

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-85470; File No. SR-FICC-2018-013)

March 29, 2019

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving a Proposed Rule Change to Expand Sponsoring Member Eligibility in the Government Securities Division Rulebook and Make Other Changes

I. Introduction

On December 13, 2018, Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> proposed rule change SR-FICC-2018-013 to expand sponsoring member eligibility and make other changes.<sup>3</sup> The proposed rule change was published for comment in the Federal Register on December 31, 2018.<sup>4</sup> On February 14, 2019, the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the

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

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

<sup>3</sup> On December 13, 2018, FICC also filed the proposal contained in the proposed rule change as advance notice SR-FICC-2018-802 with the Commission pursuant to Section 806(e)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”), 12 U.S.C. 5465(e)(1), and Rule 19b-4(n)(1)(i) of the Act, 17 CFR 240.19b-4(n)(1)(i). As of February 11, 2019, pursuant to Section 806(e)(1) of the Clearing Supervision Act, the advance notice was deemed to not have been objected to by the Commission. 12 U.S.C. 5465(e)(1); see Memorandum, Division of Trading and Markets, U.S. Securities and Exchange Commission, to File No. SR-FICC-2018-802, available at <https://www.sec.gov/rules/sro/ficc-an/2019/ficc-2018-802-memo-deemed-approved.pdf>.

<sup>4</sup> Securities Exchange Act Release No. 84951 (December 21, 2018), 83 FR 67801 (December 31, 2018) (SR-FICC-2018-013) (“Notice”).

proposed rule change and reopened the period for comment on the proposed rule change.<sup>5</sup> The Commission received five comment letters to the proposed rule change,<sup>6</sup> including a response letter from FICC. For the reasons discussed below, the Commission is approving the proposed rule change.

## II. Description of the Proposed Rule Change

FICC proposes to amend the FICC Government Securities Division (“GSD”) Rulebook (“Rules”)<sup>7</sup> to (i) allow a broader group of GSD Netting Members<sup>8</sup> to

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<sup>5</sup> Securities Exchange Act Release No. 85137 (February 14, 2019), 84 FR 5523 (February 21, 2019) (SR-FICC-2018-013).

<sup>6</sup> See letter from Robert E. Pooler, Jr., Chief Financial Officer, Ronin Capital, LLC, dated January 18, 2019, to Brent J. Fields, Secretary, Commission (“Ronin Letter”); letter from James Tabacchi, Chairman, Independent Dealer and Trade Association, dated January 22, 2019, to Brent J. Fields, Secretary, Commission (“IDTA Letter”); letter from Robert Toomey, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated January 22, 2019, to Brent J. Fields, Secretary, Commission (“SIFMA Letter”); letter from Stephen John Berger, Managing Director, Government & Regulatory Policy, Citadel, dated January 30, 2019, to Brent J. Fields, Secretary, Commission (“Citadel Letter”); and letter from Murray Pozmanter, Managing Director, DTCC, dated February 4, 2019, to Brent J. Fields, Secretary, Commission (“FICC Response Letter”). See comments on the proposed rule change (SR-FICC-2018-013), available at <https://www.sec.gov/comments/sr-ficc-2018-013/srficc2018013.htm>. Because the proposal contained in the proposed rule change was also filed as an advance notice, supra note 3, the Commission is considering all public comments received on the proposal regardless of whether the comments were submitted to the advance notice or the proposed rule change.

<sup>7</sup> Available at [http://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).

<sup>8</sup> The term “Netting Member” is defined in FICC’s GSD Rule 1 as a Member of FICC’s Comparison System (i.e., the system of reporting, validating, and matching the long and short sides of securities trades to ensure that the details of such trades are in agreement between the parties) and FICC’s Netting System (i.e., the system for aggregating and matching offsetting obligations resulting from trades).

participate in FICC as Sponsoring Members,<sup>9</sup> (ii) allow Sponsored Members to transact with Netting Members that are not the Sponsoring Member through a certain omnibus account maintained by the Sponsoring Member, and (iii) make certain conforming and technical changes.

