

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-80546; File No. SR-FICC-2017-803)

April 27, 2017

Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of No Objection to Advance Notice Filing to Establish the Centrally Cleared Institutional Triparty Service and Make Other Changes

On March 9, 2017, Fixed Income Clearing Corporation (“FICC”) filed with the Securities and Exchange Commission (“Commission”) advance notice SR-FICC-2017-803 (“Advance Notice”) pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)¹ and Rule 19b-4(n)(1)(i)² under the Securities Exchange Act of 1934 (“Exchange Act”).³ The Advance Notice was published for comment in the Federal Register on April 7, 2017.⁴ Although the Commission received no comments to the Advance Notice, it received one comment

¹ 12 U.S.C. 5465(e)(1). The Financial Stability Oversight Council designated FICC a systemically important financial market utility on July 18, 2012. Financial Stability Oversight Council 2012 Annual Report, Appendix A, <http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf>. Therefore, FICC is required to comply with the Clearing Supervision Act and file advance notices with the Commission. 12 U.S.C. 5465(e).

² 17 CFR 240.19b-4(n)(1)(i).

³ 15 U.S.C. 78s(b)(1).

⁴ Securities Exchange Act Release No. 80361 (April 3, 2017), 82 FR 17053 (April 7, 2017) (SR-FICC-2017-803) (“Notice”). FICC also filed a proposed rule change with the Commission pursuant to Section 19(b)(1) of the Exchange Act and Rule 19b-4 thereunder, seeking approval of changes to its rules necessary to implement the proposal. 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b-4, respectively. The proposed rule change was published for comment in the Federal Register on March 30, 2017. Securities Exchange Act Release No. 80303 (March 24, 2017), 82 FR 15749 (March 30, 2017) (SR-FICC-2017-803).

letter⁵ to the Proposed Rule Change in support of the proposal.⁶ This publication serves as notice that the Commission does not object to the changes set forth in the Advance Notice.

I. Description of the Advance Notice

Repurchase agreement (“repo”) transactions involve the sale of securities along with an agreement to repurchase the securities on a later date. Bilateral repo transactions involve a cash lender (e.g., a money market mutual fund, pension fund, or other entity with funds available for lending) and a cash borrower (typically a broker-dealer, hedge fund, or other entity seeking to finance securities that can be used to collateralize the loan). In the opening leg of the repo transaction, the cash borrower receives cash in exchange for securities equal in value to the amount of cash received, plus a haircut. In the closing leg of the repo transaction, the cash borrower pays back the cash plus interest in exchange for the securities posted as collateral. In tri-party repo transactions, a clearing bank tri-party agent provides to both the cash lender and the cash borrower certain operational, custodial, collateral valuation, and other services to facilitate the repo transactions. For example, the tri-party agent may facilitate and record the exchange of cash and securities on a book-entry basis for each of the counterparties to the repo transaction, as well as effectuating the collection and transfer of collateral that may be

⁵ See letter from Thomas Wipf, Chief Financial Officer, Morgan Stanley & Co. LLC, dated April 19, 2017, to Eduardo A. Aleman, Assistant Secretary, Commission, available at <https://www.sec.gov/comments/sr-ficc-2017-005/ficc2017005.htm>.

⁶ Because the proposal contained in the Advance Notice was also filed as the Proposed Rule Change, see supra note 3, the Commission is considering any comment received on the Proposed Rule Change also to be a comment on the Advance Notice.

required under the terms of the repo transaction. Cash lenders use tri-party repos as investments that offer liquidity maximization, principal protection, and a small positive return, while cash borrowers rely on them as a major source of short-term funding.⁷

FICC currently provides central clearing to a segment of the tri-party repo market through its general collateral finance repo service (“GCF Repo[®] Service”).⁸ The GCF Repo Service is available to sell-side entities, such as dealers, that enter into tri-party repo transactions, in GCF Repo Securities, with each other.⁹

The Advance Notice is a proposal by FICC to broaden the pool of entities that would be eligible to submit tri-party repo transactions for central clearing at FICC. Specifically, FICC proposes to amend its Government Securities Division (“GSD”) Rulebook (“GSD Rules”)¹⁰ to establish the “Centrally Cleared Institutional Tri-Party Service” or the “CCIT[™] Service.”¹¹ The proposed CCIT Service would allow the

⁷ See Federal Reserve Bank of New York, Tri-Party Repo Infrastructure Reform, https://www.newyorkfed.org/banking/tpr_infr_reform.html (last visited Mar. 6, 2017).

