

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-84236; File No. SR-FICC-2018-006)

September 20, 2018

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Granting Approval of Proposed Rule Change to Codify the Processing of Conditional Prepayment Rate Claims in the MBSD Rules and Make Other Changes

On July 26, 2018, Fixed Income Clearing Corporation (“FICC”) filed with the U.S. Securities and Exchange Commission (“Commission”) proposed rule change SR-FICC-2018-006 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> The proposed rule change was published for comment in the Federal Register on August 8, 2018.<sup>3</sup> The Commission did not receive any comment letters on the proposed rule change. For the reasons discussed below, the Commission approves the proposed rule change.

I. Description of the Proposed Rule Change

The proposed rule change would make amendments to FICC’s Mortgage-Backed Securities Division (“MBSD”) Clearing Rules (“MBSD Rules”)<sup>4</sup> in order to (i) add terms governing MBSD’s current processing of conditional prepayment rate (“CPR”) claims to the MBSD Rules, and (ii) make certain clarifications and corrections in the MBSD Rules,

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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> Securities Exchange Act Release No. 83767 (August 2, 2018), 83 FR 39143 (August 8, 2018)(SR-FICC-2018-006)(“Notice”).

<sup>4</sup> Available at <http://www.dtcc.com/legal/rules-and-procedures>.

as described below.<sup>5</sup>

A. CPR Claims

Mortgage pools<sup>6</sup> are often traded in To-Be-Announced (“TBA”) trades, which are trades for which the actual identities of and/or the number of pools underlying each trade are unknown at the time of trade execution.<sup>7</sup> MBSB guidelines provide that two business days prior to the established settlement date of the TBA settlement obligations, the FICC MBSB clearing member (“Clearing Member”) that has an obligation to deliver pools for the TBA transaction (i.e., the “seller”) must allocate the pools to be delivered.<sup>8</sup> FICC states that pursuant to the MBSB Rules, Clearing Members may substitute an underlying pool after it has been allocated with respect to a pool deliver obligation by providing instructions to FICC.<sup>9</sup>

CPR is the percentage of the outstanding loan balance for a pool that is expected to be repaid over a one-year period.<sup>10</sup> A CPR claim arises when an underlying TBA pool is allocated or substituted with a pool that pays down at a faster rate (i.e., has a higher CPR) than the average pay down rate for pools of the same type as the underlying pool

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<sup>5</sup> Notice, 83 FR, at 39144.

<sup>6</sup> A mortgage pool is a collection of mortgage loans or other collateral assembled by an originator or master services as collateral for a mortgaged-back security. Id.

<sup>7</sup> Notice, 83 FR, at 39144.

<sup>8</sup> Id.

<sup>9</sup> Id.

<sup>10</sup> Id.

being replaced.<sup>11</sup> The result is that the buyer is receiving a pool with less value than anticipated based on the TBA terms.

As provided in the SIFMA Guidelines,<sup>12</sup> the industry currently has a process pursuant to which a buyer may make a CPR claim against the seller. The CPR claim process is intended to compensate the buyer for the excess amount that it is paying for the pool being delivered.<sup>13</sup> Pursuant to SIFMA Guidelines, an entity is entitled to make a CPR claim if (i) the allocation or substitution giving rise to the CPR claim occurred after the factor release date<sup>14</sup> following the scheduled contractual settlement date relating to the trade; (ii) the pools involved in the claim meet the criteria for fast paying pools in accordance with SIFMA Guidelines; (iii) the amount of the CPR claim is \$10,000 or greater, or, in the case that an entity is submitting a re-transmittal<sup>15</sup> of a CPR claim, the

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<sup>11</sup> Notice, 83 FR, at 39144.

<sup>12</sup> Available at [https://www.sifma.org/resources/general/tba-market-governance/under “Uniform Practices Manual.”](https://www.sifma.org/resources/general/tba-market-governance/under%20Uniform%20Practices%20Manual) The SIFMA Guidelines are trading, clearing and settlement guidelines prepared by SIFMA intended to reflect common industry practices relating to confirming, comparing and settling mortgage-backed securities.

<sup>13</sup> Notice, 83 FR, at 39144.

<sup>14</sup> The term “factor release date” means, with respect to a pool, the date on which the Federal National Mortgage Association (“Fannie Mae”), the Federal Home Loan Mortgage Corporation (“Freddie Mac”) or the Government National Mortgage Association (“Ginnie Mae”), as applicable, release the “factor” that represents the percentage of the agency’s original balance of the pool that remains outstanding as of such date. Id.

