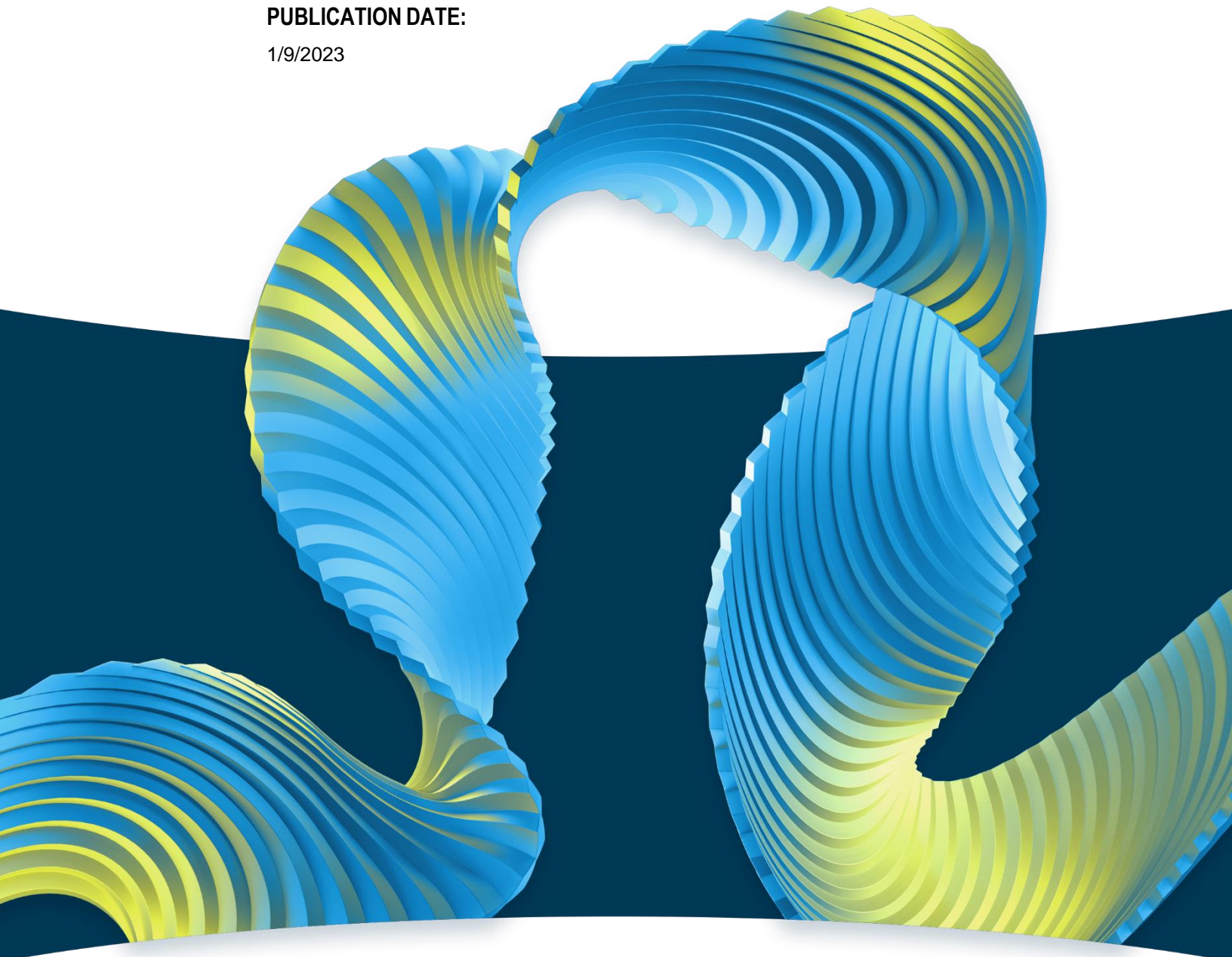




2023 FICC MARKET RISK INITIATIVES

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EXECUTIVE SUMMARY

As part of DTCC's long-term strategic focus on improving risk mitigation across the financial services industry, FICC is currently working on several risk management initiatives. The purpose of this paper is twofold: first, to provide transparency into each such initiative and its expected effects on FICC members and second, to facilitate future discussions with FICC members about the potential changes that could directly or indirectly affect them. These initiatives are pending regulatory review and thus subject to change.

The risk management initiatives described in this paper include the following:

- Modify and remove the Schedule of Haircuts for Eligible Clearing Fund Securities from the GSD and MBSD rulebooks
- Revise the FICC margin methodology documents to modify the description of the stress period used to calculate the VaR Charge
- Introduce a Portfolio Differential component at GSD
- Introduce a Minimum Margin Amount at GSD
- Enhance the Excess Capital Premium Charge

The descriptions contained herein are for informational purposes only and subject to change. It is important to note that FICC's risk framework continues to evolve as new regulatory guidance emerges or market conditions change.

