

Required fields are shown with yellow backgrounds and asterisks.

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| Page 1 of * 61 | SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4 | | File No.* SR - 2017 - * 804 | Amendment No. (req. for Amendments *) | |
| Filing by Fixed Income Clearing Corporation Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934 | | | | | |
| Initial * <input checked="" type="checkbox"/> | Amendment * <input type="checkbox"/> | Withdrawal <input type="checkbox"/> | Section 19(b)(2) * <input type="checkbox"/> | Section 19(b)(3)(A) * <input type="checkbox"/> | Section 19(b)(3)(B) * <input type="checkbox"/> |
| Pilot <input type="checkbox"/> | Extension of Time Period for Commission Action * <input type="checkbox"/> | Date Expires * <input type="text"/> | Rule <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) | | |
| Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010 Section 806(e)(1) * <input checked="" type="checkbox"/> | | | Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934 Section 3C(b)(2) * <input type="checkbox"/> | | |
| Exhibit 2 Sent As Paper Document <input type="checkbox"/> | | Exhibit 3 Sent As Paper Document <input type="checkbox"/> | | | |
| Description Provide a brief description of the action (limit 250 characters, required when Initial is checked *). <input type="text" value="Enhance the Credit Risk Rating Matrix."/> | | | | | |
| 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 * <input type="text" value="Rosa"/> Last Name * <input type="text" value="Chang"/> Title * <input type="text" value="Executive Director and Associate General Counsel"/> E-mail * <input type="text" value="rchang1@dtcc.com"/> Telephone * <input type="text" value="(212) 855-4985"/> Fax <input type="text"/> | | | | | |
| 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 <input type="text" value="03/22/2017"/> By <input type="text" value="Nikki Poulos"/> (Name *) <input type="text" value="Managing Director and Deputy General Counsel"/> <input type="text" value="npoulos@dtcc.com"/> | | | | | |
| 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 Advance Notice

(a) This advance notice of Fixed Income Clearing Corporation (“FICC”) consists of proposed modifications to FICC’s Government Securities Division (“GSD”) Rulebook (“GSD Rules”) and Mortgage-Backed Securities Division (“MBS”) Clearing Rules (“MBS Rules,” and collectively with the GSD Rules, the “Rules”),¹ annexed hereto as Exhibit 5. The proposed rule change would amend the Rules in order to (i) enhance the matrix (hereinafter referred to as the “Credit Risk Rating Matrix” or “CRRM”)² developed by FICC to evaluate the risks posed by certain GSD Netting Members and MBS Clearing Members (collectively, “CRRM-Rated Members”) to FICC and its members from providing services to these CRRM-Rated Members and (ii) make other amendments to the Rules to provide more transparency and clarity regarding FICC’s current ongoing membership monitoring process.

(b) FICC expects the proposed rule change to enhance the CRRM to have a direct effect on the application of the MBS Intraday Mark-to-Market Charge pursuant to MBS Rule 4 (Clearing Fund and Loss Allocation) with respect to MBS Clearing Members who are not currently rated by the CRRM but would be rated by the CRRM under the proposed rule change. Specifically, the Intraday Mark-to-Market Charge that FICC may collect from a MBS Clearing Member from time to time is subject to a Surveillance Threshold. The Surveillance Threshold is an amount between one million dollars and 50 million dollars that is set by FICC per MBS Clearing Member based on the MBS Clearing Member’s rating as determined by the CRRM and/or the MBS Clearing Member’s Watch List status.

The Surveillance Threshold applicable to MBS Clearing Members that are rated by the CRRM is different from the Surveillance Threshold applicable to MBS Clearing Members that are not rated by the CRRM. For a MBS Clearing Member that is not rated by the CRRM, the Surveillance Threshold is either \$50 million if the MBS Clearing Member is not on the Watch List or \$10 million if the MBS Clearing Member is on the Watch List. In contrast, for a MBS Clearing Member that is rated by the CRRM, the Surveillance Threshold is an amount between \$5 million and \$50 million depending upon the MBS Clearing Member’s CRRM

¹ Capitalized terms not defined herein are defined in the GSD Rules, [available at www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf), and the MBS Rules, [available at www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_mbsd_rules.pdf](http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_mbsd_rules.pdf).

² The proposed rule changes with respect to the enhancement of the CRRM are reflected in the inclusion of (1) qualitative factors and examples thereof in the definition of “Credit Risk Rating Matrix” in GSD Rule 1 and MBS Rule 1 and (2) certain GSD Foreign Netting Members that are banks or trust companies and MBS Bank Clearing Members that are Foreign Persons as CRRM-Rated Members in GSD Rule 3 (Section 12(b)(i)(II)) and MBS Rule 3 (Section 11(b)(i)(II)). The proposed enhancement to CRRM also necessitates a conforming change to the existing Section 12(b) (renumbered to Section 12(c) in this proposed rule filing) of GSD Rule 3 by deleting the reference to Foreign Netting Members and Bank Netting Members participating through their U.S. branches or agencies, as further discussed below.

rating. As such, FICC believes the proposed rule change to enable the CRRM to generate credit ratings for foreign bank or trust company members may have a direct effect on the application of MBSD Rule 4 with respect to MBSD Clearing Members who are not currently rated by CRRM but would be rated by the CRRM under the proposed rule change. FICC also expects the proposed rule change to enhance the CRRM to have a direct effect on the application of the MBSD Intraday Mark-to-Market Charge with respect to MBSD Clearing Members that are currently rated by the CRRM, as the applicable Surveillance Threshold may change if their ratings shift under the enhanced CRRM.

(c) The file number for the rule filing with respect to the MBSD Intraday Mark-to-Market Charge is SR-FICC-2017-004.

2. Procedures of the Clearing Agency

The filing of this advance notice with the Commission was approved by the Risk Committee of the Board of Directors of FICC at a meeting duly called and held on June 14, 2016.

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

Not applicable.

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

Not applicable.

5. Self-Regulatory Agency's Statement on Comments on the Advance Notice Received from Members, Participants, or Others

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

6. Extension of Time Period for Commission Action

Not applicable.

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

(a) Not applicable.

(b) Not applicable.

(c) Not applicable.

(d) Not applicable.

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

Not applicable.

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

Not applicable.

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

Nature of the Proposed Change

The proposed rule change would, among other things, enhance the CRRM to enable it to rate FICC members that are foreign banks or trust companies and have audited financial data that is publicly available. It would also enhance the CRRM by allowing it to take into account qualitative factors when generating credit ratings for FICC members. In addition, it would enhance the CRRM by shifting it from a relative scoring approach to an absolute scoring approach.

This rule filing also contains proposed rule changes that are not related to the proposed CRRM enhancements but that provide specificity, clarity and additional transparency to the Rules related to FICC's current ongoing membership monitoring process.

(i) Background

FICC occupies an important role in the securities settlement system by interposing itself through each of GSD and MBSD as a central counterparty between members that are counterparties to transactions accepted for clearing by FICC, thereby reducing the risk faced by members. FICC uses the CRRM, the Watch List (as defined below) and the enhanced surveillance to manage and monitor default risks of its members on an ongoing basis, as discussed below. The level and frequency of such monitoring for a member is determined by the member's risk of default as assessed by FICC. Members that are deemed by FICC to pose a heightened risk to FICC and its members are subject to closer and more frequent monitoring.

Existing Credit Risk Rating Matrix

In 2004, the Securities and Exchange Commission ("Commission") approved a proposed rule change filed by FICC ("Initial Filing")³ with respect to GSD and MBSD to establish new criteria for placing certain members of FICC on a list for closer monitoring ("Watch List").

FICC proposed in the Initial Filing that all U.S. broker-dealers and U.S. banks that were GSD Netting Members and/or MBSD Clearing Members would be assigned a rating generated

³ See Securities Exchange Act Release No. 49158 (January 30, 2004), 69 FR 5624 (February 5, 2004) (SR-FICC-2003-03).

by entering financial data of those members into an internally generated credit rating scorecard, i.e., the CRRM.⁴ In the Initial Filing, FICC stated that all other types of GSD Netting Members and MBSB Clearing Members would be monitored by credit risk staff using financial criteria deemed relevant by FICC but would not be assigned a rating by the CRRM.⁵

Following the approval of the Initial Filing, the Commission approved a subsequent proposed rule change filed by FICC that provided interpretive guidance to the Initial Filing (“Interpretive Guidance Filing”).⁶ In the Interpretive Guidance Filing, FICC reiterated that U.S. broker-dealers and U.S. banks would be assessed against the CRRM and assigned a credit rating based on quantitative factors. Unfavorably-rated members would be placed on the Watch List. In the Interpretive Guidance Filing, FICC explained that credit risk staff could downgrade a particular member’s credit rating based on various qualitative factors. An example of such qualitative factors might be that the member in question received a qualified audit opinion on its annual audit. In the Interpretive Guidance Filing, FICC noted that, in order to protect FICC and its other members, it was important that credit risk staff maintain the discretion to downgrade a member’s credit rating on the CRRM and thus subject the member to closer monitoring.

The current CRRM is comprised of two credit rating models – one for the U.S. broker-dealers and one for the U.S. banks – and generates credit ratings for the relevant members based on a 7-point rating system, with “1” being the strongest credit rating and “7” being the weakest credit rating.

Over time, the current CRRM has not kept pace with FICC’s evolving membership base and heightened expectations from regulators and stakeholders for robustness of financial models. Specifically, the current CRRM only generates credit ratings for those GSD Netting Members and MBSB Clearing Members that are U.S. banks or U.S. broker-dealers that file standard reports with their regulators, which currently comprise 77% of GSD Netting Members and 85% of MBSB Clearing Members, respectively; foreign banks and trust companies currently account for 21% of GSD Netting Members and 1% of MBSB Clearing Members.⁷ The numbers of GSD

⁴ Footnote 4 of the Initial Filing explained the new criteria for rating members: “[FICC’s] approach to the analysis of members is based on a thorough quantitative analysis. A broker-dealer member’s rating on the [CRRM] will be based on factors including size (*i.e.*, total excess net capital), capital, leverage, liquidity, and profitability. Banks will be reviewed based on size, capital, asset quality, earnings, and liquidity.” *Id.* These quantitative factors are still being applied today, and FICC currently does not plan to change them.

⁵ In the Initial Filing, FICC noted that these members would be monitored by credit risk staff by reviewing similar criteria as those reviewed for members included on the [CRRM] but such review would occur outside of the [CRRM] process. *Id.*

⁶ See Securities Exchange Act Release No. 51355 (March 10, 2005), 70 FR 12919 (March 16, 2005) (SR-FICC-2004-08).

⁷ As of March 16, 2017, there are 105 GSD Netting Members and 78 MBSB Clearing Members. Of the 105 GSD Netting Members, 13 (or 12%) are U.S. banks, 68 (or 65%)

and MBSD members that are foreign banks or trust companies increased from 16 and zero in 2012 to 22 and one in 2017, respectively, and are expected to continue to grow over the coming years. Foreign banks and trust companies are typically large global financial institutions that have complex businesses and conduct a high volume of activities. Although foreign banks and trust companies are not currently rated by the CRRM, they are monitored by FICC's credit risk staff using financial criteria deemed relevant by FICC and can be placed on the Watch List if they experience a financial change that presents risk to FICC. Given the increase in the number of foreign bank or trust company members in FICC in the recent years, there is a need to formalize FICC's credit risk evaluation process of these members by assigning credit ratings to them in order to better facilitate the comparability of credit risks among members.⁸

In addition, the current CRRM assigns each GSD Netting Member and MBSD Clearing Member that is a U.S. bank or U.S. broker-dealer and that files standard reports with its regulator(s) a credit rating based on inputting certain quantitative data relative to the applicable member into the CRRM. Accordingly, a member's credit rating is currently based solely upon quantitative factors. It is only after the CRRM has generated a credit rating with respect to a particular member that such member's credit rating may be downgraded manually by credit risk staff, after taking into consideration relevant qualitative factors. The inability of the current CRRM to take into account qualitative factors requires frequent and manual overrides by credit risk staff, which may result in inconsistent and/or incomplete credit ratings for members.

Furthermore, the current CRRM uses a relative scoring approach and relies on peer grouping of members to calculate the credit rating of a member. This approach is not ideal because a member's credit rating can be affected by changes in its peer group even if the member's financial condition is unchanged.