A. The Proposed Expansion of Sponsored Member Eligibility

FICC proposes to broaden the group of GSD Netting Members that may participate in FICC as Sponsoring Members. Currently, GSD Bank Netting Members that are well-capitalized with at least \$5 billion in equity capital are permitted to serve as Sponsoring Members (“Category 1 Sponsoring Members”) and sponsor certain institutional firms into GSD membership as Sponsored Members.<sup>10</sup> A Sponsoring Member is permitted to submit to FICC for comparison, novation, and netting certain types of eligible transactions between itself and its Sponsored Members (“Sponsored Member Trades”).<sup>11</sup> For operational and administrative purposes, FICC interacts solely with the Sponsoring Member as agent for purposes of the day-to-day satisfaction of its

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<sup>9</sup> “Sponsoring Membership” is an existing program that allows well-capitalized bank members to sponsor their eligible clients into GSD Membership. Sponsored membership at GSD offers eligible clients the ability to lend cash or eligible collateral via FICC-cleared deliver-versus payment repo throughout the day. Sponsoring Member banks facilitate their sponsored clients’ GSD trading activity and act as processing agents on their behalf for all operational functions, including trade submission and settlement with FICC.

<sup>10</sup> Notice, 83 FR at 67802; Rule 3A, Section 2, supra note 7.

<sup>11</sup> Notice, 83 FR at 67802. FICC requires the Sponsoring Member to establish an omnibus account at FICC for all of its Sponsored Members’ FICC-cleared activity (“Sponsoring Member Omnibus Account”), which is separate from the Sponsoring Member’s regular netting account. Rule 1; Rule 3A, Section 10, supra note 7.

Sponsored Members' obligations to FICC, including the Sponsored Members' securities and funds-only settlement obligations.<sup>12</sup>

FICC proposes to add a second category of Netting Members eligible to become Sponsoring Members. This second category would include Netting Members that are Tier One Netting Members ("Category 2 Sponsoring Members"),<sup>13</sup> except for Inter-Dealer Broker ("IDB") Netting Members and Non-IDB Repo Brokers with respect to activity in their segregated repo accounts.<sup>14</sup> Category 2 Sponsoring Members could include, for example, dealer Netting Members, Futures Commission Merchant Netting Members, and foreign Netting Members.<sup>15</sup>

FICC stated that it did not include IDB Netting Members and Non-IDB Repo Brokers as a \$5 million cap applies to their respective loss allocation obligations to FICC under Rule 4, Section 7, which does not apply to other types of Netting Members.<sup>16</sup> As a Sponsoring Member's loss allocation obligations could otherwise exceed \$5 million, FICC stated that it would not be appropriate to allow either IDB Netting Members or Non-IDB Repo Brokers to be eligible to become Category 2 Sponsoring Members.

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<sup>12</sup> Notice, 83 FR at 67802; see Rule 3A, Sections 5, 6, 7, 8 and 9, supra note 7.

<sup>13</sup> The term "Tier One Netting Member" is designated in FICC's GSD Rule 2A, supra note 7, as a non-registered investment company Netting Member.

<sup>14</sup> Notice, 83 FR at 67802.

<sup>15</sup> Id.

<sup>16</sup> Id. Section 7 of Rule 4, supra note 7, provides that "an Inter-Dealer Broker Netting Member, or a Non-IDB Repo Broker with respect to activity in its Segregated Repo Account, shall not be subject to an aggregate loss allocation in an amount greater than \$5 million pursuant to this Section 7 for losses and liabilities resulting from an Event Period." The limit on loss allocation for these Members reflects their risk profile.

However, FICC stated that to the extent an IDB Netting Member or Non-IDB Repo Broker also has another type of Netting Member status with respect to which it is not subject to the loss allocation cap described above, such IDB Netting Member or Non-IDB Repo Broker could apply to become a Category 2 Sponsoring Member under another Netting Member status.<sup>17</sup>

FICC stated that the minimum financial requirements applicable to Category 2 Sponsoring Members would be the same as its otherwise applicable financial requirements under Section 4(b) of Rule 2A.<sup>18</sup> However, as compared to Category 1 Sponsoring Members, the proposed rule change would provide that FICC could impose greater financial requirements on an applicant to become a Category 2 Sponsoring Member.<sup>19</sup> FICC stated that it decided to provide the option to impose greater financial requirements as a Category 2 Sponsoring Member may have substantially less capital than a Category 1 Sponsoring Member.<sup>20</sup> FICC further stated that its determination as to whether to impose such greater financial requirements on a Category 2 Sponsoring Member applicant would be based upon the level of the anticipated positions and obligations of such applicant, the anticipated risk associated with the volume and types of transactions such applicant proposes to process through FICC as a Category 2 Sponsoring Member, and the overall financial condition of such applicant.<sup>21</sup> Such a determination by

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<sup>17</sup> Notice, 83 FR at 67802–03.

