Required fields are shown with yellow backgrounds and asterisks.

Filing by  Fixed Income Clearing Corporation
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * Amendment * Withdrawal

Section 19(b)(2) * Section 19(b)(3)(A) * Section 19(b)(3)(B) *

Pilot
Extension of Time Period for Commission Action *
Date Expires *

Rule

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010
Section 806(e)(1) * Section 806(e)(2) *

Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934
Section 3C(b)(2) *

Exhibit 2 Sent As Paper Document Exhibit 3 Sent As Paper Document

Description
Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Introduce the Margin Liquidity Adjustment Charge and Include a Bid-Ask Risk Charge in the VaR Charges

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 * Jacqueline Last Name * Chezar
Title * Executive Director and Associate General Counsel
E-mail * jfarinella@dtcc.com
Telephone * (212) 855-3216 Fax

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.

Date 07/30/2020Managing Director and Deputy General Counsel
By Nikki Poulos

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.
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.

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).

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).

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.

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.

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.

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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.

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 the Advance Notice**

   (a) The advance notice of Fixed Income Clearing Corporation (“FICC”) is annexed hereto as Exhibit 5 and consists of modifications to the FICC Government Securities Division (“GSD”) Rulebook (“GSD Rules”) and the FICC Mortgage-Backed Securities Division (“MBSD”) Clearing Rules (“MBSD Rules,” and together with the GSD Rules, “Rules”) to introduce the Margin Liquidity Adjustment (“MLA”) charge as an additional component of GSD and MBSD’s respective Clearing Funds, as described in greater detail below.¹

   The advance notice also consists of modifications to the GSD Rules, the MBSD Rules, the GSD Methodology Document – GSD Initial Market Risk Margin Model (“GSD QRM Methodology Document”) and the MBSD Methodology and Model Operations Document – MBSD Quantitative Risk Model (“MBSD QRM Methodology Document,” and together with the GSD QRM Methodology Document, the “QRM Methodology Documents”) in order to (i) enhance the calculation of the VaR Charges of GSD and MBSD to include a bid-ask spread risk charge, and (ii) make necessary technical changes to the QRM Methodology Documents in order to implement this proposed change.

   (b) Not applicable.

   (c) Not applicable.

2. **Procedures of the Self-Regulatory Organization**

   The proposal to introduce an MLA charge was approved by the Risk Committee of the Board of Directors on September 12, 2017 and February 18, 2020, and the proposal to enhance the VaR Charges was approved by the Risk Committee of the Board of Directors on February 26, 2019.

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 Proposed Rule Change Received from Members, Participants, or Others**

   FICC has not received or solicited any written comments relating to this proposal. FICC will notify the Securities and Exchange Commission (“Commission”) of any written comments received by FICC.

6. **Extension of Time Period for Commission Action**

   Not applicable.

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**

    **Description of Proposed Change**

    FICC is proposing to enhance the methodology for calculating Required Fund Deposits to the respective Clearing Funds of GSD and MBSD by (1) introducing a new component, the MLA charge, which would be calculated to address the risk presented to FICC when a Member’s portfolio contains large net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type (referred to as “asset groups”), and (2) enhancing

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2 References herein to “Members” refer to GSD Netting Members and MBSD Clearing Members, as such terms are defined in the Rules. References herein to “net unsettled positions” refer to, with respect to GSD, Net Unsettled Positions, as such term is defined...
the calculation of the VaR Charges of GSD and MBSD by including a bid-ask spread risk charge, as described in more detail below.3

FICC is also proposing to make certain technical changes to the QRM Methodology Documents, as described in below, in order to implement the proposed enhancement to the VaR Charges.

(i) Overview of the Required Fund Deposits and the Clearing Funds

As part of its market risk management strategy, FICC manages its credit exposure to Members by determining the appropriate Required Fund Deposits to the GSD and MBSD Clearing Fund and monitoring their sufficiency, as provided for in the Rules.4 The Required Fund Deposits serve as each Member’s margin. The objective of a Member’s Required Fund Deposit is to mitigate potential losses to FICC associated with liquidating a Member’s portfolio in the event FICC ceases to act for that Member (hereinafter referred to as a “default”).5 The aggregate of all Members’ Required Fund Deposits constitutes the respective GSD and MBSD Clearing Funds. FICC would access the GSD and MBSD Clearing Funds should a defaulting Member’s own Required Fund Deposit be insufficient to satisfy losses to FICC caused by the liquidation of that Member’s portfolio.

3 The results of a study of the potential impact of adopting the proposed changes have been provided to the Commission and are annexed hereto as Exhibit 3a.

4 See GSD Rule 4 (Clearing Fund and Loss Allocation) and MBSD Rule 4 (Clearing Fund Formula and Loss Allocation), supra note 1. FICC’s market risk management strategy is designed to comply with Rule 17Ad-22(e)(4) under the Securities Exchange Act of 1934 (“Act”), where these risks are referred to as “credit risks.” 17 CFR 240.17Ad-22(e)(4).

5 The Rules identify when FICC may cease to act for a Member and the types of actions FICC may take. For example, FICC may suspend a firm’s membership with FICC or prohibit or limit a Member’s access to FICC’s services in the event that Member defaults on a financial or other obligation to FICC. See GSD Rule 21 (Restrictions on Access to Services), and MBSD Rule 14 (Restrictions on Access to Services), of the Rules, supra note 1.
Pursuant to the Rules, each Member’s Required Fund Deposit amount consists of a number of applicable components, each of which is calculated to address specific risks faced by FICC, as identified within the Rules. The VaR Charge comprises the largest portion of a Member’s Required Fund Deposit amount. Currently, the GSD QRM Methodology Document states that the total VaR Charge for each portfolio is the sum of the sensitivity VaR of the portfolio plus the haircut charges plus the repo interest volatility charges plus the pool/TBA basis charge. In the MBSD QRM Methodology Document, the current description of the total VaR Charge states that it is the sum of the designated VaR Charge and the haircut charge.

The VaR Charge is calculated using a risk-based margin methodology that is intended to capture the risks related to market price that is associated with the securities in a Member’s portfolio. This risk-based margin methodology is designed to project the potential losses that could occur in connection with the liquidation of a defaulting Member’s portfolio, assuming a portfolio would take three days to liquidate in normal market conditions. The projected liquidation gains or losses are used to determine the amount of the VaR Charge, which is calculated to cover projected liquidation losses at 99 percent confidence level for Members.

FICC regularly assesses market and liquidity risks as such risks relate to its margining methodologies to evaluate whether margin levels are commensurate with the particular risk attributes of each relevant product, portfolio, and market. The proposed changes to include the MLA charge to its Clearing Fund methodology and to enhance the VaR Charges by including a bid-ask spread risk charge, as described below, are the result of FICC’s regular review of the effectiveness of its margining methodology.

(ii) Overview of Liquidation Transaction Costs and Proposed Changes

Each of the proposed changes addresses a similar, but separate, risk that FICC faces increased transaction costs when it liquidates the net unsettled positions of a defaulted Member due to the unique characteristics of that Member’s portfolio. The transaction costs to FICC to liquidate a defaulted Member’s portfolio include both market impact costs and fixed costs. Market impact costs are the costs due to the marketability of a security, and generally increase when a portfolio contains large net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type, as described more below. Fixed costs are the costs that generally do not fluctuate and may be caused by the bid-ask spread of a particular security. The bid-ask spread of a security accounts for the difference between the observed market price that a buyer is willing to pay for that security and the observed market price that a seller is willing to sell that security.

6 Supra note 1.

7 Unregistered Investment Pool Clearing Members are subject to a VaR Charge with a minimum target confidence level assumption of 99.5 percent. See MBSD Rule 4, Section 2(c), supra note 1.
The transaction cost to liquidate a defaulted Member’s portfolio is currently captured by the measurement of market risk through the calculation of the VaR Charge. The proposed changes would supplement and enhance the current measurement of this market risk to address situations where the characteristics of the defaulted Member’s portfolio could cause these costs to be higher than the amount collected for the VaR Charge.

First, as described in more detail below, the MLA charge is designed to address the market impact costs of liquidating a defaulted Member’s portfolio that may increase when that portfolio includes large net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type. These positions may be more difficult to liquidate because a large number of securities with similar risk profiles could reduce the marketability of those large net unsettled positions, increasing the market impact costs to FICC. As described below, the MLA charge would supplement the VaR Charge.

Second, as described in more detail below, the bid-ask spread risk charge would address the risk that the transaction costs of liquidating a defaulted Member’s net unsettled positions may increase due to the fixed costs related to the bid-ask spread. As described below, this proposed change would be incorporated into, and, thereby, enhance the current measure of transaction costs through, the VaR Charge.

(iii) Proposed Margin Liquidity Adjustment Charge

In order to address the risks of an increased market impact cost presented by portfolios that contain large net unsettled positions in the same asset group, FICC is proposing to introduce a new component to the GSD and MBSD Clearing Fund formulas, the MLA charge.

As noted above, a Member portfolio with large net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type may be more difficult to liquidate in the market in the event the Member defaults because a concentration in that group of securities or in a transaction type could reduce the marketability of those large net unsettled positions. Therefore, such portfolios create a risk that FICC may face increased market impact cost to liquidate that portfolio in the assumed margin period of risk of three business days at market prices.

The proposed MLA charge would be calculated to address this increased market impact cost by assessing sufficient margin to mitigate this risk. As described below, the proposed MLA charge would be calculated for different asset groups. Essentially, the calculation is designed to compare the total market value of a net unsettled position in a particular asset group, which FICC would be required to liquidate in the event of a Member default, to the available trading volume.
of that asset group or equities subgroup in the market. If the market value of the net unsettled position is large, as compared to the available trading volume of that asset group, then there is an increased risk that FICC would face additional market impact costs in liquidating that position in the event of a Member default. Therefore, the proposed calculation would provide FICC with a measurement of the possible increased market impact cost that FICC could face when it liquidates a large net unsettled position in a particular asset group.