Proposed Credit Risk Rating Matrix Enhancements

To improve the coverage and the effectiveness of the current CRRM, FICC is proposing three enhancements. The first proposed enhancement would expand the scope of CRRM coverage by enabling the CRRM to generate credit ratings for GSD Netting Members and MBSD Clearing Members that are foreign banks or trust companies and that have audited financial data that is publicly available. The second proposed enhancement would incorporate qualitative factors into the CRRM and therefore is expected to reduce the need and the frequency

are U.S. broker-dealers and 22 (or 21%) are foreign banks or trust companies. Of the 78 MBSD Clearing Members, 14 (or 18%) are U.S. banks, 52 (or 67%) are U.S. broker-dealers and one (or 1%) is a foreign bank or trust company.

⁸ In the Interpretive Guidance Filing, FICC noted that CRRM is applied across FICC and its affiliated clearing agencies, National Securities Clearing Corporation ("NSCC") and The Depository Trust Company ("DTC"). Specifically, in order to run the CRRM, credit risk staff uses the financial data of the applicable GSD and MBSD members in addition to data of applicable members and participants of NSCC and DTC, respectively. In this way, each applicable GSD and MBSD member is rated against other applicable members and participants of NSCC and DTC, respectively. SR-FICC-2004-08, 70 FR 12919.

of manual overrides of member credit ratings. The third enhancement would replace the relative scoring approach currently used by CRRM with a statistical approach to estimate the absolute probability of default of each member.

A. *Enable the CRRM to Generate Credit Ratings for Foreign Bank or Trust Company Members*

The current CRRM is comprised of two credit rating models – one for the U.S. broker-dealers and one for the U.S. banks. FICC is proposing to enhance the CRRM by adding an additional credit rating model for the foreign banks and trust companies. The additional model would expand the membership classes to which the CRRM would apply to include foreign banks and trust companies that are GSD Netting Members and/or MBSB Clearing Members and that have audited financial data that is publicly available. The CRRM credit rating of a foreign bank or trust company that is a GSD Netting Member and/or MBSB Clearing Member would be based on quantitative factors, including size, capital, leverage, liquidity, profitability and growth, and qualitative factors, including market position and sustainability, information reporting and compliance, management quality, capital management and business/product diversity. By enabling the CRRM to generate credit ratings for these GSD Netting Members and MBSB Clearing Members, the enhanced CRRM would provide more comprehensive credit risk coverage of FICC's membership base.

With the proposed enhancement to the CRRM as described above, applicable foreign bank or trust company GSD Netting Members and MBSB Clearing Members would be included in the CRRM process and be evaluated more effectively and efficiently because financial data with respect to these foreign bank or trust company members could be extracted from data sources in an automated form.⁹

After the proposed enhancement, CRRM would be able to generate credit ratings on an ongoing basis for all GSD Netting Members and MBSB Clearing Members that are U.S. banks, U.S. brokers-dealers and foreign banks and trust companies, which together represent approximately 99% of the GSD Netting Members and 86% of the MBSB Clearing Members, respectively.¹⁰

⁹ In the Initial Filing, FICC noted that these members would be monitored by credit risk staff by reviewing similar criteria as those reviewed for members included on the CRRM, but such review would occur outside of the CRRM process. SR-FICC-2003-03, 69 FR 5624.

¹⁰ As of March 16, 2017, there are two GSD Netting Members that are government sponsored entities and therefore would not be rated by the enhanced CRRM, as proposed; there are also 11 MBSB Clearing Members that would not be rated by the enhanced CRRM, as proposed, because they are government sponsored entities, registered investment companies, unregistered investment pools (“UIPs”) or other entities that are eligible for MBSB Clearing Membership pursuant to Section 1(i) of MBSB Rule 2A. MBSB Rules, supra note 1.

B. Incorporate Qualitative Factors into the CRRM

In addition, as proposed, the enhanced CRRM would blend qualitative factors with quantitative factors to produce a credit rating for each applicable member in relation to the member's credit risk. For U.S. and foreign banks and trust companies, the enhanced CRRM would use a 70/30 weighted split between quantitative and qualitative factors to generate credit ratings. For U.S. broker-dealers, the weight split between quantitative and qualitative factors would be 60/40. These weight splits are chosen by FICC based on the industry best practice as well as research and sensitivity analysis conducted by FICC. FICC would review and adjust the weight splits as well as the quantitative and qualitative factors, as needed, based on recalibration of the CRRM to be conducted by FICC approximately every three to five years.

Although there are advantages to measuring credit risk quantitatively, quantitative evaluation models alone are incapable of fully capturing all credit risks. Certain qualitative factors may indicate that a member is or will soon be undergoing financial distress, which may in turn signal a higher default exposure to FICC and its other members. As such, a key enhancement being proposed to the CRRM is the incorporation of relevant qualitative factors into each of the three credit rating models mentioned above. By including qualitative factors in the three credit rating models, the enhanced CRRM would capture risks that would otherwise not be accounted for with quantitative factors alone.¹¹ Adding qualitative factors to the CRRM would not only enable it to generate more consistent and comprehensive credit ratings for applicable members, but it would also help reduce the need and frequency of manual credit rating overrides by the credit risk staff because overrides would likely only be required under more limited circumstances.¹²

C. Shifting From Relative Scoring to Absolute Scoring

As proposed, the enhanced CRRM would use an absolute scoring approach and rank each member based on its individual probability of default rather than the relative scoring approach that is currently in use. This proposed change is designed to have a member's CRRM-generated credit rating reflect an absolute measure of the member's default risk and eliminate any potential distortion of a member's credit rating from the member's peer group that may occur under the relative scoring approach used in the existing CRRM.

¹¹ The initial set of qualitative factors that would be incorporated into the CRRM includes (a) for U.S. broker dealers, market position and sustainability, management quality, capital management, liquidity management, geographic diversification, business/product diversity and access to funding, (b) for U.S. banks, environment, compliance/litigation, management quality, liquidity management and parental demands and (c) for foreign banks and trust companies, market position and sustainability, information reporting and compliance, management quality, capital management and business/product diversity.

¹² Once a member is assigned a credit rating, if circumstances warrant, credit risk staff would still have the ability to override the CRRM-issued credit rating by manually downgrading such rating as they do today. To ensure a conservative approach, the CRRM-issued credit ratings cannot be manually upgraded.

D. Watch List and Enhanced Surveillance

In addition to the Watch List, FICC also maintains an enhanced surveillance list (referenced herein and in the proposed rule text as “enhanced surveillance”) for membership monitoring. The enhanced surveillance list is generally used when members are undergoing drastic and unexpected changes in their financial conditions or operation capabilities and thus are deemed by FICC to be of the highest risk level and/or warrant additional scrutiny due to FICC’s ongoing concerns about these members. Accordingly, members that are subject to enhanced surveillance are reported to FICC’s management committees and are also regularly reviewed by a cross-functional team comprised of senior management of FICC. More often than not, members that are subject to enhanced surveillance are also on the Watch List. The group of members that is subject to enhanced surveillance is generally much smaller than the group on the Watch List. The enhanced surveillance list is an internal tool for FICC that triggers increased monitoring of a member above the monitoring that occurs when a member is on the Watch List.

A member could be placed on the Watch List either based on its credit rating of 5, 6 or 7, which can either be generated by the CRRM or from a manual downgrade, or when FICC deems such placement as necessary to protect FICC and its members. In contrast, a member would be subject to enhanced surveillance only when close monitoring of the member is deemed necessary to protect FICC and its members.

The Watch List and enhanced surveillance tools are not mutually exclusive; they may complement each other under certain circumstances. A key distinction between the Watch List and enhanced surveillance is that being placed on the Watch List may result in Clearing Fund related consequences under the Rules, whereas enhanced surveillance does not.¹³ For example, a member that is in a precarious situation could be placed on the Watch List and be subject to enhanced surveillance; however, because the Watch List status could require additional Clearing Fund deposits, when FICC has preliminary concerns about a member, to avoid potential increase to a member’s Clearing Fund deposit, FICC may opt not to place the member on the Watch List until it is certain that such concerns would not be alleviated in the short-term. Instead, in such a situation, FICC might first subject the member to enhanced surveillance in order to closely monitor the member’s situation without affecting the member’s Clearing Fund deposits. If the member’s situation improves, then it will no longer be subject to enhanced surveillance. If the situation of the member worsens, the member may then be placed on the Watch List as deemed necessary by FICC.

(ii) Detailed Description of the Proposed Rule Changes Related to the Proposed CRRM Enhancements

In connection with the proposed enhancements to the CRRM, FICC proposes to amend the GSD Rules and the MBSD Rules to (1) incorporate qualitative factors into CRRM and (2) add foreign banks and trust companies that are GSD Netting Members and MBSD Clearing

¹³ FICC expects to provide additional clarity to members regarding the Watch List and its impact on Clearing Fund deposits in a subsequent proposed rule change to be filed with the Commission in 2017.

Members to the categories of members that would be assigned credit ratings by FICC using the CRRM.

A. *Proposed Changes to GSD Rule 1 (Definitions) and MBSD Rule 1 (Definitions)*

FICC is proposing to amend the “Credit Risk Rating Matrix” definition in GSD Rule 1 and MBSD Rule 1 to include qualitative factors, such as management quality, market position/environment and capital and liquidity risk management, because, as proposed, the enhanced CRRM would blend both qualitative factors and quantitative factors to produce a credit rating for each applicable FICC member.

B. *Proposed Changes to Section 12(b)(i)(II) of GSD Rule 3 (Ongoing Membership Requirements) and Section 11(b)(i)(II) of MBSD Rule 3 (Ongoing Membership Requirements)*

FICC is proposing to amend Section 12(b)(i)(III) of GSD Rule 3 and Section 11(b)(i)(III) of MBSD Rule 3 to expand the membership types to which the CRRM would apply to include GSD Netting Members and MBSD Clearing Members, as applicable, that are foreign banks or trust companies and that have audited financial data that are publicly available.

The enhanced CRRM would assign credit ratings for each GSD Netting Member and/or MBSD Clearing Member that is a foreign bank or trust company based on its publicly available audited financial data. The credit rating would be based on an 18-point scale, which is then mapped to the 7-point rating system currently in use today, with “1” being the strongest credit rating and “7” being the weakest credit rating.

(iii) Other Proposed Rule Changes

This rule filing also contains proposed rule changes that are unrelated to the proposed enhancement of the CRRM. These proposed rule changes would provide specificity, clarity and additional transparency to the Rules with respect to FICC’s current ongoing membership monitoring process, as described below.

A. *Proposed Changes to the Definitions of “Credit Risk Rating Matrix” and “Watch List” in GSD Rule 1 (Definitions) and MBSD Rule 1 (Definitions)*

FICC is proposing to amend the definition of “Credit Risk Rating Matrix” in GSD Rule 1 and MBSD Rule 1 to state that, in addition to the proposed qualitative factors described above, the CRRM is also based on quantitative factors, such as capital, assets, earnings and liquidity.

FICC is also proposing to amend the definition of “Watch List” in GSD Rule 1 and MBSD Rule 1 to state that the Watch List is comprised of members whose credit ratings derived from the CRRM are 5, 6 or 7 as well as members that are deemed by FICC to pose a heightened risk to FICC and its members based on FICC’s consideration of relevant factors, including those set forth in Section 12(d) of GSD Rule 3 and Section 11(d) of MBSD Rule 3, as applicable.

B. Proposed Changes to GSD Rule 3 and MBSB Rule 3

Section 7 of GSD Rule 3 and Section 6 of MBSB Rule 3

FICC is proposing to amend Section 7 of GSD Rule 3 and Section 6 of MBSB Rule 3 to state that review of a GSD Member's or MBSB Member's financial or operational conditions may (1) include FICC requesting information regarding the businesses and operations of the member and its risk management practices with respect to FICC's services utilized by the member for another Person and (2) result in the member being placed on the Watch List and/or being subject to enhanced surveillance as determined by FICC.