<sup>18</sup> Notice, 83 FR at 67803.

<sup>19</sup> Id.

<sup>20</sup> Id.

<sup>21</sup> Id.

FICC to impose increased financial requirements on a Category 2 Sponsoring Member applicant would be subject to the approval of the FICC Board of Directors in connection with its approval of the application of such Category 2 Sponsoring Member.<sup>22</sup> Once approved, FICC would thereafter regularly review a Category 2 Sponsoring Member regarding its continued adherence to such increased financial requirements.<sup>23</sup>

Further, the proposed rule change would also impose an activity limit on a Category 2 Sponsoring Member's Sponsored Member activity so that a Category 2 Sponsoring Member would only be permitted to novate new Sponsored Member activity to FICC to the extent the sum of the value at risk charges ("VaR Charges")<sup>24</sup> of its Sponsoring Member Omnibus Account(s) and its Netting System accounts ("Aggregate VaR Charges") do not exceed its Netting Member Capital,<sup>25</sup> unless otherwise determined by the Corporation in order to promote orderly settlement.<sup>26</sup> FICC stated that it anticipates calculating the ratio of a Category 2 Sponsoring Member's Aggregate VaR Charges to its Netting Member Capital on at least an hourly basis.<sup>27</sup> To the extent a Category 2 Sponsoring Member's Aggregate VaR Charges exceed its Netting Member

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<sup>22</sup> Id.

<sup>23</sup> Id.

<sup>24</sup> Each Netting Member is required to make margin deposits (each, a "Required Fund Deposit") to FICC's Clearing Fund. Rule 4, supra note 7. A Netting Member's Required Fund Deposit amount is comprised of several components, the largest of which is generally the VaR Charge. Notice, 83 FR at 67803.

<sup>25</sup> The term "Netting Member Capital" means net capital, net assets, or equity capital as applicable, to a Netting Member based on its type of regulation. Rule 1, supra note 7.

<sup>26</sup> Notice, 83 FR at 67803.

<sup>27</sup> Id.

Capital, the member would not be permitted to submit new Sponsored Member activity to FICC until its Netting Member Capital equals or exceeds its Aggregate VaR Charges.<sup>28</sup> FICC stated that it anticipates it would provide exceptions in order to promote orderly settlement to include, but not be limited to, circumstances in which the novation of such activity would have a risk-reducing impact on the Category 2 Sponsoring Member's overall FICC-cleared portfolio.<sup>29</sup>

Moreover, FICC stated that to be consistent with its authority under Section 7 of Rule 3 (Ongoing Membership Requirements), FICC would reserve the right to require each Sponsoring Member, or any Netting Member applicant to become such, to furnish to FICC such adequate assurances of its financial responsibility and operational capability within the meaning of Section 7 of Rule 3 as FICC may at any time or from time to time deem necessary or advisable in order to protect FICC and its members, to safeguard securities and funds in the custody or control of FICC and for which FICC is responsible, or to promote the prompt and accurate clearance and settlement of securities transactions.<sup>30</sup> Such a determination by FICC to impose adequate assurances on a Sponsoring Member applicant would be subject to the approval of the FICC Board of Directors in connection with its approval of the application of such Sponsoring Member, and, once approved, FICC would thereafter regularly review such Sponsoring Member regarding its compliance with such adequate assurances requirements, as appropriate.<sup>31</sup>

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<sup>28</sup> Id.

<sup>29</sup> Id.

<sup>30</sup> Id.

<sup>31</sup> Id.

Any adequate assurances imposed on a Sponsoring Member by FICC after its approval would be communicated in writing to the Sponsoring Member and FICC would thereafter regularly review such Sponsoring Member regarding its compliance with such adequate assurances, as appropriate.<sup>32</sup>

B. Proposed Addition of an Omnibus Account.

FICC proposes to allow Sponsored Members to transact with Netting Members that are not the Sponsoring Member through a certain omnibus account maintained by the Sponsoring Member. Currently, Rule 1 defines the term “Sponsored Member Trade” as “a transaction between a Sponsored Member and its Sponsoring Member ....”<sup>33</sup> FICC proposes to allow a Sponsoring Member to establish one or more Sponsoring Member Omnibus Accounts that may contain transactions between a Sponsored Member and a Netting Member other than the Sponsoring Member.<sup>34</sup> A Sponsoring Member may use the Omnibus Account in addition to or in lieu of an account in which only transactions between a Sponsored Member and its Sponsoring Member would be permitted.<sup>35</sup>

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<sup>32</sup> Id.

