terms in the MBSD Rules or the FICC MBSD EPN Rules, as applicable, available at <http://www.dtcc.com/en/legal/rules-and-procedures>.

itself as the settlement counterparty for SBO-Destined Trades<sup>4</sup> to the time of trade comparison, which is earlier in the lifecycle of the trade,<sup>5</sup> (2) move the time that FICC novates and treats itself as the settlement counterparty for Trade-for-Trade Transactions<sup>6</sup> to the time of trade comparison, which is earlier in the lifecycle of the trade, (3) novate and establish itself as the settlement counterparty at the time of trade comparison for Specified Pool Trades,<sup>7</sup> and (4) guarantee and novate trades with stipulations (“Stipulated Trades”), a proposed new trade type, at the time of trade comparison and treat FICC as the settlement counterparty at such time.<sup>8</sup>

In connection with these changes, FICC is also proposing new processes that would promote operational efficiencies for MBSD Clearing Members.<sup>9</sup> These processes

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<sup>4</sup> Pursuant to the MBSD Rules, the term “SBO-Destined Trade” means a TBA transaction in the Clearing System intended for TBA Netting in accordance with the provisions of the MBSD Rules. See MBSD Rule 1, supra note 3.

<sup>5</sup> FICC currently novates SBO-Destined Trades at trade comparison. No changes are being proposed to the time that novation occurs.

<sup>6</sup> Pursuant to the MBSD Rules, the term “Trade-for-Trade Transaction” means a TBA Transaction submitted to the Corporation not intended for TBA Netting in accordance with the provisions of the MBSD Rules. See MBSD Rule 1, supra note 3.

<sup>7</sup> Pursuant to the MBSD Rules, the term “Specified Pool Trade” means a trade in which all required pool data, including the pool number to be delivered on the Contractual Settlement Date, are agreed upon by Members at the time of execution. See MBSD Rule 1, supra note 3.

<sup>8</sup> For the avoidance of doubt, no changes are being proposed to FICC’s trade guarantee (other than with respect to adding Stipulated Trades, the proposed new trade type, to the trade types guaranteed by FICC). FICC will continue to guarantee SBO-Destined Trades, Specified Pool Trades and Trade-for-Trade Transactions at trade comparison.

<sup>9</sup> Pursuant to the MBSD Rules, the term “Clearing Member” means any entity admitted into membership pursuant to Rule 2A. See MBSD Rule 1, supra note 3.

include the following: (1) eliminating the Notification of Settlement<sup>10</sup> process, (2) establishing a process (referred to as the “Do Not Allocate” (“DNA”) process) that would permit offset among SBON Trades<sup>11</sup> and Trade-for-Trade Transactions, (3) establishing a secondary process for pool netting (referred to as the “Expanded Pool Netting” process), (4) eliminating the “give-up” process for Brokered Transactions,<sup>12</sup> and (5) amending the components of the Cash Settlement<sup>13</sup> calculation.

In addition, FICC would modify its Real-Time Trade Matching (“RTTM”) system to permit the submission of SBO-Destined Trades in all trade size amounts. This change would occur systemically in the RTTM system. MBSD’s trade size submission requirements are not reflected in the MBSD Rules. As a result, this change would not require changes to the MBSD Rules.

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<sup>10</sup> Pursuant to the MBSD Rules, the term "Notification of Settlement" means an instruction submitted to the Corporation by a purchasing or selling Clearing Member pursuant to the MBSD Rules reflecting settlement of an SBO Trade, Trade-for-Trade Transaction or Specified Pool Trade. See MBSD Rule 1, supra note 3.

<sup>11</sup> Pursuant to this proposed rule change, FICC is proposing to amend the term “SBON Trade” to refer to a trade that Clearing Members settle directly with FICC. This proposed term is further described in section II.(A)1.II.H.1. of this proposed rule change.

<sup>12</sup> Pursuant to the MBSD Rules, the term “Brokered Transaction” means any “give-up” transaction calling for the delivery of an Eligible Security the data on which has been submitted to the Corporation by Members, to which transaction a Broker is a party. See MBSD Rule 1, supra note 3.

<sup>13</sup> Pursuant to the MBSD Rules, the term “Cash Settlement” refers to the payment each Business Day by the Corporation to a Member or by a Member to the Corporation pursuant to Rule 11. See MBSD Rule 1, supra note 3.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the clearing agency 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 clearing agency has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

FICC currently processes SBO-Destined Trades, Specified Pool Trades and Trade-for-Trade Transactions.<sup>14</sup> For each of these trade types, FICC guarantees the settlement of such transactions at the time of trade comparison regardless of whether such transactions are (1) novated and settled versus FICC or (2) settled bilaterally between Clearing Members.<sup>15</sup> In connection with this guarantee, the buying Clearing Member and the selling Clearing Member counterparties are contractually bound, with FICC acting as a third-party guarantor in the event that either Clearing Member fails to meet its settlement obligations.

In addition to its guarantee, FICC also currently novates certain transactions – meaning that, the legal obligations that exist between Clearing Member counterparties are

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<sup>14</sup> FICC also processes Option Contracts, however, these transactions are not the subject of this filing and no changes are being proposed in connection with this trade type.

<sup>15</sup> See MBS Rule 5, supra note 3.



terminated and such obligations are replaced with new obligations to deliver securities to and receive securities from FICC. While FICC guarantees all SBO-Destined Trades, Specified Pool Trades and Trade-for-Trade Transactions at trade comparison,<sup>16</sup> currently, FICC novates and treats itself as the settlement counterparty for SBO-Destined Trades and Trade-for-Trade Transactions at different points during the lifecycle of each trade type.

More specifically, under the current MBSD Rules, FICC novates SBO-Destined Trades at the time of trade comparison, however, FICC does not treat itself as the settlement counterparty for purposes of processing and settlement until after the Pool Netting<sup>17</sup> process is complete and FICC has established Pool Receive Obligations<sup>18</sup> or Pool Deliver Obligations,<sup>19</sup> as applicable, for each Clearing Member that has entered into an SBO-Destined Trade.<sup>20</sup> With respect to Trade-for-Trade Transactions, FICC does not novate such transactions or treat itself as the settlement counterparty for purposes of

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<sup>16</sup> Id.

<sup>17</sup> Pursuant to the MBSD Rules, the term “Pool Netting” means the service provided to Clearing Members, as applicable, and the operations carried out by the Corporation in the course of providing such service in accordance with Rule 8. See MBSD Rule 1, *supra* note 3.

<sup>18</sup> Pursuant to the MBSD Rules, the term “Pool Receive Obligation” means a Clearing Member's obligation to receive Eligible Securities from the Corporation at the appropriate Settlement Value either in satisfaction of all or part of a Pool Net Long Position. See MBSD Rule 1, *supra* note 3.

<sup>19</sup> Pursuant to the MBSD Rules, the term “Pool Deliver Obligation” means a Clearing Member's obligation to deliver Eligible Securities to the Corporation at the appropriate Settlement Value either in satisfaction of all or part of a Pool Net Short Position. See MBSD Rule 1, *supra* note 3.

<sup>20</sup> See MBSD Rule 1, *supra* note 3.

netting, processing, and settlement until the Pool Netting process is complete<sup>21</sup> and each Clearing Member that has entered into a Trade-for-Trade Transaction receives its Pool Receive Obligations or Pool Deliver Obligations, as applicable. For Specified Pool Transactions, FICC does not novate Specified Pool Trades or treat itself as the settlement counterparty during any point of the trade lifecycle.

In connection with this proposed rule change, FICC's overarching goal is to novate and treat itself as the settlement counterparty to all Transactions<sup>22</sup> (other than Option Contracts<sup>23</sup>) at the time of trade comparison. Specifically, FICC is proposing to (1) move the time that FICC treats itself as the settlement counterparty for SBO-Destined Trades to the time of trade comparison, which is earlier in the lifecycle of the trade, (2) move the time that FICC novates and treats itself as the settlement counterparty for Trade-for-Trade Transactions to the time of trade comparison, which is earlier in the lifecycle of the trade, (3) novate and establish itself as the settlement counterparty at the time of trade comparison for Specified Pool Trades, and (4) guarantee and novate Stipulated Trades at the time of trade comparison and treat FICC as the settlement

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<sup>21</sup> Id. FICC does not novate and does not become the settlement counterparty to Trade-for-Trade Transactions that do not enter the Pool Netting system. Instead, these transactions are required to settle among the Clearing Member counterparties outside of FICC.

<sup>22</sup> Pursuant to the MBSD Rules, the term "Transaction" means a trade that is eligible for processing by the Corporation in accordance with the MBSD Rules. See MBSD Rule 1, supra note 3.

<sup>23</sup> Pursuant to the MBSD Rules, the term "Option Contract" means an option to sell or buy a specified amount of Eligible Securities by or on a specified date to or from the other party to the contract against payment of the Strike Price. Upon exercise, a "Call Option Contract" entitles the purchaser to buy, and obligates the seller (writer) to sell, Eligible Securities for the Strike Price, whereas a "Put Option Contract" entitles the purchaser to sell, and obligates the seller (writer) to buy, Eligible Securities for the Strike Price. See MBSD Rule 1, supra note 3.

counterparty at such time. These changes would not create any new material risk for FICC because FICC guarantees the settlement of all Transactions at trade comparison<sup>24</sup> and no changes (other than the proposed inclusion of Stipulated Trades) are being proposed in connection with the timing or substance of FICC's guarantee.

In order to achieve the above-referenced changes, FICC is also proposing to make certain operational changes that would create efficiencies for Clearing Members. These changes include: (1) eliminating the Notification of Settlement process, (2) establishing the DNA process, (3) establishing the Expanded Pool Netting process, (4) eliminating the "give-up" process for Brokered Transactions, and (5) amending the components of the Cash Settlement calculation. In addition, FICC would modify its RTTM system to permit the submission of SBO-Destined Trades in all trade size amounts. These changes would not create any new material risk for FICC because these changes would be designed to enhance operational efficiencies while not materially affecting risk management processes.

## **I. MBSD Processing – Overview**

### MBSD's Current Trade Comparison and Netting Processes

MBSD processes (1) to-be-announced ("TBA") transactions ("TBA Transactions"), which are trades for which the actual identities of and/or the number of pools underlying each trade are unknown at the time of trade execution and (2) Specified Pool Trades, which are trades for which all pool data is agreed upon by the Clearing Members at the time of execution. TBA Transactions are comprised of (i) SBO-Destined Trades, (ii) Trade-for-Trade Transactions and (iii) Option Contracts.

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<sup>24</sup> See MBSD Rule 5, supra note 3.

MBSD's Trade Comparison<sup>25</sup> system and TBA Netting<sup>26</sup> system form the basis of all of its other services. All Compared Trades<sup>27</sup> are risk managed by MBSD, but the remainder of their respective lifecycles differ according to their trade type.

The first step of MBSD's clearance and settlement process is trade comparison, which consists of the reporting, validating and matching by FICC of both sides of a Transaction to ensure that the details of the trades are in agreement between the parties.<sup>28</sup> Trade data is entered into the RTTM system by all parties and once the trade is deemed compared, FICC guarantees the settlement of the trade, provided that the trade meets the requirements of the MBSD Rules and was entered into in good faith.<sup>29</sup> With respect to SBO-Destined Trades, upon trade comparison such trades are also novated to FICC.<sup>30</sup> This novation consists of the termination of the deliver, receive and related payment obligations between Clearing Members and their replacement with identical obligations to and from

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<sup>25</sup> Pursuant to the MBSD Rules, the term "Trade Comparison" means the service provided to Clearing Members and the operations carried out by the Corporation in the course of providing such service, in accordance with MBSD Rule 5. See MBSD Rule 1, supra note 3.

<sup>26</sup> Pursuant to the MBSD Rules, the term "TBA Netting" means the service provided to Clearing Members, as applicable, and the operations carried out by the Corporation in the course of providing such service in accordance with MBSD Rule 6. See MBSD Rule 1, supra note 3.

<sup>27</sup> Pursuant to the MBSD Rules, the term "Compared Trade" means a trade the data on which has been compared or deemed compared pursuant to Rule 5 or Rule 7, as applicable. See MBSD Rule 1, supra note 3.

<sup>28</sup> See MBSD Rule 5, supra note 3.

<sup>29</sup> See MBSD Rule 5 Section 8, supra note 3.

<sup>30</sup> See MBSD Rule 5 Section 13, supra note 3.

FICC.<sup>31</sup> With respect to Trade-for-Trade Transactions, novation does not occur at the time of trade comparison; FICC only guarantees the settlement of such Transactions upon trade comparison.<sup>32</sup> Although FICC guarantees the obligations of Specified Pool Trade counterparties to deliver, receive and make payment for securities that satisfy the same generic criteria as the securities underlying Specified Pool Trades upon trade comparison, FICC does not novate such trades.<sup>33</sup>

Next, MBSD employs two netting processes to reduce settlement obligations as well as the number of securities and the amount of cash that must be exchanged to settle certain Transactions. The netting processes occur through the TBA Netting system and the Pool Netting system.<sup>34</sup>

The TBA Netting system is used to net SBO-Destined Trades that have compared and are eligible for the TBA Netting system.<sup>35</sup> Three days before the established contractual settlement day (referred to as “72-Hour Day”),<sup>36</sup> TBA Netting for the applicable class

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<sup>31</sup> Id.

<sup>32</sup> Id.

<sup>33</sup> See MBSD Rule 5 Section 12, supra note 3.

<sup>34</sup> See MBSD Rules 6, 7 and 8, supra note 3.

<sup>35</sup> Trade-for-Trade Transactions are not netted through the TBA Netting system, however, like the SBO positions, do constitute TBA settlement obligations against which Pool Instructs may be submitted. Specified Pool Trades are also not netted through the TBA Netting system, nor do such trades enter the Pool Netting system. See MBSD Rules 6 and 8, supra note 3.

<sup>36</sup> MBSD performs the TBA Netting process four times per month, corresponding to each of the four primary settlement classes and dates established by the Securities Industry Financial Markets Association (“SIFMA”). SIFMA publishes a calendar that specifies one settlement date per month for four different product classes (known as Classes A, B, C and D) that are used to categorize the various types of TBA securities. These product classes and the associated settlement dates are

occurs. On this date, all compared SBO-Destined Trades within the class that have been designated for the TBA Netting process are netted within and across counterparties. Even though FICC has become the legal counterparty for each SBO-Destined Trade upon trade comparison, TBA Netting occurs as though each SBO-Destined Trade is with the Original Contra-Side Member.<sup>37</sup> The net positions created by the TBA Netting process are referred to as the settlement balance order positions (“SBO positions”), which constitute settlement obligations against which Clearing Members will submit pool information (“Pool Instructs”) for the Pool Netting process.<sup>38</sup>

Two business days prior to the established settlement date of the TBA settlement obligations (known as “48-Hour Day”), Clearing Members that have an obligation to deliver pools (“Pool Sellers”) must notify their counterparties (“Pool Buyers”) through MBSD’s EPN Service<sup>39</sup> of the pools that such Pool Sellers intend to allocate in satisfaction of their

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recognized by the industry, and they provide the foundation for MBSD’s TBA Netting process.

<sup>37</sup> Pursuant to the MBSD Rules, the term “Original Contra-Side Member” means a Member with whom a Member has entered into a contract for the purchase or sale of an Eligible Security or an Option Contract. See MBSD Rule 1, supra note 3.

<sup>38</sup> See MBSD Rule 6, supra note 3.

<sup>39</sup> MBSD’s electronic pool notification service (the “EPN Service”) provides Clearing Members with the ability to electronically communicate pool information to MBSD, as described in the proposed rule changes. See MBSD Rule 1, supra note 3. FICC recognizes that the term “EPN” as used in connection with the “EPN Service” also reflects the acronym of “Expanded Pool Netting.” With this in mind, FICC wishes to clarify that the EPN Service and the Expanded Pool Netting process are not associated with one another. As described above, the EPN Service is MBSD’s electronic pool notification service, which is used by Clearing Members to electronically communicate pool information to MBSD as described in this proposed rule change. Expanded Pool Netting would be a secondary pool netting process that FICC is proposing to establish as described in this proposed rule change.