FICC members are direct participants of GSD and/or MBSB, as applicable. However, there are firms that rely on the services provided by GSD Members or MBSB Members in order to have their activity cleared and settled through FICC's facilities (the "indirect participants"). These indirect participants pose certain risks to FICC that need to be identified and monitored as part of FICC's ongoing member due diligence process. In order for FICC to understand (1) the material dependencies between FICC members and the indirect participants that rely on the FICC members for the clearance and settlement of the indirect participants' transactions, (2) significant FICC member-indirect participant relationships and (3) the various risk controls and mitigants that these FICC members employ to manage their risks with respect to such relationships, FICC may request information from GSD Members or MBSB Members regarding the members' businesses and operations as well as their risk management practices with respect to services of FICC utilized by the FICC members for indirect participants. The information provided by FICC members would then be taken into consideration by FICC when determining whether a GSD Member or an MBSB Member, as applicable, may need to be placed on the Watch List, be subject to enhanced surveillance or both.

Section 12(a) of GSD Rule 3 and Section 11(a) of MBSB Rule 3

FICC is proposing to amend Section 12(a) of GSD Rule 3 and Section 11(a) of MBSB Rule 3 in order to specify the membership types that are currently subject to FICC's ongoing monitoring and review. FICC currently monitors and reviews all (a) GSD Netting Members, Sponsoring Members and Funds-Only Settling Bank Members and (b) MBSB Members on an ongoing and periodic basis, which may include monitoring news and market developments relating to these members and conducting reviews of financial reports and other public information of these members.

Section 12(b)(i) of GSD Rule 3 and Section 11(b)(i) of MBSB Rule 3

FICC is proposing to add Section 12(b)(i) of GSD Rule 3 and Section 11(b)(i) of MBSB Rule 3 to (1) clarify that FICC is currently using the CRRM to generate credit ratings for (A) GSD Members that are Bank Netting Members and MBSB Members that are Bank Clearing Members; provided that each such member files the Consolidated Report of Condition and Income ("Call Report") and (B) GSD Members that are Dealer Netting Members or Inter-Dealer Broker Netting Members and MBSB Members that are Dealer Clearing Members or Inter-Dealer Broker Clearing Members; provided that each such member files the Financial and Operational Combined Uniform Single Report ("FOCUS Report") or the equivalent with its regulator, (2)

clarify that each CRRM-Rated Member's credit rating would be reassessed upon receipt of additional information from the member and (3) delete language that states members may be placed on the Watch List based on their ratings as determined by CRRM or based on their failure to comply with operational standards and requirements.

Currently, Section 11(a) of MBS Rule 3 states that UIPs are rated by the CRRM. FICC proposes to delete this statement and amend it to state that FICC reviews and monitors UIPs (as with all MBS Members).¹⁴ This proposed change corrects an error in the MBS Rules and does not affect any rights or obligations of the MBS Members because UIPs are still reviewed by FICC through proposed Section 11(a) of MBS Rule 3.

Section 12(b)(ii) of GSD Rule 3 and Section 11(b)(ii) of MBS Rule 3

FICC is proposing to add Section 12(b)(ii) of GSD Rule 3 and Section 11(b)(ii) of MBS Rule 3 to provide that, because the factors used as part of the CRRM may not identify all risks that a member may pose to FICC, FICC may, in addition to other actions permitted by the Rules, downgrade the member's credit rating derived from the CRRM if FICC believes the CRRM-generated rating is insufficiently conservative or if it deems such downgrade as necessary to protect FICC and its members. Depending on the credit rating of the member, a downgrade may result in the member being placed on the Watch List and/or being subject to enhanced surveillance based on relevant factors.

Section 12(c) of GSD Rule 3 and Section 11(c) of MBS Rule 3

FICC is proposing to re-number the existing Section 12(b) of GSD Rule 3 and Section 11(b) of MBS Rule 3 to Section 12(c) and Section 11(c) of the respective Rules as well as to amend these sections to state that, other than those members specified in Section 12(b)(i) of GSD Rule 3 and Section 11(b)(i) of MBS Rule 3, FICC may place (1) GSD Sponsoring Members, Funds-Only Settling Bank Members and Netting Members and (2) MBS Members, on the Watch List and/or subject them to enhanced surveillance even though they are not being assigned credit ratings by FICC in accordance with the CRRM.

Section 12(d) of GSD Rule 3 and Section 11(d) of MBS Rule 3

FICC is proposing to add Section 12(d) to GSD Rule 3 and Section 11(d) to MBS Rule 3 to describe some of the factors that could be taken into consideration by FICC when downgrading a member's credit rating, placing a member on the Watch List and/or subjecting a member to enhanced surveillance. These factors include but are not limited to (i) news reports and/or regulatory observations that raise reasonable concerns relating to the member, (ii) reasonable concerns around the member's liquidity arrangements, (iii) material changes to

¹⁴ Amendment No. 1 to SR-FICC-2008-01, approved by the Commission in 2012, eliminated any reference to the CRRM with regards to UIPs; however, due to a clerical error, this change was not included in the Exhibit 5 thereto and therefore not reflected in the current MBS Rules. See Securities Exchange Act Release No. 66550 (March 9, 2012), 77 FR 15155 (March 14, 2012) (SR-FICC-2008-01). FICC is proposing to correct this error.

the member's organizational structure, (iv) reasonable concerns of FICC about the member's financial stability due to particular facts and circumstances, such as material litigation or other legal and/or regulatory risks, (v) failure of the member to demonstrate satisfactory financial condition or operational capability or if FICC has a reasonable concern regarding the member's ability to maintain applicable membership standards and (vi) failure of the member to provide information required by FICC to assess risk exposures posed by the member's activity.

Section 12(e) of GSD Rule 3 and Section 11(e) of MBSD Rule 3

FICC is proposing to re-number the existing Section 12(c) of GSD Rule 3 and Section 11(c) of MBSD Rule 3 to Section 12(e) and Section 11(e) of the respective Rules and refer to FICC's ability to retain any Excess Clearing Fund Deposits of a GSD Netting Member or an MBSD Clearing Member, as applicable, that has been placed on the Watch List pursuant to Section 9 of GSD Rule 4 or Section 9 of MBSD Rule 4, as applicable. In addition, FICC is proposing technical modifications in these sections to correct grammatical errors and add a section reference.

Section 12(f) of GSD Rule 3 and Section 11(f) of MBSD Rule 3

FICC is proposing to re-number the existing Section 12(d) of GSD Rule 3 and Section 11(d) of MBSD Rule 3 to Section 12(f) and Section 11(f) of the respective Rules and provide that FICC would, in addition to other actions permitted by the Rules, conduct a more thorough monitoring of the financial condition and/or operational capability of, and require more frequent financial disclosures from, not only those members that are placed on the Watch List but also members subject to enhanced surveillance, including examples of how the monitoring could be conducted and the types of disclosures that may be required. In addition, members that are subject to enhanced surveillance would be reported to FICC's management committees and regularly reviewed by a cross-functional team comprised of senior management of FICC.

Other Proposed Changes to GSD Rule 3 and MBSD Rule 3

In addition to the proposed changes described above, FICC is proposing to delete the existing Section 12(e) of GSD Rule 3 and Section 11(e) of MBSD Rule 3 to eliminate FICC's right to place a member with an Excess Capital Ratio of 0.5 or greater on the Watch List because FICC has not used, nor does it plan to use, this threshold.

In addition, FICC is proposing to delete the existing Section 12(f) of GSD Rule 3 and Section 11(f) of MBSD Rule 3 to eliminate language that requires FICC to place a GSD Netting Member or an MBSD Clearing Member, as applicable, on the Watch List if FICC takes any action against the GSD Netting Member or the MBSD Clearing Member under GSD Rule 3, Section 7 (General Continuance Standards) and MBSD Rule 3, Section 6 (General Continuance Standards), respectively. FICC is proposing these deletions because placement of a member on the Watch List would be covered by the proposed changes to Sections 12(b), (c) and (d) of GSD Rule 3 and Sections 11(b), (c) and (d) of MBSD Rule 3. As such, the language being deleted by this proposed change would no longer be needed.

Similarly, FICC is proposing to delete language that requires a GSD Netting Member or an MBSD Clearing Member, as applicable, to remain on the Watch List until the condition(s)

that resulted in its placement on the Watch List are no longer present or if close monitoring by FICC is no longer warranted. FICC is proposing this deletion because whether a member remains on the Watch List would be covered by the proposed changes to Sections 12(b), (c) and (d) of GSD Rule 3 and Sections 11(b), (c) and (d) of MBS Rule 3. As such, the language being deleted by this proposed change would no longer be needed.

C. Proposed Changes to GSD Rules 5, 11 and 18

FICC is also proposing to amend GSD Rules 5 (Comparison System), 11 (Netting System) and 18 (Special Provisions for Repo Transactions) to clarify that FICC may subject (1) a Comparison-Only Member to enhanced surveillance if FICC has determined that the Comparison-Only Member has violated its obligations under Section 1 of GSD Rule 5 and (2) a Netting Member to enhanced surveillance if FICC has determined that the Netting Member has violated its obligations under Section 3 of GSD Rule 11 or Section 2 of GSD Rule 18. In addition, FICC is proposing to amend GSD Rule 11 to correct a typographical error.

Implementation Timeframe

Pending Commission approval, FICC expects to implement this proposal promptly. Members would be advised of the implementation date of this proposal through issuance of a FICC Important Notice.

Expected Effect on Risks to the Clearing Agency, Its Participants and the Market

The proposed rule changes would mitigate counterparty credit risk for FICC by allowing FICC to more accurately monitor the creditworthiness and risk profile of its members. The enhanced CRRM would provide a more robust credit rating methodology by incorporating qualitative factors and adopting an absolute scoring approach. Both of these enhancements would improve FICC's ability to monitor the credit risk of its members and are expected to lessen the frequency of manual overrides. The enhanced CRRM would also expand the coverage of FICC's membership by providing credit ratings for members that are foreign banks or trust companies, which are not covered under the existing CRRM.

By mitigating counterparty credit risk for FICC as described above, the enhanced CRRM would also mitigate risk for FICC members because lowering the risk profile for FICC would in turn lower the risk exposure that FICC members may have with respect to FICC in its role as a central counterparty.

Management of Identified Risks

The proposed rule changes are designed to mitigate counterparty credit risk for FICC and to provide greater clarity and transparency to FICC's members regarding the counterparty credit risk management approach used by FICC.

The enhanced CRRM would improve FICC's ability to monitor the probability of default for members that are rated by the CRRM and is expected to lessen the need and the frequency of manual downgrades due to the anticipated improvement in the accuracy of the credit ratings generated by the enhanced CRRM.

FICC employs a risk-based approach to conducting monitoring and review of its members by using the CRRM to identify higher risk members. Once identified, FICC would place these members on the Watch List, which would result in more frequent review by FICC of these members than the other members. For members that are placed on the Watch List, FICC would conduct more thorough monitoring of these members' financial condition and/or operational capability, which could include, for example, on-site visits or additional due diligence information requests.

FICC members that have been placed on the Watch List may also be required to maintain a higher deposit to the GSD Clearing Fund or MBSD Clearing Fund, as applicable, which would help offset potential risks to FICC and its members arising from activity submitted by these members.

The enhanced CRRM would also expand the coverage of FICC's membership by providing credit ratings for foreign banks and trust companies, which are not currently rated under the existing CRRM. The addition of these entities would allow FICC to employ its risk-based approach to identify those higher risk members for additional monitoring with more efficiency (by reducing the need for manual overrides) and effectiveness (by generating a more comprehensive and accurate credit rating after taking into account both quantitative and qualitative factors and adopting the absolute scoring approach).

Thus, the enhanced CRRM would help FICC to identify those members that could present credit risk to FICC, which then would allow FICC to better manage the potential risks from these members.

