DTCC

F.A.Q. FICC - GSD

IS SPONSORED MEMBERSHIP THE ONLY ACCESS MODEL FICC OFFERS FOR MARKET PARTICIPANTS THAT ARE UNABLE TO BECOME FULL-SERVICE NETTING MEMBERS?

No. Market participants that are unable to become full-service Netting Members of the Government Securities Division (GSD) have a wide range of options for accessing clearing at FICC through one of FICC's client clearing models and/or one of FICC's limited direct access models.

A market participant looking to clear either Treasury cash activity or Treasury repo activity through FICC that is unable to become a full-service GSD Netting Member could access FICC through one of FICC's client clearing models. More specifically, a firm could (i) become a Sponsored Member of one or more FICC-approved Sponsoring Members, and/or (ii) become an indirect participant (referred to as an "Executing Firm") of one or more FICC-approved Prime Brokers or Correspondent Clearers. Both of these client clearing models offer futures commission merchant ("FCM")-style clearing capabilities for Treasury cash activity and Treasury repo activity. Please refer to the response to FAQ 4 for further information comparing the Prime Broker and Correspondent Clearing Services to FCM-style clearing.

In addition, if a market participant is a Registered Investment Company ("RIC"), it is also eligible to clear Treasury cash activity and Treasury repo activity directly through FICC. RICs are eligible to be GSD Netting Members that are designated as Tier Two Members for purposes of the application of FICC's loss allocation rules. As a Tier Two Member, a RIC Netting Member would be subject to the allocation of losses based on the transactions it executed in clearing with a defaulting member, but would be excluded from loss mutualization applicable to a full-service GSD Netting Member that has been designated as a Tier One Netting Member.

Moreover, if the market participant is looking specifically at being a cash lender into FICC-cleared tri-party Treasury repo, it could become a direct limited member of FICC's Centrally Cleared Institutional Tri-Party Service.

DOES FICC'S SPONSORED MEMBERSHIP MODEL PROVIDE SPONSORED MEMBERS WITH THE SAME BENEFITS OF CENTRAL CLEARING AS ARE OFFERED BY DIRECT MEMBERSHIP AT FICC?

Yes. FICC's Sponsored Service provides Sponsored Members with substantially the same benefits of clearing, including centralized risk management, centralized default management, comparison and multilateral netting, and substantially the same guarantee of settlement as direct Netting Members receive from FICC.

The principal differences between the services offered to Sponsored Members and those offered to direct Netting Members are the following: (a) a Sponsored Member acts through its Sponsoring Member, rather than acting directly with FICC; and (b) if a Sponsoring Member defaults, FICC has the option, under the GSD Rules, to terminate or settle the Sponsored Member's trades. More information regarding a Sponsoring Member default is available on the FICC's US Treasury Clearing microsite at FICC's Sponsored Program - Default Scenarios.

These features of the Sponsored Service are consistent with client clearing models in other asset classes as well (e.g., derivatives). For example, under an FCM-style client clearing model, the FCM's client does not have a direct relationship with the CCP and if the clearing member defaults, the CCP can terminate the customer's trades.

DOES FICC'S SPONSORED MEMBERSHIP MODEL OFFER THE SAME BENEFITS OF CENTRAL CLEARING AS ARE OFFERED BY CLIENT CLEARING MODELS IN OTHER ASSET CLASSES (E.G., DERIVATIVES)?

Yes. FICC's Sponsored Service provides Sponsored Members with substantially the same benefits of central clearing, including centralized risk management, centralized default management, comparison and multilateral netting, and substantially the same guarantee of settlement as are offered under an FCM-style client clearing offering in the derivatives space.

In the event a Sponsoring Member defaults, it is expected that Sponsored Members would have SIPA customer or similar custodial claims for the return of their assets and any amounts paid by FICC. It is also expected that Sponsored Members would not be treated as general creditors as would be the case upon a default in a bilateral transaction. However, firms should consult counsel regarding the possible impacts of a Sponsoring Member default under applicable bankruptcy law.

DO FICC'S PRIME BROKER AND CORRESPONDENT CLEARING ACCESS MODELS OFFER THE SAME BENEFITS OF CENTRAL CLEARING AS CLIENT CLEARING MODELS OFFERED IN OTHER ASSET CLASSES (E.G., DERIVATIVES)?

Yes. FICC's Prime Broker and Correspondent Clearing Services provide substantially the same benefits of central clearing, including centralized risk management, centralized default management, comparison and multilateral netting, and substantially the same guarantee of settlement as are offered under an FCM-style client clearing offering in the derivatives space.

