

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * 60	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4		File No.* SR - 2018 - * 802	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"/>	
			Rule	
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>	<input type="checkbox"/> 19b-4(f)(1) <input type="checkbox"/> 19b-4(f)(2) <input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(4) <input type="checkbox"/> 19b-4(f)(5) <input type="checkbox"/> 19b-4(f)(6)
Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010			Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934	
Section 806(e)(1) * <input checked="" type="checkbox"/>		Section 806(e)(2) * <input type="checkbox"/>	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="Expand Sponsoring Member Eligibility in the Government Securities Division Rulebook and Make Other Changes"/>				
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="Kristen"/>	Last Name *	<input type="text" value="Lam"/>	
Title *	<input type="text" value="Director and Assistant General Counsel"/>			
E-mail *	<input type="text" value="klam1@dtcc.com"/>			
Telephone *	<input type="text" value="(212) 855-5258"/>	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="12/13/2018"/>	<input type="text" value="Managing Director and Deputy General Counsel"/>		
By	<input type="text" value="Nikki Poulos"/>	<input type="text" value=""/>		
(Name *)				
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.				
		<input type="text" value="npoulos@dtcc.com"/>		

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

Form 19b-4 Information *

Add Remove View

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 *

Add Remove View

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 *

Add Remove View

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

Add Remove View

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

Add Remove View

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

Add Remove View

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

Add Remove View

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

Add Remove View

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 amendments to the FICC Government Securities Division (“GSD”) Rulebook (“Rules”),¹ attached hereto as Exhibit 5, in order to (i) allow a broader group of Netting Members to participate in FICC as Sponsoring Members, (ii) allow a Sponsoring Member to establish a Sponsoring Member Omnibus Account that may contain transactions between a Sponsored Member and a Netting Member other than the Sponsoring Member, which Sponsoring Member Omnibus Account could be in addition to or in lieu of a Sponsoring Member Omnibus Account in which only transactions between a Sponsored Member and its Sponsoring Member would be permitted, and (iii) make certain conforming and technical changes in Rules 1 and 3A.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The filing of this advance notice was approved by the Risk Committee and the Business, Technology and Operations Committee of FICC’s Board of Directors on June 19, 2018.

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

Not applicable.

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

Not applicable.

5. Self-Regulatory Organization’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.

¹ Capitalized terms not defined herein are defined in the Rules, available at http://www.dtcc.com/~media/Files/Downloads/legal/rules/ficc_gov_rules.pdf.

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 Act

Not applicable.

10. Advance Notice Filed Pursuant to Section 806(e) of the Payment, Clearing, and Settlement Supervision Act of 2010

Nature of the Proposed Change

The purpose of this proposed rule change is to (i) allow a broader group of Netting Members to participate in FICC as Sponsoring Members, (ii) allow a Sponsoring Member to establish a Sponsoring Member Omnibus Account that may contain transactions between a Sponsored Member and a Netting Member other than the Sponsoring Member, which Sponsoring Member Omnibus Account could be in addition to or in lieu of a Sponsoring Member Omnibus Account in which only transactions between a Sponsored Member and its Sponsoring Member would be permitted, and (iii) make certain conforming and technical changes in Rules 1 and 3A.

(i) Background

Under Rule 3A (Sponsoring Members and Sponsored Members), Bank Netting Members that are “well-capitalized” (as defined by the Federal Deposit Insurance Corporation’s applicable regulations)² and have at least \$5 billion in equity capital are permitted to sponsor, as “Sponsoring Members,” qualified institutional buyers as defined by Rule 144A³ under the Securities Act of 1933, as amended (“Securities Act”),⁴ and certain legal entities that, although not organized as entities specifically listed in paragraph (a)(1)(i) of Rule 144A under the

² 12 U.S.C. 1831o(a).

³ 17 CFR 230.144A.

⁴ 15 U.S.C. 77a *et seq.*

Securities Act, satisfy the financial requirements necessary to be qualified institutional buyers as specified in that paragraph (i.e., Sponsored Members) into GSD membership.

Under Rule 3A, a Sponsoring Member is permitted to submit to FICC for comparison, novation, and netting certain types of eligible securities transactions between itself and its Sponsored Members (Sponsored Member Trades).⁵ The Sponsoring Member is required to establish an omnibus account at FICC for all its Sponsored Members' FICC-cleared securities transactions (Sponsoring Member Omnibus Account),⁶ which is separate from the Sponsoring Member's regular netting accounts. For operational and administrative purposes, FICC interacts solely with the Sponsoring Member as agent for purposes of the day-to-day satisfaction of its Sponsored Members' obligations to FICC, including their securities and funds-only settlement obligations.⁷

Governance and Risk Management of Sponsoring Members

All Sponsoring Members are subject to the following governance, market risk management, and credit risk management processes specifically related to their status as Sponsoring Members under the current Rules, which would continue to apply equally to all Sponsoring Members notwithstanding the proposed rule changes described in this filing.

The governance process applicable to the approval of every applicant to become a Sponsoring Member is set forth in Rule 3A. In order to become a Sponsoring Member, an applicant is required to go through an application process, which includes a risk management review of the applicant by FICC specifically related to the activity it proposes to submit to FICC as a Sponsoring Member, and an approval of such applicant by the FICC Board of Directors⁸ as a new Sponsoring Member.⁹ This application process is separate from the applicant's original Netting Member application process. If the FICC Board of Directors denies the application of a Sponsoring Member applicant, FICC is required to handle such denial in the same way as set forth in Section 6 of Rule 2A with respect to Netting Member applications.¹⁰ FICC may also require that a Sponsoring Member applicant be a Netting Member for a time period deemed necessary by FICC prior to being considered to become a Sponsoring Member.¹¹

⁵ Rule 1, definition of "Sponsored Member Trade," supra note 1.

⁶ Rule 1, definition of "Sponsoring Member Omnibus Account," supra note 1.

⁷ Rule 3A, Sections 5, 6, 7, 8, and 9, supra note 1.

⁸ FICC Board of Directors means the Board of Directors of Fixed Income Clearing Corporation or a committee thereof acting under delegated authority. Rule 1, supra note 1.

⁹ Rule 3A, Section 2, supra note 1.

¹⁰ Rule 3A, Section 2(b) and Rule 2A, Section 6, supra note 1.

¹¹ Rule 3A, Section 2(a), supra note 1.

Once a Sponsoring Member is approved by the FICC Board of Directors, it is subject to ongoing credit surveillance and may be placed on the Watch List and/or may be subject to enhanced surveillance based on relevant factors as set forth in Rule 3, as FICC deems necessary to protect FICC and its members.¹²

FICC mitigates the market risk associated with Sponsored Member activity through the collection of Clearing Fund from the Sponsoring Member.¹³ A Sponsoring Member is required to maintain a Required Fund Deposit for all the Sponsored Member activity, which is calculated twice daily on a gross basis, in its Sponsoring Member Omnibus Account.¹⁴ Specifically, for purposes of calculating the Unadjusted GSD Margin Portfolio Amount for a Sponsoring Member Omnibus Account, each Sponsored Member's activity is assigned a separate VaR Charge, and, as such, the Unadjusted GSD Margin Portfolio Amount for the Sponsoring Member Omnibus Account is not reduced by any netting of positions as between different Sponsored Members within that Sponsoring Member Omnibus Account.¹⁵ In addition, for purposes of calculating the Unadjusted GSD Margin Portfolio Amount applicable to a Sponsoring Member Omnibus Account, FICC applies the higher of the Required Fund Deposit calculation as of the beginning of the current Business Day and intraday on the current Business Day.¹⁶ FICC has the right to apply all such Clearing Fund deposits plus all other Clearing Fund deposits of the Sponsoring Member for its Netting System accounts against any obligations owing to FICC by the Sponsoring Member, including (but not limited to) in a Sponsoring Member default situation.¹⁷ In a Sponsoring Member default situation, FICC may apply all such Clearing Fund deposits against any obligations owing to FICC by the Sponsoring Member before any of the other resources in the GSD default loss waterfall would be used, including, in the final tranche of such waterfall, potential loss mutualization to Netting Members.¹⁸

Moreover, Sponsoring Members are also responsible for providing FICC with a Sponsoring Member Guaranty¹⁹ whereby the Sponsoring Member guarantees to FICC the

¹² Rule 3, Section 12, supra note 1.

¹³ Rule 3A, Section 10, supra note 1.

¹⁴ Rule 3A, Section 10(a), supra note 1.

¹⁵ Rule 3A, Section 10(c), supra note 1.

¹⁶ Id.

¹⁷ Rule 3A, Section 10(b), supra note 1.

¹⁸ See Rule 3A, Section 10(b) and Rule 4, Section 6, supra note 1.

¹⁹ Section 2(c) of Rule 3A provides “Each Netting Member to become a Sponsoring Member shall also sign and deliver to [FICC] a Sponsoring Member Guaranty” A “Sponsoring Member Guaranty” is defined in Rule 1 as “a guaranty ... that a Sponsoring Member delivers to [FICC] whereby the Sponsoring Member guarantees to [FICC] the payment and performance by its Sponsored Members of their obligations under [the]

payment and performance by its Sponsored Members of their obligations under the Rules.²⁰ Although Sponsored Members are principally liable to FICC for their own settlement obligations under the Rules, the Sponsoring Member is required to provide a Sponsoring Member Guaranty to FICC with respect to such obligations whereby if a Sponsored Member defaults and does not satisfy its settlement obligations to FICC, the Sponsoring Member is required to satisfy those settlement obligations on behalf of its defaulted Sponsored Member. As long as the Sponsoring Member performs under the Sponsoring Member Guaranty, it would not separately be considered in default to FICC, but failure to do so would be grounds for FICC to cease to act for the Sponsoring Member.²¹

Proposed Rule Changes to Expand Sponsoring Member Eligibility

As described above, Rule 3A (Sponsoring Members and Sponsored Members) currently provides that Bank Netting Members that are “well-capitalized” (as defined by the Federal Deposit Insurance Corporation’s applicable regulations)²² and have at least \$5 billion in equity capital are eligible to become Sponsoring Members.²³

In 2017, the Securities and Exchange Commission (“Commission”) approved FICC rule filing SR-FICC-2017-003,²⁴ which expanded the types of entities that are eligible to participate in FICC as Sponsored Members under Rule 3A. Since that time, Netting Members that are not Bank Netting Members have expressed interest to FICC in participating in FICC as Sponsoring Members.

The proposed rule change would create two categories of Netting Members that would be eligible to become Sponsoring Members. The first category of Netting Members would include currently eligible Bank Netting Members that are “well-capitalized” (as defined by the Federal Deposit Insurance Corporation’s applicable regulations)²⁵ and have at least \$5 billion in equity capital (hereinafter and in the proposed rule change, “Category 1 Sponsoring Members”). The second category of Netting Members eligible to become Sponsoring Members would include Netting Members that are Tier One Netting Members, except for Inter-Dealer Broker Netting Members and Non-IDB Repo Brokers with respect to activity in their Segregated Repo Accounts

Rules, including, without limitation, all of the securities and funds-only settlement obligations of its Sponsored Members under [the] Rules.” Supra note 1.

²⁰ Rule 3A, Section 2(c), supra note 1.

²¹ Rule 3A, Section 2(g), supra note 1.

²² 12 U.S.C. 1831o(a).

²³ Rule 3A, Section 2(a), supra note 1.

²⁴ Securities Exchange Act Release No. 80563 (May 1, 2017), 82 FR 21284 (May 5, 2017) (SR-FICC-2017-003).

²⁵ 12 U.S.C. 1831o(a).