Consistency with the Clearing Supervision Act

The proposed enhancements to the CRRM as described in detail above would be consistent with Section 805(b) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act").¹⁵ The objectives and principles of Section 805(b) of the Clearing Supervision Act include, among other things, the promotion of robust risk management.¹⁶

By enhancing the CRRM to enable it to assign credit ratings to members that are foreign banks or trust companies and that have audited financial data that is publicly available, the proposed rule change would expand the CRRM's applicability to a wider group of members, which would improve FICC's membership monitoring process and promote robust risk management, consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

Similarly, by enhancing the CRRM to enable it to incorporate qualitative factors when assigning a member's credit rating, the proposed change would enable FICC to take into account

¹⁵ 12 U.S.C. 5464(b)

¹⁶ Id.

relevant qualitative factors in an automated and more effective manner when monitoring the credit risks presented by the GSD Netting Members and MBSD Clearing Members, which would improve FICC's membership monitoring process overall and promote robust risk management, consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

Likewise, by enhancing the CRRM to shift from a relative scoring approach to an absolute scoring approach when assigning a member's credit rating, the proposed rule change would enable FICC to generate credit ratings for members that are more reflective of the members' default risk, which would improve FICC's membership monitoring process and promote robust risk management, consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

The proposed enhancements to the CRRM are consistent with Rule 17Ad-22(e)(3)(i) under the Securities Exchange Act of 1934, as amended ("Act"), which was recently adopted by the Commission.¹⁷ Rule 17Ad-22(e)(3)(i) will require FICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain a sound risk management framework for comprehensively managing risks that arise in or are born by FICC, which includes...systems designed to identify, measure, monitor and manage the range of risks that arise in or are borne by FICC.¹⁸ The proposed enhancements to the CRRM have been designed to assist FICC in identifying, measuring, monitoring and managing the credit risks to FICC posed by its members. The proposed enhancements to the CRRM accomplish this by (i) expanding the CRRM's applicability to a wider group of members to include members that are foreign banks or trust companies, (ii) enabling the CRRM to take into account relevant qualitative factors in an automated and more effective manner when monitoring the credit risks presented by FICC's members and (iii) enabling the CRRM to generate credit ratings for members that are more reflective of the members' default risk by shifting to an absolute scoring approach, all of which would improve FICC's membership monitoring process overall. Therefore, FICC believes the proposed enhancements to the CRRM would assist FICC in identifying, measuring, monitoring and managing risks that arise in or are born by FICC, consistent with the requirements of Rule 17Ad-22(e)(3)(i).

The proposed rule change to Section 7 of GSD Rule 3 and Section 6 of MBSD Rule 3 with respect to the scope of information that may be requested by FICC from its members has been designed to be consistent with Rule 17Ad-22(e)(19) under the Act, which was recently adopted by the Commission.¹⁹ Rule 17Ad-22(e)(19) will require FICC to establish, implement,

¹⁷ 17 CFR 240.17Ad-22(e)(3)(i). The Commission adopted amendments to Rule 17Ad-22, including the addition of new subsection 17Ad-22(e), on September 28, 2016. See Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7-03-14). FICC is a "covered clearing agency" as defined by the new Rule 17Ad-22(a)(5) and must comply with new subsection (e) of Rule 17Ad-22 by April 11, 2017. Id.

¹⁸ Id.

¹⁹ 17 CFR 240.17Ad-22(e)(19). Id.

maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage the material risk to FICC arising from arrangements in which firms that are indirect participants in FICC rely on the services provided by GSD Members and MBSD Members to access FICC's payment, clearing, or settlement facilities.²⁰ By expressly reflecting in the Rules what is already FICC's current practice associated with its request for additional reporting of a GSD Member's or MBSD Member's financial or operational conditions to state that such request may include information regarding the businesses and operations of the member, as well as its risk management practices with respect to services of FICC utilized by the member for another Person, this proposed rule change would help enable FICC to have rule provisions that are reasonably designed to identify, monitor and manage the material risks to FICC arising from tiered participation arrangements consistent with Rule 17Ad-22(e)(19).

11. Exhibits

Exhibit 1 – Not applicable.

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

Exhibit 2 – Not applicable.

Exhibit 3 – Not applicable.

Exhibit 4 – Not applicable.

Exhibit 5 – Proposed changes to the GSD Rules and the MBSD Rules.

²⁰

Id.

EXHIBIT 1A

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-[_____]; File No. SR-FICC-2017-804)

[DATE]

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Advance Notice to Enhance the Credit Risk Rating Matrix and Make Other Changes

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)¹ and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 (“Act”),² notice is hereby given that on March __, 2017, Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) the advance notice SR-FICC-2017-804 (“Advance Notice”) as described in Items I, II and III below, which Items have been prepared by the clearing agency.³ The Commission is publishing this notice to solicit comments on the Advance Notice from interested persons.

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

This Advance Notice consists of proposed modifications to FICC’s Government Securities Division (“GSD”) Rulebook (“GSD Rules”) and Mortgage-Backed Securities Division (“MBSD”) Clearing Rules (“MBSD Rules,” and collectively with the GSD

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(1)(i).

³ On March __, 2017, FICC filed this Advance Notice as a proposed rule change (SR-FICC-2017-006) with the Commission pursuant to Section 19(b)(1) of the Act, 15 U.S.C. 78s(b)(1), and Rule 19b-4, 17 CFR 240.19b-4. A copy of the proposed rule change is available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

Rules, the “Rules”).⁴ The proposed rule change would amend the Rules in order to (i) enhance the matrix (hereinafter referred to as the “Credit Risk Rating Matrix” or “CRRM”)⁵ developed by FICC to evaluate the risks posed by certain GSD Netting Members and MBSB Clearing Members (collectively, “CRRM-Rated Members”) to FICC and its members from providing services to these CRRM-Rated Members and (ii) make other amendments to the Rules to provide more transparency and clarity regarding FICC’s current ongoing membership monitoring process.

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

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

⁴ Capitalized terms not defined herein are defined in the GSD Rules, available at www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf, and the MBSB Rules, available at www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_mbsb_rules.pdf.

⁵ The proposed rule changes with respect to the enhancement of the CRRM are reflected in the inclusion of (1) qualitative factors and examples thereof in the definition of “Credit Risk Rating Matrix” in GSD Rule 1 and MBSB Rule 1 and (2) certain GSD Foreign Netting Members that are banks or trust companies and MBSB Bank Clearing Members that are Foreign Persons as CRRM-Rated Members in GSD Rule 3 (Section 12(b)(i)(II)) and MBSB Rule 3 (Section 11(b)(i)(II)). The proposed enhancement to CRRM also necessitates a conforming change to the existing Section 12(b) (renumbered to Section 12(c) in this proposed rule filing) of GSD Rule 3 by deleting the reference to Foreign Netting Members and Bank Netting Members participating through their U.S. branches or agencies, as further discussed below.

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

Written comments relating to this proposal have not been solicited or received.

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

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

Nature of the Proposed Change

The proposed rule change would, among other things, enhance the CRRM to enable it to rate FICC members that are foreign banks or trust companies and have audited financial data that is publicly available. It would also enhance the CRRM by allowing it to take into account qualitative factors when generating credit ratings for FICC members. In addition, it would enhance the CRRM by shifting it from a relative scoring approach to an absolute scoring approach.

This rule filing also contains proposed rule changes that are not related to the proposed CRRM enhancements but that provide specificity, clarity and additional transparency to the Rules related to FICC's current ongoing membership monitoring process.

(i) Background

FICC occupies an important role in the securities settlement system by interposing itself through each of GSD and MBSD as a central counterparty between members that are counterparties to transactions accepted for clearing by FICC, thereby reducing the risk faced by members. FICC uses the CRRM, the Watch List (as defined below) and the enhanced surveillance to manage and monitor default risks of its members on an ongoing basis, as discussed below. The level and frequency of such monitoring for

a member is determined by the member's risk of default as assessed by FICC. Members that are deemed by FICC to pose a heightened risk to FICC and its members are subject to closer and more frequent monitoring.

Existing Credit Risk Rating Matrix

In 2004, the Commission approved a proposed rule change filed by FICC ("Initial Filing")⁶ with respect to GSD and MBSD to establish new criteria for placing certain members of FICC on a list for closer monitoring ("Watch List").

FICC proposed in the Initial Filing that all U.S. broker-dealers and U.S. banks that were GSD Netting Members and/or MBSD Clearing Members would be assigned a rating generated by entering financial data of those members into an internally generated credit rating scorecard, i.e., the CRRM.⁷ In the Initial Filing, FICC stated that all other types of GSD Netting Members and MBSD Clearing Members would be monitored by credit risk staff using financial criteria deemed relevant by FICC but would not be assigned a rating by the CRRM.⁸

Following the approval of the Initial Filing, the Commission approved a subsequent proposed rule change filed by FICC that provided interpretive guidance to the

⁶ See Securities Exchange Act Release No. 49158 (January 30, 2004), 69 FR 5624 (February 5, 2004) (SR-FICC-2003-03).

⁷ Footnote 4 of the Initial Filing explained the new criteria for rating members: "[FICC's] approach to the analysis of members is based on a thorough quantitative analysis. A broker-dealer member's rating on the [CRRM] will be based on factors including size (*i.e.*, total excess net capital), capital, leverage, liquidity, and profitability. Banks will be reviewed based on size, capital, asset quality, earnings, and liquidity." *Id.* These quantitative factors are still being applied today, and FICC currently does not plan to change them.

⁸ In the Initial Filing, FICC noted that these members would be monitored by credit risk staff by reviewing similar criteria as those reviewed for members included on the [CRRM] but such review would occur outside of the [CRRM] process. *Id.*

Initial Filing (“Interpretive Guidance Filing”).⁹ In the Interpretive Guidance Filing, FICC reiterated that U.S. broker-dealers and U.S. banks would be assessed against the CRRM and assigned a credit rating based on quantitative factors. Unfavorably-rated members would be placed on the Watch List. In the Interpretive Guidance Filing, FICC explained that credit risk staff could downgrade a particular member’s credit rating based on various qualitative factors. An example of such qualitative factors might be that the member in question received a qualified audit opinion on its annual audit. In the Interpretive Guidance Filing, FICC noted that, in order to protect FICC and its other members, it was important that credit risk staff maintain the discretion to downgrade a member’s credit rating on the CRRM and thus subject the member to closer monitoring.

The current CRRM is comprised of two credit rating models – one for the U.S. broker-dealers and one for the U.S. banks – and generates credit ratings for the relevant members based on a 7-point rating system, with “1” being the strongest credit rating and “7” being the weakest credit rating.

Over time, the current CRRM has not kept pace with FICC’s evolving membership base and heightened expectations from regulators and stakeholders for robustness of financial models. Specifically, the current CRRM only generates credit ratings for those GSD Netting Members and MBSD Clearing Members that are U.S. banks or U.S. broker-dealers that file standard reports with their regulators, which currently comprise 77% of GSD Netting Members and 85% of MBSD Clearing Members, respectively; foreign banks and trust companies currently account for 21% of

⁹ See Securities Exchange Act Release No. 51355 (March 10, 2005), 70 FR 12919 (March 16, 2005) (SR-FICC-2004-08).

GSD Netting Members and 1% of MBSD Clearing Members.¹⁰ The numbers of GSD and MBSD members that are foreign banks or trust companies increased from 16 and zero in 2012 to 22 and one in 2017, respectively, and are expected to continue to grow over the coming years. Foreign banks and trust companies are typically large global financial institutions that have complex businesses and conduct a high volume of activities. Although foreign banks and trust companies are not currently rated by the CRRM, they are monitored by FICC's credit risk staff using financial criteria deemed relevant by FICC and can be placed on the Watch List if they experience a financial change that presents risk to FICC. Given the increase in the number of foreign bank or trust company members in FICC in the recent years, there is a need to formalize FICC's credit risk evaluation process of these members by assigning credit ratings to them in order to better facilitate the comparability of credit risks among members.¹¹

In addition, the current CRRM assigns each GSD Netting Member and MBSD Clearing Member that is a U.S. bank or U.S. broker-dealer and that files standard reports with its regulator(s) a credit rating based on inputting certain quantitative data relative to

¹⁰ As of March 16, 2017, there are 105 GSD Netting Members and 78 MBSD Clearing Members. Of the 105 GSD Netting Members, 13 (or 12%) are U.S. banks, 68 (or 65%) are U.S. broker-dealers and 22 (or 21%) are foreign banks or trust companies. Of the 78 MBSD Clearing Members, 14 (or 18%) are U.S. banks, 52 (or 67%) are U.S. broker-dealers and one (or 1%) is a foreign bank or trust company.