Under FICC's Prime Broker and Correspondent Clearing Services, the indirect participant (referred to as an "Executing Firm") can enter into a trade with a third party that is a participant in FICC and give the trade up to its Prime Broker or Correspondent Clearer, as applicable, to clear at FICC for the benefit of the Executing Firm.

This structure is consistent with how a customer of an FCM can enter into a trade with a third party on an exchange or bilaterally and then give that trade up to its FCM for clearing on a Derivatives Clearing Organization (DCO).

Similarly, the direct participant of FICC in this structure does not function as the Executing Firm's bilateral counterparty in these models; rather, it acts in a similar manner to an FCM (or other clearing member) under a derivatives clearing model.

In the event the Executing Firm's Prime Broker or Correspondent Clearer, as applicable, defaults, it is expected that Executing Firms would have SIPA customer or similar custodial claims for the return of their assets and any amounts paid by FICC. It is also expected that Executing Firms would not be treated as general creditors as would be the case upon a default in a bilateral transaction. Firms should consult counsel regarding the possible impacts of a Prime Broker or Correspondent Clearer, as applicable, default under relevant bankruptcy law.

FICC is considering enhancements to the GSD Rules to clarify the operation of the Prime Brokerage and Correspondent Clearing Services. The enhancements should make clearer that these services are substantially similar to custodial/FCM-style clearing with respect to FICC-cleared cash and repo transactions.

DOES THE SETTLEMENT OF SPONSORED GC TRANSACTIONS DIRECTLY THROUGH THE TRI-PARTY ACCOUNTS OF THE SPONSORED MEMBER AND SPONSORING MEMBER (RATHER THAN THROUGH AN INTERMEDIATE FICC ACCOUNT) MEAN THOSE TRADES ARE NOT CENTRALLY CLEARED?

No. Repos submitted to FICC under the Sponsored GC Service (a Sponsored GC Repo) are centrally cleared transactions. FICC's guarantee of settlement, comparison, centralized risk management, centralized default management, and other benefits apply to Sponsored GC Repos to the same extent as they apply to all other FICC-cleared transactions.

Although Sponsored GC Repos are not subject to multilateral settlement netting, they are subject to multilateral close-out netting and therefore are expected to provide substantially the same balance sheet, capital, and risk mitigation benefits as other FICC-cleared transactions.

DOES FICC EVER SETTLE CLEARED TRANSACTIONS OTHER THAN ON A DELIVERY-VERSUS-PAYMENT (DVP) BASIS?

No. All FICC-cleared transactions settle DVP, either on a bilateral or tri-party basis. FICC does not hold any property for participants other than Clearing Fund. As described in response to FAQ 12 (below), Clearing Fund deposits for indirect participants' activity are made by the direct Netting Member responsible for that indirect participant, i.e., the Sponsoring Member, Prime Broker or Correspondent Clearer.

ARE START LEGS OF TREASURY REPO TRANSACTIONS NOVATED TO FICC?

The start legs of many types of repo transactions cleared by FICC are novated to and settled by FICC, including the start legs of all repos transactions between two Netting Members of FICC, the start leg of any repo under Sponsored DVP Service (a Sponsored DVP Repo) where the Sponsored Member's pre-novation counterparty is a third-party member of FICC (i.e., "done-away" from the Sponsoring Member), as well as any Sponsored DVP Repo where the start leg of such repo is scheduled to settle on some business day in the future.

FICC currently does not novate and settle the start legs of same-day settling Sponsored DVP Repos where the Sponsored Member's pre-novation counterparty is its Sponsoring Member (i.e., "done-with" Sponsored DVP Repo as well as Sponsored GC Repos). FICC's decision not to novate and settle those particular start legs was deliberate and made in consultation with the industry based on the operational complexities that novation and settlement by FICC presented to both Sponsoring Members and Sponsored Members. It was also driven by the legal complexities that clearing the start leg presented to Sponsored Members, particularly Sponsored Members that are cash providers who would be faced with a new obligation to deliver cash to FICC and where failure to satisfy such obligation on time would be grounds for FICC to deem such Sponsored Member insolvent and cease to act for them.

Nonetheless, FICC is willing and capable of novating and settling the start legs of any repo transaction that it clears, subject to the required regulatory approvals and to the extent the industry deems it appropriate for FICC to do so.

DOES THE FACT THAT FICC DOES NOT CURRENTLY NOVATE THE START LEGS OF CERTAIN SPONSORED MEMBER REPOS MEAN THAT THOSE REPOS ARE NOT CENTRALLY CLEARED?