SBO positions and/or Trade-for-Trade Transactions.<sup>40</sup> With respect to Trade-for-Trade Transactions, the relevant counterparty is the Original Contra-Side Member. With respect to SBO-Destined Trades, although MBSD is the legal counterparty, Clearing Members are directed to treat a designated SBO Contra-Side Member<sup>41</sup> as their counterparty. In addition, Clearing Members are also required to submit Pool Instructs on the 48-Hour Day to MBSD through its RTTM system for Pool Comparison<sup>42</sup> (which is a prerequisite to Pool Netting).<sup>43</sup> The pools must be bilaterally matched by each counterparty to the trade. Any pool allocations deemed compared at this stage (provided that neither Clearing Member has cancelled the submitted allocation) are processed through the Pool Netting system.<sup>44</sup> On the business day before the contractual settlement date (“24-Hour Day”), pool netting takes

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<sup>40</sup> Pool allocations occur for all TBA Obligations, whether established on 72-Hour Day through the TBA Netting process or established upon comparison when the Trade-for-Trade Transaction was submitted. Pool allocations are not performed for Specified Pool Trades because the pool that is to be delivered in connection with such trade is specified upon submission.

<sup>41</sup> Pursuant to the MBSD Rules, the term “SBO Contra-Side Member” means the Member with whom a Member is directed by the Corporation to settle an SBO Trade. An “SBON Contra-Side Member” is an SBO Contra-Side Member that is not an Original Contra-Side Member with respect to such SBO Trade. An “SBOO Contra-Side Member” is an SBO Contra-Side Member that is also an Original Contra-Side Member with respect to such SBO Trade. See MBSD Rule, supra note 3

<sup>42</sup> Pursuant to the MBSD Rules, the term “Pool Comparison” means the service provided to Clearing Members, as applicable, and the operations carried out by the Corporation in the course of providing such service, in accordance with Rule 7. See MBSD Rule 1, supra note 3.

<sup>43</sup> As with the EPN Service allocation process described above, Clearing Members submit Pool Instructs against all of their TBA Obligations regardless of whether the TBA Obligation stems from the TBA Netting process or the TBA Obligation is established upon comparison when the Trade-for-Trade Transaction was submitted.

<sup>44</sup> See MBSD Rule 8, supra note 3.

place. The Pool Netting system reduces the number of pool settlements by netting Pool Instructs stemming from SBO Trades<sup>45</sup> and Trade-for-Trade Transactions to arrive at a single net position per counterparty in a particular pool number for next-day delivery date.<sup>46</sup>

On each business day, MBSD makes available to each Clearing Member a Report<sup>47</sup> to enable such Clearing Member to settle its Pool Net Settlement Positions<sup>48</sup> on that business day. At the time that the Report is made available, all deliver, receive and related payment obligations between Clearing Members that were created by compared pools that comprise a Pool Net Settlement Position or Positions are terminated and replaced by the Pool Deliver Obligations, Pool Receive Obligations, and related payment obligations to and from FICC.<sup>49</sup> Each Clearing Member then provides appropriate

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<sup>45</sup> Pursuant to the MBSD Rules, the term “SBO Trade” means a settlement balance order that offsets an SBO Net Open Position pursuant to the MBSD Rules. A Member which has one or more “Long SBO Trades” in a particular CUSIP number is a net purchaser with respect to that CUSIP number, as the case may be; a Member which has one or more “Short SBO Trades” is a net seller. An SBO Trade may be either an SBON Trade or an SBOO Trade. See MBSD Rule 1, supra note 3.

<sup>46</sup> A Clearing Member’s “counterparty” for purposes of notifications, netting and processing as described in this paragraph is the SBO Contra-Side Member or the Original Contra-Side Member for SBO-Destined Trades and Trade-for-Trade Transactions, respectively. See MBSD Rule 6, supra note 3.

<sup>47</sup> Pursuant to the MBSD Rules, the term “Report” means any document, record, or other output prepared by the Corporation and made available to a Member in any format (including, but not limited to, machine-readable and print-image formats) or medium (including, but not limited to, print copy, magnetic tape, video display terminal, and interactive message formats) that provides information to such Member with regard to the services provided by, or the operations of, the Corporation. See MBSD Rule 1, supra note 3.

<sup>48</sup> Pursuant to the MBSD Rules, the term “Pool Net Settlement Position” means either a Pool Net Short Position or a Pool Net Long Position, as the context requires. See MBSD Rule 1, supra note 3.

<sup>49</sup> Id.



instructions to its clearing bank to deliver to MBSB, and/or to receive from MBSB, Eligible Securities against payment or receipt at the appropriate settlement value.

Certain obligations among Clearing Members settle outside of FICC – meaning that, Clearing Members are required to settle such obligations directly with their applicable settlement counterparties.<sup>50</sup> These obligations include (1) Pool Instructs that are not included in Pool Netting (either because they are ineligible or because they do not meet selection criteria for inclusion) and (2) Specified Pool Trades, which are not eligible for Pool Netting. Clearing Members must report that an obligation has settled bilaterally with their applicable settlement counterparties to FICC by submitting a Notification of Settlement to MBSB for pool settlements relating to all trade types, with the exception of Option Contracts.<sup>51</sup> This is required because MBSB will not know which pools actually have settled directly between Clearing Members unless it receives a separate notification. Once the mandatory details on the Notification of Settlement instructions submitted by both Clearing Members are compared, the associated obligation is deemed to have settled and will therefore no longer be subject to MBSB’s risk management.

## **II. MBSB Processing – Proposed Changes**

### **A. FICC’s proposed change to novate all Transactions (other than Option Contracts) and treat itself as the settlement counterparty for all such Transactions at trade comparison**

MBSB is proposing to novate all Transactions (except Option Contracts) at the time of trade comparison. This means that, upon trade comparison, the deliver, receive and related payment obligations between the Clearing Members with respect to SBO-

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<sup>50</sup> See MBSB Rule 5 Section 12 and MBSB Rule 8 Section 2, supra note 3.

<sup>51</sup> See MBSB Rule 10, supra note 3.

Destined Trades and Trade-for-Trade Transactions would terminate and be replaced by identical obligations to and from FICC (i.e., FICC would become the buyer to every seller and the seller to every buyer). A similar process would occur for Specified Pool Trades and Stipulated Trades, except that, for those trades, the existing deliver, receive and related payment obligations would be terminated and replaced with obligations to deliver, receive and make payment for securities that satisfy the same generic criteria (such as coupon rate, maturity, agency, and product) as the securities underlying the Specified Pool Trades or Stipulated Trades. FICC would not novate or guarantee the obligations to deliver the particular securities underlying Specified Pool Trades or securities that contain the particular stipulations set forth in Stipulated Trades. In addition, FICC is proposing to treat itself as the settlement counterparty throughout the lifecycle of the trade for netting, processing and settlement purposes.<sup>52</sup> These changes are described in detail below.

### **1. SBO-Destined Trades**

Currently, MBSD novates SBO-Destined Trades at the time of trade comparison, however, FICC does not treat itself as the settlement counterparty for netting and processing purposes until after the Pool Netting process is complete and FICC has established Pool Receive Obligations or Pool Deliver Obligations, as applicable, for each Clearing Member that has entered into an SBO-Destined Trade. As a result, Clearing

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<sup>52</sup> Upon trade comparison, Clearing Members would receive a notification through the RTTM system establishing FICC as each party's novated and settlement counterparty.

Members are directed to (1) allocate pools through the EPN Service to designated SBO Contra-Side Members and (2) submit Pool Instructs through the RTTM system.<sup>53</sup>

MBSD is proposing to treat itself as settlement counterparty for netting and processing purposes, at the time of trade comparison. SBO-Destined Trades would proceed to the TBA Netting process as they do today; however, the SBO positions that result from the TBA Netting process would reflect FICC as the settlement counterparty. Thus, Clearing Members would no longer be directed to settle with a designated SBO Contra-Side Member,<sup>54</sup> but with FICC. On 48-Hour Day, Clearing Members that are Pool Sellers would notify MBSD (rather than their designated SBO Contra-Side Member) through the EPN Service of the allocated pools. FICC would then submit corresponding notifications to Clearing Members that are Pool Buyers. Pool Instructs (as defined above) would continue to be submitted to MBSD on 48-Hour Day through FICC's RTTM system. In an effort to create operational efficiencies, FICC is proposing to amend its MBSD Rules to provide that, if a Clearing Member does not submit its Pool Instructs by the established deadline, FICC would determine and apply the Pool Instructs for that Clearing Member. Such determination would be based on the allocated pools that the Clearing Member has submitted through the EPN Service. As a result of this proposed change, all pools would be compared and FICC would no longer require Clearing Members to settle uncomparing pools directly with their applicable settlement counterparties (i.e., outside of FICC).

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<sup>53</sup> See MBSD Rule 7, supra note 3.

<sup>54</sup> FICC would eliminate its calculation for determining the Settlement Value of SBON Trades and SBOO Trades. The MBSD Rules refer to the calculation as "CUSIP Average Price" or "CAP" for SBON Trades and "Firm CUSIP Average Price" or "FCAP" for SBOO Trades. See MBSD Rule 6, supra note 3.

In addition to the above, FICC is also proposing to eliminate the trade size restriction for SBO-Destined Trades. Currently, SBO-Destined Trades are only eligible for the TBA Netting process if such trades details are submitted through the RTTM system in multiple amounts of one million with the minimum set at one million. FICC is proposing to remove this restriction from the RTTM system. As a result, Clearing Members would be permitted to submit SBO-Destined Trades in any trade size. MBSD's trade size restrictions are not reflected in the MBSD Rules, thus the proposed change would not necessitate any changes to the MBSD Rules.

For the avoidance of doubt, FICC is not proposing to change the trade size restrictions for Trade-for-Trade Transactions and Specified Pool Trades.

## **2. Trade-for-Trade Transactions**

Currently, FICC does not novate Trade-for-Trade Transactions or treat itself as settlement counterparty for purposes of netting, processing, and settlement until, in each case, the Pool Netting process is complete and each Clearing Member receives their Pool Receive Obligation or Pool Deliver Obligations, as applicable, from FICC.<sup>55</sup> As a result, Clearing Members are required to allocate pools to their original counterparty through the EPN Service and submit Pool Instructs through the RTTM system. Once Pool Netting is complete, the deliver, receive and related payment obligations between Clearing Members that were created by compared pools that comprise a Pool Net Settlement Position are terminated and replaced by Pool Deliver Obligations, Pool Receive Obligations, and related payment obligations to and from FICC.<sup>56</sup>

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<sup>55</sup> See MBSD Rule 8 Section 4, supra note 3.

<sup>56</sup> See MBSD Rule 8 Section 6, supra note 3.

FICC is proposing to novate Trade-for-Trade Transactions at trade comparison and treat itself as settlement counterparty, at that time, for purposes of processing and settlement. Similar to the process with SBO-Destined Trades, Clearing Members with an obligation to deliver pools would notify MBSD (rather than their original counterparty) through the EPN Service and FICC would submit corresponding notifications to Clearing Members that are Pool Buyers. Clearing Members would continue to be required to submit Pool Instructs. In the event that Pool Instructs are not submitted by the established deadline, FICC would determine Pool Instructs for that Clearing Member.

### **3. Specified Pool Trades**

Currently, FICC does not novate Specified Pool Trades during any point of the trade lifecycle (though, upon Trade Comparison of Specified Pool Trades, FICC guarantees the obligation to deliver, receive and pay for securities that satisfy the same generic criteria as the securities underlying the Specified Pool Trades).<sup>57</sup> Specified Pool Trades are eligible for neither the TBA Netting process nor the Pool Netting process. In addition, Specified Pool Trades are directly settled between the original counterparties.

FICC is proposing to novate Specified Pool Trades upon Trade Comparison. Such novation would be limited to the obligations to deliver, receive and make payment for securities satisfying the same generic criteria as the securities underlying the Specified Pool Trades. As a result, upon Trade Comparison, the existing deliver, receive and related payment obligations between Clearing Members under Specified Pool Trades would be terminated and replaced with obligations to or from FICC to deliver, receive and make payment for securities satisfying the same generic criteria as the securities

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<sup>57</sup> See MBSD Rule 5, supra note 3.

underlying the Specified Pool Trades. FICC would not novate the obligation to deliver the securities for the particular specified pool.

Additionally, FICC is proposing to settle Specified Pool Trades directly with the Clearing Member party thereto (rather than require that counterparties to such trades settle directly with one another). No other changes are being proposed with respect to the processing of Specified Pool Trades. Such trades would continue to be ineligible for the TBA Netting and Pool Netting systems.

#### **4. Stipulated Trades**

FICC is proposing to introduce Stipulated Trades as a new trade type that would be eligible for processing by MBSB. A Stipulated Trade is a trade in which pools allocated and delivered against the trade must satisfy certain conditions (i.e., stipulations) that are agreed upon by the parties at the time that the trade was executed.<sup>58</sup> FICC would guarantee and novate Stipulated Trades at Trade Comparison provided that such trade meets the requirements of the MBSB Rules and was entered into in good faith. Such guarantee and novation would be limited to the obligations to deliver, receive and make payment for securities satisfying the same generic criteria as the securities underlying the Stipulated Trade, but not the obligation to deliver securities that contain the particular stipulations contained in the Stipulated Trades. At Trade Comparison, the deliver, receive and related payment obligations between Clearing Members would be terminated and replaced with obligations to deliver, receive and make payment for securities satisfying the same generic criteria as the securities underlying the Stipulated Trades.

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<sup>58</sup> Trades carrying stipulations may reflect terms that include but are not limited to the following: issuance year, issuance month, weighted average coupon, weighted average maturity and/or weighted average loan age, etc.

Because of the narrow nature of FICC's guarantee and novation, in the event of a Clearing Member's default, FICC would only be required to deliver, receive or make payment for securities that have the same generic terms, such as coupon rate, maturity, agency, and product, as the securities that underlay the Stipulated Transaction.

Clearing Members would be required to allocate Stipulated Trades to FICC through the EPN Service. Such allocation would result in the creation of pool obligations, which would settle with FICC based on the settlement date agreed to as part of the terms of the trade. Similar to Specified Pool Trades, Stipulated Trades would be eligible for neither the TBA Netting process nor the Pool Netting process.

**B. Proposed change to eliminate the Notification of Settlement process**

As described above, the Notification of Settlement process requires Clearing Members to notify FICC of obligations that have settled directly between Clearing Members and their applicable settlement counterparties.<sup>59</sup> Once both parties to a Transaction submit a Notification of Settlement to MBSD through the RTTM system, the obligations are no longer subject to MBSD's margin calculation process.<sup>60</sup> Because FICC is proposing to novate and directly settle all SBO-Destined Transactions, Trade-for-Trade Transactions and Specified Pool Trades, the Notification of Settlement process would be eliminated from the MBSD Rules.

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<sup>59</sup> See MBSD Rule 10, supra note 3.

<sup>60</sup> See MBSD Rule 4, supra note 3.

### C. Proposed change to establish the DNA process

FICC is proposing to establish a process that would give Clearing Members the ability to offset Trade-for-Trade Transactions<sup>61</sup> and/or SBON Trades.<sup>62</sup> This process would be referred to as the “DNA” process. The purpose of this process is to exclude SBON Trades and Trade-for-Trade Transactions from the pool allocation process<sup>63</sup> and securities settlement.

The Do Not Allocate process would be available to Clearing Members at the start of business day on 48-Hour Day through 4:30 p.m. on 24-Hour Day. During this time, Clearing Members with two or more open TBA Obligations<sup>64</sup> with the same Par Amount,<sup>65</sup> CUSIP Number<sup>66</sup> and SIFMA designated settlement date would be permitted

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<sup>61</sup> Specified Pool Trades and Stipulated Trades would not be eligible for the proposed Do Not Allocate process because such trades are not eligible for the Pool Netting process. See MBSD Rule 8, supra note 3.

<sup>62</sup> The proposed MBSD Rules would use the term “SBON Trades” to signify obligations that result from the TBA Netting process. Such obligations would reflect FICC as the settlement counterparty.

<sup>63</sup> As noted above, the pool allocation process requires Clearing Members to allocate pools on 48-Hour Day through the EPN Service. Pursuant to this proposed change, Clearing Members would not be required to allocate pools for obligations that have been offset through the Do Not Allocate process.