To calculate the MLA charge, FICC would categorize securities into separate asset groups. For GSD, asset groups would include the following, each of which have similar risk profiles: (a) U.S. Treasury securities, which would be further categorized by maturity – those maturing in (i) less than one year, (ii) equal to or more than one year and less than two years, (iii) equal to or more than two years and less than five years, (iv) equal to or more than five years and less than ten years, and (v) equal to or more than ten years; (b) Treasury-Inflation Protected Securities (“TIPS”), which would be further categorized by maturity – those maturing in (i) less than two years, (ii) equal to or more than two years and less than six years, (iii) equal to or more than six years and less than eleven years, and (iv) equal to or more than eleven years; (c) U.S. agency bonds; and (d) mortgage pools transactions. For MBSD, to-be-announced (“TBA”) transactions, Specified Pool Trades and Stipulated Trades would be included in one mortgage-backed securities asset group.

FICC would first calculate a measurement of market impact cost with respect to the net unsettled positions of a Member in each of these asset groups. As described above, the calculation of an MLA charge is designed to measure the potential additional market impact cost to FICC of closing out a large net unsettled position in that particular asset group.

To determine the market impact cost for each net unsettled position in Treasuries maturing less than one year and TIPS for GSD and in the mortgage-backed securities asset group for MBSD, FICC would use the directional market impact cost, which is a function of the net unsettled position’s net directional market value. To determine the market impact cost for all other net unsettled positions, FICC would add together two components: (1) the directional

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9 FICC would determine average daily trading volume by reviewing data that is made publicly available by the Securities Industry and Financial Markets Association (“SIFMA”), at https://www.sifma.org/resources/archive/research/statistics.

10 The net directional market value of an asset group within a portfolio is calculated as the absolute difference between the market value of the long net unsettled positions in that asset group, and the market value of the short net unsettled positions in that asset group. For example, if the market value of the long net unsettled positions is $100,000, and the market value of the short net unsettled positions is $150,000, the net directional market value of the asset group is $50,000.
market impact cost, as described above, and (2) the basis cost, which is based on the net unsettled position’s gross market value.\textsuperscript{11}

The calculation of market impact cost for net unsettled positions in Treasuries maturing less than one year and TIPS for GSD and in the mortgage-backed securities asset group for MBSD would not include basis cost because basis risk is negligible for these types of positions.

For all asset groups, when determining the market impact costs, the net directional market value and the gross market value of the net unsettled positions would be divided by the average daily volumes of the securities in that asset group over a lookback period.\textsuperscript{12}

FICC would then compare the calculated market impact cost to a portion of the VaR Charge that is allocated to net unsettled positions in those asset groups.\textsuperscript{13} If the ratio of the calculated market impact cost to the 1-day VaR Charge is greater than a threshold, an MLA charge would be applied to that asset group.\textsuperscript{14} If the ratio of these two amounts is equal to or less than this threshold, an MLA charge would not be applied to that asset group. The threshold would be based on an estimate of the market impact cost that is incorporated into the calculation of the 1-day VaR charge, such that an MLA charge would apply only when the calculated market impact cost exceeds this threshold.

For each Member portfolio, FICC would add the MLA charges for net unsettled positions in each asset group to determine a total MLA charge for a Member.

\textsuperscript{11} To determine the gross market value of the net unsettled positions in each asset group, FICC would sum the absolute value of each CUSIP in the asset group.

\textsuperscript{12} Supra note 9.

\textsuperscript{13} FICC’s margining methodology uses a three-day assumed period of risk. For purposes of this calculation, FICC would use a portion of the VaR Charge that is based on one-day assumed period of risk and calculated by applying a simple square-root of time scaling, referred to in this proposed rule change as “1-day VaR Charge.” Any changes that FICC deems appropriate to this assumed period of risk would be subject to FICC’s model risk management governance procedures set forth in the Clearing Agency Model Risk Management Framework (“Model Risk Management Framework”). See Securities Exchange Act Release Nos. 81485 (August 25, 2017), 82 FR 41433 (August 31, 2017) (File No. SR-FICC-2017-014); 84458 (October 19, 2018), 83 FR 53925 (October 25, 2018) (File No. SR-FICC-2018-010); 88911 (May 20, 2020), 85 FR 31828 (May 27, 2020) (File No. SR-FICC-2020-004).

\textsuperscript{14} FICC would review the method for calculating the thresholds from time to time and any changes that FICC deems appropriate would be subject to FICC’s model risk management governance procedures set forth in the Model Risk Management Framework. See id.
The ratio of the calculated market impact cost to the 1-day VaR Charge would also determine if FICC would apply a downward adjustment, based on a scaling factor, to the total MLA charge, and the size of any adjustment. For net unsettled positions that have a higher ratio of calculated market impact cost to the 1-day VaR Charge, FICC would apply a larger adjustment to the MLA charge by assuming that it would liquidate that position on a different timeframe than the assumed margin period of risk of three business days. For example, FICC may be able to mitigate potential losses associated with liquidating a Member’s portfolio by liquidating a net unsettled position with a larger VaR Charge over a longer timeframe. Therefore, when applicable, FICC would apply a multiplier to the calculated MLA charge. When the ratio of calculated market impact cost to the 1-day VaR Charge is lower, the multiplier would be one, and no adjustment would be applied; as the ratio gets higher the multiplier decreases and the MLA charge is adjusted downward.

The final MLA charge would be calculated daily and, when the charge is applicable, as described above, would be included as a component of Members’ Required Fund Deposit.

**MLA Excess Amount for GSD Sponsored Members**

For GSD, the calculation of the MLA charge for a Sponsored Member that clears through single account sponsored by a Sponsoring Member would be the same as described above. For a GSD Sponsored Member that clears through multiple accounts sponsored by multiple Sponsoring Members, in addition to calculating an MLA charge for each account (as described above), FICC would also calculate an MLA charge for the consolidated portfolio.

If the MLA charge of the consolidated portfolio is higher than the sum of all MLA charges for each account of the Sponsored Member, the Sponsored Member would be charged the amount of such difference, to be referred to as the “MLA Excess Amount,” in addition to the applicable MLA charge. If the MLA charge of the consolidated portfolio is not higher than the sum of all MLA charges for each account of the Sponsored Member, then the Sponsored Member will only be charged an MLA charge for each sponsored account, as applicable.

The MLA Excess Amount is designed to capture the additional market impact cost that could be incurred when a Sponsored Member defaults, and each of the Sponsoring Members liquidates net unsettled positions associated with that defaulted Sponsored Member. If large net unsettled positions in the same asset group are being liquidated by multiple Sponsoring Members, the market impact cost to liquidate those positions could increase. The MLA Excess Amount would address this additional market impact cost by capturing any difference between the calculations of the MLA charge for each sponsored account and for the consolidated portfolio.

**Proposed Changes to GSD and MBSD Rules**

The proposal described above would be implemented into the GSD Rules and MBSD Rules. Specifically, FICC would amend GSD Rule 1 (Definitions) and MBSD Rule 1 (Definitions) to include a description of the MLA charge.
The proposed change to GSD Rule 1 (Definitions) would first identify each of the asset
groups and would then separately describe the two calculations of market impact cost by these
asset groups by identifying the components of these calculations. The proposed definition would
state that GSD would compare the calculated market impact cost to a portion of that Member’s
VaR Charge, to determine if an MLA charge would be applied to an asset group. The proposed
definition would then state that GSD would add each of the applicable MLA charges calculated
for each asset group together. Finally, the proposed definition would state that GSD may apply a
downward adjusting scaling factor to result in a final MLA charge. The proposed change to
GSD Rule 1 (Definitions) would also include a definition of the “MLA Excess Amount.” The
proposed definition would state that it would be an additional charge applicable to Sponsored
Members that clear through multiple accounts sponsored by multiple Sponsoring Members and
would describe how the additional charge would be determined.

The proposed change to MBSD Rule 1 (Definitions) would define the MBS asset group,
for purposes of calculating this charge, and would then describe the calculation of market impact
cost for that asset group by identifying the components of this calculation. The proposed
definition would state that MBSD would compare the calculated market impact cost to a portion
of the Member’s VaR Charge, to determine if an MLA charge would be applied to a net
unsettled position. Finally, the proposed definition would state that MBSD may apply a
downward adjusting scaling factor to result in a final MLA charge.

FICC would also amend GSD Rule 4 (Clearing Fund and Loss Allocation) and MBSD
Rule 4 (Clearing Fund and Loss Allocation) to include the MLA charge as a component of the
Clearing Fund formula.

(iv) Proposed Bid-Ask Spread Risk Charge

FICC has identified potential risk that its margining methodologies do not account for the
transaction costs related to bid-ask spread in the market that could be incurred when liquidating a
portfolio. Bid-ask spreads account for the difference between the observed market price that a
buyer is willing to pay for a security and the observed market price that a seller is willing to sell
that security. Therefore, FICC is proposing to amend the VaR models of GSD and MBSD to
include a bid-ask spread risk charge in the VaR Charges of GSD and MBSD to address this risk.

In order to calculate this charge, GSD would segment Members’ portfolios into separate
bid-ask spread risk classes by product type and maturity. The bid-ask spread risk classes would
be separated into the following types: (a) mortgage pools (“MBS”); (b) TIPS; (c) U.S. agency
bonds; and (d) U.S. Treasury securities, which would be further segmented into separate classes
based on maturities as follows: (i) less than five years, (ii) equal to or more than five years and
less than ten years, and (iii) equal to or more than ten years. FICC would further segment the
U.S. Treasury securities into separate classes based on maturities.

