



FICC SPONSORED PROGRAM – DEFAULT SCENARIOS

November 2022

The FAQs below address what could happen, pursuant to the rules (the “Rules”) of the Government Securities Division of the Fixed Income Clearing Corporation (“FICC”), to a Sponsored Member’s positions arising from Sponsored Member Trades upon a default of FICC, a Sponsoring Member, or a Sponsored Member.¹

The matters addressed in these FAQs are governed by the Rules, the current version of which is publicly available and may change from time to time.² In the event there is any conflict or inconsistency between the statements in these FAQs and the Rules, the Rules govern and control.

I. FICC Default

Q. *What would happen in the event of an FICC default?*

- **Termination of Outstanding Transactions**
 - Rule 22B would govern an FICC default and provides in such situation for the automatic termination of all transactions, including all Sponsored Member Trades, that have been novated to FICC but have not yet settled.

- **Market Action by Members**
 - Rule 22B provides that each member with outstanding positions (including any Sponsored Member that has outstanding positions arising from novated Sponsored Member Trades) shall take market action to close out such positions.
 - Such market action may include buying in the relevant securities due to the Sponsored Member or selling any securities deliverable by the Sponsored Member.
 - Rule 22B provides that all such market action must be commercially reasonable.
 - No provision of the Rules prevents a Sponsored Member from appointing an agent, including the Sponsoring Member, to conduct the market action on behalf of the Sponsored Member.

¹ The information and examples provided in these FAQs are for general informational and indicative purposes only. Such information may not be relied on by any party for any purpose, as the actions taken in an actual default event could differ materially from expectations. Each situation regarding a defaulting firm (whether that firm is FICC, a Sponsoring Member, or a Sponsored Member) is unique and the actions FICC may take in an actual event will depend on the specific facts and circumstances, and will be governed by the facts, risks, laws, rules and regulations in effect at that time and that apply in the given situation. Accordingly, the assumptions, examples and scenarios discussed in this document reflect events and circumstances that may not arise, and the impact of these events and the actions taken by FICC may differ depending on the actual circumstances. Any statements in these FAQs, like any statements regarding hypothetical scenarios, are subject to inherent uncertainties. FICC does not undertake to update these FAQs to reflect changes or events that occur after the date of publication. The range of available actions described in this document and the discussion of actions that could be taken in certain future scenarios are hypothetical only and not binding on any parties in any forum, including but not limited to FICC, any of its affiliates, a bankruptcy or other court, or any regulatory, resolution, or other governmental authority

² Capitalized terms used but not defined herein have the meanings given to them in the Rules, available at <https://www.dtcc.com/legal/rules-and-procedures>.

- **Calculation of Amount Owing**

- Rule 22B provides that each member that has taken market action must report the results of such market action (e.g., the amount and price of any securities bought or sold) to FICC's Board of Directors.
- Under Rule 22B, the Board of Directors would then calculate a single net amount owed by or to each member by applying the procedures set forth in Section 2(b)(i) of Rule 22A, as though each member were a defaulting member.
- Section 2(b)(i) of Rule 22A provides for FICC to establish a final net settlement position for each eligible netting security equal to all outstanding deliver and receive obligations in relation to such security.
- Based on the Rules discussed above, the following is an example of how the Board of Directors may, depending on the given facts and circumstances, calculate the amount owed by or to a member in relation to the member's positions in a particular security:
 - Assume a member was due to deliver 100 securities of CUSIP XXX and to receive 80 securities of CUSIP XXX.
 - Upon FICC's default, all of the member's positions in CUSIP XXX would automatically be terminated.
 - The member would then be required to take commercially reasonable market action (e.g., selling 20 securities of CUSIP XXX) to close out its positions.
 - The Board would then calculate the member's net position in CUSIP XXX as short³ 20 securities.
 - The Board would then multiply those 20 securities by the liquidation price per security of CUSIP XXX to calculate the liquidation value of the member's net position.
 - The Board would then compare that liquidation value to the net amount of cash the member was due to receive in relation to CUSIP XXX on the basis of the contractual settlement price of the member's positions.
 - If the liquidation price of CUSIP XXX was \$1 per security such that the liquidation value of the member's net position was \$20 total and the member was due to receive a net \$30 of cash in relation to CUSIP XXX based on the contractual settlement price of the member's positions, FICC would owe the member \$10.
 - If the liquidation price of CUSIP XXX was \$2 per security such that the liquidation value of the member's net position was \$40 total and the member was due to receive a net \$30 of cash in relation to CUSIP XXX based on the contractual settlement price of the member's positions, the member would owe FICC \$10.

³ The term "Net Short Position" is defined in the Rules to mean, with respect to each type of Eligible Netting Security, the amount of Eligible Netting Securities that a Netting Member either: (1) is obligated, pursuant to Rule 12, to deliver to the Corporation, or (2) will, on the Scheduled Settlement Date for such Position, be obligated to deliver to the Corporation, as the context requires.

The term "Net Long Position" is defined in the Rules to mean, with respect to each type of Eligible Netting Security, the amount of Eligible Securities that a Netting Member either: (1) is obligated, pursuant to Rule 12, to receive from the Corporation, or (2) will, on the Scheduled Settlement Date for such Position, be obligated to receive from the Corporation, as the context requires.

- FICC would then net all amounts payable by the member to FICC against all amounts payable by FICC to the member.
- However, FICC would not net amounts FICC owed a Sponsored Member against amounts a Sponsoring Member owed FICC.
- FICC may look to the Sponsored Member or the Sponsoring Member (including any Clearing Fund of the Sponsoring Member) to satisfy payment of any amounts owed by a Sponsored Member to FICC.