<sup>64</sup> Pursuant to the MBSD Rules, the term “TBA Obligations” means SBO-Destined obligations and, with respect to Trade-for-Trade Transactions, settlement obligations generated by the Trade Comparison system. See MBSD Rule 1, supra note 3.

<sup>65</sup> Pursuant to the MBSD Rules, the term “Par Amount” means for Trade-for-Trade and SBO Transactions, Option Contracts and Pool Deliver and Pool Receive Obligations, the current face value of a Security to be delivered on the Contractual Settlement Date. With respect to Specified Pool Trades, “Par Amount” shall mean the original face value of a Security to be delivered on the Contractual Settlement Date. See MBSD Rule 1, supra note 3. Pursuant to this proposed rule change, FICC is proposing to amend this defined term as described in section H. 1.



to offset (i.e., “pair-off”) such obligations. In order to initiate the offset, Clearing Members would be required to submit a request (“DNA Request”) to MBSD through the RTTM system. Upon FICC’s validation of this request, the obligations would be reduced and the Clearing Member would not be required to allocate pools against such obligations. As a result, a Clearing Member’s overall number of open obligations would be reduced.

The proposed Do Not Allocate process would generate Cash Settlement credits and debits from the price differential of the resulting offsetting obligations. The proposed Cash Settlement obligations are described below in section F.

1. *Cancellations*

Clearing Members would be permitted to cancel a DNA Request, however, such cancellation must be submitted through the RTTM system prior to the time that the designated offsetting TBA Obligations have settled. Upon FICC’s timely receipt of a cancellation request, the trades that were previously marked for the Do Not Allocate process would reopen and the Clearing Member would be expected to notify MBSD through the EPN Service of the pools that such Clearing Member intends to allocate to the open obligations.

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<sup>66</sup> Pursuant to the MBSD Rules, the term “CUSIP Number” means the Committee on Uniform Securities Identification Procedures identifying number for an Eligible Security. See MBSD Rule 1, *supra* note 3.

2. *Example of the Do Not Allocate process*

*Assume that the TBA Netting process results in the following:*

Dealer A as seller has a TBA Obligation to FICC in a Fannie Mae (“FNMA”) 30-year 3% coupon for a July 2017 settlement (CUSIP Number 01F030678) with a Par Amount of 100mm.

*Assume that the following Trade-for-Trade Transaction has been novated to FICC:*

Dealer A as buyer has a TBA Obligation to FICC in FNMA 30-year 3% coupon for a July 2017 settlement (CUSIP Number 01F030678) with a Par Amount of 100mm.

In connection with the above, Dealer A would have the option of submitting a DNA Request at anytime between the start of business day on 48-Hour Day through 4:30 p.m. on 24-Hour Day. Upon FICC’s receipt and validation of the DNA Request, FICC would reduce each of Dealer A’s TBA Obligations in accordance with the DNA Request and reduce the overall number of Dealer A’s open TBA Obligations.

In addition, FICC would calculate a Cash Settlement obligation for Dealer A (the “Do Not Allocate Transaction Adjustment Payment”) difference between the Settlement Price of the buy and sell TBA Obligation transactions multiplied by the contractual quantity.

In the event that Dealer A cancels its DNA Request, the marked TBA Obligations would reopen and Dealer A would be required to allocate pools for such obligations.

**D. Proposed change to establish a secondary Pool Netting process – Expanded Pool Netting**

As described above, the Pool Netting system reduces the number of pool settlements by netting Pool Instructs stemming from SBON Trades and Trade-for-Trade Transactions to arrive at a single net position per counterparty in a particular pool number for next-day delivery date.<sup>67</sup> Prior to the Pool Netting process, Pool Sellers must notify their Pool Buyers through MBSD’s EPN Service of the pools that will be allocated in satisfaction of a TBA Obligation. In accordance with the SIFMA Guidelines,<sup>68</sup> such notifications must occur before 3:00 p.m.<sup>69</sup> on 48-Hour Day. Notifications that take place after this time are considered late and the delivery of such pools to the related Pool Buyers will be delayed for one additional business day.

In order to capture notifications submitted after 3:00 p.m. on 48-Hour Day through 4:30 p.m. on 24-Hour Day, FICC is proposing to establish an additional netting cycle (referred to as Expanded Pool Netting). Similar to the initial Pool Netting process, Expanded Pool Netting would result in a reduction in the number of Pool Delivery Obligations. As with the existing Pool Netting process, the proposed Expanded Pool Netting process would (1) calculate Pool Net Settlement Positions in a manner that is consistent with Section 3 of MBSD Rule 8 and (2) allocate Pool Deliver Obligations and

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<sup>67</sup> A Clearing Member’s “counterparty” for purposes of notifications, netting and processing as described in this paragraph is the SBO Contra-Side Member or the Original Contra-Side Member for SBO-Destined Trades and Trade-for-Trade Transactions, respectively. See MBSD Rule 6, supra note 3.

<sup>68</sup> Pursuant to the MBSD Rules, the term “SIFMA Guidelines” means the guidelines for good delivery of Mortgage-Backed Securities as promulgated from time to time by SIFMA. See MBSD Rule 1, supra note 3.

<sup>69</sup> All times referenced herein are Eastern Time.

Pool Receive Obligations in a manner that is consistent with Section 4 of MBSD Rule 8. The Expanded Pool Netting process would occur four times per month in accordance with the SIFMA designated settlement date. Pool Net Settlement Positions and the resultant Pool Deliver Obligations and Pool Receive Obligations would only be provided to Clearing Members during such times.

The proposed Expanded Pool Netting process would generate Cash Settlement credits and debits. The proposed Cash Settlement obligations are described below in section F.

**E. Proposed change to eliminate the “give-up” process for Brokered Transactions**

Currently, FICC operates its brokered business on a “give-up” basis. This means that MBSD discloses (or “gives-up”) the identity of each Dealer<sup>70</sup> (to a Brokered Transaction) after a period of time.<sup>71</sup> Under the proposed rule change, FICC would eliminate the need to disclose Dealers’ identities because FICC would novate all Brokered Transactions and treat itself as the settlement counterparty once such transactions have been Fully Compared.<sup>72</sup> Thus, the Report that FICC issues once a Brokered Transaction has been Fully Compared would refer to FICC as settlement counterparty.

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<sup>70</sup> Pursuant to the MBSD Rules, the term “Dealer” means a Member that is in the business of buying and selling Securities as principal, either directly or through a Broker. See MBSD Rule 1, supra note 3.

<sup>71</sup> See MBSD Rule 5 Section 7, supra note 3.

<sup>72</sup> Pursuant to the MBSD Rules, the term “Fully Compared” means that trade input submitted by a Broker matches trade input submitted by each Dealer on whose behalf the Broker is acting in accordance with the Net Position Match Mode. See MBSD Rule 1, supra note 3.

**F. Proposed change to the Cash Settlement process**

Cash Settlement is a daily process of generating a single net credit or debit cash amount at the Aggregated Account<sup>73</sup> level and settling those cash amounts between Clearing Members and MBSD.<sup>74</sup> FICC's proposal to become the settlement counterparty upon trade comparison and the proposed Do Not Allocate process would necessitate the following changes to the Cash Settlement calculation.

1. FICC is proposing to eliminate the *SBO Market Differential*<sup>75</sup> because this amount calculates the price difference for SBO positions settled among Clearing Members. This amount would no longer be required because Clearing Members would settle all SBO-Destined Trades directly with FICC.

2. FICC is proposing to add the following components to the Cash Settlement calculation:

a. The proposed *TBA Transaction Adjustment Payment* would reflect the cash differential that would result when calculating the net proceeds of the contractual quantity of an SBO-

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<sup>73</sup> Pursuant to the MBSD Rules, the term "Aggregated Account" means either a single Account linked to an aggregate ID or a set of Accounts linked to an aggregate ID for the processing of Transactions in the Clearing System. Pursuant to the MBSD Rules, Members' Cash Settlement obligations and Mark-to-Market requirements are calculated on a net basis at the aggregate ID level. See MBSD Rule 1, supra note 3.

<sup>74</sup> See MBSD Rule 11, supra note 3.

<sup>75</sup> Pursuant to the MBSD Rules, the term "SBO Market Differential" means the amount computed pursuant to the MBSD Rules, reflecting the difference between Firm CUSIP Average Prices (in the case of an SBO Netted or SBO Net-Out Position) or between the CUSIP Average Price and the Firm CUSIP Average Price (in the case of an SBON Trade). See MBSD Rule 1, supra note 3.

Destined Trade when comparing such trade's Settlement Price and the System Price.<sup>76</sup>

The proposed TBA Transaction Adjustment Payment would be an amount equal to the difference between the SBO-Destined Trade's Settlement Price and the System Price, multiplied by the contractual quantity of such trade, and then divided by 100. To differentiate between the buyer and seller of the transaction, an indicator of -1 for the buy trade and +1 for the sell trade is multiplied by the contractual quantity of such trade.

For example, the TBA Transaction Adjustment Payment for an SBO-Destined Trade having a contractual quantity of 5,000,000 would be calculated as follows:

Contractual quantity (sell): 5,000,000

SBO-Destined Trade - Settlement Price: 100.25

System Price: 100

Calculation:  $1 \times 5,000,000 (100.25 - 100)/100$

TBA Transaction Adjustment Payment: \$12,500 (credit)

b. The proposed *Expanded Pool Net*

*Transaction Adjustment Payment* would be included in the event that a Clearing Member misses the deadline established by FICC for the Pool Netting process. Unlike the Pool Netting process, which runs daily, the

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<sup>76</sup> Pursuant to the MBS Rules, the term "System Price" means the price for any trade or any Pool Deliver Obligations or Pool Receive Obligation not including accrued interest, established by the Corporation on each Business Day, based on current market information, for each Eligible Security. See MBS Rule 1, *supra* note 3.

Expanded Pool Netting process would only run four times per month in accordance with the SIFMA designated settlement date. As a result, an Expanded Pool Net Transaction Adjustment Payment would only occur four times per month. The calculation for the Expanded Pool Net Transaction Adjustment Payment is the same as the Pool Net Transaction Adjustment Payment.

The Expanded Pool Net Transaction Adjustment Payment would reflect an amount equal to the difference between the System Price and the SBON Trade's Settlement Price or Trade-for-Trade Transaction's Settlement Price, as applicable, multiplied by the total current face value of the pools used to satisfy such obligation, then divided by 100. To differentiate between a buy and sell transaction, an indicator of +1 for a buy trade and -1 for a sell trade would be multiplied by the total current face value of the pools used to satisfy the obligation.

c. The proposed *Do Not Allocate Transaction Adjustment Payment* would reflect the cash differential among TBA Obligations that have been offset through the Do Not Allocate process. The proposed Do Not Allocate Transaction Adjustment Payment would be an amount equal to the difference between the Settlement Price of the buy and sell TBA Obligation transactions multiplied by the contractual quantity. To differentiate between a buy and sell transaction, an indicator of -1 for a buy trade and +1 for a sell trade is multiplied by the contractual quantity of such trade.

For example, the Do Not Allocate Transaction Adjustment Payment for a 2,000,000 DNA Request would be calculated as follows:

Contractual quantity: 2,000,000

Trade price of buy transaction: 99

Trade price of sell transaction: 100

Buy calculation:  $-1 \times 2,000,000 \times 99 = -\$1,980,000$

Sell calculation:  $1 \times 2,000,000 \times 100 = \$2,000,000$

Do Not Allocate Transaction Adjustment Payment: \$20,000 (credit)

d. The proposed *TBA Reprice Transaction Adjustment Payment* would reflect the cash differential between the price of a TBA Obligation that was not allocated by a Clearing Member by the deadline established by FICC and the price of the replacement TBA Obligation that was calculated at the System Price.

The TBA Reprice Transaction Adjustment Payment would be an amount equal to the difference between the TBA Obligation's Settlement Price and the System Price, multiplied by the unallocated contractual quantity, then divided by 100. To differentiate between a buy and sell transaction, an indicator of -1 for a sell trade and +1 for a buy trade is multiplied by the unallocated pool's contractual quantity.



For example, the TBA Reprice Transaction Adjustment Payment for a TBA Obligation with a contractual quantity of 5,000,000 that was not allocated by a Clearing Member by the deadline established by FICC would be calculated as follows:

Contractual quantity (buy): 5,000,000

SBON Trade - Settlement Price: 100

System Price: 101

Calculation:  $1 \times 5,000,000 (101 - 100)/100$

TBA Reprice Transaction Adjustment Payment: \$50,000 (credit)

e. The proposed *Variance Transaction Adjustment Payment* would capture the variance (i.e., difference)<sup>77</sup> between a TBA Obligation and the current face value of the pools allocated in satisfaction of such obligation. Specifically, this payment would reflect the cash differential calculated between the SBON Trade's Settlement Price or the Trade-for-Trade Transaction's Settlement Price, as applicable, and the System Price using the variance of the Pool Netting process or the Expanded Pool Netting process, as applicable, based on the current face value of the pools used in satisfaction of the trade.

The Variance Transaction Adjustment Payment would be an amount equal to the difference between the SBON Trade's Settlement Price or the

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<sup>77</sup> Pursuant to the SIFMA Guidelines, TBA trades are allowed to have a variance equal to plus or minus 0.01% of the dollar amount of the transaction agreed to by the parties. As a result of this guideline, FICC would capture the variance of TBA Obligations and the current face value of the pools allocated in satisfaction of such obligations.

Trade-for-Trade Transaction's Settlement Price, as applicable, and the System Price, multiplied by the difference between the TBA Obligation and the allocated pools used in satisfaction of such trade and then divided by 100. To differentiate between a buy and sell transaction, an indicator of -1 for a buy trade and +1 for a sell trade would be multiplied by the total variance amount.

For example, the Variance Transaction Adjustment Payment for a sell transaction that has one million under allocated and one million over allocated<sup>78</sup> would be calculated as follows:

Sell trade price: 100.125

Good delivery million #1 allocation: 999,895.77

Good delivery million #2 allocation: 1,000,007.13

System Price: 99

Calculation:  $1 \times (104.23 - 7.13) \times (99 - 100.125)/100$   
 $= 1 \times (97.10) \times (-1.125)/100$

Variance Transaction Adjustment Payment: \$1.09 (debit)

f. The proposed *Factor Update Adjustment Payment* would be calculated in the event that updated pool factor information is released after the clearing bank's settlement of a pool. This update would create a cash differential that would require a debit to the seller and a credit to the buyer.

Example:

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<sup>78</sup>

Id.

Seller A sells Pool 1 FNMA 30yr 3% coupon to Buyer B with a contractual settlement date of April 3, 2017, at a price of 100. Because the April 2017 factor is unavailable on the contractual settlement date, the pool would settle at the clearing bank with a settlement amount based on the factor that was released in March 2017.

Principle - current face value x price

Interest - current face value x coupon/360 x settlement date - 1

<u>Original Face</u>	<u>Current Face Value</u>	<u>Principal</u>	<u>Interest</u>	<u>Net Money</u>	<u>Factor</u>
1,000,000	1,000,000.00	1,000,000.00	166.67	1,000,166.67	1.00 (March)
1,000,000	990,000.00	990,000.00	165.00	990,165.00	0.99 (April)
				10,001.65	

Factor Update Adjustment amount: \$10,001.65 (i.e., the difference between the March 2017 and April 2017 settlement amounts)

Since Seller A was overpaid for the original settlement, they will be debited to reflect the lower factor and Buyer B will be credited.

**G. Delayed implementation of the proposed rule change**

The proposed changes would become effective within 45 Business Days after the date of the Commission’s approval of this proposed rule change. Prior to the effective date, FICC would add a legend to the MBSD Rules to state that the specified changes to the MBSD Rules are approved but not yet operative and to provide the date such approved changes would become operative. The legend would also include the file number of the approved proposed rule change and would state that once operative, the legend would automatically be removed from the MBSD Rules.

**H. Detailed description of the proposed changes to the MBSD Rules**

**1. *Proposed Changes to MBSD Rule 1 (Definitions)***

FICC is proposing to delete the terms “Broker Give-Up Date” and “Broker Give-Up Trade” because FICC would no longer disclose a Dealer’s identity on the Report that FICC issues in connection with Brokered Transactions.