<sup>33</sup> Id.; Rule 1, definition of “Sponsored Member Trade,” supra note 7.

<sup>34</sup> Notice, 83 FR at 67804.

<sup>35</sup> Id. To the extent a Sponsoring Member elects to establish a Sponsoring Member Omnibus Account that may contain transactions between a Sponsored Member and a Netting Member other than the Sponsoring Member, FICC anticipates calculating the Required Fund Deposit for such Sponsoring Member Omnibus Account to be inclusive of all transactions submitted into such account, including any transactions between a Sponsored Member and a Netting Member other than the Sponsoring Member as well as any transactions between a Sponsored Member and the Sponsoring Member.



### C. Conforming and Technical Changes

FICC proposes conforming and technical changes to its rules. In order to conform to expanding the Sponsored Membership eligibility, FICC proposes to amend Section 2(e) of Rule 3A by deleting the reference to Bank Netting Members and adding language that provides that each Sponsoring Member would submit to FICC the reports and information required to be submitted for its respective type of Netting Member.<sup>36</sup> FICC also proposes to make a conforming change to the first sentence in Section 2(h) of Rule 3A to reference to add the newly defined term “Category 1” before the first reference to Sponsoring Member.<sup>37</sup>

### IV. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act<sup>38</sup> directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and rules and regulations thereunder applicable to such organization. After carefully considering the proposed rule change, the comments received, and FICC’s response thereto, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to FICC. In particular, the Commission finds that the proposed rule change is consistent with Sections 17A(b)(3)(F)<sup>39</sup> and 17A(b)(3)(I)<sup>40</sup> of the Act and Rule 17Ad-22(e)(18) thereunder.<sup>41</sup>

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<sup>36</sup> Notice, 83 FR at 67804.

<sup>37</sup> Id.

<sup>38</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>39</sup> 15 U.S.C. 78q-1(b)(3)(F)

A. Consistency with Section 17A(b)(3)(F)

Section 17A(b)(3)(F) of the Act requires, in part, that the Rules be designed to (i) remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions and (ii) protect investors and the public interest.<sup>42</sup>

First, the Commission believes the proposed rule change is designed to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions. Specifically, the Commission believes that the expansion of the Sponsored Membership program eligibility and addition of an Omnibus Account(s) are consistent with Section 17A(b)(3)(F).<sup>43</sup> As described above, eligibility to be a Sponsored Member currently is limited to Sponsored Members of Category 1 Sponsoring Members. Entities that are not Sponsored Members of a Category 1 Sponsoring Member and otherwise engage in the same type of eligible trading activity outside of a central counterparty currently do not avail themselves of the guaranteed settlement, novation, and independent risk management offered by FICC through the Sponsored Membership program. To help address this issue, the proposal would expand the Sponsored Membership program to include Category 2 Sponsoring Members and allow Sponsored Members to transact with

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<sup>40</sup> 15 U.S.C. 78q-1(b)(3)(I)

<sup>41</sup> 17 CFR 240.17Ad-22(e)(18).

<sup>42</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>43</sup> Id.

Netting Members that are not the Sponsoring Member through an Omnibus Account maintained by the Sponsoring Member.

The Commission believes that the proposal's expansion of the Sponsored Membership program would help make the risk-reducing benefits of central clearing available to a wider range of entity types. In turn, increased trading activity through the expanded Sponsored Membership program could help (i) lower the risk of diminished liquidity in the U.S. repo market caused by a large scale exit of participants from the market in a stress scenario (through FICC's guaranty of completion of settlement for a greater number of eligible transactions); (ii) protect against fire sale risk (through FICC's ability to centralize and control the liquidation of a greater portion of a failed counterparty's portfolio); and (iii) decrease settlement and operational risk (by making a greater number of transactions eligible to be netted and subject to guaranteed settlement, novation, and independent risk management through FICC).