⁸ The term “GCF Repo” is a registered trademark of FICC. The GCF Repo Service is a service offered by FICC to compare, net, and settle general collateral repos. Notice, 82 FR at 17053.

⁹ GCF Repo Securities are securities issued or guaranteed by the United States, a U.S. government agency or instrumentality, a U.S. government-sponsored corporation (or otherwise approved by FICC’s Board of Directors), and such securities are only eligible for submission to FICC in connection with the comparison, netting and/or settlement of repo transactions involving generic CUSIP numbers (i.e., identifying numbers established for a category of securities, as opposed to a specific security). Notice, 82 FR at 17053.

¹⁰ Available at <http://www.dtcc.com/legal/rules-and-procedures>.

¹¹ CCIT is a trademark of The Depository Trust & Clearing Corporation, of which FICC is a subsidiary. FICC defines “Centrally Cleared Institutional Tri-Party Service” and “CCIT Service” as “the service offered by the Corporation to clear

submission of tri-party repo transactions in GCF Repo Securities between GSD Netting Members¹² that participate in the GCF Repo Service and institutional counterparties (other than registered investment companies (“RICs”) under the Investment Company Act of 1940, as amended),¹³ where the institutional counterparties are the cash lenders in the transactions.

To effectuate the proposed CCIT Service, FICC proposes to create a new limited service membership category in GSD for institutional cash lenders. These new members would be referred to as CCIT members, and the GSD membership provisions that apply to the CCIT members would be addressed in proposed GSD Rule 3B. These new membership provisions include:¹⁴

- membership eligibility criteria, including minimum financial requirements, operational capabilities, and opinions of counsel;

institutional tri-party repurchase agreement transactions, as more fully described in Rule 3B.” Proposed GSD Rule 1, Definitions.

¹² The term “Netting Member” is defined as a member of FICC’s Comparison System (i.e., the system of reporting, validating, and matching the long and short sides of securities trades to ensure that the details of such trades are in agreement between the parties) and FICC’s Netting System (i.e., the system for aggregating and matching offsetting obligations resulting from trades). GSD Rules, supra note 8.

¹³ 15 U.S.C. 80a-1 et seq. According to FICC, the legal ability of such registered investment companies to participate in the proposed CCIT Service is uncertain in light of applicable regulatory requirements under the Investment Company Act of 1940 (including, for example, liquid asset requirements and counterparty diversification requirements).

¹⁴ For additional discussion of the membership provisions set forth in proposed GSD Rule 3B, see also Notice, 82 FR at 17054–64.

- joint account ownership, in which one authorized entity would act as agent for two or more CCIT Members;
- membership application processes, including document provision and disclosure requirements, operational testing requirements, reporting requirements, FATCA compliance certification requirements,¹⁵ and the procedures for denying membership;
- membership agreement terms describing rights and obligations;
- procedures for the voluntary termination of CCIT membership; and
- ongoing membership requirements, including (i) annual financial and other disclosure requirements; (ii) operational testing requirements and related reporting requirements; (iii) notification of GSD rule non-compliance; (iv) penalties for GSD rule non-compliance; (v) mandatory assurances in the event that FICC has reason to believe a member may fall into GSD rule non-compliance; (vi) requirements to comply with applicable tax, money laundering, and sanctions laws;(vii) audit provisions allowing FICC to access relevant books and records; and (viii) financial/operational monitoring.

¹⁵ FATCA is the Foreign Account Tax Compliance Act, 26 U.S.C. 1471 et seq. FATCA compliance means that an “...FFI [foreign financial institution] Member has qualified under such procedures promulgated by the Internal Revenue Service...to establish exemption from withholding under FATCA such that [FICC] would not be required to withhold [anything] under FATCA....” GSD Rules 1, supra note 3.