FICC is proposing to amend the term “Brokered Transaction” to delete the reference to “give-up” because FICC would no longer disclose a Dealer’s identity on the Report that FICC issues in connection with Brokered Transactions.

FICC is proposing to amend the term “Contractual Settlement Date” to add a reference to “Stipulated Trade,” which would be a new eligible trade type. FICC is also proposing to replace the term “SBO Trade” with “SBON Trade.” The distinction between these two trade types would no longer be required because all obligations that result from the TBA Netting process would settle with FICC.

FICC is proposing to delete the term “CUSIP Average Price” and “CAP” because this calculation would be replaced by the System Price for SBON Trades.

FICC is proposing to add the new defined term “Do Not Allocate” to define the process that would allow Clearing Members to offset Trade-for-Trade Transactions and/or SBON Trades with the same Par Amount, CUSIP Number and established date in the settlement cycle.

FICC is proposing to add the new defined term “Do Not Allocate Adjustment Payment” to define the cash differential that would result when Trade-for-Trade Transactions and/or SBON Trades are offset through the Do Not Allocate process.

FICC is proposing to amend the term “EPN Service” to clarify that this service would be used by Clearing Members to electronically communicate pool information to FICC in accordance with the MBSD Rules.

FICC is proposing to add the new defined term “Expanded Pool Net Transaction Adjustment Payment” to define the cash differential that would result from SBON Trades and Trade-for-Trade Transactions, as applicable, that would be included in the Expanded Pool Netting process.

FICC is proposing to add the new defined term “Expanded Pool Netting” to define the netting process that would occur for SBON Trades and Trade-for-Trade Transactions that have missed the cut-off time for the Pool Netting process.

FICC is proposing to add the new defined term “Factor Update Adjustment Payment” to define the cash differential that would result when an updated factor is released after Pool Deliver Obligations and Pool Receive Obligations have settled.

FICC is proposing to delete the term “Firm CUSIP Average Price” and “FCAP” because this calculation would be replaced by the System Price for SBON Trades.

FICC is proposing to add the new defined term “Guaranteed/Novated Obligations” to define FICC’s obligation to deliver or receive a Security satisfying TBA criteria and the payment related thereto.

FICC is proposing to delete the term “Notification of Settlement” because all SBO-Destined Trades, Trade-for-Trade Transactions and Specified Pool Trades would settle with FICC, thus the Notification of Settlement process would no longer be required.

FICC is proposing to amend the term “Novation” to mean the termination of deliver, receive and related payment obligations between Clearing Members and the replacement of such with obligations to deliver or receive a Security satisfying certain TBA criteria as determined by FICC and the payment obligations related thereto.

FICC is proposing to amend the term “Par Amount” to include a reference to “Stipulated Trades,” which would be a new trade type, and replace the term “SBO Transaction” with the term “SBON Trade.”

FICC is proposing to add the new defined term “Pool Settlement Position” to define either a Pool Receive Obligation or a Pool Deliver Obligation.

FICC is proposing to add the new defined term “SBO” to define the settlement balance orders that constitute the net positions of a Clearing Member as a result of the TBA Netting process. The resulting transactions from this TBA Netting process are identified as SBON Trades.

FICC is proposing to delete the term “SBO Contra-Side Member” because FICC would no longer direct Clearing Members to settle trades with other Clearing Members.

FICC is proposing to delete the term “SBO Market Differential” because this term defines the price for SBO-Destined Trades that are settled between other Clearing Members. As described above, FICC would no longer direct a Clearing Member to settle its SBO obligation with another Clearing Member. As a result, the calculation for determining the price would no longer be required.

FICC is proposing to delete the term “SBO Net-Out Position” because FICC would no longer offset a Clearing Member’s purchase and sale transactions with another Clearing Member.

FICC is proposing to delete the term “SBO Netted Position” because FICC would no longer offset a Clearing Member’s purchase and sale transactions with another Clearing Member.

FICC is proposing to amend the term “SBO Trade” to refer to SBON Trade. This would be defined as a trade that is settled directly with FICC.

FICC is proposing to delete the existing definition of “SBON Trade” because FICC would no longer direct a Clearing Member to settle with another Clearing Member. FICC has redefined this definition as referenced above.

FICC is proposing to delete the term “SBOO Trade” because this term refers to a trade that FICC directs a Clearing Member to settle with another Clearing Member.

FICC is proposing to amend the term “Settlement Price” to (1) include a reference to “Stipulated Trade,” which would be a new trade type, (2) define the System Price as the Settlement Price for SBON Trades and (3) remove the reference to SBOO Trades and the related calculation for such trades.

FICC is proposing to amend the term “Settlement Value” to include a reference to “Stipulated Trade,” which would be a new trade type. FICC is also proposing to amend this definition to eliminate the reference to SBOO Trade, which is a term that FICC is also proposing to delete from the MBSD Rules.

FICC is proposing to add the new defined term “Stipulated Trade” because it would be a new trade type that Clearing Members would be permitted to submit to MBSD.

FICC is proposing to add the new defined term “TBA” or “To-Be-Announced” to define a contract for the purchase or sale of a mortgage-backed security to be delivered at

an agreed-upon future date because as of the transaction date, the seller has not yet identified certain terms of the contract, such as the pool number and number of pools, to the buyer.

FICC is proposing to add the new defined term “TBA Reprice Transaction Adjustment Payment.” This term would provide FICC’s cash settlement calculation for the repricing of TBA Obligations that have not been allocated by the time established by FICC.

FICC is proposing to add the new defined term “TBA Transaction Adjustment Payment.” This term would provide FICC’s cash settlement calculation for SBO-Destined Trades.

FICC is proposing to amend the term “Trade-for-Trade Transaction” to state that this transaction type would be eligible for the Pool Netting system and the Expanded Pool Netting system.

FICC is proposing to add the new defined term “Variance Transaction Adjustment Payment.” This term would provide FICC’s cash settlement calculation for SIFMA’s permitted variances with respect to TBA Obligations.

## **2. *Proposed Changes to MBSD Rule 2 (Members)***

FICC is proposing to amend MBSD Rule 2 to delete the reference to “Broker Give-Up Trades” and replace it with “Brokered Transactions” because a Dealer’s identity would no longer be disclosed in the Reports that FICC makes available in connection with Brokered Transactions.



**3. *Proposed Changes to MBSD Rule 4 (Clearing Fund and Loss Allocation) Section 1 (General)***

FICC is proposing to amend this section to reflect that the term “Transactions” as used in MBSD Rule 4 would apply to Stipulated Trades.

**4. *Proposed Changes to MBSD Rule 5 (Trade Comparison)***

*Proposed Changes to MBSD Rule 5, Section 1 (General)*

FICC is proposing to amend this section to specify the obligations that would be guaranteed and novated at Trade Comparison.

*Proposed Changes to MBSD Rule 5, Section 2 (General Responsibilities of Members in the Trade Comparison System)*

FICC is proposing to delete a paragraph that requires Clearing Members to settle certain Transactions directly with their applicable settlement counterparties.

*Proposed Changes to MBSD Rule 5, Section 7 (Broker Give-Up Trades)*

FICC is proposing to delete this section in its entirety because the identities of Dealers to a Brokered Transaction would no longer be disclosed in the Reports issued by FICC.

*Proposed Changes to MBSD Rule 5, Section 8 (Binding Nature of Comparisons)*

FICC is proposing to include a reference to the “Open Commitment Report,” which is currently a report provided to Clearing Members.

*Proposed Changes to MBSD Rule 5, Section 9 (Cancellation and Modification of Trade Data by Members)*

FICC is proposing to amend this section to state that trade data would be submitted to FICC.

*Proposed Changes to MBSD Rule 5, Section 12 (Obligations)*

FICC is proposing to amend this section to state that settlement obligations between each buyer and seller, respectively, would be established with FICC in connection with SBO-Destined Trades, Trade-for-Trade Transactions, Specified Pool Trades and Stipulated Trades.

*Proposed Changes to MBSD Rule 5, Section 13 (Novation)*

FICC is proposing to amend this section to state the following: (1) FICC will guarantee and novate Specified Pool Trades, Stipulated Trades and Trade-for-Trade Transactions that meet the requirements of the MBSD Rules and have been entered into in good faith; (2) FICC will not novate Specified Pool Trades, Stipulated Trades or Trade-for-Trade Transactions that are partially compared; (3) To the extent a partially compared Specified Pool Trade, Stipulated Trade or Trade-for-Trade Transaction becomes Fully Compared, FICC will novate such trade; (4) At the time that a Specified Pool Trade, Stipulated Trade or Trade-for-Trade Transaction is novated to FICC, such trade shall cease to be bound by any bilateral agreement between the parties to the trade with respect to the deliver, receive and related payment obligations; however, if the trade becomes uncomparing or is cancelled, such trade shall be governed by the bilateral agreement that governs such trade prior to the novation.

**5. *Proposed Changes to MBSD Rule 6 (TBA Netting) Section 1 (Netting)***

FICC is proposing to amend this section to delete the provisions that state that FICC would direct Clearing Members to settle SBO Trades with their original counterparties or other Clearing Members. FICC is also deleting its calculation of the Settlement Price of such trades. FICC is proposing amend this section to state that (1)

TBA Netting would result in SBON Trades, (2) FICC would assign one or more SBON Trades to offset SBO Net Open Positions<sup>79</sup> and (3) the Settlement Price for SBON Trades would be the System Price.

**6. *Proposed Changes to MBSD Rule 7 (Pool Comparison)***

*Proposed Changes to MBSD Rule 7, Section 1 (Pool Comparison)*

FICC is proposing to amend this section to state that Clearing Members with Stipulated Trades would be required to allocate and submit Pool Instructs for Pool Comparison. FICC is also proposing to amend this section to state that Clearing Members would be required to notify FICC of their pool allocations to satisfy open TBA Obligations and Stipulated Trade obligations, and that FICC would submit pool details on behalf of Clearing Members that do not submit such pool details by the time established by FICC. Because FICC would submit such details on behalf of Clearing Members, FICC is proposing to eliminate the provision that provides that pool details not submitted by Clearing Members would be identified as uncomparing. FICC is also proposing to clarify that the data submitted by each contra-party would be submitted to the Corporation.

*Proposed Changes to MBSD Rule 7, Section 2 (Cancellation and Modification of Data by Clearing Members)*

In connection with a Clearing Member's request to cancel data, FICC is proposing to amend this section to state that data that has been submitted by a Clearing Member and affirmed by FICC would be deemed compared.

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<sup>79</sup> Pursuant to the MBSD Rules, the term "SBO Net Open Position" means any SBO-Destined Trade that cannot be offset pursuant to the MBSD Rules. See MBSD Rule 1, supra note 3.

*Proposed Changes to MBSD Rule 7, Section 3 (Do Not Allocate Process for TBA Obligations)*

FICC is proposing to include this new section to describe the Do Not Allocate process. This process would allow Clearing Members that have two or more Trade-for-Trade Transactions and/or SBON Trades with the same Par Amount, CUSIP Number and established date in the settlement cycle to offset such obligations against one another. This section would provide the process for initiating a Do Not Allocate request and the process for cancelling such request.

*Proposed Changes to MBSD Rule 7, Section 4 (Pool Settlement Positions for Stipulated Trades)*

FICC is proposing to include this new section to describe Pool Settlement Positions, allocation of Pool Deliver Obligations and Pool Receive Obligations, and the process for substitutions regarding Stipulated Trades

*Proposed Changes to MBSD Rule 7, Section 5 (Pool Deliver Obligations and Pool Receive Obligations for Specified Pool Trades)*

FICC is proposing to include this new section to describe the Pool Deliver Obligations and Pool Receive Obligations for Specified Pool Trades.

**7. *Proposed Changes to MBSD Rule 8 (Pool Netting System)***

*Proposed Changes to MBSD Rule 8, Section 2 (Eligibility for Pool Netting)*

FICC is proposing to refer to this section as “Section 2A” rather than “Section 2.” In addition, FICC is proposing to delete the provision that requires pools that are ineligible for the Pool Netting process to be settled bilaterally with their settlement counterparties.

*Proposed Changes to MBSD Rule 8, Section 2B (Eligibility for Expanded Pool Netting)*

FICC is proposing to amend Rule 8 to include new “Section 2B.” This section would establish a secondary pool netting process formally referred to as the Expanded Pool Netting process.

*Proposed Changes to MBSD Rule 8, Section 3 (Calculation of Pool Net Settlement Positions)*

FICC is proposing to amend this section to apply the calculation of Pool Net Settlement Positions to Eligible Securities processed by the Expanded Pool Netting process.

*Proposed Changes to MBSD Rule 8, Section 4 (Allocation of Pool Deliver and Pool Receive Obligations)*

FICC is proposing to amend this section to establish that Pool Deliver Obligations and Pool Receive Obligations would apply to Eligible Securities processed by the Expanded Pool Netting process.

*Proposed Changes to MBSD Rule 8, Section 6 (Novation of Obligations)*

FICC is proposing to amend this paragraph to state that novation would occur with respect to the Pool Deliver Obligations and Pool Receive Obligations.

*Proposed Changes to MBSD Rule 8, Section 7 (Obligation to Submit SBOO and SBON Trades to Pool Netting)*

FICC is proposing to delete the reference to “SBOO.” This term refers to SBO-Destined Trades that are settled between Clearing Members that are not original counterparties to such trades. This term would no longer be required because FICC is proposing to treat itself as the settlement counterparty to all SBO-Destined Trades. FICC is also proposing to amend this section to reflect that Trade-for-Trade Transactions would have to be submitted into the Pool Netting system.

**8. *Proposed Changes to MBSD Rule 10 (Notification of Settlement)***

FICC is proposing to delete this rule because all SBO-Destined Trades, Trade-for-Trade Transactions and Specified Pool Trades would settle with FICC. As a result, the Notification of Settlement process would no longer be required.

**9. *Proposed Changes to MBSD Rule 11 (Cash Settlement)***

FICC is proposing to delete the “SBO Market Differential” component and replace it with the term “TBA Transaction Adjustment Payment.” The term “SBO-Market Differential” calculates the price for SBO Trades originally among different counterparties as well as SBO Trades originally among the same counterparties. This calculation would be no longer required because all SBO Trades (referred to in proposed rules as “SBON Trades”) would settle with FICC as the settlement counterparty. As a result, FICC is proposing to replace the “SBO Market Differential” component and replace it with the term “Transaction Adjustment Payment.” This component would calculate an SBO-Destined Trade in an amount equal to the difference between such trade’s Settlement Price and System Price.

FICC is also proposing to add the following new components to the Cash Settlement calculation: (a) TBA Transaction Adjustment Payment, (b) Expanded Pool Net Transaction Adjustment Payment, (c) Do Not Allocate Transaction Adjustment Payment, (d) TBA Reprice Transaction Adjustment Payment, (e) Variance Transaction Adjustment Payment, and (f) Factor Update Adjustment Payment.

**10. *Proposed Changes to MBSD Rule 12 (Fails Charge)***

FICC is proposing to amend this section to state that Clearing Members would be responsible for a fails charge if FICC receives an allocation of TBA Obligations prior to the established deadline and is unable to transmit the notification until after such time.

**11. *Proposed Changes to MBSD Rule 17 (Procedures for When the Corporation Ceases to Act) Section 2 (Action by the Corporation – Close-Out Procedure)***

FICC is proposing to delete a provision that relates to the Notification of Settlement process. FICC is also proposing to amend certain provisions that are no longer necessary because FICC has specified the obligations that it novates in the proposed definition for the term “Guaranteed/Novated Obligations.”

**12. *Proposed Changes to MBSD Rule 17A (Corporation Default)***

FICC is proposing to delete the provision that establishes Novation for all Compared Trades. This provision is no longer necessary because SBO-Destined Trades, Specified Pool Trades, Stipulated Trades and Trade-for-Trade Transactions would occur at trade comparison.