(hereinafter and in the proposed rule change, “Category 2 Sponsoring Members”). As such, the proposed rule change would provide that Category 2 Sponsoring Member applicants could include, for example, Dealer Netting Members, Futures Commission Merchant Netting Members, and Foreign Netting Members.

FICC is proposing that neither Inter-Dealer Broker Netting Members nor Non-IDB Repo Brokers with respect to activity in their Segregated Repo Accounts be eligible to become Category 2 Sponsoring Members. Although Inter-Dealer Broker Netting Members and Non-IDB Repo Brokers are types of Netting Members, a cap applies to their respective loss allocation obligations to FICC under Rule 4, Section 7²⁶ that does not apply to other types of Netting Members; therefore, FICC does not believe it would be appropriate to allow either Inter-Dealer Broker Netting Members or Non-IDB Repo Brokers to be eligible to become Category 2 Sponsoring Members. However, to the extent an Inter-Dealer Broker 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 Inter-Dealer Broker Netting Member or Non-IDB Repo Broker could apply to become a Category 2 Sponsoring Member under such other Netting Member status.

The minimum financial requirements applicable to Netting Member applicants to become Category 2 Sponsoring Members would be the same as those that apply to them with respect to their respective Netting Member category under Section 4(b) of Rule 2A. However, since a Category 2 Sponsoring Member may have substantially less capital than a Category 1 Sponsoring Member, the proposed rule change would provide that FICC could impose financial requirements on an applicant to become a Category 2 Sponsoring Member that are greater than the financial requirements applicable to such applicant in its capacity as a Netting Member under Section 4(b) of Rule 2A. FICC’s determination as to whether to impose such increased 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. Such a determination by 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, and,

²⁶ Section 7 of Rule 4 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.” Supra note 1. The limit on loss allocation for these Members reflects their risk profile. Specifically, an Inter-Dealer Broker Netting Member is required to (A) limit its business to acting exclusively as a broker, (B) conduct all of its business in Repo Transactions with Netting Members, and (C) conduct at least 90 percent of its business in transactions that are not Repo Transactions with Netting Members. Rule 3, Section 8(e), supra note 1. Likewise, a Non-IDB Repo Broker is required to operate in the same way as a Broker with respect to activity in its Segregated Repo Account. Rule 1, definition of “Repo Broker,” supra note 1.

once approved, FICC would thereafter regularly review such Category 2 Sponsoring Member regarding its continued adherence to such increased financial requirements.

In addition to reserving the right of FICC to impose financial requirements on a Category 2 Sponsoring Member that are greater than the financial requirements applicable to it in its capacity as a Netting Member under Section 4(b) of Rule 2A, the proposed rule change would also impose an activity limit on a Category 2 Sponsoring Member's Sponsored Member activity so that such Sponsoring Member would only be permitted to novate new Sponsored Member activity to FICC to the extent the sum of the VaR Charges of its Sponsoring Member Omnibus Account(s) and its Netting System accounts (hereinafter "Aggregate VaR Charges") do not exceed its Netting Member Capital. The ratio of a Category 2 Sponsoring Member's Aggregate VaR Charges to its Netting Member Capital would be calculated by FICC on at least an hourly basis for monitoring purposes. To the extent a Category 2 Sponsoring Member's Aggregate VaR Charges exceed its Netting Member Capital, it would not be permitted to submit new Sponsored Member activity to FICC until its Netting Member Capital equals or exceeds its Aggregate VaR Charges, unless otherwise determined by FICC in order to promote orderly settlement, which would 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.

FICC selected the ratio of Aggregate VaR Charges to Netting Member Capital for purposes of establishing the activity limit for Category 2 Sponsoring Members because this ratio is an important indicator that a Category 2 Sponsoring Member's financial resources, as measured by its net assets or equity capital, are sufficient to meet the largest component of its Required Fund Deposit (i.e., VaR Charges). VaR Charges and Netting Member Capital are also metrics that already exist in the Rules for purposes of determining Netting Members' Excess Capital Ratios, and, in turn, whether an Excess Capital Premium could be applied by FICC to Netting Members' Required Fund Deposits as provided in Section 14 of Rule 3 (Ongoing Membership Requirements).²⁷ As such, Netting Members that are interested in becoming Category 2 Sponsoring Members should already be familiar with and should be currently monitoring their FICC-cleared portfolio with respect to such metrics.

FICC proposes to apply the above-referenced activity limit only on Category 2 Sponsoring Members and not on Category 1 Sponsoring Members. This is because Category 1 Sponsoring Members are "well-capitalized"²⁸ and, as banks, subject to extensive prudential supervision and regulation with respect to their obligations under guaranties of performance, such as the Sponsoring Member Guaranty; therefore, FICC believes the imposition of a limit on their Sponsored Member activity would be unnecessary. However, given that FICC would not require Category 2 Sponsoring Members to be banks or bank holding company affiliates, a Category 2 Sponsoring Member may not be subject to a regulatory standard equivalent to "well-capitalized"²⁹ and/or may not be subject to the same type of prudential supervision and

²⁷ Rule 3, Section 14, supra note 1.

²⁸ 12 U.S.C. 1831o(a).

²⁹ Id.

regulation as a Category 1 Sponsoring Member; therefore, FICC believes it would be prudent from a risk management perspective to impose a limit on Category 2 Sponsoring Members' Sponsored Member activity.

Moreover, in order to be consistent with FICC's authority under Section 7 of Rule 3 (Ongoing Membership Requirements) with respect to Members and applicants to become such, FICC proposes to 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. 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 continued adherence to such adequate assurances requirements, as appropriate. Any adequate assurances requirements imposed on a Sponsoring Member after its approval would be memorialized in writing to the Sponsoring Member and regularly reviewed by senior risk management of FICC.

Proposed Rule Changes to Expand Sponsored Member Trade Definition

Currently, the term "Sponsored Member Trade" is defined in Rule 1 as "a transaction between a Sponsored Member and its Sponsoring Member ...".³⁰ Certain prospective Sponsoring Members have expressed an interest in allowing Sponsored Members to submit to FICC eligible securities transactions with Netting Members other than their Sponsoring Members. In light of the fact that in all cases, a Sponsoring Member is in control of which securities transactions it submits for clearing on behalf of its Sponsored Members³¹ and, in turn, its related obligations to FICC with respect to the Clearing Fund,³² loss allocation,³³ Capped Contingency Liquidity Facility[®] ("CCLF[®]"),³⁴ the Sponsoring Member Guaranty,³⁵ and fees,³⁶

³⁰ Rule 1, definition of "Sponsored Member Trade," supra note 1.

³¹ Section 6(b) of Rule 3A provides "The Sponsoring Member shall act as processing agent for performing all functions and receiving Reports and information set forth in the trade submission and comparison Rules on behalf of its Sponsored Members." Supra note 1.

³² Section 10(a) of Rule 3A provides "Each Sponsoring Member shall make and maintain so long as such Member is a Sponsoring Member a deposit to the Clearing Fund as a Required Fund Deposit to support the activity in the Sponsoring Member Omnibus Account... ." Supra note 1.

³³ Rule 3A, Section 12, supra note 1.

³⁴ Approved by the Commission, CCLF will be implemented on November 15, 2018. Securities Exchange Act Release No. 82090 (November 15, 2017), 82 FR 55427 (November 21, 2017) (SR-FICC-2017-002).

FICC is proposing to allow a Sponsoring Member to establish a Sponsoring Member Omnibus Account that may contain transactions between a Sponsored Member and a Netting Member other than the Sponsoring Member, which Sponsoring Member Omnibus Account could be in addition to or in lieu of a Sponsoring Member Omnibus Account in which only transactions between a Sponsored Member and its Sponsoring Member would be permitted.³⁷

Benefits of the Proposal

FICC believes that the novation of eligible securities transactions to FICC provides Sponsoring Members and their Sponsored Members the benefits of FICC's independent risk management and guaranty of completion of settlement of such transactions. In addition, Sponsoring Members may be able to offset or otherwise reduce their balance sheets with respect to their obligations to FICC on Sponsored Member Trades, as well as take lesser capital charges than would be required to the extent they engaged in the same securities transactions with their Sponsored Members outside of a central counterparty.³⁸ By participating in FICC as Sponsored Members, eligible institutional firms may be afforded increased lending capacity and income because balance sheet and capital constraints on their Sponsoring Members may be alleviated. Specifically, the opportunity for Sponsoring Members to intermediate their Sponsored Members' securities transactions in a more capital efficient manner through FICC may allow such Sponsoring Members to engage in a greater number of securities transactions, thereby potentially increasing their Sponsored Members' opportunity to lend and, in turn, their income.

FICC believes that the proposed rule changes to expand Sponsoring Member eligibility and the Sponsored Member Trade definition, as described above, would help to safeguard the

³⁵ Section 2 of Rule 3A provides "Each Netting Member to become a Sponsoring Member shall also sign and deliver to [FICC] a Sponsoring Member Guaranty" A "Sponsoring Member Guaranty" is defined in Rule 1 as "a guaranty ... that a Sponsoring Member delivers to [FICC] whereby the Sponsoring Member guarantees to [FICC] the payment and performance by its Sponsored Members of their obligations under [the] Rules, including, without limitation, all of the securities and funds-only settlement obligations of its Sponsored Members under [the] Rules." Supra note 1.

³⁶ Fee Structure, supra note 1.

³⁷ 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, the Required Fund Deposit for such Sponsoring Member Omnibus Account would be calculated 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.

³⁸ Sponsoring Members interested in such relief should discuss this matter with their accounting and regulatory capital experts.

U.S. financial market by lowering the risk of liquidity drain, protecting against fire sale risk,³⁹ and decreasing settlement and operational risk.

FICC believes that expanding the types of Netting Members that are eligible to participate in FICC as Sponsoring Members would increase the number of Sponsoring Members and, in turn, the number of Sponsored Member Trades that would be cleared and settled by FICC. Similarly, FICC believes that the proposed rule changes to expand the Sponsored Member Trade definition would also increase the number of Sponsored Member Trades that would be cleared and settled by FICC. FICC believes having more Sponsored Member Trades that clear and settle through FICC would mitigate the risk of a large scale exit by firms from the U.S. financial market in a stress scenario and therefore lower the risk of a liquidity drain in such a scenario. Specifically, to the extent firms would otherwise be engaging in the same type of eligible securities transactions (e.g., repurchase agreement transactions) outside of a central counterparty, FICC believes having such securities transactions novated to FICC and subject to FICC's guaranty of completion of settlement would reduce the risk that such firms discontinue such securities transactions in a Netting Member default situation.

Similarly, FICC believes having more Sponsored Member Trades that clear and settle through FICC would also reduce the potential for market disruption from fire sales. Specifically, in a Netting Member default situation, more securities transactions with the defaulted Netting Member could be centrally hedged and liquidated in an orderly manner by FICC rather than by individual counterparties in potential fire sale conditions.

In addition, to the extent firms would otherwise be engaging in eligible securities transactions (e.g., repurchase agreement transactions) outside of a central counterparty, FICC believes having more Sponsored Member Trades that clear and settle through FICC would also decrease settlement and operational risk in the U.S. financial market in that such securities transactions would now be eligible to be net settled⁴⁰ and subject to guaranteed settlement, novation, and independent risk management through FICC.