In addition to membership provisions, proposed Rule 3B also would set forth the applicable risk management provision relating to the new limited service membership category, including:¹⁶

- non-mutualized loss allocation obligations of CCIT members, including FICC's perfected security interest in each CCIT member's underlying repo securities;
- a rules-based committed liquidity facility for CCIT members, in which CCIT members that have outstanding CCIT transactions with a defaulting member would be required to enter into CCIT master repurchase agreement transactions with FICC for specified periods of time;
- uncommitted liquidity repos between CCIT members and FICC; and
- application of certain other GSD Rules (e.g., comparison, netting, settlement, default, and other applicable provisions) to CCIT members and transactions.

In addition to the proposed changes to the GSD Rules related to the proposed CCIT Service, the Advance Notice also contains other changes to the GSD Rules, unrelated to the CCIT proposal. These non-CCIT related changes generally are intended to update the GSD Rules and provide additional specificity, clarity, and transparency for members that rely on them.¹⁷ These non-CCIT related proposed rule changes include the following:

¹⁶ For additional discussion of the risk management provisions set forth in proposed GSD Rule 3B, see also Notice, 82 FR at 17055–64.

¹⁷ For additional description and explanation of the non-CCIT-related changes included in the Advance Notice, see Notice, 82 FR at 17054–64.

- clarifying that Comparison-Only Members must conform to FICC's operational conditions and requirements;¹⁸
- clarifying the point of time in which a member is required to notify FICC that the member is no longer in compliance with a relevant membership qualification and standard;
- providing that a member's written notice of its membership termination is not effective until accepted by FICC;
- requiring all GCF Repo transactions to be fully collateralized by 9:00 a.m. New York Time;
- prohibiting a member that receives collateral in the GCF Repo process from withdrawing the securities or cash collateral received;
- specifying the steps that members must take in the event of FICC's default so that FICC may determine the net amount owed by or to each member;
- reflecting FICC's current practice of annual study and evaluation of FICC's internal accounting control system; and
- correcting several grammatical and out-of-date cross-references.

¹⁸ GSD Members may be either Comparison-Only Members or Netting Members. Comparison-Only Members are members of the GSD Comparison System, which is the GSD system for reporting, validating, and in some cases, matching of securities trades. Netting Members are members of both the GSD Comparison System and the GSD Netting System, which is the GSD system for aggregating and matching offsetting obligations resulting from securities trades. Pursuant to GSD Rule 2A, FICC may require an entity to be a Comparison-Only Member for a period of time (during which FICC assess the entity's operational soundness) before the entity becomes eligible to apply for netting membership.

In addition to the proposed changes listed above, the Advance Notice also includes a proposal for a non-CCIT related rule change that would provide FICC with access to the books and records of a RIC Netting Member's controlling management. The change is intended to enable FICC to determine whether the RIC has sufficient financial resources and monitor compliance with FICC's financial requirements on an ongoing basis.

II. Discussion of Commission Findings

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, its stated purpose is instructive: to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.¹⁹

Section 805(a)(2) of the Clearing Supervision Act authorizes the Commission to prescribe risk management standards for the payment, clearing, and settlement activities of designated clearing entities and financial institutions engaged in designated activities for which it is the Supervisory Agency or the appropriate financial regulator.²⁰ Section 805(b) of the Clearing Supervision Act²¹ states that the objectives and principles for the risk management standards prescribed under Section 805(a) shall be to:

- promote robust risk management;
- promote safety and soundness;

¹⁹ 12 U.S.C. 5461(b).

²⁰ 12 U.S.C. 5464(a)(2).

²¹ 12 U.S.C. 5464(b).

- reduce systemic risks; and
- support the stability of the broader financial system.

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act²² and Section 17A of the Exchange Act (“Clearing Agency Standards”).²³ The Clearing Agency Standards require registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.²⁴ Therefore, it is appropriate for the Commission to review proposed changes in advance notices against the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act and in the Clearing Agency Standards.²⁵

A. Consistency with Section 805(b) of the Clearing Supervision Act

As discussed below, the Commission believes that the changes proposed in the Advance Notice are consistent with Section 805(b) of the Clearing Supervision Act because they (i) are designed to reduce systemic risk, (ii) are designed to support the stability of the financial system, (iii) are designed to promote robust risk management, and (iv) are consistent with promoting safety and soundness.