**2. Statutory Basis**

Section 17A(b)(3)(F) of the Exchange Act requires, in part, that the rules of the clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions.<sup>80</sup>

FICC believes that the proposed change to novate Specified Pool Trades, Stipulated Trades, and Trade-for-Trade Transactions at trade comparison would promote

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<sup>80</sup> 15 U.S.C. 78q-1(b)(3)(F).

the prompt and accurate clearance and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act, because this change would provide Clearing Members with legal certainty early in the trading cycle that FICC would become the legal counterparty to each Clearing Member (i.e., FICC would become the buyer to every seller and the seller to every buyer) as set forth in the proposed rule change. The legal certainty would enable Clearing Members that submit such transactions to FICC to know early in the trade processing cycle that they have only one party (that is, FICC) with which to interact following trade comparison. FICC believes that this would, in turn, simplify processing for Clearing Members and thereby promote the prompt and accurate clearance and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act.<sup>81</sup>

FICC also believes that the proposed change to establish itself as the settlement counterparty to SBO-Destined Trades, Specified Pool Trades, Stipulated Trades, and Trade-for-Trade Transactions at trade comparison would promote the prompt and accurate clearance and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act because all such trades would settle directly with FICC. As such, the settlement of all such trades would be governed by the MBSD Rules (as opposed to potentially being subject to settlement mechanisms outside of FICC). FICC believes that this would streamline settlement processing because the MBSD Rules would govern all such processing and thereby promote the prompt and accurate clearance

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<sup>81</sup> Id.



and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act.<sup>82</sup>

FICC believes that the proposed rule changes associated with providing the operational efficiencies to Clearing Members noted in this filing would also promote the prompt and accurate clearance and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act. These proposed rule changes are as follows:

- (a) the submission of Pool Instructs by Clearing Members would become optional because FICC would be permitted to submit on behalf Clearing Members, (b) Clearing Members would no longer be required to fulfill Notification of Settlement obligations because all of the above-referenced transactions would settle with FICC, (c) Clearing Members would have the ability to exclude TBA Obligations from the pool allocation process, netting and securities settlement through the DNA process, (d) Clearing Members would have the ability to have their pools netted by the Expanded Pool Netting process in the event that such Clearing Members miss the established deadline for the initial Pool Netting process, (e) Dealer Netting Members would remain anonymous with the elimination of the “give-up” process for Brokered Transactions, (f) Clearing Members would be allowed to submit SBO-Destined Trades in all trade sizes, and (g) Clearing Members would be allowed to submit Stipulated Trades as a new trade type. All of these proposed changes would either eliminate operational steps on the part of Clearing Members (such as, for example, the elimination of the Notification of Settlement process where Clearing Members currently have required processing obligations) or would enable Clearing Members to take advantage of MBSB’s processing efficiencies (such as

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<sup>82</sup>

Id.

enabling Clearing Members to submit SBO-Destined Trades in all trade sizes). FICC believes that the elimination of operational steps on the part of Clearing Members and the provision of further opportunities for Clearing Members to take advantage of MBSD's processing would streamline MBSD processing as a whole for Clearing Members and further extend the benefits of MBSD's clearance and settlement services to Clearing Members, and would thereby promote the prompt and accurate clearance and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act.<sup>83</sup>

FICC believes that the proposed changes to the cash settlement components, which are necessitated from many of the proposed operational efficiencies discussed in this filing, would also promote the prompt and accurate clearance and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act. These changes would allow FICC to continue to remain in a cash neutral position – neither owing Clearing Members funds nor having a surplus of funds on FICC's books and records. By allowing FICC to remain flat with respect to cash settlement items, the proposed rule changes would maintain the efficiency of MBSD's cash settlement process, which is an automated system for the settlement of funds. As such, FICC believes that adding the proposed changes to its automated system for funds settlement would promote the prompt and accurate clearance and settlement of securities transactions as required by Section 17A(b)(3)(F) of the Exchange Act.<sup>84</sup>

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<sup>83</sup> Id.

<sup>84</sup> Id.

For these reasons, FICC believes that the proposed changes are consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to FICC, in particular Section 17A(b)(3)(F).<sup>85</sup>

(B) Clearing Agency's Statement on Burden on Competition

FICC does not believe that the proposed rule changes as described in this filing would impose any burden on competition that is not necessary or appropriate in furtherance of the Exchange Act.<sup>86</sup>

While the proposed rule changes would require Clearing Members to make technological changes and thereby incur costs in doing so and this could burden the Members competitively, the proposed rules changes have been structured to better meet the needs of Clearing Members. Specifically, the proposed rule changes would meet Clearing Members' needs by:

- novating Specified Pool Trades, Stipulated Trades, and Trade-for-Trade Transactions at trade comparison and thereby providing Clearing Members with legal certainty early in the trading cycle that FICC would become the legal counterparty to each Clearing Member (i.e., FICC would become the buyer to every seller and the seller to every buyer) for such trades,
- eliminating operational steps on the part of Clearing Members (such as making the submission of Pool Instructs by Clearing Members optional, eliminating the "give-up" process for Brokered Transactions, and eliminating the Notification of

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<sup>85</sup> Id.

<sup>86</sup> 15 U.S.C. 78q-1(b)(3)(I).

Settlement process and Clearing Member obligations related thereto) and thereby streamlining MBSB processing as a whole for Clearing Members,

- enabling Clearing Members to take advantage of MBSB's processing efficiencies (such as, providing Clearing Members with the ability to exclude TBA Obligations from the pool allocation process, netting and securities settlement through the DNA process, allowing Clearing Members to submit SBO-Destined Trades in all trade sizes, and allowing Clearing Members to submit Stipulated Trades as a new trade type) and thereby further extending the benefits of MBSB's clearance and settlement services to Clearing Members,
- structuring the proposed changes to the cash settlement process, which are necessitated from many of the proposed operational efficiencies discussed in this filing, in a manner that would maintain the efficiency of the automated nature of the MBSB cash settlement process by calculating debits and credits to Clearing Members as applicable (and as has been described in detail in this filing) and allowing FICC to remain flat with respect to applicable cash settlement items.

Moreover, FICC believes that the proposed rule changes are appropriate in that such changes reflect Clearing Members' feedback. Consequently, FICC believes that any burden on competition derived from the proposed rule changes would be necessary and appropriate in support of the beneficial objectives of the proposed rule changes, which would be made in furtherance of the Exchange Act, as described above.

Additionally, FICC believes that any such burden on competition derived from the proposed rule changes would not be significant because Clearing Members have requested these changes and were involved in developing the business requirements.

The proposed rule changes would result in the removal of the option for Clearing Members to settle trades bilaterally amongst themselves because, as has been described in detail in this filing, FICC would treat itself as the settlement counterparty to all eligible transactions (except Option Contracts). FICC does not believe that this would impose a burden on competition. Specifically, FICC believes that trades, whether they settle with FICC or another counterparty, must settle; FICC does not believe that settling with FICC imposes greater costs on Clearing Members than settling outside of FICC. Therefore, FICC does not believe that the proposal imposes a burden on competition that is not appropriate in furtherance of the Exchange Act because all Clearing Members need to settle their trades, and FICC believes that there is an absence of any significant costs associated with its proposal that Clearing Members settle all Transactions (other than Option Contracts) with FICC.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

FICC has not received or solicited any written comments relating to this proposal.

FICC will notify the Commission of any written comments received by FICC.

III. Date of Effectiveness of the Proposed Rule Change, and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Exchange 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](mailto:rule-comments@sec.gov). Please include File Number SR-FICC-2017-012 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-2017-012. 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 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 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-2017-012 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>87</sup>

Secretary

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<sup>87</sup> 17 CFR 200.30-3(a)(12).

**Bold and underlined text** indicates proposed added language

**~~Bold and strikethrough text~~** indicates proposed deleted language

**FIXED INCOME CLEARING CORPORATION**

**MORTGAGE-BACKED SECURITIES DIVISION**

**CLEARING RULES**



*Changes to this Rule, as amended by File No. SR-FICC-2017-012, are set forth below. These changes have been approved by the SEC, but are not yet effective. Bold and underlined text indicates added language. Bold and strikethrough text indicates deleted language. These changes will become effective [within 45 Business Days after date of the SEC's approval of SR-FICC-2017-012]. Once effective, this legend will automatically be removed from the Rules and the formatting of the text of the changes in this Rule will automatically be revised to reflect that these changes are effective.*

## 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.

\* \* \* \*

### **Broker Give-Up Date**

~~The term "Broker Give-Up Date" means the date on which Dealers for which a Broker has acted in a are substituted for the Broker.~~

### **Broker Give-Up Trade**

~~The term "Broker Give-Up Trade" means an SBO-Destined Trade, Trade-for-Trade Transaction or Option Contract in which a Broker acting on behalf of selling and purchasing Dealers temporarily is identified in the applicable Reports initially made available by the Corporation as the Original Contra-Side Member with respect to each Dealer, with the Dealers to be substituted on the Broker Give-Up Date.~~

### **Brokered Transaction**

The term "Brokered Transaction" means any **“give-up”** transaction calling for the delivery of an Eligible Security the data on which has been submitted to the Corporation by Members, to which transaction a Broker is a party.

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### **Contractual Settlement Date**

The term "Contractual Settlement Date" means, in the case of a Trade-for-Trade Transaction, Specified Pool Trade, SBO-Destined Trade, **Stipulated Trade**, SBON Trade and Pool Net Settlement Position, the settlement date mutually agreed to by the parties to the Transaction.

\* \* \* \*

### **CUSIP Average Price or CAP**

~~The term "CUSIP Average Price" or "CAP" means, in the case of any SBON Trade, the average Contract price as computed by the Corporation of all SBO-Destined Trades in the CUSIP number, as the case may be, that have been netted to produce the SBON Trade.~~

\* \* \* \*

### **DK**

The term "DK" means a statement submitted to the Corporation by a Member that the Member "does not know" (i.e., denies the existence of) a Transaction reported to the Member by the Corporation.

### **Do Not Allocate**

The term "Do Not Allocate" means the process by which Clearing Members that have two or more Trade-for-Trade Transactions and/or SBON Trades with the same Par Amount, CUSIP Number and established date in the settlement cycle, may offset such transactions against one another.

### **Do Not Allocate Transaction Adjustment Payment**

The term "Do Not Allocate Transaction Adjustment Payment" means the amount equal to the difference between the Settlement Price of the buy and sell TBA Obligation transactions multiplied by the contractual quantity. To differentiate between a buy and sell transaction, an indicator of -1 for a buy trade and +1 for a sell trade is multiplied by the contractual quantity of such trade.

### **DTC**

The term "DTC" means The Depository Trust Company.

\* \* \* \*

### **EPN Service**

The term "EPN Service" means the Corporation's electronic pool notification service that enables Clearing Members and EPN Users to electronically communicate pool information to other EPN Users or the Corporation, as described in these Rules or the Corporation's EPN Rules and EPN procedures.

\* \* \* \*

### **Exchange Act**

The term "Exchange Act" means the Securities Exchange Act of 1934, as amended.

### **Expanded Pool Net Transaction Adjustment Payment**

**The term “Expanded Pool Net Transaction Adjustment Payment” means the amount equal to the difference between the System Price and the SBON Trade’s Settlement Price or Trade-for-Trade Transaction’s Settlement Price, as applicable, multiplied by the total current face of the pools used to satisfy such obligation, then divided by 100. To differentiate between a buy and sell transaction, an indicator of +1 for a buy trade and -1 for a sell trade would be multiplied by the total current face of the pools used to satisfy the obligation.**

### **Expanded Pool Netting**

**The term “Expanded Pool Netting” means the netting process that captures pool allocations when a Clearing Member has missed the deadline established by the Corporation for the Pool Netting process.**

### **Factor Update Adjustment Payment**

**The term “Factor Update Adjustment Payment” means the amount equal to a factor update that adjusts the Settlement Value of Pool Deliver Obligations or Pool Receive Obligations, as applicable, that have settled.**

### **Fail**

The term "Fail" means a Transaction the clearance of which has not occurred or has not been reported to the Corporation as having occurred on the Contractual Settlement Date, or expiration date, as applicable.

\* \* \* \*

### **~~Firm CUSIP Average Price (FCAP)~~**

~~**The term "Firm CUSIP Average Price" or "FCAP" means the average purchase or sale Contract price of a Member's SBO-Destined Trades with a particular Original Contra-Side Member in a particular CUSIP number.**~~

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### **Government Securities Issuer Clearing Member**

The term "Government Securities Issuer Clearing Member" shall have the meaning given that term in Section 1 of Rule 2A.

### **Guaranteed/Novated Obligations**

**The term “Guaranteed/Novated Obligations” means obligations to deliver or receive a Security satisfying certain TBA criteria determined by the Corporation and the payment obligations related thereto.**

## **Holiday**

The term "Holiday" means, with respect to the Holiday Charge, any day on which the Corporation is closed, but the day is not observed as a holiday by the Securities Industry and Financial Markets Association and the bond markets are open.

\* \* \* \*

## **Notification of Settlement**

~~The term "Notification of Settlement" means an instruction submitted to the Corporation by a purchasing or selling Clearing Member pursuant to these Rules reflecting settlement of an SBO Trade, Trade-for-Trade Transaction or Specified Pool Trade.~~

## **Novation**

The term "Novation" means the termination of deliver, receive and related payment obligations between Members and the replacement of such obligations with **identical obligations** the Guaranteed/Novated Obligations to and from the Corporation, pursuant to these Rules.

\* \* \* \*

## **Par Amount**

The term "Par Amount" means, for Trade-for-Trade Transactions, Stipulated Trades and SBON Trades~~Transactions~~, Option Contracts and Pool Deliver and Pool Receive Obligations, the current face value of a Security to be delivered on the Contractual Settlement Date. With respect to Specified Pool Trades, "Par Amount" shall mean the original face value of a Security to be delivered on the Contractual Settlement Date.

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## **Pool Receive Obligation**

The term "Pool Receive Obligation" means a Clearing Member's obligation to receive Eligible Securities from the Corporation at the appropriate Settlement Value either in satisfaction of all or part of a Pool Net Long Position.

## **Pool Settlement Position**

The term "Pool Settlement Position" means either a Pool Receive Obligation or a Pool Deliver Obligation, as the context requires.

## **Purchase and Sale Report**

The term "Purchase and Sale Report" means the Report furnished by the Corporation reflecting a Member's Compared Trades in Eligible Securities.

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## **Rules**

The term "Rules" means these Rules of the Mortgage-Backed Securities Division.

## **SBO**

**The term "SBO" means the settlement balance orders that constitute the net positions of a Clearing Member as a result of the TBA Netting process. The resulting transactions from this TBA Netting process are identified as SBON Trades.**

## **~~SBO Contra-Side Member~~**

~~The term "SBO Contra-Side Member" means the Member with whom a Member is directed by the Corporation to settle an SBO Trade. An "SBON Contra-Side Member" is an SBO Contra-Side Member that is not an Original Contra-Side Member with respect to such SBO Trade. An "SBOO Contra-Side Member" is an SBO Contra-Side Member that is also an Original Contra-Side Member with respect to such SBO Trade.~~

## **SBO-Destined Trade**

The term "SBO-Destined Trade" means a TBA transaction in the Clearing System intended for TBA Netting in accordance with the provisions of these Rules.

## **~~SBO Market Differential~~**

~~The term "SBO Market Differential" means the amount computed pursuant to these Rules, reflecting the difference between Firm CUSIP Average Prices (in the case of an SBO Netted or SBO Net-Out Position) or between the CUSIP Average Price and the Firm CUSIP Average Price (in the case of an SBON Trade).~~

## **SBO Net Open Position**

The term "SBO Net Open Position" means any SBO-Destined Trade that cannot be offset pursuant to these Rules.

### **SBO Net-Out Position**

~~The term "SBO Net-Out Position" means the result of offsetting purchase and sale SBO-Destined Trades originally among different Original Contra-Side Members pursuant to these Rules.~~

### **SBO Netted Position**

~~The term "SBO Netted Position" means the result of offsetting purchase and sale SBO-Destined Trades originally between the same Original Contra-Side Members pursuant to these Rules.~~

### **SBON Trade**

The term "SBON Trade" means a settlement balance order that offsets an SBO Net Open Position pursuant to these Rules. A Member which has one or more "Long SBON Trades" in a particular CUSIP number is a net purchaser with respect to that CUSIP number, as the case may be; a Member which has one or more "Short SBON Trades" is a net seller. ~~An SBO Trade may be either an SBON Trade or an SBOO Trade.~~ SBON Trades settle directly with the Corporation.

