

IMPORTANT NOTICE

Fixed Income Clearing Corporation



#: GOV016.08
Date: January 30, 2008
To: Government Securities Division Participants
Subject: Demand Repo Comparison

During the first quarter of 2008, FICC plans to submit a rule filing to the Securities and Exchange Commission (the "SEC") to amend the rules of the Government Securities Division (the "GSD") to mandate "Demand Comparison" submission and processing for all blind brokered repo trades.

Background

In 2001, the Government Securities Clearing Corporation ("GSCC"), the GSD's predecessor, redesigned its comparison rules and procedures soon after the introduction of the real-time trade matching system. At that time, GSCC also moved the timing of its settlement guaranty from the point of netting to the point of comparison, much earlier in the day. In proposing these changes, GSCC's goal was to provide straight-through processing by allowing for easy identification and resolution of trades intra-day to achieve 100 percent comparison. These steps reduced risk by ensuring that more transactions are compared earlier in the day and guaranteed through the clearing corporation so that intra-day credit exposure to counterparties would be minimized.

As part of the redesign of the GSCC comparison rules, GSCC introduced Demand Comparison, a new type of comparison that was created, at the request of some of FICC's Dealer participants, to provide members with flexibility and control over the comparison process for trades executed via designated intermediaries. Demand Comparison, which was created as an optional service in order to enhance comparison rates for both Cash and Repo trades, strikes a balance between Bilateral Comparison (the traditional form of comparison which requires two-sided submissions), where the member is required to submit trade data in order for its trade to compare, and Locked-In Comparison,¹ where the trade has essentially been operationally compared before being submitted to the clearing corporation.

Demand Comparison entails submission of trade data by approved intermediaries (e.g., brokers) called "Demand Trade Sources." The clearing corporation deems a trade submitted for Demand Comparison to be compared upon the clearing corporation's receipt of the trade data from the Demand Trade Source, without the need for submission of trade data by the dealer. However, if the dealer "does not know" a trade submitted on its behalf by a Demand Trade Source, the dealer is able to submit a DK to the GSD. The receipt of a DK by the clearing corporation will cause the demand trade to no longer be eligible for comparison. The rule further provides that in order to effect comparison for a demand trade that has been DKed, the DK must be removed. If the member that sent a DK determines that it

¹ A typical example of a trade submitted for Locked-In Comparison is a Treasury auction take-down trade.

did so erroneously, the member will be able to remove the DK and enable comparison to occur. Modification of the trade by the Demand Trade Source also removes the DK and enables comparison to occur. The removal of the DK and the DKed trade modification are subject to the prescribed timeframes for Demand DK processing.

At the present time, the Demand Processing feature is not being utilized.

FICC's current proposal

FICC's proposal will:

- Mandate Demand processing for all Blind Brokered Repo trades from FICC designated Demand Trade Sources.
- Not affect the processing of Blind Brokered Cash trades.
- Create a DK window following the deadline for Demand processing during which counterparties can DK previously received Demand Trades, however DK's can be processed at any time during the Demand Submission processing timeframe.

The GSD's members acting as inter-dealer brokers for Repos will be designated by FICC as approved Demand Trade Sources. Members on whose behalf the brokers submit will not need to separately authorize the brokers for GSD's purposes as the GSD rules will do so. Counterparties will still be required to submit trade data to the Clearing Corp. Counterparties will need to monitor the broker submissions against them in order to submit DKs where necessary to block any further processing of the submission. Under Demand Comparison processing, a counterparty that does not submit a DK with respect to a blind brokered Repo submitted against them will be responsible for that trade under the GSD rules. That trade will be administratively matched by the Clearing Corp as part of Phased Comparison.

Work Flows

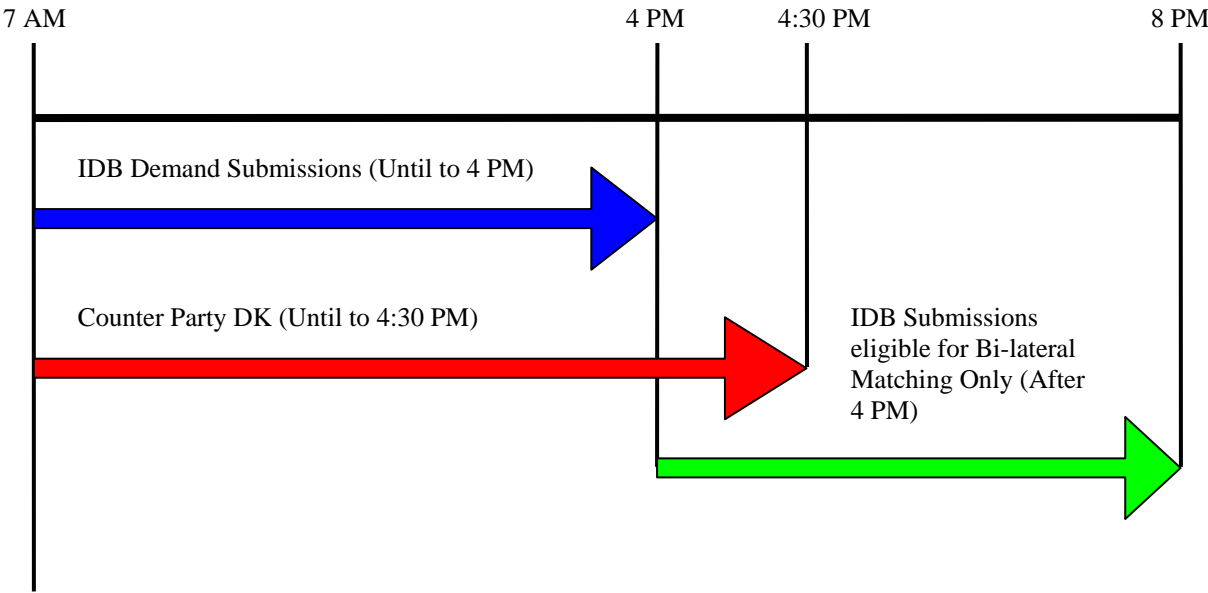
The proposed solution requires that Demand transactions be subject to a submission cutoff followed immediately by time period only for DK transaction processing.