When considering the CCIT Service in its entirety, the Commission believes that the proposal could help to reduce systemic risk presented by FICC and a tri-party repo

²² 12 U.S.C. 5464(a)(2).

²³ See 17 CFR 240.17Ad-22.

²⁴ Id.

²⁵ 12 U.S.C. 5464(b).

market member default, which in turn could help support the stability of the broader financial system. The CCIT Service would make the risk-reducing benefits of central clearing available to a wider range of types of repo transactions while at the same time ensuring that FICC is able to effectively manage the additional financial risk exposure. For example, as described above, the CCIT Service would enable a greater number of tri-party repo transactions to be eligible for netting and subject to guaranteed settlement, novation, and independent risk management through FICC, which would help decrease the settlement and operational risk of such transactions relative to those made outside of FICC, enhancing the stability of the tri-party repo market. Furthermore, by providing central clearing to a greater number of tri-party repo transactions, the CCIT Service would permit FICC to centralize and control the liquidation of a greater number of such positions in the event of a Netting Member's default, which in turn would help protect against the risk that an uncoordinated liquidation of the positions by multiple counterparties to a defaulting firm would cause a fire sale that destabilizes the broader financial system. Therefore, the Commission believes that the CCIT Service would help reduce systemic risks and support the stability of the financial system, consistent with Section 805(b) of the Clearing Supervision Act.

The Commission also believes that the CCIT Service designed by FICC is consistent with promoting robust risk management and safety and soundness at FICC and to the tri-party repo market. The CCIT Service includes certain risk management tools that facilitate FICC's management of credit, market, and liquidity risk arising from becoming a central counterparty to the new repo positions coming in via CCIT. For example, the CCIT Service would provide FICC with a perfected security interest in the

underlying repo securities of a CCIT transaction and a built-in liquidity resource to support CCIT Service liquidity demands in the form of repo transactions under the CCIT Master Repurchase Agreement (“CCIT MRA”).²⁶ Each of these elements of the CCIT Service would help FICC manage certain risks presented by the potential default of a CCIT member. Specifically, the perfected security interest would enable FICC, in the event of a Netting Member’s default, to access the defaulter’s collateral for the purposes of managing potential risks, such as credit risk, that may arise from the default.

In addition, the CCIT Service would enable FICC to manage instances where a default results in liquidity demands for FICC within the CCIT Service that exceed the level of financial resources FICC might otherwise have on hand (such as the defaulter’s collateral) at the time of the default by requiring CCIT Members to engage in repo transactions to provide cash as a liquidity resource in such instances. In addition to the risk management tools described above, the CCIT Service also would establish initial and ongoing financial responsibility and operational capacity requirements for CCIT members, as well as requirements that would be applicable to Netting Members with respect to their participation in the proposed CCIT Service. Collectively, these requirements would enable FICC to monitor the likelihood of a CCIT member default and limit its counterparty risk by (i) ensuring that FICC only takes on exposure to entities that are creditworthy counterparties; and (ii) enabling FICC to monitor the ongoing capability of these members to perform their obligations to FICC. For these reasons, the Commission believes that the CCIT Service would help promote robust risk management

²⁶ For additional details regarding the CCIT MRA, see Notice, 82 FR at 17060–61.

and safety and soundness at FICC, consistent with Section 805(b) of the Clearing Supervision Act.

In addition, the Commission believes that the CCIT Service is consistent with promoting robust risk management and safety and soundness to the tri-party repo market. As discussed above, the CCIT Service would make the risk-reducing benefits of central clearing available to a wider range of types of repo transactions, which would help decrease the settlement and operational risk of such transactions when made outside of FICC and thereby enhance stability for the tri-party repo market. Furthermore, the CCIT Service would enable a greater number of tri-party repo transactions to be subject to FICC's ability, in the event of a Netting Member's default, to centralize and control the liquidation of such positions at FICC, which in turn would help protect the tri-party repo market against the risk that a liquidation of the positions would cause a fire sale that destabilizes the broader financial system. Therefore, the Commission believes that the CCIT Service would help promote robust risk management and safety and soundness to the tri-party repo market, consistent with Section 805(b) of the Clearing Supervision Act.

