

DTCC

FICC'S Client Clearing Workflows and Related Accounting Considerations

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PRESENTER: FICC Management

DATE: May 3, 2024

DEPARTMENT: Fixed Income Clearing Corporation (FICC)

- ▶ The following slides describe the workflows for FICC's client clearing models and related considerations that may be relevant for purposes of firms' determination of appropriate accounting treatment of various FICC-cleared transactions.
- ▶ Amongst the considerations that may be relevant to firms' accounting determinations, we highlight in the following slides:
 - ▶ The parties in the workflow that are acting as principals to the transaction itself;
 - ▶ The party or parties that are obligated to FICC for such transactions, and in what capacity they are obligated to FICC (i.e., in their own capacity or as agent for their client).
- ▶ FICC also provides certain legal opinions to assist firms in their accounting analysis, including:
 - ▶ Netting/IAS 32 Opinions that apply to all transactions, which counsel plans to update to reflect updates to the Agent Clearing Service.
 - ▶ Novation opinion for Sponsored Member Transactions, which FICC plans to augment to cover Agent Clearing Transactions.
- ▶ The settlement location for all transactions novated to FICC should either be BNYM or Fedwire depending on the settlement bank used by the GSD Netting Member.
- ▶ While the workflows in the following slides focus on Repo transaction examples, it should be noted that all cash transactions submitted into either the Sponsored Service or the Agent Clearing Service are novated at point of match at FICC, and all other aspects of the workflows described below for the Sponsored Service and the Agent Clearing Service apply to cash transactions in the same way as they do to DVP Repo transactions.

01

FICC/GSD's Sponsored Service “Done-Away” and “Done-With” Workflows

Sponsoring/Sponsored Member Service

- ▶ Since 2005, GSD has offered a program under Rule 3A that allows eligible GSD Netting Members to act as “Sponsoring Members” for purposes of sponsoring certain buy-side entities (“Sponsored Members”) into a limited GSD membership.
- ▶ For operational and administrative purposes, a Sponsoring Member acts as processing agent on behalf of its Sponsored Members and establishes one or more omnibus account(s) at FICC for its Sponsored Members’ activity, which are separate from the Sponsoring Member’s regular GSD netting account(s).
- ▶ A firm is eligible to be a Sponsored Member if it is established in a permitted jurisdiction and is sponsored by at least one Sponsoring Member. Note: A Sponsored Member is also currently required to be a SEC Rule 144A Qualified Institutional Buyer or equivalent, but FICC is proposing in its pending access model improvement filing [SR-FICC-2024-005 <https://www.sec.gov/files/rules/sro/ficc/2024/34-99817.pdf>] to remove this standard.
- ▶ Eligible transactions include outright purchases and sales of U.S. Treasury and Agency securities, two-directional (i.e., cash borrowing and cash lending) overnight and term DVP repo, and tri-party repo transactions in eligible U.S. Treasury and Agency securities and Agency MBS.
- ▶ Sponsored DVP Transactions (including DVP Repo and Cash transactions) may be executed between a Sponsored Member and its Sponsoring Member (“Done With”) or between a Sponsored Member and another GSD Netting Member or another GSD Netting Member’s client (“Done-Away”). Sponsored GC (i.e., tri-party repo) Transactions may be executed only on a Done-With basis in light of their design to accommodate bilateral tri-party repo transactions.

Sponsoring/Sponsored Member Service - Continued

- ▶ Sponsored Members are limited members of FICC and have certain rights and obligations pursuant to the GSD Rulebook.
- ▶ Sponsored Members are **principally liable** to FICC for their securities and cash settlement obligations.
- ▶ The Sponsoring Member is required to provide a guaranty to FICC with respect to all obligations of its Sponsored Members. If a Sponsored Member does not satisfy any of its obligations to FICC, FICC will look to the Sponsoring Member to satisfy those obligations in full pursuant to the guaranty.
- ▶ For initial margining purposes, FICC will offer two margining options for this product: (1) a non-segregated option where the margin posted in respect of positions will be available for loss mutualization subject to the GSD rules and (2) a segregated option where the margin must be collected from customers and on-posted to FICC, and the margin will not be available for loss mutualization. Initial margin requirements under (1) and (2) will both generally be calculated on a gross (i.e., Sponsored Member by Sponsored Member basis), though certain smaller components of FICC's initial margin model will for (1) be calculated on a Net (i.e., across Sponsored Members) basis.
- ▶ FICC's liquidity needs related to activity submitted on behalf of Sponsored Members are included in calculating the Sponsoring Member's Capped Contingent Liquidity Facility[®] (CCLF) requirement for a given account under the GSD Rules.
- ▶ Sponsoring Members are responsible to FICC for all fees, margin requirements, CCLF obligations and any loss allocation obligations attributed to all submitted activity, including activity of their Sponsored Members.