II. Sponsoring Member Default

Q. What happens when FICC ceases to act for a Sponsoring Member in its capacity as a Sponsoring Member?

- **No Processing of New Trades**
 - As provided under Rule 3A, Section 14(c), if FICC ceases to act for a Sponsoring Member, FICC would no longer novate new Sponsored Member Trades submitted by that Sponsoring Member.
 - However, the Rules provide that FICC will continue to process new Sponsored Member Trades submitted by other Sponsoring Members.
- **Settlement or Close-out of Existing Trades**
 - FICC would either settle or close-out the Sponsored Member Trades that were novated to FICC before FICC ceased to act for the Sponsoring Member.
 - Rule 3A, Section 16(b) provides that, if FICC ceases to act for a Sponsoring Member, FICC shall determine whether to close-out the affected Sponsored Member trades and/or permit the Sponsored Members to complete their settlement.
 - *Settlement*
 - If the Sponsoring Member is subject to insolvency proceedings, FICC may need the permission of the relevant bankruptcy trustee or receiver for the Sponsoring Member (e.g., the Securities Investor Protection Corporation or Federal Deposit Insurance Corporation) in order to settle the Sponsored Member Trades that were novated to FICC before FICC ceased to act for the Sponsoring Member.
 - If FICC has such permission and elects to settle a Sponsored Member Trade, settlement would occur as though no default had occurred and in accordance with the Rules.
 - FICC, the Sponsored Member, and the Sponsoring Member (acting through its bankruptcy trustee or receiver, if applicable) would be required to transfer or cause to be transferred the relevant cash and securities in accordance with Section 8 of Rule 3A.

- *Close-out*
 - If FICC closes out the novated Sponsored Member Trades submitted by a defaulted Sponsoring Member, Sponsored Members would be permitted (but would not be obligated) to take market action to buy in or sell out the relevant securities.
 - The Rules do not generally limit a Sponsored Member's ability to take market action in relation to securities subject to an outstanding Sponsored Member Trade.
 - As provided under Rule 3A, Section 14(c), Section 3 of Rule 22 applies in the event of a Sponsoring Member default, such that, for its part, FICC would close out the Sponsored Member's positions in the same manner as it closes out trades of a Netting Member for which FICC has ceased to act, pursuant to Rule 22A.
 - Pursuant to the Rules cited discussed above, the following is an example of how the amount owed by or to a member in relation to the member's positions in a particular security may, depending on the given facts and circumstances, be calculated by FICC:
 - Assume a Sponsored Member was due to deliver 100 securities of CUSIP XXX and to receive 80 securities of CUSIP XXX.
 - If FICC opted not to settle the Sponsored Member's outstanding positions, FICC would calculate the Sponsored Member's net position in CUSIP XXX as short 20 securities pursuant to Section 2(b)(i) of Rule 22A.
 - FICC would then multiply those 20 securities by the liquidation price per security of CUSIP XXX to calculate the liquidation value of the Sponsored Member's net position.
 - FICC would then compare that liquidation value to the net amount of cash the Sponsored Member was due to receive in relation to CUSIP XXX on the basis of the contractual settlement price of the Sponsored Member's positions.
 - If the liquidation price of CUSIP XXX was \$1 per security such that the liquidation value of the Sponsored Member's net position was \$20 total and the Sponsored Member was due to receive a net \$30 of cash in relation to CUSIP XXX based on the contractual settlement price of the Sponsored Member's positions, FICC would owe the Sponsored Member \$10.
 - If the liquidation price of CUSIP XXX was \$2 per security such that the liquidation value of the Sponsored Member's net position was \$40 total and the Sponsored Member was due to receive a net \$30 of cash in relation to CUSIP XXX based on the contractual settlement price of the Sponsored Member's positions, the Sponsored Member would owe FICC \$10.
 - Pursuant to Section 2 of the Rule 22A, FICC would then net all amounts payable by the Sponsored Member to FICC against all amounts payable by FICC to the Sponsored Member.

- However, FICC would not net amounts FICC owed a Sponsored Member against amounts a Sponsoring Member owed to FICC.
- FICC would pay any amount owing to a Sponsored Member to the relevant Sponsoring Member in the Sponsoring Member's capacity as paying agent (or as otherwise directed by the Sponsoring Member's bankruptcy trustee or receiver, if applicable).
- FICC may look to the Sponsored Member or the Sponsoring Member (including any clearing fund of the Sponsoring Member) to collect payment of any amounts owed by a Sponsored Member to FICC.

III. Sponsored Member Default

Q. What happens when FICC ceases to act for a Sponsored Member?

- Section 18 of Rule 3A would generally govern the liquidation of a Sponsored Member's positions in the event FICC ceased to act for the Sponsored Member and the Sponsoring Member has not performed the obligations of the Sponsored Member in respect of all positions guaranteed by the Sponsoring Member.
- Section 18 provides for the Sponsoring Member to liquidate and value all, but not fewer than all, of the Sponsored Member's positions in respect of Sponsored Member Trades and to calculate any amount owing by or to the Sponsored Member in relation thereto. The Sponsoring Member would be solely responsible for paying or collecting any such amount.
- The Rules do not dictate how a Sponsoring Member must calculate the value of a Sponsored Member's positions. Accordingly, the Sponsoring Member and Sponsored Member may agree in their bilateral documentation as to the manner in which the Sponsoring Member will make such calculations. However, FICC is not responsible for such calculations or for paying any amount owed to the Sponsored Member in the event Section 18 of Rule 3A applies.