(ii) Proposed Changes to the Rules

Rule 1 (Definitions)

FICC is proposing to add two defined terms: "Category 1 Sponsoring Member" and "Category 2 Sponsoring Member" to Rule 1. In order to conform Rule 1 with the inclusion of these additional defined terms, FICC is also proposing to amend the definition of "Sponsoring

³⁹ Fire sale risk is the risk of rapid asset sales of securities held by cash lenders when a dealer defaults. This rapid sale has the potential to create a market crisis because cash lenders are likely to sell large amounts of securities in a short period of time, which could dramatically reduce the price of such securities that such lenders are looking to sell.

⁴⁰ It should be noted that net settlements of securities for Sponsored Member Trades would be executed by the Sponsoring Member's designated clearing bank in accordance with Rule 12 (Securities Settlement).

Member” to include references to a Category 1 Sponsoring Member and a Category 2 Sponsoring Member.

FICC is also proposing to amend the definition of “Sponsored Member Trade.” Currently, the term “Sponsored Member Trade” is defined in Rule 1 as “a transaction between a Sponsored Member and its Sponsoring Member”⁴¹ As described above, in light of the fact that certain prospective Sponsoring Members have expressed an interest in allowing Sponsored Members to submit to FICC eligible securities transactions with Netting Members other than their Sponsoring Member, and that, in all cases, a Sponsoring Member is in control of which securities transactions it submits for clearing on behalf of its Sponsored Members⁴² and, in turn, its related obligations to FICC with respect to the Clearing Fund,⁴³ loss allocation,⁴⁴ CCLF,⁴⁵ Sponsoring Member Guaranty,⁴⁶ and fees,⁴⁷ FICC is proposing to expand the Sponsored Member Trade definition to provide that a Sponsored Member Trade is a transaction that satisfies the requirements of Section 5 of Rule 3A and that is (a) between a Sponsored Member and its Sponsoring Member or (b) between a Sponsored Member and a Netting Member.

Similarly, FICC is proposing to amend the definition of “Sponsoring Member Omnibus Account” in Rule 1 to provide that a Sponsoring Member may elect to establish one or more Sponsoring Member Omnibus Accounts, and that each Sponsoring Member Omnibus Account may contain activity within the meaning of clause (a) of the proposed Sponsored Member Trade definition or activity within the meaning of clause (b) of such definition. In addition, FICC is proposing a technical change to revise “the Account” to “an Account” to reflect that a Sponsoring Member may have more than one Sponsoring Member Omnibus Account under this proposal.

Rule 3A (Sponsoring Members and Sponsored Members)

Currently, only Bank Netting Members that are “well-capitalized”⁴⁸ and have at least \$5 billion in equity capital are eligible to apply to become Sponsoring Members. In order to establish a second category of Netting Members eligible to become Sponsoring Members, FICC is proposing to amend Section 2(a) of Rule 3A by (i) renaming Sponsoring Members that are

⁴¹ Rule 1, definition of “Sponsored Member Trade,” supra note 1.

⁴² Supra note 31.

⁴³ Supra note 32.

⁴⁴ Supra note 33.

⁴⁵ Supra note 34.

⁴⁶ Supra note 35.

⁴⁷ Supra note 36.

⁴⁸ 12 U.S.C. 1831o(a).

well-capitalized Bank Netting Members as Category 1 Sponsoring Members and (ii) adding a sentence to Section 2(a) of Rule 3A that provides that a Netting Member that is a Tier One Netting Member, other than an Inter-Dealer Broker Netting Member, or a Non-IDB Repo Broker with respect to activity in its Segregated Repo Account, would be eligible to apply to become a Category 2 Sponsoring Member. In addition, FICC is proposing a technical change to add a missing parenthesis in Section 2(a) of Rule 3A.

FICC is proposing a conforming change to reorganize Section 2(b) of Rule 3A into four (4) subsections, grouping the current first three sentences in that section into subsection (i) and the current last sentence in that section into subsection (iii).

Under the proposal, Netting Members that are Tier One Netting Members, except for Inter-Dealer Broker Netting Members and Non-IDB Repo Brokers with respect to activity in their Segregated Repo Accounts, would be eligible to apply to become Category 2 Sponsoring Members. Accordingly, an applicant to become a Category 2 Sponsoring Member may have substantially less capital than a Category 1 Sponsoring Member. Therefore, FICC is proposing to add a new subsection (ii) to Section 2(b) of Rule 3A that would provide FICC with the right to impose financial requirements on a Netting Member applying to become a Category 2 Sponsoring Member that are greater than the financial requirements applicable to the applicant in its capacity as a Netting Member under Section 4(b) of Rule 2A, 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. FICC is also proposing to add that the Board would approve any increased financial requirements imposed by FICC in connection with the approval of an application of a Netting Member to become a Category 2 Sponsoring Member, and FICC would thereafter regularly review such Category 2 Sponsoring Member regarding its compliance with such increased financial requirements.

In addition, in order to be consistent with FICC's authority under Section 7 of Rule 3 (Ongoing Membership Requirements) with respect to Members and applicants to become such, FICC is proposing to add a new subsection (iv) to Section 2(b) of Rule 3A that would 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. FICC is also proposing to add that the Board would approve any adequate assurances imposed by FICC in connection with the approval of an application of a Netting Member to become a Sponsoring Member, and FICC would thereafter regularly review such Sponsoring Member regarding its compliance with such adequate assurances, as appropriate. Furthermore, FICC is proposing to add that 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.

Moreover, in order to conform to the proposal to allow a Netting Member that is a Tier One Netting Member, other than an Inter-Dealer Broker Netting Member, or a Non-IDB Repo Broker with respect to activity in its Segregated Repo Account, to apply to become a Category 2 Sponsoring Member, FICC is proposing 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.

Furthermore, in order to impose an activity limit on a Category 2 Sponsoring Member's Sponsored Member activity, as described above, FICC is proposing to add a new sentence to Section 2(h) of Rule 3A that provides if the sum of the VaR Charges of its Sponsoring Member Omnibus Account(s) and its Netting System accounts exceeds its Netting Member Capital, a Category 2 Sponsoring Member would not be permitted to submit activity into its Sponsoring Member Omnibus Account(s), unless otherwise determined by FICC in order to promote orderly settlement. FICC would also make a conforming change to the first sentence in this section to add "Category 1" before the first reference to Sponsoring Member.

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

FICC believes that the proposed rule changes to expand Sponsoring Member eligibility may increase the risks to FICC by creating a second category of Netting Members eligible to become Sponsoring Members in addition to Bank Netting Members that are "well-capitalized"⁴⁹ and have at least \$5 billion in equity capital. This is because, as proposed, FICC would be permitting Netting Members that may not be subject to a regulatory standard equivalent to "well-capitalized"⁵⁰ and/or may not be subject to the same type of prudential supervision and regulation as Bank Netting Members to participate in FICC as Sponsoring Members. Allowing such Netting Members to become Sponsoring Members may cause them to face significant and immediate liquidity demands in volatile market conditions given that, as described above, they are responsible for satisfying the Clearing Fund, CCLF and Sponsoring Member Guaranty obligations related to their Sponsored Member activity.

However, FICC believes any such increase in risks would be mitigated by (i) the governance, market risk management, and credit risk management processes applicable to all Sponsoring Members under the current Rules, (ii) FICC proposing under the proposed rule change to reserve the right to impose financial requirements on a Category 2 Sponsoring Member applicant that are greater than the financial requirements applicable to such applicant in its capacity as a Netting Member under Section 4(b) of Rule 2A, (iii) FICC proposing under the proposed rule change to subject Category 2 Sponsoring Members to activity limits, and (iv) FICC proposing under the proposed rule change to require each Sponsoring Member, and applicants to become such, to furnish to FICC such adequate assurances of their financial responsibility and operational capability 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

⁴⁹ 12 U.S.C. 1831o(a).

⁵⁰ Id.

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. Therefore, FICC believes that, taken as a whole, the proposed rule changes to expand Sponsoring Member eligibility would not have any risks to FICC, its members, and the market overall that cannot be prudently managed or mitigated.

Management of Identified Risks

All Sponsoring Members are subject to the following governance, market risk management, and credit risk management processes specifically related to their status as Sponsoring Members under the current Rules, which would continue to apply equally to all Sponsoring Members notwithstanding the proposed rule changes described in this filing.

The governance process applicable to the approval of every applicant to become a Sponsoring Member is set forth in Rule 3A. Specifically, in order to become a Sponsoring Member, an applicant is required to go through an application process, which includes a risk management review of the applicant by FICC specifically related to the activity it proposes to submit to FICC as a Sponsoring Member, and an approval of such applicant by the FICC Board of Directors as a new Sponsoring Member.⁵¹ This application process is separate from the applicant's original Netting Member application process. If the FICC Board of Directors denies the application of a Sponsoring Member applicant, FICC is required to handle such denial in the same way as set forth in Section 6 of Rule 2A with respect to Netting Member applications.⁵² FICC may also require that a Sponsoring Member applicant be a Netting Member for a time period deemed necessary by FICC prior to being considered to become a Sponsoring Member.⁵³

Once a Sponsoring Member is approved by the FICC Board of Directors, it is subject to ongoing credit surveillance and may be placed on the Watch List and/or may be subject to enhanced surveillance based on relevant factors as set forth in Rule 3, as FICC deems necessary to protect FICC and its members.⁵⁴

FICC mitigates the market risk associated with Sponsored Member activity in a Sponsoring Member's Sponsoring Member Omnibus Account through the collection of Clearing Fund from the Sponsoring Member.⁵⁵ A Sponsoring Member is required to maintain a deposit to the Clearing Fund as a Required Fund Deposit for all the Sponsored Member activity, which is calculated twice daily on a gross basis, in its Sponsoring Member Omnibus Account.⁵⁶ For

⁵¹ Rule 3A, Section 2, supra note 1.

⁵² Rule 3A, Section 2(b) and Rule 2A, Section 6, supra note 1.

⁵³ Rule 3A, Section 2(a), supra note 1.

⁵⁴ Rule 3, Section 12, supra note 1.

⁵⁵ Rule 3A, Section 10, supra note 1.

⁵⁶ Rule 3A, Section 10(a), supra note 1.

purposes of calculating the Unadjusted GSD Margin Portfolio Amount for a Sponsoring Member's Sponsoring Member Omnibus Account, each Sponsored Member's activity is assigned a separate VaR Charge, and, as such, the Unadjusted GSD Margin Portfolio Amount for the Sponsoring Member Omnibus Account is not reduced by any netting of positions as between different Sponsored Members within that Sponsoring Member Omnibus Account.⁵⁷ In addition, for purposes of calculating the Unadjusted GSD Margin Portfolio Amount applicable to a Sponsoring Member Omnibus Account, FICC applies the higher of the Required Fund Deposit calculation as of the beginning of the current Business Day and intraday on the current Business Day.⁵⁸ FICC has the right to apply all such Clearing Fund deposits plus all other Clearing Fund deposits of the Sponsoring Member for its Netting System accounts against any obligations owing to FICC by the Sponsoring Member, including (but not limited to) in a Sponsoring Member default situation.⁵⁹ In a Sponsoring Member default situation, FICC may apply all such Clearing Fund deposits against any obligations owing to FICC by the Sponsoring Member before any of the other resources in the GSD default loss waterfall would be used, including, in the final tranche of such waterfall, potential loss mutualization to Netting Members.⁶⁰

The proposed rule change would create two categories of Netting Members that would be eligible to become Sponsoring Members. The first category of Netting Members would include currently eligible Bank Netting Members that are "well-capitalized" (as defined by the Federal Deposit Insurance Corporation's applicable regulations)⁶¹ and have at least \$5 billion in equity capital (Category 1 Sponsoring Members). The second category of Netting Members eligible to become Sponsoring Members would include a Netting Member that is a Tier One Netting Member, except for Inter-Dealer Broker Netting Members and Non-IDB Repo Brokers with respect to activity in their Segregated Repo Accounts (Category 2 Sponsoring Members). As such, the proposed rule change would provide that Category 2 Sponsoring Member applicants could include, for example, Dealer Netting Members, Futures Commission Merchant Netting Members, and Foreign Netting Members.