Trade Execution

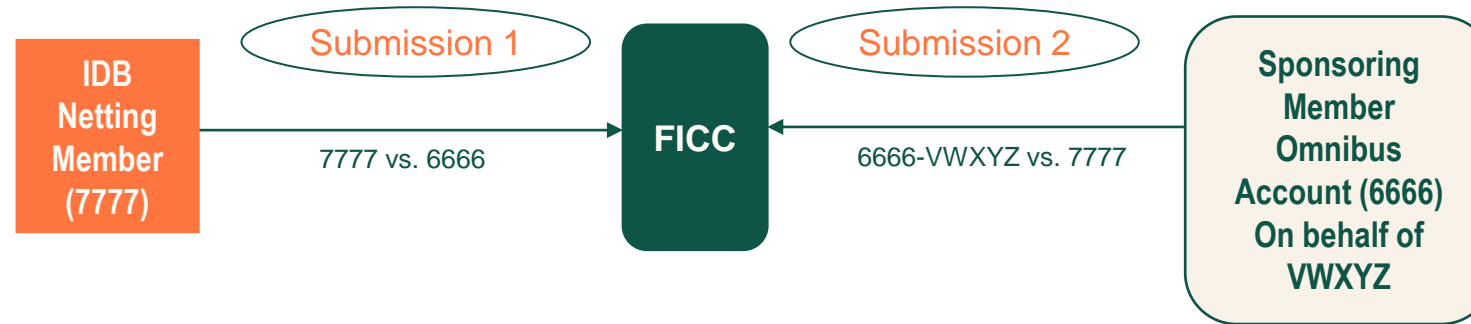


A Done-Away Sponsored Member Transaction may be executed between a Sponsoring Member's Sponsored Member and (1) another GSD Netting Member, (2) another Sponsored Member of the same Sponsoring Member or (3) a client of an Agent Clearing Member or Sponsoring Member.

Step 1 – Trade execution: Sponsored Member X executes a trade with an IDB Netting Member.

Step 2 – Notification of trade details: Sponsored Member X notifies its Sponsoring Member of the executed trade details (vs. IDB Netting Member) so the Sponsoring Member can submit this trade to FICC for match.

Trade Submission and Novation

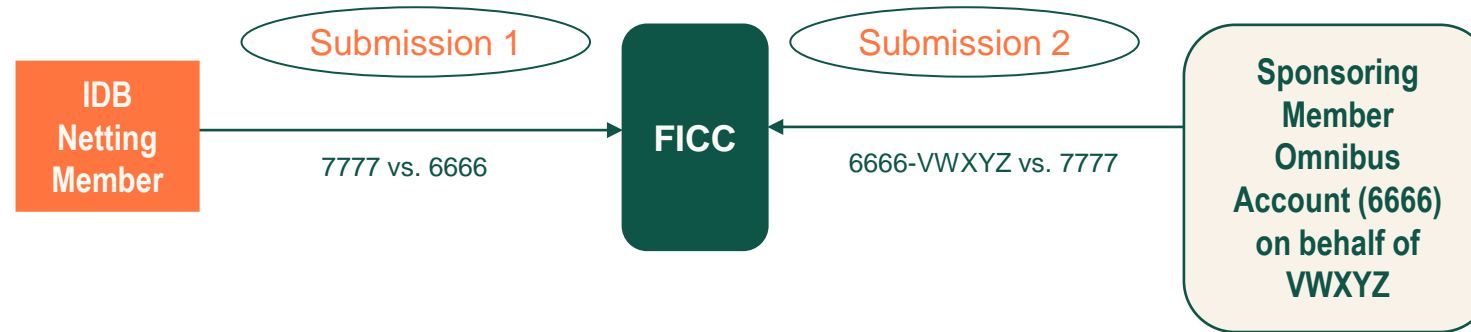


Submission 1: In this case, the IDB Netting Member submits its side of the trade to FICC from its account (shown as account no. 7777 above) vs. the Sponsoring Member Omnibus account (shown as account no. 6666 above).