No. The fact that FICC does not clear the start leg of certain Sponsored Member repo transactions (i.e., same-day settling Sponsored DVP Repos executed with a Sponsoring Member as well as Sponsored GC Repos) has no effect on the guarantee of settlement, comparison, centralized risk management, centralized default management, multilateral netting, and other benefits provided by FICC on the end leg of such repo transaction.

FICC would also note that it only began novating and settling the start legs of same-day settling DVP repos between its Netting Members in 2021. Prior to that time, the industry did not raise any concerns that the end legs of such repo transactions were not centrally cleared by FICC.

CAN ASSET MANAGERS WHO REQUIRE HAIRCUTS ON THEIR CASH LENDING ACTIVITY PARTICIPATE IN CLEARING AT FICC?

Yes. Asset managers who participate in FICC as Sponsored Members are permitted to receive a haircut on their FICC-cleared reverse repo activity in either the Sponsored DVP Service or Sponsored GC Service. Please see GSD Rule 3A, Sections 7 and 9, available on the DTCC.com website at: https://www.dtcc.com/~/media/Files/Downloads/legal/rules/ficc_gov_rules.pdf

DOES FICC HOLD OR RETAIN ANY SECURITIES THAT ARE SETTLED AS PART OF EITHER LEG OF THE REPO TRADE SETTLEMENT?

No. FICC does not hold the purchased securities received by a repo buyer (cash provider) in connection with a cleared repo transaction. Rather, such securities are delivered out to the repo buyer (cash provider) in the start leg of the trade or, in the case of Sponsored GC Trades, held in the repo buyer's (cash provider's) triparty account.

DOES FICC IMPOSE ANY LIMITATIONS ON THE ABILITY TO TRANSFER SECURITIES IN A DEFAULT SITUATION?

No. FICC does not impose any limitations on the ability of a cash provider to use the securities it purchased in connection with a repo transaction, even in the cash provider's default. For details, please see FICC's US Treasury Clearing microsite at FICC's Sponsored Program - Default Scenarios. (https://www.dtcc.com/USTclearing/-/media/Files/Downloads/Microsites/Treasury-Clearing/FICC-Default-Scenarios.pdf)

The procedures FICC may take after it has ceased to act for a defaulting member, including the process for closing out unsettled, open positions of the defaulting Member, are also provided for and described in Rule 22A of the GSD Rules, available on the DTCC.com website at: https://www.dtcc.com/~/media/Files/Downloads/legal/rules/ficc_gov_rules.pdf

Finally, FICC's default procedures are described in public disclosures (see "Principle 13: Participant-default rules and procedures; CCAS 17Ad-22(e)(13)") available on the DTCC.com website at: https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/FICC_Disclosure_Framework.pdf.

DOES FICC REQUIRE INDIRECT PARTICIPANTS TO POST MARGIN AND WILL THAT CHANGE IF THE SEC PROPOSAL IS ADOPTED?

No. Satisfying FICC's Clearing Fund requirements is the responsibility of the direct Netting Member responsible for the indirect participants' activity, i.e., the Sponsoring Member, Prime Broker or Correspondent Clearer, as applicable. For example, Netting Members that are Sponsoring Members are required to make separate deposits to the Clearing Fund for their Netting Member activity and Sponsoring Member activity. FICC does not require any of its indirect participants to post margin and, at this time, does not expect this practice to change to the extent the SEC's proposed rule regarding central clearing of U.S. Treasury cash and repurchase transactions is adopted in its proposed form.

However, FICC's rules do not preclude indirect participants from contributing to their direct participant's Clearing Fund requirements. With respect to its Sponsoring Service, see Section 2(c) of GSD Rule 3A, which express states, "Nothing in these Rules shall prohibit a Sponsoring Member from seeking reimbursement from a Sponsored Member for payments made by the Sponsoring Member (whether pursuant to the Sponsoring Member Guaranty, out of Clearing Fund deposits or otherwise) with respect to obligations as to which the Sponsored Member is a principal obligor under these Rules, or as otherwise may be agreed by the Sponsored Member and Sponsoring Member." The GSD Rules are available at:

https://www.dtcc.com/~/media/Files/Downloads/legal/rules/ficc_gov_rules.pdf

DOES FICC RECORD CLEARED POSITIONS OF INDIRECT PARTICIPANTS?

Yes. FICC records positions of Sponsored Members and positions of Executing Firms of a Prime Broker as long as the Prime Broker submits the trades to FICC using a unique client identifier called the "Executing Firm symbol."