### **SBON Trade**

~~The term "SBON Trade" means an SBO Trade which a Member is directed by the Corporation to settle with an SBON Contra-Side Member.~~

### **SBOO Trade**

~~The term "SBOO Trade" means an SBO Trade which a Member is directed by the Corporation to settle with an SBOO Contra-Side Member.~~

\* \* \* \*

### **Settlement Price**

The term "Settlement Price" means (a) in the case of a Trade-for-Trade Transaction, Specified Pool Trade, Stipulated Trade or SBO-Destined Trade, the Contractual settlement price agreed to by the parties; (b) in the case of an SBON Trade, the System CUSIP Average Price; and (c) ~~in the case of an SBOO Trade, the Firm CUSIP Average Price, and~~ (d) in the case of a Pool Deliver or Pool Receive Obligation, the Pool Net Price.

### **Settlement Value**

The term "Settlement Value" means the amount in dollars equal to the Par Amount of each Eligible Security that comprises a Trade-for-Trade Transaction, a Specified Pool Trade, an SBO-Destined Trade, a Stipulated Trade, an SBOO Trade, an SBON Trade, a Pool Deliver Obligation, a Pool Receive Obligation, multiplied by the Settlement Price

plus interest that has accrued with regard to each such Eligible Security up to the Business Day for which such dollar amount is calculated.

\* \* \* \*

### **Statutory Disqualification**

The term "Statutory Disqualification" shall have the meaning given that term in Section 3(a)(39) of the Exchange Act.

### **Stipulated Trade**

**The term "Stipulated Trade" means a trade in which allocated pools on the Contractual Settlement Date must satisfy certain trade parameters that are agreed upon by Clearing Members at the time of execution.**

### **Strike Price**

The term "Strike Price" means the price at which an option granted pursuant to an Option Contract may be exercised.

\* \* \* \*

### **TBA or To-Be-Announced**

**The term "TBA" or "To-Be-Announced" means a contract for the purchase or sale of a mortgage-backed security to be delivered at an agreed-upon future date because as of the transaction date, the seller has not yet identified certain terms of the contract, such as the pool number and number of pools, to the buyer.**

### **TBA Obligations**

The term "TBA Obligations" means SBO-Destined obligations and, with respect to Trade-for-Trade Transactions, settlement obligations generated by the Trade Comparison system.

### **TBA Reprice Transaction Adjustment Payment**

**The term "TBA Reprice Transaction Adjustment Payment" means the amount equal to the difference between the TBA Obligation's Settlement Price and the System Price, multiplied by the unallocated contractual quantity, and then divided by 100. To differentiate between a buy and sell transaction, an indicator of -1 for a sell trade and +1 for a buy trade is multiplied by the unallocated pool's contractual quantity.**

### **TBA Transaction Adjustment Payment**

**The term “TBA Transaction Adjustment Payment” means the amount equal to the difference between the SBO-Destined Trade’s Settlement Price and the System Price, multiplied by the contractual quantity of such trade, and then divided by 100. To differentiate between the buyer and seller of the transaction, an indicator of -1 for the buy trade and +1 for the sell trade is multiplied by the contractual quantity of such trade.**

### **Tier One Member**

The term “Tier One Member” means a Clearing Member whose membership category has been designated as such by the Corporation pursuant to Rule 2A for loss allocation purposes.

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### **Trade-for-Trade Transaction**

The term "Trade-for-Trade Transaction" means a TBA Transaction submitted to the Corporation ~~not~~ intended for **Pool Netting and Expanded Pool Netting, but not intended for** TBA Netting in accordance with the provisions of these Rules.

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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 of a Member, as of the time of such calculation (with respect to the specified net unsettled positions 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 Exchange Act. Such calculation shall be made utilizing such assumptions (including confidence levels) and based on such historical data as the Corporation deems reasonable, and shall cover such range of historical volatility as the Corporation from time to time deems appropriate. To the extent that the primary source of such historical data becomes unavailable for an extended period of time, the Corporation shall utilize an alternative volatility calculation. If the volatility calculation is lower than 5 basis points of the market value of a Clearing Member’s gross unsettled positions (the “VaR Floor”) then the VaR Floor will be utilized as such Clearing Member’s VaR Charge.

### **Variance Transaction Adjustment Payment**

**The term “Variance Transaction Adjustment Payment” means the amount equal to the difference between the SBON Trade’s Settlement Price or the Trade-for-Trade Transaction’s Settlement Price, as applicable, and the System Price, multiplied by the difference between the TBA Obligation and the allocated pools used in**



**satisfaction of such trade, and then divided by 100. To differentiate between a buy and sell transaction, an indicator of -1 for a buy trade and +1 for a sell trade would be multiplied by the total variance amount.**

### **Watch List**

The term “Watch List” refers to the list of Members being more closely monitored by the Corporation for any reason deemed necessary by the Corporation.

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RULE 2 – MEMBERS

(a) The Corporation may make its services, or certain of its services, available to Persons which (i) apply for membership to the Corporation for the use of its services, (ii) meet the qualifications specified in these Rules, (iii) are approved by the Board, as applicable, and (iv) if required, have contributed to the Clearing Fund as provided in Rule 4.

(b) The Corporation shall have the following membership types:

(i) Clearing Members

(ii) Cash Settling Bank Members

With respect to item (ii) above, Cash Settling Bank Members shall be governed by Rule 3A.

(c) Only Members shall be entitled to settle Contracts or other Transactions through the Corporation. Except for Brokers effecting Brokered Transactions ~~Broker Give-Up Trades~~ which have Fully Compared, a Member which processes, compares, settles or carries out through the Clearing System any Contract or other Transaction for another Member, or a partnership, corporation or other organization, entity or person who is not a Member (hereinafter a non-Member), shall, so far as the rights of the Corporation and of other Members are concerned, be liable as principal. A non-Member who processes, compares, settles or carries out Contracts or Transactions through a Member shall not possess any of the rights or benefits of a Member.

(d) All Clearing Members are required to be members of the Corporation's EPN Service.

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#### RULE 4 – CLEARING FUND AND LOSS ALLOCATION

##### Section 1 – General

Each Clearing Member shall make, and maintain so long as such Member is a Clearing Member, a deposit to the Clearing Fund at no less than the minimum required level set forth in this Rule (the "Required Fund Deposit"). Deposits to the Clearing Fund shall be held by the Corporation or its designated agents to be applied as provided in this Rule. The timing of payment of the Required Fund Deposit shall be determined in accordance with the provisions of Section 8 of this Rule. The term "Transactions" as used in this Rule 4 includes Pool Receive Obligations, Pool Deliver Obligations, TBA Obligations, ~~and~~ Specified Pool Trades **and Stipulated Trades**.

If a Member's Required Fund Deposit is charged as a result of a Clearing Fund loss solely attributable to that Member such Member shall promptly replenish the deficit in its Required Fund Deposit.

\* \* \* \*

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## RULE 5 – TRADE COMPARISON

### Section 1 – General

Trade comparison, which consists of the reporting, validating, and matching by the Corporation of the long and short sides of a Transaction to ensure that the details of such trades are in agreement between the parties, is the first step in the clearance and settlement process for these Transactions.

Trade data may be entered via any means permitted by the Corporation, and must include such identifying detail as the Corporation may require. As trade data are submitted to the Corporation, the Corporation shall generate output indicating that such trade data: (1) is compared, (2) is uncomparing, and/or (3) has been deleted from the Trade Comparison system.

The Corporation shall guarantee the settlement of ~~the~~ **Guaranteed/Novated Obligations** ~~the data on~~ which were submitted for Trade Comparison at the time at which the comparison of such trade occurs pursuant to Section 11 of this Rule, as long as the trade meets the requirements of these Rules and was entered into in good faith. This guaranty shall no longer be in effect if the Transaction becomes uncomparing, is cancelled, or settles pursuant to these Rules.

### Section 2 – General Responsibilities of Members in the Trade Comparison System

Trade data submitted to the Corporation by a Clearing Member shall be submitted in the form and manner, and in accordance with the time schedules, prescribed by, or pursuant to, these Rules or otherwise set forth by the Corporation from time to time.

The symbol corresponding to the name of a Clearing Member printed, stamped or written on any form, document or other item issued by it pursuant to this Rule shall be deemed to have been adopted by it as its signature and shall be valid and binding upon it in all respects as though it had manually affixed its signature to such form, document or other item.

Each Clearing Member shall promptly review each Report it receives from the Corporation pursuant to this Rule. Any errors, omissions, or similar problems noted by a Clearing Member with respect to a Report must be promptly reported to the Corporation.

~~Any Transactions the data on which are submitted to the Corporation by a Clearing Member pursuant to these Rules which are not novated pursuant to Section 13 of this Rule and not netted and novated through the Pool Netting system pursuant to Rule 8 shall be settled directly between the Members. Any Transaction that is novated pursuant to Section~~

~~13 of this Rule and not thereafter netted through the Pool Netting system pursuant to Rule 8 shall be settled on behalf of the Corporation between Clearing Members that are parties to offsetting Transactions with the Corporation (i.e., the Transaction shall settle between each Clearing Member and its SBO Contra-Side Member).~~

\* \* \* \*

Section 7 – ~~Broker Give-Up Trades~~ [RESERVED]

~~Any Broker identified in any Fully Compared Transaction as the Original Contra-Side Member with respect to both selling and purchasing Dealers will be deleted from the records of the Corporation and the Dealers will be substituted (i.e., "given up") as the Original Contra-Side Members after a period elected by the Broker or prescribed by the Corporation from time to time, but in any event (a) in the case of SBO-Destined Trades, prior to TBA netting, and (b) in the case of Trade-for-Trade Transactions prior to the Contractual Settlement Date.~~

Section 8 – Binding Nature of Comparisons

Comparisons generated by the Corporation through the Trade Comparison system shall constitute the trade comparison for all trades in Eligible Securities for which Clearing Members have submitted data and which the Corporation has identified as Compared Trades. Each comparison generated by the Corporation as to any Compared Trade as reported by the **Open Commitment Report**, RTTM Compare Report, the RTTM Purchase and Sale Report and the Purchase and Sale Report (to the extent information is not contained in the RTTM Purchase and Sale Report) shall each constitute the confirmation of the Transaction information contained therein and shall evidence a valid, binding and enforceable Contract in respect of such Compared Trade. Any confirmations, comparison or other documentary evidence of any such Compared Trade, other than the comparison generated by the Corporation, shall not affect the existence or terms and conditions of such a valid, binding and enforceable Contract in respect of such Compared Trade and the Corporation shall be entitled to rely upon such Reports for all purposes under the Rules.

In case of a Fully Compared or Partially Compared transaction involving a Broker, each Dealer as to which the Transaction has compared shall be bound by such Contract. In the case of a Partially Compared Transaction involving a Broker, unless the Dealer as to which the Transaction has not compared submits a DK of the Transaction in accordance with these Rules, such Dealer shall be responsible for Clearing Fund deposits with respect to such Transaction and may be responsible for such Transaction in accordance with Section 2 of Rule 17 “Procedures For When the Corporation Ceases to Act.”

If trade input with respect to a Transaction in Eligible Securities involving a Broker has not compared or has Partially Compared, the Dealer(s) for which trade input has not compared will be furnished a Report noting such uncomparing or Partially Compared Transaction. The Dealer may then either affirm the Transaction or submit a DK of the Transaction as described in Section 9 of this Rule 4. Unless the Dealer receiving the Unmatched Margin Report submits a DK of such transaction in accordance with the Corporation’s procedures, the Total Required

Fund Deposit shall be payable by the Dealer with respect to such Transaction pursuant to these Rules, the same as if such transaction had been listed in such Dealer's Open Commitment Report.

#### Section 9 – Cancellation and Modification of Trade Data by Members

If the Clearing Member determines that a transaction has not taken place, the Clearing Member shall (a) delete any trade input information previously submitted by it in error or (b) if the Clearing Member did not previously submit trade input information, submit a DK of such transaction. If the Clearing Member determines that the transaction has taken place, the Clearing Member shall affirm the transaction, correct trade input or settlement information previously submitted in error, or submit trade input information not previously submitted. If a transaction is compared, it will thereafter be reflected in a Report transmitted by the Corporation to the Clearing Member.

A Clearing Member that has submitted to the Corporation trade data that have not been compared may cancel or DK such data by providing appropriate instructions to the Corporation, pursuant to the communication links, formats, timeframes, and deadlines established by the Corporation for such purpose. Trade data that has been submitted ~~against a~~ to the Corporation Clearing Member that the Clearing Member affirms will be deemed compared.

Trade data submitted for Trade Comparison that have been compared may be cancelled from the Trade Comparison system upon receipt by the Corporation of appropriate instructions, submitted pursuant to the communication links, formats, timeframes, and deadlines established by the Corporation for such purpose, from both Clearing Members that submitted data on the trade.

#### Section 10 – Modification of Trade Data by the Corporation

The Corporation may unilaterally modify trade data submitted by Members if the Corporation becomes aware of any changes to the transaction which invalidate the original terms upon which it was submitted or compared.

#### Section 11 – Timing of Comparison

The comparison of trade data submitted to the Corporation for Trade Comparison shall be deemed to have occurred at the point in time at which the Corporation issues an output to the Clearing Members on both sides of the transaction indicating that such trade data have been compared.

#### Section 12 – Obligations

Trade data submitted for comparison through the Trade Comparison system will, once matched, constitute settlement obligations, between each of the buying and selling counterparties and the Corporation, respectively, with respect to SBO-Destined Trades, Trade-for-Trade Transactions, and Specified Pool Trades and Stipulated Trades.

Settlement obligations with respect to trade data submitted for TBA trades that are SBO-Destined Trades shall be established at the time at which the Corporation has both completed its

SBO-processing for the preparation of such Reports and has released such Reports to the Corporation's data output facility or facilities, unless the Corporation has notified such Clearing Member on such Business Day of a delay in the Corporation's making available such Reports or output to the Member.

Section 13 – Novation

(a) Each SBO-Destined Trade, **Specified Pool Trade, Stipulated Trade or Trade-for-Trade Transaction, as applicable**, that meets the requirements of these Rules and was entered into in good faith shall be novated to the Corporation and the Corporation shall guarantee the settlement of **the Guaranteed/Novated Obligations of** each such Trade at the time at which comparison of such Trade occurs pursuant to Section 11 of this Rule. Such Novation shall consist of the termination of the deliver, receive and related payment obligations between the Clearing Members with respect to the SBO-Destined Trade, **Specified Pool Trade, Stipulated Trade or Trade-for-Trade Transaction, as applicable**, and their replacement with **the Guaranteed/Novation Obligations** ~~identical obligations~~ to and from the Corporation in accordance with these Rules.

(b) Notwithstanding subsection (a) of this Section 13, an SBO-Destined Trade, **Specified Pool Trade, Stipulated Trade or Trade-for-Trade Transaction, as applicable**, that is Partially Compared shall not be novated to the Corporation. At such time as any SBO-Destined Trade, **Specified Pool Trade, Stipulated Trade or Trade-for-Trade Transaction, as applicable**, that is Partially Compared becomes Fully Compared, such Fully Compared SBO-Destined Trade, **Specified Pool Trade, Stipulated Trade or Trade-for-Trade Transaction** shall be novated to the Corporation and the Corporation shall guarantee the settlement of **the Guaranteed/Novated Obligations for** each such Fully Compared SBO-Destined Trade, **Specified Pool Trade, Stipulated Trade or Trade-for-Trade Transaction**. Such Novation shall consist of the termination of the deliver, receive and related payment obligations between the Clearing Members with respect to the Fully Compared SBO-Destined Trade, **Specified Pool Trade, Stipulated Trade or Trade-for-Trade Transaction, as applicable**, and their replacement with ~~identical obligations~~ **the Guaranteed/Novated Obligations** to and from the Corporation in accordance with these Rules.

(c) If a trade becomes uncomparing or is cancelled pursuant to these Rules, the Novation of such transaction shall be reversed, cancelling the deliver, receive, and related payment obligations between the Corporation and the applicable Clearing Members created by such Novation.