Commenters in support of the proposal argued that the proposal would enhance the repo market. Specifically, commenters believe that by replacing bilateral counterparty exposures with a model where all market participants face a central counterparty, parties are less exposed to a counterparty default.<sup>44</sup> Additionally, commenters believe that increased central clearing could improve trading conditions for market participants, as the associated netting benefits can help to alleviate dealer balance sheet constraints that negatively impact liquidity and lead to increases in volume over time, which should help reduce costs.<sup>45</sup>

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<sup>44</sup> See Ronin Letter at 5; SIFMA Letter at 2; Citadel Letter at 1.

<sup>45</sup> See Ronin Letter at 4–5; SIFMA Letter at 2; Citadel Letter at 1.

In addition, one commenter expressed concern that increased participation in FICC might not increase liquidity in the inter-dealer market as Sponsoring Members could simply match sponsored cash and collateral providers internally to take advantage of balance sheet relief.<sup>46</sup> However, the commenter did not argue against the Commission's approval of the proposal based on the proposal's potential effects on liquidity, as the commenter also acknowledged that increased participation in FICC might actually improve liquidity.<sup>47</sup> Additionally, FICC designed, and the commenter acknowledged, the proposal is an attempt to provide a potential solution for some of the structural inefficiencies that exist in the U.S. Treasury repo market.<sup>48</sup> As such, the proposed rule change is consistent with Section 17A(b)(3)(F).<sup>49</sup>

Likewise, the Commission believes that the conforming and technical changes are consistent with Section Section17A(b)(3)(F) by promoting the prompt and accurate clearance and settlement of securities transactions. The proposed changes would help clarify the Sponsored Membership rules.<sup>50</sup> By proposing changes to the Rules to improve clarity, the Commission believes that the proposed changes are designed to help GSD members better understand and remain compliant with the Rules; thus promoting the prompt and accurate clearance and settlement of securities transactions.

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<sup>46</sup> See Ronin Letter at 6–7.

<sup>47</sup> See id. at 7.

<sup>48</sup> See id.

<sup>49</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>50</sup> Id.

Further, the Commission also believes that any flexibility in the proposed rule change is consistent with Section 17A(b)(3)(F).<sup>51</sup> Commenters argue that the proposed rule change should specify under what qualitative standards Category 2 Sponsoring Members would be evaluated and what additional financial requirements and assurances FICC could impose on them.<sup>52</sup> FICC stated that it believes it is appropriate to evaluate all Category 2 Sponsoring Member applicants on a case-by-case basis as applicants can vary widely in terms of their organizational structures, capitalizations, and the nature and volume of activity they are interested in centrally clearing through FICC.<sup>53</sup>

In expanding Sponsored Membership, FICC must account for the risk of Category 2 Sponsoring Members and their Sponsored Members defaulting to FICC. As the entities eligible for Category 2 Sponsoring Membership are diverse, the Commission believes that flexibility in reviewing applicants on a case-by-case basis would help FICC account for this default risk.

Similarly, a commenter thought that the proposed rule change, as described in the Notice, should be clarified regarding how the types of transactions that can be included in a Sponsoring Member's Omnibus Account would work operationally.<sup>54</sup> In explaining how operationally a Sponsoring Member's Omnibus Account would work FICC stated that (i) while each Sponsored Member's activity is assigned a separate VaR Charge, the positions of a Sponsored Member's activity (x) between itself and its Sponsoring

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<sup>51</sup> Id.

<sup>52</sup> See IDTA Letter at 2–5.

<sup>53</sup> See FICC Response Letter at 4–6.

<sup>54</sup> See IDTA Letter at 3–5.

Member and (y) between itself and another Netting Member (in a Sponsoring Member Omnibus Account) would be netted; and (ii) FICC would allow a Sponsoring Member to establish a Sponsoring Member Omnibus Account that could contain activity between Sponsored Members and Netting Members other than Sponsoring Members.<sup>55</sup> The Commission believes that the (i) rule text and (ii) FICC's description of a Sponsoring Member's Omnibus Account are consistent with providing the clarity required for GSD members to understand the Rules, as amended by the proposed rule change.

Second, the Commission believes that the proposed rule change is designed to protect investors and the public interest. Specifically, the Commission believes that the expansion of the Sponsored Membership program and addition of an Omnibus Account(s) are consistent with protecting investors and the public interest. By expanding the types of entities that are eligible to participate and thereby benefit from FICC's guaranteed settlement, novation, and independent risk management, the proposal would help mitigate the risk of a large scale exit by such firms from the U.S. repo market in a stress scenario and, thus, help lower the risk of a liquidity drain in such a scenario. Specifically, the Office of Financial Research's U.S. Money Market Fund Monitor shows that a previous expansion of the Sponsoring Member Program lead to exponential growth in incremental cash investment from money market funds in FICC.<sup>56</sup> Likewise, by providing central clearing to a greater number of Sponsored Member trades, the proposal would help enable FICC to centralize and control the liquidation of a greater number of such positions in the event of a Sponsored Member or Sponsoring Member's default.