¹¹ In the Interpretive Guidance Filing, FICC noted that CRRM is applied across FICC and its affiliated clearing agencies, National Securities Clearing Corporation ("NSCC") and The Depository Trust Company ("DTC"). Specifically, in order to run the CRRM, credit risk staff uses the financial data of the applicable GSD and MBSD members in addition to data of applicable members and participants of NSCC and DTC, respectively. In this way, each applicable GSD and MBSD member is rated against other applicable members and participants of NSCC and DTC, respectively. SR-FICC-2004-08, 70 FR 12919.

the applicable member into the CRRM. Accordingly, a member's credit rating is currently based solely upon quantitative factors. It is only after the CRRM has generated a credit rating with respect to a particular member that such member's credit rating may be downgraded manually by credit risk staff, after taking into consideration relevant qualitative factors. The inability of the current CRRM to take into account qualitative factors requires frequent and manual overrides by credit risk staff, which may result in inconsistent and/or incomplete credit ratings for members.

Furthermore, the current CRRM uses a relative scoring approach and relies on peer grouping of members to calculate the credit rating of a member. This approach is not ideal because a member's credit rating can be affected by changes in its peer group even if the member's financial condition is unchanged.

Proposed Credit Risk Rating Matrix Enhancements

To improve the coverage and the effectiveness of the current CRRM, FICC is proposing three enhancements. The first proposed enhancement would expand the scope of CRRM coverage by enabling the CRRM to generate credit ratings for GSD Netting Members and MBSD Clearing Members that are foreign banks or trust companies and that have audited financial data that is publicly available. The second proposed enhancement would incorporate qualitative factors into the CRRM and therefore is expected to reduce the need and the frequency of manual overrides of member credit ratings. The third enhancement would replace the relative scoring approach currently used by CRRM with a statistical approach to estimate the absolute probability of default of each member.

A. *Enable the CRRM to Generate Credit Ratings for Foreign Bank or Trust Company Members*

The current CRRM is comprised of two credit rating models – one for the U.S. broker-dealers and one for the U.S. banks. FICC is proposing to enhance the CRRM by adding an additional credit rating model for the foreign banks and trust companies. The additional model would expand the membership classes to which the CRRM would apply to include foreign banks and trust companies that are GSD Netting Members and/or MBSD Clearing Members and that have audited financial data that is publicly available. The CRRM credit rating of a foreign bank or trust company that is a GSD Netting Member and/or MBSD Clearing Member would be based on quantitative factors, including size, capital, leverage, liquidity, profitability and growth, and qualitative factors, including market position and sustainability, information reporting and compliance, management quality, capital management and business/product diversity. By enabling the CRRM to generate credit ratings for these GSD Netting Members and MBSD Clearing Members, the enhanced CRRM would provide more comprehensive credit risk coverage of FICC's membership base.

With the proposed enhancement to the CRRM as described above, applicable foreign bank or trust company GSD Netting Members and MBSD Clearing Members would be included in the CRRM process and be evaluated more effectively and efficiently because financial data with respect to these foreign bank or trust company members could be extracted from data sources in an automated form.¹²

¹² In the Initial Filing, FICC noted that these members would be monitored by credit risk staff by reviewing similar criteria as those reviewed for members included on the CRRM, but such review would occur outside of the CRRM process. SR-FICC-2003-03, 69 FR 5624.

After the proposed enhancement, CRRM would be able to generate credit ratings on an ongoing basis for all GSD Netting Members and MBSD Clearing Members that are U.S. banks, U.S. brokers-dealers and foreign banks and trust companies, which together represent approximately 99% of the GSD Netting Members and 86% of the MBSD Clearing Members, respectively.¹³

B. Incorporate Qualitative Factors into the CRRM

In addition, as proposed, the enhanced CRRM would blend qualitative factors with quantitative factors to produce a credit rating for each applicable member in relation to the member's credit risk. For U.S. and foreign banks and trust companies, the enhanced CRRM would use a 70/30 weighted split between quantitative and qualitative factors to generate credit ratings. For U.S. broker-dealers, the weight split between quantitative and qualitative factors would be 60/40. These weight splits are chosen by FICC based on the industry best practice as well as research and sensitivity analysis conducted by FICC. FICC would review and adjust the weight splits as well as the quantitative and qualitative factors, as needed, based on recalibration of the CRRM to be conducted by FICC approximately every three to five years.

Although there are advantages to measuring credit risk quantitatively, quantitative evaluation models alone are incapable of fully capturing all credit risks. Certain qualitative factors may indicate that a member is or will soon be undergoing financial

¹³ As of March 16, 2017, there are two GSD Netting Members that are government sponsored entities and therefore would not be rated by the enhanced CRRM, as proposed; there are also 11 MBSD Clearing Members that would not be rated by the enhanced CRRM, as proposed, because they are government sponsored entities, registered investment companies, unregistered investment pools ("UIPs") or other entities that are eligible for MBSD Clearing Membership pursuant to Section 1(i) of MBSD Rule 2A. MBSD Rules, supra note 4.

distress, which may in turn signal a higher default exposure to FICC and its other members. As such, a key enhancement being proposed to the CRRM is the incorporation of relevant qualitative factors into each of the three credit rating models mentioned above. By including qualitative factors in the three credit rating models, the enhanced CRRM would capture risks that would otherwise not be accounted for with quantitative factors alone.¹⁴ Adding qualitative factors to the CRRM would not only enable it to generate more consistent and comprehensive credit ratings for applicable members, but it would also help reduce the need and frequency of manual credit rating overrides by the credit risk staff because overrides would likely only be required under more limited circumstances.¹⁵

C. Shifting From Relative Scoring to Absolute Scoring

As proposed, the enhanced CRRM would use an absolute scoring approach and rank each member based on its individual probability of default rather than the relative scoring approach that is currently in use. This proposed change is designed to have a member's CRRM-generated credit rating reflect an absolute measure of the member's default risk and eliminate any potential distortion of a member's credit rating from the

¹⁴ The initial set of qualitative factors that would be incorporated into the CRRM includes (a) for U.S. broker dealers, market position and sustainability, management quality, capital management, liquidity management, geographic diversification, business/product diversity and access to funding, (b) for U.S. banks, environment, compliance/litigation, management quality, liquidity management and parental demands and (c) for foreign banks and trust companies, market position and sustainability, information reporting and compliance, management quality, capital management and business/product diversity.

¹⁵ Once a member is assigned a credit rating, if circumstances warrant, credit risk staff would still have the ability to override the CRRM-issued credit rating by manually downgrading such rating as they do today. To ensure a conservative approach, the CRRM-issued credit ratings cannot be manually upgraded.

member's peer group that may occur under the relative scoring approach used in the existing CRRM.

D. Watch List and Enhanced Surveillance

In addition to the Watch List, FICC also maintains an enhanced surveillance list (referenced herein and in the proposed rule text as “enhanced surveillance”) for membership monitoring. The enhanced surveillance list is generally used when members are undergoing drastic and unexpected changes in their financial conditions or operation capabilities and thus are deemed by FICC to be of the highest risk level and/or warrant additional scrutiny due to FICC’s ongoing concerns about these members. Accordingly, members that are subject to enhanced surveillance are reported to FICC’s management committees and are also regularly reviewed by a cross-functional team comprised of senior management of FICC. More often than not, members that are subject to enhanced surveillance are also on the Watch List. The group of members that is subject to enhanced surveillance is generally much smaller than the group on the Watch List. The enhanced surveillance list is an internal tool for FICC that triggers increased monitoring of a member above the monitoring that occurs when a member is on the Watch List.

A member could be placed on the Watch List either based on its credit rating of 5, 6 or 7, which can either be generated by the CRRM or from a manual downgrade, or when FICC deems such placement as necessary to protect FICC and its members. In contrast, a member would be subject to enhanced surveillance only when close monitoring of the member is deemed necessary to protect FICC and its members.

The Watch List and enhanced surveillance tools are not mutually exclusive; they may complement each other under certain circumstances. A key distinction between the

Watch List and enhanced surveillance is that being placed on the Watch List may result in Clearing Fund related consequences under the Rules, whereas enhanced surveillance does not.¹⁶ For example, a member that is in a precarious situation could be placed on the Watch List and be subject to enhanced surveillance; however, because the Watch List status could require additional Clearing Fund deposits, when FICC has preliminary concerns about a member, to avoid potential increase to a member's Clearing Fund deposit, FICC may opt not to place the member on the Watch List until it is certain that such concerns would not be alleviated in the short-term. Instead, in such a situation, FICC might first subject the member to enhanced surveillance in order to closely monitor the member's situation without affecting the member's Clearing Fund deposits. If the member's situation improves, then it will no longer be subject to enhanced surveillance. If the situation of the member worsens, the member may then be placed on the Watch List as deemed necessary by FICC.

(ii) Detailed Description of the Proposed Rule Changes Related to the Proposed CRRM Enhancements

In connection with the proposed enhancements to the CRRM, FICC proposes to amend the GSD Rules and the MBSD Rules to (1) incorporate qualitative factors into CRRM and (2) add foreign banks and trust companies that are GSD Netting Members and MBSD Clearing Members to the categories of members that would be assigned credit ratings by FICC using the CRRM.

¹⁶ FICC expects to provide additional clarity to members regarding the Watch List and its impact on Clearing Fund deposits in a subsequent proposed rule change to be filed with the Commission in 2017.

A. *Proposed Changes to GSD Rule 1 (Definitions) and MBSD Rule 1 (Definitions)*

FICC is proposing to amend the “Credit Risk Rating Matrix” definition in GSD Rule 1 and MBSD Rule 1 to include qualitative factors, such as management quality, market position/environment and capital and liquidity risk management, because, as proposed, the enhanced CRRM would blend both qualitative factors and quantitative factors to produce a credit rating for each applicable FICC member.

B. *Proposed Changes to Section 12(b)(i)(II) of GSD Rule 3 (Ongoing Membership Requirements) and Section 11(b)(i)(II) of MBSD Rule 3 (Ongoing Membership Requirements)*

FICC is proposing to amend Section 12(b)(i)(III) of GSD Rule 3 and Section 11(b)(i)(III) of MBSD Rule 3 to expand the membership types to which the CRRM would apply to include GSD Netting Members and MBSD Clearing Members, as applicable, that are foreign banks or trust companies and that have audited financial data that are publicly available.

The enhanced CRRM would assign credit ratings for each GSD Netting Member and/or MBSD Clearing Member that is a foreign bank or trust company based on its publicly available audited financial data. The credit rating would be based on an 18-point scale, which is then mapped to the 7-point rating system currently in use today, with “1” being the strongest credit rating and “7” being the weakest credit rating.

(iii) Other Proposed Rule Changes

This rule filing also contains proposed rule changes that are unrelated to the proposed enhancement of the CRRM. These proposed rule changes would provide specificity, clarity and additional transparency to the Rules with respect to FICC’s current ongoing membership monitoring process, as described below.

A. *Proposed Changes to the Definitions of “Credit Risk Rating Matrix” and “Watch List” in GSD Rule 1 (Definitions) and MBSD Rule 1 (Definitions)*

FICC is proposing to amend the definition of “Credit Risk Rating Matrix” in GSD Rule 1 and MBSD Rule 1 to state that, in addition to the proposed qualitative factors described above, the CRRM is also based on quantitative factors, such as capital, assets, earnings and liquidity.

FICC is also proposing to amend the definition of “Watch List” in GSD Rule 1 and MBSD Rule 1 to state that the Watch List is comprised of members whose credit ratings derived from the CRRM are 5, 6 or 7 as well as members that are deemed by FICC to pose a heightened risk to FICC and its members based on FICC’s consideration of relevant factors, including those set forth in Section 12(d) of GSD Rule 3 and Section 11(d) of MBSD Rule 3, as applicable.

B. *Proposed Changes to GSD Rule 3 and MBSD Rule 3*
Section 7 of GSD Rule 3 and Section 6 of MBSD Rule 3

FICC is proposing to amend Section 7 of GSD Rule 3 and Section 6 of MBSD Rule 3 to state that review of a GSD Member’s or MBSD Member’s financial or operational conditions may (1) include FICC requesting information regarding the businesses and operations of the member and its risk management practices with respect to FICC’s services utilized by the member for another Person and (2) result in the member being placed on the Watch List and/or being subject to enhanced surveillance as determined by FICC.