(d) At the time an SBO-Destined Trade, **Specified Pool Trade, Stipulated Trade or Trade-for-Trade Transaction, as applicable**, is novated to the Corporation, such SBO-Destined Trade, **Specified Pool Trade, Stipulated Trade or Trade-for-Trade Transaction** shall cease to be bound by any bilateral agreement between the parties to such SBO-Destined Trade, **Specified Pool Trade, Stipulated Trade or Trade-for-Trade Transaction** with respect to the delivery, receive and related payment obligations. If an SBO-Destined Trade, **Specified Pool Trade, Stipulated Trade or Trade-for-Trade Transaction** becomes uncomparing or is cancelled pursuant to these Rules, such trade shall be

governed by the same bilateral agreement that governed the trade before it was novated to the Corporation.

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## RULE 6 – TBA NETTING

### Section 1 – Netting

Each Clearing Member's SBO-Destined Trades in each Account in the TBA Netting system (other than SBO-Destined Trades that have been converted to Trade-for-Trade Transactions as provided in this Rule) shall be netted by CUSIP number on a monthly basis ~~in the following manner:~~. **The TBA Netting system will generate SBON Trades. The Settlement Price of an SBON Trade shall be the System Price.**

~~(a) — The Corporation shall offset a Clearing Member's purchase and sale Transactions that had the same Original Contra-Side Member (SBO Netted Positions). The SBO Contra-Side Member for an SBO Netted Position shall be the Original Contra-Side Member.~~

~~(b) — To the extent that any purchase or sale Transactions cannot be offset as described in subsection (a) above, the Corporation shall offset the Clearing Member's purchase and sale Transactions that had any of its Original Contra-Side Members (SBO Net-Out Positions).~~

~~(c) — To the extent that any of the Clearing Member's purchase or sale Transactions cannot be offset as described in subsections (a) and (b) above (SBO Net Open Positions), the Corporation shall assign the Clearing Member one or more SBON Trades offsetting such SBO Net Open Positions. To the maximum extent practicable, the Clearing Member's SBO Contra-Side Members shall be one or more of its Original Contra-Side Members. Any remaining SBO Trades shall be SBON Trades and shall have as SBO Contra-Side Members one or more other Members who are non-Original Contra-Side Members.~~

~~The Settlement Price of an SBO Trade shall be the Firm CUSIP Average Price (FCAP), representing the average purchase or sale Contract price of the Member's SBO-Destined Trades with the Original Contra-Side Member in the TBA CUSIP as determined in accordance with this Rule 6. The Settlement Price of an SBON Trade shall be the CUSIP Average Price (CAP), representing the average Contract price as computed by the Corporation of all SBO-Destined Trades in the TBA CUSIP that have been netted to produce the SBON Trade.~~

Prior to netting as described in this Rule, any SBO-Destined Trade that remains Partially Compared shall be converted to a Trade-for-Trade Transaction.



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## RULE 7 – POOL COMPARISON AND OBLIGATIONS

### Section 1 – Pool Allocation and the Pool Comparison System

The Pool Comparison system is a system for comparing pools that have been allocated in satisfaction of open TBA Obligations. Clearing Members are required to notify the Corporation of the pools that will be allocated ~~allocating pools~~ to satisfy open TBA Obligations and open Stipulated Trade obligations recorded in the Clearing System. Clearing Members with TBA Obligations and Stipulated Trade obligations are also required to submit pool details to the Corporation. Pool details for Stipulated Trade obligations are required in order for Pool Settlement Positions to be established pursuant to Section 4 below. Pool details for TBA Obligations are required in order for such pools to be processed through the Pool Netting system pursuant to Rule 8. In the event that a Clearing Member does not submit pool details by the deadline established by the Corporation, the Corporation will submit such pool details on behalf of the Clearing Member.

In order for the Corporation to process data for Pool Comparison, the Corporation must receive data from the long and short sides of the allocated pool submission in the format and within the timeframes specified in guidelines issued by the Corporation from time to time. For a Pool Comparison to be generated by the Corporation, there must be an exact match of all required match data submitted by each contra-party as required by the Corporation's procedures. Notwithstanding the previous sentence, if the price submitted by ~~the settlement counterparties~~ each contraside to the Corporation matches within the tolerance of decimal places specified by the Corporation in its procedures, but does not match beyond such decimal place, the Corporation shall apply the Settlement Price.

~~Items identified as uncomparing by the Corporation reflect pool data submitted by a Clearing Member for which the counterparty Clearing Member either did not submit data or did not submit data which matched in all respects, except as otherwise provided in these Rules. Comparison requested (advisory) data represents trades submitted by a Clearing Member against its counterparty.~~

### Section 2 – Cancellation and Modification of Data by Clearing Members

A Clearing Member that has submitted to the Corporation data for Pool Comparison that have not been compared may modify, cancel or DK such data by providing appropriate instructions to the Corporation, pursuant to the communication links, formats, timeframes, and deadlines established by the Corporation for such purpose. Pool data submitted by ~~against~~ a

Clearing Member that is affirmed by the Corporation ~~Clearing Member~~ will be deemed compared.

Data submitted for Pool Comparison that have been compared may be cancelled from the Pool Comparison system, by either the selling or buying Original Contra-Side Member, upon receipt by the Corporation of appropriate instructions, submitted pursuant to the communication links, formats, timeframes, and deadlines established by the Corporation for such purpose.

### **Section 3 – Do Not Allocate Process for TBA Obligations**

**A Clearing Member may request that the Corporation offset two or more TBA Obligations with the same Par Amount, CUSIP Number and established date in the settlement cycle. Such Clearing Member shall submit this request by providing appropriate instructions to the Corporation in accordance with the communication links, formats, timeframes, and deadlines established by the Corporation for such purpose. Upon the Corporation's receipt and verification of this request, the Clearing Member's designated TBA Obligations will be offset and such Clearing Member's number of open TBA Obligations will be reduced.**

**If a Clearing Member determines that it would like to cancel its request to have its TBA Obligations offset through the Do Not Allocate process, the Clearing Member shall submit a cancellation request by providing appropriate instructions to the Corporation pursuant to the communication links, formats, timeframes, and deadlines established by the Corporation for such purpose. Upon the Corporation's acceptance of the cancellation request, such Clearing Member would be required to allocate pools in accordance with this Rule to the previously designated TBA Obligations.**

### **Section 4 – Pool Settlement Positions for Stipulated Trades**

(a) **Pool Settlement Positions**

**On each Business Day, for each Eligible Security, the Corporation will establish a Pool Settlement Position for eligible pools of a Clearing Member with the same Delivery Date and Contractual Settlement Date. All Pool Settlement Positions shall be reported by CUSIP Number by the Corporation in a Report issued and made available each Business Day to each Clearing Member.**

(b) **Allocation of Pool Deliver Obligations and Pool Receive Obligations**

**On each Business Day, for Eligible Securities, the Corporation will establish Pool Deliver Obligations and Pool Receive Obligations based on the pool information transmitted from the Clearing Members to the Corporation. Each Pool Deliver Obligation and each Pool Receive Obligation of a Clearing Member shall be listed in the Report that will be issued on each Business Day to each Clearing Member.**

(c) **Substitutions**

**With regard to any Pool Deliver Obligation, a Clearing Member may substitute the underlying pool that comprises such Pool Settlement Position by providing appropriate instructions to the Corporation pursuant to the communication links, formats, timeframes, and deadlines established by the Corporation for such purpose. Members with a Pool Receive Obligation that has been substituted are required to accept the substituted pools from the Corporation in accordance with the Corporation's procedures.**

(d) **Termination of Guaranteed/Novated Obligations and Replacement with Pool Deliver Obligations and Pool Receive Obligations**

**Pool Settlement Positions and resultant Pool Deliver Obligations and Pool Receive Obligations of a Clearing Member, either as originally established by the Corporation or as may be adjusted by the Corporation as the result of a correction of compared data made pursuant to these Rules, shall be fixed at the time the Report of such positions and obligations is made available by the Corporation to the Member. At that time, the related Guaranteed/Novated Obligations between such Clearing Member and the Corporation are terminated and replaced by the Pool Deliver Obligations, Pool Receive Obligations and related payment obligations listed in the Report.**

**Section 5 – Pool Deliver Obligations and Pool Receive Obligations for Specified Pool Trades**

**The Corporation will establish Pool Deliver Obligations and Pool Receive Obligations for Specified Pool Trades. Such obligations shall be consistent with the trade data that the Clearing Member has submitted to the Corporation. Obligations shall be established on the Business Day prior to the Delivery Date.**

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## RULE 8- POOL NETTING AND EXPANDED POOL NETTING SYSTEMS

### Section 1– General

Pool Netting is a system for aggregating and matching offsetting allocated pools submitted by Clearing Members to satisfy: (i) settlement obligations associated with Trade-for-Trade Transactions and (ii) settlement obligations resulting from the TBA Netting system.

Each Business Day, the Corporation will calculate and report to each Clearing Member each Pool Net Settlement Position of such Member. With respect to each such Pool Net Settlement Position, the Corporation will report to the Member the extent to which the Member is obligated to deliver Eligible Securities to the Corporation and/or to receive Eligible Securities from the Corporation in accordance with each such Pool Net Settlement Position.

### Section 2A – Eligibility for Pool Netting

A pool is eligible for Pool Netting if it meets all of the following requirements:

- (a) the pool has been compared by the Corporation pursuant to Rule 7;
- (b) the pool is assigned to a TBA Obligation generated pursuant to these Rules; and
- (c) the pool meets the criteria set forth in the Corporation's procedures for inclusion in Pool Netting.

\_\_\_\_ Notwithstanding the foregoing, the Corporation may, in its sole discretion, exclude any pools from the Pool Netting system by Clearing Member or by pool. ~~**Pools not meeting the eligibility requirements for Pool Netting are required to be settled bilaterally with the settlement counterparties and are subject to the requirements of Rule 10 with respect to Notification of Settlement.**~~

### Section 2B – Eligibility for Expanded Pool Netting

**A pool that is not allocated by the deadline established by the Corporation for Pool Netting shall be included in the Expanded Pool Netting process. The Expanded Pool Netting process will occur on each Business Day prior to the established settlement date (“Exp Day”).**

### Section 3 – Calculation of Pool Net Settlement Positions

On each Business Day, for each Eligible Security in the Pool Netting system, **and on each ExP Day, for each Eligible Security in the Expanded Pool Netting system,** the Corporation will establish a Pool Net Settlement Position for eligible pools of a Clearing Member with the same Delivery Date and Contractual Settlement Date, comparing the aggregate Par Amount of each long obligation in an Eligible Security by the Clearing Member (hereinafter, the “Long Total”) and each short obligation in an Eligible Security by the Clearing Member (hereinafter, the “Short Total”). If the Long Total exceeds the Short Total, the resulting difference will constitute the Pool Net Long Position. If the Short Total exceeds the Long Total, the resulting difference will constitute the Pool Net Short Position. All Pool Net Settlement Positions shall be reported by CUSIP Number by the Corporation in a Report issued and made available each Business Day **or each ExP Day, as applicable,** to each Clearing Member.

### Section 4 - Allocation of Pool Deliver and Pool Receive Obligations

On each Business Day, **for Eligible Securities processed by Pool Netting, and on each ExP Day, for Eligible Securities processed by Expanded Pool Netting,** the Corporation will establish Pool Deliver Obligations and Pool Receive Obligations as necessary to accomplish the settlement of Pool Net Settlement Positions. Pool Deliver Obligations and Pool Receive Obligations shall be allocated by the Corporation on an equitable basis to Clearing Members with corresponding Pool Receive Obligations and Pool Deliver Obligations that involve Eligible Securities with the same CUSIP Number. A single Pool Net Settlement Position may result in the establishment of more than one Pool Deliver Obligation or Pool Receive Obligation in an Eligible Security. Each Pool Deliver Obligation and each Pool Receive Obligation of a Clearing Member shall be listed in the Report that will be issued on each Business Day to each Clearing Member.

### Section 5 – Substitutions

With regard to any Pool Deliver Obligation, a Clearing Member may substitute the underlying pool that comprises such Pool Net Settlement Position by providing appropriate instructions to the Corporation, pursuant to the communication links, formats, timeframes, and deadlines established by the Corporation for such purpose. Members with a Pool Receive Obligation that has been substituted are required to accept the substituted pools from the Corporation in accordance with the Corporation’s procedures.

### Section 6 – Termination of Guaranteed/Novated Obligations and Replacement with Pool Deliver Obligations and Pool Receive Obligations ~~Novation of Obligations~~

Pool Net Settlement Positions and resultant Pool Deliver Obligations and Pool Receive Obligations of a Clearing Member, either as originally established by the Corporation or as may be adjusted by the Corporation as the result of a correction of compared data made pursuant to these Rules, shall be fixed at the time the Report of such Positions and Obligations is made available by the Corporation to the Member. At that time, **the related Guaranteed/Novated Obligations all deliver, receive and related payment obligations (a)** between such Clearing Member and the Corporation, ~~for SBO Trades, or (b) between Members, for other~~

~~Transactions, that were created by compared pools that comprise a Pool Net Settlement Position or Positions~~ are terminated and replaced by the Pool Deliver Obligations, Pool Receive Obligations and related payment obligations ~~for such Members that are~~ listed in the Report. ~~The associated TBA Obligations of netted pools will be terminated and replaced with Pool Deliver Obligations, Pool Receive Obligations or cash obligations as established by the Corporation in the applicable Report.~~

Section 7 – Obligation to Submit ~~SBOO~~ Trade-for-Trade Transactions and SBON Trades to Pool Netting

Each Clearing Member must submit to the Corporation for inclusion in Pool Netting each Trade-for-Trade Transaction ~~SBOO~~ and SBON Trade to which such Clearing Member is a party.

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## RULE 10 – [RESERVED] NOTIFICATION OF SETTLEMENT

### Section 1 – Settlement Obligations

~~— Except as the selling and purchasing Clearing Members in a Trade for Trade Transaction may otherwise agree, pools that are not eligible for processing through the Pool Netting system will settle bilaterally with their original allocation counterparty at the Settlement Price established by the Corporation.~~

~~— For purposes of complying with procedures for notifications, settlements and reclamations specified in the SIFMA Guidelines, the delivering and receiving Clearing Members shall be deemed Dealers.~~

### Section 2 – Notification of Settlement

~~— Upon clearance of a Specified Pool Trade or an SBO Trade or a Trade for Trade Transaction not novated by the Corporation pursuant to Rule 8 above (including an SBO Trade novated pursuant to Rule 5 and not thereafter novated by the Corporation pursuant to Rule 8 above), and within the timeframes established by the Corporation from time to time, each of the delivering and the receiving Clearing Members shall promptly submit to the Corporation, in the manner specified in the procedures, a Notification of Settlement of the Eligible Securities delivered or received by the Clearing Member.~~

~~— If the Corporation receives a Notification of Settlement with respect to an SBO Trade, Trade for Trade Transaction or Specified Pool Trade from both the delivering and the receiving Member and the information submitted by the Members compares within dollar tolerances determined by the Corporation from time to time, either with respect to the entire SBO Trade, Trade for Trade Transaction or Specified Pool Trade (or a portion thereof), the Corporation shall reflect clearance of such SBO Trade, Trade for Trade Transaction or Specified Pool Trade (or portion thereof) in each Member's Purchase and Sale Report. The SBO Trade, Trade for Trade Transaction or Specified Pool Trade (or portion thereof with respect to which information compares) will subsequently be deleted from the delivering and the receiving Member's respective Open Commitment Reports.~~

~~— If the Corporation receives a Notification of Settlement with respect to an SBO Trade, Trade for Trade Transaction or Specified Pool Trade from both the delivering and the receiving Members but the information submitted by the Members does not compare within dollar tolerances determined by the Corporation pursuant to these Rules or compares only in part, or if only one Member submits a Notification of Settlement, the Corporation shall so indicate in the applicable report distributed to each Member. Until~~

~~such time as the Member submitting incorrect information submits a correction, or, if only one Member submitted a Notification of Settlement, the information is deleted by that Member or the other Member submits a Notification of Settlement with information that compares, the SBO Trade, Trade-for-Trade Transaction or Specified Pool Trade (or portion thereof with respect to which information does not compare) will continue to be reflected on each Member's Open Commitment Report and will remain subject to Required Fund Deposit requirements as computed pursuant to these Rules.~~

~~On the last Business Day of each month, in every instance where a Clearing Member's open TBA Obligation falls below an established par amount threshold (as specified by the Corporation in its procedures or in an Important Notice), the Corporation will mark such trade as fully settled.~~



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## RULE 11 – CASH SETTLEMENT

### Section 1 – ~~SBO Market Differential~~TBA Transaction Adjustment Payment

On the established date in the settlement cycle for each Eligible Security, the Corporation will determine whether any Aggregated Account in the Clearing System has a net positive or negative ~~SBO Market Differential~~ TBA Transaction Adjustment Payment. Any net negative ~~SBO Market Differential~~ TBA Transaction Adjustment Payment will be charged against the Member's Cash Balance for such Aggregated Account on the Contractual Settlement Date, and any net positive ~~SBO Market Differential~~ TBA Transaction Adjustment Payment will be credited to the Member's Cash Balance for such Aggregated Account on the Contractual Settlement Date. ~~The SBO Market Differential is calculated as follows:~~

- ~~(a) for each of its SBO Netted Positions, the difference (positive or negative) between the FCAPs for its purchases and the FCAPs for its sales; plus or minus~~
- ~~(b) for each of its SBO Net-Out Positions, the difference (positive or negative) between the FCAPs for its purchases and the FCAPs for its sales; plus or minus~~
- ~~(c) for each of its SBO Net Open Positions that is offset by an SBON Trade, the difference (positive or negative) between the Member's FCAP for its purchase or sale transaction originally with the Original Contra-Side Member and the CAP for its SBON Trade.~~

### Section 2A – Net Pool Transaction Adjustment Payment

The Corporation shall compute a Pool Transaction Adjustment Payment for each trade that is eligible for the Pool Netting process as follows.