The minimum financial requirements applicable to Netting Member applicants to become Category 2 Sponsoring Members would be the same as those that apply to them with respect to their respective Netting Member category under Section 4(b) of Rule 2A. However, since a Category 2 Sponsoring Member may have substantially less capital than a Category 1 Sponsoring Member, the proposed rule change would provide that FICC could impose financial requirements on an applicant to become a Category 2 Sponsoring Member that are greater than the financial requirements applicable to such applicant in its capacity as a Netting Member under Section 4(b) of Rule 2A. FICC's determination as to whether to impose such increased financial

⁵⁷ Rule 3A, Section 10(c), supra note 1.

⁵⁸ Id.

⁵⁹ Rule 3A, Section 10(b), supra note 1.

⁶⁰ See Rule 3A, Section 10(b) and Rule 4, Section 6, supra note 1.

⁶¹ 12 U.S.C. 1831o(a).

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. Such a determination by 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, and, once approved, FICC would thereafter regularly review such Category 2 Sponsoring Member regarding its continued adherence to such increased financial requirements.

In addition to reserving the right of FICC to impose financial requirements on a Category 2 Sponsoring Member that are greater than the financial requirements applicable to it in its capacity as a Netting Member under Section 4(b) of Rule 2A, the proposed rule change would also impose an activity limit on a Category 2 Sponsoring Member's Sponsored Member activity so that such Sponsoring Member would only be permitted to novate new Sponsored Member activity to FICC to the extent its Aggregate VaR Charges do not exceed its Netting Member Capital. The ratio of a Category 2 Sponsoring Member's Aggregate VaR Charges to its Netting Member Capital would be calculated by FICC on at least an hourly basis for monitoring purposes. To the extent a Category 2 Sponsoring Member's Aggregate VaR Charges exceed its Netting Member Capital, it would not be permitted to submit new Sponsored Member activity to FICC until its Netting Member Capital equals or exceeds its Aggregate VaR Charges, unless otherwise determined by FICC in order to promote orderly settlement, which would 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.

FICC selected the ratio of Aggregate VaR Charges to Netting Member Capital for purposes of establishing the activity limit for Category 2 Sponsoring Members because this ratio is an important indicator that a Category 2 Sponsoring Member's financial resources, as measured by its net assets or equity capital, are sufficient to meet the largest component of its Required Fund Deposit (i.e., VaR Charges). VaR Charges and Netting Member Capital are also metrics that already exist in the Rules for purposes of determining Netting Members' Excess Capital Ratios, and, in turn, whether an Excess Capital Premium could be applied by FICC to Netting Members' Required Fund Deposits as provided in Section 14 of Rule 3 (Ongoing Membership Requirements).⁶² As such, Netting Members that are interested in becoming Category 2 Sponsoring Members should already be familiar with and should be currently monitoring their FICC-cleared portfolio with respect to such metrics.

FICC proposes to apply the above-referenced activity limit only on Category 2 Sponsoring Members and not on Category 1 Sponsoring Members. This is because Category 1 Sponsoring Members are "well-capitalized"⁶³ and, as banks, subject to extensive prudential supervision and regulation with respect to their obligations under guaranties of performance, such as the Sponsoring Member Guaranty; therefore, FICC believes the imposition of a limit on

⁶² Rule 3, Section 14, supra note 1.

⁶³ 12 U.S.C. 1831o(a).

their Sponsored Member activity would be unnecessary. However, given that FICC would not require Category 2 Sponsoring Members to be banks or bank holding company affiliates, a Category 2 Sponsoring Member may not be subject to a regulatory standard equivalent to “well-capitalized”⁶⁴ and/or may not be subject to the same type of prudential supervision and regulation as a Category 1 Sponsoring Member; therefore, FICC believes it would be prudent from a risk management perspective to impose a limit on Category 2 Sponsoring Members’ Sponsored Member activity.

Moreover, in order to be consistent with FICC’s authority under Section 7 of Rule 3 (Ongoing Membership Requirements) with respect to Members and applicants to become such, FICC proposes to 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. 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 continued adherence to such adequate assurances requirements, as appropriate. Any adequate assurances requirements imposed on a Sponsoring Member after its approval would be memorialized in writing to the Sponsoring Member and regularly reviewed by senior risk management of FICC.

Consistency with the Clearing Supervision Act

FICC believes that the proposed rule change 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”).⁶⁵ The objectives and principles of Section 805(b) of the Clearing Supervision Act are to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.⁶⁶

FICC believes that the risk management that would apply to the proposal to allow a broader group of Netting Members to participate in FICC as Sponsoring Members would promote robust risk management and promote safety and soundness. Specifically, as provided under the current Rules and as described above, all Sponsoring Members would continue to be subject to an approval process that is separate from their original Netting Member applications, ongoing credit surveillance in their capacity as Sponsoring Members, as well as the calculation of Required Fund Deposits with respect to their Sponsoring Member Omnibus Accounts

⁶⁴ Id.

⁶⁵ 12 U.S.C. 5464(b).

⁶⁶ Id.

whereby no offsets for netting of positions as between different Sponsored Members are permitted and the higher of the Required Fund Deposit calculation as of the beginning of the current Business Day and intraday on the current Business Day is applied by FICC.

In addition, as provided under the proposed rule change and as described above, Category 2 Sponsoring Member applicants would be subject to the same financial requirements as those that apply to them with respect to their respective Netting Member category under Section 4(b) of Rule 2A, but FICC would reserve the right to impose greater financial requirements on the Category 2 Sponsoring Member applicant 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. An activity limit would also be imposed on a Category 2 Sponsoring Member's Sponsored Member activity so that such Sponsoring Member would only be permitted to novate new Sponsored Member activity to FICC to the extent its Aggregate VaR Charges do not exceed its Netting Member Capital, unless otherwise determined by FICC in order to promote orderly settlement, which would 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.

Moreover, as provided under the proposed rule change and as described above, 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.

FICC also believes the proposed rule changes to expand the Sponsored Member Trade definition would increase the number of Sponsored Member Trades that would be cleared and settled by FICC. Similarly, FICC believes that the proposed rule changes to expand Sponsoring Member eligibility would increase the number of Sponsoring Members and, in turn, the number of Sponsored Member Trades that would be cleared and settled by FICC.

FICC further believes that having more Sponsored Member Trades that clear and settle through FICC would also help to promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system by lowering the risk of a liquidity drain through FICC's guaranty of completion of settlement for a greater number of eligible securities transactions and would protect against fire sale risk through FICC's ability to centralize and control the hedging and liquidation of a greater portion of a failed counterparty's portfolio.

By lowering the risk of a liquidity drain in the U.S. financial market, protecting against fire sale risk, and having more Sponsored Member Trades that clear and settle through FICC in the context of its risk management processes, FICC believes these proposed rule changes would promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. Therefore, FICC believes that the proposed rule changes to expand Sponsoring Member eligibility and the Sponsored Trade definition are

consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

FICC also believes that the proposed conforming and technical changes described above are designed to provide clear and coherent Rules regarding Sponsoring Members. FICC believes that clear and coherent Rules should enhance the ability of FICC and Sponsoring Members to more effectively plan for, manage, and address the risks and financial requirements related to Sponsoring Members. As such, FICC believes that the conforming and technical changes are designed to promote robust risk management, consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

FICC believes that the proposed rule change is also consistent with Rule 17Ad-22(e)(18) promulgated under the Securities Exchange Act of 1934, as amended (the “Act”).⁶⁷ Rule 17Ad-22(e)(18) under the Act requires, in part, that FICC establish, implement, maintain and enforce written policies and procedures reasonably designed to establish objective, risk-based, and publicly disclosed criteria for participation.⁶⁸ The proposed rule changes 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. Specifically, as described above, an applicant to become a Category 2 Sponsoring Member would be required to be a Netting Member that is a Tier One Netting Member, other than an Inter-Dealer Broker Netting Member, or a Non-IDB Repo Broker with respect to activity in its Segregated Repo Account, and the Rules establish objective, risk-based, and publicly disclosed criteria in Rules 2A and 3 for Netting Members.⁶⁹ Therefore, FICC believes that the proposed rule changes to expand Sponsoring Member eligibility are consistent with Rule 17Ad-22(e)(18) under the Act.⁷⁰

11. Exhibits

Exhibit 1 – Not applicable.

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

Exhibit 2 – Not applicable.

Exhibit 3 – Not applicable.

Exhibit 4 – Not applicable.

Exhibit 5 – Proposed changes to the Rules.

⁶⁷ 17 CFR 240.17Ad-22(e)(18).

⁶⁸ Id.

⁶⁹ Rule 2A and Rule 3, supra note 1.

⁷⁰ 17 CFR 240.17Ad-22(e)(18).

EXHIBIT 1A

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-[_____]; File No. SR-FICC-2018-802)

[DATE]

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Advance Notice to Expand Sponsoring Member Eligibility in the Government Securities Division Rulebook 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 December __, 2018, Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) the advance notice SR-FICC-2018-802 (“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 amendments to the FICC Government Securities Division (“GSD”) Rulebook (“Rules”)⁴ in order to (i) allow a broader group of Netting

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(1)(i).

³ On December __, 2018, FICC filed this Advance Notice as a proposed rule change (SR-FICC-2018-013) with the Commission pursuant to Section 19(b)(1) of the Act, 15 U.S.C. 78s(b)(1), and Rule 19b-4 thereunder, 17 CFR 240.19b-4. A copy of the proposed rule change is available at <http://www.dtcc.com/legal/sec-rule-filings.aspx>.

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

Members to participate in FICC as Sponsoring Members, (ii) allow a Sponsoring Member to establish a Sponsoring Member Omnibus Account that may contain transactions between a Sponsored Member and a Netting Member other than the Sponsoring Member, which Sponsoring Member Omnibus Account could be in addition to or in lieu of a Sponsoring Member Omnibus Account in which only transactions between a Sponsored Member and its Sponsoring Member would be permitted, and (iii) make certain conforming and technical changes in Rules 1 and 3A.

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.

(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 Clearing Supervision Act

Nature of the Proposed Change

The purpose of this proposed rule change is to (i) allow a broader group of Netting Members to participate in FICC as Sponsoring Members, (ii) allow a Sponsoring Member to establish a Sponsoring Member Omnibus Account that may contain transactions between a Sponsored Member and a Netting Member other than the

Sponsoring Member, which Sponsoring Member Omnibus Account could be in addition to or in lieu of a Sponsoring Member Omnibus Account in which only transactions between a Sponsored Member and its Sponsoring Member would be permitted, and (iii) make certain conforming and technical changes in Rules 1 and 3A.

(i) Background

Under Rule 3A (Sponsoring Members and Sponsored Members), Bank Netting Members that are “well-capitalized” (as defined by the Federal Deposit Insurance Corporation’s applicable regulations)⁵ and have at least \$5 billion in equity capital are permitted to sponsor, as “Sponsoring Members,” qualified institutional buyers as defined by Rule 144A⁶ under the Securities Act of 1933, as amended (“Securities Act”),⁷ and certain legal entities that, although not organized as entities specifically listed in paragraph (a)(1)(i) of Rule 144A under the Securities Act, satisfy the financial requirements necessary to be qualified institutional buyers as specified in that paragraph (i.e., Sponsored Members) into GSD membership.