Submission 2: The Sponsoring Member submits the trade on behalf of Sponsored Member X. The trade is submitted from its Sponsoring Member Omnibus account (account no. 6666) with a “symbol” indicating that the trade was submitted for Sponsored Member X (assume Sponsored Member X’s symbol is “VWXYZ”) vs. IDB Netting Member account (account no. 7777).

The novation of the start leg and end leg of this trade occurs upon match at FICC.

Post-Novation Considerations



- The pre-novation counterparties to the trade are IDB Netting Member and Sponsored Member X (“VWXYZ”).
- Post novation to FICC, IDB Netting Member and Sponsored Member X (“VWXYZ”) remain principals on the trade versus FICC, and Sponsored Member X (“VWXYZ”) is the **principal obligor to FICC** for the performance of all of its securities and cash settlement obligations. The Sponsoring Member is secondarily liable for such obligations of Sponsored Member X to FICC pursuant to the Sponsoring Member guaranty. The Sponsoring Member is not a principal on the trade either before or after novation to FICC.
- FICC is liable to Sponsored Member X (“VWXYZ”) in the event of the Sponsoring Member’s default pursuant to the GSD Rules, though FICC would perform to the Sponsoring Member or its bankruptcy trustee since the Sponsoring Member acts as the processing agent for Sponsored Member X [<https://www.dtcc.com/ustclearing/-/media/Files/Downloads/Microsites/Treasury-Clearing/FICC-Default-Scenarios.pdf>].

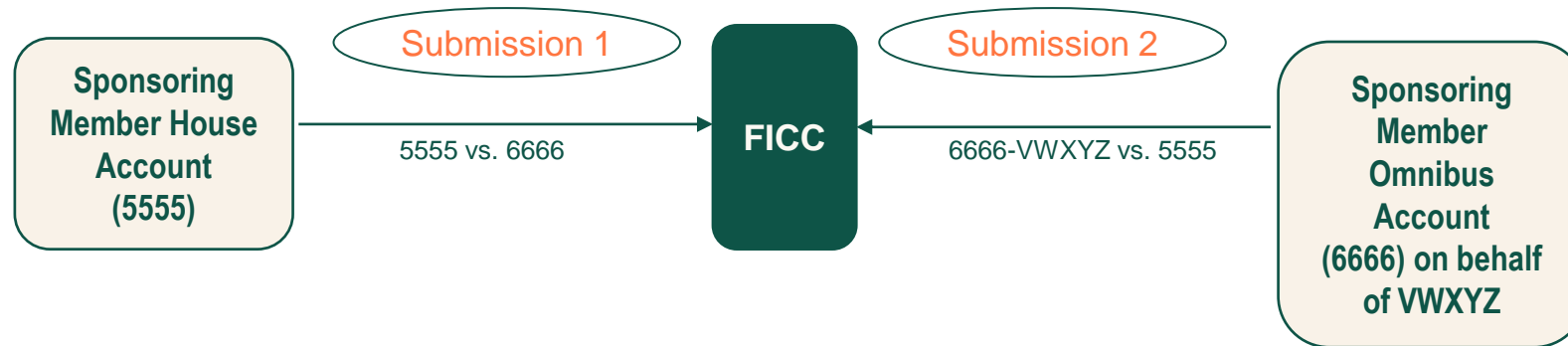
Trade Execution



A Done-With Sponsored Member Transaction is a trade executed between a Sponsoring Member and its Sponsored Member.

Trade execution: Sponsored Member X executes a trade with its Sponsoring Member.