B. Consistency with Rules 17Ad-22(e)(1), (e)(4), and (e)(18)

The Commission believes that the changes proposed in the Advance Notice are consistent with Rule 17Ad-22(e)(1) under the Act.²⁷ Rule 17Ad-22(e)(1) requires, in part, that FICC “establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [p]rovide for a well-founded, clear, transparent and enforceable legal basis for each aspect of its activities.”²⁸ As described above, FICC

²⁷ 17 CFR 240.17Ad-22(e)(2).

²⁸ Id.

proposes a number of changes that are unrelated to the proposed CCIT Service and designed to make the GSD Rules more clear, consistent, and current for members that rely on them. The Commission believes that these non-CCIT related changes could make FICC's policies and procedures in the GSD Rules more clear, consistent, and transparent for members that rely on them, and therefore believes that the proposed changes would help support FICC's rules being clear and transparent, consistent with Rule 17Ad-22(e)(1), cited above.

The Commission believes that the changes proposed in the Advance Notice are consistent with Rule 17Ad-22(e)(4)(iii) under the Act.²⁹ Rule 17Ad-22(e)(4)(iii) requires, in part, that FICC “establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [e]ffectively identify, measure, monitor, and manage its credit exposures to participants and those arising from [FICC's] payment, clearing, and settlement processes, including by...maintaining...financial resources at the minimum to enable [FICC] to cover a wide range of stress scenarios....”³⁰ As discussed above, the CCIT Service includes risk management tools, such as the perfected security interest and the CCIT MRA liquidity resource. The Commission believes that these risk management tools would help facilitate FICC's management of credit, market, and liquidity risk that would arise from becoming a central counterparty to the new repo positions coming in via the proposed CCIT Service. Accordingly, the Commission believes that the proposed changes to its policies and procedures in the GSD Rules are designed to help effectively manage FICC's exposure, including its credit exposure to

²⁹ 17 CFR 240.17Ad-22(e)(4)(iii).

³⁰ Id.

participants, arising from its payment, clearing, and settlement processes for the proposed CCIT transactions by providing for financial resources to help cover a wide range of foreseeable stress scenarios, consistent with Rule 17Ad-22(e)(4)(iii), cited above.

The Commission also believes that the proposal is consistent with Rule 17Ad-22(e)(18) under the Act.³¹ Rule 17Ad-22(e)(18) requires, in part, that FICC “establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [e]stablish objective, risk-based, and publicly disclosed criteria for participation, which . . . require participants to have sufficient financial resources and robust operational capacity to meet obligations arising from participation in the clearing agency, and monitor compliance with such participation requirements on an ongoing basis.”³²

In connection with the establishment of the proposed CCIT Service, FICC would include provisions in the GSD rules to incorporate membership standards, requiring, for example, ongoing financial responsibility and operational capacity requirements, as well as the requirements that would be applicable to Netting Members with respect to their participation in the proposed CCIT Service. The Commission believes that, by incorporating such requirements, FICC would establish in its policies and procedures objective, risk-based, and publicly disclosed criteria for participation in the CCIT Service, consistent with Rule 17Ad-22(e)(18).

Similarly, in connection with the proposed non-CCIT related change to provide FICC with access to the books and records of a RIC Netting Member’s controlling management, FICC would be authorized to review the financial information of the RIC.

³¹ 17 CFR 240.17Ad-22(e)(18).

³² Id.

Because this would enable FICC to determine whether the RIC has sufficient financial resources and monitor compliance with FICC's financial requirements on an ongoing basis, the Commission believes this requirement is consistent with Rule 17Ad-22(e)(18).

III. Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,³³ that the Commission DOES NOT OBJECT to this advance notice proposal (SR-FICC-2017-803) and that FICC is AUTHORIZED to implement the proposal as of the date of this notice or the date of an order by the Commission approving a proposed rule change that reflects rule changes that are consistent with this advance notice proposal (SR-FICC-2017-005), whichever is later.

By the Commission.

Brent J. Fields
Secretary

³³ 12 U.S.C. 5465(e)(1)(I).