<sup>15</sup> A re-transmittal of a CPR claim occurs when a party with the pool deliver obligation passes the CPR claims it received to the entities that sent it the pools it used for delivery. Id.

CPR claim is \$500 or greater; and (iv) 90 percent of the buyer’s claimable unit has settled.<sup>16</sup>

The proposed rule change would codify FICC’s existing CPR claims process in the MBS Rules, including adding a provision providing that a Clearing Member’s cash settlement obligations would include the positive or negative amount of any valid CPR claim.<sup>17</sup> FICC states that the proposed MBS CPR claims process would generally follow the CPR claims process set forth in the SIFMA Guidelines and MBS’s current CPR claims process, with the following exceptions:

1. Definition of Claimable Unit

The proposed rule change would add to the MBS Rules two definitions of “claimable unit,” the use of which would depend on the type of transaction.<sup>18</sup> According to SIFMA Guidelines and FICC’s current process, CPR claims are based on a “claimable unit” which defines the pool or group of pools that are included in a particular CPR claim.<sup>19</sup> Also according to SIFMA Guidelines, a claimable unit is based on all pools allocated for a trade between factor release dates that have the same underlying TBA characteristics, such as product, coupon, trade date, settlement date and price.<sup>20</sup>

FICC states that it currently processes CPR claims using a different definition of claimable unit than the SIFMA definition. FICC states that its CPR claims process

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<sup>16</sup> Notice, 83 FR, at 39144.

<sup>17</sup> Id.

<sup>18</sup> Id.

<sup>19</sup> Id.

<sup>20</sup> Id.

currently uses a definition of claimable unit based on characteristics of pools after MBSD Pool Netting<sup>21</sup> takes place rather than based on underlying TBA characteristics. The Pool Netting process generally reduces the number of pool settlements by aggregating and matching offsetting allocated pools submitted by Clearing Members to arrive at a single net position per counterparty in a particular pool number.<sup>22</sup> FICC states that if a pool obligation is a result of Pool Netting, FICC is unable to track the pool obligation to an original TBA trade or trades and would be unable to group pool obligations for CPR claims based on TBA characteristics as provided in SIFMA Guidelines.<sup>23</sup>

FICC proposes to use the same definition of claimable unit for CPR claims as SIFMA Guidelines if the pool obligations upon which the CPR claims are based have not been through MBSD Pool Netting. FICC states that this definition would be used for pool allocations or substitutions for pool obligations that have been allocated after the factor release date because pool obligations allocated after the factor release date do not go through the Pool Netting process.<sup>24</sup> As a result, FICC states that it would be able to track the pool obligation to an original TBA trade, which would allow FICC to group the pool obligation with other pool obligations based on TBA characteristics.<sup>25</sup>

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<sup>21</sup> Pursuant to the MBSD Rules, the term “Pool Netting” means the service provided to Clearing Members, as applicable, and the operations carried out by FICC in the course of providing such service in accordance with MBSD Rule 8.

<sup>22</sup> Notice, 83 FR, at 39145.

<sup>23</sup> Id.

<sup>24</sup> Id.

<sup>25</sup> Id.

FICC proposes to use a different definition of a claimable unit from the SIFMA Guidelines definition for CPR claims based on pool obligations that are a result of Pool Netting.<sup>26</sup> FICC proposes to define a claimable unit for such pool obligations based on pool characteristics after Pool Netting, rather than based on the original TBA pool characteristics.<sup>27</sup> FICC states that this definition would be used for substitutions for pool obligations that are a result of Pool Netting because FICC would be unable to track the pool obligation to an original TBA trade and thus unable to group such pool obligation with other pool obligations based on TBA characteristics.<sup>28</sup>

## 2. Re-transmittal Threshold

The minimum threshold for a re-transmittal of a CPR claim under SIFMA Guidelines is \$500.<sup>29</sup> FICC's current process provides that the minimum threshold for re-transmittals is \$5,000.<sup>30</sup> FICC proposes to use the \$500 re-transmittal minimum threshold for allocations (and related substitutions), where the allocations were made after the applicable factor release date, in order to be more consistent with SIFMA Guidelines and established industry practice.<sup>31</sup> Meanwhile, FICC proposes to use a \$5,000 re-transmittal threshold for substitutions relating to allocations that were made prior to the factor release date following the contractual settlement date to avoid having

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<sup>26</sup> Id.

<sup>27</sup> Id.

<sup>28</sup> Id.

<sup>29</sup> Id.

<sup>30</sup> Id.