Under Rule 3A, a Sponsoring Member is permitted to submit to FICC for comparison, novation, and netting certain types of eligible securities transactions between itself and its Sponsored Members (Sponsored Member Trades).⁸ The Sponsoring Member is required to establish an omnibus account at FICC for all its Sponsored Members’ FICC-cleared securities transactions (Sponsoring Member Omnibus

⁵ 12 U.S.C. 1831o(a).

⁶ 17 CFR 230.144A.

⁷ 15 U.S.C. 77a *et seq.*

⁸ Rule 1, definition of “Sponsored Member Trade,” supra note 4.

Account),⁹ which is separate from the Sponsoring Member's regular netting accounts. For operational and administrative purposes, FICC interacts solely with the Sponsoring Member as agent for purposes of the day-to-day satisfaction of its Sponsored Members' obligations to FICC, including their securities and funds-only settlement obligations.¹⁰

Governance and Risk Management of Sponsoring Members

All Sponsoring Members are subject to the following governance, market risk management, and credit risk management processes specifically related to their status as Sponsoring Members under the current Rules, which would continue to apply equally to all Sponsoring Members notwithstanding the proposed rule changes described in this filing.

The governance process applicable to the approval of every applicant to become a Sponsoring Member is set forth in Rule 3A. In order to become a Sponsoring Member, an applicant is required to go through an application process, which includes a risk management review of the applicant by FICC specifically related to the activity it proposes to submit to FICC as a Sponsoring Member, and an approval of such applicant by the FICC Board of Directors¹¹ as a new Sponsoring Member.¹² This application process is separate from the applicant's original Netting Member application process. If the FICC Board of Directors denies the application of a Sponsoring Member applicant,

⁹ Rule 1, definition of "Sponsoring Member Omnibus Account," supra note 4.

¹⁰ Rule 3A, Sections 5, 6, 7, 8, and 9, supra note 4.

¹¹ FICC Board of Directors means the Board of Directors of Fixed Income Clearing Corporation or a committee thereof acting under delegated authority. Rule 1, supra note 4.

¹² Rule 3A, Section 2, supra note 4.

FICC is required to handle such denial in the same way as set forth in Section 6 of Rule 2A with respect to Netting Member applications.¹³ FICC may also require that a Sponsoring Member applicant be a Netting Member for a time period deemed necessary by FICC prior to being considered to become a Sponsoring Member.¹⁴

Once a Sponsoring Member is approved by the FICC Board of Directors, it is subject to ongoing credit surveillance and may be placed on the Watch List and/or may be subject to enhanced surveillance based on relevant factors as set forth in Rule 3, as FICC deems necessary to protect FICC and its members.¹⁵

FICC mitigates the market risk associated with Sponsored Member activity through the collection of Clearing Fund from the Sponsoring Member.¹⁶ A Sponsoring Member is required to maintain a Required Fund Deposit for all the Sponsored Member activity, which is calculated twice daily on a gross basis, in its Sponsoring Member Omnibus Account.¹⁷ Specifically, for purposes of calculating the Unadjusted GSD Margin Portfolio Amount for a Sponsoring Member Omnibus Account, each Sponsored Member's activity is assigned a separate VaR Charge, and, as such, the Unadjusted GSD Margin Portfolio Amount for the Sponsoring Member Omnibus Account is not reduced by any netting of positions as between different Sponsored Members within that

¹³ Rule 3A, Section 2(b) and Rule 2A, Section 6, supra note 4.

¹⁴ Rule 3A, Section 2(a), supra note 4.

¹⁵ Rule 3, Section 12, supra note 4.

¹⁶ Rule 3A, Section 10, supra note 4.

¹⁷ Rule 3A, Section 10(a), supra note 4.

Sponsoring Member Omnibus Account.¹⁸ In addition, for purposes of calculating the Unadjusted GSD Margin Portfolio Amount applicable to a Sponsoring Member Omnibus Account, FICC applies the higher of the Required Fund Deposit calculation as of the beginning of the current Business Day and intraday on the current Business Day.¹⁹ FICC has the right to apply all such Clearing Fund deposits plus all other Clearing Fund deposits of the Sponsoring Member for its Netting System accounts against any obligations owing to FICC by the Sponsoring Member, including (but not limited to) in a Sponsoring Member default situation.²⁰ In a Sponsoring Member default situation, FICC may apply all such Clearing Fund deposits against any obligations owing to FICC by the Sponsoring Member before any of the other resources in the GSD default loss waterfall would be used, including, in the final tranche of such waterfall, potential loss mutualization to Netting Members.²¹

Moreover, Sponsoring Members are also responsible for providing FICC with a Sponsoring Member Guaranty²² whereby the Sponsoring Member guarantees to FICC the payment and performance by its Sponsored Members of their obligations under the

¹⁸ Rule 3A, Section 10(c), supra note 4.

¹⁹ Id.

²⁰ Rule 3A, Section 10(b), supra note 4.

²¹ See Rule 3A, Section 10(b) and Rule 4, Section 6, supra note 4.

²² Section 2(c) of Rule 3A provides “Each Netting Member to become a Sponsoring Member shall also sign and deliver to [FICC] a Sponsoring Member Guaranty” A “Sponsoring Member Guaranty” is defined in Rule 1 as “a guaranty ... that a Sponsoring Member delivers to [FICC] whereby the Sponsoring Member guarantees to [FICC] the payment and performance by its Sponsored Members of their obligations under [the] Rules, including, without limitation, all of the securities and funds-only settlement obligations of its Sponsored Members under [the] Rules.” Supra note 4.

Rules.²³ Although Sponsored Members are principally liable to FICC for their own settlement obligations under the Rules, the Sponsoring Member is required to provide a Sponsoring Member Guaranty to FICC with respect to such obligations whereby if a Sponsored Member defaults and does not satisfy its settlement obligations to FICC, the Sponsoring Member is required to satisfy those settlement obligations on behalf of its defaulted Sponsored Member. As long as the Sponsoring Member performs under the Sponsoring Member Guaranty, it would not separately be considered in default to FICC, but failure to do so would be grounds for FICC to cease to act for the Sponsoring Member.²⁴

Proposed Rule Changes to Expand Sponsoring Member Eligibility

As described above, Rule 3A (Sponsoring Members and Sponsored Members) currently provides that Bank Netting Members that are “well-capitalized” (as defined by the Federal Deposit Insurance Corporation’s applicable regulations)²⁵ and have at least \$5 billion in equity capital are eligible to become Sponsoring Members.²⁶

In 2017, the Commission approved FICC rule filing SR-FICC-2017-003,²⁷ which expanded the types of entities that are eligible to participate in FICC as Sponsored Members under Rule 3A. Since that time, Netting Members that are not Bank Netting

²³ Rule 3A, Section 2(c), supra note 4.

²⁴ Rule 3A, Section 2(g), supra note 4.

²⁵ 12 U.S.C. 1831o(a).

²⁶ Rule 3A, Section 2(a), supra note 4.

²⁷ Securities Exchange Act Release No. 80563 (May 1, 2017), 82 FR 21284 (May 5, 2017) (SR-FICC-2017-003).

Members have expressed interest to FICC in participating in FICC as Sponsoring Members.

The proposed rule change would create two categories of Netting Members that would be eligible to become Sponsoring Members. The first category of Netting Members would include currently eligible Bank Netting Members that are “well-capitalized” (as defined by the Federal Deposit Insurance Corporation’s applicable regulations)²⁸ and have at least \$5 billion in equity capital (hereinafter and in the proposed rule change, “Category 1 Sponsoring Members”). The second category of Netting Members eligible to become Sponsoring Members would include Netting Members that are Tier One Netting Members, except for Inter-Dealer Broker Netting Members and Non-IDB Repo Brokers with respect to activity in their Segregated Repo Accounts (hereinafter and in the proposed rule change, “Category 2 Sponsoring Members”). As such, the proposed rule change would provide that Category 2 Sponsoring Member applicants could include, for example, Dealer Netting Members, Futures Commission Merchant Netting Members, and Foreign Netting Members.

FICC is proposing that neither Inter-Dealer Broker Netting Members nor Non-IDB Repo Brokers with respect to activity in their Segregated Repo Accounts be eligible to become Category 2 Sponsoring Members. Although Inter-Dealer Broker Netting Members and Non-IDB Repo Brokers are types of Netting Members, a cap applies to their respective loss allocation obligations to FICC under Rule 4, Section 7²⁹ that does

²⁸ 12 U.S.C. 1831o(a).

²⁹ Section 7 of Rule 4 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

not apply to other types of Netting Members; therefore, FICC does not believe it would be appropriate to allow either Inter-Dealer Broker Netting Members or Non-IDB Repo Brokers to be eligible to become Category 2 Sponsoring Members. However, to the extent an Inter-Dealer Broker 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 Inter-Dealer Broker Netting Member or Non-IDB Repo Broker could apply to become a Category 2 Sponsoring Member under such other Netting Member status.

The minimum financial requirements applicable to Netting Member applicants to become Category 2 Sponsoring Members would be the same as those that apply to them with respect to their respective Netting Member category under Section 4(b) of Rule 2A. However, since a Category 2 Sponsoring Member may have substantially less capital than a Category 1 Sponsoring Member, the proposed rule change would provide that FICC could impose financial requirements on an applicant to become a Category 2 Sponsoring Member that are greater than the financial requirements applicable to such applicant in its capacity as a Netting Member under Section 4(b) of Rule 2A. FICC's determination as to whether to impose such increased financial requirements on a Category 2 Sponsoring Member applicant would be based upon the level of the

Period.” Supra note 4. The limit on loss allocation for these Members reflects their risk profile. Specifically, an Inter-Dealer Broker Netting Member is required to (A) limit its business to acting exclusively as a broker, (B) conduct all of its business in Repo Transactions with Netting Members, and (C) conduct at least 90 percent of its business in transactions that are not Repo Transactions with Netting Members. Rule 3, Section 8(e), supra note 4. Likewise, a Non-IDB Repo Broker is required to operate in the same way as a Broker with respect to activity in its Segregated Repo Account. Rule 1, definition of “Repo Broker,” supra note 4.

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. Such a determination by 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, and, once approved, FICC would thereafter regularly review such Category 2 Sponsoring Member regarding its continued adherence to such increased financial requirements.

In addition to reserving the right of FICC to impose financial requirements on a Category 2 Sponsoring Member that are greater than the financial requirements applicable to it in its capacity as a Netting Member under Section 4(b) of Rule 2A, the proposed rule change would also impose an activity limit on a Category 2 Sponsoring Member's Sponsored Member activity so that such Sponsoring Member would only be permitted to novate new Sponsored Member activity to FICC to the extent the sum of the VaR Charges of its Sponsoring Member Omnibus Account(s) and its Netting System accounts (hereinafter "Aggregate VaR Charges") do not exceed its Netting Member Capital. The ratio of a Category 2 Sponsoring Member's Aggregate VaR Charges to its Netting Member Capital would be calculated by FICC on at least an hourly basis for monitoring purposes. To the extent a Category 2 Sponsoring Member's Aggregate VaR Charges exceed its Netting Member Capital, it would not be permitted to submit new Sponsored Member activity to FICC until its Netting Member Capital equals or exceeds its Aggregate VaR Charges, unless otherwise determined by FICC in order to promote

orderly settlement, which would 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.