FICC members are direct participants of GSD and/or MBSD, as applicable. However, there are firms that rely on the services provided by GSD Members or MBSD Members in order to have their activity cleared and settled through FICC’s facilities (the

“indirect participants”). These indirect participants pose certain risks to FICC that need to be identified and monitored as part of FICC’s ongoing member due diligence process. In order for FICC to understand (1) the material dependencies between FICC members and the indirect participants that rely on the FICC members for the clearance and settlement of the indirect participants’ transactions, (2) significant FICC member-indirect participant relationships and (3) the various risk controls and mitigants that these FICC members employ to manage their risks with respect to such relationships, FICC may request information from GSD Members or MBSD Members regarding the members’ businesses and operations as well as their risk management practices with respect to services of FICC utilized by the FICC members for indirect participants. The information provided by FICC members would then be taken into consideration by FICC when determining whether a GSD Member or an MBSD Member, as applicable, may need to be placed on the Watch List, be subject to enhanced surveillance or both.

Section 12(a) of GSD Rule 3 and Section 11(a) of MBSD Rule 3

FICC is proposing to amend Section 12(a) of GSD Rule 3 and Section 11(a) of MBSD Rule 3 in order to specify the membership types that are currently subject to FICC’s ongoing monitoring and review. FICC currently monitors and reviews all (a) GSD Netting Members, Sponsoring Members and Funds-Only Settling Bank Members and (b) MBSD Members on an ongoing and periodic basis, which may include monitoring news and market developments relating to these members and conducting reviews of financial reports and other public information of these members.

Section 12(b)(i) of GSD Rule 3 and Section 11(b)(i) of MBSD Rule 3

FICC is proposing to add Section 12(b)(i) of GSD Rule 3 and Section 11(b)(i) of MBSD Rule 3 to (1) clarify that FICC is currently using the CRRM to generate credit ratings for (A) GSD Members that are Bank Netting Members and MBSD Members that are Bank Clearing Members; provided that each such member files the Consolidated Report of Condition and Income (“Call Report”) and (B) GSD Members that are Dealer Netting Members or Inter-Dealer Broker Netting Members and MBSD Members that are Dealer Clearing Members or Inter-Dealer Broker Clearing Members; provided that each such member files the Financial and Operational Combined Uniform Single Report (“FOCUS Report”) or the equivalent with its regulator, (2) clarify that each CRRM-Rated Member’s credit rating would be reassessed upon receipt of additional information from the member and (3) delete language that states members may be placed on the Watch List based on their ratings as determined by CRRM or based on their failure to comply with operational standards and requirements.

Currently, Section 11(a) of MBSD Rule 3 states that UIPs are rated by the CRRM. FICC proposes to delete this statement and amend it to state that FICC reviews and monitors UIPs (as with all MBSD Members).¹⁷ This proposed change corrects an error in the MBSD Rules and does not affect any rights or obligations of the MBSD Members because UIPs are still reviewed by FICC through proposed Section 11(a) of MBSD Rule 3.

¹⁷ Amendment No. 1 to SR-FICC-2008-01, approved by the Commission in 2012, eliminated any reference to the CRRM with regards to UIPs; however, due to a clerical error, this change was not included in the Exhibit 5 thereto and therefore not reflected in the current MBSD Rules. See Securities Exchange Act Release No. 66550 (March 9, 2012), 77 FR 15155 (March 14, 2012) (SR-FICC-2008-01). FICC is proposing to correct this error.

Section 12(b)(ii) of GSD Rule 3 and Section 11(b)(ii) of MBSD Rule 3

FICC is proposing to add Section 12(b)(ii) of GSD Rule 3 and Section 11(b)(ii) of MBSD Rule 3 to provide that, because the factors used as part of the CRRM may not identify all risks that a member may pose to FICC, FICC may, in addition to other actions permitted by the Rules, downgrade the member's credit rating derived from the CRRM if FICC believes the CRRM-generated rating is insufficiently conservative or if it deems such downgrade as necessary to protect FICC and its members. Depending on the credit rating of the member, a downgrade may result in the member being placed on the Watch List and/or being subject to enhanced surveillance based on relevant factors.

Section 12(c) of GSD Rule 3 and Section 11(c) of MBSD Rule 3

FICC is proposing to re-number the existing Section 12(b) of GSD Rule 3 and Section 11(b) of MBSD Rule 3 to Section 12(c) and Section 11(c) of the respective Rules as well as to amend these sections to state that, other than those members specified in Section 12(b)(i) of GSD Rule 3 and Section 11(b)(i) of MBSD Rule 3, FICC may place (1) GSD Sponsoring Members, Funds-Only Settling Bank Members and Netting Members and (2) MBSD Members, on the Watch List and/or subject them to enhanced surveillance even though they are not being assigned credit ratings by FICC in accordance with the CRRM.

Section 12(d) of GSD Rule 3 and Section 11(d) of MBSD Rule 3

FICC is proposing to add Section 12(d) to GSD Rule 3 and Section 11(d) to MBSD Rule 3 to describe some of the factors that could be taken into consideration by FICC when downgrading a member's credit rating, placing a member on the Watch List and/or subjecting a member to enhanced surveillance. These factors include but are not

limited to (i) news reports and/or regulatory observations that raise reasonable concerns relating to the member, (ii) reasonable concerns around the member's liquidity arrangements, (iii) material changes to the member's organizational structure, (iv) reasonable concerns of FICC about the member's financial stability due to particular facts and circumstances, such as material litigation or other legal and/or regulatory risks, (v) failure of the member to demonstrate satisfactory financial condition or operational capability or if FICC has a reasonable concern regarding the member's ability to maintain applicable membership standards and (vi) failure of the member to provide information required by FICC to assess risk exposures posed by the member's activity.

Section 12(e) of GSD Rule 3 and Section 11(e) of MBSD Rule 3

FICC is proposing to re-number the existing Section 12(c) of GSD Rule 3 and Section 11(c) of MBSD Rule 3 to Section 12(e) and Section 11(e) of the respective Rules and refer to FICC's ability to retain any Excess Clearing Fund Deposits of a GSD Netting Member or an MBSD Clearing Member, as applicable, that has been placed on the Watch List pursuant to Section 9 of GSD Rule 4 or Section 9 of MBSD Rule 4, as applicable. In addition, FICC is proposing technical modifications in these sections to correct grammatical errors and add a section reference.

Section 12(f) of GSD Rule 3 and Section 11(f) of MBSD Rule 3

FICC is proposing to re-number the existing Section 12(d) of GSD Rule 3 and Section 11(d) of MBSD Rule 3 to Section 12(f) and Section 11(f) of the respective Rules and provide that FICC would, in addition to other actions permitted by the Rules, conduct a more thorough monitoring of the financial condition and/or operational capability of, and require more frequent financial disclosures from, not only those members that are

placed on the Watch List but also members subject to enhanced surveillance, including examples of how the monitoring could be conducted and the types of disclosures that may be required. In addition, members that are subject to enhanced surveillance would be reported to FICC's management committees and regularly reviewed by a cross-functional team comprised of senior management of FICC.

Other Proposed Changes to GSD Rule 3 and MBSD Rule 3

In addition to the proposed changes described above, FICC is proposing to delete the existing Section 12(e) of GSD Rule 3 and Section 11(e) of MBSD Rule 3 to eliminate FICC's right to place a member with an Excess Capital Ratio of 0.5 or greater on the Watch List because FICC has not used, nor does it plan to use, this threshold.

In addition, FICC is proposing to delete the existing Section 12(f) of GSD Rule 3 and Section 11(f) of MBSD Rule 3 to eliminate language that requires FICC to place a GSD Netting Member or an MBSD Clearing Member, as applicable, on the Watch List if FICC takes any action against the GSD Netting Member or the MBSD Clearing Member under GSD Rule 3, Section 7 (General Continuance Standards) and MBSD Rule 3, Section 6 (General Continuance Standards), respectively. FICC is proposing these deletions because placement of a member on the Watch List would be covered by the proposed changes to Sections 12(b), (c) and (d) of GSD Rule 3 and Sections 11(b), (c) and (d) of MBSD Rule 3. As such, the language being deleted by this proposed change would no longer be needed.

Similarly, FICC is proposing to delete language that requires a GSD Netting Member or an MBSD Clearing Member, as applicable, to remain on the Watch List until the condition(s) that resulted in its placement on the Watch List are no longer present or

if close monitoring by FICC is no longer warranted. FICC is proposing this deletion because whether a member remains on the Watch List would be covered by the proposed changes to Sections 12(b), (c) and (d) of GSD Rule 3 and Sections 11(b), (c) and (d) of MBSD Rule 3. As such, the language being deleted by this proposed change would no longer be needed.

C. Proposed Changes to GSD Rules 5, 11 and 18

FICC is also proposing to amend GSD Rules 5 (Comparison System), 11 (Netting System) and 18 (Special Provisions for Repo Transactions) to clarify that FICC may subject (1) a Comparison-Only Member to enhanced surveillance if FICC has determined that the Comparison-Only Member has violated its obligations under Section 1 of GSD Rule 5 and (2) a Netting Member to enhanced surveillance if FICC has determined that the Netting Member has violated its obligations under Section 3 of GSD Rule 11 or Section 2 of GSD Rule 18. In addition, FICC is proposing to amend GSD Rule 11 to correct a typographical error.

Implementation Timeframe

Pending Commission approval, FICC expects to implement this proposal promptly. Members would be advised of the implementation date of this proposal through issuance of a FICC Important Notice.

Expected Effect on Risks to the Clearing Agency, Its Participants and the Market

The proposed rule changes would mitigate counterparty credit risk for FICC by allowing FICC to more accurately monitor the creditworthiness and risk profile of its members. The enhanced CRRM would provide a more robust credit rating methodology by incorporating qualitative factors and adopting an absolute scoring approach. Both of

these enhancements would improve FICC's ability to monitor the credit risk of its members and are expected to lessen the frequency of manual overrides. The enhanced CRRM would also expand the coverage of FICC's membership by providing credit ratings for members that are foreign banks or trust companies, which are not covered under the existing CRRM.

By mitigating counterparty credit risk for FICC as described above, the enhanced CRRM would also mitigate risk for FICC members because lowering the risk profile for FICC would in turn lower the risk exposure that FICC members may have with respect to FICC in its role as a central counterparty.

Management of Identified Risks

The proposed rule changes are designed to mitigate counterparty credit risk for FICC and to provide greater clarity and transparency to FICC's members regarding the counterparty credit risk management approach used by FICC.

The enhanced CRRM would improve FICC's ability to monitor the probability of default for members that are rated by the CRRM and is expected to lessen the need and the frequency of manual downgrades due to the anticipated improvement in the accuracy of the credit ratings generated by the enhanced CRRM.

FICC employs a risk-based approach to conducting monitoring and review of its members by using the CRRM to identify higher risk members. Once identified, FICC would place these members on the Watch List, which would result in more frequent review by FICC of these members than the other members. For members that are placed on the Watch List, FICC would conduct more thorough monitoring of these members'

financial condition and/or operational capability, which could include, for example, on-site visits or additional due diligence information requests.

FICC members that have been placed on the Watch List may also be required to maintain a higher deposit to the GSD Clearing Fund or MBSD Clearing Fund, as applicable, which would help offset potential risks to FICC and its members arising from activity submitted by these members.

The enhanced CRRM would also expand the coverage of FICC's membership by providing credit ratings for foreign banks and trust companies, which are not currently rated under the existing CRRM. The addition of these entities would allow FICC to employ its risk-based approach to identify those higher risk members for additional monitoring with more efficiency (by reducing the need for manual overrides) and effectiveness (by generating a more comprehensive and accurate credit rating after taking into account both quantitative and qualitative factors and adopting the absolute scoring approach).

Thus, the enhanced CRRM would help FICC to identify those members that could present credit risk to FICC, which then would allow FICC to better manage the potential risks from these members.

Consistency with the Clearing Supervision Act

The proposed enhancements to the CRRM as described in detail above would be consistent with Section 805(b) of the Clearing Supervision Act.¹⁸ The objectives and

¹⁸ 12 U.S.C. 5464(b)

principles of Section 805(b) of the Clearing Supervision Act include, among other things, the promotion of robust risk management.¹⁹

By enhancing the CRRM to enable it to assign credit ratings to members that are foreign banks or trust companies and that have audited financial data that is publicly available, the proposed rule change would expand the CRRM's applicability to a wider group of members, which would improve FICC's membership monitoring process and promote robust risk management, consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

Similarly, by enhancing the CRRM to enable it to incorporate qualitative factors when assigning a member's credit rating, the proposed change would enable FICC to take into account relevant qualitative factors in an automated and more effective manner when monitoring the credit risks presented by the GSD Netting Members and MBSD Clearing Members, which would improve FICC's membership monitoring process overall and promote robust risk management, consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

Likewise, by enhancing the CRRM to shift from a relative scoring approach to an absolute scoring approach when assigning a member's credit rating, the proposed rule change would enable FICC to generate credit ratings for members that are more reflective of the members' default risk, which would improve FICC's membership monitoring process and promote robust risk management, consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

¹⁹

Id.