<sup>31</sup> Id.

to process multiple smaller transactions, which FICC believes would likely be administratively burdensome.<sup>32</sup>

B. Proposed MBSD Rule Changes

To codify the CPR claims process as described above, the proposed rule change would add a description of the CPR claim process in a new Section 10 of MBSD Rule 9, including a defined term for “CPR Claim.”<sup>33</sup> In addition, the proposed rule change would specify the validation process for CPR claims, which, as described above, would codify existing FICC practices relating to CPR claims and provide that the process for CPR claims is consistent with SIFMA Guidelines, in each case, with the exceptions noted above.<sup>34</sup>

Specifically, the proposed rule change would specify that CPR claims submitted would be reviewed by FICC to validate the following: (i) the claimable unit with respect to the CPR claim meets the criteria for fast paying pools as set forth in SIFMA Guidelines; (ii) the CPR claim amount is \$10,000 or greater, unless the CPR claim is a re-transmittal of a CPR claim, in which case, (a) if the CPR claim relates to an allocation of a pool effected after the factor release date following the contractual settlement date and/or substitution of related pools, the amount is \$500 or greater, or (b) if the CPR claim relates to a substitution of a pool that was allocated prior to the factor release date following the contractual settlement date, the amount is \$5,000 or greater; and (iii) 90 percent of the Clearing Member’s claimable unit has settled.

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<sup>32</sup> Id.

<sup>33</sup> Id.

<sup>34</sup> Id.

Consistent with FICC’s current CPR claims process, the proposed rule change would also specify that (1) FICC maintains the right to process CPR claims with no minimum denomination, (2) CPR claims may be apportioned to more than one participant, (3) CPR claims may be comprised of both debits and credits, (4) FICC would process all CPR claims on the Class “B” settlement date in the month following the transmittal month, and (5) FICC would notify the Clearing Member that the CPR claim has been rejected if the CPR claim is determined to be invalid.

In addition, that the proposed rule change would specify that FICC shall not guaranty CPR claim payments, and any credit to be received with respect to a CPR claim would be reduced to the extent the corresponding debit in connection with a CPR claim is not paid.<sup>35</sup>

FICC states that to ensure that Clearing Members understand the potential credits and debits relating to CPR claims, the proposed rule change would add credits and debits relating to CPR claims in Section 7 of MBSD Rule 11 as items for end of day cash balance computations.<sup>36</sup>

FICC states that to further describe the CPR claims process as set forth above, a cross-reference for the defined term “CPR Claim” and new defined terms “Claimable Unit” and “Factor Release Date” would be added to MBSD Rule 1, which are consistent with existing FICC practices relating to CPR claims and with SIFMA Guidelines, in each case, with the exceptions noted above.<sup>37</sup>

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<sup>35</sup> Id.

<sup>36</sup> Id.

<sup>37</sup> Id.

FICC states that the definitions for Fannie Mae, Freddie Mac, and Ginnie Mae would be corrected in MBSD Rule 1 to be consistent with industry practice and with their usage throughout the MBSD Rules.<sup>38</sup> In addition, the definition of “SIFMA Guidelines” would be clarified by adding a link identifying the location of the SIFMA Guidelines on the SIFMA website.<sup>39</sup>

## II. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act<sup>40</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. The Commission believes the proposal is consistent with the Act, specifically Section 17A(b)(3)(F) of the Act and Rule 17Ad-22(e)(23)(i) under the Act, as discussed below.<sup>41</sup>

### A. Consistency with Section 17A(b)(3)(F) of the Act

Section 17A(b)(3)(F) of the Act<sup>42</sup> requires, *inter alia*, that the rules of the clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions.

As described above, FICC proposes to codify its existing CPR claims process and to specify the validation process for CPR claims. First, FICC proposes to specify that

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<sup>38</sup> Id.

<sup>39</sup> Id.

<sup>40</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>41</sup> 15 U.S.C. 78q-1(b)(3)(F); 17 CFR 240.17Ad-22(20).

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

CPR claims submitted would be reviewed by FICC to validate (i) the claimable unit with respect to the CPR claim meets the criteria for fast paying pools as set forth in SIFMA Guidelines; (ii) the CPR claim amount is \$10,000 or greater, unless the CPR claim is a re-transmittal of a CPR claim, in which case, (a) if the CPR claim relates to an allocation of a pool effected after the factor release date following the contractual settlement date and/or substitution of related pools, the amount is \$500 or greater, or (b) if the CPR claim relates to a substitution of a pool that was allocated prior to the factor release date following the contractual settlement date, the amount is \$5,000 or greater; and (iii) 90 percent of the Clearing Member's claimable unit has settled.