Pursuant to FICC's regulatory obligation, all written comments sent to FICC in connection with the initiatives described in this paper may be disclosed to the U.S. Securities and Exchange Commission and/or included in the related proposed rule change / advance notice filing. Please contact us if you have any questions about this requirement.

GSD and MBSD products and services are governed by FICC GSD Rulebook ("GSD Rules") and MBSD Clearing Rules ("MBSD Rules"), respectively, which contain the full terms, conditions, and limitations applicable to the products and services.



Modify and Remove the Schedules of Haircuts for Eligible Clearing Fund Securities from GSD and MBSD Rules

Overview

FICC members may satisfy a portion of their Required Fund Deposits with open account indebtedness fully secured by Eligible Clearing Fund Securities, subject to applicable haircuts. Currently, the haircuts are specified in the GSD Rules and MBSD Rules. FICC is proposing to modify and remove the haircuts from the GSD and MBSD Rules.

Proposed Change

Currently, collateral haircuts applicable to relevant security types and remaining maturity terms are specified as fixed percentages in the Schedule of Haircuts for Eligible Clearing Fund Securities in the GSD and MBSD Rules. Through its review, FICC has observed that under certain market conditions, the collateral value of Eligible Clearing Fund Securities may shift in a relatively short period of time and the haircuts may not sufficiently account for the change in value. However, any changes to a collateral haircut currently requires a rule filing. In order to provide FICC with more flexibility in adjusting haircuts so FICC can respond to changing market conditions more promptly, FICC is proposing to remove the GSD and MBSD Schedules of Haircuts for Eligible Clearing Fund Securities from the respective Rules and publish the haircuts on FICC's website.

Concurrent with moving the haircut schedules from the Rules to the website, FICC is also proposing to reconfigure the categories relating to Treasury securities in the haircut schedule by moving the Treasury Inflation-Protected Securities ("TIPS") to a separate category and increasing the haircut levels for TIPS in order to ensure that the haircut levels would be commensurate with the particular risk attributes of TIPS.

Implementation of this proposed charge is subject to the filing of a proposed rule change and regulatory approval. Member outreach will be conducted accordingly.

Revise the FICC Margin Methodology Documents to Modify the Description of the Stressed Period Used to Calculate the VaR Charge

Overview

Due to the market volatility observed throughout 2022 and the need to respond quickly and timely to rapidly changing market conditions, FICC is proposing to modify the detailed description of stressed period in FICC margin methodology documents.

Proposed Change

FICC calculates VaR Charge by using a methodology referred to as the sensitivity approach. The sensitivity approach provides FICC with the ability to adjust the look-back period that FICC uses for purposes of calculating the VaR Charge. In the event FICC observes that the look-back period does not contain a sufficient number of stressed market conditions, FICC has the ability to include an additional period of historically observed stressed market conditions to the look-back period or adjust the length of look-back period.



FICC has observed a number of instances where market volatility has produced price returns in excess of the 99% confidence level calibration of the FICC VaR models in recent months due to heightened volatility in the market. In order to provide FICC with more flexibility with respect to the inclusion of sufficient number of stressed market conditions in the look-back period so FICC can respond to rapidly changing market conditions more quickly and timely, FICC is proposing to replace the detailed description of stressed period in FICC methodology documents with a more general description.

Having a more general description of the stressed period in the FICC methodology documents would enable FICC to adjust the stressed period without a rule change. By being able to quickly and timely make adjustments to the stressed period, FICC would have the flexibility to respond to rapidly changing market conditions more quickly and timely.

Implementation of this proposed charge is subject to the filing of a proposed rule change and regulatory approval. Member outreach will be conducted accordingly.

Introduce a Portfolio Differential Component at GSD

Overview

GSD currently assesses the Backtesting Charge to mitigate exposures to FICC caused by certain risks that may not be adequately captured by FICC's Clearing Fund requirement. One of the drivers resulting in a backtesting deficiency is a variability in risk exposure arising from settlement of positions and execution of new trades. As Backtesting Charge is determined based on number of backtesting deficiencies that have already occurred, FICC believes implementing a Portfolio Differential Component would be a more proactive measure to strengthen the Clearing Fund model and improve the backtesting performance.