The proposed enhancements to the CRRM are consistent with Rule 17Ad-22(e)(3)(i) under the Act, which was recently adopted by the Commission.²⁰ Rule 17Ad-22(e)(3)(i) will require FICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain a sound risk management framework for comprehensively managing risks that arise in or are born by FICC, which includes...systems designed to identify, measure, monitor and manage the range of risks that arise in or are borne by FICC.²¹ The proposed enhancements to the CRRM have been designed to assist FICC in identifying, measuring, monitoring and managing the credit risks to FICC posed by its members. The proposed enhancements to the CRRM accomplish this by (i) expanding the CRRM's applicability to a wider group of members to include members that are foreign banks or trust companies, (ii) enabling the CRRM to take into account relevant qualitative factors in an automated and more effective manner when monitoring the credit risks presented by FICC's members and (iii) enabling the CRRM to generate credit ratings for members that are more reflective of the members' default risk by shifting to an absolute scoring approach, all of which would improve FICC's membership monitoring process overall. Therefore, FICC believes the proposed enhancements to the CRRM would assist FICC in identifying, measuring, monitoring and managing risks that arise in or are born by FICC, consistent with the requirements of Rule 17Ad-22(e)(3)(i).

²⁰ 17 CFR 240.17Ad-22(e)(3)(i). The Commission adopted amendments to Rule 17Ad-22, including the addition of new subsection 17Ad-22(e), on September 28, 2016. See Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7-03-14). FICC is a "covered clearing agency" as defined by the new Rule 17Ad-22(a)(5) and must comply with new subsection (e) of Rule 17Ad-22 by April 11, 2017. Id.

²¹ Id.

The proposed rule change to Section 7 of GSD Rule 3 and Section 6 of MBSD Rule 3 with respect to the scope of information that may be requested by FICC from its members has been designed to be consistent with Rule 17Ad-22(e)(19) under the Act, which was recently adopted by the Commission.²² Rule 17Ad-22(e)(19) will require FICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage the material risk to FICC arising from arrangements in which firms that are indirect participants in FICC rely on the services provided by GSD Members and MBSD Members to access FICC's payment, clearing, or settlement facilities.²³ By expressly reflecting in the Rules what is already FICC's current practice associated with its request for additional reporting of a GSD Member's or MBSD Member's financial or operational conditions to state that such request may include information regarding the businesses and operations of the member, as well as its risk management practices with respect to services of FICC utilized by the member for another Person, this proposed rule change would help enable FICC to have rule provisions that are reasonably designed to identify, monitor and manage the material risks to FICC arising from tiered participation arrangements consistent with Rule 17Ad-22(e)(19).

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

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date that the proposed change was filed with the Commission or (ii) the date that any additional information requested

²² 17 CFR 240.17Ad-22(e)(19). Id.

²³ Id.

by the Commission is received. The clearing agency shall not implement the proposed change if the Commission has any objection to the proposed change.

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

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

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

IV. Solicitation of Comments

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

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FICC-2017-804 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-2017-804. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the Advance Notice that are filed with the Commission, and all written communications relating to the Advance Notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of FICC and on DTCC's website (<http://dtcc.com/legal/sec-rule-filings.aspx>). All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FICC-2017-804 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Secretary

EXHIBIT 5

Bold and underlined text indicates proposed added language

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

Bold, underlined and shaded text indicates proposed language added in connection with a separate proposal that has not yet been approved (SR-FICC-2017-005 and SR-FICC-2017-803, filed on March 9, 2017)

~~Bold, strikethrough and shaded text~~ indicates proposed language deleted in connection with a separate proposal that has not yet been approved (SR-FICC-2017-005 and SR-FICC-2017-803, filed on March 9, 2017)

FIXED INCOME CLEARING CORPORATION

GOVERNMENT SECURITIES DIVISION RULEBOOK

RULE 1 – DEFINITIONS

Credit Risk Rating Matrix

The term “Credit Risk Rating Matrix” ~~refers to~~ means to a matrix of credit ratings of Members specified in Section 12 of Rule 3. The matrix is developed by the Corporation to ~~rate~~ evaluate the credit risk such Members a Netting Member’s potential risk pose to the Corporation and its Members and is based on factors determined to be relevant by the Corporation from time to time, which factors are designed to collectively reflect the Member’s financial and operational condition of a Member. These factors include (i) quantitative factors, such as capital, assets, earnings, and liquidity, and (ii) qualitative factors, such as management quality, market position/environment, and capital and liquidity risk management, as determined by financial information required to be submitted by that Member and other relevant information.

Watch List

The term “Watch List” ~~refers to~~ means, at any time and from time to time, the list of Members whose credit ratings derived from the Credit Risk Rating Matrix are 5, 6 or 7, as well as members that, based on the Corporation’s consideration of relevant factors, including those set forth in Section 12(d) of Rule 3, are deemed by the Corporation to pose a heightened risk to the Corporation and its Members being more closely monitored by the Corporation for any reason deemed necessary by the Corporation.

RULE 3 – ONGOING MEMBERSHIP REQUIREMENTS

Section 7 - General Continuance Standards

A Member shall promptly inform the Corporation, both orally and in writing, if it no longer is in compliance with any of the relevant qualifications and standards for admission to membership set forth in Rule 2 and in this Rule, including whether it is subject to any of the criteria set forth in subsection (d) of Section 3 of Rule 2A. Notification must take place within two ~~B~~**business** ~~D~~**days** from the date on which the Member first learns of its non-compliance. The Corporation shall assess a fine against any Member who fails to so notify the Corporation. In addition, a Member shall notify the Corporation within two ~~B~~**business** ~~D~~**days** of learning ~~that of~~ an investigation or proceeding to which it is or is becoming ~~the~~ subject ~~of that~~ would cause the Member to fall out of compliance with any of the relevant qualifications and standards for membership set forth in Rules 2, 2A and 3. Notwithstanding the previous sentence, the Member shall not be required to notify the Corporation if doing so would cause the Member to violate an applicable law, rule or regulation. If, with respect to any type of Member: (a) it fails to maintain the relevant standards and qualifications for admission to membership, including but not limited to minimum capital standards and operational testing and related reporting requirements imposed by the Corporation from time to time; (b) it violates any Rule of the Corporation or other agreement with the Corporation; (c) it fails to satisfy in a timely manner any obligation to the Corporation; (d) there is ~~a~~ Reportable Event relating to such Member; or (e) the Corporation otherwise deems it necessary or advisable, in order to protect the Corporation, its other Members, or its creditors or investors, to safeguard securities and funds in the custody or control of the Corporation ~~or for which the Corporation is responsible~~, or to promote the prompt and accurate processing, clearance or settlement of securities transactions, the Corporation will undertake appropriate action to determine the status of the Member and its continued eligibility. In addition, the Corporation may review the financial responsibility and operational capability of the Member to the extent provided in these Rules and otherwise require from the Member additional reporting of its financial or operational condition at such intervals and in such detail as the Corporation shall determine, ~~including, but not limited to, such information as the Corporation may request regarding the businesses and operations of the Member and its risk management practices with respect to services of the Corporation utilized by the Member for another Person or Persons~~, and shall make a determination as to whether such Member should be placed on the Watch List ~~and/or be subject to enhanced surveillance~~ by the Corporation consistent with the provisions of Section 12 of this Rule.

Section 12 – Ongoing Monitoring Watch List

(a) All Netting Members, Sponsoring Members and Funds-Only Settling Bank Members will be monitored and reviewed by the Corporation on an ongoing and periodic basis, which may include monitoring of news and market developments and review of financial reports and other public information.

(b) (i) A Member that is (A) a Bank Netting Member that files the Consolidated Report of Condition and Income (“Call Report”), (B) a Dealer Netting Member, or Inter-Dealer Broker Netting Member that files the Financial and Operational Combined Uniform Single Report (“FOCUS Report”) or the equivalent with its regulator or (C) a Foreign Netting Member that is a bank or trust company and that has audited financial data that is publicly available will be ~~monitored and assigned a credit rating by the Corporation in accordance with the Credit Risk Rating Matrix. Such Member’s credit rating may be placed on the Watch List based on that Member’s rating as determined by the Credit Risk Rating Matrix. will be reassessed each time the Member provides the Corporation with requested information pursuant to Section 7 of Rule 3, or as may be otherwise required under the Rules (including this Rule 3, Section 12). Such Members may also be placed on the Watch List, at the Corporation’s discretion, based on failure to comply with operational standards and requirements.~~

(ii) Because the factors used as part of the Credit Risk Rating Matrix may not identify all risks that a Member specified in paragraph (b)(i) of this Section 12 may present to the Corporation, the Corporation may, in its discretion, override such Member’s credit rating derived from the Credit Risk Rating Matrix to downgrade the Member. This downgrading may result in the Member being placed on the Watch List, and/or it may subject the Member to enhanced surveillance based on relevant factors, including those set forth in paragraph (d) below. The Corporation may also take such additional actions with regard to the Member as are permitted by the Rules.

~~(c) All other categories of Netting Members, Sponsoring Members, Funds-Only Settling Bank Members and Netting Members other than those specified in paragraph (b)(i) of this Section 12 will not be assigned a credit rating by the Credit Risk Rating Matrix but, including Foreign Netting Members and Bank Netting Members participating through their U.S. branches or agencies, may be placed on the Watch List and/or may be subject to enhanced surveillance based on relevant factors, including those set forth in paragraph (d) below, monitored for financial and/or operational factors as the Corporation deems necessary to protect the Corporation and its Members from undue risk. These Members will not be assigned a rating from the Credit Risk Rating Matrix; however, they may be included on the Watch List at the Corporation’s discretion.~~

(d) The factors to be considered by the Corporation under paragraphs (b)(ii) and (c) of this Section 12 include, but are not limited to, (i) news reports and/or regulatory observations that raise reasonable concerns relating to the member, (ii) reasonable concerns around the member’s liquidity arrangements, (iii) material changes to the member’s organizational structure, (iv) reasonable concerns of the Corporation about the member’s financial stability due to particular facts and circumstances, such as material litigation or other legal and/or regulatory risks, (v) failure of the member to demonstrate satisfactory financial condition or operational capability or if the Corporation has a

reasonable concern regarding the member's ability to maintain applicable membership standards and (vi) failure of the member to provide information required by the Corporation to assess risk exposure posed by the member's activity (including information requested by the Corporation pursuant to Section 7 of this Rule 3).

(~~ee~~) The Corporation may require a Netting Member that has been placed on the Watch List, to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with Section 2 of Rule 4 (which additional deposit shall constitute a portion of the Netting Member's Required Fund Deposit), or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members, which higher amount may include, but is not limited to ~~including~~, additional payments or deposits in any form to offset potential risk to the Corporation and its Members arising from activity submitted by such Member. **The Corporation may also retain any Excess Clearing Fund Deposits of a Netting Member that has been placed on the Watch List as provided in Section 9 of Rule 4.** Moreover, as regards a Netting Member that has been placed on the Watch List by the Corporation, the Corporation may suspend, during all or a portion of the time period that such Member is on the Watch List, its right under these Rules to collect a Credit Forward Mark Adjustment Payment. Moreover, if a Netting Member on the Watch List has a Collateral Allocation Entitlement as the result of its GCF Repo Transaction activity, the Corporation may, in its sole discretion, maintain possession of the securities and/or cash that comprise such Collateral Allocation Entitlement.