Only the MBS asset group is applicable to MBSD Member portfolios. FICC would
exclude Option Contracts in to-be-announced (“TBA”) transactions from the bid-ask spread risk
charge because, in the event of a Member default, FICC would liquidate any Option Contracts in
TBAs in a Member’s portfolio at the intrinsic value of the Option Contract and, therefore, does not face a transaction cost related to the bid-ask spread.

Each product type and maturity risk class would be assigned a specific bid-ask spread haircut rate in the form of a basis point charge that would be applied to the gross market value in that particular risk class. The applicable bid-ask spread risk charge would be the product of the gross market value in a particular risk class in the Member’s portfolio and the applicable basis point charge. The bid-ask spread risk charge would be calculated at the portfolio level, such that FICC would aggregate the bid-ask spread risk charges of the applicable risk classes for the Member’s portfolio.

FICC proposes to review the haircut rates annually based on either the analysis of liquidation transaction costs related to the bid-ask spread that is conducted in connection with its annual simulation of a Member default or market data that is sourced from a third-party data vendor. Based on the analyses from recent years’ simulation exercises, FICC does not anticipate that these haircut rates would change significantly year over year. FICC may also adjust the haircut rates following its annual model validation review, to the extent the results of that review indicate the current haircut rates are not adequate to address the risk presented by transaction costs from a bid-ask spread.15

The proposed initial haircuts are based on the analysis from the most recent annual default simulation and market data sourced from a third-party data vendor, and are listed in the table below:

<table>
<thead>
<tr>
<th>Class</th>
<th>Asset Class</th>
<th>Maturity</th>
<th>Haircut (bps)</th>
</tr>
</thead>
<tbody>
<tr>
<td>MBS</td>
<td>MBS</td>
<td>All</td>
<td>0.8</td>
</tr>
<tr>
<td>TIPS</td>
<td>TIPS</td>
<td>All</td>
<td>2.1</td>
</tr>
<tr>
<td>Agency</td>
<td>Agency bonds</td>
<td>All</td>
<td>3.8</td>
</tr>
<tr>
<td>Treasury 5-</td>
<td>Treasury</td>
<td>&lt; 5 years</td>
<td>0.6</td>
</tr>
<tr>
<td>Treasury 5-10</td>
<td>Treasury</td>
<td>5-10 years</td>
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<tr>
<td>Treasury 10+</td>
<td>Treasury</td>
<td>&gt;10 years</td>
<td>0.7</td>
</tr>
</tbody>
</table>

All proposed changes to the haircuts would be subject to FICC’s model risk management governance procedures set forth in the Model Risk Management Framework. See id.
Proposed Changes to GSD and MBSD Rules

The proposal described above would be implemented into the GSD Rules and MBSD Rules. Specifically, FICC would include a description of the bid-ask spread risk charge in the current definitions of the VaR Charge in GSD Rule 1 (Definitions) and MBSD Rule 1 (Definitions). The proposed change would state that the calculations the VaR Charge shall include an additional bid-ask spread risk charge measured by multiplying the gross market value of each net unsettled position by a basis point charge. The proposed change would also state that the basis point charge would be based on six risk classes and would identify those risk classes.

Proposed Changes to QRM Methodology Documents

To implement this proposal, FICC is proposing to amend the QRM Methodology Documents to describe the bid-ask spread risk charge. Specifically, FICC would describe (i) that the bid-ask spread risk charge is designed to mitigate the risk related to transaction costs in liquidating a portfolio in the event of a Member default; (ii) how the bid-ask spread risk charge would be calculated; and (ii) the impact analysis that was conducted in each of the QRM Methodology Documents. The GSD QRM Methodology Document would describe the proposed six classes (listed in the table above). The MBSD QRM Methodology Document would state that the only class for MBSD portfolios is the MBS asset class, and that the Option Contracts in TBAs would be excluded from the proposed charge. Finally, FICC would update the descriptions of the total VaR Charge in the QRM Methodology Documents to include the bid-ask spread risk charge as a component of this charge.

(v) Proposed Technical Changes

Finally, FICC would amend the QRM Methodology Documents to re-number the sections and tables, and update certain section titles, as necessary, to add a new section that describes the proposed bid-ask spread risk charge.

(vi) Implementation Timeframe

FICC would implement the proposed changes no later than 10 Business Days after the later of the no objection to the advance notice and approval of the related proposed rule change by the Commission. FICC would announce the effective date of the proposed changes by Important Notice posted to its website.

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Anticipated Effect on and Management of Risk

FICC believes that the proposed changes to enhance the margining methodology as described above would enable FICC to better limit its risk exposures to Members arising out of their net unsettled positions.

As stated above, the proposed MLA charge is designed to help limit FICC’s exposures to the risks presented by a Member portfolio that contains large net unsettled positions in securities of the same asset group and would enhance FICC’s ability to address risks related to liquidating such positions in the event of a Member default. The proposed MLA charge would allow FICC to collect sufficient financial resources to cover its exposure that it may face an increased market impact cost in liquidating net unsettled positions that is not captured by the VaR Charge.

As described above, the proposed MLA Excess Amount is designed to capture any additional market impact cost that could be incurred when each of the Sponsoring Members liquidates large net unsettled positions in securities of the same asset group that are all associated with one defaulted Sponsored Member.

The proposal to enhance the VaR Charges by including a bid-ask spread risk charge is also designed to help limit FICC’s exposures to the risks related to increased transaction costs due to the bid-ask spread in the market that could be incurred when liquidating a portfolio. Therefore, this proposed change would also help address FICC’s risks related to its ability to liquidate such positions in the event of a Member default.

By providing FICC with a more effective measurement of its exposures, the proposed changes would also mitigate risk for Members because lowering the risk profile for FICC would in turn lower the risk exposure that Members may have with respect to FICC in its role as a central counterparty.

Consistency with Clearing Supervision Act

FICC believes that the proposals are consistent with 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”), specifically with the risk management objectives and principles of Section 802(b), and with certain of the risk management standards adopted by the Commission pursuant to Section 805(a)(2), for the reasons described below.

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

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.

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17 12 U.S.C. 5464(a)(2) and (b)(1).
standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.\textsuperscript{18}

FICC believes the proposals are consistent with the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act and in the Covered Clearing Agency Standards.

First, the proposal would include the MLA charge as an additional component to the Clearing Fund. As described above, this new margin charge is designed to address the market impact costs of liquidating a defaulted Member’s portfolio that may increase when that portfolio includes large net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type. These positions may be more difficult to liquidate in the market because a concentration in that group of securities or in a transaction type could reduce the marketability of those large net unsettled positions, increasing the market impact costs to FICC. The proposed MLA charge would allow FICC to collect sufficient financial resources to cover its exposure that it may face increased market impact costs in liquidating net unsettled positions that is not captured by the VaR Charge.

Additionally, the proposed MLA Excess Amount would capture additional market impact cost that could be incurred when each of the Sponsoring Members liquidates large net unsettled positions in securities of the same asset group that are all associated with one defaulted Sponsored Member.

Second, the proposed bid-ask spread risk charge is designed to help limit FICC’s exposures to the risks related to increased transaction costs due to the bid-ask spread in the market that could be incurred when liquidating a portfolio. As stated above, this proposal would also help address FICC’s risks related to its ability to liquidate such positions in the event of a Member default.

Therefore, because the proposals are designed to enable FICC to better limit its exposure to Members in the event of a Member default, FICC believes they are consistent with promoting robust risk management. The proposals would also strengthen the liquidity of FICC by requiring deposits to the Clearing Fund that are calculated to address the potential risks FICC may face, which is one of FICC’s default liquidity resources.

As a result, FICC believes the proposals would be consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act, which specify the promotion of robust risk management, promotion of safety and soundness, reduction of systemic risks and support of the stability of the broader financial system by, among other things, strengthening the liquidity of systemically important financial market utilities, such as FICC.

\textsuperscript{18} 12 U.S.C. 5464(b)(1).
(ii) Consistency with Rule 17Ad-22(e)(4)(i) and (6)(i) under the Act

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, like FICC, and financial institutions engaged in designated activities for which the Commission is the supervisory agency or the appropriate financial regulator.19 The Commission has accordingly adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act20 and Section 17A of the Act (“Covered Clearing Agency Standards”).21 The Covered Clearing Agency Standards require covered 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.22

FICC believes that the proposed changes are consistent with Rules 17Ad-22(e)(4)(i) and (e)(6)(i) of the Covered Clearing Agency Standards23 for the reasons described below.

Rule 17Ad-22(e)(4)(i) under the Act requires, in part, that FICC establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.24

As described above, FICC believes that both of the proposed changes would enable it to better identify, measure, monitor, and, through the collection of Members’ Required Fund Deposits, manage its credit exposures to Members by maintaining sufficient resources to cover those credit exposures fully with a high degree of confidence.

Specifically, FICC believes that the proposed MLA charge would effectively mitigate the risks related to large net unsettled positions of securities in the same asset group within a portfolio and would address the potential increased risks FICC may face related to its ability to liquidate such positions in the event of a Member default. The proposed MLA Excess Amount

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20 Id.
21 17 CFR 240.17Ad-22(e).
22 Id.
23 17 CFR 240.17Ad-22(e)(4)(i), (e)(6)(i).
would supplement this proposed charge to capture any additional market impact cost related to Sponsored Members that clear through multiple accounts with multiple Sponsoring Members.