All trades entered, by an authorized Demand Trade Source; against a Demand Trade Recipient will be subject to the following guidelines for Demand processing:

- The proposed changes will identify a cutoff time for Demand trade entry. All trades submitted by Demand Trade Sources after the deadline for Demand trade entry will be subject to trade entry by the counterparty for bilateral matching. The processing deadline for bilateral trade matching remains unchanged at 8 PM (New York time).
- The Demand trade entry deadline will coincide with the start of a time period only for DKs by counterparties to Demand submissions. During this DK time period:
 - Counterparties can DK and remove DKs.
 - Demand Trade Sources can modify DKed submissions and make them eligible for bilateral matching.

- Both submitters and recipients may continue to enter trades for bilateral matching.
- The Remove DK entry is only available to the counterparty recipient of the Demand Trade. Removal of the DK reinstates the Demand trade. The reinstatement of a Demand Trade by the counterparty is not subject to cutoff time for Demand Trade Entry.
- The modification of a DKed trade, by the trade source, completed before the cutoff for Demand trades reinstates the Demand trade.
- The modification of a DKed trade submission by the trade source that is completed after the cutoff time for Demand trade submission is reinstated but is subject to trade entry by the counterparty for bilateral matching.
- Processing Timeline for Blind Broker Demand Repo Submissions:

Time	Eligibility
7:00 AM	System opens for trade submissions
4:00 PM	Deadline for Demand submissions
4:01 PM	Submissions eligible for bi-lateral matching only
4:30 PM	Deadline for DK submissions
8:00 PM	Deadline for all submissions



Benefits

FICC believes that requiring Demand Comparison for Blind Brokered Repos will reduce risk by promoting earlier comparison and a higher rate of comparison. The Repos, due to their size, present a greater risk than the cash trades even though the matching rates for both Cash and Repo Trades are very high. Only a few unmatched Repo trades can greatly skew members Clearing Fund Requirements

and cause risks to the Clearing Corp and its members to not be properly accounted for. Demand trade entry also encourages participants to reconcile differences today by identifying the source of the problem (i.e., “Don’t Know” or “Know a different Repo rate”). The DK, Remove DK and Modify options provide the necessary tools to manage same day reconciliation.

Table 1 below identifies trade status at specific Demand Trade entry intervals.

Demand Processing Interval	Demand Submitter Trade Status	Demand Recipient Trade Status	Recipient Advisory
Demand submission <u>before</u> deadline without matching entry by recipient	Compared	no entry	1. Demand
Demand submission <u>after</u> deadline for Demand Trade entry	Pending Comparison	no entry	1. Comparison Requested
Demand Submission and matching recipient submission	Compared/Matched	Compared/Matched	1. Demand 2. Cancelled due to Match
Demand submission without matching recipient trade <u>after</u> end of submission day	Compared/Matched	Compared/Matched (GSD creates matching trade for Demand trade recipient)	1. Demand 2. Advice of administration trade create 3. Cancelled due to Match
DK before end of DK processing period	DKed	no entry	1. Demand 2. Cancelled due to DK
DK of Demand Submission previously matched by recipient/counter party	Compared/Matched	Compared/Matched	1. Demand 2. DK Rejected
DK modified by Demand Submitter <u>before</u> deadline for Demand trade submission	Compared	no entry	1. Demand 2. Cancelled due to DK 3. Demand
DK modified by Demand Submitter <u>after</u> deadline for Demand trade Submission	Pending Comparison	no entry	1. Demand 2. Cancelled due to DK 3. Comparison Requested
DK submitted <u>after</u> DK period ends	Compared	no entry	1. Demand 2. DK Rejected

Timeline and request for comment

As stated above, FICC plans to submit a rule to effect the foregoing during this quarter. FICC will implement the changes six months after the rule filing in order to allow members to make the necessary adjustments.

FICC is interested in members' comments on the Demand Comparison proposal. We ask that you submit such comments to the attention of Bart Schiavo at 212-855-7590 or bschiavo@dtcc.com or Elke Jakubowski at 212-855-7581 or ejakubowski@dtcc.com or your Relationship Manager.

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