Consistent with FICC's current CPR claims process, FICC also proposes to specify that (1) FICC maintains the right to process CPR claims with no minimum denomination, (2) CPR claims may be apportioned to more than one participant, (3) CPR claims may be comprised of both debits and credits, (4) FICC would process all CPR claims on the Class "B" settlement date in the month following the transmittal month, and (5) FICC would notify the Clearing Member that the CPR claim has been rejected if the CPR claim is determined to be invalid.

In addition, FICC proposes to specify that FICC shall not guaranty CPR claim payments, and any credit to be received with respect to a CPR claim would be reduced to the extent the corresponding debit in connection with a CPR claim is not paid.

These proposed changes would codify FICC's existing processes surrounding CPR claims and make the CPR claims process more consistent with SIFMA Guidelines. The Commission believes that the codification would enable Clearing Members to better understand how CPR claims would be validated and processed through FICC's facilities

and how FICC's CPR claims process would differ from SIFMA Guidelines with respect to the definition of claimable unit and the re-transmittal minimum threshold, as set forth above. By enabling Clearing Members to better understand the CPR claims process, the proposal is designed to help ensure that CPR claims are submitted and processed correctly and thus promote the prompt and accurate clearance and settlement of such securities transactions.

Additionally, FICC proposes to make several clarifying changes. First, as described above, the proposed rule change would add credits and debits relating to CPR claims in Section 7 of MBSD Rule 11 as items for end of day cash balance computations. In Second, a cross-reference for the defined term "CPR Claim" and new defined terms "Claimable Unit" and "Factor Release Date" would be added to MBSD Rule 1, which are consistent with existing FICC practices relating to CPR claims and with SIFMA Guidelines, in each case, with the exceptions noted above. Third, the proposed rule change would correct the definitions for Fannie Mae, Freddie Mac and Ginnie Mae in MBSD Rule 1 to be consistent with industry practice and with their usage throughout the MBSD Rules. Fourth, FICC proposes to add a description of the CPR claim process in a new Section 10 of MBSD Rule 9, including a defined term for "CPR Claim." Finally, the definition of "SIFMA Guidelines" would be clarified by adding a link identifying the location of the SIFMA Guidelines on the SIFMA website.

By proposing these clarifying changes to the CPR claims rules, the Commission believes that the proposed changes are designed to help Clearing Members better understand and remain compliant with the CPR claims rules to help ensure that CPR

claims are submitted and processed correctly, and thus promoting the prompt and accurate clearance and settlement of such securities transactions.

As each of the aforementioned changes are designed to promote the prompt and accurate clearance and settlement of securities transactions, the Commission finds that the proposal is consistent with the requirements of Section 17A(b)(3)(F).

B. Consistency with Rule 17Ad-22(e)(23)(i)

Rule 17Ad-22(e)(23)(i) under the Act requires a covered clearing agency<sup>43</sup> to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide for publicly disclosing all relevant rules and material procedures.<sup>44</sup>

As described above, the proposed rule changes would (1) codify FICC's existing CPR claims process and (2) make clarifications to the existing CPR claims process. The Commission believes these proposed changes to codify and clarify FICC's existing practices in regards to the CPR claims process would assist in publicly disclosing all relevant and material procedures regarding the CPR claims process. Therefore, the Commission finds that the proposal is consistent Rule 17Ad-22(e)(23)(i) under the Act.

III. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent

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<sup>43</sup> A "covered clearing agency" means, among other things, a clearing agency registered with the Commission under Section 17A of the Exchange Act (15 U.S.C. 78q-1 et seq.) that is designated systemically important by the Financial Stability Oversight Counsel ("FSOC") pursuant to the Clearing Supervision Act (12 U.S.C. 5461 et seq.). See 17 CFR 240.17Ad-22(a)(5)-(6). On July 18, 2012, FSOC designated FICC as systemically important. U.S. Department of the Treasury, "FSOC Makes First Designations in Effort to Protect Against Future Financial Crises," available at <https://www.treasury.gov/press-center/press-releases/Pages/tg1645.aspx>. Therefore, FICC is a covered clearing agency.

<sup>44</sup> 17 CFR 240.17Ad-22(e)(23)(i).

with the requirements of the Act, in particular the requirements of Section 17A of the Act<sup>45</sup> and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that proposed rule change SR-FICC-2018-006 be, and hereby is, APPROVED.<sup>46</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>47</sup>

Brent J. Fields  
Secretary

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<sup>45</sup> 15 U.S.C. 78q-1.

<sup>46</sup> In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>47</sup> 17 CFR 200.30-3(a)(12).