(~~fd~~) **A member being subject to enhanced surveillance or being placed Placement** on the Watch List shall result in a more thorough monitoring of the ~~M~~member's financial condition and/or operational capability—~~condition~~, **as applicable, which could include, for example, on-site visits or additional due diligence information requests and activities by from** the Corporation. **In addition, T**the Corporation may require ~~a M~~members placed on the Watch List **and/or subject to enhanced surveillance** to make more frequent financial disclosures, ~~possibly~~ including, **without limitation**, interim and/or pro forma reports. **Members that are subject to enhanced surveillance are also reported to the Corporation's management committees and regularly reviewed by a cross-functional team comprised of senior management of the Corporation. The Corporation may also take such additional actions with regard to any member (including a member placed on the Watch List and/or subject to enhanced surveillance) as are permitted by the Rules.**

(~~e~~)—~~The Corporation shall have the right to place a Member with an Excess Capital Ratio of 0.5 or greater on the Watch List if the Corporation, in its sole discretion, deems such action necessary to protect itself and its Members. If such placement on the Watch List occurs, the Corporation will require the Netting Member to provide it with comfort satisfactory to the Corporation that the Netting Member is and shall continue to be able to fulfill its obligations to the Corporation, and may obtain or exchange with any other Clearing Organization margin information as specified in Rule 29.~~

(~~f~~)—~~A Netting Member shall be placed on the Watch List if the Corporation takes any action against such Member pursuant to Section 7 of Rule 3.~~

~~A Member shall continue to be included on the Watch List until the condition(s) that resulted in its placement on the Watch List have improved to the point where the condition(s) are no longer present or a determination is made by the Corporation that close monitoring is no longer warranted.~~

RULE 5 - COMPARISON SYSTEM

Section 1 - General

Trade comparison, which consists of the reporting, validating, and, in some cases, matching by the Corporation of the long and short sides of a securities trade, including a Repo Transaction, to ensure that the details of such trade are in agreement between the parties, is the first step in the clearance and settlement process for securities transactions. A Member of the Comparison System must submit to the Corporation for comparison trade data on all of its trades that are of the type processed by the Corporation (including trades executed and settled on the same day), calling for delivery of Eligible Securities, between it or an Executing Firm on whose behalf it is acting, and another Member or an Executing Firm on whose behalf it or another Member is acting. If the Corporation determines that a Comparison-Only Member has, without good cause, violated its obligations pursuant to this section, such Comparison-Only Member may be reported to the appropriate regulatory body, put on the Watch List **and/or be subject to enhanced surveillance** pursuant to Rule 3, or subject to an additional fee. In addition, the Corporation may discipline a Comparison-Only Member for a violation of this section in accordance with Rule 48.

RULE 11 - NETTING SYSTEM

Section 3 - Obligation to Submit Trades

If the Corporation determines that a Netting Member has, without good cause, violated its obligations pursuant to this Section, such Netting Member may be reported to the appropriate regulatory body, put on the Watch List **and/or be subject to enhanced surveillance** pursuant to Rule **43**, or subject to an additional fee. In addition, the Corporation may discipline a Netting Member for a violation of this section in accordance with Rule 48.

RULE 18 - SPECIAL PROVISIONS FOR REPO TRANSACTIONS

Section 2 - Obligation to Submit Repo Transactions

If the Corporation determines that a Netting Member has, without good cause, violated its obligations pursuant to this section, such Netting Member may be reported to the appropriate regulatory body, put on the Watch List **and/or be subject to enhanced surveillance** pursuant to Rule 3, or subject to an additional fee. In addition, the Corporation may discipline a Netting Member for a violation of this section in accordance with Rule 48.

FIXED INCOME CLEARING CORPORATION

MORTGAGE-BACKED SECURITIES DIVISION

CLEARING RULES

RULE 1 - DEFINITIONS

Credit Risk Rating Matrix

The term “Credit Risk Rating Matrix” ~~refers to~~ means a matrix of credit ratings of Members specified in Section 11 of Rule 3. The matrix is developed by the Corporation to ~~rate a Member’s~~ evaluate the credit potential risk such Members pose to the Corporation and its Members and is based on factors determined to be relevant by the Corporation from time to time, which factors are designed to collectively reflect the ~~Member’s~~ financial and operational condition of a Member. These factors include (i) quantitative factors, such as capital, assets, earnings, and liquidity, and (ii) qualitative factors, such as management quality, market position/environment, and capital and liquidity risk management, ~~as determined by financial information required to be submitted by that Member and other relevant information.~~

Watch List

The term “Watch List” ~~refers to~~ means, at any time and from time to time, the list of Members whose credit ratings derived from the Credit Risk Rating Matrix are 5, 6 or 7, as well as Members that, based on the Corporation’s consideration of relevant factors, including those set forth in Section 11(d) of Rule 3, are deemed by the Corporation to pose a heightened risk to the Corporation and its Members ~~being more closely monitored by the Corporation for any reason deemed necessary by the Corporation.~~

RULE 3 - ONGOING MEMBERSHIP REQUIREMENTS

Section 6 - General Continuance Standards

A Member shall promptly inform the Corporation, both orally and in writing, if it no longer is in compliance with any of the relevant qualifications and standards for admission to membership set forth in Rule 2A and in this Rule, including whether it is subject to any of the criteria set forth in subsection (d) of Section 2 of Rule 2A. Notification must take place within two business days from the date on which the Member first learns of its non-compliance. The Corporation may assess a fine against any Member who fails to so notify the Corporation. In addition, a Member shall notify the Corporation within two business days of learning of an investigation or proceeding to which it is or is becoming subject that would cause the Member to fall out of compliance with any of the relevant qualifications and standards for membership set forth in Rule 2A and this Rule. Notwithstanding the previous sentence, the Member shall not be required to notify the Corporation if doing so would cause the Member to violate an applicable law, rule or regulation. If, with respect to any type of Member: (a) it fails to maintain the relevant standards and qualifications for admission to membership, including but not limited to minimum capital standards and operational testing and related reporting requirements imposed by the Corporation from time to time; (b) it violates any Rule of the Corporation or other agreement with the Corporation; (c) it fails to satisfy in a timely manner any obligation to the Corporation; (d) there is a Reportable Event relating to such Member; or (e) the Corporation 40 otherwise deems it necessary or advisable, in order to protect the Corporation, its other Members, or its creditors or investors, to safeguard securities and funds in the custody or control of the Corporation, or to promote the prompt and accurate processing, clearance or settlement of securities Transactions, the Corporation will undertake appropriate action to determine the status of the Member and its continued eligibility. In addition, the Corporation may review the financial responsibility and operational capability of the Member to the extent provided in these Rules and otherwise require from the Member additional reporting of its financial or operational condition at such intervals and in such detail as the Corporation shall determine, **including, but not limited to, such information as the Corporation may request regarding the businesses and operations of the Member and its risk management practices with respect to services of the Corporation utilized by the Member for another Person or Persons,** and shall make a determination as to whether such Member should be placed on the Watch List **and/or be subject to enhanced surveillance** by the Corporation consistent with the provisions of Section 11 of this Rule. The Corporation may also, in its sole discretion, if it believes it necessary to protect itself and its Members, require a Member to deliver to the Corporation a guaranty of an Affiliate of the Member, satisfactory in form and substance to the Corporation, of the obligations of the Member to the Corporation.

Section 11 – Ongoing Monitoring Watch List

(a) All Members will be monitored and reviewed by the Corporation on an ongoing and periodic basis, which may include monitoring of news and market developments and review of financial reports and other public information.

(b) (i) A ~~Clearing~~ Member that is (A) a ~~domestic bank, broker-dealer or Unregistered Investment Pool Bank~~ Clearing Member that files the Consolidated Report of Condition and Income (“Call Report”), (B) a Dealer Clearing Member or Inter-Dealer Broker Clearing Member that files the Financial and Operational Combined Uniform Single Report (“FOCUS Report”) or the equivalent with its regulator or (C) a Bank Clearing Member that is a Foreign Person and that has audited financial data that is publicly available will be ~~monitored and assigned a credit rating by the Corporation in accordance with the Credit Risk Rating Matrix. Such Member’s credit rating will be reassessed each time the Member provides the Corporation with requested information pursuant to Section 6 of Rule 3, or as may be otherwise required under the Rules (including this Rule 3, Section 11).~~ may be placed on the Watch List based on that Member’s rating as determined by the Credit Risk Rating Matrix. Such Members may also be placed on the Watch List, at the Corporation’s discretion, based on failure to comply with operational standards and requirements.

(ii) Because the factors used as part of the Credit Risk Rating Matrix may not identify all risks that a Member specified in paragraph (b)(i) of this Section 11 may present to the Corporation, the Corporation may, in its discretion, override such Member’s credit rating derived from the Credit Risk Rating Matrix to downgrade the Member. This downgrading may result in the Member being placed on the Watch List, and/or it may subject the Member to enhanced surveillance based on relevant factors, including those set forth in paragraph (d) below. The Corporation may also take such additional actions with regard to the Member as are permitted by the Rules.

(c) ~~All other categories of Members other than those specified in paragraph (b)(i) of this Section 11 will not be assigned a credit rating by the Credit Risk Rating Matrix but may be placed on the Watch List and/or they may be subject to enhanced surveillance based on relevant factors, including those set forth in paragraph (d) below, monitored for financial and/or operational factors as the Corporation deems necessary to protect the Corporation and its Members from undue risk. These Members will not be assigned a rating from the Credit Risk Rating Matrix; however, they may be included on the Watch List at the Corporation’s discretion.~~

(d) The factors to be considered by the Corporation under paragraphs (b)(ii) and (c) of this Section 11 include, but are not limited to, (i) news reports and/or regulatory

observations that raise reasonable concerns relating to the Member, (ii) reasonable concerns around the Member's liquidity arrangements, (iii) material changes to the Member's organizational structure, (iv) reasonable concerns of the Corporation about the Member's financial stability due to particular facts and circumstances, such as material litigation or other legal and/or regulatory risks, (v) failure of the Member to demonstrate satisfactory financial condition or operational capability or if the Corporation has a reasonable concern regarding the Member's ability to maintain applicable membership standards and (vi) failure of the Member to provide information required by the Corporation to assess risk exposure posed by the Member's activity (including information requested by the Corporation pursuant to Section 6 of this Rule 3).

(ee) The Corporation may require a Clearing Member that has been placed on the Watch List, to make and maintain a deposit to the Clearing Fund over and above the amount determined in accordance with Section 2 of Rule 4 (which additional deposit shall constitute a portion of the Clearing Member's Required Fund Deposit), or such higher amount as the Board may deem necessary for the protection of the Corporation or other Members, which higher amount may include, but is not limited to ~~including~~, additional payments or deposits in any form to offset potential risk to the Corporation and its Members arising from activity submitted by such Member. The Corporation may also retain any Excess Clearing Fund Deposits of a Clearing Member that has been placed on the Watch List as provided in Section 9 of Rule 4~~The Corporation may also deny a Member's right to withdraw amounts the Member has in excess of its Required Fund Deposit.~~

(fd) A Member being subject to enhanced surveillance or being placed ~~Placement~~ on the Watch List shall result in a more thorough monitoring of the Member's financial condition and/or operational capability, condition, as applicable, and activities by which could include, for example, on-site visits or additional due diligence information requests from the Corporation. In addition, ~~the~~ Corporation may require a ~~Members~~ placed on the Watch List and/or subject to enhanced surveillance to make more frequent financial disclosures, ~~possibly~~ including, without limitation, interim and/or pro forma reports. Members that are subject to enhanced surveillance are also reported to the Corporation's management committees and regularly reviewed by a cross-functional team comprised of senior management of the Corporation. The Corporation may also take such additional actions with regard to any Member (including a Member placed on the Watch List and/or subject to enhanced surveillance) as are permitted by the Rules.

(e) ~~The Corporation shall have the right to place a Member with an Excess Capital Ratio of 0.5 or greater on the Watch List if the Corporation, in its sole discretion, deems such action necessary to protect itself and its Members. If such placement on the Watch List occurs, the Corporation will require the Clearing Member to provide it with assurances satisfactory to the Corporation that the Clearing Member is and shall continue to be able to fulfill its obligations to the Corporation, and may obtain from or exchange with any other Clearing Organization margin information as specified in Rule 22, "Release of Clearing Data."~~

~~(f) — A Clearing Member shall be placed on the Watch List if the Corporation takes any action to seek additional assurances of financial responsibility or operational capability against such Member pursuant to Section 6 of this Rule.~~

~~A Clearing Member shall continue to be included on the Watch List until the condition(s) that resulted in its placement on the Watch List have improved to the point where the condition(s) are no longer present or a determination is made by the Corporation that close monitoring is no longer warranted.~~