FICC selected the ratio of Aggregate VaR Charges to Netting Member Capital for purposes of establishing the activity limit for Category 2 Sponsoring Members because this ratio is an important indicator that a Category 2 Sponsoring Member's financial resources, as measured by its net assets or equity capital, are sufficient to meet the largest component of its Required Fund Deposit (i.e., VaR Charges). VaR Charges and Netting Member Capital are also metrics that already exist in the Rules for purposes of determining Netting Members' Excess Capital Ratios, and, in turn, whether an Excess Capital Premium could be applied by FICC to Netting Members' Required Fund Deposits as provided in Section 14 of Rule 3 (Ongoing Membership Requirements).³⁰ As such, Netting Members that are interested in becoming Category 2 Sponsoring Members should already be familiar with and should be currently monitoring their FICC-cleared portfolio with respect to such metrics.

FICC proposes to apply the above-referenced activity limit only on Category 2 Sponsoring Members and not on Category 1 Sponsoring Members. This is because Category 1 Sponsoring Members are "well-capitalized"³¹ and, as banks, subject to extensive prudential supervision and regulation with respect to their obligations under guaranties of performance, such as the Sponsoring Member Guaranty; therefore, FICC believes the imposition of a limit on their Sponsored Member activity would be

³⁰ Rule 3, Section 14, supra note 4.

³¹ 12 U.S.C. 1831o(a).

unnecessary. However, given that FICC would not require Category 2 Sponsoring Members to be banks or bank holding company affiliates, a Category 2 Sponsoring Member may not be subject to a regulatory standard equivalent to “well-capitalized”³² and/or may not be subject to the same type of prudential supervision and regulation as a Category 1 Sponsoring Member; therefore, FICC believes it would be prudent from a risk management perspective to impose a limit on Category 2 Sponsoring Members’ Sponsored Member activity.

Moreover, in order to be consistent with FICC’s authority under Section 7 of Rule 3 (Ongoing Membership Requirements) with respect to Members and applicants to become such, FICC proposes to 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. 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 continued adherence to such adequate assurances requirements, as appropriate. Any adequate assurances requirements imposed on a Sponsoring Member after its approval would be

³²

Id.

memorialized in writing to the Sponsoring Member and regularly reviewed by senior risk management of FICC.

Proposed Rule Changes to Expand Sponsored Member Trade Definition

Currently, the term “Sponsored Member Trade” is defined in Rule 1 as “a transaction between a Sponsored Member and its Sponsoring Member”³³ Certain prospective Sponsoring Members have expressed an interest in allowing Sponsored Members to submit to FICC eligible securities transactions with Netting Members other than their Sponsoring Members. In light of the fact that in all cases, a Sponsoring Member is in control of which securities transactions it submits for clearing on behalf of its Sponsored Members³⁴ and, in turn, its related obligations to FICC with respect to the Clearing Fund,³⁵ loss allocation,³⁶ Capped Contingency Liquidity Facility[®] (“CCLF[®]”),³⁷ the Sponsoring Member Guaranty,³⁸ and fees,³⁹ FICC is proposing to allow

³³ Rule 1, definition of “Sponsored Member Trade,” supra note 4.

³⁴ Section 6(b) of Rule 3A provides “The Sponsoring Member shall act as processing agent for performing all functions and receiving Reports and information set forth in the trade submission and comparison Rules on behalf of its Sponsored Members.” Supra note 4.

³⁵ Section 10(a) of Rule 3A provides “Each Sponsoring Member shall make and maintain so long as such Member is a Sponsoring Member a deposit to the Clearing Fund as a Required Fund Deposit to support the activity in the Sponsoring Member Omnibus Account... .” Supra note 4.

³⁶ Rule 3A, Section 12, supra note 4.

³⁷ Approved by the Commission, CCLF will be implemented on November 15, 2018. Securities Exchange Act Release No. 82090 (November 15, 2017), 82 FR 55427 (November 21, 2017) (SR-FICC-2017-002).

³⁸ Section 2 of Rule 3A provides “Each Netting Member to become a Sponsoring Member shall also sign and deliver to [FICC] a Sponsoring Member Guaranty” A “Sponsoring Member Guaranty” is defined in Rule 1 as “a guaranty ... that a Sponsoring Member delivers to [FICC] whereby the Sponsoring Member

a Sponsoring Member to establish a Sponsoring Member Omnibus Account that may contain transactions between a Sponsored Member and a Netting Member other than the Sponsoring Member, which Sponsoring Member Omnibus Account could be in addition to or in lieu of a Sponsoring Member Omnibus Account in which only transactions between a Sponsored Member and its Sponsoring Member would be permitted.⁴⁰

Benefits of the Proposal

FICC believes that the novation of eligible securities transactions to FICC provides Sponsoring Members and their Sponsored Members the benefits of FICC's independent risk management and guaranty of completion of settlement of such transactions. In addition, Sponsoring Members may be able to offset or otherwise reduce their balance sheets with respect to their obligations to FICC on Sponsored Member Trades, as well as take lesser capital charges than would be required to the extent they engaged in the same securities transactions with their Sponsored Members outside of a central counterparty.⁴¹ By participating in FICC as Sponsored Members, eligible

guarantees to [FICC] the payment and performance by its Sponsored Members of their obligations under [the] Rules, including, without limitation, all of the securities and funds-only settlement obligations of its Sponsored Members under [the] Rules.” Supra note 4.

³⁹ Fee Structure, supra note 4.

⁴⁰ 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, the Required Fund Deposit for such Sponsoring Member Omnibus Account would be calculated 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.

⁴¹ Sponsoring Members interested in such relief should discuss this matter with their accounting and regulatory capital experts.

institutional firms may be afforded increased lending capacity and income because balance sheet and capital constraints on their Sponsoring Members may be alleviated. Specifically, the opportunity for Sponsoring Members to intermediate their Sponsored Members' securities transactions in a more capital efficient manner through FICC may allow such Sponsoring Members to engage in a greater number of securities transactions, thereby potentially increasing their Sponsored Members' opportunity to lend and, in turn, their income.

FICC believes that the proposed rule changes to expand Sponsoring Member eligibility and the Sponsored Member Trade definition, as described above, would help to safeguard the U.S. financial market by lowering the risk of liquidity drain, protecting against fire sale risk,⁴² and decreasing settlement and operational risk.

FICC believes that expanding the types of Netting Members that are eligible to participate in FICC as Sponsoring Members would increase the number of Sponsoring Members and, in turn, the number of Sponsored Member Trades that would be cleared and settled by FICC. Similarly, FICC believes that the proposed rule changes to expand the Sponsored Member Trade definition would also increase the number of Sponsored Member Trades that would be cleared and settled by FICC. FICC believes having more Sponsored Member Trades that clear and settle through FICC would mitigate the risk of a large scale exit by firms from the U.S. financial market in a stress scenario and therefore lower the risk of a liquidity drain in such a scenario. Specifically, to the extent firms

⁴² Fire sale risk is the risk of rapid asset sales of securities held by cash lenders when a dealer defaults. This rapid sale has the potential to create a market crisis because cash lenders are likely to sell large amounts of securities in a short period of time, which could dramatically reduce the price of such securities that such lenders are looking to sell.

would otherwise be engaging in the same type of eligible securities transactions (e.g., repurchase agreement transactions) outside of a central counterparty, FICC believes having such securities transactions novated to FICC and subject to FICC's guaranty of completion of settlement would reduce the risk that such firms discontinue such securities transactions in a Netting Member default situation.

Similarly, FICC believes having more Sponsored Member Trades that clear and settle through FICC would also reduce the potential for market disruption from fire sales. Specifically, in a Netting Member default situation, more securities transactions with the defaulted Netting Member could be centrally hedged and liquidated in an orderly manner by FICC rather than by individual counterparties in potential fire sale conditions.

In addition, to the extent firms would otherwise be engaging in eligible securities transactions (e.g., repurchase agreement transactions) outside of a central counterparty, FICC believes having more Sponsored Member Trades that clear and settle through FICC would also decrease settlement and operational risk in the U.S. financial market in that such securities transactions would now be eligible to be net settled⁴³ and subject to guaranteed settlement, novation, and independent risk management through FICC.

(ii) Proposed Changes to the Rules

Rule 1 (Definitions)

FICC is proposing to add two defined terms: "Category 1 Sponsoring Member" and "Category 2 Sponsoring Member" to Rule 1. In order to conform Rule 1 with the inclusion of these additional defined terms, FICC is also proposing to amend the

⁴³ It should be noted that net settlements of securities for Sponsored Member Trades would be executed by the Sponsoring Member's designated clearing bank in accordance with Rule 12 (Securities Settlement).

definition of “Sponsoring Member” to include references to a Category 1 Sponsoring Member and a Category 2 Sponsoring Member.

FICC is also proposing to amend the definition of “Sponsored Member Trade.” Currently, the term “Sponsored Member Trade” is defined in Rule 1 as “a transaction between a Sponsored Member and its Sponsoring Member”⁴⁴ As described above, in light of the fact that certain prospective Sponsoring Members have expressed an interest in allowing Sponsored Members to submit to FICC eligible securities transactions with Netting Members other than their Sponsoring Member, and that, in all cases, a Sponsoring Member is in control of which securities transactions it submits for clearing on behalf of its Sponsored Members⁴⁵ and, in turn, its related obligations to FICC with respect to the Clearing Fund,⁴⁶ loss allocation,⁴⁷ CCLF,⁴⁸ Sponsoring Member Guaranty,⁴⁹ and fees,⁵⁰ FICC is proposing to expand the Sponsored Member Trade definition to provide that a Sponsored Member Trade is a transaction that satisfies the requirements of Section 5 of Rule 3A and that is (a) between a Sponsored Member and its Sponsoring Member or (b) between a Sponsored Member and a Netting Member.

⁴⁴ Rule 1, definition of “Sponsored Member Trade,” supra note 4.

⁴⁵ Supra note 34.

⁴⁶ Supra note 35.

⁴⁷ Supra note 36.

⁴⁸ Supra note 37.

⁴⁹ Supra note 38.

⁵⁰ Supra note 39.

Similarly, FICC is proposing to amend the definition of “Sponsoring Member Omnibus Account” in Rule 1 to provide that a Sponsoring Member may elect to establish one or more Sponsoring Member Omnibus Accounts, and that each Sponsoring Member Omnibus Account may contain activity within the meaning of clause (a) of the proposed Sponsored Member Trade definition or activity within the meaning of clause (b) of such definition. In addition, FICC is proposing a technical change to revise “the Account” to “an Account” to reflect that a Sponsoring Member may have more than one Sponsoring Member Omnibus Account under this proposal.

Rule 3A (Sponsoring Members and Sponsored Members)

Currently, only Bank Netting Members that are “well-capitalized”⁵¹ and have at least \$5 billion in equity capital are eligible to apply to become Sponsoring Members. In order to establish a second category of Netting Members eligible to become Sponsoring Members, FICC is proposing to amend Section 2(a) of Rule 3A by (i) renaming Sponsoring Members that are well-capitalized Bank Netting Members as Category 1 Sponsoring Members and (ii) adding a sentence to Section 2(a) of Rule 3A that provides that a Netting Member that is a Tier One Netting Member, other than an Inter-Dealer Broker Netting Member, or a Non-IDB Repo Broker with respect to activity in its Segregated Repo Account, would be eligible to apply to become a Category 2 Sponsoring Member. In addition, FICC is proposing a technical change to add a missing parenthesis in Section 2(a) of Rule 3A.

⁵¹ 12 U.S.C. 1831o(a).

FICC is proposing a conforming change to reorganize Section 2(b) of Rule 3A into four (4) subsections, grouping the current first three sentences in that section into subsection (i) and the current last sentence in that section into subsection (iii).