Trade Submission and Novation

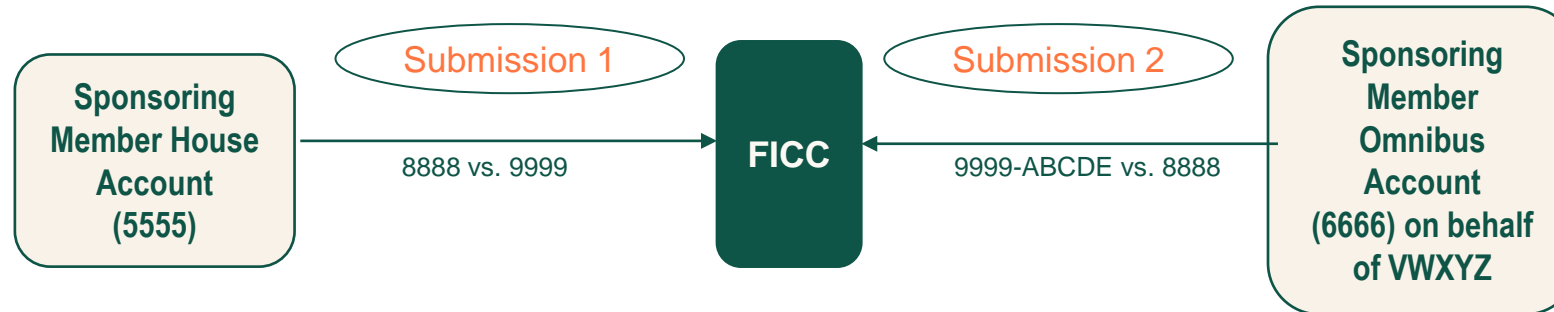


In order to facilitate the submission of a Done-With Sponsored Member Transaction, a Sponsoring Member must have two accounts at FICC: one to represent its House activity including the trades with its Sponsored Members (Sponsoring Member House Account no. 5555 above) and another one to represent the Sponsored Members' sides of the trades (Sponsoring Member Omnibus Account no. 6666 above).

Trade Submission: Sponsoring Member submits both sides of this trade to FICC for match. The Sponsoring Member's side is submitted out of its House Account (account no. 5555) and the side on behalf of Sponsored Member X is submitted from its Sponsoring Member Omnibus Account (account no. 6666) with a "symbol" indicating that the trade was submitted for Sponsored Member X (assume Sponsored Member X's symbol is "VWXYZ").

The novation of the start leg and end leg of this trade occurs upon match at FICC, unless the start leg of the repo is scheduled to settle on the same day as submission in which case only the end of the trade is novated to FICC.

Post-Novation Considerations



- The pre-novation counterparties to the trade are the Sponsoring Member and Sponsored Member X (“VWXYZ”).
- Post novation to FICC, Sponsoring Member and Sponsored Member X (“VWXYZ”) remain principal on the trade versus FICC, and Sponsored Member X (“VWXYZ”) is the **principal obligor to FICC** for the performance of all of its securities and cash settlement obligations. The Sponsoring Member is secondarily liable for such obligations of Sponsored Member X to FICC pursuant to the Sponsoring Member guaranty.
- FICC is liable to Sponsored Member X (“VWXYZ”) in the event of the Sponsoring Member’s default pursuant to the GSD Rules, though FICC would perform to the Sponsoring Member or its bankruptcy trustee since the Sponsoring Member acts as the processing agent for Sponsored Member X [<https://www.dtcc.com/ustclearing/-/media/Files/Downloads/Microsites/Treasury-Clearing/FICC-Default-Scenarios.pdf>].