The Pool Transaction Adjustment Payment shall be an amount equal to the difference between the Pool Net Price that was established during the allocated pool's Pool Netting process and the compared pools Settlement Price, multiplied by the contractual quantity.

The sum of all Pool Transaction Adjustment Payments that have been calculated for a Member during a given Pool Netting process will constitute such Member's Net Pool Transaction Adjustment Payment, which can be positive or negative. On the first Business Day that follows the calculation of a Member's Net Pool Transaction Adjustment Payment, any negative Net Pool Transaction Adjustment Payment will be charged against the Member's Cash

Balance for such Aggregated Account and any positive Net Pool Transaction Adjustment Payment will be credited to the Member's Cash Balance for such Aggregated Account.

### **Section 2B – Expanded Pool Net Transaction Adjustment Payment**

**The Corporation shall compute an Expanded Pool Net Transaction Adjustment Payment for each TBA Obligation included in the Expanded Pool Netting process.**

**The sum of all Expanded Pool Net Transaction Adjustment Payments that have been calculated for a Member during a given Expanded Pool Netting process will constitute such Member's Expanded Pool Net Transaction Adjustment Payment, which can be positive or negative. On the established date in the settlement cycle for each Eligible Security that follows the calculation of a Member's Expanded Pool Net Transaction Adjustment Payment, any negative Expanded Pool Net Transaction Adjustment Payment will be charged against the Member's Cash Balance for such Aggregated Account, and any positive Expanded Pool Net Transaction Adjustment Payment will be credited to the Member's Cash Balance for such Aggregated Account.**

### **Section 3 – Do Not Allocate Transaction Adjustment Payment**

**The Corporation shall compute a Do Not Allocate Transaction Adjustment Payment for TBA Obligations that have been offset through the Do Not Allocate process.**

**The sum of all Do Not Allocate Transaction Adjustment Payments that have been calculated for a Member during a given Do Not Allocate process will constitute such Member's Do Not Allocate Transaction Adjustment Payment, which can be positive or negative. On the established date in the settlement cycle for each Eligible Security that follows the calculation of a Member's Do Not Allocate Transaction Adjustment Payment, any negative Do Not Allocate Transaction Adjustment Payment will be charged against the Member's Cash Balance for such Aggregated Account, and any positive Do Not Allocate Transaction Adjustment Payment will be credited to the Member's Cash Balance for such Aggregated Account.**

### **Section 4 – TBA Reprice Transaction Adjustment Payment**

**The Corporation shall compute a TBA Reprice Transaction Adjustment Payment for the repriced TBA Obligations that remain unallocated after the deadline established by the Corporation.**

**The sum of all TBA Reprice Transaction Adjustment Payments that have been calculated for a Member during a given TBA Reprice process will constitute such Member's TBA Reprice Transaction Adjustment Payment, which can be positive or negative. On the established date in the settlement cycle for each Eligible Security that follows the calculation of a Member's TBA Reprice Transaction Adjustment Payment, any negative TBA Reprice Transaction Adjustment Payment will be charged against the Member's Cash Balance for such Aggregated Account, and any positive TBA Reprice Transaction Adjustment Payment will be credited to the Member's Cash Balance for such Aggregated Account.**

### **Section 5 – Variance Transaction Adjustment Payment**

**The Corporation shall compute a Variance Transaction Adjustment Payment to capture the difference of the TBA Obligation and the current face of the pools allocated in satisfaction of the obligation. Pursuant to the Chapter 8 in the SIFMA Guidelines, TBA trades are allowed a variance on all TBA transactions equal to plus or minus 0.01% of the dollar amount of the transaction agreed to by the parties.**

**The sum of all Variance Transaction Adjustment Payments that have been calculated for a Member during a given Pool Netting and Expanded Pool Netting process will constitute such Member's Variance Transaction Adjustment Payment, which can be positive or negative. On the established date in the settlement cycle for each Eligible Security that follows the calculation of a Member's Variance Transaction Adjustment Payment, any negative Variance Transaction Adjustment Payment will be charged against the Member's Cash Balance for such Aggregated Account, and any positive Variance Transaction Adjustment Payment will be credited to the Member's Cash Balance for such Aggregated Account.**

### **Section 6 – Factor Update Adjustment Payment**

**The Corporation shall compute a Factor Update Adjustment Payment in the event that updated pool factor information is released after the clearing bank's settlement of a pool. This update would cause a cash differential that will require a debit to the seller and a credit to the buyer.**

### **Section 37 – Computation of Cash Balance for Each Account**

Each Business Day, the Corporation shall compute a Cash Balance for each applicable Account, which for Clearing Members shall be a net positive or negative amount equal to:

- (a) the positive or negative amount of any ~~SBO Market Differential~~ **TBA Transaction Adjustment Payment** computed for such Account pursuant to Section 1 of this Rule; plus or minus
- (b) the positive or negative amount of any Net Pool Transaction Adjustment Payment ~~amount~~; plus or minus
- (c) **the positive or negative amount of any Expanded Pool Net Transaction Adjustment Payment; plus or minus**
- (d) **the positive or negative amount of any Do Not Allocate Transaction Adjustment Payment; plus or minus**
- (e) **the positive or negative amount of any TBA Reprice Transaction Adjustment Payment; plus or minus**
- (f) **the positive or negative amount of any Variance Transaction Adjustment Payment; plus or minus**

- (g) **the positive or negative amount of any Factor Update Adjustment Payment; plus or minus**
- (eh) the positive or negative amount of any Principal and Interest payments required as a result of the clearance of Deliver and Receive Obligations which are not eligible for processing through FedWire (Fail Tracking/Interim Accounting) Securities Service Automated Claims Adjustment Process (ACAP); plus
- (di) in the case of a Broker, any commissions that the Corporation, at such intervals as are prescribed by the Corporation from time to time, determines are due the Broker as a result of Transactions effected by the Broker on behalf of purchasing and selling Dealers; or minus
- (ej) in the case of a Dealer effecting Transactions through a Broker, any commissions that the Corporation, at such intervals as are prescribed by the Corporation from time to time, determines are due the Broker with respect to such Transactions; minus
- (fk) if applicable, the amount of any charges for services rendered with respect to such Account pursuant to Rule 18; minus
- (gl) the amount of any fines, billing fees, charges for financing costs or interest imposed by the Corporation or other charges for services rendered by the Corporation, with respect to such Account pursuant to these Rules; or plus
- (hm) if applicable, the amount of interest payable by the Corporation with respect to such Account pursuant to Section 1 and Section 6 of this Rule; plus or minus(in) the positive or negative value of any Clearance Difference Amount.

**Section 48 – Netting of Cash Balances for Aggregated Accounts**

Each Business Day, the Corporation shall net the positive or negative Cash Balance for each Account in an Aggregated Account to produce a single Cash Settlement amount for such Aggregated Account.

**Section 59 – Cash Settlement**

\* \* \* \*

**Section 610 – Failure to Pay**

\* \* \* \*

*Changes to this Rule, as amended by File No. SR-FICC-2017-012, are set forth below. These changes have been approved by the SEC, but are not yet effective. Bold and underlined text indicates added language. Bold and strikethrough text indicates deleted language. These changes will become effective [within 45 Business Days after date of the SEC's approval of SR-FICC-2017-012]. Once effective, this legend will automatically be removed from the Rules and the formatting of the text of the changes in this Rule will automatically be revised to reflect that these changes are effective.*

## RULE 12 – FAILS CHARGE

\* \* \* \*

If fails accrue at a particular fails charge and the fails charge changes, the existing fails will keep the original accrual and new fails will be subject to the new rate. When there is a substitution of the underlying pool, fails charges will be calculated pursuant to the above formula using (in the formula) the fed funds target rate for each day of the substitution period beginning on the Contractual Settlement Date.

In the event that the Corporation is the failing party because (i) the Corporation received Eligible Securities issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae too near the close of Fedwire for redelivery or for any other reason, ~~or~~ (ii) the Corporation received a substitution of a pool deliver obligation of Eligible Securities issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae too near the specified cut-off time in the SIFMA 48-Hour Rule for same day redelivery of securities or for any other reason or (iii) the Corporation received an allocation of a TBA Obligation of Eligible Securities issued or guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae and the Corporation is unable to deliver such obligations by the specified cut-off time in the SIFMA 48-Hour Rule to be eligible for the specified SIFMA Contractual Settlement Date, the fails charge will be distributed pro rata to the Clearing Members based upon usage of the Mortgage-Backed Securities Division's services.

Each business day, the Corporation shall provide reports reflecting fails charge amounts to Clearing Members and will generate a consolidated monthly report at month end for those Eligible Securities issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae that were settled during the month. Clearing Members with a net debit (i.e., the fails charge amounts owed by the Clearing Member exceed the fails charge amounts it is owed) shall be required to pay such net amount in respect of those delivery obligations that have settled the previous month and which are reflected in the previous month's consolidated month end report by the Class "B" payable date (as established by SIFMA Guidelines) of the month following settlement in conjunction with other cash movements. The fails charge funds received by the Corporation will then be used to pay members with fail net credits.

\* \* \* \*

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RULE 17 – PROCEDURES FOR WHEN THE CORPORATION CEASES TO ACT

\* \* \* \*

Section 2 – Action by the Corporation – Close-Out Procedure

Except as otherwise may be determined by the Board in any particular case, from and after the time the Corporation ceases to act for a Member, the following shall apply:

\* \* \* \*

(b) **[Reserved]** ~~Not later than the time specified by the Corporation in its procedures or in an Important Notice, all Clearing Members that have open settlement obligations pursuant to these Rules with the Defaulting Member as settlement counterparty shall be required to submit Notifications of Settlement with respect to such obligations that have in fact been settled but for which the Corporation has not yet been provided with Notifications of Settlement. Except for loss allocations against Members in accordance with Section 7 of Rule 4, a Member that follows the foregoing procedures shall not have any liability to the Corporation with respect to such settlement obligations.~~

\* \* \* \*

(d) All long and short settlement obligations of the Member, with the exception of those obligations associated with Option Contracts, outstanding at the time the Corporation ceases to act for the Member that have been reported by the Corporation to Members pursuant to these Rules shall be assumed by the Corporation and closed out by (i) for each Eligible Security with a distinct CUSIP Number, establishing a final net settlement obligation (hereinafter, the "Final Net Settlement Obligation") that shall be equal to the net of all outstanding deliver and receive obligations of the Member in each Security, and (ii) buying, borrowing, or reversing in or selling, lending or reposing out the Securities deliverable by or to such insolvent Member, and/or borrowing or lending monies, in order to close out the Final Net Settlement Obligations established for each Security. ~~Pool Net Deliver and Receive Obligations may be disposed of based upon the generic terms of the underlying TBA transaction from which the obligation was created.~~

(e) With respect to the disposition of Option Contracts, those that are deemed by the Corporation to be "out of the money" will be canceled; those deemed by the Corporation to be "in the money" shall be settled in cash based upon the difference between the last System Price at the time the Corporation ceases to act for the Member and the Strike Price.

(f) ~~[Reserved] Specified Pool Trades may be disposed of as if they did not contain a specified pool (i.e., the Trade will be disposed of based on its generic trade terms such as agency, product, coupon rate and maturity).~~

(g) ~~Trade-for-Trade Transactions may be disposed of based upon their generic terms (i.e., agency, product, coupon rate and maturity).~~ In the event of a Clearing Member's default, the Corporation may settle any Pool Deliver Obligation or Pool Receive Obligation with the Defaulting Clearing Member or any other Clearing Member as though the termination and replacement described in Section 6 of Rule 8 had not occurred.

This close-out procedure shall be completed as promptly as practicable after the Corporation has given notice pursuant to Section 1 of this Rule of the Corporation's determination to cease to act, unless the Board determines that the immediate close out of Obligations in a security may be disadvantageous to the Corporation or may promote a disorderly market in that security, in which case the Corporation may suspend the operation of this close-out provision until such later time as is determined by the Board, except that the Board may not suspend the operation of such close-out procedure for a period longer than 30 calendar days without the approval of such by the SEC. If, in the aggregate, the close-out of all of the Final Net Settlement Obligations established for a Member results in the Corporation incurring any loss or liability, such loss or liability shall be allocated as provided in Rule 4. If, in the aggregate, the close-out of all of the Final Net Settlement Obligations established for a Member results in a profit to the Corporation (after the Corporation has fulfilled its obligations under any Cross-Guaranty Agreements), such profit shall be credited to the Member, or to a duly-appointed legal representative of the Member.

Subsequent to the close-out of a Member's Positions, the Corporation shall in accordance with these Rules, ensure the settlement of all obligations that would have arisen had the Corporation not ceased to act, in accordance with the terms of the Transactions that comprise such obligations, subject to the provisions of this Section 2.

If the Corporation takes any action pursuant to this Section, it shall promptly notify the SEC.

\* \* \* \*

**Changes to this Rule, as amended by File No. SR-FICC-2017-012, are set forth below. These changes have been approved by the SEC, but are not yet effective. Bold and underlined text indicates added language. Bold and strikethrough text indicates deleted language. These changes will become effective [within 45 Business Days after date of the SEC's approval of SR-FICC-2017-012]. Once effective, this legend will automatically be removed from the Rules and the formatting of the text of the changes in this Rule will automatically be revised to reflect that these changes are effective.**

**RULE 17A – CORPORATION DEFAULT**

(a) If a "Corporation Default" occurs pursuant to subsection (b) below, all Transactions which have been subject to Novation pursuant to these Rules but have not yet settled and any rights and obligations of the parties thereto shall be immediately terminated and the Board shall determine a single net amount owed by or to each Member with respect to such Transactions by applying the close out and application procedures in Section 2 of Rule 17 and Section 7 of Rule 4 (interpreted in all such cases as if each Member were a Defaulting Member) taking into account the other provisions in these Rules relating to loss allocation, including in the event that any Member is a Defaulting Member. For purposes of this Rule 17A and notwithstanding any other provision to the contrary, ~~Novation is deemed to occur and~~ Pool Deliver Obligations and Pool Receive Obligations **shall be** established with respect to all Transactions, ~~whether or not such Transactions are SBO-Destined Trades,~~ at the time at which the data submitted in respect of such Transactions are compared and such Transactions constitute Compared Trades. The Board shall notify each Member of the net amount so determined and Members who have been notified that they owe an amount to the Corporation shall pay that amount on or prior to the date specified by the Board, subject to any applicable setoff rights. Members who have a net claim against the Corporation shall be entitled to payment thereof along with other Members' and any other creditors' claims pursuant to the underlying Contracts with respect thereto, these Rules and applicable law. Nothing herein shall limit the rights of the Corporation upon a Member default (including following a Corporation Default) including under any Cross-Guaranty Agreement with the Government Securities Division or any other Cross-Guaranty Counterparty.

\* \* \* \*