Under the proposal, Netting Members that are Tier One Netting Members, except for Inter-Dealer Broker Netting Members and Non-IDB Repo Brokers with respect to activity in their Segregated Repo Accounts, would be eligible to apply to become Category 2 Sponsoring Members. Accordingly, an applicant to become a Category 2 Sponsoring Member may have substantially less capital than a Category 1 Sponsoring Member. Therefore, FICC is proposing to add a new subsection (ii) to Section 2(b) of Rule 3A that would provide FICC with the right to impose financial requirements on a Netting Member applying to become a Category 2 Sponsoring Member that are greater than the financial requirements applicable to the applicant in its capacity as a Netting Member under Section 4(b) of Rule 2A, 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. FICC is also proposing to add that the Board would approve any increased financial requirements imposed by FICC in connection with the approval of an application of a Netting Member to become a Category 2 Sponsoring Member, and FICC would thereafter regularly review such Category 2 Sponsoring Member regarding its compliance with such increased financial requirements.

In addition, in order to be consistent with FICC's authority under Section 7 of Rule 3 (Ongoing Membership Requirements) with respect to Members and applicants to

become such, FICC is proposing to add a new subsection (iv) to Section 2(b) of Rule 3A that would 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. FICC is also proposing to add that the Board would approve any adequate assurances imposed by FICC in connection with the approval of an application of a Netting Member to become a Sponsoring Member, and FICC would thereafter regularly review such Sponsoring Member regarding its compliance with such adequate assurances, as appropriate. Furthermore, FICC is proposing to add that 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.

Moreover, in order to conform to the proposal to allow a Netting Member that is a Tier One Netting Member, other than an Inter-Dealer Broker Netting Member, or a Non-IDB Repo Broker with respect to activity in its Segregated Repo Account, to apply to become a Category 2 Sponsoring Member, FICC is proposing 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.

Furthermore, in order to impose an activity limit on a Category 2 Sponsoring Member's Sponsored Member activity, as described above, FICC is proposing to add a new sentence to Section 2(h) of Rule 3A that provides if the sum of the VaR Charges of its Sponsoring Member Omnibus Account(s) and its Netting System accounts exceeds its Netting Member Capital, a Category 2 Sponsoring Member would not be permitted to submit activity into its Sponsoring Member Omnibus Account(s), unless otherwise determined by FICC in order to promote orderly settlement. FICC would also make a conforming change to the first sentence in this section to add "Category 1" before the first reference to Sponsoring Member.

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

FICC believes that the proposed rule changes to expand Sponsoring Member eligibility may increase the risks to FICC by creating a second category of Netting Members eligible to become Sponsoring Members in addition to Bank Netting Members that are "well-capitalized"⁵² and have at least \$5 billion in equity capital. This is because, as proposed, FICC would be permitting Netting Members that may not be subject to a regulatory standard equivalent to "well-capitalized"⁵³ and/or may not be subject to the same type of prudential supervision and regulation as Bank Netting Members to participate in FICC as Sponsoring Members. Allowing such Netting Members to become Sponsoring Members may cause them to face significant and immediate liquidity demands in volatile market conditions given that, as described above, they are

⁵² 12 U.S.C. 1831o(a).

⁵³ Id.

responsible for satisfying the Clearing Fund, CCLF and Sponsoring Member Guaranty obligations related to their Sponsored Member activity.

However, FICC believes any such increase in risks would be mitigated by (i) the governance, market risk management, and credit risk management processes applicable to all Sponsoring Members under the current Rules, (ii) FICC proposing under the proposed rule change to reserve the right to impose financial requirements on a Category 2 Sponsoring Member applicant that are greater than the financial requirements applicable to such applicant in its capacity as a Netting Member under Section 4(b) of Rule 2A, (iii) FICC proposing under the proposed rule change to subject Category 2 Sponsoring Members to activity limits, and (iv) FICC proposing under the proposed rule change to require each Sponsoring Member, and applicants to become such, to furnish to FICC such adequate assurances of their financial responsibility and operational capability 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. Therefore, FICC believes that, taken as a whole, the proposed rule changes to expand Sponsoring Member eligibility would not have any risks to FICC, its members, and the market overall that cannot be prudently managed or mitigated.

Management of Identified Risks

All Sponsoring Members are subject to the following governance, market risk management, and credit risk management processes specifically related to their status as Sponsoring Members under the current Rules, which would continue to apply equally to

all Sponsoring Members notwithstanding the proposed rule changes described in this filing.

The governance process applicable to the approval of every applicant to become a Sponsoring Member is set forth in Rule 3A. Specifically, in order to become a Sponsoring Member, an applicant is required to go through an application process, which includes a risk management review of the applicant by FICC specifically related to the activity it proposes to submit to FICC as a Sponsoring Member, and an approval of such applicant by the FICC Board of Directors as a new Sponsoring Member.⁵⁴ This application process is separate from the applicant's original Netting Member application process. If the FICC Board of Directors denies the application of a Sponsoring Member applicant, FICC is required to handle such denial in the same way as set forth in Section 6 of Rule 2A with respect to Netting Member applications.⁵⁵ FICC may also require that a Sponsoring Member applicant be a Netting Member for a time period deemed necessary by FICC prior to being considered to become a Sponsoring Member.⁵⁶

Once a Sponsoring Member is approved by the FICC Board of Directors, it is subject to ongoing credit surveillance and may be placed on the Watch List and/or may be subject to enhanced surveillance based on relevant factors as set forth in Rule 3, as FICC deems necessary to protect FICC and its members.⁵⁷

⁵⁴ Rule 3A, Section 2, supra note 4.

⁵⁵ Rule 3A, Section 2(b) and Rule 2A, Section 6, supra note 4.

⁵⁶ Rule 3A, Section 2(a), supra note 4.

⁵⁷ Rule 3, Section 12, supra note 4.

FICC mitigates the market risk associated with Sponsored Member activity in a Sponsoring Member's Sponsoring Member Omnibus Account through the collection of Clearing Fund from the Sponsoring Member.⁵⁸ A Sponsoring Member is required to maintain a deposit to the Clearing Fund as a Required Fund Deposit for all the Sponsored Member activity, which is calculated twice daily on a gross basis, in its Sponsoring Member Omnibus Account.⁵⁹ For purposes of calculating the Unadjusted GSD Margin Portfolio Amount for a Sponsoring Member's Sponsoring Member Omnibus Account, each Sponsored Member's activity is assigned a separate VaR Charge, and, as such, the Unadjusted GSD Margin Portfolio Amount for the Sponsoring Member Omnibus Account is not reduced by any netting of positions as between different Sponsored Members within that Sponsoring Member Omnibus Account.⁶⁰ In addition, for purposes of calculating the Unadjusted GSD Margin Portfolio Amount applicable to a Sponsoring Member Omnibus Account, FICC applies the higher of the Required Fund Deposit calculation as of the beginning of the current Business Day and intraday on the current Business Day.⁶¹ FICC has the right to apply all such Clearing Fund deposits plus all other Clearing Fund deposits of the Sponsoring Member for its Netting System accounts against any obligations owing to FICC by the Sponsoring Member, including (but not limited to) in a Sponsoring Member default situation.⁶² In a Sponsoring Member default

⁵⁸ Rule 3A, Section 10, supra note 4.

⁵⁹ Rule 3A, Section 10(a), supra note 4.

⁶⁰ Rule 3A, Section 10(c), supra note 4.

⁶¹ Id.

⁶² Rule 3A, Section 10(b), supra note 4.

situation, FICC may apply all such Clearing Fund deposits against any obligations owing to FICC by the Sponsoring Member before any of the other resources in the GSD default loss waterfall would be used, including, in the final tranche of such waterfall, potential loss mutualization to Netting Members.⁶³

The proposed rule change would create two categories of Netting Members that would be eligible to become Sponsoring Members. The first category of Netting Members would include currently eligible Bank Netting Members that are “well-capitalized” (as defined by the Federal Deposit Insurance Corporation’s applicable regulations)⁶⁴ and have at least \$5 billion in equity capital (Category 1 Sponsoring Members). The second category of Netting Members eligible to become Sponsoring Members would include a Netting Member that is a Tier One Netting Member, except for Inter-Dealer Broker Netting Members and Non-IDB Repo Brokers with respect to activity in their Segregated Repo Accounts (Category 2 Sponsoring Members). As such, the proposed rule change would provide that Category 2 Sponsoring Member applicants could include, for example, Dealer Netting Members, Futures Commission Merchant Netting Members, and Foreign Netting Members.

The minimum financial requirements applicable to Netting Member applicants to become Category 2 Sponsoring Members would be the same as those that apply to them with respect to their respective Netting Member category under Section 4(b) of Rule 2A. However, since a Category 2 Sponsoring Member may have substantially less capital than a Category 1 Sponsoring Member, the proposed rule change would provide that

⁶³ See Rule 3A, Section 10(b) and Rule 4, Section 6, supra note 4.

⁶⁴ 12 U.S.C. 1831o(a).

FICC could impose financial requirements on an applicant to become a Category 2 Sponsoring Member that are greater than the financial requirements applicable to such applicant in its capacity as a Netting Member under Section 4(b) of Rule 2A. FICC's determination as to whether to impose such increased 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. Such a determination by 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, and, once approved, FICC would thereafter regularly review such Category 2 Sponsoring Member regarding its continued adherence to such increased financial requirements.

In addition to reserving the right of FICC to impose financial requirements on a Category 2 Sponsoring Member that are greater than the financial requirements applicable to it in its capacity as a Netting Member under Section 4(b) of Rule 2A, the proposed rule change would also impose an activity limit on a Category 2 Sponsoring Member's Sponsored Member activity so that such Sponsoring Member would only be permitted to novate new Sponsored Member activity to FICC to the extent its Aggregate VaR Charges do not exceed its Netting Member Capital. The ratio of a Category 2 Sponsoring Member's Aggregate VaR Charges to its Netting Member Capital would be calculated by FICC on at least an hourly basis for monitoring purposes. To the extent a

Category 2 Sponsoring Member's Aggregate VaR Charges exceed its Netting Member Capital, it would not be permitted to submit new Sponsored Member activity to FICC until its Netting Member Capital equals or exceeds its Aggregate VaR Charges, unless otherwise determined by FICC in order to promote orderly settlement, which would 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.

FICC selected the ratio of Aggregate VaR Charges to Netting Member Capital for purposes of establishing the activity limit for Category 2 Sponsoring Members because this ratio is an important indicator that a Category 2 Sponsoring Member's financial resources, as measured by its net assets or equity capital, are sufficient to meet the largest component of its Required Fund Deposit (i.e., VaR Charges). VaR Charges and Netting Member Capital are also metrics that already exist in the Rules for purposes of determining Netting Members' Excess Capital Ratios, and, in turn, whether an Excess Capital Premium could be applied by FICC to Netting Members' Required Fund Deposits as provided in Section 14 of Rule 3 (Ongoing Membership Requirements).⁶⁵ As such, Netting Members that are interested in becoming Category 2 Sponsoring Members should already be familiar with and should be currently monitoring their FICC-cleared portfolio with respect to such metrics.

FICC proposes to apply the above-referenced activity limit only on Category 2 Sponsoring Members and not on Category 1 Sponsoring Members. This is because

⁶⁵ Rule 3, Section 14, supra note 4.