02

Agent Clearing Service “Done-Away” and “Done- With” Workflows

- ▶ FICC GSD's proposal to establish the Agent Clearing Service is currently under regulatory review and has been published by the Securities and Exchange Commission for public consultation. That review and public consultation remains ongoing. Under that proposal:
 - ▶ GSD Netting Members that are approved to act as Agent Clearing Members are permitted to submit to FICC transactions on behalf of their clients that are not GSD members (referred to as “Executing Firms Customers” in the GSD Rules).
 - ▶ Executing Firm Customers are represented by ticker symbols mapped to the relevant Agent Clearing Member and must specifically authorize the Agent Clearing Member to submit their transactions (referred to as “Agent Clearing Transactions”) to FICC on their behalf.
 - ▶ The Agent Clearing Member can submit eligible transactions executed between its Executing Firm Customer and any of the following: another GSD Netting Member, the Agent Clearing Member itself, another Executing Firm Customer of the Agent Clearing Member, another GSD Netting Member's client.
 - ▶ Agent Clearing Transactions are required to be submitted to FICC into an Agent Clearing Omnibus Account.
 - ▶ Eligible transactions include outright purchases and sales of U.S. Treasury and Agency securities, as well as two-directional (i.e., cash borrowing and cash lending) overnight and term DVP repo.

- ▶ FICC only has a legal relationship with the Agent Clearing Member and does not have any rights or obligations with respect to the Executing Firm Customers.
- ▶ FICC will offer two initial margin options for this product: (1) a non-segregated option where the margin posted in respect of the positions will be available for loss mutualization and (2) a segregated option where the margin must be collected from customers and on-posted to FICC, and the margin will not be available for loss mutualization. Margin under option (1) will be calculated on a Net basis (i.e., the positions of all Executing Firm Customers that are carried in the same account will be netted against one another). By contrast, margin requirements under option (2) will be calculated on a gross (i.e., Executing Firm Customer by Executing Firm Customer) basis.
- ▶ FICC's liquidity needs related to activity submitted on behalf of Executing Firm Customers are included in calculating the Agent Clearing Member's Capped Contingent Liquidity Facility[®] (CCLF) requirement for a given account under the GSD Rules.
- ▶ The Agent Clearing Member acts solely as agent of its Executing Firm Customers but remains fully liable for all outstanding obligations to FICC on behalf of Executing Firm Customers. For example, the Agent Clearing Member is responsible to FICC for all fees, settlement obligations, margin requirements, CCLF obligations and any loss allocation obligations attributed to activity submitted on behalf of an Executing Firm Customer.

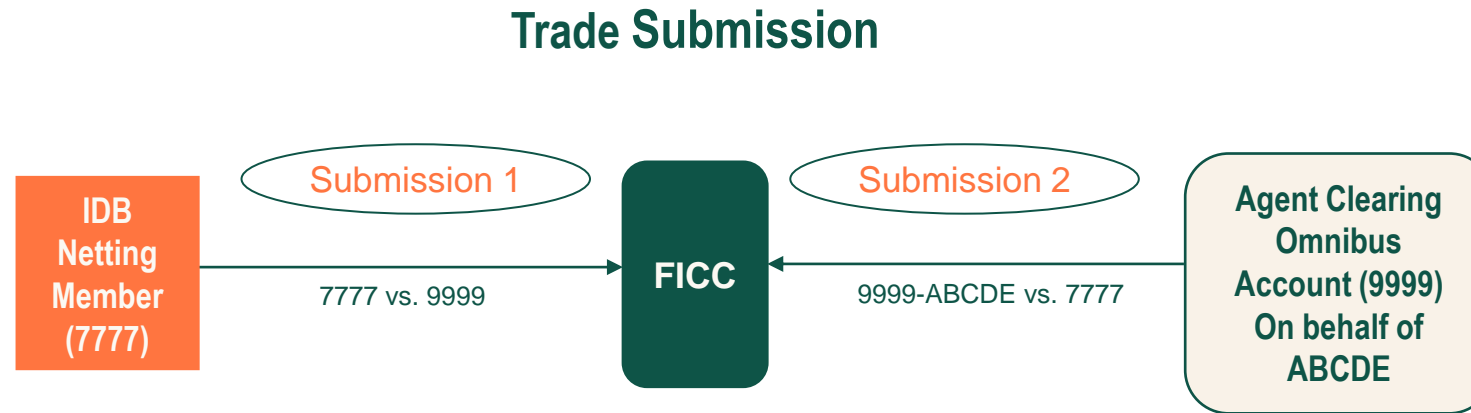
Trade Execution



A Done-Away Agent Clearing Transaction is a trade executed between an Agent Clearing Member's Executing Firm Customer and (1) another GSD Netting Member, (2) another Executing Firm Customer of the same Agent Clearing Member or (3) a client of an Agent Clearing Member or Sponsoring Member.