Therefore, FICC believes that the proposal would enhance FICC’s ability to effectively identify, measure and monitor its credit exposures and would enhance its ability to maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. As such, FICC believes the proposed changes are consistent with Rule 17Ad-22(e)(4)(i) under the Act.25

Additionally, FICC believes that the proposed bid-ask spread risk charge would enhance FICC’s ability to identify, measure, monitor and manage its credit exposures to Members and those exposures arising from its payment, clearing, and settlement processes because the proposed changes would better ensure that FICC maintains sufficient financial resources to cover its credit exposure to each Member with a high degree of confidence. FICC believes that the proposed change would enable FICC to more effectively identify, measure, monitor and manage its exposures to risks related to market price, and enable it to better limit its exposure to potential losses from Member defaults by providing a more effective measure of the risks related to market price. As described above, due to the bid-ask spread in the market, there is an observable transaction cost to liquidate a portfolio. The proposed bid-ask spread risk charge is designed to manage the risk related to this transaction cost in the event a Member’s portfolio is liquidated. As such, FICC believes that the proposed change would better address the potential risks that FICC may face that are related to its ability liquidate a Member’s net unsettled positions in the event of that firm’s default, and thereby enhance FICC’s ability to effectively identify, measure and monitor its credit exposures and would enhance its ability to maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. In this way, FICC believes this proposed change is also consistent with Rule 17Ad-22(e)(4)(i) under the Act.26

Rule 17Ad-22(e)(6)(i) under the Act requires, in part, that FICC establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market.27

The Required Fund Deposits are made up of risk-based components (as margin) that are calculated and assessed daily to limit FICC’s credit exposures to Members, including the VaR Charges. FICC’s proposed change to introduce an MLA charge is designed to more effectively address the risks presented by large net unsettled positions in the same asset group. FICC believes the addition of the MLA charge would enable FICC to assess a more appropriate level

25 Id.
26 Id.
27 17 CFR 240.17Ad-22(e)(6)(i).
of margin that accounts for these risks. This proposed change is designed to assist FICC in
maintaining a risk-based margin system that considers, and produces margin levels
commensurate with, the risks and particular attributes of portfolios that contain large net
unsettled positions in the same asset group and may be more difficult to liquidate in the event of
a Member default. The proposed MLA Excess Amount would further this goal by measuring
any additional risks that could be presented by a Sponsored Member that clears through multiple
accounts at multiple Sponsoring Members. Therefore, FICC believes the proposed change is
consistent with Rule 17Ad-22(e)(6)(i) under the Act.28

Furthermore, FICC believes that including the bid-ask spread risk charge within the
calculation of the final VaR Charges of GSD and MBSD would provide FICC with a better
assessment of its risks related to market price. This proposed change would enable FICC to
assess a more appropriate level of margin that accounts for this risk at the portfolio level. As
such, each Member portfolio would be subject to a risk-based margining system that, at
minimum, considers, and produces margin levels commensurate with, the risks and particular
attributes of each relevant product, portfolio, and market, consistent with Rule 17Ad-22(e)(6)(i)
under the Act.29

11. Exhibits

   Exhibit 1 – Not applicable.

   Exhibit 1A - Notice of advance notice for publication in the Federal Register.

   Exhibit 2 – Not applicable.

   Exhibit 3a – Impact Study Data. Omitted and filed separately with the Commission. Confidential treatment of this Exhibit 3a pursuant to 17 CFR 240.24b-2 being requested.

   Exhibit 3b – FICC Methodology Document, FICC Margin Liquidity Adjustment. Omitted and filed separately with the Commission. Confidential treatment of this Exhibit 3b pursuant to 17 CFR 240.24b-2 being requested.

   Exhibit 3c – Responses to SEC Information Requests. Omitted and filed separately with the Commission. Confidential treatment of this Exhibit 3c pursuant to 17 CFR 240.24b-2 being requested.

   Exhibit 4 – Not applicable.

   Exhibit 5a – Proposed changes to the GSD Rules and MBSD Rules.

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28 Id.

29 Id.
Exhibit 5b – Proposed changes to the GSD QRM Methodology Document. Omitted and filed separately with the Commission. Confidential treatment of this Exhibit 5b pursuant to 17 CFR 240.24b-2 being requested. 30

Exhibit 5c – Proposed changes to the MBSD QRM Methodology Document. Omitted and filed separately with the Commission. Confidential treatment of this Exhibit 5c pursuant to 17 CFR 240.24b-2 being requested. 31


31 Id.
Self-Regulatory Organizations; Fixed Income Clearing Corporation; Notice of Filing of Advance Notice to Introduce the Margin Liquidity Adjustment Charge and Include a Bid-Ask Risk Charge in the VaR Charges

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") and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 ("Act"), notice is hereby given that on July __, 2020, Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") the advance notice SR-FICC-2020-802 ("Advance Notice") as described in Items I, II and III below, which Items have been prepared by the clearing agency. The Commission is publishing this notice to solicit comments on the Advance Notice from interested persons.

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I. Clearing Agency’s Statement of the Terms of Substance of the Advance Notice

This Advance Notice consists of modifications to the FICC Government Securities Division (“GSD”) Rulebook (“GSD Rules”) and the FICC Mortgage-Backed Securities Division (“MBSD”) Clearing Rules (“MBSD Rules,” and together with the GSD Rules, “Rules”) to introduce the Margin Liquidity Adjustment (“MLA”) charge as an additional component of GSD and MBSD’s respective Clearing Funds, as described in greater detail below.4

The advance notice also consists of modifications to the GSD Rules, the MBSD Rules, the GSD Methodology Document – GSD Initial Market Risk Margin Model (“GSD QRM Methodology Document”) and the MBSD Methodology and Model Operations Document – MBSD Quantitative Risk Model (“MBSD QRM Methodology Document,” and together with the GSD QRM Methodology Document, the “QRM Methodology Documents”) in order to (i) enhance the calculation of the VaR Charges of GSD and MBSD to include a bid-ask spread risk charge, and (ii) make necessary technical changes to the QRM Methodology Documents in order to implement this proposed change.

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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

FICC has not received or solicited any written comments relating to this proposal. 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

Description of Proposed Change

FICC is proposing to enhance the methodology for calculating Required Fund Deposits to the respective Clearing Funds of GSD and MBSD by (1) introducing a new component, the MLA charge, which would be calculated to address the risk presented to FICC when a Member’s portfolio contains large net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type (referred
to as “asset groups”), and (2) enhancing the calculation of the VaR Charges of GSD and MBSD by including a bid-ask spread risk charge, as described in more detail below.  FICC is also proposing to make certain technical changes to the QRM Methodology Documents, as described in below, in order to implement the proposed enhancement to the VaR Charges.

(i) **Overview of the Required Fund Deposits and the Clearing Funds**

As part of its market risk management strategy, FICC manages its credit exposure to Members by determining the appropriate Required Fund Deposits to the GSD and MBSD Clearing Fund and monitoring their sufficiency, as provided for in the Rules. The Required Fund Deposits serve as each Member’s margin. The objective of a Member’s Required Fund Deposit is to mitigate potential losses to FICC associated with liquidating a Member’s portfolio in the event FICC ceases to act for that Member.

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5 References herein to “Members” refer to GSD Netting Members and MBSD Clearing Members, as such terms are defined in the Rules. References herein to “net unsettled positions” refer to, with respect to GSD, Net Unsettled Positions, as such term is defined in GSD Rule 1 (Definitions) and, with respect to MBSD, refers to the net positions that have not yet settled. Supra note 4.

6 The results of a study of the potential impact of adopting the proposed changes have been provided to the Commission.

7 See GSD Rule 4 (Clearing Fund and Loss Allocation) and MBSD Rule 4 (Clearing Fund Formula and Loss Allocation), supra note 4. FICC’s market risk management strategy is designed to comply with Rule 17Ad-22(e)(4) under the Act, where these risks are referred to as “credit risks.” 17 CFR 240.17Ad-22(e)(4).
(hereinafter referred to as a “default”). The aggregate of all Members’ Required Fund Deposits constitutes the respective GSD and MBSD Clearing Funds. FICC would access the GSD and MBSD Clearing Funds should a defaulting Member’s own Required Fund Deposit be insufficient to satisfy losses to FICC caused by the liquidation of that Member’s portfolio.

Pursuant to the Rules, each Member’s Required Fund Deposit amount consists of a number of applicable components, each of which is calculated to address specific risks faced by FICC, as identified within the Rules. The VaR Charge comprises the largest portion of a Member’s Required Fund Deposit amount. Currently, the GSD QRM Methodology Document states that the total VaR Charge for each portfolio is the sum of the sensitivity VaR of the portfolio plus the haircut charges plus the repo interest volatility charges plus the pool/TBA basis charge. In the MBSD QRM Methodology Document, the current description of the total VaR Charge states that it is the sum of the designated VaR Charge and the haircut charge.

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8 The Rules identify when FICC may cease to act for a Member and the types of actions FICC may take. For example, FICC may suspend a firm’s membership with FICC or prohibit or limit a Member’s access to FICC’s services in the event that Member defaults on a financial or other obligation to FICC. See GSD Rule 21 (Restrictions on Access to Services), and MBSD Rule 14 (Restrictions on Access to Services), of the Rules, supra note 4.

9 Supra note 4.
The VaR Charge is calculated using a risk-based margin methodology that is intended to capture the risks related to market price that is associated with the securities in a Member’s portfolio. This risk-based margin methodology is designed to project the potential losses that could occur in connection with the liquidation of a defaulting Member’s portfolio, assuming a portfolio would take three days to liquidate in normal market conditions. The projected liquidation gains or losses are used to determine the amount of the VaR Charge, which is calculated to cover projected liquidation losses at 99 percent confidence level for Members.\(^\text{10}\)

FICC regularly assesses market and liquidity risks as such risks relate to its margining methodologies to evaluate whether margin levels are commensurate with the particular risk attributes of each relevant product, portfolio, and market. The proposed changes to include the MLA charge to its Clearing Fund methodology and to enhance the VaR Charges by including a bid-ask spread risk charge, as described below, are the result of FICC’s regular review of the effectiveness of its margining methodology.