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<sup>55</sup> See FICC Response Letter at 6–7.

<sup>56</sup> See FICC Response Letter at 8.

Doing so would help protect against the risk that an uncoordinated liquidation of the positions by multiple counterparties to the defaulting member would cause a fire sale of positions that negatively impacts the counterparties, FICC, and potentially the broader financial system.

One commenter requested greater information than FICC provided in the Notice regarding whether the proposed rule change would benefit the market.<sup>57</sup> Specifically, the commenter stated that the actual impact of the proposed rule change is unknown and the proposed rule change could increase concentration risk at FICC.<sup>58</sup> The Commission believes the proposed rule change is designed to protect investors and the public interest as expanding the Sponsored Membership program would include independent risk management designed to help account for any increased concentration risk. While the actual impact of the proposed rule change cannot be known, prior expansion of the Sponsored Membership program provides insight into the likely effect of future expansions of the program. Specifically, prior expansion has led to exponential growth in incremental cash investment in FICC.<sup>59</sup> Similarly, although the greater activity in a Sponsoring Member Account would likely increase the exposure to FICC from a Netting Member default, FICC would help account for this risk by individually margining each Sponsored Member.

By better enabling FICC to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities

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<sup>57</sup> See IDTA Letter at 3–5.

<sup>58</sup> See id.

<sup>59</sup> See FICC Response Letter at 8.

transactions and protect investors and the public interest, as described above, the Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act.<sup>60</sup>

B. Consistency with Section 17A(b)(3)(I) of the Exchange Act

Section 17A(b)(3)(I) of the Exchange Act requires that the rules of a clearing agency do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.<sup>61</sup> As discussed above, FICC is proposing a number of changes to expand the Sponsored Membership program. The proposed changes are designed to (i) remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions and (ii) protect investors and the public interest, consistent with Section 17A(b)(3)(F) of the Exchange Act.<sup>62</sup>

A commenter expressed concerns about the ability of Netting Members that are not affiliated with a bank to participate as Sponsoring Members due to VaR margin requirements.<sup>63</sup> Specifically, separate VaR charges for each Sponsored Member will likely limit wide adoption of Sponsored Membership to those Netting Members that have a low cost of capital.<sup>64</sup> Likewise, the commenter expressed concern that expanding Sponsored Membership might increase the Capped Contingency Liquidity Facility

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<sup>60</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>61</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>62</sup> See 15 U.S.C. 78q-1(b)(3)(F).

<sup>63</sup> See Ronin Letter at 6.

<sup>64</sup> Id.



(“CCLF”)<sup>65</sup> responsibilities of other Netting Members if the liquidity needs of the largest Netting Members grow substantially.<sup>66</sup> Conversely, one Commenter supported the proposed framework of risk management outlined in the proposal as appropriate to ensure proper risk controls and integrity with the FICC environment.<sup>67</sup>

The Commission understands that the impact of the cost of meeting a margin or CCLF requirement would depend, in part, on each Netting Member’s specific business model and that some Netting Members could satisfy the increase at a lower cost than others. For example, when the Commission originally approved the CCLF, the Commission’s approval was based in part on the Commission’s belief that FICC appropriately sought to mitigate the relative burdens on Netting Members that present relatively less liquidity risk to FICC by only requiring them to contribute their allotted share of the Aggregate Regular Amount, which is allocated among all Netting Members, but Netting Members with larger obligations are required to contribute a larger amount.<sup>68</sup>

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<sup>65</sup> CCLF is a rules-based, member-funded, committed repo facility designed to ensure that FICC has sufficient liquid resources to satisfy its cash settlement obligations in the event of the default of the participant family that would generate FICC’s largest aggregate payment obligation. Rule 22A, Section 2a, supra note 7. FICC designed the CCLF funding obligations to be generally proportionate to the liquidity needs that members present to FICC. See Securities Exchange Act Release No. 82090 (November 15, 2017), 82 FR 55427 (November 21, 2017) (SR-FICC-2017-002) (“CCLF Approval Order”).