Step 1 – Trade execution: Executing Firm X executes a trade with an IDB Netting Member.

Step 2 – Notification of trade details: Executing Firm X notifies the Agent Clearing Member of the executed trade details (vs. IDB Netting Member) so the Agent Clearing Member can submit this trade to FICC for match.

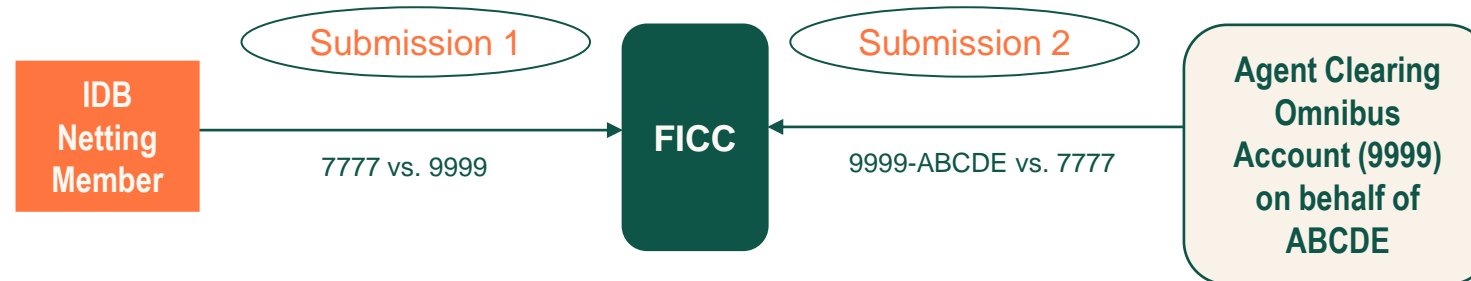


Submission 1: In this case, the IDB Netting Member submits its side of the trade to FICC from its account (shown as account no. 7777 above) vs. the Agent Clearing Omnibus account (shown as account no. 9999 above).

Submission 2: The Agent Clearing Member submits the trade on behalf of Executing Firm X. The trade is submitted from its Agent Clearing Omnibus account (account no. 9999) with a “symbol” indicating that the trade was submitted for Executing Firm X (assume Executing Firm X’s symbol is “ABCDE”) vs. IDB Netting Member account (account no. 7777).

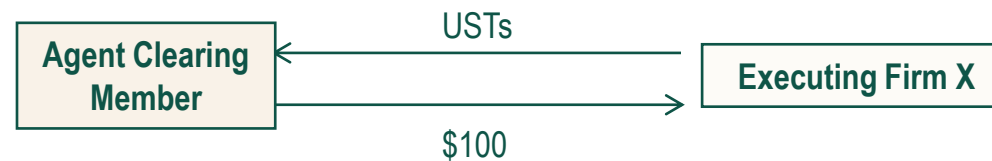
The novation of the start leg and end leg of this trade occurs upon match at FICC.