\(^{10}\) Unregistered Investment Pool Clearing Members are subject to a VaR Charge with a minimum target confidence level assumption of 99.5 percent. See MBSD Rule 4, Section 2(c), supra note 4.
(ii) **Overview of Liquidation Transaction Costs and Proposed Changes**

Each of the proposed changes addresses a similar, but separate, risk that FICC faces increased transaction costs when it liquidates the net unsettled positions of a defaulted Member due to the unique characteristics of that Member’s portfolio. The transaction costs to FICC to liquidate a defaulted Member’s portfolio include both market impact costs and fixed costs. Market impact costs are the costs due to the marketability of a security, and generally increase when a portfolio contains large net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type, as described more below. Fixed costs are the costs that generally do not fluctuate and may be caused by the bid-ask spread of a particular security. The bid-ask spread of a security accounts for the difference between the observed market price that a buyer is willing to pay for that security and the observed market price that a seller is willing to sell that security.

The transaction cost to liquidate a defaulted Member’s portfolio is currently captured by the measurement of market risk through the calculation of the VaR Charge.\(^\text{11}\) The proposed changes would supplement and enhance the current measurement of this market risk to address situations where the characteristics of the defaulted Member’s portfolio could cause these costs to be higher than the amount collected for the VaR Charge.

\(^\text{11}\) The calculation of the VaR Charge is described in GSD Rule 1 (Definitions) and MBSD Rules 1 (Definitions). Supra note 4.
First, as described in more detail below, the MLA charge is designed to address the market impact costs of liquidating a defaulted Member’s portfolio that may increase when that portfolio includes large net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type. These positions may be more difficult to liquidate because a large number of securities with similar risk profiles could reduce the marketability of those large net unsettled positions, increasing the market impact costs to FICC. As described below, the MLA charge would supplement the VaR Charge.

Second, as described in more detail below, the bid-ask spread risk charge would address the risk that the transaction costs of liquidating a defaulted Member’s net unsettled positions may increase due to the fixed costs related to the bid-ask spread. As described below, this proposed change would be incorporated into, and, thereby, enhance the current measure of transaction costs through, the VaR Charge.

(iii) Proposed Margin Liquidity Adjustment Charge

In order to address the risks of an increased market impact cost presented by portfolios that contain large net unsettled positions in the same asset group, FICC is proposing to introduce a new component to the GSD and MBSD Clearing Fund formulas, the MLA charge.
As noted above, a Member portfolio with large net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type may be more difficult to liquidate in the market in the event the Member defaults because a concentration in that group of securities or in a transaction type could reduce the marketability of those large net unsettled positions. Therefore, such portfolios create a risk that FICC may face increased market impact cost to liquidate that portfolio in the assumed margin period of risk of three business days at market prices.

The proposed MLA charge would be calculated to address this increased market impact cost by assessing sufficient margin to mitigate this risk. As described below, the proposed MLA charge would be calculated for different asset groups. Essentially, the calculation is designed to compare the total market value of a net unsettled position in a particular asset group, which FICC would be required to liquidate in the event of a Member default, to the available trading volume of that asset group or equities subgroup in the market.\textsuperscript{12} If the market value of the net unsettled position is large, as compared to the available trading volume of that asset group, then there is an increased risk that FICC would face additional market impact costs in liquidating that position in the event of a Member default. Therefore, the proposed calculation would provide FICC with a measurement of the possible increased market impact cost that FICC could face when it liquidates a large net unsettled position in a particular asset group.

\textsuperscript{12} FICC would determine average daily trading volume by reviewing data that is made publicly available by the Securities Industry and Financial Markets Association (“SIFMA”), at https://www.sifma.org/resources/archive/research/statistics.
To calculate the MLA charge, FICC would categorize securities into separate asset groups. For GSD, asset groups would include the following, each of which have similar risk profiles: (a) U.S. Treasury securities, which would be further categorized by maturity – those maturing in (i) less than one year, (ii) equal to or more than one year and less than two years, (iii) equal to or more than two years and less than five years, (iv) equal to or more than five years and less than ten years, and (v) equal to or more than ten years; (b) Treasury-Inflation Protected Securities (“TIPS”), which would be further categorized by maturity – those maturing in (i) less than two years, (ii) equal to or more than two years and less than six years, (iii) equal to or more than six years and less than eleven years, and (iv) equal to or more than eleven years; (c) U.S. agency bonds; and (d) mortgage pools transactions. For MBSD, to-be-announced (“TBA”) transactions, Specified Pool Trades and Stipulated Trades would be included in one mortgage-backed securities asset group.

FICC would first calculate a measurement of market impact cost with respect to the net unsettled positions of a Member in each of these asset groups. As described above, the calculation of an MLA charge is designed to measure the potential additional market impact cost to FICC of closing out a large net unsettled position in that particular asset group.

To determine the market impact cost for each net unsettled position in Treasuries maturing less than one year and TIPS for GSD and in the mortgage-backed securities asset group for MBSD, FICC would use the directional market impact cost, which is a
function of the net unsettled position’s net directional market value. To determine the market impact cost for all other net unsettled positions, FICC would add together two components: (1) the directional market impact cost, as described above, and (2) the basis cost, which is based on the net unsettled position’s gross market value.

The calculation of market impact cost for net unsettled positions in Treasuries maturing less than one year and TIPS for GSD and in the mortgage-backed securities asset group for MBSD would not include basis cost because basis risk is negligible for these types of positions.

For all asset groups, when determining the market impact costs, the net directional market value and the gross market value of the net unsettled positions would be divided by the average daily volumes of the securities in that asset group over a lookback period.

FICC would then compare the calculated market impact cost to a portion of the VaR Charge that is allocated to net unsettled positions in those asset groups. If the ratio

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13 The net directional market value of an asset group within a portfolio is calculated as the absolute difference between the market value of the long net unsettled positions in that asset group, and the market value of the short net unsettled positions in that asset group. For example, if the market value of the long net unsettled positions is $100,000, and the market value of the short net unsettled positions is $150,000, the net directional market value of the asset group is $50,000.

14 To determine the gross market value of the net unsettled positions in each asset group, FICC would sum the absolute value of each CUSIP in the asset group.

15 Supra note 12.

16 FICC’s margining methodology uses a three-day assumed period of risk. For purposes of this calculation, FICC would use a portion of the VaR Charge that is
of the calculated market impact cost to the 1-day VaR Charge is greater than a threshold, an MLA charge would be applied to that asset group. If the ratio of these two amounts is equal to or less than this threshold, an MLA charge would not be applied to that asset group. The threshold would be based on an estimate of the market impact cost that is incorporated into the calculation of the 1-day VaR charge, such that an MLA charge would apply only when the calculated market impact cost exceeds this threshold.

For each Member portfolio, FICC would add the MLA charges for net unsettled positions in each asset group to determine a total MLA charge for a Member.

The ratio of the calculated market impact cost to the 1-day VaR Charge would also determine if FICC would apply a downward adjustment, based on a scaling factor, to the total MLA charge, and the size of any adjustment. For net unsettled positions that have a higher ratio of calculated market impact cost to the 1-day VaR Charge, FICC would apply a larger adjustment to the MLA charge by assuming that it would liquidate based on one-day assumed period of risk and calculated by applying a simple square-root of time scaling, referred to in this proposed rule change as “1-day VaR Charge.” Any changes that FICC deems appropriate to this assumed period of risk would be subject to FICC’s model risk management governance procedures set forth in the Clearing Agency Model Risk Management Framework (“Model Risk Management Framework”). See Securities Exchange Act Release Nos. 81485 (August 25, 2017), 82 FR 41433 (August 31, 2017) (File No. SR-FICC-2017-014); 84458 (October 19, 2018), 83 FR 53925 (October 25, 2018) (File No. SR-FICC-2018-010); 88911 (May 20, 2020), 85 FR 31828 (May 27, 2020) (File No. SR-FICC-2020-004).

FICC would review the method for calculating the thresholds from time to time and any changes that FICC deems appropriate would be subject to FICC’s model risk management governance procedures set forth in the Model Risk Management Framework. See id.
that position on a different timeframe than the assumed margin period of risk of three business days. For example, FICC may be able to mitigate potential losses associated with liquidating a Member’s portfolio by liquidating a net unsettled position with a larger VaR Charge over a longer timeframe. Therefore, when applicable, FICC would apply a multiplier to the calculated MLA charge. When the ratio of calculated market impact cost to the 1-day VaR Charge is lower, the multiplier would be one, and no adjustment would be applied; as the ratio gets higher the multiplier decreases and the MLA charge is adjusted downward.

The final MLA charge would be calculated daily and, when the charge is applicable, as described above, would be included as a component of Members’ Required Fund Deposit.

**MLA Excess Amount for GSD Sponsored Members**

For GSD, the calculation of the MLA charge for a Sponsored Member that clears through single account sponsored by a Sponsoring Member would be the same as described above. For a GSD Sponsored Member that clears through multiple accounts sponsored by multiple Sponsoring Members, in addition to calculating an MLA charge for each account (as described above), FICC would also calculate an MLA charge for the consolidated portfolio.

If the MLA charge of the consolidated portfolio is higher than the sum of all MLA charges for each account of the Sponsored Member, the Sponsored Member would be charged the amount of such difference, to be referred to as the “MLA Excess Amount,” in addition to the applicable MLA charge. If the MLA charge of the
consolidated portfolio is not higher than the sum of all MLA charges for each account of the Sponsored Member, then the Sponsored Member will only be charged an MLA charge for each sponsored account, as applicable.