IS THE GOVERNMENT SECURITIES DIVISION OF FICC A QUALIFIED CUSTODIAN FOR REGISTERED ADVISERS?

While it is not currently clear that GSD is a qualified custodian for registered advisers, GSD would explore the possibility of seeking relief from the SEC to clarify its status as such if appropriate based on industry need and/or regulatory requirement.

We note the SEC has separately proposed amendments to the existing qualified custodian requirements.

IS THERE A DIFFERENCE IN THE UCC TREATMENT OF SECURITIES RECEIVED AS COLLATERAL PURSUANT TO A SPONSORED DVP REPO VS. A SPONSORED GC REPO?

Please note that firms should consult counsel regarding the UCC treatment of securities in connection with the Sponsored DVP and Sponsored GC Services.

However, it is not expected that there would be any difference in such treatment. In both a FICC-cleared Sponsored DVP Repo and a FICC-cleared Sponsored GC Repo (i.e., a tri-party repo), the cash provider perfects its interest in the transferred securities through the same mechanism cash providers use in the uncleared space, i.e., by obtaining "control" of the securities within the meaning of the UCC. Intermediated securities, like Treasury securities, cannot be subject to "possession" within the meaning of the UCC since that refers to physical tangible possession (i.e., holding certificates).

In the case of a DVP repo transaction (whether a FICC-cleared Sponsored DVP Repo or a bilateral, uncleared DVP repo), the collateral provider "delivers out" the securities to the cash provider (i.e., it causes the securities to be transferred to the cash provider's account at the cash provider's broker/bank).

In the case of a tri-party repo transaction (whether a FICC-cleared Sponsored GC Repo or a bilateral, uncleared tri-party repo), BNYM or another bank acts as triparty custodian pursuant to a custodial undertaking, control, or similar agreement, and the collateral provider instructs BNYM to have the securities transferred to the triparty account in the cash provider's name. In both cases, the cash provider obtains "control" within the meaning of the UCC by becoming the "entitlement holder," i.e., the customer to whose account the securities are credited.

Importantly, FICC does not hold the securities that are posted under a cleared Sponsored DVP Repo or a Sponsored GC Repo. Rather, those securities are delivered out to the cash provider (in the case of a Sponsored DVP Repo) or credited to the cash provider's triparty account (in the case of a Sponsored GC Repo).

DOES FICC HAVE A CLEAR PROCESS FOR THE CLOSE-OUT OF SPONSORED MEMBER TRANSACTIONS IN A DEFAULT SCENARIO?

Yes. FICC lays out the process for what occurs in the event a Sponsoring Member defaults, a Sponsored Member defaults or in the unlikely event, FICC defaults on its US Treasury Clearing microsite at FICC's Sponsored Program - Default Scenarios. (https://www.dtcc.com/USTclearing/-/media/Files/Downloads/Microsites/Treasury-Clearing/FICC-Default-Scenarios.pdf)

The procedures FICC may take after it has ceased to act for a defaulting member, including the process for closing out unsettled, open positions of the defaulting Member, are also provided for and described in Rule 22A of the GSD Rules, available on the DTCC.com website at: https://www.dtcc.com/~/media/Files/Downloads/legal/rules/ficc_gov_rules.pdf

Finally, FICC's default procedures are described in public disclosures (see "Principle 13: Participant-default rules and procedures; CCAS 17Ad-22(e)(13)"), available on the DTCC.com website at: https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/FICC_Disclosure_Framework.pdf

DOES FICC MAKE CLEAR WHICH SAFE HARBORS APPLY TO THE CLOSE-OUT NETTING RIGHTS OF A NON-DEFAULTING PARTY UPON THE DEFAULT OF A MEMBER OR FICC?

Yes. FICC provides background in its PFMI disclosures regarding how the multilateral netting provisions of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) support the enforceability of FICC's close-out netting rules, including in the event of the default of a participant or FICC. See "Principle 1: Legal Basis; CCAS 17Ad-22(e)(1)") available on the DTCC.com website at: https://www.dtcc.com/-/media/Files/Downloads/legal/policy-and-compliance/FICC_Disclosure_Framework.pdf

Briefly, the provisions of FDICIA applicable to clearing organization netting are expected to override any conflicting provisions of state or federal law, including the Bankruptcy Code, except where expressly provided. The netting provisions of FDICIA were designed to reduce systemic risk to the financial markets.

FICC also produces netting opinions, available to its members upon request, explaining how FDICIA will give effect to FICC's close-out rules in the event of a default of a FICC member and in the unlikely default of FICC.