Accounting Considerations



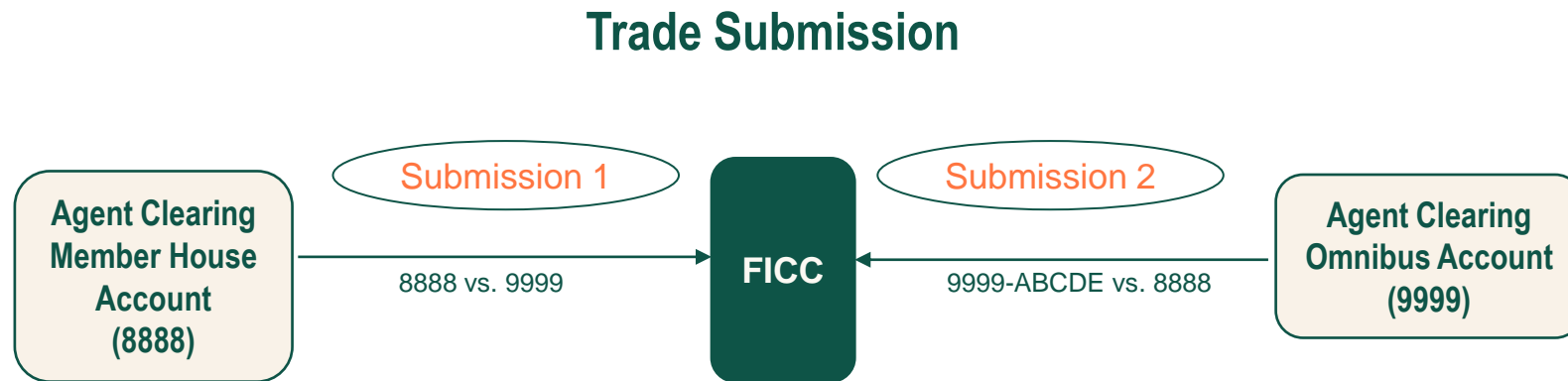
- The pre-novation counterparties to the trade are IDB Netting Member and Executing Firm X (“ABCDE”).
- Post novation to FICC, the Agent Clearing Member acts solely as agent on the trade but is fully responsible to FICC for the performance of all outstanding obligations to FICC on behalf of Executing Firm X (“ABCDE”).
- The Agent Clearing Member is not a principal on the trade either before or after novation to FICC.
- FICC has no responsibility to Executing Firm X (“ABCDE”) in the event of the Agent Clearing Member’s default.

Trade Execution



A Done-With Agent Clearing Transaction is a trade executed between an Agent Clearing Member and its Executing Firm.

Trade execution: Executing Firm X executes a trade with its Agent Clearing Member.

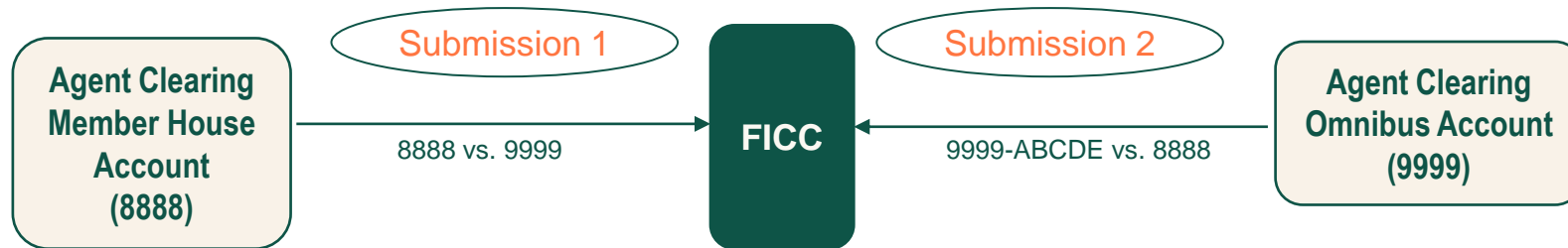


In order to facilitate the submission of a Done-With Agent Clearing Transaction, an Agent Clearing Member must have two accounts at FICC: one to represent its House activity including the trades with its Executing Firm Customers (House Account no. 8888 above) and the other one to represent the Executing Firm Customers' sides of the trades (Customer Account no. 9999 above).

Trade Submission: Agent Clearing Member submits both sides of this trade to FICC for match. The Agent Clearing Member's side is submitted out of its House Account (account no. 8888) and the side on behalf of the Executing Firm X is submitted from its Agent Clearing Member Omnibus Account (account no. 9999) with a "symbol" indicating that the trade was submitted for Executing Firm X (assume Executing Firm X's symbol is "ABCDE").

The novation of the start leg and end leg of this trade occurs upon match at FICC.

Post-Novation Considerations



- The pre-novation counterparties to the trade are the Agent Clearing Member and Executing Firm X (“ABCDE”).
- Post novation to FICC, the Agent Clearing Member acts as agent on behalf of Executing Firm X (“ABCDE”) on the trade, but is fully responsible to FICC for the performance of all outstanding obligations to FICC on behalf of Executing Firm X (“ABCDE”).
- The Agent Clearing Member out of its House Account remains principal on the trade after novation to FICC.
- FICC has no responsibility to Executing Firm X (“ABCDE”) in the event of the Agent Clearing Member’s default.

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