Proposed Change

Pursuant to GSD Rules, a GSD Member may be assessed a Backtesting Charge if that Member has a 12-month trailing backtesting coverage below the 99 percent backtesting coverage target. FICC may assess this charge on a GSD Member's start of the day portfolios (the "Intraday Backtesting Charge") and/or its intraday portfolios (the "Regular Backtesting Charge"), as needed, to enable FICC to achieve its backtesting coverage target. GSD proposes to implement a Portfolio Differential component that is designed to more effectively address value-at-risk ("VaR") exposure correlated to position change. The Portfolio Differential component would be calculated as the factor adjusted sum of the exponentially weighted moving average ("EWMA") of the daily positive incremental VaR changes over a defined look back period. Assessed on a period-over-period basis, this approach is designed to mitigate additional incremental exposure from settlement of positions and execution of new trades. The incremental VaR changes would be determined from the increase between the start-of-day VaR and the noon VaR, and the increase between the noon VaR and the end-of-day VaR. The applied weighting apportions greater value to the most recent changes while observing historical performance with diminishing weighted value.

Implementation of this proposed charge is subject to the filing of a proposed rule change and regulatory approval. Member outreach will be conducted accordingly.



Introduce a Minimum Margin Amount at GSD

Overview

GSD uses value-at-risk (“VaR”) Charge to capture the potential market price risk associated with the securities in a GSD Member’s portfolio. The VaR Charge is generally the largest component of GSD Member’s margin requirement and is designed to provide an estimate of GSD’s projected liquidation losses with respect to a defaulted GSD Member’s portfolio at a 99 percent confidence level. To determine each GSD Member’s daily VaR Charge, GSD uses a model-based calculation designed to quantify the risks related to the volatility of market prices associated with the securities in a GSD Member’s portfolio. During the periods of extreme market volatility in 2022, GSD observed that in certain cases its margin collections yielded backtesting deficiencies beyond FICC’s risk tolerance. These deficiencies arose from extreme market moves on the short to medium part of the curve that were outside of the current model calibration. As the long lookback period provides an anti-procyclicality effect on the responsiveness of the model, in order to balance this effect, GSD is proposing to introduce a new Minimum Margin Amount at GSD to bolster the current VaR Floor.

Proposed Change

While still in the initial prototype state, GSD is looking to calculate the Minimum Margin Amount per member portfolio to supplement its VaR Charge.

Implementation of this proposed charge is subject to the filing of a proposed rule change and regulatory approval. Member outreach will be conducted accordingly.

Enhance the Excess Capital Premium

Overview

The Excess Capital Premium is designed to mitigate risk presented by members whose capital levels are low relative to their FICC margin requirements. Currently, this charge may be imposed when a member’s VaR Charge exceeds its specified regulatory capital (MBSD uses Excess Net Capital and GSD uses Net Capital). The amount that a member’s VaR Charge exceeds its Excess Capital is known as the Excess Capital Differential. If a member’s Excess Capital Ratio exceeds 1.0 (i.e., a member’s VaR Charge exceeds its specified regulatory capital, as described above), an Excess Capital Premium is calculated by multiplying the Excess Capital Ratio by the Excess Capital Differential.

Proposed Change

FICC is proposing to enhance the Excess Capital Premium in order to improve (1) the transparency of the charge to FICC members and (2) FICC’s ability to measure the risks that are presented by members who operate with lower capital. The proposed changes would improve transparency by simplifying the calculation of the Excess Capital Premium and clarifying the description of the Excess Capital Premium in the GSD and MBSD Rules. The enhancement is designed to reduce the circumstances in which FICC would need to exercise its discretion to reduce or waive the Excess Capital Premium. Collectively, the proposal would make Excess Capital Premium more consistent, transparent, and predictable to members, while maintaining the effectiveness of FICC’s risk-based margining methodology as it relates to the Excess Capital Premium.



More specifically, the proposed changes to the Excess Capital Premium would (1) revise the methodology for calculating the Excess Capital Premium to consistently use Net Capital at both GSD and MBSD when calculating the Excess Capital Ratio; (2) establish a cap of 2.0 for the Excess Capital Ratio that is used in calculating a member's Excess Capital Premium; and (3) improve the transparency of the GSD and MBSD Rules regarding FICC's discretion to waive or reduce the Excess Capital Premium in certain circumstances.

Implementation of this proposed change is subject to the filing of a proposed rule change and regulatory approval. Member outreach will be conducted accordingly.

Next Steps & Impact Studies

As the aforementioned initiatives continue to be finalized, FICC will keep members updated of expected rule filing dates and implementation dates.

Conclusion

FICC plays a vital role in reducing risk and providing stability to the financial industry through its function as a central counterparty. FICC believes that having a long-term strategic focus on risk mitigation is essential for FICC to embrace this role effectively. The initiatives presented in this paper supports this long-term strategic vision. FICC believes that successful implementation of these initiatives will further enhance its ability to mitigate risk during potential member default events in the future.