The MLA Excess Amount is designed to capture the additional market impact cost that could be incurred when a Sponsored Member defaults, and each of the Sponsoring Members liquidates net unsettled positions associated with that defaulted Sponsored Member. If large net unsettled positions in the same asset group are being liquidated by multiple Sponsoring Members, the market impact cost to liquidate those positions could increase. The MLA Excess Amount would address this additional market impact cost by capturing any difference between the calculations of the MLA charge for each sponsored account and for the consolidated portfolio.

**Proposed Changes to GSD and MBSD Rules**

The proposal described above would be implemented into the GSD Rules and MBSD Rules. Specifically, FICC would amend GSD Rule 1 (Definitions) and MBSD Rule 1 (Definitions) to include a description of the MLA charge.

The proposed change to GSD Rule 1 (Definitions) would first identify each of the asset groups and would then separately describe the two calculations of market impact cost by these asset groups by identifying the components of these calculations. The proposed definition would state that GSD would compare the calculated market impact cost to a portion of that Member’s VaR Charge, to determine if an MLA charge would be applied to an asset group. The proposed definition would then state that GSD would add each of the applicable MLA charges calculated for each asset group together. Finally, the
The proposed definition would state that GSD may apply a downward adjusting scaling factor to result in a final MLA charge. The proposed change to GSD Rule 1 (Definitions) would also include a definition of the “MLA Excess Amount.” The proposed definition would state that it would be an additional charge applicable to Sponsored Members that clear through multiple accounts sponsored by multiple Sponsoring Members and would describe how the additional charge would be determined.

The proposed change to MBSD Rule 1 (Definitions) would define the MBS asset group, for purposes of calculating this charge, and would then describe the calculation of market impact cost for that asset group by identifying the components of this calculation. The proposed definition would state that MBSD would compare the calculated market impact cost to a portion of the Member’s VaR Charge, to determine if an MLA charge would be applied to a net unsettled position. Finally, the proposed definition would state that MBSD may apply a downward adjusting scaling factor to result in a final MLA charge.

FICC would also amend GSD Rule 4 (Clearing Fund and Loss Allocation) and MBSD Rule 4 (Clearing Fund and Loss Allocation) to include the MLA charge as a component of the Clearing Fund formula.

(iv) Proposed Bid-Ask Spread Risk Charge

FICC has identified potential risk that its margining methodologies do not account for the transaction costs related to bid-ask spread in the market that could be incurred when liquidating a portfolio. Bid-ask spreads account for the difference between the observed market price that a buyer is willing to pay for a security and the observed
market price that a seller is willing to sell that security. Therefore, FICC is proposing to amend the VaR models of GSD and MBSD to include a bid-ask spread risk charge in the VaR Charges of GSD and MBSD to address this risk.

In order to calculate this charge, GSD would segment Members’ portfolios into separate bid-ask spread risk classes by product type and maturity. The bid-ask spread risk classes would be separated into the following types: (a) mortgage pools (“MBS”); (b) TIPS; (c) U.S. agency bonds; and (d) U.S. Treasury securities, which would be further segmented into separate classes based on maturities as follows: (i) less than five years, (ii) equal to or more than five years and less than ten years, and (iii) equal to or more than ten years. FICC would further segment the U.S. Treasury securities into separate classes based on maturities.

Only the MBS asset group is applicable to MBSD Member portfolios. FICC would exclude Option Contracts in to-be-announced (“TBA”) transactions from the bid-ask spread risk charge because, in the event of a Member default, FICC would liquidate any Option Contracts in TBAs in a Member’s portfolio at the intrinsic value of the Option Contract and, therefore, does not face a transaction cost related to the bid-ask spread.

Each product type and maturity risk class would be assigned a specific bid-ask spread haircut rate in the form of a basis point charge that would be applied to the gross market value in that particular risk class. The applicable bid-ask spread risk charge would be the product of the gross market value in a particular risk class in the Member’s portfolio and the applicable basis point charge. The bid-ask spread risk charge would be
calculated at the portfolio level, such that FICC would aggregate the bid-ask spread risk charges of the applicable risk classes for the Member’s portfolio.

FICC proposes to review the haircut rates annually based on either the analysis of liquidation transaction costs related to the bid-ask spread that is conducted in connection with its annual simulation of a Member default or market data that is sourced from a third-party data vendor. Based on the analyses from recent years’ simulation exercises, FICC does not anticipate that these haircut rates would change significantly year over year. FICC may also adjust the haircut rates following its annual model validation review, to the extent the results of that review indicate the current haircut rates are not adequate to address the risk presented by transaction costs from a bid-ask spread.18

The proposed initial haircuts are based on the analysis from the most recent annual default simulation and market data sourced from a third-party data vendor, and are listed in the table below:

18 All proposed changes to the haircuts would be subject to FICC’s model risk management governance procedures set forth in the Model Risk Management Framework. See id.
<table>
<thead>
<tr>
<th>Class</th>
<th>Asset Class</th>
<th>Maturity</th>
<th>Haircut (bps)</th>
</tr>
</thead>
<tbody>
<tr>
<td>MBS</td>
<td>MBS</td>
<td>All</td>
<td>0.8</td>
</tr>
<tr>
<td>TIPS</td>
<td>TIPS</td>
<td>All</td>
<td>2.1</td>
</tr>
<tr>
<td>Agency</td>
<td>Agency bonds</td>
<td>All</td>
<td>3.8</td>
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<tr>
<td>Treasury 5-&lt;5</td>
<td>Treasury</td>
<td>&lt; 5 years</td>
<td>0.6</td>
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<td>Treasury 5-10</td>
<td>Treasury</td>
<td>5-10 years</td>
<td>0.7</td>
</tr>
<tr>
<td>Treasury 10+</td>
<td>Treasury</td>
<td>&gt;10 years</td>
<td>0.7</td>
</tr>
</tbody>
</table>

**Proposed Changes to GSD and MBSD Rules**

The proposal described above would be implemented into the GSD Rules and MBSD Rules. Specifically, FICC would include a description of the bid-ask spread risk charge in the current definitions of the VaR Charge in GSD Rule 1 (Definitions) and MBSD Rule 1 (Definitions). The proposed change would state that the calculations the VaR Charge shall include an additional bid-ask spread risk charge measured by multiplying the gross market value of each net unsettled position by a basis point charge. The proposed change would also state that the basis point charge would be based on six risk classes and would identify those risk classes.

**Proposed Changes to QRM Methodology Documents**

To implement this proposal, FICC is proposing to amend the QRM Methodology Documents to describe the bid-ask spread risk charge. Specifically, FICC would describe (i) that the bid-ask spread risk charge is designed to mitigate the risk related to transaction costs in liquidating a portfolio in the event of a Member default; (ii) how the
bid-ask spread risk charge would be calculated; and (ii) the impact analysis that was conducted in each of the QRM Methodology Documents. The GSD QRM Methodology Document would describe the proposed six classes (listed in the table above). The MBSD QRM Methodology Document would state that the only class for MBSD portfolios is the MBS asset class, and that the Option Contracts in TBAs would be excluded from the proposed charge. Finally, FICC would update the descriptions of the total VaR Charge in the QRM Methodology Documents to include the bid-ask spread risk charge as a component of this charge.

(v) Proposed Technical Changes

Finally, FICC would amend the QRM Methodology Documents to re-number the sections and tables, and update certain section titles, as necessary, to add a new section that describes the proposed bid-ask spread risk charge.

(vi) Implementation Timeframe

FICC would implement the proposed changes no later than 10 Business Days after the later of the no objection to the Advance Notice and approval of the related proposed rule change19 by the Commission. FICC would announce the effective date of the proposed changes by Important Notice posted to its website.

19 Supra note 3.
Anticipated Effect on and Management of Risk

FICC believes that the proposed changes to enhance the margining methodology as described above would enable FICC to better limit its risk exposures to Members arising out of their net unsettled positions.

As stated above, the proposed MLA charge is designed to help limit FICC’s exposures to the risks presented by a Member portfolio that contains large net unsettled positions in securities of the same asset group and would enhance FICC’s ability to address risks related to liquidating such positions in the event of a Member default. The proposed MLA charge would allow FICC to collect sufficient financial resources to cover its exposure that it may face an increased market impact cost in liquidating net unsettled positions that is not captured by the VaR Charge.

As described above, the proposed MLA Excess Amount is designed to capture any additional market impact cost that could be incurred when each of the Sponsoring Members liquidates large net unsettled positions in securities of the same asset group that are all associated with one defaulted Sponsored Member.

The proposal to enhance the VaR Charges by including a bid-ask spread risk charge is also designed to help limit FICC’s exposures to the risks related to increased transaction costs due to the bid-ask spread in the market that could be incurred when liquidating a portfolio. Therefore, this proposed change would also help address FICC’s risks related to its ability to liquidate such positions in the event of a Member default.

By providing FICC with a more effective measurement of its exposures, the proposed changes would also mitigate risk for Members because lowering the risk profile
for FICC would in turn lower the risk exposure that Members may have with respect to FICC in its role as a central counterparty.

**Consistency with Clearing Supervision Act**

FICC believes that the proposals are consistent with the Clearing Supervision Act, specifically with the risk management objectives and principles of Section 802(b), and with certain of the risk management standards adopted by the Commission pursuant to Section 805(a)(2), for the reasons described below.\(^{20}\)

\[(i) \quad \textit{Consistency with Section 805(b) of the Clearing Supervision Act}\]

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.\(^{21}\)

FICC believes the proposals are consistent with the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act and in the Covered Clearing Agency Standards.