<sup>66</sup> See Ronin Letter at 6.

<sup>67</sup> See SIFMA Letter at 1.

<sup>68</sup> See CCLF Approval Order, 82 FR at 55430.

As a result, the Commission believes that any competitive burden imposed by the proposed changes would not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.<sup>69</sup>

FICC proposes that while it would provide a netting benefit to a Sponsoring Member's offsetting positions at FICC, FICC would individually margin each Sponsored Member as FICC novates and guarantees the settlement of each Sponsored Member's position. Likewise, to the extent the CCLF were to potentially increase as a result of Sponsored Member activity, the CCLF is designed so that requirements are in proportion to the liquidity exposure that each Netting Member presents to GSD. It is necessary for FICC to collect margin requirements and impose liquidity requirements to help ensure FICC can complete settlement in the event of a Netting Member default. Similarly, it is appropriate to assess individual members VaR Charges and CCLF requirement based upon the guarantee and liquidity risks that FICC assumes based upon the member's position.

Therefore, the Commission believes that the proposed rule change is consistent with Section 17A(b)(3)(I) of the Exchange Act, as the proposal would not impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.<sup>70</sup>

A. Consistency with Rule 17Ad-22(e)(18) of the Exchange Act

Rule 17Ad-22(e)(18) under the Act requires that FICC establish, implement, maintain and enforce written policies and procedures reasonably designed to establish

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<sup>69</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>70</sup> 15 U.S.C. 78q-1(b)(3)(I).

objective, risk-based, and publicly disclosed criteria for participation, which permit fair and open access by direct and, where relevant, indirect participants and other financial market utilities, require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency, and monitor compliance with such participation requirements on an ongoing basis.<sup>71</sup>

As described above, the proposed rule change would expand the Sponsored Membership program eligibility. The proposed rule change to expand Sponsoring Member eligibility would establish objective, risk-based, and publicly disclosed criteria for additional types of Netting Members to participate in FICC as Sponsoring Members. As described above, FICC could impose greater financial requirements on an applicant to become a Category 2 Sponsoring Member as they may have substantially less capital than a Category 1 Sponsoring Member. Likewise, the proposed rule change would also impose an activity limit on a Category 2 Sponsoring Member's Sponsored Member activity. Moreover, FICC would reserve the right to require each Sponsoring Member, or any Netting Member applicant to become such, to furnish to FICC such adequate assurances of its financial responsibility and operational capability. Each of these proposed changes would assist FICC in requiring Netting Members to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency.

As described above, commenters argued that the proposed rule change should specify under what qualitative standards Category 2 Sponsoring Members would be evaluated and what additional financial requirements and assurances FICC could impose

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<sup>71</sup> 17 CFR 240.17Ad-22(e)(18).

on them.<sup>72</sup> FICC stated that it believes it is appropriate to evaluate all Category 2 Sponsoring Member applicants on a case-by-case basis as applicants can vary widely in terms of their organization structures, capitalizations, and the nature and volume of activity they are interested in centrally clearing through FICC.<sup>73</sup>

The Commission believes that the limited discretion in the publicly disclosed criteria for participation is consistent with Rule 17Ad-22(e)(18) as it is design to help ensure sufficient financial resources and robust operational capacity by Netting Members. In expanding Sponsored Membership, FICC must account for the risk of Category 2 Sponsoring Members and their Sponsored Members defaulting to FICC. As the entities eligible for Category 2 Sponsoring Membership are diverse, the Commission believes that flexibility in reviewing applicants on a case-by-case basis would help FICC account for this default risk. Therefore, the Commission finds that the proposal is consistent Rule 17Ad-22(e)(18) under the Act

V. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act<sup>74</sup> and the rules and regulations promulgated thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act<sup>75</sup> that

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<sup>72</sup> See Ronin Letter at 5; SIFMA Letter at 2–3.

<sup>73</sup> See FICC Response Letter at 4–6.

<sup>74</sup> 15 U.S.C. 78q-1.

<sup>75</sup> 15 U.S.C. 78s(b)(2).

proposed rule change SR-FICC-2018-013, be, and hereby is, APPROVED.<sup>76</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>77</sup>

Eduardo A. Aleman  
Deputy Secretary

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<sup>76</sup> In approving the proposed rule change, the Commission considered the proposals' impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>77</sup> 17 CFR 200.30-3(a)(12).