Category 1 Sponsoring Members are “well-capitalized”⁶⁶ and, as banks, subject to extensive prudential supervision and regulation with respect to their obligations under guaranties of performance, such as the Sponsoring Member Guaranty; therefore, FICC believes the imposition of a limit on their Sponsored Member activity would be unnecessary. However, given that FICC would not require Category 2 Sponsoring Members to be banks or bank holding company affiliates, a Category 2 Sponsoring Member may not be subject to a regulatory standard equivalent to “well-capitalized”⁶⁷ and/or may not be subject to the same type of prudential supervision and regulation as a Category 1 Sponsoring Member; therefore, FICC believes it would be prudent from a risk management perspective to impose a limit on Category 2 Sponsoring Members’ Sponsored Member activity.

Moreover, in order to be consistent with FICC’s authority under Section 7 of Rule 3 (Ongoing Membership Requirements) with respect to Members and applicants to become such, FICC proposes to 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. Such a determination by FICC to impose adequate assurances on a Sponsoring Member

⁶⁶ 12 U.S.C. 1831o(a).

⁶⁷ Id.

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 continued adherence to such adequate assurances requirements, as appropriate. Any adequate assurances requirements imposed on a Sponsoring Member after its approval would be memorialized in writing to the Sponsoring Member and regularly reviewed by senior risk management of FICC.

Consistency with the Clearing Supervision Act

FICC believes that the proposed rule change would be consistent with Section 805(b) of the Clearing Supervision Act.⁶⁸ The objectives and principles of Section 805(b) of the Clearing Supervision Act are to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.⁶⁹

FICC believes that the risk management that would apply to the proposal to allow a broader group of Netting Members to participate in FICC as Sponsoring Members would promote robust risk management and promote safety and soundness. Specifically, as provided under the current Rules and as described above, all Sponsoring Members would continue to be subject to an approval process that is separate from their original Netting Member applications, ongoing credit surveillance in their capacity as Sponsoring Members, as well as the calculation of Required Fund Deposits with respect to their Sponsoring Member Omnibus Accounts whereby no offsets for netting of positions as

⁶⁸ 12 U.S.C. 5464(b).

⁶⁹ Id.

between different Sponsored Members are permitted and the higher of the Required Fund Deposit calculation as of the beginning of the current Business Day and intraday on the current Business Day is applied by FICC.

In addition, as provided under the proposed rule change and as described above, Category 2 Sponsoring Member applicants would be subject to the same financial requirements as those that apply to them with respect to their respective Netting Member category under Section 4(b) of Rule 2A, but FICC would reserve the right to impose greater financial requirements on the Category 2 Sponsoring Member applicant 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. An activity limit would also be imposed on a Category 2 Sponsoring Member's Sponsored Member activity so that such Sponsoring Member would only be permitted to novate new Sponsored Member activity to FICC to the extent its Aggregate VaR Charges do not exceed its Netting Member Capital, unless otherwise determined by FICC in order to promote orderly settlement, which would 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.

Moreover, as provided under the proposed rule change and as described above, 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.

FICC also believes the proposed rule changes to expand the Sponsored Member Trade definition would increase the number of Sponsored Member Trades that would be cleared and settled by FICC. Similarly, FICC believes that the proposed rule changes to expand Sponsoring Member eligibility would increase the number of Sponsoring Members and, in turn, the number of Sponsored Member Trades that would be cleared and settled by FICC.

FICC further believes that having more Sponsored Member Trades that clear and settle through FICC would also help to promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system by lowering the risk of a liquidity drain through FICC's guaranty of completion of settlement for a greater number of eligible securities transactions and would protect against fire sale risk through FICC's ability to centralize and control the hedging and liquidation of a greater portion of a failed counterparty's portfolio.

By lowering the risk of a liquidity drain in the U.S. financial market, protecting against fire sale risk, and having more Sponsored Member Trades that clear and settle through FICC in the context of its risk management processes, FICC believes these proposed rule changes would promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system. Therefore, FICC believes that the proposed rule changes to expand Sponsoring

Member eligibility and the Sponsored Trade definition are consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

FICC also believes that the proposed conforming and technical changes described above are designed to provide clear and coherent Rules regarding Sponsoring Members. FICC believes that clear and coherent Rules should enhance the ability of FICC and Sponsoring Members to more effectively plan for, manage, and address the risks and financial requirements related to Sponsoring Members. As such, FICC believes that the conforming and technical changes are designed to promote robust risk management, consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act cited above.

FICC believes that the proposed rule change is also consistent with Rule 17Ad-22(e)(18) promulgated under the Act.⁷⁰ Rule 17Ad-22(e)(18) under the Act requires, in part, that FICC establish, implement, maintain and enforce written policies and procedures reasonably designed to establish objective, risk-based, and publicly disclosed criteria for participation.⁷¹ The proposed rule changes 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. Specifically, as described above, an applicant to become a Category 2 Sponsoring Member would be required to be a Netting Member that is a Tier One Netting Member, other than an Inter-Dealer Broker Netting Member, or a Non-IDB Repo Broker with respect to activity in its Segregated Repo Account, and the Rules establish objective, risk-

⁷⁰ 17 CFR 240.17Ad-22(e)(18).

⁷¹ Id.

based, and publicly disclosed criteria in Rules 2A and 3 for Netting Members.⁷²

Therefore, FICC believes that the proposed rule changes to expand Sponsoring Member eligibility are consistent with Rule 17Ad-22(e)(18) under the Act.⁷³

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 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.

⁷² Rule 2A and Rule 3, supra note 4.

⁷³ 17 CFR 240.17Ad-22(e)(18).

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-2018-802 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-2018-802. 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. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FICC-2018-802 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Secretary

FIXED INCOME CLEARING CORPORATION

GOVERNMENT SECURITIES DIVISION RULEBOOK

TEXT OF PROPOSED RULE CHANGE

Bold and underlined text indicates proposed added language

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

RULE 1 – DEFINITIONS

* * * *

Category 1 Sponsoring Member

The term “Category 1 Sponsoring Member” shall have the meaning given that term in Section 2(a) of Rule 3A.

Category 2 Sponsoring Member

The term “Category 2 Sponsoring Member” shall have the meaning given that term in Section 2(a) of Rule 3A.

* * * *

Sponsoring Member

The term “Sponsoring Member” means a Netting Member whose application to become a **Category 1 Sponsoring Member or a Category 2** Sponsoring Member has been approved by the Board pursuant to Rule 3A.

* * * *

Sponsoring Member Omnibus Account

The term “Sponsoring Member Omnibus Account” shall mean ~~the~~**an** Account maintained by a Sponsoring Member that contains the activity of its Sponsored Members that is submitted to the Corporation. **A Sponsoring Member may elect to establish one or more Sponsoring Member Omnibus Accounts. Each Sponsoring Member Omnibus Account may contain activity within the meaning of clause (a) of the Sponsored Member Trade definition or activity within the meaning of clause (b) of such definition.** The Sponsoring Member Omnibus Account shall be separate from the Accounts associated with the Sponsoring Member’s activity as a Netting Member except as contemplated by Sections 10, 11 and 12 of Rule 3A and under the Sponsoring Member Guaranty.

* * * *

Sponsored Member Trade

The term “Sponsored Member Trade” means a transaction **that satisfies the requirements of Section 5 of Rule 3A and that is (a)** between a Sponsored Member and its Sponsoring Member **or (b) between a Sponsored Member and a Netting Member**~~that satisfies the requirements of Section 5 of Rule 3A.~~

* * * *

RULE 3A—SPONSORING MEMBERS AND SPONSORED MEMBERS

* * * *

Section 2 – Qualifications of Sponsoring Members, the Application Process and Continuance Standards

(a) A Netting Member shall be eligible to apply to become a **Category 1** Sponsoring Member if: (i) it is a Bank Netting Member, (ii) it has a level of equity capital as of the end of the month prior to the effective date of its membership of at least \$5 billion, (iii) it is “well-capitalized” as defined by the Federal Deposit Insurance Corporation’s applicable regulations, and (iv) if it has a bank holding company that is registered under the Bank Holding Company Act of 1956, as amended, such bank holding company is also “well-capitalized” as defined by the applicable regulations of the Board of Governors of the Federal Reserve System. **A Netting Member that is a Tier One Netting Member, other than an Inter-Dealer Broker Netting Member, or a Non-IDB Repo Broker with respect to activity in its Segregated Repo Account, shall be eligible to apply to become a Category 2 Sponsoring Member.** The Corporation may require that a Person be a Netting Member for a time period deemed necessary by the Corporation before that Person may be considered to become a Sponsoring Member.

(b) (i) Each Netting Member applicant to become a Sponsoring Member shall complete and deliver to the Corporation an application in such form as may be prescribed by the Corporation from time to time and any other information requested by the Corporation. An application to become a Sponsoring Member shall first be reviewed by the Corporation. The Corporation shall recommend approval or disapproval of the application to the Board.

(ii) The Corporation may impose financial requirements on a Netting Member applying to become a Category 2 Sponsoring Member that are greater than financial requirements applicable to the applicant in its capacity as a Netting Member under Section 4(b) of Rule 2A, 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 the Corporation as a Category 2 Sponsoring Member, and the overall financial condition of such applicant. The Board shall approve any increased financial requirements imposed by the Corporation in connection with the approval of an application of a Netting Member to become a Category 2 Sponsoring Member, and the Corporation shall thereafter regularly review such Category 2 Sponsoring Member regarding its compliance with such increased financial requirements.

(iii) If the Board denies the application of a Netting Member to become a Sponsoring Member, such denial shall be handled in the same way as set forth in Section 6 of Rule 2A with respect to membership applications.

(iv) Each Sponsoring Member, or any Netting Member applicant to become such, shall also furnish to the Corporation such adequate assurances of its financial responsibility and operational capability within the meaning of Section 7 of

Rule 3 as the Corporation may at any time or from time to time deem necessary or advisable in order to protect the Corporation and its members, to safeguard securities and funds in the custody or control of the Corporation and for which the Corporation is responsible, or to promote the prompt and accurate clearance and settlement of securities transactions. The Board shall approve any adequate assurances imposed by the Corporation in connection with the approval of an application of a Netting Member to become a Sponsoring Member, and the Corporation shall thereafter regularly review such Sponsoring Member regarding its compliance with such adequate assurances, as appropriate. Any adequate assurances imposed on a Sponsoring Member by the Corporation after its approval shall be communicated in writing to the Sponsoring Member, and the Corporation shall thereafter regularly review such Sponsoring Member regarding its compliance with such adequate assurances, as appropriate.

* * * *

(e) Each Sponsoring Member shall submit to the Corporation, within the timeframes and in the formats required by the Corporation, the reports and information that all Netting Members are required to submit regardless of type of Netting Member and the reports and information required to be submitted **specifically by Bank Netting Members for its respective type of Netting Member**, all pursuant to Section 2 of Rule 3.

* * * *

(h) If a **Category 1** Sponsoring Member falls below one or more of the required minimum financial standards for being a Sponsoring Member set forth in subsection (a) above, it shall, for the period beginning on the day on which it fell below such level and continuing until the later of the 90th calendar day after the date on which (i) it returned to compliance with such standard, or (ii) the Corporation received notice of the applicable violation, have a Sponsoring Member Omnibus Account Required Fund Deposit equal to the greater of either: (x) the sum of the normal calculation of its Sponsoring Member Omnibus Account Required Fund Deposit plus \$1,000,000, or (y) 125 percent of the normal calculation of its Sponsoring Member Omnibus Account Required Fund Deposit. **If, in the case of a Category 2 Sponsoring Member, the sum of the VaR Charges of its Sponsoring Member Omnibus Account(s) and its Netting System accounts exceeds its Netting Member Capital, the Category 2 Sponsoring Member shall not be permitted to submit activity into its Sponsoring Member Omnibus Account(s), unless otherwise determined by the Corporation in order to promote orderly settlement.**

* * * *