First, the proposal would include the MLA charge as an additional component to the Clearing Fund. As described above, this new margin charge is designed to address the market impact costs of liquidating a defaulted Member’s portfolio that may increase

\(^{20}\) 12 U.S.C. 5464(a)(2) and (b)(1).

when that portfolio includes large net unsettled positions in a particular group of securities with a similar risk profile or in a particular transaction type. These positions may be more difficult to liquidate in the market because a concentration in that group of securities or in a transaction type could reduce the marketability of those large net unsettled positions, increasing the market impact costs to FICC. The proposed MLA charge would allow FICC to collect sufficient financial resources to cover its exposure that it may face increased market impact costs in liquidating net unsettled positions that is not captured by the VaR Charge.

Additionally, the proposed MLA Excess Amount would capture additional market impact cost that could be incurred when each of the Sponsoring Members liquidates large net unsettled positions in securities of the same asset group that are all associated with one defaulted Sponsored Member.

Second, the proposed bid-ask spread risk charge is designed to help limit FICC’s exposures to the risks related to increased transaction costs due to the bid-ask spread in the market that could be incurred when liquidating a portfolio. As stated above, this proposal would also help address FICC’s risks related to its ability to liquidate such positions in the event of a Member default.

Therefore, because the proposals are designed to enable FICC to better limit its exposure to Members in the event of a Member default, FICC believes they are consistent with promoting robust risk management. The proposals would also strengthen the liquidity of FICC by requiring deposits to the Clearing Fund that are calculated to address the potential risks FICC may face, which is one of FICC’s default liquidity resources.
As a result, FICC believes the proposals would be consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act, which specify the promotion of robust risk management, promotion of safety and soundness, reduction of systemic risks and support of the stability of the broader financial system by, among other things, strengthening the liquidity of systemically important financial market utilities, such as FICC.

(ii) Consistency with Rule 17Ad-22(e)(4)(i) and (6)(i) under the Act

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, like FICC, and financial institutions engaged in designated activities for which the Commission is the supervisory agency or the appropriate financial regulator.\textsuperscript{22} The Commission has accordingly adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act\textsuperscript{23} and Section 17A of the Act ("Covered Clearing Agency Standards").\textsuperscript{24} The Covered Clearing Agency Standards require covered 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.\textsuperscript{25}

\textsuperscript{22} 12 U.S.C. 5464(a)(2).
\textsuperscript{23} Id.
\textsuperscript{24} 17 CFR 240.17Ad-22(e).
\textsuperscript{25} Id.
FICC believes that the proposed changes are consistent with Rules 17Ad-22(e)(4)(i) and (e)(6)(i) of the Covered Clearing Agency Standards\textsuperscript{26} for the reasons described below.

Rule 17Ad-22(e)(4)(i) under the Act requires, in part, that FICC establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.\textsuperscript{27}

As described above, FICC believes that both of the proposed changes would enable it to better identify, measure, monitor, and, through the collection of Members’ Required Fund Deposits, manage its credit exposures to Members by maintaining sufficient resources to cover those credit exposures fully with a high degree of confidence.

Specifically, FICC believes that the proposed MLA charge would effectively mitigate the risks related to large net unsettled positions of securities in the same asset group within a portfolio and would address the potential increased risks FICC may face related to its ability to liquidate such positions in the event of a Member default. The proposed MLA Excess Amount would supplement this proposed charge to capture any

\textsuperscript{26} 17 CFR 240.17Ad-22(e)(4)(i), (e)(6)(i).

\textsuperscript{27} 17 CFR 240.17Ad-22(e)(4)(i).
additional market impact cost related to Sponsored Members that clear through multiple accounts with multiple Sponsoring Members.

Therefore, FICC believes that the proposal would enhance FICC’s ability to effectively identify, measure and monitor its credit exposures and would enhance its ability to maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. As such, FICC believes the proposed changes are consistent with Rule 17Ad-22(e)(4)(i) under the Act.\textsuperscript{28}

Additionally, FICC believes that the proposed bid-ask spread risk charge would enhance FICC’s ability to identify, measure, monitor and manage its credit exposures to Members and those exposures arising from its payment, clearing, and settlement processes because the proposed changes would better ensure that FICC maintains sufficient financial resources to cover its credit exposure to each Member with a high degree of confidence. FICC believes that the proposed change would enable FICC to more effectively identify, measure, monitor and manage its exposures to risks related to market price, and enable it to better limit its exposure to potential losses from Member defaults by providing a more effective measure of the risks related to market price. As described above, due to the bid-ask spread in the market, there is an observable transaction cost to liquidate a portfolio. The proposed bid-ask spread risk charge is designed to manage the risk related to this transaction cost in the event a Member’s portfolio is liquidated. As such, FICC believes that the proposed change would better

\textsuperscript{28} Id.
address the potential risks that FICC may face that are related to its ability liquidate a Member’s net unsettled positions in the event of that firm’s default, and thereby enhance FICC’s ability to effectively identify, measure and monitor its credit exposures and would enhance its ability to maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence. In this way, FICC believes this proposed change is also consistent with Rule 17Ad-22(e)(4)(i) under the Act.  

Rule 17Ad-22(e)(6)(i) under the Act requires, in part, that FICC establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market.

The Required Fund Deposits are made up of risk-based components (as margin) that are calculated and assessed daily to limit FICC’s credit exposures to Members, including the VaR Charges. FICC’s proposed change to introduce an MLA charge is designed to more effectively address the risks presented by large net unsettled positions in the same asset group. FICC believes the addition of the MLA charge would enable FICC to assess a more appropriate level of margin that accounts for these risks. This proposed change is designed to assist FICC in maintaining a risk-based margin system

\[29 \text{ Id.} \]

\[30 \text{ 17 CFR 240.17Ad-22(e)(6)(i).} \]
that considers, and produces margin levels commensurate with, the risks and particular attributes of portfolios that contain large net unsettled positions in the same asset group and may be more difficult to liquidate in the event of a Member default. The proposed MLA Excess Amount would further this goal by measuring any additional risks that could be presented by a Sponsored Member that clears through multiple accounts at multiple Sponsoring Members. Therefore, FICC believes the proposed change is consistent with Rule 17Ad-22(e)(6)(i) under the Act.\textsuperscript{31}

Furthermore, FICC believes that including the bid-ask spread risk charge within the calculation of the final VaR Charges of GSD and MBSD would provide FICC with a better assessment of its risks related to market price. This proposed change would enable FICC to assess a more appropriate level of margin that accounts for this risk at the portfolio level. As such, each Member portfolio would be subject to a risk-based margining system that, at minimum, considers, and produces margin levels commensurate with, the risks and particular attributes of each relevant product, portfolio, and market, consistent with Rule 17Ad-22(e)(6)(i) under the Act.\textsuperscript{32}

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

\textsuperscript{31} Id.

\textsuperscript{32} Id.
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.

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-2020-802 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-2020-802. 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-2020-802 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Secretary
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**RULE 1 - DEFINITIONS**

* * *

**Margin Liquidity Adjustment Charge or MLA Charge**

The terms “Margin Liquidity Adjustment Charge” or “MLA Charge” mean, with respect to each Margin Portfolio, an additional charge applied to Net Unsettled Positions of a Member. The MLA Charge shall be calculated daily and shall be included in each Member’s Required Fund Deposit.

For purposes of calculating this charge, Net Unsettled Positions shall be categorized into the following asset groups: (a) U.S. Treasury securities, which shall be further categorized by maturity – those maturing in (i) less than one year, (ii) equal to or more than one year and less than two years, (iii) equal to or more than two years and less than five years, (iv) equal to or more than five years and less than ten years, and (v) equal to or more than ten years; (b) Treasury-Inflation Protected Securities (“TIPS”), which shall be further categorized by maturity – those maturing in (i) less than two years, (ii) equal to or more than two years and less than six years, (iii) equal to or more than six years and less than eleven years, and (iv) equal to or more than eleven years; (c) U.S. agency bonds; and (d) mortgage pools transactions.

The Corporation shall first calculate a measurement of market impact cost for each Net Unsettled Position in each of the asset groups, as described below:
(i) For Net Unsettled Positions in U.S. Treasury securities maturing in less than one year and TIPS, the directional market impact cost should be used, which is a function of the Net Unsettled Position’s net directional market value;

(ii) For all other Net Unsettled Positions, two components shall be added together: (1) the directional market impact cost, as described above, and (2) the basis cost, which is based on the Net Unsettled Position’s gross market value.

For all asset groups, the net directional market value and the gross market value shall be divided by the average daily volumes of the securities in that asset group over a lookback period.

The calculated market impact cost for each Net Unsettled Position in an asset group shall be compared to a portion of the VaR Charge that is allocated to that Net Unsettled Position. If the ratio of the calculated market impact cost to a portion of the VaR Charge is greater than a threshold, to be determined by the Corporation from time to time, an MLA Charge will be applied to that asset group. If the ratio of these two amounts is equal to or less than this threshold, the MLA charge will not be applied to that asset group.

Each applicable MLA Charge for each asset group shall be added together to result in one total MLA charge.

The Corporation may apply a downward adjusting scaling factor based on the ratio of the calculated market impact cost to a portion of the VaR Charge to result in a final MLA Charge, where a higher ratio would trigger a larger downward adjustment of the MLA Charge and a lower ratio would trigger no downward adjustment of the MLA Charge.

MLA Excess Amount

Sponsored Members that clear through multiple accounts sponsored by multiple Sponsoring Members may be charged an MLA Excess Amount in addition to the MLA Charge. In order to determine if this additional amount is applicable, FICC shall calculate both an MLA Charge for each account and an MLA Charge for the consolidated portfolio.

If the MLA charge of the consolidated portfolio is higher than the sum of all MLA Charges for each account of the Sponsored Member, the Sponsored Member shall be charged the amount of such difference, as an MLA Excess Amount, in addition to the applicable MLA Charge.

* * *
VaR Charge

The term “VaR Charge” means, with respect to each Margin Portfolio, a calculation of the volatility of specified Net Unsettled Positions of a Netting Member as of the time of such calculation. Such volatility calculations shall be made in accordance with any generally accepted portfolio volatility model, including, but not limited to, any margining formula employed by any other clearing agency registered under Section 17A of the Securities Exchange Act of 1934. Such calculation shall be made utilizing such assumptions (including confidence levels) and based on such observable market data as the Corporation deems reasonable, and shall cover such range and assessment of volatility as the Corporation from time to time deems appropriate. To the extent that the primary source of such market data becomes unavailable for an extended period of time, the Corporation shall utilize the Margin Proxy as an alternative volatility calculation. In its assessment of volatility, the Corporation shall calculate an additional bid-ask spread risk charge measured by multiplying the gross market value of each Net Unsettled Position by a basis point charge, where the applicable basis point charge shall be reviewed at least annually and shall be based on the following risk groups: (a) mortgage pool transactions; (b) TIPS; (c) U.S. agency bonds; and (d) U.S. Treasury securities, which shall be further categorized by maturity – those maturing in (i) less than five years, (ii) equal to or more than five years and less than ten years, and (iii) equal to or more than ten years.

If the volatility calculation is lower than an amount designated by the Corporation (the “VaR Floor”) then the VaR Floor will be utilized as such Clearing Member’s VaR Charge. Such VaR Floor will be determined by multiplying the absolute value of the sum of Net Long Positions and Net Short Positions of Eligible Securities, grouped by product and remaining maturity, by a percentage designated by the Corporation from time to time for such group. For U.S. Treasury and agency securities, such percentage shall be a fraction, no less than 10%, of the historical minimum volatility of a benchmark fixed income index for such group by product and remaining maturity. For mortgage-backed securities, such percentage shall be a fixed percentage that is no less than 0.05%.

* * *
RULE 4 – CLEARING FUND AND LOSS ALLOCATION

Changes to this Rule 4, as amended by File Nos. SR-FICC-2020-009 and SR-FICC-2020-802, are available at dtcc.com/~/media/Files/Downloads/legal/rule-filings/2020/FICC/SR-FICC-2020-009.pdf and dtcc.com/~/media/Files/Downloads/legal/rule-filings/2020/FICC/SR-FICC-2020-802.pdf, respectively. These changes have been approved by the SEC but have not yet been implemented. By no later than [insert date within 10 Business Days after the later of the approval of SR-FICC-2020-009 and no objection to SR-FICC-2020-802 by the SEC], 2020, these changes will be implemented, and this legend will automatically be removed from this Rule 4.

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Section 1b – Unadjusted GSD Margin Portfolio Amount

(a) Each Business Day, the Corporation shall determine, with respect to each Margin Portfolio, an Unadjusted GSD Margin Portfolio Amount as the sum of the following:

(i) the VaR Charge,

minus

(ii) in the case of a Margin Portfolio of a Cross Margining Participant that is subject to one or more Cross-Margining Arrangements, in the discretion of the Corporation, an amount not to exceed the sum of any applicable Cross-Margining Reductions, calculated on the current Business Day for such Cross-Margining Participant in accordance with the applicable Cross-Margining Agreements,

plus

(iii) in the case of a Margin Portfolio of a GCF Counterparty, the GCF Premium Charge and/or GCF Repo Event Premium and/or the Early Unwind Intraday Charge, if applicable,

plus or minus

(iv) in the case of a Margin Portfolio of a GCF Counterparty, the Blackout Period Exposure Adjustment, if applicable, during the monthly Blackout Period or until the applicable GCF Clearing Agent Bank updates the Pool Factors used for collateral valuation,

plus

(v) in the case of a Netting Member with backtesting deficiencies, the Backtesting Charge, if applicable,
(vi) the Holiday Charge, if applicable, on the Business Day prior to a Holiday,

plus

(vii) a Margin Liquidity Adjustment Charge and an MLA Excess Amount, if applicable.

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**RULE 1 - DEFINITIONS**

Changes to this Rule 1, as amended by File Nos. SR-FICC-2020-009 and SR-FICC-2020-802, are available at dtcc.com/~media/Files/Downloads/legal/rule-filings/2020/FICC/SR-FICC-2020-009.pdf and dtcc.com/~media/Files/Downloads/legal/rule-filings/2020/FICC/SR-FICC-2020-802.pdf, respectively. These changes have been approved by the SEC but have not yet been implemented. By no later than [insert date within 10 Business Days after the later of the approval of SR-FICC-2020-009 and no objection to SR-FICC-2020-802 by the SEC], these changes will be implemented, and this legend will automatically be removed from this Rule 1.

**Margin Liquidity Adjustment Charge or MLA Charge**

The terms “Margin Liquidity Adjustment Charge” or “MLA Charge” mean, with respect to each Margin Portfolio, an additional charge applied to net unsettled positions of a Member. The MLA Charge shall be calculated daily and shall be included in each Member’s Required Fund Deposit.

For purposes of calculating this charge, net unsettled positions in TBA transactions, Specified Pool Trades and Stipulated Trades shall be included in one mortgage-backed securities asset group.

The Corporation shall first calculate a measurement of market impact cost for each net unsettled position in this asset group by using the directional market impact cost, which is a function of the net unsettled position’s net directional market value. The net directional market value and the gross market value shall be divided by the average daily volumes of the securities in that asset group over a lookback period.

The calculated market impact cost for each net unsettled position shall be compared to a portion of the VaR Charge that is allocated to that net unsettled position. If the ratio of the calculated market impact cost to a portion of the VaR Charge is greater than a threshold, to be determined by the Corporation from time to time, an MLA Charge will be applied to the net unsettled position. If the ratio of these two amounts is equal to or less than this threshold, the MLA Charge will not be applied to the net unsettled position.
The Corporation may apply a downward adjusting scaling factor based on the ratio of the calculated market impact cost to a portion of the VaR Charge to result in a final MLA Charge, where a higher ratio would trigger a larger downward adjustment of the MLA Charge and a lower ratio would trigger no downward adjustment of the MLA Charge.

* * *

VaR Charge

The term “VaR Charge” means, with respect to each margin portfolio, a calculation of the volatility of specified net unsettled positions of a Clearing Member, as of the time of such calculation (with respect to the specified net unsettled positions as of the time of such calculation). Such volatility calculations shall be made in accordance with any generally accepted portfolio volatility model, including, but not limited to, any margining formula employed by any other clearing agency registered under Section 17A of the Exchange Act. Such calculation shall be made utilizing such assumptions (including confidence levels) and based on such historical data as the Corporation deems reasonable, and shall cover such range of historical volatility as the Corporation from time to time deems appropriate. To the extent that the primary source of such historical data becomes unavailable for an extended period of time, the Corporation shall utilize the Margin Proxy as an alternative volatility calculation. In its assessment of volatility, the Corporation shall calculate an additional bid-ask spread risk charge measured by multiplying the gross market value of each Net Unsettled Position by a basis point charge, where the applicable basis point charge shall be reviewed at least annually.

If the volatility calculation is lower than an amount designated by the Corporation (the “VaR Floor”) then the VaR Floor will be utilized as such Clearing Member’s VaR Charge. Such VaR Floor will be determined by multiplying the sum of the absolute values of Long Positions and Short Positions, at market value, by a percentage designated by the Corporation that is no less than 0.05% and no greater than 0.30%. The Corporation shall determine the percentage within this range to be applied based on factors including but not limited to a review performed at least annually of the impact of the VaR Floor parameter at different levels within the range to the backtesting performance and to Clearing Members’ margin charges. The Corporation shall inform Clearing Members of the applicable percentage utilized by the VaR Floor by an Important Notice issued no later than 10 Business Days prior to the implementation of such percentage.

* * *
RULE 4 – CLEARING FUND AND LOSS ALLOCATION

Changes to this Rule 4, as amended by File Nos. SR-FICC-2020-009 and SR-FICC-2020-802, are available at dtcc.com/~/media/Files/Downloads/legal/rule-filings/2020/FICC/SR-FICC-2020-009.pdf and dtcc.com/~/media/Files/Downloads/legal/rule-filings/2020/FICC/SR-FICC-2020-802.pdf, respectively. These changes have been approved by the SEC but have not yet been implemented. By no later than [insert date within 10 Business Days after the later of the approval of SR-FICC-2020-009 and no objection to SR-FICC-2020-802 by the SEC], these changes will be implemented, and this legend will automatically be removed from this Rule 4.

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Section 2 – Required Fund Deposit Requirements

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(c) Each Business Day, each Clearing Member shall be required to make a Required Fund Deposit to the Clearing Fund equal to the greater of: (i) the Minimum Charge, or (ii) the sum of the following:

(i) the VaR Charge

plus

(ii) the amount of the Deterministic Risk Component

plus

(iii) an additional payment (“special charge”) from such Member as determined by the Corporation from time to time in view of market conditions and other financial and operational capabilities of the Member. The Corporation shall make any such determination based on such factors as the Corporation determines to be appropriate from time to time

plus

(iv) in the case of Clearing Member with backtesting deficiencies, the Backtesting Charge, if applicable

plus

(v) the Holiday Charge, if applicable, on the Business Day prior to a Holiday

plus
(vi) an Intraday Mark-to-Market Charge, if applicable.

plus

(vii) a Margin Liquidity Adjustment Charge, if applicable.

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